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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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U.S. Court of Appeals for the 6th Circuit Rules in Favor of OfficeMax. Inc. Against the Three Percent (3%) Federal Excise Tax on Toll Telecommunications Service

The U.S. Court of Appeals for the 6th Circuit in a 2-1 decision ruled in favor of OfficeMax, Inc. in *OfficeMax v. United States of America*, Case No. 04-4009, in which OfficeMax, Inc. ("OfficeMax") sought a refund of amounts it paid the Internal Revenue Service ("IRS") under the three percent (3%) federal excise tax on toll telecommunications services from 1999 through 2002.

OfficeMax had filed claims with the IRS for a full refund of $380,296.72 in excise taxes it had paid through its long distance carrier, MCI. As you know, an end user's long distance carrier collects the federal excise tax and remits it to the IRS. OfficeMax argued that MCI was not providing a taxable telecommunications service, because it did not provide a telephone-quality communication for which there is a toll charge which varies in the amount with the distance and elapsed transmission time of each individual communication. When OfficeMax did not receive the refund, OfficeMax filed suit for declaratory ruling in the U.S. District Court for the Northern District of Ohio at Cleveland. The District Court granted OfficeMax's Motion for Summary Judgment, reasoning that the statutory language at issue, in 26 U.S.C. §4252(b)(1) requires a telephone service plan's charges to vary both with the distance and elapsed time of each call. The Court also rejected the IRS' argument that OfficeMax's long distance plan met an alternative definition of toll service

provided in 26 U.S.C. §4252(b)(2) or the definition of local telephone service in 26 U.S.C. §4252(a), both of which services are also subjected the three percent (3%) excise tax.

The U.S. Court of Appeals for the 6th Circuit upheld the District Court, ruling that the statutory language of 26 U.S.C. §4252(b)(1) requires a telephone service plan's charges to vary both with the distance and elapsed time of each call for the three percent (3%) excise tax to apply. Accordingly, OfficeMax was entitled to the refund.

The Court's decision follows a decision of the U.S. Court of Appeals for the 11th Circuit which came to the same conclusion in *American Bankers Insurance Group v. U.S.*, which we reported in our May 2005 newsletter (Volume II, No. 3).

In October, the IRS issued a notice directing telecom providers to continue collecting the federal excise tax on services similar to those involved in both federal appeals courts' rulings that rejected the IRS' interpretation of the 26 U.S.C. §4252(b)(1). The fact that the IRS issued the notice directing telecom providers to continue collecting the excise may be an indication that the IRS intends to take this matter to the U.S. Supreme Court. We believe the IRS may seek *certiorari* from the U.S. Supreme Court on this case. As we have previously advised, the IRS is also seeking public comment on the issue of how the tax should be structured.

As we previously advised you, this is an excellent time for long distance users to file claims for refunds either through the IRS or a suit for declaratory order in the federal district court seeking refunds, especially where the user has large telecommunications bills on which it has paid large amounts of federal excise tax through its long distance provider or providers.

If any of you have questions about this issue, please let us know.

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FCC's Enforcement Bureau Outlines Requirements for Interconnected Voice-Over Internet Protocol 911 Compliance Letters: Existing Interconnected VoIP Will Not Be Disconnected

The FCC's Enforcement Bureau has decided that interconnected voice-over internet protocol ("VoIP") service providers must file with the FCC a compliance letter pursuant to the FCC's June 3, 2005, Order establishing enhanced 911 requirements for internet protocol-enabled service providers. These compliance letters must be filed with the FCC on or before November 28, 2005.

Additionally, the FCC's Enforcement Bureau has decided not to require VoIP providers who have not achieved full compliance with the FCC's VoIP 911 Order, summarized below, to discontinue VoIP service to their existing customers.

The U.S. Court of Appeals for the D.C. Circuit denied a request for a stay of the FCC's decision on November 15, 2005.

