No. 00-587

In the Supreme Court of the United States

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, PETITIONERS

v.

IOWA UTILITIES BOARD, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

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TABLE OF AUTHORITIES

REPLY BRIEF FOR THE PETITIONERS

1. No party opposes certiorari on the first question presented in our petition—a question also presented in the petitions of WorldCom (in No. 00-555) and AT&T (in No. 00-590). That question concerns the court of appeals' invalidation of a key component of the forward-looking pricing methodology adopted by the Federal Communications Commission (FCC) to determine the rates that new entrants must pay incumbent local exchange carriers to lease elements of, or interconnect with, the incumbents' networks. Indeed, the incumbent local exchange carriers—respondents here and petitioners in No. 00-511—acknowledge (at 7) that it would be "artificial" to grant certiorari to review their petition but not to review the first question presented in ours.

A full discussion of the merits of the FCC's pricing methodology is beyond the scope of this brief. Because respondents discuss that methodology at some length, however, we offer three points in response. First, the FCC's methodology does not presuppose, as respondents suggest (at 11), that incumbents will replace "all network assets * * * instantly and simultaneously" once more efficient technologies are deployed. The question here is not whether it is sometimes prudent for a firm to make do with dated assets even after more efficient alternatives appear on the market; the question is whether those alternatives should be taken into account in determining the compensation to which the firm is entitled for the use of those assets. Those are two different questions. For example, if a firm's assets were condemned, it could not demand compensation above fair market value by ignoring the effect of recently deployed alternatives on the value of those assets, even if the firm had acted reasonably in not replacing the assets as soon as the alternatives appeared on the market. As discussed in our petition (at 5-8, 16-20) and in our response (at 9-16) to Verizon's

petition, the FCC's pricing rules are both reasonable and fully compensatory.

Respondents also contend (at 8-9) that, because the forward-looking costs of some facilities will predictably decrease over their expected useful lives, the FCC's approach will preclude a carrier from ever recovering its costs. As discussed in our petition (at 5-6), however, the FCC has left it to the States to adopt "specific depreciation rate adjustments that reflect expected asset values over time," including, where relevant, "expected declines in the value of capital goods." Pet. App. 71a-72a (¶ 686). Respondents provide no basis for doubting the States' ability to perform that task.

Finally, respondents offer no clear interpretation of what the court of appeals actually held on this issue (*e.g.*, what sort of forward-looking methodology the court believed would be permissible under the 1996 Act). See Opp. 9-11. That omission, which foreshadows years of additional controversy if certiorari is denied, underscores the need for this Court to bring some legal certainty to the industry.[1]

2. a. The second question presented in our petition concerns whether the 1996 Act precludes "combinations" requirements of the kind set forth in 47 C.F.R. 51.315(c). In the aftermath of *AT&T* v. *Iowa Utilities Board*, 525 U.S. 366 (1999) (*Iowa Utils. Bd. I*), the Eighth and Ninth Circuits have split on that question. Respondents do not dispute that the States within the Eighth and Ninth Circuits now are subject to two sharply contradictory legal regimes. States in

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[1] On November 2, 2000, the Court granted Verizon's unopposed motion to dismiss *GTE Service Corp.* v. *FCC*, No. 99-1244, which sought to challenge essentially the same pricing methodology in the context of federal universal-service support. As we explain in our petition (at 22-24), this case independently warrants the Court's review. The dismissal of the *GTE* case removes the option of holding this case pending disposition of that one and thus makes review here all the more appropriate.

the Ninth Circuit remain free to adopt such a combinations requirement as a means of opening local markets to competition, whereas States in the Eighth Circuit are barred from doing so because the Eighth Circuit has erroneously held that, in Section 251(c)(3), "Congress has directly spoken on the issue" and has foreclosed such a requirement as a substantive matter. Pet. App. 28a; see U.S. Pet. 27-28.

