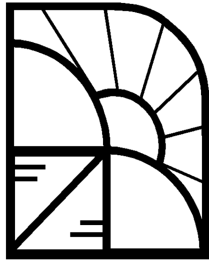


PHOENIX CENTER POLICY PAPER SERIES

Phoenix Center Policy Paper Number 13:

The Telecoms Twilight Zone: Navigating the Legal Morass Among the Supreme Court, the D.C. Circuit, and the Federal Communications Commission

Lawrence J. Spiwak, Esq.

(August 2002)

© Phoenix Center for Advanced Legal and Economic Public Policy Studies and Lawrence J. Spiwak (2002).

Phoenix Center Policy Paper No. 13

The Telecoms Twilight Zone: Navigating the Legal Morass Among the Supreme Court, the D.C. Circuit, and the Federal Communications Commission

Lawrence J. Spiwak, Esq. *

(© Phoenix Center for Advanced Legal & Economic Public Policy Studies and Lawrence J. Spiwak (2002))

Abstract: Given the conflicting characteristics of the telecoms business – *i.e.*, huge dollars at stake on the one hand but the inherent "public utility" characterization of the industry on the other – public policy decision-making can often take on a surreal quality. After the events of the first half of 2002, however, the politics of telecoms are becoming just plain weird. First, the Federal Communications Commission (FCC) announced a new broadband initiative and releases three Notices of Proposed Rulemaking (NPRMs) and one Notice of Inquiry, all ostensibly designed to provide investors with sufficient regulatory clarity so as to lead to more advanced broadband deployment. Rather than focus on how to promote new entry and mitigate incumbents' market power for the "last mile", these "Four Horsemen of the Broadband Apocalypse" so nakedly seek to benefit incumbent monopolists exclusively that they collectively act as a proposal by the FCC to abandon the pro-competitive provisions of the Telecommunications Act of 1996.

Shortly thereafter, the Supreme Court in *Verizon et al v. FCC* clearly upheld the FCC's forward-looking "Total Element Long-Run Incremental Cost" ("TELRIC") methodology for unbundled network element ("UNE") pricing and other unbundling rules. The *Verizon* decision finally put an end to nearly seven years of Regional Bell Operating Company ("RBOC")-driven litigation surrounding the Telecommunications Act of 1996. More importantly, however, the Court made several important findings of law and fact (including, *inter alia*, that the Bells are monopolists for the "last mile" and, as such, Congress specifically decided to treat Competitive Local Exchange Carriers or "CLECs" and RBOCs differently) that rips the analytical heart out of the RBOC arguments against the Act – and, by extension, the FCC's current "inter-modal" broadband initiatives. Less than a fortnight after the Supreme Court finally resolved these issues conclusively in *Verizon*, the D.C. Circuit issued its opinion in *United States Telecom Association et al. v. FCC*, which significantly handcuffed the FCC's ability to identify network elements that incumbent local exchange carriers (ILECs) must unbundle pursuant to the 1996

* President, Phoenix Center for Advanced Legal and Economic Public Policy Studies. The views expressed herein are strictly exclusively those of the author alone, however, and do not reflect the views of the Phoenix Center or any of the Center's individual Adjunct Fellows or Editorial Board Members.

Telecom Act. In a startling act of judicial activism, the D.C. Circuit cited Supreme Court Stephen Breyer's dissent from *AT&T Corp. v. Iowa Utilities Board* repeatedly and virtually ignored the Supreme Court Majority's rejection of RBOC anti-unbundling arguments in *Verizon*. In both in terms of analysis and factual conclusions, therefore, the *USTA* decision appears to ignore deliberately the Supreme Court's holding in *Verizon* made less than two weeks earlier.

These two widely inapposite cases place the FCC into the "Telecoms Twilight Zone" from any conceivable perspective: legally, economically and, of course, politically. On one hand, the Supreme Court's Opinion in *Verizon* simply confirms the obvious: the FCC's proverbial "Four Horsemen" – if adopted as currently proposed – are patently antithetical to the maximization of consumer welfare and must be revised. On the other hand, the D.C. Circuit's Opinion in *USTA* appears to give the FCC the perfect legal and political cover to adopt the anti-unbundling agenda of the RBOCs. This Policy Paper examines both the *Verizon* and *USTA* decisions, and argues that if the FCC truly is in favor of less government and a market economy, therefore, then the FCC must demonstrate by both word and deed that the problem remains one of *monopoly* and not the lack of regulatory certainty.

TABLE OF CONTENTS:

I. Introduction 3
II. The "Four Horsemen of the Broadband Apocalypse" 5
III. Dispelling the RBOC's Myths – The Supreme Court's Opinion in *Verizon* 12
A. Incumbent LECs are in Fact Monopolists and, as such, Congress Intended to Treat them Differently and Impose Asymetrical Regulation to Mitigate their Market Power 12
B. The *Verizon* decision rejects incumbent LEC arguments that "convergence" of networks (i.e., so called "inter-modal" competition") has overcome that almost in-surmountable advantage. 14
C. RBOC Sabotage is Real and Must be Addressed 15
D. The Term "Cost"in the 1996 Act does NOT *a fortiori* mean Historical Costs, and Therefore TELRIC is NOT Confiscatory. 16
E. Element Dependent Entrants are NOT "Parasitic Competitors" 19
IV. Ignorance is Bliss: The D.C. Circuit's Decision in *USTA* 20
A. The RBOCs' Are NOT Suffering From Alleged Cross Subsidization Requirements 21
B. Element Dependent Entry Does NOT Impose the Sort of Costs the D.C. Circuit Fears 22
C. The D.C. Circuit Improperly Placed Far Too Much Emphasis on the "Essential Facilities" Doctrine 24
1. Application of the "Essential Facilities" Doctrine to Section 251 Makes no Analytical Sense 25
2. Local Loop Unbundling is a "Policy-Relevant" Barrier to Entry 28
3. The "Essential Facilities" doctrine does not give the BOCs the "limiting" immunity they seek from making UNEs available at reasonable cost and on a non-discriminatory basis. 29
V. Conclusion: Telecom Policy Going Forward 31

I. Introduction

Given the conflicting characteristics of the telecoms business – *i.e.*, huge dollars at stake on the one hand but the inherent "public utility" characterization of the industry on the other – public policy decision-making can often take on a surreal quality. After the events of the first half of 2002, however, the politics of telecoms are becoming just plain weird.

First, the Federal Communications Commission (FCC) announced a new broadband initiative and releases three Notices of Proposed Rulemaking (NPRMs) and one Notice of Inquiry, all ostensibly designed to provide investors with sufficient regulatory clarity so as to lead to more advanced broadband deployment. As explained more fully below, however, rather than focus on how to promote new entry and mitigate incumbents' market power for the "last mile" (indeed the concept of market power has all but disappeared from the FCC's lexicon), these "Four Horsemen of the Broadband Apocalypse" so nakedly seek to benefit incumbent monopolists exclusively that they collectively act as a proposal by the FCC to abandon the pro-competitive provisions of the Telecommunications Act of 1996. In so doing, these proposals threaten to eviscerate nearly twenty-five years of FCC precedent and would cut off the remaining lifeblood of the competitive local exchange carrier (CLEC) industry.

Shortly thereafter, the Supreme Court in *Verizon et al v. FCC*[1] ("*Verizon*") clearly upheld the FCC's forward-looking "Total Element Long-Run Incremental Cost" ("TELRIC") methodology for unbundled network element ("UNE") pricing and other unbundling rules. The *Verizon* decision finally put an end to nearly seven years of Regional Bell Operating Company ("RBOC")-driven litigation surrounding the Telecommunications Act of 1996. More importantly, however, the Court made several important findings of law and fact (including, *inter alia*, that the Bells are monopolists for the "last mile" and, as such, Congress specifically decided to treat Competitive Local Exchange Carriers or "CLECs" and RBOCs differently) that rips the analytical heart out of the RBOC arguments against the Act – and, by extension, the FCC's current "inter-modal" broadband initiatives. As such, one would think that the Supreme Court's opinion in *Verizon* would stop the "Four Horsemen" cold in their tracks.

Unfortunately, that thought would be wrong. Less than a fortnight after the Supreme Court finally resolved these issues conclusively in *Verizon*, the D.C. Circuit issued its opinion in *United States Telecom Association et al. v. FCC*[2] ("*USTA*"), which

---

[1] 535 U.S. ___, *Verizon Tel. Cos. v. FCC*, 122 S.Ct. 1646 (2002).

[2] 290 F.3d 415 (D.C. Cir. 2002).

significantly handcuffed the FCC's ability to identify network elements that incumbent local exchange carriers (ILECs) must unbundle pursuant to the 1996 Telecom Act. In a startling act of judicial activism, the D.C. Circuit cited Supreme Court Stephen Breyer's dissent from *AT&T Corp. v. Iowa Utilities Board*[3] ("*Iowa*") repeatedly and virtually ignored the Supreme Court Majority's rejection of RBOC anti-unbundling arguments in *Verizon*. In both in terms of analysis and factual conclusions, therefore, the *USTA* decision appears to ignore deliberately the Supreme Court's holding in *Verizon* made less than two weeks earlier.

These two widely inapposite cases place the FCC into the "Telecoms Twilight Zone" from any conceivable perspective: legally, economically and, of course, politically. On one hand, the Supreme Court's Opinion in *Verizon* simply confirms the obvious: the FCC's proverbial "Four Horsemen" – if adopted as currently proposed – are patently antithetical to the maximization of consumer welfare and must be revised. On the other hand, the D.C. Circuit's Opinion in *USTA* appears to give the FCC the perfect legal and political cover to adopt the anti-unbundling agenda of the RBOCs.

Notwithstanding, *USTA* may be a "wolf in sheep's clothing" in that it sets such an incredibly high bar to satisfy the 1996 Act's "necessary and impair" standard[4] that it may be impossible for the FCC to formulate *any* definition that would be acceptable to the court. As explained more fully below, one of the central justifications set forth by the D.C. Circuit in *USTA* in striking down the FCC's unbundling rules was that the FCC did not take into account the "state of competitive impairment in any particular market." Yet, if the FCC attempted to engage in the rigorous and cohesive analytical analysis surrounding the competitive impact of unbundling *every* element in *every* geographic area of the country, then the fact-finding capabilities of the FCC (to the extent they exist) would be severely tested.[5] As a result, the only way the FCC may be able to comply with the *USTA*

---

[3] 525 U.S. 366, 119 S.Ct. 721, 142 L.Ed.2d 835 (1999). *Iowa* was the case where the Supreme Court first upheld the FCC's authority to promulgate rules under the 1996 Act.

