means to allocate certain special access or private line costs to the intrastate or the interstate jurisdictions when such facilities carry both intrastate and interstate traffic. The Part 36 separations process, at the time the 10% Rule was adopted, applied to dominant carriers, such as the Bell Operating Companies and other large incumbent local exchange carriers.[25] The separations process has never been applied by the Commission to competitive carriers such as XOCS.

Even if it were to apply, USAC has the presumption exactly backwards. Physically intrastate private line circuits are intrastate *unless* the carrier presents evidence (such as through a certification) that more than a *de minimis* amount of traffic on the circuit is interstate.

2. The History and Purpose of the 10% Rule Are at Odds with USAC's Presumptions

The history of the 10% Rule illuminates its proper interpretation and why USAC is incorrect in its interpretation of the rule. When considering adoption of the 10% Rule in 1989, the Commission noted that, previously, "the cost of special access lines *carrying both state and interstate traffic* [had been] generally assigned to the interstate jurisdiction."[26] The Joint Board appointed to study the issue concluded that this approach "tended to deprive state regulators of authority over largely intrastate private line systems carrying only small amounts of interstate

statements regarding the remainder of the Dedicated Transport Services at issue are not equally probative as the similar statements he made regarding the school system.

25 *See In re: Jurisdictional Separations and Referral to the Federal-State Joint Bd.,* 16 FCC Rcd 11382, 11384 (2001).

26 *MTS and WATS Market Structure, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, 4 FCC Rcd 1352, ¶1 (1989) (emphasis supplied) ("Recommended Decision").

traffic."[27] Consequently, the Joint Board recommended that the Commission adopt separations procedures for private lines and that such lines be allocated to the intrastate jurisdiction, unless there is a showing "through customer certification that each special access line carries *more than a* de minimis *amount of interstate traffic*."[28] Thus, contrary to USAC's application of the 10% Rule here, the Joint Board did ***not*** recommend that there be a presumption that a private line was interstate in nature unless there was a clear demonstration to the contrary. Rather, the Joint Board recommended quite the opposite, namely that, *where a private line carried both intrastate and interstate traffic, the line be allocated to the interstate jurisdiction* ***only*** *if there was a certification or other basis to conclude that the line carried* ***more than a certain amount of interstate traffic.***

Because, twenty years ago, the Joint Board sought to address a perceived problem of excessive interstate allocation, its recommendation, distilled to its essence, was that absent certification of more than 10% interstate use, the line should be treated as *intrastate* when the end points are located within the same state. The Joint Board noted that the "typical situation involves physically intrastate systems carrying very small amounts of interstate traffic."[29] The Commission adopted the Joint Board's recommendations later that same year without modification to the recommended 10% Rule.[30]

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27 *Id.*

28 *Id.* at 1357, ¶32 (emphasis added).

29 *Id.*

30 *MTS and WATS Market Structure, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board,* 4 FCC Rcd 5660, ¶ 3 (1989).

As discussed herein, XOCS does not claim that all of its geographically intrastate circuits be treated as intrastate. Where physically intrastate Dedicated Transport Services are sold to a reseller, an ISP, or other Carrier Group customers, even if not exempt, XOCS has treated those circuits as interstate.[31] But, in the remaining cases, where XOCS had configured the Dedicated Transport Services circuits to support communications only between a single customer's locations or the locations of a closed user group, and where XOCS did not have any evidence to the contrary, XOCS – consistent with the 10% Rule as adopted – treats the traffic as intrastate. (Notably, the Joint Board recognized that indications of the jurisdiction of a private line would be "system configuration" and "the nature of [a customer's] communications needs."[32])

Since 1989, the Commission has reaffirmed that certification is required to establish the *interstate* jurisdiction of a dedicated circuit that otherwise is ostensibly *intrastate* in nature due to the end points. For example, in 1995 the Commission summarized its rule regarding the jurisdiction of mixed-use private lines as follows: "a subscriber line is deemed to be interstate *if the customer certifies that ten percent or more of the calling on that line is interstate*."[33]

31 Carrier's Response to XOCS Product and Jurisdiction DAF at 18.

32 *Recommended Decision.* at 1357, n.137.

33 *Petition for an Expedited Declaratory Ruling filed by National Association for Information Services, Audio Communications, Inc., and Ryder Communications, Inc.*, 10 FCC Rcd 4153, 4161, ¶17 (1995) (emphasis added). In this case, the Commission articulated the 10% Rule as requiring a showing that "10% or more" of the traffic is interstate rather than "more than 10%" of the traffic is interstate. The distinction is not relevant in resolving XOCS' appeal, and XOCS summarizes the rule as requiring a showing that more than 10% of the traffic is interstate as do the 2008 Form 499-A Instructions.

Three years later, when faced with the question of whether GTE's DSL line service should be tariffed before the Commission or at the state level, the Commission applied the 10% Rule to conclude that these services were interstate.[34] Critical to this conclusion was the Commission's finding that "GTE will ask every ADSL customer to certify that ten percent or more of its traffic is interstate."[35] In other words, GTE - unlike XOCS here - configured the lines to carry more than a *de minimis* share of interstate traffic and intended to require corroborating certifications.

