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## Confusion in the Wake of the Telecommunications Act of 1996: What Standard of Review Should Courts Employ When Evaluating Interconnection Agreements?

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# FLORIDA STATE UNIVERSITY LAW REVIEW



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WHAT STANDARD OF REVIEW SHOULD COURTS EMPLOY WHEN  
EVALUATING INTERCONNECTION AGREEMENTS?

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KIMBERLY L. SHARKEY\*

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I. INTRODUCTION

Congress enacted the Telecommunications Act of 1996<sup>1</sup> (“the Act”) to “promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.”<sup>2</sup> While the Act covers several aspects of the telecommunications industry, including broadcast services<sup>3</sup> and cable television,<sup>4</sup> one of the most important goals of the Act centers on the local telephone sector.<sup>5</sup> The Act aims to foster local competition by “break[ing] down the local monopol[ies] . . . and . . . encourag[ing] competitors to enter the local telephone market.”<sup>6</sup>

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\* J.D., Florida State University, 2001; B.A., Southeastern Louisiana University, 1998. I would like to thank Joseph A. McGlothlin for his ideas and guidance but especially for his kindness and patience. I would also like to thank my parents, Kristin and Kelly, for their endless love and support.

1. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.). Unless otherwise specified, all references in this Note to the “Act” refer only to Title I of the Act, the portion of the Act entitled “Telecommunications Services.”

2. *Id.* at preamble, 100 Stat. at 56.

3. *See generally id.* at tit. II, 100 Stat. at 107.

4. *See generally id.* at tit. III, 100 Stat. at 114.

5. *See generally id.* at tit. I, 110 Stat. at 56.

6. Duane McLaughlin, Note, *FCC Jurisdiction over Local Telephone Under the 1996 Act: Fenced Off?*, 97 COLUM. L. REV. 2210, 2224 (1997).

This goal is a marked departure from traditional ideas surrounding the nature of local telephone service, which until the 1990s was seen as “a natural monopoly.”<sup>7</sup> Historically, local exchange carriers (LECs) received exclusive franchises from the state.<sup>8</sup> The franchise extended to the elements that comprise the physical network.<sup>9</sup> However, with the passage of the Act, Congress ended the tradition of “state-sanctioned monopolies” in the local telephone industry.<sup>10</sup> Congress perceived that undoing this long tradition held potentially great benefits for consumers. It has been estimated that creating competition in the local telephone market could save consumers as much as \$12 billion.<sup>11</sup>

But the task is a daunting one. Before the passage of the Act, the local telephone market generated \$95 billion in annual revenues and was far and away “the largest and most concentrated sector of the telecommunications market.”<sup>12</sup> As a result of the barriers to local competition, seven companies received eighty percent of the industry’s annual revenues.<sup>13</sup> Additionally, ten providers that did not compete against one another in any local market controlled ninety-two percent of the local telephone industry.<sup>14</sup>

To ease newcomers’ entry into the market and prevent incumbents from engaging in anticompetitive behavior, the Act obligates incumbents to share their networks with any requesting carrier.<sup>15</sup> It

7. *AT&T Co. v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999); see also HENK BRANDS & EVAN T. LEO, *THE LAW AND REGULATION OF TELECOMMUNICATIONS CARRIERS* 16-19 (Artech House 1999) (explaining that where there is a natural monopoly, competition is typically considered ineffective and uneconomical, but that regulation prohibiting market entry makes it difficult to determine if the local telecommunications industry is a natural monopoly).

8. See *Iowa Utils. Bd.*, 525 U.S. at 371.

9. See *id.* These elements generally include “the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destinations), and the transport trunks (wires carrying calls between switches) that constitute a local exchange network.” *Id.*

10. *Id.*

11. See McLaughlin, *supra* note 6, at 2212 (citing *Eleven Attorneys’ General Support Competition in Local Multipoint Distribution Market*, ANTITRUST REP. (National Ass’n of Att’ys Gen., Wash., D.C.), May/June 1996, at 7); see also BRANDS & LEO, *supra* note 7, at 10-11 (noting that telecommunications services, including local and long-distance services, wireless services, and pay phone services, generate a combined \$220 billion annually, with half of this coming from local services). Ninety-seven percent of the revenues from local services are generated by incumbent local exchange carriers (ILECs). See *id.*

12. McLaughlin, *supra* note 6, at 2211.

13. The seven largest ILECs are GTE (serving 20 million access lines); Sprint (7 million access lines); and the Regional Bell Operating Companies (RBOCs): Ameritech (20 million access lines), Bell Atlantic (40 million access lines), BellSouth (22 million access lines), SBC (35 million access lines), and U.S. West (15 million access lines). See BRANDS & LEO, *supra* note 7, at 11.

14. See McLaughlin, *supra* note 6, at 2211 (citing H.R. Rep. No. 104-204, pt. 1, at 49-50 (1995), *reprinted in* 1996 U.S.C.C.A.N. 10, 13).

15. See 47 U.S.C. § 251(c)(2) (1994 & Supp. V 1999); see also *AT&T Communications Sys. v. Pacific Bell*, 203 F.3d 1183, 1184 (9th Cir. 2000) (explaining that Congress imposed

requires the parties to negotiate to form interconnection agreements detailing their arrangement.<sup>16</sup> If the parties cannot reach an agreement, they will be subject to arbitration by their controlling commission.<sup>17</sup>

The Act states that parties may appeal the arbitration's outcome to federal district courts.<sup>18</sup> But the Act is entirely silent as to the extent of the courts' involvement, failing to designate which standard of review to apply to determinations of state commissions.<sup>19</sup> Although courts owe deference to *federal* agency interpretations,<sup>20</sup> there is no established rule that delineates what level of deference courts should give interpretations by *state* agencies on issues of federal law. Confusing matters further is the fact that jurisdiction over the Act is divided between the federal and state levels. In an attempt to sort out the confusion, the Federal District Court for the District of Colorado, in *U.S. West Communications v. Hix*,<sup>21</sup> created a two-level standard of review to be employed in these telecommunications cases, assigning the majority of issues an arbitrary-and-capricious standard.<sup>22</sup>

This Note argues that it is improper to apply a deferential standard to interpretations of federal law by state commissions arbitrating interconnection agreements; a *de novo* standard is more appropriate. Deference might be appropriate when the Federal Communi-

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the duty for ILECs to share networks after "[r]ecognizing that competitors would have difficulty replicating local network facilities").

16. See 47 U.S.C. § 251(c)(1).

17. See *id.* § 252(b). The telecommunications carriers in each state are governed by a state commission, typically referred to as the state's public service commission or public utilities commission. See BRANDS & LEO, *supra* note 7, at 8-9. When this Note discusses the commissions or the state agencies charged with implementing certain provisions of the Act, it is these entities to which the Note is referring.

18. Section 252(e)(6) provides:

In any case in which a State commission makes a determination [approving or rejecting the agreement], any party aggrieved by such determination may bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements of section 251 of this title and this section.

*Id.*

19. Although the appropriate standard of review is a debated issue, the *scope* of review is undisputed—even though Congress failed to address it in the Act. See, e.g., *U.S. West Communs., Inc. v. MFS Intelenet, Inc.*, 1998 WL 350588, at \*1 (W.D. Wash. 1998) (stating that when evaluating interconnection agreements, the scope of review is confined to the administrative record); *U.S. West Communs., Inc. v. Hix*, 986 F. Supp. 13, 15 (D. Colo. 1997) (citing *U.S. v. Carlo Bianchi & Co.*, 373 U.S. 709, 714 (1963)); see also *Franklin Savings Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127, 1136 (10th Cir. 1991) (defining the scope of review as "the evidence the reviewing court will examine in reviewing an agency decision").

