CHAPTER 1

A Brief History of Communications Regulation in the United States

Chapter Contents

§ 1.01 Early Regulation of Radio: The Radio Act of 1927

[1]—The Invention of Radio

[a]—The Ideas

Guglielmo Marconi patented his version of the radio in 1896,[1] though when he had introduced it in Britain earlier that year, many academicians dismissed it as highly derivative.[2] It was, in fact, the right combination of a series of discoveries made by European academics over the course of the previous sixty years.

Michael Faraday of England is credited with discovering electromagnetic conduction in the 1830s. With it, he and others found, a circuit could be completed without using two wires.[3] By the 1840s, people began to study the possibility of using induction and conduction to send signals without using wires. In 1888, Heinrich Hertz produced and detected electromagnetic waves, as James Clerk Maxwell had predicted could be done. Hertz's sparking Leyden jar became the early radio transmitter.[4] In 1894, Oliver Lodge developed his "coherer," which would become the receiver.[5]

By the end of the century, the technology of the radio was known to the scientific community. To the academics studying electromagnetics, however, using Hertz's discoveries for commercial purposes might have seemed vulgar.[6] Marconi, though, was only twenty years old, a student from a wealthy family, and more drawn to invention

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[1] Brock, *The Telecommunications Industry: The Dynamics Of Market Structure,* 162 (1981).
[2] Douglas, *Inventing American Broadcasting 1899-1922,* 10 (1987).
[3] Aitken, *Syntony and Spark: The Origins of Radio* (1976).
[4] *Id.* at 48-74.
[5] *Id.* at 103-108.
[6] Douglas, N. 2 *supr*a, at 14.

than academics. He sought all along to develop Hertz's discovery into something for the marketplace.[7]

Marconi discovered that, by connecting both transmitter and receiver to the ground as well as to the aerial, he was able to transmit over a distance of miles. With his mother, Annie Jameson, of the prominent Scotch-Irish family of brewers and distillers, he took the invention to the Italian Ministry of Posts and Telegraphs. The Italians rejected it, seeing no advantage over the telegraph.

Marconi, then age twenty-two, went to England, and spent 1896 and 1897 patenting the invention, demonstrating it, and finding financing. With cousins, Marconi founded the Wireless Telegraph and Signal Company Limited in 1897; in 1900, the company changed its name to Marconi's Wireless Telegraph Company, Ltd.[8]

Marconi spent 1899 marketing the device to the public, demonstrating as much flair for public relations as he had for invention.[9] In October, he brought it to the United States, to announce the America's Cup yacht races as they occurred. The device caught on quickly in the United States, particularly in the press.[10]

Marconi's invention was also seen as an alternative to the telegraph and the telephone. Western Union was widely hated at the turn of the century, and Bell Telephone had already begun to display monopolistic characteristics. Newspapers also saw good prospects for themselves in Marconi's device: they paid extremely high fees for news transmission.[11]

[b]—The Early Radio Patents

Marconi was awarded patents in radio transmission and the basic technology for tuning.[12] With these patents, the Marconi Wireless and Telegraph Company was able to establish itself as the dominant presence in the early radio industry. Marconi's patent, for an improvement of the tuning system invented by Lodge, "was one of the most frequently litigated claims in wireless history."[13]

While Marconi was promoting his new technology, other inventors were rapidly improving on it. Reginald Fessenden developed the electrolytic detector and the wireless telephone,[14] and in 1906 he gener-

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[7] *Id.* at 15-17.

[8] Douglas, *Inventing American Broadcasting 1899-1922,* 17 (1987); Aitken, *Syntony and Spark: The Origins of Radio,* 224 (1976).

[9] Head and Sterling, *Broadcasting in America,* 35 (6th ed. 1990).

[10] Douglas, *Inventing American Broadcasting 1899-1922,* Ch. 1 (1987).

[11] *Id.* at 25-26.

[12] MacLaurin, *Invention and Innovation in the Radio Industry,* 45 (1949).

[13] Douglas, N. 10 *supra,* at 38.

[14] Sterling and Kittross, *Stay Tuned: A Concise History of American Broadcasting* (2d ed. 1990).

ated the first radio broadcast in the United States.[15] John S. Stone refined the tuning system.[16] Lee De Forest developed the three-element vacuum tube in 1907,[17] essential to the receiver that allowed broadcasting to become a source of entertainment.

Several other firms patented these important innovations. In some cases this caused companies to block one another from using key components, interfering with the development of technology.[18]

AT&T, concerned that radio could possibly compete with its longdistance telephone line service,[19] entered radio service by acquiring the rights to the patents on the triode vacuum tube, an early radio amplification device that significantly advanced Marconi's work,[20] patented by Lee De Forest.[21] The two companies soon deadlocked over their patents, and the matter was brought to court.

The United States District Court for the Southern District of New York held that Marconi's diode patent took precedence over DeForest's triode.[22] Neither party would license the other, however, so the triode, a significant advancement, was not used.[23]

Licensing of long-range transmission was also difficult.[24] Eventually several of the clashing American companies got together, prompted in large part by the United States Navy, and on October 17, 1919 formed the Radio Corporation of America (RCA).[25] They then pooled their resources, and with government encouragement, purchased all other patent interests in radio in the United States from British-owned American Marconi.[26]

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[15] Head and Sterling, *Broadcasting in America,* 35 (6th ed. 1990).

[16] Douglas, *Inventing American Broadcasting 1899-1922,* at 51-52 (1987).

[17] Brock, *The Telecommunications Industry: The Dynamics Of Market Structure,* 164 (1981).

[18] Aitken, *The Continuous Wave: Technology and American Radio 1900-1932,* 249 (1985); Merges and Nelson, "On the Complex Economics of Patent Scope," 90 Columbia L. Rev. 839, 890-894 (1990).

[19] Douglas, *Inventing American Broadcasting 1899-1922,* 242 (1987).

[20] Aitken, N. 18 *supra,* at 195; Douglas, *The Early Days of Radio Broadcasting,* 8 (1987).

[21] Radio Corp. of America v. Radio Engineering Laboratories, 293 U.S. 1, 2-7, 54 S.Ct. 752, 79 L.Ed. 163 (1934).

[22] Marconi Wireless Telephone Co. of America v. DeForest Radio Telephone & Telegraph Co., 236 F. 942, 955 (S.D.N.Y. 1916), *aff'd* 243 F.560 (2d Cir. 1917).

[23] Federal Trade Commission, Report of the Federal Trade Commission on the Radio Industry in Response to H. R. 548, 67th Cong., 4th Sess., at 26 (1924).

[24] *Id.* at 14-16.

[25] MacLaurin, *Invention and Innovation in the Radio Industry,* 103 (1949).

[26] McChesney, *Telecommunications, Mass Media, and Democracy,* 12 (1993); White, *The Radio,* 11-12 (1947).

[2]—Early Radio Regulation: 1910—1920

[a]—The United States

The United States government first regulated radio in 1910, enacting the Wireless Ship Act.[27] The Wireless Ship Act, prompted by outrage following the sinking of the Titanic, and the sea rescue of the crew and passengers of another ship whose distress signal was heard by amateur radio operators on shore,[28] prohibited any steamer that could carry fifty or more persons from leaving an American port without a radio apparatus and a skilled operator for it.

By 1912, ship-to-shore communication was meeting interference from amateur radio users on land. The armed forces, particularly the navy, began to demand regulation.[29] Congress enacted the Radio Act of August 13, 1912.[30] The 1912 Act forbade the operation of radio equipment without a license, allocated certain frequencies for government use, and restricted wave emissions.[31]

Few questions arose under the 1912 Act. The Act had not set aside any particular frequencies for private broadcast, but enough frequencies existed for all stations, so interference was rare.[32]

American Marconi dominated radio at the time of the 1912 Act, exerting "a virtual monopoly in the United States, having bought out or driven out of business its major competitors."[33] In 1919, however, Marconi sold its American rights to the newly formed RCA, creating the beginning of the radio age.[34]

[b]—International Agreements

In response to the monopolistic practices of the Marconi Wireless Company, which refused to install equipment in ocean-going vessels unless they agreed to communicate only with other vessels using

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[27] Wireless Ship Act of June 14, 1910, S. 7021, 36 Stat. 629 (1911).

[28] Schmeckebier, *The Federal Radio Commission,* 5 (1932).

[29] Barnouw, *A Tower in Babel,* 31-32 (1966).

[30] Radio Act of 1912, ch. 287, 27 Stat. 302, repealed by Communications Act of 1934, ch. 652 § 602(1), 48 Stat. 1064, 1102.

[31] *Id*.

[32] National Broadcasting Co., Inc. v. United States, 319 U.S. 190, 210-211, 63 S.Ct. 997, 87 L.Ed. 1344 (1943).

[33] Douglas, *Inventing American Broadcasting 1899-1922*, 235 (1987).

[34] See: MacLaurin, *Invention and Innovation in the Radio Industry*, 103 (1949); Federal Trade Commission, *Report of the Federal Trade Commission on the Radio Industry*, 18-21 (1924).

Marconi equipment,[35] an international convention formed the International Radiotelegraph Union in 1906.[36] The Union sought international cooperation in establishing safety regulations that would require ships and coastal stations to exchange wireless telegrams regardless of whether the ships carried Marconi equipment.[37] After the sinking of the Titanic, the Union called for compulsory installation of radios.[38] In 1932, the Union was merged into the International Telecommunications Union.

[3]—1920s Radio Chaos

[a]—1919—February 1923

The First World War accelerated the development of radio. Radio broadcasting became viable in 1920-1921.[39] New stations emerged rapidly. By the end of 1922, 576 stations existed.[40] Congress and the executive branch were almost totally unprepared for the radio boom.

