

## **Part 2 Telecommunications Regulation**

### **REGULATION OF THE TELEPHONE INDUSTRY: A BRIEF HISTORY OF THE LAW**

**Curtis M. Long**

**December 19, 2001**

Although regulation of the telecommunications industry has changed rather dramatically in the last several years, regulation in some form or fashion has been a constant for a century. Today, the regulators are struggling to adapt a regulatory regime to a more competitive environment. Various regulatory principles still apply, but telecommunications regulations are being liberalized and even removed to promote competition. In this “deregulated” environment, new carriers, new services and new technologies have appeared. Meanwhile, the industry and its regulators struggle with legacy networks that were designed and built in a highly regulated, monopoly atmosphere.

The telephone industry was born in 1876 when Alexander Graham Bell filed patent applications for his new invention. A year later, the Bell Telephone Company was formed. By 1885, the company had established a vertically integrated supply division, a network of companies licensed by the parent, and a strong research and development arm. When the Bell patents expired in 1893 and 1894, numerous independent competitors sprang up. Unfortunately, many of these competing networks were not interconnected.

AT&T, as the Bell organization was then called, refused to allow other carriers to connect with its network. Without interconnections, many independent networks were of limited value. In 1912, the U.S. Justice Department filed suit to

resolve the matter. The following year, AT&T agreed to provide interconnection to all independent carriers. This agreement, known as the Kingsbury Commitment, arrested the growth of AT&T, but left local telephone monopolies intact.<sup>1</sup>

Monopoly was the clear premise in 1934 when Congress enacted the landmark Federal Communications Act of 1934. Telephony was considered a natural monopoly and the 1934 Act treated it as such. Government regulation was established by the Act as a surrogate for the regulating effects of a competitive market. The Act created the Federal Communications Commission, which was charged with "cradle to grave" regulation of interstate carriers, including their rates and terms and conditions of service, as well as their monopoly status. To be authorized to provide service, a carrier needed first to demonstrate that the "public convenience and necessity" required its entry. Under this principle, would-be competitors were barred from competing with incumbent carriers; on the other hand, monopoly local exchange carriers were required to provide service to all within their respective service areas. The FCC determined rates for interstate carriers that were "just and reasonable." Interconnection between carriers could be required if "necessary or desirable in the public interest."<sup>2</sup>

One of the most important principles of the 1934 Act was the call for "universal service." The policy was clearly stated in the Act:

"For the purpose of regulating intrastate 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,

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<sup>1</sup> P. Huber, *Federal Telecommunications Law*, 2d Ed. § 1.3.2 (1999).

<sup>2</sup> *Id.*, § 1.3.4; 47 U.S.C. §§ 201-220.

Nationwide, and worldwide wire and radio communication service with adequate facilities at reasonable charges ....<sup>3</sup>

Under this principle, a price support structure for universal service was established under which certain customers (principally long distance users, business subscribers and customers in low cost urban areas) subsidized the cost of serving high-cost customers (principally those in rural locations).<sup>4</sup>

The jurisdiction of the FCC generally applied to interstate telecommunication services. However, most telephone services remained local and thus regulated by the several states. In Oklahoma, regulation of the telephone industry began when Oklahoma set up state government in 1907. The Oklahoma Constitution requires the regulation of "transportation and transmission" companies by the Oklahoma Corporation Commission.<sup>5</sup> A "transmission company" includes a telephone company and the Corporation Commission's initial regulatory jurisdiction thus covered telephone.<sup>6</sup> Since statehood, the Corporation Commission has consistently held the authority to regulate the rates and terms and conditions of service as well as market entry for telephone carriers operating intrastate in Oklahoma.<sup>7</sup>

This federal and state regulatory regime continued more or less unaltered until the 1980s. In November 1974, the U.S. Justice Department once again filed suit to break up AT&T and the Bell system. The case lumbered along for years, but after a lengthy trial presided over by Judge Harold Green, AT&T announced

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<sup>3</sup> 47 U.S.C. § 151.

<sup>4</sup> P. Huber, *Federal Telecommunications Law*, 2d Ed. § 1.3.4 (1999).

<sup>5</sup> Okla. Const. art. 9, § 18.

<sup>6</sup> Okla. Const. Art. 9, §§ 18, 34; *Hine v. Wadlington*, 109 P. 301 (Okla. 1910).

<sup>7</sup> See Okla. Const. art. 9, § 18; 17 Okla. Stat. §§ 131-134.

on January 8, 1982, that it had agreed to break up its \$136.8 billion empire.<sup>8</sup> AT&T would divest its local Bell operating telephone companies which would be broken up into seven regional operating companies (Bell Atlantic, NYNEX, BellSouth, Ameritech, U.S. West, Pacific Telesis and Southwestern Bell). These Regional Bell Operating Companies ("RBOCs") would operate solely as local exchange carriers ("LECs"). AT&T would keep its manufacturing facilities and its long distance network. The agreement took effect January 1, 1984.