20. See *Chevron U.S.A., Inc. v. Natural Resource Defense Council*, 467 U.S. 837, 842-43 (1984).

21. 986 F. Supp. 13.

22. *Id.* at 19.

cations Commission<sup>23</sup> (FCC) has promulgated rules on the issue, because the state commission is likely to merely be implementing the FCC's rules. But when the FCC has not issued rules on ambiguous provisions of the Act, state commissions cannot implement them without interpreting them. Allowing state agencies to interpret the Act would endanger its uniformity. There is need for consistent interpretation of federal acts among the states, especially in the telecommunications industry, where many of the same parties compete in numerous states and debate the same issues in each of these states.

Part II of this Note outlines important provisions of the Act, explaining how interconnection agreements are created and reviewed by state commissions. Part III describes the relevant jurisdictional issues, revealing that while the FCC has broad authority to regulate in this area, important issues involving interpretation of the Act remain for which there are no helpful FCC rules. These issues have been left for state commissions to resolve. Part III offers two examples, reciprocal compensation and pricing methodology, of areas in which states have been actively interpreting the Act. Part IV then turns to the appropriate standard of review federal courts ought to employ in reviewing the decisions of state commissions, arguing that the need for uniformity dictates the use of a *de novo* standard whenever state commissions interpret the Act. Part V describes the case law on this issue, explaining how application of the *Hix* standard has resulted in federal courts improperly deferring to state commissions on important issues of federal law. This Note suggests that an appropriate standard of review would distinguish negotiated from arbitrated agreements. Part VI then concludes that the *Hix* standard should be reformulated to require *de novo* review of arbitrated agreements; if necessary, Congress should step in to explicitly provide for this by statute.

## II. SPECIFICS OF THE ACT: CREATION AND REVIEW OF INTERCONNECTION AGREEMENTS

The Act has two main components. First, it prohibits states from "enforc[ing] laws that impede competition."<sup>24</sup> Second, it subjects incumbent local exchange carriers (ILECs) "to a host of duties intended to facilitate market entry."<sup>25</sup> Among these duties is an obligation to

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23. See *AT&T Co. v. Iowa Utils. Bd.*, 525 U.S. 366, 378 (1999). The FCC is the federal agency with the "rulemaking authority to carry out the 'provisions of this Act,' which include [sections] 251 and 252," the sections dealing with the local telephone sector. *Id.* (refusing to agree with arguments that the FCC's "rulemaking authority is limited to those provisions dealing with purely *interstate and foreign* matters").

24. *Iowa Utils. Bd.*, 525 U.S. at 371.

25. *Id.*

offer carriers seeking entry to the market “nondiscriminatory access to network elements.”<sup>26</sup> The Act sets forth a number of important standards:

[ILECs must provide access] on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.<sup>27</sup>

An ILEC may fulfill the access requirement in one of three ways: 1) It can sell the requesting carrier telephone services at wholesale rates that the requesting carrier can resell to consumers; 2) it can lease unbundled network elements to the requesting carrier; or 3) it can allow the requesting carrier to interconnect the requesting carrier’s facilities with its own.<sup>28</sup> The details of these arrangements are negotiated between the parties at the market entrants’ request. The resulting agreements are referred to as “interconnection agreements.”<sup>29</sup>

The Act requires that these agreements include provisions governing certain aspects of the arrangement between the ILEC and the competitor, including resale,<sup>30</sup> number portability,<sup>31</sup> dialing parity,<sup>32</sup> access to rights-of-way,<sup>33</sup> and reciprocal compensation.<sup>34</sup> The agreement must also, at a minimum, “include a detailed schedule of itemized charges for interconnection and each service or network element included in the agreement.”<sup>35</sup>

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26. 47 U.S.C. § 251(c)(3) (1994 & Supp. V 1999).

27. *Id.* § 251(c)(3). Section 252 specifies “[p]rocedures for negotiation, arbitration, and approval of agreements.” *Id.* § 252.

28. *See* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371 (1999) (citing § 251(c)).

29. *See* § 251(c)(1).

30. *See* § 251(b)(1). ILECs have a “duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services.” *Id.*

31. *See* § 251(b)(2). ILECs have a “duty to provide, to the extent technically feasible, number portability in accordance with requirements prescribed by the Commission.” *Id.*

32. *See* § 251(b)(3). ILECs have a “duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service, and the duty to permit all such providers to have nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.” *Id.*

33. *See* § 251(b)(4). ILECs have an imposing “duty to afford access to the poles, ducts, conduits, and rights-of-way of such carrier to competing providers of telecommunications services or rates, terms, and conditions that are consistent with section 224.” *Id.*

34. *See* § 251(b)(5). ILECs must “establish reciprocal compensation arrangements for the transport and termination of telecommunications.” *Id.*

35. 47 U.S.C. § 252(a)(1).

Not all agreements are negotiated. Where the parties are unable to reach an agreement,<sup>36</sup> industry newcomers looking to become LECs may force ILECs “to negotiate . . . and to engage in a state-supervised mediation and arbitration process in order to produce an interconnection agreement.”<sup>37</sup> If the parties have not reached an agreement within 135 days of the initial request for an interconnection agreement, then either party to the negotiation may petition the state commission for arbitration on any unresolved issues.<sup>38</sup> When arbitrating issues, the Act requires the commission to ensure that the agreement meets the requirements of section 251, follows FCC rules promulgated under section 251, and adheres to a pricing standard set forth in section 252(d).<sup>39</sup> The states have nine months from the initial request to resolve arbitrated issues.<sup>40</sup>

The Act also requires the approval of the relevant state commission; this requirement applies to both arbitrated and negotiated agreements.<sup>41</sup> “A State commission to which an agreement is submitted shall approve or reject the agreements, with written findings as to any deficiencies.”<sup>42</sup> When reviewing negotiated interconnection agreements, the commission is only to consider whether the agreement “discriminates against a telecommunications carrier not a party to the agreement”<sup>43</sup> and whether “implementation of such agreement . . . is not consistent with the public interest, convenience and necessity.”<sup>44</sup> After the parties submit their negotiated agreement, the state commission has ninety days to act to approve or reject the agreement; if the commission does not act, the negotiated agreement will be deemed approved.<sup>45</sup>

Even when the commission itself serves as an arbitrator, it must still approve or reject the agreement upon completion. However, the commission’s review here is of wider scope than that of arbitrated agreements; it may reject arbitrated agreements for failure to meet the requirements of section 251, follow the FCC rules, or adhere to section 252(d)’s pricing standards.<sup>46</sup> With both negotiated and arbitrated agreements, in the absence of action by the state commission, the FCC will determine whether to approve the agreement:

36. The Act includes a provision requiring ILECs to negotiate in good faith. *See* § 251(c)(1).

37. McLaughlin, *supra* note 6, at 2226.

38. *See* § 252(b)(1).

39. *See* § 252(c).

40. *See* § 252(b)(4)(C).

41. *See* § 252(e)(1).

42. *Id.* § 252(e)(1).

43. *Id.* § 252(e)(2)(A)(i).

44. *Id.* § 252(e)(2)(A)(ii).

45. *See* § 252(e)(4).

46. *Id.* § 252(e)(B).



If a State commission fails to act to carry out its responsibility under [section 252,] . . . then the [FCC] shall issue an order preempting the State commission's jurisdiction of that proceeding or matter within 90 days after being notified (or taking notice) of such failure, and shall assume responsibility of the State commission under this section with respect to the proceeding or matter and act for the State commission.<sup>47</sup>

Finally, the Act provides that parties can appeal a commission's final order approving or rejecting an agreement to federal district court.<sup>48</sup> This is true for both negotiated and arbitrated agreements. Unfortunately, the Act does not provide a standard of review. It does not distinguish, with respect to judicial review, between negotiated and arbitrated agreements. Nor does it distinguish between issues governed by FCC rules and those issues that the FCC has not yet addressed.

