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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

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Federal Communications Commission
Office of the Secretary

Petition For An Expedited Declaratory Ruling That Section 332 of the FCA Does Not Preempt State Law Protecting Consumers Against Unlawful Penalty Fees	)	Docket No.
	)	Docket No.

OPENING COMMENTS OF CALIFORNIA CONSUMERS CHALLENGING COMMERCIAL MOBILE SERVICE PROVIDERS' PRACTICE OF CHARGING UNLAWFUL PENALTY FEES UNDER CALIFORNIA STATE CONSUMER PROTECTION STATUTES

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I. EXECUTIVE SUMMARY

Petitioners respectfully request the Federal Communications Commission to enter a declaratory finding that the commercial mobile service ("CMS") providers' practice of imposing penalty fees for late payment involve "terms and conditions" of service and are not "rates" under Section 332 of the Federal Communications Act ("FCA").[1] To find otherwise would give an overly broad meaning to the word "rates", contrary to Section 332's express statutory language preserving the states' historic consumer protection powers and would bar state law from protecting millions of consumers against CMS providers' practice of charging illegal contractual penalties for late payment.

State consumer protection laws of general application, such as California's, protect individual consumers against large corporations with superior bargaining power. Four CMS providers – AT&T Mobility, LLC ("AT&T"), Cellco Partnership, d/b/a Verizon Wireless ("Verizon Wireless"), Sprint Solutions, Inc. ("Sprint"), and T-Mobile USA, Inc. ("T-Mobile") – control approximately 91% of the CMS market in the United States. Each of these providers includes penalty fee provisions in its terms and conditions of service. Unless checked by state law, CMS providers will continue to insert unlawful penalty fees provisions with impunity into boilerplate terms and conditions in consumer contracts that are presented to millions of consumers on a take-it-or-leave-it basis.

CMS providers violate clear and longstanding consumer protection law by charging late fees that far exceed the actual damages caused by consumers who pay late. As a result, CMS providers have extracted millions of dollars in illegal profits from consumers who are in an inferior bargaining position and have limited resources and information at their disposal.

The penalty fees CMS providers charge do not play a special role in fostering greater adoption or use of CMS – any more so than in any other industry. In fact, late fees are clearly not a central part of CMS providers' business model of providing wireless services. As one director of finance for a CMS provider testified:

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[1] 47 U.S.C. § 332(c)(3)(A) ("Section 332").

> We spend our – we drive revenue through products and services to our customers, so in the majority of what my team analyzes, we're looking at providing services to our customer, loyalty. We want to keep our customers, so we're looking at growth in the larger revenue streams. ***We don't – we're not in business to charge customers fees, so when I'm – so late fees and taxes aren't things that we want, I guess, aren't things that I'm trying to grow.*** Late fees are kind of a leading indicator of a customer paying late, and they're going to leave us probably at some point. So it's not a – it's not something that I'm really focused on.[2]

Even though penalty fees unquestionably are not part of the services CMS providers offer, to escape complying with consumer protection laws, CMS providers have sought immunity under the preemption language found in Section 332. CMS providers claim their illegal contractual penalties are not "terms and conditions of service" (which are not preempted) but instead are "rates charged" (which are preempted).

This is not the first time the CMS providers have so argued in litigation concerning contractual penalties. The wireless industry has made similar arguments in the context of early termination penalties. But courts addressing this question have almost universally rejected the wireless industry's efforts and have narrowly interpreted Section 332's preemption language.

If the Commission were to side with the CMS industry on this question, it would substantially free the four entities that dominate the CMS market to impose on consumers whatever economically punitive measure the wireless industry sees fit. Allowing these practices does not increase competition to the benefit of consumer welfare – it shields competition by burying revenue that exceeds costs in penalty fees tacked on at the back-end of the transaction.

For example, the Commission has recently seen Verizon Wireless hike its early termination fee penalty to $350 for "advanced devices." When the Commission questioned whether Verizon Wireless's early termination fee ("ETF") was designed to recoup the actual wholesale cost of these so-called advanced devices, Verizon Wireless admitted that its penalty fees far exceed these costs. Verizon Wireless stated that its "ETF is not ***limited*** to the recovery

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[2] Appendix of Materials Submitted in Support of Petition For an Expedited Declatory Ruling That Section 332 of the Federal Communications Act Does Not Preempt State Law Protecting Consumers Against Unlawful Penalty Fees ("App."), Ex. 1 at 47:23-48:10.

of the wholesale cost of the device over the life of the contract. . . . [T]he ETF partially compensates Verizon Wireless for all the costs and risks of providing service, which include advertising, commission, store costs, and network costs."[3]

In the context of late payment, Petitioners allege the CMS providers are similarly charging penalty fees far exceeding the cost caused by customers who pay late. The CMS providers are getting consumers coming, staying, and going with these fees.

The abusive practice of extracting higher penalty fees to offset rate competition has been demonstrated in the credit card industry. When granted immunity from state consumer protection laws, the credit card industry nearly tripled its average late fee from about $12 to nearly $35 today.

Petitioners ask the Commission to reject such a broad reading of the term "rate" in the FCA that would allow the CMS providers to ape the conduct of the credit card industry. A properly narrow interpretation of the FCA would be consistent with the dozens of courts holding the FCA does not preempt penalty provisions, and would protect consumer welfare on this important question.

Finally, to be clear, Petitioners are not claiming CMS providers may not recoup legally cognizable damages caused by customers who pay late – only that the CMS providers must abide by consumer protection law when doing so. As such, Petitioners have not presented a record in this proceeding and are not asking the Commission to make any determination as to a permissible amount of a fee that a wireless provider may charge due to a customer paying late. Rather, this Petition is limited to addressing a narrow question: whether contractual late payment penalties are "terms and conditions" of service subject to state consumer protection law or preempted "rates charged" pursuant to Section 332.

