BALLER STOKES & LIDE

A PROFESSIONAL CORPORATION
2014 P STREET, N.W.
SUITE 200
WASHINGTON, D.C. 20036
(202) 833-5300
FAX: (202) 833-1180

MEMORANDUM

TO: **Clients, Colleagues, and Other Interested Parties**

FROM: **Jim Baller, Sean Stokes, Casey Lide, and Ashley Stelfox**

DATE: **March 2017**

RE: **Federal Universal Service Program**

In this memo, we provide our annual review of the federal Universal Service Program ("USP"). It is intended to provide a general, practically-oriented understanding of key concepts underlying of the program, but it is not intended to provide legal advice and should not be treated as such.

The Federal Communications Commission ("FCC") did not make any significant changes to the program in the last year. The FCC did, however, issue a decision in the *WebEx* proceeding that provided important guidance on how certain services should be treated. We discuss this decision and its implications in Section II.A.4(b) below.

As of this writing, the impact of the FCC's 2015 *Open Internet Order*[1] on the USP remains uncertain. In that *Order*, as discussed in Section IV below, the FCC reclassified mass-market, retail Broadband Internet Access Service ("BIAS") as a Title II "telecommunications service" and at the same time forbore from imposing USP contribution obligations on BIAS providers.[2] The FCC issued the *Order* over the objections of Republican commissioners Ajit Pai and Michael O'Rielly, and they are now in the majority at the FCC and intent upon overturning aspects of the *Order*.[3] It is too early to say how the FCC and Congress will ultimately deal with the *Order*, but at least some changes are highly likely.

---

1 *In the Matter of Protecting and Promoting the Open Internet*, 30 FCC Rcd. 5601 (F.C.C.), 2015 WL 1120110 ("*Open Internet Order*"), *aff'd United States Telecom Association v. Federal Communications Commission*, 825 F.3d 674 (D.C. Cir. 2016).

2 The FCC listed Section 254 (Universal Service) as among the "core broadband Internet access service requirements," but chose to forbear from their immediate application until such time as the Commission can further develop the record and determine how best to implement the rules. *See Open Internet Order*, at ¶ 486.

3 *See, e.g.*, Ajit Pai, FCC Commissioner, Address at the Free State Foundation Tenth Anniversary Gala (Dec. 7, 2016) ("On the day that the Title II Order was adopted, I said that 'I don't know whether this plan will be vacated by a court, reversed by Congress, or

TABLE OF CONTENTS

overturned by a future Commission. But I do believe that its days are numbered.' Today, I am more confident than ever that this prediction will come true."); Brendan Bordelon, "Net Neutrality Rollback Under Trump Will Face Hurdles" *Morning Consult* (Dec. 21, 2016) available at: https://morningconsult.com/2016/12/21/net-neutrality-rollback-trump-will-face-hurdles/.

I. OVERVIEW OF FEDERAL UNIVERSAL SERVICE PROGRAM

The federal USP is highly complex and counterintuitive in many ways. As a result, many of its requirements are widely misunderstood. Yet, the importance of compliance with the USP cannot be overstated. Over the last few years, as claims for universal service subsidies have skyrocketed, the FCC has aggressively sought to round up all entities with potential filing and universal service payment obligations. In July 2014, the FCC created a "Universal Service Fund Strike Force" dedicated to aggressive USP enforcement efforts.[4] In 2015, the FCC adopted a treble-damages approach to calculating fines and penalties for non-compliers.[5] That is, the FCC now calculates a non-complier's apparent base forfeiture liability and multiplies that amount by three. Under 47 C.F.R. § 1.80(b), the FCC can assess total forfeiture penalties of up to $160,000 for each violation, or each day of a continuing violation, and up to a statutory maximum of $1,575,000 for a single act or failure to act.[6] The FCC has put all entities on notice that it "will not hesitate" to exercise its "maximum enforcement authority."[7]

A. Key Principles

In general, the USP requires all providers of "interstate" and "international" "telecommunications," "telecommunications services," and/or Voice over Internet Protocol service that enable calls to and from the Public Switched Telephone Network ("Interconnected VoIP"), to pay into the Universal Service Fund (USF) a certain percentage of their "end-user" revenues on sales of these services. Each quarter, the FCC announces the relevant percentage for that quarter, which now generally ranges from 16% to 18% of gross "end user" revenues. Below we highlight a few of the key features of, and important exceptions to, the federal USP, in particular as it applies to providers of "telecommunications" and "telecommunications services."[8]

1. **Interstate** – The USP exempts "intrastate" connections from USP obligations, thus the distinction between "interstate" and "intrastate" communications is of great importance. To determine whether a connection is intrastate or interstate the physical location of the line itself is not alone determinative. If more than 10% of the traffic transmitted over the line or

---

4 FCC, "FCC Chairman Wheeler Announces Universal Service Fund Strike Force," (July 14, 2014), http://www.fcc.gov/document/fcc-chairman-wheeler-announces-universal-service-fund-strike-force.

5 FCC, Policy Statement, "Forfeiture Methodology for Violations of Rules Governing Payment to Certain Federal Programs (Forfeiture Methodology Policy Statement)" February 3, 2015, https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-15A1.pdf.

6 *See* 47 U.S.C. § 503(b)(2)(B); see also 47 C.F.R. § 1.80(b); Amendment of Section 1.80(b) of the Commission's Rules, Adjustment of Forfeiture Maxima to Reflect Inflation, Order, 28 FCC Rcd 10785 (2013).

7 *Forfeiture Methodology Policy Statement* at ¶ 7.

8 Again, while the FCC reclassified mass market, retail broadband Internet access service as a "telecommunications service" under the *Open Internet Order*, the FCC has chosen not to apply these rules to such services for the time being.

circuit is interstate in nature, all revenue derived from it will be deemed "interstate."

2. **End-User Revenues** – Universal service contributions are based on revenues from the sale of covered services to end-users. As discussed below, the definition of "end-user" for purposes of compliance with the USP is complicated.

3. **Non-Covered Services** – Services or facilities that do not qualify as "telecommunications," "telecommunications service," or "interconnected VoIP" – such as dark fiber, cable television service, or information services, pole attachments, towers access, etc. – are not subject to universal service contribution requirements.[9]

4. **Exemptions**

   a. ***De minimis* revenues.** If the projected contribution to the USP based on end-user revenues for the coming year is less than $10,000, a provider of "telecommunications" is exempt from USP reporting and contribution requirements. In contrast, a *de minimis* provider of "telecommunications *service*" or "interconnected VoIP" must complete and file Form 499-A and contribute relatively nominal amounts to three other federal funding mechanisms supporting Telecommunications Relay Service, Local Number Portability, and the North American Numbering Plan Administration.

   b. **Service solely to government entities or public safety organizations.** A provider that serves *only* government entities or public safety entities is not subject to Universal Service reporting or contribution obligations, except to the extent that the entity is a provider of "telecommunications service" or "interconnected VoIP," with an independent obligation to contribute relatively nominal amounts required under the TRS/NANPA/LNP programs (for which 499-A is used as a reporting mechanism). The provision of service to even a single non-governmental entity (e.g., a private non-profit entity) can result in the loss of this exemption. If a provider's customers include both government/public safety and non-government entities, it can potentially still take advantage of this exemption by establishing separate entities to handle exempt and non-exempt sales.

   c. **Service by non-profit schools, libraries, colleges, universities, and broadcasters**. Non-profit schools, non-profit libraries, non-

[9] Provision of Interconnected Voice over Internet Protocol (VoIP) telephony is an exception. Although the FCC has not yet classified Interconnected VoIP for regulatory purposes, it has subjected providers of such services to Universal Service reporting and contribution obligations similar to those that apply to providers of Telecommunications Services.

profit colleges, nonprofit universities, non-profit health care providers and broadcasters are exempt from USP reporting and contribution obligations on the services they provide to themselves or each other. This exemption does not apply to outside providers that serve these entities.

d. **Self-service, system integrators.** A provider whose only customer is itself (for example, a city-owned network serving city government entities, or a privately-owned network serving a corporate campus) is exempt from USP reporting and contribution. System integrators who receive no more than five percent of their revenue from the resale of telecommunications also are exempt.

B. Universal Service Compliance: Forms 499-A and 499-Q

All providers of "interstate" "telecommunications services" and "interconnected VoIP" are required to make an annual filing of an FCC Form 499-A by **April 1**, and all providers owing contributions to the USF are required to make quarterly filings of an FCC Form 499-Q by February 1, May 1, August 1, and November 1.

