

BREAKING UP THE LOCAL TELEPHONE MONOPOLIES: THE LOCAL COMPETITION PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996

At one time, the telephone industry was quite simple. A person who needed to make a call simply picked up the phone and dialed, without giving a second thought as to what company would be carrying the call. After all, there was just "the phone company." In most instances, this "phone company" was American Telephone & Telegraph ("AT&T").¹ AT&T handled practically all of the nation's long-distance phone calls and, through its wholly-owned subsidiaries, a majority of the nation's local calls as well.²

In 1934, Congress passed the Communications Act ("1934 Act"), transferring telephone regulation from the Interstate Commerce Commission to the Federal Communications Commission ("FCC").³ The 1934 Act granted the FCC the power to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of [the 1934 Act]."⁴ In section 2(b) of the 1934 Act, Congress granted jurisdiction over interstate regulation to the FCC, while reserving regulation of intrastate matters for the states, thus creating a dual system of federal/state jurisdiction.⁵ This dual jurisdiction system has remained in effect to the present.⁶

¹ See James A. White, *Local Bell Companies Begin Push to Re-enter Long-Distance Market*, WALL ST. J., Feb. 2, 1984 (page unavailable). In 1984, AT&T controlled 95% of the long-distance market. See *id.*

² See Brief for Respondents Federal Communications Commission and United States of America at Counterstatement, *Iowa Utils. Bd. v. FCC ("Iowa III")*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321). Until 1984, AT&T wholly owned 22 Bell Operating Companies ("BOCs"), which were consolidated into seven Regional Bell Operating Companies ("RBOCs") as part of the 1982 Consent Decree. See *infra* note 11. In 1995, the RBOCs controlled 80% of the local telephone revenue. See Daniel Pearl, *'Baby Bells' See Better Chance of Gaining Access to New Markets With GOP-Controlled Congress*, WALL ST. J., Jan. 20, 1995, at A14.

³ Communications Act of 1934, 47 U.S.C.A. §§ 151-61, 201-14 (West 1991 & Supp. 1997).

⁴ *Id.* § 201(b).

⁵ See *id.* § 152. Section 2(b) was codified as 47 U.S.C. § 152(b), so the terms "§ 2(b)" and "§ 152(b)" have the same meaning and are used interchangeably. For purposes of this Note, 47 U.S.C. § 152(b) will be referred to as "section 2(b)." Section 2(b) provides, in pertinent part, "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service" *Id.* § 152(b).

⁶ See *id.* § 152.

Although this dual system of jurisdiction remains in effect, society's understanding of the telephone industry has changed.⁷ Until recently, society had viewed it as a "natural monopoly"—an industry whose economies of scale represent a barrier to competition and result in a single provider of a good or service.⁸ Because telephone carriers were monopolists, the federal and state governments heavily regulated the carriers, prescribing the rates, terms and conditions of the telephone service provided by the monopolistic carriers in return for granting an exclusive franchise and allowing the carriers to earn a fair rate of return on their investments.⁹ As technology advanced, the assumptions underlying the natural monopoly theory began to crumble, and new opportunities for competition arose.¹⁰ In 1982, the federal government and AT&T entered into a consent decree in which AT&T divested itself of its Regional Bell Operating Companies ("RBOCs").¹¹ Under the terms of the consent decree, the newly liberated RBOCs, which held exclusive franchises to provide local telephone service, were prohibited from entering the long-distance market, while AT&T was prohibited from entering local markets.¹² Thus, a new regulatory scheme developed in which the long-distance market was open to competition, while local markets continued to operate under natural monopoly regulations.¹³

Since the 1982 consent decree opened up the long-distance telephone market, competition has been fierce as new competitors en-

⁷ See Brief for Petitioners Regional Bell Companies and GTE at 2-3, *Iowa III*, (No. 96-3321).

⁸ See *id.* The McGraw-Hill Dictionary of Modern Economics defines "natural monopoly" as "a natural condition that makes the optimum size of the firm so large in relation to the market that there is room for only one firm." THE MCGRAW-HILL DICTIONARY OF MODERN ECONOMICS 394 (2d ed. 1973). In a natural monopoly market, the most efficient firm is one of a size that is sufficient to serve the entire market; its average cost is still decreasing, which makes any competition against that provider impracticable. See CHARLES H. KENNEDY, AN INTRODUCTION TO U.S. TELECOMMUNICATIONS LAW 140 (1994).

⁹ See Brief for Petitioners Regional Bell Companies and GTE at 2-3, *Iowa III* (No. 96-3321).

¹⁰ See *id.* at 3.

¹¹ See *United States v. American Tel. & Tel.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd mem.*, 460 U.S. 1001 (1983). In this case, also referred to as the Modification of Final Judgment ("MFJ"), the United States District Court for the District of Columbia approved the consent decree between AT&T and the United States Justice Department, providing for the separation of AT&T's wholly-owned local exchange carrier ("LEC") subsidiaries, which provided local telephone service, from the rest of AT&T, which continued to provide long-distance service. See *id.* at 226-28. These 22 former subsidiaries consolidated into seven RBOCs, namely Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, SBC Communications and US West. See KENNEDY, *supra* note 8, at 50-51. At the time of this writing, two mergers had occurred: Pacific Telesis with SBC Communications and Bell Atlantic with NYNEX, reducing the number of RBOCs to five.

¹² See *AT&T*, 552 F. Supp. at 226-28.

¹³ See *id.*

tered the market; long-distance rates have fallen sixty percent.¹⁴ As this new marketplace evolved, Congress perceived that the 1934 Act was no longer geared to address it effectively.¹⁵ In response, Congress enacted the Telecommunications Act of 1996 ("TCA").¹⁶ The TCA addresses a wide range of communications-related markets, such as local telephone, long-distance telephone, broadcast television, cable television and the internet.¹⁷ The local telephone competition provisions of the TCA established a few principal goals.¹⁸ Among these were opening the local markets to competition and promoting increased competition in markets that were already open to competition.¹⁹ Congress chose to implement the TCA by amending and supplementing the 1934 Act, such that its provisions are still in effect unless amended or repealed by specific provisions of the TCA.²⁰

As required by section 251(d)(1) of the TCA, the FCC on August 8, 1996, issued regulations implementing the local competition provisions of the TCA.²¹ Shortly thereafter, multiple telephone carriers and state regulatory commissions sued in an effort to enjoin the regulations from taking effect, claiming that the regulations were beyond the scope of the FCC's authority and were contrary to the provisions of the TCA.²² The United States Court of Appeals for the Eighth Circuit, after consolidating these cases, granted injunctions on September 27 and October 15, 1996, the latter to be effective until a decision could be made on the merits after oral arguments, which were made on January 17, 1997.²³ On July 18, 1997, the Eighth Circuit issued its decision on the merits of the case and vacated a portion of the FCC regulations,

¹⁴ See John J. Keller, *Telecommunications (A Special Report): Making the Call*, WALL ST. J., Sept. 16, 1996, at R14.

¹⁵ See generally Telecommunications Act of 1996, Pub. L. No. 104-104, 1996 U.S.C.A.N. (110 Stat.) 56 (codified in scattered sections of 47 U.S.C.).

¹⁶ See *id.*

¹⁷ See *id.*

¹⁸ See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, No. 96-98 (released Aug. 8, 1996) ("First Report & Order") [hereinafter FRO].

¹⁹ See *id.* at n.3.

²⁰ See *supra* note 15.

²¹ See 47 U.S.C.A. § 251(d)(1) (West Supp. 1997); FRO, *supra* note 18. Section 251(d)(1) states that "[w]ithin 6 months after the date of enactment of the [TCA], the [FCC] shall complete all actions necessary to establish regulations to implement the requirements of this section." 47 U.S.C.A. § 251(d)(1).

²² See Iowa Utils. Bd. v. FCC ("*Iowa II*"), 109 F.3d 418 (8th Cir. Oct. 15, 1996) (order granting preliminary injunction).

²³ See *id.*; Iowa Utils. Bd. v. FCC ("*Iowa I*"), 96 F.3d 1116 (8th Cir. Sept. 27, 1996) (per curiam) (order granting temporary restraining order).

holding, *inter alia*, that the FCC exceeded its jurisdiction in issuing its pricing regulations.²⁴

This Note focuses on one aspect of the TCA—the opening of local telephone markets to competition. More specifically, this Note will analyze the proposed FCC regulations regarding pricing of access to the existing networks by new entrants. Section I will describe the specific relevant provisions of the TCA, describe the related regulations promulgated by the FCC, provide relevant background material and give a brief overview of the first federal court case to address these pricing regulations.²⁵ Section II will describe the competing arguments involved in the dispute, and explain in greater detail the court's decisions granting a stay against enforcement of the regulations and then vacating a portion of the regulations.²⁶ Section III will analyze the competing arguments and the court's decisions and will propose a resolution.²⁷

I. THE TELECOMMUNICATIONS ACT OF 1996, THE FCC PRICING REGULATIONS AND THE EIGHTH CIRCUIT'S DECISION

A. *Specifics of the Telecommunications Act of 1996*

The relevant portions of the TCA are section 251 ("Interconnection"), section 252 ("Procedures for Negotiation, Arbitration, and Approval of Agreements") and section 253 ("Removal of Barriers to Entry").²⁸ Section 251 addresses the duties and obligations of telecommunications service providers, such as providing competitors with access to existing networks at reasonable rates, negotiating in good faith with competitors and reselling existing retail product offerings to competitors at wholesale prices.²⁹ Section 252 explains the procedures to be followed by companies and state regulators in order to effectively grant competitors access to local phone markets.³⁰ Section 253 ensures that state and local governments will not enforce any unreasonable barriers to entry into the local telephone markets.³¹

²⁴ See *Iowa III*, No. 96-8321, 1997 WL 403401, at *9 (8th Cir. July 18, 1997).

²⁵ See *infra* notes 28-152 and accompanying text.

²⁶ See *infra* notes 153-296 and accompanying text.

²⁷ See *infra* notes 297-408 and accompanying text.

²⁸ See 47 U.S.C.A. §§ 251-53 (West Supp. 1997).

²⁹ See *id.* § 251.

³⁰ See *id.* § 252.

³¹ See *id.* § 253.

1. Section 251

At its most basic level, a local telephone network consists of a "local loop," which connects a telephone to a switch that in turn routes calls from one telephone to another.³² The loop and the switch, along with other similar components of a telephone network, are referred to as "network elements."³³ In order to complete a call, a local exchange carrier ("LEC") must route the call through each of the necessary network elements.³⁴ The technical problems of competition within a local telephone market involve allowing competitors to access the existing networks.³⁵ Because local telephone carriers are monopolies, each carrier owns the network that connects all of its customers.³⁶ A competitor who cannot access this network cannot compete against the incumbent carrier because the competitor's customers will be unable to place calls to those consumers who are connected to the existing network.³⁷ To allow potential competitors to enter local telephone markets, Congress created three rights.³⁸ The first, the right to interconnection, allows a competitor to access the existing network.³⁹ The second right, unbundled access, allows a competitor to use only those network elements which it requires without being forced to use unwanted elements.⁴⁰ The third, resale, allows a competitor to purchase

³² See KENNEDY, *supra* note 8, at 3.

³³ See 47 U.S.C.A. § 153(45) (West Supp. 1997). The TCA defines "network element" as: a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment, including subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service.

Id.

³⁴ See KENNEDY, *supra* note 8, at 3.

³⁵ See Brief for Respondents Federal Communications Commission and United States of America at Counterstatement, *Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321).

³⁶ See *id.*

³⁷ See *id.*

³⁸ See 47 U.S.C.A. § 251 (West Supp. 1997).

³⁹ See *id.* § 251(c)(2). This section provides that an incumbent LEC has the duty to provide: interconnection with the [LEC's] network—(A) for the transmission and routing of telephone . . . service . . . ; (B) at any technically feasible point within the carrier's network; (C) that is at least equal in quality to that provided . . . to itself; and (D) on rates, terms, and conditions of the agreement and the requirements of this section and section 252.

Id.

⁴⁰ See *id.* § 251(c)(3). This section provides that an incumbent LEC has the duty to provide: to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled

the incumbent LEC's existing retail offerings at a wholesale rate, which the competitor may then resell to customers.⁴¹

Congress imposed certain duties upon existing telecommunications carriers because these carriers could not be expected to agree voluntarily to help any competitors access their networks.⁴² Section 251 imposes upon both existing and new carriers the duty to "interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers"⁴³ In addition to this general obligation, all local exchange carriers have other duties.⁴⁴

Incumbent LECs have additional duties.⁴⁵ Among these are the duties to negotiate with potential competitors in good faith concerning the rates, terms and conditions of agreements to fulfill the duties the TCA imposes, and to provide quality interconnection with its network to any competitor at any feasible point on that network on rates, terms and conditions outlined in the agreement and consistent with the requirements of the TCA.⁴⁶ In addition, incumbent LECs must provide unbundled access, which entails providing the individual elements of telecommunications service, and offer their own retail products for resale to a competitor at a wholesale rate.⁴⁷

basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252. An incumbent [LEC] shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

Id.

⁴¹ See *id.* § 251(c)(4). This section provides that an incumbent LEC has the duty:

(A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and (B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with regulations prescribed by the [FCC] under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers.

Id.

⁴² See Brief for Respondents Federal Communications Commission and United States of America at Counterstatement, *Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321).

⁴³ 47 U.S.C.A. § 251(a)(1).

⁴⁴ See *id.* § 251(b). Among these duties are the following: not to prohibit nor impose unreasonable or discriminatory conditions on the resale of its telecommunications services; to provide number portability, which allows a consumer to keep his or her phone number even after changing carriers; and to establish reciprocal compensation agreements with competitors for the transport of telecommunications. See *id.*

⁴⁵ See *id.* § 251(c).

⁴⁶ See *id.*

⁴⁷ See *id.* §§ 251(c)(3), (c)(4). The purpose of 47 U.S.C. § 251 is to lay the groundwork for

2. Section 252

Merely requiring incumbent LECs to negotiate with competitors will not by itself result in these parties actually reaching an agreement.⁴⁸ In order to put some teeth into the duties outlined in section 251, Congress outlined procedures for these negotiations and, should the negotiations fail, for arbitration or mediation of the negotiations.⁴⁹ The procedures describe the steps each party may take during the negotiation or arbitration, including what a voluntary agreement must specify, when either party can request mediation by the state regulatory commission, when each party can request arbitration by the state regulatory commission and the standards to be followed in this arbitration.⁵⁰ This section also requires that any agreement, whether reached by voluntary negotiation or by arbitration, be approved by the state commission and sets forth the reasons a state may reject an agreement.⁵¹ Section 252(i)

competition within the local phone markets. *See id.* § 251. Because existing LECs have monopoly power within their markets, they have no incentive to help competitors who have little, if anything, to offer them, and who are attempting to expand market share at the expense of the existing LECs. *See KENNEDY, supra* note 8, at 140–43. The method Congress chose to allow competitors to enter local markets, therefore, was to impose a duty upon the incumbent LECs to allow access to existing networks. *See* 47 U.S.C.A. §§ 251(a), (b), (c). Congress designed the specific duties imposed upon LECs to ensure that competitors can compete in the local markets by requiring that LECs negotiate in good faith, connect competitors to their networks in a quality manner and at a reasonable and just price, offer existing retail products for resale by competitors and allow access to the individual elements of telecommunications so that competitors are not forced to purchase unwanted elements. *See id.* § 251. In addition to imposing duties upon LECs, 47 U.S.C. § 251 addresses other areas of telecommunications service. *See id.* 47 U.S.C. § 251(d) addresses the implementation of the provisions of the TCA. *See id.* § 251(d)(3). This section states:

[i]n prescribing and enforcing regulations to implement the requirements of this section, the [FCC] shall not preclude the enforcement of any regulation, order, or policy of a state commission that—(A) establishes access and interconnection obligations of [LECs]; (B) is consistent with the requirements of this section; and (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.

