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FCC Acted “Arbitrarily and Capriciously” Under the Telecommunications Act of 1996

By Bonnie Katubig

In Illinois Public Telecommunications Association v. Federal Communications Commission, 123 F.3d 693 (D.C. Cir. 1997), the United States Court of Appeals for the District of Columbia held in a per curiam decision that the Federal Communications Commission (“FCC”) acted “arbitrarily and capriciously” in numerous aspects of its Order pursuant to § 276 of the Telecommunications Act of 1996 (“Act”), 47 U.S.C. § 276. The court reviewed 20 consolidated petitions in this case and held that the FCC acted “arbitrarily and capriciously” by: (1) mandating both the interim and permanent compensation rates “for access code and subscriber 800 calls;” (2) requiring only large interexchange carriers (“IXCs”) to pay pay-phone service providers (“PSPs”) for such calls in the first interim-plan year; (3) failing to provide any compensation for “0+” calls; and (4) adopting a market-based value for pay-phone assets of Bell Operating Companies (“BOCs”).

Technological Advances Impede Adequate Compensation for Pay-Phone Service Providers

Through § 276 of the Act, Congress sought to “promote competition among pay-phone service providers.” Technological advances forced PSPs to compete against local exchange carriers (“LEC”) for pay-phone compensation. However, PSP compensation generally fell well below a fair rate. For example, PSPs provided three types of services, yet they were compensated only for two services, often at depressed rates. First, PSPs received compensation for their local call services through the direct deposit of coins into pay-phones. Second, unless it was affiliated with a BOC, the PSP also received compensation through direct contacts with IXCs, which allowed for the PSP’s provision of operator services for collect calls and calls billed to calling cards or third parties (collectively, “0+ calls”). Under such contracts, the IXC becomes the default provider for 0+ calls in exchange for a percentage of its revenues from that PSP’s pay-phones. However, PSPs operated at a competitive disadvantage with the LECs, who also received subsidies from the IXCs for originating and terminating the long-distance calls. Finally, PSPs received zero compensation for their provision of access code calls, those calls allowing the caller to choose the long-distance carrier, or for subscriber 800 calls. PSPs once were able to mitigate this problem by blocking such calls, but the Telephone Consumer Services Improvement Act, 47 U.S.C. § 226(c)(1)(B) (1990), disallowed this practice. At that time, the FCC had ordered IXCs to compensate PSPs for access code calls, yet declined to require compensation for 800 calls. This action forced PSPs to provide 800 call service without compensation.

Measures Taken to Avoid Unfair Competition

Recognizing the unfair compensation plans for PSPs, Congress enacted § 276 of the Act, which mandated that the FCC establish a plan which would ensure that all PSPs receive fair compensation for each call made from their pay-phones. Additionally, the Act forbade BOCs from subsidizing their pay-phone service using their telephone exchange service or access operations and from discriminating in favor of their particular pay-phone service. The FCC also halted intrastate and interstate carrier access charge pay-phone service elements, payments, and subsidies from basic exchange and exchange-access revenues. Finally, the FCC mandated a set of nonstructural safeguards for BOCs.

The FCC determined that the Act required it to alter the compensation plans only for those calls for which PSPs currently did not receive fair compensation. These were local coin calls, access code calls, subscriber 800 and other toll-free calls, and 0+ calls made in affiliation with BOCs. The FCC determined that the competitive market price for each call was the best marker for fair compensation to the PSPs. With this objective in mind, the FCC set rules for each type of call listed.

For local coin calls, the FCC required deregulation unless the state could prove that competition would not constrain prices. Believing that
interim compensation plan for access
For those PSPs not affiliated with an
phone in order to determine the exact
of these types of calls from each pay-
responsibility of tracking the number
feasible, IXCs were given the
Because the FCC found it technically
block such calls from their phones.
Because the FCC found it technically
feasible, IXCs were given the
responsibility of tracking the number
of these types of calls from each pay-
phone in order to determine the exact
amount owed to each individual PSP.
For those PSPs not affiliated with an
LEC, the FCC devised a two-year
interim compensation plan for access
code, subscriber 800, and toll-free
calls. During the first year of this
plan, IXCs with annual toll revenues
totaling over $100 million would
have to make monthly pro rata
contributions based upon their share
of total long distance toll revenues to
PSPs. The FCC determined the total
amount to be paid into the fund by
multiplying the average number of
such calls made from pay-phones
each month by $0.35—the price of a
local call in the majority of deregulated
states. In the second year, all
IXCs must pay PSPs either a
negotiated rate or the set default rate
of $0.35 per call for these types of
calls.