### III. JURISDICTIONAL ISSUES: WHO INTERPRETS THE ACT?

Jurisdictional issues have always been a complicated matter in the telecommunications field.<sup>49</sup> The Act serves only to compound these complications. It relies heavily on state commissions to oversee interconnection agreements between the local market's incumbent monopolist and new entrants.<sup>50</sup> Nonetheless, it delegates substantial authority to the FCC as well. For example, in addition to granting the FCC the authority to evaluate agreements when state commissions fail to do so,<sup>51</sup> the Act directs the FCC to establish rules regarding a number of other issues, including number portability<sup>52</sup> and access requirements to network elements.<sup>53</sup> It also authorizes the FCC to create "impartial entities to administer telecommunications num-

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47. *Id.* § 252(e)(5).

48. See § 252(e)(6); see also § 252(e)(4) (precluding a state court's jurisdiction to review the action of a State commission in approving or rejecting an agreement under section 252). *But see* *Illinois Bell Tel. Co. v. WorldCom Techs., Inc.*, 179 F.3d 566, 574 (7th Cir. 1999) (explaining that the parties can take issues involving interpretation of agreements—matters of contract law—to state court), *cert. granted in part sub. nom. Mathias v. WorldCom Techs., Inc.*, 121 S. Ct. 1224 (Mar. 5, 2001).

49. See generally M. Anne Swanson & J.G. Harrington, *The Future of Telecommunications (As We Know It)—Blurred Boundaries and Jurisdictional Conflicts*, in 17TH ANNUAL INSTITUTE ON TELECOMMUNICATIONS POLICY & REGULATION 139, 146 (PLI Patents, Copyrights, Trademarks & Literary Prop. Course Handbook Series No. 584, 1999) (explaining that in the telecommunications industry, companies are subject to regulatory requirements on a routine basis at local, state, federal, and international levels), *available at* Westlaw, 584 PLI/Pat 139.

50. See Phillip J. Weiser, *Chevron, Cooperative Federalism, and Telecommunications Reform*, 52 VAND. L. REV. 1, 3 (1999).

51. See 47 U.S.C. § 252(e)(5).

52. See *id.* § 251(b)(2).

53. See § 251(d)(1).

bering.<sup>54</sup> Finally, it draws federal courts into the jurisdictional mayhem by subjecting the state commission's approval or rejection of an interconnection agreement to review by the federal courts.<sup>55</sup>

### A. *The Role of the FCC*

In 1996, the FCC promulgated rules implementing and interpreting various provisions of the Telecommunications Act.<sup>56</sup> These rules gave rise to a number of challenges, which was not surprising given the scope of state commissions' authority prior to the Act and the amount of intrusion the rules appear to make into areas of obviously intrastate concern, such as pricing standards. All challenges to the rules, initiated by both state commissions and ILECs, were ultimately consolidated into one proceeding in the Eighth Circuit Court of Appeals.<sup>57</sup> In *Iowa Utilities Board v. FCC*, the Eighth Circuit invalidated a number of the FCC's rules, including the pricing standards, holding that the FCC has authority over interstate matters only.<sup>58</sup>

The FCC, joined by AT&T and MCI, appealed the Eighth Circuit's decision, and the Supreme Court finally addressed the issue in 1999, in *AT&T Corp. v. Iowa Utilities Board*.<sup>59</sup> The ILECs defended the Eighth Circuit's opinion, arguing that the FCC's rulemaking authority extends only to interstate and foreign matters—and not to intrastate concerns.<sup>60</sup> The Eighth Circuit had held that 47 U.S.C. § 152(b) would prevent FCC rulemaking in this area without express authority by the 1996 Act, which it found was not included in the Act.<sup>61</sup> Insisting that express authority was required, the ILECs argued that the Act does not provide the FCC the necessary express jurisdictional

54. *Id.* § 251(e)(1).

55. See § 252(e)(6). After a determination by a state commission to approve or reject an interconnection agreement, whether arbitrated or negotiated, "any party aggrieved by such determination may bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements" of sections 251 and 52 of the Act. *Id.*; see also Weiser, *supra* note 50, at 13-14. But see *BellSouth Telecommuns., Inc. v. North Carolina Utils. Comm'n*, 240 F.3d 271 (4th Cir. 2001) (holding that federal courts may only review the final decisions by state commissions to approve or reject interconnection agreements; all other issues must be brought in state court).

56. See generally First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 4 Communications Reg. (P&F) 1 (Aug. 8, 1996) (codified in scattered sections of 47 C.F.R. pts. 1, 20, 51, 90) [hereinafter First Report], 1996 WL 452885, summarized at 61 Fed. Reg. 45,476 (Aug. 29, 1996), 1996 WL 489810.

57. See *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 792 (8th Cir. 1997) (noting the earlier consolidation), *rev'd in part sub nom.* *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

58. *Id.* at 819.

59. 525 U.S. 366.

60. See *id.* at 374.

61. See *id.* at 375.

grant.<sup>62</sup> They also pointed out that the Act gives state commissions a role in problem solving, and they argued that this limits the FCC's jurisdiction.<sup>63</sup> Finally, they argued that the FCC should not be given power to review agreements that state commissions have approved.<sup>64</sup>

The Court rejected the jurisdictional arguments; it pointed to section 201(b) of the Act, which "gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies."<sup>65</sup> Thus, the FCC acted within its jurisdiction in making rules that regulate intrastate communications.<sup>66</sup> The Court explained that "Congress expressly directed that the 1996 Act, along with its local-competition provisions [sections 251 and 252], be inserted into the Communications Act of 1934."<sup>67</sup> Further, section 251(i), created by the 1996 Act, states that "[n]othing in this section shall be construed to limit or otherwise affect the [FCC]'s authority under section 201."<sup>68</sup> Consequently, the Court ruled that Congress took regulation of local telecommunications away from the States, and it was therefore within the jurisdiction of the FCC to make rules regarding the regulation of intrastate communications.<sup>69</sup> The Court swept away the ILECs' other arguments as well, to specifically hold that "the Commission has jurisdiction to design a pricing methodology" under section 252(d), notwithstanding the role granted to state commissions in reviewing prices: "It is the States that will apply those standards and implement that methodology . . . . That is enough . . . ."<sup>70</sup>

Thus, the Court embraced an interpretation of the 1996 Act that offers the FCC a strong role in regulating in this area. This would suggest that Congress intended that important portions of the Act be interpreted in a uniform way, on a federal level. It also has implications for determining the proper role of state commissions. The next section addresses this issue.

### B. *The Continuing Role of State Commissions*

For the time being, the FCC's jurisdiction is secure. Nonetheless, there remain a number of important issues under the Act that are not governed by FCC regulation. The pricing standard of section 252(d) and the reciprocal compensation requirement of section

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62. The Court deemed this argument "academic" after rejecting the second argument. See *id.* at 383.

63. See *id.* at 383-84.

64. The Court found this argument to be unripe, as no such event had yet occurred. See *id.* at 386.

65. *Id.* at 380.

66. See *id.* at 379-80.

67. *Id.* at 377-78 (citing 47 U.S.C. § 201(b)).

68. 47 U.S.C. § 251(i).

69. See *Iowa Utils. Bd.*, 525 U.S. at 378-79.

70. *Id.* at 384.

251(b)(5) are two such examples. Without FCC guidance, state commissions arbitrating and/or reviewing interconnection agreements are left to interpret these provisions on their own.

