

DEREGULATION OF TELECOMMUNICATIONS AND THE BREAKDOWN IN THE STATE-FEDERAL BALANCE

by

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I. Introduction

Recent years have witnessed a fundamental reorientation of federal policy in the telecommunications sector. A series of actions after 1968, culminating in the Federal Communication Commission (FCC) 1980 Second Computer Inquiry decision 1/ and the 1982 American Telephone and Telegraph Company (AT&T) divestiture decree, 2/ greatly transformed the once rigorous controls that the FCC and the Justice Department (the latter through its 1956 consent decree with AT&T 3/) had imposed on telecommunications. In a federal system, policy changes at one level of governmental regulation have ramifications on the regulation by other levels, and the telecommunications sector is no exception. Major changes in the nature of the federal-state relationship in communications regulations have accompanied the dynamic development and application of communications technology.

The system of federal and state responsibility for communications regulation traditionally had been one of coregulation. A high degree of commonality of federal and state goals existed in this system. The cooperative spirit was so great that the federal level permitted major revenue transfers to the states' domain to alleviate local rate pressures for which the federal government had no direct oversight responsibility. 4/ As the 1970's unfolded, however, the divergence in goals between the federal and state levels of government became pronounced. The federal redistributory or equity goal became secondary to a pursuit of economic efficiency through reliance on a change in markets and competition.

During the last decade the traditional system has disintegrated rapidly, with the federal government pursuing a fundamentally different policy than the states and becoming the predominant force in the shaping of telecommunications policy. 5/ The federal government uses a different basic

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regulatory technique than the states do, and indirectly deprives them of the means to fulfill their traditional goals. Moreover, the government legally constrains the states' ability to pursue these objectives in alternative ways by invoking the doctrine of federal preemption.

II. The Traditional and Changing Roles of Federal and State Regulators in Telecommunications

The traditional division of regulatory responsibility in telecommunications is easy to summarize: the regulation of all forms of wireless communication is exclusively federal, whereas the federal government shares regulation of wire communications with state and local governments.

While state involvement in telephone services dates to the 1880's, 6/ and regulation by state commission began in 1907, 7/ over time the emerging interstate telephone network also called for some federal responsibility. Therefore, the Mann-Elkins Act 8/ which Congress passed in 1910 extended some undefined regulatory authority to the Interstate Commerce Commission (ICC). Although the ICC largely failed to exercise this authority in its early years, it did to exercise this authority in its early years, it did actively establish a position of dominance over state regulation of railroad transportation in the Shreveport Rate Cases. 9/ By Analogy to the Shreveport cases, the states' authority in the telephone area became tenuous; the states ultimately were only as powerful as the ICC allowed them to be, even though barely two percent of telephone messages were interstate. 10/

The Communications Act of 1934 11/ merged the ineffectual Federal Radio Commission's authority and the ICC's telephone jurisdiction into the newly created Federal Communications Commission 12/ and increased and clarified that agency's mandate. 13/ At the same time, the states urged a statutory limitation of the FCC's authority over intrastate wire communications, and Congress responded by adding to the Act Sections 2(b) 14/ and 221 (b). 15/ Sections 2(b), which applied only to the first section of the Act, prohibits FCC regulation "in connection with intrastate communication service by wire" 16/ The congressional intent clearly was to limit the scope of federal telephone regulation. 17/ Thus the House reported that "some 97 1/2 or 98 percent of all telephone communication is intrastate, which this bill does not affect." 18/

Despite the statutory language, the physical network facilities are not neatly separable into their intrastate and interstate components. On the contrary, they fulfill both functions simultaneously. During the era following the 1934 Act, public policy-makers were under continuous pressure to reconcile the statutory fiction of separation with the reality of integration. What emerged from these efforts was a system of coregulation, in which both federal and state agencies regulated the same facilities at the same time.

The cooperative system, however, could not last when its constituents' fundamental goals diverged. This divergence of goals occurred when the FCC began to embrace the concepts of efficiency, competition, markets, and entry, while the state commissions continued to emphasize equity and redistribution. The split emerged first in the accessory equipment area. In a series of decisions culminating in Carterfone 19/ and the equipment registration decision, the FCC opened the accessory equipment market to rivals of AT&T's manufacturing arm, Western Electric. The states, on the other hand, advocated a restrictive approach during this period, largely for fear of losing the subsidy to residential rates that the liberalization would cause.

