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 REPLY BRIEF

Jeffrey A. Lamken
Counsel of Record
Lucas M. Walker
MOLOLAMKEN LLP
The Watergate, Suite 660
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 556-2000

Counsel for Windstream Corporation and Windstream Communications, Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTE

REGULATION

OTHER MATERIALS

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
FCC Br.	Federal Respondents' Response to the Windstream Principal Brief (filed Mar. 27, 2013)
FNPRM	Further Notice of Proposed Rulemaking
ICC	Intercarrier Compensation
ILEC	Incumbent Local Exchange Carrier
Intervenors Br.	Brief of Intervenors Supporting Respondents in Response to the Windstream Principal Brief (filed Apr. 24, 2013)
IP	Internet Protocol
IXC	Interexchange Carrier
LEC	Local Exchange Carrier
NPRM	Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC No. 11-13, 26 FCC Rcd. 4554 (2011)
Order	USF/ICC Transformation Order, FCC Order No. 11-161, 26 FCC Rcd. 17663 (2011)
PSTN	Public Switched Telephone Network

PUC	Public Utility Commission
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)
Windstream Br.	Windstream Principal Brief (filed Dec. 10, 2012)

Time and again, the FCC's rulemaking emphasized two policies integral to intercarrier compensation ("ICC") reform: Avoiding disruptive flash-cuts in rates, and deferring originating access charge reductions given the insufficiency of the data. But when it came to originating access for *VoIP* calls, the FCC abandoned both principles without any reasoned explanation, slashing rates without offering any realistic analysis of that flash-cut's financial impact or providing a revenue recovery mechanism like that established to cushion reductions in terminating access rates.

The FCC attempts to fill that gap on appeal by re-purposing its rationales for reducing *terminating* access for VoIP calls to justify reductions in VoIP *originating* access. But those rationales do not make sense for originating access. For example, although the FCC now claims flash-cutting VoIP originating access was necessary to prevent arbitrage, the agency acknowledged below that it actually *creates* arbitrage risks. The FCC's other explanations for radically different treatment between traditional and VoIP originating access likewise fail: They were not offered below; defy reason; and have no foundation in evidence.

The FCC's refusal to provide a revenue recovery mechanism and phased-in transition fares even worse. The FCC offered no explanation for that decision below. And its new explanation on appeal—that purported increases in VoIP terminating access revenues will offset lost originating revenues—is unsupported.

The FCC never attempted to quantify the supposed increase in terminating revenues. In fact, that increase comes nowhere near offsetting lost originating revenues, and scheduled reductions in VoIP terminating rates only further deplete whatever scant "recovery" those charges might provide. Nor does the FCC's suspension of its flash-cut on reconsideration justify denying a recovery mechanism. Carriers will still suffer an abrupt rate reduction next year, contrary to the FCC's avowed policy of providing *gradual* transitions. The suspension, moreover, does nothing to remedy the six-month flash-cut the Order already imposed without any explanation.

ARGUMENT

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

The FCC identifies nothing in the Order that explains why it cut originating access charges for intrastate VoIP calls while preserving intrastate originating rates for traditional calls. Instead, the FCC urges that the reasons it gave for reducing *terminating* access charges for VoIP calls also apply to *originating* access for VoIP calls: Because the Order defined "VoIP-PSTN traffic" as "traffic exchanged over PSTN facilities that originates and/or terminates in IP format," Order ¶940(JA at 733), the FCC insists that "[e]very use of that term throughout the VoIP section of the *Order . . . necessarily referred to originating access*" as well as terminating access. FCC Br. 16 (emphasis added). That argument permeates the FCC's brief.

See id. at 9, 10, 16, 20-21, 22. But it is verbal sleight of hand. And it underscores the arbitrariness of the FCC's decision: The stated rationales make no sense for originating access.

1. The FCC contends that, whenever it offered a justification for reducing VoIP *terminating* access rates—the only context it discussed—it really meant *all* VoIP access charges. But defining VoIP as traffic that "originates and/or terminates in IP" means only that a call is *classified as VoIP* if IP is used at either end of the call. It says nothing about *how VoIP is regulated*, much less that originating and terminating access are regulated identically for VoIP (they are not for traditional calls). Nor does it say what rates apply to VoIP terminating and originating access, let alone that those rates are the same (they are not for traditional calls). The FCC's efforts to re-purpose rationales offered for terminating access to justify flash-cutting originating access for VoIP calls are mere "*post hoc* rationalizations of counsel" this Court must "disregard." *Sorenson Commc'ns, Inc. v. FCC*, 567 F.3d 1215, 1221 (10th Cir. 2009).