By way of background, on June 3, 2005, the FCC released its VoIP 911 Order adopting rules that require interconnected VoIP providers to provide their new and existing subscribers with 911 service no later than November 28, 2005. Specifically, as a condition of providing interconnected VoIP service, each interconnected VoIP provider must satisfy the subscriber notification,

acknowledgment, and labor requirements set forth in Section 9.5(e) of the FCC's rules, 47 C.F.R. § 9.5(e). In addition, interconnected VoIP providers must:

- Transmit all 911 calls to the public safety answering point ("PSAP"), designated statewide default answering point, or appropriate local emergency authority that services the caller's "Registered Location". An enduser's Registered Location is the most recent information obtained by an interconnected VoIP service providers that identifies the physical location of the end user. Such transmissions much include the caller's automatic numbering information ("ANI") and registered location to the extent that the PSAP designated statewide default answering point or appropriate local emergency authority is capable of receiving and processing such information. ANI is a system that identifies the billing account for a call, and for 911 assistance, identifies the calling party and may be used as a callback number;

- Route all 911 calls to the use of ANI and, if necessary, a pseudo-ANI via the wireline E911 network, and make a caller's registered location available to the appropriate PSAP designated statewide default answering point or appropriate local emergency authority from or through the appropriate automatic location identification database. A pseudo-ANI is a number consisting of the same number of digits as an ANI that is not a North American numbering plan telephone directory number and may be used in place of an ANI to convey special meaning. The special meaning is determined by agreements, as necessary, between the communications system originating the call, intermediate communications systems handling and routing the call, and the destination communications system. The wireline 911 network is a dedicated wireline network that is interconnected with those largely separated from the public switch telephone network, includes a selective router, and is utilized to route emergency calls and related information to PSAPs;

- Obtain from each of its existing and new customers prior to initiation of service, a registered location; and

- Provide all of their end users one or more methods of updating their registered location at will and in a timely manner. At least one method must allow end users to use only the same equipment such as an internet telephone that they use to access the interconnect to the VoIP service.

The FCC requires interconnected VoIP providers to include in their compliance letters the following information:

- 911 solution – this solution should describe quantification, on a percentage basis, of the number of subscribers to whom the provider is able to provide 911 service in compliance with the VoIP Order.

- Obtaining initial registered location information – a detailed description of all actions the provider has taken to obtain each existing subscriber's current registered location and each new subscriber's initial registered location. The information should include, but is not limited to, relevant dates and methods of contact with subscribers

and a qualification on a percentage basis of the number of subscribers from whom the provider has obtained a registered location.

- Obtaining updated registered location information – a detailed description of the methods the provider has offered it subscribers to update their registered locations. This information should include a statement as to whether the provider is offering its subscribers at least one option for updating the registered location that permits them to use the same equipment that they used to access their interconnected VoIP service.

- Technical solution for subscribers who move locations frequently – a detailed description of any technical solutions the provider is implementing or has implemented to ensure that subscribers have access to 911 service whenever they use their service and frequently change locations.

Significantly, the FCC has determined that it will not require providers who have not achieved full 911 compliance by November 28, 2005, to discontinue the provision of interconnect the VoIP service to any existing customers. However, such providers are expected to discontinue marketing VoIP services and discontinue accepting new customers for such service in all areas where another provider is not transmitting 911 calls to the appropriate PSAP.

In short, the FCC has decided not to hold the November 28, 2005, as a firm date for requiring interconnected VoIP providers who have not achieved full 911 compliance to discontinue providing interconnected VoIP service to existing customers.

Let us know if you have any questions on the foregoing.

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FCC Approves SBC/AT&T Merger and Verizon/MCI Merger

On October 31, 2005, the Federal Communications Commission ("FCC") approved the mergers of SBC Communications Inc. ("SBC") with AT&T Corp. ("AT&T"), and Verizon Communications Inc. ("Verizon") with MCI, Inc. ("MCI").

In approving the mergers, the FCC determined that the mergers would produce substantial benefits to the public interest. These benefits include:

(1) integration of complementary networks, which will increase efficiency and provide consumers with new services and improved network performance and reliability;

(2) creation of stable, reliable U.S.-owned telecommunications companies that will provide improved service to government customers thereby benefiting national defense and homeland security;

(3) increased economies of scale and scope of the merged companies, which should increase incentives and resources to engage in basic research and development of telecommunications services; and

(4) substantial cost savings which should benefit consumers.

In approving the mergers, the FCC analyzed the comparative effects of the mergers by focusing on six key telecommunications services. These services are:

- **Special Access**: the FCC found that, in a limited number of buildings where AT&T in SBC's territory and MCI in Verizon's territory is the only competitive carrier with direct connections, that mergers could have an anti-competitive effect on wholesale special access services that are provided entirely over a single carrier's facilities. SBC and Verizon, however, entered into consent decrees with the U.S. Department of Justice which addressed this concern. Under the Consent Decree, SBC and Verizon will dispose of special access facilities in a limited number of buildings where AT&T and SBC's territory, and MCI in Verizon's territory, is the only competitive carrier with direct connections.