Respondents contend (at 19-20), however, that the Ninth Circuit may consider abandoning its own precedent now that the Eighth Circuit has reaffirmed the very result that, in the Ninth Circuit's view, *this* Court has repudiated. There is no plausible reason to suppose that the Ninth Circuit will do so. In a number of recent decisions, the Ninth Circuit has consistently held that it is now "absolutely clear," in light of *Iowa Utilities Board I*, that federal law preserves the authority of state public utility commissions to adopt combinations requirements like those contained in Rule 315(c). *MCI Telecomms. Corp.* v. *U.S. West Communications*, 204 F.3d 1262, 1268 (2000), cert. denied, No. 00-214 (Nov. 13, 2000).[2]

Respondents nonetheless argue (at 18) that, under the Hobbs Act, the Eighth Circuit's invalidation of Rule 315(c) somehow deprives state commissions in other circuits of the authority to impose such combinations obligations. That is incorrect. The Eighth Circuit's decision has "nationally binding effect" (Opp. 3) only in the sense that it removes Rule 315(c) from the body of *federal* regulations; state commissions outside the Eighth Circuit are free, but not compelled, to impose similar requirements on their own. As the Ninth Circuit itself has squarely held, that is, for all relevant purposes, the *only* effect of the Eighth Circuit's decision

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[2] Accord *U.S. West Communications, Inc.* v. *Hamilton*, No. 99-35586, 2000 WL 1568707, at *1, *8 (9th Cir. Sept. 13, 2000); *U.S. West Communications* v. *MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9th Cir. 1999), cert. denied, 120 S. Ct. 2741 (2000).

outside the Eighth Circuit; in other words, the Eighth Circuit lacks extraterritorial jurisdiction to determine the validity of combinations obligations imposed by state commissions in other circuits. See *MCI Telecomms.*, 204 F.3d at 1268. The Ninth Circuit cannot be expected to revisit that jurisdictional holding simply because the Eighth Circuit has repeated its earlier error on the merits.[3]

Respondents are likewise incorrect in contending (at 19) that it would be inappropriate, as a policy matter, to allow the States to "follow or ignore as they see fit FCC rules that are invalidated." That argument misconceives the role of the States in the statutory scheme. Congress did not require the FCC to straitjacket the States in their efforts to open local telecommunications markets to competition, and neither the local competition provisions of the 1996 Act nor the FCC's implementing regulations are designed to preempt the regulatory field in its entirety. To the contrary, throughout the Act, Congress took care to preserve the authority of the States to *supplement* the FCC's rules with local competition requirements of their own, so long as they are not inconsistent with federal law (including any extant FCC rules). See 47 U.S.C. 251(d)(3), 261(b) and (c) (Supp. IV 1998).

For that reason, respondents are mistaken in suggesting (at 20) that the *FCC* may "dissolve" the current circuit conflict by issuing a new regulation *prohibiting* the States

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[3] There is no merit to respondents' suggestion (at 20 n.12) that the Court should deny certiorari in this case so that it may review a yet-undecided case presenting not just the subject matter of this circuit conflict but also the "preliminary" issue of state authority to supplement existing federal requirements. That preliminary issue is not itself worthy of this Court's review because the Ninth Circuit's resolution of it (against respondents' position) is correct and does not conflict with any decision of another court of appeals. See *MCI Telecomms.*, 204 F.3d at 1268. Indeed, this Court has denied certiorari in two Ninth Circuit cases presenting that preliminary issue. See p. 3 & note 2, *supra*.

from adopting combinations requirements similar to Rule 315(c). The 1996 Act specifically bars the FCC from preempting "any regulation, order, or policy of a State commission" that, while supplementing the FCC's own regulations, is (among other things) "consistent with the requirements" of Section 251. 47 U.S.C. 251(d)(3)(B) (Supp. IV 1998). As the Ninth Circuit has explained, combinations requirements such as Rule 315(c) *are* "consistent with the requirements" of Section 251, despite the contrary holding below. Although the Eighth Circuit has barred the FCC from imposing such an obligation on a national level, it has not compelled the FCC to issue any regulation precluding States throughout the Nation from enforcing similar obligations on their own. The FCC has no intention of issuing any such regulation, because such a prohibition would be inconsistent with the Ninth Circuit's correct interpretation of the Act and undesirable as a policy matter.

