The FCC's Implementation of the 1996 Act: Agency Litigation Strategies and Delay

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I. INTRODUCTION

Since it began promulgating rules to implement the local competition provisions of the Telecommunications Act of 1996 ("1996 Act"),[1] the Federal Communications Commission ("Commission" or "FCC") has been under attack in the courts. The road has been a rough one, and the Commission has lost on a good many issues. Most recently, for example, the United States Court of Appeals for the Eighth Circuit vacated the pricing rules that the Commission had directed states to use in setting prices for incumbent local exchange carriers' ("ILECs" or "incumbents" or "incumbent carriers") unbundled network elements ("UNEs").[2] Earlier this year, in separate opinions, the District of Columbia Circuit vacated and remanded key aspects of the Commission's collocation and reciprocal compensation rules.[3] In practical terms, the litigation has meant that today—nearly four and one-half years after President Clinton signed the 1996 Act into law—much remains uncertain regarding the local competition requirements.

The Commission has regularly accused its opponents in these legal battles—chiefly the ILECs—of using litigation to impede the implementation of the 1996 Act's local competition provisions. In October 1999, Chairman William Kennard upbraided a group of incumbent carriers for refusing to "think about competition" and responding instead to the Commission's rules with "confrontation."[4] In an earlier interview with the *Los Angeles Times*, Chairman Kennard said that one reason why local phone competition had not developed more quickly was that "too many of the stakeholders in this debate would rather litigate than compete."[5] Former Chairman Reed Hundt was even more blunt. Incumbent carriers, he said, rely on lawsuits to "bolster monopolies and stifle interstate commerce and create years of litigation-induced delay."[6]

These criticisms of incumbent carriers may not be wholly without foundation. Some analysts have speculated that the largest incumbent carriers, the regional Bell operating companies ("RBOCs"), may have

1. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

2. *See* Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000).

3. *See* GTE Serv. Corp. v. FCC, 205 F.3d 416 (D.C. Cir. 2000); Bell Atlantic Tel. Co. v. FCC, 206 F.3d 1 (D.C. Cir. 2000).

4. Chris O'Brien, *FCC Chairman Pushes Bells to Open Phone Networks*, SAN JOSE MERCURY NEWS, Oct. 19, 1999.

5. Jube Shiver, Jr., *Los Angles Times Interview; William Kennard: On Regulating the Marketplace of the Telecommunications Boom,* L.A. TIMES, Jan. 18, 1998, at M3.

6. Bill Pietrucha, *Hundt Calls Internet the Key to Competition*, NEWSBYTES NEWS NETWORK, Aug. 28, 1997, available at http://web.lexis-nexis.com/universe/printdoc.

business reasons for protecting their existing positions in the local exchange markets, at the expense of gaining entry into the long-distance business under section 271.[7] Even if these carriers have tried to use litigation to postpone opening their networks to competitors, however, that is only part of the picture. As discussed in this Article, if litigation has in fact slowed the introduction of competition in the local exchange markets, the Commission itself must share some of the blame. In several of the Orders in which the Commission has implemented the 1996 Act's local competition provisions, the Commission has acted aggressively, and it has taken positions that have been in tension—if not directly at odds—with some of the 1996 Act's key provisions. The FCC might more effectively have encouraged the introduction of competition in the local markets had it taken an approach less antagonistic toward parties affected by its local competition rules and more defensible in light of the statute's provisions.

II. THE STATUTE, THE COMMISSION'S ORDERS, AND THE RESULTING LITIGATION

Although this Article is not meant as a comprehensive summary of the 1996 Act or the Commission's local competition precedent, it is useful to review quickly the background of the controversies discussed within.[8]

A. The 1996 Act

The 1996 Act's local competition provisions appear in sections 251 and 252.[9] Acting on the hypothesis that competition would come more swiftly to the local exchange markets if competitors were given access to some of the incumbent carriers' existing facilities, Congress, in section 251, imposed certain duties on various types of local exchange carriers.[10] Incumbent carriers are subject to the most demanding requirements.[11]

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7. In order to offer interLATA, or long-distance, service, a Bell operating company must demonstrate to the FCC that its markets are open to competition. *See* 47 U.S.C. § 271 (Supp. IV 1998); *see also* Bill Arkwright & Debbie Stipe, *The Secret of OSS Success*, 103 AM. NETWORK 50, Apr. 15, 1999 ("[S]ome ILECs now appear less willing to accept the loss of their local market revenues as a tradeoff to enter the long distance market."); *Nightly Business Report* (Cmty. Television Found. of S. Fla, Inc. broadcast, Feb. 21, 2000) ("[T]he Bell companies have more to lose from local competition than they have to gain from long distance entry and that's part of the reason why it's taken so long.").

8. For a more complete discussion of the 1996 Act and its local competition requirements, refer to PETER W. HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 5.5 (2nd ed. 1999).

9. 47 U.S.C. §§ 251-252.

10. H.R. Rep. No. 104-458, at 117-18, 120-24, 126 (1996).

11. The term "incumbent local exchange carrier" (often referred to as "ILEC") is defined in section 251(h) of the 1996 Act. *See* 47 U.S.C. § 251(h). In essence, an incumbent

Among many other things, incumbent carriers must provide requesting telecommunications carriers with "unbundled access" to those network elements that the Commission determines must be made available—that is, incumbents must lease to competitors certain pieces or elements of their networks.[12] The idea is that, by purchasing unbundled elements (such as the "loop" or wire that connects the customer to the switch), new entrants will be able to begin offering service without having to build out the full facilities needed to serve even a small number of customers.

