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CASE NOTE

Tearing Down a Fence that is Hog Tight, Horse High & Bull Strong: The Supreme Court Reshapes Jurisdiction of Local Telephone Markets

by T. Jason White

I. INTRODUCTION

In a sweeping decision that shifts control of local telephone markets from the states and their regulatory agencies to the United States and the Federal Communications Commission (FCC), the Supreme Court in *AT&T v. Iowa Utilities Board* reshaped local telephone competition.¹ The Court ruled that the FCC has jurisdiction to regulate competition in local telephone markets under the Telecommunications Act of 1996 (TCA).² Once the Court dictated that the FCC had jurisdiction to regulate the TCA's mandates, it applied the *Chevron U.S.A., Incorporated v. Natural Resources Defense Council, Incorporated*³ standard to the FCC's regulations of the TCA and found that all but one were reasonable interpretations of the statute.⁴

The TCA and Supreme Court's decision in *AT&T* has broad implications to consumers. At first glance, the Court's ruling appears to follow the spirit of the TCA by accelerating competition in local telephone markets. A closer look, however, reveals that the decision and the hawkish policies of the FCC do not

benefit consumers; instead, the FCC's regulations create a marketplace with simulated rather than real competition. Part II of this note discusses the history of the telecommunications industry in America and the goals of Congress in passing the TCA. Part III discusses the *AT&T* decision. Part IV analyzes the *AT&T* decision as it interpreted the TCA and as it applied the *Chevron* standard to the FCC regulations. Part V discusses the implications that the decision and the FCC regulations will have on consumers.

II. BACKGROUND

A. History of Telecommunications in America

Alexander Graham Bell introduced the telephone in 1876. Consequently, the American Telephone & Telegraph (AT&T) monopoly was quickly established, consisting of AT&T, the local Bell Operating Companies, and Western Electric.⁵ AT&T had the long distance market, the local Bells had the local telephone market, and Western Electric had the telephone equipment market. Congress

enacted the Federal Communications Act of 1934 in response to AT&T's monopoly.⁶ Under the 1934 Act, Congress transferred authority over interstate communications from the Interstate Commerce Commission to the newly created FCC.⁷ States, however, maintained control over intrastate communications based on Section 2(b), which states that "nothing in this chapter shall be construed to apply to or give the Commission [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or connection with intrastate communication service."⁸

In 1938, Congress amended the Communications Act and granted the FCC general rulemaking authority, however, states maintained jurisdiction over local telephone markets.⁹ The pertinent provisions of the 1938 amendments are Sections 201(a) and 201(b). Section 201(a) deals with "interstate or foreign communication by wire and radio." Section 201(b) provides that "[t]he Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."¹⁰ The 1934 Act and the 1938 amendments proved ineffective in regulating the AT&T monopoly.¹¹

The United States Department of Justice continued to battle with the monopoly and, in 1956, AT&T entered into a Consent Decree divesting itself in Western Electric but maintaining its monopoly of the local and long distance telephone markets.¹² Because

AT&T was able to hold onto the most valuable pieces of the monopoly, namely, the local and long distance telephone markets, its monopoly power was unabated by the 1956 consent decree.

The Department of Justice renewed its battles with A&T in 1974. This resulted in the 1982 Modified Final Judgment.¹³ The Modified Final Judgment effectively ended the monopoly of AT&T by completely divesting them of the local telephone market; it ended the collective reign of the twenty two Bell Operating Companies.¹⁴ The Modified Final Judgment allowed for seven surviving independent Local Exchange Carriers (LEC), each maintaining a monopoly over a designated geographical area. For example, Ameritech was created as a provider of local telephone service in the Midwest, US West provided services in the Rocky Mountain regions, and the five other LECs divided up the remainder of the country.¹⁵

Until recently, the LECs were able to maintain their monopolies because the industry was considered to be a natural monopoly.¹⁶ The advent of technologies allowing multiple companies to use the same telecommunication equipment and facility eventually made the natural monopoly theory out-of-date. Responding to these technological advancements, Congress passed the Telecommunications Act of 1996.

B. The Telecommunications Act of 1996

1. The Congressional Mandates of the TCA

The TCA is intended to "promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."¹⁷ The TCA fundamentally restructures telephone markets to "establish a national policy framework designed to accelerate rapidly the private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition" ¹⁸ Congress did not address in the TCA whether the FCC had jurisdiction to regulate the mandates of the Act; however, Congress expressly directed that the TCA be inserted into the Communications Act of 1934, which puts the TCA within the provisions of the 1934 Act and the 1938 amendments.¹⁹

The TCA binds the seven LECs, such as Ameritech and US West, to a host of duties designed to spur growth by allowing competitors access to their equipment.²⁰ Competitors must use the LECs network and equipment because it is the only effective way for them to enter local telephone markets. The alternative would be for a competitor to rewire a whole city with its own

equipment, a duplicative and tremendous waste of resources. Competitors can access the LEC's "network elements," which is defined under the TCA 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" ²¹

Once Congress defined the term "network element" it mandated under what circumstances a LEC's "network element" should be made available to a requesting carrier. Section 251(d)(2) requires that the FCC consider two factors in determining if a network element should be made available to a requesting carrier: (1) whether access to the requested network element is necessary; and, (2) whether failure to provide access to the network element would impair the ability of the requesting carrier to provide the services that it seeks to offer (the "necessary" and "impair" standards).²²

Under the TCA, a requesting carrier can obtain access to the LEC's network in three ways: (1) by purchasing local telephone services at wholesale rates for resale to end users; (2) by leasing elements of the LEC's network on an unbundled basis; or (3) by interconnecting its own facilities with the LEC's network.²³ A requesting carrier and the LEC can negotiate an agreement without regard to the above mentioned duties. If negotiations fail, however, either party can petition the state commission that regulates local telephone service to mediate and

arbitrate the matter, subject to the TCA and the FCC regulations.²⁴

2. The FCC Regulations Implementing the TCA

Six months after the 1996 Act was passed, the FCC issued its First Report and Order, which implemented the local competition provisions.²⁵ The FCC released rules that gave practical effect to the TCA mandates by further defining terms used in the Act and by elucidating the "necessary" and "impair" standards of section 251(d)(2). Many of the rules implemented by the FCC are at issue in the *AT&T* case.

