RECENT DEVELOPMENTS IN TELECOMMUNICATIONS LAW

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INTRODUCTION

It has been four years since President Clinton signed the revolutionary and ambitious Telecommunications Act of 1996[1] ("TA 96" or "the Act") in order to remove barriers to competition in the local telecommunications market and provide all Americans with access to affordable telecommunications service. Since that time, and particularly within the past year, there have been a large number of regulatory and judicial decisions at the federal and state levels that endeavor to implement the goals of the Act and to regulate telecommunications carriers under specific provisions of state law. This Article reviews some of the significant developments in federal and Indiana telecommunications law[2] for the period of October 1, 1998 to October 31, 1999.

I. IMPLEMENTATION OF LOCAL COMPETITION

The Act's goal is to eliminate barriers to local competition in the telecommunications marketplace by requiring that incumbent local exchange carriers ("ILECs") provide access to their networks to competitive local exchange carriers ("CLECs"). This access is facilitated by requiring ILECs

> (1) to permit a requesting new entrant in the [ILEC's] local market to interconnect with the [ILEC's] existing local network and thereby use the [ILEC's] network to compete with the [ILEC] in providing telephone services (interconnection); (2) to provide its competing

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1. Pub. L. 104-104, 110 Stat. 56 (codified at 47 U.S.C. § 151 (Supp. III 1997)).

2. In addition to state law developments, this survey Article primarily concerns issues related to the implementation of the local competition and universal service provisions set forth in Title I of the Act, "Telecommunications Services," and does not include discussion of precedent implementing: Title II, "Broadcast Services"; Title III, "Cable Services"; Title V, "Obscenity and Violence." Even with these restrictions, a discussion of the precedent issued within the survey period concerning telephony issues would constitute volumes of material. Accordingly, this survey Article covers some of the issues encountered most frequently in the author's practice and that are, or have been, the subject of proceedings before the federal and state administrative tribunals and that have resulted in significant judicial precedent. For more information concerning the issues discussed in this article and other telecommunications issues, see *Federal Communications Law Journal* (published jointly by the Indiana University School of Law in Bloomington and the Federal Communications Bar Association), the Federal Communications Commission's website at <http://www.fcc.gov> (visited July 26, 2000), or the Indiana Utility Regulatory Commission's website at <http://www.state.in.us./iurc/index.html> (visited July 26, 2000).

> telecommunications carriers with access to individual elements of the [ILEC's] own network on an unbundled basis (unbundled access); and (3) to sell to its competing telecommunications carriers, at wholesale rates, any telecommunications service that the [ILEC] provides to its customers at retail rates, in order to allow the competing carriers to resell the services (resale).[3]

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3. Iowa Utils. Bd. v. FCC, 120 F.3d 753, 791 (8th Cir. 1997) (footnote omitted), *aff'd in part, rev'd in part sub nom.* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999). The court in *Iowa Utilities Board* cited 47 U.S.C. § 251(c) (Supp. III 1997), which provides in relevant part:

> (2) Interconnection.—The duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection to the local exchange carrier's network —
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> (A) for the transmission and routing of telephone exchange service and exchange access;
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> (B) at any technically feasible point within the carrier's network;
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> (C) that is at least equal in quality to that provided by the local exchange carrier to itself or to any subsidiary, affiliate, or any other party to which the carrier provides interconnection; and
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> (D) on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, in accordance with the terms and conditions of the agreement and the requirements of this section and section 252.
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> (3) Unbundled Access.—The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.
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> (4) Resale—The duty—
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> (A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and
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> (B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with the regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such

A. *The Eighth Circuit: Iowa Utilities Board v. FCC*

In 1996, the Federal Communications Commission (FCC), the agency charged with implementing the Act's local competition provisions, issued *In re Implementation of the Local Competition Provisions in the Telecommunication Act of 1996*,[4] which promulgates local competition rules. Local exchange carriers ("LECs") and state utility commissions challenged the First Report and Order on the grounds that the FCC exceeded its jurisdiction in promulgating rules regarding prices "for interconnection, unbundled access, and resale, as well as [] the rules regarding the prices for the transport and termination of local telecommunications traffic."[5] Most of these challenges were consolidated by the Eighth Circuit in *Iowa Utilities Board v. FCC*, where the court of appeals vacated several of the FCC's local competition rules and upheld the state commissions' authority to regulate intrastate telecommunications.[6] However, the Supreme Court granted certiorari, and, as discussed below, several of the Eighth Circuit's holdings were reversed.[7] In order to discuss the Supreme Court's decision, it is necessary to briefly summarize the Eighth Circuit's determinations.[8]

1. FCC's Pricing Rules.—Petitioners challenged the FCC's rules requiring state commissions to implement the total element long-run incremental cost (TELRIC) methodology to determine the costs of ILEC facilities[9] and the proxy rates[10] to be used if the state commission chooses not to employ the TELRIC.[11] The court held that under the plain language of §§ 251 and 252 of the Act and § 2(b) of the Communications Act of 1934,[12] the FCC lacked statutory authority to

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service to a different category of subscribers.

Id.

4. CC Docket Nos. 96-98 and 95-185, 11 F.C.C.R. 15,499 (released Aug. 8, 1996) [hereinafter First Report & Order].

5. *Iowa Utils. Bd.*, 120 F.3d at 792 (footnote omitted).

6. *See id.* at 792-94.

7. *See* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999)j, *aff'g in part and rev'g in part* Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997).

8. The order and titles of the following issues are set forth according to the order in which they were considered in *Iowa Utilities Board v. FCC*. The following summary does not cover all of the FCC rules vacated by the Eighth Circuit. See *Iowa Utilities Board v. FCC*, 120 F.3d at 819 n.19 for a complete list of FCC rules and portions of the First Report and Order that were vacated.

9. *See id.* at 793 (citing 47 C.F.R. §§ 51.503, 51.505 (1996)).

10. *See id.* (citing 47 C.F.R. §§ 51.503(b)(2), 51.513, 51.705(a)(2), 51.707).

11. *See id.*

12. 47 U.S.C. § 152(b) (1994). This section provides in relevant part:

> Except as provided in sections 223 through 227 . . . inclusive, and section 332, and subject to the provisions of section 301 of this title . . . nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service.

promulgate these pricing rules.[13]

2. *The "Pick and Choose" Rule.*—The court vacated an FCC rule allowing carriers requesting interconnection to "pick and choose"[14] favorable terms and conditions related to interconnection, service and network elements from existing interconnection agreements without having to adopt the entire interconnection agreement.[15] The court found this rule to be an "unreasonable interpretation of subsection 252(i),"[16] reasoning that the Act as a whole reveals Congress' preference for voluntarily negotiated interconnection agreements, and that allowing requesting carriers to adopt provisions in a "piecemeal fashion" would thwart this process.[17]

3. *Rural Exemptions.*—In response to claims that 47 C.F.R. § 51.405 improperly imposed additional standards on state commissions in making determinations concerning the exemption of small or rural LECs from the duties required of ILECs under the Act,[18] the court found that § 251(f) gives state commissions the exclusive authority to determine rural LEC exemptions.[19] Thus, the FCC did not have jurisdiction to impose standards in addition to those in § 251(f).[20]

4. *FCC's Authority to Review State Approved Agreements.*—The court rejected the FCC's claims in the First Report and Order[21] that the FCC possessed authority under 47 U.S.C. § 208 to review and enforce the terms of state approved interconnection agreements,[22] and held that § 252(e)(6)[23] provides the "exclusive means of obtaining review of state commission determinations under the Act."[24]

Id. The Act amends the Communications Act of 1934.

13. *See Iowa Utils. Bd.*, 120 F.3d at 794, 800.

14. *See id.* (citing 47 C.F.R § 51.809 (1997)).

15. *See id.*

16. *Id.* at 800.

17. *Id.* at 800-01.

18. *See id.* at 801-02.

19. *See id.* at 802.

20. *See id.* at 803.

21. *See* First Report & Order, *supra* note 4, ¶¶ 121-128.

22. *See Iowa Utils. Bd.*, 120 F.3d at 803.

23. 47 U.S.C. § 252(e)(6) (Supp. III 1997) provides:

> Review of state commission actions.—In a case in which a State fails to act as described in paragraph (5), the proceeding by the Commission under such paragraph and any judicial review of of the Commission's actions shall be the exclusive remedies for a State commission's failure to act. In any case in which a State commission makes a determination under this section, any party aggrieved by such determination may bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements of section 251 and this section.

24. *Iowa Utils. Bd.*, 120 F.3d at 804. The court further held that § 252(e) vests primary authority with the state commissions to enforce the terms of interconnection agreements approved under §§ 251 and 252 and that in any event, § 2(b) bars FCC jurisdiction over intrastate

5. *FCC Review of Preexisting Agreements.*—The court rejected the FCC's interpretation of § 252(a)(1) requiring that agreements negotiated prior to the enactment of TA 96 to be submitted for approval by the state commission[25] on the grounds that the FCC did not have jurisdiction under § 2(b) of the Communication Act of 1934[26] to determine "which interconnection agreements must be submitted for state commission approval."[27] The court also found that nothing within the plain language of § 252 authorized the FCC to regulate "which interconnection agreements must be submitted for state approval."[28]

6. *State Compliance with FCC Rules.*—The court also rejected the FCC's interpretation of § 251(d)(3)[29] preempting "state policy that conflicts with an FCC regulation promulgated pursuant to § 251."[30] The court found this to be an unreasonable interpretation of § 251(d)(3), holding that the states' authority over the local telephone markets and interconnection agreements should be protected so long as state rules are consistent with § 251.[31]

7. *FCC's Unbundling Rules.*—Regarding the unbundled network element rules promulgated by the FCC:

(a) The court disagreed with arguments that operational support systems (OSS), operator services, and vertical switching features do not constitute "network elements" subject to the Act's unbundling requirements and upheld the FCC's rules qualifying these features as network elements.[32]

(b) The court upheld the FCC's definition of "technically feasible"[33] as set

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communications service. *See id.*

25. *See id.* at 804-05 (citing 47 C.F.R. § 51.303 (1997) (settings forth the FCC interpretation of § 252(a)(1) of the Act)).

26. 47 U.S.C. § 152(b) (1994).

27. *Iowa Utils. Bd.*, 120 F.3d at 805.

28. *Id.*

29. 47 U.S.C. § 251(d)(3) (Supp. III 1997) provides:

> In prescribing and enforcing regulations to implement the requirements of this section, the [FCC] shall not preclude the enforcement of any regulation, order, or policy of a State commission that—
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> (A) establishes access and interconnection obligations of local exchange carriers;
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> (B) is consistent with the requirements of this section;
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> (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.

Id.

30. *Iowa Utils. Bd.*, 120 F.3d at 806.

31. *See id.* at 807.

32. *See id.* at 808-09 (upholding 47 C.F.R. §§ 51.319(f-g) (1997)).

33. The Act provides for interconnection and unbundled access at any "technically feasible point." *Id.* at 810 (quoting 47 U.S.C. §§ 251(c)(2), (3)).

forth in 47 C.F.R. § 51.5,[34] despite claims that disregarding the economic costs at points of interconnection (POI) could result in "[ILECs] having to incur unwarranted expenses in order to meet the demands of competing carriers seeking access to their networks."[35] Although the court upheld the FCC's definition of "technically feasible," the court rejected the FCC's finding "that [because] it is technically feasible to unbundle a particular element[, there is] a presumption that the element must be unbundled . . . ."[36]

(c) In determining which network elements ILECs should be required to make available to requesting carriers under § 251(d)(2) of the Act, the FCC must consider whether access to proprietary network elements is "*necessary* and whether the failure to provide access to a network elements would *impair* the ability" of the requesting carrier to provide telecommunications service.[37] The court upheld the FCC's interpretation of the "necessary" and "impair" standards as not "requir[ing] an evaluation of whether a requesting carrier could obtain the desired elements from an alternative source."[38] Additionally, the court upheld the FCC's interpretation that a proprietary network element is "'necessary' if a requesting carrier's ability to compete would be 'significantly impaired or thwarted'"[39] and the FCC's interpretation of "impair" as whether "the quality of service the entrant can offer, absent access to the requested element, declines and/or the cost of providing the service rises." [40]

(d) The court vacated the FCC's "Superior Quality Rules" which require ILECs to provide interconnection, unbundled network elements, and unbundled access to requesting carriers at levels of quality greater than the ILEC provides to itself,[41] on the grounds that such requirement violates the plain language of § 251(c).[42]

(e) The court found that the FCC's rules that prohibited ILECs from unbundling network elements purchased by competing carriers,[43] were contrary to the terms of § 251(c)(3).[44] Allowing a competing carrier to purchase a

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34. 47 C.F.R. § 51.5 (1999) provides in pertinent part: "A determination of technical feasibility does not include consideration of economic, accounting, billing, space, or site concerns . . . ."

35. *Iowa Utils. Bd.*, 120 F.3d at 810. The court held that additional costs would be accounted for in the determination of just and reasonable rates and that "an [ILEC] will recoup the costs involved in providing interconnection and unbundled access from the competing carriers making these requests." *Id.*

36. *Id.* (citations omitted).

37. *Id.* (emphasis added) (citing 47 U.S.C. § 251(d)(2)(A-B) (Supp. III 1997)).

38. *Id.* at 811 (citing First Report & Order, *supra* note 4, ¶ 283).

39. *Id.* (quoting First Report & Order, *supra* note 4, ¶ 282).

40. *Id.* at 812 (quoting First Report & Order, *supra* note 4, ¶ 285).

41. *See* 47 C.F.R. §§ 51.305(a)(4), 51.311(c) (1999).

42. *See Iowa Utils. Bd.*, 120 F.3d at 812-13.

43. *See* 47 C.F.R. § 51.315(b-f).

44. *See Iowa Utils. Bd.*, 120 F.3d at 813. The Eighth Circuit issued an Order on Petition for Rehearing dated October 14, 1997 striking the language appearing under Part II(G)(1)(f) of the

complete "platform"[45] of the network elements to create a finished service at cost would eviscerate § 251(c)(4) which allows competing carriers to purchase an ILEC's telecommunications services at wholesale rates for resale.[46]

8. Dialing Parity.—In a separate proceeding,[47] the court held that the FCC lacked jurisdiction to implement its rules[48] regarding dialing parity[49] to the extent that those rules apply to intraLATA (local access and transport area) traffic.[50]

B. The U.S. Supreme Court: AT&T v. Iowa Utilities Board

The FCC and several parties appealed the decisions, and the U.S. Supreme Court granted certiorari[51] to review the Eighth Circuit's holdings regarding the FCC's jurisdiction to implement local competition provisions, the unbundled network element rules, and the "pick and choose" rule.[52]

1. FCC's Jurisdiction to Implement Local Competition Provisions.—The Court's analysis of the FCC's jurisdiction to implement local competition provisions primarily concerned the application of two statutory provisions. First, § 201(b)[53] of the Communications Act of 1934 expressly gives the FCC authority to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[54] Reasoning that TA 96 was intended to supplement the Communications Act of 1934, the Court concluded that the FCC's rulemaking authority under § 201(b) extended to the Act's local competition provisions.[55] In reaching this conclusion, the Court rejected the Eighth Circuit's reliance on language in § 201(a), which prescribes "the dut[ies] of every common carrier engaged in *interstate or foreign* communications,"[56] and held that the FCC's jurisdiction extended only to those communications that were "interstate and foreign."[57] The Court noted that a limitation on the class of common carriers charged with the duty set forth in § 201(a) did not act as a

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opinion dated July 18, 1997 found at 120 F.3d 753, 813 and substituting language which vacates 47 C.F.R. § 51.315(b-f).

