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Verizon Communications, Inc. v. FCC- Telecommunications Access Pricing and Regulator Accountability through Administrative Law and Takings Jurisprudence

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Verizon Communications, Inc. v. FCC—Telecommunications Access Pricing and Regulator Accountability through Administrative Law and Takings Jurisprudence

Michael J. Legg*

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I. INTRODUCTION

The need for regulators to manage changing economic conditions and technology in the telecommunications industry has given rise to access regimes characterized by broad guidelines and considerable flexibility for the regulator. The incumbent local exchange carriers (“ILECs”) sought to challenge this broad discretion in *Verizon Communications, Inc. v. Federal Communications Commission*,¹ which required the Supreme Court to scrutinize the Telecommunications Act of 1996 and Implementation of the Local Competition Provision in the Telecommunications Act of 1996, First Report and Order (“Local Competition Provisions”).² Two issues before the Court were (1) the legality of using forward-looking economic cost for setting rates for interconnection or leasing of network elements and further, the legality of defining forward-looking economic cost through the total element long-run incremental cost (“TELRIC”) of the element which measures costs through a hypothetically efficient network; and (2) whether a rate-setting methodology could amount to a ‘taking’ for the purposes of the Fifth Amendment, which states “nor shall private property be taken for public use, without just compensation” (the “Takings Clause”).³

This Article draws on the Supreme Court decision in *Verizon* to argue that the intersection of ambiguous telecommunications access statutes and the limits on judicial review as a result of the separation of powers and the application of *Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc.*⁴ mean that administrative law has become an ineffective tool in ensuring the accountability of telecommunications regulators. Telecommunications regulation has become too reliant on regulatory expertise, and in the process, has ceded control over a vital area of economic policy to the regulator.⁵ A dearth of regulator accountability can give rise to a technocratic approach that undermines democratic governance. This Article argues for Congress to address access pricing in

1. 535 U.S. 467 (2002).

2. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, *First Report and Order*, 11 F.C.C.R. 15499, 4 Comm. Reg. (P & F) 1 (1996) [hereinafter *Local Competition Provisions*].

3. U.S. CONST. amend. V. The Court also addressed the provisions on unbundling and combining network elements to determine when an incumbent is required to combine network elements for a new entrant and when a combination is not technically feasible. This issue is not discussed in this article as it does not relate to access pricing.

4. 467 U.S. 837 (1984).

5. See Stephen Labaton, *F.C.C. Ruling is Expected to Favor Bells*, N.Y. TIMES, Feb. 20, 2003, at C1 (“[T]he rules that govern how much the Bell companies can charge their rivals—is one of the most important policy issues in Washington affecting the competitive landscape of the telephone markets.”).

greater detail. If further guidance is not provided, the Article argues, further challenges to TELRIC based on the Takings Clause and the Supreme Court's rate-setting cases can be expected. The limits on judicial review that are embodied in *Chevron* do not apply to the enforcement of a fundamental constitutional guarantee such as the Takings Clause. It follows that this constitutional protection will be more frequently invoked to establish a "just compensation" floor as a brake on the lack of regulator accountability.

II. U.S. TELECOMMUNICATIONS REGULATION

The deregulation of the U.S. Telecommunications industry took place through the Telecommunications Act of 1996, which amended the Communications Act of 1934.⁶ The application of the rules varies depending upon whether an entity is an ILEC, or a new entrant, referred to in the legislation as a competitive local exchange carrier ("CLEC").

A. *Deregulation Framework*

There are two types of rules. The first type may be described as the necessary conditions for a CLEC to enter the local call market, which apply equally to ILECs and CLECs. The rules require mandatory interconnection for the exchange of traffic to overcome the natural monopoly.⁷ Interconnection must be provided at any technically feasible point, must be at least equal in quality to that provided by the ILEC to itself and must be provided according to rates, terms, and conditions that are nondiscriminatory.⁸

The second type of rules aim to remove an ILEC's economic advantages flowing from its monopoly position by making it easier for CLEC's to enter the market. ILECs must unbundle network elements to allow CLECs to lease them,⁹ and resell them so that the CLEC can buy

6. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified at scattered sections of 47 U.S.C.) (2000). For an overview of the 1996 Act, see Deonne L. Bruning, *The Telecommunications Act of 1996: The Challenge of Competition*, 30 CREIGHTON L. REV. 1255 (1997); Thomas W. Hazlett, *Economic and Political Consequences of the 1996 Telecommunications Act*, 50 HASTINGS L.J. 1359 (1999); Thomas W. Hazlett, *Explaining the Telecommunications Act of 1996: Comment on Thomas G. Krattenmaker*, 29 CONN. L. REV. 217 (1996) [hereinafter Hazlett Comment]; Thomas G. Krattenmaker, *The Telecommunications Act of 1996*, 49 FED. COMM. L.J. 1 (1996); Michael I. Meyerson, *Ideas of the Marketplace: A Guide to the 1996 Telecommunications Act*, 49 FED. COMM. L.J. 251 (1997); and Glen O. Robinson, *The "New" Communications Act: A Second Opinion*, 29 CONN. L. REV. 289 (1996).

7. 47 U.S.C. § 251(a), (c) (2000).

8. *Id.* § 251(b)(2).

9. 47 U.S.C. § 251(c)(3).

service in bulk, brand it, and sell it under its own name.¹⁰ A network element must be unbundled if it is necessary and if a lack of access to it would impair the CLEC's ability to offer the service.¹¹

As a result, competition in the local market may be achieved through either a CLEC building its own network and relying on the first type of rules (facilities-based competition), operating as a pure reseller using the second type of rules, or using a hybrid of both approaches whereby a CLEC uses some of its own facilities and leases the unbundled network elements that it lacks so as to combine them into a complete service.¹²

B. Access Pricing

The Telecommunications Act of 1996 provided for rates to be either negotiated or set by state commissions.¹³ The Act provided for the "just and reasonable rate" for interconnection pursuant to Section 251(c)(2) and rates for unbundled network elements pursuant to Section 251(c)(3) to be determined by state commissions on the basis that they "shall be . . . based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and . . . nondiscriminatory, and . . . may include a reasonable profit."¹⁴

The Federal Communications Commission's ("FCC's") Local Competition Provisions gave effect to Congress's mandate by ruling that the state commissions should set arbitrated rates for interconnection and access to unbundled elements pursuant to a forward-looking economic cost-pricing methodology. The FCC's pricing methodology provided for a new entrant seeking access to a network element of an ILEC to pay (1) any costs directly attributable to the CLECs' use (incremental or marginal costs); (2) a proportional share of the depreciation in the elements value from use over time; (3) a proportional share of joint and common costs, otherwise called overhead costs, associated with element use (i.e., personnel costs, billing costs, etc.); and (4) a share of the cost of the capital

10. 47 U.S.C. § 251(b)(1), (c)(4).

