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

UNCITED ADDITIONAL INTERCARRIER COMPENSATION ISSUES PRINCIPAL BRIEF

(DEFERRED APPENDIX APPEAL)

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November 6, 2012

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Glossary

1996 Act	Telecommunications Act of 1996
CAF	Connect America Fund
CLEC	Competitive Local Exchange Carrier
CMRS	Commercial Mobile Radio Service
COLR	Carrier of Last Resort
ETC	Eligible Telecommunications Carrier
FCC, or Commission	Federal Communications Commission
ICC	Intercarrier Compensation
ILEC	Incumbent Local Exchange Carrier
ISP	Internet Service Provider
IXC	Interexchange Carrier
LEC	Local Exchange Carrier
MOU	Minute of Use
MTA	Major Trading Area
NECA	National Exchange Carriers Association
NPRM	Notice of Proposed Rulemaking
RBOC	Regional Bell Operating Company
RLEC	Rate-of-Return ILEC
USF	Universal Service Fund

Statement of Issues[1]

1. The *Order* (*Connect America Fund*, 26 F.C.C.R. 17663, (2011) ("*Order*") provides USF support for ILECs' lost interstate and intrastate access revenues, but not for rural CLECs' lost revenues, based on the FCC's finding that because their rates are not regulated, CLECs are not prohibited from either declining to provide service or raising their rates to make up access revenue shortfalls. Was this conclusion an arbitrary departure from its findings in the same order that CLECs lack market power, *i.e.*, the ability to charge supra-market rates, or otherwise in arbitrary disregard of the constraints on rural CLECs?

2. Whether the requirement that LECs and CMRS carriers exchange intraMTA, non-access telecommunications traffic ("CMRS-LEC traffic") at a zero rate on the effective date of the *Order*, or within six months thereof, should be vacated as discriminatory, internally inconsistent, an unexplained change in policy, and

[1] Two of the issues that Petitioners initially requested to be included in the Supplemental Briefs, listed as Issues 1 and 4 in the Petitioners' Motion to Establish a Procedural Schedule filed June 11, 2012 ("*Motion*"), are not being separately briefed. *See Motion*, at 8-9. Accordingly, the issues listed therein as Issues 2, 3, and 5 are presented herein as Issues 1, 2, and 3, respectively.

arbitrary and capricious.

3. Whether the requirement that a CLEC engaged in "access stimulation" (as defined in the *Order*) must lower, or "benchmark," all of its interstate switched access rates applicable in a state to that of the price cap LEC with the lowest rate in that state, should be vacated as discriminatory and arbitrary and capricious.

Statement of Additional Facts[2]

2. The FCC extended the bill-and-keep deadline for CMRS-LEC traffic, but only for six months (until July 1, 2012), and only for carriers with an interconnection agreement in effect as of the effective date of the FCC's Order on Reconsideration. *See Connect America Fund*, 26 F.C.C.R. 17633, ¶ 7 (2011) ("*CMRS Recon*").

3. Since 2001, the FCC has permitted CLECs to "benchmark" their interstate switched access rates to those of the incumbent LEC(s) operating in the service territory or territories in which the CLEC offers switched access services to IXCs. *See Access Charge Reform*, 16 F.C.C.R. 9923 (2001) ("*CLEC Access Order*"). The FCC also created a "rural exemption" for CLECs operating in

[2] *See* Joint Preliminary Brief, 36 (Issue 2), 44-45 (Issue 3).

rural parts of a mid-sized or price cap LEC's territory, through which the CLEC is permitted to benchmark its rates to "those in the NECA access tariff, assuming the highest rate band for local switching." *Id.* ¶ 80.

In the *Order*, the FCC explicitly continued these CLEC switched access benchmarking rules throughout the multi-year transition to bill-and-keep. *See Order*, ¶ 807 ("For interstate switched access rates, competitive LECs are permitted to tariff interstate access charges at a level no higher than the tariffed rate for such services offered by the incumbent LEC serving the same geographic area."). The FCC also retained the rural exemption. *Id.* ("rural competitive LECs offering service in the same areas as non-rural incumbent LECs are permitted to 'benchmark' to the access rates prescribed in the NECA access tariff . . . .") However, the FCC also created a new exception to the benchmarking rule. *Id.* ("competitive LECs meeting the access revenue sharing definition are required to benchmark to the lowest interstate switched access rate of a price cap LEC in the state.").

In section XI.A. of the *Order*, the FCC established new restrictions on the rates that RLECs and CLECs may charge for switched access. *See generally*, *Order*, ¶¶ 656-701. The FCC proscribed these "access stimulation" rules in response to IXC complaints that RLECs and CLECs operating in rural rate-of-return territories were charging high switched access rates in connection with conference call traffic which the LECs "stimulated" by entering into revenue-sharing arrangements with conference call providers. According to the FCC, "[t]he record confirms the need for prompt Commission action . . . to help ensure that [LEC] interstate switched access rates remain just and reasonable, as required by § 201(b) of the Act." *Id.* ¶ 662. Access rates are traditionally calculated by dividing a carrier's costs by anticipated traffic volumes. In the Commission's view, the problem was "that the interstate switched access rates being charged by access stimulating LECs do not reflect the volume of traffic associated with access stimulation," which "almost uniformly [made] their interstate switched access rates unjust and unreasonable." *Id.*

