Federal Preemption of State Universal Service Regulations Under the Telecommunications Act of 1996

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I. INTRODUCTION

Section 254(f) of the Telecommunications Act of 1996 provides that states may adopt regulations "not inconsistent with" the Federal Communications Commission's (FCC or Commission) universal service regulations.[1] After careful analysis of both the new federal universal service regulations and developments in preemption law, this Article develops a legal test for determining whether a state universal service program is in whole or in part "inconsistent with" and thereby preempted by federal law.

Part II of the Article provides a brief overview of the history and policy objectives of the Federal Universal Service Program. Part III provides a brief chronology of the jurisprudence surrounding federal preemption of

1. 47 U.S.C. § 254(f) (Supp. II 1996).

state regulations with a focus on cases dealing with FCC regulations. By combining developed theories of preemption law with the substantive FCC universal service requirements, this Article develops a test for determining whether a state universal service program is "not inconsistent with" the Federal Plan.

Part IV analyzes the Universal Service Program established by the FCC pursuant to the Telecommunications Act of 1996 (1996 Act or Act). In Part V, the proposed test is applied to the Kansas and California universal service plans to determine if any portion of either state plan is preempted. The states selected represent both urban and rural demographics in state universal service regulation.

II. GENERAL OVERVIEW OF UNIVERSAL SERVICE

The goal of the Federal Universal Service Program is to extend telecommunications services "to as many members of society as possible" while providing the necessary funding to support the policy.[2] Although notions of universal service existed prior to the Communications Act of 1934 (1934 Act),[3] the Act evidenced Congress's intent for all consumers to receive telecommunications services at nondiscriminatory prices regardless of the additional costs involved in providing service to rural areas.[4] Under the regulated monopoly regime that existed prior to the breakup of AT&T, companies could internally generate funds to support their universal service responsibilities by cross-subsidizing—that is, using long-distance revenues to amortize the fixed cost of building local service networks. After the divestiture of AT&T separated local and long-distance service provision, carriers increasingly subsidized service in high-cost rural areas with revenues earned in low-cost urban areas and subsidized residential service with business service revenues. Long-distance continued to subsidize local service through switched access charges that local exchange companies assessed on interexchange carriers.

The goal of the 1996 Act is to increase competition in the telecommunications industry at the local service level by removing regulatory barriers to entry. However, promoting competition in local service is at odds with the current method of funding universal service through cross-subsidies. Because the most profitable services, such as business service, attract the most new entrants, competition decreases the profit margin on services typically

2. Eli M. Noam, *Will Universal Service and Common Carriage Survive the Telecommunications Act of 1996?*, 97 COLUM. L. REV. 955, 957 (1997).

3. *See* Mann-Elkins Act of 1910, 36 Stat. 539 (codified in scattered sections of 49 U.S.C.).

4. *See* 47 U.S.C. §§ 151, 201-202 (1994 & Supp. II 1996).

used to subsidize universal service. As incumbents are forced to sell their previously profitable services at more competitive prices, their ability to cross-subsidize diminishes. In addition, new competitive entrants are unable to compete in residential markets and high-cost areas because, unlike the incumbent providers, they do not have a captive customer base to subsidize the provision of such service. Congress attempted to solve this inherent paradox between the goals of competition and universal service by replacing cross-subsidies with explicit subsidies from a universal service fund.[5] The FCC's new universal service plan attempts to transform implicit subsidies into explicit subsidies so that Congress's goal of increasing competition in telecommunications is not achieved at the expense of universal service.

With respect to intrastate service, traditionally, states have the responsibility to ensure that universal service is available at just, reasonable, and affordable rates. Under the Telecommunications Act of 1996, Congress has given states significant responsibility to maintain universal service in a competitive environment.[6] Specifically, section 254(f) of the Act provides:

> State authority
>
> A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. 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

5. Prior to the enactment of the Telecommunications Act of 1996 and the FCC's implementation orders, the Federal Universal Service Program was comprised of both explicit and implicit support mechanisms. Explicit support mechanisms that provided subsidies directly to specific groups of subscribers include Lifeline Assistance, Link Up America, and Telecommunications Relay Services programs. Additional explicit support mechanisms provided support to local exchange carriers (LECs): the Universal Service Fund, the dial equipment minutes weighting subsidy (DEM weighting), the Long Term Support program (LTS), and the Rural Utilities Service (RUS) loan programs. COMMON CARRIER BUREAU, FEDERAL COMMUNICATIONS COMMISSION, PREPARATION FOR ADDRESSING UNIVERSAL SERVICE ISSUES: A REVIEW OF CURRENT INTERSTATE SUPPORT MECHANISMS, Feb. 23, 1996, at 3. Additional explicit subsidies include: (1) the use of the carrier common line charge (CCLC) to recover a portion of the non-traffic sensitive costs of the common line, (2) subscriber line charges (SLCs), (3) study area rate averaging, and (4) the recovery of non-traffic sensitive switching costs on a traffic sensitive basis and the interim transport rate structure. *Id.* Implicit support mechanisms are difficult to identify because a monopoly regime provides mismatches between cost and price and cross-subsidies. Implicit federal universal service support prior to the Act included inflated interstate access charges and business and vertical services priced well above cost.

6. Phillip Rosario & Mark F. Kohler, *The Telecommunications Act of 1996: A State Perspective*, 29 CONN. L. REV. 331, 338-39 (1996).

mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.[7]

State commissions have authority to determine which carriers are eligible to receive universal service support and are subject to universal service obligations, to determine the service area for universal support to nonrural carriers, and to determine when a carrier may be relieved of its universal service obligations.[8] Under the Act, states also may adopt separate state universal service programs, provided that their rules are "not inconsistent with" the FCC's universal service regulations and are supported by "specific, predictable, and sufficient mechanisms . . . that do not rely on or burden Federal universal service support mechanisms."[9] Section 254(f) thus creates a delicate balance between encouraging states to adopt intrastate universal service programs and ensuring that state programs do not interfere with the federal universal service mechanism.

III. A TEST FOR DETERMINING WHETHER STATE UNIVERSAL SERVICE PLANS ARE "NOT INCONSISTENT WITH" SECTION 254(F) OF THE ACT

The following section details preemption law as it applies to section 254(f) of the Telecommunications Act of 1996, and develops a test for determining whether state universal service regulations are "not inconsistent with" the FCC's universal service rules. This section also provides an overview of FCC preemption of state law.

A. Preemption

1. Preemption of State Law by Congress

The Supremacy Clause of the U.S. Constitution provides that federal law is the supreme Law of the Land.[10] The doctrine of preemption derives from the Supremacy Clause and provides that federal law will invalidate state law in some instances.[11] To conclude that a federal law has preemptive effect, there must be evidence of congressional intent.[12] Such intent may be

7. 47 U.S.C. § 254(f) (Supp. II 1996).

8. *Id.* § 214(e)(2)-(4).

9. *Id.* § 254(f).

10. U.S. CONST. art. VI, cl. 2.

11. Marilyn R. Stahl, Note, *Affordable Rates: The Case Against FCC Preemption of Telephone Depreciation*, 35 AM. U. L. REV. 517, 527 (1986) (citing WILLIAM B. LOCKHART ET AL., CONSTITUTIONAL LAW 346 (5th ed. 1980)).

12. *See, e.g.*, Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 152-53 (1982); Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977).

determined by reviewing the history and language of the federal law.[13] If state regulation of an area existed before the federal regulation, there must be a clear showing of congressional intent to preempt.[14] Properly promulgated federal agency regulations that reflect congressional intent have the same preemptive effect as federal laws.[15]

Although commentators argue that preemption law cannot be reduced to general formulas, the common law has defined at least two and possibly three categories of preemption.[16] First, Congress preempts state regulation by expressly providing for such preemption in a federal statute.[17] Second, when express language of Congress's intent to preempt state law is absent from federal law, Congress's intent to preempt state law may be inferred.

A court infers intent to preempt state law in two instances. First, preemptive intent is inferred where Congress has legislated comprehensively so as to occupy an entire field of regulation.[18] In these instances of "field preemption," there is no room for a state to supplement federal law. Second, a court may infer Congress's intent to preempt state law when state law conflicts with federal law. This is known as "conflict preemption." Conflict preemption occurs when it is impossible to comply with both state and federal law.[19] Mere inconsistency with federal law is not sufficient to warrant conflict preemption—the state law must substantially compromise an important federal interest.[20] Conflict preemption also occurs when a state law "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress."[21]

In *Cipollone v. Liggett Group, Inc.*, the Supreme Court addressed two issues integral to delineating the scope of federal preemption of state law.[22] First, the opinion seemed to conclude that express preemptive language precludes a conflict preemption analysis;[23] however, in a later decision, the Court clarified that *Cipollone* does not preclude a conflict preemption

13. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 232-36 (1947).

14. Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 256 (1984).

15. Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 369 (1986); *Fidelity Fed. Sav. & Loan Ass'n*, 458 U.S. at 153; Lincoln Sav. & Loan Ass'n v. Federal Home Loan Bank Bd., 856 F.2d 1558, 1560 (D.C. Cir. 1988).

16. LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 479 (2d ed. 1988).

17. *See, e.g.*, Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 91 (1983).

18. City of New York v. FCC, 486 U.S. 57, 65 (1988).

19. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963).

20. Hisquierdo v. Hisquierdo, 439 U.S. 572, 581 (1979).

21. John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 99 (1993) (quoting Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 248 (1984)); *see also* Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 368-69 (1986).

22. *Cipollone*, 505 U.S. 504 (1992).

23. *Id.* at 517.

analysis where express preemption exists.[24] Second, *Cipollone* provides some indication of the level of intent required in the statutory language before express preemption occurs.[25]

In an attempt to define the interplay between express and conflict preemption, the Court concluded that "Congress' enactment of a provision defining the pre-emptive reach of a statute implies that matters beyond that reach are not pre-empted."[26]

> When Congress has considered the issue of pre-emption and has included in the enacted legislation a provision explicitly addressing that issue, and when that provision provides a "reliable indicium of congressional intent with respect to state authority, . . . there is no need to infer congressional intent to pre-empt state laws from the substantive provisions" of the legislation.[27]

Although lower courts have interpreted *Cipollone* to preclude a conflict preemption analysis when express preemptive language exists,[28] the Supreme Court later clarified its position in a manner that rendered the lower court interpretations moot.[29] An express preemption clause merely gives rise to a reasonable inference that no additional implied preemption should be inferred.[30]

> The fact that an express definition of the pre-emptive reach of a statute "implies"—*i.e.*, supports a reasonable inference—that Congress did not intend to pre-empt other matters does not mean that the express clause entirely forecloses any possibility of implied preemption. . . . At best, *Cipollone* supports an inference that an express pre-emption clause forecloses implied pre-emption; it does not establish a rule.[31]

In *Cipollone*, the Supreme Court required that express preemption language provide "a reliable indicium of congressional intent."[32] As later case law demonstrates, the "reliable indicium" standard is relatively simple to

24. Freightliner Corp. v. Myrick, 514 U.S. 280 (1995).

25. *Cipollone*, 505 U.S. at 517.

26. *Id.* (restates the canon of statutory interpretation known as *inclusio unius est exclusio alterius*).

27. *Id.* (citations omitted).

28. Betsy J. Grey, *Make Congress Speak Clearly: Federal Preemption of State Tort Remedies*, 77 B.U. L. REV. 559, 620-21 (1997) (citing Stamps v. Collagen Corp., 984 F.2d 1416, 1420 (5th Cir. 1993); King v. Collagen Corp., 983 F.2d 1130, 1134 (1st Cir. 1993); Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 823 (1st Cir. 1992)).

29. *Freightliner Corp.*, 514 U.S. 280.

30. *Id.* at 288-89.

31. *Id.* (noting that *Cipollone* employed a conflict preemption analysis to make its determination that the express language of the statute preempted the state tort law); *see also* Michael K. Carrier, *Federal Preemption of Common Law Tort Awards by the Federal Food, Drug, and Cosmetic Act*, 51 FOOD & DRUG L.J. 509, 571 (1996).