11. *Id.* § 251(d)(2); Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, *Third Report and Order*, 15 F.C.C.R. 3696, 18 Comm. Reg. (P & F) 888 (1999).

12. *Verizon Comm., Inc. v. FCC*, 535 U.S. 467, 491-92 (2002); *Local Competition Provisions*, *supra* note 2, para. 12.

13. 47 U.S.C. § 252(a); *Verizon*, 535 U.S. at 492.

14. 47 U.S.C. § 252(d)(1)(A)-(B).

invested in the network element (either interest paid or the foregone returns on alternative investments), which is equivalent to a reasonable profit.¹⁵

The FCC also considered three alternative access pricing theories. The FCC determined that the Telecommunications Act did not specify whether historical/embedded costs should be included in setting prices. However, the FCC decided that when calculating rates under TELRIC, it would not consider the embedded costs of facilities in place before February 8, 1996, the date of the Act's passage.¹⁶ Embedded costs include any portion of the fixed costs of building the network that the incumbent has not yet recovered through its service prices. The FCC adopted this approach on the basis that adopting historical cost measures would advantage ILECs and hinder competition.

The FCC excluded opportunity cost from TELRIC as part of the rejection of an Efficient Component Pricing Rule ("ECPR"). The FCC defined ECPR as pricing an input at the incremental cost of that input plus the opportunity costs that the ILEC incurs when the new entrant provides the services instead of the incumbent. The rejection was based on ECPR not being cost based and having no ability to move prices towards a competitive level, thus hampering the development of competition.¹⁷

The FCC also ruled out the use of 'Ramsey Pricing'¹⁸ because it would allocate common costs in inverse proportion to the sensitivity of demand for various network elements and services. This type of allocation could limit the extent of entry into local exchange markets by allocating more costs to, and thus raising the prices of, the most critical bottleneck inputs, the demand for which tends to be relatively inelastic. A methodology which hampers market entry is inconsistent with the Act's goals.¹⁹

Additionally, the FCC decided that, at any point in time, the total element long-run incremental cost of an element should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration given the existing

15. *Local Competition Provisions*, *supra* note 2, paras. 672-82, 699-700; 47 C.F.R. § 51.505 (2003).

16. 47 C.F.R. §51.505(d)(1); *Local Competition Provisions*, *supra* note 2, paras. 705, 707.

17. *Local Competition Provisions*, *supra* note 2, paras. 708-10.

18. Ramsey pricing is based on the principle that goods should be taxed or priced according to demand, so that taxes or prices should be higher as to goods for which demand is relatively inelastic. See F. P. Ramsey, *A Contribution to the Theory of Taxation*, 37 *ECON. J.* 47 (1927).

19. See *Local Competition Provisions*, *supra* note 2, para. 696.

location of the ILEC's wire centers.²⁰ TELRIC included the costs explained above, except that they were based not on the costs associated with the ILEC's actual network, but on the costs associated with a hypothetically efficient network.

III. ADMINISTRATIVE LAW AND REVIEWING TELECOMMUNICATIONS ACCESS PRICES

A. *The Verizon Decision*

The Supreme Court examined the FCC's interpretation of the Telecommunications Act in accordance with the standard in *Chevron*, which involves a two step approach. First, does the statute clearly answer the interpretive inquiry? If so, apply the statute by its terms to affirm or reverse the agency. If not, the Court adopts a position of deference towards the agency and will only reject an interpretation if it is "unreasonable."²¹

The FCC's rule adopting TELRIC was initially challenged in *Iowa Utilities Board v. Federal Communications Commission*,²² where the Eighth Circuit upheld the choice of a forward-looking methodology,²³ but struck down the rule defining TELRIC as being based upon the use of a hypothetically efficient network.²⁴ Both issues were before the Supreme Court in *Verizon*.

The Supreme Court found that the FCC could require state commissions to set the rates charged by incumbents for leased elements on a forward-looking basis unrelated to the incumbents' investment. The Court focused on the term "cost" in the statute²⁵ and found that apart from a

20. *Local Competition Provisions*, *supra* note 2, at para. 685; 47 C.F.R. § 51.505(b)(1).

21. *Chevron U.S.A. Inc. v. Nat'l Resources Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984); WILLIAM N. ESKRIDGE, JR. ET AL., *LEGISLATION AND STATUTORY INTERPRETATION* 318 (2000).

22. 219 F.3d 744 (8th Cir. 2000).

23. The court stated:

We conclude the term "cost," as it is used in the statute, is ambiguous, and Congress has not spoken directly on the meaning of the word in this context. . . . The FCC has the authority to make rules to fill any gap in the Act left by Congress, provided the agency's construction of the statute is reasonable.

Id. at 751-52.

24. The court found that the FCC violated the plain meaning of the Act:

It is clear from the language of the statute that 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.

Id. at 750 (citation omitted).

25. 47 U.S.C. §252(d)(1) (2000).

prohibition against rate of return or other rate-based proceedings, the term was a chameleon capable of multiple interpretations.²⁶ In particular, the Court noted that the Act used “cost” as an intermediate term in the calculation of “just and reasonable rates” and that historically regulatory bodies required to set rates expressed in these terms had ample discretion to choose methodology.²⁷ The Court thus rejected the incumbents’ argument that “cost” meant the past cost to an incumbent of furnishing the actual network element to be physically provided, as distinct from its value or the price that would be paid for it on the open market.²⁸ Because the statute was ambiguous and because the deference to the FCC was not defeated by the incumbent’s showing of unreasonableness, the Supreme Court upheld the Eighth Circuit’s ruling, which allowed a forward-looking methodology.²⁹

Justice Souter, for the majority, then addressed whether TELRIC’s calculation of forward-looking cost by reference to a hypothetical, most efficient element at existing wire centers, not the actual network element being provided, meant that TELRIC was neither consistent with the plain language of Section 252(d)(1) nor within the zone of reasonable interpretation subject to *Chevron* deference. Justice Souter found the legislation to be ambiguous based on his earlier finding that the term “cost” was ambiguous.³⁰ The analysis lasts one paragraph but it appears that Justice Souter interpreted the ILEC’s argument that a hypothetical network was an impermissible standard, as equating with an argument that only the actual or historical network was allowed under the Act. Because “cost” did not equate with historical cost, then the “network” did not have to be the actual or historical network.³¹ Justice Souter then proceeded to step two of *Chevron* and determined that the FCC’s resolution of the ambiguity was reasonable. Justice Souter reached this conclusion on the basis that rate-

26. *Verizon Comm., Inc. v. FCC*, 535 U.S. 467, 500 (2002).