Most recently, in 2001, the Commission reaffirmed the continued use of the 10% Rule in the context of Part 36 based on an affirmative certification of *more than 10% interstate use*. The Commission explained that, under the rule, "mixed-use lines would be treated as interstate *if the customer certifies that more than ten percent of the traffic on those lines consists of interstate calls*."[36]

As the foregoing makes clear, the Commission has repeatedly and consistently held that the interstate treatment of a private line with A and Z points in the same state requires certain conditions to be satisfied. First, the 10% Rule only comes into play if a private line carries ***both*** intrastate and interstate traffic. Second, under the 10% Rule, a line may be considered jurisdictionally interstate ***only if*** the customer has certified that more than ten percent of the traffic on that line is interstate in nature. Significantly, the Commission has never

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34 *GTE Telephone Operating Cos., GTOC Transmittal No. 1148*, 13 FCC Rcd 22466, 22481 (1998).

35 *Id.* n.95.

36 *MTS and WATS Market Structure, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, 16 FCC Rcd 11167, ¶ 2 (2001) (emphasis added).

indicated that under the 10% Rule there is a presumption that a private line is interstate in the absence of a certification or other circuit-specific affirmative evidence that 90% or more of the traffic is intrastate.

3. USAC's Application of the 10% Rule Is Incorrect

Given the foregoing history of the 10% Rule, USAC's application of such a presumption is plainly wrong. If USAC's presumption were correct, the Joint Board's 1989 recommendation, which the Commission adopted, would be inexplicable. The goal of the Joint Board recommendation was to preserve *state* regulatory authority over physically intrastate private lines absent evidence that more than a *de minimis* amount of interstate traffic was being carried. USAC's presumption assigns *federal* jurisdiction to these intrastate private lines absent a traffic study that is infeasible to conduct.[37] Furthermore, GTE, in the tariff decision discussed earlier, to name another example, would not have needed to collect customer certifications regarding the interstate use of DSL. Instead, were USAC's application of the 10% Rule correct, the Commission would have explained, in finding GTE's DSL service jurisdictionally interstate, that the jurisdictional nature of the line, by default, is interstate and certifications would be required only if more than 90% or more of the traffic was *intrastate*. However, as noted above, the Commission instead underscored that GTE obtained certifications that more than 10% of the traffic was *interstate* and, on that basis, concluded that GTE's DSL product was interstate.

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[37] USAC personnel indicated that proper customer certifications *might* be sufficient to determine the jurisdiction of the circuits. However, due to the large number of customers involved and the significant time period that has elapsed since the audit period, it would be impractical for XOCS to seek such certifications for the revenues at issue.

The 10% Rule, then, is more properly read as creating a presumption that the revenues from a physically intrastate private line are to be treated as intrastate absent evidence that the traffic carried over the line is more than 10% interstate. Indeed, and perhaps most significantly for the present appeal, this is effectively how the 2008 Form 499-A instructions read: "*If over ten percent of the traffic carried over a private or WATS line is interstate, then the revenues and costs generated by the entire line are classified as interstate.*"[38] By treating *every* Dedicated Transport Services circuit that *may* be configured by the customer to tie into an interstate line or service as one that *is in fact* tied into such an interstate line or service and *presuming* that more than 10% of the circuit's traffic is interstate, without any supporting evidence, the USAC Board not only ignores how the Commission's 10% Rule was created and has been interpreted, it ignores the 499-A Instructions for the year of the audit. In fact, USAC even recognized that, if a private line that is physically intrastate is tied to an interstate circuit, it does not automatically mean that more than 10% of the traffic over the physically intrastate circuit is interstate.[39] In the absence of documented contrary evidence that physically intrastate Dedicated Transport Services circuits of its business customers were being used for interstate

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[38] 2008 499-A Instructions III.C.3. (emphasis supplied).

[39] Specifically, on page 27 of IAD's Response, IAD explained that "If traffic travels from the start point across the private line circuit with points in the same state and then travels across a private line circuit with a point in another state, the traffic being carried on the circuit with points in the same state would still be classified as interstate traffic, *which may require the circuit with points in the same state to be classified as interstate under the 10% rule.*" (emphasis added) *See also id.* at 30-31 ("the introduction of one interstate circuit to a predominantly intrastate WAN allowing interstate communications creates the *potential* for multi-use circuits carrying more than *de minimis* amounts of interstate traffic." (emphasis added))

purposes, therefore, XOCS reasonably and justifiably treated revenues from such circuits as intrastate.[40]

Indeed, USAC's application of the rule to create an interstate presumption contradicts *NARUC v. FCC*, the very precedent that it had relied upon.[41] Consistent with the authorities XOCS cites in the foregoing paragraphs, the *NARUC* case, rather than creating the presumption that a physically intrastate private line is interstate, absent other evidence, requires evidence that there is interstate traffic on the circuit before the interstate jurisdiction is proper: "Every court that has considered the matter, however, has held that the physically intrastate location of that service does not preclude FCC jurisdiction *so long as the service is used for the completion of interstate communications* . . . ."[42] USAC would have the Commission forego the need for affirmative evidence that "the service is used for the completion of interstate communications" and instead presumptively assert interstate jurisdiction over physically intrastate private lines, in essence turning the split intrastate and interstate jurisdiction over communications in this country reflected in section 2(b) of the Communications Act of 1934, as