### 1. States' Interpretation of the Act's Pricing Provisions

After the Supreme Court's ruling in *Iowa Utilities Board*, the Eighth Circuit on remand again invalidated several FCC regulations, including pricing regulations promulgated under section 252(d), this time holding that the regulations were not reasonable interpretations of the Act.<sup>71</sup> Although courts must defer to interpretations of federal law made by federal agencies, they are only required to do so if the agency's "interpretation is consistent with the plain meaning of the statute or is a reasonable construction of an ambiguous statute."<sup>72</sup> Applying this rule, the Eighth Circuit held that the FCC's pricing rules conflicted with the clear language of the Act.<sup>73</sup>

Section 252(d)(1) states that pricing standards "may include a reasonable profit,"<sup>74</sup> but that they must be both nondiscriminatory<sup>75</sup> and "based on the cost . . . of providing the interconnection or network element."<sup>76</sup> The Act does not specify how to calculate the cost. The FCC's pricing rules would calculate cost using "a forward-looking economic cost methodology that is based on the Total Element Long-run Incremental Cost (TELRIC) of the element."<sup>77</sup> This methodology ties the costs for access charged to the carrier seeking entry to the most efficient technology available in the industry, regardless of what technology the ILEC actually possesses.<sup>78</sup> The Eighth Circuit found this contradicted the clear meaning of the statute:

Congress intended the rates to be "based on the cost . . . of providing the interconnection or network element," not on the cost some imaginary carrier would incur by providing the newest, most efficient, and least cost substitute for the actual item or element which will be furnished by the existing ILEC pursuant to Congress's mandate for sharing. . . . Congress knew it was requiring the existing ILECs to share their existing facilities and equipment with new competitors . . . and it expressly said that the ILECs'

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71. See *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 748 (8th Cir. 2000), cert. granted, 121 S. Ct. 877-79 (Jan. 22, 2001).

72. *Iowa Utils. Bd.*, 219 F.3d at 748-49 (citing *Chevron U.S.A., Inc. v. Natural Resource Defense Council*, 467 U.S. 837, 842-43 (1984)).

73. See *id.* at 749-50.

74. 47 U.S.C. § 252(d)(1)(B).

75. See § 252(d)(1)(A)(ii).

76. *Id.* § 252(d)(1)(A)(i) (emphasis added).

77. *Iowa Utils. Bd.*, 219 F.3d at 749 (explaining the FCC's pricing standards); see also 47 C.F.R. § 51.505 (2000); First Order, *supra* note 56, at ¶ 685.

78. See sources cited *supra* note 77.

costs of providing those facilities and that equipment were to be recoverable by just and reasonable rates.<sup>79</sup>

While the Supreme Court has granted certiorari in this case,<sup>80</sup> it is impossible to predict when a final ruling will come. In the meantime, five years after the Telecommunications Act was enacted,<sup>81</sup> the FCC still has no comprehensive body of regulations in place. The Eighth Circuit's decision thus only adds to the uncertainty and confusion. Further, these invalidations may lead the FCC to delay issuance of any new rules.

As a consequence, state commissions are not only implementing the Act, but also interpreting it by making decisions ordinarily made by the FCC. For example, after the Eighth Circuit stayed the FCC's pricing regulations in 1997 (before they ever took effect), the Florida Public Service Commission (FPSC) interpreted the pricing provisions of the Act for itself.<sup>82</sup> The FPSC "addressed the matter independently, without regard to the FCC regulations."<sup>83</sup> Indeed, the FPSC ignored the FCC's TELRIC pricing methodology, instead adopting its own pricing methodology, "Total Service Long Run Incremental Cost" (TSLRIC).<sup>84</sup> While the FCC's TELRIC based costs on a *hypothetical*, efficient network that could be incorporated into existing facilities, the FPSC's methodology "uses the *current network architecture* and future replacement technology as the basis for determining long-run incremental cost."<sup>85</sup> The difference in interpretation is not insignificant, and the resulting confusion has predictably spawned litigation, described more fully in Part V below. The point here is merely that state commissions continue to interpret the provisions on their own—which will, as later discussed, pose a problem for courts subjecting their decisions to review.

## *2. States' Interpretation of the Act's Reciprocal Compensation Provisions*

In addition to interpreting the Act's pricing provisions, state commissions have been left to interpret section 251 of the Act, which (among other things) requires LECs "to establish reciprocal compensation arrangements for the transport and termination of telecommunications."<sup>86</sup> When one LEC delivers traffic that originated on an-

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79. *Iowa Utils. Bd.*, 219 F.3d at 750 (citations omitted).

80. *Verizon Communs., Inc. v. FCC*, 121 S. Ct. 877 (Jan. 22, 2001).

81. *See* Pub. L. No. 104-104, 110 Stat. 56 (Feb. 8, 1996).

82. *See generally* *MCI Telecommuns. Corp. v. BellSouth Telecommuns., Inc.*, 112 F. Supp. 2d 1286 (N.D. Fla. 2000).

83. *Id.* at 1292 (explaining the FPSC's reaction to *Iowa Utils. Bd. v. Bell Atlantic Corp.*, 120 F.3d 753, 800 (8th Cir. 1997)).

84. *Id.*

85. *Id.*

86. 47 U.S.C. § 251(b)(5).

other LEC's (the initiating LEC's) networks, the delivering LEC must be compensated for its costs.<sup>87</sup> Because an initiating LEC is able to recoup the cost of transporting the call from the caller, but the delivering LEC cannot, the initiating LEC must reimburse the LEC that delivers the call—that is, it must provide “reciprocal compensation.”<sup>88</sup>

The FCC has construed the duty of reciprocal compensation to apply only to *local* traffic (compensation for long-distance traffic was unaffected by the Act).<sup>89</sup> This has created a question as to whether calls bound for Internet service providers<sup>90</sup> (“ISP-bound calls”) should be considered “local” for reciprocal compensation purposes.

The FCC traditionally has looked to a call's end point when determining its own jurisdiction (which did not extend to local communications before the 1996 Act) and “consistently has rejected attempts to divide communications at any intermediate points.”<sup>91</sup> However, calls to an ISP do not end at that ISP's local server; rather, they move on to an Internet website often located in another state.<sup>92</sup> As such, “a substantial portion of Internet traffic involves accessing interstate or foreign websites.”<sup>93</sup> Despite the eventual endpoint of the call, the initial ISP-bound portion of the call remains a local call, prompting the FCC to declare ISP-bound traffic “jurisdictionally mixed.”<sup>94</sup> But this moniker does not address the problem that the initiating LEC incurs costs for which it is not compensated.<sup>95</sup>

87. See *Illinois Bell Co. v. WorldCom Techs., Inc.*, 179 F.3d 566, 568 (7th Cir. 1999) (explaining the concept of reciprocal compensation), *cert. granted in part sub nom. Mathias v. WorldCom Techs., Inc.*, 121 S. Ct. 1224 (Mar. 5, 2001).

88. *Id.*; see also *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000) (“[W]hen a customer of LEC A calls a customer of LEC B, LEC A must pay LEC B for completing the call, a cost usually paid on a per-minute basis.”).

89. See 47 C.F.R. § 51.701 (2000); First Report, *supra* note 56, at ¶ 7. The D.C. Circuit explained:

LECs that originate or terminate long-distance calls continue to be compensated with “access charges,” as they were before the 1996 Act. Unlike reciprocal compensation, these access charges are not paid by the originating LEC. Instead, the long-distance carrier itself pays both the LEC that originates the call and links the caller to the long distance network, and the LEC that terminates the call.

*Bell Atlantic*, 206 F.3d at 4.

90. An Internet service provider (ISP) is a company that offers its customers the ability to obtain an Internet connection through the phone lines. See *Illinois Bell Tel. Co.*, 179 F.3d at 569.

91. Declaratory Ruling, *Inter-Carrier Compensation for ISP-Bound Traffic*, 17 Communications Reg. (P&F) 201, at ¶ 10 (Feb. 26, 1999) [hereinafter 1999 Ruling], 1999 WL 98037, summarized at 64 Fed. Reg. 14,203 (proposed Mar. 24, 1999), 1999 WL 155163, vacated and remanded, *Bell Atlantic*, 206 F.3d 1.

