

EDUCATIONAL ADVISORY

UNIVERSAL SERVICE FUND AUDITS & APPEALS: Primer on Processes and Risks

Through the years, both our law firm and its affiliated consulting arm, [The Compliance Group](#), have represented hundreds of telecommunications and VoIP service providers with an assortment of legal and regulatory compliance matters on a nationwide basis. More than any other area of communications regulation, the one that has confounded our clients and the industry at large has been, and continues to be, the Federal Communications Commission's ("FCC" or "the Commission") Universal Service Fund ("USF") program, and the administration/enforcement of the program by the Universal Service Administrative Company ("USAC").

In recent times our law firm has been called upon to represent numerous clients with USF contributor audits initiated by USAC, and with few exceptions, the resulting appeals to the FCC of adverse USAC audit decisions. Our collective experience representing clients BEFORE, DURING, and AFTER such USAC audits has shed tremendous amounts of light onto what was, heretofore, a rather opaque, fluid and uncertain process.

In the interests of sharing knowledge and educating clients about the FCC Form 499 revenue reporting, USAC audit, and FCC appeals processes, we have reflected on our experiences and compiled the following "Primer." We hope you find the following information both useful and informative.

UNIVERSAL SERVICE FUND AUDITS & APPEALS: Primer on Processes and Risks

A. The Role of the FCC, the Universal Service Administrative Company, and the Courts in Universal Service Fund Audits

In 1996, Congress directed the FCC to establish the USF to preserve and advance universal service in the telecommunications industry.^[1] The FCC delegated the day-to-day management and administration of the USF to USAC.^[2] USAC could not, and did not, receive authority to create, change, or interpret substantive rules and regulations.^[3] Instead, USAC could *only* adopt and follow administrative processes and procedures to implement the Commission's substantive rules.^[4] For several years after its creation, USAC played a limited and narrow role administering its duties as the Data Collection and Billing Agent by applying the FCC's substantive rules and orders. However, in more recent times, USAC has played an increasingly active, important, and "aggressive" role. At times, USAC has appeared to act as an extra-governmental "adjudicatory arm" that actively and knowingly moves the goal posts to achieve its fundamental mission – "to preserve and enhance" the stability and predictability of the USF programs.

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By and large, USAC has leveraged its audit authority to achieve the aforementioned goals. In accordance with FCC rules, USAC can audit contributors to ensure accurate revenue reporting, and calculation of USF contribution liabilities.^[5] The FCC's rules, however, contain little guidance on the specifics of USAC's audit authority. In recent years, USAC has taken full advantage of this lack of clarity, and with the FCC's blessings (or purposefully blind eyes), has frequently used the audit process as a crucible for interpreting and expanding the meaning of Commission rules, adopting new policies, and enforcing "rules" with a noticeable slant in the direction of increased USF contributions. The FCC, in turn, has increasingly relied upon both USAC audits, and the resulting adjudications (Petitions for Review of USAC Audits) to clarify these rules.

Appeals of USAC audits have languished for years before the Commission. The FCC has been unwilling to oppose USAC's audit findings because, by and large, USAC audit decisions have resulted in increased USF contributions. The FCC has been equally reluctant to decide appeals that would provide well-funded contributors with a final administrative action; which is a requirement for the FCC action to be appealed to the appellate courts. The combination of an aggressive, somewhat unrestrained USAC, the purposefully slow FCC appeals process, USAC's "Pay and Dispute" policy, and lack of a recognized limitations period (issues we expound upon below), created a paradigm that stacks the deck against aggressive revenue reporting positions. On the other hand, sky-high contribution factors, and the inconsistent application of regulatory fees to different, but comparable technologies create undeniable competitive pressures to pursue lawful mitigation of said fees. The overarching challenge is defining what "lawful" means when USAC is given the freedom to move the goal posts whenever USAC concludes it is necessary in order to fulfill its' USF administrative goals.

