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

JOINT PRELIMINARY BRIEF OF THE PETITIONERS

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July 15, 2013

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Legislative Materials

Agency Decisions

Other

STATEMENT OF RELATED CASES

There are no prior appeals, and all related cases have been consolidated into this omnibus case, except *Windstream Corp. et al. v. FCC et al.* (Case No. 12-9575), which was transferred to this Court from the D.C. Circuit, but has not been consolidated into this case. A previous order arising from one of the administrative proceedings in which the Order below was entered is before the Ninth Circuit in *Ronan Tel. Co. et al. v. FCC et al.* (9th Cir. Case No. 05-71995).

GLOSSARY

1996 Act	Telecommunications Act of 1996
Act, or 1934 Act	Communications Act of 1934, as amended
APA	Administrative Procedure Act
ARC	Access Recovery Charge
Board	Federal-State Joint Board on Universal Service
BOC	Bell Operating Company
CAF	Connect America Fund
CETC	Competitive Eligible Telecommunications Carrier
CLEC	Competitive Local Exchange Carrier
CMRS	Commercial Mobile Radio Service
COLR	Carrier of Last Resort
ER	Eligible Recovery
ETC	Eligible Telecommunications Carrier
ESP	Enhanced Service (or Information Service) Provider
FCC, or Commission	Federal Communications Commission
HCLS	High Cost Loop Support
HCMS	High Cost Model Support
IAS	Interstate Access Support
ICC	Intercarrier Compensation

ICLS	Interstate Common Line Support
ILEC	Incumbent Local Exchange Carrier
IP	Internet Protocol
ISP	Internet Service Provider
IXC	Interexchange Carrier
JA	Joint Appendix
LEC	Local Exchange Carrier
LSS	Local Switching Support
Mobility Fund	CAF Mobility Fund
MTA	Major Trading Area
NPRM	Notice of Proposed Rulemaking
POTS	Plain Old Telephone Services
PSTN	Public Switched Telephone Network
RLEC	Rate-of-Return ILEC
ROFR	Right of First Refusal
RTC	Rural Telephone Company
SA	Supplemental Joint Appendix
Separations Joint Board	Federal-State Joint Board on Jurisdictional Separations
SNA	Safety Net Additive
TDM	Time Division Multiplexing
TELRIC	Total Element Long-Run Incremental Cost

USAC	Universal Service Administrative Company
USF	Universal Service Fund
VoIP	Voice over Internet Protocol
WCB	The FCC's Wireline Competition Bureau

JURISDICTIONAL STATEMENT

The FCC has jurisdiction under the Act, 47 U.S.C. §§154(i), 201(a), 254, 303(r), to prescribe rules and regulations to implement provisions of the Act. Petitioners seek judicial review of its order prescribing USF and ICC rules and regulations. *Connect America Fund,* 26 F.C.C.R. 17663 (2011) (*"Order"*) (JA at 390-1141).

Petitioners were parties to the FCC's rulemaking proceeding below.[1] The *Order,* final for purposes of judicial review as to each of them, was published on November 29, 2011. 76 Fed. Reg. 73830 (2011). Within sixty days, Petitioners filed timely petitions for review. The Judicial Panel on Multidistrict Litigation consolidated these in this Court. *Consolidation Order of the Judicial Panel on Multidistrict Litigation*, FCC 11-1914, MCP No. 108 (Dec. 14, 2011).

Petitioners ask this Court to hold unlawful and set aside the *Order*, and have standing to seek such relief. This Court

[1] Petitioner AT&T does not join this brief.

has jurisdiction under the Act, 47 U.S.C. §402(a), and the Hobbs Act, 28 U.S.C. §2342(1).

SUMMARY OF ISSUES PRESENTED

Did the FCC violate the APA or act arbitrarily and capriciously, or contrary to statutory and constitutional provisions, by:

1) preempting the states' authority to set intrastate rates;

2) preempting state regulation of intrastate rates and recovery of prudently incurred costs with rate ceilings, floors, and surcharges on intrastate rates with no support;

3) adopting auctions that preempt and conflict with the states' authority to designate ETCs and establish service areas;

4) providing USF support for services not designated as "telecommunications services" and conditioning USF support on provision of unregulated "information service";

5) requiring recipients of USF support to provide information services without additional support for the costs of those services;

6) modifying and eliminating high-cost support mechanisms, including limiting support payments and eligibility for support programs differently for various classes of telecommunications carriers;

7) retaining federal COLR obligations while denying federal high-cost support;

8) regulating information services provided by wireless CETCs;

9) making USF support available exclusively to ILECs in their service areas;

10) eliminating the identical support rule and adopting a single-winner reverse auction to award support to wireless CETCs;

11) budgeting insufficient USF support to wireless CETCs;

12) failing to address the need for a USF support mechanism for insular areas;

13) retroactively reversing past approvals so as to curtail USF revenues that certain small LECs relied upon to construct existing networks and operations;

14) prescribing ICC revisions including a "bill-and-keep" rate of zero for all intercarrier traffic;

15) imposing carrier or quasi-carrier status on ESPs for purposes of its ICC and "phantom traffic" rules;

16) imposing an obligation barring call blocking on VoIP providers;

17) allowing ILECs to impose end-user surcharges and ILECs but not CLECs to receive CAF support for some, but not all, lost ICC revenues; and

18) infringing Tribal sovereignty.

Petitioners' subsequent briefs will describe these issues in more detail; not all Petitioners will join in all arguments.

