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May 25, 2000

RECEIVED
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY MESSENGER

Magalie Roman-Salas
Secretary, Federal Communications Commission
445 12th Street S.W.
Washington DC 20554

Re: *In the Matter of American Communications Services, Inc. and MCI Telecommunications Corp.*, Petitions for Expedited Declaratory Ruling Preempting Arkansas Telecommunications Regulatory Reform Act of 1997 Pursuant to Sections 251, 252, and 253 of the Communications Act of 1934, as amended.
CC Docket No. 97-100.

Dear Ms. Roman-Salas:

Enclosed for filing in the above referenced proceeding, please find an original and four comments of the *Ex Parte* Comments of MCI WORLDCOM Network Services, Inc. An extra copy has also been included to be file stamped and returned.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Jodie L. Kelley

Jodie L. Kelley

Enclosure

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Re: *In the Matter of American Communications Services, Inc. and MCI Telecommunications Corp.*, Petitions for Expedited Declaratory Ruling Preempting Arkansas Telecommunications Regulatory Reform Act of 1997 Pursuant to Sections 251, 252, and 253 of the Communications Act of 1934, as amended.
CC Docket No. 97-100.

EX PARTE COMMENTS OF MCI WORLDCOM NETWORK SERVICES, INC.

Dear Ms. Roman-Salas:

In 1997, Arkansas enacted a statute designed to shield incumbent local exchange carriers from the competition Congress sought to foster in passing the Telecommunications Act of 1996 ("the 1996 Act").[1/] The Arkansas' Telecommunications Regulatory Reform Act of 1997 ("the Arkansas Act")[2/] was designed to preserve the monopoly of Arkansas' incumbent local exchange carriers ("ILECs"). After MCI WorldCom Network Services, Inc. ("MCI WorldCom") (formerly MCI Telecommunications Corp.) filed a request seeking preemption of the Arkansas

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1/ Pub. L. No. 104-104, 110 Stat. 56 (1996). The Act is codified throughout Title 47 of the United States Code.

2/ Codified at Ar. St. § 23-17-401 *et seq.* Relevant provisions of the Arkansas Act are cited by section number.

Act, the Federal Communications Commission struck down the bulk of its provisions. *See In the Matter of American Communications Services, Inc. and MCI Telecommunications,,* Memorandum Opinion and Order, 14 F.C.C.R. 21,579 (1999) ("Arkansas Order"). The Commission asked for further comment on Sections 4 and 5 of the Arkansas Act, Ar. St. §§ 23-17-404 & 23-17-405, which dealt with universal service. *See* Arkansas Order ¶ 112.

The challenged universal service provisions are flatly anticompetitive. They make it difficult – and in some instances, impossible – for competing carriers to enter local markets, guarantee incumbents higher subsidies than their competitors for providing the same service, and subject new carriers to regulatory burdens that incumbents are free to ignore. For these reasons, MCI WorldCom joins Western Wireless Corporation and CenturyTel, Inc. in requesting preemption of these provisions and respectfully submits these *ex parte* comments to supplement their comments.

I. THERE ARE TWO SEPARATE LEGAL GROUNDS FOR PREEMPTING THE UNIVERSAL SERVICE PROVISIONS OF THE ARKANSAS ACT.

Two independent legal grounds require the Commission to preempt Sections 4 and 5 of the Arkansas Act. First, the Supremacy Clause of the United States Constitution allows an agency acting within the scope of its congressionally delegated authority to preempt state or local laws where "there is outright or actual conflict between federal and state law, where compliance with both federal and state law is in effect physically impossible . . . or where the state law stands as an obstacles to the accomplishment and execution of the full objectives of Congress." *Louisiana Public Service Comm'n v. FCC*, 476 U.S. 355, 368-69 (1986). To avoid preemption under this standard "it is not enough to say that the ultimate goal of both federal and state law is the same. A state law . . . is also preempted if it interferes with the *methods* by which the federal statute was designed to reach that goal." *Gade v. National Solid Wastes Management Ass'n*, 505 U.S. 88, 103 (1992).

