Law Offices

SHUGHART THOMSON & KILROY

A Professional Corporation

VOLUME II, ISSUE 4
June 2005

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

* * * * * * *

Shughart Thomson & Kilroy, P.C.'s Telecommunications and New Technologies Practice Group has substantial experience in regulatory and enforcement proceedings before the Federal Communications Commission ("FCC") and state regulatory agencies, and in litigation involving telecommunications matters in the federal and state courts. We present below for your information various recent regulatory and court rulings affecting the telecommunications industry. We are available to assist you in such matters.

* * * * * * * * * * * * * * *

FCC Initiates Broad Inquiry into Management and Administration of the Universal Service Fund

The Federal Communications Commission ("FCC") has initiated a broad inquiry into the management, administration and oversight of the Universal Service Fund ("USF") by issuing a Notice of Proposed Rule Making and Further Notice of Proposed Rule Making ("NPRM") on June 14, 2005. Specifically, the FCC seeks comments on ways to improve the management, administration and oversight of the USF, including issues such as simplifying the process for applying for USF support, expediting the process for disbursement of funds to recipients, simplifying the process for billing and collection, addressing issues related to the Universal Service Administration Company ("USAC"), which administers the USF under the direction of the FCC, and exploring performance measures suitable for assessing and managing the USF's problems. In addition, the FCC seeks comments on ways to further deter waste, fraud, and abuse through audits of USF recipients of funds and other measures, and on various measures for recovering improperly disbursed funds.

Congress, in the Telecommunications Act of 1996, and specifically in Section 254 of this Act, mandated specific universal service mechanisms to ensure affordable telecommunications services to all Americans, including those persons living in high-cost areas, low-income consumers, eligible schools and libraries, and rural healthcare providers. Under Section 254, telecommunications carriers providing interstate telecommunications services are required to contribute to the USF. Their contributions are based on a percentage factor applied to their interstate revenues. The FCC established the USAC in 1997 to administer universal support mechanisms, including the collection of contributions from contributors to the USF, and disbursements from the USF to recipients who are eligible for support.

In the NPRM, the FCC is seeking comment on the following subjects:

- **Management and administration of the USF.** The FCC wishes to explore ways to simplify and streamline the management of the USF. The FCC has tentatively concluded that a multi-year application process for telecommunications services for universal service mechanisms for schools and libraries (also known as the "E-rate program") into the rural healthcare program would simplify the process in a manner that guards against abuse and fraud. The FCC seeks comments on whether reducing or consolidating application forms and adopting deadlines and other criteria to provide to certainty to program applicants is appropriate.

- **Oversight of the USF.** The FCC requests comment on the effectiveness of existing efforts to prevent potential misuse and abuse of the USF. The FCC has tentatively concluded that more aggressive debarment procedures are necessary to safeguard the fund, and requests comments on ways in which it can improve the debarment rules. In addition, the FCC is seeking comment on whether it should establish independent audits for certain USF beneficiaries and contributors, and seeks comments on what rules would help ensure that audits are effective and fair. The FCC is also requesting comment on whether it should establish rules for recovering monies disbursed from USF, which were not used in accordance with program rules. In this connection, the FCC has requested comments on whether it should establish a five-year period within which the FCC or USAC would initiate and conclude audits and investigations of recipients of funds, and for seeking adjustment of a carrier's contribution obligation to make the correct contribution amount to the USF. This proposal is in contrast to the FCC's Wireless Competition Bureau's December 9, 2004, Order that established a 12-month deadline for contributors to seek a refund from the USF for overpayments.

- **Administrative Structure.** The FCC is requesting comment on the existing administrative structure of the USF and USAC, and has requested whether any rules changes are needed to alter the USF structure, or the Board of Directors of the USAC, to ensure that the USF is administered in an effective and competitively neutral way.

- **Performance Measures.** The FCC is requesting public comment on establishing performance measures to assess the effectiveness of the programs under the USF.

This rule making is comprehensive in nature, and is intended to assist the FCC in determining whether it needs to change any rules in order to manage and administer the USF more effectively, overturning waste, fraud and abuse.

Comments on the NPRM will be due 90 days after the RPM is published in the *Federal Register*, which is expected to take place within the next few days. Thus, comment will likely be due during the first week of September, 2005. Reply comments are due 150 days after publication of the NPR in the *Federal Register*, which would make the reply as likely due during the first week of November 2005.

