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Communications Law Bulletin Special Edition: Nebraska Preempted and Enjoined from Applying State USF to VoIP Services

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The Eighth Circuit Court of Appeals has affirmed the Nebraska federal district court holding that Nebraska was preempted and enjoined from enforcing its state universal service fund ("USF") surcharge fee against a Voice over Internet Protocol ("VoIP") service provider. *Vonage Holdings Corp. v. Nebraska Public Service*, --- F.3d ----, 2009, WL 1161584 (C.A.8 Neb. May 1, 2009) ("*Nebraska PSC*") This decision, though binding only on the states in the Eighth Circuit, could have the potentially far-reaching effect of prohibiting all states from imposing their state USF fees against any nomadic interconnected VoIP service providers, such as Vonage. However, on May 14, 2009, the NPSC filed a petition with the federal Court of Appeals requesting a rehearing en banc.

Background of the Case

In 1997, Nebraska enacted the Nebraska Universal Service Fund ("NUSF"), authorizing the Nebraska Public Service Commission ("NPSC") to establish a *state* fund to subsidize telecommunication services in high-cost and remote areas throughout Nebraska. The NPSC included interconnected VoIP service providers among those companies required to collect from their customers and remit a NUSF surcharge fee. However, in 2006, the Federal Communications Commission ("FCC") had issued an order directing interconnected VoIP service providers to collect a *federal* USF surcharge fee. *See In the Matter of Universal Service Contribution Methodology*, 21 F.C.C.R. 7518, 7545 (2006) (extending 47 U.S.C. § 254(d) permissive authority to require interconnected VoIP providers to contribute to the USF), *petition for review denied, and vacated in part on other grounds*, *Vonage Holding Corp. v. FCC*, 489 F.3d 1232 (D.C. Cir. 2007). In its USF Order, recognizing the difficulties associated with attempting to identify the interstate and intrastate portions of interconnected VoIP communications services, the FCC established a "safe harbor" provision denoting 64.9 percent of a customer's interconnected VoIP communications determined to be interstate, and to which the USF surcharge fee applied. In determining intrastate usage for purposes of applying the NUSF, the NPSC simply adopted the remaining 35.1 percent as necessarily reflecting the amount of intrastate nomadic interconnected VoIP use.

When Vonage refused to collect the NUSF surcharge, the NPSC sought to enforce the NUSF order. Vonage filed an action seeking a declaration that the NUSF was preempted by federal law, and a preliminary injunction prohibiting Nebraska from enforcing the NUSF. Vonage relied principally upon an FCC order concluding that Vonage was subject to regulation exclusively by the FCC. See *In re Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n,* 19 FCC Rcd 22404 (Nov. 12, 2004) ("*Vonage Preemption Order*"). This same Eighth Circuit court affirmed the FCC's *Vonage Preemption Order* in *Minn. Pub. Utils. Comm'n v. FCC*, 483 F.3d 570 (8th Cir.2007) ("*Minnesota PUC*"). In its Order, the FCC preempted all state regulation of Vonage under the "impossibility exception," by which the FCC deemed it impossible or impractical to separate Vonage's VoIP service between its interstate and intrastate components, such that any state regulation would interfere with the FCC's exclusive authority over interstate telecommunications services.

The Decision

The federal district court had concluded that the FCC had preempted *all* state regulation of nomadic interconnected VoIP service providers under such impossibility exception, and concluded that the Vonage Preemption Order categorically preempted *all* state attempts to impose regulations on nomadic interconnected VoIP services. *Vonage Holdings Corp. v. Nebraska Public Service.* 543 F.Supp.2d 1062 (D. Neb. 2008). The Court of Appeals affirmed, noting that in its *Minnesota PUC* decision it had concluded, as did the FCC, that VoIP services cannot be separated into interstate and intrastate use and such application of the impossibility exception was dispositive of the FCC's authority to preempt state regulation of VoIP services. The court found nothing in the NPSC's arguments here to alter its earlier conclusion. The court ruled that because Vonage's nomadic interconnected VoIP service cannot be separated into interstate and intrastate usage, the impossibility exception was determinative of the NPSC's authority as well.

