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STATE REGULATION OF THE BELL SYSTEM AFTER THE MODIFIED FINAL JUDGMENT: SOME QUESTIONS AND SUGGESTED ANSWERS

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FOREWORD

A part of NRRI's research agenda for FY83 was the commissioning of this report now published as an Occasional Paper. By having recognized regulatory experts outside the staff of the Institute produce such reports allows a broader source of viewpoints and is a useful elements of outreach for NRRI. Charles A. Zielinski, attorney and former Chairman of the New York Public Service Commission and Gilbert E. Hardy, attorney and, from time to time, special counsel to the District of Columbia Public Service Commission are two such contributors.

As 1984 approaches with the announced restructuring of the domestic telecommunications industry, state commissions are grappling with many major questions regarding their regulatory responsibilities and authorities in the post-divestiture environment. Messrs. Zielinski and Hardy here consider ten such questions and pose suggested answers to each. We feel the clear statements of the problems and the lines of reasoning offered as ways to think about them will be helpful to state regulators - commissioners and staff. The views and opinions presented are, of course, those of the authors and do not necessarily reflect those of the NRRI, the National Association of Regulatory Utility Commissioners (NARUC), NARUC member commissions, or The Ohio State University.

Douglas N. Jones
Director
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Columbus, Ohio

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A. INTRODUCTION

Early in 1984, a significant restructuring of the domestic telecommunications industry will occur. The American Telephone & Telegraph Company (AT&T), the dominant company in the industry for more than a century, will divest approximately two-thirds of its assets -- principally local exchange distribution and switching facilities -- pursuant to the Modified Final Judgment (MFJ) that settled the government's antitrust suit against AT&T.1/ These divested assets, used to initiate and complete both interstate and intrastate communications, will be owned by separate Bell Operating Companies (BOCs) organized as seven distinct regional holding companies.2/

1/ The MFJ can be found as an appendix to United States v. American Tel. & Tel. Co., 552 F. Supp. 121, 226 (D.D.C. 1982) aff'd sub nom. Maryland v. United States, 51 U.S.L.W. 3628 (March 1, 1983) (settling Civil No. 74-1698 (D.D.C.) [hereinafter "Greene I"].

2/ The seven regional companies will be holding companies for the twenty-two Bell Operating Companies. The Northeast regional company (NYNEX) will include New England Telephone Co. and New York Telephone Co. The Mid-Atlantic regional company (Atlantic Bell) will include New Jersey Bell Telephone Co., the Bell Telephone Company of Pennsylvania, the Diamond State Telephone Company and the Chesapeake and Potomac Telephone Companies of Washington, D.C., Virginia, Maryland, and West Virginia. The Southern Regional Company (Southern Bell) will include Southern Bell Telephone and Telegraph Co. and South Central Bell Telephone Company. The Midwest regional company (Ameritech) will include the Ohio Bell Telephone Co., Michigan Bell Telephone Co., Indiana Bell Telephone Co., Illinois Bell Telephone Co., and Wisconsin Telephone Co. The Northwest regional company (U.S. West) will include Northwestern Bell Telephone Co., the

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The adoption of the MFJ adds yet another dimension to an already uncomfortable situation facing state regulators of the telecommunications industry. Even before the MFJ, the era of end-to-end monopoly provision of two-way electronic communications was being brought to a close by the entry of new telecommunications technologies, services, and companies competing for AT&T's business. This trend toward competition struck at the core of the economic justification for public utility regulation of telecommunications in the "public interest." The MFJ's restructuring of AT&T will make it even more difficult for state commissions to follow traditional public utility regulatory precepts in exercising their governmental powers over the telecommunications industry.

In this paper, we attempt to shed some light on some of the state regulatory issues raised by the MFJ. We make no claim, however, that the ten questions we have chosen to address constitute all of the conceivable issues related to the MFJ that are important to state regulators. Nor do we suggest that our answers to the questions necessarily cover all of the considerations pertinent to their resolution. It would be presumptous (and naive) to make either claim. Decisions pending before the Federal Communications Commission (FCC) and the courts, additional decisions from Judge Greene with respect to the MFJ, as well as legislative action by Congress, could raise new issues or change the suggested answers to existing questions. We do intend, however, to provide some guidance for analyzing

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Mountain States Telephone and Telegraph Co., and Pacific Northwest Bell Telephone Co. The Far West Regional Company (Pacific Telesis) will include the Pacific Telephone and Telegraph Co. and Bell Telephone Company of Nevada. The Southwest regional company (Southwest Bell) will comprise Southwestern Bell Telephone Co.

the new telecommunications regulatory issues that pose both legal and policy questions for state regulators. Some of the questions we address have been specifically suggested by researchers at the National Regulatory Research Institute. Others we have chosen because they are now pending (or likely at some point to be pending) before the state commissions.

To analyze properly the issues in state regulation of telecommunications, we must first identify the applicable legal requirements. Accordingly, in the next sections of this paper we will briefly describe pertinent requirements of the MFJ; the FCC's authority to preempt state regulation and its related general policies; and the residual authority of the state commissions. We then pose and discuss ten selected state telecommunications regulatory issues. In our concluding section, we make some recommendations.[3]

B. LEGAL CONSTRAINTS ON STATE REGULATION

Although the authority of state commissions to regulate communications services is conferred by state public utility laws, these statutes are not the only limitations on the exercise of state regulatory power. Both the Communications Act of 1934 and now the MFJ constitute additional important limitations.

3/ While we will refer to state public utility statutes and current policies, a comprehensive summary of all such statutes and policies is beyond the scope of this article. Accordingly, we will refer to New York and North Carolina statutes and policies as illustrations when appropriate.

1. The Modified Final Judgment

At the outset, we should describe briefly how the MFJ will divide Bell System assets and business in 1984. The parent company (AT&T) will retain ownership of:4/ all terminal equipment currently leased to customers; the assets of Western Electric, its equipment manufacturing arm; the resources of Bell Laboratories, its research subsidiary; and the transmission and switching facilities used predominantly to provide service between so-called Local Access and Transport Areas (LATAs).5/ Except for "information" services, AT&T will be free of antitrust restrictions on its entry into new business.6/

Transmission and distribution facilities within LATAs will generally belong to the divested, separately owned BOCs. The MFJ allows the BOCs to provide "exchange telecommunications service,"

4/ The MFJ does not explicitly provide that AT&T retain ownership of these properties and entities; but it permits retention because it does not require their transfer to the BOCs.

5/ The MFJ does not use the term "LATA," and speaks instead about "exchange areas." However, an "exchange area" under the MFJ actually encompasses many separate local exchange areas; thus the term LATA was adopted to describe MFJ "exchange areas." For a history of the different terminology, see United States v. American Tel. & Tel. Co., slip. op. at 4 n.9 (April 20, 1983) (reprinted in 1983-1 Trade Cas. ¶ 65,333 (D.D.C. April 20, 1983)) [hereinafter Greene II].

