**State of Florida**

Blanca S. Bayó, Director
Division of Records and Reporting
(904) 413-6770

# Public Service Commission

DATE: November 26, 1996

TO: Parties of Record

FROM: Blanca S. Bayó, Director BSB
Division of Records and Reporting

RE: Docket No. 960833-TP - Petition by AT&T Communications of the Southern States, Inc. for arbitration of certain terms and conditions of a proposed agreement with BellSouth Telecommunications, Inc. concerning interconnection and resale under the Telecommunications Act of 1996.
DOCKET NO. 960846-TP - Petition by MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc. for arbitration of certain terms and conditions of a proposed agreement with BellSouth Telecommunications, Inc. concerning interconnection and resale under the Telecommunications Act of 1996.
DOCKET NO. 960916-TP - Petition by American Communications Services, Inc. and American Communications Services of Jacksonville, Inc. for arbitration of certain terms and conditions of a proposed agreement with BellSouth Telecommunications, Inc. concerning interconnection and resale under the Telecommunications Act of 1996.

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This is to inform you that the Chairman has reported the following communication in the above referenced docket.

- Telephone conversation with Mr. Tony Lombardo on November 25, 1996.

ACK
AFA
APP
CAF

The Chairman's memorandum concerning the telephone call together with a portion of the brief filed in the appeal of the FCC's interconnection rules by Mid-Sized Incumbent Local Exchange Carriers and the Brief of Amici Curiae filed by a group of congressmen in the same proceeding, copies of which are attached, are being made a part of the record in these proceedings. Pursuant to Section 350.042, F.S., any party who desires to respond to an ex parte communication may do so. The response must be received by the Commission within 10 days after receiving notice that the ex parte communication has been placed on the record. Please mail your response to the Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0870. Because of time frames established by the Federal Communications Act, the Commission will take up these dockets at its December 2, 1996 Commission Conference.

BSB/cp
Attachments
cc: Rob Vandiver/w/letter

12635 11/26/96

State of Florida

# Public Service Commission

-M-E-M-O-R-A-N-D-U-M-



**DATE:** November 25, 1996

**TO:** Blanca Bayó, Director of Records and Reporting

**FROM:** Susan F. Clark, Chairman SFC

**RE:** Communications Regarding Docket Nos. 960833-TP, 960846-TP, and 960916-TP

On November 25, 1996, I returned a phone call to Mr. Tony Lombardo, representing BellSouth. During the conversation, Mr. Lombardo spoke with me about an issue that is being considered in the appeal of the FCC's interconnection rules filed in the 8th Circuit Court of Appeals (Docket No. 96-3321, Iowa Utilities Board, et al, Petitioners v. Federal Communications Commission, et al, respondents). Mr. Lombardo directed my attention to two documents delivered to my Aide by Ms. Nancy Sims on November 25, 1996. The first of these documents is a portion of the brief filed in the above appeal by the Mid-Sized Incumbent Local Exchange Carriers. The second document is the Brief of Amici Curiae filed by a group of congressmen in the same proceeding.

Mr. Lombardo indicated that he believed that it was important for the state to oppose the FCC's effort to allow alternative local exchange carriers to subscribe to and combine unbundled elements to recreate existing local exchange service offerings at prices that are lower that the otherwise applicable resale rate.

Because there are similar issues being considered in the above three Commission arbitration proceedings, it is appropriate to disclose this conversation and the attached documents to the parties to the Commission proceedings. Therefore, please send a copy of this memorandum and attachments to the parties and provide them an opportunity to respond. Section 350.042, F.S., allows parties 10 days to respond; however, please advise the parties that, because of time frames established by the Federal Communications Act, the Commission will take up these dockets at its December 2, 1996, Agenda Conference.

**IN THE UNITED STATES COURT OF APPEALS**

**FOR THE EIGHTH CIRCUIT**

**Docket No. 96-3321 (and consolidated cases)**

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**IOWA UTILITIES BOARD, et al.,**

**Petitioners,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION, et al.,**

**Respondents.**

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**ON PETITIONS FOR REVIEW OF THE FIRST REPORT AND ORDER OF THE FEDERAL COMMUNICATIONS COMMISSION**

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**BRIEF OF THE MID-SIZED INCUMBENT LOCAL EXCHANGE CARRIERS**

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**[Listing of counsel continued on reverse side]**

invest in their own networks when the FCC's rules operate to deny them an opportunity to recover the actual cost of those investments.

Moreover, because the FCC's rules would systematically deprive LECs of the minimum return guaranteed by the Fifth Amendment, the Court should interpret the Act, consistent with its plain terms, to avoid the significant constitutional questions that would be raised if the FCC's reading of the statute were correct.

3. The FCC also does violence to the statute's unbundling provisions. Congress required a LEC to unbundle only the physical equipment and facilities used to route and transmit calls over its network and any features and functions provided by those facilities or equipment. Congress determined that the duty to provide those elements on an unbundled basis should depend on whether a competitor's access to them is "necessary" (in the case of a proprietary network element) or whether the failure to provide access on an unbundled basis would "impair" a competitor's ability to provide telecommunications service (in the case of all other network elements). The FCC's Order upsets the delicate balance chosen by Congress in favor of a sweeping, and essentially unlimited, obligation to unbundle. Thus, under the Order, incumbent LECs are required to unbundle not only necessary network elements, but also other items by which a LEC could distinguish itself in a competitive market, such as operator and directory assistance service, "vertical services" such as Caller ID and Call Waiting, and back-room operations support systems such as software used in communicating with retail customers. Moreover, the Order commands a LEC fictitiously to "unbundle," then "reassemble," all the necessary elements to provide completed local

service, and sell it to its competitors at the FCC's bargain-basement "cost" based prices for network elements, thereby allowing competitors to evade the pricing and other limits imposed by Congress on the resale of LEC services.

