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SUPREME COURT OF THE UNITED STATES

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VERIZON COMMUNICATIONS INC. ET AL. *v.* FEDERAL COMMUNICATIONS COMMISSION ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 00–511. Argued October 10, 2001—Decided May 13, 2002*

In order to foster competition between monopolistic carriers providing local telephone service and companies seeking to enter local markets, provisions of the Telecommunications Act of 1996 (Act) entitle the new entrants to lease elements of the incumbent carriers' local-exchange networks, 47 U. S. C. §251(c), and direct the Federal Communications Commission (FCC) to prescribe methods for state utility commissions to use in setting rates for the sharing of those elements, §252(d). Such "just and reasonable rates" must, *inter alia*, be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the . . . network element." §252(d)(1)(A)(i). Regulations appended to the FCC's First Report and Order under the Act provide, among other things, for the treatment of "cost" under §252(d)(1)(A)(i) as "forward-looking economic cost," 47 CFR §51.505, something distinct from the kind of historically based cost previously relied on in valuing a rate base, see, *e.g., FPC* v. *Hope Natural Gas Co.,* 320 U. S. 591, 596–598, 605; define the "forward-looking economic cost of an element [as] the sum of (1) the total element long-run incremental cost of the element [TELRIC,] and (2) a reasonable allocation of forward-looking common costs," §51.505(a), "incurred in providing a group of elements that "cannot be attributed

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*Together with No. 00–555, *WorldCom, Inc., et al.* v. *Verizon Communications Inc. et al.,* No. 00–587, *Federal Communications Commission et al.* v. *Iowa Utilities Board et al.,* No. 00–590, *AT&T Corp.* v. *Iowa Utilities Board et al.,* and No. 00–602, *General Communications, Inc*. v. *Iowa Utilities Board et al.,* also on certiorari to the same court.

directly to individual elements," §51.505(c)(1); and, most importantly, specify that the TELRIC "should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent['s] wire centers." §51.505(b)(1). The regulations also contain so-called "combination" rules requiring an incumbent, upon request and compensation, to perform the functions necessary to combine network elements for an entrant, unless the combination is not technically feasible. §§51.315(b)–(f). Challenges to the regulations, mostly by incumbent carriers and state commissions, were consolidated in the Eighth Circuit, which initially held, *inter alia*, that the FCC had no authority to control state commissions' ratesetting methodology and that the FCC misconstrued §251(c)(3)'s plain language in implementing the combination rules. Reversing in large part in *AT&T Corp.* v. *Iowa Utilities Board*, 525 U. S. 366, 384–385, this Court, among its rulings, upheld the FCC's jurisdiction to impose a new ratesetting methodology on the States and reinstated the principal combination rule, Rule 315(b), which forbids incumbents to separate currently combined network elements before leasing them to entrants who ask for them in a combined form. On remand, the incumbents' primary challenge went to the FCC's ratesetting methodology. The Eighth Circuit understood §252(d)(1) to be ambiguous as between "forward-looking" and "historical" cost, so that a forward-looking ratesetting method would presumably be reasonable, but held that §252(d)(1) foreclosed the use of the TELRIC methodology because the Act plainly required rates based on the actual, not hypothetical, cost of providing the network element. The court also invalidated the additional combination rules, Rules 315(c)–(f), reading §251(c)(3)'s reference to "allow[ing] requesting carriers to combine . . . elements" as unambiguously requiring requesting carriers, not providing incumbents, to do any and all combining.

Held:

1. The FCC can require state commissions to set the rates charged by incumbents for leased elements on a forward-looking basis untied to the incumbents' investment. Because the incumbents have not met their burden of showing unreasonableness to defeat the deference due the FCC, see *Chevron U. S. A. Inc.* v. *Natural Resources Defense Council, Inc.,* 467 U. S. 837, 843–845, the Eighth Circuit's judgment is reversed insofar as it invalidated TELRIC. Pp. 25–58.

