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PUBLIC UTILITIES - CALIFORNIA

Sierra Telephone Company, Inc. v. Reynolds

United States District Court, E.D. California - November 27, 2023 - F.Supp.3d - 2023 WL 8190262

Telephone service provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural and remote areas of California, internet service provider (ISP), and their parent company, brought action against commissioners of the California Public Utilities Commission (CPUC), in their official capacities, challenging application of CPUC's broadband imputation policy, which imputed the revenues of ISPs to affiliate telephone service providers, in calculation of provider's subsidies under the program, as an unconstitutional taking, preempted by the Federal Communications Commission's (FCC) Restoring Internet Freedom Order, and in violation of the Dormant Commerce Clause.

Plaintiffs moved for a preliminary injunction and defendants moved to dismiss for failure to state a claim.

The District Court held that:

- Johnson Act did not preclude district court from exercising subject matter jurisdiction over plaintiffs' action;
- Plaintiffs failed to state a takings claim;
- Plaintiffs failed to state a per se takings claim;
- FCC's order did not preempt CPUC's ratemaking decisions;
- Claim preclusion did not bar preemption claim;
- Issue preclusion did not bar preemption claim; and
- Plaintiffs failed to state a claim for violation of the Dormant Commerce Clause.

Johnson Act, which deprived federal courts of jurisdiction over suits challenging an order affecting rates chargeable by a public utility that were based solely on diversity of citizenship or repugnance of the order to the Federal Constitution, did not preclude district court from exercising subject matter jurisdiction over action brought by telephone service provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural and remote areas of California, internet service provider (ISP), and their parent company, challenging California Public Utilities Commission's (CPUC) imputation of ISP's revenues to telephone provider in calculation of provider's subsidies, as an unconstitutional taking, preempted by the Federal Communications Commission's (FCC) Restoring Internet Freedom Order, and in violation of the Dormant Commerce Clause; plaintiffs' preemption claim was not solely constitutional.

Telephone service provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural and remote areas of California, internet service provider (ISP), and their parent company, did not sufficiently allege that telephone service provider had a property interest in the subsidies, in support of their claim challenging California Public Utilities Commission's (CPUC) imputation of ISP's revenues to telephone service

provider in calculation of provider's subsidies, pursuant to broadband imputation policy, as an unconstitutional taking; complaint did not include factual allegations that participation in the subsidy program was mandatory or that CPUC was compelling telephone service provider's participation in the program.

California Public Utilities Commission's (CPUC) ratemaking decision for telephone provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural and remote areas of California, which imputed revenues of affiliate internet service provider (ISP) to telephone provider in calculation of provider's subsidies, and concluded that telephone provider required a 5.98% rate of return on regulated investments to cover its costs of capital, was not unfair or unreasonable, and thus did not constitute an unconstitutional taking; ISP used telephone provider's infrastructure to deliver broadband services, and the CPUC rate design accounted for ISP's usage of and benefit derived from the subsidized infrastructure, balancing interests of the providers, other carriers contributing to the subsidy program, and the public.

Telephone and internet service providers, and their parent company, did not sufficiently allege that California Public Utilities Commission's (CPUC) ratemaking decision for telephone provider, which imputed revenues of internet provider to telephone provider in calculation of subsidies under government program for small, rural, independent telephone providers, pursuant to its broadband imputation policy, and concluded that telephone provider required a 5.98% rate of return on regulated investments to cover its costs of capital, was unreasonable in light of prior CPUC decision which determined that telephone provider required a 9.22% rate of return, in support of their takings claim; plaintiffs did not allege that 9.22% remained the minimal rate of return for operations or include factual allegations regarding impacts of broadband imputation policy on telephone provider's ability to achieve a sufficient rate of return to draw investment and cover costs.

Telephone and internet service providers, and their parent company, did not sufficiently allege that California Public Utilities Commission's (CPUC) ratemaking decision for telephone provider, which imputed revenues of internet provider to telephone provider in calculation of subsidies under government program for small, rural, independent telephone providers, pursuant to its broadband imputation policy, and concluded that telephone provider required a 5.98% rate of return on regulated investments to cover its costs of capital, was unreasonable because it did not allow telephone provider to earn a return on the value of property equal to the return being made in the same general part of the counties in which it operated, in support of takings claim; plaintiffs did not allege facts that compared telephone provider's rate of return to other rates of return in the same territory.

California Public Utilities Commission (CPUC) did not compel telephone service provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural and remote areas of California to operate a loss by conflating its financials with affiliate internet service provider's (ISP) financials, in its ratemaking decision, which imputed revenues of ISP to telephone provider in calculation of provider's subsidies, and concluded that telephone provider required a 5.98% rate of return on regulated investments to cover its costs of capital, and thus CPUC's decision did not result in an unconstitutional taking; CPUC did not compel telephone provider to look to its affiliate internet provider to recover its losses or compel telephone provider to participate in the subsidy program.

Claim asserted by telephone and internet service providers, and their parent company, challenging California Public Utilities Commission's (CPUC) imputation of internet provider's revenues to affiliate telephone provider in calculation of provider's subsidies under government program for small, rural, independent telephone providers, as a unconstitutional taking, which incorporated all

65 preceding paragraphs in the complaint without distinction, was an improper shotgun pleading that did not give proper notice to either the CPUC Commissioners or the district court; if specific paragraphs supported the claim and plaintiffs intended to rely on them, those paragraphs, not the wholesale incorporation of every paragraph, should have been specifically incorporated by reference.