The FCC established the pricing system, known as Total Element Long Run Incremental Cost (TELRIC), that LECs must use in charging requesting carriers for interconnection and unbundled access to the LECs equipment.²⁶ TELRIC pricing is based upon the cost of operating a hypothetical network built with the most efficient technology available.²⁷

Additionally, the FCC promulgated Rule 319, which listed specific LEC services and equipments that fall under the TCA's "network element" definition.²⁸ Rule 319 defines "network element" to include operator services, directory assistance, operational support systems, vertical switching functions such as caller I.D., call forwarding, and call waiting.²⁹ In addition to the broad definition of "network element," the FCC made it easier for requesting carriers to enter the local telephone market by failing to

adopt a facilities-ownership requirement. The facilities-ownership doctrine would have required a requesting carrier to establish its own facility and it could not have relied solely on the LECs equipment to conduct business.³⁰

Rule 319 also clarified the "necessary" and "impair" standards of section 251(d)(2). Specifically, Rule 319 states that the "necessary" standard is met regardless of whether requesting carriers can obtain network elements from a source other than the LEC.³¹ Rule 319 states that the "impair" standard is met if the LEC's failure to provide access to a network element would decrease the quality, or increase the cost, of the service a requesting carrier seeks to offer, compared with providing the service with the LEC's network.³²

Another area addressed by the FCC was whether a LEC could separate already-combined network elements before providing them to requesting carriers. For example, without a regulation a LEC could separate a vertical switching function that had already-combined caller I.D., call forwarding, and call waiting into one package because doing so would make the requesting carrier re-combine them. Rule 315(b) forbids LECs from separating any already-combined network element.³³ This is so because of Section 251(c)(3) of the TCA, which establishes the duty to provide access to network elements on nondiscriminatory rates, terms, and conditions and in a manner that allows

requesting carriers to combine the elements.³⁴ The FCC interpreted Section 251(c)(3) to mean that LECs cannot separate already-combined network elements before providing them to requesting carriers.

Finally, FCC adopted Rule 809, referred to as the “pick and choose” rule.³⁵ This rule requires LECs to make available to a requesting carrier any network element it has made available to another requesting carrier at the same rates, terms, and conditions.³⁶ Basically, requesting carriers can pick and choose from all the LECs agreements with other carriers on terms advantageous to them.

The FCC State utility commissions and LECs attacked the First Report and Order, arguing that the FCC had no jurisdiction to regulate local telephone markets. The numerous cases challenging the FCC’s regulations were consolidated in the United States Court of Appeals for the Eighth Circuit.³⁷ The court held that the general rulemaking authority conferred upon the FCC by the Communications Act of 1934 extended only to interstate matters, and that the FCC lacked the requisite specific congressional authorization needed to implement provisions of the 1996 Act addressing intrastate telecommunications.³⁸ The court found nothing in the 1996 Act to overcome the presumption that the states control intrastate telecommunications, a presumption which it described as a fence that is “hog tight, horse high, and bull strong, preventing the FCC from intruding on the states’ intrastate

turf.”³⁹

Beyond jurisdiction, the LECs challenged the substance of the FCC’s regulations.⁴⁰ One of the regulations the LEC challenged, Rule 319, sets forth a minimum number of network elements that LECs must make available to requesting carriers.⁴¹ The Court of Appeals disagreed with the LECs and ruled that the FCC’s interpretations were reasonable and hence lawful under *Chevron*.⁴²

The Court of Appeals did rule in favor of the LECs on two issues other than jurisdiction.⁴³ The court ruled that Rule 315(b) went too far in forbidding LECs to separate network elements before leasing them to competitors.⁴⁴ The court also vacated the “pick and choose” rule because, according to the court, it would deter the “voluntary negotiated agreements” that the 1996 Act favored.⁴⁵

III. *AT&T v. IOWA UTILITIES BOARD*

In *AT&T v. Iowa Utilities Board*, the United States Supreme Court reversed the Eighth Circuit on the jurisdictional issue and ruled that the FCC does have jurisdiction to regulate local telephone markets.⁴⁶ The Court also held that the FCC did not effectively consider the “necessary” and “impair” standards of § 251(d)(2). Additionally, the Court did agree with the Eighth Circuit that the FCC reasonably omitted a facilities-ownership requirement. Yet, the Court reversed the Court of Appeals on Rule 315, concluding that the FCC

reasonably interpreted § 251(c)(3). Finally, the Court also reversed the Court of Appeals on the “pick and choose” rule.⁴⁷

A. The AT&T Decision Relating to Jurisdiction

1. The Majority Opinion

The Court relied on Section 201(b), a 1938 amendment to the Communications Act of 1934, in its ruling that the FCC has jurisdiction to regulate intrastate telecommunications pursuant to the 1996 Act.⁴⁸ Section 201(b) states that “[t]he Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.”⁴⁹ The Court found that “[s]ince Congress expressly directed that the 1996 Act, along with its local competition provisions, be inserted into the Communications Act of 1934 . . . the Commission’s rulemaking authority would seem to extend to implementation of the local-competition provisions.”⁵⁰

