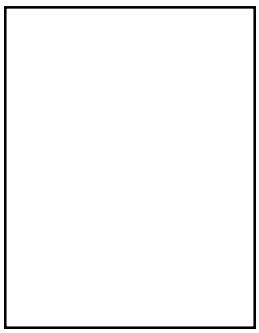
The Telecommunications Act of 1996 and the FCC's "Spin"

John C. Wohlstetter



Mr. John C. Wohlstetter, a Washington attorney, is Director of Technology Affairs for GTE Service Corporation. His primary responsibility at GTE is strategic assessment of technology, regulatory, and market trends. From 1986 to 1988, he served as senior advisor to the Committee on Review of Synchronization, Switching, and Network Control in National Security Telecommunications. Its report, *Growing Vulnerability of the Public Switched Networks: Implications for National Security Emergency Preparedness*, was issued by the National Research Council, the operating arm of the National Academy of Sciences. He has 18 years experience in the telecommunications industry with Contel and then with GTE.

Passage of the Telecommunications Act of 1996 touched off the predictable avalanche of learned—and other—commentary as to what the new world will bring consumers, investors, and various industry players. Needless to say, this rush is but the beginning of a continuing flood—one thing the bill is sure *not* to bring is *tranquillity*.

The bill marks a genuine watershed in the industry's history—a cliché, but as is often the case, true, if less soul-satisfying than poetry. It supplants a six-decade-old law enacted when radio was not yet commonplace and television not yet even a curio. Digital communication was the stuff that techno-dreams were made of. And cyberspace-inspired flights of imagination would have qualified as a medical dictionary entry (*delusions, schizophrenic*).

From the standpoint of regulation, two questions invariably arise in the wake of passage of major legislation:

(1) How will the legislative design, as evidenced from the bill text and associated commentary, reshape the present regulatory landscape?
(2) Will the Federal Communications Commission (FCC) confine itself to furthering the legislative design, or instead will the agency seek to circumvent elements of the design it finds unappealing?

This second question reflects realities of Washington practice. Legal language rarely being a model of clarity, an agency may put its own "gloss" on legislation—at times, in ways not anticipated by the lawmakers.

The Legislative Design: Competition and Eventual Deregulation—*Vive La Différence!*

The legislation that capped a 19-year procession of hearings, draft bills, and end-of-session pile-ups finds a marketplace radically different from that envisioned in 1977. In those days, telecom deregulation meant competition in long distance and monopoly in the local loop; the mantra today for every market is "compete, compete, compete!" "Terminal equipment" then meant a PBX; today, the modem and file server are center stage. The PC was not even on the horizon of policy makers (to Beltway denizens, Apple denoted a fruit). Optical fiber was first deployed that year, and ISDN concepts were being floated in standards groups. The idea of auctioning spectrum was to the great mass of the policy wonk set unthinkable—not merely wrong, but a betrayal of the public trust.

But times have changed. The perceived success of long distance competition and divestiture, plus the explosive growth of the personal computer market and the emergent growth of the Internet, plus a more market-minded Congress, came together and led to

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passage of a bill whose stated policy goals are to promote competition and foster eventual deregulation.

The biggest short-term change in federal telecom regulation is that Judge Greene, at long last, finally gets his long-overdue gold watch. Yet, for the regional Bell operating companies, Judge Greene's retirement is a "good news/bad news" proposition: with the withdrawal of the courts from supervision over RBOC business entry, federal regulatory power has been consolidated at the FCC.

The Telecom Act seeks competition, open entry, and eventual emancipation of established carriers from barnacle-encrusted restraints. But, it also mandates extensive interconnection obligations and an expansive, evolving definition of universal service.

The act has four cornerstones:

(1) The *social* aspect, embodied in universal service and Internet content policy.
(2) The *economic* aspect, embodied in interconnection and pricing policies.
(3) The *structural* aspect, embodied in differential levels of regulation between classes of providers.
(4) The *vision* aspect, facilities-based competition, embodied in the act's "two-wire" policy.

This article focuses on the economic aspect, and discusses the universal service and vision aspects only insofar as they may affect the economics of telecom competition. (Structure is not covered.)

The FCC: Interpretive License As Poetic License—*Plus Ça Change!*

The attitude of key agencies may prove of greater import than the letter of the law. Looking at the four cornerstones of the act through the lenses of the FCC presents a picture whose elements combine social activism and economic micro-management of the transition to competition.

Already, the FCC has clashed with the Congress on the interpretation of the act's provisions on RBOC structural separation and universal service. Congress, for its part, takes a more liberal view of RBOC entry and a less expansive view of universal service than the FCC.[1] Meanwhile, the U.S. Court of Appeals for the Eighth Circuit agreed on October 15 to stay the pricing provisions of the FCC's interconnection rulemaking until it considers broader challenges to the rules in January 1997.

