Oral Argument Requested

In the
UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

No. 19-1085

Agency No. 18-182

THE IRREGULATORS, NEW NETWORKS INSTITUTE, BRUCE A. KUSHNICK, MARK N. COOPER, TOM ALLIBONE, KENNETH LEVY, FRED GOLDSTEIN, AND CHARLES W. SHERWOOD, JR.,

PETITIONERS,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,

RESPONDENTS.

ON PETITION FOR REVIEW OF AN ORDER OF THE FEDERAL COMMUNICATIONS COMMISSION

REPLY BRIEF FOR PETITIONERS THE IRREGULATORS, ET AL

W. Scott McCollough
MCCOLLOUGH LAW FIRM, P.C.
2290 Gatlin Creek Rd.
Dripping Springs, TX 78620
DC Circuit Bar. No. 53446
(V) 512.888.1112
(FAX) 512.692.2522
EMAIL wsmc@dotlaw.biz

Attorney for Petitioners

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ARGUMENT

FCC and *Amici* run away from Petitioners' standing and record (merits) evidence, and mischaracterize Irregulators' position below and before the Court. Much of their case is based on the proposition–proven only through vigorous assertion–that Irregulators' contentions and complaints are "irrelevant," "outside the scope," of no concern or were not preserved.

Importantly, they do not specifically contest any of the Irregulators' evidence. Neither brief challenges the state-level financial information and impact analysis Irregulators produced below. They did not dispute or supply countervailing affidavits attacking Petitioners' standing evidence. It is all uncontested and therefore admitted.

FCC deemed the carriers' interests and burdens as paramount; consumer interests, especially on the intrastate side, was hardly on the radar screen even though consumers are the "agency's prime constituency." *Maryland People's Counsel v. FERC*, 761 F.2d 780, 781, 787 n.16 (D.C. Cir. 1985); *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1207 (D.C. Cir. 1987)(Mikva, J Dissenting). The Commission had a duty to analyze the impact of its proposal on consumers, but it failed to do so. FCC entirely ignored Irregulators' uncontested evidence that current jurisdictional misallocations force intrastate consumers to fund between $14 and $53 billion in costs that should be recovered from interstate

private line and other services supplied to wireless and broadband providers, many of which are affiliates of the LEC. Irregulators August 27, 2018 comments 5, 9, 11, 30 [JA __]. The separations freeze has harmed consumers; continuation perpetuates the harm, especially as LEC expand support of "5G." Ending the freeze will massively benefit consumers, especially intrastate local service users.

Petitioners made a compelling case for both "substantive unreasonableness" and "lack-of-reasoned-explanation." *See Multicultural Media Telecom & Internet Council v. FCC*, 873 F.3d 932, 936-37 (2017)(explaining the difference). The failure and refusal to consider Irregulators' submissions on consumer impact "renders its decision arbitrary and capricious in that part and warrants a remand to address the issues raised." *Mozilla Corp. v. FCC*, 2019 U.S. App. LEXIS 29480 *100 (D.C. Cir. Oct. 1, 2019) (slip op. 100).

Respondents' arguments are unconvincing and cannot carry the day. The only real issue is remedy. Petitioners request *vacatur* but remand with instructions would still provide redress.

RESPONSE TO FCC STANDARD OF REVIEW (FCC Br. 24)

FCC's standard of review discussion did not dispute Pet. Br. 47-48 or in any way contend that it deserves *Auer* or *Chevron* deference. It has therefore forfeited any claim to deference. *Mozilla*, 2019 U.S. App. LEXIS 29480 *192 (slip op. 138), *citing In re U.S. Office of Personnel Mgmt. Data Sec. Breach Litig.*, 928 F.3d 42,

71 (D.C. Cir. 2019) and *United States v. Gewin*, 759 F.3d 72, 87 n.2 (D.C. Cir. 2014).

I. PETITIONERS HAVE ARTICLE III STANDING (FCC Br. 25-33)

A. Petitioners' Standing Evidence and Argument

Petitioners' standing evidence[1] and argument[2] clearly demonstrate several injuries-in-fact fairly traceable to the *Freeze Order* that are likely to be redressed by a favorable decision on the merits. *Humane Soc'y of the U.S. v. Vilsack*, 797 F.3d 4, 8 (D.C. Cir. 2015). FCC's[3] objection to standing argues (1) the evidence should be ignored because it was not repeated verbatim in the brief (FCC Br. 25, n.5, 27, 28); Petitioners are wrong on the merits and lack standing as a result (FCC Br. 20, 26-28, 31-32); (2) Petitioners have not proven any or a sufficient injury (FCC Br. 25-32); and (3) even if there is injury and error nothing can or should be done about it (FCC Br. 22, 32-33).

Sierra Club v. EPA, 292 F.3d 895, 900-01 (D.C. Cir. 2002) requires petitioners to establish standing "at the first appropriate point in the review

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[1] The evidence comprises 85 pages, and includes an affidavit from each of the individual Petitioners establishing their individual factual circumstances as relevant to the issues in this case. Three affidavits (Goldstein, Cooper and Kushnick) provide expert analysis connecting the basic facts to injuries traceable to the *Freeze Order*. The three experts explain how remand would provide a remedy. The affidavits provide the information FCC Br. 25, n.5, 27, 28 demands.

[2] Pet. Br. 37-39.

[3] *Amici* support the Commission's challenge on p. 9 n.5, without additional argument.

proceeding." They do so by filing "affidavits" "sufficient to support [the] claim." Then, the brief must contain a "*concise recitation* of the basis upon which [petitioner] claims standing." (Emphasis added).

The "first appropriate point" for the standing demonstration is the Docketing Statement required by Circuit R. 15.5(c)(2) and Part 6.e. of the Court's "Agency Docketing Statement" Form. Petitioners' May 20, 2019 Docketing Statement included a 38 page, 9,115 word "Standing Argument" along with the same affidavits as were appended to the brief. The Docketing Statement contained almost all of the fine-grained legal analysis FCC Br. 25, n.5, 27, 28 wrongly contends should have been in the brief. FCC did not challenge standing in its responsive filing on June 3, 2019 or file a motion to dismiss. Petitioners' reasonably believed they did not have to repeat the same legal argument in full a second time, especially since the Court has repeatedly indicated the *briefing* standing argument should be "concise."

Ams. for Safe Access v. DEA, 706 F.3d 438, 445 (D.C. Cir. 2013) and *Am. Library Ass'n v. FCC*, 401 F.3d 489, 494 (D.C. Cir. 2005) hold that long legal arguments merely regurgitating the evidence "would waste, rather than conserve, judicial resources and place an unnecessary burden on litigants." The rules require a "plausible argument" supported by "concrete evidence."