The Court rejected the LEC’s argument that § 201(a) of the 1938 amendment limits the general rulemaking authority of § 201(b) because subsection (a) deals solely with interstate and foreign matters.⁵¹ According to the Court, the qualifier “interstate or foreign,” which limits the class of common carriers with the duty of providing communication service, reaches forward into the last sentence of § 201(b) to limit the class of

provisions that the Commission has authority to implement.⁵²

The Court was also unpersuaded by Section 152(b), a provision from the 1934 Act. Section 152(b) states that, except for Sections 223 through 227 and Section 332, “nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service”⁵³ The LECs pointed out that the local competition provisions of the 1996 Act are not identified in the except clause in section 152(b); therefore, the effect of the “nothing . . . shall be construed” provision is to require an explicit application to intrastate service and an explicit grant of FCC jurisdiction.⁵⁴

The Court rejected this argument, again relying on the general rulemaking authority of section 201(b).⁵⁵ The Court stated that “[f]or even though ‘Commission jurisdiction’ always follows where the Act ‘applies,’ Commission jurisdiction (so-called ‘ancillary’ jurisdiction) could exist even where the Act does not ‘apply.’”⁵⁶ Accordingly, “[t]he term ‘apply’ limits the substantive reach of the statute . . . and the phrase ‘or give the Commission jurisdiction’ limits, in addition, the FCC’s ancillary jurisdiction.”⁵⁷

The LECs next argued that specific provisions of the Act give state commissions jurisdiction and that several FCC rules should therefore be voided.⁵⁸ One such provision is section

252(c), which states that “[i]n resolving by arbitration under subsection (b) any open issues and imposing conditions upon the parties to the agreement, a state commission shall . . . establish any rates for interconnection, services, or network elements”⁵⁹ The Court admitted that there is a “lack of parallelism” between subsection (c)(1), which adds “including the regulations prescribed by the Commission pursuant to Section 251” whereas subsection (c)(2) says nothing about Commission regulations applicable to subsection (d).⁶⁰ The Court explained this lack of parallelism by stating that Section 251 specifically requires the Commission to promulgate regulations implementing Section 251, whereas subsection (d) of section 252 does not.⁶¹ The Court concluded that “[i]t seems to us not peculiar that the mandated regulations should be specifically referenced, whereas regulations permitted pursuant to the Commission’s section 201(b) authority are not.”⁶²

Finally, the Court reversed the Court of Appeal’s determinations that the FCC had no jurisdiction to promulgate rules regarding state review of pre-existing interconnection agreements between LECs and other carriers.⁶³ The Court again relied on the general rulemaking authority of section 201(b).

2. The Dissents

Justice Thomas and Justice Breyer dissented with respect to the

jurisdictional aspect of the majority’s decision. Justice Breyer discussed how the history of local telecommunications from the 1982 Modified Final Judgment to the 1996 TCA demonstrates that Congress intended for states to regulate local telephone markets. Justice Thomas’ dissent discussed the well established rules of statutory construction that compel a contrary decision. Taken together, the dissents offer a complete and persuasive argument that jurisdiction of intrastate communications should remain with the states.

Justice Breyer argued that the 1996 Act does not give the FCC authority to regulate local telephone markets because “(1) a century of regulatory history establishes state authority as the local telephone service rate making norm and (2) the 1996 Act nowhere changes, or creates an exception to, that norm.”⁶⁴

According to Justice Breyer, the TCA attempts to establish local competition without wasteful duplication of facilities. The TCA does not, however, purport to explain how exactly to obtain that goal; the TCA simply eliminates legal barriers to local competition.⁶⁵ Justice Breyer concluded that state regulatory commissions have a better understanding of each unique local market and can effectively regulate the new competitive market by establishing realistic rates, consequently, they should maintain jurisdiction.⁶⁶ Justice Breyer reasoned that “local regulators have experience setting rates that recover both the

immediate, smaller, added costs that demand for additional service imposes upon a local system, and also a proper share of the often huge fixed costs . . . and overhead needed to provide the dial tone itself."⁶⁷

Justice Breyer also explained that the experience of local regulators "along with the fact that the relevant technology changes rapidly, argue in favor of, not against, local rate-setting control, including local rate-setting differences, for those differences can amount to the kind of 'experimentation' long thought a strength of our federal system."⁶⁸ Only in light of the purposes of the TCA can an effective regime of cooperation between state and federal regulatory commissions be created: "[T]he Act's language more clearly foresees retention, not replacement, of the traditional allocation of state-federal rate-setting authority."⁶⁹

Justice Thomas' dissent, in which Justice Breyer and Chief Justice Rehnquist joined, relied on both the well established principles of statutory construction⁷⁰ and section 152(b), a section from the 1934 Act that limits federal jurisdiction to exclude intrastate matters. He concluded that Congress intended for states to maintain regulation of local telecommunications.⁷¹

Justice Thomas pointed out that Section 152(b) has been closely guarded by the Supreme Court because it is a codification of a "historical jurisdictional division" of regulatory telecommunications.⁷² In *Louisiana*

Public Service Commission v. FCC, the Court held that section 152(b) precluded the FCC from preempting state regulations.⁷³ The Court stated that section 152(b) "fences off from the FCC reach and regulation intrastate matters—indeed, including matters in connection with intrastate service" and that the FCC could breach 152(b)'s jurisdictional fence only when Congress used "unambiguous or straightforward" language to give it jurisdiction over intrastate communications."⁷⁴ Justice Thomas concluded that the jurisdictional challenge contravenes the division of authority set forth in the 1996 Act and disregards the 100-year tradition of state authority over intrastate telecommunications.⁷⁵

B. The AT&T Decision Relating to the FCC Regulations

Once the Court got over the jurisdictional hurdle, it analyzed the FCC's regulations relating to the TCA under the *Chevron* standard of reasonableness. Specifically, the Court ruled, first that the FCC's rules governing unbundled access are reasonable, with the exception of Rule 319; and second, that the FCC's "pick and choose" rule was reasonable.⁷⁶ Justice Souter disagreed with the Court that Rule 319 was unreasonable and he filed a dissent to that issue only.⁷⁷ The Court did not address the merits of the FCC's TELRIC pricing system because it was not ruled on by the Court of Appeals.⁷⁸

