Overturning the FCC's Computer III Inquiry: Implications for ONA, Regulation, and Federal-State Regulation

Remarks of Speakers

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This is a rather unusual event with shorter notice than normal given the immediacy of the decision and we are delighted that so many people and such a group of experts are able to join us. Let me introduce them, and then talk briefly about the format which we will have for this evening.

On the far end is Jerry Brock, who was chief of the Common Carrier Bureau between 1987 and 1989. As many of you know, Jerry is an academic and has left the Commission to go back to teaching at George Washington University. He is the author of a standard text in the field, The Telecommunications Industry, and is in the process of revising that text and I'm sure he will have some interesting things to say both in the book and this evening on Computer III.

Sitting next to him is Tom Sugrue, who is the second of command at NTIA, the Deputy Administrator. As you know, NTIA and the FCC have been playing a game of musical chairs, with some important people going in either direction. Tom was an important player during Computer III at the FCC. while he was the director of the Office of Planning and Analysis in the Common Carrier Bureau, he had major responsibilities in the Computer III inquiry and decision.

Sitting to the left of Tom is Catherine Brown from the New York State Public Service Commission. Cathy Brown was involved with this case for a three-year period, and was one of the chief co-counsels from the State perspective in a successful appeal of the Ninth Circuit. Prior to her joining the Public Service Commission she spent a good deal of time in Appeals

Court up in Albany.

To her left is Joel Gross, the Vice President of Research at Donaldson, Lufkin, and Jenrette, one of the premier analysts in the field of the telecommunications service industry. For some time prior to his present post, he was a Vice President of Research at Dean Witter, and prior to that he spent eight years at AT&T learning the business and the lexicon which is necessary to follow this industry.

Next is Henry Geller, who in Computer I, was very much involved as General Counsel of the FCC, and watched as he was the head of the NTIA as Computer II was formulated. He is now the sage of all three Computer Inquiries and, as all of you know, has been observing communication issues for many years. The unusual thing about Computer III: this is one of the few cases that Henry Geller did not appear as one of the plaintiffs or respondents.

And finally, Eli Noam, who just returned from the New York Public Service Commission where he served as a Commissioner to teach again at Columbia. As many of you know in addition to writing about ONA and a variety of related issues for many years, Eli was very responsible for getting the ONA inquiry the New York Commission both started and finished.

So this is indeed a distinguished group of people. I am sure all of us have a long list of questions on what the impact will be on a whole host of major categories: on legislation, on Judge Greene's information services remand, and perhaps some secondary things like on the

Computer III Phase 2 appeal. If each person could take a maximum of five minutes to take an overview, kind of stepping back from it, trying to place this decision in a larger context of current telecommunication policy, are there any things which are important for us to discuss this evening, any comments which are missing the boat from those statements which already have been made publicly about the Computer III decision? Then, assuming that the decision stands as written, that the appeals are not successful and in denying the appeals, the Supreme Court doesn't issue a statement that this decision is the law of the land for the moment, how important do you think that it will be in five years and what variables could affect your predictions over that five year period? We'll start with Eli Noam.

NOAM: Thank you very much, Barry. One thing that has changed since I left here is that those Draconian five-minute rules were instituted, but I will try to comply. Perhaps it can be said that sometimes the worst that can happen to you is to get what you want, and as a former state regulator, I am partly happy that the Ninth Circuit came out the way it did, but at the same time I'm not so sure if it is not more than what the states can actually chew. Let me start with some of the implications and my observations.

On the arbitrary and capricious nature of the Court decisions: Here the court has set a very high standard for regulatory commissions to meet, not just the FCC, but by implication states, too. There were lots of briefs in that case. There was a big record, so I find it a bit hard to see how one can say that there has been no record. Some of the lessons should be for parties in the future to help provide records to regulatory commissions when they appear before them in this

fashion, but I think there is more to it, and that is the following: in the future the real problem for the states is not going to be the FCC, but it is going to be the State and Federal courts. We have seen this already with Judge Greene and there is no reason to believe that this is not necessarily going to be an exception. It is quite possible that cases like the NYNEX one, now both a civil and a criminal case, will be with us for a long time and affect state regulation as much as the FCC. I think the states should work with the FCC in a political fashion, not through the courts. We shouldn't judicialize telecommunications regulation even more. Just look at this particular case. It was argued in January of 1989, so it has taken 17 months. That's what you get if you start to rely on the courts. Secondly, on preemption in general — I don't think that the impact will be a big deal. The FCC has preempted too much in a blanket fashion, and I agree with the court that the FCC has to show greater specificity, that ultimately Federal policy is negated. But this is not a real problem. The FCC has to do more of its homework, just as on the record, but that is not going to be a big issue. On the other hand, more specifically, the impact on enhanced services preemption is going to be more of a problem. States are not preempted under the Ninth Circuit Decision. This is significant.

What are the states going to do about it? Some enhanced services will be intrastate, some will be in between. I think the most sensible thing to do is for the states and the Feds not to fight it out in the courts, but to have some form of a joint committee that will decide under some agreed upon procedure. It is much harder to talk about video-text or information services and, indeed, it would be a problem if information services more generally are subject to general tariffing, whether by the states or by the Federal government. And I think that the impact on

the ESPs might be considerable, if you think about the burden of going to 51 jurisdictions. So I am not sure what they have actually gained in the process.

Thirdly, what about ONA? This question is raised because at least in a technical sense, Computer III dealt not only with structural separation, but also with ONA. However, while there may have been some sort of a quid pro quo, the two really are not necessarily related to each other. You don't need a separate subsidiary for ONA and therefore I believe that the RBOCs shouldn't drop the ONA ball and say, "We don't have a quid pro quo, therefore no game anymore." I think if they drag their feet on ONA it will one day come back to haunt them. I always recommend reading the books on AT&T and its divestiture, just to remind people how soon actions can return to haunt a powerful company.

Lastly, the structural separation. I believe this is not really a big issue. In fact, I sometimes thought it was a phantom issue. What is the big deal about the structural separation versus the accounting separations? In many instances, the RBOCs organized enhanced services through separate subsidiaries anyway for perfectly good business reasons. In other instances, they may not have done it but I don't think it will make a big difference. However, the decision seems to imply that intrastate should be treated differently than interstate, which is clearly going to create an undesirable organizational mess. The real issue is not whether it is a structural or accounting separation, but whether the incentives for intracorporate transfers is still going to exist or not. That is why the move into pure price regulation is much more important than the question of how you structure it.

