Supreme Court Ruling Favors Local Competition

Washington, D.C. May 22, 2002. Last week, the United States Supreme Court ruled in favor of competition in the industry's highly anticipated case of *Verizon Communications, Inc., et al. v. Federal Communications Commission, et. al.*, No. 00-511. The two significant rulings handed by the court were that (1) "The FCC can require state commissions to set the rates charged by incumbents for leased elements on a forward-looking basis untied to the incumbents' investment" and (2) "The FCC can require incumbents to combine elements of their networks at the request of entrants who cannot combine themselves, when they lease them to the entrants."

Since the passage of the Telecommunications Act of 1996 ("Act"), new entrants to the local telecommunications market were entitled to lease the network elements of monopoly incumbent carriers. The deregulation sparked a competitive frenzy and a battle by the incumbents to maintain their dominance. The agency empowered to govern the deregulatory process and development of rules to foster competition was the FCC. In the development of these rules, the FCC, in turn, allowed state utility commissions to retain some control over their local markets. The Court's decision in this case took absolute control over rates away from the states and, thereby opened the door to increased competition in the telecommunications industry.

For years, there has been inconsistency among the states regarding the ratesetting methodologies used in calculating the "cost" applicable to the services incumbent carriers were required to make available for resale. "Ratemakers often rejected the utilities' "embedded costs," their own book-value estimates, which typically were geared to maximize the rate base with high statements of past expenditures and working capital, combined with unduly low depreciation rates." The Act provided that "such 'just and reasonable rates' must, among other things, be 'based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the … network element.' §252(d)(1)(A)(i). Regulations appended to the FCC's First Report and Order under the Act provide, among other things, for the treatment of "cost" under §252(d)(1)(A)(i) as "forward-looking economic cost," (i.e., Total Element Long Run Incremental Cost or "TELRIC") distinct from the kind of historically based cost previously relied on in valuing a rate base.

The Court noted that the FCC did not act unreasonably in selecting TELRIC over any alternatives. The "FCC was reasonable to prefer TELRIC over alternative fixed-cost schemes that preserve home-field advantages for the incumbents . . . A comparison of TELRIC with alternatives proposed by the incumbents as more reasonable – embedded-cost methodologies, an efficient component pricing rule, and "Ramsey pricing," the most commonly proposed variant of fixed-cost recovery ratesetting – are plausibly answered by the FCC's stated reasons to reject the alternatives, §51.505(d); First Report and Order ¶¶655, 696, 705, 709. Pp. 36—45." The Court also found unimpressive the incumbent carriers' contention that TELRIC amounted to an unconstitutional taking of property.

The other spark to competition was the Court's ruling on the "so-called combination rules." The Court interpreted the combination rules as meaning that the FCC *can require* incumbent carriers to bundle services at the request of their competitors, unless an incumbent carrier could show that a specific request would be unreasonable. Traditionally, incumbents have been providing to their competitors only those bundled services that it provided to their own customers. With the Court's ruling, the FCC can require incumbents to provide any reasonably bundled service requested by its competitor. The requesting competitor must pay only the costs incurred by the incumbent in bundling those services. The decisive factor remains, however, whether and how long it will take for the FCC to implement the Court's ruling.