92. See *id.* ¶ 18.

93. *Id.* ¶ 18.

94. *Id.* ¶ 19.

95. See *id.* ¶ 29.

In a declaratory order adopted February 25, 1999, the FCC discussed the debate over reciprocal compensation for ISP-bound traffic and concluded that it would form a rule to govern these issues.<sup>96</sup> First, it determined that ISP-bound traffic was not in fact local; however, it gave state commissions the authority to interpret the matter for themselves until promulgation of a rule.<sup>97</sup> In addition to granting parties the option of including reciprocal compensation provisions in their interconnection agreements, the FCC gave state commissions the authority, during arbitration proceedings, to construe agreements as requiring compensation. Moreover, “even when the agreements of interconnecting LECs include no linguistic hook for such a requirement, the commissions can find that reciprocal compensation is appropriate.”<sup>98</sup>

However, the D.C. Circuit eventually vacated and remanded the FCC’s 1999 order. The court held that the FCC failed to adequately explain how it reached its decision that a LEC’s terminated, ISP-bound calls are not local.<sup>99</sup> Thus, state commissions are left to interpret this provision of the federal act as well without guidance from the FCC.<sup>100</sup>

### 3. Summary

Despite the Supreme Court’s *Iowa Utilities Board* opinion, “the content of the new regulatory model remains unclear.”<sup>101</sup> Reciprocal compensation and pricing methodology issues are just two examples of the scope left for state commission interpretation of the Act. When the Court had the opportunity to address whether courts should extend deference to state commission interpretations, it did not take it. The Court noted that while it is well established that state officers can interpret and apply federal law,<sup>102</sup> it knew of no similar instances in which state administrative agencies could make federal policy.<sup>103</sup> However, instead of discussing the proper standard of review federal district courts should apply, the Court simply pointed out the novelty of “the attendant legal questions [that will arise from the Act],” in-

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96. See *id.* ¶ 28.

97. See *id.*

98. *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000); see also 1999 Ruling, *supra* note 91, at ¶ 18.

99. See *Bell Atlantic*, 206 F.3d at 1.

100. [Editor’s Note: As this Note was going to publication, the FCC on remand promulgated a new rule. See *Intercarrier Compensation for ISP-Bound Traffic*, 66 Fed. Reg. 26,800-01 (May 15, 2001) (to be codified at 47 C.F.R. pt. 51). The new rule provides that ISP-bound traffic is exempt from reciprocal compensation under the 1996 Act. See *id.* at 26,801. It also provides a pricing mechanism. See *id.* at 26,802-03.]

101. McLaughlin, *supra* note 6, at 2212.

102. See *Iowa Utils. Bd.*, 525 U.S. at 385 n.10 (citing *United States v. Jones*, 109 U.S. 513 (1883)).

103. See *id.*

cluding the important question whether federal courts must defer to interpretations of federal law by state commissions.<sup>104</sup>

#### IV. WHAT LEVEL OF DEFERENCE SHOULD COURTS OWE STATE COMMISSIONS WHEN THEY INTERPRET THE ACT? THE IMPORTANCE OF DE NOVO REVIEW OF NON-FCC INTERPRETATIONS OF THE ACT

As Duane McLaughlin has pointed out, the legislative history of the Act reveals three important policies:

(1) Congress intended there to be basic national standards to ensure that states would not be able to thwart competition, (2) Congress saw the FCC as the natural creator of these national standards, and (3) Congress intended to preserve a significant role for the states in assuring that the implementation would conform to local needs and conditions.<sup>105</sup>

This raises the question of whether a *de novo* standard or an arbitrary-and-capricious standard of review best promotes the Act's goals. In *Iowa Utilities Board*, the Supreme Court stated that it is "aware of no similar instances in which federal policymaking has been turned over to state administrative agencies."<sup>106</sup> This important statement appears to point in favor of *de novo* review. Indeed, a recent district court opinion, *MCI Telecommunications Corp. v. Bell-South Telecommunications, Inc.*,<sup>107</sup> provides extensive reasoning for applying a *de novo* standard to issues of interpretation.<sup>108</sup> The court explained why courts should not give a state agency's interpretation of a federal act the same level of deference that it gives a federal agency's interpretation:

State commissions have no special expertise in interpreting federal statutes and no authority to make federal law. Federal courts are or should be at least as adept as state commissions in interpreting federal statutes. There is thus far less reason for deference to state commissions on issues of the meaning and import of the Act, and it makes sense for district courts to address such issues *de novo*, as Congress apparently intended.<sup>109</sup>

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104. *Id.*

105. McLaughlin, *supra* note 6, at 2236.

106. *Iowa Utils. Bd.*, 525 U.S. at 385.

107. 112 F. Supp. 2d 1286 (N.D. Fla. 2000).

108. *Id.* at 1290-91.

109. *Id.* at 1291 (comparing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), with *Amisub (PSL), Inc. v. Colorado Dep't of Social Servs.*, 879 F.2d 789 (10th Cir. 1989)). The court explained that it would "review *de novo* issues regarding the meaning and import of the Telecommunications Act and will review the Florida Commission's determinations of how to implement the Act as so construed only under the arbitrary and capricious standard." *Id.*



Moreover, the court read section 252(e)(6) of the Act, which designates federal district courts as the proper authority to review decisions made by state commissions, as requiring *de novo* review of state commissions' interpretations of the Act, but requiring deference in all other instances.<sup>110</sup>

However, some have argued that *de novo* review exposes federal courts to a number of risks. Professor Weiser has summarized the three greatest risks:

(1) causing bad results through their involvement in policy decisions for which they are ill-suited; (2) damaging their perceived legitimacy if they are seen as making pure policy decisions; and (3) acting undemocratically by depriving accountable policymakers of the opportunity to make such decisions.<sup>111</sup>

Further, he suggests that employing an arbitrary-and-capricious standard will increase interstate competition.<sup>112</sup> By deferring to state agencies, courts can increase "individual tailoring by and competition between different states in implementing a federal statute,"<sup>113</sup> as each state will attempt to tailor the Act to best fit its local conditions.<sup>114</sup> Secondary benefits include the promotion of state autonomy, local participation, and greater accountability.<sup>115</sup> Furthermore, the implementation of the Act would "rely on the economy of local agencies (rather than creating or expanding a new national bureaucracy)."<sup>116</sup> It is also true that a more deferential standard would promote at least one important goal of the Act by giving the states a significant role in implementing standards that conform to local needs and conditions. However, of all the arguments touting the benefits of a deferential standard, the most important include increased competition and state experimentation.<sup>117</sup>

Yet, while it seems logical that innovations in problem solving will result when fifty different state governments interpret and implement an act, innovation has not in fact been a byproduct of "cooperative federalism" under the Telecommunications Act. The debate over reciprocal compensation<sup>118</sup> provides an example: In industries like

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110. See *id.* at 1291.

111. Weiser, *supra* note 50, at 28.

112. See *id.* at 3.

113. *Id.* at 23.

114. See *id.* at 36 (explaining that giving states such an active role in implementing the Act "allow[ed] Congress to pursue a policy of diversity and experimentation within a federal scheme").

115. See *id.*

116. *Id.*

117. See *id.*; Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317, 397 (1997) (stating that the benefits of using states as laboratories is one of the primary reasons for advocating a decentralized government).