The FCC defined "access stimulation" as follows. "The first condition is that the LEC has entered into an access revenue sharing agreement . . ." *Id.* ¶ 667. "The second condition is met where the LEC either has had a three-to-one interstate terminating-to-originating traffic ratio in a calendar month, or has had a greater than 100 percent increase in interstate originating and/or terminating switched access MOU in a month compared to the same month in the preceding year." *Id.*

In order to ensure that LEC switched access rates "reflect the volume of traffic associated with access stimulation," the FCC established different rules for RLECs and CLECs that meet the two conditions. As to RLECs, the FCC required "carriers filing interstate switched access tariffs based on projected costs and demand pursuant to section 61.38 of the rules to file revised access tariffs . . ." *Id.* ¶ 685. The FCC found that "[t]his tariff filing requirement provides the carrier with the opportunity to show, and the Commission to review, any projected increase in costs, as well as to consider the higher anticipated demand in setting revised rates." *Id.* The FCC concluded that "the rule we adopt will require section 61.38 carriers to set their rates based on projected costs and demand data." *Id.* ¶ 687.

For CLECs, the FCC mandated benchmarking to a significantly lower rate than in the past, "a rate no higher than the lowest rate of a price cap LEC in the state." *Id.* ¶ 689. The FCC found that:

> [N]either the switched access rate of the rate-of-return LEC in whose territory the competitive LEC is operating nor the rate used in the rural exemption is an appropriate benchmark when the competitive LEC meets the access stimulation definition. In those instances, the access stimulator's traffic vastly exceeds the volume of traffic of the incumbent LEC to whom the access stimulator is currently benchmarking. Thus, the competitive LEC's traffic volumes no longer operationally resemble the carrier's traffic volumes whose rates it had been benchmarking because of the significant increase in interstate switched access traffic associated with access stimulation. Instead, the access stimulating LEC's traffic volumes are more like those of the price cap LEC in the state, and it is therefore appropriate and reasonable for the access stimulating LEC to benchmark to the price cap LEC.

Id.

The FCC rejected alternatives, such as letting CLECs use the NECA schedules (as it did previously with respect to the rural exemption) and permitting CLECs to submit, like incumbent RLECs, §61.38 cost and volume data:

> We also decline to . . . permit a competitive LEC to use section 61.38 procedures to establish its interstate switched access rates if the price cap LEC rates would not adequately compensate the competitive LEC. We maintain the benchmarking approach to the regulation of the rates of competitive LECs . . . . There is insufficient evidence in the record that abandoning the benchmarking approach for competitive LEC tariffs and compelling competitive LECs to comply with 61.38 rules

> is necessary to address concerns regarding access stimulation, particularly considering the burden that would be imposed on competitive LECs to start maintaining regulatory accounting records. Instead, we believe it is more appropriate to retain the benchmarking rule but revise it to ensure that the competitive LEC benchmarks to the price cap LEC with the lowest rate in the state, a rate which is likely most consistent with the volume of traffic of an access stimulating LEC.

Order, ¶ 694.

Standard of Review

The standard of review governing all three sections of this Brief is the arbitrary and capricious standard set out at pages 41-42 of the Joint Preliminary Brief.[3]

Summary of Argument

1. The Order proposes to replace rural carrier ICC revenues lost through its reforms with some USF support, but only for ILECs, not CLECs. Its twofold justification for this disparate treatment – (1) that rural CLECs lack market power and are therefore free to raise their end-user rates to make up for the shortfall and (2) that, because they allegedly have not built out their systems they can simply decline to serve high cost customers – is contradicted by its

[3] Joint Preliminary Brief, at 41-42.

own findings.

First, the agency contradicts itself by stating in the same order that if carriers with pricing flexibility could simply raise their end user rates they would have done so already. And, by citing CLECs' lack of market power, the FCC ignores the logic of its own observation: by definition, as the FCC has correctly observed in the past, sellers without market power cannot raise their rates without losing customers. The FCC's further conclusion that, unlike ILECs, CLECs losing ICC revenues could simply choose to continue serving only their most profitable customers is based on a false premise: to qualify for USF, CLECs must be eligible telecommunications carriers (ETCs), which requires offering service to all. The FCC's rationale also contradicts its own prior observation that CLECs are "lacking the lower-cost urban operations that non-rural ILECs [with whom CLECs compete] can use to subsidize their rural operations." *See CLEC Access Order*, ¶ 65. The Commission's conclusion about CLECs' ability to select customers also contradicts its own prior observations that the rural CLEC model is predicated on building complete systems ("overbuilding") to fully replace service by incumbent LECs; they cannot selectively build out to certain customers to save costs.

2. The FCC's flash cut to bill-and-keep for CMRS-LEC traffic is arbitrary and capricious because the Commission offers no reasoned justification for it, while other "coextensive" §251(b)(5) traffic is subject to a multi-year transition. The FCC contradicts its own "commitment" to avoid flash cuts in the *Order*, ignores significant record evidence of the market disruption that is likely to occur, and attempts to justify its action based on claims of "arbitrage" (which are not supported by the record). At the same time the FCC reversed without explanation its policy of imposing the same compensation rate to avoid such arbitrage. The FCC's flash cut to the zero rate for CMRS-LEC traffic is internally inconsistent, inadequately explained, and should be vacated.