The effect of the FCC's invasive unbundling and rebundling requirements is effectively to expropriate the LECs' networks for the use of their competitors. The circumstances are no different in principle than they would be if the FCC had ousted LECs from their property and installed their competitors in their place. Because Congress did not authorize any such taking of LECs' network property, however, there is no guarantee of just compensation for the displaced LECs. The statute must therefore be construed narrowly to avoid the serious constitutional questions that would otherwise be raised by the FCC's actions — a task made all the easier here because the plain terms of the Act do not come close to supporting the FCC's intrusive rules.

4. The FCC's rules undermine in two significant ways the private negotiations on which Congress principally relied for opening local telephone service to competition. First, the Commission's proxy prices preclude meaningful price negotiations because neither party has any reason to accept a price less favorable than that established by the default proxies. Second, even more insidiously, the FCC has replaced the mandatory bargaining requirement of section 252(i) with a tariffing scheme by imposing an extraordinary "pick-and-choose" provision under which a competitor may freely impose on the incumbent LEC any single term, including a price, from any interconnection agreement without having to accept the quid pro quo from the original interconnection agreement. That rule has the effect of

of things that might be considered network elements since it must refer to "information" used in functions beyond the "physical delivery" of telephone calls. (Report ¶ 261).

The FCC's interpretation of § 153(29) is fatally flawed because it ignores settled principles of statutory construction. In particular, it ignores the principle of *ejusdem generis*, which requires general terms in a statute to be interpreted in accord with more specific terms preceding it. See, e.g., Krauel v. Iowa Methodist Medical Center, 95 F.3d 674, 679 (8th Cir. 1996). As applied to § 153(29), the rules require that the reference to "other provision" be interpreted in accord with the specific terms -- "transmission" and "routing" -- which precede it. Thus, the reference to "other provision" simply acknowledges that there are a series of discrete functions known by different technical names involved in transmitting a telephone call from one point in a network to another. In addition to "transmission" and "routing" there are signaling, switching, terminating, etc. Rather than reciting an exhaustive list of these terms, the Act uses a shorthand to encompass them all. OSS and services like call waiting, however, are not involved in transmitting a call from point to point. They are not, therefore, "network elements."[33]

**2. The FCC's access rules permit new entrants to evade restrictions that the Act imposes on resale of telecommunications services.**

The Act provides for two alternative ways for new entrants to provide local telephone service. As previously explained, a requesting carrier can interconnect with an incumbent

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[33] The FCC further overreached by ordering incumbent LECs to provide access to OSS systems no later than January 1, 1997. (Rule § 51.319(f)(2)). Notwithstanding its acknowledgement that different LECs use different OSS systems and that no national standards are yet available, the FCC ordered immediate implementation of access to OSS. This requirement is enormously costly and burdensome to mid-sized LECs and the costs of complying with it will be for naught if new national standards are adopted, as may happen in the near future. The January 1, 1997 deadline, therefore, is arbitrary and capricious.

LEC and purchase discrete elements of its network, combine those elements as it sees fit, and provide its own unique telephone service. Under § 251(c)(4), a new entrant can also provide fully furnished telephone service simply by purchasing, at wholesale rates, an incumbent's own telephone service and then reselling that same service under its own name.

Notwithstanding the clear and obvious distinctions between resale and unbundled access, the FCC's interpretation of § 251(c)(3) permits a requesting carrier to evade the restrictions and cost burdens associated with purchasing services for resale. The requesting carrier can do so by simply purchasing *all* of an incumbent's network elements, on a putatively "unbundled" basis, *forcing the incumbent* to put them back together again (i.e., "recombine" them), and then reselling under its own name what is functionally the incumbent's own telephone service. The FCC's interpretation is without merit.

The FCC commits several errors in arriving at an interpretation of § 251(c)(3) that permits requesting carriers to accomplish an end-run around § 251(c)(4). First, it mistakenly argues that the Act "does not impose any limitations on carriers' ability to obtain access to unbundled network elements." (Report ¶ 329). That argument conflicts with § 251(d)(2), which expressly limits the incumbent LEC's obligation to provide access to elements of its network. Moreover, the plain language and structure of §§ 251(d)(2) and (c)(3) underscore that an incumbent's obligation is simply to provide access to a limited number of discrete parts of its network on an unbundled basis.

The FCC next errs by interpreting § 251(c)(3) to require incumbent LECs, rather than requesting carriers, to recombine the network elements purchased from incumbents on an unbundled basis. (Report ¶¶ 294-95). This untenable interpretation once again ignores the plain language of § 251(c)(3), which provides that incumbents must provide unbundled elements "in a manner that allows **requesting carriers** to combine such elements in order to provide . . . telecommunications service." (emphasis added). Thus, the FCC's interpretation is akin to requiring an automobile manufacturer to disassemble one of its cars, sell all of the parts to a competitor (on some hypothetical, least cost basis), and then reassemble the parts at the competitor's request! Nothing in § 251(c)(3) warrants such an interpretation.

As the above analogy illustrates, the FCC's interpretation would also impose substantial burdens on incumbents, particularly mid-sized and small LECs, that Congress never contemplated, much less authorized. Requiring incumbents to reassemble network elements would forcibly conscript the incumbents' personnel (and their expertise and training) into the service of their competitors. No justification for such a bizarre result exists. To the contrary, if new entrants are to be competing telecommunications companies, not just storefronts reselling phone service over recombined pieces of an incumbent's own network, new entrants must be expected to hire their own personnel and train them.