Significantly, outside the Eighth Circuit, the court of appeals' invalidation of Rule 315(c) creates the same state of affairs that would have existed had the FCC never issued Rule 315(c). Then, the FCC plainly could have permitted the States to decide whether to impose combinations requirements, just as the States individually impose a variety of requirements in other contexts to supplement federal rules.[4]

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[4] Contrary to respondents' suggestion (at 18), this is not a context in which the absence of a valid FCC rule would permit the States to disagree about the meaning of crucial federal statutory terms, such as whether the "cost" standard of Section 252(d)(1) means historical cost or forward-looking economic cost. See generally *Iowa Utils. Bd. I*, 525 U.S. at 378 n.6. Instead, this is a context in which each State exercises its explicitly preserved authority to *supplement* the 1996 Act and the FCC's rules with consistent requirements of its own. The exercise of that authority will vary from State to State, a result that Congress anticipated and intended. Indeed, with judicial approval, the FCC has permitted variation among

Although the FCC seeks here to restore Rule 315(c) itself, the present arrangement is not inconsistent with principles of federalism, and it is far preferable to a regime in which *no* State has authority to adopt such combinations requirements.

The present arrangement does, however, present an anomaly of a different kind: The States in the Eighth Circuit, but not those in other circuits, are prohibited from enforcing combinations requirements like Rule 315(c), because the decision below erroneously holds that such requirements are substantively inconsistent with the plain language of Section 251(c)(3). As discussed in our petition, this Court's intervention is needed to resolve that anomaly by affirming that, contrary to the decision below, nothing in Section 251(c)(3) precludes the adoption of such a requirement, whether by the FCC itself or by the States.

b. Respondents oppose resolution of that circuit conflict on the independent theory that, because the government did not seek review of the combinations issue in its 1997 certiorari petition in *Iowa Utilities Board I*, it has somehow "forfeited" (Opp. 3) any opportunity to seek review of that issue now. That position is without merit. This Court has never adopted a practice of penalizing a party for deferring a request for certiorari until an issue has become an obvious candidate for review, such as by the development of an explicit circuit conflict.[5]

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the States in their implementation of certain FCC rules. See, *e.g.*, *AT&T* v. *FCC*, 220 F.3d 607, 615-616 (D.C. Cir. 2000).

[5] *Communist Party* v. *Subversive Activities Control Board*, 367 U.S. 1 (1961), does not support respondents' contrary position (Opp. 14-16). There, the Communist Party challenged an agency order on a procedural ground that it had omitted from a previous appeal, even though the procedural claim, had it been raised before, might have rendered much of the agency's complex subsequent proceedings unnecessary. 367 U.S. at 31 & n.8. This Court held that, in challenging agency orders, private parties

Any such rule, moreover, would be counterproductive. The federal government commonly defers seeking certiorari on particular issues until after the need for the Court's intervention has become clear; that gatekeeping function has long served this Court well.[6] We declined to raise the present combinations issue in our 1997 petition because the competitive significance of the issue had not yet become obvious and because there was not yet an acknowledged circuit conflict that subjected different States to different federal limitations on their authority. It would be a perverse rule that would penalize the litigants and the rest of the industry now because the United States properly exercised

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may not "withhold in this Court and save for a later stage procedural error" that could "make waste" more than "ten years of litigation"; the Court explained that permitting such tactics would lead to unnecessary "expenditures of agency time" on remand and would "foist upon the Court constitutional decisions which could have been avoided had those errors been invoked earlier." *Id.* at 31-32 & n.8. No similar circumstance is presented here. Petitioner is the government itself, so that any concern about "expenditures of agency time" is absent; the claim presented is not a procedural issue antecedent to a constitutional issue that the Court might have sought to avoid; and the lower courts have now split on the consequences of this Court's previous decision, such that the need for the Court's intervention is now obvious. Nothing in *Communist Party* remotely precludes seeking certiorari in these circumstances. And the lower court precedent that respondents cite in passing (at 15-16 n.9), which involves "law of the case" principles applicable where a party omits issues from an appeal as of right, is inapposite here, both because the United States *had* no appeal as of right to this Court in 1997 and also because the court of appeals has, in any event, revisited the issues on the merits. See generally *Christianson* v. *Colt Indus. Operating Corp.*, 486 U.S. 800, 817 (1988).