3. As they apply to CLECs, the FCC's access stimulation rules are arbitrary and capricious and should be vacated[4] for three

[4] If the Court rules that the FCC's transition to bill-and-keep for all traffic is unlawful, the access stimulation rules should be vacated in their entirety, since they are part and parcel of the transition. *See Order*, ¶ 701 ("Our new [access stimulation] rules will work in tandem with the comprehensive intercarrier compensation reforms we adopt below, which will, when fully implemented, eliminate the incentives in the present system that give rise to access stimulation.").

reasons. *First*, by prohibiting CLECs from submitting actual cost and demand data, the FCC unreasonably discriminates against CLECs vis-à-vis ILECs, which are permitted to do so. *Second*, the FCC's rules, which apply to CLECs regardless of the rates they charge or their service territories, bear no rational relationship to the rules' stated purpose—to prevent CLECs operating in rate-of-return LEC territories from collecting corresponding rates when actual traffic volumes are much higher than those rates support. *Third*, the FCC's choice of the lowest price cap LEC rate in a state as the benchmark for access stimulation CLECs is devoid of record support and ignores the evidence in the record.

Argument

I. The Commission Improperly Denied Rural CLECs USF Support To Offset Lost ICC Revenues While Providing Such Support To Their ILEC Competitors; The FCC's Rationale That Rural CLECs Could Offset Their Losses By Raising Rates Is Inconsistent With The FCC's Prior Finding That Rural CLECs Lacked Market Power And Hence The Ability To Raise Rates.

The *Order* recognizes that, as FCC policy moves "away from implicit support, some high cost, rural areas may need new explicit support from the universal service fund." *Order*, ¶ 917. To do this, the Commission proposed that some of the intercarrier compensation revenues lost through its reforms be replaced through the USF. *Id.* But rather than providing explicit USF support for ***all*** carriers in high cost areas, the Order offers it only to ILECs operating in those areas, not to rural CLECs operating there. *Id.* ¶¶ 862-66.

The FCC's terse purported justification for this disparate treatment of rural CLECs is that it rests on a supposed difference in the two groups' ability to recover costs: "Unlike incumbent LECs," it states, "because competitive carriers have generally been found to lack market power in the provision of telecommunications services, their end-user charges are not subject to comparable rate regulation and therefore those carriers are free to recover reduced access revenue through regular end-user charges." *Id.* ¶ 864. The FCC disparaged CLEC objections that competitive forces constrain their ability to offset lost ICC revenues by raising end user rates on two grounds: (1) that competition constrains incumbent LECs "as well" and (2) that CLECs, unlike incumbents, "have not built out their networks subject to COLR [carrier of last resort] obligations" and "can elect whether to enter a service area and/or serve particular classes of customers (such as residential customers) depending on whether it is profitable to do so without a subsidy." *Id.*

These purported distinctions are not the product of reasoned decision making or agency expertise. On the contrary, the agency's conclusions fly in the face of its own fact findings, depart without explanation from its prior orders and either ignore or minimize the contrary arguments and evidence presented below.

Take first the Commission's conclusion that rural CLECs' "lack of market power" frees them (unlike ILECs) from rate regulation and hence allows them to raise end user rates to offset lost ICC revenues.[5] The *Order* provides its own refutation: "If carriers were unconstrained in their ability to increase particular rates, it is not clear why they would not already have set them at the profit-maximizing level, such that further increases would not be profitable." *Order*, n.1816.[6]

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[5] The FCC's alternative "argument" that if rural CLECs cannot raise their rates, neither can ILECs (*Order*, ¶ 864) is downright silly. ***ILECs*** get USF support to cover some of their lost access revenues.

[6] The Commission was referring at n.1816 of the *Order* to carriers in states that have "deregulated basic local phone service rates," but its point self-evidently applies to any carrier, RLEC or CLEC, that

The FCC's finding that rural CLECs lack market power, moreover, should also have led it to reject its own conclusion. Sellers that lack market power, as the FCC has previously said, are "***unable*** to extract supracompetitive or discriminatory rates from customers." *MCI Telecomm. Corp. v. Am. Tel. & Tel. Co.*, 512 US 218, 237 (1994), Stevens, dissenting (quoting *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor,* 77 F. C. C. 2d 308 (1979)) (emphasis added). Indeed, the premise for relaxed rate regulation for sellers without market power is that they cannot raise rates "without losing business to rival sellers" ***because*** they lack market power. *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 871 (D.C. Cir. 1993). *See also Louisiana Energy and Power Auth. v. FERC*, 141 F.3d 364, 365-66 (D.C. Cir. 1998). The well-established principle that sellers without market power cannot raise prices without losing customers is central to antitrust law, as well. *E.g., SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F. 3d 958, 965-66 (10th Cir. 1994).

> [W]hen an agency is statutorily required to adhere to basic economic and competition principles — or when it has exercised its discretion and chosen basic economic

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has the nominal right to set its own end user rates.

> and competition principles as the guide for agency decision making in a particular area, as [the FCC] did in [the CAF] Order — the agency must adhere to those principles when deciding individual cases.