The first challenge to the FCC's unbundling rules was that the FCC included features and services that do not meet the statutory definition of "network element."⁷⁹ The FCC included operator services, directory assistance, operational support systems, caller I.D., call forwarding, and call waiting as services that fall under the definition of "network elements."⁸⁰

The Court ruled that the FCC's rule interpreting the definition of "network element" was reasonable in so much as a "network element" need not be a physical facility or equipment.⁸¹ According to the Court, operator services and directory assistance are "features, functions, and capabilities" of a network element.⁸²

The Court turned next to FCC Rule 319, which requires a LEC to provide requesting carriers with access to a minimum of seven network elements; if a requesting carrier wants access to additional elements it must petition the state commission.⁸³ Rule 319 interprets Section 251(d)(2) of the TCA, which provides that in determining what network elements should be made available, the Commission shall consider whether "access to such network elements . . . is necessary" and "the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer."⁸⁴

The Court ruled that Rule 319 was unreasonable and vacated the rule

because it did not consider the "necessary" and "impair" standards of Section 251(d)(2).⁸⁵ The Court reasoned that Rule 319 read the two standards out of the statute. For example, the FCC reported in its First Report and Order that it would consider the "impair" standard met if "the failure of an incumbent to provide access to the network element would decrease the quality, or increase the financial or administrative cost of the service a requesting carrier seeks to offer, compared with providing that service over other unbundled elements in the incumbent's LEC's network."⁸⁶ The Court disagreed: "Since any entrant will request the most efficient network element that the incumbent has to offer, it is hard to imagine when the incumbent's failure to give access to the element would not constitute an impairment under this standard."⁸⁷

Notably, the Court expressly failed to adopt the "essential facilities" doctrine to the "necessary" and "impair" standards.⁸⁸ Adopting that doctrine would have required requesting carriers to use only those facilities of the incumbent that are essential for it to conduct business, putting the onus on requesting carriers to seek out and establish facilities available elsewhere.⁸⁹

The Court next addressed the "all elements" rule, which allows competitors to provide local phone service relying solely on the elements in an incumbent's network.⁹⁰ The incumbents argued that to access their networks, a requesting carrier must

own its own facility.⁹¹ The Court rejected this argument and concluded that the TCA suggests that a requesting carrier could rely solely on a LEC's facilities by "requiring in [Section] 251(c)(3) that LECs provide access to 'any' requesting carrier."⁹² Accordingly, the Court ruled that the FCC was reasonable in not imposing a facilities-ownership requirement.

Next, the Court addressed FCC Rule 315(b), which forbids LECs from separating already-combined network elements before leasing them to a competitor.⁹³ The FCC explained that this rule is designed so that LECs cannot "disconnect previously connected elements, over the objection of the requesting carrier, not for any productive reason, but just to impose wasteful reconnection costs on new entrants."⁹⁴ The Court concluded that the FCC was reasonable because, in the absence of Rule 315(b), incumbents could impose wasteful costs on those carriers who requested less than the whole network.⁹⁵

Finally, the Court ruled that the FCC's "pick and choose" rule was reasonable.⁹⁶ The "pick and choose" rule requires the LEC to "make available . . . to any requesting telecommunications carrier any individual interconnection, service, or network element arrangement contained in any agreement to which it is a party that is approved by a state commission . . . upon the same rates, terms, and conditions as those provided in the agreement."⁹⁷ The LECs argued that this rule threatens

the give-and-take of negotiations because every agreement they make with one competitor must be available to all others.⁹⁸ A competitor will literally be able to pick and choose provisions from each agreement that benefits it. Without getting to the substance of that argument, the Court ruled that the FCC's rule is reasonable under *Chevron*.

To summarize, the Supreme Court, in *AT&T v. Iowa Utilities Board*, ruled that the FCC has jurisdiction, based on Section 201(b) of the TCA, to promulgate rules effecting intrastate telecommunications. The Court vacated Rule 319, in as much as the FCC did not consider Section 251(d)(2)'s "necessary" and "impair" standards. The Court ruled that all the other FCC's rules relating to the TCA were reasonable, including omitting a facilities-ownership requirement; interpreting the definition of "network element" to include non-physical elements such as call waiting and directory assistance; forbidding LECs to separate already-combined network elements; and adopting a "pick and choose" rule allowing competitors to have access to any agreement the LEC entered into with another carrier.⁹⁹

IV. ANALYSIS

As Justice Thomas' dissent effectively demonstrated, the Court erred in ruling that the FCC has jurisdiction, under the TCA, to regulate local telephone markets. The Court, faced with the constrictions of *Chevron*,

properly determined that the FCC's regulations were reasonable interpretations of the TCA; however, the FCC has promulgated rules that, left unrevised, will create a simulated instead of real competition in local telephone markets.

A. Jurisdiction

Taken together, the Thomas and Breyer dissents present a strong argument that Congress never intended to usurp state commissions' regulatory duties of intrastate telecommunications. The Court itself spoke convincingly of this matter in *Louisiana Public Service Commission* and established that the state's jurisdictional fence could be breached only when Congress uses "unambiguous or straightforward" language to give it jurisdiction over intrastate communications.¹⁰⁰ This position is further verified by Justice Thomas' statutory construction analysis.