The Economic Aspect: The FCC Rewrites the Great Compact

Interconnection is regarded by many regulators as the siege engine that will breach what they see as the walls of the citadel of the local exchange. The new law requires carriers to negotiate in good faith, and entitles *any* party to bring in the state PUC to mediate logjams; the entire process is to be completed within nine months.[2]

Any question concerning the extent to which the FCC was prepared to go in pursuing its own vision was answered with the release of the most massive order in the agency's 62-year existence, proposing detailed rules governing the interconnection, unbundling, and assorted arrangements LECs must enter into—in the case of the RBOCs, the set of conditions prerequisite to their winning entry into long distance and equipment markets.[3]

The *Interconnection Order* imposes an extraordinarily sweeping regulatory regime in the name of implementing an act aiming for deregulation. In it, the FCC:

- Uses the general legislative policy goal of promoting competition to confer authority for the agency to promulgate national standards where no substantive authority is expressly granted in the act (e.g., national standards for interconnection agreements prior to state PUC review mandated by the act).
- Uses "necessary to implement" authority under the act with respect to certain policy areas to bootstrap substantive implied authority over other policy areas (e.g., setting national pricing standards without express authorization to do so).
- Selectively relies on rules of statutory construction—using them to expand the agency's authority while denying their applicability in contexts where the result would be to curtail agency power (e.g., applying the maxim *inclusio unius est exclusio alterius* [to include one is to exclude others] to deny LEC costs as a factor in determining technical feasibility of interconnection points).
- Discounts the value of legitimate LEC competitive advantages—notably, the value of LEC innovation is subordinated to aiding new entry; also, outright denial of LEC ability to exploit *any* economies of scale or scope (e.g., unbundling of various network elements).
- Adopts a cost model that grossly under-compensates local exchange carriers for use of their facilities by

competitors, in violation of the Fifth Amendment of the U.S. Constitution.

Each of these points bears discussion.

General Legislative Policy

The plainest example of the FCC's use of general federal policy to supersede the legislative design is with respect to interconnection pricing standards. The law provides that interconnection and network element charges shall be determined by *state commissions*, at rates that are "just," "reasonable," and "non-discriminatory." Rates must be based upon cost and "may include" a "reasonable profit."[4]

The FCC attempts to "piggyback" pre-emption authority for new section 252 (negotiations) off of 251 (duty to interconnect).[5] This turns traditional statutory construction on its head, i.e., specific provisions supersede general propositions (else exceptions written into law could never stand); 252 mentions the FCC *only* in connection with stepping in *if a state refuses to act*.[6] Hence, there is *no* legal basis justifying imposition of *any* specific national standards; *broad principles*—e.g., equal terms and conditions, non-discrimination—pass muster, but not *specific rules*.

The law does provide that nothing a state does can create barriers to entry as to either inter- or intrastate service, and empowers the FCC to intervene and use its federal pre-emption authority to void the rule. Such power, however, arises *only if a state first acts illegally*.[7] Finding that demographic and territorial variation among states is insufficient to outweigh the need for national standards constitutes the plainest repudiation of the federalist approach taken in the Telecom Act.[8]

"Necessary to Implement" Authority

The FCC finds (conveniently) pre-emptive authority by *necessary implication* despite the fact that Congress declined to expressly supersede section 2(b) of the 1934 Communications Act, calling its (the FCC's) interpretation "*the only reasonable way* to reconcile the various provisions of sections 251 and 252, and the statute as a whole."[9] Thus, *if there is another "reasonable way"* to reconcile the 1934 and 1996 Acts, then a reviewing court should vacate and remand here, as in such event implied pre-emption would not be *necessary*.[10]

The FCC cites express power granted in other sections of the Telecom Act to support authority under 251 and 252.[11] This runs counter to a traditional rule of statutory construction: the rule presumes the legislature knows what it wants to do. Further, per the "plain meaning" doctrine, resort to legislative history is justified *only* if the statute's wording is vague, and not to contravene clearly-worded language.

The old chestnut of "necessary to implement" is invoked to justify expansive pre-emption under 251 and 252.[12] This is the time-honored technique of bootstrapping, i.e., where new substantive authority is said to arise out of "necessary and proper" language. Such implied authority is not intended to create powers not given per statute, but pertains *only to powers actually granted*.[13]

National pricing standards are justified by the identical techniques applied to interconnection and entry: the general mandate given the commission to ensure that rates are "just, reasonable, and non-discriminatory" is said to create authority to adopt national pricing rules.[14] The Telecom Act's pricing standards section mentions the commission only *once*—in the *negative*, at that.[15] *In other words, there is not any positive grant of authority whatsoever to the FCC under the pricing provisions of section 252.*

What makes the agency's position all the more radical is that prices—in ancient parlance, rates—were the prime traditional area of intrastate authority. States vigorously lobbied the Congress to refrain from treading on that preserve, and prevailed.

The apparent real justification for the agency's finding is its fear that LEC misconduct will frustrate federal pro-competition policy, i.e., that LECs *could* stall interconnection at the balkanized state level more effectively than at the unitary federal level, to the detriment of competition and the ability of non-LEC competitors to raise investment capital.[16] While obstructionism could occur, Congress was well aware of the potential for such activity, and chose *not* to expressly grant authority for the FCC to set national prices up front.

The agency asserts that "a narrow reading of ["necessary to implement" in] section 251(d) … would require the Commission to neglect its statutory duty to implement the provisions of section 251 and to promote rapid competitive entry into local telephone markets."[17] This creates legal authority out of a policy goal in contravention to the plain language of the enabling statute. But *it is the policy choices of Congress that govern. For the agency to presume license to impose its policies in furtherance of that goal is to*

elevate administrative discretion over legislative prerogative.