Mobil Pipe Line v. FERC, 676 F.3d 1098, 1104 (D.C. Cir. 2012). The Commission failed this obligation miserably. Its conclusion that CLECs without market power could raise their end user rates to offset lost ICC revenues is wholly disconnected from the settled economic principles and agency policies it purports to apply. *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962). This conclusion, in fact, is "so implausible that it could not be ascribed to a difference in view or the project of agency expertise." *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983). The FCC's "let them raise their rates" solution is the regulatory equivalent of Marie Antoinette's alleged infamous advice to the starving French peasantry who could not afford bread: "Let them eat cake."

The Commission's alternative explanation, that if competitive forces constrain CLEC pricing to end users, they (unlike ILECs) can simply (1) terminate service to existing high cost customers or (2) decline to enter unprofitable markets (*Order*, ¶¶ 864-65), is equally arbitrary.

First, its assumption that CLECs seeking comparable USF treatment would not be subject to the obligations of ILECs to serve customers regardless of "whether it is profitable to do so without subsidy," is simply false. *Id.* Only CLECs that are or become ETCs are eligible for USF. 47 U.S.C. § 254(e). *See* Joint USF Brief, Section I.B. As ETCs, such CLECs are subject to the requirement of §214(e)(1) to offer the supported services ***throughout*** their designated service areas and advertise the availability and rates of the service. 47 U.S.C. § 214(e)(1); *Order*, ¶ 518.

Second, even assuming CLECs receiving USF support had no obligations to serve all comers, the Commission itself has described the practical difficulties CLECs would face attempting to limit their service.

Over a decade ago, the Commission disabused the notion that rural CLECs could simply pick and choose to retain their most profitable customers, stating that rural CLECs are "lacking the lower-cost urban operations that non-rural ILECs [with whom CLECs compete] can use to subsidize their rural operations." *CLEC Access Order*, ¶ 65. To help CLECs overcome this disadvantage, the

Commission found it appropriate to "permit rural CLECs competing with non-rural ILECs to charge access charges above those charged by the competing ILEC." *Id.* This disadvantage remains as strong today as it was then; there are not enough "lower cost" rural customers whose rates can be increased to subsidize the CLECs' revenue loss from the proposed reduced access charge revenues.

Providing CLECs the same USF support available to their ILEC competitors is necessary to assure that CLECs can continue to provide viable rural service. The *Order*'s failure to provide such support exacerbates the problem identified in the *CLEC Access Order* and that remains an issue today. The Commission's failure to acknowledge, much less to explain, its departure from its *CLEC Access Order* reasoning that dropping higher cost customers is not the answer was arbitrary. *See FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009); *Grace Petroleum Corp. v. FERC*, 815 F.2d 589, 591 (1987).[7]

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[7] As discussed in Section I of the Supplemental USF Brief, the *Order* also departs without reasoned explanation from the FCC's USF neutrality principle, that "universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another." *Universal Service Order*, 12 F.C.C.R. 8776, ¶ 47 (1997).

The same logical flaw in the FCC's argument that CLECs can simply terminate ***existing*** service to unprofitable customers defeats its argument that CLECs can selectively ***enter*** markets. Obviously, the selective entry alternative will not help rural CLECs that have ***already*** entered a market. The rural CLEC model involves overbuilding in rural areas served by ILECs. The viability of rural CLECs depends on displacing or largely supplanting existing ILECs through facility-based competition.[8] *See* Comments of RICA at 6, CC Docket. 01-92 (filed Mar. 27, 2006). Such overbuilding, as the FCC has noted, has been the prevailing rural CLEC model. *See, e.g., Pet. of Mid-Rivers Tel. Coop., Inc. for Order Declaring It to be an Incumbent Local Exch. Carrier in Terry, Montana Pursuant to Section 251(h)(2)*, ¶ 6, WC Docket No. 02-78 (Aug. 31, 2006) ("this pattern has occurred in a number of rural areas where a small incumbent local exchange carrier has entered a neighboring exchange or group of exchanges as a competitive LEC and overbuilt existing facilities."). Having overbuilt the ILEC's existing system, the rural

[8] Facilities-based competition refers to competition between carriers, both of which have physical infrastructure. Many CLECs in urban areas, by contrast, compete with incumbent carriers by purchasing various component services at wholesale and reselling them to end use customers. *See* 47 U.S.C. § 251(c)(3), (4).

CLEC, unlike an urban CLEC, cannot save costs by purchasing fewer wholesale services from the ILEC. Nor can it save costs by disconnecting service to some customers where it has already built the facilities to serve them. In the face of this reality, the Commission's insistence that selective entry is a viable alternative to USF support constitutes a quintessentially arbitrary failure to consider an important aspect of the problem. *Motor Vehicle Mfrs. Assn. of United States, Inc.*, 463 U.S. at 43.

Finally, not only is selective entry no solution for existing rural CLEC operations, relying on the selective market alternative would defeat the stated policy objective under 47 U.S.C. § 706 of the 1996 Act: to encourage the spread of more services for rural consumers. *CLEC Access Order*, ¶ 65. Forcing rural CLECs to compensate for lost access revenues by abandoning or reducing services is self-defeating if the Commission's objective is protecting universal service and expanding broadband to rural areas.

