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FEDERAL, STATE, AND LOCAL REGULATION OF VIDEO AND TELECOMMUNICATIONS INFORMATION SYSTEMS—THE ACTUAL AND THE IDEAL

by FRANK W. LLOYD*

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New and competing technologies which deliver information to businesses and homes have attracted the attention of media entrepreneurs, real estate developers, federal regulators, and state and municipal offi-

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cial. These new systems, designated by strange acronyms such as MDS, DBS, and SMATV, deliver video programming in direct competition with conventional broadcast television and cable. New competitors offer data transmission, bank or shop at home, and other telecommunications services traditionally provided by telephone companies. Two-way cable, digital termination systems, city-wide teleports, and "smart" office buildings are being designed to serve the increasing demand for information of American business. Broadcasters, faced with this competition, are also entering the data delivery business by using FM radio subcarrier frequencies for paging, or by carrying text on unused lines of the television signal.

While the information ultimately received through any of these technologies may be identical, the regulatory treatment each mode of transmission receives is markedly different. This anomaly holds true at all levels of government. The critical issue of the 1980s is how long federal and state regulators can continue to adhere to the regulatory framework of the past. The former bright lines between a "common carrier," a "broadcaster," or an "ancillary" communications service are becoming increasingly blurred. Regulators are finding it harder to support theories that are based on these distinct categories.

New questions need to be asked about these new media outlets. Rather than asking which category includes the new medium, the more relevant question is simply whether it should be regulated at all, and if so how and to what degree. Regulators and courts have considered whether the Federal Communications Commission ("FCC") can and should eliminate behavioral regulation and substitute structural regulation, forbear experimentally from any regulation, or preempt states that adopt conflicting regulations.

This article provides a brief overview of the competing technologies in both video and non-video communications, and the issues involved in their conflicting regulatory treatment at federal and state levels. It analyzes recent cases that have complicated the FCC's attempts to promote unregulated competition in the video field. State efforts to hamper the FCC's development of competition in both the video and telecommunications sectors are described. Two of the fiercest controversies of the past several years between regulators and providers of these competing technologies are described in some detail: (1) the fight between state and local regulators, the FCC, and real estate developers over the burgeoning satellite master antenna television ("SMATV") industry; and (2) the competition between the cable and telephone industries to bring two-way services to homes and businesses.

The more recent battle between the telephone companies and two competitors, teleports and "smart" office buildings, is analyzed as well. These competitors, like cable, are called "bypassers" of the local tele-

phone network. Finally, some predictions of and recommendations for future policy towards both video and non-video competition are offered.

I. OVERVIEW OF THE COMMUNICATIONS ACT OF 1934

In the Communications Act of 1934, Congress issued a mandate to the FCC "to make available . . . to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges . . ."¹ Title I of that Act grants the FCC primary jurisdiction over "all interstate and foreign communication by wire or radio . . ."² This charge has been construed expansively. For example, the FCC has been held to have jurisdiction over communications facilities that are physically located within a single state if the essential nature of the communications carried over those facilities is interstate.³ States are limited to regulating intrastate communications without any significant interstate connection. Even those communications can be subject to federal oversight if they are intermingled on the same facility with interstate links.

A. COMMON CARRIERS

The FCC has various regulatory tools to control interstate communications. Title II of the Communications Act gives the FCC power over "common carriers." The Act circularly defines a "common carrier" as "any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio . . ."⁴ The FCC sets threshold requirements for entry into the common carrier business, and after entry it regulates a carrier's rates, services, and facilities.

Common carriers traditionally act as conduits for information transmitted by others over their facilities. Their customers, rather than the carrier itself, exercise control over content.⁵ A critical duty of a common carrier, which distinguishes it from other communicators, is

1. 47 U.S.C. § 151 (1982).

2. *Id.* § 152(a).

3. *See, e.g., California v. FCC*, 567 F.2d 84, 86 (D.C. Cir. 1977) (per curiam), *cert. denied*, 434 U.S. 1010 (1978).

4. 47 U.S.C. § 153(h) (1982). This section also says that "a person engaged in radio broadcasting shall not . . . be deemed a common carrier." *Id.*

5. The courts and the FCC have found a common carrier to have four essential elements:

- (1) the activity has a "quasi-public" character;
- (2) the carrier undertakes to carry for all people indifferently;
- (3) the carrier holds itself out indiscriminately to the clientele it is suited to serve; and
- (4) the user must choose the intelligence transmitted over the carrier.

