

Morgan, Lewis & Bockius LLP
2020 K Street, NW
Washington, District of Columbia 20006-1806
Tel. 202.373.6000
Fax: 202.373.6001
www.morganlewis.com

Morgan Lewis
C O U N S E L O R S A T L A W

Andrew D. Lipman
+1.202.373.6033
andrew.lipman@morganlewis.com

July 6, 2015

ELECTRONICALLY FILED

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: **WC Docket No. 12-375: Rates for Interstate Inmate Calling Services**

Dear Ms. Dortch:

Pursuant to 47 C.F.R. § 1.1206(b)(1), the undersigned submits this written *ex parte* presentation, on behalf of clients with an interest in the provision of Inmate Calling Services (ICS), for filing in the above-referenced docket.

In previous filings in this docket, dated February 20, 2015; April 8, 2015;¹ May 1, 2015;² and June 1, 2015;³ the undersigned has advocated that the Commission should permit ICS providers to increase their rates above a strictly “cost-based” level to allow for payment of a reasonable level of site commissions to correctional facilities, despite the fact that the Commission previously held that such commission payments are not recoverable as a cost of service. The purpose of this letter is two-fold: first, to provide additional detail on the legal rationale by which the Commission could adopt such a rule; and second, to respond to comments on this issue submitted by other parties, most notably the *ex parte* filed by the National Sheriffs’ Association on June

¹ Letter from Andrew Lipman to Marlene H. Dortch, WC Docket No. 12-375, filed April 8, 2015 (“Lipman April 8 *ex parte*”).

² Letter from Andrew Lipman to Marlene H. Dortch, WC Docket No. 12-375, filed May 1, 2015 (“Lipman May 1 *ex parte*”).

³ Letter from Andrew Lipman to Marlene H. Dortch, WC Docket No. 12-375, filed June 1, 2015 (“Lipman June 1 *ex parte*”).

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12, 2015.⁴ As will be discussed further below, the NSA is now in agreement with the undersigned that the appropriate way to deal with site commissions is for the FCC to permit ICS providers to recover in their rates a limited, reasonable amount to cover payment of commissions, based upon the size of the correctional facility.

1. Legal Basis for Enabling Recovery of Limited Site Commissions

It is well-established that the Commission has broad discretion in establishing just and reasonable rates, as long as it articulates a rational basis for its decisions and as long as the result is not confiscatory. As the Supreme Court has explained in construing the similar “just and reasonable rates” provision of the Natural Gas Act,

... the Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within a "zone of reasonableness." *FPC v. Natural Gas Pipeline Co.*, 315 U. S. 575, 585. No other rule would be consonant with the broad responsibilities given to the Commission by Congress; it must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests.

Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); *see also Verizon Communications Inc. v. FCC*, 535 US 467, 501-02 (2002) (citing *Permian Basin* as guidance for interpretation of Telecommunications Act of 1996); *National Ass'n of Reg. Util. Com'rs v. FCC*, 737 F.2d 1095, 1141 (D.C. Cir. 1984) (“*NARUC*”) (citing *Permian Basin* in upholding Commission’s adoption of \$25 special access surcharge).

Thus, for example, the Commission is not required to impose the same maximum rate of return on all types of carriers, or even on all carriers of the same class. This is amply demonstrated by the adoption of price cap rules for local exchange carriers, under which a carrier that succeeds in operating its business more efficiently may achieve a higher rate of return than others that fail to realize similar efficiency. *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, para. 22 (1990) (subsequent history omitted). The Commission found that the public interest benefits of creating economic incentives for carriers to reduce their costs justified the departure from its historic practice of strict rate-of-return regulation. *Id.*, at 6787 para. 2; *see National Rural Telecom Ass’n v. FCC*, 988 F.2d 174, 183-85 (D.C. Cir. 1993) (rejecting as

⁴ Letter from Mary Sisak, attorney for National Sheriffs’ Association, to Marlene H. Dortch, WC Docket No. 12-375, filed June 12, 2015 (“NSA Letter”).

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“complete *non sequitur*” MCI’s argument that price cap earnings sharing rule was arbitrary because it “does not retain as much of rate-of-return regulation” as would have another proposal).