32. *Cipollone*, 505 U.S. at 517 (citation omitted).

satisfy. The Supreme Court's determination that statutory analysis must begin and end with the plain wording of an express preemption clause supports this inference.[33] The treatment of the "indicium" requirement in *Cipollone* and lower court interpretation of this requirement establish a presumption that any express preemption clause is a "reliable indicium of congressional intent."[34] According to the Eleventh Circuit, a preemption clause could possess some ambiguity, yet constitute a "reliable indicium of congressional intent."[35] Despite the fact that the Supreme Court clarified some aspects of the *Cipollone* decision in a later case, the "reliable indicium" standard remains as a relaxed tool to measure statutory language for preemptive effects.

2. Federal Agency Preemption of State Law: A Case Study of the FCC's Preemptive Power

Properly promulgated federal agency regulations have the effect of federal law for purposes of determining whether a state law is preempted.[36] Upon the grant of authority to promulgate rules, the agency's actions have preemptive effect when state laws stand as an obstacle to the federal objective or when state laws cannot coexist with the federal rule. However, in some cases Congress expressly limits a federal agency's power to preempt state law. This Part describes the effect of such congressional limitation on the preemptive power of FCC rules and orders.

The 1934 Act created a dual federal-state regulatory model for interstate and intrastate radio and wire communications.[37] Section 1 of the 1934 Act created the FCC and granted it authority over "interstate and foreign commerce in wire and radio communication."[38] Section 2(b) limits FCC jurisdiction by denying it power to regulate intrastate communications service: "[N]othing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services,

33. CSX Transp., Inc. v. Easterwood, 507 U.S. 658, 664 (1993).

34. Heiple v. C.R. Motors, Inc., 666 A.2d 1066, 1083 (Pa. Super. Ct. 1995) (noting that none of its sister circuits that have considered the application of the *Cipollone* rule have determined that an express preemption clause was not a reliable indicium), *overruled by* Cellucci v. General Motors Corp., 676 A.2d 253 (Pa. Super. Ct. 1996).

35. Myrick v. Freuhauf Corp., 13 F.3d 1516, 1527 (11th Cir. 1994). The Supreme Court did not take issue with the Eleventh Circuit's opinion. *See* Freightliner Corp. v. Myrick, 514 U.S. 280 (1995).

36. Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 369 (1986); Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1982); Lincoln Sav. & Loan Ass'n v. Federal Home Loan Bank Bd., 856 F.2d 1558, 1560 (D.C. Cir. 1988).

37. Duane McLaughlin, Note, *FCC Jurisdiction over Local Telephone Under the 1996 Act: Fenced Off?*, 97 COLUM. L. REV. 2210, 2213 (1997).

38. Communications Act of 1934, ch. 652, Title I, § 1, 48 Stat. 1064 (codified as amended at 47 U.S.C. § 151 (Supp. II 1996)).

facilities, or regulations for or in connection with intrastate communication service."[39] Courts interpret section 2(b) to deny the FCC of the commerce power to regulate based on intrastate communications services' incidental effect on interstate commerce.[40]

In *North Carolina Utility Commission v. FCC*, the Fourth Circuit fashioned a test to determine when the FCC may preempt state laws governing intrastate telecommunications services.[41] The court determined that the FCC is allowed to intrude into intrastate communications when it is difficult to separate interstate components from intrastate components or when the FCC is pursuing a policy objective important for the furtherance of interstate communications.[42] These negations of section 2(b) have become known as the "impossibility exception." In dicta, the court noted that rate making, unlike equipment, is an area where it is practical to separate interstate from intrastate service.[43]

The Supreme Court adopted a more restrictive approach in *Louisiana Public Service Commission v. FCC*.[44] In *Louisiana Public Service Commission*, the Court significantly restricted the ability of the FCC to preempt state action involving jurisdictionally mixed services.[45] In determining whether the FCC could preempt state depreciation rates for telephone plants and equipment, the Supreme Court found that depreciation rates were within the meaning of "charges" in section 2(b).[46] The Court determined that it was possible to allocate the depreciation rates between the interstate and intrastate jurisdictions, and as a result held that the state law was not preempted.[47]

However, the Court stated that section 2(b) provides express jurisdictional limitations: "By its terms, this provision fences off from FCC reach or regulation intrastate matters—indeed, including matters 'in connection with' intrastate service."[48] One commentator concluded that the Supreme Court

39. Communications Act of 1934, ch. 652, Title I, § 2(b), 48 Stat. 1064 (codified as amended at 47 U.S.C. § 152(b) (1994)); *see also* McLaughlin, *supra* note 37, at 2213.

40. *Louisiana Pub. Serv. Comm'n*, 476 U.S. 355.

41. *North Carolina Util. Comm'n*, 537 F.2d 787 (4th Cir. 1976).

42. *Id.* at 793. Other cases illustrating the preemptive nature of the Communications Act of 1934 are *Diamond Int'l Corp. v. FCC*, 627 F.2d 489 (D.C. Cir. 1980) (upholding an FCC decision not to preempt state tariffs) and *Computer & Comm. Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982).

43. *North Carolina Util. Comm'n*, 537 F.2d at 793 n.6.

44. *Louisiana Pub. Serv. Comm'n*, 475 U.S. 355.

45. *See id.*

46. *Id.* at 373; McLaughlin, *supra* note 37, at 2217.

47. *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 375-76.

48. *Id.* at 370 (citation omitted).

"whittled down" the FCC's preemptive powers "to their statutory base."[49] According to *Louisiana Public Service Commission*, FCC jurisdiction over intrastate service only will be sustained in cases where it is impossible to separate interstate from intrastate services and where the state regulation will negate the FCC's lawful authority over interstate communications.[50] The FCC bears the burden of showing that the state regulation would negate valid FCC regulatory goals.[51]

In *Iowa Utilities Board v. FCC*, the Eighth Circuit used *Louisiana Public Service Commission* reasoning to interpret the Telecommunications Act of 1996.[52] The court determined that the FCC could not preempt the state's authority to set prices for intrastate services, rejecting the FCC's argument that *Louisiana Public Service Commission* did not apply because sections 251 and 252 of the 1996 Act constitute a specific, statutory delegation of authority to the FCC by Congress.[53] Instead, the court found that section 2(b) also requires that Congress be explicit when it seeks to provide the FCC with jurisdiction over intrastate matters: "Congress could override section 2(b)'s command only by unambiguously granting the FCC authority over intrastate telecommunications matters or by directly modifying section 2(b)."[54] With respect to pricing of local service, the court held, Congress did not override section 2(b)'s command by unambiguously granting the FCC authority over intrastate telecommunications matters or by directly modifying section 2(b).[55]

The FCC's arguments in favor of preempting state pricing under sections 251 and 252 also failed the "impossibility exception" because the separation rules provide a means to allocate between interstate and intrastate jurisdictions, and the FCC did not show that state rate making would negate FCC authority over interstate communications.[56] *Iowa Utilities Board* is relevant to whether section 2(b) applies to section 254(f) of the Act because section 254 and sections 251 and 252 were added to the Communications Act in 1996.

49. Michael J. Zpevak, *FCC Preemption After* Louisiana PSC, 45 FED. COMM. L.J. 185, 185-86 (1993).

50. *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 375 n.4.

51. California v. FCC, 39 F.3d 919, 931 (9th Cir. 1994).

52. *Iowa Utils. Bd.*, 120 F.3d 753 (8th Cir. 1997), *rev'd on other grounds*, AT&T Corp. v. Iowa Utils. Bd., No. 92-826 et al., 1999 WL 24568 (U.S. 1999).

53. *Id.* at 796; Implementation of the Local Competition Provisions in the Telecomms. Act of 1996, *Third Order on Reconsideration and Fourth Notice of Proposed Rulemaking*, 12 F.C.C.R. 12,460, para. 2, 8 Comm. Reg. (P & F) 1206 (1997).

54. *Iowa Utils. Bd.*, 120 F.3d at 796 (citing Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 377 (1986)).

55. *Id.* (citing *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 377).

56. *Id.* at 798.

The Supreme Court reversed the jurisdictional determination in *Iowa Utilities* and instead concluded that the FCC had the authority to promulgate local competition rules regarding the prices for interconnection under sections 251 and 252.[57] Although the Supreme Court affirmed the use of *Louisiana PSC* to interpret section 2(b),[58] the Court held that the 1996 Act has in effect extended the FCC's section 201(b) rulemaking authority to cover purely intrastate matters in order to implement the Act's local competition provisions.[59] The Supreme Court also rejected the argument that the FCC's authority under sections 251 and 252 was limited by section 2(b).[60]

The Supreme Court's decision in *AT&T v. Iowa Utilities Board* does not necessarily place section 254(f) beyond the reach of section 2(b)'s limitation. Nonetheless, the Supreme Court's analysis implies that section 2(b) does not limit section 254(f). The Court noted that after the 1996 Act, section 2(b) "may have less practical effect . . . because, Congress, by extending the Communications Act into local competition, has removed a significant area from the States' exclusive control."[61] Although the Court does not single out the universal service provisions of the 1996 Act, section 254(f) fits the Court's description to the letter. In fact, the Supreme Court's opinion implies that the entire 1996 Act is not limited by section 2(b) because it states that only "[i]nsofar as Congress has remained silent . . . [section 2(b)] continues to function."[62] The Supreme Court's recent decision in *AT&T v. Iowa* regarding sections 251 and 252 strongly suggests that section 2(b) does not limit federal power under the remaining provisions of the 1996 Act, including section 254(f). However, the Court's decision is not dispositive and the question still remains.

In sum, there are several exceptions to section 2(b)'s limitation on the FCC's power over the intrastate jurisdiction. First, Congress can override

57. AT&T Corp. v. Iowa Utils. Bd., No. 92-826 et al., 1999 WL 24568, at *15 (U.S. 1999).

58. *Id.* at *7 n.7 ("We discuss the *Louisiana* case because of the light it sheds upon the meaning of [section 2(b)].").

59. *Id.* at *6. Section 201(b) provides "the [FCC] may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act." 47 U.S.C. § 201(b) (1994). The Supreme Court's reliance on section 201(b) to override section 2(b)'s command is somewhat perplexing. Since section 201(b) is a general provision giving the FCC power to promulgate rules as necessary, the section would then override section 2(b) in all instances where the Communications Act applies.

60. *Id.* at *6.

61. *Id.* at *7 n.8.

62. *Id.* Justice Thomas dissented on this point: "Nothing in the 1996 Act eliminates [section] 2(b)'s fence. Congress has elsewhere demonstrated that it knows how to exempt certain provisions from [section] 2(b)'s reach . . . ." *Id.* at *22 (Thomas, J., dissenting). Justice Thomas then refers to several instances where Congress modified the language of section 2(b) to exclude certain provisions of the Communications Act. *Id*.

section 2(b) by directly modifying it.[63] Second, Congress can unambiguously grant the FCC authority over intrastate communications.[64] In other words, despite the limiting language of section 2(b), Congress can expressly provide the FCC with preemptive power over the intrastate jurisdiction anywhere in the Communications Act and the express language will override section 2(b). *Iowa Utilities Board* provides several examples of Congress directly granting the FCC jurisdiction over intrastate matters. For instance, the Cable Act provides that "[t]he Commission shall, by regulation, ensure that the rates for the basic service tier are reasonable."[65] Furthermore, section 276 of the Telecommunications Act of 1996 provides that the FCC is responsible for a compensation plan for intrastate pay phones.[66] Third, the "impossibility exception" provides that section 2(b) can be negated when it is impossible to separate interstate and intrastate components and when state laws conflict with the FCC's lawful authority over the interstate jurisdiction.[67] For all practical purposes, the "impossibility exception" is the equivalent of the type of "conflict preemption" that exists when state law stands as an obstacle to the objective of a federal law.