6/ See Greene I, 552 F. Supp. at 170. Section VIII(D) of the MFJ provides that AT&T will not "engage in electronic publishing over its own transmission facilities." Electronic publishing refers to the production and provision of information to persons not affiliated with AT&T. This restriction may be removed, at the discretion of the court, seven years after the entry of the decree. See generally id. 180-86.

i.e., electronic transmission of messages within a LATA, via any technology available for that purpose, including cellular and conventional land mobile radio facilities as well as coaxial and fibre optic cable wires.7/ BOCs may also provide services "essential" to the provision of exchange telecommunications, such as pole and conduit space.8/ In addition, BOCs may sell or lease newly acquired telecommunications terminal or customer premises equipment (CPE).9/ Beyond these services, however, the BOCs may not "provide any other product or service . . . that is not a natural monopoly service actually regulated by tariff," and are specifically precluded from providing inter-LATA services or "information" services, and from the manufacture of telecommunications equipment.10/ These restrictions can be removed only by the Federal District Court for the District of Columbia (Judge Greene).11/

7/ See section II (A)(1) of the MFJ; Department of Justice, Response to Public Comments on Proposed Modification of Final Judgment, 47 Fed. Reg. 23320, 23335 (1982) (section II(c)(1)(f)).

8/ See id., 47 Fed. Reg. at 23333 (Section II(c)(1)(b)).

9/ The proposed decree initially prohibited the BOCs from providing CPE. Judge Greene subsequently changed this restriction, permitting BOCs to provide, but not manufacture, CPE. See sections II(D)(2) and VIII(A) of the MFJ; see generally Greene I, 552 F. Supp. at 190-93.

10/ See section II(D) of the MFJ. For Judge Greene's discussion of these restrictions, see Greene I, 552 F. Supp. at 186-95. Section VIII(c) of the MFJ empowers the court to remove any of these restrictions if "there is no substantial possibility that [a BOC] could use its monopoly power to impede competition in the market it seeks to enter."

11/ See section VII of the MFJ, where Judge Greene retains broad jurisdiction over the MFJ and the AT&T reorganization generally.

A primary purpose of the MFJ is to remove the asserted incentive and ability of AT&T to discriminate against its competitors for long-distance, or interexchange, communications business. Because AT&T had monopoly control of local exchange distribution and switching facilities, the government alleged that AT&T had (notwithstanding the constraints of regulation): (a) the ability to hold prices for monopoly services above cost, and the incentive to do so in order to cross-subsidize its competitive services; and (b) the ability and incentive to deny (or make very costly and difficult) access to the monopoly exchange (or "bottleneck") facilities needed by its competitors to provide service to ultimate customers.12/ Divestiture of the "bottleneck" facilities;13/ a prohibition against the owners of those facilities engaging in competitive interexchange service;14/ and a requirement that they provide carriers "equal access" to "bottleneck" facilities15/ are measures imposed by the MFJ to remove the incentive and ability of AT&T to discriminate against competitors.16/

12/ For an overview of these allegations and the evidence offered to prove them, see Greene I, 552 F. Supp. at 160-65. Judge Greene was careful to note that he was not rendering a final judgment on the allegations.

13/ See Section I(A) of the MFJ, which specifically requires transfer of sufficient resources to the BOCs to perform "exchange telecommunications and exchange access functions."

14/ See Section II(D)(1) of the MFJ, which specifically provides that no BOC shall provide "interexchange telecommunications services or information services."

15/ Section II(A) of the MFJ requires access "that is equal in type, quality and price."

16/ See generally Greene I, 552 F. Supp at 186-200 (discussing the various restrictions and the rationale for each of them).

The MFJ does not purport to change the authority and responsibility of state regulatory commissions over intrastate telecommunications services,17/ although it obviously does restrict the entities providing those services. AT&T, as a provider of intrastate inter-LATA telecommunications service, is subject to both the jurisdiction of state commissions and the requirements of the MFJ. The BOCs, as providers of intrastate intra-LATA services, also are subject to both the jurisdiction of state commissions and the restrictions of the decree. Thus, although Judge Greene has required the BOCs to provide equal access arrangements for, and "nondiscriminatory" access charges to, multiple inter-LATA and intra-LATA carriers,18/ he has not compelled state commissions to adopt a policy of competition for intrastate telecommunications services.19/

2. Federal Communications Commission Authority and Policy

Under the authority granted to it by the Congress in the Communications Act of 1934, the FCC can preempt state regulation of telecom-

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17/ The MFJ itself makes no mention of state commissions. In his discussion of the conflict between state regulation and the MFJ, Judge Greene noted that the MFJ only preempted state regulation to the extent necessary to implement federal policies. See Greene I, 552 F. Supp at 160.

18/ The MFJ does not specifically require equal access for intra-LATA carriers. However, Judge Greene conditioned his approvals of various exceptions sought by the BOCs to LATA configurations on the BOC's acceptance of an obligation to provide intra-LATA equal access. See Greene II, slip. op., at 31-34.

19/ "Nothing in the proposed decree would require a State to replace its regulatory system with a system of competition; they may continue to require a regulated monopoly in, say, local telephone services or intrastate toll service." Greene I, 552 F. Supp. at 159, fn. 117.

munications services.20/ Although virtually all of the facilities used to provide interstate communications also provide intrastate service, the FCC has consistently maintained that states may not regulate those facilities in a manner inconsistent with a valid FCC policy governing the provision of interstate communications services. The courts have upheld FCC preemption of a considerable amount of state regulation on these grounds.

Early preemption cases involved terminal equipment. After directing AT&T to remove restrictions in its interstate tariffs prohibiting the interconnection of terminal equipment furnished by other suppliers who were not franchised telephone utilities, and thus opening the terminal equipment supply market to competition,21/ the FCC later held that state commissions could not adopt an intrastate regulatory policy inconsistent with the federal scheme.22/ In affirming the FCC's decision on an appeal by the North Carolina Commission, the United States Court of Appeals for the Fourth Circuit specifically held that a state policy permitting a customer to make only interstate calls on a telephone supplied by a company other than AT&T could be preempted by the FCC.23/ Thereafter, the FCC successfully

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20/ 47 U.S.C. § 152(a) states that the provisions of the Communications Act "shall apply to all interstate and foreign communications by wire or radio"; the definitions of "wire", "radio" and "interstate" communications cover "all facilities" that are "incidental to" communication between states. 47 U.S.C. § 153(a), (b), (c).

21/ This pioneering decision was Carterphone v. AT&T, 13 F.C.C.2d 420, reconsideration denied, 14 F.C.C.2d 571 (1968).

22/ See In the Matter of Telerent Leasing Corp., 45 F.C.C.2d 204 (1974).