This point is sufficiently important to merit amplification. The FCC feels it is right in its assessment that national pricing standards are necessary to promote rapid entry. However, Congress did not agree—it declined to set national pricing standards. Should corrections be necessary, the proper lawful process is for *Congress* to do it, not for the FCC or any court to do so.[18] Put yet another way, the FCC does *not* have *carte blanche* to impose any policy it deems essential to promote competition by assuming authority out of the general policy goals set by Congress. Rather, Congress provided in the Telecom Act highly detailed rules *within whose ambit* the FCC crafts regulations.

Selective Reliance on Statutory Construction Rules

The agency uses the statutory construction rule *inclusio unius est exclusio alterius* when it suits *its* purpose, i.e., finding that Congress intended interconnection contracts antedating the new law to be subject to state PUC review.[19]

In sum, the FCC seeks *de facto* plenary power to set competition policy, using general legislative goals to justify its acts where specific statutory authorization is lacking. Judicial appeal of such agency excess is a classic remedy, per deference to legislative prerogative. As for deference to administrative agency interpretation, the rule applies to lawfully-exercised power only.[20]

Discounting Legitimate LEC Competitive Advantages

The commission reads the "necessary" prerequisite to LECs making available proprietary network elements to requesting carriers as "without such elements, their ability to compete will be significantly impaired or thwarted." It declines to require such carriers to "demonstrate a heavy burden of need, a burden LECs are not relieved of in situations where *they* possess superior knowledge."[21]

Incumbent LECs need *not* combine network elements "in any technically feasible manner," as this could affect the reliability and security of the incumbent's network, and also the ability of other carriers to obtain interconnection or unbundled elements. However, provided those hurdles can be surmounted—and the burden rests with the LECs to prove they cannot—then the LECs must "perform the functions necessary to combine elements, *even if they are not ordinarily combined in the incumbent's network*, provided that the combination is technically feasible."[22] This can include treating local loops with different types of line conditioning as distinct network elements.[23]

Mandating combining network elements upon request risks serious problems with network software. Altering software is a notoriously precarious exercise; the secondary and tertiary interactions of altered software with unaltered parts is inherently highly unpredictable. And, as complexity of software increases arithmetically, potential problems jump exponentially. It was a defective software patch from a switch vendor that triggered massive SS7 (Signaling System 7) crashes in 1991 and led (coupled with other severe outages in 1990-1991) to the formation of the FCC's first Network Reliability Council. Indeed, the *First Report and Order* (FR&O) notes reliability risks in deferring to 1997 consideration of "subloop unbundling,"[24] SS7, and AIN (Automated Intelligent Network).[25]

The "just and reasonable" adjectives in section 251(c)(3) are to mean that incumbent LECs must provide unbundling on terms and conditions "that would provide an efficient competitor with a meaningful opportunity to compete."[26] Just how does the FCC expect to ascertain which of hundreds of competitors is "efficient?" What standards of efficiency are to be set? Must new entrants file reports with the commission showing they are efficient? If not, will the FCC adopt a generic model of new entrant efficiency? (The agency's notion of efficiency is *not* facilities-dependent, i.e., an "efficient new entrant" need not be as efficient as the incumbent LEC, and is thus entitled to LEC efficiencies.[27])

Further, the FCC's goal is to "[allow] new entrants to take full advantage of incumbent LECs' scale and scope economies."[28] *If new entrants have access to all LEC economies, facilities-based LECs have little incentive to develop greater network-derived efficiencies as they must share them with every competitor.* This will operate to undercut the Telecom Act's policy goal of promoting efficiency of *all* market players—i.e., maximizing LEC incentives to improve efficiency is as much a goal as maximizing opportunities for non-LECs to be efficient.

Then, the agency flatly derides the impact of this rule on LEC innovation:

> We acknowledge that prohibiting incumbents from refusing access to proprietary elements could reduce their incentives to offer innova-

> tive services. We are not persuaded, however, that this is a sufficient reason to prohibit generally the unbundling of proprietary elements, because *the threat to competition from any such prohibition would far exceed any costs to customers resulting from reduced innovation by the incumbent LECs.* Moreover, the procompetitive effects of our conclusion generally will stimulate innovation in the market, offsetting any *hypothetical reduction* in innovation by the incumbent LECs.[29]

Although generally the judgment of an administrative agency is entitled to great deference, i.e., via the presumption of agency expertise, this particular "purple passage" so cavalierly dismisses the value of potential innovation by LECs that it appears vulnerable to challenge. To decide that the benefits of its rule will "far exceed" the possible loss to customers from lessened LEC innovation is to profess a degree of confidence about future events that is risible. Idle, airy conjecture is hardly fact.

Property Takings, Just Compensation, and Stranded Investment

The classical regulatory compact entitles carriers to an opportunity to obtain full recovery of reasonable investment expense. It arises primarily in two contexts:

(1) The right to charge rates sufficient to fully recover actual plant investment.
(2) The right to unfettered use of private property and compensation for its "taking" on behalf of any other entity, a right re-affirmed in 1994 by a federal appeals court.[30]

"Takings" is the great battle to come, one in which the ultimate "trump card" is held by the judges—Fifth Amendment constitutional law.

