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MEMORANDUM

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

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

DATE: **February 2018**

RE: **Federal Universal Service Program: 2018 Annual Memorandum**

In this memorandum, we present our annual review of the federal Universal Service Program ("USP"). We provide a practically-oriented guide to key concepts underlying of the program, citations to the relevant underlying authorities, and a checklist of important dates.

During the last year, several notable developments occurred, the most important of which was the Federal Communications Commission's issuance of its *Restoring Internet Freedom Order*,[1] which overturned the Commission's *Open Internet Order* of 2015.[2] At the appropriate points in this memorandum, we discuss how the various new developments affect the USP. We have also added substantially to our coverage of enforcement practices of the Commission and its administrative agent for the purposes of the USP, the Universal Service Administrative Company (USAC).

Disclaimer: This memorandum is for general informational purposes only. It is not intended, and should not be interpreted, as legal advice. For case-specific legal advice, please contact us or other qualified legal counsel.

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1 *In the Matter of Restoring Internet Freedom*, WC Docket No. 17-108, *Declaratory Ruling, Report and Order, and Order*, FCC 17-166, 2018 WL 305638 (F.C.C.) (rel. January 4, 2018). Multiple petitions for review are pending. *See, e.g., State of New York, et al. v. Federal Communications Commission*, Case No. 18-1013 (D.C. Circuit), filed January 16, 2018.

2 *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).

TABLE OF CONTENTS

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 USP filing and payment obligations. In July 2014, the FCC created a "Universal Service Fund Strike Force" dedicated to aggressive USP enforcement efforts.[3] In 2015, the FCC adopted a treble-damages approach to calculating fines and penalties for non-compliers.[4] That is, the FCC now calculates a non-complier's apparent base forfeiture liability and multiplies that amount by three. Adjusted for inflation, the maximum assessable forfeiture under Section 503(b)(2)(B) was $192,459 as of January 25, 2017, for each violation or each day of a continuing violation up to $1,924,589 for any single act or failure to act. The maximum assessable forfeiture under Section 503(b)(2)(D) was $19,246 for each violation or each day of a continuing violation up to $144,344 for any single act or failure to act.[5] The FCC has put all entities on notice that it "will not hesitate" to exercise its "maximum enforcement authority."[6]

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."

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3 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.

4 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.

5 *In the Matter of Amendment of Section 1.80(B) of the Commission's Rules, Adjustment of Civil Monetary Penalties to Reflect Inflation*, 31 FCC Rcd. 13485 (F.C.C.), 82 FR 8170, 2016 WL 7492481 (rel. December 30, 2016).

6 *Forfeiture Methodology Policy Statement* at ¶ 7.

1. "Interstate" or "Intrastate"

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 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 (including Internet access service), pole attachments, towers access, etc. – are not subject to universal service contribution requirements.[7]

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-

[7] 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.

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-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.

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 16-19%, creeping ever closer to 20%. The contribution factor for Q1 of 2018 is 19.5%.[8]

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

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[8] FCC Public Notice, Proposed First Quarter 2018 Universal Service Contribution Factor (December 14, 2017), http://transition.fcc.gov/Daily_Releases/Daily_Business/2017/db1214/DA-17-1203A1.pdf. *See also*, Contribution Factor & Quarterly Filings – Universal Service Fund (USF) Management Support, https://www.fcc.gov/general/contribution-factor-quarterly-filings-universal-service-fund-usf-management-support .

reports. All forms must be filed electronically. This is a departure from years past where electronic filing was optional.

Providers of solely "telecommunications" (as defined in Part III below) must make the relevant calculations and keep them for five years, but they need not file a Form 499-A unless their contribution obligations exceed the *de minimis* amount of $10,000.[9]

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.

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).[10]

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.

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[9] To calculate its payment obligations, a provider must multiply its projected eligible end-user revenues by an "estimation factor" (18.8% for the fourth 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 18.8%, a provider would have to exceed $53,191.49 in eligible end-user revenues to meet the *de minimis* payment obligation of $10,000 (= $53,191.94 x 18.8%).

[10] *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*")

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.[11]

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" Services

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.

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

> 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.[12]

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.[13]

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.

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12 Instructions to Form 499-A (2017) at 38.

