August 5, 2008

NOTICE OF EX PARTE PRESENTATION
(47 C.F.R. § 1.1206)

VIA ECFS
Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, NW
Washington, DC 20554

Re: ***Petition for Declaratory Ruling Filed by CTIA,*** **WT Docket No. 05-194**

Dear Ms. Dortch:

The National Association of State Utility Consumer Advocates ("NASUCA") submits this ex parte to call the Commission's attention to the "Proposed Statement of Decision" issued on July 28, 2008 by the Superior Court of California for Alameda County in *Ayyad, et al. v. Sprint Spectrum, L.P.*, Case No. RG03-121510 (copy attached).[1] As the Commission is aware, the *Ayyad* case involved a class action lawsuit under California state law on behalf of nearly 2 million class members, challenging early termination fees ("ETFs") imposed pursuant to Sprint Spectrum, L.P.'s ("Sprint") consumer contracts.[2] The court in *Ayyad* concluded that Sprint's ETF is an unlawful penalty under California Civil Code § 1671(d) and ordered the carrier to pay $73 million to the class plaintiffs ($18.25 million to members who paid the ETFs and $54.75 million in credits to those charged but who did not pay the ETFs). *Ayyad*, slip op. at 34, 37. While the decision speaks for itself, several aspects of the court's decision merit attention by the

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[1] NASUCA is mindful of the fact that the "proposed" decision in *Ayyad* does not become final if any party "specifies controverted issues or makes proposals not covered" in the decision by August 5, 2008 (subsequently extended to August 14, 2008). *Ayyad*, slip op. at 37. Regardless, the California court's proposed decision is clearly relevant to the issues pending before the Commission in this proceeding, properly analyzes the relevant law and facts, and should be taken into account in any decision by the Commission.

[2] NASUCA will refer to Sprint generally when referring to the named defendant in *Ayyad*. However, the reference at times is awkward because Sprint, after commencement of the action, merged with Nextel Corporation ("Nextel") and is now known as Sprint Nextel Corporation ("Sprint Nextel"). References to Sprint in this ex parte should be understood to include, where appropriate, post-merger Sprint Nextel.

Commission as it considers CTIA's March 15, 2005 petition for a declaratory ruling that ETFs are "rates charged" by wireless carriers and therefore not subject to state regulation under 47 U.S.C. § 332(c)(3)(A).

First, the court correctly noted that federal statutes preempting state law are read narrowly and that preemption should not be found unless there is a "clear and manifest" expression of preemptive intent by Congress. *Ayyad*, slip op. at 11, *citing Rice v. Santa Fe Elevator Company*, 331 U.S. 218, 230 (1947). More importantly, the court properly noted that, for purposes of preemption analysis, "[w]here it is possible to interpret a federal statute as not preempting a state claim, the statute must be interpreted in that way." *Id., citing Bates v. Dow Agrosciences LLC*, 544 U.S. 431, 447 (2005). Much of the debate in this proceeding – and indeed in past proceedings before the Commission and in the courts – has focused on the issue of what the term "rates charged by" commercial mobile radio service ("CMRS") means. Most recently, Sprint Nextel submitted a lengthy ex parte presentation to the Commission expounding upon its reading of "rates" in support of preemption.[3] Yet those parties, like Sprint Nextel, who argue for a broadly preemptive reading of "rates charged" in 47 U.S.C. § 332(c)(3)(A), never address longstanding judicial precedent that requires courts – and administrative agencies – to interpret statutory terms in a way that avoids preempting state laws, particularly state laws that are part of their core police powers. Those same parties also do not reconcile that precedent with their interpretations of the statutory terms. Unlike parties, who are free to advocate virtually any interpretation of the statute, or ignore it, the Commission is obligated to obey the courts' directives when it interprets the preemptive scope of the statutes it implements.

Consistent with the plain language of the statute, and the injunction that federal statutes must be interpreted to avoid preemption if possible, the California superior court rightly concluded that "Congress intended that 'rates charged by a commercial mobile service' are what a cellular carrier charges its customers for the services it provides" and that this interpretation was consistent with the plain language of the statute, the legislative history of the 1993 amendments to 47 U.S.C. § 332(c)(3)(A), and judicial and Commission precedent. *Ayyad*, slip op. at 12. This reading, the court concluded, is consistent with Congress' statement that it "intended to remove state regulations about the setting of rates but intended that state law would apply to the interpretation and enforcement of consumer contracts and continue its traditional role in consumer protection matters." *Id*. at 11, *citing* H.R. Rep. No. 103-111, 1993 U.S.C.C.A.N. 378, 588. The court's determination squarely contradicts the proposition asserted by wireless carriers (such as Sprint Nextel in its July 2, 2008 ex parte), that "rates" include any amount that a carrier decides to charge its customers under the terms and conditions of its service contract.[4]

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[3] Sprint Nextel ex parte, pp. 3-9 (July 2, 2008). NASUCA intends in the near future to file a separate ex parte responding to Sprint Nextel's July 2 ex parte.