The fundamental Constitutional principle of the takings clause is that the government should pay just value for property taken—period.[31] Just compensation is an *economic constraint* on unchecked *political power*. A "just compensation" issue arises in the FCC's decision to mandate interconnection pricing based on forward-looking economic costs rather than actual investment.[32] Regulated public utility investor expectations have been to trade upside return potential for a more secure realization of a below-competitive market return.[33] For the FCC to disregard this in the name of "necessity" in promoting policies to foster competition is to finesse a constitutional issue—a warrant not given to *any* governmental entity in *any* branch of the government.[34]

Arguments raised against the pro-takings position are:

(1) Many state PUCs already use a forward-looking cost methodology.
(2) Inclusion of a risk-adjusted cost of capital in forward-looking costs compensates LEC investors.
(3) LEC claims are premature, not specific enough, and overstate the amount.
(4) No compensation is required unless, in its absence, the "operating and financial integrity" of the LEC would thereby be jeopardized.[35]

The FCC rejects LEC arguments based upon investments made pursuant to regulatory social policy: "contrary to assertion by some incumbent LECs, regulation does not and should not guarantee full recovery of their embedded costs."[36] Further, interconnection and network element pricing is not, in the agency's view, the proper remedy for under-depreciation.[37] Recovery of such cost is to be deferred to other proceedings.[38] The FCC cites one case as holding incremental rates as satisfying the just compensation requirement, and a Supreme Court case as supporting the proposition of balancing consumer and investor interests.[39]

Thus, the FCC has staked out a triple "bottom line" on "takings" and "just compensation":

(1) The issue of LEC compensation is to be deferred to other proceedings.
(2) LEC claims can be satisfied by a forward-looking cost standard of compensation.
(3) Investors who relied in "good faith" on the promise that accepting reduced investment return would, in turn, confer security as to its eventual recovery will find that their expectations will not *be fully protected.*

One key factor the FCC virtually ignores is the impact upon investors of denying full recovery of existing actual investment. The certain consequence of its action will be to raise, for an indefinite period, the cost of capital for *any* public utility, to compensate investors for the reduced security of eventual capital recovery. *This will be true not just for telephone*

utilities, but also for any other federally regulated companies which have massive actual investment.

The FR&O adopts a Total Element Long Run Incremental Cost (TELRIC) model that combines current LEC wire center physical locations with the most efficient cost model for architecture, sizing, technology, and operating decisions.[40] This juxtaposition *implicitly assumes that the current LEC physical topology would pertain with the substitution of best-available technology for current actual LEC plant. Such an assumption is unreasonable, and will result in an unrealistic cost model.* The FR&O also rejects cost models based on inverse elasticity of demand; given that prices will have to be cost-based to pass regulatory muster, this appears to rule out Ramsey prices (i.e., pricing multiple services according to their respective inverse demand elasticities).[41] The FCC deems TELRIC compensatory because it includes operating expenses + depreciation cost + risk-adjusted cost-of-capital.[42]

One policy view that has gained currency in recent years is that deregulation constitutes an amendment of the regulatory compact. Superficial plausibility is conferred by the fact that, since the late-1970s, telephone companies have filed pleadings at the FCC asking for deregulation and supporting the introduction of competition into all of telephony.

This proposition is mistaken:

(1) LECs *never* conceded that compensation for investments made under the compact be dispensed with.
(2) AT&T and other LECs originally opposed competition policy, until it became crystal clear that it was inevitable.

Property Confiscation

The FCC's interpretation of the Telecom Act raises anew the prospect of appropriation of private property. Under the act, LECs have a "duty to provide, on rates, terms and conditions that are just, reasonable, and non-discriminatory, for physical co-location of equipment necessary for interconnection or access to unbundled network elements at (their) premises." Virtual co-location will suffice *only* if LECs convince state PUCs that physical co-location is "not practical for technical reasons or because of space limitations."[43]

Competition, Washington Style: "Fasten Your Seat Belts…"

Lawmakers envision that, ultimately, this competition will be among *facilities-based* carriers. The conferees took great pains to state that mere resale was *not* their idea of competition.[44] Prominent policy makers have assailed mega-mergers, whether among telephone companies[45] or in-region telco/cable combines.[46] The act expressly repeals a section in the old law that allowed telephone companies to merge free of antitrust scrutiny; the conferees specifically stated their view that telco/cable mergers be subject to full antitrust review.[47]

In one key area, the legislation opens a door for common carriers: they are subjected to lighter regulation as new entrants into cable markets, and are not regulated under traditional common carrier rules when providing video service unless they so elect (as was the case under the 1934 Act and pertinent FCC regulations).[48] In expressly repealing the FCC's video dialtone rules, the conferees conceded that the FCC rules had impeded development of telco/cable competition.[49] Telcos may enter video markets in four ways:

- As a radio licensee under existing Title III.
- As a common carrier under existing Title II.
- As a cable provider under existing Title VI.
- As an Open Video Systems (OVS) provider under the new law.[50]

The FCC began by issuing a rulemaking to consider how to regulate OVS providers.[51] What was truly remarkable about the Notice was, with apologies to the Great Detective, "the dog that did not bark." The *Notice of Proposed Rulemaking* hardly discussed how to facilitate telco entry as viable competitors; rather, the document focused on how to prevent telco video providers from discriminating against, or otherwise engaging in anti-competitive conduct at the expense of, competitors.[52]

In its subsequent order spelling out OVS rules, the agency made OVS available to all entrants, despite the statute's focus on common carriers, a strong indication that the agency will interpret its powers broadly—again, at odds with the Telecom Act.[53] Indeed, the order baldly states that even if the new law were interpreted as *not* allowing non-common carriers to offer OVS platforms, the FCC, *on its own*, would have done so per its view of its general "public interest" mandate.[54]

The Economics of Universal Service: The Great Gigabit Giveaway?

