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SHUGHART THOMSON & KILROY'S TELECOMMUNICATIONS AND NEW TECHNOLOGIES PRACTICE GROUP TELECOM REPORT

FCC Adopts Rules for Network Unbundling Obligations of Incumbent Local Exchange Carriers

In an Order or Remand, announced on December 15, 2004, the Federal Communications Commission ("FCC") adopted rules concerning incumbent local exchange carriers' obligations to make elements of their local exchange networks available to other carriers who seek to enter the local telecommunications market.

These new rules respond directly to the decision of the United States Court of Appeals for the District of Columbia Circuit which, in March 2004, reversed portions of the FCC's unbundled network element rules which the FCC promulgated in its Triennial Review Order issued in August 2003. See _United States Telecom Ass'n. v. FCC and U.S.A._, 359 F. 3d. 554, U.S. App. D.C., 202 (March 2, 2004). Under the Court's decision, those FCC network unbundling rules adopted in August 2003, which the Court overturned, became invalid on June 16, 2004.

The following represents a summary of the FCC's new rules:

- **Unbundling.** The FCC clarified the impairment standard which it had adopted in its August 2003 Triennial Review Order in one respect and modified the application of this standard in three respects. First, the FCC clarified that it would evaluate impairment with respect to the capabilities of a "reasonably efficient competitor." Second, the FCC set aside the Triennial Review Orders "qualifying service"

interpretation of Section 251(d)(2) of the Communications Act, 47 U.S.C. § 251(d)(2), but decided to prohibit the use of unbundled network elements ("UNEs") for the provision of telecommunications services in the mobile wireless and long-distance markets, which the FCC had previously found to be competitive. Third, in applying the impairment standard, the FCC stated that it will draw reasonable inferences regarding the prospects for competition in one geographic market based on the state of competition in other, similar geographic markets. Fourth, the FCC considered the appropriate role of tariffed and incumbent local exchange services in the unbundling framework, and determined that in the context of the local exchange market, a general rule prohibiting access to UNEs whenever a requesting carrier is able to compete using an incumbent local exchange carrier's tariff offering would be inappropriate. This latter modification means that incumbent local exchange carriers cannot force competing carriers to purchase facilities need to compete from "special access tariffs."

- **Dedicated Inter-Office Transport**. The FCC determined that competing carriers are impaired without access to DS-1 transport facilities except on routes connecting a pair of wire centers, where both wire centers contain at least four (4) fiber-based co-locators or at least 38,000 business access lines. Moreover, the FCC determined that competing carriers are impaired without access to DS-3 and dark fiber transport except on routes connecting a pair of wire centers, each of which contain at least three (3) fiber-based co-locators or at least 24,000 business access lines. Finally, the FCC determined that competing carriers are not impaired without access to entrance facilities connecting an incumbent local exchange carrier's network with a competitive local exchange carrier's network in any instance.

- **Transaction Plan for Inter-Office Transport**. The FCC also adopted a 12-month plan for competing carriers to transition away from the use of DS-1 and DS-3 capacity dedicated transport where they are not impaired, and an 18-month plan to transition away from dark fiber transport. These transition plans only apply to the embedded customer base of a competing carrier, and will not permit competitive carriers to add new dedicated transport UNEs in the absence of impairment. During the transition periods, competitive carriers will retain access to unbundled dedicated transport at a rate equal to the higher of (1) 115% of the rate the requesting carrier paid for the transport element on June 15, 2004, or (2) 115% of the rate the applicable state public utilities commission has established or establishes, if any, between June 16, 2004 and the effective date of the FCC's Order or Remand.
- **High-Capacity Loops (DS-3, DS-1 and Dark Fiber)**. The FCC determined that competitive local exchange carriers are impaired without access to DS-3 capacity loops except in any building within the service area of a wire center containing 38,000 or more business lines and four (4) or more fiber-based co-locators. Competitive local exchange carriers are impaired without access to DS-1 capacity loops except in any building within the service area of the wire center containing 60,000 or more business lines and four (4) or more fiber-based co-locators. The FCC determined that competitive local exchange carriers are not impaired without access to dark fiber loops in any instance.
- **Transition Plan for High Capacity Loops**. The FCC adopted a 12-month plan for competing carriers to transition away from the use of DS-1 and DS-3 capacity loops where they are not impaired, and an 18-month plan to transition away from dark fiber local loops. These transition plans will apply only to the embedded customer base,

and will not permit embedded local exchange carriers to add new high-capacity loop UNEs in the absence of impairment. During the transition periods, competitive carriers will retain access to unbundled facilities at a rate equal to the higher of: (1) 115% of the rate the requesting carrier paid for the transport element on June 15, 2004, or (2) 115% of the rate the applicable state public utilities commission has established or establishes, if any, between June 16, 2004 and the effective date of the FCC Order or Remand.

- **Mass Market Local Circuit Switching**. The FCC decided that incumbent local exchange carriers have no obligation to provide competitive local exchange carriers with unbundled access to mass market local switching. The FCC adopted a 12-month plan for competing carriers to transition away from the use of unbundled mass-market local switching. The transition plan will apply only to embedded customer base, and will not permit competitive local exchange carriers to add new switching UNEs. During the transition period, competitive carriers will retain access to the UNE platform, that is, the combination of an unbundled loop, unbundled local circuit switching, and shared transport elements, at a rate equal to the higher of (1) the rate at which the requesting carrier leased the combination of elements on June 15, 2004, plus one dollar ($1.00), or (2) the rate the applicable state public utilities commission establishes, or if any, its June 16, 2004, and the effective date of this Order or Remand, for this combination of elements, plus one dollar ($1.00).
- The FCC's Order or Remand has not yet been publicly released, but we expect it to be issued within the next several weeks.