45. *Iowa Utils. Bd.*, 120 F.3d at 813.

46. *See id.*

47. *See* California v. FCC, 124 F.3d 934 (8th Cir. 1997).

48. *See* 47 C.F.R. §§ 51.205-51.215.

49. "Dialing parity" refers to the "technological capability that enables a telephone customer to route a call over the network of the customer's preselected carrier without having to dial an access code of extra digits." *California v. FCC*, 124 F.3d at 939 (citation omitted).

50. *See id.* at 943.

51. 522 U.S. 1089 (1998) (mem.).

52. AT&T v. Iowa Utils. Bd., 525 U.S. 366 (1999).

53. Section 201(b) was added to Communications Act of 1934 in 1938. *See* Pub. L. No. 75-561, 52 Stat. 588 (1938).

54. 47 U.S.C. § 201(b) (1994).

55. *AT&T*, 525 U.S. at 377-78.

56. 47 U.S.C. § 201(a) (emphasis added).

57. *See AT&T*, 525 U.S. at 378.

limitation on the FCC's rulemaking authority set forth in § 201(b).[58] Furthermore, given the Court's construction of § 201(b), arguments that the Act expressly confers jurisdiction on the FCC to implement the local competition provisions only in certain sections (e.g., §§ 251(d), 251(b)(2), 251(c)(4)(B), 251(d)(2), 251(g), and 251(h)(2)) were dismissed.[59]

Second, some parties argued that the FCC's rulemaking authority to implement local competition provisions was circumscribed by § 2(b)[60] because the local competition provisions are not among those sections contained in § 2(b)'s "except clause." Thus, the FCC's implementation of the local competition provisions required an express grant of FCC jurisdiction over intrastate service.[61] The Court rejected this position, again citing the express grant of FCC jurisdiction contained in § 201(b). Moreover, examination of § 2(b) supported the majority's conclusion that the language in § 2(b), "nothing in this Act shall be considered to apply or to give the Commission jurisdiction . . . ," did not create a mutually exclusive alternative as argued by the Respondents, but rather two distinct limitations: "[t]he term 'apply' limits the substantive reach of the statute (and the concomitant scope of primary FCC jurisdiction), and the phrase 'or give the Commission jurisdiction' limits, in addition, the FCC's ancillary jurisdiction."[62]

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58. *See id.* The logic of the majority's holding on this issue is exemplified by Justice Scalia's rejection of Justice Breyer's "appeal[] to our cases which say that there is a 'presumption against the preemption of state police power regulations.'" *Id.* at 730 n.6 (citation omitted). Justice Scalia stated:

> [T]he question in this case is not whether the Federal Government has taken the regulation of local competition away from the States. With regard to the matters of addressed by the 1996 Act, it unquestionably has. The question is whether the state commissions' participation in the administration of the new federal regime is to be guided by federal-agency regulations. If there is any "presumption" applicable to this question, it should arise from the fact that a federal program administered by 50 independent state agencies is surpassing strange.
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> The appeals by Justice THOMAS and Justice BREYER to what might loosely be called "States' rights" are most peculiar, since there is no doubt, even under their view, that if the federal courts believe a state commission is not regulating in accordance with federal policy they may bring it to heel. This is, at bottom, a debate not about whether the States will be allowed to do their own thing, but about whether it will be the FCC or the federal courts that draw the lines to which they must hew.

Id.

59. *See id.* at 383.

60. *See id.* at 379 (quoting 47 U.S.C. § 152(b)).

61. *See id.* at 380.

62. *Id.* at 731 (citing Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355 (1986)). According to the Court, the need for two limitations is "exemplified" by the two arguments raised by the FCC in *Louisiana Public Service Commission* regarding its rulemaking authority over depreciation methods used by local telephone companies. *Id.* In the above case, the Court rejected

In addition to upholding the FCC's general rulemaking authority under §§ 201 and 2(b), the Court upheld the FCC's authority to promulgate rules regarding TELRIC pricing, states' review of preexisting interconnection agreements, rural exemptions, and dialing parity, despite claims that certain sections of the Act negated aspects of the FCC's authority.[63] Regarding TELRIC pricing, Respondents cited § 252(c), which provides in relevant part:

> In resolving by arbitration under subsection (b) any open issues and imposing conditions upon the parties to the agreement, *a state commission shall*—
>
> > (1) ensure that such resolution and conditions meet the requirements of section 251, *including the regulations*

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the FCC's argument that the intent of the Communications Act was that depreciation provisions would apply to the states. The Court held that such provisions could not be read to negate § 2(b). *See id.* (citing *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 376-77). Alternatively, the Court rejected the FCC's argument that it could regulate intrastate depreciation methods if such would affect interstate telecommunications on the grounds that under § 2(b), the FCC could not regulate intrastate telecommunications solely to further the federal goal of increasing interstate telecommunications. *See id.* (citing *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 369).

In *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 423 (5th Cir. 1999), the Fifth Circuit succinctly explained the Supreme Court's holding concerning the FCC's jurisdiction under § 201(b) and § 2(b):

> Though § 2(b)'s language stating that "nothing in this Act shall be construed to apply orto give the Commission jurisdiction" implies that FCC jurisdiction does not always follow where the Act applies, the [Supreme] Court held that "the term 'apply' limits the substantive reach of the statute . . . and the phrase 'or the Commission's jurisdiction' limits . . . the FCC's *ancillary* jurisdiction.
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> In reconciling its holding with *Louisiana PSC*, the Court held that the FCC must show that the meaning of a statutory provision *applies* to intrastate matters in an "unambiguous and straightforward" manner as to "override the command of § 2(b)." If the agency fails in this initial task, it cannot use its normally broad regulatory authority to assert what is now only *ancillary* jurisdiction because of the still intact jurisdictional fence created by § 2(b). Therefore, after [*AT&T v. Iowa Utilities*], § 2(b) still serves as (1) a rule of statutory construction requiring the FCC to find unambiguous statutory authority *applying* to intrastate matters and (2) a jurisdictional barrier restricting the agency from using its plenary authority to assert *ancillary* jurisdiction by "taking intrastate action solely because it further[s] an interstate goal."

Texas Office, 183 F.3d at 423 (footnotes omitted) (citing *AT&T*, 525 U.S. at 380-81; *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 374).

63. *See AT&T*, 525 U.S. at 385 (reinstating 47 C.F.R. §§ 51.303, 51.405, and 51.205-215 (1999)).

> *prescribed by the Commission pursuant to section 251.*
>
> (2) *establish any rates* for interconnection, services, or network elements according to subsection (d).[64]

Despite arguments that § 252(c)(2) confers state commissions with the authority to "establish any rates," the Court found the TELRIC pricing rule, in prescribing a pricing methodology, did not infringe on the State commissions' duty to "establish [] rates for interconnection, services, or network elements"[65] any more than the pricing standards set forth in subsection (d).[66]

The Court further addressed the apparent "lack of parallelism" between subsections (c)(1) and (c)(2) evidenced by the proviso in (c)(1) concerning the states' duty to ensure compliance with § 251 including the FCC's rules implementing that section.[67] This "lack of parallelism" is logically explained by the fact that § 251(d)(1) expressly requires the FCC to promulgate rules and regulations to implement that section.[68] The Court held that regardless, any "lack of parallelism" did not override the FCC's authority to implement the provisions of the Act under § 201(d).[69] Under the same rationale, the Court reversed the Eighth Circuit's decisions upholding the FCC's rules regarding preexisting agreements, rural exemptions, and dialing parity holding that "[n]one of the statutory provisions that these rules interpret displaces the Commission's general

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64. 47 U.S.C § 252(c)(1-2) (Supp. III 1997) (emphasis added).

65. *Id.*

66. *See AT&T*, 525 U.S. at 384. The Court explained:

> We think this attributes to [the State commissions'] task a greater degree of autonomy than the phrase "establish any rates" necessarily implies . . . It is the States that will apply those standards and implement that methodology, determining the concrete result in particular circumstances. That is enough to constitute the establishment of rates.

Id.

Although this holding is consistent with Court's decisions to uphold the FCC's jurisdiction to implement local competition rules, the Court's rationale begs the question of the extent to which State commissions enjoy autonomy under the Act's express delegations of power. Pursuant to the Court's analysis, the States' authority is severely limited. The Court noted that the Act

> assume[s] a scheme in which Congress has broadly extended its law into the field of intrastate telecommunications, but in a few specified areas (ratemaking, interconnection agreements, etc.) has left the policy implications of that extension to be determined by state commissions, which—within the broad range of lawful policymaking left open to the administrative agencies—are beyond federal control. Such a scheme is decidedly novel, and the attendant legal questions, such as whether federal courts must defer to state agency interpretations of federal law, are novel as well.

Id. at 385 n.10.

67. *Id.*

68. *Id.*

69. *Id.*

rulemaking authority."[70]

2. *FCC's Unbundling Rules.—*

(a) ILECs challenged the FCC's rules[71] regarding network elements arguing that the FCC improperly included OSS, operator services and directory assistance ("OS/DA"), and vertical switching functions[72] within the definition of "network elements."[73] ILECs argued that a "'network element' must be part of the physical facilities and equipment used to provide local phone service."[74] Finding that the definition of "network element" in § 153(29) was sufficiently broad to include OSS, OS/DA and vertical switching functions, the Court rejected the ILECs argument and upheld the Eighth Circuit's determination that the FCC's interpretation of network element was reasonable.[75]

(b) However, the Court did not agree with the FCC's interpretation of the "necessary" and "impair" standards under § 251(d)(2)(A & B).[76] The Court began its analysis by noting that the FCC requires ILECs to provide requesting carriers with a minimum of seven unbundled network elements,[77] and that a requesting carrier can petition the state commission for additional elements.[78] ILECs argued that § 251(d)(2) of the Act served only as a means to supply access to those network elements otherwise unavailable.[79] The FCC should therefore "apply some limiting standard, rationally related to the goals of the Act, which it has simply failed to do."[80] In contrast, the FCC's interpretations of the

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70. *Id.* Furthermore, the Court noted that § 251(b)(3), governing dialing parity, "does not even mention the States, [and thus] it is even clearer that the Commission's § 201(b) authority is not superseded." *Id.*

71. *See* 47 C.F.R. §§ 51.319(f-g) (1999); First Report & Order, *supra* note 4, ¶413.

72. Vertical switching functions include services such as caller I.D., call forwarding, and call waiting. *See AT&T*, 525 U.S. at 386.

73. *Id.* A "network element" is defined by the Act as:

> [A] facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment, including subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of telecommunications service.

47 U.S.C. § 153(29) (Supp. III 1997).

74. *AT&T*, 525 U.S. at 387.

75. *See id.* (citing Chevron v. Natural Resources Defense Council, 467 U.S. 837, 866 (1984)).

76. *See id.*

77. *See id.* at 387-88. These network elements include: "the local loop, the network interface device, switching capability, interoffice transmission facilities, signaling networks and call-related databases, operations support system functions, and operator services and directory assistance." *Id.* (citing 47 C.F.R. § 51.319 (1997)).

78. *See id.* at 388 (citing 47 C.F.R. § 51.317).

79. *See id.*

80. *Id.* ILECs analogized § 251(d)(2) to the "essential elements" doctrine in antitrust law whereby the ILECs would make available "only those 'bottleneck' elements unavailable elsewhere

"necessary" and "impair" standards effectively gave requesting carriers "blanket access" to the ILECs' networks.[81]

For example, the FCC's "impair" standard requires a determination as to whether

> the failure of an incumbent to provide access to a network element would decrease the quality, or increase the financial or administrative cost of the service a requesting carrier seeks to offer, compared with providing that service over other unbundled elements in the incumbent LEC's network.[82]

This standard, by its terms, necessarily excludes consideration of "self provision or . . . purchasing from another provider," and "[s]ince any entrant will request the most efficient network element that the incumbent has to offer, it is hard to imagine when the incumbent's failure to give access to the element would not constitute an 'impairment' under this standard."[83] According to the Court, the FCC's limitation of inquiry to ILECs under the "impair" standard unreasonably shifts the determinations of whether access to a proprietary network element is "necessary" and whether the failure to gain access to a non-proprietary network element would "impair" the provision of service from the FCC to the requesting carrier.[84] Furthermore, the Court rejected the FCC's reasoning that an increase in cost or decrease in quality resulting from the denial of a network element necessarily renders access to that element "necessary," and thus, failure to provide access to that element would "impair" the ability of the requesting carrier to provide service.[85]

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in the marketplace." *Id.* However, the Court declined to decide whether such standard is required by the Act as a matter of law. *See id.*

81. *Id.* at 390.

82. First Report & Order, *supra* note 4, ¶ 285.

83. *AT&T*, 525 U.S. at 389.

84. *Id.*

85. *Id.* at 389-90. To illustrate, the Court noted that a requesting carrier whose

> anticipated annual profits from the proposed service are reduced from 100% of investment to 99% of investment has perhaps been "impaired" in its ability to amass earnings, but has not ipso facto been "impaired . . . in its ability to provide the service it seeks to offer"; and it cannot realistically be said that the network element enabling it to raise its profits to 100% is necessary.

Id. at 390.

Commenting on Justice Souter's dissent, the majority also offered the following analogy:

> JUSTICE SOUTER points out that one can say his ability to replace a light bulb is "impaired" by the absence of a ladder, and that the ladder is "necessary" to replace the bulb, even though one "could stand instead on a chair, a milk can, or eight volumes of Gibbon." True enough (and nicely put), but the proper analogy here, it seems to us, is not the absence of a ladder, but the presence of a ladder tall enough to enable one to do the job, but not without stretching one's arm to its full extension. A ladder one-half inch taller is not, "within an ordinary and fair meaning of the word," "necessary," nor

The FCC's interpretation is based upon its misinterpretation of § 251(c)(3), which requires ILECs to provide access to network elements "at any technically feasible point"[86] as imposing a duty upon ILECs to make available "all network elements for which it is technically feasible to provide access."[87] Agreeing with the interpretation of the Eighth Circuit, the Court held that § 251(c)(3) "indicates 'where unbundled access must occur, not which [network] elements must be unbundled.'"[88] The FCC's application of the "necessary" and "impair" standards under § 251(d)(2)(A-B) were based on the false premise that § 251(c)(3) allowed access to all network elements and thus the FCC, interpreting both § 251(c)(3) and § 251(d)(2), reached the erroneous conclusion that "the proprietary and impairment standards in § 251(d)(2) grant us the authority to refrain from requiring incumbent LECs to provide all network elements for which it is technically feasible to provide access on an unbundled basis."[89] According to the Court:

> Section 251(d)(2) does not authorize the [FCC] to create isolated exemptions from some underlying duty to make all network elements available. It requires the Commission to determine on a rational basis which network elements must be made available, taking into account the objectives of the Act and giving some substance to the "necessary" and "impair" requirements.[90]

The Court concluded that the FCC's unreasonable application of § 251(d)(2) governed the consideration of several network elements, and accordingly, the Court vacated 47 C.F.R § 51.319 (1997).[91]

This holding also largely disposed of the ILECs' argument regarding the "all elements" rules, which allow requesting carriers to provide complete service solely through the purchase of unbundled network elements.[92] The Court noted

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> does its absence "impair" ones ability to do the job.