118. See generally, e.g., *U.S. West Communs. v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1117 n.4 (9th Cir. 1999) (listing as one issue to be reviewed under a *de novo* standard a

telecommunications, states have been reluctant to experiment. As of January 2000, seventeen state public utilities commissions had addressed whether reciprocal compensation should apply to calls to ISP traffic.<sup>119</sup> As described above, in its now vacated 1999 ruling, the FCC had explained that the states were free (until the issuance of an FCC rule) to adopt another method of compensation.<sup>120</sup> The FCC explicitly assured states that the FCC has the ultimate authority, as ISP-traffic is substantially interstate, but that some form of compensation is certainly appropriate.<sup>121</sup> Yet only New Jersey decided that reciprocal compensation does not apply to ISP-bound traffic.<sup>122</sup> The fact that no state took the initiative to develop innovations in the methods of compensation typically used shows that cooperative federalism does not necessarily breed experimentation. As Susan Rose-Ackerman has explained, the decentralized government that results from cooperative federalism “can create additional disincentives for innovative activity because of spillovers and the lack of sorting by risk preferences.”<sup>123</sup>

Furthermore, any benefits that might flow from innovation and experimentation are far outweighed by the danger created when allowing each state to interpret the federal Act on its own.<sup>124</sup> It is im-

commission’s determination that reciprocal compensation was due for ISP-bound traffic), *cert. denied*, 530 U.S. 1284 (June 29, 2000).

119. See *Pacific Bell*, Application 98-11-024 (Cal. Pub. Util. Comm’n June 24, 1999) (arbitration proceeding); *Global NAPs South*, Docket No. 98-540 (Del. Pub. Serv. Comm’n Mar. 9, 1999) (same); *Pac-West Telecom, Inc.*, Docket No. 98-10015 (Nev. Pub. Util. Comm’n Mar. 4, 1999) (same); *Global NAPs, Inc.*, Docket No. TO98070426 (N.J. Bd. of Pub. Util. July 12, 1999); *Electric Lightwave, Inc.*, Order No. 99-218, ARB 91 (Or. Pub. Util. Comm’n Mar. 17, 1999) (same); *Nextlink Tenn., L.L.C.*, Docket No. 98-00123 (Tenn. Reg. Auth., May 18, 1999) (same); *WorldCom v. GTE Northwest*, Docket No. UT-980338 (Wash. Util. & Trans. Comm’n May 12, 1999) (same); *ICG Telecom Group*, Docket 26619 (Ala. Pub. Serv. Comm’n March 4, 1999) (interpretation of a preexisting agreement); *Intermedia Comm., Inc., v. GTE Florida, Inc.*, Docket No. 980986-TP (Fla. Pub. Serv. Comm’n July 30, 1999) (same); *Time Warner Communs., v. Indiana Bell Tel. Co.*, Cause No. 41097 (Ind. Util. Reg. Comm’n June 9, 1999) (same); *MFS Intelenet v. Bell Atlantic*, Case No. 8731 (Md. Pub. Serv. Comm’n June 11, 1999) (same); *U.S. West Communs., Inc.*, Docket No. P-421/M-99-529 (Mn. Pub. Util. Comm’n Aug. 17, 1999) (same); *ICG TelecomGroup, Inc. v. Ameritech Ohio*, Case No. 97-1557-TP-CSS (Oh. Pub. Util. Comm’n May 5, 1999) (same); *NEVD of Rhode Island, L.L.C.*, Docket No. 2935 (R.I. Pub. Util. Comm’n July 21, 1999) (same); *GTE Hawaiian Tel. Co.*, Docket No. 99-0067 (Haw. Pub. Util. Comm’n May 6, 1999) (declaratory statement); *Opinion Concerning Reciprocal Compensation*, Case No. 99-C-0529 (N.Y. Pub. Serv. Comm’n Aug. 26, 1999) (same); *Adoption of Partial Settlement*, No. P 00991648 (Penn. Pub. Util. Comm’n Aug. 26, 1999) (same).

120. See 1999 Ruling, *supra* note 91, at ¶ 27.

121. See *id.*

122. See *Global NAPs, Inc.*, Docket No. TO98070426 (N.J. Bd. of Pub. Util. July 12, 1999).

123. Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?*, 9 J. LEG. STUDIES 593 (1980).

124. *But see Weiser*, *supra* note 50, at 3-4 (“[C]omplete uniformity in the implementation of cooperative federalism statutes is both an undesirable and unattainable goal, as the

portant that federal courts not defer to state agencies. By not deferring, Federal courts promote uniformity in the interpretation of the law, offer regulated parties certainty and predictability, and keep the cost of legal battles low. Even if certain involved parties “would benefit marginally by having a myriad of local statutes,”<sup>125</sup> the benefits do not necessarily outweigh the associated transaction costs.

If courts were to defer to state agencies, it would eliminate uniform interpretation and application of federal law.<sup>126</sup> Though courts have generally deferred to federal agencies, they have done so on the basis that federal agencies can contribute to the uniformity of federal law, whereas state agencies cannot.<sup>127</sup> In fact, the Supreme Court stated in *Iowa Utilities Board* that there is a presumption that “a federal program administered by 50 independent state agencies is surpassing strange.”<sup>128</sup> It would be even stranger in the telecommunications industry, in which the same parties frequently debate the same issues in multiple states.

Generally, market participants prefer regulations that “emanate from the center,”<sup>129</sup> because increased uniformity promotes lower costs. As has been pointed out with regard to legislation, even where federal regulation may be “stricter than what the states might have adopted, the transaction costs of fighting fifty . . . battles, only to comply with fifty different . . . schemes, [make] it attractive to submit to national control.”<sup>130</sup> These types of considerations are equally true of the need for uniform *interpretation* of the laws. It would do the parties little good to have one, uniform body of federal law interpreted fifty different ways. This applies especially to the telecommunications industry, where the same LECs often compete in many different states.<sup>131</sup>

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costs of intrusive judicial review are considerable, and there are important benefits that come from experimentation and interstate competition.”).

125. Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 271 (1990) (explaining that interest groups would often prefer the passage of a federal law over the passage of separate state statutes, due to the high costs “associated with obtaining passage of all those statutes”).

126. See, e.g., *Amisub, Inc. v. Colorado Dep’t of Soc. Servs.*, 879 F.2d 789, 795-96 (10th Cir. 1989); *Turner v. Perales*, 869 F.2d 140, 141 (2d. Cir. 1989).

127. See Weiser, *supra* note 50, at 20-21.

128. *AT&T Co. v. Iowa Utils. Board*, 525 U.S. 366, 378 n.6 (1996).

129. Friedman, *supra* note 117, at 374.

130. *Id.*

131. See, e.g., Teligent, *About Us*, at <http://www.teligent.com/docs/aboutus.html> (last visited May 20, 2001) (stating that Teligent’s does business in over 40 local markets); see also KMC Telecom, *The 1*, at <http://www.kmctelecom.com/cities/index.cfm?fuseaction=map> (last visited May 20, 2001) (40 cities); e.spire Communications, *Press Releases*, at <http://www.espire.com/press/index.cfm> (last visited May 20, 2001) (38 cities); ITC^DeltaCom, *Fiber Network*, at <http://www.itcdeltacom.com/network.html> (last visited May 20, 2001) (10 states); ICG Communications, *Profile: Office Locations*, at <http://www.icgcomm.com/profile/locations.asp> (last visited May 20, 2001) (9 states); Global

The need for certainty in the law is particularly important when the law is designed to facilitate market entry by new participants. This idea has been recognized by the FCC. In its Third Report and Order on implementing the Act,<sup>132</sup> the FCC delineated factors to be considered in evaluating what network elements ILECs are obligated to share with market entrants. One of these factors was "certainty in the market,"<sup>133</sup> or specifically "how the unbundling obligations [the FCC] adopt[s] can provide the uniformity and predictability that new entrants and fledging competitors need to develop national and regional business plans."<sup>134</sup> Thus, courts ought to resist applying a deferential standard to interpret state commissions' interpretations of the act and turn instead to de novo review.