[4] 47 U.S.C. § 251(d)(2) provides in relevant part that:

In determining what network elements should be made available for purposes of subsection (c)(3) of this section, the Commission shall consider, at a minimum, whether –

(A) access to such network elements as are proprietary in nature is *necessary*; and

(B) 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.

(Emphasis supplied).

[5] By way of example, the Texas Public Utility Commission recently engaged in such an analysis over one unbundled network element (unbundled local switching), and the record in that case generated over six boxes of documents, testimony by eight witnesses, a week-long hearing, and two

(Footnote Continued. . . .)

standard would be to delegate fact-finding and standard-setting to the authorities that can engage in that analysis – the State commissions. Accordingly, this reading of *USTA* would severely limit the FCC's authority and deprive it of the ability to implement a federal, de-regulatory agenda. And, since the overwhelming majority of States are, at this point, taking a far more aggressive approach to promoting competition than the FCC,[6] however, it will be very tough for the FCC to put the "jurisdictional genie" back in the bottle.

II. The "Four Horsemen of the Broadband Apocalypse"[7]

As discussed below, the Supreme Court in *Verizon* dispelled many of the myths behind the anti-unbundling, anti-entry arguments against the 1996 Act of the RBOCs. It did so at an opportune time, because only a few months prior, the FCC released a series of proposals that seek comment as to whether it should accept those myths and abandon the framework of the 1996 Act. Before discussing the Court's decision in detail, therefore, it is important to understand the policy debate currently before the FCC.

COMMUNICATIONS WEEK INTERNATIONAL, 01 April 2002

---

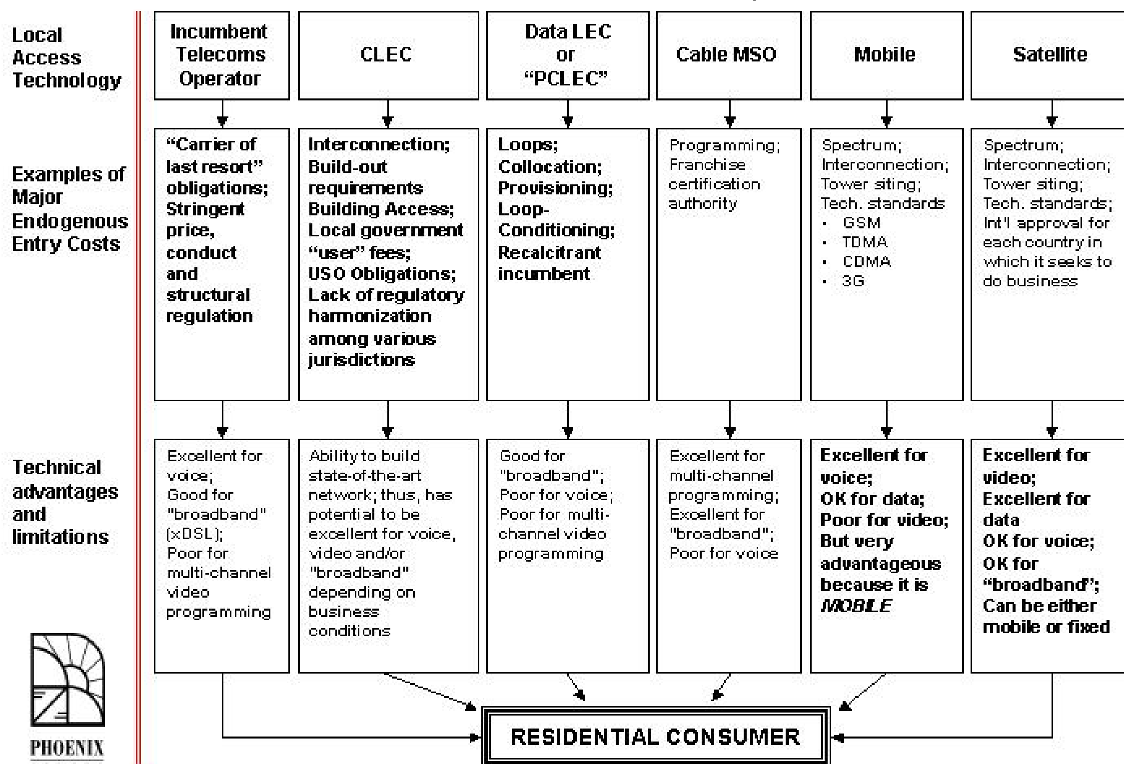
rounds of post-hearing briefing by the parties. *See Petition of MCIMetro Access Transmission Services LLC for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996*, Docket No. 24542 (May 1, 2002) at DPL Issue No. 8. Given that extensive record for one UNE in one state, it is inconceivable to imagine that the FCC could engage in similar fact-finding for all UNEs in all geographic areas of every state.

[6] For example, in 2001, the Illinois General Assembly passed a telecommunications reform law that required unbundling beyond current FCC requirements. According to the Illinois Commerce Commission, "the legislature intended that the situation in Illinois be different than that required by the FCC." Order, *Illinois Bell Telephone Company Filing to Implement Tariff Provisions related to Section 13-801 of the Public Utilities Act*, Docket No. 01-0614 (ICC June 11, 2002) at 19.

[7] COMMUNICATIONS WEEK INTERNATIONAL, *Opinion: U.S. Competition Policy – The Four Horsemen of the Broadband Apocalypse* (01 April 2002) (available at http://www.phoenix-center.org/commentaries/CWIHorsemen.pdf).

Overarching all of the FCC's current initiatives is an apparent belief in a so-called "inter-modal" competition and the FCC's apparent acceptance that "unbundling" requirements on monopoly ILEC networks somehow hampers the development of so-called "inter-modal" competition.[8] Reality is much different. As illustrated in Illustration No. 1 below and as the Supreme Court recognizes, the current so-called "inter-modal" players are not close substitutes to each other and inter-modal competition has absolutely no effect on dominant firms' strategic behavior for their core products and services.[9] As such, sole reliance on so-called "inter-modal" competition as a long-term public policy vision will not promote consumer welfare.[1]

Illustration No. 1: ***Substitutes or Complements?***



Source: Naftel & Spiwak, *THE TELECOMS TRADE WAR* (HART 2001).

---

[8] *See, e.g.,* April 30, 2002 Statement of FCC Chairman Michael Power before the Broadband Technology Summit, U.S. Chamber of Commerce (the "Commission will conceptualize broadband broadly to include any platform that is capable of fusing communications power with computing power to provide high-bandwidth intensive content to meet the broad needs and demands of consumers."); March 7, 2002 Testimony Before the Subcommittee on Commerce, Justice, State, and the Judiciary of the Committee on Appropriations United States Senate ("Under my leadership, the Commission has been outspoken in its support for competition, both inter- and intra-modal.")

[9] See n. 30 *infra*.

[10] *Outside View: The Broadband Shibboleth*, UNITED PRESS INTERNATIONAL (Dec. 14, 2001) (available at http://www.phoenix-center.org/commentaries/UPI_Shibboleth.pdf).

Specifically, the RBOCs have long argued that while they may be dominant for voice services, they are only nascent players in the burgeoning broadband market. They say the pro-competitive provisions of the U.S. Telecommunications Act – unbundling, collocation, interconnection, pricing and so on – hinder their incentive to compete against the other "inter-modal" broadband players who are not saddled with such asymmetrical regulatory burdens.[11] But while competition is becoming increasingly "multi-dimensional," the hard reality is that, even with dramatic technological advancement, the majority of telecoms and IT services *are not close substitutes for each other* (*i.e.,* if one provider attempts to raise prices or restrict output, consumers will simply switch to another). Instead, consumers perceive them as *complements* (*i.e.,* consumers will have a fixed line phone *and* a mobile phone *and* a cable company *and* an ISP *and* so forth and so on.) As such, we have yet to see widespread evidence that new technology – in whatever form – is having a contestable effect on dominant incumbents' strategic behavior. Instead, the concept of "broadband" is rapidly becoming a shibboleth to mask the fundamental structural monopoly problem of the "last mile."[12]

Four current FCC proceedings – launched shortly before the *Verizon* and *USTA* decisions – address these arguments directly. In particular, the current FCC seems to have bought the RBOCs' arguments hook-line-and-sinker. These "Four Horsemen of the Broadband Apocalypse" not only ignore the fundamental economics of the telecoms industry, however, but also threaten to eviscerate nearly twenty-five years of FCC precedent and cut off the remaining lifeblood of the competitive local exchange carrier (CLEC) industry.

---

[11] *See, e.g.,* December 19, 2001 Comments of Verizon Communications Inc. Before the National Telecommunications and Information Administration, In the Matter of Request for Comments on Deployment of Broadband Networks and Advanced Telecommunications, Docket No. 011109273-1273-01 (available at http://www.ntia.doc.gov/ntiahome/broadband/comments/verizon/verizon.htm); December 19, 2001 Comments of Verizon Communications Inc. Before the National Telecommunications and Information Administration, In the Matter of Request for Comments on Deployment of Broadband Networks and Advanced Telecommunications, Docket No. 011109273-1273-01 (available at http://www.ntia.doc.gov/ntiahome/broadband/comments/SBCComments.htm); December 19, 2001 Comments of BellSouth Communications Inc. Before the National Telecommunications and Information Administration, In the Matter of Request for Comments on Deployment of Broadband Networks and Advanced Telecommunications, Docket No. 011109273-1273-01 (available at http://www.ntia.doc.gov/ntiahome/broadband/comments3/BellSouth.htm).

[12] *The Broadband Shibboleth*, *supra* n. 10.

Horseman No. 1: ***The FCC's NPRM to Define ILEC Networks as "Broadband" Networks***

On 20 December 2001, the FCC issued an NPRM to help it classify ILEC "broadband" networks as "non-dominant."[13] There are several significant analytical problems with the NPRM at the outset, however.