The magic phrase in the new law's view of universal service is "preservation *and advancement*"—i.e., Info-Age Man does not live by voice (telephony) alone.[55] To press "advancement," the Federal-State Joint Board that has been convened to address universal service issues must, per statute, include a state-appointed consumer advocate.[56]

The act lists six universal service principles:

(1) "Quality" service at "just, reasonable, and affordable" rates.
(2) All-region advanced service access.
(3) Access for low-income users and those in "rural, insular, and high-cost" areas.
(4) "Equitable and non-discriminatory" contributions.
(5) "Specific and predictable" support mechanisms.
(6) Advanced access for schools, healthcare, and libraries.[57]

Universal service under the act is an "evolving" concept that the FCC may re-visit "periodically."[58] Most educational institutions are eligible for discount access.[59] The disabled are entitled to equal access if "readily achievable."[60] Contributions are required from all carriers.[61]

Universal service expansion is contemplated under the law as to:

(1) Services "essential" for healthcare, educational, and library users.
(2) Services subscribed to by a "substantial majority" of residential users; or are being deployed in the public networks by carriers.[62]

The FCC has commenced the universal service mega-rulemaking mandated per the Telecom Act. One subset of issues it will address is advanced services and the universal service umbrella. Services mentioned as candidates range from ISDN and Internet to T-3 (45 Mb/s—more than two 20 Mb/s digital HDTV channels) and ATM-based services.[63] One consumer advocate calls ISDN an "essential mass market service" and states that 28.8 Kb/s modem access is insufficient in a world moving to ISDN.[64] Congress also invites government intervention to accelerate diffusion of advanced technology into the nation's schools—specifically, as to switched broadband services.[65]

This is one congressional invitation that FCC Chairman Reed Hundt eagerly accepted. He recently called on local exchange carriers to connect every single American school to the Internet, asserting that the cost of doing so would be $10 billion over five years—two-tenths of one percent of the $5 *trillion* revenues projected for the combined information industries over that period.[66] (One analyst notes that 28.8 Kb/s modem access to the Internet would cost $200 per household for each of the nation's 100 million households, or $20 billion.[67] Few homes today have 28.8 access.)

The FCC is flirting with the temptation to pick winners, i.e., what services people "need." Arguments for "equal access" must be parsed carefully. Does everyone need 128 Kb/s ISDN, or will 28.8 Kb/s access suffice?[68] Is near video on demand (NVOD) close enough to video on demand (VOD)? Is free Internet access on terms comparable to those now being offered by AT&T and MCI "essential" to participate in modern life? Perhaps more importantly, should *transitional* services—those likely to be supplanted in the near- or medium-term future—*ever* be mandated as part of universal service? If terminal equipment becomes part of the equation, is everyone *entitled* to a Pentium? What are the baseline tools for participation in modern society?

Regulators may profit from examining lessons from the recent past:

- Three years ago, next to no one was talking about, or even *knew* about, the Internet.
- Five years ago, ADSL would have sounded like the acronym for a soccer league, and, until General Instrument unveiled its digital HDTV system, analog HDTV was widely touted as the product that would determine information age global leadership.
- Ten years ago, client-server local area networks were a novelty.
- Twenty years ago, "PC" was neither a computer nor a political term in the public consciousness.

The accelerating market evolution in communications technology bears a striking similarity to that experienced in the personal computer marketplace during the 1980s and early 1990s. A proliferation of competing PC technologies presented customers with a bewildering array of choices, more than most customers—and sales personnel, for that matter—could handle.

Within the PC box itself, a host of communications standards were deployed over a 15-year period (e.g., ISA, EISA, PCI, SCSI). By the mid-1990s, technology had stabilized to a significant degree. Ditto for hard drives (IDE, EIDE, SCSI), CPUs (Intel, Motorola), control software (operating systems such as DOS, Windows, CPM), and applications software (multiple word processing, publishing, graphics, spreadsheet programs—too numerous to name). Printers were even more fragmented for the buyer. Today's purchaser of a mid- or high-end Pentium buys a system configuration more stable than at any time since the PC market's inception.

But today's purchaser of communications access faces a more daunting package of choices than ever before—technologies, providers, service packages. Newly-minted offerings—Internet, ISDN, cable modems, ADSL—promise to complicate the selection process for some years. *Therefore, it is hard to imagine a less appropriate time for regulators to force widespread deployment of any particular technology or service. Doing so would be akin to forcing selection of a particular PC in the mid-1980s.* The result would be to impose excess costs on carriers as competition intensifies.