Finally, the automobile analogy illustrates well that the FCC's interpretation of § 251(c)(3) enables new entrants to avoid the resale provisions of § 251(c)(4). Obviously, a competitor who purchases all of the unbundled elements of an incumbent's network, and forces the incumbent to reassemble them, is simply buying the incumbent's network, and thus its telephone service. Congress, however, provided a distinct method for competitors to achieve that objective: the resale provisions of § 251(c)(4).

rights of unregulated third parties. Nor can such a right be inferred more generally under the Communications Act.[21]

### C. The FCC Erred in Reading Section 251(c)(3) to Allow New Entrants to Evade the Act's Limitations on Resale

In addition to expanding the definition of "network elements" and nullifying the Act's limitations on what elements incumbents must provide, the FCC eliminated yet another critical distinction that Congress built into the Act. Under section 251(c)(4), Congress imposed a distinct duty on incumbent LECs to provide retail services to requesting carriers at wholesale rates so that those carriers can resell the services to subscribers. Congress defined a distinct pricing standard for resold services, see § 252(d)(3) , and expressly restricted the uses that can be made of them, see § 271(e)(1). The Order would nullify these provisions by construing section 251(c)(3) to give requesting carriers an entirely different avenue for reselling the incumbent LEC's own finished service, solely through the imaginary process of "unbundling" the LEC's entire network and "reassembling" the pieces. See Order ¶¶ 338-41. The FCC's "rebundle" rule in effect adds to the two options enacted by Congress (unbundled elements and resale) a third option that does not appear in the statute (rebundled elements). These rebundled elements can be exactly the same, in every respect, as the LECs' resold services, but they must be priced at rates much lower than those derived from the wholesale discount for resold services. This not only is contrary to the terms of

[21] See, e.g., Teleprompter Corp. v. CBS, Inc., 415 U.S. 394, 406 & n.11 (1974) (FCC has no power to alter rights established under the Copyright Act).

section 251(c)(3), but also flatly contradicts the specific pricing standards and other restrictions that Congress crafted for limiting the reselling of services under the Act.

The plain terms of section 251(c)(3) refute the notion that services can be obtained for resale simply by purchasing an incumbent's entire network as "unbundled elements." In imposing a duty on incumbents to provide access to "elements" of their network, section 251(c)(3) by its terms contemplates an obligation to provide discrete elements — that is, parts of the network — on an "unbundled basis." A new entrant that purchases an incumbent's entire network from end to end, however, is not getting anything on an "unbundled basis."

The FCC attempts to justify its reading of the unbundling duty in part by noting that under section 251(c)(3) a requesting carrier should be allowed to "combine such elements" to provide telecommunications services. Order ¶ 293. But just as a requesting carrier purchasing the whole network is not obtaining any "part" of the network on an "unbundled basis," so it is not "combining" any "elements" that have been "unbundled." Rather, the requesting carrier is simply buying fully finished telephone services. Any "unbundling" or "combining" involved in the entire process is the purest fiction. It is as if the FCC had transformed a statutory obligation to sell spare parts for an automobile into a requirement that incumbents provide a fully assembled car. Once again, by allowing new entrants to buy services from incumbents under the "unbundled elements" label, without having to contribute any network facilities of their own, the FCC is creating a profound disincentive to facilities-based competition in direct contravention of congressional intent.

The FCC would also require incumbent LECs to treat some retail telecommunications services — so-called vertical services that are provided on the network switch, such as Caller ID and call forwarding — as if they were themselves unbundled network elements. See Order ¶ 263, 413. Indeed, the Order obligates incumbents to offer these services to competitors as both unbundled elements and finished services for resale. But it would have been nonsensical for Congress to direct State commissions to establish two different prices for the same service. Nor did Congress do any such thing. As already noted, the Conference Committee chose to eliminate the term "services" when it defined the scope of unbundling. Conference Report at 121. Congress also specified that unbundled elements are to be used only as inputs "for the provision of" a competitor's own telecommunications services, § 251(c)(3), and separately addressed resale of "telecommunications services" that are offered to retail customers, § 251(c)(4). Thus, Congress clearly indicated that the resale provisions, not the unbundling requirements, control where the incumbent's finished telecommunications services are at issue. See generally United States v. Eagle, 539 F.2d 1166, 1173 (8th Cir. 1976), cert. denied, 429 U.S. 1110 (1977) (specific provisions govern over general ones).[22]

[22] Moreover, if a particular telecommunications service is available via resale, its unavailability as an "unbundled element" would clearly not "impair the ability of a [competing] carrier . . . to provide the services that it seeks to offer." § 251(d)(2)(B). Thus, even if a vertical service were wrongly viewed as a "network element" under the statute, the incumbent LEC still should not have to provide it in the form of an "unbundled element" pursuant to the Act's separate pricing rules for such elements.

Giving new entrants the right to order, as "network elements," either the assembled collection of network facilities needed to provide a telecommunications service or individual vertical services would allow them to evade express statutory limitations on a competitor's right to resell the incumbent's retail services. Unlike unbundled network elements, which incumbents must offer to their rivals at cost (47 U.S.C. § 252(d)(1)), incumbents must set the prices for services for resale by discounting from retail rates. See 47 U.S.C. § 252(d)(3) (wholesale service rates equal "retail rates charged to subscribers for the telecommunications service requested, excluding . . . costs that will be avoided by the local exchange carrier").

Congress legislated this difference in order to prevent exploitation of regulatory price differentials. See H.R. Rep. No. 204, 104th Cong., 1st Sess., pt. 1, at 72 (1995) ("The [resale] rate should reflect whether, and to what extent, the local dialtone service is subsidized by other services . . . ."). Regulators require incumbent carriers to provide certain services to certain consumers at artificially low rates (for example, basic telephone service to rural users). Incumbents are expected to subsidize these public service burdens by pricing other services above cost (for example, service to business users and vertical services such as Caller ID and call waiting). If competitors could obtain business services or vertical services at cost rather than at prices pegged to retail rates, they could be used unfairly to serve an incumbent's "subsidizing" customers at prices below those that the incumbent must charge to recoup the cost of serving subsidized customers. A competitor could thereby undercut the incumbent's prices and take its customers, without providing any improvements on the incumbent's service.