[4] *See, e.g., id*. at 5. NASUCA notes that the court in *Ayyad* observed that "the F.C.C.'s need for a hearing on the issue in June 2008 suggests the issue is unclear, which in turn suggests that Congress had no clear intent to preempt." *Id*. at 12. This somewhat oblique statement might be seized upon by a wireless carrier as a basis for urging deference to the FCC's interpretation under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837 (1984). However, such an effort would be inappropriate and misguided. The court clearly did not mean that the phrase "rates charged" itself was ambiguous, but rather offered its statement in the context of

The California court also noted, as NASUCA has emphasized in this proceeding, that handsets and term service contracts coupled with ETFs are a "bundled product," something Congress clearly intended to include within the scope of "other terms and conditions" of CMRS that states may continue to regulate. *Ayyad*, slip op. at 12-13. The court also concluded that "'rates charged' cannot include all moneys paid by consumers for handset/term contract bundles . . . Sprint's ETFs were not assessed for the services that Sprint provided over the term of a service contract [but rather] they were assessed when contracts were terminated." *Id.* at 13. Further evidencing the fact that Sprint's ETFs were not "rates charged" for CMRS, the court noted, was the fact that "[t]he amount of Sprint's ETFs did not vary with the services provided – a customer with a $40/month plan paid the same ETF as a customer with a $150/month plan." *Id.*

Second, the court in *Ayyad* concluded that Sprint failed to prove that its ETFs were "rates" based on the evidence presented in the case. On this point, it is worth noting that the *Ayyad* court's analysis of the evidence regarding Sprint's motivation in adopting its ETFs is more detailed than that provided by any decision of which NASUCA is aware. That analysis sheds light on a number of the claims made by the wireless industry to the Commission during the June 12, 2008 en banc hearing regarding ETFs.[5]

For example, the California court addressed what factors prompted wireless carriers to adopt ETFs in the first place. The court noted three relevant decision points in connection with Sprint's ETFs: (1) Sprint's adoption of a $150 ETF in May 2000; (2) Nextel's adoption of a $200 ETF in 2000; and (3) Sprint Nextel's post-merger adoption of a $200 ETF companywide. *Ayyad*, slip op. at 22. With regard to the first decision point, based on the evidence, the court concluded that Sprint's motivation and purpose was not to reasonably estimate damages resulting from customers' termination of service prior to the end of the service contract's term but rather was to decrease churn. *Id.*; *see also id.* at 2-3.[6] The court noted that the evidence showed that Sprint considered three factors when adopting and setting the amount of its ETF: (1) whether the

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whether Congress had expressed a "clear and manifest" intent to preempt state laws regulating ETFs – and concluded that Congress had not. Moreover, NASUCA notes that the FCC's en banc hearing addressed a much wider array of issues than the narrow question whether ETFs are "rates charged" under 47 U.S.C. § 332(c)(3)(A): The June 12, 2008 hearing also addressed ETF practices in other communications-related industries, consumer perspectives on such business practices, the underlying costs justifications for ETFs, and the degree to which the FCC should consider adopting regulations governing wireless ETFs.

[5] With regard to Sprint Nextel's motivation regarding its adoption of the ETFs, NASUCA notes that the court concluded that "Sprint's subjective motivation and intent is irrelevant." However, that observation was offered in the context of the court's preemption analysis, as clearly indicated by the fact that it is set forth in that portion of the court's opinion entitled "Preemption – Evidence and Conclusion." *Ayyad*, slip op. at 12. Sprint Nextel's motives were relevant to the court's discussion of whether the ETFs charged by Sprint Nextel constituted illegal liquidated damages under California state law. *See id.* at 22.

[6] It is worth noting here that Sprint's service was exclusively month-to-month prior to 1999, when it began to study the concept of longer-term contracts and ETFs and to test-market such offerings. What motivated Sprint to roll out term contracts coupled with ETFs was its desire to reduce customer "churn." *Id.* at 2-3.

competition had similar contracts and ETFs, (2) whether customers would sign service contracts with ETFs, and (3) how different ETF amounts would impact Sprint's profitability. *Id*.