See, e.g., National Ass'n of Regulatory Util. Comm'rs v. FCC, 525 F.2d 630, 641-42 (D.C. Cir. 1976). *See also Frontier Broadcasting Co. v. Collier*, 24 F.C.C. 251 (1958) (applying

that it cannot discriminate among potential customers. Traditionally, this duty has been imposed on common carriers because of their perceived "natural monopoly" over particular transmission paths. As certain types of communications carriers have lost their prior monopoly, the FCC has reduced its control over these carriers' entry and pricing of their services.

The most obvious examples of common carriers are local telephone companies. These include the large former Bell Operating Companies, divested from AT&T in 1983 pursuant to a judicial Consent Decree,⁶ as well as many smaller local systems controlled by independent carriers. AT&T, MCI, and GTE/Sprint are all common carriers of long distance data and voice information. Satellite and terrestrial microwave carriers are also placed in this regulatory category. The Multipoint Distribution Service ("MDS") is a type of microwave carrier that has become a video competitor of cable.

B. BROADCASTERS

Title III of the Communications Act governs broadcasters, such as radio and television stations. Broadcasters use the electromagnetic spectrum to transmit programming to the general public. Unlike common carriers, broadcasters have a duty to oversee the material they carry, and they need not act as a nondiscriminatory conduit for the messages of others (except in limited cases involving a federal candidate's right of access to purchase time). Title III does, however, impose upon broadcasters a general mandate to operate in the "public interest." Specific manifestations of that requirement include providing "equal time" in political broadcasting, and an overall balance of opposing views on controversial issues under a general "fairness" obligation. The FCC also attempts to carry out certain "localism" and "diversity" objectives that have long been held necessary and proper under Title III of the Act.

In addition to commercial advertiser-supported radio and television broadcasters, and "public" or "educational" non-profit broadcasters, several other entities are also classified by the FCC as broadcast services. Subscription over-the-air television ("STV") is not intended to be distributed to the general public. It operates in a scrambled mode so its programming can be obtained only by paying subscribers. Yet the FCC has found this distinction meaningless, and it calls STV "broadcasting."⁷

these factors to determine whether community antenna television systems are common carriers).

6. *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 103 S. Ct. 1240 (1983) (mem.).

7. *In re Amendment of Part 73 of the Commission's Rules and Regulations (Radio*

Low power television ("LPTV"), a service recently started by the FCC to add hundreds of new television stations throughout the country, is also placed under the "broadcast" rubric. While LPTV stations clearly are "broadcasting" under Title III, the FCC has exempted their services, like those of STV operators, from traditional FCC public service regulations applied to other broadcasters through a policy of "forbearance."⁸

C. CABLE TELEVISION: BETWEEN THE CRACKS

Other means of communications, such as cable television, fit into neither the "common carrier" nor the "broadcast" category. Cable operators, rather than serving all customers indifferently like common carriers, make individualized decisions whether to deal with program or data suppliers. But, because they do not use the broadcast airwaves, they are not directly regulated under Title III.

Until the recent passage of the Cable Communications Policy Act of 1984,⁹ which gave the FCC a separate statutory grant of authority over cable, the FCC regulated cable under an "ancillary to broadcasting" theory.¹⁰ This approach to cable jurisdiction derived, in part, from reliance on an outmoded concept of cable television. Although cable originally did nothing but retransmit and enhance broadcast signals, cable has increasingly carried unique program origination services which are truly competitive with broadcasting.

The major function performed by many rural and mid-sized town cable systems is still retransmission of broadcast signals. This is largely due to the FCC's "must carry" rules, which, until they were held unconstitutional in 1985,¹¹ required systems to carry all "local" broadcast sig-

Broadcast Services) To Provide for Subscription Television Service, 3 F.C.C.2d 1, 9 (1966). The FCC has, however, relieved STV operators of "behavioral" broadcasting regulations. See *In re* Amendment of Part 73 of the Commission's Rules and Regulations in Regard to Section 73.642(a)(3) and Other Aspects of the Subscription Television Service, 90 F.C.C.2d 341 (1982).

8. An Inquiry into the Future Role of Lower Power Television Broadcasting and Television Translators in the National Telecommunications System, Report and Order, 47 Fed. Reg. 21,468 (1982) (codified at 47 C.F.R. pts. 73, 74, 76, and 78).