13 *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*).*

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."[14] 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, until recently, the FCC had numerous appeals before it challenging USAC's hard-nosed interpretations of the rule.

On March 20, 2017, the FCC issued an Order largely confirming that USAC had appropriately applied the Rule.[15] The FCC rejected the petitioners' arguments that there is or should be a presumption that private lines are intrastate. Instead, the FCC found that applicants must provide evidence, generally through customer certifications, that the nature of the traffic is indeed "intrastate" if they wish to categorize a line as such. Regarding customer certifications, the FCC noted:

> To ensure that customers make informed certifications, carriers should provide basic guidance to their customers regarding what constitutes intrastate or interstate traffic. Carriers should specifically make customers aware that it is the nature of the traffic over the private line that determines its jurisdictional assignment, not merely the physical endpoints of the facility over which service is delivered. ... [but customers] need not perform detailed traffic studies to support the certifications.[16]

The FCC confirmed that applicants may also submit a technical declaration confirming that a private line is technically unsuitable for any interstate use. The FCC recognized, however, that the complexity of modern networks may make a technical declaration less feasible to attain than a customer certification. Regardless of the documentation provided, however, it is critical that documentation accompany a jurisdictional classification because "[i]n cases where documentation

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14 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)).

15 *In the Matter of Federal-State Joint Board on Universal Service; Changes to the Board of Directors of the National Exchange Carrier Association, Inc.; Universal Service Contribution Methodology; Request for Review by McLeod USA Telecommunications Services, Inc. Universal Service Administrator Decision; XO Communications Services, Inc. Request for Review of Decision of the Universal Service Administrator; Request for Review of PaeTec Communications, Inc. of Universal Service Administrator Decision; Request for Review by Puerto Rico Telephone Company, Inc. of Decision of the Universal Service Administrator; Request for Review by US Link, Inc. of Universal Service Administrator Decision; Request for Review by Deltacom, Inc. of Universal Service Administrator Decision*, CC Docket No. 96-45, CC Docket No. 97-21, WC Docket No. 06-122, FCC, Order (March 30, 2017) ("*2017 10 Percent Rule Order*").

16 *Id.* at ¶ 25-26.

submitted is inadequate … USAC may draw an adverse inference from the lack of documentation."[17]

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 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.

With some exceptions discussed below, the FCC has repeatedly held that pure data transmission services, including local private lines and business data services,[18] are subject to regulation as "telecommunications" or "telecommunications service," depending on how the service is offered.[19] The FCC has also determined that Internet access service differs from pure transmission service in that Internet access service includes transmission service intertwined inextricably with information-processing capabilities, and pure transmission service does not include information-processing capabilities.[20]

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17 *Id*. at ¶ 29.

18 The Wheeler-led FCC had proposed rules that would "affirm" that "packet-based Business Data service ("BDS")(previously referred to as "special access service") is largely a telecommunications service." *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. The Pai-led FCC opposed these rules and stripped them from the FCC's agenda for its open meeting in December 2017.

19 *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 determined that sales by *private carriers* to ISPs are exempt from the USP, whereas sales by *common carriers* are not. The differences between private and common carriers are explained in Section III.A.3 below.

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

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"

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[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."

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.[24] 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 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.
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> …
>
> 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.[25]

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,

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

[25] *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).

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."[26]

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.

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. Most recently, the FCC reversed the FCC's 2015 *Open Internet Order* and returned mass-market, broadband Internet access services (BIAS) to their original designation as information services.[27]

a. Classification of "Broadband Internet Access Service"

Some background is useful to understand the evolution of BIAS classification. 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."[28] In a 2005 case commonly known as *Brand X*, the Supreme Court reexamined the FCC's

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26 *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).

27 *See Restoring Internet Freedom Order*, *supra* n.1.

28 *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).

