No. 11-9900

IN THE

United States Court of Appeals

FOR THE TENTH CIRCUIT

IN RE: FCC 11-161

On Petition for Review of an Order of the
Federal Communications Commission

WINDSTREAM PRINCIPAL BRIEF

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, petitioners Windstream Corporation and Windstream Communications, Inc. state as follows:

Windstream Corporation is a publicly held corporation. No publicly held corporation has a 10% or greater ownership interest in Windstream Corporation. As relevant to this litigation, Windstream Corporation wholly owns numerous local exchange carrier subsidiaries that operate throughout the United States, including in rural areas.

Windstream Communications, Inc. is a wholly owned subsidiary of Windstream Corporation; no other publicly held company has a 10% or greater ownership interest in Windstream Communications, Inc. As relevant to this litigation, Windstream Communications, Inc. is a local exchange carrier that offers broadband and voice service.

July 17, 2013

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STATEMENT OF RELATED CASES

There are no prior appeals, and all related cases known to counsel have been consolidated into this omnibus case except *Accipiter Communications, Inc. v. FCC* (D.C. Cir. No. 12-1258). That case, which challenged the Third Reconsideration Order in the administrative proceedings below (an order not at issue in Windstream's case or any of the other cases consolidated before this Court), was dismissed by the D.C. Circuit on December 6, 2012. Additionally, as listed in Petitioners' Joint Preliminary Brief at xxii, a previous order arising from one of the administrative proceedings below is before the Ninth Circuit in *Ronan Telephone Co. et al. v. FCC* (9th Cir. No. 05-71995).

GLOSSARY

ABC Plan	America's Broadband Connectivity Plan
APA	Administrative Procedure Act
ARC	Access Recovery Charge
CAF	Connect America Fund
FCC or Commission	Federal Communications Commission
FNPRM	Further Notice of Proposed Rulemaking
ICC	Intercarrier Compensation
ILEC	Incumbent Local Exchange Carrier
IP	Internet Protocol
IXC	Interexchange Carrier
LEC	Local Exchange Carrier
NPRM	Notice of Proposed Rulemaking
Order	USF/ICC Transformation Order, FCC Order No. 11-161, 26 FCC Rcd. 17663 (2011)
PSTN	Public Switched Telephone Network
Second Reconsideration Order	Second Order on Reconsideration, FCC Order No. 12-47, 27 FCC Rcd. 4648 (2012)
TDM	Time-Division Multiplexing
USF	Universal Service Fund
VoIP	Voice over Internet Protocol (also called VoIP-PSTN)

JURISDICTIONAL STATEMENT

Windstream[1] seeks review of the FCC's Second Order on Reconsideration in its *Connect America Fund* proceeding, FCC Order No. 12-47, 27 FCC Rcd. 4648 (2012) ("Second Reconsideration Order") (JA at 1151-99), which is not addressed by any of the other petitions in this consolidated case, as well as the underlying USF/ICC Transformation Order, FCC Order No. 11-161, 26 FCC Rcd. 17663 (2011) ("Order" or "USF/ICC Transformation Order") (JA at 390-1141).

Windstream adopts the jurisdictional statement in Petitioners' Joint Preliminary Brief, but adds the following: The USF/ICC Transformation Order was published in the Federal Register on November 29, 2011. 76 Fed. Reg. 73,830. Windstream timely sought reconsideration on December 29, 2011. JA at 4054; *see* 47 C.F.R. §§1.4(b), 1.429(d). The FCC's Second Reconsideration Order, which finally disposed of Windstream's petition, was published on May 29, 2012. 77 Fed. Reg. 31,520.

Windstream timely petitioned for review on July 27, 2012. The D.C. Circuit transferred the case to this Court, which consolidated it with petitions for review of the USF/ICC Transformation Order. This Court has jurisdiction under 47 U.S.C. §402(a) and 28 U.S.C. §2342(1). Windstream participated below and is directly

[1] Petitioners are Windstream Corporation, Windstream Communications, Inc., and Windstream Corporation's wholly owned regulated subsidiaries.

and adversely affected by the FCC's reductions to intercarrier compensation in the Orders under review.

ISSUE PRESENTED

Long-distance telephone companies use the networks of Local Exchange Carriers ("LECs") to connect their calls. They pay "originating access" charges to the LEC on whose network a long-distance call begins and "terminating" access to the LEC on whose network the call ends. In the USF/ICC Transformation Order, the FCC reduced the default rates for terminating access, but provided a recovery mechanism for LECs to make up some of the resulting lost revenue. The FCC declined to reduce originating access charges, deferring that issue to a further rule-making where, among other things, the FCC could consider an appropriate recovery mechanism. In the Second Reconsideration Order, however, the FCC announced that it had reduced originating access rates for intrastate Voice over Internet Protocol ("VoIP") calls. Unlike with terminating access charges, however, it refused—without explanation—to provide an accompanying revenue recovery mechanism. The issue presented is:

Whether the FCC's decision to cut originating access rates for intrastate VoIP traffic, without establishing a mechanism for recovering lost revenues or explaining why a recovery mechanism was unnecessary, was arbitrary, capricious, and/or inconsistent with reasoned decisionmaking.

STATEMENT OF THE CASE AND FACTS

I. Regulatory Framework

A. Originating and Terminating Access

The facilities of long-distance carriers (also called Interexchange Carriers or "IXCs") typically do not reach all the way to their customers' premises. Accordingly, to allow their customers to complete long-distance calls, IXCs use the local telephone networks of Local Exchange Carriers ("LECs") on both ends of the call. NPRM ¶494(SJA at 149-50). When a customer makes ("originates") a long-distance call, the LEC's network is used to connect the customer to the IXC's facilities. Likewise, IXCs typically use a LEC's network to reach the customer being called (the "terminating" end of the call). LECs are required to terminate calls delivered to them by IXCs. 47 U.S.C. §251(c)(2). And incumbent LECs ("ILECs") like Windstream are obligated to provide "equal access" to their networks for originating calls, making them available to IXCs on the terms the ILEC affords its own affiliates. *See* 47 U.S.C. §251(g).

