

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE PETITION OF MCI FOR EXEMPTION)
FROM THE REGULATION FOR ENHANCED) CASE NO. 92-552
SERVICES)

O R D E R

In its December 16, 1992 petition for exemption, MCI Telecommunications Corporation ("MCI") contests the Commission's prima facie finding that the provision of intrastate enhanced services falls within the Commission's jurisdiction. MCI, incorporating by reference its September 3, 1991 response, asserts that: (1) The Commission lacks jurisdiction to regulate MCI's enhanced services under both federal and Kentucky law because of the predominantly interstate nature of enhanced services; (2) MCI's provision of enhanced service in Kentucky involves transmissions between Kentucky users and out-of-state processors that act on the call; (3) Even if the Commission could legally exercise its jurisdiction over interstate services, the Commission should exercise restraint to avoid discrimination between interexchange ("IXC") carrier and noncarrier enhanced service providers; and (4) Regulation of IXC enhanced service providers would adversely affect the public interest by stifling the entry of potential enhanced service providers. MCI also asserts that regulation is not practical given the broad assortment of enhanced services and that

MCI may have no means for identifying the location of an end-user of any specific enhanced service call.

STATUTORY BASIS FOR COMMISSION JURISDICTION

Before the Commission can determine whether the enhanced services of MCI or any other utility should be exempted from its jurisdiction, the Commission must first determine that it has jurisdiction over the intrastate provision of enhanced services. The Commission has jurisdiction over utilities, statutorily defined as,

any person except a city, who owns, controls or operates or manages any facility used or to be used for or in connection with the transmission or conveyance over wire, in air or otherwise, of any message by telephone or telegraph for the public, for compensation.

"Facility" includes

all property, means and instrumentalities owned, operated, leased, licensed, used, furnished or supplied for, by, or in connection with the business of any utility.

KRS 278.010(3)(e) and (9) and 278.040. Based on this broad language of the Kentucky statute, the Commission has jurisdiction to regulate any intrastate enhanced service call.

Intrastate calls, subject to the jurisdiction of the Commission, are those which originate and terminate within the Commonwealth of Kentucky. The routing of the call by the telephone utility outside of Kentucky, or the storage of information by the utility outside of Kentucky, does not change the call into an interstate call.

CALIFORNIA V. FCC: NINTH CIRCUIT'S REVERSAL

The Federal Communications Commission ("FCC") preempted state regulation of enhanced services through its Computer Inquiry III proceeding (amendment of Sections 64.702 of the Commission Rules and Regulations, CC Docket No. 85-229). However, the Ninth Circuit in People of the State of Cal. v. F.C.C., 905 F.2d 1217 (1990), reversed the FCC's decision and remanded the proceeding back to the FCC. The Ninth Circuit traces the history of structural separations found in the Second Computer Inquiry proceedings, 77 F.C.C. 2d 384 (F.C.C., 1980), which were "designed to protect the integrity of two distinct markets - the unregulated market for enhanced services and the regulated market for basic telephone service," 905 F.2d at 1228. The Court then states that the FCC "reversed course and announced its intention to relieve the BOCs [Bell Operating Companies] of the separation requirements." Id. The FCC concluded that the cost of separation exceeded the public benefits and "proposed to replace the requirement with accounting and other nonstructural regulations." Id. at 1229.

The regulatory goals resulting from structural separation could be achieved, according to the FCC, by two non-structural safeguards. First, the FCC would develop cost allocation methods to minimize the BOCs' ability to shift costs from their unregulated to regulated activities. Second, the FCC adopted regulations specifically designed to prevent the BOCs from exercising their market power and providing network access to discriminate against competing providers of enhanced services. This antidiscrimination

regulation had three prongs: (a) an open network policy requiring BOCs to make the network as accessible to competitors as to the BOCs; (b) requiring BOCs to notify competitors of changes in the network that may affect their provision of enhanced services; and (c) requiring BOCs to provide competitors with information about customer use of the telephone network. Id.

The Ninth Circuit held that it was arbitrary and capricious for the FCC to "abandon structural separation and rely on cost accounting regulations to provide regulatory protection for ratepayers and competitors against the harmful affects of cross-subsidization." Id. at 1238.

In addition to separation requirements, Computer Inquiry III preempted nearly all state regulation of the sale of enhanced services by communications common carriers.