Over the past several years, USAC has matured as an organization, and has become emboldened by the FCC's acquiescence and support. This has recently included appellate review of USAC decisions. Generally, the Commission has either upheld USAC's findings, or avoided addressing audit challenges. In those few rare instances where a court has been able to review a challenge to USAC's unbridled authority, procedural hurdles have prevented a review of the issue on the merits. For example, in a recent decision, the U.S. Court of Appeals for the D.C. Circuit ("D.C. Circuit") found that the petitioner lacked standing to challenge both the FCC's 2008 *InterCall Order* (issued in response to InterCall's challenge to a USAC audit decision finding InterCall's services to be USF assessable), and a 2012 petition for reconsideration of the *InterCall Order*.^[6] The D.C. Circuit determined that the *InterCall Order* was an adjudication, and that the petitioner lacked standing under Article III of the U.S. Constitution because the petitioner was not a party to that adjudication.^[7]

With this ruling, the D.C. Circuit deferred substantially to the FCC to interpret its rules in upholding the determinations of USAC. Accordingly, the D.C. Circuit plainly stated that it will not be easily persuaded to address the harms caused by the FCC's continued deferral to USAC. In this environment, USF contributors must be very careful about their reporting decisions, and recognize the potential risks and consequences of taking a position that is contrary to both the FCC Form 499-A Instructions, or other policies adopted by USAC. Keeping this in mind, the following section discusses the potential reporting options available to service providers, risks associated with the various options, and the consequences of adopting certain positions.

B. Weight Given to FCC Form 499-A Instructions in USAC Audits

Technically speaking, the FCC Form 499-A Instructions do not carry the weight of the law. Instead, they are intended to function merely as guidance for filers.^[8] USAC, however, strictly adheres to the Instructions, and reclassifies the revenues of filers failing to follow the Instructions. While the full Commission has never expressly recognized USAC's right to reclassify revenues, the FCC's Wireline Competition Bureau ("Bureau") has determined that USAC possesses the authority to reclassify revenues. The Commission has implicitly endorsed the Bureau's finding.^[9] Accordingly, any filer failing to abide by the Instructions risks reclassification of revenues with serious procedural and financial consequences, as discussed below.

C. Procedural and Financial Consequences of Adverse USAC Audit Determinations Resulting in Revenue Reclassification and Increased USF Contribution Invoice Amounts

A service provider who fails to abide strictly by both the FCC Form 499-A Instructions and USAC "guidance" risks the consequences of adverse USAC audit determinations. These consequences include both the reclassification of revenues, and the issuance of supplemental invoices for USF fees. Failure to pay any such invoice results in a "contributor delinquency."^[10] If the contributor fails to pay the invoice by the due date, USAC will send an initial notice of delinquency. The notice explains that the contributor's account has been placed in "Red Light" status. Red Light status prevents a contributor and its affiliates (*i.e.*, any companies sharing a Tax ID with the delinquent company) from receiving any disbursements from USAC.^[11]

If the invoiced amount is overdue by more than 30 days, USAC sends a *second* notice that includes the delinquent amount, and requires the contributor to contact USAC for the final pay-off amount – which may include both penalties and/or interest.^[12] However, the second notice does not actually identify the amount of penalties and/or interest owed, which can be significant. If a USF contribution amount is past due by one day, it becomes a "debt" subject to the Debt Collection Improvement Act ("DCIA").^[13] Accordingly, the DCIA governs the amount of interest to be applied to the outstanding debt. Interest is applied at the prime rate as of the date of delinquency plus 3.5 percent.^[14] Moreover, if the debt remains unpaid for over 90 days after the due date, an *additional* penalty of 6 percent per year is applied. The additional penalty is calculated based on the original delinquency date.^[15]

If the invoice remains unpaid after 60 days, USAC sends a *third* notice which likewise includes the principal balance, and requires the contributor to contact USAC for the full amount due. Finally, if an invoice remains unpaid for more than 90 days, USAC sends a *fourth and final* notice. This includes the same information as the prior notices, but also notifies the contributor that failure to pay the full delinquent amount within 30 days of the final notice will result in a transfer of this "debt" to the U.S. Department of Treasury for collection pursuant to the DCIA.^[16] In addition, administrative costs (28 percent of the debt) will be imposed on any debt transferred to Treasury under the DCIA.^[17]