Incumbent carriers must provide access "at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory."[13] In deciding whether a network element must be unbundled, the Commission is to consider, at a minimum, whether failure to provide access to the element "would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer."[14] If a network element is "proprietary," the Commission must consider whether access is "necessary."[15]

Section 252 of the 1996 Act sets forth a framework that incumbent and competing carriers must use in arriving at agreements that will govern the terms under which an incumbent will share its network with its competitors, including the prices at which an incumbent will lease its network elements to a competitor. If parties are unable to negotiate an agreement voluntarily, the 1996 Act directs state commissions to arbitrate open issues.[16] In conducting this arbitration, state commissions must ensure that the ultimate agreement meets the requirements of section 251, "including the regulations prescribed by the Commission pursuant to section 251."[17] Additionally, the state commission must establish rates for interconnection, services, or network elements consistent with section 252(d), which provides, among other things, that rates for network

carrier is a local carrier that offered local exchange service before the 1996 Act was passed. The RBOCs are the largest incumbent carriers, but there are also other large companies and many much smaller carriers that come within the definition of ILEC. Although the 1996 Act imposes market-opening requirements on most incumbent carriers, only the Bell operating companies are precluded by section 271 from entering the long-distance markets unless they make specific showings regarding the state of competition in their markets. *See id*. § 271.

12. *Id*. § 251(c)(3). A "network element" is "a facility or equipment used in the provision of a telecommunications service," including the "features, functions, and capabilities that are provided by means of such facility or equipment." *Id.* § 153(29).

13. *Id.* § 251(c)(3).

14. *Id.* § 251(d)(2)(B).

15. *Id.* § 251(d)(1)(A).

16. *Id.* § 252(b). If a state commission chooses not to act or otherwise fails to act on a carrier's request for arbitration, the Commission must preempt the state commission's jurisdiction of the proceeding and assume the state commission's role. *Id.* § 252(e)(5).

17. *Id.* § 252(c)(1).

elements shall be "based on the cost . . . of providing the . . . network element."[18]

As Justice Scalia observed in *AT&T v. Iowa Utilities Board*, the 1996 Act is no model of clarity.[19] It is, rather, in "many important respects a model of ambiguity or indeed even self-contradiction."[20] The 1996 Act leaves many key terms undefined. For example, whether an incumbent must offer access to a given network element hinges on the meaning of section 251(d)(2)'s terms "impair," "proprietary," and "necessary," but these words are not defined in the statute. Nor does the statute make apparent the roles that the FCC and state commissions are to play in setting the rates and terms under which an incumbent must provide access to its network. Section 251(d)(1) directs the Commission to "complete all actions necessary to establish regulations to implement the requirements of [section 251],"[21] and section 251(d)(2) tells the Commission to consider various factors in deciding whether an element must be unbundled.[22] At the same time, however, section 252(d)(1) instructs state commissions to make determinations regarding the "just and reasonable rate for network elements."[23] On top of everything else, Congress said nothing about how it intended the 1996 Act to harmonize with section 2(b) of the Communications Act of 1934 ("1934 Act"), which states that, subject to certain specified exceptions, "nothing in this Act . . . shall be construed to . . . give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire."[24]

B. The Local Competition Order

In its 700-page *Local Competition Order*,[25] issued six months after the 1996 Act was signed into law, the Commission adopted rules to implement sections 251 and 252. Two aspects of this *Order* have proved especially controversial. First, the FCC expansively interpreted its authority to issue nationwide rules, including rate-setting requirements, to govern the local exchange markets—thereby assigning itself a role that until then the state

18. *Id*. § 252(d)(1)(A)(i).
19. 525 U.S. 366, 397 (1999).
20. *Id*.
21. 47 U.S.C. § 251(d)(1).
22. *Id*. § 251(d)(2).
23. *Id*. § 252(d)(1).
24. *Id*. § 152(b).
25. Implementation of the Local Competition Provisions in the Telecomm. Act of 1996, *First Report and Order*, 11 F.C.C.R. 15,499, 4 Comm. Reg. (P & F) 1 (1996) [hereinafter Local Competition, *Order*].

commissions had played almost exclusively. In addition, the FCC promulgated a framework for the implementation of section 251 and sweepingly interpreted that provision's network-opening requirements.

Declaring that it had authority to adopt "national pricing rules," the FCC directed state commissions to use a particular methodology in determining the prices that incumbents could charge for access to their networks.[26] The approach that the agency adopted is called the Total Element Long Run Incremental Cost ("TELRIC") methodology.[27] Under TELRIC, the prices for an incumbent's UNEs are calculated based on the forward-looking costs of a hypothetical carrier that uses the most efficient technology and network configuration possible.[28] In simplistic terms, an incumbent carrier must lease its network elements to competitors at prices based on an idealized version of what its network would look like if it were built today, in the most efficient manner possible. How an incumbent's network is actually configured is not relevant to the TELRIC inquiry. Applying this methodology, the Commission set specific prices, or "proxy prices," for states to use unless they were able to justify a departure based on a cost study prepared to the FCC's specifications.[29]

Second, the Commission broadly interpreted section 251(c)(3)'s unbundling requirements. It ruled that section 251(c)(3)'s statement that access be provided "at any technically feasible point" established an expansive presumption that an incumbent must provide access to every element that it is technically able to unbundle.[30] The FCC went on to interpret section 251(d)(2)'s "necessary" and "impair" standards in light of this premise, such that section 251(d)(2) did not "significantly diminish the obligation imposed by section 251(c)(3)."[31] Accordingly, the Commission held that whether access to an element was "necessary," or whether failure to provide the element would "impair" a competitor's ability to provide service, would be determined by looking only to the availability of alternative facilities within an incumbent carrier's own network—not the availability of comparable facilities from other sources.[32]

C. The Eighth Circuit and Supreme Court Litigation

What has happened as a result of the Commission's *Local*

26. *Id.* para. 111.
27. *See id.* paras. 672-740.
28. *See, e.g., id.* para. 685.
29. *See id.* paras. 772-86.
30. *Id.* para. 278.
31. *Id.* para. 286.
32. *Id.* para. 287.

Competition Order? To date, more than four years after the 1996 Act was signed into law, the issues with which the *Order* dealt have not been fully resolved. An appeal of the Commission's most recent unbundling requirements has been held in abeyance, at the Commission's request, in the D.C. Circuit since February 2000.[33] The Eighth Circuit has invalidated the Commission's TELRIC methodology, and the Supreme Court will likely address the validity of this approach sometime during the October 2000 term.