II. WIRELESS INDUSTRY PENALTY FEES PRACTICES

Four CMS companies dominate the United States market for wireless telephone and data service. Together Verizon Wireless, AT&T, Sprint, and T-Mobile have contracts with 91% of

[3] *See* App., Ex. 2 at 10.

all wireless customers in the United States.[4] Estimates of respective market shares are: Verizon Wireless (32%), AT&T (29%), Sprint (18%) and T-Mobile (12%). *Id.* In 2008, the annual revenues from wireless service for these four companies exceeded $145 billion: Verizon Wireless ($49.3 billion), AT&T ($44.2 billion), Sprint ($30.4 billion) and T-Mobile ($21.8 billion).[5]

All four of these CMS providers impose late fees and service impairment fees ("Penalty Fees") through standardized contracts without any negotiation with consumers over the terms and conditions of service. The CMS providers charge late fees when consumers do not pay within a specified time after the due date printed on the bill. Soon after the CMS provider deems the bill late, it impairs a consumer's wireless services. Impairment can involve preventing outgoing calls and routing them to the CMS provider call center, as well as blocking incoming calls. Incredibly, some carriers do not pro rate a customer's bill for the impaired period.

If the consumer pays his bill, including the late fee, the CMS provider stops impairing service, but to do so imposes an additional fee to "reactivate" the account. These Penalty Fees are not disclosed on the CMS providers' rate plans or highlighted in marketing materials. Penalty Fees are only found buried in the CMS providers' terms and conditions of service and are assessed only if the consumer does not comply with those terms and conditions by paying his bill within the time specified by the CMS provider. If consumers pay their monthly charges for usage within the prescribed time, they receive the contracted for services from the wireless providers at the agreed-upon rate for increments of usage and are not assessed Penalty Fees. Described below is each of the major CMS providers' Penalty Fees terms and conditions.

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[4] *See* App., Ex. 3 at 17 (Cheetna/Sharma U.S. Wireless Data Market Update—Q3 2009 http://www.chetansharma.com/usmarketupdateq309.htm).

[5] *See* App., Exs. 4-7 (excerpts from 2008 financial statements of Verizon Wireless, AT&T, Sprint and T-Mobile).

Verizon Wireless's Penalty Fees Terms and Conditions

Verizon Wireless's standardized contracts describe its late Penalty Fees as follows:

> Payment is due in full as stated on your bill. IF WE DON'T RECEIVE PAYMENT IN FULL WHEN DUE, WE MAY, TO THE EXTENT PERMITTED BY LAW OF THE STATE OF THE BILLING ADDRESS WE HAVE ON FILE FOR YOU AT THE TIME, CHARGE A LATE FEE OF UP TO 1.5 PERCENT A MONTH (18% ANNUALLY) OR A FLAT $5 A MONTH, WHICHEVER IS GREATER, ON UNPAID BALANCES.[6]

Verizon Wireless's practice in California is to impose the greater of 1.5% of the balance or $5 whenever a consumer's payment is late – regardless of being 1 day or 25 days past the prescribed period for payment. If the bill remains unpaid, within days, Verizon Wireless impairs the consumer's ability to place outbound calls, through a practice it calls "hotlining." When the consumer dials an outbound call, Verizon Wireless re-directs the call to Verizon Wireless's bill collection call center. If the bill remains unpaid after a few days of being hotlined, Verizon Wireless then blocks inbound calls as well. Then if the consumer does not pay, Verizon Wireless will suspend wireless service. Once a consumer's account has been either hotlined or suspended, if the consumer pays the amount due, including the $5 late fee, Verizon Wireless will reinstate wireless service and will impose a $15 "reconnect fee." If the bill remains unpaid after a further prescribed time, Verizon Wireless will disconnect and write-off the customer's account.

Sprint's Penalty Fees Terms and Conditions

Sprint imposes a late fee of 5% of the total amount due. This equates to an annual penalty rate of 60% – assuming consumers paid 30 days late. Through the end of 2006, Sprint disclosed in its standardized consumer contracts that: "You must pay all charges by the due date on the invoice. Past due amounts accrue late charges until paid at the rate of 5% per month or at the highest rate allowed by law and may result in immediate suspension of your account."[7]

In 2007, Sprint began concealing the amount of its late fee in these contracts stating only: "Payment is due in full as stated on your bill. If we do not receive payment in full by the date

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[6] *See* App., Ex. 8.

[7] *See* App., Ex. 9 at 5.

specified on your bill, a late payment charge, which may be charged at the highest rate permissible by law, may be applied to the total unpaid balance."[8] This remains all that Sprint discloses about its late fee. A consumer reading this and shopping for wireless service has no notice of how much Sprint will impose for late payment.

Sprint also charges an impairment fee. If a bill remains unpaid, soon after assessing a late fee Sprint will impair the customer's service. If the consumer pays her bill, Sprint will re-establish service and charge a $25 "reconnect" fee. Until 2007, Sprint did not disclose the amount of the reconnect fee in its consumer contracts. Sprint merely stated: "Based on our Policies, we may charge activation, prepayment, reactivation, program or other fees to establish or maintain Services. . . . You will be provided notice of these types of fees before we complete the requested transaction." *Id.*

T-Mobile's Penalty Fees Terms and Conditions

T-Mobile customers will also be charged a late Penalty Fees if they do not pay their bill within a few days from the due date printed on the bill. From December 2004 until June 2008, T-Mobile's standardized contract provided that:

> Late Fees. You agree to pay 1.5% or $5.00 per month (or portion of a month), whichever is greater, on any past due balances until paid, subject to the highest amount permitted by law. Except to the extent prohibited by law, this late fee may be charged regardless of any disputes you may have raised regarding your invoiced charges.[9]

From June 1, 2008 through the present T-Mobile has disclosed that:

> If we do not receive payment in full by the due date on your bill you may be charged a late fee of the greater of 1.5% per month (18% annually) or $5/month subject to the maximum allowed by law. We may use a collection agency and you agree to pay collection agency fees we incur to collect payment.[10]

T-Mobile also charges $20 per line to consumers whose wireless service is impaired for late payment. T-Mobile does not disclose the amount of this fee stating only: "If your service

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[8] *See* App., Ex. 10 at 7.