A contributor who disagrees with an assessment must first appeal to USAC and await USAC's decision prior to filing with the FCC. An appeal must be filed within 60 days of the invoice

date.^[18] If the contributor receives an adverse ruling on its USAC appeal, it can then file an appeal with the FCC within 60 days.^[19] USAC has adopted a “pay and dispute” policy, which the FCC has endorsed.^[20] USAC’s pay and dispute policy requires contributors to pay all outstanding invoices before disputing an invoice to avoid continued accrual of interest and penalties.^[21] Although interest and penalties will continue to accrue on any unpaid amounts, the debt will not be transferred for collection under the DCIA. Also, if the debt is subject to an appeal, it is not subject to the Red Light Rule.^[22] The recent *Ascent Media* decision confirmed that only the Commission can waive these fees.^[23] Otherwise, penalties and interest will not be removed unless an appeal is successful before USAC, the FCC, or a reviewing court.^[24]

On top of the additional USF fees, penalties, and interest assessed by USAC, a filer could also be subject to forfeitures for non-compliance with the FCC. A provider failing to make required USF contributions can be subject to FCC forfeiture penalties of at least \$10,000.00 for each month in which a provider does not fully satisfy its required USF contributions, and at least \$20,000.00 for each month in which a provider does not make any USF contributions.^[25] The Commission has also imposed upward adjustments based on approximately one-half of the largest amount of the filer’s unpaid USF contributions during the period covered by the Commission’s investigation.^[26] In addition, the Commission has treated failures to pay universal service and other obligations as continuing violations that are not cured until the belated filing is made.^[27] In 2008, the Commission proposed a \$10 million penalty on Global Crossing North America, Inc. for failure to make its required USF contributions.

CONCLUSION

As a result of the “framework” described above, FCC Form 499 filers must take their revenue reporting decisions seriously, and recognize that any material departure from the Form 499 Instructions risks serious financial consequences. The likelihood of success of any appeal of a USAC audit decision or invoice varies based upon the strength of the legal position supporting the challenge. But, regardless of the chances of success, any appeal will be an expensive uphill battle, and could potentially embroil the petitioner in litigation for years. Of course, management must weigh all these considerations in determining how to address any potential USAC audit or reclassification instruction.

If you are concerned about your company’s FCC Form 499 / USF compliance profile and want to achieve greater peace of mind, contact [The CommLaw Group](#) today and inquire about our [USAC Compliance, Audit Preparation and Defense Practice](#).

DISCLAIMERS: This Advisory has been prepared for informational purposes only. It is not for the purpose of providing legal advice and does not create an attorney-client relationship between Marshlian & Donahue, LLC and you. You should not act upon the information set forth herein without seeking experienced counsel. This Advisory may be considered Attorney Advertising in certain jurisdictions. The determination of the need for legal services and the choice of lawyer are extremely important decisions and should not be based solely upon advertisements or self-proclaimed expertise.