First, the FCC asks the industry to submit comments on what the relevant market for "broadband" should be. While this NPRM might be a useful Socratic exercise between the FCC and the industry, the key point to understand is that in any meaningful analysis, the operative word here is "*relevant*." Thus, while there may be a market for broadband, it is *not relevant for public policy purposes*. As such, the market for "broadband" is about as relevant as the market for "global seamless service" or "video dial tone" – to other artificial services that the FCC has dedicated significant time and resources to.[14] Instead, The relevant market for policy inquiry is, and will continue to be for the foreseeable future, "last-mile" access, because this is where the incumbents' market power remains and, unfortunately, flourishes.

Second, even assuming *arguendo* that there is a relevant severable market for inter-modal broadband, it still strains credulity to think broadband deployment would increase by deregulating the RBOCs' broadband networks and grant ILECs *de jure* exceptions to the unbundling requirements of the 1996 Act. Again, just to re-emphasize the point, the major problem with the FCC's broadband classification proceeding is *not* "broadband" *per se* but is, and will continue to be for the foreseeable future, "last-mile" access because this is where the incumbents' market power remains and flourishes. "Broadband" is simply a "service" provided over network components, and with regard to the unbundling decision, the FCC's clear mandate under the 1996 Act is *not* to determine what service can be provided over a UNE but to write rules so that incumbents provide unbundled access to those network components in a just, reasonable and non-discriminatory fashion. The FCC's focus upon the technology that converts traffic into ones and zeros capable of

---

[13] *In re Review of Regulatory Requirements for Incumbent LEC Broadband Telecoms Services*, FCC 01-360, Notice of Proposed Rulemaking, ___ FCC Rcd ___ (rel. Dec. 20, 2001)

[14] On March 15, 2002, the FCC issued a declaratory order classifying all cable modem services as "information services." *In re Inquiry Concerning High Speed Access to the Internet Over Cable and Other Facilities*, FCC 02-77, __ FCC Rcd __, Declaratory Ruling and Notice of Proposed Rulemaking (rel. March 15, 2002). While this action is consistent with the FCC's attempt to create a level playing field for "inter-modal" broadband competition, because of the radical nature and technical capabilities of cable and public switched telephone networks, it is unlikely that in the U.S. cable companies will be providing voice or phone companies offering multi-channel video programming any time soon. The RBOCs discovered this reality more than six years ago with their failed TeleTV experiment, where all they managed to produce was a weak competitor to the local video store by offering old re-runs of sitcoms on a video-on-demand basis.

carrying voice, video and data – especially as the digitalization of the traffic continues to creep up to the customer premises equipment (CPE) – and its discussion of the level of "inter-modal" broadband competition may be interesting but has no basis in the requirement that the FCC enforce the unbundling provisions of the 1996 Act.

Horseman No. 2: ***The FCC's NPRM to Take a Fresh Look at What Falls Under the Classification of an Unbundled Network Element (UNE).***

Simultaneously with the "broadband definition" Notice, in December 2001 the FCC launched a wholesale review of every single UNEs that are to be provided pursuant to section 251(d)(2) of the Act. Far from promoting "regulatory certainty", this proceeding places in question the viability of *every* CLEC business plan. In setting forth its proposed framework, the FCC articulates the RBOC-inspired anti-unbundling myths, signaling that it is prepared to change the 1996 Act by regulatory fiat.

What further adds to the appearance of naked regulatory capture by the RBOCs is the fact that the FCC started this proceeding despite the fact that its current rules were in litigation – litigation that eventually resulted in the Supreme Court and D.C. Circuit decisions in May 2002. That said, even in the wake of those decisions, the FCC now seems intent upon devoting considerable taxpayer resources to this wholesale revision to its UNE regime.[15] The big question, therefore, is whether the FCC will align itself with the Supreme Court's holding in *Verizon* or whether it will use the D.C. Circuit's decision in *USTA* to bolster a narrow reading of section 251. And if the FCC decides to follow *USTA*, the other major issue is whether the FCC will even attempt to engage in the rigorous factual analysis that *USTA* requires – even though it clearly does not sufficient fact-finding tools at its disposal.

Horseman No. 3: The FCC's NPRM to Classify all RBOC Broadband Services as Information Services Under Title 1 of the Communications Act.

Many years ago, when the Internet was just research project at the Department of Defense, the FCC in its *Computer II* paradigm recognized that in order to create sufficient non-incumbent demand to warrant the construction of new networks, it had to ensure that dominant local exchange carriers could not leverage their market

---

[15] For example, under this rubric, it seems unlikely that the FCC will restore unbundled switching in the top 50 metropolitan statistical areas (MSAs) to the UNE list – even though empirical evidence shows that where unbundled local switching is freely available, CLECs serve more residential and small business consumers *and* more CLECs deploy their own switches and networks. In addition, other elements, such as unbundled transport, dark fiber, and high-capacity loops are also at risk, despite the fact that incumbent LECs still remain the *only* local provider with networks of scale and scope to provide services over those facilities economically.

power over the "last mile" into ancillary and enhanced services.[16] That paradigm created the conditions under which new providers could develop packet switched networks and a new product called a "modem" –key components of the Internet that the AT&T monopoly originally refused to develop and deploy for the Department of Defense. As such, the FCC declined to impose traditional public-utility price regulation on new entrants by classifying them as Information Service providers under Title I of the Communications Act rather than as common carriers under Title II.[17]

The FCC's paradigm worked because it utilized *structural regulation* to carve out data processing and CPE markets away from the Bell monopoly. The FCC modified this *Computer II/III* paradigm over the years, but it *never sought to remove regulation where market power concerns persisted; to the contrary it was the very presence of narrowly-tailored structural regulation on incumbents that allowed the Internet to flourish.* That all changed on 15 February 2002, when the FCC proposed to eliminate all of these protections.[18] The basis for this proposal is the flawed belief that the *Computer II/III* requirements were somehow standing in the way of "inter-modal" competition.[19]

---

[16] *In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry*), 77 FCC 2d 384, 419 (1980) (*Computer II Final Decision).*

[17] On March 15, 2002, the FCC issued a declaratory order classifying all cable modem services as "information services." *In re Inquiry Concerning High Speed Access to the Internet Over Cable and Other Facilities*, FCC 02-77, __ FCC Rcd __, Declaratory Ruling and Notice of Proposed Rulemaking (rel. March 15, 2002). While this action is consistent with the FCC's attempt to create a level playing field for "inter-modal" broadband competition, because of the radical nature and technical capabilities of cable and public switched telephone networks, it is unlikely that in the U.S. cable companies will be providing voice or phone companies offering multi-channel video programming any time soon. The RBOCs discovered this reality more than six years ago with their failed TeleTV experiment, where all they managed to produce was a weak competitor to the local video store by offering old re-runs of sitcoms on a video-on-demand basis.

But wait, there's more. By proposing in this NPRM to reclassify the RBOCs broadband services as an "information service" rather than a telecommunications service – even though broadband can be used to carry voice – the FCC is essentially removing the RBOCs' obligation to pay into the U.S. Universal Service Fund. Although universal service certainly is a worthy social goal, the current fund already acts as a major barrier to entry and therefore acts as a self-defeating exercise. Firms have to pay up to 10% of their gross revenues into the fund, but the RBOCs are essentially spared from harm because they are the ones that generally receive the funds to provide the USO. *See* Mark Naftel and Lawrence J. Spiwak, The TELECOMS TRADE WAR: THE UNITED STATES, THE EUROPEAN UNION AND THE WTO (Hart Publishing 2000), Chapter 15 *passim*. So the current proposal threatens both to double competitors' current contributions and to force Internet service providers (ISPs) to make up the shortfall. Thus, in an effort to appease the RBOCs, Mr. Powell's "de-regulatory" FCC taxes the Internet.

[18] *In re Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, FCC 02-43, Notice of Proposed Rulemaking (rel. Feb. 15, 2002). On a similar note, on May 16, 2002 in Docket No. WC 02-112 , the FCC announced that it is beginning a proceeding to determine whether it should

(Footnote Continued. . . .)

Horseman No. 4: The FCC's Notice of Inquiry to Determine the Relevance of Equal Access and Non-Discrimination Interconnection Obligations on Incumbent Local Exchange Carriers.

For more than twenty years, the concepts of non-discriminatory interconnection and equal access to rival local and long distance networks have been a cornerstone of U.S. telecoms policy. Moreover, these obligations are among the central principles contained in the 1997 WTO Agreement on Basic Telecoms Services Regulatory Reference Paper.[20] On the one hand, the Equal Access rules require, among other things, that local telephone networks implement 10-digit dialing of long-distance calls for all types of long-distance carriers. In the absence of these Equal Access rules during the early days of long-distance competition in the U.S., consumers would have to dial multiple digits to utilize MCI or another long-distance network that was not affiliated with the local Bell monopoly. It was only after the Equal Access rules were in place that long-distance competition took off for residential and small business customers.

On the other hand, the concept of non-discriminatory interconnection is the very *sine qua non* of telecoms restructuring itself. Simply stated, if rivals cannot interconnect on a non-discriminatory basis with the incumbent to exchange traffic, then the inevitable result is a "market of one" – *i.e.,* monopoly.

Despite the above, for some unknown reason, on 27 February 2002, the FCC nonetheless released a Notice of Inquiry to re-examine all of these rules.[21] Indeed, it is extremely difficult to fathom that no one in the FCC's decision-making chain recognized the obvious fact that by proposing to remove these obligations, the FCC will remove all incentives for an incumbent LEC to provide non-discriminatory

---

sunset the statutory separate affiliate and related requirements for RBOCs that provide in–region inter-LATA telecommunications services. Considering that the Supreme Court in *Verizon* specifically recognized the obvious in that the RBOCs have both the ability and incentive to engage in strategic, anticompetitive vertical conduct under current market conditions (see *supra* Section III.C), this "Fifth Horseman" does nothing to mitigate the perceived RBOC capture of the FCC.

[19] Unfortunately, Mr. Powell's FCC's actions in this regard simply continue on a theme first raised in the Clinton/Gore Administration where, for example, the FCC IN ITS OPP WORKING PAPER 31, *The FCC and the Unregulation of the Internet* (1999) (available at: http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp31.pdf), the Commission engaged in an incredible act of revisionist history and deliberately ignored the issue of the incumbents' market power and instead focused exclusively on how the FCC removed price regulation to encourage entry (albeit knowingly failing to mention that it was only for new entrants who lacked market power).

[20] *See* TELECOMS TRADE WAR, *supra* N. 17, Chapter 5 *passim*.