- **Retail Enterprise**: the FCC found that the mergers are not likely to result in anti-competitive effects for medium or large enterprise customers, because these customers are sophisticated, high-volume purchasers of telecommunications services, and because a significant number of carriers will continue to compete in the retain market.

- **Mass Market Competition**: The FCC found that the mergers are not likely to result in anti-competitive effects for mass market customers because AT&T has ceased to market services to mass market customers, and is gradually withdrawing from this market, while MCI has significantly reduced its marketing activities in this market. The FCC further found that facilities, based upon inner mobile competition, including competition from cable television providing voice communications, voice-over Internet protocol services, and wireless services, are growing rapidly and will provide increasing competition to mass market customers.

- **Internet Backbone**: The FCC found that the two mergers are not likely to result in anti-competitive effects in the Internet backbone market, because the mergers would not cause the Internet to become a monopoly or duopoly, or give the merged companies the incentive or ability to tip the Internet backbone market to a monopoly, increase prices to super competitive levels, or reduce service quality.

- **Wholesale Interexchange**: The FCC found that the wholesale market is likely to remain competitive after the mergers, primarily due to the presence of numerous, competitive nationwide fiber networks that have excess capacity.

- **International**: The FCC found that the mergers are not likely to result in anti-competitive effects for mass market, enterprise or global telecommunications customers.

- **Public Interest Benefit**: The FCC recognized that SBC and AT&T and Verizon and MCI were making progress in implementing the FCC's VoIP 911 requirements for interconnection to VoIP providers.

- In approving the mergers, the FCC adopted enforceable conditions based upon certain voluntary commitments made by SBC and AT&T and Verizon and MCI. SBC/AT&T and Verizon/MCI committed:

- not to seek an increase in state-approved rates for unbundled network elements ("UNEs") for two years (except for rates that are subject to current appeals in the specific states);

- a one-time recalculation to exclude fiber-based co-location arrangements established by AT&T in SBC's region, and MCI in Verizon's region in identifying wire centers in which SBC or Verizon claim there is no impairment pursuant to the UNE triggers in the FCC's Triennial Review Remand Order, so that dedicated transport and/or high capacity loops need not be unbundled;

- implement a service quality measurement plan which will provide the FCC with quarterly performance results for interstate special access services. SBC/AT&T and Verizon/MCIs' commitment to implementing this plan will terminate the earlier of thirty (30) months and forty-five (45) days after the beginning of the first full quarter following the closing of the mergers, or the effective date of an FCC order adopting general special access performance measurement requirements;

- for thirty (30) months not to increase the rates paid by existing in-region customers of AT&T and SBC's region or MCI and Verizon's region for wholesale DS1 and DS3 local private line services;

- for a period of thirty (30) months not to provide special access services to themselves, their inter-exchange affiliates, or each other or their affiliates, that are not generally available to other similarly-situated customers;

- for a period of thirty (30) months before they provide new or modified contract tariff services to their own affiliates under Section 277(a) of the Communications Act. They will certify to the FCC that they provide service pursuant to those contract tariffs to unaffiliated customers other than each other or their wireline affiliates;

- for a period of thirty (30) months not to increase rates set forth in SBC and Verizon's interstate tariffs or special access services, including contract tariffs, that they provide in their in-region territory that are on file with the FCC on the closing date of the mergers;

- for a period of three (3) years to maintain settlement-free peering arrangements with at least as many providers of Internet backbone services as they did in combination on the date the mergers closed;

- for a period of two (2) years to post their peering policies on publicly-accessible websites. During this two (2) year period, SBC, AT&T, Verizon and MCI will post any revisions to their peering policies on a timely basis as they occur;

- AT&T owns Alascom, a major provider of interexchange service to and from Alaska. Accordingly, SBC/AT&T acknowledged that:

  (1) their merger does not change carrier-of-last-resort obligations imposed by the State of Alaska on inner exchange services provided by Alascom;

  (2) their merger will not alter statutory and regulatory geographic rate gouging and rate integration rules that apply on the merger closing date to Alascom; and

  (3) after the merger closing date, they will operate Alascom as a distinct, though not structurally separate corporate entity:

  - to provide within twelve (12) months within the closing of the mergers, DSL service to end region customers without requiring them to also purchase circuit switch voice telephone services. SBC/AT&T and Verizon/MCI will make the offering for two years from the time it is made available on a particular state. This means that these companies will provide naked DSL to end region customers without requiring them to also purchase local exchange services.

