DEPARTMENTS OF COMMERCE, JUSTICE, AND STATE, THE JUDICIARY, AND RELATED AGENCIES APPROPRIATIONS FOR 2001

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

SUBCOMMITTEE ON THE DEPARTMENTS OF COMMERCE, JUSTICE, AND STATE, THE JUDICIARY, AND RELATED AGENCIES

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NOTE: Under Committee Rules, Mr. Young, as Chairman of the Full Committee, and Mr. Obey, as Ranking Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

GAIL DEL BALZO, JENNIFER MILLER, MIKE RINGLER, and CHRISTINE RYAN
Subcommittee Staff

PART 8

THE JUDICIARY

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DEPARTMENTS OF COMMERCE, JUSTICE, AND STATE, THE JUDICIARY, AND RELATED AGENCIES APPROPRIATIONS FOR 2001

WEDNESDAY, MARCH 15, 2000.

SUPREME COURT

WITNESSES

JUSTICE DAVID H. SOUTER, SUPREME COURT
JUSTICE CLARENCE THOMAS, SUPREME COURT
JAMES C. DUFF, ADMINISTRATIVE ASSISTANT TO THE CHIEF JUSTICE
DALE E. BOSLEY, MARSHAL
BILL SUTER, CLERK
TONY DONNELLY, DIRECTOR OF BUDGET AND PERSONNEL

OPENING REMARKS

Mr. ROGERS. The committee will come to order. Good morning. We are here today regarding the fiscal 2001 budget request for the Supreme Court. We welcome again before the subcommittee Justice David Souter and Justice Clarence Thomas. Welcome. Justice Souter has been here I think six times, which I think may set a record. And Justice Thomas, this is your second appearance in this unique process in your position at the Supreme Court. But we were privileged to have your presence when you were head of the EEOC here at this subcommittee a couple of years ago. This hearing is an extraordinary opportunity for the Congress to interact with the Court, the highest court of the separate independent branch working within the system of checks and balances envisioned by the Founding Fathers.

One of the constitutional bases of our government is that no money may be spent from the Treasury, except as a result of an appropriation, enacted into law, to paraphrase Article 1, Section 9. And that's what leads to your appearance here, and we are, of course, pleased to welcome you.

Our role is to exercise oversight over the expenditure of public funds, but obviously not over the deliberations of the Court. The independence and the integrity of the judicial process is, of course, a binding principle of our government that we hold dear. We know that this hearing always sparks some media interest, and we suspect that it has more to do with your being here than us. So welcome.

After hearing from the Justices, we will hear from the Architect of the Capitol, who has responsibility for the care of the Supreme Court Building and the grounds that will follow this hearing. Mr. Justice Souter, we will make your prepared testimony a part of the

record. And we will be delighted to hear from you as soon as I yield to my fellow worker and friend, Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman. It gives me great pleasure as always to join you in welcoming Justices Souter and Thomas again this year. As one who has served in public office for over 25 years and who has met and worked with Presidents and Governors, Senators and foreign dignitaries, and many other public servants, I still get a little chill facing Justices of the Supreme Court. Their world seems so different from ours and their decisions have such far-reaching impact that it is hard to believe the same Constitution that created our position, Mr. Chairman also created theirs. I am looking forward to their testimony today, and stand ready to assist in supporting their request and the work they have to do. I also have to be especially nice to them, since I know that some day they may decide whether they think Puerto Ricans' American citizenship is statutory or constitutional. And I am still trying to find out from them if a guy born in Puerto Rico can run for President, but feel no pressure on any of the questions that I will ask you today. Thank you, Mr. Chairman.

STATEMENT OF JUSTICE SOUTER

Mr. ROGERS. Mr. Justice Souter, and each of you will be recognized for your remarks.

Justice SOUTER. Mr. Chairman, thank you and thank you for welcoming us as usual. As you mentioned earlier, you have already placed on the record the summary of the request that we have. And I will be even briefer than the summary in just adverting to what is remarkable, if it can be called that, about this year's budget. I think there are two things.

We have not historically asked for many increases in position. We have, in the last couple of years, most notably for security last year. This year we are asking for two, and those two positions account for virtually all of the budgetary increase above those increases that are simply mandated as a matter of law for mandatory pay increases and inflation and whatnot.

The two positions that we are asking for this morning are each necessitated by the world of computers that some of us increasingly live in. I try to avoid it. But the Court itself does not. One of those positions is, in fact, for an expert on computer security. As we get closer and closer to a greater integration with the Internet and the Court's computers, the security issue of course becomes more intense. So we need help there.

The second position is for that of research librarian. And the reason we need the first new research librarian in, I think, 18 years is due to the proliferation of computer programs, which are, in effect, the means of access to the kinds of data that these people have to be looking up for us. As the programs have proliferated, and the access to that data becomes more complicated, the librarians simply have to spend more time familiarizing themselves with the technical regimes that they have to know to get from us to the information. And they have reached the point where they are spending so much time on that that they feel, and we agree, that they need some further help. So those are the two new positions.

The second thing to remark upon is something that you will probably spend more time discussing with the Architect of the Capitol than with us, but I should just anticipate it. The Architect of the Capitol, certainly with our understanding and agreement, is asking for a total of about $3½ million in his budget to continue both planning work and preliminary design work for the renovations and the security beefing up that we have been considering for the Court for the last couple of years.

I think my recollection is that when we were over here a year ago, both the Architect and Justice Thomas and I guessed that by this time we would have sugared off with a specific request to you and we have not. It has simply proven a much more complicated process than we thought. In the course of the year, the court itself has got a couple of independent architectural consultants to help us in trying to evaluate the proposals that we have got, and to work with the architect to get the costs of it, or the estimated costs of it, down. And that still goes on. My guess is and I think it is probably a sounder guess than last year's, is that by this time next year, we will have a definite proposal. But for now, the only proposal is to keep on planning. And with that, I have nothing further to say by way of anticipation and defer to my brother.

Justice THOMAS. I have nothing additional to add, Mr. Chairman.

Mr. ROGERS. Well, you are being very judicious in your comments this morning.

Justice SOUTER. He learned from me.

USE OF MODERN TECHNOLOGY

Mr. ROGERS. New England terseness. Let me ask you briefly about computers and the Court. When I practiced law 20 years ago now, computers were a relatively unknown thing. Word processors were a new invention that was to overtake the law profession. And we have seen actually the computerization of the practice of law in many of the lower courts in the last 20 years.

I have not seen as much of that in the appellate courts, and particularly the Supreme Court, as we have seen in other levels in the law. Why is that? And is that a problem?

Justice SOUTER. I am not sure that it is so, actually. As we have said before, you are talking to a Luddite when you are talking with me, because I am computer illiterate, unlike Justice Thomas. But the fact is, I can sit over there as a Luddite, but everybody around me is using computers. I mean, I get away with it simply because my clerks, my secretaries, don't get away with it and the librarians don't get away with it.

So I am guessing, although I am not much of an expert witness on the subject, I am guessing that, at least my appellate court is probably as computerized as it is helpful for appellate courts to be. I am not sure that our computer situation is as up to the moment as it should be. Justice Thomas has told me and the others on more than one occasion that the problem that we all have, or those who do the computer work have, is simply keeping up with the technology. On that subject, I will claim ignorance. But I am not sure in terms of the basic approach that we are doing less with computers than it would be helpful to do.

Mr. ROGERS. Justice Thomas.

Justice THOMAS. I think, Mr. Chairman, that the courts are moving, I think, rather effectively. I can't speak for all the courts of appeals. I think the courts may have gotten into the ball game at a slower pace than some of the other parts of our lives. I tended to be rather aggressive in automation when I ran an agency. I don't know whether the courts can afford to do that with the volume and types of data that we use. But the Supreme Court is moving at a steady pace. We have a more complicated system. We have to prepare our opinions, for example, in a way that they can then be printed in the form that you ultimately see them.

And so our internal work interfaces with that system. And we have to—it is a delicate balance and it is rather complicated. I think we are beginning to use more in our clerk's office for tracking systems and filing systems, that is being automated. And this is a process, remember that only began about a decade ago. I would probably be—personally it would like to be a little bit more aggressive. I can understand the pace, the measured pace that we are taking. I think we are moving very effectively in the right direction.

To give an example, our job is rather portable with computers. As a result of, say, laptops and the encrypted systems, we are able to work anyplace in the world. With access to Lexis and Nexis, to my law clerks, to draft opinions, to edit and then transfer those opinions back to the court. Last night, for example, we had a late night execution. I was able to work on that just simply by sitting in my study at home and effectively get the files by the individual involved, read those and then communicate with my clerk.

So we are moving, I think, quite effectively with automation. And it is changing our jobs. I think the court is slower than some of the other institutions for a variety of reasons. But I don't think it can be said that we are not automating in an effective manner. I think we are.

SUPREME COURT WEBSITE

Mr. ROGERS. You said last year before the subcommittee that the Court had begun to develop a Web site. We found that many agencies have discovered that those Web sites yield big cost savings in such areas as distribution of public documents and the like.

First, tell us where we are with the Web site that you talked about last year, and tell us whether or not your staff has studied opportunities for cost savings that might be achieved through the use of technology in general.

Justice THOMAS. Oh, I don't know that I have an answer to the latter question. I am sure we have, but again, we are not like most of the other agencies. We don't have as many filings, we don't have Federal Register filings, we don't have public notifications. We have a certain number of opinions, and ultimately we have the U.S. reports. Now we have had cost savings in preparing our opinions for the U.S. reports. Our Web site is actually quite inexpensive. It will be—it is developed by GSA—by the Government Printing Office. And it is due to be in operation in the near future. I can't give you an exact date but it will certainly be up and running long before we come back before this committee.

Mr. ROGERS. Mr. Serrano.

COMPUTER SECURITY

Mr. SERRANO. Thank you. On the issue of using technology and security, you know one of the issues that this committee and my colleagues are following is that issue in Miami of the Elian Gonzalez case. It seems that the judge will issue a decision in the next 24 to 48 hours, and he will do it online. I am sure that is being done quite a lot now. But it just seemed to me a little strange that he would not stand in a courtroom and say something, that he would issue it online. First, how are Supreme Court decisions issued? And second, as you are working to reach a decision, what security measures are you taking so that the press, or somebody else for that matter, doesn't end up knowing about where you are going before you make your final decision?

Justice SOUTER. Well, on the issuance of opinions, ours are online, I think, within minutes of the literal handout. But the Supreme Court still follows, at least in a shadowy way, the old tradition of announcing its judgments right from the bench. There are those who were on the court in the time that I have been on who remembered the day when the justices literally read every word of their opinions from the bench in that courtroom. Justice White told me that that is why he became a devotee of crossword puzzles because everybody sat there while these things were read. I am happy to say that I came along after that day.

But there is, even though we issue our judgments with a summary of what is behind them now rather than reading them verbatim, there is something, I think, symbolically wonderful about it. Because it is the only occasion when you come right down to it that the court, in a literal sense, is speaking to the country represented by the people in that room, as opposed to talking to lawyers or talking to ourselves.

But the fact is, when that ceremony is over, I say literally within minutes, maybe on the instant that we arise from the bench, the complete opinion is available online.

Mr. SERRANO. And the security issues?

Justice SOUTER. On security, you know, we have been lucky on the security up to this point, I think, in large part because we have limited the Internet hookups to just a couple of individual computers within the court. There is no hookup to the system as such. So that our security has basically, up to this point, been a dependence on individual integrity. And that is why we have haven't had a problem of leaks. I can think of only one instance in the time that I have been on the court that even a fax has gone astray. And so we have, you know, knock on wood, but we have been lucky up to this point. But the reason, as I said a minute ago, the reason we are asking for a new position is we realize we can't continue to live with the luxury of that kind of independence.

Mr. SERRANO. So you're saying you hook into yourself, so to speak, and not into the outside world.

Justice SOUTER. That is basically it.

Mr. SERRANO. Mr. Chairman, I have a series of questions on the issue of minority clerks that we discussed last year. But I am not going to ask those questions at this time because I know that my colleague, Mr. Dixon, is not only very interested in it, but an expert

on the issue. I will let him ask those questions. You are an expert on the issue.

Mr. DIXON. I don't know if there is an expert on the issue. I was reading Mr. Taylor's comments from last year. He seems to be the expert, at least in written form.

FEDERALIZING CRIME

Mr. SERRANO. Okay. Let me ask you, last year we discussed the workload of the court and one of the issues we discussed was the impact that the federalization of crimes by Congress may have on the court. We discussed that. Any update on that, any thoughts?

Justice SOUTER. There is really nothing new to say. The court, as a policy matter, like the judicial conference, has continued, and we continue this morning, to recommend great caution in federalizing crime. We think of the workload frankly in the first instance in terms of the district courts, but sooner or later it all filters up to us. And so it is going to have an effect on us. I will be candid to say that I think just as important as the concern institutionally that we have for ourselves and for the other courts in the Federal system, is simply the concern for preserving basically a sensible Federal balance of responsibility.

There is, I think, an undeniable tendency when the national government federalizes crime for the responsibility over that criminal prosecution to gravitate in the Federal direction. And as a general proposition, I think that is a very unsound way to run a Federal union. The criterion ought to be, basically, is Federal prosecution needed because State prosecution for any number of reasons, including perhaps the interstate character of the activity, going to prove itself ineffective. If the Congress will ask that question, and abide by the answers to that question, I am not going to worry where this goes. But I do worry about indiscriminate federalization.

Mr. SERRANO. Thank you, Mr. Chairman.

Mr. ROGERS. Mr. Latham.

CONSOLIDATION IN AGRICULTURE

Mr. LATHAM. Thank you, Mr. Chairman. And welcome gentlemen, it is an honor to have you here. I wanted to thank Judge Thomas in particular for the kindness when I had a group of Iowans in to be admitted to the bar, and the time he spent and the generosity that of your time with those people. That was great. We appreciate it very much.

Actually, several questions that I had really have been covered talking about federalizing a lot of the crimes. One area that is of particular interest in Iowa and throughout the midwest in agriculture today is the consolidation, vertical integration question. I think a lot of the cases that the Justice Department has seemed to take up focus more on high tech companies and trying to look at lack of competition in certain areas.

I guess my question to you would be do you think that the laws on the books currently are adequate to safeguard not just high tech or telecommunications, but in agriculture, and if you had any comments on that. We had testimony from the Attorney General last week, she basically said that she didn't think she could do anything

as far as consolidation or in agriculture and various areas, that the laws weren't there.

Justice SOUTER. I will be candid to say it is a subject on which I don't have an opinion. We get, as you probably know, occasional antitrust appeals. But we have had nothing that I can think of in the time that I have been on the court that would, you know, give me a basis to give you a helpful answer on that subject.

Justice THOMAS. I agree with that. I don't have a clue. And we certainly haven't had any major antitrust cases since I have been on the court. We have had a few. But not of the sort you are talking about. And we have had other large cases that involved telecommunications, but that was as a result of specific legislation by Congress. But I would just be speculating, and not even on any firm basis, on how to solve your problem.

Mr. LATHAM. To me, I guess just the fact that it has not been, I guess, brought to the court's attention on any kind of frequency, when we look at the consolidation and telecommunications financial industries, agriculture, petroleum, all through the economy, there is massive consolidation going on, that I think it is interesting that there hasn't been anything brought up on the subject. Anyway, that is all I have. I thank you very much.

Mr. ROGERS. Mr. Dixon.

COMPUTER SECURITY POSITION

Mr. DIXON. Thank you very much, Mr. Chairman. And I certainly join in welcoming the Justices here today. And Mr. Justice Souter, I notice that you highlighted the fact that you want to hire computer security position. And my staff thought it was quite unusual that it is only going to cost $52,000; $42,000 for salary and $10,000 in benefits. He thought that was exceptionally low in this competitive world. What is your view of that?

Justice SOUTER. We drive a hard bargain.

Mr. DIXON. Apparently so.

Mr. ROGERS. It is the honor of the job.

LAW CLERK SELECTION—LAW SCHOOLS

Mr. DIXON. It is the honor of working for the court, isn't it. I do want to pursue just briefly, but first I would like to thank Justice Thomas and Justice Souter for their dialogue last year. I thought it was very open, very candid. It brought to light some of the issues that I was not totally familiar with. And it is the issue of sex and race, as it relates to the hiring of clerks in the Supreme Court. Last year, Mr. Latham asked a question in writing, and he asked if in regards to the Supreme Court clerks, would you be able to provide an annual list of Supreme Court clerks who served each of the last 10 years.

Would you also be able to include their race, sex, the law school from which they received their degree, in which state they resided before law school, and under which Supreme Court Justices served? Your response was that the names, law schools and employing Justices of law clerks of the Supreme Court during the last decade are available. Sex could be determined on the basis of names in most instances. But the clerks are not categorized by sex, race, or state of origin. And my question to you is why is that?

Justice SOUTER. I guess my answer would be why not? Those simply are not criteria on which we hire. And they are not indices of quality and we simply have never had any reason to treat people on a sex or a race or ethnicity basis.

Mr. DIXON. Well, do you keep track of the law schools they attend?

Justice SOUTER. I don't know. I mean, I don't. I couldn't tell you over the—I have been on the court for 10 years, I couldn't tell you offhand whether there is an annual pattern in the law school hiring. I can tell you, without any question, that the bulk of my clerks have come from Harvard or Yale law schools, but I think over the course of that same 10 years, probably there have been seven or eight or nine other law schools that I have hired from. So I don't keep track of it.

Mr. DIXON. Mr. Justice, let me ask you this: I didn't really plan to pursue this at length today, but you do recognize that there is a pattern as it relates to the law schools that the Justices hire from? I mean, that was well documented, has consistently been well documented and we talked about it last year.

Justice SOUTER. Please note there is no question, as I just said, where the bulk of mine come from. But I don't—you know I don't make a list either before or after hiring to keep track of it. As I said, I know that there is a spread of about, in my case, of about oh, nine or ten law schools. I think in the case of one of the members of the court, that spread is about 30 law schools. That is unusual. But there is no question about the source of the bulk of my clerks, and generally for the court.

Mr. DIXON. Have you provided to Mr. Latham the list that he requested?

Justice SOUTER. I have not. I don't know whether there was a specific request for the list. That is something I never heard any more about.

Mr. DIXON. I am wondering since you say that they are available, could you provide to the committee the list?

Justice SOUTER. Sure.

[CLERK'S NOTE.—Subsequent to the hearing, the Supreme Court provided a complete list of all of its law clerks and the names of the law schools they attended, dating from its 1990 term. The list is on file and available for review in the offices of the subcommittee, Subcommittee on Commerce, Justice, State, and the Judiciary, H–309 Capitol Building, Washington, DC.]

LAW CLERK SELECTION—FEDERAL COURT EXPERIENCE

Mr. DIXON. Last year we had a dialogue about the clerks as it related to the pool from which you draw. And you indicated, I believe, that many of the clerks come from the circuit courts or other courts; is that correct?

Justice SOUTER. It is rare that somebody comes from outside of the Federal system. It has happened. I think today I probably would not hire a clerk from outside of the Federal system. I won't say I wouldn't, but it would be an exception. And the reason has nothing to do with the work that they do on the cases that we actually take. Where the Federal experience, as a practical matter, I think, is a necessity, is on the cert work, because there is no break-

in time for it. It is the kind of thing, if you are not at square 2 when you start, you can't very well keep up with. I know that, as a matter of fact, from what it is like to be a first-year justice, and a law clerk is in about the same boat.

Mr. DIXON. I was not challenging that practice at all. I thought you made that statement to indicate that a lot of this, as it related to women or minorities, was out of the control of the Court because the pool that you are selecting from did not have many minorities or women in it. And since that is the practice, that these courts are the feeder, that we would not anticipate a large number of minorities. I thought that was your point.

Justice SOUTER. No, I think that is fair. My guess is that the pool, the pool of all district and circuit court clerkships, has probably got a pretty good spread. It does not have anything that you would call a proportional representation in terms of the general population.

Mr. DIXON. I was not suggesting that. I just thought that one of the reasons was that there were not a large number of either minorities or women to choose from since they are coming primarily from the circuit courts.

LAW CLERK SELECTION—WOMEN AND MINORITIES

Justice SOUTER. That is true. The only thing I would add to that is my impression that the number of women continues to grow. I was surprised at one number that I have learned as a result of a speech that Justice Ginsberg gave some time within the last 6 months. She was talking about just the history of women law clerks at the court, which began actually with Justice Douglas during the war.

But in any event, she was talking about numbers. And I don't recall her numbers exactly, but I think they boil down in recent years to something in the neighborhood of about 35 to 40 percent of our clerks being——

Mr. DIXON. 40.

Justice SOUTER. And frankly, I would have guessed the number was a little bit lower than that. But in any case, that number has continued to rise.

Justice THOMAS. May I add something. I think it is—with respect, I think, that the women pool is different from the minority pool. And I think that the pool, it has to be segmented. It is not that difficult to find women law clerks. It is far more difficult to find others in that pool. I have one woman clerk this year, I have two for next year, and two for the following year. It is just not that difficult. And so the—I think if you go back to the courts of appeals, they are fairly well represented there. But we do draw very extensively from the courts of appeal, as one criterion for hiring law clerks. But I do think that the women law clerks are quite different than the minority law clerks.

Mr. DIXON. It would appear from the statistic that that is true. Would it be a fair statement to say, Mr. Justice Thomas, that it is not difficult to find white women law clerks?

Justice THOMAS. I think it is not difficult to find any white law clerks, or it is not difficult, in many instances, to find a significant number of Asian law clerks.

Mr. DIXON. But have there been a significant number of Asian law clerks?

Justice THOMAS. From a representation standpoint, I think so.

Mr. DIXON. And you mean, based on the population in law school?

Justice THOMAS. That is right.

Mr. DIXON. Mr. Justice Souter, let me just ask, has the court or any of the justices made any effort to have any dialogue with the circuit courts as it relates to their selection process at all?

Justice SOUTER. The court, as an institution, has not, because the court doesn't do the law clerk hiring. That is radical federalism within the court. Every justice does his own. And I literally can speak only for myself on that because I have not canvassed the others. But I can tell you, two things that have happened, and I have no doubt, that in part, they have happened as a result of a conversation we had a year ago. I have had calls from circuit judges and I have had conversations with law professors initiated by them that I probably wouldn't have had five years ago. There is no question the subject is on the minds of those who are pushing people in our direction. And I presume that that experience of mine is probably represented in every other chamber too.

Mr. DIXON. Mr. Justice Thomas, have you made any effort to talk to the circuit courts or other Federal courts that may be recommending, people for the pool from which you draw?

Justice THOMAS. Oh, I think we all in response to anything, it is just routine matter for me, we don't talk necessarily to the courts as institutions. We talk to Federal judges we know, people we respect in the law schools. And we keep our eyes and ears open for kids we are interested in. But I agree with Justice Souter, there has certainly been heightened awareness of this. And there have been any number of conversations I would say on an informal—in an informal way about it. But I will underscore, and we keep repeating this, we don't have a central approach to hiring law clerks at our court.

I don't discuss my approach with Justice Souter, and he doesn't discuss his hiring processes with me. We may refer to them from time to time, there is just simply no uniform way of doing it, and that may be a part of the problem in responding to some of your questions. We just can't speak for the others.

Mr. DIXON. I think we both made that point last year, because in looking at Justice Sandra Day O'Connor about half of her clerks, 34 out of 76 have been women. And she is a woman. So that would tell me that she had some pattern of looking for women. And compared to the others she has certainly, you know, hired more women. And I want to assure both of you that I understand thoroughly that it is a very complex issue, and I appreciate the fact that both of you are aware that it is a very complex issue. But it is an issue that I don't think is going to go away. It isn't going away in Congress, and there is legislation although I question its Constitutionality. But as long as I serve on the committee, it is not going to go away. I hope it just isn't cumulative in the fact that a year or 2 or 3 years from now, there is no change. But I would say that I notice that in this year's law clerks that there is some improvement from my perspective. And that is that out of the 34

clerks, five are minorities, there are two blacks and three Asians who are now working for Justices of the Court. Are any of these blacks or Asians working for either one of you gentlemen?

Justice THOMAS. Not for me.

Justice SOUTER. I will be candid to say that that is a subject I don't want to get into. When my clerks come on board, they make a deal with me that they are going to do a certain amount of work for me. If they want to become public figures and the object of public attention, I want them to go ahead and take the initiative. All I feel that it is fair to say is that I am looking with as broad an eye as I have traditionally looked. And if some of them turn out to be minorities, that is great. I would, in fact, keep an even sharper eye for a good minority clerk, but I don't want to make a clerk a public figure. I want the clerk to do that if he wants to.

Mr. DIXON. You feel by stating the ethnicity of one of your clerks they would automatically become a public figure?

Justice SOUTER. I think a clerk whom I mentioned is probably going to be the subject of public attention.

Mr. DIXON. Thank you, Mr. Chairman.

BUILDING IMPROVEMENTS

Mr. ROGERS. Now, we need to talk about the building. The architect who testifies momentarily is going to, I think, tell us that he has settled on a plan to request $100 million for the renovation of the Supreme Court building. And I have to tell you that that would be very difficult for us to find. This modernization effort really has climbed Jacob's ladder. In 1998, when the project was first described, it was described as only a $7 million project, with us replacing some of the systems in the building. And then since that time, the estimates have gone up and down, even as high as $140 million, down to $85 million and now it looks like the plan is to request $100 million in 2002 that would be used in the year 2003.

This is a unique relationship that we share, the Congress and the Court, two separate independent branches of government. When we appropriate funds for executive agencies, many times there are strings that we attach to the accidental detour of those funds to affect some policy that the agency is involved in. That is just the way the political process in this government works.

We have never done that, of course, to the Supreme Court, and wouldn't think of it because the Court is independent, we recognize that, we would be derelict if we attempted to, in any way, suggest how you spend the money. We do have a duty to oversee the proper expenditure of all tax dollars, including the monies that we give to the court. But when it comes to the physical plant in which the court works, it has to be a different story. Because we are talking about a huge expenditure of funds, number one, and we are ultimately responsible for the security that you have at the building among other things. We want to find every dollar we can to help you perform your duties in a safe, efficient and expeditious way, and that is our obligation. We will do that. But at the same time we have to be mindful of the limited amount of monies we have for everything that we deal with in this subcommittee from the State Department, foreign Embassy security to the FBI, to the Immigration Naturalization Service, Commerce Department, the lower

courts and so on, the prisons. And we have not shirked or shied away from being critical and tight, I guess you will say, with the monies that we allocate for many of these projects. This one has raised a lot of eyebrows. I would be interested to know what you think about the Architect's plan, and whether or not every aspect of what he has planned is necessary. And have you thought about alternatives, given the amount of money that we find would be very difficult to raise?

Justice SOUTER. Well, Mr. Chairman, you are preaching to the choir in a way on the problem of the size of the bill. I didn't get specific authorization to say this, but I think it is fair to say that everybody on the Supreme Court would like to postpone the whole thing until he retires. We look upon this with a certain degree of horror. Justice Kennedy and I, as you well remember, were those who sat here for several years on the assumption that the bill might be around $10 million, and we were among those who had heart failure when we heard the figure of 140-something last year.

And I think the only things that I can say at this point are these: Number one, there is no final decision on what is going to be done, as I think the architect has said. We have worked the probable cost of the likely project elements down to from 140 at the high side down to around 100. Whether—and the extent to which we can work it below that is an open question. I will be candid to say my guess is we are not going to get it very much below that.

On questions of necessity, I think it is a fair statement that most of the subjects, most of the elements of the planned renovations that are contributing to the very high dollar figure are elements that either are pretty close to pure security elements that nobody 5 years ago was thinking much about, or they are elements of architectural update, which we now realize have tremendous security implications.

That is not salve to cover the soreness of the price tag completely, but it goes at least some way towards an explanation of why the figures are coming in the way they are coming in and why we think it is necessary to get into them.

In the course of the past year, as I said very briefly in my statement before we got going this morning, the court itself has availed itself of the services of two outside architectural consultants, one of whom is the Dean of the architecture school at the University of Virginia. We felt the need of help because although there is a committee of which I am unfortunately a member that has been studying this thing for about the last year and a half, we are still babes in the woods on this. And one of the charges that we gave to our own consultants is to alert us to what they saw as unusual cost estimates. And at this point where the number is down from the 140 to somewhere close to 100, maybe a little under, what they are telling us is they don't see a way to squeeze many more nickels out of it.

Which is to say that if we get to the point where that is the estimated bill and the money isn't there, as with everything else in life, we are going to have to come up with priorities and decide what most needs to be done.

PERIMETER SECURITY

Mr. ROGERS. Well, that is exactly right. And now, as far as security is concerned, that will be prime on our list as well. But I understand from the Architect that the perimeter security of the building will be handled in the overall Capitol Hill perimeter security plan that is being developed. And the cost of that perimeter security is not a part of this cost, the $100 million.

Justice SOUTER. I think some of the cost is in there, and I couldn't give you a number, but the amount of it that was within the 100 million is pretty low. I agree, I think we all agree, that it does not make sense for us to make independent security plans without knowing what else is going to be done on Capitol Hill.

Mr. ROGERS. I understand that that overall Capitol Hill perimeter security plan is being developed by the Capitol Hill police and will come under another budget category. But the security within the Supreme Court building obviously is—will have to be—a part of the cost of the renovation. But to be perfectly honest with you, there is no way, I don't think, that we can find that amount of money given the tight budget constraints that we are still operating under up here until we can be satisfied that every penny of it is absolutely necessary.

We scrub, we will give this kind of scrubbing to every embassy that we build around the world through this subcommittee, or any security renovation of any public building that we have jurisdiction over. And we have to treat everyone alike in that respect. So I would hope that the Court and the Architect can scrub the number a lot more.

Justice SOUTER. I am going to file a tax return a month from today so more power to you.

Mr. ROGERS. Justice Thomas.

Justice THOMAS. I was just going to say, Mr. Chairman, you have got the right person here to scrub that budget. Not a penny escapes his eyes. But——.

Justice SOUTER. If you will make me pay for the whole project, I will get it down fast.

TELECOMMUNICATIONS WIRING IMPROVEMENTS

Justice THOMAS. But you asked me earlier about technology and the movement of the court, et cetera. I will just give you one example of what our problems are. Our internal communications systems now cannot be handled by the wiring of that building. To go back and rewire that building because of the way it was constructed is a major undertaking. The duct work has to be changed in the building. Right now it has significant problems. Whether it is fire hazards or the ventilation, et cetera, just because of the way it is designed. That is, the building isn't constructed like modern buildings where you can go and just rip the ventilation out without doing major damage to the building.

And, you know, I think, and I know that working with these older buildings is far different than working with a newer structure. And so I think that the entire conference at the court has agonized over these numbers and had the same shock that you had in seeing the escalation, even when we were halfway up Jacob's lad-

der. And I would, as the architect testifies on this, I think you will see that this has nothing to do with the amenities of the building. It has everything to do with infrastructure and maintaining.

Mr. ROGERS. He explained that last year. I understand that. We are dealing, of course, with the historic building whose architectural integrity we all want to preserve. And we realize that the building was built at a time when no one anticipated the kinds of problems we have today with security or communications and the like. And we want to—we want the renovation to take place. We are still suffering from sticker shock, as Justice Souter, I think, has spoken about. Anyway, we hope we can have more conversations about this and see if there is a way to scrub.

Anyone else with questions?

Mr. SERRANO. No.

Mr. DIXON. No.

Mr. ROGERS. Thank you very much for your time and your testimony. We will be scrubbing our budget. We don't know yet what the full committee allocation will be for our subcommittee, so we think we are very forthcoming at this moment about the success of your request, but we, of course, will give great weight to your testimony and to the request.

Justice SOUTER. Thank you.

Justice THOMAS. Thank you, Mr. Chairman.

Mr. ROGERS. My regards to the Chief Justice.

Justice SOUTER. I will tell him. Thanks.

Mr. ROGERS. The committee will come to order. We are pleased to have with us the Architect of the Capitol, Alan M. Hantman, who has jurisdiction over the Supreme Court building and grounds among others. The budget request for us is $7,530,000 for Fiscal Year 2001. But it also contains an ambitious outyear plan for some $100 million to be presented within the 2002 budget request for use of fiscal year 2003 funds for renovation of the Supreme Court building. So we will have a bit to chew on as we consider this request.

Mr. Hantman, we want to welcome you and your staff that are with you. We will make your statement, written statement, a part of the record, and we will be delighted to have a summary of that if you would like. You are recognized, Mr. Serrano.

Mr. SERRANO. Just to join you in welcoming Mr. Hantman. In my earlier life, I was Ranking Democrat on the Legislative Branch Appropriations. We did a lot of work together, especially on the renovation of the U.S. Botanical Garden, and the security upgrades at the U.S. Capitol. So I certainly welcome you and look forward to your testimony.

WEDNESDAY, MARCH 15, 2000.

ARCHITECT OF THE CAPITOL

WITNESSES

ALAN M. HANTMAN, AIA, ARCHITECT OF THE CAPITOL
MICHAEL G. TURNBULL, AIA, ASSISTANT ARCHITECT OF THE CAPITOL
STUART PREGNALL, BUDGET OFFICER/DIRECTOR OF FINANCIAL SERVICES
JAMES MILLER, FACILITIES MANAGER

OPENING STATEMENT

Mr. HANTMAN. Thank you, sir. Good morning, and thank you for that welcome, Mr. Chairman and Mr. Serrano. First, may I introduce to you Mr. Michael Turnbull, who is the Assistant Architect of the Capitol and Stuart Pregnall, who is our Budget Officer joining me here today. We also have other supporting staff if we need to get into some technical areas. I am pleased to appear before this subcommittee to present the budget for the care of the building and grounds of the Supreme Court. As Mr. Serrano alluded to, we have responsibility in this agency for basically all the buildings on Capitol Hill, including the Supreme Court itself. We are responsible for the building and grounds, the basic operation of that facility although the Court itself is responsible for basic maintenance and cleaning facilities management within the structure itself. So we work hand in glove together on that.

As you mentioned, Mr. Chairman, our request this year is for $7,530,000, which represents a net $442,000 decrease from last year's budget. Within that amount, we are providing for ongoing staffing for maintenance costs as well as funding to continue the design of the building improvements project that you alluded to. I would certainly be pleased to answer any questions that you and the committee have on our budget or the building improvement project itself.

[The information follows:]

SUPREME COURT OF THE UNITED STATES
CARE OF THE BUILDING AND GROUNDS
SUMMARY STATEMENT OF ACCOUNT REQUIREMENTS

Fiscal Year 2000 Appropriation	**$8,002,000**
2001 Budget Estimate	**$7,530,000**
Proposed decrease	**($472,000)**

APPROPRIATION LANGUAGE

SUPREME COURT OF THE UNITED STATES
CARE OF THE BUILDING AND GROUNDS

For such expenditures as may be necessary to enable the Architect of the Capitol to carry out the duties imposed upon the Architect by the Act approved May 7, 1934 (40 U.S.C. 13a-13b), [$8,002,000] *$7,530,000*, of which [$5,101,000] *$4,460,000* shall remain available until expended.

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SUMMARY OF REQUEST
SUPREME COURT OF THE UNITED STATES
CARE OF BUILDINGS AND GROUNDS
FISCAL YEAR 2001
(Dollar amounts in thousands)

Summary of Changes:

		FTE	Amount
	FY 2000 Appropriation	**26**	**8,002**
	Section 301 Rescission	...	(30)
	FY 2000 Available Appropriation	**26**	**7,972**
Page No.	**Adjustments to Base**		
1.26	1. FY 2001 pay and benefits increases (includes adjustment for one less compensable day)	...	99
1.26	2. Within-grade salary increases and other pay adjustments	...	12
1.26	3. Increase in the cost of utilities	...	56
1.26	4. Increase in cost of services, supplies, and equipment	...	12
1.27	5. Increase in care of grounds	...	10
1.27	6. Decrease for nonrecurring projects	...	(2,602)
	Subtotal, Adjustments to Base	...	**(2,413)**

	Resources for Program Increases and Capital Budget		
1.27	7. Building improvements and utilities systems upgrades	...	1,971
	Subtotal, program increases and capital budget	...	**1,971**
	Total decreases requested	...	**(442)**
	Total appropriation requested, FY 2001	**26**	**7,530**

SUPREME COURT OF THE UNITED STATES
CARE OF THE BUILDING AND GROUNDS
Obligations by activity

Authorization.	FY 1999 Actual		FY 2000 Appropriation		FY 2001 Adjusted Base		FY 2001 Program/Capital Items		FY 2001 Request	
	FTE	Amount ($000)	FTE	Amount ($000)	FTE	Amount ($000)	FTE	Amount ($000)	FTE	Amount ($000)
Comparison by activities										
Care of the Building and Grounds										
Obligations	21	3,910	26	7,338	26	4,074	0	1,971	26	6,045
Unobligated Balance,										
Start of Year	...	(949)	.	(2,021)	...	(2,655)	..	..	.	(2,655)
Section 301 Rescission	..	..	..	30	...	...	..	. .	.. ..	
Unobligated Balance,										
End of Year	. .	2,021		2,655	. .	4,140	...	.		4,140
Unobligated Balance Expiring		418	. .	...	..	.	...	.	. .	...
Budget Authority	21	5,400	26	8,002	26	5,559	. .	1,971	26	7,530

Object Classification

		1999 Actual ($000)	2000 Estimate ($000)	2001 Estimate ($000)	Difference (+) or (-) ($000)
11	Personnel compensation	1,021	1,349	1,427	78
12	Personnel benefits	212	279	312	33
23	Rent, communications and utilities	797	892	978	86
25	Other services	1,798 *	4,690 **	3,210 ***	(1,480)
26	Supplies and materials	47	57	57	0
31	Equipment	9	31	11	(20)
32	Land and structures	26	40	50	10
	Total obligations	3,910	7,338	6,045	(1,293)
Unobligated balance available, start of year		(949)	(2,021)	(2,655)	(634)
Section 301 Rescission			30		
Unobligated balance available, end of year		2,021	2,655	4,140	1,485
Unobligated balance expiring		418	0	0	0
	Budget Authority	5,400	8,002	7,530	(472)

* Includes total of $1,292,000 "No Year" obligations
** Includes total of $4,467,000 "No Year" obligations
*** Includes total of $2,975,000 "No Year" obligations

SUPREME COURT OF THE UNITED STATES
CARE OF THE BUILDING AND GROUNDS

Relation of Obligations to Outlays

	FY 1999 Actual ($000)	FY 2000 Estimate ($000)	FY 2001 Estimate ($000)	Difference (+) or (-) ($000)
Obligations incurred, net	3,910	7,338	6,045	(1,293)
Obligated balance, start of year	623	738	650	(88)
Obligated balance, end of year	(738)	(650)	(543)	107
Adjustments in expired accounts	14	...	...	...
Outlays	3,809	7,426	6,152	(1,274)

Personnel Summary

	FY 1999 Actual	FY 2000 Estimate	FY 2001 Estimate	Difference
Total compensable workyears:				
Full-time equivalent employment	21	26	26	...

FY 2001 CAPITAL BUDGET
SUPREME COURT, CARE OF THE BUILDING AND GROUNDS
FIVE-YEAR CAPITAL BUDGET

ARCHITECT OF THE CAPITOL (Dollar amounts in thousands)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006 - FY 2010	TOTAL FUNDING REQUIRED	FUNDING THRU FY 2000	TOTAL ESTIMATE	TYPE OF FUNDS
SUPREME COURT, CARE OF THE BUILDING AND GROUNDS											
ITEMS APPROPRIATED IN FY 2000 (NON-RECURRING)											
Renovations to North and South Driveways (1)	82	-	-	-	-	-	-	-	194	194	NY
Replace Power Sweeper	20	-	-	-	-	-	-	-	20	20	Annual
Perimeter Security Enhancements: Barriers N & S Driveways (2)	400	-	-	-	-	-	-	-	1,050	1,050	NY
Bullet-Resistent Glass, Demonstration	2,000	-	-	-	-	-	-	-	2,000	2,000	NY
Mock-up Design Coordination - Chamber	100	-	-	-	-	-	-	-	100	100	NY
Subtotal, Items Appropriated in FY 2000	2,602	-	-	-	-	-	-	-	3,364	3,364	
CAPITAL PROJECTS IN THE BASE											
Design, Building Improvements (3)	1,529	3,500	-	-	-	-	-	3,500	3,283	6,783	NY
Telecommunications Support	700	700	-	-	-	-	-	700	800	1,500	NY
Renovations to Elevators	160	160	-					160	1,295	1,455	NY
Improvements for Disabled Accessibility	25	25	25	25	-	-	-	75	175	250	NY
Subtotal, Capital items in Base	2,414	4,385	25	25	-	-	-	4,435	5,553	9,988	
NEW REQUIREMENTS (FY 2001)											
None	-	-	-	-	-	-	-	-	-	-	-
CAPITAL/NEW REQUIREMENTS (FY 2002 - FY 2005) (4)											
Construction, Building Improvements	-	-	-	**	-	-	-	-	-	-	
Lightning Protection System	-	-	-	200	-	-	-	200	-	200	
Roof Fall Protection	-	-	-	304	-	-	-	304	10	314	
Replace/Upgrade Kitchen Fire Suppression Systems	-	-	-	75	-	-	-	75	-	75	
Replace Slate Flooring in Courtyards	-	-	-	200	-	-	-	200	-	200	
Replace/Retrofit 13 2 KV Switchgear & Cables	-	-	-	200	-	-	-	200	-	200	
Conservation of Exterior Stone Sculpture	-	-	-	-	200	-	-	200	-	200	
Replace X-Ray Machines	-	-	-	-	195	-	195	390	-	390	
Subtotal, New Requirements	-	-	-	979	395	-	195	1,569	10	1,579	
TOTAL, SUPREME COURT	5,016	4,385	25	1,004	395	-	195	6,004	8,927	14,931	

** Cost of Building Improvements Project to be determined.

(1) Includes FY 2000 rescission of $30,000

(2) Senate Report 106-76 states that the Committee expects a report detailing the options for installing protective barriers

(3) Senate Report 106-76 directs that a space utilization study on the Court to be provided to the Appropriations Committee by February 1, 2000 The study should detail the number of employees per square foot and the usage rate of the ceremonial and intermittently used space.

(4) Capital requirements for the outyears will be considered for inclusion in the Building Improvements Project

GENERAL STATEMENT AND INFORMATION

This appropriation, for expenditure by the Architect of the Capitol, provides for the structural and mechanical care of the United States Supreme Court Building and Grounds, including maintenance and operation of mechanical, electrical, and electronic equipment. The Architect is not charged with responsibility for custodial care, which is under the jurisdiction of the Marshal of the Supreme Court and is provided for in the Supreme Court salaries and expenses appropriation. The Architect performs his duties under authority of the Act of May 7, 1934 (48 Stat. 668).

The equipment includes such items as air conditioning, refrigeration and ventilating systems with more than 1,000 pieces of equipment; electrical transformer stations and emergency power system; 300 plumbing fixtures and related piping; 8 elevators and 5 dumbwaiters; electrical fixtures and wiring; and electronic security equipment. A cap of 26 full-time equivalent positions is established to cover two shifts daily.

Justification of Changes

The fiscal year 2001 budget request for the Care of the Building and Grounds, Supreme Court, totals $7,530,000. This represents a decrease of $442,000 under the revised fiscal year 2001 appropriation. The funding changes are divided into "Adjustments to Base," a decrease of $2,413,000, and "Resources for Program Increases and the Capital Budget," an increase of $1,971,000.

Additional positions are not requested. Full-time equivalent employment (FTE) cap for this account is 26 and actual FTEs for fiscal year 1999 total was 21. However, the actual FTE is higher during the years when temporary labor is hired to accomplish construction and installations. When feasible, projects will be performed on a contractual basis, and in certain situations additional FTEs for supplemental temporary labor may be required.

Adjustments to Base include funds for pay and benefit increases for staff paid under the general and wage board schedules. Also included are adjustments to costs of operational activities and reductions for non-recurring expenses in fiscal year 2000.

Resources for Program Increases and the Capital Budget
In an effort to provide a basis for long-range planning and to assist in the management of capital resources and finances, the Architect's Office compiles and presents a multi-year capital planning budget for all appropriations under the jurisdiction of the Architect of the Capitol. The projects relating to the buildings and grounds in the Capitol complex are included in the Legislative Branch budget. However, the projects pertaining to the Supreme Court, Care of the Building and Grounds are presented within the judiciary budget. In keeping with the Architect's effort to provide long range plans, a five-year capital budget for the Supreme Court Building and grounds is presented in this justification.

ADJUSTMENTS TO BASE:

Total net decrease: - $2,413,000

1. FY 2001 pay and benefits increases

Requested Increase: $99,000

A net amount of $99,000 is requested for increased costs related to pay and benefits in fiscal year 2001.

Of this amount, $91,000 is required to provide the increased cost of nine months of anticipated pay increases in fiscal year 2001 for employees paid under the General Schedule and the cost of twelve months for Wage Board employees. The pay cost estimate is based upon an anticipated increase of 3.7 percent for both categories of employees. It is expected that the increases will be effective for the Wage Board employees in October, 2000 and in January, 2001 for employees on the General Pay Schedule.

Increases in health benefits rates estimated at $12,000 are expected to take place in January, 2001. Additionally, an amount of $3,000 is requested for agency retirement contributions.

A decrease of $7,000 is included also to take into account one less compensable day in fiscal year 2001.

2. Within-grade increases and other adjustments

Requested Increase: $12,000

Increases for within-grades are authorized by 5 U.S.C. 5102(c)(7), 5102(d), 5341-5349 for Wage-Board employees and by 5 U.S.C. 5331-5336 for general schedule employees. An amount of $12,000 is requested in fiscal year 2001 to cover the costs of within-grade increases and other adjustments such as career ladder pay increases.

3. Increase in utilities costs

Requested Increase: $56,000

In fiscal year 2001, it is estimated that the cost of utilities will increase by $56,000. This increase is comprised of $56,000 for the purchase of steam and chilled water.

The increase for the purchase of steam and chilled water for the heating and cooling of the Supreme Court is based upon meter readings for fiscal year 1999 projected to 2001. This will increase the current allotment from $506,000 to $562,000.

4. Increase in cost of services, supplies, and equipment

Requested Increase: $12,000

It is requested that an increase of $12,000 be provided for services, supplies, and equipment in fiscal year 2001. The amount of $12,000 will provide for an increase in the annual elevator repairs and improvements account for annual inspections and elevator recabling.

5. Increase in care of grounds

Requested Increase: $10,000

In fiscal year 1998, the Architect of the Capitol was requested by the Marshal of the Supreme Court to provide a higher level of care to the grounds of the Supreme Court. In response, the Architect transferred supervisory responsibilities of the grounds crew from the Supreme Court Facility Manager to the Landscape Architect of the Capitol.

The Landscape Architect has recommended that an increase in the Court's budget for the care of the grounds is necessary for the purchase of plants. Therefore, it is requested that the budget be increased to $50,000, an increase of $10,000.

6. Decrease for nonrecurring projects

Requested Decrease: - $2,602,000

A total of $2,602,000 in non-recurring items will be decreased from the budget base. This decrease is comprised of funding provided in fiscal year 2000 for one-time nonrecurring items. The projects that are decreased from the base are: $20,000 for the purchase of a power sweeper; $82,000 for renovations to the driveways and snowmelt system; $400,000 for barriers on the north and south driveways; $100,000 for mock-up design coordination; and $2,000,000 for a demonstration area of bullet-resistant glass.

In addition to the base for operating costs, the following items will be retained in the base in fiscal year 2001: $25,000 for improvement for disabled accessibility; $160,000 for the elevator modernization program; $700,000 for renovations to the telecommunications infrastructure for the Court's cabling system; and $1,529,000 for further design of the building improvements and systems upgrade master plan.

RESOURCES FOR PROGRAM INCREASES AND THE CAPITAL BUDGET:

Total Increase: $1,971,000

7. Design, building improvements and utility systems upgrade

Requested Increase: $1,971,000

An increase of $1,971,000 is requested on a "No Year" basis over the base amount of $1,529,000 which will be retained in the base amount for a total of $3,500,000 in fiscal year 2001. This amount will be used to complete design efforts on which the building improvements construction funding request will be based and to begin construction documentation.

To date, a total of $3,283,000 has been appropriated for the building improvements project. In fiscal year 1998, $225,000 was appropriated on an annual basis to provide for a study on improvements and upgrades to the Supreme Court building and systems. Preliminary design of this project began in fiscal year 1999 with an amount of $1,529,000 which was maintained in the budget base in fiscal year 2000 for continued design work.

In the Spring of 1999 a master plan for the modernization of the Supreme Court building systems identified concepts and design alternatives that addressed major upgrades needed for life safety, security and other essential building systems. Based

upon that master plan, a schematic design was instituted and will be concluded shortly.

In November, a peer review was conducted based upon the 50% submissions of the Schematic Design documents. The Peer Review Team was selected from a list of nationally prominent individuals in several fields of building designs. The team was composed as follows: Paul Spencer Byard, Esq., FAIA, Historic Preservation Architect; R. Shankar Nair, P.E., FASCE, Structural Engineer; Vincent D. Lee-Thorp, P.E., Mechanical Engineer; David Stroup, P.E., Fire Protection and Life Safety Engineer; Stephen Curran, Cost Consultant. In addition to these individuals, the court had two representatives: Carl Stein and Karen Van Lengen. The Peer Review Team, including members of the Architect of the Capitol's staff and the Court's staff, met for a period of three days and conducted an intense review of the Hillier/Loring Design. The results confirmed that the Schematic Design effort was proceeding in a logical and consistent manner and that the overall scope of the basic mechanical refit was correct in light of the nature of working in a historic building and the difficulties associated with that effort. Some recommendations and options to consider were proposed and those ideas are being investigated and will be analyzed for their cost benefit potential and their constructability.

The current status of the project calls for a meeting with the Court in early 2000 to review the feasibility of the options, to finalize direction on those options, and to proceed with the next level of design (Design Development) and cost estimating in FY 2000.

The anticipated directions for FY 2001 will be to build upon the Design Development work and continue on the next phase of the project which would be Construction Documents. Based upon completion of the documents and a final cost estimate, bid documents would be prepared for bidding, award and start of construction in FY 2003.

FIVE-YEAR CAPITAL BUDGET (OUT YEARS)

In addition to the projects described in the previous section, the following section describes projects that are planned to be performed between fiscal years 2003 and 2005, but do not require funding in fiscal year 2001. At this time, it is anticipated that there will be no new projects requested in fiscal year 2002.

Construction, Building Improvements

It is anticipated that following the completion of the design work and construction documents for the building improvements project that funding will be requested for construction in fiscal year 2003. The cost of this project will be determined through the design and documentation process.

Lightning Protection System ($200,000)

It is anticipated that funds in the amount of $200,000 will be requested on a "No-Year" basis in fiscal year 2003 to install a lightning protection system on the Supreme Court building. This effort is part of a Hill-wide effort to protect the buildings and electronic equipment.

Lightning has been known to strike a building, causing damage to the building structure and equipment. Funds will be requested for the development of design criteria by the in-house

Electrical Engineering Division. Construction will be performed by contract.

This project is under consideration for inclusion in the building improvements and systems upgrade project.

Roof Fall Protection ($304,000)

The buildings in the Capitol complex have been cited for noncompliance with OSHA Standard, sub-part M1926 "Fall Protection". To correct these conditions, funding will be requested to install fall protection for all horizontal and vertical surfaces 6 feet or more above adjacent surfaces (roofs and walls). Trades who most frequently require fall protection include roofers, HVAC technicians, plumbers, stonemasons, carpenters, window washer and birdproofing technicians performing regularly scheduled maintenance programs and emergency services.

Fall protection systems recognized by OSHA include guard rails, fall arrest systems and safety nets. It is proposed to utilize a combination of guard rails and fall arrest systems where deemed appropriate.

It is anticipated that funding for the construction of this project will be requested in fiscal year 2003. This project is under consideration for inclusion in the building improvements and systems upgrade project.

Replace/Upgrade Kitchen Fire Suppression Systems ($75,000)

Funding will be requested to replace the fixed fire suppression systems protecting the cooking surfaces in the kitchens of the Court building. It is anticipated that funds will be requested in fiscal year 2003. However, this project is under consideration for inclusion in the building improvements and systems upgrade project.

Replace Slate Flooring in Courtyards ($200,000)

The Architect's staff has long pursued a summer restoration project to restore masonry and caulking in the court's four internal courtyards through the exterior pointing and caulking program. Since the surface of the existing slate is deteriorated and potentially unsafe, it has been determined that it is necessary to expand this project to include the replacement of the slate flooring in each of the four courtyards.

It is anticipated that funding in the amount of $200,000 will be requested for this project in fiscal year 2003 and is under consideration for inclusion in the building improvements and systems upgrade project.

Replace/Retrofit 13.2 KV (High Voltage) Switchgear and Cables ($200,000)

The existing high voltage electrical system, including switchgear and high voltage cables, is sixty years old and requires replacement or retrofit with up-to-date equipment. The typical life of cables and switchgear is approximately fifty years. Therefore, the existing equipment has outlived the normal lifespan. In addition, the cables need to be upgraded to meet code requirements to increase short circuit current capacity in case of a fault.

It is planned that funds in the amount of $10,000 will be obligated from Miscellaneous Improvements to contract an

architectural and engineering firm to perform a study to determine the best method to replace or retrofit the incoming high voltage system with the least disturbance to the occupants of the Supreme Court building. A detailed cost estimate of the total project will be available upon completion of the study.

This project is under consideration for inclusion in the building improvements and systems upgrade project.

Conservation and Maintenance of Exterior Stone Sculpture ($200,000)

The exterior marble sculpture on the Supreme Court building will be examined by a conservator to determine its structural condition and the need for treatment and estimated cost. The sculpture includes the east pediment by Herman MacNeil, the west pediment by Robert Aitkens and the figures of Contemplation and Executor of Law by James E. Fraser. Carved in 1935, the marble has been vulnerable to severe deterioration caused by air pollution and moisture with loss of detail and danger of breakage of sculptural elements. Funds for access by scaffolding or other means will be included in the cost of the conservation treatment.

This effort is presently planned to be requested in fiscal year 2004. This project is under consideration for inclusion in the building improvements and systems upgrade project.

Replace Two X-Ray Machines ($195,000)

It is planned to replace the four existing security x-ray machines in the Court building as follows: The two machines which were purchased in 1996 will be replaced in fiscal year 2004. The units which were purchased in fiscal year 1999 will be replaced in 2007.

STATEMENT OF THE HONORABLE ALAN M. HANTMAN, AIA
ARCHITECT OF THE CAPITOL

Fiscal Year 2001 Appropriation Request

SUPREME COURT, CARE OF THE BUILDING AND GROUNDS

U.S. House of Representatives
Committee on Appropriations
Subcommittee on Commerce, Justice, State, The Judiciary

March 15, 2000

Mr. Chairman, I am pleased to again appear before this Subcommittee to present the budget for the Care of the Building and Grounds of the Supreme Court. I would like to begin with a brief overview of the overall role of this agency and its relationship to the Supreme Court.

As you know, for the Legislative Branch, the Office of the Architect of the Capitol (AOC) is the agency responsible for the structural and mechanical care, maintenance, cleaning, and operations of the buildings and facilities supporting the Congress, including the Capitol Power Plant. This responsibility extends to the Botanic Garden and the structural and mechanical care and maintenance of the Library of Congress buildings and grounds. This office also undertakes the design and construction of new facilities and alterations of existing facilities in these jurisdictions.

For the Judiciary Branch, the Architect of the Capitol, by authority of the Act of May 7, 1934, is responsible for the structural and mechanical care of the United States Supreme Court building and grounds, and this is the reason for my appearance before this

Subcommittee today. We are not charged with responsibility for custodial care, which is under the jurisdiction of the Marshal of the Supreme Court and is provided for in the Court's salaries and expenses appropriation.

FY 2001 BUDGET REQUEST

The budget request for the care of the building and grounds for fiscal year 2001 that I bring to this Subcommittee today begins on page 1.19 of the Supreme Court justification and amounts to $7,530,000. The request represents a decrease of $442,000 under the fiscal year 2000 appropriation of $7,972,000, including the rescission. Included in this amount is a net decrease of $2,413,000 to the budget base and an increase of $1,971,000 in funding required for continued design of the major building improvements project.

The adjustments to the base are costs that support ongoing operations and maintenance, including compensation. The net decrease of $2,413,000 in base adjustments is comprised of an increase of $111,000 for mandated pay related costs, increases totaling $78,000 in costs of utilities, services, supplies, equipment and care of the grounds; and decreases from the fiscal year 2000 funding level totaling $2,602,000 for nonrecurring projects, which are outlined in the budget justification..

CAPITAL BUDGET

Once again the budget includes a five-year capital budget plan. A total amount of $4,385,000 is requested for four capital budget projects in fiscal year 2001, of which $2,414,000 is in the budget base. The projects include improvements for disabled accessibility $25,000; Renovation of elevators $160,000; Telecommunications infrastructure support $700,000; and completion of design efforts for the building improvements and utility

systems upgrade $3,500,000. By far, the most significant item in this budget is the effort to improve and upgrade the building and systems.

BUILDING IMPROVEMENTS PROJECT

I would like to begin this portion of the testimony by noting that during last year's hearing you clearly expressed the Subcommittee's concern and desired direction regarding the Supreme Court project. We heard you, and we responded to your directives. We conducted an extensive review of the methodology and magnitude of this important initiative through use of an independent peer review. That review led to a validation of the need for this project; it provided some opportunities for refining the design to achieve less costly renovation solutions; and it supported the reasonableness of the order of magnitude cost. I am pleased to report that the scope of the project is now clearly defined and has the support of the Court. Further, the earlier order of magnitude cost estimates of up to $140 million range is now estimated at approximately $109 million, including funding to date of $5.4 million and the current request of $3.5 million. That cost will be further refined as we proceed with design development.

To date, a total of $5,383,000 has been appropriated for the improvements project. This includes an amount of $225,000 that was appropriated in fiscal year 1998 to provide for a study on improvements and upgrades to the Supreme Court building and systems. Preliminary design of this project began in fiscal year 1999 with an amount of $1,529,000 that was maintained in the budget base in fiscal year 2000 for continued design work. Additionally, in fiscal year 2000 an amount of $2 million was appropriated for security windows and $100,000 to provide for a mock-up design coordination related to the building

improvements project.

Much progress has been made in the planning of the building improvements project since our preliminary presentation during last year's hearing. In the Spring of 1999 a master plan for the modernization of the Supreme Court building systems identified concepts and design alternatives that addressed major upgrades needed for life safety, security and other essential building systems. Based upon that master plan, a schematic design was instituted.

As previously noted, in November, 1999 an independent peer review was conducted based upon the 50 percent submissions of the Schematic Design documents. The Peer Review Team was selected from a list of nationally prominent individuals in several fields of building design. The team was composed as follows:

Paul Spencer Byard, Esq., FAIA, Historic Preservation Architect;

R. Shankar Nair, P.E., FASCE, Structural Engineer;

Vincent D. Lee-Thorp, P.E., Mechanical Engineer;

David Stroup, P.E., Fire Protection and Life Safety Engineer;

Stephen Curran, Cost Consultant.

In addition to these individuals, the court had two representatives: Carl Stein and Karen Van Lengen, both respected practicing architects. The Peer Review Team including members of the Architect of the Capitol's staff and the Court's staff, met for a period of three days and conducted an intense review of the design. The results confirmed that the Schematic Design effort was proceeding in a logical and consistent manner and that the overall scope of the fire protection, life safety, and basic mechanical, electrical and telecommunications systems upgrades and improvements was correct in light of the nature

of working in a historic building and the difficulties associated with that effort. Some recommendations and options to consider were proposed and those ideas have been investigated and analyzed for cost benefit potential and constructability. Over seventeen different schemes were analyzed before the current recommended scheme was confirmed for further evaluation and design.

In February, 2000, a joint presentation was provided to the Justices' Building Committee and other Court officials on an analysis of options to modernize the Court's 65-year-old infrastructure.

Subsequently, a meeting with the Court was held to review the options and to establish a clear direction. The Court has provided direction to the design team and has approved the next level of Design Development and cost estimating in FY 2000.

The direction for FY 2001 will be to build upon the design development work and continue on to the next phase of the project which will be Construction Documentation. Based upon completion of the design elements of the proposed improvements and a final cost estimate, bid documents will be prepared for competitive bidding. Construction could begin in FY 2003, providing that Court's final approval of this project has been received and that funding issues are worked out with the Appropriations Committees. To support the implementation of the building improvements, it is anticipated that a funding plan will be presented with the FY 2002 budget.

In a separate matter, Mr. Chairman, will you remember that the Court is also considering a project to further improvements to perimeter security. The Court has advised that it desires to wait until a Capitol Hill-wide perimeter security plan is developed before

it further considers its own perimeter security program. That Capitol Hill-wide plan is presently underway and is being developed under the jurisdiction of the Capitol Police Board, of which I am a Member.

I assure the Chairman that I will continue to work closely with you and the Subcommittee staff, as well as the Court, to achieve a rational and adequate funding level to support the needs of the Court.

Mr. Chairman, that concludes my statement and I shall be pleased to respond to any questions that you and the Subcommittee may have.

SUPREME COURT RENOVATION PROJECT

Mr. ROGERS. Well, that really is a major part of what we will be talking about—the Supreme Court renovation project. As has been said, the first scope of the project, I guess in 1998, that I was aware of at that time, describes about a $7 million project to replace systems, improve security and the like, which was a doable-type figure. Since that time, though, as we have said, that $7 million project has gone down, grown now to at one time $140 million, which I think is what, 20-fold? And then went back down to $85 million, now it appears you have settled on $100 million, which is a size that I don't think we can quite swallow without some real hard justifications for spending that kind of money.

I guess my real question is why has this project grown in scope and size so dramatically in just 2 years?

Mr. HANTMAN. Excellent question, Mr. Chairman. In 1998, this committee funded $225,000 to do a master plan, a conceptional study of the Supreme Court. This had never been done before. The approach had been piecemeal, Scotch tape and glue to keep things together that basically have been functioning since 1935. When we first discussed this, the results of that $225,000 study last year, clearly it was a shock to all of us that the magnitude of the dollars really were in the range, as I pointed out $120, $140 million. It was certainly very appropriate for this committee to direct us to go back and take a look at that master plan study, build on it, really analyze it, and see what was, in fact, truly necessary, no bells and whistles, basic life safety, basic security, basic concerns about the mechanical electrical systems.

We took you very seriously on that. In the year since our last hearing, we have done an awful lot to check into it, to revise it, to modify it and to bring it down to the point where we think it truly is in the right ballpark, as you indicated, about $100 million after the design request that we are talking about for this fiscal year. What we have done over the past year is working with the Court very strongly on the conceptual master plan. We proceeded to the 50 percent completion level of schematic design, more detailed design. When you talk about a master plan, a concept, you are talking about square foot costs, you are talking about comparing it to additional projects that may be of a similar landmark or occupied status. But when we got to the 50 percent mark on schematic design, we brought in an independent peer review team to evaluate the project scope and its costs. The team was composed of prominent experts in several aspects of building design. It included a historic preservation architect, structural engineer, mechanical engineer, and a fire protection and life safety engineer. Fire and life safety work was not included in any budget request prior to what we are talking about right now.

RENOVATION PROJECT PEER REVIEW

Mr. HANTMAN. We also brought in an independent cost consultant. All these people, in fact, were independent, in other words, no prior connection to the project. As a belt-and-suspenders type of thing, the Court brought in independent practicing architects to represent its part and its concern. The overall peer review process

proceeded. The peer review group analysis focused on the basic needs of the project, that is, replacing critical building systems. They looked at whether or not there were opportunities for reducing the scope by cutting back or eliminating any of the building renovation systems we were talking about as part of a no-frills system modernization.

Some scope elements previously planned, such as exterior stone renovation, was deferred to a future date. This resulted in an ability to more tightly focus design options on the issues really being reviewed, the basic concerns of the building. We also reviewed construction methodologies, the concern about how do we minimize overtime premium costs on a project of this nature with an occupied building where the Court is truly functioning.

The peer review team results confirmed that the schematic design information which was built on our master plan, was proceeding in a logical and a consistent manner, that it was consistent to critical building system needs. They also found that there were no viable options for cutting back or eliminating major scope elements. The building systems have simply outlived their useful life expectancy. Further investment to sustain them for a period of 3 to 5 years would be money wasted, as they would soon have to be replaced fully and at greater cost than today. We would then have to get into the Court and do another project disrupting the operations of the Court a second time. This peer review committee found that the overall scope related to life safety, fire protection, basic mechanical, electrical, telecommunications systems, all of these retrofits were consistent with the nature of working in a historic building and the difficulties associated with the effort of working in a building that, in fact, was continuing to operate, and we have to do it in phases and segments.

The peer review team also validated that the order of magnitude of cost for renovating this occupied monumental building was, in fact, reasonable. They did find some opportunities for cost reduction, however. Examples of potential reductions as a result of this in-depth review includes selection of a design for the mechanical system that utilizes the existing vertical duct system, it substantially reduced the impact on interior finishes. We don't have to cut holes in the floor, cut open walls to get major ducts and utility runs up into the building. So that, in itself, is a savings, which is why we are down from the $120- to $140-million range.

