Legal Issues in Preemption

Henry Geller
Markle Foundation

The main thrust of my comments is simply stated: State regulation of intrastate telecommunications is desirable on a number of grounds—the so-called "grass roots" factor (i.e., the states are closer and more attuned to the particular facts in their jurisdictions than a centralized federal authority can be), and Justice Brandeis' apt point about the states as "laboratories" (i.e., the gains from substantial diversity in policy approaches among the states; Haring & Levitz, 1989). Thus, some states have been more innovative than the FCC in deregulatory approaches, such as with respect to intrastate toll and in substituting price regulation for the traditional rate-of-return method.

But there is a clear need for a federal "captain" in several areas, such as deregulation of enhanced services or effective introduction of new radio-based services. Congress should supply general guidelines, but has failed to do so, except for the 1993 legislation that preempts state rate regulation of cellular and other radio-based services. That leaves the task to its delegatee, the FCC, but as the 1990 Ninth Circuit decision shows,[1] the FCC is greatly handicapped here because of the existence of an anachronistic provision of the 1934 Act. As it confronts other telecommunications issues in 1994 and beyond, the Congress should act to repeal the provision and allow the normal preemption test to prevail in this area. Congress is unlikely to do this. Thus, as Noam noted, we are likely to muddle along, with strong cooperation between the states and the federal

[1] *People of California v. FCC*, 905 F.2d 1217 (9th Circuit 1990).

regulators as the best hope for limiting potential damage in this area, so important to national growth.

PREEMPTION STANDARDS

First, there is the matter of the normal preemption approach in our federal–state system. This can be gleaned by looking at court decisions in the cable television area. Thus, in *City of New York v. FCC* (486 U.S. 57, 63-64, 1988), sustaining FCC preemption of state technical standards governing cable television, the Court first pointed to the Constitution ("the Laws of the United States . . . shall be the supreme Law of the Land"), and then notes that this phrase "encompasses both federal statutes themselves and federal regulations that are properly adopted in accordance with statutory authorization." And in *Capital cities Cable, Inc. v. Crisp* (467 U.S. 691, 699, 1984), where again federal preemption of state cable regulatory action was found to be valid, the Court stated that enforcement of a state regulation may be preempted by federal law, *inter alia*, "when compliance with both state and federal law is impossible or when the state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress' . . ." The court further quoted:

> Federal regulations have no less pre-emptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited. "If his choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."

These standards—reasonable accommodation of conflicting policies and especially, "obstacle to the accomplishment of the full [federal] purposes and objectives"—clearly bestow wide authority on federal regulators to act preemptively, unless these is a specific Congressional bar. As a final example, there is the Brookhaven case,[2] where the court tersely held that the FCC "has the authority to preempt state and local price regulation of special pay cable programming" because its "policy of permitting development free of price restraints at every level is reasonably ancillary to the objective of increasing program diversity."

In the telephone area, no problems arose for decades simply because federal and state regulators agreed on policy aims and the means for achieving those

---

[2] *Brookhaven Cable TV, Inc., v. Kelly*, 573 F.2d 765, 767 (2d Circuit 1978), *cert. denied*, 441 U.S. 907 (1979).

aims; in particular achieving universal service by fostering low rates for local service (with the states' benefitting greatly from shifts of costs to the interstate jurisdiction where costs were declining because of technological advances). But this extended honeymoon ended in the 1970s when federal actions introduced competition into the system and thus threatened to undermine state maintenance of low rates through the subsidy scheme. This led to a series of court cases testing whether federal policies, based on Sections 1 and 2(a) of the Communications Act, should prevail over state actions taken under Sections 2(b) and 221(b) of the Act.

