Nos. 00-511, 00-555, 00-587, 00-590 and 00-602

In the Supreme Court of the United States

VERIZON COMMUNICATIONS, INC., ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

AND RELATED CASES

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR PETITIONERS FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES

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QUESTIONS PRESENTED

This Court granted certiorari on the following questions presented in the petition for a writ of certiorari filed by the Federal Communications Commission and the United States (No. 00-587):

1. Whether the court of appeals erred in holding that 47 U.S.C. 252(d)(1) (Supp. IV 1998), a provision of the Telecommunications Act of 1996, forecloses the cost methodology adopted by the Federal Communications Commission for determining the rates that new entrants into local telecommunications markets must pay incumbent local telephone companies for providing interconnection and network elements.

2. Whether 47 U.S.C. 251(c)(3) (Supp. IV 1998) prohibits regulators from requiring that incumbent local telephone companies combine certain previously uncombined network elements when a new entrant requests the combination and agrees to compensate the incumbent for performing that task.

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OPINIONS BELOW

The opinion of the court of appeals (No. 00-587 Pet. App. 1a-43a) is reported at 219 F.3d 744. The *Local Competition Order* of the Federal Communications Commission (FCC) is reported at 11 F.C.C.R. 19,392.

JURISDICTION

The judgment of the court of appeals was entered on July 18, 2000. The government's petition for a writ of certiorari in No. 00-587 was filed on November 29, 2000, and was granted on January 22, 2001. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, are reproduced in the appendix to our petition in No. 00-587 (U.S. Pet. App.) at 104a-125a and in the Joint Appendix (J.A.) at 9-48. In referring to the provisions of the Act, we have cited the 1998 Supplement to the United States Code.

STATEMENT

1. a. Throughout most of the United States, local telephone service has long been dominated by a single incumbent "local exchange carrier," or LEC. That incumbent LEC, whether a regional Bell company or an independent carrier, owns almost all of the loops (the wires that connect telephones to switches) in its service area, along with the switches (which direct calls to their destinations) and the transport trunks (which carry calls between switches). The incumbents' control over those facilities has solidified their de facto monopoly position in most local telecommunications markets. Indeed, even today, after years of efforts to open those markets to competition, incumbents still provide service over approximately 93% of local telephone lines. See Industry Analysis Division, FCC, *Local Telephone Competition: Status as of June 30, 2000*, at 1 (2000); see also Industry Analysis Division, FCC, *Local Telephone Competition at the New Millennium*, Table 6 (2000) (as of December 1999, incumbents controlled approximately 94% of total local telecommunications revenues).

The barriers to entry into local telecommunications markets are different from, and vastly more formidable than, the barriers to entry into the long-distance market. It has been economically practicable for some long-distance carriers to build their own interexchange

infrastructure—*e.g.*, to lay cable or build microwave networks connecting local calling areas to one another —because they can rely (albeit at a cost) on the LECs on either end of an interexchange call to route the call through the various switches and local loops from the call's origin to its destination. But, at least with current technology, it would be economically impracticable for even the largest prospective competitor to duplicate completely the functions of an incumbent LEC's entire network. And, without rights of interconnection, a potential competitor could not gradually enter the market through partial duplication of those functions; a new carrier would win few customers if its customers could call only one another and not customers on the incumbent LEC's separate (and completed) network.

b. "Until the 1990s, local phone service was thought to be a natural monopoly. * * * Technological advances, however, have made competition among multiple providers of local service seem possible." *AT&T* v. *Iowa Utils. Bd.* (*Iowa Utils. Bd. I*), 525 U.S. 366, 371 (1999). Congress enacted the Telecommunications Act of 1996 (1996 Act), Pub. L. No. 104-104, 110 Stat. 56, to open local telecommunications markets to full competition. Congress recognized that no prospective entrant could replicate, at least in the short term, all of an incumbent's existing local network infrastructure. Accordingly, in the local competition provisions of the 1996 Act, 47 U.S.C. 251-253, Congress provided the means for potential competitors to enter local markets by using the incumbents' networks in a variety of ways. See 47 U.S.C. 251(c)(2)-(4).

Central to the local competition provisions is Section 251(c)(3), which entitles a new entrant to gain "access" to (*i.e.*, to lease) an incumbent's "network elements," such as loops, switching capability, and other com-

ponents and capabilities of the incumbent's network. 47 U.S.C. 251(c)(3); see also 47 U.S.C. 153(29) (defining "network element"). That provision permits new entrants, some of which may also have network elements of their own, to lease from an incumbent whatever elements they need to provide services to their own customers.[1] The 1996 Act further permits new entrants to "interconnect" their own facilities with those in the incumbent's network "at any technically feasible point." See 47 U.S.C. 251(c)(2).

An incumbent may charge a new entrant for interconnection and access to network elements. If the incumbent and the new entrant cannot agree on those charges, the state public utility commission, acting as arbitrator, sets the rates that the incumbent may charge.[2] Under the 1996 Act, the state commissions must set rates that are "nondiscriminatory" and "based

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[1] An incumbent's obligation to lease network elements to new entrants extends only to those elements designated by the FCC under Section 251(d)(2). That provision states that, "[i]n determining what network elements should be made available for purposes of" Section 251(c)(3), the FCC "shall consider, at a minimum," certain competitive standards. 47 U.S.C. 251(d)(2). With respect to most elements, the statutory standard that the FCC must consider is whether "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." 47 U.S.C. 251(d)(2)(B); see also 47 U.S.C. 251(d)(2)(A) (providing that, with respect to "proprietary" elements, the relevant standard is whether "access to such network elements * * * is necessary").

[2] A state commission may decline to perform of that statutory role, in which case the FCC would resolve individual disputes between carriers over the rates to be charged for providing interconnection and access to network elements. See 47 U.S.C. 252(e)(5).

on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable)." 47 U.S.C. 252(d)(1).[3] The rates "may include a reasonable profit" for the incumbent. *Ibid.* In setting such rates, the state commissions must follow the FCC's pricing rules that give content to that statutory standard. See *Iowa Utils. Bd. I*, 525 U.S. at 383-385. Those are among the rules at issue here.

The 1996 Act also conferred significant benefits on the incumbent LECs. For example, the 1996 Act "relieves the [regional Bell companies] of several of the burdens imposed by the [1982 AT&T consent decree], particularly by prescribing in [47 U.S.C.] § 271 a method whereby [they] can achieve a long-sought-after presence in the long distance market." *BellSouth Corp.* v. *FCC*, 162 F.3d 678, 690 (D.C. Cir. 1998) (emphasis and citation omitted); see also 1996 Act, Title VI, § 601(a)(2), 110 Stat. 143 (superseding GTE consent decree). The 1996 Act further entitles incumbent LECs,

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[3] Section 252(d)(1), titled "Interconnection and network element charges," provides in full:

> Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251 of this title, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section—
>
> (A) shall be—
>
> (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
>
> (ii) nondiscriminatory, and
>
> (B) may include a reasonable profit.

like other telecommunications carriers, to invoke its local competition provisions to expand their operations into new geographic areas throughout the United States and compete for the customers of other incumbents.

2. In August 1996, the FCC issued its initial order addressing the most basic issues involving local competition arising under the 1996 Act. See *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order* (*Local Competition Order*), 11 F.C.C.R. 15,499 (1996). A cornerstone of that order is the FCC's choice of the cost methodology—"total element long-run incremental cost," or TELRIC—that state public utility commissions are to employ in resolving disputes between carriers about the "cost[s]" that Section 252(d)(1) allows the incumbent to recover from the new entrant for providing interconnection and network elements. See *Local Competition Order* (paras. 674-703), J.A. 376-396.

a. TELRIC embodies a "forward-looking" approach to calculating the cost of providing network elements and interconnection. The essential objective of any forward-looking methodology is to determine what it would cost, in today's market, to replace the functions of an asset that make it useful. That is the asset's "forward-looking" cost (also known as its "replacement" or "economic" cost), as distinguished from the cost of duplicating the asset in every physical particular (sometimes called an item's "reproduction" or "replication" cost). Thus, under a forward-looking methodology, if an incumbent bought an analog switch in 1985 at a fixed cost of $150 per line, and an efficient carrier would address the same business needs today by purchasing a digital switch at a fixed cost of $100 per line (more

efficient digital switches have supplanted analog switches in the market), the latter figure is the appropriate basis for determining what a new entrant would pay for leasing switching capacity. Similarly, if a loop cost $100 to install in 1985 but would cost $150 to install today (because, for example, labor costs have increased), the rate for leasing that loop would be based on the higher current cost figure.[4]

The forward-looking purchase price of an asset is only one variable in the TELRIC compensation calculus. TELRIC also takes into account (1) the duration of an element's useful life, as reflected in the applicable depreciation schedule; (2) the cost of capital (*i.e.*, the required return, or profit, on investment); and (3) various types of costs, such as maintenance costs. See *Local Competition Order* (para. 703), J.A. 396. One of TELRIC's principal objectives is to ensure an incumbent's opportunity, when leasing network elements to others, to recover the full forward-looking cost of those elements (including the cost of capital) over their useful lives.