2. The FCC's new explanations also defy reason. The FCC conceded on reconsideration that a primary rationale for reforming VoIP *terminating* access—"significant billing disputes and litigation"—did not apply to VoIP *originating* access, where such disputes did not exist. Second Reconsideration Order ¶32(JA at 1163-64); *see* Order ¶937(JA at 730-31). The FCC thus abandons that rationale

on appeal. FCC Br. 27-28. It nonetheless re-embraces the error by urging that allowing intrastate originating rates for VoIP would have required it to "extend" the existing access regime "into a new area." FCC Br. 24 (citing Order ¶948). But that assumes LECs were not already receiving intrastate rates for originating VoIP calls—an assumption the FCC has conceded to be false. *See* Second Reconsideration Order ¶32 (JA at 1163-64); Windstream Br. 22-24. The question before the FCC was thus whether to maintain the originating-access status quo for some calls (traditional calls) but disrupt it for others (VoIP).

None of the FCC's rationales justifies that differential treatment. The FCC asserts that cutting originating access for VoIP calls will "'guard against new forms of arbitrage'" by establishing "'symmetrical' VoIP rules that apply equally to both originating and terminating traffic." FCC Br. 24-25 (quoting Order ¶941). That rationale appears nowhere below. The Order discussed arbitrage only with respect to VoIP *terminating* access, which could arise if different terminating rates applied depending on the technology used for the call ("IP-originated" versus "IP-terminated"). Order ¶942 (JA at 734). The Order never claimed that "addressing only *terminating* access charges and not *originating* charges" would create arbitrage opportunities. FCC Br. 25 (emphasis added). Nor could it: A carrier cannot exploit differences between originating and terminating access charges, because it cannot control whether it is on the sending or receiving end of the call.

If such arbitrage were possible, the Order's treatment of non-VoIP traffic—reducing terminating but not originating access charges—would be irrational.

The FCC's decision to cut originating access for VoIP calls while preserving originating access for non-VoIP actually *creates* arbitrage risks. Having different originating access rates for VoIP and non-VoIP traffic provides "incentives for IXCs to misidentify the technology the terminating LECs use to terminate their calls—something that the originating LEC has no ability to verify." Windstream Petition for Reconsideration Reply 12-13(JA at 4267-68). The FCC never disputed that. Indeed, when confronted with the issue, the agency *disclaimed* arbitrage as a rationale, denying "that the *Order* should be interpreted categorically to preclude any individual rules that could preserve incentives for any form of arbitrage." Second Reconsideration Order ¶32 n.89(JA at 1163). The FCC's invocation of arbitrage here is thus an improper *post hoc* rationalization—and an erroneous one at that. An agency cannot defend its actions by claiming its chosen course *redresses* evils that it concededly *exacerbates*.[1]

[1] The FCC notes that, years ago in a different proceeding, Windstream stated that "maintaining a disparity in originating and terminating rates does not make economic sense." FCC Br. 25 n.5. Windstream, however, was supporting an earlier proposal, the Missoula Plan, which provided for *measured* reform of terminating and originating access—including opportunities to recover lost revenue for both. *See* Missoula Plan for Intercarrier Compensation Reform 4, 12 (Jul. 18, 2006), http://apps.fcc.gov/ecfs/document/view?id=6518404368 (PDF pages 86, 94). Windstream does not oppose rational ICC reform, including originating access

Finally, the FCC argues that maintaining current originating rates for VoIP calls would "'create incentives to retain old voice technologies'" and "'hinder[] progress to all IP networks.'" FCC Br. 25-26 (quoting NPRM ¶¶495, 506(SJA at 150, 156)). But the quoted statements from the NPRM were explaining ICC reform generally—they appear in the NPRM's *general* discussion of ICC reform, *not* the "specific section" "dedicated uniquely to VoIP," *see* FCC Br. 26. They thus cannot support treating VoIP and non-VoIP differently. More important, the FCC's distinction between VoIP and non-VoIP originating access actually *discourages* upgrading to IP technology. LECs that convert from older TDM technology to IP *guarantee* that they will receive lower interstate originating access rates for all traffic, whereas LECs that stick with TDM preserve the right to higher intrastate rates for originating traffic that terminates in TDM. The FCC nowhere explains how rewarding upgrades with a guaranteed rate cut (and no revenue recovery) promotes investment in IP networks.[2]

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reform. But reform must have real, stated justifications and allow reasonable transitions. The Missoula Plan did that; the Orders under review do not.