The FCC orders had precluded state regulators from three areas: (1) tariffing of enhanced services sold by communications carriers; (2) requiring communications carriers to maintain structural separation from their basic and enhanced service operations; and (3) requiring nonstructural safeguards that are inconsistent or more stringent than the FCC's nonstructural safeguards. In the Ninth Circuit case, the State of California asserted that the FCC preemption orders violated §2(b)(1) of the Communications Act which denies FCC jurisdiction with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication

service by wire or radio of any carrier. 47 U.S.C. §152(b)(1).
Id. at 1239. (Emphasis added.)

Quoting Louisiana Public Service Commission v. FCC, 476 U.S. 355 at 370, the Ninth Circuit stated that the sphere of state authority which the Communications Act "fences off from FCC reach or regulation" includes at a minimum services that are delivered by a telephone carrier in connection with its intrastate common carrier telephone services. According to the Ninth Circuit, "as long as enhanced services are provided by communications carriers over the intrastate telephone network, the broad 'in connection with' language of §2(b)(1) placed them squarely within the regulatory domain of the state." 905 F.2d at 1240. The Ninth Circuit, thus, rejected any distinction between basic and enhanced services when establishing jurisdiction. Accordingly, §2(b)(1) of the Communications Act fences off from FCC reach or regulation intrastate communications applicable to enhanced services as well as basic services.

Next, the Ninth Circuit addressed the "impossibility" exception to the §2(b)(1) restrictions on the FCC's preemption authority. The FCC had argued that its preemption of state-imposed structural separation requirements and some state-imposed nonstructural safeguards was valid because such state regulations could not feasibly coexist with the Computer Inquiry III scheme. Id. at 1242. The Ninth Circuit recognized the impossibility exception to §2(b)(1) but, quoting NARUC v. F.C.C., 880 F.2d 422, 429, stated that this exception was a "limited one" and that "the

FCC bears the burden of justifying its entire preemption order by demonstrating that the order is narrowly tailored to preempt only such state regulation as would negate valid FCC regulatory goals." 905 F.2d at 1243.

The Ninth Circuit reversed the FCC's preemption of state structural separation requirements (not an issue here in Kentucky) because the FCC neglected to address "the possibility that enhanced services may be offered on a purely intrastate basis." Id. at 1244.

Concerning the FCC preemption of state nonstructural safeguards, the Ninth Circuit held that the record failed to support the FCC's preemption of (1) all state nonstructural safeguards applicable to AT&T and the BOCs which are inconsistent with the nonstructural safeguards imposed on AT&T and the BOCs by the FCC; and (2) all state nonstructural safeguards applicable to the independent communications carriers that are more stringent than those imposed by the FCC on AT&T and the BOCs. Id. The Ninth Circuit held that "an argument that state regulation will negate valid federal purposes in 'many' cases does not suffice to justify preemption of all state regulations in an area. The impossibility exception to §2(b)(1) is a narrow one that may be invoked only when state and federal regulation cannot feasibly coexist." Id.

In conclusion, the Ninth Circuit held that the FCC failed to carry its burden of showing that its preemption orders are necessary to avoid frustrating its regulatory goals and therefore

vacated the Computer Inquiry III orders and remanded to the FCC for further proceedings consistent with this opinion. Id. at 1246.

COMPUTER INQUIRY III REMAND PROCEEDINGS

Next, we turn to consideration of the FCC's Computer Inquiry III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards. CC Docket No. 90-623 released December 20, 1991 ("Remand Proceedings"). The FCC on remand declined to preempt all the state regulation preempted in Computer Inquiry III but did preempt certain forms of state regulation that would thwart or impede federal objectives. Id. at paragraph 1.

The Ninth Circuit concluded that the FCC could have justified its preemption decision on the grounds that the national interest in allowing the BOCs to compete more efficiently in the enhanced services industry justified reduced regulatory protection against cross-subsidization. Lacking this finding, the Ninth Circuit held that the FCC acted arbitrarily in removing structural separation safeguards and preempting state regulation of enhanced services. Id. at paragraph 4.

In response to the Ninth Circuit, the FCC adopted a strengthened set of cost accounting safeguards which in its opinion constitute an effective alternative to structural separation to protect against cross-subsidization. Also, the FCC adopted various safeguards against discrimination including network disclosure rules, nondiscrimination reporting requirements, and revised Customer Proprietary Network Information (CPNI) rules. Id. at paragraph 10.

The FCC first addressed cross-subsidization safeguards. It concluded that the strengthened system of cost accounting safeguards protects ratepayers against cross-subsidization by BOCs. This system consists of five principal parts: (1) effective accounting rules and cost allocation standards; (2) filed cost allocation manuals reflecting the established rules and standards; (3) independent audits of carrier cost allocations, requiring a positive opinion that the carriers' allocations comply with the manuals; (4) detailed reporting requirements and the development of an automated system to store and analyze the cost data; and (5) on site audits by FCC Staff. Id. at paragraph 46.