Several states attempted to impose restrictions notwithstanding the FCC's actions, but the Commission prevailed in the courts; North Carolina Utilities Commission v. FCC. 20/ The separation of interstate and intrastate communications by sections 2(b) and 221(b), the legal linchpins of the cooperative system, did not survive this decision. Instead, the court found that state action had frustrated the Commission's efforts to discharge its responsibilities under section 201 through 205 of the 1934 Act to create a national system of telecommunications. 21/ The state action, therefore, was invalid. The court read section 2(b) to apply only when intrastate networks were "in their nature and effect ... [separate] from and ... not substantially affect[ing] the conduct or development of interstate communications. 22/ This narrow interpretation rendered the section meaningless, since the integration of interstate and intrastate aspects of telephone communications exists nearly everywhere. If virtually all facilities of a nationwide network are part of the interstate network, FCC jurisdiction extends to all aspects, and the federal preemption relegates the states to a dependent role. Hence, state regulation of telephone service, in the presence of an articulated FCC policy, is largely at the sufferance of the FCC.

III. The New Federal Regulation

The FCC has received much attention for its new policies toward telecommunications regulation, which commentators generally describe as deregulatory in nature. 23/ These policies, coupled with the Justice Department's AT&T divestiture agreement, however, are not deregulatory in the true sense of the word. Rather than eliminate governmental intervention, the policies substitute a fairly rigorous control of market structure for control over the regulator's behavior in setting prices and quality levels. Thus, absence of intervention does not accurately describe the federal policy, and it mischaracterizes the disagreement between federal and state policies as one between free-marketeters and regulators, whereas the conflict actually is between different approaches to regulation. Limited entry decontrol more aptly describes the federal policy in the communications sector. The FCC frequently permits entry,

and indeed even encourages it. The Commission, however, segregates different segments of the communications sector from each other, and often restricts participants in one area from entering another sector.

Despite the talk about freedom of entry and convergence of technology, the communications sector abounds with entry restrictions on some of its most likely entrants -- those firms already operating in other segments of the communications industry. The divested former BOCs, for example, may not provide any non-monopoly service. 24/ They may not enter interexchange transmission or offer information services, and they cannot manufacture equipment -- although they may market it. Similarly, the FCC prohibits BOCs from owning and operating cable television systems. 25/ Since the BOCs comprise two-thirds of AT&T's assets and employees, the overall effect of divestiture on the Bell System quite possibly has been to add restrictions rather than to reduce them.

The FCC has imposed similar restrictions in the broadcast field. The Commission still forbids commercial television networks from owning more than seven stations. 26/ At present, they may not own cable television franchises 27/ and they are subject to a ceiling of airing no more than three hours of prime time programming per day. 28/ Cable television operators may not own television stations broadcasting in the area in which the cable operators are located; similarly, television stations may not own cable networks operating in their area. 29/ In addition, cable television operators must carry, at no charge, the programs of all television broadcasters in their geographical area, 30/ which, in effect, makes these broadcasters favored entrants in the competition for viewers. Other structural restrictions prohibit foreign broadcasters from having control ownership interests in United States stations, or in telephone companies. 31/ The FCC has structured the cellular radio market to consist of two services in each locality, with one assured to a local wireline carrier, i.e., a local telephone company, and the other set aside to anyone else.

Of course, structural regulation is not a new approach, as several of the examples indicate. The 1913 Kingsbury Commitment 32/ subjected the Bell System to structural restrictions by requiring AT&T to exit from public telegraphy, to divest itself of Western Union stock, to cease acquiring new territories, and to interconnect with independent telephone companies. 33/ Nor is structural regulation the policy that the FCC has pursued in every instance. Indeed, the Commission has removed some barriers that separated different communication firms. For example, the FCC recently eliminated the careful separation of domestic and international telegraphy, which Western Union and the so-called IRCs operated respectively. 34/ In addition, the agency

permitted the IRC to provide voice service. 35/ Yet despite such instances of structural decontrol, the present policies of the FCC and the Justice Department rest strongly on the structural separation of communication firms.

