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### 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.

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#### FCC Adopts Modifications to its Approval for Assessing Contributions to the Federal Universal Service Fund

On June 21, 2006, the FCC adopted two modifications to its approach for assessing contributions to the Universal Service Fund ("USF"). First, the FCC raised the existing wireless "safe harbor" percentage used to estimate interstate revenues from 28.5% to 37.1% of total-end user telecommunications revenue. The FCC had previously updated this wireless "safe harbor" in 2002. Notwithstanding the FCC's adoption of the 37.1% of total end user telecommunications revenue which wireless carriers should use to estimate interstate revenue, wireless carriers still retain the option to base their contributions on their actual revenues or on traffic studies that estimate their actual interstate revenues.

Second, the FCC expanded the base of USF contributions by extending universal service contribution obligations to providers of interconnected voice over protocol ("VoIP") service. For interconnected VoIP providers, the FCC has established a "safe harbor" percentage of interstate revenue at 64.9% of total VoIP service revenue. As is the case with wireless carriers, interconnected VoIP providers may also calculate their interstate revenues based on their actual revenues or by using traffic studies.

The FCC also adopted a Notice of Proposed Rule Making ("NPRM") requesting comment on interim contribution obligations imposed the FCC's decision to modify the USF contributions in the two respects described above. The FCC has requested comments on the issues raised in the NPR thirty (30) days from its publication in the Federal Register and reply comments sixty (60) days from its publication in the Federal Register.

The FCC justified its actions by stating that the two steps described above will stabilize the contribution base for the USF in the near term and minimize the impact of any changes on

consumers. As most of you know, effective this year, telecommunications providers will not be required to make contributions based on revenue from DSL service since DSL service has been declared an information service.

The FCC still has not determined whether VoIP service is a “telecommunications service” under the Communications Act for purposes of applying access charges, only that VoIP service is an interstate service, and not subject to regulation by the states. In a recent court decision which we discuss below, the U.S. Court for the DC Circuit held that VoIP providers must comply with the Communications Assistance for Law Enforcement Act (“CALEA”), because VoIP providers are “telecommunications carriers” within the meaning of that statute.

Please let us know if you have any questions about the above-discussed FCC action.

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**The DC Circuit Upholds the FCC’s Determination that  
Providers of Broadband Internet Access and Voice Over Internet Protocol (“VoIP”)  
Services Are Regulable as Telecommunications Carriers Under the Communications  
Assistance for Law Enforcement Act (“CALEA”), 47 U.S.C. §§ 1001-1010**

In *American Council of Education v. Federal Communications Commission and USA*, the U.S. Court of Appeals for the DC Circuit upheld the FCC’s determination that providers of broadband Internet access and voice over Internet protocol (“VoIP”) service are regulable as “telecommunications carriers” under the Communications Assistance for Law Enforcement Act (“CALEA”). Thus, as “telecommunications carriers”, for purposes of CALEA, broadband and VoIP providers must ensure that law enforcement officers are able to intercept communications transmitted over their providers’ networks.

In its decision, the Court noted that CALEA only applied to “telecommunications carriers” and that CALEA defines a “telecommunications carrier” as an “entity engaged in the transmission or switching of wire or electronic communications as a common carrier for hire.” The Court also pointed out that CALEA also includes in its definition of a “telecommunications carrier” the following: “a person or entity engaged in providing wire or electronic communications switching or transmission service to the extent that the FCC finds that such service is a replacement for a substantial portion of the local telephone exchange service and that it is in the public interest to deem such a person or entity to be a telecommunications carrier for persons of this subchapter...”.

The Court upheld the FCC’s determination that this provision of CALEA, known as the “substantial replacement provision” (“SRP”), allows the FCC to expand the definition of a “telecommunications carrier”, for purposes of CALEA, to include new technologies that substantially replace the functions of an old-fashioned telephone network.