Brock: Despite the fact that Eli and I were officially on separate sides of this case, myself as a federal regulator and he as a state regulator, now that we are both academics, I think we tend to have fairly similar views. On the long-term significance, the part which concerned me the most and which, I think, will have the greatest long-term significance is what Eli referred to — the extremely high standard set by the court for making a change in policy. Quite independently of any of the specific questions about Computer III, structural separation, and so forth, if this becomes accepted as the standard, it will be extraordinarily difficult for a Federal regulatory agency to make a change in policy. It may well have an effect on state regulatory agencies as well. It has often been remarked in the academic literature on regulation that regulatory agencies tend to preserve the status quo. This kind of decision greatly accentuates that effort. It is, in one sense, a move in the judicial activism, as Eli suggested, where the courts take a greater role versus the commissions, but fundamentally it means you simply cannot change courses. Whatever exists and has been accepted then must stand for a long period of time.

Now, I don't really think it is likely that this will become the fundamental standard. Certainly in the FCC context, the fact that this was a Ninth Circuit decision, and that these judges were obviously somewhat antagonistic — that is, there are suggestions in the case that they would have overturned Computer I and Computer II as well if they had a chance — and that it was a 2-1 decision, all suggest that the overall tone should not be taken as dominating. Should that become the pattern, however, it would be very significant. Turning to the specific issues of the case, the biggest surprise to me was the arbitrary and capricious ruling. We had focussed on all the various preemption issues as the likely danger elements. However, I do not believe that

these will have a major effect, other than to cause some short-term confusion. It seems to me that the court made some specific errors in not fully explaining its reasoning. For example, it stated that the ONA process had nothing to do with the ease or difficulty of cost allocation. It may be that the Commission never explained that link very well, but clearly in the minds of the Commission staff, and in my mind, there is a very definite link. As on of the authors of the cost allocation tools, I wrote them very much with the ONA standards in mind and saw ONA as a very important part of the cost allocation rules. Some things like that simply need to be better explained. More fundamentally, a large amount of time has passed since Computer II. It is very easy to make a case when large numbers of things have changed. Most significantly, should the price caps regime be adopted for the BOCs prior to the time when a final remand decision on this is written, as now appears likely? That in itself should be of fundamental importance, because the courts seem particularly concerned about the possibilities for cross-subsidization. And under price caps, those same kinds of incentives do not exist.

So in summary, with regard to the arbitrary and capricious aspect of the decision, in the short-term it is going to throw some confusion into the system, but I don't see any fundamental long-term significance to that. With regard to the preemption, my comments would be similar to those of Eli. It would be of concern to me as a policy matter if states were to begin large-scale regulation of enhanced services. However, I don't see that as terribly likely, and therefore I do not view the overthrowing of preemption as having a major effect on the industry. First, a large number of enhanced services are interstate in character. This decision will put much more emphasis upon the interstate/intrastate distinction, but in a somewhat related case, with regard

to whether private line networks were interstate or intrastate, a joint board process cooperatively worked out an agreement with the states, that if as much as 10% of the traffic was interstate, the network should be considered interstate. Should a similar standard be applied here, it is likely that a large number of the enhanced services would be interstate. With regard to those that are purely intrastate, certainly some states will adopt restrictive regulatory policies, but many won't. At least in my time at the Commission, we always spoke of "the great laboratory of the state." Now we get to see whether or not we believe that rhetoric.

BROWN: I'll have to take a slightly different position from Eli and Jerry on the importance this decision has for the states. From a legal perspective, it was a very important decision for us in that it reaffirmed the meaning of 152(b) of the Communications Act. We firmly believe that section preserves for the states their role in determining telecommunications policy, and that in New York we have responded quite well to that. In fact we may even be ahead of the FCC on some issues. The FCC, for instance, based its ONA order on the enhanced service market and the need in opening that up. New York, on the other hand, has taken a broader view of the necessity of opening the market up to all comers and all end-users. So it is really interesting that at least in New York, our experiment is going a little bit ahead of the FCC. Nevertheless, the importance for us of this decision is that now the states are secured in their place as players in this policy. It is clear that New York sees itself as a cooperative player and not necessarily as an antagonist to the FCC's goals, though in fact there may be different methods of getting to that same goal. Our position is that those goals can and should co-exist. We think the court did an important thing legally in terms of telling the FCC that their legal theory regarding 152(b)

only shields off common carrier services rather than services offered by a common carrier. You may say this is legal mumbo jumbo; but in fact it is not. Traditionally, the states have regulated common carriers and regulated all services of common carriers and decided for themselves which services would be regulated and which would not. It is our position that we are in a better position to determine which services are more or less competitive in the local market, and I think we have responded appropriately to that. New York has not regulated enhanced services, nor do I see any regulation on the horizon. With respect to the ONA preemption, the driving force behind our participation in the lawsuit was a fear that the FCC would determine how facilities in fact would be designed. Perhaps in the future, without the states having an opportunity to be involved in that regulation, and with the fall-out that the intrastate rate-payer would end up paying a large part of that cost, that the system — and the facilities — would be determined by the FCC without the states having their appropriate role. We think it is significant. We briefed this case to go farther than the court actually went. We would say that if there is a conflict with respect to facilities, that the states win out. The court took the middle line and said, "Well, we'll take a look at the possibility of conflicts as it comes up, and we think that it is important." We think as this comes up on a case-by-case basis, we will be in a better position to know whether there is in fact conflict and whether that conflict cannot be worked out.

SUGRUE: I am at NTIA, now, although I think I was invited because the only person who is up to his elbows in blood in this case, because I worked on the decision at that time back at the FCC. Jerry wasn't Bureau Chief when the main decisions came out that were overturned in this case. So, let me make a couple of comments with an FCC hat on and then a couple of quick

ones as an NTIA observer. I agree with Eli and Jerry that one significant element that came out of here — and I was interested that they picked up on it — was the standard for when a regulatory agency wants to change policy. The court relied on the State Farm case, which is a 1983 case involving the air bags regulation. When the new Republican administration came into office in 1981, it embarked on a deregulatory regime and very quickly repealed the air bag regulations, which gad been in effect but had yet to be implemented. That was litigated through the courts, and in a Supreme Court decision, it said if you are going to shift courses you have got to explain yourself look at anew record. You just can't come in and turn the boat around. That has come to be used by courts below as a broad mandate to examine changes in policy, changes in rules, almost at a level beyond which they will examine promulgating a rule in the first place, which is a little bit ironic. The government, in the state Farm case, had argued that the proper standard to be applied when you change or remove a rule is whether the agency could have decided not to promulgate a rule in the first place. One reason the government wanted that standard is that it is very broad. An agency has almost unlimited discretion not to promulgate a rule. It is sort of like prosecutorial discretion not to remove it is more like initially doing the rule in the first others Courts of Appeals, citing State Farm is erecting a barrier when you want to change a rule. That appears to be, at least in the way it is applied, a substantially higher standard than when you wanted to promulgate a rule in the first place. It is a little troublesome, particularly in an area like telecommunications, which is subject to a lot of rapid marketplace and technological changes to see, that shift in promulgating or modifying new rules subject to a very strange test in appellate review. I don't know what will happen with that doctrine or how far it will go, but that is one thing out there on the legal landscape that is potentially

troublesome.