Section 201(b) states that "[t]he Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter."¹⁰¹ As Justice Thomas points out, the statutory construction principle of *ejusdem generis* that Section 201(b) only applies to that which proceeded it. *Ejusdem generis* means that when a general term follows a specific one, the general term should be understood as a reference to subjects akin to the one with the specific enumeration.¹⁰²

Applying the *ejusdem generis* principle to this case, Section 201(b) does not announce a broad jurisdictional grant to the FCC on all matters relating to the TCA. Specifically, Section 201(b) applies to matters enunciated in Section 201(a), the immediately preceding subsection. That subsection refers exclusively to "interstate or foreign communication by wire or radio" and the first sentence of 201(b) refers to "charges, practices, classifications, and regulations for and in connection with such communication service."¹⁰³

In addition, Section 152(b) is written in the disjunctive. As Justice Thomas states, "canons of construction ordinarily suggest that terms connected by a disjunctive by given separate meanings, unless the context dictates otherwise . . ."¹⁰⁴ Applying that principle to 152(b), the majority's interpretation "necessarily implies that Congress *sub silentio* rendered . . ." the statute a nullity.

Indeed Section 152(b), which reads "nothing in this chapter shall be construed to apply to or to give the Commission jurisdiction with respect to (intrastate telecommunications)" becomes a dead letter because the majority gives the FCC jurisdiction, in Section 201(b) over all matters relating to the TCA; therefore, applying the majority's holding to the TCA, Congress now must expressly give state commissions jurisdiction.

B. The FCC Regulations

Because, under *Chevron*, federal agency regulations will not be vacated unless they are unreasonable, the Court's rulings on the FCC regulations were appropriate. Aside from judicial review, the FCC regulations should be held to the highest level of scrutiny because there is not another model available for comparison in real world situations. Unfortunately for consumers, the FCC regulations do not hold up well. The "necessary" and "impair" standards of Rule 319 must be given more consideration and effect to properly provide for a realistic competitive marketplace. Also, the pick and choose rule should be vacated because LECs lose the ability to negotiate unique provisions and contracts with requesting carriers.¹⁰⁵ Finally, although not before the Court in *AT&T*, the FCC's TELRIC pricing scheme should be discarded and replaced with a more realistic and historically-proven pricing system.

The TCA provides that in determining what network elements should be made available to a requesting carrier, the FCC shall consider whether access to the network element is necessary and whether failure to provide access to the network element would impair the ability of the requesting carrier to provide services it seeks to offer.¹⁰⁶ The FCC, in Rule 319, gutted the "necessary" and "impair" standards and the Court correctly vacated Rule 319. The Court failed, however, to adopt the "essential facilities" doctrine to the TCA¹⁰⁷ which

establishes liability on the monopolist who denies a competitor access to a resource essential for competition in a relevant antitrust market.¹⁰⁸

By adopting the doctrine under the TCA, the FCC could establish a mechanism by which requesting carriers can share necessary equipment. It would be presumed that certain equipment under the control of the incumbent LEC would be necessary, thereby impairing a requesting carrier to enter the local telephone market without it. By adopting the essential facilities doctrine, the FCC can effectively establish what equipment the presumption would apply to, and, consequently, eliminate needless administration and litigation. On the other hand, incumbent LECs would not have to provide other equipment to a requesting carrier unless the requesting carrier could show why it needed it under the "necessary" and "impair" standard.

The goal in adopting the essential facilities doctrine is to allow requesting carriers access to equipment they could not, without wasteful reproduction, get otherwise. Conversely, requesting carriers should not be able to rely on equipment and services of incumbent LECs that the competitor can get elsewhere, albeit at higher costs. The doctrine is not intended for competitors to enter a previously monopolized industry and reap artificial profits from a simulated market designed only to appear competitive.

The FCC should adopt a narrow essential facilities doctrine that imparts on LECs to provide necessary equipment to requesting carriers. The FCC should strictly adhere to this doctrine in establishing only those services and equipment necessary to conduct business in the local telephone market. Requesting carriers should not, however, be able to have access to any equipment or service that they could get in other ways. Unlike Rule 319, which allowed requesting carriers access to a significant portion of the LEC's equipment, the essential facilities doctrine creates real competition.

An additional way to create a reality-based market is for the FCC to vacate its "pick and choose" rule. Currently, LECs must provide to any requesting carrier the same terms and conditions it provides other carriers. In other words, a requesting carrier may review all agreements between the incumbent LEC and other carriers and pick and choose the ones that benefit it. LECs are placed in the awkward position of negotiating with a requesting carrier, knowing that any agreement they reach will be available to all other carriers. LECs will be unable to trade off network element terms or services against provisions unrelated to the TCA.

Companies in stronger positions to enter the local telephone market should be able to do so unimpeded by unnecessary barriers to entry. As discussed previously, LECs cannot discriminate when it comes to essential

facilities; however, companies and LECs should have the freedom to negotiate deals relating to other equipment and services not deemed essential to entry in the local telephone market. These types of agreements should not only be allowed but encouraged. A LEC, knowing that its monopoly power has been eliminated by the TCA, will want to secure the best possible agreements in anticipation of decreased profits and will begin to diversify into other markets. Companies entering the local telephone market will want to use whatever assets they have available to enter a market with monopolistic profits. The exchange of assets between companies and LECs would allow for quicker entry into the market with limited regulatory interference.

Finally, the FCC should discard the TELRIC pricing system.¹⁰⁹ As indicated earlier, the FCC requires that LECs charge requesting carriers access to their network elements based on "Total Element Long Run Incremental Cost."¹¹⁰ TELRIC pricing is based upon the cost of operating a hypothetical network built with the most efficient technology available.¹¹¹ The TELRIC pricing scheme fails in that it does not consider historical and realistic costs of the provided equipment or services. Incumbent LECs are essentially penalized for not maintaining the most update equipment and not maintaining an efficient and streamlined operation. The FCC need not do this when market forces will weed out weaker LECs.¹¹²

For example, assume an

incumbent LEC in Florida has failed to reinvest in equipment and services for many years. A requesting carrier would have to pay the historical cost of that equipment and service, which concedingly, may be higher than what another requesting carrier is paying in California. The Florida LEC, if not reinvesting in equipment and services, probably does not do other things well either, such as marketing and sales. The new entrant into the market will, if aggressive, overtake the incumbent LEC through more innovative marketing and higher services in other areas. It is here that the LEC will be penalized, through natural market forces.