To compensate LECs for the use of their networks, IXCs pay "access" charges, also called intercarrier compensation ("ICC"). "Originating" access charges are paid to the LEC on whose network a long-distance call originates—*i.e.*, where the caller is located. The caller generally is the LEC's customer for local telephone service but the IXC's customer for long distance. Thus, for long-distance calls, the IXC—not the LEC—has a billing relationship with the caller.

Pet'rs Preliminary Br. 16. As a result, compensation from IXCs is often the only way LECs can recover the cost of originating long-distance calls.

On the other end of the call, the IXC pays "terminating" access charges to the LEC on whose network the call terminates—*i.e.*, where the called party is. As the FCC recognized, "the most acute intercarrier compensation problems, such as arbitrage" and billing disputes, historically have arisen in connection with terminating rather than originating access. Order ¶800(JA at 660).

B. Interstate and Intrastate Access Charges

LECs are permitted to charge for originating and terminating access at default or "tariff" rates set by regulators. The FCC sets default access charges for *inter*state calls, while state commissions historically have set rates for *intra*state calls. NPRM ¶494 n.697(SJA at 150). Intrastate access rates, set by state regulators, generally are significantly higher than interstate rates. NPRM ¶494(SJA at 150). States use the higher intrastate rates—which may be 13.5 cents per minute or more, compared to interstate rates that can be less than one cent per minute—to subsidize local telephone service, offsetting the below-market, regulated rates LECs must charge some customers. *See id.*; *Qwest Corp. v. FCC*, 258 F.3d 1191, 1196 (10th Cir. 2001).

Intrastate ICC revenues thus help offset the losses ILECs incur providing service to high-cost rural customers (*e.g.*, where the LEC might need miles of

poles and wires for a single customer). As "carriers of last resort," ILECs are required to serve those customers, but statutory and regulatory constraints limit their ability to adjust rates to reflect the higher costs. *See* Order ¶862(JA at 691-92). ICC has provided critical support, allowing ILECs to serve high-cost areas where there is otherwise "no business case" to offer service at regulated rates. *Id.* ¶¶862, 948 & n.1916(JA at 691-92, 737).

C. VoIP Traffic

Traditionally, telephone traffic has traveled on the Public Switched Telephone Network ("PSTN") in Time-Division Multiplexing ("TDM") format. Pet'rs Preliminary Br. 6. More recently, some providers have begun to transmit traffic in Internet Protocol ("IP") format. A single call can be transmitted in different formats as it traverses telephone networks: It may originate in TDM format on one carrier's network but be converted into IP by the time it terminates on another ("TDM-IP" calls). Conversely, a call may begin in IP and end in TDM format ("IP-TDM" calls). In these proceedings, the FCC classified both kinds of calls as Voice over Internet Protocol ("VoIP") traffic. Order ¶940(JA at 732-33); Second Reconsideration Order ¶28 & n.69(JA at 1160-61). This traffic is sometimes called "VoIP-PSTN" traffic. Order ¶940(JA at 732).

From a cost-recovery standpoint, it makes no difference to an originating LEC that a TDM call is later converted into IP on another carrier's network. The

cost of originating the call is the same. Indeed, the LEC has no reliable way of knowing that a call is converted into IP after it leaves the LEC's hands. Rather, to determine what portion of the traffic it originates is VoIP traffic, the LEC must rely on IXCs to report those figures. *See* Order ¶948 n.1917(JA at 738) (citing LEC comments).

IXCs have traditionally paid intrastate *originating* access rates for intrastate VoIP calls. Very few (if any) disputes have arisen, especially with respect to TDM-originating calls. Second Reconsideration Order ¶33(JA at 1164). Like terminating access generally, however, VoIP *terminating* access has been the subject of significantly more "disputes and instances of non-payment or under-payment." *Id.*

II. Proceedings Below

A. The Notice of Proposed Rulemaking

On February 9, 2011, the FCC issued its Notice of Proposed Rulemaking ("NPRM"), proposing to reduce or eliminate per-minute ICC in the long term. NPRM ¶40(SJA at 17). The FCC emphasized, however, that it would "avoid sudden changes or 'flash cuts' in [its] policies, acknowledging the benefits of measured transitions that enable stakeholders to adapt to changing circumstances and minimize disruption." *Id.* ¶12(SJA at 8); *see id.* ¶17(SJA at 9) ("We do not propose any 'flash cuts,' but rather suggest transitions and glide paths that . . .

facilitate adaptation . . . ."); *id.* ¶533(SJA at 167) ("[I]t is important for any transition to be gradual enough to enable the private sector to react and plan appropriately."). To that end, the NPRM "propose[d] to adopt a mechanism for recovery" of lost revenues to mitigate the impact of reducing ICC. *Id.* ¶43(SJA at 18); *see id.* ¶34 fig.3(SJA at 16) (transitional step of "[a]dopt[ing] framework for long-term ICC reform, including glide path and recovery mechanisms").