23/ See North Carolina Util. Comm'n v. FCC, 537 F.2d 787, 793 (4th Cir.), cert. denied, 429 U.S. 1027 1976). When the Fourth

Footnote continued --

expanded its competition policy by implementing a national registration program for terminal equipment, designed to maintain minimum technical standards, which preempted all other interconnection requirements. Thus, market entry requirements became uniform for all terminal equipment suppliers.24/ The FCC also went on to preempt essentially all price regulation of terminal equipment largely exercised by the state commissions.25/

The FCC has also preempted a certain amount of state control over the exchange switching and distribution facilities that the BOCs will own, through which interstate toll and private line (soon to be inter-LATA) services are provided. In decisions successfully overturning rulings of the California and New York commissions that conflicted with its policy, the FCC has confirmed its authority to establish the rates and interconnection arrangements for certain exchange facilities, located completely within a single state, when

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Circuit subsequently reconsidered this decision, if affirmed its earlier ruling. See North Carolina Util. Comm'n v. FCC, 552 F.2d 1036, 1044-52 (4th Cir.), cert. denied, 434 U.S. 874 (1977).

24/ This national registration program was enacted in two FCC decisions: First Report and Order in Docket No. 19528, 56 F.C.C.2d 593 (1975); and Second Report and Order in Docket No. 19528, 58 F.C.C.2d 736 (1976). The program was upheld in North Carolina Util. Comm'n v. FCC, 552 F.2d 1036 (4th Cir.), cert. denied, 434 U.S. 874 (1977). The preempted state regulations allowed customer supplied terminal equipment only if the connection were implemented with a carrier-supplied connecting arrangement and a carrier-supplied network control signalling unit. See 552 F.2d at 1041.

25/ This decision by the FCC, which emerged from a series of orders that collectively comprised the Computer II decision, was affirmed in Computer Communications Indus. Asso. v. FCC, 693 F.2d 198, 214-18 (D.C. Cir. 1982). The series of FCC orders are cited in that decision. See 693 F.2d at 202 n.1.

those facilities are components in the provision of interstate service.26/ Thus, it appears that the FCC can override state policies that in form appear only to regulate intrastate communications, but that in effect interfere with the provision of interstate communications in accordance with a valid federal regulatory policy.

The FCC also exercises some indirect control over state regulation through its authority to allocate the costs of facilities used to provide both interstate and intrastate services between the federal and state jurisdictions. Since the FCC determines what portion of the total costs of these facilities should be recovered from interstate service rates, it necessarily determines the residual costs which state commissions must allow to be recovered from intrastate service rates.27/

The FCC's broad power over interstate communications encompasses authority not only to regulate but also to deregulate. The FCC has moved to deregulate -- i.e., exempt from rate, entry, and exit regulation -- certain providers of particular interstate interexchange services. This deregulation has been premised in large part on the

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26/ See New York Tel, Co. v. FCC, 631 F.2d 1059, 1066 (2d Cir. 1980) (FCC can preempt state regulation of charges for interstate use of a local exchange that "substantially affect the conduct or development of interstate communication and encroaches upon FCC authority"); California v. FCC, 567 F.2d 84, 86-87 (D.C. Cir. 1977) (per curiam), cert. denied, 434 U.S. 1010 (1978) (FCC can preempt state restrictions on use of FX and CCSA facilities for interstate services that interfere with FCC policy).

27/ Although a Federal/State Joint Board, consisting of four state regulators and three FCC members, has authority to recommend appropriate jurisdictional cost allocations, only the FCC itself can establish the actual allocation. See 47 U.S.C. § 410(c); see also infra, pp. 25-27.

FCC Competitive Common Carrier rulemaking. In this proceeding, the FCC first tentatively concluded that it has the authority to deregulate communications common carriers that do not have "substantial market power." It offered two possible legal theories to support this conclusion. First, the Commission suggested a "definitional" approach: that carriers possessing little or no market power were not "common carriers" within the meaning of the Communications Act. Second, the Commission suggested a "forebearance" approach: as a reasonable exercise of its discretion, it could refrain from regulating carriers without market power when the costs of regulation exceeded the benefits.28/ The Commission has already exempted from regulation providers of resold terrestrial interstate services (resellers) that are not controlled by a carrier with market power (i.e., a "dominant" carrier), 29/ as well as providers of so-called "enhanced" services. 30/

3. Reservation of Legal Authority to the States

The Communications Act reserves to the states:

> jurisdiction with respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service by wire or radio of any carrier, [and] (2) any carrier engaged in interstate or foreign communication solely through physical connection with facilities of another

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28/ See Further Notice of Proposed Rulemaking, 84 F.C.C.2d 445, 463-96 (1981); see also infra, pp. 21-24.

29/ See Second Report and Order, (FCC 82-350), at 17 (Aug. 20, 1982). All local exchange companies are considered "dominant."

30/ See Final Order, 77 F.C.C.2d 384, 417-35 (1980) (Computer II).

> carrier not directly or indirectly controlled by, or under direct or indirect common control with such carrier . . . 31/

The Communications Act also reserves to the states jurisdiction over telephone exchange service, "even though a portion of such exchange service constitutes interstate or foreign communication."32/ Finally, if a "wire or radio communication between points in the same state" is "regulated by a state commission," it does not become an interstate communication subject to federal regulation simply because it happens to be routed through another state. 33/

These provisions of the Communications Act are far more limited than the broad authority granted to the FCC over "all interstate . . . communication by wire or radio."34/ Communication by wire or radio includes "all instrumentalities, facilities, apparatus, and services . . . incidental to such transmission."35/ The courts have read these provisions to permit the FCC to make national policy decisions governing the use of all facilities employed to provide interstate communications, even though those same facilities are used to provide

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31/ 47 U.S.C. § 152(b). The carriers to which this section refers (so-called "connecting" or "2(b) (2)" carriers), however, are subject to §§ 201-205 of the Act. See 47 U.S.C. 152(b)(4).

32/ See 47 U.S.C. § 221(b). The statute defines exchange service in § 153(r) ("... service of the character ordinarily furnished by a single exchange and which is covered by the exchange service charge").

33/ See 47 U.S.C. § 153(e).

34/ 47 U.S.C. § 152(a).

35/ 47 U.S.C. § 153(a), (b).

intrastate communications.36/ In doing so, the courts have, in effect, also interpreted the reservation of jurisdiction to the states narrowly -- states may only regulate telecommunication services in a manner consistent with valid federal policy. As one federal court has specifically observed.

> . . . Section 2(b) deprives the [FCC] of regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications. But beyond that, we are not persuaded that section 2(b) sanctions any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the [FCC's] authority 37/

The states are confined in their regulation of telecommunications not only by the Communications Act, but also by whatever constraints are imposed by their enabling state statutes. For example, if those statutes are interpreted to require certification and tariff regulation of a company's intrastate communications business, whose interstate communications business the FCC has found it can deregulate, a state commission may find itself, absent a change in its governing statute, with less regulatory discretion than the FCC.

36/ See the preemption cases discussed supra, pp. 8-10.

37/ North Carolina Util. Comm'n v. FCC, 537 F.2d 787, 793 (4th Cir.), cert. denied, 429 U.S. 1027 (1976) (footnote omitted). In a later decision, this same court reaffirmed its limiting interpretation of the authority reserved to the states under the Communications Act. See North Carolina Util. Comm'n v. FCC, 552 F.2d 1036, 1046 (4th Cir.), cert. denied, 434 U.S. 874 (1977).