[9] *See* App., Ex. 11 at 4.

[10] *See* App., Ex. 12 at 3.

account is suspended or terminated and then reinstated, you may be charged a reactivation fee." *Id.*

AT&T's Penalty Fees Terms and Conditions

The current AT&T wireless consumer contract states that:

> Late payment charges are based on the state to which the area code of the wireless telephone number assigned to you is assigned . . . . You agree that for amounts not paid by the due date, AT&T may charge as a part of its rate and charges, and you agree to pay, a late payment fee of $5 in CT, D.C., DE, IL, KS, MA, MD, ME, MI, MO, NH, NJ, NY, OH, OK, PA, RI, VA, VT, WI, WV; the late payment charge is 1.5% of the balance carried forward to the next bill in all other states.[11]

AT&T also imposes a $36 fee when it impairs service for late payment.[12] This fee is not conspicuously disclosed in AT&T's standardized consumer contract.

III. PENALTY FEES LITIGATION BACKGROUND

Petitioners Cheryl Barahona, Kuba Ostachiewcz, Rudolph Thomas, Joseph Ruwe, and Elizabeth Orlando ("California Consumers") purchased wireless telephone and data service from T-Mobile, Verizon Wireless, and Sprint. The California Consumers paid late fees and impairment fees to these CMS companies.

Beginning in 2007, the California Consumers filed three separate class action lawsuits in federal district court, two in San Francisco and one in Seattle, against Verizon Wireless, Sprint, and T-Mobile. The core claim in these cases is that the Penalty Fees violate California consumer protection law prohibiting contractual penalties.[13]

Both Verizon Wireless and T-Mobile argued to the district courts that their practices of charging illegal Penalty Fees should be immune from challenge, because Section 332 of the Federal Communications Act preempts states from regulating "the entry of or the rates charged

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[11] *See* App., Ex. 13 at 1.

[12] *See* App., Ex. 14 at 1.

[13] Only the complaint against Verizon Wireless expressly challenges the practice of charging fees for removing the impairment of service ("reconnect" fee). But the plaintiffs in the other two actions intend to amend their complaints to challenge Sprint's and T-Mobile's impairment fees.

by" wireless providers.[14] Sprint did not move to dismiss the action based on the preemptive effect of Section 332. Sprint instead answered the complaint.

A. Verizon Wireless Penalty Fees Litigation

In 2007, a California consumer filed a class action lawsuit in federal court in the Northern District of California, alleging Verizon Wireless's terms and conditions, which include a late fee penalty provision, violates California law.[15] Specifically, plaintiff claims Verizon Wireless's practice violates Section 1671 of California's Civil Code.[16] Section 1671 was enacted to protect consumers from penalties imposed in standardized contracts. Section 1671 prohibits companies with superior power from using terms and conditions that include liquidated damage clauses to extract calculable or unsustained damages from consumers. Its purpose is to prevent punitive economic terms from being forced into contracts.[17]

California law has developed a two-part test to determine if a liquidated damage provision for an alleged breach in a consumer contract is an illegal penalty provision. The test looks at: (1) whether the amount of actual damages was extremely difficult or impracticable to fix; and (2) whether the amount selected was a "reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained."[18]

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[14] *See* 47 U.S.C. § 332(c)(3)(A).

[15] *Gellis v. Verizon Communications, Inc., et al.*, Case No. C 07-3679 (N.D. Cal.).

[16] *See* Cal. Civ. Code § 1671 ("Section 1671").

[17] Section 1671 in relevant part states:

> [A] party to a contract for the retail purchase or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes . . . . a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damages.

Cal. Civ. Code § 1671.

[18] *See Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 9 Cal. 3d 731, 739 (1973). In contrast, for California ***commercial*** contracts, liquidated damages provisions (such as late fees) are presumed valid, and the party seeking to invalidate them must prove that the provision was unreasonable at the time of contracting. Cal. Civ. Code § 1671(b).

Verizon Wireless violated Section 1671 because it is not difficult or impracticable for a wireless carrier to calculate the damages from a consumer paying late; it can simply calculate the time value of money based on the number of days after the due date that it receives payment. Verizon Wireless can also calculate the actual expenses incurred to collect payment.[19] Moreover, the parties never made a reasonable endeavor to estimate the damages caused by late payment when arriving at the Penalty Fees amounts.

Verizon Wireless moved to dismiss the complaint, claiming all state law claims are preempted by Section 332. On November 5, 2007, Judge Jeffery S. White denied Verizon Wireless's motion to dismiss. Judge White held that the state law claims were not preempted because Verizon Wireless's late fee was not a "rate" pursuant to Section 332.[20]

Judge White reasoned that the term "rate" is "an amount paid for a good or service" and consistent with preemption principles the term "must be construed narrowly."[21] Judge White in part rejected Verizon Wireless's argument for expansive reading of the term "rate" in this context because "the late fee is not charged in exchange for providing any service, but instead, is imposed as a penalty for failing to pay bills on time."[22] Judge White also rejected Verizon Wireless's preemption claim based on late fees being part of Verizon Wireless's "rate structure," observing that Congress could have preempted state regulation of any "charge" but chose to only preempt regulation of a more narrow subset of charges – i.e. "rates." After the motion to dismiss was denied, discovery proceeded during 2008.

As a result of facts learned in discovery in the Verizon Wireless case, plaintiffs amended their complaint in 2008 to include allegations that Verizon Wireless imposed an impairment fee

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[19] The complaint also alleges Verizon Wireless's fee violated other California consumer protection laws including the Unfair Competition Law ("UCL"), Cal. Bus. & Prof. Code §§ 17200, *et seq.*, and Consumers Legal Remedies Act ("CLRA"), Cal. Civ. Code §§ 1750, *et seq.*

[20] *See* App., Ex. 15 at 4.

[21] *See* App., Ex. 15 at 3 (citing *National Ass'n of State Util. Consumer Advocates v. FCC*, 457 F.3d 1238, 1254 (11th Cir. 2006) and *Black's Law Dictionary* 1268 (7th ed. 1999)).