1. USP payment obligations are imposed on providers of "interstate and international end-user telecommunications revenues, net of prior period actual contributions," 47 C.F.R. § 54.709(a), and are calculated on the basis of a contributor's "projected collected end-user telecommunications revenues, and on a contribution factor determined quarterly by the Commission." *Id*. The FCC determines the contribution factor each quarter "based on the ratio of total projected quarterly expenses of the universal service support mechanisms to the total projected collected end-user interstate and international telecommunications revenues, net of projected contributions." 47 C.F.R. § 54.709(b). The contribution factor has in recent years been in the range of 16-18%. The proposed contribution factor for Q1 of 2017 is 16.7%.[10]

2. The FCC requires providers subject to the USP to register and file Telecommunications Reporting Worksheets, utilizing FCC Form 499-A for annual reports and FCC Form 499-Q for quarterly reports. All forms must be filed electronically. This is a departure from years past where electronic filing was optional.

3. Providers of solely "telecommunications" (as defined in Part III below) must make the relevant calculations and keep them for five years, but they

[10] FCC Public Notice, Proposed First Quarter 2017 Universal Service Contribution Factor (December 9, 2016), https://www.fcc.gov/document/proposed-first-quarter-2017-usf-contribution-factor-167-percent.

need not file a Form 499-A unless their contribution obligations exceed the *de minimis* amount of $10,000.[11]

4. All providers of "telecommunications service" and/or Interconnected VoIP service (as defined in Part III below) must register and begin to file reports within thirty days of the commencement of their services, but they need not make contributions until their payment obligations are expected to exceed $10,000 in the year ahead. Even if providers of "telecommunications service" qualify for the *de minimis* exception, they must still file Form 499-A, which facilitates reporting and contributions in furtherance of three other federal programs: Local Number Portability, Telecommunications Relay Service, and the North American Numbering Plan.

5. If a provider's customers resell the services in question and are themselves subject to the USP, the provider can avoid having to make USP payments on its sales of "telecommunications" or "telecommunications service" to those customers if it can show that the customers/resellers are making appropriate payments into universal service support mechanisms themselves. To the extent that the provider's customers are making such payments, the customers are treated as resellers, and are not treated as "end users" of the provider. The FCC's instructions to Form 499-A specify the kinds of information that providers must obtain and retain for this purpose, and an FCC order involving XO Communications provides additional guidance (as discussed further below).[12]

6. Providers that have not yet made any USP filings or contributions must initially file Form 499-A, writing "NEW" in the space seeking the filer ID number. Upon filing, the FCC will issue a filer ID to be used for all subsequent Form 499 purposes.

7. The quarterly report (Form 499-Q) is due **February 1, May 1, August 1,** and **November 1.** The annual report (Form 499-A) is due **April 1**. To access the most current version of the forms, visit the FCC Form Page.[13]

---

11 To calculate its payment obligations, a provider must multiply its projected eligible end-user revenues by an "estimation factor" (16.7% for the first quarter of 2017) that the FCC publishes from time to time. 2017 Instructions to the Telecommunications Reporting Worksheet, FCC Form 499-A, at 50 ("Instructions to Form 499-A"). For example, using the FCC's estimation factor of 16.7%, a provider would have to exceed $59,880.24 in eligible end-user revenues to meet the *de minimis* payment obligation of $10,000 (= $59,880.24 x 16.7%).

12 *In the Matter of Universal Service Contribution Methodology, Petition for Clarification and Partial Reconsideration by XO Communications Services, LLC, Order on Reconsideration*, FCC 14-104, rel. July 25, 2014 ("*XO Order on Reconsideration*")

13 FCC form page, available at: https://www.fcc.gov/licensing-databases/forms.

II. DETAILED DISCUSION OF UNIVERSAL SERVICE PROGRAM

A. Key Concepts

The USP requires all providers of "interstate" and "international" "telecommunications," "telecommunications service," or Voice over Internet Protocol service that enables calls to and from the Public Switched Telephone Network ("Interconnected VoIP"), to file various reports and contribute to the Universal Service Fund (USF) a certain percentage of their "end-user revenues" on sales of these services. More specifically, all providers of interstate telecommunications services and interconnected VoIP must make an annual filing of an FCC Form 499-A by April 1, and all providers owing "contributions" to the USF are required to make quarterly filings of an FCC Form 499-Q by February 1, May 1, August 1, and November 1. To determine the contributions that an entity owes to the USF, the FCC's administrative agent, the Universal Service Administration Corporation (USAC), multiplies the entity's assessable end-user revenues by a percentage – called the "contribution factor" – that the FCC announces for each calendar quarter. The contribution factor generally ranges from 12% to 18%.

1. "Interstate" vs. "Intrastate"

The Communications Act defines the term "interstate communication" as follows:

> The term "interstate communication" or "interstate transmission" means communication or transmission (A) from any State, Territory, or possession of the United States (other than the Canal Zone), or the District of Columbia, to any other State, Territory, or possession of the United States (other than the Canal Zone), or the District of Columbia, (B) from or to the United States to or from the Canal Zone, insofar as such communication or transmission takes place within the United States, or (C) between points within the United States but through a foreign country; but shall not, with respect to the provisions of title II of this Act (other than section 223 thereof), include wire or radio communication between points in the same State, Territory, or possession of the United States, or the District of Columbia, through any place outside thereof, if such communication is regulated by a State commission. 47 U.S.C. § 153(22).

The term "intrastate" is not defined in the Act, but the FCC has interpreted it as follows in its Instructions to Form 499-A:

> Intrastate telecommunications means communications or transmission between points within the same State, Territory, or possession of the United States, or the District of Columbia.
>
> Interstate and international telecommunications means communications or transmission between a point in one state, territory, possession of the United States or the District of Columbia and a point outside that state, territory, possession of the United States or the District of Columbia.[14]

[14] Instructions to Form 499-A (2017) at 38.

The physical location of a line is only one factor relevant to determining whether the line is interstate or intrastate. Crucially, one must also consider the nature of the traffic over the line, in accordance with the FCC's traditional "end-to-end" approach:

> …Under this analysis, the Commission considers the "continuous path of communications," beginning with the end point at the inception of a communication to the end point at its completion, and has rejected attempts to divide communications at any intermediate points. Using an end-to-end approach, when the end points of a carrier's service are within the boundaries of a single state the service is deemed a purely intrastate service, subject to state jurisdiction for determining appropriate regulations to govern such service. When a service's end points are in different states or between a state and a point outside the United States, the service is deemed a purely interstate service subject to the Commission's exclusive jurisdiction. Services that are capable of communications both between intrastate end points and between interstate end points are deemed to be "mixed-use" or "jurisdictionally mixed" services. Mixed-use services are generally subject to dual federal/state jurisdiction, except where it is impossible or impractical to separate the service's intrastate from interstate components and the state regulation of the intrastate component interferes with valid federal rules or policies. In such circumstances, the Commission may exercise its authority to preempt inconsistent state regulations that thwart federal objectives, treating jurisdictionally mixed services as interstate with respect to the preempted regulations.[15]

For example, if a carrier provides private-line transmission services to connect two or more of a customer's facilities within a state and the traffic between those facilities consists entirely of enterprise data that will not continue to locations outside the state (e.g., employee records, accounting information, CAD-CAM drawings, etc.), then the service is purely intrastate in nature. In contrast, if the traffic consists entirely of long-distance telephone calls, Internet-bound traffic, or other communications that will begin or terminate outside the state, then the traffic is interstate in nature.

For the purposes of the USP, the FCC has adopted a rule commonly referred to as the "10 Percent Rule." According to the FCC's Instructions to Form 499-A, "[i]f over ten percent of the traffic carried over a private or WATS line is interstate, then the revenues and costs generated by the entire line are classified as interstate."[16] The rule is easy to state, but it can be difficult to apply in practice, and it has proven to be highly controversial. In fact, the FCC has numerous appeals before it challenging USAC's hard-nosed interpretations of the rule.

For example, petitioners have claimed that, since at least 2007, USAC has improperly presumed that a line is interstate in nature in the absence of contemporaneous annual customer certifications or traffic studies proving the contrary. The petitioners contend that the presumption should be the

---

15 *In the Matter of Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, 22413; 2004 FCC LEXIS 6429, *26 (rel. November 19, 2004), *review denied, Minn. PUC v. FCC,* 483 F.3d 570, 2007 U.S. App. LEXIS 6448 (8th Cir., 2007*).*

16 Instructions to Form 499-A (2017) at 39, citing *In the Matter of Federal-State Joint Board on Universal Service,* 12 FCC Rcd 8776, 9173, ¶ 778 (citing 47 C.F.R. § 36.154(a)).

opposite, that carriers should not be restricted to submitting contemporaneous customer certifications or traffic studies, and that design considerations or other relevant information should be sufficient. They also claim that the FCC cannot uphold USAC's presumption without conducting a formal notice-and-comment rulemaking, which can have only prospective effect. The FCC may or may not decide these cases anytime soon.

There are also a number of issues arising out of ambiguities in the FCC's instructions on how one enters interstate/intrastate data on the Form 499-A. We will address these issues below.