Several justifications support the FCC's structural separation policies. First, structural separation prevents possible cross-subsidization of the competitive segments of a firm's activities by the firm's naturally monopolistic parts. A strict separation between the two segments is necessary if sustainable entry into competitive markets is to exist. 36/ Second, concerns of diversity, political power, and localism favor the diffusion rather than the concentration of control over communication. 37/ Last, since encouraging entry into content markets such as information services or entertainment programming strengthens the importance of conduit access, structural separation may be necessary to reduce the potential for unfair competition by a vertically integrated firm that is both an essential conduit and a content supplier with other nonintegrated providers.

The problems with structural regulation are several. First, structural regulation must be recognized as a form of regulation, often quite restrictive in nature. 38/ To draw an analogy, the exclusion of certain types of vehicles from a highway is at least as restrictive as a speed limit. Furthermore, structural regulation is not easy to maintain in the midst of unprecedented technological change and entrepreneurial application. A regulator can restrict the participants in one market from entering another market only when the technologies in question are clearly distinguishable.

Efficacy is another fundamental problem of structural regulation. Underlying the structuralist approach is the expectation that entry, coupled with separation of markets, will lead to competition in prices and quality of service. In addition, proponents of structural regulation claim that it will provide users with a welcome choice, eliminate market power, and obviate the need for traditional price/earnings conduct regulation. 39/ Whether structural regulation can accomplish these feats is questionable. 40/ This points to the fundamental weakness of an entry-based policy. Although open entry -- or at least the threat of potential competitors -- is necessary to achieve competitive markets, it is not sufficient by itself. To assume that the de jure removal of barriers leads to de facto competition is wishful thinking. For sustainable entry, an entrant's cost must not be above those of the incumbent firm or firms, and a reduction of the incumbent's ability to cross-subsidize the contested service segment is necessary. The FCC and the Justice Department have concentrated on limiting cross-subsidization, and have largely disregarded the issue of sustainable entry in its absence.

Since the FCC has chosen an open entry approach, the federal policy now depends for success on the survival of entrants, which tends to lead to a policy that focuses on ensuring the presence of competitors rather than necessarily of competition. For example, under the 1982 settlement, local exchange companies must give AT&T's competitors in the interexchange markets access to the local exchanges at the same rates they charge AT&T, even if AT&T's large scale of operation and the resultant cost advantages may justify a lower rate, "provided that the access is equal in type and quality." 41/ Indeed, under the FCC's recently proposed access charge arrangement, AT&T's indirect access charges are actually higher during a five-year transition period than are the charge of its competitors. 42/

IV. Federal Preemption

State commissions have been remarkably insignificant throughout the development of the federal structural policies. Although many states intervened, litigated, and testified vigorously at every stage of the process, in not one major instance did they carry the day.

The pendulum has swung from partnership in a coregulatory regime -- at least for wire communications to overwhelming federal predominance over the regulation of telecommunications. The primary legal weapon that the federal government has used to achieve its position is the doctrine of federal preemption, which precludes local and state governments from taking actions that impair federal policies. 43/

The FCC has been outspoken in its determination not to let states interfere with its policies. In the 1980 Competitive Carrier proceedings, 44/ the Commission stated unequivocally:

...We intend to preclude the states from regulating non-dominant entities providing communications services in competitive markets on an interstate basis. 45/

In almost all instances the courts have agreed with the Commission.

Thus, in North Carolina Public Utilities Commission v. FCC, 46/ the court decided in favor of the FCC, which had provided for the interconnection of terminal equipment by suppliers unaffiliated with the local telephone companies. The court held that the FCC's regulatory authority over interstate communications includes authority over equipment, services, and facilities that are inseparable from intrastate services. 47/ Similarly, the United States Court of Appeals for the District of Columbia upheld the Second Computer Inquiry decision in Computer and Communications Industry Association v. FCC 48/ against challenges by state bodies, including the California Public Utilities Commission and the National Association of Regulatory Utility Commissioners. 49/ Echoing North Carolina Utilities Commission, the court stated: "[W]hen state regulation of intrastate equipment or

facilities would interfere with achievement of a federal regulatory goal, the Commission's jurisdiction is paramount and conflicting state regulations must necessarily yield to the federal regulatory scheme." 50/

Significantly, the court in Computer and Communications Industry Association upheld the FCC's power to abandon an area of traditional regulatory concern, such as the setting of CPE rates, provided the Commission substituted other regulatory tools. For example, the Commission required the structural separation of regulated and nonregulated activities of AT&T, the dominant carrier. 51/ By declaring an affirmative regulatory policy not to regulate an area, the Commission can prevent states from usurping regulatory authority in a particular area. To use the FCC's jurisdiction regulatory mandate of the Communications Act of 1934 as the basis both for not regulating an area and for excluding states from doing so is an expansive interpretation of preemption. Furthermore, under the appellate court's opinion, the FCC is free to establish new regulatory tools as it deems necessary in the changing telecommunications environment and in each situation it may preclude states from a nonconforming response.