- [1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended at 47 U.S.C. § 254(a)).
- [2] See *In re Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, Report and Order and Second Order on Reconsideration, 12 F.C.C.R. 18400, ¶ 11 (July 17, 1997) (“USAC Order”). The FCC designated USAC as the interim USF Administrator in 1997. USAC became permanent Fund Administrator in 1998. See *In re Changes to the Board of Directors of the National Exchange Carrier Association*, Third Report and Order, CC Docket No. 97-21, Fourth Order on Reconsideration in CC Docket No. 97-21 and Eighth Order on Reconsideration in CC Docket No. 96-45, 13 F.C.C.R. 25058, 25069-70, ¶ 20 (Nov. 19, 1998).
- [3] See, e.g., 47 C.F.R. § 54.702(c); see also, USAC Order at 18425-28, ¶¶ 41-51.
- [4] *Id.*
- [5] 47 C.F.R. § 54.707.
- [6] *Conference Grp., LLC v. F.C.C.*, 12-1124, 2013 WL 3305698 at *1 (D.C. Cir. July 2, 2013).
- [7] *Id.* See also, *In the Matter of Federal-State Joint Board on Universal Service, Request for Review of Decision of the Universal Service Administrator by Global Crossing Bandwidth, Inc.*, Order – Wireline Competition Bureau, 24 FCC Rcd. 10824, 10828 (Aug. 17, 2009) (“GX Order”) (“Although the Commission has not dictated how a carrier may meet the reasonable expectation standard, it has provided guidance in the FCC Form 499-A instructions.”) (emphasis added); *Id.* at 10830 (“[T]he instructions are indeed guidance from the Commission on how wholesale carriers may substantiate their customers’ reseller status.”) (emphasis added); *In the Matter of Universal Service Contribution Methodology, Request for Review of Decision of Universal Service Administrator by Network Enhanced Telecom, LLP*, Order- Wireline Competition Bureau, 26 FCC Rcd. 6169, 6171 (Apr. 26, 2011); *In the Matter of Universal Serv. Contribution Methodology, Request for Review of Decision of the Universal Service Administrator by Network Enhanced Telecom, LLP*, Order- Wireline Competition Bureau, 25 F.C.C.R. 14533, 14536 (Oct. 19, 2010); *In the Matter of Universal Service Contribution Methodology, a Broadband Plan for our Future*, Order – Commission, 27 FCC Rcd. 5357, 5418 (Apr. 30, 2012).
- [9] Only one Bureau-level decision has concluded that USAC is authorized to reclassify revenues. GX Order, 24 F.C.C.R. at 10825-26. As a Bureau-level decision, this order does not carry the weight of the law.
- [10] *In the Matter of Comprehensive Review of the Universal Serv. Fund Mgmt., Admin., & Oversight Fed.-State Joint Bd. on Universal Serv. Sch. & Libraries Universal Serv. Support Mechanism Rural Health Care Support Mechanism Lifeline & Link-Up Changes to the Bd. of Directors for the Nat’l Exch. Carrier Ass’n, Inc.*, 22 F.C.C.R. 16372, 16381 (2007) (“USF Debt Order”) (“The date of payment on the invoice is the due date. If full payment is not received by the date due, the debt is delinquent.”). Reclassifications likewise could result in additional invoices for TRS or other program fund fees. Failure to pay these invoices by the due date results in an “FCC delinquency.”
- [11] *Amendment of Parts 0 and 1 of the Commission’s Rules; Implementation of the Debt Collection Improvement Act of 1996 and Adoption of Rules Governing Applications or Requests for Benefits by Delinquent Debtors*, MD Docket No. 02-339, Report and Order, FCC 04-72, 19 FCC Rcd. 6540 (2004) (implementing Pub. L. No. 104-134, 110 Stat. 1321, 1358 (1996)) (“Debt Collection Report and Order”).
- [12] See, e.g., USAC Contributor Delinquency Slideshow (June 2013) at http://usac.org/res/flash/cont/Contributor_percent20Delinquency/player.html.
- [13] USF Debt Order, 22 F.C.C.R. at 16381 (“[T]he unpaid amount is a debt owed to the United States.”).
- [14] 31 U.S.C. § 3717; 31 C.F.R. § 285.12(j).
- [15] USF Debt Order, 22 F.C.C.R. at 16381.
- [16] *Id.*
- [17] *Id.* at 16399, n. 50.
- [18] The FCC has adopted USAC’s position that an invoice qualifies a decision, and the date of issuance starts the 60-day appeals clock under 47 C.F.R. § 54.720(a). USAC’s invoices advise: “If you wish to appeal this invoice, you may file an appeal within 60 days of the statement date on the invoice pursuant to the requirements of 47 C.F.R. Part 54, Subpart I. Detailed instructions for filing appeals are available at <http://www.usac.org/cont/about/program-integrity/appeals.aspx>.” See USAC invoice attached to Mercury

Wireless, Request for Waiver - USAC late filing fees, filed Aug. 15, 2012, available at <http://apps.fcc.gov/ecfs/document/view?id=7022004590>.

[19] 47 C.F.R. § 54.720(a).

