

PUBLIC UTILITIES

Full Competition Comes to the Telecommunications Market in New Jersey

by: [Anne S. Babineau](#), [Hesser G. McBride, Jr.](#) and [Adrian D. Hronich](#)

With the passage of the Federal Telecommunications Act of 1996 on February 8, 1996, the United States Congress had a significant impact on the restructuring of the telecommunications industry in New Jersey. Although the New Jersey Board of Public Utilities was already in the process of moving to bring more competition to the telecommunications market in New Jersey, Congress set forth a series of requirements and procedures aimed at opening to full competition both the markets for local exchange and long-distance telephone service. The magnitude of this change in government policy and its real-life implications can be appreciated only when viewed against the prior government-mandated scheme that dominated this field for decades.

The Prior Telephone Service Regime

Prior to 1984, AT&T (through the former Bell System) provided both local exchange and long-distance service, with little competition. In 1984, however, pursuant to the modified final judgment approved by Judge Harold Greene in settlement of the Department of Justice antitrust suit against AT&T, AT&T divested itself of 22 local telephone companies (called Bell Operating Companies or BOCs), which were then reorganized as subsidiaries of seven newly-created Regional Bell Operating Companies (RBOCs), such as Bell Atlantic Corporation.

Under the terms of the modified final judgment, the entire country was divided into geographic regions known as local access and transport areas (LATAs). RBOCs and their subsidiaries were prohibited from offering interLATA services (*i.e.*, carrying calls that originate and terminate in different LATAs), commonly known as long-distance toll services. These interLATA services could be provided only by interexchange carriers, such as AT&T, MCI and Sprint. Conversely, at that time, the divestiture decree provided that the state commissions would individually have the discretion as to whether or not the long distance carriers should be permitted to compete with the local exchange carriers for the provision of intrastate intraLATA service (*i.e.*, carrying calls that originate and terminate within the same LATA; commonly known as regional toll service).

In New Jersey in 1984, based on its commitment to universal service and reasonable basic exchange rates, the Board determined not to allow intraLATA competition at that time. Subsequent Board decisions have allowed interexchange carriers (IXCs) to offer intraLATA service. However, for the most part, local exchange telephone service in New Jersey was at the time of divestiture, and has remained until the adoption of the act, a service offered only by the local BOC or independent telephone company serving as the local exchange carrier (LEC) -- not by the interexchange carriers.

The Act's Competitive Scheme

The act seeks to abolish the entire scheme that is dependent upon LATA restrictions and to encourage the development of local exchange competition.

Regarding interLATA calling, the act establishes a mechanism for allowing a BOC to compete for the first time in that market. Pursuant to the act, a BOC is permitted to compete in the interLATA market with interexchange providers (such as AT&T, MCI, and Sprint) after it has complied with certain conditions enabling the development of competition in the local telephone market.

The act requires that the BOC apply to the Federal Communications Commission (FCC) for authorization to provide such interLATA services originating in any of the states in which a BOC or any of its affiliates is authorized to provide

wireline telephone exchange service. The FCC is to consult with the relevant state commission(s) to verify the BOC's compliance with the requirements of Section 271(c) of the act.

Regarding local exchange telephone service, the act provides that the former government-sanctioned regime that resulted in almost all local exchange being provided by the incumbent local exchange carrier is to give way to a government-mandated competitive regime. In the words of the United States Supreme Court, previously

States typically granted an exclusive franchise in each local telephone service area to a local exchange carrier (LEC), which owned, among other things, the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destinations), and the transport trunks (wires carrying calls between switches) that constitute the local exchange network.

Based on what the Supreme Court described as a recognition that technological progress increased the possibility of competition among multiple local service providers, Congress passed the Act to usher in competition. As the Supreme Court explained, under the act,

incumbent LECs ["ILECs"] are subject to a host of duties intended to facilitate market entry. Foremost among these duties is the LEC's obligation ... to share its network with competitors [A] requesting carrier [termed "competitive local exchange carrier" or "CLEC"] can obtain access to an incumbent's network in three ways: It can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the incumbent's network 'on an unbundled basis' [unbundled network elements are also known as "UNEs"]; and it can interconnect its own facilities with the incumbent's network.