The FCC has delegated many of the essential details of implementing TELRIC to the state public utility

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[4] It cannot be said in the abstract whether a forward-looking approach or a historical approach will producer higher cost figures in a particular setting. Cf. *Iowa Utils. Bd. I*, 525 U.S. at 384 (noting that "[i]t is the States that will * * * implement that methodology [*i.e.*, TELRIC], determining the concrete result in particular circumstances"). Indeed, when the Iowa Utilities Board challenged the FCC's jurisdiction to set prices for network elements, it expressed concern that TELRIC would produce higher, not lower, network element prices in Iowa than would a historical cost methodology. See Mot. of Iowa Utils. Bd. for Stay at 9, *Iowa Utils. Bd.* v. *FCC*, No. 96-3321 (8th Cir., filed Sept. 19, 1996).

commissions. For example, the FCC has not set depreciation schedules itself, but has left it to the state commissions to determine, among other things, how best to adopt "specific depreciation rate adjustments that reflect expected asset values over time," including, where relevant, "expected declines in the value of capital goods." *Local Competition Order* (para. 686), J.A. 384-385. Similarly, the FCC has given the state commissions great discretion to determine the appropriate cost of capital. *Local Competition Order* (para. 702), J.A. 395-396. The FCC has authorized the state commissions to increase the cost of capital, if warranted, to compensate incumbents for the risk of increased competition. *Ibid.*

The FCC rejected the argument of several incumbent LECs that the 1996 Act entitles them to rates for interconnection and network elements based on the "historical" (or "embedded") costs reflected on their accounting books. The FCC recognized that those costs could be either higher or lower than forward-looking costs. *Local Competition Order* (para. 705), J.A. 398-399. With respect to those circumstances in which historical costs are higher (the only circumstances with which the incumbents were concerned), the FCC reasoned that the use of such costs in determining the rates charged new entrants would be economically arbitrary and would frustrate the competitive objectives of the 1996 Act. See *Local Competition Order* (paras. 704-711), J.A. 397-403.

In asking what it would cost to replace the functions that make an asset valuable, a forward-looking cost methodology requires an inquiry into currently available substitutes—including assets that perform the same functions as the asset in the incumbent's network, but that do not resemble the asset in all re-

spects (*e.g.*, because they embody more efficient technology than the original asset). See pp. 6-7, *supra*. Some incumbents urged the FCC to foreclose any consideration of currently available substitutes in TELRIC. The FCC rejected the incumbents' suggestion as arbitrarily limiting the inquiry into the forward-looking cost of replacing an asset's useful functions in today's market. See *Local Competition Order* (paras. 683-685), J.A. 382-384.

The FCC determined that TELRIC should, however, take as given the incumbent's existing wire centers (*i.e.*, its switch locations), thereby confining the inquiry to efficient alternatives that are compatible with the most basic geographical design of the existing network. *Local Competition Order* (para. 685), J.A. 383-384. The FCC observed that such a limitation would give new entrants additional incentives to save costs by constructing facilities of their own embodying "more efficient network configurations." *Ibid.*

The FCC codified its determinations on this subject in a regulation providing that, for purposes of determining the rates at which an incumbent may lease network elements to a new entrant, an element's cost "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 C.F.R. 51.505(b)(1).

b. At the same time that the FCC promulgated the pricing rules discussed above, the FCC also promulgated another set of rules, which have come to be known as the "combinations" rules. See *Local Competition Order* (paras. 292-297), J.A. 295-299. Rule 315(b) provides that, "[e]xcept upon request, an incumbent LEC shall not separate requested network

elements that the incumbent LEC currently combines." 47 C.F.R. 51.315(b). Rule 315(c)—the principal combinations rule at issue here—further requires incumbent LECs, at the request of a new entrant (and for a cost-based fee), to combine previously uncombined elements, "even if those elements are not ordinarily combined" within the incumbent's network. 47 C.F.R. 51.315(c). This latter rule is designed principally for circumstances in which an incumbent is able to link facilities within its network more efficiently, and thus less expensively, than the new entrant. The new entrant must bear the costs of combination, whether performed by the new entrant itself or by the incumbent; the principal objective of Rule 315(c) is to help the new entrant avoid *unnecessary* costs and delays.

3. a. In 1996 and 1997, the Eighth Circuit stayed and then invalidated the FCC's pricing rules on the ground that the 1996 Act gives state public utility commissions, not the FCC, general jurisdiction to interpret the pricing provisions of Sections 251 and 252. *Iowa Utils. Bd.* v. *FCC*, 120 F.3d 753, 794-800 (1997). The Eighth Circuit's jurisdictional orders remained in effect until early 1999. During that period, the great majority of state commissions voluntarily applied the FCC's basic forward-looking methodology in adjudicating disputes between incumbents and new entrants over the rates to be charged for interconnection and network elements. See pp. 25-26, *infra*. In January 1999, this Court reversed the Eighth Circuit's jurisdictional ruling, holding that the FCC has statutory authority to establish national pricing standards under Sections 251 and 252. *Iowa Utils. Bd. I*, 525 U.S. at 376-385. The Court remanded the case to the Eighth

Circuit to address (among other things) the substantive validity of the FCC's cost methodology.[5]

In July 2000, the Eighth Circuit issued its decision on remand. The court upheld the FCC's use of a forward-looking, rather than historical, cost methodology and rejected as premature the incumbents' Takings Clause challenge to that methodology. U.S. Pet. App. 10a-18a. But the court nonetheless invalidated the key regulation specifying that, apart from the "wire center" exception, the forward-looking cost of an element "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration," 47 C.F.R. 51.505(b)(1). U.S. Pet. App. 6a-10a.

The Eighth Circuit held that the regulation was contrary to "the plain meaning" of Section 252(d)(1) and thus did not satisfy step one of this Court's *Chevron* analysis. U.S. Pet. App. 8a; see also *id.* at 4a; see generally *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 842-843 (1984) ("First, always, is the question whether Congress has directly spoken to the precise question at issue * * * for the court, as well as the agency, must give effect to the unambiguously ex-

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[5] This Court separately upheld several of the FCC's rules on the merits but invalidated a portion of the FCC's original implementation of the "necessary" and "impair" standards of Section 251(d)(2), see note 1, *supra*, and remanded to the FCC for further rulemaking. See *Iowa Utils. Bd. I*, 525 U.S. at 387-392. The FCC issued an order on remand in December 1999. See *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order and Fourth Further Notice of Proposed Rulemaking (UNE Remand Order)*, 15 F.C.C.R. 3696 (1999), petitions for review pending *sub nom. United States Telecom Ass'n* v. *FCC*, Nos. 00-1015, et al. (D.C. Cir. Jan. 19, 2000).

pressed intent of Congress."). The court noted that Section 252(d)(1) requires that the determination of the "just and reasonable rate" that an incumbent may charge for interconnection or network elements be based on "the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element." U.S. Pet. App. 5a. Emphasizing the word "the" in the final phrase of that provision (*id.* at 7a, 8a), the court concluded that Congress's use of the definite article generally forecloses regulators from looking beyond "the" actual facilities deployed by the incumbent in determining forward-looking costs. *Id.* at 8a-10a.[6]

b. In July 1997, the Eighth Circuit invalidated Rules 315(c)-(f), which require incumbents to combine previously uncombined elements in their networks at the request of new entrants. The court concluded (among other things) that such a requirement was foreclosed by Section 251(c)(3), which states that an incumbent must provide new entrants with "nondiscriminatory access to network elements on an unbundled basis" and "in a manner that allows requesting carriers to combine such elements." The court reasoned that a new entrant's right to "unbundled" elements embodies only a right to "physically separated" elements; that the second sentence of Section 251(c)(3) requires incumbents only to "provide such unbundled network elements in a man-

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[6] After the Eighth Circuit ruled, the FCC and the United States moved for a partial stay of the mandate pending this Court's disposition of the case, explaining that, if the mandate were to issue immediately, it would cause severe and potentially unnecessary disruption in implementation of the 1996 Act. The Eighth Circuit granted that motion and stayed its mandate, pending this Court's review, with respect to the FCC's pricing rules implementing Section 252(d)(1).

ner that allows requesting carriers to combine such elements"; and that the plain language of that sentence, by negative implication, precludes provisions that, like Rules 315(c)-(f), require incumbents to provide new combinations of elements to potential competitors. See 120 F.3d at 813. The court did not discuss Rule 315(b). Each side filed petitions for rehearing arguing for or against the proposition that the court's invalidation of Rules 315(c)-(f) compelled the invalidation of Rule 315(b) as well. In October 1997, the court resolved those petitions in favor of invalidating Rule 315(b). See *id.* at 813, 820.