Post-Telecom Act Regulation: *Plus Ça Change or Vive La Différence?*

The architects of the Telecom Act of 1996 faced a dilemma: how to encourage full-scale tele-market competition, while preserving and expanding the social policy of universal access whose support still requires some manner of providing for consumers who cannot pay market price. Unfortunately, instead of "taking the bull by the horns" (in the political arena, a task no more pleasant than in the bullring), lawmakers finessed the underlying contradictions between market competition and prices skewed to subsidize universal access. The classic economic solution for implementing social subsidies in a competitive marketplace—paying support directly to the user and letting market forces alone determine market price—was cast aside.

On balance, the ability of incumbent common carriers to compete will be significantly harmed if the act's economic and social policies are left in the hands of a runaway FCC. The economic impact of *de facto* "takings" and the social impact of periodic expansion of universal service policy will tilt the proverbial competitive playing field toward new entrants, whether truly efficient or not.

Tension between the act's economic and social visions—i.e., between promotion of facilities-based competition at competitive prices and egalitarian social activism to expand universal service—has been acknowledged by top Clintonites. Antitrust chief Anne Bingaman suggested today's universal service support web be replaced by some form of tax or levy.[69] But there are Clintonites opposing this, including FCC Chairman Hundt and NTIA chief Larry Irving.[70]

There is a tension between the economic and social policies embodied in the act that will prove unsustainable. Price competition will likely be tempered by regulation to preserve universal service.[71] And, price competition is further imperiled by the FCC's below-cost interconnection pricing, a decision that will seriously damage the local exchange carriers in terms of their ability to respond to competition. Network modernization will be made uneconomic, and facilities-based competition will be unlikely to develop in such an investment environment. Investors will be reluctant to fund new network projects whose prospects are undercut by FCC rules.

The future? It will belong either to the FCC's *plus ça change* or to Congress's *vive la différence*. The two *cannot* coherently co-exist in the same policy environment and market universe. ntq

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[1] Regarding separation, a few weeks after passage of the law, the FCC proclaimed that it planned to impose separation for RBOC long distance provision outside their regions; prominent Congressmen, including Senator Pressler who led the Senate legislative effort (he sponsored S.652), told the FCC in no uncertain terms that had Congress wanted to impose structural safeguards on RBOC out-of-region, it would have done so. The agency backed off. As to universal service, the "pagers for the homeless" flap showed that Congress takes a somewhat less expansive view of the act than Chairman Hundt wants. (Hundt denies that the "pagers" proposal was ever given serious consideration, but several commissioners and a staff memo attest otherwise.) In fairness to the FCC, the language of section 254 of the act tacks onto already expansive language the catch-all phrase "public interest, convenience, and necessity," this clearly invites the FCC to read legislative intent very liberally.

[2] *Telecom Act*, secs. 251 (duty to interconnect and negotiate) and 252 (procedure for negotiation).

[3] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, *First Report and Order*, CC Docket No. 96-98 (FCC 96-325, released Aug. 8, 1996) ("*FR&O*").

[4] *Telecom Act*, sec. 252(d)(1). (Emphasis added.)

[5] *FR&O,* para. 60.

[6] *Telecom Act*, sec. 252(e)(5). By contrast, the FCC is mentioned in several places in sec. 251. Using language of another section would, of course, be reasonable in the event such language *expressly* overrides 252. A reading of *implied* override would be disfavored, as the general should bow to the specific.

[7] *Act,* sec. 253(d). The FCC cites its 253 powers, but omits the "state action" trigger. *FR&O*, para. 87.

