BINGHAM

VIA ECFS

February 1, 2010

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

Re: WC Docket No. 06-122
U.S. TelePacific Corp. d/b/a TelePacific Communications Emergency Petition for Stay Pending Commission Review; Request for Review and Reversal of USAC Decision Letter

Dear Ms. Dortch:

U.S. TelePacific Corp. d/b/a TelePacific Communications ("TelePacific" or "Company"), pursuant to Section 1.1206(b) of the Commission's Rules, *47 CFR §§1.1206(b)*, provides supplemental information to explain the legal arguments raised on page 7 of the *April Letter* and pages 16 and 17 of the *October Letter* incorporated by reference in, and attached to, its January 8, 2010 Request for Review as Exhibits B and C, respectively. The question presented in the Request for Review is whether TelePacific has an obligation to contribute directly to the Universal Service Fund ("USF" or "Fund") when it provides a broadband Internet access service. TelePacific has shown that because the Commission has classified such services as information services regardless of the underlying transmission technology, the answer to that question is no.

Assuming, *arguendo*, that the Commission agrees that there is no legal obligation for TelePacific, in offering these broadband Internet access services, to contribute directly to USF, the logical secondary question is whether TelePacific must contribute to USF indirectly. The question therefore is whether the incumbent local exchange carriers ("ILECs") selling TelePacific T-1 special access circuits should be required to treat TelePacific as an end user if the Company uses the T-1 circuit solely to provide broadband Internet access service.[1] TelePacific respectfully submits that legal and policy considerations compel the same answer irrespective as to whether contributions are required either directly or indirectly. While TelePacific agrees that ensuring the

[1] TelePacific also uses T-1 special access circuits purchased primarily from ILECs to offer service bundles of switched voice and broadband Internet access. Zahn Decl., ¶ 17. Because TelePacific provides a telecommunications service when it offers both voice and Internet access over the same T-1, and makes USF contributions on the interstate and international voice services, it satisfies the Form 499-A worksheet instruction's definition of an "other contributor." Thus the ILEC should not be permitted to treat TelePacific as an end user for T-1 circuits used to provide both voice and Internet access services.

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sufficiency of the Fund is important, that goal does not override all other USF principles. Requiring TelePacific to make *indirect* USF contributions when its ILEC competitors are not subject to the same requirements would violate Section 254 of the Act (which requires equitable and nondiscriminatory contributions), contradict the Commission's policy of a level playing field for all broadband Internet access services, and violate the policy of competitive neutrality by creating a cascading effect that imposes USF on providers of broadband Internet access services utilizing certain leased local loop facilities.

Level Playing Field for Broadband Internet Access Services

In a series of orders, the Commission deliberately and expressly created a level playing field for all broadband Internet access services, regardless of the transmission technology or network used to deliver such services to end users.[2] In the seminal *Wireline Broadband Order*, the Commission was clear that a broadband Internet access service would be classified as an information service regardless of the underlying transmission technology.[3] As explained below, the Commission subsequently clarified that this bedrock nondiscrimination principle also applies in the case of indirect

[2] *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, WT Docket No. 07-53, Declaratory Ruling, 22 FCC Rcd 5901, ¶ 56 (2007) (stating the Commission's goal of "encouraging the development of information services by ensuring that they remain free from common carrier regulation, and services the Act's overarching goal of fostering competition by providing a level playing field in the market and removing unnecessary regulatory impediments."); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, WC Docket No. 06-10, Memorandum Opinion and Order, 21 FCC Rcd 13281, ¶2 (2006) (classifying broadband over power lines as an information service and holding that such classification "furthers the Commission's goal of developing a consistent regulatory framework across broadband platforms by regulating like services in a similar manner"); *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶ 1 (2005) ("*Wireline Broadband Order*") (finding that the Commission's determination that broadband access to the Internet over wireline is an information service "furthers the goal of developing a consistent regulatory framework across platforms by regulating like services in a similar functional manner, after a transitional period"); *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, ¶ 6 (2002) (holding that the Commission's Order "seek[s] to create a rational framework for the regulation of competing services that are provided via different technologies and network architectures" and "strive[s] to develop an analytical approach that is, to the extent possible consistent across multiple platforms").

[3] *Wireline Broadband Order,* ¶ 16.

contributions by downstream providers that purchase broadband transmission from facilities-based carriers to incorporate in their broadband Internet access services.

Indirect USF Contributions and the *Contribution Methodology Order*

In 2006, an independent Internet Service Provider ("ISP"), Earthlink, Inc. ("Earthlink"), wrote to then-Bureau Chief Thomas Navin seeking clarification of the *Wireline Broadband Order* to ensure that it was implemented to treat ILECs and other ISPs in a competitively neutral manner.[4] Earthlink explained that if the ILEC selling DSL transmission service treated Earthlink as an end user, Earthlink would be required to make an indirect contribution to USF. In contrast, the ILEC would not be required to make any USF contribution when providing the wireline broadband Internet access service to its direct end users. In short, Earthlink's indirect USF contribution (through the ILEC) put Earthlink at a distinct competitive disadvantage in the market for wireline broadband Internet access service.