40 Carrier's Response to XO Product and Jurisdiction DAF at 19. Inexplicably, despite the clear evidence of Mr. Alexander's explanations, USAC faulted XOCS for an alleged lack of "a complete understanding of each of its customers' network topology and design." USAC IAD Response to XO Product and Jurisdiction DAF at 30 and 31. Indeed, without justification, USAC claimed that XOCS presented "no additional evidence . . . to IAD to support that 10% or less of the traffic is interstate." USAC IAD Response XO Product and Jurisdiction DAF at 27. What USAC seems to be saying is that XOCS must become expert not in the services it provided but in all aspects of the customers' use of such services by each of its many business customers. This raises too high a bar for providers of telecommunications.

41 *NARUC v. FCC,* 746 F.2d 1492, 1498 (D.C. Cir. 1984) *cited in* USAC IAD Response to XO Product and Jurisdiction DAF at 30.

42 746 F.2d at 1498 (emphasis added).

amended, on its head.[43] According to USAC, services are to be treated as intrastate only if they are accompanied by "document[ation of a] *de minimis* amount of interstate traffic."[44]

Even where Dedicated Transport Services facilities with end points in one state are configured in a manner that may allow for interstate as well as intrastate traffic, the 10% Rule is clear. Only where there is customer certification or proof that more than 10% of the traffic is interstate will the facility be considered interstate in jurisdiction. Here, such certifications by XOCS's customers for the circuits at issue are not in XOCS's possession or in evidence.[45] But USAC has nonetheless failed to explain why, in the absence of such certifications, the Dedicated Transport Services revenues at issue should be treated as interstate.[46]

In short, USAC's presumption that XOCS's Dedicated Transport Services with end points within one state are presumptively interstate turns the 10% Rule on its head, and would, effectively, turn the clock back more than twenty years and reinstate the *status quo ante* that existed prior to the Joint Board's recommendation and the Commission's Order in 1989 adopting the 10% Rule.

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43 47 U.S.C. §152(b).

44 USAC IAD Response to XO Product and Jurisdiction DAF at 30.

45 XOCS confirms that it did not receive such certifications from its business customers regarding 2007 usage.

46 USAC correctly points out that XOCS is required to maintain any documentary evidence used to support its completion of Form 499-A for five years. *See* USAC Final Response to XO Product and Jurisdiction DAF at 42. XOCS provided USAC with all of the documentary evidence in its possession supporting or bearing on the question of the proper treatment of Dedicated Transport Services revenues. However, while XOCS may not have the precise evidence which USAC sought – namely customer certifications – regarding Dedicated Transport Services, that does not change the fact that Dedicated Transport Services circuits that are physically intrastate and configured as closed networks are to be treated as intrastate unless there is a customer certification or other evidence that *more* than 10% of the circuits are used for interstate communications.

4. <u>**The 10% Rule Is Inapplicable in Any Event Because the XOCS Dedicated Transport Services Circuits at Issue Do Not Carry Mixed-Use Traffic**</u>

As explained above, USAC improperly read a presumption in the 10% Rule that, absent affirmative circuit-specific evidence that 90% or more of the traffic on a private line is intrastate, the circuit and the revenues therefrom should be treated as 100% interstate. Assuming *arguendo* that the interstate presumption was appropriate – which it is not -- the 10% Rule should not be applied to the Dedicated Transport Services that XOCS has classified as intrastate because there is no evidence the circuits are mixed-use circuits, carrying both interstate and intrastate traffic. To the contrary, the manner in which they were configured leaves no room for a presumption that there is *any* interstate traffic on the circuits. Accordingly, the 10% Rule should not even apply.

As noted above, the 10% Rule was designed to allocate the costs, under Part 36 of the Commission's Rules, of mixed-use facilities to the interstate jurisdiction if the customer provided a certification that more than 10% of the traffic on the facility would be interstate in nature. Indeed, without even first establishing a reasonable basis for presuming that the facilities carry *any interstate communications*, USAC's auditors proceeded to classify all of these facilities by default as 100% interstate. The 10% Rule applies only to facilities that, in the first instance, are already known to be mixed-use facilities. As the discussion in previous sections makes clear, the Dedicated Transport Services circuits in question are *not* known – by XOCS *or USAC* – to be mixed-use circuits.

In applying the presumption here, USAC appears willing to overlook that XOCS reasonably relied on knowledge of its customers' businesses and networks to determine the jurisdictional nature of the services. For the circuits in question here, XOCS treated as intrastate those revenues from physically intrastate DTS circuits of its business customers that were configured by XOCS for intrastate use only.[47] Due to their configuration, XOCS explained that the circuits were not likely to carry mixed-use traffic.