Creating such an opportunity for arbitrage would drive incumbent carriers toward financial ruin and threaten the public service objectives that State regulators are trying to achieve. To avoid losing the customers from whom they earn a profit, incumbents would have to reduce their prices. The contribution to public-service subsidies that those customers provided would be lost, although incumbents would not be freed of their public service obligations. This combination of cost-based competition and regulatorily-imposed subsidies, as the Commission has acknowledged, "is inherently unstable and unsustainable." Order ¶ 8.

The Order similarly allows carriers completely to evade the Act's express restriction on the joint marketing of resold local services, thus reading that restriction out of the statute as well. Congress sought to ensure level competition by preventing large long-distance carriers from jointly marketing their long-distance service with local service obtained from a Bell company incumbent under the Act's resale provisions, until the Bell company is authorized to provide long-distance service in its home region. See 47 U.S.C. § 271(e)(1). This section is intended "to provide parity between the Bell operating companies and other telecommunications carriers in their ability to offer 'one stop shopping' for telecommunications services," an option that is likely to be highly attractive to consumers. S. Rep. No. 23, 104th Cong., 1st Sess. 43 (1995). As the FCC acknowledges, however, a carrier selling the *equivalent* of the Bell company's retail service through the use of unbundled network elements would not be subject to the joint marketing restriction. Order ¶ 335. The FCC has taken a mandatory restriction in the Act and made it trivial to avoid.

The FCC should not be permitted to nullify Congress's intended distinction between network elements and finished services subject to resale merely by redefining network elements to include existing LEC retail services.

### D. By Requiring Incumbents to Turn Major Portions of Their Networks and Operations Over to Competitors, the FCC's Order Would Effect an Unauthorized Taking of Property

We have already seen that the FCC's pricing rules, if allowed to stand, would lead to confiscatory rates for network elements and wholesale services. This same infirmity infects the Commission's demand that LECs make additional investments in their networks for the benefit of their competitors. But the rules concerning unbundling and resale discussed in this section also create another, distinct takings problem: the unacknowledged effect of the FCC's rules is to take LEC property for public use without statutory authority to do so. By permitting new entrants to appropriate all aspects of the LEC's existing business, demand upgrades from the LEC, and evade statutory restrictions on resale, the FCC's rules effectively nationalize the LEC's business for the benefit of its competitors. Since Congress never authorized such a wholesale takeover of the LEC's business, the FCC's rules cannot stand.

Congress required the LECs to grant competitors access to the critical, physical portions of their existing networks. Congress also required the LECs to permit physical collocation of competitors' equipment as necessary for such access. But the FCC has taken these limited requirements and expanded them into an expropriation of LEC networks.

Farkey

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 96-3321
(and consolidated cases)

IOWA UTILITIES BOARD, ET AL.,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.,

Respondents.

On Petitions for Review of an Order of the
Federal Communications Commission

**BRIEF OF AMICI CURIAE**
**THE HONORABLE JOHN D. DINGELL, M.C.,**
**THE HONORABLE W. J. (BILLY) TAUZIN, M.C.,**
**THE HONORABLE RICK BOUCHER, M.C., AND**
**THE HONORABLE DENNIS HASTERT, M.C.**

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November 15, 1996

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IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 96-3321
(and consolidated cases)

IOWA UTILITIES BOARD, ET AL.,

<u>Petitioners</u>,

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.,

<u>Respondents</u>.

On Petitions for Review of an Order of the
Federal Communications Commission

**BRIEF OF AMICI CURIAE**
**THE HONORABLE JOHN D. DINGELL, M.C.,**
**THE HONORABLE W. J. (BILLY) TAUZIN, M.C.,**
**THE HONORABLE RICK BOUCHER, M.C., AND**
**THE HONORABLE DENNIS HASTERT, M.C.**

## INTEREST OF AMICI CURIAE

Amici are members of Congress who have a strong institutional interest in ensuring that federal agencies correctly interpret statutory provisions and do not exceed the jurisdiction conferred on them. This interest is especially acute with respect to the Federal Communications Commission's implementation of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, in which the Commission has taken a perfectly legible statute and turned it on its head.

Amici include both Republican and Democratic members of the House Committee on Commerce, which had jurisdiction over the 1996 Act. Amici believe that if properly interpreted this legislation will open the door to fuller competition in all telecommunications markets. Because of our involvement in shaping the relevant provisions of the Telecommunications Act, and because our constituents will benefit directly from the healthy competitive environment the Act was designed to foster, amici have a particular interest in seeing that it is implemented in accord with legislative mandates.

## SUMMARY OF ARGUMENT

The FCC's First Report and Order[1] is an act of extraordinary arrogance. The Order blatantly disregards congressional intent in two material respects: it asserts federal jurisdiction in areas that Congress intended to reserve for state control, and it establishes rules for the unbundling of network elements that are contrary to congressional intent, and that threaten the viability of established telecommunications networks.

In order to reach the conclusions found in the Order, the Commissioners either had to determine that they had the authority to ignore the plain intent of the peoples' elected representatives, or that Congress doesn't know enough about legislative drafting to explicitly amend sections of the law that it wanted to change.

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[1] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, FCC No. 96-325, CC Docket 96-98 (August 8, 1996) ("Order").

Apparently unbeknownst to the Commission, however, Congress debated at great length about the proper allocation of state and federal responsibilities. In the end, we decided to leave regulation of most local matters, including especially the pricing of local facilities and services, to the states. To implement that design, the House/Senate conference committee added specific language clearly vesting such authority in the states. See, e.g., 47 U.S.C. § 252(d) (governing local pricing). Just as important, Congress left key provisions of the 1934 Act in place. These include § 2(b), codified at 47 U.S.C. § 152(b), which plainly states that "nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to . . . intrastate communication service . . . ."