While the act imposed significant duties upon ILECs, it also sought to ensure that those duties were balanced with the rights of the ILECs. An ILEC is to receive "just and reasonable," "cost-based" compensation for allowing CLECs interconnection and access to UNEs. Additionally, an ILEC must provide a competitor with access to those UNEs that the FCC finds are "necessary" for such access and that "the failure to provide access to such [UNEs] would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer."

As was later reinforced by the United States Supreme Court, the FCC must

determine on a rational basis which network elements must be made available, taking into account the objectives of the Act and giving some substance to the 'necessary' and 'impair' requirements."

The Supreme Court emphasized that the FCC may not disregard the availability of elements outside the ILEC's network and may not consider

any 'increased cost or decreased service quality' as establishing a 'necessity' and an 'impairment' of the ability to 'provide ... services'.

Under the act, the terms and conditions for interconnection and access to UNEs between a CLEC and the ILEC is to be set forth in what the act terms an "interconnection agreement." Section 252 of the act anticipates that private negotiations would play a dominant role in reaching agreement between competitors and ILECS concerning the terms and conditions that would govern their relationships. That section provides a fallback, however, permitting parties to seek the assistance of state public utility commissions in the event private negotiations fail to achieve a complete agreement. During negotiations, any party may request the state commission to participate and to mediate any differences between the parties arising during negotiation.

Section 252 also provides for arbitration. If the parties are unable to agree on all issues within 135 days after the competitor's initial request for negotiation, either party may petition the state commission for arbitration of any open

issues. After the arbitration, which is to be concluded within nine months from the date on which the ILEC received the request for interconnection, the parties are to incorporate the results of their negotiations and the arbitration into an interconnection agreement, which they are required to submit to the state commission for its review.

The standards for approving or rejecting negotiated or arbitrated terms differ and are explicitly set forth in the act. In New Jersey, more than a dozen interconnection agreements and over 40 resale agreements between BA-NJ and new competing carriers have been approved by the board.

Finally, the Act specifically provides for federal district court review of state commission actions. Pursuant to Section 252(e)(6) of the Act,

any party aggrieved by a [state commission] determination may bring an action in an appropriate Federal district court to determine whether the agreement ... meets the requirements of section 251 and [section 252]."

Section 252(e)(4) correspondingly precludes state court review of a state commission's action in approving or rejecting an agreement under Section 252.

FCC Regulations Implementing The Act

In the act, Congress directed the FCC to "establish regulations to implement the requirements of this section [i.e., Section 251]." Accordingly, in August 1996, the FCC issued rules. The FCC also simultaneously issued a substantial 700-page order describing the proposed rules, comments received, and the rationale behind the rules. The FCC rules set forth requirements concerning various technical aspects of interconnection between CLECs and ILECs. The rules also called for rates for each UNE to be established in one of two ways. The state commission was to develop rates pursuant to a forward-looking economic cost methodology set forth in the rules (called "Total Element Long Run Incremental Cost or TELRIC). Alternatively, recognizing that state commissions might not be able to review TELRIC cost studies within the tight time frames set forth in the act, the rules included a series of proxy rates that a state commission could use in the interim until it was able to review and approve TELRIC-based costs.

In New Jersey, the proxy rates were employed in the interconnection agreements for many carriers while the board conducted a proceeding, *I/M/O Notice of Pre-Proposal and Notice of Investigation Regarding Local Exchange Competition for Telecommunications Services*. In that proceeding, after reviewing economic cost studies, the Board established rates for interconnection and access to UNEs.

Numerous state commissions and ILECs challenged the FCC's TELRIC pricing guidelines and certain other aspects of the FCC order. The United States Court of Appeals for the Eighth Circuit first stayed and then ultimately vacated all the FCC's pricing rules (and certain other FCC rules) on the grounds that they were beyond the federal agency's statutory jurisdiction, which was largely limited to *interstate* communications. The United States Supreme Court, however, reversed the Eighth Circuit on jurisdictional grounds, finding that the FCC did have jurisdiction to promulgate regulations under the Act.

Legal Implications of The Act's New Regime

Jurisdictional Issues

In the past, the intrastate telecommunications market was largely controlled locally by each state commission; federal regulation by the FCC was reserved for interstate telecommunications. The Supreme Court's recent determination that in promulgating the act, Congress intended to delegate to the FCC general authority to issue regulations governing local telephone competition (including pricing) in the act -- which is predominantly if not completely intrastate in

nature -- alters that previous scheme.