XOCS acknowledges that physically intrastate Dedicated Transport Services circuits *could theoretically* be linked by the end users to separately-provided (*i.e.*, third party or end user-owed) private line circuits or other services that allowed interstate communications to be carried over the XOCS Dedicated Transport Services circuits.[48] However, XOCS explained through the Declaration of Matthew Alexander that XOCS had configured the physically intrastate Dedicated Transport Services circuits in question *as closed systems* and had no information that any of these Dedicated Transport Services were connected to any interstate facilities or circuits.[49] Thus, XOCS submits it presented sufficient evidence that the "system

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47 Carrier's Response to XO Product and Jurisdiction DAF at 19; *see also discussion id.* at 9-10, 12, 16-19.

48 *See* Carrier's Response to XO Product and Jurisdiction DAF at 19, *Alexander Declaration*, ¶15; *cf.* USAC IAD Response to XO Product and Jurisdiction DAF at 31.

49 Indeed, it would appear that USAC conjured up yet another presumption that is neither the Commission's rules nor the 499-A Instructions. USAC stated that XOCS must presume (rebuttably) that the physically intrastate Dedicated Transport Services circuits of its customers are used for a substantial amount of interstate use where those same customers buy separate interstate circuits from XOCS. *See* USAC IAD Response to XO Product and Jurisdiction DAF at 31. IAD explained that "[u]pon review of the Carrier's Ethernet points report there were many circuits that the Carrier had identified as intrastate that were associated to [sic] a customer that also had circuits identified as interstate." USAC IAD Response to XO Product and Jurisdiction DAF at 31. USAC overlooks the fact that a customer can simultaneously have separate requirements for both interstate and intrastate services. In other words, the mere fact that a customer purchases both intrastate and interstate services, even if obtained from the same carrier, is not evidence that the two services are linked together operationally by the customer. Yet, this is the very leap that IAD made when it contended in support of its findings that separate purchase of an interstate circuit "again creates the potential for multi-use circuits that physically originate and terminate within the same state to carry more than 10% traffic, meaning

design and functions" of Dedicated Transport Services configured by XOCS allowed for intrastate use only.[50]

USAC tried improperly to bypass the threshold issue of mixed-use by *presuming, in effect, that all private lines are mixed-use*, unless definitely shown not to be. In the Audit Report, USAC stated that "[f]acilities that *may* carry both interstate and intrastate traffic are considered 'mixed-use.'"[51] In practice, as shown by USAC's audit of XOCS, USAC presumes that all private lines are mixed-use, unless all the traffic carried is affirmatively shown to be only intrastate or interstate *in toto*. The proper approach for USAC would have been to require some evidence that the facilities carry both intrastate and interstate traffic before finding they are mixed-use and applying the 10% Rule. Accordingly, the Commission should conclude that by presuming that all Dedicated Transport Services circuits are mixed-use, USAC misapplied the 10% Rule to those Dedicated Transport Services circuits that XOCS classified as intrastate.

5. Ratification of USAC's Presumptions Would Have Adverse Consequences

If the 10% Rule operated as USAC believes, the states would be forced to abdicate regulatory authority over private lines fully contained within their boundaries. This would result in a drop in the reporting of intrastate revenues associated with such dedicated, non-switched services and have a corresponding adverse impact on intrastate regulatory charges. Notably, in 2007, XOCS treated Dedicated Transport Services with end points within the same

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that they should be classified as interstate." USAC IAD Response to XO Product and Jurisdiction DAF at 31.

[50] *See Final 10% Order,* 4 FCC Rcd 5660, ¶6, n.7, *cited in* USAC IAD Response to XO Product and Jurisdiction DAF at 28.

[51] XO Product and Jurisdiction DAF at 29 (emphasis added).

state as intrastate for all relevant purposes, including reporting and assessment, collection, and remittance, as appropriate, of state taxes and surcharges. Moreover, where such Dedicated Transport Services were provided in states that assess for a state universal service fund, XOCS made USF payments for 2007.[52] In addition, prospective contributions to support state programs would be significantly reduced.

USAC criticizes XOCS for not providing invoices showing state universal service fund surcharges in support of XOCS's statements that it contributed to state universal service funds on the basis of Dedicated Transport Services revenues.[53] However, XOCS points out that, as with the federal USF, the state universal service funds to which XOCS is required to contribute leave it to the carrier whether to pay contributions from service revenues or to recover the amount of contributions from a separate surcharge. If USAC were correct, XOCS would be entitled to refunds from state universal service funds for prior contributions and have a potential right to recover from state coffers other state regulatory fees, taxes, and surcharges paid with respect to the reclassified private lines, the revenues from which are belatedly classified as interstate.

Given the Commission's consistent requirement that certification is a precondition to treating a private line with end points in a single state as interstate, rather than the

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[52] *See* Letter to Colleen Grant, USAC from Steve Augustino, Kelley Drye & Warren LLP (Mar. 1, 2010), *attaching* XOCS Response to Detailed Audit Finding No. 3, XO Product and Jurisdiction at 9. ("XOCS Initial Response – XO Product and Jurisdiction DAF"). *See also*, XOCS Initial Response – XO Product and Jurisdiction DAF, Exhibit 8 – "Intrastate Taxes for DTS". (This Exhibit is available upon request). XOCS has identified customer invoices containing these state charges and these invoices can be provided upon request.