B. *Interpreting Section 254(f): Is It Express Preemption and Is It Limited by Section 2(b)?*

With regard to statutory interpretation of a section of the Communications Act, section 2(b) operates to limit the FCC's preemptive power over state regulations governing intrastate services provided the section does not meet one of the exceptions described above. By implication, section 2(b) renders state laws governing "purely intrastate" services and charges immune from FCC preemption. "Purely intrastate" refers to intrastate "charges, classifications, practices, services, facilities, or regulations" that are easily distinguishable from the interstate jurisdiction.[68] Thus, if section 2(b) applies to section 254(f), any test for determining state laws "not incon-

63. For instance, section 2(b) does not apply to sections 223-227 or section 332. *See* 47 U.S.C. § 152(b) (1994). Congress modified section 2(b) to exclude section 332 from its reach in 1993 in conjunction with obtaining authority for spectrum allocation via auction. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 6002(b)(3)(B)(i), 107 Stat. 396.

64. Iowa Utils. Bd. v. FCC, 120 F.3d 753, 796 (8th Cir. 1997), *rev'd on other grounds*, AT&T Corp. v. Iowa Utils. Bd., No. 92-826 et al., 1999 WL 24568 (U.S. 1999) (citation omitted).

65. Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (codified in relevant part in 47 U.S.C. § 543(b)(1) (1994)), *cited in Iowa Utils. Bd.*, 120 F.3d at 795 n.14.

66. 47 U.S.C. § 276(b) (Supp. II 1996), *cited in Iowa Utils. Bd.*, 120 F.3d at 797.

67. California v. FCC, 39 F.3d 919, 931-33 (9th Cir. 1994).

68. 47 U.S.C. § 152(b) (1994).

sistent with" the FCC's rules must make allowances for purely intrastate "charges, classifications, practices, services, facilities, or regulations."[69] In other words, a state plan that affects purely intrastate "charges, classifications, practices, services, facilities, or regulations" would survive section 254(f)—even if inconsistent with the FCC's rules.[70]

1. Plain Language

As discussed *supra*, the preemption inquiry begins with an examination of congressional intent. If Congress unambiguously grants the FCC the power to regulate the intrastate jurisdiction at issue, express preemption exists and the state law is preempted.[71] In cases where Congress's intent is ambiguous, section 2(b) and the cases interpreting it determine whether an FCC policy preempts state law. Therefore, it must first be determined whether section 254(f) unambiguously grants the FCC the power to preempt state laws that are inconsistent with its rules or whether section 2(b) limits its reach.

Section 254(f) of the Act provides:

> State authority
>
> A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. 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.[72]

Section 254(f) creates three possible instances of preemption when: (1) a state universal service plan is inconsistent with the Commission's rules; (2) the law is not specific, predictable, and sufficient; and (3) the state mechanism relies on or burdens the federal mechanism. Using a plain language analysis, section 254(f) provides that states have authority to design a state universal service mechanism to which providers of intrastate services contribute. However, according to the first sentence, state universal service mechanisms must not be "inconsistent with" the FCC's rules. Hence, the "not inconsistent with" language is an unambiguous preemptive clause that

69. *Id.*

70. *Id.*

71. *Iowa Utils. Bd.*, 120 F.3d at 796 (citing Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 377 (1986)).

72. 47 U.S.C. § 254(f) (Supp. II 1996).

applies to everything contained in state plans, including the portions of the plans that govern purely intrastate "charges, classifications, practices, services, facilities, or regulations." Section 2(b) therefore does not limit the preemptive effect of section 254(f).

2. Legislative History

The legislative history provides additional evidence that Congress intended section 254(f) to preempt state plans that (at the very least) fail to fulfill the federal minimum definition of universal service or do not consistently comply with the requirement that all telecommunications carriers contribute.[73] A conference report, the Senate version of which became the 1996 Act, provided:

> [T]he Senate intends that States shall continue to have the primary role in implementing universal service for intrastate services, so long as the level of universal service provided by each State meets the minimum definition of universal service established under new section 253(b) and a State does not take any action inconsistent with the obligation for all telecommunications carriers to contribute to the preservation and advancement of universal service under new section 253(c).[74]

Although the legislative history does not speak directly to the issue of whether the language in section 254(f) renders section 2(b) inoperative, the above passage clarifies that Congress was intervening in an area normally governed by state law. Arguably then, because Congress was legislating in an area traditionally governed by states, it intended to remove section 2(b)'s limitation on the preemptive effect of section 254(f).

3. *Iowa Utilities* Methodology

The *Iowa Utilities* method of preemption analysis also results in the conclusion that section 254(f) should be given preemptive effect. According to the Eighth Circuit, which followed *Louisiana PSC*, a statute qualifies for an exception from section 2(b) if the statute unambiguously applies to intrastate telecommunications matters and unambiguously directs the FCC to implement its provisions.[75] In *Iowa Utilities*, the court determined that sections 251 and 252 did not meet this threshold, however, the plain language and substance of section 254(f) indicate that if the court was applying this analysis to section 254(f) instead of sections 251 and 252, a different conclusion

73. *But see infra* notes 76-77 and accompanying text.

74. H.R. CONF. REP. NO. 104-458, at 128 (1996), *reprinted in* 1996 U.S.C.C.A.N. 124, 139.

75. *Iowa Utils. Bd.*, 120 F.3d at 796, *rev'd on other grounds*, AT&T Corp. v. Iowa Utils. Bd., No. 92-826 et al., 1999 WL 24568 (U.S. 1999).

would result. First, because universal service is comprised mostly of local telephone service, it is an "intrastate telecommunications matter." Second, section 254(f) makes reference to the fact that the FCC has the jurisdiction to implement the Federal Universal Service Plan. Although the Supreme Court reversed the Eighth Circuit's ultimate conclusion, it affirmed the use of this line of reasoning in interpreting section 2(b).[76] Thus, according to the analysis employed (notwithstanding the result reached) by the Eighth Circuit, section 2(b) should not operate to limit section 254(f). This conclusion is bolstered by the Supreme Court's holding that sections 251 and 252 of the 1996 Act are not limited by section 2(b). Both the Eighth Circuit opinion and the recent Supreme Court decision suggest that section 254 should be treated similar to sections 251 and 252 for purposes of determining the scope of section 2(b).

4. FCC Interpretation

The FCC also has concluded that section 2(b) does not limit section 254. In affirming its ability to assess federal universal service contributions on intrastate carriers, the FCC interpreted section 254 to provide it with jurisdiction over intrastate services for purposes of determining the revenue base for the fund.[77] Although the FCC did not single out section 254(f), it determined that it has jurisdiction to assess contributions on intrastate revenue and can require carriers to seek authority from states to recover a portion of the contribution in intrastate rates.[78]

The FCC states that it derives this authority from the plain meaning of section 254.[79] Specifically, section 254 imposes the ultimate responsibility for implementing the universal service program on the FCC. Furthermore, section 254(c)(1) authorizes the FCC to define the parameters of universal service.[80] Finally, section 254(b)(5) requires the FCC to design a mechanism that is "specific, predictable and sufficient."[81]

These provisions indicate that the Commission has the primary responsibility and authority to ensure that universal service mechanisms are "specific, predictable, and sufficient" to meet the statutory principle of "just,

76. *AT&T Corp. v. Iowa Utils. Bd.*, No. 92-826 et al., 1999 WL 24568, at *7 n.7 (U.S. 1999).

77. Federal-State Joint Bd. on Universal Serv., *Report to Congress*, 13 F.C.C.R. 11,501, para. 202, 11 Comm. Reg. (P & F) 1312 (1998) [hereinafter *Universal Serv. Report to Congress*].

78. *Id.*

79. *Id.* para. 203.

80. 47 U.S.C. § 254(c)(1) (Supp. II 1996).

81. *Id.* § 254(b)(5).

reasonable, and affordable rates."[82] Arguably, if faced with the question of whether the FCC is limited in its power to preempt inconsistent state universal service policies, the FCC would provide the same statutory argument.

With respect to section 2(b), the FCC states that "section 254 envisions that the Commission would not be bound by the prior system of universal service mechanisms, which was based on the traditional jurisdictional spheres."[83] Furthermore,

> [S]ection 254's express directive that universal service mechanisms be "sufficient" ameliorates any section 2(b) concerns. As a rule of statutory construction, section 2(b) only is implicated where the competing statutory provision is ambiguous. As discussed above, section 254 unambiguously establishes that the services to be supported have intrastate as well as interstate characteristics and permits the Commission to establish regulations implementing federal support mechanisms for the supported intrastate services.[84]

5. The Case for Section 2(b)'s Limitation on Section 254(f)

Based on the plain language of the statute, standard maxims of statutory construction, and the FCC's interpretation of section 254 generally, it appears that section 254(f) provides express preemption unlimited by section 2(b). However, there are several arguments to the contrary. First, although Congress enumerated sections of the Communications Act that are immune from section 2(b)'s reach, Congress did not include section 254 among them.[85] For example, Congress, in passing the 1996 Act, contemplated modifying section 2(b) to expressly exclude the local competition provisions of the Act. These modifications of section 2(b) were deleted by the Conference Committee in its final version of the Act.[86] The legislative history of section 254 does not indicate that Congress considered modifying section 2(b) to exclude section 254 from its reach.

Second, section 254(f) does not use the word "preemption." In section 253, Congress expressly preempted any state law that acts as a barrier to entry by using the word "preempt."[87] Because Congress invoked its express preemption power by using the word "preempt" in other portions of the Act

82. *Universal Serv. Report to Congress*, *supra* note 77, para. 203.

83. *Id.* para. 208.

84. *Id.* para. 207 (citation omitted).

85. For instance, section 2(b) does not apply to sections 223 to 227 or section 332. *See* 47 U.S.C. § 152(b) (1994). This argument was used in *Iowa Utilities Board v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev'd on other grounds*, AT&T Corp. v. Iowa Utils. Bd., No. 92-826 et al., 1999 WL 24568 (U.S. 1999).

86. *Iowa Utils. Bd.*, 120 F.3d at 797 n.17 (citing S. 652, 104th Cong. § 101(c)(2) (1995); H.R. 1555, 104th Cong. § 101(e)(1) (1995)).

87. 47 U.S.C. § 253(d) (Supp. II 1996).

but not in section 254, 254(f) may not provide express preemption. Finally, the language in section 254(f) arguably is not as clear as the language in the Cable Act or the language in section 276, two provisions cited by the *Iowa Utilities* court as examples of unambiguous direction by Congress to the FCC to preempt state law.[88]

Commissioner Furchtgott-Roth supports this alternative interpretation of section 254.[89] Although he directed his comments to the FCC's ability to fund the federal mechanism based, in part, on intrastate revenues and did not speak to the issue of state universal service policies, he strongly contends that section 254 does not extend the FCC's power beyond the limitations of section 2(b).[90] "[S]ection 254, read in light of the express directive of section 2(b), precludes the Commission from asserting jurisdiction over revenues based on intrastate activities."[91] Commissioner Furchtgott-Roth reasons that the practice of allowing the FCC power to calculate the contributions of intrastate carriers would "undermine the dual scheme established in section 254 and, in any event, violate section 2(b)."[92]

Commissioner Furchtgott-Roth supports his interpretation with a policy rationale: "The assertion of federal authority over intrastate revenues impinges upon the states' ability to establish their own universal service funds, which Congress expressly provided for in section 254(f)."[93] Furthermore, he reasons that since section 254(f) of the Act provides that state plans cannot rely on or burden federal mechanisms, any state plan that relies on intrastate revenues would violate the Act.[94] However, the Commissioner's argument reads the first sentence of section 254(f) out of existence. According to section 2(b), states by default have jurisdiction over intrastate "charges, classifications, practices, services, facilities, or regulations." Why would Congress need to restate that "states may adopt [universal service] regulations not inconsistent with the Commission's rules" unless its purpose was to limit the state regulatory power beyond the safeguards provided in section 2(b)?

Although Commissioner Furchtgott-Roth's interpretation of section 254(f) may fail to recognize Congress's intent to preempt state universal service regulations that are inconsistent with the Act, his position with respect to the FCC's ability to base contributions on intrastate revenues may

88. *See supra* notes 65-66.

89. *Universal Serv. Report to Congress*, *supra* note 77 (dissenting statement of Comm'r Furchtgott-Roth).

90. *Id*.

91. *Id*.

92. *Id*.

93. *Id*.