The Department of Commerce formally adopted "broadcasting" as a separate regulatory category in 1920. The first standard broadcast stations were established in 1921, as the Department of Commerce issued five licenses.[41] Stations were limited to two frequencies, one for general programming, the other for crop reports and weather forecasts. The Department of Commerce left it to the individual stations to work out among themselves how they would share the frequencies. This did not always work well. In Los Angeles, for example, twenty-three stations shared the same frequency. Because the stations operated at anywhere from ten to 500 watts, and often changed over without warning to listeners, they could cause discomfort and even injury because of erratic changes in volume.[42]

In 1922, Secretary of Commerce (later President) Herbert Hoover called the first of four National Radio Conferences, which brought representatives of the communications industry and government together in Washington to try to adopt self-regulation. The members

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[35] Glazer, "The Law-Making Treaties of the International Telecommunication Union Through Time and in Space," 60 Mich. L. Rev. 269, 274-279 (1962).

[36] Berlin Radiotelegraph Convention, Nov. 3, 1906, 37 Stat. 1565, T.S. No. 568.

[37] Glazer, N. 35 *supra*, 60 Mich. L. Rev. at 269, 274.

[38] *Id*. at 269, 275.

[39] Archer, *History of Radio to 1926,* 201-204 (1938).

[40] Hazlett, "The Rationality of U.S. Regulation of the Broadcast Spectrum," 33 J. Law & Econ. 133, 139-140 (1990).

[41] Barnouw, *A Tower in Babel,* 91 (1966).

[42] *Id*. at 94.

decided that they could not regulate themselves, and made recommendations to Congress for legislation. Two bills were drafted, but Congress failed to agree on legislation.[43]

At the recommendation of the First Conference, the Department of Commerce began assigning specified frequencies to particular stations. The Secretary divided the frequencies into numerous bands, but still did not have enough frequencies for the rapidly increasing number of applications for new stations. By November 1925, almost 600 stations had been licensed, and 175 applications for new stations awaited review.[44] In addition to the licenses issued to major corporate powers, including AT&T, RCA and Westinghouse, licenses were issued to 126 colleges and universities between 1921 and 1925; these nonprofits played a significant role in spreading radio throughout the country.[45]

The Secretary of Commerce had little power to handle the problem. In February 1923, the United States Court of Appeals for the District of Columbia held that a station otherwise legally qualified could not be denied a license on the ground that the proposed station would interfere with existing stations.[46] The court ruled that the Secretary of Commerce had no discretion over the number of licenses that could be issued, and was limited to assigning wavelengths.

[b]—February 1923—July 1926

Though he had no official authority to do so, Secretary Hoover attempted to manage the growing interference problem by telling new applicants that no new licenses were being issued because all wavelengths were in use. In defiance of the Court of Appeals' decision, Hoover refused to process applications. Thus, parties seeking new licenses turned to the market, and bid to acquire existing stations.[47] Many commercial stations bought existing educational and religious stations to get their licenses.[48] Morris Ernst, a noted New York attorney, testifying for the American Civil Liberties Union, told Congress that stations were being sold for "exorbitant sums."[49] RCA paid

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[43] S. 3694, H.R. 11964, 6th Cong., 2d Sess. (1922).

[44] National Broadcasting Co., Inc. v. United States, 319 U.S. 190, 211, 63 S.Ct. 997, 87 L.Ed. 1344 (1943).

[45] McChesney, *Telecommunications, Mass Media, and Democracy,* 14 (1993).

[46] Hoover v. Intercity Radio Co., 286 F. 1003 (D.C. Cir. 1923).

[47] Barnouw, *A Tower in Babel,* 174 (1966).

[48] *Id*. at 122.

[49] Pool, *Technologies of Freedom,* 122 (1983).

AT&T $1 million for radio station WEAF in New York in September 1926.[50] The situation prompted outrage in Congress.[51]

In April 1926, the United States Court of Appeals for the Northern District of Illinois held that the Secretary had no authority to impose restrictions as to frequency, power, or hours of operation.[52] According to the court, there was "no grant of power in the Act [of 1912] to the Secretary of Commerce to establish regulations." Furthermore, "the Secretary of Commerce is required to issue the license subject to the regulations in the Act. The Congress has withheld from him the power to prescribe additional regulations."[53] Commentators at the time blamed the April 1926 court decision for disrupting a situation that "was fairly well in hand."[54]

Hoover did not appeal the decision, but turned to Acting Attorney General William Donovan to interpret the law. On July 8, 1926, Donovan held that the Secretary of Commerce had no power, under the Radio Act of 1912, to regulate the power, frequency, or hours of operation of stations.[55] The Attorney General also suggested that new legislation be passed "to meet the needs of the present and future."[56] The next day, the Secretary of Commerce abandoned regulation of stations, and urged that stations limit themselves.[57]

[c]—July 1926—February 1927

Between July 1926 and February 1927, when Congress enacted the Radio Act of 1927, almost 200 new stations went on the air, using any frequency they wanted, without concern for interference with other stations. Broadcasting was open to "anyone who will transmit."[58] The result "was confusion and chaos. With everybody on the air, nobody could be heard."[59] It quickly

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[50] Barnouw, *A Tower in Babel,* at 185-186 (1966).

[51] *Id*. at 175.

[52] United States v. Zenith Radio Corp., 12 F.2d 614 (N.D. Ill. 1926).

[53] *Id*., 12 F.2d at 616-617.

[54] Rowley, "Problems on the Law of Radio Communication," 1 U. Cinn. L. Rev. 5 (1927).

[55] 35 Ops. Att'y Gen. 126.

[56] 35 Ops. Att'y Gen. 132.

[57] National Broadcasting Co., Inc. v. United States, 319 U.S. 190, 212, 63 S.Ct. 997, 87 L.Ed. 1344 (1943).

[58] 67 Cong. Rec. 5749 (Rep. White).

[59] National Broadcasting Co. v. United States, 319 U.S. 190, 212, 63 S.Ct. 997, 87 L.Ed. 1344 (1943). See also, Coase, "The Federal Communications Commission," 2 J. Law & Econ. 1 (1940).

became "apparent that broadcast frequencies constituted a scarce resource whose use could be regulated and rationalized only by the Government." [60] Without government control, "the medium would be of little use because of the cacophony of competing voices, none of which could be clearly and predictably heard." [61]

On December 7, 1926, the President appealed to Congress to enact a comprehensive radio law, noting that "the whole service of this most important public function has drifted into such chaos as seems likely, if not remedied, to destroy its great value." [62]

[4]—The Radio Act of 1927

[a]—Adoption of the Radio Act. Between 1921 and 1927, twelve bills were introduced in Congress which would have replaced the Radio Act of 1912, and four bills were introduced which would have modified it. After much debate, a bill passed the House of Representatives in March 1926. [63] A similar bill was presented in the Senate. [64] The bill passed the Senate and was sent to conference in July. The conferees reached agreement on the bill in January 1927. [65]

At the time the bill was adopted, the general public took little interest in its content. The emerging broadcast industry, however, applied significant political pressure in shaping the bill.

Facing intense public pressure, Congress adopted the 1922 bill. The Radio Act of 1927 was actually drafted in 1922, when broadcasting was dominated by hobbyists and manufacturers of receivers. [66]

[b]—Significance of the Radio Act of 1927. The Radio Act of 1927 made significant advances beyond the scope of the Radio Act of 1912. Where the 1912 Act had aimed merely at controlling interference among users of the broadcast spectrum, the 1927 Act included provisions for regulation of programming and licensing, totally unrelated to interference.

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[60] Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 89 S.Ct. 1794, 23 L.Ed.2d 371 (1969).

[61] *Id.*, 395 U.S. at 375. See also, Bensman, "The Zenith-WJAZ Case and the Chaos of 1926-27," 14 J. of Broadcasting 423 (1970).

[62] H. Doc. 483, 69th Cong., 2d Sess., (1927) ¶ 10.

[63] H.R. 9971, 68th Cong., 2d Sess. (1926).

[64] S. 1754, 68th Cong., 2d Sess. (1926).

[65] Radio Act of 1927, ch. 169, 44 Stat. 1162 (1927), repealed by Communications Act of 1934, Pub. L. No. 73-416, ch. 652 § 602(a), 48 Stat. 1064, 1102 (1934).

[66] Le Duc, *Beyond Broadcasting*, 9 (1987).

The Federal Radio Commission (FRC) was established to allocate frequencies among competing applicants, in consideration of the public "convenience, interest, or necessity." [67] Congress placed the broadcast spectrum under federal control, and sought to reconcile competing uses of the airwaves by setting aside a limited number of frequencies for each of the important uses of radio. Because the number of frequencies allocated to public broadcasting was limited, the government was forced to deny licenses to some applicants. [68]

With the creation of the FRC on February 23, 1927, the government began to assert ownership of the spectrum, giving the FRC the authority to allocate exclusive, enforceable broadcasting rights. The government would retain ownership of the spectrum, on the premise that frequencies were inalienable public property, and would assign rights to use it on short-term lease bases. Broadcasters would receive the leases according to their furtherance of the public interest. [69]

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[67] Radio Act of 1927, § 4, 44 Stat. 1163. See Davis, "The Radio Act of 1927," 13 Va. L. Rev. 611 (1927).

[68] See: Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 375-377, 89 S.Ct. 1794, 23 L.Ed.2d 371(1969); National Broadcasting Co. v. United States, 319 U.S.190, 210-214, 63 S.Ct. 997, 87 L.Ed. 1344 (1943).

[69] See Hazlett, "The Rationality of U.S. Regulation of the Broadcast Spectrum," 33 J. Law & Econ. 133, 136 (1990).