The preemption issue is also present in United States v. AT&T. 52/ Judge Greene, in his opinion affirming and modifying the consent decree agreement between the Justice Department and AT&T, found that federal preemption exists even before an actual conflict arises between federal and state actions. 53/ In General Telephone Company of California v. FCC 54/ then Judge Warren Burger upheld federal jurisdiction over intrastate facilities used for interstate services. In his opinion for the court he wrote: "Any other determination would tend to fragment the regulation of a communications activity which cannot be regulated on any realistic basis except by the central authority; fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication." 55/ Similarly, when the FCC sought to preclude the New York State Commission on Cable Television's asserted jurisdiction over the master antenna television (MATV), the Second Circuit upheld the Commission on the ground that state regulation could frustrate the FCC's policy of encouraging interstate Multipoint Distribution Services used in pay television. 56/

The FCC's string of successes is not unbroken. When the Commission attempted to preempt state regulation of cable television's use of two-way leased channels, the District of Columbia Court of Appeals reversed the Commission in a multiple opinion decision, National Association of Regulatory Utility Commissioner v. FCC, 57/ because the FCC had failed to establish a nexus between the particular communications activity if sought to regulate and its jurisdictional powers over broadcasting. 58/

V. The Impact of Federal Structural Policies on the States

The redirection of federal regulation toward a structural approach has ushered in a period of difficult adjustment for the states. Their own regulatory priorities, which strongly reflect social policy concerns, have not changed. Affordable residential rates, universal service encompassing low income users and rural areas, and the viability of local telephone companies subject to state regulation remain the state commissions' primary regulatory goals. 59/ The third of these goals is a prerequisite for achieving the first two objectives, which concern equity and redistribution 60/ and reflect the political and historical context for the Commissions' raison d'etre. These goals have not changed in the past decade. If anything, their public proponents have become more assertive, and the increased panoply of services available over telephone. 61/ coupled with the greater geographical dispersion of population, have made access to telecommunications services more important than ever.

State commissions were able to maintain their regulatory goals through the use of revenue sources over which they had no control -- interstate long distance rates that the FCC established 62/ -- and through activities such as equipment leasing whose revenues depended critically on market structures and entry conditions that also were susceptible to FCC regulations.

As part of its policy reorientation, the federal government achieved divestiture, which resulted in the loss of interexchange service cross-subsidy. The effect that the loss of this revenue will have on local exchange rates and on universal service is difficult to assess because of the many variables involved. 63/ The New York State public Services Commission's estimates show, for example, that, depending on the assumptions relied upon, local rates will increase between 40% and 182%. 64/ Commentators frequently make the counter argument that increased access charges, either to the interexchange carriers such as MCI and the remaining AT&T, or to long distance customers, which require access, theoretically can offset dollar-for-dollar any increases in local rates. 65/ If state commissions, however, seek to adhere to their fundamental redistributive policy of subsidizing residential customers with revenues from large business customers, a serious limit to the policy of increasing access charges arises. An increase in access charges substantially above cost would encourage large users to seek "by-pass" technologies as an alternative to local telephone company distribution. 66/ Cable television networks, 67/ analog or digital microwave systems, 66/ in-house private exchanges (so-called class-6 exchanges), 68/ and duplicative regular telephone systems are capable of providing local distribution services. 69/

While it is not likely that any by-pass technology will be competitive with cost-priced telephone distribution, high access charges may divert a significant number of major business users to long distance carriers via non-BOC routes. Since less than eight percent of all long distance users account for seventy-five percent of all long distance billings, 70/ by-pass alternatives need attract only a relatively small number of high volume users to divert a major share of the access charge subsidy from local exchange services. To prevent the loss of large scale users -- typically business customers -- the local operating companies would have to give them rebates; residential customers, therefore, would have to bear a greater share of total cost. The resulting rate increases for residential customers would be difficult for politically sensitive utility commissions to support and would run counter to their goal of affordable rates. In addition, to the extent that the FCC's access charge policy toward interexchange carriers is uniform and nondiscriminatory -- that is, not cost-based and reflective of the Commission's desire to protect new entrants -- the FCC probably will oppose "predatory" access rate reductions by local telephone companies to business users.