Standing turns on the facts, and the facts come from evidence–here the twice-filed Affidavits. The opening brief need not slavishly restate all the evidence, or fully rehash the experts' basis for opinion on harm and redressability. The Affiants' substance was over 13,000 words, so it would not have been possible to do what the Commission demands under the briefing rules.[4]

The evidence determines the outcome, not whether the initial brief ingeminated each tiny detail. "[C]ourts do their best based on the complaint and declarations to assess whether the plaintiff's assertions suffice to show the elements of standing." *Carpenters Indus. Council v. Zinke*, 854 F.3d 1, 5 (D.C. Cir. 2017).

B. Petitioners Did Show Concrete Injury (FCC Br. 25-27)

1. Court must assume Petitioners prevail on the merits

FCC Br. 20, 26-28, 31-32 argues the Irregulators are not harmed because their substantive challenge is without merit. But "[i]n assessing [Irregulators'] standing, we must assume they will prevail on the merits of their claims." *Ams. for Safe Access v. DEA*, 706 F.3d 438, 443 (D.C. Cir. 2013).

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[4] Petitioners were not trying to make "the Court do counsel's work." FCC Br. 28. The FCC's way would require the Court to read the same thing twice and leave no room for merits argument.

2. FCC Misconstrues Financial Injury Precedent

FCC Br. 28 claims the injury is not "substantial." Pages 29 and 30 assert the injury is "vanishingly small" and "not sufficiently large." Page 29 argues that any jurisdictional mismatch causing higher intrastate assessments will be netted out by lower interstate assessments. These assertions fail.

"For standing purposes, a loss of even a small amount of money is ordinarily an 'injury.'" *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 983 (2017). "[E]ven a small financial injury confers Article III standing." *Twin Rivers Paper Co. LLC v. SEC*, 934 F.3d 607, 616 (D.C. Cir. 2019). "[T]he amount is irrelevant. A dollar of economic harm is still an injury-in-fact for standing purposes." *Carpenters Indus. Council*, 854 F.3d at 6 "The consumers' alleged economic harm–even if only a few pennies each–is a concrete, non-speculative injury." *Wallace v. ConAgra Foods, Inc.*, 747 F.3d 1025, 1029 (8th Cir. 2014).

(i) Petitioners' Price-cap carriers' local rates

FCC Br. 20, 27 baldly asserts Petitioners "never substantiate that the separations rules harm consumers" and did not "make clear how they are forced to pay higher prices." FCC Br. 25 n.5 then admits Cooper and Kushnick provide that very information. Goldstein (¶5C-M) also exhaustively details how consumers are forced to pay higher prices.

(ii) Petitioners' wireless and IXC access cost

FCC Br. 28 argues the Irregulators did not prove their wholesale providers pass through increased or decreased costs. Allibone ¶4; Cooper ¶¶4, 5, 7K, Goldstein ¶¶4-5, Kushnick ¶5, Levy ¶4 and Sherwood ¶4 directly averred they do. Further, counsel seems unaware that FCC "generally expect[s]" IXCs to make "some passthrough of any decline in costs." *Updating the Intercarrier Compensation Regime to Eliminate Access Arbitrage*, FCC 19-94, __ FCC Rcd ___, ¶32 (2019).[5]

(iii) Petitioners' wireless, IXC and Internet USF passthroughs

FCC Br. 29 asserts Petitioners' total federal and state USF assessment passthrough would likely remain about the same due to netting. This accounting-based contention works only if revenue-based assessment percentages are the same in both jurisdictions. FCC, however, provides no evidence this is so. The Court cannot just accept this unsupported representation, which even if true would not justify overcharging in one jurisdiction.

Regardless, potential netting cannot preclude standing. "[S]tanding analysis is not an accounting exercise." *NCAA v. Governor of N.J.*, 730 F.3d 208, 223 (3d Cir. 2013). *L.A. Haven Hospice, Inc. v. Sebelius*, 638 F.3d 644, 656-57 (9th Cir. 2011) rejected a similar "net" injury argument.

[5] Available at https://docs.fcc.gov/public/attachments/FCC-19-94A1.pdf.

(iv) Competitive Harms

FCC Br. 30-32 contends Irregulators did not prove any competitive harm. Most of the argument is based on the price-cap issue. FCC Br. 32 also argues that most competitors are not subject to any form of economic regulation, so they are indifferent to separations. This completely misses the point.

All competitors purchasing inputs from LECs must pay LEC state or federal regulated rates (including intercarrier compensation). Even if a competitor can get lines elsewhere it must still contend with the LEC's (or its affiliates') retail prices and call rating. Subsidization or predation harms competition. Cooper ¶4, Goldstein ¶¶4-5, Sherwood ¶4. Cooper ¶5 and Kushnick ¶9D and 19M show that the current separations regime allows Verizon and other price-cap carriers to subsidize their affiliated and unregulated competitive activities using revenues obtained from basic local service. Cooper ¶7 and Goldstein ¶6 explain how this harms consumers and competition and reduces social welfare, and then observe that new 5G wireless costs will make things even worse.

C. Petitioners Did Show Redressability (FCC Br. 32-33)

FCC Br. 21-22, 25, 32-33 says the Court should deny the petition because the "only relief the Court could order, *vacatur* and remand of the *Order*, would provide no benefit" and lead to disruption. These claims rest on the proposition the Commission cannot make substantive changes without a Joint Board

recommendation. FCC Br. 6, 10, 13-15, 19-20, 22, 33, 37-38. But this argument directly contradicts *Freeze Order* ¶48 [JA __]:

> [n]othing in section 410(c) obligates the Commission to wait indefinitely for a recommended decision before acting. We conclude that the only reasonable interpretation of the statutory language allows the Commission to act unilaterally where, as here, issues have been pending before the Joint Board for many years without a recommended decision."

FCC also ignores the *Freeze Order's* substantive change to the separations rules granting rate-of-return carriers a category relationships unfreeze option, even though there was no Joint Board recommendation. FCC had the authority to make other substantive changes, including Petitioners' interim and short-term solutions that mitigated the burden on small carriers.

When this Court vacated FCC-promulgated "UNE" rules in *USTA v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), the FCC quickly acted to preserve the *status quo* on an interim basis pending further action. *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 19 FCC Rcd 16783, 16784, 16793-16797 (2004). The Commission has the tools it needs to prevent any significant disruptions from *vacatur*.

Petitioners' complaints about the *Freeze Order's* erroneous holding that separations are "irrelevant to price-cap carriers" (¶28) can be remedied through a remand requiring the FCC to reevaluate the impact of extension on price-cap

carriers for intrastate purposes. Cooper ¶¶7.N & O, 8; Goldstein ¶6. Addressing the price-cap issue would not require Joint Board involvement.