2. "Telecommunications"

Section 3(43) of the Communications Act, 47 U.S.C. § 153(43), and the FCC's USF regulations, 47 C.F.R. § 54.5, define "telecommunications" in virtually identical terms, as follows:

> The term "telecommunications" means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received. 47 U.S.C. § 153(43);

47 C.F.R. § 54.5.

The FCC has expressly held that pure data transmission service provided to Internet Service Providers (ISPs), including local private lines and business data services,[17] is subject to traditional regulation as "telecommunications" or "telecommunications service," depending on how the service is offered.[18] This service is distinct from BIAS, defined in the *Open Internet Order* as "a mass-market retail service by wire or radio that provides the capability to transmit data to and receive data from all or substantially all Internet endpoints, including any capabilities that are incidental to and enable the operation of the communications service, but excluding dial-up Internet access service"[19] and other services that offer Internet access capabilities. The FCC has determined that the distinction between transmission services and Internet access services rests on

---

17 The previous FCC had proposed adopting rules that would "affirm" that "packet-based BDS is largely a telecommunications service." The proposed rules were opposed by the Republican Commissioners and were stripped from the FCC's December Open Meeting Agenda. *See* "Chairman Wheeler's Proposal to Promote Fairness, Competition, and Investment in the Business Data Services Market" FCC (rel. Oct 7, 2017) https://apps.fcc.gov/edocs_public/attachmatch/DOC-341659A1.pdf.

18 *In the Matters of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, ¶¶ 9, 89-90, 20 FCC Rcd 14853; 2005 FCC LEXIS 5257 (rel. September 23, 2005) ("*Wireline Broadband Internet Access Order*"); see also *In the Matter of General Telephone Operating Cos.*, 13 FCC Rcd. 22466, 1998 WL 758441 (F.C.C.). As discussed in greater detail below, the FCC has at times suggested that sales by *private carriers* to ISPs are exempt from the USP, whereas sales by *common carriers* are not. This matter is currently at issue in several proceedings before the FCC. The differences between private and common carriers are explained in Section III.A.3 below.

19 *Open Internet Order*, ¶ 336.

the fact that transmission services lack the key characteristics of Internet access services because they do not inextricably intertwine transmission with information-processing capabilities.[20]

The term "telecommunications" does not include the provision of dark fiber. Because the definition of "telecommunications" includes the "transmission" of information, the provision of mere facilities, such as dark fiber, which does not include the electronics necessary for the transmission of information, is **not** considered telecommunications, and is not subject to federal Universal Service contribution requirements. The instructions to Form 499 specifically indicate that revenues from the lease of dark fiber should be listed under line 418 of the form as non-telecommunications revenues that are not subject to USP contribution requirements.

Similarly, universal service contributions are not assessed on a variety of other communications related offerings such as cable television service, information services, inside wiring maintenance, customer premises equipment or directory publishing, that do not constitute the provision of telecommunications.

3. "Telecommunications Service"

Section 3(46) of the Communications Act, 47 U.S.C. § 153(46), and the FCC's USF regulations, 47 C.F.R. § 54.5, define "telecommunications service" in virtually identical terms, as follows:

> The term "telecommunications service"' means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.

47 U.S.C. § 153(46); 47 C.F.R. § 54.5.[21]

As the FCC and the courts have often made clear, the difference between "telecommunications" and "telecommunications service" is the manner in which the provider holds itself out to the public. In general, if a provider offers its services indiscriminately on the same terms and conditions to any purchaser willing to pay the going rate and meet standard terms and conditions, the provider is considered a "common carrier," and its services are considered "telecommunications service[s]."[22] This can include indiscriminate service to other carriers – that is, "carriers' carrier"

---

20 *Wireline Broadband Internet Access Order*, ¶ 9.

21 A "telecommunications carrier" is defined in 47 U.S.C. § 153(44) as "any provider of telecommunications services, except that such term does not include aggregators of telecommunications services (as defined in section 226). A telecommunications carrier shall be treated as a common carrier under this Act only to the extent that it is engaged in providing telecommunications services, except that the Commission shall determine whether the provision of fixed and mobile satellite service shall be treated as common carriage."

22 See, e.g. *In the Matter of Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, ¶ 785 (1997), citing the Joint Explanatory Statement of the Conference Committee, S. Rep. No. 104-230, 104th Cong., 2d Sess. 115 (1996) and *National Association of Regulatory Utility Commissioners v. FCC*, 553 F.2d 601, 608 (D.C. Cir. 1976).

services.[23] In contrast, if a provider negotiates individual, one-one-one deals with potentially different terms and conditions for each, the provider is generally considered a "private carrier."

The FCC's *Open Internet Order* applied these same principles to providers of broadband Internet access services (BIAS), and found that BIAS (again, defined as a "mass market" "retail" service) is offered "directly to the public." While the FCC recognized that there may be some individualization of pricing or terms as well as implied promises to arrange for the exchange of Internet traffic, such factors "[do] not change the underlying fact that a broadband provider holds the service out directly to the public."[24] Similarly, the FCC determined that mobile broadband Internet access was not offered on a private basis. The FCC stated "mobile broadband Internet access service is functionally equivalent to commercial mobile service because, like commercial mobile service, it is a widely available, for profit mobile service that offers mobile subscribers the capability to send and receive communications on their mobile device to and from the public."[25] As a result of its findings, the FCC reclassified both broadband Internet access services and its mobile broadband counterpart as telecommunications services.[26]

Notably, the FCC in the *Open Internet Order* did not directly address the treatment of an Internet access service that is not "mass market" and "retail."

A couple of cases further illustrate how the agency applies its common carriage principals. In a case involving the state-operated Iowa Communications Network (ICN), the network operator, over the objections of Qwest, the incumbent telecommunications carrier, sought to be treated as a "telecommunications carrier" in order to qualify for subsidies under the federal E-Rate program.[27] The FCC granted its request, even though the ICN served only a limited number of entities – schools and libraries:

> [T]o determine whether ICN satisfies the first prong of the common carriage test, we must consider whether ICN offers indiscriminate service to whatever public it is legally authorized to serve. Resolution of this issue depends on a close examination of the facts

---

23 *In the Matter of Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776; 1997 FCC LEXIS 5786, ¶ 786 (1996) ("Common carrier services include services offered to other carriers, such as exchange access service, which is offered on a common carrier basis, but is offered primarily to other carriers.").

24 *Open Internet Access Order* at ¶ 364.

25 *Id.* at ¶ 404.

26 While the FCC reclassified mobile and fixed broadband Internet access services as telecommunications services, it elected to forbear from applying USF contribution requirements to these entities for the time being. The FCC's decision to forebear has no effect on its analysis of broadband Internet access providers as telecommunications service providers. As we noted earlier, the FCC has stated that it intends to examine this issue further, and it is possible it could require broadband Internet access providers to contribute to the USF in the future.

27 Since that time, E-Rate subsidies have been made available to a broader set of providers than "telecommunications carriers."

> surrounding ICN and its customer base, for 'whether an entity in a given case is a common carrier or a private carrier depends on the particular practice under surveillance.'… Based on our examination of the record, we conclude that ICN offers service to all of its authorized users.
>
> …
>
> We also conclude that ICN satisfies the requirement of indiscriminate service. In determining whether ICN satisfies this requirement, we must consider whether ICN's "practice is to make individualized decisions, in particular cases, whether and on what terms to deal." … [W]e find persuasive ICN's position that while its enabling statute may discriminate among various classes of users, it does not allow ICN to discriminate among entities within each class of users. Thus, while the statute makes a distinction between "certified" and ""pre-authorized" users, it also dictates that ICN provides the same treatment to all users within each class of users.[28]

In contrast, in the *Virgin Islands Submarine Cable* case, the FCC found that AT&T was *not* acting as a common carrier in offering telecommunications to "a significantly restricted class of users, including common carrier cable consortia, common carriers, and large businesses." According to the FCC (and later the D.C. Circuit), the key consideration was that AT&T "would have to engage in negotiations with each of its customers on the price and other terms which would vary depending on the customers' capacity needs, duration of the contract, and technical specifications."[29]

In short, both private carriers and common carriers provide "telecommunications," but, by definition, only the latter provide "telecommunications services" and can qualify as a "telecommunications carrier."

4. "Information Service"

Section 3(20) of the Communications Act, 47 U.S.C. § 153(46), and the FCC's USF regulations, 47 C.F.R. § 54.5, define "information service" in virtually identical terms, as follows:

> The term "information service" means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.

---

[28] *In the Matter of Federal-State Joint Board on Universal Service*, 16 FCC Rcd 571, 2000 WL 1869492, ¶¶ 9-11 (rel. December 26, 2000) (citations and footnotes omitted); *see also U.S. Telecom Ass'n v. F.C.C.*, 295 F.3d 1326 (D.C. Cir. 2002) (emphasizing that ICN's distinction among what entities to serve is legislatively compelled); *State of Iowa v. FCC*, 218 F.3d 756 (D.C. Cir. 2000); *Virgin Islands Tel. Corp. v. FCC*, 198 F.3d 921, 922, 925 (1999).