The Commission's foray into areas Congress reserved to the states is doubly improper because it establishes rules for the unbundling of network elements that would hamper full competition and reduce investment in local telecommunications networks. Congress deliberately crafted separate pricing methods for competitors to have access to local facilities and services, depending on whether they are facilities-based competitors or resale competitors. The purpose of this distinction was to encourage investment in telecommunications facilities and to create jobs. The Commission's rules eviscerate this important distinction by making the more attractive cost-based pricing method available to other types of competitors. The result of the Commission's failure to respect

Congress' distinction between the two types of competitors is that the pricing benefits Congress intended to inure to those who invested and created jobs will instead be available to pure resellers. The Commission adopts quick fixes that Congress rejected in favor of encouraging long-term investment and employment. The Commission's agenda must, where there is conflict, take a back seat to Congress' own plan for the industry.

## ARGUMENT

## I. THE TELECOMMUNICATIONS ACT PRESERVES STATE JURISDICTION OVER INTRASTATE PRICING

The Telecommunications Act did not create an entirely new federal regulatory scheme in the telecommunications area. Rather, it amended existing law in response to market developments that have rendered old monopolies obsolete. Congress drew upon more than sixty years of experience under the Communications Act of 1934 and, in particular, decided not to upset the basic jurisdictional balance of the 1934 Act.

### A. The 1934 Act Assigned Jurisdiction of Intrastate Services to the States.

The Communications Act of 1934 firmly established a "system of dual state and federal regulation" of the telecommunications industry. Louisiana Public Serv. Comm'n v. FCC, 476 U.S. 355, 360 (1986). Congress created the Federal Communications Commission and granted it authority to regulate "interstate and foreign commerce" in wire and radio communication, 47 U.S.C. § 151, while leaving intrastate service to state control. To brace this divide, and ensure that federal regulators would not encroach on a state's jurisdiction, Congress expressly denied the FCC jurisdiction over intrastate matters, except in a few enumerated instances. 47 U.S.C. § 152(b).

The proper division of federal and state power was the "'dominating controversy'" during the drafting of the 1934 Act.[2] The states were particularly concerned by the broad power that the Interstate Commerce Commission, which then regulated both railroads and interstate telecommunications, had claimed over intrastate railroad rates as an incident of regulating interstate rates. See Houston & Texas Ry. v. United States, 234 U.S. 342 (1914); Wisconsin R.R. Comm'n v. Chicago, B & Q R.R., 257 U.S. 563 (1922). State authorities feared that if the new federal communications agency were given the same power that the ICC had, they would be displaced from the field of telecommunications.[3]

Congress responded with § 2(b) of the 1934 Act. Section 2(b) provided in 1934, as it does today, that "nothing in this Act shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services,

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[2]Louisiana PSC, 476 U.S. at 372 (quoting Richard McKenna, "Preemption Under the Communications Act," 37 Fed. Comm. L.J. 1, 2 (1985)).

[3]See, e.g., Hearings on H.R. 8301 Before the House Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess. 136 (1934) (statement of John E. Benton), reprinted in A Legislative History of the Communications Act of 1934, at 482 (Paglin ed., 1989); id. at 74 (statement of Mr. Clardy); Hearings on S. 6 Before the Senate Interstate Commerce Committee, 71st Cong., 2d Sess. 2179 (1930).

facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." 47 U.S.C. § 152(b). The provision straightforwardly "reserves to the States exclusive jurisdiction over intrastate telephone and telegraph communication." S. Rep. No. 781, 73d Cong., 2d Sess. 3 (1934).

Consistent with this legislative intent, the Supreme Court held in Louisiana PSC that § 2(b) "fences off from FCC reach or regulation intrastate matters -- indeed, including matters 'in connection with' intrastate service." 476 U.S. at 370. The Court explained that any attempt by the FCC to regulate intrastate matters, even to effectuate a federal policy, would constitute an agency conferring power on itself. "To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress." Id. at 374-75. This the Court was "both unwilling and unable to do." Id. at 375.

**B. The Telecommunications Act Preserves the States' Authority to Regulate Intrastate Communications.**

Since 1934, the FCC by and large has respected the limitation that § 2(b) places on its jurisdiction. Even under the 1996 Act, it generally admits that "in the absence of a grant of authority to the Commission, State and local regulators retain jurisdiction over intrastate matters." Memorandum Opinion and Order, In re Classic Telephone, Inc., CCBPol 96-10, ¶ 24 (FCC Oct. 1, 1996). Yet the FCC apparently thought it could get around this basic principle in its Order. While conceding that the 1996 Act does not explicitly grant it authority over local interconnection and pricing, the FCC contends that Congress implicitly "expand[ed] the applicability of . . . national rules to historically intrastate issues." Order ¶¶ 83-84. Nothing is further from the truth.

There was no general effort to expand federal power through the 1996 Act. Rather, Congress was concerned with limiting federal regulation.[4] Thus, members carefully considered the proper limits of federal and state jurisdiction. Where it wanted to give the FCC authority in areas of traditional state responsibility, Congress said so. For example, §§ 251(b)(2) and (d)(2) give the FCC authority to draw up rules concerning local number portability and network unbundling, respectively. Likewise, as explained below, Congress indicated when regulatory powers should be exercised exclusively by the states. In particular, Congress did not silently transfer the states' traditional responsibility to set prices for local services to federal regulators.

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[4] See 141 Cong. Rec. H4521 (daily ed. May 3, 1995) (statement of Rep. Bliley) (proposed legislation would "substantially reduce Federal regulations of telecommunications" and largely would be "administered locally rather than federally"); 141 Cong. Rec. S8198 (daily ed. June 12, 1995) (statement of Sen. Pressler) ("It is time we reduced the federal bureaucracy. . . . Inside the beltway, these agencies grow and grow and they do not want to give up their turf."); 142 Cong. Rec. H1150 (daily ed. Feb. 1, 1996)(statement of Rep. Goss)(Act will "reduce Federal involvement in decisions that are best made by the free market").