[21] *In re Notice of Inquiry Concerning a Review of the Equal Access and Non-Discriminatory Obligations Applicable to Local Exchange Carriers*, FCC 02-57 (rel. Feb. 28, 2002).

service to long-distance providers.[22] Accordingly, the simple fact that these cornerstones of telecoms policy are even on the table speaks volumes about the level of the RBOCs' regulatory capture of the FCC.

III. Dispelling the RBOCs' Myths – The Supreme Court's Opinion in *Verizon*

The FCC proceedings discussed briefly above share one common benchmark: that unbundling and similar access regulations are hampering the development of "inter-modal" competition. RBOCs have been making those arguments against the thesis of the 1996 Act for years. And on May 13, 2002, the Supreme Court took these arguments head on and dismissed them out-of-hand.

The extensive Supreme Court decision in *Verizon v. FCC* will stand as a landmark ruling in the telecommunications industry.[23] Directly at issue in the case were 1996 FCC rules on the TELRIC pricing standard for UNEs and FCC rules relating to requirements to "combine" UNEs. However, RBOC opposition to those 1996 FCC rules centered directly upon the anti-unbundling myths that the FCC is considering in its Four Horsemen agenda.

Indeed, as explained below, the Majority in *Verizon* very conscientiously and very deliberately took great pains to address and dispel the RBOC-sponsored myths that have been floating around Washington, D.C. since the 1996 Act was first enacted. As a result, the *Verizon* decision speaks directly and clearly to the speciousness of the FCC's pending agenda.

A. *Incumbent LECs are in Fact Monopolists and, as such, Congress Intended to Treat them Differently and Impose Asymetrical Regulation to Mitigate their Market Power*

The RBOCs have strenuously argued that they are but nascent competitors in the "broadband" market and that they should be regulated "at parity" with other "broadband" providers like cable. The Supreme Court rejected this approach, holding that because the RBOCs are monopolists in the "last mile," the 1996 Telecoms Act "*proceeds on the understanding that incumbent monopolists and contending competitors are unequal….*"[24] and, as such, Congress deliberately decided that asymmetric government regulation and remediation of incumbent LEC networks is required. As Justice Souter's Majority Opinion states:

---

[22] It also threatens to open the U.S. to a WTO complaint (*see supra* n. 17).

[23] *Supra* n. 1.

[24] 122 S.Ct at 1684 (emphasis supplied).

> [Congress aimed] to reorganize [telecommunications] markets by rendering regulated utilities' monopolies vulnerable to interlopers, even if that meant swallowing the traditional federal reluctance to intrude into local telephone markets. The approach was deliberate, through a hybrid jurisdictional theme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree but leaving it to state utility commissions to set the actual rates.[25] In other words, Congress designed the 1996 Act as a direct governmental intervention into the operations of local telecommunications network.

The Majority opinion in *Verizon* went on to recognize this intervention was appropriate, because: (1) due to the incredibly high cost of entry into the local market, incumbent LECs, as local telephone monopolies, have an "almost in-surmountable competitive advantage"; and (2) with such market power, the incentive and ability to engage in strategic anticompetitive conduct.[26] As Justice Souter further explains:

> *[Incumbent LECs have] an almost in-surmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the markets for terminal equipment and long-distance calling as well. A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the "last mile" of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses.* The incumbent company could also control its local-loop plant so as to connect only with terminals it manufactured or selected, and could place conditions or fees (called "access charges") on long-distance carriers seeking to connect with its network. *In an unregulated world, another telecommunications carrier would be forced to comply with these conditions, or it could never reach the customers of a local exchange.*[27]

To anyone with any institutional knowledge of the telephone business, the Supreme Court's express recognition that the RBOCs have the incentive and ability

---

[25] *Id.* at 1661 (Emphasis supplied.)

[26] T. Randolph Beard, George S. Ford and Lawrence J. Spiwak, *Why ADCo? Why Now? An Economic Exploration into the Future of Industry Structure for the "Last Mile" in Local Telecommunications Markets*, PHOENIX CENTER POLICY PAPER SERIES NO. 12 (2001) (http://www.phoenix-center.org/pcpp/PCPP12.pdf); *reprinted in* 54 FED. COM. L. J. 421 (May 2002) (http://www.law.indiana.edu/fclj/pubs/v54/no3/spiwak.pdf).

[27] 122 S.Ct. at 1662 (emphasis supplied); *c.f.*, Beard, Ford and Spiwak, *supra* n. 26.

to engage in strategic anticompetitive vertical conduct as a result of their monopoly in the "last mile" should come as no surprise. (Indeed, as discussed *passim*, these concerns were the primary motivating force behind the original AT&T Divestiture, as well as the FCC's incredibly successful *Competitive Carrier* and *Computer II* paradigms.) The fact that the current FCC – ostensibly the expert agency charged with developing a cohesive, long-term view of industry structure – does not understand this basic economic concept is.[28] Accordingly, the 1996 Act does not regulate in a vacuum – instead, as discussed more fully below, it provides specific remedies to remove significant policy-relevant barriers to entry that are detrimental to American consumer welfare.[29]

B. *The* Verizon *decision rejects incumbent LEC arguments that "convergence" of networks (*i.e., *so called "inter-modal" competition") has overcome that almost insurmountable advantage.*

The Majority in *Verizon* clearly state that there are little or no true close substitutes for "last mile" access under current and foreseeable market conditions. Taking on dissenting Justice Breyer directly, the Majority took great pains to point out that:

---

[28] Unfortunately, this economic naïvety is also spreading to Capitol Hill, where several lawmakers believe that all of broadband's problems can be solved if only there is "regulatory" parity, not withstanding the numerous underlying structural problems that provide fertile ground for incumbents' ability to exercise market power. *See, e.g.*, S. 2430 "Broadband Regulatory Parity Act of 2002" (the "Breaux-Nickles Bill"), available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:s2430is.txt.pdf; S.2863 "Consumer Broadband Deregulation Act of 2002" sponsored by Senator John McCain, available at: http://mccain.senate.gov/acrobat/rbroadbill.pdf.

[29] An excellent example of this important point can be found when the Supreme Court upheld the FCC's regulation that requires RBOCs to combine elements upon the request of a new entrant, "even if those elements are not ordinarily combined in the incumbent['s] network." Indeed, the Court noted specifically that although the 1996 Act:

> would not be violated literally by an incumbent that provided elements so that a requesting carrier could combine them, and thereafter sat on its hands while any combining was done. But whether it is plain that the incumbents have a right to sit is a question of context as much as grammar. *If Congress had treated incumbents and entrants as equals, it probably would be plain enough that the incumbents' obligations stopped at furnishing an element that could be combined, and within the actual statutory confines it is not self-evident that in obligating incumbents to furnish, Congress negated a duty to combine that is not inconsistent with the obligation to furnish, but not expressly mentioned. Thus, it takes a stretch to get from permissive statutory silence to a statutory right on the part of the incumbents to refuse to combine for a requesting carrier, say, that is unable to make the combination, or may even be unaware that it needs to combine certain elements to provide a telecommunications service.*

Id. at 1684.

> JUSTICE BREYER makes much of the availability of new technologies, specifically, the use of fixed wireless and electrical conduits, but *the use of wireless technology in local-exchange markets is negligible at present* (36,000 lines in the entire Nation, less than 0.02 percent of total lines, FCC, Local Telephone Competition: Status as of June 30, 2001 (Feb. 27, 2002) (table 5)), *and the FCC has not reported any use whatsoever of electrical conduits to provide local telecommunications service*.[30]

Accordingly, it would appear that the "tectonic plates" of technology are not spinning so hard as to force Adam Smith's invisible hand to mitigate incumbents' market power by giving them a good thrashing. While the notion of the phone company and cable companies acting as inter-modal "fighting duopolists" may make for a great name for a high school football team and marching band, because cable MSOs and RBOCs rarely, if ever, compete for each other's "core" products and services, the RBOCs' argument is just another example of regulatory wealth reallocation, rather than a public policy proposal that could maximize long-term consumer welfare.

C. *RBOC Sabotage is Real and Must be Addressed*

The economic model in PHOENIX CENTER POLICY PAPER NO. 12 demonstrated conclusively that incumbents can and do sabotage competitive entry.[31] The Supreme Court recognized these same economics in upholding the FCC's UNE combination rule. The Supreme Court noted that due to the incumbents' constant incentive to sabotage:

> A separate rate for an unbundled element is not much good if an incumbent refuses to lease the element except in combination with others that competing carriers have no need of; or if the incumbents refuse to allow the leased elements to be combined with a competitor's own equipment. *And this is just what was happening before the FCC devised its combination rules. Incumbents, according to the FCC's findings, were refusing to give competitors' technicians access to their physical plants to make necessary connections*.[32]

---

[30] *Id.* at 1677, n. 35. (Capitals in original and emphasis supplied)

[31] *Supra* n. 26.

[32] 122 S.Ct. at 1683 (citations omitted and emphasis supplied).

To assume otherwise is policy naïvety of the worst sort.[33]

D. *The Term "Cost"in the 1996 Act does NOT* a fortiori *mean Historical Costs, and Therefore TELRIC is NOT Confiscatory.*

Another central RBOC argument for the last six years is that TELRIC rates are below-cost and confiscatory in violation of the U.S. Constitution.[34] The Supreme Court rejected this argument outright, however, and pointed out that incumbent LECs do not have a statutory or constitutional right to protect their historic, monopoly-driven cost structure. Noting *twice* that the incumbents' have "picked an uphill battle",[35] the Court decided:

> [I]t would have been passing strange to think Congress tied "costs" to historical cost without a more specific indication, when the very same sentence that requires "cost" pricing also prohibits any reference to a rate-of-return or other rate-based proceeding, each of which has been identified with historical cost ever since *Hope Natural Gas* was decided. The fact is that without any better indication of meaning than the unadorned term, the word "cost" in §252(d)(1), as in accounting generally, is "a chameleon," a "virtually meaningless" term" [and, as such, there is] nothing in §252(d)(1) [that] plainly requires reference to historical investment when pegging rates to forward-looking "cost."[36]

Moreover, the Court held that FCC's choice of TELRIC bears a strong "rational connection" to the Act's deregulatory purpose. As the Majority explain, the "FCC rules stressing low wholesale prices are by no means inconsistent with the deregulatory and competitive purposes of the Act", because:

> a policy promoting lower lease prices for expensive facilities unlikely to be duplicated reduces barriers to entry (particularly for smaller

---

33 *See, e.g.*, COMMUNICATIONS DAILY (November 30, 2001) at 3, where Com Daily reported about then-FCC Common Carrier Bureau Chief Dorothy Attwood's comments at a conference sponsored by the Association of Local Telecommunication Services (ALTS). According to COM DAILY:

> *Attwood said "no one disputes" those complaints but she urged audience to listen to call[s] … for ILECs and CLECs to try to work together to resolve disputes over UNE provisioning before they escalated to FCC or state regulators.* When audience of competitive business people groaned, Attwood said that wasn't bad idea because ILECs knew they couldn't throw out their statutory requirements so they appeared to be willing to cooperate more. "I think it's in the interests of incumbents to be an efficient wholesaler," she said. *(Emphasis supplied.)*

34 See *supra* n. 11.

35 122 S.Ct. at 1666

36 *Id.* at 1667, citations omitted.