94. *Id*.

be entirely accurate. Arguably, the express language of section 254(f) takes the subsection beyond the reach of section 2(b). However, the remaining subsections of section 254 are subject to section 2(b)'s limitation.

6. Conclusion

Given statutory construction, FCC interpretation, and Supreme Court jurisprudence, there is a substantial likelihood that a court would determine that section 254(f) expressly preempts conflicting state law. Therefore, all state universal service policies are subject to preemption if they violate the subsection's express language. In the alternative, if section 2(b) limits section 254(f), the preemptive language of section 254 only applies to state policies regarding jurisdictionally mixed services for which no separation can be made between interstate and intrastate service. In other words, the FCC may not force its will on state policies that deal exclusively with intrastate issues. Although it is unlikely that a court will determine that section 2(b) limits section 254(f), the test provides an optional prong that accounts for the section 2(b) factor.

C. A Three-Pronged Test for Determining Whether State Universal Service Plans Are Preempted by Section 254(f)

1. Prong 1: Express Preemption

The first prong of the test is that a state plan must not be inconsistent with the FCC's rules; must be specific, predictable, and sufficient; and may not burden the federal mechanism. This prong is derived from an examination of section 254(f) in light of the case law on express preemption, which is read to direct an express preemption analysis. The basic rule governing express preemption requires express preemption language to provide a "reliable indicium" of congressional intent.[95] While express preemption language gives rise to a reasonable inference that an implied preemption analysis is inappropriate, it does not entirely foreclose the possibility.[96]

Congress expressly prohibits state universal service program requirements that (1) are "inconsistent with the Commission's rules to preserve and advance universal service," (2) are not "specific, predictable, and sufficient," or (3) burden the federal program.[97] The "inconsistent with the Commission's rules" clause could be interpreted in several ways. First, the

95. Cipollone v. Liggett Group, Inc., 505 U.S. 504, 517 (1992) (citation omitted).

96. Freightliner Corp. v. Myrick, 514 U.S. 280, 288-89 (1995). Agency regulations may have the effect of federal law for preemptive purposes, but Congress must explicitly override section 2(b). Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 369 (1986).

97. 47 U.S.C. § 254(f) (Supp. II 1996).

term “inconsistent” must be construed to determine whether it constitutes express preemption. Congress’s use of a “not inconsistent with” test in section 254(f) suggests that a state need not adopt the exact same universal service funding methodology as that selected by the FCC. Instead, this language would appear to give states the flexibility to use various means to achieve an end that preserves and enhances universal service.

A narrow interpretation would limit the scope of section 254(f) to inconsistencies between a state plan and the FCC’s rules as codified in the Code of Federal Regulations. This approach excludes the preemption of inconsistencies with the particulars of the FCC’s implementation orders that establish and modify the FCC’s universal service rules.[98] The alternative approach is to define “rules” expansively, allowing the definition to include all of the language in the FCC’s implementation orders. Arguably, the entire Federal Universal Service Plan is what Congress intended when it referred to the Commission rules to preserve and advance universal service.

However, consistency with the FCC’s rules is not sufficient to protect a state universal service regulation from federal preemption. Although section 254(f)’s requirement that universal service support be specific, predictable, and sufficient is included among the design principles listed in the FCC’s implementing regulations,[99] the restriction on burdening the Federal Plan is not.

2. Prong 2: Conflict Preemption

The second prong of the test requires a simple conflict preemption analysis in addition to the express preemption analysis required in prong 1. Consistency with the FCC’s rules is not sufficient to ensure that a state universal service plan is not preempted by the Act. A state plan could be technically “not inconsistent with” the Commission’s rules and not burden the federal program, yet fail a “conflict preemption” test. This form of preemption is contemplated by the analysis in *Freightliner Corp.*, which held that the *Cipollone* case “supports an inference that an express pre-emption clause forecloses implied pre-emption; it does not establish a rule.”[100] Therefore, if the express preemption clause contains more than “some” ambiguity,[101] conflict preemption analysis is warranted.

98. A description of these rules can be found in Part IV *infra*.

99. Federal-State Joint Bd. on Universal Serv., *Report and Order*, 12 F.C.C.R. 8776, para. 44, 7 Comm. Reg. (P & F) 109 (1997) [hereinafter *Universal Serv. Report and Order*].

100. *Freightliner Corp.*, 514 U.S. at 288-89 (discussing *Cipollone*, 505 U.S. 504).

101. *See supra* note 35 and accompanying text.

Conflict preemption occurs when it is impossible to comply with state and federal law simultaneously or when a state law obstructs an important objective of federal regulation.[102] The first prong of the express preemption test under section 254(f) makes a separate inquiry into the second type of conflict preemption (the obstruction of federal objectives) duplicative because any state universal service plan consistent with FCC design principles would comply with the objectives of the Act.

However, a state plan will have to meet the additional requirement that all of its parts must coexist with the federal mechanism. In particular, state plans that include requirements "in addition to" the federal mechanism should almost always pass this prong of the test if they preserve and enhance universal service. Only if a state adopts universal service regulations "in addition to" the policies adopted by the FCC that are not for the purpose of enhancing and preserving universal service, or if a state decides a particular issue differently from the Federal Universal Service Plan, will the conflict preemption requirement pose a significant barrier to a state universal service regulation.

3. Prong 3: (Optional) Exclusion of Purely Intrastate Services

The optional third prong of the test requires that regulations governing equipment used exclusively in the intrastate jurisdiction, services provided exclusively in the intrastate jurisdiction, or charges for intrastate services are immune, pursuant to section 2(b), from the preemptive reach of section 254(f), even if inconsistent with the federal program. As discussed above, if section 2(b) is held to limit the preemptive authority of section 254(f), the classification of a state law or regulation as either completely interstate, completely intrastate, or jurisdictionally mixed further affects the preemptive effect of section 254(f). Acknowledging this distinction preserves section 2(b)'s limitation on FCC power over intrastate services.

4. Conclusion

To determine whether a state universal service plan is inconsistent with the Telecommunications Act of 1996, a state plan must not be inconsistent with the FCC's rules (including the requirement that the plan be specific, predictable, and sufficient), must not burden the federal mechanism (prong 1), and must be able to coexist with each policy adopted by the Federal Universal Service Plan (prong 2). Additionally, if section 254 is held to be limited by section 2(b), state laws concerning purely intrastate services, equipment, and charges are immune from FCC preemption.

102. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963) (citation omitted).

IV. THE FEDERAL UNIVERSAL SERVICE PLAN PURSUANT TO THE TELECOMMUNICATIONS ACT OF 1996

This section describes the "rules," collectively known as the Federal Universal Service Plan (Federal Plan), that the FCC adopted in a *Report and Order* entitled Federal-State Joint Board on Universal Service (*Universal Service Report and Order*) to implement the universal service provisions of the 1996 Act.[103] The FCC developed the Federal Plan in response to Congress's mandate of a new universal service plan, which constitutes the "Commission's rules to preserve and advance universal service" referred to in section 254(f).

The Federal Plan establishes seven universal service design principles: (1) "[q]uality services should be available at just, reasonable, and affordable rates"; (2) "[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation"; (3) "[c]onsumers in all regions of the Nation . . . should have access to telecommunications and information services, including interexchange services and advanced . . . services, that are reasonably comparable [in substance and price] to those services provided in urban areas"; (4) "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to . . . universal service"; (5) "[t]here should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service"; (6) "[e]lementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services"; and (7) universal support mechanisms should be competitively neutral.[104]

The Federal Plan also defines the basic universal services supported by the federal universal service program. These services include "single-party service; voice grade access to the public switched network; DTMF signaling or its functional equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation services for qualifying low-income consumers."[105]

The Federal Plan also specifies which carriers are eligible to receive universal service support; only a common carrier may be eligible to receive universal service support.[106] Each eligible carrier must offer the services supported by the Federal Universal Service Plan and must do so "using its own facilities or a combination of its own facilities and resale of another

103. *Universal Serv. Report and Order*, *supra* note 99.
104. *Id.* paras. 44-45 (citation omitted).
105. *Id.* para. 61.
106. *Id.* para. 134.

carrier's services."[107] Carriers are required to advertise the availability and charges associated with supported services.[108]

The *Universal Service Report and Order* implementing the Federal Plan also provides nonrural and rural service area definitions. It requires that states exercise their authority in designating nonrural service areas "in a manner that promotes the pro-competitive goals of the 1996 Act as well as the universal service principles of section 254."[109] The FCC concluded that service areas should be "sufficiently small to ensure accurate targeting of high-cost support" and should encourage competition.[110] With respect to rural service areas, the FCC retained the pre-Act study areas of rural telephone companies; however, the FCC encourages states to consider the anticompetitive impacts of noncontiguous service areas.[111]

The Federal Plan establishes four separate universal service programs: (1) high-cost support; (2) low-income support; (3) educational provider support; and (4) rural health care support. The Federal Plan provides that the FCC will use forward-looking cost study methodologies to determine universal support levels. The new high-cost program provides different implementation timelines for rural and nonrural carriers.[112] Nonrural carriers are expected to convert to a forward-looking economic cost basis by 1999, while rural carriers remain on an embedded cost basis for at least three years from the date of the *Order*.[113]

The federal high-cost program will operate in the following manner. The FCC will set a revenue benchmark that represents the average revenue per line, per month collected by incumbent local exchange carriers (ILECs). Universal service support will equal the difference between the federal benchmark and a carrier's forward-looking cost of providing basic universal service. The FCC will apply federal universal service support to a carrier's revenues in the interstate jurisdiction to reduce the carrier's interstate access charges.[114]

Local service, access, and discretionary revenues are included in the FCC's revenue benchmark.[115] The FCC adopted a temporary benchmark of $31 for residential lines and $51 for single-line businesses; universal service

107. *Id.*
108. *Id.*
109. *Id.* para. 184.
110. *Id.*
111. *Id.* para. 190.
112. *Id.* para. 222.
113. *Id.* paras. 245, 273, 294.
114. *Id.* para. 381.
115. *Id.* para. 267.

support will be provided for all lines.[116] Initially, the FCC determined that the Federal Universal Service Fund would support 25 percent of the difference between the benchmarks and the economic cost of providing service.[117] The remaining 75 percent of the difference between the cost of providing service and the revenue benchmark was to be funded by the states.[118] In the FCC's *Report to Congress* (*Universal Service Report to Congress*), the FCC announced that it was reconsidering its decision to allocate 75 percent of the universal service program funding to the states.[119]

The Federal Plan provides states with the opportunity to develop their own cost-proxy models for determining the state contribution amount.[120] States that do not elect to use their own cost-proxy model to determine distributions will use the FCC's cost-proxy model. The FCC was scheduled to select a cost-proxy model platform by the end of 1997, and a final model by August 1998; however, this schedule was delayed.[121] On October 28, 1998, the FCC rejected two industry-proposed models and instead adopted a hybrid cost model combining components of the industry models with the FCC's in-house model.[122]

The FCC decided to continue the Lifeline and Link Up America programs with some minor adjustments.[123] The Lifeline program was expanded

116. *Id.* paras. 267, 275, 296.

117. *Id.* para. 269.

118. The FCC reasons that state universal service support has, in the past, been substantial. Furthermore, the FCC notes that it does not have any authority over the local rate-setting process or implicit subsidies inherent in local rates. Accordingly, the FCC decided not to substitute explicit federal support for implicit intrastate universal service support. *See id.* para. 271.

119. *Universal Serv. Report to Congress*, *supra* note 77, paras. 230-31. The FCC is currently considering a recommendation of the Federal-State Joint Board to modify the separations rules. *See* Common Carrier Bureau Seeks Comment on Universal Service Joint Board's Second Recommended Decision, CC Docket No. 96-45, *Public Notice*, 1998 FCC LEXIS 6037 (Nov. 25, 1998) [hereinafter *Universal Serv. Public Notice*]; Federal-State Joint Bd. on Universal Serv., *Second Recommended Decision*, 1998 FCC LEXIS 6027 (Nov. 25, 1998) [hereinafter *Universal Serv. Second Recommended Decision*].