STATEMENT OF THE CASE

The *Order* resulted from a notice-and-comment rulemaking under the Act, 47 U.S.C. §254(a), and the APA, 5 U.S.C. §553. The FCC released an NPRM on February 9, 2011, consolidating seven long-pending proceedings with it, for the stated purpose of modernizing and refocusing USF and ICC "to make affordable broadband available to all Americans." *Connect America Fund*, 26 F.C.C.R. 4554, 4560 (2011) (*"NPRM"*) (SA at 1-289).

The FCC received (1) four rounds of comments, *Order* at Appendix J-M (JA at 1029-45), including on a filing by state members of the Board at the FCC's request and other proposals by price-cap companies and RLEC associations,[2] *Further Inquiry into Certain Issues in the USF-ICC Transformation Proceeding,* 26 F.C.C.R. 11112 (WCB 2011) (JA at 349-67) and (2) oral and written *ex parte* presentations submitted until days before it adopted rules. *Order*, ¶12 (JA at 398).

The *Order* amended Parts 0, 1, 36, 51, 54, 61, 64, and 69 of the Rules, *Order*, ¶1428 (JA at 880), and disposed of many

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[2] Price-cap carriers are larger carriers that serve both urban/suburban and rural areas, and are subject to incentive regulation. *Order*, ¶21 (JA at 400). RLECs are mostly rural carriers, whose interstate rates are regulated under a traditional rate base/return methodology.

other pending proceedings, including petitions for waivers and for declaratory rulings. *Id.* ¶¶979, 1003-1007, 1415-1427 (JA at 758-59, 768-70, 879-80).

STATEMENT OF FACTS

I. Introduction

Telephone calls, whether across the street, the Nation, or the world, use the Public Switched Telephone Network (PSTN), a collection of carrier-owned networks. The calling party pays one carrier to complete the call, but calls often travel across more than one network. When that happens, carriers transmitting a call may receive payments from other carriers using their networks. *AT&T Corp. v. FCC*, 292 F.3d 808, 809 (D.C. Cir. 2002). This is intercarrier compensation. The FCC historically regulated rates for interstate ICC and states regulated intrastate ICC.

National policy, since 1934, has been "to make available, so far as possible, to all the people of the United States … a rapid, efficient … communication service with adequate facilities at reasonable charges." 47 U.S.C. §151. This is universal service.

This Court recognizes that "… it is generally more expensive for a telephone company to provide service in a rural area, where customers are dispersed, than it is to provide the same service in an urban area, where customers are more concentrated." *Qwest Corp. v. FCC*, 258 F.3d 1191, 1195 (10th Cir. 2001). Carriers serving an area where network costs are high may get federal and/or state support to make service more affordable. The more customers who can afford service, the greater the "network effect"; *i.e.,* the network is more valuable to each user the more other users are connected.[3]

II. Statutory Background

This case concerns the 1996 Act,

> an unusually important legislative enactment … [whose] primary purpose was to reduce regulation and encourage "the rapid deployment of new telecommunications technologies." The major components of the statute have nothing to do with the Internet; they were designed to promote competition in the local telephone service market, the

[3] *See, e.g., U.S. v. Microsoft*, 253 F.3d 34, 49 (D.C. Cir. 2001).

> multichannel video market, and the market for over-the-air broadcasting.[4]

The 1996 Act introduced "two new important regulatory classifications," *Time Warner Telecom v. FCC*, 507 F.3d 205, 213 (3d Cir. 2007), by defining "telecommunications service," a common-carrier service subject to regulation under Title II, 47 U.S.C. §153(53); and "information service," a service exempt from Title II regulation, *id.* §153(24). *Federal-State Joint Board on Universal Service*, 13 F.C.C.R. 11501, 11508 (1998). The definition of "telecommunications carrier" provided that such a carrier "shall be treated as a common carrier … only to the extent that it is engaged in providing telecommunications services." 47 U.S.C. §153(51).

The 1996 Act redesignated most of Title II's existing provisions as "Part 1− Common Carrier Regulation," and restructured regulation of the local telecommunications marketplace by adding a new "Part II – Development of Competitive Markets," which gave all telecommunications carriers a duty to interconnect their networks. 47 U.S.C.

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[4] *Reno v. ACLU*, 521 U.S. 844, 857-58 (1997).

§251(a). LECs, which are local telephone companies, have additional duties including reciprocal compensation. 47 U.S.C. §251(b). Larger ILECs (LECs in existence before 1996) have further obligations, including to open their networks to competitors, and to negotiate in good faith with any requesting telecommunication carrier the terms of reciprocal compensation and interconnection agreements. *See generally* 47 U.S.C. §251(c); *cf*. 47 U.S.C. §251(f)(1).

Part II continued Section 152(b)'s joint federal-state regulation of telecommunications – today called "cooperative federalism." *BellSouth Telecommunications v. Sanford*, 494 F.3d 439-40, 448-49 (4th Cir. 2007). Although "§201(b) explicitly gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies," it is "the States that will … implement that methodology, determining the concrete results in particular circumstances." *AT&T Corp. v. Iowa Utilities Bd.,* 525 U.S. 366, 380, 384 (1999)

Relationships between CLECs (newer companies that compete with the older ILECs) and ILECs are governed by "interconnection agreements" negotiated between carriers and approved by the relevant state commissions. If negotiations fail, states conduct arbitrations, applying FCC rate-setting methodologies to set rates, subject to federal district court review. *AT&T v. Illinois Bell,* 349 F.3d 402, 405 (7th Cir. 2003); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* 11 F.C.C.R. 15499, 15554-61 (1996) ("*Local Competition Order*"). Under this authority, state commissions "establish any rates" in dispute between the parties, ensuring that they meet specific statutory pricing standards. 47 U.S.C. §252(d)(1); *Iowa Utilities Bd.*, 525 U.S. at 384.