Id. at 390 n.11 (quoting *id.* at 399 (Souter, J., concurring in part and dissenting in part)) (citations omitted).

86. *Id.* at 391 (citing 47 U.S.C. § 251(c)(3) (Supp. III 1997)).

87. *Id.* (quoting First Report & Order, *supra* note 4, ¶ 278).

88. *Id.* (quoting Iowa Utils. Bd. v. FCC, 120 F.3d 753, 810 (8th Cir. 1997), *aff'd in part, rev'd in part sub. nom.* AT&T v. Iowa Utils. Bd., 525 U.S. 366 (1999)). While the Eighth Circuit's holding regarding the FCC's interpretation of 251(c)(3) was not at issue before the Court, it was noted that the FCC's misapplication of 251(d)(2) "was colored by [the Eighth Circuit's] error." *Id.*

89. *Id.* (quoting First Report & Order, *supra* note 4, ¶ 279)

90. *Id.* at 391-92.

91. *See id.* The FCC has since issued its response to the Supreme Court's mandate that it revise the "necessary" and "impair" standards of § 251(d)(2) for the purposes of determining unbundling obligations under § 251(c)(3). *See In re* Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, No. 96-98 15 F.C.C.R. 3696 (Released Nov. 5, 1999).

92. *See AT&T*, 525 U.S. at 392 (citing First Report & Order, *supra* note 4, ¶¶ 328-340.) Recall that ILECs argued to the Eighth Circuit that a requesting carrier should at least partially own

that the FCC may, on remand, make fewer unbundled network elements available such that the ability to provide complete service through unbundled network elements is no longer possible.[93] Regardless, the Court agreed with the Eighth Circuit in upholding the FCC's refusal to implement a requirement that requesting carriers own their own facilities before purchasing unbundled network elements, finding that the Act did not impose such a requirement.[94]

(c) As stated, the FCC's pricing rule imposes the TELRIC pricing methodology, allowing requesting carriers to lease network elements at cost, and 47 C.F.R. § 51.319 and the "all elements" rule allow the requesting carrier to rely solely on an ILEC's network to obtain virtually all elements on an unbundled basis.[95] When these rules are combined with 47 C.F.R. § 51.315(b) ("Rule 315(b)"), which prohibits an ILEC from unbundling bundled network elements, a requesting carrier "can lease a complete, preassembled network at (allegedly very low) cost-based rates."[96]

Understandably, ILECs argued that such a result could not possibly be consistent with the legislative intent underlying the Act.[97] For example, § 251(c)(4) provides that ILECs have the duty "to offer for resale *at wholesale rates* any telecommunications service . . ."[98] Thus, allowing a requesting carrier to "construct" a network to provide complete services at cost-based rates would nullify the resale provisions of the Act.[99] In addition, ILECs pointed out the fact that local phone rates contain universal service subsidies to help keep rural and residential services low.[100] These universal service subsidies are built into the retail rates, and are thus passed on through resale rates.[101] However, a competing carrier, by leasing its network at cost, can not only avoid the universal service subsidy built into the retail rates but also can cherry pick business customers by offering lower rates (that do not include the subsidy), depleting the ILECs' source of subsidies for high-cost rural and residential customers.[102]

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its own facilities to provide local service before purchasing unbundled network elements from ILECs. *See Iowa Utils. Bd.*, 120 F.3d at 814.

93. *See AT&T*, 525 U.S. at 392.

94. *See id.* at 392-93. The Court stated that the Act actually suggested the opposite given the requirement set forth in § 251(c)(3) that access must be provided to "any requesting telecommunications carrier." *Id.* at 393.

95. *See id.*

96. *Id.*

97. *See id.*

98. 47 U.S.C. § 251(c)(4) (Supp. III 1997) (emphasis added).

99. *AT&T*, 525 U.S. at 376-77; *see also* Iowa Utils. Bd. v. FCC, 120 F.3d 753, 813 (8th Cir. 1997), *aff'd in part, rev'd in part sub nom.* AT&T v. Iowa Utils. Bd., 525 U.S. 366 (1999).

100. *See AT&T*, 525 U.S. at 393. Under such universal service subsidies, "[b]usiness customers, for whom the cost of service is relatively low, are charged significantly above cost to subsidize service to rural and residential customers, for whom the cost of service is relatively high." *Id.*

101. *See id.*

102. *See id.*

The Court rejected out of hand these legitimate arguments stating only that given the Court's disposition of Rule 319, ILECs concern *may* be rendered "academic."[103] The Court provided no explanation as to the apparent conflict between the application of Rule 315(b) and the resale provisions under § 251(c)(4) as adeptly described by the Eighth Circuit:

> To permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other.[104]

The Court's inexplicable holding, allowing competing carriers to use Rule 315(b) to lease a complete network at cost-based rates, obviates the Act's resale provisions and eviscerates § 251(c)(4).[105] Similarly, ILECs' universal service argument was also summarily dismissed under the reasoning that "§ 254 requires that universal-service subsidies be phased out, so whatever possibility of arbitrage remains will be only temporary."[106]

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103. *Id.*

104. *Iowa Utils. Bd.*, 120 F.3d at 813.

105. The Court, however, acknowledged that:

> It would be a gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. That is most unfortunate for a piece of legislation that profoundly affects a crucial segment of the economy worth tens of billions of dollars. The 1996 Act can be read to grant (borrowing a phrase from incumbent GTE) "most promiscuous rights to the FCC vis-a-vis the state commissions and to competing carriers vis-a-vis the incumbents—and the [FCC] has chosen in some instances to read it that way. But Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency. We can only enforce the clear limits that the 1996 Act contains, which in the present case invalidate only Rule 319.

AT&T, 525 U.S. at 397 (citation omitted).

106. *Id.* at 393-94. The Court's statement regarding the requirement that universal service subsidies be phased out provides no specific citation to authority within § 254. Given the context of the ILECs' argument and the Court's discussion, it is clear that the Court is referring to implicit, as opposed to explicit, universal service subsidies. The Court is likely referring to § 254(f), which provides in relevant part that:

> A state may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

47 U.S.C. § 254(f) (Supp. III 1997).

Section 254 has been interpreted as not requiring the elimination of implicit universal service support mechanisms at the state level. *See In re* Federal-State Joint Board on Universal Service, The decision to reverse the Eighth Circuit's holding vacating Rule 315(b) was based on the Court's belief that the FCC reasonably interpreted the language of § 251(c)(3).[107] Finding the language of § 251(c)(3) to be ambiguous as to whether or not network elements must be separated,[108] the Court held that the language in § 251(c)(3), requiring elements to be provided in a manner that "allows requesting carriers to combine" them, did not foreclose the FCC's prohibition on unbundling combined network elements.[109] The Court stated that § 251(c)(3) "does not say, or even remotely imply that elements must be provided in this fashion and never in combined form."[110] Additionally, the Court rejected the notion that the language requiring ILECs to make network elements available "on an unbundled basis" necessarily means that those network elements must be "physically separated."[111] Admitting that Rule 315(b) allows competing carriers "access to an entire preassembled network" at cost-based prices, the Court nevertheless found that the FCC reasonably interpreted the "nondiscriminatory access" provision in § 251(c)(3)[112] in promulgating Rule 315(b) to prevent ILECs from engaging in anti-competitive conduct by deliberately unbundling combined network elements for no "productive reason."[113]

3. FCC's "Pick and Choose" Rule.—Finally, the Court reversed the Eighth Circuit and upheld the FCC's "Pick and Choose" Rule as a reasonable and most readily apparent construction of § 252(i) of the Act,[114] rejecting ILECs'

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13 F.C.C.R. 24,744 (released Nov. 25, 1998) (Separate Statement of Public Counsel Margaret Hogerty) ("The recommendation focuses on reasonable comparability and not on the elimination of implicit support .... Section 254 does not require that regulators take measures to identify and eliminate all 'implicit support' .... Consistent with our view on implicit support, there is no recommendation that a state remove implicit support or that a state establish a universal service fund."). This interpretation and the fact that local telecommunication services are still implicitly subsidized, casts doubt upon the Court's opinion that "whatever possibility of arbitrage remains will only be temporary." *AT&T*, 525 U.S. at 394. In addition, whether Congress intended to put ILECs at such a competitive disadvantage must be questioned. Although promoting competition by the elimination of access barriers is proper, Congress most likely did not intend to saddle ILECs with inherently unfair disadvantages.

107. *See AT&T*, 525 U.S. at 394.

108. *See id.* at 395.

109. *Id.*

110. *Id.* at 394.

111. *Id.*

112. Iowa Utils. Bd. v. FCC, 120 F.3d, 753 (8th Cir. 1997), *aff'd in part, rev'd in part sub nom.* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999).

113. *AT&T*, 525 U.S. at 395.

114. *See id.* at 396. The Court found that the "Pick and Choose" Rule, 47 C.F.R. § 51.809 (1999) tracks § 251(i) almost exactly. *See id.* Section 252(i) provides:

> A local exchange carrier shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement.

arguments that this Rule

> threatens the give-and-take of negotiations, because every concession as to an "interconnection, service, or network element arrangement" made (in exchange for some other benefit) by an [ILEC] will automatically become available to every potential entrant into the market. A carrier who wants one term from an existing agreement [] should be required to accept all the terms in the agreement.[115]

The Court correctly observed that in certain respects the "Pick and Choose" Rule is "more generous" to the ILECs than § 252(i).[116] For example, the "Pick and Choose" Rule exempts certain ILECs that can demonstrate that providing the requested interconnection is "more costly than providing it to the original carrier" or "technically infeasible,"[117] and limits the amount of time in which a carrier can request an interconnection, service or network element under § 252(i).[118] Ultimately, deference to the FCC's interpretation of § 252(i) against ILECs' opposing arguments was the result of the Court's recognition that "whether the [FCC's] approach will significantly impede negotiations . . . is a matter eminently within the expertise of the Commission and eminently beyond our ken."[119]

The Eighth Circuit's and Supreme Court's analyses of the FCC's rules and regulations implementing the Act's local competition provisions demonstrate, at the very least, the Act's ambiguity regarding the respective roles taken by the FCC and the state commissions in regulating intrastate telecommunications. The Supreme Court clarifies these ambiguities in its decision to uphold the FCC's rules attacked by the state commissions and ILECs pursuant to the general grant of authority under § 201(b). The questions remain, however, regarding the extent to which state commissions may determine the policy implications of the extension of federal law into intrastate telecommunications and the extent to which "federal courts must defer to state agency interpretations of federal law."[120] These are frequently recurring but unanswered questions at the local level, as the state commissions attempt to implement the Act's provisions regarding local competition. Ultimately, it will be necessary to address these questions lest the "surpassing strange" result of a "federal program administered by 50 independent state agencies" occur.[121]

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47 U.S.C. § 252(i) (Supp. III 1997).

115. *AT&T*, 525 U.S. at 396.

116. *Id.*

117. *Id.* (citing 47 C.F.R. § 51.809(b)).

118. *See id.* (citing 47 C.F.R. § 51.809(c)).

119. *Id.*

120. *Id.* at 385 n.10.

121. *Id.* at 378.

C. *Reciprocal Compensation for Termination of Internet Service Provider Traffic*

Another area in which issues have arisen regarding the scope of federal and state jurisdiction concerns reciprocal compensation for telecommunications traffic that originates on an ILEC's network and is delivered to an Internet Service Provider[122] ("ISP").[123] Section 251(b)(5) of the Act provides that each LEC has "[t]he duty to establish reciprocal compensation arrangements for the transport and termination of traffic."[124] Section 252(d)(2)(A) provides in relevant part:

> For the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5) of this title, a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless –
>
> (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier.[125]

The FCC has determined that for the purposes of § 251(b)(5), a carrier is entitled to reciprocal compensation only for traffic that "originates and terminates within a local area . . . We disagree with [the] contention that § 251(b)(5) entitles an [interexchange carrier ("IXC")] to receive reciprocal compensation from a LEC when a long-distance call is passed from the LEC serving the caller to the IXC."[126]

However, the proper classification of ISP traffic has been the subject of debate, and problems have arisen where CLECs demand reciprocal compensation from ILECs for calls delivered to the CLECs' ISP customers. According to the FCC:

> Generally speaking, when a call is completed by two (or more) interconnecting carriers, the carriers are compensated for carrying that traffic through either reciprocal compensation or access charges. When two carriers jointly provide interstate access (*e.g.*, by delivering a call to

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122. An Internet Service Provider sometimes is referred to as an Information Service Provider. ISPs "are companies which offer their customers connections to the Internet through the telephone network." Illinois Bell Tel. Co. v. Worldcom Techs., Inc., 179 F.3d 566, 569 (7th Cir. 1999).

123. *See id.* at 568 ("Through the Telecommunications Act of 1996 Congress has opened the door to competing local exchange carriers and has inserted both the Federal Communications Commission (FCC) and the federal courts into the previously state-regulated monopoly. Just how far into the scheme does the federal presence reach? is the $64,000 question.").

124. 47 U.S.C. § 251(b)(5) (Supp. III 1997).

125. *Id.* § 252(d)(2)(A).