Consensus also was created that there be no major intrusion for life safety systems say in the Great Hall, because sprinklers are really not necessary in an area where you have hard surfaces, you have marble floors and walls, there is very little that can burn. So it is a refinement of an overall concept looking at individual spaces that we need to work on. Also, a design solution for creating new mechanical equipment space was developed that did not involve potentially costly subbasement excavation. We have gone through, Mr. Chairman, in this last year, 17 to 19 iterations of the basic system. The major cost is in mechanical systems and distribution. One of the major options was that, in order to leave the functions of the basement, which includes a lot of shops and support facilities intact, we could excavate beneath the parking pods. There are four quadrants, and a parking pod in each quadrant of the building. If

we excavated in those pods, down to a new level giving us 18-foot headroom, and were able then to run the ducts effectively while the basic building systems were still in operation, that would be one major methodology, and a very viable method to do it.

But there is some level of risk involved in terms of underpinning the existing foundations. There were also concerns there that it might drag on another year or so into the renovation process. And that the dollars would be more expensive than an existing basement scheme. The key here of course is the existing building systems need to be kept in operation while we are putting in the new systems and that we cut over to the new systems once they are proven and tested. We are now looking at a basement scheme rather than a subbasement scheme, which we think can give us significant savings as well. So based on the peer review team's analysis, the Court has now approved the overall scope of the project, and it agrees that the order of magnitude of cost is reasonable and necessary. Much progress has been made in the planning of the building renovations since last year.

In closing, basically this part of the discussion, the buildings really have been in a 65-year-old time capsule. We really need, and all the consultants and the peer experts agree, it is time to open that time capsule and make sure that the base building systems and this wonderful historic movement itself will continue to serve the Court, and serve the American people well into the new millennium.

BUILDING APPEARANCE

Mr. ROGERS. Correct me on this now, as I understand it, there will be no real change in the appearance of the building inside or out?

Mr. HANTMAN. This is the basic approach.

Mr. ROGERS. The idea is to preserve the architectural integrity of the building, the appearance of the building outside and inside.

Mr. HANTMAN. That is correct, sir.

MECHANICAL SYSTEMS

Mr. ROGERS. But what you are attempting to do then, inside and outside, for that matter, but inside especially, is to renovate the heating and air conditioning systems?

Mr. HANTMAN. Yes.

Mr. ROGERS. The electrical wiring?

Mr. HANTMAN. Right. Telecommunications.

Mr. ROGERS. Telecommunications.

Mr. HANTMAN. Life safety systems. This building does not meet current codes in many areas. It is not an unsafe building, but it needs to be brought up to code, and ADA as well.

Mr. ROGERS. In what respect?

Mr. HANTMAN. Sprinklers. We have areas that are not sprinklered at this point in time. We have concerns that there are open stairways, monumental stairways, a similar process that we are beginning to address in the Capitol building itself. This building is of landmark proportions, having monumental stairs, the concern being able to detect any fire to get alarms appropriately

sounding in time, to quash them at an early stage. Those facilities don't exist in the court right now.

SECURITY IN THE BUILDING

Mr. ROGERS. What about security, not perimeter security, but security in the building itself, will that be incorporated into this plan?

Mr. HANTMAN. In the analysis that I described relative to the basement versus subbasement scheme, if we had gone to the subbasement scheme, most of the facilities could have been accommodated within the building shell. We are looking now at issues of basic building operations and security control. For instance, there are no truck docks in the building right now. No place outside of the base building structure where you can inspect mail.

So what we are looking at now, Mr. Chairman, as one of the options we are working with the Court on as we are concluding the schematic design phase, is the possibility of building an underground structure to replace those functions that have been dislocated by the basement scheme.

On the north side of the building, there is a triangular piece of land off Maryland Avenue between the court and Maryland Avenue. We are looking at the option of building underground, and an allowance for that type of construction is within this $100 million order of magnitude that we are talking about to accommodate some security-related, some truck dock-related, some other operations that are important to the day-to-day functioning of the court.

RENOVATION PROJECT CHALLENGES

Mr. ROGERS. Well, we are looking here at the renovation of one of the seats of one of the branches of government. And sometimes we forget that the Supreme Court building itself is the home of the third branch of government. The same as the White House, I guess, and the Old Executive Office Building, are the home of the executive branch, this Capitol Building is the home of the legislative branch. And we think nothing, I guess, of spending a lot of money on the homes of both of those branches. But it has not occurred to us it has been 65 or 66 years since the Supreme Court building opened, and was constructed at a time when practically none of today's marvels were even dreamt about—telecommunications, terrorist threats, computers and the like. And you are dealing with a building that is constructed without false ceilings in which you can insert ducts. So you really do have a problem in that building, do you not, in trying to bring it up to modern-day standards?

Mr. HANTMAN. We do indeed. The telecommunications part of the project is proceeding with design right now. We have done some preliminary probes through walls to find out if there are chases, there are no hung ceilings, as you pointed out, Mr. Chairman, to hide wires behind to change duct work configurations, to find chases that will allow us not to chop through marble, not to chop through fine finishes in this building so that we can retain what we are all concerned about which is the grandeur and the majesty of this building, so that future generations will really be able to respect the fact that the Supreme Court, as you pointed out, is the third branch of our government and a necessary and critical one.

RENOVATION PROJECT COSTS

Mr. ROGERS. Suppose we were unable to find that kind of money. What happens then?

Mr. HANTMAN. I think what we need to do now, Mr. Chairman, with the funds that we are requesting we will be finishing up the schematic design and going into the detailed design phase. In that detail design phase, we will be further refining and doing more exploratory work of what we can do to minimize again chopping those fine finishes, spending all the general condition dollars for repairing, replacing, repainting critical areas within the court. Hopefully, we can find that much of this work can be accommodated in double wall systems, in cavities within ceilings that we can find and find that we can run our wires and our cabling through. That hopefully will then reduce the cost. The issue of what we can phase for future times is really problematic, Mr. Chairman, in that there is so much of this that has to be done in virtually all the spaces of the Supreme Court, that if we delayed a piece of the work until later on, we will have to come back and disrupt the court and their operations once again in the same spaces. Which is why we need to look at, during this design development phase again, what needs to be done, what potentially might be deferred. Anything that we could consider to be bells and whistles, et cetera. We took you very seriously last year, Mr. Chairman, I have no intention of coming back here again saying there are any such bells and whistles in this project.

Mr. ROGERS. Well, you are asking for $1,971,000 for this study of the further construction design, I guess, for this coming year.

Mr. HANTMAN. Over and above the base.

Mr. ROGERS. Over and above your base?

Mr. HANTMAN. That is correct.

PERIMETER SECURITY

Mr. ROGERS. Now, we have not talked about perimeter security. But as I understand it, now as opposed to 1998, we are talking about the perimeter security for the Supreme Court building being a part of the overall Capitol Hill perimeter security plan; is that correct?

Mr. HANTMAN. That is correct. I think that is the only way we can appropriately address it. We have created a task force that involves the Library of Congress, the Senate Sergeant at Arms, the House Sergeant of Arms and myself, who comprise the Capitol Police Board, as well as the police force itself, to make sure that whatever we do with the Court is consistent with what we are proposing to do throughout the Capitol.

Mr. ROGERS. When do you anticipate that that plan would be available?

Mr. HANTMAN. There are some studies under way right now, which are expected to be coming in within the next 2 to 3 months dealing with the threat level on the Senate and the House side as well. Some of those studies had been completed on the court but not on the Senate or the House side. Once those studies are at the Capitol Police Board, the task force will focus on the implications of those studies and what the board as a totality wants to bring

to the Congress as well as to your committee, and the court itself to again come up with a comprehensive plan. We are hoping that we can do that this year.

Mr. ROGERS. Now, under what category in the budget would that perimeter construction be?

Mr. HANTMAN. Thus far, we had had a separate line item, separate from this $100 million that we are talking about from the basic building itself. We had requested—I think you had granted us some $500,000 in fiscal year 1999 and that is what we have been building on, and we have been deferring the completion of that study until we get the input from the rest of the people on Capitol Hill.

Mr. ROGERS. When it comes time to build perimeter security, what subcommittee will that be under?

Mr. HANTMAN. I believe it will be this subcommittee, because we are still talking about for the Court itself. Although we are talking about a comprehensive integrated plan, anything that deals with any of the streets that surround the court deal also with the Senate and the House side, also with the Library of Congress. So this has to be thoroughly thought out. But I think, since we are talking about court grounds, that we would still be coming to this committee.

Mr. ROGERS. But there are no monies in your present request for perimeter security?

Mr. HANTMAN. That is correct sir.

Mr. ROGERS. Okay.

Mr. Serrano.

HISTORIC BUILDING MODERNIZATION

Mr. SERRANO. Let me ask the dramatic question. In listening to you I wonder if, in the long run, it would cost less to take the present Supreme Court building make it a museum, and build them a new building. I mean, it seems to me that so much needs to be repaired, it seems to me there is no guarantee that we are going to pull this off and bring them to the point of where they should be. Of course, the same argument could be made about the Capitol building. And we are certainly not intending on building a new Capitol building. But as we look at these issues, are these doable? Are all these structures that we have to repair and bring up to this modern day, is this a doable situation?

Mr. HANTMAN. They are indeed doable, sir. We had looked at the issue of what if the Supreme Court were to relocate. Clearly the Court itself has no interest in relocating to another facility. They are very clear on that. This is the building they want to remain in. In fact, the costs of building a building that was appropriate for the Supreme Court somewhere in the district and then still having to come back and retrofit this building—the mechanical systems, they would have to be replaced, even if the building were to be a museum. I think the overall dollar value would still exceed the retrofit, although it may be a 6-to-8 year period that we are going to. We recognize the court is going to be in session, that the justices are very sensitive to disruptions to their work. But we can do the work. In fact, we are going to have to be doing the same thing in the Capitol itself. We have not yet gotten carte blanche access to

any portion of the totality for us to do life safety elements. That is why it is going to take longer to do that building as well while it continues to be occupied.

OCCUPANCY DURING RENOVATION

Mr. SERRANO. So you expect the Court to stay in residence during the renovation?

Mr. HANTMAN. Absolutely, sir.

Mr. SERRANO. And they agree with that.

Mr. HANTMAN. They do agree with that. Quite frankly, I think anything we do, despite the fact that we will be doing a lot of work on overtime hours and at times that the court is not in session, will create some level of inconvenience.

Mr. SERRANO. What are their periods that they are not in session?

Mr. HANTMAN. July 1st through the end of September is the primary block of time. And the noisiest work could certainly be reserved for the period of time that they are not here. But as for the issue of inconveniences, I don't think anybody, quite frankly, whether you are talking about the Capitol building renovation or the Supreme Court building renovation, or we are talking about the visitor center on the east front of the Capitol, appreciates that there will be disruptions, there will be noise, there will be dirt. And that is a normal part of, an unfortunate part of retrofitting existing buildings. And that will, in fact, be the case.

Several weeks ago I had the pleasure of meeting Senator Voinovich, who was recently elected to the Senate from Ohio. He had been the Governor of Ohio prior to that. And there had been an article in the *Roll Call* newspaper at that point in time that we were discussing. And it was an article about life safety systems and going in and renovating the buildings. He said, you know, when he was Governor of Ohio, he had a real problem with the State capital. He had, as governor, to vacate the state capital for 3 years to do half the building. It was a 400,000-square-foot building, so 200,000 square feet was vacated for 3 years. They went to another structure that had been built for the expansion of the government services. When he moved back, and the other half of the building was done in another 3 years, a total evacuation of the building. Poor word, perhaps, but they evacuated the building for that period of time.

That is certainly an approach that people around the country are taking to some structures. That is not the case in the Capitol nor—certainly in the Supreme Court. They had just built another building in Ohio in which they had turn around space unoccupied at that point, where there was no other costs to build another facility to house them during that period of time. So they were able to do their renovation. I don't believe we have that option.

ANTICIPATING FUTURE NEEDS

Mr. SERRANO. I am just concerned. I don't want to question the abilities of any of you gentlemen, but it worries me that by the time these projects are finished, we are going to have folks before these committees again saying that some things were not taken care of. I just wonder if the present structures lend themselves for

us to understand everything that needs to be done with them and everything that has to be changed and renovated.

Mr. HANTMAN. We are undergoing——

Mr. SERRANO. We are dealing with security issues, right? But you are also dealing with rewiring, if you will.

Mr. HANTMAN. That is correct.

Mr. SERRANO. Then the normal aging problems of replumbing and other structural situations. I am hopeful that we have taken a very close look at everything that has to happen here so that when the 6- or 5-year period is over, we don't find we have to do something else. You know, I remember in 1974, I got elected to the State assembly in New York and in 1975, we inaugurated the Rockefeller Plaza. By the time I left there in 1990, it was being rebuilt. That is a different story, whoever built it didn't—in 1975 didn't anticipate what they needed in 1990. And everybody was moved out of this whole complex downtown and people had to be—the whole thing had to be attacked again.

Mr. HANTMAN. Your concern is a real concern. Any time you go into an existing structure, no matter what you do you will find some surprises. We think that we have looked at the major systems, the major issues that need to be addressed in the renovation. As we go through design and construction documents, we will be looking, in more detail, at what the real issues are before we come to you with a full construction budget. We think it is in the magnitude of $100 million at this point in time. We will be doing a lot more cost estimating and detail design work before we come back to you.

Mr. SERRANO. A 100 million dollars for everything that needs to be done in the Supreme Court or the whole complex?

Mr. HANTMAN. The Supreme Court, in addition to the dollars we are asking for the design phase right now.

Mr. SERRANO. Thank you, Mr. Chairman.

CLOSING REMARKS

Mr. ROGERS. Well thank you very much for your testimony. You have got a tough job. It is hard to get the money out of these lemons up here.

Mr. HANTMAN. Quite frankly, you have real allies in wanting to look at belt-and-suspenders methodologies. The court, as you are well aware, sir, is a very deliberative body. We have met many times with three of the justices on the court who took it back to the full court themselves, coming back with lots of questions, lots of iterations and which we have had to study and study productively for this last year. So for the court to be convinced at this point in time, I have never pleaded a case before the Supreme Court before, but they are committed to it right now. They recognize that it needs to be done. Quite frankly, they need to all recognize that there, by necessity, will be some disruptions, but we will try to minimize that.

Mr. ROGERS. I can only imagine the difficulty of getting those people in a consensus on reconstruction of that facility. And I am sure that has been a tedious process that you have gone through.

Mr. HANTMAN. It has been a constructive one, sir.

Mr. ROGERS. Thank you very much.

WEDNESDAY, MARCH 22, 2000.

JUDICIAL CONFERENCE OF THE UNITED STATES

WITNESSES

JOHN G. HEYBURN II, CHAIRMAN, COMMITTEE ON THE BUDGET OF THE JUDICIAL CONFERENCE OF THE UNITED STATES; JUDGE, UNITED STATES DISTRICT COURT, DISTRICT OF WESTERN KENTUCKY

ROBERT C. BROOMFIELD, MEMBER, COMMITTEE ON THE BUDGET OF THE JUDICIAL CONFERENCE OF THE UNITED STATES; JUDGE, UNITED STATES DISTRICT COURT, DISTRICT OF ARIZONA

LEONIDAS RALPH MECHAM, DIRECTOR, ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS; MEMBER, EXECUTIVE COMMITTEE OF THE JUDICIAL CONFERENCE OF THE UNITED STATES

FERN M. SMITH, DIRECTOR, FEDERAL JUDICIAL CENTER, JUDGE, UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF CALIFORNIA

Mr. ROGERS. The committee will come to order.

We are pleased to have with us today a distinguished panel of jurists from our Federal Courts to defend the fiscal 2001 budget request for the Judiciary.

The panel is being led for the fourth time by Judge John G. Heyburn, who sits on the United States District Court in the District of Western Kentucky in Louisville, and who has brought great distinction to the bench. I might add that, in his capacity as Chairman of the Judicial Conference's Committee on the Budget, he has the task of presenting the budget for the entire Judiciary to the Congress, and to make the case for the resources necessary to assure that the Federal Courts can carry out their heavy duties. It is always a pleasure to welcome my friend, Judge Heyburn, and his colleagues to this subcommittee.

He is joined by Judge Robert C. Broomfield, from the District of Arizona, also a member of the Budget Committee; Judge Fern Smith, Director of the Federal Judicial Center—and congratulations to you on your new assignment.

Judge SMITH. Thank you.

Mr. ROGERS. And Leonidas Ralph Mecham, Director of the Administrative Office of the U.S. Courts, and a long-time visitor to this subcommittee.

As you know, fiscal year 2000 was a difficult year, for us as well as yourselves. We struggled to find every dollar that we could for the needs of the courts, and still came up short, I'm sure, in yours and others' views. I think it's fair to say that the prospects for fiscal year 2001 are about the same as they were last year, so we're going in with the wick of expectations burning real low.

We will make your statements a part of record. Judge Heyburn, if you would like to begin by summarizing your statement, we would look forward to hearing from you.

Judge HEYBURN. Thank you very much, Mr. Chairman. It is always a pleasure for me. This is my fourth occasion, as Chair of the Budget Committee, and perhaps my sixth occasion overall, to appear before you, and to represent the men and women of the judiciary, it's really a proud moment for me to have that opportunity.

I practiced law for 16 years, and now it is astonishing to me to think that I'm entering my eighth year as a judge. I have a tremendous appreciation for the hard work and dedication of the people who are in the judiciary. It's been a very fulfilling experience for me and it's a pleasure to represent them.

Also, as you have said on a number of occasions at the outset of these hearings—Congressman Serrano, welcome. As you have said on a number of occasions during these hearings, these sessions never cease to amaze me about the majesty and the delicacy of our constitutional system. We know that the founding fathers created the judiciary to protect the rights of our citizens and to mediate disputes among citizens and among branches of Government. And yet, here we are, as a separate and independent branch of the Government, coming before you, another independent branch, and asking for the resources to do the very job that the Constitution and your own legislation requires it to do.

I feel very positive about your and Mr. Serrano's deep understanding of our constitutional system and the dynamics that are at work, and it's always a pleasure to be able to discuss these issues with you.

Also, as you know, we have had a very cooperative and terrific working relationship with your staff, getting them the information that we think you need to make the tough decisions that you have to make. We're looking forward to working with Gail Del Balzo in her new capacity, and we will try to get you all the information that you need and look forward to working with you.

Also, as you suggested, we really do appreciate the efforts that you, Congressman Serrano, and members of the committee went to, to help the judiciary receive the funding that it did last year. Sure, it wasn't everything we asked for, but our job, after we receive our appropriation, is not to complain about what we didn't get or what we did get. Our job is to do our job. Our main appreciation that we can express to you is, after we get the appropriation, is to go ahead and do our job as best as we possibly can and as efficiently and as fairly for the American people as we can. We hope that every year we justify your faith in us by doing exactly that.

We know you had a hard year last year. I was hoping you were going to say that this year was going to be a little easier. I hope at the very least, for all of our sakes, that you will finish a little earlier. But we are here to help you and, of course, to justify our request.

Our request this year is for about an eight-and-a-half percent increase in obligations, and that translates to about an eleven-and-a-half percent increase in appropriations. We can discuss that difference, of course, if you like.

That really amounts to about a $360 million increase in the obligations that we need to run the judiciary. Of course, that's a small amount compared to the entire budget, but we know that every increase, every dollar, is something that you need to weigh against the other priorities, not only within this committee but compared to other committees as well.

But of the $360 million, a huge percentage of that, about $260 million, is necessary just to maintain the ongoing operations. It's for inflationary pay increases for employees; it's to pay the increased rent that GSA charges us; it's to pay the rent for new buildings. That leaves about $100 million that is really meeting the new challenges of the judiciary, for new security needs, and for some new judges and magistrate judges that are coming on board.

The focal point of our discussion this year is the continuing rise in the Federal caseload—that is, the work that we have to do. This is something that we don't complain about. It's just a fact of life. It's something that is, to a certain extent, beyond everyone's control. Particularly the criminal caseload continues to rise. Over the last four years, criminal filings have increased 28 percent, and all the things that are related to that have increased about the same: the number of people on supervision, the number of pretrial reports that are necessary, the number of panel representations that are required for indigent defendants et cetera.

But over the past couple of years, and this year particularly, we have noticed another phenomenon, and that is the concentration of the increase in the criminal caseload in certain areas, particularly along the southwest border. I don't want to bore you with the statistics, but sometimes they are telling. Of the increase in the Federal criminal caseload, which is substantial, over the last four years, almost 70 percent of that increase has occurred in only five judicial districts. What's happening is a unique set of circumstances created by the border situation, the crossing at the border, and all the related problems that go along with it, drug trafficking and other, both State and Federal, violations.

The result is that the Executive Branch of our Government is devoting an incredible array of resources to combat this problem. I know in some cases there are some people who say they haven't devoted enough, and maybe other people say too much. Our job is not to question whether the resources devoted are too much or too little, but simply to respond and make sure the judiciary is not the bottleneck. But over the last four years, Border Patrol agents have increased about 100 percent, and INS and DEA agents a similar amount. The effect on our caseload is to be expected.

Of course, there are other areas that also have seen a tremendous increase in the criminal caseload, and areas that are not on the border, one of which is in our own home State. For reasons that are probably related to geography and transportation methods, the Eastern District of Kentucky over the last two years has shown a 33 percent increase in the criminal filings.

Part of what I'm here to tell you about is the extraordinary efforts the judiciary has already made to confront these challenges. We know the situation is, to some extent, a crisis, and we need to respond. We have done that by committing resources to the southwest area, making sure extra judges are there. We know there may

not be confirmations of new judges in quite a while. There have been sixteen new judges applied for for that area. We recognize that that may not happen any time soon, so we've got visiting judges in. We've got personnel from other areas to try to deal with the problem.

One of the reasons that I asked Bob Broomfield to come with me, in addition to being a member of our Budget Committee and being on our Economy Subcommittee, whose job it is to look for ways we can find efficiencies in the judiciary, but he's also the immediate past Chief Judge of the District of Arizona, which is right in the middle of this problem, so if you have any particular questions of him, I know he would be glad to address them.

There are a lot of other things we could discuss, and I think I will leave that to the questions that you may have. But obviously, we feel like we've had some success over the past couple of years, and we don't take all the credit. A lot of the credit goes to this committee, the questions that you have raised, the challenges you have given us.

In the habeas corpus area, I think we have shown some progress, and we've probably got some progress to make. But at least we're heading in the right direction on bringing down those costs.

Generally, in the defender area, I think over the past few years, with a lot of prodding on your part, I think we have shown a reorganization of that program, an ability to deliver better service at a lower per-case cost, so I think we're on the right road there.

We do need some help in defenders, though. We would like to get the defender panel rate up to $75.

We've got the U.S. Sentencing Commission back in business. That's important for the judges. We have continued our efforts to evaluate our ongoing practices in security, in buildings, in personnel. We've got studies going in all three of those areas, to reevaluate how we do our work, to see if there's a better way we can do it. We know we've got budgetary pressures, and our caseload is changing. The country is changing and we've got to respond.

I am proud to represent the judiciary. This has been and continues to be a very fulfilling experience for me, and to have Ralph Mecham with me, under whose charge the Administrative Office has really taken a leadership role in addressing the various problems that have confronted us. Also, to have Judge Fern Smith, under whose new leadership I think you'll see the FJC continue to be a real integral part of addressing the problems we have.

In long distance learning, they have helped out already in the Southwest Border Initiative, and in getting information to judges who are confronted with habeas corpus cases, both capital trials and capital habeas cases that they're not used to. They have been getting judges the kind of training that will help run those cases more efficiently and hold down costs, if possible.

So we're glad to be here. We are glad to help out in any way, and all of us would be delighted to answer any questions that you and Congressman Serrano would have of us.

Mr. ROGERS. And Mr. Wamp.

Thank you, Judge.

Mr. Serrano, do you have any opening comments you would care to make?

Mr. SERRANO. No. I would just apologize for being late. The Vice President was visiting the building, as you know——

Mr. ROGERS. No, I didn't know. [Laughter.]

Mr. SERRANO. You weren't invited. But he had some very kind things to say about you. [Laughter.]

I would just like to welcome you folks. I will have some questions, especially on the whole issue of the Southwest Border.

Mr. ROGERS. Does any other witness care to give a statement at this time? Well, thank you very much.

Yes, Mr. Mecham.

Mr. MECHAM. Since you did mention the fact that I have been here so often, I would like to thank you for your patience over the years. This is my 15th time before this subcommittee, in the modern era, and two years under the "sainted" John Rooney, in an earlier incarnation.

My agency celebrated its 60th anniversary this last year. We were created because everyone felt it was inappropriate for the largest litigator in the courts to control the management of the judiciary. So in '39 my agency was created, hopefully also to increase efficiency and service, as we have tried to do. We operate "lean and mean" and we are pleased that you have supported us well—not as well as we would like, but always well.

May I join Judge Heyburn in thanking you for what you did this last year. Not only did you do well by us in this subcommittee, but in conference you went higher than either the Senate or House figure, which was unprecedented, and we are grateful for that and are using it wisely.

Thank you.

Mr. ROGERS. Well, as an old state court judge, a mentor of mine back home in Kentucky, once said, after I had my first case—this was Judge Roscoe Tartar—after the jury came back and acquitted my man, who should have been convicted——

[Laughter.]

Judge Tartar says, "The Lord is mighty in battle, mighty in battle. Mighty in battle, indeed." So I guess in these budget negotiations there is some other force working. "Let the force be with you." [Laughter.]

I thank all of you for being here and for your testimony. It is a pleasure working with Judge Heyburn and his committee. They are always above board and fair and honest in their dealings, obviously.

APPROPRIATIONS FOR THE JUDICIARY

It is a particular atmosphere in which we have to work in the courts' appropriation, because there is a special factor involved here that is not involved when we're dealing with the State Department or the Commerce Department or whatever. This is an independent branch that is, indeed, separate and equal. It is the obligation of this branch of government to appropriate, to tax and appropriate funds, for all agencies of the government, including the judiciary. But we are very mindful of the need and constitutional separation of powers, and we dare not, in any way, try to influence the other branch of government in dispensing equal justice.

It is always the temptation of the appropriators—that is to say, the Federal Congress—it is always our temptation to put strings on any monies we give to another agency. And we do that quite often. But, my goodness, we have never attempted to do that with the Judiciary, nor shall we. If we do, I'm sure the public would be outraged. We will, though, exercise our obligation to scrutinize your spending, to be sure that it is adequate, to be sure it is being done the right way. That's the purpose of this procedure.

Now, you have requested $4.6 billion in total obligations. That's an eight-and-a-half percent increase, as you say, over the current level of $4.3 billion, but I see that is the request for total obligations, not appropriations.

Judge HEYBURN. Yes.

Mr. ROGERS. Because, as we know, you're funded by the appropriated moneys that we give you, and then you have other sources of funds—fees, carryover balances and the like—that go with the appropriated funds to give you your total obligations. Your total obligations request is for an eight-and-a-half percent increase, yet your request for appropriated funds is an 11 percent increase, an 11.7 percent increase.

Judge HEYBURN. Right.

Mr. ROGERS. And that is so, I am told, because of a sharp decline in your other sources of funds, a projected decline of almost 34 percent in the other funds.

As we have said, Judge Heyburn, you're aware that our appropriated funds source remains subject to tight restrictions. We're not going to have a lot of money to throw around. So could you comment on the decline in this category of "other" sources of funds and how would you explain that trend? Do you expect that decline to continue and, if so, how are we going to make up for it?

Judge HEYBURN. Well, as you know, the judiciary is somewhat unique in the way we are funded, not because we have other sources of funds—there are other agencies that have that—but at its high-water mark, those funds represented almost ten percent of the total budget. At one point we had a carryover that exceeded $250 million, plus fees of about $150 million. That's $400 million in non-appropriated funds.

But the unusual thing about our funding, as you know—and it's a tribute to the trust that has developed between the judiciary and this committee—is that the funds that are unused at the end of the year have been allowed to be carried over to the next fiscal year. That seems to be a positive for both sides. It encourages us to spend the money wisely, knowing we won't lose it, and the next year any carryover naturally reduces the necessary appropriation by a like amount. If there's a carryover of $200 million, then that's $200 million less that needs to be appropriated. It's as simple as that.

These carryovers occur for a lot of reasons that are basically beyond our control. We can't control the number of judges that are confirmed. We can't control when buildings come on line and when rent will be due. We can't control a lot of other things, such as a caseload that may result in increased or decreased costs.

Of course, we're always trying to save resources. This past year, for instance, the individual courts returned $40 million to us at the

end of the year. Of course, that then reduced the appropriation need for the next year. But each year, for the past two years, because of tight appropriations, we have had to, in essence, spend the carryover. Although I'll use sort of gross numbers, going into FY '99, the carryover, including everything—and some of this was earmarked funds—was about $250 million. This past year, in FY '99, we spent about $80 million of that carryover, so that going into FY 2000, we're down to $190 million of carryover.

We anticipate that this year we will spend about $100 million of that carryover, because we don't have any other sources of funds. So that beginning in FY 2001, we're not going to have a carryover to spend. So in order to even exist at the same level that we had before, those carryover funds that we have spent need to be replaced. It's as simple as that. You can only spend the carryover until there's essentially no carryover left. Obviously, every year, even if you budgeted absolutely precisely, there's going to be a little bit left over.

We have gotten to the point, as I think the chart on page 24 of our budget summary demonstrates, where the carryover is going down and down and down. Of course, we're estimating right now that the carryover in S&E operations will be about $50 million. As you know, as the year goes on, if we think it's going to increase, we'll let your staff know. Of course, that directly reduces the appropriation that's necessary.

But the bottom line is that there isn't a $200 million carryover to spend in lieu of an appropriation any more. That is really the long and the short answer to your question.

But the whole relationship I think is one of trust between your committee and the judiciary, and it has really worked well, because our courts and the judiciary as a whole understand that we don't spend the money just because it happened to have been appropriated to us. We spend it only if we need it, and if we don't need it this year, it's carried over to the next year.

Mr. ROGERS. Well, I hope you appreciate that your request does include an 11.7 percent increase as far as our monies are concerned, and that is a huge increase for anybody in our type of budget circumstances. So it will be difficult to do that kind of a number.

Mr. MECHAM. Mr. Chairman, may I raise a related point?

Mr. ROGERS. Yes.

Mr. MECHAM. This committee, in its wisdom, determined last year to raise bankruptcy fees in certain instances by about $25 million. You decided to split that roughly between the judiciary and the U.S. Trustees.

You may want to take a look at the Senate version of the bankruptcy bill, because they're going to take all that away from you and us, which will mean you will have less of this funding available than you had before and, not only that, the Senate bill may redistribute all the fees which we had before. You may want to have your staff talk with Mr. Hyde and other House conferees; otherwise, we may end up together losing a significant amount of some of these carryovers and other resources.

OPTIMAL USES OF JUDICIAL RESOURCES

Mr. ROGERS. Well, we have begun those discussions and we will be following through with that. Thanks for reminding us.

Now, in a report sent to our subcommittee in February, the judiciary outlined optimal uses of judicial resources—and I quote from that report. "The Federal Judiciary continues to embrace the challenge to improve services, enhance productivity, and reduce costs."

Could you provide us with some examples of your efforts to operate in a more cost-effective manner, and at the same time maintain superior service to the courts and to the American people?

Judge HEYBURN. As you point out, we have provided this report—we do every year—of the efforts that we've made to be more efficient. I suppose the one evidence of our increased efficiency is due to the budget crunch and due to the crisis, if you will, at the southwest border. We have had to reduce the funding levels to many of our courts, below what we may think is appropriate. And yet those courts, so far, are doing their job through a tremendous effort, in part due to the automation efficiencies that we have encouraged over the years. So, we think the fact that we're able to still do the job with lesser resources is a testament to the efficiencies that we've developed.

The judiciary has, on occasion, recommended that certain bankruptcy judgeships go unfilled, where we don't think the need is there for an additional judgeship. You know, everybody always wants to fill judgeships, but the judiciary has, on a number of occasions, recommended that bankruptcy judgeships—which we do have control over and don't require Senate confirmation—that those go unfilled, when we didn't think the workload was there.

We have moved judges around, sought out help from visiting judges, to go to those areas where the workload is increasing, so that we haven't had to ask for additional judgeships but put the resources where they're needed.

We have developed a national gateway to the Internet. A lot of our people do research on the Internet, and we have saved millions of dollars by having one national gateway, rather than individual gateways from separate courts. We have developed a hand-held drug testing system which is used by the probation officers and supervised releases, a tremendous savings there.

We have ongoing studies in the space and facilities area, in security and in our personnel area, to try to see how we can use those resources in a better and more efficient way. Those studies, at least two of them, ought to be completed within the next six months.

We continue with the bankruptcy noticing system that saves millions of dollars. The educational programs that the FJC has been involved in are continuing their use of alternative learning devices that don't require everybody to go to a hotel and travel long distances in order to have educational programs, for both judges and for staff. So that's another area where we've tried to become more efficient.

LONG DISTANCE COMMUNICATIONS

Judge Broomfield is on our economy subcommittee, and from a budget point of view, we are constantly stressing and addressing:

Is there a more efficient way of accomplishing the same objective; is there a different way of accomplishing the same objective. So it is something that we focus on. And your attention to that area obviously adds a little heft to our own efforts. So we appreciate that from you.

Mr. ROGERS. Have you an estimate of the amount of savings that have been accomplished?

Judge HEYBURN. It is millions of dollars. I would hesitate to guess, but I'm sure the number is in here. Just a couple of the items that I have mentioned could involve millions of dollars of savings. It is a substantial amount. It's a substantial amount.

Mr. ROGERS. We can perhaps address this question to the head of the Judicial Center, Judge Fern Smith, or anybody on the panel. In the field of medicine, telemedicine now is saving zillions of dollars. We're experimenting with using that, of course, in the prison system as well, to save needless trips from prison to the doctor's office a hundred miles away, saving all the expenses involved with that, and perhaps providing even better and more expert care for prisoners.

The Navy, of course, uses telemedicine elaborately. If you're on an aircraft carrier in the Indian Ocean, you're hooked up by teleconference with a doctor in Bethesda, MD to be diagnosed.

Can we not duplicate, to some extent more so, in the courts the use of these new techniques such as teleconferencing, to save time and money and expense in the court process?

Judge SMITH. I'll take a stab at that.

First, if I can, let me just say what a pleasure it is to be here and thank you for your welcome.

I think the courts are experimenting in that. I was reading recently about someone who conducted a court trial by video conferencing. He was a visiting judge, actually, and rather than go into the jurisdiction where the case was, he dealt with the attorneys by a video conference. That was very successful. I think other experiments are going on.

There are, of course, when it gets into the criminal area, some constitutional problems and challenges to right of confrontation that are going on. We, of course, at the Center are using video conferencing and trying to use web-based communication in a greater and greater degree. We have had noticeable results. I think it's only a matter of time before it does spread more and more to the courts.

But my guess is that, in the actual application of the courts, either Judge Heyburn or Judge Broomfield probably know more about what's going on in the Judicial Conference, if anything, on those programs.

Judge HEYBURN. I think Judge Broomfield may have a comment on that.

Judge BROOMFIELD. Mr. Chairman, the video is really catching on in the judiciary in a significant way, and in a variety of ways. We use it for our judges meetings, when we have judges a long distance away. Instead of having to get together and essentially losing an entire day, we do it over the noon hour. Nobody loses anything.

But that's just the tip of the iceberg. We can use it on the civil side, and do, in the courtroom. I have tried some cases myself,

where we've had inmates at the State prison testifying from the prison in a civil rights case. We've had psychologists testifying in a civil rights case. I just go over and sit in the jury box with the jurors and we all watch the television set. It was all pursuant to an agreement with the parties and they were very satisfied.

I have even discovered that many of the inmates in the prison system would prefer that because they don't upset others who may be forced to come to the court to testify when they don't want to. So it is very positive.

In addition, lawyers have tended not to want to use it, particularly on the defense side, to talk with their clients. This is on the criminal side. But we have encouraged them to try to use it, and they are starting to use it. Instead of driving an hour-and-a-half each way to the facility where they can interview their client, to go over a presentence report, a proposed plea agreement or something like that, they can do it by video conferencing. More and more of them are doing it because they see the advantage to them.

These is a whole host of ways that technology is being used. Probation officers are now doing a lot of their own presentence reports because of the technology we have given them. We have even converted some clerical positions into line probation officer positions, just to keep up with the workload. That's sort of the southwest border thing. So we are using technology in a major way, and video conferencing is very strong.

Now, someone mentioned other judges. We use visiting judges in our district to survive, mostly on the civil side, but not entirely, and we get them in a variety of ways. Sometimes they will come in for a week or two weeks and try whatever there is to try. Sometimes they will come in and try a long, three- or four-week trial. But for several years now we have used judges with block assignments. We will give them 20 or 30 cases from their own home district. They will deal with those cases from the district and will never travel to our district, unless there's a trial or a hearing, which doesn't happen very frequently.

The one I think they were referring to was a member of the Budget Committee, who is the Chief Judge in Massachusetts, and who has a block of 20 of our cases. He was the one who used this video conferencing to deal with a contested evidentiary hearing, with the agreement of the parties, to be sure. That saved a tremendous amount of resources, actual dollars, plus he didn't have to come and was able to spend more time in his own home district. They're using it in a big way.

Judge SMITH. Could I add to that, Mr. Chairman?

One of the projects the FJC Research Department has going on now is an update of our publication on how to effectively use visiting judges. It was something that we put out several years ago. But because of technology, and because of progress in that area, there are so many new, innovative ways to approach it, many mentioned by Judge Broomfield. And so we're updating that publication and we're going to make sure that all judges and all districts have it, so that these innovations can be more widely used and tested.

Mr. ROGERS. There have got to be more ways to bring this technology revolution that's occurring in business and everything else in the world, we have got to be sure that the courts are utilizing

that machinery, where appropriate, because it does multiply your efficiency and save money.

With the kind of growth in your caseload now, and expected in the future, unless we utilize these new methods, we're going to get swamped, it seems to me. I would even suggest, half-way tongue-in-cheek, that we hire a 21 year old to work with you in the Center, that understands the new machinery of this age better than any of us, to keep up-to-date with the Internet changes and all the benefits that need to be brought to the courts.

Judge HEYBURN. I might add that one very practical thing that we have done, from the Administrative Office point of view and the budget point of view, obviously, when you've got judges who span the age from 35 to 85, you've got sort of a cultural divide, it would be fair to say, in terms of their desire to use electronic means of research versus books.

You know, clearly, electronic research is the wave of the future, and yet we spend $40–50 million on books every year. This year, for the first time, the Budget Committee recommended—and it was approved—that the book budget be cut by 10 percent, to really enforce, to begin a forced transition to more use of cheaper electronic means of research.

Obviously, we have got to make available the kinds of research materials that judges and law clerks want, and many of them want the books. But we are also trying to look to the future and encourage, in hopefully a gentle way, a transition to what ultimately will be a cheaper and more accessible form of legal research.

Mr. ROGERS. I would like to challenge the Judicial Center, and the Conference, to focus, maybe in some sort of report, on what experimental things are going on in the electronic world, the information age, that could be applied to the procedures of the courts, that could result in significant savings or a multiplication of efficiencies of judges and personnel in the system. What do you think about that?

Judge SMITH. Well, we are actually working on that.

Let me go back to your "tongue in cheek" remark, of hiring a 21 year old. Our computer people aren't 21, but they're not far removed, I'll tell you, at least in my eyes. They seem remarkably young and remarkably gifted. You probably noticed that basically all of the requests we have asked for would go to eight new positions, four in our computer area and four in our video area, because we agree with you, that it is the wave of the future and we need to stay on top of it.

Sometimes I think, when you're not in the field, trying to understand it is like going up a down staircase. So we need these people. And it's a very competitive market. Trying to hire people in those areas and compete with private industry is very difficult. So we think this is critical.

Another thing we're doing along the lines you have suggested, Mr. Chairman, is we are speaking more and more to law schools, to private foundations, to the National Academy of Sciences, groups who are interested in this same area, trying to discuss with them whether there are things we can learn and projects that we might be able to do with them, using part of their resources and knowledge, rather than re-inventing the wheel. So I think your idea is

a good one, and we will continue to look into it and see what we can do about coming up with that kind of report.

Mr. MECHAM. I think you would be gratified, Mr. Chairman, to see how much has gone on. When I became Director in '85, there were practically no computers in the entire Federal Judiciary. Now we have a computer for everyone who knows how to use them and wants to use them.

We set up a data communication network nationwide. We are on the J-Net. We have Internet. We have now gone completely in our agency to sending communication out over e-mail instead of using postage and we're saving tens of thousands of dollars a year already. There are these things going on now.

We have set up systems of case management. We are now even looking at electronic case filing. That may be a bit far out. But there is a lot going on, including, by the way, in partnership with Judge Smith and the FJC and, in part, because of your prodding, we have the largest TV training network in the government, except for Social Security. The AO is broadcasting 80 hours a month on that. I know that Judge Smith and the Sentencing Commission are doing 50 hours a month combined saving an immense amount of money in travel. It's not going to replace face-to-face training across the board, but we are making savings. I give you a lot of credit for pushing us in that direction.

Mr. ROGERS. Thank you very much. The subcommittee, working with the Center and the Conference, I'm very proud of that. I'm proud of what the Center is now doing to save a lot of travel time, and other things.

I wonder if we could ask you to do a "term paper" for us. [Laughter.]

Judge SMITH. It's been a while, but I think I could manage that. What subject would you like?

Mr. ROGERS. Could we have you do a "term paper" for us, after you put some time in on thinking about it, on the question I asked you about what is going on in the system, in the courts, to electronically multiply your efficiencies; and two, what can we expect in the future? What do you see out there that possibly might be applied to the courts? I hope you will be futuristic and take off your judge's robe and put on your think tank cap and give us your thoughts.

Judge SMITH. I would be happy to do that, Mr. Chairman. It's an area that I care very deeply about, both as a judge and as the Director of the Federal Judicial Center. I think it is critical for us and it's an appropriate request. We will be happy to respond in a mutually agreed upon time.

Mr. ROGERS. I hope the audience has noticed the irony of the Congress trying to preach efficiency to anyone. [Laughter.]

Mr. Serrano.

Mr. SERRANO. First of all, Mr. Chairman, let me join our guests in congratulating you on having the vision to work not only with this particular group of folks but with a lot of other folks, in bringing about the changes that we need to have.

Any time we have the judicial branch, not being a lawyer, I'm always in awe. But I must tell you, I must remind you, that I, for

one moment in my life, did play a judge on "Law and Order". [Laughter.]

In fact, it was just replayed for the 30-something time this past week.

I will tell you a quick story, Mr. Chairman, which is very interesting. When I was in the judge's chambers, taking a break from filming, I started looking around and I noticed—I was playing Judge Luis Rodriguez, typecasting—[Laughter.]

I look on the wall and it says the Puerto Rican Bar Association honors Judge Luis Rodriguez, a plaque. I look over here and it says the American Federation of Teachers, whatever, honors Judge Luis Rodriguez. There's all these plaques. I asked the director, I said, "Why do you waste money on this? Who sees that?" He says, "No, there are people who watch our show. They tape it, enlarge the picture, and then they write to us and insult us, because what's on the wall doesn't match the . . ." [Laughter.]

So, you see, judges have more video problems than you think.

I just wanted to find out about this whole issue of using—You know, I use video conferencing. I have surfed the net and we use e-mail and the web extensively in my office. I'm not as good as my 11 year old son, who set up this whole web page last week. It was voting, a poll on your favorite basketball team. I'm worried about him. He threw away any votes for any team other than the Knicks. [Laughter.]

I hope that doesn't extend to his future.

But in dealing with this technology, in dealing with video conferencing and the possibility of conducting trials this way, what are the dangers, if any, in terms of dispensing proper justice, dispensing justice to everyone?

Judge HEYBURN. I think we all have our own comments, but I think the foremost thing that would be in everybody's mind is that, when you're dealing with the liberty of one of our citizens, efficiency is not necessarily the primary objective. That is, justice and fairness. So everything we do has to be filtered through that.

As a number of others have suggested, there are occasions where the technology can be used and it doesn't compromise one iota fairness and justice. On other occasions, you know, I suspect that when you've got a criminal trial going, it might be fairer that jurors be able to look directly in the eye and not through a screen at someone who is accusing one who has been indicted. So I think it is a challenge to us to figure out where the technology can be used and in what circumstances it's fair and in what circumstances we're better off sacrificing efficiency for a higher objective.

So that would be, to the extent I have something to say about, our general view. Judge Broomfield has really dealt with this in a much more direct way than I've had to, just because our criminal caseload is not such that we've had to deal with this, although we are using video conferencing on some civil hearings with inmates in our State prisons very effectively.

Judge BROOMFIELD. Mr. Serrano, maybe it's the color of my hair, but I hope we never have a virtual courtroom, where nobody is in a common place, and everybody is at home or someplace else participating—jurors, lawyers, litigants and the like. But that doesn't mean we can't or shouldn't use technology to our advantage.

I think, particularly on the criminal side, because of constitutional limitations, we have to be extremely careful in how we use that sort of technology. You notice I said what I did, and people disagree, but there's a potential benefit for them. I know that sometimes criminal defense lawyers will say this is the camel's nose and what you really want is virtual courtrooms. That isn't true. You can image that some defendant may have an expert witness who they simply can't afford to bring from Chicago or New York, or maybe a psychiatrist from Vienna. But you can by video, as if it's next door.

So the potential for equal and fair use across the spectrum is there, but let's not ever go to a virtual courtroom.

Mr. SERRANO. So what you're saying, which makes sense to me, is that, in cases where you have an expert witness, a person who has no reason to be lying or doing anybody in, that's okay. But, of course, if somebody is going to accuse me of stealing something, the jury should be able to see me in person, and see my body language and how I react.

Judge HEYBURN. That is certainly one line you can draw, and there may be some others. But one great thing about our court system is that we have a lot of very qualified judges and administrators out there who are testing out various and different things, much like our Federal system where the States are incubators for ideas. Although we exercise some control over what they can do and can't do, through the Constitution, the statutes, and our own Administrative Office, there are lots of different judges who are trying various and different things, gingerly, and we have reports of how they're doing. I think we see some advancements and possibilities there.

Judge SMITH. If I could just support what my colleagues have said, Mr. Serrano, I think a good analogy is what the FJC has done in the education field, with the prodding and guidance of Chairman Rogers and this committee. We have shifted the proportion of distance education to travel-based education, so that a vast majority now of our educational programs are done by distance learning. But it will never completely, and shouldn't completely, displace face-to-face learning. There are critical programs that need to be done that way.

I think the same is true in a court, as Judge Broomfield said. You wouldn't want a virtual courtroom. But there are certainly times when it's in everybody's best interest. I know that I've had even prisoners say they really don't want to travel three hours on a van, through heavy traffic, to simply come to court for a routine hearing. They would much rather do it from the prison and do it on television. So I think careful lines have to be dawn. I think we will be able to do that fairly.

Mr. SERRANO. So you don't envision, for instance, people going before a parole board via video, or do you?

Judge HEYBURN. Of course, in the Federal system, we essentially do not have parole any more. But, no, even our equivalent might be a revocation of supervised release, and there the jeopardy of the individual is in place. So I think most people would want to appear in person, unless everyone agreed in advance what was going to happen. And often that occurs. So it might be possible.

Mr. SERRANO. Thank you, Mr. Chairman.

COURTHOUSES

Mr. ROGERS. Ms. Roybal-Allard.

Ms. ROYBAL-ALLARD. Thank you, Mr. Chairman.

The administration has asked for $488 million for courthouse projects, which is considerably less than what the Judicial Conference requested, which was $750 million, for 18 courthouses. That is going to have a tremendous impact on a lot of judicial districts, such as Los Angeles.

Could you please tell me if OMB consulted with the AO's office and what the basis of this plan was?

Judge HEYBURN. I'll make a brief comment and I think the Director might want to say something, also.

First of all, as you are well aware, this is not just the judiciary's request. This is the request that GSA forwarded to OMB, to its own administration, and their request was $780 million or so and was cut to $480 million. Obviously, people can differ on what courthouses are needed, and we went through a whole process with GSA, according to established regulations, and came up with a number we felt was the right number of courthouses.

But what we believe they have done is totally distorted this process, in a very unfortunate and very unfair way for everybody, by not just cutting courthouses but by lopping essentially the top off of courthouses, without consulting us, and very arbitrarily deciding the numbers of courtrooms needed. For instance, the courthouse at LA, which is much needed, a growing area of the country, they decided that rather than having 33 courtrooms, it should have only 24. That's like saying that, before that courthouse is even finished, it will already be outmoded and outdated. It's a very short-sighted approach to justice and the construction of courthouses, and I might say that it was done without any study, very arbitrarily, and certainly without any consultation with the judiciary, other than notifying us at the time the budget was submitted that it was going to be happening.

Mr. MECHAM. We appreciate your leadership on this, by the way. What happened was that OMB, on its own, without the benefit of either statutory authority or constitutional underpinning, undertook to come up with a formula of its own on how much space judges needed and how many courtrooms there should be. They did not consult us. GSA joined with us in the request that was made, and OMB acted unilaterally.

In the case of Los Angeles, OMB cut from 33 courtrooms down to 24. In fact, they are forcing the judges to say you cannot have a single building for the court, that they're going to have to have two. OMB can't justify the process legally, economically, or in any other way. We would appreciate your help in trying to get this reversed—OMB won't reverse it. We need the Congress to do something.

Ms. ROYBAL-ALLARD. Can you elaborate a little bit on what you think the impact is going to be if the OMB plan goes through?

Mr. MECHAM. Well, you're going to have an inadequate number of courtrooms for judges, and without sufficient courtrooms, then you're probably going to end up with an increased backlog in cases.

Ms. ROYBAL-ALLARD. More than we have now?

Mr. MECHAM. More than you have now. You have a good many already.

This process is one that required years of work. We not only set up design guidelines, working with GSA and engineers and architects, we set up a prioritization system, being prodded by Congress, by the way, to do so. It was very painful for us to prioritize these buildings. We would rather have Congress do it and take the pain away. But it was done. OMB has basically thrown all of this out and said this is the way you're going to do it.

I will give them credit since, with one exception, they did follow our priority list. It's just that, with respect to the priority list, they knocked Miami down, from 16 courtrooms to eight; they took D.C. from nine to five; they knocked out one in Richmond, and a number of others across the country, with no basis, no study, no nothing. No one in OMB knows anything about courtrooms, about the judiciary, or about buildings. But they undertook to do this anyway.

Ms. ROYBAL-ALLARD. You've made my point.

Judge HEYBURN. The point is, of course, that it's not a simple. These are buildings that have already been designed and, in some cases, perhaps even had been put out for bid. Of course, there's going to be a substantial delay. It's not an easy thing to turn a building such as in LA, from 33 down to 24 courtrooms. This is going to require substantial redesign, which is going to be costly.

You know, I think you're going to end up with a product that really, in some cases, is probably not worth the effort. Then the problem will just be worse.

Ms. ROYBAL-ALLARD. I think the judges in Los Angeles are very, very concerned about this, and the impact it's going to have.

Mr. ROGERS. Will the gentlelady yield?

Ms. ROYBAL-ALLARD. Yes.

Mr. ROGERS. On a much, much smaller scale, I have witnessed the same problem, the desire for a new building in London, KY, in the Eastern District. It's been an absolute fiasco. What the judges have needed and wanted, and what GSA has come in and stripped away, with no knowledge at all about the needs of the courts, as Mr. Mecham has mentioned, it's an absolute abomination. I wish I had the answer, but it is a problem.

I thank the gentlelady.

SOUTHWEST BORDER

Ms. ROYBAL-ALLARD. In response to one of the questions—I believe it was the Chair's—you mentioned that, as a result of the Southwest Border Initiative, you have had to make certain concessions and changes. You said one of them was that you had to shift money from other courts.

Could you tell me what impact that has had on these other courts?

Judge HEYBURN. Generally, the impact is that the resources they thought they were going to be receiving, based on the funding levels, they are not receiving currently this year. After we have received our appropriation, we realized it was going to be a very tight situation for all the courts, and then recognized that the caseloads were increasing in certain specific areas. We, in essence, cut our al-

location to all court units, set aside a pot of resources that we could then devote to those courts that are most in need, and now we've done that. So the other courts, all of which are experiencing some increases, are simply getting less resources. They're having to make do. They're having to make very tough choices.

Ms. ROYBAL-ALLARD. To help me understand, what kinds of choices are they having to make? What isn't getting done?

Judge HEYBURN. Well, people that may have retired in a number of cases, where courts had people retire in the middle of the summer, the Administrative Office had to go in and say essentially we're freezing the level of your employees. So sometimes a key employee left and they were not able to refill that position, or planned computer purchases to upgrade equipment that they couldn't follow through on, or couldn't follow through to the extent that they would like to. So it's all these things.

We have a system of budgeting within the courts so that each individual district receives an allocation from the Administrative Office, and then has to decide for itself what portion the funds will be spent on—personnel, computers, travel, sometimes new equipment, sometimes refurbishing space. So we leave those decisions on what's necessary in an individual court to the individual court. We believe they have the best knowledge of what's needed in their particular district. They're just having to make some very, very tough decisions.

We are fortunate that we have good managers, but it doesn't make it any easier. Again, we would like to have the resources so that all the courts can do what they think is necessary, and that's essentially what we're asking for this year. It's going to be tough on them this year because of the increased need and the challenge we face along the southwest border.

Do you have further comments on that?

Judge BROOMFIELD. I have a direct comment on what's happening. We have had to rob Peter to pay Paul with probation officers and pretrial services officers. We don't have enough of them to do all the presentence reports and supervise the people as we should. We have had to take probation officers from supervision into writing presentence reports. The people they are supposed to be supervising are not being supervised the way you and I and the rest of society would like. That's a consequence of what has happened.

If I could add something on your prior question; the presence of courtrooms resolves cases, whether by trial or settlement. Most of them settle. If you have the courtrooms, they'll resolve them. If you don't have the courtrooms, they won't resolve them. It's as simple as that. Each judge has to have a courtroom in order to do it.

Ms. ROYBAL-ALLARD. That's the issue in LA, exactly.

You recently submitted a report to our subcommittee regarding the habeas corpus costs of the Ninth Circuit and compared it to the rest of the United States. Could you elaborate a little bit on those findings?

HABEAS CORPUS

Judge HEYBURN. As you know, for the last couple of years we have had a discussion with the Chair and others about the habeas

costs around the country, and particularly the Ninth Circuit. We have taken his challenge to heart—I call it a challenge. I dare say that some members of the judiciary in the Ninth Circuit have had occasion to view the videotape from last year's hearing and were either impressed or had the fear of God placed in them by the chairman's words.

But in all seriousness, his challenge we have undertaken. The costs over the last three years of capital habeas cases in the Ninth Circuit has decreased about 30 percent.

Now, our efforts in this area are nationwide, so the habeas costs nationwide are also decreasing, not as much as in California. Of course, they didn't have as far to go as California. We have submitted a report to the Chair, which you may have a copy of, which is a cover letter from Mr. Mecham and a letter from Proctor Hug, who is the Chief Judge in the Ninth Circuit, detailing all the efforts they have made over the past few years, and are continuing to make, to get a hold of this problem.

Primarily, the FJC is involved in better training for judges and clerical personnel. We have developed a case management requirement for these cases, and they have put a cap on the rates that attorneys charge.

Those are the three main things that have resulted in this 30 percent decline in the costs of habeas. We hope that that's going to continue. But mostly we're going to continue our efforts. We think we're on the right track, and, of course, thanks to the members of this committee for their concern in the area. We hope that we have responded in an aggressive and appropriate way.

Does that answer your question?

Ms. ROYBAL-ALLARD. Yes. It really was under the leadership of our Chair that this has taken place.

Mr. MECHAM. Let me give a lot of credit——

Judge HEYBURN. This trend line that we have, it shows the decline in California from close to $100,000 per case, the average cost per case, down to $59,000 this past year. Maybe $59,000 is still too high, but it's a lot less than $100,000. So we're glad for the direction it's going.

Sorry to interrupt.

Mr. MECHAM. I just wanted to say that Chief Judge Proctor Hug of the Ninth Circuit has really taken this on as a personal crusade. His leadership has played an important role in this, along with a lot of other judges, too.

Mr. ROGERS. Thank you, Ms. Roybal-Allard.

Continuing on that topic for a moment, I do want to compliment you. The costs nationwide for habeas corpus representation is decreasing, as it is in the Ninth Circuit. But, a pat on the back is only six inches from kicking the rump. [Laughter.]

The average annual cost per petitioner in California is still double the national average. How can we explain that?

Judge HEYBURN. I think there are a couple of actually straightforward explanations.

I mentioned the three things that I think we have done to improve the situation. Unfortunately, two of them can't really affect the ongoing cases. That is the institution of a case management program at the beginning of the case. So that doesn't really affect

a case that's already in progress. It's very difficult to sort of change the rules in the middle of a case.

Also, the capping of the rates. If that didn't occur at the beginning, it is sometimes difficult to impose that once the case has already begun.

Those would be the two primary things that I would cite as to the reason why you can't have an immediate change. But I think we're heading in the right direction, and hopefully the trend will continue.

Mr. ROGERS. Well, I like the trend lines, and you're right. The average cost per petitioner in California in 1996 was roughly $100,000, and you've got it down to about $60,000 now. But I would point out that the national average, not including the Ninth Circuit, is about $23–24,000, which is less than half, quite a bit less than half the California average. You have to understand that we can't tolerate that.

Judge HEYBURN. Well, every State is different. Judge Broomfield may be able to comment on this, but I have talked with Chief Judge Hug out there. One of the real difficulties they have in California is simply the way the State of California deals with capital prosecutions. Some of the judges, many of the judges who review these cases in a Federal habeas situation, believe—and there is strong evidence to support this—that the resources that the State of California is devoting to the defense side in capital cases is woefully insufficient and, therefore, it is left to the Federal side to test the conviction, if you will. That's exactly what the attorneys are doing. If there were greater resources devoted by the State to the defense of these cases, then we would have a fuller record. We would have a more complete record come before the Federal court.

Many of these cases that are appealed in the California State courts, the appeal is rejected, it's called a "postcard affirmance". We don't get an opinion like you do in a Federal court, detailing all the issues and addressing all the points of law. You get a postcard that says "Appeal Denied." That's very difficult for a Federal judge to deal with sometimes.

Mr. ROGERS. Let's switch from California to the Ninth Circuit as a whole. The Ninth Circuit costs are double what the national average is.

Judge HEYBURN. They are, and they're coming down.

Mr. ROGERS. I'm sure California is a little bit different in some of these things——

Ms. ROYBAL-ALLARD. Careful, Mr. Chairman. [Laughter.]

Mr. ROGERS. What about the balance of the circuit? I mean, why are their costs double the national average, in the Ninth Circuit?

Judge HEYBURN. I don't know that we have an answer on particularly why the Ninth Circuit on the whole is above the national average, except that it is coming down substantially.

Judge BROOMFIELD. There's a variety of answers. The Ninth Circuit, without California numbers, would be significantly different. But——

Mr. ROGERS. Not that much different, if you'll forgive me for a moment. According to your own data, the California cost is about $60,000 per case, and the Ninth Circuit is about $48,000, while the national average is $23-24,000.

Judge BROOMFIELD. My understanding is the $48,000 does include California.

But in more direct response to your question, many of the cases that were in a lot of the courts in the Ninth Circuit were there for a long time, because their death penalty statutes were being contested in the Supreme Court. A lot of cases were stayed. When that happens, and there is no movement, costs simply go up.

The term "case management" has been used here before, and that's really a critical term that the judges are using. I want to echo what the others have said about Chief Judge Hug. He has really taken on this problem, as has the Ninth Circuit Judicial Council.

The case management, in effect, has the effect of reducing costs, but not reducing the quality of the work that's done. It simply means that people have deadlines set from the very beginning. With the older cases—and we're seeing some of that still in these numbers—they've been around for many years. Even in the habeas process, under the new AEDPA, it is much less, and because of case management, I believe those numbers will continue to go down, not just in California, in the Ninth Circuit, but nationally, as the end result of the passage of that act.

Mr. ROGERS. Time will tell, and we're going to keep an eye on these numbers. This is still way out of line. I congratulate you on making some good progress, but we're still way out of line. The balance of the country will not tolerate us letting California taking half the money.

Judge HEYBURN. Mr. Chairman, we will provide you with the information on the average cost of these cases in the Ninth Circuit absent California. I think you will see that it's probably a lot more in line with the Nation, although maybe not quite down to that level.

Mr. ROGERS. So you're saying California is the problem. [Laughter.]

Judge HEYBURN. California is a wonderful State. [Laughter.]

I was just out there. It's a great place to live and visit.

Judge BROOMFIELD. In defense of them, they are trying. Believe me, Mr. Chairman. We heard the Chairman's words two years in a row. I think the whole Ninth Circuit, including the California districts, are trying. The trend is going the right way. It can go further down, to be sure, but the trend is correct.

Mr. ROGERS. The trend is good. But finally, let me just say that the lawyers in California are great lawyers, no doubt about that. There are also great lawyers in all the other 49 States, and the California lawyers are being paid at twice the rate of the other lawyers.

Now, all of you are lawyers. In your private practice, would you tolerate such a scheme, where the lawyers of one State got twice the rate that you did? No. It's not fair and it will not be tolerated with tax dollars. Now, if California wants to do it with their tax dollars, that's their business. If some private foundation wants to help out, so be it. But for Federal tax dollars that run through this body, we're going to insist that there be some fairness and equality. I don't know how much stronger to put that.

But this is not the only problem in the Ninth Circuit. You've heard me say that before, and I'll say it again. I hope the Ninth Circuit shapes up, because there may not be a Ninth Circuit if they don't shape up.

Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman.

Just for clarification, there are good lawyers in all 50 States and the territories. [Laughter.]

The increase in the work at the southwest border, that is mostly all related to immigration issues, right, or issues of crossing the border, if you will?

Judge HEYBURN. It's related to that, but there are issues of crime that are related to the influx, issues related to drug trafficking and other things that affect both the State and Federal courts all along that area. So, yes, broadly stated, I believe it is related to the influx of people across the border.

Mr. SERRANO. Are some of these related to crossing of the border without proper documentation?

Judge HEYBURN. Oh, absolutely.

Mr. SERRANO. How does that then compare to the workload of people crossing the Canadian border?

Judge HEYBURN. I don't know the answer to that question.

Mr. SERRANO. Or people coming into New York on airplanes, with no documentation?

Judge HEYBURN. I don't know the answer to that. I'm sure we can get that information because we have the information on specific kinds of cases in every district.

Mr. SERRANO. The reason I would like to know is because there's always been a dual feeling about our immigration service and immigration policy by many people, like myself. On the one hand, we need to enforce the law, and, on the other hand, we need to make sure the law is not being applied selectively on one border or another.

As I said, we have more than borders. We have people that can arrive by airplane, also, in New York. The border there, technically, is at the airport. You can board in Puerto Rico, for instance, or somewhere else, and there is very little way of finding out if you're an American citizen getting on that plane going to New York or Miami, or not.

I would like to alleviate my concerns and my fears, that this is not selective prosecution, which makes that workload so much higher, so much bigger.

Judge HEYBURN. We can certainly give you the statistics that we have. Of course, this area—and it's interesting that you brought it up—this area is like many other areas of our work, where we don't create the work. We're simply responding to someone else's statute or a policy judgment, that this is where resources ought to be devoted in a law enforcement area. We simply salute and do our job.

If the administration decided that it was going to have a stricter enforcement of environmental laws someplace, then we would see a lot more environmental cases. In this case, a combination of the Congress and the administration has, for one reason or other, decided to devote a tremendous amount of new resources in this particular area, and our caseload is affected accordingly.

Mr. MECHAM. Mr. Serrano, much of the data we would need to answer your question we would have to get from INS, and I believe they're appearing before you this afternoon. You may want to pose the same question to them.

Mr. SERRANO. Yes. Unfortunately, I want to use most of my time to beat them up on the Elian Gonzalez issue. [Laughter.]

Mr. MECHAM. I saw you on "Rivera Live" last night. You did very well.

DEFENDER SERVICES

Mr. SERRANO. So it is fair to say that most of these issues are immigration-related, but that also speaks to any other crime that's committed there.

Now, on another issue, last year we increased the fee—forgive me. I'm not a lawyer—but the hourly fee, I think by five dollars?

Judge HEYBURN. Yes. It is now $70 for in court and $50 out of court.

Mr. SERRANO. And you want to bring it to $75 for both.

Judge HEYBURN. Yes.

Mr. SERRANO. I'm supportive of that, and I've been supportive of it in the past. But for the record, tell us why that's important.

Judge HEYBURN. It is important because we see, more and more, a problem in getting high-quality lawyers to represent indigent defendants. The Chief Justice has mentioned this now two years in a row in his annual report, and he doesn't weigh in on these issues unless he really believes they're important.

The panel attorney rate has only been raised—and we appreciate what was done last year, we really do. It meant a lot to people. But it was only the second year in 15 that it's been raised. The rates, at the levels they are now, obviously don't cover the overhead of lawyers who are providing the service. They're essentially providing it as a public service, and free.

But we need to encourage better quality lawyers. You might say, well, what's happening? Is bad lawyering causing innocent people to be convicted? I certainly can't say that. But I do know that the quality of justice suffers overall. Cases may be going to trial that shouldn't go to trial. A good lawyer would see the strength of a case against the defendant and get an appropriate plea and dispose of the case.