The New York Commission, for one, recently suggested that it does not have authority to deregulate carriers that is comparable to the FCC's power.38/

C. KEY QUESTIONS AND SOME SUGGESTED ANSWERS

We will apply the foregoing general legal requirements in suggesting answers to the questions posed below. Beyond these legal requirements, however, state regulators must also consider the policy implications of their decisions. We will therefore attempt to include some policy considerations in our discussion. The questions we address fall within four subject matter areas that relate to the MFJ: LATAs, Regulation of Competing Carriers, Access Charges, and CPE Regulation.

1. LATAs

Are state commissions permitted to change LATA boundaries?

The MFJ made it necessary to draw LATA boundaries for two principal reasons. First, since the existing switching and distribution assets of AT&T must be divided between AT&T and the divested BOCs, some device for distinguishing ownership of assets became necessary. LATAs serve this function: as a general rule, assets used predominantly for traffic within a LATA will be owned by the BOCs, and assets used predominantly for traffic between LATAs will belong to AT&T.39/ Second, and more importantly, because the BOCs are confined to the provision of "exchange" service by the MFJ, it is necessary to delineate the area of "exchange" service beyond which the BOCs cannot,

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38/ See *infra*, p. 23.

39/ See *Greene II*, slip. op. at 6 n.14.

absent specific approval by the court, carry traffic. A LATA generally serves to provide the necessary boundaries.40/

In practice, the BOCs will carry some traffic beyond LATA boundaries. For example, BOCs may carry traffic to and from independent telephone company territories that are "associated" with a BOC LATA.41/ In addition, certain "corridor" exemptions have been granted to allow BOCs to carry traffic on limited routes between LATAs in order to avoid excessive network rearrangement costs.42/

A number of the LATA boundaries originally proposed by AT&T were modified at the request of the Justice Department, and then further modified by Judge Greene.43/ State commissions can, in a similar manner, petition Judge Greene to change the boundaries of a particular LATA.44/ Since these boundaries are designed to carry out substantive requirements of the MFJ, however, it does not appear that state commissions can unilaterally change them.

40/ See id., slip op. at 5-7 and n.14.

41/ See id., slip op. at 43-44 and n.95.

42/ See id., slip op. at 24 n.54.

43/ See id., slip op. at 47-160, where Judge Greene considered sequentially all of the proposed LATAs, and amended many of them.

44/ The Justice Department has proposed a simplified procedure for making minor changes in a LATA:

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It should be noted, however, that LATA boundaries do not appear to confine severely the ratemaking discretion of state commissions. As Judge Greene has pointed out, the definition of a LATA as an "exchange" area within which the BOCs can provide service led some people to believe incorrectly that the MFJ was redefining the areas in which "local" exchange service would be offered to the public.45/ In fact, a LATA generally encompasses a large geographic area -- some cover an entire state --46/ and within that area a state commission retains broad powers.47/ For example, it has the

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> [T]he proponent of a minor LATA or association adjustment (involving, for example, 2 percent or less of the subscribers in the LATA) would first petition the Department for the requested change. The Department would then seek the views of affected parties (including state commissions) as to the proposed change. In the event that the Department, the proponent, the relevant state commission, and any affected ITC or BOC agree to the change, the Department and the appropriate BOC would file a stipulation with the Court indicating the change, and as well notify the Court that all affected parties have agreed to the change. Only in the event that agreement among all affected parties could not be reached, would the proponent of the change need to petition the Court for relief.

Response of the United States to GTE's Petition for Limited Reconsideration, Civil No. 82-0192 (Aug. 3, 1983), at 2 n.**.

45/ See Greene II, slip op. at 7.

46/ For example, Maine, New Hampshire, Rhode Island, and Vermont each will constitute a single LATA.

47/ See Greene II, slip op. at 32-33 (intra-LATA regulation not preempted, therefore "state regulatory bodies will control traffic within the LATAs themselves").

power to determine the number and size of the local calling areas. It can also determine whether local calls should be provided at a flat rate or as a measured service. Moreover, between local calling areas, state commissions are free to require measured "toll" charges or to allow extended area service (EAS) for a flat rate. Indeed, the MFJ does not appear to prohibit EAS arrangements between local calling areas that are on the borders of separate LATAs.48/

In exercising their discretion over BOC rates for service within LATAs, however, state commissions should recognize the relationship between their ratemaking decisions and the intra-LATA competition which Judge Greene has sought to promote.49/ If a state commission chooses to rely on competition for intra-LATA service, BOC rate structures should not be regulated in a manner that will deter effective and efficient competition. Rate structures which permit BOC customers to make "toll-free" calls to all points within a LATA, in circumstances where the cost of those calls is significantly greater than zero, are not likely to stimulate effective competition for intra-LATA traffic. Conversely, if BOCs maintain intra-LATA toll or measured service rates that far exceed their cost of carrying intra-LATA traffic, the competition which develops may be inefficient.

Can state commissions preclude competition for intrastate inter-LATA communications?

If a state commission's enabling statute permits it to control competitive entry into the intrastate inter-LATA

48/ See Greene II, slip op. at 24 n.54.

49/ See id., slip op. at 31-34.

market, the state commission is theoretically able to limit entry to a single carrier.50/ Neither Judge Greene, nor the FCC, has yet purported to preempt the state commissions' jurisdiction to regulate intrastate inter-LATA communications in this fashion. Indeed, Judge Greene has specifically stated that he "lacks the authority to require the opening-up of states and LATAs to internal competition over the objections of the states or their regulatory agencies."51/ However, preservation of a monopoly for intrastate inter-LATA communications could conceivably interfere with a national telecommunications policy and lead the FCC to preempt such a state regulatory policy.52/

Consider, for example, the hypothetical case of a state commission granting a certificate to provide intrastate inter-LATA service only to AT&T, and denying certificates to other companies already providing FCC authorized

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50/ Entry is usually controlled by requiring certificates of public convenience and necessity. See, e.g., N.Y. Pub. Serv. Law § 99(1) (McKinney 1955). It appears that only Virginia specifically prohibits intrastate inter-LATA competition at this time. See Greene II, slip. op. at 33, n.71.

51/ See Greene II, slip. op. at 33.

52/ Moreover, Judge Greene has not totally ruled out the possibility of his intervention. ". . . [T]he trend among the states has been toward encouraging intrastate competition. Thus, the Court need not consider at this point what measures could or should be taken under the decree or otherwise if states attempted on a significant scale to impede the development of the competitive environment envisioned by the decree." Id. at n.71.

interstate inter-LATA service to customers within the state. While the latter carriers may then ostensibly offer only interstate inter-LATA service, their customers could have the capability to make intrastate inter-LATA calls through their facilities. Thus, to enforce its monopoly policy, the state commission might have to order the BOC to block such intrastate calls. Such an order could result in interference with interstate calls. For example, problems in distinguishing between intrastate and interstate calls could lead to the erroneous blocking of interstate calls. Any significant interference with interstate communications, or the federal policy governing interstate communications, would provide grounds for federal preemption.