The 1996 Act obliged LECs to "establish reciprocal compensation agreements for the transport and termination of telecommunications," 47 U.S.C. §251(b)(5), and section 252 requires states to ensure that reciprocal compensation rates allow for "the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." 47 U.S.C. §252(d)(2)(A)(i).

States must base reciprocal compensation rates on "a reasonable approximation of the additional costs of terminating such calls." *Id.* §252(d)(2)(A)(ii). "[A]rrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)" are not precluded. *Id.* §252(d)(2)(B)(i).

Congress recognized that competition in local communications markets would threaten the existing revenue flows that traditionally supported universal service. Therefore, the 1996 Act both codified universal service policy and created a statutory USF program in Parts I and II of Title II. *See* 47 U.S.C. §§214(e), 254.

The 1996 Act mandates that only common carriers designated as ETCs under Section 214 by states[5] are eligible for USF support; they must offer FCC-defined supported telecommunications services throughout their service areas. *Id.* §§214(e)(1)(A), 254(c)(1). States may designate more than

[5] The FCC makes ETC designations if the state lacks jurisdiction. 47 U.S.C. §214(e)(6).

one ETC per RTC-served area, but must do so in an area not so served. *See id.* §§214(e)(2), 254(c)(1). An ETC can use USF support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." *Id.* §254(e).

Service areas are established by states, or by the FCC where the ETCs are not state regulated. *Id.* §214(e)(5). An RTC's "service area" is defined as its "study area," unless the FCC and the state, after considering the Board's recommendation, establish a different definition. 47 U.S.C. §214(e)(5).

Congress established the Board, composed of state and federal regulators and a consumer advocate, to "coordinate federal and state regulatory interests" related to universal service. *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 406 (5th Cir. 1999). It defined universal service as "an evolving level of telecommunications services that the [FCC] shall establish periodically … taking into account advances in telecommunications and information technologies and services," and directed the Board to recommend, and the FCC to establish, the definition of the telecommunications services supported by the USF. 47 U.S.C. §254(c)(1). When defining the supported services, the Board and the FCC must consider, *inter alia*, the extent to which the telecommunications services: are essential to education, public health, or public safety; have been subscribed to by a substantial majority of residential customers; and "are being deployed in public telecommunications networks by telecommunications carriers." *Id.* §254(c)(1)(A)-(C).

The FCC's USF rules must be based on six statutory universal service principles and additional Board-recommended principles adopted by the FCC. *Id.* §254(b)(1)-(7). These principles include, *inter alia*, that "[q]uality services should be available [and] affordable"; services in all areas of the Nation should be "reasonably comparable" to services available in cities, at "reasonably comparable rates"; and "[t]here should be specific, predictable, and sufficient … mechanisms to preserve and advance universal service." *See also Qwest Corp. v. FCC,* 398 F.3d 1222, 1234 (10th Cir. 2005).

Separately, §254(h) authorized the FCC to designate by rule "special services," including advanced telecommunications and information services, to which "public institutional telecommunications users" (schools, libraries, and rural healthcare providers) were to have access at discounted prices. 47 U.S.C. §254(c)(3), (h)(2).

The miscellaneous provisions of Title VII of the 1996 Act included §706, which provided:

> The [FCC] and each [s]tate commission with regulatory jurisdiction over telecommunications services shall encourage deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans … by utilizing … price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.

1996 Act, Pub. L. No. 104-104, Title VII, §706(a), 110 Stat. 56, 153 (1996). This section was not an amendment to the 1934 Act, but was codified in the notes to 47 U.S.C. §157 until 2008, when it was amended and codified at 47 U.S.C. §1302 by the Broadband Data Improvement Act. Pub. L. No. 110-385, 122 Stat. 4096 (2008).

III. Regulatory Background

A. ICC

Telecommunications networks provide inter- and intrastate communications. Consequently, state and federal governments share jurisdiction over ICC-related issues.

In 1930, the Supreme Court held that regulators must allocate (*i.e.*, "separate") the costs of commonly used facilities between jurisdictions for ratemaking purposes. *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 148 (1930).

In 1934, Congress granted the FCC jurisdiction over interstate and international communications but preserved state authority over intrastate communications. 47 U.S.C. §152(b).

After the 1984 AT&T divestiture, the FCC established "access tariffs" under which IXCs compensate LECs for using their networks to originate and terminate interstate toll calls, and most states adopted similar schemes for intrastate calls. *AT&T v. FCC,* 349 F.3d 692 (D.C. Cir. 2003).

Access charge tariffs, along with the rise of IXCs, created the ICC traffic flows that exist today. With toll calls, one carrier originates a call and delivers it to a second carrier (the designated IXC), and a third carrier terminates the call. The IXC pays compensation to both the originating LEC (originating access) and to the terminating LEC (terminating access). Originating access charges have been paid in toll traffic because LEC-provided originating access is an input to the IXC's telephone toll service. The IXC uses originating access to reach its own end-user customer, with whom it has a billing relationship.

The 1996 Act required "reciprocal compensation" arrangements for the transport and termination of telecommunications. The FCC originally decided that "reciprocal compensation obligations" applied only to local traffic and, except for traffic to or from a CMRS (wireless telecommunications) network, state commissions had the authority to determine the geographic areas considered "local." *Local Competition Order,* 11 F.C.C.R. at 16013. It also ruled that CMRS traffic originating and terminating within the same MTA would be subject to reciprocal compensation. *Id.* at 16014.