If anyone is interested in receiving a copy of the NPRM or filing comments on the issues raised in the NPRM, please let us know.

* * * * * * * * * * * * * * *

$5,000,000 Punitive Damages Arbitration Award in the Absence of Compensatory Damages Held Not to Violate Either Due Process or Public Policy

The Connecticut Supreme Court, in *Medvalusa Health Programs, Inc. v. Memberworks*, Inc., recently affirmed an arbitrator's award of $5,000,000 in punitive damages, holding that the award did not violate due process or state public policy, notwithstanding the lack of any award of compensatory damages.

In rejecting the defendant's claim that the arbitrator's award of punitive damages violated its right to due process because the award was excessive, the Court observed that the constitutional protections of individual rights and liberties extend only to government actions. The Court then held that the act of the Superior Court in confirming the arbitration award did not convert the arbitration award into state action.

The Court also rejected the defendant's claims that the arbitration award violated Connecticut public policy against excessive punitive damage awards, grounded in Connecticut common law and in the Constitution of the United States. In rejecting this claim, the Court first noted that the submission to arbitration was voluntary and unrestricted. The Court further noted that an arbitrator's award may be vacated if it violates clear public policy. However, the award must be "clearly illegal or clearly violative of the strong public policy." The Court then held that the defendant failed to sustain its burden of establishing that the arbitration panel's award violated a clearly demonstrated Connecticut public policy against excessive damage awards. In so holding, the Court observed that the award was based on the panel's finding that defendant violated the Connecticut Unfair Trade Practices Act ("CUTPA"), which expressly allows the award of punitive damages, and does not, by its express terms, provide a cap on the amount of damages awarded. Thus, the Court "fail[ed] to find in the combination of general limitations on damage awards in courts, the kind of well-defined and dominant public policy against excessive punitive damages that would justify setting aside a private, consensual arbitration award on the basis of the stringent in narrow confines of the public policy exception."

Although the *Medvalusa* decision is binding only in the state of Connecticut, other jurisdictions could very well apply the same analysis in confirming a punitive damages award which is grossly disproportionate to the compensatory damages awarded. A party to a telecommunications contract containing an arbitration clause can prevent an arbitrator from awarding such disproportionate punitive damages by including a specific provision in the arbitration clause prohibiting such awards.

We will be pleased to assist you in drafting such provisions, as well as other provisions limiting an arbitrator's unbridled discretion in awarding damages, in your telecommunications contracts.

* * * * * * * * * * * * * * *

FCC Denies Coalition of Rural Local Exchange Carriers' Petition That Their Carrier Change Verification Actions Do Not Violate FCC Rules

The FCC recently denied a Petition for Declaratory Ruling filed by a coalition of rural local exchange carriers ("Petitioners") seeking an order that their carrier change verification actions did not violate FCC rules. In denying this Petition, the FCC concluded that an executing carrier's rejection of carrier change submissions by a submitting carrier, based on the executing carrier's own conclusion that the customer contacting the submitting carrier was not authorized to make a long-distance carrier change, violates FCC Rule 64.1120(a)(2).

Petitioners filed their Petition in the wake of informal complaints filed by MCI against Petitioners alleging that they were unlawfully rejecting MCI's carrier change submissions when information in the submissions differed from that in the Petitioners' records. Specifically, MCI alleged that the Petitioners were unduly impeding the carrier change process, and were engaging in a form of additional verification of carrier changes, in violation of FCC Rule 64.1120(a)(2). FCC Rule 64.1120(a)(2) defines the duties of "submitting" and "executing" carriers, and provides that " [a]n executing carrier shall not verify the submission of a change in the a subscriber's selection of a telecommute occasions service received from a submitting carrier," or otherwise unreasonably delay the execution of the carrier change.

In denying Petitioners' Petition, the FCC rejected Petitioners' argument that there is no basis in law, including agency law, to hold that the executing LEC "has any right to rely on a claim of authority of a person without authorization from a subscriber and thus no obligation to its subscriber to make changes to the subscriber's account." The FCC held that the executing carrier may not make an independent determination regarding whether the person authorizing the switch was an authorized agent of the party identified on the executing carrier's account. Moreover, the FCC observed that the fact that the name(s) contained in the executing carrier's local account information differs from that of the contact person on the submitting carrier's change is not necessarily indicative of a lack of authority or agency on the part of the person requesting the long-distance change.