120. *Universal Serv. Report and Order*, *supra* note 99, para. 248.

121. *Id.* para. 245.

122. Federal-State Joint Bd. on Universal Serv., *Fifth Report and Order*, 13 F.C.C.R. 21,323, para. 3 (1998). The FCC required states that did not want to use the FCC model to submit an alternative for FCC review. Although the FCC required that states submit cost models by April 28, 1998, Federal-State Joint Bd. on Universal Serv., *Order*, 12 F.C.C.R. 20,255 (1997), the FCC did not select the federal model platform until the release of the *Fifth Report and Order* in November 1998. Because most states that submitted a state model to the FCC adopted one of the two industry models, all of these states now have a cost model that differs substantially from the federal model. This result supports the conclusion that consistency with the FCC's rules does not require that state universal service plans exactly mirror the Federal Plan.

123. Both the Lifeline and Link Up America programs are managed by the states to

to include all eligible telecommunications providers, and all eligible carriers are required to offer Lifeline to qualified customers.[124] The extension of Lifeline is consistent with the requirement that universal service be provided on a nondiscriminatory basis. The FCC decided to no longer tie Lifeline support to the subscriber line charge (SLC). Instead, Lifeline recipients will receive $5.25 of federal support.[125] In addition to the $5.25 in federal support, the federal program will match one-half of any state support up to $1.75.[126] If a state provides a $3.50 contribution, Lifeline recipients will receive $10.50, with the limitation that the total Lifeline support is not to exceed the Lifeline rate.[127] The only change in the Link Up America program is its expansion to include all eligible telecommunications carriers.[128] Link-up carriers may recover from the Universal Service Fund based on foregone revenues.[129] Although not detailed here, the FCC places additional restrictions on carriers participating in either low-income program.[130]

All eligible schools and libraries will receive discounts of between 20 and 90 percent of the cost of telecommunications services, Internet services, and internal connections provided by telecommunications providers. However, the total federal support for the schools and libraries program is limited to $2.25 billion.[131] In an effort to foster competition, the FCC extended the schools and libraries program to non-telecommunications carriers.[132] Schools and libraries have "maximum flexibility" to determine the package of services they believe best meets their needs.[133] The program offers greater support to eligible schools and libraries in high-cost and economically depressed areas.[134] The FCC provides guidelines for determining which bene-

provide benefits to low-income or elderly telephone subscribers. COMMON CARRIER BUREAU, *supra* note 5, at 3. The FCC adopted Lifeline plans in 1984 and 1985 that reduced an eligible subscriber's monthly telephone bill. The 1984 plan provided a 50% waiver of the subscriber line charge (SLC), and participating states matched this amount with an explicit subsidy. The 1985 plan completely waived the SLC, and participating states provided an amount equal to the SLC in subsidy support. The Link Up America program provides for half of the first $60 of connection charges and the interest on the balance (in cases where LECs have deferred payment plans).

124. *Universal Serv. Report and Order*, *supra* note 99, para. 346; 47 C.F.R. § 54.405 (1998).

125. *Universal Serv. Report and Order*, *supra* note 99, para. 351.

126. *Id.* para. 352.

127. *Id.* para. 353 n.891.

128. *Id.* para. 380.

129. *Id.* para. 379 n.956.

130. *See id.* paras. 384-85, 390, 393, 398.

131. *Id.* para. 425.

132. *Id.*

133. *Id.*

134. *Id.* para. 494.

ficiaries are economically disadvantaged. The FCC developed a discount matrix providing the appropriate rates for all eligible beneficiaries.[135] Schools and libraries are required to self-certify to ensure that only eligible entities receive funds and that these entities have adopted plans securing efficient access to and use of all services purchased from telecommunications and non-telecommunications carriers.[136]

Funding for the schools and libraries program is derived from a broader base than funding for the high-cost and other universal service programs. Contributions for schools and libraries will be based on interstate and intrastate revenues, while funding for the other universal service programs is based solely on interstate revenues.[137] The FCC takes the position that it has the authority to base contributions for all universal service programs on both interstate and intrastate revenues. As discussed *supra*, one FCC Commissioner disagrees that the FCC has such authority.[138]

The Rural Health Care program extends to all public and nonprofit care providers that are both located in rural areas and meet the statutory definition of "health care provider."[139] The program supports telecommunications services that are both necessary for the provision of health care and have a bandwidth of 1.544 Mpbs or less.[140] Telecommunications service providers are restricted from charging health care providers any rate higher than the highest tariffed or publicly available rate charged by a carrier to a commercial customer for a similar service in the state's closest city with a population of more than 50,000 (taking long-distance charges into account).[141] Carriers providing service under the program may recover the difference "between the rate for similar services provided to other customers in comparable rural areas . . . and the [actual] rate charged to the rural health care provider."[142] The program provides limited support to all health care providers for toll-free access to an Internet service provider. The support for the health care program is subject to a $400 million cap.[143]

The FCC also altered the long-term support program and the access charge structure to make them consistent with the 1996 Act.[144] The FCC

135. *See id.* para. 498.

136. *Id.* paras. 522-25.

137. *Universal Serv. Report to Congress*, *supra* note 77, paras. 199-200.

138. *Id.* (dissenting statement of Comm'r Furchtgott-Roth).

139. *Universal Serv. Report and Order*, *supra* note 99, para. 608; see 47 U.S.C. § 254(h)(5)(B) (Supp. II 1996) for the statutory definition of eligible health care providers.

140. *Universal Serv. Report and Order*, *supra* note 99, para. 608.

141. *Id.*

142. *Id.*

143. *Id.*

144. The long-term support (LTS) program supports LECs with higher than average

removed long-term support from the interstate access charge system because it was inconsistent with the Act's requirement that contributions "be equitable and nondiscriminatory, and available to all eligible telecommunications carriers."[145] Instead, the higher-than-average subscriber line costs (SLCs) will be recovered on a per-line basis through new federal universal support mechanisms.[146] The FCC decided not to raise the SLC cap "for primary residential and single-line business lines."[147] Instead, the FCC "create[d] and implemente[d] a system of flat, per-line charges on" presubscribed interexchange carriers to replace the carrier common line charge (CCLC).[148]

Contributions to the Universal Service Fund are to be made by all telecommunications providers. These contributions are to be based on retail, end-user telecommunications revenue.[149] Wholesale revenues billed to other carriers and resellers are excluded from the calculation.[150] The interstate share of the universal service contribution amount must come from interstate operations.[151] Carriers are allowed to pass through the contribution amount to interstate customers.[152]

Although the *Universal Service Report and Order* provided for many changes in the Federal Plan, it is by no means the end of the inquiry. The *Universal Service Report and Order* is currently being reviewed by the Fifth Circuit.[153] Furthermore, subsequent FCC orders clarified and adjusted the Federal Plan. The *Universal Service Fourth Order on Reconsideration* clarified that high-cost loop support, dial equipment minutes (DEM) weighting assistance,[154] and Long Term Support (LTS) are to be removed

subscriber line costs. COMMON CARRIER BUREAU, *supra* note 5, at 5. These high-cost LECs recover the full interstate portion of their subscriber line costs through a nationwide average common line interstate access rate charge on IXCs (long-distance providers). Long-term support is provided though pooling arrangements; individual LTS payments equal the difference between a pool member's actual costs and the rates charged to IXCs. Local exchange carriers outside the pool fund LTS by charging above interstate costs.

145. *Universal Serv. Report and Order*, *supra* note 99, para. 751.

146. *Id.*

147. *Id.* para. 752.

148. *Id.* para. 768; Access Charge Reform, *First Report and Order*, 12 F.C.C.R. 15,982, para. 71, 7 Comm. Reg. (P & F) 1209 (1997).

149. *Universal Serv. Report and Order*, *supra* note 99, para. 843.

150. *Id.* para. 848.

151. *Id.* paras. 825-26.

152. *Id.* para. 829.

153. Texas Office of Pub. Util. Counsel v. FCC, No. 97-60421 (5th Cir. 1997).

154. The DEM weighting subsidy, established prior to the 1996 Act, is based on the premise that smaller telephone companies realize higher local switching costs per line because smaller companies are unable to realize economies of scale. As a result, the DEM weighting rules allow small companies to recover local switching costs through interstate traffic. COMMON CARRIER BUREAU, *supra* note 5, at 5. The separations rules allocate local switching equipment costs between the interstate and intrastate jurisdictions based on the

from interstate access charges and instead recovered from the new universal service support system.[155] Pursuant to the *Fourth Order on Reconsideration*, rural local exchange carriers (LECs) receive modified high-cost loop fund support, DEM weighting program support, and LTS.[156] Non-rural LECs receive support from the modified high-cost fund and LTS programs and will continue to receive this support until they transition to forward-looking methodologies in 1999.[157]

In addition to the Fifth Circuit review of the Federal Universal Service Plan and the FCC's subsequent orders,[158] interested parties are using the political process in an attempt to further modify the Federal Plan. In November 1997, Joel Shifman and Thomas Welch of the Maine Public Utilities Commission presented a paper produced by an *ad hoc* staff group that proposes an alternative to the FCC's high-cost distribution mechanism.[159] The proposal was prepared at the request of the Chairman of the Communications Committee of the National Association of Regulatory Commissioners (NARUC). The proposal allows the FCC to meet its statutory obligation to provide sufficient support for high-cost areas but limits federal funding to cases in which it would be impossible for a state to internally generate enough support to ensure that rates in rural areas in the state are reasonably comparable to average urban rates in the nation.[160]

The Shifman proposal's focus on minimizing the federal universal service fund may not be misplaced. The proposal increases speculation about the inequities that may result from a federal program that treats all states the same, regardless of urban/rural demographics. More importantly, the proposal evidences the fact that the FCC's universal service rules may be modified by Congress, the FCC, or the courts before the publication of this Article.

jurisdiction's relative number of dial equipment minutes of use (DEM). Local exchange carriers with fewer than 50,000 lines are allowed to allocate an additional amount of local switching costs, determined by weighting the interstate minutes of use, to the interstate jurisdiction. DEM weighting is funded by the entities that pay switched access charges, IXCs and their customers.

155. Federal-State Joint Bd. on Universal Serv., *Fourth Order on Reconsideration*, 13 F.C.C.R. 5318, para. 26, 10 Comm. Reg. (P & F) 1282 (1997) [hereinafter *Universal Serv. Fourth Order on Reconsideration*].

156. *Id.*

157. *Id.*

158. Texas Office of Pub. Util. Counsel v. FCC, No. 97-60421 (5th Cir. 1997).

159. Joel Shifman et al., High Cost Support Proposal, Nov. 3, 1997 (submitted *ex parte* to the FCC in Docket No. 96-45, Nov. 18, 1997).

160. *Id.* at 1.

For example, on April 10, 1998, the FCC released a *Report to Congress*.[161] The *Report* affirmed the majority of the FCC's decisions regarding the implementation of section 254 of the Act, as well as indicated that it will reconsider certain aspects of the new universal service plan. First, the FCC affirmed its policies regarding: (1) the definition of information service; (2) the application of its definition of information service; (3) the broad class of carriers required to contribute to universal service; (4) the class of carriers eligible to receive universal support; and (5) the FCC's ability to require contributions based on intrastate revenues.[162] However, the FCC decided to reconsider its allocation of 75 percent of the cost of the universal service program to the state jurisdiction. The FCC concluded that "a strict, across-the-board rule that provides 25 percent of unseparated high-cost support to the larger LECs might provide some states with less total interstate universal service support than is currently provided . . . ."[163] The FCC's position on these issues evidences its serious consideration of the concerns described in the Shifman proposal.[164]

The FCC's *Report* also touched on its authority over state universal service plans. With regard to the assessment and recovery of universal support mechanisms, section 254 provides the FCC with jurisdiction to assess contributions for universal service support mechanisms from intrastate revenues. This conclusion is relevant because, as discussed in detail *supra*, the FCC does not automatically have jurisdiction over intrastate revenues and services.[165] Currently, this issue is the subject of pending petitions for reconsideration and will be addressed in a forthcoming FCC *Order*.[166]

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161. *Universal Serv. Report to Congress*, *supra* note 77.