The FCC initially won several large battles. Thus, in two Fourth Circuit cases,[3] the court upheld an FCC order preempting state regulations prohibiting subscribers from connecting *their own* phone sets to any telephone facilities used for intrastate calling, because limiting sets to either interstate or intrastate use was a "practical and economic impossibility," thereby rendering "federal tariffs authorizing interconnection . . . nugatory" (*NCUC II*, 552 F.2d at 1043). The high-water mark here is the FCC action in Computer II,[4] where the FCC, acting under its ancillary jurisdiction in Sections 1, 2(a), and 3(a) of the Act, deregulated all but the basic service market in order to enhance consumer choice and encourage efficiencies, and, to achieve fully these objectives, preempted the states from regulating the offering of CPE and enhanced services. In a sweeping decision, the D.C. Circuit affirmed these preemptive actions.

But there has always been a bomb waiting to explode in the Communication Act's provisions governing this issue. In 1934, when power over interstate communications services was centralized in the FCC, Title II incorporated provisions of the Interstate Commerce Act. This, in turn, raised concerns of state regulators that their intrastate actions could be readily preempted by the new agency based on the 1914 *Shreveport* decision,[5] holding that the ICC could preempt an intrastate railroad rate prescribed by the state in order to prevent unjust discrimination against interstate traffic. The states therefore sought and obtained a provision in Section 2(b) (and 221(b)), which preserved their authority over "charges, clarifications, practices, or regulations for or in connection with intrastate common carriage." Although the legislative history makes clear that this provision was added because of concern over *Shreveport*, the Act itself sets up a puzzling conflict: Sections 1 and 2(a) give the FCC exclusive authority to regulate interstate communications; Section 2(b) vests similar exclusive authority to regulate intrastate communications in the states; and nowhere does the Act come to grips with the stark reality that the same telephone plant is used to carry both interstate and intrastate traffic.

---

[3] *NCUC I*, 537 F.2d 787 (4th Circuit 1976), *cert. denied*, 429 U.S. 1027; *NCUC II*, 552 F.2d 1036 (4th Circuit), *cert. denied*, 434 U.S. 834 (1977).

[4] See 77 FCC 2d 384 (1980); *recon.*, 84 FCC 2d 512; *further recon.*, 88 FCC 2d 512 (1981), *aff'd sub nom. Computer & Communications Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Circuit 1982), *cert. denied*, 461 U.S. 938 (1983).

[5] 234 U.S. 342.

With the growing conflict between the federal government and the states, a case was bound to reach the Supreme Court eventually, and in the 1986 Supreme Court decision in *Louisiana*,[6] the bomb went off. The Court did not resolve all conflicts. Rather, it held that Congress, in dealing with the *Shreveport* issue, meant what it said in Section 2(b) and that there are accordingly "two hands on the wheel." The Court disapproved the FCC's attempt to preempt states from applying their own depreciation rules in setting intrastate rates, even though the FCC had found that such state rules frustrated the federal policy served by its own depreciation rules regarding this same equipment. The Court found that Section 1 does not permit FCC preemption of any state regulation encroaching on interstate communication because of the express provision in Section 2(b); that provision, it held, does not bar FCC action only when the matter in question is purely local and does not affect interstate communication. Rather, Section 2(b) explicitly limits the FCC's power by "fencing off from FCC reach or regulation intrastate matters—indeed including matters 'in connection with intrastate service' " (476 U.S. at 370). Because "it is certainly possible" for interstate and intrastate depreciation rules to coexist, even though it might adversely affect full accomplishment of the federal purpose, the Court set aside the FCC preemption order. The Court, citing the *NCUC* cases, did recognize that the FCC may preempt conflicting states rules where it cannot "separate the interstate and the intrastate components of [its] asserted . . . regulation" and thus "state regulation would negate the federal tariff" (476 U.S. at 374).

Louisiana thus established an entirely different standard from that normally applied in preemption cases. Even if the FCC has reasonably concluded that the state regulation prevents full accomplishment of the federal objective, it cannot preempt. Rather, it must find that there is no way to separate the intrastate and interstate components and that the state regulation *negates* or renders nugatory the federal action. This infeasibility/negation test is obviously a much more difficult hurdle for the federal agency.