§ 1.02 The Communications Act of 1934: The Federal Communications Commission and Its Functions

By the 1920s, broad support existed for a new regulatory regime. State authorities also wanted to establish clear limits on federal authority, and in particular a repudiation of the *Shreveport Rate Case*, which had affirmed federal authority to regulate even intrastate rates "where interstate commerce itself is involved."[1]

In 1933, President Franklin D. Roosevelt called for the convening of a committee to study government regulation of electronic communications. President Roosevelt had a limited purpose: to bring telephony and broadcasting under the same jurisdiction.[2] The committee went further, recommending that Congress establish a single agency to regulate all foreign and interstate communications, including radio, telegraph and telephone, with provisions for any new technologies that might be related.

On February 24, 1934, President Roosevelt sent a proposal to Congress to create a separate agency, known as the Federal Communications Commission (FCC). Roosevelt explained that the FCC should have the authority "now lying in the Federal Radio Commission and with such authority over communications as now lies with the Interstate Commerce Commission—the services affected to be all of those which rely on wires, cables, or radio as a medium of transmission."[3] Congress agreed, and enacted the Communications Act of 1934, which created the Federal Communications Commission.

Section 1 of the Communications Act of 1934 describes Congress' purpose in creating the Federal Communications Commission:

> "For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more

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[1] Houston & Texas Railway v. United States (The Shreveport Rate Case), 234 U.S. 342, 358 34 S.Ct. 833, 58 L.Ed. 1341 (1914). "Congress in the exercise of its paramount power may prevent the common instrumentalities of interstate and intrastate commercial intercourse from being used in their intrastate operations to the injury of interstate commerce." 234 U.S. at 353.

[2] Barnouw, *The Golden Web: A History of Broadcasting in the United States, Vol. II—1933 to 1953,* 23 (1968).

[3] President Franklin D. Roosevelt, Message to Congress, S. Doc. 144, 73d Cong. 2d Sess., Feb. 26, 1934.

> effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the 'Federal Communications Commission,' which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act."[4]

The new seven-member FCC took office in July 1934. Two members remained from the FRC; the rest were new appointments. Licenses at that time were issued for six-month terms, so the FCC's chief task was to act on applications for new licenses and renewals.[5]

Since its establishment in 1934, the FCC's mandate has remained essentially unchanged. As communications technologies have grown, the FCC has grown. The Commission has issued new rules for new technologies, and in some cases Congress has amended the Communications Act of 1934 in recognition of changed circumstances.

The FCC created an uproar with its 1946 report, *Public Service Responsibility of Broadcast Licensees*, a definitive policy statement regarding factors relevant to the public interest.[6]

Known as the "Blue Book" because of the color of it's cover, the work defined programming policy. The FCC required license renewal applicants to submit detailed listings of programming and advertising, in order to monitor the relationship between the two, and to encourage noncommercial programming, local live programming, and public issues coverage.[7] The book was designed to explain FCC policy on these issues,[8] and warned that the Commission thereafter would pay closer attention to broadcaster's programming, and would view more favorably those stations that avoided excessive advertising.[9] Broadcasters proclaimed censorship. Enforcement was limited.[10]

The FCC updated its approach, repealing the Blue Book requirement for noncommercial programming in 1960.[11] In its place, the FCC added

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[4] Communications Act of 1934, Pub. L. No. 73-416, § 1, 48 Stat. 1064 (1934), 47 U.S.C. § 151.

[5] Barnouw, N. 2 *supra,* 28-29 (1968).

[6] See Meyer, "Reaction to the 'Blue Book,'" Lichty and Topping, eds., *American Broadcasting: A Source Book on the History of Radio and Television,* 589 *et seq*. (1975).

[7] See Ramsey, "The Federal Communications Commission and Broadcast Advertising: An Analytical Review," 20 Fed. Communications L.J. 71, 83-85 (1966).

[8] See Friendly, *The Good Guys, the Bad Guys and the First Amendment: Free Speech vs. Fairness in Broadcasting,* 22 (1976).

[9] FCC, *Public Service Responsibility of Broadcast Licensees,* 55 (1946).

[10] Ramsey, N. 7 *supra,* at 88.

[11] Report and Statement of Policy Re: En Banc Programming Inquiry, 44 F.C.C. 2303, 2314-2316 (1960).

a requirement that licensees "ascertain and serve diverse community programming needs."[12] This shifted programming responsibility to the licensee, and established a philosophy of industry self-regulation, as supported by Congress.[13]

Despite the policy shift to self-regulation, the FCC became a significant social force in the 1960s, as it began to implement the "public interest, convenience and necessity" provision of the Communications Act. Newton Minow, named Chairman of the FCC in 1961, attempted to bring "New Frontier" activism to the Commission, and encouraged it to play a more active regulatory role. Perhaps most notable was Minow's May 1961 speech to the National Association of Broadcasters, in which he denounced television as a "vast wasteland."[14]

Prompted by activism within the Commission, citizens and Congress began to call for social change in communications industries. Congress supported public involvement in communications with measures such as the Public Broadcasting Act of 1967,[15] which created the Public Broadcasting Service and established our current system of noncommercial television.[16] Congress also supported content regulation in some contexts, most notably by banning cigarette advertising "on any medium of electronic communication subject to the FCC's jurisdiction.[17]

New technologies, including cable, cellular, and satellite, became increasingly significant issues for the FCC in the late 1970s. This resulted both in dramatic growth and extensive delays: in 1975, license renewal petitioners often waited three years for processing.[18] Traditional broadcast media began to give way to new forms. Cable in particular strained the FCC's resources.[19]

In 1980, the FCC accelerated a deregulation process begun in 1977. This led to new challenges, as the FCC rapidly sought to deconstruct much of the regulatory framework put into place in the 1960s and 1970s.

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[12] *Id.*, 44 F.C.C. at 2313-2314.

[13] See Broadcast Advertisements: Hearings on H.R. 8316 Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 88th Cong., 1st Sess. 162 (1963).

[14] Address of Newton Minow at the Thirty-Ninth Convention of the National Ass'n of Broadcasters, Washington, D.C., May 9, 1961. See also, Emord, *Freedom, Technology and the First Amendment,* 198 (1991).

[15] Public Broadcasting Act of 1967, Pub. L. No. 90-129, 81 Stat. 365 (codified as amended at 47 U.S.C. §§ 390-399).

[16] See Bollinger, *Images of a Free Press,* 20 (1991).

[17] Federal Cigarette Labeling and Advertising Act, Pub. L. No. 89-92, 79 Stat. 282 (1965).

[18] "Broadcasters Give in to Citizen's Demands on Program Content," Wall Street Journal, p. 1 (Jan. 2, 1975). See also, Grundfest, *Citizen Participation in Broadcast Licensing Before the FCC,* 95-103 (1976).

[19] See Besen and Crandall, "The Deregulation of Cable Television," 44 Law & Contemp. Prob. 77, 90 (1981).

The FCC remained an independent agency, responsible directly to Congress.[20] The Commission has substantive jurisdiction over regulation of interstate and international communications by radio, cable, wire, and satellite.

When the FCC was created in 1934, it consisted of seven commissioners. In 1982, that number was reduced to five. The President appoints commissioners, who must be confirmed by the Senate. No more than three members may come from the same political party. Commissioners serve five-year terms; these terms are staggered so that no two expire in the same year. The President also chooses a Chairman, who sets the FCC's agenda. Commission staff also play an important role: some have argued that staff control the channels of communication at the FCC, and, therefore, feed the Commissioners the information on which decisions are based.[21]

In March 2002, the FCC completed an internal reorganization plan.[22] Among the changes was the integration of the Mass Media and Cables Services bureaus into a new "Media Bureau," created to oversee cable, television broadcast, radio and direct broadcast satellite services. With these communications services converging across technology platforms, the FCC found that a functional approach was more appropriate. A new "Wireline Competition Bureau," replacing the Common Carrier Bureau, will oversee policies affecting most telecommunications common carriers other than wireless carriers.[23] The Wireless Telecommunications Bureau will handle multipoint distribution services formerly handled by the Mass Media Bureau.[24] The International Bureau will be realigned under the plan "along functional lines," including consolidation of international communications policies and spectrum allocation responsibilities.[25]

[1]—Office of Communications Business Opportunities

The Commission created the Office of Communications Business Opportunities (OCBO) in 1994 to promote business opportunities for entrepreneurs and other small businesses, including minority- and women-owned businesses. OCBO develops, coordinates, evaluates, and recommends to the Commission, policies, programs and practices that promote participation by small entities, women and minorities in the communications industry.[26]

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[20] See Hilliard, *The Federal Communications Commission,* 1 (1991).

[21] Krasnow and Longley, *The Politics of Broadcast Regulation,* 25 (1973).

[22] FCC Approves Reorganization Portion of Reform Effort, FCC Order 02-10 (released Jan. 17, 2002).

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] In the Matter of Section 257 Triennial Report to Congress Identifying and Eliminating Market Entry Barriers For Entrepreneurs and Other Small Businesses (FCC 11-13), March 3, 2011.