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.[29] 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."[30]

The *Brand X* analysis remained the critical determiner of whether an offering was a "telecommunications service" or an "information service" until the FCC's 2015 *Open Internet Order*, which reclassified broadband Internet access services as a Title II "telecommunications service." Then, in December 2017, the FCC voted to return to the *Brand X* analysis in the *Restoring Internet Freedom Order*:

> We reinstate the information service classification of broadband Internet access service consistent with the Supreme Court's holding in *Brand X*. Based on the record before us, we conclude that the best reading of the relevant definitional provisions of the Act supports classifying broadband Internet access as an information service. . . . We find that it is well within our legal authority to classify broadband Internet access service as an information service, and reclassification also comports with applicable law governing agency decisions to change course. While we find our legal analysis sufficient on its own to support an information service classification of broadband Internet access service, strong public policy considerations further weigh in favor of an information service classification. Below, we find that economic theory, empirical data, and even anecdotal evident also counsel against imposing public-utility style regulation on ISPs. The broader Internet ecosystem thrived under the light-touch regulatory treatment of Title I, with massive investment and innovation by both ISPs and edge providers, leading to previously unimagined technological developments and services. We conclude that a return to Title I classification would facilitate critical broadband investment and innovation by removing regulatory uncertainty and lowering compliance costs.[31]

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

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

31 *Restoring Internet Freedom Order*, ¶ 20.

While the FCC expressed concern with the obligations the *Open Internet Order* imposed on ISPs, the FCC was also sympathetic to industry concerns about how the FCC ***could*** regulate ISPs in the future, including concerns that ISPs might at some point be subject to USP contributions. By reclassifying BIAS as an information service, the FCC took USP contributions off the table for BIAS providers for the time being.

b. The *WebEx* Decision

Not all Internet-related services were reclassified by the 2015 *Open Internet Order*, and in 2016, the FCC went a step further and defined the key characteristics of information services in its *WebEx* Decision.[32] 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 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.

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[32] *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).

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.[33] Notably, in the *Wireline Broadband Order*, the FCC laid the foundation for

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[33] *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.).

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.

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).[34]

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*.[35]

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34 *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.

35 For a discussion of the FCC’s subsequent treatment of “special access,” see footnote 18 above.

- *Revenues for the provision of wireline broadband Internet access on a non-common-carrier basis should be reported on Line 418.*[36]

The 2017 Instructions to Form 499-A succinctly affirm this point: "Revenues for the provision of broadband transmission offered on a non-common-carrier basis to providers of broadband Internet access should be reported on Line 418."[37]

6. "End-User" vs. "Reseller"

Universal service contributions are only calculated on "end-user revenues." Ordinarily, one thinks of an "end-user" as the last purchaser in a chain of distribution, typically a retail customer.[38] 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.[39] 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

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[36] 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.

[37] Instructions to Form 499-A (2017) at 26.

[38] 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.

[39] 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.

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 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.[40]

In July 2014, the FCC issued an order involving XO Communications that sheds further light on procedural requirements relating to the Wholesaler-Reseller exemption. In December 2010, XO Communications had sought review of a USAC finding that found XO had failed to demonstrate that it had a "reasonable expectation" that six of its reseller customers would contribute to the USF and, therefore, determined that the associated revenues were subject to USF contributions by XO. The FCC subsequently set forth the basic "reasonable expectations" requirements outlined above in its November 2012 *Wholesaler-Reseller Clarification Order.* The FCC also 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,*[41] 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

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

41 *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).

establish that the customer contributed *on revenues from services that incorporate the wholesale provider's telecommunications input.*"[42]

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).

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.[43] 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.

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42 *Id.*, ¶ 14.

43 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.

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.[44]

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.[45] 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.[46]

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. 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. Do you sell telecommunications, telecommunications services, or interconnected VoIP solely to government or public safety organizations? If so, your revenues

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44 Instructions to Form 499-A (2017) at 7.

45 *Id.* at 7.

46 *Id.* at 7-8.

from these services are exempt from the USP and you need not make USP filings or payments.

2. Do you sell transmission service to resellers and have reasonable grounds for believing that the resellers are themselves making required USP payments? If so, obtain and retain the information that the FCC specifies in its instructions to Form 499-A (including certifications from your resellers), and report your revenues from these sales in Block 3, where they will not be assessable.