Conversely, a new market entrant that receives artificially lower prices because of TELRIC will be at an advantage over LECs without having to do the things that in other non-regulatory markets would be required for success. By requiring the LEC to provide equipment and services at lower than cost prices to the new entrant profits are being artificially shifted from the LEC to the new entrant. The consumer will be penalized by the misguided TELRIC pricing scheme because new entrants will reap artificial profits and will not have the incentive to invest in newer equipment or better services.

V. IMPACT

A recent article suggested Illinois consumers are overcharged \$600 million a year because of insufficient

competition in the local telephone market.¹¹³ The benefits of competition as envisioned by Congress will not be felt by consumers for many years because of the Court's decision in *AT&T* and the policies of the FCC. The national restructuring of the local telephone market will not have the advantage of experimentation and diversity inherent in cooperative federalism regimes. Now the consumer will be wholly reliant on the FCC, an agency too aggressive in its approach and unwilling to allow even a semblance of market forces to help shape the newly-competitive local telephone market.

Consumers will be adversely affected by the decision to shift regulatory control from the states to the federal agencies. Allowing the states to regulate local telephone competition essentially creates many different models and approaches in varying markets. A model that did not work in California negatively effects Californian consumers but the rest of the country is spared of the flawed approach. Conversely, a model that is working in one state can be imitated by other states. This trial and error approach has been used in other areas of law effectively.¹¹⁴

An approach of this nature calls for cooperation between Congress, state regulatory agencies, and federal courts. This cooperative federalism approach to the TCA is more fully discussed by Philip Weiser in his article, *Chevron, Cooperative Federalism, and Telecommunications Reform*.¹¹⁵ Mr.

Weiser wisely quoted the words of Justice Jackson, dissenting in a Supreme Court decision that took authority away from the states to regulate utilities:

Congress may well have believed that diversity of experimentation in the field of regulation has values which centralization and uniformity destroy Long before the Federal Government could be stirred to regulate utilities, courageous states took the initiative and almost the whole body of utility practice has resulted from their experiences It must be remembered that closer than any federal agency to those they regulate and to their customers are the state authorities, whose mechanisms are less cumbersome and whose principles can much more quickly be adjusted to the changing times. We should not utilize the centralizing powers of the federal judiciary to destroy diversities between states which Congress has been scrupulous to protect. If now and then some state does not regulate its utilities according to the federal standard, it may be small price to pay for preserving the state initiative which gave us utilities regulation far in advance of federal initiative.¹¹⁶

The appearance of competition does not, in the long run, lower costs to consumers. That can only be done through the creation of actual competition, which is created only

where competitors create their own company, with their own services, marketing plan, and sales staff and rely on the monopolist only for equipment otherwise unavailable.

A simulated market is just that, artificial and fake, and requesting carriers are not really competing in the local telephone market. A company reaping profits from the ingenuity and entrepreneurial spirit of another company will not bring added value to that industry. Knowing the fruits of his research and development are being shared with other, less talented companies, the monopolist will no longer have the incentive to spend money and resources on that area of its business. It will, instead, spend more money on lobbying efforts to get laws passed to protect itself. The undue transactional and lobbying cost of doing business takes away opportunities for companies to invest in updated equipment and research. These types of investments benefit consumers through added value in products, services, or lower prices.

Conversely, companies bootstrapping on to monopolists never had the incentive to spend money on research and development in the first place: they relied on the monopolist's research and development. New companies will not be offering anything to the newly opened industry except for the appearance of competition. A market simulated to have competition is no better off than a monopoly market that is highly regulated. Indeed, a simulated market

is arguably worse because the monopolist invests less in its industry.

VI. CONCLUSION

The Supreme Court, in *AT&T v. Iowa Utilities Board*, failed to adopt a cooperative federalism regime for the Telecommunications Act of 1996. Instead, the FCC will have regulatory control on matters relating to competition in local telephone markets. Justice Breyer and Justice Thomas demonstrate that Congress did not intend for this result. The opportunity for state agencies to regulate the TCA's mandates would have allowed experimentation and diversity so that models and approaches could have been tried in smaller markets before exposing the nation's consumers to them.

The FCC's hawkish policies, as reflected in the regulations relating to the TCA, demonstrate that consumers will benefit from the TCA only when regulatory subsidies are eliminated and, as in other industries, market forces dictate which companies survive. Now that technology allows for competition in local telephone markets, governmental policies should allow a natural progression of new entrants who rely on good business to gain marketshare. New entrants should be allowed access to only the LEC equipment and services that are essential to conduct business. The price charged for the equipment and services should reflect historical and actual costs. In short, consumers will benefit

from real competition and will pay for simulated competition.

Endnotes

¹ 119 S.Ct. 721 (1999).

² Although beyond the scope of this paper, section 332 of the TCA creates certain duties of municipalities to accommodate providers of wireless communications to place personal wireless service facilities in their localities. See 47 USC § 332 (7)(A). Importantly, federal courts now have the power to order municipalities to issue special use permits to providers of wireless communications, which is another example of the broad federalism that the TCA appears to create. See, e.g., *Illinois RSA No. 3, Inc.*, 963 F. Supp. at 745; *AT & T Wireless PCS, Inc.*, 979 F. Supp. at 430; *Western PCS II Corp. v. Extraterritorial Zoning Auth. Of Sante Fe*, 957 F. Supp. 1230 (D.N.M. 1997). But see *Primeco Personal Communications, L.P. v. Village of Fox Lake*, 26 F. Supp.2d 1052 (N.D. Ill. 1998)(remanding to Village Trustees to either grant special use permit or conduct further evidentiary hearings and decide the issue anew).