[22] *See* App., Ex. 15 at 4.

that also was an impermissible contractual penalty. Verizon Wireless again attempted to invoke Section 332 to argue that this claim was preempted.

On March 18, 2009, Judge White denied Verizon Wireless's arguments concerning the preemptive scope of Section 332. Judge White held that Verizon Wireless's fee imposed for impairing a customer's service is "triggered by nonpayment, which, . . . Verizon Wireless concedes constitutes breach under the Customer Agreement."[23] Accordingly, the impairment fee is not a rate, but "more accurately falls within the 'other terms and conditions' not preempted by Section 332."[24]

B. Sprint and T-Mobile Penalty Fees Litigation

In November 2008, California consumers filed class actions similar to the Verizon Wireless litigation against Sprint and T-Mobile in the Northern District Court of California and Western District of Washington, respectively.[25]

Sprint did not move to dismiss the complaint on preemption grounds and instead answered the complaint on January 14, 2009. The parties commenced discovery.

T-Mobile moved to dismiss the lawsuit, making the same preemption arguments rejected by Judge White in the Verizon Wireless litigation. In addition, however, T-Mobile moved to stay the action pursuant to the primary jurisdiction doctrine, arguing that the Commission should, in the first instance, interpret Section 332 and issue a declaratory ruling as to whether T-Mobile's Penalty Fees are "rates" under the statute.

In so arguing to Judge Martinez, T-Mobile noted that Judge Martinez had previously referred cases challenging CMS providers' imposition of early termination penalties to the

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[23] *See* App., Ex. 16 at 9.

[24] *See* App., Ex. 16 at 4.

[25] *Thomas v. Sprint Nextel Corp.*, Case No. CV 08-4119 THE (N.D. Cal.); *Barahona v. T-Mobile USA, Inc.*, Case No. CV8 1631 RSM (W.D. Wash.). Another class action challenging T-Mobile's late fee practices under California law was originally filed in the Northern District of California and then transferred to the Western District of Washington. *Cardoza v. T-Mobile USA, Inc.*, No. 08-5120, 2009 U.S. Dist. LEXIS 25895 (N.D. Cal. Mar. 18, 2009).

Commission.[26] Plaintiffs argued that T-Mobile's motion to dismiss or stay should be denied for the same reasons that Judge White denied Verizon Wireless's motion and the issue was one of statutory interpretation which federal courts engage in commonly.

On May 15, 2009, Judge Martinez denied the motion to dismiss, but stayed the case and referred the matter to the Commission under the primary jurisdiction doctrine.[27]

Because plaintiffs believed the issue of interpreting the preemptive scope of Section 332 is properly within the province of the federal judiciary, they moved to certify Judge Martinez's stay order for immediate appeal to the Ninth Circuit. Judge Martinez denied this motion.

C. Sprint and Verizon Wireless Litigation Stayed Pending FCC Proceedings

After Judge Martinez stayed the T-Mobile action, Verizon Wireless moved to stay its action pending a decision by the Commission. Even though the Court twice ruled Section 332 does not preempt the claims challenging the Penalty Fees, on July 10, 2009, Judge White granted the motion to stay proceedings pending a ruling by this Commission.

Sprint, which did not argue Section 332 preempted plaintiffs' causes of action, also moved to stay the action pending the Commission's decision as a result of the referral in the T-Mobile action. On September 2, 2009, Judge Thelton Henderson denied Sprint's motion to stay claims that related to Sprint's failure to disclose the amount of its late fees, but granted the motion to stay as to the claims that Sprint's late fee violated California's prohibition against contractual penalty terms and conditions in consumer contracts.

IV. SECTION 332 DOES NOT PREEMPT STATE CONSUMER PROTECTION CLAIMS WHICH CHALLENGE CMS PROVIDER PENALTY FEES

There is a strong presumption against preemption under the Supremacy Clause.[28] "[B]ecause the States are independent sovereigns in our federal system, we have long presumed

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[26] *See Greene v. T-Mobile, USA, Inc.*, No. C-07-1563-RSM, 2008 U.S. Dist. LEXIS 12605 (W.D. Wash. Feb. 07, 2008) and *Sweetnam, et al. v. T-Mobile USA, Inc.*, No. 06-1463-RSM, Slip. Op. (W.D. Wash. June 14, 2007) (App., Ex. 17).

[27] App., Ex. 18 at 5.

[28] *See Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996).

that Congress does not cavalierly pre-empt state-law causes of action."[29] This presumption applies to the ***existence*** as well as the ***scope*** of preemption. *Id.*

Congressional purpose is the touchstone of preemption analysis.[30] Particularly in those areas that the states have historically occupied, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the ***clear and manifest purpose*** of Congress."[31] The California Supreme Court has recently reaffirmed that "consumer protection laws such as the UCL, false advertising law, and CLRA, are within the states' historic police powers and therefore are subject to the presumption against preemption."[32]

Congress's intent is primarily discerned from the language of the preemption statute and the statutory framework surrounding it.[33] "Also relevant, however, is the structure and purpose of the statute as a whole, as revealed not only in the text, but through the reviewing court's reasoned understanding of the way in which Congress intended the statute and its surrounding regulatory scheme to affect business, consumers, and the law."[34]

Here, all of these analytical factors militate against a finding of preemption.

A. Congress Unambiguously Preserved the States' Ability to Regulate Terms and Conditions of CMS Contracts, Billing Practices, and Consumer Protection Matters Which Include Penalty Fees

Section 332 expressly recognizes the states' historic police power to regulate consumer protection matters and intends for this power to be unaffected by passage of the statute. Section 332 explicitly preserves state law regulation of "the other terms and conditions of commercial

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[29] *Id.* All internal quotations and citations omitted and all emphasis added, unless otherwise indicated.

[30] *See Cipollone v. Liggett Group,* 505 U.S. 504, 516 (1992).

[31] *Medtronic*, 518 U.S. at 485.

[32] *Farm Raised Salmon Cases*, 42 Cal. 4th 1077, 1088 (2008).

[33] *Medtronic*, 518 U.S. at 486.