[6] See Robert L. Stern et al., *Supreme Court Practice* 164 (7th ed. 1993) (noting that function); cf. *id.* at 40 ("[T]he Court on certiorari to review a final decree can reach back and correct errors in the interlocutory proceedings below, even though no attempt was made to secure review of the interlocutory decree.").

its customary gatekeeping function in 1997. Indeed, respondents' efforts to preclude review of the issue are particularly unavailing, because the court of appeals *itself* agreed to revisit the issue on the merits, and because the resulting circuit conflict reflects a dispute about the significance of this Court's intervening decision in *Iowa Utilities Board I*. That dispute was, of course, unforeseeable before that case was decided.

Finally, respondents are wrong in suggesting (at 16) that "[j]udicial review would never come to an end" unless certiorari were foreclosed in circumstances like this one. A grant of certiorari is always discretionary, and many issues will never warrant review, because (for example) they lack sufficient importance or have not become the subject of a circuit conflict. The question here, however, is whether the Court should deny review of an issue that otherwise *does* warrant certiorari—and that the court of appeals found appropriate to revisit on remand—merely because the petitioning party did not raise the issue at an earlier time when it did not so clearly warrant this Court's review. The answer is no. Cf. 28 U.S.C. 2106.

c. Respondents further contend (at 22-24) that the Eighth Circuit's holding on the combinations issue was correct on the merits. Of course, the conflict between the Eighth and Ninth Circuits warrants this Court's review no matter which of those courts is correct. In any event, the decision below was wrong.

Respondents could not prevail on the merits by showing that Congress was silent on the combinations issue (cf. Opp. 22-23), for that would merely confirm the FCC's discretion to adopt Rule 315(c). See *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 842-843 (1984). Instead, respondents would have to show, under step one of *Chevron*, that Congress directly spoke to the issue and affirmatively foreclosed that combinations requirement. That they cannot do. The sum total of

respondents' argument on the point is that "the second sentence of Section 251(c)(3)" shows that Congress "envisioned that competitive LECs would do the combining." Opp. 22. As discussed in our petition (at 28-29), however, that sentence gives new entrants particular rights when they *seek* to do the combining themselves. In giving new entrants those rights in that circumstance, Congress manifested no intent to force them to incur economic waste in a different circumstance: when the incumbent can more efficiently combine its elements for a fee.

Despite respondents' suggestions to the contrary (Opp. 20-24), this combinations issue has a great deal of competitive significance, as the FCC has determined. See U.S. Pet. 25-26. That is one reason why the issue has been litigated so heavily in the lower courts in recent months. Moreover, although respondents argue (at 21 & n. 15) that new entrants can function effectively with whatever "arrangement[s]" incumbents might allow in the absence of a combinations rule, that is simply a factual quarrel with the expert agency's explicit findings that the rule is necessary to protect the prospects for competition and to ensure rational implementation of Section 251(c)(3). See U.S. Pet. 25-26 (citing FCC orders).

Finally, respondents return to their principal theme in this litigation: that courts and regulators should err on the side of making it more cumbersome and expensive for new entrants to exercise their rights under Section 251(c)(3), even when doing so would produce economic waste, because then, respondents contend (at 23-24), those new entrants would have powerful incentives to forgo those rights and immediately build their own facilities from scratch (if they can). As the FCC has found, that approach would severely retard, if not preclude, competition in many local markets, most of which are still dominated by the incumbents almost five years after the Act's passage. See U.S. Pet. 2, 6-7, 25-26.

In any event, the FCC acted reasonably in implementing the Act to avoid economic waste in these circumstances, and that decision is entitled to substantial deference. See *Iowa Utils. Bd. I*, 525 U.S. at 397.[7]

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For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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NOVEMBER 2000

[7] Respondents' contrary policy argument (Opp. 24) relies on a passage in Justice Breyer's separate opinion, which addressed a different issue arising under a different provision, 47 U.S.C. 251(d)(2) (Supp. IV 1998). See *Iowa Utils. Bd. I*, 525 U.S. at 428-430 (Breyer, J., concurring in part and dissenting in part). That provision generally requires the FCC, "[i]n determining what network elements should be made available" for purposes of Section 251(c)(3), to "consider, at a minimum," whether denial of those elements "would impair the ability" of the new entrants to provide the services they seek to offer. In contrast, the question here is whether new entrants must incur unnecessary costs and delays when ordering combinations of elements that *meet* the standards of Section 251(d)(2).