[53] *See* USAC Final Response to XO Product and Jurisdiction DAF at 41.

other way around, USAC's audit conclusion reclassifying Dedicated Transport Services as interstate should be reversed. USAC is plainly wrong in contending that, effectively, the revenues from a private line automatically are interstate revenues unless there is a customer's certification or other affirmative circuit-specific evidence that 90% or more of traffic on that private line is intrastate. This is particularly true where there is no basis for concluding, based on how the Dedicated Transport Service is configured, that any of the traffic on a Dedicated Transport Service circuit is interstate. To the contrary, under the 10% Rule properly applied, absent a certification or other evidence that more than 10% of the traffic over a geographically intrastate Dedicated Transport Service is interstate, USAC should treat the revenues from any such private line as intrastate.[54]

III. <u>ISSUE: DID XOCS APPROPRIATELY CLASSIFY REVENUE FROM SIX RESELLER CUSTOMERS WHERE XOCS RELIED ON "OTHER RELIABLE PROOF" TO DEMONSTRATE THE CUSTOMER'S RESELLER STATUS?</u>

XOCS seeks *de novo* review of USAC's treatment of revenues XOCS received from six resellers during the audit year. XOCS seeks review of USAC's reclassification of this reseller revenue from Block 300 (wholesale revenues) to Block 400 (end user telecommunications revenues). The amount that was reclassified is **[REDACTED]**

[REDACTED] (Reseller DAF p. 23).

XOCS highlights that this appeal is the latest iteration of a question repeatedly raised in USF appeals before the FCC, namely the standard that wholesale carriers must satisfy in order to classify revenues as reseller revenue in block 300 of the FCC Form 499-A. The

[54] If the Commission were to change the 10% Rule and establish a presumption *absent certification* that a line is interstate, the impact on USF contribution obligations would be prospective only.

Wireline Competition Bureau addressed this question most recently in orders issued in October 2010 involving Network Enhanced Telecom LP[55] and in August 2009 involving Global Crossing Bandwidth, Inc.[56] An application for review is pending of the latter decision.[57] In addition, the question is pending in a number of appeals presently before the Bureau, including:

> ILD Telecommunications, Inc. and Intellicall Operator Services, Inc., WC Docket No. 96-45 (filed 03/31/06) (supplemental appeal filed 06/05/06)
>
> IDT Corp. and IDT Telecom, WC Docket No. 96-45 (filed 04/10/06) (filing years 2003-05)
>
> IDT Corp. and IDT Telecom, WC Docket No. 96-45 (filed 06/30/08) (filing years 2006 and 2007)

XOCS's experience is consistent with the experiences of the wholesale carriers in the above appeals. USAC has been applying an increasingly unrealistic standard for the classification of revenues as "carrier's carrier" revenues. The resulting rigidity with which USAC approaches the issue has imposed on wholesale carriers a virtually insurmountable burden to support its classification. XOCS submits that the Commission must reign in USAC's aggressive interpretation and restore the allocation of responsibility between wholesale and retail providers that was established in the *Universal Service Orders*.[58]

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55 *In re Universal Service Contribution Methodology; Request for Review of Decision of the Universal Service Administrator by Network Enhanced Telecom, LLP*, DA 10-2005 (WCB Oct. 19, 2010) ("NetworkIP Order").

56 *Request for Review of Decision of the Universal Service Administrator by Global Crossing Bandwidth, Inc.*, Order, 24 FCC Rcd 10824 (2009) ("Global Crossing Order").

57 Global Crossing Bandwidth, Inc., Application for Review, WC Docket No. 96-45 (filed Sept. 16, 2009).

58 *Federal-State Joint Board On Universal Service*, 12 FCC Rcd 8776, ¶¶ 844, 846-847 (1997).

A. Statement of Facts

XOCS is one of the largest wholesale providers of telecommunications services in the country. During the time period at issue, XOCS's customers included some of the country's largest carriers such as **[REDACTED]** **[REDACTED]** as well as a host of other smaller wholesale and retail carriers.

When providing wholesale services to other carriers, XOCS followed long-standing documented procedures for identifying the services provided by its customers and for confirming that the customers contributed directly to the FCC's USF program.[59] Upon receipt of a request for a USF exemption, XOCS's Customer Care or Sales department would send an exemption certificate that included language confirming that (a) the customer was purchasing telecommunications services for resale as telecommunications to end users (or to customers that in turn resold them to end users) and (b) the customer (or its own wholesale customers) would contribute directly to the USF. The exemption language complied with the guidance provided in the FCC Form 499-A Instructions and was sufficient to confirm that the customer was a reseller of telecommunications services and could be expected to contribute directly to the USF.