Id. 47 U.S.C. § 251(e) outlines jurisdiction and cost issues for numbering administration. *See id.* § 251(c) (“[t]he [FCC] shall have exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States. Nothing in this paragraph shall preclude the [FCC] from delegating to state commissions or other entities all or any portion of such jurisdiction”). 47 U.S.C. § 251(f) addresses exemptions, suspensions and modifications of the duties imposed upon LECs. *See id.* § 251(f). 47 U.S.C. § 251(h) provides for the definition of “incumbent LEC” for the purposes of the section. *See id.* § 251(h).

⁴⁸ *See id.* § 252.

⁴⁹ *See id.*

⁵⁰ *See id.* Section 252(c)(1) states “[i]n resolving by arbitration . . . any open issues and imposing conditions upon the parties to the agreement, a state commission shall—(1) ensure that such resolution and conditions meet the requirements of section 251, including the regulations prescribed by the [FCC] pursuant to section 251 . . .” *Id.* § 252(c)(1).

⁵¹ *See id.* § 252(e).

requires that each incumbent LEC provide any service on the same terms and conditions to any requesting competitor.⁵²

Section 252(d) outlines the methods state commissions should use in setting prices for interconnection and network elements, transport and termination of traffic and resale of retail offerings.⁵³ The statute requires that the prices for interconnection and network elements be based on the cost of providing the interconnection or network element.⁵⁴ Another portion of this subsection states that the wholesale rate for retail offerings shall be the incumbent LEC's retail rate, less any marketing, billing, collection and other costs that will be avoided.⁵⁵ The statute also addresses the availability of so-called "bill-and-keep" arrangements.⁵⁶

3. Section 253

Because individual states regulate local telephone service, Congress intended to ensure that states could not erect barriers to entry to any local market.⁵⁷ Therefore, in section 253, Congress included a provision that no state or local regulation shall have the effect of prohibiting entry of a competitor into a local phone market.⁵⁸ Congress did, however, provide exceptions for ensuring quality service, protecting the rights of consumers and protecting the public safety and

⁵² See 47 U.S.C.A. § 252(i). This section states in full, "Availability to other telecommunications carriers.—A[n] [LEC] shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement." *Id.* This is the statutory basis for 47 C.F.R. § 51.809, the "pick-and-choose" rule. See *id.*; see also 47 C.F.R. § 51.809 (1996).

⁵³ See 47 U.S.C.A. § 252(d).

⁵⁴ See *id.* § 252(d)(1)(A)(i). This subsection provides that rates for interconnection and network elements "shall be . . . based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element" *Id.*

⁵⁵ See *id.* § 252(d)(3). This subsection provides, in full:

(3) *Wholesale prices for telecommunications services.*—For the purposes of section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection and other costs that will be avoided by the [LEC].

Id.

⁵⁶ See *id.* § 252(d)(2)(B). The subsection provides, in pertinent part, "(B) *Rules of construction.*—This paragraph [dealing with the state commission's responsibility to approve reciprocal compensation agreements] shall not be construed—(i) to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)" *Id.* For a description of a "bill-and-keep" arrangement, see *infra* note 102.

⁵⁷ See *id.* § 253 (West Supp. 1997).

⁵⁸ See *id.* § 253(a).

welfare.⁵⁹ Section 253 also provides that if the FCC determines that a state or local regulation does prohibit entry of a competitor into a local market, then the FCC shall preempt enforcement of that regulation.⁶⁰

B. *Specifics of the FCC's Pricing Regulations*

In section 251(d)(1) of the TCA, Congress authorized the FCC to promulgate regulations in order to implement the provisions of the TCA and required that the FCC do so within six months from the date the bill was signed into law.⁶¹ On August 8, 1996, the FCC issued its First Report and Order ("FRO"), which contained the regulations (and explanations of the regulations) for implementing the local competition provisions of the TCA.⁶² The relevant regulations are divided into four separate parts—pricing of elements, pricing of resale of retail offerings, reciprocal compensation for transport and termination of local telecommunications traffic and the "pick-and-choose" rule.⁶³

1. Pricing of Elements

The general pricing standard for network elements is a choice between two alternatives.⁶⁴ The first alternative a state commission may choose is a forward-looking economic cost-based pricing methodology set forth in the regulations.⁶⁵ The second choice is a pricing methodology consistent with FCC-mandated proxy rates set forth in the regulations.⁶⁶

a. *Forward-Looking Economic Cost*

Section 51.505 of the FRO sets forth in detail the forward-looking economic cost-pricing methodology.⁶⁷ The forward-looking economic

⁵⁹ See *id.* § 253(b).

⁶⁰ See *id.* § 253(d). This section reads, in full:

(d) *Preemption*—If, after notice and an opportunity for public comment, the [FCC] determines that a State or local government has permitted or imposed any statute, regulation, or legal requirement that violates subsection (a) or (b), the [FCC] shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency.

Id.

⁶¹ See *id.* § 251(d)(1).

⁶² See FRO, *supra* note 18. The regulations contained therein were published in Chapter 47 of the Code of Federal Regulations.

⁶³ See 47 C.F.R. §§ 51.501–15, .601–17, .701–17, .809 (1996).

⁶⁴ See *id.* § 51.503.

⁶⁵ See *id.* § 51.503(b)(1).

⁶⁶ See *id.* § 51.503(b)(2).

⁶⁷ See *id.* § 51.505.

cost of an element is the sum of the total element long-run incremental cost ("TELRIC") of the element, plus a reasonable allocation of forward-looking common costs.⁶⁸ This total cost is then divided by the reasonable projection of the number of units to be used by the incumbent LEC and the competitor to arrive at a per-unit cost.⁶⁹

TELRIC is a method of calculating costs based solely on forward-looking costs, without regard to prior "embedded" costs.⁷⁰ It is the sum of all the long-run forward-looking costs that are directly attributable to that element.⁷¹ The regulations contain assumptions to be used in calculating the cost.⁷² The most important assumption is that the incumbent LEC is using the most efficient telecommunications technology currently available and the lowest cost network configuration, whether or not the LEC is actually using them.⁷³ The second part of the equation, a reasonable allocation of forward-looking common costs, is designed to capture those costs that cannot be directly attributed to a specific element but are incurred by the LEC.⁷⁴ This calculation is based upon the forward-looking common costs incurred by a hypothetical LEC that is efficient and produces nothing but the specific network element.⁷⁵ The regulations list specific factors that may *not* be considered when calculating the forward-looking costs of an element.⁷⁶ They are embedded costs (costs incurred in the past by the LEC that are on the LEC's books); retail costs (costs such as marketing, billing and collection); opportunity costs (revenues that the LEC would have received in the absence of the new competitor); and revenues to subsidize other services.⁷⁷

⁶⁸ See 47 C.F.R. § 51.505(a).

⁶⁹ See *id.* § 51.511.

⁷⁰ See *id.* § 51.505(b), (c).

⁷¹ See *id.* § 51.505(b).

⁷² See *id.* § 51.505(b)(1).

⁷³ See 47 C.F.R. § 51.505(b)(1).

⁷⁴ See *id.* § 51.505(c).

⁷⁵ See *id.* § 51.505(c)(2)(A).

⁷⁶ See *id.* § 51.505(d).

⁷⁷ See *id.* For illustrative purposes, assume an existing LEC named Carrier A. Potential competitor B has asked A to negotiate a deal to provide B with one of the elements in the network, but the two sides cannot work out an agreement and the matter is submitted to the state commission for arbitration. Under the FCC regulations, the state commission must calculate a rate based upon the forward-looking costs of providing that element. See *id.* § 51.505. Thus, in this procedure, unlike in traditional rate-setting procedures, the state commission cannot look at how much A has spent in the past building its network, nor can it look at A's current incremental cost of providing the element to B, nor can it look at the long-run future incremental cost of providing that element to B. See *id.* Rather, the state commission can look only at two costs: first, the long-run direct costs of providing that element to B, assuming that A has and will continue to have the most efficient telecommunications technology and the lowest cost network configu-

b. FCC Proxy Rates

In the alternative, state commissions may choose a rate for each network element that is consistent with proxy rates set forth in the regulations.⁷⁸ The FCC realized that with the short time-span that Congress allotted to the FCC to promulgate the regulations and for state commissions to set rates based on those regulations, many states would not have time to review the forward-looking cost analyses outlined above.⁷⁹ In order to alleviate this situation, the FCC calculated price ranges for each network element.⁸⁰ If a state commission determines that it does not have enough time to review a TELRIC analysis fully, it has the option of setting a price for each element based on the FCC-mandated price range.⁸¹ That price is to be effective only until the state commission is able to conduct a TELRIC analysis and set a price based thereon.⁸² The proxy rates are different for each network element, and are either price ceilings, under which the state commission must set its rate, or price ranges, which provide for both a ceiling and a floor.⁸³

2. Pricing of Resale of Retail Offerings

The regulations for resale of retail offerings are structured similarly to the regulations for pricing of network elements.⁸⁴ State commissions have a choice between either rates based on a cost methodology outlined in the regulations or rates that are consistent with FCC-mandated interim wholesale rates.⁸⁵ If the state chooses the latter because it does not have the time to review a full cost analysis, these interim wholesale rates are to be in effect only until the state commis-

ration, *whether or not this is true*, and second, a reasonable allocation of forward-looking common costs—costs that are incurred by the LEC but cannot be attributed to one specific network element—assuming that A's costs are equal to those of a hypothetical efficient producer of that network element, *whether or not this is true*. See *id.* The total of these two costs is the rate that the state commission must set to be charged by A to B for B's use of A's network element. See *id.*

⁷⁸ See 47 C.F.R. § 51.503.

⁷⁹ See FRO, *supra* note 18, at n.767.

⁸⁰ See 47 C.F.R. § 51.513.

⁸¹ See *id.*

⁸² See *id.* § 51.513(a)(1).

⁸³ See *id.* § 51.513. For example, for local loops, the FCC has set forth a price ceiling on a state-by-state basis. See *id.* § 51.513(c)(1). The prices vary from a low of \$9.83 in Massachusetts to \$25.36 in North Dakota. See *id.* For local switching, the price range is no less than 0.2 cents per minute and no more than 0.4 cents per minute, unless a state commission has previously set a rate less than 0.5 cents per minute. See *id.* § 51.513(c)(2). For tandem switching, the rate is no greater than 0.15 cents per minute. See *id.* § 51.513(c)(5).

⁸⁴ See *id.* §§ 51.609, .611.

⁸⁵ See 47 C.F.R. § 51.609, .611.

sion can conduct a full cost analysis based on the methodology outlined in the regulations.⁸⁶

The method for determining the permanent wholesale rate to be charged by incumbent LECs is described in section 51.609 of the FRO.⁸⁷ This method entails calculating the current retail price, less any avoided retail costs.⁸⁸ The avoided retail costs consist of "those costs that reasonably can be avoided when an incumbent LEC provides a telecommunications service for resale at wholesale rates to a requesting carrier."⁸⁹ The regulations list the costs that are included as avoidable, such as advertising, sales, customer service and product management, and those costs that are not considered avoidable, such as plant expenses.⁹⁰ The regulations provide an opportunity for both sides to prove that certain expenses should or should not be deemed avoidable expenses notwithstanding their inclusion or exclusion in the regulations' calculations.⁹¹

Alternatively, state commissions may choose interim wholesale rates if the commission cannot calculate, based on the information available to it, a rate consistent with the above pricing methodology.⁹² If the state commission chooses this option it must, within a reasonable time, establish wholesale rates on the basis of the avoided cost pricing methodology.⁹³ The state commission may establish an interim wholesale rate that is at least seventeen percent and no more than twenty-five percent below the existing retail rate.⁹⁴ The commission must explain its basis for choosing the particular rate, and must apply that rate for all retail offerings.⁹⁵

3. Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic

The regulations for reciprocal compensation for transport and termination of local telecommunications traffic are also similarly structured to the regulations for the pricing of network elements and the resale of retail offerings.⁹⁶ Again, state commissions have a choice

⁸⁶ See *id.* § 51.611(c).

⁸⁷ See *id.* § 51.609.

⁸⁸ See *id.*

⁸⁹ *Id.* § 51.609(b).

⁹⁰ See 47 C.F.R. § 51.609(c).

⁹¹ See *id.* § 51.609(d).

⁹² See *id.* § 51.611(a).

⁹³ See *id.* § 51.611(c).

⁹⁴ See *id.* § 51.611(b).

⁹⁵ See 47 C.F.R. § 51.611(b).

⁹⁶ See *id.* § 51.705.

between either a cost methodology outlined in the regulations—in this instance there are two methodologies—or rates that are consistent with FCC-mandated interim proxy rates.⁹⁷ If the state chooses the latter because it does not have the time to conduct a full cost analysis, these interim proxy rates are to be in effect on a temporary basis until the state commission can conduct a full cost analysis based on the methodology outlined in the regulations.⁹⁸

The rates for transportation and termination of local telecommunications traffic are set by the state commission on one of three bases: the forward-looking costs of providing the service; FCC default proxy rates; or so-called “bill-and-keep” arrangements.⁹⁹ Under the first alternative, states are to set the rates using the TELRIC pricing methodology outlined above.¹⁰⁰ In the interim period while the state is conducting the TELRIC cost study, the state may use the FCC proxy rates as long as it explains its basis for selecting that particular rate within the FCC’s proxy range.¹⁰¹ Under the third alternative, in which neither LEC charges the other for use of its network, the FCC’s regulations allow the state commission to impose a bill-and-keep arrangement if it determines that the amount of telecommunications traffic going between the respective networks is roughly balanced.¹⁰²

4. The “Pick-and-Choose” Rule

Section 252(i) requires that each incumbent LEC provide any telecommunications service that it already provides under an existing agreement with another carrier to any requesting competitor on the same terms and conditions as that of the existing agreement.¹⁰³ In promulgating its regulations, the FCC provided that the incumbent LEC must provide any service on “the same *rates*, terms, and conditions as provided in the agreement.”¹⁰⁴ The incumbent LEC can avoid this

⁹⁷ See *id.*

⁹⁸ See *id.* § 51.707(a)(1).

⁹⁹ See *id.* § 51.705.

¹⁰⁰ See 47 C.F.R. § 51.705(a)(1).

¹⁰¹ See *id.* § 51.707. The FCC’s proxy rates for termination provide for a range of \$0.002 to \$0.004 per minute, unless a state had established a rate less than or equal to \$0.005 per minute prior to August 8, 1996. See *id.*

¹⁰² See *id.* § 51.713. Unlike the regular billing procedure for calls between different networks, in which the originating carrier collects the charge from the customer and then pays the other carrier for the use of its network, a bill-and-keep arrangement eliminates the payment to the other carrier for network use, allowing the originating carrier to retain all of the revenue from the call. If the amount of telephone traffic in each direction is equal and each network’s cost is equal, then each carrier ends up collecting roughly the same amount of revenue without having to incur the expense of billing and collecting from the other carrier.

¹⁰³ See 47 U.S.C.A. § 252(i) (West Supp. 1997); see *supra* note 52 and accompanying text.