I'll disagree a bit with Jerry and Eli and agree with Catherine that the preemption issue is fairly significant. I don't like the result, unlike Catherine, but I think it is significant. I think the FCC's ability to deregulate and open up the market on a national basis for non-common carrier services, such as CPE and enhanced services, is a fairly important set of tools to have from a national policy perspective. I am a little afraid that going on a state-by-state basis on some of these issues won't serve our nation well. So, I don't view it as trivial, even though New York -- -I agree-- is ahead of the FCC in many respects, and so are some other states. It is not that the FCC has is right, but the ability to set a national policy is important.

A couple of NTIA observations. One: We have initiated -- and this ties in with my last comment -- a study of a telecommunications infrastructure, where it is now, where it is going, and what factors have been affecting it. In that record, Northern Telecom, a major manufacturer of equipment, submitted a big set of comments and one of things they included was a survey they had done of state regulators in which they were asked, among other things, to evaluate on a scale of one to four factors they would consider important in their decision as to improvements or upgrades in telecommunications infrastructure, where four is very high and one is hardly anything at all. The effect on rates for basic local service scored a 3.9, as one would expect. The effect on the overall competitiveness of the United States scored a 1.8 rating, which was somewhere between not at all and hardly important. I guess what I found surprising wasn't so much the 3.9 for basic rates -- indeed the only thing surprising is why it was not 4.0 (I don't

know if Eli got to vote on this one or not) but the 1.8 for competitiveness of the nation as a whole, because that is more of a "motherhood and apple pie" issue. One would expect to see a high rating attached to that as well, though perhaps not a 3.9. From a national perspective that is a little worrisome if the shift in power as a result of this case is back to the states. Second, the federal government is involved in international trade negotiations in the telecommunications area in the Uruguay Round of the GATT. Although we say our market is open and our market is very competitive, in that arena we run into a lot of arguments and claims by our trading partners that indeed our market is not really as open as we assert because of state regulations, barriers to entry, and the state regulatory climate. This is something we face continually there, and we try to explain that we have a national competitive policy, that the FCC can preemptively open up markets to new competition and it has done so in these areas. I think that we are going to run into more resistance from some of our trading partners on this score. And finally, again in terms of our international competitiveness, we have noticed that in the European Community, the participating nations are looking to Europe 1992 and moving toward a unified set of regulations and governance for telecommunications networks while, it seems this case potentially moves us in the opposite direction. Ironically, the EC, sitting in Brussels, may have more authority over telecommunications policy in the twelve different EC nations than the FCC in Washington now has over US policy. When the rest of the world seems to be moving in our direction, this seems to be a move backwards.

Geller: I think you have to divide the decision, like Gaul, into three parts, two of which

aren't too significant and the third one is very significant. On the first one, that the FCC was arbitrary in its judgment to get off separate subs and use accounting with respect to protecting against cross-subsidization, you can argue whether or not the court was overstepping its bounds and really substituting a judgment, but I don't really think the decision is of any great significance. The court went out of its way to say that the Commission simply botched the writing of it. If they had said that accounting doesn't work too well but it is outweighed by the benefits from getting rid of the separate sub, that would have been a judgment that the court would have had to sustain. The Commission didn't say that. Instead, I think they wrote a very bad decision by arguing that accounting is so wonderful. I don't believe it, I don't think anybody really believes it, and they could have simply said accounting isn't so wonderful, but the inefficiencies are too great her and they outweigh it. So for all those reasons I don't think that is too great. I really think the court may have even done the Commission a favor, although it doesn't recognize it, and because the matter is pending in Congress, and it is pending before Judge Greene on the Modified Final Judgment restrictions. The Commission ought to take another look at more modified forms of separate subs the way Ameritech uses them. They aren't so horrible. People use them all the time. It may be that in many instances there are great inefficiencies and that one ought to, by waiver, allow the separate sub, but all I am saying is that there are no great shakes in that part of the decision.

On the second part, the preemption of the states on their use of separate subs: The court said that has to be done narrowly. You have a burden of proof showing you have to take out all state regulation. And it went on to say that if a state used a separate sub for all intrastate enhanced

services, it clearly would negate the Federal policy and run into a proper preemption. I think what the Commission will do there is to lift an eyebrow as they did in inside wiring: They will simply say, "We won't do anything here, but come to us if you run into any horrendous situation in the states; we will take a hard look at it." So I think there will be an overhang there, and the states will be under some pressure to act reasonably.

The third area is the area where I agree with Tom, and I think it does have great potentially mischievous problems. This is the area where the court held that the states can tariff enhanced services. The Commission's only argument that one couldn't do so was very poor. The commission was legally wrong. The court was absolutely right. The Commission isn't going to upset it on re-hearing or get served and even if they were to get served, they would regret it. The court is right and there is not much one can do about it. It is terrible policy, however. Tom is absolutely right. If you look at the Commission's preemption of customer premises equipment, it has worked very well. It really has had enormous benefits. It would have been terrible if North Carolina had won that case. Incidentally, if we get into it, there is actually an argument based upon these recent decisions that the states could do something in CPE. If you look at CPE and then you look at enhanced services, they are functionally the same thing. You can either use customer premises equipment to do protocol and code conversion voice storage and forwarding, or you can use an enhanced service in the network. One of them is deregulated and the other is not. The same thing is true in the inside wiring area. In these areas, it's sound policy to deregulate them. As to how significant it will be, I think Eli is right. I doubt if it is going to have great significance. New York, won't do it, California has always indicated they

will proceed very cautiously, Florida may even back off from tariffing protocol and code conversion. You don't really know. I think what will happen is a lot of summit conferences, a lot of eyebrow-raising, and that the states by and large will act reasonably. But the point I would make is that what you have here is Louisiana revisited. You have two hands on the wheel and that is wonderful. Because the states are laboratories, they have been more innovative than the FCC in the area of price regulation and others. But at some point you need a federal captain. you need it as to CPE, as to inside wiring, as to enhanced services. you need it for trade barrier purposes. you need it for a number of reasons. And there is no federal captain. The federal captain ought to be Congress. We all know Congress is paralyzed, absolutely paralyzed. They can't enact anything. They can send messages, but they can't act. So that leaves the FCC, which can't act and under Louisiana, can't proceed. Congress is not apt to patch that unless the states go crazy and I don't think they will. So I think we will just muddle along. If you look at where we would be five years from now: Same mess.

