FEDERAL RESPONDENTS' UNCITED RESPONSE TO THE BRIEF OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

NO. 11-9900

IN RE: FCC 11-161

ON PETITIONS FOR REVIEW OF AN ORDER OF THE
FEDERAL COMMUNICATIONS COMMISSION

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GLOSSARY

ARC	Access Recovery Charge
Br.	Petitioner's Brief
CAF	Connect America Fund
FCC	Federal Communications Commission
ICC	Intercarrier Compensation
ILEC	Incumbent Local Exchange Carrier
JA	Joint Appendix
LEC	Local Exchange Carrier
NASUCA	National Association of State Utility Consumer Advocates
SLC	Subscriber Line Charge

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ISSUE PRESENTED

Whether the Federal Communications Commission ("FCC") lawfully established a transitional Access Recovery Charge ("ARC") that incumbent local exchange carriers ("incumbent LECs" or "ILECs") may charge their end-user customers to recover some of the revenues that are reduced pursuant to the agency's intercarrier compensation ("ICC") reforms.

INTRODUCTION AND SUMMARY OF ARGUMENT

In the *Order* on review,[1] the FCC started a comprehensive reform of the way local exchange carriers are compensated when they exchange telecommunications with other telecommunications providers. The revised regime "phase[s] out regulated per-minute intercarrier … charges," *Order*

[1] *Connect America Fund*, 26 FCC Rcd 17663 (2011) ("*Order*") (JA__).

¶736 (JA__), and replaces them over time with "a uniform national bill-and-keep framework as the ultimate end state for all telecommunications traffic exchanged with a LEC," *id*. ¶34 (JA__). The FCC determined that a bill-and-keep framework – under which the LEC looks to its own subscribers (and, if necessary, explicit universal service subsidies) to recover its network costs (*id.* ¶737 (JA__)) – would "eliminat[e] the existing opaque implicit subsidy system under which consumers pay" billions of dollars to support other carriers' networks, and would help ensure that "consumers pay only for services that they choose and receive." *Id.* ¶738 (JA__); *see also id.* ¶¶748-751 (JA__-__). The FCC also determined that a bill-and-keep framework was well within its authority to replace implicit subsidies with explicit ones and to adopt a regulatory framework for telecommunications traffic that LECs exchange with other providers. *See Order* ¶¶747, 760-781 (JA__-__); *see also* FCC Preliminary Brief 32-37.

To implement its bill-and-keep methodology, the FCC established a transitional federally-tariffed ARC that incumbent LECs may bill to their end users. *Id.* ¶¶906-916 (JA__-__). The ARC is part of a recovery mechanism (which also includes direct subsidies from the Connect America Fund ("CAF")) that the FCC established to enable incumbent LECs to recover some of the intercarrier compensation revenues that the *Order* reduces over

time. *Id.* ¶905 (JA__); *see generally* Argument II of the FCC's Principal ICC Brief (describing the operation of the recovery mechanism).

Petitioner National Association of State Utility Consumer Advocates ("NASUCA") challenges the lawfulness of the ARC in three respects.

I. NASUCA contends (Br. 5-8) that the FCC failed to identify its legal authority to adopt the ARC in the *Order*, and therefore cannot do so before this Court. This claim is barred by 47 U.S.C. §405(a) because no party presented it to the agency in the administrative proceedings below. *Sorenson Commc'ns, Inc. v. FCC*, 659 F.3d 1035, 1044 (10th Cir. 2011) ("*Sorenson II*"). The claim is baseless, in any event, because the FCC's *Order* fully explained the statutory basis for the ARC: 47 U.S.C. §§201(b) & 251(b)(5). *Order* ¶¶760-781 (JA__-__).

II. The FCC lawfully designed the ARC to recover *intra*state, as well as interstate, ICC revenues reduced under the reforms adopted in the *Order*. *Compare* Br. 8-11. As the Supreme Court held in *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378 (1999) ("*AT&T*"), the FCC has authority to implement section 251(b)(5), which requires LECs to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." That provision plainly covers intrastate telecommunications. *See Order* ¶761

(JA__). Accordingly, under established Supreme Court precedent, the FCC acted lawfully in establishing the ARC to recover intrastate revenues.