27. *Id.* (referring to *Fed. Power Comm’n. v. Hope Nat’l Gas Co.*, 320 U.S. 591, 602 (1944) “[T]he Commission was not bound to the use of any single formula or combination of formulae in determining rates.”).

28. *Verizon*, 535 U.S. at 498-99.

29. *Id.* at 501; *id.* at 539 (Breyer, J., concurring).

30. *Id.* at 501.

31. Justice Souter placed emphasis on different words in § 252(d)(1)(A)(i) as compared with the Eighth Circuit and therefore came up with a different interpretation and outcome. *Cf. Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 750 (8th Cir. 2000). The Eighth Circuit put emphasis on what was to be provided, and therefore interpreted “cost” as being “the cost . . . of providing the interconnection or network element,” while Justice Souter focused on the term “cost” by itself, which was open to a number of interpretations, except for the prohibition on considering rate-of-return or other rate-based proceedings. *Id.* (citation omitted).

setting methodologies that must be “just and reasonable” are traditionally within the discretion of the regulator.³² Nonetheless, Justice Souter considered the incumbents’ three arguments: (1) TELRIC may simulate the competition envisioned by the Act but does not induce it; (2) TELRIC is incapable of providing enough depreciation and allowance for capital costs to induce rational competition on the theory’s own terms; and (3) TELRIC is needlessly and unreasonably complicated and impracticable.³³

The incumbents’ most important argument was that, by setting rates using hypothetical most efficient costs, the FCC would discourage facilities-based competition, which is inconsistent with the objectives of the Act. The incumbents argued that in purporting to set incumbents’ wholesale prices at the level that would exist in a perfectly competitive market (in order to make retail prices similarly competitive), TELRIC sets rates so low that entrants will always lease and never build network elements.³⁴ Further, an entrant would be deterred from building a network element more efficient than the best one on the market at that time (the one assumed in setting the TELRIC rate), as its lower cost in building and operating this new element would be immediately available to its competitors. TELRIC is characterized by the incumbents as preventing competition and instead fostering “parasitic free-riding.”³⁵

Justice Souter dealt with this argument by pointing out that TELRIC does not assume a perfectly efficient wholesale market but instead includes several features of inefficiency that provide an incentive to build telecommunications infrastructure. Some “network elements . . . will not be priced at their most efficient cost and configuration”³⁶ because the FCC requires “ratesetters to calculate cost on the basis of ‘the existing location

32. *Verizon*, 535 U.S. at 501-02 (citing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-45, 866 (1984); *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968) (“We must reiterate that the breadth and complexity of the Commission’s responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties.”)).

33. *Verizon*, 535 U.S. at 503.

34. Justice Breyer illustrated this point through a new entrant seeking to provide local services to a customer whose house may be accessed by the new entrant laying their own cable, using a pre-existing electricity conduit, installing their own wireless system or using the incumbent’s pre-existing pair of twisted copper wires. It is then assumed that wireless or the electricity conduit are the most efficient ways to provide the service. Under TELRIC and using the hypothetical cost of the most efficient method, the FCC would require the incumbent to provide access to its twisted copper wires at the cost of a hypothetical wireless system so that there is no incentive to build the wireless system. *Id.* at 547, 549-50.

35. *Id.* at 504.

36. *Id.* at 505.

of the incumbent[’s] wire centers.”³⁷ Further, TELRIC rates in practice will differ from the outcome of a perfectly competitive market owing to lags in price adjustments built into the rate setting process. The state commissions that set rates do so for three- or four-year periods so that the rate is constant while the new entrant works to produce a lower cost. In addition, the new entrant’s lower cost may take time to impact the market due to the need to install equipment, conduct marketing, and convince consumers to switch services.³⁸

Justice Souter also disputed the argument that a competitor would not invest because it would have to give access to other competitors. TELRIC is based on the use of the most efficient telecommunications technology currently available, so that “the marginal cost of a most efficient element that a new entrant alone has built and uses would not set a new pricing standard” until it was generally available.³⁹ To Justice Souter’s response it may also be observed that the statute does not require new entrants to lease their network elements to competitors, only incumbents are subject to this requirement pursuant to Section 251(c)(3). Further, Justice Souter points out that the entrants invested \$55 billion in new facilities from 1996 through 2000, so that in fact facilities-based competition was taking place.⁴⁰

The next step in the reasoning of the majority was to evaluate the alternative pricing models, embedded-cost methodologies, an efficient component pricing rule, and “Ramsey pricing,” that the FCC considered and rejected.⁴¹ Justice Souter explained that each of the alternatives shared the characteristic of “includ[ing] . . . additional costs beyond what would be most efficient in the long run.”⁴² The incumbents argued that this increase in costs meant that there was greater incentive for a new entrant to build its own facilities with lower marginal costs. Further, the incumbent faced with such competition would have an incentive to innovate and reduce its

37. *Id.* (citation omitted).

38. *Id.* at 505-06.

39. *Id.* at 506.

40. *Id.* at 516.

41. *Id.* at 508.

42. *Id.* Other reasons for rejecting the alternatives were: (1) embedded cost methodologies allow for the passing of inefficiencies (i.e., poor management or poor investment decisions) onto competitors and the manipulation of book costs to overstate the costs to be recovered, (2) the Efficient Component Pricing Rule (“ECPR”) incorporates opportunity costs based on retail prices from a monopolistic local exchange market rather than efficient marginal costs and lacks any mechanism to move prices towards competitive levels, and (3) Ramsey pricing increases the prices of inelastic goods which would be the bottleneck elements so that those elements least capable of being duplicated would be the most expensive to access. *See id.* at 511-16.

marginal costs in response.⁴³ Justice Souter rejected this argument on the basis that TELRIC already had built-in inefficiencies because of the use of existing wire center locations and the lag in price setting. Additionally, a higher rate could prevent a competitor from initially entering the market, thus reducing competition.⁴⁴

The incumbents' second reason for calling TELRIC an unreasonable exercise of the FCC's regulatory discretion was its alleged inability to provide enough depreciation and allowance for capital costs to induce rational competition. The focus on marginal costs would mean that incumbents would be unable to fully depreciate their equipment or obtain a sufficient return on their investments.⁴⁵ Justice Breyer also advanced the argument that TELRIC will force incumbents to share their cost-reducing innovations with competitors, but they will bear the cost of unsuccessful investments alone.⁴⁶ Justice Souter referred to the Local Competition Provisions, which provided for incumbents to demonstrate the need for a different risk-adjusted cost of capital or depreciation rate and also for state commissions to make adjustments if warranted. Because states had the discretion to make changes, it could not be said that the FCC's decision was unreasonable.⁴⁷

The incumbents' third argument was that TELRIC is needlessly and unreasonably complicated and impracticable. Justice Souter observed that under traditional rate-setting procedures, which had to determine an incumbent's costs, involved an asymmetry of information that created its own complexities.⁴⁸ The majority found that "battles of experts are bound to be part of any ratesetting scheme, and the FCC was reasonable to prefer TELRIC"⁴⁹

Justice Breyer dissented on the reasonableness of TELRIC due to the adoption of a hypothetically efficient network standard for determining costs. He disagreed with the majority's finding that TELRIC is "authorized

43. *Id.* at 509.