162. *See generally id.*

163. *Id.* para. 197.

164. As discussed, the FCC is currently soliciting comment on the Joint Board's *Second Recommended Decision*. The decision adopted some of the proposed modifications included in the Shifman proposal. *See supra* note 119 and accompanying text.

165. *See generally* Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355 (1986); 47 U.S.C. § 152(b) (1994).

166. *Universal Serv. Report to Congress*, *supra* note 77, para. 209.

V. KANSAS AND CALIFORNIA: CONTRASTING APPROACHES TO PROVIDING UNIVERSAL SERVICE AND THEIR ADEQUACY UNDER THE SECTION 254(F) TEST

A. *Kansas*

1. The Kansas Universal Service Plan

The Kansas Universal Service Plan (Kansas Plan), currently the subject of a pending FCC proceeding, has in the past been the subject of scrutiny by both federal and state courts reviewing whether it is "consistent" with the Telecommunications Act of 1996. The Kansas Court of Appeals determined that portions of Kansas's Universal Service Plan were inconsistent with both the 1996 Act and the Kansas Act and remanded these provisions to the Kansas Corporation Commission (KCC).[167] However, the Kansas Supreme Court reversed the Court of Appeals and upheld most of the Kansas Plan as originally adopted by the KCC.[168] A federal challenge to the Kansas Plan by wireless carriers was dismissed by the U.S. District Court for the District of Kansas in July 1998.[169] In August 1998, the FCC sought comment on the Kansas Universal Service Plan in response to a petition filed by Western Wireless requesting preemption of the Kansas Plan.[170]

The Kansas Universal Service Plan was created pursuant to the Kansas Act, adopted on July 1, 1996. [171] The Kansas Act mandated reform of the state access charge system in the form of a rate rebalancing. Because Kansas's intrastate access charges were higher than the FCC's interstate access charges, the Kansas legislature mandated that the KCC rebalance rates

167. Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n of Kan., 943 P.2d 494 (Kan. Ct. App. 1997). The Kansas Act is codified at KAN. STAT. ANN. §§ 66-2001 to 2008 (Supp. 1998).

168. Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n of Kan., 956 P.2d 685, 700 (Kan. 1998).

169. On July 24, 1998, the Federal District Court of Kansas dismissed *Sprint Spectrum v. State Corporation Commission of Kansas*, 149 F.3d 1058 (10th Cir. 1998), at the request of the complaining parties. The parties challenged the KCC's assessment of universal service contributions on wireless carriers. Some counts were dismissed with prejudice. Previous to the dismissal, the Tenth Circuit Court of Appeals affirmed a denial of a preliminary injunction from the universal service contribution requirement requested by the complainants on the ground that "there is not a substantial likelihood that the wireless providers will succeed on their preemption claim." *Id.* at 1059. Wireless issues aside, the Kansas Universal Service Plan is arguably inconsistent with the 1996 Act in many respects.

170. Commission Seeks Comment on Western Wireless Petition for Preemption of Statutes and Rules Regarding Kansas State Universal Service Fund, *Public Notice*, 13 F.C.C.R. 14,049 (1998).

171. KAN. STAT. ANN. § 66-2002(h) (Supp. 1998).

to align intrastate access charges with federal access charges. The statute created the Kansas Universal Service Fund (KUSF), initially comprised of LEC revenues lost as a result of access charge rate rebalancing over a three-year period.[172]

The Kansas Act requires all telecommunications carriers, including wireless, providing intrastate services to contribute to the KUSF on an equitable and nondiscriminatory basis.[173] The Kansas Act was later amended to relieve wireless carriers from contributions based on the portion of their intrastate revenue derived from services provided exclusively over a wireless network.[174] By statute, carriers are permitted to pass through contributions to their customers.[175] Carriers can request supplemental funding from the KUSF based on additional lines. Payments from the KUSF were scheduled to begin March 1, 1997. The KUSF administrator was to be selected through a competitive bidding process.[176] State law also requires LECs to offer Internet services to those locations where 14.4 Kpbs transmission is not available.[177]

The KCC adopted an *Order* implementing the Kansas Plan on December 27, 1996.[178] The *Order* implements the statutory requirement that state universal service support be provided from the KUSF on a revenue-neutral basis.[179] This means that incumbent carriers would be entitled to recover the decline in their intrastate access charge revenues from the KUSF. The KUSF is funded by an equal assessment on all intrastate retail revenues.[180] In 1997, the KCC estimated that the surcharge will reach 14.1 percent at the end of 1999, and the initial KUSF would be $111.6 million, which is equivalent to the reduction in intrastate toll and access rates over a three-year phase-in period.[181] LECs are permitted to offset payments to the KUSF with expected distributions. Competitive local exchange carriers will be responsible for the KUSF assessment related to resold or unbundled services.[182]

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172. *Id.* § 66-2008(a).

173. *Id.* § 66-2008(b).

174. 1998 Kan. Sess. Laws ch. 138 (S.B. 212).

175. In April of 1998, the Kansas legislature modified the pass-through requirements. *Id*.

176. The National Exchange Carrier Association is the current administrator of the Kansas Universal Service Fund.

177. KAN. STAT. ANN. § 66-2011.

178. General Investigation into Competition Within the Telecommunications Industry in the State of Kansas, *Order* (Dec. 27, 1996) [hereinafter *1996 KCC Order*].

179. KAN. STAT. ANN. §§ 66-2005(c), 66-2008(a).

180. *Id.* § 66-2008(b).

181. *1996 KCC Order*, *supra* note 178, para. 112.

182. ALECs are competitive local exchange carriers (CLECs).

Unlike the Federal Plan, which makes support available to all carriers, in Kansas, ALECs are only eligible to receive state universal service support for their exchange areas with less than 10,000 access lines.[183] The ALEC support is paid at a rate of $36.88 per line. The KUSF only supports residential lines.[184]

Several requirements of the Kansas Act and the *KCC Order* were contested in federal and state court. First, in federal district court wireless carriers challenged the Kansas Act's requirement that they contribute to the KUSF.[185] The challengers argued that the contribution requirement regulated wireless carriers without proper authority. The Federal District Court of Kansas concluded that this provision does not conflict with 47 U.S.C. section 332(c)(3)(A).[186] The federal court stated that the KUSF contribution imposed by the KCC was not a regulation of rates or market entry, but was simply "an additional cost of doing business."[187]

Second, a citizen's group contested in state court the Kansas Act and *KCC Order*'s revenue-neutrality requirements as inconsistent with section 254(b)(4), (b)(5), (f), and (i) of the Telecommunications Act of 1996.[188] The plaintiffs also argued that the Kansas Act prevented the KCC from performing its regulatory responsibilities, both in general and, in particular, in its responsibility to insure that carriers complied with section 254(k).[189] (Section 254(k) requires that states ensure that services related to universal service "bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[190]) The latter contention was based on the fact that the KCC did not investigate ILEC cost of providing local service and instead arbitrarily adopted the $111.6 million figure.[191] The Kansas Appeals Court, which was subsequently overturned, held:

> The result is a final order that fully protects incumbent LECs by shifting lost revenues from one corporate pocket to another while re-

183. *1996 KCC Order*, *supra* note 178, para. 123.

184. *Id.* para. 125.

185. Mountain Solutions, Inc. v. State Corp. Comm'n of Kan., 966 F. Supp. 1043, 1048 (D. Kan. 1997).

186. *Id.*; *see* 47 U.S.C. § 332(c)(3)(A) (1994).

187. *Mountain Solutions, Inc.*, 966 F. Supp. at 1048. This issue was subsequently addressed and resolved in the FCC's *Universal Serv. Fourth Order on Reconsideration*, *supra* note 155, para. 262. *See also* Petition of Pittencrieff Comm., Inc. for Declaratory Ruling Regarding Preemption of the Texas Pub. Util. Regulatory Act of 1995, 13 F.C.C.R. 1735, para. 13, 9 Comm. Reg. (P & F) 1041 (1997).

188. Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n of Kan., 943 P.2d 494, 506 (Kan. Ct. App. 1997).

189. *Id.*

190. 47 U.S.C. § 254(k) (Supp. II 1996).

191. *Citizens' Util. Ratepayer Bd.*, 943 P.2d at 507.

> quiring all other providers and consumers to bear the financial burden of "revenue neutral" regulation. The funding methodology also precludes meaningful review of whether LECs are using services that are not competitive to subsidize services that are subject to competition. Finally, the KCC order has created a $111.6 million fund that bears no rational relation to the concept of universal service and its cost.[192]

The Kansas Court of Appeals remanded the case back to the KCC with instructions to make the *Order* consistent with section 254(f), (i), and (k).[193] The court also remanded the issue of whether it is competitively neutral for wireless carriers to subsidize ILECs through the KUSF.[194] The court determined that the KCC's allocation of 100 percent of the loop costs to the intrastate jurisdiction was inconsistent with section 254(k) of the Act.[195] Because approximately 75 percent of loop costs can be attributed to the cost of providing local service, the KCC was ordered to ensure reasonable apportionment on remand.[196]

Most of the Kansas Court of Appeals decision was reversed by the Kansas Supreme Court: "We hold the revenue neutral concept is not prohibited by or contrary to the Federal Act. When Kansas passed the Act in question, there were no federal regulations in place. We do not have before us the federal regulations concerning the Federal Act."[197] As a result, the court held that the Kansas Act does not conflict with the KCC's statutory duty to regulate and ensure just and reasonable rates and charges to consumers.[198] Finally, with regard to the challenge of requiring wireless carriers to contribute to the KUSF, the court relied on the FCC determination that "section 332(c)(3) *does not preclude states from requiring CMRS providers to contribute to state support mechanisms*."[199] The court concluded that the law denying the KCC jurisdiction over wireless carriers did not conflict with the provision assessing KUSF contributions on wireless carriers.

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192. *Id*. at 506-07. Competitive neutrality is at the heart of testing state universal service plans against the requirements of the 1996 Act. Section 254 requires that universal service support be provided on an equitable and nondiscriminatory basis. The FCC adopted competitive neutrality as a universal service design principle in its *Order* implementing the universal service provisions of the Act. Universal service provisions are competitively neutral if they "neither unfairly advantage or disadvantage one provider over another." *Universal Serv. Report and Order*, *supra* note 99, para. 47.

193. *Citizens' Util. Ratepayer Bd.*, 943 P.2d at 507.

194. *Id.*

195. *Id.*

196. *Id.* at 507-08.

197. Citizens' Util. Ratepayer Bd. v. State Corp. Comm'n of Kan., 956 P.2d 685, 700 (Kan. 1998).

198. *Id.*

199. *Id.* at 704.

Litigants have also asked the FCC to determine the validity of Kansas's Universal Service Plan. On July 20, 1998, Western Wireless petitioned the FCC to preempt the Kansas Plan.[200] Western Wireless argued that the Kansas Plan should be preempted under section 253 because it creates a barrier to entry for competitive carriers. According to Western Wireless, the Kansas Plan bars entry in two ways. First, the Kansas Plan favors ILECs by guaranteeing them revenue neutrality during the KCC's reform of access charges.[201] Second, the Kansas Plan is not competitively neutral because it denies statewide universal service support to CLECs, while it provides statewide support to incumbents.[202]

In addition, Western Wireless argues that the Kansas Plan is inconsistent with section 254(f) because the standards and definitions adopted in Kansas are not targeted to enhance and preserve universal service.[203] According to Western Wireless, the Kansas Plan is also inconsistent with section 254 for the following reasons: (1) the Kansas Plan does not ensure that consumers in rural or high-cost areas have reasonably priced access to telecommunications services pursuant to section 254(b)(3); (2) the KUSF is not equitable, nondiscriminatory, and targeted to preserve and enhance universal service as required by section 254(b)(4) and 254(d); (3) the Kansas Plan does not ensure that carriers use KUSF support for the provision, maintenance, and upgrading of the facilities used to provide basic service; (4) the Kansas Plan has no reasonable relationship to ensuring just, reasonable, and affordable rates under 254(i); and (5) the Kansas Plan fails to prevent cross-subsidization between competitive and noncompetitive services under 254(k).[204]

The KCC filed comments in response to Western Wireless's *Petition for Preemption*. Most notably, the KCC argued, "unlike [s]ection 253(a), [s]ection 254 contains no grant to the Commission of direct regulatory authority over intrastate matters. Consequently the basic presumption of [s]ection [2(b)] against Commission assertion of jurisdiction applies."[205]

2. Applying the Three-Pronged Test

The Kansas Plan was selected because it is significantly different from the Federal Plan. First, the Kansas Plan uses revenue neutrality to determine

200. Western Wireless Corp., *Petition for Preemption*, File No. CWD 98-90 (July 20, 1998).

201. *Id.* at 13-14.