The Court of Appeals concluded also that the impossibility exception further required a finding that application of the NUSF to nomadic interconnected VoIP service providers interfered with valid federal USF rules or policies, thereby negating even the NPSC's claim under the NUSF to the 35.1 percent of use not encompassed within the FCC's USF safe harbor provision. While a universal service fund surcharge could be assessed for *intrastate* VoIP services, the Court said, the FCC has made clear that it, and not state commissions, has the sole responsibility to decide the application of such federal regulations.

The FCC itself garnered some public attention during this proceeding by its unexpected filing of an amicus brief in support of the NPSC. Vonage dismissed the FCC filing by noting it was made by the FCC's Office of General Counsel without specific direction from or a vote of the FCC commissioners, which Vonage claimed accorded it no due deference. The court may have agreed, as its decision makes no mention of the FCC's filing.

Potential Effect of the Decision

If upheld on rehearing, the *Nebraska PSC* decision could have the ultimate effect of prohibiting all states from imposing state USF fees on nomadic interconnected VoIP service providers. Several other states, similar to Nebraska, have attempted to include VoIP service providers within the purview of their state USF fees. These include Indiana, Kansas (but only if not preempted by federal law), Missouri, and New Mexico.

The National Association of Regulatory Utility Commissioners has taken the position that the *Nebraska PSC* decision stands to imperil state universal service funds and the federal USF. With the growing trend toward VoIP usage, the NARUC warned that the loss of those funds could mean that the 23 states with universal service funds will have to raise their rates significantly, resulting also in a greater burden on the federal fund. It should be noted, though, that the District of Columbia and as many as ten states have already exempted VoIP from their USF fees or otherwise disclaimed state USF jurisdiction over VoIP.

The New Mexico Public Regulation Commission filed a lawsuit (*New Mexico Public Regulation Commission v. Vonage Holdings Corp*., case 08-CV00607) in the U.S. District Court for the District of New Mexico seeking a declaratory judgment that Vonage is subject to the PRC's state USF surcharge on intrastate retail telecommunications services. The PRC required VoIP service providers to report intrastate revenue based on either the FCC's 'safe harbor' formula for estimating intrastate revenue by deducting the interstate percentage from 100%, actual revenue allocations, or a traffic study. However, the federal district court judge determined to stay the case pending the outcome of the *Nebraska PSC* appeal. The judge said that although his court is not bound by the decisions of the Eighth Circuit, the appellate court's findings in the then pending case would be 'helpful' as a guide in resolving the New Mexico case.

Finally, while *nomadic* interconnected VoIP service providers appear to be protected from any state USF fees under the *Nebraska PSC* decision, the decision may have left open the liability of so-called *fixed* VoIP service providers for such fees. As the Court of Appeals did in its *Minnesota PUC* decision, its *Nebraska PSC* decision distinguishes “nomadic” from “fixed” interconnected VoIP services. The court explains that nomadic service allows a customer to use the service by connecting to the Internet wherever a broadband connection is available, making the geographic originating point difficult or impossible to determine. However, fixed VoIP service (offered generally by cable and telecommunications companies) originates from a fixed geographic location, such as the lines running to and from the customer's residence. As a result, the court found that the geographic originating point of the communications can be determined and the interstate and intrastate portions of the service are *more easily* distinguished.

The court then made clear that this case involves only the specific issue whether *nomadic* interconnected VoIP service providers may be subjected to a state regulation requiring them to collect a universal service fund surcharge. Because the court agreed with the FCC that the impossibility of distinguishing between interstate and intrastate *nomadic* VoIP usage accorded the FCC sole regulatory control over whether to allow or preempt Nebraska from imposing its own USF fee upon such nomadic VoIP service providers, its finding that the interstate and intrastate portions of a fixed VoIP service are more easily distinguished and its deliberate effort to contrast fixed from nomadic VoIP services suggest that its holding may not clearly carry over to fixed VoIP service providers.