Theoretically, state commissions could regulate by-pass technology rates to prevent them from attracting much of the local telephone companies' business. Again, however, the FCC's policy of protecting entry is likely to prevent the states from imposing burdens on new entrants. Indeed, the FCC already has claimed regulatory authority over by-pass technologies for local distribution. When the Commission allocated radio spectrum to digital termination systems, 71/ it announced its intent to preempt state regulation. 72/ Similarly, in New York State Commission on Cable Television v. FCC 73/ the Second Circuit recognized the Commission's preeminent interest in regulating Multipoint Distribution Services (MDS) because of the technology's potential use in local distribution of interstate communications. 74/

VI. Outlook

If federal goals and actions have dominated the recent history of federal and state division of responsibility in the regulation of telecommunications, what is the outlook for the near future? To attempt an answer, of course, is to invite speculation.

The strict separation of the BOCs from competitive services is intellectually consistent with the theory underlying divestiture, but its success may sow the seeds of its own destruction. With the BOCs precluded from the major areas of new technological applications, with by-pass technologies nibbling at their most profitable customer base, and with political and economic forces constraining their ability to obtain rates that adequately compensate

them for the loss of the interexchange subsidy, the BOCs may well deteriorate financially, even with increasing rates. State regulators conceivably might take this opportunity to circumvent or modify the strictness of the structural regulation. Eventually, the BOC's revenue plight with its distributional implications, and the companies' willingness to compete actively in other markets, may lead to the removal of restrictions and to BOC reentry into many of the markets that the FCC currently has allocated to AT&T. In that event, the segmental separation approach of the FCC and the Justice Department will largely break down -- as it must with increasingly integrated technology.

In the short run, however, the logic of the FCC's structural policy is likely to lead to a further restriction of local and state governmental authority.

If the new entrants are less efficient than the firms already in the market, a fundamental irony exists. The success of the FCC's policy of entry rests on the presence of new entrants. Yet some of these entrants may exist or survive largely because of the equity centered, "nonefficient" concerns of state and local regulators. If these regulators were to adopt the federal efficiency goals entirely, the underlying cost structures in several telecommunications markets could result in monopolistic conditions. Monopolization, in turn, would likely lead to a re-emergence of more traditional forms of conduct regulation such as price/earnings restrictions. Therefore, the present system of federal and state regulation is probably not stable. If the states abandoned their policy aims in favor of the federal goals, they would greatly weaken federally inspired entry of interchange carriers such as by-pass carriers, MDS, and SMATV. The success of federal policies thus depends to some extent on the states' maintenance of rate regulation that cross-subsidizes high cost users with proceeds from low cost users.

While in the traditional coregulatory system federal forbearance made achievement of state goals possible, the converse is true today. Now the states, by their adherence to equity goals, provide a foundation for achieving federal policy aims. When the states become unable or unwilling to follow these equity objectives, a new intergovernmental consensus will be necessary to replace the present federal dominance.

FOOTNOTE

1. Amendment of Section 64.702 of the Comm'n's Rules & Regulations (Second Computer Inquiry), 77 F.C.C.2d 384, modified on reconsideration, 84 F.C.C.2d 50 (1980), modified on further reconsideration, 88 F.C.C.2d 512 (1981), aff'd, 693 F.2d 198 (D.C. Cir. 1982).

2. United States v. AT&T, 552 F. suppl 131 (D.D.C. 1982), cert denied 103 S. Ct. 1240 (1983).

3. United States V. Western Elec. Co., 1956 Trade Cas. (CCH) para. 68,246 (D.N.J. 1956).

4. See generally Ordovery & Willig, Local Telephone Pricing in a Competitive Environment, in E. NOAM TELECOMMUNICATIONS REGULATION: TODAY AND TOMORROW 267 (1983).