The NPRM expressed the FCC's intent to encompass VoIP traffic in particular in its rulemaking. NPRM ¶608(SJA at 191-92). Because the FCC had previously declined to address VoIP ICC, "disputes increasingly have arisen among carriers and VoIP providers regarding intercarrier compensation for VoIP traffic." *Id.* ¶610(SJA at 192-93). According to the NPRM, different carriers took diametrically opposed positions on VoIP access charges, with some contending that VoIP "traffic is subject to the same intercarrier compensation obligations as any other voice traffic," while "other carriers contend no compensation is required." *Id.*

B. The ABC Plan

In response to the NPRM, a group of carriers proposed a negotiated compromise plan for reform, called America's Broadband Connectivity Plan or "ABC Plan." Letter from Robert W. Quinn, Jr. *et al.*, Attachment I, Framework of the Proposal (July 29, 2011) (JA at 2988-3001) ("ABC Plan Framework"). The ABC

Plan proposed gradually reducing *terminating* ICC rates along a "glide path." ABC Plan Framework 9(JA at 2997). Intrastate terminating rates would be reduced to interstate levels over about two years, then transitioned to a uniform rate of $0.0007 per minute over the following three years. *Id.* at 11(JA at 2999).

Those proposed reductions were "inextricably linked" to accompanying revenue recovery mechanisms: Carriers would be "able to reduce their reliance on implicit support from intercarrier compensation" by turning to "support from new explicit mechanisms." ABC Plan Framework 9(JA at 2997). Those included an "access replacement mechanism" allowing carriers to recover part of their lost ICC revenue from the universal service fund ("USF"). *Id.* The "access replacement mechanism is necessary to ensure that the intercarrier compensation reforms do not jeopardize the operations of broadband providers that rely on intercarrier compensation revenues for implicit support of networks in high-cost areas." *Id.* at 12(JA at 3000).

The ABC Plan proposed not reducing *originating* access charges immediately, instead providing that they be capped at current levels. As the Plan's proponents explained, originating access did not present the same pressing problems as terminating access because "most existing arbitrage schemes . . . take advantage of widely disparate *terminating* rates in different jurisdictions." Joint Comments of AT&T *et al.* 22 (Aug. 24, 2011) (JA at 3437) (emphasis added). If the FCC were

to reduce originating access rates, it would "need to address rate rebalancing through potential end-user rate increases and additional recovery from the transitional access replacement mechanism." *Id.* at 26(JA at 3441). Those demands might "make it more difficult to keep the access replacement fund at a manageable size" and "threaten the USF budget." *Id.* at 22, 27(JA at 3437, 3442). "The need to address such recovery," the Plan's proponents concluded, "is an important reason why the Commission should not reform originating access charges at this time." *Id.* at 27(JA at 3442).

C. The USF/ICC Transformation Order

1. The USF/ICC Transformation Order targeted "bill-and-keep"—where each carrier bills its own customers and keeps the full amount without paying compensation to other carriers—as the eventual "default methodology" for ICC, which would eliminate ICC altogether. Order ¶736(JA at 631); *see* Pet'rs Preliminary Br. 34. But the Order provided for a staged transition, "limiting reductions at this time to *terminating* access rates," because that is "where the most acute inter-carrier compensation problems, such as arbitrage, currently arise." *Id.* ¶800(JA at 660) (emphasis added). The Order largely "adopt[ed] the transition proposed in the ABC Plan." *Id.* ¶801 n.1497(JA at 661). Terminating charges thus will be reduced from intrastate to interstate levels in two steps, followed by a multi-year transition to a flat rate of $0.0007/minute, and eventually to bill-and-keep (*i.e.*,

zero). *Id.* ¶¶739, 800-804 & fig.9(JA at 632, 660-63).[2] That gradual transition was necessary "to avoid flash cuts and enabl[e] carriers sufficient time to adjust to marketplace changes and technological advancements." *Id.* ¶802(JA at 663).

The Order established a concomitant two-pronged mechanism to allow ILECs to recoup a portion of lost terminating ICC revenues (called the "Eligible Recovery"). Order ¶¶847-932(JA at 683-729). First, ILECs may add an Access Recovery Charge ("ARC") to end users' monthly bills, subject to prescribed caps. *Id.* ¶852(JA at 685-88). Second, ILECs may receive explicit support from the Connect America Fund ("CAF") to the extent their Eligible Recovery exceeds the permissible ARC. *Id.* ¶¶853, 917-920(JA at 688, 721-23).[3] The FCC opened the recovery mechanism to all ILECs, recognizing that "regulatory constraints on their pricing and service requirements otherwise limit their ability to recover their costs." *Id.* ¶862(JA at 691-92). As carriers of last resort, ILECs "have limited control over the areas or customers that they serve, having been required to deploy their network in areas where there was no business case to do so absent subsidies, including the implicit subsidies from intercarrier compensation." *Id.* Denying re-

[2] The Order adopted slightly different transitions and recovery mechanisms for price-cap LECs and rate-of-return LECs. We focus on price-cap LECs like Windstream, although the distinctions are largely irrelevant here.

[3] The CAF was established by the USF portion of the Order to promote broadband deployment. *See* Order ¶¶115-120(JA at 436); Pet'rs Preliminary Br. 26-27. Price-cap ILECs accepting ICC recovery from the CAF must use that support to build and operate broadband networks. Order ¶918(JA at 721-22).

covery, the FCC declared, "would represent a flash-cut for price-cap LECs, which is inconsistent with our commitment to a gradual transition and could threaten their ability to invest in extending broadband networks." *Id.* ¶890(JA at 704).

Consistent with the ABC Plan, the Order stated repeatedly that it was not reducing *originating* access charges, explaining that terminating access was "the principal source of arbitrage problems today" and that the FCC's "concerns . . . with respect to network inefficiencies, arbitrage, and costly litigation are less pressing with respect to originating access." Order ¶¶35, 777(JA at 403, 650); *see also id.* ¶¶653, 739, 764, 778, 800, 818, 922, 928, 1296-1298, 1301(JA at 600, 632, 643, 650, 660-61, 669, 723, 726, 836-37, 837-38). Deferring originating access reductions also helped "manage the size of the access replacement mechanism." *Id.* ¶800(JA at 660).