The Commission, in order to ensure its commitment to a level playing field, correctly fixed this inequity in footnote 206 of the *Contribution Methodology Order*.[5] Citing the Earthlink ex parte, the Commission held that providers of detariffed broadband transmission services would not be required to contribute to USF on such services after the end of the transition period (August 2006). At the time the Order was adopted, only DSL broadband transmission services were detariffed. Through subsequent forbearance orders, however, ILECs were permitted to detariff additional wireline broadband services.[6] Thus, as TelePacific explained in its Petition for Stay, wireline broadband Internet access services offered over DSL, ATM, frame relay, Ethernet, and OCn circuits

[4] *See* Letter from Mark J. O'Connor, Counsel to EarthLink, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 02-33, at 1 (filed June 8, 2006). (Attached as Exhibit A.)

[5] *Universal Service Contribution Methodology*, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518, n.206 (2006) ("*Contribution Methodology Order*") ("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.").

[6] *See Petition of AT&T Inc. for Forbearance Under 47 USC Section 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, 22 FCC Rcd 18705 (2007) (subsequent history omitted); *Qwest Petition for Forbearance Under 47 USC Section 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services*, 23 FCC Rcd 12260 (2008); *Verizon Telephone Companies' Petition for Forbearance from Title II and Computer Inquiry Rules with Respect to their Broadband Services Is Granted by Operation of Law*, WC Docket No. 04-440, News Release (rel. Mar. 20, 2006); *Petition of the Verizon Telephone Companies For Forbearance*, WC Docket No. 04-440 (filed Dec. 20, 2004).

would experience a competitive disadvantage if only T-1 circuits used in wireline broadband Internet access services are assessed USF.[7]

Section 254 and the USF Principle of Competitive Neutrality

Section 254(d) requires contributions to USF be assessed on an "equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the [FCC]."[8] In the *First Report and Order*, the FCC adopted a principle of competitive neutrality:

> competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.[9]

Assessing USF contributions on the provider of the upstream transmission service (here, the ILECs providing TelePacific T-1 circuits) utilized as an input to TelePacific's broadband Internet access service violates the principle of competitive neutrality. It also contradicts and undermines the USF exemption the Commission granted for the finished service, especially because the Commission went out of its way to emphasize that "there is no reason to classify wireline broadband Internet access services differently depending on who owns the transmission facilities."[10] In effect, the level playing field the Commission announced it was adopting is tilted in favor of the provider "who owns the transmission facilities" if the Commission imposes USF contribution on the transmission input purchased by the incumbent's direct competitor.

The Commission must resist any reflexive action to impose USF on the transmission service merely because it is offered as a telecommunications service. Although footnote 206 of the *Contribution Methodology Order* does not specify directly that common carrier services (telecommunications services) enjoy the same exemption when sold for use as an input in a broadband Internet access service, for purposes of Section 254(g)'s equitable and nondiscriminatory requirement and the competitive neutrality principle, common versus private carriage is a distinction without a difference. Imposing USF indirectly on the telecommunications service input is like pulling the first string that unravels the Commission's competitive neutrality objective of the *Wireline Broadband Order*.

Exempting telecommunications services from USF contribution, in certain circumstances such as these, is consistent with the text of the statute, congressional intent,

[7] Petition for Stay, p. 16.

[8] *See* 47 U.S.C. § 254(d).

[9] *See Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, ¶ 47 (1997) ("*First Report and Order*").

[10] *Wireline Broadband Order*, ¶ 16.

and the authority delegated to the FCC. By way of example, in the *First Report and Order* the Commission recognized that carriers providing telecommunications services on a wholesale basis would not make contributions to USF on such services, even though such services fall under the “mandatory” contribution category of telecommunications services. The Commission justified this “exemption” of certain telecommunications services in order to avoid the double counting problem.[11] The Commission explained the problem as follows:

> [I]f facilities-based carrier X sells $200.00 worth of telecommunications services directly to a customer, its contribution will be $20.00. If reseller B buys $180.00 worth of wholesale services from carrier A and B sells the same retail services in competition with X after adding $20.00 of value, B would owe a contribution of $20.00 on these $200 worth of services, but B would also be required to recover the portion of the $18.00 contribution that A must make and would likely pass on to B. Therefore, while X would face $200.00 in service costs and $20.00 in support costs, B would face $200.00 in service costs and almost certainly substantially more than $20.00 in support costs.[12]

The facts here are strikingly similar. If facilities-based carrier X sells $200 worth of broadband Internet access to a direct customer, its USF contribution will be $0. If reseller B (here, TelePacific) buys $180 worth of wholesale services from carrier A and B sells the same retail services in competition with X after adding $20 of value, B would owe a contribution of $0, but B would also be required to recover the portion of the $18 USF contribution that A must make and would likely pass on to B. Therefore, while X would face $200 in service costs and $0 in USF contribution costs, B would face $200 in service costs and $18 in USF contribution costs.