[8] *FR&O*, paras. 53-62.
[9] *FR&O*, para. 84. (Emphasis added.)
[10] The Supreme Court confronted this situation in *Louisiana Public Service Commission v. FCC* (1986) in overturning an FCC reading of section 220 of the 1934 Act. Therein, the FCC cited frustration of its pro-competition policy as a justification for mandating that the state PUCs emulate the FCC's prescription of accelerating depreciation for local telephone companies. The state PUCs relied on section 2(b)'s express language that nothing in the act usurps state authority over intrastate "charges, classifications, practices." The High Court sided with the states, despite the fact that *the FCC's policy rationale therein was grounded in the identical policy underlying the Telecom Act—promotion of telecom market competition.*
[11] Specifically, sections 253 and 276(b) and 276(d). *FR&O*, para. 93.
[12] *FR&O*, para. 96.
[13] Federal courts have proven sympathetic to bootstrapping, most notably with regard to the Necessary and Proper Clause of U.S. Constitution, Article I. Legal commentators have long criticized such license, and the outcome of a particular case here depends greatly on the proclivities of the judges that hear it. The FCC, for its part, takes the view that 251 and 252 constitute a *de facto* partial repeal of the Supreme Court's interpretation of old section 2(b) in *Louisiana Public Service Commission v. FCC*. This is *very* questionable.
[14] *FR&O*, para. 111.
[15] *Telecom Act*, sec. 252(d)(2)(B)(ii).
[16] *FR&O*, para. 114.
[17] *FR&O*, para. 117.
[18] The classic case illustrating this point is the Tellico Dam/snail darter case (around 1979 or 1980), in which the Supreme Court declined to read an exception into applicable environmental law that would have allowed construction of the dam to go ahead despite possible adverse impact on the snail darter. The remedy, said the High Court, was for Congress to undo what it originally did; Congress, in fact, went on to do so. (The dam was built, and the snail darter moved downstream to a new neighborhood.)
[19] "When Congress sought to exclude preexisting (*sic*) contracts from provisions of the new law, it did so expressly." *FR&O*, para. 165.
[20] Appeals from the *FR&O* have been consolidated in the Eighth Circuit (including GTE's).
[21] *FR&O*, para. 282. Where the LEC has superior knowledge of pertinent facts the order places the burden of proof on the LEC, for instance, as to reliability concerns. *FR&O*, para. 203.
[22] *FR&O*, para. 296. (Emphasis added.)
[23] *FR&O*, para. 297.
[24] *FR&O*, para. 391.
[25] *FR&O*, paras. 480, 488-90, 497. Based on "significant evidence in the record," requesting carriers will not be allowed to link their STPs directly to incumbent LEC switches or to their call-related databases.
[26] *FR&O*, para. 315.
[27] *FR&O*, para. 441.
[28] *FR&O*, para. 340.
[29] *FR&O*, para. 282. (Emphasis added.)
[30] The U.S. Court of Appeals, D.C. Circuit has already held (*Bell Atlantic v. FCC*, 24 F.3d 1441 [1994]) that mandating physical co-location of equipment in exchange carrier central offices (for benefit of competitors) constitutes a "taking" sufficient to require payment of just compensation to the carrier.
[31] The FCC recently made reference to the federal constitutional standard for "just compensation" per the Fifth Amendment Takings Clause, quoting the Supreme Court: "[I]t is the owner's loss, not the taker's gain, which is the measure of the value of the property taken." *In the Matter of Implementation of Section 302 of the Telecommunications Act of 1996*, *Second Report and Order*, CC Docket 96-46, para. 221 (released May 31, 1996).
[32] *FR&O*, para. 620.
[33] An argument has been raised in policy wonk circles to the effect that investors knew that changes in regulation could operate to deprive them of full recovery on their investment. Such a "sophisticated investor" exception is not to be found in the language of the Fifth Amendment, and should be resisted vigorously. In any event, not all investors are sophisticated—does the stereotypical Aunt Tillie who holds a telephone stock really understand what the regulatory agencies have been up to in recent years? The *FR&O* notes the "investor expectations argument" and also the companion argument that utilities made uneconomic investments pursuant to social policies embraced by regulators. *FR&O*, para. 658.
[34] GTE raised the constitutional issue in its filing. *FR&O*, para. 670.
[35] *FR&O*, para. 671. One filing against the LEC position was made by the Justice Department.
[36] *FR&O*, para. 706.
[37] *Id.*
[38] *FR&O*, para. 707. The universal service and access charge proceedings will address these issues. *Id.*
[39] *FR&O*, paras. 733-740.
[40] *FR&O*, paras. 683-685.
[41] *FR&O*, para. 696. (GTE and other LECs proposed Ramsey pricing. *FR&O*, para. 645.)
[42] *FR&O*, para. 703.
[43] *Telecom Act*, sec. 251c(6). *The Conference Report does not even discuss the 1994 federal appeals court ruling declaring mandatory physical co-location unconstitutional.* Presumably the bill's authors believe that the "just, reasonable" language suffices to immunize regulators from successful constitutional challenge by the LECs.
[44] The conference language is quite explicit:

> With respect to the facilities-based competitor requirement, the presence of a competitor offering the following services specifically does *not* suffice to meet the requirement: (1) exchange access; (2) telephone exchange service offered exclusively through the resale of the BOC's telephone exchange service; and (3) cellular service. The competitor must offer telephone exchange service either exclusively over its own facilities or predominantly over its own facilities in combination with the resale of another carrier's service ... (t)he conference agreement includes the "predominantly over their own telephone facilities" requirement to ensure a competitor offering service exclusively through the resale of the BOC's own … service does not qualify…. *Conference Report*, sec. 271. (Emphasis in original.)

[45] Ed Markey (D-MA), House Telecom Chairman when Democrats ruled the Hill, said, "Without the introduction of vigorous competition in the Baby Bells' local telephone market, today's merger between Bell Atlantic and NYNEX could lead to a disturbing stifling of competitive energies." *Praise, Fire*, p. 4. Senator Pressler (R-SD), who chaired the Senate telecom panel, said, "I'm always concerned about the effect of a merger … we still need companies smaller than AT&T." "NYNEX-Bell Atlantic Merger Prompts Mixed Wall St. Reaction," *Communications Daily* (April 24, 1996):2. Senator Hollings (D-SC), the ex-chairman (now ranking minority member), echoed his colleague, "If we don't watch out, we'll have AT&T all over again." *Id.* But FCC Commissioners Rachelle Chong and James Quello voiced optimism for BA-NYNEX, citing scale economies and adjacent territories (the latter, however, is not present in the SBC-Telesis merger). Dsvid Henry, "Bell-NYNEX Deal Receives Static," *USA Today* (April 23, 1996):B1.

