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NO. COA00-718

NORTH CAROLINA COURT OF APPEALS

Filed: 2 January 2002

STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; PUBLIC STAFF--NORTH CAROLINA UTILITIES COMMISSION, Intervenor; BELLSOUTH TELECOMMUNICATIONS, INC., Intervenor; CAROLINA TELEPHONE AND TELEGRAPH COMPANY, Intervenor; CENTRAL TELEPHONE COMPANY, Intervenor; and GTE SOUTH, INC., Intervenor,
Appellees,

N.C. Utilities Commission
Docket No. P-100, Sub 84b

v.

THE NORTH CAROLINA PAYPHONE ASSOCIATION, Petitioner,
Appellant

Appeal by petitioner North Carolina Payphone Association from an order of the Utilities Commission entered 16 June 1999. Heard in the Court of Appeals 16 May 2001.

Robert Carl Voigt, Corporate Counsel, for intervenor-appellees Carolina Telephone and Telegraph Company and Central Telephone Company.

Law Office of Robert W. Kaylor, P.A., by Robert W. Kaylor, and Hunton & Williams, by Richard D. Gary, for intervenor-appellee Verizon South, Inc.

Edward L. Rankin, III, and Andrew D. Shore, Corporate Counsel, for intervenor-appellee BellSouth Telecommunications, Inc.

Brooks, Pierce, McLendon, Humphrey & Leonard, L.L.P., by Wade H. Hargrove, Marcus W. Trathen and David Kushner, for petitioner-appellant.

CAMPBELL, Judge.

On 20 March 1997 petitioner-appellant North Carolina Payphone Association ("NCPA") filed a petition with the North Carolina Utilities Commission ("the Commission") requesting the Commission review the current intrastate tariffs for payphone line access rates and payphone line usage rates that the various local exchange carriers ("LECs") charge independent payphone service providers ("PSPs") to determine whether those rates complied with Section 276 of the Telecommunications Act of 1996 ("the Act") and the orders of the Federal Communications Commission ("FCC") implementing Section 276 of the Act. Specifically, NCPA requested the Commission order the LECs to file cost and revenue information related to payphone services so the Commission could evaluate the payphone line access and usage rates the LECs charge PSPs to determine the existence of any subsidies in these rates and whether these rates comply with the new services test.[1]

On 15 May 1997 the Commission issued an order (1) requiring any LEC that found its existing payphone rates did not meet the requirements of the new services test to file revised rates and

[1]In implementing Section 276 of the Act, the FCC determined that the rates assessed by LECs for payphone services tariffed at the state level must satisfy the "new services test," a cost-based test that establishes the direct cost of providing the service as a price floor, and then allows the LECs to add a reasonable amount of overhead to arrive at the overall price of the service. *See* 47 C.F.R. § 61.49(g),(h)(1999).

supporting data with the FCC, and (2) requiring all LECs except BellSouth to file a statement with the Commission of their conclusions concerning the existence of any subsidy to LEC payphone operations in their intrastate rates. On 12 September 1997 the FCC informed the Commission of its intention to require federal tariffing and review of all incumbent LEC payphone services offered in North Carolina, due to the Commission's failure to affirmatively conclude that the rates satisfied the requirements of Section 276 of the Act. On 20 March 1998 the FCC's Common Carrier Bureau ordered all North Carolina LECs to file payphone tariffs with the FCC.

On 29 April 1998 BellSouth, on behalf of itself and fourteen other telephone companies ("the NC Telcos"), filed a motion with the Commission asking it to reconsider its 15 May 1997 order and conduct its own review of the LECs' intrastate payphone rates for compliance with the new services test. On 17 June 1998 the Commission informed the FCC of its intention to review the existing payphone service rates in North Carolina.

On 10 July 1998 the Commission issued an order granting the NC Telcos' motion for reconsideration and stating that it would:

> 1. Require the four major LECs to select studies already done with respect to existing business services in the context of Docket No. P-100, Sub 133b, and Sub 133d, to adjust those costs to capture the unique characteristics of payphone service provider (PSP) offerings, and to file those studies with the Commission . . .
>
> 2. Require the Public Staff to make its recommendations based on the filings of the LECs, including whether studies comply with

> the new services test and whether they are applicable to other LECs . . .
>
> 3. Allow interested parties to make comments and reply comments on the studies and the Public Staff's recommendations no later than two months thereafter; and
>
> 4. Render a decision as soon as practicable thereafter.