[29] *In the Matter of AT&T Submarine Systems, Inc.*, 13 FCC Rcd 21585, 21588-89, 1998 FCC LEXIS 5228, **10-11, *aff'd, Virgin Islands Tel. Corp. v. FCC*, 198 F.3d 921, 925 (D.C. Cir. 1999).

There has been much confusion about the proper classification and regulation of "telecommunications," "telecommunications service," and "information service" as applied to wholesale and retail Internet access service over the years. Although the FCC's *Open Internet Order* recently concluded that broadband Internet access service should be classified as a telecommunications service, this is a significant departure from the FCC's previous decisions to classify broadband Internet access services as information services. Some background is useful to understand the evolution and necessary given the uncertainty surrounding the *Open Internet Order*. In 2002, the FCC found that cable modem service was offered to consumers as a combination of two services: "information services" and "telecommunications" as defined in the Communications Act (see above). Because these services were inextricably intertwined and offered as a single service, the data transmission component loses its identity and the combination becomes an "information service."[30] In a 2005 case commonly known as *Brand X*, the Supreme Court reexamined the FCC's 2002 decision and agreed with the FCC, while stressing that the FCC's decision applied only to services in which "information services" and "telecommunications" are inseparably bound together.[31] This is a critically important issue for many reasons, including that providers of "information service" were – and are – exempt from universal service contribution requirements.

> The question, then, is whether the transmission component of cable modem service is sufficiently integrated with the finished service to make it reasonable to describe the two as a single, integrated offering. We think that they are sufficiently integrated, because "[a] consumer uses the high-speed wire always in connection with the information-processing capabilities provided by Internet access, and because the transmission is a necessary component of Internet access."[32]

The *Brand X* analysis remained the critical determiner of whether an offering was a "telecommunications service" or an "information service" until the FCC's *Open Internet Order*, which reclassified broadband Internet access services.

a. Reclassification of BIAS

As discussed above, the FCC's *Open Internet Order* reclassified fixed and mobile broadband Internet access services as "telecommunications services" rather than an "information service" in which the information service component subsumes the data transmission component. Justifying its change in course, the FCC wrote:

> [T]oday's *Order* concludes that the facts in the market today are very different from the facts that supported the Commission's 2002 decision to treat cable broadband as an information service and its subsequent application to fixed and mobile broadband services. Those prior decisions were based largely on a factual

---

30 *In the Matter of Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, Declaratory Ruling and Notice of Proposed Rulemaking*, 17 FCC Rcd 4798; 17 FCC Rcd 4798, 2002 WL 407567 (rel March 15, 2002).

31 *Nat'l Cable & Telecom. Ass'n v. Brand X Internet Services*, 545 U.S. 967 (2005) ("*Brand X*").

32 *Brand X*, 545 U.S. at 990-91 (internal citations omitted) (emphasis added).

> record compiled over a decade ago, during an earlier time when, for example, many consumers would use homepages supplied by their broadband provider. In fact, the Brand X Court explicitly acknowledged that the Commission had previously classified the transmission service, which broadband providers offer, as a telecommunications service and that the Commission could return to that classification if it provided an adequate justification. Moreover, a number of parties who, in this proceeding, now oppose our reclassification of broadband Internet access service, previously argued that cable broadband should be deemed a telecommunications service. As the record reflects, times and usage patterns have changed and it is clear that broadband providers are offering both consumers and edge providers straightforward transmission capabilities that the Communications Act defines as a "telecommunications service.[33]

Thus, the FCC defines broadband Internet access services as: "[a] mass-market retail service by wire or radio that provides the capability to transmit data to and receive data from all or substantially all Internet endpoints, including any capabilities that are incidental to and enable the operation of the communications service, but excluding dial-up Internet access service."[34] Anything meeting that description will be considered BIAS and subject to Title II as a telecommunications service.

b. *WebEx* Decision

Not all Internet-related services were reclassified by the *Open Internet Order*, and this year, the FCC went a step further and defined the key characteristics of information services in its *WebEx* Decision.[35] As background, in 2012, USAC audited Cisco's revenues including its WebEx revenues. Based on its audit, USAC determined the WebEx offered two distinct services: (1) an online desktop and document sharing application ("Desktop Application") and (2) an "audio bridging product." WebEx's "audio bridging product" could be accessed either through a VoIP service or through a PSTN number provided by WebEx. USAC found that all calls made through the PSTN (including minutes used in conjunction with the Desktop Application) were a separate telecommunications service "and not sufficiently integrated with the Desktop Application because: (1) the two services were accessed separately (i.e., the Desktop Application is accessed through the Internet and the Cisco PSTN Minutes are accessed through the PSTN); (2) customers can substitute other audio options for the Cisco PSTN Minutes; (3) participants may use only the Cisco PSTN Minutes without the Desktop Application; (4) the Cisco PSTN Minutes are billed separately on customer invoices; and (5) revenue from the Cisco PSTN Minutes are recorded separately in Cisco's books of account."

Cisco did not challenge USAC's determination that WebEx's provision of PSTN minutes without the Desktop Application was essentially a teleconferencing service subject to Universal Service obligations. In fact, Cisco developed a mechanism for detecting which participants were only

---

33 *Open Internet Order* at ¶ 43.

34 *Open Internet Order* at ¶ 25.

35 *In the Matter of Universal Service Contribution Methodology, Request for Review of a Decision of the Universal Service Administrative Company by Cisco WebEx LLC*, Order, FCC WC Docket No. 06-122 (rel. Dec. 16, 2016).

using the PSTN without the Desktop Application, and it has contributed to the universal service fund based on those calls.

Cisco did object to USAC's treatment of PSTN as a "telecommunications service" when those calls were used in conjunction with the Desktop Application. Since 1996, the FCC has applied various versions of the same test to determine how to classify a service that includes both a "telecommunications service" and an "information service." Essentially, classification turns on whether the end-user is receiving a single, integrated information service or two separate and distinct services (i.e. a telecommunications service and an information service). Some factors the FCC considers is whether the telecommunications is always used with the information processing capabilities or is inextricably intertwined to the information services. The FCC's 2015 *Open Internet Order* also considered how the service is marketed, how it is offered, and how it works.

In reviewing how the PSTN calls and Desktop Application operate together, the FCC determined (with footnote omitted) that:

> "[W]hen the Cisco PSTN Minutes are used in conjunction with the Desktop Application, the audio stream is integrated into, and is 'part and parcel' of the collaboration session. The Desktop Application, which is an information service, utilizes the data from the audio stream provided by the Cisco PSTN Minutes to, among other things, graphically represent who has joined the WebEx session and who is speaking, enable the interface to highlight the video of the speaker, and allow the host to perform certain control functions, such as muting or ejecting particular participants, or highlighting the video of a participant who is not speaking. The audio stream (whether it is PSTN or computer-based) is directly linked to, and being used in conjunction with, the information processing capabilities being utilized in the collaboration session – i.e. document sharing, video, etc. During the course of the collaboration session, participants can switch seamlessly from the Cisco PSTN Minutes to the Cisco Non-Interconnected VoIP provided as part of the Desktop Application (i.e. to their computer microphones), and vice versa. The Desktop Application takes information from the voice stream (e.g. whether a participant is currently speaking or has muted her phone) and displays it to all of the participants. Finally, the Desktop Application includes controls that utilize the data from the audio stream that enable hosts of the collaboration session to eject participants, control who can speak, and otherwise modify and control the transmission capabilities of a session, including transmission that occurs using the Cisco PSTN Minutes."

Thus, the FCC concluded that when the two services are utilized together, they are functionally integrated such that the whole service becomes an information service that is not subject to Universal Service obligations.

5. Broadband Transport Service to Providers of Internet Access

Following the Supreme Court's decision in *Brand X*, the FCC issued several additional orders that applied the rationale of the *Cable Modem Declaratory Order* and *Brand X* to other forms of wireline broadband service, to broadband service over power lines, and to broadband service over

wireless facilities.[36] Notably, in the *Wireline Broadband Order*, the FCC laid the foundation for a distinction between common carriers and private carriers that could have a significant impact on some USP filers.