The FCC adopted symmetrical reciprocal compensation rules, with the ILEC's prices serving as a proxy for the other telecommunications carrier's "additional costs" of transport and termination. *Id.* at 16040.

State commissions were to establish an ILEC's transport and termination rates in arbitrations based on default price "ceilings and ranges" until they either established their own rates using the FCC's TELRIC pricing methodology, or a bill-and-keep arrangement where carrier rates were symmetrical and traffic was in balance. *Id.* at 15883-884, 16024.

The Eighth Circuit vacated these default rates, based on the Supreme Court's determination that only states may set rates under sections 251 and 252. *Iowa Utilities Bd. v FCC*, 219 F.3d 744, 757 (8th Cir. 2000).

In *Verizon*, the Supreme Court reiterated that Congress established "a hybrid jurisdictional scheme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree, but leaving it to state utility commissions to set the actual rate." *Verizon Communications v. FCC*, 535 U.S. 467, 489 (2000).

The FCC subsequently made "incremental efforts" to modify its ICC regime, *NPRM*, 26 F.C.C.R. at 4574 (SA at 21), and issued a series of rulings that eventually resulted in rate caps for reciprocal compensation for dial-up calls to ISPs. *Core Communications v. FCC*, 592 F.3d 139, 141-42 (D.C. Cir. 2010).

B. **USF**

The FCC adopted "competitive neutrality" as a seventh universal service principle in 1997. *Federal-State Joint Board on Universal Service*, 12 F.C.C.R. 8776, 8801 (1997) ("*First USF Order*"). The FCC wanted rules that would "neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another." *Id.* at 8801. It made all telecommunications carriers, including wireless carriers, eligible for USF support regardless of technology. *Id.* at 8858.

The FCC established the USF as the explicit support mechanism. *Id.* at 8780. It defined nine "core" or "designated" telecommunications services or functionalities eligible for USF support. *Id.* at 8807, 9323-24. USF is funded by contributions from telecommunications carriers providing interstate telecommunications services based upon their end-user interstate revenues.[6] *Id.* at 9173.

Concluding that "portability" was required to allocate USF support in a competitively neutral manner, the FCC adopted the "identical support rule" in 1999, under which a CETC would receive the same amount of USF support on a per line basis as the ILEC with which it competed. *Federal-State Joint Board on Universal Service*, 14 F.C.C.R. 20432, 20480 (1999).

In March 2002, the FCC found that cable Internet access service was an information service.[7] In July 2002, the Board opined that, if classified as information service, broadband Internet access service could not be included within the statutory definition of USF-supported services, because §254

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[6] The 1996 Act also provided that telecommunications carriers providing intrastate services could be required by a state to contribute to the preservation and advancement of universal service in the state. 47 U.S.C. §254(f).

[7] *High-Speed Access to the Internet Over Cable and Other Facilities*, 17 F.C.C.R. 4798, 4822-23 (2002), *aff'd, NCTA v. Brand X Internet Servs.*, 545 U.S. 967 (2005).

"limits the definition of supported services to telecommunications services." *Federal-State Joint Board on Universal Service*, 17 F.C.C.R. 14015, 14103 (Jt. Bd. 2002). The FCC then issued a series of decisions classifying other broadband Internet access services as information services.[8]

In 2007, the Board recommended, *inter alia*, that the FCC revise the definition of supported services to include broadband service, finding that it met the statutory criteria for inclusion. *See High-Cost Universal Service Support*, 22 F.C.C.R. 20477, 20491-92 (Jt. Bd. 2007).

The FCC rejected the Board's recommendations the next year, *High-Cost Universal Service Support*, 24 F.C.C.R. 6475, 6492 (2008), and sought public comment on three draft USF reform proposals that had been circulated among the FCC Commissioners, but not adopted. *Id.* at 6493. Two proposals

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[8] *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities,* 20 F.C.C.R. 14853, 14862-65 (2005), *aff'd, Time Warner Telecom v. FCC,* 507 F.3d 205 (3d Cir. 2007); *Classification of Broadband Over Power Line Internet Access Service as an Information Service,* 21 F.C.C.R. 13281, 13286 (2006); *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks,* 22 F.C.C.R. 5901-12 (2007).

would have required all high-cost support recipients to offer broadband Internet access service to all customers as a condition of receiving support. *Id.* at 6500, 6700.

C. Broadband Plan

In response to the American Recovery and Reinvestment Act of 2009, the FCC delivered its staff-authored 350-page National Broadband Plan to Congress in spring 2010. 2010 WL 972375, at *1 (2010) (*Broadband Plan*). *See also Joint Statement on Broadband*, 25 F.C.C.R. 3420, 3420 (2010). High among its recommendations to promote universal broadband deployment, the *Broadband Plan* called for a "comprehensive reform" of USF and ICC. 2010 WL 972375, at *2, *5, *116.

The *Broadband Plan* deemed USF restructuring necessary because "the current USF was not designed to support broadband directly [with some exceptions] …." 2010 WL 972375, at *121. Despite recognizing that "broadband is not a supported service," *id.* at *125, the *Broadband Plan* recommended replacing the high-cost program with two new funds: a CAF that would shift $15.5 billion over the next decade from supporting existing telephone networks to direct support for broadband networks, and a Mobility Fund to provide "targeted funding" for mobile broadband networks. *Id.* at *5.