It was the Commission that observed in the 2001 *CLEC Access Order* that, "CLECs often are more likely to deploy in rural areas the new facilities capable of supporting advanced calling features and advanced telecommunications services than are non-rural ILECs, which are more likely first to deploy such facilities in their more concentrated, urban markets." *CLEC Access Order*, ¶ 65. Additionally, "[g]iven the role that CLECs appear likely to play in bringing the benefits of new technologies to rural areas," the FCC added, "we are reluctant to limit unnecessarily their spread by restricting them to the access rates of non-rural ILECs." *Id.* Yet, the *Order* both reduces the access charges rural CLECs can collect, and deprives them of the offsetting USF support extended to their ILEC competitors. In other words, ILECs, who are less likely to extend the advanced services to rural customers receive USF support, while CLECs, who are more likely to do so, receive no USF support. This outcome is arbitrary and capricious.

For the reasons stated, this Court should vacate and remand the *Order* insofar as it denies rural CLECs the same USF support available to their ILEC competitors.

II. Implementation of "Bill-and-Keep" for CMRS-LEC Traffic on a Different Schedule Than Other Telecommunications Traffic Exchanged with LECs is Arbitrary and Capricious

The FCC offers no reasoned justification for transitioning CMRS-LEC traffic to bill-and-keep immediately (or within six months), *Order*, ¶¶ 988-1002, *CMRS Recon*, ¶ 7, while establishing a multi-year transition for other telecommunications traffic exchanged with LECs ("non-CMRS-LEC traffic"). *Order*, ¶ 801. Because "[p]atently inconsistent application of agency standards to similar situations lacks rationality and is arbitrary," the flash cut transition to a zero rate for CMRS-LEC traffic must be vacated. *Contractors Transp. Corp. v. United States*, 537 F.2d 1160, 1162 (4th Cir. 1976) (vacating order denying a certificate of convenience and necessity to one carrier when agency had granted another carrier's certificate under similar circumstances). The FCC's disparate flash-cut treatment of CMRS-LEC traffic contradicts the Notice of Proposed Rulemaking that preceded the *Order*: "we intend to avoid sudden changes or 'flash-cuts' in our policies, acknowledging the benefits of measured transitions that enable stakeholders to adapt to changing circumstances and minimize disruption." *NPRM*, ¶ 12. It also contradicts the *Order's* findings that rate reduction transitions "minimize disruption to consumers and service providers by giving parties time, certainty, and stability as they adjust to an [internet protocol] world and a new compensation regime." *Order*, ¶ 798; *see also id.*, ¶ 35 ("we adopt a gradual, measured transition that will facilitate predictability and stability.”). The *Order* highlights the harms associated with flash cuts: “We believe that these transition periods strike the right balance between our ***commitment*** to avoid flash cuts and enabling carriers sufficient time to adjust to marketplace changes and technological advancements.” *Id.* ¶ 802 (emphasis added). Yet no such transition was provided with respect to this single subclass of traffic.

In 1996, the FCC found that §251(b)(5) obligates LECs to establish reciprocal compensation arrangements for the exchange of intraMTA traffic between LECs and CMRS providers. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 F.C.C.R. 15499, ¶ 1041 (1996) (“*Local Competition Order*”). The *Order,* affirming this similarity, found that the “compensation obligations under § 20.11 are ***coextensive*** with reciprocal compensation requirements” under §251(b)(5). *Order*, ¶ 994 (emphasis added). “Consistent with that determination, . . . [the FCC] conclude[d] that bill-and-keep should also be the default pricing methodology between LECs and CMRS providers under section 20.11 of [its] rules.” *Id.* It “harmonize[d]” the §251(b)(5) reciprocal compensation requirement (applicable to all traffic exchanged with LECs) and Rule 20.11(b)'s "reasonable compensation" requirement (applicable to CMRS-LEC non-access traffic). *Order*, ¶ 990.

As a threshold matter, the CMRS-LEC compensation transition to bill-and-keep is dependent upon the validity of bill-and-keep for wireline traffic. Given the FCC's focus on its "decision to harmonize section 20.11 with section 251(b)(5)," if bill-and-keep for landline traffic is found invalid, it must also be invalid for CMRS-LEC traffic. *Id.* ¶ 993.

Even assuming, *arguendo*, that bill-and-keep was a lawful end point, the disparate treatment of wireline and CMRS traffic and the immediate flash cut "transition" for CMRS-LEC traffic to bill-and-keep is arbitrary and capricious. After finding that the governing legal standards for CMRS and all other traffic are the same, the FCC adopted different deadlines to implement bill-and-keep: a multi-year transition to a zero rate for non-CMRS-LEC traffic, but an immediate flash cut to zero for CMRS-LEC traffic. The FCC's dissimilar treatment of similar traffic is arbitrary and capricious and must be vacated.

The flash cut for CMRS-LEC traffic is also arbitrary and capricious because it reverses, without acknowledgement or justification, prior FCC findings. Agencies must apply their own precedents consistently or reasonably explain any departures from those precedents. *Fox Television Stations*, 556 U.S. at 515. In 1996, the FCC rejected singling out CMRS-LEC traffic and subjecting it to bill-and-keep. *Local Competition Order*, ¶ 1118 ("we do not adopt the interim bill-and-keep arrangement tentatively proposed in the LEC-CMRS Interconnection NPRM.").