Can state commissions preclude competition for intra-LATA communications?

If a state commission were to adopt a policy of monopoly for intra-LATA service, a BOC could be the franchised monopolist. However, a state commission could not legally give a BOC a monopoly for all intra-LATA service. Both AT&T and its interstate inter-LATA competitors can install facilities within a LATA for the purpose of providing interstate communications to their ultimate customers.53/ Once a company establishes such intra-LATA links, of course, its customers could have the capability to make intra-LATA calls between exchanges. Thus, a state regulation precluding intra-LATA calls via facilities of both AT&T and its competitors may be unenforceable, unless the BOCs are directed to block such calls. The FCC could attempt to preempt such an order if, for example, it resulted in erroneous blocking of interstate calls.

53/ Both the FCC and Judge Greene have refused to prohibit such "bypass" facilities. See infra, pp. 30-32.

Moreover, it appears that a state commission attempting to maintain a monopoly for intra-LATA communications must be able to distinguish successfully the preemption cases. (See supra pp. 8-12). In one case, for example, it was held that a regulation by the North Carolina Commission precluding the use of competitive CPE for intrastate calls could be preempted. The FCC might argue that a state regulation confining the use of competitive intra-LATA transmission links to interstate communications is no different because it would effectively preclude the development of competitive intra-LATA facilities for interstate communications.54/

2. Regulation of Competing Carriers
Can state commissions require AT&T to serve as an inter-LATA "carrier of last resort" in order to assure preservation of service to all local exchanges?

This is not an issue of immediate concern. AT&T's transmission facilities are now interconnected with all local exchanges to form a nationwide network that assures world-wide voice telephone service to all customers of local exchange companies. AT&T has not expressed a desire to discontinue service to any particular exchange in the near future.

However, it must be recognized that the cost of providing service to all local exchanges is not the same.

54/ See North Carolina Util. Comm'n v. FCC, 537 F.2d 787 (4th Cir.), cert. denied, 429 U.S. 1027 (1976); see also, California v. FCC, 567 F.2d 84 (D.C.Cir. 1977), cert. denied, 434 U.S. 1010 (1978). The FCC has already expressed a general policy preference for competition for all interstate services. See Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 F.C.C.2d 177 (1980) (free entry preferable to monopoly to promote efficiency).

With a monopoly in the provision of interexchange service it was possible for AT&T to charge uniform rates based on an average cost of service. Prices based on broad cost averages may not be sustainable with competition. More specifically, over the long run, AT&T presumably would not be able to sustain a price structure designed to obtain higher returns from lower cost markets, in order to offset losses in serving higher cost markets, because competition will force prices closer to cost in the lower cost markets. Thus, requiring AT&T to serve as a carrier of last resort with uniform prices for service to all markets could ultimately constitute impermissible regulation.55/

With a rate structure that varied with the cost of serving different local exchanges, the imposition of a carrier of last resort obligation on AT&T would not necessarily preserve service to high cost markets. In certain markets, customers may simply be unwilling to pay the prices that AT&T would charge to cover its cost of service. In these circumstances, the goal of preservation of service to all local exchanges would not appear to be readily susceptible to a regulatory solution. Direct subsidies from the government would be one way to assure service to high cost areas over the long run.56/

55/ AT&T would argue that the regulation, combined with competition, effectively prevents it from earning revenues sufficient to cover its total cost of service. Companies subject to government price regulation are constitutionally entitled to a reasonable opportunity to recover prudently incurred expenses and to earn a fair rate of return on their investment in the provision of regulated public service. See, e.g., Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).

56/ See, e.g., L. Johnson, Competition and Cross-Subsidization in the Telephone Industry 56-63 (1983) (Rand Publication).

Are state commissions required to regulate new communications carriers in the same manner as they are regulated by the FCC?

Because of the FCC's general policy in favor of competition for interstate services, many new companies have entered the telecommunications industry to provide voice and data services to the public through their own facilities, or through facilities leased from carriers. The FCC has found that it can and should relax its traditional entry and rate regulation for many of these companies.57/ For example, carriers who provide interstate service only through leasing terrestrial facility services of other carriers (resellers) can now provide and expand service, as well as change their rates, without first seeking the FCC's approval.58/ AT&T, the BOCs, and certain other carriers have not been deregulated principally because the FCC believes they could engage in cross-subsidization. However, carriers without significant market power do not pose the same danger, in the FCC's view, and, therefore, need not be subject to the same degree of regulation.59/

Carriers providing interstate service for whom the FCC has relaxed regulation also provide intrastate service and, assuming their activities are covered by the

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57/ See Further Notice of Proposed Rulemaking, 84 F.C.C.2d 445 (1981) (Competitive Common Carrier proceedings). The Commission reached this decision in the context of an extended consideration of the issue. The full history of the proceedings is reflected in: Notice of Inquiry and Proposed Rulemaking, 77 F.C.C.2d 308 (1979); First Report and Order, 85 F.C.C.2d 1 (1980); Further Notice of Proposed Rulemaking, 84 F.C.C.2d 445 (1981); Second Report and Order, (FCC 82-350) (Aug. 20, 1982).

58/ See Second Report and Order, (FCC 82-350), at 17.

59/ See supra pp. 10-11.

state commission's enabling statute,60/ are subject to the jurisdiction of state commissions.

The New York Commission has found, for example, that "resellers" are subject to its jurisdiction and, under its governing statute, must obtain a certificate of public convenience and necessity to provide intrastate services as well as file tariffs for their rates. Although the New York Commission has suggested that it would prefer not to regulate resellers, it found that only a change in its statute could authorize deregulation.61/ The New York York Public Service Law applies to all "telephone corporations", which are defined as all corporations "owning, operating or managing any telephone line." The term "telephone line" includes "all devices .... used, operated or owned .... to facilitate the business of affording telephonic communication."62/ Because a reseller at least "manages" a telephone line, it appears to fall within the strict definition of a telephone corporation under New York law.

Different federal and state entry and rate regulation of carriers providing distinct interstate and intrastate services is undoubtedly permissible up to a point. As we have already noted, however, state regulation that is inconsistent with federal policy governing interstate communications can be preempted. Thus, even if a state statute specifically required a state commission to follow a particular regulatory scheme, it could be precluded

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60/ For an example of the breadth of jurisdiction over communications under state statutes, see e.g., N.Y. Pub. Serv. Law § 5(4) and § 2(17)(18) (McKinney Supp. 1982).

61/ See New York Public Service Commission, Case 27946, Order Directing the Filing of Tariff Revisions and Requesting Comments (May 25, 1982).