9. Pub. L. No. 98-549, 98 Stat. 2779 (1984) (codified at scattered sections of 47 U.S.C.) [hereinafter cited as Cable Act]. Section 2 of the Cable Act amended the Communications Act of 1934 by adding a new Title VI, and the various sections were to be numbered in a 600 series. When the Cable Act was codified, however, Title VI was redesignated subchapter V-A, and the various sections were renumbered in a 500 series. To avoid confusion, subsequent references to the Cable Act cite the section of the Act, followed by the original 600 series section number. The locations where the sections were codified in the United States Code Annotated is given parenthetically.

10. See, e.g., *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968); *United States v. Midwest Video Corp.*, 406 U.S. 649 (1972).

11. *Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434 (D.C. Cir. 1985), *petition for cert.*

nals, and the effect of these rules on the channel utilization choices of smaller twelve channel systems. Urban systems with large channel capacity, however, provide a wide variety of video program services designed for cable transmission, such as HBO and CNN, and one-way or two-way nonbroadcast services that compete with traditional "common carrier" services. These services fell between the cracks of the FCC's "ancillary to broadcasting" cable jurisdiction as previously articulated.

In a June 1984, decision striking down state regulations banning liquor ads on cable,¹² the Supreme Court affirmed the FCC's inherent jurisdiction over cable. For the first time the Court did not explicitly limit the FCC to regulations that merely promote its Title III objectives under the "ancillary to broadcasting" theory. Rather, it referred to the FCC's "general authority under the Communications Act to regulate cable television systems."¹³

The Cable Act, enacted on October 30, 1984, only a few months after the *Crisp* decision, attempted to resolve some of the issues relating to the FCC's jurisdiction over cable's provision of video and non-video services. The Cable Act, however, left many jurisdictional questions open. For example, Congress took a complex jurisdictional approach to certain types of services offered by cable systems. The new statutory scheme was not based on the traditional FCC categories of "broadcast" or "common carrier" services, but on a new dichotomy between "cable services" and "non-cable services." This novel separation is discussed in detail below in connection with the current competition between cable and telephone companies.

D. THE CONFUSION OVER CATEGORIZING VIDEO DELIVERY SYSTEMS

As additional communications companies provide virtually identical information to consumers, it becomes increasingly difficult to categorize the types of services used to deliver programming. Two microwave services authorized to deliver video programming to consumers are the Instructional Television Fixed Service ("ITFS") and the Private Operational Fixed Service ("OFS"). Home video transmitted by ITFS or OFS licensees is neither broadcasting nor common carrier service. The FCC classifies ITFS as a "private" service, and OFS as a "hybrid" service. Under either label, however, the services are essentially unregulated. Yet they are being allowed by the FCC to carry the same kinds of pay video programming to home subscribers as STV (broadcasting), MDS (common carrier), or cable.

filed sub nom. National Ass'n of Broadcasters v. Quincy Cable TV, Inc., 54 U.S.L.W. 3229 (U.S. Sept. 23, 1985) (No. 85-502).

12. *Capital Cities Cable, Inc. v. Crisp*, 104 S. Ct. 2694 (1984).

13. *Id.* at 2702.

The FCC's confusion is also illustrated by its differing treatment of "electronic publishing" materials. This is textual information carried as "teletext" over spare lines in the television signal and "read" by special decoders, or as "videotex" over cable or telephone lines. Depending on the mode of carriage, precisely the same lines of electronic information would be regulated differently if the traditional FCC categories were applied.

Text delivery by telephone wire is considered to be totally separate from the common carrier that transmits it to the home. Therefore, it retains its full first amendment status as electronic publishing, similar to print.¹⁴ If the same material is carried over broadcast frequencies, however, a teletext provider may be legally subject to the same "public trustee" fairness doctrine or equal time laws as the host broadcast licensee. The regulatory treatment of the same bits of data carried over cable may depend on whether this "electronic magazine" is part of a re-transmitted broadcast signal or an originated channel by the cable operator. The FCC, seeing the anomalies of this policy, has tried to remove content restraints from broadcast teletext by putting it on a parity with videotex carried by common carriers.¹⁵ From a legal perspective this approach may prove difficult without amendment of the Communications Act to take account of this new technology.¹⁶

The FCC's reluctance to impose the full panoply of statutory obligations on new video media has led to disputes within the agency,¹⁷ and to conflicts with the courts. The Court of Appeals for the District of Columbia Circuit recently rejected the FCC's exemption of certain direct broadcast satellite ("DBS") transmissions from the Communications Act's broadcast requirements.¹⁸ The FCC had authorized DBS to operate as either a common carrier, leasing its channels to customers who would then send their own programs to viewers over them, or as a

14. AT&T and local telephone carriers are barred from electronic publishing over their own lines by the 1982 Consent Decree in the AT&T antitrust case. AT&T is barred for seven years, while the divested Bell Operating Companies are barred until they can make a showing that they cannot use their monopoly power to impede competition. *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 223-25 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 103 S. Ct. 1240 (1983) (mem.).