On 14 September 1998 the four major LECs filed the cost studies required by the Commission. On 16 June 1999 the Commission entered its "Order Ruling on Petition," concluding that the LECs' existing intrastate tariffs for payphone services are "cost based[sic], consistent with the requirements of Section 276 of the Act with regard to the removal of subsidies from exchange and exchange access services, are nondiscriminatory, and meet the new services test." NCPA appeals from the Commission's order, contending that it should be reversed on the grounds that it is (1) in excess of the Commission's jurisdiction, (2) affected by errors of law, (3) not supported by competent, material, and substantial evidence, and (4) arbitrary and capricious.

This Court's standard of review of an order of the Commission is set forth in N.C. Gen. Stat. § 62-94, which provides in pertinent part:

> (b) So far as necessary to the decision and where presented, the court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning and applicability of the terms of any Commission action. The court may affirm or reverse the decision of the Commission, declare the same null and void, or remand the case for further proceedings; or it may reverse or modify the decision if the substantial rights of the appellants have been

> prejudiced because the Commission's findings, inferences, conclusions or decisions are:
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> (1) In violation of constitutional provisions, or
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> (2) In excess of statutory authority or jurisdiction of the Commission, or
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> (3) Made upon unlawful proceedings, or
>
> (4) Affected by other errors of law, or
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> (5) Unsupported by competent, material and substantial evidence in view of the entire record as submitted, or
>
> (6) Arbitrary or capricious.

N.C. Gen. Stat. § 62-94(b)(1999). While orders of the Commission are deemed *prima facie* just and reasonable pursuant to N.C.G.S. § 62-94(e), this Court is not bound by findings, inferences, or conclusions that are based on errors of law. *See* N.C. Gen. Stat. § 62-94(b)(4).

Congress enacted Section 276 of the Telecommunications Act of 1996 "to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1)(Supp. 2001). In addition, Section 276 forbids any Bell operating company ("BOC") from "subsidiz[ing] its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations," and from "prefer[ing] or discriminat[ing] in favor of its payphone service." *Id.* § 276(a). Section 276 also provides that the FCC is to prescribe regulations that, *inter alia*,

> (A) establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every

> completed intrastate and interstate call using their payphone . . .;
>
> (B) discontinue the intrastate and interstate carrier access charge payphone service elements and payments in effect on such date of enactment and all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues, in favor of a compensation plan as specified in subparagraph (A);
>
> (C) prescribe a set of nonstructural safeguards for Bell operating company payphone service to implement the provisions of paragraphs (1) and (2) of subsection (a) of this section, which safeguards shall, at a minimum include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding;
>
> . . . .

Id. § 276(b)(1).

In its Payphone Reclassification Proceeding,[2] the FCC adopted regulatory requirements implementing Section 276 that fundamentally resructured the manner in which payphones are regulated:

> [O]ur ultimate goal in this proceeding is to ensure the wide deployment of payphones through the development of a competitive, deregulatory payphone industry. To achieve this goal, we found that it would be necessary to eliminate certain vestiges of a long-standing regulatory approach to payphones. To this end, the *Report and Order* directs the removal of subsidies to payphones, provides for nondiscriminatory access to bottleneck

[2] *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecomm. Act of 1996*, CC Docket No. 96-128, *First Report and Order*, 11 FCC Rcd 20541(1996); *Order on Reconsideration*, 11 FCC Rcd 21233(1996)(*Payphone Reconsideration Order*), *aff'd in part and remanded in part sub nom., Ill. Public Telecomm. Ass'n v. FCC,* 117 F.3d 555(D.C. Cir. 1997); *Second Report and Order,* 13 FCC Rcd 1778(1997)(*Payphone Clarification Order*), *aff'd in part and remanded in part sub nom., MCI v. FCC*, 143 F.3d 606(D.C. Cir. 1998).

> facilities, ensures compensation for all calls from payphones, and allows all competitors an equal opportunity to compete for essential aspects of the payphone business.