44. *Id.*

45. *Id.* at 517.

46. *Id.* at 551 ("It makes no economic sense for the [incumbent] to invest in technologies that lower its own marginal costs, so long as competitors can achieve the identical cost savings by regulatory fiat." (quoting Thomas M. Jorde et al., *Innovation, Investment, and Unbundling*, 17 *YALE J. ON REG.* 1, 8 (2000))).

47. *Verizon*, 535 U.S. at 519-21.

48. *Id.* at 522.

49. *Id.*

by the Act.”⁵⁰ He adopted a purposive analysis of the Act,⁵¹ and proceeded directly to the second step of *Chevron* after rejecting the Eighth Circuit’s plain meaning interpretation. He relied on *Motor Vehicle Manufacturers Association of United States, Inc. v. State Farm Mutual Automobile Insurance Co.*⁵² to argue that the FCC’s choice of TELRIC bears no “rational connection” to the Act’s deregulatory purpose.⁵³ The reasonableness of an agency’s interpretation is, therefore, weighed against the statute’s purpose. Justice Breyer argued that “[t]he primary goal of the Telecommunications Act is to ‘promote competition and reduce regulation’ in both local and long-distance telecommunications markets.”⁵⁴ TELRIC could not pass the second step of *Chevron* because the choice of TELRIC was not reasonable in light of the purpose of the statute.⁵⁵ The statute is “not a ratemaking statute seeking better regulation. It is a deregulatory statute seeking competition.”⁵⁶ As a result it is not permissible to adopt the current TELRIC methodology which combined “with a broad definition of ‘network element’ will tend to produce widespread sharing of entire incumbent networks under regulatory supervision” rather than a competitive market.⁵⁷

Justice Breyer also provides a rejoinder to the majority’s reasoning by questioning whether the amount of investment by new entrants was in facilities like broadband “for which an incumbent’s historical network offers no substitute” and by pointing out that what may have been invested if another methodology was adopted is unknown.⁵⁸ Further, a state commission’s ability to make changes to risk-adjusted cost of capital or depreciation rates will not adequately ensure recovery of investments unless the exception swallows the rule. The FCC’s adoption of TELRIC as the default rule means that changes should be reserved for special situations and should not be employed to allow a back door method of using historic

50. *Id.* at 539.

51. Justice Souter’s and Justice Breyer’s approaches to reasonableness under *Chevron* step two both rely on the use of intention, although they look to different sources for that intent. Justice Souter’s approach is a historical analysis that looks at where responsibility for “just and reasonable” rate-setting decisions have traditionally been situated. Justice Breyer’s approach, on the other hand, focuses on the legislative purpose of the Act under review.

52. 463 U.S. 29 (1983).

53. *Verizon*, 535 U.S. at 542 (citing *Motor Vehicle Mfr. Ass’n*, 463 U.S. at 56).

54. *Id.* at 539-40 (citing Telecommunications Act, Preamble, 110 Stat. 56 (1996); H. R. CONF. REP. NO. 104-458, at 1 (1996)).

55. *Id.* at 541-42.

56. *Id.* at 543.

57. *Id.* at 550-51.

58. *Id.* at 552.

cost.⁵⁹ Lastly, Justice Breyer argued that the reliance on “regulatory lag” is an inadequate way in which to justify a pricing methodology as “lags will differ, depending upon regulator, time, and circumstance, thereby introducing a near random element that might, or might not, ameliorate the system’s otherwise adverse effects.”⁶⁰

The ambiguity of the access pricing provisions, the strictures of *Chevron* deference, and the cogent reasoning of both Justice Souter and Justice Breyer raises questions as to the utility of administrative law in ensuring the accountability of the FCC.

B. *Administrative Law and Access Pricing*

Courts are required to ensure that an administrative body or regulator is conducting its responsibilities in conformance with its legislative mandate of enforcing the rule of law.⁶¹ Equally, a regulator acts legitimately if it stays within the parameters of its statutory authorizations. Justice Souter in *Verizon* phrases the issue for courts as follows:

Whether the FCC picked the best way to set these rates is the stuff of debate for economists and regulators versed in the technology of telecommunications and microeconomic pricing theory. The job of judges is to ask whether the Commission made choices reasonably within the pale of statutory possibility in deciding what and how items must be leased and the way to set rates for leasing them.⁶²

However, it is also recognized that regulation requires discretion and the application of expertise to solve social problems.⁶³ *Verizon* questions the courts’ role in relation to regulators generally, and the FCC specifically, if *Chevron* deference is taken as a given.⁶⁴ This relationship is examined in

59. *Id.* at 555.

60. *Id.* at 561.

61. *Nat’l Brcdst. Co. v. United States*, 319 U.S. 190, 224 (1943) (“Our duty is at an end when we find that the action of the Commission was . . . pursuant to authority granted by Congress.”); *Sec. & Exch. Comm’n v. Chenery Co.*, 332 U.S. 194, 207 (1947) (“[W]e are free to disturb the Commission’s conclusion only if it lacks any . . . statutory foundation.”).

62. *Verizon*, 535 U.S. at 539.

63. *Aluminum Co. of America v. Cent. Lincoln Peoples’ Util. Dist.*, 467 U.S. 380, 390 (1984); *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 697 (1991); *see also Verizon*, 535 U.S. at 542 (Breyer, J., dissenting) (also acknowledging the need for expertise).

64. The merits of *Chevron* deference have been examined on a number of occasions and will not be revisited here. *See, e.g.*, John F. Duffy, *Administrative Common Law in Judicial Review*, 77 TEX. L. REV. 113 (1998); Cynthia R. Farina, *Statutory Interpretation and the Balance of Power in the Administrative State*, 89 COLUM. L. REV. 452 (1989); Jonathan T. Molot, *The Judicial Perspective in the Administrative State: Reconciling Modern Doctrines of Deference with the Judiciary’s Structural Role*, 53 STAN. L. REV. 1 (2000); Richard J. Pierce, Jr., *Chevron and Its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 VAND. L. REV. 301 (1988); Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511 (1989);

the context of Verizon's review of access pricing and the intersection between the objectives of administrative law and the nature of telecommunications.