¹⁰⁴ 47 C.F.R. § 51.809(a) (emphasis added).

requirement only by showing the state commission either that the costs of providing the service to the requesting competitor are greater than the costs of providing the service to the original competitor or that the provision of the particular service to the requesting competitor is not technically feasible.¹⁰⁵ The rule thus permits new entrants to "pick and choose" the lowest priced individual elements from among existing agreements without having to accept all of the terms of the agreements.¹⁰⁶ In addition, new entrants can demand that their rates be adjusted if the incumbent LEC and a later entrant agree to rates that are lower than the rates agreed to by the original new entrants.¹⁰⁷

C. *Background of Common Law and Economic Theory*

To understand more fully each side's arguments regarding this dispute, some basic background material regarding previous court cases and economic theory is necessary. The first case addresses the general nature of an agency's discretion in interpreting a statute.¹⁰⁸ The second case involves a specific application of a statute that governs the regulation of the telecommunications industry.¹⁰⁹ Finally, some basic economic theory addresses the reasoning behind certain managerial decision-making.¹¹⁰

The dispute here concerns a federal agency's interpretation of a statute and a court's deference to that interpretation. *Chevron v. Natural Resources Defense Council*, decided in 1984, is the preeminent case regarding this issue.¹¹¹ In *Chevron*, the United States Supreme Court held that when reviewing an agency's construction of a statute administered by that agency, a court should determine whether Congress has directly spoken to the issue in question.¹¹² If so, the court must give effect to the clearly expressed intent of Congress, regardless of the agency's interpretation.¹¹³ If not, the court may not impose its own construction of the statute, but rather must defer to the agency's interpretation as long as that interpretation is reasonable.¹¹⁴

¹⁰⁵ See *id.* § 51.809(b).

¹⁰⁶ See *id.* § 51.809(a).

¹⁰⁷ See *id.*

¹⁰⁸ See *infra* notes 111-21 and accompanying text.

¹⁰⁹ See *infra* notes 122-41 and accompanying text.

¹¹⁰ See *infra* notes 142-44 and accompanying text.

¹¹¹ 467 U.S. 837, 842-44 (1984).

¹¹² See *id.* at 842.

¹¹³ See *id.* at 842-43.

¹¹⁴ See *id.* at 843.

In *Chevron*, the Environmental Protection Agency ("EPA") issued regulations defining the term "stationary source" of air pollution in the context of the Clean Air Act ("CAA").¹¹⁵ The CAA prohibited certain states from issuing permits for new stationary sources of air pollution unless they met several stringent requirements.¹¹⁶ The EPA's definition of "stationary source" provided for a "bubble" concept, in which an entire plant, rather than each individual pollution-emitting device, was viewed as a stationary source.¹¹⁷ The respondents sued to have this definition of "stationary source" reviewed and set aside by the courts, arguing for a return to the EPA's original definition of "stationary source," which provided that each individual pollution-emitting device was viewed as a stationary source.¹¹⁸ In upholding the EPA's definition of the term "stationary source," the Court reasoned that because Congress does not always legislate every detail, and because an agency whose purpose is to administer congressional edicts has more expertise than a reviewing court, a court should not substitute its judgment for that of an agency unless an agency's judgment is clearly at odds with a statute's provisions or the regulations are arbitrary and capricious.¹¹⁹ The Court held that a reviewing court must give controlling weight to an agency's reasonable interpretation of a statute unless Congress has expressed its intent, in which case a reviewing court must give effect to that express intent.¹²⁰ The Court thus upheld the EPA's definition of "stationary source."¹²¹

In 1986, in *Louisiana Public Service Commission v. FCC*, the United States Supreme Court held that section 2(b) of the 1934 Act denies the FCC the power to preempt state regulation of depreciation for intrastate rate-making purposes.¹²² The issue in question was whether the FCC could preempt the rate-setting procedures of state regulatory commissions with regard to accounting practices for state-regulated telephone companies.¹²³ In the early 1980s, the FCC issued several orders regarding the procedures for calculating depreciation of tele-

¹¹⁵ See *id.* at 840.

¹¹⁶ See *Chevron*, 467 U.S. at 840.

¹¹⁷ See *id.* Thus, a plant could modify or add pollution-emitting devices without meeting the stringent permit requirements as long as the total emissions from the plant did not increase. See *id.*

¹¹⁸ See *id.* at 841, 857.

¹¹⁹ See *id.* at 843-44.

¹²⁰ See *id.* at 842-44.

¹²¹ See *Chevron*, 467 U.S. at 845.

¹²² 476 U.S. 355, 373 (1986).

¹²³ See *id.* at 358.

phone company assets.¹²⁴ The FCC initially issued a memorandum stating that states were not required to follow these procedures when calculating depreciation for the purposes of intrastate rate-making.¹²⁵ Later, the FCC reversed itself and declared that these orders preempted conflicting state procedures, in effect requiring state rate-making commissions to follow the FCC's accounting procedures for purely intrastate purposes.¹²⁶ In holding that section 2(b) of the 1934 Act bars the FCC from preempting state commissions, the Court acknowledged that the theoretical split between interstate matters regulated by the FCC and intrastate matters regulated by states was in practice not possible because the same equipment is used for both interstate and intrastate purposes.¹²⁷ Nevertheless, the Court concluded that a regulatory split between inter and intrastate functions is possible and further found that section 2(b) precludes the FCC from regulating the purely intrastate portion.¹²⁸

The Court began by noting the conflict between various sections of the 1934 Act.¹²⁹ Section 151 states that the purpose of the 1934 Act is to regulate interstate communications in order to create an efficient, nationwide communications service.¹³⁰ Congress created the FCC in order to implement this stated purpose.¹³¹ Section 220 states that the FCC shall prescribe the methods of depreciation to be used by communications carriers.¹³² On the other hand, section 2(b) states that the 1934 Act shall not be construed as granting jurisdiction to the FCC over matters relating to intrastate pricing procedures.¹³³ The FCC's position was that section 220 should be read as a grant to the FCC of exclusive jurisdiction for determining depreciation methods for all communications carriers.¹³⁴ The FCC argued in the alternative that it is entitled to preempt conflicting state law when it frustrates a clearly

¹²⁴ See *id.* at 360-61.

¹²⁵ See *id.* at 361-62.

¹²⁶ See *id.* at 362.

¹²⁷ See *Louisiana*, 476 U.S. at 360.

¹²⁸ See *id.* at 370.

¹²⁹ See *id.* at 365-68.

¹³⁰ See 47 U.S.C.A. § 151. The section states, in relevant part, that its purpose is "regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States, . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges" *Id.*

¹³¹ See *Louisiana*, 476 U.S. at 369.

¹³² See 47 U.S.C.A. § 220 (West 1991 & Supp. 1997).

¹³³ See *id.* § 152(b). For the text of this section, see *supra* note 5.

¹³⁴ See *Louisiana*, 476 U.S. at 366-67.

defined federal policy.¹³⁵ The states responded that section 2(b) clearly prohibits the FCC from regulating purely intrastate rate matters.¹³⁶

In light of these seemingly conflicting provisions of the 1934 Act, the Court reviewed the different methods that Congress may use in order to preempt state law.¹³⁷ Among these are a clear congressional intent to preempt state law and preemption by virtue of the fact that state law stands in the way of the accomplishment and execution of the objectives of Congress.¹³⁸ The Court noted that both issues were involved in this case, but that both grounds ultimately failed as a method of preempting state law.¹³⁹ These two grounds failed because nowhere in the statute did Congress clearly express its intent to preempt state law and because a federal agency cannot grant power to itself to carry out a policy when Congress has not granted it that power.¹⁴⁰ The Court thus concluded that in order to overcome the jurisdictional bar on intrastate matters placed on the FCC by section 2(b), Congress must specifically grant the FCC this jurisdiction, which in this case it did not.¹⁴¹

In addition to these cases, an introduction to economic theory is helpful in understanding each side's position. In making a business decision as to whether to make an investment, a manager must estimate the anticipated revenues, compare them to the anticipated costs of the investment, and then decide whether the excess of revenue over cost, if any, is enough to justify the investment.¹⁴² In deciding which costs to consider, the manager should look only at future (or marginal) costs and ignore any "sunk" or historical costs.¹⁴³ Because nothing can be done about historical costs, they are irrelevant to the calculation of costs from the time of the proposed investment looking forward, and therefore should not play any role in the manager's decision to make the proposed investment.¹⁴⁴

¹³⁵ See *id.* at 368.

¹³⁶ See *id.* at 365-66.

¹³⁷ See *id.* at 368-69.

¹³⁸ See *id.*

¹³⁹ See *Louisiana*, 476 U.S. at 369, 373.

¹⁴⁰ See *id.* at 373, 374-75.

¹⁴¹ See *id.*

¹⁴² See PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 175-76 (14th ed. 1992).

¹⁴³ See *id.*

¹⁴⁴ See *id.* A good example of this principle, called the "marginal principle," is the Shoreham nuclear power plant on Long Island. See *id.* The owner of the plant spent six billion dollars by 1991, but had not yet received an operating license. See *id.* At that point, in the decision as to whether to continue to pursue the license or abandon the plant, the six billion dollars already spent was completely irrelevant. See *id.* The only costs to be considered were those costs that the owner would incur from that point forward. See *id.*

D. *The Dispute*

On August 8, 1996, the FCC issued its First Report and Order ("FRO"), containing all of the above regulations, which were published in the *Federal Register* on August 29, 1996 and took effect September 30, 1996.¹⁴⁵ Shortly thereafter, numerous state regulatory commissions and incumbent LECs filed suit, seeking an injunction against enforcement of the regulations.¹⁴⁶ The suits were consolidated into *Iowa Utilities Board v. FCC*, which was heard by the United States Court of Appeals for the Eighth Circuit.¹⁴⁷ After an initial hearing, the court issued a temporary injunction against enforcement of portions of the regulations shortly before they were to take effect.¹⁴⁸ After oral arguments on October 3, 1996, the court, on October 15, 1996, extended its injunction until it could make a decision on the merits after full oral arguments and submission of briefs.¹⁴⁹ After considering the four criteria for issuing an injunction, the court found that an injunction was warranted.¹⁵⁰ The court determined that at first glance the petitioners were likely to succeed on the merits of their claim that the FCC's regulations were beyond the scope of its authority or were contrary to Congress's intent and that the petitioners were likely to suffer irreparable harm if an injunction was not issued.¹⁵¹ On July 18, 1997, the court issued its decision on the merits, described more fully below, affirming its initial belief that the FCC exceeded its jurisdiction in issuing the pricing regulations and that the pick-and-choose rule was an unreasonable interpretation of the TCA.¹⁵²

II. THE COMPETING ARGUMENTS AND THE COURT'S DECISION

A. *RBOCs'/State Commissions' Arguments*

The parties opposing the FCC's proposed regulations consisted mainly of the LECs and RBOCs, along with state regulatory boards.¹⁵³ The two main thrusts of the opponents' arguments were that the FCC has no authority to set rates and procedures for intrastate telecommu-

¹⁴⁵ See FRO, *supra* note 18.

¹⁴⁶ See *Iowa II*, 109 F.3d 418 (8th Cir. Oct. 15, 1996) (order granting preliminary injunction).

¹⁴⁷ *Id.*

¹⁴⁸ See *Iowa I*, 96 F.3d 1116, 1118 (8th Cir. Sept. 27, 1996) (per curiam) (order granting temporary restraining order).

¹⁴⁹ See *Iowa II*, 109 F.3d at 427.

¹⁵⁰ See *id.*

¹⁵¹ See *id.* at 423, 426.

¹⁵² See *Iowa III*, 120 F.3d 753, 800, 801 (8th Cir. July 18, 1997).

¹⁵³ See *Iowa II*, 109 F.3d at 418.

nications under the TCA and that the rates and procedures set by the FCC are either unconstitutional or are contrary to Congress's intent as expressed in the TCA.¹⁵⁴ The RBOCs discussed both of these arguments, with more emphasis on the illegitimacy of the rates and procedures, while the state commissions focused solely on the FCC's lack of authority to set intrastate rates.¹⁵⁵ Each of these arguments will be discussed in turn.

1. FCC Lacks Authority to Set Rates and Procedures for Intrastate Telecommunications

The petitioners first focused on whether the FCC has jurisdiction to set rates and procedures for intrastate telecommunications.¹⁵⁶ Section 2(b) of the 1934 Act provides that "nothing in this Act shall be

¹⁵⁴ See generally Brief for Petitioners Regional Bell Companies and GTE, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties, *Iowa III* (No. 96-3321). The RBOCs stated that this case involved four issues:

1. Whether the FCC has jurisdiction to issue regulations, binding on the States, dictating the prices and other terms and conditions of local interconnection, unbundling of network elements, and resale of services

2. Whether the FCC's pricing methodologies and proxy prices are contrary to the plain terms and express intent of the [TCA] and would interpret the [TCA] to effect an unconstitutional taking of carriers' property by systematically depriving them of the opportunity to earn a fair return consistent with the Fifth Amendment

3. Whether the FCC's rules on unbundled network elements and resale of services violate the plain terms of the [TCA], thwart Congress's intent to encourage facilities-based competition, and would effect an unauthorized taking of private property without just compensation

4. Whether the FCC's proxy prices and pick-and-choose rule improperly displace and unlawfully subvert the system of private negotiations established by Congress.

Brief for Petitioners Regional Bell Companies and GTE at xi, *Iowa III* (No. 96-3321). The state commissions stated that the issues were:

1. Whether the FCC may properly prescribe to state commissions the methodology for determining intrastate rates that local telephone companies charge competitors . . . notwithstanding § 2(b) of the [1934 Act]

2. Whether the FCC correctly concluded that §§ 251, 252 and 253 of the [TCA] abrogate, impliedly repeal or preempt § 2(b) of the 1934 Act

3. Whether the FCC's facial preemption of all state pricing determinations for intrastate services other than those resulting from its prescribed pricing methodology is impermissibly overbroad

. . . .

5. Whether the FCC's interpretation of the [TCA] violates the Commerce Clause, Tenth Amendment, and the spirit of the Guarantee Clause to the United States Constitution.

Joint Brief for the State Commission Parties at 1-2, *Iowa III* (No. 96-3321).

¹⁵⁵ See Brief for Petitioners Regional Bell Companies and GTE at 16-20, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties at 11-14, *Iowa III* (No. 96-3321).

¹⁵⁶ See Brief for Petitioners Regional Bell Companies and GTE at 21, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties at 14, *Iowa III* (No. 96-3321).

construed to apply or to give the [FCC] jurisdiction with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication¹⁵⁷ Under the holding of *Louisiana Public Service Commission v. FCC*, only a clear and unambiguous grant of authority to the FCC by Congress will overcome this jurisdictional bar.¹⁵⁸ The petitioners believed that there is no clear and unambiguous grant of intrastate regulatory authority in the statute, and therefore section 2(b) bars the FCC from implementing its proposed intrastate regulations.¹⁵⁹

To support this position, the petitioners pointed to the legislative history of the relevant sections of the TCA.¹⁶⁰ Earlier versions of the TCA would have excepted sections 251 and 252 from the applicability of section 2(b), thus allowing the FCC to regulate these intrastate matters.¹⁶¹ After intense lobbying by state regulators, however, this exception was deleted from the final bill passed by Congress and signed by President Clinton.¹⁶² The petitioners argued that the deletion of this provision from the final bill evidenced Congress's intent that the existing regulatory framework of split jurisdiction not be disturbed.¹⁶³ Because the statute contains no clear language granting jurisdiction over intrastate matters and because Congress deleted a proposal to grant this jurisdiction to the FCC, the petitioners argued that Congress has not granted the clear and unambiguous authority to the FCC necessary to overcome section 2(b)'s jurisdictional bar.¹⁶⁴ Thus, the petitioners argued, the FCC has no jurisdiction to promulgate the proposed regulations.¹⁶⁵

In addition, the petitioners argued that not only did Congress *not* grant the FCC the authority to regulate intrastate pricing, it *expressly* granted this authority to the states.¹⁶⁶ They pointed to section 252(d), which specifically addresses pricing standards, and section 252(c),

¹⁵⁷ 47 U.S.C.A. § 152(b) (West Supp. 1997).