[2] Quoting the ABC Plan proponents' Joint Comments, the FCC asserts that "Windstream itself suggested that the FCC 'treat VoIP traffic differently from non-VoIP traffic.'" FCC Br. 27. But that addressed only VoIP *terminating* access. The Comments state that "distinct treatment of VoIP will last for only the first 18 months of the transition, after which existing [non-VoIP] intrastate rates will have been reduced to interstate rates." Joint Comments 35(JA at 3450). That could not have referred to originating access, because "[t]he ABC Plan d[id] not call for reductions in originating access charges." *Id.* at 26(JA at 3441). The Plan was explicit, stating that the VoIP traffic made "subject to current interstate access

3. None of the FCC's proffered rationales supports its flash-cut of VoIP *originating* access because none was offered for that purpose—until this appeal. The FCC does not deny that each example the Order gave regarding VoIP dealt with terminating access. Windstream Br. 12. The FCC nonetheless claims that both originating and terminating access were necessarily covered because the Order stated that "all long-distance VoIP traffic 'will be subject to charges not more than *originating* and terminating interstate access rates.'" FCC Br. 21 (quoting Order ¶961 (JA at 746)) (emphasis added). But the FCC omits footnote 1976, appended to the word "originating." That footnote made clear that the FCC was distinguishing between originating and terminating access for VoIP: It provided that "originating access charges" will be addressed "pursuant to a transition *to be specified* in response to the FNPRM." Order ¶961 n.1976 (JA at 746) (emphasis added). And the FNPRM confirmed that, "seek[ing] comment on that final transition for *all* originating access charges." *Id.* ¶1298 (JA at 837).

The FCC urges that footnote 1976 "does not address VoIP calls specifically." FCC Br. 23. But the footnote appeared in what the FCC repeatedly describes as the "specific section" of the Order "dedicated uniquely to VoIP." *Id.* at 26; *see id.* at 8, 11, 17, 20, 23, 27. Nowhere does the FCC explain why a footnote in the

rates" would be "incorporated in the overall transition as rates for *terminating* interstate access traffic are reduced." ABC Plan Framework 10 (JA at 2998) (emphasis added). Neither filing, moreover, advocated *indefinite* discrimination between VoIP and non-VoIP like that ordered here.

dedicated VoIP section should be read to exclude VoIP calls. That the footnote discusses "section 251(b)(5) traffic"—which includes traditional and VoIP traffic, *id.* at 23—confirms that originating access for VoIP and non-VoIP was to be treated alike.

The FCC's plea for deference (at 20) falls short. Courts must still "'independently insure that the agency's interpretation'" of its Order "'comports with the language it has adopted.'" *Sekula v. FDIC*, 39 F.3d 448, 453 (3d Cir. 1994). The FCC's construction does not. For preservation purposes, moreover, Windstream maintains that deference is inappropriate and violates separation of powers. *See Decker v. Nw. Envtl. Def. Ctr.*, 133 S. Ct. 1326, 1339-42 (2013) (Scalia, J., concurring in part and dissenting in part).

4. Ultimately, the FCC argues that the language of the Rule the Order adopted "plainly applies to both originating and terminating traffic." FCC Br. 22. But that again confuses how VoIP is *defined* with how VoIP is *regulated*. The quoted language addresses the *traffic* "the VoIP access charge regime applies to," not the *substance* of that regime; none mentions originating access charges. *Id.* By contrast, the revised Rule *does* explicitly address originating access. 47 C.F.R. §51.913(a)(JA at 1174). Besides, whatever the Rules mean, the FCC failed to provide reasoned explanations for adopting them. They cannot be sustained.

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

The FCC does not dispute that, throughout these proceedings, it emphasized its "commitment to a gradual transition" and "glide paths," its opposition to "flash cuts," and the corresponding need for a recovery mechanism to offset revenue losses. Order ¶¶870, 890 (JA at 695, 704); NPRM ¶17 (SJA at 9). Consistent with that commitment, the FCC paired terminating access reductions with a recovery mechanism. Order ¶¶847-932 (JA at 683-729). But when the FCC cut VoIP *originating* access charges, it refused to do so. The FCC's entire rationale for that about-face was one sentence: "Our reconsideration here does 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).

1. The FCC urges that, in fact, it "discussed the issue and explained that explicit replacement revenue was unnecessary" because of "offsetting compensation"—namely "'additional revenues for previously disputed terminating VoIP calls'" and "'savings associated with reduced litigation and disputes.'" FCC Br. 29-30 (quoting Second Reconsideration Order ¶35). The FCC claims to have "predict[ed] that increases in *terminating* access revenue would make up for" lost *originating* access revenue. *Id.* at 31 (emphasis added).