Next, the FCC addressed non-structural safeguards to protect independent enhanced service providers from possible BOC discrimination in access to underlying basic services. These included (1) open network architecture as adopted by the FCC in December 1990; (2) the Computer III nondiscrimination reporting requirements; (3) Computer III network information disclosure rules; and (4) CPNI disclosure rules. Id. at paragraph 57.

The Remand Proceeding also discusses preemption issues at length. The FCC stated that:

Preemption of state regulation in this area should be as narrow as possible to accommodate differing state views while preserving federal goals. In this proceeding, we preempt state requirements for structural separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services, state CPNI rules requiring prior authorization that is not required by our rules, and state network disclosure rules that require initial disclosure at a time different than the federal rule. These state rules would thwart or impede the nonstructural safeguards pursuant to which

AT&T, the BOCs, and the independents may provide interstate enhanced services and the federal goals that they are intended to achieve. We do not preempt the other state safeguards, which we will review if necessary, on a case-by-case basis.

Id. at paragraph 121. (Emphasis added.)

According to the FCC, state structural separation requirements that apply to purely intrastate enhanced services or that merely require a separate corporate entity with separate books of accounts for the intrastate portion of jurisdictionally mixed enhanced services would not thwart federal objectives, but state requirements for separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services would thwart the FCC's objectives and therefore such requirements were preempted. Id. at paragraph 122.

The FCC has found that for a state commission to require separate corporate entities with separate books of account for the intrastate portion of jurisdictionally mixed enhanced services would not thwart the federal objective and, therefore, would not be preempted. This affords the Kentucky Commission latitude in regulating enhanced services. The FCC states that it is not now persuaded that a state requirement for a separate corporate entity with separate books of account for the provision of the intrastate component of a jurisdictionally mixed enhanced service would thwart federal objectives. Id. at paragraph 128.

The FCC determined that carrier implementation of a state's "prior authorization" rule for CPNI where it is not required under the federal rule would effectively require the separation of

marketing and sales personnel dealing with interstate enhanced services from personnel dealing with interstate basic services. Access to CPNI permits integrated marketing of enhanced services and permits the efficient use of carrier resources to provide enhanced services to the mass market. Thus, the FCC preempted state CPNI rules applicable to the BOCs, AT&T, and independents that require prior authorization whenever such authorization is not required by the FCC's rules. No other aspects of state CPNI rules were preempted. Id. at paragraph 130.

Last, the FCC addressed the preemption network disclosure rules for information affecting the interconnection of enhanced service providers. The FCC has required that carriers disclose such network interface information at the "make/buy point." The FCC has preempted state network disclosure rules that require initial disclosure at a time different than the FCC rule, but the FCC did not preempt any state rule that required disclosure of different or broader information and will address these situations on a case-by-case basis. Id. at paragraph 131.

Thus, the FCC Remand Proceeding has left to the states the regulation of enhanced services under a number of circumstances.

CONCLUSION

Based on the FCC's decision on remand from the Ninth Circuit, regulation of intrastate enhanced service calls by the Kentucky Commission is not preempted, provided the regulation does not thwart narrowly defined federal objectives.

The Kentucky Commission does have jurisdiction over the intrastate portions of this jurisdictionally mixed service and can construct reasonable regulations regarding the intrastate portions.

MCI alternately requests in its petition that intrastate enhanced services be exempted from Commission regulation pursuant to the exemption statute and briefly discusses the criteria listed in KRS 278.512. MCI shall address each of the criterion identified in KRS 278.512 and provide additional data to support its petition for exemption from regulation. Upon receipt of this information, the Commission will weigh each of the components and determine the appropriate regulatory status for MCI's enhanced services in Kentucky.

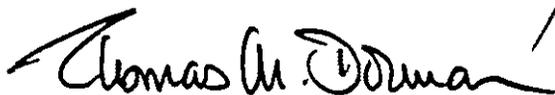
The Commission, having been otherwise sufficiently advised, HEREBY ORDERS that:

1. MCI shall specifically and separately address each criterion identified in KRS 278.512 and shall provide data to support its views no later than April 21, 1993.
2. Requests for information to MCI from the Commission and any intervenors shall be due no later than May 12, 1993.
3. MCI shall mail or deliver responses to the requests for information no later than June 2, 1993.
4. Any request for a public hearing shall be due no later than June 9, 1993.

Done at Frankfort, Kentucky, this 26th day of March, 1993.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director