3. Do you sell transmission service to end-users? If so, your revenues should be reported on the appropriate line in Block 4. To determine which one, answer the following questions:

    a. Do you sell local private line service (i.e., point-to-point transmission service)? If so:

        i. If the traffic over the line is intrastate (i.e., if the endpoints are within the same state and no more than 10 percent of the traffic through the line does not begin or terminate beyond the endpoints and across state lines), your revenues are exempt from the USP.

        ii. If the traffic over the line is interstate (i.e., the endpoints are in different states or more than 10 percent of the traffic through the line begins or terminates beyond the endpoints and crosses state lines), your revenues should be entered on Line 406, where they will be assessable. [47]

    b. Do you sell transmission service to Broadband Internet Access Service providers? If so,

        i. If you provide such services on *a common-carriage basis*, enter such revenues on Line 406, where they will be assessable.

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

4. Do you have communications-related revenues from sales of anything other than telecommunications, telecommunications services, or interconnected VoIP (e.g., Broadband Internet Access Services, dark fiber, cable service, rack space, inside wiring, etc.)? If so, enter such revenues on Line 418, where they will not be assessable.[48]

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47 See detailed discussion of "interstate" vs. "intrastate" services, beginning at page 7, above.

48 Revenues reported in Line 418 need not be broken into interstate and intrastate.

B. USAC and the FCC's Enforcement Authority

During the last few years, the FCC has substantially expanded subsidies under various USP-funded programs. At the same time, service providers have increasingly offered Internet-based services that are exempt from USP payment obligations. The FCC and USAC have responded by stepping up their efforts to identify and punish parties that are not fully complying with their USP reporting and payment obligations. Among other things, the FCC has adopted onerous new methods of calculating penalties, and neither the FCC nor USAC has shown much flexibility in accepting excuses for failure to comply with USP obligations. In this section, we review various recent holdings and proceedings concerning FCC and USAC enforcement authority and activities.

1. USAC Enforcement Authority

As indicated, the FCC has delegated to USAC the task of administering the USP, including assessing overdue payments, interest, fines, late fees, etc. for any failure to make timely filings or payments. This does not include forfeitures, which only the FCC itself can impose (as discussed in greater detail below). USAC's responsibilities are prescribed by the regulation copied immediately below (which refers to USAC as the "Administrator"):

> **47 C.F.R. § 54.713 Contributors' failure to report or to contribute.**
>
> **(a)** A contributor that fails to file a Telecommunications Reporting Worksheet and subsequently is billed by the Administrator shall pay the amount for which it is billed. The Administrator may bill a contributor a separate assessment for reasonable costs incurred because of that contributor's filing of an untruthful or inaccurate Telecommunications Reporting Worksheet, failure to file the Telecommunications Reporting Worksheet, or late payment of contributions. Failure to file the Telecommunications Reporting Worksheet or to submit required quarterly contributions may subject the contributor to the enforcement provisions of the Act and any other applicable law. The Administrator shall advise the Commission of any enforcement issues that arise and provide any suggested response. Once a contributor complies with the Telecommunications Reporting Worksheet filing requirements, the Administrator may refund any overpayments made by the contributor, less any fees, interest, or costs.
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> **(b)** If a Universal Service Fund contributor fails to make full payment on or before the date due of the monthly amount established by the contributor's applicable Form 499-A or Form 499-Q, or the monthly invoice provided by the Administrator, the payment is delinquent. All such delinquent amounts shall incur from the date of delinquency, and until all charges and costs are paid in full, interest at the rate equal to the U.S. prime rate (in effect on the date of the delinquency) plus 3.5 percent, as well as administrative charges of collection and/or penalties and charges permitted by the applicable law (e.g., 31 U.S.C. 3717 and implementing regulations).

> **(c)** If a Universal Service Fund contributor is more than 30 days delinquent in filing a Telecommunications Reporting Worksheet Form 499-A or 499-Q, the Administrator shall assess an administrative remedial collection charge equal to the greater of $100 or an amount computed using the rate of the U.S. prime rate (in effect on the date the applicable Worksheet is due) plus 3.5 percent, of the amount due per the Administrator's calculations. In addition, the contributor is responsible for administrative charges of collection and/or penalties and charges permitted by the applicable law (e.g., 31 U.S.C. 3717 and implementing regulations). The Commission may also pursue enforcement action against delinquent contributors and late filers, and assess costs for collection activities in addition to those imposed by the Administrator.
>
> **(d)** In the event a contributor fails both to file the Worksheet and to pay its contribution, interest will accrue on the greater of the amounts due, beginning with the earlier of the date of the failure to file or pay.
>
> **(e)** If a Universal Service Fund contributor pays the Administrator a sum that is less than the amount due for the contributor's Universal Service contribution, the Administrator shall adhere to the "American Rule" whereby payment is applied first to outstanding penalty and administrative cost charges, next to accrued interest, and third to outstanding principal. In applying the payment to outstanding principal, the Administrator shall apply such payment to the contributor's oldest past due amounts first.