Second, Arkansas' universal service provisions should be preempted pursuant to Section 253 of the 1996 Act, which specifies that no state or local law "may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." 47 U.S.C. § 253(a). Under this standard, a state law must be preempted whenever it "erect[s] barriers to entry that would potentially frustrate the 1996 Act's explicit goal of opening local markets to competition." *In the Matter of the Public Utility of Texas*, Memorandum Opinion and Order, 13 F.C.C.R. 3460 ¶ 41 (1997) ("Texas Order"). That means that the Commission should "preempt not only express restrictions on entry, but also restrictions that indirectly produce that result." *Id.*

Although Section 253(b) grants the states limited authority to adopt rules "necessary to preserve and advance universal service," states may do so only if those rules are imposed "on a competitively neutral basis and consistent with Section 254." 47 U.S.C. § 253(b). Thus, if a state law "favors incumbent LECs over new entrants (or vice-versa)," that fact "suffices of itself to disqualify [it] from the 253(b) exception" and requires its invalidation. *In the Matter of AVR, L.P.*, Memorandum Opinion and Order, 14 F.C.C.R. 11064 ¶¶ 16, 18 ("Tennessee Order").

II. THE CHALLENGED UNIVERSAL SERVICE PROVISIONS SHOULD BE PREEMPTED.

Sections 4(e)(4)(A), 5(b)(1-3), and 5(d) unquestionably fail these two tests for preemption. Each of these provisions treats incumbent LECs more favorably than new entrants. Not only do they represent "express restrictions on entry" that would deter other carriers from entering local markets, but they "indirectly produce that result" by requiring new entrants to compete on different terms than incumbents. Texas Order ¶ 41. Indeed, by favoring incumbents over new entrants, these requirements "materially inhibit[] or limit[] the ability of any competitor or potential competitor to compete in a fair and balanced legal and regulatory environment." Texas Order ¶ 3. Because the universal service provisions of the Arkansas Act plainly "stand[] as an obstacle to the accomplishment and execution of the full objectives of Congress," *Louisiana Public Service Comm'n*, 476 U.S. at 368, they should be preempted under both the Supremacy Clause and Section 253 of the 1996 Act.

A. Section 4(e)(4)(A).

Section 4(e)(4)(A) of the Arkansas Act represents precisely the type of barrier to entry that the 1996 Act forbids. Pursuant to that section, ILECs are guaranteed a fixed revenue stream that is equal to that which the ILEC received from federal universal service support prior to passage of the Arkansas Act. Specifically, section 4(e)(4)(A) provides that if any action is taken by the FCC that results in a reduction in the amount of federal universal service fund revenues available to ILECs, this reduction will be offset by a corresponding rate increase for basic local exchange service, an increase in the ILEC's draw from the Arkansas Universal Service Fund ("AUSF"), or a combination thereof. *See* Ar. St. § 23-17-404(e)(4)(A).[3/] By its own terms, this guaranteed revenue stream is available only to incumbent LECs. This type of discriminatory treatment is facially unlawful.

As this Commission has made clear, *any* state law that treats incumbents differently from new entrants is fundamentally incompatible with the 1996 Act in general and Section 253 in particular. *See* Tennessee Order ¶ 16 (holding that such a law conflicts with the "plain meaning

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3/ The section states that, "[i]n the event of an FCC order, rule or policy, pursuant to Section 254(a)(2) of the Federal Act, (47 USC 254(a)(2)) the effect of which is to change the federal universal service fund revenues of an incumbent local exchange carrier, the Commission shall either increase the rates for basic local exchange service or increase the incumbent local exchange carrier's recovery from the AUSF or a combination thereof to replace the reasonably projected change in revenues." *Id.*

of section 253(b) and the predominant pro-competitive policy of the 1996 Act").[4] That is because Section 253(b) explicitly requires "competitive neutrality among the entire universe of participants and potential participants in the market." *Id.* And to be competitively neutral,"universal support mechanisms and rules [must] neither unfairly advantage nor disadvantage one provider over another . . ." *In re Federal-State Joint Board on Universal Service*, Report and Order, 12 F.C.C.R. 8776 ¶ 47 (1997) ("Universal Service Order"). Thus, the principle of competitive neutrality requires preemption of any state law that "favors incumbent LECs over new entrants." Tennessee Order ¶ 16.

Section 4(e)(4)(A) plainly violates the requirement of competitive neutrality. Pursuant to this section, incumbent LECs receive not only a guaranteed revenue stream, they are entitled to the same revenue stream they received when they were a monopoly, serving every customer in a low-cost area. In sharp contrast, new entrants receive no guaranteed revenue stream at all, and certainly receive no guarantee that they'll receive the amount that an ILEC received when it

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4/ Some commentators have argued that § 4(e)(4)(A) should not be preempted because the ILEC's net revenue will be maintained through state programs, and thus this revenue guarantee is consistent with Section 254(f)'s requirement that the state regulation "not rely on or burden Federal universal service support mechanisms." *See* Comments of CenturyTel, Inc. at 12 (Feb. 18, 2000); Comments of Rural Arkansas Telephone Systems at 7 (Feb. 18, 2000). That argument misses the point; the Arkansas Act's revenue guarantee is discriminatory in violation of Section 253. And as Section 253 itself makes clear, a state regulation is preempted if it violates that section, whether or not it also violates Section 254(f).

operated as a monopolist.[5/] Simply put, this provision is flatly indefensible.[6/] Accordingly, § 4(e)(4)(A) should be preempted.