Also, importantly, the FCC may base ratemaking decisions on surrogates and even “reasoned guesswork,” if informed by its “historical experience and expertise,” in the absence of specific, reliable data. *NARUC*, 737 F.2d at 1140-41. In that case, the FCC had adopted a \$25 access surcharge on private lines that could “leak” interstate traffic to the public network, so that users of these lines would contribute something to the cost of the interstate network. The FCC was unable to obtain reliable data concerning the volume of leaked traffic, but decided to impose an interim rate of \$25 as a surrogate until more accurate data could be compiled. The Court of Appeals, on review, found this approach reasonable, and rejected arguments that the FCC had the burden of providing a more specific cost justification for its rate prescription. “It is not the Commission’s chore to convince us that what it has done is the best that could be done, but that what it has done is reasonable under difficult circumstances. Here the unique nature of an unmeasurable but real problem of hidden access assists the FCC in justifying what it has ordered.” *Id.* at 1141.

In this case, the Commission faces a problem similar in some respects to that confronted in the *NARUC* decision. The record shows clearly that correctional facilities incur some costs to make ICS available to their inmates, but (as discussed further in the following section) the evidence is far less clear as to the amount of those costs. Furthermore, the entities incurring the costs (typically sheriffs and prison systems) are not themselves offering regulated communications services, are not subject to the direct jurisdiction of the FCC, and have no uniform system of accounting for ICS-related costs. It will therefore be difficult and resource-intensive for the FCC to obtain reliable cost information, if it is possible at all; and such information would then require constant updating and revision to keep it current. This is precisely the type of situation in which the use of reasonable surrogates is not only permissible, but desirable, to avoid placing substantial new compliance burdens on sheriffs and other correctional agencies that wish to continue receiving site commission payments.

Besides the private line surcharge discussed above, the FCC has used surrogates and formulae in lieu of actual cost data in a number of contexts. In administering the Universal Service program, for example, the Commission established a reimbursement formula for schools and libraries that relied on surrogate data to estimate each recipient’s level of need, rather than performing site-specific analyses that would have been administratively infeasible. *See Letter to Mel Blackwell, Vice President Schools and Libraries Division, USAC, from Trent B. Harkrader, Chief, Telecommunications Access Policy Division, Wireline Competition Bureau, 27 FCC Rcd 8860 (Wireline Comp. Bur. 2012)*. Also, the Commission decided to base high-cost reimbursement for larger ILECs on forward-looking cost models that estimate costs for specific locations based on mathematical formulae, recognizing that conducting a separate cost study for each particular

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location would be entirely impracticable. *See Connect America Fund; High-Cost Universal Service Support*, Report and Order, 28 FCC Rcd 5301 par. 1 (Wireline Comp. Bur. 2013); *Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17734 par. 184 (2011) (“*USF/ICC Transformation Order*”) *aff’d* 753 F.3d 1015 (10th Cir. 2014), *cert denied*. *United States Cellular Corp. v. FCC*, Case 14-610 et al. (May 4, 2015); *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8888-89, paras. 199, 203 (1997). For smaller ILECs, the FCC has adopted a formula to limit the corporate operations expenses recoverable from the high cost fund, as a more feasible alternative to conducting company-specific investigations of the reasonableness of such expenses. *See USF/ICC Transformation Order*, 26 FCC Rcd at 17747-48 par. 229-232.

Moreover, the fact that the FCC treats site commission payments as an allocation of profit, rather than as a cost of service, has no bearing on its ability to adopt a sliding-scale formula to limit such payments. The Commission has ample statutory discretion to determine the level of “profit” that can be included in a just and reasonable rate. As already noted, it has effectively allowed for a wide range of potential earnings in adopting incentive regulation for large ILECs. It can similarly allow for a range of earnings, albeit with more constraints, by permitting a range of site commission payments based on the size of the facility.⁵

Similarly, for purposes of determining whether maximum rates are confiscatory, in violation of the Fifth Amendment, it does not matter whether the FCC considers site commissions as “costs” or as “profits.” The Supreme Court has made it clear that the review of whether a regulation is confiscatory considers whether the “rate order ‘viewed in its entirety’ ... produce[s] a just and reasonable ‘total effect’ on the regulated business.” *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (internal citations omitted). “It is not the theory but the impact of the rate order which counts.” *Id.* Therefore, a maximum rate that prevents an ICS provider from charging enough to cover its economic costs plus site commission payments, and still pay some reasonable return to its investors, would be unconstitutional.⁶

Accordingly, it would be both reasonable and proper for the Commission to adopt a formula approach to determining the maximum reasonable site commission payment for ICS providers, instead of going down the burdensome and potentially endless path of trying to analyze costs on a site-by-site basis. This provides an administratively feasible and flexible method of capping site commissions, and if experience proves that the cap results in a reduction in the availability of

⁵ State regulatory agencies operating under similar statutory authority have, for example, sometimes allowed some regulated companies to earn higher rates of return than others as a reward for good management or for undertaking particular investments that served the public interest. *See, e.g., Pennsylvania Public Util. Comm’n v. PPL Electric Utils. Corp.*, R-2012-2290597, Order at 93-98 (Pa. Pub. Util. Comm’n 2012).