Gross: I am going to defer most of the comments about policy and law to the colleagues on the panel, because that is really not my forte. Being a member of the Wall Street community, what Wall Street tends to look at are more the dollar-and-cents implications of events like this. Wall Street, in terms of its outlook, is always based on expectations, always looking into the future, looking to see what the pluses and minuses are and then trying to calibrate the cost implications. Its outlook, and I would have to agree with what Henry said,

has been; accounting can be anything you want it to be. This is a passing comment. My belief is that there has been significant perception on the part of the investment community, and i don't mean just the people who work for Wall Street firms, but more so the investment communities who buy the stocks as an investment in telephone companies and the infrastructure, that there was a real opportunity here in terms of enhanced services and all the parts that go along with that, be they from the service delivery point of view or the manufacturer who has to provide the service itself. To the degree that there were these expectations, Wall Street and the investment community had a very positive outlook. There was going to be a tremendous demand for enhanced services and the rebuilding of the infrastructure that was going to entail. And as you and I sit her tonight you keep hearing words like "delays," "complexity," "confusion." Of course words like "delay" and "confusion" and "complexity" mean that the time horizons have been pushed out, if they ever get resolved at all, which means that these things aren't perhaps going to happen as quickly as perhaps they were supposed to. Inevitably that brings uncertainty and/or disappointment to the Wall Street community, which is, if you are an investor, not a good thing to have happen to you. Sooner or later the market is going to reflect that. My personal opinion as to where this issue or that issue comes out is not all that relevant to my role on the panel tonight since I don't represent any particular camp. But from my perspective, to the degree that one looks out at these things, phone companies are going to see this uncertainty and delay. They themselves will be paralyzed. As you know, many of the experiments in terms of new services have not gone terribly well to begin with, because of Judge Greene's regulations and others. This is only going to set them back even deeper into the mire. From the point of the enhanced service provider, I think the prospects of dealing state by state with fifty different

sets of rules is an utter nightmare, and they weren't exactly stepping up to the plate in most places anyway when we thought we had a single policy. So this has got to be a major setback for them. Then you get into another issue: if you do have to go a separate subsidiary and all the rest, what are the expense and efficiency implications of doing that? That is another setback. So there are some real problems from the investment community, from the participants in the market -- meaning the enhanced service providers or the telephone industry -- in trying to move forward. I don't know how long it will take to resolve, but just judging by the interest and all the different camps and views, it will take quite some time getting back to where we were, much less going forward and trying to get a clear set of directions that the phone companies will either use or someone will push them to use. I am not quite sure where the lead or lag is on this issue. In trying to bring this forward, I tried to show you that all Wall Street guys are not driven solely by dollars and cents. From a policy point of view, and my own personal point of view, I think the American public is losing out here because we don't have a captain of the ship -- we don't have that strong direction. It is not that I am a big proponent of federal-versus-state; it is just that you need a clear set of guidelines to move forward in those kinds of complex areas and we don't have that from our perspective. To the degree that we are not going to get infrastructure development, or new services deployed into the marketplace, I think the American public in general is a loser. How many years it takes us to come back to that I don't know, but it gets into some of the issues that Tom was referring to in terms of our competitiveness and those kinds of things. Thank you for your attention.

Cole: I'd like to open it up to group discussion, and start with a question about the appeal process, just with respect to where Computer II and III stands, what must the FCC do to keep things going, and what do you think the FCC should be doing now? Jerry?

Brock: On what the FCC should do, on the preemption questions; as Henry noted, we had a relatively weak case and were aware of that. We certainly tried. But many of these decisions were made before the louisiana case and there was a certain amount of effort to reconcile the stronger preemption policy we had followed prior to that case with what we had to do afterward. My view would be that the best thing at this point for the Commission is to proceed as rapidly as possible on correcting the arbitrary and capricious finding -- by issuing an NPRM asking what kinds of changes have occurred and what is wrong with structural separation, by writing up a nice tight decision with a careful eye on this particular court case in order to get a solid standing under Computer III. And all this should be done somewhat independently of any appeal process. I might note that I basically agree with Tom that it is bad policy to have the lack of preemption, but i simply take that as a function of where the law is right now, and consider that there is little likelihood that Congress will give the FCC any more preemptive authority. It may be worthwhile to appeal, but then you risk even a stronger statement further on.

Geller: They might very well seek clarification, because the Court vacated all their

Computer III orders, which have more in them than just what the Court reversed. They have ONA and a number of other things. I don't know whether they will do it or not. It allows the Commission complete flexibility in what they want to do. The Court might have thought that it is all together, it is not severable the way aspects of legislation are. But it is possible that the Commission, when they go in, will simply seek clarification, saying restrict your decision to vacating or remanding those parts of Computer III you dealt with, not the entire order.

So far as the arbitrary and capricious finding, I agree totally with what Jerry has said. The Commission has complete control over it. They ought to just take it back and do what they want. If they go back to the Court and argue it, they are in the Court's bailiwick and they are in trouble. If they take it back, they can use price caps and they can make judgments. They are fare better off not contesting that any longer in the courts, and simply making judgments. They are not hurt by that decision at all. They may be a little bit chagrined and annoyed, but they really are in control of that and they ought to keep it in their bailiwick, not the Court's. Their problem is the preemption issue and that is enormous. What the Ninth Circuit did was to embrace the D.C. Circuit's opinion on inside wiring. The Commission didn't go up on that. The D.C. Circuit's opinion and the Ninth Circuit's opinion are correct. The words are "in connection with' and i think that there is nowhere to go with it. They gave it their best shot. They argued it and they lost, and therefore I don't even know -- they may go back, but in my opinion i agree with Jerry: They ought to have the right to proceed very rapidly. When you get to the Modified Final Judgment, some of the parties are going to argue that Greene should not do a thing until the Commission settles this. How can you decide what to do about

information services until you know what the protection is? And se that holds up Greene's remand. So I think the quicker the Commission lays this to rest, the better from all points of view. Therefore, I believe they are going to follow inside wiring. That's the other aspect, as i told you, and simply say come to us if something untoward

happens, then we will look at it.

Sugrue: I'll give a contrary point of view and I hope this is not just because I am annoyed and chagrined by the decision, although henry is right. I am both. I think it is worthwhile to seek cert, and this is a personal opinion. on the one hand, I don't know if it is worthwhile going back to the Ninth Circuit and seeking a rehearing. I don't know if that is a promising course, it is a slow Circuit; it took a year and a half to decide this case. I don't know how long they would decide whether to even hear the hearing petition. The time frame wouldn't be felicitous. With the cert petition, you could probably get a decision, whether the Court will be willing to hear the case, and I would say it is less than 50-50 they would. If they don't indicate they'd hear it, then you could pursue your other courses. If they were to indicate they would hear it that's some sign that they probably wouldn't take the case unless they were going to change something courts did below.