Payphone Reconsideration Order at ¶ 139. The FCC recognized that in the existing payphone service market--where LECs are the primary providers of lines that interconnect payphones to the public telephone network, and LECs are the principal competitors of independent PSPs--"LECs may have an incentive to charge their competitors unreasonably high prices for [basic payphone] services." *Payphone Order* at ¶ 146. To address this concern, the FCC required, *inter alia*, that incumbent LECs file tariffs for basic payphone lines at the state level, and that all incumbent LEC payphone tariffs filed at the state level be cost-based, nondiscriminatory, and consistent with both Section 276 and the Commission's Computer III tariffing guidelines. *Payphone Clarification Order*, 13 FCC Rcd at 1780(citing *Payphone Reconsideration Order*, 11 FCC Rcd at 21308). Consistent with the Computer III tariffing guidelines, the FCC determined that the rates assessed by LECs for payphone services tariffed at the state level must satisfy the new services test--the test the FCC applies to new interstate access service proposed by incumbent LECs subject to price cap regulation. *See Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, CC Docket No. 85-229, *Report and Order*, 104 FCC 2d 958(1986). The new services test is a cost-based test that establishes the direct cost of providing the service as a price floor, then allows the LECs to add a reasonable amount of overhead to derive the overall price of

the service. 47 C.F.R. § 61.49(h). In applying the new services test, the FCC requires the following:

> Once the direct costs have been identified, LECs will add an appropriate level of overhead costs to derive the overall price of the new service. To provide the flexibility needed to achieve efficient pricing, we are not mandating uniform loading, but BOCs [Bell Operating Companies] will be expected to justify the loading methodology they select as well as any deviations from it.

Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524 at ¶ 44(1991).

The FCC stated that it would rely initially on state commissions to ensure that the rates, terms, and conditions applicable to the provision of basic payphone lines comply with the requirements of Section 276, but that the FCC retained jurisdiction under Section 276 to ensure that all of its requirements are met. *Payphone Order,* 12 FCC Rcd 20997. Thus, the Commission's job in the underlying proceeding was to apply Section 276 and the FCC's regulations adopted pursuant thereto, subject to review not only by this Court and our Supreme Court, but also by the FCC.[3]

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[3]We note that NCPA currently has a "Petition for Expedited Review of and/or Declaratory Ruling Concerning, Local Exchange Company Tariffs for Basic Payphone Services" pending before the FCC. Despite the possibility that this Court's decision may conflict with the FCC's anticipated ruling in the case pending before it, we nevertheless go forward with our decision, with this caveat: the FCC retains ultimate jurisdiction in this area, and nothing in our opinion should be construed by the Commission other than in a manner that is consistent with the FCC's ruling, when ultimately rendered.

NCPA argues that the Commission erred in its review of the LECs' payphone line access and usage rates by applying a public policy analysis that was inconsistent with the policy decisions made by Congress in enacting Section 276 of the Act, and by the FCC in implementing the Act. We agree.

First, NCPA argues that the Commission disregarded and attempted to override Congress' and the FCC's conclusion that the reduction of payphone line rates to cost-based levels, consistent with the new services test, would benefit competition in the payphone market and benefit end users of payphone services.

Second, NCPA contends that the Commission erred by acknowledging that the existing payphone line access and usage rates include implicit subsidies intended to benefit universal service (i.e., low cost residential service), and concluding, as a policy matter, that maintaining these subsidies to universal service was appropriate and consistent with Section 276 of the Act. Rather, NCPA maintains that Section 276 and the FCC orders implementing it clearly require the elimination of all subsidies to other services from the payphone line access and usage rates, and that by applying an inconsistent public policy analysis to its review of the existing rates, the Commission failed to properly apply the cost-based rate requirements and the new services test mandated by the FCC.

NCPA points to the following findings of fact to indicate the Commission applied a public policy analysis of its own creation:

> 4. The rates adopted for the trunks and the usage rates for individual PSP lines reflect

> the additional value traditionally assigned to business services consistent with the Commission's goal of keeping basic residence rates affordable and with the methodology the Commission has historically employed when setting rates for most business and premium rate features.
>
> . . .
>
> 17. Reductions for payphone providers would also come at a cost to other ratepayers, since offsets would fall on rates for other services, most likely the least competitive. Reductions should be considered only in conjunction with changes in other rates which have contributed to the Commission's goal of universal service. Even if reductions in the PSP rates were deemed appropriate, the need for such reductions would have to carefully be weighed against reductions in rates for other services, for example, access charges for interexchange carriers and rates for business end users.
>
> 18. Reducing the contribution toward coverage of common overhead costs from PSP rates would not have a sustainable positive effect on payphone users and would have a negative effect on other telephone ratepayers in North Carolina.
>
> 19. Reducing current PSP rates to a level closer to the LECs' costs of providing PSP services is not required by federal law, would not result in a sustainable reduction in rates paid by end users of payphone service in North Carolina, would have negative impacts on other ratepayers whose rates would ultimately be increased, and would have a net negative effect on end users of telecommunications services in North Carolina.