The FCC also found that the comments before it did "not provide a sufficient basis . . . to proceed at this time" with a recovery mechanism for originating access. Order ¶1301(JA at 837-38). The FCC issued a Further Notice of Proposed Rulemaking ("FNPRM") "seek[ing] comment on th[e] final transition for *all* originating access charges." *Id.* ¶1298(JA at 837); *see id.* ¶¶1297-1305(JA at 836-39) (relevant section of FNPRM). For the time being, the FCC capped interstate and intrastate originating access rates for price-cap LECs at existing levels. *Id.* ¶800 n.1494(JA at 661).

2. Focusing on VoIP traffic in particular, the FCC opined that there were "significant billing disputes and litigation," with many providers paying less-than-full ICC rates or even nothing at all. Order ¶937-938(JA at 730-32). In response, the FCC *immediately* set the default access rates for toll VoIP traffic, whether inter- or intrastate, "equal to [the] interstate access rates applicable to non-VoIP traffic." *Id.* ¶943-944(JA at 735).

The FCC did not retreat from its repeated statements that it was addressing terminating access only, leaving originating access for another rulemaking. Nor did it suggest that its rationales for deferring originating access reductions, *see* p. 11, *supra*, did not apply to VoIP originating access. To the contrary, when addressing VoIP access charges, the Order consistently referred to *terminating* access: Every example of VoIP ICC arbitrage, litigation, and confusion involved terminating access.[4] So did the FCC's examples of how VoIP ICC would work under the Order.[5]

[4] *See* Order ¶938(JA at 732) (Some "terminating carriers state that they receive no intercarrier compensation payments at all for [VoIP] traffic," while "some providers cite asymmetries in payments where . . . some VoIP providers' wholesale carriers charge full access charges while refusing to pay them to the terminating LEC.")

[5] *See* Order ¶942(JA at 734) ("We . . . adopt a symmetrical framework for VoIP-PSTN traffic, under which providers that benefit from lower VoIP-PSTN rates when their end-user customers' traffic is terminated" on others' networks "also are restricted to charging the lower VoIP-PSTN rates when other providers' traffic is terminated" on their networks.).

The Order's only mention of originating access specific to VoIP came in one sentence stating that, under the new rules, "toll VoIP-PSTN traffic will be subject to charges not more than originating[FN] and terminating interstate access rates." Order ¶961 (JA at 746). The appended footnote clarified that "originating access charges" would apply "in this context, subject to the phase-down and elimination of those charges *pursuant to a transition to be specified in response to the FNPRM*." *Id.* ¶961 n.1976 (JA at 746) (emphasis added).

D. Proceedings on Reconsideration

1. Windstream's Petition for Reconsideration or Clarification

After the Order's release, some carriers insisted that the Order reduced both terminating *and* originating access rates for intrastate VoIP traffic, despite the FCC's repeated statements that it was "limiting reform to terminating access charges" and "need[ed] to further evaluate the timing, transition, and possible need for a recovery mechanism" for originating access. Order ¶739 (JA at 632).

Windstream (and others) petitioned the FCC to clarify "that the *Order* does not apply to, and is not intended to displace, intrastate originating access rates for PSTN-originated calls that are terminated over VoIP facilities" (or to reconsider that position). Petition for Reconsideration and/or Clarification 21 (Dec. 29, 2011) ("Windstream Petition") (JA at 4076). Windstream explained that nearly all disputes over VoIP ICC involved *terminating* access, not originating access. *Id.* at

24(JA at 4079). Thus, as with non-VoIP traffic, it was appropriate to address only terminating access rates now and defer originating access issues. Moreover, the FCC had conceded it lacked a sufficient record regarding how to structure changes to originating access and any accompanying recovery mechanism. *Id.* at 22-23(JA at 4077-78). There was no reason to carve out intrastate VoIP calls from the Order's repeated and unqualified statements that it was not reducing originating access rates. *Id.* at 24(JA at 4079).

The petition argued that "flash-cutting one category of intrastate originating access rates to interstate levels" would "conflict with the Commission's goal of 'a measured, predictable transition' and 'transitional recovery' for lost access revenues." Windstream Petition 27(JA at 4082) (quoting Order ¶917). "[A]t the very least," the petition urged, the FCC "would need to permit LECs" a "mechanism to recover lost originating access revenues." *Id.* at 28(JA at 4083).

Even carriers that opposed Windstream's petition recognized the need to avoid a disruptive flash-cut. AT&T urged that all VoIP traffic should be subject to interstate originating access rates, but "agree[d] with Windstream . . . that LECs should be permitted to use the recovery mechanism to recover access revenues that are lost as a result of" that change. AT&T Comments 38-39 (Feb. 9, 2012) (JA at 4232-33). Verizon similarly acknowledged Windstream's "legitimate concern" over revenue cuts "not accounted for in the *USF-ICC Transformation Order*'s

access revenue recovery mechanisms." Verizon Ex Parte 1 (Mar. 16, 2012) (JA at 4334).

2. The Second Reconsideration Order

The FCC denied Windstream's petition. Second Reconsideration Order ¶¶27-42 (JA at 1160-70). The FCC acknowledged that, in discussing VoIP ICC, the Order gave examples only of terminating charges. *Id.* ¶31 (JA at 1163). But it stated that the Order's one "reference to both 'originating and terminating' interstate access rates" "provide[d] clarity" that the new VoIP ICC framework applied to originating as well as terminating access. *Id.* ¶31 n.86 (JA at 1163) (citing Order ¶961); *see* pp. 12-13, *supra*. The FCC denied that the Order's "general intent to address reductions to originating access" at a later date (and repeated statements to that effect) applied to VoIP traffic. The FCC asserted that it adopted a "distinct" framework for VoIP "based on its findings specific to that traffic." *Id.* ¶31 (JA at 1162).