126. First Report & Order, *supra* note 4, ¶ 1034.

> an interexchange carrier (IXC)), the carriers will share access revenues received from the interstate service provider. Conversely, when two carriers collaborate to complete a local call, the originating carrier is compensated by its end user and the terminating carrier is entitled to reciprocal compensation pursuant to section 251(b)(5) of the Act. Until now, however, it has been unclear whether or how the access charge regime or reciprocal compensation applies when two interconnecting carriers deliver traffic to an ISP.[127]

The lack of clarity is due to the nature of ISP traffic. For example, as the customer of a competing carrier, the ISP is generally assigned a local telephone number, and the originating caller (the person establishing the Internet connection) is billed for a local call.[128] However, the originating caller's ultimate connection though, is not to the ISP but rather a distant website.[129] As stated above, § 251(b)(5) requires the provision of reciprocal compensation for calls "originating and terminating within a local area."[130] ILECs have therefore argued that because ISP traffic is destined for a distant website, ISP traffic is interstate in nature, or at the very least constitutes a mixture of intrastate and interstate traffic, and thus, is not subject to the reciprocal compensation provisions of the Act. CLECs have made the opposite argument, that is, that ISP traffic actually terminates at the ISP's local server, and thus, reciprocal compensation is due.[131]

The issue has been litigated in Indiana in proceedings before the Indiana Utility Regulatory Commission ("IURC"),[132] as well as before several state commissions throughout the country which have largely concluded that traffic delivered to ISPs is local traffic subject to reciprocal compensation.[133] In the

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127. *In re* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic, 14 F.C.C.R. 3689, ¶ 9 (released Feb. 26, 1999) [hereinafter ISP Order].

128. *See Illinois Bell*, 179 F.3d at 569.

129. *See id.*

130. 42 U.S.C. § 251(b)(5) (Supp. III 1997).

131. *See* ISP Order, *supra* note 127, ¶ 12.

132. *See, e.g., In re* Complaint of Time Warner Communications of Indiana, L.P. against Indiana Bell Telephone Company, Incorporated, d/b/a Ameritech Indiana, for Violation of the Terms of the Interconnections Agreement, No. 41097 [hereinafter Time Warner Complaint]. In the discussion below, three separate orders by the IURC in Cause No. 41097 are referenced as follows: (Ind. U.R.C. Sept. 16, 1998), (Ind. U.R.C. Feb. 3, 1999), and (Ind. U.R.C. June 9, 1999).

133. *See* Time Warner Complaint, *supra* note 132, (Ind. U.R.C. Feb. 3, 1999). Specifically, the IURC took administrative notice of state commission decisions from Arizona, Connecticut, Delaware, Florida, Georgia, Illinois, Maryland, Michigan, Minnesota, Missouri, New York, North Carolina, Oklahoma, Ohio, Oregon, Pennsylvania, Tennessee, Texas, Virginia, Washington, and Wisconsin. *See id.* at 8. In *Illinois Bell v. Worldcom Technologies., Inc.*, 157 F.3d 500 (7th Cir. 1998), the court ran the statistics on the reciprocal compensation for ISP traffic litigation finding 21 state commissions deciding that reciprocal compensation was due and three district courts and one state court enforcing the administrative decisions making "the score at the moment . . . 25-0

proceedings before the IURC, Time Warner charged Ameritech Indiana with breach of the terms of its interconnection agreement for failing to provide reciprocal compensation to Time Warner for traffic terminated by Time Warner's ISP customers.[134]

During these proceedings, the FCC also reviewed issues concerning reciprocal compensation for ISP traffic.[135] Although the IURC acknowledged the concurrent proceedings before the FCC, the IURC found

> that any decision by the FCC regarding the manner in which ISPs might be regulated if they are to be treated as telephone companies will not resolve Time Warner's allegation of a breach of contract of the interconnection agreement. Nor will any decision by the FCC regarding the jurisdictional nature of ISP traffic on a going forward basis bind the [IURC's] determination of the parties' intention of how ISP traffic should be treated at the time the [i]nterconnection [a]greement was executed.[136]

Further, the IURC concluded that the Act "specifically charges the state with the responsibility of enforcing the provisions of interconnection agreements,"[137] and that the terms of the interconnection agreement itself expressly authorize the IURC to resolve disputes between the parties.[138]

Ameritech Indiana argued that the FCC has recognized ISP traffic to be exchange access traffic, and has exempted ISPs from paying access charges. Thus ISP traffic is exchange access traffic rather than local traffic, because if ISP traffic were local traffic, no exemption from access charges would be necessary.[139] The IURC rejected this argument and determined that the evidence, the terms of the interconnection agreement, and the applicable precedent existing at the time the interconnection agreement was executed, demonstrated the parties' intent that ISP traffic would be treated as local traffic.[140]

The IURC first looked to the express terms of the interconnection agreement, finding them to unambiguously indicate the parties' intention that traffic

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against Ameritech and the other Baby Bells." *Id.* at 502.

134. *See* Time Warner Complaint, *supra* note 132 (Ind. U.R.C. Feb. 3, 1999).

135. *See* FCC Public Notice, Pleading Cycle Established for Comments on Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, 12 F.C.C.R. 9715 (released July 2, 1997). This Public Notice sought comments on whether information service traffic should be treated differently than local traffic for the purposes of reciprocal compensation provisions in existing interconnection agreements between ILECs and CLECs.

136. Time Warner Complaint, *supra* note 132, at 2 (Ind. U.R.C. Feb. 3, 1999).

137. *Id.* (citing *Iowa Utils. Bd.*, 120 F.3d at 804); *see also id.* at 8 (Ind. U.R.C. Sept. 16, 1998).

138. *See id.* at 2 (Ind. U.R.C. Feb. 3, 1999).

139. *See id.* at 8.

140. *See id.* at 10.

terminating at ISPs be treated as local traffic.[141] The parties defined "Local Traffic" as "local service area calls *as defined by the Commission*," and the IURC concluded that traffic delivered to ISPs constituted "local traffic" under its definition of "Local Service Area-Local Calling Area."[142] Traffic delivered to ISPs also was not included in the parties' express exceptions to reciprocal compensation obligations set forth in the interconnection agreement.[143] The IURC further noted the fact that while the interconnection agreement expressly defined certain types of traffic, such as Feature Group A traffic,[144] it neither defined ISP traffic nor did it establish accounting methods that in any way differentiated ISP traffic from other traffic.[145] Finally, the IURC determined that treating traffic destined for ISPs as local traffic was consistent with the "unusual" "unanimous agreement" of other state commissions[146] and consistent with the FCC's actions and proceedings regarding ISPs.[147]

In February 1999, the FCC attempted to provide some guidance on the issue

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141. *See id.* at 11.

142. *Id.* at 10-11 (emphasis added). The IURC's definition of "Local Traffic" is taken from the definition of "Local Service Area-Local Calling Area— the area within which telephone service is furnished to customers under a specific schedule of exchange rates and without toll charges." IND. ADMIN. CODE tit. 170, r. 7-1.1-2(21) (1996).

143. *See* Time Warner Complaint, *supra* note 132, at 11 (Ind. U.R.C. Feb. 3, 1999).

144. "Feature Group A" is an exchange access service and is a type of long distance call that is initiated by dialing a seven digit number. *Id.* at 8. The IURC rejected Ameritech Indiana's argument that ISP traffic is analogous to Feature Group A noting that the Michigan and Illinois commissions have likewise rejected this argument. *See id.* (citing Brooks Fiber Communications v. Ameritech Mich., consolidated Case Nos. U-11178, U-11502, U-11522, U-11553 and Illinois Bell Tel. Co. v. Worldcom Techs. Inc., 1998 U.S. Dist. LEXIS 11394 (N.D. Ill. July 21, 1998) (affirming the Illinois Commerce Commission's rejection of Ameritech's contention that ISP traffic is essentially the same as Feature Group A traffic)).

145. *See id.* The IURC also pointed to other factors outside the interconnection agreement's "four corners" supporting its conclusion that ISP traffic is local traffic:

> Ameritech's own treatment of ISP traffic is revealing. For instance, Ameritech treats traffic to its own ISP customers as local for purposes of booking revenues, separations, and ARMIS reporting, despite its argument that in this case, such traffic is exchange access [traffic]. Ameritech's end users who make calls to an ISP served by Ameritech within Ameritech's local calling area are not assessed toll charges, and such calls are treated by Ameritech as local calls.

Id. at 11.

146. *Id.* at 12.

147. *See id.* Specifically, the IURC noted that "[t]he FCC has indicated that it does not intend to answer the question of whether ISP calls are local calls within the Interconnection Agreements already executed and with which the state commissions are charged with enforcement" and that "the FCC agrees with the [IURC] that the proper construction of an existing interconnection agreement does not turn on any subsequent decision of the FCC." *Id.* (citing *Response of FCC as Amicus Curiae to Motion for Referral of Issues* in BellSouth Telecomms., Inc. v. US LEC, Civil Action No. 3:98-CV170-MU (W.D.N.C.)).

of reciprocal compensation for ISP traffic by issuing a declaratory ruling and Notice of Proposed Rulemaking.[148] The FCC began by discussing the nature of ISP traffic, upholding its prior precedent that the jurisdictional nature of telecommunications traffic (i.e. whether it is interstate or intrastate) is determined by considering the communications from inception to completion regardless of intermediate facilities.[149] Accordingly, the FCC agreed with arguments advanced by ILECs "that the communications at issue here do not terminate at the ISP's local server, as CLECs and ISPs contend, but continue to the ultimate destination or destinations, specifically at a Internet website that is often located in another state."[150]

The FCC then turned to the question of whether an Internet call constitutes interstate telecommunications.[151] Generally, a call that originates and terminates within a state is jurisdictionally intrastate, and a call that originates in one state and terminates in a different state is jurisdictionally interstate.[152] The analysis concerning Internet communications does not fit within this simple construct, and the FCC ultimately determined that ISP traffic is largely interstate in nature:

> An Internet communication does not necessarily have a point of "termination" in the traditional sense. An Internet user typically communicates with more than one destination point during a single Internet call, or "session," and may do so either sequentially or simultaneously. In a single Internet communication, an Internet user may, for example, access websites that reside on servers in various states or foreign countries, communicate directly with another Internet user, or chat on-line with a group of Internet users located in the same local exchange or in another country. Further complicating the matter of identifying the geographical destinations of Internet traffic is that the contents of popular websites increasingly are being stored in multiple servers throughout the Internet, based on "caching" or website "mirroring" techniques. After reviewing the record, *we conclude that, although some Internet traffic is intrastate, a substantial portion of Internet traffic involves accessing interstate or foreign websites.*[153]

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148. *See* ISP Order, *supra* note 127.

149. *See id.* ¶ 11 (quoting Teleconnect Co. v. Bell Tel. Co., 10 F.C.C.R. 1626, 1629, *aff'd sub nom.* Southwestern Bell Tel. Co. v. FCC, 116 F.3d 593 (D.C. Cir. 1997)). "[T]he [FCC] traditionally has determined the jurisdictional nature of communications by the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers." *Id.* ¶ 10. Thus, the FCC "has jurisdiction over, and regulates charges for, the local network when it is used in conjunction with the origination and termination of interstate calls." *Id.* ¶ 12 (quoting Petition for Emergency Relief and Declaratory Ruling filed by BellSouth Corporation, 7 F.C.C.R. 1619, 1621 (1992)).

150. *Id.* ¶ 12 (footnote omitted).

151. *See id.* ¶ 18.

152. *See id.*

153. *Id.* (emphasis added) (footnotes omitted).

Moreover, it is important to point out that, consistent with Ameritech Indiana's argument in the Time Warner Complaint, the FCC recognizes that ISPs provide exchange access, but exempts ISPs from paying access charges.[154] In the ISP Order, the FCC stated:

> That the Commission *exempted* ESPs from access charges indicates its understanding that ESPs in fact use interstate access service; otherwise, *the exemption would not be necessary*. We emphasize that the Commission's decision to treat ISPs as end users for access charge purposes and, hence, to treat ISP-bound traffic as local, does not affect the Commission's ability to exercise jurisdiction over such traffic.[155]
>
> * * *
>
> CLECs also argue that the traffic they deliver to ISPs must be deemed either "telephone exchange service" or "exchange access." They contend that ISP traffic cannot be "exchange access," because neither LECs nor CLECs assess toll charges for the service. CLEC delivery of ISP traffic is, therefore, according to CLECs, "telephone exchange service," a form of local telecommunications for which reciprocal compensation is due. . . . [T]he [FCC] consistently has characterized ESPs as "users of access service" but has treated them as end users for pricing purposes. Thus, we are unpersuaded by this argument.[156]

The FCC also concluded that its determination that ISP traffic is largely interstate did *not* alter the current access charge exemptions for ISPs.[157]

Although the FCC essentially agreed with ILECs that Internet traffic was substantially interstate in nature and subject to the FCC's jurisdiction, this determination did not resolve existing reciprocal compensation issues. Because there is no rule governing interstate compensation mechanisms, the ISP Order sought comment on the implementation of such a rule.[158] In the interim, the FCC found "no reason to interfere with state commission findings as to whether reciprocal compensation provisions of interconnection agreements apply to ISP-

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154. *See id.* ¶ 16.

155. *Id.* (emphasis added) (footnotes omitted).

156. *Id.* ¶ 17 (footnotes omitted).

157. *See id.* ¶ 20. While the FCC's explanation seemingly would have supported Ameritech Indiana's access charge exemption arguments in the Time Warner Complaint proceedings, the FCC made clear that its determinations would not be dispositive of interconnection disputes before state commissions. *See id.* Further, as discussed below, despite the FCC's position in the ISP Order, the Seventh Circuit was not persuaded by Ameritech Illinois' access charge exemption argument. Following the FCC's issuance of the ISP Order, Ameritech Indiana did indeed file a Petition for Rehearing and Reconsideration, which was denied by the IURC. *See generally* Time Warner Complaint (Ind. U.R.C. June 9, 1999).

158. *See* ISP Order, *supra* note 127, ¶ 22.

bound traffic"[159] because parties voluntarily entering into interconnection agreements could have reasonably agreed to treat ISP traffic as local traffic so that reciprocal compensation obligations would apply.[160] Furthermore, the FCC determined that where parties have not voluntarily agreed on reciprocal compensation for ISP traffic, "state commissions nonetheless may determine in their arbitration proceedings at this point that reciprocal compensation should be paid for this traffic."[161] According to the FCC, under the arbitration provisions of § 252, state commissions have authority over both interstate and intrastate matters,[162] and thus, "the mere fact that ISP-bound traffic is largely interstate does not necessarily remove it from the § 251/252 arbitration process."[163]

Subsequently, the Seventh Circuit upheld a district court ruling upholding an order by the Illinois Commerce Commission (ICC) that under specific interconnection agreements, parties reasonably agreed that reciprocal compensation would apply to traffic billed as local traffic, including traffic to ISPs.[164] The court clarified that its duty

> is to examine the ICC order, not to determine whether the ICC correctly applied principles of state contract law, but to see whether its decision violates federal law, as set out in the Act or in the FCC's interpretation.
>
> The short answer is that it does not. The FCC could not have made clearer that in the absence of a rule, a state agency's interpretation of an agreement so as to require payment of reciprocal compensation does not necessarily violate federal law.[165]

Ameritech Illinois argued that the Act does not require the payment of reciprocal compensation,[166] and that the interconnection agreements at issue "were negotiated against a backdrop of longstanding FCC policy that ISP traffic is not local traffic" and thus, the parties did not intend for reciprocal compensation to apply to ISP traffic.[167] Rejecting these arguments, the court cited several factors set forth in the ISP Order which the state commissions could consider in determining whether the parties intended for reciprocal compensation to apply to ISP traffic and "conclud[ed] that the factors are illustrative only and that *the state commissions, not the FCC*, are the arbiters of what factors are relevant in the determination."[168] Furthermore, the court pointed out the FCC's finding that interconnection agreements negotiated prior to the ISP Order

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159. *Id.* ¶ 21.
160. *See id.* ¶ 24.
161. ISP Order, *supra* note 127, ¶ 25.
162. *See id.* (citing First Report & Order, 11 F.C.C.R. at 15544, 15547).
163. *Id.* ¶ 25.
164. *See* Illinois Bell Tel. Co. v. Worldcom Techs., Inc., 179 F.3d 566, 572 (7th Cir. 1999).
165. *Id.*
166. *See id.* at 573.
167. *Id.*
168. *Id.* (citing ISP Order, *supra* note 127, ¶ 24) (emphasis added).