We sought certiorari to challenge the Eighth Circuit's invalidation of Rule 315(b). This Court reinstated Rule 315(b). *Iowa Utils. Bd. I*, 525 U.S. at 393-395. The Court concluded that Section 251(c)(3) "is ambiguous on whether leased network elements may or must be separated," and that Rule 315(b) is an "entirely rational" means for the FCC to "ensur[e] against an anticompetitive practice." *Id.* at 395. In concluding that nothing in Section 251(c)(3) prevented the FCC from adopting that rule, the Court found that the term "unbundled" in Section 251(c)(3) could refer to separately priced assets as distinguished from "physically separated" assets; the Court also found that the second sentence of Section 251(c)(3) "does not say, or even remotely imply, that elements *must* be provided [in discrete pieces] and never in combined form." *Id.* at 394. The Court did not explicitly address Rules 315(c)-(f).

On remand, the FCC and certain private parties asked the Eighth Circuit to restore Rules 315(c)-(f), arguing that this Court's rationale for reinstating Rule 315(b) applied equally to those rules. The Eighth Circuit rejected that request. U.S. Pet. App. 26a-29a.

Once again, the court held that Congress, in the second sentence of Section 251(c)(3), "has directly spoken on the issue of who shall combine previously uncombined network elements," and stated that "[i]t is the requesting carriers who shall 'combine such elements.'" *Id.* at 28a-29a. The court acknowledged that its holding on that point conflicts with a recent decision of the Ninth Circuit, which sustained, as consistent with the 1996 Act, a state public utility commission's imposition of combinations requirements similar to Rules 315(c)-(f). *Id.* at 27a-28a (citing *US West Communications* v. *MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9th Cir. 1999), cert. denied, 120 S. Ct. 2741 (2000)).

4. The local competition provisions of the 1996 Act are complemented by 47 U.S.C. 254, the provision of the 1996 Act relating to "universal service." For many years, federal and state regulators sought to ensure low rates for subscribers in "high cost" areas through a variety of implicit cross-subsidy mechanisms. For example, incumbent LECs often charged retail rates to customers in densely populated urban areas that well exceeded the cost of serving those customers; those revenues were then used to subsidize the retail rates charged customers in remote rural areas that are much more expensive to serve. Congress recognized that the emergence of local competition would tend to erode the source of such cross-subsidies, as new entrants won the business of customers who would otherwise pay above-cost rates to incumbents. A central objective of Section 254 is to phase out the implicit cross-subsidies and replace them with explicit and competitively neutral funding mechanisms supported by all providers of telecommunications services, including new entrants that provide service through the use of an incumbent LEC's network elements under Section 251(c)(3).

In 1997, the FCC issued rules implementing Section 254 and, among its many other determinations, chose a forward-looking cost methodology similar to TELRIC as a key factor in determining the level of federal funding to supplement state efforts to subsidize affordable service to high cost areas. See *In re Federal-State Joint Board on Universal Service, Report and Order* (*Universal Service Order*), 12 F.C.C.R. 8776 (1997). In 1999, the Fifth Circuit adjudicated various challenges to the *Universal Service Order*. See *Texas Office of Pub. Util. Counsel* v. *FCC*, 183 F.3d 393 (1999). Among its other holdings, that court rejected the argument of certain incumbent LECs that construing Section 254 to permit the use of TELRIC (instead of a historical cost methodology) is barred by the Takings Clause. *Id.* at 413 & n.14. In June 2000, this Court granted a petition for a writ of certiorari on that issue that was filed by GTE, one of the corporate predecessors (along with Bell Atlantic) to Verizon Communications, Inc. See *GTE Serv. Corp.* v. *FCC*, 120 S. Ct. 2214 (No. 99-1244). On November 2, 2000, the Court granted Verizon's unopposed motion to dismiss that case. See 121 S. Ct. 423.

SUMMARY OF ARGUMENT

This case concerns two sets of rules adopted by the FCC to implement the provisions of the 1996 Act that are designed to stimulate competition in local telecommunications markets by giving new entrants a right of access to incumbents' existing networks. One set of rules prescribes the methodology that state public utility commissions are to apply in setting the rates that new entrants must pay in order to interconnect with, and lease elements of, the incumbents' networks. The other set of rules requires that incumbents provide

network elements to new entrants in combined form, if the new entrant requests the combination and agrees to compensate the incumbent for implementing it. Both sets of rules are fully consistent with the text and purpose of the Act, and reflect reasonable policy choices of the expert agency charged with implementing the Act. The court of appeals had no valid basis to set aside any of those rules.

A. In the 1996 Act, Congress sought to encourage the development of competition in local telecommunications markets by enabling new entrants, at rates based on "cost," to interconnect with, and lease elements of, incumbent carriers' existing networks. 47 U.S.C. 252(d)(1); see 47 U.S.C. 251(c)(2) and (3). As the court of appeals recognized, "cost" is a term of some ambiguity. The FCC, after considering various methodologies for determining the costs of providing interconnection and network elements, determined that a methodology based on "forward-looking" costs is both faithful to the Act and necessary to ensure robust local competition.

The forward-looking cost of an asset (*i.e.*, its "economic" or "replacement" cost) reflects the cost, in today's market, of obtaining the functions of the asset that make it valuable. An asset's forward-looking cost necessarily varies with the cost of currently available substitutes that, although not identical to the asset in all respects, perform the same functions. The FCC thus provided that, as a general matter, the forward-looking cost of "network elements" (*i.e.* equipment, facilities, or functions used in the provision of telecommunications service, 47 U.S.C. 153(29)) "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 C.F.R. 51.505(b)(1). The

court of appeals, while upholding the FCC's choice of a methodology based on forward-looking costs, struck down that key rule for measuring such costs.

The court of appeals concluded that the text of the 1996 Act, and specifically Section 252(d)(1), forecloses a methodology that takes into account the costs of efficient, currently available alternatives. But Section 252(d)(1) does not dictate any particular cost methodology. Section 252(d)(1) provides simply that the rate that an incumbent may charge for network elements is to be based on "the cost * * * of providing the * * * network element." That is precisely the cost that the FCC's rule seeks to measure. The FCC's methodology, including its consideration of efficient, currently available alternatives, is directed at determining the forward-looking cost of the element of the incumbent's network that the new entrant seeks to lease. It is not, as the court of appeals apparently believed, directed at determining the cost of something else.

The court of appeals also suggested that the FCC's rule is inconsistent with the 1996 Act because "Congress was dealing with reality, not fantasizing about what might be." U.S. Pet. App. 9a. A primary objective of rate regulation, however, is to establish the price that would exist in a fully competitive market. Given that objective, the more appropriate way to "deal[] with reality" in determining the forward-looking costs of network elements is to take currently available alternatives into account, rather than to pretend that they do not exist. In competitive markets, the price that a firm would pay to lease particular facilities varies with the cost of obtaining the function of those facilities through some other means, including through the use of more efficient substitutes. Taking those substitutes fully into account is not "fantasizing about what might

be," but a routine component of any sensible inquiry into the forward-looking cost of an asset, which approximates the going market price (or current value) of the asset in a competitive market. It is particularly sensible to account for such substitutes when dealing with an industry, such as telecommunications, in which technology changes rapidly.

There is nothing novel about regulators' use of forward-looking cost methodologies that consider the costs of efficient, currently available alternatives. Other federal agencies, with court approval, have employed similar methodologies, based on "hypothetical" costs, for other regulated industries. The FCC's methodology is based on the similar forward-looking methodologies developed by several state public utility commissions, which had already moved to open local telecommunications markets to competition before the enactment of the 1996 Act. Such experience belies concerns, which may underlie the court of appeals' invalidation of the FCC's rule, about the administrability of a forward-looking methodology that considers the costs of efficient, currently available alternatives.

B. The court of appeals also erred in invalidating the FCC's combinations rules, Rules 315(c)-(f), which require incumbent carriers, at the request of a new entrant (and for a cost-based fee), to combine certain elements in their networks that they do not ordinarily combine. Those rules, like the related Rule 315(b) that this Court upheld in *Iowa Utilities Board I*, serve to enforce Congress's mandate that incumbents provide new entrants with "nondiscriminatory access" to network elements. 47 U.S.C. 251(c)(3). Rule 315(b) prohibits an incumbent from separating previously combined network elements over the objection of a new

entrant, whereas Rules 315(c)-(f) allow a new entrant to pay the incumbent to combine previously uncombined network elements in the many instances in which the incumbent may do so more efficiently.

The court of appeals viewed Rules 315(c)-(f) as inconsistent with the second sentence of Section 251(c)(3), which states that an incumbent "shall provide * * * unbundled network elements in a manner that allows requesting carriers to combine such elements." The court drew from that language the negative inference that incumbents cannot be required to provide network elements in combined form. But that sentence simply guarantees new entrants the right, if they so choose, to obtain network elements in a form that allows them to combine those elements themselves. It does not speak to whether the FCC may *also* require incumbents to combine requested network elements when the new entrant is willing to pay for that service. Indeed, the Court expressly rejected the court of appeals' similar reading of that statutory provision in *Iowa Utilities Board I*, recognizing that Section 251(c)(3) "does *not* command th[e] conclusion" that incumbents may be compelled to "leas[e] * * * network elements in discrete pieces" only, and "never in combined form." 525 U.S. at 394 (emphasis added).