[20] *In the Matter of Universal Serv. Contribution Methodology*, 23 F.C.C.R. 17903, 17907 (2008). Also note that USAC applies a payment toward any delinquent amount to the oldest outstanding interest and penalties first, followed by principal. USF Debt Order, 22 F.C.C.R. at 16399 n. 51 (2007) (“It is USAC’s practice to apply partial payments to the oldest debt carried on USAC’s books first, and not to the current billed amount.”) citing *North American Telephone Network, LLC*, Forfeiture Order, 16 FCC Rcd. 4838, ¶ 8 & n.12 (2001); *Intellicall Operator Services*, Forfeiture Order, 15 FCC Rcd. 21771, 21772, ¶ 6 and n.8 (2000).

[21] *Id.*

[22] See, e.g., USAC Contributor Delinquency Slideshow (June 2013) at http://usac.org/res/flash/cont/Contributor_percent20Delinquency/player.html.

[23] *In the Matter of Universal Service Contribution Methodology, Petition for Reconsideration by Ascent Media Group, Inc.*, WC Docket No. 06-12, Order on Reconsideration, DA 13-966 at ¶ 5 (May 3, 2013); *Universal Service Contribution Methodology, A National Broadband Plan For Our Future*, WC Docket No. 06-122, GN Docket No. 09-51, Further Notice of Proposed Rulemaking, 27 FCC Rcd. 5357, 5482, ¶ 362 (2012); 47 C.F.R. § 54.702(c); See also *In the Matter of Universal Serv. Contribution Methodology*, 23 F.C.C.R. 17903, 17907 (2008).

[24] *In the Matter of Universal Service Contribution Methodology, Petition for Reconsideration by Ascent Media Group, Inc.*, WC Docket No. 06-12, Order on Reconsideration, DA 13-966 at ¶ 5 (May 3, 2013); *Universal Service Contribution Methodology, A National Broadband Plan For Our Future*, WC Docket No. 06-122, GN Docket No. 09-51, Further Notice of Proposed Rulemaking, 27 FCC Rcd. 5357, 5482, ¶ 362 (2012); 47 C.F.R. § 54.702(c); See also *In the Matter of Universal Serv. Contribution Methodology*, 23 F.C.C.R. 17903, 17907 (2008).

[25] See, e.g., *Kajeet Inc. and Kajeet/Airlink, LLC*, Notice of Apparent Liability for Forfeiture and Order, 26 FCC Rcd. 16684, 16694, ¶ 21 (2011) (“Kajeet NAL”); *ADMA Telecom, Inc.*, Forfeiture Order, 26 FCC Rcd. 4152, 4158, ¶ 15 (2011) (“ADMA Forfeiture Order”); *NTS Communications, Inc.*, Notice of Apparent Liability for Forfeiture, 25 FCC Rcd. 5137, 5142, ¶¶ 12–13 (2010) (“NTS NAL”); *Telrite Corp.*, Notice of Apparent Liability for Forfeiture, 23 FCC Rcd. 7231, 7242–44, ¶¶ 25–28 (2008) (“Telrite NAL”); *OCMC, Inc.*, Order of Forfeiture, 21 FCC Rcd. 10479, 10482, ¶ 10 (2006); *Globcom, Inc.*, Order of Forfeiture, 21 FCC Rcd. 4710, 4721–24, ¶¶ 31–38 (2006) (“Globcom Forfeiture Order”).

[26] See, e.g., Kajeet NAL, 26 FCC Rcd. at 16696, ¶ 26; *ADMA Telecom, Inc.*, Notice of Apparent Liability for Forfeiture, 24 FCC Rcd. 838, 852–53, ¶ 34 (2009) (“ADMA NAL”); Telrite NAL, 23 FCC Rcd. at 7243, ¶ 28.

[27] See, e.g., Kajeet NAL, 26 FCC Rcd. at 16694, ¶ 21; ADMA Forfeiture Order, 26 FCC Rcd. at 4159, n.56; Telrite NAL, 23 FCC Rcd. at 7245–46, ¶ 36.