[46] Sec. 652 of the act limits LECs to a 10% interest in cable franchises within the LEC's serving area, and prohibits joint LEC/cable ventures in-region. Indicative of the pro-facilities competition sentiment among conferees is that in allowing several exceptions to the buyout restrictions, *the conferees chose, for each exception, the more restrictive version* of the House and Senate bills. *Conference Report*, sec. 652.
[47] *Act*, section 601, repealing section 221(a) of the 1934 Act. *Conference Report*, p. 200.
[48] Section 653(c) states that rules for "Open Video Systems" are expressly in lieu of Title II regulation. This constitutes a tacit acknowledgment by the conferees that LECs lack "market power" in cable markets—precisely the opposite of the policy view underlying the FCC's video dialtone rules.
[49] Regarding video dialtone, the *Conference Report* language for sec. 653 states, "Those rules implemented a rigid common carrier regime … and thereby created substantial obstacles to the actual operation of open video systems."
[50] *Telecom Act*, section 651. OVS rules are contained in section 653.
[51] *In the Matter of Implementation of Section 302 of the Telecommunications Act of 1996*, *Report and Order and Notice of Proposed Rulemaking*, CC Docket 96-46 (FCC 96-99, released March 11, 1996). The Commission issued a simultaneous order abolishing its telco-cable cross-ownership and video dialtone rules (*Report and Order*, CC Docket 87-266).
[52] The *NPRM* does not even *mention* the conferee language regarding how the FCC's video dialtone rules impeded LEC entry.
[53] *In the Matter of Implementation of Section 302 of the Telecommunications Act of 1996*, *Second Report and Order*, CC Docket 96-46, paras. 11-27 (released May 31, 1996).
[54] *Id.,* para. 20. Section 4(i) of the 1934 Act authorizes the FCC to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." This is a typical catch-all for residual powers of an administrative agency.
[55] *Telecom Act*, sec. 254(b). (Emphasis added.)
[56] *Id.,* sec. 254(a)(1).
[57] *Id.,* sec. 254(b)(1-6). In addition, there is a catch-all provision covering "such other principles" as the Joint Board and FCC deem to be in the "public interest, convenience and necessity." *Id.,* sec. 254(b)(7). Rural inter-exchange rates are also averaged (as are local). *Id.,* sec. 254(g). "Insular" areas are islands, e.g., Pacific Islanders. *Conference Report.*
[58] *Telecom Act*, sec. 254(c)(1). Long-held principles barring cross-subsidy are enshrined in the law. *Id.,* sec. 254(k).
[59] *Id.,* sec. 254(h)(2)(b)(4). Institutions with endowments exceeding $50 million are ineligible.
[60] *Id.,* sec. 255(c). Private suits to enforce this provision are barred. *Id.,* sec. 255(f). Section 713 mandates closed captioning and video description, with an exemption for "undue burden"—defined as "significant difficulty or expense" (from the standpoint of a given service and a given provider).
[61] *Id.,* sec. 254(d). A narrow exception, for carriers whose contribution would be *de minimis*, is confined to those carriers whose payment would be less than the cost of administering their contribution. *Conference Report*, sec. 254.
[62] *Telecom Act*, sec. 254((c)(1). The law does *not* define "substantial majority."
[63] *In the Matter of Federal State Joint Board on Universal Service*, *Notice of Proposed Rulemaking*, CC docket 96-45, FCC 96-93 (adopted and released March 8, 1996). Thus, ISDN, Internet access, and broadband for rural, low-income and high-cost subscribers (para. 23); Internet, T1, and T3 for educational institutions and libraries (para. 79 and fn. 174); ISDN and ATM for healthcare providers, plus high-resolution video (paras. 91-93 and fn. 201).
[64] Remarks of Mark Cooper, Director, Consumer Federation of America, at the CPT workshop. He further stated that ISDN should not be regarded as a "discretionary profit center" but instead as part of the "network architecture." His proposed ISDN pricing formula: double the price for POTS, plus an additional 10%. Other advocates echo Cooper's ISDN views. (Source: author's notes.)
[65] *Telecom Act*, sec. 706. The words: "high-speed, switched, broadband telecommunications capability."
[66] "Hundt Urges Telcos To Back Proposals To Connect Classroom To Internet," *Communications Daily* (September 19, 1996):4.
[67] Lawrence Gasman, "The Telecommunications Act of 1996," *Regulation*, No. 3 (1996):49, 52-53.
[68] The federal judiciary has been quite creative as to "finding" constitutional rights where none existed before, but are they really ready to say that the 215.2 second difference between downloading a one megabyte file at 28.8 (277.7 sec. = 4 min. 37.7 sec.) and 128 (62.5 sec. = 1 min. 2.5 sec.) is a *constitutionally significant* difference?
[69] Remarks at *Deregulating Telecommunications: Lessons From Other Network Industries*, Brookings Institution Briefing, May 21, 1996. (Source: author's notes.)
[70] Irving recently re-affirmed his support for activist intervention on behalf of education and healthcare. Remarks at *The Intensive Seminar Series on the Telecommunications Act of 1996*, Glasser Legal Works/FCBA (May 21, 1996). (Source: author's notes.)
[71] On March 4, the America's Carriers Telecommunication Association (ACTA) petitioned the FCC to regulate provision of voice telephony over the Internet to prevent siphoning off carrier revenues necessary to support universal service. ACTA asked the commission to (1) declare its legal authority over Internet voice providers; (2) enjoin provision of such services pending resolution of legal issues; and (3) begin a rulemaking to examine how such service should be regulated. The FCC issued a Public Notice (RM No. 8775, Mar. 8, 1996) seeking comment. *In the Matter of The Petition of America's Carriers Telecommunication Association for Declaratory Ruling, Special Relief, and Institution of Rulemaking.*