I think the preemption issue is no big deal, because it is like inside wiring. That may be true in respect to structural separation, because the Commission could and did take that back, and has put out a notice and will patch it up. So I believe all will be fine. But with respect to the

preemptive deregulation of enhanced services and with the preemptive deregulation of anything else it wants to do, I don't see how it can fix that up. I think that is a legal issue and there are some respectable legal arguments that could be made that the Court of Appeals didn't address. I'd be hay to talk with them about you {sic] later. I don't think we should get into them now. But I think it might be worth presenting those to the Court. This is an extension of Louisiana. Louisiana dealt very fundamentally with rate-making for intrastate services. The depreciation allowances feed right into rate-making on a rate base regulation scheme. These decisions now extend that and that had been the heart of what the states were regulating back in 1934. These decisions now take that further and go into areas like enhanced services or arguably CPE. And I think one might want to present with the Court and argue, "look the Courts of Appeals, the lower courts are taking your broad language in this decision and moving it over here and extending it quite a bit. Is this really what you intended?" Sometimes the court will sort of pull back on a decision it puts out there, if it feels the lower courts are running too far with it.

Geller: I certainly agree with Tom that the key, the heart of this decision so far in what's wrong lies in the preemption issue as to tariffing of enhanced services. But as the Court pointed out, the only argument the Commission advanced was a legal one. In Footnote 38, they said you have not advanced any arguments the way you do on separate subs, and this negates Federal policy. The only thing they relied on was "2B1 is not applicable because it is not a common carrier service and therefore 2B1 only extends to that." I thought the Court's decision and the D.C. Circuit's decision on that was fairly persuasive. Unless you've got some new argument

to make, I don't know what you can do about it. You can go to the House of Lords, maybe, or something. Really, I think they are right. You have to go to Congress, and Congress isn't receptive. They don't want to act in this political milieu. But if you have no new argument, there is no sense petitioning for re-hearing, and there is no conflict of circuits. I just don't think that it is an argument that you can win. There may be other arguments you can make they you are negating Federal policy, but they aren't advanced in the case.

Brown: I feel like a one-woman show here from this point of view, but I'll try it again. I think it is interesting to point out that with all this doom and gloom that if the states are participating in this process, competition will be lessened and the entire scheme goes out the window. The FCC is flat on its back right now, New York has moved along, and while it is unsure in my view whether the ONA plans will go ahead and be filed at the FCC, even New York has required them to be filed, they will be filed, and the network is being opened in this state. So it is sort of interesting that while the FCC was unable to make its case, New York has been able to make its case and is in fact moving forward. Now whether states will then go ahead and tariff these enhanced services, I suspect they won't. I suspect that the markets that will be open to these services are New York, Chicago, Los Angeles, and the big cities and i suspect that the states will have the same interests as the FCC has in being sure that these markets ate open and competitive. We shall see. The BOCs haven't been even able to offer these services yet and until the restrictions are lifted, that is not going to happen. So all of this is really pure conjecture. It seems to me that on the legal front, there is no question that the

states were right. 152b shields this kind of preemption. Although Louisiana was concerned with charges, and this case is concerned with facilities if you will, the statute shields Federal preemption just as much from these sorts of FCC interference as it does from charges. So I don't think that it is an extension beyond where the Supreme Court was in Louisiana. They were clearly looking at that statute and looking at the intent of Congress in 1934, saying this has got to be a dual system. We believe it can work and it will work and I think New York is demonstrating that it is working.

Geller: I agree that it is working in New York. It will probably work in California. What if Florida goes ahead and tariffs protocol and code conversion, voice storage and forwarding? What if some others do it? You will have a patchwork out there and it's a mess. i think that the FCC was right to preempt CPE. Functionally, that is an enhanced services and all you are saying is that they won't do it. You're probably right. After there Louisiana case, thirty states followed the FCC's manner of prescribing depreciation and some of them even did better. Only a few did worse and it is not a big issue any more. The same thing will probably happen here. If it doesn't happen, I think that Joel was right about one thing: Information service providers need stability, and they will rise in fury if they find that they are being tossed around by state after state being different, being tariffed here and not tariffed there, and they will go to Congress and say for God's sake do something. We can't operate this way. So I think that you are probably right, Catherine. It probably will turn out all right. But it doesn't mean that there isn't a large overhang here about the need for a federal captain so that you don't

get into these messes.

Noam: Perhaps I should clarify that I don't read this opinion as preempting the states, as preventing the preemption of the states from enhanced services. The Court here says they agree with the Commission, that the language of Louisiana PSC requires us to recognize an impossibility exception to 2B1. And then it says, the FCC bears the burden of justifying its entire preemption order by demonstrating that the order is narrowly tailored to preempt only state regulations that would negate valid FCC regulatory goals. In other words, if the FCC can show that state regulation runs counter to its national policy, it still can preempt. It can not only preempt in this blanket way. In other words, it didn't do its homework right when it preempted.

Geller: As to tariffing, though, the only defense is a legal one. They didn't defend on the ground that there was any impossibility exception. On the one we are all arguing about, the tariffing issue, the Court pointed out that the Commission does not defend its preemption on the state authority to tariff enhanced services under the impossibility exception. The only thing that they defended on was that 2B1 is inapplicable because it deals only with common carrier services. The only argument the Commission felt it had in the area of tariffing enhances services was a legal argument. I agree with Catherine. I think it's a lousy legal argument. You won't win on it. I agree with Tom that it is a wonderful policy argument. Congress has to patch it and they won't patch it.

Sugrue: I was resisting responding to henry's legal argument, but after the third time you called it lousy, I'll have to quickly rise to the bait. Catherine mentioned the intent of Congress in 1934. One interesting thing in the Court's decision: The FCC made an elaborate legislative history argument, what the status of regulation was prior to 1934 and what the hearings indicated 2B1 was trying to preserve for the states. The Court virtually conceded that the Commission's legislative history theory was correct. It didn't exactly say that. It said, "Well, in any event we don't have to look at legislative history when the statue is clear on its face". Now, I don't know how many of you looked at this statute, but it is not clear on its face. Before the Louisiana decision, six, seven, eight different Courts of Appeals consistently ruled that it meant something else. Then the Supreme Court comes around, and the Supreme Court didn't say it was clear on its face. It analyzed the legislative history and decided that it was intended to preserve state authority over basic telephone regulation and that the Commission's preemption of depreciation practices eviscerated that principal goal of section 2B1. Frankly, I don't find that response by the Court to the legislative history argument to be even intellectually honest. One can make other responses to it. Second, the Court said that 2B1 goes well beyond the scope of Title 2; it is not limited by Title 2. The Commission argued that it is congruent with Title 2. The very language the Court relied on to say that 2B1 goes well beyond Title 2, for or in connection with the communication service of the carrier, is virtually identical to the language used repeatedly in Title 2 to describe the extent of the jurisdiction there over common carrier regulation. The opinion didn't even mention that argument. Now, either it didn't consider it worthy of mention or it didn't have a response to it. But to say that this section is

much broader than that section when the two are described in almost precisely the same terms, at least that's an argument I think.

Cole: Let's talk about other ways of changing the system around. --What impact if any is this decision going to have on the Judge Greene proceeding, the information services remand, which is now under way? And the second question --What impact if any will this decision have on legislation?