The administration of justice just works so much better when you have equal quality, good quality lawyers going against each other. Unfortunately, the reports we're getting back is that, because of the low panel rate, we're not able to get the quality and number of panel attorneys that we have in the past. Of course, we do have Federal defenders who represent about half the indigent defendants. But we think that should be a mix of Federal defenders and panel attorneys. You will always need panel attorneys in multiple defendant cases, and in other cases where the Federal defender has conflicts.

It's really important to have both. It keeps both on their toes. We're able to be more efficient. We're seeing the cost of these cases go down, both with panel attorneys and with Federal defenders. So the cost of this $75 rate is not great. It's only, on a total year basis, about $15 million, I think.

We think that, over time, it would really have a substantial and a beneficial impact on the administration of criminal justice. Our people out there on the committee, the people who provide this service to districts all over the country, really believe this to be true. They're not really in it for gain. Most of them take a couple of cases a year. So this is not a big revenue source for any of these people.

But, you know, we need to have some way of encouraging them to continue to participate. It's really important for the system.

Mr. SERRANO. Do we have any studies that indicate what the average rate is, if you will, for private individuals, when they hire attorneys?

Judge HEYBURN. Sure. It would be $150, $200, even higher, for a first-class criminal defense attorney. Many of these people that we're paying $50 an hour could charge $200 or $300 an hour in major cities. Even in the State of Kentucky, where the legal rates and salaries are not exorbitant compared to around the country, these kinds of lawyers would be getting twice as much easily, I would say. In New York, who knows what the discrepancy would be. I imagine the difficulty is even worse in a city like New York or Los Angeles, the bigger cities.

Mr. SERRANO. Let me move on briefly to another subject. There's a lot of talk here about going into two-year budgeting. How would that affect you?

Judge HEYBURN. Well, it would affect us. Of course, we're not sure how. I can just tell you, number one, whatever you decide to do, then we'll do the best to address it. As a person who's interested in government, I can certainly see some advantages to it.

On the other hand, it poses some particular challenges to the judiciary. As you are well aware, a lot of our budget is based upon projections of what's going to happen during a coming fiscal year. You have seen, in your experience on this committee, how I think most of the time we're pretty much on target. But a lot of times we're off, just because of circumstances completely beyond our control. We have to project the number of new judges that will come on line, new space that will come on line, the number of defendants that will be indicted. In a given year we can miss our projection, and if the projections have to be made two years in advance, this presents very difficult problems for us.

Now, the positive is we have such a good working relationship with the committee that I think we could probably overcome these difficulties. But I think we each have to be sensitive to our own needs. So we're probably in a better position than most other agencies to deal with the difficulties. But it would certainly present some challenges, I believe, and the ones I have mentioned would just be a few of them.

Mr. SERRANO. I have no further questions.

Mr. ROGERS. Back to the panel attorney compensation, in capital cases, can you tell me the current rate of pay for capital case attorneys?

Judge HEYBURN. $125. That's the maximum.

Mr. ROGERS. Are costs associated with capital cases increasing as rapidly as they have been in recent history?

Judge HEYBURN. They're actually going down. The cost per case is going down, and the total cost is going down.

Now, admittedly, when you talk about total cost, you know, we've had some very high profile cases that were in full array in FY '98 and '99 that are no longer going on now. But generally, the costs are going down, and the increase in the number of cases has leveled off. So, as you remember, we had a number of years—I think there was one four-year period where we went from 25 Federal capital cases in existence to 150. That has now leveled off.

One problem we had is that simply most Federal judges who got a capital case, unless they were a State judge, it was the first capital case they ever had. They really were not prepared to deal with all the issues. So FJC has developed an educational program, and now, by and large, judges who get these capital cases I think are better prepared to deal with them, with case management at the outset. So generally the costs are more under control than they were before.

Judge SMITH. If I could echo that—and thank you for that acknowledgement, Judge Heyburn—we have developed, first of all, a whole set of materials for Federal capital cases that are available on our website, and that will also send a hard copy to judges who get those kinds of cases.

We are also preparing a two-volume manual for judges, one on habeas cases and one on Federal death penalty cases, to bring judges up-to-date with current law, which we think will help considerably.

They are very challenging cases to judges who have never had them before. They're challenging to judges, period. They're serious, but for new judges especially. So we are trying to develop distance materials that will make their ability to handle these cases more easily, while still maintaining fairness.

Mr. MECHAM. Apropos of an earlier question, Mr. Chairman, Mr. Serrano, my staff advises me that the private attorney billing rate, the national average, for partners, is $206 an hour, and an associate, $145 an hour. That's the national average.

Judge HEYBURN. Of course, with the explosion in legal salaries, we're also waiting with baited breath to see what impact that's going to have on the judiciary. Now, when we hire law clerks, for instance, we're essentially asking—you know, we would love to give you a job, you're at the top of your law school class, and we would like you to give up $100,000 a year for the great opportunity of working with me for a year. We hope we can keep on convincing young law students to take up that opportunity, because it is a unique one. But the economics are bound to have some effect.

Mr. ROGERS. On the compensation of panel attorneys, we're all a product of our environment, our history and upbringing. When I first started practicing law in 1964, there was no compensation for representing indigent defendants. You were summoned by the judge and you were ordered to defend this man, for free. You quit everything else you were doing and went to work for nothing. But it was considered a civic duty; it was considered an obligation of lawyers to give back to the community what they had been given. None of us really thought about being paid. Once you were sum-

moned by the court to defend a person, all of your ethical obligations poured out in defense of that person. I did a lot of that.

But, a side benefit of doing that was that I built up my reputation. It got around that, "Hey, this guy can do pretty good in the courtroom. I think I ought to hire him." So I got some business because I sacrificed some time for indigent defense.

I hope there is still some of that left in the profession. Do you think there is?

Judge HEYBURN. I think there is. And you ask a very, very good question. You know, although you started out a little bit before I started practicing, I think that ethic still exists. It still exists among many lawyers. It is a problem we all deal with and ask ourselves about.

One thing I can say about Federal criminal work now—and times do change. We all say the law has gotten more complicated, this and that. I suppose that's true. But the Federal sentencing guidelines, which I happen to be a general proponent of—I mean, I might disagree with certain aspects of them—they have, to a significant degree, complicated the defense of Federal criminal cases. So if you're going to represent a person charged with the Federal offense, you can't walk into Federal court without a pretty thorough knowledge of the sentencing guidelines. If you do, you are doing a great disservice to your client.

It is no longer the situation when you and I might have done an occasional criminal case, where you walk in and the judge has this huge discretion, and you argue your client's a good guy and he'll never do this again, and you maybe know the judge and do the best you can.

It's not really that way any more. The rules are very technical, particularly when you're up against United States Attorneys, who know this stuff inside and out. If you're not an expert, then you shouldn't be there. It's sad to say that, and we do have probation officers who try and do give an even-handed approach to the issue.

That's not a reason to say we ought to pay them $150 an hour. It's just that we need to encourage quality people, and people who have some experience to do it.

What we do in our district, we will pair—We have a system where we pay the lead attorney whatever the law allows, but then we get a young attorney, who has never had a case. We don't pay them. We pair that person with the lead attorney, so he gets a little bit of experience, and then he can have a case later that he or she gets paid for, after they've gained a little bit of experience.

We have seminars that the Federal Defender puts on to educate our panel attorneys about the Federal sentencing guidelines. It's just a little bit of a different situation than when you and I grew up, starting out, I'm sorry to say. But I don't think the ethics have changed. It's just the situation has changed a little bit. That's all I can say about it.

Mr. ROGERS. Any other questions?

Mr. SERRANO. No.

Mr. ROGERS. Well, thank you very much for your testimony today. Judge Broomfield, we appreciate your coming from afar to share your knowledge with us. All of you, we appreciate your testimony and your dedication to your job and to justice in this country.

As I said at the outset, we still have budgetary problems up here, even in spite of the fact that the press reports there's a huge surplus of funds. We are still bound, as you know, by the 1997 Balanced Budget Act. So even if those monies are there, we can't spend them. It's as if we were wearing a chastity belt. So we'll do the best we know how to deal with your legitimate needs and our real restrictions.

It's good to see you. Thank you. The hearing is adjourned.

THURSDAY, FEBRUARY 17, 2000.

LEGAL SERVICES CORPORATION

WITNESSES

JOHN N. ERLENBORN, VICE-CHAIRMAN
JOHN McKAY, PRESIDENT

OPENING STATEMENT

Mr. ROGERS. This morning the committee will begin our hearings for the fiscal year 2001 appropriations cycle and would like to welcome the vice-chairman of the board and former colleague of ours in this body, John Erlenborn. Good to see you John, and the president of the corporation, John McKay. We are pleased to have you with us today. We will be discussing your request for the Legal Services Corporation, which is requesting a budget of $340 million for fiscal year 2001. That is a 12 percent increase over the amount provided in the current year.

This committee will face the difficult task of doing its part to keep spending at a reasonable level while at the same time finding a way to fund a number of competing and deeply important priorities. It will be another tough year of tough choices for us, and we will be looking for ways to maximize our scarce resources.

In addition to reviewing the corporation's budget requests, there are numerous policy issues of concern to this committee. These issues include serious concerns about the accuracy of case statistical reports which provide Congress with important information of the corporations grantees caseload and continued monitoring of grantee compliance with the reforms adopted by the Congress. We continue to be interested in closely monitoring these and other issues.

At this point, we will insert into the record your written statements.

[The information follows:]

Statement of the
LEGAL SERVICES CORPORATION
John N. Erlenborn, Vice-Chairman
John McKay, President

Before the
Subcommittee on Commerce, Justice, State, and the Judiciary
Committee on Appropriations
U.S. House of Representatives

February 17, 2000

Mr. Chairman and Members of the Subcommittee, thank you very much for the opportunity to testify. The Legal Services Corporation ("LSC" or "the Corporation") welcomes this opportunity to present our Budget Request for Fiscal Year 2001 and to report on our activities over the past year.

Although we live in a time of great economic prosperity, there are still an estimated 34.5 million Americans living below the poverty level.[1] Some 10 million additional individuals with incomes up to 125 percent of the poverty level are also potentially eligible for federally funded legal services. America's children are particularly affected by poverty; even though the poverty rate has slightly declined, 18.9 percent of children are still poor.[2] To continue to ensure these Americans are not left out of the justice system, a strong federal role in supporting legal services is vital.

To fulfill LSC's mandate successfully, the Board of Directors recently approved a new set of "Strategic Directions" for 2000-2005. Over the next five years, LSC will develop and implement initiatives to ensure that a dramatically increased number of persons have access to the American civil justice system and that they receive quality services. LSC will also use its national leadership position to engage in a multi-year effort to address issues of access, availability, and quality of

[1] U.S. Census Bureau, *Poverty in the United States: 1998*, http://www.census.gov/prod/99pubs/p60-207.pdf
[2] Center for Budget and Policy Priorities, *Analysis of 1998 Poverty and Income Data*, (September 1999).

relevant, responsive, client-centered legal assistance and representation throughout the United States.[3] Although the Corporation is not obligated under the Government Performance and Results Act (GPRA), LSC is endeavoring to use GRPA as a guide for performance improvement, and as a critical tool in implementing its multi-year strategic plan.

For FY 2001, LSC seeks an appropriation of $340,000,000. Most ($24,000,000) of the increase above the FY 2000 level will go to local programs that provide legal services to the poor in every state and county in the United States.[4] We are also requesting $10,000,000 to complete the funding of a technology initiative designed to significantly increase access to legal information and assistance for low-income Americans. Five million dollars ($5,000,000) was provided for this project in FY 2000. Additionally, LSC is requesting $2.1 million for legal needs research to provide LSC, Congress, and the Administration with a national, up-to-date, credible and comprehensive legal needs study.

LSC's FY 2001 budget request has been structured to allow the Corporation to focus on (1) dramatically increasing the availability of legal services to eligible persons; (2) ensuring legal services clients receive appropriate and high quality legal assistance; and (3) ensuring legal services programs fully comply with all legal requirements.

[3] Legal Services Corporation, *Strategic Directions 2000-2005*, (January 29, 2000).

[4] With its FY 2000 budget of $303,841,000, LSC funds 237 local legal services programs, providing service to low-income residents in every county in the nation. Federal funds received by grantees are leveraged to raise nearly $260 million annually in other funding to help support their activities. Many state and local governments appropriate funds for legal services to the poor, and programs are also eligible to compete for other types of federal and private grant money.

Program Services to Clients: $313,000,000

The foundation of our Budget Request is funding to preserve and maintain the services provided by local programs that provide civil legal assistance to low-income persons throughout the United States.

In FY 2001, we seek to increase grants to local legal services programs by $24,000,000, or approximately 8 percent above the FY 2000 level of $289,000,000. This increase will enable local programs to increase their levels of service and provide legal assistance to a greater number of eligible low-income persons.

In FY 1995, the Congress appropriated $402,500,000 for field programs. Assuming inflation stays steady at current rates through 2001, almost $450,000,000 would be required in FY 2001 to maintain the purchasing power of the FY 1995 level. Since all studies show there are low-income individuals with critical legal problems that do not have access to the justice system, this increase will begin to allow LSC to address these unmet needs.

Technology Initiative: $10,000,000

In FY 2001, LSC will allocate $10,000,000 for a technology initiative designed to significantly increase access to legal information and assistance for low-income Americans. A total of nearly $15,000,000 is required for the project; $5,000,000 was appropriated in FY 2000.

Recent surveys have found that many local legal services programs lack the technological capacity to make full use of new technology-based methods of improving efficiency and expanding services to clients. LSC has directed programs to enhance and expand technology based community legal education and support for client self-help.

LSC's Office of Inspector General, in an August 1996 report, *Increasing Legal Services Delivery Capacity through Information Technology*, concluded that delivery capacity could be significantly increased through enhanced use of available technology. The recommendations in the report include greater use of centralized telephone and computer-based intake systems, public-access kiosks providing legal information and forms, and the provision of legal information through the Internet.

The grants will be provided to fund projects that:

- Provide direct legal information – for example, through statewide websites accessible through public facilities such as libraries and other organizations;
- Increase services through advice and brief service by developing centralized telephone intake systems and exploring web-based and e-mail approaches;
- Create and improve self-representation materials and guidance through expanded use of technology in *pro se* clinics and through *pro se* projects, websites and stand-alone kiosks, now available in some courthouses around the country;
- Increase private attorney involvement through websites that facilitate *pro bono* services by providing easier methods to connect lawyers and clients needing assistance; and
- Create a "model" legal services technology office that combines several of these approaches in one office to encourage replication and allow for extensive evaluation and study.

Legal Needs Research: $2,100,000

The Corporation is requesting $1.6 million for FY 2001 to conduct a comprehensive national legal needs assessment and $500,000 to conduct additional research through pilot projects. One of

the challenges in meeting the legal needs of indigent people has been the difficulty in assessing and understanding the nature and scope of those needs. Although a comprehensive assessment has not been performed since the early 1990's, there is much anecdotal evidence from all LSC funded programs to show that the need for legal services far outstrips the resources available, and every program has to turn away hundreds or thousands of eligible applicants each year. A new study will provide LSC and the Congress with an accurate picture of the extent and nature of unmet legal needs among low-income Americans.

The additional $500,000 will fund pilot projects to collect data on (1) legal problems addressed through non-traditional means such as legal education, (2) the number of qualified applicants turned away due to lack of resources, and (3) outcomes for clients resulting from the delivery of free legal services. This information is necessary for LSC to provide a complete and accurate assessment of the impact of federal funding on the legal problems of the poor.

LSC Management and Administration: $12,500,000

The Corporation requests $12,500,000 for Management and Administration for FY 2001, or just over 3 percent of the total amount. The funds will be used to support the functions of the Corporation's central administration. The increase will allow for inflationary adjustments and includes $1.54 million to strengthen LSC's compliance and enforcement activities by increasing the number of on-site visits to grantees.

With a small, efficient staff, LSC management ensures accountability to Congress and the taxpayers through aggressive oversight and enforcement of federal laws and other requirements. The Corporation uses its system of competition for grants to promote the efficient and effective delivery of legal services. LSC encourages competition for grants through broad circulation of information

about availability of grant funds, outreach, and provision of technical support to applicants. In the competition process, LSC evaluates applications according to established quality standards and awards grants to the applicants best able to provide high-quality legal services in accordance with applicable legal requirements. LSC also uses the competition process to promote increased volunteer private attorney involvement and expansion of public-private partnerships through which other resources can be secured to build upon federal funding. During the grant period, LSC follows up with individual local programs on areas identified in the competition process as requiring improvement in program quality and identifies broader issues affecting the legal services delivery system. In FY 2001, LSC will continue to seek the reconfiguration or consolidation of programs where it appears that federal funds could be used more efficiently and effectively by programs. In addition, LSC will seek to identify, test, and evaluate new strategies to enhance the effectiveness and quality of legal services.

The Corporation's compliance and enforcement activities are to enforce compliance within applicable federal law and regulations. These include investigating complaints and inquiries from clients, the public, and Members of Congress and taking appropriate action; following up on referrals from the Office of Inspector General regarding possible violations discovered through compliance audits of local programs; developing and enforcing corrective action plans; and imposing and enforcing sanctions where necessary. The FY 2001 budget request includes funds to enhance these capabilities. The additional $1.54 million will provide for 40 annual specialized on-site compliance reviews, instead of the 15 or so the Corporation can conduct with the current funding level. This request is partially in response to last year's findings by the General Accounting Office (GAO) and

LSC's OIG on the inaccuracy of Case Service Reporting data and the lack of LSC systems and resources in place to correct these problems.

Office of Inspector General: $2,400,000

The Office of Inspector General seeks $2.4 million for FY 2001, an increase of $300,000 from FY 2000. The increase will fund an Assessment of 2000 Case Statistical Data. (The Appropriations Committees directed such an assessment of 1999 data in the FY 2000 appropriation.) The OIG mission is to prevent and detect fraud and abuse, and to promote efficiency and effectiveness in LSC operations and grant programs. In addition, the OIG oversees routine monitoring of grantee compliance with laws and regulations through annual audits by Independent Public Accountants of LSC grantees and on-site reviews.

FY 1999 Activities

In 1996, Congress enacted fundamental changes to the national legal services program, reaffirming the federal government's commitment to providing representation for individuals facing legal problems who would otherwise be unable to afford assistance. With the intention of refocusing the LSC delivery system on serving individual clients with particular legal needs, a series of new limitations were placed upon activities in which LSC-funded programs can engage on behalf of their clients, even with non-LSC funds. Among them are prohibitions on class actions, challenges to welfare reform, collection of court-awarded attorneys' fees, many types of lobbying, litigation on behalf of prisoners, and representation of undocumented and other categories of aliens.

Legal services programs are primarily focused on serving the basic, critical legal needs of low-income individuals. Ten percent of LSC clients are elderly. The most common categories of

cases are family, housing, income maintenance, and consumer. More than one out of every six LSC cases involves efforts to obtain protection from domestic violence. Other case types frequently encountered include evictions, foreclosures, child custody and support, child abuse or neglect, wage claims, access to health care, and unemployment or disability claims.

The Corporation continues to be diligent in maximizing the use of federal dollars and in ensuring that the restrictions are enforced. We have been successful in developing a system of effective oversight of the activities of all LSC grant recipients.

State Planning

Beginning in February 1998, the Corporation has required all grant recipients to participate in a process to develop and implement a comprehensive, integrated statewide delivery system in every state. The goals of this process are to ensure the following: that programs ensure a delivery system that maximizes client access and provides high quality legal assistance; that there are substantial opportunities for training and information sharing between programs; that programs increase access to legal services; and that programs are working together to increase resources and develop new initiatives to expand the scope and reach of their services. In concert with stakeholders (i.e. the courts), each LSC-funded program must, therefore, assess the strengths and weaknesses of the current approach in their state, establish goals to strengthen and expand services to eligible clients, and determine the major steps and a timetable necessary to achieve those goals. Our overall objective in this process is to promote the most effective use of federal dollars in every state system.

As a component of the LSC "Strategic Directions" mentioned above, the state planning initiative will continue to address the following:

- Identify the most important issues involving the delivery of legal services in each of the fifty states, the territories and the District of Columbia, and
- Develop the financial and programmatic capability to reach more clients within the state with a wider range of services than ever before.

LSC is radically changing the landscape of the national legal services delivery system. To date, programs in every state have submitted plans to improve client services, and eight states have significantly restructured their delivery systems with the goal of improving services and reaching more clients. The Corporation will continue to pursue the appropriate restructuring of state systems consistent with the mission of the LSC Act and our strategic plan for 2000-2005.

Competition

The role of LSC is to manage and oversee the federal funds that support the direct provision of legal services by some 237 grantees across the nation and its territories. Since 1996, the Corporation has used a system of competition for grants to promote the economical and effective delivery of legal services, as required by § 1007(a)(3) of the Legal Services Corporation Act. We encourage local legal services providers and others to compete for available grants by broadly circulating information about the availability of grant funds and by providing outreach and technical support to potential applicants.

In the competition process, LSC evaluates applications according to established quality standards and awards grants to the applicants best able to provide high-quality legal services in accordance with applicable legal requirements. In 1999, our fourth year of competition, we received grant applications from 169 applicants for 217 service areas in 41 states and the District of Columbia. There were multiple applicants in five (5) service areas. These FY 2000 grant decisions

were made this November. In most states where service areas were eligible for competition, programs received regular, three-year grants. However, in some states, programs received two- or one-year grants. These variations in grant terms were made to encourage programs to continue developing methods to enhance effective statewide services for clients and to allow for consolidation of service areas consistent with state plans and prior LSC decisions. In some instances, shorter grant periods were established to encourage improvement of program performance. In addition, seventy-three current recipients whose grants were not up for competition this year were subject to a grant renewal process to ensure their continued compliance with grant conditions.

Competition has resulted in improved legal assistance to our client community. First, it ensures the most effective and efficient applicant in each service area is awarded the grant to deliver legal assistance to low-income persons. While competition between more than one applicant for a service area does not yet occur on a widespread basis, the process has allowed for several changes in legal services providers in the last four years. When necessary, programs are visited, short funding periods are initiated and improvement efforts are undertaken. This process has led to important improvements and, where reform was not forthcoming, to the replacement of providers. Second, through the use of technology, LSC is developing the capacity to analyze application data in order to identify significant statistics regarding the programs; for example, where programs are most successful in leveraging non-LSC funding. Finally, the state planning process, as a component of competition, asks programs and other legal services providers in each state to work together to more effectively deliver services. This effort has already led to the growth of centralized intake systems, to increased consumer education and self-representation projects, and to more effective *pro bono* efforts.

Challenges to LSC Regulations

The Corporation has continued to vigorously and successfully defend its regulations and the underlying statutory provisions in *Carmen Velazquez et al. vs. Legal Services Corporation* (U.S. District Court, Eastern District of New York).

On January 7, 1999, the Second Circuit upheld as constitutional virtually all of the statutory restrictions on the use of funds by LSC's grantees that were challenged in *Velazquez v. Legal Services Corporation.* However, the panel was divided with respect to welfare reform. The majority found that the proviso to the exception for "suits-for-benefits" that bars challenges to existing welfare reform laws discriminates on the basis of viewpoint -- that is, it permits representation only if it favors the status quo over change. On October 5, 1999, LSC filed a petition for a *writ of certiorari* for the limited purpose of Supreme Court review of the 2d Circuit's ruling that the "suit-for-benefits" proviso on the restriction on welfare reform litigation was unconstitutional as viewpoint discrimination. The Department of Justice filed a petition upholding the statutory restrictions in their entirety on December 5, 1999. The Court is in recess until February 24, 2000, and it is unlikely that action will be taken on the cross petitions for *certiorari* before that date.

Challenge to IOLTA funding

Also of note to the committee, a serious challenge to a significant source of non-LSC funding, state IOLTA (Interest On Lawyer Trust Accounts) programs, has been dismissed. After the Supreme Court on June 15, 1998, ruled in *Hon. Thomas Phillips v. Washington Legal Foundation* that IOLTA funds are the private property of clients, the case went back to a lower Texas court to determine if the state has taken private property and must compensate the owners for it. On January 28, 2000, U.S. District Court Judge Nowlin issued his ruling in the remanded IOLTA case, captioned

Washington Legal Foundation, et al. v. Texas Equal Access to Justice Foundation, et al., dismissing the case with prejudice on all counts. While the plaintiffs are expected to appeal the decision, this news is good for LSC grantees, considering that in 1998, they received over $63,457,108 from IOLTA programs, which accounts for eleven percent of their total income.

Compliance Monitoring

The Corporation's FY 1996 appropriations language also mandated a new system for oversight of program compliance. The principal mechanism for checking grantee compliance with all statutory and regulatory requirements and restrictions is now the grantee's annual audit. These audits are conducted by Independent Public Accountants ("IPA's"), under the guidance and oversight by LSC's OIG. LSC Management retains responsibility for interpreting applicable law and regulations, investigating complaints, and enforcing compliance. Management worked cooperatively with the OIG to implement the new system, which is now fully in place.

The results to date demonstrate substantial compliance by grantees with the new Congressional requirements and restrictions. As reported by the OIG in its *Recipient Audit Reports* for 1998, the IPA's did not report any cases of noncompliance with statutory prohibitions or restrictions on the types of matters for which legal assistance may be provided.

Case Service Reporting Follow-up

Last year, this committee raised serious concerns about the accuracy of LSC's case service reporting (CSR) system. Since then, LSC has taken steps to improve the system and has implemented the recommendations of the GAO in its September 1999 report.[5] Last year, it required

[5] General Accounting Office, *Legal Services Corporation: More Needs to be Done to Correct Case Service Reporting Problems*, (September 29, 1999).

programs to complete a self-inspection process to certify to the Corporation that their CSR data was substantially accurate. Sixty programs were not able to certify their data, and LSC has put each of these programs on a corrective action plan. The Office of Compliance and Enforcement is currently conducting follow-up, and a select number of on-site visits are being conducted to analyze whether the corrective action is sufficient. After implementing recommendations from the GAO on improving this self-inspection procedure, LSC is again this year requiring programs to assess the accuracy of their 1999 CSR numbers. Additionally, we will continue to further clarify to programs what types of information they should be reporting to LSC. As directed by the subcommittee, LSC's 1999 CSR data will be reported to Congress by April 30, 2000, and its accuracy will be assessed by the LSC Inspector General by July 30, 2000. LSC's FY 2001 Request includes additional resources to allow the Corporation to conduct 40 additional specialized, on-site compliance reviews. These reviews will allow LSC Management to identify program weaknesses, implement effective corrective action plans, and provide program specific guidance and oversight.

Conclusion

Mr. Chairman and Members of the Subcommittee, we thank you for this opportunity to share with you our Budget Request for FY 2001. We believe that LSC provides a vital role in our society by upholding the laws and enforcing the rights on which our democracy rests. LSC looks forward to working with the subcommittee this year to ensure we can continue to fulfill these duties in FY 2001 and in future years.

Mr. ROGERS. In a moment, we will allow you to proceed with your oral testimony. In the meantime, let me recognize Mr. Serrano for any remarks he might have.

Mr. SERRANO. Thank you, Mr. Chairman. I want to welcome you both to this hearing today. But first I want to take this opportunity once again, Mr. Chairman, to thank you and your staff for all the courtesies that you have extended to me and to my staff in my first year as Ranking Member of this subcommittee. And I look forward once again to working with you to make sure that we come up with the kind of bill that we can all be proud of, though we have many challenges in providing adequate resources; and as we have discussed before, this committee will have a short period of time to accomplish what we have to.

I think a good sign of our working relationship is the fact that you were smiling when these folks walked in and you know how important this agency is to me because they do the kind of work that unfortunately still deals with the haves and the have-nots in this society. I support their efforts, I try to help them in every way I can, and I know any consideration that you give to their request is something that I take very seriously and appreciate very much.

And with that in mind, I want to hear their testimony, and commit myself to working with you this year to make this a productive year.

Mr. ROGERS. Thank you, and again, last year you were very helpful. You attended every single hearing of this subcommittee, which probably is a record.

Mr. SERRANO. Probably a foolish record.

Mr. ROGERS. But nevertheless you did take the job seriously and you are a very valuable asset to us and we appreciate you.

Who would care to proceed? Mr. Erlenborn.

Mr. ERLENBORN. Thank you, Mr. Chairman. It is a pleasure to be here again to report to you and the members of the subcommittee on our most recent activities and requests our budget for fiscal year 2001.

I am before you today with John McKay, the Legal Services Corporation president, to request a $340 million appropriation for fiscal year 2001.

The $340 million appropriation includes an 8 percent increase for our basic field grants, providing $313 million to LSC grantees for the next fiscal year.

This modest increase is desperately needed to ensure grantees can continue to provide poor Americans with critical legal assistance. On behalf of the board of directors of the LSC, I want you to know that we are very proud of our accomplishment this past year. In particular, we are very pleased with the progress we have made through our State-planning initiative to maximize the use of Federal resources in every State.

Every grantee is required by LSC to report to us on progress made to increase and improve services in every State. This process has already yielded many important improvements. We are also glad to report that the corporation continues to successfully implement the will of Congress by aggressively enforcing all restrictions. We have also worked very diligently to correct problems associated with LSC's case reporting system.

Finally, I would like to mention that our board recently approved a set of strategic directions to guide the corporation into the year 2005. The plan establishes some very important goals of increasing access to thousands of additional clients and ensuring all receive high quality legal assistance. The plan is referenced in our budget request.

I know John will cover these accomplishments and more with you shortly. My role here today is to assure you that the bipartisan board of the Legal Services Corporation is committed to faithfully fulfilling the mission of the LSC Act and working with you and members of the committee to accomplish this.

I would now like to turn over the table to our president, John McKay. John is close to completing his 3rd year as the LSC president. And our board has requested that he extend his service. I am very pleased to report to you that he has agreed to remain at the corporation until at least October of this year.

We are very fortunate to have John as our president. His leadership team has worked tirelessly to improve the quality of the National Legal Services Program and to ensure compliance with all congressional restrictions.

I yield the floor to—or allow you to recognize our President John McKay.

Mr. MCKAY. Mr. Chairman, thank you, members of the subcommittee, thank you so much for giving us the opportunity to be here today. Obviously, we have our budget submittal before you and a written statement; and I just want to supplement that briefly by highlighting, I think, some major accomplishments, not just of the Legal Services Corporation and its many staff and volunteers across the country who do this important work, but also the work of this subcommittee and of the Congress in refocusing the energies of legal services across the country on the needs of individual clients. And I think that is a very important change in federally funded legal services, and I think it has very much to do with the attention of the Congress to this issue.

And we in legal services across the country have embraced this change because it means that we focus on the individual needs of clients, the battered woman, the senior citizen who has been defrauded through an equity stripping scheme. Issues I think that every Member of this subcommittee and frankly every Member of Congress would agree with.

As a Republican—and I know that the Chairman and others on the committee are aware of the fact that I myself am a Republican with a long history of involvement in both political causes and former service on Capitol Hill to the late representative Joel Pritchard—I embrace this vision, and it has been my pleasure to help lead its implementation over the past 3 years. It is fundamental, it is important, and it is pervasive now throughout the Legal Services Corporation system.

We are restructuring the delivery of legal services around this vision. We have made substantial changes in at least eight States since I have been President of Legal Services Corporation, Arizona being among them, where we have required our programs to engage in careful planning which we direct their services through public-private partnerships to individual clients. And I think there

is broad consensus throughout the legal aid community, not just at the Legal Services Corporation but in the courts, other local stakeholders, and folks who really care about those low-income people who need our help very critically.

And I think this is a bipartisan vision. It is one that says there is an obligation by the Federal Government to participate in the access to justice issue in our Constitution. In all of the documents that are engaged in the creation of our great country, we focus on the issue of access to justice for all people, not just those with the price of admission. And as a Republican, I believe in that fervently. As a lawyer, I think it is my solemn responsibility, and as president of the corporation, I want to tell you I have been proud to be involved in that very substantial change that is happening across the country.

I am pleased to be here, and gratefully acknowledge the help of the staff of this committee in the submission of our budget. I think it is modest comparatively. It is focused on the important aspect of providing adequate funding for our recipients and to increase our ability to monitor their compliance with both the law as imposed by this Congress and on the focus of the work that should be done which is representing individual clients. And I think that our recipients across the country have risen to this challenge, I am very proud of the work that they have done.

So I am pleased to be here today and welcome any questions, Mr. Chairman, that you may have or any other members of the subcommittee.

Mr. ROGERS. Thank you, Mr. McKay and Mr. Erlenborn, thanks for your testimony.

I have learned in this job that you can almost gauge the well-being of Legal Services Corporation by the number of complaints that we receive from Members around the country. And I will have to say that we are at a low point in that regard which I think is a high point in your case.

Mr. ERLENBORN. I am glad you made that clear.

Mr. ROGERS. You are not completely free, but we are hearing fewer complaints, at least I am, from Members around the country. So, you must be doing something right.

CASE SERVICES REPORTING

Let me ask you now about case service reporting. At last year's hearings there was a good deal of concern about the accuracy of your 1997 case reporting.

There were indications that the 1997 numbers were inflated. Questions were asked as to whether the corporation had done everything that it could to ensure the accuracy of the reported numbers.

Last year GAO reviewed the statistics of five of your largest grantees and found numerous overcounting errors as well as other problems such as improper case file creation, files without required documentation of financial eligibility, files without documentation of citizenship or eligible alien status.

We don't disburse funds, nor do you, based on the number of cases that each grantee has or opens and closes. But it is important, I think, to this committee and to you that we know accurately

and completely the information about the volume of your work so that we can evaluate how well the taxpayers' money is being spent.

Now, this has been a point of some contention and some heat and I want you to have a chance to tell us what is happening with your case reporting.

Mr. ERLENBORN. Mr. Chairman, if I may just make a preface to the statement that I know John McKay is prepared to give in answer to your question. Let me first of all remind the committee how this failure or shortcoming in case reporting came about.

Mr. McKay, as president, and Ed Quatrevaux as the Inspector General, he can fill you in with more details if necessary, decided that it was necessary to look at several of the grantees to see if their case statistic reporting was accurate. And the answer was that it was not accurate. The Inspector General made the investigation, he issued the reports; and that is how it became a matter that the Congress was aware of because that information was passed on to the Congress.

I must also say that in making his report, the Inspector General made it clear that there was no one who was purposely changing these figures. No one was guilty of fraud or deceit, but rather this was sloppy bookkeeping. There are many causes for it. But he, not only in his reports but also in the committee hearing last year before this subcommittee, made it clear that he found that there were no fraud or deceit.

The Inspector General, I think, can be believed in this regard. Not only was that his opinion but the Republican leadership of the House asked the General Accounting Office to look into this. They found shortcomings very much the same as the Inspector General. They also, in a subcommittee hearing of the Judiciary Committee, rendered their report and stated that they found no fraud or deceit. There were real shortcomings in this process of collating and sending—collecting and sending on to the corporation who collected it across the country, real shortcomings that are being aggressively addressed today. But contrary to many of the charges that were made, no one in a responsible position found evidence of fraud or deceit.

Mr. MCKAY. Mr. Chairman, if I may follow up with our vice chairman's remarks, obviously the inquiry and the conclusions of the GAO, the office of the Inspector General and our own office of compliance and enforcement that there was no fraud did not end our inquiry. We certainly took this issue very, very seriously, and I want to assure the subcommittee that the follow-up by first of all the Inspector General, who I want to commend, the decision to go out and do this investigation, of course, was his as our independent Inspector General. He initiated that, and I think appropriately. The management staff of LSC of which I am the head responded to his initial reports. And as we received more reports, we continued to develop, I think, an appropriate response.

Let me tell you very briefly what we have done. Every single office that was found to have shortcomings in the GAO report has been visited or will be visited by our compliance and enforcement staff which will be an on-site inspection with a detailed review of all elements of the case-statistic reporting issue.

The purpose of that is twofold. One, to determine exactly what the level of difficulty is or the inaccuracy in the reporting; and, two, to work with our recipients to implement systems that will correct those errors.

We have been in the field in 14 places. We expect to do more. Part of our budget request is to request additional staff to continue that sort of monitoring, that sort of compliance review, and that sort of instruction because, very importantly, we are working with a system here which is essentially a 25-year-old reporting system. We are not the only agency that has had problems with its statistics, but I certainly won't hang my hat on that. I am going to assure the subcommittee that we will continue to work on this issue.

We also have required 42 programs to file with us corrective action plans which we have approved. In other words, we don't have to, in our judgment, go to the field in those programs, but they have submitted to us adequate intensive corrective action plans which we have reviewed, provided feedback, and now approved.

We plan, with the help of this committee and with the Congress with additional funding, to undertake regular monitoring visits to try and head off any such problems that we have completely, in utilizing the advice of the GAO, required every single program that receives Federal funds through LSC to certify the accuracy first of their 1998 data and then, with additional feedback from GAO who has been very, very helpful, we are going through this process now with regard to 1999 data.

We have been instructed by the Congress to report by April 30th on the 1999 data, and we will do so. We are working also with our Inspector General as he goes through his process to certify all of the data for 1999. And I would describe that as a very cooperative, very professional working relationship between my staff and the staff of the Inspector General. I know he is here today, and I feel he would comment on that if any members of the subcommittee would like him to do that.

We also expect to reissue guidelines to our programs. Some of these areas are very gray in terms of case statistics. They have to do with the nature of the representation, whether it is advice, whether it is extended representation in court. That has not been clarified over the years, and we have moved to do that. And finally, Mr. Chairman, it is our intention to completely revamp the way in which we determine performance measures for our recipients; and that is being done pursuant to the guidelines of the Results Act.

Our vice chairman has reported to you that our board recently passed a very important statement regarding the strategic direction for LSC for the next 5 years. Our next step is to develop detailed performance measures pursuant to the Performance Act and that will guide our new system of performance measures to the field. And part of our budget request is for a modest effort to create pilot programs during fiscal year 2001 to launch that effort in a careful way in accordance with the Results Act.

So I hope, Mr. Chairman, that that response—and we certainly welcome any questions of members of the subcommittee or written follow-up which we would be glad to provide on the way I think that we are carefully, coherently responding to questions regarding case statistics generated by our recipients.

Mr. ROGERS. Well, it is not just the number of cases open and closed. The GAO found that there were a lot of files that did not show that the person was eligible, financially, without the required documentation of citizenship or was otherwise ineligible to be represented.

A lot of sloppiness in these files. Not just the number of open and shut cases. Can you help us with this?

Mr. MCKAY. Actually, the number of cases, Mr. Chairman, those are related. It was the fact that there was not adequate documentation which caused GAO to throw some of those files out of the case count. The ultimate question would be were we representing ineligible clients, and the answer to that I think as we have gotten into the files themselves and visited on-site, whether it be the GAO, Inspector General, or our own compliance staff, found that we have eligible clients but as you pointed out, some sloppy file work to document them. We are not convinced that we have a major eligibility question, but we have a major documentation issue and that is just as serious.

So we have reemphasized—and when I have indicated to you that we have required corrective action plans first and foremost, it is documentation that relates to the eligibility of these clients.

And the field visits have done the same. We are convinced that we have, one, required corrective action plans and two, been in the field to ensure that our project directors and programs are working to correct those inadequacies. And I would point out that we really have across our system a remarkable record of meeting the many requirements for eligibility that are placed upon our programs. Most of them want to practice law and represent eligible clients. And we have reemphasized to them that along with the Federal funding they receive comes some very important documentation requirements' that we know they do not take lightly, but it does require their attention.

Mr. ROGERS. Is everybody cooperating? Are all the grantees cooperating?

Mr. MCKAY. Yes, they have.

Mr. ROGERS. Even Maryland?

Mr. MCKAY. Yes, and I was involved directly in that issue. We had initially an issue regarding access to certain client file information. And I know that you can see this coming, when the agency comes in and asks to look at actual client files, there are issues of client confidentiality and attorney-client privilege which have to be worked out; and so we have worked with programs. Maryland was the first actually, in which we, pursuant to a referral from the Inspector General, worked out a protocol or methodology by which we could review the files, protect the attorney-client privilege, it was legitimately present, and do the job that the Congress requires us to do which is make sure that those funds are being spent wisely, efficiently and certainly in accordance with the law. And we did work that out to the Legal Aid Bureau of Maryland's satisfaction. We have one or two pending, but I am confident that we will get those resolved. And in almost every other case, we have been provided with actually quite wide-ranging access to files.

Mr. ROGERS. Well, now this first came up based on the 1997 numbers. And you had 3 years-plus to work this thing out. And I want to know how far along you are. Tell me what kind of confidence you have in the 1999 statistics that you could share with us.

Mr. MCKAY. Well, Mr. Chairman let me put a little bit different viewpoint on that. When we first became aware of the Inspector General's preliminary results, we were talking about auditing files which were already completed in programs. So 1997 data is analyzed in 1998, by the time we were testifying last year in 1999 when this issue was first raised by the subcommittee, all of the 1998 services had been provided, and we were actually well into 1999. We are now into 2000.

So what we did in reissuing our guidance to the field, as soon as we could in 1998, was to affect the 1999 data. And I think that the review of that data which is only just now occurring will show an improvement over the accuracy of the 1998 data. And ultimately, what we are doing is designing a new system, as I said, pursuant to the Results Act so we really, in 1999, before this committee, could only influence by tightening up our CSR guidance for the remainder of 1999.

We haven't had a chance yet to report on that. My hope is that the data that we are starting to go into the data banks of each our recipients will be much greatly improved for 2000. I am very confident of that given the number of field visits we had out there, the corrective action plans, and the clearing up of some guidance which, frankly, was some inaccurate guidance from LSC. It was old guidance, it had not responded properly to the increases in technology, and we had to clarify that. So we bear some significant responsibility for the inaccuracies that our field programs were reporting.

So I think the answer really is 1999 is the first full year that we will have had an opportunity to clarify guidance to the field to improve accuracy; and really, I think, the benefits of our field visits, the teaching, and the corrective action plans will not be seen until we analyze the data that is collected in 2000.

Mr. ROGERS. Well, we are supposed to get your 1999 case reports by April 30 of this year. And, needless to say, the spotlight is going to be on those numbers not just by us but by the Inspector General the GAO, and the world at large.

Mr. MCKAY. And we welcome that.

Mr. ROGERS. We look forward to seeing those reports to see how they have been corrected.

Mr. MCKAY. Yes.

Mr. ROGERS. And we better not find many errors, or some folks on this committee may be mad.

Mr. Serrano?

Mr. SERRANO. Thank you, Mr. Chairman. Let me just continue the line of questioning of the Chairman, which has concerned even many of the people who are not mad at your agency. With staff's help I came with up with some numbers. I believe when the bill left the committee the amount was $141 million. Then we amended

it on the floor in a bipartisan effort. An amendment that I put forth took it to $150 million. And then, with further negotiations, it went to $300 million, and finally we ended up at $305 million. That is the good news.

The bad news is that to have to go from $141 million to $305 million means that there were opposition and questions getting to that point; otherwise, it would have been easier to get to that point at the beginning. So I can't overemphasize to you the importance of what the Chairman is talking about to those of us who—at times almost blindly—support you and the work that you do. You have to make sure that you do not give those who have blindly opposed you the ammunition to continue to say that something is terribly wrong.

And while I know that nothing is terribly wrong, and while I believe that you have to do your work and do it well, this issue of reporting is one that traditionally arises in all kinds of Federal funding. My experience has been that it always jams things up when people really feel that someone is not telling the truth and you are asking for money because someone locally is fudging their numbers. So I would hope that you realize that this is a bipartisan request to get this taken care of so that we can all be supportive to the extent that we all need to be supportive.

Mr. ERLENBORN. I can assure you, Mr. Serrano, that we are very much aware of that. And I think the steps that we have taken will prove to be successful in giving you much more accurate figures. I am not going to say that at any particular point in time you are going to have totally accurate figures. There can be some mistakes made. But certainly they shouldn't be more than 1 or 2 percent, and I would not focus on that. But I would say that under the leadership of President McKay, we began corrective action on this issue before it became an issue in Congress. And under President McKay and the strong support of the board, we are seeing that there is follow-up so that we can guarantee the greatest degree of accuracy possible.

GRANTEES' REPORTING

Mr. SERRANO. Let me just—how many grantees do you have?

Mr. MCKAY. We currently have 237 recipients.

Mr. SERRANO. And of those, how many were involved in bad reporting or bad numbers that we know of.

Mr. MCKAY. Well, as was pointed out by the chairman, the GAO visited five of our largest programs all of which were seen to have some difficulties. The Inspector General visited a number of other programs, not all of which had difficulties but a number of them did. In addition to that, after the inquiry and as part of our response to the Inspector General's reports, we required all of our programs to go in and look at all of their files and recertify them. And we had something in excess of 50. And I am sorry I do not have the exact number, but out of 250 programs, about 50 could not certify. And under that report, we then required corrective action plans, and in some of those programs we actually went on site to get them corrected.

So while most programs were able to certify the accuracy of their statistics following protocols established by the GAO—they had to

go in and basically turn over their files, open them up, and assure us that the numbers they were providing were accurate, a major massive undertaking by our programs in response to this. But the 50 that couldn't certify, all have been required to file corrective action plans being monitored by Legal Services Corporation. So I think the answer really is 50-plus programs with substantial difficulties all of which now have corrective action plans.

Mr. SERRANO. Now, aside from this issue, moving on, what would you say are the corporation's biggest challenges facing you this coming year and in the few years to come?

2001 CHALLENGES

Mr. MCKAY. I think, Mr. Serrano, that the biggest challenge we face is to reach the huge number of eligible low-income people who do not know that we exist. And although, as we pointed out and requested in our budget request for fiscal year 2001, we need to learn more about the unmet legal need of eligible clients whom we are required to serve under the LSC Act, all of the anecdotal information that we have and the most recent reports that we have show that we only serve 1-in-4 to 1-in-5 eligible clients.

That means that women who are victims of domestic violence, senior citizens who have been victims to equity stripping scams are simply living with that injustice in their lives; and we feel it is incumbent first as the federally-funded entity responsible for building public-private partnerships working with courts and individual states, it is upon us to develop planning and the resources at the Federal, State, local, and private sector levels to address that unmet legal need.

And the greatest challenge we have is to create a vision and to create the kind of management at the LSC level to build partnerships at State levels to provide systems that will address those people so that the woman who lives in the trailer home up the gravel road who does not know that there is a program in Tucson, Arizona, to help her will get that information. Or that there is an 800 number that she can call to give her some assistance. Our biggest challenge is to leverage the modest resources that we have to provide the education that we need to provide those unmet legal needs and reduce the injustice that is far too rampant in our country, that we will begin to address those needs. I mean it is a very fundamental basic question of injustice.

Mr. SERRANO. Do you have any thoughts about new ways of doing the outreach other than the traditional ways you have used in the past? Because if you have a number of people yet, and you are correct, one of the saddest parts of our society is the fact that so many people do not know that there are services available to them and suffer the consequences of the lack of services. Any thoughts? And in conjunction with the fact that you are asking for $1.6 million to conduct a comprehensive national legal needs assessment, how does that all tie in and what are you looking to accomplish? What approaches are you looking to use?

Mr. MCKAY. Well, I appreciate the question. We take this challenge very seriously, and as we work through the Results Act, which I think has really helped LSC focus on this question, first we need to figure out what we are dealing with and how many peo-

ple we are missing and where they are. That is why we have asked for additional funding in fiscal year 2001.

Secondly, we are not going to wait because we know through the reports of our recipients, I know from my own visits to many programs across the country that we are not serving these folks. First we need to find new ways to reach them. Technology is a huge asset to us. When I indicated to the Chairman and the rest of the subcommittee that we have had eight States now reorganizing, many of them are reorganizing around new technologies. Let me give you an example.

Public access terminals are appearing now in courthouses and public libraries, and we are learning that low-income people have access to the Internet. We think that through Internet technologies it is going to be possible, and we have seen this now already in a number of our programs, for a low-income person to access information about their legal rights that has never been available to them before through touch screen kiosks. At this point with the technology that is present, a woman who is being beaten can go to an information kiosk and it can say, right up on the screen, are you being abused in your home? Touch here. And you can begin to get the kind of information not just about someone who might be able to help you at a legal aid office but a phone number to a shelter, maybe a direct link to a shelter.

We are challenging federally-funded programs to work with the courts, to work with prosecutors, to work with local people in the communities to come up with those kinds of technologies, and we have some wonderful examples. We toured the Maricopa County program in Arizona to help us do this. And we are very grateful that in our last year's appropriation, we have some funds that will be granted out by the corporation to encourage new technologies so that we can reach these folks.

Telephone developments, Mr. Serrano, have made a major improvement in the ability of Legal Services to leverage these funds. Some States now have an 800 number where anyone anywhere in the state can dial an 800 number and get an advocate who can help them with their legal problem.

This is a brand-new approach, but we have problems. We have places in Louisiana, in California, in Texas, where low-income people don't have telephones. And so technology is not the only answer, but we do find that by emphasizing State systems that are coordinated and integrated with local stakeholders, with courts with others who, of course, are dedicated to providing access to justice that we will reach those folks. We will need more resources to, but I think we are headed down that path.

Mr. SERRANO. Let me ask you one next question. Grantees are now prohibited from engaging in activities such as class action litigation. In the needs assessment, are you going to focus only on that which you are allowed to cover, represent them in so to speak, or will your needs assessment look at all legal needs that low-income folks have in this country.

Mr. MCKAY. I think we are going to have to look at all the needs of low-income people. We will not have any preconceived notions about what those will be. And clearly this is a study that will need to be conducted with professional assistance to make sure that it

has credibility with people here on this committee; and we will share, obviously, the results of this study with the subcommittee and with Members of Congress.

I want to point out that we have very carefully and very aggressively defended the restrictions that were imposed by the Congress, including a recent decision to take up to the United States Supreme Court, a decision in the second circuit called the Velasquez case and it involves welfare reform and we are going to defend that before the United States Supreme Court, if necessary. That is the law, and I am sworn to uphold it. But we do need to take a look at the ability of low-income people and low-income communities to exercise their legal rights.

A lot of our programs do important impact litigation that is not class action and so that is not a tool that is presently available to our recipients. I think a legal assessment, a legal needs study ought to be broad based and ought to ask those questions.

Mr. SERRANO. Thank you.

INSPECTOR GENERAL

Mr. ROGERS. We would point out that the Inspector General of the agency is here with us as well, and if he would care to say anything at any point, we would like to hear from you. Anything you would like to say at this point?

Mr. QUATREVAUX. Thank you, Mr. Chairman. The only thing I would point out is that this committee's report on the 2000 appropriation tasked my office with performing an assessment of the accuracy of the 1999 data, which is due in March 1st to the corporation. Our report to the committee is due by July 30th. And we have completed our planning for that project, and I am confident we will be able to carry it out and report to you the results that are statistically valid and in which I have a lot of confidence.

Mr. ROGERS. You are satisfied with the corrective procedures that the LSC has taken on the case report?

Mr. QUATREVAUX. We haven't reviewed those procedures; we are aware of them. I think that the test is going to be what the results of this coming assessment are.

H2A PROGRAM

Mr. ROGERS. Thank you. I will be submitting some questions for the record on behalf of my colleague, Representative Whitfield, on the H2A program.

[The information follows:]

THE HONORABLE EDWARD WHITFIELD

Question 1:
Why did the Corporation empanel the Erlenborn Commission to explore the meaning of "present in the United States" when that definition, as set forth in Sec. 504(a)(11) of P.L. 104-34 and subsequent appropriations, clearly states "is present in the United States"?

Answer 1:
The Erlenborn Commission was established to evaluate the scope of permissible representation for eligible aliens by LSC grantees. On Nov. 16, 1998, the LSC Board of Directors adopted Resolution 98-011, providing authority to establish the Commission with the express purpose of studying the presence requirement for the representation of eligible aliens.

Since 1983, LSC's appropriations act and its regulation on the representation of aliens have required that an alien be "present in the United States" to be eligible for legal assistance from an LSC grantee. However, neither the appropriations act nor LSC's regulations defines the term "present in the United States." This language must be analyzed in light of judicial canons of legislative interpretation. This analysis does not allow words to be interpreted in isolation. Instead one must consider the context in which the words are used.

Construing the term "present" according to its ordinary meaning, it is clear that the statute requires the alien to be physically present in the United States at some point. This conclusion does not end the inquiry, however, because the issue is not whether an alien must be physically present in the United States, but when the alien must be present in order to be entitled to LSC representation. By itself, the language provides no express statement on when an alien must be present in the United States. In addition, familiar terms of immigration law, such as "continuous physical presence" are not used.

In order to provide meaning to the words "present in the United States" one must consider the statutory scheme in which the language arises, the legislative history of the presence requirement, as well as the factual circumstances under which representation of eligible aliens occurs.

Question 2:
Why does the Corporation continue to disobey these congressional directives and allow LSC grantees to represent aliens not present in the United States?

Answer 2:
LSC obeys all congressional directives. The Corporation's interpretation of the presence requirement is based on the factual findings of the Erlenborn Commission, along with an analysis of the statutory scheme in which the "present in the United States" language occurs as well as the legislative history of the alien eligibility provision. The full report is available for download at www.lsc.gov.

Question 3:
Has the Corporation audited the records of Texas Rural Legal Aid to determine the number of cases where TRLA has or is representing alien workers who were not present in the United States and, if not, would the Corporation be willing to perform such an audit?

Answer 3:
LSC, through the Office of Compliance and Enforcement (OCE), has investigated two complaints filed by two different complainants, on the issue that TRLA was representing H2A workers who were not present in the United States at the time of the assistance. As a result of the findings of the Erlenborn Commission, these complaint segments were closed, finding no violation.

If you have information that TRLA is representing aliens workers who have never been present in the United States, LSC will investigate the matter promptly. LSC takes seriously the restrictions on representation to alien workers who have never been present in the United States, as evidenced by the severe sanction imposed on Legal Services of North Carolina. In 1998, LSC launched an extensive investigation of Farmworker Legal Services (FLSNC), an affiliate program of Legal Services of North Carolina (LSNC), and found a trip to Mexico was in violation of the LSC Act for representing non-US citizens who were never in the United States. LSC imposed a fine of $17,050 on the program – an amount equal to all costs associated with the trip – and further prohibited LSC funds to be awarded to FLSNC as of January 1, 1999. LSC then transferred management of the migrant program to Legal Services of North Carolina. Further information can be found at www.lsc.gov.

CASE REPORTING ACCURACY

Mr. ROGERS. Mr. Kolbe.

Mr. KOLBE. Thank you, Mr. Chairman. I have a few questions in that area as well.

Mr. McKay, I think what you are talking about last—using computers to bring—to bring, your clients and your organization, your grantees into the modern world, I think is to be commended. I think too often our agencies don't do that rapidly enough, take advantage of what is so commonplace out there in the private sector. So I commend you for that.

I don't want to beat a dead horse here, but I am going to come back to the issue here of the case reporting and paraphrase Shakespeare, this strikes me a little bit, I think you protesteth too much here about all of this.

You referred to the fact that there was no fraud and no evidence of anybody that was deliberately misreporting, and I will accept that. The definition of the term fraud suggests somebody is getting some kind of financial gain from the act, personal financial gain, and I don't suggest that anybody was doing that. But it just seems to me that you had some pretty whopping discrepancies and this Congress—Mr. Serrano talked about the process we followed getting to the final appropriation of 305, I guess it was last year. And I remember on the floor some of the discussion of this. And part of it had to do with the caseloads that LSC or its grantees had.

And what we now know is that those—is it not correct to say those numbers were greatly overstated, very vastly overstated? Is that not accurate?

Mr. MCKAY. Oh, I don't think so. This issue—let me just——

Mr. KOLBE. Just to be specific, I think that the number that you reported total of your grantees last in 1998 was 1.9 million cases, and I think it turned out something like more like 1.1 million. Isn't it a 7 percent overstatement?

Mr. MCKAY. I am not going to fight you Congressman Kolbe on whether it is significant. It is clearly significant, but the actual numbers of closed cases that we were talking about was in the 1.5 to 1.6 million range, and we have corrected that down to about 1.1 million cases closed.

Mr. KOLBE. The latter figure we have agreement on. I would think that 1.6 to 1.1 million is pretty significant.

Mr. MCKAY. It is very significant, and yet there is a massive disconnect here. We did attend an oversight hearing of the House Judiciary subcommittee on this issue and there is substantial testimony there with respect to this issue and what occurred my own belief is that while cases closed is an important indicator of the work that we are doing with the Federal funds that we administer, it really is not and should not be the only way to determine the nature of our service to eligible low-income Americans.

Mr. KOLBE. I would agree with that.

Mr. MCKAY. And what we are trying to do is assess the impact of our program in ways that are related to outcomes for clients that show the real ability of what we do. This is sort of a metaphysical equality here that Shakespeare would appreciate and that is going to court and representing a client, if you do, that may not be to the

benefit to the client itself. I mean, it may be that you went to court, and you did a crummy job.

Mr. KOLBE. I understand that, and I appreciate that. And that there are other criteria. But don't you agree that this subcommittee has to have some objective data in order to make our appropriation.

Mr. MCKAY. Absolutely.

Mr. KOLBE. So if you can't give it to us, when you say the closed cases is only one of those, fine. Can you provide us with other objective criteria?

Mr. MCKAY. Yes.

Mr. KOLBE. Measurable criteria that we can use? That is what I think the subcommittee is asking for.

Mr. MCKAY. And I want to assure you that is exactly what we are in the process of developing.

Mr. MCKAY. As we move technologically to things like providing websites so that they are accessible to clients, not to make the job easier for lawyers, but for clients, when they go up on the website and download a form that they can use to get a protective order on their own in court, I think that is a valuable service provided.

Mr. KOLBE. I agree.

Mr. MCKAY. We should be able to tell you how many hits there were on that website.

Mr. KOLBE. I agree. It seems to me you have gone backwards. You come with a budget request, and now you are going to go out and measure the criteria of how you are going to spend that. It seems to me that you would say here are our goals, here is how we are going to measure it.

Mr. MCKAY. I am going to scare you with my answer.

Mr. KOLBE. Okay.

Mr. MCKAY. I am going to scare you with my answer. I think the charge of the Legal Services Corporation is set forth the LSC Act and it is says that we will provide legal services to Americans living at 125 percent of the poverty level. We know, without the legal-needs study, we know that the best available information says that we are serving about 1 in 4 or 1 in 5 clients. There is a disconnect between saying, and I think it has simply been disproven, that the fundamental basis for the congressional appropriation is the number of cases closed. We at the corporation have helped ourselves fall into that trap by relating to you on a yearly basis the number of cases closed. That is not the correct analysis. We, as the agency responsible, should be saying to you, here is our statutory charge, here is the need, here is what we need to accomplish it, and we are going to do a great job of that.

We have not been able to do that. That is why we are before the committee asking you for an appropriation to conduct a legal-needs study.

Mr. ERLENBORN. If I might add, Mr. Kolbe, we would be ecstatic if the action on the appropriation was based upon the need.

Mr. KOLBE. Right. And I appreciate you trying to steer me away from the caseload question here, and I understand that there are other data, and as I have said, I would agree with you. But since it is one, and it is an important measurement that we use, I just want to focus on that.

What kind of written communications have you sent to your grantees about reporting? What kind of procedures have you—have you submitted all of that to the subcommittee?

Mr. MCKAY. I do not know whether we have submitted it to the committee.

Mr. KOLBE. Have you had significant numbers of communications?

Mr. MCKAY. Oh, yes.

Mr. KOLBE. You have developed procedures?

Mr. MCKAY. Yes, we have. They are detailed. Let me just put it this way. A lot of recipients are using the word "onerous."

Mr. KOLBE. Have you told them that accurate reporting is going to be a criteria for renewing a grant or giving a grant?

Mr. MCKAY. Well, first of all, it really is a grant condition anyway, for programs to cooperate with us and provide us with information that we request. Let me just give an example. We are requiring every program to take a two-page checklist through every case that was filed in 1999, and they have to certify the accuracy of the cases that they undertook. They will not physically turn over every single file, but they will, as guided by GAO, conduct basically a massive testing of their case files for 1999 so that in addition to the work being done by the Inspector General, we will be in a position to say that individual programs are self-certifying, pursuant to our guidelines.

We reissued a very thick case statistic reporting guide. We are about to do it again for 2000, as we have learned from GAO and listened to what they have had to say. So we have been in a great deal of contact with our programs. I convened a working group of about 15 Project Directors in Dallas, Texas to help engage the dialogue in how this impacts them in the field; and believe me, I have gotten more than an earful. But I want to say that I commend our programs. This has been very difficult. Many of them have been visited by GAO, by the Inspector General; many more are being visited by our Office of Compliance and Enforcement and now all of them are self-certifying. I have Project Directors who have said I am creating an office of audit to respond to all of these.

Now, that is a light comment, but I wanted to give you it so that you know.

SANCTIONS FOR REPORTING FAILURES

Mr. KOLBE. Has any grantee been sanctioned for their failure of reporting?

Mr. MCKAY. Not directly, no. Not directly. Now, had we found instances of fraud, Mr. Kolbe, or had we found instances of folks who had——

Mr. KOLBE. You told me, there is none.

Mr. MCKAY. That is right. Well, we have not found any. And I welcome anyone, if the evidence is there—I am the chief regulatory officer here; and I will enforce that very aggressively. It just has not happened. Frankly, I bear some responsibility as president of LSC for having out in the field unclear guidance on some of these materials. We have now reissued that guidance. I do not think we are perfect yet, but we are going to keep working at it and we are going to get this data accurate for the Congress. So for me to go

sanction programs, I think part of the responsibility since it lands on our shoulders at LSC is to get it right so that our programs can provide accurate data. We were not there, and we are making a lot of progress, but we are not there.

Mr. KOLBE. Thank you. My time has expired. I guess I will have to rely on Mr. Mollohan's question to give me some answers to the H2A program.

Mr. ROGERS. Mr. Mollohan.

IOLTA FUNDING

Mr. MOLLOHAN. Thank you, Mr. Chairman. Gentlemen, I join the Ranking Member and other members of the committee in welcoming you all to the hearing today.

What is the status of the IOLTA funds with regard to their support to grantee programs throughout the various States?

Mr. MCKAY. We have had some good news in that regard, Mr. Mollohan.

Mr. MOLLOHAN. I know you had the district court dismissed with prejudice.

Mr. MCKAY. Yes. And that was the key decision. The matter went up, as you know, with the United States Supreme Court and put in question the State IOLTA programs upon which many of our recipients rely for substantial additional funding.

Mr. MOLLOHAN. So the case has been dismissed. What impact has that had the possibility of grantees receiving funds from IOLTA?

Mr. MCKAY. I do not think it ends the challenges, but I think in the near term, the next few years, that we can continue to look to State IOLTA programs to supplement our funding significantly.

Mr. MOLLOHAN. Are any States having their funds supplemented now with IOLTA funding?

Mr. MCKAY. Oh, yes. Virtually every State continues.

Mr. MOLLOHAN. Still?

Mr. MCKAY. Yes.

Mr. MOLLOHAN. So these cases did not stop IOLTA funding?

Mr. MCKAY. I am aware of one or two States who temporarily halted the distribution of IOLTA funds to legal aid programs and other recipients, and I believe that those have now been freed up pursuant to the guidelines of individual State supreme courts. So that money now continues to flow to our local programs and to other recipients, and of course they are not LSC funds, but they are certainly used by our recipients to represent clients.

Mr. MOLLOHAN. That is about $60–$65 million a year?

Mr. MCKAY. I believe it is more than that now. I am told it is about $65 million.

Mr. MOLLOHAN. I took the number out of your testimony.

Mr. MCKAY. Okay. Well, you can depend on it. Thank you.

TECHNOLOGY INITIATIVE

Mr. MOLLOHAN. Could you explain in greater detail than your testimony about the technology initiative that you requested $5 million for last year and are asking $10 million for this year? What has been done with the first $5 million, and what do you propose to do with the $10 million?

Mr. MCKAY. The numbers that we have available are about $4.25 million. We have moved very quickly to implement these grants which are discretionary to the corporation. We are not distributing them on a pro rata basis. So we are looking for innovative technologies along the type that I was describing to Mr. Kolbe.

Mr. MOLLOHAN. You are soliciting proposals from your grantees as to how you would use this money to improve your operations?

Mr. MCKAY. Yes.

Mr. MOLLOHAN. And the delivery of services?

Mr. MCKAY. No, I think a little bit more directly we have said we are looking for programs, for technology projects that will be trend-setting projects and providing direct representation for pro se and for clients directly. So we are looking for in our RFP, which will be issued, our goal is the first of March, we have set up categories. We are looking for a model program, we are looking for a series of substantial grants out to programs who are doing innovative things like two-way teleconferencing which will save us the cost of establishing offices in areas.

Mr. MOLLOHAN. Is it directly increasing the number of clients you can serve.

Mr. MCKAY. Absolutely. We are not talking about nice computers on the desks of attorneys, we are talking about reaching clients. One of the main emphases is going to be rural poverty. We cannot open an office in every small town in Utah, Iowa, or my home state of Washington. We have to find ways to reach them, and technology is a real opportunity. We are very excited. We have already put the word out to our programs, and we have received a huge number of inquiries about the availability of those funds. And we are very excited about them and very grateful to have this opportunity.

Mr. MOLLOHAN. What are some of your ideas? Take West Virginia, for example, not because of any other reason other than I am more familiar with it. How many program grantees do you have in West Virginia?

Mr. MCKAY. We currently have three, Mr. Mollohan. But I am told that as of March 31st that will become one in West Virginia. We will have one recipient. They are going to reorganize around the questions of technology. We are very excited about West Virginia. In the past, we actually had three programs in one building in Charleston.