In the *Contribution Methodology Order*, the Commission determined that an upstream contribution such as this would undermine its exemption for the finished broadband Internet access service. The same rationale justifies an “exemption” for telecommunications services used as an input in broadband Internet access. As explained below, it is also consistent with well-established principles that once an exemption is granted for a certain product, the fee or tax will not be imposed on upstream providers. The upstream exemption is necessary to avoid the manifest unfairness of the cascading effect of fees and taxes.

[11] *First Report and Order*, ¶ 845.

[12] *Id.*

499-A Instructions

In the *First Report and Order*, the Commission ruled that a USF contribution shall be assessed on end user telecommunications revenues only.[13] The Commission concluded that:

> [USF] contributions will be based on revenues derived from end users for telecommunications and telecommunications service, or "retail revenues"…End user revenues would also include revenues derived from other carriers *when such carriers utilize telecommunications services for their own internal uses* because such carriers would be end users for those services. This methodology is both competitively neutral and relatively easy to administer.[14]

The Bureau held that the *Second Reconsideration Order* clarified the distinction between end user and carrier's carrier revenues:[15]

> the contribution mechanism should operate in a competitively neutral manner by preventing double counting of revenue for contribution, but at the same time ensure that such revenue was subject to contribution once.[16]

The Bureau recently reaffirmed that USF obligations must be consistent with the Act and Commission rules and orders.[17] Indeed, the Form 499 Instructions state that contributors should consult Commission rules to determine their obligations.[18]

[13] *Id.* at ¶ 843.

[14] *Id*. at ¶ 844 (emphasis added).

[15] While the initial Form 457 was attached to the *Second Reconsideration Order*, most subsequent revisions to the Form 499 have been released by Public Notice with no opportunity for comment. *See* Letter from Jonathan Banks, Senior Vice President and General Counsel, United States Telecom Association and Paul Garnett, Assistant Vice President, Regulatory Affairs, CTIA, to Marlene Dortch, Secretary, Federal Communications Commission, CC Docket No. 96-45 (filed Dec. 12, 2007) (requesting that the FCC put changes to the Form 499 Instructions out for public notice and comment).

[16] *Federal-State Joint Board on Universal Service Request for Review of Decision of the Universal Service Administrator by Global Crossing Bandwidth, Inc*., Order, 24 FCC Rcd 10824, ¶ 15 (2009).

[17] April 1, 2009 Letter from Jennifer McKee, Acting Chief, Telecommunications Access Policy Division to Michelle Tilton, Director of Financial Operations, USAC, DA 09-748.

[18] 2009 Form 499-A Instructions, p. 4.

Even assuming, *arguendo*, that the current Form 499 Instructions are binding, in this instance, TelePacific satisfies the standard for certifying that the amounts it pays ILECs for T-1 circuits qualify as revenues from "other contributors." The Form 499 Instructions provide that a carrier may classify revenues as revenue from other contributors if they "are revenues from services provided by underlying carriers to other entities that currently are contributors to universal service support mechanisms and that are resold in the form of telecommunications."[19] TelePacific is a "current contributor" to USF, making contributions on the voice and other telecommunications services it offers to end users. Zahn Decl., ¶ 17. Moreover, the *Wireline Broadband Order* found that a provider of broadband Internet access services provides telecommunications.[20] Thus TelePacific, like all providers of Internet access service, is providing "telecommunications" when it offers broadband Internet access service to end users. Because the Commission determined that no USF contribution is required on the finished Internet access service that incorporates telecommunications, TelePacific is contributing on its resold telecommunications in accordance with Commission rules and satisfies the Form 499-A test for treatment as an "other contributor."

Refusing to Apply USF to the Upstream Carrier Promotes Good Policy

Although tax policy considerations are not directly relevant to USF policy considerations, they are helpful as analogies. Like the USF, state sales taxes as applied nationwide are cascading taxes that are generally only imposed on retail sales made to consumers. Therefore, sales at stages earlier than the retail level (non-retail sales), are generally not subject to the tax. The exemption for non-retail sales avoids the cascading effect of taxes imposed at each stage of the production process.