The *Broadband Plan* stated that the "current per-minute ICC system was never designed to promote deployment of broadband networks." *Id.* at *125. It found the ICC system unsustainable in an all-broadband IP world where traffic exchange payments are "typically based on charges for the amount of bandwidth consumed per month." *Id.*

It also stated that the ICC regime created "disincentives to migrate to all IP-networks[,]" and that continued declines in ICC could hamper broadband investment. *Id.* at *126. It called for ICC restructuring to eliminate per-minute charges. *Id.* at *117.

The *Broadband Plan* listed over 60 initiatives that the FCC could undertake to implement its recommendations. It also acknowledged that the classification of broadband services as information services created uncertainty surrounding the FCC's jurisdiction to implement this broadband agenda. *Id.* at *299-301.

D. *Comcast Corp. v. FCC*

Shortly after Congress received the *Broadband Plan*, the D.C. Circuit held that the FCC, having conceded it lacked express statutory jurisdiction, was also without Title I ancillary jurisdiction to impose the broadband requirements it had adopted. *Comcast Corp. v. FCC*, 600 F.3d 642, 644-47, 651-61 (D.C. Cir. 2010). The FCC's Chairman said before Congress that *Comcast* cast "serious doubt" on their ability to implement the *Broadband Plan*.[9]

The FCC then initiated a proceeding to determine whether it has authority to promote investment and innovation in what it had previously called "broadband Internet access service." *Framework for Broadband Internet Service*, 25 F.C.C.R. 7866, 7866-87 & n.1 (2010). Specifically questioning whether it had statutory authority under §254 of

[9] *Reviewing the National Broadband Plan: Hearing before the Senate Comm. on Commerce, Science, and Transportation*, 111th Cong. 44, 69, 95 (2010).

the Act and §706 of the 1996 Act to restructure USF to support broadband Internet service, *id.* at 7880-83, but without waiting to answer that question, the FCC moved to implement the *Broadband Plan*.

IV. The *NPRM*

On February 9, 2011, the FCC issued the *NPRM* to "fundamentally modernize" the USF and ICC system as recommended by the *Broadband Plan*. *NPRM*, 26 F.C.C.R. at 4557 (SA at 4). The FCC sought to "refocus USF and ICC to make affordable broadband available to all Americans and accelerate the transition from circuit-switched to IP networks." *Id*. at 4560 (SA at 7).

With barely a mention of *Comcast*,[10] the FCC opined that it could extend USF support to "broadband services offered as information services" either under §§254 and 706, or pursuant to Title I ancillary authority, or both. *Id*. at 4577 (SA at 24). The FCC solicited public comment on its opinion, as well as on any other legal theories under which it could provide USF

[10] The FCC mentioned *Comcast* once, but not its holding. *NPRM*, 26 F.C.C.R. at 4580 & n.95 (SA at 27).

support to broadband. *Id.* at 4577, 4582 (SA at 24, 29). The FCC also invited comment on its authority to regulate intrastate access, and if so, on its authority to impose a bill-and-keep rate of zero for ICC.

V. THE *ORDER*

The FCC proceeded to implement the USF and ICC recommendations of the *Broadband* Plan and "to support broadband networks, regardless of regulatory classification." *Order*, ¶68 (JA at 415-16). It adopted the Board's recommended eighth universal service principle, that support "should be directed where possible to networks that provide advanced services, as well as voice services." *Order*, ¶65 (JA at 413-14). The FCC held that §254 and §706 empowered it to provide USF support for telecommunications services and to "condition" the receipt of that support on the deployment of broadband networks. *Order*, ¶60 (JA at 410-11). The FCC did not add broadband to its list of USF-supported services, *id.* ¶65 (JA at 413-14), but required telecommunications carriers that receive USF support both to "invest in modern broadband-capable networks," *id.* (JA at 413-14), and to offer broadband services meeting "basic performance requirements," "at rates reasonably comparable to offerings of comparable broadband services in urban areas." *Id.* ¶86 (JA at 422).

On ICC, the FCC abandoned the current per-minute ICC compensation system and imposed a bill-and-keep rate of zero for all traffic. *Order,* ¶741 (JA at 632).

A. **USF Rule Changes**

The FCC consolidated its definition of USF-supported services into a single service called "voice telephony" regardless of technology. *Order*, ¶77 (JA at 419). It adopted a new rule restating the §254(e) restriction that support be used "only for … facilities and services for which the support is intended," but added that support can be used for "investments in plant that can … provide access to advanced telecommunications and information services." *Id.* Appendix A (§54.7) (JA at 925-26).

The FCC prescribed a $4.5 billion target budget for USF high-cost support programs. *Order,* ¶125 (JA at 438). The FCC stated this would ensure a "specific, predictable and sufficient" USF support program as envisioned by §254(b)(5) of the Act. *Id.* ¶123 (JA at 437-38).

The FCC allocated $1.8 billion in CAF support to areas served by price-cap ILECs. Under CAF Phase I, existing high-cost support to these carriers is frozen, but up to $300 million of new funding will be available to them, but not to CETCs, to promote broadband deployment. *Id.* ¶¶22, 25 (JA at 400, 401).