This did not seem to make a lot of sense to us at LSC, and yet they are local recipients with a lot of local input. They have some very interesting ideas under the leadership of a district court judge in West Virginia who chairs a symposium there. They have done substantial work in bringing new technologies into West Virginia, State-wide training around substantive law issues, and I am particularly pleased with the fact that they are looking at new ways to provide client intake and access into the system to reach people who are in remoter areas of West Virginia where we can't open an office.

Mr. MOLLOHAN. Using this technology initiative?

Mr. MCKAY. Absolutely.

Mr. MOLLOHAN. Explain in more detail how they do that? For instance, operating out of Charleston, how did you serve Hampshire County?

Mr. MCKAY. One way you can do it is by having an 800 telephone access system. What is happening here is not that they call on an 800 number and someone says here is a place you can call to get help, they are actually getting advocates on the other end of the line who understand the law of West Virginia, who understand what the resources are, who can say to someone who is being abused, here is a social services provider.

Mr. MOLLOHAN. Just tell me mechanically. A telephone——

Mr. MCKAY. A telephone intake system which is tremendously widespread.

Mr. MOLLOHAN. What is another one?

Mr. MCKAY. Another one would be Web-based access which would be a Web site. We have several programs working in other States where in courthouses in West Virginia, in public libraries in West Virginia, in a public access terminal, a low-income person could get on to the Web site of the new legal aid program in West Virginia.

Mr. MOLLOHAN. Would one tie into the grantee?

Mr. MCKAY. You can tie into the grantee directly first for information, that is the first step. But what is happening now is we are starting to find down-loadable forms with step-by-step, easily structured ways to describe your problem. You could take a form that comes out at the end of this touch screen dialogue which could be walked into a local court in West Virginia and you could obtain an order of protection on your own, without an attorney. This is exciting, and while we like to have an attorney there in every instance, we know we are not going to get an attorney throughout West Virginia that can serve low-income people.

Mr. MOLLOHAN. Is this happening everywhere?

Mr. MCKAY. Yes.

Mr. MOLLOHAN. Where is the best case of that?

Mr. MCKAY. I think the best case of the Web-based access is probably Pine Tree Legal Services in Maine. I have to plug some of my own hometown folks, I would say the State of Washington has moved very aggressively with Web based technology. But they may have the best 800 telephone system throughout the State of Washington.

Mr. MOLLOHAN. Let's take West Virginia as an example, again you estimate that you are servicing one in four or one in five?

Mr. MCKAY. Yes. And I am not—I do not know what the symposium in West Virginia came up with, but they would have tried to study that a little more closely.

Mr. MOLLOHAN. It must be huge in West Virginia. If you are searching one in five across the State as a Nation——

Mr. MCKAY. Well, we have three. It is not the number of programs, it is the number of clients that they are serving.

Mr. MOLLOHAN. Well, I think there is some correlation between the number of grantees and the number of clients served.

Mr. MCKAY. No, there is not.

Mr. MOLLOHAN. With all three in Charleston——

Mr. MCKAY. It will be one service area when we are done with one program. Currently there are three.

Mr. MOLLOHAN. So you have three grantees in West Virginia, all operating out of Charleston, West Virginia.

Mr. MCKAY. I believe that is right. That is kind of an anomaly of history. But remember, we administer a system of nationwide grants. What we have done in the last 2 years really is become very aggressive about implementing this new version of legal services. We are telling them, you have to come up with innovations to reach low-income people in West Virginia. I think they have risen to the challenge. I am very proud of what they have done there.

Mr. MOLLOHAN. I am very supportive of your thinking about how you can use technology to multiply your efforts and reach a greater number of people. I will be very interested to see how it develops. I think it is a good thing, and I look forward to working with you.

Thank you, Mr. Chairman.

Mr. ROGERS. Mr. Latham.

Mr. LATHAM. Thank you, Mr. Chairman. I welcome you very much today. I really want to compliment you, John, on the vision and the statement that you put out. I thought it was excellent. Despite what maybe Mr. Serrano indicates, actually, I am quite happy today.

Mr. ROGERS. What?

GRANTEE ACCOUNTABILITY

Mr. LATHAM. Yes. And maybe there is some misunderstanding. I have supported in the past maintaining, actually increasing funding for the Legal Services Corporation, and I think there is a role of support. Actually, George Witcrab, who maybe you know is from my district, is a very good friend, but he was as concerned as I am and have been when you are presented with facts which are not in line with what has been reported. Obviously we are very much justified last year, you know, when you see the account went from 1.9 million in 1997 to 1.1 million in 1998, and it may not be part of your justification, but I think we are all aware on the floor of the House when we debate this that the people who are supporting additional funding use these numbers over and over and over again. So whether or not you use it as a justification; in fact, a lot of people do. I just think I would not be representing my constituents, the taxpayers of my district if when presented with real facts, that we didn't act on it. I really, I compliment you. I think you have acted swiftly, and I think your leadership has really made a difference. I look forward to it.

I am curious, and the Chairman I think touched on this somewhat, but is there real resistance or delays by the grantees as far as the accountability and the—it would seem to me that it would maybe shake them up a little bit or they may think that maybe their job is not justified or something if their numbers were not as large as they were before, if they are really reporting actual cases.

Mr. MCKAY. Oh, I think they have been shaken up. But the issue is not—I do not believe the issue from their standpoint is that we think they are less effective because their numbers, when they are accurately reported, are fewer. I do not think anybody in legal serv-

ices really believes that today. As you know, a case—we take really a small percentage of our cases all the way to litigation, and that is the most time-consuming work that we can do, is to actually go before a court and handle a case.

I was a private practice lawyer in Seattle, and I know the difference between trying a commercial litigation case for the Nordstrom Company in Federal court for a couple of years versus brief advice to a client who may call me on the phone. Under our system, each of those is one case. And that is one of the problems that we have and one of the shortcomings, frankly, that has been revealed here. We have not found a way to accurately and adequately report to the Congress on what Congress is getting when it invests in us and that is a terrible shortcoming and we are going to address it. But there are responses to that that need to be worked out.

So we are not flipping burgers; we are not serving people in kiosks; we really are providing important legal advice. I have traveled across the country and I have been in legal aid offices and we have tremendously dedicated people who are working in these offices for wages that are far below private practice, far below government service, and they do it because they believe in this work.

I think we have to commend them for what they are trying to do, which is to represent low-income people who need this service. We have not served them well, frankly, the leadership. We are not finding a way to characterize the hard work that they are doing and the fact that they know they bear responsibility in Iowa and my State of Washington and Arizona and California and Kentucky for not serving people who desperately need their help.

So I think that is what—the resistance, in fact, is to what is viewed as paperwork when they have clients sitting out in their waiting room. But we—I can tell you, we have got their attention on this. I know we have their attention on this. I hear the phone calls, I have conducted the meetings in the field, I have supervised the paperwork that has come from our staff, I have worked with our Inspector General as he has done that independently under a separate statutory charge. I think it is the right thing to do and yet, we have to revamp this system, a total difference between those two kinds of services that are given to clients.

Mr. LATHAM. You do not have to be in government very long to understand there is a lot of paperwork as part of the job.

One question I would have on the technology. How do you know if somebody goes up to a computer screen and starts pushing their needs and all that, how do you know that they are eligible?

Mr. MCKAY. You do not. You really do not. I think the question——

Mr. LATHAM. Do we need to look at the law then?

Mr. MCKAY. Yes.

Mr. LATHAM. Because are you not providing services for people——

Mr. MCKAY. We do need to look at the law on that. We have taken a preliminary look, and I am convinced that we do not have any kind of a legal issue with regard to information, which is available to low-income people, established for low-income people, but happens to be accessible by say a middle-income person.

You know, domestic violence against a woman is not uniquely owned by low-income people. I am a former prosecutor and I am a former judge and I know that that is not the case. It happens in all spectrums of socioeconomic status in the country. If there is literally no cost, and I think in the example you gave, there is literally no cost if a middle-income or upper-income woman, for example, were to come into a courthouse or a public library and download information. It is virtually no cost.

Now, in the telephone system—I think that is the part we really do have to study and will study more carefully, but on the telephone call situation, the same screening is being done now. There is brief advice over a technologically sophisticated telephone system which is not given until eligibility is established, including income eligibility.

Mr. LATHAM. Again, I am actually very pleased with what you have done. You may be shocked.

Mr. MCKAY. Not shocked at all.

Mr. LATHAM. I really am, and I think this committee, under your leadership, Mr. Chairman, has gone a long way to bring credibility to the legal services, and I think in the long run it has been very, very positive. Thank you, Mr. Chairman.

Mr. ROGERS. Thank you, Mr. Latham.

Well, see there? I told you he was nice all along.

Mr. LATHAM. Was there a question?

Mr. ROGERS. Ms. Roybal-Allard.

LEGAL SERVICES FOR URBAN AREAS

Ms. ROYBAL-ALLARD. Thank you, Mr. Chairman.

As you know, I have always been a strong supporter of legal aid, but I do want to associate myself with the concerns that have been voiced by the Chairman and others about what has taken place, and I am very pleased that you are moving in the right direction to correct that.

I have just a couple of follow-up questions before I get into some others. You were talking about this Web-based technology. From your testimony, it sounds like this is geared primarily toward the rural areas. But there are urban areas in which people are isolated because of lack of transportation or even the libraries, if they exist in their community, do not have any computers or any of the technology necessary to even put them in. How are you going to address the problems in those kinds of areas?

Mr. MCKAY. Let me just first apologize. I do not want to give the impression that that is the purpose of either the additional technology grants that we have been allowed to make or the vision of the corporation. The technology is certainly being applied in urban areas. First and foremost, it has been, I think, sort of incumbent on our board and on me to emphasize the need not to forget rural America and rural poverty.

In fact, the truth of it is, most of the technologies that are occurring are occurring in urban areas. There is this—we are all focusing on the digital divide and whether it is available to our eligible clients, and we monitor that very carefully. In fact, one of the requirements we put on our programs is we have told them, you have to be in this discussion about where we will have public access ter-

minals and how they will be accessible, because you have to speak for the low-income civil, legal needs of eligible clients. If you set up, if you presume, for example, that the courts will only be accessible by someone with a PC at their home, you have just cut out low-income people because they do not have a PC sitting in their home.

We have to be advocates for public access capability throughout the community if that is going to be the way that anyone really enters into the justice system. I think that is where the justice system is going. We have to be at the table to do that.

So one, the grants that we receive will clearly involve urban areas. Two, we are at the table now, both as the corporation and in our recipient networks where decisions are being made about how people will enter the justice system, and we want to be the advocates for low-income people to make sure that isolated communities or isolated parts of the country, whether they are rural or just as isolated as you pointed out in the middle of skyscrapers.

Ms. ROYBAL-ALLARD. A lot of these communities have people that have limited English skills. Will the services be available in Spanish or some of the Asian languages?

Mr. MCKAY. Absolutely. The Orange County program has done a tremendous job. I was told, I do not know how many number of different languages there are, but it is a huge number, as you know, and their telephone access system which I have observed in operation has available Vietnamese speaking, obviously Spanish speaking, Chinese, and they are on call to come into that system as a referral. Web-based, I know the Washington State Web-based access system has a completely separate entry point for Spanish speakers.

Ms. ROYBAL-ALLARD. In response to a question by the Chair to the Inspector General, I was actually surprised to learn that the procedures had not been reviewed prior to your implementation. I am trying to understand the thinking there, because if, in fact, the Inspector General is going to make an assessment of whether or not you have developed procedures that are effective and address the concerns that have been raised by this committee, would it not make more sense for the Inspector General to review the procedures first? And say yes, you are on the right track, rather than have you put procedures into place now that everybody is using, and now he is going to review them and hopefully this will not happen, but he may say these procedures put in place are not any good, you did not do X, Y and Z. I am trying to understand what the thinking was here that did not get the clearance on the procedures before you implemented them?

Mr. MCKAY. If I may just ask the Inspector General to comment on your question and first indicate that, in fact, I have very much been in communication with the Inspector General, but some of the functions are separate functions in our offices. I believe they complement each other, but I think I should ask the Inspector General if he would be willing to comment if that is all right with you.

Ms. ROYBAL-ALLARD. Sure.

Mr. QUATREVAUX. First of all, there were staff exchanges. Our views were solicited, and they were provided at a staff level. But those exchanges were based on the work we had done prior to that time, and we have really no way to know whether these procedures

will be effective when implemented without testing them, and that is what we are going to do this spring.

Ms. ROYBAL-ALLARD. But you did have input?

Mr. MCKAY. Absolutely. Absolutely.

Ms. ROYBAL-ALLARD. In my district in Los Angeles, there is the Legal Aid Foundation of Los Angeles. They have started or have expanded their services. I would like to, if I may, Mr. Chairman, just tell a story about some apartments in an area of my district, it is Cambria Apartments.

What was happening there, it was a slum, it was rat infested, it was one of the major drug trafficking places for that area. The complaints of the residents were falling on deaf ears. The landlord did nothing. Eventually what happened is they went to legal aid, they started paying their rent—giving their rent to legal aid, and the landlord actually abandoned the apartments.

Then legal aid assisted them in obtaining ownership. They helped them with the financing, all of the legal issues necessary. As a result, what was once a slum is now a very, very nice apartment. It is owned by the tenants, it has given them a sense of self-worth and independence that they did not have before.

Legal aid tells me that this kind of transactional representation is becoming an increasing part of their portfolio. My question is, is this something that is unique to Los Angeles, or is it something that is happening in other parts of the country? They are also helping with the legal process, for example, in establishing day care centers in these areas which are very important in communities like that so people can go to work and have their children taken care of.

So is this something that is unique to Los Angeles or is it happening elsewhere?

Mr. MCKAY. No. But I want to say that the situation you described is a wonderful event, just the wonder of what they accomplished in that community in a way makes it unique. I have been to the Cambria Apartments and toured them with the new owners and was very, very impressed. Economic development of that kind, which is really a representation of low-income communities, we certainly encourage that. I toured a brand-new hospital in Brooklyn which was accomplished in the same way. Legal aid lawyers representing the community helped bring a new hospital into a low-income neighborhood in Brooklyn where there was no health care.

My view is that while that is not individual representation, whether it is the community, business owners or other stakeholders in the community, nobody wants a rat-infested apartment, and it is clearly something that everyone can agree is a benefit to all of the community and to the low-income community to pursue that kind of representation. That was very intensive legal work—to allow the development of the Cambria Apartments—and to build the hospital across the way in Brooklyn was tremendously time consuming and hugely valuable. I have been to both places. A number of our programs across the country have dedicated resources to community development successfully. We want to encourage that as we represent more and more clients.

Ms. ROYBAL-ALLARD. Mr. Speaker, do I have time for one more question?

Mr. ROGERS. Sure.

DOMESTIC VIOLENCE

Ms. ROYBAL-ALLARD. For several years, you have proposed a $15 to $20 million initiative regarding domestic violence. I notice that you do not have that in your budget this year. Yet, my understanding is that domestic violence is just as serious a problem as it always has been. Can you tell me how you are responding to this need and whether or not the Violence Against Women Act has been helpful to such an extent that you no longer need this additional funding?

Mr. MCKAY. No. Let me see if I can clarify that.

First of all, I think responding to the concerns of the subcommittee, as stated by the Chairman over the last two hearings, we took a look at the basis for our request, which was listed as increasing programs for domestic violence. I think all of our field funds should be on call for representation of domestic matters, most of which have to do with either violence or the threat of violence against women and children. And so I think every single dollar in our field funds is on call for that. We do not in any way signal a decrease in the commitment of legal services or its recipients to domestic representation and certainly domestic violence. We have been more successful, and I think through, in large part, the attention of the Chairman and this subcommittee in winning the award of grants to our recipients, LSC-eligible recipients.

We have had an increase, in part because this committee has focused on the availability, helped us with the Department of Justice who I would like to commend for opening up their guidelines so that more can receive them. But one is not a replacement for another. Clearly the core of our requested increase, the 8 percent increase that we have requested so that we can continue to represent our most vulnerable clients and those who are subject to violence, we cannot say enough about the need that they face.

Mr. ERLENBORN. I might add just one thing and that is that every recipient program, their board must establish priorities, what kind of cases would come first, so that they can utilize the limited funds for the most important. I believe every community has violence against women as one of the top priorities.

Ms. ROYBAL-ALLARD. Thank you, Mr. Chairman.

ACCOUNTING FOR FEDERALLY FUNDED CASES

Mr. ROGERS. Thank you.

Now, the 2000 Conference Report required that you tell us the feasibility of providing separate accountings for the federally funded cases as of June 1st of this year. What are you doing toward that requirement?

Mr. MCKAY. I am sorry, I did not hear the first part.

Mr. ROGERS. Federally funded cases, an assessment of feasibility for providing separate accountings for federally funded cases.

Mr. MCKAY. Well, we are studying that issue as the conference report asked us to do. It is a difficult question to answer because, of course, our programs, as we requested them to do, have obtained other sources of funds. All of those funds bear the restrictions imposed by the appropriations language in 1995 and since then, but

it is a difficult task to account for a Federally funded case versus a non-Federally funded case. You assign the overhead of the office, for example, to a case you might have pursuant to an HHS grant or to a VAWA grant. But we are studying that, and I think that is the purpose of the inquiry and we will provide a report to the Congress.

We have been urged in terms of looking at the CSR question to count all of the questions that we undertake. That is the most valid way to determine the effectiveness of the Federal dollar. But, Mr. Chairman, it is a difficult issue and we are struggling with it but we will provide you and the subcommittee with a report.

Mr. ROGERS. We are looking forward to hearing from you. Now, we also required that you submit an assessment of the feasibility of requiring grantees to submit case service reports on the Federal fiscal year basis instead of a calendar year basis. What is your assessment of that?

Mr. MCKAY. I think that is going to be a really difficult task for us to meet. We have always—I think in the near term when we look at 2000, calendar year 2000 case reports, most programs are working with case data software which has been in place for some time. That would be a difficult adjustment. If the committee directs us to change it, then of course we will require our systems to do that. I do not think it is a wise request at this point. It is a wise request to have a study, but I do not think it would be, at this point, a wise decision to make, to change the reporting time.

Mr. ROGERS. Why?

Mr. MCKAY. Well, because our programs have built into—we have learned that we have something like over 50, maybe 70 different case management softwares around the country. To make this adjustment would be, we are told, difficult and require a significant investment into a system that we think is going to change radically anyway, as I reported earlier to the subcommittee. We are going to develop performance measures that are going to be substantially different. As we build into those changes and as we create the kinds of systems that are necessary, I think that is the time to build into whatever reporting mechanism the committee asks us to build in. Of course, we will do whatever we are asked to do by the committee and the Congress.

Mr. ROGERS. Chairman Gekas, the authorizing chairman before whom you testified about all of these matters some time back, has communicated to us and suggested that the corporation in 2001 ought to provide Congress with accurate case reporting data on a quarterly basis instead of an annual basis. What do you think about that?

Mr. ERLENBORN. Mr. Speaker, if I might address that. There has been a lot of talk about the accuracy of the CSR data. In all of the talk that I have heard or comments that I have read, I have never heard that there was a problem with timeliness. The question is getting accurate data, and it would seem to me that getting it on a quarterly basis would not aid the Congress.

What you want is accurate data on an annual basis because you make annual decisions. It would be a great burden on the recipient programs, and it would probably mean spending money again on paperwork and, in my view, unnecessary paperwork and unneces-

sary activities. It would take away from the ability of programs to provide legal services.

CARRY-OVER SPENDING ON TECHNOLOGIES

Mr. ROGERS. Now, in the current year, we gave you $4.3 million, an increase of $4.3 million, plus the ability to use carry-over funds for technology projects, including *pro se* representation, and other prevention and self-help matters. How much carry-over do you expect to spend for technology?

Mr. MCKAY. Well, I think that our carry over is really obligated in the current year. We have an accounting basis, and so there is sometimes a misperception about how much fluidity we have in terms of carry over. What we have and what might be unspent we will certainly use in terms of field grants. We just do not anticipate that we will have substantial carry over for technology use. We appreciate, however—may I add, Mr. Chairman, that we certainly appreciate the flexibility so that if we do have available management funds, that we may be able to grant those out.

Mr. ROGERS. What type of activities would you be funding, and how will that help increase the number of clients?

Mr. MCKAY. Well, in addition to the Web-based technologies that are part of the RFPs that we expect to issue within the next couple of weeks. We have in Florida, for example, a Web-based, but two-way conferencing, video conferencing capability that has been developed by Florida Rural Legal Services that we are very excited about. It is called the ICON program. What it allows for is a very cheap PC with a, perhaps you have seen them, little teeny camera that sits on top of the PC which really, for very cheaply, can be placed throughout what for them is a very broad service area. But we have others just like that. We are looking for those kinds of innovative technologies that we might be able to use.

So I think the Internet is probably the first. Telephone brief advice and referral services are another. We have some that have gone to mobile offices that are attempting to use through cell technology and other access to the Internet an ability to extend the reach of legal services lawyers. So I would say access through telephone systems that are sophisticated, Web-based systems which offer us a myriad of suggestions and frankly, Mr. Chairman, we have a number of innovative programs out there that have not had the opportunity to try and address some of the unique challenges they face in their service areas. And we think that through the flexibility that the subcommittee and the Congress have given us, we will draw some of these out and our objective is to replicate them across the country. We are very excited about this.

Mr. ROGERS. Are you proposing to offer these grants exclusively to your grantees, or would you open the grants beyond the grantees to include such things as law school clinics, bar associations, other interested parties who might have innovative ways to deliver their programs?

Mr. MCKAY. Well, our current proposal is for LSC recipients. We have asked for the flexibility to go beyond our recipients for one reason, and that is that the local programs, pursuant to our initiative to work with courts, law schools, other providers, people who are working with our client communities, it may be more beneficial,

for example, to piggyback on to a Web that already exists through a local court, because the courts are moving heavily into Web-based access. While we do not see this today, we think in future grants that we may be facing the opportunity to award these grants to someone other than our recipients.

So we certainly will utilize these for our recipients, but we would like the flexibility, if it is possible, to work more closely with law schools and courts and others.

RESTRICTION COMPLIANCE

Mr. ROGERS. Let me change gears rapidly here, and finally.

As we discussed last year, some law students, some LSC grantees, and some outside parties filed a lawsuit challenging the constitutionality of the restrictions the Congress had placed on the LSC. Those were upheld except for one on appeal, and the one remaining issue is the restriction on challenging welfare reform laws.

I understand from your written testimony that your petition for rehearing was denied, and that LSC has petitioned the Supreme Court to review the welfare issue. Is that correct?

Mr. MCKAY. That is correct.

Mr. ROGERS. When do you expect the court to decide whether the grant is certain?

Mr. MCKAY. That is a very good question. We have a number of guesses as to when that might occur. I would suspect that we will not learn anything until late in this year, if then, probably early part of next year. It will be some time before that issue is considered by the Supreme Court.

Mr. ROGERS. Well, before the enactment of restrictions, you had not defunded or severely sanctioned any grantee in over 15 years. In 1998, three grantees were disciplined for violations of restrictions. The Inspector General has collected audits of a number of grantees. Can you update us from last year's hearing and describe for us any violations of the restrictions or LSC implementing regulations that were found in 1999 and what, if any, disciplinary actions that you took as a result.

Mr. MCKAY. Well, we have had a very active Office of Compliance and Enforcement in calendar year 1999. Those visits continue. Much of our attention was drawn to the CSR issue, but we learned, as you point out, Mr. Chairman, that some of our review, of course, turned up questions regarding violations of our regulations, and therefore some of the congressional restrictions. We have not found in any of those visits a pervasive case of violation regulations, I think this is correct, since we visited the previous program in Oakland, California. And following our findings in Oakland, California, we dismissed that recipient and asked another LSC recipient to take over its administration.

We have conducted approximately 13 visits in 1999. They involve a number of issues. The core, maybe more than half of them, began as CSR visits to follow up on CSR issues. Some were complaints which were investigated by our program. Some were follow-ups to referrals from the Inspector General's Office.

In each of those cases, and I think the Inspector General's audit reports will show this as well with respect to his visits, the corrective actions that were taken by programs have dealt with any

issues that were found. Certainly from the Office of Compliance and Enforcement standpoint, we have not found a similar situation that was exposed in Alameda.

In our State-planning initiative, we have worked with States, and the decrease in the number of programs I think in LSC over the past 2 years, Mr. Chairman, is worth noting here. Part of what we have done is we have been moved by a desire to increase and improve the quality of legal service for low-income people. Part of that has involved either the merger or consolidation of some programs that were not doing the very best job for low-income people, and they simply are not providing that service any more, they are being provided by someone else.

So we have been very active, we have been on the ground, we have concluded that we need to be in the field more for compliance review, and we have asked for some additional resources to do that. I think the Inspector General would join me in indicating to the subcommittee that it would be useful. We have asked for resources to make up to 40 program visits per year, to make sure that we are complying with the congressional requirements, and to make sure that we are not violating any of the restrictions. I think the Inspector General would join us in making that recommendation.

Mr. QUATREVAUX. Mr. Chairman, I would like to point out that my office oversees compliance-checking through a system put in place by this committee several years ago, which relies on the annual audits of grantees by independent auditors in their areas. In October, I sent to the committee a report reviewing the 3 years of their work. It indicated that while a number of deficiencies were reported, none of these were of the type that we call practice restrictions; that is, violations of the restrictions that were essentially put in place in the 1996 appropriation.

Let me correct that. In the first year, there were three, but two of those were transition-related where the grantees could not withdraw from a case quickly enough because of limitations imposed by the court or the State in another case.

We then turned our attention to how good a job are these local auditors doing in checking for compliance, and we have conducted I think over 70 what we call audit service reviews where we go out and we check the auditor's work papers to make sure that they check for compliance, and we included that in our report as well. In general, we have found that that system is working effectively.

MEANING OF PRESENT IN THE UNITED STATES

Mr. ROGERS. Now, finally, Mr. Erlenborn, at last year's hearing, we talked about the scope of what LSC is authorized to do to some degree. One of the questions dealt with a sub-grantee who had traveled to Mexico, allegedly to provide legal assistance to H2A workers, and that matter stirred up a question.

What does your mandate to serve those "present in the United States" mean? And you were heading up a commission that would be looking at that issue. Can you tell us where you are now with that question?

Mr. ERLENBORN. I just happened to bring a few copies of the report for anyone who has not had an opportunity to see it.

Let me first say that the board, in late 1998, authorized the commission. I was the chair, and that is why the commission and the report bear my name. We had a total of five law professors who served as the commissioners. One was not currently a law professor, but had been in the past. We conducted hearings, two hearings. One in North Carolina and one in California. We published an invitation to anyone who wished to give us information, to either do that in writing or, if they cared to, they could ask to be heard before one of the two hearings that we had. I can assure you that everyone who asked to be heard was given an opportunity to be heard. All of the written material was reviewed by either the members or the staff who would then inform the members as to the content.

It seemed rather simple when you first looked at the limitation on the appropriation, which, by the way, was changed in the early 1980s. It used to say that to be eligible for representation, an alien must be present—excuse me, a resident of the United States. The legislative history is extremely quiet. There is no legislative history as to why that phrase was changed to "to be present" in the United States.

As I say, at first view, you looked at that and you said well, that is pretty clear. It is not ambiguous, but it was in the context, because it did not say when the alien was to be present in the United States. Was it necessary that the alien be present at the time the action arose, at the time they first saw the attorney, at the time a lawsuit was filed, continuously over a period. If you get into a lawsuit or an administrative hearing, maybe over a course of years, does the alien have to be continuously present in the United States every day during that period of time.

So that was the question, really, that we found we were posed with; and we found that it was ambiguous, so we followed the rules of statutory construction based upon the hearings and the information we gained.

We came to—I have this in a very short form somewhere. Well, I can find it here. We came to this conclusion. The commission concluded the following—and there was an awful lot of work. We worked on this for over a year, as I recall.

The Commission concluded the following: for an alien—oh, before I read this, let me say, it has been called the H2A program. That is a segment of the aliens in this country who may be eligible for representation, and a fairly small segment, I believe. There are an awful lot of legally resident aliens, some permanent resident aliens who would be just as much affected as these temporary agricultural workers, the H2A workers.

So we are talking about a restriction that would have a great impact on a great many people who have been furnished with, if they otherwise qualify, have been furnished with legal services from our grantee programs.

But we came to this conclusion. The commission concluded the following: one, for an alien in one of the unrestricted categories, that would be those who are not H2A workers, whose representation is limited by law, only to those causes of action that may have arisen out of the contract the H2A worker had, so we called those the restricted category. As to the aliens in the unrestricted cat-

egories, representation would be authorized so long as the eligible alien is present sufficient to maintain residence or lawful immigration status. For the H2A workers, representation is authorized if the workers have been admitted to and have been present in the United States pursuant to an H2A contract and the representation arises under their H2A contract.

And in the larger, more extensive representation of the commission's position, we did say in both of those categories that no alien who had not ever been present in the United States could be represented by the Legal Services Corporation grantees.

I might, by the way, since this did arise because of legal services' lawyers going into Mexico to recruit clients, that the corporation and the president of the corporation took prompt action. The subgrantee was no longer allowed to operate under the sub-grant. The grantee, since the action was taken, must run the H2A representation itself.

But that is what the commission concluded, and I might say, there were many good reasons for it. I will not take the committee's time to go into it, but one would be, for instance, that if you said that the alien had to be continuously present—as I say, this might be over a period of several years, an attorney, the legal services attorney representing that alien would have to keep in constant communication to find out if that alien crossed the border into Canada, flew over to Italy to visit relatives or attend a funeral; and, if that happened, then the legal services attorney would have to go into court and try to withdraw from the case. He may run into ethical problems and problems with the court if the attorney did that.

Mr. ERLENBORN. So there are some very practical reasons why we believe that the congressional intent—and that is what we were looking for under the general rules, the congressional intent—could not have been to deny representation to people in that category.

And lastly as to the H2A workers they are here for a specified period of time and must go back. That period of time, by the way, may be shortened by the employer by firing them. So if the case arose on behalf of an H2A alien, and we said that the alien had to be here present in the United States for representation, the employer who might have been the defendant in that case would have the ability to deny representation just by firing that worker who would then be required by our immigration laws to return to the country of origin.

So there are very good reasons, I think, for the conclusion that the Congress could not have meant these absurd results.

Mr. ROGERS. So, these will now become the regulations by which you will live?

Mr. ERLENBORN. At the present time, there is guidance that has been given by the general counsel and the board must decide for itself. But I think it is likely the board may take this up and draft a regulation incorporating, to the extent the board thinks it is proper, the recommendations of the commission.

Mr. ROGERS. So is this your final answer.

Mr. ERLENBORN. Final answer.

Mr. ROGERS. Well, now that you have settled the question of what "present" means, can you take on the chore of telling us what "is" is?

Mr. ERLENBORN. I have given up on that one.
Mr. ROGERS. Mr. Serrano.
Mr. ERLENBORN. A higher authority than I has not been able to.

REACHING THE POOR

Mr. SERRANO. That is the next hearing.

Just one final issue. And I am sorry, I stepped out, if I missed this. Stop me, Mr. Chairman, if I did. But there seems to me to be a contradiction in how you are trying to bring information to the needy. On the one hand you have to and you do use the new technologies that are available. But on the other hand, the poor are the least able to use technology at this point, not having it available to them, so there is a contradiction in that. How do you compensate for that?

In our office we have made very serious efforts to communicate with folks. And we have our Web page and are one of the few Members of Congress with video conferencing. And yet I am embarrassed or sorry to tell you that most of my e-mail is from outside of my district. It has nothing to do with the fact that, as the Chairman knows, I am a man of international issues. They use what is available. For people from the South Bronx that write to me, the machine, the equipment is not there.

So how do you deal with that in trying to reach the poor? And secondly, are you allowed to advertise, if you will, your services in other means like schools? It might be that children are leaving their parents behind in poor communities because children have more access to computers at schools than parents do at home. Are you allowed to use those facilities to make your services known?

Mr. MCKAY. Just when I was starting to feel good about some of our accomplishments. That is a real tough issue for us. We do not have adequate resources to provide the kind of community law office that probably was envisioned in the Legal Services Corporation Act. And so what we are trying to do is make careful choices and to ask our local programs to make careful choices about how to use technology.

I guess I am just old enough to appreciate the benefits of technology in this way. I know how to use a computer. I see what its benefit is; I am enthusiastic about it, but I still used a slide rule in high school physics so I have some question about its utility. I think fundamentally what we do in legal services is provide legal counsel and advice and representation. That is never going to happen through a computer alone.

And so we have said, you know, be open to the use of technology where it will represent clients. You missed an earlier exchange that I had where we recognized and acknowledged the digital divide that exists for our clients and what we have said at the core is get to the table so that when the courts set up programs, they don't bypass low-income people. Our commitment is to continue to emphasize the need for a continuum of legal services. Some we can reach through telephones, computers; and if we are advocates when they set up those systems, we will reach more low-income people. But we still have to have the dedicated lawyers and staff people and volunteers who will somehow be available to low-income people. We are missing way too many of them, as you know, Mr.

Serrano; and we have got to continue to seek the continuum of legal services and yet be open to the benefits that technology can provide our clients.

Mr. SERRANO. Does the law allow you to advertise, if you will, through schools or other institutions? I mean, when a child is in school, that child and that parent knows that there is a police department. They know there is a fire department. They know if they get sick, there is a local hospital. We can argue back and forth about the quality of services but that is different. But they know it is available.

Legal access—to me—is an essential need, an essential service, certainly one that is at the center, at the core of the beauty of this democracy. But some people who can't afford legal services do not know they can be available to them. Now, we advertise the census in schools and we encourage teachers to let people know that November 7th is Election Day, and I am one who believes children should be allowed to take home a booklet with every candidate to let their parents know who is running and so on.

But this service which is so needed in my community, are you allowed to step into other places to advertise your wares, if you will?

Mr. MCKAY. Let me mention three things that are happening in legal services that are encouraging. One, of our programs is high tech, one is through accepted media, and one is really low tech. The high-tech one I think that our schools today are becoming incubators for access to information through technology. And clearly the availability of web sites that are meant for low-income people is where we need to put additional resources and we are doing that. Maine, Washington State, New Mexico, Michigan, Minnesota, tremendous movement forward in terms of those kinds of technologies.

Secondly, the media. The media approach is through—more and more of our programs are coordinating through the courts, social service providers, schools—law schools, we are using things like public service announcements to bring people to the knowledge that there is someone who can help them. The fear in legal services is that when you tell people that the services are available it is like, you know, standing under the waterfall. The need is really huge. But we think that is the kind of pressure that should be brought to bear on our system. That we should know how many people really need our service, and we cannot provide it so we are using more in the way of public service announcements.

And the third one is a really low-tech solution. Our programs all across the country have been using it for years. It is called community education. They do not get one CSR credit for what they do, but we have legal aid lawyers and staff people and volunteers every single night of the week in programs at senior centers, schools, any place where people gather concerned about justice and their legal rights and responsibilities. And our legal aid lawyers on their own time are out there educating people about the availability of legal services and about their legal rights. And I think that is something that has escaped the notice of the benefit of Federally funded legal service. It has been around for years, and we ought to acknowledge it. And I certainly, as the President of Legal

Services, commend those people. They are not getting overtime and they are doing a great job.

Mr. SERRANO. Thank you.

CLOSING

Mr. ROGERS. Well, again, thank you very much for your testimony. And Inspector General, thanks for being here as well. You have got a tough chore. You have been under a lot of fire, the agency has, for several years. It seems to me that we are making some real progress now toward straightening out the agency. And being sure that we are doing what we are supposed to if not more than that. I think there have been times in the history of the agency when they got in the most trouble it seems to me when some of the grantees, subjectees, went beyond the legal scope of what LSC was supposed to do.

And it seems to me like you are making progress in reigning in those grantees and we commend you for that. We think you are on the right track.

And I think we are a lot better off this year than last at this stage of the game. But it is early in the season.

So thank you for your testimony. Thank you for your good work, and we look forward to seeing more progress.

THE HONORABLE DAN MILLER
ON BEHALF OF THE HONORABLE SAXBY CHAMBLISS

Question 1:
The Georgia Growers Association, in the spirit of cooperation, agreed to allow GLS outreach workers (often accompanied by one or more attorneys) to meet with H2A workers to apprise them of their rights. The agreement included GLS's pledge that many problems discovered, as a result of these meetings/interviews would be brought to the attention of the growers for solution prior to any litigation/official activities. This agreement was breached several times, the most notable being the lawsuit against Hamilton Farms located in South Georgia.

Does this not overstep your role by providing attorneys in attendance an opportunity to solicit complaints that would then result in lawsuits?

Answer 1:
The Director of the Georgia Legal Services Program confirmed that the relationship between the Georgia Growers Association (GGA) and her program has been cordial and productive in the past. Georgia Legal Services Program Migrant Farmworker Project ("Project") staff did reach an agreement in 1998 with the Georgia Growers Association ("GGA"), through its agent Dan Bremer, that recognized the interests of the farmworkers in obtaining information about their legal rights, the interest of the Project in being able to talk with farmworkers while they were on the growers' property, and the interests of the growers in resolving problems informally. In most instances, informal resolution of problems has been productive and efficient, and since this agreement was reached, many problems in fact have been worked out informally.

However, at no time did Project staff relinquish their ability to exercise independent professional judgment concerning the best legal strategy to solve any given client's problem. Nor could they have done so consistently with applicable Standards of Conduct administered by the State Bar of Georgia; the LSC Act explicitly recognizes this point in 42 U.S.C. δ 2996 *et seq.*[1] In the case of the litigation against Hamilton Farms, the Project attorneys handling the case determined there were reasons why the issues presented could not be resolved consistent with the clients' goals by informally approaching the grower involved. In any event, notwithstanding the assertion made in the first question, the only instance in which a lawsuit was brought instead of an effort to informally work out a problem has been the Hamilton case.

Project staff are well aware of the LSC prohibition on solicitation and are careful to comply with it. In addition, the LSC Regulations state that when a grantee files a complaint in court or engages in litigation or pre-complaint settlement negotiations with a prospective defendant, the attorneys must notify the defendant of the nature of the complaint unless the attorney "reasonably believes that delay is likely to cause harm to a

[1] Section 1007(a)(1) provides that LSC, in the provision of grants and contracts for legal assistance, shall "insure the maintenance of the highest quality of service and professional standards, the preservation of attorney-client relationships, and the protection of the integrity of the adversary process from any impairment in furnishing legal assistance to eligible clients."

significant safety, property or liberty interest of the client." [Part 1636.2(c)] In this particular instance, the attorneys involved felt they were acting in the best interests of their clients by filing the lawsuit without prior notification.

Question 2:
What is the relationship between LSC/GLS/private attorneys/organizations such as Greg Schell/Farmworker Justice fund? Why is Greg Schell directing the activities of GLS in the matter of the Hamilton lawsuit? Why did one of his employees pose as a GLS employee to accompany GLS outreach workers when they met with the Hamilton's workers? Does this relationship allow GLS/LSC to use information gathered as a result of private organizations' exemptions from congressional restrictions/limitations/oversight to further their actions against H2A growers? (Class action lawsuits, travel outside US to solicit complaints?)

Answer 2:
The Director of Georgia Legal Services Program also confirmed that its attorneys routinely consult with attorneys in private practice, LSC-funded programs, and many other non-profit firms in a variety of contexts to provide high-quality representation for its clients.

Similarly, GLSP Migrant Project staff has a working relationship with the Farmworker Justice Project in Florida, of which Greg Schell is an attorney, and with the Farmworker Justice Fund in Washington, D.C. Neither program is LSC-funded. The Project has co-counseled with Florida Rural Legal Services (LSC-funded) in a court case recently settled with the grower. Additionally, other farmworker advocates are consulted about legal issues and common problems. Referrals from many sources, including FJP, are accepted, but an independent determination is always made of whether GLSP will provide services for the applicants and if so, what level and type of legal representation will be given.

Greg Schell is one of the most experienced farmworker attorneys in the country and provides GLSP with valuable information and services. GLSP feels they would be remiss not to consult with him or others of his caliber because of the complexity of representing farm workers. However, Mr. Schell is not "directing the activities of GLSP in the matter of the Hamilton lawsuit." Garay v. Southern Valley Fruit and Vegetable, Inc., No. 6:99-CV-74(WLS) (M..D. Ga.), to which Representatives Miller and Chambliss refer, is being handled by Georgia Legal Services Program attorneys Nan Schivone, Litigation Director Lisa J. Krisher (with 21 years of practice experience), and private practitioner William J. Cobb (with 25 years of practice), who is working on a part-time contract with GLSP.

Raul Barrera, who is not an attorney, was employed to help Georgia Legal Services conduct outreach at Hamilton Farms in 1998 because the Project was short of staff at that time. There were over 300 H2A workers from Mexico at the Hamilton Farm at the time and GLSP sought to provide workers information about their rights and responsibilities under the contract. Although Mr. Barrera may have spoken to some farmworkers who ultimately became plaintiffs in the Hamilton lawsuit, each of those individuals

independently later contacted GLSP for representation concerning the issues related to their wages and working conditions.

With respect to the last question in this paragraph, the Project has neither filed any class actions nor have staff traveled outside of the United States to "solicit complaints" or even see applicants or clients. The Hamilton case was not filed as a class action and GLSP is not attempting to have it certified as a class action. It was filed as a "collective" action under 29 U.S.C. Section 216(b) of the Fair Labor Standards Act.

Question 3:
Does the relationship between LSC and Farmworker Justice Fund also include collaboration with USDOL's Wage and Hour Farmworker Division Director Michael Hancock, a former executive director of Farmworker Justice Fund? Does this collaboration include such initiative [sic] as Wage & Hour [sic] recent unannounced enforcement of a heretofore unused (and UN-enforced) "notification of termination" requirement that was immediately used by GLS to support its contention that the Hamilton case should be class action? GLS is also presently Freedom of Information Acting [sic] the GA Department of Labor or notices submitted by several other GA H2A growers. Is this action by USDOL, which has been deemed unnecessary/unusable/burdensome by several states, an effort by Mr. Hancock and his FJF partners to provide anti-H2A LSC organizations new materials for their "fishing trips"?

Answer 3:
The Director of the Georgia Legal Services Program has informed LSC that Project staff did not communicate with Michael Hancock on any matter related to the Hamilton case, but it has discussed other issues in other cases with Mr. Hancock.

No one on the Project staff had any knowledge of Wage & Hour's initiative related to enforcement - or non-enforcement - of the "notification of termination" regulation at the time this lawsuit was filed, nor did they have knowledge of any change in policy by W&H in this regard. Another Project lawyer who is not working on the Hamilton case learned of the regulation in November 1999 after the Hamilton lawsuit was filed, but also was unaware of W&H's policy of enforcement related thereto. The first knowledge GLS had of any possible change in policy was Representative Chambliss's and Rep. Miller's questions.

Georgia Legal Services has filed requests under the Georgia Open Records Act (not the Freedom of Information Act) with the Georgia Department of Labor for information related to claims in other cases. Information reported by growers to the Georgia DOL has been found to be inconsistent with information provided to farm workers. GLSP has made a similar request in the Hamilton case. This is a common strategy employed by any lawyer representing any client where a government agency might have useful information. Failure to explore these avenues could be considered failure to represent one's client professionally.

LSC has also been assured by the Administration of Georgia Legal Services that they have not undertaken any "fishing trips" to seek information with which to create claims for clients. They have used only legitimate methods of obtaining information from government agencies in pursuing client claims believed to be of merit.

THE HONORABLE TOM LATHAM

Question 1:
Is it true that the 1.1 million cases subsequently reported to Congress as the annual caseload for the 1998 legal services program is the lowest reported case count in the history of the program?

Answer 1:
Yes. There are several reasons why this total was as low as compared to other years. *See Answer 3 for details.*

Question 2:
Am I correct to assume LSC is basing their FY '01 budget request based on these numbers?

Answer 2:
No. While we readily acknowledge that we have made reference to the number of cases closed in our budget requests in past years, these statistics have never been the cause of any increase in the amount of money we have requested from Congress. Our requests are based on what we feel is necessary to meet the mandate of this Congress and the LSC Act to provide low-income individuals in our nation with access to justice in order to resolve civil legal problems. Examining the history of LSC funding, it is evident Case Service Reporting (CSR) numbers have not been used as a measure to determine LSC's annual appropriation. As the following chart illustrates, there appears to be no correlation between the number of cases closed by grantees and LSC's annual appropriation.

Case Data*	% Change	Fiscal Year	House Committee Appropriations*	% Change (from previous year)	House Floor Action Appropriations*	% Change (from previous year)
1.56(1992)		1994	$415		$415	
1.62(1993)	+3.5%	1995	278	-33%	278	-33%
1.69(1994)	+4.3%	1996	141	-49%	250	-10%
1.66(1995)	-1.7%	1997	141	No Change	250	No Change
1.43(1996)	-14.0%	1998	141	No Change	250	No Change
1.46(1997)	+2.5%	1999	141	No Change	250	No Change

* All amounts in millions

We do, however, recognize that this information is important for Congress to better assess the performance of federal dollars in the national legal services program. We are strongly committed to ensuring Congress receives reliable and timely information about the work of LSC grantees. Over the past twelve months, the Corporation's management has worked diligently to improve guidance to grantees and to ensure better the accuracy of LSC CSR data.

Question 3:
If so, how do you justify a $35 million budget increase, despite your case numbers declining to 1.1 million from approximately 1.9 million?

Answer 3:
The 1998 Fact Book listed 1.46 million "closed" (resolved) cases and 471,600 "open" (not yet resolved at the end of the year) cases for 1997. The total of these two figures produced the 1.9 million figure. Thus, the decline in closed cases was from 1.46 million to 1.125 million for 1998. After resubmission corrections, programs reported 1.3 million cases to LSC for 1998. After analyzing the results of the Self-Inspection of 1998 CSR data, LSC further corrected the total figure, reducing it by approximately 100,000 for programs that could not certify and assuming a 5% error rate for those that could certify.

This reduction demonstrates a progressively more active and stringent process for checking the data and excluding cases that (1) are clearly not reportable, (2) may be ineligible, or (3) are probably fully eligible but are missing some documentation, such as a citizenship attestation signature. These factors produced the 1997 to 1998 decrease in the number of reported cases, as opposed to a real decline in the level of services being provided by LSC grantees. This reduction is still quite significant, as LSC has acknowledged, which is why we are continuing to work diligently to improve the reporting system at the same time we are working to increase our grantees' levels of service.

LSC justifies its budget request in the following ways, all of which will support LSC's ability to carry out its mandate to serve low-income individuals with civil legal problems according to the direction of Congress:

1. **$24 million increase for Program Services to Clients:** This will allow the grants to local legal services programs to be increased by 8 percent from the FY 2000 level. This increase will allow local programs to keep up with inflation, increase their levels of service, and provide legal assistance to a greater number of eligible low-income Americans. All anecdotal evidence and legal needs studies of the past show that most low-income individuals do not have the advantage of an attorney when they are in serious situations in which an attorney's advice and assistance would make a difference. LSC must begin to attempt to address these unmet needs.

2. **$10 million for Technology Initiatives (increase of $5 million from FY 2000):** This will allow LSC to continue this initiative begun with $5 million included as part of LSC's FY 2000 appropriation. LSC will use these funds to provide grants to LSC-funded programs that demonstrate they will use technology to increase legal information and assistance to low-income persons.

3. **$2.1 million for National Legal Needs Assessment:** LSC will use this amount to conduct a comprehensive national legal needs assessment ($1.6 million) and to fund pilot projects ($500,000) to collect data on the impact of federal funding on legal problems of the poor.

4. **$1.54 million for Compliance and Enforcement (Management and Administration):** This amount will be used to strengthen the Corporation's compliance and enforcement activities by increasing the number of on-site compliance visits. This would enable LSC to become proactive in its compliance role, partially in response to last year's findings by the General Accounting Office and LSC's Inspector General on the inaccuracy of CSR data and the lack of systems in place to correct these problems.

Additionally, LSC Management and Administration and LSC's Office of Inspector General are requesting nominal increases to make inflationary adjustments.

Question 4:
Could you please explain the expected results of LSC's new technology initiatives?

Answer 4:

We have designated three areas for our Technology Initiative Grants:

1. **Model Programs:** LSC will provide substantial grants to two or three states that will become models for other states and programs to emulate. These model states will integrate all that has been learned on using technology to improve intake, referrals, *pro se* pleading, and *pro bono* systems. These model states will then demonstrate to different members of the legal services community how they can work together using technology vehicles to deliver services to low-income clients on a timely, efficient basis.

2. **Innovation Grants:** These grants will be designated to developing new solutions to old problems. For example, the Internet is an effective way to deliver legal information, but clients must be able to access this information in an uncomplicated and easy manner. Additionally, clients will also need to receive hard copy instructions and pleadings, either produced by an attorney or by the client, from a delivery vehicle that is accessible and easy for them to use, such as over a computer with e-mail capabilities and a printer. For example, computers with e-mail and printers, linked to legal services offices, could be placed in locations easily accessible by clients.

Pro bono lawyers are a useful component of the legal services delivery system, but they are currently underused in the education of *pro se* litigants. LSC will use innovation grants to encourage grantees to think of new ways to involve the private bar in the delivery of legal services. For example, a *pro bono* lawyer with a camera on his computer could give *pro se* assistance without ever leaving his or her office. This assistance could be recorded and made available to clients 24 hours a day.

3. **Integration Grants:** These grants will be smaller, and designed to provide programs the ability to increase the technology level of existing projects. For example, state A might have a good set of client *pro se* materials in pamphlet form, but not enough funding to integrate the information onto a website. Such a task could be accomplished for as little as $10,000, and this category of grants will be used for these types of projects.

Question 5:
Among other things, didn't LSC advise the Subcommittee that auditing inaccuracies in the 1997 reports were, in large part, due to antiquated office technologies?

Answer 5:
Yes, LSC advised the subcommittee that some of the inaccuracies were due to outdated technology. Specifically, LSC required programs to completely automate their case reporting, and subsequently found that grantees currently use over 50 types of case management software to do this.

Question 6:
Was the FY '00 appropriation of approximately $4.2 million for technology upgrades not sufficient to resolve these problems?

Answer 6:
The $4.2 million LSC received in FY 00 for technology was directed toward "client self-help and information technology," not for basic technology upgrades within legal services offices. The conference report language stated this amount should be used "to provide technology grants to LSC grantees to be used to make basic legal information and court forms accessible to *pro se* litigants." Knowing its grantees have limited resources and that there are overwhelming legal needs in the eligible client community, LSC felt this additional funding would be used most efficiently in attempting to reach a greater number of clients faced with civil legal problems who are currently denied access to the justice system.

Question 7:
If so, why are you requesting additional monies for "...increased services through advice and brief service by developing centralized intake systems and exploring web based and e-mail approaches..."

Answer 7:
We are requesting an additional $10 million to continue the initiative begun with the $4.2 million we received last year. *See Answer 6.*

Question 8:
If not, why do you propose to dedicate monies to new technology initiatives when you still have unmet needs for upgraded equipment?

Answer 8:
LSC's top priority is ensuring that eligible low-income individuals receive high quality legal assistance as mandated by the LSC Act. LSC believes one of the benefits to be gained from technological advances is to increase access to that high quality legal assistance for eligible clients. From our experience, programs have increased significantly their computer capacities in the past couple of years. LSC will continue to encourage grantees to allocate funding, and to apply for a technology grant, to upgrade their computer systems as they relate to providing the best possible service to low-income eligible clients in their service areas.

Question 9:
Could you please give a scenario where information obtained from an "information kiosk" would be a sufficient replacement for a consultation from an LSC attorney?

Answer 9:
Ideally, every individual who needs legal assistance would have access to legal assistance from an actual attorney. Unfortunately, most LSC grantees have inadequate resources to provide this level of service.

For example, at an Oklahoma program in the early 1990's, clients were only seen on the first and third Tuesdays of each month. Potential clients were allotted only a limited number of appointments. When the number of slots for the week were filled, clients were told to call back the next week and try again. No priority was given to more important, pressing cases.

While it will never be an equivalent substitute to a conversation with an attorney, a visit to a "legal information kiosk" can provide important legal information and/or assistance. In an all-too-realistic scenario, an eligible low-income individual has received an eviction notice. He goes to the local legal services office for assistance. Unfortunately, due to limited funding, the program has had to eliminate landlord/tenant cases from its program priorities.

However, the potential client is referred to a kiosk located at the courthouse, or a computer terminal located at the library. Once there, the client can access, perhaps on a website, detailed information which gives step by step instructions on how to respond to the eviction notice. The client now has information that ensures he is an informed *pro se* litigant. Perhaps the kiosk or website can go one step further and actually provide the client the ability to "fill-in-the-blanks" of a standard pleading. Once the client fills in those blanks and prints out the document, he now has a pleading to file at the courthouse, the instructions on how to file having also been included at the kiosk or website. Now, a client who otherwise may have been evicted without representation, simply because he did not even know where to start the process, has the opportunity to present, *pro se*, his position on the eviction issue.

And this one kiosk or website can help not only this client, but all the other clients who also have received an eviction notice in that area. And unlike an attorney who only can only consult with one client at a time, this one kiosk or website can potentially serve all these clients, **simultaneously**, 24 hours a day.

The very same kiosk or website can also provide legal assistance information on a wide range of legal issues that impact low-income individuals every day. A client will not have to wait for the attorney who specializes in her problem to have an appointment available. For example, domestic violence situations can also be resolved, in part, using technology. A kiosk or website can provide to the client, or to a social worker assisting the client, the necessary information on preparing and filing a protective order, as well as explaining the procedure for making a court appearance. Since this information can be accessed around-the-clock, domestic violence victims may have the tools at their fingertips for immediately receiving important legal information. They do not have to wait for an attorney to report to work on Monday morning.

Of course, kiosks or websites are not the only way legal services programs are using technology to serve a greater number of clients. Other methods include workstations hooked to the Internet, video teleconferencing, and the use of web TV to make legal information and pleadings available to clients. Since current funds do not allow programs to provide every possible eligible low-income client the opportunity to consult an attorney, giving the client the benefit of the attorney's knowledge through technology is the next best thing.

Question 10:
Wouldn't the resources dedicated to these kiosks be better used if dedicated to actual program services to clients?

Answer 10:
These kiosks *are* actual program services to clients. *See Answer 9.*

Question 11:
If not, why?

Answer 11:
See Answer 9.

Question 12:
Why is the reported annual caseload for the 1998 program about 360,000 cases less than the reported annual caseload for the 1997 program?

Answer 12:
Problems with the reporting of caseload by LSC grantees first emerged concerning 1997 data as the result of audits conducted by LSC's Office of Inspector General and a study by the General Accounting Office. By the time the seriousness of these problems was discovered, it was well into 1999. LSC felt it was more appropriate and a more efficient use of management resources to concentrate on the accuracy of 1998 case service reporting data, and therefore focused its efforts in that direction. In reality, by reissuing our guidance in late 1998 and through the subsequent actions taken to deal with the CSR problems, we positively affected the accuracy of 1999 data. LSC is confident that the 1999 data it reports to the subcommittee by April 30, 2000, which will be later analyzed by the Office of Inspector General, will be substantially more accurate.

LSC has also made it a priority to work on developing a new system that will do a better job of communicating information on the volume and types of work that its grantees are performing for low-income individuals. For example, the new system will keep track of the valuable work being conducted by grantees that does not fall under the category of "cases." *(See also answer 3.)*

Question 13:
In May 1999, LSC asked grantees to perform a self-assessment of reported cases. Could you please provide the results of the self-assessment and provide an update as to how problems identified in the assessment are being rectified?

Answer 13:
The 1999 Self-Inspection was for LSC grantees to examine the 1998 figures they had already reported to LSC and certify their accuracy within 5 percent. Of the 262 LSC grantees in 1998, 194 certified and 58 did not certify. The remaining programs were either exempted because of an extensive Office of Inspector General audit or Office of Compliance and Enforcement review of their figures (five programs), because they had since been merged with another program (four programs), or because they never submitted CSR data because they were defunded (one program).

The 58 grantees that did not certify had an overall error rate of 20.4%. LSC accordingly adjusted its estimated 1998 case totals downward by 102,000 to account for these errors. This adjustment was a part of the 175,000 reduction LSC made in the total of 1.3 million cases reported to LSC – the remainder being a 5% reduction in all other grantees' totals and some technical adjustments. Thus the adjusted 1998 totals were reduced from 1.3 million to 1.125 million; we believe that the adjusted totals for 1998 are, if anything, conservative.

Follow-up is being conducted with programs that identified problems during the Self-Inspection by phone and through written communications. LSC's Office of Compliance and Enforcement will conduct on-site visits for a select group (as limited by LSC resources) to ensure these programs are making changes that will correct their CSR problems. LSC is requesting additional funding in FY 2001 that will be used to further strengthen its compliance and enforcement activities by providing funding for more on-site visits of grantees.

Question 14:
Have you, or do you have scheduled, a formal audit plan to evaluate the controls LSC has in place at its headquarters to ensure the accuracy of the case information provided to the Congress?

Answer 14:
It is a top priority for LSC management to provide accurate information to Congress on the work being conducted by its grantees. Efforts are currently being conducted on several different levels to ensure the accuracy of CSR data reported to Congress.

1. **Self-Inspection:** Last year, LSC required each of its grantees to conduct a Self-Inspection of their 1998 case statistics submitted to LSC and to certify the accuracy of this information within 5 percent. As part of the General Accounting Office study conducted last summer, the GAO examined the Self-Inspection process devised by LSC and made several specific recommendations. This year, LSC is requiring its grantees to perform a Self-Inspection of their 1999 data, and has implemented all of the recommendations of the GAO to make this process even more extensive.

2. **On-site compliance visits:** LSC has conducted four on-site visits during FY 2000, and has five on-site visits currently scheduled for April and May 2000. In addition, LSC will conduct seven additional visits in FY 2000. A majority of these on-site compliance reviews involve either a mix of CSR issues with other elements, or are fully CSR-oriented reviews.

3. **Office of Inspector General assessment:** As required by the FY 2000 appropriations legislation, the Office of Inspector General will analyze the 1999 CSR data and report to the subcommittee on its accuracy by July 31, 2000.

THE HONORABLE DAN MILLER

Question 1:
It is my understanding that after the inaccuracies in your case reporting statistics were uncovered, you asked your grantees to verify with signature that their 1999 information was accurate. What percentage of your grantees was able to do this? What penalties did you impose on any that failed to verify?

Answer 1:
All but three (98.5%) of our current grantees have signed and returned the Self-Inspection form for 1999 cases. This form is a standardized questionnaire based on a sample of each grantee's cases that provides LSC with information on the level and types of errors that may have occurred in each grantee's CSR submissions.

Pursuant to a GAO recommendation, LSC developed a standard procedure and protocol for Self-Inspections. Answers to a standard list of specific questions have been recorded for each sampled case and the totals for the sample have been sent electronically to LSC. The individual sample forms will be preserved for review and audit.

The process is designed to determine what types of errors exist at each program, rather than simply produce a certification or a non-certification. This information is still being analyzed. At its conclusion, LSC should have the percentages of cases from each program that have one or more exceptions, so we will be able to determine not only each program's sampled rate of exceptions, but also what kinds of exceptions exist at each program. In the Self-Inspection of 1998 CSR data performed last year, LSC received this kind of information only for the programs that could not certify the accuracy of their data.

We cannot answer the question as to what percentage of programs certified, since the process was not a "yes" or "no" certification, but a certification that the sample was drawn and reviewed according to instructions. There was no certification of "reasonable accuracy." When we submit our report to Congress due on April 30, the plan is to use detailed analysis of this data to give Congress current reliable data for 1999.

Question 2:
The GAO reported last year that some of your grantees were failing to obtain proof of citizenship or financial eligibility. What have you done to rectify this?

Answer 2:
Enforcement of 45 CFR Parts 1611 (income eligibility) and 1626 (citizenship eligibility) are fundamental to all LSC Office of Compliance and Enforcement (OCE) work done both by on-site visits and through other follow-up methods. Numerous efforts have been made to ensure program compliance with these essential requirements, including ongoing assessment of any identified problems and telephonic or on-site review as necessary. Enforcement of the requirements of Parts 1611 and 1626 continue to be an active and ongoing effort of LSC. When issues are evidenced, LSC requires corrective action to remedy all problems. Corrective action oversight includes follow-up to ensure the adequacy of the corrective measures.

Regarding the specific five programs that were audited by the GAO, the current status of LSC's oversight is as follows:

Legal Aid Foundation of Los Angeles (LAFLA)

A two-week on-site review was conducted of this program. The program cooperated fully with LSC and minor continuing issues were evidenced. The program is currently taking continued corrective actions steps to ensure accuracy.

Legal Aid Foundation of Chicago (LAFC)

An on-site visit to this recipient is scheduled for May 2000. This visit was delayed due to the need to allow the OIG to first identify the programs it would assess as part of its current CSR analysis. As LAFC was not selected in the OIG's random sample, OCE will now conduct its review.

Legal Aid Bureau of Maryland
Legal Services of New York City

Both of these programs are currently part of the OIG's CSR sampling for 1999 data. However, both of these programs have not provided the information as required to the OIG and as such, the OIG has issued subpoenas to force production. Also, LSC has notified these two programs of its intention to suspend funding effective May 1, 2000, as a result of the programs' failure to cooperate, in violation of the law.

LSC management will await the resolution of these serious matters regarding these two programs before conducting its independent follow-up and enforcement.

Puerto Rico Legal Services

The follow-up for this program has been divided into two components. First, the issue regarding the destruction of records has been handled by the LSC Office of Compliance and Enforcement as a separate matter. A preliminary determination finding a violation of the law has been issued and further action will be taken.

Second, the CSR issues will be reviewed in an on-site visit to the program, which is as yet unscheduled.

Question 3:
How do you handle grantees who are not cooperative with the efforts of your Inspector General to investigate potential Case Service Reporting problems, or any other problems?

Answer 3:
The majority of programs has been cooperative with these efforts, and has put an overwhelming amount of staff time and effort into resolving CSR problems. In the case of two current

recipients who have failed to cooperate with the OIG request for data, the Legal Aid Bureau of Maryland, and Legal Service of New York City, LSC has notified the programs of its intent to suspend their funding, effective May 1, 2000.

Question 4:
Have there been any changes in the way you define a 'case' in your case reporting guidance since 1997? If there have been changes, please specify the difference between the two definitions.

Answer 4:
There have been significant changes in the definition of and the rules for counting cases since 1997.

A) TIGHTENING REQUIREMENTS

1) A requirement has been added that some actual counsel and advice or other legal assistance must have been provided to the client before a case can be counted. Thus, analysis and referral of a case to another legal services provider cannot be counted, nor can service be counted as a case where the client is accepted and work is done, but the client withdraws or loses contact with the program before any actual legal assistance is provided to the client.

2) Programs have been required to screen their submissions for "duplicates." A "duplicate" is not merely the submission of exactly the same case twice by computer or other error, but also any situation in which the same client returns to the program with the same legal problem in the same year. (The test as to how similar the issue in two separate requests for assistance has to be before it is counted as one case has presented significant borderline problems, but there have been a significant number of clear duplicates eliminated from the case reports.)

3) It has been clarified that if a case fails to meet any required eligibility criterion (financial eligibility, citizenship/eligible alien status, within program priorities, etc.) it may not be reported to LSC as a case.

4) Especially for 1999, LSC has substantially strengthened the documentation requirements for reporting a case to LSC. As a result, numerous cases have been excluded from reporting because they were not documented as meeting all LSC requirements, even though in many instances, it was overwhelmingly likely that the client and the case was actually eligible.

B) INCLUSION OF NON-LSC FUNDED CASES

1) Beginning with 1999 cases, grantee programs were instructed to report all cases closed that met LSC eligibility requirements, even if such cases were 100% supported by non-LSC funds. The prior rule was that the case had to be at least partially funded by LSC funds, as well as being LSC-eligible. This change is intended to make case reporting more consistent among grantee programs, since these programs have varying mixes of LSC and non-LSC funding and varying, legitimate methods of allocating LSC and non-LSC funding among their activities

which produce case closures. As a result, there have been artificial variations in reported case statistics among similar grantee programs. This method of case reporting will lead to much greater uniformity among grantee programs and will better capture the cases closed by these programs for LSC-eligible clients.

2) Furthermore, cases closed for the elderly and for battered women under the following specific programs may be reported to LSC in the absence of financial eligibility information, because these Federal programs require that clients be accepted regardless of financial circumstances:

Title XX Social Security Act,
Titles III and IV Older Americans Act, and
Violence Against Women Act.

THURSDAY, MARCH 16, 2000.

U.S. SMALL BUSINESS ADMINISTRATION

WITNESSES

AIDA ALVAREZ, ADMINISTRATOR
BERKY KULIK, ASSOCIATE ADMINISTRATOR FOR DISASTER ASSISTANCE
GREG WALTER, DEPUTY CHIEF FINANCIAL OFFICER
CHARLES TANSEY, ASSOCIATE DEPUTY ADMINISTRATOR FOR CAPITAL ACCESS
KRISTINE MARCY, CHIEF OPERATING OFFICER
DARRYL DENNIS, ASSOCIATE DEPUTY ADMINISTRATOR FOR ENTREPRENEURIAL DEVELOPMENT

INTRODUCTION

Mr. ROGERS. The committee will be in order.

We are pleased again to welcome to the subcommittee Aida Alvarez, the Administrator of the Small Business Administration.