The FCC noted Windstream's argument that "setting default rates equal to intrastate originating access [is] necessary to avoid 'flash cuts' or 'reductions'" in ICC. Second Reconsideration Order ¶32 (JA at 1163-64). But it asserted that the argument "assume[d] that LECs were receiving intrastate originating access for intrastate toll VoIP traffic under the *status quo*"—an "assumption . . . not reflected

in the *USF/ICC Transformation Order* itself," which was premised on the contrary belief that *all* VoIP ICC "was widely subject to dispute and varied outcomes." *Id.*

The FCC nonetheless conceded that the premise it attributed to the prior Order was erroneous, and that Windstream was factually correct: "[M]arketplace evidence in the record on reconsideration demonstrate[d] the accuracy of that position in many cases," and numerous commenters had shown they would "experience annual reductions in originating access revenues" if intrastate VoIP originating access were cut to interstate levels. Second Reconsideration Order ¶¶32-33 (JA at 1163-64). There were also "fewer disputes and instances of non-payment or under-payment of origination charges billed at intrastate originating access rates . . . , particularly for calls that originated in TDM format." *Id.* The widespread dispute noted in the prior Order was limited to *terminating* access. *See id.*

Despite admitting that the Order's premise regarding the *status quo* for VoIP access charges was erroneous, the FCC declined to change course. Instead, it amended its rules to state that intrastate VoIP calls are subject to interstate originating access rates. Second Reconsideration Order App. A (JA at 1174) (amending 47 C.F.R. §51.913(a)(1)). At the same time, the FCC temporarily suspended the rate reduction, allowing LECs to resume charging intrastate originating access rates until July 2014—at which point those rates would again be flash-cut to interstate levels. *Id.* ¶35 (JA at 1165-66). That suspension was prospective only,

leaving unredressed the six months—from the original Order's effective date until the suspension took effect—during which intrastate VoIP originating access rates had already been flash-cut to interstate rates. *See id.* ¶52(JA at 1172).

The FCC also refused Windstream's request that the agency at least provide a mechanism for LECs to make up lost VoIP originating access revenues, as it had done when cutting terminating access rates. It offered no explanation other than to state, in one sentence of a 23-line footnote, that it did "not adopt the Frontier-Windstream Petition's proposal that, 'the Commission, at the very least, would need to permit LECs to use the recovery mechanism to recover lost originating access revenues.'" Second Reconsideration Order ¶35 n.97(JA at 1165). Immediately afterward, the FCC added that "[r]elated issues, such as advocacy regarding the elimination of equal access obligations due to reduced originating access revenues are more appropriate for consideration in the context of a rulemaking proceeding or a forbearance petition." *Id.* The FCC did not dispute that the Order and Second Reconsideration Order were themselves part of a rulemaking proceeding.

SUMMARY OF ARGUMENT

Throughout these proceedings, the FCC emphasized the need for gradual transitions, avoiding flash-cuts, and providing mechanisms for ILECs to recover losses that result when access charges are cut to interstate rates—particularly given ICC's role in supporting service for high-cost (*e.g.*, rural) customers. For termi-

nating access, the FCC adhered to those principles, pairing gradual reductions in terminating rates with a revenue recovery mechanism. For originating access generally, the FCC applied those principles, declining to cut intrastate originating access until it could develop, in another proceeding, sufficient information to assess a recovery mechanism.

A. But the FCC abandoned those principles with respect to originating access for intrastate VoIP calls, subjecting them to an unexplained flash-cut. The FCC's original Order did not justify that result. In fact, the Order did not even appear to address VoIP originating access, much less make findings specific to it. The FCC eventually conceded that its rationale for immediate reform of terminating access (that it was rife with disputes) was absent for VoIP originating access. And the FCC nowhere justified immediately reducing VoIP originating access rates, rather than addressing them later with originating access generally. A more obvious failure to provide the reasoned decisionmaking required by the Administrative Procedure Act ("APA") is hard to imagine.

B. The FCC's refusal to provide a revenue recovery mechanism to compensate for reductions to originating access rates for VoIP fares no better. The FCC recognized the critical role of ICC in supporting high-cost customers. It then slashed ICC revenues for VoIP originating access. But, unlike with terminating access, the FCC provided no mechanism to allow ILECs to mitigate the revenue

losses that resulted. And it offered no reason for that omission. The FCC's sole explanation was that it was "not adopt[ing]" a recovery mechanism. Under the APA, however, an agency cannot simply announce its decision; it must offer a reasoned rationale for its chosen result. The FCC failed to do so here.

ARGUMENT

THE FCC'S DECISION TO FLASH-CUT ORIGINATING ACCESS CHARGES FOR INTRASTATE VOIP TRAFFIC WITHOUT PROVIDING ANY REVENUE RECOVERY MECHANISM WAS ARBITRARY, CAPRICIOUS, AND CONTRARY TO REASONED DECISIONMAKING

Under the Administrative Procedure Act ("APA"), courts must "hold unlawful and set aside agency action" that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). APA review may be "narrow in scope, but [it] is still a probing, in-depth review." *Sorenson Commc'ns, Inc. v. FCC*, 567 F.3d 1215, 1221 (10th Cir. 2009). The Court must ensure that, "[w]hen an administrative agency sets policy, it . . . provide[s] a reasoned explanation for its action." *Judulang v. Holder*, 132 S. Ct. 476, 479 (2011).

An agency must "'examine the relevant data and articulate a satisfactory explanation for its action.'" *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009). It "must treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so." *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1258 (D.C. Cir. 1996). It must "consider responsible alternatives to its chosen policy and . . . give a reasoned explanation for its rejection of such

alternatives." *Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 242 (D.C. Cir. 2008). And it must "engage the arguments raised before it." *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1165 (D.C. Cir. 1998).