Rules 315(c)-(f), like Rule 315(b), are consistent with the text of the 1996 Act, and advance its purpose of encouraging competition in local telecommunications markets. All of those rules are designed to prevent incumbents from imposing unnecessary and often debilitating costs and delays on new entrants that incumbents would not incur when serving their own retail customers—costs and delays that the FCC found could significantly undermine the utility of new entrants' statutory right to enter the marketplace

through the leasing of network elements. The FCC's choice in Rules 315(c)-(f), as in Rule 315(b), to "opt in favor of ensuring against an anticompetitive practice" that incumbents may employ against new entrants "is well within the bounds of the reasonable." *Iowa Utils. Bd. I*, 525 U.S. at 395.

ARGUMENT

I. THE FCC'S CHOICE OF A FORWARD-LOOKING PRICING METHODOLOGY BASED ON THE MOST EFFICIENT TECHNOLOGY CURRENTLY AVAILABLE IS CONSISTENT WITH THE TEXT AND PURPOSE OF THE 1996 ACT

In the 1996 Act, Congress directed that the rate that an incumbent LEC may charge a new entrant for leasing a network element "shall be based on the cost * * * of providing the * * * network element." 47 U.S.C. 252(d)(1). In the order under review here, the FCC made two critical decisions in implementing that statutory standard. First, the FCC determined that the "cost" of "providing" a network element is the *forward-looking* ("economic" or "replacement") cost of the element, *i.e.*, the cost of replacing the features or functions of the element on today's market, not whatever "historical" costs might be reflected on a particular incumbent's accounting books. Second, the FCC determined that ascertaining an element's forward-looking cost involves consideration of the cost of any efficient alternatives currently available on the market, not just alternatives that are physically identical to the facilities currently in place. See *Local Competition Order* (paras. 672-707), J.A. 375-401. In each instance, the FCC made a reasonable policy choice, in an area of its expertise, on a matter that Congress left for the

FCC to resolve. See *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 842-845 (1984).

The court of appeals sustained the first of the FCC's determinations but erroneously rejected the second as inconsistent with the text of the 1996 Act. The court had no basis under *Chevron* to decline to defer to either determination. The FCC's recognition that a forward-looking cost methodology must consider efficient, currently available alternatives, like the FCC's choice of that methodology itself, not only comports with Congress's language, but also advances Congress's purpose of promoting competition in local telecommunications markets. See 1996 Act, preamble, 110 Stat. 56. Indeed, a forward-looking cost inquiry that does *not* take into account the costs of efficient available alternatives would, like a historical cost inquiry, produce rates that turn on choices that a particular incumbent made in the past about which equipment to install or when to install it. It would ignore factors relevant to any carrier's present choices in a competitive market with respect to entry, expansion, and pricing.[7]

1. Congress provided that the "just and reasonable rate" at which an incumbent LEC may lease a network element to a new entrant is a rate "based on the cost * * * of providing the * * * network element." 47

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[7] At the same time that the Court granted our petition for certiorari in this case, the Court granted the petition of Verizon Communications, Inc., in No. 00-511, which challenges the FCC's choice of a pricing methodology based on forward-looking, as opposed to historical, costs. It is necessary to discuss the FCC's decision to adopt a forward-looking methodology in order to explain why such a methodology necessarily, and appropriately, entails a consideration of efficient, currently available alternatives. We will, however, defer our full discussion of that methodology until our response to Verizon's brief on the merits.

U.S.C. 252(d)(1)(A). As the court of appeals recognized, Congress did not itself prescribe how that "cost" is to be determined; rather, Congress left it to the FCC to consider which of the several methodologies for determining "cost" would most appropriately serve the purposes of the 1996 Act. See U.S. Pet. App. 11a ("We conclude the term 'cost,' as it is used in the statute, is ambiguous, and Congress has not spoken directly on the meaning of the word in this context."); cf. *Strickland* v. *Commissioner, Me. Dep't of Human Servs.*, 48 F.3d 12, 19 (1st Cir.) (describing the term "cost" as "one of equivocal meaning") (quoting 20 C.J.S. *Cost* (1940)), cert. denied, 516 U.S. 850 (1995).

The FCC, in determining that the appropriate "cost" of providing a network element, for purposes of 47 U.S.C. 252(d)(1), is the forward-looking cost of that element, found guidance in the central purposes of the 1996 Act: to bring meaningful competition to local telecommunications markets; to ensure the efficient use of existing network facilities, many of which embody significant economies of scale and scope; and to encourage new entrants to make economically rational decisions about whether, or how, to enter a given local market. See *Local Competition Order* (paras. 620, 630, 679, 705-706), J.A. 327-328, 333-334, 379-380, 398-399. The FCC explained that a forward-looking methodology emulates rational economic behavior in a competitive market; a firm considers forward-looking costs, not historical costs, in making decisions about entry, expansion, and price. See *Local Competition Order* (paras. 620, 679, 740), J.A. 327-328, 379-380, 422-423; see also *MCI Communications* v. *AT&T*, 708 F.2d 1081, 1116-1117 (7th Cir.) ("[I]t is current and anticipated cost, rather than historical cost that is relevant to business decisions to enter markets."), cert. denied, 464

U.S. 891 (1983); U.S. Pet. App. 12a (acknowledging that "[f]orward-looking costs have been recognized as promoting a competitive environment which is one of the stated purposes of the Act"). The FCC thus concluded that a forward-looking methodology would send appropriate signals for entry, investment, and innovation to potential competitors in local telecommunications markets. See *Local Competition Order* (paras. 620, 630), J.A. 327-328, 333-334.

Any inquiry into forward-looking costs asks how much it would cost, in today's market, to replace the functions of an item that make it valuable. See pp. 6-9, *supra*. An item's forward-looking cost, like its fair market value, necessarily varies with the cost of currently available substitutes that perform the item's functions. For example, the forward-looking cost (as well as the fair market value) of a personal computer, a video cassette recorder, or a telephone switch declines as more efficient substitutes are introduced into the market; those substitutes, although performing the same functions as the original item, may not resemble the original item in every physical particular. That principle is embodied in the key regulation at issue here, which provides that, as a general matter, forward-looking cost "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 C.F.R. 51.505(b)(1).[8]

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[8] As noted above (p. 9), however, the FCC directed that the inquiry into forward-looking costs is to take as given "the existing location of the incumbent LEC's wire centers" (*i.e.*, switch locations). 47 C.F.R. 51.505(b)(1); see *Local Competition Order* (paras. 683-685), J.A. 382-384. That pragmatic limitation serves to confine the forward-looking cost inquiry to those efficient alternatives that are compatible with the most basic geographic

There is nothing novel about regulators' use of forward-looking cost methodologies that take into account the costs of efficient, currently available alternatives. Other federal agencies, with court approval, have employed similar methodologies, based on "hypothetical" costs, to govern other regulated industries. In the 1980s, for example, the Interstate Commerce Commission employed a forward-looking cost methodology based on "most efficient" alternatives to determine the maximum rate that a market-dominant railroad could charge a coal shipper that was the "captive" of that railroad.[9]

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structure of the existing network. It also enabled the state public utility commissions and the industry to employ existing forward-looking cost models, which typically incorporated a wire-centers limitation as part of their methodology. See generally *Universal Service Order*, 12 F.C.C.R. at 8903-8905. And the FCC observed that this limitation, by encouraging new entrants to save costs "by designing more efficient network configurations," would provide an incentive for new entrants to construct their own facilities. *Local Competition Order* (para. 685), J.A. 383-384.

[9] Under the ICC's standard, the railroad could charge the captive shipper no more than the "stand alone" cost of transporting the coal, defined as the forward-looking cost that the shipper itself would incur were it to transport the coal to its destination using the most efficient railroad system that could be configured to accomplish that task. See Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520, 542-546 (1985), aff'd *sub nom. Consolidated Rail Corp.* v. *United States*, 812 F.2d 1444, 1451, 1457 (3d Cir. 1987); see also Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide*, slip op. 10-13 (unpublished decision issued Feb. 8, 1983) (delineating substantially similar interim standard). The D.C. Circuit, in an opinion joined by then-Judge Scalia, upheld the ICC's use of that methodology. The court reasoned that, although the methodology "deals with hypothetical and not actual transportation situations, it provides an appropriate analytical tool for determining whether a return on noncompetitive

The FCC based TELRIC on the similar, and similarly "hypothetical," forward-looking cost methodologies developed by several state public utility commissions that had already taken steps to open local markets to competition. *Local Competition Order* (paras. 631, 681), J.A. 334-336, 381. The European Commission has endorsed a cost methodology similar to TELRIC—based on a model hypothesizing "an efficient operator employing modern technology"—as a means of opening European telecommunications markets to competition.[10]

Moreover, during the period from 1996 through early 1999 when the FCC's pricing rules were stayed and then vacated by the Eighth Circuit on jurisdictional grounds (see p. 10, *supra*), the overwhelming majority of state public utility commissions independently and voluntarily embraced the essentials of TELRIC, including its consideration of efficient available alternatives, in their implementation of the local-competition provisions of the 1996 Act. See Peter Huber, Michael Kellogg & John Thorne, *Federal Telecommunications Law* § 2.4.4.1, at 185 (2d ed. 1999) ("While the *Iowa*

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traffic 'properly reflects the high demand for the service, but is not set at an unreasonably high or "monopoly" level.' " *Potomac Elec. Power Co.* v. *ICC*, 744 F.2d 185, 193-194 (D.C. Cir. 1984) (quoting interim ICC Guidelines); see also *Consolidated Rail Corp.*, 812 F.2d at 1453-1457 (affirming in full final ICC guidelines); *Burlington N. R.R.* v. *Surface Transp. Bd.*, 114 F.3d 206, 212-215 (D.C. Cir. 1997) (affirming Surface Transportation Board's application of those guidelines).

