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Regulatory Forbearance and the Rule of Law: The FCC's Arbitrary and Capricious Obstruction of Deregulation

by

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On August 6, the U.S. Court of Appeals for the Tenth Circuit upheld the FCC's 2010 *Qwest Phoenix MSA Order*. The *Phoenix Order* threw up significant hurdles for wireline voice providers seeking relief from network forced-sharing mandates and other outdated legacy-era telephone regulations. The FCC's *Order* rejected a Qwest forbearance petition by invoking a new and previously unannounced framework for evaluating such petitions. That framework excluded wireless competition from its analysis.

The Tenth Circuit's decision approved the FCC's almost insurmountable procedural barriers to regulatory forbearance. With more than 31% of all households nationwide now wireless-only, wireless competition with wireline has become too obvious for the agency to continue to deny. That wireless competition should drive policy further toward free market solutions. But the Tenth Circuit's decision gave a shot in the arm to economically counterproductive regulations.

FCC Chairman Julius Genachowski called the Tenth Circuit's decision "a win for competition and smart government." When it comes to competition, that statement is hard to reconcile with the *Qwest Phoenix MSA Order*'s pro-regulatory approach and its rejection of wireless as a competitor to wireline. As to smart government, the

Chairman's statement hardly fits with the Tenth Circuit's understatement that the *Order*'s "goalpost-moving does not reflect and optimal mode of administrative decisionmaking."

Unfortunately, the Tenth Circuit nevertheless accepted the FCC's standards-shifting and wireless-excluding maneuvers as a basis for rejecting regulatory forbearance. Bending over backwards to uphold agency power, the Tenth Circuit glossed over or explained away the FCC's arbitrary actions.

If arbitrary agency power is the ultimate winner in *Qwest v. FCC*, then the rule of law is the ultimate loser. If nothing else, the Tenth Circuit's highly deferential review of the FCC's arbitrary action lends support to FSF President Randolph May's argument that the actions of independent agencies such as the FCC should receive less deference upon review than those of executive branch agencies.

Background: The FCC's Forbearance Fiasco in Phoenix

As the Tenth Circuit's opinion explains, in March 2009, Qwest filed a petition for forbearance from certain regulations in the Phoenix metropolitan statistical area (MSA). Qwest's submission included wireless-only household data indicating that Qwest's market share was below the 50% figure on which the FCC previously relied. Qwest offered data regarding wireless-only households in the Phoenix area because the FCC's earlier *Qwest 4 MSA Order* concluded that "petitioners relying on mobile wireless substitution to support forbearance relief should submit complete and reliable data that is geographically specific to the areas for which forbearance is sought." (The Phoenix MSA was under consideration in the *Qwest 4 MSA Order*.)

The FCC issued its *Qwest Phoenix MSA Order* in June 2010. But in the words of the Tenth Circuit: "[T]he Commission moved the goalpost. It criticized Qwest's evidentiary showing *again*, this time because Qwest failed to present evidence that consumers consider wireline voice services and wireless voice services to be substitutes, such that the latter materially constrains the price of the former." A half-dozen times in its opinion, the Tenth Circuit describes the FCC's action as "goalpost-moving."

Nonetheless, the Tenth Circuit offered excuses for the FCC. First, it claimed there were "unique factual circumstances surrounding the issuance of the *Phoenix Order*, which should have provided Qwest with at least some (albeit limited) notice that a policy shift to a market-power analytical framework might be in the offing." Second, by deferring repeatedly to the FCC's questionable application of its procedural rules and its dubious reasoning, the Tenth Circuit upheld the FCC's exclusion of wireless from its forbearance analysis.

But those turn out to be empty excuses for the arbitrary exercise of agency power.

"Unique Circumstances" Excusing Agency "Goalpost-Moving"

Those "unique circumstances" said by the Tenth Circuit to "counsel against a determination that the Commission acted arbitrarily or capriciously in moving the policy goalpost" include the D.C. Circuit's 2009 decision in *Verizon v. FCC*. The D.C. Circuit ruled the FCC acted contrary to agency precedent and therefore arbitrarily and capriciously in rejecting forbearance relief in the *Verizon 6 MSA Order*. Since the *Qwest 4 MSA Order* relied on identical reasoning, the D.C. Circuit remanded both orders to the FCC.

Apparently the FCC's task of remedying two of its own unlawful actions constituted special reason for cutting the agency extra slack when it decided yet again to change its analytical framework. Such "unique circumstances" even included the FCC's launching its process for revisiting its analytical framework long after Qwest had already filed its forbearance petition for the Phoenix MSA.

Said the Tenth Circuit in its half-hearted defense of the FCC's conduct:

> The Commission, to be sure, did not commit to a definite policy shift in the April 2010 notice. And this more specific signal that a policy change might be coming came pretty late in the day. The notice was issued only a little more than two months before the Commission actually issued the *Phoenix Order*. However, the foregoing factual circumstances suggest to us that the Commission did not act whimsically or rashly in altering its forbearance policy--the D.C. Circuit remands gave the Commission a concrete reason to step back and assess its current policy direction--and that the Commission did provide Qwest with some notice (albeit of a temporally and substantively limited sort) that a policy move to a market-power approach might be in the offing, thus significantly diminishing the reliance that Qwest reasonably could have placed on the Commission's previous policy stance.