III. The Court also should reject NASUCA's assertion (Br. 11-13) that it was arbitrary, and unlawfully discriminatory, for the FCC to permit ILECs to determine "at the holding company level" how eligible recovery will be allocated among subsidiary ILECs' ARCs. NASUCA's discrimination claim is barred by section 405(a) because it was not presented to the agency. Its claim fails on the merits, in any event, because the FCC provided a "neutral, rational basis" for the holding-company rule. *Nat'l Ass'n of Reg. Util. Comm'rs v. FCC*, 737 F.2d 1095, 1133 (D.C. Cir. 1984) ("*NARUC*"). As the FCC explained, that rule spreads out ARC recovery over a broader class of customers and helps reduce burdens on the CAF at the same time it maintains consumer protections to ensure that end-user rates remain reasonable. *Order* ¶910 (JA__). Although NASUCA may disagree with the FCC's policy judgment, the agency's balancing of factors is entitled to significant deference and should be affirmed.

ARGUMENT

I. THE FCC JUSTIFIED THE ARC UNDER SPECIFIC GRANTS OF STATUTORY AUTHORITY.

The Court should dismiss NASUCA's claim (Br. 5-8) that the FCC failed to cite any authority for the ARC. No one presented this argument

before the FCC. It thus is barred by section 405(a) of the Communications Act, which prevents review of "questions of fact or law upon which the [FCC] … has been afforded no opportunity to pass." 47 U.S.C. §405(a); *accord Sorenson II*, 659 F.3d at 1044; *Sorenson Commc'ns, Inc. v. FCC*, 567 F.3d 1215, 1227-28 (10th Cir. 2009) ("*Sorenson I*").

The claim is meritless, in any event, because the agency set out in detail its statutory authority to adopt the ICC reforms *of which the ARC is a part*. *Order* ¶¶760-781 (JA__-__). The FCC determined that 47 U.S.C. §§201(b) & 251(b)(5), among other provisions, empowered it to adopt rules establishing how LECs are compensated when they exchange traffic that originates or terminates on their networks. *Order* ¶760 (JA__). Acting under those provisions, the FCC adopted bill-and-keep as the end point of its ICC reforms, while allowing a gradual transition from the existing regime. *Order* ¶¶736-739 (JA__-__). Because the ARC provides a portion of the compensation ILECs may receive during that transition, *id* ¶¶906-916 (JA__-__), and forms an integral part of the overarching mechanism for transitioning to bill-and-keep, it falls squarely within the *Order*'s detailed

explanation of the agency's statutory authority to adopt a bill-and-keep framework, *id*. ¶¶760-81 (JA__-__).[2]

II. THE ARC LAWFULLY RECOVERS BOTH INTERSTATE AND INTRASTATE REVENUES THAT ARE REDUCED BY ICC REFORMS.

NASUCA argues (Br. 8-11) that the FCC lacks authority to regulate intrastate access traffic and that the ARC therefore must be unlawful, because it is designed to offset reductions in intrastate (as well as interstate) access charges. This claim is baseless.

The FCC reasonably found authority to adopt rules governing *all* telecommunications – intrastate, as well as interstate – exchanged with a LEC. *See Order* ¶¶760-762 (JA__-__). The FCC explained that the Supreme Court had confirmed its authority under 47 U.S.C. §201(b) to adopt rules implementing the Communications Act, including section 251(b)(5). *Id.* ¶760 (JA__) (citing *AT&T*, 525 U.S. at 378). The agency further determined that section 251(b)(5), by its terms, covers intrastate "telecommunications" exchanged with a LEC. *Order* ¶761 (JA__). Because the ARC recovers some of the intrastate access revenues reduced by the *Order* pursuant to that federal authority, the ARC falls well within the FCC's statutory powers. The

[2] NASUCA's argument (Br. 6-8) that the FCC lacks ancillary authority to adopt the ARC is irrelevant because the FCC never invoked such authority for the ARC.

FCC's reasonable construction of the statute is entitled to deference under *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837 (1984). *See* FCC Principal ICC Brief, Argument I (explaining in detail the FCC's statutory authority to adopt comprehensive ICC reform).