5. See infra notes 59-74 and accompanying text.

6. Gabel, The Early Competitive Era in Telephone Communications, 1893-1920, 34 LAW & CONTEMP. PROBS. 340, 355 (1969).

7. Id.

8. Act of June 18, 1910, Ch. 309, § 7.36 Stat. 539, 544-47 (codified as amended in scattered sections of 49 U.S.C. (1976)). See Note, supra note 26, at 737 n.15.

9. The Shreveport Rate Cases greatly expanded I.C.C. authority over the railroads at the expense of state regulators. The court based its decisions on the power that the commerce clause grants to the federal government. See, e.g., Railroad Comm'n of Wis. v. Chicago B. & Q.R.R., 257 U.S. 563 (1922); Houston, E & W Tex. Ry. v. United States, 234 U.S. 342 (1914) (The Shreveport case); Southern Ry. v. United States, 222 U.S. 20 (1911). See generally Note, Administrative Agencies -- Separating the Jurisdictional Authorities of State and Federal Administrators in the Regulation of the Physical Equipment within the Nation's Network, 8 U. TOL.L. REV. 733, 737-43 (1977) (discussion of the effect of the Shreveport Rate cases on I.C.C. authority).

10. 78 Cong. Rec. 10136 (1934) (statement of Rep. Merritt); see H.R. Rep. No. 1850, Cong., 2d Sess. 4-7 (1934) (explaining the general provisions of the Communications Act 84, which does not apply to purely intrastate business).

11. 47 U.S.C. § 151-609 (1976) (amended 1981 and 1978).

12. Id. §§ 154-155.

13. See Wheat The Regulation of Interstate Telephone Rates, 51 Harv. L. Rev. 846, 848-49 (1938).

14. Pub. L. No. 83-345, § 1, ch. 175, 68 Stat. 63, 63-64 (codified as amended at 47 § 152(b) (1976)). The provision reads: Subject to the provisions of section 301 .

. . [relating to radio and television], nothing in this chapter shall be construed to apply to or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier...

15. Pub. L. No. 83-345, § 4, ch. 175, 68 Stat. 63,64 (codified as amended at 47 U.S.C. § 221 (b) (1976).
16. 47 U.S.C. § 152(b) (1976) (amended 1981 and 1978).
17. See Note, supra note 9, at 748-49. Congress did grant the FCC power, which was not limited to interstate telecommunications, to establish a uniform system of accounting. 47 U.S.C. § 220 (1976).
18. 78 Cong. Rec. 10136 (1934) (statement of Rep. Merritt); see H.R. Rep. No. 1850, 73d Cong., 2d Sess. 4-7 (1934).
19. Use of the Carterfone Device, 13 F.C.C.2d 420 (1968).
20. 537 F.2d 787 (4th Cir.), cert. denied, 429 U.S. 1027 (1976). See Note, supra note 9 at 758-61; Comment, Competition in the Telephone Equipment Industry: Beyond Telerent, 86 YALE L.J. 538, 540-44 (1977).
21. 537 F.2d at 793.
22. Id.
23. Special Report 1983: The Second 50 Years of the Fifth Estate, BROADCASTING, Jan. 3, 1983, at 62. "Market-place has become the watchword Broadcasters and others in telecommunications are looking forward to 1983 as a year in which the transformation of their industry from one regulated by government to one regulated by the market-place will continue." Id.
24. Other than exchange telecommunications and exchange access services, a BOC may not offer any product or service when a substantial possibility exists that it could use its monopoly power to impede competition in the market it seeks to enter. United States v. AT&T, 552 F. Supp. 131, 187 (D.D.C. 1982).
25. 47 C.F.R. § 64.602(a) (1980); see Application of Telephone Companies for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems, 21 F.C.C.2d 307 (1970). An exception to the prohibition of cross-ownership is available through a waiver procedure for areas where cable franchises otherwise would not exist. Id.; see Noam, Towards an Integrated Communications Market: Overcoming the Local Monopoly of Cable Television, 34 Fed. Com. L.J. 209, 243 n.152 (1982).
26. 47 C.F.R. §§ 73.35, 73.240, 73.636 (1982). Congress, however, has slated this 7-7-7 rule for reconsideration. See BROADCASTING, Dec. 20, 1982, at 56.
27. Amendment of Part 74, Subpart K, of the Comm'n's Rules and Regulations Relative to Community Antenna Television Systems, 39 F.C.C.2d 377 (1973). The FCC has granted CBS a waiver to operate systems serving areas with a total population of 90,000, and an FCC staff report has recommended complete repeal of this restriction. See FCC Office of Plans and Policy, FCC Staff Report on Cable TV Cross Ownership Policies (Nov. 17, 1981) (Report released for public comment).
28. 47 C.F.R. § 73.658(k) (1982).
29. Id. § 76.501 (originally adopted as § 74.1131 in Community Antenna Television Systems, 23 F.C.C.2d 816, 823 (1970)).