Thus, the Tenth Circuit treated the D.C. Circuit's rebuke of the FCC for disregarding its own standards without prior notice as a justification for the FCC further disregarding its own standards. That the agency offered "some notice" provided the necessary pretense. In this instance, "temporally limited notice" meant notice provided approximately fifteen months after Qwest filed its Phoenix MSA petition. And "substantively limited notice" meant an FCC request for public comments on whether it should apply basic principles contained in the FTC-Horizontal Merger Guidelines to forbearance petitions, including the Qwest's already pending petition for the Phoenix MSA.

Agency Rule Changes Under a Rule of Law

Of course, administrative law jurisprudence recognizes that federal agencies can change their rules. For instance, the D.C. Circuit's decision in *Verizon v. FCC* reiterated

that agencies can depart from prior precedents so long as they provide a reasoned explanation for doing so. And in *Fox v. FCC I* (2009), the U.S. Supreme Court concluded that agencies "must show that there are good reasons for the new policy" even though they "need not demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one." Running through these judicial decisions, however, is the recognition that even agency rule changes must follow a basic set of principles.

Conformity to certain fundamental principles is a necessary ingredient for any government operating according to the rule of law. The July FSF *Perspectives* essay "The FCC and the Rule of Law" described certain essential elements of a rule of law regime. Those elements include: (1) fidelity to rules, (2) of principled predictability, (3) embodied in valid authority, and (4) that are external to individual government decisionmakers.

The Supreme Court highlighted some critical implications flowing from rule of law principles in *Fox v. FCC II* (2012). As the Court declared, "[a] fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." Moreover, said the Court:

> Even when speech is not at issue, the void for vagueness doctrine addresses at least two connected but discrete due process concerns: first, that regulated parties should know what is required of them so they may act accordingly; second, precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way.

While the Court addressed the issue of fair notice in the context of a Fifth Amendment Due Process claim, it regarded fair notice as fundamental to "our legal system." High-level concerns for certainty and predictability should inform all reviews of allegedly arbitrary and capricious agency action. That includes review of the FCC's *Qwest Phoenix MSA Order* and the agency process that preceded it.

The FCC's rule-changing process, particularly as it applied to Qwest, failed to satisfy any commonsense understanding of fair notice, certainty, and predictability. The agency's forbearance "goalpost-moving," preceded by only a vague and last minute warning, epitomized arbitrary and capricious conduct. Especially disturbing is the FCC's rejection of Qwest's proffered data regarding geographically wireless-only data that the agency had specifically invited in a prior order involving the Phoenix MSA. The FCC's disregard of Qwest's reliance on that prior order combined goalpost-moving with goalpost-shrinking.

That the Tenth Circuit bent over backwards to defend the FCC's conduct in such circumstances is deeply disappointing. *Qwest v. FCC* sets a disturbing precedent. It offers deference run riot to agencies imposing *ad hoc* rule changes in ongoing proceedings. The court appears to be satisfied by agencies hinting through ambiguous

public pronouncements issued shortly before the new rules are applied. It effectively stands for the ready dismissal of the reliance interests of parties that make good faith attempts to follow specific agency directives in order to ensure compliance with the law. And the decision gives a legal nod to the FCC's procedurally roadblocking a critical deregulatory mechanism to which Congress attached a 12-to-15-month shot clock to ensure compliance.

Deferring to the FCC's Dubious Market Definitions

The Tenth Circuit was surely correct that *Qwest v. FCC* involved "unique" factual circumstances. Those circumstances included: Section 10's shot clock, the *Qwest 4 MSA Order*'s statements regarding geographically specific wireless-only household data, the then-pending D.C. Circuit remand, and the timing of Qwest's Phoenix MSA petition relative to the FCC's process for reformulating its forbearance analytical framework and applying it in the *Qwest Phoenix MSA Order*. Such unique circumstances could have easily supplied grounds for the Tenth Circuit to reject the FCC's particular application of its new forbearance framework to Qwest's petition without actually striking down the FCC's framework and the agency's rejection of wireless competition.

Nonetheless, there are highly problematic aspects to the FCC's disregard of wireless competition in its new forbearance analytical framework. The Tenth Circuit upheld the FCC's policy by repeatedly deferring to the agency's procedural glosses on Section 10 and to its dubious reasons for excluding wireless from analysis.

Section 10 requires the FCC to forbear from applying any regulation or telecommunications law where it determines that: (1) enforcement is not necessary to ensure that charges are just and reasonable; (2) enforcement is not necessary to protect consumers, and (3) forbearance is consistent with the public interest.

The FCC has put an extra-statutory procedural gloss on these requirements that make them difficult, if not impossible, to meet. First, the agency's 2009 forbearance procedural rules placed the burden of production on forbearance petitioners. More specifically, the *Qwest Phoenix MSA Order* required that forbearance petitioners provide evidence of the price-constraining effect of wireless on rates for wireline voice services.