The hearing will focus this morning on the SBA's fiscal year 2001 budget request. For fiscal year 2001, you are requesting $1.06 billion. That is an increase of $215 million or 25 percent above the comparable level enacted last year. We want to hear today how in a climate of limited resources SBA is improving its lending assistance programs to the nation's small businesses.

An outstanding feature of your budget is a significant improvement in requesting sufficient funding for the Disaster Loan Program for the first time in many years. We will want to hear more about that request as well as the pending supplemental request to respond to Hurricane Floyd.

As you know, I have insisted on realistic and adequate funding requests from SBA, and it appears that we are finally making some headway in that process. This year you are seeking substantial program increases, including a number of new program initiatives. We will be seeking to identify priorities within your request in recognition of our funding limitations.

We would also like to know what program and administrative efficiencies are being achieved, particularly relating to your portfolio management and systems modernization efforts, and what you see as the major opportunities and challenges facing SBA in the coming year.

We are very pleased to have you with us. In a moment, we will recognize you for your opening statement. We will make your written statement a part of the record, but before we do so, let me recognize my friend, Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman.

It is a pleasure to welcome the Administrator, a friend of mine to the subcommittee. It is good to see you.

The Small Business Administration has come a long way from when it was created in 1953 on a temporary basis to address problems facing small businesses. Today it is a vital component of American business, providing essential financial, technical and management assistance.

Ms. Alvarez, you have submitted a significant fiscal year 2001 budget request, and I look forward to your testimony to hear how the SBA will continue to assist our Nation's small businesses.

Mr. Chairman, I guess at every opportunity I will proudly remind the Committee that Ms. Alvarez and I go back a long way. How proud I am to see her in the position she is in and also perhaps to give her some of the blame for my success. She was the first journalist ever to interview me when I started out in politics.

Mr. ROGERS. Are you saying that she is responsible for your——

Mr. SERRANO. And I hope that you don't hold that against her budget.

Ms. ALVAREZ. I was a mere child.

Mr. SERRANO. She helped me out a lot.

I remember the first thing that we did together. I was looking at a rotten ceiling in a public housing project, and the picture was me pointing to the ceiling with a story by Aida Alvarez. She then became a big-shot TV reporter and told me one time when she was interviewing somebody else to please get out of the picture. I have not held that against her.

It is nice to see you, Aida.

Thank you, Mr. Chairman.

OPENING REMARKS

Mr. ROGERS. You are recognized, Administrator Alvarez.

Ms. ALVAREZ. Those are very mixed compliments there.

Good morning, Mr. Chairman and Ranking Member Serrano. I am sure that we will be joined by other members of the committee. I am pleased to be here with all of you today and appreciate having my written testimony entered into the record.

I would like to discuss SBA's fiscal year 2001 budget which I believe is an important part of our plan to keep this historic economic expansion going while reaching out to new markets that have been bypassed.

I think this budget has to be viewed in the context of today's booming economy. This is truly a small business economy. There are now 25 million small businesses in the United States, 5 million more than in 1990 and the most ever in the country. This steady increase in the number of small businesses and our desire to continue the economic expansion, including new markets, are the elements that have shaped our fiscal year 2001 budget proposal.

Our request of $1.06 billion primarily—you mentioned, Mr. Chairman, as a 25 percent increase is what I think we calculated as a 21 percent increase. Of this increase—about 1 percent goes to provide full disaster funding. Actually, 14 percent of the increase goes to our core programs, our traditional programs, and about 6 percent to new programs.

I hope you all have the charts that I made available. We had big ones, but this hearing room is too small so I am sorry everybody can't see these.

This first chart is really a very dramatic illustration of the way in which our core credit and investment programs have tripled in size since 1993, while their cost has been cut in half. In fiscal year 1993, for example, small businesses benefited to the tune of $8 billion in loans and investments at a cost to the taxpayer of $325 million. For fiscal year 2001, we project $20 billion in benefits for $200 million. So that is half the cost.

Our request of $200 million will deliver more than $20 billion of credit and venture capital assistance, which is up from $17 billion this year. On the loan side, what that means is an $11.5 billion program level for 7(a), up from the $9.8 billion appropriated this year, $3.7 billion in 504 loans accompanied by a reduced guarantee fee for the fourth year in a row, and $60 million for microloans, which is a doubling of that program.

On the venture capital side, we propose a $2.5 billion program level for the Small Business Investment Companies. We expect this investment to attract an additional $1.25 billion in private capital. With $3.75 billion in new SBA-leveraged funding, plus their on-hand private capital, we estimate the SBICs will be able to make $4.5 billion in investments in fiscal year 2001. That is an increase over what we have done this past year, where the SBICs made available $4.2 billion in equity assistance to small businesses, and that is really a dramatic figure. Fifty-three percent of all the venture capital deals done by institutional investors in the United States were done through the SBA's SBIC program.

In addition, this program has returned $131 million to the Treasury as the taxpayer's share of profits in SBA's participating security program.

What is not shown on the chart is the technical assistance that is a necessary corollary to our core debt and equity programs. Without the technical assistance, we wouldn't see the corresponding growth in the chart.

The budget proposes full funding, $88 million, for the Small Business Development Centers, which includes $3 million for a Native American SBDC network, $12 million to expand our network of Women's Business Centers, $10 million to maintain our One-Stop Capital Shops and to open new ones in empowerment zones across the country, $5 million for SCORE, up from $3.5 million this year, and $4 million for our veterans' program.

The next chart is one that shows how SBA bridges the gap throughout the country, and what we see is sort of a curve in terms of the size of assistance. We start out with microloans and then we see a big gap which we hope to fill with the New Markets Venture Capital Program, followed 7(a), 504 and SBIC venture capital.

From its beginning back in 1953, as Congressman Serrano mentioned, we started out as an experiment, if you will, but we have become a very important part of the economy by bridging the gap that the private sector alone could not fulfill. And in partnership with the private sector we have been a catalyst for small business growth and are doing so with 22 percent fewer employees than in 1990.

The Bridging the Gap chart illustrates the gap for venture capital needs. There is a significant lack of equity capital available for growth firms in rural and urban areas as well as Native American

reservations. Smaller-sized equity investments accompanied by technical assistance would bridge that gap.

The following chart shows you the kind of investment assets that are available around the country, and you can see a tremendous disparity between what is available from the private sector, what is being provided through SBIC currently, and the really tiny sliver that currently is available for these growth firms, these new market firms. In fact, what most resembles the new market venture capital companies that we are proposing are these community development venture capital companies. You can see from the chart that what they contribute is a mere sliver, $157 million for the entire country as of 1999, in a venture capital world where billions are the rule, not the exception. Right now, in the entire United States, there are only 25 such firms of which only 14 holding assets of over $5 million, and we consider $5 million to be the absolute minimum for economic viability.

The next chart, a map of the United States, gives you some idea of where these community development venture capital companies are located and where we are making investments through SBIC in low and moderate income new market type areas. There is a lot of empty space on this map, places that do not have access to equity investments. Most of the country is left out even with our own Small Business Investment Company program investing $800 million. Although there are quite a few in Kentucky, three, but there is also room for more in Kentucky and in other states.

Mr. SERRANO. I notice that there are two in New York.

Ms. ALVAREZ. There you go. We have taken care of the committee. We have actually gotten a lot of support for new markets venture capital from those community development companies in those States.

SBIC companies invested $800 million in low and moderate income areas last year, but the fact is only $66 million of those investments were new market type investments of a million dollars or less. Out of the universe of around $140 billion, only $200 million in investments went to our inner cities, our poor rural areas and Native American communities. The New Markets Venture Capital Program proposes to bridge that gap. Our request of $51 million will provide an additional $150 million in equity investments plus technical assistance.

Now, coupled with our desire to sustain unprecedented growth and to penetrate new markets, Mr. Chairman and members of the committee, Mr. Serrano, we have a solid commitment to maintaining the financial soundness of our portfolio. In fiscal year 1999, we instituted for the first time ever a safety and soundness examination program for our Small Business Lending Companies and examined all 14. We expect to complete a second round of reviews this September.

We have established an Office of Lender Oversight—and thank you, Mr. Chairman, for approving that reorganization—and a Risk Management Committee. We have completed our first full cycle of reviews for the Preferred Lending Program, PLP, and expect to complete a second round of reviews by April.

In addition, we request $14.3 million to fund our Inspector General. This level will ensure the necessary review, audit and oversight of SBA's programs and services.

Mr. Chairman, Mr. Serrano, Congresswoman Roybal-Allard, since 1990 our portfolio has grown from $17.5 billion to about $50 billion. At the same time, the number of our employees has decreased 22 percent, from 4,000 in fiscal year 1990 to about 3,100 now. This has been accomplished while keeping our fiscal house in order.

We are proud to report a clean opinion in our fiscal year 1999 audit report. It is the highest rating that a Federal entity can receive, and this was the fourth year in a row that we have attained this rating.

Joe Loddo is our new Chief Financial Officer, and I am sure that he will be working with all of you. He is doing a terrific job.

We have laid out an aggressive agenda to improve our internal management and infrastructure. We are requesting $13 million for system modernization, lender oversight and risk management activities, $7 million for information technology infrastructure and $4 million to train and transition the workforce.

As a result of these efforts, by this summer, for example, for the first time the majority of transactions with our lenders will be done electronically. We will have the most comprehensive electronic files ever on every single loan, and it will be available in real time as needed and will be the basis for some new analysis that has never been done before, and also the basis for monitoring risk.

Finally, in light of the important work done by the Office of Advocacy, we request an increase of $400,000 to $1.5 million. Advocacy just yesterday released its annual regulatory study which shows that Advocacy's work in cooperation with others resulted in changes to proposals that reduced the costs to small businesses by almost $5.3 billion. So it is working.

Mr. Chairman, this budget is very sound for fiscal year 2001. It fully funds the disaster program, the SBDCs. It supports the growing demand for our 7(a), 504, SBIC and microloan programs. It includes a modest number of new initiatives to help us reach out to areas bypassed by today's economy, and it does all of this while maintaining the safety and soundness of our growing portfolio, and moves us forward as a modern SBA.

Mr. Chairman, members of the committee, thank you for the opportunity to be here with you, and I will be happy to answer your questions.

[The prepared statement of Administrator Alvarez follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

STATEMENT OF

AIDA ALVAREZ

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

SBA'S FISCAL YEAR 2001 BUDGET REQUEST AND REAUTHORIZATION

BEFORE THE

SUBCOMMITTEE ON COMMERCE, JUSTICE, STATE AND JUDICIARY
COMMITTEE ON APPROPRIATIONS

UNITED STATES
HOUSE OF REPRESENTATIVES

MARCH 16, 2000

Mr. Chairman, Ranking Member Serrano, and Members of the Subcommittee, thank you for inviting me here today. I am very proud to present the U.S. Small Business Administration's (SBA) budget request for Fiscal Year 2001.

For small businesses and for the SBA, this is a great budget. It represents an unprecedented investment in the talent, drive, and entrepreneurial spirit of Americans. It recognizes the vital role small business plays in our economic growth and vitality. And, it delivers results at a fiscally prudent cost to the taxpayers.

A Decade of Success

There are now more than 25 million small businesses in the United States, five million more than in 1990, and the most ever in the United States.

Over the last decade, business ownership has grown even more rapidly for Hispanics, African-Americans, Asians, and for women. Hispanic-owned firms have increased 232 percent, African American-owned firms by 108 percent, and Asian-American and Pacific Islander-owned firms by 180 percent.

The number of women-owned firms has almost doubled to an estimated 8.5 million in the last 10 years. Women now own about one-third of all firms and employ 24 million people. These companies generated $3.1 trillion in revenue in 1997, more than triple the amount from a decade earlier.

And, small firms remain the job creators – they have produced a majority of the 20 million new jobs created between 1993 and 1998.

It has been a period of astounding growth and change. And throughout, SBA, working with this subcommittee, has adapted its products and services to contribute to the overall growth and vibrancy of the small business sector. Further, we have focused our help more clearly on those who need it the most. Our training, financing, technical assistance, and contracting opportunity programs are tools used to help build economic development in distressed inner city and rural communities.

SBA partners with the private sector to help fill the gaps that prevent people from owning their own business and that impede our nation's overall economic progress. To succeed we must fill gaps in both financial access and skills training, often at the same time.

Our lending policies have facilitated a dramatic expansion in the scope of private lending to small businesses. Programs like SBA Express, Low Doc, and Preferred 7(a) Lenders have fueled the growth by giving our lending partners greater responsibility and by simplifying the loan approval process for smaller and non-traditional loans.

SBA guaranteed 50,000 loans in FY 1999—loans that would not have been made without our support. Approximately a third of our 7(a) loans in FY 1999 went to start-up firms less than 24 months old. That is filling a gap. Since 1992, we have doubled our lending to African-Americans and Hispanic-Americans, while tripling our lending to women.

We also play a significant role in the availability of equity capital. In 1999, Small Business Investment Companies (SBICs) averaged less than $1 million per investment, while other venture capital firms averaged $6.2 million. In 1999, SBICs accounted for 53 percent of all institutional venture capital transactions in the United States.

In the area of procurement, small businesses achieved a 22.4 percent share of total Federal procurement. We were pleased to launch the Historically Underutilized Business Zone (HUBZone) Program. I am happy to report that nearly 900 businesses are now qualified as HUBZone firms.

SBA's Office of Advocacy worked to show agencies how their regulations could accomplish their policy objectives without placing an undue burden on small businesses. The Office's efforts save small businesses literally billions of dollars. Our budget proposes increasing funding for Advocacy's research and database to $1.5 million, $400,000 more than FY 2000.

To assist families and businesses hit by disasters, we approved 36,000 loans for a little more than $900 million in 1999. Our loans enabled firms to continue their business and retain 35,000 jobs.

Mr. Chairman, preparing to testify before you today gave me the opportunity to review the truly enormous changes that have taken place at the SBA. SBA is a great story of reinvention, about which this committee should be very proud. Now, we must continue to build on successful strategies and successes of the past to help small businesses meet the challenges of the future.

SBA requests funding of $1.06 billion for FY 2001. This budget will allow us to guarantee a record level of small business loans, finance record levels of venture capital, and support record levels of business development, technical assistance, and innovation. It gives us the resources to help create jobs and economic development in places the current economic expansion hasn't yet reached. It supports our continuing efforts to transform the SBA into a 21st century leading edge institution.

Finally, it fully supports our commitment to assist families and businesses recently hit by disasters. Mr. Chairman, we request full funding to allow us to provide $871 million in low cost loans for disaster victims.

New Markets

In his State of the Union address, President Clinton repeated his belief that more must be done to extend the benefits of today's economy to our inner cities, poor rural areas, and Native American reservations. He thanked Speaker Hastert for his bipartisan effort to achieve this common goal. We hope we all can come to an agreement soon that includes our New Markets Venture Capital proposal so we can start to put our FY 2000 appropriation to work.

This budget includes several proposals designed to make investment capital available to newer, smaller firms.

We request $21.6 million in budget authority to support a $150 million program level, and an additional $30 million for technical assistance for the New Markets Venture Capital program. Smaller size equity investment plus technical assistance are key to the long-term success of New Markets firms.

The cost of the program, which we calculated using the most conservative assumptions, will go down as we develop experience with the program. The long-term benefits are impressive.

Right now, there are virtually no institutional sources of equity-type capital in these distressed communities. Nationwide, the community development venture capital industry consists of essentially 25 firms with about $157 million under management. Only 14 of these funds are capitalized at $5 million or more—the absolute minimum for economic viability.

Our own analysis of these community development venture capital companies indicates that one direct job is created for each $10,000-$15,000 equity investment. On this basis, $51.7 million should generate between 13,300 and 20,000 direct jobs at a cost of between $2,600 and $4,000 each. If the indirect jobs are included, the cost is even less. We believe that this investment in New Markets will ultimately pay off in a big way.

SBA is requesting funding for other New Markets initiatives as well.

At the close of the last session of Congress you passed, and the President signed, a law establishing the Program for Investment in Micro-Entrepreneurs (PRIME). This program provides much needed technical assistance to very low-income entrepreneurs to improve their capacity to succeed in business. We request $15 million in budget authority for PRIME. In addition to serving the micro-enterprise industry generally, PRIME will perfectly complement our overall micro strategy.

In addition, we are making every effort to expand the reach of our existing Microloan program. We request $5.37 million to support $60 million in Microloans, along with $45 million for Microloan technical assistance.

We request $6.6 million for SBA's BusinessLINC program, which encourages large businesses to work with small business owners as technical advisors and mentors—especially in America's rural areas and inner cities.

We began accepting HUBZone applications last March. As demand increased we added staff and are now up to nearly 900 certified HUBZone companies in 47 states. We request $5 million to integrate this program into

our field structure, and broaden our outreach and oversight efforts to help this program meet its full potential. This compares to $2 million appropriated in FY 2000.

To better serve Native American communities and to honor the federal government's trust responsibility to tribes, the President's budget overall includes an increase of $1.2 billion over FY 2000 for key new and existing programs assisting Native Americans and Indian reservations.

Mr. Chairman, one of every three Native Americans live in poverty. On some reservations, between 40 percent and 60 percent of the population is unemployed. Fifty-three percent of Indian homes on reservations do not have a telephone.

We want to tap into the entrepreneurial drive within the Native American community. SBA's budget proposes $5.75 million ($3 million for Native American SBDCs, $1.25 million for reservation-based BusinessLINC, and $1.5 million for TBICs) to provide access to business development assistance that recognizes the cultural differences and specific needs of this country's Native American entrepreneurs.

Access to Capital

The SBA is filling critical gaps in the marketplace and helping those who have not shared in the tremendous economic growth of the past several years. Smaller loans are out there – but they are still hard to get. If you are from a distressed urban or rural area, if your business is newer, if you are smaller, if you lack sufficient equity, or an established track record, you are more likely to be turned down by a commercial lender. This is the gap that we fill and the unique value that we bring to businesses.

We request $274 million to deliver more than $20 billion of credit, venture capital and technical assistance. The $20 billion compares to $17 billion in FY 2000. Our request includes:

- an $11.5 billion program level for the 7(a) loan program, up from $9.8 billion this year;
- a $3.75 billion program level for 504 loans—and we propose to lower the guarantee fee for the fourth year in a row.

To encourage more lenders to offer loans in smaller amounts, SBA proposes to raise the guaranty for 7(a) loans of $150,000 and less to 90 percent. Relatively high transaction costs and the loss of smaller rural and community lenders is shrinking the financing options available to smaller businesses. Our 90 percent guaranty will encourage more institutions to lend using our 7(a) product, making capital more available at a more competitive price, and expanding financing options for small business owners. We also propose to simplify the guaranty fee structure for all loans.

We request $26.2 million in budget authority to support $2.5 billion in venture capital in the Small Business Investment Company program. We expect this investment will attract an additional $1.25 billion in private capital to the smaller and newer end of the venture capital investment spectrum. With the $3.75 billion in new SBA leveraged funding, plus their on-hand private capital, we estimate the SBICs will be able to make $4.5 billion in investments in FY 2001.

I am pleased to report that since the SBIC participating security program's inception in 1995, the SBICs have returned over $131 million to the U.S. Treasury as the taxpayers' share of their profits.

To appreciate SBA's success in assisting small business, we need to step back and look at the bigger picture. Since 1992 SBA has backed more than $71 billion in small business loans and venture capital. That's more than in the previous 25 years combined!

Safety and Soundness

Coupled with our desire to sustain unprecedented growth and to penetrate new markets, Mr. Chairman, is our solid commitment to maintaining the financial safety and soundness of our portfolio. We are a financial institution with more than $50 billion in our portfolio. Just like financial institutions in the private sector we have the fiduciary responsibility to make our lending decisions wisely and guard our current investments carefully. Anything else would be a disservice to our borrowers and lenders, as well as the Federal taxpayer.

In FY 1999, Mr. Chairman, we instituted—for the first time—a safety and soundness examination program for the Agency's Small Business

Lending Companies and examined all 14. We expect to complete our FY 2000 reviews in September. We established the Office of Lender Oversight and a Risk Management Committee. We completed our first full cycle of reviews for participants in the Agency's Preferred Lender Program (PLP). We expect to complete FY 2000 reviews by April.

In addition, we request $14.3 million to fund our Inspector General, to provide the necessary review, audit, and oversight of SBA's programs and services to the small business community. This compares to $11.5 million appropriated for FY 2000. The increase will allow the Inspector General to oversee areas identified as high priority by the Agency and Congress, such as loan monitoring and lender oversight.

Access to Training and Technical Assistance

SBA also fills gaps in the area of training and technical assistance, reaching out to new and non-traditional markets through our Small Business Development Centers, Service Corps of Retired Executives (SCORE) Women's Business Centers, One-Stop Capital shops, Tribal Business Information Centers (TBICs), and U.S. Export Assistance Centers. Our small business counseling and technical assistance programs provided help to more than a million entrepreneurs in FY 1999 alone—many of them are also loan customers.

For FY 2001, we propose funding of $88 million for Small Business Development Centers (SBDCs), including $3 million to fund an SBDC network in Native American communities. In addition, we are pleased to be working with the SBDCs in considering ways to grow their non-government resources and extend their reach to even more small businesses.

To upgrade SCORE's computer network, allowing SCORE counselors to communicate better among themselves and with the SBA, we propose funding of $5 million—an increase of $1.5 million from this year.

SBA's Women's Business Centers have more than tripled in three years, going from 18 funded centers to 59 (including 25 new WBC's in FY 1999.) The budget includes $12 million, up from $9 million in FY 2000, to expand our network of Women's Business Centers even further. The request would widen our nationwide network to more than 80 sites. It is our hope to have at least one center in each state.

SBA requests $10 million to maintain our existing One Stop Capital Shops and to open new ones in empowerment zones across the country. These community-based outlets provide hands-on assistance to help businesses start, grow, and provide employment in these distressed areas.

In addition, this year our budget proposes $4 million for our veterans programs, compared to $615,000 appropriated in FY 2000. We owe our veterans the best service possible when they are interested in starting or expanding a small business. Our request will fund research and outreach efforts to help us better tailor our products to the particular needs of the veterans' community. It will also fund the National Veterans' Business Development Corporation, which was created by Congress last year to help improve access to small business development training and counseling for our Nation's veterans.

Promoting Procurement for Small Business

The Federal Government spends nearly $200 billion for goods and services each year. This is a tremendous marketplace for America's small businesses. SBA works with the major procuring departments to ensure that small businesses receive 23 percent of these Federal contracting dollars.

Mr. Chairman, it has become increasingly difficult to maintain the level of contracting opportunities for small businesses. Over the past 10 years we have seen agencies increasingly rely on contract bundling. Unfortunately, bundling tends to limit procurement opportunities available to small businesses.

To counter the effects of contract bundling, we plan to issue a final rule later this year that will provide clear guidelines and procedures that we believe will curtail agencies practice of bundling contract requirements.

Small businesses, particularly minority-owned small businesses, often do not receive a fair share of government contracts. To help them become more competitive we are requesting $5 million for the 7(j) program. This program provides technical assistance and executive training to 8(a) firms and small businesses in areas of high unemployment or low-income. If we are to develop these minority-owned firms, we must provide targeted

Our research indicates that even after the firms in our Small Business Innovation Research Program have fully developed their products, they still lack the venture capital they need to market and fully commercialize those high quality technologies. Commercial venture funds typically are not interested in the types of investment opportunities SBIR firms present at that stage, referred to as phase III, of their development. We request $15 million in FY 2001 to fund the first-year of a three-year SBIR Phase III matching grant pilot program, designed to promote commercialization of the research and development (R&D) efforts by small high technology firms.

Modernization

SBA's workforce and the way we deliver programs have changed dramatically in the past decade, too. Since 1990, our loan portfolio has grown from $17.5 billion to about $50 billion. At the same time the number of our employees has decreased 22 percent.

We are devoting significant energy and resources toward improving our capacity to monitor our loan portfolio. SBA is building an early warning system of indicators and graduated enforcement remedies. We will soon have a new system in place that will enable us to better identify and manage portfolio risk and integrate SBA's system with those of private sector lenders.

Working closely with the Congress, SBA has recognized where the private sector could perform our tasks more efficiently, and has contracted out or delegated those activities. SBA is delegating greater authority than ever before to its lending partners. This transition permits greater use of staff for community outreach and greater attention to more complicated loan matters. Most importantly, according to our auditors, we are making the transition in a manner that is financially safe and sound. SBA received a clean opinion in its FY 1999 financial audit report, the highest rating an entity can receive. This was the fourth year in a row SBA attained this rating.

As you know we completed our first asset sale last fall and enjoyed great success. We realized an estimated $90 million premium over what SBA would have received had we held the loans to maturity. We plan a second sale in FY 2000 and are strategizing how to continue in FY 2001.

We are emphasizing the importance of improved internal controls and program oversight. We are upgrading and modernizing our information systems, offering every small firm electronic access to our products and services to extend our outreach and offer more customer-driven assistance. And we are transitioning our people to meet the challenges of the new knowledge-based economy.

We have laid out an aggressive agenda to improve our internal management. We request $13 million for systems modernization to improve our lender oversight, risk management, and program evaluation activities; $7 million for information technology infrastructure support; and $4 million to train and transition our workforce.

E-Commerce

SBA was among the first government agencies to create an on line presence. In the last seven years we have grown from no businesses served on the Internet to over 6 million small businesses served each week. We expect that number to double this year.

SBA's current activities include:

- Online Education, Training, and Counseling. The accessibility and affordability of the Internet offer businesses online counseling, distance learning, online classrooms, and web-based tutorials, e.g., SBA classroom, SCORE online.

- Access to Networks and Matchmaking. Increasingly, the new SBA is taking on the role of creating markets, fixing market imperfections where possible, and/or providing a platform for "buyers and suppliers" to connect and transcend the boundaries of time and distance. Some call this function electronic brokering, e.g., ACE-Net, PRO-Net, TradeNet, Tech-Net, HUBZones, Sub-Net, TM-Online, NewMarkets.

- One-Stop-On-Line-Shop for Government Information. SBA is providing anytime, anyplace access to Government information and services through its own web site and is developing and sponsoring

cross-agency gateways and portals, e.g., *U.S. Business Advisor*, TradeNet's *Export Advisor*, Women's Online Business Center.

This unique movement has leveled the playing field for unprecedented numbers of entrepreneurs from every background who seek to own their own business. But as always in business, this potential is accompanied by risk. SBA's small business customers cannot afford to overlook or fail to take advantage of the opportunities created by new technologies. And if technology is going to revolutionize the way small companies do business, then SBA must increase its own digital dexterity and focus its assistance on helping firms compete in the new economy.

To respond, we are creating an electronic SBA, one that can serve as an example for bridging the "digital divide" and help small firms take advantage of the technological revolution.

The budget includes $5 million to ensure that we provide more of our services electronically, and to ensure that all small businesses are able to participate in the opportunities created by e-commerce. Building on the success of our Y2K outreach initiative, where 1,300 workshops were attended by about 1.5 million small businesses, we will now work with the Department of Commerce and the Department of Agriculture to reach out to entrepreneurs looking to get on-line. For those who are on-line, we will expand our training, offering virtual classes on topics such as building a website, conducting e-commerce on the Internet, marketing your business on-line, bidding electronically and catalogue sales.

Conclusion

SBA's budget is a key element of the President's plan to maintain today's unprecedented economic expansion. The Agency is confident that our flagship programs and services—credit and capital, business development and technical assistance, and procurement assistance—are some of the best forms of Federal assistance to broaden access to small business opportunities, and help sustain our strong economy. These programs also make SBA even more vital in this Administration's strategic focus on new markets areas.

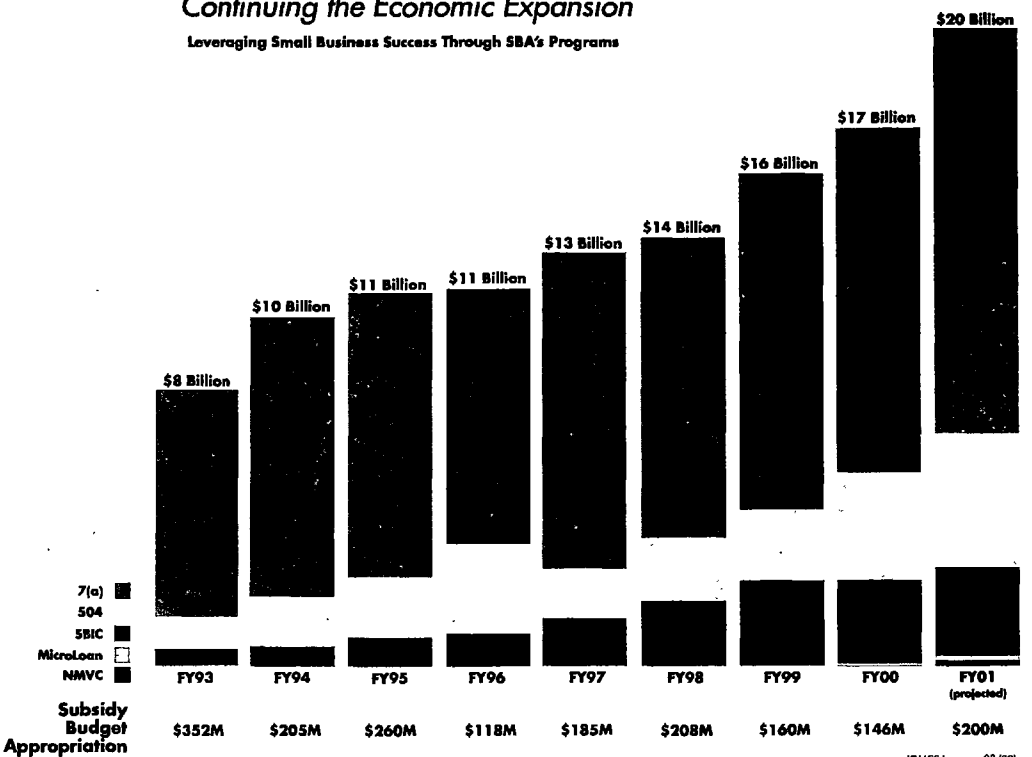
I look forward to working with you and the Subcommittee toward the implementation of this budget.

SBA It's a Small Business Economy

U.S. Small Business Administration

Continuing the Economic Expansion

Leveraging Small Business Success Through SBA's Programs



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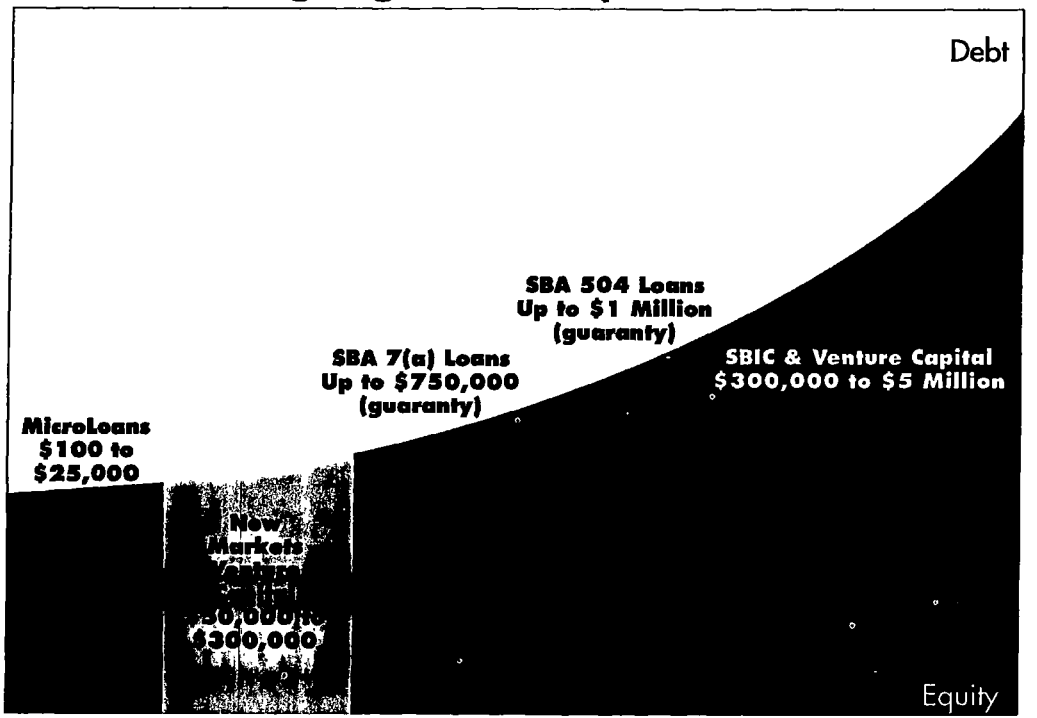
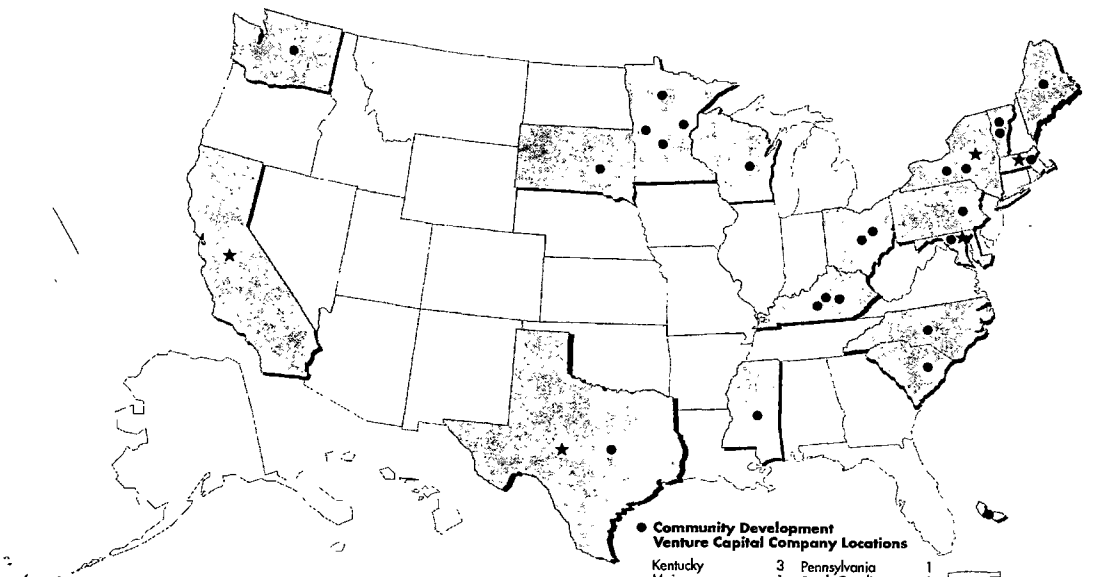
SBA Bridging the Gap

U.S. Small Business Administration



SBA Targeted New-Market-Type Investments

U.S. Small Business Administration



[OMCS CDVCC/LMI 03/00]

SBA
U.S. Small Business Administration

Investment Assets

Private Venture Companies

Small Business Investment Companies

$157M

Community Development Venture Capital Companies

DISASTER LOAN BUDGETING

Mr. ROGERS. Thank you for your testimony. I feel like declaring victory or celebrating because, finally, the budget request from the White House and the SBA for the disaster loan budget, which has been habitually shortchanged, even zeroed out, knowing that we would have to find the money somewhere, gaming the system, seems adequate this year. And I have had many talks with Jack Lew from OMB about this, and finally he and OMB and SBA have seen the light.

But that has been a constant irritant, as you recollect, between this subcommittee and SBA, even before you came on board. I know that it was not your fault. I know that it was OMB that was gaming the system, and finally they have seen the light. Nevertheless, I am pleased that you have at least made a request in your budget for monies for the Disaster Loan Program without saying that we are going to have to increase the interest rates on the disaster victims to pay for these disaster loans, which I think is absolutely, incredibly stupid—not to say unfair. These are the people who have been turned down by commercial banks, and SBA is the last resort, and here we are proposing in previous years to pump up interest rates on those poor people. Finally, that has ceased.

We have been consistent on that over time, and that is reflected in the fiscal year 2000 budget from the regular discretionary appropriation and only extraordinary needs are covered by emergency funding.

So you are asking for $296 million in regular discretionary appropriations, which would be sufficient to support a loan program of $871 million. Is that an average annual loan program level and a reasonable projection for next year?

Ms. ALVAREZ. Yes. I would be happy to comment. We use a 5-year average, which is consistent with what FEMA uses to estimate the costs of the program. We believe that this request is sufficient to meet the projected needs using that 5-year average.

Mr. ROGERS. It has varied widely. In 1998, it was $639 million; and 1999 it was $763 million; and in the current year it is $1.2 billion. In the past, you have estimated the level by averaging the past 10 years?

Ms. ALVAREZ. Yes, we did. This year, along with other changes which you noted, OMB agreed that FEMA was using a 5-year average all along. We were using a 10-year average, and OM13 agreed that it made more sense to have a consistent average. Actually, there is very little difference between the 5- and the 10-year average. Berky has the exact numbers, but the difference is negligible.

Mr. ROGERS. We marked up the other day in full committee the emergency supplemental. That includes $60.9 million for the Disaster Loan Program, $10.4 million more than the President requested for extraordinary loan demands due to Hurricane Floyd. Assuming that is enacted, would that give you enough money to meet your estimated loan demand this year?

Ms. ALVAREZ. Yes. Berky, do you want to add anything?

Mr. KULIK. My name is Berky Kulik. I am the Associate Administrator for disaster assistance. Yes, that certainly would give us

sufficient funding for the balance of the year, absent any mega disasters such as Northridge or a real killer hurricane.

Mr. ROGERS. This year will be the biggest year for disaster loans since Northridge, $1.2 billion. How much of the total can we attribute to Floyd?

Mr. KULIK. As of now, Floyd loans are running at $650 million for original approvals, which works out to $590 million against the appropriation. These figures are as of the end of February.

REQUESTED PROGRAM INCREASES

Mr. ROGERS. One aspect of your request that hasn't changed is the enormous program increases. The total amount of your appropriations you are requesting is $1.062 billion?

Ms. ALVAREZ. Yes, sir.

Mr. ROGERS. That is an increase of $215 million. It is 25 percent, if you take out the one-time projects.

Ms. ALVAREZ. Okay.

Mr. ROGERS. How much of that increase is for mandatory increase in pay and inflation?

Mr. WALTER. Good morning, Mr. Chairman. I am Greg Walter, the Deputy Chief Financial Officer.

Within our budget request for the operating budget, we have a $15 million increase, of which $11 million is for people, that is primarily the annualization of the pay raise that occurred this year. We have to annualize it to 2001 plus the President's proposed pay raise for employees for next January.

Mr. ROGERS. That is $15 million out of $215 million. That is quite an increase. That means that $200 million of the requested increase is for program increases?

Ms. ALVAREZ. That is right. I had mentioned earlier that 1 percent of that goes to funding of the disaster program; 14 percent goes to increases in our traditional core programs like 7(a), 504, SBIC, et cetera; and 6 percent goes to new program initiatives like PRIME, SBIR, Native American, SBDC, new markets and so forth. It is really a handful of new programs that we want to see funding for.

Mr. ROGERS. Correct me if I am wrong, you are requesting $40 million in new programs, $66 million for noncritical program increases, $65 million for increases in business loan programs, $19 million for increases in administrative initiatives. I have to tell you, without commenting on the merits of those programs, that we can't find that kind of money. It would be a miracle if we can find that kind of money. No agency under this subcommittee will get that kind of increase.

We need to have you prioritize for us. You have got to narrow down your wish list. I would rather hear what you would request that we do than have us blindly apply a meat ax to some of these program increases. So over the next several weeks we will want to hear from you ways to prioritize with the limited resources that we are going to have.

I say that in a constructive way. I want to be helpful, but we can't find those kinds of moneies to fund this agency. If everything in your budget request is a priority, I know that, but that means nothing is a priority because we have to know where you really

want to put the money with the limited funds that we are going to have.

Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman.

Let me just speak to the Chairman's comment, because I think it is important that we listen closely to the Chairman. What he is trying to do is get this issue solved before it gets to the House floor and conference.

There is a bit of history that we should know that I am very grateful for, and that is that last year SBA did better in conference than it has in many cases. That happened, but we should know that the chairman had been agreeable to all of the changes right at the time that we approved the bill on the House floor. It was my understanding with him that the SBA would do better.

So with all due respect to the White House, who did what they had to do in those last hours, I can tell you for sure that, as far as SBA goes, Chairman Rogers was on board with trying to make that budget better.

Ms. ALVAREZ. We appreciate that.

Mr. SERRANO. I say that to strengthen his comment that it is better that we set priorities now than thât it happens in conference. It is much better that way.

DISASTER LOAN PROGRAM

Just curiosity here, when you folks are putting together your request for disaster loans, does someone look at the Farmer's Almanac to see what was going to happen? You never thought I was going to know about that.

Mr. ROGERS. We have a Farmer's Almanac.

Mr. SERRANO. I was really born in the south, and she was born not far from where I was born.

How are those predictions made? Do you go based on what we had in the last few years?

Ms. ALVAREZ. Yes. That is the 5-year average. We just look backwards at what the cost of the programs were in the previous 5 years and make a simple mathematical calculation.

Mr. KULIK. Unfortunately, there is no way of telling what is going to happen during the year. The 5-year and 10-year average are only about $3 million apart.

Mr. SERRANO. Let me ask you a question which has nothing to do with this hearing. Is it television that is showing us more disasters or are there more disasters?

Mr. KULIK. Since 1989, disaster, unfortunately, became a growth industry. Prior to 1989, it was a relatively small operation. In 1989, we had an enormous hurricane on the East Coast, Hugo, and 30 days later we had the Loma Prieta earthquake in California and since then the Northridge earthquake.

Ms. ALVAREZ. It might lend some credibility to the global warming.

Mr. KULIK. The forecast is for increased hurricane activity for the next 5 to 10 years. Last year, we had Hurricane Georges, and that did a job on Puerto Rico; and the year ended with Hurricane Floyd. That covered the whole East Coast, 10 States.

Mr. SERRANO. Thank you for that. I was just wondering if I had noticed things differently or was something going on.

Ms. ALVAREZ. We all get a little older and don't remember as well. It happened in the past.

Mr. SERRANO. We are even now.

7(a) LOAN PROGRAM

First of all, I know the supplemental request that came down had funding for 7(a) but it was not included in the bill reported out of the Committee. Can you tell us what that situation creates and why there is additional need for loan subsidies for the 7(a) program? And, in general, just give me a short rundown on 7(a) and what problems we are facing.

Ms. ALVAREZ. For this year, we requested authorization for $10.5 billion, and we got $9.75 billion. We have worked—not only done our own analysis but worked with the industry to anticipate what the demand might be. It has turned out that, in fact, we are operating at a level of activity that will require funding for anywhere between $10.2 and $10.5 billion.

What we are seeing is, on average, we are doing between 8 to 10 percent more than we did last year in the 7(a) program. That is a huge concern for us. That is why we requested supplemental funding to the tune of $5.1 million for 7(a), plus an additional $1 million to meet the needs—the trucks are in town today to underscore the need for that $1 million that we hope will help us meet the needs of companies, small companies that are in the heating oil business and the oil business.

We are very concerned. We have a source for funding the $5.1 million. We believe that we can take funding from the Delta Program and the Microloan Guarantee Program to cover that, to cover about $6.6 million. And the $1 million for the home heating oil companies would come from a program at Commerce.

If we do nothing, by around Labor Day we will have to shut down the program.

Mr. SERRANO. By Labor Day?

Ms. ALVAREZ. Around Labor Day. We are taking the administrative steps that we can take to at least minimally reduce the demand. We are pursuing a very aggressive cancellation policy. All of our district directors are out there talking to the lenders, asking them to please disburse funds on loans that they think are viable and, if not, cancel those loans, take them off the books, because that will make more money available to those who need it. We are also looking at a cap of $1.25 million for these loans that would require congressional notification.

Even so, that will only reduce our needs by about a week, so I am very concerned. I started out at this agency as Administrator facing a similar situation, and it was really a very difficult situation. I have asked my staff to start looking at possible options and the only alternative I can see is a plan to ration the funds on a monthly basis so that we have some funding available every month, even if it is limited. Otherwise, if we don't do that, we would have to shut the program down without the supplemental funding.

Mr. SERRANO. And the supplemental was for how much?

Ms. ALVAREZ. It is $5.1 million for 7(a), a million for the home heating oil lending, and then, of course, you mentioned we have a request for a million dollars for PRIME and half a million for veterans.

Mr. SERRANO. Your budget compensates for this? Or was the budget put together prior to finding out that you were not going to get the supplemental?

Ms. ALVAREZ. For this year we requested funding for $10.5 billion in the 7(a), but we only got $9.75 billion, so there is a shortfall. In fact, our projections appear to have been accurate. At the rate that we are going with this 8 to 10 percent increase of activity over last year, we are going to run out of funding.

SMALL BUSINESS AND E-COMMERCE

Mr. SERRANO. Okay. The three members that are sitting here, interestingly enough, share something in common in that we do not represent wealthy districts, we may not even represent what is considered middle income districts, depending on how you read our figures, per capita or median. My understanding is that the chairman represents a rural district which would qualify as one of the less wealthy districts in the Nation.

Ms. ALVAREZ. We visited it.

Mr. SERRANO. One of my main concerns these days is the issue of the digital divide and how our communities are being left behind not only at the schools and in the home. How does this divide affect small businesses and what can we do to alleviate that through this committee?

Ms. ALVAREZ. We are actually seeing that now as we modernize the SBA. By this summer we are looking to have the majority of lenders on-line providing us with information. Transactions will be done electronically. We are discovering that there are lenders out there that are rural, small-niche lenders who don't have the capacity to provide us with that information electronically. And of course we are going to make accommodations for them, but the counterpart to that is that there are small businesses out there who are in the same position, and they are a reflection of the circumstances of their community. I think this is a national priority. I know that the President is planning to do sort of a tour to focus on how the Congress and the Administration are trying to meet this need.

We have a proposal for $5 million for an e-commerce initiative that we would like to develop at the SBA. There are two principal approaches. First of all, we had tremendous success with our Y2K initiative. We did thousands of workshops and forums. We worked with other agencies. We really raised the level of awareness among small businesses, and this is an issue ultimately having to do with technology and e-commerce, and we realized that we don't want to lose that momentum.

Also, we have been studying what other agencies are doing, DOD, Commerce, Agriculture. They all have their own electronic commerce initiatives directed at small businesses, and we think that rather than duplicate them, we can actually leverage off what they are doing.

In addition, there are courses that we can develop and basically just raise the awareness around the country. We have some pilots

in mind. We have partners like LAMA that can basically target small businesses in underserved communities to raise their exposure to the computer and technology.

Mr. SERRANO. Is there going to be any collaboration with the Commerce Department?

Ms. ALVAREZ. Yes, absolutely. What I have asked my staff to do is give me a report that concretely identifies the activities of DOD, Commerce, and Agriculture as they relate to small business because we can bring something to the table there without having to start our own centers. DOD has centers right now that they are directing to small businesses, but I think that there are pieces that are missing.

Mr. SERRANO. Right.

Ms. ALVAREZ. Rather than duplicate, we can leverage.

Mr. SERRANO. We really have to look at this, Mr. Chairman, because a lot of our folks are being totally left behind.

I have no further questions for now, but through your graciousness we were able to get some dollars for this whole issue, and my initial reaction was to find out if you have a chain store over here and a chain store over here and then all of the businesses in the middle here have never been on a computer and are something like 30 years behind. We got to the bottom of the problem, that this was one of the main reasons that they couldn't compete.

Ms. ALVAREZ. That is it. It is a real problem, and it goes hand in hand with new markets, the idea of helping those businesses.

Mr. ROGERS. Thank you.

Ms. Roybal-Allard.

UNDERSERVED REGIONS

Ms. ROYBAL-ALLARD. I couldn't help notice when I came in that you were showing these different maps.

Ms. ALVAREZ. Yes.

Ms. ROYBAL-ALLARD. I noticed that all of the dots are on the east side?

Ms. ALVAREZ. Yes.

Ms. ROYBAL-ALLARD. There is kind of an East Coast mentality here in Washington, and sometimes we have a tendency to forget that the United States does exist west of the Mississippi.

Mr. SERRANO. You will get even in November when you pick the next President.

Ms. ROYBAL-ALLARD. Could you briefly explain to me what the dots are or how we can get some dots over on the West Coast?

Ms. ALVAREZ. There are mostly dots and a few stars. The dots are the community development venture capital companies which have operated without us, and they are basically community development organizations that invest in small businesses.

For example, the chairman has a terrific one in Kentucky called the Kentucky Highlands. We have used them as one of our models for New Market Venture Capital companies. And they have been operating on their own. If, for example, one of those community development companies were to qualify as a New Market company, they could double and triple the amount of capital they would have to invest in small businesses. Plus, through the technical assistance component, they would get some breathing room. Because for

these companies, this is not just helping a small business with their business plan, this is protecting long-term capital at risk. We are in it for the long haul. They might need to get a new management team. They might need to talk about digital divide upgrade. That is what we are talking about.

These stars represent where we have Small Business Investment Companies. They made about $800 million worth of investments in what is technically described as low and moderate income areas. But the truth is that only $66 million of those investments really resemble new market type investments which are a million dollars or less, the kind of growth businesses that are usually overlooked.

I think it really speaks for itself. That is why we are so focused on the New Markets Venture Capital Program. We were very conservative in our estimates for that program. The cost of that program is high in terms of the subsidy costs because we were as conservative as we could be. We think that that will change, just as the subsidy rates for microloans and SBIC have changed with experience. If we added $150 million more to the pot, you would more than double what is available in the country. We would have a competitive process.

Initially, we could see licensing 10 to 20. It is still modest, but I think it would make a difference.

We have also studied the cost of developing new jobs through new market venture capital. We looked at how these community development venture capital companies have done in creating new jobs. It costs them between $2,000 to $4,000 to create a direct new job through their program, which is a bargain. I mean, $2,000 to $4,000 to create a new job is something that you don't see.

The difference between SBICs and New Markets Venture Capital Companies is SBICs, by and large, are profit driven. New Market Venture Capital companies will make a profit, but they are really mission driven. They are more interested in community development. If you want to talk about priorities, Mr. Chairman, we feel quite passionate about New Market Venture Capital companies, because we think that it is the missing piece. Those in combination with microloans will really address the needs of true start-ups.

When you talk to most lenders, when they talk about start-ups, they are talking about businesses that have been in business for 4 to 5 years. What about the little guy who doesn't have a rich uncle? This is where the microloan comes into play.

Ms. ROYBAL-ALLARD. That has to do with my next question. The President's budget requests a program level of $60 million for direct loan and $45 million in the technical assistance for the microloan program. So can you expand a little bit on how you are planning to use that money in terms of the needs and the geographic distribution of that?

Ms. ALVAREZ. The microloan program started out as a pilot in 1994. As with most pilots, there usually are some fairly stringent restrictions because it is small. It is really relatively recently that we started to realize this is no longer a pilot and we can't continue to live with rules that make it almost impossible for people to qualify.

At one point, you couldn't have more than one SBA microloan in a State. This was a self-imposed rule. Charles Tansey has done a

terrific job in holding roundtables with members of the microlending community to find ways to improve the program.

So in our legislative package we have a number of reforms to the microloan program. Midway through the year, we have already put out as much in microloan dollars as we did for the entire year last year. We are operating at twice the pace.

The demand is enormous. In the chairman's State of Kentucky, we have been engaged in conversations because there is an interest in having a Statewide microloan program so many tobacco farmers who suddenly find themselves out in the cold and who are entrepreneurial can get started with a microloan. They are not going to get a loan from the bank, and they need technical assistance because they are switching businesses. So Charles has been engaged in conversations in Kentucky. They came to us for help.

This would apply to many other States. I think you will see that we will more than use up the $60 million and the TA is a good investment.

The way that the PRIME program fits into this is that the hardest money to get is money for low-income, entry-level people to become eligible for a microloan. You need to counsel and work with about 10 of these folks in order to get one that ultimately qualifies for a microloan, and there is very little money available for that kind of counseling and technical assistance.

Really, we have thought through all of the pieces in this chain, and that other chart that shows the bridge reflects a lot of thinking on how do we get people into the economy, really starting all the way back here because the traditional system doesn't work.

The other thing that we are doing is working with credit unions that are very focused on geographic areas that are low income. They have an enormous interest not only in our 7(a) program but in becoming microlenders. So we have been doing everything that we can.

Mr. TANSEY. I think that all of those points are right.

Mr. ROGERS. Identify yourself for the record.

Mr. TANSEY. Charles Tansey. I am the Associate Deputy Administrator for Capital Access.

Mr. Chairman, members of the committee, all of the points that Administrator Alvarez has made about the microloan program are right to the point.

We have talked to a series of existing practitioners. We have talked with the National Federation of Community Development Credit Unions, which represent low-income credit unions in rural and inner city areas. We have talked to a number of other trade groups. We have talked to the Department of Agriculture, with whom we are working in partnership—in particular their IRP lenders.

This microloan structure is tailor made for the entry level entrepreneur. Our problem is that the program has been organized as a pilot, and it has a series of burdensome regulations and restraints. As we peel those away, the demand increases, and that is what is going on right now. We fully expect to hit the $30 million loan level projection for this year.

The question regarding the size of the technical assistance keeps coming up. Why would we be asking for $60 million in loans in FY

2001 and providing $45 million in technical assistance? That $45 million of technical assistance is applied against a whole balance of loans outstanding to our intermediaries, and we would anticipate that by the end of 2001 we would have, assuming this budget were approved, maybe $150, $160 million in loans outstanding. The technical assistance is based on that number, not the amount that we extend in annual loans.

Ms. ALVAREZ. *Twenty-five percent over the course of the life of the loan.* The technical assistance accompanies that loan for the life of the loan, and 25 percent of the value of that loan can be provided in TA grants per year. It is substantial, but it is what works.

Mr. TANSEY. This money is what allows the technical assistance providers, the microlender, to provide ongoing, committed assistance to the entrepreneur. And, typically, it goes beyond a year or 2 years. That estimate is based on all sorts of rules of thumb that you find in the industry about the cost per client for borrowing which runs between $2,500 and $3,500.

Ms. ALVAREZ. We have concluded that you have to have a certain level of technical assistance to really educate the business person to succeed.

MINORITY BUSINESS ASSISTANCE

Ms. ROYBAL-ALLARD. We all know that the SBA programs have been extremely helpful in terms of helping small and minority businesses in this country, and that certainly has been true of Latino businesses which have grown between 1987 and 1992. The figure that I have is 83 percent, which exceeds the overall growth of all businesses by 26 percent.

Last year there was a series of partnership agreements that were designed specifically to help Latino entrepreneurs. Can you elaborate a little bit on what the results of those agreements have been? And in your answer are there specific problems that are encountered by Latinos who want to start businesses as opposed to other small business entrepreneurs?

Ms. ALVAREZ. At the national level, we have signed about 34 partnerships with national Hispanic organizations. We have also signed agreements with African American organizations, women business organizations, and so forth. And, in addition, we have at the local level signed hundreds of agreements. The district directors have really gone out there and worked with the community.

I felt that there were too many folks out there who did not feel welcome at the SBA. Nobody had personally reached out to them and said to them, this is for you. This program is for your membership. It is a very simple idea, but I discovered it was true. When I first took this job, I saw that some of our worst critics should have been our best friends—including Hispanic business organizations. And I said, why is that? They said, it is because we haven't talked to them. We haven't brought them in and made them a part of the solution.

I am pleased to say we have had an ongoing dialogue. I have assigned senior people to be point of contact and entries to all of our programs. Not too long ago we had an entire day where we invited all of our partners to come to Washington, and it was an unbelievable meeting. I had all of my senior people there with them, and

the exchange was really productive. They keep us aware of what we are doing right and what we are doing wrong. It is really that simple.

We put them on our mailing list, if they have websites, we link up with them. In the Hispanic organizations, we have an on-line Women's Business Center that is in Spanish as well as English. We have materials in Spanish if they so desire. We have an 1-800 number that is in Spanish. The bilingual aspect is important.

We work with the U.S. Conference of Mayors because we believe that we have to work at the community level with mayors who are so involved in economic development with small businesses.

Ms. ROYBAL-ALLARD. This question has to do with the SBA Women's Business Centers which have more than tripled in the 3 years from 18 funded centers to 59. You are requesting funds to expand the network even further?

Ms. ALVAREZ. Yes.

Ms. ROYBAL-ALLARD. Part of the answer may be similar to what you just stated in regards to Latinos and African Americans, there was never a sense that the SBA was there for them. Could you describe in more detail the role that the centers have played specifically in increasing businesses among women, and my understanding also is that the fastest growing segment of small business is among Latino entrepreneurs?

Ms. ALVAREZ. That is right. Women sometimes have special needs. I said from the beginning, all of our programs are for women. When I arrived, I was told these are the women's programs, and I said no, all of our programs are for women. But the fact of the matter is in particular communities there are specialized needs. There are women who are single parents who don't feel comfortable going into our centers and asking for advice. Whereas if they go to a center where people understand what their experience is, they blossom. We have centers that are focused on women who have come off of welfare to assist them to become microentrepreneurs. Fifty-five percent of all of our microloans go to women, and many of our women business centers are also microlenders. We have a center in Chicago focused on understanding the venture capital needs of women. So they have arisen in a specialized way in response to unmet needs.

Through the RFP, we invited organizations to submit their proposals and if they had compelling proposals that realistickly could meet unmet needs and they had enough experience, they became Women's Business Centers. Now we have a network of centers some of which we are no longer funding. Initially funding was provided for a 3-year period, which is now a 5-year period. They need to match the funding. After that they are part of our network, even when and we are not funding them anymore. We like to keep them connected through meetings and communications and projects and so forth. We think that there is more room to grow. There are still some States that don't have women business centers and there are still unmet needs.

Ms. ROYBAL-ALLARD. Thank you, Mr. Chairman.

Mr. ROGERS. Thank you.

OPERATING EXPENSES

As you recollect, we had a major problem with the way you reallocated appropriations last year. You diverted $34 million away from funding provided specifically for direct disaster loan administration, and instead used it for regular SBA operating. This year we solved that problem with a bill language cap of $20 million on transfers from disaster loans absent reprogramming. As a result, we now have, for the first time, a fixed amount, $285.7 million that is clearly for overall SBA operating expenses. Do you agree with that number and is there any change to that. Any change to that amount would be subject to reprogramming from the subcommittee.

Ms. ALVAREZ. Yes, sir. I would certainly be in touch with you and also provide a written notification of any changes. I think we agreed that is the way we would proceed.

Mr. ROGERS. Two things. Is that figure accurate?

Ms. ALVAREZ. Yes.

Mr. ROGERS. Two, any change to that figure would have to be approved by the subcommittee?

Ms. ALVAREZ. Yes. I would seek your approval.

Mr. ROGERS. Thank you.

Now, do you anticipate a need to reprogram funds this fiscal year to boost those operating expenses?

Ms. ALVAREZ. No, sir.

Mr. ROGERS. The bill language cap on transfers is the only way we found to arrive at a common understanding of the overall operating expenses and staffing. You are requesting to eliminate that language in the current coming year bill. Why is that?

Ms. ALVAREZ. This is referring to the request for reprogramming?

Mr. ROGERS. The bill language cap.

Ms. ALVAREZ. I believe it is because this was viewed as a limitation which we would prefer not to have. In the past we had gotten both support from OMB and our General Counsel on the ability of the administrator to go forward and use those funds without making any kind of reprogramming request. That new language was introduced, which would represent a limitation on how we had operated in the past, and I believe that is why that language is there.

Mr. ROGERS. The reason we put it in was that we have been struggling to gain control and oversight over your operating expenses. That is the amount you apply to overall salaries and administrative costs because in the past, operating expenses were funded out of three different appropriations accounts, and bill language gave you the authority to transfer monies, and we feel a bit gamed here in the past. So we are attempting to gain some simplification of the process so we can have proper oversight. That is the reason for that cap on transfers.

In 1999, in the absence of that bill language, that transfer authority was used to contradict explicit report language that we had put in the report, and so it is a fail-safe method and we must not let that happen again, and that is the reason for this language.

Now, in fiscal year 2001, you split your request for salaries and expenses into two accounts. What good is that?

Ms. ALVAREZ. Let me ask Greg to comment, if I may.

Mr. WALTER. Mr. Chairman, exactly in response to some of your earlier comments about how confusing our administrative budget was because of the separate funding sources, this year's budget to fiscal year 2001 was an attempt to separate what was used as the operating expenses versus the program dollars, which are usually identified in the line items. The purpose was to make the budget more simplified and easier to understand by separating the operations from the program dollars.

Mr. ROGERS. I will have more questions in a moment. I yield to Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman. Let me just follow-up on that. Maybe I missed the earlier part. You are saying that your budget did not break down operating expenses from program accounts?

Ms. ALVAREZ. Well, there are various sources of funding.

Mr. WALTER. The confusion was that the budget did break it down in our request, but when money was appropriated to SBA, both the program dollars such as those for Small Business Development Centers and Women's Business Centers were mixed in with the operating dollars, and a single appropriation was provided to the agency. There was confusion in trying to identify how much of that appropriation was for the noncredit programs versus the operating dollars. In order to provide better clarity to the appropriation, we suggested that the appropriation be made one side for specific program dollars and another side for specific operating dollars, so we have a clearer direction about how much is being provided for operations versus programs.

Mr. SERRANO. Is that common practice in other agencies, or is this something uniquely yours?

Mr. WALTER. We understand from OMB that this is fairly common, that programs are appropriated separate from operations.

SYSTEM MODERNIZATION

Mr. SERRANO. Okay. I don't know, Ms. Alvarez, if you began or did answer this part when talking about the digital divide. You identified a multi-year project to modernize your technology and information systems?

Ms. ALVAREZ. Yes.

Mr. SERRANO. There are three phases to modernization which are expected to overlap. Can you fill me in rather than asking you a series of questions, what that is all about and what you need from us?

Ms. ALVAREZ. In total, we are asking for $24 million. We've divided that into three parts: $13 million, which is really the most substantive piece and would be used to continue the work we are doing in systems modernization. I mentioned earlier, for example, that we were going to have, hopefully, all of our lenders on-line basically operating in a paperless fashion with us. We intend also to, for example, do electronic disaster lending. We are looking at totally overhauling our accounting systems so that it is all done electronically rather than manually. That is where the $13 million would be used. In addition, we asked for $7 million which we really need to update and upgrade our existing computers. We have a Novell operating system, which is two versions behind. We have

6,000 workstations that are 4 to 5 years old. You can't modernize the SBA and invest money to make it paperless and not basically provide the employees and the folks who work at the agency with the latest equipment. So that is the $7 million.

The $4 million is for workforce transition. What we are going to see in an ongoing way is the need to not only provide some funding for relocation because the jobs are going to be shifting but training. Actually, we really have done very poorly in terms of our funding availability for training. Right now, for example, in the figures I have for fiscal year 1998, SBA basically had about $560 per employee for training, which is one of the lowest compared to HUD, which had $2,000 per employee, and compared to the SEC, which had $643 per employee. We can't be modernizing the SBA and not be training employees. So we are looking to get some funding, a modest increase, really, to be part of the retraining process.

Mr. SERRANO. And you do that with $24 million?

Ms. ALVAREZ. It is a piece of it. We have been working with the chairman's office and Mike Ringler, and we do have a request for the release of $8 million for our systems modernization in FY 2000, which would help us cover the costs, not only of direct staff costs in the modernization efforts but also would allow us to pursue the acquisitions and development of the systems that we need. We have spent quite a bit of time together with GAO and the Inspector General and others and our authorizing committees developing all of the steps for the modernization. We have now developed all of the steps, the eight planning steps, and we are ready to begin implementation. That is where the dollars would go.

Mr. SERRANO. Thank you, Mr. Chairman.

Mr. ROGERS. On that note on the systems modernization, this was originally presented as a 5-year, $40 million project to modernize all of the SBA loan and accounting systems. We provided the first three installments of $8 million in the last 3 years. Then all of a sudden, we get the request this year for $13 million? Help me out.

Ms. ALVAREZ. Kris Marcy is my chief operating officer and she is the lead on systems modernization. She has her hands full. Kris, would you like to speak to that?

Ms. MARCY. I would. Essentially, what we did this budget year, fiscal year 2001 budget, we folded in the disaster program and its paperless disaster application process for the first time. So when you spoke to the $8 million for 3 years, that was for phase 1, the loan monitoring system, and for phase 2, our core accounting systems, and in 2001 we have added the disaster program.

Mr. ROGERS. Is this still a $40 million project or has the baseline changed?

Ms. MARCY. When the estimate was made for $40 million, that essentially looked at phase 1, the loan monitoring system and phase 2. The agency did not make any estimates available at that time nor contemplate including the disaster program, nor did the agency contemplate in any very specific way any of the program requirements for the GC/MED program or the ED program. So to the extent that we want to fold in those programs like disaster, we will have to ask for more than the $40 million.

Mr. ROGERS. Well if we approve your current year pending plan, I understand that you will begin to roll out the new loan monitoring system this summer. What results can we expect to see? And how soon?

Ms. MARCY. We are currently, and we have shared this with your staff, contemplating most of our implementation for the loan monitoring system in the remainder of this fiscal year and in fiscal year 2001. So you will see most of the benefits for phase 1 by the end of 2001. I should point out, however, that we have worked extraordinarily closely with the General Accounting Office, and they have made a number of suggestions for improvements as we have gone along. The technology has changed as we have gone along. So we have looked at some features that no one even began to contemplate when the original request was made. These are things such as fraud detection systems, expanded credit scoring, risk determinants. We can't argue that these are not good technologies to use. We think that they are good, but when you say will you have everything done, probably not. Those newer technologies will probably be implemented in the outyears.