The positions taken by Justice Souter and Justice Breyer illustrate the difficulty in applying administrative law to the changing circumstances of the telecommunications market. Justice Souter believed the Act's objective was to open local markets to competition, which may be hampered by allowing higher access rates that would force new entrants to build infrastructure to compete, rather than seeking access, which could in turn prevent a competitor from entering the market altogether due to the higher cost of building, and thus reduce competition.⁶⁵ Justice Souter then relied on regulator discretion to correct any adverse outcomes from using a hypothetical network.

Justice Breyer dissented, asserting that the legislative purpose behind the Telecommunications Act of 1996 was to achieve facilities-based competition. This purpose is thwarted by giving access to services rather than building a competing infrastructure. It does not result in a competitive marketplace, but instead results in reregulation, as the regulator must determine which services should be available for leasing and what access prices should be charged for those services.⁶⁶

Both justices evaluated the FCC's actions against an objective of promoting competition, but they assume different prevailing economic conditions as to the local loop. Justice Souter assumes a continuing natural monopoly, while Justice Breyer assumed the existence of competitive alternatives. These two positions illustrate that technology and economic conditions in telecommunications are in a state of flux.⁶⁷ For instance, at certain times and locations the local loop will be essential to competition but will exhibit bottleneck or natural monopoly characteristics so that the development of a competing infrastructure is problematic. Equally, those

Laurence H. Silberman, *Chevron—The Intersection of Law & Policy*, 58 GEO. WASH. L. REV. 821 (1990); Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 YALE J. ON REG. 283 (1986); Cass R. Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071 (1990).

65. *Verizon*, 535 U.S. at 509.

66. *Id.* at 543-44; see also Robert W. Crandall, *A Somewhat Better Connection*, 25 REGULATION 22 (2002) ("Local telephone companies are more highly regulated today than 25 years ago because they are now required to sell services to their competitors at (regulated) cost-based prices.").

67. William H. Melody, *Telecom Reform: Progress and Prospects*, 23 TELECOMM. POL'Y 7, 16-17 (1999) (explaining that there are competing schools of thought as to whether telecommunications will become fully competitive and no longer need specific regulation or whether continuing regulation will be required to deal with market failures); see also PETER W. HUBER ET AL., *FEDERAL TELECOMMUNICATIONS LAW 89-90* (2nd ed. 1999).

economic characteristics may be overcome as technological developments create substitutes. The classic example is the Internet, which can now be provided via cable, telephone, satellite, wireless, and public utilities.⁶⁸ As a result, what is currently a bottleneck may cease to be so in the future. The ability to make telephone calls over cable companies' broadband networks or the increased penetration of wireless could make unbundling the local loop unnecessary.⁶⁹ Although the telecommunications market is in flux, the legislation that the Court must interpret is static.

The disorderly interactions between regulation, economic conditions, and technology give rise to a range of policy choices that requires a regulator with considerable expertise and flexibility to adjust regulations.⁷⁰ However, this must be balanced against the need for administrative agencies to be made accountable through the rule of law and democratic government. Administrative law is an attempt to constrain regulators' discretion and avoid abuses, balanced against the need to leave the regulatory experts sufficient freedom to pursue optimal outcomes.⁷¹ It is also a product of the separation of powers between the judiciary, the legislature, and the executive.⁷² As a result, accountability is achieved through the legislature setting out a clear legislative framework so that a court, through statutory interpretation, can ensure compliance with the legislative mandate.⁷³ The conflicting requirements of flexibility and accountability means that there must be a compromise between these two very important objectives. Too much faith in a regulator's expertise can give rise to a technocratic approach that makes legal restraint difficult and

68. Barbara Esbin, *Internet over Cable: Defining the Future in Terms of the Past*, 7 *COMM-LAW CONCEPTUS* 37 (1999); Arlan Gates, *Convergence and Competition: Technological Change, Industry Concentration and Competition Policy in the Telecommunications Sector*, 58 *U. TORONTO FAC. L. REV.* 83, 87 (2000).

69. Seth A. Cohen, *Deregulating, Defragmenting & Interconnecting: Reconsidering Commercial Telecommunications Regulation in Relation to the Rise of Internet Telephony*, 18 *J.L. & COM.* 133 (1998).

70. *Id.* at 148; Melody, *supra* note 67, at 31-33.

71. Andrew P. Morriss, *Implications of Second-Best Theory for Administrative and Regulatory Law: A Case Study of Public Utility Regulation*, 73 *CHI.-KENT L. REV.* 135, 186-87 (1998).

72. *Tenn. Valley Auth. v. Hill*, 437 U.S. 153, 195 (1978) ("[I]n our constitutional system the commitment to the separation of powers is too fundamental for us to pre-empt congressional action by judicially decreeing what accords with 'common sense and the public weal.' Our Constitution vests such responsibilities in the political branches.")

73. Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 *YALE L.J.* 969, 1031 (1992); Abner J. Mikva, *How Should the Courts Treat Administrative Agencies?*, 36 *AM. U. L. REV.* 1, 7 (1986); Starr, *supra* note 64, at 311-12; Harold J. Krent, *Delegation and Its Discontents: Power Without Responsibility*, 94 *COLUM. L. REV.* 710, 717 (1994) (book review).

undermines democratic governance.⁷⁴ Equally, very prescriptive legislation may overly inhibit a regulator.⁷⁵ The compromise should never become so great that one objective trumps the other, otherwise society would pay the high price of either an unaccountable or an ineffective regulator.

Regulators thus retain the capacity to affect economic performance as a whole and citizens' individual well-being to a great extent. It follows that the regulator must be held accountable and there remains a role for courts in monitoring a regulator's use of discretion. However, the limits on judicial review as a consequence of respecting the separation of powers and the requirements of *Chevron* means that courts can only provide accountability when the legislature provides meaningful guidance to the regulator and to the court. However, that guidance is limited in the case of telecommunications, because regulators need the freedom to adapt to the uncertainties of changes in economic conditions, technology, and behavior of regulated firms. The combination of congressional delegation, the separation of powers, and *Chevron* deference may create an accountability abyss for regulators.⁷⁶ The likelihood of an accountability abyss is heightened in the complex and contentious area of telecommunications because Congress legislates in generalities, and the court defers to regulators' reasonable interpretations of those generalities.

One suggested approach to achieving a balance between accountability and discretion is through the "re-missioning"⁷⁷ of the regulator at various intervals, allowing the legislature to revisit the legislative mandate and make amendments. However, this solution is not without problems. It assumes that the legislature can perceive the need and direction for "re-missioning" on a timely basis, which may not be possible.⁷⁸ The legislature may be overly reliant on the regulator's expertise

74. John Hart Ely, *Democracy and Distrust: A Theory of Judicial Review* 132-134 (1980); Thomas O. Sargentich, *The Future of Administrative Law*, 104 Harv. L. Rev. 769, 772, 774 (1991) (reviewing Christopher F. Edley, Jr., *Administrative Law: Rethinking Judicial Control of Bureaucracy* (1990)).