³ 467 U.S. 837 (1984). The Supreme Court ruled that when "a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute . . . [t]he question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843. The Court then established a two-tier reviewing standard for regulatory interpretations. First, if Congress

has explicitly left a gap for the agency to fill, the Court will apply a arbitrary, capricious, or manifestly contrary to the statute standard of review. *See id.* at 844. If the delegation to the regulatory agency is implicit, that is, if Congress is silent on the question at issue, the court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the agency. *See id.* For a discussion of the policy reasons for judicial deference to administrative agencies, *see* Philip J. Weiser, *Chevron, Cooperative Federalism, and Telecommunications Reform*, 52 VAND. L. REV. 1 (1999).

⁴ *See AT&T*, 119 S.Ct. at 721-740.

⁵ John T. Soma, David A. Forkner, & Brian P. Jumps, *The Essential Facilities Doctrine in the Deregulated Telecommunications Industry*, 13 BERKELEY TECH. L.J. 565, 568 (1998).

⁶ Soma, Forkner & Jumps, *supra* note 5, at 568.

⁷ *See* 47 U.S.C. 151 (1994).

⁸ 47 U.S.C. S 152(b); The Supreme Court discussed section 2(b) of the 1934 Act and the 1938 amendments in *Louisiana Pub. Serv. Comm'n v. FCC*. In *Louisiana*, the Court held that 2(b) precluded the FCC from preempting state regulations and that section 2(b) "fences off from the FCC reach or regulation intrastate matters." The Court further stated that FCC could breach section 2(b)'s jurisdictional fence only when Congress used unambiguous or straightforward language to give it jurisdiction over intrastate communications. *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355 (1986).

⁹ *See* 47 U.S.C. § 201 (1938).

¹⁰ 47 U.S.C. § 201(b).

¹¹ For a discussion on the 1934 Act, *see* Robert B. Friedrich, *Regulatory and Antitrust Implications of Emerging Competition in Local Access Telecommunications: How Congress and the FCC Can Encourage Competition and Technological Progress in Telecommunications*, 80 CORNELL L. REV. 646 (1995).

¹² *See* *United States v. American Telephone & Telegraph Co.*, 552 F. Supp. 131 (D.D.C. 1982).

¹³ *See id.* at 225.

¹⁴ *See id.* at 160-225.

¹⁵ *See* *United States v. American Telephone & Telegraph Co.*, 569 F. Supp. 990 (D.D.C. 1983).

¹⁶ For a discussion of natural monopoly, *see* Soma, Forkner, & Jumps, *supra* note 6.

¹⁷ The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996); *see also* Jon Van, *Ameritech Customers overpay, group says*, CHICAGO TRIBUNE, March 23, 1999, at § 3 (reporting that a consumer group analysis concluded that Illinois customers were being overcharged by at least \$600 million a year).

¹⁸ S. 652, 104th Cong. § 4 (1995).

¹⁹ *See* 110 Stat. 56 (codified as 47 U.S.C. §§ 251, 252 (1996)).

²⁰ Among other duties, an LEC has the duty to 1) negotiate in good faith, 2) provide for the facilities and equipment of any requesting telecommunications carrier, 3) provide access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, and 4) offer for resale at wholesale rates any telecommunications service that the carrier

provides at retail to subscribers who are not telecommunications carriers. *See* 47 U.S.C. § 251(c) (1994, Supp. II).

²¹ 47 U.S.C. § 153(29).

²² *See* 47 U.S.C. § 251(d)(2).

²³ *See* 47 U.S.C. § 251(c); *see also* *AT&T*, 119 S.Ct. At 726.

²⁴ *See* 47 U.S.C. § 252(a)(1).

²⁵ *See* *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996).

²⁶ *See id.*

²⁷ *See id.*

²⁸ *See* 47 C.F.R. § 51.319 (1997).

²⁹ 47 C.F.R. § 51.319.

³⁰ *See* *AT&T*, 119 S.Ct. at 736.

³¹ *See* 47 C.F.R. § 51.319.

³² *See* 47 C.F.R. § 51.319.

³³ *See* 47 C.F.R. § 51.319.

³⁴ *See* 47 C.F.R. § 51.315(b) (1997).

³⁵ *See* 47 C.F.R. § 51.809 (1997).

³⁶ *See id.*

³⁷ *Iowa Utilities Board v. FCC*, 120 F.3d 753, 805-806 (8th Cir. 1997).

³⁸ *See id.* at 795.

³⁹ *See id.* at 800.

⁴⁰ *See* 47 U.S.C. § 251(c)(3).

⁴¹ *See* 47 C.F.R. § 51.319 (1997).

⁴² *See* *Iowa Utilities Board*, 120 F.3d at 809-810.

⁴³ *See id.* at 801-813.

⁴⁴ *See id.* at 813.

⁴⁵ *See id.* at 801.

⁴⁶ *See* *AT&T*, 119 S.Ct. at 723-733.

⁴⁷ *See* *Iowa Utilities Board*, 120 F.3d at 809.

⁴⁸ *See id.* at 729.

⁴⁹ *See* 47 U.S.C. § 201(b).

⁵⁰ *Id.* at 729.

⁵¹ *See id.* at 729; *see also* 47 U.S.C. § 201(a) (stating that it is a "duty of every common carrier engaged in interstate or foreign communications . . .") (emphasis added).

⁵² *See id.* at 729.

⁵³ *See* 47 U.S.C. § 152(b).

⁵⁴ *See* *AT&T*, 119 S.Ct. at 730.

⁵⁵ *See id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *See id.* at 732.

⁵⁹ *See* 47 U.S.C. § 252(c).

⁶⁰ *See* *AT&T*, 119 S.Ct. at 732 (quoting 47 U.S.C. § 252(c)(1) & (2)).

⁶¹ See *id.* at 732.