> competitors) and puts competitors that can afford these wholesale prices (but not the higher prices the incumbents would like to charge) in a position to build their own versions of less expensive facilities that are sensibly duplicable. And while it is true, as JUSTICE BREYER says, that the Act was "deregulatory," in the intended sense of departing from traditional "regulatory" ways that coddled monopolies, that deregulatory character does not necessarily require the FCC to employ passive pricing rules deferring to incumbents' proposed methods and cost data. On the contrary, the statutory provisions obligating the incumbents to lease their property, §251(c)(3), and offer their services for resale at wholesale rates, §251(c)(4), are consistent with the promulgation of a ratesetting method leaving state commissions to do the work of setting rates without any reliance on historical-cost data provided by incumbents.[37]

And, as if the preceding findings were not enough, the Court was quick to point out that the incumbents' had not even presented a specific rate that it could evaluate as possibly being confiscatory. As the Court explained, it is Ratemaking 101 that: "any question about the constitutionality of rate setting is raised by rates, not methods, and this means that the policy of construing a statute to avoid constitutional questions where possible is presumptively out of place when construing statutes prescribing methods."[38]

Ignoring this basic rule, however, the RBOCs pressed on and argued that this action was one of the "rare ones placed outside the general rule, to strong to ignore, that takings will occur if the TELRIC interpretation of § 252(d)(1) is allowed."[39] To support this argument, the RBOCs compared, at the level of the entire network (as opposed to element-by-element), industry balance-sheet indications of historical investment in local telephone markets with the corresponding estimate of a TELRIC evaluation of the cost to build a new and efficient national system of local exchanges providing universal service. In particular, the RBOCs juxtaposed an estimated $180 billion for a new system against a value of roughly $342 billion representing "total plant" on the industry balance sheet for 1999. Thus, reasoned the RBOCs, "the huge and unreasonable difference is proof that TELRIC will necessarily result in confiscatory rates."[40]

---

[37] *Id.* at 1668, n 20.

[38] *Id.* at 1680.

[39] *Id.*

[40] *Id.*

Upon review, the Court held that the RBOCs' comparison was "*spurious*" because "the numbers assumed by the incumbents are *clearly wrong*."[41] First, the Court discovered that the $180 billion cited by the RBOCs was "too low" because while it was supposed to be based on constructing a barebones universal-service telephone network, it failed to cover elements associated with more advanced telecommunications services that incumbents are required to provide by lease under 47 U.S.C. §251(c)(3).

Secondly, the Supreme Court found that the RBOCs' balance sheet number was "*patently misstated*", because any rates under the traditional public-utility model would be calculated on a rate base (whether fair value or cost of service) subject to deductions for accrued depreciation.[42] As such, the Court explained (and demonstrated clearly by citing to FCC public statistics) that the net plant investment after depreciation was not $342 billion but $166 billion, an amount "less than the TELRIC figure the incumbents would like us to assume." Moreover, explained the Court, even if the $166 billion is increased by the amount of net current liabilities ($22 billion) on the balance sheet, as a rough (and generous) estimate of the working-capital allowance under cost of service, the rate base would then be $188 billion, which was "still a far cry from the $342 billion the incumbents tout, and less than 5 percent above the incumbents $180 billion universal-service TELRIC figure."[43]

Accordingly, the Supreme Court summed up the issue succinctly:

> If leased elements were priced according to embedded costs, the incumbents could pass these inefficiencies to competitors in need of their wholesale elements, and to that extent defeat the competitive purpose of forcing efficient choices on all carriers whether incumbents or entrants. *The upshot would be higher retail prices consumers would have to pay*.[44]

As such, the Court clearly held that "the FCC was reasonable to prefer TELRIC over alternative fixed-cost schemes that preserve home-field advantages for the incumbents."[45]

---

41 *Id.* (emphasis supplied).

42 *Id.* (emphasis supplied).

43 *Id.* (citations omitted)

44 *Id.* at 1673.

45 *Id.* at 1678. A related RBOC myth is that the current telecoms meltdown is the result of "too much" competition as because TELRIC improperly subsidized new entry via below-cost rates. The

(Footnote Continued. . . .)

E. *Element Dependent Entrants are NOT "Parasitic Competitors"*

Over the last several years, we have heard politicians talk of wanting the "right kind of investment", which is usually a euphemism for "facilities-based" investment. As explained in great detail in PHOENIX CENTER POLICY PAPER NO. 12, however, it is high time that we stop thinking that "facilities-based" investment *a fortiori* means "network-based" investment, because "element dependent entry" – *i.e.*, those entrants who's primary business strategy is to enter via the purchase of unbundled network elements from the incumbent – also requires firms to commit significant sunk equipment costs, albeit not "network" equipment costs. Moreover, given the complex and difficult economics of the "last mile", "element dependent entry" is an essential economic prerequisite to creating sufficient non-incumbent demand to warrant new network deployment.[46]

Always choosing to ignore the fundamental economics of the "last mile," however, the RBOCs have long-argued that unbundling at TELRIC pricing would never produce the network-based competition supposedly intended by Congress but rather some sort of "parasitic free-riding".[47] Thankfully, the Supreme Court in *Verizon* quashed these arguments once and for all, finding that "the basic assumption of the incumbents' no-stimulation argument – that in a perfectly efficient market, no one who can lease at a TELRIC rate will ever build – is contrary to fact."[48]

First, the Supreme Court explained that "TELRIC does not assume a perfectly competitive efficient wholesale market or one that is likely to resemble perfection in any foreseeable time."[49] Moreover, the Supreme Court explained that TELRIC rates

---

Supreme Court similarly rejected this argument out of hand, noting that while in "theory embedded cost could be lower than efficient cost … the goal of efficient competition would be set back for the different reason of too much market entry." (*Verizon* fn 29) However, the recent wave of CLEC bankruptcies was not caused by "too much" competition (if so, where were the price wars for local service *à la* the airline experience?); these carriers were driven out of the market because they could not achieve scale economies in sufficient time to cover their debt loads due to unjust and unreasonable entry costs and sabotage for the "last mile" created by the incumbents' market power. (*See* Beard, Ford and Spiwak, *supra* n. 26 *passim.*) Indeed, "inter-modal" broadband competition is not like the airline industry where various providers' products are close substitutes and price wars frequently brake out, thus driving competitors from the market.

[46] *Id.*

[47] *See supra* n. 11.

[48] 122 S.Ct. at 1650

[49] *Id.* at 1669. It is well established that various economic factors make it impossible to achieve "perfect competition" in most industries, including many regulated network and public utility industries. For example, because the telecommunications and cable industries are characterized by high fixed and sunk costs, true marginal cost pricing (the *raison d'être* of perfect competition) is almost

(Footnote Continued. . . .)

in practice differ from the products of a perfectly competitive market owing to "built-in lags" in price adjustments – including the fact that wholesale TELRIC rates are set by State public utility commissions, usually by arbitrated agreements with 3- or 4-year terms.[50] Yet, the Supreme Court noted that "the significance of the incumbents' mistake of fact may be indicated best not by argument … but by evidence of actual investment in facilities-based competition since TELRIC went into effect."[51] And, to further add insult to the RBOCs' injury, the Court took further pains to explicitly point out that the evidence does not support:

> JUSTICE BREYER'S assertion that TELRIC will stifle incumbents' "incentive . . . either to innovate or to invest" in new elements. As JUSTICE BREYER himself notes, incumbents have invested "over $100 billion" during the same period. *The figure affirms the commonsense conclusion that so long as TELRIC brings about some competition, the incumbents will continue to have incentives to invest and to improve their services to hold on to their existing customer base.*[52]

Of course, the Majority's Opinion also states the obvious corollary: If the incumbents do not face any competition – as the "Four Horsemen" appear intended to do – then pre-maturely de-regulating the RBOCs "broadband" services will not lead to more investment as they claim; *rather, it will inevitably to less, because monopolists – by definition – never innovate or cut costs*.

IV. Ignorance is Bliss: The D.C. Circuit's Decision in *USTA*

As noted in the preceding section, the Supreme Court quashed conclusively with the various RBOC arguments/myths that have been floating around Washington, D.C. for the last six years. Yet, less than a fortnight later, the D.C. Circuit issued its opinion in *United States Telecom Association et al. v. FCC*[53] ("*USTA*"),

---

impossible to achieve. *See generally* David Evans & Richard Schmalensee, *A Guide to the Antitrust Economics of Networks*, ANTITRUST (Spring 1996) at 36, 38. Also, the presence of network externalities (*i.e.*, the value of the network increases with the number of users) makes "perfect competition" difficult to obtain. Finally, the FCC's continuing application of residual "public interest" regulation wholly unrelated to improving overall economic performance (*i.e.*, universal service obligations) will continue to distort market performance by affecting both the structure of many markets and the conduct of firms within those markets. *See generally* John Haring & Kathleen Levitz, *What Makes the Dominant Firm Dominant?*, FEDERAL COMMUNICATIONS COMMISSION OPP WORKING PAPER NO. 25 (1989); *see also* Stephen Martin, INDUSTRIAL ECONOMICS: ECONOMIC ANALYSIS AND PUBLIC POLICY 16 (1988) ("[perfect] competition is a Shangri-La up to which no real-world market can measure").

[50] 122 S.Ct. at 1670.