Specifically, OCBO oversees the administration and implementation of the Commission's obligations under the Regulatory Flexibility Act (RFA), the Small Business Regulatory Enforcement Fairness Act (SBREFA), the Small Business Act, and certain other statutes governing small business issues. OCBO's staff participates in conferences and seminars across the country to inform the public about relevant agency proceedings, policies, and initiatives. As part of the Commission's outreach to entrepreneurs and other small businesses, OCBO maintains an extensive database of approximately 3,000 small businesses to which it sends information regarding Commission rulemakings and orders, as well as new service opportunities. In addition OCBO meets with entrepreneurs and small businesses and representatives of trade organizations. OCBO maintains an internet site which contains vital information concerning Commission rulemakings and ownership opportunities for the small business community.[27]

OCBO implements the RFA and assists in the drafting of RFA analyses of all notice and comment rulemakings. OCBO works with Bureaus and Offices to ensure that RFA analyses are precise and helpful, including a focus on plain language. Major goals of the RFA include increasing agency awareness and understanding of the impact of proposed agency regulations on small entities, ensuring agency communication and explanation of any findings concerning such impacts, and encouraging regulatory flexibility and relief to small entities, where appropriate. With few exceptions, an RFA analysis (or, alternatively, a certification that no such analysis is warranted) is required for every federal rulemaking that requires public notice and comment. The analyses describe the need for the agency action, discuss alternatives the agency has considered, and describe which entities are considered "small" within the context of the rulemaking. In this last regard, OCBO assists the Bureaus and Offices in determining and describing the appropriate small business size standards for the various services regulated by the Commission. Overall, the commission's RFA work assists with educational outreach to small entities and results in greater small-entity participation in rulemakings.[28]

Pursuant to Section 212 of SBREFA, the Commission is required to publish Small Entity Compliance Guides when it conducts a Final Regulatory Flexibility Analysis (FRFA) under Section 604 of Title 5 of the U.S. Code. Congress enacted Section 212 to benefit small businesses, non-profits, and small governmental jurisdictions (with staffing or populations fewer than 50,000) by giving them concrete, easily understand-

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[27] *Id*. at 10.

[28] *Id*. Section 212 is SBREFA is classified to 5 U.S.C. § 601 note. The agency's compliance guides are available at http://www.fcc.gov/ocbo (last visited March 15, 2011).

able guidelines for compliance. In 2004, the OCBO coordinated the Commission's initiation of a Compliance Guide Program. The program is designed to implement Section 212 of the SBREFA by publishing documents that explain in plain language the actions a small entity must take to comply with a rule or a group of rules. OCBO has drafted a Compliance Guide Manual which established internal agency policies and procedures for creating and publishing Compliance Guides in a timely manner.[29]

Section 610 of the RFA requires agencies to publish annually in the Federal Register a plan for the periodic review of rules that have a significant economic impact on a substantial number of entrepreneurs and other small businesses. The Commission's compilation identifies numerous rules that might be amended or rescinded, if appropriate, in an effort to better serve the public interest. The Commission's record of compliance with this program remains among the top of the sixty or so federal agencies subject to Section 610. This effort yields comments from the public, which are directed to the pertinent Bureau and Offices for initial review. The agency may then choose to initiate Notices of Proposed Rulemaking for those comments warranting further action.[30]

Generally, federal departments and agencies that promulgate regulations that affect small businesses use the SBA's size criteria as they develop their regulations. To ensure that the FCC's initiatives accurately target entrepreneurs and other small business participation in the telecommunications sector, OCBO works closely with the SBA's Office of Size Standards to obtain approval of any necessary new telecommunications small business size standards. To accomplish this, the Commission forwards to the SBA all descriptions and analyses of proposed size standards prior to the Commission's adoption of a Notice of Proposed Rulemaking, and, thereafter, sends the SBA additional comments and documentation at each stage of the rulemaking process. Near the end of the process, prior to final Commission consideration of the new size standard, the Commission sends a formal request for approval to the SBA Administrator.[31]

[2]—Procedural Issues

In February 2011, the FCC revised a number of procedural rules applicable to parties in various types of Commission proceedings.[32]

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[29] *Id.* at 10-11.

[30] In the Matter of Section 257, N. 26 *supra*, at 11. Section 610 of RFA is classified to 5 U.S.C. § 610.

[31] In the Matter of Section 257, N. 26 *supra*, at 11.

[32] In the Matter of Amendment of the Commission's Ex Parte Rules and Other Procedural Rules, GC Docket No. 10-43 (FCC 11-11), Feb. 2, 2011.

Ex parte notices will be required for all oral ex parte presentations in permit-but-disclose proceedings, not just for those presentations that involve new information or arguments not already in the record. If an oral ex parte presentation is limited to material already in the written record, the notice must contain either a succinct summary of the matters discussed or a citation to the page or paragraph number in the party's written submission(s) where the matters discussed can be found. If an oral ex parte presentation includes new information, the notice must contain a summary of the new data and arguments presented.[33]

Notices for all ex parte presentations must include the name of the person(s) who made the ex parte presentation as well as a list of all persons attending or otherwise participating in the meeting at which the presentation was made.

The Commission's rules define a "presentation" as a communication directed to the merits or outcome of a proceeding. An oral presentation is "ex parte" when it is made without advance notice to other parties to a proceeding and without the opportunity for them to be present.

For purposes of the ex parte rules, Commission proceedings are divided into three categories: those in which there is no restriction on ex parte presentations ("exempt" proceedings); those in which ex parte presentations are prohibited ("restricted" proceedings); and those in which ex parte presentations are permitted subject to disclosure ("permit-but-disclose" proceedings).

Notices of ex parte presentations made outside the Sunshine period must be filed within two business days of the presentation. The Sunshine period will begin on the day (including business days, weekends, and holidays) after issuance of the Sunshine notice, rather than when the Sunshine Agenda is issued (as the former rules provided).[34]

If an ex parte presentation is made on the day the Sunshine notice is released, an ex parte notice must be submitted by the next business day, and any reply would be due by the following business day. If a permissible ex parte presentation is made during the Sunshine period (under an exception to the Sunshine period prohibition), the ex parte notice is due by the end of the same day on which the presentation was made, and any reply would need to be filed by the next business day. Any reply must be in writing and limited to the issues raised in the ex parte notice to which the reply is directed.

Commissioners and agency staff may continue to request ex parte presentations during the Sunshine period, but these presentations should be limited to the specific information required by the Commission.

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[33] *Id.* at 2.
[34] *Id.* at 3.

Ex parte notices must be submitted electronically in machine-readable format. PDF images created by scanning a paper document may not be submitted, except in cases in which a word processed version of the document is not available. Confidential information may continue to be submitted by paper filing, but a redacted version must be filed electronically at the same time the paper filing is submitted. An exception to the electronic filing requirement will be made in cases in which the filing party claims hardship. The basis for the hardship claim must be substantiated in the ex parte filing.

To facilitate stricter enforcement of the ex parte rules, the FCC's Enforcement Bureau is authorized to levy forfeitures for ex parte rule violations. The rules are modified to require that copies of electronically filed ex parte notices also must be sent electronically to all staff and Commissioners present at the ex parte meeting so as to enable them to review the notices for accuracy and completeness. Filers may be asked to submit corrections or further information as necessary for compliance with the rules. Where staff believe there are instances of substantial or repeated violations of the ex parte rules, staff should report such to the General Counsel.

Comments made on the Commission's new media sites will not routinely be incorporated into the records of all permit-but-disclose proceedings at this time. The Commission will continue to incorporate this material into some Notices of Inquiry and other proceedings, and will continue to develop ways that will make its inclusion in additional proceedings technically possible. In the interim, users of new media may file comments electronically in any permit-but-disclose proceeding consistent with the ex parte rules by clicking on the link to ECFS Express on the Commission's homepage.[35]

Consistent with the goal of expanding the ability of interested parties to examine and test information that has been submitted to the government, the FCC also indicated that electronic filings with the Commission should be machine readable whenever technically possible. In particular, filings containing text should be submitted in a format conducive to electronic search and/or copying, such as a Microsoft Word document or an Adobe .pdf copy. Similarly, filings containing non-text information should be submitted in native format such that, for example, third parties can sort the spreadsheet data within a filing using Microsoft Excel or similar programs. Filings submitted to ECFS in .pdf or similar format should not be locked or password-protected. Failure to abide by this requirement may result in rejection by the filing system, and parties will

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[35] *Id*. The FCC's homepage is http://www.fcc.gov (last visited March 15, 2011).

have to resubmit by the filing deadline a machine-readable file that meets this requirement.[36]

In cases of attachments exceeding 500 pages, information to be submitted in a format that does not permit electronic filing, and other exceptional circumstances, the FCC will consider a waiver of the electronic filing requirement on a case-by-case basis.

To further its goal of minimizing paper submissions to the Commission, parties are required to file with the Commission only one original and one copy of each submission made in paper format, unless another Commission rule specifically provides otherwise. In addition to easing the practical burdens of participation on parties and members of the general public, this reform will lessen the storage demands on Commission staff and promote more environmentally sustainable agency practice.

In order to streamline Commission processes and improve efficiency, the Commission's rules also were amended to allow the agency to serve parties to a proceeding in an electronic format (e.g., email or an Internet-based notification system such as an RSS feed) following any change in the docket, to the extent the Commission is required to serve such parties. In a proceeding involving a large number of parties, the FCC determined that its service obligation will be satisfied by issuing a public notice that identifies the documents required to be served and that explains how parties can obtain copies of the documents. The Commission will allow staff to decide the appropriate format for electronic notification in a particular proceeding, consistent with any applicable statutory requirements.

Executive Order 13579, Regulation and Independent Regulatory Agencies, recognizes that independent agencies should promote the goals of protecting public health, safety, welfare and the environment while promoting economic growth, innovation, competitiveness and job creation. The Order asks independent agencies to develop a plan, consistent with law and reflecting the agency's particular resources, regulatory priorities and processes, to periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded or repealed.