This reorganization opened up the long-distance telephone business to competition. Competitors such as Sprint and MCI quickly began building microwave and fiber-optic long-distance infrastructure. Customers were allowed to choose an interexchange carrier (IXC) for their long distance service. In each local area, the RBOCs were required to provide a Point of Presence (PoP) within their switching offices for IXCs.<sup>9</sup>

The RBOCs were required to provide their services within specific geographic Local Access and Transport Areas (LATAs). LATAs were created to separate local and long-distance telephone markets. RBOCs were given exclusive authority within a LATA to provide intraLATA services, but service was limited to that which could be provided within a single LATA (intraLATA service). The RBOCs and the independent LECs were limited to providing local telephone service, producing yellow pages, and selling equipment, and were restricted from providing long-distance service, information services, and cable TV services.

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<sup>8</sup> See *United States v. AT&T*, 552 F. Supp. 131, 226-234 (D.D.C. 1982); *aff'd sub nom, Maryland v. United States*, 460 U.S. 1001 (1983). See also, *United States v. Western Electric Co.*, 569 F. Supp. 1057 (D.D.C. 1983), *aff'd mem sub nom, California v. United States*, 464 U.S. 1013 (1983).

<sup>9</sup> Shelton, *Encyclopedia of Networking and Telecommunications*, p. 1233 (2001).

AT&T and other IXCs were prohibited from providing intraLATA or local exchange service.<sup>10</sup>

This remained the status quo until 1996 when Congress passed the Telecommunications Act of 1996. The 1996 Act threw most of the rules established by Judge Green in the AT&T antitrust litigation out the window. Local exchange markets were open to competition. AT&T and other competitors are allowed to enter those markets and the RBOCs and all other incumbent local exchange carriers (ILECs) are required to open their networks to competitors. Among other obligations, ILECs are required to provide interconnection to requesting carriers, to provide unbundled elements of their networks to their competitors at regulated rates and to allow resale of their telecommunication services by competitors at wholesale discounts to be set by state commissions.<sup>11</sup> A detailed set of rules for negotiation, arbitration and approval of interconnection agreements between incumbent LECs and competitors are set forth in the Act.<sup>12</sup> Barriers to market entry are removed except for those necessary to "preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunication service and safeguard the rights of consumers."<sup>13</sup> State and local regulation of public rights-of-way is preserved.<sup>14</sup> Universal service is also preserved, but reformed upon recommendations of a federal-state joint board.<sup>15</sup>

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<sup>10</sup> *Id.*

<sup>11</sup> 47 U.S.C. §§ 251(c), 252(d)(1).

<sup>12</sup> 47 U.S.C. § 252.

<sup>13</sup> 47 U.S.C. § 253(a, b).

<sup>14</sup> 47 U.S.C. § 253(c).

<sup>15</sup> 47 U.S.C. § 254.

Under the 1996 Act, RBOCs are allowed competitive entry to provide in-region interLATA long distance services upon demonstrating that the company is providing or offering to its competitors access and interconnection to its network facilities and that such access or interconnection is being offered pursuant to compliance with a specific fourteen point checklist.<sup>16</sup> Upon authorization to provide interLATA service, RBOCs are required to do so by establishing a separate long distance affiliate and maintaining strict separation between the local exchange carrier and the interexchange carrier affiliate.<sup>17</sup>

Meanwhile, the FCC had migrated from traditional rate of return regulation to a price cap regulatory scheme. Traditional ratemaking required the Commission to prescribe just and reasonable rates upon review of assets in the ratebase, expenses allowed for ratemaking purposes and a reasonable rate of return on investment. In response to the complexity and limited effectiveness of this type of rate regulation, the FCC subsequently undertook a more simplified approach to rate of return regulation.<sup>18</sup> Currently, the FCC has abandoned rate of return regulation for price cap regulation, an incentive-based regulatory scheme that sets limits on prices.<sup>19</sup> With price cap regulation, the Commission sets prices only, with no specific control of underlying costs. Rate of return regulation attempted to control costs, but without discretion over the price.

Although Section 252(d) of the 1996 Act assigns to the states the authority to determine "just and reasonable" rates for interconnection and unbundled

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<sup>16</sup> 47 U.S.C. § 271.

<sup>17</sup> 47 U.S.C. § 272.