Specifically, in paragraph 103 and footnote 357 of the *Wireline Broadband Order*, the FCC stated,

> 103. We address two circumstances under which the statutory classification of the transmission component arises: the provision of transmission as a wholesale input to ISPs (including affiliates) that provide wireline broadband Internet access service to end users, and the use of transmission as part and parcel of a facilities-based provider's offering of wireline broadband Internet access service using its own transmission facilities to end users. First, we address the wholesale input. Nothing in the Communications Act compels a facilities-based provider to offer the transmission component of wireline broadband Internet access service as a telecommunications service to anyone. Furthermore, consistent with the *NARUC* precedent, the transmission component of wireline broadband Internet access service is a telecommunications service only if one of two conditions is met: the entity that provides the transmission voluntarily undertakes to provide it as a telecommunications service; or the Commission mandates, in the exercise of our ancillary jurisdiction under Title I, that it be offered as a telecommunications service. As to the first condition, we explain above that carriers may choose to offer this type of transmission as a common carrier service if they wish. In that circumstance, it is of course a telecommunications service. Otherwise, however, it is not, as we would not expect an "indifferent holding out" but a collection of individualized arrangements. As to the second condition, based on the record, we decline to continue our reflexive application of the *Computer Inquiry* requirement, which compelled the offering of a telecommunications service to ISPs. Thus, we affirm that neither the statute nor relevant precedent mandates that broadband transmission be a telecommunications service when provided to an ISP, but the provider may choose to offer it as such.
>
> …
>
> n.357 Of course, as we stated above, some providers of wireline broadband Internet access service may choose to offer a stand-alone broadband telecommunications service on a common carrier basis. To the extent that they do so, they must continue to contribute to universal service mechanisms on a permanent basis pursuant to section 254(d).

With these statements, the FCC implied, but did not explicitly state, that common carriers that elected to renounce that status and become private carriers would not have to continue to contribute to universal service mechanisms on sales to ISPs. The FCC did not address whether private carriers that had never been common carriers would similarly be exempt.

---

[36] *Wireline Broadband Internet Access Order, supra; In the Matter of United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service, Memorandum Opinion and Order*, 21 FCC Rcd 13281, 2006 WL 3207080 (2006), ¶ 2 (rel. Nov. 7, 2006); *In the Matter of Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, 22 FCC Rcd. 5901, 2007 WL 1288052 (F.C.C.).

The FCC returned to this issue in June 2006, in a footnote of its *Interim Contribution Methodology Order*:

> n.206 … [W]e note that in the *Wireline Broadband Internet Access Order*, the Commission permitted facilities-based providers to cease providing the transmission component underlying that service as a separate common carrier service if they choose. … To the extent that a provider has discontinued providing that service as a common carrier service, it is not required to contribute to the universal service fund based on the revenues derived from providing that transmission service after the expiration of the 270 day contribution freeze period. *See id. at 14915-16, para. 113.*..

In this footnote, the FCC removed any doubts about whether common carriers that elected to become private carriers of transmission services to ISPs would have no further universal service contribution obligations on such sales, but the FCC still did not address whether private carriers that had never been common carriers would be entitled to similar treatment. The FCC finally disposed of this issue in April 2010, in yet another footnote, this time in a proceeding involving *U.S. TelePacific Corporation*:

> [I]f an entity provides broadband transmission service to an Internet Service Provider (ISP) on a non-common carrier (i.e. a private carriage basis), that entity is not required to contribute to universal service on the basis of revenues derived from the provision of that transmission service. *Wireline Broadband Internet Access Services Order,* 20 FCC Rcd at 14909-10, para. 103; *id*. at 14916 n.357; *Interim Contribution Methodology Order*, 21 FCC Rcd at 7549, n.206 (restating this holding).[37]

The 2016 Instructions to Form 499-A formally embraced this distinction:

> Filers *that have voluntarily provided the transmission component of wireline broadband Internet access service on a common carrier basis should continue to report those revenues on Line 406.* Pursuant to the forbearance granted in the 2015 *Open Internet Order*, revenues for the provision of wireline broadband Internet access that are not reported on Line 406 should be reported on Line 418. All other revenues from local private line service and special access service billed to end users must be reported on Line 406.
>
> - Specifically, Line 406 includes all revenue from broadband service voluntarily provided on a common carrier basis.
> - *Filers should report on Line 406 revenues derived from the sale of special access on a common carrier basis to providers of retail broadband Internet access service.*

---

37 *Request for Review of the Decision of Universal Service Administrator and Emergency Petition for Stay by U.S. TelePacific Corp.*, 25 FCC Rcd 4652, DA 10-752, rel. April 30, 2010 ("*TelePacific Order"*), at n.6.

- *Revenues for the provision of wireline broadband Internet access on a non-common-carrier basis should be reported on Line 418.*[38]

In other words, common carriers, but not private carriers, must treat broadband Internet transport service to providers of Internet access as assessable end-user revenues. This language is consistent with the language provided in the 2017 Form 499-A Instructions, although is has been condensed in the newer instructions.

6. End-User vs. Reseller

Universal service contributions are only calculated on "end-user revenues" from sales of telecommunications. Ordinarily, one thinks of an "end-user" as the last purchaser in a chain of distribution – typically a retail customer.[39] Under the USP, however, "end-user" has a special meaning – it also includes purchasers of covered "telecommunications," "telecommunications services," or "interconnected VoIP" that do not themselves make USP contributions, either because they are exempt or because they have failed to comply with their contribution obligations. For example, if a provider sells "telecommunications service" to an ISP that combines the telecommunications service with information services and then sells the combined service at retail as Internet access service, the ISP's retail sales are exempt from USF obligations, and the provider must treat the ISP as an "end-user." If the seller is a common carrier, it must include such "end-user revenues" in calculating its USF contribution obligations.[40] In contrast, if the provider sells "telecommunications service" at wholesale to a telephone company that resells the service at retail as telephone service, the telephone company is itself subject to USP contribution obligations. In that case, the USP treats the retail telephone company's customers as the "end-users" and requires the telephone company to make the appropriate payments into the USP. If the wholesale carrier can document that the telephone company has actually made such payments, by collecting and maintaining the information required by the FCC, then the carrier is relieved of any obligation to include its revenues from the retail telephone company in its calculation of end-user revenues.

Wholesale carriers must demonstrate a "reasonable expectation" that a customer contributes to the USP to take advantage of the Wholesaler-Reseller exemption. This may be shown through compliance with certain "safe harbor" procedures, or by submitting "other reliable proof" (to be

---

[38] Instructions to Form 499-A (2016) at 26 (*emphasis* added). As indicated above, Line 418 refers to service revenues that are not subject to USF contribution obligations.

[39] That is, in fact, how the FCC defines an "end-user" for the purposes of its Form 477:

> A residential, business, institutional, or government entity that uses services for its own purposes and does not resell such services to other entities. For the purposes of this form, an Internet Service Provider (ISP) is not an end user of a broadband connection.

FCC Instructions to Form 477 (Dec. 5, 2016), at 6.

[40] As we discuss in greater detail above, if the provider sells "telecommunications" to the ISP rather than "telecommunications service" – that is, if the provider sells "telecommunications" on a private-carriage basis rather than on a common-carriage basis – the revenues the provider receives from the ISP will not be subject to Universal Service contribution obligations.

considered on a case-by-case basis). The safe harbor includes an obligation that the filer obtain a certification from the customer. Given its great importance, we quote in detail the relevant discussion in the Instructions to Form 499-A:

> *Revenues from Resellers* -- For purposes of completing Block 3, a "reseller" is a telecommunications carrier or telecommunications provider that: (1) incorporates purchased telecommunications services into its own telecommunications offerings; and (2) can reasonably be expected to contribute to federal universal service support mechanisms based on revenues from such offerings. Specifically, a customer is a reseller if it incorporates purchased wholesale service into an offering that is, at least in part, assessable telecommunications and can be reasonably expected to contribute to the federal universal service support mechanisms for that portion of the offering.
>
> …
>
> *"Reasonable Expectation" Standard.* Pursuant to the 2012 Wholesaler-Reseller Clarification *Order*, a filer may demonstrate that it has a "reasonable expectation" that a customer contributes to federal universal service support mechanisms based on revenues from the customer's offerings by following the guidance in these instructions or by submitting other reliable proof.
>
> Filers that comply with the procedures specified in this section of the instructions will be afforded a "safe harbor"- i.e., that filer will be deemed to have demonstrated a reasonable expectation. If a wholesale provider follows procedures that deviate in any way from the guidance in this section, the wholesale provider will have to demonstrate a reasonable expectation via "other reliable proof." USAC shall evaluate the use of "other reliable proof" to demonstrate a "reasonable expectation" on a case-by-case basis, based on the reasonableness of the utilized method or proof.
>
> Filers that do not comply with the safe harbor procedures or that do not otherwise meet the reasonable expectation standard will be responsible for any additional universal service assessments that result if their revenues must be reclassified as end user revenues.
>
> Safe Harbor Procedures for Meeting the "Reasonable Expectation." Each filer should have documented procedures to ensure that it reports as "revenues from resellers" only revenues from entities that meet the definition of reseller. The procedures must include, at a minimum, the following information on resellers:
>
> 1. Filer 499 ID;
> 2. Legal name;
> 3. Legal address;
> 4. Name of a contact person;
> 5. Phone number of the contact person; and,
> 6. As described below, an annual certification by the reseller regarding its reseller status

Filers shall provide this information to the Commission of the Administrator upon request.