XOCS's Tax department evaluated all exemption certificates for completeness and returned to the customer any certificates that were incomplete or otherwise invalid. All complete certificates were retained for future reference.[60]

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59 *See* Declaration of Earl Espejo at 1-2. ("Espejo Declaration"). Attached hereto as Exhibit 4.

60 *Espejo Declaration* at 1-2.

During the audit, USAC initially proposed to reclassify virtually *all* of XOCS' reseller revenues to end user revenues, on the grounds that XOCS "did not obtain valid annual USF certificates from its resellers each year" and had not "provide[d] documentation from the FCC website to support the classification of its customers as resellers for the period audited."[61] USAC staff told XOCS that USAC did not find fault with the *substance* of the certifications that XOCS possessed, but instead based the revenue reclassification on the fact that the certifications were not signed in the year in which revenues were reported.[62] USAC's auditors also did not appear to consider other evidence indicating that the entities qualified as resellers; instead, USAC only tested whether XOCS could fully document compliance with the safe harbor instructions in the Form 499-A.

During the review process following USAC's initial audit findings, XOCS provided additional evidence and legal argument to show that XOCS had reason to believe its reseller customers qualified either as retail carriers that contribute directly to the USF or as intermediate wholesale carriers whose customers, in turn, contribute directly to the USF. This information has narrowed the present dispute to a handful of resellers where USAC contends that the customers are not, in fact, contributors to the USF. USAC explained:

> Based on the information available, USAC was able to determine whether the Carrier's reseller customers were USF contributors or non-contributors. USAC divided the Carrier's reseller customers based on whether they contributed to the USF as reflected in USAC's records. Revenue associated with non-contributors was

61 Reseller DAF, at 4. The Reseller DAF is attached hereto as Exhibit 1.A.

62 *Id.* at 8-9.

> reclassified as end user (Block 4) revenue and included in the Carrier's contribution base.[63]

For the non-contributors, USAC rejected the evidence XOCS presented to support the "reasonable expectation" standard. First, USAC rejected the certifications XOCS had in hand prior to the audit as "outdated certifications."[64] Second, USAC contended that it was "inappropriate" for XOCS to submit confirmatory certifications for these entities because "USAC records" indicate that the resellers in question were non-contributors.[65] Finally, USAC rejected the remainder of the argument and evidence submitted by XOCS because XOCS "does not satisfy the established standards for classifying its revenue as reseller revenue."[66]

At this time, the resellers in question are few, and the reseller revenue that USAC proposes to reclassify as end user revenue is **[REDACTED]**

[REDACTED][67]

B. Summary of Argument

The FCC recently confirmed that filer compliance with the Form 499-A Instructions is not mandatory to meet the "reasonable expectation" standard. Specifically, wholesale carriers may classify a customer as a reseller after reliance on the verification procedures in the Instructions or based on "other reliable proof" of a customer's reseller status.

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63 *Id.* at 38.

64 *Id.* at 39.

65 *Id.* at 38. As explained in the text above, USAC treated the confirmatory certifications from *contributors* as "Other Matter No. 2" in the Audit Report and did *not* reclassify revenue associated with the contributing resellers at this time. USAC's treatment of confirmatory certifications from contributors is not implicated in this appeal.

66 *Id.* at 36.

67 *Id.* at 23.

Despite these clear statements from the FCC, USAC persists in treating the Form 499-A instructions as the only acceptable method of classifying reseller revenues. Specifically, the Audit Report asserts:

> ***[USAC] rejects the Carrier's contention that the Instructions are merely guidance.*** In the *Global Crossing Order*, the FCC recognizes that the Instructions "have been updated" and "modified" to reflect FCC rulings, court decision, and the FCC's rules and regulations. ***Indeed, in nearly every instance, the Instructions can be traced to the FCC's rules or applicable precedent.***
>
> The ***FCC has consistently treated the instructions as binding*** and instructed "contributors to report their end-user telecommunications revenues to the Universal Service Administrative Company (USAC) in accordance with the instructions and requirements set forth in the Telecommunications Reporting Worksheet (FCC Form 499)." [68]

In light of USAC's continued insistence on treating the Instructions as binding, the Commission cannot have confidence in USAC's evaluation of XOCS's classification of its reseller revenues. USAC is overstepping its boundaries as the USF administrator and failing to heed the Bureau's directions. The Commission must reign in this unlawful stance at once.

The record in this proceeding shows that XOCS relied on a combination of evidence to classify the resellers in question. With respect to these carrier customers, XOCS had reliable proof that the customer incorporated purchased telecommunications service into its own telecommunications offerings and that the reseller (or, in turn, the reseller's customers) could reasonably be expected to contribute directly to the USF based on those revenues.

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[68] Reseller DAF, at 16 (internal citations omitted) (emphasis added).

USAC's interpretation imposes an unreasonably high burden on the wholesale carrier. Not only does this burden in effect make the wholesale carrier a guarantor of its customers' compliance with FCC obligations, but it inevitably leads to unlawful double recovery of USF from the same subject revenues. The Commission should prevent USAC from pursuing double recovery in the future by clarifying that a wholesale carrier satisfies its obligation to identify resellers when it has a "reasonable expectation" that a reseller will contribute even if the reseller ultimately does not contribute to the Fund.