While each state commission is charged with the critical role of arbitrating and approving the numerous interconnection agreements that will govern the CLECs' and ILECs' relationships, the FCC is responsible for issuing the regulations that will serve to guide the state commissions' decisions. Thus, although the FCC guidelines leave much discretion to state commissions and although state commissions must still play a significant role in the implementation and development of local exchange competition, the shift toward increasing federal oversight represents somewhat of a departure from the decentralized scheme that formerly left local telecommunications service almost completely within the State's domain.

The extent of the shift is not clear given that the substantive aspects of the FCC pricing rules have yet to be resolved by the Eighth Circuit and, therefore, the degree to which the regulations will stand as the outer bounds of what would constitute reasonable rate setting is undetermined.

The answer to the question of where one will litigate telecommunications issues is also not necessarily clear. As noted above, Sections 252(e)(4) and (6) provide for federal court jurisdiction in the case of a challenge to "action of a State commission in approving or rejecting an agreement under this section" and for "any party aggrieved by [determinations by a state commission under section 252.]"

A considerable number of other controversies involving issues under the act, however, may or may not fall within the act's grant of federal court jurisdiction. For example, at least one federal court has determined that it lacked jurisdiction with respect to negotiated (as opposed to arbitrated) terms of an interconnection term.

Prior to the Act, review of state commission determinations in the area of telecommunications rested almost exclusively with the state appellate courts. As litigants are presented with issues that might not fall within the grants of federal court jurisdiction, the state commission and state court jurisdiction may remain the appropriate avenues of dispute resolution with respect to certain telecommunications issues.

Substantive Legal Issues

The act's new regime is also likely to alter the substance of the legal issues facing the telecommunications industry. Legal disputes common to a field governed by a monopoly are likely to be superceded by issues that dominate a competitive market. Rather than state commissions discussing an ILEC's fair rate of return or its ability to charge consumers certain prices, issues such as interference with contractual relations, unfair competition, consumer fraud, etc. are likely to be regular fare on the legal menus.

The Evolving Role of State Commissions

The new character of the legal disputes raise interesting questions concerning the future role of the state commissions, including the New Jersey board. The nature and extent of continuing state commission regulation is unsettled and likely will remain so as the effects of competitive forces are unveiled in the market. Some may argue that continued state commission oversight is necessary, given that some of the present issues are likely to remain, even in the new world of competition; *e.g.*, who will oversee issues of service quality or consumer protection? Others, however, pointing to the Internet market for instance, may suggest that regulatory forbearance should be the norm -- competitive forces should be permitted to play out in the market and what competition does not resolve, the courts will.

One major area of continuing state commission involvement is certain. The state commission will be assuring that at least one carrier retains the duty to serve a customer who may not get service elsewhere. The act requires that the state commission designate an "eligible telecommunications carrier" that will offer universal service in a specific area of the state. This new role under the act is consistent with the authority that the board has had under the New Jersey Statutes

to assure that safe adequate and proper service is provided.

Conclusion

In summary, the implementation of the Telecommunications Act of 1996 in New Jersey will open all markets to competition -- local and long distance -- and affect the role of the Board, the Courts and the substantive law. It remains to be seen the extent to which the Act will federalize telecommunications law and to which the Board will need to actively take steps to ensure that competition works here in New Jersey. For at least the transition period, the board has played a major role in setting the ground rules for competition.

Endnotes

¹ Pub. L. 104-104, 110 Stat. 56.

² In December 1995, the Board “initiated an investigation and rulemaking proceeding to determine whether or not to permit local exchange competition in New Jersey and, if so, under what terms and conditions such competition should be allowed.” A Notice of Pre-Proposal and Notice of Investigation (“NOI”) (PPR 1996-1) was published in the New Jersey Register on January 16, 1996 at 28 N.J.R. 247(b).

³ A Bell Operating Company, as defined in the Act, includes certain specifically-enumerated companies. 47 U.S.C. §153(4). Bell Atlantic - New Jersey, Inc., formerly New Jersey Bell Telephone Co., is a BOC.

⁴ In New Jersey, there are three LATAs, the North Jersey LATA, the Delaware Valley LATA, and the Atlantic Coastal LATA.