Louisiana has profoundly affected subsequent FCC and court decisions. Thus, the FCC retreated from a prior preemptive ruling as to state regulation of cable companies' institutional networks because of its adverse effect on interstate competitive markets.[7] The D.C. Circuit held that the FCC can not preempt state regulation of "inside wiring" used for both interstate and intrastate purposes, on the ground that installation and maintenance of such wiring is not a common carrier service, because Section 2(b)(1) includes matters "in connection with" intrastate service.[8] The Court further held that "a valid FCC preemption order

---

[6] *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986).

[7] See *Cox Cable Communications, Inc.*, 1 FCC Record 561 (1986), *vacating as moot*, 102 FCC 2d 110 (1985) ("state regulation of institutional services offered by cable companies that acts as a *de facto* or *de jure* barrier to entry into the interstate communications market or to the provision of interstate communications must be preempted").

[8] See *NARUC v. FCC*, 880 F.2d 422, 426 (D.C. Circuit 1989).

must be limited to [state] tariffing that would necessarily thwart or impede the operation of a free market in the installation and maintenance of inside wiring" (*id.* at 430). On remand, however, the Commission, "in the interests of comity, . . . determined that it should monitor any state actions in relation to the prices and terms and conditions of service under which telephone companies provide [unbundled] inside wiring services, rather than propose to preempt such action at this time."[9] This reliance on a "lifted eyebrow" technique instead of preemption undoubtedly stems from caution due to *Louisiana.*

The same caution is apparent in the FCC's 1988 *Open Network Architecture Order*,[10] where the Commission declined to preempt state actions conflicting with the tariffing and technical requirements of Computer III (*id.* at 168). Rather to reduce conflict between federal and state ONA policies, the Commission created a state–federal ONA conference (*id.* at 115).

The lower appellate courts also have adhered to the teaching of *Louisiana.* Thus, in the *ARCO* decision,[11] where the FCC, in order to protect a customer's "federal right of interconnection" preempted conflicting state regulations embodying the state's determination that local service be provided by the state-franchised monopoly, the preemption was sustained because on the record before the agency, it was concededly not possible to "separate the interstate and intrastate components" of the state regulation and therefore deferring to the state regulation would negate the federal policy on interconnection for interstate purposes.[12]

In two other decisions, the courts displayed the wide scope of *Louisiana.* In *California v. FCC*,[13] the FCC, acting under its Title III authority over radio licensing, preempted state regulation of wholly intrastate radio common carrier services provided on FM subcarrier frequencies, to the extent that such state regulation blocks or impedes entry of these services.[14] For if that were the case, the FCC pointed out that the state action would conflict with the public interest licensing determination of the FCC, restrict the beneficial use of the radio spectrum, and frustrate the FCC's efforts to encourage competition. The court noted that the FCC had made "a persuasive case in support of its policy objectives, but that case must be made to Congress and not to this court," in light of the holding in *Louisiana.*[15]

---

[9]FCC Report No. DC-1645, May 31, 1990.

[10]4 FCC Record 1 (1988).

[11]*Public Utility Commission of Texas v. FCC*, 886 F.2d 1325 (D.C. Circuit 1989).

[12]*Id.* at 1333-5. The court therefore found "it is unnecessary in this case to accept the broad proposition that a private microwave operator has an absolute federal right of access to the public switched network at location of its choice, unimpaired by state regulatory interests, in order to affirm the FCC's order." *Id.* at 1335.

[13]798 F.2d 1515 (D.C. Circuit 1986).

[14]57 R.R. 2d 1607. *recon. denied*, 57 R.R. 2d 1684 (1984).

[15]In one of Congress' few definitive actions in this area, it did preempt state rate regulation of cellular and other wireless services in legislation in 1993 related to auctioning off portions of the electronic spectrum.