Petitioners request *vacatur*, but remand without one would still provide meaningful redress of Petitioners injuries. An inadequately supported rule "need not necessarily be vacated." *Comcast Corp. v. FCC*, 579 F.3d 1, 8 (D.C. Cir. 2009); *Fox TV Stations, Inc. v. FCC*, 280 F.3d 1027, 1048 (D.C. Cir. 2002), *amended* 293 F.3d 537 (D.C. Cir. 2002). This Court vacated a portion of the FCC's "Internet Freedom" rules that had no legal basis, but merely remanded other rules for further consideration because the reversal was premised on "lack of reasoned decisionmaking" and a "failure to adequately consider," *Mozilla*, 2019 U.S. App. LEXIS 29480, at *202-03 (slip op. 145-146).

Petitioners, however, are concerned that an open-ended remand will allow the FCC to avoid compliance by effectively granting itself an "indefinite stay of the court's decision." *See In re Core Communs., Inc.*, 531 F.3d 849, 862-863 (D.C. Cir. 2008) (Griffith J concurring). If the Court does remand without *vacatur*, Petitioners request an order that the FCC promptly proceed and conclude the remand within a reasonable time.

II. The FCC's Decision To Extend The Freeze Was Not Reasonably Explained Or Substantively Reasonable (FCC Br. 33-46)

A. No Waiver of Any Point on Review

FCC and *Amici* assert Petitioners did not preserve certain issues. For example, FCC Br. 46 tries to claim Petitioners did not assert extending the freeze would harm consumers. This was, however, the seminal point of every Irregulator filing contained in the Joint Appendix.[6]

The FCC Br. 41, 42 n.10, 43 incorrectly claims Petitioners did not discuss the still-binding nature of Part 36 outcomes. Petitioners' August 27, 2018 comments 7 asserted "states, who are still bound to the supposedly forborne separations, are basing policy and in some cases rate-making proceedings on these obsolete numbers." Pages 3, 6 and 13 showed how the "Zombie" separations rules still bind the states when dealing with price-cap carriers' intrastate matters [JA __]. The April 27, 2018 Hartman Memorandum 20 [JA __] observed that many state commissions and price-cap carriers like Verizon NY apply Part 36 outcomes. He provided Verizon financial material calculating amounts "subject to separations."

Amicus Br. 17 argues the Irregulators did not oppose "delegating" the choice whether to update category relationships to rate-of-return carriers. This is wrong.

[6] Irregulator filings on April 17, 2017 [JA __], May 24, 2017 [JA __], July 18, 2017 [JA __], April 27, 2018 [JA __], August 27, 2018 [JA __] and September 4, 2018 [JA __] explained how the "Big Freeze" harms consumers and competition in numerous ways. Some individual documents were filed more than once, but the JA includes only one copy.

The Irregulators opposed any extension–voluntary or otherwise–for "all carriers" and advocated an all-encompassing mandatory end. Irregulators August 27, 2018 comments 8 [JA __]. This necessarily means Petitioners opposed granting a voluntary option, or delegating the decision, to individual carriers.

B. The Agency Did Not Adequately Consider Petitioners' Arguments (FCC Br. 39-46)

The evidence below was uncontested and not even controversial: the LECs and FCC admit current separations outcomes significantly over allocate costs to intrastate and local, and under allocate to interstate. Pet Br. 33-34. Irregulators' unrebutted comments showed that the rules enable cross-subsidization of unregulated and competitive activities like wireless (including 5G) and broadband. Irregulators May 24, 2017 "Wireless" report [JA __] and August 27, 2018 comments 6-8 [JA __] stressed this point. The *Freeze Order* refused to consider these points based on its holding that the comments were "out of scope."

1. Petitioners have repeatedly "made clear the link between the Part 36 rules and state regulation of price-cap carriers" (FCC Br. 40-45)

Petitioners' Brief 24-29, 51-67 explained why states are still required to apply Part 36 outcomes despite price-cap forbearance. This was a direct invitation for the FCC to declare without equivocation that Petitioners are wrong as a matter of law, and expressly inform the Court that forbearance completely freed states to develop their own separations methods when it comes to price-cap carriers. Had it

done so the Court could have relied on that representation just as it did in *Crockett Tel. Co. v. FCC*, 963 F.2d 1564, 1573 (D.C. Cir. 1992). Petitioners would lose the legal argument over the still-binding nature of Part 36 for intrastate purposes, but we would nonetheless embrace that outcome on the price-cap issue.

An unequivocal holding that forbearance released the states from Part 36 outcomes would free the states from the compulsion expressed by Maine in *Northern New England Telephone Operations LLC d/b/a Fairpoint Communications-NNE; Request for Increase in Rates and for Maine Universal Service Fund Support for Provider of Last Resort Service*, 2014 Me. PUC LEXIS 179, *86 (2014).[7] Pet. Br. 62-63. States could independently determine price-cap carriers' intrastate costs adopt an intrastate Category 3 loop factor that is lower than the 75% required by 47 C.F.R. 36.154(c) (Pet. Br. Addendum 99). Each could adopt different intrastate factors and category relationships like for Dial Equipment Minutes (47 C.F.R. §36.125(i), Pet. Br. Addendum 88) or Corporate Operations Expense (47 C.F.R. §36.391, Pet Br. Addendum 124). Then each state could require price-cap and rate-of-return carriers to reduce local rates since–as explained below–separations changes are "exogenous" under all state and federal price-cap regimes.

[7] FCC Br. 44 n.11 dismisses the Maine holding by asserting there was "no analysis." Maine probably thought the proposition so clear it did not require exposition. Significantly, FCC does not say Maine was wrong.

FCC Br. 11-13, 31 argues states can employ state law to calculate "similar" Part 36 outcomes. It carefully avoided any hint that states can independently devise *entirely different* methods, factors and category relationships even though Pet. Br. 28-29, 36, 48-67 specifically challenged FCC on the question. FCC did not directly respond. Instead, it dissembled.

FCC Br. 11, 32, 55 claims separations is irrelevant to price-cap carriers since "price-cap regulation severs the direct link between regulated costs and prices." FCC Br. 23 argues that Petitioners have "never made clear the purported link between the Part 36 rules and state regulation of price-cap carriers." FCC cannot see the link because it refuses to look. Every Petitioner presentation below extensively showed that state commissions still use Part 36 outcomes. Pet. Br. 51-67 explained why they–like Maine–think they have no choice. Intrastate rates today are so high because state commissions believe local rates do not recover their intrastate separated costs. The perception of losses drove local rate increases and carrier retention of funds that should have been passed through to ratepayers. It is a big reason telephone companies are being allowed to tear down their copper networks, even though they retain value and could still support many services. Irregulators August 27, 2018 comments 3-19 [JA __].