[10] See *Commission Recommendation on Interconnection in a Liberalised Telecommunications Market (Pt. 1, Interconnection Pricing)*, O.J. 1998 L073/42 ("Interconnection costs should be calculated on the basis of forward-looking long run average incremental costs, since these costs closely approximate those of an efficient operator employing modern technology.").

Utilities Board case was being litigated, most states used their price-setting authority in ways closely following the FCC models.").[11] The federal courts have consistently endorsed that choice on the merits in their review of the state commissions' actions. See, *e.g.*, *GTE S. Inc.* v. *Morrison*, 6 F. Supp. 2d 517, 528-530 (E.D. Va. 1998), aff'd on other grounds, 199 F.3d 733, 742-744, 749 (4th Cir. 1999); see also *Bell Atlantic-Del., Inc.* v. *McMahon*, 80 F. Supp. 2d 218, 235-236 (D. Del. 2000).

2. While affirming the FCC's choice of a forward-looking cost methodology, the Eighth Circuit rejected, as contrary to the text of Section 252(d)(1), the FCC's explanation of what that methodology should measure —*i.e.*, that, for the most part, forward-looking cost "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 C.F.R. 51.505(b)(1). Contrary to the Eighth Circuit's conclusion, just as Congress left it to the FCC to define "cost" for purposes of Section 252(d)(1), Congress left it to the FCC to determine how that "cost" should be calculated. Nothing in Congress's directive that "the just and reasonable rate for network elements * * * shall be based on the cost * * * of providing the * * * network element," 47 U.S.C. 252(d)(1), forecloses consideration of efficient, currently available alternatives.

The Eighth Circuit gave little explanation for its holding beyond the twin observations that (1) "Con-

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[11] Similarly, in their brief opposing the FCC's petition for certiorari on the jurisdictional question in *Iowa Utilities Board* (on the ground that the question was not of sufficient national importance), the Bell companies appeared to acknowledge that "'virtually every state in the union' has adopted pricing policies compatible with the FCC's own notions." Reg'l Bell Operating Cos. Br. in Opp. at 19-20, *Iowa Utils. Bd. I*, Nos. 97-826, et al.

gress intended the rates to be 'based on the cost . . . of *providing the interconnection or network element*'" requested by a new entrant and (2) "Congress was dealing with reality, not fantasizing about what might be." U.S. Pet. App. 8a-9a. Neither observation, however, is at all inconsistent with the FCC's methodology.

First, the Eighth Circuit appears, at the outset, to have misconstrued the statutory term "network element." Congress used that term to describe, at an appropriately high level of generality, the *class* of "facilit[ies]" (or "features, functions, and capabilities") associated with particular tasks within the network. See 47 U.S.C. 153(29) (defining "network element"); see *Iowa Utils. Bd. I*, 525 U.S. at 387 (concluding, given "the breadth of this definition," that the term "network element" is not limited to "physical facilities and equipment," but includes such "features, functions, and capabilities" as directory assistance, caller I.D., and call forwarding). For example, fiber wires and copper wires, despite their physical differences, are both examples of the loop element because they serve the same function. See *Local Competition Order* (para. 380), J.A. 310-311. Similarly, analog switches and digital switches are both examples of the switching element. See *Local Competition Order* (para 412), J.A. 323-324. The Eighth Circuit's decision, however, seems to rest on the erroneous premise that the term "element" is confined to individual pieces of equipment.

Second, the Eighth Circuit apparently thought that regulators, in considering the costs of efficient substitutes, are determining the forward-looking cost of something *other than* the underlying "network element" whose functions the new entrant seeks to obtain. That is simply wrong. As the Eighth Circuit itself recognized, the "cost" inquiry mandated by Section

252(d)(1) is reasonably construed to permit an inquiry into forward-looking cost. The forward-looking cost of an asset turns on the cost of replacing the *functions* of the asset, an inquiry that necessarily entails consideration of any efficient, currently available substitutes that perform those same functions. By definition, then, that inquiry requires examination of the current cost of obtaining those substitutes.[12]

Perhaps the Eighth Circuit thought that the forward-looking inquiry should turn on the cost of replicating an incumbent's existing facilities in every physical particular (rather than simply replacing their functions), whether or not any rational actor would construct such facilities in today's market. But nothing in the language of Section 252(d)(1) remotely compels the adoption of that wooden and long-discredited methodological approach. See *Local Competition Order* (para. 684), J.A. 383 (recognizing that such an approach could produce rates "that reflect inefficient or obsolete network design and technology"); see also *Missouri ex rel. S.W. Bell Tel. Co.* v. *Public Serv. Comm'n*, 262 U.S. 276, 312 (1923) (Brandeis, J., dissenting) (disparaging, as the *least* appropriate cost methodology, an inquiry into "what it would cost to reproduce the identical property").

Third, contrary to the Eighth Circuit's suggestion, the more appropriate way to "deal[] with reality" (U.S.

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[12] To take an example from common experience, a real estate appraiser is still determining the fair market value of one's own house (and not somebody else's), even though the appraiser takes into account the prices at which comparable houses in the neighborhood have sold. Similarly, here, a utility regulator is still determining the forward-looking cost of the incumbent's own facilities, even though the regulator takes into account the costs of other facilities that perform the same functions.

Pet. App. 9a) in determining the forward-looking costs of network elements is to take currently available alternatives into account, rather than to pretend that they do not exist. The central objective of rate regulation has traditionally been to "restore the 'true' market price — the price that would result through the mechanism of a truly competitive market." *Farmers Union Cent. Exch., Inc.* v. *FERC*, 734 F.2d 1486, 1510 (D.C. Cir.), cert. denied, 469 U.S. 1034 (1984); see, *e.g.*, *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 397-398 (1974). In competitive markets, the price that a firm would pay or charge to lease particular facilities varies with the cost of obtaining the function of those facilities through some other means, including through the use of more efficient substitutes; the firm would not arbitrarily blind itself to the availability of such substitutes.

Thus, taking efficient substitutes fully into account is not, as the Eighth Circuit stated, "fantasizing about what might be." It is instead a routine component of any sensible inquiry into the forward-looking cost of an asset, which approximates the going market price (or current value) of the asset in a competitive market. Indeed, it would be unrealistic, in conducting such an inquiry, to omit any consideration of efficient substitutes and to proceed on the assumption that technology has frozen in time and has no bearing on the cost of replacing the functions of an asset. That is particularly true with respect to an industry, such as the telecommunications industry, in which technology changes so rapidly.

An unstated premise of the Eighth Circuit's ruling may have been that an inquiry into the cost of obtaining a given function with "the most efficient telecommunications technology currently available," rather than the technology actually employed by the incum-

bent, would be unduly difficult to administer.[13] We intend to address the administrability of TELRIC generally in our response to Verizon's challenge to that methodology. See note 7, *supra*. The short answer, however, is that regulators and businesses have been engaging, for some years, in inquiries into the costs of efficient available alternatives. See pp. 24-25, *supra*; *Local Competition Order* (para. 681), J.A. 381 ("disagree[ing]," based on the experience of "[a] number of" state commissions with similar forward-looking methodologies, that "the information required to compute prices based on forward-looking costs is inherently so hypothetical as to be of little or no practical value"); David Gabel & David I. Rosenbaum, *Who's Taking Whom: Some Comments And Evidence on the Constitutionality of TELRIC*, 52 Fed. Comm. L.J. 239, 256-257 (2000) (noting examples of telecommunications companies' using forward-looking methodologies in their own pricing decisions well before the FCC's adoption of TELRIC, including BellSouth's use of an analysis that "assumed that the network engineer will * * * select[] the most economically efficient technology"). Moreover, all cost methodologies, including those based on historical costs, involve inquiries that are to some extent "hypothetical." A historical cost methodology, for example, entails inquiries into, among other things, whether, and to what extent, the investments made by a regulated entity in the past were prudent. See, *e.g.*, *City of New Orleans* v. *FERC*, 67 F.3d 947, 954 (D.C.