75. Ely, *supra* note 74, at 182-83.

76. Concerns over an accountability void have been expressed by a number of authors. See, e.g., Lisa Schultz Bressman, *Disciplining Delegation After Whitman v. American Trucking Ass'ns*, 87 CORNELL L. REV. 452, 452-53 (2002) (arguing for filling the void by requiring regulators to set standards for their exercise of discretion); and Farina, *supra* note 64, at 456, 464-66, 514 (arguing that *Chevron* has further shifted responsibility for regulator accountability to the President, which created a power imbalance that the Supreme Court should redress).

77. Phil Weiser, *Paradigm Changes in Telecommunications Regulation*, 71 U. COLO. L. REV. 819, 837-38 (2000); see also William H. Read & Ronald Alan Weiner, *FCC Reform: Governing Requires a New Standard*, 49 FED. COMM. L.J. 289 (1997).

78. Mikva, *supra* note 73, at 7.

and may make amendments in response to the regulator's requests without giving enough weight to alternative views.⁷⁹ Alternatively, to avoid deciding a controversial issue or to covertly benefit an interest group, policy decisions may be deliberately delegated to the regulator.⁸⁰ Indeed, access pricing's ability to shift resources between ILECs, CLECs, and the public may be why the issue was delegated to the FCC. Nonetheless, as Congress is the democratically-elected body that represents the people and has legislative or lawmaking powers, it is the branch of government that must begin the accountability process.⁸¹ Although the Supreme Court "say[s] what the law is,"⁸² and the President "take[s] Care that the Laws be faithfully executed,"⁸³ in the regulatory state, these important roles presuppose a legislative mandate.

The Telecommunications Act's brief reference to "cost" and the Supreme Court's identification of multiple meanings for that term demonstrates that an issue as important as access pricing should be prescribed in more detail by the legislature. Although no statute can be entirely precise, the current legislative mandate falls far short of giving a desirable degree of direction to the FCC.⁸⁴ Congress could provide greater guidance, without overly compromising the FCC's discretion, by elaborating on whether "cost" is historical cost or forward-looking cost (marginal cost) and specifying whether "cost" is to be determined by reference to an actual or most efficient network design. Alternatively, Congress could express a preference for access prices that promote price competition or the promotion of innovation. If Congress does not give greater guidance, then administrative law under *Chevron* will not achieve regulator accountability, leaving the private sector with only the Takings Clause to define "just and reasonable rates." Equating "just and reasonable

79. Richard J. Pierce, Jr., *The Role of the Judiciary in Implementing an Agency Theory of Government*, 64 N.Y.U. L. REV. 1239, 1245 (1989).

80. *Id.*; Ely, *supra* note 74, at 131; Edward L. Rubin, *Law and Legislation in the Administrative State*, 89 COLUM. L. REV. 369, 381 (1989); Peter L. Strauss, *Legislative Theory and the Rule of Law: Some Comments on Rubin*, 89 COLUM. L. REV. 427, 428-30 (1989); *see also* *Chevron v. Nat'l Resource Def. Council*, 467 U.S. 837, 865 (1984) (commenting that Congress may have wanted the administrator to accommodate conflicting policies or was unable to build a consensus for the drafting of the legislation).

81. U.S. CONST. art. I, § 1.

82. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177 (1803).

83. U.S. CONST. art. II, § 3.

84. Douglas Lichtman and Randal C. Picker, *Entry Policy in Local Telecommunications: Iowa Utilities and Verizon*, 2002 SUP. CT. REV. 41, 65 (2002), ("[G]iven the vague language used in the [Telecommunications] Act, virtually anything the Commission had put forward in terms of its pricing methodology would have fallen within the scope of *Chevron* deference.").

rates” with “just compensation” requires an examination of the Takings Clause doctrine as it is applied to telecommunications access prices.

IV. TAKINGS JURISPRUDENCE AND REVIEWING TELECOMMUNICATIONS ACCESS PRICES

A. *Takings and Telecommunications Before Verizon*

The Supreme Court originally only applied the Takings Clause to direct government appropriations of private property or physical invasions that effectively divested the owner of possession.⁸⁵ The Supreme Court subsequently recognized two types of takings that can arise without a physical occupation. First, rate regulation may effect a taking if the rate is set so low as to be confiscatory.⁸⁶ Second, government regulation that “goes too far” in limiting the owner’s use of his or her property (noninvasive regulatory takings) may result in a taking.⁸⁷ In the telecommunications access sphere ILECs raised all three areas of takings jurisprudence in the FCC’s Local Competition Provisions to support their argument that TELRIC was unconstitutional.⁸⁸

The takings issue also arose in academic circles with the coining of the new phrase “Deregulatory Takings”⁸⁹ and its subsequent critique.⁹⁰ The proponents of deregulatory takings, J. Gregory Sidak and Daniel F.

85. Daniel F. Spulber & Christopher S. Yoo, *Access to Networks: Economic and Constitutional Connections*, 88 CORNELL L. REV. 885, 933-34 (2003) (citing Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg’l Planning Agency, 535 U.S. 302, 325 n.21 (2002)).

86. *Id.* (citing Covington & Lexington Tpk. Rd. Co. v. Sandford, 164 U.S. 578, 597 (1896)).

87. *Id.* (quoting Penn. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922)).

88. *Local Competition Provisions*, *supra* note 2, paras. 670, 736, 737, 740.

89. J. Gregory Sidak & Daniel F. Spulber, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES (1998) [hereinafter DEREGULATORY TAKINGS 1]; J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851 (1996) [hereinafter *Deregulatory Takings* 2]; J. Gregory Sidak & Daniel F. Spulber, *Givings, Takings and the Fallacy of Forward-Looking Costs*, 72 N.Y.U. L. REV. 1068 (1997).

90. William J. Baumol & Thomas W. Merrill, *Deregulatory Takings, Breach of the Regulatory Contract, and the Telecommunications Act of 1996*, 72 N.Y.U. L. REV. 1037 (1997); William J. Baumol & Thomas W. Merrill, *Does the Constitution Require That We Kill the Competitive Goose? Pricing Local Phone Services to Rivals*, 73 N.Y.U. L. REV. 1122 (1998); Jim Chen, *The Second Coming of Smyth v. Ames*, 77 TEX. L. REV. 1535 (1999); Stephen F. Williams, *Deregulatory Takings and Breach of the Regulatory Contract: A Comment*, 71 N.Y.U. L. REV. 1000 (1996); Oliver E. Williamson, *Deregulatory Takings and Breach of the Regulatory Contract: Some Precautions*, 71 N.Y.U. L. REV. 1007 (1996); Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L. J. 801 (1999) (book review).