DRUG-FREE WORKPLACE GRANT PROGRAM

Mr. ROGERS. Now, we provided a total of $7.5 million for the last 2 years for the Drug-Free Workplace grant program and you request no monies for that in the coming year. Why is that?

Ms. ALVAREZ. Mr. Chairman, as with so many new programs where you have to work across agencies, the grant money for that program was not disbursed until pretty much the end of the year, the last fiscal year, which means that we are only now beginning to see some preliminary results. I think it is fairly early. We felt that there was still funding for this year. In the meantime, we would like to see if this program is effective or not, because we really have no basis for judging whether we should continue to fund it.

Mr. ROGERS. You are required to submit an evaluation report this month, in fact.

Ms. ALVAREZ. Yes. We have something in hand, I believe. Darryl.

Mr. DENNIS. Mr. Chairman, Ranking Member Serrano, my name is Darryl Dennis. As the administrator outlined, we are compiling our report on the assessment of grantees under the Drug Free Workplace Program, and we will file our report to the Congress. Preliminary reports appear to be favorable, and we will provide a more complete report to the Congress.

Mr. ROGERS. The House passed H.R. 4833 yesterday, reauthorizing that program at $5 million for the next 3 years. Every other program authorized in that bill got an increase in your budget request. Why do you single this one out?

Ms. ALVAREZ. I don't believe that it was singled out. The thinking here was that there was still funding available. This is a program in process and we really had no basis for going forward and asking for any additional amount of funding. But we are quite hopeful, Mr. Chairman, that the program will be successful.

NEW MARKETS

Mr. ROGERS. Let me close out with—you made reference several times to the New Markets Initiative, which is something that we agree on greatly. We appropriated $16.5 million for the Venture Capital Program in the current year subject to authorization.

Ms. ALVAREZ. That was the key.

Mr. ROGERS. And New Markets programs account for about $60 million of your fiscal year 2001 budget. We are starting to run out of time. Can you help us out on where we are on authorization?

Ms. ALVAREZ. Chairman Jim Talent and Congresswomen Velazquez have been working closely to put together a proposal that really meets their expectations. I am told that by next week we will see the results of that collaborative effort. I am very eager to see it because we obviously cannot go forward without the legislation.

Mr. ROGERS. What result would you anticipate from that program that you aren't getting from the existing credit programs?

Ms. ALVAREZ. The House Small Business Committee is holding a New Markets hearing next week to examine it in great detail.

There is a huge lack of equity capital for growth companies in this country. The availability of what will initially be a modest sum of money I think will produce tremendous results. We know from interacting with those who are in the field providing equity type investments, that they are very eager for this to happen, because those communities that have been underserved will benefit from it. We believe it will penetrate the cities, the rural areas, Native American reservations. These are places where businesses have been underserved.

In a sense, this new venture capital program is not unlike the micro loan program. You are putting your capital at risk and, in each case, you do need to make a significant commitment to technical assistance. The difference is when you invest through a New Markets Venture Capital company you are a part owner. You would act, I think, the way an owner acts in trying to create a company that will be successful. A New Market Venture Capital company is unlike a microenterprise, which may be an idea in someone's mind that needs to be developed, so it is seed funding. New Market Venture Capital is for growth a business, a business that has already demonstrated that it can succeed but it can't really grow and develop without the money. The program will lead to job creation in these communities.

CLOSING REMARKS

Mr. ROGERS. Thank you for your testimony here today. No one can say that you are not enthusiastic.

Ms. ALVAREZ. I like what I do.

Mr. ROGERS. And it shows. You bring a lot of energy and excitement to this sometimes quiet agency and you have brought new ideas and you have been very impressive in your performance at the SBA.

Ms. ALVAREZ. Thank you.

Mr. ROGERS. I enjoyed the visit that you gave to my district this past year. The people down there liked you and liked what you are doing, and I hope that you like what they are doing as well.

Ms. ALVAREZ. I do. It is what we should be doing.

Mr. Serrano.

Mr. SERRANO. I want to thank you for the 2 years that we have been together now. We are in a situation where a lot of folks we may be seeing for the last time.

Ms. ALVAREZ. There is that possibility.

Mr. SERRANO. For that matter people sitting on this side, too. It is that time of the year.

Ms. ALVAREZ. It is.

Mr. SERRANO. I want to once again thank you for the work that you do and to put in that personal note of how proud I am to know you personally. Thank you.

Mr. ROGERS. The hearing is adjourned.

[Recess.]

THURSDAY, MARCH 30, 2000.

U.S. SECURITIES AND EXCHANGE COMMISSION

WITNESSES

ARTHUR LEVITT, CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION

JAMES McCONNELL, EXECUTIVE DIRECTOR, U.S. SECURITIES AND EXCHANGE COMMISSION

INTRODUCTION

Mr. ROGERS. The committee will be in order. I am pleased to welcome today Mr. Arthur Levitt, Chairman of the Securities and Exchange Commission. He is accompanied by the Executive Director.

The fiscal year 2001 budget request for the SEC totals $422.8 million, an increase of $45.8 million or 12 percent over the current program level. The Commission is responsible for the oversight of the nation's financial markets. Our financial markets have been transformed over the past few years, both by phenomenal growth and by technological advances. It is an extraordinarily dynamic environment and one that provides no shortage of oversight challenges to us.

The Congress provided an unprecedented increase to the Commission last year, over $15 million above the President's request. We will be interested to hear about how that funding is translating into results, particularly in detecting and preventing the explosion of securities fraud on the Internet.

Your 2001 request seeks to continue funding for new staff and activities this year, and includes major initiatives to further boost enforcement staffing, improve the Commission's automated systems, and to address the problem of staff attrition. We want to hear more about these proposals as well as your views on other legislative developments.

Before I recognize Chairman Levitt, let me recognize my friend, Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman. It is once again a pleasure to welcome Chairman Levitt to the subcommittee. It is an exciting time as we have seen phenomenal growth in the markets just in the last few years. The Securities and Exchange Commission has many new challenges ahead of them as the markets change and we forge ahead into the cyber age of Internet trading. We are very happy to have you here today, sir. I look forward to your testimony.

Mr. LEVITT. Thank you.

OPENING REMARKS

Mr. ROGERS. We will make your written statement part of the record and we would ask you to summarize for us.

Mr. LEVITT. I appreciate the opportunity to testify today in support of the Securities Exchange Commission budget request for fiscal 2001. When I testified before you last year, I described the market environment of unprecedented trading volume, tremendous growth, increased volatility, globally integrated markets, and continued advancements in technology. The environment becomes more intense almost by the day. Changes in market structure and the influence of the Internet continue to create both historic opportunities and imperatives for all market participants. Not surprisingly, the confluence of these extraordinary developments represents a time of great challenge for the Commission.

To meet it we seek an appropriation of $422.8 million for 2001, an increase of 45 million or 12 percent over last year's level. The increased funding in the President's budget will give us additional resources in a number of areas from continuing to combat fraudulent conduct on the Internet, to disclosure operations, to examinations and to our continuing focus on financial accounting fraud. Two areas, however, in particular, are dominating the Commission's agenda. Number one, our inability to retain qualified staff and, secondly, the widespread effects of the Internet. With the vital support of this committee, we have made immediate strides in our Internet initiatives. We have increased the number of staff investigating Internet fraud; new technologies to aid our efforts are being evaluated and will hopefully be in place within the next few months. The $12.5 million we received in fiscal 2000 was an absolutely critical first step in our efforts to combat Internet fraud.

It is for this reason that, aside from fixed costs and our information technology program, we are requesting a small increase in Internet funding for the next year. We intend to use this year's additional resources to refine our practices and introduce new methods that will make us even more responsive to changes in law and technology.

Now you could give us all the money in the world. It won't make a difference if we cannot retain and recruit the staff we need. In the last 2 years, the Commission has lost a quarter of its attorneys, accountants, and examiners to the private sector. It seems that almost every day I see promising young and mid-level attorneys or experienced accountants leave for compensation packages that more than double their current pay. For 65 years, the SEC has prided itself in consistently attracting and developing some of the strongest legal and financial minds in the country, but today's private sector salaries make it increasingly difficult to attract and retain the staff we need to oversee the securities markets that are growing by leaps and bounds.

What is even more troubling, however, is the fact that SEC salaries are far below the salary levels of the other federal financial agencies, such as the OCC, FDIC, and Federal Reserve Board. And it won't surprise you to know that their attrition rates are dramatically lower than ours. It is one thing for staff to make salary comparisons with the private sector, but quite another for them to see

their government counterparts making anywhere from 24 to 39 percent more than they are.

While the maximum salary for a second-year attorney at the SEC is $66,000, an FDIC staff maybe will be paid as much as $91,000. The SEC's staff is its most valuable asset. Given the dramatic increase in starting legal salaries, unless we are put on equal footing with our fellow financial regulators, our attrition rates will only grow worse.

I thank the committee for its interest and support in helping to address all of these important issues.

[The prepared statement of Chairman Levitt follows:]

TESTIMONY OF

ARTHUR LEVITT, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING APPROPRIATIONS FOR FISCAL YEAR 2001

BEFORE THE SUBCOMMITTEE ON
COMMERCE, JUSTICE, STATE, AND THE JUDICIARY
COMMITTEE ON APPROPRIATIONS

UNITED STATES
HOUSE OF REPRESENTATIVES

MARCH 29, 2000

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

TESTIMONY OF
ARTHUR LEVITT, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING APPROPRIATIONS FOR FISCAL YEAR 2001

BEFORE THE SUBCOMMITTEE ON
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UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 29, 2000

Chairman Rogers, Ranking Member Serrano, and Members of the Subcommittee:

I appreciate this opportunity to testify in support of the Securities and Exchange Commission's (SEC or Commission) fiscal 2001 budget. When I spoke before you last year, I described a market environment that was characterized by unprecedented volume, tremendous growth, increasing complexity, and globalization. I also indicated that the SEC would need multi-year increases in budget and staffing to meet these demands. These same forces and the increasing use of new technologies continue to dominate our markets and needs today.

Recent advances now permit a variety and combination of services that blur the distinction between markets, intermediaries, and service providers. Electronic Communication Networks (ECNs) are challenging traditional trading floors. The nation's stock exchanges are considering shedding their long-held membership status. Online trading is empowering retail investors. Institutional trading has increased the demand for greater liquidity, anonymity, and even new trading venues. Market

participants are demanding more: twenty-four hour trading, immediate execution of orders, and lower costs.

It is against this backdrop that the President's fiscal 2001 budget request seeks an appropriation for the SEC of $422.8 million, 12 percent above the Commission's fiscal 2000 spending level of $377 million. This $422.8 million request will fund 3,037 staff years, an increase of 77 staff years (2.6%) over our current staffing levels. Our funding request covers $15.6 million in mandatory and inflationary expenses, $15 million to reinstitute special pay authority, $10 million for information systems, and $5.2 million for new staff. Additional staffing for our law enforcement activities will better enable us to detect and take action against fraudulent securities activity on the Internet and other online information services, as well as respond to continued growth and change in electronic forms of communication.

Assuming we are able to retain the necessary staff in fiscal 2001, this request will provide the Commission with the resources necessary to responsibly fulfill our mission of protecting investors and maintaining our markets' integrity. In particular, it will allow the Commission to:

- continue combatting fraudulent conduct on the Internet;
- provide effective oversight of the increasingly complex activities of regulated entities, including examining on-line and day trading activities;
- further implement a formal inspection cycle program of the increasing number of alternative trading systems;
- continue focusing on financial accounting frauds, earnings management practices, and developments in domestic and international accounting, independence, and auditing matters;

- meet the anticipated workload stemming from the increasing number of mergers resulting from the convergence of the gas and electric markets and the globalization of the utility industry;

- update and improve prospectus requirements for variable insurance products;

- develop a tailored disclosure document for unit investment trusts; and

- strengthen its technological infrastructure to support the agency in its three most rapidly growing areas: electronic forms, document and records management, and market data and analysis tools.

In requesting the funding to support these activities, however, I must focus on two specific areas that are dominating the Commission's agenda: the Internet and our inability to retain qualified staff. Without bringing these factors into our discussion of the SEC's budget needs, I believe we would fail to give a clear picture of how we plan to meet the challenges that lie ahead, including protecting investors and maintaining the integrity of our markets.

The Challenges of the Internet

The Internet is having a profound effect on the way investors participate in the capital markets and on the Commission. By the end of this year, there will be nearly 5.5 million domestic online brokerage accounts[1], with 20 million expected by 2003.[2] During the first quarter of 1999, nearly one in six equity trades was placed through online brokerage accounts. For retail investors, the percentage of trades executed via the Internet is even higher. A November 1999 report by SEC Commissioner Laura S.

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[1] *See* Adam Zagorin, *Taking Stock Scams Offline*, Time Magazine, March 13, 2000.
[2] *See* Rebecca Bickman, *What now? The growth in online investing heralds all sorts of changes in the near future*, Wall St. Journal, June 14, 1999.

Unger notes that more than one in three trades by retail investors are effected online.[3] These numbers will only increase as a greater percentage of investors avail themselves of the economies of online trading.

Moreover, the Internet has changed the way investment research is conducted. The Internet affords retail investors easy access to all kinds of information, both fact (real-time stock quotes, SEC filings, and corporate news releases) and opinion (newsgroup or message board postings, Internet mailing lists, analysts' reports, website discussions, and chat rooms). Entire Internet communities -- some with their own celebrity spokespersons -- have grown up around particular industries, technologies or issuers, providing an incubator for investment ideas, and a forum for competing viewpoints. One of the most popular Internet message board services, for example, has over 13.2 million investment-related messages available for its patrons' viewing.[4]

The Internet and Securities Fraud

While the Internet has brought significant benefits to investors, it also has created significant dangers for the unwary. The Internet, coupled with the greatest bull market in history, has brought millions of relative novices to the markets, while also providing simple, effective, and anonymous ways for unscrupulous people to defraud them. A single mass e-mail, or "spam," sent through the click of a mouse, can more easily and cheaply reach investors than hundreds of cold calls from an old-fashioned boiler room. The use of digital media also can lend fraudulent material an air of

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[3] *See* ONLINE BROKERAGE: KEEPING APACE OF CYBERSPACE, Report of Laura S. Unger, Commissioner, U.S. Securities and Exchange Commission, November 1999. This Report is available online at http://www.sec.gov/pdf/cybrtrnd.pdf.

[4] *See* http://www.siliconinvestor.com (viewed March 14, 2000).

credibility. Someone with a home computer and knowledge of computer graphics can create an attractive, professional-looking website, rivaling that of a Fortune 500 company.

In the earliest days of the Commission's Internet fraud program, the frauds that prevailed online were simply electronic versions of scams that had long been conducted through paper newsletters, mass organizational meetings, and orchestrated telephone solicitations. Principal among these were: stock manipulations, offerings frauds, and illegal touts. We continue to witness these scams, particularly manipulation, with too great a frequency on the Internet. For example, on March 2, 2000 the Commission brought a settled manipulation case against several Washington, D.C. area law students. We allege that one of the students created a website that he used to drive up the short-term price of four stocks. According to the complaint, the student inflated the short-term price for each stock by as much as 700 percent. By trading in advance of his stock recommendations, the student generated over $345,000 in total profits for himself, his mother, three of his law school classmates, and two of his friends.

As the Internet has evolved, however, so too has Internet fraud. New fraudulent schemes have begun to emerge, such as: momentum trading websites, day trading recommendation websites, recommendation scalping, imposter message board frauds, and messages that appear to be misdirected. These scams often result in sizable investors losses. One purported pyramid scheme offered through the Internet, for example, raised more than $150 million from over 155,000 investors before the Commission shut it down. In another action, a popular online stock touter, whom the Commission recently charged with improperly trading ahead of his stock

recommendations to the detriment of his subscribers, maintained a website with 3,800 paying members.

SEC Approach

The Commission's ongoing program to fight Internet securities law violations is a team effort, in which every Division and Office plays a significant part. Since it is charged with uncovering, investigating and litigating Internet cases, however, the lead role in combatting online fraud is played by the Division of Enforcement. The SEC brought its first Internet enforcement action in 1995. While the amount of any fraud is impossible to quantify with precision, based on our surveillance and the number of complaints we receive, Internet securities fraud is on the rise. To date, the Commission has filed approximately 120 Internet actions -- most in the last two years -- alleging securities law violations by hundreds of persons and entities.

In July 1998, as a result of the Internet's growing importance and the rising incidence of Internet fraud, a formal Office of Internet Enforcement ("OIE") was created within the Enforcement Division. OIE began serving primarily as a coordinator of the Commission's Internet program and as a liaison with other regulatory and criminal law enforcement agencies at the federal, state, and local levels.

Between the spring of 1999 and the present, OIE has grown from three to 13 attorneys, with experience and expertise in a wide variety of areas pertinent to Internet enforcement. OIE's current functions include:

- identifying areas for surveillance and conducting surveillance,
- analyzing the complaints we receive from our online Enforcement Complaint Center ("ECC"),

- formulating investigative procedures,
- coordinating Internet initiatives,
- conducting staff and outside law enforcement training,
- engaging in special projects,
- ensuring staff compliance with federal communications privacy statutes and applicable laws, and
- working on Internet matters for the entire Commission.

Alongside OIE is the so-called "Cyberforce" – approximately 240 Commission attorneys, accountants, and investigators nationwide – whose purpose is to conduct regular Internet surveillance. Cyberforce members dedicate a portion of their work week to surfing the Internet, developing leads for potential enforcement cases. The Cyberforce also participates in coordinated surveillance projects both within the SEC and with other federal agencies, such as the law enforcement "surf days" orchestrated over the past three years by the Federal Trade Commission.

Committee Responsiveness

With the vital support of this Committee and Chairman Rogers, the Commission has made immediate strides in its Internet initiatives. In November 1999, the Commission received a fiscal 2000 appropriation that provided an additional $7 million over our request which supplemented a reprogramming of an additional $5.5 million specifically to combat Internet fraud. These funds are being spent both to augment the staff investigating online securities law violations and otherwise studying aspects of the electronic marketplace, and to supplement and improve the technological systems that

support those staff members. Already the Commission has turned these dollars into tangible additions to its Internet program. We have created 92 positions for our Internet fraud program with these funds. Seventy-five of these positions have been assigned to our Division of Enforcement and 17 have been assigned to aid other offices and divisions in their Internet-related efforts. In addition, staff currently is evaluating contractor proposals to provide technological assistance in our surveillance of the Internet, in response to a request for proposals that we issued in January.

Most of the new Enforcement staff will spend all of their time investigating and prosecuting Internet fraud. Among these 75 positions, 23 have been allocated to our headquarters in Washington, D.C. and the remaining 52 positions to our regional offices throughout the country. The 17 positions allocated to the other divisions and offices will be used for a variety of purposes, including bolstering our inspections and examinations of regulated entities operating online, developing policies for the securities industry's use of the Internet, and furthering investor education and assistance. These additional resources no doubt better equip us to prosecute Internet-related securities fraud and keep the Internet safe for investors.

As the Commission enters the new millennium, profound changes are drastically reshaping the securities industry, and compelling the agency to reassess traditional approaches to its mission of investor protection. In order to fulfill that mission, the SEC must be forward-looking, strive to anticipate issues and challenges, and welcome new ideas and new strategies for meeting those challenges. The $12.5 million we received in fiscal 2000 for combatting Internet fraud was a critical first step in this direction. We intend to build on our past achievements, refine those practices that

continue to serve us well, and introduce new methods that will make us even more responsive to changes in law and technology. Equally important, we intend to work responsibly with the resources we have been given. For this reason, aside from fixed costs and our information technology program, we have requested only a minimal increase above our fiscal 2000 level to fund our Internet activities in fiscal 2001. We also are requesting only a small increase in Internet funding because we cannot do more without being able to retain and recruit staff, which brings me to the second issue we would like to discuss today.

Staffing Crisis

The SEC is in the midst of a serious staffing crisis. On February 24, I wrote a letter to you, Committee Chairman Young, Ranking Member Obey, and the Congressional leadership alerting you to our inability to retain staff. This problem goes to the very heart of the agency's ability to oversee the nation's growing securities markets and to protect America's savers and investors. In the last two years, the Commission has lost 25 percent of its attorneys, accountants, and examiners. (In fiscal 1999, we lost 13.5 percent of our attorneys, 16.8 percent of our accountants, and 9.9 percent of our examiners.) Our overall attrition rate was 13 percent -- nearly twice the government-wide average, and our largest regional office alone lost a devastating 20% of its attorney workforce.

The Commission is losing staff before they become fully productive because we cannot pay them enough. In a world where first-year associates are routinely making six-figure salaries in Washington, D.C. law firms, the salaries the SEC can provide

simply are not competitive to attract and retain a sufficient number of talented professionals to reduce high turnover, let alone to fill open positions.

While we fully recognize that the SEC cannot match the higher salaries offered by brokerages, law firms, self-regulatory organizations, and other securities-related businesses, something needs to be done to narrow the pay gap and reduce the turnover problems we face.[5] Practically every day at least one of my senior managers comes to me expressing his or her frustration in not being able to keep tomorrow's leaders.

Effect on the Commission

Our current level of turnover and inability to attract qualified staff is threatening our ability to oversee the nation's securities markets and to respond in a timely manner to the changing events and innovations in our markets by:

- hampering our ability to bring cases to trial and disrupting the continuity we need when pursuing cases;
- hindering us from responding to changing markets in a timely fashion, including through targeted de-regulatory efforts;
- limiting our institutional memory, which is a crucial component of our long-term effectiveness as a regulator; and
- lowering employee morale, which in turn reinforces the staffing crisis.

We also become less productive. SEC staff work hard and well to handle the Commission's increasing, and increasingly complex, workload. The time that our managers and senior staff can devote to this workload is, however, reduced by the time it takes to recruit and train new staff. The SEC conservatively estimates that it takes

[5] The Commission recently contracted for a study comparing the significant disparity between SEC salaries and what the private sector offers for the same line of work. We

approximately two years for new staff to become fully productive. During this period, new staff are actually a drag on the efficiency of the agency because they are still moving up the learning curve. If these staff leave just as they become fully productive to the agency, we do not recover our substantial investment in training them. That is a loss not only for us, but also for the investing public and our markets.

Retention Efforts

Over the past several years the Commission has explored virtually every available approach to keeping staff longer. In 1992, we petitioned and received from the Office of Personnel Management the authority to pay the majority of our attorneys and accountants approximately 10 percent above their base pay. While special pay was a step in the right direction, it proved to be a short-term solution. This is because staff that receive special pay do not receive the government-wide locality increase each year, which means that their special pay becomes less valuable over time (it is now almost entirely superseded by locality pay) and hence becomes less effective as a retention tool. In addition to our special pay authority, which the President's fiscal 2001 budget requests the funds to reinstate, the Commission has used retention allowances and economist special pay to help alleviate our retention problem. While all of these tools have proved somewhat effective when targeted to specific staff and situations, we believe they are incapable of providing the broad relief that we need to combat the Commission's losses and treat all staff fairly.

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would be happy to share the results of that study if you think it would be helpful in highlighting the magnitude of our problems.

Recruitment

The SEC also is facing a problem recruiting attorneys and accountants. We have used recruitment bonuses where possible, but have not met with much success. A typical first-year associate in a top-tier New York or Washington D.C. law firm makes at least double the salary of a comparable staff attorney at the SEC. The costs of three years of law school leave most graduates entering the job market with significant amounts of student loan debt. It is not difficult to understand why the private sector looks so appealing.

Our problem is even worse for accountants, who need to be experienced when they walk in the door. This is of particular concern in an era where financial fraud and earnings management has been on the rise. Experienced accountants are difficult to find and expensive to hire because their ability to analyze complex financial statements is highly prized. We do not have the luxury, if you can call it that, of being able to take someone directly out of school. The Commission has attempted to ameliorate this problem by developing an "in-service" placement program that allows certain Securities Compliance Examiners to be reassigned as accountants if they meet specific criteria, but even this effort has fallen short. In fact, last year only 46 percent of our available accountant positions were filled. The Commission needs the ability not only to keep staff longer, but also to bring them to the Commission in the first place.

Parity with the Banking Regulators

Another real concern the Commission has about staff salaries is the effect of the landmark Gramm-Leach-Bliley Act of 1999 ("GLBA"). By allowing securities firms, banks, and insurance companies to affiliate with one another, GLBA requires increased

coordination of activities among all the financial regulators. Even more so than in the past, Commission staff will work side-by-side with their counterparts from the banking regulatory agencies, like the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation ("FDIC"). However, we cannot match the salaries that these regulators pay.

Since all of the federal banking regulators are exempted from the standard government-wide pay schedule established under the civil service laws, they are able to provide their staffs with appreciably more in compensation and benefits than we can. While the maximum salary for a second-year attorney at the SEC, for example, is $66,000, an FDIC attorney with similar levels of experience, technical skills, and responsibilities can be paid as much as $91,000. This is a significant drain on morale. It is difficult to explain to SEC staff why they should not be paid at similar levels, especially when they are conducting similar oversight, regulatory, and examination activities. It is one thing for staff to make salary comparisons with the private sector, but quite another for them to see their government counterparts making anywhere from 24 to 39 percent more than they are. Moreover, the Commission has already seen several staff leave to take positions with these agencies, primarily because of pay. Unless we are put on equal footing, this trend will continue and most likely intensify.

Given the complexities of our markets and the new business affiliations we are likely to see, the SEC believes it is most beneficial to have all the financial regulators working together from the same starting point. Towards that end, the Commission believes that providing our staff with pay comparable to the banking regulatory

agencies would significantly help in extending the tenures of key employees and help the Commission attract sufficient staff in the first place.

The Agency and Its Staff

The SEC should be a place where highly motivated people come to perform public service and hone their skills, both before entering the private sector and after a stint in the private sector. Such career paths speak highly of the Commission's professionalism and the industry's regard for the agency and its staff. However, the Commission should be able to keep staff for a minimum of three to five years before they leave, and show existing staff how much their efforts are valued. The SEC can ill afford to have its future walk out the door. Moreover, we need to ensure that the Commission has the staffing resources to meet the significant regulatory challenges that lie ahead as technology in general, and the Internet in particular, continue to re-shape our markets.

Proposals to Provide Relief

The President's fiscal 2001 budget request includes $15 million to reinstitute 10 percent special pay for certain attorneys and accountants. As I stated before, we previously had this authority and used it in conjunction with recruitment bonuses, retention allowances, and other retention tools. However, we do not believe that bringing back special pay will be sufficient to resolve our staffing problem. A legislative solution that would provide the Commission with the same pay authority as the banking agencies is vital. I have been discussing our need for pay relief with the Senate Banking and House Commerce Committees, and the Administration. I hope we can all work together to attract and keep the best possible professionals at the SEC. I

cannot emphasize too strongly the importance of this issue as it relates to our mission of protecting investors and ensuring market integrity.

Conclusion

The Commission applauds the support that this Committee has given us to respond to the changing face and form of our nation's securities markets. Our fiscal 2001 request for $422.8 million will go a long way toward enabling the Commission to fulfill its mission of protecting investors and maintaining the integrity of our markets as they continue to dramatically change. In addition, we are dedicated to making the Internet a safe medium for investors and are grateful for the support that this Committee has given us in helping pursue this objective. At this time, our most significant challenge is to ensure that the Commission maintains the skills, abilities, and expertise necessary to address the tremendous and competing demands presented by the industry with which we work. For this reason, we look forward to working with you to obtain the fiscal 2001 funding level we need and the pay authority essential to keeping the people necessary to fulfill our mission of keeping our nation's securities markets the safest, fairest, and most liquid in the world.

INTERNET FRAUD ACTIVITIES IN FY2000

Mr. ROGERS. Chairman Levitt, we have a vote on the floor. We will recess the hearing for a couple of minutes.

[Recess.]

Mr. ROGERS. Chairman Levitt, before we get to your request for next year, let me take a few minutes with you on your current year spending with the monies that we dramatically increased to you for this year, particularly to address Internet fraud. In addition to the 42 new positions that the President requested, we provided $12.5 million on top of that, specifically to strengthen your campaign against Internet fraud. And last year you described the SEC as "behind the curve" in terms of keeping up with Internet fraud. Where do we stand today?

Mr. LEVITT. I suspect that every regulatory agency is always a little bit behind the curve, and that is probably all right. We are certainly in better shape today as a result of the allocation of funds made last year. We used that money to create 92 new positions, 75 of them within the enforcement division, and we also created dedicated Internet fraud centers in each of our regional branches throughout the country.

What we are doing with that is to make it easier for investors to provide us information on fraud perpetrated on the Internet. And our next step, which we hope to implement within the next several months, will be to use technology to help replace some of our attorneys who are surveilling the Internet. We would rather have those attorneys prosecuting cases than watching screens, and technology, I think, will help us do that.

Mr. ROGERS. What can you do today that you couldn't do this time last year?

Mr. LEVITT. I think we can find more evidence of the kinds of manipulations and swindles that are taking place on the Internet. We are bringing more cases than ever before. We are able to discern between cases that represent serious fraud and cases that come about sometimes from pranksters. We are able to help the public as a result of the kinds of cases we are bringing and the publicity that goes with those cases to do a better job of protecting themselves and not succumbing to some of the alluring enticements that appear on the Internet these days, sometimes involving massive amounts of money. We had one case involving over $125 million that was raised for some bogus Internet scheme. So we are not talking about minor amounts in this connection.

AUTOMATED SURVEILLANCE

Mr. ROGERS. Part of your effort, I think, is the creation of what is called "automated surveillance system" using key words to search for fraud. I understand that is kicking up some privacy concerns here and there. How are you responding to that and are there other less invasive ways to get at that type of fraud?

Mr. LEVITT. I am keenly aware, obviously, of privacy issues. It is an issue that has been raised in the Congress in various connections in recent months, and, as a law enforcement agency, the Commission has always been mindful of its responsibilities and restrictions in this regard. As we endeavor to use more sophisticated

surveillance methods, we are using technology, in effect, to replace people who are doing exactly the same work.

That is not to say that we are going to have surveillance of chat rooms any more than we had any of our SEC employees entering into chat rooms. We don't do that. But if we are able to use automated methods to pick up key words that are being used in some static sites offered on the Internet, that will relieve our lawyers to bring cases, which I believe is the most efficient use of their time. So this surveillance program, this automation that we speak of, is in no way a new effort to seek out information. It is, rather, replacing people with computers to do the same job.

INTERNET FRAUD RELATED ENFORCEMENT

Mr. ROGERS. How many Internet cases have you developed so far?

Mr. LEVITT. I have Richard Walker, our chief of enforcement.

Mr. WALKER. The number changes pretty much every day because it is a fast growth area for us. We have brought, at a minimum, 125 cases. This afternoon we may be bringing another case. We have been enhancing our output substantially over the past 2 years. Most of these cases have been brought in the past year and a half.

Mr. ROGERS. That is the total number of cases?

Mr. WALKER. That is correct.

Mr. ROGERS. What types of fraud are you uncovering in those cases?

INCREASING COMPLEXITY OF INTERNET FRAUD CASES

Mr. WALKER. We have seen actually an evolution in the types of cases we have brought. Initially we saw very primitive types of offering schemes, people that were offering limited partnership interests in crazy types of ventures. Over time the schemes have become more sophisticated. We have seen a substantial amount of illegal touting where people make statements about a security, are being paid to make those statements but don't disclose the fact that they have been paid.

More recently we brought some very complicated manipulation cases where people manipulated the markets by false and misleading postings to excite interest in a particular security, having acquired that security before the manipulation occurred and then sold out at a profit. We have also seen a number of imposter cases where people created or made false postings, imitating others, by either penetrating someone's website or, in one case, disguising postings as a Bloomberg story which, in fact, was false.

In that particular instance, we tracked down the person that did that, and the person was arrested and sued within one week's time. There is constant evolution on the Internet, which is why it is very important to us to stay current and keep our best efforts up on surveillance.

Mr. ROGERS. When you say we have so many cases pending, are those administrative procedures?

Mr. WALKER. They are both administrative proceedings and cases brought in our Federal courts. We have authority to proceed

in both venues. Many of the cases are cases that we do bring in Federal court, but it really depends on the facts of each case.

Mr. ROGERS. How many of the 125 are in Federal court?

Mr. WALKER. I don't know. I don't know the number on that. I would be happy to——

Mr. ROGERS. Is it half?

Mr. WALKER. I would certainly think it is half or more of the cases.

Mr. ROGERS. And those are criminal proceedings?

Mr. WALKER. We only have civil authority, but we have worked closely with criminal law enforcement authorities, and in several cases recently we have teamed up with criminal prosecutors and brought both civil cases and criminal prosecutions that accompanied the civil cases. We work with United States attorneys' offices throughout the country and the Department of Justice.

Mr. ROGERS. A case we saw on the news recently involved some area law students involved in an Internet price manipulation scheme. The case was settled quickly. The penalty seemed a little more than an agreement to cease and desist. Is that the right signal you want to send out there?

Mr. WALKER. We were confronted in that case with people who are students and who had no money to pay disgorgement and penalties. Under the circumstances, and when we are confronted with situations like that, we use all efforts that are available to us to determine whether these individuals have assets. We require that they file sworn financial statements with us. We may take their testimony, put them under oath, and we condition our settlements on the fact that if they are not telling the truth about not having assets, then the deal is busted.

Sometimes in cases like this, over time, we may be able to recover some small amounts of money, but generally speaking, we think that as a matter of resource allocation, our efforts are better spent, rather than trying to chase people down for very uncertain recoveries to use the staff to pursue current cases and evolving frauds. Our experience has been when people don't have money for a variety of reasons, it is often very, very difficult to achieve collections and it is a losing proposition.

Mr. ROGERS. You have sufficient authority to adequately prosecute these cases, Mr. Chairman?

Mr. LEVITT. Yes, I think we do.

Mr. ROGERS. You need any more law?

Mr. LEVITT. No.

INCREASING FRAUD ACTIVITIES ON THE INTERNET

Mr. ROGERS. Tell me whether or not the Internet fraud is increasing, decreasing, leveled off?

Mr. LEVITT. I would say it is increasing. Obviously as more and more people begin to use the Internet, as our markets continue to be strong, the numbers of instances of fraud correlate very well with that. People tend to be much less careful at times of market—in rising markets than they would in more stable or falling markets. I would say we have a public that is more susceptible to fraud today. We have got an Internet that is interfacing with more of

those people, and we probably have more fraudsters out there trying to take advantage of those people at this time.

Mr. ROGERS. What was the phrase——

Mr. LEVITT. Irrational exuberance.

Mr. ROGERS. He hit the phrase right off.

Well, that is not something you learn on the golf course.

Mr. Serrano.

EFFECT OF INTERNET FRAUD ON LEGITIMATE E-BUSINESSES

Mr. SERRANO. Thank you, Mr. Chairman. Let's stay for a second on the same subject. You talk about Internet fraud and it is most people's understanding it is people using the net to offer schemes, if you will, and ways to defraud people. Now, there are also folks that have done very well by being legitimate Internet providers, you have your E-Bays, Amazon.coms and so on. Now, two questions on both sides. One, have any of those outfits, not just those I mentioned, but any of the so-called dot.coms, run into trouble with the way they do business on the Internet and/or have any of these other people that defraud the public used the Internet to try to defraud these larger corporations? Because it seems one of the big areas in the stock market is investing in these stocks primarily on the Internet. How does all that tie into what we are talking about today?

Mr. LEVITT. The kind of problems that a large publicly owned Internet company would run into are much less likely to be instances of the kind of fraud we are talking about than they might have problems in terms of accounting issues, and, from time to time, some of those companies have had a dialogue with the Commission about particular accounting treatments which we feel may not give an accurate picture of the company's financial status to America's investors.

We have seen, from time to time, efforts on the part of rogue investors to feed false information over the Internet—which might have an impact on the price of shares in which they have an interest—by feeding into a chat room a story about a phony decline in earnings or proposed acquisition. Other participants in that chat room might bid the price of the stock up and the fraudsters would benefit from that by selling out at that point.

So there have been a number of instances of that. I think you put your finger on how the Internet can be used to take advantage of legitimate companies, and also how companies may not be guilty of manipulations of any kind but they may have accounting problems with us.

Mr. SERRANO. The accounting problems—without telling me what you shouldn't need to tell me, but the way they present themselves to the public may not be a true picture of their accounting situation?

Mr. LEVITT. I am firmly of the belief that America's markets are the best in the world because of the confidence placed in them by the American public. The American public has that confidence because they trust the numbers, and they believe in the fairness of the system. Anything which tends to distort those numbers I think presents a substantial risk to the integrity of our markets, and that's why distorting the numbers is something that this Commis-

sion is very, very mindful of. And you are correct, what happens is a particular company tries to present their numbers in a way that is the most favorable, and, sometimes in doing that, they step pretty close to the line. That is a cause of continuous tension between some companies and the Commission.

INTERNET STOCKS ACTIVITY

Mr. SERRANO. Sounds like some of our pollsters.

I don't know, Mr. Chairman. I have been paying more attention to this lately. You will have to tell me if this is something that has always gone on. But it seems to me I read more and more every day about some of these Internet stocks, if you will, where the stock has gone haywire in terms of the price and the company still hasn't made a profit.

Now, is the percentage of that happening among these kinds of stocks the same in the non-Internet world, if you will, or is that a phenomenon unique to that area?

Mr. LEVITT. Markets tend to be fashionable, and by that I mean, some years ago it may have been biotechnology. In the 1970's it was companies that acquired other companies. Today it is the Internet and as a result of that, you have some things taking place, which I think represent some risks for America's investors. What company is really worth a thousand times nothing? And too many of these companies going public depend upon a subsequent public offering in order to survive. When markets trend down, the IPO market disappears. What will happen to an Internet company that depends for its survival on a new offering? I think that is really playing a very dangerous game.

But you have put your finger on an area of markets today which probably has more of the excesses in it than other areas, but there will be changes. Two years from now we will be looking at another area that people get very enthusiastic about, and, if you are lucky enough to get in at the right time, you may make money. But the risks obviously with stocks that are selling at extraordinary multiples are obviously higher.

INDIVIDUAL INVESTING

Mr. SERRANO. One last question, Mr. Chairman. There was a time not long ago when you went to a broker and you got advice from a broker or from somebody of that nature and you bought stock and whatever. And now, of course, the ability to sit in front of your computer allows you to do this on your own. In addition to what we already discussed here today, has this opened other doors that we haven't discussed, other than the doors of fraud, the ability of people to just sit in front of their computer and go out there and buy up half the world if they can afford it? There seems to me—I am not saying it is good or bad. I actually think it is good there is access, but it seems to me there was a certain control or it was sort of—there was a circle that surrounded this whole area. Now the circle is broken.

Mr. LEVITT. I think you put your finger on another phenomenon.

Mr. SERRANO. I keep putting my finger on things I want you to know I know nothing of. It is shocking my staff over here.

Mr. LEVITT. What you are touching on is the fact that our markets have shifted from being largely controlled by institutional investors to markets that are being largely impacted by individual investors. We are seeing really an extraordinary empowerment of the individual investor. By and large, I think that is constructive, but it carries with it some significant risks in my judgment.

Our society, its literature, its movies, its magazines, its newspapers, has kind of defied the power, the prestige of the trader. The trader is viewed with extraordinary strength, virility, wisdom, toughness, all great American values. And when Mr. And Mrs. America sit behind a computer and recognize that they can buy or sell hundreds of thousands of dollars worth of securities, they fancy themselves, I suspect, as having the same kind of power of the much vaunted trader. What they lack, however, is the experience, the resources, the temperament of the trader; and it is very risky to assume that they have the same abilities and the same culture.

So I think it is a two-edged sword, but we are clearly experiencing today the empowerment of the individual investor. It is our job to see to it that that investor is not disillusioned in terms—not relative to the performance of the market—but its fairness and its systemic soundness. I regard those as being the primary responsibilities of the Commission.

Mr. SERRANO. I would leave you with this thought. I know what you are saying. There is a need, obviously, to make sure that people are protected. But I think, by and large, and you have said it, that it empowers people. It is, to me, some sort of a decentralization of capitalism, maybe, and that is not such a bad thing at the local neighborhood level. People can begin to really put their hand into it at any level they can. So I think in the long run it is good for us.

Thank you, Mr. Chairman.

Mr. ROGERS. Thank you. I think you are sort of saying that these individual traders with no experience on the Internet at home are a little bit like representing yourself in court on a very important case?

Mr. LEVITT. Not quite. I think that giving investors the ability to use the Internet is fine as long as they have some appreciation of risk, as long as they understand that if they are going to do without the services of an advisor, counselor, or broker, they would be very ill-advised not to be prepared to do their own homework, to read about companies, to talk to others about the company and its qualifications, and to have intellectual rather than pure emotional reasons to buy or sell securities. I worry about investors today becoming more emotional about investments than intellectual, and I think that is where they run into trouble.

EFFECT OF DOWN TURN IN THE MARKET

Mr. ROGERS. So you are talking about emotional exuberance?

Mr. LEVITT. That is correct.

Mr. ROGERS. Mr. Wamp.

Mr. WAMP. Thank you, Mr. Chairman. Welcome back, sir. Last month I spent the afternoon with Bill Johnston on the floor of the New York Stock Exchange, and learned a lot and found him to be a pleasant person. I had these thoughts as I was coming back and

thinking about what is ahead. You are coming and you have needs, and we need to hear about problems you are having with personnel and maintaining salaries, where they need to be and the struggles that you face day in and day out.

But in the marketplace, the gas crisis here has caused me, and I think other members, to reflect on some of the questions that might need to be addressed when things are good and no one is worried, and things in the marketplace are still really strong and no one seems to be worried. But after just spending a few hours there and asking questions and talking, there may very well be a financial train wreck somewhere down the road when all this actually shakes out. And what questions need to be asked? What issues need to be discussed?

If you were Bill Richardson and he is in this dilemma now with the energy crisis, and you recognized that things were happening last year that have led to this and now people are wondering how it all happened overnight, that is exactly what is going to happen at some point with this situation, I believe. What are the questions that we need to be asking and how should we be alerting the American people that there is going to be a major correction when all this comes to a head?

It is going to have to happen at some point, and it could probably shock the markets. If Mr. Greenspan even mentioned it, it would cause immediate action and reaction. I really think it is going to happen, and when it does, much like this oil crisis, I wonder what we should be looking at in the Congress and through the Securities and Exchange Commission, et cetera, to try to remedy as much of the pain, or at least brunt the shock as much as possible.

Mr. LEVITT. Well, I think that it is essential that America's investors are reminded of the fact that markets, by definition, go two ways. No matter how often you remind them of that, following a period of prolonged market increase, many of them won't heed those warnings. So that the next responsibility that policymakers have is to see to it that the system is sound, that whatever happens in the market, that the system is able to handle it.

If we have markets that rise or markets that fall on very heavy volume, if we have new electronic participants interfacing with existing markets around the country, if we are moving, as I expect we are, very rapidly toward a globalized electronic market, we need to assure that America's system doesn't remain stuck in the 20th century, that it has the capability in terms of capacity, in terms of responsiveness, in terms of efficiency to compete against new markets that are developing. If there is anything that can damage the confidence of America's investors, even more than economic tribulation, it would be a systemic rupture, and I think it is our responsibility as a government agency and responsibility of all policymakers to see to it that our system is able to handle these issues. And it is one of the reasons that I am concerned about how we introduce decimalization, because that will obviously raise some systemic strains. I think clearly we will be able to do it, but how we do it is a matter of great concern with the Commission.

STAFFING AND THE INTERNET

Mr. WAMP. This case I read about where these guys from Georgetown were I guess in the NASDAQ, engaged in some fraudulent trading, is the Internet going to open up or has it already opened up major problem areas that you need to beef your staff up to prepare for that?

Mr. LEVITT. Sure. The Internet has opened up vast areas of opportunity for America's investors that far outweigh the obvious implications for fraud, but clearly with this kind of rising market, with the number of people growing that have access to the Internet, and with the gullibility of the American people at a time of rising markets, fraudsters are much more prevalent today than you would see in different market environments with different technology, and that is why it is essential that it remain our number one priority.

Mr. WAMP. You retain the competent legal staff, to get to the bottom of these problems?

Mr. LEVITT. That is our number one priority. With the new legislation, the Gramm-Leach-Bliley legislation passed last year, the obligation of all financial regulators to work intimately together is essential for good government. And for SEC employees to be working right next to people who are doing similar jobs but making 30 percent more than they are is terribly demoralizing, and for the agency to see good people go not just to the private sector but to colleagues across the street is devastating.

RELATIONSHIP BETWEEN SEC AND THE NYSE

Mr. WAMP. One final question which is kind of interesting. I asked Mr. Johnston last week what kind of relationship the New York Stock Exchange had with the Securities and Exchange Commission. He stopped short of saying you all were a good wife but he did say—well, I see relationships sometimes between Federal agencies and other institutions where they are such partners that they are like a marriage, you know. You can't live with them, you can't live without them.

And in this deal he said they clearly know their role is a regulatory role. They are not in this business with us but they are at our side and they are supportive and helpful. It sounded to me like you have got a great relationship, but it is an arm's length relationship. That is how it ought to be.

How about the other markets? Do you feel you have got a very good healthy relationship with the other markets? I felt like you had a healthy relationship not too close, not too far away from the New York Stock Exchange.

Mr. LEVITT. I think if there is one word that has been emblazoned on my personality, since I have been at this dealing with markets through the years, it has been the word balance. And I believe there is a balance with the various groups with whom we interface. Sometimes there is more tension than at other times, but any regulator will soon recognize that without the support, without the trust and the confidence of all of the people that he regulates, she regulates, you just can't do the job.

There will be outliers from time to time, but you can't have a whole industry against you and be effective, and I think in this agency, I was fortunate in inheriting a tradition of balance and fairness in terms of not abusing the regulatory power.

Mr. WAMP. A lot of tradition in your industry on both sides. Thank you, Mr. Chairman.

INFORMATION TECHNOLOGY REQUEST

Mr. ROGERS. Thank you. Now, last year—well, you are requesting $10 million to improve your information systems. Last year we gave you a 24 percent base increase for automation plus a one-time infusion of $7.4 million to address Y2K. And last year's money was supposed to help you monitor examinations, improve data distribution in your regions, and better handle the floods of correspondence that you get. Why do you need another 32 percent increase?

Mr. LEVITT. Correspondence was really an enormous problem for us and very disconcerting for the people who would write to us or call us and be unable to get answers, but I was down in that office the other day answering queries from irate customers. It was a revelation to me to hear what was troubling the American investor, and I am going to go down there fairly regularly. I am going to ask my fellow commissioners to do it as well. But I am satisfied that that is pretty much under control, but the additional funds we are using to strengthen our information technology security program, nearly $3 million, is going toward that and $2 million is being allocated to expand the information system support for our enforcement, our Internet enforcement program.

Also using market data for research and analysis will cost us in the neighborhood of $2 million, and our communications network going out to all of the areas that we have to reach will cost us another million and a half.

The rest of the funds, about a million and a half, will go toward improving our Website, which I think is critical. It will allow investors to interface with us, to talk to us, and to hear from us and to provide other forms of electronic communication to the public. This technology is wonderful, but it is wonderful if used constructively to help the public protect themselves.

And finally, a whole new world has opened up with new electronic trading systems developing and it is happening almost by the month. So we must now capture and analyze that of new markets from new stock exchanges, from new dealers that are growing by leaps and bounds.

RELATIONSHIP BETWEEN TECHNOLOGY AND STAFFING LEVEL

Mr. ROGERS. Will this money for automation lead to reduced staffing requirements?

Mr. LEVITT. I think in some areas it clearly will.

Mr. ROGERS. Can you identify that for us?

Mr. LEVITT. I am being told that it will reduce the number of people we are hiring rather than replacing staff that we have already hired.

SEC STAFF ATTRITION

Mr. ROGERS. Now, let's talk about your staffing and your attrition problem. And I think anyone from this distance even could see that given the nature of the business that you are regulating-high risk, high reward in the markets-that your personnel can make a good deal more money in the private sector than with you, and essentially doing the same thing, requiring the same talents, would indeed cause you problems and obviously it is. But you have always had that attrition problem, haven't you?

Mr. LEVITT. Never to the extent which we are experiencing today, nor do I believe the Commission has ever faced the kinds of challenges in terms of the public interest that we have today where we so badly need experienced people.

Mr. ROGERS. Well, my figures show that the attrition rate for attorneys actually improved from 1998 to 1999, went from 15.2 percent to 13.5 percent. I don't know what it is for the year 2000. What is it for the current year?

Mr. LEVITT. Over the last 2 years we have lost approximately 25 percent of our attorneys and accountants. That is a rate that in the private sector would come close to putting a company out of business.

Mr. ROGERS. Is it double the government-wide average?

Mr. LEVITT. Yes.

COST OF REDUCING TURNOVER

Mr. ROGERS. In 1999 you asked for $7 million to pay retention allowances to individuals in certain posts. We never provided that money, so it was not carried out. In your 2001 request, you have broadened the pool. You are asking $15 million for a 10 percent special pay rate hike which would apply to about 60 percent of your work force. Under Senator Gramm's bill, he would give a whole new pay system, which would create an annual appropriation requirement between $50 million and $100 million for us. I don't, in any way, dispute we have got a real problem with attrition, but we would have gone from a 7 million solution to a potentially $100 million solution in the next 2 years. Do you think that is beyond what is really necessary to address the attrition problem?

Mr. LEVITT. Mr. Chairman, I don't think any of the issues that we faced at the Commission over the past seven years rise to the level of problem that the SEC's attrition rate represents to the whole issue of protecting America's investors. The cost to replace the very few people who are experienced in areas that can't be duplicated elsewhere in our markets is so consuming and so enormous that I would suggest to you that in terms of losses to the American public, losses to our government would far exceed the $50 to $100 million. And considering the fact that the Commission does contribute nearly five times what it costs to run it, I think our government has a pretty good deal with the Commission, and, if the Commission loses its viability, I think the risk to the system is considerable, and I have to say to you on a very personal basis that if there is any one issue that I would want to have part of my legacy to this extraordinary body, it would be to preserve its integ-

rity by providing them with just the same kind of fair compensation that their colleagues across the street have.

I owe it to them. I really owe it to them, and I believe that the Congress in turn does as well. I know there are other agencies competing for these funds, but if I were to address our agency's problems with respect to the government's budget, I simply couldn't appear before you on this, but I feel passionately about it obviously.

Mr. ROGERS. I know that you do because we have talked about it privately. I know how strongly the chairman feels on this issue. And we want to try to help you address it. We are trying to figure out how we can manage that kind of appropriation, particularly in another year when it looks like we are going to have less money than we had last year to deal with, with demands from all over the front for increases all over—most all of them legitimate. So it is something we will work with you on, and I want to continue to stay in touch with you and we will work with you to try to address what everyone admits is a serious problem.

PAY DISPARITY BETWEEN SEC AND OTHER FINANCIAL REGULATORS

Mr. LEVITT. Thank you very much, Mr. Chairman.

Mr. ROGERS. One of the difficulties as well that we would have is trying to justify a retention, special pay rate for SEC while denying it for others, other agencies, who as well feel they have a problem, and many of them do, as you well know. Help me with that.

Mr. LEVITT. They don't contribute to the government as a whole five times the cost of running the agency as the Commission does, and they don't have to work hand-in-glove with the same kinds of regulators that do the same sorts of things, but who are paid far more. You could take almost any agency, but to have an SEC employee having to deal with an employee of the Federal Reserve Board or the OCC on an almost daily basis, and one is getting 30 percent more than the other, one of two things will happen: either the lower paid employee will migrate to the other agency, or he'll quit, and both of them are far more devastating to people who remain at the agency than if this was just a situation of losing someone periodically to the private sector, which is a governmentwide problem. This is a phenomena that has been forced upon us by the fact that these agencies are now working so closely together.

Mr. ROGERS. Well, that is another point. The exposure of a government employee to a business where zillions of dollars are being handled, the temptations are great in many other agencies. But you make a valid point.

So you would put this at the top of your priority list?

Mr. LEVITT. Far at the top.

Mr. ROGERS. Above anything?

Mr. LEVITT. Above everything.

Mr. ROGERS. Above automation?

Mr. LEVITT. Above everything. Without these key people, automation won't help us.

Mr. ROGERS. Mr. Latham.

MARGIN REQUIREMENTS AND RECOMMENDATIONS

Mr. LATHAM. Thank you, Mr. Chairman.

Welcome, Chairman.

There was a Washington Post article, I believe it was yesterday talking about the margin requirements and recommendations from the New York Stock Exchange and from NASDAQ about raising the amount of cash investors have. In the last 6 months, according to the article, the amount of money people borrow from the brokers has increased 50 percent. I just wonder what your feeling is on this and what course of action the SEC is taking. They are basically day traders. We all know that is somewhat risky.

Mr. LEVITT. It is a casino. The day trading activity is characteristic of a casino mentality, but it represents a relatively small part of our market at this point, but I am concerned about the level of borrowing today because it kind of defines an attitude of some of America's investors that markets go only in one direction, and the implications to particularly smaller investors of a falling market in the event they are margined can be very, very serious. I think our job is to acquaint investors with the fact that markets don't go in only one direction and that, while they can double their money on the way up with a 50 percent margin, they can be wiped out on the way down.

And investors should be very cautious about whether—how much they are borrowing. And I guess I am even more concerned about investors who borrow outside of regulated channels, who may be borrowing on other assets. And I think that is something that those of us who interface with the markets must really be mindful of. I know that the New York Stock Exchange and NASDAQ are considering proposals to possibly address the issue of margin retention rates, and it is something that we discussed at the President's working group, and it goes to the issue of risks being taken by the public.

INVESTOR EDUCATION EFFORTS

Mr. LATHAM. Is there a timetable as far as any kind of decision? Also, I guess I would ask, you mentioned about somehow educating or informing the public of the risk. In the budget, was it money that you asked for to be able to do this? Was there a risk to OMB that was reduced or changed in this regard?

Mr. LEVITT. Well, we have an Office of Investor Education which has become critically important to the agency, and it does just that function. I participated in probably my 36th town meeting in St. Louis last week since we have been here and every time I meet the thousands of people that come to these town meetings, cautioning them about margin is something that I do, and I know Chairman Greenspan does the same thing.

I think that the issue as to whether changing margin limits will change public behavior is an issue that really has not been defined, but I do believe that the symbolism of the exchanges addressing the margin issue as a cautionary note to the American public would be constructive.

Mr. LATHAM. While it is a small part of the entire market, it is concentrated in high-tech industry as far as the amount of trading that is done on low margin and with the day traders. We have obviously seen fantastic growth in some of those dollars, but it could be a house of cards the way it looks to me.

Mr. LEVITT. I think the extent to which a particular stock or group of stocks has great volatility, that will obviously impact the implications of people being on margin, both on the up and the down side. But I don't know offhand whether more money is being borrowed on Internet stocks than other parts of the market for the moment, but clearly the risks for borrowing for highly volatile stocks that go up and down as much as 10 or 20 percent in a day are greatly amplified over the risk of borrowing on stocks that have greater inherent stability.

Mr. LATHAM. Thank you.

RISKS OF DAY TRADING

Mr. ROGERS. Thank you, Mr. Latham. To follow up on that—on day trading—I know you have been closely monitoring that industry and have questioned the casino mentality that sometimes is prevalent among many of the investors in those confines. Have you found reason for concern in areas of fraud or insufficient investor education or what have you?

Mr. LEVITT. I am more concerned about fraud, which manifests itself in terms of certain characteristics of some of the day trading operations, than I am about misleading investors in terms of what their expectations should be. Occasionally, we will run into a day trading firm that uses false advertising to lure investors into their casinos, and I guess I have such an old-fashioned view about day trading conditioned by my experience in the markets that I frankly think that anyone, except the most experienced professional who goes into our markets as a day trader, might just as well go to the racetrack. Maybe do better in the racetrack.

Mr. ROGERS. I will testify to that. [Laughter.]

Well, what are you doing about it?

Mr. LEVITT. I think public education is the best thing that we can do about it. To expect that you are going to get people to stay away from day trading or to think that it is government's role to tell a particular participant in the market such as day traders that they can't operate, I think is abusive of government's role. The best thing we can do is to educate investors to see to it that the firms that engage in this practice don't mislead the public and give them false expectations and to see to it that the system is sound enough to handle the business that comes.

And the best lesson, the best discipline to be acquired in this connection will come from the market itself. If our markets trend down at some point in the future, the number of day traders will diminish almost exponentially.

DECIMALIZATION OF MARKETS

Mr. ROGERS. You mentioned decimal pricing. You issued an order in January calling for all self-regulatory organizations to implement decimal pricing on July 3 of this year. NASDAQ announced they won't be able to meet that deadline. What is going to happen and what kind of risks might there be for investors in this switchover?

Mr. LEVITT. I think, if the transition is handled in a reasonable and measured way, investors will endure no risks, and when I say "reasonable way," I believe that we have to be certain that our sys-

tems are adequate to handle the vast increase in quote traffic that will result from moving toward decimalization—that not only will our markets be ready, but that the various firms will have systems adequate to handle both quote traffic as well as the order flow.

No one can tell with absolute precision what the impact of decimalization will have on liquidity in our markets, and, again, that is another reason why we have to phase into this. I want to be absolutely certain that our markets are systematically ready to handle a transition to decimalization. I think the benefits to the American public in terms of narrower spreads and comprehensible pricing are really very, very considerable. But, in measuring the risks inherent in doing this too quickly before we are prepared for it, versus the rewards of doing it either by July 3 or doing it several months later, I think it clearly comes down in favor of phasing in decimalization when we are satisfied that the systems are adequate to handle it.

Mr. Zarb has written to me about the inability of the NASD to handle a transition at this time. The New York Stock Exchange has indicated that they have the capability of going ahead and doing it in July. I have great reservations about having a hybrid system with trading in decimals and trading in fractions at the same time. I think that might be massively confusing to the American public. I guess my answer is kind of a long-winded way of saying that decimalization is clearly a priority for the Commission but it is a priority that it think must be implemented in a way that it will assure America's investors that the system is adequate to handle it.

Mr. ROGERS. I don't know of any down side to decimalization. Is there a down side?

Mr. LEVITT. The downside could be if we are not ready to handle it and the system can't take it. That could create very serious problems to force upon the NASD—trading in decimals, when they told us they don't have the capacity to do it—I think would be wrongheaded of the Commission. But I expect to have both Congress and the Commission bring the kind of pressure on those that may not be ready so it won't be very long from now when we will be ready. It is a priority at the Commission. I want and expect our markets to move toward a decimalized environment.

Mr. ROGERS. I can't imagine in this era, in this age of the Internet and worldwide communications and moon shots and computers smaller than the mode of your eye, that the stock market can't convert from fractions to decimals. That is an astounding discovery.

Mr. LEVITT. Well, if you consider our options exchanges, for instance, where there are many, many classes of options that investors require quotes on, and if you multiply that number by many times ten, you have to be certain that that enormous increase in quote traffic doesn't disrupt the ordinary run of business that takes place. Now, I think clearly we will be ready for that, and we have placed demands upon our options exchanges as well as our equity markets and brokerage firms to have the technology in place to do it. One of the principal players, however, has said we are not ready. I have asked them to find for us why they aren't ready to retain outside consultants and to tell us precisely when they will be ready and how much confidence I can have in that. I will be in

a better position to determine the likelihood of a particular date for implementing decimalization, but we are talking about months, not more than that.

NASDAQ EFFORTS TO CONVERT TO DECIMALS

Mr. ROGERS. Well, decimalization clearly is a goal that needs to be achieved. What are NASDAQ's reasons for not being able to comply?

Mr. LEVITT. NASDAQ has explained to me that the enormous increase in volume, which is many times what they had anticipated and many times what they are geared for, has created a backlog in terms of their ability to have the technology to be certain that the public will be protected when we move toward decimals. I have written a letter to NASDAQ, which I will share with the committee in which I say that every single expenditure that NASDAQ makes should be viewed in terms of its alternative expenditures being made for technology, which I regard as their most important commitment today. Before they spend a dollar for advertising, before they spend a dollar for bricks and mortar, before they spend a dollar for any other purpose that technology be their principal concern, because I am frankly dismayed and disappointed that they have not been able to meet the commitment that they made to the Commission last summer to be ready for that July 3 date.

Mr. ROGERS. This subcommittee is sorely disappointed as well. This clearly is a goal if I may say so of Congress, the intent of Congress, that this be achieved. I can't imagine the New York Stock Exchange would be capable of switching by July 3, even earlier than that, I think, and the NASDAQ, I gather, can't even tell you when they would be ready.

Mr. LEVITT. No, they have indicated when they would be ready. I am not thoroughly satisfied in terms of that number and I would rather reserve judgment on that until I have the benefit of the analysis that is taking place right now.

Mr. ROGERS. Well, we would like a report from you rather quickly here about why the NASDAQ is incapable of conversion and the exact reasons and exact date they will be ready.

Mr. LEVITT. I will submit such a report to this committee within the next 30 days.

Mr. ROGERS. And include in that the specific reasons why they cannot comply with your directive to switch on July 3.

Mr. LEVITT. Yes, sir.

Mr. ROGERS. If the New York Stock Exchange can do this, it seems to me that the others should be able to do the same.

EDGAR MODERNIZATION STATUS

Now, finally, on EDGAR, we supported your $22.4 million multiyear plan to modernize the EDGAR database. I understand that for several weeks earlier this year, investors were unable to access certain disclosure documents from that database due to some technical glitches. Can you tell us what happened and if you have fixed it?

Mr. LEVITT. This was a capacity problem with old files that has been remedied. We are about two-thirds of the way through with the conversion of the old EDGAR to the new EDGAR.

Mr. ROGERS. And when will you be converted?
Mr. LEVITT. Next July.
Mr. ROGERS. This coming?
Mr. LEVITT. A year from July.
Mr. ROGERS. Why so long?
Mr. MCCONNELL. It was always intended as a 3-year effort, and we are about 2 years now. It may be before July but that is our outside date.
Mr. ROGERS. Are you requesting more money in next year's budget for that purpose?
Mr. MCCONNELL. Not to my estimation.
Mr. ROGERS. The $22.4 million we have already approved is for the full 3 years?
Mr. MCCONNELL. That is for the full 3 years.
Mr. ROGERS. Are you on schedule?
Mr. MCCONNELL. We have had one slippage, but we are making that up and we will meet the final 3-year deadline.
Mr. ROGERS. Within budget?
Mr. MCCONNELL. Within budget, on time.
Mr. ROGERS. Under budget?
Mr. MCCONNELL. We will see what we can do.
Mr. ROGERS. When that is finished, are you satisfied that we will have a system that provides investors easy, quick access to files?
Mr. LEVITT. I think we will have a pretty terrific system. In this era of new technology, there will be something else, some other enhancement, something that I think will be even better for investors. I think America's investors today have more information, more access to the kind of information necessary to make investment decisions than ever before in history, and I think it is our job to see to it that we are able to avail ourselves of every new development, many of the new developments in terms of technology to benefit investors.
Mr. ROGERS. Mr. Latham?
Mr. LATHAM. No, thank you.

CLOSING REMARKS

Mr. ROGERS. Chairman Levitt, we are very pleased to see you today, pleased your health appears to be good and it is good to see you and your staff here. You have a tough chore these days. It is like riding a wild bronco the way the market is going over there, but we will attempt to equip you with the resources that are necessary to keep up with this age that we are in.

It is ironic down here in Washington that you read about these huge surpluses that the economy has generated in government revenues and yet we are capped in what we can spend. That is a good thing, but it is an ironic circumstance when the grass is green just across the fence and we can't quite reach it, so to speak, to fund improvements like yours that are absolutely necessary. But rest assured, we will attempt every effort to make that happen, in automation equipment and in pay equity to help you with your severe attrition problem. So we will be staying in touch with you and we thank you for your testimony.

Mr. LEVITT. You have been incredibly sensitive and constructive, and I appreciate that, and the agency is grateful for the sensitivity of the Congress to their problems.

Mr. ROGERS. Well, in fact, keep in mind that next year, in 2001, indications are that your agency will generate nearly a billion dollars in revenues for us to spend, but that doesn't make you different in many respects from other witnesses before this committee.

Mr. LEVITT. Thank you very much.

Mr. ROGERS. Thank you, Mr. Chairman.

QUESTIONS FROM MS. ROYBAL-ALLARD

Fraud over the Internet

Q.1. What steps is SEC taking to determine the extent of Internet securities fraud so we can allocate enforcement resources appropriately?

A.1.

While the amount of any fraud is impossible to quantify with precision, the SEC is taking a number of steps to determine the extent of Internet securities fraud. Our main efforts in this regard include: surveillance of the Internet; analysis of information received in our on-line complaint center; and consultation with the self-regulatory organizations (SROs), such as the NYSE and the NASD, and other law enforcement authorities.

The bulk of the SEC's surveillance is done by the "CyberForce," a group of approximately 240 Commission attorneys, accountants, and investigators nationwide. CyberForce members dedicate a portion of their work week to surfing the Internet, identifying trends in on-line securities fraud, and developing leads for potential enforcement cases. The Cyberforce operates within guidelines that dictate where and how to search the Internet, and information collected through these efforts is reviewed carefully before it is referred to the enforcement staff for investigation.