(A) This Court rejects the incumbents' argument that "cost" in §252(d)(1)'s requirement that "the . . . rate . . . be . . . based on the cost . . . of providing the . . . network element" can only mean, in plain language and in this particular technical context, the past cost to an incumbent of furnishing the specific network element actually, physically, to be provided, as distinct from its value or the price that would be paid for it on the open market. At the most basic level of common usage, "cost" has no such clear implication. A merchant asked about the "cost" of his goods may reasonably quote their current wholesale market price, not the cost of the items on his shelves, which he may have bought at higher or lower prices. When the reference shifts into the technical realm, the incumbents are still unconvincing. "Cost" as used in calculating the rate base under the traditional cost-of-service method did not stand for all past capital expenditures, but at most for those that were prudent, while prudent investment itself could be denied recovery when unexpected events rendered investment useless. *Duquesne Light Co.* v. *Barasch,* 488 U. S. 299, 312. And even when investment was wholly includable in the rate base, ratemakers often rejected the utilities' "embedded costs," their own book-value estimates, which typically were geared to maximize the rate base with high statements of past expenditures and working capital, combined with unduly low depreciation rates. See, *e.g., Hope Natural Gas Co., supra,* at 597–598. Equally important, the incumbents' plain-meaning argument ignores the statutory setting in which the mandate to use "cost" in valuing network elements occurs. First, the Act uses "cost" as an intermediate term in the calculation of "just and reasonable rates," §252(d)(1), and it was the very point of *Hope Natural Gas* that regulatory bodies required to set rates expressed in these terms have ample discretion to choose methodology, 320 U. S., at 602. Second, it would be strange to think Congress tied "cost" to historical cost without a more specific indication, when the very same sentence that requires "cost" pricing also prohibits any reference to a "rate-of-return or other rate-based proceeding," §252(d)(1), each of which has been identified with historical cost ever since *Hope Natural Gas* was decided. Without any better indication of meaning than the unadorned term, the word "cost" in §252(d)(1) gives ratesetting commissions broad methodological leeway, but says little about the method to be employed. *Iowa Utilities Bd., supra,* at 423. Pp. 25–29.

(B) Also rejected is the incumbents' alternative argument that, because TELRIC calculates the forward-looking cost by reference to a hypothetical, most efficient element at existing wire centers, not the actual network element being provided, the FCC's particular methodology is neither consistent with §252(d)(1)'s plain language nor within the zone of reasonable interpretation subject to *Chevron* deference. Pp. 29–52.

(1) The term "cost" is simply too protean to support the incumbents' argument that plain language bars a definition of "cost" untethered to historical investment. What the incumbents call the "hypothetical" element is simply the element valued in terms of a piece

of equipment an incumbent may not own. Pp. 29–30.

(2) Similarly, the claim that TELRIC exceeds reasonable interpretative leeway is open to the objection that responsibility for "just and reasonable" rates leaves methodology largely subject to discretion. *E.g., Permian Basin Area Rate Cases,* 390 U. S. 747, 790. The incumbents nevertheless field three arguments, which the Court rejects. Pp. 30–52.

(a) The incumbents argue, first, that a method of calculating wholesale lease rates based on the costs of providing hypothetical, most efficient elements may simulate the competition envisioned by the Act but does not induce it. There are basically three answers to this no-stimulation unreasonableness claim. Pp. 31–46.

(i) The basic assumption of the no-stimulation argument—that in a perfectly efficient market, no one who can lease at a TELRIC rate will ever build—is contrary to fact. TELRIC does not assume a perfectly efficient wholesale market or one that is likely to resemble perfection in any foreseeable time, cf. *Iowa Utilities Board, supra,* at 389–390, but includes several features of inefficiency that undermine the incumbents' argument. First, because the FCC has qualified any assumption of efficiency by requiring ratesetters to calculate cost on the basis of the existing location of the incumbent's wire centers, §51.505(b)(1), certain network elements will not be priced at their most efficient cost and configuration. Second, TELRIC rates in practice will differ from the products of a perfectly competitive market owing to lags in price adjustments built into the state-commission ratesetting process. Finally, because measurement of the TELRIC is based on the use of the most efficient telecommunications technology currently available, *ibid.,* the marginal cost of a most efficient element that an entrant alone has built and uses would not set a new pricing standard until it became available to competitors as an alternative to the incumbent's corresponding element. Pp. 32–35.