(including those at issue in *Illinois Bell*) "were negotiated in the 'context of this Commission's longstanding policy of treating this traffic as *local*, and the conduct of the parties pursuant to those agreements.'"[169] The court also concluded that the ICC reasonably considered relevant factors such as the fact that: calls to ISPs are billed as local calls; customers dial local numbers to reach ISPs; and calls to ISPs are routed over local, rather than long-distance lines.[170] Finally, the court pointed out that the interconnection agreements at issue "specifically granted to the ICC the right to define local traffic for reciprocal compensation purposes."[171]

In *Bell Atlantic Telephone Co. v. FCC*,[172] the D.C. Circuit found the FCC's determinations in the ISP Order insufficient. Specifically, the court found that the FCC did not satisfactorily explain why dial-up calls to Internet service providers (ISPs) are more like local "exchange access" calls rather than "telephone exchange" traffic.[173] Accordingly, the D.C. Circuit vacated and remanded the ISP Order to the FCC.

II. UNIVERSAL SERVICE

A. Background of Universal Service

Section 254 requires the FCC and state commissions to establish support mechanisms and take actions to uphold the principles of Universal Service.[174]

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169. *Id.* (citing ISP Order, *supra* note 127, ¶ 24) (emphasis added). The court rejected Ameritech Illinois' citations to prior statements and actions made by the FCC that could be construed as a determination that ISP traffic is interstate traffic. *See id.* at 573-74. For example, Ameritech Illinois pointed out that ISPs are exempted from paying access charges for connections to distant websites; if ISP traffic did not contribute interstate traffic, there would be no need for such exception. *See id.* Ameritech Illinois also relied upon the decisions in *In re GTE Telephone Operating Cos.*, 13 F.C.C.R. 22,466 (1998) and *In re Bell Atlantic, Telephone Cos., Bell Atlantic Tariff No. 1, Bell Atlantic Transmittal No. 1076*, 13 F.C.C.R. 23,667 (1998) for the proposition that ISP traffic terminates on the Internet rather than on the local server. *See Illinois Bell Tel. Co.*, 179 F.3d at 573. Without addressing Ameritech Illinois' access charge exemption argument, the court noted that both the *Bell Atlantic* and *GTE* decisions were entered after the interconnection agreements at issue were negotiated, and thus, the FCC's statements contained therein could not have affected the parties' intentions. Moreover, the court quoted the FCC's statement in *GTE* that:

> This Order does not consider or address issues regarding whether local exchange carriers are entitled to receive reciprocal compensation when they deliver to information service providers, including Internet service providers, circuit-switched dial-up traffic originated by interconnecting LECs.

Id. at 574 (citation omitted).

170. *See id.*

171. *Id.*

172. 206 F.3d 1 (D.C. Cir. 2000).

173. *Id.* at 8.

174. 47 U.S.C. § 254(b) provides:

Prior to the Act, "Universal Service" meant providing "plain old telephone service" or "POTS" (i.e. basic dial-tone service) at rates made affordable by cross-subsidization through implicit subsidies from monopolized services.[175] However, the Act recognizes that with advancements in technology, "universal service" now constitutes more than POTS. Moreover, the Act contemplates that universal service be funded by explicit funding mechanisms[176] because implicit subsidies cannot be maintained in a competitive environment.[177]

> Universal Service Principles.—The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles:
>
> (1) Quality and Rates.—Quality services should be available at just, reasonable, and affordable rates.
>
> (2) Access to advanced services.—Access to advanced telecommunications and information services should be provided in all regions of the Nation.
>
> (3) Access in rural and high cost areas.—Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.
>
> (4) Equitable and nondiscriminatory contributions.—All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.
>
> (5) Specific and predictable support mechanisms.—There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.
>
> (6) Access to advanced telecommunications services for schools, health care, and libraries.—Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h).
>
> (7) Additional principles.—Such other principles as the Joint Board and Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.

47 U.S.C. § 254(b) (Supp. III 1997).

175. Cross-subsidization through implicit subsidies refers to the ability of a monopoly to artificially increase prices of services that are relatively low-cost to subsidize the prices of services that are relatively high-cost.

176. *See* 47 U.S.C §§ 254(e), (f).

177. *See* THOMAS G. KRATTENMAKER, TELECOMMUNICATIONS LAW AND POLICY 464 (2d ed. 1998).

> The basic goal of section 254 is to establish rules and procedures for the reform of universal service in a competitive market, while allowing for periodic evaluations of the concept, evaluations that consider "advances in telecommunications and information technologies and services." Section 254 also appears to require that, in the future, favored services be supported by direct and apparent taxes, not by implicit subsidies hidden inside pricing schemes. Beneficiaries of universal service support are to include low income consumers and those who reside in rural, insular, and high cost areas, as well as schools, libraries, and health care providers.[178]

During the survey period, the FCC and the Federal-State Joint Board on Universal Service ("Joint Board") have been hard at work at the monumental task of implementing universal service in accordance with the Act.[179]

B. Federal Universal Service Proceedings

The FCC initiated a proceeding in CC Docket No. 96-45 to receive the Joint Board's recommendations and to promulgate rules implementing the Act's universal service provisions.[180] Since the FCC's issuance of its First Report and Order in the Universal Service Docket in 1997,[181] the FCC has issued several subsequent Reports and Orders and Orders on Reconsideration in an effort to implement the provisions of § 254.[182]

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178. *Id.* (footnote omitted).

179. The Federal-State Joint Board on Universal Service is an entity created pursuant to § 254(a)(1) to make recommendations to the FCC concerning the implementation of universal service. *See* 47 U.S.C. § 254(a)(1).

180. *See id.* § 254(a)(2).

181. *See In re* Federal-State Joint Board on Universal Service, 12 F.C.C.R. 8776 (Released May 8, 1997) [hereinafter Universal Service First Report & Order].

182. In addition to the Local Competition and Universal Service Dockets, the FCC has included *In re* Access Charge Reform, CC Docket 96-262 to the "trilogy of actions collectively intended to foster and accelerate the introduction of competition into all telecommunications markets, pursuant to the mandate of the Act." *In re* Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, and End User Common Line Charges, 12 F.C.C.R. 15,982, ¶ 1, (Released May 16, 1997) [hereinafter Access Reform First Report and Order]. Specifically, the Access Charge Reform Docket addresses "Congress's command to create secure and explicit mechanisms to achieve universal service goals, [and the FCC's conclusion] that implicit subsidies embodied in the existing system of interstate access charges cannot be indefinitely maintained in their current form." *Id.* ¶ 35. Similar to the First Report and Order and the Universal Service First Report and Order discussed below, several portions of the Access Reform First Report and Order were challenged. These challenges were consolidated in the Eighth Circuit Court of Appeals, which deferred to the FCC's determinations and upheld the Access Reform First Report and Order. *See* Southwestern Bell Tel. Co. v. FCC, 153 F.3d 523 (8th Cir. 1998).

A significant decision within the survey period concerning the Universal Service First Report and Order came from the Fifth Circuit Court of Appeals in *Texas Office of Public Utility Counsel v. FCC.*[183] *Texas Office* was the consolidated challenge by several parties to certain provisions of the FCC's Universal Service First Report and Order and concerned two primary sets of challenges. The first set of challenges concerned "the FCC's plan for replacing the current mixture of explicit and implicit subsidies with an explicit universal service support system for high-cost areas."[184] The second set concerned "the FCC's proposal for implementing § 254(h) programs supporting schools, libraries, and health care providers."[185] Although the court upheld most of the challenged provisions of the Universal Service First Report and Order, some FCC determinations were reversed.

1. "No Disconnect" Rule.—Bell Atlantic and various states challenged the FCC's rule that bars "carriers receiving universal service support from disconnecting Lifeline services from low-income consumers who have failed to pay toll charges"[186] on the grounds that the FCC exceeded its jurisdictional authority under § 2(b), which proscribes FCC regulation of intrastate telecommunications service.[187] The FCC's response was based on three separate arguments, each of which the court rejected.

First, the FCC argued that § 254(b)(3) granted it unambiguous authority to adopt policies based on the principle that low income consumers should have access to telecommunications and information services.[188] The court held that "§ 254(b) identifies seven principles the FCC should consider in developing its policies; it hardly constitutes a series of specific statutory commands," and noted that the court had refused to use the same "aspirational language" in § 254(b) to require the FCC to adopt certain universal service support cost methodologies.[189]

Next, the FCC argued that the "no disconnect" rule did not attempt to regulate intrastate service, "but merely prevent[ed] the disconnection of interstate service (and, as a consequence, of intrastate service) for failure to pay toll charges."[190] Finding that the "no disconnect" rule was indeed a regulation

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183. 183 F.3d 393 (5th Cir. 1999), *cert. denied*, 120 S. Ct. 2212; 120 S. Ct. 2237, *and cert. granted sub nom.* GTE Serv. Corp. v. FCC, 120 S. Ct. 2214 (2000).

184. *Id.* at 408.

185. *Id.* at 408-09.

186. *Id.* at 421 (citing 47 C.F.R. § 54.401(b) (1999)).

187. *See Texas Office*, 183 F.3d at 421 (footnote omitted) (citing Universal Service First Report & Order, *supra* note 181, ¶ 390). "Lifeline" is a program that provides telecommunications services to qualifying low-income customers. "Lifeline" services include "single-party service; voice-grade access to the public switched network; [dual tone multifrequency] DTMF or its functional digital equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll-limitation services . . ." Universal Service First Report & Order, *supra* note 181, ¶ 384.

188. *See Texas Office*, 183 F.3d at 421 (citing 47 U.S.C. § 254(b)(3) (Supp. III 1997)).

189. *Id.*

190. *Id.* (footnote omitted).

proscribed by § 2(b), as "it dictates the circumstances under which local service must be maintained,"[191] the court rejected the FCC's argument that even if the rule was a regulation, it should be upheld under the "impossibility exception," whereby the FCC has jurisdiction to regulate in instances where interstate service cannot be separated from intrastate service.[192] Analyzing the FCC's "impossibility exception" argument pursuant to the framework set forth in *Maryland Public Service Commission v. FCC*,[193] the court found that the FCC's argument "failed to show why allowing the states to control disconnections from local service would 'negate the exercise of the FCC's lawful authority . . . .'"[194]

Finally, relying on the Supreme Court's decision in *AT&T v. Iowa Utilities Board*, the FCC argued that it is authorized to implement the "no disconnect" rule because § 201(b) confers "jurisdiction over all areas, including intrastate matters, to which the Act applies" including § 254.[195] The court found, however, that pursuant to the Supreme Court's reconciliation of its decision in *Louisiana PSC*[196] with its jurisdictional holding in *AT&T v. Iowa Utilities Board*,[197] the question was not whether § 254 merely "applies" to intrastate matters, but whether § 254 "does indeed 'apply' to intrastate matters in a sufficiently 'unambiguous' manner" to override the jurisdictional proscription in § 2(b).[198] The court answered the question in the negative, rejecting the FCC's arguments that the language in §§ 254(b)(3), (c), and (j) unambiguously applied to intrastate service.[199] The court found that § 254(d), which directs interstate carriers to contribute to the FCC's funding mechanism, and § 254(f), which directs intrastate carriers to contribute to individual states' universal service funds

191. *Id.* at 422.

192. *Id.* ("FCC has jurisdiction to prescribe the conditions under which terminal equipment may be interconnected with the interstate telephone line network." (citing North Carolina Utils. Comm'n v. FCC, 552 F.2d 1036, 1048 (4th Cir. 1977))).

193. 909 F.2d 1510, 1515 (D.C. Cir. 1990). This framework involves a three part test to determine whether the FCC may appropriately intervene in local service issues:

> To permit the FCC to preempt state regulation of whether to cut off low-income subscribers, the [D.C.] circuit requires the agency to show that "(1) the matter to be regulated has both interstate and intrastate aspects; (2) FCC preemption in necessary to protect a valid federal regulatory objective; and (3) state regulation would negate the exercise by the FCC of its own lawful authority because regulation of the interstate aspects of the matter cannot be unbundled from regulation of intrastate aspects."

Texas Office, 183 F.3d at 422 (quoting *Maryland PSC*, 909 F.2d at 1515).

194. *Id.*

195. *Id.* at 423.

196. 476 U.S. 355 (1986).

197. 525 U.S. 366 (1999).

198. *Id.* The Fifth Circuit found that *AT&T v. Iowa Utilities Board* provides little guidance to answer this question, except to find that the Act has "unquestionably" "taken the regulation of local telecommunications competition away from the States." *See Texas Office*, 183 F.3d at 424 Nevertheless, the Fifth Circuit noted that the Supreme Court fails to explain why. *See id.*

199. *See id.*

contemplate a "dual regulatory structure" distinguishable from the statutory schemes contained in §§ 251 and 252 that solely concern intrastate issues.[200]

2. Recovery of Universal Service Contributions Through Access Charges.—Another dispute decided against the FCC concerned the FCC's interpretation of the term "explicit" in its rules requiring ILECs to recover universal service contributions through access charges.[201] Specifically, GTE argued that the FCC's rules "unfairly disadvantage[] ILECs because, unlike their potential new competitors, they cannot recover their universal service contributions through explicit charges on their end users, but, instead, are required by the FCC to increase their access charges on long-distance service providers."[202] Although GTE may not necessarily be disadvantaged in the amounts actually recovered, the recovery method would put GTE at a competitive disadvantage because the customers of competitive carriers would see the cost of universal service explicitly itemized on his bill, and the ILEC customer will pay for the cost of universal service through higher rates.[203] According to the FCC's interpretation, the recovery method "'satisfies the statutory requirement that support be explicit' by requiring each carrier to contribute a specific percentage of its end user revenues."[204] The court found "explicit" to mean the opposite of "implicit," and that requiring ILECs to recover universal service contributions from access charges maintained an implicit subsidy.[205] This violated the express statutory mandate of § 254(e).[206] The court therefore reversed this FCC rule.[207]

3. Contribution of Interstate Carriers on the Basis of International Revenues.—The court also reversed the FCC's decision to include international revenues of interstate carriers in the universal service base.[208] Under the FCC's scheme, universal service contributions by "small interstate carriers specializing in providing international telephone service"[209] would exceed the interstate revenues of those carriers, and would therefore violate the "equitable and

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200. *Id.*

201. *Id.* at 424-25. 47 U.S.C § 254(e) (Supp. III 1997) provides:

> UNIVERSAL SERVICE SUPPORT.—After the date on which Commission regulations implementing this action take effect, only an eligible telecommunications carrier designated under section 214(e) shall be eligible to receive specific Federal universal service support. A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. *Any such support should be explicit and sufficient to achieve the purposes of this section.*

Id. (emphasis added).