Although 47 C.F.R. § 54.713 goes into considerable detail in prescribing how USAC should calculate fines and other costs associated with late filings and/or payments, it also leaves USAC considerable discretion in performing its responsibilities. As seen below, USAC has taken advantage of this flexibility in several controversial ways.

2. Limitation of actions vs. "continuing violations"

USAC does not consider itself bound by any statute of limitations or other time constraint in calculating amounts owed for non-compliance with filing or contribution requirements. USAC's approach – which the FCC has expressly endorsed – is based on the rationale that such acts or omissions are "continuing violations" that are not time-barred.

For example, in *Advanced Tel., Inc.* (ATI), the FCC treated each of the following as separate violations: (1) ATI's failure to make timely filings, (2) ATI's failure to make timely contributions, and (3) ATI's failure to pay appropriate regulatory fees. In describing ATI's failure to file, the FCC stated (with our emphasis added):

> ATI neglected to timely file the Quarterly Worksheet due November 1, 2013. This failure to timely file constituted a ***continuing violation until ATI cured it by filing the required Worksheet.*** USAC did not receive the Company's November 2013 Quarterly Worksheet until January 27, 2014, nearly three months past its due date. Based on the preponderance of the evidence, we find that apparently ATI willfully

> violated Section 54.711 of the Rules by failing to timely file its November 1, 2013 Quarterly Worksheet.

Elsewhere in its decision, the FCC also found that ATI "failed to contribute to the USF on at least a total of 36 occasions between October 22, 2011 and September 22, 2014," and that each of these failures was a continuing violation.[49]

USAC considers filing or contribution violations to have been cured only when the service provider has completed making all required filings and payments. When allocating a service provider's payments among the various obligations that the provider owes, 47 C.F.R. § 54.713(e) requires USAC to "adhere to the 'American Rule' whereby payment is applied first to outstanding penalty and administrative cost charges, next to accrued interest, and third to outstanding principal. In applying the payment to outstanding principal, the Administrator [USAC] shall apply such payment to the contributor's oldest past due amounts first."

In various proceedings, service providers have repeatedly argued that there must be some limit to USAC's ability to demand retroactive filings and payments of alleged obligations going back many years. USAC has uniformly rejected such arguments, and the FCC has consistently upheld USAC's position.

3. USAC's "Pay and Dispute Policy"

Under USAC's "Pay and Dispute Policy," service providers are required to pay the amounts that USAC asserts to be due, even if the providers disagree with USAC's assessment and have filed an appeal with USAC or the FCC to dispute those charges. If the provider does not pay the amount assessed by USAC, that amount will continue to garner late fees and interest until it is paid in full – or until USAC's charges are found to have been erroneous. The FCC has consistently upheld USAC's Pay and Dispute policy, finding that it "increases the stability and predictability of the Fund by preventing contributors from engaging in nonpayment or underpayment of invoices with which they disagree."[50]

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49 *In the Matter of Universal Service Contribution Methodology Federal-State Joint Board on Universal Service, Request for Review of Decision of the Universal Service Administrator by Morris Communications, Inc.*, 32 FCC Rcd. 4094 (F.C.C.), 2017 WL 2537147 (rel. May 23, 2017) ("*Morris Communications*"). *See also Telrite Corp., Notice of Apparent Liability for Forfeiture and Order*, 23 FCC Rcd 7231, 7243, ¶ 27 (2008); *Compass Global Inc., Notice of Apparent Liability for Forfeiture*, 23 FCC Rcd 6125, at 6138-40, ¶¶ 31–34 (2008); *Global Crossing North America, Inc., Notice of Apparent Liability for Forfeiture*, 23 FCC Rcd 6110, 6117–19, ¶¶ 16, 21 (2008); *Globcom Forfeiture Order*, 21 FCC Rcd at 4725, n.105.