Spulber, argue, in short, that a regulatory contract exists between regulators and regulated firms which promises that the regulated firms will be able to recover a competitive return on their investments that were undertaken at the behest of the regulator. The failure to set access prices which honor that commitment results in a taking. Further, although deregulation is aimed at promoting competition to benefit consumers, the rights of ILECs and their investors may be compromised, leading to the observation that "the predictable appeal that competition holds for legislators and regulators should not obscure the fact that the transition from regulated monopoly to competition, like the transition from dirty air to clean, is not free."⁹¹

The most relevant category of takings jurisprudence relates to rate setting. The regulation of rates chargeable for the employment of private assets for public uses is constitutionally permissible,⁹² although the charge cannot be so unjust as to be confiscatory.⁹³ The case of *Federal Power Commission v. Hope Natural Gas Company* stands for the proposition that a court should look at the total effect of the rate order.⁹⁴ Further, a taking would only arise when the rate endangered a firm's survival, or prevented successful operations (i.e., an inability to maintain its financial integrity) to attract capital, and to compensate its investors for the risks assumed.⁹⁵ In *Duquesne Light Company v. Barasch*, the Supreme Court reiterated the need to look at the net effect of a rate order and focused on whether the investors' rate of return from investing in the entire business was commensurate with the risk of that type of business. As the rate orders did not show a failure to give a reasonable rate of return on equity given the risks of the regime, there was no taking.⁹⁶

In *Texas Office of Public Utility Counsel v. Federal Communications Commission*,⁹⁷ the Fifth Circuit approached the deregulatory takings issue from the rate-setting perspective by contrasting one ILEC's claim that a regulated entity cannot be forced to operate one segment of its business at a loss on the expectation that it can make up the shortfalls from another competitive line of business,⁹⁸ with the FCC response that the ILEC must

91. *Deregulatory Takings 2*, *supra* note 89, at 861.

92. *Munn v. Illinois*, 94 U.S. 113, 133-134 (1877).

93. *See Covington & Lexington Tpk. Rd. Co. v. Sanford*, 164 U.S. 578, 597 (1896).

94. 320 U.S. 591, 602 (1944).

95. *Id.* at 605.

96. 488 U.S. 299, 315 (1989).

97. 183 F.3d 393 (5th Cir. 1999), *cert. granted sub nom.* GTE Serv. Corp. v. FCC, 530 U.S. 1213, *cert. denied* 531 U.S. 975 (2000).

98. The ILEC relied on *Brooks-Scanlon v. Railroad Commission*, 251 U.S. 396 (1920), where the Court did not look at the whole enterprise but only at the railway branch of the

show that a taking will “necessarily” result from the regulatory actions and the ILEC must demonstrate that its losses are so significant that the “net effect” is confiscatory.⁹⁹ The Fifth Circuit rejected the takings claim as the ILEC could not satisfy the requirements of *Duquesne*, because it could not demonstrate any loss of revenue, let alone enough of a loss to constitute a taking.

B. *Takings and Telecommunications After Verizon*

In *Verizon*, the incumbents sought to rely on a rule of constitutional avoidance¹⁰⁰ to argue that “cost” should be construed by reference to historical investment to avoid a serious constitutional question: whether TELRIC leads to a taking of property in violation of the Fifth Amendment.¹⁰¹ A unanimous Court addressed the incumbents’ argument in terms of the above rate-setting cases, and it found that the result rather than the methodology must be examined so that the takings question was not ripe.¹⁰² Further, the ILECs made no argument that TELRIC jeopardized their financial integrity or that it failed to provide adequate compensation to current equity holders for the risk associated with their investments, so that TELRIC could not be shown to be confiscatory.¹⁰³ Lastly, the Court rebuffed the idea of a regulatory contract creating some expectation that historical cost would be used by observing that “no such promise was ever made.”¹⁰⁴ As a result, it is clear that the rate-setting category of takings jurisprudence is applicable to access pricing, but to succeed in showing a taking, an ILEC must demonstrate the firm’s operations will be rendered unsuccessful¹⁰⁵ or the rate fails to give a reasonable rate of return on equity given the risks of the regime.¹⁰⁶

Verizon did not consider the other two categories of takings jurisprudence. The noninvasive regulatory takings category is applied through a three factor test that weighs the following considerations: (1) “economic impact of the regulation on the claimant,” (2) “extent to which

business. It concluded that a business cannot be compelled to operate other components of its business, here a sawmill and lumber business, to maintain the railroad for others’ use.

99. *Texas Pub. Util. Counsel*, 183 F.3d at 413 n.14, 437.

100. Legislation ought not be construed to violate the Constitution if any other possible construction remains available. See *Nat’l Labor Relations Bd. v. Catholic Bishop of Chicago*, 440 U.S. 490, 500 (1979).

101. *Verizon Comm., Inc. v. FCC*, 535 U.S. 467, 523 (2002).

102. *Id.* at 523-25, 539 (Breyer, J., concurring in part, dissenting in part).

103. *Id.* at 525-28.

104. *Id.* at 528.

105. *Federal Power Comm’n. v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944).

106. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315 (1989).

the regulation has interfered with distinct investment-backed expectations,” and (3) “character of the governmental action.”¹⁰⁷ The distinct investment-backed expectations criterion limited takings to situations where the property owner could demonstrate that they purchased their property in reliance on a state of affairs that did not include the regulatory regime. If an owner bought property with knowledge of the regime then they “have assumed the risk of any economic loss.”¹⁰⁸

The ILECs argue that the historical regulation of telecommunications created expectations that investments in specialized facilities would make compensatory returns.¹⁰⁹ The category has been argued to be inapplicable to access pricing because it is concerned with balancing financial burdens between a property owner and the public in general, while a telecommunications investor is able to spread risk and mitigate losses through an investment portfolio that the owner of physical property cannot do.¹¹⁰ Further, the finding in *Verizon* that there was no promise that could create the expectation that historical cost would be used suggests the lack of any interference with investment-backed expectations. Nonetheless, whether noninvasive regulatory takings law may be applicable remains an open question because it shares similar policy concerns with the rate regulation jurisprudence. In particular, the recognition that there is a need to balance government’s need for a certain degree of leeway to be able to function with government action that may adversely affect the value of private property because the power to regulate can become the power to take.¹¹¹

The third category is physical invasions of property which are regarded as per se takings when the “character of the governmental action” is a permanent physical occupation of property, without regard to the first and second factors above.¹¹² In the access pricing scenario, the argument is that access requires use of the ILEC’s physical property, the collocation of equipment, or the sending of electromagnetic signals through the owner’s

107. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978); *Eastern Enters. v. Apfel*, 524 U.S. 498, 523-24 (1998) (citing *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979) (citation omitted)).

108. *Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171, 1177 (Fed. Cir. 1994).