CALEA, however, does not apply to persons or entities if they are engaged in providing “information services”. CALEA defines “information service” as the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available

information via telecommunications. Because information providers are not subject to CALEA, they do not have to make their networks accessible to law enforcement agencies.

The FCC's decision which the DC Circuit upheld stems from a petition for expedited rulemaking filed by the Department of Justice with the FCC in 2004, asking that the FCC take action against providers who were not implementing CALEA-compliant intercept capabilities. In response, the FCC ruled that broadband and VoIP providers are covered (at least in part) by CALEA's definition of "telecommunications carriers". In reaching this conclusion, the FCC determined that CALEA created three categories of communications services: (1) pure telecommunications which plainly fall within CALEA; (2) pure information which plainly falls outside of CALEA; and (3) hybrid telecommunications which are information services that are only partially governed by CALEA. The FCC then concluded that broadband and VoIP are hybrid services that contain both telecommunications and information components. The FCC determined that CALEA applies to providers of those hybrid services only to the extent that they qualify as "telecommunications carriers" under three prongs of SRP. First, providers of both technologies must perform switching and transport functions. Second, providers of both technologies serve as replacements for a substantial functionality of the local telephone exchange, that is, broadband replaces the transmission function previously used to reach dial-up Internet service providers ("ISP") and VoIP replaces traditional telephone service's voice capabilities. Third, the public interest requires the application of CALEA to "the telecommunications" component of both technologies.

The FCC further determined that applying CALEA to the telecommunications component of hybrid services would not impede competition or innovation, and would safeguard homeland security and combat crime. The FCC also clarified that CALEA does not apply to private networks. However, to the extent a private network qualifies as a telecommunications carrier because it is connected with a public network, either the public voice network, or the Internet, in it is subject to CALEA under the SRP.

The Court upheld the FCC's reasoning, pointing out that the definitions used in CALEA of telecommunications and information services, and telecommunications, differ significantly from those definitions used in the Communications Act of 1934, as amended. Because the statutes have different texts, structures and legislative histories and purposes, the Court ruled that the FCC conclusions with respect to the application of CALEA to broadband and VoIP services was lawful, and therefore, would be upheld.

If any of you have any questions concerning the FCC's application of CALEA to broadband and VoIP services, please let us know.

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**The DC Circuit Upholds the FCC's Unbundling Provisions of the Telecommunications Act of 1996**

*In Covad Communications Company and DIECA Communications, Inc., d/b/a Covad Communications Company v. FCC and U.S.A.*, the U.S. Court of Appeals for the DC Circuit upheld

the FCC's fourth attempt to implement the unbundling provisions of the Telecommunications Act of 1996 (the "1996 Act").

### **Background of Case**

Some background information on the 1996 Act is appropriate to understand this DC Circuit opinion. The 1996 Act sought to foster competition in the local telecommunications exchange market. Thus, Congress gave the FCC broad powers to require incumbent local exchange carriers to make unbundled network elements available to competitive local exchange carriers. A network element is a facility or equipment used in the provision of a telecommunications service. Thus, the FCC may require incumbent local exchange carriers ("ILECs") to offer pieces of their networks as unbundled billing blocks which competitive local exchange carrier ("CLEC") can lease, repackage and use to compete against ILEC in the telecommunications markets across the country. Congress, however, left to the FCC the choice of elements to be unbundled, specifying that the FCC must consider at a minimum, whether the failure to provide access to such network elements would "impair" the ability of the telecommunications carrier seeking access to provide the services it seeks to offer.

Relying on the impairment language, the FCC in 2005 amended its unbundling determination for three types of unbundled network elements: (1) switches, which are devices which direct calls to their destinations in the same way that switchboard operators once did; (2) transport trunks, which are wires that carry calls between the switches; and (3) local loops, which are wires that run from the switches over the last mile to consumer telephones. The FCC's determination with respect to these three types of units to be unbundled is what was before the DC Circuit.