FCC Br. 43-44 contends that the states are "permitted, rather than required to rely on federal Part 36 rules." Page 31 argues that if states are applying Part 36

they have "done so under state law." But that is not responsive. 47 U.S.C. §160(e) directly prohibits continued state commission enforcement of forborne rules, whether under state law or otherwise. If the formal separations rules no longer apply that just means there must be an informal method. *Crockett*, 963 F.2d at 1572-73 ("under the *Smith* analysis as adopted by Congress there must be some determination by which the federal regulator computes rates based on the carrier's property apportioned to interstate usage and the state regulator conducts ratemaking based on that portion allocated to intrastate usage").

Petition of AT&T Inc. for Forbearance under 47 U.S.C. §160 from Enforcement of Certain of the Commission's Cost Assignment Rules; *Petition of BellSouth Telecommunications, Inc. for Forbearance under 47 U.S.C. §160 from Enforcement of Certain of the Commission's Cost Assignment Rules*, 23 FCC Rcd 7302, 7321-7322, ¶¶33-34 (2008) adopts a *Crockett*-style informal method by telling states to maintain or adopt "similar" state rules that lead to *the same outcome* as Part 36. FCC Br. 12 and 31 make this clear. But this only proves Petitioners' point. The states cannot determine price-cap carriers' intrastate costs using methods, factors or relationships that significantly vary from those in Part 36.

The Commission is correct that forbearance made Part 36 no longer relevant for *interstate* purposes when it comes to price-cap carrier rates. But the

Commission is wildly wrong about how it works on the intrastate side, even though Petitioners repeatedly explained the problem in their comments. The FCC Brief fundamentally misrepresents how price-cap carriers' rates were initially established and the importance of Part 36 to ongoing price-cap rate adjustments. This is curious, since most of the states that employ price-cap ratemaking largely track the FCC regime.

(i) Carriers' initial price-cap rates were cost-based and calculated using cost-accounting rules; the states use separated cost results for periodic "reality checks"

FCC apparently forgets how the first capped prices were set. The program started with then-current rates, which were based on the cost accounting rules, including separations. Then, on a going-forward basis, the carrier adjusts the cap using "an escalator based on general price inflation, minus an annual percentage reduction for expected savings from innovation and other economies." *Nat'l Rural Telecomms. Ass'n v. FCC*, 988 F.2d 174, 178 (1993) ("*NRTA*").

The same is true for every state-based price-cap regime. For example, FCC Br. 4-5 and n.2 cite to *Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, 2006 N.Y. PUC LEXIS 193 (2006). NYPSC started its analysis of Verizon's situation by noting significant "access line" and "revenue" "losses" "result[ing] in the companies' reported rates of return declining and being much

lower than what those companies would be allowed in a traditional rate case." 2006 N.Y. PUC LEXIS 193 at *103-*104. NYPSC found that basic local rates were "well below cost" and "should be raised." *Id.* at *119. These findings were based on carrier-supplied annual reports (*Id.* at *104) that rely on the intrastate results flowing from Part 36. April 27, 2018 Hartman Memorandum 20 [JA __] (analyzing Verizon financial documents calculating amounts "subject to separations."). New York's variant of the price-cap regime started off by relying on what rates would be under traditional rate-of-return regulation and intrastate Part 36 results.

The New York price-caps regime periodically "check[s] to see whether the cap has gotten out of line with reality." *NRTA*, 988 F.2d at 178. It does so by reviewing Verizon's annual reports. NYPSC's "reality check" uses cost accounting rules, including intrastate amounts as calculated by Part 36. Several recent decisions illustrate. Verizon has recently received significant tax refunds. NYPSC granted Verizon a series of waivers allowing it to keep the refunds rather than sharing them with consumers. The expressly stated reason was "financial stress" flowing from "intrastate net operating losses" as measured from the annual reports (which, again, all rely on Part 36 based intrastate results). *Petition of Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2) of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New*

York, 2016 N.Y. PUC LEXIS 95, *9-13 (2016); *Petition of Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2) of a Proposed Allocation and Disposition of Certain Tax Refunds from the Town of Hempstead*, 2016 N.Y. PUC LEXIS 93 (2016); *Petition of Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2) of a Proposed Allocation and Disposition of Certain Tax Refunds from the Town of Oyster Bay*, 2016 N.Y. PUC LEXIS 94 (2016); *Petition of Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2) of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, 2016 N.Y. PUC LEXIS 650 (2016); *Petition of Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2) of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, 2019 N.Y. PUC LEXIS 221 (2019).

(ii) Interstate price-cap rates are adjusted for "exogenous" events separations

The FCC's presentation also ignores a more fundamental and compelling point: separations changes are "exogenous" drivers for price-cap carrier rate adjustments. The FCC price-cap regime provides for "exogenous" adjustments due to separations changes. *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6807, ¶¶166-167 (1990)("*LEC Price Cap Order*")("We will require an exogenous cost adjustment for changes in interstate costs for LECs that are caused by changes in the Separations Manual").

The FCC price-cap rules still require "exogenous" adjustments, and "separations" changes are still an express item. 47 C.F.R. §61.45(d)(1)(iii).[8] Exogenous cost changes (including separations changes) are part of the "Z" factor in the price-cap formula spelled out in 61.45(b)(i)(i) pursuant to 61.45(d). The FCC's price-cap rule requires every price-cap carrier to "recognize all exogenous cost changes" as part of their "annual access tariff filing." 47 C.F.R. §61.45(a), (b), (d)(2), (3).

The FCC has now forborne from enforcement of Part 36 for price-cap carriers for *interstate* purposes. So a separations change no longer triggers a requirement that price-cap carriers flow the change through in their interstate rates. But separations changes are still "exogenous" under <u>intrastate</u> price-cap regimes.

(iii) State price-cap regimes also include "exogenous" adjustments and treat separations as an exogenous item

FCC Br. 4-5 cites the New York intrastate regime, but fails to acknowledge that the original New York plan treated separations as an exogenous item. *Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company–Track 2*, 1995 N.Y. PUC LEXIS 440, *16 (1995)("Exogenous changes, which generally may be recovered only to the extent they exceed $6 million, are defined as the effects of jurisdictional separations").

[8] *See* Reply Addendum Pertinent Regulations.

Oregon's "Price Plan" provides for "Exogenous change adjustments" for "changed circumstances outside CenturyLink's control that will have an overall material impact on the Company." *Qwest Corporation et al,* 2018 Ore. PUC LEXIS 356, *39 (2018). Mississippi does the same: "For purposes of this section, the term exogenous change will include, but shall not be limited to, a change in any federal, state or local government tax, mandate, rule, regulation, or statute which causes a net change in a local exchange carrier's total intrastate regulated revenue, expenses, or plant in service." *Notice of Intent of the Mississippi Rural Incumbent Local Exchange Companies to Modify Their Form of Regulation and to Adopt a Price Cap Regulation Plan*, 2018 Miss. PUC LEXIS 60, *27 (2018). The California Frontier plan adjusts "for the impact of exogenous events that materially impact [] operations ... including but not limited to, orders of the Federal Communications Commission and this Commission." *Joint Application of Frontier Communications Corporation et al*, 2015 Cal. PUC LEXIS 762, *253 (2015). Under Pennsylvania "Chapter 30" alternative regulation plans "'exogenous events' such as (1) jurisdictional shifts in cost" are part of the formula for rate adjustments. *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund*, 2011 Pa. PUC LEXIS 1502 *44, n.29 (2011).