B. Section 5(a).

Like Section 4(e)(4)(A), Section 5(a) of the Arkansas Act is invalid on its face because it expressly treats incumbents differently from new entrants for purposes of state and federal universal service.[7/] Section 5(a) provides that "an incumbent local exchange carrier" is automatically "the eligible telecommunications carrier" for purposes of receiving universal service funding. Ar. St. § 23-17-405(a). New entrants, in sharp contrast, must satisfy no fewer than five conditions in order to be eligible for state and federal funding. *Id.* § 23-17-405(b). These conditions include building stand-alone facilities throughout a service area, advertising, and satisfying the Commission that their eligibility for funding is in the public interest. *Id.*

This provision violates the principle of competitive neutrality and frustrates the pro-competitive goals of the 1996 Act. It cannot be squared with the Act's requirement of competitive neutrality because it subjects new entrants to costly and burdensome preconditions for obtaining universal service funding while giving incumbents a free pass. And, as a practical

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5/ The Arkansas Telecommunications Association asserts that this is a "hold-harmless" provision akin to those adopted by the FCC. *See* Comments of the Arkansas Telecommunications Association at 6 (Feb. 18. 2000). That assertion is wrong. The FCC's hold-harmless rule is competitively neutral, providing the same level of funding to new entrants and incumbents. *See In the Matter of Federal-State Joint Board on Universal Service*, Ninth Report and Order, 1999 WL 993655 ¶ 85 (Nov. 2, 1999) ("Ninth Report and Order"). Arkansas' rule is facially non-neutral.

6/ The Arkansas Act is not a model of clarity, and there is a small chance that this Section could be interpreted to guarantee that incumbent LECs will receive the same amount per customer as they had received prior to passage of the Arkansas Act, even if the FCC reduces those rates. Under that interpretation, of course, new entrants would not be entitled to this higher rate per customer. Thus, this interpretation of Section 4(e)(4)(A) (which no party has advanced) is equally unlawful. Such a regime would effectively preclude new entrants from competing with incumbents in high cost areas, because the incumbent would *always* receive greater universal service funding for providing precisely the same services. This, too, would facially violate the requirement of competitive neutrality, and would clearly impede the ability of new entrants to compete in high cost areas in Arkansas.

7/ The assertion that incumbents have been vetted by the Arkansas Public Service Commission in other circumstances, *see* Comments of the Arkansas Telecommunications Association at 8 (Feb. 18. 2000), does not excuse the state's failure to require incumbents to meet the same statutory obligations as their counterparts entering the market.

matter, this differential treatment makes it more difficult for new entrants to compete on a level playing field with incumbents. Section 5(a) thus "materially inhibit[s] or limit[s] the ability of any competitor or potential competitor to compete in a fair and balanced legal and regulatory environment." Texas Order ¶ 3. Accordingly, established FCC precedent mandates preemption here. *Id.*[8/]

C. Sections 5(b).

Sections 5(b)(1), (2), and (3) must also be invalidated. Each of these provisions materially limits the ability of new entrants to compete in high-cost areas, is fundamentally incompatible with the pro-competitive aims of the 1996 Act, and is squarely foreclosed by FCC precedent.

1. Sections 5(b)(1) & (2).

Sections 5(b)(1) and 5(b)(2) impermissibly require new entrants to build their own facilities in order to qualify for universal service funding. Section 5(b)(1) requires a new entrant seeking universal service funding to serve all the customers in an ILECs' local exchange area "using its own facilities or a combination of its own facilities and resale of another carrier's services." Ar. St. § 23-17-405(b)(1). And Section 5(b)(2) specifies that a "telecommunications provider may only receive funding for the portion of its facilities that it owns and maintains." Ar. St. § 23-17-405(b)(2).[9/] Under the Arkansas Act, then, a carrier cannot obtain full universal service funding if it relies even in part on UNEs or resale to serve its customers.