[51] *Id.*

[52] *Id.* at 1676, n 33.

[53] 290 F.3d 415 (D.C. Cir. 2002).

where in reversing and remanding the FCC's unbundling rules, the D.C. Circuit established such a high bar for the "necessary and impair" standard that it is unlikely the FCC could ever write unbundling rules that would satisfy the court.

What is so significant about *USTA*, however, is that both in terms of analysis and factual conclusions, it appears to dismiss deliberately the Majority's Opinion in *Verizon* (it cited it only three times) by citing to Justice Breyer's concurrence and dissent in *Iowa* (over ten times) as definitive authority.[54] In light of this naked disregard of established law and an acceptance of the RBOCs' economic myths hook, line and sinker, it is extremely difficult to give the D.C. Circuit's opinion in USTA any analytical credibility. For example:

A. *The RBOCs' Are* NOT *Suffering From Alleged Cross Subsidization Requirements*

One of the D.C. Circuit's central rationales for reversing and remanding the FCC's unbundling rules was that, in the court's opinion, the FCC could not impose a national rule because it did not take into account the "state of competitive impairment in any particular market." If they had, reasoned the court, "UNEs will be available to CLECs in many markets where there is no reasonable basis for thinking that competition is suffering from any impairment of a sort that might have the object of Congress's [sic] concern."[55] As support for this proposition, the D.C. Circuit pointed to the "cross subsidization often ordered by state regulatory commissions, typically in the name of universal service." According to the D.C. Circuit:

> Competitors will presumably not be drawn to markets where customers are already charged below cost, unless either (1) the availability of UNES priced well below the ILECs' historical cost makes a strategy promising, or (2) provision of service may, by virtue of economies of scale and scope, enable a CLEC to sell complementary services (such as long distance or enhanced services) at prices high enough to cover incomplete recovery of costs in basic service.[56]

There are several significant problems with the D.C. Circuit's analysis, however. First and foremost, as noted *supra*, the Supreme Court specifically held that TELRIC does *not* produce confiscatory rates. As such, there is no way CLECs can be drawn

---

54 *See supra* n. 3.

55 290 F. 3d at 422.

56 *Id.*

to where customers are already charged below cost by purchasing UNEs at TELRIC rates.

Second, the Supreme Court specifically rejected the argument that TELRIC fails to account for local conditions, because the Supreme Court found that TELRIC accounts for differing cost issues by permitting various states "considerable discretion" to calculate the proper rates – a process incidentally that the Court found to be "smoothly running affairs".[57] More importantly, however, shortly after the D.C. Circuit released its opinion in *USTA*, the D.C. Circuit in *Verizon Telephone et al. v. FCC* ("*Verizon Telephone*") upheld the FCC's collocation rules.[58] Significantly, although the D.C. Circuit was again faced with evaluating the reasonableness of the FCC's interpretation of a similar "necessity" test under Section 251(c)(6)[59], the D.C. Circuit did *not* require the FCC to account for local conditions but instead upheld the FCC's national collocation rules.

Finally, the D.C. Circuit completely ignored how the current Universal System Fund works – *i.e.*, CLECs have to pay in (huge barrier to entry) and then the RBOCs are held harmless.[60] As such, it is extremely difficult to see how the RBOCs are being forced to subsidize anything. Moreover, if the Universal Service Horseman (*supra*) goes into effect, then CLECs and others would shoulder nearly 100% of the USF burden with the RBOCs receiving a tidy subsidy of cash in return.

B. *Element Dependent Entry Does NOT Impose the Sort of Costs the D.C. Circuit Fears*

According to the D.C. Circuit in *USTA*, universal unbundling rules will not promote the goals of the Act and lead to more facilities-based competition, investment and innovation, because if "parties who have not shared the risks are able to come in as equal partners on the successes, and avoid payment for the losers, the incentive to invest plainly declines." Thus, reasoned the court, so long as firms

---

57 122 S.Ct. at 1678.

58 *Verizon Telephone Companies, et al. v. FCC*, 292 F.3d 903 (D.C. Cir 2002).

59 Section 251 of the 1996 Telecommunications Act, 47 U.S.C. 251 (c)(6), requires ILECs to "provide, on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, for physical collocation of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier." However, the statute also provides certain exceptions for instances where an ILEC can demonstrate to a state commission that "physical collocation is not practical for technical reasons or because of space limitations." *Id.*

60 For full discussion, *see* THE TELECOMS TRADE WAR *supra* n. 17, Chapter 15 *passim*.

are allowed to pursue a UNE-P entry strategy, the end result will be nothing more than "completely synthetic competition."[61]

In fact, the court chided the FCC's unbundling rules for apparently reasoning that "if competition performed by ubiquitously provided ILEC facilities counts, the more unbundling there is, the more competition". Instead, again citing to Justice Breyer's dissent in *Iowa*, the court held that the real question at bar "is how much investment compares with what would have occurred in the absence of the prospect of unbundling." According to the court, Justice Breyer instructed that each "unbundling of an element imposes costs of its own, spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities" and therefore a "fulfillment of the Act's purposes … called for 'balance' between these competing concerns." In the court's view, however, "a cost disparity approach that links 'impairment' to universal characteristics, rather than one linked (in some degree) to natural monopoly, can hardly be said to strike such a balance" between these two concerns and, as such, the FCC had made little effort to "pin 'impairment' to cost differentials based on characteristics that would make genuinely competitive provision of an element's function wasteful."[62]

While the court's exegesis in *USTA* deserves an "'A' for effort," there is only one slight problem with its analysis: ***The blatant fact the Supreme Court thoroughly rejected Justice Breyer's argument on this exact point less than two weeks before.*** In the Court's clear words from *Verizon*:

> JUSTICE BREYER may be right that "firms that share existing facilities do not compete in respect to the facilities that they share," (at least in the near future), but this is fully consistent with the FCC's point that entrants may need to share some facilities that are very expensive to duplicate (say, loop elements) in order to be able to compete in other, more sensibly duplicable elements (say, digital switches or signal-multiplexing technology). In other words, JUSTICE BREYER makes no accommodation for the practical difficulty the FCC faced, that competition as to "unshared" elements may, in many cases, only be possible if incumbents simultaneously share with entrants some costly-to-duplicate elements jointly necessary to provide a desired telecommunications service. Such is the reality faced by the hundreds of smaller entrants (without the resources of a large competitive carrier such as AT&T or WorldCom) seeking to gain toeholds in local-exchange markets, *see* FCC, Local Telephone

---

[61] 290 F.3d at 424.

[62] *Id.* at 427 (citations omitted).

> Competition: Status as of June 30, 2001, p. 4, n. 13. (Feb. 27, 2002) (485 firms self-identified as competitive local-exchange carriers). JUSTICE BREYER elsewhere recognizes that the Act "does not require the new entrant and incumbent to compete in respect to" elements, the "duplication of [which] would prove unnecessarily expensive." It is in just this way that the Act allows for an entrant that may have to lease some "unnecessarily expensive" elements in conjunction with building its own elements to provide a telecommunications service to consumers. In this case, low prices for the elements to be leased become crucial in inducing the competitor to enter and build [– *i.e.*, "wholesale prices should send 'appropriate signals'"].[63]

C. *The D.C. Circuit Improperly Placed Far Too Much Emphasis on the "Essential Facilities" Doctrine*

Although the D.C. Circuit took great pains to point out that it did "not intend to suggest that the Act requires the use" of the criteria making up the "Essential Facilities" doctrine commonly used under Section 2 of the Sherman Act,[64] the court tacitly relied extensively upon this doctrine nonetheless, noting that it "offer[ed] useful concepts for agency guidance when Congress has directed an agency to provide competitor access in a specific industry."[65] As a result, the D.C. Circuit held that:

> cost comparisons sons of the sort made by the Commission, largely devoid of any interest in whether the cost characteristics of an "element" render it at all unsuitable for competitive supply, seem unlikely either to achieve the balance called for explicitly by Justice Breyer or implicitly by the Court as a whole in its disparagement of the Commission's readiness to find "any" cost disparity reason enough to order unbundling. The Commission's addition of a materiality notion [*i.e.*, finding impairment in any case where lack of access to an element "materially" diminishes ability to provide services], submits to the Court's ruling in a nominally quantitative sense (though the reality of such acquiescence cannot be measured and may be belied by the virtual identity of the old and new orders). More important, adding the adjective "material" contributes nothing

---

63 See *Verizon*, 122 S.Ct. 1672, n 27.

64 Sherman Act. § 2, 15 U.S.C. § 2 (Supp. III 1991), provides that, "[E] very person who shall monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several status . . . shall be deemed guilty of a felony...."

65 *USTA*, 290 F.3d at 428, n 4.

> of any analytical or qualitative character that would fulfill the Court's demand for a standard "rationally related to the goals of the Act."[66]

As explained below, Congress did not intend for the Commission to impose the antitrust doctrine of "Essential Facilities" to local loop unbundling. (Indeed, if they had, they would have expressly made it a part of the 1996 Act; instead, the fact that Congress adopted a wholly different scheme speaks volumes that they deliberately did not want the "Essential Facilities" doctrine applied under Section 251.) What Congress *did* recognize in the 1996 Act, however, is that non-discriminatory access to UNEs is an *essential input* of production and therefore is *essential* to any successful restructuring effort – *i.e.*, a "policy-relevant" barrier to entry. It is for this very reason that courts have long held that the FCC is not bound by the narrow confines of the antitrust laws when exercising its expert authority under the Communications Act. Moreover, even assuming *arguendo* the Commission should be convinced to apply the "Essential Facilities" doctrine, it is crucial to understand that the "Essential Facilities" doctrine still does not give the RBOCs the "limiting" immunity they seek from making UNEs available at a reasonable cost and on a non-discriminatory basis.

1. *Application of the "Essential Facilities" Doctrine to Section 251 Makes no Analytical Sense*

It has been long established that administrative agencies (and the FCC in particular) governed by the public interest standard are *not* obligated to enforce the antitrust laws. Rather, they must "*make findings related to the pertinent antitrust policies, draw conclusions from the findings, and weigh these conclusions along with other important public interest considerations.*"[67] The FCC's different mandate results directly from the fact that the Commission must solve two discrete economic problems that do not come under either the DOJ's or FTC's mandate – *i.e.*, (1) assuring that the regulated firms under the Commission's jurisdiction do not engage in anticompetitive behavior or charge captive ratepayers monopoly prices; and (2), where practical, *affirmatively* formulating regulatory paradigms designed to improve overall market performance in both the short-run and especially, given the

---

[66] *Id.* at 427.