Certifications -- Annual Certificates. A filer may demonstrate that it had and has a reasonable expectation that a particular customer is a reseller with respect to purchased service(s) by providing a certificate signed each calendar year by the customer that:

> (1) specifies which services the customer is or is not purchasing for resale pursuant to the certificate; and
>
> (2) is consistent with the following sample language:
>
> *I certify under penalty of perjury that the company is purchasing service(s) for resale, at least in part, and that the company is incorporating the purchased services into its own offerings which are, at least in part, assessable U.S. telecommunications or interconnected Voice over Internet Protocol services. I also certify under penalty of perjury that the company either directly contributes or has a reasonable expectation that another entity in the downstream chain of resellers directly contributes to the federal universal service support mechanisms on the assessable portion of revenues from offerings that incorporate the purchased services.*
>
> …
>
> n.69. At the filer's discretion, the filer may, for example, rely on certificates that specify any of the following: (1) that all services purchased by the customer are or will be purchased for resale pursuant to the certificate ("entity-level certification"); (2) that all services associated with a particular billing account, the account number for which the customer shall specify, are or will be purchased for resale pursuant to the certificate ("account-level certification"); (3) that individual services specified by the customer are or will be purchased for resale pursuant to certification ("service-specific certification"); or (4) that all services except those specified either individually or as associated with a particular billing account, the account number(s) for which the customer shall specify, are or will be purchased for resale pursuant to the certificate. A customer may certify that additional services will be purchased for resale pursuant to the certificate if the customer (or another entity in the downstream chain of resellers) will contribute to the federal universal service support mechanisms on revenues attributed to such services for the relevant calendar year.

Services Purchased After Date of Annual Certificate. A filer may sell additional service(s) to a customer after the date that the annual certificate is signed. If the annual certificate does not cover those additional services, the filer may demonstrate a reasonable expectation that a customer is a reseller with respect to a

service purchased after the date of the annual certificate signed by the customer by relying on either of these received prior to the filing of the applicable Form 499-A:

> (1) a verifiable notification from the customer that the customer is purchasing the service for resale consistent with the valid, previously signed annual certificate, or
> (2) a subsequent certificate covering the purchased service signed by the customer.[41]

In July 2014, the FCC issue an order involving XO Communications that sheds further light on procedural requirements relating to the Wholesaler-Reseller exemption. In December 2010, XO Communications sought review of a USAC finding that XO had failed to demonstrate that it had a "reasonable expectation" that six of its reseller customers would contribute to the USF. As a result, USAC had determined that the associated XO revenues were retail revenues subject to USF contributions by XO. In the November 2012 *Wholesaler-Reseller Clarification Order*, the FCC set forth the basic "reasonable expectations" requirements outlined above, and stated that the standard of evidence for establishing a "reasonable expectation" based on "other reliable proof" was the "clear and convincing evidence" standard.

XO sought reconsideration of the *Wholesale-Reseller Certification Order*'s use of the clear and convincing evidence standard, arguing that the proper standard is "preponderance of the evidence." XO also sought clarification that a Confirmatory Certificate (i.e., an after-the-fact statement by the reseller customer concerning services not addressed in an annual certification), with wording consistent with applicable FCC Form 499-A instructions, sufficiently demonstrates that actual contributions were made to the USP on the relevant services. In its *Order* of July 2014, entitled *XO Communications Order on Reconsideration,*[42] the FCC agreed with XO that "preponderance of the evidence" is the proper standard. The remainder of the *Order,* however, may render that a pyrrhic victory, because the FCC went on to state that Confirmatory Certificates, standing alone, are insufficient to demonstrate the reseller's actual contribution to the USP, regardless of the standard of evidence. Moreover, even if the wholesaler demonstrates that the reseller did in fact contribute to the USP and USAC confirms receipt of such payments, this "does not in itself establish that the customer contributed *on revenues from services that incorporate the wholesale provider's telecommunications input.*"[43]

In other words, if a wholesaler does not obtain pre-sale certifications from resellers for the year in question but relies on after-the-fact confirmatory certificate, it must essentially prove that reseller in fact paid the amount in question *on its resales of the services purchased from the wholesaler*. This tracing requirement is a substantially greater burden than the compliance with the "safe harbor" process set forth in the Instructions to Form 499 (involving an annual certification).

---

41 FCC Instructions to Form 499-A (2017), at 35-38.

42 *In the Matter of Universal Service Contribution Methodology, Petition for Clarification and Partial Reconsideration by XO Communications Services, LLC, Order on Reconsideration,* FCC 14-104, rel. July 25, 2014 ("*XO Order on Reconsideration*") (emphasis added).

43 *Id.,* ¶ 14.

7. Other Exemptions

In addition to the exclusions discussed above, the USP also includes several exemptions that relieve qualifying service providers in whole or in part from USP reporting or contribution requirements.

a. *De minimis* exemption

First, providers of "telecommunications," "telecommunications service," or "interconnected VoIP" need not make payments into the USF in any year in which their contributions would be "*de minimis*" – i.e., less than $10,000. In such a year, a person or entity that only provides "telecommunications" would not have to file a Form 499-A, but persons or entities that provide any "telecommunications service" or "interconnected VoIP" would still have to make a 499-A filing, as well as make very small contributions to the federal funds supporting Telecommunications Relay Service, Local Number Portability, and the North American Numbering Plan Administration.[44] Providers of "telecommunications service" or "interconnected VoIP" must make such filings and payments from the time they first begin to provide service and must continue to do so as long as they are providing even a trace of these services.

To calculate its payment obligations, a provider must multiply its projected eligible end-user revenues by an "estimation factor" that the FCC publishes from time to time, and which historically has ranged from 12% - 15%. For example, if the FCC's estimation factor was 10 percent, a provider would have to exceed $100,000 in eligible end-user revenues to meet the *de minimis* payment obligation of $10,000. Providers of telecommunications services and/or interconnected VoIP who fall below the *de minimis* threshold need to file the annual 499-A and the *de minimis* worksheet included in Appendix A of Form 499-A. Providers of telecommunications who fall within the *de minimis* threshold need not make any filing but must retain their calculation worksheet for five years.

b. Service solely to government and public safety entities

A private carrier that sells telecommunications only to government and public safety entities (licensed under Part 90 of the FCC's rules) is exempt from USP reporting and contribution requirements, except to the extent that the entity is a provider of "telecommunications service" or "interconnected VoIP," with an independent obligation to contribute relatively nominal amounts required under the TRS/NANPA/LNP programs (for which 499-A is used as a reporting mechanism). If, however, the provider serves even a single non-governmental or public safety entity (including non-profit or charitable institutions that perform government-like services), the exemption disappears.[45]

---

[44] The fact that providers of "interstate telecommunications service" must contribute to these programs, while providers of mere "telecommunications" do not, helps to explain why providers of "telecommunications service" must file Form 499-A even if they might fall beneath the *de minimis* threshold, while providers of only "telecommunications" need not do so. *See* Instructions to Form 499-A (2017) at 6.

[45] Instructions to Form 499-A (2017) at 7.

Providers that receive a significant amount of revenue from government or public safety entities, but also wish to serve one or more non-governmental entities, may wish to explore setting up a separate entity to do so.

c. Service by non-profit schools, libraries, and health care providers, and broadcasters

Non-profit schools, non-profit libraries, non-profit colleges, nonprofit universities, non-profit health care providers and broadcasters are exempt from USP reporting and contribution obligations.[46] Note that this exemption applies to the entities listed *themselves*, not to providers of services to these entities.

d. Self-service and system integrators

"Entities that provide telecommunications only to themselves or to commonly-owned affiliates" have no USP reporting or contribution obligation. Systems integrators that derive less than five percent of their revenues from the resale of telecommunications also have no USP reporting or contribution obligation.[47]

8. Form 499-A

Given the complexities in the underlying rules, filers often struggle with how to categorize and present their revenue and services on Form 499-A itself. While filers are likely to have individualized considerations that must be addressed, the questions below frame a relatively simple decision tree that can be applied to every individual or class of customer, service, and revenue in question.

1. Are revenues received from services provided on a reseller basis? If so, these services should be reported in Block 3 but are not assessable.

2. Are revenues from services provided on an end-user basis? If so, go to Block 4:

3. Are revenues from local private line service (i.e., point-to-point transmission service)? If so, input them in Line 406.

    a. Intrastate/interstate determination: (a) Is the point-to-point service between two points within the same state, *and* (b) does it consist of only intrastate traffic (i.e., no substantial VoIP or Internet traffic, to the provider's knowledge)? If so, then no revenue for that service is interstate. (See discussion of 10 percent rule elsewhere in this memo).