30. 47 C.F.R. § 76.61 (1982).
31. See id § 25.390 (1981).
32. Gabel, supra note 6, at 352.
33. See Trebing, A Critique of Structural Regulation in Common Carrier Telecommunications, in E. Noam, supra note 4, at 125.
34. International Record Carriers' Scope of operations in the Continental United States, 76 F.C.C.2d 115 (1980); Western Union Int'l, Inc., 76 F.C.C.2d 166 (1980).
35. Western Union, 76 F.C.C.2d 166 (1980).
36. If an existing firm subsidizes its competitive activities through its monopolistic segments, it can provide the competitive service at lower prices than market entrants.
37. See B. OWEN, J. BEEBE, & W. MANNING, TELEVISION ECONOMICS 49 (1974); supra note 29 and accompanying text; see also B. OWEN, ECONOMICS AND FREEDOM OF EXPRESSION 111, 143 (1975).
38. See supra text accompanying notes 83-96.
39. See Trebing, supra note 33.
40. The legal ability to enter a market is neither sufficient nor always necessary for competitive conditions to emerge. Theoretically, even a 100% market share may not permit a firm to engage in monopolistic behavior if potential entrants hover at the edge of the market, ready to enter if returns become sufficiently attractive. Economic theorists recently have refined this argument, which the Court anticipated to some extent in FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967). See Baumol, Contestable Markets: An Uprising in the Theory of Industry Structure, 72 Am. Econ. Rev. 1 (1982). For a more detailed discussion of this argument, see W. BAUMOL, J. PANZAR & R. WILLIG, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE (1982). For a critique of the theory when applied to the specific conditions of the telecommunications sector, see Shepherd, Concepts of Competition and Efficient Policy In The Telecommunications Sector, in E. Noam, supra note 4, at 79.
41. See United States v. AT&T, 552 F. Supp. 131, 199 (D.D.C. 1982).
42. See Exchange Network Facilities for Interstate Access (ENFIA), 71 F.C.C.2d 440 (1979); MTS and WATS Market Structure, 90 F.C.C.2d 135 (1982).
- AT&T's interexchange competitors urged the district court to withhold its approval of the consent decree until AT&T had agreed not to seek increases in the level of Operating Company charges to interexchange carriers, which the FCC sets. See Exchange Network Facilities for Interstate Access (ENFIA), 90 F.C.C.2d 202 (1982), review pending sub nom. MCI Telecommunications Corp. v. FCC, No. 82-1554 (D.C. Cir. 1982). AT&T and the other intercity carriers initially negotiated the ENFIA agreement under the aegis of the FCC, and the Commission recently extended these agreements for an additional two years. AT&T filed new tariffs to implement the ENFIA agreement, but other carriers challenged these

tariffs. The Commission then suspended the tariffs and imposed an arbitrary interim rate until it determined the proper tariff rate under the ENFIA agreement. Its proposed new action opened for comments in December 1982.

43. Federal regulators preempt state regulation of interstate commerce when the need exists for a uniform national policy. See Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977); Rice v. Santa Fe Elevator Corp. 331 U.S. 218, 230 (1947); P. Hochberg, THE STATES REGULATE CABLE: A LEGISLATIVE ANALYSIS OF SUBSTANTIVE PROVISIONS 13-14 (Program on Information Resources Policy, Harvard University, Pub. No. P-78-4, July 1978).

44. Policy and Rules Concerning Rates for Competitive Carrier Services and Facilities Authorizations Thereof, 84 F.C.C.2d 445 (1980).

45. Id. at 519.

46. 537 F.2d 787 (4th Cir.), cert. denied, 429 U.S. 1027 (1976).

47. Id. at 793-94.

48. 693 F.2d 198 (D.C. Cir. 1982).