Geller: I told you that I think that on Greene it's important to resolve the problem quickly because he will be somewhat puzzled when he looks at what the protections are when they up in the air. I believe that it depends on what the FCC does. If the FCC has adopted price cap, and that does diminish, as Jerry says, the incentive to cross-subsidize, and it is an effective price-cap regime, I think that will be helpful. Greene is under some pressure from that Court of Appeals decision to let go of information services. This will be a further opportunity. You remember that Greene slammed the Commission in his own order, saying that you went from separate sub to accounting, and he indicated pretty much what he thought of accounting as an effective shield in the area. So that if there have been changes, and there is an opportunity for the FCC now to state what they are, I think the Commission has a chance of improving its position before Greene. Congress was, as you know, in the House legislation, was turning

somewhere towards separate subs, particularly for content, because its all point of the argument why you have to integrate content into the parent. I think that the decision will add fuel to the Congressional view that says we ought to give a real, hard look at the use of separate subs. On the other hand, Congress isn't going to enact legislation anyway, so even if it means that a different draft comes out, it isn't going anywhere. I think all Congress does is send messages. Messages are very important. Greene hears them. The FCC hears them. But there is going to be no legislation out of them.

Brown: I think that is right. I think that when people were speaking about the Ninth Circuit, they were setting a higher standard. When I read this opinion, what I see is that Court's same problem with anti-competitive behavior that Greene has. I think you see a judicial mind thinking about cross-subsidization. I think that is more what this is about than actually setting a higher standard. I think what is coming through here is their concern that the cost allocation methods are not going to work, and I think that echoes Greene, so it is clear to me that the FCC needs to do something for the judiciary to move, and they need to so something to convince them that the anti-competitive issues that were before the judiciary are somehow dealt with.

Sugrue: I agree with Catherine, but I think that what was behind the Court's decision was some concerns about the Commission's policies. i think that is precisely what a Court of Appeals is supposed to be doing. Arguably, Judge Greene may have the sort of jurisdiction not

to overturn the Commission's decisions, but rather to evaluate their effectiveness in his forum. That is a matter of debate, and the Court of Appeals danced around that (and when I say Court of Appeals now, I mean the Judge Greene remand on information services). I think, on the one hand, one could argue before the Court that if the only thing in jeopardy is whether we will have nonstructural safeguards or structural separation, Judge Greene likes structural separation more. It is arguably a more rigorous, tougher safeguard. So, he could analyze the case arguably as if the Commission's rules had not been overturned and the only uncertainty would be whether a set of safeguards he presumably would be more comfortable with would come into effect. It would be helpful if one could at least see where one might get to, where it wouldn't adversely affect the proceeding other than where it is before this decision came out.

ONA on the other hand has been a central part of what the Department of Justice has pled before the Judge as a reason that they supported lifting the information services restriction. The remand to the Court put a lot of weight on the fact that lifting the information services restriction was not opposed by any of the parties to the decree. It was opposed by a lot of people and different parties, but not by parties to the decree. if Justice were to say, if ONA is in jeopardy, we'd want to rethink it, I think that could throw everything out of whack. Now, as Henry pointed out, the Court of Appeals did not say it disliked ONA, and indeed at one point seemed to indicate that it rather liked it, but then went ahead and vacated the entire decision which established ONA. That is a little bit perplexing and perhaps and the court was not as careful as it could have been in framing the scope of its ordering clause. So, if ONA is in jeopardy, I think that is a Problem, but I don't think that is what the Court intended, and one way or the other I think the Commission will get that straightened out fairly quickly.

Geller: There's an interesting sidelight to all this, and that is that Greene has the power to order separate subs himself. It would be very interesting if he did it, because he would run into a conflict possibly with the FCC, and they have been doing an adagio dance to avoid that. But in one footnote, in the last go-round, in the March 1988 order he put out, he noted that he has the power to order further relief. For example, he could let them go into content or content manipulation but insist upon a separate sub. So that we talk as if it is just the FCC's opportunity, but Greene really can act here. The reason why he doesn't is that he is a little worried about doing so. You remember at one point he did require separate subs, in the very beginning of this when they wanted to go into non-communication services. That's now gone.

Noam: I just want to repeat again that the main problems that NYNEX has with its subsidiaries — MECO, B-squared are with fully separated subsidiaries, so I find it somehow surreal that this whole discussion is moving into something that is now in the news as having created a problem, and that is also supposed to be some for the better solution.

Brock: The Computer II decision of the FCC and the divestiture put great emphasis on structural separation, and I think those were philosophically consistent. The FCC's Computer III decision was coming from a different philosophical perspective that puts much more emphasis on concern about economies of scope, about the necessity of integrating services. Judge Greene

is obviously far more sympathetic to the structural separations perspective, and it seems to me that he could well use this decision as an excuse to take a hard line on the information services remand. So, insofar as it has any effect, I think it would slow momentum toward lifting the information services restrictions on the BOCs.

Cole: I have just one other series of questions and then we'll open it up for discussion. The impact on ONA implementation, the incentive of the BOC's, the future of the enhanced service industries, the ONA proceeding itself: what are we looking at in the next year or two?

Brock: Obviously, as has been stated before, there is some confusion and uncertainty and that makes such a question hard to answer. It seems to me that one option for the Commission is to take a narrow view of the finding of "arbitrary and capricious". That is, at the moment, the Commission has not lifted the structural separation rules. Clearly, they cannot lift those under this decision until they do further proceedings, but they aren't ready to do that anyway. So, if I were still Bureau Chief, we would be trying to work out an appropriate legal strategy that would allow us a policy justification for proceeding forward in all the things that are currently under way, assuming that the basic underlying foundations will be shored up before it gets to be a problem, and that you simply would withhold the final lifting of separation until you released a revised Computer III order that the FCC could claim is valid, and then it would be up to any litigators that chose to take it on.

Brown: The problem, it seems to me, is that the ONA order could theoretically go ahead without the separate sub issue being decided. The problem I see is that the OnA order is connected to such a degree with the lifting of the separate subs. In other words, cost allocation and the ONA plan were that program that was put in place. And so if I were given the advice of counsel, I would say -- come back quickly and get other rationale for going ahead with ONA, and let's worry about the separate sub issue as we go along. Now, whether that can be done quickly, I don't know, but I am doubtful whether from a legal perspective, it can go forward without some record.

Geller: It does seem to me that there is another rationale for it that is very strong, and that is the one used by the Ninth Circuit. It is terribly important to access and access is in and of itself, and never mind the cross subsidies issue. Eli has been insisting that what is needed is this open network, this modular network, and I think he is right. And I think the FCC can simply say we want it. We want it because it allows greater use of the network. It even helps the BOCs themselves, although they might not recognize it. They take a year and a half now to reprogram the switch when they want to do something, and if they had a generic interface they could move more rapidly. But i think there is another rationale in the Ninth Circuit opinion, and the real question of how far and how fast you go on ONA depends very much on how far and how fast the FCC and states like New York push it, because there is some foot-

dragging involved.