The FCC failed here on all counts. It gave no explanation in its original Order for flash-cutting intrastate VoIP originating access rates to much-lower interstate rates. Indeed, the Order and accompanying rules—which the FCC felt compelled to amend in the Second Reconsideration Order—did not make clear that the FCC even had taken such a step. Nor did the FCC explain why it was flash-cutting VoIP originating access with no means of offsetting lost revenue, even though it subjected terminating access to a gradual transition with a recovery mechanism that cushions revenue losses. The FCC compounded its error on reconsideration. While clarifying that it intended to cut VoIP originating access rates, the FCC again failed to explain why LECs should be denied the same transitional glide path—with accompanying opportunity to recover lost revenue—that the FCC considered to be essential when reducing terminating access charges.

A. The FCC Failed To Justify Its Decision To Reduce Originating Access Rates for Intrastate VoIP

The heart of the "reasoned decisionmaking" required by the APA is the agency's explanation of what it did and why. Here, the FCC provided no such explanation for reducing intrastate VoIP *originating* access rates to interstate levels.

1. For *terminating* access, the FCC found that widespread arbitrage problems and billing disputes justified its decision to fix rates at interstate levels, using a multi-stage phase-down that included a mechanism for recovering lost revenues. Order ¶739(JA at 632). For *originating* access, the FCC found no such grounds and found it lacked sufficient information to create a recovery mechanism; it therefore declined to reduce intrastate originating access rates. *Id.* ¶¶35, 777(JA at 403-04, 650). But the FCC, with *no* rationale, imposed a flash-cut reduction on one type of originating access—VoIP originating access—reducing those rates to interstate levels with no recovery mechanism. That unexplained trajectory cannot be sustained under the APA. Indeed, it was far from clear that the Order had reduced VoIP originating access. The Order's substantive discussion of VoIP access charges revolved entirely around *terminating* access. *See* pp. 12-13, nn. 4-5, *supra*. Originating access was mentioned just once—and there the FCC declared that VoIP originating access charges would be "phase[d]-down" in the future "pursuant to a transition to be specified" in another rulemaking. Order ¶961 & n.1976(JA at 746); *see* pp. 12-13, *supra*. It is hard to read that as saying the FCC was consciously choosing to flash-cut VoIP originating rates.

The FCC has claimed that the Order's language discussing VoIP generally (and accompanying rule) was broad enough to encompass VoIP originating access charges. *See* Second Reconsideration Order ¶31 nn.86-87(JA at 1163); p. 15,

supra. But APA review is not an exercise in linguistic possibilities. The "agency must cogently explain *why* it has exercised its discretion in a given manner," *Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48 (1983) (emphasis added), by "provid[ing] a reasoned explanation for its action," *Judulang*, 132 S. Ct. at 479. The Order's failure even to state clearly *that* the FCC was reducing VoIP originating access rates forecloses any conclusion that the Order adequately spelled out *why* the FCC was doing so.

Nor does the Order reconcile its (putative) decision to reduce VoIP originating access with the FCC's repeated statements that any action on originating access was being deferred to a further rulemaking proceeding. It was necessary to postpone originating access reform, the Order stated, because the submitted comments did "not provide a sufficient basis . . . to proceed at this time"; the FCC thus requested additional comments on the appropriateness of a revenue recovery mechanism for originating access as well as "how such recovery should be implemented." Order ¶1301(JA at 837-38); *see* p. 11, *supra*. The Order nowhere explains how the record was nonetheless sufficient to reduce *VoIP* originating access rates.

2. The FCC's attempted explanation in the Second Reconsideration Order exacerbated the error. The FCC asserted that the initial Order's general statements about deferring originating access reform did not apply to VoIP because

the Order's VoIP discussion was based on "findings specific to that traffic." Second Reconsideration Order ¶31 (JA at 1162). But the Order did not contain *any* findings specific to VoIP *originating* access. The Second Reconsideration Order therefore construed the FCC's prior Order as finding that VoIP ICC *generally* was subject to dispute, adding that the FCC "did not reach a different conclusion in the case of originating access." *Id.* ¶32 (JA at 1164). But that does not constitute a determination that originating VoIP (and not just terminating) was in fact the subject of dispute. Neither Order identifies any determination to that effect.

And the proceedings on reconsideration made clear that any such determination would have been incorrect. Commenters on both sides agreed that, as with non-VoIP or traditional telephony, VoIP *originating* access did not present the same problems as *terminating* access (especially for calls originated on a TDM network). Windstream explained that "the vast majority" of VoIP ICC disputes concerned "the *termination* of VoIP-PSTN calls." Windstream Petition 24 (JA at 4079). And Verizon (which opposed Windstream's petition) concurred that "[b]efore the *Order*, intercarrier compensation disputes were *rare—or even non-existent*—with respect to intrastate originating access charges for TDM-IP calls." Verizon Ex Parte, White Paper 7 (Mar. 23, 2012) (JA at 4359) (emphasis added).

The FCC therefore found on reconsideration that "there were fewer disputes and instances of non-payment or under-payment of . . . intrastate originating access

rates for intrastate toll VoIP traffic than was the case for terminating charges for such traffic." Second Reconsideration Order ¶33 (JA at 1164). That is precisely the same conclusion the FCC reached for non-VoIP traffic—that terminating access was the "principal source" of ICC problems, while "concerns . . . are less pressing with respect to originating access." Order ¶¶35, 777 (JA at 403, 650). For that very reason, the FCC deferred any change to *non-VoIP* originating access. *Id.* ¶777 (JA at 650). But it failed to "proffer[ ] an explanation for why [VoIP originating access] should be treated differently." *Prometheus Radio Project v. FCC*, 373 F.3d 372, 411 n.41 (3d Cir. 2004), *cert. denied*, 545 U.S. 1123 (2005). Instead, confronted with the patent error in its prior assumption that *VoIP* originating access—like terminating access and unlike originating access generally—was rife with dispute, the FCC retreated to vague platitudes about the need to "mov[e] away from reliance on ICC revenues." Second Reconsideration Order ¶35 (JA at 1166). But the desire to move away from ICC revenues applies equally to non-VoIP traffic. *See* Order ¶736 (JA at 631). It provides no basis for singling out VoIP originating access for a flash-cut reduction before the rulemaking process on originating access has run its course.