We anticipate that interested parties will file petitions for reconsideration of the Order or Remand with the FCC, or file a petition for review with the United States Court of Appeals for the

D.C. Circuit of the Order or Remand. In either case, the petitions must be filed thirty (30) days from the date the Order or Remand is publicly released.

Moreover, several incumbent local exchange carriers filed a petition for mandamus with the United States Court of Appeals for the District of Columbia Circuit months ago, asking for an Order directing the Commission not to issue any new rules, and to adhere to the Court's United States Telecom Assn.'s decision which, as stated above, overturned certain of the FCC's unbundling rules adopted in its Triennial Review Order in August 2003. The Court, however, placed the petition for mandamus on hold until the first week in January 2005, at which time the FCC must respond to it.

The scope of access to incumbent local exchange carrier networks by facilities-based competitors seeking to enter the local telecommunications market is far from over. We will keep you posted in subsequent newsletters of further decisions of the FCC and the Courts on this issue.

II. Possible Refunds for Payment of 3% Federal Excise Tax for Communications Services.

A Federal Excise Tax on telecommunications services has been in effect continuously since 1932 to the present. In 1954, Congress initially enacted Sections 4251 and 4252 of the Internal Revenue Code, 26 U.S.C. § 4251 and 4252, and amended these sections in 1958. In the Excise Tax Reduction Act of 1965, Congress adopted the current definitions of communications services which are found in Section 4252 of the Internal Revenue Code.

Section 4251 imposes a 3% excise tax on amounts paid for "communications services," which include (i) local telephone service (ii) toll telephone service and (iii) teletypewriter exchange service. Section 4252(b) defines "toll telephone service" as (1) a telephone-quality communication for which (a) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication and (b) the charge is paid within the United States, and (2) a service which entitles the subscriber, upon payment of a periodic charge determined as a flat amount or upon the basis of toll or elapsed transmission time, to the privilege of an unlimited number of

telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

When Congress passed the 1965 amendments to these sections of the Internal Revenue Code, AT&T was the dominant long distance carrier in the United States. Moreover, the definition of "toll telephone service" essentially covered AT&T's two types of long-distance service: (1) Message Telephone Service ("MTS"), under which AT&T charged callers for each call based on the time of day, duration of the call, and distance traveled, and (2) Wide Area Telephone Service ("WATS"), under which AT&T generally allowed subscribers, for a flat charge, to make unlimited calls within a defined area, sometimes limited as to the total elapsed time. MTS rates were based on a system of "mileage bands", where, for example, AT&T would charge a different rate for calls traveling 1 – 10 miles, 11 – 22 miles, 23 – 55 miles, 56 – 124 miles, etc. From 1965 until 1997, MTS was the largest toll telephone service, in terms of traffic volume and revenue levels, and the most publicly recognizable long distance service of the traditional telephone industry service offerings.

Between 1997 and 2000, AT&T and other long distance carriers started to abandon the mileage band system, so that the dominant form of interstate long distance service currently involves a single interstate long distance rate for minutes of use for the continental United States, although mileage have remained in use in some states for intrastate long distance service.

As a result, the question is raised whether telecommunications services that are not distance-sensitive fall within the meaning of Section 4252(b)(1) of the Internal Revenue Code, which, as noted above, defines toll telephone service as involving a toll charge which <u>varies in amount with the distance and elapsed transmission time of each individual communication</u>. Thus, to be taxable under the 3% Federal Excise Tax under Section 4252(b)(1) it appears that long distance charges must be based on both distance traveled and time elapsed.

Accordingly, there is an opportunity for those taxpayers who are large telecommunications users to obtain refunds of this Federal Excise Tax.

Four federal District Courts have recently ruled on this issue, three of which found that Section 4251 is clear and unambiguous, and that the Federal Excise Tax does not apply to long distance telephone service if the charges vary only with respect to elapsed time, one federal Court reached the opposite conclusion. The Internal Revenue Service has appealed these decisions.

In July 2004, the Internal Revenue Service issued an advance notice proposed rulemaking in which the IRS solicited comments from interested parties concerning this issue. In addition, it confirmed the continued collection of the tax. Under the current IRS scheme, long distance carriers such as AT&T, MCI and Sprint add the excise tax to a subscriber's bill, collect the tax and then remit it to the IRS. As a consequence, the taxpayer has a right to seek a refund of such tax, for the period of time allowed by the applicable statute of limitations, which is generally three years from the time the taxpayer filed its last tax return, directly from the IRS, and not from the taxpayer's long distance carrier.

As a law firm, Shughart Thomson & Kilroy, P.C. has substantial experience in dealing with all telecommunications issues including telecommunications taxes. We are available to consult with you with respect to filing for a refund of the FET tax, or on any telecommunications issue.

BPL Update

In our previous newsletters, we informed you of the FCC's decision to authorize broadband over power line service as a "last mile" alternative. And we also advised you that the FCC did not promulgate competitive rules for this service, so that third parties would have access to an electric power utility's power lines to offer such an alternative. We have recently become aware that some electric utilities are entering into partnerships or similar business arrangements with third parties to

offer a "last mile" alternative to wireline, wireless and cable providers. Accordingly, a competitive provider may wish to

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Shughart Thomson & Kilroy, P.C.'s Telecommunications and New Technologies Practice Group has substantial experience in enforcement proceedings before the FCC, state regulatory agencies and in the federal and state Courts. We are available to assist you in such matters. Therefore, please do not hesitate to contact us if you have any questions about this Special Report, or recent FCC or state regulatory actions, or any of our services. You may reach us as follows:

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