202. *Texas Office*, 183 F.3d at 425.

203. *See id.*

204. *Id.* (quoting Universal Service First Report & Order, *supra* note 181, ¶ 854).

205. *See id.*

206. *See id.*

207. *See id.*

208. *See id.* at 435.

209. *Id.* at 433.

nondiscriminatory" provisions of § 254(d).[210] The court held that the FCC's discretion to "balance the competing concerns set forth in section 254(b), which include the need for sufficient revenues to support universal service," did not reasonably justify the inequitable and discriminatory result.[211]

4. Authority to Assess Contributions on Intrastate Revenues.—Similar to the "no disconnect" rule, the FCC's practice of assessing universal service contributions based upon both interstate and intrastate rules was challenged on the ground that the FCC exceeded its jurisdiction by regulating intrastate service in violation of the proscription in § 2(b).[212]

The FCC first argued that its practice merely factored intrastate revenue into universal service contributions and that, in any event, carriers could only recover universal service contributions from interstate rates.[213] Thus, the FCC's practice did not constitute a regulation within the proscription set forth in § 2(b) or the rule in *Louisiana PSC*.[214] However, looking to the express language of § 2(b),[215] the court rejected the FCC's argument and held that "the inclusion of intrastate revenues in the calculation of universal service contributions easily constitutes a 'charge . . . in connection with intrastate communications service.'"[216]

The FCC then contended that § 254 did in fact unambiguously apply to intrastate matters.[217] Specifically, the FCC cited the language of § 254(d) concerning interstate carrier universal service contributions[218] and the language set forth in § 254(f) requiring that state adopted universal service mechanisms not "rely on or burden Federal universal service support mechanisms,"[219] and argued that a comparison of the statutory provisions evidences Congress' intent that the FCC "bear the primary responsibility for ensuring the sufficiency of universal service for both interstate and intrastate universal service."[220] The court found that the language in §§ 254(d) and (f) did not constitute an unambiguous grant of authority sufficient to withstand the proscription in § 2(b).[221]

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210. *Id.* Section 254(d) provides in relevant part that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service." 47 U.S.C. § 254(d) (Supp. III 1997).

211. *Texas Office*, 183 F.3d at 434.

212. *See id.* at 446-47.

213. *See id.* at 447.

214. *See id.*

215. *See* 47 U.S.C. § 152(b) (1994).

216. *Texas Office*, 183 F.3d at 447 (quoting § 2(b)).

217. *See id.*

218. *See id.*

219. *Id.*

220. *Id.*

221. *See id.* In declining to defer to the FCC on this issue, the court compared its analysis under § 2(b) and *Louisiana PSC* to the traditional analysis under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

While under *Chevron* step-two, we usually give the agency deference in its

On October 8, 1999, the FCC released its response to *Texas Office*,[222] and implemented the following revisions to its rules regarding universal service:

> * Incumbent LECs may recover their universal service contributions through interstate access charges or through interstate end-user charges. To the extent an incumbent LEC is currently recovering its universal service contributions through interstate access charges, and chooses to recover its contribution through an interstate end-user charge, it must make a corresponding reduction in its interstate access charges to avoid any double recovery.
>
> * Contributions to the FCC's universal service program will be assessed on providers of interstate telecommunications services using a single contribution factor based on providers' interstate and international end-user telecommunications revenues. As directed by the court, the FCC removed intrastate end-user telecommunications revenues from the assessment base for the schools and libraries and rural health care support mechanisms.
>
> * Consistent with the court's decision, the FCC is no longer able to prohibit local telephone companies that are eligible for universal service support from disconnecting Lifeline service to consumers that fail to pay toll charges.
>
> * In response to the court's remand of this issue, providers of interstate telecommunications service whose interstate end-user telecommunications revenues account for less than 8 percent of their combined interstate and international end-user telecommunications revenues are not required to contribute on the basis of their international revenues. These providers are still required to contribute on the basis of their interstate end-user telecommunications revenues.[223]

C. State Universal Service Proceedings

In Indiana, universal service has been the subject of an ongoing and active

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> interpretation of ambiguous statutory language, the Supreme Court continues to require the agency to overcome the § 2(b) statutory presumption with unambiguous language showing that the statute applies to intrastate matters.

Texas Office, 183 F.3d at 447.

222. *See* Universal Service First Report and Order, *supra* note 181; Access Reform First Report and Order, *supra* note 182; Sixteenth Order on Reconsideration in CC Docket No. 96-45, Eighth Report and Order 96-45, Sixth Report and Order, 96-262, *In re* Federal-State Joint Board on Universal Service, 15 F.C.C.R. 1679 (released Oct. 8, 1999).

223. *FCC Implements Court's Decision on Universal Service*, Report No. 99-46, 1999 FCC LEXIS 5021, at *3-4 (Oct. 8, 1999).

proceeding before the IURC.[224] Within the survey period, the IURC issued several orders[225] concerning universal service and access charge reform. The following is a brief discussion of three major orders in the universal service docket, also known as the "trilogy" of orders.[226]

1. Comparability/Affordability Order.—This Order examined the standards that the IURC should adopt to ensure that rates for services included in the FCC's definition of universal service are consistent with the affordability principles set forth in § 254(b)(1)[227] and § 254(i),[228] and with the comparability principles set forth in § 254(b)(3).[229] The following is a brief description of the IURC's findings:

(a) Finding a formal adoption to be in the public interest, the IURC adopted each of the principles set forth in § 254(b),[230] including the principle of "competitive neutrality," which was adopted by the FCC as an additional universal service principle under the grant of authority contained in §

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224. *See In re* Matter of the Investigation on the Commission's Own Motion Into Any and All Matters Relating to Access Charge Reform and Universal Service Reform, Including, But Not Limited to, High Cost or Universal Service Funding Mechanisms Relative to Telephone and Telecommunications Services Within the State of Indiana Pursuant to: I.C. 8-1-2-51, 58, 59, 69; 8-1-2.6 et seq. and Other Related Statutes, as well as the Federal Telecommunications Act of 1996 (47 U.S.C. Sec. 151, et seq.), No. 40785, 1999 WL 236854 (Ind. U.R.C. Feb. 1, 1999).

225. These orders include the "trilogy" of orders issued in Cause No. 40785: September 16, 1998 ("Comparability/Affordability Order"), October 28, 1998 ("Loop Allocation/254(k) Order"), and December 9, 1998 ("Access Reform Order"). Other orders issued in Cause No. 40785 in the survey period include: *In re Universal Service Reform*, No. 40785, 1999 WL 236854 (Ind. U.R.C. Feb. 1, 1999) (concerning the Transitional DEM Weighting Fund and Indiana High Cost Fund) and on December 29, 1998 (concerning the mirroring of interstate carrier access tariffs). *See* Sue E. Stemen, Esq., Ameritech Indiana, *Telecommunications Update—Indiana State Bar Association*, April 16, 1999.

226. Following the issuance of the "trilogy" of orders, the IURC initiated three subdockets to investigate Indiana's three largest ILECs, Ameritech Indiana, GTE, and Sprint United, and their compliance with § 254(k) and the IURC's orders issued in Cause No. 40785. *See In re* Investigation on the Commission's Own Motion into Any and All Matters to Access Charge Reform and Universal Service Reform, No. 40785-S2, 2000 Ind. PUC LEXIS 78 (Ind. U.R.C. Jan. 26, 2000); *In re* Investigation on the Commission's Own Motion into Any and All Matters to Access Charge Reform and Universal Service Reform, No. 40785-S3, 2000 Ind. PUC LEXIS 35 (Ind. U.R.C. Jan. 26, 2000); *In re* Investigation on the Commission's Own Motion into Any and All Matters to Access Charge Reform and Universal Service Reform, No. 40785-S1, 1999 Ind. PUC LEXIS 59 (Ind. U.R.C. Apr. 7, 1999).

227. *See* 47 U.S.C. 254(b)(1) (1994).

228. Section 254 provides: "Consumer Protection.—The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable." 47 U.S.C. § 254(i) (Supp. III 1997).

229. *See* Comparability/Affordability Order, *supra* note 225, at *1.

230. *See* 47 U.S.C. § 254(b).

254(b)(7).[231]

(b) The IURC found that quality of service standards under § 254(b)(1),[232] applied to more than those services found by the FCC to be eligible for universal service support.[233] The IURC stated that § 254(b)(1) establishes a policy that "applies to all states and to the following services: interexchange services; advanced telecommunications services; information services; and basic telephone services."[234] The IURC justified the application of § 254(b)(1) to the additional services because "if Congress had intended section 254(b)(1) to apply only to the supported universal services, it would not have been necessary to include a separate protection for these services in § 254(i) of the Act."[235] The IURC found that service quality standards found in 170 IAC 7-1.1-1 should apply to the provisioning of universal service,[236] and noted that under current statutory provisions,[237] the IURC retained the authority to monitor local providers' service quality.[238]

(c) The IURC then considered that standards to be adopted to ensure that the services and rates for universal service met the "comparability" standards set forth in § 254(b)(3).[239] The IURC adopted a standard whereby "people in urban and rural or high cost areas or those with low incomes pay pretty much the same for services that are pretty much the same," and "[g]enerally available services at the price generally available in urban areas is the standard of comparison."[240] Further, no single set of "reasonably comparable" rates should apply statewide for all providers, because allowing such could potentially "disincent competitive entry by other local service providers in both urban and non-urban areas and thus would be inconsistent with one of the prime tenets of TA 96."[241] The IURC determined that these standards should be considered "concurrently with a specific LEC's section 254 rate rebalancing as a measurement of the

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231. Comparability/Affordability Order, *supra* note 225, at *10.

232. *See* 47 U.S.C. § 254(b).

233. These services include: "[v]oice grade access to the public switched network; local usage; dual tone multifrequency ('DTMF') signaling or its functional equivalent; access to emergency services; access to operator services; access to interexchange services; access to directory assistance; and toll limitation for qualifying low-income customers." Comparability/Affordability Order, *supra* note 225, at *10 (citing 47 C.F.R. § 54.101(a) (1998)).

234. *Id.*

235. *Id.*

236. *See id.* (citing IND. ADMIN. CODE tit. 170, r. 7-1.1-1 (1996)). The IURC did however note that its rules regarding service quality were more than 20 years old, and thus were probably inadequate given technological advances. *See id.* at *11. The IURC directed an agent to initiate an investigation of service quality with the goal of identifying necessary revisions to the service quality rules. *See id.*

237. *See, e.g.*, IND. CODE §§ 8-1-2-58; 8-1-2-69 (1998).

238. *See* Comparability/Affordability Order, *supra* note 225, at *11.

239. *Id.* at *12.

240. *Id.*

241. *Id.*

reasonableness of any such proposal in the pricing of universal service."[242]

(d) Finally, Regarding the appropriate standard(s) for "affordability" under §§ 254(b)(1) and 254(i), the IURC considered factors set forth in the Universal Service First Report and Order including "subscribership levels, in conjunction with rates for other services (such as local and toll) and certain non-rate factors" such as the size of calling scope, consumer income levels, cost of living, population density, and local variations in rate design.[243] Citing the lack of competition in Indiana, the IURC was unable to set an absolute affordability level.[244] Nevertheless, based in part on evidence concerning current service penetration levels, the IURC concluded that rates in Indiana *are* affordable.[245] Regarding § 254(i), which specifically addresses services eligible for universal service support,[246] the IURC defined the term "affordable"to mean

> that the package of supported universal services should be available at a price that all consumers are able to pay, and that no individual consumer should bear a substantial burden in order to subscribe to the universal service package. An affordable rate, for the purposes of Section 254(i), must be defined from the perspective of the individual consumer and should not depend on the cost of providing universal service to that consumer.[247]

The IURC also concluded that affordability can also be accomplished through existing Lifeline and Link-Up programs targeted to low-income customers.[248]

2. Loop Allocation/254(k) Order.—On October 28, 1998, the IURC issued the second, and largest, in its "trilogy" of Orders[249] in an effort to establish guidelines for carriers seeking to rebalance their rates to comport with the provisions of § 254(k).[250] Although space constraints preclude an analysis and technical explanation of the IURC's findings, the reader should know that the

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242. *Id.* at *13.

243. *Id.* (citing Universal Service First Report & Order, *supra* note 181, ¶¶ 114-117).

244. *See id.*

245. *See id.* at *13.

246. *See* 47 U.S.C. § 254(i) (Supp. III 1997).

247. Comparability/Affordability Order, *supra* note 225, at *14 (citing Testimony filed on behalf of the Office of the Utility Consumer Counselor).

248. *See id.*

249. *See* Loop Allocation/254(k) Order, *supra* note 225.

250. Section 254(k) provides:

> (k) Subsidy of Competitive Services Prohibited.—A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The IURC, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

47 U.S.C. § 254(k).

Loop Allocation/254(k) Order contains findings concerning the following issues: the IURC's confiscation liability; the services to be included in the definition of universal service; the first sentence of § 254(k) prohibiting subsidization of non-competitive services by competitive services; and the second sentence of § 254(k) concerning cost allocation and joint and common costs.[251]

3. Access Reform Order.—On December 9, 1998, the IURC issued the last in its "trilogy" of orders. In the Access Reform Order, the IURC sought to address issues concerning intrastate access charge reform for price cap non-rural ILECs "prior to implementing or approving company-specific "rate rebalancing" plans."[252]

The IURC also addressed a possible process for implementing intrastate access charges when and if mirroring of interstate access charges is discontinued, and addressed issues related to interexchange services and rates with regard to § 254(g)[253] of the Act. Similar to the Loop Allocation/254(k) Order, an analysis of the IURC's findings requires a discussion of underlying technical issues that are beyond the scope of this article. However, the following is a very brief summary of the IURC's findings.

(a) The IURC adopted legal definitions concerning "telecommunications service" and "intrastate access," and determined that in the context of section 8-1-2-88.6(b) of the Indiana Code, "'interexchange carrier' is a provider of telecommunications services 'between exchanges,' and includes both interLATA and intraLATA carriers."[254]

(b) In order to comply with the objectives of § 254(g), e.g., that rates for interexchange services for rural or high-cost customers shall not be higher than the rates to customers in urban areas,[255] the IURC found that "all Indiana retail intrastate interexchange toll rates are to be geographically averaged."[256] However, the IURC recognized that the switched carrier access structure mirrored by some ILECs includes some geographic deaveraging, and allowed continued deaveraging of such provided that this practice does not cause a

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251. *See generally* Loop Allocation/254(k) Order, *supra* note 225.

