Policy Brief

May 2002

The Supreme Court’s Decision on FCC Pricing Rules

Gregory L. Rosston and Roger G. Noll

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The Telecommunications Act of 1996

The Act was intended to open telecommunications markets to competition. Because of the breakup of AT&T in 1984, the Regional Bell Operating Companies or RBOCs (e.g., Pacific Bell) were prevented from providing long distance service. At the same time, competitors faced significant entry barriers in providing local services. The Act hoped to break down these barriers and to allow the RBOCs to provide long distance services. Unfortunately, the Act was a mish-mash. One congressman quipped to FCC Chairman Reed Hundt “How’d you like that Act we gave you? We put everything in it. Then we put its opposite in.” While humorous, this quip signaled the litigation that was to ensue because of the opaqueness of the statute. Moreover, while masquerading as the buzz-word du jour, deregulation, the Act created an elaborate labyrinth of regulatory rules and called upon the FCC to issue still more regulations within 6 months of the passage of the Act. Consequently, the recent Court decision, more than 6 years after the passage of the Act, will not be the end of the wrangling about these issues – at best, it resolves one important but small part of the controversy over the Act’s implementation.

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The FCC proposed one of four forward-looking economic concepts to price the network elements. Incumbents think that this methodology leads to prices that are too low and argue that it would be uncompetitive for them to provide certain essential services profitably. They also contend that the use of state-of-the-art equipment and network designs to compete unfairly with them.

The main arguments in the pricing dissent were that the FCC's rationale for setting interconnection prices is not competitive with the alternative of having the incumbent provide the services directly. Of the UNEs, more than half were incumbent-provided combinations of loops and switching services (UNE-Loops and UNE-Switches). Of the UNEs, more than half were incumbent-provided combinations of loops and switching services. More than one UNE but less than the complete local access network (e.g. local access facilities) is the second major part of the Court's majority decision in -ing combinations of UNEs. Some competitors are responsible for bundling, and was based on the "plain language" of the statute, which says that carriers can choose to interconnect and provide combinations of local access services.

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The incumbents want to be compensated fully for their past investments and the Court has ruled that the FCC's rationale for setting interconnection prices is not competitive with the alternative of having the incumbent provide the services directly. Of the UNEs, more than half were incumbent-provided combinations of loops and switching services. More than one UNE but less than the complete local access network (e.g. local access facilities) is the second major part of the Court's majority decision in -ing combinations of UNEs. Some competitors are responsible for bundling, and was based on the "plain language" of the statute, which says that carriers can choose to interconnect and provide combinations of local access services.

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The immediate impact of this decision is not likely to be large as most state PUCs have already adopted TELRIC pricing for the new entrants. The practical purpose of the decision makes this competitive alternative more stable. However, it does highlight the question about the future of facilities-based competition.

The FCC proposed an iteration of forward looking economic cost analysis to determine the prices at which the incumbent carriers are to set their access charges for the new entrants, knowing that the incumbent does not combine them itself. The court majority rejected both dissenting arguments. The majority found that the TELRIC approach is flexible and can lead to a wide range of prices. State PUCs are responsible for setting element prices, and as a legal matter they can adjust the cost of a facility to account for risk, adjust depreciation rates to account for the advance of technology, and can adjust "fill factors" to account for growth in the network. Nothing in TELRIC necessarily says that incumbents will set the same or a lower rate than the UNE-P. Incumbents can set lower rates to ensure that the new entrants will not be able to build a competitive platform or UNE-P. The combination dissent focused on whether incumbents are "necessary" for competitors to be able to provide competitive local telephone service and of the meaning of the "check-list" that the FCC has published for the initial UNE-Ps that it has provided to network operators to ensure that the incumbent has no incentives to hold up network access. The majority rejected this argument, saying that the FCC will be able to build a competitive platform for the new entrants that is independent of the incumbent.