First, Congress determined to keep § 2(b), and hence the Louisiana PSC decision, intact.[5] This determination was deliberate. Congress knows how to amend § 2(b) to carve out specified intrastate services from its broad scope. For example, when Congress drew up provisions relating to telecommunications services for hearing- and speech-impaired individuals under the Americans with Disabilities Act, it amended the first clause of § 2(b) so that those provisions would cover intrastate services. See Pub. L. 101-336, Title IV, § 401(b)(1), 104 Stat. 369 (1990). Congress similarly amended § 2(b) in 1991 and 1993 when imposing federal restrictions on telephone dialing equipment and regulation of mobile services, respectively.[6]

In 1996, the House and Senate conferees decided, after much debate, not to establish a similar carve-out from state jurisdiction in the new telecommunications law. Both the House and Senate bills would have added Part II, Title II of the amended Communications Act (which includes the interconnection, resale, and unbundling requirements) to the list of provisions carved from § 2(b)'s scope.[7] But the conferees deleted that language. This

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[5]See Lorillard v. Pons, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of . . . [a] judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.").

[6]See Pub. L. 102-243, § 3(b), 105 Stat. 2401 (1991) & 47 U.S.C. § 227; Pub. L. 103-66, Title VI, § 6002(b)(2)(B)(I), 107 Stat. 396 (1993) & 47 U.S.C. § 332(c)(3)(A).

[7]See H.R. 1555, 104th Cong., 1st Sess. § 101(e)(1) (1995); S. 652, 104th Cong., 1st Sess. § 101(c)(2) (1995).

Court should respect the conferees' decision and reject the FCC's claim that § 2(b) was implicitly amended.[8]

Indeed, the conferees specifically addressed whether federal or state rules would be used to resolve disputes regarding the terms and prices of interconnection, unbundling, and resale. Under the House bill's proposed § 242(a)(2), local carriers were required "to offer unbundled services, elements, features, functions, and capabilities whenever technically feasible, at just, reasonable, and nondiscriminatory prices and in accordance with [proposed] subsection [242](b)(4)." Proposed subsection (b)(4), in turn, authorized the FCC to promulgate regulations implementing section 242's guidelines for interconnection and pricing. H.R. 1555, 104th Cong., 1st Sess. § 101(a) (1995). State commissions would merely "supervis[e]" the private negotiations. Id. (proposed § 242(a)(8)). The Senate bill, by contrast, gave the state commissions responsibility to "resolve" open issues and "impose[e] appropriate conditions upon the parties" in arbitration proceedings, S. 652, 104th Cong., 1st. Sess. § 101(a) (1995) (proposed § 251(d)(5)(C)), subject to FCC regulations.[9]

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[8]See Gulf Oil Corp. v. Copp Paving Co., 419 U.S. 186, 199-200 (1974) (deletion of a provision by a conference committee "militates against a judgment that Congress intended a result that it expressly declined to enact"); North Haven Board of Educ. v. Bell, 456 U.S. 512, 528 (1982) (deleting a provision of the House and Senate bills was a "conscious choice" by Congress).

[9]See S. Rep. No. 23, 104th Cong., 1st Sess. 21 (1995) ("the solution imposed by a State must be consistent with the FCC's rules"); S. 652, § 101(a) (proposed § 251(i)(1)) (requiring FCC to issue regulations).

Procedurally, the conferees largely followed the Senate approach. Where local competitors can resolve their differences through private negotiations, they are left to do so, subject only to a state determination that the final agreement is nondiscriminatory and consistent with the public interest. 47 U.S.C. § 252(e)(2)(A). But where the terms and prices of interconnection cannot be resolved through private negotiations, either party can ask "a State commission" to mediate differences, id. § 252(a)(2), or to arbitrate any open issues, id. § 252(b). If the parties select arbitration, the Act provides rules, including pricing standards, for the "State commission" to follow. Id. § 252(c),(d).

The final version of the law vests much more substantive authority in the state commissions than either the House or the Senate bill. Consistent with the Senate approach, § 252(c)(1) of the Act requires state commissions, as a general matter, to conduct arbitrations in a manner that "meets the requirements of section 251, including the regulations prescribed [by the FCC] thereunder." But the very next subsection of the Act establishes a special rule for pricing: It instructs state arbitrators "to establish any rates for interconnection, services, or network elements according to subsection (d)," without any reference to Commission regulations. 47 U.S.C. § 252(c)(2).

Section 252(d) confirms the states' responsibility for pricing. Subsection 252(d)(1) provides that "a State commission," in determining "the just and reasonable rate" for interconnection or network elements, should ensure that the rates are "nondiscriminatory" and "based on the cost . . . of providing the interconnection or network element" and "may include a reasonable profit." Subsection (d)(2) provides guidance regarding so-called "reciprocal compensation," where carriers pass calls back and forth between their networks. Subsection (d)(3) specifies that "a State commission" is to determine wholesale rates for telecommunications services "on the basis of retail rates charged to subscribers . . ., excluding . . . costs that will be avoided by the local exchange carrier."

These provisions, we thought, would make it crystal clear that the states set prices for local interconnection, unbundling, and resale where the parties need outside help. As the Conference Report explained with respect to wholesale rates, the rate "is to be determined by the State Commission." S. Rep. No. 230, 104th Cong., 2d Sess. 126 (1996).

Incredibly, the Commission read these provisions as crying out for federal regulation. It reasoned that regulations are needed to "equaliz[e] bargaining power" between incumbent local carriers and new entrants, and that "[n]ational (as opposed to state) rules more directly address these competitive circumstances." Order ¶ 55. The Commission simply refuses to accept Congress' judgment that state regulators -- who have decades of experience with local pricing issues -- are better positioned than the FCC to know what constitutes an unreasonable demand in particular local negotiations. As long as a state commission complies with the statutory pricing constraints and abides by FCC regulations in those areas (such as number portability and unbundling) where the FCC was given specific authority, the state commission is free to arbitrate pricing disagreements as it sees fit.