The plain text of the Act and established FCC precedent require preemption of each of these provisions. First, the Commission has already deemed preempted a state requirement identical in all relevant respects to that challenged here. In the Texas Order, this Commission preempted a Texas law requiring a competitive carrier to build its own facilities, expressly holding that "[a]

8/ Depending on the size of the local exchange areas chosen by the state at the time it makes eligibility determinations, Section 5(a) could also be preempted on a second ground. As the Commission has observed, if universal service obligations are imposed in too large a service area, they will result in an undue burden on competitive entry. *See* Universal Service Order ¶¶ 184-85. Moreover, those requirements are anticompetitive at least as applied to wireless carriers. *See* Comments of Western Wireless Corporation at 5 (Feb. 18, 2000).

9/ This section of the Arkansas Act is not subject to the same limiting construction the FCC has applied to the phrase "own facilities" in Section 214(e)(1). With regard to Section 214(e)(1), the FCC has held that this phrase encompasses facilities leased under Section 251(c)(3). *See* Universal Service Order ¶ 154. But the state attorney general has already construed the "facilities" phrase in Sections 5(b)(1) and (2) of the Arkansas Act as requiring ownership of stand-alone facilities. *See* Reply Comments of Arkansas Attorney General at 6 (Mar. 3, 2000) (conceding that Section 5(b)(2) is designed to "encourage[] investment in facilities").

state may not . . . require that an entity provide telecommunications services via its own facilities." Texas Order ¶ 91. As the Commission made clear in that Order, "Section 253(a) bars states or local requirements that restrict the means or facilities through which a party is permitted to provide service." Texas Order ¶ 74.

This conclusion is the only one consistent with the mandates of the 1996 Act. The Act is premised on the assumption that there should be three independent routes of entry into the local market: facilities-based competition, leasing of network elements, and resale. *See* 47 U.S.C. § 251(c)(4); *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 791 (8th Cir. 1997), *affirmed in relevant part sub nom AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999); Texas Order ¶ 75. Any effort to handicap one or more of these congressionally mandated routes of entry cannot be squared with the mandates of Sections 251 and 214. *See* Texas Order ¶ 91; *see also Gade*, 505 U.S. at 103 ("A state law . . . is preempted if it interferes with the *methods* by which the federal statute was designed to reach that goal."). To the contrary, Section 251 requires that "new entrants . . . be able to choose whether to resell incumbent LEC services, obtain incumbent LEC unbundled network elements, utilize their own facilities, or employ any combination of these options." Texas Order ¶ 75. Accordingly, Section 214 mandates that a carrier may obtain federal universal service support for services offered "using . . . a combination of its own facilities and resale of another carrier's services." 47 U.S.C. § 214(e)(1)(a).

The Arkansas provisions thus thwart the Act's goals by "erecting barriers to entry that would potentially frustrate the 1996 Act's explicit goal of opening local markets to competition." Texas Order ¶ 41. In effect, the Arkansas Act requires every company that wishes to obtain universal-service support to build complete, stand-alone networks throughout the state. As was true of similar rules adopted in Texas to promote facilities-based competition, such a requirement would ensure that entry into high-cost markets "is not economically viable" and therefore would "have the practical effect of prohibiting [a new entrant] from providing service." Texas Order ¶ 82. In short, the Arkansas provisions should be preempted for precisely the same reasons that comparable provisions adopted in Texas were invalidated; they "expressly and directly restrict[] the ability of [new entrants] to provide service to end users by reselling incumbent LEC services or by using unbundled network elements." Texas Order ¶ 77.

2. Section 5(b)(3).

Section 5(b)(3) represents another example of Arkansas' improper efforts to shield incumbents from the threat of competition. It provides that a new entrant "will not receive [Arkansas universal service] funding at a level higher than the level of funding received by the incumbent local exchange carrier in the same area." Ar. St. § 23-17-405(b)(3). That means that if a new entrant provides better, cheaper service than the incumbent in high-cost areas and thus wins the majority of customers in those areas, it will nonetheless receive *less* state universal-service support than the incumbent. Even more remarkably, under the plain terms of the statute, if a new entrant were able to win *all* customers in a high-cost area, the incumbent – which provides *no* service there – would nonetheless receive more universal service funding than the new entrant.

This patently anticompetitive practice must be preempted. First, Section 5(b)(3) unquestionably violates the principle of competitive neutrality by guaranteeing incumbents more universal service funds than their competitors even if they serve fewer high-cost customers. That fact "suffices of itself to disqualify [it] from the 253(b) exception" and requires invalidation under Section 253. Tennessee Order ¶¶ 16, 18.