Invoking the highly deferential standard of review in *Chevron* and its progeny, the Tenth Circuit treated those agency glosses as authoritative interpretations of Section 10. On that basis it likewise deferred to the FCC's rejection of Qwest's geographically specific wireless-only household data. The Tenth Circuit deferred to the FCC's rejection of Qwest's arguments that requiring evidence of price-constraining data is unreasonable because of the nature of regulated telecommunications networks with high up-front capital costs and where regulations limit the ability of providers to charge different rates to customers in different areas. The Tenth Circuit also deferred to the FCC's misgivings about the effects of the agency's previously granting forbearance in the Omaha MSA as a reason for adopting its new forbearance framework.

So deferring, the Tenth Circuit upheld the FCC's treatment of Qwest as an "effective" monopoly that could potentially harm consumers. The Tenth Circuit turned back Qwest's arguments that the FCC improperly excluded wireless competition by simply invoking the FCC's product market definitions. Deferring to the agency meant assuming the answer to the question under dispute. In other words, wireless competition in the market was not improperly rejected because the FCC had already excluded wireless from the market by definition. The Tenth Circuit also invoked the FCC's stated concerns in the *Qwest Phoenix MSA Order* about post-forbearance competition in Omaha. That is, the Tenth Circuit approved the FCC's actions based on the agency's apparent concerns about a different market where the agency likewise excluded wireless by definition.

Deferring to the FCC's Disconnect With Wireless Competitive Reality

Due to the elastic deference standard provided by the *Chevron* doctrine perhaps Qwest faced too high a climb to mount a successful legal challenge to the *Qwest Phoenix MSA Order*. Perhaps *Chevron* provides room for a federal court so inclined to uphold agency power and explain away the FCC's "goalpost-moving" and last-minute, vague notice. Regardless, it's important to take stock of the practical consequences of exaggerated judicial deference to highly dubious agency actions. And, if nothing else, the Tenth Circuit's highly deferential review of the FCC's arbitrary action lends support to FSF President Randolph May's argument in the *Administrative Law Review* that the actions of independent agencies such as the FCC should receive less deference upon review than those of executive branch agencies.

In this case, the Tenth Circuit's deferral to the FCC results in the exclusion of commonsense data and observations about wireless usage from being brought to bear in determining whether Section 10's criteria have been met. It results in a glaring disconnect between the monopoly-era assumptions behind the regulations that the FCC insisted that Qwest remain subject to and the actual competitive conditions in a voice services market characterized by cross-platform competition and wireless substitution. And it results in disconnect in the FCC's own policies regarding advanced telecommunications services.

Consider the following:

First, and as previously mentioned, there is the geographically specific data regarding wireless-only households that Qwest submitted to the FCC. Wireless carriers such as AT&T, Verizon Wireless, T-Mobile, Sprint, and Cricket offer consumers a readily substitutable service in the Phoenix MSA.

Second, there is the FCC's recognition of the significance of wireless-only and cut-the-cord data in its annual wireless competition reports. For instance, those reports routinely include wireless-only household surveys prepared by the Center for Disease Control. The latest CDC survey indicates that 31.6% of households nationwide are wireless-only. That number has been steadily growing. And it is expected to rise further. Households

inhabited by adults in younger age brackets are more likely to rely exclusively on wireless for voice services than adults in older age brackets.

Third, there are official FCC notices and orders recognizing the effects of wireless competition and substitutability on wireline voice services. For example, the FCC's June 2011 *Lifeline Reform Order* declared that "[t]he telecommunications marketplace has changed significantly over the last fifteen years with a wide array of wireline and wireless services that compete with traditional incumbent telephone companies." Similarly, in its February 2011 notice proposing comprehensive universal service and intercarrier compensation system reforms the FCC recognized that one of the "four fundamental problems" with the ICC system is that "technological advances, including the rise of new modes of communications such as texting, e-mail, and wireless substitution have caused local exchange carriers' compensable minutes to decline, resulting in additional pressures on the system and uncertainty for carriers." And the FCC's November 2011 *USF Reform Order* stated that "consumers increasingly shift from traditional telephone service to substitutes including Voice over Internet Protocol (VoIP), wireless, texting, and e-mail."

Conclusion

By upholding the FCC's exclusion of evident wireless competition with wireline voice services in *Qwest v. FCC*, the Tenth Circuit has prolonged the life of network forced-sharing mandates and outdated legacy telephone regulations. This despite cable and wireless entrants having overturned the monopolistic assumptions upon which those regulations were based. The result is a blatant disconnect between the FCC's enforcement of legacy regulations over a presumed non-competitive voice market and the vibrant cross-platform competition actually taking place in today's dynamic market.

The most disturbing aspect to the Tenth Circuit's decision, however, is its approval of the arbitrary and capricious manner in which the FCC engaged in "goalpost-moving" and the way it disowned the reliance interests its own prior order had induced. A commitment to the rule of law requires that even agency rule changes be undertaken and applied in a manner consistent with basic principles of fair notice, predictability, and certainty. But the Tenth Circuit excused the FCC's procedural misconduct and upheld agency power at the expense of the rule of law.

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Further Readings

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