The record belies that argument. The paragraph the FCC cites does not address a recovery mechanism. *See* Second Reconsideration Order ¶35(JA at 1165-66); FCC Br. 29-30. It addresses the FCC's decision not to "indefinitely permit[ ] [VoIP] origination charges at the level of intrastate access." Second Reconsideration Order ¶35(JA at 1166). Declining to maintain current ICC charges is not the same as refusing some means of recovering lost revenue. A statement made to support one agency decision cannot sustain a different decision. *See Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005) (refusing to consider statement that SEC "was not aware of any costs associated with the hiring of staff" because agency "made that observation . . . in regard not to the independent chairman condition [under review] but to a condition not challenged here").

The point of a recovery mechanism is to facilitate a "gradual transition *away from ICC revenues*" by providing "*alternative* revenue sources." Order ¶847(JA at 683) (emphasis added); *see* Second Reconsideration Order ¶35(JA at 1166) (expressing "overall policy goal" of "moving away from reliance on ICC revenues"). The notion that there should be no recovery mechanism for VoIP originating access (one form of ICC) because LECs could rely more heavily on terminating access (another form of ICC) thus does not merely violate the rule against *post hoc* rationalizations; it also violates the "overall policy goal" undergirding the Orders on review. The FCC nowhere explains that inconsistency.

2. The FCC's new rationale fails both the reasoned decisionmaking and the substantial evidence requirements. The FCC asserts that "increases in terminating access revenue would make up for the (eventual) fall in originating access revenue." FCC Br. 31. But it "points to no data to support this claim." *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1171 (D.C. Cir. 1987). Nor could it. "The record does not quantify the net effect of the revenue reduction and cost savings" of the transitional VoIP ICC regime. Order ¶948 n.1914(JA at 737). Absent any analysis, the FCC's newly minted "predictive judgment" is unsupported assertion. Such "conjecture cannot substitute for a reasoned explanation." *Graphic Commc'ns Int'l Union, Local 554 v. Salem-Gravure Div. of World Color Press*, 843 F.2d 1490, 1494 (D.C. Cir. 1988).[3]

That conjecture is also mathematically implausible. Intrastate access rates can be more than ten cents per minute, whereas interstate rates can be a fraction of a cent per minute. NPRM ¶494(SJA at 149-50). Even assuming (unrealistically) that LECs previously received nothing for VoIP terminating access, an extra penny per minute for terminating access nowhere approaches the loss of a dime per

[3] The FCC errs in claiming (at 31) that "Windstream does not challenge the FCC's prediction that increases in terminating access revenue would make up for the (eventual) fall in originating access revenue." That "prediction," first asserted on appeal, is unsupported and unsupportable.

minute on VoIP originating access.[4] Moreover, terminating access for VoIP calls will be cut still further on July 1, 2014—the same day VoIP originating access rates are flash-cut. Order ¶801(JA at 661-62), Second Reconsideration Order ¶35(JA at 1165). The FCC nowhere reconciles its new theory with basic math.

The FCC also double-counts the supposed benefits from VoIP terminating access. The original Order invoked that same justification—"more certain revenue" and "reduced litigation and administrative expense associated with VoIP"—in connection with reducing non-VoIP terminating access. *See* Order ¶930(JA at 726-28). The FCC offers nothing to show those putative benefits will cover both terminating and originating losses. The Order, moreover, identified those supposed benefits in connection with terminating access only as factors to consider where carriers request *additional* recovery *beyond* that available under the mechanism the FCC established. *See id.* ¶¶924-930(JA at 723-28). The FCC's Order thus posits that any increase in VoIP terminating revenue is so slight as to matter only in individual cases where a recovery mechanism falls short; but in its appellate brief, that purported increase is so great as to justify denying *any* recovery mechanism when originating access charges are pared to a fraction of their former amount. That inconsistency is unexplained and inexplicable.

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[4] Rates vary by State, and there are other complicating factors. But the FCC did not attempt even a rudimentary estimate, much less a reasoned estimate based on record evidence.