252. Access Reform Order, *supra* note 225, at 1-2.

253. Section 254(g) provides:

> (g) Interexchange and Interstate Services.—Within 6 months after the date of enactment of the Telecommunications Act of 1996, the Commission shall adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates not higher than the rates charged to its subscribers in any other State.

47 U.S.C. § 254(g).

254. Access Reform Order, *supra* note 225, at 10.

255. *See id.*

256. *Id.*

violation of § 254(g).[257]

(c) Regarding mirroring, the IURC found that it would be appropriate "to mirror the *structure* of interstate access charges on an interstate basis, as that structure has been reformed by the FCC."[258] However, the IURC discontinued the practice of mirroring interstate access charge *rate levels*.[259] Consistent with these findings, the IURC ordered Indiana ILECs "to mirror the structure, relationship between recurring and non-recurring charges, and the terms and conditions of interstate access services in the cost studies filed with the Commission as part of their company-specific rate-rebalancing cases."[260]

(d) While citing the findings set forth in the Loop Allocation/254(k) Order, the IURC noted that intrastate access charges are now included within the category of services regulated by the IURC, but not included within the definition of universal service, and a company is free to allocate the joint and common costs of these services as it sees fit subject to IURC approval. Additionally, the IURC stated that a company can use any cost basis and methodology for cost studies presented to the IURC, so long as the same methodology is used for any confiscation claims.[261] Accordingly, the IURC rejected claims that access charge rates must be based on the cost of unbundled network elements using the TELRIC methodology.[262]

(e) Finally, regarding a requirement that IXCs, ILEC toll providers, and other intrastate toll providers pass through decreases in access charge rate levels, the IURC found that a "demonstration of such pass through for interLATA toll providers" and for "toll providers in areas where intraLATA equal access has been implemented" is not required at this time.[263] However, the IURC expressly stated that it may revisit this issue in the future.[264] Moreover, the IURC found that reporting requirements showing the benefits of access charge reductions passed through to the customers may be necessary, and that such reporting requirements would be considered in company-specific rate compliance proceedings.[265]

III. The Merger Between SBC and Ameritech

One of the most significant and publicized developments in Indiana law during the survey period concerned whether section 8-1-2-83(a) of the Indiana Code[266] gave the IURC authority to approve the merger (worth approximately

257. *See id.* at 11.
258. *Id.*
259. *See id.*
260. *See id.* at 13.
261. *See id.* at 11.
262. *See id.*
263. *Id.* at 12.
264. *See id.*
265. *See id.*
266. IND. CODE § 8-1-2-83(a) (1998) provides in relevant part:

$60 billion) between SBC Communications Corporation ("SBC") and Ameritech Corporation ("Ameritech").[267] On an Emergency Petition to Transfer, the Indiana Supreme Court appropriately answered this question in the negative in *Indiana Bell Telephone Co. v. Indiana Utility Regulatory Commission.*[268]

Prior to the merger, Ameritech was the corporate parent and holding company of Indiana Bell Telephone Company Incorporated d/b/a Ameritech Indiana ("Ameritech Indiana").[269] Ameritech Indiana is the public utility that operates sixty-five percent of the local exchange telephone access lines in Indiana.[270] The transaction between SBC and Ameritech involved a merger between Ameritech and a wholly-owned subsidiary of SBC and a stock-swap whereby Ameritech shareholders transferred shares of Ameritech stock to SBC in exchange for shares of the SBC subsidiary.[271] The transaction transferred control of Ameritech Indiana to SBC, though Ameritech Indiana itself did nothing to effectuate the transaction. Upon closing, Ameritech Indiana became a wholly-owned subsidiary of Ameritech, which, in turn, became a wholly-owned subsidiary of SBC.[272] Ameritech Indiana remains "the same regulated

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> No public utility, as defined in section 1 [IND. CODE § 8-1-2-1] of this chapter, shall sell, assign, transfer, lease, or encumber its franchise, works or system to any other person, partnership, limited liability company, or corporation, or contract for the operation of any part of its works or system by any other person, partnership, limited liability company, or corporation, without the approval of the commission after hearing.

Id.

267. This issue also affected the proposed merger between GTE Corporation and Bell Atlantic Corporation.

268. 715 N.E.2d 351 (Ind. 1999). *See also* GTE Corp. v. Indiana Util. Regulatory Comm'n, 715 N.E.2d 360 (Ind. 1999) (upholding the decision in *Indiana Bell* unanimously and denying the IURC jurisdiction under section 8-1-2-83(a) of the Indiana Code to approve the merger between GTE Corporation and Bell Atlantic Corporation).

269. *See Indiana Bell*, 715 N.E.2d at 353. Ameritech was also the corporate parent and holding company of the operating telephone public utilities in Michigan, Wisconsin, Ohio, and Illinois. *See id.*

270. *See id.*

271. *See id.*

272. *See id.* Generally, such mergers also require approval by the FCC. The Ameritech/SBC merger has been approved by the FCC subject to certain conditions. *See In re* Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Section 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules, 14 F.C.C.R. 14,712 (released Oct. 8, 1999). Other mergers currently pending before the FCC include mergers between MCI WorldCom and Sprint, US West and Qwest, AT&T and TCI, and GTE Corporation and Bell Atlantic Corporation. For more information concerning these mergers, see *Merger of Common Carriers Requiring FCC Approval* (visited June 12, 2000) <http://www.fcc.gov/ccb/mergers.html>.

Additionally, some states have enacted statutes that specifically require approval by state commissions of the transfer of a controlling interest in a utility such as the SBC/Ameritech merger.

utility . . . with the same assets and liabilities, the same customers and suppliers, and the same corporate structure and capitalization."[273]

In September 1998, the IURC issued an Order initiating an investigation of the merger under sections 8-1-2-58, 83, and 84 of the Indiana Code, and for the purposes of filing comments with the FCC on the grounds that "we believe the merger of SBC, which also operates various telephone subsidiaries in Indiana, with Ameritech Indiana's parent could affect the state of telephone competition in Indiana, and might also impact employment levels, quality of service, and even rates . . . ."[274] Following eight months of investigation, the IURC issued an Order on May 5, 1999, asserting jurisdiction to approve or disapprove the merger pursuant to section 83(a).[275] In doing so, the IURC overruled its own prior precedent[276] and distinguished Indiana Supreme Court precedent[277] holding that section 83(a) of the Indiana Code does not provide the IURC with jurisdiction to approve transfers of stock. The IURC stated:

> Prior Commission decisions to the contrary notwithstanding, we thus find a transaction in which at least fifty percent of a public utility's voting capital stock is sold, transferred, etc. necessarily constitutes a sale transfer, etc. of that public utility's franchise, works, or system. And when a corporation qualifies as a public utility under I.C. 8-1-2-1(a) and a transaction would involve the sale, assignment, transfer, lease or encumbrance of a majority of the voting capital stock in that corporation to some other person or corporation, we find that Section 83(a) requires our review of the proposed transaction.[278]

Respondents SBC, Ameritech, and Ameritech Indiana appealed.[279]

The Appellants argued that the express language of section 83(a) clearly evinces the legislative intent that transactions at the holding company level

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See Indiana Bell, 715 N.E.2d at 357. The state commissions of Illinois and Ohio both approved the merger between SBC and Ameritech. *See id.*

273. *Id.* at 354.

274. *In re* Ameritech Corp., No. 41255, 1998 WL 999989, at *1 (Ind. U.R.C. Sept. 2, 1998).

275. *See Indiana Bell*, 715 N.E.2d at 353.

276. *See In re* Dalecarlia Util. Corp., No. 38827 (Ind. U.R.C. Apr. 11, 1990); *In re* Madison Light & Power Co., 1924C P.U.R. 517 (PISC 1994).

277. *See* Office of the Util. Consumer Counselor v. Public Serv. Co., 608 N.E.2d 1362 (Ind. 1993) [hereinafter OUCC v. PSI].

278. *In re* Investigation on the Commission's Own Motion into All Matters Relating to the Merger of Ameritech Corp. and SBC Communications, Inc., No. 41255, at *5-6 (Ind. U.R.C. May 5, 1999).

279. Under section 8-1-3-1 of the Indiana Code, final orders of the IURC are appealed to the Indiana Court of Appeals. *See* IND. CODE § 8-1-3-1 (1998). However, in this case, the Indiana Supreme Court granted an Emergency Petition to Transfer filed by Respondents SBC, Ameritech and Ameritech Indiana pursuant to Indiana Appellate Rule 4(A)(9) and set an expedited briefing schedule. *See Indiana Bell*, 715 N.E.2d at 353.

involving transfers of stock not be regulated by the IURC.[280] The IURC and Office of the Utility Consumer Counselor ("OUCC") argued that the merger is the "functional equivalent of a transfer of all of [Ameritech Indiana's] assets to SBC" and that the merger would shift "control" of Ameritech Indiana from Ameritech to SBC.[281] Thus, the IURC and OUCC argued that the IURC had jurisdiction to approve or disapprove the merger.[282]

The court first looked to the express language of section 83(a) of the Indiana Code, and examined the meanings of "public utility" and "franchise, works, or system."[283] The court noted that "public utility" is expressly defined in section 8-1-2-1(a) of the Indiana Code to mean an entity "that may own, operate, manage, or *control* any plant or equipment within the state."[284] The court held that while this language could be interpreted to include within the definition of "public utility" an entity that has "control" of the plant or equipment through stock ownership, "a very sizeable body of precedent points in the other direction."[285] Including holding companies within the definition of public utilities "would effect a major change in relatively settled doctrine," calling into question several past transactions involving holding companies.[286] Furthermore, the court noted that if holding companies are public utilities within the statutory definition, then "a vast number of very public violations of these sections have been committed over the years in full view of the [IURC], the courts and the General Assembly" without concern evidencing the "common understanding" that holding companies are not public utilities within the statute.[287]

Next, the court analyzed what constitutes the "franchise, works, or system" of the utility. Noticeably absent from the phrase "franchise, works, or system" it is the term "stock."[288] Therefore, a transfer of outstanding shares of stock should not fall within the mandate of section 83(a). This is precisely how the Indiana Supreme Court interpreted the language in section 83(a) in *OUCC v. PSI*.[289] There, the court held that section 83(a) did not give the IURC authority to approve a transaction that involved PSI's creation of a holding company in which shares of the operating company were exchanged for shares of the holding company.[290] Appellees attempted to distinguish this precedent on the grounds that the transaction at issue in *OUCC v. PSI* did not involve a transfer in control of the utility, because following the transaction the same shareholders, the board

280. *See id.* at 354.
281. *Id.*
282. *See id.*
283. *Id.* at 355-56.
284. *Id.* at 355 (emphasis added) (quoting IND. CODE § 8-1-2-1).
285. *Id.*
286. *Id.*
287. *Id.*
288. *Id.* at 355-56.
289. *See id.* at 356 (citing OUCC v. PSI, 608 N.E.2d 1362 (Ind. 1993)).
290. *See id.*

of directors and management still controlled.[291] While the court agreed that the *OUCC v. PSI* transfer differed from the merger between SBC and Ameritech in this respect, the court noted that the rationale in *OUCC v. PSI* concerned the fact that the object of the transfer—the stock—was not the "franchise, works, or system" of a public utility and *not* whether there was an absence of a "transfer."[292] Accordingly, the court rejected Appellees' distinction and reaffirmed the holding of *OUCC v. PSI* "that transactions by a public utility's shareholders do not require [IURC] approval."[293]

The court rejected Appellees' arguments that section 83(a) should be read to apply to stock transactions because it should be construed in *pari materia* with sections 83(b) and (d), which both expressly refer to the "stock" of a public utility.[294] However, the fact that sections 83(b) and (d) each expressly refer to "stock" led the court to the opposite conclusion that the general assembly consciously excluded "stock" from the transaction affected by section 83(a) because "the General Assembly knows how to say stock when it means stock."[295]

The court was also persuaded by Appellants' presentation of the legislative history of section 83(a), which according to the court, "embodies a specific choice by the legislature not to require approval of shareholder transactions. . . . [T]he General Assembly has repeatedly made the conscious decision not to include holding companies within the definition of 'public utility.'"[296] In the 1920s and 1930s, abuse of the holding company structure was "rampant," and the General Assembly was called upon on three separate occasions to regulate public utility holding companies.[297] On each occasion, the General Assembly declined to extend the statutory definition of "public utility" to include holding

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291. *See PSI*, 608 N.E.2d at 1364.

292. *Id.*

293. *Id.* The court also rejected the IURC's reliance on *Illinois-Indiana Cable Television Association, Inc. v. Public Service Commission*, 427 N.E.2d 1100 (Ind. Ct. App. 1981) finding the opinion to have "no bearing on a transfer by shareholders of a public utility's holding company." *Indiana Bell*, 715 N.E.2d at 359. Even if the case did have bearing, the opinion is a court of appeals opinion superseded by the Indiana Supreme Court's holding in *OUCC v. PSI*. *See id.* at 359. Additionally, the court rejected the OUCC's reliance on *In re Central Vermont Public Service Commission*, 84 P.U.R.4th 213 (F.E.R.C. 1987) which held that the Federal Energy Regulatory Commission ("FERC") had jurisdiction over the creation of a holding company by the sale of a utility's stock under the Federal Power Act. *See Indiana Bell*, 715 N.E.2d at 359.

294. *Id.* at 356. IND. CODE § 8-1-2-83(b) (1998) provides in relevant part: "No such public utility shall directly or indirectly purchase, acquire, or become the owner of any of the property, stock, or bonds of any other public utility . . . unless authorized to so by the commission." *Id.* IND. CODE § 8-1-2-83(d) provides in relevant part: "Every contract by any public utility for the purchase, acquisition, assignment, or transfer to it of any of the stock of any other public utility . . . without the approval of the commission shall be void and of no effect . . ." *Id.*

295. *Indiana Bell*, 715 N.E.2d at 356.