The story is one with which those in the telecommunications industry are by now quite familiar. Immediately after the Commission promulgated the *Local Competition Order*, an assortment of state public utility commissions and incumbent carriers joined forces and brought suit in the Eighth Circuit.[34] These petitioners contended that section 252 of the 1996 Act gave state public utility commissions exclusive authority to set prices for incumbents' networks, and that the Commission had therefore exceeded its jurisdiction in imposing its pricing requirements on the states.[35] In addition, some of the petitioners, chiefly the incumbent carriers, asserted that the FCC's unbundling rules violated the 1996 Act.[36] Among other things, these parties contended that the Commission had misread section 251(d)(2)'s limiting standards for determining when unbundling of a network element is required.[37]

In early 1997, a year after the *Local Competition Order* was promulgated, the Eighth Circuit handed down its decision.[38] With respect to the jurisdictional issues, the court ruled that the 1996 Act gave states the sole authority to set rates associated with incumbents' networks, and it vacated the FCC's pricing rules on that basis, without reviewing the TELRIC methodology on its merits.[39] The court rejected the argument, however, that the Commission had unreasonably interpreted section 251(d)(2)'s "necessary" and "impair" standards (although it struck down other unbundling requirements not discussed in this Article).[40]

The parties obtained review of the decision in the Supreme Court, and in January 1999 (nearly three years after the 1996 Act was signed into law),

33. *See* United States Telecom Ass'n v. FCC, No. 00-1012, Order, (D.C. Cir. Apr. 3, 2000) (on file with the FEDERAL COMMUNICATIONS LAW JOURNAL).

34. Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), *aff'd in part, rev'd in part sub nom.* AT&T v. Iowa Utils. Bd., 525 U.S. 366 (1999).

35. *Id*. at 792.

36. *Id*.

37. *Id*.

38. *Id.* at 753.

39. *Id.* at 800.

40. *Id.* at 810-12.

the Court issued an opinion that reversed most aspects of the Eighth Circuit's decision. Significantly for the FCC, five members of the Court ruled that the Commission possessed authority to design a nationwide pricing methodology and could require states to set prices for incumbent carriers' networks according to the FCC's rules.[41] In a win for the incumbent carriers, however, the Court held that the Commission had not adequately considered section 251(d)(2)'s "necessary" and "impair" standards in deciding which network elements incumbent carriers must unbundle.[42]

Although the Supreme Court's decision may have settled the jurisdictional issue, matters were by no means fully resolved. The opinion required the Commission to reevaluate the "necessary" and "impair" standards and to apply its new definitions of those terms in deciding which network elements it would require incumbents to unbundle. The Commission eventually released an *Order* that addressed this issue on November 5, 1999, and used its revised understanding of section 251(d)(2)'s standards to establish a new list of network elements that incumbents must provide to competitors.[43] The United States Telecom Association, an industry group that represents incumbent carriers, has petitioned for review of this *Order* in the D.C. Circuit, contending that once again the Commission has not meaningfully limited incumbents' unbundling obligations.[44] The Commission asked the court to hold the case in abeyance, pending the agency's action on petitions for reconsideration filed by other parties.[45] The court granted that motion and has taken no further action on the case.[46]

The Supreme Court's opinion also left open the question whether the Commission's TELRIC methodology was valid on its merits. The parties returned to the Eighth Circuit in the fall of 1999 to contest that issue (as

41. AT&T v. Iowa Utils. Bd., 525 U.S. 366, 371-87 (1999). Chief Justice William H. Rehnquist and Justices Stephen G. Breyer and Clarence Thomas dissented from this jurisdictional analysis. Justice Sandra Day O'Connor took no part in the consideration or decision of the case.

42. *Id.* at 387-91.

43. Implementation of the Local Competition Provisions of the Telecomm. Act of 1996, *Third Report and Order and Fourth Further Notice of Proposed Rulemaking*, 15 F.C.C.R. 3696, 18 Comm. Reg. (P & F) 888 (1999).

44. *See* Motion of Petitioners for Expedition and for Coordinated Oral Argument, United States Telecom Ass'n v. FCC (D.C. Cir. Docket Nos. 00-1015 & 00-1025) (filed Feb. 22, 2000) (on file with the FEDERAL COMMUNICATIONS LAW JOURNAL).

45. *See* Motion to Hold in Abeyance, United States Telecom Ass'n v. FCC (Docket Nos. 00-1015 (and consolidated case)) (filed Feb. 22, 2000) (on file with the FEDERAL COMMUNICATIONS LAW JOURNAL).

46. *See* United States Telecom Ass'n v. FCC, No. 00-1012, Order (D.C. Cir. Apr. 3, 2000) (on file with the FEDERAL COMMUNICATIONS LAW JOURNAL).

well as other matters that had been remanded, which this Article does not address). On July 18, 2000, the court issued a rather cryptic decision. It rejected the incumbent carriers' contention that the term "cost," as used in section 252(d)(1)(A), necessarily means "historical cost," and it accepted as reasonable the FCC's conclusion that an incumbent's costs should be determined based on a forward-looking model.[47] The court vacated, however, the specific TELRIC methodology that the Commission had instructed state commissions to use. According to the court, the 1996 Act did not permit costs to be based on a hypothetical network. "Congress was dealing with reality," wrote the court, "not fantasizing about what might be."[48] The court clarified:

> [I]t is the cost of providing the *actual* facilities and equipment that will be used by the competitor (and not some state of the art presently available technology ideally configured but neither deployed by the [incumbent] nor to be used by the competitor) which must be ascertained and determined.[49]

The court sidestepped the question whether the Commission's TELRIC methodology was an unconstitutional taking in violation of the Fifth Amendment, ruling that the claim would not be ripe for review until actual rates had been established under TELRIC.[50]

At least some aspects of the Eighth Circuit's decision are likely to be tested in the Supreme Court this term. Earlier this year, the Court agreed to review a Fifth Circuit decision that upheld the TELRIC methodology in connection with the Commission's restructuring of the "universal service" funding mechanism, where the TELRIC model is used to determine incumbent carriers' costs of providing service in certain high-cost areas.[51] In simplistic terms, GTE Service Corporation (which has since merged with Bell Atlantic Corporation to form Verizon Communications) argues that the FCC's use of the TELRIC methodology has resulted in an

47. Iowa Utils. Bd. v. FCC, 219 F.3d 744, 751-52 (8th Cir. 2000).

48. *Id.* at 750.