⁶ *See also Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307 (1989).

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telephones to inmates (or, conversely, results in unreasonably high rates for ICS calls), the Commission would be able to adjust the formula.

Considering the record evidence, including the studies submitted by GTL and other parties, the undersigned suggests that the Commission should find that agreeing to pay site commissions in excess of the following levels is an unreasonable practice by ICS providers:

Average Daily Population (ADP) of Facility	Maximum per minute
1,000 or greater	\$0.01
300 to 999	\$0.02
Below 300	\$0.03

Conversely, if an ICS provider agrees to pay site commissions that do not exceed these levels, it should be permitted to increase its rates by an amount equal to the required payments under its agreement.⁷

There are no practical alternatives to this approach in the record. No party has seriously suggested that the Commission should, or even could, attempt to make site-by-site cost determinations, either through rulemaking or through individualized waiver proceedings. Either of these approaches would be unreasonably wasteful of both parties' and the Commission's limited resources. The only other possibilities would be to prohibit site commission payments entirely, or else to leave them completely unrestricted (as they were before the first Report and Order in this docket). The former, although within the scope of the Commission's authority,⁸ appears likely to lead to results contrary to the public interest, as it could lead some correctional facilities to reduce or eliminate inmate access to phones. The latter would simply reinstate the principal cause of the unreasonable ICS rates that led the Commission to act in the first place.⁹ As the record amply shows, in the absence of any regulatory constraint, site commissions were not related in any way to cost, nor were they restrained by any market forces. ICS providers had an incentive to offer increased site commissions, not to restrain them, as a way of getting access to more facilities; and consumers had no influence at all on the negotiation of these commissions, even though this expense was being passed through to them in rates for calls. Therefore, there is

⁷ See Lipman May 1 *ex parte* at 6; Lipman June 1 *ex parte* at 18-19. This approach allows individual States to impose their own regulations limiting or prohibiting site commissions, since it merely permits but does not require ICS providers to enter into agreements to pay site commissions, and the FCC should announce expressly that any such State regulations are not inconsistent with its rules.

⁸ Lipman June 1 *ex parte* at 9-12 (discussing Commission authority under sections 276 and 4(i) among others); Lipman April 8 *ex parte* at 1-7 discussing Commission authority under sections 201, 276, and 4(i) of the Act).

⁹ Lipman June 1 *ex parte* at 3, 5; Lipman April 8 *ex parte* at 2-3.

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no alternative to adopting a cap on site commissions based on a surrogate formula that would be both feasible to administer and consistent with the FCC's public interest goals.

2. Response to NSA and Other Comments

The NSA devotes a section of its June 12 *ex parte* to critiquing the undersigned's previous filings. It is worth noting, however, NSA's current position is remarkably similar to that advocated by the undersigned. NSA supports "the recovery of the cost incurred by Sheriffs and jails as a per minute add-on to the ICS rates charged by ICS providers for their services." NSA Letter at 2, 7-9. Further, NSA agrees that this "add-on" should be capped based on facility size, measured by Average Daily Population (ADP), NSA Letter at 4-5, which is the same approach suggested by the undersigned.¹⁰ The only significant difference between the two proposals is in the amounts that would be allowed. Not surprisingly, since it advocates for the interests of sheriffs, NSA's proposal would allow much higher payments to facilities.

It must be noted that the NSA Letter misleadingly includes, in a paragraph in the middle of its discussion of the undersigned's statement, the statement, "the NSA survey shows that payments to Sheriffs from ICS providers cannot be labeled as 'kickbacks' as they, at least in part, compensate Sheriffs for costs they incur to allow ICS in jails." NSA Letter at 5. There is no citation for this sentence and it makes no reference to any specific filing by the undersigned, but its placement creates the misleading impression that it is responding to something the undersigned filed. In fact, the undersigned never used the term "kickback" in any filings in this docket, except in one direct quotation from comments filed by another party.¹¹