Finally, the most devastating setback to the FCC was the Ninth Circuit's decision in *California v. FCC*,[16] setting aside the FCC's *Third Computer Inquiry* decision. The FCC there held that it would preempt state regulations conflicting with its nonstructural safeguard. The court reversed, holding that under *Louisiana*, states retained the right to require separate subsidiaries for wholly intrastate enhanced service operations by carriers. Even more important, because the FCC foolishly reopened the issue of federal preemption of state enhanced service regulation, the court held that under *Louisiana* states could regulate the terms, charges, and conditions of such operations. And two jurisdictions, Florida and the District of Columbia, soon indicated they would explore such regulation, and the FCC opened proceedings to deal with the remand order.[17]

IMPLICATIONS

It is the poorest possible policy for states to regulate the charges or terms of enhanced services. Consumer Premises Equipment (CPE) is completely deregulated, and CPE and enhanced services are functionally equivalent. Further, enhanced services offered by noncarriers are not regulated, whereas those offered by carriers can now be subject to regulation—again an anomalous situation. The plain fact is that regulation in an area where there is effective competition makes no sense. Further, if the states do impose regulatory conditions on important enhanced service providers such as the LECs, it can impede the nationwide development of such services, so important to the United States in this information age and era of global competition.

But the crucial consideration for my purposes is not the substantive one, but rather the extraordinary absence of any federal captain in this most vital area of telecommunications. The normal preemptive standards apply and there is thus a federal captain in the broadcast area, in cable television, in Master Antenna services (MATV),[18] and in Satellite Master Antenna Television (SMATV).[19] But in the most critical area of all—telecommunications—the issue is ruled by a 1934 provision, based on restricting the application of a 1914 Supreme Court decision. There is no clear-cut federal authority to ensure full effectuation of important national goals. For example, important ONA goals can be thwarted by state action. The FCC's deregulation of CPE, accomplished by preemption of conflicting state action, has been a resounding success for the nation. But if the

---

[16]905 F.2d 1217 (9th Circuit 1990).

[17]See, for example, *Telecommunications Reports*, November 5, 1990, at 2; December 17, 1990, at 1–6.

[18]See *New York State Com. v. FCC*, 669 F.2d 58 (affirming FCC's action preempting state's application of cable franchising conditions to MATC systems).

[19]See *New York State Com. v. FCC*, 749 F.2d 804 (D.C. Circuit 1984) (affirming FCC action preempting state's application of cable certification requirements to SMATV).

states so wish, they can undermine the similarly desirable effort in the functional equivalent to CPE, the enhanced services.

This is folly. No other nation operates in this fashion. Again, I stress that the United States, in light of its size, gains immensely from state regulation (the grassroots and laboratory factors discussed initially). But there is a need for federal leadership and preemption when the national interest so requires—when state action has perverse effects beyond the state's borders. There is simply no warrant for handicapping the federal captain (the FCC) in this area.

The problem would not be so serious if Congress itself acted to provide the necessary national structure or guidelines, on appropriate occasion. The preemption of state cellular rate regulation in 1993 was a start. Although Congress will hopefully continue this line of activity, based on the experience of the last two decades, one must be uncertain. Congress does hold hearings and send messages, but because of the strong conflicts among contending parties and industries, the Act remains in the same form, echoing 1934 and 1910 provisions, despite the enormous changes that have occurred since 1970. In my view, Congress should at least revise the Act so the normal preemptive standard applies to this area.

In her final speech as NARUC president at the Annual Meeting on November 12, 1990, Sharon Nelson deplored the absence of leadership by the federal government in the last decade, and called for that government "to once again become acquainted with its role as an important policymaker." There is certainly justification for this assertion that policy can not consist simply of reliance on "free market rhetoric."

But Nelson then immediately qualified that she was "not calling for increased federal preemption" but rather for dialogue, collaboration, and cooperation. Certainly there is, and always will be, the need for such cooperative efforts in our dual system. But Nelson and NARUC are dead wrong in clinging to the 1914/1934 process. That is not "to set aside narrow parochial interests" but rather to cling to the same insistence on turf priority, however inconsistent it is with the national interests in these changed times.

The only hope for improvement is that NARUC does set aside its narrow parochial interests and call for revision, or that Congress finally does screw up its courage to act. If this does not occur, we will muddle along, hopefully with greater cooperation and sense of responsibility among the regulators, until some scandal or worsening national situation finally compels reform.