### **Unbundling**

Unbundling is a simple process. If a CLEC wants to serve a customer in Denver, Colorado, one way of doing so is for the CLEC to purchase its own switches, trunks and loops, which it can then use to offer services to its customers. However, because the CLEC serving Denver (Qwest) has already deployed switches, trunks and local loops to serve the market, it might not be economically possible for the CLEC to duplicate Qwest's infrastructure competitively. With unbundling, however, the CLEC might be able to lease Qwest's switches, trunks, and loops as UNEs. The CLEC could then use combinations of units to cobble together a network to compete against Qwest in Denver.

Under the 1996 Act, the CLEC must pay Qwest for every facility and every piece of equipment that the CLEC requests from Qwest on an unbundled basis. After a rulemaking proceeding, the FCC concluded that UNE prices must be based on each element's total element incremental cost ("TELRIC"). TELRIC rates are similar to wholesale prices, because CLECs should be able to economically rent UNEs and then use them to sell telecommunications services to their regional customers.

Accordingly, ILECs, however, do not want their own networks being used by competitors, especially when CLECs enjoy access to UNEs at TELRIC rates. ILECs, therefore, favor the use of substitute facilities or services that allow CLECs to compete without demanding access to serve

ILEC's individual network elements. The only relevant substitute facility or service is a Tariff Special Access Service ("TSAS") which ILECs currently offer. Thus, CLECs can purchase TSAS from ILECs at prices at the TELRIC rates associated with UNEs. TSAS allows CLECs to complete point-to-point calls over dedicated lines. Thus, instead of purchasing or renting a loop, switch, space in a central office, and a transport trunk to complete a call from an ILEC, a CLEC could pay the higher TSAS rate for a dedicated line which does not require separate switching or transport.

### **Litigation Between ILECs and CLECs**

CLECs, however, want more in unbundling, whereas ILECs favor fewer UNEs and more availability of higher priced TSAS. The position of the CLECs and ILECs has been litigated since the 1996 Act was enacted in February 1996. There have been three FCC orders which the FCC attempted to interpret the Act's "impairment" standard. All three FCC orders have been reversed by U.S. Courts of Appeals, one of whose decision has been upheld by the U.S. Supreme Court because the FCC failed to fully and properly interpret the word "impairment". Finally, in 2003, the FCC issued its Triannual Review Order ("TRO") in response to one of the DC Circuit's reversals of the FCC's previous interpretation of impairment. The DC Circuit reversed much of the TRO, in *United States Telecom Assn. v. FCC*, 359 F.3d 554, 576 (D.C. Cir.) ("*USTA I*") cert. den. *sub nom. National Association of Regulatory Utility Commissioners v. U.S. Telecom Association*, 543 U.S. 925 (2004).

In *USTA II*, the DC Circuit concluded that the FCC's interpretation of impairment based on "uneconomic entry" was excessively vague. Moreover, the DC Circuit held that the FCC could not delegate power to state regulatory commissions to make non-impairment exceptions to the FCC's nationwide rule. Instead, the DC Circuit ruled that the FCC must establish unbundling criteria that took into account relevant market characteristics, which captures significant variation, sensibly to define the relevant markets, connects those markets to the FCC's impairment findings, and considers whether the element in question is significantly deployed on a competitive basis. The DC Circuit noted that the fact that CLECs can viably compete without UNEs, by utilizing TSAS, precluded the finding that CLECs are impaired by lack of access to a particular element under the 1996 Act.

On remand from the DC Circuit, the FCC issued an interim order of Notice of Proposed Rulemaking, and after receiving and considering comments, the FCC issued its four part order in 2005, which is the subject of this case before the DC Circuit.

