

## [Updates](#)

July 31, 2024

Fifth Circuit Shocks Telecom Industry by Overturning the FCC's Universal Service Fund



The U.S. Court of Appeals for the Fifth Circuit recently [ruled](#) in a closely divided 9-7 *en banc* decision that the Federal Communications Commission's (FCC) method of funding the Universal Service Fund (USF) is an unconstitutional tax.

The ruling upends decades of bipartisan federal policy that enables the USF to collect billions and subsidize communications services to low-income households, high-cost areas, rural healthcare, and schools and libraries. With the U.S. Courts of Appeals for the Sixth and Eleventh Circuits recently denying similar challenges to the USF's constitutionality by the same petitioners, review by the Supreme Court of the United States is likely to resolve the split. However, if affirmed or left to stand, the ruling frustrates an important mechanism for ensuring all Americans have access to communications services.

### **The Universal Service Fund**

Universal service—the [principle](#) that all Americans should have access to a baseline of communications services—has been a foundational component of American communications policy since the enactment of the Communications Act of 1934. With the Telecommunications Act of 1996, Congress strengthened this policy by promoting consumer access to telecommunications and internet services at just, reasonable, and affordable rates. Under this authority, the FCC established the USF to fund the following four programs that address the expanded principle:

- Connect America Fund to support rural, high-cost areas.
- Lifeline to support low-income consumers.
- The E-Rate Program to support telecommunications service, internet access, and internal connections to schools and libraries.

- Rural Health Care Support Program to allow rural healthcare providers to pay rates comparable to those of their urban counterparts.

Telecommunications service providers, such as wireless and landline telecom carriers, fund the USF based on an assessment of their revenues, which is typically referred to as "universal service contributions." The FCC sets the specific percentage of the providers' revenues that they must contribute, which varies based on the demand for USF funds. The required contributions are submitted to a private nonprofit company administered by the FCC known as the Universal Service Administrative Company (USAC). Providers, however, may (and often do) elect to recover their contributions directly from customers via surcharges on their customers' telecommunications bills. The FCC has long required that when providers seek to reimburse themselves for their USF contributions, they cannot display the charge on consumer bills as a "tax"—it must be described as a reimbursement surcharge for the benefit of the provider.

### **The Fifth Circuit's Ruling**

The Fifth Circuit disagreed with the FCC's assertion that USF line items on consumer bills are not a tax. According to the Fifth Circuit, a fee that is not a tax has three characteristics: (1) it is incurred incident to a voluntary act; (2) it is imposed by an administrative agency only on those persons or entities subject to that agency's regulation for regulatory purposes; and (3) the revenue raised through its collection is used to supply benefits inuring to the person or entity paying it, rather than the public generally.

The Fifth Circuit found that the universal service contribution does not have any of these characteristics. First, because all telecommunications providers must contribute, the contribution is "a condition of doing business in the telecommunications industry." It does not result from a voluntary act. Second, the providers typically pass it on to customers, so it is ultimately imposed on persons or entities not subject to FCC regulation (*i.e.*, the end user subscribers). Finally, the programs the USF funds benefit the public generally, not the providers or customers that pay for it.

Because the Fifth Circuit found the universal service contribution to be a tax, it further held that the FCC's USF program required the power to tax. Constitutionally, the power to tax belongs to Congress, and Congress can only delegate its authority to federal agencies like the FCC by setting out an intelligible principle in the law that empowers the federal agency. The Fifth Circuit ultimately declined to resolve whether such an intelligible principle exists in the Telecommunications Act of 1996. However, the court still concluded the combination of Congress's delegation to the FCC and the FCC's sub-delegation to USAC, a private entity, amounts to a constitutional violation and remanded the issue to the FCC for reconsideration. It is unclear how the FCC will cure the apparent constitutional violation on remand when the entire USF structure, including the role of USAC, has been found to violate the Constitution.

The dissent, meanwhile, set the stage for further appeal to the Supreme Court. The dissent argued that the majority's decision breaks with precedents from other circuits and "blurs the distinction between fees and taxes," and that the universal service contribution does have the characteristics of a fee (as opposed to a tax). According to the dissent, first, doing business in the telecommunications industry is voluntary, and the USF results from that voluntary action. Second, the contribution is imposed on telecommunications providers, and they are not required to pass on the costs to their end users. Private providers seeking reimbursement for their costs of compliance is not unlawful. Finally, the providers receive the primary benefit of the USF: They are beneficiaries of direct subsidies from the USF to carry out the universal service objectives. Providers further benefit from the USF's promotion of a more developed and larger network. The public receives an ancillary benefit in the form of subsidized services.

## Key Takeaways

Recently, the [Sixth](#) and [Eleventh](#) Circuits upheld the constitutionality of the USF against similar challenges. The U.S. Court of Appeals for the D.C. Circuit heard oral arguments in a case challenging the USF as well, though the parties jointly stipulated to voluntarily dismiss the case in June 2024. The Supreme Court had denied *certiorari* in those cases. Now, with the significant split created by the Fifth Circuit's decision and the FCC's stated intention to "[pursue all available avenues for review](#)," Supreme Court review seems highly likely.

The reversal of decades-old federal policy on universal service has also shocked the telecommunications industry. Telecom trade groups, such as the National Cable and Telecommunications Association, the Competitive Carriers Association, and USTelecom, have [issued](#) statements criticizing the decision, noting that the USF "has been, and continues to be, a critical tool to narrow the digital divide and help address connectivity gaps," and that the decision "could put at risk the availability and affordability of essential communications services for millions of rural Americans." Advocacy groups have voiced similar concerns, [observing](#) that the Fifth Circuit's decision will have a "profound detrimental impact" on the ability of the United States to close the digital divide and will "severely hurt families in rural and urban communities" that rely on USF.

Prior to this decision, multiple bills had been introduced in Congress that would affect how the USF is funded and the programs it supports. For instance, bills such as the Lowering Broadband Costs for Consumers Act (S. 3321), the FAIR Contributions Act (S. 856), and the Reforming Broadband Connectivity Act (S. 975 and H.R. 1812) would require the FCC to study and report on its methods of funding the USF. These bills seek to expand the USF contribution base, particularly to include certain edge providers (*i.e.*, providers of online content or services). But these bills do not address the constitutional concerns of the Fifth Circuit. In short, the USF program's future will remain in doubt while it awaits its fate before the Supreme Court and potentially significant restructuring from Congress.

© 2024 Perkins Coie LLP

## Authors

## Explore more in

[Technology Transactions & Privacy Law](#) [Appeals, Issues & Strategy](#) [Communications](#)

## Related insights

Update

### [Insight Into the Upcoming Trump Administration's Antitrust Policy](#)

Update

### [Why the FCC's Net Neutrality Rules Were Struck Down](#)