15. Amendment to the Commission's Rules To Authorize the Transmission of Teletext by TV Stations, Report and Order, 48 Fed. Reg. 27,054 (1983) (codified at 47 C.F.R. pts. 2, 73, and 74), *reconsideration denied*, Memorandum Opinion and Order, FCC 84-529 (Jan. 24, 1985) (available on LEXIS, Fedcom library, FCC file).

16. For a further discussion of this issue, see H. Geller & D. Lampert, *Constitutional and Policy Issues Concerning New Information Services: The Structural Versus Behavioral Approach* (1984) (available at Washington Center for Public Policy Research).

17. H. Rivera, FCC Commissioner, Remarks before the American Law Institute, American Bar Association (Mar. 29, 1984).

18. *National Ass'n of Broadcasters v. FCC*, 740 F.2d 1190 (D.C. Cir. 1984).

broadcaster, retaining control over the content of its transmissions to subscribers. Under the FCC approach, when DBS operated as a common carrier, it would be subject to the tariff, entry, and exit requirements of the Communications Act, but its customer-programmers would not have to comply with any statutory provisions imposed on either broadcasters or common carriers. When operating as a broadcaster, however, the DBS operator would be fully subject to Title III's political broadcasting equal time, federal candidate access, and fairness doctrine requirements.

The court disapproved of the FCC's scheme of dual regulation. Fearing that the statutory political broadcast provisions could be circumvented through a common carrier leasing arrangement, the court broadly found that:

When DBS systems transmit signals directly to homes with the intent that those signals be received by the public, such transmissions rather clearly fit the definition of broadcasting; radio communications are being disseminated with the intent that they be received by the public. That remains true even if a common carrier satellite leases its channels to a customer-programmer who does not own any transmission facilities; in such an arrangement, someone—either the lessee or the satellite owner—is broadcasting.¹⁹

Although the court did not dictate a particular approach for the FCC to follow on remand, it did suggest that its goals could be accomplished by either licensing the lessee of each channel as a broadcaster, or by making the DBS satellite owner responsible for the customer's compliance with a broadcaster's statutory obligations. This is not totally unprecedented. Local television stations are today theoretically responsible for the violation of any fairness doctrine or other content regulation committed by the national network which they carry.

The court in the DBS case also questioned whether the FCC could continue its similar non-regulation policy regarding pay video customer-programmers of MDS carriers. The FCC was also concerned about the impact of the DBS decision on its exemption of teletext from the political broadcasting protections of the Communications Act. As a result, the FCC wrote a lengthy explanation in a recent order why it would not, despite the court's ruling, change its view that teletext was an "ancillary service not strictly related to the traditional broadcast mode of mass communication."²⁰ Thus, the FCC is finding it increasingly difficult to treat differently entities that provide the same pay video serv-

19. *Id.* at 1201.

20. Memorandum Opinion and Order, FCC 84-529 (Jan. 24, 1985) (available on LEXIS, Fedcom library, FCC file), ¶¶ 15-17 *denying reconsideration*, Amendment to the Commission's Rules To Authorize the Transmission of Teletext by TV Stations, Report and Order, 48 Fed. Reg. 27,054 (1983) (codified at 47 C.F.R. pts. 2, 73, and 74).

ices, and still have courts uphold these actions as consistent with congressional intent embodied in the Communications Act.

In response to the District of Columbia Circuit's remand order, the FCC adopted a proposed rulemaking to classify STV and DBS services as point to multipoint (non-broadcast) services, which exempts them from fairness doctrine, equal opportunities, and other statutory broadcast regulations.²¹ The FCC said it was attempting to be consistent in treating STV and DBS like MDS and OFS, which already had been classified as non-broadcast services. If this new FCC approach is adopted and upheld, it would at least treat most of the new subscription video technologies consistently, but would still leave cable subject to Title III broadcasting content regulations.

II. STATE AND LOCAL REGULATION

State and local governments also attempt to regulate the services of communications companies. Intrastate communications services offered on a common carrier basis are regulated by state public service commissions. The FCC may preempt the state commissions concerning particular services or types of regulation of those services on the basis of overriding and conflicting federal concerns. As regulated utilities, common carriers such as the telephone companies must obtain state certificates of public convenience and necessity to provide purely local services. In addition, many states have cable authorities that issue comprehensive regulations governing intrastate cable television operations.