We also rely on the Enforcement Division's Enforcement Complaint Center to gauge the scope of Internet fraud and the variety of forms it takes. The Complaint Center enables members of the public to submit to the Division's staff allegations of possible wrongdoing by fax, mail, and, most importantly, e-mail. Over the last few years, the Complaint Center has received an average of 200 to 300 public investor complaints a day. The Complaint Center also receives copies of unsolicited mass e-mail advertisements, or "spam," of a type frequently used by perpetrators of fraud to inflate the price of thinly-traded stocks. This information has been, and continues to be, a significant source of investigative leads for the Enforcement Division. During fiscal year 2000, we plan to automate many of the functions of the Complaint Center and create a fraud-complaint database that will be a useful resource for this agency and other law enforcement agencies that may seek our assistance.

The Commission's Office of Investor Education and Assistance receives an additional 200 complaints per day. Complaints relating to potential on-line securities fraud are referred to the Division of Enforcement.

The combination of the Cyberforce's activities and analysis of the complaints we receive generates a great deal of useful information about conduct on the Internet. The Commission also receives a steady stream of information about on-line conduct from the Enforcement Division's Office of Market Surveillance, the Commission's other offices and divisions, the SEC's contacts in the Federal Bureau of Investigation, the Federal Trade Commission, the NASD (particularly NASD Regulation's Office of Market Surveillance and the NASD's enforcement department), various state securities and consumer agencies, and the international community of securities regulators.

Q.2. What are the special problems in determining the level of Internet fraud, and what steps is SEC taking to overcome these problems?

A.2

The principal challenge of assessing the level of Internet fraud stems from the Internet's ever-expanding size and scope. There are more websites and message boards than even the most popular search engines can catalog. In order to keep up with this growth, we are increasing the number of staff devoted to Internet matters. With the assistance of recent Congressional appropriations and reprogramming, we have created 92 new positions for our Internet fraud program. Seventy-five of the positions have been assigned to the Division of Enforcement and divided between our headquarters in Washington, D.C. and our regional offices throughout the country. We also are planning to automate our Internet surveillance.

Q.3. How does SEC gather information about the extent of the fraud problem, and how will SEC coordinate this information gathering with similar activities being conducted by state regulatory agencies?

A.3.

As noted previously, we primarily gather data about the extent of Internet fraud through surveillance, complaints received from the public, and interaction with the SROs and law enforcement authorities.

Cooperation among agencies at all levels is a high priority for the SEC. The SEC engages in regular dialogue with the states and their umbrella organization, the North American Securities Administrators Association (NASAA), to discuss issues of common interest, including Internet securities fraud. Currently, dedicated Internet branches within the SEC are actively pursuing investigations in tandem with their state counterparts.

State regulators refer examples of suspicious conduct to us through their network of contacts within the Enforcement Division, and the SEC is actively exploring a number of methods for effectively channeling complaints it receives to state securities agencies for follow-up. The Commission is working with the National White Collar Crime Center in Richmond, Virginia to share complaint information and tap into that organization's planned multi-state database. Similarly, the Commission is considering ways to link its planned computerized complaint database with interested state and federal law enforcement organizations.

The Commission shares data on Internet fraud with the states through regular dialogue, sessions like its semi-annual strategy meetings with NASAA enforcement leadership, and training sessions it sponsors for officials of state and federal civil and criminal law enforcement agencies. State regulators have access to liaison persons within each SEC regional and district office, and are kept apprised of the latest SEC enforcement developments through the SEC's prompt notification of NASAA headquarters of all recently filed enforcement actions.

Illegal Trading

Last year, 64 New York Stock Exchange (NYSE) floor brokers who have access to sensitive financial information such as impending big trades, made millions illegally trading stocks. The SEC reached a settlement with NYSE to overhaul its system for regulating brokers, but NYSE admitted no wrongdoing.

Q.1. Describe the background and the result of your investigation of the New York Stock Exchange floor brokers.

A.2.

In late 1997, the United States Attorney's Office for the Southern District of New York ("USAO") notified the NYSE about corruption that was taking place on the exchange floor. Floor brokers – members of the NYSE – had been violating the securities laws by effecting trades for their own accounts and accounts over which they exercised investment discretion. This was illegal because the floor brokers should have been trading only for their customers' accounts. The discovery of this evidence arose in the context of a joint investigation by the USAO, the SEC's Northeast Regional Office, and the Internal Revenue Service Criminal Investigation Division.

Specifically, beginning in or around January 1993, William S. Killeen ("Killeen") and Thomas W. Bock ("Bock"), the principals of The Oakford Corporation ("Oakford"), a registered broker-dealer located in New York, conspired with at least eight independent floor brokers to share in the profits and losses of transactions initiated and effected by those independent brokers on the floor of the NYSE. The floor brokers made their trades through accounts with Oakford over which these floor brokers exercised significant investment discretion. The accounts constituted the floor brokers' "own accounts" because the floor brokers were receiving between 70% and 90% of the trading profits. By engaging in this proprietary and discretionary trading, the floor brokers violated Section 11(a) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 11a-1 thereunder, and a variety of NYSE rules. These proscriptions against trading by floor brokers are intended to prevent floor brokers from taking unfair advantage of their position on the floor of the exchange and to prevent the brokers from interfering with the orderly execution of public orders. In addition, these brokers engaged in a pattern of initiating and executing transactions for their own accounts while holding unexecuted customer orders for the same securities, often receiving a better price for themselves than they obtained for their customers ("frontrunning" or "trading ahead"). This activity violates the antifraud provisions of the Exchange Act, the Securities Act of 1933, and various NYSE rules.

On February 25, 1998, the Commission filed a civil injunctive action against these floor brokers and other defendants in the United States District Court for the Southern District of New York. Named in the Complaint were: The Oakford Corporation and its principals Killeen and Bock; eight independent floor brokers, namely Thomas J. Cavallino, Edward J. Mueger, Robert J. Carucci, Christine A. Beyer, Michael A. Frayler, Mark R. Savarese, John J. Savarese, and John R. D'Alessio; and several of their alter ego firms. On May 18, 1998, the Commission filed an

amended complaint charging Cavallino, Carucci, Beyer, Frayler, John Savarese, and their alter ego companies with trading ahead of and frontrunning customer orders.

The USAO brought related criminal cases in 1998 against Oakford, Bock, Killeen, Beyer, Carucci, Frayler, D'Alessio, Mueger, the Savareses, Cavallino, and others. All of the defendants in the criminal case, with the exception of John D'Alessio and his alter ego firm, pled guilty to conspiracy to violate Section 11(a) of the Exchange Act and Rule 11a-1 thereunder. In addition, Carucci, Beyer, and Frayler pled guilty to violations of Section 10(b) of the Exchange Act and rule 10b-5 thereunder. Oakford's principals, Bock and Killeen, pleaded guilty to additional tax-related charges.

In December 1998, Carucci, Frayler, Beyer, R.M. Carucci Corp., and Touchdown Securities settled the Commission's case against them by consenting to injunctions against future violations of the securities laws and payment of disgorgement and civil penalties. Payment of all disgorgement and civil penalties by Carucci and Frayler has been waived based on their demonstrated inability to pay. In addition, Carucci and Beyer have been barred from the securities industry with a right to reapply after five years. Also, the broker-dealer registration of R.M. Carucci Corp. and Beyer has been revoked. The Commission voluntarily dismissed its action against the remaining defendants in 1998 to prevent the Commission's action from posing complications that could have adversely affected the USAO's criminal case. The dismissal of the Commission's case, however, was without prejudice to the Commission's right to refile against the defendants pending resolution of the criminal charges.

The criminal defendants who pleaded guilty the USAO's charges were sentenced in January 2000. The Commission recommenced its action against Oakford, Bock, Killeen, D'Alessio, the Savareses, Cavallino, Mueger, and their respective companies on March 30, 2000. The allegations in that complaint are similar to the allegations in the Commission's 1998 complaints, except that the new complaint adds certain additional charges against D'Alessio and D'Alessio Securities, Inc. for frontrunning and trading ahead of customer orders, and for books and records violations. The Commission's action is pending.

Beyond Oakford, the Commission is continuing its investigation into on-floor trading at the NYSE.

Q.2. Did anybody go to jail, and if not, why not?

A.2.

Yes. In 1999, Carucci, Beyer, and Frayler were sentenced to six month prison terms. Frayler moved to stay execution of the sentence, and his motion was denied on February 14, 2000. On January 7, 2000, the remaining Oakford defendants with the exception of D'Alessio were sentenced as follows:

Defendant	Incarceration	Criminal Fine
Killeen	20 months imprisonment	$50,000
Bock	18 months imprisonment	$50,000
J. Savarese	4 months imprisonment; 2 months home confinement	$15,000
M. Savarese	4 months imprisonment; 2 months home confinement	$15,000
Mueger	3 months imprisonment; 3 months home confinement	$15,000
Cavallino	6 months home confinement	$100,000

All of the above have begun serving their sentences except Mueger, who will surrender on Monday, April 17, 2000.

Unionization

Nearly half of Chairman Levitt's written testimony is devoted to improving staff salaries in what is termed a "staffing crisis," yet the SEC appears to be taking vigorous steps to oppose efforts by these same employees who want to unionize. For example, over 90% of the SEC employees in Los Angeles have signed up in support of unionization.

Q.1. What is the purpose of hiring the firm Krupin, Greenbaum, and O'Brien, whose own advertisements cite its record of rendering "union avoidance" assistance?

A.1.

By way of introduction, the SEC does not oppose the efforts of its employees to unionize; to the contrary, it fully endorses the right of its employees to decide whether to unionize. We recently have appealed to the Federal Labor Relations Authority ("FLRA") from an initial decision by a FLRA Regional Director finding that the single, nationwide bargaining unit proposed by the NTEU for SEC employees is appropriate. We believe there should be separate units for headquarters and each field office so that each office is free to set its own local conditions of employment. In our view, the single unit proposed by the NTEU is contrary to the federal labor laws and would deprive our field office employees of the ability to shape and adopt policies tailored to their local geographic conditions and concerns. Thus, our appeal is not an effort to oppose union organizing, but to ascertain the appropriate configuration of bargaining units to best protect our employees and our ability to continue to achieve our statutory mission. Indeed, had the NTEU agreed to separate units for each office, the Commission stood ready to conduct the election in September 1999.

The SEC retained the firm of Krupin, Greenbaum, and O'Brien for technical advice and assistance to help it comply with the Federal Labor-Management Relations Act, 5 U.S.C. 7101 et seq., because we currently have no labor-relations counsel or expert on staff. The firm has

provided guidance and training to SEC managers and attorneys as to their rights, obligations, and responsibilities under that Act. The firm has not represented the SEC in any proceedings before the FLRA. Attorneys from the Office of the General Counsel have represented the SEC in all proceedings before the FLRA.

As to your statement concerning Krupin, Greenbaum, and O'Brien's advertisement that it provides advice on "union avoidance," it is my understanding that the firm represents many private employers in union matters under the National Labor Relations Act. The National Labor Relations Act, unlike the Federal Labor-Management Relations Act, governs private employers and permits them to campaign against unions. That language in the advertisement was not a factor in the SEC's decision to hire Krupin, Greenbaum, and O'Brien. The SEC remains neutral concerning the organizing campaign and fully respects the right of its employees to decide whether to unionize.

Q.2. How much have you spent for their services? How much do you project to spend in FY 2001?

A.2.

The SEC has been billed $46,134 by Krupin, Greenbaum and O'Brien for technical advice and assistance for the ten month period ending April 1, 2000. There is no specific spending projection for FY 2001. The amount that will be spent, if any, depends on the SEC's advisory and training needs during FY 2001.

Q.3. The Office of Personnel Management has written you to offer guidance for labor-management relations – do you intend to take advantage of their services? If not, why not?

A.3.

The SEC's General Counsel, David M. Becker, sent a letter to Janice Lachance, Director of the Office of Personnel Management, on March 31, 2000, responding to her offer of assistance. Mr. Becker expressed an interest in having the SEC meet with her and her staff to discuss any ideas they may have and services that OPM might render.

WEDNESDAY, MARCH 29, 2000.

FEDERAL COMMUNICATIONS COMMISSION

WITNESSES

WILLIAM E. KENNARD, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

ANDREW FISHEL, MANAGING DIRECTOR, FEDERAL COMMUNICATIONS COMMISSION

Mr. ROGERS. The committee will be in order. We are pleased to welcome today in his third appearance as Chairman of the Federal Communications Commission, William Kennard. Chairman Kennard will testify regarding his 2001 budget request for the FCC, which is $237.2 million, an increase of $27.3 million, 13 percent over the current level. We will want to hear today about the details of this request and how the Commission is adapting and restructuring to better achieve the deregulation and competition goals envisioned in the Telecom Act of 1996. In a moment, we will recognize you, Mr. Chairman, for any brief summary of your written statement which we will put in the record, but first, let me recognize my distinguished Ranking Member, Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman. I would like to welcome Chairman Kennard to our hearing today. I am fascinated by the technology and the progress that is made every day in this information age. The FCC has a very important primary mission to promote competition in communications, protect consumers, and, something I feel very strongly about, to support access for every American to advanced communications services. I am glad you are here today. I am looking forward to hearing your testimony.

Mr. ROGERS. Mr. Chairman.

Mr. KENNARD. Thank you, Mr. Chairman. Once again, it is an honor to appear before you and before this committee. I very much appreciate this opportunity to present for you today the FCC's fiscal year 2001 budget proposal. I would like to outline a summary of our budget estimates and give you an update on the activities of the Commission, particularly with regard to our implementation of the Telecommunications Act of 1996. I also would like to present to you a clear picture of our accomplishments during the past year and what we anticipate our agenda to be for the next year.

I also would like to present for you a report card on our progress in implementing my blueprint for the 21st century. This is a blueprint that I presented to the Congress in the summer which is, in effect, a strategic plan for the FCC as we move into this century. We have now updated the plan with some specific milestones that we have met, and I wanted to present that to you and ask, Mr. Chairman, that it be associated in the record with my testimony.

Mr. ROGERS. It shall be.

Mr. KENNARD. Thank you. I also would like to thank the subcommittee for its attention to the FCC budgetary needs during my tenure, Mr. Chairman. I recognize that all agencies that come before you have important programs and sometimes competing financial requirements that must be resolved by you during a compressed time period. Your work is critical to the operation of this government and provides us with a yearly forum to discuss our achievements and planned improvements and receive from you valuable input. Although we do not always agree on budget matters related to the FCC, I believe that we share a common desire to improve the Commission and finance programs essential to the development of a better telecommunications marketplace.

FCC BUDGET—FY 2001

As you mentioned earlier, Mr. Chairman, our budget request for fiscal year 2001 is for $237 million. FTEs will be at a full-time equivalence and will be funded from both direct appropriations and our Auctions resources. This represents a $27 million increase over fiscal year 2000, a 13 percent increase. Most of that increase is attributable to uncontrollable cost increases. That is principally rent, salary, and increases for our information technologies program. The total amount to be collected from regulatory fees would increase from approximately $185 million in fiscal year 2000 to $200 million in fiscal year 2001.

I might note, Mr. Chairman, that the FCC is a cash cow for the Federal Government. We bring in billions of dollars in Auctions revenue. Last year we brought in $1.5 billion which is many times more than our budget. When you combine our regulatory fees and our licensing fees, it exceeds the total amount of our appropriated budget. So we are actually a net profit center, if you will, for the Federal Government. And so we think that in marketplace terms, we are a very wise investment for the Federal Government.

Mr. Chairman, we have discussed in recent months our request to you that we be allowed to use $5.8 million in excess regulatory fees from previous years to support our fiscal year 2000 IT budget. We have done everything within our power to satisfy this committee's directives, yet we have had to make do with less than we need. We must pay our rent while simultaneously carrying out much needed improvements in the Commission.

I have previously written to you to discuss the effects of your denial of the use of our excess regulatory fees, and I have had to implement drastic measures to fund our IT programs including a hiring freeze, scaling back our IT program, and drastically reducing our ability to travel to essential programmatic functions.

We believe that it is vitally important that the FCC be funded adequately to fulfill our mission. We are operating in an environment of great change. The implementation of the Telecommunications Act of 1996 has been a great success for consumers and the marketplace. I also want to present to you today in that regard a report which the FCC issued on the fourth anniversary of the Telecommunications Act of 1996, which outlines—it really takes a snapshot of all sectors of the telecommunications marketplace 4 years into the Act. I think that you will see that this Act is enhancing the economy. All of the economic indicators are up across the

board. We have seen tremendous growth in every sector of the telecommunications marketplace. It is responsible for fully a third of our Nation's economic growth.

We are seeing just in the last 12 months, an explosion in the "dot com" world. When you turn on the television and the radio you are bombarded with these "dot com" ads. America is waking up to the power of the Internet. It didn't happen by happenstance, it happened in this country because we have the right policy and regulatory framework of limited regulation, open markets, and competition.

The challenge as we move ahead is to further create conditions for investment in these networks. We are launching this country into what I call the broadband Internet age. As Americans are waking up to the power of the Internet in their lives, they want it to move faster and faster. Everybody I talk to that does shopping online or uses the Internet to download CDs, they say they love it but it moves too slow. That is going to change if we continue to create the conditions for more investments in these high speed networks, both in wireless and land line.

This year we are going to see a very exciting development as the Internet moves out of the personal computer and into the wireless world. It is going to be very exciting because it means that people will be able to access the Internet over small network hand-held devices like Palm Pilots. That is going to democratize the Internet. It is going to be accessible to more people.

But there is one limiting factor when you are using spectrum to deliver data: you must have adequate spectrum to fuel these devices. We have seen just in the last 5 years this explosion in data traffic on all of our networks. Data traffic is doubling every 100 days on the wire line networks. If you take that same rate of growth to the wireless side, we will run out of spectrum. What that means is that my agency needs the resources to manage this spectrum efficiently or quite frankly we are going to run out of spectrum. We are going to have a spectrum drought right at the time when millions and millions of Americans want to buy these hand-held devices to communicate and access the Internet.

We also must have resources to make sure that there is a safety net of universal service so that all Americans have access to this wondrous technology.

The other good news that I have to report to you this morning is that much of the uncertainties surrounding the implementation of the Telecommunications Act of 1996 has settled out. Most of the major jurisdictional challenges have been addressed by the courts. We are moving into a period of much more certainty. That is good for investment. It is good for consumers.

In conclusion, Mr. Chairman, and members of the Committee, I would like to reiterate my pledge to continue to work with you to make sure that the agency does its job and continues to serve the American consumers, to enhance broadband deployment, enhance competition, and increase the productivity of this tremendous marketplace. Thank you again for the opportunity to appear before you today.

Mr. ROGERS. Thank you, Mr. Chairman.

[The information follows:]

Statement of

WILLIAM E. KENNARD
CHAIRMAN
FEDERAL COMMUNICATIONS COMMISSION

Before the

SUBCOMMITTEE ON COMMERCE, JUSTICE, STATE, AND THE JUDICIARY
COMMITTEE ON APPROPRIATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

on the

FEDERAL COMMUNICATIONS COMMISSION'S
FISCAL YEAR 2001 BUDGET ESTIMATES
MARCH 29, 2000

Mr. Chairman, Ranking Member, and members of the CJSJ Subcommittee, I appreciate this opportunity to appear before you today to discuss the Federal Communications Commission's (FCC) Fiscal Year 2001 Budget. Today I will provide you with a summary of our FY 2001 Budget Estimates, discuss the ongoing changes initiated by the Telecommunications Act of 1996, and present you with a clear picture of our accomplishments during the past year, our agenda for the current year, and outline our plans for the future. I also will discuss the release last week of my Report Card on Implementation of the Draft Strategic Plan – "A New FCC for the 21st Century."

Forging a Partnership for the Future

Before I begin discussing our budget request for FY 2001, I would like to thank this Subcommittee for its attention to the FCC's budgetary needs during my tenure as Chairman. I recognize that all agencies that come before you have important programs and sometimes competing financial requirements that must be resolved by you during a very compressed time period. Your work is critical to the operation of this government and provides us with a yearly forum for discussing both our achievements and planned improvements. Although we do not always agree on budget matters related to the FCC, I believe that we share a common desire to improve the Commission and to finance programs essential to the development of an even better telecommunications marketplace.

I am committed to working with this Subcommittee to achieve our mutual goals for the FCC. We stand together on the front step of the third millennium -- ready to venture up and swing open the door to our future. If the past is prologue, this next century will see accelerating and phenomenal change. Just as our ancestors living at the turn of the last century could never have imagined zooming along a vast array of super concrete byways and computer highways, we have not yet begun to imagine the achievements of our descendants.

We all play a critical role in determining what new goals will benefit our children and our children's children. Communications technology is the engine of their century. It is the basis for fueling the economy, encouraging invention and bringing the world closer together. We all want our legacy to be one of investment in this future. We all want to be remembered for giving the next generation an edge in the future.

The Federal Communications Commission is poised to assume its role as market facilitator in building the infrastructure of the future. Our primary mission is to promote competition in communications, protect consumers, and support access for every American to existing and advanced communications services.

In five years, we expect the U.S. telecommunications markets to be characterized predominately by vigorous competition that will greatly reduce the need for direct regulation. The advent of Internet-based and other new technology driven communications services will continue to erode the traditional regulatory distinctions between different sectors of the telecommunications industry.

Congress gave us the Telecommunications Act of 1996, and in doing so, cemented a partnership for establishing a new pro-competitive, deregulatory model for communications policy. Now it is time to reassess our core policy functions, structure and processes, and fund the changes that will shape our future. New competitors and technological innovation currently are transforming telecommunications markets. History has shown that markets that have been highly monopolistic often do not naturally become fully competitive. History also has shown that domestic markets that have been protected from foreign competition do not naturally become open to global competition.

As I said, the past is prologue. Nevertheless, we can always alter the remainder of any story and create our own future. We must work together to promote competition, open markets, and increase technological innovation. We must continue to protect and empower consumers as they navigate the new world of telecommunications. Together we can achieve the twin goals of the 1996 Act: a fully competitive marketplace and access for every American to current and future advanced communications services.

Pursuing these strategic objectives will require the identification of clear goals and the continued execution of my Draft Strategic Plan, "A New FCC for the 21st Century." As we accomplish our transition goals, we will set the stage for a competitive environment in which communications markets look and function like other competitive industries. We turn to you for your support this year to help us continue to transform our agency, adapt to new and emerging technologies, and ensure that future generations will benefit equally from these changes.

An Affordable Future: The FY 2001 Budget Request

The FCC as we know it today will be very different both in structure and mission as we evolve to meet the challenges of the future. Increased automation and efficiency will enable the FCC to streamline its licensing activities, accelerate the decision making process, and allow the public faster and easier access to information. The FCC will be a "one-stop, digital shop" where form filing and document-location are easy and instantaneous. The FCC will continue consolidation along functional lines so that its structure is more consistent with convergence.

In order to follow through on this agenda, the FCC will require a FY 2001 budget of $237,188,000 and a staff ceiling of 1,975 full-time equivalent (FTEs). This includes FTEs to be funded from appropriations and auctions resources. These numbers reflect a total increase of $27,188,000 or approximately 13 percent over the FY 2000 Appropriation. Uncontrollable cost increases to fund proposed government-wide pay

raises, rent increases and other inflationary increases constitute 47 percent of the total requested increase in funds. Specifically, our request includes $6.8 million for mandatory salary and benefit increases, $5.1 million for increases Rent and Operating Fees, and $.9 million for Consumer Price Index adjustments in contract services.

Programmatic increases to accomplish the Commission's comprehensive information technology strategic plan initiatives comprise the remaining portion of the requested funds for FY 2001. This amounts to $14.4 million for information technology (IT) enhancements. Since the automation enhancements will directly benefit the industry served by the Commission, this increase should be paid for by an increase in regulatory fees. Approximately 80 percent of the requested IT funding increase will be used for maintenance and life cycle replacement of our existing systems. The remaining 20 percent or $3 million dollars will be used to promote competition through better tracking of consumer issues and complaints and better manage the use of the nation's airwaves in the public interest. Without adequate automation funding, the Commission will be unable to carry out its basic functions of awarding licenses to applicants for communications services, overseeing the implementation of new services for the public, and reviewing and updating existing rules and regulations. In view of the importance of these services to the economy of the United States, this investment in technology is critical.

The total amount to be collected from regulatory fees would increase from $185,754,000 in FY 2000 to $200,146,000 in FY 2001.

As you are aware, the FCC also has requested authorization to use $5.8 million in excess regulatory fees from previous years to support our FY2000 IT needs. I recognize that you did not approve this authorization, but I would like to take this opportunity to re-emphasize our need for these funds. I do not believe that our request is frivolous or extravagant. The FCC has done everything within its power to satisfy this Subcommittee's directive that we make do with less than we need to pay our rent, while simultaneously carrying out much-needed improvements to the Commission. We want to begin FY2001 with a fresh fiscal outlook -- without feeling the effects of insufficient resources. I have previously written to you to discuss the effects of your denial of the use of our excess regulatory fees. As you know, I have had to implement drastic measures to fund our IT programs. I hope that you will take a second look at our situation and permit us to utilize our funds to continue the FCC's efforts to improve as an agency and better serve you and the public.

Past Accomplishments Build a Successful Future

The telecommunications industry in the United States is, to date, a great success story. We have worked hard to implement the 1996 Act and effectuate the changes necessitated by a continually evolving marketplace. We have promoted competition across converging technologies and throughout the telecommunications marketplace.

When I began my tenure as Chairman, we had to finish writing new rules to comply with the 1996 Act and the Supreme Court still had to pass on major sections of the law. Reports of the 1996 Act's premature death were rampant. Persistence paid off. We worked together to properly implement the 1996 Act, and with Congress' support, we managed to make the telecommunications marketplace more viable and better equipped to face the future.

As a result, the world is not the same as it was in 1996. The telecommunications industry has grown since then, creating 230,000 new jobs and generating $57 billion more revenues. Revenues in communications services, which include all telephone services, radio, cable and broadcast television, and certain other services, have grown by $7 billion from 1996-1998, a growth of 17 percent in real terms. That figure does not include the rapid growth in sales of communications equipment – telephone headsets, central office switching equipment, etc. – where revenues have grown $26 billion, 24 percent, between 1997 and 1999. With the growth in output, employment in the communications equipment and services industries has grown by $.2 million during the past four years.

During the past year, the FCC's staff has strived to implement common sense rules and programs to enhance the industry's growth, and defend those rules already in place. From wireless auctions to broadcasting and international, our staff has handled more applications and more public participation in telecommunications issues than ever before. Our aggressive implementation of the 1996 Act is generating new classes of competitors, new industries and lower prices.

Making a More Competitive Environment

Our most important work has been in realizing the goals of the 1996 Act to achieve competition and universal access to new services. To that end, we adopted rules and initiated rulemakings to eliminate barriers to entry in domestic telecommunications markets. The FCC implemented the local competition provisions of the 1996 Act, including: (1) revised unbundling rules in response to the Supreme Court remand in Iowa Utilities Board; (2) strengthened collocation rules; and (3) pricing flexibility which also included a Notice of Proposed Rulemaking on whether competitive local exchange carrier access rates should be regulated. We also expect to complete action on two Access Reform Proceedings during the second quarter of this year.

The FCC approved Bell Atlantic's application under section 271 of the 1996 Act to provide long distance service in New York after determining that New York's local service markets are open to competition. During the past month, the FCC negotiated a consent decree to address Bell Atlantic's problems processing its competitors' orders. This enforcement action promotes local competition by ensuring that consumers will have additional choices and lower rates through expanded local competition.

We also initiated proceedings to gather information on (1) the status of deployment of advanced telecommunications capabilities; and (2) the deployment of

broadband facilities and the development of local competition. The FCC's staff forged ahead with determined speed to complete rulemakings on advanced services in the areas of loops, LATAs, DSL resale, and line sharing.

Benefits to consumers in the long distance and local phone markets are an important achievement and priority. Domestic long-distance rates dropped nearly 56 percent in real terms since 1984, saving consumers about $200 billion. Some companies are offering services for as low as five cents per minute.

On the international front, we are less than two years into the implementation of the WTO Agreement and the FCC's August 1997 Benchmarks Order and we have already started to see dramatic results. These policies have increased liberalization, privatization, and competition, which have led to significantly lower international accounting rates. In turn, that has led to lower international calling rates. In 1996, the year just prior to Benchmarks and the WTO, the average price of an international long distance call originating from the United States was 74 cents per minute. By 1998, it fell by 25 percent to 55 cents per minute, and finally to the current average of less than 55 cents per minute. By the time that Benchmarks is fully implemented in 2003, we expect to see much deeper reductions in international calling rates. Moreover, prices on competitive routes have fallen even more dramatically. For example, rates on the U.S.-U.K. route are as low as 10 cents per minute.

Sometimes success is measured not so much by what we do, as what we decide not to do. The FCC's "hands-off" policy toward the Internet has helped fuel tremendous growth in this industry. Over 40 percent of American households have Internet access. In 1998, the U.S. Internet economy was a $633 billion market, accounting for nearly 8 percent of the nation's economy and 4.8 million jobs. Electronic commerce, which will be 90 percent business-to-business, is projected to be a trillion-dollar activity in the next three to five years.

Accessible Services for All Americans

We want everyone to have a piece of the Internet's potential, which is why we have established a framework and funding mechanism for ensuring that all of our country's schools and libraries are connected and that rural health care has access to information technology. We also have worked to ensure that those individuals living on Native American lands will likewise reap the benefits of this new technology.

When the FCC's staff was not busy passing and implementing rules that would enhance the delivery of telecommunications services to the public or upgrading our systems and eliminating backlogs, we were working with Congress to study cutting edge issues like rural broadband rollout. We participated with rural Senators in two special hearings, here in Washington and in North Dakota, to study rural broadband rollout technologies and encourage their implementation throughout the United States.

We also convened the Federal-State Joint Conference on Advanced

Telecommunications Services (Joint Conference) on October 8, 1999, to further the vision of section 706 of the Telecommunications Act of 1996. Patterned on a resolution by the National Association of Regulatory Utility Commissioners (NARUC), the Joint Conference joins federal and state forces to encourage the deployment of advanced telecommunications services to all Americans.

Safeguarding the Integrity of the Auctions Process

One of our most important accomplishments during the past year is the judicial recognition of the integrity of the auctions process in the NextWave case. The Second Circuit has demonstrated that the application of common sense ensures that the auctions process will be a workable method for licensing the spectrum in the future.

I cannot emphasize enough the importance of the Second Circuit's holding in this case. Auctions will play an especially critical role in ensuring that sufficient spectrum is available to meet the needs of the growing digital economy. We have witnessed an explosion of telecommunications services since auctions began. In 1993, there were 15 million wireless phones in America. Today, there are 80 million. We have seen subscribership increase four-fold and the average wireless bill drop by 40 percent during this period. Moreover, wireless is taking over parts of the Internet. Already we are able to use portable devices like laptops and Palm Pilots to accomplish tasks that once required us to remain hooked to a hard line tether. Wireless represents mobility and access for new groups of people.

Over the past six years we have completed 24 auctions with over 1,800 qualified bidders participating. Most of these bidders were qualified and worked hard to bring service to the public. Unfortunately, there are those who tried to obtain the spectrum and then not pay a fair price for it. If we want to build upon our past auctions successes, we have to ensure that the system is fair and predictable. That is why I support using the legislative process to prevent future abuses of the auctions system. I recognize that this Subcommittee has not supported the use of language in past CJSJ Appropriations bills to protect the auctions process. I hope that you will reconsider this position.

Addressing the Influx of Transactions

The increasing number of licensees and changing market forces have dramatically increased the number of transfer/assignment applications processed at the Commission. Some bureaus have experienced *extreme* growth in the number of applications processed during the past four years and most of the bureaus saw a significant increase in the number of applications processed. The Wireless Telecommunications Bureau approved 23,889 license transfers in 1996. In 1999, this number jumped to 40,879. The Mass Media Bureau's Audio Division processed 3,869 license transfer applications in 1996 and 4,951 in 1999. In the last year prior to passage of the 1996 Act, Audio Services only processed 1,866 transfer and assignments.

Most of these transfers have been processed quickly and efficiently, with little fanfare. Recently, the FCC has been faced with the challenge of how to facilitate the review of major transactions while ensuring that the public interest is met in an era of increasing consolidation and convergence. Some have been more complex and deserving of a hard look to protect the interests of the American consumer -- SBC/Ameritech, MCI/Worldcom, Airtouch/Vodafone, Direct TV/Primestar – all of these mergers consumed Commission resources, but were worth the careful study. In the end, our job is to protect the consumer and under the 1996 Act that you passed, promote competition. We would be remiss in our duty to you and the American public if we did not expend the time and effort that it takes to ensure that these mergers comply with our statutes and rules.

Responding to congressional calls for improving the system for handling mergers, I directed FCC General Counsel Christopher Wright to assess the Commission's merger review process, and hire appropriate staff for addressing concerns raised by the crush of applications and their growing complexity. The result is a Transactions Team, which has already initiated the process for improving the way that we handle mergers. The Transaction Team has moved fast to address the concerns of the public, licensees and Members of the House and Senate. Already, the Transactions Team has identified areas of concern and moved to find workable policy solutions. They are working to ensure that our merger review process is transparent, efficient and predictable. They have established a web page and held a public forum on March 1, 2000.

Improving licensing processing -- whether for transfers and assignments or applications for service -- has been a key ingredient of our work during the past year. We are nearing completion on the implementation of a Universal Licensing System that provides streamlined electronic filing capabilities for most wireless services. Now potential licensees can obtain their applications and a wide range of other forms over the Internet, and file them back within minutes.

Electronic filing capabilities also are available in the other bureaus as well: Common Carrier, International, and Mass Media. All routine common carrier Local Access Transport Area modifications are now immediately placed on public notice and are accessible electronically through the Commission's Digital Index. We also implemented an electronic tariff filing system that permits incumbent ILECs to submit federal tariffs and associated documents via the Internet.

Meeting Daily Challenges with Innovative Solutions

The need for a fast response to increased use of telecommunications services means that the FCC must find new and innovative solutions to a broad range of problems. For instance, just two weeks ago, the Commission released new rules to confront the issue of the rapid telephone number consumption by allocating telephone numbers in a more efficient, predictable and orderly fashion. Competition in telecommunications markets is partially dependent upon fair and impartial access by all telecommunications carriers to telephone numbers. After careful study, we adopted new policies to reduce the

need for new area codes, avoiding the inconvenience, costs and confusion associated with changes in area codes for consumers and businesses.

While our work during the past year is too voluminous to print here in detail, I would like to highlight a few special projects. In the past year, the FCC has:

- Technology Advisory Council. Established as a means by which a diverse array of recognized technical experts selected from a variety of interests such as industry, academia, government, citizens groups, etc. can provide advice to the FCC on innovation in the communications industry.

- Public Safety. National Coordinating Committee, CALEA, and E911: ensured that our public safety and law enforcement bodies had the tools necessary to ensure our safety throughout the country.

- Assistance to other Nations. Set out in great detail the way our country's telecommunications system is regulated and made this available to other countries that are in the process of establishing independent telecommunications systems.

- Helped Disabled Americans. Adopted rules to ensure access for persons with disabilities under Section 255, and increased access to the communications network by the 54 million Americans with disabilities.

- Restructuring of FCC. Redesigned the Commission to establish two new "one-stop-shopping" bureaus – Enforcement and Consumer Information Bureaus -- rather than having their responsibilities spread throughout the Commission.

- Y2K. With the determined coordination of Commissioner Michael K. Powell, the FCC assisted the rest of the country in ringing in the new millennium free of computer glitches and ready to correct any that did occur.

Back to the Future

We have worked hard in the past year to bring the Commission into the present and move toward a better future, and our pace will not slacken during the current year. Last week, I released a Report on the Implementation of the Draft Strategic Plan that was submitted to Congress in August 1999. My goals were to create a model agency for the digital age, promote competition in all communications markets, promote opportunities for all Americans to benefit from the communications revolution, and manage the electromagnetic spectrum in the public interest. Since introducing the plan, we have met with a wide range of interested parties to effectively gauge the response to our goals. We spoke with experts from academia, consumers, industry representatives, state and local government representatives and many of your staffs to discuss the future and our mutual goals. My first priority in the coming year is to continue keeping the promises outlined in the Strategic Plan.

Be assured that we will continue to move toward a digital agency – a user-friendly and electronic environment where consumers and licensees alike feel comfortable communicating directly with the agency via online services or old-fashioned phone calls. This goal is the first one in my Implementation Report Card, and I know that success in this area is a certain sign that we are using our funding wisely and appropriately.

Our aspirations for the future do not end there, because we are, after all, an agency dedicated to serving the public in a variety of ways. We have a wide range of futuristic goals in the Report Card, and I intend to work hard to follow through on the report's promises. Let me plot out what I call the ABC's of our current goals for the year.

First, "**access.**" The E-Rate program is bringing its second successful year to a close, and now provides connectivity for one million public school classrooms. This program is a down payment on our children's futures, and on the skills needed to keep our high-tech economy going. One of my highest priorities is to funding E-rate program to wire the nation's rural and urban schools and libraries to the Internet. I want to continue promoting access to the digital tools and services for the 54 million Americans with disabilities [video description, TTY Access, TRS]. This year, the Commission adopted EO rules to help shatter glass ceilings and pave the way for the employment of more women and minorities at radio and television stations. The Commission also has issued a Notice of Inquiry on the public interest obligations of digital television licensees. We hope that this Notice will initiate a national dialogue on how America's broadcasters can best serve the public in the transition to digital television.

Second, "**broadband rollout.**" The Commission will continue its active role in speeding the delivery of high-speed Internet access to every business and home in America. We will take all necessary steps to keep the nation's broadband infrastructure open to competition. We will track the deployment of broadband in the marketplace to maximize the use of this new technology. We will auction new spectrum to bring innovative services to the marketplace and the wireless web to consumers.

As part of the broadband rollout, The 706 Joint Conference is holding six field hearings in coming months to gather information on the status of deployment of advanced telecommunications capability to all Americans. These field hearings will focus on two goals in particular. First, the Joint Conference will seek information on to what extent data is available at the state level on the status of deployment of advanced services. Second, the Joint Conference will seek examples of "best practices" of successful deployment in communities. Some communities have found creative ways to bring high speed Internet access to areas that were previously underserved. For example, a community may speed deployment by bringing many potential users of advanced services together, thereby aggregating demand to increase their buying power. A compilation of creative efforts, or best practices, will provide guidance to communities in other states to speed deployment of advanced services.

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We have set up Federal-State Joint Conference field hearings in a variety of locations: Anchorage Alaska on April 12, 2000; South Sioux City, Nebraska on April 19, 2000; Lowell, Massachusetts on May 22, 2000; Miami, Florida on June 9, 2000; and Cheyenne, Wyoming on June 23, 2000. When I think about these locations, I cannot but wonder about the convergence of the past, present and future in our country. It is somehow fitting that Lowell, Massachusetts, which saw the advent of the industrial revolution, will host a field hearing to discuss the future of telecommunications technology in the new millennium.

Finally, let me address the "C" in my ABC's, "**competition.**" This Subcommittee has my commitment to continue working toward full and open competition. I will encourage the protection of consumers by giving them the information they need to navigate an increasingly complex telecommunications marketplace. I personally will review the findings of the Transaction Team to ensure that all mergers now pending and filed in the future will receive fast, efficient and flexible handling. We will make DTV compatible with the nation's cable networks. We will reform access charges to make more equitable phone billing and pricing practices. We will promote competition in local and long-distance markets that will give consumers lower rates, better services, and more choices.

Conclusion

Together, and with full funding of our request, we will work toward implementing the Strategic Plan -- "A New FCC for the 21st Century" to create a faster, flatter, more functional agency in an era of convergence. I appreciate your support for making this plan a reality. Again, I hope that you reconsider our request to use excess regulatory fees from past years to meet this year's IT needs. It is time to transform the FCC into a paperless, electronic agency. More importantly, it is time to ensure that the future includes providing access to communications services to all Americans. I believe that we share the same concerns and goals about the future. Together, we can ensure that our third millennium telecommunications infrastructure is a proud legacy.

Mr. ROGERS. Now, before we get into a discussion of your request for next year, we need to—I would like to get a better sense of where you are going with some 2000 year funding. Because after 5 years of virtually flat funding, in this current year, we appropriated a very generous increase for fiscal year 2000, an $18 million increase, to be precise. And yet I am disappointed to learn that despite that largest percentage annual increase since the 1996 Telecom Act, you are unable to fund base requirements. You have restricted hiring and travel. Why is that?

PORTALS

Mr. KENNARD. Well, as you well know, Mr. Chairman, much of those increases went to fund what I call uncontrollable cost increases: fixed costs, salaries, rent and IT expenses. When we moved to the new Portals building, our rent increased approximately $9.6 million. For a small agency like the FCC, that is a huge increase. As you know we have had difficulty before and after the move to the Portals having a clarified situation, if you will, as to how we are going to meet these increased moving costs. We have struggled to make do, to try to amortize as much of our moving cost as possible and to cut back where possible. But it is very difficult, and this agency is facing a very, very challenging resource problem.

I was remiss earlier, Mr. Chairman, in introducing my colleague, Andrew Fishel, who is our Managing Director, who I believe you know and has appeared before.

Mr. ROGERS. How much were you paying annually for headquarters rent before you moved to Portals?

Mr. KENNARD. Before we moved to the Portals, $15.3 million.

Mr. ROGERS. You moved into the Portals last year, and how much was GSA seeking from you for rent for fiscal year 1999?

Mr. KENNARD. I believe that GSA billed the FCC $17.9 million for the total cost of rent, and accepted $15.3 million in payment.

Mr. ROGERS. So there is some precedent of withholding rent for some of your higher priorities, right?

Mr. KENNARD. Well, the difficulty is that we have never had that rent appropriated. And so we have had to rely on the GSA to amortize some of our cost increases as a result of the move. It has been very challenging because every year now we move into a situation of uncertainty, not knowing how to pay our rent and having to cut costs elsewhere in order to meet these increased rent cost.

Mr. ROGERS. How much do you plan to pay for headquarters rent this year?

Mr. KENNARD. In 2000 or 2001?

Mr. ROGERS. 2000.

Mr. KENNARD. The rent would be $24.9 million.

Mr. ROGERS. So you went from $15.3 million in your old buildings to $24.9 million, almost a $10 million increase.

Mr. KENNARD. Yes, it is a $9.6 million increase over 1999.

Mr. ROGERS. You see, some of us feel—including this member—that what you are doing is rewarding fraud. I think that there was fraud practiced on the U.S. Government by some of its high officials who walked out of here with a sack full of money expecting us to pick up the bill. That is the reason we have not given you money to pay GSA to reward the fraud that took place. That is a

burr under my saddle. I am sorry, I can't get it out. So there may be a little bit of us going through you to punish somebody else. And for that I am sorry. But I don't have any other club to hit them with.

Mr. KENNARD. Mr. Chairman, I do feel like a whipping boy here because we are an independent agency. As you know we had no choice in whether or not we would move to the Portals. We were forced to move. I must say that the move has worked out for us, and we are enjoying our new headquarters facility. But we were very, very reluctant to make that move, as you know, because this rent situation was not clarified. We had no choice. And I believe that given the responsibilities of this independent agency in what is the fastest growing, most important sector of our economy, that with due respect, sir, it doesn't make sense to punish 2,000 employees at the FCC for something they had no responsibility for and no choice in the matter. I might add further, Mr. Chairman, that I understand that these allegations of fraud were fully investigated by the Justice Department and no action was taken.

Mr. ROGERS. Exactly.

Mr. KENNARD. So it seems to me that from our perspective at the agency, we had to move on and do the work of the American people. We have no choice but to do that. And so I again——

Mr. ROGERS. Let's not get too high on the horse here, because in 1997 we found out, after the fact, that you had entered a contract with GSA under which GSA fronted you the money for the move to Portals 2. And then you asked us for appropriations to reimburse GSA to refund you the money which we never knew about in the first place. If you want to get into that, we will get into it. So the FCC, you, are not completely innocent in all of this—not of the original thing but in this subsequent agreement—which we found out about after the fact. You didn't come to us at the outset and tell us here is what we are going to try to do. So this whole business of paying GSA this $10 million more per year rent still sticks in our craw.

Mr. KENNARD. Mr. Chairman, if I may, I think that we have a disagreement over some of those facts which may not be worthwhile going into now. It is sort of old history now. But again, the FCC was ordered to make this move under the most difficult of circumstances. We had no choice but to make the best of a very difficult situation for the agency. And the agency is suffering the consequences years after that event. And again, I just want to go on the record and say that it is important for the mission of this agency, its mission to the American consumer that we put this behind us and allow this agency to continue to operate.

Mr. ROGERS. Well, the administration could work with GSA and with you on getting the rent back down, because of that $18 million increase we gave you in the current year, more than half of that has gone to pay this rent—in GSA's pocket—something that the administration could work on if they took a notion to do that. But instead, your budget request last year included $11 million for upgrades in replacement of automated systems. And if I am not mistaken, hardly any of that would be used for that purpose this year. Is that right?

Mr. FISHEL. We first had to pay the rent, that is correct, so the money that we hope to pay——

Mr. ROGERS. Exactly. And so to come in here and blame us or ask us to bail you out again just falls on deaf ears, because we gave you—and rather than apply that to your automated systems upgrades, which you desperately need, and get the administration to get GSA to back off on this higher rent falls on deaf ears here.

Mr. KENNARD. Mr. Chairman, the FCC is really between a rock and a hard place here. We have gone everywhere we possibly can to try to improve the situation for the agency. I have met with Dave Baron, the head of GSA and pled my case there. We have pled our case at OMB. Unfortunately, our pleas are falling on deaf ears all over town.

Mr. ROGERS. I tell you what we probably need to do. We probably need to hire Jim Sasser and have him approach GSA. He may have some influence there. Obviously he does. Have you thought about that?

Mr. KENNARD. No, I haven't, Mr. Chairman.

Mr. ROGERS. Good. Well, who made the decision that paying $10 million more in rent to GSA, a 63 percent increase over the previous year, is a more important use of appropriated funds than these base automation improvements that are desperately needed?

Mr. KENNARD. Rent is a fixed cost, Mr. Chairman. The GSA has the ability to take that money out of our operating accounts to pay it. We don't have the discretion in the matter. It is sort of like your car payment or your rent payment. It has got to be made. We don't have discretion.

Mr. ROGERS. How much was the cost of the move into Portals?

Mr. KENNARD. I will ask Mr. Fishel to give you the exact figure.

Mr. FISHEL. Quite frankly, the agency doesn't have the exact figures. As you are aware, the GSA paid for the move and did not give us a final accounting of how much it cost the government.

Mr. ROGERS. But they are expecting you to pay them for that, aren't they?

Mr. FISHEL. We are paying the portion that they paid the building owner to make improvements in the building. The building was built for the FCC. It had no walls, no lights in the ceiling, no wiring for cables, no wiring for telephones. All of that the FCC was required to pay to build out and we are being asked to pay GSA for those costs.

Mr. ROGERS. No one knows how much that is?

Mr. FISHEL. We are being billed by GSA $3.3 million a year.

Mr. ROGERS. For how long?

Mr. FISHEL. 18 years.

Mr. ROGERS. That is for fitting the building for your purposes?

Mr. FISHEL. Yes, it is.

Mr. ROGERS. How about the actual cost of moving into the building?

Mr. FISHEL. GSA paid for that.

Mr. ROGERS. How much was that?

Mr. FISHEL. I don't have an amount for that.

Mr. ROGERS. Do we know how much that is?

Mr. FISHEL. We never got a cost accounting from GSA on their costs.

Mr. ROGERS. You have got to pay them, reimburse them for those costs?

Mr. FISHEL. We are no longer being asked to reimburse them for that.

Mr. ROGERS. Do you know how much it is or was?

Mr. FISHEL. I believe it was about—they are paying about $6 million a year for that.

Mr. ROGERS. Who is?

Mr. FISHEL. GSA.

Mr. ROGERS. Is paying whom?

Mr. FISHEL. They are paying themselves, basically. They are asking Congress in their own appropriation process for that money.

Mr. ROGERS. $6 million a year for how long?

Mr. FISHEL. I am not certain. I think it is 9 years.

Mr. ROGERS. The smell is so putrid. Well, so the GSA's costs of fitting the building for your purposes are being billed to you on an annual basis for 10 years?

Mr. FISHEL. 18 years.

Mr. ROGERS. How much is that per year?

Mr. FISHEL. $3.3 million.

Mr. ROGERS. Normally, who would pay that cost? Would that be the lessee or the lessor?

Mr. FISHEL. It always would be the tenant making the improvements if you are building a shell. The government practice is always the agency pays those costs.

Mr. ROGERS. What agency?

Mr. FISHEL. Whatever agency is moving into the building.

Mr. ROGERS. The lessee. So normally, this $3 million-plus per year for 18 years, that figure normally would have been put up by the FCC under these conditions to fix the building, right?

Mr. FISHEL. Yes, that is right.

Mr. ROGERS. But how come GSA said no, we will do that?

Mr. FISHEL. GSA ordered us to move into the building knowing that we had no appropriations to pay for it.

Mr. ROGERS. So they, in essence, fronted you the money?

Mr. FISHEL. That is correct.

Mr. ROGERS. And you are paying them back over 18 years?

Mr. FISHEL. That is correct.

Mr. ROGERS. So of your annual budget, $3.3 million is being used to reward the fraud, my version of fraud, that took place in the procurement of this lease?

Mr. FISHEL. The agency was ordered to move, Mr. Chairman. Whether or not there was telephone lines, cable lines for us to do business, we were ordered to move and the GSA was prepared to make use of its authority that it has under statute to do so. The agency needed to make certain that it could continue to operate its program.

Mr. ROGERS. We will come back.

Mr. Serrano.

Mr. SERRANO. I just want to clarify that for a second. The agency was ordered to move. So if something went wrong, it is somewhere else, not with this agency?

Mr. KENNARD. That is correct. In fact, Congressman Serrano, we would have preferred to have had more control over the process. It

was very frustrating to make a move of this magnitude and not have the ability to control the costs of the move, to know what the total costs of the move were. But this was beyond our control.

Mr. ROGERS. If you will yield on that point briefly, the original deal was when Reed Hunt was chairman of the FCC, right?

Mr. KENNARD. That is when the lease was signed, yes.

Mr. ROGERS. That is when all of this started. At the time you were not absent from the FCC, you were the general counsel, were you not?

Mr. KENNARD. I was general counsel at that time. For the record, Mr. Chairman, as general counsel, I sent a letter to GSA objecting to the signing of that lease at that time on the grounds that it was uncertain how our rent was going to be paid. And so I am on record in writing at that time as is the agency—in objecting to how this lease was entered into from the agency's perspective, not based on the purported fraud as you term it. But you should understand that the FCC had no choice in the matter. We had no choice in the matter.

Mr. ROGERS. Well, you had the current membership that didn't have a choice in the matter, but the FCC at the outset, under Chairman Hunt, was a participant in the deal.

Mr. KENNARD. No. I would take issue with that, Mr. Chairman. Because when I was general counsel acting under the direction of Chairman Hunt, Chairman Hunt had similar concerns about the GSA leasing arrangements for the FCC. In fact, there was a lawsuit about this which went on for quite some time, the FCC objecting to our arrangements for this lease.

LOW POWER FM STATIONS

Mr. SERRANO. Thank you, Mr. Chairman. Mr. Chairman, I want you to bring us up to date on this whole issue of low power FM stations. There is a certain excitement about the possibility of local folks and organizations being able to get on the air waves, but then there are questions. There is opposition, the NPR questions what we are going to do with their equipment for reading services for the blind. There is the issue of what happens in areas like New York with so many signals. Just kind of bring us up to date on where you see problems. But first, I hope that you don't get upset at me, but I am just thinking I will take the prerogative of the ranking member: How is Robert James Kennedy Kennard doing?

Mr. KENNARD. He is doing fine. My wife and I adopted him over the weekend and he is probably doing better than his sleep deprived parents at this point. Thank you for asking.

Mr. SERRANO. That is great. Good luck and I hope that you just enjoy him on a daily basis.

Mr. KENNARD. Thank you.

Mr. SERRANO. Now, let's get him a low power FM station.

Mr. KENNARD. Sure. About 2 years ago the FCC began the process of developing a record to determine whether we could have a low power FM service for the country. This was in response to a lot of concern around the country that in an increasingly consolidated market, small players were being shut out of access to the air waves. Community groups and schools and universities, nonprofit organizations wanted to access the air waves to speak to

their communities. So after a very extensive process of developing a record we determined, based on the work of our expert engineering staff, that low power FM can coexist in harmony with the incumbent broadcast service.

So in January of this year, we authorized the service. We authorized two classes of low power FM stations, 100 watt stations and 10 watt stations, small stations, but big enough to serve neighborhoods or small communities so that you can give voices to people who want to access the air waves like the non-English speaking community. The Creole speaking Haitian community in south Florida is very interested in this. The farm working community in California, schools and universities all over the country who have broadcast journalism programs but no radio station are very interested in it. We have never had more interest and excitement about a new radio service in the history of the Commission.

Thanks to the Internet, we get tens of thousands of e-mail inquiries about low power FM. So it has generated a lot of excitement. As you mentioned it has also generated controversy because the incumbent broadcasters are concerned about harmful interference. Our record demonstrates there will not be harmful interference from low power FM. We know a lot about the way FM signals propagate in the marketplace. We have 10 years of experience with FM signals. Based on that experience, we have determined there will not be interference.

Mr. SERRANO. I guess it works differently in different places. In a rural community with open spaces 100 watts can go a long way.

Mr. KENNARD. If their terrain is flat, yes.

Mr. SERRANO. How far would it cover in Mr. Wamp's district, for instance? He will get better sound than I do.

Mr. KENNARD. A 100 watt station, assuming flat terrain would probably be—approximately, I am not an engineer, so don't hold me to this—probably about 4 or 5 miles maximum.

Mr. SERRANO. In a city, in a tight building-filled area like mine?

Mr. KENNARD. Well, it really depends on the terrain. In a more mountainous area it is going to propagate not as far. In the more urban areas there is less space on the air waves to accommodate new stations. So we would probably anticipate more in the rural areas and fewer in the cities.

Mr. SERRANO. When is this program supposed to get going?

Mr. KENNARD. The FCC adopted rules for inaugurating the service in January. On Monday of this week we held a lottery to determine which states would be first to receive low power FM stations. We are rolling it out slowly. We are not opening a window of filing for the entire Nation for 2 reasons: One, so that people can get more comfortable with the concept and also the nonprofit groups applying for these stations—they will be noncommercial stations—will have the opportunity to anticipate when the window opens in their State and get ready for it.

Mr. SERRANO. One last question. Who cannot run one of these stations? We know who can, but who cannot?

Mr. KENNARD. It is a noncommercial service. So the application requirements state that you have to be a local nonprofit organization rooted in the community. We also have decided that anyone who has been a broadcast pirate, who has flaunted our rules in the

past by broadcasting illegally won't be able to apply. We are really reserving this for community-based organizations and schools——

Mr. SERRANO. And churches?

Mr. KENNARD. Yes.

Mr. SERRANO. Could local political organization? Could we have WDEM or anything like that? Or WREP?

Mr. KENNARD. It would have to be a noncommercial entity.

NEXT WAVE ADS

Mr. SERRANO. One other issue. I think you have seen the ads that we have been kind of bombarded with about Next Wave and the truth in this. This I believe was an issue of pulling somebody's license or agreement. Could you just give us a quick understanding of why we are being bombarded by these ads?

Mr. KENNARD. Certainly. The company that placed these ads is a company named Next Wave that participated in FCC auctions for personal communication service licenses a couple of years ago. To make a long story short, we had auctions for the spectrum. They were offered installment payments to create incentives for smaller businesses to participate in the auction. This company bid too much. They went into bankruptcy.

The FCC has been clear from the outset that if a company bids and is unable to fulfill its financial obligations to the government, the FCC will take the license back. That is exactly what we did. This company at the 11th hour after they had lost an important bankruptcy appeal in the second circuit came to the Commission and offered to pay this $4.3 billion which is what they owe us. The offer came too late in the game.

As a matter of policy, the FCC has been on record as saying that if you can't pay, the license is reauctioned for the benefit of the American people. We are still in litigation with that company. It is my position what we should do is reauction that spectrum, get it out of the bankruptcy court, reauction it. It is likely to be very valuable, far in excess to the $4.3 billion, and any excess money should belong to the U.S. Treasury.

Mr. SERRANO. How many outlets did this speak to?

Mr. KENNARD. How many licenses?

Mr. SERRANO. Right.

Mr. KENNARD. I don't know the exact number. They were the largest bidder in the C block options and have licenses all around the country. I would have to supply you with the exact number of licenses.

Mr. SERRANO. So as far as you are concerned, this issue is over?

Mr. KENNARD. As far as I am concerned, yes. We are awaiting the outcome of an appeal in the 7th Circuit in order to go ahead with the reauction process. We have already scheduled a reauction for July 26. We are hopeful that the courts will vindicate our rights to go ahead and reauction the spectrum and get it working for the American people as quickly as we can.

Mr. SERRANO. Thank you, Mr. Chairman. I don't want to take any more time because I see Mr. Wamp——

Mr. WAMP. Sitting on the edge of my chair. Thank you, Mr. Chairman. I have another hearing where we have the director of the Forest Service, but I want to submit some questions for the

record and not take time today on the issue of partner owners being required to provide telecommunications service, whether or not that constitutes a taking issue. I will submit those questions for the record.

CABLE RATES

I may also have some questions on the low power issue depending on how much we talk about that today and what information is provided for the record on the low power issue. The only question I have verbally today, Mr. Chairman, after I welcome you as well, is following the Act of 1996, I just assumed that my cable rates were going to go down and they haven't. As a matter of fact, they continue every year to go up. And people back home complain about this.

And, frankly, I don't have any movie channels in my house, but I have kids that love basketball and we have sports channels. My rates just keep going up. I wonder what the national experience is with respect to cable and competition setting in, slowly but surely, and at what point we can expect cable rates to go down, and should they actually be raising above inflation which I think is the experience in my part of the world?

Mr. KENNARD. Congressman, cable rates are too high. I hear from many Americans who, like your constituents, are concerned about these rising cable rates. In 1996, in the Telecommunications Act, Congress took away the FCC's authority to regulate these rates, for the most part, and opted for competition to constrain these rates. We are hopeful that with the passage in the last Congress of the changes in the law that allow satellite companies to access local broadcast signals, those companies like Echo Star and Direct TV will be more formidable competitors to cable television. We see they are continuing to take more market share.

About two out of every three new multi-channel video subscribers is now going to satellite. It is a fairly effective product. But the fact remains that cable rates are not going in the right direction. I can't tell you when people will stop complaining about them and see them as reasonable. But we do know that given the tools that we have today, which does not include rate regulation, the only thing that we can do is aggressively promote more competition to cable television.

Mr. WAMP. The point in question, and then I will close, is are cable companies gouging customers right now given their share of the market share and the profits in that particular industry? That is the complaint that I have.

Mr. KENNARD. I expect that some are and some aren't. We do an annual report to Congress on the status of competition in this marketplace, and clearly programming costs are going up. The cable industry asserts that consumers of cable television services are getting more product for their money, more channels. The problem is that many people don't necessarily want those channels, they still have to pay for them. The only long-term solution to this is more competition as quickly as we can.

Mr. WAMP. Amen. Thank you.

H.R. 3439 AND LPFM

Mr. ROGERS. Back briefly to low power radio. As you, I am sure, know, I cosponsored H.R. 3439 to block you from authorizing new low power FM radio. There are some real concerns that the FCC rules were rushed through without adequate consideration of the potential impacts on existing broadcasters. Why was the—what explains that brief approval period compared to other FCC actions such as low power TV, digital TV?

Mr. KENNARD. I guess I would take issue with the premise of your question. This docket was not rushed through. It was a 2-year process. We developed an extensive record. In fact, the National Association of Broadcasters, which is the main opponent of low power FM, asked for and was granted 4 extensions of time in that proceeding for a total of 10 months extension. That was so that we could develop an ample record and so that we would be able to demonstrate that we had ample technical data in the proceeding, which we do. In fact, Mr. Chairman, no radio service has been authorized, based on a more extensive record than low power FM. It is ironic because we know a lot about the FM service. This is not rocket science, this is not new and experimental types of uses of the spectrum. This is FM broadcasting. We have lived with it 50 years and we now how it propagates in all sorts of different circumstances and terrain. Indeed we can look at the marketplace and point to stations that have the same interference protections as low power FM; grandfather short space FM stations, for example, class D FM station; we don't get any interference complaints about those to speak of.

Mr. ROGERS. In the past, didn't the FCC eliminate class D radio licenses because it determined that those low power stations were an inefficient use of spectrum?

Mr. KENNARD. Yes, but not to interference concerns. That was because the Commission, at that time, wanted to go with more wide area licensing. The net effect of that has been that smaller companies and smaller groups, churches, universities and schools, have not had as much access to the air waves. So low power FM is the means to address their needs to serve their communities.

Mr. ROGERS. Well, but weren't class D radio licenses eliminated in the past?

Mr. KENNARD. Yes, for the reason I stated, to go to more wide area licensing.

Mr. ROGERS. In other words, to use that same spectrum for wider higher power stations?

Mr. KENNARD. Yes, but the FM band has matured significantly since that time. We have many more FM stations, many more high powered stations. The need for those wide area stations has basically been met. The unmet needs today are the needs of smaller enterprises, particularly churches and schools and community groups, to get access to the air waves to serve their smaller communities.

Mr. ROGERS. Tell us a bit about the schedule on which you plan to proceed with low power.

Mr. KENNARD. On Monday we announced that we will be licensing low power FM stations in 5 groups. Basically what we did is divide the country into 5 different groups based on States, and we

will be opening the first window for filing low power FM applications in late May. That will be the first group of states. Then the other 4 will roll out over time and so that the last window of filing would be in November-December of 2001, if memory serves.

Mr. ROGERS. Can you tell us the States that will lead off?

Mr. KENNARD. I would have to——

Mr. SERRANO. Kentucky, New York——

Mr. ROGERS. I'm sorry.

Mr. KENNARD. To be clear on that, the States were selected at random. We had a lottery and we selected them at random. I don't have the list of States, but we can certainly provide that to you.

I do have the list of states. The lottery determined that the group number one would include Alaska, California, the District of Columbia, Georgia, Indiana, Louisiana, Maine, the Mariana Islands, Maryland, Oklahoma, Rhode Island, and Utah. Would you like me to read the other groups?

Mr. ROGERS. Just file it for the record, if you would.

Mr. KENNARD. Okay, certainly.

[The information follows:]

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FOR IMMEDIATE RELEASE:
March 27, 2000

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FCC LOTTERY TODAY DETERMINES ORDER FOR ACCEPTING APPLICATIONS FOR LOW POWER FM RADIO STATION LICENSES

Actual Dates of Filing Windows to be Announced in Later Public Notice

Washington, DC – The FCC today held its low power FM lottery to determine the order in which it will accept applications for this new radio service.

The lottery determined that the applicants from the following group of states will be the first to be accepted: Alaska, California, District of Columbia, Georgia, Indiana, Louisiana, Maine, Mariana Islands, Maryland, Oklahoma, Rhode Island, Utah

The Commission will take applications during a five-day filing window that will be announced in a subsequent Public Notice to be issued at the end of April, 30 days prior to the first day of the filing window, which will be at the end of May.

As he kicked-off the lottery process, FCC Chairman William E. Kennard, said, "Today we begin a process that offers access to the airwaves to many Americans – such as members of schools, churches, minority groups, public safety agencies, volunteer fire departments and other local community groups. I look forward to the FCC's soon receiving applications from many groups that, through these short-range, low power radio stations, will have a voice to serve their local communities."

Commissioner Gloria Tristani said, "My grandfather, the late U.S. Senator Dennis Chavez, taught me that one of the most important things we can do as public servants is to give a voice to the voiceless. That's why low power radio is so impórtant."

The Commission will be accepting applications in five groups. Evenly divided within those five groups are the 50 states, as well as U.S. possessions and territories.

(over)

The following is the order, also determined by lottery today, for processing applications from applicants in the remaining state groups:

No. 2. Connecticut, Illinois, Kansas, Michigan, Minnesota, Mississippi, Nevada, New Hampshire, Puerto Rico, Virginia, Wyoming. (Public Notice July 2000; filing window: August 2000)

No. 3. American Samoa, Colorado, Delaware, Hawaii, Idaho, Missouri, New York, Ohio, South Carolina, South Dakota, Wisconsin (Public Notice October 2000; filing window: November 2000)

No. 4. Arizona, Florida, Iowa, New Jersey, North Dakota, Oregon, Tennessee, Texas, U.S. Virgin Islands, Vermont, West Virginia (Public Notice January 2001; filing window: February 2001)

No. 5. Alabama, Arkansas, Guam, Kentucky, Massachusetts, Montana, Nebraska, New Mexico, North Carolina, Pennsylvania, Washington (Public Notice April 2001; filing window: May 2001)

The actual dates for the filing windows in each state grouping will be announced in subsequent Public Notices.

- FCC -

Mr. ROGERS. Now, in those first states, those are the ones that you will accept applications for first, right?

Mr. KENNARD. That is correct.

Mr. ROGERS. What is the timetable for that?

Mr. KENNARD. Again, that filing window would open approximately late May.

Mr. ROGERS. Those licenses would be acted upon by what date?