¹⁵⁸ 476 U.S. 355, 377 (1986).

¹⁵⁹ See Brief for Petitioners Regional Bell Companies and GTE at 25, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties at 16, *Iowa III* (No. 96-3321).

¹⁶⁰ See Brief for Petitioners Regional Bell Companies and GTE at 23-24, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties at 18-20, *Iowa III* (No. 96-3321).

¹⁶¹ See Brief for Petitioners Regional Bell Companies and GTE at 23, *Iowa III* (No. 96-3321) (citing S. 652, 104th Cong. § 101(c)(2) (1995) and H.R. 1555, 104th Cong. § 101(c)(1) (1995)).

¹⁶² See Joint Brief for the State Commission Parties at 19, *Iowa III* (No. 96-3321).

¹⁶³ See *supra* note 160.

¹⁶⁴ See Brief for Petitioners Regional Bell Companies and GTE at 21-25, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties at 14-20, *Iowa III* (No. 96-3321).

¹⁶⁵ See *supra* note 164.

¹⁶⁶ See Brief for Petitioners Regional Bell Companies and GTE at 26, *Iowa III* (No. 96-3321); Joint Brief for the State Commission Parties at 22, 26, *Iowa III* (No. 96-3321).

which addresses state arbitration standards.¹⁶⁷ According to the petitioners, the language and structure of these provisions specifically grant the states the power to set prices while providing limited circumstances in which the states must follow the FCC's regulations.¹⁶⁸ The petitioners thus argued that it is clear that Congress intended for the states to have the sole power to set rates, and also that the states shall follow the FCC's regulations *only where those regulations are specifically mentioned*.¹⁶⁹ Because the text is so clear and the FCC's regulations are mentioned only in areas outside the rate-setting procedure, the petitioners concluded that Congress intended the states, and not the FCC, to have rate-setting power.¹⁷⁰

The petitioners also argued that the FCC cannot resort to judicial deference to an agency's interpretation of a statute.¹⁷¹ First, under the holding in *Chevron v. Natural Resources Defense Council*, a court must defer to the express intent of Congress, regardless of the agency's interpretation.¹⁷² According to the petitioners, because the statute clearly expresses Congress's intent to grant the power to set rates to the states, the court must defer to Congress's intent and not to the FCC's interpretation.¹⁷³ They also argued that because section 2(b) of the 1934 Act provides that nothing in the Act should be construed as giving the FCC jurisdiction over intrastate pricing matters, the FCC is prohibited from exercising its own statutory construction contrary to the Act's provisions.¹⁷⁴ Thus, the petitioners argued that the court should not give deference to the FCC's interpretation of the TCA.¹⁷⁵

2. The FCC's Pricing Rules Are Contrary to the Intent of the TCA

The RBOCs next argued that whether or not the court decided that the FCC lacked the appropriate jurisdiction, the court should find

¹⁶⁷ See Brief for Petitioners Regional Bell Companies and GTE at 26, *Iowa III* (No. 96-3321).

¹⁶⁸ See *id.* at 26-27. Section 252(d)(1) provides that the state commission shall make a determination of just and reasonable rates in an arbitration setting, while section 252(d)(2) provides that the state commission shall determine if a carrier's reciprocal compensation arrangements are just and reasonable. See 47 U.S.C.A. §§ 252(d)(1), (2) (West Supp. 1997). Section 252(c) provides that the state commission shall ensure that its decision meets the requirements of section 251, including any regulations promulgated by the FCC pursuant to that section; it also provides that the decision shall establish rates according to section 252(d). See *id.* § 252(c).

¹⁶⁹ See Brief for Petitioners Regional Bell Companies and GTE at 27-28, *Iowa III* (No. 96-3321).

¹⁷⁰ See *id.*

¹⁷¹ See *id.* at 30.

¹⁷² 467 U.S. 837, 842-44 (1984).

¹⁷³ See Brief for Petitioners Regional Bell Companies and GTE at 30, *Iowa III* (No. 96-3321).

¹⁷⁴ See *id.* at 31.

¹⁷⁵ See *id.*

that the proposed pricing regulations are invalid because they are contrary to the plain terms and express intent of the TCA.¹⁷⁶ The RBOCs argued that if the court found that the FCC lacked jurisdiction to promulgate its regulations, the court should not stop there.¹⁷⁷ Rather, the court should rule on the merits of the proposed regulations because the FCC indicated that absent a judicial invalidation of its regulations, it would apply them in situations in which it assumed jurisdiction from a state commission pursuant to section 252(e)(5).¹⁷⁸

The RBOCs began by asserting that the FCC's pricing regulations regarding interconnection and unbundled elements, which prohibited state commissions from considering actual costs in determining rates, are contrary to the clear provisions of the TCA.¹⁷⁹ The TCA provides that the cost of providing a service should be the basis of the just and reasonable rate for that service.¹⁸⁰ It also provides that the rates may include a reasonable profit.¹⁸¹ The RBOCs argued that because a carrier cannot make a profit without recovering all of its costs, the TCA requires that states be permitted to set rates which will allow a carrier to recover at least its actual costs.¹⁸² In two areas, however, the FCC's regulations prohibit states from considering actual costs—the carrier's historical or "embedded" costs and the carrier's actual forward-looking costs of providing the service.¹⁸³ Instead, the FCC's regulations demand that a state consider only forward-looking costs (ignoring any embedded costs), and even then only the forward-looking costs of a hypothetical network constructed with the most efficient technology (ignoring any actual costs of the carrier's existing network).¹⁸⁴ The RBOCs argued that these regulations violate the TCA's plain language that prices be based on costs, which means actual costs, or at least require that state commissions be allowed to determine which costs to include.¹⁸⁵

¹⁷⁶ See *id.*

¹⁷⁷ See *id.*

¹⁷⁸ See Brief for Petitioners Regional Bell Companies and GTE at 31, *Iowa III* (No. 96-3321). Section 252(e)(5) provides, in relevant part, "[i]f a State commission fails to act to carry out its responsibility under this section . . . then the [FCC] shall issue an order preempting the State commission's jurisdiction . . ." 47 U.S.C.A. § 252(e)(5).

¹⁷⁹ See Brief for Petitioners Regional Bell Companies and GTE at 32, *Iowa III* (No. 96-3321).

¹⁸⁰ See 47 U.S.C.A. § 252(d)(1). The section provides that state commissions shall determine the "just and reasonable rate for interconnection of facilities and equipment . . . and . . . network elements . . ." *Id.*

¹⁸¹ See *id.* § 252(d)(1).

¹⁸² See Brief for Petitioners Regional Bell Companies and GTE at 33, *Iowa III* (No. 96-3321).

¹⁸³ See 47 C.F.R. § 51.505 (1996).

¹⁸⁴ See *id.*

¹⁸⁵ See Brief for Petitioners Regional Bell Companies and GTE at 34-35, *Iowa III* (No. 96-3321).

The RBOCs next argued that the FCC's regulations regarding wholesale pricing of retail offerings are similarly contrary to the plain language of the TCA.¹⁸⁶ Section 252(d)(3) provides that the wholesale price charged to a competitor shall be the retail price less the costs avoided by selling at wholesale.¹⁸⁷ The FCC's regulations provide that the price shall be the retail rate less any costs that are *reasonably avoidable*, and lists items to be treated as presumptively avoidable.¹⁸⁸ Once again, the RBOCs argued that these regulations ignore the plain language of the TCA and will ultimately prohibit the carriers from recouping their actual costs because these costs may be unavoidable.¹⁸⁹

The third regulation that the RBOCs argued is violative of the plain language of the TCA regards rates for transport and termination of calls between networks.¹⁹⁰ The TCA requires that rates must allow for mutual and reciprocal recovery of costs by each carrier, and addresses the availability of bill-and-keep arrangements.¹⁹¹ The RBOCs argued that the proposed FCC regulations violate the language of both of these provisions.¹⁹² According to the RBOCs, the first is violated because the FCC applied its TELRIC pricing methodology, which does not provide for a recovery of a carrier's actual costs.¹⁹³ The RBOCs argued that the second provision is violated for two reasons: first, because the regulations provide that under certain circumstances a state may impose a bill-and-keep arrangement, even though the TCA states that bill-and-keep arrangements must be agreed to by both parties; and second, because the regulations provide that these bill-and-keep arrangements may be imposed when the amount of *traffic* going between networks is roughly equal, even though the TCA states that these arrangements must ensure mutual recovery of *costs*.¹⁹⁴ Thus, the RBOCs argued, these regulations should not stand because the three pricing provisions—interconnection and unbundled elements, whole-

¹⁸⁶ See *id.* at 35.

¹⁸⁷ See 47 U.S.C.A. § 252(d)(3) (West Supp. 1997). For the full text of this section, see *supra* note 55.

¹⁸⁸ See 47 C.F.R. § 51.609 (1996) (emphasis added).

¹⁸⁹ See Brief for Petitioners Regional Bell Companies and GTE at 35–36, *Iowa III* (No. 96–3321).

¹⁹⁰ See *id.* at 36.

¹⁹¹ See 47 U.S.C.A. § 252(d)(2).

¹⁹² See Brief for Petitioners Regional Bell Companies and GTE at 36–37, *Iowa III* (No. 96–3321).

¹⁹³ See *id.* at 36.

¹⁹⁴ See 47 U.S.C.A. § 252(d)(2); Brief for Petitioners Regional Bell Companies and GTE at 37, *Iowa III* (No. 96–3321).

sale prices and transport and termination charges—violate the plain language of the TCA.¹⁹⁵

3. The FCC Proxy Prices Are Contrary to the TCA, Arbitrary and Capricious

The petitioners argued that the FCC's proxy prices, designed as a temporary measure while state commissions completed cost studies based on the TELRIC method, are contrary to the TCA, arbitrary and capricious.¹⁹⁶ They argued that because the proxy prices are based on methodologies contrary to the TCA, the proxy rates are themselves contrary to the TCA.¹⁹⁷ In addition, the proxy rates are arbitrary and capricious because the methods used to calculate them are not based on sufficient and accurate data and are not even calculated using the TELRIC methodology required by the FCC itself.¹⁹⁸

4. Pricing Methodologies and Proxy Prices Will Undermine Congress's Express Intent to Encourage Facilities-Based Competition

Next, petitioners argued that the FCC's pricing methodologies and proxy prices will undermine Congress's express intent to encourage facilities-based competition.¹⁹⁹ Petitioners argued that Congress created the local competition provisions of the TCA to encourage facilities-based competition, and that the FCC acknowledges this purpose.²⁰⁰ They argued that the effect of the pricing regulations is that competitors will not construct new facilities, but instead will simply use the incumbent LECs' networks.²⁰¹ This result arises, they posited, because competitors will build new facilities only if they feel they can provide service at a lower cost than the incumbent, but no competitor

¹⁹⁵ See Brief for Petitioners Regional Bell Companies and GTE at 31-48, *Iowa III* (No. 96-3321).

¹⁹⁶ See *id.* at 37-40.

¹⁹⁷ See *id.* at 37-38.

¹⁹⁸ See *id.* at 38-39. For example, the Florida Public Service Commission pointed out that the FCC's proxy rates for local loops in that state did not include certain costs required to be included by the FCC's own regulations, and therefore were more than 20% lower than the average rate set by the Florida commission. See *id.* at 41. The FCC, on its own motion, acted to correct some of the more glaring mistakes. See Order on Reconsideration, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, No. 96-98 (released Sept. 27, 1996).

¹⁹⁹ See Brief for Petitioners Regional Bell Companies and GTE at 40, *Iowa III* (No. 96-3321).

²⁰⁰ See *id.*

²⁰¹ See *id.* at 41.

can possibly provide service at a lower cost than the hypothetical fully-efficient network upon which the FCC's pricing regulations are based.²⁰² In addition, the RBOCs argued, not only will competitors not build new facilities, but also the incumbent LECs will not upgrade their existing networks because the LECs will never be able to recover their costs under the FCC's pricing regulations.²⁰³ Consequently, the petitioners argued, the end result will not be the multiple technologically improved networks that Congress envisioned, but rather a single network with outdated technology.²⁰⁴

5. The FCC's Pricing Rules Violate the Constitution

The petitioners next argued that the statute cannot be construed to permit the FCC's pricing regulations because doing so would constitute an unconstitutional taking without compensation.²⁰⁵ They pointed to established principles of statutory construction that require a statute to be interpreted to avoid an unconstitutional result.²⁰⁶ The RBOCs argued that under the FCC's pricing regulations, carriers would be unable to recover not only their actual current costs, but also the millions of dollars in assets that are un-depreciated because of the previous scheme of strict regulation of asset depreciation schedules.²⁰⁷ They further argued that the carriers would not be able to recover these costs through higher rates in other non-regulated businesses because competitive pressures will drive rates in those businesses close to the carrier's costs.²⁰⁸ Thus, the petitioners argued, the TCA cannot

²⁰² See *id.*

²⁰³ See *id.*

²⁰⁴ See Brief for Petitioners Regional Bell Companies and GTE at 43, *Iowa III* (No. 96-3321).

²⁰⁵ See *id.* at 43-44. The Fifth Amendment provides, in pertinent part, "nor shall private property be taken for public use, without just compensation." U.S. CONST. amend. V.

²⁰⁶ See Brief for Petitioners Regional Bell Companies and GTE at 44, *Iowa III* (No. 96-3321). A utility must be allowed to recover its costs, as well as to provide returns to its investors. See *id.* (citing *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989)).

²⁰⁷ See Brief for Petitioners Regional Bell Companies and GTE at 45-47, *Iowa III* (No. 96-3321).

²⁰⁸ See *id.* at 47-48. The FCC argued that the regulations do not constitute a taking because as an overall pricing scheme, the regulations allow the carriers to achieve a fair rate of return. See FRO, *supra* note 18, at n.737. The petitioners claimed that the FCC's claim is based on its assumption that the carriers will be able to receive higher rates in other non-regulated businesses. See Brief for Petitioners Regional Bell Companies and GTE at 47-48, *Iowa III* (No. 96-3321). The petitioners claim that existing Supreme Court precedent refutes the proposition that a partially regulated entity may be forced to operate at a loss on the theory that its non-regulated businesses will compensate for the confiscatory rates. See *id.* (citing *Brooks-Scanlon Co. v. Railroad Comm'n*, 251 U.S. 396, 399 (1920)). Furthermore, the FCC does not guarantee that these non-regulated businesses will compensate for the carriers' losses due to the regulations. See *id.* at 48.

be interpreted to allow the FCC's pricing regulations because this would result in an unconstitutional taking.²⁰⁹

A second constitutional argument made by the petitioners was that the regulations violate the Commerce Clause and the Tenth Amendment.²¹⁰ According to the petitioners, the regulations violate the Commerce Clause because the FCC is attempting to regulate purely intrastate matters and also because they strip the states of their power to regulate by forcing compliance with federal regulations.²¹¹ The petitioners also argued that the regulations violate the Tenth Amendment because they turn the states into federal field offices by imposing the choice of either following federal regulations or relinquishing their power to regulate intrastate matters.²¹²

B. FCC's Arguments

The FCC, along with a coalition of long-distance carriers, argued against the petitioners. These parties' arguments mirrored those of the RBOCs and state commissions.²¹³ First, they argued that the FCC *did*

²⁰⁹ See Brief for Petitioners Regional Bell Companies and GTE at 48, *Iowa III* (No. 96-3321). The petitioners also argued that the regulations requiring carriers to allow competitors to use their networks and operations effectively cause the nationalization of the carriers' private property because the carriers will be forced to invest in their networks for the benefit of others without receiving adequate compensation in return. See *id.* at 69.