Sugrue: In regards to one of the commission's orders, Ameritech raised the argument that, looking at the whole set of ONA regulations, they prefer to sit it out and keep structural separation, thank you very much. The Commission said -- oh no this is not an invitation, this is a command performance, so you can do what you want with structural separation, but you are going to have to implement ONA because we do have these other independent policies that ONA serves. So, to some extent, there is a little bit of a groundwork already laid for severing the structural separation issue from ONA because of the Ameritech reconsideration petition that it filed at one point in the proceeding. In April, the Commission did approve the BOCs ONA plans and prior to this order structural separation was to be lifted when they certified or filed something with the FCC indicating that the tariffs implementing their initial set of ONA services had either been filed or gone into effect. I am not sure what will happen with that filing, and while legally you can sever the issues, it was sort of a quid pro quo as a matter of practicality. Whether the BOCs will pursue this aggressively or whether they will use this as rationale to not move it forward quickly is something that we sill have to see.

Cross: This is not my expertise from a legal point of view, but the sense I get is that the phone companies collectively were never thrilled with ONA to begin with, and I think there is still some of the old Bell mentality out there that perceives us as a threat. I think that without

ONA you don't get the enhanced services providers involved, and I think there are some trade-offs politically, shall we say, that in order for them to get this moving that they really wanted the accounting and not the physical separation issue, and I think they are going to continue to drag their feet and try to negotiate their way through this. As long as policy is mired, either from a legal a regulatory point of view, they are going to continue to kind of let this thing just slide by, and I think it was Henry or Tom that said in the long run this will cost them but people don't get paid to worry about what is going to happen in ten years. They worry about this year and this week and this paycheck, and yeah it will probably cost all of us something, the American public and them as companies and the infrastructure and the competitors in the trade, but I think you have to get down to the real day-to-day operations and I am not here to speak on behalf of any of the phone companies specifically but that is just the impression I get from dealing with these people, be it officially or unofficially. Once you get the policy side cleaned up, or at least moving in a singular direction, --whether it is singular by the states or singular by the Federal jurisdiction to me makes no difference then the policymakers, if you will, basically have to go out and kick the phone companies in the pants and get them moving on this: this is necessary if we are ever going to move ahead from a social point of view.

Questions from audience: A mention was made that the states would act reasonably. What about the situation in Florida where Bell South came up with this crazy access deal where you are charged for originating and you are charged for terminating? I don't think that was too reasonable an approach. If that goes on in all 50 states, what will happen.

Geller: Southern Bell did go around, also, saying how much money they could make off this and how it would help out many, and I think the Florida Public Utility Commission started salivating saying wonderful how do you move in on all this-- and that is why Florida is considering doing it. Florida then stopped short the outcome of the Ninth Circuit opinion. I agree with you that it can be very messy. If the states start imposing access charges and information service providers, there will be an explosion, a real explosion. They'll be running up to the Hill tomorrow. I think you just are going to have to wait and see what happens. I believe that Catherine is right, that cooler heads will prevail here, but if not then you will finally get --and in some ways that will be a good thing-- a confrontation on Louisiana, on two hands on the wheel, on what comes from a 1910 ICC Act and then went into the 1934 Act, I believe it is a good policy in this age of global competition where you have to move rapidly, where there is dynamic technology, to have a number of states acting in a way that makes no sense at all --and I think it makes no sense at all to regulate CPE enhanced services, inside wiring, any of those thins. We'll just have to wait and see what happens though. There's one other point I'll make and that is that I think Southern Bell oversold all this stuff too. There is no way in God's green earth these services are going to make money in the beginning. They are going to take money from Aunt Minnie. They make money later on. They will make money , I think, later on, but some states want to get at it earlier because they thought the money would be good earlier. I believe that on the West Coast, the California commission has moved a packet-enhanced service out of regulation into below-the-line, because it was costing them $20 million a year.

Gross: If I could just make one comment relative to what Henry said, I am pretty much on Henry's wave-length on most of these issues, but he made a comment earlier and again here that the enhanced service providers would create this fury and go to the Hill and ask for clarification. I'm not so sure that this is really going to take place. I think they are just going to take their money and go elsewhere and say "the hell with it" and "when you guys get your act together, you call us and let us know" and to the degree that the enhanced services providers don't know what products the American public wants or how to provide them. They don't know what the demand is and don't know what the business case is, they are not going to tolerate this added burden and try to slug their way through this. There are a lot of things they probably would like to do to invest their money or try to find some other channel, and again they are just going to go away for some perhaps very extended period of time again the American public is going to be left without anything, because there won't be an incentive for these people to put their money at risk to try to go after such an uncertain situation.

Sugrue: I would just add that one of the Commission's concerns wasn't that there was a litany of crazy things states had done with respect to enhanced services, but just the fact of regulation if fifty states or fifty-one jurisdictions each require licenses, even if it is granted rather easily. Those rates will be subject to regulation. They may be subsidized. Who knows what they will be, but it well be different from competition, than a free marketplace, and you are right: it is a risky business to get into anyway, and if you are picking what to invest in, does

this decision mean there is going to be a lot of new investment in delivering information services to the American public? I've got to think not.

Brown: But it hasn't happened. it hasn't happened, and to suggest that there is not some self-regulation going on among the states I think is also a wrong perception to give. The states regularly meet, the states regularly discuss these policies, and i don't think we are going to find this kind of sky-is-falling mentality prevailing. I really don't.

Question: The MFJ preempted state regulation once. Are there still grounds for finding that the anti-trust laws might do it again?

Surgue: Certainly the judge and the Justice Department take the view that the Sherman Act isn't subject to 2B1; and Catherine is a hell of a lawyer, but I think that would be a big bite even for her. I don't know how far he will go there, but again his view and Justice's view is to take state concerns into account in reaching their decision, but if the delay in making certain ground rules, they view it as a national market and a national piece of regulation, then there should be anti-trust laws.

Geller: I don't see where there is a violation of the anti-trust laws if the states regulate the pricing of enhanced services. It may be, and i believe it is, terrible policy for them to do that or to be regulating the prices of CPE or inside wiring, but they would say we are going to do it reasonably, we are going to go to the cost causer. They're not going to say "we are going to do it unreasonably, we are going to overcharge or undercharge." And so unless you can establish something, I don't see where there is any violation of anti-trust law that they could precede under. It's Federal policy to allow the states to regulate the charges, etc., etc., etc., in connection with services, and they are just doing it.

Question: Back to ONA, the RBOCs haven't yet reached that trade-off in entering the enhanced services market, and throw that out and you take it back in the states and you say the trade-off now includes some form of price deregulations, then don't you agree there is a different set of incentives for the RBOCs?