Local authorities also exercise control over the provision of certain communications services to their communities. They grant franchises or other permits for cable or telephone company construction, and issue zoning regulations for satellite earth stations. Local governments have regulated cable subscriber rates and required franchise fees from cable. The attempted justifications for these forms of local regulation are either cable's use of public streets, or that the city is entitled to compensation for the cost of cable regulation and supervision.

With so many regulatory levels involved, many cross-jurisdictional battles have erupted. Communications companies have increasingly looked to the FCC and Congress to preempt state and local regulation to avoid the confusion, cost, and delay of complying with conflicting regulatory schemes.

Federal law preempts state law when state law would frustrate or retard federal policy. The preemptive federal policy can be an affirmative one embodied in a set of federal statutes or regulations, or it can be

21. Notice of Proposed Rulemaking, Subscription Video Services, Gen. Docket No. 85-298, FCC 85-538 (released Jan. 8, 1986).

established simply by a federal agency declaring that there shall be a deliberate absence of any regulation of a particular communications mode, or of certain aspects of its operation, at either the federal or state levels.

In recent years, the FCC has increasingly prevailed in the courts in the exercise of its preemptive muscle. The power of state and local governments in communications matters has been correspondingly limited. For example, in the June 1984 Supreme Court decision in *Capital Cities Cable, Inc. v. Crisp*,²² discussed above, the Supreme Court affirmed the FCC's preemptive power in the cable field. The Court stated that:

if the FCC has resolved to pre-empt an area of cable television regulation and if this determination "represents a reasonable accommodation of conflicting policies" that are within the agency's domain, we must conclude that all conflicting state regulations have been precluded.²³

The Court concluded that the FCC had "unambiguously expressed its intent to pre-empt any state or local regulation of [the] entire array of signals carried by cable television systems."²⁴ It therefore eliminated an Oklahoma ban on liquor ads on cable.

Section 3 of the Cable Act amended Title I of the Communications Act of 1934, to give the FCC explicitly a broad and exclusive jurisdictional grant over cable. The FCC is given the power to extend its authority to "cable service, to all persons engaged within the United States in providing such service, and to the facilities of cable operators which relate to such service, as provided in Title VI."²⁵ The states and cities argue that the new Title VI added by the Cable Act in some respects limits FCC involvement in certain cable activities. Cable operators argue for a more expansive reading of FCC authority under the Act.

Where FCC involvement clearly has been limited by the Cable Act, either states and municipalities have gained new power or the area has been deregulated. In the former situation, courts are given the task of adjudicating disputes in areas such as franchise renewal, franchise modification, or leased access. An example of deregulation is the Act's removal of state or local authority to set subscriber rates, in most cases, after two years. The FCC is given specific authority over certain areas, but several explicit causes of action under the Act are directed initially to the state or district courts, rather than to the FCC, creating the potential for widely divergent interpretations of the Act.

State and municipal governments will continue to attempt to exer-

22. 104 S. Ct. 2694 (1984).

23. *Id.* at 2701 (citation and footnote omitted).

24. *Id.*

25. Cable Act, *supra* note 9, § 3(a)(1) (codified at 47 U.S.C.A. § 152(a) (West Supp. 1985)).

cise primary control over the cable franchising process, subject to the restrictions contained in the Cable Act. All state or local laws inconsistent with the Act are deemed preempted and superseded by the Act as of its effective date.²⁶ Notably, cable operators gained new powers over access to easements provided by developers or homeowners to other utilities, as well as faster adjudication of state complaints over utility pole access.²⁷ This should spur cable construction and penetration of both urban and rural markets.

Despite passage of the Cable Act, continuation of the municipal cable franchising process is in some constitutional jeopardy. A number of court cases have challenged the franchising process in Sacramento, Palo Alto, Los Angeles, and several other cities on both antitrust and first amendment grounds. Cable operators who refused to participate in the franchise bidding claimed that numerous conditions placed on franchise awards by these cities impermissibly burden their free speech rights. Cable advocates claim that they neither use scarce spectrum space as do broadcasters, nor burden city streets more than newspaper racks, nor cost city governments more than it does to clean up newspapers.

The Los Angeles case first reached the Ninth Circuit Court of Appeals.²⁸ The court held that the traditional cable franchising process facially violated the first amendment. Under that process, as practiced in Los Angeles, one applicant would be selected to speak, and other cable companies would be precluded from speaking. Without a showing that there was no physical space on utility poles for the additional cable operators, or economic scarcity such that only one cable operator could survive in the market, competing cable systems could not be excluded. The action of the Supreme Court will determine whether agreeing to the Cable Act has not created a long-standing roadblock to the cable industry's ultimate aim of being treated as a medium of speech akin to a newspaper.