62/ N.Y. Pub. Serv. Law § 2(17)(18)

from doing so if that scheme necessarily interfered with development of interstate communications according to valid FCC policy.63/

3. <u>Access Charges</u>

<u>Are state commissions required to adopt an intrastate customer access line charge (CALC) similar to the interstate CALC adopted by the FCC?</u>

In developing a policy to govern the access charges required by the MFJ, the FCC decided that customers as well as carriers should pay access charges. The FCC's CALC -$2 per month for each residential subscriber in 1984 -- is designed to recover some of the exchange distribution or subscriber loop costs that are allocated to the interstate jurisdiction via the jurisdictional cost separations process. One of the primary functions of the CALC is to reduce the amount of these non-traffic-sensitive costs that now have to be recovered from rates that vary with interstate usage of the telephone network. The FCC found that, without a CALC, high volume interstate users would continue to pay far more than the subscriber loop costs incurred to provide them with access to the network. As a result of the FCC's action, the BOCs will bill all of their customers the CALC each month without

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63/ Moreover, because of its broad authority over radio facilities (e.g., microwave facilities) the FCC may be able to preclude state regulation of even intrastate services via those facilities. *See* 47 U.S.C. § 301 (granting the FCC broad authority to govern radio spectrum use); *see also* *Land Mobile Radio Service*, 46 F.C.C.2d 752 (1974), *aff'd sub nom. National Ass'n. of Regulatory Util. Comm'rs. v. FCC (NARUC I)*, 525 F.2d 630 (D.C. Cir. 1976) (FCC properly preempted state entry regulation when assigning spectrum space to a new class of competitive mobile operators because it did not create a common carrier service that could be regulated; but the FCC's authority under § 301 could have supported preemption. *Id.* at 646-47). *See also* *New York State Commission on Cable Television v. FCC*, 669 F.2d 58, 65 n.12 (2d Cir. 1982).

regard to the amount of their interstate calling each month.64/

To reduce the amount of non-traffic-sensitive loop costs recovered from usage rates in the intrastate jurisdiction, a state commission could merely transfer these costs from the intrastate toll (soon to be intrastate carrier access charge) revenue requirement to local service revenue requirements. High volume intrastate toll users would then also be spared from having to pay for more than the subscriber loop costs incurred to provide them with access to the network. Monthly rates for local services could be increased to the extent necessary to cover these costs.

But state commissions are under no apparent legal obligation to provide for the recovery of non-traffic-sensitive costs in any particular fashion. The portion of the costs of subscriber loop facilities that are assigned by the FCC to the state jurisdiction must simply be recovered from intrastate services. State commissions regulate the rates for intrastate services and therefore may determine how those assigned intrastate costs are to be recovered from intrastate services. The FCC has not as yet attempted to preempt the states' discretion in this area.65/

64/ For a discussion of the purpose of the CALC *see* *In the Matter of MTS and WATS Market Structure*, CC Docket No. 78-72, Phase II, (FCC 82-579) at ¶ 169-175 (Third Report and Order, adopted Dec. 22, 1982) [hereinafter "*Access Charge Decision*"]; *see also*, *Order on Reconsideration* (FCC 83-356), adopted July 27, 1983 [hereinafter "*Access Reconsideration*"].

65/ *But see* the discussion of "bypass" (*infra* pp. 30-32) for policy reasons that may persuade the states to follow the FCC's lead. The FCC has yet to decide explicity whether it could preempt the states' discretion by, for example, assigning *all* subscriber loop costs to the interstate jurisdiction and then requiring all

Footnote continued --

Can state commissions establish access charges to intrastate inter-LATA carriers that differ from those approved for interstate inter-LATA carriers by the FCC?

Since the FCC determines through the jurisdictional cost separations process,66/ what portion of the costs of exchange carrier plant (and related expenses) used to provide both interstate and intrastate service67/ is to be recovered from the rates for interstate services, access charges to interstate inter-LATA carriers are designed to produce revenue that will recover the portion of those exchange costs that is not recovered by the interstate CALC. The remaining exchange carrier costs falling under the jurisdiction of state commissions can be recovered from access charges to intrastate inter-LATA carriers and rates for local and other regulated intrastate services.

State commissions do not appear required to adopt the same access charges to carriers as the FCC because, thus far, the FCC has not attempted to preempt state ratemaking discretion over intrastate carrier access charges. Moreover, although the MFJ requires "cost-based

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Footnote continued --

exchange carriers to adopt a CALC that would cover those costs. The legality of such an action would be likely to turn on whether Smith v. Illinois Bell Telephone Co., 382 U.S. 133 (1930) actually mandates a division of subscriber loop costs between jurisdictions. See Access Charge Decision (separate statement of Com'r Jones).

66/ See 47 U.S.C. § 221(c); see also Federal/State Cost Separations Manual (1971).

67/ This includes both traffice-sensitive central office switching costs, as well as non-traffic-sensitive subscriber loop costs.

and "non-discriminatory" access charges, it does not appear to require state commissions to "mirror" FCC access charges to meet either of these requirements. If state commissions reasonably divide exchange carrier costs under their jurisdiction between revenue requirements for local services and intrastate carrier access charges, and then design non-discriminatory access charges to recover the access charge revenue requirement, they would violate neither the MFJ nor any current FCC order.68/

As a matter of policy, however, state commissions may find it desirable to "mirror" interstate access charges to inter-LATA carriers. Under the FCC's access charge rate structure, inter-LATA carriers (except AT&T) will pay a uniform common line and carrier access charge per "access" minute of use of exchange carrier plant for interstate inter-LATA calls. If state commissions require carrier access charges to be significantly higher for intrastate inter-LATA calls, the inter-LATA carriers would have an incentive to report intrastate minutes of use as interstate minutes of use in order to lower their access charge payments. Uniformity in interstate and intrastate charges would eliminate this incentive. Apparently, it would be neither easy nor costless for exchange carriers to assure that inter-LATA carriers accurately divided their access minutes between interstate and intrastate use.69/ Thus, exchange carriers could incur additional enforcement costs that ultimately would be paid by consumers if rates differed between jurisdictions.

68/ Indeed, Judge Greene apparently thought that a significant portion of subscriber loop costs could properly be covered by carrier access charges, since he openly criticized the FCC's adoption of a CALC. See Greene II, Slip op. at 14-19.

69/ USITA has apparently encouraged its members to mirror interstate access charges in their intrastate access

Footnote contined --

Is it permissible to charge a "premium" for access to particular carriers for intrastate inter-LATA or intra-LATA access service?

The FCC has found that AT&T should pay a "premium" carrier charge for originating and terminating its interstate inter-LATA traffic in the BOCs' local exchange networks.70/ Although it may not be more costly to provide AT&T with access, the FCC found that AT&T would receive a quality of access service superior to that of its competitors until the BOCs develop the capability to provide "equal" access to all carriers pursuant to the requirements of the MFJ.71/ Since only one carrier (AT&T) can be given superior quality access service at this time, the FCC found that AT&T should pay a premium charge equal to the "opportunity cost" of the superior access quality -- i.e. the amount other carriers would be willing to pay for the superior quality access service.72/

Since AT&T will also have a higher quality of access to BOC exchanges for its intrastate inter-LATA traffic, state commissions (assuming they permit competition for

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Footnote continued --

charge tariffs for this reason. See Telecommunications Reports (Aug. 8, 1983). For a brief discussion of a related enforcement problem that led the FCC to drop a customer access usage charge, see Access Charge Reconsideration at ¶'s 18-30; see also Judge Greene's July 8, 1983 opinion at 16, n.33.