⁵ For a discussion of the Modified Final Judgment, see *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131 (D.C. 1982), *aff’d sub nom. Maryland v. United States*, 460 U.S. 1001, 103 S. Ct. 1240, 75 L.Ed. 472 (1983) (“Modified Final Judgment”)

⁶ Modified Final Judgment at 159, n. 117.

⁷ In the Matter of the Board’s Investigation of Intrastate Telecommunications Competition in the State of New Jersey, Docket No. 8312-1126 (June 11, 1984). The Board also employed safeguards to ensure that revenue contribution would continue to flow in the event that intraLATA calls were completed in violation of the Board’s prohibition; the Board required a payment of compensation for such improper completion. In the Matter of the Proposed Compensation Plan for Illegal IntraLATA Traffic, Docket No. 8312-1126 (November 30, 1984). Thereafter, the Board conducted a proceeding to investigate whether it should permit IXC’s to complete intraLATA calls under circumstances that required the calling party to dial an access code (10XXX). As a result of a settlement in that case, IXC’s were allowed to complete intraLATA calls on an access code basis, and the requirement for compensation was removed and a transitional surcharge was established. In the Matter of the Petition of Sprint, MCI and AT&T for Authorization of IntraLATA Competition and Elimination of IntraLATA Compensation, Docket No. TX90050349 (June 30, 1994). In that Order the Board stated that it would commence a proceeding to investigate whether there should be intraLATA presubscription in New Jersey, i.e., whether the interexchange carriers should be allowed to complete intraLATA calls without requiring the calling party to dial an access code. The Board determined to allow IXC’s to complete intraLATA calling without the use of an access code (i.e., to allow intraLATA presubscription) by its Order Approving Presubscription and Proposal of Rules, In the Matter of the Investigation of IntraLATA Toll Competition for Telecommunications Services on a Presubscription Basis, Docket No. TX94090388 (December 14, 1995).

⁸ Although there were some instances in which the IXC’s were providing local service directly to the customer, the Superior Court Appellate Division has commented generally that “[l]ocal access is essentially a monopoly service provided by local exchange carriers.” In the Matter of the Petition of MCI Telecommunications Corporation for Authorization of IntraLATA Competition and Approval of Certain Tariffs, 263 N.J. Super. 313, 317 (App. Div. 1993).

⁹ Regarding intrastate intraLATA calling, the Act provided that except for single LATA states and states where an order had been issued prior to December 19, 1995 requiring a BOC to implement intraLATA calling without use of an access code (i.e., toll dialing parity), the state may not require a BOC to implement intraLATA toll dialing parity in that state before a BOC has been granted authority to provide interLATA service or before 3 years after the date of enactment of the Telecommunications Act of 1996, whichever is earlier. 47 U.S.C. § 271 (e) (2)(B).

¹⁰ The Act provides a fourteen-point checklist for authorization for a BOC provide interLATA services originating in any of the its in-region States. 47 U.S.C. § 271(c)(2)(B)(i)-(xiv). A BOC or its affiliate “may provide interLATA services originating outside its in-region States after the date of enactment of the Telecommunications Act of 1996, subject to subsection (j) [of Section 271].” See *id.* at § 271(b)(2) (emphasis added).

¹¹ 47 U.S.C. § 271(b)(1), (i)(1).

¹² *Id.* at § 271(d)(2)(B). The FCC is also required to consult with the Attorney General who is to provide the FCC “an evaluation of the application using any standard the Attorney General considers appropriate” and whose evaluation is to be given “substantial weight” but not “preclusive effect.” *Id.* at § 271(d)(2)(A).

¹³ *AT&T Corp. v. Iowa Utilities Board*, Nos. 97-826, et al., 1999 U.S. LEXIS 903 at *8 (January 25, 1999) (“Iowa Utilities Board”).

¹⁴ *Id.* at *8-9.

¹⁵ *Id.* at *9.

¹⁶ 47 U.S.C. § 252(d).

¹⁷ *Id.* at § 251(d)(2)(A), (B).

¹⁸ *Iowa Utilities Board*, at *39.

¹⁹ *Id.* at **35-36, 39-40. The FCC is planning to open an expedited proceeding immediately to consider the “necessary” and “impair” standards for all seven UNEs it previously determined that access to which was “necessary” and that lack of such access would “impair” the competitor’s ability to offer service.

²⁰ 47 U.S.C. § 252(a)(1).

²¹ *Id.* at § 252(a)(2), (b)(1).