Other city-imposed restraints on cable are under attack. One California state court, citing a Supreme Court case involving a tax on newspapers, has held that a special city tax on an MDS pay TV service impermissibly singled out the press.²⁹ The Supreme Court recently re-

26. Cable Act, *supra* note 9, § 2, 636(b) (codified at 47 U.S.C.A. § 566(b) (West Supp. 1985)).

27. *But see* Florida Power Corp. v. FCC, 772 F.2d 1537 (11th Cir. 1985) (invalidating federal pole access statute on constitutional grounds).

28. Preferred Communications, Inc. v. City of Los Angeles, 754 F.2d 1396 (9th Cir.), *cert. granted*, 106 S. Ct. 380 (1985).

29. City of Alameda v. Premier Communications Network, 156 Cal. App. 3d 148, 202 Cal. Rptr. 684, *cert. denied*, 105 S. Ct. 567 (1984) (citing Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue, 460 U.S. 575 (1983)).

fused to hear an appeal from this decision,³⁰ emboldening those who see this case as a precursor to a successful direct constitutional attack on cable franchise fees.

III. THE DEREGULATION OF SMATV: A CASE STUDY

In November 1984, the Court of Appeals for the District of Columbia Circuit affirmed the FCC's preemption of state and local barriers to satellite master antenna television ("SMATV") systems that compete with cable.³¹ SMATVs, or "private cable" systems, receive satellite transmissions through earth stations and carry them to residents of multi-unit dwellings. SMATV systems are increasingly popular with real estate developers, who can obtain and resell pay movie services, CNN, WTBS, or other satellite delivered services, to their occupants without the high construction costs that a city-franchised cable system incurs. SMATVs do not normally use public rights of way to deliver services to their subscribers. Thus, the traditional rationale to require a municipal franchise for provision of cable service (itself under attack as a violation of the first amendment) is missing.

The lawsuit resulted from an FCC declaratory ruling overriding a New Jersey court's order enjoining a SMATV operator from providing services until it obtained a state public utility commission certificate of approval.³² The FCC preempted state and local regulation of SMATV that has "the effect of interfering with, delaying, or terminating interstate and federally controlled communications services."³³

In the past the FCC had explicitly preempted the component parts of SMATV service: licensing of satellites and earth stations; regulation of pay television programming services and rates; and carriage of television broadcast signals. Relying heavily on the Supreme Court's *Crisp* opinion, the District of Columbia Circuit upheld the FCC's preemption based on the "critical distinction the Commission has made between cable television systems that use public rights-of-way and systems, like SMATV, that are operated solely on private property."³⁴

The FCC's preemption order did not extend to all state and local regulation of SMATV, but it warned that zoning, public safety, and

30. 105 S. Ct. 567 (1984).

31. *New York State Comm'n on Cable Television v. FCC*, 749 F.2d 804 (D.C. Cir. 1984).

32. *Suburban Cablevision v. Earth Satellite Communications, Inc.*, No. C-1554-83E (N.J. Super. Ct. Ch. Div. May 20, 1983).

33. *In re Earth Satellite Communications, Inc.*, 95 F.C.C.2d 1223, 1235 (1983), *reconsideration denied*, FCC 84-207 (May 14, 1984) (available on LEXIS, Fedcom library, FCC file).

34. *New York State Comm'n on Cable Television v. FCC*, 749 F.2d 804, 809 (D.C. Cir. 1984).

health regulation of earth stations could not be used as a pretext for frustrating the federal policy favoring the development of diverse modes of delivery of interstate transmission of satellite signals.³⁵ In fact, immediately after the FCC's SMATV decision, a DBS operator filed for an FCC declaratory ruling seeking preemption of a Chicago ordinance precluding the placement of any satellite earth stations in that city without undergoing a rigorous certification process.³⁶

Real estate interests successfully lobbied in 1984 to kill a provision originally contained in the Cable Act that granted a mandatory federal right of cable access to apartment dwellings. This result, plus the District of Columbia Circuit decision, may stimulate SMATV development beyond the current national estimate of one half million subscribers. The decision, however, may also have beneficial side effects for the cable industry. SMATV, as an unregulated competitor to cable, has already provided an effective rationale for limiting the former demands placed on franchised cable operators by urban municipalities such as Chicago. The rise of SMATV, MDS, and similar pay video competitors may ultimately lead to complete deregulation of cable at both the federal and local levels.