The FCC developed a Preliminary Plan for Retrospective Analysis of Existing Rules which identified numerous Commission proceedings and described the ongoing agency-wide process of identifying outmoded or counterproductive rules. After a period of public comment and internal review, the Commission developed its Final Plan

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[36] In the Matter of Amendment of the Commission's Ex Parte Rules and Other Procedural Rules, GC Docket No. 10-43 (FCC 11-11), Feb. 2, 2011, at 4.

for Retrospective Analysis of Existing Rules in May 2012. The Final Plan represents the Commission's strategy for incorporating retrospective analysis into its processes for reviewing its rules. Key among its findings was that the Commission had removed 219 rules as of May 2012. The following list indicates the part number and the date first published in the Federal Register:

- Eliminated rules for International Fixed Public Radio Communication Services, Part 23 3/25/10
- Eliminated restrictions on mobile repeater stations for the business radio frequency users, Parts 90.247(b) 90.247(c) 90.267(e)(3) (5/14/10)
- Eliminated restrictions on WCS service, Parts 27.53(a) (6) 27.53(a)(9) (9/1/10)
- Removed rules to simplify and streamline the E-rate program, Parts 54.506 54.517 54.522 (1/3/11)
- Revised the Amateur Radio Service rules to clarify the rules with respect to amateur service vanity call signs, eliminating licensee confusion, Parts 0.191(o) 0.392(g) (2/14/11)
- Eliminated restrictions on Amateur Radio Service: eliminated the automatic power control provision which has proven to be virtually impossible to implement, and to encourage amateur stations to experiment with spread spectrum communications technologies, Parts 97.311(d) 97.5(b)(4) (4/29/11)
- Eliminated outdated and unnecessary reporting requirements related to international telecommunications traffic, Parts 43.53 43.61 (b) 43.61 (c) 63.23 (e) (7/19/11)
- Rule revisions enabling all tariff filers to file tariffs electronically over the Internet, Parts 61.21 61.22 61.23 61.32 61.33 61.151 61.152 61.153 61.52(a) (7/20/11)
- Fairness Doctrine, Personal Attack and Political Editorial Rules, Parts 73.1910 76.209 76.1612 76.1613 (9/9/11)
- Broadcast Flag , Part 73.8000 73.9000-9009 (9/9/11)
- Cable Programming Service Tier Complaints, Parts 76.950-951 76.953-957 76.960-961 76.1402 76.1605-1606 (9/9/11)
- Part 1, Subpart D Broadcast Applications & Proceedings (duplicative of rules in Part 73), Parts 1.502-615 (9/9/11)
- Required Commission to review the Interstate Cost Recovery Plan (the TRS Fund) and the TRS Fund administrator's performance after two years (i.e. in 1995) Removed note that certain provisions of the rule are not effective until OMB approval. OMB approval received August 2000. Parts 64.604(c)(5)(iii)(J) 64.2401, removed (10/13/11)

- Eliminated rule describing the Commission's former "protest" process, which by its express terms does not apply to applications filed on or after December 12, 1960, Part 1.120 (11/16/11)
- Eliminated rule sections pertaining to comparative hearings for broadcast license renewal applications. The enactment of section 309(k) of the Communications Act of 1934 eliminated comparative broadcast hearings for license renewal applicants. Parts 1.227(b)(6) 1.229(b)(2) (11/16/11)
- Eliminated rule sections pertaining to comparative hearings involving applicants for new commercial broadcast facilities and calling for the production of a Standardized Integration Statement and other information pertaining to the Commission's former integration standard and other broadcast comparative hearing criteria. Under § 309(j) of the Communications Act of 1934, as amended, the Commission no longer has authority to conduct comparative hearings for new commercial broadcast facilities and instead awards licenses for new broadcast service using competitive bidding. Part 1.325(c) (11/16/11)
- Eliminated rule requiring common carriers to file reports regarding pensions and benefits and requiring compliance with a regulation in Part 43 of the rules that the Commission has eliminated. Part 1.788 (11/16/11)
- Eliminated requirement that common carriers engaged in public radio service operations file reports in conformance with Part 23, which the Commission has eliminated, Part 1.805 (11/16/11)
- Eliminated requirements that carriers engaged in domestic public radio services report and file documents in accordance with Part 21, which has been eliminated, Part 1.811 (11/16/11)
- Eliminated rules regarding random selection procedures for Multichannel Multipoint Distribution Service (MMDS). The Commission no longer has authority to use random selection for MMDS or its successor service, Broadband Radio Service , Parts 1.821, 1.822, 1.824, (11/16/11)
- Eliminated rule that is duplicative of 1.2002 (Anti-Drug Abuse Certification), Part 1.2003(11/16/11)
- Eliminated rules implementing PUHCA 1935, which was repealed and replaced with Public Utility Holding Company Act of 2005, Parts 1.5000, 1.5001, 1.5002, 1.5003, 1.5004, 1.5005, 1.5006, 1.5007 (11/16/11)
- Eliminated rule regarding complaints filed by television stations alleging that a satellite carrier has retransmitted their signals in violation of Section 325(b)(1) of the Communications Act of

1934, as amended. No complaints may be filed under this subpart after December 31, 2001 and no complaints filed on or before that date are pending. Parts 1.6000, 1.6001 1.6002, 1.6003, 1.6004, 1.6005, 1.6006, 1.6007, 1.6008, 1.6009, 1.6010, 1.6011, 1.6012 (11/16/11)

- Eliminated rule establishing backup power requirements for communications providers. This rule never took effect. Part 12.2, adopted 11/1/11 pending Federal Register publication
- Eliminated rule providing that UHF television translators on Channels 70 to 83 must operate on a secondary basis to land mobile operations in the 800 MHz band and will not be protected from such operations. There are no UHF television translators operating on Channels 70 to 83, and the Commission has eliminated the TV allocation from these channels. Part 90.621(d), adopted 11/1/11 pending Federal Register publication
- Eliminated rule allocating specified channels for Basic Exchange Telecommunication Radio Service (BETRS); the FCC removed the allocation in 2005. Part 90.621(h), adopted 11/1/11 pending Federal Register Publication
- Eliminated rules that provided a framework for the relocation of incumbent site—based licensees in the upper 200 channels of the 800 MHz Band by incoming geographically—based (EA) licensees. These provisions were a component of the 1995 reconfiguration of the 800 MHz band from site-based to geographic-based service that has since been completed. Parts 90.699(a), 90.699(b), 90.699(c), 90.699(e), 90.699(f), adopted 11/1/11 pending Federal Register Publication
- Removed rules to reform and modernize the universal service and intercarrier compensation systems, Part 36.602, 51.707, 51.717, 54.303, 54.311, 54.316 (12/29/11)
- Eliminated Part 2, Subpart N, FCC procedure for testing Class A, B and S Emergency Position Indicating Radiobeacons (EPIRBs) , Parts 2.1501-2.1517 (2/1/12)
- Eliminated rules listing the dates by which intentional radiators, unintentional radiators, radio receivers and equipment operating in the 902-905 MHz band had to comply with the rules adopted in the 1989 revision to Part 15, Parts 15.37(a), 15.37(b), 15.37(c), 15.37(d), 15.249(f), (2/1/12)
- Eliminated rule specifying dates by which cordless telephones must comply with the requirements of § 15.214(d). Manufacture of cordless telephones that did not comply with these requirements had to cease on or before September 11, 1991. Parts15.37(e) (2/1/12)

- Required scanning receivers manufactured or imported after April 26, 1994 to comply with the provisions of § 15.121(a)(1). Effectively superseded by § 15.37(h), which requires scanning receivers manufactured or imported after October 25, 1999 to comply with a revised § 15.121, Part 15.37(f) (2/1/12)
- Announced the date that authorization under either the DoC or certification procedure became mandatory for CPU computer boards and related equipment, Part 15.37(g) (2/1/12)
- Prohibited the marketing of TV bands devices before the planned February 18, 2009 digital television transition date, Part 15.37(n) (2/1/12)
- Required television receivers and related devices manufactured between April 1, 2009 and June 30, 2009 to include consumer information about the DTV transition, Part 15.124 (2/1/12)
- Listed the dates by which specific types of Industrial, Scientific and Medical (ISM) equipment must comply with limits on radio frequency emissions conducted from a device onto the AC power lines, Part 18.123 (2/1/12)
- Removed rules to reform and begin to modernize the Universal Service Fund's Lifeline program, Parts 54.209, 54.411, 54.415 (4/2/12)

§ 1.03 Cable Television: The Emerging Role of Congress

[1]—Early FCC Regulation of Cable Television

The FCC first showed interest in cable television in 1952, inquiring in a memorandum about the status of cable: "(1) Do such operations constitute broadcasting within the meaning [of the Communications Act of 1934] or (2) do such operations constitute interstate common carrier operations within the meaning . . . of the Act?"[1] The question was critical because, under the Communications Act of 1934, the Commission only had jurisdiction over common carriers and broadcasters; thus, if cable fell into neither category, the Commission could not regulate it. The FCC decided not to assert jurisdiction at that time, primarily for pragmatic reasons.[2]

The FCC issued a report on the impact on television of community antenna systems, TV translators, TV satellites, and TV repeaters in 1959.[3] Cable grew rapidly after that, and pressure mounted on the FCC to do something about it. In response, the FCC first established rules relating to cable in 1965.[4] The United States Supreme Court upheld the FCC's right to regulate cable in 1968, finding that it was a case of authority over "interstate commerce by wire or radio." The Supreme Court did not determine in detail the limits of the FCC's authority to regulate cable television, but it emphasized that the authority was restricted to that which was reasonably ancillary to effective performance of the FCC's responsibilities for broadcast television.[5]

The FCC began an official rule making proceeding, to develop comprehensive rules for cable, in 1968. The FCC clarified its authority to regulate cable in 1972, issuing definitive rules, including a requirement that all cable television operators obtain a certificate of compliance from the Commission before constructing or operating a cable system.[6]

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[1] Senate Committee on Interstate and Foreign Commerce, Review of Allocation Problems of TV Service to Small Communities, 85th Cong., 2d Sess., 1958, at 3490.

[2] See Goodale and Frieden, *All About Cable and Broadband,* § 1.03 (Law Journal Seminars-Press 1981).