[34] *Id.*

mobile services." Section 332 thus narrowly carves out from state regulation only "market entry" and "rates charged."[35]

Legislative history demonstrates Congress did not intend for the states to be stripped of broad authority to protect consumers from various practices harmful to consumer welfare. Congress's intent for the states to retain broad consumer protection authority is supported by the fact that "terms and conditions" was intended to be interpreted expansively, as evidenced by the House Report on the Omnibus Budget Reconciliation Act of 1993, which enacted the relevant language in Section 332:

> It is the intent of the Committee that the states still would be able to regulate the terms and conditions of these services. By "terms and conditions," the Committee intends to include such matters as ***customer billing information and practices and billing disputes and other consumer protection matters*** . . . . This list is illustrative only and not meant to preclude other matters generally understood to fall under "terms and conditions."[36]

This express and expansive reservation of states' consumer protection authority supports a narrow interpretation of the term "rates charged."

There is no similar legislative evidence supporting a broad interpretation of the term "rates charged," and in fact, legislative evidence is to the contrary. For example, the "rates charged" language in Section 332 should be contrasted with the more broadly worded language found in Section 201(b) of the FCA, which covers all "charges" and "practices."[37] Congress could have used "charges" instead of "rates" if it intended to broadly put beyond state regulation all charges – including both rates and fees – to consumers of CMS. Congress did not do so.

And although Congress did not define the term "rate" in the statute, a basic rule of statutory interpretation requires courts and the Commission to "read the statute using the normal

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[35] In relevant part, Section 332(c)(3)(A) reads: "[N]o State or local government shall have any authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service, except that this paragraph shall not prohibit a State from regulating the other terms and conditions of commercial mobile services." 47 U.S.C. § 332(c)(3)(A).

[36] H.R. Rep. No. 103-111, 103rd Congress, 1st Sess., 1993, 261.

[37] *See* 47 U.S.C. § 201(b) ("Section 201(b)").

meaning of its words."[38] In applying a word's normal meaning, context must be a tethering guidepost. As the Supreme Court has cautioned, it is important not to label something a "rate" in a vacuum: "Rates . . . do not exist in isolation. They have meaning only when one knows the services to which they are attached."[39] And the Commission has followed the Supreme Court's guidance when it states that "a 'rate' has no significance without the element of service for which it applies."[40]

Reference sources define the word "rate" to mean "[a]n amount paid or charged for a good or service" or "a charge per unit of a public-service commodity."[41] Consistent with these definitions, courts have attached to the meaning of the word "rate" units of service or commodities, such as time or quantity.[42]

In the context of CMS, consumers pay a certain amount of money – set forth in CMS providers' rate plans – in exchange for certain allotment or usage of minutes to make mobile telephone calls. Similarly, in the fast-growing business of providing wireless data service, a "rate" applies to payment of money in exchange for a certain allotment or usage of "bytes" of data. Rate plans and consumer marketing materials often extensively set forth the various "rates" (price per package or usage of minutes or bytes of data).

For example, T-Mobile's individual rate plans offer consumers minutes of telephone service for between $39.99 and $59.99 per month – dictated by the number of minutes

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[38] *Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 457 F.3d 1238, 1254 (11th. Cir. 2006) ("*NASUCA*").

[39] *Am. Tel. & Tel. Co. v. Centraloffice Tel.*, 524 U.S. 214, 223 (1998).

[40] *In the Matter of Southwestern Bell Mobile Sys., Inc.*, 14 FCC Rcd 19898, 19906 (1999).

[41] *Black's Law Dictionary* 1268 (7th ed. 1999); Merriam-Webster Online Dictionary, http://www.merriam-webster.com/dictionary/rate (last visited Jan. 5, 2010).

[42] *See Ball v. GTE Mobilnet*, 81 Cal. App. 4th 529, 538 (2000) ("In the context of cellular service, the element of time can no more be divorced from rate than a clock from its hands."); *NASUCA*, 457 F.3d at 1254 ("a charge per unit of a public-service commodity"); *Pollice v. Nat'l Tax Funding, L.P.*, 225 F.3d 379, 391 n.11 (3d Cir. 2000) ("Webster's Third New International Dictionary defines a 'rate' as 'a charge per unit of a public-service commodity (as electricity, gas, water)'"). These definitions are consistent with the Commission's and Supreme Court's view that a "rate" must be in exchange for providing some unit of service. *Am. Tel.*, 524 U.S. at 223.

purchased.[43] Under one of these rate plans, if consumers exceed 500 minutes, they will pay a rate of $.045 for each additional minute of calling time.

What type of plan are you looking for?

Even More
Even More Plus
Prepaid
T-Mobile @Home
Internet & Email
Business

Plan Type
☑ Individual
☑ Family

T-Mobile Even More ℠ Plans

Pick your plan. Connect the way you want.

- Great phone discounts with 2 Year Contract
- FREE nationwide T-Mobile to T-Mobile calling
- FREE Nights and Weekends
- Whenever Minutes® you can use *whenever*

ZIP Code [go] To see all available plans, please enter the ZIP Code where you'll be using your phone the most.

Individual plans

Even More Individual Plans offer the outstanding combination of affordability and dependable nationwide coverage. Unlimited plans start as low as $59.99 per month. So now you can get even more of everything—except price.

compare

Even More Unlimited Talk	Unlimited Whenever Minutes Unlimited Nights and Weekends Unlimited T-Mobile to T-Mobile calling	$59.99	add to cart ☐ compare
Even More 1000 Talk	1000 Whenever Minutes Unlimited Nights and Weekends Unlimited T-Mobile to T-Mobile calling	$49.99	add to cart ☐ compare
Even More 500 Talk	500 Whenever Minutes Unlimited Nights and Weekends Unlimited T-Mobile to T-Mobile calling	$39.99	add to cart ☐ compare

T-Mobile also offers data plans under which consumers are allowed Internet access for between $29.99 and $49.99 per month. Once again, these rate plans are tiered based on data usage, such as quantities of megabytes or gigabytes. If consumers exceed the allotted amount of data, they will pay an additional rate.[44]

Internet Only Plans ↑ top

Want Internet access for your laptop or Windows Mobile® device? Get connected anywhere within the T-Mobile network with an Internet-only plan.
View Data Plan Terms

Plan name	Whenever Minutes	Data per month	E-mail per month	Price per month	
T-Mobile webConnect 200 MB Data Plan Lite	None	200 MB	N/A	$29.99	add to cart ☐ compare
T-Mobile Total Internet	None	Unlimited	Unlimited	$39.99	add to cart ☐ compare
T-Mobile webConnect 5GB Data Plan	None	5 GB	N/A	$49.99	add to cart ☐ compare

[43] *See* App., Ex. 19 at 1.