²¹⁰ See Joint Brief for the State Commission Parties at 36, *Iowa III* (No. 96-3321). The Commerce Clause provides that: "Congress shall have power . . . to regulate commerce . . . among the several States . . ." U.S. CONST. art. I, § 8. The Tenth Amendment provides that "powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X.

²¹¹ See Joint Brief for the State Commission Parties at 36-37, *Iowa III* (No. 96-3321).

²¹² See *id.* at 37-38 (citing *New York v. United States*, 505 U.S. 144, 176 (1992) (holding that a federal statute requiring states to take title to low-level radioactive waste is unconstitutional because it violates the Tenth Amendment by forcing a state to choose between two unconstitutional choices, effectively turning states into federal field offices)). The petitioners also made several other arguments. Among these is that the FCC regulations are contrary to Congress's intent by requiring the following: an expanded definition of "network element" which includes software and operators; carriers to unbundle *all* network elements that are capable of being unbundled, not just those elements that the requesting carrier requires; and carriers to unbundle and then re-bundle all network elements, thus allowing competitors to avoid the resale of retail products pricing guidelines. See Brief for Petitioners Regional Bell Companies and GTE at 49-52, 53-56, 64, *Iowa III* (No. 96-3321). In addition, they argued that the pricing regulations as a whole would discourage the facilities-based competition that Congress desired and would displace the system of private negotiations that Congress intended to create. See *id.* at 49, 73.

²¹³ See Brief for Respondents Federal Communications Commission and United States of America, *Iowa III* (No. 96-3321). In the FCC's view, the relevant issues involved were:

Whether the [TCA] authorizes the FCC to adopt regulations implementing the [TCA]'s pricing provisions Whether the FCC's pricing rules reasonably and lawfully implement the [TCA]'s pricing provisions in a manner that achieves the [TCA]'s procompetitive objectives Whether the FCC's rules reasonably define

have the authority to promulgate its regulations regarding intrastate pricing.²¹⁴ Second, those regulations are a *reasonable* interpretation of the TCA and conform with Congress's intent.²¹⁵

1. The FCC's Regulations Are Within the Commission's Authority

The FCC first asserted that its regulations are within the scope of its authority under the 1934 Act.²¹⁶ The FCC viewed the statutory language in section 251 and section 252 as creating a new relationship between federal and state regulators.²¹⁷ This new relationship is one in which federal and state regulators do not each control their own sphere but share overlapping responsibilities.²¹⁸ In the FCC's view, its duty is to issue rules of general applicability for the states to implement in specific determinations.²¹⁹ Given this new relationship and a need for a uniform set of rules, combined with the FCC's traditionally broad powers to implement regulations in furtherance of congressional goals, the FCC argued that the statutory language grants the FCC the power to issue the disputed regulations.²²⁰ The FCC maintained that Congress's intention for it to interpret the statute is supported by the TCA's legislative history.²²¹ Thus, the FCC argued, the broad authorization contained in the 1934 Act, combined with the new federal/state relationship outlined in the TCA, supports its authority to promulgate its pricing regulations.²²²

In addition, the FCC argued, section 2(b)'s jurisdictional bar does not apply for several reasons.²²³ First, because the statutory language is clear in granting the FCC authority to issue these regulations, there is

incumbent LECs' obligations to provide access to unbundled network elements pursuant to section 251(c)(3) of the [TCA]

Id. at Statement of Issues.

²¹⁴ *See id.* § I.

²¹⁵ *See id.* §§ II, III, IV, V.

²¹⁶ *See id.* § I.

²¹⁷ *See id.* at Counterstatement.

²¹⁸ *See* Brief for Respondents Federal Communications Commission and United States of America at Counterstatement, *Iowa III* (No. 96-3321).

²¹⁹ *See id.*

²²⁰ *See id.* at Counterstatement, § I(A).

²²¹ *See id.* § I(A). The FCC pointed to the fact that Senator Gorton, one of the Senate managers of the bill, successfully fought a proposal to delete section 253(d), which directs the FCC to preempt any state law that has the effect of prohibiting local competition, even though he acknowledged that it was a very broad prohibition on state activities; and that another senator noted the need to centralize authority in the FCC. *See id.*

²²² *See id.* at Counterstatement, § I(A).

²²³ *See* Brief for Respondents Federal Communications Commission and United States of America § I(B), *Iowa III* (No. 96-3321).

no need to "construe" the statutory language.²²⁴ Second, section 2(b) applies only to purely intrastate matters, while the regulations in question involve both inter and intrastate matters.²²⁵ Third, section 2(b) was designed to prevent ancillary jurisdiction by the FCC, not to limit the FCC's traditional jurisdiction to implement the regulations.²²⁶

The FCC also argued that the language granting the states the right to "establish" rates did not divest the FCC of rule-making authority.²²⁷ According to the FCC, making rules and establishing rates are different functions.²²⁸ Even if states are required to follow the FCC's rules, nothing in this arrangement violates the language of the statute because states still retain their power to "establish" rates while the FCC only issues rules.²²⁹ Moreover, argued the FCC, different sections of the TCA direct the FCC to issue regulations governing the establishment of rates or direct the states to follow FCC regulations during the rate-setting procedure.²³⁰ Thus, the FCC argued, it has the authority to promulgate its pricing regulations.²³¹

The FCC further argued that practical considerations support its interpretation of the statute.²³² The question is not whether the FCC or the states will interpret the statute, because ultimately the federal courts will be the final arbiters.²³³ Rather, the FCC urged, the question is whether this court review will take place efficiently under one set of federal regulations, or inefficiently under fifty different sets of rules.²³⁴ Under our system of federalism, maintained the FCC, only the federal government has the power to issue nationwide regulations.²³⁵

In addition, the FCC said, under the holding in *Chevron*, the court should defer to the FCC's interpretation of the statute.²³⁶ The FCC ar-

²²⁴ See *id.*

²²⁵ See *id.*

²²⁶ See *id.*

²²⁷ See *id.* § 1(C).

²²⁸ See Brief for Respondents Federal Communications Commission and United States of America § 1(C), *Iowa III* (No. 96-3321).

²²⁹ See *id.*

²³⁰ See 47 U.S.C.A. §§ 251(d)(1), 252(c)(1) (West Supp. 1997).

²³¹ See Brief for Respondents Federal Communications Commission and United States of America § 1(C), *Iowa III* (No. 96-3321).

²³² See *id.* § 1(D).

²³³ See *id.*

²³⁴ See *id.*

²³⁵ See *id.* The FCC argued that given the underlying principle that federal statutes should have uniform applicability nationwide, it only makes sense that to implement Congress's goals, a federal agency, not 50 separate state agencies, should be the source of regulations. See *id.*

²³⁶ See Brief for Respondents Federal Communications Commission and United States of America § 1(F), *Iowa III* (No. 96-3321).

gued that there is no ambiguity—the statutory language clearly grants the FCC the power to issue its regulations—but if the court did find ambiguity, it should defer to the FCC's interpretation.²³⁷ According to the FCC, this deference applies not only to substantive interpretation, but also to interpretation of an agency's jurisdiction.²³⁸

2. The Regulations Lawfully Promote the Objectives of the TCA

The FCC's second major argument was that the regulations create an environment in which Congress's goal of competition within the local phone markets could be achieved.²³⁹ The FCC argued that the TELRIC pricing methodology is a reasonable interpretation of calculating costs for the interconnection and unbundling requirements assigned to incumbent LECs.²⁴⁰ In addition, the provisions for calculating wholesale rates for resale, as well as those for pricing transport and termination, are also reasonable interpretations of the TCA.²⁴¹ The FCC further argued that the court should not or could not rule on certain portions of the regulations, either because they were not ripe for judicial determination or because the court would be exceeding its jurisdiction.²⁴²

In support of its TELRIC pricing methodology, the FCC, like the petitioners, argued that the statutory term "cost" cannot be confined to one definition.²⁴³ The FCC, however, took the view that because it is an ambiguous term, and because the FCC has the power to interpret the ambiguous language, it should use a definition that best fulfills Congress's intent, rather than use actual costs or allow the states to decide which costs to include.²⁴⁴ According to the FCC, to fulfill Congress's intent of increasing competition, the agency should use a definition that fits within this context.²⁴⁵ In a competitive environment, the costs that are relevant are not historical costs, but rather forward-looking costs.²⁴⁶ Additionally, the FCC countered the petitioners' argument that the TELRIC pricing methodology is contrary to the TCA's purpose

²³⁷ See *id.*

²³⁸ See *id.* (citing *Oklahoma Natural Gas Co. v. Federal Energy Regulatory Comm'n*, 28 F.3d 1281, 1283-84 (D.C. Cir. 1994)).

²³⁹ See *id.* § II.

²⁴⁰ See *id.* § II(A).

²⁴¹ See Brief for Respondents Federal Communications Commission and United States of America § II(B), (C), *Iowa III* (No. 96-3321).

²⁴² See *id.* § II(D), (E).

²⁴³ See *id.* § II(A)(1).

²⁴⁴ See *id.*

²⁴⁵ See *id.*

²⁴⁶ See SAMUELSON & NORDHAUS, *supra* note 142, at 175-76; see also *MCI Communications*

because it will discourage facilities-based competition.²⁴⁷ The FCC argued that Congress intended for competition to exist in both facilities-based and non-facilities-based forms and that the TELRIC methodology will encourage facilities-based competition in the long run.²⁴⁸ The agency also argued that TELRIC does not pose a constitutional "taking," but merely represents what a competitive market would impose upon a carrier.²⁴⁹

In support of its regulations regarding resale of retail product offerings, the FCC argued that practical and historical considerations support its contention that "avoided" costs should mean any costs that can be avoided by a reasonable LEC, rather than costs actually avoided by an LEC.²⁵⁰ As a practical matter, requiring an "actual costs avoided" standard would not give any incentive to incumbent LECs to act efficiently, because the wholesale rate to competitors would be based on the LECs' actual costs, no matter what those costs are.²⁵¹ As a historical matter, the FCC pointed out that many state regulatory commissions had already interpreted this provision of the Act to require the states to assess costs based on those that "reasonably can be avoided."²⁵² In addition, the FCC's standard avoids the self-regulation problem inherent when an LEC is required to report its own avoided costs, especially

Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1116-17 (7th Cir. 1983). In *MCI*, the Seventh Circuit stated:

[I]t is current and anticipated cost, rather than historical cost, that is relevant to business decisions to enter markets and price products. The business manager makes a decision to enter a new market by comparing anticipated additional revenues (at a particular price) with anticipated additional costs The historical costs associated with the plant already in place are essentially irrelevant to this decision since those costs are 'sunk' and unavoidable and are unaffected by the new product decision.

Id.

²⁴⁷ See Brief for Respondents Federal Communications Commission and United States of America § II(A)(1), *Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321).

²⁴⁸ See *id.*

²⁴⁹ See *id.* § II(A)(2). The FCC argued that many investments made by carriers in recent years were made under "price caps," which set rates based on maximum prices rather than a strict rate-of-return formula, and therefore imposed some elements of a competitive market upon the carriers. See *id.* § II(A)(2)(c). Thus, the carriers cannot claim that it is unfair to switch to a regulatory scheme that suddenly imposes competitive market-like forces upon them. See *id.* "Given that the Fifth Amendment does not shield carriers from losses due to competition, neither should it shield carriers from having to charge competitive rates." *Id.*

²⁵⁰ See *id.* § II(B)(1).

²⁵¹ See *id.*

²⁵² See Brief for Respondents Federal Communications Commission and United States of America § II(B)(1), *Iowa III* (No. 96-3321) (citing 47 C.F.R. § 51.609 (1996)). The FCC listed Colorado, Georgia, Illinois, New York and Ohio as the states that have adopted this type of standard. See *FRO*, *supra* note 18, at n.911.

considering the fact that these reported avoided costs will form the basis of pricing to a competitor.²⁵³

In support of its pricing rules for transport and termination of local telecommunications traffic, the FCC argued that its regulations meet the statutory requirement of providing for "the mutual and reciprocal recovery by each carrier of [its] costs."²⁵⁴ According to the FCC, the TELRIC methodology provides for an adequate recovery of costs.²⁵⁵ The FCC stated that the petitioners' arguments that bill-and-keep arrangements must be voluntary and cannot be ordered by a state commission are incorrect because section 252(d), in which the bill-and-keep provisions are located, applies only when there is no voluntary agreement.²⁵⁶ The FCC also argued that the statutory requirement of mutual recovery of costs should not be interpreted as an exact dollar-for-dollar match, but rather a rough equivalent.²⁵⁷ Therefore, according to the FCC, allowing the imposition of bill-and-keep arrangements where the amount of traffic going each way is roughly equivalent is acceptable because the carriers have the right to rebut the presumption that a roughly equivalent amount of traffic in each direction equates to a mutual recovery of costs.²⁵⁸

The FCC also argued that its interpretation of incumbent LECs' obligations to unbundle network elements *do* conform with the statutory language.²⁵⁹ The FCC stated that its expansive definition of "network element," which includes not only physical equipment such as loops and switches but also features such as databases, software and operator services, is broader than the petitioners' suggested definition, but still conforms to the statutory language.²⁶⁰ In addition, the FCC

²⁵³ See Brief for Respondents Federal Communications Commission and United States of America § II(B)(1), *Iowa III* (No. 96-3321).

²⁵⁴ 47 U.S.C.A. § 252(d)(2)(A)(i) (West Supp. 1997); see Brief for Respondents Federal Communications Commission and United States of America § II(C), *Iowa III* (No. 96-3321).

²⁵⁵ See Brief for Respondents Federal Communications Commission and United States of America § II(C), *Iowa III* (No. 96-3321).

²⁵⁶ See 47 U.S.C.A. § 252(d); Brief for Respondents Federal Communications Commission and United States of America § II(C), *Iowa III* (No. 96-3321).

²⁵⁷ See Brief for Respondents Federal Communications Commission and United States of America § II(C), *Iowa III* (No. 96-3321).

²⁵⁸ See *id.*

²⁵⁹ See *id.* § III.

²⁶⁰ See *id.* § III(A). The TCA defines "network element" to include "a facility or equipment used in the provision of a telecommunications service," as well as "features, functions, and capabilities that are provided by means of such facility or equipment." 47 U.S.C.A. § 153(45) (West Supp. 1997). The RBOC's definition of "network element" limited that term to just the physical equipment, "as well as the features, functions, and capabilities that are produced by means of such facilities or equipment." Brief for Petitioners Regional Bell Companies and GTE at 49-50, *Iowa III* (No. 96-3321).

argued, given the statutory language, the agency's regulations requiring incumbent LECs to allow unbundled access at any technically feasible point *for any network element* is just as reasonable as the petitioners' argument that incumbent LECs are required to provide unbundled access only for network elements that the requesting carrier *needs*.²⁶¹ Finally, the FCC argued that its regulations, which allow a competitor to unbundle and then re-bundle all the necessary network elements, do not contradict the purpose of the statute regarding resale of existing retail product offerings, but rather supplement the resale provisions by allowing a competitor an option as to how to provide its services.²⁶²

The FCC also denied the petitioners' argument that the proxy prices and pick-and-choose rule will undermine arbitration and negotiations.²⁶³ The FCC argued that the proxy prices were not a hindrance, but rather facilitated those negotiations and arbitrations by providing suggested guidelines to the negotiating parties and interim prices to state regulatory commissions.²⁶⁴ According to the FCC, the proxy prices provide an "icebreaker" for the negotiations, and allow the state regulatory commissions to comply with strict timing deadlines for implementing arbitrated prices.²⁶⁵ The FCC also argued that its pick-and-choose rule will further Congress's intent and not undermine the arbitration and negotiation process.²⁶⁶ In the FCC's view, potential competitors should be given "most favored nation" status, because considering the inherent advantage incumbent LECs have in controlling the existing market, competitors need favorable rules in order to compete effectively.²⁶⁷ The FCC believed that providing potential entrants with the most favorable portions of existing agreements between LECs and other competitors fulfills this goal.²⁶⁸ The FCC argued that although the statutory language does not specifically state that existing LECs must grant the same *rates* to competitors—the language speaks

²⁶¹ See Brief for Respondents Federal Communications Commission and United States of America § III(B), *Iowa III* (No. 96-3321).