The FCC next dealt with 0+ calls
made under BOCs. BOCs were
required to make available to all
PSPs any of the basic services that
BOCs provided to their own pay-
phone affiliate. However, the FCC
allowed BOCs to discriminate
against PSPs for un tariffed services
such as installation or maintenance.
Finally, the FCC had to ensure that
LCs could not subsidize their pay-
phone operations with revenues from
other telephone services since this
maintains the LECs' competitive
advantage over PSPs even with the
above provisions. The FCC therefore
regarded all LEC pay-phones as
"unregulated, untariffed customer
premises equipment," which forced
LCs to transfer their pay-phone
assets accounts.

Petitioners Challenge the FCC's
Requirements Under the Act

Pursuant to the FCC mandates,
various petitions for review came
before the court. First, state regula-
tory commissions and the National
Association of the State Utility
Consumer Advocates ("NASUCA")
challenged the FCC's authority to
regulate local coin call rates. Second,
the IXCs contended that the FCC
acted arbitrarily and capriciously
when it: (1) applied the market-
based rate for the interim compensa-
tion for access code and subscriber
code calls; (2) excluded IXCs with
toll revenues totaling under $100
million from compensating PSPs for
such calls; (3) excluded toll revenue totaling
over $100 million from compensating
PSPs for access code and subscriber
calls.

Third, two IXCs joined to argue
that the FCC did not provide
adequate notice of the adopted
market-based interim compensation
plan. Fourth, the Personal Communi-
cations Industry Association
("PCIA"), members of the paging
industry, alleged that the FCC
arbitrarily and capriciously required
 carriers, instead of callers, to pay
PSPs for access code and subscriber
code calls. Fifth, together with a
group of IXCs, PCIA further chal-
enged the FCC decision that carriers
track these calls. Sixth, the BOCs
collectively argued against the FCC's
requirement to transfer the valuation
of pay-phone assets. Seventh, the
BOCs contended that the FCC
arbitrarily and capriciously excluded
inmates and other 0+ calls from the
interim compensation plan. The court
handled each contention in turn,
granting in part and denying in part
the petitions for review.

Federal Decisions Provide Proper
Textual Analysis for Determining
Jurisdiction Over Intrastate Rates

The court relied heavily on the
language of § 276 of the Act and on
federal case law to provide the proper
basis for its decision. First, the court
considered the NASUCA's conten-
tion that the FCC lacked the power
under the Act to regulate local coin
calls. The court in Louisiana Public
Service Commission v. Federal
Communications Commission, 476
U.S. 355 (1986), held that proper
preemption analysis questions
whether Congress intended the
federal regulation to trump state law.
The court noted that under § 152(b)
of the Communications Act of 1934,
the FCC was not given jurisdiction
with respect to "charges, classifica-
tions, practices, services, facilities, or
regulations" except where the
language of the Act is "so unambigu-
ous or straightforward so as to
override . . . § 152(b)." This rule
applied to the language of § 276,
which is an amendment of the Act of
1934 as well, and therefore is subject
to the same limitations.

The court in the present case
concluded that the Act expressly
granted the FCC the power to
regulate local coin calls. The Act required the FCC to provide “fair compensation” to PSPs for all calls; however, PSPs were not receiving adequate compensation for local coin calls. NASUCA argued that “fair compensation” did not mean that the FCC had the power to determine rates and charges. The court disagreed, however, holding that because PSPs only receive the coins from these calls, the FCC could properly regulate the rates of such calls to ensure fair competition. NASUCA further argued that even if the FCC did have the power to regulate local coin call rates, it made its decision to deregulate these rates arbitrarily and capriciously by not considering the possibility of “locational monopolies.” The court dismissed this claim, reasoning that the FCC reserved the right to modify the deregulation plans if such problems made it necessary.

The court also rejected NASUCA’s argument that the FCC lacked the power to preempt existing state regulation of these calls, opining that the language of the amendment gave the FCC the express authority to mandate these calls. Lastly, NASUCA argued that the FCC could regulate local coin calls only if the three requirements of 47 U.S.C. § 160 were met, which declares that enforcement of the Act is not necessary to ensure “just and reasonable” charges or “for the protection of consumers,” and that forbearance is “consistent with the public interest.” Still, the court agreed with the FCC that these requirements fail to apply in the case at bar because the FCC acted in direct accordance with the amended statute. Thus, the court dismissed each of these arguments as well.

**Criticisms of FCC’s Compensation Rate**

The court first departed from the FCC’s Order by criticizing the FCC decision to set the access code and 800 calls at the same compensation rate as the local coin calls. According to the court, the FCC erroneously concluded that the costs for access and 800 calls mirrored the costs of local calls “because the cost of originating the various types of payphone calls are similar.” The court pointed to evidence provided by IXCs that conclusively showed that local coin call costs incorporate origination and termination costs, whereas access code and 800 calls only include origination costs. The FCC countered that, even if access code and 800 calls warrant higher compensation, this rate acts as the default rate, and the FCC left IXCs with the ability to block such calls. Although the court agreed with both of the FCC contentions, it still held that the FCC could not force IXCs to abide by an erroneously set default rate or to resort to blocking such calls from their service. Accordingly, the court remanded this issue for further consideration.