49. *Id.* at 751 (emphasis added).

50. *Id.* at 754.

51. GTE Serv. Corp. v. FCC, 183 F.3d 393 (5th Cir. 1999), *cert. granted*, No. 99-1427, 120 S. Ct. 2214 (June 5, 2000). Section 254 contains the 1996 Act's "universal service" provisions. 47 U.S.C. § 254 (Supp. IV 1998). The term "universal service" describes the policy that all Americans should have access to affordable basic telephone service, regardless of whether they are low-income, and regardless of whether they live in areas that are expensive to serve (such as rural areas). The Commission used the TELRIC methodology to calculate the costs of serving different local customers, and incumbent carriers will receive subsidies for providing service to high-cost customers based on these calculations. The Commission's universal service policy is more completely described in Federal-State Joint Bd. on Universal Serv., *Report and Order*, 12 F.C.C.R. 8776, 7 Comm. Reg. (P & F) 109 (1997).

unconstitutional taking.[52] Verizon has asked the Court to review a related takings argument based on the Commission's use of TELRIC to set rates for incumbents' network elements,[53] and the Commission has also sought review of the Eighth Circuit's resolution of pricing and other issues.[54] Because the Court has already expressed interest in the issue, it could likely decide to review the Eighth Circuit's TELRIC ruling as well. Whether the Commission may require states to follow the TELRIC approach, as opposed to some other forward-looking model, will be settled only when the Supreme Court rules on these issues.[55]

D. Other Controversies

Although the bulk of the litigation over the Commission's local competition requirements has centered on its pricing and unbundling rules, the Commission's so-called "collocation" and "reciprocal compensation" requirements—both of which bear significantly on local exchange markets—have also been under attack in the federal appellate courts. Last spring, important aspects of these rules were vacated and remanded to the Commission for further consideration. To date, the FCC has sought comment on the remanded issues, but has resolved neither matter.[56]

The Commission's collocation requirements are found in section 251(c)(6), which imposes on incumbent carriers a duty to provide for

52. *See* GTE Serv. Corp., 183 F.3d 393, *cert. granted*, No. 99-1427, 120 S. Ct. 2214 (June 5, 2000).

53. Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000), *petition for cert. filed sub nom. Verizon Comms. Inc. v. FCC*, 69 U.S.L.W. 3269 (Oct. 4, 2000) (No. 00-511). *See also Verizon Told U.S. Supreme Court Late Wednesday it Wanted to Withdraw*, COMM. DAILY, Oct. 20, 2000, at 3.

54. Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000), *petition for cert. filed sub nom. FCC v. Iowa Utils. Bd.*, 69 U.S.L.W. 3282 (Oct. 13, 2000) (No. 00-587).

55. As this Article went to press, Verizon had filed a motion with the Supreme Court asking to withdraw its petition for review of the Fifth Circuit's decision. Industry analysts and lobbyists have speculated that Verizon's request for withdrawal was part of its effort to bolster its chances that the Supreme Court would review the Eighth Circuit's TELRIC decision. *Verizon Told U.S. Supreme Court Late Wednesday it Wanted to Withdraw*, COMM. DAILY, Oct. 20, 2000, at 3. As of October 30, 2000, the Supreme Court had not ruled on Verizon's request.

56. Comment Sought on Remand of the Commission's Reciprocal Comp. Declaratory Ruling by the U.S. Court of Appeals for the D.C. Circuit; Pleading Cycle Established, *Public Notice*, 15 F.C.C.R. 11,311 (2000) [hereinafter Comments Sought on Reciprocal Comp.]; In the Matters of Deployment of Wireline Servs. Offering Advanced Telecomms. Capability and Implementation of the Local Competition Provisions of the Telecomm. Act of 1996, *Order on Reconsideration and Second Further Notice of Proposed Rulemaking in CC Docket No. 98-147 and Fifth Further Notice of Proposed Rulemaking in CC Docket No. 96-98*, CC Dkt. Nos. 96-98, 98-147, paras. 81-83, 103-12, 119-28 (Aug. 10, 2000), 2000 WL 1128623 (F.C.C.) [hereinafter Deployment of Wireline Servs.].

"physical collocation of equipment necessary for interconnection or access to unbundled network elements."[57] In everyday language, this means that an incumbent must permit its competitors to physically place certain "necessary" pieces of equipment on the incumbent's property so that competitors can connect their own equipment with the incumbent's network. Again, an incumbent's obligation turns on the meaning of the term "necessary," which the statute leaves undefined.

In the wake of the Supreme Court's decision in *AT&T v. Iowa Utilities Board*, the Commission issued an *Order* in March 1999 adding to its existing collocation requirements.[58] Among other things, the Commission ruled that section 251(c)(6) permitted a competitor to physically collocate as "necessary" any equipment that could be "used or useful" for interconnection or access to an incumbent's unbundled network elements, regardless of whether that equipment might provide other, independent functionalities (such as switching or enhanced service capabilities).[59] The *Order* additionally permitted competitors to collocate equipment they would use only to interconnect equipment with that of other competing carriers, a process known as a "cross-connection."[60] Finally, the Commission gave a competitor the right to collocate its equipment "in any unused space" on an incumbent's premises and forbade incumbents from requiring competitors to "collocate in a room or isolated space separate from the incumbent's own equipment."[61]

The D.C. Circuit struck down most of the Commission's new collocation requirements, ruling that the agency had packed too much into its interpretation of "necessary" under section 251(c)(6).[62] Citing *AT&T v. Iowa Utilities Board*, the court held that the FCC failed to construe the term "consistent with the ordinary and fair meaning"[63] of the word and "'diverge[d] from any realistic meaning of the statute.'"[64] The court singled out the agency's cross-connect rules for particular criticism: "[T]he Commission does not even attempt to show that cross-connects are in any sense 'necessary for interconnection or access to unbundled network

57. 47 U.S.C. § 251(c)(6) (Supp. IV 1998).