In light of this statutory authority for establishing the ARC, NASUCA misses the point in emphasizing (Br. 8-11) that the FCC's earlier precedents involving interstate access charges do not themselves establish the agency's authority for the ARC. The FCC merely mentioned those precedents as examples of analogous reforms the agency had previously undertaken. *Order* ¶852 (JA__); *see also id.* ¶¶906-916 (JA__-__).

In those prior decisions, which were upheld on judicial review, the FCC had moved incrementally to phase out certain per-minute interstate charges that LECs had imposed on long-distance carriers, in favor of flat monthly end-user charges (called "subscriber line charges" or "SLCs") that did not vary with subscribers' usage. The FCC determined that switching from intercarrier charges to end-user charges would better reflect cost-causation principles and reduce implicit subsidies that had been embedded

within the intercarrier charges.[3] These decisions fully support the reasonableness of the ICC reforms adopted in the *Order*.

III. THE *ORDER* LAWFULLY PERMITS ELIGIBLE RECOVERY TO BE ALLOCATED TO ARCS ON A HOLDING-COMPANY BASIS.

In designing the ARC, the FCC adopted numerous safeguards to ensure that consumers will see only small increases in their monthly bills. It capped at $0.50 per year any increases in the monthly ARC charged to residential and single-line business customers. *Order* ¶909 (JA___). It capped at $1.00 (per line) per year any increases in the monthly ARC for multi-line business customers, and it required "potential revenue from such increases to be imputed to carriers" – whether or not they actually imposed those charges – thereby reducing the revenues eligible for recovery through ARCs charged to residential consumers. *Id.* Price cap LECs may adopt annual increases in the ARC for only five years, and rate-of-return LECs for only six years. *Id.* ¶908 (JA__). Additionally, the FCC adopted a $30.00 per month residential rate

[3] *See*, *e.g.*, *Access Charge Reform*, 12 FCC Rcd 15982, 16007-09 ¶¶69-71 (1997), *aff'd Sw. Bell Tel. Co. v. FCC*, 153 F.3d 523, 557-59 (8th Cir. 1998); *Access Charge Reform*, 15 FCC Rcd 12962, 12975-76 ¶¶30-33 (2000), *aff'd in pertinent part*, *Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313, 321-23 (5th Cir. 2001). *See also Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 372 F.3d 454, 456-60 (D.C. Cir. 2004) (describing migration from intercarrier charges to end-user charges and rejecting NASUCA's challenge to that process).

ceiling for both price cap and rate-of-return LECs, *id.* ¶913 (JA__), so that a LEC may not charge residential consumers an ARC if it would drive above $30.00 the consumer's aggregate monthly bill for the federal SLC, the ARC, and assorted local service charges, *id.* ¶¶913-914 (JA__-__).

Subject to these consumer protections, the FCC also allowed parent ILEC holding companies to pool the amounts their subsidiary ILECs are eligible to recover under the *Order*, and then reallocate those amounts among the ILEC subsidiaries for purposes of calculating the ARCs that each may charge. *Id.* ¶910 (JA__). This does not alter the total revenues that the related ILECs collectively may recover, but it does potentially affect the amount and source of each subsidiary ILEC's recovery.[4] Assume, for example, that Holding Company X has two ILEC subsidiaries – ILEC A and ILEC B. Assume, further, that a $0.25 ARC increase (below the $0.50 annual cap on ARC increases) will recover all of ILEC A's eligible recovery

[4] The *Order*'s methodology for calculating eligible recovery allows each ILEC to recover a portion of its annual reduction in ICC revenues resulting from reform. For any given carrier, the size of the required annual reduction depends on the level of its *existing* charges for the rate elements subject to reform. *See Order* ¶801 & Figure 9 (JA__-__) (showing timetable and size of intercarrier rate reductions); *id* ¶¶867-920 (JA__-__) (describing recovery mechanism). Because each carrier's existing ICC rate levels are likely to differ (depending on prior state regulatory policies), the calculation of any two ILECs' eligible recoveries under the FCC's reforms is likely to yield different results.

in Oklahoma, without resort to CAF subsidies. And assume that a full $0.50 ARC increase by ILEC B in Colorado is insufficient to recover all of that company's eligible recovery without turning to explicit subsidies from the CAF. The holding-company rule permits the carriers to reallocate some of ILEC B's eligible recovery to ILEC A, thus permitting ILEC A to recover more of the companies' combined eligible revenues through the ARC, while requiring ILEC B to make offsetting reductions in its subsidy demands on the CAF.