**FCC Established Interim Plan**

Under the FCC’s interim plan, compensation rates were set for access code and 800 calls, 0+ calls, and inmate calls for a two-year period. While IXCs challenged the rates set for access and 800 calls, BOCs contested the compensation plans for the 0+ calls and inmate calls.

The FCC required that IXCs with assets over $100 million bear the total compensation for PSPs based on a flat rate for the first year. The IXCs first questioned the FCC-mandated flat rate, which was based on $.35 per access and 800 calls. The court stood by its prior determination that this rate, which erroneously equated local coin calls with access code and 800 calls, was arbitrary and capricious. The court held that the FCC needed to set a new interim rate for these types of calls. The court further agreed with the IXCs, stating that the FCC had not justified its decision to place full compensation responsibilities on large IXCs for the first interim year. Although the FCC based its decision on administrative convenience, the court held that this reason fails to justify a payment exemption for all but large IXCs. This issue was remanded for review.

The BOCs then challenged the interim compensation plans set for both 0+ calls and inmate calls. Per the FCC’s Order, PSPs receive payment for access and 800 calls, but zero compensation for 0+ or inmate calls. The FCC did not challenge the merits of the BOCs’ complaint of failing to provide fair compensation for the 0+ calls. Instead, it relied on the procedural issue regarding the BOCs’ failure to bring the claim to the FCC. However, the court found that the BOCs had set aside this challenge, provided that the FCC devise at least some plan of compensation for these calls. Therefore, when the FCC’s interim scheme omitted such a plan, the BOCs properly raised this challenge. The court held that the FCC acted arbitrarily and capriciously in not creating a compensation scheme for these calls when the Act expressly sought fair payment for all calls.

Furthermore, the BOCs challenged the exclusion of inmate calls from the interim plans. Since the FCC stated that the interim plan only accounted for access code and 800 calls, inmate calls were excluded from the plan. Again, the court called into question the FCC’s failure to account for all calls as prescribed by the Act. Although the FCC requested that the court defer judgment on this issue until it could provide alternate information on inmate calls from a separate petition, the court held that

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the FCC needed to review its interim plan to fit the Act's goal of providing fair compensation for all calls, including 0+ and inmate calls.

**Mandates of the FCC Order**

The FCC Order mandated that carriers, not callers, pay the initial compensation for 800 calls. Pursuant to this goal and with available technologies in mind, the FCC further required that IXC s track such calls to determine their compensation to each PSP. The PCIA petitioners first contended that requiring carriers to pay the 800 costs was arbitrary and capricious because it did not advance the legislative goal of promoting competition. PCIA argued that the callers used the service provided by the carriers, yet the FCC still expected the carriers to bear the costs of such calls with no option to avoid the costs. However, the FCC successfully countered that the carriers could effectively negotiate for lower compensation amounts by blocking calls through excessive rates. The FCC also argued against PCIA's contention that the caller, not the carrier, received the primary benefit of 800 calls. The FCC explained that the carrier was, in fact, the primary beneficiary of the call because the caller relied on a particular carrier no matter where the call originated. Moreover, the court supported the FCC's decision to maintain the convenience of coinless 800 calling to the inconvenience to the carrier. Because the FCC sought to balance these considerations, the court did not find the FCC's decision arbitrary and capricious.

In conjunction with this mandate, the FCC had given IXC s the responsibility of tracking pay-phone calls so that each IXC could determine its compensation rate. The court quickly dismissed the IXC s' argument that this decision was arbitrary and capricious. As all parties agreed that this technology remained available to the IXC s, the Court of Appeals held that the FCC acted reasonably in requiring IXC s to track these calls.

**Challenge to the FCC Order**

The APCC petitioners challenged the FCC Order allowing BOCs to only discriminate in basic service provisions but not in actual communication services. The court applied the two-part test to review an agency's construction of a statute established by the Supreme Court in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The first part asks whether Congress has specifically addressed the precise issue at bar so that the court may follow the legislative language. However, where Congress has left the issue unanswered, the court then must ask whether the agency proposed a permissible interpretation of the statute.

The court further relied upon *Amalgamated Transit Union v. Skinner*, 894 F.2d 1362 (D.C.Cir. 1990), ruling that the court must consider not only the language of the statutory provision, but also the structure and context of the total statute to properly determine whether Congress had specifically addressed the issue. Pursuant to this case law, the court held that § 276(b)(1)(C) seemed ambiguous when considering the statute as a whole, but it still ruled the APCC interpretation impermissible. The court opined that the Act sought to reduce regulation to promote competition. It agreed with the FCC that although it was necessary to ensure nondiscrimination for services which BOCs could withhold, discrimination for basic services provided by other entities was unnecessary. The court collectively denied these challenges.