(ii) It cannot be said that the FCC acted unreasonably in picking TELRIC to promote the mandated competition. Comparison of TELRIC with alternatives proposed by the incumbents as more reasonable—embedded-cost methodologies, an efficient component pricing rule, and "Ramsey pricing," the most commonly proposed variant of fixed-cost recovery ratesetting—are plausibly answered by the FCC's stated reasons to reject the alternatives, §51.505(d); First Report and Order ¶¶655, 696, 705, 709. Pp. 36–45.

(iii) The claim that TELRIC is unreasonable as a matter of law because it simulates, but does not produce, facilities-based competition founders on fact. The entrants say that they invested $55 billion in new facilities from 1996 through 2000, and the incumbents do not contest the figure. A regulatory scheme that can boast such substantial competitive capital spending in four years is not easily described as an unreasonable way to promote competitive investment in facilities. Pp. 45–46.

(b) Also unavailing is the incumbents' second reason for calling TELRIC an unreasonable exercise of the FCC's regulatory discretion: the supposed incapacity of this methodology to provide enough depreciation and allowance for capital costs to induce rational competition on the theory's own terms. This argument rests upon a fundamentally false premise, that the TELRIC rules limit the depreciation and capital costs that ratesetting commissions may recognize. On the contrary, First Report and Order ¶702 gave state commissions considerable discretion on these matters, specifically permitting more favorable allowances for costs of capital and depreciation than were generally allowed under traditional ratemaking practice. The incumbents' fallback position, that existing rates of depreciation and costs of capital are not even reasonable starting points, is unpersuasive. This attack tends to argue in highly general terms, whereas TELRIC rates are calculated on the basis of individual elements. Those rates leave plenty of room for differences in the appropriate depreciation rates and risk-adjusted capital costs depending on the nature and technology of the specific element to be priced. In light of the many TELRIC rates to be calculated by state commissions across the country, the FCC's prescription of a general "starting point" is reasonable enough. Pp. 46–51.

(c) Finally, the incumbents' third argument, that TELRIC is needlessly and unreasonably complicated and impracticable, is unpersuasive. The record suggests that TELRIC rate proceedings are surprisingly smooth-running affairs, with incumbents and competitors typically presenting two conflicting economic models supported by expert testimony, and state commissioners customarily assigning rates based on some predictions from one model and others from its counterpart. At bottom, battles of experts are bound to be part of any ratesetting scheme, and the FCC was reasonable to prefer TELRIC over alternative fixed-cost schemes that preserve home-field advantages for the incumbents. Pp. 51–52.

(C) The incumbents' attempt to apply the rule of constitutional avoidance does not present a serious question. They say that "cost" should be construed by reference to historical investment in order to avoid the serious constitutional question whether a methodology so divorced from actual investment will lead to a taking of property in violation of the Fifth (or Fourteenth) Amendment. However, they do not argue that any particular, actual TELRIC rate is so unjust as to be confiscatory, despite the fact that some state commissions have already put TELRIC rates in place. This want of any rate to be reviewed is significant, given that this Court has never considered a taking challenge to a ratesetting methodology without being presented with specific rate orders alleged to be confiscatory. See, *e.g., Duquesne, supra,* at 303–304. Indeed, the general rule is that any question about the constitutionality of ratesetting is raised by rates, not methods. See, *e.g., Hope Natural Gas Co.,* 320 U. S., at 602. Thus, the policy of construing a statute to avoid constitutional questions is presumptively out of place when construing a measure like TELRIC that prescribes a method. The incumbents argue unpersuasively that this action is placed outside the general rule by strong signs that takings will occur if the TELRIC interpretation of §252(d)(1) is allowed. First, their comparison of historical investment in local telephone markets with the corresponding estimate of a TELRIC evaluation is spurious because their assumed numbers are clearly wrong. Second, they misplace their reliance on dicta in *Duquesne,* 488 U. S., at 315, to the effect that there may be a taking challenge if a ratemaking body makes opportunistic methodology changes just to minimize a utility's return on capital investment. There is no evidence that the decision to adopt TELRIC was arbitrary, opportunistic, or undertaken with a confiscatory purpose. Indeed, the indications in the record are very much to the contrary. Pp. 52–58.