#### V. THE *HIX* STANDARD AND THE FAILURE TO DISTINGUISH BETWEEN NEGOTIATED AND ARBITRATED AGREEMENTS

Case law reveals that while the federal courts theoretically apply de novo review to state commissions' interpretations of the Act, in many instances they are in fact using a more deferential standard. The question of the suitable level of deference to commissions' decisions was first addressed in a 1997 federal district court opinion, *U.S. West Communications, Inc. v. Hix*.<sup>135</sup> In the absence of Supreme Court guidance, the *Hix* test continues to be applied by other District Courts and even Circuit Courts.<sup>136</sup> The *Hix* court decided "the appropriate standard of review to be applied to [state commissions'] decision[s] approving certain interconnection agreements."<sup>137</sup> The court detailed a two-part inquiry to guide a court's review of state commissions' decisions.<sup>138</sup>

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NAPs, *Sites*, at <http://www.gnaps.com/sites.html> (last visited May 20, 2001) (six states plus Washington, D.C.); Focal Communications Corporation, *Overview*, at <http://www.focal.com/about> (last visited May 20, 2001) (21 cities; 15 states plus Washington, D.C.).

132. Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 F.C.C. Record 3696 (Nov. 5, 1999), 1999 WL 1008985, *order modified*, Supplemental Order, 18 Communications Reg. (P&F) 1041 (Nov. 24, 1999), 1999 WL 1065185, and *order clarified* Supplemental Order Clarification, 15 F.C.C. Record 9587 (June 2, 2000), 2000 WL 713746.

133. *Id.* at ¶ 15.

134. *Id.*

135. 986 F. Supp 13 (D. Colo. 1997).

136. See *U.S. West Communs. v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1117 (9th Cir. 1999); *MCI Telecommuns. Co. v. Michigan Bell Tel. Co.*, 79 F. Supp. 2d 768, 773 (E.D. Mich. 1999); *U.S. West Communs., Inc. v. Public Serv. Comm'n*, 75 F. Supp. 2d 1284, 1286 (D. Utah 1999); *AT&T Communs. of the Southwest, Inc. v. Southwestern Bell Tel. Co.*, 86 F. Supp. 2d 932 (W.D. Mo. 1999); *MCI Telecommuns. Co. v. BellSouth Telecommuns., Inc.*, 7 F. Supp. 2d 674, 678 (E.D.N.C. 1998) ("The court's standard of review in considering these matters was set forth in [*Hix*].").

137. *Hix*, 986 F. Supp. at 14.

138. See *id.* at 18.

Under the *Hix* test, the court must first determine whether the commission's decision "procedurally and substantively" adheres to the Act.<sup>139</sup> Because this is a question of law, the *Hix* court stated that it is subject to de novo review in federal court.<sup>140</sup> If the reviewing court finds that the commission acted in compliance with the Act, it is then to review all remaining issues under an arbitrary-and-capricious standard.<sup>141</sup> The *Hix* court elaborated that the rule it developed does not rely on technical distinctions between "questions of law" and "questions of fact."<sup>142</sup> Instead, the court insisted that the critical question is whether the issue involves procedural or substantive compliance with the Act.<sup>143</sup> Essentially, under the procedural-and-substantive-compliance classification delineated in *Hix*, the only issue courts are to review de novo is whether commissions' decisions comply with the Act.<sup>144</sup> For instance, the Act outlines some factors the commission should consider before approving or rejecting the interconnection agreement.<sup>145</sup>

But *Hix's* classification is problematic. While courts act appropriately when they apply the *Hix* standard to negotiated agreements, applying the *Hix* standard to arbitrated agreements is completely improper. The difference in the appropriate levels of deference hinges on the different factors state commissions use when approving negotiated and arbitrated agreements.<sup>146</sup> Few courts have acknowledged the distinction between arbitrated and negotiated agreements;<sup>147</sup> nonetheless, they generally acknowledge that the level of appropriate

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139. *Id.* at 18-19.

140. *See id.* at 18 (quoting *Colorado Health Care Ass'n v. Colorado Dep't of Soc. Servs.*, 842 F.2d 1158, 1165 (10th Cir. 1998)).

141. *See id.* (explaining that the arbitrary-and-capricious standard is "highly deferential; the agency's action is presumed valid if a reasonable basis exists for its decision," and citing *Amisub, Inc. v. Colorado Dep't of Soc. Servs.*, 879 F.2d 789, 800 (10th Cir. 1989)).

142. *Id.* at 19 (ordering the parties to "avoid use of those labels in arguing how the standard of review applies to the specific issues").

143. *See id.*

144. *See id.*

145. *See* 47 U.S.C. §§ 252(e)(2)(A)(i-ii).

146. Despite the fact that decisions by arbitrators are generally afforded a high level of deference, "the appropriate standard derives from that ordinarily applicable to judicial review of administrative decisions, not arbitration decisions." *MCI Telecommuns. Corp. v. BellSouth Telecommuns., Inc.*, 112 F. Supp. 2d 1286, 1291 n.7 (N.D. Fla. 2000).

147. *But see* *Bell Atlantic Maryland, Inc. v. MCI WorldCom, Inc.*, 240 F.3d 279, 2001 WL 123663 (4th Cir. 2001). The court explained:

While [the Act] authorizes review of § 252 arbitration determinations ultimately leading to the formation of interconnection agreements, in the final analysis, the State commission determinations under § 252 involve only approval or rejection of such agreements. With respect to negotiated agreements in particular, the federal review is narrower. The *only* "determination" that can be made by the State commission under § 252 on a negotiated agreement is a determination to approve or reject it . . . .

*Id.* at \*\*21 (footnote omitted).

deference depends on whether the issue is one of interpretation or implementation.

For example, the court in *MCI Telecommunications Corp. v. Bell-South Telecommunications*<sup>148</sup> explained that “district court review of the meaning and import of the Telecommunications Act should be *de novo* and that, when acting in conformance with a correct interpretation of the Act, state commissions have broad discretion reviewable only under the arbitrary-and-capricious standard.”<sup>149</sup> While the *Hix* standard intends to promote this idea, it fails to do so by overlooking the important distinction between negotiated and arbitrated agreements. When a commission has arbitrated an agreement under “a correct interpretation of the Act,”<sup>150</sup> its approval or rejection of the agreement *should* be given deferential treatment. However, even under this standard, the court must first evaluate whether the commission in fact correctly interpreted the Act. This is even more true when the court is reviewing an arbitrated agreement.

Courts are skipping this inquiry entirely. Instead, they begin with a deferential view of the commissions’ actions and, apparently, a presumption that the commissions are correctly interpreting the Act. *MCI Communications* and a later case before the same court illustrate. In *MCI Communications*, MCI challenged the Florida Commission’s (FPSC’s) pricing methodology (TSLRIC) described in Part III above, arguing that it should mirror the FCC’s methodology (TELRIC).<sup>151</sup> The FPSC had imposed this methodology during an arbitration of an interconnection agreement between MCI and Bell-South.<sup>152</sup> The U.S. District Court in the Northern District of Florida noted that the Act does not address whether TSLRIC or TELRIC provides the proper pricing methodology and that valid arguments existed for either methodology:

Nothing in the Telecommunications Act specifies which of these two methodologies must be followed. . . . This is, therefore, an issue on which the appropriate administrative agency’s adoption of either methodology would survive judicial review under the applicable arbitrary and capricious standard.

. . . Had [the Eighth Circuit’s initial invalidation of the FCC rules] remained intact [following appeal to the Supreme Court],

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148. 112 F. Supp. 2d 1286 (N.D. Fla. 2000).