The BOC and APCC Petitioners joined to challenge the FCC decision that LECs providing pay-phone services could either transfer their pay-phone operations to structurally separate affiliates or operating divisions with no common use of assets. However, the FCC required the LECs to record the transfer of assets at the higher of fair market value or net book value. The FCC reasoned that the higher valuation would note appreciations in values of the transferred assets, helping to ensure that gains benefit rate-payers and shareholders. The court agreed with the rule stated in *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926) that utility service rate-payers pay for their service so that they "do not acquire any interest . . . [in] the company. Property paid for out of moneys received for service belongs to the company." But the court also cited the rule in *Democratic Cent. Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission.*, 485 F.2d 786 (D.C. Cir. 1973), that rate-payers and shareholders are not necessarily the beneficiaries of increases in the company's value.

The court at bar thus applied the two-part test established by the court in *AT & T Information Systems, Inc. v. Federal Communications Commission*, 854 F.2d 1442 (D.C. Cir. 1989). The court first asked which party bore the risk of loss of the assets. Where this determination proved difficult, the second step of the test dictated that those who then bear the financial burden of the particular activity should receive the benefits. While the court noted that rate-payers bore this risk in the past, it determined that recent changes in the regulations transferred this risk to the
investors. Following this trend, the court found that the investors bore the risk of loss, thus negating the need to proceed to the second step of the Democratic test.

Therefore, the court rejected the APCC’s challenge to the book valuation method for the same reason it accepted the BOCs’ challenge to the FCC’s fair market method: the shareholder bore the risk of loss so the shareholder should reap the benefits. Finally, the court rejected the APCC argument that the FCC required a transfer of pay-phone assets from regulated to unregulated books, stating that the Order instead only required that pay-phone assets not be accounted in separate affiliates.

In sum, the court sought to preserve the legislative intent of the Act while abiding by the express language of § 276. It interpreted the legislative intent to be the promotion of fair competition within the area of pay-phone service while it adhered to the language of providing PSPs with fair compensation for each call they serviced. In accordance with these goals, the court remanded the issues of: (1) the interim and permanent rates for access code and 800 calls; (2) requiring only large IXCs to pay full compensation in the first interim year; (3) failing to provide interim compensation for 0+ and inmate calls; and (4) assigning fair market value for pay-phone assets transferred from BOCs to separate affiliates.

Credit Reporting Agencies Have a Duty to Go Beyond Original Sources When Reinvestigating Credit Report Inaccuracies

By Andrew Geier

In Cushman v. Trans Union Corp., 115 F.3d 220 (3d Cir. 1997), the United States Court of Appeals for the Third Circuit reversed and remanded the district court’s judgment that, as a matter of law, Trans Union Corporation (“TUC”) met its obligations under the Fair Credit Reporting Act (“FCRA”) when it relied solely on the creditors’ original information in determining the accuracy of a consumer’s credit information. The court held that the FCRA requires a credit reporting agency to go beyond its original sources of credit information when reinvestigating inaccuracies in a credit report after the consumer informs the agency of those inaccuracies.

Credit Cards Falsely Obtained

Jennifer Cushman (“Cushman”) was a college student in Vermont in the summer of 1993 when an unknown person applied for and obtained credit cards in her name from American Express (“Amex”), Citibank Visa (“Citibank”), and Chase Manhattan Bank (“Chase”). This person obtained the credit cards by providing the credit grantors with Cushman’s name, address, social security number, and other identifying information. Cushman was unaware of the existence of these cards until the following year when a bill collector informed her that TUC had published a credit report showing that she was delinquent in her payments on the cards. By that time, the unknown person had accumulated charges of approximately $2,400 between the three cards.

Cushman informed TUC that she had neither applied for, nor used, the cards and suggested that someone had fraudulently obtained them. TUC responded by contacting Amex and Chase to determine whether Cushman’s verifying information (such as her name and social security number) in TUC’s report matched the information that they had. Amex and Chase confirmed that their information was the same. Additionally, TUC discovered that Cushman had not opened a fraud investigation with the credit grantors. Since she had not begun a fraud investigation and the verifying information matched, TUC left the information on Cushman’s credit report. However, since TUC was unable to contact Citibank, it deleted the Citibank delinquencies from the report.

TUC sent Cushman an updated copy of the report containing the Amex and Chase delinquencies. Upon receiving the report, Cushman wrote a letter to TUC contesting the delinquencies still contained in the report and offered to sign affidavits explaining that these delinquencies were not hers. In response to the letter, TUC performed a reinvestigation that was identical to its first