[44] *See* App., Ex. 19 at 2.

The other major CMS providers have a similar assortment of rate plans for wireless phone and data service.[45]

These are the "rates" – the provision of minutes of airtime, number of text messages, or bytes of data in exchange for an advertised price – that states may not regulate under Section 332.

In stark contrast, Penalty Fees are not tied to or charged in exchange for usage of minutes, text messages, or any other unit of any mobile phone service. Rather, the Penalty Fees in CMS provider contracts are intended to penalize consumers who purportedly breach the terms and conditions of service – namely the promise to timely pay for usage minutes or units of mobile phone service. The impairment fee is imposed as an additional penalty for a longer duration of nonpayment. Thus, these Penalty Fees are clearly not rates, but rather fall within "other terms and conditions" that Congress expressly intended for the states to continue to police through consumer protection laws of general application.

Finally, further statutory context demonstrates Section 332 does not operate to strip state law protections against unlawful billing practices. Section 414 of the FCA contains a savings clause that "[n]othing in this Act contained shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this Act are in addition to such remedies."[46] The "FCA's savings clause indicates that Congress intended to preserve state law causes of action for breaches of duties that do not exist under the Act."[47]

Thus, when tethered to the context in which the CMS industry operates, a straightforward reading of the phrases "rates charged" and "other terms and conditions" evidences the "clear and manifest purpose of Congress" to leave intact the states' broad ability to

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[45] *See* App., Exs. 20-22.

[46] 47 U.S.C. § 414 ("Section 414").

[47] *Shaw v. AT&T Wireless Servs.*, No. 3:00-CV-1614-L, 2001 U.S. Dist. LEXIS 6589, at *12 (N.D. Tex. May 18, 2001).

protect consumers from unlawful contract practices, such as regulating illegal contractual penalties.[48]

B. Courts Have Overwhelmingly Rejected CMS Providers' Preemption Arguments

Before staying the Verizon Wireless action, the district court reviewed the exact issues presented to the Commission and found Penalty Fees are not "rates" under Section 332. In rejecting Verizon Wireless's claim that late fees are "rates" and are therefore preempted from state regulation, Judge White held that the term "rate" must be construed narrowly. Judge White found to do otherwise would effectively find that "any charge imposed by a wireless carrier to recover costs and make profit would qualify as a 'rate,' regardless of whether it was imposed in exchange for providing [phone] service or not."[49] Judge White specifically held that "the late fee is not charged in exchange for providing any service, but instead, is imposed as a penalty for failing to pay bills on time."[50] Judge White reached the same conclusion in a separate order holding that Section 332 does not preempt state law claims challenging impairment fees. There he held that impairment fees are not rates but instead are triggered by a breach of contract. These are "other charges" that Congress expressly allows states to regulate.[51]

Similarly, in *Brown v. Washington/Baltimore Cellular*, the district court found "that late fees are not included in 'rates' of service, but rather are part of the 'other terms and conditions' of service."[52] The court in *Brown* rejected defendant's argument that Congress intended to preempt a reduction in late fee charges because it might result in an increase in rates for service. The court noted that such an expansive interpretation of "rates" would mean that "any legal claim that results in an increased obligation for Defendants could theoretically increase rates."[53]

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[48] *See Medtronic,* 518 U.S. at 485.

[49] *See* App., Ex. 15 at 5-6.

[50] *See* App., Ex. 15 at 4.

[51] *See* App., Ex. 16 at 6.

[52] *Brown v. Washington/Baltimore Cellular,* 109 F. Supp. 2d 421, 423 (D. Md. 2000).

[53] *Id.* at 423.

But it was not Congress's intent to "preempt all claims that would influence rates, but only those that involve the reasonableness or lawfulness of the rates themselves."[54]

Moreover, outside of the late fee context, the overwhelming weight of cases directly analyzing other penalty provisions in CMS contracts have held Section 332 does not preempt state regulation of contractual penalties in consumer contracts. Most of these cases are challenges to early termination penalties, where wireless providers charge a penalty for the early termination of a contract. No less than eight courts have rejected the argument that these penalties are "rates" under Section 332.[55]

Additional authority supports Petitioners' position as well. Courts and the Commission have repeatedly rejected an expansive reading of "rates." As reasoned by the court in *U.S. Cellular*, "any interference with [defendant's] business practices will increase its business expenses. . . . [which] would likely be passed on to customers as rate increases."[56] The court nevertheless, concluded that it could not have been Congress's intent that "'rate' included any action that indirectly induced rate increases, [as] the exception would be swallowed by the rule."[57] Other courts have similarly rejected interpreting "rates" expansively to include any state action that might have some effect on the charge to a consumer.[58]

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[54] *Id.*

[55] *See, e.g., Phillips v. AT&T Wireless,* No. 4:04-cv-40240, 2004 U.S. Dist. LEXIS 14544 (S.D. Iowa July 29, 2004); *Carver Ranches Washington Park, Inc. v. Nextel South Corp.*, Case No. 04-cv-80607 (S.D. Fla. Sept. 23, 2004) (App., Ex. 23); *Zobrist v. Verizon Wireless*, No. 02-Civ. 1000-DRH (S.D. Ill. Dec. 3, 2002) (App., Ex. 24); *Kinkel v. Cingular Wireless, LLC,* Case No. 02-999-GPM (S.D. Ill. Nov. 8, 2002) (App., Ex. 25); *Iowa v. United States Cellular Corp.*, No. 4-00-CV-90197, 2000 U.S. Dist. LEXIS 21656 (S.D. Iowa Aug. 7, 2000); *Cedar Rapids Cellular Tel., L.P. v. Miller*, No. C00-58 MJM, 2000 U.S. Dist. LEXIS 22624, at *21 (N.D. Iowa Sept. 15, 2000); *Esquivel v. Southwestern Bell Mobile Sys., Inc.*, 920 F. Supp. 713 (S.D. Tex. 1996). State courts have reached similar conclusions. *See, e.g., Pac. Bell Wireless, LLC v. California Pub. Util. Comm'n*, 140 Cal. App. 4th 718 (2006).