  - for a period of two (2) years to conduct business in a way that comports with the FCC's Internet policy statement issued in September, which we detailed in our September newsletter, Volume II, Issue 7.

  - file annual certifications that they are complying with these enforceable commitments.

If you want further information on the FCC's decision or the merger conditions, please let us know.

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FCC Begins Rulemaking to Ensure Reasonable Franchising Process for New Video Market Entrance

The FCC adopted a Notice of Proposed Rulemaking ("NPRM") in Docket No. 05-189, that requests comments on issues relating to the implementation of Section 621(a)(1) of the Communications Act of 1934, as amended. The NPRM seeks public comment on what actions, if any, the FCC should take to ensure that local franchising authorities do not unreasonably refuse to award cable franchises to competitive entrants.

The FCC has tentatively concluded that the mandate of Section 621(a)(1) of the Act should be interpreted to prohibit not just the element of refusal to award a franchise, but also a broader range of behaviors. The NPRM seeks public comment on the FCC's tentative conclusion.

In addition, the NPRM requests comment on the following issues:

- whether local franchising authorities are unreasonably refusing to grant competitive franchises. The NPRM requests comment on problems that cable incumbents have encountered with local franchising authorities, including how the FCC can ensure that the local franchising process is not inhibiting the ability of incumbent cable television operators to invest in broadband services;

- whether the FCC has authority to implement the pro-competitive mandate of Section 621(a)(1) of the Act. This section provides, in pertinent part, that a local franchising authority may award one or more franchises within its jurisdiction, and that a franchising authority may not grant an exclusive franchise and may not unreasonably refuse to award an additional competitive franchise for cable service within its jurisdiction. The NPRM has tentatively concluded that the FCC is empowered by both Title I and Title VI of the Communications Act to take appropriate steps to ensure that the local franchising process for cable systems does not serve as an unreasonable barrier to entry for competitive cable operators. The NPRM also tentatively concludes that the FCC may deem to be preempted and supersede any law or regulation of a state or local franchising authority that causes an unreasonable refusal to ward a competitive franchise in contravention of Section 621(a) of the Act;

- the NPRM has also tentatively concluded that it is not unreasonable for a local franchising authority, in awarding a franchise, to assure that access to cable services is not denied to any group of potential residential subscribers because of the income levels of residents in the local area in which the groups resides, allows a cable system a reasonable period of time to become capable of providing cable service to all households in the franchise area, and requires adequate assurance that the cable operator will provide sufficient public, educational and governmental access channel capacity, facilities, or financial support. The FCC seeks comment on this tentative conclusion;

- the NPRM requests comment on how the FCC should interpret the mandate of Section 621(a)(1), assuming there is both the need and the authority for the FCC to intervene in the local franchising process. The NPRM tentatively concludes that the FCC should interpret the relevant language of Section 621(a)(1) of the Act broadly, in order to prohibit not only unreasonable refusal to award competitive franchises, but also the establishment of procedures and other requirements that unreasonably interfere with the ability of new entrants to introduce their competitive offerings quickly;
- the NPRM seeks comments on what specific steps, if any, the FCC should take to implement Section 621(a)(1) of the Act;

- the NPRM seeks comment on whether the FCC has the authority to establish a minimum amount of time for potential competitors with existing facilities to build out their networks beyond their current service territories. The NPRM also seeks comments on what constitutes a reasonable, minimum timeframe; and

- the NPRM requests comment on whether the FCC should address actions at the state level, to the extent the FCC finds that such actions create unreasonable barriers to entry for potential competitors for cable service.

The FCC has not yet released the NPRM, but when it does so, it will announce comment dates based upon based upon publication of the NPRM in the *Federal Register*. We will let you know those comment dates in one of our subsequent newsletters or in a special alert

In the meantime, if anyone has questions on the NPRM, or the issues on which the FCC has requested comment, please let us know.

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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.

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