These are just some of the more recent state-level plans. As FCC Br. 4 observes, price-cap plans are in effect in many AT&T states and others have existed for several years. If the plan is "price-cap" it probably includes "exogenous" adjustments.

There *is* a "direct link between regulated costs and rates" for intrastate price-caps. *C.f.*, FCC Br. 32. Changes to Part 36 outcomes require exogenous adjustments to price-capped intrastate rates.

2. Petitioners fully explained how "letting the freeze expire would help" (FCC Br. 45-46)

Contrary to the claim in FCC Br. 36, Petitioners did then and do now assert that "allowing the freeze to expire would be a good idea." Irregulators August 28, 2018 comments 3, 8 unequivocally stated that "[t]he freeze should not be extended" and advocated an immediate end to the factor and category relationship freeze for "all carriers" including rate-of-return carriers and price-cap carriers [JA __].

Further, Petitioners did "explain how ending the freeze would alleviate alleged misallocations" and "alleviate their purported injuries." *C.f.* FCC Br. 33, 36. For example, Petitioners' August 27, 2018 Comments 13 [JA __] listed the harms inflicted by the freeze and contended that extending the freeze would maintain "massive financial cross-subsidies, rate increases, massive financial losses that save billions in taxes." Allowing the freeze to expire, on the other hand,

would *end* between $2.4 and $3.7 billion in Verizon NY annual overcharges. On a nationwide basis expiration would save consumers somewhere between $14 and $53 billion. Irregulators September 4, 2018 comments at 5, 9-11, 28, 30 [JA __].[9]

Expiration would lead to lower intrastate cost burdens and rates for rate-of-return carriers. It would also reduce interstate switched access rates. Pet. Br. 21, 33, 52, 73. Small rate-of-return LECs would incur some compliance costs to calculate the new factors, but as the Petitioners noted below the FCC could reduce the burden in several ways pending full and complete reform. Irregulators Aug. 27, 2019 Comments at 8 [JA __].

FCC/*Amici* do not contest Petitioners' showing (Pet. Br. 33-34) that updating separations to reflect current jurisdictional use would transfer billions of dollars in cost responsibility from the intrastate jurisdiction to the interstate jurisdiction. Intrastate price-cap "exogenous" adjustments would reduce price-cap and rate-of-return carriers' intrastate prices, especially for intrastate retail basic local service. If the freeze expires *all carriers* will have to update separations factors[10] and category relationships to better reflect current jurisdictional use. Rate relief will follow.

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[9] The September 4, 2018 comments analyzed the latest data from 2017 and employed various methods to calculate the range.

[10] *Amici* Br. 15 n.7 expresses "confusion" about whether Petitioners meant to address "factors" and "category relationships." The "freeze" extends to both. *FNPRM* ¶¶7, 9 n.21 [JA __]. The *Freeze Order* allowed rate-of-return carriers to

Rate-of-return carriers' allocation to interstate End User Common Line (paid by consumers) and interstate carrier common line switched access (paid by the consumer's toll provider) would go down. On the other hand, allocations to special access service (BDS) would increase. Rate-of-return carriers would be required to adjust those rates accordingly. Going forward, no LEC could use the current jurisdictional cost misalignment to engage in anti-competitive affiliate transactions or subsidize wireless service build-out, including 5G. Consumers would benefit, competition would benefit and pricing would become more rational. That would "help."

C. Irregulators' Suggestions For Separations Reform Were Not Outside The Scope Of The Rulemaking (FCC Br. 36-39)

Freeze Order ¶24 finds that Petitioners' recommendations were "beyond the scope" of the NPRM since they went beyond the "binary" question of whether to end or extend the freeze. FCC Br. 18, 22, 23, 36-39 repeat the assertion and argue that Petitioners' arguments were "not properly before the agency." FCC Br. 14 claims the *NPRM* "did not seek comment or substantive proposals to reform the separations rules" and page 22 asserts "revis[ing] the separations rules" was "never proposed in the *NPRM* and especially in the absence of a recommended decision from the Joint Board." *Amici* Br. 15, n.7 makes a related argument by claiming

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unfreeze category relationships but not factors. Irregulators opposed extending relationships or factors.

Petitioners discussion of "factors" should be ignored since the *Freeze Order* only dealt with "category relationships." Both parties mischaracterize the *NPRM*.

NPRM ¶¶34-37 discussed whether to allow a voluntary "category relationships" unfreeze." But *NPRM* ¶38 went on to ask whether "any other aspects of the freeze" should be modified. Paragraph 39 sought comment on whether LECs should "reset their jurisdictional allocation factors using current data" and "how any reset of jurisdictional allocation factors should be implemented, including providing information regarding timeframes, deadlines, period of data to be used, and any other related details." [JA __] Irregulators August 27, 2018 comments [JA __] responded to this invitation by seeking and end to all factor *and* category relationship freezes. Irregulators also sought a change to the 75%/25% allocator for Subcategory 1.3 loops.[11] The comments provided methods to ameliorate any compliance burden by–again, in response to *NPRM* ¶39–proposing ways all carriers could "reset their jurisdictional allocation factors using current data" and "how any reset of jurisdictional allocation factors should be implemented, including providing information regarding timeframes, deadlines, period of data to be used, and any other related details."

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[11] The Subcategory 1.3 loop "jurisdictional allocation factor" is frozen but unlike many other factors and relationships there is no stated end-date. *See* 47 C.F.R. §36.154(c) (Pet. Addendum 99).

FCC's claim these direct responses to *NPRM* ¶39 were "out of scope" and precluded by the lack of a Joint Board recommendation is arbitrary and capricious. Recall that the *Freeze Order* did "revise the separations rules" "in the absence of a recommended decision from the Joint Board" and held "[n]othing in section 410(c) obligates the Commission to wait indefinitely for a recommended decision before acting." *Freeze Order* ¶¶29-34, 48 [JA __]. *C.f.* FCC Br. 22.

Pet. Br. 31, 49-51 cited to the relevant *NPRM* paragraphs. The FCC brief did not discuss them; it merely parroted the *Freeze Order* "out of scope" finding. Respondents never advise the Court why Irregulators' suggestions were outside the scope established by *NPRM* ¶¶38-39. Perhaps it is because there is no rational basis to explain the Commission's action.