The FCC also rejected Petitioners' argument that their actions do not constitute reverification in violation of FCC Rule 64.1120(a)(2). The FCC distinguished the Petitioners' conduct from other situations resulting in LEC's return of the carrier change request to the submitting carrier, such as when a customer is already presubscribed to the submitting carrier, when a customer has a PIC freeze in place, or when PIC changes are not permitted (e.g., certain college dormitory rooms). These situations, unlike Petitioners' conduct, do not constitute reverification in violation of FCC rules.

Because the FCC found that Petitioners' actions violate the prohibition on verification by executing carriers established in Rule 64.1120(a)(2), it found it unnecessary to reach a conclusion as to whether these actions also result in unreasonable delay by an executing carrier in violation of FCC rules.

The FCC's denial of Petitioners' Petition demonstrates that, although efforts by LECs to deter slamming may appear laudable, their anti-competitive effects outweigh the potential benefits. If an LEC is engaging in conduct ostensibly to deter slamming, but which has the effect of unduly

impeding the carrier change process and the carrier change requests an inter-exchange carrier ("IXC") submits to the LEC, the IXC may be able to prohibit the LEC from engaging in such unlawful conduct.

We are available to discuss with you whether such LEC's conduct is, in fact, unlawful, and what steps you should take to stop the LEC from continuing to engage in such conduct.

* * * * * * * * * * * * * * *

FCC Affirms Decision that Local Exchange Carriers May Not Impose Specific Contractual Restrictions on Competing Directory Assistance Providers' Use of Directory Assistance Data

The Federal Communications Commission ("FCC") has affirmed its earlier decision that local exchange carriers ("LECs")may not impose specific contractual restrictions on competing directory assistance ("DA") providers' use of DA data obtained pursuant to Section 215(b)(3) of the Communications Act of 1934 as amended. As most of you know, LECs gather local directory assistance data as part of the processing of a subscriber's service order, and then compile it in a local DA data base that contains names, addresses and telephone numbers of the telephone exchange service subscribers within a particular geographic area who do not elect to have their numbers unpublished.

In affirming its earlier decision, the FCC clarified that competing DA data providers may not use data obtained pursuant to Section 251(b)(3) of the Act for purposes not permitted by the Act, the FCC's rules, or state regulations, and that use of similar data for directory publishing is governed separately under Section 222(e) of the Act. Section 222(e) provides that a LEC offering local exchange service must provide subscriber list information gathered in its capacity as a provider of such service on a timely and unbundled basis, under non-discriminatory and reasonable rates, terms and conditions, to any person upon request for the purpose of publishing directories in any format.

The FCC affirmed its earlier decision on the basis that Section 251(b)(3) of the Act imposes on LECs a duty to permit all competing providers of telephone exchange service and telephone toll service non-discriminatory access to DA, and that this section of the Act requires local exchange carriers to provide such competing providers with access to directory assistance equal to that which the LEC provide to themselves, and that LECs treat all such competitors equally.

The FCC did note that Section 222 of the Act provides for access to subscriber list information which is substantially similar to that information contained in the DA data bases, but recognized that this Section of the Act relates to the use of such information for the purpose of publishing directories specifically not compiling a DA data base In contrast, the FCC stated that there is no such limitation expressed for DA information in Section 251(b)(3) of the Act, and that this Section of the Act does not limited the use of DA data solely for the provision of DA. The LECs had wanted the FCC to prohibit the use of DA data bases for bulk resale to other DA providers, for subsequent use by DA providers serving as an agent to serve multiple carriers, for non-directory assistance purposes such as direct marketing, telemarketing, and sales solicitation.

The FCC rejected this LEC request, ruling that such restrictions on use of DA data would substantially increase costs of providing competitive service, and thereby reduce benefits to consumers arising from the presence of competitive DA providers in the marketplace. Furthermore, the FCC noted that Section 251(b)(3) does not by its terms limit the use of DA data solely to the provision of DA, and that if Congress had intended to restrict the use of DA data under Section 251(b)(3), it could have done so. The FCC specifically noted that Section 222(e) of the Act provides for access to subscriber list information which is substantially similar to that information contained in DA databases but such access is only used for the purpose of publishing directories. In contrast, there is no such limitation expressed for DA information in Section 251(b)(3) of the Act. The FCC recently concluded that the statutory difference between. DA and directory publishing should continue to be observed.