CAF II will develop a cost model to estimate the support necessary to fund broadband in high-cost areas. *Order*, ¶23 (JA at 400). Following adoption of the cost model, the incumbent price-cap carrier "shall be the presumptive recipient of the model-derived support amount for the five-year CAF Phase II period," *Order*, ¶171 (JA at 456), provided it accepts a state-level broadband deployment commitment. *Id.* (JA at 456).[11]

Unlike price-cap ILECs, RLECs remain under the current high-cost support program, but with many changes. In

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[11] If a price-cap incumbent declines to receive CAF Phase II support, the FCC expects to use competitive bidding to disburse support. *Order*, ¶172 (JA at 456-57).

general, these changes cap or eliminate many of the components that comprise the high-cost support program. The FCC intends these changes to transition USF support to RLECs towards incentive-based regulation. *Id.* ¶195 (JA at 465).

The *Order* imposed limits on the amount RLECs can recover for certain capital and operations expenses. *Id.* ¶214 (JA at 470). The FCC delegated authority to its WCB to establish such limits, updated annually, for each RLEC, using a regression methodology intended to compare an RLEC's costs to those of similarly-situated carriers. *Id.* ¶¶217, 218 (JA at 471).

The FCC capped certain support for corporate operations expenses, and modified the limitations formula for all corporate operations expenses by using the most recent data and adding a "growth factor." *Order*, ¶¶229-231 (JA at 474-75).

Finding residential rates in some rural areas lower than urban rates, the FCC limited support where end-user rates are below a specified "urban rate floor." *Id.* ¶238 (JA at 478). The rate floor will be phased in and then adjusted annually based on data collected by the FCC. *Id.* ¶239 (JA at 478-79).

SNA, which is support for RLECs who make significant network investments, is phased out and eliminated. *Order*, ¶250 (JA at 484). The FCC found that many RLECs qualifying for SNA did so "due to significant loss of lines, not because of significant increases in investment." *Id.* ¶249 (JA at 484).

Finding that modern IP networks employ equipment "which tend[s] to be cheaper and more efficiently scaled to smaller operating sizes" than the legacy equipment, *id.* ¶253 (JA at 485-86), the FCC eliminated LSS, which allowed the smallest RLECs to receive increased support. *Id.* ¶257 (JA at 487). It allowed some limited support through the CAF's ICC recovery mechanism. *Id.* ¶255 (JA at 486).

HCLS is the program that provides support to RLECs for the "last mile" of connection. While the FCC previously had capped the HCLS program overall, the FCC had not limited support available to individual service areas. *Id.* ¶272 (JA at 491-92). But finding that only a few ILECS and CLECs serving less than 5,000 customers in aggregate received support that exceeded $250 per month per line, *id.* ¶273 (JA at 492), the FCC concluded that "to implement responsible fiscal limits," total high-cost support per line would be limited to $250 per month. *Id.* ¶274 (JA at 492).

The FCC found that, as a result of these high-cost support program rule changes as applied to RLECs, "almost 34 percent or rate-of-return carriers will see no reductions whatsoever, and more than 12 percent of providers will see an increase in high-cost universal service receipts." *Id.* ¶290 (JA at 496).

The FCC eliminated all support to study areas where 100% of the territory is already served by one or more unsubsidized providers. *Id.* ¶¶195, 281 (JA at 465, 494).

CETCs' existing support was capped effective December 31, 2011, and will be phased-out over five years. *Id.* ¶519 (JA at 559). CETCs are also subject to the $250/month/line cap. *Id.* ¶¶274, 516 (JA at 492, 558).

As recommended by the *Broadband Plan*, the FCC established a Mobility Fund to expand the coverage of mobile broadband networks in unserved areas. *Order,* ¶28 (JA at

401-402). Having capped USF support for CETCs in 2010, the FCC limited Phase I of the Mobility Fund to a one-time infusion of $300 million. *Id.* ¶314 (JA at 505-506). Mobility Fund Phase II provides $500 million per year for ongoing support of mobile services. *Id.* ¶¶493-494 (JA at 551).

Eliminating prior USF support to multiple CETCs in an area, the FCC limited Mobility Fund Phase I support to only one wireless CETC per area, *Order*, ¶316 (JA at 506), through a reverse auction. *Id.* ¶322 (JA at 508). The FCC determined that it would identify areas eligible for Mobility Fund Phase I support at the census block level. *Order*, ¶332 (JA at 510-11). Having opted to distribute support to wireless CETCs by reverse auction, the FCC concluded its identical support rule "is no longer necessary or in the public interest," and repealed it. *Id.* ¶ 502 (JA at 554).

A Remote Areas Fund of at least $100 million annually will support customers in areas with extremely high broadband deployment costs to obtain broadband "through alternative technology platforms such as satellite and unlicensed wireless." *Id.* ¶533 (JA at 564-65).

The FCC had sought comment "on whether [it] should reserve a defined amount of funds in the CAF for insular areas," *NPRM*, 26 F.C.C.R. at 4655 (SA at 102), but did not address the issue in the *Order*. *See Order,* ¶481 n.790 (JA at 546-47).

The FCC established a waiver mechanism "under which a carrier can seek relief from some or all of [its] reforms if the carrier can demonstrate the reduction in existing high-cost support would put consumers at risk of losing voice service, with no alternative terrestrial providers." *Id.* ¶32 (JA at 403). The FCC stated that this waiver test will consider "not only all revenues derived from network facilities that are supported by universal service but also revenues derived from unregulated and unsupported services." *Id.* ¶540 (JA at 567).