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[13] The Eighth Circuit did not describe what sort of forward-looking methodology it would consider permissible under the 1996 Act. Nor has such a description yet been offered by the incumbent LECs, such as Verizon, which oppose *any* forward-looking methodology.

Cir. 1995). And a replication or reproduction cost methodology entails inquiries into the cost, in today's market, of duplicating the precise facilities that were constructed years ago and that may since have become obsolete or unavailable.

In sum, the FCC's determination that the forward-looking cost inquiry must consider the costs of efficient, currently available alternatives is consistent with the text of Section 252(d)(1) and reasonably seeks to advance the 1996 Act's pro-competitive purposes. The court of appeals thus erred in invaliding 47 C.F.R. 51.505(b)(1).

II. THE COMBINATIONS RULES AT ISSUE HERE, LIKE THE ONE UPHELD IN *IOWA UTILITIES BOARD I*, ARE CONSISTENT WITH THE TEXT OF THE 1996 ACT AND PROMOTE CONGRESS'S PURPOSE OF ASSURING REASONABLE AND NONDISCRIMINATORY ACCESS TO INCUMBENTS' NETWORKS

The Eighth Circuit also erred in vacating the FCC's Rules 315(c)-(f) governing the combination of network elements. See 47 C.F.R. 51.315(c)-(f). The court of appeals' ruling is predicated on a strained "plain language" reading of the statute that is, in all pertinent respects, indistinguishable from the analysis that this Court rejected in *Iowa Utilities Board I*, 525 U.S. at 394-395. The FCC's rules, by contrast, reflect a reasonable reading of ambiguous statutory language and promote the purposes of the statute by deterring a species of discriminatory conduct by incumbents against new entrants.

1. a. Rules 315(c)-(f) are part of a package of regulations implementing the important provision of the

1996 Act, codified at 47 U.S.C. 251(c)(3), that requires incumbent LECs to grant new entrants access to network elements for a just and reasonable cost-based fee. Those regulations also include Rule 315(b), which was upheld by this Court in *Iowa Utilities Board I*.

Section 251(c)(3) provides, in pertinent part, that each incumbent LEC has:

> [t]he duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory * * *. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.

47 U.S.C. 251(c)(3); see *Iowa Utils. Bd. I*, 525 U.S. at 394-395 (discussing Section 251(c)(3)).

Section 251(c)(3) thus grants new entrants the right, among other things, to lease network elements on an "unbundled" basis—that is, to select those elements that they need, without also being forced to use and pay for elements that they do not need or that they can more efficiently provide themselves or obtain elsewhere. See *Iowa Utils. Bd. I*, 525 U.S. at 394-395. New entrants often need more than just a single network element, however. In those instances in which new entrants need "combinations" of network elements, the additional mandate of Section 251(c)(3) that incumbents offer "nondiscriminatory access" on "reasonable" terms prohibits incumbents from imposing arbitrary and

economically wasteful limitations on access that would not apply to their own retail operations.

Section 251(c)(3) serves a crucial role in opening local markets to competition. Virtually no competitor, with current technology, could replicate an incumbent's entire network, at least in the short term. While resale is one competitive option, that option limits new entrants to competing only on price, and only within the margin between the incumbent's retail price and the wholesale discount required under 47 U.S.C. 251(c)(4) and 252(d)(3). See *Local Competition Order* (para. 332), J.A. 307. Access to unbundled network elements, on the other hand, provides new entrants with the ability to compete broadly with incumbents, not just as to price, but also as to product, since network elements may be capable of performing functions that incumbents have not chosen to offer to their retail customers, but that new entrants may incorporate into their own offerings. See *Local Competition Order* (paras. 332-333), J.A. 307-308.

b. The FCC adopted its various combinations rules to implement comprehensively the nondiscrimination mandate of Section 251(c)(3) in the varied instances in which a new entrant might require more than one network element. Rule 315(b), the first in the package of combinations rules, applies to *existing* network element combinations, *i.e.*, those that the incumbent LEC "currently combines" for itself. Rule 315(b) prohibits the incumbent, "[e]xcept upon [the competitor's] request," from disconnecting those network elements and providing them only in "separate[d]" form. 47 C.F.R. 51.315(b). As the Court recognized in *Iowa Utilities Board I*, Rule 315(b) enforces the nondiscrimination mandate of Section 251(c)(3) by "preventing incumbent LECs from 'disconnect[ing] previously con-

nected elements * * * not for any productive reason, but just to impose wasteful reconnection costs on new entrants.'" 525 U.S. at 395.

Rules 315(c)-(f), the remaining combinations rules, address the incumbent LEC's duty to provide new entrants with a meaningful opportunity to obtain *new* combinations of existing network elements. That duty is set out principally in Rule 315(c), which requires an incumbent LEC, at the request of a new entrant and for a reasonable cost-based fee, to combine network elements "even if those elements are not ordinarily combined" within the incumbent's network. 47 C.F.R. 51.315(c).[14] Rule 315(c) advances the nondiscrimination requirement of Section 251(c)(3) by allowing new entrants to pay the incumbent to combine network elements in the many instances in which the incumbent may do so more efficiently, thereby enabling new entrants to avoid unnecessary and often debilitating costs and delays that an incumbent would not suffer

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[14] The duty set forth in Rule 315(c) applies only where the requested combination is "[t]echnically feasible" and only where compliance with the request "[w]ould not impair the ability of other carriers to obtain access to unbundled network elements or to interconnect with the incumbent LEC's network." 47 C.F.R. 51.315(c)(1) and (2). Rules 315(d), (e), and (f) supplement or clarify the basic obligation of Rule 315(c) in various ways that the Eighth Circuit did not consider independently problematic. Rules 315(e) and (f) provide state public utility commissions with specific guidance on the application of the two qualifications to the general duty stated in Rule 315(c). 47 C.F.R. 51.315(e) and (f). Rule 315(d) imposes on incumbent LECs a related duty to "perform the functions necessary to combine unbundled network elements with elements possessed by the requesting telecommunications carrier in any technically feasible manner." 47 C.F.R. 51.315(d). In all cases, the requesting carrier would have to pay the reasonable cost of effecting a combination.

when serving its own retail customers. See *Local Competition Order* (paras. 293-294), J.A. 295-297; see also *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order and Fourth Further Notice of Proposed Rulemaking* (*UNE Remand Order*), 15 F.C.C.R. 3696, 3909-3910 (1999) (para. 481), petitions for review pending *sub nom. United States Telecom Ass'n* v. *FCC*, Nos. 00-1015, et al. (D.C. Cir. Jan. 19, 2000).

c. In its first *Iowa Utilities Board* decision, the Eighth Circuit struck down all of the FCC's combinations rules based on a single integrated analysis. See 120 F.3d at 813. Focusing on two portions of Section 251(c)(3), the court of appeals ruled that—whether one considers network elements that are already combined by an incumbent LEC or new combinations of network elements sought by a competitor—the FCC had no statutory basis to require incumbents to provide new entrants with access to network elements in combined form. The Eighth Circuit reasoned, first, that the term "unbundled" in the first sentence of Section 251(c)(3) means disconnected or "uncombined," and that Section 251(c)(3) therefore "requires an incumbent LEC to provide access to the elements of its network only on an unbundled (as opposed to a combined) basis." *Ibid.* Second, drawing a negative inference from language in the second sentence of Section 251(c)(3) that requires incumbents to provide access to network elements "in a manner that allows requesting carriers to combine such elements," the court of appeals concluded that the provision "unambiguously indicates that requesting carriers will combine the unbundled elements themselves." *Ibid.*

On review of that decision in *Iowa Utilities Board I*, this Court reinstated Rule 315(b), the only one of the

combinations rules then before the Court, while rejecting the court of appeals' rationale for striking down all of the combinations rules. First, the Court disagreed with the court of appeals' construction of the statutory term "unbundled" as meaning "physically separated," noting that "the only [dictionary] definition given * * * matches the FCC's interpretation of the word: 'to give separate prices for equipment and supporting services.'" *Iowa Utils. Bd. I*, 525 U.S. at 394. Second, the Court found that the requirement in the second sentence of Section 251(c)(3) that incumbents provide access to network elements in a manner that "'allows requesting carriers to combine' them * * * does not say, or even remotely imply, that elements *must* be provided only [in discrete pieces] and never in combined form." *Ibid.* To the contrary, the Court found that Rule 315(b), with its purpose of preventing incumbent LECs from "impos[ing] wasteful reconnection costs on new entrants," is an "entirely rational" application of Section 251(c)(3)'s nondiscrimination requirement. *Id.* at 395.

Because this Court's decision in *Iowa Utilities Board I* with respect to Rule 315(b) undermines the Eighth Circuit's rationale for invalidating all of the combinations rules, the FCC and others asked the court of appeals on remand to reinstate Rules 315(c)-(f).[15] In response, the court of appeals reconsidered the validity

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[15] In the interim, the Ninth Circuit concluded that this Court's reasons for upholding Rule 315(b) apply equally to, and thus had undermined the Eighth Circuit's analysis with respect to, combinations requirements such as those contained in Rules 315(c)-(f). See *US West Communications* v. *MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9th Cir. 1999), cert. denied, 120 S. Ct. 2741 (2000); *MCI Telecomms.* v. *U.S. West*, 204 F.3d 1262, 1268 (9th Cir. 2000).

of Rules 315(c)-(f),[16] but ultimately reaffirmed its original holding that those Rules "violate the plain language" of Section 251(c)(3). U.S. Pet. App. 29a.