D. FCC's Remaining Arguments Have No Merit

1. "Separations is Increasingly Irrelevant (But Still Hard)"

The Commission proffers several policy-based arguments in support of its order. For example, FCC claims that "6 months" was inadequate to fulfill the "complex" task of separations reform. The FCC waited until there were only 6 months. They created the problem and then used it as an excuse to bum's rush the Irregulators.[12] FCC's own failure cannot be a basis to deny relief to Petitioners.

[12] Two months after the 2017 extension and 13 months before the *NPRM* Petitioners filed comments urging the FCC to proceed with reform. Irregulators July 18, 2017 comments [JA __].

FCC Br. 22, 14, 34, 37, 39. FCC Br. 17 acknowledges the "complex" task is actually getting simpler[13] because the industry is transitioning from circuit-switched to broadband and packet-switched. Even so, FCC Br. 45 uses the same transition to claim an unfreeze would not lead to factors and relationships that reflect reality.

The Commission overstates the need for studies to capture the transition. The "studies" requiring lost carrier expertise are largely for allocations among different *circuit-switched* services. *See Freeze Order* ¶22 (explaining lack of study expertise for "voice-related" services).

Part 36 addresses both circuit-switched and private line[14] service, and should automatically capture a large part of any reduced circuit-switched costs and increased private line costs. Many private line costs are directly assigned. 47 C.F.R. §36.154(a), (b) (Pet. Br. Addendum 99)("state" and "interstate" private lines "directly assigned to the appropriate jurisdiction."); 36.126(e)(3)(i) (Pet. Br. Addendum 92)(interexchange circuit costs directly assigned); 36.377(a)(1)(iv), (v) (Pet. Br. Addendum 117)(private line service order expense). There is no "jurisdictional factor" freeze for private lines. 47 C.F.R. §36.3(a) (Pet Br.

[13] The Commission asserts only a relative few carriers are now impacted. Petitioners disagree, but if that is true the task is easier, not harder.

[14] For Part 36 purposes "private line" is synonymous with "special access" and "Business Data Service."

Addendum 75)("Direct assignment of private line service costs between jurisdictions shall be updated annually"). A local loop repurposed for broadband or BDS immediately shifts from intrastate to interstate.

Category relationships do drive some allocations between "voice" and private line. 47 C.F.R. §36.3(b) (Pet Br. Addendum 75). Corporate Operations Expense, for example, is a "frozen" category relationships item. 47 C.F.R. §36.392(c) (Pet. Br. Addendum 125). This traps costs in the intrastate jurisdiction despite the ongoing shift from "local" to interstate private line as loops are increasingly repurposed from basic service to broadband or BDS. A category relationships "unfreeze" would allow the "category" costs to shift in tandem with the loop transition, thereby ending intrastate local's category relationship subsidization of interstate private line.

2. Consumer Impact

Freeze Order ¶¶20-23, 33 [JA __] found the costs of moving forward with updated factors and relationships for all carriers would outweigh the benefit, but its analysis focused on only one side of the equation. The Commission fixated on carriers' cost but failed to estimate potential consumer benefit. Irregulators September 4, 2018 comments 5, 9, 11, 30 [JA __] showed that on a nationwide basis consumers are presently harmed by at least $14 billion per year and the amount may be as high as $53 billion. Separations reflecting reality would yield

that same amount of consumer benefit. Carriers' compliance costs come nowhere near that amount, so consumer benefit clearly outweighs compliance cost.[15] The *Freeze Order* refused to consider the Irregulators' calculations as part of the cost/benefit analysis based on the "scope" holding. Pet. Br. 34, 68-69. The Court must direct FCC to address Irregulators' financial showing on remand.

3. Wireless Acceleration (FCC Br. 48)

FCC is astoundingly sanguine about Petitioners' showing that accelerating investment in 5G will magnify the harm. The current frozen rules assign significant common costs to "local" that actually belong in the interstate private line category. Rate-of-return and price-cap LECs are expending large sums to provide interstate private lines (BDS) that support wireless in general and 5G in particular. The factor and relationships freeze unfairly dumps a large portion of these private line costs on intrastate local users. Pet Br. 33-34, 72-74. FCC Br. 48 admits this "misallocation will grow." Its sole (and incorrect) argument is that Petitioners are wrong about the impact on price-cap carriers. FCC entirely ignores, however, that the admitted misallocation will remain for rate-of-return carriers that do not voluntarily unfreeze.

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[15] The Third Circuit held that "the FCC's analysis is so insubstantial that it would receive a failing grade in any introductory statistics class" in a recent case. *Prometheus Radio Project v. FCC*, 2019 U.S. App. LEXIS 28673, at *39 (3d Cir. Sep. 23, 2019). In the case below FCC did not even try its hand at arithmetic, much less statistical analysis.

E. Voluntary Unfreeze To Category Relationships (FCC Br. 48-49; *Amici* Br. 8-17)

Petitioners are glad some carriers will voluntarily unfreeze their relationships. The problem is those that do not, even though the reset would benefit their users along with other consumers whose providers must purchase switched access or pay USF assessments they then pass through. The other problem is that jurisdictional factors remain frozen for all carriers. Consumers are suffering the result. The FCC erred by not unfreezing all carriers factors and relationships on a mandatory basis.

Petitioners request *vacatur* and/or remand to the FCC with instructions that the Commission promptly address Petitioners' issues and make such rule adjustments as are necessary and appropriate.

SIGNATURE OF COUNSEL

Respectfully Submitted,

/s/ W. Scott McCollough
W. Scott McCollough
McCollough Law Firm, P.C.
2290 Gatlin Creek Rd.
Dripping Springs, TX 78620
DC Circuit Bar. No. 53446
(V) 512.888.1112
(FAX) 512.692.2522
EMAIL wsmc@dotlaw.biz

Attorney for Petitioners

CERTIFICATE OF SERVICE

I hereby certify that on October 10, 2019, I submitted the foregoing document with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit by uploading to ECF.

/s/ W. Scott McCollough
W. Scott McCollough

CERTIFICATE OF COMPLIANCE

1. All required privacy redactions have been made.

2. The CM/ECF electronic submission is an exact copy of the paper document from which it was prepared.

3. This document has been scanned for viruses with the most recent version of a commercial virus scanning program and is free of viruses.

4. Pursuant to the requirements of Fed. R. App. P. 32(a)(7), I hereby certify that the accompanying Brief for Petitioner in the captioned case contains 6,415 words as calculated by the word processing program. This brief also complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2016 in 14-point Times Roman font.

/s/ W. Scott McCollough

W. Scott McCollough

Dated: October 10, 2019

REPLY ADDENDUM – PERTINENT REGULATIONS

FEDERAL REGULATIONS

47 C.F.R. Part 61.45

§61.45 Adjustments to the PCI for Local Exchange Carriers.