## II. THE FCC'S RULES WILL REDUCE COMPETITION, JOB CREATION, AND INVESTMENT

The FCC's rules would eliminate virtually all of the flexibility that Congress gave the state commissions. Worse than that, however, they would frustrate the development of genuinely competitive local telecommunications markets.

Congress carefully balanced the interests of incumbent local carriers and new entrants when it drew up the 1996 Act. The conference committee hammered out critical compromises that were designed to give all carriers, old and new, a fair chance to compete. Legislators believed that full and fair competition would "unleash such competitive forces and innovation that our Nation [would] see more technological development and deployment in the next 5 years than we have already seen this century," leading to "hundreds of thousands of new jobs and tens of billions of dollars being invested in infrastructure and technology." 142 Cong. Rec. H1174 (daily ed. Feb. 1, 1996) (statement of Rep. Buyer). Much of the anticipated growth was expected to come from the local exchange market.

The idea was simple. For several decades, competition in local markets has been artificially constrained by authorized monopolies. If those monopolies are eliminated, new businesses will enter the market. They will install their own wires and switches, and they will develop new products and services to attract customers. Today's incumbents will fight back by increasing their own investments in local facilities and services.

But a rational new entrant will not spend the money to install facilities if it has a guaranteed competitive advantage when it uses the incumbent's network. And the incumbent will not invest in upgrading its facilities when its competitors get the greatest benefit from that investment. Neither side would have an incentive to build or invest. Congress' whole plan for job creation and economic growth would be frustrated.

The Commission has arrogantly imposed, through the Order, its <u>own</u> view of what Congress should have done through the Act. The FCC's overreaching is well illustrated by the unbundling provisions of the FCC's rules, under which new entrants have a choice of buying retail services under one pricing formula, or buying all the network capacity needed to provide that same service under a totally different pricing formula. <u>See</u> Order ¶¶ 328-41. These provisions erase carefully drawn statutory distinctions between resale pricing, on one hand, and pricing of network elements, on the other.

Section 252(d) sets out distinct pricing formulas for network unbundling and resale of retail services. 47 U.S.C. § 252(d). As with jurisdiction over local pricing disputes, this distinction was hammered out in the House/Senate conference. The Senate bill contained no specific pricing guidelines relating to resale of incumbent carriers' retail services, but introduced the requirement that local exchange carriers make pieces of their networks separately available for competitors' use at prices "based on the cost . . . of providing the unbundled element" which "may include a reasonable profit." S. 652, § 101(a) (proposed § 251(d)(6)). Conversely, the House bill established only a broad "just, reasonable, and nondiscriminatory prices" standard for unbundling of local network facilities, H.R. 1555, § 101(a) (proposed § 242(a)(2)), but required that local carriers "offer services, elements, features, functions, and capabilities for resale at wholesale rates," id. (proposed § 242(a)(3)(A)).

The conferees realized that the specific pricing rules in the House and Senate bills addressed different situations. The House's formula for resale was designed principally for situations where a non-facilities-based carrier wants to sell the very same service that the incumbent provides its customers. H.R. Rep. No. 204, 104th Cong., 1st Sess. 72 (1995). Local regulators set some retail prices (usually prices for basic residential service) below cost, and make up for these losses by setting other retail prices (like prices for advanced business services) above cost. Id. If the Senate's "cost plus profit" approach were used for sales to pure resellers of the incumbent's retail services, those resellers could earn large profits by targeting business customers whom the incumbent must charge above-market prices. This targeted approach, or "cream-skimming," would leave incumbents no way to recover the losses they must incur from serving subsidized customers.[10]

When the conference committee reconciled the two bills it clearly distinguished (as the Senate and House had not done) between (1) a competitor's right of "access to network elements on an unbundled basis" for the provision of its own <u>facilities-based</u> telecommunications services and (2) a competitor's right to purchase the incumbent's retail services at wholesale rates for the purpose of <u>resale</u>. 47 U.S.C. § 251(c)(3), (4). The conferees adopted pricing models that reflected that distinction. The Senate's "cost plus profit" formula was adopted for the purchase of <u>unbundled elements</u>, and the House's "retail price minus avoided costs" formula was adopted for the purchase of <u>retail services</u> to be made available to resellers. 47 U.S.C. § 252(d).

The FCC, however, has allowed competitors who have no local facilities of their own, and thus were expected to be governed by the House's wholesale pricing formula, to obtain all the network

[10]In the Senate, Senators Inouye and Stevens offered an amendment that would have set wholesale prices at the incumbent carrier's "actual cost." 141 Cong. Rec. S8369 (daily ed. June 14, 1995). That amendment was withdrawn, 141 Cong. Rec. S8438 (daily ed. June 15, 1995), indicating the Senate's concurrence that cost-based pricing was not appropriate for resold services.

elements that go into an incumbent's service under the Senate's "cost plus profit" formula. The Commission's rules have the perverse effect of allowing a competitor to chose the more favorable cost-based pricing method, effectively gutting the statutory distinction and guaranteeing that non-facilities-based carriers can make money by undercutting the incumbent's price for any offering that the incumbent must -- under state regulatory policies -- price above cost. As long as they can accumulate risk-free profits with minimal investment, competitors will not build their own networks to provide competing services.