[67] *United States v. FCC*, 652 F.2d 72, 81-82 (D.C. Cir. 1980) (*en banc*) (*quoting Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 961 (D.C. Cir. 1968)). *See also FCC v. National Citizens Comm. for Broad.*, 436 U.S. 775, 795 (1978); *Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 755-62 (1973) (regulatory agencies must consider "matters relating to both the broad purposes" of their enabling statutes "and the fundamental national economic policy expressed in the antitrust laws"); *FCC v. RCA Communications, Inc.*, 346 U.S. 86 (1953) ("There can be no doubt that competition is a relevant factor in weighing the public interest.").

huge sunk costs inherent to the telecommunications industry, the long-run.[68] Given this daunting and difficult task, courts generally hold that the Commission's are significantly *broader* than those of the antitrust enforcement agencies, because the Commission is "entrusted with the responsibility to determine when and to what extent the public interest would be served by competition in the industry."[69]

Yet, despite the fact that economic regulation and antitrust approach and analyze market performance from different perspectives, none other than then-Judge Stephen Breyer of the 1st Circuit explained that they are really two sides of the same coin – *i.e.*, while economic regulation seeks to promote competitive rivalry directly "through rules and regulations" and while antitrust enforcement by the DOJ and FTC seeks to foster competitive rivalry "indirectly by promoting and preserving a process that tends to bring them about",[70] both regimes are designed

---

[68] *See* L. Spiwak, *Antitrust, the "Public Interest" and Competition Policy: The Search for Meaningful Definition in a Sea of Analytical Rhetoric*, ANTITRUST REPORT (Matthew Bender Dec. 1997) at 2, 6-14 (http://www.phoenix-center.org/library/neo_comp.doc). It should be noted, however, that the FCC's challenge is made more complex because telecommunications is clearly an industry characterized by rapid change and innovation. This challenge is now exacerbated with the passage of the Telecommunications Act of 1996. *See, e.g., Turner Broadcasting System, Inc., v. FCC*, 117 S. Ct. 1174, 1189 (1997) (regulatory schemes concerning telecommunications have "special significance" because of the "inherent complexity and assessments about the likely interaction of industries undergoing rapid economic and technological change"); *Denver Area Educational Telecommunications Consortium, Inc.*, v. FCC, 116 S. Ct. 2374, 2385 (1996) (Court is "aware . . . of the changes taking place in the law, the technology, and the industrial structure, related to telecommunications, see, e.g., Telecommunications Act of 1996 . . . ."); *Columbia Broadcasting, Inc v. Democratic National Committee*, 412 U.S. 94, 102, 93 S. Ct. 2080, 2086 (1973) ("The problems of regulation are rendered more difficult because the . . . industry is dynamic in terms of technological change"); *FCC v. Pottsville Broadcasting Co.,* 309 U.S. 134, 138 (1940) ("Communications Act is not designed primarily as a new code for the adjustment of conflicting private rights through adjudication. Rather it expresses a desire on the part of Congress to maintain, through appropriate administrative control, a grip on the dynamic aspects" of the telecommunications industry).

[69] *FCC v. RCA Communications, Inc*., 346 U.S. 86, 93-95 (1953); *Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 947-48 (1st Cir. 1993) (public interest standard does not require agencies "to analyze proposed mergers under the same standards that the [DOJ] . . . must apply" because administrative agency is not required to "serve as an enforcer of antitrust policy in conjunction" with the DOJ or FTC; thus, while agency "must include antitrust considerations in its public interest calculations . . . it is not bound to use antitrust principles when they may be inconsistent with the [agency's] regulatory goals"). *See also National Broadcasting Co. v. United State*s, 319 U.S. 190, 219 (1943) (Congress, through the Communications Act, "gave the Commission not niggardly but expansive powers."); *Craig O. McCaw*, Memorandum Opinion & Order, 9 FCC Rcd. 5836 (1994) at ¶ 7, *aff'd*, *SBC Communications v. FCC*, 56 F.3d 1484 (D.C. Cir. 1995) (FCC's "jurisdiction under the Communications Act gives us much more flexibility and more precise enforcement tools that the typical court has").

[70] *Town of Concord v. Boston Edison Co*., 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, J.), *cert. denied*, 499 U.S. 931 (1991).

fulfill *identical* public-policy goals, specifically "low and economically efficient prices, innovation, and efficient production methods."[71]

As such, the RBOCs' arguments that the FCC must suddenly be bound by the narrow confines of antitrust doctrine of "Essential Facilities" rather than by a "public interest" standard that they perceive to be too vague (or, in reality, too permissive) completely miss the point.[72] Congress clearly intended this "direct/indirect" dual regime approach because there are often situations where certain market conditions or an individual firm's conduct may not satisfy the requisite legal criteria to violate the antitrust laws but nonetheless have a direct negative impact on market performance.[73] The FCC itself has referred specifically to these conditions as "policy-relevant" barriers to entry – *i.e.*, costs borne by entrants but not incumbents that have adverse affects on consumer welfare.[74] If a "policy-relevant" barrier to entry is present, then regulatory intervention may be appropriate.[75]

---

[71] *Id. Accord United States v. FCC*, 652 F.2d 72, 88 (D.C. Cir. 1980) ("basic goal of direct governmental regulation through administrative bodies and the goal of indirect governmental regulation in the form of antitrust law is the same—to achieve the most efficient allocation of resources possible"); *see also* Jerry Hausman, *Taxation by Telecommunications Regulation*, *in* Tax Policy and the Economy (1998) ("The public interest standard should recognize economic efficiency as one of its primary goals. Economic efficiency implies not assessing unnecessary costs on U.S. consumers and firms.").

[72] *See United States v. AT&T, 498 F. Supp*. 353, 364 (D.D.C. 1980) (Green, J.) (it is "not appropriate to distinguish between Communications Act standards and antitrust standards" because "both the FCC, in its enforcement of the Communications Act, and the courts, in their application of the antitrust laws, guard against unfair competition and attempt to protect the public interest").

[73] *See, e.g., Turner Broadcasting System v. FCC*, 512 U.S. 622, 670 (Stevens, J. concurring) (Must carry rules do not violate First Amendment because "[c]able operators' control of essential facilities provides a basis for intrusive regulation that would be inappropriate and perhaps impermissible for other communicative media.") Again, as now Justice Breyer once wrote, an "antitrust rule that seeks to promote competition but nonetheless interferes with regulatory controls could undercut the very objectives the antitrust laws are designed to serve." As such, where regulatory and antitrust regimes coexist, "antitrust analyses must sensitively 'recognize and reflect the distinctive economic and legal setting' of the regulated industry to which it applies." *Town of Concord*, 915 F.2d at 22. *See also Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 760 (1973) ("Consideration of antitrust and anticompetitive issues by [regulatory agencies,] moreover, serves the important function of establishing a first line of defense against those competitive practices that might later be the subject of antitrust proceedings.").

[74] *See In re Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 9 F.C.C.R. P 141, at 7513-14 (1994) [hereinafter 1994 Competition Report].

[75] A classic example of how the Commission identified and mitigated a public policy barrier entry can be observed in the Commission's highly successful Program Access policy. For example, while ESPN, CNN, HBO or Showtime appropriately should not be considered to be an "essential facility" under the antitrust laws, without these popular channels, new entrants will find it extremely

(Footnote Continued. . . .)

2. *Local Loop Unbundling is a "Policy-Relevant" Barrier to Entry*

In formulating the concept of a "policy-relevant" barrier to entry, the FCC based its analysis on the work of Joseph Bain, George Stigler, and C.C. von Weizsäcker.[76] According to the FCC, a "zero tolerance toward barriers to entry suggests . . . that such a policy without important qualifications is unlikely to optimal." Indeed, the Commission recognized that "[f]rom a public policy perspective, not all impediments, however, or necessarily barriers to entry that require some type of government intervention or remediation." Instead, the Commission held that:

> [C]osts borne by entrants but not incumbents that have adverse affects on consumer welfare are defined as policy-relevant barriers to entry. Barriers to entry defined in this way are candidates for regulatory or antitrust scrutiny, where such scrutiny may result in policy recommendations for reducing or limiting such entry barriers. Such scrutiny should be approached as a cost-benefit analysis that identifies all possible economic efficiencies, if any, that might result from presence of the barrier to entry; identifies all offsetting economic inefficiencies that might be attributable to the barrier to

---

difficult to establish a viable, rival distribution system for delivered multi-channel video programming. As such, Congress in the 1992 Cable Act required, *inter alia*, parties to an exclusive programming distribution contract to demonstrate that such contract is in the public interest.[75] (*See* 47 U.S.C. § 548.) When undertaking this review – just like under antitrust precedent – the Commission must weigh the pro-competitive benefits of an exclusive distribution contract against its likely anticompetitive harms. Moreover, societal costs are reduced by a prospective plaintiff's ability to bring a claim exclusively and expeditiously before the Commission – as the expert administrative agency – rather than clog the courts and deal with wide-ranging precedent.

Indeed, antitrust litigation is an expensive, time-consuming process with often uncertain results. Even if a plaintiff can successfully prove that a vertical restraint has, in fact, injured competition in the distribution market for delivered multi-channel video programming – an achievement that no party apparently has accomplished to date – one case alone cannot significantly enhance overall long-term market performance because other similarly-situated plaintiffs must nonetheless incur substantial litigation costs to prove the merits of their respective cases. Similarly, because each judicial decision is fact-specific, the precedent created – if applied to other situations – may not lead to optimal long-term market performance. In fact, the litigation of one case might last nearly as long as the entire program access policy. *See* James Olson & Lawrence Spiwak, *Can Short-Term Limits on Strategic Vertical Restraints Improve Long-Term Cable Industry Market Performance?* 13 CARDOZO ARTS & ENT. L.J. 283 (1994).

[76] *See In re Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for Delivery of Video Programm*ing, 9 FCC Rcd 7442, App. H at ¶¶ 29-31 (1994); *see also* Jerry Duvall & Michael Pelcovits, *Reforming Regulatory Policy for Private Line Telecommunications Services: Implications for Market Performance*, FEDERAL COMMUNICATIONS COMMISSION OPP WORKING PAPER NO. 4 (1980) (analysis should focus on market performance, rather than on market participants' residual market power). The FCC has never mentioned this test again, however.