58. Deployment of Wireline Servs. Offering Advanced Telecomms. Capability, *First Report and Order and Further Notice of Proposed Rulemaking*, 14 F.C.C.R. 4761, 15 Comm. Reg. (P & F) 553 (1999) [hereinafter *Collocation Order*]. The Commission first promulgated rules implementing section 251(c)(6) in its Local Competition, *Order*, *supra* note 25, paras. 579-607.

59. *Collocation Order*, *supra* note 58, para. 28.

60. *Id.* para. 33.

61. *Id.* para. 42.

62. GTE Serv. Corp. v. FCC, 205 F.3d 416 (D.C. Cir. 2000).

63. *Id*. at 423.

64. *Id*. quoting Massachusetts v. Dept. of Transp., 93 F.3d 890, 893 (D.C. Cir. 1996).

elements.' Rather, the Commission is almost cavalier in suggesting that cross-connects are efficient and therefore justified under § 251(c)(6)."[65] The court also held that the rights the FCC gave competitors vis-à-vis incumbent carriers were too extensive, observing that the Commission had given "no good reason" why it gave competitors the ability to choose where to establish collocation on an incumbent's property or why it precluded incumbents from requiring competitors to collocate equipment in isolated areas.[66]

A few days later, the D.C. Circuit dealt the Commission another blow by vacating the rules that the Commission had issued regarding "reciprocal compensation" for calls made to Internet Service Providers ("ISPs").[67] Section 251(b)(5) imposes on all local exchange carriers, both incumbent and competing, a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[68] Where more than two local carriers collaborate to complete a call (as they often will in a competitive environment), "reciprocal compensation" describes the compensation that the carrier that terminates the call receives.[69] The typical arrangement (arrived at through the section 252 process) is that the originating carrier pays the terminating carrier a per-minute transport and termination fee. Thus, the longer a call lasts, the more the originating carrier pays to the terminating carrier. In a typical situation, local traffic should flow about equally in both directions, so neither carrier will end up paying proportionally more in reciprocal compensation fees than the other.

How calls made to ISPs fit into this picture has proven to be particularly problematic. The threshold question is whether calls to ISPs are local, such that section 251(b)(5) applies, or whether they are long-distance, such that they come under a different rubric, known as "access charges."[70] The statute provides very little guidance on the issue, although

65. *Id*.

66. *Id.* at 426.

67. Bell Atlantic Tel. Co. v. FCC, 206 F.3d 1 (D.C. Cir. 2000).

68. 47 U.S.C. § 251(b)(5) (Supp. IV 1998).

69. Historically, the customer that has placed a local phone call has paid for all the costs associated with that call, often via a flat monthly payment to his local exchange carrier that allows him to make an unlimited number of local calls. When only one local exchange carrier served an area, there was no need to worry about how to allocate costs of originating and terminating a local call, because the same carrier performed both these functions. In a competitive environment, however, local calls will frequently be handled by more than one carrier—that is, a customer of one local carrier will make calls to a customer of a different local carrier. Section 251(b)(5) therefore instructs carriers to establish a way of compensating the so-called "terminating" carrier for the costs that it incurs in transporting and terminating a local call.

70. The Commission has decided that section 251(b)(5) applies only where two *local* carriers collaborate to complete a call. 47 C.F.R. § 51.701(a) (1999). For long-distance calls,

it appears to contemplate that the Commission will treat local and long-distance calls differently.[71]

If calls to ISPs are deemed local, then the following problem arises: Assume that a competing carrier serves the ISP and an incumbent serves most of the ISP's customers (most of whom pay the incumbent a flat monthly fee for local service). Each time a customer places a call to the ISP, the incumbent carrier winds up paying the competing carrier a per-minute termination fee. Consider also the nature of ISP traffic. First, such traffic is typically "one-way." That is, many customers call an ISP in order to connect to the Internet, but an ISP seldom places calls to other customers. Second, calls made to ISPs are typically much longer than the average voice call, since people often surf the Internet for hours at a time. The potential for regulatory arbitrage is obvious—a competing carrier that signs up an ISP as a customer stands to collect far more in reciprocal compensation fees than it will pay out in connection with serving that customer.

The Commission undertook the rulemaking process to decide how local carriers should be compensated when they collaborate to deliver a call to an ISP, and issued an *Order* in February 1999.[72] The FCC began by deciding that calls to an ISP are jurisdictionally interstate, based on the observation that a call to an ISP typically does not terminate at the ISP's server, but frequently continues to an out-of-state web site.[73] Despite this conclusion, however, the FCC ruled that state commissions were free, in arbitrating section 252 disputes, to determine that reciprocal compensation should be paid for this traffic.[74]

which typically originate in one local network and terminate in another, the costs of origination and termination are governed by the Commission's "access charge" regime, which has its origins in sections 201 and 202 of the Act. *See* Local Competition, *Order*, *supra* note 25, paras. 1033-34. Under this framework, a calling party's long-distance carrier pays *both* the originating and terminating local exchange carriers what are known as "access charges" for the local costs involved in transmitting the long-distance call. Put very simply, if a call is long-distance, the originating local carrier does not pay another local carrier for the cost of terminating that call; that cost is paid by the long-distance carrier.

71. There is no indication that Congress intended to disturb the existing access charge regime when it enacted section 251(b)(5)'s reciprocal compensation requirements. Accordingly, the Commission has concluded that the Act "preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic." Local Competition, *Order*, *supra* note 25, para. 1033.

72. Implementation of the Local Competition Provisions in the Telecomm. Act of 1996, *Declaratory Ruling and Notice of Proposed Rulemaking*, 14 F.C.C.R. 3689, 15 Comm. Reg. (P & F) 201 (1999) [hereinafter *Reciprocal Comp. Order*].

73. *Id.* para. 12.

74. *Id.* para. 25.