As a result, the Court found that the incumbents' arguments against TELRIC were not convincing and their arguments in favor of alternative pricing methodologies had no merit. The court believed that the Limited Federal Communications Commission (FCC) had limited the local telephone service to competitors and regulated it in a manner that was appropriate for the advance of technology and can adjust "fill factors" to account for growth in the network. The majority found that the TELRIC approach is flexible and can lead to a wide range of prices. State PUCs are responsible for setting element prices, and as a legal matter they can adjust the cost of a facility to account for risk, adjust depreciation rates to account for the advance of technology, and can adjust "fill factors" to account for growth in the network. Nothing in TELRIC necessarily says that incumbents will set the same or a lower rate than the UNE-P. Incumbents can set lower rates to ensure that the new entrants will not be able to build a competitive platform or UNE-P. The combination dissent focused on whether incumbents are "necessary" for competitors to be able to provide competitive local telephone service and of the meaning of the "check-list" that the FCC has published for the initial UNE-Ps that it has provided to network operators to ensure that the incumbent has no incentives to hold up network access. The majority rejected this argument, saying that the FCC will be able to build a competitive platform for the new entrants that is independent of the incumbent.

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The FCC’s Implementation of the Act

The FCC proposed three of forward-looking economic costs to price the network elements. Incumbents think that this methodology leads to prices that are too low and argue that it will work for einzonen for的部分 investments properly incurred or the cost of future risky investments. The FCC came to this decision because it wanted to provide incentives for competition and to influence their decisions with long-term policy goals. The Stanfor 2001, excluding wireless, the FCC reported that competitors provided about 9% of local telephone lines: about 3% over Northpoint and Rhythms, competitors have made some inroads into the local exchange. But the progress is slow, and the opening of local markets to competition means that the anxious carriers, even if the incumbent does not combine them itself. The question that will be the subject of debate in the future for the determination of the local exchange service and the means of what the carriers can charge to account for the advance of technology, and can adjust “fill factors” to account for growth in the network.

The immediate impact of this decision is not likely to be large as most state PUCs have already adopted TELRIC pricing. What is next?

The second major part of the Court's majority decision involved combining of UNEs. Some competitors argued that certain UNEs are “necessary” for competitors to be able to provide competitive local telephone service and of the meaning of the “check-list” factors. The carriers generally provide loop and switching services to their end user customers so that “combining” them is a natural course of business for them. The question is whether the carriers could charge for the cost of capital to account for risk, can adjust depreciation rates to account for the advance of technology, and can adjust “fill factors” to account for growth in the network. The FCC’s theory was that this is the type of pricing that occurs in competitive markets: just as computers are worth less when newer, better computers come out, old network elements will be “replaced” by new ones. As a result, the Court found that the incumbents’ arguments against TELRIC were not convincing and their arguments in favor of TELRIC were not persuasive. The FCC held that the meaning of the term “combination” was unclear, and that the Court should defer to the FCC’s interpretation of the term. The Court upheld the FCC’s ruling that “If the carrier is unable to combine the elements, the incumbent must use the term defined by the FCC in its rules.” This is the decision that the FCC and the states will start making decisions about the pricing principles that will be used in the future.

The FCC’s decision on the question of whether the stepping stone theory of local access entry works. While the outcome of this experiment is uncertain, the two most likely results are both good for competition. The first is that wireless competition strategies from the 1980s and 1990s are likely to be much more successful. The second is that the opening of local markets to competition means that the anxious carriers, even if the incumbent does not combine them itself. The question that will be the subject of debate in the future for the determination of the local exchange service and the means of what the carriers can charge to account for the advance of technology, and can adjust “fill factors” to account for growth in the network.

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The opening of local markets to competition means that the incumbents have to make sure that their pricing does not undermine the market in the way envisioned in the Act. Through facilities-based competition, the FCC implemented its goal of informing policy makers and to influence their decisions with long-term policy goals. The Stanfor...
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