[3] Inquiry into the Impact of Community Antenna Systems, TV Translators, TV Satellites and TV Repeaters on the Orderly Development of Television Broadcasting, 18 Rad. Reg. (P&F) 1573 (1959).

[4] Notice of Inquiry and Notice of Proposed Rulemaking, 1 F.C.C.2d 453 (1965). See Goodale, N. 2 *supra*, § 1.07 (Law Journal Seminars-Press 1981).

[5] United States v. Southwestern Cable Co., 392 U.S. 157, 88 S.Ct. 1994, 20 L.Ed.2d 1001 (1968).

[6] Cable Television Report and Order, 36 F.C.C.2d 143 (1972).

[2]—Deregulation: The Cable Communications Act of 1984

In the early 1970s, the FCC's rules for cable covered a broad range of subjects, including franchising standards, equal employment opportunity, and political broadcasting. By December 31, 1980, however, the Commission had eliminated or modified most of these rules.[7]

Congress created the first federal framework for cable television regulation in 1984. In enacting the Cable Communications Act of 1984,[8] Congress removed most of the FCC's power over cable.

The Cable Communications Act of 1984 deregulated cable in areas including municipality fees, subscriber rates, and required program carriage. Another major thrust of the legislation was a limit on state and local regulation, which were thought to have an excessively burdensome impact on the growth of cable systems.[9] In particular, the Cable Act permitted franchising authorities to regulate basic cable rates only in situations where the cable system was not subject to "effective competition." The FCC determined that a cable system was subject to "effective competition" if three or more unduplicated broadcasting signals were available within its service area.[10]

The FCC maintained jurisdiction over some areas, including: registration of community systems prior to operation; offering of A-B switches to allow customers to receive both cable and broadcast signals; carriage of full, unaltered, undeleted broadcast programs; and nonduplication of network programs.[11]

[3]—The Cable Television Consumer Protection and Competition Act of 1992

Cable rates rose rapidly after Congress deregulated in 1984. According to one study, the monthly rate for the lowest priced service rose by 56%, more than three times the rate of general inflation, between November 1986 and April 1991.[12] In 1990, faced with

(Text continued on page 1-17)

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[7] See, e.g.: Amendment of Part 76 of the Commission's Rules and Regulations Relative to Diversification of Control of Community Antenna Television Systems, 57 Rad. Reg.2d (P&F) 509 (1984); Amendment of Part 76 of the Commission's Rules and Regulations with Respect to the Definition of a Cable Television System and the Creation of Classes of Cable Systems, 63 F.C.C.2d 956 (1977).

[8] Cable Communications Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779, codified as amended at 47 U.S.C. §§ 521 *et seq*.

[9] See Goodale and Frieden, *All About Cable and Broadband,* § 2.01 (Law Journal Seminars-Press 1981).

[10] Implementation of the Provisions of the Cable Communications Policy Act of 1984, Report and Order, 50 Fed. Reg. 18,637 (1985).

[11] See Hilliard, *The Federal Communications Commission*, 40 (1991).

[12] House Committee on Energy and Commerce, Cable Television Consumer Protection and Competition Act of 1992, H.R. Rep. No. 628, 102d Cong., 2d Sess. 33 (1992).

mounting demands for action, the FCC sent Congress a comprehensive report, concluding that cable systems "do possess varying degrees of market power in local distribution."[13] The Commission advocated encouragement of competition as the appropriate response.[14]

Despite the FCC's recommendation to the contrary, Congress overrode a veto by the President and enacted the Cable Television Consumer Protection and Competition Act of 1992.[15] This Act repealed large sections of the Cable Act of 1984, and added many new provisions to the Communications Act. As directed by the Cable Television Consumer Protection and Competition Act, the FCC established a series of tiers and benchmarks for cable pricing.[16] In the wake of the 1992 legislation, FCC regulation of cable has again expanded.[17]

[4]—The Telecommunications Act of 1996

Less than three years after passage of the Cable Television Consumer Protection and Competition Act, Congress overwhelmingly passed the Telecommunications Act of 1996.[18] The 1996 Act represents the first comprehensive revision of American communications law since the Communications Act of 1934, and grants the FCC broad powers over the development of competitive telecommunications markets. It signals a major shift in regulatory power from state and local governments to the FCC and other federal bodies, preempting a variety of state and local statutes and regulations in the process.[19]

With respect to cable television, Section 302 of the 1996 Act, among other things, curtails the FCC's regulation of cable rates and eliminates rate regulation regarding the upper cable tiers (cable programming

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[13] Competition, Rate Deregulation, and the Commission's Policies Relating to the Provision of Cable Television Service, 5 F.C.C. Rcd. 4962, ¶ 8 (1990).

[14] *Id*., 5 F.C.C. Rcd. ¶ 69.

[15] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460, codified as amended at 47 U.S.C. § 533.

[16] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking, 8 F.C.C. Rcd. 5631, ¶ 38 (1993). See also, Johnson, *Toward Competition in Cable Television*, 6-10 (1994).

[17] See Goodale and Frieden, *All About Cable and Broadband,* Chapters 3-6 (Law Journal Seminars-Press 1981).

[18] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

[19] The Telecommunications Act of 1996 directs the FCC to take numerous actions and to initiate and implement more than fifty new rulemaking proceedings. The Commission has released an implementation schedule for rulemakings pursuant to the Telecommunications Act of 1996. The implementation schedule is available through the Internet at http://www.fcc.gov.

service tiers) after March 31, 1999 for larger systems.[20] Smaller systems are given regulatory relief immediately.[21] The Act also repealed the telephone-cable television cross-ownership ban of the 1984 Cable Act, and eliminated the FCC's video dialtone rules, which were designed to allow telephone companies to enter the video distribution market consistent with the statutory cross-ownership prohibition.[22]

In an effort to encourage competition in the market for video program distribution, the Telecommunications Act of 1996 gives telephone companies broad discretion regarding the manner in which they will enter into competition with cable television operators. They may enter as traditional cable operators, as radio-based system operators, as common carriers of video traffic, or as "open video system" operators (the open video system, or OVS, is a creation of the Telecommunications Act of 1996 that replaces the FCC's video dialtone regime). In addition, the telephone companies are generally subject to reduced regulatory burdens in competing with cable television companies.[23]

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[20] Telecommunications Act of 1996, Pub. L. No. 104-104, § 302(b), 110 Stat. 56 (1996).

[21] *Id*.

[22] *Id*. See also, Cable Communications Policy Act of 1984, Pub. L. No. 98-549, § 613(b) (codified at 47 U.S.C. § 533(b)) (the telephone-cable television cross-ownership ban). Prior to the enactment of the Telecommunications Act of 1996, both the United States Courts of Appeal for the Fourth and Ninth Circuits found the cross-ownership ban to be a violation of the First Amendment, and the FCC had been enjoined from enforcing it against virtually all local exchange carriers.

Fourth Circuit: Chesapeake & Potomac Telephone Co. of Virginia v. United States, 42 F.3d 181 (4th Cir. 1994), *rehearing denied* (Jan. 18, 1995), *cert. granted* 115 S.Ct. 2608 (June 26, 1995), *remanded* (Feb. 27, 1996).

Ninth Circuit: U.S. West, Inc. v. United States, 48 F.3d 1092 (9th Cir. 1995), *cert. granted* 516 U.S. 1155, 116 S.Ct. 1037, 134 L.Ed.2d 186 (1996), *remanded* Pacific Telesis Group v. United States, 84 F.3d 1153 (9th Cir. 1996) (*dismissed as moot*).

See also, United States Telephone Ass'n v. United States, No. 1:94CV01961 (D.D.C. Feb. 14, 1995).

[23] Telecommunications Act of 1996, Pub. L. No. 104-104, § 302, 110 Stat. 56 (1996), adding new Sections 651-53 to the Communications Act of 1934. See also: In the Matter of Implementation of Section 302 of the Telecommunications Act of 1996, Open Video Systems, Third Report and Order and Second Order on Reconsideration, CS Docket No. 96-46, FCC 96-334, 1996 WL 457194 (F.C.C.); Telephone Co.-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, CC Docket No. 87-266 (Terminated), Report and Order, FCC 96-99, 11 F.C.C. Rcd. 14639 (released March 11, 1996). Since the FCC promulgated the OVS regulations. Metropolitan Fiber Systems, Inc. (MFS), 1996 WL 706003, Bell Atlantic-New Jersey, 11 F.C.C. Rcd. 13249 (1996), and Digital Broadcasting OVS, 11 F.C.C. Rcd. 12854 (1996), have been granted licenses to operate open video systems.

§ 1.04 Regulation of Common Carriers Before Divestiture

[1]—Early Telegraph Regulation

The telegraph, invented by Samuel F.B. Morse, was developed in the 1840s. It grew rapidly. The major New York newspapers together formed the Associated Press in the late 1840s, to get pooled telegraph reports of the Mexican War. The technology was so simple that Morse could not protect his patent; more than fifty telegraph companies existed by 1851. The first transcontinental telegraph line opened in 1861. The telegraph quickly eliminated all competition from other forms of communication, like the Pony Express. [1]

Government has involved itself in telecommunications in the United States since the beginning of telegraphy. Congress subsidized the building of the first telegraph line, connecting Baltimore and Washington, in 1844. The federal government then operated the line for a year, without charge to customers. [2]

Competition developed soon after, and many companies sought to enter the market. In the 1850s, the six leading companies attempted to form a cartel to curtail new entrance. [3] Business boomed during the Civil War, however, and led to dramatic industry expansion.