The ruling pleased neither the competing carriers nor the incumbents, and groups of both parties challenged the Commission's *Order* in the D.C. Circuit. The competing carriers asserted that the Commission had incorrectly decided the jurisdictional issue, contending that calls to ISPs were actually local traffic.[75] The incumbent carriers supported the agency's jurisdictional determination, but maintained that the FCC had erred in ruling that state commissions could nevertheless require them to pay reciprocal compensation for calls to ISPs.[76] Agreeing with the competing carriers, the court held that the Commission had not satisfactorily explained why it had concluded that calls to ISPs were interstate, and remanded the issue to the FCC for further consideration.[77] The Commission has sought comment on the remanded issues, but has not yet issued an Order.[78]

III. DISCUSSION

As a result of these various challenges to the Commission's local competition rulings, much remains unresolved regarding exactly how the 1996 Act requires incumbent carriers to open their networks to competition. Congress plainly hoped for certainty regarding these issues within a much shorter time frame. It directed the Commission to complete "all actions necessary to establish regulations" to implement section 251 within six months after the date of enactment of the 1996 Act.[79] It would be quite optimistic to think that such significant legislation could be fully implemented in that time frame—affected parties were virtually certain to dispute at least some of the FCC's determinations, regardless of how it had decided the issues.

A review of the Commission's actions in its various local competition Orders suggests that it need not have taken quite *this* long to reach the current state of affairs. First, the Commission's decision to impose mandatory pricing guidelines on the states—the legality of which the courts took more than two years to resolve—may very well have been a needless assertion of federal power. Had the Commission simply established pricing guidelines and encouraged state commissions to set the prices for incumbents' network elements based on forward-looking pricing methodologies, there is every indication that the states would have followed the Commission's lead. Second, the Commission has interpreted key statutory terms in ways that have been in significant tension with the

75. Bell Atlantic Tel. Co. v. FCC, 206 F.3d 1, 3 (D.C. Cir. 2000).
76. *Id*.
77. *Id*. at 7-9.
78. Comments Sought on Reciprocal Comp., *supra* note 56.
79. 47 U.S.C. § 251(d)(1) (Supp. IV 1998).

1996 Act. Had its approach been more circumspect, at least some of the litigation and subsequent agency proceedings that have held up the implementation of the 1996 Act likely would have been avoided.

A. Were the National Pricing Rules Really Necessary?

In its *Local Competition Order*, the Commission took the position that it was critical to "establish among the states a common, pro-competition understanding of the pricing standards for interconnection and unbundled elements."[80] Waiting for a common interpretation to emerge through the section 252 process, the Commission reasoned, would result in unacceptably lengthy delays in the development of competition in the local markets.[81]

In retrospect, however, it appears that the Commission's edict that the states follow its national pricing rules caused a delay of more than two years—the time it took for the Supreme Court to issue its decision in *AT&T v. Iowa Utilities Board*. Although the Court ultimately vindicated the FCC's position regarding its authority to set national requirements, it is unclear whether the agency actually gained anything by drawing a jurisdictional line in the sand. If the FCC's objective was for states to apply TELRIC-like methodologies to price incumbents' network elements, the agency could have achieved that goal simply by offering guidance on how states should shape their own forward-looking methodologies. As the Eighth Circuit indicated, such an approach undoubtedly would have been upheld on review.[82]

There is no reason to think that states would have refused to follow the Commission's guidance. Rather, the evidence supports the opposite conclusion. As the FCC itself recognized at the time the *Local Competition Order* was issued, many states had adopted forward-looking, long-term incremental cost methodologies for setting prices for UNEs.[83] These states almost certainly would have continued to adhere to their already established approaches, perhaps modified to conform more closely to the Commission's recommendations, and those states that had not yet adopted a framework for pricing network elements very likely would have acted on

80. Local Competition, *Order*, *supra* note 25, para. 618.

81. *Id.*

82. *See* Southwestern Bell Tel. Co. v. FCC, 153 F.3d 597, 607 (8th Cir. 1998) (ruling that the agency could express to the states a preference for a particular pricing methodology, such as usage-based pricing).

83. *See* Local Competition, *Order*, *supra* note 25, para. 631 nn.1508-14 (noting that California, Michigan, Texas, Colorado, Hawaii, Louisiana, Washington, Wisconsin, Connecticut, Arizona, Ohio, Missouri, Wyoming, and Oklahoma had either adopted or were considering whether to adopt TELRIC-like approaches to pricing network elements).

the Commission's advice. Indeed, in the aftermath of the Eighth Circuit's decision, when the FCC's pricing rules were stayed pending review by the Supreme Court and states were free to use whatever methodology they wished to price incumbents' network elements, most states nevertheless established rates pursuant to the Commission's TELRIC methodology.[84]

Had the Commission taken a less antagonistic approach toward the states in its *Local Competition Order*, at the very least an appeals court would have weighed in on the merits of TELRIC much sooner than July 2000, when the Eighth Circuit finally released a ruling on this issue. A decision most likely would have been reached by early to mid-1997. Moreover, in the absence of the jurisdictional dispute, it is doubtful that the Supreme Court would have agreed to review an appellate decision on the FCC's *Local Competition Order*. The Court would have been presented only with questions regarding the legitimacy of TELRIC and the Commission's unbundling rules. Even though the Court recently has shown interest in the constitutional validity of the Commission's TELRIC methodology, it is improbable that it would have wanted to review rules that were not actually binding on the states.[85] Nor would the Court likely