C. The Form 499-A Instructions are Non-Binding Guidance for Determining a Customer's Reseller Status and Filers May Use Other Means to Demonstrate a Reasonable Expectation that Their Reseller Customers Will Contribute to the USF

When completing the FCC Form 499-A, filers are required to report information on revenues from resellers and end user customers. A reseller is defined as "a telecommunications carrier or telecommunications provider that: 1) incorporates purchased telecommunications services into its own telecommunications offerings; and 2) can reasonably be expected to contribute to federal universal service support mechanisms based on revenues from such offerings when provided to end users."[69] The 499-A Instructions outline one method for determining if a reseller customer will contribute directly to the USF. This "safe harbor" verification method requires the filer to obtain a reseller certification on an annual basis, gather the customer's Filer 499 ID; legal name; address; name of a contact person and phone number of

69 Telecommunications Reporting Worksheet, FCC Form 499-A Instructions at 19 (2010) ("Instructions").

the contact person and check the FCC's own online USF contributor database to confirm the customer is identified as a contributor.[70]

1. <u>The FCC Has Made Clear that the Form 499-A Instructions are Non-Binding Guidance for Use in Determining a Customer's Reseller Status</u>

The FCC has consistently stated that the Form 499-A Instructions provide guidance and are not the only or mandated means for determining a customer's reseller status. In fact, and as the Instructions note, wholesale carriers may use other means of establishing a reasonable expectation that a reseller customer will contribute directly to the USF for the purpose of classifying reseller revenues on the Form 499-A. In the *NetworkIP Order* released less than three months ago, the Bureau acknowledged that "the Commission does not dictate what procedures a carrier must implement to meet the 'reasonable expectation' standard, the agency has provided guidance in the FCC Form 499-A instructions to assist wholesale carriers regarding how to satisfy the reasonable expectation standard."[71] Similarly, in its 2009 *Global Crossing Order*, the Bureau explicitly stated that "Global Crossing is correct that the 2005 FCC Form 499-A instructions do not mandate how wholesale carriers must substantiate the status of their customers as resellers; the instructions are indeed guidance from the Commission on how wholesale carriers may substantiate their customers' reseller status."[72]

The Instructions must be considered only "guidance" because any attempt by USAC to treat the Form 499-A Instructions as binding would violate the Administrative

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70 Form 499-A Instructions at 19.

71 *NetworkIP Order*, DA 10-2005, ¶8.

72 *Global Crossing Order*, ¶16.

Procedures Act. When the Commission delegated authority to the Bureau to publish the Form 499-A Instructions, the FCC delegated authority over only "the administrative aspects of the reporting requirements, not to the substance of the underlying programs."[73] Consequently, the Bureau lacks authority to adopt substantive rule changes via changes to the Instructions. Furthermore, the Bureau makes changes to the Form 499-A and Instructions each year but does so without following the notice and comment procedures that would be required if the Bureau were adopting binding rules.[74] Accordingly, the Instructions are non-binding and cannot be enforced by USAC.

2. Contrary to the FCC's Repeated and Explicit Statements that the Form 499-A Instructions are Non-Binding Guidance, USAC Continues to Assert that Filers Must Comply with the Form 499-A Instructions When Classifying Reseller Revenues

USAC, in the Audit Report, takes the position that the Form 499-A Instructions are binding and that the procedures identified therein are the only means for a filer to confirm its customer's status as a reseller. This position directly contradicts the Commission's expressed view that the Instructions are non-binding guidance and that a filer may use other means to show that the filer had a reasonable expectation that its reseller customer would contribute directly to the USF. Furthermore, as discussed below, USAC's unyielding position colors USAC's entire analysis of XOCS's verification of its reseller customers' status.

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73 *1998 Biennial Regulatory Review – Streamlined Contributor Reporting requirements Associated with Administration of Telecommunications Relay Services, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, 14 FCC Rcd 16602, 16621, ¶¶ 39-40 (1999) ("Carrier Contribution Reporting Requirements Order").

74 *See* 5 U.S.C. §553.

In the Audit Report, USAC repeatedly asserts that the Form 499-A Instructions regarding determination of a customer's reseller status are binding – despite the Commission's explicit statements to the contrary – and USAC's assertions become more strident with each iteration. In the initial draft audit report, USAC's auditors recommended that XOCS "should document and implement reseller procedures that meet the annual certification requirement per the Instructions."[75] In its rebuttal to XOCS on the issue, USAC becomes more entrenched in its position on the binding nature of the Form 499-A Instructions. Specifically, USAC states:

> ***[USAC] rejects the Carrier's contention that the Instructions are merely guidance.*** In the *Global Crossing Order*, the FCC recognizes that the Instructions "have been updated" and "modified" to reflect FCC rulings, court decision, and the FCC's rules and regulations. ***Indeed, in nearly every instance, the Instructions can be traced to the FCC's rules or applicable precedent.***
>
> The ***FCC has consistently treated the instructions as binding*** and instructed "contributors to report their end-user telecommunications revenues to the Universal Service Administrative Company (USAC) in accordance with the instructions and requirements set forth in the Telecommunications Reporting Worksheet (FCC Form 499)." [76]

In its "final response" in the Audit Report, USAC asserts that XOCS does not satisfy "the established standards" for classifying revenue as reseller revenue.[77] These "established standards," however, are none other than the Instructions themselves. USAC contends that the Instructions "reflect the FCC's rules and precedent with respect to the reporting of revenues for USF purposes" and, as such, that its role is to enforce the FCC rules *"as those*

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75 Reseller DAF, at 5.