296. *Id.*

297. *Id.* at 357.

companies.[298] In 1933, however, the General Assembly enacted a statute, now codified at section 8-1-2-49 of the Indiana Code, authorizing the IURC[299] to investigate a public utility's affiliates.[300] The court concluded that:

> In light of the three failed attempts in the preceding six years to include holding companies in the definition of public utility, this addition must be viewed as a compromise that brought holding companies under limited scrutiny of the Commission by providing access to affiliate information, but did not go so far as to subject them to all requirements imposed on a public utility. In short, we agree with appellants that section 49 "reflects a continued legislative choice to use indirect, rather than direct, regulation of holding companies."[301]

Turning to the IURC's prior precedent interpreting section 83(a), the court noted that as recently as 1990 the IURC held that it does not have jurisdiction to approve stock transfers at the shareholder level.[302] Although the IURC has recently approved several transactions involving holding companies, each case concerned a *voluntary* request for approval by the public utility and its holding company parent, and thus the issue of the IURC's section 83(a) jurisdiction was not questioned or litigated.[303] Such voluntary submission to the IURC's jurisdiction does not affect the scope of the IURC's statutory jurisdiction under section 83(a).[304] The IURC further argued that it is not bound by its prior decisions and that the change in interpretation of its jurisdiction under section 83(a) is necessary "in order to avoid the 'shipwrecking justice' in light of the 'modern economic reality that holding-company transactions . . . are the method *du jour* by which control of utilities is transferred.'"[305] Although the court agreed that the IURC is not bound by its prior rulings, it held that the legislative history demonstrates that the IURC's authority under section 83(a) had been resolved by the General Assembly and the issue is not open to administrative or judicial interpretation.[306]

Similarly, the court found that the doctrine of legislative acquiescence lent

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298. *Id.* (citing 1925 JOURNAL OF THE STATE SENATE OF INDIANA, 11-12, 178-79; Senate Bill 18, 74th General Assembly (Ind. 1925); 1929 JOURNAL OF THE STATE HOUSE OF REPRESENTATIVES OF INDIANA, 448-49; and 1931 JOURNAL OF THE STATE SENATE OF INDIANA, 121, 621-22).

299. At that time, the IURC was called the Public Service Commission of Indiana.

300. *See Indiana Bell*, 715 N.E.2d at 357 (citing ACTS OF THE INDIANA GENERAL ASSEMBLY, 1933, ch. 190, § 6.)

301. *Id.*

302. *See id.* (citing *In re* Dalecarlia Util. Corp., No. 38827, 1990 Ind. PUC LEXIS 114, at *4 (Ind. U.R.C. Apr. 11, 1990).

303. *See id.* at 358 (citing *In re* Frontier Corp., No. 40205, 1995 WL 735627 (Ind. U.R.C. July 12, 1995); *In re* Rochester Tel. Corp., No. 40099, 1995 Ind. PUC LEXIS 40 (Ind. U.R.C. Feb. 8, 1995)).

304. *See id.*

305. *Id.* (citation omitted).

306. *See id.* at 358, 360.

credence to the IURC's prior precedent holding that it did not have jurisdiction under section 83(a):

> [W]e assume that if the General Assembly were dissatisfied with the Commission's long-standing interpretation of section 83(a) or this court's decision in *PSI*, it would have amended the Act to include holding companies in the definition of "public utility," or to regulate transactions in control of a utility regardless of the parties to this transaction.[307]

The court further dismissed arguments by the IURC that Appellants could not rely upon the doctrine of legislative acquiescence without a showing of detrimental reliance.[308] The court stated that even if Appellants could not make such a showing, a holding that the IURC has jurisdiction to approve or disapprove stock transfers at the holding company level would have profound implications on transactions by other holding companies relying upon the previous IURC precedent.[309]

Finally, citing the potential for abuse by holding companies, Appellees argued that public policy requires that the IURC have jurisdiction to approve or disapprove transactions such as the merger between SBC and Ameritech in order to adequately protect the interests of the ratepayers.[310] The court conceded that such public policy arguments were "compelling"[311] and that authorizing the IURC to approve or disapprove such mergers may indeed be more effective and efficient in protecting the interests of ratepayers.[312] Nonetheless, such "arguments are for the General Assembly, not this Court or the [IURC]."[313]

IV. OPPORTUNITY INDIANA

Another proceeding that was before the IURC and the Indiana Court of Appeals during the survey period concerned Ameritech Indiana's alternative regulation under section 8-1-2.6 of the Indiana Code[314] commonly known as

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307. *Id.* at 358.

308. *See id.*

309. *See id.* at 358-59.

310. *See id.* at 360.

311. *Id.*

312. *See id.*

313. *Id.* On October 6, 1999, the IURC issued an order acknowledging that given the Indiana Supreme Court's decision, it did not have jurisdiction to approve or disapprove the merger.

314. IND. CODE § 8-1-2.6 is hereinafter referred to as the "alternative regulation statute." "Alternative regulation" refers to a manner of regulation different than regulation under a traditional rate of return methodology. *See* IND. CODE §§ 8-1-2.6-1, -8 (1998). For a discussion of traditional rate of return methodology, see *City of Evansville v. Southern Indiana Gas & Electric Co.*, 339 N.E.2d 562, 568-71 (Ind. App. 1975). IND. CODE § 8-1-2.6-1(5) authorizes the IURC to

> formulate and adopt rules and policies as will permit the commission, in the exercise of its expertise, to regulate and control the provision of telephone services to the public in

> an increasingly competitive environment, giving due regard to the interests of consumers and the public and to the continued availability of universal telephone service.

Id. IND. CODE § 8-1-2.6-2 allows the IURC to decline to exercise jurisdiction over telephone companies or services providing in relevant part:

> (a) Notwithstanding any other statute, the commission may . . . enter an order, after notice and hearing, that the public interest requires the commission to commence an orderly process to decline to exercise, in whole or in part, its jurisdiction over telephone companies or certain telephone services.
>
> (b) In determining whether the public interest will be served, the commission shall consider:
>
> (1) Whether technological change, competitive forces, or regulation by other state and federal regulatory bodies render the exercise of jurisdiction by the commission unnecessary or wasteful;
>
> (2) Whether the exercise of commission jurisdiction produces tangible benefits to telephone company customers; and
>
> (3) Whether the exercise of commission jurisdiction inhibits a regulated entity from competing with unregulated providers of functionally similar telephone services or equipment.

Id. IND. CODE § 8-1-2.6-3 authorizes the IURC to adopt alternative regulatory procedures and provides in relevant part:

> Notwithstanding any other statute, the commission may . . . adopt rules or by an order in a specific proceeding provide for the development, investigation, testing, and utilization of regulatory procedures or generic standards with respect to telephone companies or services. The commission shall adopt the rules or enter an order only if it finds, after notice and hearing, that the regulatory procedures or standards are in the public interest and promote (1) or more of the following:
>
> (1) Telephone company cost minimization to the extent that a telephone company's quality of service and facilities are not diminished.
>
> (2) A more accurate evaluation by the commission of a telephone company's physical or financial conditions or needs, as well as a less costly regulatory procedure for either the telephone company, its consumers, or the commission.
>
> (3) Development of depreciation guidelines and procedures that recognize technological obsolescence.
>
> (4) Increased telephone company management efficiency beneficial to consumers.
>
> (5) Regulation consistent with a competitive environment.

Opportunity Indiana. The proceedings before the IURC resulted in the Final Order on Interim Relief ("Final Order")[315] that changed the way Ameritech Indiana was regulated under Opportunity Indiana, required a rate reduction for residential and business basic local services, and ordered Ameritech Indiana to comply with infrastructure investment commitments that were a part of the settlement agreement that established Opportunity Indiana.[316] Ameritech Indiana appealed the Final Order,[317] and on October 14, 1999, the Indiana Court of Appeals issued its opinion in *Indiana Bell v. OUCC*.[318]

First and foremost, the court held that the IURC unlawfully ordered Ameritech Indiana to reduce its rates for residential and business basic local services.[319] In the Opportunity Indiana proceedings, the IURC was not acting pursuant to its traditional rate making authority,[320] but rather pursuant to the authority contained in the alternative regulation statute.[321] Consequently, in adopting the alternative regulation and rate reduction in the Final Order, the IURC was required to act according the provisions set forth in section 8-1-2.6-3.[322] These provisions require the IURC to provide an opportunity for notice and hearing prior to adopting any alternative regulatory standards, to find that the alternative regulatory standards are in the public interest, and to find that the

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Id.

315. Ameritech Indiana's original alternative regulatory plan under Opportunity Indiana expired on December 31, 1997. Under the terms of the settlement agreement establishing Opportunity Indiana, the earliest date Ameritech Indiana could petition for a "successor" alternative regulatory plan was May 1, 1997. *See* Indiana Bell Tel. Co. v. Office of Util. Consumer Counselor, 717 N.E.2d 613, 618 (Ind. Ct. App. 1999). On May 1, 1997, Ameritech Indiana petitioned the IURC for such relief. However, there was not enough time to establish a permanent alternative regulatory plan prior to the expiration of Opportunity Indiana 1. The IURC directed Ameritech Indiana to proceed on the issue of what interim relief should apply pending the IURC's final order on permanent alternative regulatory relief. *See id.* On December 30, 1997, the IURC issued the Final Order on Interim Relief which was the subject of the appeal discussed below." *See generally id.* The background and specifics of Opportunity Indiana will not be covered in this article. However, the court's opinion in *Indiana Bell v. OUCC* does an excellent job of succinctly stating the factual and procedural history of Opportunity Indiana, and the reader is referred to the court's opinion for further background information. *See id.* at 616-20.

316. *See In re* Petition of Indiana Bell Telephone Co. d/b/a Ameritech Indiana for the Commission to Decline to Exercise in Whole or in Part its Jurisdiction Over, and to Utilize Alternative Regulatory Procedures for, Ameritech Indiana's Provision of Retail and Carrier Access Services Pursuant to I.C. 8-1-2.6 *et seq.*, No. 40849, 1999 WL 590486 (Ind. U.R.C. Dec. 30, 1997).

317. The OUCC cross-appealed.

318. *See Indiana Bell*, 717 N.E.2d at 613.

319. *See id.* at 624-25.

320. Under its traditional ratemaking authority, if the IURC finds that rates are unjust or unreasonable, it is authorized to fix "just and reasonable rates" for the future. *See* IND. CODE § 8-1-2-68 (1998).

321. *See Indiana Bell*, 717 N.E.2d at 622.

322. *See id.*

alternative regulatory standard promotes at least on of the standards set forth in section 8-1-2.6-3.[323]

The court found that the IURC did not comply with the notice and hearing requirements before adopting the alternative regulation and rate reduction.[324] Ameritech Indiana's Petition for Interim Relief requested that if an order on permanent relief could not be issued prior to the expiration of Opportunity Indiana, that the alternative regulatory procedures contained in Opportunity Indiana continue in the interim.[325] While notice and a hearing were provided to determine whether interim relief was *appropriate*, notice and a hearing concerning the *adoption* of an alternative regulatory standard were not provided.[326] According to the court, this was not sufficient to meet the notice and hearing requirements of section 8-1-2.6-3:

> We interpret the statute as requiring the Commission to give notice of the specific alternative regulatory procedure it is considering with sufficient specificity to allow interested parties to present evidence and participate in a hearing on that procedure. It is not sufficient for the Commission to give notice that it is considering some undecided form of alternative regulatory procedure.[327]

The court also held that the Final Order did not set forth the requisite findings showing that the alternative regulation and rate reduction are in the public interest and promote the criteria set forth in section 8-1-2.6-3.[328] Accordingly, the court held the Final Order to be contrary to law and reversed and remanded the Final Order to the IURC to make a determination as to interim relief consistent with the court's holding.[329]

Pending the IURC's determinations, the court held that Ameritech Indiana's rates on file with the IURC upon the expiration of Opportunity Indiana should remain in place.[330] Under section 8-1-2-44 of the Indiana Code, a public utility must charge the rates on file with the IURC until such rates are changed in accordance with the Public Service Commission Act.[331] Thus, in order to lawfully change Ameritech Indiana's rates, the IURC must act pursuant to either its traditional ratemaking authority or through section 8-1-2.6-3, which as

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323. *See id.*

324. *See id.*

325. *See id.*

326. *See id.* at 622-23. The IURC's preliminary order on interim relief set a procedural schedule that included an evidentiary hearing to consider additional evidence on the form that interim relief should take. *See id.* at 622. This procedural schedule was subsequently vacated, prefiled testimony was stricken, and parties were directed to submit briefs based on the existing record. *See id.* at 623.

327. *Id.*

328. *See id.* at 624.

329. *See id.*

330. *See id.* at 625.

331. *See id.* (citing IND. CODE § 8-1-2-44 (1998)).

discussed, requires the opportunity for notice and hearing.[332]

Citing section 8-1-2-68 of the Indiana Code, which provides that the IURC may fix just and reasonable rates only to be applied in the *future*,[333] the court further rejected OUCC's argument that Ameritech Indiana's interim rates should be subject to further review and refund.[334] It is settled law in Indiana that the IURC may not engage in retroactive ratemaking,[335] and thus, the IURC is not authorized "to fix Ameritech[] [Indiana's] rates on an interim basis, rescind those rates after further review and require any overcharges to be returned to consumers."[336]

Finally, the court disagreed with Ameritech Indiana that the Final Order was contrary to law because it effectively "rewrites" Ameritech Indiana's infrastructure investment commitments in the Opportunity Indiana settlement agreement.[337] Specifically, the evidence in the proceedings before the IURC showed that Ameritech Indiana only provided $15.6 million in infrastructure investments out of the agreed "$20 million per year for each year 1994-1999 to provide digital switching and transport facilities . . . to every interested school, hospital and major government center . . ."[338] Ameritech Indiana argued, however, that it was unable to generate interest in schools, hospitals, and government centers sufficient to meet this obligation.[339] The IURC was not persuaded, and found that Ameritech Indiana failed to comply with its infrastructure investment obligation.[340] The IURC stated that if Ameritech Indiana "has trouble generating sufficient interest, it should try harder, perhaps with the advice and assistance of other parties to the Settlement Agreement . . . or to otherwise propose some other means for its shareholders to provide infrastructure improvements consistent with (the terms of Opportunity Indiana)."[341]

The court agreed with the IURC and found that Ameritech Indiana "undertook an *unconditional* commitment to make certain infrastructure investments that would be in effect for the six-year period of 1994 through 1999," and upheld the Final Order in this respect.[342] While the court agreed with Ameritech Indiana that it would be error for the IURC to impose upon Ameritech Indiana infrastructure commitments not specified in the Opportunity Indiana

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332. *See id.*

333. *See* IND. CODE § 8-1-2-68.

334. *See Indiana Bell*, 717 N.E.2d at 625.

335. *See id.*

336. *Id.*

337. *See id.* at 625-26.

338. *Id.* at 626.

339. *See id.*

340. *See id.*

341. *Id.* (citation omitted).

342. *Id.* (emphasis added).

settlement agreement, the Final Order "merely states that Ameritech [Indiana] may propose alternative methods by which it might provide the required infrastructure investments in a manner which would comply with the terms and the intent of Opportunity Indiana."[343]

343. *Id.* at 627 n.12. The court discussed the potential contract liability of Ameritech Indiana. Finding the Opportunity Indiana settlement agreement to be properly enforced according to the general principles of contract law, the court held that Ameritech Indiana's failure to provide the infrastructure investments could be construed as a breach of contract. The court stated that if the IURC found such breach, Ameritech Indiana could be liable for damages and be required "to return to the public of over $100 million in funds which were supposed to be made available for infrastructure improvements as well as any damages which might be proven by other settling parties under Opportunity Indiana." *Id.* at 627-28 n.12.