84. *See, e.g.*, GTE South, Inc. v. Morrison, 199 F.3d 733, 739, 746-48 (4th Cir. 1999) (noting that Virginia state commission voluntarily adopted TELRIC pricing following Eighth Circuit's stay of those pricing rules); Bell Atlantic-Delaware, Inc. v. McMahon, 80 F. Supp.2d 218, 235 (D. Del. 2000) (observing that the Delaware commission "voluntarily adopted the Local Competition Orders' TELRIC methodology even though that portion of the Local Competition Order had never gone into effect"); Consol. Issues Raised in Petitions for Arbitration Pending Before the Pub. Serv. Comm'n, Telecomms. Arbitration Case, Order No. 5, at 5-6 (D.C. Pub. Serv. Comm'n Nov. 8, 1996), 1996 WL 694995 (adopting the Commission's TELRIC "proxy rates" as interim rates); Approval of Agreements and Arbitration of Unresolved Issues Arising Under § 252 of the Telecomm. Act of 1996, Case No. 8731, Phase II, Order No. 73707, 180 P.U.R. 4th 521 (Md. Pub. Serv. Comm'n Sept 27, 1997) (adopting forward-looking cost pricing methodology); Investigation Regarding Local Exch. Competition for Telecomms. Servs., Telecomms. Decision and Order, Docket No. TX95120631, at 8-9 (N.J. Bd. Pub. Utils. Dec. 2, 1997), 1997 WL 795071("[T]he Board HEREBY ADOPTS the principles upon which the [Commission's] TELRIC model is based. Adopting a methodology based on forward-looking, economic costs . . . will best replicate to the extent possible the conditions of a competitive market."); *MFS Intelenet of Pa., Inc.*, MFS Phase III, Interim Order, Docket Nos. A-310302F0002, *et al.*, at 13 (Pa. Pub. Utils. Comm'n Apr. 10, 1997) ("[W]e will continue to use TELRIC as a tool to evaluate the proposals before us and view the [*Local Competition Order*] as instructive."); *Pet. to Establish a Proceeding to Review the State of Generally Available Terms and Conditions Offered by Bell Atlantic in Accordance with Sections 251, 252, and 271 of the Telecomm. Act of 1996*, Order on Arbitration, Case Nos. 96-1516-T-PC, *et al.*, at 34 (W. Va. Pub. Serv. Comm'n Apr. 21, 1997) ("[T]he Commission will adopt rates and prices for interconnection, [network elements] and collocation based on a TELRIC methodology.").

85. Robert L. Stern, et. al., Supreme Court Practice § 4.18, at 224 (6th ed. 1986) quoting Hamilton-Brown Shoe Co. v. Wolf Bros. & Co., 240 U.S. 251, 258 (1916) ("[T]he lack of finality in the judgment below may 'of itself alone' furnish 'sufficient ground for the denial of the application.'").

have found questions regarding the reasonableness of the Commission's unbundling rules worthy of review, as they presented only questions of the reasonableness of the FCC's statutory interpretation.[86]

In retrospect, it appears that there was little need for the Commission to autocratically direct the states to follow its pricing rules, as it did in the *Local Competition Order*. Instead, had the Commission simply recommended that the states use TELRIC to price network elements, the states would very probably have followed the FCC's lead, and any challenges to the merits of the TELRIC methodology would have been resolved sooner. At the very least, there would have been little downside to the Commission simply testing this approach. If states had refused to go along with the Commission's pricing guidelines, the FCC could then have stepped in with mandatory rules.

B. Have the Commission's Expansive Statutory Interpretations Delayed Implementation of the Local Competition Requirements?

The Commission's understanding of certain key terms in the 1996 Act has also met with significant opposition in the courts. As described above, the Eighth and D.C. Circuits, as well as the Supreme Court, have remanded various issues to the FCC for further consideration. The litigation and subsequent agency proceedings on the remanded matters have eaten up considerable time. To be sure, the task of implementing the 1996 Act, which left so many important questions open to debate, was a formidable one. Nevertheless, the Commission has taken positions in its *Local Competition Orders* that were highly susceptible to attack in the courts. Had the agency more carefully thought through the consequences of the positions it decided to take, providers of local telecommunications would very likely be operating under a more stable set of rules today.

Consider, for example, the Commission's interpretation of section 251(d)(2)'s access standards. The provision directs the Commission to determine which network elements incumbents must unbundle, based on the "necessary" and "impair" considerations described above. The Commission began by reading into this subsection an *additional* requirement, which it lifted from section 251(c)(3), that incumbents must provide access to *all* network elements for which it is technically feasible to provide access.[87] Operating on this presumption, the Commission decided that section 251(d)(2) simply authorized it to "decline to require

86. *Id*. § 4.17, at 221-24 (noting that the Court generally will not grant certiorari just because the decision below may be erroneous).

87. Local Competition, *Order*, *supra* note 25, para. 278; 47 U.S.C. § 251(c)(3) (Supp. IV 1998).

incumbent [carriers] to provide access to unbundled network elements at technically feasible points."[88] From there, the Commission went on to announce that section 252(d)(2)'s "necessary" and "impair" standards would be met if denial of access to an element meant a competitor would experience *any* increase in cost or *any* decrease in quality, regardless of whether it could obtain the element from a source outside the incumbent's network.[89]

This reading of the 1996 Act is nothing short of tortured. First, the FCC's understanding of the relationship between section 251(c)(3) and section 251(d)(2) finds no support in the statutory language. As the Eighth Circuit observed, "[b]y its very terms," section 251(c)(3) establishes only "*where* unbundled access may occur, not *which* elements must be unbundled."[90] Section 251(d)(2) sets out the criteria for determining which network elements must be made available, and that provision does not contain any general presumption that incumbents must unbundle *all* network elements. Second, the Commission's interpretation of section 252(d)(2) essentially read the "necessary" and "impair" standards out of the statute. In effect, the agency said that "whatever requested element can be provided must be provided."[91] As the Supreme Court declared, if Congress had intended to give competitors such sweeping access to incumbents' networks, it would not have included section 251(d)(2) in the statute at all.[92]

The FCC's lawyers must surely have recognized the stretch. If the agency's aim was to promulgate rules that would quickly bring competition to the local exchange markets, it would have served that goal far better by interpreting the statute in a way that was at least defensible on review, particularly on issues so central to incumbents' section 251 obligations. Had the FCC been able to justify its interpretation of section 252(d)(2), its rules implementing this provision would have been final, at the latest, by February 1999, when the Supreme Court issued its decision. Instead, petitions for reconsideration of the FCC's second stab at the issue are

88. *Id.* para. 279.

89. *Id.* para. 283.

90. Iowa Utils. Bd. v. FCC, 120 F.3d 753, 810 (8th Cir. 1997) (emphasis added); *see also* AT&T v. Iowa Utils. Bd., 525 U.S. 366, 391 (1999) ("The Commission's premise was wrong. Section 251(d)(2) does not authorize the Commission to create isolated exemptions from some underlying duty to make all network elements available. It requires the Commission to determine on a rational basis *which* network elements must be made available, taking into account the objectives of the Act and giving some substance to the 'necessary' and 'impair' requirements." (emphasis added)).

91. *AT&T*, 525 U.S. at 390.

92. *Id.*

currently pending before the agency, and after the FCC acts on these petitions, the D.C. Circuit is likely to review the matter.