²² *Id.* at § 252(a)(2).

²³ *Id.* at § 252(b)(1). If a State commission “fails to act to carry out is responsibility” under Section 252, the FCC will preempt the state commission’s jurisdiction, assume the state commission’s responsibility, and act for the state commission. See *id.* at § 252(e)(5).

²⁴ *Id.* at § 252(e)(4)(C).

²⁵ *Id.* at § 252(e)(1).

²⁶ See First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499, CC Docket No. 96-98 (rel. Aug. 8, 1996) (“FCC Order”).

²⁷ In response to the objections of ILECs which were concerned that they would be denied the opportunity to recover costs that they incurred under federal and state oversight and under the belief that they would have the opportunity to recover, the FCC recognized that in public utility ratemaking the “guiding principle has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so ‘unjust’ as to be confiscatory,” quoting *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307, (1989) (citing *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 597, (1896)) (quotations omitted). FCC Order, 737. Although the FCC determined that prices for interconnection and access to UNEs would be based on TELRIC, the FCC sought to reassure the incumbent local exchange carriers that they would not be foreclosed from the opportunity to recover, to some extent, their embedded costs through a mechanism separate from rates for interconnection and unbundled network elements.” FCC Order, 739.

²⁸ Docket No. TX95120631.

²⁹ See *Iowa Utils. Bd. v. FCC*, 109 F.3d 418 (8th Cir. 1996); *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 799 (8th Cir. 1997), rev’d in part, affirmed in part and remanded sub nom *Iowa Utilities Board*.

³⁰ *Iowa Utilities Board*, at *28.

³¹ See *Indiana Bell v. McCarty*, Cause No. IP 97-0662-C-B/S, at 5-9 (S.D. Ind. June 25, 1998). In *Indiana Bell v. McCarty*, the court held that it lacked subject matter jurisdiction under Section 252(e)(6) of the Act to resolve AT&T’s counterclaim regarding the interpretation of negotiated terms in an agreement between Ameritech Indiana and AT&T. The court noted that the state commission had reviewed and approved the disputed negotiated sections of the

agreement under section 252(e)(2), which allows a state commission to reject such terms only if they discriminate or are inconsistent with public interest, convenience, and necessity. The court noted that the commission had made no determination that the negotiated terms were consistent with any other section of the Act besides 252(e)(2). As the commission had not addressed the issues raised by AT&T's counterclaims, namely, the proper interpretation of the negotiated terms and/or their consistency with Section 251 of the Act, the court accordingly dismissed those counterclaims, finding no "state commission determination" to review.

³² In a recent decision of the New Jersey Supreme Court, *Smart SMR of New York, Inc. v. Borough of Fair Lawn Bd. of Adjustment*, 152 N.J. 309, 326-27 (1998), Justice Pollock, writing for a unanimous Court, recognized the shift away from almost exclusive state court relief in the area of telecommunications. Discussing in particular wireless communications, Justice Pollock noted: "Under the Telecommunications Act, 'Any person adversely affected by any final action or failure to act by a State or local government ... may ... commence an action in any court of competent jurisdiction.' 47 U.S.C.A. § 332(c)(7)(B)(v). Thus, an unsuccessful applicant may challenge in a United States District Court final State or local governmental action that violates the Telecommunications Act." *Id.* at 326 (citations omitted)

³³ 47 U.S.C. at § 214.

³⁴ N.J.S.A. 48:2-23.

Anne S. Babineau and Hesser G. McBride, Jr. are partners at Wilentz, Goldman & Spitzer, P.A. in Woodbridge, specializing in Telecommunications and Energy Law. The authors wish to express their appreciation for the contribution of Adrian D. Hronich, Esq., who participated in the arbitrations and generic proceeding at the New Jersey Board of Public Utilities regarding interconnection along with Ms. Babineau and Mr. McBride.

[Back to Publications](#)

[Home](#) | [What's New](#) | [Corporate Services](#) | [Individual Services](#) | [Attorney Biographies](#) | [Publications](#)
[Employment Opportunities](#) | [Directions](#) | [Search](#) | [Guest Book](#) | [Disclaimer](#)

Send e-mail to webmaster@wilentz.com with questions or comments about this web site.
Copyright © 1998-99 Wilentz, Goldman, & Spitzer, P.C., All rights reserved.