These findings of fact clearly reflect that the Commission proceeded upon the assumption that reduction of the payphone line access and usage rates would not benefit competition in the payphone industry and would not have a positive effect on end users of payphone service. However, in prescribing regulations pursuant

to Congress' mandate "to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public," 47 U.S.C. § 276(b)(1), the FCC made a contrary policy determination. Recognizing that LECs had an incentive to charge PSPs unreasonably high prices for basic payphone services, the FCC required that the payphone line access and usage rates charged by LECs be cost-based. We agree with NCPA that the Commission did not have the authority to override this policy decision and replace it with its own opinion that a reduction in payphone rates would not benefit competition in the payphone market. Rather, the Commission's duty was to apply the FCC's rate guidelines without regard to whether the Commission agreed that these guidelines would ultimately benefit end users of payphones. Therefore, to the extent that the Commission's application of the new services test was affected by its public policy assumptions concerning the end result of applying the FCC's cost-based rate guidelines to the LECs' payphone rates, the Commission erred and its order must be reversed.

The aforementioned findings of fact also indicate that in its review of the LECs' payphone rates, the Commission proceeded under the assumption that maintaining subsidies to universal service within the LECs' payphone service rates was consistent with the requirements of Section 276. Initially, we note that Section 276 does not expressly require the elimination of all subsidies contained in payphone line access and usage rates. In fact, Section 276 only expressly prohibits a Bell operating company from

"subsidiz[ing] its *payphone service* directly or indirectly from its telephone exchange service operations or its exchange access operations . . . ." 47 U.S.C. § 276(b)(1)(B)(emphasis added).

However, the FCC's orders implementing Section 276 broadened its reach to require the elimination of all subsidies in payphone line rates, including subsidies to universal service. By requiring that payphone tariffs comply with the cost-based new services test, the FCC established that LECs could only recover a reasonable amount of their overhead costs through their payphone rates. In implementing the new services test, the FCC concluded that

> [T]ariffs for payphone services must be filed with the Commission as part of the LECs access services to ensure that the services are reasonably priced and do not include subsidies.

Payphone Order at ¶ 147. Moreover, in an order in its Wisconsin Payphone Proceeding,[4] the FCC stated:

> Given that the new services test is a cost-based test, overhead allocations must be based on cost, and may not be set artificially high in order to subsidize or contribute to other LEC services.

Wisconsin Order at ¶ 11(citing *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order,* 11 FCC Rcd 15499 ¶ 713 (1996). Therefore, we conclude that the new services test requires the elimination of all

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[4] A proceeding pending at the FCC, in which an order was entered directing the four largest incumbent LECs in Wisconsin to submit their current effective tariffs for intrastate payphone service offerings so the FCC could determine their compliance with Section 276. This order clearly sets forth the requirements of Section 276 and the FCC's orders implementing the Act.

subsidies in payphone line rates, including subsidies to universal service. Thus, the Commission erred in its review of the LECs' payphone rates by attempting to maintain subsidies to universal service.

The Commission's effort to maintain subsidies to universal service in payphone rates is symptomatic of the Commission's overall failure to apply the new services test correctly. As earlier stated, to satisfy the new services test, an incumbent LEC filing payphone line rates must demonstrate that the proposed rates do not recover more than the direct costs of the service "plus a reasonable portion of the carrier's overhead costs." 47 C.F.R. § 61.49(f)(2). While the LECs presented cost studies that identified the direct costs of providing payphone line service to PSPs, they did not add to the direct costs any specified overhead loadings (i.e., costs) to arrive at the total price of the service. Rather, the Commission appears to have based its conclusion that the LECs' rates complied with the new services test on a simple examination of the ratio of the direct costs of providing the service to the price charged ("cost/price ratio"). The Commission compared this cost/price ratio with the cost/price ratios for rates that had been allowed to go into effect by the FCC for other similar and dissimilar LEC services. Finding the cost/price ratio of the payphone services at issue to be within the range of cost/price ratios for previously approved services, the Commission held that the existing payphone rates complied with the new services test. In so doing, the Commission erred.