49. Arkansas, Wisconsin, Maine, Alabama, Minnesota, Maryland, Kansas, and Connecticut were amici curiae. See id. at 202.

50. Id. at 214. The Computer and Communications Indus. Ass'n court also found that the FCC's structural policy was not in the nature of an impingement on state regulatory authority: "In Computer II the Commission has [not] attempted to set rates for intrastate communications services or facilities Rather, the Commission here exercised its direct authority to determine the regulatory treatment of CPE used for interstate communications." Id. at 216.

51. Id. at 219.

52. 552 F. Supp. 131 (D.D.C. 1982).

53. Judge Greene stated:

The Court must decide the preemption issue at this juncture even though no State has yet taken specific action which conflicts with the terms of the proposed decree. In the first place, many States have made it abundantly clear that, unless the Court acts, they will proceed in a manner inconsistent with the decree.... Finally, the possibility that provisions of the decree could be vetoed by regulators on a state-by-state basis, with the resulting "balkanized scheme of telecommunications service" (Joint Comments of Alabama, et al., at 12) would obviously have a bearing on the basic question whether the proposed decree would and could effectively open the telecommunications industry to competition. Id. at 154 n.100.

In Challenging the AT&T consent decree, several states, citing National League of Cities v. Usery, 426 U.S. 833 (1976), asserted that the decree unconstitutionally invaded powers reserved to the states under the tenth amendment. The court dismissed this argument. 552 F. Supp. at 155-56.

54. 413 F.2d 390 (D.C. Cir.), cert. denied, 396 U.S. 888 (1969).
55. Id. at 401.
56. New York State Comm'n on Cable Television v. FCC, 669 F.2d 58, 66 (2d Cir. 1982).
57. 533 F. 2d 601 (D.C. Cir. 1976) (NARUC II).
58. Id. at 615.
59. See Gioia, A State Regulator's View of the Present Situation in Telecommunications and of the Changes in the Industry, in E. Noam, supra note 4, at 183.
60. Reasons other than redistributive concerns support the concept of universal service. The value of a telephone subscription to each customer rises with the number of reachable parties. Thus, each additional subscriber usually provides positive externalities to the other customers. A purely cost-based charge ignores the positive benefit that the additional subscriber bestows on the system. A cross-subsidy, therefore, is a way in which existing users encourage the participation of other users whose connections in turn contribute to the overall value of the telephone network.
61. See, e.g., Rosengerb & Hirschman, Retailing Without Stores, Harv. Bus. Rev., July-Aug. 1980, at 103.
62. See Cornell & Pelcovits, Access Charges, Costs, and Subsidies: The Effect of Long Distance Competition on Local Rates, in E. NOAM supra note 4, at 307.
63. According to one estimate, a doubling in prices would reduce subscribers, as a percentage of total households, from 92% to 84%. See Defendant's Exhibit D-4-1518. Table entitled, "Estimated PERcentage of Households with Basic Telephone Services," United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982) (cited in Trebing, supra note 33, at 172 n. 62).
64. See Gioia, supra note 59.
65. See, e.g., Ordover & Wilig, supra note 4.
66. For a more detailed discussion of the issue of local by-pass, see id.
67. See Noam, supra note 25.
68. See Amendment of Parts 2, 21, 87, and 90 of the Comm'n's Rules to Allocate Spectrum for, and to Establish other Rules and Policies Pertaining to, the Use of Radio in Digital Termination Systems for the Provision of digital communications services, 86 F.C.C.2d 360, 361 (1981), modified, 90 F.C.C.2d 319 (1982).
69. A private branch exchange (PBX) is customer-owned or leased telephone exchange serving an individual organization and connecting to a public telephone exchange.
70. See Capital Tel. Co. v. City of Schenectady, No. 82-CV-468, (N D.N.Y.) (1983) (Characteristically protective local regulators prevent approval of new telephone company's attempt to enter market served by BOC).

71. See Trebing, supra note 33, at 150.

72. See Amendment of Parts 2, 21, 87, and 90 of the Comm'n's Rules to Allocate Spectrum for, and to Establish other Rules and Policies Pertaining to, the Use of Radio in Digital Termination Systems for the Provision of Digital Communications Services, 86 F.C.C.2d 360, 361 (1981), modified, 90 F.C.C.2d 319 (1982).

73. Id. at 389-90.

74. 669 F.2d 58 (2d Cir. 1982).

75. Id. at 66.