Mr. KENNARD. I anticipate that the first licenses in that group would be issued probably in the fall, September-October time frame, assuming things go smoothly. The benefit of that is that we wouldn't be flooding the marketplace with licenses throughout the country all at once. People will be able to get comfortable with this service. I am confident that once these low power FM stations begin turning on around the country, people will realize that they are not going to cause harmful interference and they can coexist peacefully with incumbent stations.

Mr. ROGERS. How many stations did you perceive this first group would include?

Mr. KENNARD. It is hard for me to answer that question because we don't know how many applicants there will be and what the spectrum opportunities will be. We will have to look at a computer database and figure out how many new stations can be accommodated. I can have my engineers run these numbers for you and submit them if you would like.

Mr. ROGERS. Do I understand you correctly that—let's say Alaska is one of those states, let's say that you have applications for two or three or four from Anchorage, you would determine that the frequency that an applicant is seeking on low power would have no interference possibilities with existing incumbent stations in Anchorage?

Mr. KENNARD. That is correct.

Mr. ROGERS. Then why are these incumbent stations so upset?

Mr. KENNARD. Well, Mr. Chairman, it is quite predictable. I have been a communications lawyer or policy maker for almost 20 years now, and I have seen a lot of battles waged about the use of spectrum. Almost invariably, when you introduce a new service, the incumbents try to fight it. We saw this with low power television. We have a low power television service in this country which was inaugurated in the late '70s, early '80s. There the incumbent commercial interest fought it tooth and nail. That service was authorized. We have low power television stations around the country. Last year Congress reaffirmed the value of those stations by passing an act to give them primary status in the marketplace, interference protection in the marketplace.

Those stations today are wonderful little microcosms of diverse programming. They cover high school baseball games and local news and things that a lot of the bigger stations don't. A lot of the interference concerns were raised then are looked back 20 years later and people say they were scare tactics. We are having the same misinformation and scare tactics swirling around low power FM. I have seen some of these—this propoganda that is being circulated around here to kill low power FM. It is wrong. It belies the

basic engineering facts of this service. I would be happy to meet with you and give you as much information and data as you would like about the service. I believe that I could convince you that low power FM is not going to cause harmful interference, and indeed would be good for the country.

Mr. ROGERS. Have you thought about a less offensive beginning of this service? In other words, to start it on a much slower scale to give it time to be evaluated before we go the whole route?

Mr. KENNARD. I think by opening these filing windows over time, we are taking a phased-in approach. Certainly if these stations create harmful interference, which they won't, we are certain they won't, we wouldn't have authorized this service. But if they do, we will act to take action, just like we do with full power stations. If there are interference complaints filed, we take action. But we have engineered the service so that each station, if it operates within its licensed parameters, will not cause harmful interference.

Mr. ROGERS. I would encourage you to start this process on a small scale for two or three reasons; one, to allay any fears that incumbent stations might have which they can see—if you did this on a small scale, we could all watch; they could all watch and see there is, in fact, no harm being done. And, in fact, some good is being done. That would be a nice test bed that you could then convince others to back off. And two, it would decrease the work load on the FCC. This is going to be a fairly good workload you have taken on, isn't it?

Mr. KENNARD. We have designed the application process so it is very streamlined and user friendly from both the applicant standpoint and the FCC standpoint. I don't anticipate a huge resource strain. But on your first point, I could show you stations around the country that will have comparable interference protection to low power FM stations. We have 400 what we call "grandfathered short space stations," which are not causing interference protection. They have been on the air since the mid 1960s, the same interference criteria as low power FM and they have caused a problem in the marketplace.

So given all we know and the extensive record we have developed and what we know in the marketplace, it seems it would be wrong to deny the tens of thousands of people around the country who have—who are excited about this service and want to roll it out for interference concerns that frankly, Mr. Chairman, just are not realistic.

Mr. ROGERS. Well, normally this kind of a sweeping change is something that would be initiated either in the executive branch and reacted to by Congress or initiated in the Congress. But here we see the FCC, an independent agency, proposing and acting without congressional approval. In fact, in the face of congressional intent, willy-nilly forthwith, hurly burly going out there and going all of the way with stiff opposition in the Congress. I think that is at least a bit different from the norm.

Mr. KENNARD. May I respond to that, Mr. Chairman?

Mr. ROGERS. Please.

Mr. KENNARD. The Communications Act which is, of course, our organizing statute delegates expressly to the Commission the responsibility for managing the spectrum. It is our legal obligation to

manage the spectrum in a way that promotes its most efficient use, which means finding ways for more people to use it consistent with interference concerns. If you look at the myriad of services that use the spectrum, from paging, to cellular telephone, to PCS, to satellite services, most of them are authorized by the FCC and historically has been, because the FCC is the expert agency that has been given this mandate to manage the spectrum efficiently and finding the uses for it. It is actually rare that Congress or the executive branch would actually authorize a new spectrum use. That is why we have an FCC, to manage the spectrum. This is not an unusual action by this agency.

Mr. ROGERS. We will see. I have a few more questions but I feel compelled to yield for a moment.

Mr. SERRANO. Sure. Hardly ever do I disagree with a chairman during hearings.

Mr. ROGERS. And you shan't today, right?

Mr. SERRANO. I will, but I will wait until you are gone. I really understand what you are saying, that this is all part of—you keep referring to the incumbents. Why would the incumbents complain? We do as incumbents. I think I should be in office forever, no one should ever run against me, but that is the way it is. So I can see where people just in a knee jerk reaction object right away to any change, anything different. Plus I can tell you that one of the areas that I pay a lot of attention to is the Spanish-speaking market. Those guys and ladies leave a lot to be desired in fairness in programming. That is another hearing someday. Sure they are going to complain, because the thought that someone local could actually have a talk show that doesn't have an agenda other than to let everybody talk or to bring in guests or music or whatever from parts that they don't want to have on the air, because they control it now, this is a whole new thing. That is why I am excited about it because of the possibility. I will take my chances that David Duke will have his show. That is the country that we live in.

MERGER REVIEWS

Very quickly, one question here. As you know, both the House and Senate have legislation pending that would limit the time that the FCC reviews applications for transferring these applications. I understand that in response to these bills the Commission has pledged to complete all such reviews within 6 months, and I applaud your efforts to conform the Commission's process. However, in light of this pledge, some folks are perplexed about the amount of time that it is taking the Commission to complete action on the AT&T-Media One transaction, given the fact that the issues that came up within the context of this merger of telephone service on cable, and Internet over cable, was addressed by the commissioner in previous proceedings. So our question is what is the problem, why is it taking so long, and how do we answer all of the folks that are asking questions about this?

Mr. KENNARD. It is certainly a major transaction that has a lot of complexity. We are in the process of developing a record there. We have had to go back to the company and get some additional information which we had to put out to public comment. That has extended the period of deliberation. But we are, I will say, in the

final stages of considering that particular case. We believe that it is very important for the FCC to have procedures in place to move these transactions along quickly.

But part of this is also training the industry because when the industry oftentimes will file an application, it is incomplete. We have to go back to them, they have to file more documents, we have to put those documents out for public comment. I am confident that as we get more experience with these major transactions then things will move more smoothly. That is what is happening with the Media One transaction.

Mr. SERRANO. I am going to go vote now and I will be back. In the meantime, I will consider whether I will ask you a Howard Stern question or not.

Mr. ROGERS. To follow up briefly on the merger, the question that Mr. Serrano dealt with somewhat, there has been a lot of attention given lately to the FCC's role in merger review. Legislation has been introduced in the House, at least, that would limit that role. I understand that you are undertaking your own independent review to improve your process and complete all merger reviews within the 6-month time frame; is that right?

Mr. KENNARD. That is correct, Mr. Chairman.

Mr. ROGERS. I assume a goal of that would be to streamline your efforts to make a merger review less labor intensive, right?

Mr. KENNARD. That is correct.

Mr. ROGERS. Tell us how many staff are currently allocated to merger reviews?

Mr. KENNARD. That is difficult for me to answer off the top of my head. We don't have a one merger review staff. The mergers are handled by various bureaus that have substantive responsibility for the industry. Their secretary is proposing the merger. So, for example, a merger of two wireless companies would go to the wireless bureau. A merger of two telephone companies would go to our telecommunications bureau, et cetera. So that information would be—I suppose I could pull it together for you if you would like, but it is difficult for me to answer off the top of my head.

Mr. ROGERS. I am trying to get some idea of the savings that could be achieved if you are successful in streamlining your efforts. At the end, what is the bottom line?

Mr. KENNARD. Well, the bottom line is more predictability in the way that mergers are handled by the FCC. To put this in context, after the 1996 Act, companies were allowed to enter into combinations that were not permitted by law before that Act. And so the FCC was flooded with these transactions. This industry is literally restructuring before our eyes, every sector of it. We are seeing combinations that were never possible before. A long distance company acquiring a cable television company, for example. So that has put a tremendous strain on the FCC, but we are working our way through it.

Mr. ROGERS. Well, as you know, this subcommittee funds the Justice Department as well as the Federal Trade Commission, both of which obviously are engaged in merger reviews. In fact, that is most of what the FTC does anymore, it seems, as well as the Antitrust Section in Justice, with hundreds of people involved. Why do

we need the FCC as well, a third agency, looking at merger possibilities?

Mr. KENNARD. Well, the simple answer, and then I will be happy to elaborate, is that the agencies have different statutory mandates. The FCC is charged with determining whether a proposed transaction serves the public interest and is consistent with the goals of the Communications Act. That is a fundamentally different type of review than is undertaken by the Justice Department or FTC which are charged with enforcing the anti-trust laws. It is a different burden of proof. It is a different standard. I don't want to suggest that they are completely unrelated because they do overlap in some ways, but it is fundamentally a different statutory mandate. Given what is happening in the marketplace today, Mr. Chairman, where you have consolidation of unprecedented size and scope, now is the time to reaffirm the FCC's fundamental authority to protect the public and make sure that no transaction goes through unless it serves the public interest. Now is not the time for the FCC to just be rubber stamping mergers. This is an extraordinary time and we have got to protect the public against undue consolidation. That is what we have been doing.

FREE AIR TIME

Mr. ROGERS. Final topic, free air time. Last year I urged you not to pursue Commission action—any Commission action—on free air time for political candidates absent any legislation from Congress. There has been no legislation from Congress and yet you proceeded regardless. Tell us what actions have been taken.

Mr. KENNARD. Well, under the 1996 Act, the Congress reaffirmed the public interest obligations of television broadcasters in the digital age. And as a result of that Act, the FCC commenced a proceeding or what we call a notice of inquiry to broadly examine the public interest's responsibilities of broadcasters. This included not only issues involving the political process, but also access of Americans with disabilities to television, for example, how to deal with emergency situations, public safety situations. We believe that this inquiry is completely consistent with our statutory mandate and we have developed, or are in the process of developing a record which I believe will be very informative to the Congress on these issues.

Mr. ROGERS. Well, the Congress, as you know, has repeatedly debated various proposals to grant candidates free air time. We have always refused to adopt that requirement. And one of the big questions is who would be responsible paying for the free air time that is mandated. The first thought would be, well, broadcasters would through lost advertising revenue. But we all know that they have to have a bottom line, so they would pass that cost on, assumedly, to other advertisers. And it very well could be the very candidates for public office buying ads on this station which was required by you to give them free air time.

So it is, in essence, a tax on somebody without the Congress having acted on it. How can you justify that?

Mr. KENNARD. Well, first of all, please understand, Mr. Chairman, that the FCC has not proposed any rules on free air time. We have responded, however, to the scores and scores of members of Congress, to the President of the United States, the Vice President

of the United States, that would have asked the agency to develop information on this topic to answer precisely some of the questions that you raise. That will be for the benefit of this debate and certainly for the benefit of the Congress.

Mr. ROGERS. How do you intend to proceed, if at all, once this incumbent period is over?

Mr. KENNARD. We are going to look at the record and make some determinations from there.

Mr. ROGERS. And would you go forward with a rule absent action from the Congress?

Mr. KENNARD. Well, as you know, as I have told you personally many times, we would be consulting with you and other key members of Congress before taking action. But Mr. Chairman, millions of Americans, as you know, are very concerned about this issue. Many people, not only political leaders and members of Congress, but many Americans have asked the FCC to look into these questions. It is our obligation to develop a record, particularly in the wake of provisions in the Telecommunications Act, that reaffirm the public interest obligations of broadcasters in the digital age.

Mr. ROGERS. So you maintain that you do have the legal authority to proceed, to put a program in place for free air time?

Mr. KENNARD. Yes. As you know, I believe, and I believed for many years now, that the FCC has that authority. But again, I respect the role of Congress in this area. We will certainly be consulting intensely with you and other members of Congress before we move forward. But I do believe that it is important for the FCC to serve as a constructive voice in this debate and provide you and other members a record that will be beneficial.

Mr. ROGERS. We do, as you know, have our own sources of information that we have been very happy with in the past. So I appreciate the offer, but no thanks.

Mr. KENNARD. Understood.

Mr. ROGERS. Now, you claim there is a great groundswell of support for free airtime for candidates. I have yet to receive the first letter, to my knowledge, asking me to go forward and try to get free air time for these candidates. I would suspect that there is more of a sentiment to deny candidates any time. I think people are sick of candidates on television, but I don't perceive that there is any groundswell of support for free air time for candidates. As I said, I don't recollect any single person ever mentioning it to me or writing me a letter to that effect. I guess they are writing you and not me, and that is fine.

Mr. KENNARD. I would love to share some of my e-mail messages with you on this topic, Mr. Chairman.

Mr. ROGERS. Who seeks time? Mr. Latham, are you ready?

CALEA

Mr. LATHAM. Thank you, Mr. Chairman. Regulations require all carriers to be compliant with the Communications Assistance for Law Enforcement Act of 1994 by June 30 of this year. However, the network suppliers have not even made available software for the industry. And suppliers are—according to 2000, the date that the upgrades are supposed to be completed as a release date for the standard software. Are you going to give an extension to carriers

in order to facility compliance with the statute. I have got, 154 small telephone companies in the state of Iowa and $10,000 a day fines is just going to be too much to handle.

Mr. KENNARD. Certainly. I really couldn't answer for you today whether we would be granting extensions. We would have to look at those on a case-by-case basis and determine what the specific request is. I will say that it is very important that we go ahead and implement CALEA. As you know, Congressman, it has been, in my view, far too many years that we have not had the statute implemented. It is important for law enforcement. I will certainly be sympathetic to the needs of small companies, but I would have to see their specific questions.

Mr. LATHAM. But the software is not available until the date—doesn't that make sense that maybe there would be some blanket extension? For each one of these 154 small phone companies to have a request—these are small tiny little phone companies.

Mr. KENNARD. As someone who reviews these extension requests all the time, you really have to look at them carefully. We will have to independently determine whether, in fact, there is software available or not. That would have to be based on the factual record before us. We have granted extensions before on CALEA. And in some cases, the Commission has been criticized for being too easy, that the statute has not been implemented as quickly as it should be. So we will have to be diligent in that regard.

Mr. LATHAM. You realize that companies are between a rock and a hard spot without the software available until the day says they have to be compliant.

Mr. KENNARD. I understand your point. But what I am trying to convey is if anyone comes before me and has a compelling reason for an extension, then certainly it would be warranted. But I can't just, as a general proposition, say that we will grant them all or not any. We would have to look at the record.

Mr. LATHAM. Okay.

Mr. ROGERS. Mr. Serrano.

Mr. SERRANO. I have no questions.

Mr. ROGERS. I have no further questions.

Mr. LATHAM. I think you have covered everything based on my other questions. So I will submit some things for the record.

Mr. SERRANO. The chairman still did not tell us when Kentucky and New York, what group of stations——

Mr. KENNARD. I think I can tell you——

Mr. SERRANO. That is all right.

Mr. KENNARD. Here it is. Let's see.

Mr. SERRANO. And the other question, is there any limit to how many applications? Did we ask that?

Mr. KENNARD. Yes. We are limiting an applicant to one application in the community. The goal here is to——

Mr. SERRANO. How many applicants? Are we limiting the number of applicants?

Mr. KENNARD. No. As many as we have opportunities for them. New York is in group 3. So we anticipate a filing window for New York opening in approximately November of 2000. Please, let's not forget Kentucky. The filing window for Kentucky is group 5, which would be the last group. We anticipate a filing window for Ken-

tucky to open in approximately May of 2001. That would be the last window.

Mr. ROGERS. Mr. Chairman, thank you for your time this morning. We appreciate you and your staff for being here with us to answer questions. You take some punches now and then and you always do that with good grace.

Mr. KENNARD. I appreciate that very much.

Mr. ROGERS. Mr. Serrano, Mr. Latham, and me, and the whole subcommittee is congratulatory to you on the adoption of your son, and we wish you——

Mr. SERRANO. Robert James Kennedy?

Mr. KENNARD. That is right.

Mr. ROGERS [continuing]. And we wish you and your wife and your son all of the happiness in the world——

Mr. KENNARD. Thank you very much. I appreciate that.

Mr. ROGERS [continuing]. And good health.

Mr. KENNARD. Thank you very much.

Mr. ROGERS. Thank you very much.

[Questions submitted for the record follow:]

QUESTIONS FOR RECORD

(Representative Latham)

QUESTION A 1

What is the factual basis for reports that the FCC is considering or planning to shift into the United States Treasury the funds collected, held and distributed by a private entity, the Universal Service Administration Company (USAC) to support the Universal Service principles enacted by Congress in Section 254 of the Telecommunications Act of 1996?

ANSWER:

There is no plan to shift the Universal Service Fund (USF) monies into the United States Treasury. However, in the course of preparing for the Commission's first audited financial report, questions arose as the staff and the auditors examined various USF administrative and financial functions. Further, in connection with the ongoing General Accounting Office (GAO) study of the "E-rate" program, the GAO inquired about the authority for the arrangement whereby USAC administers and invests universal service funds. For these reasons, the Commission sought advice from the Office of Management and Budget (OMB) concerning whether the funds must be considered "public money" within the meaning of 31 U.S.C. § 3302 requiring deposit of public money in the Treasury or a designated depository.

OMB advised that it has classified universal service funds as federal revenues and outlays only for purposes of the United States Budget, and that it does not consider Universal Service Funds to be "federal funds" for all purposes. OMB specifically advised that the Universal Service Fund does not constitute "public money" pursuant to 31 USC § 3302 and is appropriately maintained outside the Treasury by a non-governmental manager. *See* Letter from Robert Damus, General Counsel, OMB to Christopher J. Wright, General Counsel, FCC, April 28, 2000 (attached) *See also* Letter from William E Kennard, General Counsel, FCC, to Michael R. Volpe, Assistant General Counsel of GAO, April 28, 2000 (attached).

QUESTION A 2

What statutory or regulatory authority, written decision, rule or regulation, statement of policy or other source of legal authority does the FCC, the Office of Management and Budget (OMB), the Congressional Budget Office or any other government body claim as the basis for transferring universal service funds to the U.S. Treasury and continuing to place such funds in the United States Budget? What opportunity has or will be provided to the public to seek judicial or other

review under applicable law of decision to shift the universal service fund into the Treasury or the earlier decision to place the universal service fund in the federal Budget?

ANSWER:

The interplay of section 3302 of Title 31, United States Code, and implementing Treasury regulations, with the OMB decision to include USF in the United States budget raised the issue of whether these funds are public money that must be deposited in the Treasury. As noted above, however, the Commission sought authoritative guidance on the issue from OMB and OMB has determined that the funds are appropriately maintained outside the Treasury by a non-governmental manager. The FCC has no authority to make determinations concerning the scope of the United States Budget. Questions concerning OMB's authority to make such decisions should be directed to OMB.

We are not aware of a process by which the public may challenge a decision by the OMB to include a special fund in the United States Budget.

QUESTION A 3

Has the FCC decided or has it been told by OMB or any other federal entity that the universal service fund is or should be subject to appropriation by Congress?

ANSWER:

The FCC has neither decided, nor has OMB told it that the Universal Service Fund is subject to the annual appropriation process.

QUESTION A 4

Has the FCC decided or has it been told by OMB or any other federal entity that the universal service funds administered by USAC are federal funds and should be commingled with other federal funds in the Treasury?

ANSWER:

As noted above, OMB has advised that the Universal Service Fund is appropriately maintained outside the Treasury by a non-governmental manager.

QUESTION A 5

What guarantee can the FCC provide to Congress that transferring the universal service funds administered by USAC to the Treasury and continuing to reflect these privately administered funds in the federal budget has and will have no adverse consequences with respect to the achievement of the national telecommunications policy enacted by Congress in the Telecommunications Act of 1996?

ANSWER:

As noted above, the Commission has been advised by OMB that the funds are appropriately maintained outside the Treasury by a non-governmental manager, and therefore, the FCC has no plans to do otherwise.

QUESTION A6

What assurances can the FCC provide to Congress that including the universal service funds administered privately by USAC will not lead to a recurrence of the unfortunate efforts in 1998 to "balance the budget" by manipulation of the universal service funds, which was averted by a Sense of the Senate Resolution and repeal of the appropriations provision before the scheme took place?

ANSWER:

As noted above, the FCC has been advised by OMB that the Universal Service Fund is appropriately maintained outside the Treasury by a non-governmental manager, and therefore, the FCC has no plans to do otherwise.

QUESTION A 7

What impact does or would transferring the universal services funds administered by USAC or any other funds administered by USAC or the National Exchange Carriers Association (NECA) have on the authority and exposure to liability of any employee, officer or director of USAC or NECA that has been or will in the future be involved in the administration of any such funds transferred to the U.S. Treasury or by reason of inclusion as part of the federal budget?

ANSWER:

As noted above, the Commission has been advised by OMB that the Universal Service Fund is appropriately maintained outside the Treasury by a non-governmental manager, and therefore, the FCC has no plans to do otherwise.

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QUESTION A 8

What guarantee can the FCC provide to Congress that shifting the universal service funds administered by USAC to the U.S. Treasury will not have any adverse impact on the FCC's ability to oppose successfully and the result of the court action on the Celpage Petition for Certiorari pending in the Supreme Court, which claims that some or all of the universal service programs administered by USAC are unlawful taxes?

ANSWER:

As noted above, the Commission, consistent with guidance received from OMB, does not intend to deposit universal service funds in the Treasury. In any event, deposit of the funds in the Treasury would not have affected the constitutional analysis in the pending litigation.

The United States Court of Appeals for the Fifth Circuit has recognized previously that universal service funds had been determined to be federal funds by CBO and OMB, but nevertheless found that the statutory contributions were not unconstitutional taxes in accord with *United States v. Munoz-Flores*, 495 U.S. 385, 398-99 (1972) ("A statute that creates a particular program and that raises revenue to support that program" is not a bill raising general revenues and thus is not an unconstitutional tax). *Tex. Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 442-445, (5th Cir. 1999), petitions for cert. Pending. Whether or not the funds are deposited in the Treasury, universal service contributions may only be used to support the universal service program. Thus, like the statutory assessments in *Munoz-Flores*, the funds are not considered general revenues and therefore are not taxes.

(Representative Wamp)

QUESTION B 1

Under what statutory authority does the FCC have power to require private property owners and managers to open up their properties to telecommunications providers?

ANSWER:

In its Promotion of Competitive Networks in Local Telecommunications Matters rulemaking proceeding ("Competitive Networks" proceeding), the Commission identified several potential statutory bases for imposing limited access requirements on owners of property serving multiple tenants ("multiple tenant environments"). With respect to its statutory authority, the Commission asked whether the use of in-building facilities to

provide interstate and foreign communication is within its subject matter jurisdiction to regulate under Title I of the Communications Act. Notice of Proposed Rulemaking and Notice of Inquiry, 14 FCC Rcd 12673, 12702-03 (1999) ("NPRM/NOI"). In this regard, the Commission cited Sections 1 and 2(a) of the Act, which give the Commission jurisdiction to enforce the Act with respect to "all interstate and foreign communication by wire or radio" and Section 3 of the Act, which broadly defines radio and wire communications to include "all instrumentalities, facilities, apparatus and services . . . incidental to" such communications. Id. The Commission also sought comment regarding its authority, under Sections 224 and 251(c) of the Act, to require utilities to provide competitive telecommunications carriers with reasonable and nondiscriminatory access to utility-owned or controlled rights-of-way and facilities that are located in multiple tenant environments. Id. at 12693-700. Under Section 224, utilities are required to provide telecommunications carriers and cable television systems with nondiscriminatory access to "any pole, duct, conduit, or right-of-way owned or controlled by [the utility],"and under Section 251(c)(3), incumbent local exchange carriers ("LECs") are required to provide telecommunications carriers with nondiscriminatory access to network elements on an unbundled basis. See 47 U.S.C. §§ 224 (f)(1), 251(c)(3). Finally, the Commission sought comment on whether Sections 4(i) and 303(r) of the Communications Act – which authorize the Commission to take such action as may be necessary to perform its duties and carry out the purposes and provisions of the Act – provide the Commission with authority to require building owners who give any carrier access to their premises to make comparable access available to all such carriers under nondiscriminatory rates, terms and conditions. See NPRM/NOI, 14 FCC Rcd at 12701, 12703-04 (1999) ("NPRM/NOI").

The Commission received numerous comments in response to the Competitive Networks NPRM/NOI, arguing both in favor and against Commission jurisdiction. The Commission is currently evaluating the record and has not reached a decision on the scope of its statutory authority to require access to multiple tenant environments.

QUESTION B 2

Wouldn't this represent a "taking" and thus open the Federal government to huge payments to property owners?

ANSWER:

In the Competitive Networks proceeding, the Commission also sought comment on this constitutional issue. See NPRM/NOI, 14 FCC Rcd at 12704-06. Under the Fifth Amendment to the United States Constitution, the government may not effect a taking of private property without just compensation. The Supreme Court has ruled that a state requirement that building owners provide access to install equipment to certain service providers (there, providers of cable television service) constitutes a permanent physical occupation of the landlord's property that amounts to a per se taking for which just

compensation is constitutionally required. Loretto v. TelePrompter Manhattan CATV Corp., 458 U.S. 419 (1982).

The Commission's basic proposals in the Competitive Networks NPRM, however, would not mandate access in the first instance, but would only apply if the property owner had already granted a telecommunications provider access to the property. Some commenters have argued that a nondiscriminatory access requirement may not constitute a per se taking. See, e.g., Comments of Teligent, Inc., Competitive Networks proceeding, at 54-60 (filed Aug. 27, 1999); Comments of WinStar Communications, Inc., Competitive Networks proceeding, at 39-42 (filed Aug. 27, 1999); see also Heart of Atlanta Motel v. United States, 379 U.S. 241, 261 (1964) (holding that Civil Rights Act's nondiscrimination access requirement mandating general access to places of public accommodation did not constitute a taking). Again, other commenters have disagreed. See, e.g., Comments of Real Access Alliance, Competitive Networks proceeding, at Appendix E (filed Aug. 27, 1999). The constitutionality of governmental action that does not rise to the level of a per se taking is evaluated under the three-part regulatory takings analysis first outlined in Penn Central Transportation Co. v. New York City, 438 U.S. 104 (1978). Under this analysis, some commenters assert that the nondiscrimination requirements described in the Competitive Networks proceeding would not constitute a taking because the requirements would further the public interest, would have minimal economic impact, and would not undermine investment-based expectations. See, e.g., Teligent Comments at 59-60; WinStar Comments at 41-42.

Commenters have also addressed the Federal government's potential exposure in the event a taking is determined to have occurred. Some commenters have argued that builder owners would have a Tucker Act remedy against the United States, exposing it to enormous financial liabilities for the uncompensated fair market value of property taken as determined under a Fifth Amendment analysis. See, e.g., Real Access Alliance Comments, Appendix E, at 37, 45; see also Bell Atlantic v. FCC, 24 F.3d 1441, 1445 n.3 (D.C. Cir. 1994). Others have argued that this exposure is small because, among other reasons, the Commission is contemplating regulations that would ensure property owners receive just compensation. See, e.g., WinStar Comments at 42.

As with the statutory authority issues, the Commission is reviewing the record in order to assess carefully and decide correctly these complex and novel constitutional issues.

QUESTION B 3

If the FCC did mandate that any and all telecommunications providers had access to a property without the property owner's approval, would this really foster competition?

ANSWER:

It is the goal of the Competitive Networks Proceeding, consistent with the mandate of the Telecommunications Act of 1996, to foster competition in local telecommunications services. The NPRM sought comment on whether new rules are necessary to achieve that goal. The comments of all parties who addressed the question, including numerous property owners and associations, are being given full consideration in the ongoing rulemaking process.

QUESTION B 4

I have heard, particularly from apartment community owners, that "forced access" might actually result in less competition because only the biggest telecommunications providers could survive in that type of environment. Did you know, that many providers insist on the right to be on a given property exclusively for some limited period of time in order to recoup their investment? How could the smaller and newer providers survive without some form of limited exclusive contract?

ANSWER:

In paragraphs 61 and 64 of the NPRM, the Commission sought comment on this very issue and the views of all parties are being given every consideration.

QUESTION B 5

Are you talking about forced access for voice, video and data? If yes, what would be the clear safeguards for a property to expel a provider from the property if that provider was not dependable or not innovative? What if the provider promises to deliver, but clearly comes up short? What are the immediate remedies available to the apartment manager?

ANSWER:

The NPRM deals with access to telecommunications services, defined in Section 3(43) of the Communications act of 1934, as amended, as transmissions, between or among points specified by the user, of information of the user's choosing. This includes voice, video and data, but not multi-channel video programming or other services that do not fall within the definition of telecommunications. If the Commission decides that a rule governing access to multiple tenant environments is appropriate, then it will consider what remedies are and should be available to address providers that fail to live up to their commitments.

QUESTION B 6

In the apartment market, the annual turnover rate of residents is often greater than 50 percent. How would an apartment community owner ever be able to manage a community if every month there was a whole new set of demands for individual types of service?

ANSWER:

The owners and managers of many apartment communities have submitted comments on this issue and these comments are being fully considered by the Commission.

QUESTION B 7

Resident moves out and within days or hours, a new resident moves in. That new resident expects the phone to work, the TV to work and possibly get high speed data. Providers cannot meet this type of turnaround. What is the apartment community owner to do if his/her right to manage the property in an efficient manner is taken away?

ANSWER:

The Commission will examine this issued during this proceeding and provide a comprehensive answer prior to finalizing its rule making. The underlying goal of the Telecommunications Act of 1996 is to increase the number of choices consumers have in the telecommunications market place. The NPRM sought comment on the best way to do this in the multi-tenant environment. The Commission is taking full account of the concerns of apartment owners.

QUESTION B 8

Between properties there is tremendous competition. Why would the FCC want to step into this competitive environment?

ANSWER:

Again, the Commission is interested in fostering competition in the provision of telecommunications facilities, and will make its final determination taking into account all of the comments filed.

(Representative Royball Allard)

QUESTION C 1

On December 23, 1999 FCC Chairman Kennard wrote to Commerce Subcommittee Chairman Tauzin stating that "given the instructional nature of the service and the long-standing reservation of ITFS spectrum for non-commercial educational use, it is possible that Congress did not intend its expansion of our auction authority to include ITFS.

Is this still an accurate assessment of the FCC view on the ITFS issue?

ANSWER:

Yes, this is a correct assessment. Please see below for a complete explanation.

QUESTION C 2

In light of the current budget surpluses, some argue it is not prudent to require schools and other non-profit educators to pay the federal government for ITFS spectrum licenses.

Does the FCC advocate for the passage of H.R. 879, or another similar legislative fix, that would remove the FCC's authority to auction ITFS spectrum?

ANSWER:

Yes. The Instructional Television Fixed Service (ITFS) is a point-to-point multipoint microwave service whose channels are allocated to educational organizations and are used primarily for the transmission of instructional, cultural and other types of educational material. Section 309(j)(1) of the Communications Act, as amended by the Balanced Budget Act of 1997, mandates the utilization of competitive bidding to resolve mutually exclusive applications, with certain specified exemptions. The exceptions to this general auction mandate are set forth in Section 309(j)(2), which provides that the Commission's competitive bidding authority shall not apply to licenses or construction permits issued for three specific services, of which ITFS is not one. See 47 U.S.C. § 309(j)(2)(A)-(C). ITFS, a non-broadcast service, is outside the scope of Section 309(j)(2)(C), which is expressly limited to "noncommercial educational broadcast station(s)' and 'public broadcast station(s).'" See 47 U.S.C. § 397(6) (emphasis added). However, we are concerned that, given the instructional nature of ITFS, Section 309(j), as amended, may not on its face reflect Congress's intent with regard to the treatment of competing ITFS applications. Indeed, virtually all commenters in the Commission rulemaking proceeding regarding the implementation of the Commission's auction authority, as expanded by the 1997 Balanced Budget Act, opposed subjecting competing

ITFS applications to auction, and several urged the Commission to seek a clarifying amendment of Section 309(j) from Congress.

According to Commission regulations, authorized ITFS "channels must be used to transmit formal educational programming offered for credit to enrolled students of accredited schools," with certain limited exceptions. 47 C.F.C. § 74.931(a)(1). In addition, ITFS station licenses are "issued only to an accredited institution or to a governmental organization engaged in the formal education of enrolled students or to a nonprofit organization whose purposes are educational and include providing educational and instructional television material to such accredited institutions and governmental organizations." 47 C.F.R. § 74.932(a). Given these limitations placed on the use of ITFS channels, and the general instructional nature of the service, we recommend that Congress amend Section 309(j)(2) to exempt this service from competitive bidding procedures. We do not believe it would serve the public interest to require educational institutions and governmental educational entities to bid at auction for spectrum reserved for instructional purposes. An explicit exemption from competitive bidding would allow us to continue to resolve competing ITFS applications through its well-established point system, which reflects the unique nature of the ITFS service. See 47 C.F.R. § 74.913.

QUESTION C 3

What is the FCC doing to respond to the findings of the study which provided strong evidence that advertisers often exclude radio stations serving minority audiences from ad placements and pay them less than non-minority owned stations when they do advertise on minority-owned stations?

ANSWER:

In 1999, the Vice-President established an Interagency Working Group on Advertising Practices (Advertising Working Group). The Advertising Working Group includes staff representatives from the FCC, FTC, NTIA, SBA and the Office of the Vice President. The Group has focused on advertising policies of the (i) federal government that may disfavor small business, including business owned by women and minorities and (ii) of major private-sector advertising agencies that devalue minority broadcasters, other advertising agencies, and consumers.

Over the last several months, the Advertising Working Group has maintained an ongoing dialogue with the American Advertising Federation, the American Association of Advertising Agencies, the Association of Hispanic Advertising Agencies, and African American and Hispanic committees of those organizations as well as the Offices of Representatives Kilpatrick and Menendez.

The Advertising Working Group has encouraged the government and the industry to examine their respective advertising practices. As a result, the federal government will issue a study on the government's advertising practices in the next two months. The

American Advertising Federation also plans to adopt specific principles to help the industry eradicate unfair practices and promote inclusion of women and minorities. In addition, the Working Group is currently discussing the feasibility of convening a conference on fairness in advertising in the fall 2000 to further explore the results of these studies and facilitate further dialogue.

QUESTION C 4

How is the E-Rate program assisting in confronting the "digital divide" that is being experienced by many poor schools?

ANSWER:

While we have made a great deal of progress in eliminating the "digital divide" in K-12 schools through the E-Rate program, there is still more work to be done. According to a February 2000 National Center for Education Statistics (NCES) report, entitled Internet Access in U.S. Public Schools and Classrooms: 1994-99, 95% of all public schools buildings had at least one point of access to the Internet as of 1999, a 30 percentage point rise since 1996. Similar large gains have been made at the instructional classroom level: whereas in 1996 only 14% of public school instructional classrooms were connected to the Internet, this figure had grown to 63% as of 1999.

NCES statistics bear out, however, that significant rate disparities continue to exist between economically disadvantaged schools and their wealthier counterparts in terms of Internet access. In the neediest of our nation's schools, defined as those that have 71% or more of their students eligible for the federal lunch program, only 39% of instructional classrooms had Internet access as of 1999. In this country's wealthiest schools, by contrast, 74% of instructional classrooms have Internet access. Of even greater concern is the fact that our neediest schools made no progress in connecting instructional classrooms to the Internet in the last two years– with the number of classrooms connected not growing by a single percentage point – while the wealthiest schools saw a 12 point surge in instructional classroom access to the Internet.

The Commission has made a strong effort to target resources to our nation's neediest schools, striving to narrow this digital divide. Early in the program's history, the Commission adopted E-Rate program rules that ensured that the neediest schools and libraries, as determined by federal lunch program eligibility statistics, received the largest discounts (80% to 90% discounts on the price of eligible services). Additionally, the Commission decided that these neediest schools and libraries would receive priority in the disbursement of funds available for internal connections discounts. In the first two years of the program, the nation's poorest schools and libraries (those falling into either the 80% or 90% discount levels) received over $2 billion in support for telecommunications services, Internet access, and internal connections discounts. In Year 3 of the program, the Commission will fully fund the E-Rate to its annual cap of $2.25 billion, and the program's administrator has begun issuing funding commitment decision

letters. I expect that this year's commitment of support to schools and libraries nationwide, with its continuing focus on assisting our most economically disadvantaged schools gain access to the Internet, will help make additional headway in bridging the digital divide.

QUESTION C 5

What success is the FCC's new Enforcement Bureau having in responding to complaints about ethnic slurs and other broadcast segments that are objectionable to Hispanic-Americans, African-Americans or other ethnic minorities?

ANSWER:

The Enforcement Bureau carefully reviews all complaints from members of the public, including those that complain about ethnic slurs and objectionable broadcast material. When we receive such complaints, we recommend that members of the public share their concerns with the management personnel of the broadcast station involved. We believe the best action to take against insensitive or offensive programming is to have members of the public let stations and programmers know that they do not approve of such programming.

Although we understand concerns about ethnic slurs and other statements that are offensive to ethnic minorities being broadcast over the public airwaves, the Commission is generally prohibited from involving itself in the content of specific programs or otherwise engaging in activities that might be regarded as censorship or interfering with the right of free speech. *See* Section 326 of the Communications Act of 1934, as amended, 47 U.S.C. § 326. The Commission generally may not take action against a broadcaster simply because it engages in speech that is racist or offensive to minorities. Such speech is constitutionally protected. If, however, the racist or offensive speech presents a "clear and present danger" to life or property, the Commission may take action. As the Commission has stated:

> It is the judgment of the Commission, as it has been the judgment of those who drafted our Constitution and of the overwhelming majority of our legislators and judges over the years, that the public interest is best served by permitting the expression of any views that do not involve 'a clear and present danger of serious substantive evil that rises far above public inconvenience, annoyance, or unrest . . . .' This most assuredly does not mean that those who uphold this principle approve of the opinions that are expressed under its protection. On the contrary, this principle insures that the most diverse and opposing opinions will be expressed, many of which may be even highly offensive to those officials who thus protect the rights of others to free speech. If there is to be free speech, it must be free for

speech that we abhor and hate as well as for speech that we find tolerable or congenial.

Anti-Defamation League of B'nai B'rith, 4 FCC 2d 190, 191-192 (1966). In addition, to the extent the racist or offensive language also includes reference to sexual or excretory matters such that it is indecent, the Commission may also take enforcement action under the statutory prohibition on indecency.

QUESTION C 6

What level of complaints are you receiving about so-called "dial-around" calls, and what is FCC doing to address any advertising abuses?

ANSWER:

The Consumer Information Bureau has received 187 written and verbal consumer complaints regarding "dial around" services since November 8, 1999.

The FCC created the Enforcement Bureau in November 1999 to, among other functions, provide consumers with more efficient and effective protection involving issues such as "dial-around" advertising. The Telecommunications Act of 1996 has promoted increased competition and additional innovative services for long distance telephone customers. The proliferation of advertisements for services such as dial-around, however, has resulted in an increase in the number of complaints by consumers regarding confusing or misleading carrier marketing and advertising.

In November 1999, the FCC, in conjunction with the Federal Trade Commission, held a public forum to discuss and address marketing and advertising of dial-around services as well as other long distance telecommunications services. On March 1, 2000, the FCC and FTC issued a joint Policy Statement based on the information gathered at the forum. The Policy Statement provided guidelines for carriers in order that they might adhere to lawful and acceptable advertising standards and practices.

Additionally, on March 1, 2000, the Enforcement Bureau released an order adopting a Consent Decree between the Bureau and MCI WorldCom in which MCI WorldCom agreed to modify its advertising and marketing practices for its dial-around and casual billing services. MCI WorldCom also made a voluntary contribution to the U.S. Treasury of $100,000.

The Enforcement Bureau is closely monitoring adherence to the Commission's consumer protection initiatives and intends to investigate any carrier where there is evidence of widespread abuse regarding advertising practices. The Commission is committed to ensuring that consumers have the knowledge and protection they need to receive fair charges and service for the services they use.

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON

OFFICE OF
THE CHAIRMAN

April 28, 2000

Michael R. Volpe, Esq.
Assistant General Counsel
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Volpe:

This letter is in response to your letter dated March 6, 2000, regarding the General Accounting Office's on-going study of the "E-rate program," which is one of the universal service support mechanisms established pursuant to section 254 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996. Specifically your letter requested written responses to several questions on various aspects of the program. The questions and our responses are provided below.

Are the contributions collected to fund the E-rate program federal funds? Please explain.

The term "E-rate program" is often used to describe one of the mechanisms adopted by the Commission to implement section 254 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996. In particular, this mechanism provides for discounted telecommunications and certain information services to schools and libraries.[1] The other section 254 mechanisms support the provision of universal telecommunications service to rural and high cost areas, low income consumers, and health care providers.[2]

All of the universal service support mechanisms described above are funded by mandatory contributions from all telecommunications carriers that provide interstate telecommunications services, and from any other providers of interstate telecommunications as required in the public interest.[3] For purposes of the United States Budget, the Office of Management and Budget (OMB) has classified these contributions

[1] 47 U.S.C. § 254(h)(1)(B) & (h)(2); *see also* 47 U.S.C. § 254(c)(3).

[2] 47 U.S.C. § 254(b) & (h)(1)(A).

[3] 47 U.S.C. § 254(d).

and the resulting support payments as federal funds, and more specifically, "[the universal service] fund is included in the FCC portion of the budget as a special fund."[4]

The Universal Service Fund as designated in the United States Budget consists of five elements: the high cost mechanism, the low income mechanism, the schools and libraries mechanism, the health care mechanism, and the telecommunications relay service fund. The Congressional Budget Office (CBO) has explained that:

> CBO and [OMB] count payments into the Universal Service Fund as federal revenues and payments from the fund as federal outlays. Both agencies have interpreted the Telecommunications Act of 1996 to mean that the fund's expenditures should be part of the federal budget, because the transfers of income between various classes of telephone users would not occur but for the exercise of the sovereign power of the United States.[5]

Because OMB is the expert agency responsible for determinations regarding the status of these funds, the Commission's General Counsel also consulted with OMB concerning the effect of OMB's decision to include the fund in the United States Budget. OMB's General Counsel advised that universal service funds are included in the Budget in order to convey the full scope of government activity. See Attachment, Letter from Robert Damus, General Counsel, OMB, to Christopher J. Wright, General Counsel, FCC (April 28, 2000). OMB does not, however, consider universal service funds to be "federal funds" for all purposes. More specifically, OMB has advised that the universal service fund "does not constitute public money pursuant to the Miscellaneous Receipts Statute, 31 U.S.C. 3302, and is appropriately maintained outside the Treasury by a non-governmental manager." In putting the fund on the United States Budget as a special fund, OMB also noted to Congress that the fund is "maintained outside the Treasury by a non-governmental entity."[6] We concur with OMB's conclusion that the universal service fund is appropriately maintained outside the Treasury by a non-governmental manager, particularly in light of the legal history of the universal service fund.

The universal service fund was created initially under the general authority of the Commission to regulate the telecommunications industry. Prior to 1996, universal service funds were "calculated, collected, and disbursed by the National Exchange Carrier Association ('NECA'), an independent organization of LECs [local exchange carriers] created by order of the FCC." *ALC Communications Corp. v. FCC*, 1991 WL 17222 *1 (D.C. Cir. 1991) (unpublished); see also *Rural Telephone Coalition v.*

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[4] Significant Presentation and Technical Changes in the Budget of the United States, Fiscal Year 1997.

[5] Congressional Budget Office, *Federal Subsidies of Advanced Telecommunications for Schools, Libraries, and Health Care Providers*, January 1998, p.5.

[6] OMB Significant Presentation and Technical Changes to the Budget of the United States, Fiscal Year 1997.

FCC, 838 F.2d 1307, 1315 (D.C. Cir. 1988) (establishment of the fund "was within the Commission's statutory authority" set forth in 47 U.S.C. 151 and 154(i)).

In enacting section 254 in 1996, Congress built upon the existing universal service fund. It added the e-rate program to ensure that advanced telecommunications technologies reached classrooms. In subsection 254(d) of the Act, Congress also directed the Commission to collect universal service funds – whether used for the high cost program, the e-rate program, or any other universal service program – from every telecommunications carrier providing interstate service. Congress did not direct any change in the treatment of the universal service funds, however, once they were collected. The Commission accordingly broadened the base from which universal service funds were collected and the purposes for which they were distributed. But it kept the procedure by which universal service funds were collected and disbursed – matters not addressed by Congress in 1996, but presumably known to it, – largely intact. The primary difference was that NECA (described by the D.C. Circuit in 1988 as "an independent organization of LECs created by order of the FCC") created a subsidiary, the Universal Service Administration Corporation (USAC), which more broadly represents both contributors to and beneficiaries of universal service support. Given this history, and consistent with OMB's conclusions, we believe that the universal service fund is appropriately maintained outside the Treasury.

It is our understanding that these funds are currently deposited in an interest-bearing account at Mellon Bank. Under what name is the E-rate account held and who has authority to deposit and withdraw monies from this account?

The monetary contributions of telecommunications carriers and other required telecommunications providers are not segregated by mechanism, therefore there is no separate "E-rate" account. The carriers and providers deposit the required universal service contributions into a commercial lockbox account at Mellon Bank, Pittsburgh, Pennsylvania. Amounts not to be immediately disbursed as support payments are deposited in various commercial, interest-bearing money-market accounts or invested as determined by the entity appointed to administer the universal service mechanisms, USAC. The investments include marketable federal securities, notes and bonds, commercial paper, and repurchase agreements held in USAC's name. The Mellon Bank lockbox account and commercial money-market accounts at First Union Bank, Merrill Lynch, and BancOne Trust are held in USAC's name. The authorized signatories are the Treasurer and Assistant Treasurer of USAC and their authorized designees (which include employees of the National Exchange Carriers Association ("NECA")), USAC's subcontractor for collection and disbursement of funds, as authorized by USAC's Board of Directors.

What is the Commission's authority for this arrangement?

The universal service mechanisms are established and administered pursuant to Section 254 of the Communications Act of 1934, as amended by Telecommunications Act of 1996, which requires the Commission to establish "specific, predictable and sufficient

mechanisms" to preserve and advance universal service.[7] In implementing section 254, the Commission directed that the contributions be remitted to USAC.[8] USAC has provided for the investment or retention in money-market accounts of these contributions as part of its financial management of the universal service support mechanisms to ensure their sufficiency.

As noted above, prior to the passage of section 254, Commission regulations provided for a universal service fund that was managed by a non-federal entity (NECA) through a system of inter-carrier transfers and held in accounts outside the Treasury. The record indicates that both Congress and the OMB were aware of that prior arrangement, and the Commission has received no direction from OMB or Congress that the funds should now be handled differently. As noted above, the Commission also consulted with OMB, the expert agency charged with resolving these matters. OMB's guidance is reflected in our response to question one and the Attachment to this letter.

Please provide the specific statutory authority that permits the Commission to collect and disburse funds to support discounts on (1) telecommunication services, (2) Internet access, and (3) internal connection?

The statutory authority for the Commission to collect and disburse funds to support discounts on telecommunications services, Internet access, and internal connections arises from section 254 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996.[9] Specifically, section 254(c), the definitional section for universal service, provides that, in addition to services designated as universal service pursuant to section 254(c)(1), the Commission may "designate additional services for such support mechanisms for schools [and] libraries."[10] Thus, pursuant to section 254(h)(1)(B) and 254(c)(3), the Commission designated all commercially available telecommunications services, Internet access services, and internal connections as services eligible for support for schools and libraries. Moreover, as required by section 254(a)(1), the Commission reached this decision only after convening a Federal-State Joint Board and obtaining its recommendations, which are reflected in the Commission's decision.[11]

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[7] 47 U.S.C. § 254(d).

[8] *Changes to the Board of Directors of the National Exchange Carriers Association, Inc., Report and Order and Second Order on Reconsideration (NECA I)*, 12 FCC Rcd. 18400, 18427 (1997).

[9] 47 U.S.C. §§ 154(i) and 254.

[10] 47 U.S.C. § 254(c)(3).

[11] *Federal-State Joint Board on Universal Service, Report and Order (Universal Service Order)*, 12 FCC Rcd 8776, 9006-9020 at paras. 437 – 463 (1997); *see also* 47 U.S.C. § 254(a)(1) ("the Commission shall institute and refer to a Federal-State Joint Board . . . a proceeding to recommend changes to any of its regulations in order to implement . . . this section, including the definition of the services that are supported by Federal universal service support mechanisms.")

On July 30, 1999, the United States Court of Appeals for the Fifth Circuit upheld the Commission's decision to designate all commercially available telecommunications services, as well as Internet access services and internal connections as eligible services for support from the universal service support mechanism for schools and libraries.[12]

Under what authority does the Universal Service Administrative Company (USAC), a private corporation, collect and disburse these funds?

The Commission has appointed USAC the permanent universal service administrator responsible for the collection and disbursement of universal service funds, pursuant to the Commission's rules and orders implementing section 254.[13]

Under what authority have these contributions been deposited into an interest-bearing account?

The universal service mechanisms and the administrative provisions that implement them were established under the authority of section 254 of the Communications Act of 1934, as amended, 47 U.S.C. § 254. USAC has provided for the investment or retention in money-market accounts of contributions as part of its financial management of the universal service support mechanisms to ensure their sufficiency.

What is the authority for the Commission to use E-rate program funds to cover the administrative costs of the program?

In implementing section 254, the Commission expressly provided that the contributions required by the statute to fund all of the universal service mechanisms include the expenses incurred by the entity administering the mechanisms.[14] The administrative expense of managing all of the universal service support mechanisms, including those to support the provision of universal telecommunications service to rural and high cost areas, low income consumers, and health care providers, as well as the mechanism to support the provision of discounted telecommunications services and certain information services to schools and libraries, is necessary and incident to carrying out the purposes of section 254, and is not otherwise provided for or prohibited.

What is the Commission's authority to set an annual funding level? Please explain.

In the Universal Service Order, the Commission explained that it established an annual cap to fulfill its statutory obligation under section 254 to create "specific, predictable, and sufficient universal service mechanisms."[15] The Commission has set caps on

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[12] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 442-445, (5th Cir. 1999), *petitions for cert. pending on other grounds.*

[13] 47 C.F.R. §§ 54.701 & 54.702(b).

[14] *NECA I*, 12 FCC Rcd. at 18424-25; 47 C.F.R. § 54.715.

[15] *Universal Service Order*, 12 FCC Rcd at 9054-9055, para. 530; *see also* 47 U.S.C. §254(d).

several of the mechanisms. Based on the recommendation of the Joint Board, which the Commission sought pursuant to section 254(a), the Commission instituted an annual cap of $2.25 billion for the schools and libraries support mechanism,[16] and an annual cap of $400 million for the rural health care support mechanism.[17] In addition, the high cost support mechanism for rural carriers is subject to an indexed cap, which limits the growth of the mechanism to the annual average growth in the number of telephone lines.[18]

How is the funding level determined each year? Are there factors, other than demand projections from the Schools and Libraries Division, used to set the annual funding level? If so, identify them and the relative weights assigned to these factors? How were these factors selected? Has the Commission conducted or utilized any research to determine the appropriate funding level?

Each year's funding level for the schools and libraries mechanism is determined based on demand and the expense of administering the program, subject to the annual cap. As noted above, the Commission set the annual cap based on the recommendation of the Joint Board. In setting the annual cap, the Commission noted that the Joint Board:

> carefully weighed the benefits of higher discounts to eligible schools and libraries, which would lead advanced telecommunications services to become more affordable to schools and libraries, against the costs of greater discounts, which would create the need for larger support mechanisms.[19]

This annual funding cap, which was recommended by the Joint Board and subsequently adopted by the Commission, is based on cost data extrapolated from a 1995 McKinsey and Company report entitled *Connecting K-12 Schools to the Information Superhighway* and adjusted with respect to the Joint Board's modeling assumptions. Based on McKinsey and a few other sources, the Joint Board estimated:

> that the total cost of the [eligible] communications services [sought by schools and libraries] ...would be approximately $3.1 to $3.4 billion annually during an initial four year deployment period, and approximately $2.4 to $2.7 billion annually during subsequent years.[20]

[16] *Universal Service Order*, 12 FCC Rcd at 9054, para. 529.

[17] *Universal Service Order*, 12 FCC Rcd at 8940, para. 302.

[18] *Universal Service Order*, 12 FCC Rcd at 9140, para. 704.

[19] *Id.* at 9056.

[20] Federal-State Joint Board on Universal Service Recommended Decision, *12 FCC Rcd. 87, 369-70, para. 554 (1996).*

These estimates include the costs of internal connections, telecommunications services and Internet access.[21]

In the first funding year of the program. however, the Commission took into account the need to phase in contribution collection rates "to ensure a smooth transition to the new universal service support mechanisms and to minimize disruption to consumers."[22] In addition, the Commission found that the timing for implementation of a new program would likely lead to less disbursements in the first year than in future years.[23] In view of these factors, the Commission elected to treat the first year differently and funded the program at $1.925 billion for the first year only.[24] In the program's second-year, the demand for discounts was $2.435 billion, which exceeded the cap. Because of the cap, the funding was set at $2.25 billion.

Is the Commission considering a review of the funding cap in view of the anticipated increase in demand for third year funding, which is estimated to be $4.72 billion?

The funding level for the third year of the schools and libraries support mechanism will remain at the $2.25 billion cap provided for in our rules. The funding level for the third year of the rural health care support mechanism will remain capped at $400 million. The high cost support mechanism for rural carriers, including the indexed cap, is currently subject to comprehensive review.

Does the Commission expect that the need for E-Rate funding will decline over time? Please explain.

The Joint Board, before the implementation of the section 254 mechanisms, contemplated that demand for the schools and libraries mechanism would decrease after the fourth year of funding.[25] At the current time, after only the second year of operation, the data are insufficient to determine whether the need for funding will in fact decline over time.

The Commission's Strategic Plan goals for fiscal year 2001 listed one goal specifically connected with the E-Rate program: "90% of schools and libraries are connected to the Internet." What does it mean to be connected?

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[21] *Id.*

[22] *Federal-State Board on Universal Service, Fifth Order on Reconsideration and Fourth Report and Order (Fifth Order on Reconsideration)*, 13 FCC Rcd 14915, 14927, para. 19 (1998).

[23] *Universal Service Order*, 12 FCC Rcd at 9054.

[24] *Fifth Order on Reconsideration*, 13 FCC Rcd. at 14917.

[25] *Id.*

A school or an instructional classroom or library is connected to the Internet when the Internet can be accessed at that site. The Internet is usually accessed through internal connections, such as the wiring of a computer to a telephone line, which are among the services funded by the universal service mechanism.[26] The statute expressly recognizes, however, that the telecommunications services to be supported will evolve over time, as advances occur in telecommunications and information technologies.

The original funding cap was based, in part, on a model looking at the estimated cost of providing one computer per every five students served by an Ethernet LAN across and within all classrooms and a T-1 connection to the public network. What percentage of schools and libraries are currently connected? What data source are you relying on to track progress towards meeting this goal?

The Commission and USAC use data gathered by the National Center for Education Statistics (NCES) and school and library program applications to estimate the percentage of schools and the number of classrooms connected to the Internet. For libraries, the Commission and USAC rely on data supplied by the research arm of the American Library Association. These data sources indicate the following connectivity rates:

- Public Schools: According to a February 2000 report by the NCES, *entitled Internet Access in U.S. Public Schools and Classrooms: 1994-99,* 95% of public schools and 63% of public school instructional classrooms had Internet access in 1999.

- Private Schools: In a report issued in February 2000, entitled *Computer and Internet Access in Private Schools and Classrooms: 1995 and 1998,* NCES found that 67% of private schools and 25% of all private school instructional classrooms had Internet access as of 1998.

- Libraries: In its *1998 National Survey of Public Library Outlet Internet Connectivity,* the American Library Association's sampling survey of public library outlets determined that 73.3% of public libraries were connected to the Internet and provided the public with access. The survey also found that 16.4% of public library outlets were connected to the Internet but did not provide its patrons with access.

In addition, the Commission has asked the United States Department of Education (DoEd) to look at certain aspects of the schools and libraries mechanism, including the number of classrooms connected, in its assessment of the educational impact of the mechanism. The DoEd assessment has not been completed, but the Department expects to have preliminary figures in the next few months.

[26] 47 C.F.R. § 54.506.

If a school or library has met this goal, would it still be eligible for funding?

The goal of 90% connection in the Commission's Strategic Plan is an overall goal for the schools and libraries mechanism, but neither the statute nor the program's rules preclude connecting all classrooms and all libraries - to the 100% level - to the Internet. Indeed, in my five-year strategic plan for the agency, one of my goals is to ensure that all schools and libraries are connected to the Internet. Moreover, as technologies evolve over time, schools and libraries may seek funding to upgrade their level of connectivity. We will evaluate such requests as the program evolves.

Are there other goals of the program? If so, are these goals reflected in the Strategic Plan, program rules, or in the determination of the appropriate level of funding? How does the Commission measure progress towards meeting these goals?

One other significant goal of this program is to ensure that the neediest schools and libraries receive priority in the event that requests for support exceed available funding. This goal is reflected in the Commission's rules of funding priority. Under these rules, funding for telecommunications and Internet access services discounts is disbursed first, and any remaining funds are used to fund applicant requests for internal connections.[27] Requests for internal connections are prioritized, with the poorest applicants receiving internal connections funding before all other applicants.[28]

In response to a recommendation from the General Accounting Office, the Commission is developing a strategic plan for the schools and libraries mechanism, which will define strategic goals and performance measures for the mechanism. As discussed above, the DoEd is assessing the educational impact of the schools and libraries mechanism. Although the Commission's strategic plan for the mechanism is still being developed, its goals likely will focus on issues of connectivity, under-served populations, and cost efficiency. Therefore, the Commission asked that DoEd's assessment of the mechanism use specific performance measures that relate to such

[27] *See Fifth Order on Reconsideration*, 13 FCC Rcd at 14938, para. 36.

[28] *See id*

goals, including the number of classrooms and libraries connected to the Internet, the number of applications filed from rural or poor areas, coordination with state and local procurement processes, bid outreach efforts, and the number of new services requested.

I hope this information proves responsive. If you have any questions please contact Debra Weiner at (202) 418-1736.

Sincerely,

William E. Kennard
Chairman

Attachment

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D C 20503

GENERAL COUNSEL

April 28. 2000

Mr. Christopher Wright
General Counsel
Federal Communications Commission
Washington, D.C.

Dear Mr. Wright:

This letter sets forth the legal opinion of the Office of Management and Budget on the status of the Universal Service Fund (USF). and responds to your internal memo on this subject, dated March 7. 2000.

As you note, this fund has a long history and has, since its inception, been maintained outside the Treasury and managed by a non-governmental entity. The Telecommunications Act of 1996 amended the previously existing framework of the USF and added specific statutory provisions relating to the Fund. But, as your memo states, "There is, however, no indication that Congress intended fundamentally to change the manner in which the fund is maintained and administered."

After enactment of the 1996 Act, OMB displayed the USF in the budget for the first time. See Fiscal Year 1997 Budget, pp. 978-79. The determination to do so was based on the larger role of the Federal Government with respect to the USF program. However, inclusion of the account in budgets beginning in fiscal year 1997 does not, in our view, support reclassifying the Fund as "governmental" or "public money" for all purposes.

The question most basically at issue here is whether the funds collected for the Universal Service Fund pursuant to the Telecommunications Act of 1996 are "public moneys" received "for the use of the United States" (9 Stat. 398, R.S.§3617, codified at 31 U.S.C. 484, recodified in 1982 without substantive change at 31 U.S.C. 3302(b)). If the funds are for such use, then they are properly "public money" which, under 31 U.S.C. 3302, is to be deposited in the miscellaneous receipt account of the Treasury. Once in

this account, they are subject to a range of requirements that govern public money. If not public moneys "for the use of the United States", then these requirements do not apply However, this question is distinct from the budget presentation of such funds. See *infra* for further discussion.

The legal guidance defining the phrase, "for the use of the United States," is not extensive. The most helpful guidance for purposes of this case is found in a few Comptroller General and Attorney General opinions.

The general principle has been articulated by the Comptroller General as follows: "Funds are received for the use of the United States only if they are to be used to bear the expenses of the Government or to pay the obligations of the United States." (1982 U.S. Comp. Gen. Lexis 1005, B0205901). The Comptroller General relied in this 1982 opinion on a 1922 opinion of the Attorney General. 33 Op. Atty. Gen. 316 (1922).

In the 1922 case, the Interstate Commerce Commission pursuant to statute established a fund of the ICC into which railroads were required to pay annually one-half of any net operating income in excess of 6 percent of the value of their property used for transportation. The statute provided that the carrier was to hold that amount "as trustee for the United States," and was to pay it to the United States. Id. at 317. It further provided that the fund was to be administered by the ICC to make loans to carriers for necessary capital expenditures, to purchase equipment and facilities to be leased to carriers, or to refund maturing securities originally issued for capital investments. Id. at 318. Further, the statute required that unused balances of the fund be invested in U.S. securities, but it did not require that these balances be deposited in the Treasury. Id. at 319.

In reviewing the cross-subsidy scheme established by the statute, the Attorney General noted that even though the contingent fund was "under the immediate supervision and control of the Interstate Commerce Commission", "when the entire section is read together it conclusively appears that the Government of the United States possesses no beneficial interest whatever in such fund and that it is held solely for the purposes therein prescribed" (i.e., to make loans and leases to carriers) (id. at 319). Therefore, the Attorney General concluded that to be subject to the Miscellaneous Receipts Statutes, funds "for the use of the United States" refers only to "funds to be used in bearing the expenses of the Administration of the Government and paying the obligations of the United States." Id. at 321.

The principle of the case is that a federal statute may establish a broad regulatory regime, and a federal agency be extensively involved in defining the parameters of and even in administering a program – in this 1922 case, one involving the redistribution of carrier assets for use by other carriers – and yet the funds involved would not be construed as public money subject to the Miscellaneous Receipts Statute.

A more recent example is the United Mine Workers of America Combined Benefit Fund. Established by the Coal Industry Retiree Health Benefit Act of 1992, the fund was intended to replace two insolvent private health benefit funds, which were merged into the new account.

The UMW Combined Benefit Fund has some characteristics normally associated with private entities, as well as those that appear governmental in nature. On the one hand, the statute designates the Combined Fund as "private". The Fund is managed by the private trustees selected by coal companies and the UMWA. The trustees choose the health care providers. Premiums are paid for current and former members of the coal operators' association directly to the Combined Fund (not to the Treasury), and the Fund trustees hold and distribute the funds.

On the other hand, there are also governmental features to the program – particularly the governmental nature of the activities undertaken by or on behalf of the Combined Fund. Coal companies can be compelled to pay premiums to the Fund, and the UMWA pension fund can also be compelled to make payments to Fund. The coal companies cannot withdraw from the Fund, and if a company refuses to pay its premiums, it can be fined $100 per day per beneficiary. The Government determines the premium amount, and assigns each company an amount of premiums to be paid. This amount, in many cases, is not related to services previously provided to the company by its retirees. The Government determines the type of delivery system that will be used to provide benefits.

Having weighed both the private and public characteristics of the Combined Benefit Fund, a decision was reached that this fund is not characterized as public money "for the use of the United States." As a result, it is not held in the Treasury, and is not subject to the usual requirements that apply to public monies.

In light of the above precedents, we conclude that the Universal Service Fund does not constitute public money pursuant to the Miscellaneous Receipts Statute, 31 U.S.C. 3302, and is appropriately maintained outside the Treasury by a non-governmental manager.

Further, we believe that this conclusion is consistent with legislative intent. As your memo notes, there was no evidence that in enacting the 1996 Act, Congress intended to change the manner in which the USF is administered. Faced with the opportunity when considering this legislation to revise the FCC's long-standing administrative practice, Congress was silent. In fact, subsequent action in the Senate indicates agreement that the funds are not public money. The Senate passed a "sense of the Senate" provision in 1997 that stated, "Federal and State universal contributions are administered by an independent, non-Federal entity and are not deposited into the Federal Treasury and therefore are not available for Federal appropriations." Section 614, H.R. 2267 (105th Congress).

Funds which are not "public money" within the definition of the Miscellaneous Receipts statute as a legal matter may, nonetheless, be appropriately included in the President's budget in order to convey the full scope of government activity. This is principally true in cases such as the USF and UMW Combined Fund. The budgetary treatment in such cases is distinct from, and not intended to resolve, the legal issue under 31 U.S.C. 3302.

Sincerely,

Robert G. Damus

Robert G. Damus
General Counsel

WITNESSES

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Small Business Administration

Securities and Exchange Commission

The Federal Communications Commission