<sup>18</sup> See *Nader v. FCC*, 520 F.2d 182 at 202 (D.C. Cir. 1975); *United States v. FCC*, 707 F.2d 610 at 612 (D.C. Cir. 1983); *New England Telephone & Telegraph Co. v. FCC*, 826 F.2d 1101 (D.C. Cir. 1987); *AT&T v. FCC*, 836 F.2d 1386 (D.C. Cir. 1988).

network elements, the FCC nevertheless undertook to adopt "national pricing rules" for incumbents to charge their competitors. The FCC's actions were upheld by the U.S. Supreme Court.<sup>20</sup>

Rates for local telephone service and intrastate long distance service remained, generally speaking, regulated by the states. Oklahoma still requires certification of LECs and IXC's, but on grounds that are compatible with express federal restrictions placed on the states in order to remove barriers to entry.<sup>21</sup> As to rates, in 1997, the Oklahoma Legislature directed the Corporation Commission to revise the regulated telecommunications rate structure and access charges for intrastate local exchange service.<sup>22</sup> The Commission has since done so and, among other actions, has adopted a plan of alternative rate regulation for local exchange carriers. This plan allows local exchange carriers to abandon traditional rate base and rate of return regulation in favor of a process of flexible pricing based on a system of price floors and price caps and permitted percentage increases, all depending on the type of service and the extent of competition for such service.<sup>23</sup> For IXC's, interstate competitive services remain subject to Oklahoma tariffs but changes to the rates for competitive long distance services may now go into effect immediately upon notification of the Commission staff.<sup>24</sup>

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<sup>19</sup> See, e.g. *Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking*, 4 F.C.C. Rec. 2873, 2889-2883, ¶¶ 29-35 (1989) (hereinafter *AT&T Price Cap Order*).

<sup>20</sup> *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 119 S.Ct. 721, 733 (1999).

<sup>21</sup> OAC 165:55-3-1. Section 253 of the Telecommunications Act of 1996 limits state regulation of entry to "requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure continued quality of telecommunications service, and safeguard the rights of consumers."

<sup>22</sup> 17 Okla. Stat. §§ 139.101-139.109.

<sup>23</sup> See OAC 165:55-5-50 through 55-5-76.

<sup>24</sup> OAC 165:55-5-10 through 55-5-10.3.

Regulation of wireless telecommunications advanced on a different track. Initially, all wireless spectrum and all aspects of radio broadcasting were regulated under the Radio Act of 1927.<sup>25</sup> That act was later incorporated into the 1934 Act.<sup>26</sup> Providers of public mobile phone services were regulated as common carriers by the FCC and, as to intrastate services, by the respective states.<sup>27</sup> Oklahoma regulated radio common carriers by statute until 1987, when it repealed the Corporation Commission's authority to regulate entry and rates for such carriers.<sup>28</sup>

In 1993, Congress set up a new regulatory framework for providers of public wireless telecommunications or "commercial mobile service."<sup>29</sup> Wireless providers continued to be regulated as common carriers and subject to Title II of the 1934 Act (which requires regulation of rates and carrier entry).<sup>30</sup> However, the FCC was authorized to forebear from regulating wireless rates and many other parts of Title II.<sup>31</sup> The FCC did so forebear as to rate regulation and entry regulation of wireless carriers.<sup>32</sup> In the 1993 Act, Congress preempted the states entirely as to entry and rates.<sup>33</sup> States retained jurisdiction over "placement, construction and modification" of wireless facilities such as cell towers.<sup>34</sup> Commercial mobile service carriers were specifically excluded from the definition

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<sup>25</sup> 44 Stat. 1163.

<sup>26</sup> 47 U.S.C. § 301 et seq.

<sup>27</sup> See *National Ass'n. of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630, 634 (D.C. Cir. 1976).

<sup>28</sup> See, 17 Okla. Stat., §§ 200-206.

<sup>29</sup> 47 U.S.C. § 332(d)(1).

<sup>30</sup> See, e.g., 47 U.S.C. §§ 205, 214.

<sup>31</sup> 47 U.S.C. § 332(e)(1)(A).

<sup>32</sup> *National Assn. of Regulatory Util. Commrs. v. FCC*, 525 F.2d 630, 634 (D.C. Cir. 1976) (*NARUC I*); In the Matter of the Implementation of Sections 3(N) and 332 of the Communications Act Regulatory Treatment of Mobile Services, Second Report and Order, 9 F.C.C. Rcd. 1411 at 1414, ¶ 3; 1418-1419, ¶ 16; 1463-1493, ¶¶ 124-129 (March 7, 1994).

<sup>33</sup> 47 U.S.C. 332(c)(3)(A); see also *Comm. Dept. of Public Util. Control v. FCC*, 78 F.3d 842, 845-46 (2d Cir. 1996).

of Local Exchange Carriers in the 1996 Act; accordingly, wireless carriers have no obligations under Section 251(c) of the Act.<sup>35</sup>

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<sup>34</sup> 47 U.S.C. § 332(c)(7)(A).

<sup>35</sup> 47 U.S.C. § 153(26).