202. *Id.* at 8.

203. *Id.* at 17.

204. *Id.* at 15-17.

205. Western Wireless Corp., *Comments of the Kansas State Corporation Commission*, File No. CWD 98-90, at 18 (Sept. 3, 1998) [hereinafter *KCC Comments*].

the level of universal service support. Second, the Kansas Plan provides statewide support to ILECs but denies statewide support to CLECs. As illustrated below, in order for a state universal service plan to be consistent with the 1996 Act, it must meet both prongs of the test, unless a court determines that section 2(b) applies to limit the preemptive reach of section 254(f), exempting purely intrastate policies. In that case, the "optional" third prong of the test would be applied in order to determine which aspects of the plan are purely intrastate, jurisdictionally mixed, or purely interstate. In addition, purely intrastate portions of a state plan would still need to survive a conflict preemption test. If a state universal service plan cannot withstand such scrutiny, it is preempted by the 1996 Act.

Prong 1 of the test for determining inconsistencies with section 254(f) of the Act requires an express preemption analysis. This prong requires that the state universal service plan be consistent with the express language in section 254, including the requirement of consistency with the FCC's rules for implementing universal service.[206] Several of the Kansas Plan's policies stray from the FCC's rules and polices for implementing the universal service provisions of the Act and as a result may be inconsistent with the FCC's implementation of the universal service provision of the Act.

As mentioned in Part IV, the FCC adopted seven design principles. Several aspects of the Kansas Plan are at odds with these principles. Specifically, the Kansas Plan's reliance on revenue neutrality as a means for sizing the KUSF and the limitation on statewide high-cost support for CLECs are arguably inconsistent with several of these principles.

The FCC adopted the following universal service design principle: There should be specific, predictable, and sufficient federal *and state* mechanisms to preserve and enhance universal service.[207] In conforming the Federal Plan to this principle, the FCC decided to use a forward-looking cost model to determine the level of high-cost support that will be provided to nonrural carriers. A cost model, which uses company specific information to develop inputs that approximate actual costs of an efficient telephone network, ensures that the universal service support mechanism is specific, predictable, and sufficient to preserve and enhance universal service. The FCC encouraged states to adopt cost models by providing guidelines for states to use when developing their cost models and permitting states to use a state cost model, instead of the FCC's model, for determining the level of federal universal service support to be funded by the states.[208]

206. *See supra* notes 98-100 and accompanying text.

207. *Universal Serv. Report and Order*, *supra* note 99, para. 44.

208. *See generally* Guidance to Proponents of Cost Models in Universal Service Proceeding: Customer Location and Outside Plant, *Public Notice*, 12 F.C.C.R. 18,340 (1997).

In contrast to both the design principle and the specific FCC-adopted means of achieving a specific, predictable, and sufficient mechanism to preserve and enhance universal service, the Kansas Plan does not employ a cost model. Instead, the amount of support in the KUSF is based on the principle of revenue neutrality. The amount in the fund is equal to the difference between interstate and intrastate access charges. Incumbent local exchange carriers are entitled to recover from the KUSF losses resulting from reduced intrastate access charges. Because the mechanism is not based on the cost of providing basic telephone service to residents of Kansas, the Kansas Plan is not specific, predictable, or sufficient.

Second, the Kansas Plan is inconsistent with the FCC's principle that universal service mechanisms should be competitively neutral.[209] The FCC defines as competitively neutral those policies that "neither unfairly advantage or disadvantage one provider over another."[210] The Kansas Plan provides statewide universal service support to incumbent local exchange carriers, which are able to tap the fund to recover their losses in intrastate access charges.

Competitive carriers providing service in Kansas, however, are only eligible for state universal service support for their exchanges with fewer than 10,000 lines.[211] Nonetheless, these carriers are required to contribute to the fund in the same manner as incumbent local exchange carriers. In essence, the CLECs, which are ineligible to receive statewide universal service support, arguably subsidize incumbents because incumbents are guaranteed revenue neutrality. The result unfairly advantages incumbents in two ways: (1) incumbents are eligible for statewide support and competitors are not; and (2) competitors subsidize the revenues guaranteed to incumbents. Arguably, the limitation on statewide support is not competitively neutral and, as a result, is inconsistent with the FCC's rules for implementing the universal service provisions of the Act.[212]

In addition to the requirement that state universal service plans be consistent with the FCC's rules for implementing universal service, the state plan must also comply with the remaining express language of section 254(f). These additional provisions include: (1) additional state definitions

209. *Universal Serv. Report and Order*, *supra* note 99, para. 47.

210. *Id.*

211. *1996 KCC Order*, *supra* note 178, para. 123(b).

212. The KCC, in its comments to Western Wireless's *Petition for Preemption* of the Kansas Universal Service Plan, argues that "as with any other anti-discriminatory principle, different treatment is fair if it corresponds to differences in characteristics between providers." In sum, the KCC contends that the mandated rate cuts faced by incumbent local exchange carriers justifies the different treatment and does not provide them with an unfair advantage over CLECs. *KCC Comments*, *supra* note 205.

and requirements must be supported by a specific, predictable, and sufficient mechanism, and (2) state mechanisms must not rely on or burden the federal mechanism. The specific, predictable, and sufficient requirement is encapsulated in the FCC rules for implementing universal service. As discussed above, the KUSF lacks a specific, predictable, and sufficient mechanism because the mechanism is not directly related to the cost of providing basic service. However, the Kansas Plan is consistent with the requirement that a state plan not burden or rely on the Federal Plan because the Kansas fund and distribution mechanism are completely unrelated to the federal universal service mechanism.

Because the Kansas Plan cannot pass muster under the first prong of the test, further analysis is not required. However, for illustrative purposes, the Kansas Plan is analyzed under prong 2, the standard conflict preemption test. Conflict preemption occurs when it is impossible to comply with state and federal law simultaneously or when a state law obstructs an important objective of federal regulation.[213] As discussed *supra*, if a state universal service regulation fails prong 1, the regulation also obstructs an important federal objective and consequently fails prong 2. For instance, the policies of basing universal service support on revenue neutrality and limiting statewide support to incumbents obstruct the federal objective stated in section 254(f) of a mechanism that is "specific, predictable and sufficient" to "enhance and preserve" universal service.

Prong 2 also requires that it be possible for a carrier to comply simultaneously with both state and federal universal service regulations. With regard to Kansas, the relevant inquiry is whether a state universal service plan can use revenue neutrality concepts to size its fund, while the Federal Plan uses a cost model for purposes of sizing the Federal Universal

213. *See supra* note 19 and accompanying text.

Service Fund. Without confusing the analysis, it is interesting to note that section 254(f) addresses state universal service plans that provide support in addition to the support carriers received from the Federal Plan. However, as discussed *supra*, the separation rules require that states provide 75 percent of the funding for the federal mechanism.[214] The FCC also permits states to use their own cost models to determine the state portion of the federal requirement. Clearly, Kansas could not use revenue neutrality to determine universal service support with regard to its obligation to fund 75 percent when the FCC requires that the states use the federal cost model or an FCC-approved state model. However, it is conceivable that Kansas could use revenue neutrality to size the state universal service fund while its federal support is determined using the FCC's cost model. Therefore, although the Kansas revenue neutrality concept probably obstructs an important federal objective, in theory the policy could coexist with federal regulations.

Although it is unlikely that a state or federal court will determine that section 254(f)'s preemption power is limited by section 2(b), the three-pronged test provides an optional third prong in anticipation of this remote possibility. The first question to ask under this prong is whether the state regulations at issue cover purely intrastate services. The third prong recognizes that section 2(b) of the Act exempts from section 254(f) all state universal service regulations governing equipment used exclusively in intrastate jurisdiction, services provided exclusively in the intrastate jurisdiction, or charges for intrastate services.

Universal service programs ensure that all residents have access to *basic* telephone services and therefore generally deal with purely intrastate issues. However, interstate issues are implicated with respect to some aspects of a universal service plan. For instance, the definition of basic service includes access to a long-distance service provider.[215] Furthermore, the FCC adopted separation rules that allocate the cost of the local loop between the interstate and intrastate jurisdictions. These policies indicate that some of the equipment used in the provision of basic service is "jurisdictionally mixed."[216] Therefore, individual state universal service policies must be

214. As noted in Part IV, the FCC is investigating the 75% figure and is currently seeking comment on the Joint Board's proposed modifications to the separations rules. *See Universal Serv. Public Notice*, *supra* note 119; *Universal Serv. Second Recommended Decision*, *supra* note 119.

215. *Universal Serv. Report and Order*, *supra* note 99, para. 61.

216. With respect to interpreting section 2(b), jurisdictionally mixed equipment implicates the impossibility exception if the state law conflicts with the FCC's lawful authority over the intrastate jurisdiction. *See supra* notes 41-43 and accompanying text. However, in *Iowa Utilities Board*, the court indicated that the separation rules provide a means to allocate between interstate and intrastate jurisdictions. *See supra* note 56 and accompanying text. Thus, the mere application of the separation rules to universal service should not ren-

analyzed for consistency with section 2(b) to determine if they are exempt from the preemptive effect of section 254(f)—even if at first glance they appear to involve purely intrastate services.

The Kansas Plan's use of revenue neutrality as the guiding principle to size its state universal service plan is arguably a purely intrastate policy. Despite the fact that the KUSF supports access to interexchange services, the Kansas Plan should not be automatically deemed outside the ambit of section 2(b). Instead, a section 2(b) jurisdictionally mixed analysis should be completed, guided by the case law as discussed in Part III. According to the "impossibility exception," section 2(b) is negated when it is impossible to separate interstate and intrastate components and when the state law conflicts with the FCC's lawful authority over the interstate jurisdiction. The reverse should also be true: A state universal service policy involving jurisdictionally mixed services, equipment, or charges should be protected by section 2(b) if it does not conflict with the FCC's lawful authority over the interstate jurisdiction. Included within the FCC's lawful authority over interstate services is its authority over the federal universal service mechanism. Hence the question of whether section 2(b) protects the revenue neutral mechanism of the Kansas Plan from preemption depends on whether this policy conflicts with the Federal Plan. As discussed above, such a policy undermines the federal objective of specific, predictable, and sufficient mechanisms although the burden is on the FCC to prove this to a court. Hence, this policy will not be exempted from preemption by the third prong of the test. More importantly, this analysis confirms the hypothesis in Part III that the "impossibility exception" turns on whether a plan presents the type of conflict preemption in which a state law stands as an obstacle to a federal law, and is thus preempted.[217]

In conclusion, the Kansas Plan's long history of challenges in its relatively short life indicates its potential inconsistencies with the Federal Plan. Applying the three-pronged test for determining inconsistencies with section 254(f) of the 1996 Act confirms that the Kansas Plan should be preempted by federal law.

B. California

1. The California Universal Service Plan

California's commitment to preserving and enhancing universal service predates the Telecommunications Act of 1996. In 1993, the California Pub-

der it jurisdictionally mixed.