2. The FCC can require incumbents to combine elements of their networks at the request of entrants who cannot combine themselves, when they lease them to the entrants. Thus, the Eighth Circuit erred in invalidating the additional combination rules, Rules 315(c)–(f). Pp. 58–69.

(A) The Court rejects the incumbents' threshold objection that the Government's and competing carriers' challenge to the rules invalidation is barred by waiver because the *Iowa Utilities Board* petition to review the Eighth Circuit's earlier invalidation of Rule 315(b) did not extend to its simultaneous invalidation of Rules 315(c)–(f). The incumbents argue that the Eighth Circuit exceeded the scope of this Court's mandate when it revisited the unchallenged portion of its earlier holding, and that this Court should decline to reach the validity of Rules 315(c)–(f) because doing so would encourage the sort of strategic, piecemeal litigation disapproved in *Communist Party of United States* v. *Subversive Activities Control Bd.,* 367 U. S. 1, 30–31. However, that case does not block consideration of Rules 315(c)–(f) here. Addressing the issue now would not "make waste" of years of efforts by the FCC or the Eighth Circuit, *id.,* at 32, n. 8, would not threaten to leave a constitutional ruling pointless, and would direct the Court's attention not to an isolated, "long-stale" procedural error by the agency, *ibid.,* but to the invalidation of FCC rules meant to have general and continuing applicability. There is no indication that litigation tactics prompted the failure last time to appeal on these rules, which were reexamined on remand at the Eighth Circuit's behest, not the Government's nor the competing carriers'. Any issue pressed or passed upon by a federal court is subject to this Court's broad discretion on certiorari, and there are good reasons to look at Rules 315(c)–(f). The Eighth Circuit passed on a significant issue that has been placed in a state of flux by a split among federal cases. Pp. 58–60.

(B) The Eighth Circuit read 47 U. S. C. §251(c)(3)'s requirement that "[a]n incumbent . . . provide . . . network elements in a manner that allows requesting carriers to combine such elements" as unambiguously excusing incumbents from any obligation to combine provided elements. But the language is not that plain. If Congress had treated incumbents and entrants as equals, it probably would be plain enough that the incumbents' obligations stopped at furnishing an element that could be combined. The Act, however, proceeds on the understanding that incumbent monopolists and contending competitors are unequal. Cf. §251(c). And because, within the actual statutory confines, it is not self-evident that in obligating incumbents to furnish, Congress silently negated a duty to combine, the Court reads §251(c)(3)'s language as leaving open who should do the work of combination. Under *Chevron,* that leaves the additional combination rules intact unless the incumbents can show them to be unreasonable. The Court finds, however, that those rules reflect a reasonable reading of the statute. They are meant to remove practical barriers to competitive entry into local-exchange markets while avoiding serious interference with incumbent network operations. The rules say an incumbent shall, for payment, "perform the functions necessary," Rules 315(c) and (d), to combine elements in order to put a competing carrier on an equal footing with the incumbent when the requesting carrier is unable to combine, First Report and Order ¶294, when it would not place the incumbent at a disadvantage in operating its own network, and when it would not place other competing carriers at a competitive disadvantage, Rule 315(c)(2). This duty is consistent with the Act's goals of competition and nondiscrimination, and imposing it is a sensible way to reach the result the Act requires. Pp. 60–69.

219 F. 3d 744, affirmed in part, reversed in part, and remanded.

SOUTER, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and STEVENS, KENNEDY, and GINSBURG, JJ., joined, in which SCALIA and THOMAS, JJ., joined as to Part III, and in which THOMAS, J., also joined as to Part IV. BREYER, J., filed an opinion concurring in part and dissenting in part, in which SCALIA, J., joined as to Part VI. O'CONNOR, J., took no part in the consideration or decision of the cases.