The FCC's four-part order under appeal in this DC Circuit case issued the following rulings:

### **The FCC's 2005 Decision on Unbundling**

First, the FCC altered its unbundling framework by clarifying that it would find impairment where it would be uneconomic for a reasonably efficient CLEC to compete without UNEs. Significantly, the FCC concluded that UNEs are vital to continued development of competition in a local exchange market, and therefore retained its unbundling requirements, regardless of whether a CLEC was currently using a TSAS to provide local exchange service. The FCC ruled that it would be inappropriate to limit CLECs access to UNEs whenever a requesting carrier is able to compete using TSAS.

Second, the FCC made a determination with respect to dedicated transport facilities. Dedicated transport facilities refer to facilities that are dedicated to particular carrier used for transmission between or among ILEC wire centers. There are two types of transport. First, DS-1, which can carry 24 voice calls simultaneously, and DS-3 which has 28 times the capacity of DS-1 facilities and therefore can carry 672 voice calls simultaneously. CLECs use DS-1 transports as part of an end-to-end circuit call and enhanced extended length (“EELs”), which can be used to serve a single customer, usually a small or medium sized business. EELs are composed of DS-1 lengths combined with a DS-1 transport length. The FCC identified two means for determining whether entry into a particular market would be economic without unbundled DS-1 or DS-3 facilities. The first, the extent of fiber-based call location facilities, and second, business line density. The FCC found that CLECs are not impaired without DS-1 transport lengths when both ends of the transport will terminate in Tier 1 wire centers, which are those wire centers with four or more fiber-based call locators, or 38,000 or more business lines. Similarly, the FCC found that CLECs are not impaired without access to DS-3 transport where both ends of the route terminate in the Tier 2 wire center, those with at least three fiber-based call locators or at least 24,000 business lines. The higher impairment threshold for DS-1 transport reflects the fact that DS-1 facilities have less capacity and generate less revenue, thus making them less likely to be deployed by CLECs.

If a CLEC certifies that a transport trunk meets the applicable test, the ILEC is obligated to offer immediate access to the trunk on an unbundled basis. If the ILEC seeks to challenge the propriety of unbundling the trunk, it must first provide the UNE to the CLEC and then raise a challenge through a dispute resolution process contained in an interconnection agreement between the ILEC and the CLEC.

Third, the FCC amended its impairment of findings for DS-1 and DS-3 loops. The FCC determined that it is generally not economical for a CLEC to deploy its own DS-1 loops, given their capacity limitations. Thus, the FCC explained that to offer DS-1 and DS-3 service, CLECs generally install high capacity fiber optic cables and then use the electronics to light the fiber at a specific capacity level, all from channelizing in the higher capacity offerings into multiple lower capacity streams. Accordingly, the FCC concluded that CLECs are not impaired without DS-1/ DS-3 UNEs in markets where CLECs have deployed or could economically deploy higher capacity facilities that can be channelized to provide service at lower levels.

Specifically, the FCC found that CLECs are not impaired without DS-1 loops within the service area of the wire center that has at least four fiber-based call locators and at least 60,000 business lines. The FCC also determined that CLECs are not impaired without access to DS-3 loops within the service area of a wire center containing at least four fiber-based call locators and at least 38,000 business lines. As with DS-1/DS-3 UNEs in the transport area, if a CLEC certifies that a DS-1/DS-3 loop meets impairment thresholds, the ILEC must offer immediate unbundled access and then litigate the issue before the relevant state utility commission.

Fourth, the FCC concluded that ILECs no longer need to provide CLECs with unbundled access to mass market local circuit switching. Specifically, the FCC gave CLECs twelve (12) months to eliminate their reliance on unbundled mass market local circuit switching, and increase the rates at which ILECs are compensated for unbundled local switching during the transitional period.

The DC Circuit upheld all four of these findings, concluding that the FCC's conclusions were reasonable, and supported by the record.

It is unclear whether the CLECs who had appealed the FCC's order below will seek a review of the DC Circuit's opinion in the Supreme Court.

Please let us know if you have any questions about this DC Circuit ruling, upholding the FCC's fourth attempt at establishing unbundling rules.

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If you have any questions about this Report or prior Reports, 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.

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