> entry, if any; identifies all relevant positive and negative externalities; and, finally, estimates the economic cost of eliminating the barrier to entry or minimizing its effects.[77]

Accordingly, to the extent the D.C. Circuit is concerned about the necessity of adopting some sort of limiting standard to the plain language of Section 251, the preceding analysis provides an excellent analytical framework to determine which network elements must be unbundled pursuant to sections 251(c)(3) and 251(d)(2). Not only is such an approach well-grounded in law and economic theory, but it is also wholly-consistent with the Commission's statements about the need to require unbundle the local loop if the promise of the 1996 Act is ever to be realized.[78]

3. *The "Essential Facilities" doctrine does not give the BOCs the "limiting" immunity they seek from making UNEs available at reasonable cost and on a non-discriminatory basis.*

Even assuming *arguendo* that the D.C. Circuit was correct and that the FCC has to look at the "Essential Facilities" doctrine as guidance, it is nonetheless crucial to recognize that the "Essential Facilities" doctrine still does *not* give the BOCs the "limiting" immunity they seek from making UNEs available to rivals at a reasonable cost and on a non-discriminatory basis. The case law sets forth four elements necessary to establish liability under the "Essential Facilities" doctrine:

(1) Control of the essential facility by a monopolist;

(2) A competitor's inability *practically or reasonably* to duplicate the essential facility;

(3) The denial of the use of the facility to a competitor; and

(4) The feasibility of providing the facility.[79]

---

77 *Id.* at ¶ 31.

78 *See, e.g., Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, CC Docket No. 96-98, 11 FCC Rcd 15499, 15782-807, (1996) (*Local Competition Order*) at ¶ 17:

> *This Order addresses other operational barriers to competition, such as access to rights of way, collocation, and the expeditious provisioning of resale and unbundled elements to new entrants. The elimination of these obstacles is essential if there is to be a fair opportunity to compete in the local exchange and exchange access markets. As an example, customers can voluntarily switch from one interexchange carrier to another extremely rapidly, through automated systems. This has been a boon to competition in the interexchange market. We expect that moving customers from one local carrier to another rapidly will be essential to fair local competition.*

79 *MCI Communications Co. v. AT&T*, 708 F.2d 1081, 1132-33 (7th Cir.), *cert. denied*, 464 U.S. 891, 104 S.Ct. 234, 78 L.Ed.2d 226 (1983).

Over the last several years, there has been significant debate over the exact circumstances in which an "essential" input is "capable" of duplication. While this debate has been zesty, nearly everyone seems to agree that the "Essential Facilities" standard requires something more than just "expensive" entry costs.[80] For this reason, courts have found everything from cable programming[81] to airline reservation systems[82] of being capable of "duplication." Rather, as highlighted above, the "Essential Facilities" doctrine also requires the fact-finder to look at whether it is *practical* or *reasonable* – in the context of the conditions of the relevant market – to duplicate the essential input as well. Sadly, the local loop remains the quintessential example of an essential input that cannot be "reasonably and practically" duplicated in many areas of the United States until sufficient alternative demand is produced and consolidated to make additional facilities-based entry profitable.

Indeed, very little has changed since the Seventh Circuit held specifically over fifteen years ago that AT&T violated Section 2 of the Sherman Act by refusing to connect MCI to its network. There, AT&T had complete control over the local distribution facilities that MCI required. As such, the court found the local loop "essential" for MCI to offer FX and CCSA service. In other words, AT&T's refusal just did not *impede* competition – it *eliminated* it altogether.[83]

Yet, some would argue that with the 1996 Act and technological developments, any claim that local loop access is an "essential" facility should fail because the local loop is no longer a "natural" monopoly and there are plentiful alternative sources of supply.[84] However, have things really improved all that much such that access to local loops is no longer a policy-relevant barrier to entry and that a national

---

[80] *See generally* Phillip Areeda, *Essential Facilities: An Epithet In Need Of Limiting Principles*, 58 ANTITRUST L.J. 841 (1989).

[81] *C.f. TV Communications Network, Inc. v. ESPN, Inc.,* 767 F. Supp. 1062 (D. Colo. 1991), *aff 'd*, 964 F.2d 1022 (10th Cir.), cert. denied, 113 S. Ct. 601 (1992); *Futurevision Cable Systems of Wiggins v. Multivision Cable TV Corp.*, 789 F. Supp. 760 (S.D. Miss. 1992), aff 'd, 986 F.2d 1418 (5th Cir. 1993).

[82] *Alaska Airlines Inc. v. United States Airlines, Inc.,* 948 F.2d 536 (9th Cir. 1991), *cert. denied*, 112 S. Ct. 1603 (1992).

[83] *MCI* at 1132-33.

[84] Proponents of this argument will no doubt cite to the Seventh Circuit's language in *MCI* that:

> Given present technology, local telephone service is generally regarded as a natural monopoly and is regulated as such. It would not be economically feasible for MCI to duplicate Bell's local distribution facilities (involving millions of miles of cable and line to individual homes and businesses), and regulatory authorization could not be obtained for such an uneconomical duplication.

MCI at 1133.

standard is unwarranted? Absolutely not. Whether one declines to describe the local loop as a "natural" monopoly does nothing to refute the reality that the local loop for the overwhelming potion of the country remains a "*de facto*" monopoly. Moreover, despite some recent small victories such as the final promulgation of effective collocation rules, achieving facilities-based entry remains a difficult objective.[85] Such an objective is made even more difficult by the naked reconcentration of both the ILEC and cable industries.[86]

Finally, what is even more particularly interesting to ask is why the RBOCs even believe that using the "Essential Facilities" doctrine is even in their best interest in the first instance? The "Essential Facilities" doctrine constitutes a claim under Section 2 of the Sherman Act; Section 2, however, deals specifically with monopolization.[87] Thus, is seems a bit hypocritical of the RBOCs to argue that they are no longer monopolists (or even dominant) yet want themselves limited by a standard that specifically applies to monopolists. Moreover, the RBOCs have absolutely no "legitimate business justification" (the primary defense to a Section 2 monopolization claim) to deny rivals access to their loops either.[88] Congress has made that clear by the plain terms of Section 251. As such, RBOCs may not use this defense to refuse access in an anticompetitive effort to "warehouse" loops. In fact, to the extent there are insufficient loops from the central office to the home, it is the *customer* – and not the ILEC – who pays for additional loop construction.

V. Conclusion: Telecom Policy Going Forward

Given the events discussed above, it is apparent that we have all entered into the bizarre world of the "Telecoms Twilight Zone." Even though Supreme Court clearly quashed all of the RBOCs' flawed arguments, there are still far too many people in Washington who want to ignore the obvious – *i.e.*, that the Bells are monopolists and, as such, absent: (1) government oversight, they have both the incentive and ability to raise prices and restrict output; and (b) absent competitive pressures, will never seek to innovate and reduce costs. The fact that highly

---

85 *See, e.g.*, George S. Ford, *Opportunities for Local Exchange Competition Are Greatly Exaggerated*, ELECTRIC LIGHT & POWER (April 1998) at 20-21 (http://www.phoenix-center.org/library/ford_1.doc); *Perspective: Why Local Loop Unbundling is no Telecoms Panacea*, COMMUNICATIONS WEEK INTERNATIONAL (26 April 1999).

86 *See, e.g.*, BUSINESS WEEK January 11, 1999 (According to SBC CEO Ed Whitacre: "We can sit here and get picked on" . . . "or get bigger and have more clout."); *see also Reconcentration of Telecommunications Markets After the 1996 Act: Implications for Long-Term Market Performance (Second Edition)*, PHOENIX CENTER POLICY PAPER SERIES NO. 2 (July 1998) (http://www.phoenix-center.org/pcpp/pcpp2.doc).

87 *See supra* n. 64.

88 *See, e.g., City of Anaheim v. Southern Cal. Edison Co.*, 955 F.2d 1373, 1380-81 (9th Cir. 1992).

educated people are actually buying with a straight face the incumbent monopolists' arguments on how best to promote competition – *when the notion of* any *competition runs completely against the RBOCs' self-interest in the first instance* – simply adds to the incredulity.

Moreover, since when have we fallen for the false notion that there is really such a thing as a "benevolent monopolist"?[89] It is Economics 101 that monopolists – *by definition* – do not innovate or seek to become more efficient. Indeed, the recent spate of Bell xDSL roll-out was *not* spurred on by some entrepreneurial spirit (to the contrary, DSL sat on the Bells' shelves for almost twenty years) but because of competitive pressure from new entrants. To therefore willingly and knowingly facilitate the presence of unshackled monopolists – who can and will stamp out the remaining blood of the competitive telecoms industry – in the ridiculous hope that this policy will somehow result in *more* broadband deployment is irresponsible public policy at the highest level. Quite to the contrary, we will not see more broadband investment; instead such policies will bring broadband investment to a screeching halt.

This concept is hardly revolutionary to true conservatives, because as Friedrich von Hayek – the Nobel prize-winning father of conservative and libertarian economics – warned nearly sixty years ago, an economic policy that deliberately facilitates the creation and maintenance of monopoly *"will, in the end, defeat the potential for competition and deregulation because as monopolies become stronger, it is inevitable that people will become united in a general hostility to competition."* And, as von Hayek argued, once competition continues to erode, then "the only alternative to a return to competition is control of the monopolies to the state – a control that, if it is to be made effective, must become increasingly more complete and more detailed."[90]

Unfortunately, with the economy and telecoms industry in grave trouble, consumers and politicians are now vigorously complaining about pitfalls of "competition" and "de-regulation" just as Von Hayek predicted. If Chairman Powell truly is in favor of less government and a market economy, therefore, then the FCC under his leadership must demonstrate by both word and deed that the problem remains one of *monopoly* and not the lack of regulatory certainty. If not, then Mr. Powell's policies will do a grave disservice both to the American consumer and to the Nobel Prize-winning intellectual heritage he purports to promote.

---

89 UNITED PRESS INTERNATIONAL, *Commentary: A Crisis Of Conscience* (8 September 2001) (available at http://www.phoenix-center.org/commentaries/UPICrisis.pdf).

90 F.A. Hayek, THE ROAD TO SERFDOM (1944).