Congress enacted the Post Roads Act of 1866, [4] the most important early regulation, in response to the usage boom. The Post Roads Act required telegraph companies to interconnect and accept each other's traffic. In exchange, the companies were allowed to run their lines freely along post roads and cut down publicly owned trees for telegraph poles. [5]

Congress did little else to regulate telegraph service. Telegraph regulation was primarily local, and construction charters were the primary tools used by regulators. [6]

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[1] Sterling and Kittross, *Stay Tuned: A Concise History of American Broadcasting*, 9 (2d ed. 1990).

[2] Brock, *The Telecommunications Industry: The Dynamics Of Market Structure*, 56-57 (1981).

[3] *Id.* at 72-88.

[4] Post Roads Act of July 24, 1866, 14 Stat. at L. 221, reenacted at Revised Statutes § 5263.

[5] See: City of Richmond v. Southern Bell Telephone & Telegraph Co., 85 F. 19 (4th Cir. 1898); Western Telegraph Co. v. Public Service Comm'n of New York, 230 N.Y. 95 (1920).

[6] Brock, N. 2 *supra*, at 84.

Industry consolidation began in the 1870s. By 1880, Western Union carried 92% of messages and received 89% of revenue. [7]

[2]—Invention of the Telephone

Alexander Graham Bell taught at schools for the deaf in the 1870s. In 1873, he was made professor of vocal physiology at Boston University. At the same time, he was experimenting with his "harmonic telegraph," a device that could distinguish among musical notes and, therefore, allow the transmission of several messages on a single wire at the same time. [8]

In July 1874, while working on a device to help the deaf, Bell discovered the principle of the telephone. [9] Gardiner Greene Hubbard, the father of one of Bell's pupils and a prominent Boston attorney, offered Bell funding in exchange for a share of patent rights. George Sanders, a wealthy merchant and the father of another pupil, joined soon after. The three formally signed an agreement in February 1875, under which Bell would provide the experiments, the other two would provide the funds, and all three would share in the proceeds. [10]

In June 1875, Bell and his assistant Thomas Watson were testing the harmonic telegraph apparatus Bell had created when they accidentally transmitted sounds. On March 7, 1876, a patent (patent number 174,465) was issued to Alexander Graham Bell. The patent claimed "a method and apparatus for transmitting sound by means of an undulatory current of electricity." [11]

The Blake transmitter, introduced by the Bell Company in 1878, "was the embodiment in one piece of mechanism and its use of four distinct inventions made by four different men." [12] As the United States Supreme Court explained in 1896, "Mr. Bell hit upon the true principle, in relation to the kind of current to be employed, and was justly entitled to his patent." [13] Bell's invention "was one of the first rank—nothing less than

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[7] Herring and Gross, *Telecommunications: Economics And Regulation*, 3 (1936, reprinted 1974).

[8] Brooks, *Telephone: The First Hundred Years*, 40 (1976).

[9] See: Bruce, *Bell: Alexander Graham Bell and the Conquest of Solitude*, 121 (1973); Rhodes, *Beginnings of Telephony*, 13-14 (1929).

[10] Brooks, N. 8 *supra*, at 41-43.

[11] United States v. American Bell Telephone Co., 167 U.S. 224, 17 S.Ct. 809, 42 L.Ed. 144 (1896); The Telephone Cases, 126 U.S. 1, 8 S.Ct. 778, 31 L.Ed. 863 (1888).

[12] United States v. American Bell Telephone Co., 167 U.S. 224, 244, 17 S.Ct. 809, 42 L.Ed. 144 (1896).

[13] *Id.*, 167 U.S. at 244.

the discovery of a new law of nature."[14] The Court also explained, however, that while Bell "invented the telephone, the apparatus he described was inefficient for public uses. Berliner invented something by which, taken in connection with Edison's and Blake's inventions, Bell's undulatory current could be made practically available for carrying on conversation at long distances. In other words, the telephone, as we use it—that which has become such an important factor in the commercial and social life of today—does not embody simply the invention of Bell, but also those of Edison, Blake and Berliner."[15]

Berliner discovered "that the undulatory current necessary to transmit speech can be produced by means of another form of transmitter—one operating by variation of pressure between its electrodes at their point of contact."[16] Edison discovered "that the use of carbon as the material for the construction of the electrodes of the Berliner transmitter gave to that instrument a greatly increased power and reach of operation." Blake "devised a particular combination of carbon and metallic electrodes, with mechanism for their mounting, which secured an improved ease and permanence of adjustment and superior adaptation to common use."[17]

In *The Telephone Cases,*[18] Bell claimed a patent on "[t]he method of, and apparatus for, transmitting vocal or other sounds telegraphically, as herein described, by causing electrical undulations, similar in form to the vibrations of the air accompanying said vocal or other sounds, substantially as set forth."[19] The United States Supreme Court upheld Bell's claim, distinguishing it from Samuel F.B. Morse's claim on the ground that Bell's claim described a process, and not a result.[20] Bell received the patent because he described the technology he himself had invented, and "made no pretense of claiming technology beyond the signal of his invention."[21]

[3]—Telephone Regulation Before the 1934 Act

Telephony was not regulated significantly for its first thirty-five years. Early common carrier law did not require telephone companies "to accord any . . . outside organization or its patrons connection with

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[14] *Id.,* 167 U.S at 245.
[15] *Id.,* 167 U.S. at 243.
[16] *Id.*
[17] *Id.,* 167 U.S. at 244.
[18] The Telephone Cases, 126 U.S. 1, 8 S.Ct. 778, 31 L.Ed. 863 (1888).
[19] *Id.,* 126 U.S. at 13-14.
[20] *Id.,* 126 U.S. at 534.
[21] See Grady and Alexander, "Patent Law and Rent Dissipation," 78 Va. L. Rev. 305, 324 (1992).

its switchboard on an equality with its own patrons."[22] Despite brief periods of competition, AT&T emerged in this unregulated environment as the controlling force in telephone service.

[a]—AT&T's Patent Monopoly: 1876—1893

After the filing of the first telephone patent in 1876, patent disputes and legal challenges between Western Union and the Bell Company emerged. Eventually, the companies reached an agreement under which Bell would stay out of the telegraph business and Western Union would stay out of telephony.[23] AT&T then dominated the telephone industry on the strength of it's patents.

Congress enacted the Interstate Commerce Act in 1887.[24] The Act dealt with railways, but it later became Congress's basis for the 1934 Communications Act.[25] Congress also created the Interstate Commerce Commission, and gave it the power to regulate government-subsidized telegraph companies the following year.[26]

In 1888, the Supreme Court ruled the original Bell patent valid, and read it broadly, to cover telephone communication in general, rather than one particular method.[27]

AT&T continued to dominate the telephone industry until 1893 and 1894, when it's patent-driven monopolies were undermined severely. The patents covering the telephone handset and the methods for transmitting vocal sounds expired; and the Supreme Court construed the patent covering the telephone transmitter so narrowly that it essentially lost effect.[28]

[b]—Competition: 1894—1913

After the original Bell patents expired, independent carriers began to emerge. AT&T had not offered service extensively to rural areas or to residential areas of many large cities. Many of the lines it operated were of poor quality, and its monopolistic rates limited demand.[29]

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[22] Pacific Telephone & Telegraph Co. v. Anderson, 196 F. 699 (E.D. Wash. 1912).

[23] Brock, *The Telecommunications Industry: The Dynamics Of Market Structure,* 93-95 (1981).

[24] Interstate Commerce Act, 24 Stat. 379 (1887) (49 U.S.C. §§ 10101-11917).

[25] Communications Act of 1934, Pub. L. No. 73-416, c.652, 48 Stat. 1064 (1934), *codified* at 47 U.S.C. §§ 151 *et seq*. See S. Rep. No. 781, 73d Cong., 2d Sess. 2 (1934).

[26] Act of Aug. 7, 1888, ch. 772, § 3, 25 Stat. 382, 383 (1888).

[27] The Telephone Cases, 126 U.S. 1, 8 S.Ct. 778, 31 L.Ed. 863 (1888).

[28] Lavey, "The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915," 39 Fed. Communications L.J. 171, 177 (1987).

[29] See Burch, "Common Carrier Communications by Wire and Radio: A Retrospective," 37 Fed. Communications L.J. 85, 86 (1985).

In 1894, competitors of the Bell system held a national market share of 5%.[30] In 1899, the independents attempted to form a competing long-distance network, but failed for lack of capital. By 1902, however, over 3,000 non-Bell commercial telephone carriers existed.[31] Of the 1,002 cities having telephone service and populations greater than 4,000, 45% were served by two or more separate phone systems; between 8% and 13% of subscribers in these cities paid for service from both companies.[32] The independents owned 3 million telephone stations in the United States by 1907,[33] 49% of the total.[34]

In 1.899, AT&T reorganized and became the parent company of a vertically integrated Bell system. Shortly after, the Bell System began buying out independent telephone companies throughout the country.[35]

Most telephone regulation at the turn of the century was local. Many city governments asserted authority, primarily over health and safety concerns in construction.

The Mann-Elkins Act of 1910[36] gave the Interstate Commerce Commission regulatory control of telegraph and telephone services and designated telegraph and telephone companies as common carriers.[37] It did little else.

Despite the Mann-Elkins Act, AT&T, led by Theodore N. Vail, began an aggressive program of intimidation and acquisition, refusing to sell equipment or provide interconnection to independents.[38]

[c]—Consolidation of AT&T's Power: 1913—1934

In 1913, under threat of antitrust action, AT&T officially ended the period of rapid growth by agreeing to the Kingsbury Commitment, named for AT&T vice president Nathan Kingsbury.[39]

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[30] Brock, *The Telecommunications Industry: The Dynamics Of Market Structure,* 111 (1981).

[31] *Id*. at 112-114.

[32] Bornholz and Evans, "The Early History of Competition in the Telephone Industry," Evans, ed., *Breaking Up Bell,* 17-18 (1983).