70/ See Access Charge Decision, 151-168.

71/ Only access rates that are below cost, and not premiums that are above cost, are precluded by the MFJ. See Greene I, 552 F. Supp. at 199, n. 287.

72/ See Access Charge Decision, at ¶ 154. Since an auction to determine what the other carriers would be willing to pay would not be feasible, the Commission decided to use an estimate of the theoretically correct opportunity cost in order to determine the premium charge.

intrastate inter-LATA traffic) could presumably impose a "premium" charge on AT&T based on the FCC's rationale for such a charge.73/ Once the BOCs provide truly "equal" access, however, neither an interstate nor an intrastate "premium" charge to AT&T would appear justifiable.74/

Assuming competition for the BOCs' intra-LATA traffic is permitted, a premium charge to the BOCs may also be warranted for similar reasons. Each individual BOC may enjoy superior quality access for its traffic between exchanges within a LATA until "equal" access is provided to competing intra-LATA carriers.75/

In calculating the proper level of a "premium" charge, however, state commissions may be confused rather than aided by the FCC's action. Lacking a persuasive calculation of the actual value of AT&T's superior quality acccess, the FCC first estimated that value to be about $1.4 billion on a nationwide basis, the amount of estimated 1984 CPE costs assigned to the interstate revenue requirement,76/ and decided that the premium should be a lump sum charge to AT&T. This action suggested that state commissions could employ the amount of estimated 1984 CPE costs assigned to their respective intrastate toll revenue requirements as

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73/ Various parties have made this argument before the New York Public Service Commission (NYPSC) in its Case No. 28425. See, e.g., Submission of MCI Telecommunications Corp. (June 13, 1983); Brief of Satellite Business Systems (June 10, 1983).

74/ This is why the Access Charge Decision contemplates phasing out the "premium" charge. See ¶ 156. See also Access Charge Reconsideration at ¶ 107.

75/ See, e.g., Submission of MCI Telecommunications Corp., NYPSC Case 28425 (June 13, 1983) (describing superior access received by New York Telephone Co).

76/ See Access Charge Decision, at ¶ 167.

the basis for an intrastate premium charge,77/ although some commissions may have found those costs to be a wholly inappropriate measure of the value of "premium" access,78/ or that it was simply infeasible to measure the value in this manner.79/ Later, the FCC reconsidered its action and decided that AT&T should pay a charge for each interstate access minute of use that is 35% higher than the charge to other inter-LATA carriers.80/ The FCC's most recent action might permit state commissions to "mirror" the interstate per access minute of use charges to both AT&T and its inter-LATA competitors.

However, state commissions, unlike the FCC, must also develop an intra-LATA premium access charge policy which will, of course, affect the BOCs' existing intrastate short-haul toll rates. The revenue currently produced by those rates may not even be sufficient to cover post-divestiture BOC costs that are now recovered via a statewide toll rate schedule. Offering intra-LATA competitors a discount from existing short-haul toll rates may therefore be infeasible. Increases in existing short-haul toll rates, or reallocation

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77/ Most state commissions divide costs between local and intrastate toll revenue requirements by employing the same formula used to divide costs between the intrastate and interstate jurisdictions. They could, therefore, have used the CPE costs assigned to their intrastate toll revenue requirements as a basis for an intrastate premium charge.

78/ Assigned CPE costs may or may not represent a close approximation of the actual value of superior access in any particular state, since CPE costs themselves have no relationship to access service.

79/ For example, the New York Commission makes no assignment of CPE costs to the intrastate toll revenue requirement. See In re New York Tel. Co., 23 P.U.R.4th 554, 17 NYPSC 923 (1977).

80/ See Access Reconsideration order at ¶'s 92-128.

of assigned BOC toll costs to local revenue requirements may then be necessary to create an intra-LATA premimum charge. 81/

How do "bypass" technologies affect access charges and to what extent can they be regulated?

"Bypass" technologies encompass a variety of communications facilities that can connect an inter-LATA carrier's facilities with the carrier's ultimate customer. These facilities allow the carrier to "bypass" the local networks of BOCs in providing their service. If the price inter-LATA carriers must pay for using local exchange networks is higher than the cost of employing an alternative means to serve their customers, they have an incentive to employ a "bypass" technology.82/

There is a variety of bypass technologies, some of which are feasible today and others of which will be feasible in the future. They include two-way cable TV systems, cellular radio systems, "short-hop" microwave radio links, and receiving and transmitting satellite earth stations.83/

81/ But see Staff's Memorandum in Support of Its Plan for Initial Intrastate Access Rates, NYPSC Case No. 28425 (June 10, 1983), at p. 48, where it argues that mirroring the interstate charges for intrastate inter-LATA access service could also produce a surplus of inter-LATA access revenues that would offset an intra-LATA revenue deficiency.

82/ Bypass, of course, is simply a form of intra-LATA competition for the BOCs. See supra, pp. 19-20.

83/ See generally Access Charge Decision, Appendix F (status report on bypass technology done by the FCC Common Carrier Bureau).

As we have already noted,84/ the use of "bypass" technologies for interstate communications is permissible.85/ If state commissions attempted to preclude the use of "bypass" technologies simply because they might also be used to provide intrastate communications, they would likely be preempted by the FCC.

To the extent this technology is used to provide intrastate communications, however, state regulation of rates for intrastate services has not been preempted and would appear to be permissible. Regulation must, of course, be authorized by the applicable state enabling statute, which may not be very clear. For example, under the New York Public Service Law, it can be argued that the statute applies only to "telephonic communication for hire." "Telephonic communication" is not defined by the statute and could be construed to exclude, for example, intrastate data communications provided via a bypass technology.86/

84/ See supra pp. 19-20.

85/ See Greene I, 552 F. Supp. at 175-76; see also Access Charge Decision, at ¶s 110-11. Rational firms generally seek to minimize costs and by doing so they maximize profits. Both the FCC and Judge Greene implicitly acknowledge this in their consideration of the bypass issue.

86/ See N.Y. Pub. Serv. Law § 2(17) (McKinney 1955); see also infra, p. 38, n.100 for a possible argument against regulation of data communication under New York Law because it is "telegraphic". It should be noted, however, that the FCC was unsuccessful in its attempt to assert preemptive jurisdiction over intrastate two-way data communications over a cable television system. See National Association of Regulatory Utility Comm'rs v. FCC, 533 F.2d 601 (D.C. Cir. 1976).

4. CPE Regulation

Can state commissions regulate the provision of customer premises equipment (CPE) by the BOCs?