Again, in 2001, when the FCC rejected bill-and-keep for ISP-bound traffic, it was unwilling to adopt different §251(b)(5) compensation rates for two sub-classes of §251(b)(5) traffic. *Intercarrier Compensation for ISP-Bound Traffic*, 16 F.C.C.R. 9151, ¶ 90 (2001) ("We therefore are unwilling to take any action that results in the establishment of separate intercarrier compensation rates, terms, and conditions for local voice and ISP-bound traffic.") ("*ISP Remand Order*"). The FCC reasoned that where two calls cause a carrier to incur the same costs, they should be rated identically. *Id.* The *Order* reverses the Commission's findings in 1996 and 2001, and contradicts the conclusion in the *Order* itself that CMRS traffic should be treated like all other traffic. The FCC did so without acknowledging or justifying its reversal. Nor does the FCC explain why it is good policy for one class of §251(b)(5) traffic to flash-cut to the zero rate, while another class of traffic remains subject to a positive rate for multiple years.

Rather than justifying disparate treatment for CMRS-LEC traffic based on facts that distinguish it from non-CMRS-LEC traffic, the FCC retreats to the twin mantras of "stimulation" and "arbitrage." *Order*, ¶ 995. When faced with allegations of ISP-bound traffic "arbitrage" years earlier, the FCC required LECs to offer the ***same*** compensation rate for voice and ISP-bound traffic to avoid arbitrage. *ISP Remand Order,* ¶ 89. Similarly, elsewhere in the *Order*, the FCC denied requests to adopt different transition periods in part because "new arbitrage opportunities could arise" by creating a separate transition for certain carriers. *Order*, ¶ 808. Without explanation, the agency inconsistently finds later in the same decision that arbitrage ***justifies*** a different rate for CMRS-LEC traffic. In short, the FCC has concluded consistently that adopting disparate rates creates arbitrage—except in the case of CMRS-LEC traffic, where for inexplicable reasons it concludes that arbitrage would be ***created*** unless a disparate rate is adopted immediately.

Moreover, there is no factual basis for the FCC's rationale, because the FCC-defined conditions for "stimulation" that allegedly leads to "arbitrage" do not exist for CMRS-LEC traffic. "Access stimulation occurs when a LEC ***with high switched access rates*** enters into an arrangement with a provider of high call volume operations."[9] *Order,* ¶¶ 23, 656 (emphasis added). According to the FCC, prior to the *Order*, rates for termination of CMRS-LEC traffic were already low or zero. *Order*, ¶¶ 996-997. The FCC never explains how "stimulation," which results from the existence of "high . . . rates," can exist where carriers received only a low rate. Because the FCC's primary justification for the flash-cut to zero is internally inconsistent, it should be vacated. *See, e.g., Gen. Chem. Corp. v. United States*, 817 F.2d 844, 846 (D.C. Cir. 1987) (vacating agency action because it was "internally inconsistent and inadequately explained").

The FCC's secondary rationale is that a flash cut to zero for CMRS-LEC traffic presents "a far smaller risk of market disruption"

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[9] Although the *Order* cites comments that claim "traffic stimulation" is a problem, it does not establish a separate definition of "stimulation."

because (a) CLECs had no legal basis to demand any compensation, (b) most large ILECs already adopted very low rates, and (c) RLECs would be protected from any "harmful impacts" of the flash cut by the recovery mechanisms. *Order*, ¶¶ 996-97. This rationale fails for several reasons.

First, the FCC acknowledges its inaction is responsible for CLECs' inability to collect CMRS compensation. *Order*, ¶ 993 ("the record shows that the absence of a federal methodology has been a growing source of confusion and litigation."). Moreover, beginning in 1994, Commission rules required mutual compensation for CMRS-LEC traffic. 47 C.F.R. § 20.11(b)(2). Rule 20.11(b)(2) provides: ***"[a] commercial mobile radio service provider shall pay reasonable compensation to a local exchange carrier*** in connection with terminating traffic that originates on the facilities of the commercial mobile radio service provider." *Id.* (emphasis added). The FCC affirmed that "reasonable compensation" is due for CMRS-CLEC traffic and directed state commissions to set the rate in *N. Cnty. Commc'n. Corp. v. MetroPCS Cal., LLC*, 24 F.C.C.R. 14036 (2009) ("*North County Order*"), *aff'd*, *MetroPCS Cal., LLC v. FCC*, 644 F.3d 410 (D.C. Cir. 2011). The record shows that state commissions ordered CMRS carriers to compensate CLECs for termination of LEC-CMRS traffic. *See, e.g.,* Michael Hazzard, (Counsel to Pac-West Telecomm) Ex Parte, WC Docket No 01-92, at 3 & n.4 (July 10, 2011) ("*Hazzard Letter*") (*citing* Compl. of xChange Telecom, Inc. Against Sprint Nextel Corp. for Refusal to Pay Terminating Comp., *et al.*, N.Y. P.S.C. Case Nos. 07-C-1541, 09-C-0370 (Jan. 19, 2010) (establishing New York rate of $0.001)). The record also shows that CLECs entered into agreements that permitted them to collect compensation from CMRS carriers. *See, e.g.,* Thomas Jones (counsel to Integra Telecom, Inc. and tw telecom inc.) Ex Parte, WC Docket No 01-92 (Dec. 19, 2011) ("*Jones Letter*"); Nancy Lubamersky (counsel to U.S. TelePacific Corp.) Ex Parte, WC Docket No 01-92 (Dec. 22, 2011) ("*Lubamersky Letter*") (concerning compensation arrangements with CMRS providers). Other CLECs, including North County and Pac-West, in reliance upon their Rule 20.11(b)(2) legal right to compensation, have been pursuing collection actions to quantify the "reasonable compensation" owed by CMRS providers to LECs. *See* Reply Comments of Pac-West Telecomm at 4, CC Docket 01-92 (Apr. 18, 2011) (four CMRS carriers "have aggressively opposed Pac-West's efforts to collect on literally years and years of minutes of use in California.") ("*Pac-West Reply Comments*"). The "substantiality of evidence must take into account whatever in the records fairly detracts from its weight," *Universal Camera Corp. 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). There is substantial record evidence that CLECs had established legal rights to reasonable compensation payments from CMRS providers[10] since at least 1994 and the FCC's failure to recognize those rights and flash cut to the zero rate only for CMRS-LEC traffic was therefore arbitrary and capricious.

