

ALERT

Fifth Circuit Declares Universal Service Fund Unconstitutional; Issue Likely Headed for U.S. Supreme Court

July 29, 2024

On July 24, 2024, on a petition for rehearing *en banc*, the U.S. Circuit Court of Appeals for the Fifth Circuit held in *Consumers' Research v. FCC (Consumers' Research)* that the current funding mechanism for the Universal Service Fund (USF) is unconstitutional and remanded the case to the Federal Communications Commission (FCC or Commission) for further proceedings. In doing so, the Fifth Circuit reversed its prior three-judge panel decision affirming the constitutionality of the USF and thereby creating a split among the circuit courts following the Sixth and Eleventh Circuits' denial of nearly identical challenges brought by the same petitioners in 2023. This substantially increases the chance that the Supreme Court will take up the case. But, if left to stand, *Consumers' Research* could upend the Commission's \$9 billion annual USF mechanism for providing access to affordable telecommunications to consumers, including low-income families and those in high-cost areas, as well as schools, libraries, and health care providers.

Background

With the Telecommunications Act of 1996, Congress took a number of major steps to encourage competition in the provision of telecommunications services. One of these initiatives was to replace then-existing implicit cross-subsidies for providing "universal service" with explicit support mechanisms, which could be administered in a competitively neutral manner.

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Telecom, Media & Technology
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Pursuant to Section 254 of the Communications Act, as amended, every telecommunications carrier that provides interstate telecommunications services must contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service. The USF is supported by contributions from providers of telecommunications services and certain other contributors based on their interstate and international end-user revenues. USF contributions are determined using a quarterly contribution factor that is determined by the Universal Service Administrative Company (USAC), an independent not-for-profit corporation created by the Commission to administer its universal service programs. The Commission's rules permit providers to pass through the contributions to their end-users in their rates or in the form of a line item on consumers' bills. USAC's actions are subject to Commission rules and oversight. In addition, USAC may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Commission.

The Petitioners – a nonprofit organization, a group of consumers, and a telephone service provider – have brought a series of essentially identical challenges to USAC contribution factors in various different Circuits. In 2023, the Sixth Circuit and Eleventh Circuit each rejected petitioners' arguments, in *Consumers Research v. FCC*, 67 F.4th 773 (6th Cir. 2023) and *Consumers Research v. FCC*, 88 F.4th 917 (11th Cir. 2023), respectively, and a panel of the Fifth Circuit initially did the same. However, the Petitioners sought *en banc* review of the Fifth Circuit's panel decision, and the *en banc* court accepted Petitioners' arguments, creating a split between the Fifth Circuit and the Sixth and Eleventh Circuits.

In their Fifth Circuit appeal, Petitioners sought review of the first quarter 2022 contribution factor. As in their other challenges, the Petitioners argued that the contribution factor was unlawful for two reasons. First, they argued that Section 254 of the Communications Act violated the U.S. Constitution's Legislative Vesting Clause by delegating legislative (taxing) powers vested in Congress to the FCC without providing the Commission with an intelligible principle to guide its discretion. The nondelegation doctrine, rooted in the separation of powers, is the principle that Congress cannot delegate its legislative powers or lawmaking ability to other entities. Second, petitioners argued that the Commission was without express congressional authority to subdelegate its regulatory authority under Section 254 to a private entity, USAC.

In March 2023, a three-judge panel of the Fifth Circuit ruled unanimously that Section 254 expressly requires the Commission to ensure that telecommunications services are: (1) of decent quality and reasonably priced; (2) equally available in rural and urban areas; (3) supported by state and federal mechanisms; (4) funded in an equitable and nondiscriminatory manner; (5) established in important public spaces (schools, health care providers, and libraries); and (6) available broadly across all regions in the nation. Therefore, the panel concluded that Congress supplied the FCC with intelligible principles when it tasked the agency with overseeing the USF.

The panel also rejected the argument that the Commission unlawfully subdelegated its regulatory authority to USAC. Specifically, the panel noted that: (a) federal statutory law expressly subordinates USAC to the Commission; (b) USAC merely makes proposals to the Commission, which are not binding on carriers until the Commission approves them; (c) the Commission permits telecommunications carriers to challenge USAC proposals directly to the agency and often grants relief to those challenges; and (d) the Commission dictates

how USAC calculates the USF contribution factor and subsequently reviews the calculation method after USAC makes a proposal. Therefore, the panel concluded that the Commission did not violate the private nondelegation doctrine because the agency properly subordinated USAC.

The Petitioners' request for a rehearing by the Fifth Circuit *en banc* was granted on June 29, 2023.

Fifth Circuit *En Banc* Decision

Reviewing the lower court's decision *de novo*, the Fifth Circuit first found that at least one petitioner had standing when the petition was filed and disposed of the Commission's motion to dismiss on the ground of issue preclusion as dilatory. The Fifth Circuit then held that the universal service contribution mechanism violates the Legislative Vesting Clause, which states that, "All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives." U.S. Const. art. I, § 1. The holding is based on the following findings: (a) the power to levy USF contributions is the power to tax; (b) Congress, through Section 254, may have delegated legislative power to the Commission without supplying an intelligible principle to guide the Commission's discretion; (c) the Commission may have impermissibly delegated the taxing power to private entities; and (d) the combination of Congress' broad delegation to the Commission and the Commission's subdelegation to private entities amounts to a constitutional violation.

(a) USF contributions are a tax, not a fee.

The Court states that the power to levy USF contributions is the power to tax, which is a quintessentially legislative power, and cites to the Commission's authority under Section 254(d) to mandate that telecommunications carriers contribute to the universal service support mechanisms.