When a cascading tax is applied, it causes an amount of tax paid at a previous stage to be again subject to tax at a later stage in the production and, as a result, the same amount may be taxed multiple times in the processes of production and distribution, creating a "tax-on-tax" effect.[21] Cascading taxes have the obvious flaw of taxing specialized, nonintegrated production processes far more highly than others. To combat this effect, most states impose the sales tax on the gross amount of the retail sale ensuring that all of the component costs of production (i.e., raw materials, labor, etc.) as well as returns on capital (i.e., interest, rent, and profits) are included in the tax base as reflected in the final price of the product sold to the consumer, thus avoiding discrimination

[19] 2009 Form 499-A Instructions, pp. 18-19.

[20] *Wireline Broadband Order*, ¶¶ 5, 104 (finding that transmission underlying broadband Internet access is telecommunications, not a telecommunications service), ¶ 16 (finding the service classification does not vary based on who owns the transmission facilities).

[21] Dr. Robert F. Van Brederode, *A Normative Evaluation of Consumption Tax Design: The Treatment of the Sales of Goods Under VAT in the European Union and Sales Tax in the United States*, 62 Tax Law 1055, 1064 (2009).

against nonvertically integrated companies in favor of vertically integrated companies.[22] Under the U.S. sales tax system, downstream taxes are not levied on upstream taxes.

While an indirect USF contribution based upon the cost of the broadband transmission service may result in a smaller overall tax than a direct contribution based on retail revenue, it is still a cost that the competing provider owning loop facilities does not bear. For this reason, it is axiomatic sales tax policy that once an end user is provided an exemption, the taxing authority should not undermine that exemption by imposing tax on the upstream provider. In fact, where one party in the chain is ultimately required to bear the burden of a tax, the tax law provides the necessary exemption, deduction and credit mechanisms to ensure the tax falls as intended.

Similarly, a value added tax (VAT) is a tax assessed and collected at each stage over the entire production process of a commodity (at the different points of turnover of goods and services). The VAT is based on the value added at each step and is payable by all business units regardless of whether they sell at retail. Although on its face, the VAT seems to impose a cascading tax on all producers in the chain, each producer can recover the VAT paid on its taxable purchases.[23] Where the sale of a particular type of good to end users is desired by the taxing authority to be exempted from VAT (such as food purchases in some countries which impose a VAT), upstream sales of the particular good are always exempted from the VAT, for the simple reason that exempting an end user but not an upstream provider defeats the purpose of the VAT exemption.

For the same reasons that VAT policy eschews the upstream imposition of VAT in general, but particularly in situations where the sales of a particular good is exempted entirely, USF policy should eschew the upstream imposition of USF, particularly where the announced intention is that the final consumer not bear the burden of the imposition.

Finally, tax policy lends support for the principle that different producers of like products and services should be treated similarly unless economic considerations otherwise distinguish the producers. The Supreme Court in *Complete Auto Transit v. Brady*[24] found that a Commerce Clause violation occurs where a tax unfairly burdens and, as a result discriminates against, interstate commerce, unless the state provides a sufficient justification for the discrimination. The policy reasons against discriminating against otherwise similar providers because of geographic or technological distinctions between service providers is equally applicable to USF policy. Giving one type of technology a tax advantage over another amounts to a governmental preference for one technology over another, and is generally avoided under tax policy as distortive to the proper functioning of free markets.

[22] Daniel S. Goldberg, *E-Tax: Fundamental Tax Reform and the Transition to a Currency Free Economy*, 20 VA Tax L. Rev. 1, 34 (2000).

[23] Joseph Isenberg, *The End of Income Taxation*, 45 Tax L. Rev. 283, 333 (1990).

[24] 430 U.S. 274 (1977).

<u>Conclusion</u>

Requiring TelePacific to make USF contributions, either directly or indirectly through its ILEC suppliers, would have an adverse effect on competition and the supply of broadband because it would significantly disadvantage broadband service provided through older wireline technology, such as T-1s, simply because those underlying facilities have been "traditionally" used to provide stand-alone telecommunications service. While the *USAC Decision* handicaps only one of several technologies used to provide broadband Internet access, imposing indirect USF contributions on the transmission service input used in the finished broadband Internet access product would handicap all providers that do not own loop facilities. Either way, a direct or indirect USF contribution on TelePacific's broadband Internet access service will tilt the playing field and determine winners and losers in the competitive broadband Internet marketplace. Since it is consistent with law and FCC policy for TelePacific to have categorized its Internet access services provided over T-1 circuits as exempt from USF contributions, both on a retail and wholesale basis, there should be no requirement for TelePacific to make direct or indirect USF contributions retroactively. If contributions on broadband Internet access are necessary to ensure the sufficiency of the Fund, then the Commission should change the rules, prospectively, so that all providers (wireline, cable, wireless, etc.), whether or not they own loop facilities, contribute on an equitable and nondiscriminatory basis.

Sincerely,

/s/

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Counsel for U.S. TelePacific, Corp. d/b/a TelePacific Communications

cc: Vickie Robinson, FCC Wireline Competition Bureau
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