149. *Id.* at 1290 (basing this standard on “the statutory language, the standards generally applicable to judicial review of administrative action, the apparent purpose of involving state commissions in this process while providing for federal district court review of their decisions, and the emerging case law under the Act”). The court noted, “This accords with the consistent approach of courts that have addressed this issue under the Act.” *Id.* at 1291-92 (citing, among others, *Hix*).

150. *Id.* at 1290.

151. *See id.* at 1286.

152. *See id.* at 1289.

the Florida Commission's adoption of TSLRIC would have been unassailable.<sup>153</sup>

However, the court invalidated FPSC's adoption of TSLRIC because it conflicted with the FCC's rules.<sup>154</sup>

Shortly after the *MCI* decision, the Eighth Circuit again invalidated the FCC rules that relied on TELRIC.<sup>155</sup> Thus, less than four months after *MCI*, Florida's pricing provisions were again before the court; in *AT&T Communications of the Southern States, Inc. v. BellSouth Telecommunications*, the same federal district court in Florida readdressed the validity of TSLRIC—and this time upheld it.<sup>156</sup> With all conflicting FCC rules invalidated by the Eighth Circuit, the court deferred to the FPSC's decision.<sup>157</sup>

The *AT&T* court stressed, as it had noted in *MCI*, that there was nothing *unreasonable* about the FPSC's methodology.<sup>158</sup> Given the Eighth Circuit's finding that the FCC's methodology violated the plain meaning of the Act, this is not too surprising. What is striking is not that *AT&T* upheld the FPSC's methodology, but how.

The court explicitly referred to the methodology as “an . . . *interpretation* of the Act.”<sup>159</sup> One might have expected this to lead to *de novo* review. In fact, the court had formulated its standard of review this way: “I will review *de novo* issues regarding the meaning and import of the Telecommunications Act, and I will review state commission determinations of how to implement the Act as so construed only under the arbitrary and capricious standard.”<sup>160</sup> Yet in upholding the TSLRIC approach, the court characterized it as “an acceptable administrative interpretation of the Act that would survive review under the arbitrary and capricious standard. . . . [The] methodology does not violate the Act and is not arbitrary and capricious.”<sup>161</sup>

*MCI* and *AT&T* reflect the confusion that has been generated by application of the *Hix* test to arbitrated agreements. The *Hix* standard, in theory, provides courts with an opportunity to evaluate the commissions' interpretation of the Act by applying a *de novo* stan-

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153. *Id.* at 1292.

154. *See id.* at 1290.

155. *See Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 748 (8th Cir. 2000), *cert. granted*, 121 S. Ct. 877-79 (Jan. 22, 2001). “Technically, [the Eighth Circuit's ruling to invalidate the FCC regulations] leaves the situation as if the FCC had adopted no regulations at all.” *AT&T Communs. of the Southern States, Inc. v. BellSouth Telecommuns.*, 122 F. Supp. 2d 1305, 1311 n.5 (N.D. Fla. 2000) (declining to address whether the Eighth Circuit's decision would be binding in this situation).

156. *AT&T Communs.*, 122 F. Supp. at 1310.

157. *See id.* at 1311 (“But for the FCC's regulations, I would have upheld the Florida Commission's decision from the outset.”).

158. *See id.* at 1311.

159. *Id.* (emphasis added).

160. *Id.* at 1309.

161. *Id.* at 1311.

dard to issues of procedural and substantive compliance. However, in practice this is not happening because courts, including the *Hix* court, have not been separating these two elements. Once the court decides that a state commission followed the Act's procedural requirements to approve or reject the agreement in light of specified factors, the court does not question whether the commission's consideration of the factors substantively complied with the Act. Instead, courts defer by using an arbitrary-and-capricious standard when assessing how the commission considered the factors. However, there are significant distinctions between the two.

When reviewing a negotiated agreement, as described above, the state commission can only consider whether the agreement "discriminates against a telecommunications carrier not a party to the agreement"<sup>162</sup> and whether "implementation of such agreement . . . is not consistent with the public interest, convenience and necessity."<sup>163</sup> Under *Hix*, the court reviews de novo whether the commission procedurally and substantively complied with the above regulation. So long as the commission *considered* possible discrimination against other carriers and the public's interest, the court must affirm the commission's decision. Any additional questions, including the commission's decision regarding those factors, are reviewed under the arbitrary-and-capricious standard. The factors used by state commissions to evaluate negotiated agreements do not require them to interpret the Act. As a result, when courts defer to the commissions, they are deferring on questions of *implementation* only. Thus, the arbitrary-and-capricious standard makes sense.

However, in arbitration cases, state commissions actually *interpret* the Act. In reviewing arbitrated agreements, the Act requires state commissions to assess whether they meet the requirements of section 251 (the section outlining the LECs' duties), the FCC rules promulgating the Act—and the pricing standard of section 252(d).<sup>164</sup> It was this latter standard that was at issue in the *AT&T* and *MCI* cases. Under the *Hix* standard, courts should initially decide, under a de novo standard, *whether* the commission considered these factors. But according to *Hix*, courts must then use the "highly deferential"<sup>165</sup> arbitrary-and-capricious standard to review *how* the commissions considered these factors. What this standard overlooks is that the commission must also first determine *what* the factors are; where the statutory standards are unclear, the commission, using its own judgment, must give them content before it can consider them. Thus, when a court defers to a state commission's assessment of whether

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162. 47 U.S.C. § 252(e)(2)(A)(i).

163. *Id.* § 252(e)(2)(A)(ii).

164. *See id.* § 252(e)(B).

165. *Hix*, 986 F. Supp. at 18.



an arbitrated agreement complies with the Act, in all practicality the court is deferring to the state commission's own interpretation of the Act.

As noted above, the courts' own articulation of the standard of review suggests that state agencies are not supposed to be left to their own devices in formulating interpretations of federal law. Yet the case law suggests that the courts, perhaps understandably reluctant to venture into areas outside their expertise, have been doing just that. State commission review of arbitrated agreements inherently requires interpretations of the Act; when the FCC has provided none (or it has, but the courts have repudiated them) and the courts have provided none, then the commissions cannot avoid providing them themselves. According deference to these kinds of commission determinations, however, can never create the kind of uniformity that is needed in area like this one. The *Hix* standard ought to be revised to account for this fact by requiring courts to review commission decisions involving arbitrated agreements under more rigorous standards.

## VI. CONCLUSION

As Justice Scalia explained, "there is no doubt . . . that if the federal courts believe a state commission is not regulating in accordance with federal policy they may bring it to heel."<sup>166</sup> However, for courts to ever determine this, they must reformulate the *Hix* test and consider arbitrated interconnection agreements under a *de novo* standard. As evidenced by the reciprocal compensation and pricing methodology situations, state commissions inevitably interpret the Act in the absence of FCC regulations.

To require federal courts to defer to state interpretations sacrifices uniformity, and a uniform interpretation of the Telecommunications Act is essential to promote competition in the local telephone sector. The only way that this can occur is if courts review appeals of arbitrated interconnection agreements under a *de novo* standard of review. Deference to state commissions' decisions results in inconsistent interpretation of the Act.

Courts' applications of *Hix's* standard of review guidelines are dangerous, because they fail to distinguish between arbitrated agreements and negotiated agreements. When arbitrating disputed issues, the commissions, for all practical purposes, are interpreting the Act. These interpretations take effect because courts continue to claim that they are imposing *de novo* review on matters regarding "the meaning" of the Act, when truly they are deferring to state agencies on important questions of interpretation.

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166. *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 379 n.6 (1999).

If courts continue to apply *Hix* in this manner, Congress will need to revisit the Act and specify that a de novo standard must be used in appeals of arbitrated agreements. Federal courts should not be permitted to defer to state commissions' interpretation of a federal act. Otherwise, the ultimate goal of competition for the consumers' benefit will be at best delayed, at worst sacrificed.