(a) Price cap local exchange carriers shall file adjustments to the PCI for each basket as part of the annual price cap tariff filing, and shall maintain updated PCIs to reflect the effect of mid-year exogenous cost changes.

(b)(1)(i) Adjustments to price cap local exchange carrier PCIs, in those carriers' annual access tariff filings, the traffic sensitive basket described in §61.42(d)(2), the trunking basket described in §61.42(d)(3), the special access basket described in §61.42(d)(5) and the Interexchange Basket described in §61.42(d)(4)(i), shall be made pursuant to the following formula:

"$PCI_t = PCI_{t-1}[1 + w[GDP\text{-}PI - X] + Z / R]$."

$PCI_{t-1} = PCI_{t-1}[1 + w[GDP\text{-}PI - X] + Z / R]$

Where the terms in the equation are described:

GDP-PI = For annual filings only, the percentage change in the GDP-PI between the quarter ending six months prior to the effective date of the new annual tariff and the corresponding quarter of the previous year. For all other filings, the value is zero.

X = For the CMT, traffic sensitive, and trunking baskets, for annual filings only, the factor is set at the level prescribed in paragraphs (b)(1)(ii) and (iii) of this section. For the interexchange basket, for annual filings only, the factor is set at the level prescribed in paragraph (b)(1)(v) of this section. For the special access basket, for annual filings only, the factor is set at the level prescribed in paragraph (b)(1)(iv) of this section. For all other filings, the value is zero.

g = For annual filings for the CMT basket only, the ratio of minutes of use per access line during the base period, to minutes of use per access line during the previous base period, all minus 1.

Z = The dollar effect of current regulatory changes when compared to the regulations in effect at the time the PCI was updated to PCI_{t-1}, measured at base period level of operations.

Targeted Reduction = the actual possible dollar value of the (GDP-PI − X) reductions that will be targeted to the ATS Charge pursuant to §61.45(i)(3). The reductions calculated by applying the (GDP-PI − X) portion of the formula to the CCL element within the CMT basket will contain the "g" component, as defined above.

R = Base period quantities for each rate element "I", multiplied by the price for each rate element "I" at the time the PCI was updated to $PCI_{t-1.}$

w = R + Z, all divided by R (used for the traffic sensitive, trunking, and special access baskets).

w_{ix} = R—(access rate in effect at the time the PCI was updated to PCI_{t-1} * base period demand) + Z, all divided by R.

PCI_t = The new PCI value.

PCI_{t-1} = the immediately preceding PCI value.

(ii) The X value applicable to the baskets specified in §§61.42(d)(1), (d)(2), and (d)(3), shall be 6.5%, to the extent necessary to reduce a tariff entity's ATS charge to its Target Rate as set forth in §61.3(qq). Once any price cap local exchange carrier tariff entity's ATS Charge is equal to the Target Rate as set forth in §61.3(qq) for the first time (the former NYNEX telephone companies may be treated as a separate tariff entity), then, except as provided in paragraph (b)(1)(iii) of this section, X is equal to GDP-PI and no further reductions will be mandated (*i.e.,* if applying the full X-factor reduction for a given year would reduce the ATS charge below the Target Rate as set forth in §61.3 (qq), the amount of X-factor reduction applied that year will be the amount necessary to reach the Target Rate as set forth in §61.3 (qq)). A filing entity does not reach the Target Rate as set forth in §61.3(qq) in any year in which it exercises an exogenous adjustment pursuant to §61.45(d)(vii). For companies with separate tariff entities under a single price cap, the following rules shall apply:

(A) Targeting amounts as defined in §61.45(i)(1)(i) shall be identified separately, using the revenue for each of the tariff entities under the cap.

(B) Each tariff entity shall only be required to use the amount of targeting necessary to get to the Target Rate as set forth in §61.3 (qq).

(iii)(A) Except as provided in paragraph (b)(1)(iii)(B) of this section, once the Tariff Entity's Target Rate as set forth in §61.3 (qq) is achieved, the X-factor for

the CMT basket will equal GDP-PI as long as GDP-PI is less than or equal to 6.5% and greater than 0%. If GDP-PI is greater than 6.5%, and an entity has eliminated its CCL and multi-line business PICCs charges, the X-factor for the CMT basket will equal 6.5%, and all End User Common Line charges, rates and nominal caps, will be increased by the difference between GDP-PI and the 6.5% X-factor. If GDP-PI is less than 0, the X-factor for the CMT basket will be 0.

(B) For tariff filing entities with a Target Rate of $0.0095, or for the portion of a filing entity consolidated pursuant to §61.48(o) that, prior to such consolidation, had a Target Rate of $0.0095, in which the ATS charge has achieved the Target Rate but in which the carrier common line (CCL) charge has not been eliminated, the X-factor for the CMT basket will be 6.5% until the earlier of June 30, 2004, or until CCL charges are eliminated pursuant to paragraph (i)(4) of this section. Thereafter, in any filing entity in which a CCL charge remains after July 1, 2004, the X-factor for the CMT basket will be determined pursuant to paragraph (b)(1)(iii)(A) of this section as if CCL charges were eliminated.

(iv) For the special access basket specified in §61.42(d)(5), the value of X shall be 2.0% beginning December 1, 2017, notwithstanding any language in §61.45(b)(1)(i).

(v) For the interexchange basket specified in §61.42(d)(4), the value of X shall be 3.0% for all annual filings.

(2) Adjustments to price cap local exchange carrier PCIs and average price cap CMT revenue per line, in tariff filings other than the annual access tariff filing, for the CMT basket described in §61.42(d)(1), the traffic sensitive basket described in §61.42(d)(2), the trunking basket described in §61.42(d)(3), the interexchange basket described in §61.42(d)(4), and the special access basket described in §61.42(d)(5), shall be made pursuant to the formulas set forth in paragraph (b)(1)(i) of this section, except that the "w(GDP-PI − X)" component of those PCI formulas shall not be employed.

(c) Effective July 1, 2000, the prices of the CMT basket rate elements, excluding special access surcharges under §69.115 of this chapter and line ports in excess of basic under §69.157 of this chapter, shall be set based upon Average Price Cap CMT Revenue per Line month.

(d) The exogenous cost changes represented by the term "Z" in the formula detailed in paragraph (b)(1)(i) of this section shall be limited to those cost changes

that the Commission shall permit or require by rule, rule waiver, or declaratory ruling.