While the new services test does not require a uniform method for justifying overhead allocations, and one component of the new services test evaluation is an examination of the ratio of direct costs to rates, the cost/price ratio itself is not a substitute for a proper application of the new services test. The new services test always requires the LEC to justify that the amount of overhead it is seeking to recover is just and reasonable. In its Wisconsin Payphone Proceeding, the FCC set forth the new services test as follows:

> In determining a just and reasonable portion of overhead costs to be attributed to services offered to competitors, the LECs must justify the methodology used to determine such overhead costs. Absent justification, LECs may not recover a greater share of overheads in rates for the service under review than they recover in rates for comparable services. . . . For purposes of justifying overhead allocations, UNEs appear to be "comparable services" to payphone line services, because both provide critical network functions to an incumbent LECs competitors and both are subject to a "cost-based" pricing requirement. Thus, we expect incumbent LECs to explain any overhead allocations for their payphone line services that represent a significant departure from overhead allocations approved for UNE services.

Wisconsin Order at ¶ 11.

Here, the cost studies submitted by the LECs were the studies that had previously been approved by the Commission in its UNE proceeding,[5] and already included a just and reasonable allocation

[5] UNE services are business services which the FCC considers to be "comparable services" to payphone line services, because both provide critical network functions to an incumbent LEC's competitors and both are subject to a "cost-based" pricing requirement. *See Wisconsin Order* at ¶ 11.

of overhead costs. The Commission's order does not indicate that the LECs provided any justification for overhead allocations that exceeded those allowed in the UNE proceeding. The only basis given for the Commission's decision that the LECs' access and usage rates complied with the new services test was that "[t]he cost/price ratios of the existing PSP services of the four largest LECs are within the range of cost/price ratios of interstate offerings which the FCC has allowed to become effective and reflect a reasonable allocation of overhead costs to these services." We conclude that the Commission did not correctly apply the new services test, and on remand, the Commission must require the LECs to justify that their overhead allocations are just and reasonable.

NCPA next maintains that the Commission erred by failing to analyze access and usage rates separately. We agree.

PSPs pay a per-minute usage rate for local calls made over payphone lines, which is a separate and distinct rate element mandated by the Commission. This usage rate is a substantial portion of the monthly charges paid by PSPs and is priced well above cost. For example, the record shows that BellSouth's current average monthly revenue from usage is $16.95, which is 33% of its current average monthly revenue for payphone lines of $51.60. However, BellSouth's total usage costs, inclusive of overhead and return is $3.30 per month, resulting in a markup of 413%. By analyzing the usage rate together with the access rate, which has costs that are substantially higher, this tremendous amount of markup is hidden. Allowing such an extreme amount of markup

without justification is not consistent with the purpose of the new services test to only allow the recovery of a just and reasonable amount of overhead. Further, in its *Wisconsin Order*, the FCC required the LECs to submit complete cost studies for each rate element, both usage-sensitive elements and flat-rate elements. *See Wisconsin Order* at ¶ 7. This is an indication that the FCC intended to analyze the usage and access rates separately. Accordingly, we hold that the Commission erred in not analyzing usage rates and access rates separately.

NCPA next argues that the Commission committed reversible error in failing to separately analyze the payphone rates for lines serving confinement facilities and in failing to individually analyze the payphone tariffs of the smaller LECs in North Carolina. We agree.

Section 276(d) of the Act defines payphone service as "the provision of public or semi-public pay telephones, the provision of inmate telephone service in correctional institutions, and any ancillary services." 47 U.S.C. § 276(d). Therefore, it is clear that Congress intended for Section 276, as well as the FCC's orders implementing Section 276, to apply to payphone rates for lines in inmate confinement facilities. Thus, these confinement facility payphone rates must also be cost-based, nondiscriminatory, and consistent with both Section 276 and the new services test.

However, review of the record indicates that the LECs that submitted cost studies to the Commission in this proceeding did not conduct a separate new services test analysis on the payphone rates

charged in confinement facilities, even though the rates for lines servicing confinement facilities are higher than the regular payphone rates. Further, the Commission's order does not contain factual findings or conclusions indicating that payphone rates in confinement facilities were separately analyzed for compliance with Section 276. The Commission's failure to do so is error.