4. Revenues from transmission portion of broadband Internet access service are inherently interstate. If you provide such services on *a common-carriage basis*, enter your revenues from them on Line 406, where they will

---

46 *Id.* at 7.

47 *Id.* at 7-8.

be assessable. If you provide such services on a *private-carriage basis*, enter your revenues on Line 418, where they will not be assessable.

5. Revenues other than telecommunications, including information services, revenue from the provision of broadband transmission offered on a non-common-carriage basis, dark fiber, broadband Internet access, inside wiring? (Line 418)

   a. Revenues reported in Line 418 do not count toward the USF contribution base.

   b. Revenues reported in Line 418 need not be broken out into interstate/intrastate.

Whether to proceed through this exercise on a customer-by-customer basis or to use an aggregated approach for classes of customers and services while completing Form 499-A is a question that you must consider according to your own circumstances. In our experience, providers with a relatively small number of customers can simply do so on a customer-by-customer basis and relatively easily assign revenues accordingly, while others may need to aggregate revenue and customers based on certain classifications.

Reporting revenue on an aggregated basis should be done with caution, though, especially as it relates to the interstate/intrastate "10 Percent Rule" and its application in Line 406. In general, the "10 Percent Rule" should be applied on a customer-by-customer, line-by-line basis, not on an aggregated basis. For example, assume that a provider has a total of 10 customers of point-to-point transmission services, with each customer transmitting 10 GB of traffic and generating $1000 of revenue for the provider. Assume further that the point-to-point services provided to Customers 1 through 8 are used purely for "intrastate" purposes; that 50% of the point-to-point service provided to Customer 9's is used for interconnected VoIP traffic; and that 100% of the point-to-point service provided to Customer 10 is used to haul traffic to and from an Internet Point of Presence. In this scenario, the provider should use a customer-by-customer approach and report the $8000 in revenues from Customers 1-8 as non-assessable "intrastate" service. If the provider aggregated all 10 of its customers, 15% of the total traffic would be "interstate" in nature, and all of the revenue from all 10 customers would be deemed assessable "interstate" service.

B. The FCC's Enforcement Authority

Due to systemic changes in the telecommunications industry, the FCC is under tremendous pressure to maximize receipts under the Universal Service Program, and enforcement of USP compliance by USAC and the FCC has become more strident in recent years. Most recently, the FCC has adopted a new, more severe methodology for calculating penalties for non-compliers. The FCC has stated that the purpose for the new methodology was to discourage non-compliers, and to streamline the calculation process to make enforcement actions more efficient. In this section we review a few recent holdings and proceedings concerning the FCC's overall enforcement authority, its authority to assess penalties retroactivity, and the implementation of treble damages as the new methodology for calculating penalties.

1. Source of Enforcement Authority

In a recently reported enforcement decision under the USP, the FCC explained the source of its enforcement authority and described cases in which it would exercise its authority:

> Under Section 503(b)(1) of the [Communications] Act, any person who is determined by the Commission to have willfully or repeatedly failed to comply with any provision of the Act or any rule, regulation, or *Order* issued by the Commission shall be liable to the United States for a forfeiture penalty. Section 312(f)(1) of the Act defines willful as "the conscious and deliberate commission or omission of [any] act, irrespective of any intent to violate" the law. The legislative history to Section 312(f)(1) of the Act clarifies that this definition of willful applies to both Sections 312 and 503(b) of the Act, and the Commission has so interpreted the term in the Section 503(b) context. The Commission may also assess a forfeiture for violations that are merely repeated, and not willful. "Repeated" means that the act was committed or omitted more than once, or lasts more than one day. To impose such a forfeiture penalty, the Commission must issue a notice of apparent liability, and the person against whom the notice has been issued must have an opportunity to show, in writing, why no such forfeiture penalty should be imposed. The Commission will then issue a forfeiture if it finds, based on the evidence, that the person has violated the Act or a Commission rule.[48]

Similarly, in an earlier decision, the FCC found Kajeet, Inc. liable for a forfeiture for "apparently willfully and repeatedly failing to contribute fully and timely to the USF on a total of nineteen occasions between September 2009 and June 2011."[49]

2. Retroactive Application of Penalties

The Kajeet case illustrates the extent of the FCC's authority, but also raises another important issue. In *Kajeet* the FCC's decision to apply penalties from 2009 to 2011 begs the question: how far back can USAC and the FCC require non-compliant entities to go, in filing reports showing deficiencies and in imposing liability on them for the base forfeiture and additional damages? This is another hotly-contested issue before the FCC. The FCC has stated that providers may be subject to liability and contribution obligations retroactively, to the date the provider began offering telecommunications service. In a 2008 proceeding involving a delinquent operator, Compass Communications, the FCC stated:

---

[48] *In the Matter of Telseven, LLC,* ¶ 11, 27 FCC Rcd 6636; 2012 FCC LEXIS 2528 (rel. June 14, 2012) (footnotes omitted).

[49] *In the Matter of Kajeet, Inc. and Kajeet/Airlink, LLC; Apparent Liability for Forfeiture*, 26 FCC Rcd 16684; 2011 FCC LEXIS 4982 (rel. December 5, 2011) (footnotes omitted). In October 2015, the FCC and Kajeet, Inc. reached a settlement agreement with Kajeet, Inc. admitting it willfully and repeatedly failed to contribute to the Universal Service Fund and agreed to pay a $4.5 million civil penalty. *See In the Matter of Kajeet, Inc. and Kajeet/Airlink, LLC, Order,* DA 15-1079 (re. Oct. 7, 2015) https://apps.fcc.gov/edocs_public/attachmatch/DA-15-1079A1.pdf.

> Compass should have filed Worksheets when it first began providing telecommunications service in the United States. Although the Worksheets were due on specific dates, Compass' failure to report revenue had a continued, harmful impact on various programs because the relevant fund administrators could not assess Compass' payment obligations. Based on this conclusion, we therefore reconsider our previous position, as stated in the *Globecom Forfeiture Order*, that the statute of limitations under *section 503(b)(2)(B)* bars a forfeiture for the failure to file a Worksheet more than one year beyond the filing deadline. Rather, Compass' failures to file constitute continuing violations for which the statute of limitations for forfeiture is tolled until the violation is cured. Because of our previous position, however, we exercise our prosecutorial discretion here and decline to propose forfeitures for Compass' failures to file Worksheets more than one year prior to the date of the NAL [Notice of Apparent Liability]. We caution Compass and other carriers that future enforcement actions may consider all failures to file Worksheets as continuing violations subject to forfeiture action. . . .
>
> Although we have stated that each failure to make a full monthly payment to the USF constitutes a separate, continuing violation until the carrier pays its outstanding contributions, we have not sought to propose forfeitures on that basis. Instead, we have proposed forfeitures based solely on violations that began in the previous twelve month period. We have placed carriers on notice, however, that they face potential liability of as much as the statutory maximum for each continuing violation of our USF contribution requirements. Most recently, in the *Globcom Forfeiture Order*, we warned that "if the forfeiture methodology described herein is not adequate to deter violations of our USF and TRS rules, our statutory authority permits the imposition of much larger penalties and we will not hesitate to impose them." Based on the facts of this case, as well as the accumulating record of non-compliance by other carriers, we find that it is now appropriate to impose such penalties.[50]

USAC has on at least one occasion required a service provider to file reports retroactively for the previous 15 years. Industry commenters, including Verizon, XO, and others have vigorously argued that it is unfair to give covered entities only one year to refile reports that would benefit them while at the same time placing no limits on how far back such entities must go if the new reports would hurt them. The respondents in the IVANS proceeding propose that the FCC establish symmetric periods of 4 or 5 years.[51] The proceeding remains open.

---

50 *In the Matter of Compass Global, Inc.*, Notice of Apparent Liability for Forfeiture, 23 FCC Rcd 6125, April 9, 2008.

51 See *In the Matter* of Request for Review by IVANS, Inc. of Decision of the Universal Service Administrator, Petition for Declaratory Ruling on the Assessability of Certain Information Services, Joint Reply Comments of Verizon and Verizon Wireless, Orange Business Services, BT Americas Inc., BCE Nexxia Corporation, and Xo Communications, LLC, WCB Docket No. 06-122 (filed October 22, 2013).