Finally, the rules do not provide additional funding for carriers serving Tribal lands. The *Order* recognizes that Tribal lands are typically "remote and underserved areas," *Order,* ¶28 (JA at 401-402), with "significant telecommunications deployment and connectivity challenges," *id.* ¶481 (JA at 546-47), and that a "deep digital divide … persists between the

Native Nations of the United States and the rest of the country" such that "[b]y virtually any measure, communities on Tribal lands have historically had less access to telecommunications services than any other segment of the population." *Id.* ¶636 & n.1048 (JA at 595). Moreover, this divide extends beyond advanced telecommunications services, as "[m]any residents of Tribal lands lack not only broadband access, but even basic telephone service." *Id.* ¶636 (JA at 595).

The FCC has recognized that "various characteristics of Tribal lands may increase the cost of entry and reduce the profitability of providing service, including … [t]he lack of basic infrastructure in many tribal communities" and "a high concentration of low-income individuals with few business subscribers." *Id.* ¶482 (citation omitted) (JA at 547).

The FCC concluded that "greater financial support … may be needed in order to ensure the availability of broadband in Tribal lands." *Id.* ¶479 (JA at 545-46). Despite providing wireless carriers (but not wireline carriers) in Tribal areas a one-time $50 million award and ongoing funding, this is significantly less funding than wireless carriers serving Tribal lands received under the legacy program. *Id.* ¶¶479, 485 (JA at 545-46, 548).

Wireline carriers serving Tribal lands (which now must provide broadband in addition to voice service) are subject to the same rule changes as wireline carriers serving non-Tribal lands. The FCC stated those changes reduce USF support to more than 65 percent of RLECs. *Order* ¶290 (JA at 496).

B. **ICC Rule Changes**

The *Order* preempted state regulation of intrastate rates, abolished the current per-minute compensation system and adopted a "uniform national bill-and-keep framework." *Order,* ¶34 (JA at 403).

The new rules transition intrastate and interstate termination rates to a national bill-and-keep rate of zero for all traffic. *Order,* ¶741 (JA at 632). This "bill and keep" rate applies to all telecommunications, including local traffic and traffic previously "subject to the interstate and intrastate access regimes." *Id.* ¶769 (JA at 646).

Finding that "both parties generally benefit from participating in a call, and … should split the cost of the call," *id.* ¶744 (JA at 634), the FCC abandoned the traditional "calling party pays" regime for one in which "carriers … recover the cost of their network through end-user charges" on their own customers. *Id.* ¶742 (JA at 632-33).

It immediately banned LEC rate increases for interstate origination and termination services, intrastate termination services, and, for price cap ILECs, intrastate origination services. *Order,* ¶801 (JA at 661-62). It set a final rate of zero for core terminating access rate elements. It held that originating access ultimately should fall under bill-and-keep but only reduced certain originating transport elements, while seeking comment "on the ultimate transition away from" originating access charges. *Order,* ¶¶777-778, 817-818 (JA at 650, 669).

RLEC and price-cap ILEC terminating charges (and CLEC rates benchmarked to them) are reduced to zero over multiple years. Intrastate terminating access rates will first be lowered to equal interstate access rates, and then terminating compensation rates will be lowered, in stages, to $0.0007, and then to zero. *Id.* ¶801 (JA at 661-62).

The FCC claimed its authority to impose these rules "flows directly" from the §251(b)(5) duty of LECs to establish reciprocal compensation for the transport and termination of telecommunications, and from its §201(b) rulemaking authority to carry out the provisions of the Act. *Order*, ¶760 (JA at 641-42).

It acknowledged these rules supersede the traditional access regime, which the FCC claims is preserved under §251(g). *Order*, ¶764 (JA at 643). It dismissed concerns with preemption and rejected arguments that §251(b)(5) does not apply to intrastate access traffic, *id.* ¶765 (JA at 643-44), that it exceeded its authority under §252 by setting a rate of zero, rather than only establishing a methodology, and that a zero rate contravenes applicable statutory requirements. *Id.* ¶774-75 (JA at 648-49).

The states will no longer set intrastate ICC rates but will oversee tariffing of the FCC's rates during the transition, and conduct interconnection agreement approvals and arbitrations under §§251 and 252. *Order,* ¶776 (JA at 649-50).

Unlike its treatment of wireline traffic, the FCC adopted bill-and-keep as the "immediately applicable" default compensation for *all* non-access (intraMTA) traffic exchanged between LECs and CMRS providers. *Id.* ¶988 (JA at 761-62). The FCC found authority to adopt bill-and-keep as the federal pricing methodology for non-access CMRS-LEC traffic in §§201(b), 251(b)(5), 252 and 332 of the Act. *Id.* ¶1001 (JA at 767-68).

The *Order* allowed ILECs, exclusively, to replace some revenues lost due to reductions in ICC revenues through a two-component Eligible Recovery (ER) mechanism: (1) the ARC, which allows limited rate increases on ILEC end users; and (2) CAF support, to the extent ER exceeds allowable ARC revenues. *Id.* ¶849 (JA at 684). Carriers may receive CAF support only if they fulfill existing voice mandates and newly imposed broadband mandates. *Order,* ¶853 (JA at 688).

The Commission acknowledges that these mechanisms will not replace all the lost revenue, *id.* ¶848 (JA at 683-84), and this limited compensation will eventually disappear. *Id.* ¶905 (JA at 714). It asserted it "has no legal obligation to ensure that carriers recover access revenues lost as a result of reform, absent a showing of a taking," *Order,* ¶924 (JA at 723-24).