3. The FCC likewise errs in characterizing its two-year suspension of the cut as a gradual transition because carriers may "charge rates for intrastate toll VoIP traffic in excess of interstate access rates *for longer than the approximately eighteen months . . . that the Commission permitted for terminating access*." Second Reconsideration Order ¶36 n.104(JA at 1166-67) (emphasis added); FCC Br. 32-33. A flash-cut is still a flash-cut whether imposed today or deferred; abrupt financial changes do not cease to be abrupt (and disruptive) simply because they are scheduled two years out. On June 30, 2014, originating LECs will be compensated at intrastate levels; on July 1, they will receive a fraction of that, with nothing to narrow the gap. Nor is the originating access cut gradual compared to reductions in terminating rates. FCC Br. 32-33. Reductions in terminating access do start earlier, but those reductions *are paired with a revenue recovery mechanism*. That calibrated transition cannot be compared to a flash-cut imposed without any revenue recovery.[5]

[5] Seeking to downplay the flash-cut's impact, Intervenors invoke materials outside the administrative record. Intervenors Br. 6-7 nn. 2-3. But an "agency's action must be reviewed on the basis articulated by the agency and on the evidence and proceedings before the agency at the time it acted." *Am. Min. Cong. v. Thomas*, 772 F.2d 617, 626 (10th Cir. 1985). Besides, those materials are unsupportive. A company offering many services can suffer great losses in a single line of business before it becomes "material" to the company as a whole. Windstream's 10-Q confirms that ICC reform will result in "numerous disputes," some "significant," over "the proper amount of intercarrier compensation." Windstream Corp. 10-Q for Q2 2012, at 55. And Windstream's letter to the Texas PUC reflects one such dispute (instigated by Verizon).

4. The FCC's theory that "carriers do not have the same reliance interests in [VoIP originating access] revenue" that they have in traditional call revenue, FCC Br. 31, fares no better. It is undisputed that, before the Order, LECs consistently received intrastate originating access rates for intrastate VoIP traffic, at least where that traffic originated in TDM. That VoIP is "a relatively new technology that the FCC had never previously determined to be subject to the access charge regime," *id.* at 24, did not matter. LECs could not tell how calls terminated, so all traffic originating in TDM was treated the same. *See* Verizon White Paper 7(JA at 4359).

The FCC, moreover, never made an unquestioned entitlement to access charges a condition for revenue recovery. *Terminating* access for VoIP calls (unlike originating access) was subject to dispute. Yet the FCC made VoIP terminating access eligible for the Order's recovery mechanism—in fact, the agency declined to adopt immediate bill-and-keep for VoIP terminating access specifically to "limit the initial burden that the intercarrier compensation reform recovery mechanism places on the Universal Service Fund." Order ¶952(JA at 739-40). Even if differing reliance interests might explain treating originating access for *VoIP* and *non-VoIP* calls differently—and they do not—they cannot justify affording a recovery mechanism to offset cuts to *terminating* access for VoIP calls but none for *originating* access for VoIP calls. That "internally inconsistent and inadequately explained" decision cannot stand. *Gen. Chem. Corp. v. United States*, 817 F.2d 844, 846 (D.C. Cir. 1987).

5. The FCC cannot salvage the Order's immediate six-month flash-cut of VoIP originating access charges, which was imposed without considering a recovery mechanism. Windstream Br. 29. Because the FCC "entirely failed to consider an important aspect of the problem," that flash-cut was arbitrary and capricious. *MVMA v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). While the FCC makes noises about retroactive rates (at 33-34), it does not deny it has authority to reverse the effects of any order overturned on judicial review. *See United Gas Improvement Co. v. Callery Props., Inc.*, 382 U.S. 223, 229-30 (1965) (agency may order refund of money paid under invalidated order because "[a]n agency, like a court, can undo what is wrongfully done by virtue of its order").

CONCLUSION

This Court should vacate the FCC's rule reducing intrastate VoIP originating access.

July 31, 2013

Respectfully submitted,

/s/ Jeffrey A. Lamken
Jeffrey A. Lamken
Counsel of Record
Lucas M. Walker
MOLOLAMKEN LLP
The Watergate, Suite 660
600 New Hampshire Ave., N.W.
Washington, D.C. 20037
(202) 556-2000

Counsel for Windstream Corporation and Windstream Communications, Inc.

CERTIFICATE OF COMPLIANCE

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 3,497 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 31, 2013

/s/ Jeffrey A. Lamken
Jeffrey A. Lamken

CERTIFICATE OF SERVICE

I hereby certify that, on July 31, 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 31, 2013

/s/ Jeffrey A. Lamken
Jeffrey A. Lamken

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I hereby certify that with respect to the foregoing:

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/s/ Jeffrey A. Lamken
Jeffrey A. Lamken