²⁶² See *id.* § III(C). The FCC pointed out that although unbundling and re-bundling network elements will probably be a lower cost option than resale of retail products, it also carries a higher risk, and therefore the occurrence of unbundling and then re-bundling will not be as great as the LEC's claim. See *id.*

²⁶³ See *id.* § IV.

²⁶⁴ See *id.* § IV(A).

²⁶⁵ See *id.*

²⁶⁶ See Brief for Respondents Federal Communications Commission and United States of America § IV(A), (B), *Iowa III* (No. 96-3321).

²⁶⁷ See *id.* § IV(B).

²⁶⁸ See *id.*

only of terms and conditions—this interpretation is reasonable given the fact that the statutory language allows competitors to choose certain provisions of existing agreements without being forced to accept others.²⁶⁹ In addition, according to the FCC, the rule allows incumbent LECs to avoid this rule by proving that differences in technical feasibility or cost of providing the service justify treating the parties differently.²⁷⁰

C. Court's Decisions/Reasoning

In October 1996, in *Iowa Utilities Board v. FCC*, the United States Court of Appeals for the Eighth Circuit granted an injunction against enforcement of the portions of the FCC's regulations designed to implement the local competition provisions of the TCA.²⁷¹ Numerous telecommunications carriers and state regulatory boards had sued for injunctive relief, and the Eighth Circuit, after combining the actions, issued a temporary stay on September 27, 1996.²⁷² After hearing oral arguments, the court on October 15 extended the stay until a full hearing could be held and the issue decided fully on the merits.²⁷³ This hearing took place on January 17, 1997.

²⁶⁹ See *id.*

²⁷⁰ See *id.*

²⁷¹ 109 F.3d 418, 427 (8th Cir. Oct. 15, 1996) (No. 96-3321) (order granting preliminary injunction). The FCC released its FRO on August 8, 1996, with the regulations scheduled to take effect on September 30, 1996. See FRO, *supra* note 18.

²⁷² See *Iowa I*, 96 F.3d 1116, 1118 (8th Cir. Sept. 27, 1996) (per curiam) (order granting temporary restraining order).

²⁷³ See *Iowa II*, 109 F.3d at 427. Although the various parties seeking an injunction approached the issue differently, the court concluded that the principal objection was the proposed pricing rules. See *id.* at 422. The three pricing regulations are TELRIC for network element rates and transport and termination rates, FCC proxy rates for state commissions to use temporarily in lieu of FCC-mandated cost methodologies such as TELRIC and the pick-and-choose rule. See *id.* In granting the injunction, the court considered the following four factors: the likelihood that the party seeking the stay will prevail on the merits, the likelihood that the moving party will be irreparably harmed, the prospect that others will be harmed if the court grants the stay and the public interest in granting the stay. See *id.* at 423. Under Eighth Circuit precedent, these are the factors a court should consider when determining whether to grant a stay. See *id.* (citing *Arkansas Peace Ctr. v. Department of Pollution Control*, 992 F.2d 145, 147 (8th Cir. 1993)). In light of these four factors, the court concluded that it was justified in granting a stay of the pricing provisions and the pick-and-choose rule. See *id.* at 423.

The court first concluded that the petitioners were likely, but not necessarily certain, to succeed on the merits. See *id.* at 424. In reaching this conclusion, the court evaluated the reasonableness of the FCC's interpretation of the TCA using the historical regulation of the telephone industry as a reference point. See *id.* at 423-24. The court noted that section 252(d), which indicates that state commissions have the authority to set "just and reasonable rates" for intrastate communications services, is consistent with the historical practice of states setting rates for intrastate telephone service. See *id.* In addition, section 252(c)(2) directs states to establish

rates according to section 252(d). *See id.* Nowhere in sections 251 or 252 is the FCC authorized to set rates, nor are state commissions directed to obey the FCC's pricing rules. *See id.* The court reasoned that the absence of any language authorizing the FCC to issue pricing guidelines or directing state commissions to comply with FCC guidelines indicated that Congress intended to grant authority over pricing of local telephone service to the state commissions and not to the FCC. *See id.* at 424.

The court next discussed the FCC's contrary interpretation of the TCA. *See id.* Under the rule announced by the Supreme Court in *Chevron v. Natural Resources Defense Council*, courts must give deference to an agency's reasonable interpretation of an unclear statute. 467 U.S. 837, 843-45 (1984). Courts do not have to defer to an agency, however, if the agency's interpretation conflicts with the plain meaning of the underlying statute. *See id.* at 842-43, 844. The court indicated that upon its first review, it was skeptical that the FCC's interpretation giving the agency authority to establish prices would override what seemed to be clear language granting the states the authority to set prices. *See Iowa II*, 109 F.3d at 424-25.

The court also discussed the applicability of the rule announced in *Louisiana Public Service Commission v. FCC* regarding exceptions to section 2(b) of the 1934 Act. *See id.* *See generally* 476 U.S. 355 (1986). For a discussion of *Louisiana*, see *supra* notes 122-41 and accompanying text. Section 2(b) provides that the 1934 Act shall not be construed to grant the FCC jurisdiction over certain intrastate matters. *See* 47 U.S.C.A. § 152(b) (West Supp. 1997). For the relevant text of this section, see *supra* text accompanying note 5. In *Louisiana*, the Supreme Court determined that in order to overcome the provisions of section 2(b), a statute must either contain a straightforward or unambiguous grant of intrastate pricing authority to the FCC or modify section 2(b) itself. *See* 476 U.S. at 377. Although the court acknowledged that portions of the TCA contained straightforward grants of authority to the FCC over some intrastate matters, it indicated that it had been able to find neither a modification of section 2(b) nor any straightforward or unambiguous grants of authority regarding intrastate pricing. *See Iowa II*, 109 F.3d at 424-25. The court concluded that based on a combination of the above factors, the petitioners were likely to succeed on the merits of their appeal. *See id.* at 425.

The court then proceeded to the remaining three factors—the likelihood that the moving party will be irreparably harmed, the prospect that others will be harmed if the stay is issued and the public interest in granting the stay. *See id.* at 425-27. The court found that the likelihood of irreparable harm to the petitioners existed in several areas—a breakdown in negotiations due to competitors' holdouts for the FCC's proxy rates and after-the-fact renegotiating due to the "pick-and-choose" rule; irrecoverable economic loss resulting from proxy rates that may be below actual costs; and loss of customer goodwill. *See id.* at 425-26. Petitioners argued that competitors would have no incentive to negotiate for any rate above the FCC-mandated proxy rates because an impasse in negotiations would lead to a state commission arbitration hearing at which the state commission could not impose any rate above the FCC proxy rate. *See id.* at 425. This would restrict the traditional give-and-take of private negotiations, which is the method preferred by Congress. *See id.* The state commissions noted that given the time constraints imposed in the TCA, many commissions have felt obliged to impose the FCC proxy rates without the proper knowledge as to whether these rates are just and reasonable as required by the TCA. *See id.* The FCC argued that the petitioners' claims of irreparable harm were speculative because the pricing provisions were merely an option for states to consider, and therefore, there was no showing of the required certain and imminent harm. *See id.* at 425-26.

Furthermore, the court found that this showing was sufficient to satisfy the requirement of likely irreparable harm. *See id.* In considering the third criterion, the court determined that if it were to grant the stay, the harm avoided by the petitioners would outweigh the harm suffered by other parties. *See id.* at 426. The court acknowledged that either way it ruled, one side would suffer harm. *See id.* If it granted a stay and the regulations were later upheld, competitors and the LECs would have to renegotiate their agreements to conform with the regulations. *See id.* The court decided, however, that this inconvenience did not outweigh the difficulties involved if the opposite occurred. *See id.* It would be easier to rewrite a non-conforming agreement to conform with the FCC regulations if the stay was overruled than it would be to renegotiate an

On July 18, 1997, the Eighth Circuit issued its decision on the merits of the case.²⁷⁴ In its opinion, the court held, *inter alia*, that the FCC exceeded its jurisdiction in issuing its pricing regulations, and that the FCC's pick-and-choose rule is an unreasonable interpretation of the relevant provision of the TCA.²⁷⁵ The court thus vacated the FCC's pricing rules and the pick-and-choose rule.²⁷⁶

In ruling that the FCC exceeded its jurisdiction in issuing its pricing rules, the court first focused on the fact that the plain language of the TCA provides no direct authority for the FCC to issue the pricing regulations.²⁷⁷ The court rejected the FCC's argument that section 251(d) of the TCA, in conjunction with the general rule-making provisions of the 1934 Act, gives the agency parallel authority to regulate intrastate pricing.²⁷⁸ The court stated that section 251(d) was merely a time constraint designed to ensure an expeditious issuance of regulations, and that the general rule-making provisions of the 1934 Act provides the FCC with only ancillary jurisdiction to issue regulations that may be necessary to fulfill its objectives contained elsewhere in that statute.²⁷⁹ The court also rebuffed the FCC's attempt to compare the TCA's regulatory framework to that of the Cable Act, in which the FCC was given authority to set prices on an intrastate level.²⁸⁰ The court stated that not only was the Cable Act substantially different from the TCA, but also that the structure of the Cable Act actually lent credence

agreement, formed in accordance with the regulations, if the regulations were later overturned. *See id.*

Last, the court concluded that a stay would promote the public interest. *See id.* at 426-27. The FCC argued that a stay would not promote the public interest because it would not maintain the status quo and would impede the path to competition for local telephone service, but the court rejected both of these arguments. *See id.* The court noted that before the FCC published its regulations, the TCA's system of private negotiations among incumbent LECs and potential competitors, backed by state-run arbitration, was operating in many states without interference from the FCC. *See id.* The court also noted that states had historically been successful in preventing incumbent LECs from charging excessive rates, and that the court had no reason to doubt the states' ability to enforce rates that are just and reasonable, as required by the TCA. *See id.* The court, after considering the four factors in determining whether a stay is justified, issued a stay effective until oral argument could be heard and a decision made on the merits. *See id.* at 427.

²⁷⁴ *See Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997).

²⁷⁵ *See id.* at 800, 801. The FCC's jurisdiction over the pick-and-choose rule was not questioned; therefore, the court ruled on the merits of the rule. *See id.* at 801.

²⁷⁶ *See id.* at 800, 801.

²⁷⁷ *See id.* at 794-96.

²⁷⁸ *See id.*

²⁷⁹ *See Iowa III*, 120 F.3d at 794-96.

²⁸⁰ *See id.* at 795-96 (citing Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (codified as amended in scattered sections of 47 U.S.C.)).

to the RBOCs' arguments that the language of the TCA does not authorize the FCC to regulate intrastate pricing.²⁸¹

After discussing the lack of FCC authority in the plain language of the TCA, the court next discussed the role of section 2(b) of the 1934 Act.²⁸² Section 2(b) fences off intrastate matters from federal regulation unless Congress explicitly grants the FCC the authority to regulate those matters or modifies section 2(b) itself, or if the regulatory framework meets the "impossibility" exception.²⁸³ The court first held that the language of the TCA does not constitute a straightforward grant of regulatory power to the FCC and therefore does not circumvent the restrictions of section 2(b).²⁸⁴ The Eighth Circuit then addressed the applicability of the impossibility exception to this situation, holding that the exception did not apply.²⁸⁵

The court first noted that telephone rate-making traditionally has been separated into interstate and intrastate components, thereby failing the first requirement of the impossibility exception.²⁸⁶ Secondly, and to the court, more importantly, the FCC did not show that the states' authority to set intrastate rates would negate the FCC's valid authority to regulate interstate communications, thereby failing the second requirement of the impossibility exception.²⁸⁷ The court stated that based on an analysis of either the language of the local competition provisions of the TCA or the historical dichotomy of intra versus interstate regulation, the FCC has no regulatory authority over intrastate matters that state regulation would negate.²⁸⁸

After vacating the FCC's pricing regulations, the court addressed the pick-and-choose rule.²⁸⁹ The court stated that because the language

²⁸¹ See *id.* "In sharp contrast to the [TCA], several provisions of the Cable Act explicitly grant the [FCC] the authority to regulate the rates of cable companies and explicitly require state authorities to follow the [FCC's] rate-making rules." *Id.*

²⁸² See *id.* at 796-800.

²⁸³ See *supra* text accompanying notes 122-41. This narrow "impossibility" exception, which has evolved out of *Louisiana*, provides that the FCC may regulate intrastate telecommunications matters if (1) it is impossible to separate the interstate and intrastate components of the federal regulation and (2) the state regulation would negate the federal regulation of interstate matters. See, e.g., *Louisiana Pub. Serv. Comm. v. FCC*, 476 U.S. 355, 375-76 n.4 (1986); *California v. FCC*, 39 F.3d 919, 931 (9th Cir. 1994), *cert. denied* 514 U.S. 1050 (1995); *NARUC v. FCC*, 880 F.2d 422, 429 (D.C. Cir. 1989).

²⁸⁴ See *Iowa III*, 120 F.3d at 794-96.

²⁸⁵ See *id.* at 796-800.

²⁸⁶ See *id.* at 798.

²⁸⁷ See *id.*

²⁸⁸ See *id.* at 798-800. The court acknowledged that state regulation may have a tangential effect on interstate services, but stated that this effect was not sufficient to overcome the operation of section 2(b) and does not alter the fundamentally intrastate nature of the TCA's local competition provisions. See *id.* at 800.

²⁸⁹ See *Iowa III*, 120 F.3d at 800-01.

of the statutory provision underlying the pick-and-choose rule is ambiguous, the court needed to look to the structure and language of the statute as a whole in order to determine if the FCC's interpretation is reasonable.²⁹⁰ In doing so, the court held that the pick-and-choose rule is not a reasonable interpretation, and therefore vacated the rule.²⁹¹ The court noted that the TCA's preference is for voluntarily negotiated agreements between existing LECs and potential competitors, with state-run arbitrations serving as a backstop.²⁹² The pick-and-choose rule, according to the court, would thwart the preferred negotiation process by discouraging the give and take necessary to any successful negotiation, because existing LECs would be reluctant to make any concession for fear that a later competitor would be able to receive that concession without having to grant to the existing LEC the corresponding benefit.²⁹³ Not only would this undermine the preferred negotiation process, the court noted, but it also would contradict the terms of section 251(a), which requires that these agreements be "binding."²⁹⁴ The court also rejected the FCC's arguments that the waiver provision of the pick-and-choose rule would allow the existing LECs to negotiate with the traditional give and take, stating that the waivers would probably be rarely granted and that the potential to receive a waiver would not be enough to persuade the existing LECs to make concessions during negotiations.²⁹⁵ The Eighth Circuit thus concluded that the pick-and-choose rule is an unreasonable construction of the relevant provision of the TCA because it conflicts with the TCA's design to promote negotiated agreements.²⁹⁶

III. ANALYSIS OF THE COMPETING ARGUMENTS AND THE COURT'S DECISION

The Eighth Circuit's decision to grant a stay and its subsequent decision to vacate portions of the FCC regulations were correct.²⁹⁷ The court, however, should have taken the additional step of ruling on the lawfulness of the regulations themselves, to avoid future litigation in a situation in which the FCC applies the disputed regulations after obtaining the unquestioned jurisdiction provided for in section

²⁹⁰ See *id.* at 800.