It adopted a "rebuttable presumption" that its ICC rules allow ILECs to "earn a reasonable return on their investment," *id.* (JA at 723-24), subject to a "Total Cost and Earnings Review" by which a carrier may rebut this presumption and seek "additional support." *Id.* (JA at 723-24). Carriers seeking to rebut the presumption will bear a "heavy burden." The analysis will examine numerous factors, including revenues derived from other services. *Order* ¶¶925-926 (JA at 724-25). There is no state role when intrastate rates are involved.

The FCC established a prospective ICC regime for so-called "VoIP-PSTN traffic," by subjecting all such traffic to the reciprocal compensation "framework" of §251(b)(5); adopting default ICC rates for both originating and terminating "toll" VoIP-PSTN traffic that mirror the interstate rate structure and prices for TDM traffic, including intrastate calls; applying the default reciprocal compensation rates to non-toll VoIP-PSTN traffic; and allowing LECs to include default charges for toll

VoIP-PSTN traffic in their federal and state tariffs for use in the absence of an intercarrier ICC agreement.[12] *Order*, ¶944 (JA at 735). The FCC's new regime will apply to all LECs, including wholesale partners of VoIP providers. *Id.* ¶968 (JA at 752).

The *Order* also affirmed §201(b)'s prohibition against blocking of telephone traffic by telecommunications carriers. *Id.* ¶974 (JA at 756). Recognizing that some VoIP services may be deemed "information services" rather than "telecommunications services," the FCC found that if such services "are information services, we exercise our ancillary authority and prohibit blocking of voice traffic to or from the PSTN by those providers just as we do for carriers." *Id.* (JA at 974).

The FCC also adopted rules to address "phantom traffic," which it defined as "calls for which identifying information is missing or masked in ways to frustrate intercarrier billing." *Id.* ¶33 (JA at 403). It required "originating" telecommunications

[12] On reconsideration, the FCC limited its reforms to VoIP terminating rates, until 2014. *Connect America Fund,* 27 F.C.C.R. 4648, 4659 (2012) (JA at 1162).

carriers and interconnected VoIP service providers, as well as "intermediate" providers, to transmit specified call information to subsequent providers in the call path. *Id.* at 18227 (47 C.F.R. §§64.1600(f), 64.1601(a)) (JA at 954).

STANDARD OF REVIEW

This Court reviews an agency's interpretation and application of a statute it administers under the two-step approach of *Chevron USA v. Natural Resources Defense Council,* 467 US 837, 842-843 (1984). "When Congress has spoken to the precise question at issue," this Court gives effect to that express intent. *Id.* However, "if the statute is silent or ambiguous," the Court will "defer to the agency's interpretation, if it is reasonable." *Id.* (citations omitted).

"Deference to [the agency's] statutory interpretation is called for only when the devices of judicial construction have been tried and found to yield no clear sense of congressional intent." *General Dynamics Land Sys. v . Cline*, 540 U.S. 581, 600 (2004). In addition, "[a] court's prior judicial construction of a statute trumps an agency construction … [if the prior] construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Brand X*, 545 U.S. at 982.

Even where a statute is ambiguous, the Court will not defer when the agency's decision "was not based on [its] own judgment but rather on the unjustified assumption that it was Congress' judgment that such [an outcome is] desirable or required." *PSEG Energy Res. & Trade LLC v. F.E.R.C.*, 665 F.3d 203, 209 (D.C. Cir. 2011) (citations omitted). Nor is an agency's statutory interpretation "entitled to deference absent a delegation of authority from Congress to regulate in the areas at issue." *American Library Ass'n v. FCC*, 406 F.3d 689, 699 (D.C. Cir. 2005).

Deference does not extend to an agency interpretation that "raises serious constitutional questions" or is "conclusively unconstitutional." *U.S. West v. FCC*, 182 F.3d 1224, 1231 (10th Cir. 1999). "In all pre-emption cases … we 'start with the assumption that the historic police powers of the States were not to be superseded … unless that was the clear and manifest purpose of Congress.'" *Medtronic v. Lohr*, 518 U.S. 470, 485 (1996).

Although a court will not substitute its judgment for that of the agency, its review still must be searching and must ensure a rational connection between the facts found and the conclusions made. *Marsh v. Oregon Natural Res. Council*, 490 U.S. 360, 378 (1989). "An agency's action will be set aside as unlawful if [the Court is] able to discern the agency relied on factors which Congress did not intend it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Thomas Brooks Chartered v. Burnett,* 920 F.2d 634, 643-44 (10th Cir. 1990).

The agency also acts arbitrarily if it fails "to engage the arguments raised before it." *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1165 (D.C. Cir. 1990). Agencies must apply their own precedents consistently or reasonably explain any departures from those precedents. *FCC v. Fox Television*

Stations, 556 U.S. 502, 515 (2009). Finally, while the Court will sustain agency decisions supported by substantial evidence, "[s]ubstantiality of evidence must take into account whatever in the records fairly detracts from its weight," *Universal Camera Corporation v. NLRB,* 340 U.S. 474, 488 (1951), such that an agency must "explain why it rejected evidence that is contrary to its findings," *Carpenters and Millwrights v. NLRB*, 481 F.3d 804, 809 (D.C. Cir. 2007).

An agency is not entitled to deference insofar as it has failed to abide by the APA's notice and comment obligations. *North American Coal Corporation v. Director, Office of Workers' Compensation Programs,* 854 F.2d 386, 388 (10th Cir. 1988).

An agency violates due process by commingling rulemaking and rate adjudications without providing a meaningful opportunity to be heard. *Sierra Club v. Costle,* 657 F.2d 298 (D.C. Cir. 1981).

Respectfully submitted,

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July 15, 2013

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