As for the smaller LECs in North Carolina, the Commission's order shows that they did not present company-specific cost studies to support their payphone tariffs. Instead, the Commission adopted the analysis of the Public Staff, concluding:

> The Public Staff's study of the other LECs indicates that the cost/revenue [price] relationships for these companies are in the range previously found reasonable for the four largest LECs. Thus, the existing tariffs of these LECs also comply with the new services test.

Having already concluded that analysis of the cost/price (revenue) relationship is not a substitute for conducting the new services test, and finding that the FCC orders implementing Section 276 require all LEC payphone line access and usage rates be reviewed for compliance with the new services test, we hold that the Commission erred in analyzing the rates charged by smaller LECs without requiring the filing of company-specific cost studies.

NCPA next argues that the Commission erred in failing to base the LECs' direct costs of providing payphone service solely on the costs of business loops, instead of a percentage weighting of business/residential loops. We agree.

In recognition of the fact that payphone service is a business service, the Commission, in initiating this proceeding, directed the LECs to "select studies . . . done with respect to existing business services . . . ." Despite this directive, only Verizon South, Inc., claimed to have filed costs based exclusively on business loops. The primary effect of using a business/residential weighting is that business loops are less expensive than residential loops, and by including residential loops in the direct costs, the cost of the service is increased.

Despite its directive to file studies relating to business services, the Commission allowed the LECs (except Verizon) to base their costs in part on the cost of residential loops. In support of this decision, the Commission made the following finding of fact:

> There is no evidence that the cost of payphone loops is closer to the cost of business loops than residence loops. If residence loop costs are removed from the cost studies in this proceeding, the resulting TELRIC cost of a payphone loop for PSPs would be less than the TELRIC cost of a payphone loop for CLPs; and if equal amounts of overhead were added to each, the wholesale CLP rate would be greater than the retail PSP rate. Thus, the NCPA's suggestion that the studies be adjusted to remove residence loop cost is rejected.

This finding of fact indicates that the Commission took into consideration something other than the new services test in determining the direct costs of providing payphone service to PSPs. We conclude that the Commission erred in doing so and on remand the Commission should provide further support for its determination

that the cost of payphone loops should be based on a percentage weighting of business/residential loops.

Finally, NCPA contends that the Commission erred in ignoring the possibility that the LECs' payphone line access and usage rates allow for the double recovery of costs associated with the facilities (i.e., local loops) involved in providing line access to PSPs. We agree.

In its Wisconsin Payphone Proceeding, the FCC set forth the following requirement:

> We also note that the forward-looking cost studies we have required in the contexts described above produce cost estimates on an "unseparated" basis. In order to avoid double recovery of costs, therefore, the LEC must demonstrate that in setting its payphone line rates it has taken into account other sources of revenue (*e.g.*, SLC/EUCL, PICC, and CCL access charges) that are used to recover the costs of the facilities involved.

Wisconsin Order at ¶ 12.

Our review of the Commission's order does not indicate that the LECs demonstrated that in setting their payphone rates they had taken into account other sources of revenue that are used to recover the costs of the facilities involved in providing service to PSPs. The Commission's failure to make such a finding is reversible error.

In summary, we reverse the Commission's order and remand to the Commission for additional proceedings consistent with this opinion. Upon remand, the Commission is instructed to order all smaller LECs in North Carolina to file company-specific cost studies which are to be reviewed for compliance with the new

services test. In reviewing these tariffs, as well as in re-examining the tariffs of the larger LECs, the Commission is instructed to analyze usage rates and access rates separately. The Commission is further instructed to conduct a separate analysis of payphone rates for lines in confinement facilities to determine their compliance with the new services test. In applying the new services test on remand, the Commission is not to replace Congress' and the FCC's judgment as to the effect of reducing payphone rates with its own policy determinations, and is not to consider maintaining subsidies to universal service as a factor in its determination of compliance with the new services test. The Commission is instructed to direct the LECs to fully justify the reasonableness of any recovery of overhead costs and cannot rely solely on examination of the cost/price ratio. The Commission must also indicate that the LECs have sufficiently demonstrated that in setting their payphone rates they have taken into account other sources of revenue that are used to recover the costs of the facilities involved. We finally note that on remand the Commission's proceedings must be consistent with the FCC's ultimate ruling on NCPA's pending petition, and any conflict between this Court's opinion and the FCC's ruling regarding the governing federal law should be resolved in favor of the FCC's ruling.