2. The court of appeals' decision on remand once again to invalidate Rules 315(c)-(f) on the basis of an alleged plain language reading of Section 251(c)(3) conflicts with this Court's reading of that provision in *Iowa Utilities Board I*. Nothing in Section 251(c)(3) gives incumbent LECs the right to force new entrants to combine network elements themselves, even when the incumbents can do the combining more efficiently and the new entrants will pay the incumbents to do so. To the contrary, the FCC has ample authority to prohibit such conduct in light of Congress's directive in Section 251(c)(3) that an incumbent provide new

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[16] See Order at 2-3, *Iowa Utils. Bd.* v. *FCC*, No. 96-3321 (8th Cir. June 10, 1999) ("The briefs should also address whether or not, in light of the Supreme Court's decision, this court should take any further action with respect to * * * § 315(c)-(f)."). In opposing our petition for certiorari and those of other parties with respect to this question, Verizon suggested that we "forfeited" our opportunity to challenge the court of appeals' invalidation of Rule 315(c)-(f) by not having done so in *Iowa Utilities Board I*. See Verizon et al. Br. in Opp. 13-16, *WorldCom, Inc.* v. *Verizon Communications, Inc.*, Nos. 00-555, et al. For reasons that we explained in our reply brief at the petition stage, our decision not to seek review of the court of appeals' invalidation of Rules 315(c)-(f) in *Iowa Utilities Board I* should not preclude our doing so now, especially given the emergence of a circuit conflict, acknowledged by the court of appeals in this case, concerning the scope of the duty to provide access to network element combinations under Section 251(c)(3). See No. 00-587 U.S. Reply Br. 6-8. Indeed, the Eighth Circuit itself reopened the question of the validity of Rules 315(c)-(f) after this Court's decision in *Iowa Utilities Board I* and ruled anew on that question in the decision on review here. This Court granted certiorari on that question. See Order 3-4, *Verizon Communications* v. *FCC*, Nos. 00-511, et al. (Jan. 22, 2001).

entrants with "nondiscriminatory access" to its network and Congress's overriding purpose in the 1996 Act to stimulate competition in local telecommunications markets.

a. On remand, the court of appeals again focused, as it had in its earlier decision invalidating the combinations rules, on the second sentence of Section 251(c)(3), which states that an incumbent LEC must provide unbundled elements "in a manner that allows requesting carriers to combine such elements." U.S. Pet. App. 28a (quoting 47 U.S.C. 251(c)(3)). The court reasoned that "Congress has directly spoken on the issue of who shall combine previously uncombined network elements," and that "[i]t is the requesting carriers who shall 'combine such elements.'" *Id.* at 28a-29a. The court was mistaken.

The statutory sentence upon which the court of appeals relied simply guarantees new entrants the right, if they so choose, to obtain network elements in a form that allows them to combine the network elements themselves. It does not speak to whether the FCC may *also* require incumbents to combine requested network elements when the new entrant is willing to pay for that service. Indeed, this Court expressly addressed the same statutory language in *Iowa Utilities Board I*. The Court recognized that, although the second sentence of Section 251(c)(3) "contemplates that elements *may* be requested and provided" in "discrete pieces," it "does not say, or even remotely imply, that elements *must* be provided only in this fashion and never in combined form." 525 U.S. at 394. Similarly, there is no basis here to conclude that, because that same sentence confers on new entrants the right to combine elements of the incumbent's network, it precludes the FCC from issuing rules recognizing a new entrant's additional

right to have an incumbent combine those elements for a cost-based fee. Cf. *id.* at 397 (recognizing that "[w]e can only enforce the clear limits that the 1996 Act contains").

The court of appeals sought to distinguish the question presented in *Iowa Utilities Board I* with respect to Rule 315(b), which the court characterized as "whether the [1996] Act prohibited the combination of network elements," from the question presented on remand with respect to Rules 315(c)-(f), which the court characterized as "*who* shall be required to do the combining." U.S. Pet. App. 28a. But none of the combinations rules presents the question whether Section 251(c)(3) *prohibits* the combination of network elements (even if a new entrant requests a combination and the incumbent is willing to provide it). The incumbents would not have asked for such a ruling, which would curtail their own freedom to provide combinations when it suits them, and Section 251(c)(3) could not plausibly be read to impose such a prohibition. Instead, all of the combinations rules, Rule 315(b) as well as Rules 315(c)-(f), raise the same question of "*who* shall be required to do the combining," whether the combination is an existing one made by the incumbent for its own business purposes (the circumstance addressed by Rule 315(b)) or is a new one that the new entrant requests and compensates the incumbent for making (the circumstance addressed by Rules 315(c)-(f)). This Court's determination that the second sentence of Section 251(c)(3) "does not say, or even remotely imply" that incumbents cannot be required to provide network elements in combined form, *Iowa Utils. Bd. I*, 525 U.S. at 394, vitiates the "plain language" basis for the court of appeals' ruling on remand.

b. In *Iowa Utilities Board I*, after concluding that Rule 315(b) satisfies step one of the *Chevron* analysis because "§ 251(c)(3) is ambiguous on whether leased network elements may or must be separated," the Court considered whether Rule 315(b) also satisfies step two of that analysis. See *Chevron*, 467 U.S. at 845 (once a count determines that Congress did not express its intent on a given issue, the only question that remains is whether the agency's resolution of that issue "is a reasonable one"). The Court recognized that Rule 315(b), which "find[s] its basis in § 251(c)(3)'s nondiscrimination requirement," is designed to prevent incumbent LECs from disconnecting previously combined network elements "not for any productive reason, but just to impose wasteful reconnection costs on new entrants." *Iowa Utils. Bd. I*, 525 U.S. at 395. The Court concluded that "[i]t is well within the bounds of the reasonable for the Commission to opt in favor of ensuring against [that] anticompetitive practice" by promulgating Rule 315(b). *Ibid.*

The same analysis should apply here. Rules 315(c)-(f), like Rule 315(b), are based on Section 251(c)(3)'s requirement that incumbent LECs provide "nondiscriminatory access" to their networks on "reasonable" terms and conditions. Moreover, Rules 315(c)-(f), like Rule 315(b), are designed to "ensur[e] against an anticompetitive practice" of incumbents. *Iowa Utils. Bd. I*, 525 U.S. at 395. Here, the anticompetitive practice is an incumbent's refusal to combine network elements, which the incumbent has the technological capability to combine but which the incumbent has not combined for its own business purposes, when a new entrant requests the combination and agrees to compensate the incumbent to effectuate the combination. Such a practice, like the similar practice addressed by Rule

315(b), typically is engaged in by incumbents "not for any productive reason," *ibid.*, because the new entrant will compensate the incumbent for its costs in combining the network elements. Instead, incumbents engage in the practice "just to impose wasteful * * * costs on new entrants," *ibid.*, because a new entrant would combine the elements itself if it could do so more efficiently, and thus at lower cost, than could the incumbent. A new entrant has no interest in incurring *unnecessary* costs to obtain network element connections.

Thus, Rules 315(c)-(f), like Rule 315(b), are designed to prevent incumbents from erecting barriers to new entrants' access to network element combinations that incumbents themselves would not encounter. The FCC found that incumbent LECs "routinely" create new network element combinations for themselves when it serves their own business purposes to do so. *UNE Remand Order* (para. 481), 15 F.C.C.R. at 3909-3910. That is surely the case, for instance, when incumbents provide their own customers with a "second line" (*e.g.*, for a computer, a home business, or a teen-ager), or when they provide dedicated lines to high-end customers. *Ibid.* Rules 315(c)-(f) prevent incumbents from arbitrarily impeding the ability of new entrants also to provide such combinations. *UNE Remand Order* (paras. 481-482), 15 F.C.C.R. at 3909-3910.[17] Indeed, the FCC has found that the refusal of

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[17] The FCC has thus far withheld judgment on the question whether Rule 315(b) preserves a new entrant's right to obtain combinations of network elements that are "ordinarily combined" in the incumbent's network, even if the particular facilities at issue are not yet connected. See *UNE Remand Order* (para. 479), 15 F.C.C.R. at 3908-3909.

incumbents to combine network elements sought by new entrants not only is discriminatory, but significantly undermines the utility of the statutory right of prospective competitors to enter the marketplace through the leasing of network elements. See *Local Competition Order* (paras. 293-294), J.A. 295-297; *UNE Remand Order* (paras. 481-482), 15 F.C.C.R. at 3909-3910.

c. To be sure, new entrants may, under the Eighth Circuit's ruling, combine network elements themselves. But that strategy for obtaining combinations may not be available to new entrants in all instances. The FCC has found that "practical difficulties," such as a new entrant's lack of information about the incumbent's network, may "in practice" make it "impossible" for the new entrant to make new combinations of network elements without the incumbent's assistance. *Local Competition Order* (paras. 293-294), J.A. 295-297.