The Commission's establishment of unbundling rules that act as a <u>substitute</u>, rather than an <u>alternative</u>, for purchasing retail services at wholesale rates slants competition in another way as well. Congress was aware that it would be unfair and anti-competitive to allow the major long distance carriers to market resold local service with their own long distance service where the local telephone company (which provides the local service) cannot sell long distance.[11] Section 271(e)(1) thus provides, in substance, that if AT&T, MCI, and Sprint want to sell packages of local and long distance services before the local exchange carrier

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[11]<u>See</u> 142 Cong. Rec. S713-14 (daily ed. Feb. 1, 1996) (statement of Sen. Harkin) (joint marketing restriction designed "to prevent the big long distance companies from having a competitive advantage"); 142 Cong. Rec. S716-17 (daily ed. Feb. 1, 1996) (statement of Sen. Hollings) (preventing competitors from "cherry pick[ing]" profitable business customers while Bell Operating Companies are excluded from interLATA markets is contrary to public interest and interests of other local customers).

can do the same, they must build a local network of some sort. Under the FCC's approach, however, a company like AT&T can obtain all the unbundled network elements it needs to sell local service with its long distance service, without having a single foot of local telephone wire of its own. See Order ¶ 328.

This unfairness is compounded by the specific pricing rules developed by the Commission. As already explained, § 252(d)(1) of the Act instructs state arbitrators to set prices for interconnection and access to network elements based on the incumbent's "cost" plus "a reasonable profit." The Order, however, instructs state commissions to set prices based on a hypothetical "incremental cost" that would be incurred if the incumbent were using an ideally efficient network. 47 C.F.R. § 51.505(b)(1).

Congress meant what we all understand "cost" to mean, i.e., the amount actually paid for something. Furthermore, the Commission's approach of deriving prices from a hypothetical incremental cost would in many cases push prices even below the "actual cost" standard that Congress rejected as too low because it did not include a "reasonable profit." New competitors, who could obtain access to the incumbent's facilities below actual cost, would not build any of their own. And incumbents, lacking any incentive to incur additional construction costs that could not be recovered, would neglect their networks.

The FCC's Order likewise undermines the intent underlying § 252(d)(3), which governs resold local services and instructs the states to fix wholesale prices at the retail rate less the costs that "will be avoided." Again, the decision to subtract only those costs that actually "will be avoided" was deliberate. Congress wanted to be sure that -- whether local regulators set the retail rate at, above, or below cost -- at least the incumbent will receive the same amount of profit or loss on the wholesale service as it would on the regulated retail service. The conferees thus rejected proposed language that would have set the statutory standard at retail rates minus "avoidable" costs, thereby altering the relationship between price and cost that state regulators built into the retail rate.

Yet the Commission set wholesale prices at the retail rate less any costs that the state determines "can be avoided." 47 C.F.R. § 51.609. It re-opened debate on the rejected "avoidable costs" proposal and then adopted it. See Order ¶¶ 884, 911. The Commission has eviscerated the Act's guarantee that incumbent carriers will receive enough from wholesale transactions so that they are no worse off than they would be under the retail rates, and can fulfill their obligation to provide subsidized services.

Finally, Congress specified that, when drafting rules regarding what network elements must be unbundled, the FCC should consider whether access to a particular proprietary element is "necessary." 47 U.S.C. § 251(d)(2). This provision was designed to reflect the "necessary" standard found in proposed § 251(b)(2) of the Senate bill. S. 652, § 101(a). Yet the Commission has run around the plain language of the Act, by saying that access to an incumbent's proprietary network elements may be "necessary" even if the competitor can obtain the same elements elsewhere. Order ¶ 283. The Commission reasoned that applying the statute as written might raise competitors' costs somewhat, even if it did not actually prevent competition. Congress, however, wanted to encourage construction of competitive networks, not to set up a system whereby new entrants live indefinitely off of the incumbent's investment.

These examples all reflect the same problem. The Commission has adopted proposals Congress specifically rejected and that will slow the very "private sector deployment of advanced telecommunications and information technologies and services" that Congress meant to "accelerate." S. Rep. No. 230, at 1. We think the Commission is wrong about sound policy, as well as about the law. Its approach will reduce employment and economic growth. But if Congress did make policy mistakes, they are for Congress to fix. The Commission may not override our legislative judgments.

## CONCLUSION

We have tried, through the congressional oversight process, speeches and letters, to encourage the Commission to respect the traditional jurisdictional division of authority that is embodied in the Communications Act. But the Commission is behaving like a renegade agency. It appears to believe that it isn't accountable to anyone, and should be free to substitute its own judgments for congressional directives.

Apparently the Chairman of the Commission doesn't even believe that Commission decisions should be subject to judicial review. At a press conference in October, he likened this Court's Order Granting Stay Pending Judicial Review to the "imperial sovereignty" exercised by the Chinese emperors.[12]

But under our system, agencies aren't free to substitute their own judgments for those of the Congress. They must obey the law. This Court should strike down the local pricing provisions of the Order as beyond the FCC's jurisdiction and direct the Commission to respect carefully crafted statutory restrictions on resale of incumbents' services and unbundling of local networks.

Respectfully submitted,

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November 15, 1996

[12]Hundt Calls Court Stay of FCC Rules Example of Extreme Judicial Activism, BNA Analysis and Reports, at C-1 (Oct. 17, 1996).

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of November, 1996, I caused copies of the MOTION OF THE HONORABLE JOHN D. DINGELL, M.C., THE HONORABLE W. J. (BILLY) TAUZIN, M.C., THE HONORABLE RICK BOUCHER, M.C., AND THE HONORABLE DENNIS HASTERT, M.C. FOR LEAVE TO FILE BRIEF AS AMICI CURIAE and the BRIEF OF AMICI CURIAE OF THE HONORABLE JOHN D. DINGELL, M.C., THE HONORABLE W. J. (BILLY) TAUZIN, M.C., THE HONORABLE RICK BOUCHER, M.C., AND THE HONORABLE DENNIS HASTERT, M.C. to be served upon the parties listed on the attached service list by first-class mail, postage prepaid.

David Smith