Perhaps these criticisms simply second guess the Commission. After all, the Commission was struggling to put together an enormous Order in a very short time frame, and no court had yet weighed in on any aspect of the 1996 Act. In such circumstances, the Commission conceivably could have overlooked the leap of logic it made in its original interpretation of sections 251(c)(3) and 251(d)(2), but the same cannot be said of the Commission's more recently issued *Collocation Order*.[93]

In that ruling, issued only weeks after the Supreme Court had handed down an opinion pinpointing the deficiencies in the Commission's interpretation of section 252(d)(2), the FCC again addressed the term "necessary." This time the word appeared in section 251(c)(6), which allows competitors to collocate equipment that is "necessary" to access network elements or to interconnect. Once again, as discussed above, the Commission relied on a definition that went far beyond any fair meaning of the term. Without even mentioning the Supreme Court's discussion of the term, the agency ruled that equipment was "necessary" if it was "used or useful" for interconnection or access to network elements, regardless of whether the equipment might also be used for other purposes.[94] Relying on *AT&T v. Iowa Utilities Board*, the D.C. Circuit struck down the FCC's rules. The Commission, it held, had failed to "operate within the limits of 'the ordinary and fair meaning of [the statute's] terms.'"[95]

As compared to the *Local Competition Order*, it is much more difficult to see the *Collocation Order* as an excusable lapse in agency judgment. The Commission had the benefit of the Supreme Court's *AT&T v. Iowa Utilities Board* decision, and it was not rushing to meet a statutory deadline. The Commission's disregard of the statute is, as the D.C. Circuit described it, "almost cavalier."[96] For example, in one staggering paragraph, the FCC wrote that it would not require incumbent carriers to permit collocation of equipment that is "*not necessary* for either access to UNEs or for interconnection."[97] The agency reasoned that the record before it did not sufficiently support such a requirement, although it held out the possibility that it might impose one in the future.[98]

93. *See Collocation Order*, *supra* note 58.

94. *Id.* para. 28.

95. GTE Serv. Corp. v. FCC, 205 F.3d 416, 424 (D.C. Cir. 2000) (quoting *AT&T*, 525 U.S. at 390).

96. *Id.* at 423.

97. *Collocation Order*, *supra* note 58, para. 30 (emphasis added).

98. *Id.*

It is certainly unsettling that the Commission could even suggest that —despite section 251(c)(6)'s manifest directive that incumbents had a duty to allow the collocation only of "necessary" equipment—it could still somehow require the collocation of *unnecessary* equipment. More to the point, however, it is remarkable that with this Order the FCC, yet again, seems to have shot itself in the foot. Had the agency promulgated more defensible rules, its collocation requirements would have become final in March 2000, with the D.C. Circuit's decision. By promulgating rules that did not withstand review on the first go-round, however, the FCC wound up with yet another delay. The agency sought comment on the remanded issues just last summer.[99] At the earliest, a new set of collocation rules could come sometime before the close of 2000, and those requirements will themselves not be final until a court has reviewed them.

The FCC's March 1999 *Reciprocal Compensation Order* provides a final illustration of how the Commission's adoption of hard-to-defend requirements has ended up impeding its implementation of the 1996 Act's local competition provisions. In that *Order*, the Commission relied on certain of its previous decisions that involved long-distance (or "interexchange") carriers, rather than ISPs. The Commission offered only the most cursory of explanations to support its determination that this precedent controlled: "Although the cited cases involve interexchange carriers rather than ISPs, and the Commission has observed that 'it is not clear that ISPs use the public switched network in a manner analogous to [interexchange carriers],' . . . the Commission's observation does not affect the jurisdictional analysis."[100] Not surprisingly, the D.C. Circuit found this justification unsatisfactory.[101]

The court did not address the Commission's even more baffling decision that, although it had determined calls to ISPs were jurisdictionally interstate, it would nevertheless leave regulation of those calls to the states. The court simply observed in dicta that the Commission's jurisdictional analysis yielded "intuitively backwards results," in that *intra*state calls would be subject to federal reciprocal compensation standards, but state regulators would set compensation for *inter*state calls to ISPs.[102]

Because the Commission again adopted rules that it was unable to justify to a court, local carriers continue to operate under uncertain rules

99. Deployment of Wireline Servs., *supra* note 56.

100. *Reciprocal Comp. Order, supra* note 72, para. 12 n.36, quoting In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exch. Carriers; Transp. Rate Structure and Pricing End User Common Line Charges, *First Report and Order*, 12 F.C.C.R. 15,982, para. 345, 7 Comm. Reg. (P & F) 1209 (1997).

101. *See* Bell Atlantic Tel. Co. v. FCC, 206 F.3d 1, 6-7 (D.C. Cir. 2000).

102. *Id.* at 6.

regarding reciprocal compensation for calls to ISPs. The Commission has sought comment on the issue and should release an Order addressing the matter sometime in late 2000.[103] Assuming that interested parties petition a court for review of that decision, and the court upholds the FCC's new rules, the requirements would become final at the earliest when the reviewing court issues a decision sometime next spring—nearly two years after the Commission issued its previous *Order*.

IV. CONCLUSION

As revealed by this review of the Commission's local competition precedent, the agency's approach to implementing the 1996 Act's local competition requirements has, in important respects, backfired. Affected parties have taken the FCC to court over dubious rules fashioned in the *Local Competition Order* and its subsequent decisions. The litigation and subsequent proceedings on remand have taken a long time. Today—more than four years since the agency released its initial *Order*—significant aspects of its pricing, unbundling, collocation, and reciprocal compensation rules remain unsettled. Even where the agency has ultimately prevailed, as it did on the jurisdictional issue in the Supreme Court, the question whether winning was worth the time and effort it took remains open.

Paradoxically, the FCC has taken aggressive positions in an effort to bring competition to the local exchange markets more quickly. It seems to have missed the point that quickly setting up a stable set of ground rules might better have served this objective. Had the FCC initially taken a less controversial view of its role and of the 1996 Act's network-opening requirements, carriers today would be operating under a more certain set of local competition rules.

103. Comments Sought on Reciprocal Comp., *supra* note 56.