²⁹¹ See *id.* at 801.

²⁹² See *id.*

²⁹³ See *id.*

²⁹⁴ See *Iowa III*, 120 F.3d at 801.

²⁹⁵ See *id.*

²⁹⁶ See *id.*

²⁹⁷ See *infra* notes 300-22 and accompanying text.

252(c)(1), which provides that in certain circumstances a state commission shall follow the regulations of the FCC; and section 253(d), which grants power to the FCC to preempt any state or local rule that effectively prohibits entry by any competitor into a local telephone market.³⁰⁷

These provisions, in the FCC's view, create a new "partnership" between the FCC and state regulatory commissions, granting overlapping regulatory functions to both parties.³⁰⁸ Other than section 201(b), however, none of these provisions explicitly states anything regarding the FCC's authority to regulate pricing, and section 201(b)'s grant is limited to interstate matters.³⁰⁹ The FCC infers its power from the fact that the statutory provisions of the TCA do not *prevent* the FCC from regulating intrastate matters, arguing that Congress's passage of such a significant restructuring of the regulatory scheme without specifically barring the FCC from regulating intrastate matters represents a clear and unambiguous grant of jurisdiction.³¹⁰ This grant eliminates the need to "construe" the language, thereby overcoming section 2(b)'s statutory bar.³¹¹

This argument lacks merit. The language of the statute is neither clear enough to avoid the need to "construe" it, nor explicit enough to consider it a clear and unambiguous grant of jurisdiction.³¹² Had Congress wanted to grant intrastate jurisdiction to the FCC, surely it could have written explicit language to do so, or at least not have deleted the proposal to exempt the pricing provisions from section 2(b)'s jurisdictional bar—especially considering the radical change this proposal would have had on the regulatory scheme in place for decades.³¹³ It seems more likely that the clear and unambiguous grant needed to overcome section 2(b)'s bar is typified by section 251(e),

³⁰⁷ See 47 U.S.C.A. §§ 201(b), 251(d)(1), 251(d)(3), 252(c)(1), 253(d) (West 1991 & Supp. 1997). For the relevant text of § 201(b), see *supra* note 4 and accompanying text. For the text of § 251(d)(1), see *supra* note 21. For the text of § 251(d)(3), see *supra* note 47. For the text of § 252(c)(1), see *supra* note 50. For the text of § 253(d), see *supra* note 60. The TCA did not repeal the 1934 Act, but rather simply supplemented it. Thus, any provision of the 1934 Act, such as § 201's general grant of power, is still in effect unless specifically repealed by a provision of the TCA.

³⁰⁸ See Brief for Respondents Federal Communications Commission and United States of America at Counterstatement, *Iowa III* (No. 96-3321).

³⁰⁹ See 47 U.S.C.A. §§ 201(b), 251(d)(1), 251(d)(3), 252(c)(1), 253(d).

³¹⁰ See Brief for Respondents Federal Communications Commission and United States of America § I, *Iowa III* (No. 96-3321).

³¹¹ See *id.*

³¹² See 47 U.S.C.A. §§ 201(b), 251(d)(1), 251(d)(3), 252(c)(1), 253(d).

³¹³ See Brief for Petitioners Regional Bell Companies and GTE at 23-24, *Iowa III* (No. 96-3321).

which grants the FCC exclusive jurisdiction regarding administration of the North American Numbering Plan.³¹⁴

Not only does the statute fail to grant the FCC jurisdiction to regulate intrastate pricing, it explicitly grants this power to the state regulatory commissions.³¹⁵ The Eighth Circuit pointed out that historically, state commissions have regulated intrastate pricing, and the provisions of the TCA seem consistent with this practice.³¹⁶ Section 252(d), entitled "Pricing Standards," provides that state commissions shall make determinations regarding the just and reasonable rates for interconnection and unbundled access and makes no mention of the FCC.³¹⁷ Section 252(c)(2) states that the state commissions shall establish the rates for interconnection, services and network elements, and again makes no mention of the FCC.³¹⁸ The FCC is mentioned in section 252(c)(1), which requires state commissions to ensure that arbitration resolutions meet the requirements of section 251, including the FCC's regulations.³¹⁹ Thus, as the Eighth Circuit stated, Congress directed the states to follow the FCC's regulations in certain instances, which supports the conclusion that Congress intended the states to follow the FCC's regulations only where specifically mentioned.³²⁰ The sections of the TCA that detail pricing guidelines contain no requirements that state commissions follow FCC regulations, which, when combined with the state commissions' historical role of regulating intrastate pricing, indicates that Congress intended the states, and not the FCC, to regulate intrastate pricing.³²¹ Therefore, because the language of the TCA does not grant jurisdiction over intrastate rate-setting procedures and is not a clear, unambiguous grant of authority necessary to overcome section 2(b)'s jurisdictional bar, the court was correct in ruling that the FCC overstepped its authority in promulgating its local telephone pricing regulations.³²²

As discussed above, both sides argued not only the merits of the FCC's claim of jurisdiction over intrastate rate-setting, but also whether the court should rule on the validity of the regulations themselves if the court found that the FCC lacked jurisdiction.³²³ Section 252(e)(5)

³¹⁴ See *Iowa III*, 120 F.3d at 794. For the text of § 251(e), see *supra* note 47.

³¹⁵ See, e.g., 47 U.S.C.A. § 252(c), (d).

³¹⁶ See *Iowa II*, 109 F.3d 418 (8th Cir. Oct. 15, 1996) (order granting preliminary injunction).

³¹⁷ See 47 U.S.C.A. § 252(d).

³¹⁸ See *id.* § 252(c)(2).

³¹⁹ See *id.* § 252(c)(1).

³²⁰ See *id.*; *Iowa III*, 120 F.3d 753, 794 (8th Cir. July 18, 1997).

³²¹ See *Iowa III*, 120 F.3d at 794-800.

³²² See *supra* notes 312-21 and accompanying text.

³²³ See *supra* notes 176-78, 242 and accompanying text.

permits the FCC to preempt a state's jurisdiction over any proceeding or matter if the state does not fulfill its responsibilities under the TCA.³²⁴ Absent a judicial determination that its regulations were invalid, the FCC may apply the regulations in any situation in which it acquired jurisdiction under section 252(e)(5).³²⁵ Thus, because the court ruled that the FCC lacked jurisdiction but did not address the validity of the regulations themselves, the FCC might use the regulations in any instance in which it gains the unquestioned jurisdiction provided for under section 252(e)(5).³²⁶

B. *The Regulations Are Contrary to the Intent of the TCA*

In an environment in which regulated marketplaces are being transformed into competitive ones, the FCC must take steps beyond simply allowing potential competitors to enter the marketplace.³²⁷ As discussed earlier, without access to the existing network at a reasonable cost, competitors cannot make a profit and therefore will not enter the marketplace.³²⁸ Congress took some steps to ameliorate some of these problems by requiring incumbent LECs to offer unbundled access to their networks, interconnection to existing networks and resale of retail product offerings, thereby "jump-starting" the competitive process.³²⁹ The FCC's pricing regulations seem not only to jump-start this process, but also to accelerate it by fast-forwarding the competitive process so that the starting point becomes what normally is the finish line—a system in which efficiency and threat of entry by competitors drive prices down to cost.³³⁰ This goal, however, cannot be achieved by contradicting the provisions of the underlying statute.³³¹ Some of the FCC's pricing regulations do so and therefore should not be allowed

³²⁴ See 47 U.S.C.A. § 252(c)(5).

³²⁵ See Brief for Petitioners Regional Bell Companies and GTE at 31, *Iowa III* (No. 96-3321).

³²⁶ See 47 U.S.C.A. § 252(c)(5).

³²⁷ See Brief for Respondents Federal Communications Commission and United States of America § IV(B), *Iowa III* (No. 96-3321). A quote from President Lyndon Johnson, with regard to affirmative action, seems appropriate to this situation. "You do not wipe away the scars of centuries by saying: Now you are free to go where you want, and do as you desire . . . you do not take a person who, for years, has been hobbled by chains and liberate him, bring to the starting line of a race and then say, you are free to compete with all the others." President Lyndon Johnson, Address at Howard University (1965).

³²⁸ See *supra* notes 243-70 and accompanying text.

³²⁹ See 47 U.S.C.A. § 251 (West Supp. 1997).

³³⁰ See Brief for Petitioners Regional Bell Companies and GTE at 42-43, *Iowa III* (No. 96-3321); KENNEDY, *supra* note 8, at 129-31.

³³¹ See Brief for Petitioners Regional Bell Companies and GTE at 43, *Iowa III* (No. 96-3321).

to stand.³³² But others do not contradict the TCA's provisions, and are therefore valid interpretations of the statute.³³³

1. TELRIC

The policy behind the FCC's decision to use long-run costs, incorporated in its TELRIC methodology, has support in the realities of economic markets.³³⁴ As the FCC correctly pointed out, the relevant costs for potential competitors in a market are not historic costs, but rather the future anticipated costs and offsetting anticipated revenues.³³⁵ Managers making investment decisions are not concerned with sunk costs because these costs have no effect on whether the proposed venture will be profitable from that time forward.³³⁶ Managers are concerned only with what costs they will incur in the future, and whether these costs will be more than offset by future revenues.³³⁷ Thus, the emphasis on future costs which forms the basis of the FCC's TELRIC pricing methodology is supported by economic theory and reality.³³⁸

The details of TELRIC, however, are more problematic, both in the assumptions the FCC uses and in the fact that it is the only method allowed in the regulations. The crux of the TELRIC methodology is the assumption that the incumbent LECs use the most efficient telecommunications technology and the lowest cost network configurations, *regardless of whether this assumption is true*.³³⁹ Thus, the cost to a competitor to use the incumbent LEC's network will be lower than the incumbent LEC's actual cost because no LEC can meet the cost assumptions upon which TELRIC is based.³⁴⁰ In fact, the cost would be the lowest possible cost had the competitor built its own network from scratch using the most technologically advanced equipment in every aspect of the network and ignoring any carrying costs, financing charges and any other indirect costs of owning a network.³⁴¹ As a result, a potential competitor is faced with a choice between two alternatives:

³³² See *infra* notes 334-57, 386-403 and accompanying text.

³³³ See *infra* notes 358-85 and accompanying text.

³³⁴ See KENNEDY, *supra* note 8, at 129-31.

³³⁵ See SAMUELSON & NORDHAUS, *supra* note 142, at 175-76.

³³⁶ See *id.*

³³⁷ See *id.*

³³⁸ See *id.*

³³⁹ See *supra* note 73 and accompanying text.

³⁴⁰ See Brief for Petitioners Regional Bell Companies and GTE at 32-35, *Iowa III* (No. 96-3321); *infra* notes 391-96 and accompanying text.

³⁴¹ See 47 C.F.R. § 51.505 (1996).

either build its own network, with the inherent risks, or purchase from the incumbent at the same or lower cost than if it built its own network.³⁴² Given this choice, a competitor almost always would choose the latter because that choice allows the competitor to incur the same or lower cost without the risk.³⁴³

As a result most, if not all, potential competitors would choose to purchase capacity from existing LEC networks rather than build new networks.³⁴⁴ Although the FCC and the petitioners disagree on whether facilities-based competition was the primary goal of the local competition provisions of the TCA, both sides do agree that it was at least a factor.³⁴⁵ Because the TELRIC methodology would likely cause competition using existing networks rather than through the construction of new networks, the regulations would, in at least some part, thwart the TCA's overall goal of providing for "private sector deployment of advanced telecommunications and information technologies and services to all Americans."³⁴⁶

The assumptions upon which TELRIC is based, practically speaking, can never be achieved.³⁴⁷ TELRIC assumes that the hypothetical LEC always will be using the most efficient and most technologically advanced equipment at all times.³⁴⁸ Even if incumbent LECs upgraded their equipment on a regular basis, new equipment always would be on the market.³⁴⁹ The new equipment would render the equipment just installed no longer the most efficient and technologically advanced.³⁵⁰ Because this type of equipment is expensive, the LECs are, for the most part, stuck with what they have and can only do so much at a time.³⁵¹ Add to this the limited capital available to LECs to purchase and install new equipment and the result is a cycle in which LECs can never meet the assumptions that form the cornerstone of the FCC regulations.³⁵²

³⁴² See Brief for Petitioners Regional Bell Companies and GTE at 41, *Iowa III* (No. 96-3321).

³⁴³ See *id.*

³⁴⁴ See *id.*

³⁴⁵ See *id.* at 40; Brief for Respondents Federal Communications Commission and United States of America § II(A)(1), *Iowa III* (No. 96-3321).

³⁴⁶ S. CONF. REP. NO. 104-230, at 1 (1996) (Conference Committee Report accompanying TCA); see *supra* notes 342-45 and accompanying text.

³⁴⁷ See Brief for Petitioners Regional Bell Companies and GTE at 33-34, *Iowa III* (No. 96-3321).

³⁴⁸ See 47 C.F.R. § 51.505 (1996).

³⁴⁹ See Brief for Petitioners Regional Bell Companies and GTE at 41-42, *Iowa III* (No. 96-3321).

³⁵⁰ See *id.*

³⁵¹ See *id.* at 42.

³⁵² See *id.*

The second problem of the TELRIC details is that TELRIC is the only methodology permitted under the FCC's regulations.³⁵³ The TCA states that the rates set by state commissions must be based upon "cost."³⁵⁴ Both parties agree that in the context of the telecommunications industry, the term "cost" can have several meanings, such as historical cost, hypothetical cost, average cost and future cost.³⁵⁵ Congress did not specify the meaning of "cost" but did provide that the rates may include a profit.³⁵⁶ In sum, Congress did not specifically define "cost"—the term itself has many meanings and the FCC's authority to issue regulations in the first place is somewhat suspect. It thus seems more reasonable that Congress intended the state commissions to have more discretion in determining the rate-setting procedures, as long as the resulting rates are in some way based on one of the meanings of "costs."³⁵⁷

2: Resale Provisions

The resale pricing provisions, on the other hand, *are* a reasonable interpretation of the TCA.³⁵⁸ The discount from the retail rate that incumbent LECs are to charge to competitors is based on costs that reasonably can be avoided.³⁵⁹ Like the TELRIC pricing methodology, these regulations do not consider actual costs, but rather hypothetical costs—in this case, costs avoided.³⁶⁰ The TCA requires that the state commission set the wholesale rate at the retail rate less any marketing, billing, collection and other costs that will be avoided by the incumbent LEC.³⁶¹ The FCC's interpretation adds a reasonableness component: it requires a discount based on costs that may be reasonably avoided by the incumbent LEC, not just on costs that are actually avoided.³⁶²

The addition of a reasonableness requirement is a sensible interpretation of the TCA's provisions because, unlike the TELRIC meth-

³⁵³ See 47 C.F.R. § 51.505. The state commissions can choose proxy rates as a temporary alternative, but TELRIC is the only methodology allowed for the permanent rate-setting procedure. See *id.*

³⁵⁴ See 47 U.S.C.A. § 252(d)(1)(A)(i) (West Supp. 1997).

³⁵⁵ See Brief for Petitioners Regional Bell Companies and GTE at 33, *Iowa III*, (No. 96-3321); Brief for Respondents Federal Communications Commission and United States of America § II (A)(1), *Iowa III* (No. 96-3321).

³⁵⁶ See 47 U.S.C.A. § 252(d)(1)(B).

³⁵⁷ See *supra* notes 300-22, 353-56 and accompanying text.

³⁵⁸ See *infra* notes 359-74 and accompanying text.

³⁵⁹ See 47 C.F.R. § 51.609 (1996).