NASUCA argues that the holding-company rule requires "consumers in states that have previously reduced their intrastate access charges as well as jurisdictions that have no such charges" to "pick up the burden from states that have not done so" – an outcome it characterizes as arbitrary and contrary to the statutory prohibition against "'unjust or unreasonable discrimination in charges.'" Br. 12, 13 (quoting 47 U.S.C. §202(a)).

The Court should not consider NASUCA's unreasonable discrimination claim because it was not presented to the FCC. *See* 47 U.S.C. §405(a); *Sorenson II*, 659 F.3d at 1044.

NASUCA's challenge is unsound in any event. By its terms, section 202(a) prohibits only "*unjust or unreasonable* discrimination in charges." 47 U.S.C. §202(a) (emphasis added); *see also NARUC*, 737 F.2d at 1133

(section 202(a) addresses "*unjustifiably* different rates for the same service") (emphasis added). That provision does not bar rates that have "a neutral, rational basis." *NARUC*, 737 F.2d at 1133; *accord Reservation Tel. Coop. v. FCC*, 826 F.2d 1129, 1136 (D.C. Cir. 1987). The ARC rates that the *Order* permits pursuant to the holding-company rule have such a neutral and rational basis.

First, allowing eligible revenue recovery to be reallocated among subsidiary ILECs enables carriers to "spread the recovery" through the ARC "among a broader set of customers," thereby potentially "minimizing the increase experienced by any one customer." *Order* ¶910 (JA__). Second, by enabling a holding company's subsidiary ILECs (as a group) to receive a higher proportion of their overall eligible recovery through the ARC, the holding-company rule "limit[s] the potential impact on the CAF," which provides carriers with direct subsidies if the ARC is insufficient to generate all of the revenues to which carriers are entitled. *Id.*; *see also id.* ¶¶917-919

(JA__-__) (describing the role of the CAF under the recovery mechanism).[5] Third, while the holding-company rule provides these benefits, "[t]he ARC's modest and capped size, its interim nature, … [its revenue imputation feature], … [and] the $30 Residential Rate Ceiling" all combine to "ensure that overall rates remain affordable and set at reasonable levels." *Order* n.1791 (JA__). The FCC "enjoys broad discretion" when conducting such balancing, particularly in the universal service context. *RCA*, 588 F.3d at 1103.

Finally, *Connecticut Office of Consumer Counsel v. FCC*, 915 F.2d 75 (2d Cir. 1990), undermines rather than supports NASUCA's discrimination claim. *See* Br. 13. Although the court in that case upheld an FCC decision to permit AT&T to pass through to its Connecticut customers, alone, the costs of that state's gross receipts tax, it did not hold that state-specific costs always must be recovered from in-state consumers to avoid unlawful discrimination. Indeed, the court acknowledged the lawfulness of the underlying interstate regulatory regime at the time, which, in general, called

[5] Although NASUCA complains that the holding-company rule may require consumers to pay higher ARCs in some states to cover revenue losses in other states, a similar result would occur if the *absence* of the rule led to increased demands on the CAF. That is so because CAF funds are recovered through contributions from telecommunications providers *nationwide* and are "almost always pass[ed on] … to their customers." *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1099 (D.C. Cir. 2009) ("*RCA*").

for ratemaking on the basis of a nationwide pooling of fixed costs across state lines. *Id.* at 76-77, 79. Like the holding-company rule here, that nationwide system of pooling lawfully permitted carriers to recover some costs incurred in one state through charges imposed on customers in other states.

CONCLUSION

The petition for review should be dismissed in part and otherwise denied.

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March 18, 2013

CERTIFICATE OF SERVICE

I hereby certify that on March 18, 2013, I caused the foregoing Federal Respondents' Uncited Response to the Brief of The National Association of State Utility Consumer Advocates to be filed by delivering a copy to the Court via e-mail at FCC_briefs_only@ca10.uscourts.gov. I further certify that the foregoing document will be furnished by the Court through (ECF) electronic service to all parties in this case through a registered CM/ECF user. This document will be available for viewing and downloading on the CM/ECF system.

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