Nextel's considerations in adopting its own ETFs, the evidence showed, were identical to Sprint's. Nextel's action likewise was not an attempt to estimate damages caused by a customer's breach of contract in adopting and setting the amount of its ETF. *Id*. at 23; *see also id*. at 4. Finally, the evidence demonstrated that Sprint Nextel's post-merger increase of its ETF to $200 companywide was not intended to estimate damage from early terminations but was motivated solely by a desire to establish a uniform ETF for the post-merger company. *Id*. at 23; *see also id*. at 4.

In other words, Sprint, Nextel, and ultimately the post-merger Sprint Nextel, adopted ETFs not so much to offset lost revenues stemming from a customer's early termination of service, but rather as a device to coerce customers to remain with the carriers until the end of their service contracts. The carriers made no attempt, the evidence showed, to actually calculate their damages from early termination in adopting ETFs but rather charged what they believed the market would bear based on the ETFs other wireless carriers were imposing on their customers.

Third, an interesting feature of Sprint's practices regarding ETFs that came to light in the California proceeding was addressed in the court's discussion of the "alternative means of performance" doctrine under state law. The court noted that ETFs did not simply provide customers with an alternative means of performance (which would have foreclosed the conclusion that ETFs were unlawful penalties under state law) since Sprint's contracts gave the *carrier* the opportunity to *both* unilaterally terminate customers' contracts *and* impose an ETF. *Ayyad*, slip op. at 14-15. The evidence showed that, in approximately 80% of the situations where Sprint's ETF clause was triggered, it was the carrier – not the customer – that terminated customer contracts early and imposed an ETF. *Id*. at 15. Thus, the court noted, the "Termination – Term Contracts" clauses in Sprint's contracts permitted the carrier to "both take the termination decision away from its subscribers and to impose the ETF," meaning that the ETF did not give customers a rational choice of paying the ETF or completing the contract. *Id*. To NASUCA's knowledge, the Commission's attention has not previously been called to this particular aspect of wireless carriers' use of ETFs.

Fourth, the court's discussion of why Sprint's ETFs amounted to an unlawful penalty sheds light on the proposition, being circulated in connection with this proceeding, that adopting some proration formula for ETFs is sufficient to alleviate the anti-consumer, anti-competitive effects of ETFs. As NASUCA made clear in its written and oral testimony for the June 12, 2008 en banc hearing before the Commission, simply adopting some proration formula for wireless carriers' ETFs assumes that such fees are reasonable in the first place, something for which there simply is no hard evidence. The court noted that Sprint Nextel's "ETF was set as a fixed flat fee without regard to the amount of Sprint's sunk costs (handset subsidies), the term of the contract (1 year or 2 year), or the monthly recurring charge on the contract," and "did not vary depending on the months remaining in a term contract." *Ayyad*, slip op. at 23. Under California law, "[w]here a fixed sum is agreed upon as liquidated damages for one of several breaches of varying degree, it is to be inferred that a penalty was intended." *Id.* at 24, *citing Smith v. Royal Mfg. Co.*, 185 Cal. App.2d 315, 324 (Cal. App. 1st Dist. 1960).

On a related point, the court cited the "evidentiary disconnect between charging ETFs on a per line basis and the evidence presented on a per-subscriber or per-account basis," noting that charging a separate ETF for each phone line terminated early produced results that were counterintuitive. For example, the court noted, "a subscriber with a contract for a $100/month low monthly minute family plan with four phones would be subject to $700 in ETFs for terminating the contract early"[7]; in contrast, "another subscriber with a contract for a high monthly minute $100/month plan with one phone would be subject to a $175 ETF for terminating the contract early." *Id.* at 4-5.

In summary, the *Ayyad* decision provides additional factual and legal bases that the Commission must consider that support the conclusion that wireless ETFs are not "rates charged" by CMRS providers but instead fall within the broad scope of "other terms and conditions" of wireless service that Congress expressly intended states to continue to regulate.

Please do not hesitate to contact me if you have any questions about the foregoing.

Very truly yours,

/s/

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[7] Here, the *Ayyad* court appears to be referring to the $175 ETF charged by one of the Nextel carriers, rather than the $150 ETF charged by pre-merger Sprint or the $200 ETF charged by post-merger Sprint Nextel.