109. *Local Competition Provisions*, *supra* note 2, para. 670; *Deregulatory Takings 2*, *supra* note 89, at 945-46.

110. Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings*, 86 VA. L. REV. 1435, 1456 (2000); Chen, *supra* note 90, at 1558-59.

111. Spulber & Yoo, *supra* note 85, at 944.

112. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 434-35 (1982).

network, each of which amounts to a physical invasion.¹¹³ However, the Supreme Court has held that it is “inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim [involving] a ‘regulatory taking,’” making the physical invasions category inapplicable to an access regime.¹¹⁴

The Supreme Court in *Verizon* has intimated that the rate-setting category of takings is applicable to telecommunications regulation once there is a result rather than just a mere method. While the possibility of administrative law providing a remedy to ILECs remains slim—due to the accountability abyss created by *Chevron* deference and congressional delegation—ILECs will continue to pursue constitutional law remedies such as those provided by the Takings Clause. The rate-setting category of takings may allow the regulated firm to recover only its reasonable costs of providing the service in question or be entitled to earn a rate of return on investment comparable to the return that investors expect to receive before committing funds to investments having commensurate risks.¹¹⁵ Although receiving “just compensation” may equate to a low return on investment or recovery of costs, it will continue to be pursued by ILECs whenever it amounts to a better outcome than receiving a TELRIC-based rate set by a state commission.

However, the ability of the Takings Clause to protect against confiscations of property and, incidentally, to ensure regulator accountability requires that the jurisprudence be updated for the current regulatory environment. The current jurisprudence sets the bar for a just rate at a low level by focusing on the impact of the rate on the entire regulated enterprise.¹¹⁶ Future cases should question whether such an approach is appropriate in a deregulated environment—where some telecommunications services are regulated but others are not—so that

113. *Local Competition Provisions*, *supra* note 2, paras. 670, 740; DEREGULATORY TAKINGS 1, *supra* note 89, at 237-40; Spulber & Yoo, *supra* note 85, at 959.

114. *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 323 (2002) (footnote omitted).

115. DEREGULATORY TAKINGS 1, *supra* note 89, at 276; Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. ENVTL. L.J. 110, 125-26 (2002).

116. A taking arose when the rate endangered a firm's survival, prevented successful operations (i.e., an inability to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed) or failed to give a reasonable rate of return on equity given the risks of the regime. *See Fed. Power Comm'n v. Hope*, 320 U.S. 591, 605 (1944); *Dusquene Light Co. v. Barasch*, 488 U.S. 299, 312 (1989).

losses in one area cannot be offset by altering rates in another area.¹¹⁷ In a competitive environment, aggressive competitors in the market in which the subsidy is drawn (prices are increased above economic cost to support some other activity) can price below the ILEC and engage in “cream-skimming” so as to thwart any cross-subsidization.¹¹⁸ However, there may still be explicit subsidies (e.g., universal service)¹¹⁹ or regulatory benefits (e.g., having the line of business restrictions lifted if ILECs meet certain criteria)¹²⁰ that complicate any determination of the total effect of regulation. The Supreme Court has battled with the appropriate property denominator in the other takings categories and in determining how to classify a temporary deprivation.¹²¹ The Supreme Court needs to redetermine the appropriate property denominator to which the rate is applied. The denominator could be the network element subject to access or a combination of network elements that make up a marketable service. The essential point is that the takings jurisprudence must reflect the economic reality of a deregulating telecommunications market rather than the extinct fully regulated private monopoly.

V. CONCLUSION

The Telecommunications Act deals with access pricing through ambiguous provisions that rely on the chameleonic term “cost” to achieve the equally imprecise “just and reasonable rates.” When combined with *Chevron* deference the FCC is given an enormous amount of discretion as to how it deploys its expertise and decides policy questions. To some extent

117. See *MCI Telecomms. Corp. v. GTE Northwest, Inc.*, 41 F. Supp. 2d 1157, 1170 (D. Or. 1999); Theodore V. Morrison, Jr. et al., *Deregulatory Takings and Breach of the Regulatory Contract*, 4 RICH. J. L. & TECH. 2, 40-41 (Fall 1997), at <http://law.richmond.edu/jolt/v4si/speech2.html#h3>.

118. DEREGULATORY TAKINGS 1, *supra* note 89, at 34; Williams, *supra* note 90, at 1001. Cross-subsidization may also lead to claims of anti-competitive conduct like predatory pricing or monopolization.

119. 47 U.S.C. § 254(b)(4) (2000) requires all providers of telecommunications services to contribute to universal service so that ILECs who actually provide universal service will receive offsetting subsidies from CLECs that do not.

120. Hazlett Comment, *supra* note 6, at 225; DEREGULATORY TAKINGS 1, *supra* note 89, 278-81.

121. *Penn. Cent. Transp. Co. v. New York City*, 438 U.S. 104, 130-31 (1978); *Andrus v. Allard*, 444 U.S. 51, 65-66 (1979); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 496-97, 515-16 (1987); *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 325-27 (2002). The clearest recognition of the importance of the proper scope of the property interest is in Justice Scalia's footnote 7 in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1016 (1992), where he acknowledges that “regrettably, the rhetorical force of our ‘deprivation of all economically feasible use’ rule is greater than its precision, since the rule does not make clear the ‘property interest’ against which the loss of value is to be measured.”

such discretion is necessary because of the difficulties in setting out precise guidelines *ex ante* and the need to be responsive to changing conditions in the telecommunications sector. However, the need for discretion must be balanced with ensuring that the FCC remains an accountable regulator. The separation of powers between the judiciary and Congress requires that judicial review be limited to ensuring that a regulator complies with the legislative mandate set out in its governing legislation. As a result, a regulator such as the FCC can only be effectively monitored through judicial review when Congress amends the Telecommunications Act to set out clear objectives and addresses the important issue of access pricing.

If legislative guidance is not forthcoming, then constitutional protections such as the Takings Clause will be more frequently invoked due to *Chevron* deference and congressional delegation making administrative law remedies ineffective, and the limits on judicial review being inapposite. *Verizon* has confirmed the applicability of the rate-setting takings jurisprudence to access pricing. The Takings Clause is therefore available as a mechanism for seeking review of TELRIC results (not methodology) and a determination of whether the actual price received by an ILEC falls below the floor that is “just compensation” and therefore amounts to a constitutionally impermissible rate.

Fostering competition is a legitimate political goal, but it should not be able to be pursued at all costs, in particular, at the expense of regulator accountability. Congress needs to revisit the Telecommunications Act to provide clearer guidance for the FCC and reviewing courts. The Supreme Court needs to ensure that clear language is given effect, and it needs to update its rate-setting takings jurisprudence to bring it in line with the new era of deregulation. Through these changes, telecommunications can realize its potential to make a significant contribution to economic advancement without violating principles of democratic government.