Gross: The answer is yes, you can always create new sets of trade-offs, but until you get those trade-offs resolved I just don't see a whole lot happening. Part of it is that there is a set of logical arguments that are made in all these situations, and it is fine to sit here and argue logically and academically as to what is real, but then you watch the day-to-day real world kind of grind away at you and you find that you are operating at a different level. And those two are always tugging at each other. It's hard to get some of that stuff resolved. Again, my concern as a quote Wall Street type, as a shareholder type, is the delay issue, and as long as there are

these ongoing negotiations, items that have to be resolved, that's just ongoing delay and as long as there is delay in the real world not a whole lot is going to happen. And so my advocacy is to have one set of regulations, to get this resolved in a clean, uniform way because without the uniformity I don't think you get the players to step up to the plate to take their risks, to put in their money, to say let's go into the marketplace and see what happens, and what doesn't happen. A lot of people I think may have this perception that if suddenly the phone companies offer voice store and forward service, they are all going to fly, to be wonderful, and to make money. But if you study new product introduction, you find that for every thousand ideas that are out there maybe a hundred get to the marketplace and maybe one or two ever succeed financially. There is a tremendous amount of financial risk in playing these games, particularly in an industry that has been kicking around for about a hundred years, that never had to market anything in its whole creation. And now you are asking companies, be it the phone companies, to participate or other players to come in and take a lot of risk and put a lot of money on the table to find out if there is any golden age at the end of this and you can't even tell which direction the road is going to turn at any given moment. If it was me, I wouldn't want to take my money and play that game, and I don't think they do either.

Brown: The key to that, it seems to me, is opening up the system, and what we need to find is the right hook to not cajole the BOCs to do it but to do it, as we have done in New York, and we have said, we don't want discriminatory practices. You have to make those interconnections open and available to other end-users, all end-users. So I am not sure. Yes, there are going to be some incentives, there are going to be some deregulating or backing off

on some of the things the BOCs are doing, but what we want to make sure is that other users can end up with that network. I think the FCC can do it easily enough. I think they can, and I think it is there in the opinion. They go after their anti-discrimination power and they say we don't want you to be discriminating against any end-user, and therefore you have to unbundle. You have to allow them to come in, so that it becomes competitively possible and probably that these other folks will come in and play.

I've seen enough battles in the hearing rooms to realize the uselessness of the entire bureaucratic process, if somehow it is done your way, you work it out. In reality, if you watch what happens and deregulate a little bit, you won't have to come up with all these weird rules because it hasn't happened. You like to think that states will reach a long-run consensus of rationality, but I wish I had a thorough survey of stupid issues being discussed in state legislatures. The mischief in the states goes on and on. There may be 50 crazy things going on right now.

Geller: But the issue before you now was enhanced services and you really had unanimity, with the one possible exception, I think, of saying that they ought to be just what you said: deregulated, just as CPE and inside wiring but — and it is a "but" here — even you would admit you are dealing with a monopoly. You might deregulate the enhanced services, say no one should tariff it, no one should go near the terms and condition, but you are going to go on and say however that somebody is going to protect that monopoly rate payer and that is all we are arguing about here: the separate sub-issue, or the price cap issue, what's the best way to protect the monopoly ratepayer. If you get effective price caps, I am in favor of going in that direction. That's all this is about, that the issue that you have run into here is that that decision

says that the states can regulate. Now, at the present time, they can regulate inside wiring, they can go too far, but they can regulate the pricing of inside wiring, and they can regulate enhanced services for...

Question: But MFS had to battle state after state to get in. They got New York to do something, California, now they're trying in Texas — it's a total zoo down in Houston with what's going on, and this gets to Joel's point. These are national services, these people are national carriers. Why do we have to deal with 50 different roadblocks?

Noam: It's not only the monopoly ratepayer. I agree with Henry, who incidentally predicted the Courts decision of the Ninth Circuit more than a year ago, much faster than the Court itself had made up its mind. But it's also the access arrangement for enhanced service providers as long as you are do have a certain bottleneck power you are going to have to deal with that, so I don't think you can say let's just forget about any kind of regulation. Now, similarly, I am sure that you find a lot of stupid state decisions, even in New York — in the last few weeks — {laughter} but on some level, you can find some very good decisions. I talked about, for example, ONA things like that. So, you do have a spectrum. The question is not only to find the exceptions, but to find where the center of gravity is, and whether you have, in fact, through the process of trial and error, gained a better system. And I think some of it exists. Now, the counter-problem, of course, is that the process takes a long time, and you may in fact be in a situation where people will go out of business because of inconsistency and because they can't get to the market quickly enough. And that's I think what we are talking

about, and I don't think it can be categorized into regulation and deregulation. I think that is part of it, but certainly not the whole picture.

Sugrue: Clearly it is more efficient to have a dictator, as long as that dictator does the right thing, and our political system is set up on the assumption that the dictator is going to do the wrong thing and the combination of state and Federal regulation is one minor aspect of that overall structure of the government, with its multitudinous checks and balances. When you are in the government, it often seems like you get checked at every point you try to do something, but that is intentional and from an outside perspective it is nice to be stopping all those stupid decisions those guys would be making. Now, my reason for some optimism on this, despite the grossly confusing aspect of having a large number of jurisdictions with their hands in it, is that, first, we have faced this several times before: the Louisiana decision clearly changed the Federal preemption of depreciation. That turned out actually to give the FCC more freedom. There were things we wanted to do, such as amortizing the reserve deficits, that we were holding back because we knew they would upset the state and whatever we did had to be imposed on them. Once the Louisiana decision came down, we went ahead for the Federal jurisdiction. We tried to convince the states to go along. Some did, some didn't, but it was their decision. With regard to interstate long distance services, there has never been a question of preemption there. When the Federal jurisdiction announced a general policy of open entry, some states went along, some didn't. That was confusing and certainly made it slow for MCI, Sprint, and any number of the smaller carriers to get effective intra-state long-distance competition, but it fundamentally worked. I think a similar thing will go on here. We already

have the joint conference on ONA set up as a vehicle to discuss these things. It was set up on the assumption that the Federal jurisdiction would be in the driver's seat. It is now a more truly equal thing, that the Federal jurisdiction is not, but I tend to think that although it won't be real fast, eventually some reasonable results will come out.

Geller: I just want to point out an anomaly here, and that is that in the cable television field, the FCC preempted all regulation of premium services in order to allow maximum experimentation. That's HBO, Showtime, things like that. It went to court, because New York wanted to regulate. New York lost in the case called Brook Haven; the Supreme court denied cert. So, we had the absurd situation that cable television is not all that important in the entertainment field. The Feds can move in, preempt, and order the provision of new services and enhanced services, which is just as important to the information services. When the Feds go to move in, saying we want maximum contribution, keep you hands off, don't tariff it, the answer is no you can't do it. Somebody coming down from Mars would be very puzzled by that.