The FCC clarified, however, that it never intended to grant competing DA providers greater latitude in their use of DA data than that permitted to providing local exchange carriers, or to permit competing DA providers to use the data in a manner inconsistent with federal or state laws or regulations. Thus, competing DA providers must observe state limitations regarding the use of access directory information which, for example, may prohibit the sale of customer information to telemarketers, as long as the state regulations are consistent with the non-discrimination requirement in Section 251(b)(3) of the Act. Furthermore, there is no statutory basis under the Act for allowing DA providers to use DA listings obtained pursuant to Section 251(b)(3) to publish directories. The publishing of directors is specifically governed by Section 222(e) of the Act.

If you want more information on exactly how competing DA information providers may use DA data obtained from local exchange carriers, please don't hesitate to give us a call.

* * * * * * * * * * * * * * *

FCC Requests Comments on Rule Changes Needed to Implement the Commercial Spectrum Enhancement Act

The Commercial Spectrum Enhancement Act ("CSEA") became law on December 23, 2004. The CSEA establishes a mechanism to use proceeds from spectrum auctions to reimburse federal agencies operating in the 216-220MHz, 1432-1435 MHz, 1710-1755 MHz, and 2385 - 2390 MHz frequency bands, and certain other frequency bands that may be reallocated from federal to non-federal use, for the cost of relocating operations. The 1710-1755 MHz frequency band accounts for one-half of the radio frequency spectrum the FCC plans to auction as early as June 2006 for advanced wireless services, including third generation or "3G" wireless services.

Under the CSEA, the FCC's auction of eligible frequencies may not be completed if the total cash proceeds of the auction are less than 110% of the total estimated relocation costs of federal users of the frequency bands auction. The CSEA does not define total cash proceeds, so the FCC determined that, for purposes of the CSEA, total proceeds should be defined as winning bids net of any applicable discounts, such as small business bidding credits.

The FCC seeks comments on prospective modifications of its auction bidding rules designed to implement the CSEA, and on how to update the FCC spectrum auction rules, including the following issues:

- revision to the reserve price rule to ensure that auctions of frequencies under the CSEA are not concluded without raising 110% of the estimated federal user relocation costs, as required by the CSEA;

- options for preserving the availability of travel and bidding credits in auctions of frequencies eligible, subject to the CSEA;

- an increase in the FCC's discretion regarding the amount of interim bid withdrawal and additional default payments;

- establishment of procedures in advance of each auction for portioning bid amounts among licenses in their packets;

- change to the payment rules and procedures for broadcast construction permits when at auction to conform to the rules for non-broadcast licenses won at auctions; and

- facilitation of the use of small business bidding consortium.

The FCC has requested comments on proposed modifications to its bidding rules thirty (30) days after the FCC's Notice of Proposed Rule Making is published in the *Federal Register* by the first week in August 2005.. The NPRM is expected to be published in the *Federal Register* in the third week in June 2005, which would make comments due the third week of July 2005. Reply comments in 45 days after the NPRM is published in the *Federal Register*, or by the first week in August 2005.

If any of you wish to file comments on this rule making, please let us know and we will provide you with the exact dates when comments and reply comments are due.

* * * * * * * * * * * * * * *

Shughart Thomson & Kilroy, P.C.'s Telecommunications and New Technologies Practice Group's Telecom Report is intended to provide general information about regulatory and legal development in the telecommunications industry, and does not constitute legal advice. Our distribution of this Telecom Report does not create an attorney-client relationship between any recipient and Shughart Thomson & Kilroy, P.C.

* * * * * * * * * * * * * * *

For more information about Shughart, Thomson & Kilroy, P.C. and its Telecommunications Practice, please consult our websites at www.stklaw.com and www.telecomattorneys.com.

If you have any questions about this Report, or other recent FCC or state regulatory rulings, or federal or state court decisions affecting telecommunications, or any of our services, please don't hesitate to contact us.

Shughart Thomson & Kilroy, P.C.
1050 Seventeenth Street, Suite 2300
Denver, Colorado 80265
Facsimile: 303.572.7883

Phil Bledsoe Direct: 720.931.1172 Email: pbledsoe@stklaw.com	Howard Gelt Direct: 720.931.8143 Email: hgelt@stklaw.com
Michael L. Glaser Direct: 720.931.8133 Email: mglaser@stklaw.com	Christopher Strohmenger Direct: 720.931.1167 Email: cstrohmenger@stklaw.com
Michael D. Murphy Direct: 720.931.8137 Email: mmurphy@stklaw.com	