⁶² See *id.* at 733. There seems to be a lack of parallelism in the Court's logic here. Subsection 201(b) was promulgated in 1938 when legislatures were not contemplating intrastate telecommunication jurisdiction of the FCC, however, over sixty years later, subsection 201(b) is a repository of FCC jurisdictional powers over intrastate telecommunications in all cases except where the TCA gives states express jurisdiction. The Court was correct in stating that "[t]here is undeniably a lack of parallelism here"

⁶³ See *id.* at 733.

⁶⁴ See *id.* at 746.

⁶⁵ See *id.*

⁶⁶ See *id.*

⁶⁷ *Id.* Justice Breyer's opinion becomes particularly poignant in analyzing the FCC's TELRIC rate system in Part IV & V of this note.

⁶⁸ *Id.* at 748. The cooperative federalism regime that Justice Breyer advocates for the TCA is explored in detail in a recent law review article. See Philip J. Weiser, *Chevron, Cooperative Federalism, and Telecommunications Reform*, 52 VAND. L. REV. 1 (1999).

⁶⁹ *Id.*

⁷⁰ See *id.* at 743.

⁷¹ See *id.*; see also 47 U.S.C. § 152(b).

⁷² See *id.* at 742 (citing *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 106 S.Ct. 1890, 90 L.Ed.2d 369 (1986)).

⁷³ See *id.*

⁷⁴ *Id.* (quoting *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 377).

⁷⁵ See *id.* at 743.

⁷⁶ See *AT&T*, 119 S.Ct. at 730.

⁷⁷ See *id.* at 738.

⁷⁸ See *id.* at 728.

⁷⁹ See *id.* at 733.

⁸⁰ See 47 C.F.R. §§ 51.319(f)-(g).

⁸¹ See *AT&T*, 119 S.Ct. at 734.

⁸² See *id.*

⁸³ See *id.*; see also 47 C.F.R. § 51.319 (1997).

⁸⁴ See 47 U.S.C. § 251(d)(2).

⁸⁵ See *AT&T*, 119 S.Ct. at 735.

⁸⁶ *Id.*

⁸⁷ *Id.* Justice Souter dissented on this point. He argued that the words "impair" and "necessary" are ambiguous and undefined in the TCA and are susceptible to a fairly wide range of meanings, and the FCC's meanings are reasonable. See *id.* at 739.

⁸⁸ See *id.* at 734.

⁸⁹ For a discussion on the "essential facilities" doctrine, see Areeda & Hovenkamp, *Antitrust Law*, 771-773 (1996).

⁹⁰ See *AT&T*, 119 S.Ct. at 736.

⁹¹ See *id.* The LECs argued that a facilities-ownership requirement should be imposed on requesting carriers pursuant to section 251(c)(3).

⁹² *Id.*

⁹³ *Id.*; see also 47 C.F.R. § 51.315(b) (1997).

⁹⁴ *Id.* at 737.

⁹⁵ *Id.* The LECs argued that if Rule 315(b) is added to the rules already in place then a competitor can lease a complete, preassembled network at (allegedly very low) cost-based rates.

⁹⁶ *Id.* at 738.

⁹⁷ See 47 C.F.R. § 51.809 (1997).

⁹⁸ See *AT&T*, 119 S.Ct. at 738.

⁹⁹ See *id.*

¹⁰⁰ See *Louisiana Pub. Serv. Comm'n*, 476 U.S. at 370.

¹⁰¹ See 47 U.S.C. § 201(b).

¹⁰² See *AT&T*, 119 S.Ct. at 744; see also *Neal v. Clark*, 95 U.S. 704, 708 (1877) (Justice Harlan observing that “[i]t is a familiar rule in the interpretation of . . . statutes that a passage will be best interpreted by reference to that which precedes and follows it”).

¹⁰³ See *AT&T*, 119 S.Ct. at 744.

¹⁰⁴ *Id.* (quoting *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339, 99 S.Ct. 2326 (1979)).

¹⁰⁵ FCC Rule 315(b) is not addressed in this section. Forbidding LECs to separate already combined network elements before leasing them to competitors, is appropriate and cost effective.

¹⁰⁶ See 47 U.S.C. § 251(d)(2).

¹⁰⁷ See *AT&T*, 119 S.Ct. at 734.

¹⁰⁸ See John T. Soma, David A. Forkner, and Brian P. Jumps, *The Essential Facilities Doctrine in the Deregulated Telecommunications Industry*, 13 BERKELEY TECH. L.J. 565, 580 (1998) (citing to A.D. Neale, *The Antitrust Laws of the United States of America: A Study of Competition Enforced by law* 67 (2d ed. 1970) (“The Sherman Act requires that where facilities cannot practicably be duplicated by would-be competitors, those in possession of them must allow them to be shared on fair terms. It is illegal restraint of trade to foreclose the scarce facility”).

¹⁰⁹ See 47 C.F.R. §§ 51.503, 51.505 (1997).

¹¹⁰ See *id.*

¹¹¹ See *id.*

¹¹² For a discussion on FCC pricing under the TCA, see Sidak and Spulder, *The Tragedy of the Telecommons: Government Pricing of Unbundled Network Elements Under the Telecommunications Act of 1996*, 97 COLUM. L.REV. 1081 (1997).

¹¹³ See Jon Van, *Ameritech Customers overpay, group says*, CHICAGO TRIBUNE, March 23, 1999, at § 3.

¹¹⁴ See, e.g., *Wilson v. Garcia*, 471 U.S. 261 (1985)(concluding that state law provides the statute of limitations for civil laws); *Yamaha Motor Corp. v. Calhoun*, 516 U.S. 199 (1996)(allowing state law a “wide scope” to apply federal admiralty law).

¹¹⁵ 52 VAND. L. REV. 1 (1999).

¹¹⁶ *Federal Power Comm’n v. East Ohio Gas Co.*, 338 U.S. 464, 488-89 (1950)(Jackson, J., dissenting).





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