³⁶⁰ See *id.*

³⁶¹ See 47 U.S.C.A. § 252(d)(3).

³⁶² See 47 C.F.R. § 51.609.

odology, it reflects the practical realities involved and does not place an undue burden on the incumbent LECs.³⁶³ Basing rates on an incumbent LEC's actual avoided costs causes two problems.³⁶⁴ First, it provides no incentive for the incumbent to act efficiently because the competitors' costs will be based upon the incumbent's actual costs, no matter what they are.³⁶⁵ Second, it results in the awkward position of having the incumbent LEC, which obviously has a vested interest in keeping this figure as low as possible, calculate these avoided costs.³⁶⁶ Both of these problems conflict with the overall goal of the local competition provisions of the TCA, which is to lower the cost of local telephone service through the introduction of competition.³⁶⁷

The reasonableness requirement differs from the efficient costs of a hypothetical LEC upon which the TELRIC methodology is based. Although both require a calculation based upon assumptions that may not be necessarily true, there is an important difference. Specifically, the TELRIC assumptions are largely out of the control of incumbent LECs and can never practically be achieved, while the wholesale rate assumptions are realistic and are largely within the incumbent LEC's control.³⁶⁸

The FCC regulations regarding resale of existing retail products list a number of costs that are presumptively avoidable.³⁶⁹ The costs, such as sales, product advertising and customer services, are costs that are variable and related either directly or indirectly to the retail products.³⁷⁰ These types of costs are much more easily controlled by the incumbent LEC because they are based either on employee labor or purchasing services from outside of the corporation and therefore can be adjusted relatively quickly.³⁷¹ Because the company can control the factors involved in meeting the assumptions that form the basis of the

³⁶³ See *infra* notes 364-74 and accompanying text.

³⁶⁴ See *supra* notes 251-53 and accompanying text.

³⁶⁵ See *supra* note 251 and accompanying text. This efficiency idea is the driving force behind the regulatory shift from profit caps to rate caps for regulated utilities. See KENNEDY, *supra* note 8, at 145. By regulating profits, states provided no incentives for utilities to act efficiently, because the utilities could not earn more by acting more efficiently. See *id.* By switching to rate regulation, states achieved their primary goal of ensuring reasonable prices for consumers, while utilities became more efficient because they were no longer limited in the amount of profits they could earn. See *id.*

³⁶⁶ See Brief for Respondents Federal Communications Commission and United States of America § II(B)(1), *Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321).

³⁶⁷ See *Iowa III*, 120 F.3d at 791-92.

³⁶⁸ See *infra* notes 371-74 and accompanying text.

³⁶⁹ See 47 C.F.R. § 51.609(c) (1996).

³⁷⁰ See *id.*

³⁷¹ See KENNEDY, *supra* note 8, at 132-34.

rate provisions, the incumbent LEC has the *choice* of whether to meet those assumptions.³⁷² Unlike TELRIC, which provides for assumptions that an LEC cannot meet even if it chooses to do so, the resale provisions provide for assumptions that can be met by an incumbent LEC if it chooses to do so.³⁷³ Where a regulated company chooses not to become more efficient, its competitors should not be forced to suffer because of that choice; where a regulated company cannot possibly meet regulatory standards even if it chooses to do so, its competitors should not be allowed to benefit. Thus, because the wholesale rate provisions are based on assumptions that the regulated parties can meet if they so choose, these provisions differ from the TELRIC provisions and are not contrary to the intent of the TCA.³⁷⁴

3. Transport and Termination Rates

The rates that state commissions are to set for transportation and termination ("T&T") of telecommunications traffic are based on the FCC's TELRIC pricing methodology.³⁷⁵ TELRIC is not a valid embodiment of the TCA's requirements; the provisions for setting the T&T rates using TELRIC are correspondingly invalid.³⁷⁶ The other portion of the T&T provisions involve bill-and-keep arrangements.³⁷⁷ The RBOCs' two arguments discussed above—that the regulations are contrary to the TCA because they allow a state commission to impose a bill-and-keep arrangement without the parties' consent and when the traffic in each direction is only roughly equivalent—do not render the regulations invalid.³⁷⁸

The first argument is based upon the RBOCs' belief that the text of the TCA allows a bill-and-keep arrangement only if both parties voluntarily agree to it.³⁷⁹ This section of the TCA, however, does not require that a bill-and-keep arrangement be entered into voluntarily.³⁸⁰ Rather, it merely precludes a state from preventing two carriers from voluntarily entering into such an agreement, and thus does not support the RBOCs' argument that the TCA does not allow a state commission to impose a bill-and-keep arrangement involuntarily.³⁸¹ The

³⁷² See *id.*

³⁷³ See 47 C.F.R. § 51.609.

³⁷⁴ See *supra* notes 358–73 and accompanying text.

³⁷⁵ See 47 C.F.R. § 51.705(a)(1).

³⁷⁶ See *supra* notes 334–57 and accompanying text.

³⁷⁷ See 47 C.F.R. § 51.713.

³⁷⁸ See *supra* notes 190–94 and accompanying text.

³⁷⁹ See 47 U.S.C.A. § 252(d)(2)(B) (West Supp. 1997).

³⁸⁰ See *id.*

³⁸¹ See *id.*

second argument is based on the possibility that even if traffic is equal in each direction, costs for each carrier may not be equal.³⁸² The TCA requires "mutual" recovery of costs; the FCC regulations require that telecommunications *traffic* in each direction be "roughly balanced," which the FCC assumes would lead to approximate mutual recovery of costs.³⁸³ Even if the RBOCs are correct that costs may differ when the amount of traffic is equal, the regulations provide for an opportunity for the incumbent LEC to rebut the presumption that costs are equal when the amount of traffic is equal.³⁸⁴ Thus, because the regulations provide this opportunity to rebut the reasonable presumption of cost equivalence when traffic amounts are equivalent, the T&T regulations are a reasonable interpretation of the TCA.³⁸⁵

4. Proxy Rates and the Pick-and-Choose Rule

Because the TCA imposes strict deadlines on state commissions for arbitrating negotiations between incumbent LECs and potential competitors, the FCC developed proxy rates for state commissions to use as temporary rates while long-term cost studies could be conducted.³⁸⁶ The proxy rates cover unbundled access, wholesale rates for resale of retail products and T&T rates.³⁸⁷ The proxy prices are invalid for two reasons. First, the method the FCC used to calculate the proxy rates was arbitrary and unscientific and violated the FCC's own regulations; second, they undermine the TCA's system of private negotiations.³⁸⁸

The FCC's main pricing methodology is TELRIC—used to calculate an LEC's costs for purposes of setting rates based on those costs.³⁸⁹ In calculating its proxy rates, however, the FCC did not use the TELRIC methodology, thereby contradicting its own policy.³⁹⁰ The data it did use were incomplete; the FCC used limited data from an expedited rule-making process involving a small number of states and extrapolated that data into nationwide rules.³⁹¹ TELRIC is based upon a scien-

³⁸² See Brief for Petitioners Regional Bell Companies and GTE at 37, *Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321).

³⁸³ See 47 U.S.C.A. § 252(d)(2)(A)(i); 47 C.F.R. § 51.713(b) (1996).

³⁸⁴ See 47 C.F.R. § 51.713(c).

³⁸⁵ See *supra* notes 379-84 and accompanying text.

³⁸⁶ See 47 C.F.R. §§ 51.513, .611, .707.

³⁸⁷ See *id.*

³⁸⁸ See *infra* notes 389-403 and accompanying text.

³⁸⁹ See 47 C.F.R. § 51.505.

³⁹⁰ See FRO, *supra* note 18, at nn.792-98; Brief for Petitioners Regional Bell Companies and GTE at 38-39, *Iowa III*, 120 F.3d 753 (8th Cir. July 18, 1997) (No. 96-3321).

³⁹¹ See *supra* note 390.

tific, fact-specific study of a particular LEC, and the method the FCC used clearly did not follow it.³⁹²

Not only are these proxy rates arbitrary, but they also undermine the system of private negotiations preferred by the drafters of the TCA.³⁹³ The text of the TCA supports the idea that the preferred method of introducing competition into local markets is through negotiated agreements between incumbent LECs and potential competitors.³⁹⁴ For these negotiations to work, however, the regulatory framework surrounding them cannot serve to undermine those negotiations.³⁹⁵ This is what the proxy rates, in conjunction with the pick-and-choose rule, do.³⁹⁶ Most state commissions will probably have to resort to the proxy rates because of the extensive time needed to complete the TELRIC cost studies.³⁹⁷ Knowing this, potential competitors have no reason to negotiate any agreement that will set rates higher than the FCC proxy rates.³⁹⁸ This in turn will result in delayed entry into the market by competitors because the state arbitration process takes a substantial amount of time.³⁹⁹ This delay is contrary to the TCA's preference for timely negotiated agreements.⁴⁰⁰ Even if parties eventually do reach an agreement, it can be undermined by the pick-and-choose rule.⁴⁰¹ This rule undermines the finality of a negotiated agreement by allowing a competitor to pick and choose the best rates, terms and conditions of any other agreement an incumbent LEC has with another competitor and to incorporate it into its own agreement, even after an agreement has been negotiated.⁴⁰² Thus, any agreement entered into by an LEC with a competitor is always subject to change, which inherently undermines any negotiated agreement.⁴⁰³

³⁹² See 47 C.F.R. § 51.505; FRO, *supra* note 18, at nn.792-98. It seems particularly egregious for a federal agency, acting with questionable jurisdiction and limited data, to set preemptive rates for each facet of telecommunications without consulting the state commissions whose historic role has been to set these rates on a recurring basis.

³⁹³ See *infra* notes 394-403 and accompanying text.

³⁹⁴ See 47 U.S.C.A. § 252(a), (b) (West Supp. 1997).

³⁹⁵ See Brief for Petitioners Regional Bell Companies and GTE at 1, *Iowa III* (No. 96-3321).

³⁹⁶ See *infra* notes 397-403 and accompanying text.

³⁹⁷ See FRO, *supra* note 18, at n.767.

³⁹⁸ See Brief for Petitioners Regional Bell Companies and GTE at 74, *Iowa III* (No. 96-3321).

³⁹⁹ See 47 U.S.C.A. § 252(b). When a state commission arbitrates a dispute between an incumbent LEC and a potential competitor, the total amount of time can be up to nine months from when the potential competitor asks to negotiate with the incumbent LEC until the rates are actually set. See *id.*

⁴⁰⁰ See *id.* § 252(a), (b).

⁴⁰¹ See 47 C.F.R. § 51.809(a) (1996). For the relevant text of the rule, see *supra* text accompanying note 104.

⁴⁰² See *id.*

⁴⁰³ See *id.* In addition, the "pick-and-choose" rule has a questionable textual base. It is based

IV. CONCLUSION

The transition from a regulated telephone market, dominated by monopolists, to a free-wheeling competitive market is a difficult exercise in balancing the interests of the existing carriers, potential competitors, state regulators and consumers.⁴⁰⁴ With the TCA, Congress attempted to pave the way into this new world by establishing goals and delegating the responsibilities necessary to achieve those goals.⁴⁰⁵ Within the regulated telephone industry, these responsibilities often overlap, which caused the dispute involved in this case.⁴⁰⁶

The RBOCs, along with the state regulators, have a vastly different view of each party's respective roles than does the FCC.⁴⁰⁷ In the FCC's view, the TCA created a partnership between the states and the FCC that allowed the FCC to establish nationwide pricing rules to be followed by states in setting intrastate rates.⁴⁰⁸ The RBOCs and state regulators, however, view the TCA as explicitly granting state commissions the power to set rates.⁴⁰⁹ The FCC's view ultimately fails because under the holding of *Louisiana Public Service Commission v. FCC*, Congress must provide a clear and unambiguous grant of intrastate jurisdiction in order for the FCC to have the power to set purely intrastate rates.⁴¹⁰ Congress did not provide this unambiguous grant in the language of the TCA, and therefore section 2(b) of the 1934 Act prevents the FCC from exercising intrastate jurisdiction.⁴¹¹

Both sides also have differing views with regard to the validity of the pricing regulations themselves.⁴¹² The RBOCs argued that the regulations for pricing of network elements, resale of retail products, transport and termination of telecommunications traffic, interim proxy rates and the pick-and-choose rule were invalid because they contra-

upon 47 U.S.C. § 252(i), which states that a LEC "shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same *terms and conditions* as those provided in the agreement." 47 U.S.C.A. § 252(i) (West Supp. 1997) (emphasis added). The FCC regulations interpret this as the same "*rates, terms and conditions*." 47 C.F.R. § 51.809(a) (emphasis added).

⁴⁰⁴ See generally Telecommunications Act of 1996, Pub. L. No. 104-104, 1996 U.S.C.A.N. (110 Stat.) 56 (codified in scattered sections of 47 U.S.C.).

⁴⁰⁵ See *id.*

⁴⁰⁶ See *id.*

⁴⁰⁷ See *supra* notes 153-270 and accompanying text.

⁴⁰⁸ See *supra* notes 213-70 and accompanying text.

⁴⁰⁹ See *supra* notes 153-212 and accompanying text.

⁴¹⁰ See *supra* notes 122-41 and accompanying text.

⁴¹¹ See *supra* notes 300-22 and accompanying text.

⁴¹² See *supra* notes 176-212, 239-70 and accompanying text.

dicted the language and intent of the TCA.⁴¹³ The FCC argued that these regulations were consistent with the TCA's language and intent and were a reasonable interpretation of the statute.⁴¹⁴

The Eighth Circuit should have ruled on the merits of the pricing regulations and should have found that the regulations for pricing of network elements are invalid because the TELRIC pricing methodology provides no opportunity for an LEC ever to conform to the assumptions upon which the methodology is based.⁴¹⁵ The court should have concluded that the proxy rates are invalid because they were calculated in an arbitrary fashion and serve to undermine the system of private negotiations, the method preferred by the drafters of the TCA.⁴¹⁶ The court was correct in ruling that the pick-and-choose rule is invalid because it, too, undermines the TCA's system of private negotiations.⁴¹⁷

On the other hand, the court should have upheld the regulations regarding resale of retail product offerings and transport and termination ("T&T") of telecommunications traffic as valid interpretations of the TCA.⁴¹⁸ It should have ruled that the resale regulations are valid because unlike TELRIC, they provide incumbent LECs an opportunity to meet the assumptions upon which the regulations are based, because the assumptions are realistic and permit the incumbent LEC to choose whether to meet them.⁴¹⁹ The court should have concluded that the T&T regulations are valid because they provide an LEC the opportunity to rebut a reasonable presumption that an equal amount of traffic approximates an equal amount of cost.⁴²⁰ The Eighth Circuit therefore was correct in holding that the FCC exceeded its jurisdiction in promulgating its intrastate pricing regulations, but the court should have ruled on the merits of the regulations.⁴²¹ In doing so, the court would have advanced Congress's intention of opening local telephone markets to competition while respecting the economic rights of the existing monopolistic local exchange carriers.⁴²²

GARY J. GUZZI

⁴¹³ See *supra* notes 176-212 and accompanying text.

⁴¹⁴ See *supra* notes 239-70 and accompanying text.

⁴¹⁵ See *supra* notes 334-57 and accompanying text.

⁴¹⁶ See *supra* notes 386-403 and accompanying text.

⁴¹⁷ See *supra* notes 386-403 and accompanying text.

⁴¹⁸ See *supra* notes 358-85 and accompanying text.

⁴¹⁹ See *supra* notes 358-74 and accompanying text.

⁴²⁰ See *supra* notes 375-85 and accompanying text.

⁴²¹ See *supra* notes 297-403 and accompanying text.

⁴²² See *supra* notes 297-403 and accompanying text.