Moreover, Section 5(b)(3) plainly "stands as an obstacles to the accomplishment and execution of the full objectives of Congress." *Louisiana Public Service Comm'n*, 476 U.S. at 369. Congress intended the 1996 Act to bring full and robust competition to local markets "as quickly as possible." H.R. Rep. No. 104-204, at 89 (1995). That goal is plainly thwarted by a funding mechanism that *guarantees* one company more revenues than another even if it serves fewer customers.[10/]

D. Section 5(d).

Finally, Section 5(d) of the Arkansas Act must be invalidated. Section 5(d) provides that, for purposes of both the Arkansas and federal universal service fund, "for the entire area served by a rural telephone company . . . there shall be only one eligible telecommunications carrier which shall be the incumbent local exchange carrier that is a rural telephone company." Ar. St. § 23-17-405(d). Further, "the rural telephone company may elect to waive its right to be the only eligible telecommunications carrier within the local exchange area." *Id.* Thus, Arkansas has not only granted rural incumbents a monopoly franchise in their service areas, it has left it entirely to the incumbent's discretion whether rural markets will ever be open to competition.

Once again, settled FCC precedent requires preemption here. As the Commission has already explained, state efforts to guarantee rural carriers a monopoly are fundamentally inconsistent with the 1996 Act. That is because state requirements that "shield the incumbent LEC from competition by other LECs . . . are not competitively neutral, and therefore do not fall within the reservation of state authority set forth in section 253(b)." Tennessee Order ¶ 12.

10/ Assuming that Section 5(a) is preempted and ILECs and new entrants are equally subject to the public-interest determination required by Section 5(b)(5), at this time the FCC need not decide whether to preempt Section 5(b)(5), which provides that a carrier will not be deemed eligible for universal service funding unless "it is determined by the commission that the designation is in the public interest." Ar. St. § 23-17-405(b)(5). The FCC should, however, declare that it will preempt the public interest requirement (1) if the state implements it in a discriminatory or anticompetitive manner, or (2) the state fails to designate more than one eligible carrier in a given non-rural territory.

"'Competitive neutrality' for purposes of 253(b) does not countenance absolute exclusion" of competitors from the market. *Id.* ¶ 17. To the contrary, no matter what justification a state may offer for statutorily excluding competitors from rural areas, "outright bans of competitive entry are never 'necessary' to preserve and advance universal service within the meaning of section 253(b)." *Id.* ¶ 18; *see also* Texas Order ¶¶ 107-08. Thus, the FCC's rulings in Tennessee and Texas mandate preemption here.

The FCC's Wyoming decision is also squarely on point. In Wyoming, as here, the state had granted rural incumbents "the ability to block the grant of [a Certificate of Public Convenience and Necessity to] potential competitors." *In the Matter of Silver Star Telephone Company, Inc.*, 12 F.C.C.R. 15,639 ¶ 38 (1997) ("Wyoming Order"). There, as here, the "state statutory provision favors certain incumbent LECs over all potential new entrants and allows those incumbent LECs, entirely at their own discretion, to determine if and when they will face competition." *Id.* ¶ 42.[11/] Thus, the Wyoming statute, like Arkansas' provision, granted the incumbent "the ultimate competitive advantage – preservation of monopoly status – and saddles new potential entrants with the ultimate competitive disadvantage – an insurmountable barrier to entry." *Id.*

As the Commission explained in invalidating the Wyoming provision, "section 253(a), at the very least, proscribes State and local legal requirements that prohibit all but one entity from providing telecommunications services in a particular state or locality." *Id.*[12/] The Commission also flatly rejected Wyoming's view that its protective ban in competition was consistent with the protections Congress afforded to rural carriers – precisely the arguments offered to defend Section 5(d) during this proceeding. *See, e.g.,* Reply Comments of the Arkansas Telecommunications Association at 8 (Mar. 3, 2000). Indeed, the Commission found that, far from supporting the view that a state can grant an outright monopoly to a rural carrier, the protections the 1996 Act affords to rural carriers signal Congress's "intent to preclude States from imposing the far more competitively restrictive protection of an absolute ban on competition." Wyoming Order ¶ 43; *see also id.* ¶ 44. For these reasons, reliance on Section 14(e)(2) cannot shield this patently anticompetitive provision from preemption.

11/ If anything, the Wyoming provision invalidated by the Commission was *less* restrictive than the one challenged here since it expired within a decade. *Id.*

12/ Moreover, even if it were permissible for the state to adopt such a rule, at the very least every carrier – not just the incumbent – should be eligible to compete for that favored position.

CONCLUSION

For the foregoing reasons, the universal service provisions of the Arkansas Act should be preempted.

Sincerely,

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CERTIFICATE OF SERVICE

I, Jodie L. Kelley, do hereby certify that copies of the foregoing "Ex Parte Comments of MCI Telecommunications Corp." were served via first class mail, postage prepaid, to following on May 25, 2000:

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