IV. THE TELCO-CABLE BATTLEGROUND: CABLE PROVISION OF DATA TRANSMISSION SERVICES

While the FCC believes that different services can and should be regulated differently, many state regulators have increasingly maintained that different entities providing similar communications services should receive substantially the same treatment. Moreover, while the FCC has increasingly relied on market forces to check anticompetitive behavior of communications companies, states have continued to exercise the full panoply of regulatory tools when the FCC has left a void. This approach is most evident in the area of telephone/cable competition for the lucrative business data market, and for two-way delivery of security or banking/shopping services to the home.

Cable television began in the 1950s as an antenna service for areas unable to obtain broadcast television service. Over the last three decades, cable services have greatly expanded and now present a new area of conflict with local telephone companies. The two-way broadband ca-

35. *In re Earth Satellite Communications, Inc.*, 95 F.C.C.2d 1223, 1228 (1983), *reconsideration denied*, FCC 84-207 (May 14, 1984) (available on LEXIS, Fedcom library, FCC file).

36. *In re United Satellite Communications Inc.*, FCC Report No. DS-293 (June 8, 1984). The FCC decided in 1986 to grant limited preemption of local earth station regulation. *In re Preemption of Local Zoning Regulations of Receive-Only Earth Stations*, CC Docket No. 85-87, FCC 86-28 (released Jan. 14, 1986).

capacity of cable allows carriage of interactive services, such as security alarm monitoring, remote home and business energy management and meter reading, and participative home viewer polling. The largest market for interactive cable, however, may be interoffice business data transmission.

Coaxial cable has a far greater data carrying capacity than conventional twisted copper wire telephone lines. This allows companies to send high speed data from computer to computer, as well as interoffice electronic mail. For almost a decade, Manhattan Cable has been providing data transmission for Chase Manhattan Bank and other business users, and it recently generated over \$1 million in annual revenue.³⁷

A. STATES' ATTEMPTS TO REGULATE CABLE

This phenomenon has not escaped the attention of state regulators. With the divestiture of AT&T and the fear that large users will find more efficient alternatives to the local telephone exchange (in turn causing local phone rates to rise for remaining customers), many states have begun so-called "anti-bypass" proceedings to limit cable provision of two-way services. Ironically, in many cases it is the local municipalities that have required cable operators to build these costly "institutional networks" or "I-NETS" often to provide the city governments and other nonprofit institutions with alternatives to local phone service. This, however, has not deterred the state public utility commissions ("PUCs") from blocking cable operators from putting this capacity to use.

The Connecticut DPUC, for example, ruled in May 1984 that entry and tariff regulation of data and other services provided by cable or I-NETS are within its jurisdiction and not that of the FCC.³⁸ The California PUC subsequently ruled its jurisdiction extended to any competitor of local telephone companies, including cable high speed data services, and said it would scrutinize carefully any applications for such services.³⁹ New York permitted cable companies to provide data transmission service pending the outcome of a generic proceeding investigating the proper scope of regulation of "bypass" services that found jurisdiction over cable data services, but adopted streamlined regulatory procedures for them.⁴⁰ New Jersey, Missouri, Colorado, and many other states have outstanding proceedings on the same issue.

37. Rothbart, *Common Carrier Look-Alike?*, CABLEVISION, Feb. 7, 1983, at 60.

38. Connecticut DPUC Interlocutory Decision on Jurisdiction, No. 81-11-15 9 (May 1984).

39. California PUC, No. 83-0613 (June 13, 1984).

40. NYPSC—Provision of Tel. Servs. that Bypass Local Exch. or Toll Networks, No. 28710, Opinion No. 85-16 (Oct. 3, 1985).

In August 1984, the New Mexico State Corporate Commission issued a broad order asserting jurisdiction over any cable company that offers a communications service.⁴¹ The New Mexico Commission found that the definition of telephone service "cannot be limited to use of a particular transmission medium, to transmission of a particular type of signal, to transmission at only certain speeds, or to only switch transmission."⁴² The Commission declared that any person "who owns, leases, operates or constructs any facility which forms any part of a link or network for transmission of communications signals for compensation, whether as a common carrier or on a private contract basis, is a telephone company providing telephone service" under state law.⁴³ Accordingly, the Commission barred cable companies from constructing facilities that furnish so-called "public telephone services" without first obtaining a certificate of public convenience and necessity. Several cable companies have filed an appeal with the New Mexico Supreme Court seeking to overturn the Commission's ruling.⁴⁴ The decision prompted several cable companies to discontinue experiments in two-way data transmission in New Mexico.⁴⁵