76 *Id.* at 16 (internal citations omitted) (emphasis added).

77 *Id.* at 36.

Rules are reflected in the Instructions."[78] Thus, despite the change in rhetoric, USAC clearly continues to equate the Instructions with binding FCC rules and to enforce the Instructions alone.

Nowhere does USAC accept the *Global Crossing Order*'s holding that wholesale carriers may submit "other reliable proof" – proof not meeting the strict procedures described in the Instructions – as support for the classification of revenue as reseller revenue. This is evident in USAC's rejection of XOCS customer certifications as "outdated" merely because they were not signed in 2007 (even though, as explained below, many of the certifications were signed a few weeks to a few months before the beginning of 2007).[79] This also is evident in USAC's rejection of the "other proof" submitted by XOCS because such proof did not meet "the FCC-established standards for classification of its revenues as carrier's carrier revenues."[80] The *Global Crossing Order* obligated USAC to consider the "other proof" on a case-by-case basis, and did not mandate specific standards for its evaluation. USAC's reference to "FCC-established standards" in this context makes sense only as a reference to the Instructions themselves, which puts us right back where we started: USAC applies the Instructions as if they are binding FCC rules.

In light of USAC's continued insistence on treating the Instructions as binding, it is extremely doubtful that USAC will assign due weight or seriously consider XOCS's evidence supporting its "reasonable expectation" that its customers would contribute directly to the USF. USAC refuses to undertake the task the Bureau assigned to it in the *Global Crossing Order* and

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78 *Id.* at 37 (emphasis added).

79 *Id.* at 39.

80 *Id.* at 38.

is failing to heed the Bureau's directions. Accordingly, XOCS respectfully requests the Commission instruct USAC that it must give independent consideration to all "other proof" submitted by wholesale carriers.

3. Wholesale Filers May Classify Revenues as Reseller Revenues When the Filer Reasonably Expects the Reseller will Contribute to the USF

As noted above, filers have more than one option for verifying a customer's status as a reseller. FCC rules applicable to the time in question provided several options for a filer to use when determining if its customer was a reseller, including but not limited to the "safe harbor" procedures described in the Instructions.[81] Compliance with the verification processes outlined in the Form 499-A Instructions were deemed evidence of a filer's reasonable expectation that a reseller customer will contribute directly to the USF. However, as mentioned above, the Form 499-A Instructions are only guidelines and filers may use other means of establishing that the filer had a reasonable expectation that its reseller customers would directly contribute to the USF.

In particular, in the *Global Crossing Order*, the Bureau identified at least three options for a filer to establish a reasonable expectation. Specifically, the Order stated:

> If a carrier fails to demonstrate that it either has affirmative knowledge that its customer is contributing to the universal service fund as a reseller or has a reasonable expectation that its customer is contributing as a reseller based on the guidance provided in the FCC Form 499-A instructions or other reliable proof, USAC may properly reclassify that carrier's reported reseller revenue as end-user revenue.[82]

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81 *See* FCC Form 499-A Instructions at 19.

82 *Global Crossing Order*, ¶ 14.

Accordingly, the filer can show that it has a reasonable expectation based on: (i) "affirmative knowledge that its customer is contributing to the universal service fund as a reseller", (ii) "guidance provided in the FCC Form 499-A instructions", or (iii) "other reliable proof."[83]

4. <u>XOCS Reasonably Expected the Reseller Customers at Issue Would Contribute to the USF</u>

When evaluating XOCS's appeal, the Commission must evaluate XOCS's evidence in accordance with the standard outlined above. While XOCS may not have utilized the "safe harbor" verification method outlined in the Form 499-A Instructions with respect to the handful of reseller customers at issue, it did take other steps to demonstrate that it had a reasonable expectation that these reseller customers would directly contribute to the USF.

First, XOCS's standard verification procedures provided evidence that the customers are resellers purchasing service for resale as telecommunications services. XOCS used a certification form modeled after the language in the Form 499-A instructions. As stated, USAC's *only* objection to these certifications was that they were not signed in 2007 and thus were "outdated." As explained below, the contemporaneous certifications were executed sufficiently close to the audit year that they provide "other reliable proof" of reseller status, even though they were not executed in 2007. Indeed, in one instance, the certification was executed on December 12, 2006, a mere 19 days before the audit year in question.

Second, in addition to obtaining these contemporaneous certifications, XOCS also submitted other types of supporting information to USAC. For two of the resellers, this

83 *Global Crossing Order*, ¶ 14.