Under the MFJ, the BOCs are permitted to provide CPE to their customers. Since the CPE they now lease to customers will belong to AT&T after the divestiture is completed in 1984, however, the BOCs would have to acquire new terminal equipment and attempt to market it in competition with AT&T and other CPE vendors. The FCC has ruled, in effect, that the prices for new CPE provided by the BOCs may not be regulated by the state commissions.87/

Moreover, with respect to the CPE now leased to customers, equipment that will belong to AT&T, the FCC has recently proposed a plan that would preclude state regulation of that CPE as well after divestiture. If adopted, the plan would essentially require AT&T to allow customers to purchase their CPE at prices based on net book value. It would also limit increases in the price of leased CPE for up to two years. Thereafter, AT&T would be free to offer the CPE under any terms and conditions it might choose.88/

The FCC's pervasive legal authority over the provision of CPE is now well established, and any future state regulation of CPE must be consistent with the FCC's policies. The FCC has promised to address on an ad hoc basis the legality of "future attempts by the states to regulate CPE in ways that

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87/ This preemption of state authority emerged from the Computer II proceedings. See Final Order, 77 F.C.C.2d 384 (1980), reconsideration, 84 F.C.C.2d 50 (1980), further reconsideration, 88 F.C.C.2d 512 (1981), aff'd sub nom. Computer Communications Indus. Asso. v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 51 U.S.L.W. 3685, 3826 (March 21, 1983; May 16, 1983).

88/ See, Notice of Propsed Rulemaking in Docket 81-893 (FCC-83-181), adopted April 27, 1983, released June 21, 1983.

they perceive to be consistent with" the FCC's policies.89/ Recently, the FCC made it clear that continuing tariff regulation by state commissions of new CPE will not be permitted.90/ In addition, the FCC has ruled that state commissions cannot require BOCs to serve as CPE "providers of last resort."91/ Such a requirement would be inconsistent with a federal policy that precludes the BOCs from offering CPE unless they create entirely separate subsidiaries to conduct that business.92/ On the other hand, should the FCC remove this restriction, state commissions could require the BOCs to provide a basic telephone instrument to any customer who wants one, for at least two years.93/

D. SOME RECOMMENDATIONS

Although the BOCs' facilities consist primarily of indivisible units of plant providing both interstate and intrastate services, regulation of that plant and the services it provides has for many decades been divided between the FCC and the state commissions. For many years, the federal/state regulatory partnership shared a similar goal and policy: assuring "universal" subscription to the telephone network by holding down the price of local telephone service provided by an end-to-end monopoly industry.

89/ See Memorandum Opinion and Order (FCC 83-222) (May 12, 1983) [hereinafter "NARUC Order"].

90/ See Memorandum Opinion and Order, (FCC 83-223) (May 12, 1983) (preempting Florida Public Service Commission CPE pricing rules as inconsistent with Computer II).

91/ See NARUC Order, at ¶ 11.

92/ This "structural separation" requirement was established in Computer II. See NARUC Order, at n.2.

93/ See NARUC Order, at ¶'s 8, 11.

However, recent decisions of the FCC and now the MFJ, all of which have been upheld by the courts, have significantly eroded monopoly power in the telephone industry and preempted state regulation of the industry in a variety of areas. CPE is now provided by a variety of competitors and is likely soon to be totally free of federal and state price regulation. The asserted source of AT&T's monopoly power in the interexchange (or inter-LATA) market has been removed, raising the possibility of price deregulation in that market at some point in the future. The BOCs still have monopoly power within their LATAs, but interexchange competition within LATAs and the development of competitive alternatives to their local exchange networks may erode that power in the future. These developments suggest that it will be difficult for state regulators to hold the price of any service below its cost over the long run. If the market price for any service becomes unacceptable as a matter of social policy (because it jeopardizes the goal of universal subscription) Congress may be a better forum than regulatory agencies to address the problem.94/

The legal history of competition in the telecommunications industry has thus far been dominated by federal decisions. Notwithstanding an enabling statute enacted for the regulation of an essentially monopoly industry, the FCC has been able to foster competition, exempt competitors from standard public utility regulatory requirements, and foreclose state regulation

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94/ Congress has already held hearings on the problem of rising phone rates. See Telecommunications Reports (Aug. 1, 1983).

that is inconsistent with federal policy. If this trend continues, the role of state regulators in the making of telecommunications policy will diminish. The future of state regulation in this field may therefore depend on the ability of state commissions to develop sound practices that are consistent with federal policy governing the telecommunications industry -- i.e., a policy of competition. This implies an ability and willingness on the part of state regulators to foster rather than preclude competition.

To develop policies that are consistent with competition, state regulators must either be able to interpret their enabling statutes in ways that will permit them to accommodate competition, or obtain from state legislatures appropriate changes in those statutes. Some discretion clearly exists already. For example, under the North Carolina Commission's enabling statute, it can waive "for good cause" the statutory requirement of thirty days' notice before a change in rates can go into effect.95/ Presumably, therefore, that commission could adopt general rules that would at least facilitate rate changes in competitive markets. On the other hand, it is not certain that, for example, either the North Carolina Commission96/ or the New York Commission 97/

95/ See N.C. Gen. Stat. § 62-134(a) (Michie 1982).

96/ See N.C. Gen. Stat. § 62-110 (Michie 1982) (requiring certification).

97/ See N.Y. Pub. Serv. Law § 99(1) (McKinney 1955) (requiring certification); New York PSC, Case 27946, Order Directing the Filing of Tariff Revisions and Requesting Comments (May 25, 1982), at 29 (Public Service Law requires regulation of resellers; no authority to deregulate).

could completely exempt particular carriers from certification or tariff requirements under a "forebearence" theory similar to that developed by the FCC. Indeed, in North Carolina the commission may have to overcome a presumption against competition to permit new carriers to enter intrastate markets, since the commission apparently operates under a statutory "policy that, nothing else appearing, the public is better served by a regulated monopoly than by competing suppliers."98/

Thus, to facilitate development of state practices that are consistent with a federal competition policy, changes in state public utility statutes may be necessary or desirable. It seems well worth the effort of state regulators and state legislatures to determine whether and to what extent changes in these statutes should be made. In our federal system, states have traditionally played the role of "experimental laboratories" where innovative government initiatives have been tested and, when successful, adopted as national policy.99/ To preserve such a role for the states in the future goveranance of the provision of telecommunications services, the state regulatory commissions should have the necessary flexibility to develop creative policies for an increasingly

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98/ State ex rel Utilities Comm'n v. Carolina Tel. & Tel. Co., 148 S.E.2d 100, 111 (N.C. 1966).

99/ See New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J, dissenting) ("it is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.")

competitive industry. Public telecommunications service, it appears, can no longer be governed properly by traditional public utility regulatory precepts that have evolved from statutes enacted decades ago when monopoly, and not open competitive entry, defined the structure of the telecommunications industry.100/

100/ *Ad hoc* efforts to change public utility statutes in light of competiton have been made. For example, in New York the Public Service Law was amended to deregulate "telegraphic communication" unless the commission found it necessary to regulate "because of a lack of effective competition." N.Y. Pub. Serv. Law § 90(2), as amended L. 1981, c.414 § 2. However, no comprehensive effort has been made to change the New York statute in light of competitive developments, and many of its provisions still contain language adopted more than 70 years ago.