50 *In the Matter of Universal Service Contribution Methodology, Federal-State Joint Board on Universal Service, Request for Review of Decision of the Universal Service Administrator by Morris Communications, Inc.*, DA 17-499, WC Docket No. 06-122, ¶ 16 (rel. May 23, 2017).

4. Forfeitures

The FCC has the sole authority to assess forfeitures for non-compliance and often invokes such penalties in cases of significant non-compliance. Section 503(b)(1) of the Communications Act authorizes the FCC – but not USAC – to impose forfeitures in addition to the exactions discussed thus far.

> (1) Any person who is determined by the Commission … to have (A) willfully or repeatedly failed to comply substantially with the terms and conditions of any license, permit, certificate, or other instrument or authorization issued by the Commission; [or] (B) willfully or repeatedly failed to comply with any of the provisions of this chapter or of any rule, regulation, or order issued by the Commission under this chapter or under any treaty, convention, or other agreement to which the United States is a party and which is binding upon the United States; …
>
> …shall be liable to the United States for a forfeiture penalty. A forfeiture penalty under this subsection shall be in addition to any other penalty provided for by this chapter; except that this subsection shall not apply to any conduct which is subject to forfeiture under subchapter II, part II or III of subchapter III, or section 507 of this title.

A forfeiture is a distinct penalty designed to deter willful or repeated non-compliance with the FCC rules.[51] Interpreted broadly, particularly as applied to "each day of a continuing violation," Section 503(b)(2) would allow forfeitures in staggering amounts:

> (B) If the violator is a common carrier subject to the provisions of this chapter or an applicant for any common carrier license, permit, certificate, or other instrument of authorization issued by the Commission, the amount of any forfeiture penalty determined under this subsection shall not exceed $100,000 for each violation or each day of a continuing violation, except that the amount assessed for any continuing violation shall not exceed a total of $1,000,000 for any single act or failure to act described in paragraph (1) of this subsection.
> . . .
> (D) In any case not covered in subparagraph (A), (B), or (C), the amount of any forfeiture penalty determined under this subsection shall not exceed $10,000 for each violation or each day of a continuing violation, except that the amount

[51] 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 FCC applies the same definition to Section 503(b)(1). See *Unipoint Technologies Inc. Forfeiture Order*, File No. EB-IHD-13-00011665, § 5 and n.25 (rel. February 9, 2014) ("*Unipoint Forfeiture Order*"), https://goo.gl/doPAAb, citing *Application for Review of S. Cal. Broad. Co., Memorandum Opinion and Order*, 6 FCC Rcd 4387, 4388, ¶ 5 (1991).

> assessed for any continuing violation shall not exceed a total of $75,000 for any single act or failure to act described in paragraph (1) of this subsection.[52]

Adjusted for inflation, the maximum assessable forfeiture under Section 503(b)(2)(B) as of January 25, 2017, was $192,459 for each violation or each day of a continuing violation up to $1,924,589 for any single act or failure to act. The maximum assessable forfeiture under Section 503(b)(2)(D) was $19,246 for each violation or each day of a continuing violation up to $144,344 for any single act or failure to act.[53]

It is worth emphasizing that forfeitures may be assessed for every violation individually. For example, 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."[54]

5. Retroactive Application of FCC Penalties

FCC forfeitures, unlike the penalties USAC assesses for non-compliance, are explicitly subject to a statute of limitations. Section 503(b)(6), the Act lays out the statute of limitations for forfeitures:

> No forfeiture penalty shall be determined or imposed against any person under this subsection if—
> (A) such person holds a broadcast station license issued under subchapter III of this chapter and if the violation charged occurred—
> (i) more than 1 year prior to the date of issuance of the required notice or notice of apparent liability; or
> (ii) prior to the date of commencement of the current term of such license, whichever is earlier; or
> (B) such person does not hold a broadcast station license issued under subchapter III of this chapter and if the violation charged occurred more than 1 year prior to the date of issuance of the required notice or notice of apparent liability.

