FCC Provides Guidance on Inability to Pay Analysis in Enforcement Actions; Significantly Reduces Slamming/Cramming Penalty

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The Federal Communications Commission (FCC) reduced the penalty assessed against a long distance carrier by over $6 million in a Forfeiture Order issued earlier this week, after the carrier demonstrated an inability to pay the proposed fine. In doing so, the FCC provided rare insight into how it assesses inability to pay claims raised by enforcement action targets and balances such claims against other forfeiture adjustment factors. The Forfeiture Order provides the most recent detailed guidance about how a company's finances can impact the FCC's forfeiture analysis, but offers little comfort to low-margin businesses with limited net revenues.

In 2013, the FCC proposed a $7.6 million fine against Advantage Telecommunications Corp. (Advantage), alleging it "slammed" consumers by changing their long distance carriers without authorization and "crammed" unauthorized charges onto their bills. The FCC further claimed that Advantage violated the FCC's truth-in-billing rules and its telemarketers engaged in deceptive marketing. Although the FCC determined that Advantage committed the violations in the Forfeiture Order, it reduced the fine to $1 million. Under the Communications Act, the FCC must consider a party's ability to pay when determining fine amounts. The FCC will review tax returns, financial statements, and any other documentation offering a reliable picture of a party's financial status. Critically, the FCC normally only considers a party's *gross* revenues, not the *net* profits earned by the party, when assessing an inability to pay claim. As a result, the fact that a party operates at a loss or faces significant operational costs does not automatically qualify it for a penalty reduction. If a party demonstrates an inability to pay, the FCC historically has reduced the fine imposed to approximately 2-8% of the party's average gross revenues.

Advantage turned over three years of recent tax returns, but argued that the FCC should consider its net revenues and the reputational harm it suffered because of the FCC's investigation when assessing its ability to pay. Advantage highlighted its costs associated with marketing, customer service, regulatory compliance, and paying the network providers whose service it resells. The difference between gross and net revenues often can be substantial for service resellers and other low-margin businesses like prepaid calling card providers.

The FCC refused to consider these expenses in its inability to pay calculation. But in a departure from past enforcement actions, the FCC explained its continued reliance on gross revenues over net revenues when determining a party’s ability to pay. First, the FCC stated that relying on net revenues encourages companies to “gold plate” operations by inflating expenses so they can claim limited profits in response to a proposed fine. Second, the FCC argued that a net revenue-based approach would require its staff to expend considerable time and effort reviewing company expenses to determine their legitimacy. The FCC stated that the potential for gamesmanship and protracted expense reviews justified its use of gross revenues as the primary yardstick for assessing inability to pay claims.

Based on Advantage’s tax returns, the FCC determined that the company’s average gross revenues were “far below” the $7.9 million proposed forfeiture. But instead of lowering the fine to the standard 2-8% of average gross revenues, the FCC found that Advantage deserved only a “partial” reduction to $1 million. While recognizing the importance of its inability to pay analysis, the FCC noted that the Communications Act also requires it to weigh a party’s financial condition against other mitigating factors, including the violations’ egregiousness and the substantial harm caused to consumers. The FCC pointed to Advantage telemarketers’ deceptive marketing practices and the company’s refusals to provide refunds for unauthorized charges as examples of egregious misconduct causing substantial consumer harm. The FCC found that such misconduct prevented Advantage from receiving a full inability to pay forfeiture reduction.

Beyond the rare inability to pay guidance, the Forfeiture Order also raised eyebrows by drawing a partial dissent from Commissioner O’Rielly. Although he did not provide a statement explaining his dissent, Commissioner O’Rielly previously criticized the FCC’s reliance on gross revenues as the metric for assessing inability to pay claims. Commissioner O’Rielly criticized his colleagues during the prior Administration for failing to recognize the detrimental effect large fines can have on the continued viability of low-margin companies and pushed for consideration of net revenues when determining inability to pay.

Although the FCC again rejected a net revenues-based framework, the Forfeiture Order signals the FCC’s openness to inability to pay claims and underscores the importance of a company’s financial condition when defending against significant enforcement penalties.