Nor can the FCC ignore, without explanation, evidence of higher rates for CMRS-LEC compensation and find that most CMRS-LEC traffic was compensated at $0.0007. *Order*, ¶ 997. The

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[10] To buttress its "market disruption" argument, the FCC states that CLECs can make up any losses resulting from the flash cut by charging their end-users more; and that incumbent LECs can make up the difference by seeking funds from the Recovery Mechanism. *Order*, ¶¶ 996-97. Aside from arbitrarily and abruptly departing from the intercarrier payment framework of Rule 20.11(b)(2), these arguments are faulty for the same reasons they are faulty outside of the CMRS-LEC non-access traffic context, as explained in Section I.C.2 of the principal ICC brief.

FCC ignored evidence of agreements applying rates well above $0.0007 to CMRS-LEC traffic. *See Jones Letter*, at 2; *Lubamersky Letter*, at 1-2.[11] The record also reflects a series of LEC-CMRS agreements with terminating rates over $0.005, with some as high as $0.0175. *Hazzard Letter*, Att. A. Even if some larger LECs "adopted" low rates for terminating CMRS-LEC traffic,[12] that rate was all but mandated by the FCC's "mirroring rule" which required incumbent LECs to offer the $0.0007 rate for all voice (including CMRS) traffic in order to gain the benefit of the same rate for ISP-bound traffic. *ISP Remand Order*, ¶¶ 8, 89. The FCC's earlier virtual mandate of the $0.0007 rate cannot support a default rule that mandates zero compensation for a sub-class of §251(b)(5) traffic, particularly in the face of higher rates prevalent among CLECs and other LECs. The appropriate rate and transition for CMRS-LEC traffic would be a rate that matches the cost-based rates established by the state commissions for §251(b)(5) traffic

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[11] The extension of the flash cut by six months for carriers with agreements (*see supra*, Statement of Additional Facts) does not provide equitable treatment with the transition for "coextensive" §251(b)(5) traffic, which is subject to a multi-year transition.

[12] *Order,* ¶ 997 (FCC relying upon evidence presented by T-Mobile, CMRS provider that stands to gain by the flash cut to bill-and-keep).

which the FCC found to be "coextensive" with CMRS-LEC traffic.

As to the RLECs, contrary to the FCC's claims (*Order*, ¶ 997), the recovery mechanisms the FCC adopted do not protect RLECs from flash cuts in terminating compensation revenues, as shown in the Joint USF and ICC Briefs.[13]

In sum, the FCC's flash cut to bill-and-keep for CMRS-LEC traffic is arbitrary and capricious because it is inconsistent with the FCC's commitment in the *Order* to avoid flash cuts, with the FCC's finding that §20.11(b)(2) and §251(b)(5) are coextensive, and with the record evidence concerning the existing rates and rights to compensation of competitive, incumbent, and rural LECs.

III. The FCC's Access Stimulation Benchmark Rules As Applied to CLECs Are Unlawfully Discriminatory and Arbitrary and Capricious

The FCC's access stimulation benchmark rules unlawfully discriminate against CLECs, which, unlike ILECs, are given no opportunity to demonstrate actual costs and demand to support a rate higher than the benchmark. The FCC's sole reason to deny CLECs the right to submit cost data is the false conundrum that

[13] *See* Joint ICC Brief, Part II, Joint USF Brief, Part V.

> [t]here is insufficient evidence in the record that abandoning the benchmarking approach for competitive LEC tariffs and compelling competitive LECs to comply with 61.38 rules is necessary to address concerns regarding access stimulation, particularly considering the burden that would be imposed on competitive LECs to start maintaining regulatory accounting records.

Order, ¶ 694.

Yet, the FCC never explains why it did not simply permit (without requiring) CLECs to have the same option as ILECs to rely upon the §61.38 rules to demonstrate actual costs and demand in the rate-of-return territories in which they provide switched access. In short, the FCC arbitrarily withheld that opportunity from CLECs. If the FCC is only concerned about the welfare of CLECs that might not want to take on such cost analysis, providing recourse to §61.38 as an option but not a requirement cures that concern without discriminating against those CLECs that seek equal treatment vis-à-vis their ILEC competitors. *See* Section XV Comments of Bluegrass at 14, CC Docket. 01-92 (Apr. 1, 2011) ("if the volumes of traffic and associated costs do not actually reflect the RBOC/ILEC costs and traffic volume," then "the CLEC should be entitled to accept the burden of filing its tariff with rates that conform to the requirement of § 61.38, which the Commission recognizes as among the available options to establish just and reasonable rates.") ("*Bluegrass Comments*").