B. The FCC's Failure To Provide a Revenue Recovery Mechanism Was Arbitrary, Capricious, and Inconsistent with Reasoned Decisionmaking

1. In the NPRM and the USF/ICC Transformation Order, the FCC repeatedly emphasized its "commitment to a gradual transition" toward bill-and-keep and corresponding opposition to any "flash-cut" that might "threaten [LECs'] ability to invest in extending broadband networks." Order ¶890 (JA at 704); NPRM ¶12 ("we intend to avoid sudden changes or 'flash cuts'"), ¶17 ("We do not propose any 'flash cuts,' but rather suggest transitions and glide paths . . . .") (SJA at 8, 9).[6] Correspondingly, when the FCC reduced terminating access charges, it emphasized the need for a recovery mechanism to offset the resulting revenue loss. Order ¶858 (JA at 690) ("Predictable recovery during the intercarrier compensation reform transition is particularly important to ensure that carriers 'can maintain/enhance their networks while still offering service to end-users at reasonable rates.'"). That recovery mechanism is critical, the Order recognized, because statutory and regulatory constraints prevent ILECs from raising end-user rates to compensate for decreased ICC revenues. *Id.* ¶862-863 (JA at 691-92); p. 10,

[6] *See also* Order ¶802 ("transition periods strike the right balance between our commitment to avoid flash cuts and enabling carriers sufficient time to adjust"), ¶809 ("a flash cut would entail significant market disruption"), ¶870 ("commitment to a gradual transition with no flash cuts"), ¶875 ("we are committed to a gradual transition with sufficient predictability to enable continued investment"), ¶935 ("we are mindful of the need for a measured transition for carriers that receive substantial revenues from intercarrier compensation") (JA at 663, 665, 695, 697, 730).

supra.[7] The FCC thus paired reductions in terminating access rates with a contemporaneous recovery mechanism.

Consistent with those principles, Windstream urged the FCC that, if it cut VoIP originating access rates, it should provide a transitional mechanism allowing LECs to recover lost revenue. Windstream Petition 28(JA at 4083). The FCC's answer was "No," unaccompanied by any reason for that decision. Instead, the FCC simply announced, in a single sentence, that it "d[id] not adopt the . . . proposal." Second Reconsideration Order ¶35 n.97(JA at 1165); p. 17, *supra*.

That non-explanation was legally deficient. "[A]n agency's action must be upheld, if at all, on the basis articulated by the agency itself." *State Farm*, 463 U.S. at 50. But here "the agency submitted no reasons at all" for its decision to deny a recovery mechanism. *Id.* The FCC's single sentence that it "d[id] not adopt" such a mechanism provides no insight into "the determinative reason for the final action taken." *Camp v. Pitts*, 411 U.S. 138, 143 (1973). "[S]o conclusory a statement cannot substitute for a reasoned explanation." *Am. Radio*, 524 F.3d at 241; *see State Farm*, 463 U.S. at 48 (agency action arbitrary where analysis of significant alternatives "was nonexistent").

[7] That concern is acute for originating access: Because the IXC, not the originating LEC, has a billing relationship with the caller for long-distance traffic, the LEC often has no way to recover offsetting revenues from the customer initiating the call. *See* pp. 3-4, *supra*.

2. The absence of any explanation for refusing a recovery mechanism for VoIP originating access is particularly stark given the FCC's rationale for declining to reduce originating access charges generally: Recognizing the need to provide a gradual transition with offsetting revenue, the FCC declined to cut non-VoIP originating access because (a) it lacked sufficient information to properly consider and develop an originating access recovery mechanism and (b) budgetary constraints might make it difficult to fund an adequate mechanism at this time. Order ¶¶739, 1301(JA at 632, 837-38); p. 11, *supra*. Rather than reduce originating rates now without a recovery mechanism, the FCC deferred both questions until it could resolve them together.

But "the same rationale also applies" to VoIP originating access. *Prometheus*, 373 F.3d at 405. The FCC recognized that LECs currently receive intrastate originating access charges for VoIP traffic and that, as a result, a flash-cut to interstate levels will impose significant revenue losses. *See* p. 16, *supra*. Those losses threaten to impair LECs' ability not only to invest in broadband networks, but also to maintain existing voice service in some high-cost areas. Even carriers opposing Windstream's petition for reconsideration recognized that potential impact, with AT&T "agree[ing] . . . that LECs should be permitted to use the recovery mechanism to recover access revenues that are lost as a result of assessing only interstate originating access charges." AT&T Comments 39(JA at 4233).

The FCC could have allowed ILECs to participate in a recovery mechanism (as the FCC provided for terminating access). Or it could have deferred any reduction in VoIP originating rates until a proper recovery mechanism could be developed (as the FCC did for originating access). At the very least, the FCC was required to "engage the arguments raised before it," *NorAm*, 148 F.3d at 1165, "consider [those] responsible alternatives to its chosen policy and . . . give a reasoned explanation for its rejection of such alternatives," *Am. Radio*, 524 F.3d at 242 (quotation marks omitted). But "the Commission never explain[ed] why" its policy of avoiding disruptive flash-cuts and pairing rate reductions with recovery decisions "should not also be reflected" in its approach to intrastate originating access for VoIP calls. *Sinclair Broad. Grp., Inc. v. FCC*, 284 F.3d 148, 164 (D.C. Cir. 2002). That failure is particularly perplexing given that, from the originating LEC's perspective, TDM-IP VoIP calls are indistinguishable from TDM calls: On the LEC's network they *are* TDM calls; they are converted to IP after they leave the LEC's network, an event the LEC cannot even detect. *See* pp. 5-6, *supra*. The absence of reasoned decisionmaking on this issue is unmistakable.