The Commission had argued that universal service contributions are fees, not taxes, because universal service confers special benefits on contributing carriers by, among other things, expanding the network they can serve. The Court rejected this argument, holding that USF contributions are not fees because: (a) they are not incident to a voluntary act but rather are a condition of doing business in the telecommunications industry; (b) the cost of universal service contributions is not borne by the parties the Commission regulates since most carriers pass the cost of contributions on to consumers; and (c) the associated benefits inure to the public rather than to the entities that pay them. Therefore, the Court concluded that Congress, through Section 254, gave the Commission the power to levy taxes and thereby delegated its taxing power.

(b) Congress may have failed to supply an intelligible principle to guide the Commission's legislative discretion.

Under the nondelegation doctrine, Congress cannot delegate its legislative powers or lawmaking ability to other entities. In *J.W. Hampton v. U.S.*, 276 U.S. 394 (1928), the Supreme Court clarified that when Congress does give an agency the ability to regulate, Congress must give the agencies an "intelligible principle" on which to base their regulations. In this case, the Court found that neither Section 254(d) nor 254(b)(1) supply an intelligible principle to guide the Commission's discretion.

The Court explained that the provision in Section 254(d) that USF funding should be “sufficient … to preserve and advance universal service” would be meaningful only if the concept of universal service is sufficiently intelligible. However, the Court found that universal service is an “amorphous” standard in which Congress instructs the FCC to “exact as much tax revenue for universal service projects as [the] FCC thinks is good.” The Court also found that Section 254(b)(1), which states that telecommunications services “should be available at … affordable rates,” amounts to no guidance at all, explaining that because the demand for mobile phones is uncommonly inelastic, the FCC could impose “eye-watering” taxes on them but still argue that they are “affordable” because most would choose to keep using them.

Lastly, the Court found that the scope of Section 254’s delegation is particularly troubling because the statute insulates the Commission from Congress’ appropriations power, stating that, “[t]he whole point of USF is to fund universal service *outside* the regular appropriations process” (emphasis in original). To the extent Congress’ ability to control agencies through regular appropriations supplies some justification for broad delegations, the Court noted that justification is absent here.

(c) The Commission may have impermissibly delegated the taxing power to private entities.

The Court emphasized that the scope of the Commission’s delegation to USAC and, in turn, USAC’s subdelegation to other private, for-profit telecommunications carriers may have violated the Legislative Vesting Clause by allowing private entities to exercise governmental power without congressional authorization. Specifically, the Court found that USAC’s projections, which the Court states are based on “projections made by its private, for-profit constituent companies,” take legal effect without formal Commission approval, which gives private entities the ultimate decision regarding the size of the USF contributions. The Court noted that, before the litigation started, the Commission had never made “a single substantive change to the contribution amounts proposed by USAC, which it deemed a “*de facto* abdication.” This, the Court said, gives private entities significant discretionary power in determining contribution amounts, a task that goes beyond a permissible “trivial fact-gathering role.” Thus, the Court concluded that the Commission impermissibly delegates the taxing power to private persons vested with no government power.

(d) The combination of Congress’ broad delegation to the Commission and the Commission’s subdelegation to private entities amounts to a constitutional violation.

The Court stated that it did not need to resolve definitively whether the USF contribution factor comports with the bar on congressional delegations of legislative power or the general rule that private entities may not wield governmental power. However, the Court held that the *combination* of Congress’ delegation to the Commission and the agency’s unauthorized subdelegation to USAC violates the Legislative Vesting Clause, citing Supreme Court precedent for the proposition that, with respect to the separation of powers at least, “two constitutional parts do not necessarily add up to a constitutional whole.”

FCC Reaction

FCC Chairwoman Jessica Rosenworcel released a statement indicating that the decision is “misguided and wrong,” that it “reflects a lack of understanding of the statutory scheme that helped create the world’s best and most far-reaching communications network,” and vowed to pursue all available avenues for review. Commissioner Geoffrey Starks categorized the decision as “a monumental blow” to the agency’s efforts to close the digital divide and stated he is reviewing the decision and how the Commission can continue to fulfill its universal service mandate. Similarly, Commissioner Anna M. Gomez explained that the decision “threatens our ability to close the digital divide domestically and our global economic leadership.”

What Happens Next?

We note that the Fifth Circuit remanded the case to the Commission for further proceedings without expressly vacating the quarterly contribution factor at issue in the appeal. Courts sometimes remand without vacatur when they believe that the federal agency can correct the problems identified in the order and the defects identified are not substantial. Here, however, the Fifth Circuit did not indicate it believed that, and to the contrary, the constitutional problems identified in the case are fundamental to the current USF regulatory scheme. It is, therefore, unclear how the agency would proceed if the Fifth Circuit’s order were not stayed or overturned, given that the same petitioners will almost certainly challenge future contribution factors developed under the current system on the same grounds.

Given that universal service is one of the core mandates of the Communications Act of 1934 and that the Commission’s universal service goals for broadband rely squarely on the USF, the Commission will likely seek review before the U.S. Supreme Court, as well as a stay to ensure that it may continue to administer the program. As stated at the beginning of this alert, the Fifth Circuit’s *en banc* decision creates a split among three circuit courts, which increases the chance that the Supreme Court will take up the case. As a practical matter, the only remedy for preserving the existing USF, short of the Supreme Court overruling the Fifth Circuit, may be Congress stepping in with legislation that confers explicit and necessary authority to the Commission to continue its administration of the USF, and makes clear that authority extends to the Commission’s subdelegation of ministerial administrative duties to USAC. The Commission might also be well-served to take the opportunity of this remand to finally address reform of the contribution methodology used to fund the USF.

Wiley’s Telecom, Media & Technology and TMT Appellate practices can assist with any questions related to the implications of this decision, the USF program, and the FCC remand process. For more information about these issues, please contact one of the attorneys listed on this alert.