The FCC's rationale for the access stimulation benchmark is also arbitrary and capricious because the benchmark applies ***regardless of whether a CLEC operates in the territory of a rate-of-return LEC***. The access stimulation triggers are (1) revenue sharing; and (2) a 3-to-1 ratio of terminating-to-originating traffic or 100% growth in minutes. These triggers can be met in ***any*** service territory in which a CLEC operates, and if they are met, the CLEC is subject to the access stimulation benchmark in ***every*** service territory in which it operates statewide. *See Bluegrass Comments* at 3 ("For carriers with revenue sharing agreements, but relatively low volumes of traffic, the requirement to mirror the RBOC/ILEC rate may result in rates that are insufficient to meet costs (irrespective of the ability to share revenues).").

The FCC concludes that when the triggers are met, "the access stimulator's traffic vastly exceeds the volume of traffic of the [rate-of-return] incumbent LEC to whom the access stimulator is currently benchmarking." *Id.* Again, the FCC's decision is irrational. CLECs typically operate in a wide variety of incumbent

LEC territories, from the smallest rate-of-return LECs to the largest RBOCs (*e.g.*, AT&T and Verizon). The FCC's one-size-fits-all CLEC access stimulation benchmark invalidates ***all*** of a CLEC's above-benchmark rates statewide, even in parts of the state where its volumes may be consistent with those of the corresponding incumbent LEC, in territories in which the CLEC does not engage in access stimulation and in non-rate-of-return territories. Indeed, the benchmark applies even to CLECs which do not even operate—much less engage in access stimulation—in rate-of-return LEC territories.

The FCC's access stimulation triggers are completely unrelated to the volume of minutes a CLEC terminates in rural rate-of-return service territories. This is arbitrary and capricious because the FCC itself identified high traffic volumes in rate-of-return territories as the very problem it set out to solve. *Order*, ¶ 689 ("the competitive LEC's traffic volumes no longer operationally resemble the carrier's traffic volumes whose rates it had been benchmarking because of the significant increase in interstate switched access traffic associated with access stimulation."). *See, e.g., Gen. Chem. Corp.*, 817 F.2d at 846.

The FCC's selection of the lowest rate of any price cap LEC in a state as the benchmark for CLECs is bereft of any record support and is therefore arbitrary and capricious. There is nothing in the record to support the FCC's finding that "the access stimulating LEC's traffic volumes are more like those of the price cap LEC in the state, and it is therefore appropriate and reasonable for the access stimulating LEC to benchmark to the price cap LEC." *Order*, ¶ 689. The FCC ignored record evidence showing that CLEC traffic volumes—even ***with*** access stimulation—are nowhere near as large as those of a typical price cap LEC, a category which includes the nation's largest local telephone companies (AT&T and Verizon). CLEC traffic volumes are much more likely aligned with those of competing RLECs than with AT&T or Verizon.

Access rates are traditionally calculated by dividing a carrier's costs by anticipated traffic volumes in a service territory. The FCC claims that its benchmarking rule accounts for an access stimulation CLEC's "traffic volumes," but the benchmark it selected is appropriate only for much larger carriers with much larger traffic volumes. *See Bluegrass Comments* at 11 ("There simply does not appear to be any evidence in the record comparing the volumes of traffic terminating to those carriers with existing revenue sharing agreements with the RBOC/ILEC carriers that the Commission suggests would be an appropriate comparison."); *see also* Section XV Comments of Core Commc'ns at 16, CC Docket 01-92 (Apr. 1, 2011) ("Whether or not the proposed trigger is met, it simply makes no sense to cap CLEC rates at RBOC rates in rural territories where RBOCs do not even offer service.").

By contrast, permitting CLECs to comply with §61.38 would provide precisely the cost data required to make the same calculation as their ILEC competitors, putting CLECs on a level playing field with ILECs. Because the FCC did not provide this option, and had no record evidence of either CLEC or ILEC traffic volumes, the FCC's decision is arbitrary and capricious and, for the foregoing reasons, should be vacated as applied to CLECs.

Respectfully submitted,

On behalf of Petitioners listed inside the cover.

BY: /s/ James C. Falvey

November 6, 2012

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I hereby certify that, on November 6, 2012, consistent with the Court's October 17, 2012 filed "Order Governing Procedures for the Electronic Filing of All Briefs in the Consolidated Proceeding," I caused the foregoing document to be sent electronically to **FCC_briefs_only@ca10.uscourts.gov** in Adobe format with the subject line containing the 11-9900 case number and specifying that this is the Uncited Additional Intercarrier Compensation Issues Principal Brief of Petitioners. I also certify, that, consistent with that October order, this document will be furnished through ECF electronic service to all parties in this case through a registered CM/ECF user. This document is available for viewing and downloading on the CM/ECF system.

/s/ James C. Falvey

November 6, 2012