Turning to more substantial matters, NSA argues that the undersigned's criticism of NSA's incomplete and methodologically unsound cost analysis is inappropriate because, "as unregulated entities, Sheriffs are not required to keep data in the same format as entities regulated by the Commission. Sheriffs and jails also do not have staffs that include attorneys, accountants and economists schooled in the art of ratemaking principles and Commission rules and regulations on cost studies." NSA Letter at 6. The undersigned agrees. This is one of the reasons that it would be infeasible for the Commission to try to apply traditional regulatory tools to determine precise economic costs of offering telephone service in correctional facilities. As noted in the Lipman May 1 *ex parte*, at 2, correctional facilities are not operated as for-profit businesses, so it stands to reason that they cannot be expected to generate the same type of cost information that a private business would. The FCC should instead adopt a more practical and readily administrable approach using a simple formula to estimate the maximum reasonable commission payment, as urged by both NSA and the undersigned.

¹⁰ See Lipman May 1 *ex parte*.

¹¹ Lipman May 1 *ex parte*, at 1, quoting from Letter from Lee G. Petro, Counsel for Petitioners, to Marlene H. Dortch, filed April 20, 2015.

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NSA also disputes the undersigned's criticisms of its cost analysis. To some extent, NSA acknowledges the criticisms are accurate but contends they do not matter. For example, it acknowledges that its study was based on only three months of usage data, but contends that this is "sufficient" and that the Commission can gather more data if it needs it. NSA Letter at 6. It also concedes that most sheriffs did not identify costs for specific tasks, so that NSA was unable to provide this level of detail in its results. NSA Letter at 7. The undersigned submits that these admissions by NSA simply confirm that its cost study is not a reliable basis for estimating those costs relevant to the Commission's statutory task of determining "fair" compensation. Other assertions are unsupported and unverifiable. Notably, NSA contends that its survey respondents "are a *representative sample* of jails of different sizes and in different states" (NSA Letter at 6, emphasis supplied.) In fact, however, only about 5% of NSA's members responded to its survey, and there is no data from which one could determine whether these relatively few respondents are representative of the rest of the membership.¹² There is good reason to suspect the opposite, since those sheriffs with relatively low costs would have had less motivation to respond to the survey than those with relatively high costs. NSA admits, in particular, that it received a response from only *one* jail with an ADP over 2,500, NSA Letter at 3, rendering its cost estimate for this category especially suspect.

NSA's arguments are largely echoed in the May 8 *ex parte* submitted on behalf of Pay Tel Communications.¹³ Like NSA, Pay Tel argues that the cost data collected by NSA is "robust" based on the number of sheriffs surveyed, without any analysis of whether or not this self-selected sample is representative of the overall population of jails. Pay Tel Letter at 4-5. Pay Tel also argues that all functions performed by jail personnel that relate in any way to ICS must be treated as direct costs of ICS, because "they would not be required *but for* the availability of ICS[.]" Pay Tel Letter at 5 (emphasis in original). This is a simplistic analysis. One could just as easily conclude that if a jail provides chess boards for its inmates to use in a recreation facility, the cost of playing chess includes the salaries of the officers who attend to the recreation room, because those officers would not be needed if the inmates were not permitted to play chess. It is obvious that any activity conducted in a correctional facility costs much more than doing the same thing in the "outside" world; no one needs elaborate studies or economic analyses to prove this. But that does not make it sound public policy to shift the costs of those activities to the families and friends of inmates, as the sheriffs seek to shift the costs of telephone service to those who wish to receive calls from inmates.

¹² Lipman April 8 *ex parte* at 11. Ironically, *more* sheriffs' offices and associations have filed comments or *ex parte* letters in this docket (214), according to the Commission's Electronic Comment Filing System, than responded to NSA's cost questionnaire (152).

¹³ Letter from Timothy G. Nelson to Marlene H. Dortch, May 8, 2015 ("Pay Tel Letter").

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3. Conclusion

The Commission should not lose sight of the forest for the trees. The central issue in this proceeding is not determining the precise costs incurred by correctional facilities due to offering ICS; it is establishing reasonable rates for ICS that are fair to customers, providers, and facility operators alike. To achieve this, it should establish maximum rates for both interstate and intra-state ICS calls that permit providers both to recover their costs, including a reasonable rate of return on investment; and to pay a modest and reasonable, but limited, site commission to facility owners in those jurisdictions that permit such payments, to provide an incentive for continued availability of ICS in those facilities.

Sincerely,

/s/ Andrew D. Lipman

Andrew D. Lipman