217. *See supra* note 21 and accompanying text.

lic Utilities Commission (CPUC) submitted a strategy report to the Governor regarding the state's telecommunications infrastructure.[218] The report, entitled *Enhancing California's Competitive Strength: A Strategy for Telecommunications Infrastructure*, promoted competition in the telecommunications market as the most effective way to keep pace with innovation and change in telecommunications.[219] In 1994, the legislature passed two bills. Assembly Bill 3606 opened all of California's telecommunications markets to local competition by January 1, 1997.[220] Assembly Bill 3643 required the CPUC to develop universal service policies to "define the goals of universal service given new technologies and increasingly competitive markets, with emphasis on the role of basic service in education, health care, and in the workplace."[221]

The CPUC defines basic service as those telecommunications services customers have come to expect, including access to single party local exchange services; access to interchange carriers; ability to place and receive calls; touch-tone dialing; free access to emergency services; access to directory assistance; Lifeline rates for eligible customers; customer choice of flat or measure service (California high-cost fund A (CHCF-A) entities are exempt from this requirement); access to directory listing; access to operator services; voice grade connection to public switched network; access to information services; one-time billing adjustment for charges incurred inadvertently; free access to information about ULTS (Lifeline); and free access to information regarding service activation, termination, repair, and billing.[222] All carriers providing residential services are required to provide all of the elements of basic service.[223] Local exchange carriers are also required to actively pursue California's objective of achieving 95 percent subscribership among groups.[224]

218. Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service, *Order Granting a Limited Rehearing of D.96-03-020 and Modifying D.96-03-020*, D.97-04-090, 1997 WL 373215, at *1 (Cal. P.U.C. Apr. 23, 1997).

219. *Id*.

220. Assembly Bill 3606, Stats. 1994, ch. 1260, § 3, CAL. PUB. UTIL. CODE § 709.5 (West Supp. 1999) (directs the CPUC to ensure that the goals of universal service are met as competition develops).

221. Mandates of Assembly Bill 3643, *Opinion*, D.96-10-066, 1996 WL 651546 (Cal. P.U.C. Oct. 25, 1996) (describing the requirements of Assembly Bill 3643, Stats. 1994, ch. 278, § 2(a)).

222. *Id.* app. B, rule 4.A.-B.

223. *Id.* rule 4.A.

224. *Id.* rule 3.B.3(a).

California has two high-cost funds. California high-cost fund A provides support for rural LECs; CHCF-B supports nonrural LECs.[225] The CPUC selected a cost model for CHCF-B, and the carriers have been assessing the Commission-determined surcharge since February 1997.[226] For the most part, the surcharge is assessed on all telecommunications providers, except one-way paging companies.[227]

Instead of adopting the FCC's concept of a revenue benchmark, the CPUC adopted a statewide cost benchmark for determining universal service levels. Geographic serving areas qualify for high-cost support if the cost providing basic local service exceeds the statewide cost of $20.30 or the carrier's flat rate plus the end-user common line charge, whichever is greater.[228] The subsidy amount is funded by an all-end-user surcharge estimated to 2.87 percent.[229] All surcharges must be itemized on customer bills.

Incumbent local exchange carriers are required to adjust downward the price of all services in an amount equal to the explicit subsidy received from the CHCF-B.[230] To receive CHCF funding, a carrier must be a carrier of last resort (COLR).[231] Incumbent local exchange carriers are automatically COLRs,[232] and competing carriers may apply for COLR designation.[233] A reseller receives universal service support if it purchases at market-based or de-averaged prices. In all other cases, the initial provider of the resold services receives the support.

The California Lifeline Program (ULTS) requires that all carriers providing basic service offer Lifeline.[234] Carriers may not charge more than the statewide ULTS rate to qualifying low-income customers and must provide the service to all requesting customers.[235] Carriers may recover the difference between their tariffed rate and the Lifeline rate, but may not recover an amount greater than that recovered by the incumbent serving the same geographic area. The ULTS subsidy is funded by a separate surcharge on all end-users of telecommunications.[236] Competitive local carriers are eligible to receive ULTS support.

225. *Id.* Ordering paras. 8a, 9.
226. *Id.* Ordering para. 8h.
227. *Id.* Ordering para. 8g.
228. *Id.* Ordering para. 10d.
229. *Id.* Ordering para. 8h.
230. *Id.* app. B, rule 6.C.3.
231. *Id.* rule 6.C.2.
232. *Id.* Ordering para. 7e (providing that all 22 ILECs in California are COLRs).
233. *Id.* Ordering para. 9.
234. Lifeline is included in the required basic service offerings. *See id.* app. B, rule 4.B.
235. *Id.*
236. *Id.* Ordering para. 7d.

The schools and libraries program is consolidated with the health care program and both discounts are recovered from the California Teleconnect Fund (CTF). The CTF is funded by a 0.41 percent surcharge on customer bills.[237] In addition to rules regarding CHCF-A, CHCF-B, CTF, and ULTS, California adopted a series of consumer protection rules.[238]

2. Applying the Three-Pronged Test

The California Universal Service Plan (California Plan) has been selected because it is significantly similar to the Federal Plan and, in some regards more explicit and forward looking than the Federal Plan. First, the California Plan expands the federal definition of basic service. Second, the Plan creates a virtual voucher funding mechanism for CHCF-B, supplemented by an auction system. Third, the Plan ties CHCF-B support to COLR designation. This analysis focuses on California's expanded definition of basic service.

To be consistent with the 1996 Act, the state plan must pass both prongs of the test (unless a court determines that section 2(b) applies to limit section 254(f)). If the state plan cannot pass one of the test's two required prongs, it will be vulnerable to preemption by the 1996 Act.

Prong 1 of the test for determining inconsistencies with section 254(f) of the Act is an express preemption analysis. This prong requires that the state universal service plan be consistent with the express language in section 254, including the requirement of consistency with the FCC rules for implementing universal service. The California Plan is not only "not inconsistent" with the Federal Plan, it actively advances the goals of universal service.

As noted earlier, the California Plan significantly expands the federal definition of basic service to incorporate services Californians have come to rely on and expect. California expands the definition of basic services without deleting any of the federally defined services. The California Plan is not identical to the Federal Plan, but neither is it inconsistent with the federal rules. The California Plan satisfies prong 1 of the test.

The California Plan's definition of basic service does not burden the federal mechanism. Under section 254(f), the state is responsible for setting up an intrastate plan that promotes universal service in a competitive environment. The California plan does not stop at a one-time expansion of the basic service definition, it includes a periodic review of its basic service definition. Every three years the CPUC will consider whether even further

237. *Id.* Ordering para. 10e.
238. *See generally id.* For example, the CPUC adopted a bilingual outreach program.

expansion of the listed services is warranted in order to continually provide the greatest possible range of telecommunications services to all Californians. This is an even more progressive approach to preserving and advancing universal service than is required by the federal rules.

Prong 2 of the test is a conflict preemption analysis; it requires that it be possible to comply simultaneously with both the federal and state universal service regulations. As noted above, the California Universal Service Plan includes an expanded definition of basic service from that of the FCC. These two sets of regulations can exist contemporaneously as there is no added burden placed on federal universal service, and this "in addition to" requirement serves to preserve and advance universal service.

Because the California Plan incorporates more into basic service than the federal regulations require, there is an inconsistency between the two. However, this is an inconsistency created by California's intrastate components, which are in addition to the federal regulations. This "in addition to" language is consistent with section 254(f), which allows states to adopt additional definitions to preserve and advance universal service. In this instance, both sets of regulations can be complied with simultaneously, thereby rendering this particular inconsistency outside of 254(f)'s preemptive reach. Further, the California Plan's expanded list of basic service supports the federal objective of enhancing and advancing universal service rather than obstructing this important federal objective. Therefore, California's Plan meets the requirements for prong 2.

Prong 3 is the optional prong to the preemption test. This prong is viable if a state or federal court concludes that section 254(f)'s preemption power is limited by section 2(b). When there are mixed jurisdiction considerations or the equipment used, services rendered, or charges made are purely intrastate, section 2(b) stands between 254(f) and preemption of state regulations.

Most of the services included on California's expanded basic service list fall within the purely intrastate exemption. However, the list does include access to interexchange carriers and access to information services and 1-800 numbers. These two services probably qualify as jurisdictionally mixed as they consist of a combination of interstate and intrastate components.

Just because services are jurisdictionally mixed does not immediately open a state plan to 254(f)'s preemption power. As discussed earlier, case law had defined the "impossibility exception." This exception negates section 2(b) when it is impossible to separate interstate and intrastate components and when the state law conflicts with the FCC's lawful authority over the interstate jurisdiction. If it is impossible to separate the interstate and intrastate components of interexchange carriers and information services to include 1-800, then preemption will hinge on whether California's expanded version of basic service conflicts with the FCC's lawful authority over the interstate jurisdiction. As previously discussed, the expansion of basic services does not undermine federal objectives. In fact, it goes beyond the federal requirement in promoting federal objectives. Hence, this policy should be exempted from preemption by the third prong of the test.

In conclusion, the California Universal Service Plan shows a pattern of being both consistent with the Federal Universal Service Plan and going beyond the federal mandate to preserve and advance universal service. The application of the test for determining inconsistencies with section 254(f) of the 1996 Act leads to the conclusion that federal law should not preempt the California Plan.

VI. CONCLUSION

With the passage of the Telecommunications Act of 1996, Congress revamped federal universal service policy by requiring that universal service support be explicit. With the introduction of competition in the local market, the requirement that universal service support be explicit ensures that both high and low-cost areas will have reasonably comparable access to telecommunications services, without impairing the ability of carriers to price telecommunications services on a competitive basis.

Universal service policy provides a compelling framework to examine legal issues because it embodies the greatest paradox contained in the Telecommunications Act of 1996—introducing unbridled competition while at the same time preserving access to quality telecommunications services in "less attractive" market segments. To achieve this goal in a manner that satisfies varying local, regional, and national interests, the Telecommunications Act of 1996 provides for both a mandatory federal universal service fund and permissive state universal service funds. It is therefore important to determine the amount of flexibility individual states are permitted under the Act to develop universal service funding plans that comport with local interests without frustrating national objectives.

Congress provided that states could supplement federal universal service support with state universal service support only if the state program is not inconsistent with the FCC's rules for implementing the Federal Plan. In adopting this section of the Act, Congress expressly provided for preemption of state universal service plans that are not consistent with the FCC's rules. In doing so, Congress removed state universal service plans from the ambit of section 2(b), which limits the FCC's jurisdiction over state charges, rates, and services. Therefore, the FCC's rules for implementing universal service are the determining factor in whether a state universal service plan can withstand judicial or FCC challenge.

Section 254(f) provides for express preemption of state universal service plans but uses FCC rules as a measure for determining when preemption is required. As a result, the case law governing express preemption by Congress is in and of itself an insufficient guide for determining the scope of the section 254(f) preemption power. To interpret section 254(f), case law governing preemption by the FCC of state law must also be incorporated. Thus, a three-pronged test is required to determine whether a state universal service plan is preempted by section 254(f). First, a state plan must be consistent with the FCC's rules and must not burden the federal mechanism. Second, a state plan must be able to coexist with each policy adopted by the Federal Universal Service Plan. Additionally, if a court insists that section 2(b) applies to section 254(f), a third prong is required—state laws concerning purely intrastate services, equipment, and charges are immune from FCC preemption.

The test for determining whether state universal service plans are inconsistent with the Telecommunications Act of 1996 yields predictable results. California, a state known for its pro-consumer laws and its progressive telecommunications policies, has a universal service plan that easily passes the test. On the other hand, Kansas, a state with many rural areas and a public utility commission pressured by incumbents to quash local competition, adopted a state universal service plan that does not pass the test.

Finally, the test created herein is not a new test applied to new law, but instead, a method to ensure consistent application of preemption jurisprudence to the evolution of the Communications Act of 1934. Clearly, the FCC's power to preempt state law should not increase or decrease depending on which section of the Communications Act is being challenged by a state law. Instead, all sections of the Communications Act that provide the FCC with power to preempt state law should be governed by the same body of case law. The test for determining whether state universal service plans are inconsistent with the Act is grounded in the principles set out in *Louisiana PSC*, which has been consistently applied by appeals courts and was recently confirmed by the Supreme Court in *AT&T v. Iowa Utilities Board*.

Although the test for determining whether state universal service plans are inconsistent with the Telecommunications Act of 1996 was devised with the universal service provisions of the Act in mind, its use is not so limited. This test should provide a framework for determining whether state law is preempted by any section of the Communications Act of 1934.