[56] *U.S. Cellular*, 2000 U.S. Dist. LEXIS 21656, at *19-*20.

[57] *Id.* at *20.

[58] *See NASUCA*, 457 F.3d at 1255 ("That [a] prohibition or requirement . . . has some effect on the charge to the consumer does not necessarily place a regulation within the meaning of 'rates' and outside the ambit of state regulation of 'other terms and conditions.'"); *Cedar Rapids*, 2000 U.S. Dist. LEXIS 22624, at *21 (rejecting a broad definition of "rate" that would allow any challenge to a wireless provider's conduct to "be couched in terms of its effect on rates").

And the Ninth Circuit recently confirmed that states are able to regulate line items on wireless consumers' bills, even if such regulation may cause a carrier to quote rates to customers on a tax-inclusive basis.[59]

The Commission has similarly rejected the argument that all matters impacting rates are preempted rate regulation. In *In the Matter of Wireless Consumers Alliance Inc.*, the Commission rejected arguments by the wireless carriers that awarding monetary damages was equivalent to rate regulation.[60] The Commission reasoned there is a significant difference between the indirect effect that monetary liability might have on a company's behavior and the direct effect of legislative or administrative rate regulation activities.[61] The Commission recognized Congress's intent in enacting Section 332 to promote the wireless industry's reliance on "competitive markets in which private agreements and other contract principles can be enforced."[62] It follows from this that in a competitive market wireless providers should be subject to the same generally applicable state contract and tort law claims as other businesses.[63] In subsequent litigation, the Commission "has disavowed the argument that a regulation with some effect on prices is per se rate regulation under Section 322 (c)(3)(A)."[64]

Against the heavy weight of this authority stand two cases, both of which do almost nothing to support a finding of preemption. The first is *Kiefer v. Paging Network, Inc.*[65]

The plaintiff in *Kiefer* alleged that a paging service company's late fee was unjust and unreasonable under Section 201(b).[66] Section 201(b) requires that "[a]ll charges, practices,

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[59] *See Peck v. Cingular Wireless, LLC.*, 535 F.3d 1053, 1057 (9th Cir. 2008).

[60] *In the Matter of Wireless Consumers Alliance Inc.*, 15 FCC Rcd 17021, 17034 (2000).

[61] *Id.*

[62] *Id.*

[63] *Id.* at 17034-35.

[64] *NASUCA*, 457 F.3d at 1256; *see also In the Matter of Petition of Pittencrieff Communications, Inc. for Declaratory Ruling Regarding Preemption*, 13 F.C.C.R. 1735, 1745 (1997) ("The Commission has found the 'rates charged by' language to prohibit states from prescribing, setting, or fixing rates of CMRS providers. We have not found, however, that it preempts state authority over matters which may have an impact on the costs of doing business for a CMRS operator.").

[65] *Kiefer v. Paging Network, Inc.*, 50 F. Supp. 2d 681 (E.D. Mich. 1999).

classifications, and regulations . . . shall be just and reasonable." But the district court in *Kiefer* never engaged in any statutory interpretation concerning preemption under Section 332 of the FCA. Rather, the issue the district court decided was whether to refer plaintiff's claim under Section 201(b) of the FCA to this Commission – which it did. The district court referred the question to the Commission because "the Sixth Circuit has determined that such questions [the reasonableness of charges and practices under Section 201(b)] should be determined, in the first instance, by the FCC."[67]

And when the Commission later addressed the district court's referral, it found "it appropriate to exercise our authority to address the complaint before us by limiting our ruling to the issues raised under section 201(b) of the Act."[68] Thus, neither the district court nor the Commission made any determination regarding the preemptive effect of Section 332 on state law at it relates to regulating CMS Penalty Fees.

In addition, there is a fundamental distinction underlying the *Kiefer* proceedings. There, the district court and the Commission focused on the reasonableness of a "charge" under Section 201(b), because the plaintiff brought a specific claim pursuant to Section 201(b). Thus, the focus of the analysis did not turn on the term "rate" under Section 332.

As noted by Judge White in the Verizon Wireless action, the reasoning applied in *Kiefer* is inapposite here because the finding that a fee constitutes a "charge" under Section 201(b) does not dictate whether that fee is a preempted "rate" under Section 332.[69] In fact, the district court in *Kiefer* highlighted the difference between the action pending before it based on Section 201(b) and a series of class actions regarding late fees in the cable industry involving only state law. To further support referral pursuant to the primary jurisdiction doctrine, the district court noted that those class actions in the cable industry benefited from the Commission's prior determination

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[66] *Id.* at 684.

[67] *Id.* at 685.

[68] *Kiefer v. Paging Network, Inc.*, 16 FCC Rcd 19129 (2001).

[69] *See* App., Ex. 15 at 6.

that late fees were not preempted under federal law.[70] Thus, not only was the district court in *Kiefer* silent on preemption, gleaning preemption from the court's rationale would be contrary to its view that the question of preemption was better addressed by the Commission in the first instance.