3. Penalties for Non-Compliance

In February 2015, the FCC issued a policy statement updating its methodology for calculating forfeitures and subsequent penalties.[52] The FCC elected to adopt a treble damages approach to determining an entity's forfeiture liability. Under the treble damages method, a non-complying entity's apparent base forfeiture liability will be three times its overall debt to the USP. Treble damages will also apply to any economic gain the non-complying entity received from USP surcharges paid by its customers. In other words, if an entity receives payments from its customers through surcharges and then fails to pay the regulatory programs, the revised forfeiture will be three times the amount of economic gain from the violation, in addition to three times the amount it owes under the USP. The FCC may increase the overall fine where the violation was "egregious, intentional, or repeated, or that cause substantial harm or generate substantial economic gain for the violator."[53] The FCC is authorized to assess non-complying entities a forfeiture of up to $160,000 for each violation, or each day of a continuing violation, up to a statutory maximum of $1,575,000 for a single act or failure to act.[54]

Prior to adopting a treble damages approach to calculating damages, the FCC would calculate penalties based on the number of unpaid monthly contributions to USF. The FCC would add a fine of one-half of the largest amount of unpaid debt during the period at issue, taking into account any interest that would have accrued, prior payments, collection transfers and reversals, installment plan activities, and the nature of the offense to determine the overall amount owed. The FCC's policy statement found that this process was overly-complicated, resource intensive, and had not deterred violators as much as necessary, and for the same reasons, instituted a treble damages calculation.

IV. EFFECTS OF THE *OPEN INTERNET ORDER* ON USP CONTRIBUTIONS

A. Reclassification of Broadband Internet Access Services

As the previous sections have discussed, the FCC has grappled with how to classify broadband Internet access services for years. The FCC defines broadband Internet access services as:

> A mass-market retail service by wire or radio that provides the capability to transmit data to and receive data from all or substantially all Internet endpoints, including any capabilities that are incidental to and enable the operation of the

---

52 FCC, Policy Statement, "Forfeiture Methodology for Violations of Rules Governing Payment to Certain Federal Programs (Forfeiture Methodology Policy Statement)" February 3, 2015, https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-15A1.pdf. As a policy statement, the FCC's decision did not go through the normal notice-and-comment period, and it became enforceable as soon as it was issued. Several groups recently filed a Petition for Reconsideration and a Petition for Stay with the Commission. http://goo.gl/yYmUiZ.

53 47 C.F.R. § 1.80(b)(8), note to paragraph (b)(8).

54 See 47 U.S.C. § 503(b)(2)(B); see also 47 C.F.R. § 1.80(b); Amendment of Section 1.80(b) of the Commission's Rules, Adjustment of Forfeiture Maxima to Reflect Inflation, Order, 28 FCC Rcd 10785 (2013).

> communications service, but excluding dial-up Internet access service. This term also encompasses any service that the Commission finds to be providing a functional equivalent of the service described in the previous sentence, or that is used to evade the protections set forth in this Part.

Prior to the *Open Internet Order*, the FCC classified BIAS as an information service. The FCC rationalized this classification by finding that cable modem service was a "single, integrated service that enables subscribers to utilize Internet access service" with a telecommunications component that was not "separable from the data processing capabilities of the service."[55] This view of cable modem services was upheld by the Supreme Court in *Brand X* and extended to other Internet access services, including wireless Internet access services.

The FCC's decision to reclassify BIAS as a telecommunications service was largely the result of several court decisions that found the FCC was attempting to impose common carrier regulations (i.e. open Internet rules) on BIAS providers, while still classifying BIAS as an unregulated "information service." First, in 2010, the D.C. District Court found that the FCC could not impose open Internet rules based on its Title I ancillary authority.[56] As a result, the FCC drafted the *2010 Open Internet Rules*, which based its authority for the rules on Title I, but also section 706 of the Telecommunication Act of 1996. This *Order* was also challenged before the D.C. District Court in *Verizon v. FCC.*[57] In *Verizon*, the Court found that while the FCC may have authority under section 706, it was effectively imposing common carrier regulations on BIAS providers, violating the providers' status as information service providers. As a result of *Verizon*, the FCC sought public input to determine the best way to impose open Internet rules on Internet access providers.

The FCC issued its *Open Internet Report and Order on Remand* on March 12, 2015, and reclassified BIAS as "telecommunications services." The *Order* explained the FCC's decision to reclassify was due both to its desire to impose enforceable open Internet rules as well as the changes in the Internet access marketplace, which made it more appropriate to classify BIAS as a "telecommunications service." First, the *Verizon* decision had limited the FCC's ability to regulate BIAS to "open Internet protections to those that do not amount to common carriage." Therefore, the FCC was forced to look for a more legally sound mechanism for imposing open Internet rules. Second, the *Order* also pointed to the *Brand X* Court's mandate to "consider the wisdom of its classification decision on a continuing basis." In light of the mandate, the FCC found it could not "maintain [its] prior finding that broadband providers are offering a service in which transmission capabilities are inextricably intertwined with various proprietary applications and services." Instead, the FCC found it was more reasonable "to assert that the indispensable function of broadband Internet access service is the connection link that in turn enables access to the essentially unlimited range of Internet-based services."[58] As a result, the FCC concluded that broadband Internet access service is a telecommunications service subject to its regulatory authority under Title II.

---

55 *Cable Modem Declaratory Ruling*, 17 FCC Rcd at 4823, paras. 38-39.

56 *Comcast v. FCC*, 600 F.3d at 661 (D.C. Cir. 2010).

57 *Verizon*, 740 F.3d at 635-42 (D.C. Cir. 2014).

58 *Open Internet Order*, at ¶ 330 (internal citations omitted).

The 2017 Form 499-A Instructions provide that BIAS revenues should be reported to the FCC. Instructions for Line 418.3 instruct filers to report "all other revenues properly reported on line 418 … including broadband Internet access services subject to forbearance."[59] Instructions for Form 499-Q also require BIAS providers to report BIAS revenue on Line 117 under "other revenue that should not be reported in the universal service contribution base."[60] The updated form specifically notes those revenues include telecommunications services subject to forbearance from a contribution obligation. Although BIAS is clearly subject to reporting requirements, the FCC has continued to forbear from applying contribution obligations, as described in the following section.

B. Forbearance from USP Contribution Requirements

Section 10 of the Communications Act allows the FCC to forbear from applying regulations to "telecommunications" or "telecommunication services" where the regulations may not be necessary for ensuring the providers of such services are acting reasonably and justly or for promoting the public interest.[61] Although the FCC reclassified BIAS as a "telecommunications service," the FCC simultaneously elected to use its authority under Section 10 to grant BIAS providers "substantial forbearance" from regulations that apply to other "telecommunications service" providers. Among the regulations subject to forbearance for BIAS providers are most of the key USP requirements, although the FCC may decide to impose contribution requirements in the future.

The FCC based its decision to forbear from applying USP contribution requirements on the following:

> [W]e do forbear in part from the first sentence of section 254(d) and our associated rules insofar as they would immediately require new universal service contributions associated with broadband Internet access service. The first sentence of section 254(d) authorizes the Commission to impose universal service contributions requirements on telecommunications carriers—and, indeed, goes even further to require "[e]very telecommunications carrier that provides interstate telecommunications services" to contribute. Under that provision and our implementing rules, providers are required to make federal universal service support contributions for interstate telecommunications services, which now would include broadband Internet access service by virtue of the classification decision in this *Order*….
>
> [W]e note that on one hand, newly applying universal service contribution requirements on broadband Internet access service potentially could spread the

---

59 *2017 Telecommunications Reporting Worksheet Instructions* (FCC Form 499-A), p. 34, available at: http://transition.fcc.gov/Daily_Releases/Daily_Business/2017/db0209/DA-17-161A3.pdf.

60 *Telecommunications Reporting Worksheet, FCC Form 499-Q (2017), Instructions for Completing the Quarterly Worksheet for Filing Contributions to Universal Service Support Mechanisms*, at 17.

61 47 U.S.C. § 160(a).

> base of contributions to the universal service fund, providing at least some benefit to customers of other services that contribute, and potentially also to the stability of the universal service fund through the broadening of the contribution base. We note, however, that the Commission has sought comment on a wide range of issues regarding how contributions should be assessed, including whether to continue to assess contributions based on revenues or to adopt alternative methodologies for determining contribution obligations. We therefore conclude that limited forbearance is warranted at the present time in *Order* to allow the Commission to consider the issues presented based on a full record in that docket.[62]

At present, this decision still stands. The previous FCC indicated that it would consider applying contribution requirements to BIAS providers in the future. That FCC stated that it was limiting its decision "only to forbearing from applying the first sentence of section 254(d) and…implementing rules insofar as they would immediately require new universal service contributions for broadband Internet access services sold to end users *but not insofar as they authorize the Commission to require such contributions in a rulemaking in the future*."[63]

The current FCC, however, is unlikely to extend contribution requirements to BIAS providers. The newly-appointed Chairman of the FCC and the President, himself, have indicated they would like to overturn the *Open Internet Order.* Given the support for network neutrality and the *Open Internet Order* among major businesses and vast numbers of engaged, tech-savvy citizens, overturning the Order completely may be more challenging than expected. .At the very least, though, it is highly improbable that the new FCC will impose additional requirements on BIAS providers for the foreseeable future.

---

62 *Open Internet Order,* at ¶¶ 488, 489.

63 *Id.* at ¶ 490.