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52 Communications Act, Sections 503(b)(2)(B) and (D). Subsections (A) and (C) are inapplicable here.

53 *In the Matter of Amendment of Section 1.80(B) of the Commission's Rules, Adjustment of Civil Monetary Penalties to Reflect Inflation*, 31 FCC Rcd. 13485 (F.C.C.), 82 FR 8170, 2016 WL 7492481 (rel. December 30, 2016).

54 *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.

For many years, the FCC interpreted Section 503(b)(6) as only allowing the FCC to impose forfeitures for violations that occurred within the twelve months prior to the issuance of a Notice of Apparent Liability. More recently, the FCC has interpreted Section 503(b)(6) as permitting the FCC to assess forfeitures for violations that occurred outside the preceding twelve-month period, where the violations are continuing and have not been rectified:

> 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 Globcom Forfeiture Order, that the statute of limitations under section 503(b)(2)(B) [sic] 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. 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.[55]

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[55] *In the Matter of Compass Global, Inc., Notice of Apparent Liability for Forfeiture*, 23 FCC Rcd 6125 (April 9, 2008).

In the *Kajeet NAL*, the FCC imposed forfeitures for several violations that occurred more than one year prior to the issuance of the NAL. In doing so, however, the FCC explicitly noted the forfeitures were for violations that had not been cured more than a year prior to the issuance of the NAL.[56]

6. Calculating FCC Forfeitures

On February 3, 2015, the FCC adopted a treble damages approach to determining forfeiture liability for Universal Service violations.[57] Previously, to determine a delinquent contributor's forfeiture liability, the FCC had employed various methodologies that required time-consuming and resource-intensive accounting processes for gathering and analyzing large amounts of data that were difficult to track, and usually involve multiple entities over multiple years. Recognizing that this system was burdensome and had resulted a large number of complaints, the FCC claimed that its new approach would result in a "more straight-forward method of calculating base forfeitures for contribution and regulatory fee violations."[58]

Under the treble damages approach, a violator's apparent base forfeiture liability would be three times the delinquent contributor's outstanding debt for contribution or regulatory fee obligations. For example, in *Momentum Telecom*, the FCC did not ultimately impose treble damages, but it explained how it would have made the calculations had it elected to do so:

> Based on our thorough investigation, we have determined that, as of July 1, 2015, Momentum had been delinquent in its USF contributions for nearly two years. As of that date, the Company's delinquent debts to the USF totaled $107,555.25. These debts were invoiced to Momentum and were not paid by the deadlines specified in the invoices that Momentum received every month. Were we to assess a forfeiture penalty for Momentum's delinquency as of July 1, 2015, we would be guided by the 2015 Forfeiture Policy Statement, which provides for the use of a treble damages methodology, when appropriate, to calculate a company's base

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56 *Kajeet NAL*, 26 FCC Rcd. 16684, 16694, ¶¶ 21-22, FN 88 (2001).

57 FCC, Policy Statement, "Forfeiture Methodology for Violations of Rules Governing Payment to Certain Federal Programs (Forfeiture Methodology Policy Statement)" February 3, 2015, https://goo.gl/dfPglw. Shortly afterward, several groups submitted a Petition for Reconsideration and a Petition for Stay, arguing that the FCC's policy should be stayed because it was not issued under the normal notice and comment procedures. Petition for Reconsideration, https://goo.gl/v9UyXu, and Petition for Stay, https://goo.gl/zXQWMR. The FCC ignored the petitions.

58 *Id*. at ¶ 6.

> forfeiture liability to the USF. In this matter, trebling Momentum's delinquent debts would have resulted in a base forfeiture of $322,665.75.[59]

While the treble damages policy now seems to be the FCC's approach for calculating forfeitures, the FCC has not been entirely consistent in applying this methodology. Even its statement above, the FCC indicates that it can use treble damages "when appropriate." This harkens back to the FCC's previous posture of using "adjustment factors" to adjust a forfeiture upward or downward depending on the circumstances. Over time, as more enforcement decisions become public, we will be able to better determine the level of discretion the FCC employs when setting forfeiture amounts.

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[59] *In the matter of Momentum Telecom, Inc*., DA 16-818, *Admonishment Order*, ¶ 7 (rel. July 22, 2016).