Nor does the second case, *Gilmore v. Southwestern Bell Mobile Systems, Inc.*, support a finding of preemption.[71] In finding plaintiff's challenge to an administrative fee preempted, the *Gilmore* court distinguished itself from *Brown* because *Gilmore* did not allege the administrative fee was "a charge for something other than [the] provision of cellular telephone services."[72] Instead, the plaintiff in *Gilmore* "explicitly raise[d] the issue of whether it received sufficient services in return for the Fee."[73]

Here, Petitioners allege that wireless providers impose late fees as a penalty for failing to make timely payment. There is nothing in Petitioners' claims that relates to assessing the value or sufficiency of any wireless service.

V. POLICY CONSIDERATIONS FAVOR ALLOWING STATES TO POLICE CONTRACTUAL PENALTY FEES

In addition to the statutory text and authorities interpreting the meaning of "rates" and "terms and conditions," state regulation of unlawful contractual penalties is consistent with policy goals set forth in the FCA. In fact preemption would have the opposite result by frustrating the goals of Congress to foster competition in the CMS industry. Further, preemption would unnecessarily interfere with the states' strong interest in protecting its citizenry, contrary to President Obama's stated policy against such acts by the Executive branch.

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[70] *Kiefer*, 50 F. Supp. 2d at 685.

[71] *Gilmore v. Southwestern Bell Mobile Systems, Inc.*, 156 F. Supp. 2d 916, 923 (N.D. Ill. 2001).

[72] *Id.* at 923 n.8.

[73] *Id.* at 924.

A. Penalty Fees Hurt Consumer Welfare, Contrary to the Congressional Purpose of the FCA

The FCA was in enacted in 1934 "[f]or the purpose of regulating interstate and foreign commerce in communication by wire and radio . . . ."[74] In 1993, Congress amended the FCA to add a new regulatory class for commercial mobile services. The House Report reflects that Congress was seeking to promote "interconnection" which "serves to enhance competition and advance a seamless national network." H.R. Rep. No. 103-111, at 261.

The legislative history of Section 332 makes clear Congress intended to allow the growth of a national network of wireless service through competitive market conditions, including rate competition. For example, the FCA requires the Commission to publish an annual report commenting on the state of competition in the wireless market place, including the number of competitors, whether there is effective competition, competitors' market share and the possibilities for the enhancement of competition.[75] Congress's purpose in preempting the regulation of "rates" was to allow market competition to drive efficiencies and dictate the rates for mobile phone services set by wireless providers in order to benefit consumer welfare.

But the challenged practices here, if allowed, are contrary to Congress's purpose in enacting the statute. There is no evidence that CMS providers engage in any competition concerning Penalty Fees or that market forces restrain Penalty Fees. This is obvious for several reasons.

Penalty Fees are not up-front pricing terms that consumers are likely to see and compare to other wireless providers at the beginning of the customer relationship. CMS providers do not market Penalty Fees as a service or a distinguishing feature. Penalty Fees are instead either not disclosed or inconspicuously buried in the fine print of the CMS providers' multi-page, non-negotiable legalese. By imposing Penalty Fees that far exceed the damages caused by late payment, CMS providers in effect protect from competitive market forces profits in the form of a

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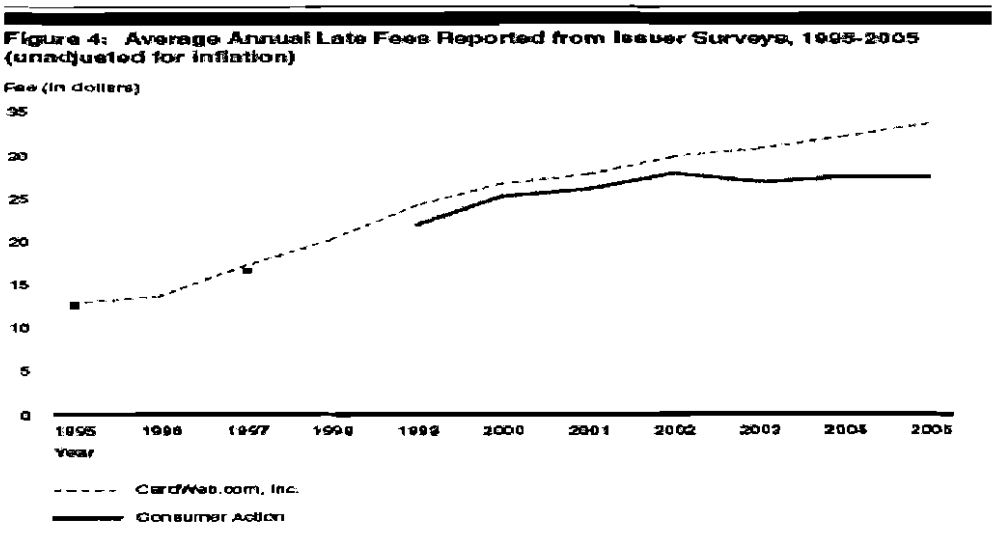
[74] 47 U.S.C. § 151.

[75] 47 U.S.C. § 332(c)(1)(C).

purported cost recoupment (e.g., the costs wireless providers purportedly expend to carry and collect the overdue balance). This practice is antagonistic to consumer welfare.

Rather than fostering competition for mobile phone services Congress intended by enacting the FCA, such hidden Penalty Fees actually defeat market competition. As is clear by both the FCA's and Section 332's legislative history and purpose, Congress did not intend to preempt generally applicable consumer protection laws and contract law governing billing practices.[76] Prohibiting state legislatures and courts from performing one their core functions – adjudicating contractual disputes – detracts from fair and robust competition. Wireless provider Penalty Fees are exactly the type of billing practice and consumer protection issue that Congress intended to be left to state regulation.

To see the potential harm to consumer welfare preemption could have here, one need look no further than the consumer experience in the credit card industry. After the Supreme Court in 1996 held in *Smiley v. Citibank* that states were preempted from regulating credit card late fees,[77] these fees dramatically increased by staggering proportions. As reflected in the chart below, prepared by the Government Accountability Office, after 1996 average annual late fees over a ten year period skyrocketed:[78]



[76] *See, e.g.*, 47 U.S.C. § 332(c)(1)(C); H.R. Rep. No. 103-111, at 261.

[77] *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996).

[78] App., Ex. 26 at 19.