Reversed and remanded.

Judge SMITH concurs.

Judge BIGGS dissents.

Report per Rule 30(e).

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BIGGS, Judge dissenting.

I respectfully dissent. I find the doctrine of primary jurisdiction applicable to this case and, accordingly, would stay the present appeal pending resolution of NCPA's petition before the FCC.

Primary jurisdiction "is a doctrine specifically applicable to claims properly cognizable in court that contain some issue within the special competence of an administrative agency." *Reiter v. Cooper*, 507 U.S. 258, 268, 122 L. Ed. 2d 604, 617 (1993). This doctrine:

> is concerned with promoting proper relationships between the courts and administrative agencies[,]. . . and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body[, . . . particularly in cases raising issues of fact not within the conventional experience of judges[.]

United States v. Western Pac. R. Co., 352 U.S. 59, 63-64, 1 L. Ed. 2d 126, 132 (1956). Consideration of the doctrine of primary jurisdiction serves "to guide a court in determining *whether the court should refrain from exercising its jurisdiction until after an administrative agency has determined some question or some aspect of some question arising in the proceeding before the court.*" *N.C. Chiropractic Assoc. v. Aetna Casualty & Surety Co.*, 89 N.C. App. 1, 8, 365 S.E.2d 312, 316 (1988). Under this

doctrine, even where a court has jurisdiction over a matter as in this case, it should stay the proceedings if an administrative agency has special expertise that would help resolve the issues, or if there is a need for a uniform application of administrative standards. *VoiceStream Wireless Corp. v. All U.S. Communications*, 149 F.Supp.2d 29, (S.D. N.Y. 2001).

In the case *sub judice,* the same issues are presented both in this appeal and in the FCC petition. These issues raise many questions requiring technical knowledge and policy interpretations that implicate the specialized competence and expertise of the FCC. Indeed, "[t]he establishment of appropriate payment rates under a regulatory scheme is a paradigmatic subject of agency expertise." *Phone-Tel Communications, Inc. v. AT & T Corp.*, 100 F.Supp.2d 313, 317, (E.D.Pa. 2000) (referring claim involving pay phone rates to FCC, noting that "the FCC is the expert regulatory agency on affairs relating to telecommunications carriers").

The doctrine of primary jurisdiction has previously been employed in this state. *See Johnson v. First Union Corporation*, 128 N.C. App. 450, 496 S.E.2d 1 (1998), *rehearing on other grounds*, 131 N.C. App. 142, 504 S.E.2d 808 (1998) (applying primary jurisdiction to stay claims raising "common factual issues" with claims before administrative agency); *N.C. Chiropractic Assoc. v. Aetna Casualty & Surety Co.*, 89 N.C. App. 1, 365 S.E.2d 312 (1988) (staying claims raised in state court where consideration of primary jurisdiction suggests that claims are better resolved by Industrial Commission). The doctrine is especially applicable to

cases addressing the complex and highly regulated telecommunications industry. *See, e.g., Sprint Spectrum L.P. v. AT&T Corp.*, 168 F.Supp.2d 1095, 1101 (W.D. Mo. 2001) (where dispute involves rate that Sprint may charge AT & T for use of the Sprint PCS network, "these issues should be referred to the FCC for determination under the doctrine of primary jurisdiction, as they involve matters within the agency's special expertise and which require a uniform national resolution"); *Miranda v. Michigan*, 141 F.Supp.2d 747 (E.D. Mich. 2001) (holding that claims challenging reasonableness of payphone rates are "within the primary jurisdiction of the FCC"); *Digital Communications Network, Inc. v. AT & T Wireless Services*, 63 F.Supp.2d 1194 (C.D. Cal. 1999) (holding that FCC had primary jurisdiction in dispute over rates charged by commercial mobile radio service provider).

Finally, I note the possibility, acknowledged in the majority opinion, that this Court might render a decision inconsistent with that ultimately issued by the FCC, requiring further litigation to determine the extent of the inconsistency, and which aspects of our ruling were subject to federal preemption.

To avoid unnecessary confusion, expense, and the uncertainty that might be caused by inconsistent rulings, I believe the better course is to stay this appeal pending a determination by the FCC.