The FCC's failure to justify its decision, however, is not inexplicable. In fact, the agency never contemplated that its original Order would cut VoIP originating rates. The Order certainly did not attempt to justify that action. Only on reconsideration did the FCC declare that the Order had done so—a pronouncement

that prompted the FCC to revise its rules to reflect the change. *See* p. 16, *supra*. By that point, the FCC may have believed expanding the Order's recovery mechanism to cover VoIP originating access too expensive. But "cheapness alone cannot save an arbitrary agency policy." *Judulang*, 132 S. Ct. at 490. If the FCC could not provide an adequate recovery mechanism, that militated in favor of deferring reductions to VoIP originating access rates until the FCC could devise one, as the FCC did for non-VoIP originating access. The Second Reconsideration Order's failure even to consider that alternative is the paradigm of unreasoned decisionmaking. *See State Farm*, 463 U.S. at 48.

3. It is no answer that the FCC, on reconsideration, permitted LECs to resume charging intrastate rates on a temporary basis. *See* Second Reconsideration Order ¶35(JA at 1165-66); pp. 16-17, *supra*. That left in place the FCC's arbitrarily imposed flash-cut to originating access for the six months between the original Order and the suspension's effective date. The FCC's temporary stay, moreover, did nothing more than kick the flash-cut further down the road. Come July 2014, Windstream and other LECs will again be subject to an abrupt reduction in ICC charges. The FCC provided no justification for that bizarre flash-cut/flash-back/flash-cut approach.

Nor can the FCC argue that Windstream's objections are premature because the FCC may consider a recovery mechanism as part of the FNPRM. The rate cut

ordered here "must rise or fall [based] upon the FCC's articulated policies *at the time of the order*." *Nat'l Ass'n of Broadcasters v. FCC*, 740 F.2d 1190, 1201 (D.C. Cir. 1984) (emphasis added). It cannot be salvaged based on speculation that the FCC might later reverse course and adopt a recovery policy that, had it been adopted in the first place, might have rendered the decision defensible.

Even dividing VoIP originating access rate reductions and revenue recovery into separate proceedings would be arbitrary and unreasoned. For terminating access, the Order paired gradual rate reductions with an explicit recovery mechanism. For non-VoIP originating access, the Order deferred rate reductions to permit consideration of reductions and recovery at the same time. *See* pp. 9-11, *supra*. But for VoIP originating access, the FCC inexplicably separated the two, ordering a flash-cut in one proceeding while implying recovery might be addressed in another. "The Commission's failure to provide any explanation for this glaring inconsistency is without doubt arbitrary and capricious," and reinforces the need to set aside the flash-cut here. *Prometheus*, 373 F.3d at 411.

That "wait-and-see" approach to recovery would also defy the FCC's recurring emphasis on the need for predictability in future ICC revenue streams. For terminating access, the FCC provided that ILECs could recoup revenues up to the "Eligible Recovery" limit. *See* p. 10, *supra*. The FCC emphasized that its recovery mechanism allowed price-cap LECs "to determine *at the outset exactly*

how much their Eligible Recovery will be each year," so as to "provide[ ] the necessary predictability" for carriers to invest in their networks. Order ¶879 & n.1697(JA at 698) (emphasis added).[8] Here, the FCC never offered any explanation for abandoning that approach with respect to VoIP originating access and subjecting carriers to ICC revenue losses with at best an uncertain possibility of future relief.

Indeed, the FCC did not even commit to consider a recovery mechanism in some further rulemaking. After rejecting a recovery mechanism, the FCC asserted in the next sentence that "*[r]elated issues*, such as . . . the elimination of equal access obligations," are "more appropriate for consideration in the context of a rulemaking proceeding." Second Reconsideration Order ¶35 n.97(JA at 1165) (emphasis added). But that statement refers only to "related issues" and does not promise implementation of the requested and denied recovery mechanism. The statement is also nonsensical; it fails to appreciate that the FCC was *already* engaged in "a rulemaking proceeding"—and a comprehensive one at that.

Simply put, the FCC cannot—consistent with reasoned decisionmaking—repeatedly emphasize the necessity of gradual transitions, revenue recovery, and

[8] The recovery mechanism sets an Eligible Recovery baseline using 2011 revenues and provides for a 10% reduction of that amount each year, rather than requiring annual "true-up" adjustments to reflect variations in the actual volume of traffic. Order ¶879(JA at 698).

certainty; implement those measures for one type of access; but then refuse to adhere to the same principles for another without explaining that departure.

CONCLUSION

This Court should vacate the FCC's rule reducing intrastate VoIP originating access and remand with directions to pair any reduction with a recovery mechanism or, at the very least, to provide a reasoned explanation for its chosen course.

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Respectfully submitted,

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1. This brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B)(ii) and this Court's October 1, 2012 Order establishing a briefing schedule in Windstream's case because this brief contains 6,993 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2003 in Times New Roman 14-point font.

July 17, 2013

/s/ Jeffrey A. Lamken
Jeffrey A. Lamken

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I hereby certify that, on July 17, 2013, per this Court's order of October 17, 2012, I caused the foregoing document to be electronically filed with the Court via e-mail. This document will be served on all parties in this case by the Notice of Docket Activity upon the Court's docketing of the brief in the CM/ECF system.

July 17, 2013

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