Moreover, even where a new entrant has the technical ability to combine elements itself, the incumbents have imposed other obstacles to the new entrant's doing so. For instance, incumbents often have prohibited new entrants from making connections unless they first purchase collocation space—for which charges can run into the hundreds of thousands of dollars—in the incumbents' central offices. See *UNE Remand Order* (paras. 263, 482), 15 F.C.C.R. at 3815-3816, 3910 (citing *In re Application of BellSouth Corp., et al., for Provision of In-Region, InterLATA Services in Louisiana*, 13 F.C.C.R. 20599, 20703-20705 (1998) (para. 168)).[18] Such restrictions not only are anti-

[18] Verizon has suggested that, in granting Verizon authority to provide long-distance services in New York, the FCC endorsed such restrictions as consistent with Section 251(c)(3). See Verizon

competitive, but also defeat the purpose of some network element combinations, which are designed, at least in part, to avoid the need to purchase collocation space.[19] Such restrictions also undermine the assump-

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Br. in Opp. 21-22 & n.15 (citing *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Sevices in the State of New York*, 15 F.C.C.R. 3953, 4078-4079 (1991) (paras. 231-232)). That contention mischaracterizes the FCC's ruling. Due to the expedited nature of proceedings under Section 271, compliance with the "competitive checklist" prerequisites to Bell company entry into the long-distance market is determined in light of interpretations of the FCC's rules in existence at the time the application is filed. See *AT&T* v. *FCC*, 220 F.3d 607, 631-632 (D.C. Cir. 2000). In the cited order, the FCC noted that its finding that Verizon had satisfied the prerequisites for entry in the long-distance market under 47 U.S.C. 271 was predicated on the Eighth Circuit's decision to vacate Rules 315(c)-(f) and on the view that, "[g]iven this vacuum, * * * it would be inequitable to penalize [Verizon] for complying with the rules established by the New York Commission." 15 F.C.C.R. at 4080 (para. 236) & n.753. That ruling does not constitute an endorsement of the Eighth Circuit's view of Section 251(c)(3) or of the reasonableness of Verizon's conduct in the absence of the Eighth Circuit's decision.

[19] That would be the case with respect to the so-called "enhanced extended link" (or EEL), which consists of the combination of a local loop and dedicated transport from the loop's end office to another central office. See *UNE Remand Order* (para. 477), 15 F.C.C.R. at 3908. A new entrant with some switches of its own, but without collocation space at each end office, may seek to use this network element combination in order to serve customers whose loops are connected to end offices other than those at which the new entrant has a switch. Incumbents customarily require new entrants first to purchase special access service under tariff in place of the dedicated transport network element, and then to convert to the EEL once the "combination" has thereby been created. *UNE Remand Order* (paras. 480-481), 15 F.C.C.R. at 3909-3910.

tion underlying the Eighth Circuit's invalidation of the combinations rules that incumbents "would rather allow entrants access to their networks than have to rebundle the unbundled elements for them." 120 F.3d at 813.

Other practices of incumbent LECs since the Eighth Circuit vacated Rules 315(c)-(f) further demonstrate the need for those rules as a protection against discrimination. One such practice involves the so-called "UNE platform" (or UNE-P)—the "entire pre-assembled network" that incumbents must provide to new entrants pursuant to Rule 315(b). See *Iowa Utils. Bd. I*, 525 U.S. at 395. To date, the UNE platform has been the most important vehicle for competitive entry into local markets for residential and small business customers, because the UNE platform allows new entrants to lease all of the facilities needed for providing local service to those customers at their forward-looking cost. See *UNE Remand Order* (para. 12), J.A. 15 F.C.C.R. at 3702-3703; Comments of the Competitive Telecommunications Ass'n at 49-51, CC Dkt. No. 96-98, (filed May 26, 1999). Yet, many incumbents, citing the Eighth Circuit's vacatur of Rules 315(c)-(f), are refusing to make the UNE platform available to new entrants, except when the new entrant wins over a customer of the incumbent at the customer's existing location, *i.e.*, where there is an existing combination that falls squarely within the scope of Rule 315(b). Thus, when a customer moves from one location to another, even within the same building, an incumbent may claim that the connection at the new location constitutes a "recombination" outside the scope of Rule 315(b). See, *e.g.*, Comments of the ALTS at 79, CC Dkt. No. 96-98 (filed May 26, 1999). The incumbent may do so even though no new physical connection is required

and the incumbent can activate an existing connection through a few simple computer keystrokes.

In sum, the court of appeals and the incumbent LECs view the 1996 Act as requiring incumbents to share their networks only in narrowly circumscribed ways. Thus, even if combining network elements costs them nothing because they will be fully compensated for the economic cost of doing so, and even if refusing to combine network elements results in the wasteful, inefficient, and discriminatory imposition of costs on competitors, the incumbents assert that the FCC is without authority to require incumbents to combine network elements, because the 1996 Act, while referencing a duty to provide elements in unbundled form, does not expressly reference a duty to combine. But nothing in the text or purpose of the Act suggests that Congress intended a result so contrary to its central purpose of encouraging competition in local telecommunications markets by, *inter alia*, providing new entrants with "nondiscriminatory access" to incumbents' network elements on "reasonable" terms and conditions. 47 U.S.C. 251(c)(3). The FCC's requirement that incumbents perform the combinations sought by new entrants—if the combination is "[t]echnically feasible," 47 C.F.R. 51.315(c), and if the new entrant bears the costs—is "well within the bounds of the reasonable." *Iowa Utils. Bd. I*, 525 U.S. at 395.

CONCLUSION

The decision of the court of appeals should be reversed insofar as it vacated 47 C.F.R. 51.505(b)(1) and 47 C.F.R. 51.315(c)-(f).

Respectfully submitted.

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APRIL 2001

APPENDIX

The parties to the proceeding are as follows:

The petitioners in this Court in No. 00-587 are the United States and the Federal Communications Commission.

The respondents are:

Ad Hoc Telecommunications Users Committee
Airtouch Communications, Inc.
Alabama Public Service Commission
American Communications Services, Inc.
Ameritech Corporation
AT&T Corporation
BellSouth Corp.
California Public Utilities Department
Cincinnati Bell Telephone Company
Citizens Telephone Company of Kecksburg
Comcast Corporation
Concord Telephone Company
Consumers' Utility Counsel Division, Governor's Office of Consumer Affairs
Contel of Minnesota, Inc.
Contel of the South, Inc.
Department of Public Utilities of the Commonwealth of Massachusetts
Excel Telecommunications, Inc.
General Communications, Inc.
GST Telecom, Inc.
GTE Alaska, Inc.
GTE Arkansas, Inc.
GTE Midwest, Inc.
GTE Service Corporation
GTE Southwest, Inc.
ICG Telecom Group, Inc.

Information Technology Industry Council
Iowa Utilities Board
Jones Intercable, Inc.
Kansas Corporation Commission
Kentucky Public Service Commission
KMC Telecom, Inc.
Maryland Public Service Commission
MCI Telecommunications Corporation
Mid-Sized Incumbent Local Exchange Carriers
Mississippi Public Service Commission
National Cable Television Association
National Rural Telecom Association
National Telephone Cooperative Association
New York State Department of Public Service
North Carolina Utilities Commission
North State Telephone Company
Oregon Public Utility Commission
Organization for the Promotion and Advancement of Small Telecommunications Companies
Pennsylvania Public Utility Commission
People of the State of California & PUC of California
Public Utilities Commission of the State of Colorado
Public Service Commission of Wisconsin
Public Service Commission of the State of Montana
Qwest Communications
Rock Hill Telephone Company
Roseville Telephone Company
Rural Telecommunications Group
Rural Telephone Coalition
SBC Communications, Inc.
South Dakota Public Utilities Commission
Sprint Communications Company
Sprint Corporation

Sprint PCS
Sprint Spectrum, L.P.
State of Texas
Telecommunications Resellers Association
Texas Office of Public Utility Counsel
The Ad Hoc Coalition of Telecommunications Manufacturing Companies
The Competition Policy Institute
United States Telecom Association
US Telephone Association
Verizon California, Inc. (formerly GTE California, Inc.)
Verizon Communications, Inc. (formerly Bell Atlantic Corp.)
Verizon Florida, Inc. (formerly GTE Florida, Inc.)
Verizon Hawaii Int'l, Inc. (formerly GTE Hawaiian Tel. Co., Inc.)
Verizon North, Inc. (formerly GTE North, Inc.)
Verizon Northwest, Inc. (formerly GTE Northwest, Inc.)
Verizon South, Inc. (formerly GTE South, Inc.)
Verizon West Coast, Inc. (formerly GTE West Coast, Inc.)
Virginia State Corporation Commission
Winstar Communications