(1) Subject to further order of the Commission, those exogenous changes shall include cost changes caused by:

(i) The completion of the amortization of depreciation reserve deficiencies;

(ii) Such changes in the Uniform System of Accounts, including changes in the Uniform System of Accounts requirements made pursuant to §32.16 of this chapter, as the Commission shall permit or require be treated as exogenous by rule, rule waiver, or declaratory ruling;

(iii) Changes in the Separations Manual;

(iv) [Reserved]

(v) The reallocation of investment from regulated to nonregulated activities pursuant to §64.901 of this chapter;

(vi) Such tax law changes and other extraordinary cost changes as the Commission shall permit or require be treated as exogenous by rule, rule waiver, or declaratory ruling;

(vii) Retargeting the PCI to the level specified by the Commission for carriers whose base year earnings are below the level of the lower adjustment mark, subject to the limitation in §69.731 of this chapter. The allocation of LFAM amounts will be allocated pursuant to §61.45(d)(3). This section shall not be applicable to tariff filings during the tariff year beginning July 1, 2000, but is applicable in subsequent years;

(viii) Inside wire amortizations;

(ix) The completion of amortization of equal access expenses.

(2) Price cap local exchange carriers specified in §§61.41(a)(2) or (a)(3) shall, in their annual access tariff filing, recognize all exogenous cost changes attributable to modifications during the coming tariff year in their Subscriber Plant Factor and the Dial Equipment Minutes factor, and completions of inside wire amortizations and reserve deficiency amortizations.

(3) Exogenous cost changes shall be apportioned on a cost-causative basis between price cap services as a group, and excluded services as a group. Total exogenous cost changes thus attributed to price cap services shall be recovered from services other than those used to calculate the ATS charge.

(e) [Reserved]

(f) The exogenous costs caused by new services subject to price cap regulation must be included in the appropriate PCI calculations under paragraphs (b) and (c) of this section beginning at the first annual price cap tariff filing following completion of the base period in which such services are introduced.

(g) In the event that a price cap tariff becomes effective, which tariff results in an API value (calculated pursuant to §61.46) that exceeds the currently applicable PCI value, the PCI value shall be adjusted upward to equal the API value.

(h) [Reserved]

(i)(1)(i) Price cap local exchange carriers that are recovering revenues through rates pursuant to §§69.106, 69.108, 69.109, 69.110, 69.111, 69.112, 69.113, 69.118, 69.123, 69.124, 69.125, 69.129, or §69.155 of this chapter shall target, to the extent necessary to reduce the ATS Charge to the Target Rate as set forth in §61.3 (qq) for the first time, any PCI reductions associated with the dollar impact of application of the (GDP-PI − X) portion of the formula in §61.45(b)(1)(i) to the traffic sensitive and trunking baskets. In order to calculate the actual dollars to transfer to the trunking and traffic sensitive baskets, carriers will first determine the "Targeted Revenue Differential" that will be transferred to the trunking and traffic sensitive baskets to reduce the ATS Charge to the Target Rate as set forth in §61.3(qq). The Targeted Revenue Differential shall be applied only to the trunking and traffic sensitive baskets to the extent necessary to reduce the ATS charge to the Target Rate as set forth in §61.3 (qq), and shall not be applied to reduce the PCIs in any other basket or to reduce Average Price Cap CMT Revenue per Line month, except as provided in §61.45(i)(4).

(ii) For the purposes of §61.45(i)(1)(i), Targeted Revenue Differential will be determined by adding together the following amounts:

(A) R* (GDP-PI − X) for the traffic sensitive basket, trunking basket, and the CMT basket excluding CCL revenues; and

(B) CCL Revenues* [(GDP-PI − X − (g / 2)] / [1 + (g / 2)]

Where "g" is defined in §61.45(b)(1)(i).

(2) Until a tariff entity's ATS Charge equals the Target Rate as set forth in §61.3 (qq) for the first time, the Targeted Revenue Differential will be targeted to reduce the following rates for that tariff filing entity, in order of priority:

(i) To the residual per minute Transport Interconnection Charge, until that rate is $0.00; then

(ii) To the Information Surcharge, until that rate is $0.00; then

(iii) To the other Local Switching charges and Switched Transport charges until the tariff entity's ATS Rate equals the Target Rate as set forth in §61.3(qq) for the first time. In making these reductions, the reductions to Local Switching rates as a percentage of total X-factor reductions must be greater than or equal to the percentage proportion of Local Switching revenues to the total sum of revenues for Local Switching, Local Switching Trunk Ports, Signalling Transfer Point Port Termination, Switched Direct Trunked Transport, Signalling for Switched Direct Trunked Transport, Entrance Facilities for switched access traffic, Tandem Switched Transport, and Signalling for Tandem Switching (*i.e.,* Local Switching gets at least its proportionate share of reductions).

(3) After a price cap local exchange carrier reaches the Target Rate as set forth in §61.3(qq), the ATS Rate will be recalculated each subsequent Annual Filing. This process will identify the new ATS Charge for the new base period level. Due to change in base period demand and inclusion of new services for that annual filing, the absolute level of a tariff entity's ATS Charge may change. The resulting new ATS Charge level will be what that tariff entity will be measured against during that base period. For example, if a company whose target is $0.0055 reached the Target Rate during the 2000 annual filing, that level may change to $0.0058 in the 2001 annual filing due to change in demand and inclusion of new services. Therefore, it will be the $0.0058 average rate that the tariff entity will be measured against for all non-annual filings. Likewise, if that same company was at the Target Rate during the 2000 filing, that level may change to $0.0053 average rate in the 2001 annual filing due to change in demand and inclusion of new services. In that case, it will be at the $0.0053 average rate that the tariff entity will be measured.

(4) A company electing a $0.0095 Target Rate will, in the tariff year it reaches the Target Rate, apply any Targeted Revenue Differential remaining after reaching the Target Rate to reduce Average Price Cap CMT Revenue per Line month until

the CCL charge is eliminated. In subsequent years, until the earlier of June 30, 2004 or when the CCL charge is eliminated, tariff filing entities with a Target Rate of $0.0095, or the portion of a filing entity consolidated pursuant to §61.48(o) that, prior to such consolidation, had a Target Rate of $0.0095, will reduce Average Price Cap CMT Revenue per Line month according to the following method:

(i) Filing entity calculates the maximum allowable carrier common line revenue, as defined in §61.46(d)(1), that would be permitted in the absence of further adjustment pursuant to this paragraph;

(ii) Filing entity identifies maximum amount of dollars available to reduce Average Price Cap CMT Revenue per Line month by the following:

(CMT revenue in a $0.0095 Area −CCL revenue in a $0.0095 Area) * (GDP-PI −X) + (CCL Revenue in a $0.0095 Area) * [(GDP-PI − X) − (g / 2)] / [1 + (g / 2)]

(iii) The Average Price Cap CMT Revenue per Line month shall then be reduced by the lesser of the amount described in paragraph (i)(4)(i) of this section and the amount described in paragraph (i)(4)(ii) of this section, divided by base period Switched Access End User Common Line Charge lines.

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