[33] Gabel, "The Early Competitive Era in Telephone Communication, 1893-1920," 34 J.L. & Contemp. Prob. 340, 352 (1964).

[34] Brock, N. 30 *supra,* at 121.

[35] *Id*. at 89-125.

[36] Mann-Elkins Act, Pub. L. No. 61-218, 36 Stat. 539 (1910).

[37] Mann-Elkins Act, Pub. L. No. 61-218, § 7, 36 Stat. 539, 544 (1910).

[38] Burch, "Common Carrier Communications by Wire and Radio: A Retrospective," 37 Fed. Communications L.J. 85, 87 (1985).

[39] See: *Telecommunications In Transition: The Status Of Competition In the Telecommunications Industry,* Report of the Majority Staff of the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, U.S. House of Representatives 70 (Nov. 3, 1981); Brock, *The Telecommunications Industry: The Dynamics of Market Structure,* 89-125 (1981).

AT&T also agreed to interconnect with the independent phone companies and to obtain Justice Department approval prior to any acquisition of competing companies.[40] The agreement contained one significant exception, however: AT&T would "make no purchases of, or consolidations with, independents unless demand for the convenience of the public or unless special reasons existed making the transaction desirable for the protection of the general public service or Bell System property." The Bell System used the exception to continue its acquisitions of independents.[41]

Public policy in this period was directed primarily at efficiency.[42] To avoid the harmful effects of excessive revenues,[43] a policy of eliminating opportunities for telephone companies to derive excessive revenues from their customers developed.[44]

At the same time, a policy against competition developed. The Indiana Public Service Commission, for example, found that the telephone industry, "which under proper regulation and for public convenience and necessity should be regarded as a natural monopoly, has been subjected to sharp and destructive competitive conditions, until telephone service in Indiana has been reduced to a chaotic condition."[45]

Regulators responded to efficiency problems by eliminating competition and duplication of facilities, denying entry to new carriers where existing carriers provided adequate service.[46] Major cities began to require independents competing against the Bell System to obtain charters or franchises to hang or lay cables,[47] putting the

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[40] *Id.*

[41] Gabel, "The Early Competitive Era in Telephone Communication, 1893-1920," 34 J.L. & Contemp. Prob. 340, 353 (1964).

[42] See, e.g., "Extension of the Telephone System in the District of Columbia," H.R. Rep. No. 379, 65th Cong., 2d Sess. (1918).

[43] See Lavey, "The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915," 39 Fed. Communications L.J. 171, 173 (1987).

[44] See: Smith v. Illinois Bell Telephone Co., 282 U.S. 133, 160, 51 S.Ct. 65, 75 L.Ed. 255 (1930); State of Missouri *ex rel* Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, 262 U.S. 276, 289, 43 S.Ct. 544, 67 L.Ed. 981 (1923); Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679, 692-693, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[45] Central Union Telephone Co., 1920B Pub. Util. Rep. (PUR) 813, 847-848 (Ind. Pub. Serv. Comm'n 1920).

[46] Lavey, N. 43 *supra,* 39 Fed. Communications L.J. 171, 184 (1987).

[47] Brock, *The Telecommunications Industry: The Dynamics Of Market Structure,* 112-113 (1981).

independents at a competitive disadvantage that often forced them out of the industry.[48] The Michigan Public Utilities Commission, for example, announced that the state's policy "for the regulation of telephones is to provide, through control of construction, by the granting or withholding of certification of public convenience and necessity, for elimination of duplication in investment and service."[49] Courts regularly approved denial of construction certificates on the ground that they would be duplicative.[50]

Regulators also promoted consolidation in the industry, so that each carrier would operate a monopoly. Regulators believed that these monopolies would decrease the cost of providing service while increasing quality.[51] The two major Ohio phone companies, for example, sought consolidation on the ground "that a sound policy must recognize the economic losses involved in the maintenance of a competitive situation in a field which is recognized as preeminently that of a natural monopoly."[52]

Under the prevalent public utility schemes, telephone companies were generally allowed to earn revenues which covered their reasonable operating costs and depreciation expenses, and yielded a fair return on capital invested.[53]

[4]—The Communications Act of 1934

By 1934, AT&T was solidly entrenched: AT&T and its affiliated operating companies generated 94.3% of all local exchange messages.[54] Congress adopted the Communications Act, stating the provision of

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[48] Lavey, N. 43 *supra,* 39 Fed. Communications L.J. 171, 179 (1987).

[49] Citizens Telephone Co. of Grand Rapids, 1921E Pub. Util. Rep. (PUR) 308, 315 (Mich. Pub. Util. Comm'n 1921).

[50] See, e.g., Perry County Telephone & Telegraph Co. v. Public Service Commission, 108 A. 659 (Pa. 1919).

[51] Lavey, "The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915," 39 Fed. Communications L.J. 171, 186 (1987).

[52] See, e.g., Joint Application of Ohio Bell Telephone Co. and Ohio State Telephone Co. for a Certificate that Consolidation will be in the Public Interest, 70 I.C.C. 463, 465 (1921).

[53] See: State of Missouri *ex rel* Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, 262 U.S. 276, 289, 43 S.Ct. 544, 67 L.Ed. 981 (1923); New York Telephone Co. v. Prendergast, 36 F.2d 54 (S.D.N.Y. 1929).

[54] *Telecommunications In Transition: The Status Of Competition In the Telecommunications Industry,* Report of the Majority Staff of the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, U.S. House of Representatives (Nov. 3, 1981), at 1.

nationwide and worldwide service as its primary purpose.[55] The Act required "just and reasonable" prices,[56] but allowed new firms to compete only if they could demonstrate that "public convenience and necessity" required it.[57]

[5]—"Natural Monopoly" and "Continued Surveillance"

According to the National Telecommunications and Information Agency (NTIA), a natural monopoly "is generally said to exist if there are declining average costs to scale or a massive capital outlay is required to provide service, or both, and thus customer demand for a particular service can be satisfied at the lowest cost by a single firm."[58]

Economists have long disagreed on whether or not telephone service is a natural monopoly. According to the FCC, where natural monopoly conditions prevail, competitive entry will prove short-lived, and waste scarce resources.[59] Prior to the mid-1960s, the FCC believed that a natural monopoly existed, so it regulated the Bell system as a public utility. Reviewing its policy in 1965, the FCC described its " 'continued surveillance,' . . . a process by which many previous interstate rate adjustments have been brought about without formal proceedings."[60] Under continued surveillance, "either the Commission or [AT&T] has acted to initiate discussions looking toward appropriate rate changes whenever the level of [AT&T's] total interstate earnings has appeared to warrant such action."[61]

[6]—Entry of MCI Into the Market

Regulatory decisions of the 1960s and 1970s, motivated by political considerations, allowed telephone rates to deviate substantially from cost. Traditional rate design levied high charges on long-distance service, well above cost, as a huge subsidy for residential and small business customers in access and local calling.[62] At divestiture, these subsidies were left in place.[63]

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[55] Communications Act of 1934 § 1; 47 U.S.C. § 151.

[56] *Id.,* 47 U.S.C. §§ 201(a),(b).

[57] *Id.,* 47 U.S.C. § 214(a).

[58] U.S. Dep't of Commerce, National Telecommunications and Information Administration, *NTIA Alternatives Report* 8 (1987).

[59] Policy and Rules Concerning Rates for Dominant Carriers, Notice of Proposed Rulemaking, 2 F.C.C. Rcd. 5209, 5210 (1987).

[60] AT&T, Charges for Interstate and Foreign Communication Service, Notice of Inquiry and Proposed Rulemaking, 2 F.C.C. 2d 173, 177 (1965).

[61] *Id.*

[62] See Weisman, "Default Capacity Tariffs: Smoothing the Transitional Regulatory Asymmetries in the Telecommunications Market," 5 Yale J. on Reg. 149 (1988).

[63] See § 5.05 *infra*.

To the company now known as MCI, the distortion was inviting. The revenues available from long-distance service provision, particularly in dense routes, far exceeded the costs of that service. MCI was not required to divert parts of its revenues to subsidize local service, and could use local circuits at a fixed cost.[64]

In 1969, the FCC approved MCI's application to provide private line service between Chicago and St. Louis via microwave relay.[65] Within a year of that approval, the FCC received over a thousand more applications to provide similar nonswitched services. In May 1971, the Commission announced "a public need and demand for the proposed facilities and services and for new and diverse sources of supply."[66]

MCI then filed to provide Execunet services, in direct competition with AT&T. Though they were not explicitly authorized, neither were the services specifically excluded in MCI's authorization, according to the United States Court of Appeals for the District of Columbia Circuit.[67]

MCI's growth initially was limited by its lack of connection to local subscribers and its inability to attract business customers. Thus, in 1980, MCI and all other competing common carriers combined accounted for less than 5% of interexchange revenues and 2% of all telephone output.[68]

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[64] Crandall, "Fragmentation of the Telephone Network," 1 Newberg, ed., *New Directions In Telecommunications Policy,* 50-52 (1989).

[65] Microwave Communications, Inc., 18 F.C.C. 2d 953 (1969).

[66] Specialized Common Carriers, First Report and Order, 29 F.C.C. 2d 870 (1971), *aff'd sub nom*. Washington Utilities and Transportation Commission v. FCC, 513 F.2d 1142 (9th Cir. 1975).

[67] MCI Telecommunications Corp. v. FCC, 561 F.2d 365 (D.C. Cir 1977), *cert. denied* 434 U.S. 1040 (1978) (Execunet I); MCI Telecommunications Corp. v. FCC, 580 F.2d 590 (D.C. Cir.), *cert. denied* 439 U.S. 980 (1978) (Execunet II).

[68] Crandall, N. 64 *supra,* at 57.