Telephone service provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural areas of California, internet service provider (ISP), and their parent company, did not allege that California Public Utilities Commission's (CPUC) ratemaking decision for telephone provider, which imputed ISP's revenues to telephone provider in calculation of provider's subsidies, pursuant to its broadband imputation policy, directly appropriated ISP's private property or ousted it from its domain, that CPUC required a permanent physical invasion of ISP's property, or that ISP was the owner of real property which had been called upon to leave its property economically idle, and thus failed to state a per se takings claim under one of the traditional theories.

Telephone service provider that participated in subsidy program for small, rural, independent telephone companies that provided local telephone service in rural areas of California, internet service provider (ISP), and their parent company, did not sufficiently allege that California Public Utilities Commission's (CPUC) ratemaking decision for telephone provider, which imputed ISP's revenues to telephone provider in calculation of provider's subsidies, pursuant to its broadband imputation policy, indirectly mandated a transfer of ISP's profits to telephone provider to fulfill telephone provider's revenue requirement on an annual basis, in support of their per se takings claim; plaintiffs failed to allege how imputing ISP's profits in telephone provider's rate design mandated a transfer of property.

Federal Communications Commission's (FCC) decision in its Restoring Internet Freedom Order to stop classifying broadband services as "telecommunications services" subject to regulation pursuant to Title II of Communications Act, and to instead reclassify them as "information services" not subject to regulation under Title I, did not preempt California Public Utilities Commission's (CPUC) imputation of internet service provider's (ISP) revenues to affiliate telephone service provider, in calculation of provider's subsidies under statute establishing subsidy program for small, rural, independent telephone companies that provided local telephone service in rural areas of California; FCC's Order was merely a policy preference for a "light-touch" broadband regulatory approach, and CPUC's broadband imputation did not conflict with federal law or with purposes and objectives of Congress.

Federal Communications Commission's (FCC) policy preference for a "light-touch" broadband regulatory approach, expressed in its decision to reclassify broadband services as "information services" not subject to regulation under Title I of the Communications Act, did not preempt California Public Utilities Commission's (CPUC) imputation of internet service provider's (ISP) revenues to affiliate telephone service providers, in calculation of subsidies under voluntary subsidy program for small, rural, independent telephone companies that provided local telephone service in rural and remote areas of California; CPUC's broadband imputation applied only to those who desired a state subsidy and did not compel participation in the subsidy program.

Finding in prior state court action, brought by ten telephone companies that participated in program that provided subsidies to small, rural, independent providers of telephone service in rural and remote areas of California against California Public Utilities Commission (CPUC), that CPUC's broadband imputation policy, which imputed revenues of internet service providers (ISP) to affiliate telephone companies in calculation of subsidies under the program, was not facially preempted by Federal Telecommunications Act and Federal Communications Commission (FCC) order exempting

broadband internet services from utility-style regulation, was not res judicata in subsequent federal court action brought by one of the telephone companies from state court action against CPUC, claiming that CPUC's use of broadband imputation in ratemaking decision for company was preempted by federal law; company's as-applied challenge in federal case included facts specific to its rate case, whereas prior case did not raise specific effect of CPUC's policy on each company.

Prior state court proceeding, brought by telephone companies that participated in program that provided subsidies to small, rural, independent providers of telephone service in rural and remote areas of California against California Public Utilities Commission (CPUC), wherein statute allowing CPUC to impute broadband revenues of telephone companies' internet service provider (ISP) affiliates in determining subsidies under the program was found not to be preempted by the Federal Telecommunications Act and Federal Communications Commission (FCC) order exempting broadband internet services from utility-style regulation, did not collaterally estop one telephone company from prior case from litigating claim in federal court that CPUC's use of broadband imputation in ratemaking decision for company was preempted by FCC's determinations; prior case presented facial challenge to broadband policy, whereas federal court action disputed application of broadband imputation on behalf of one telephone company.

Telephone company that participated in program that provided subsidies to small, rural, independent providers of telephone service in rural and remote areas of California, internet service provider (ISP), and their parent company, did not sufficiently allege that California Public Utilities Commission's (CPUC) ratemaking decision for telephone company, which imputed revenues of ISP to company in calculation of subsidies under the government program, pursuant to its broadband imputation policy, burdened interstate commerce, in support of claim that CPUC's ratemaking decision violated the Dormant Commerce Clause; all burdens alleged by plaintiffs were upon ISP's internal operations.

Claim asserted in federal court action by telephone company that participated in program that provided subsidies to small, rural, independent providers of telephone service in rural and remote areas of California, internet service provider (ISP), and their parent company against California Public Utilities Commission (CPUC), that CPUC's imputation of ISP's revenues to affiliate telephone company in calculation of company's subsidies under the program violated the Dormant Commerce Clause, was not within the scope of prior state court action challenging CPUC's broadband imputation policy as facially unconstitutional, and thus was not precluded, under doctrine of res judicata; transactional nucleus of facts of prior facial challenge differed from the as-applied challenge raised in federal court.