In response to similar efforts by the state of Nebraska to regulate cable data transmission by its Commline subsidiary, Cox Cable Communications, Inc. asked the FCC in 1983 to preempt all state entry and rate regulation that has the effect of impeding the development of cable broadband data carriage.⁴⁶ Supporters of the Cox petition portrayed cable as an attractive alternative provider of data services. Cable's viability would be threatened, they claimed, by application of traditional state entry barriers and tariffing restraints appropriate for monopoly services. In August 1983, a federal court restrained the Nebraska PUC from denying entry to Cox's Commline data service pending a decision on the matter by the FCC.⁴⁷

Carriers filing in the *Cox Commline* proceeding at the FCC argued that intrastate data transmission, security, and similar residential and business interactive services are beyond the scope of the FCC's jurisdiction, and fall within the traditional category of state PUC-regulated telephone service. Cable operators, in response, stressed the indivisible

41. *In re* Generic Investigation into Cable Servs. in N. M., Decision and Order, No. 1060 (issued Aug. 6, 1984).

42. *Id.* at 10.

43. *Id.* at 11.

44. *Las Cruces TV Cable v. New Mexico State Corp. Comm.*, No. 15620 (N.M. filed 1984). See State Tel. Regulation Report 12 (Aug. 30, 1984). The National Cable Television Association has also intervened.

45. *Communications Daily* 3 (Oct. 16, 1984).

46. *Cox Cable Communications, Inc.*, FCC File No. CCB DFD 83-1, FCC Mimeo No. 3832 (Apr. 27, 1983).

47. *Cox Cable Communications, Inc. v. Simpson*, 569 F. Supp. 507 (D. Neb. 1983).

nature of interstate and intrastate communications offered over cable facilities, and the FCC's broad powers under Title I of the Communications Act to further its goals of diversity and competition under both Title II and Title III. They argued that state preemption could be based on both these goals and alternative FCC principles of "private carriage," or "enhanced services," as well as the FCC's recent "competitive carrier" doctrine, which states that regulation of "non-dominant carriers" is unnecessary when competition is an adequate substitute.⁴⁸

B. THE CABLE ACT

The FCC did not act on this petition during 1984 in the hope that Congress would resolve this conflict. Those hopes were dashed, however, with the passage of the Cable Act of 1984. The Senate version of the legislation had provided for federal preemption of state regulation of all two-way services provided over cable, except for traditional switched voice telephone service. Only the filing of informational tariffs for other services would have been allowed. The House bill, however, because of a compromise between the telephone and cable interests, essentially ducked the issue of two-way cable service regulation by throwing the issue back to the FCC, the state PUCs, and the courts.

The Cable Act adopts the House bill approach. It only gives the FCC explicit and exclusive authority over intrastate communications service defined as "cable service" and carried via cable systems. The Act restricts the definition of "cable service" to "the one-way transmission to subscribers of (i) video programming, or (ii) other programming service," and any subscriber interaction necessary to obtain those programming services.⁴⁹ According to the Cable Act's legislative history, this definition was meant to give the FCC clear primacy in pay-per-view and menu-style videotex grab-frame interaction with cable subscribers, but not in truly interactive services such as security, bank or shop-at-

48. See, e.g., Comments of Cablevision Systems Development Company, FCC File No. CCB DFD 83-1 (July 1, 1983). The FCC has allowed its "competitive carrier" regulation to take two forms: (1) "streamlined" regulation, where carriers file tariffs on short notice without extensive supporting data and report on facilities changes after the fact; and (2) "forbearance" regulation, where no tariffs or reports are filed at all. See, e.g., *In re Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, Fourth Report and Order, 95 F.C.C.2d 554 (1983). For a further discussion of this theory of cable data preemption as well as the other theories cited above, see Lloyd, *Cable Television's Emerging Two-Way Services: A Dilemma for Federal and State Regulators*, 36 VAND. L. REV. 1045, 1085-88 (1983).

49. Cable Act, *supra* note 9, § 2, 602(5) (codified at 47 U.S.C.A. § 522(5) (West Supp. 1985)).

home, or business data.⁵⁰

The Cable Act provides that "[a]ny cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service."⁵¹ But the Cable Act purports not "to affect the authority of any State to regulate any cable operator to the extent that such operator provides any communication service other than cable service, whether offered on a common carrier or private contract basis."⁵²

There will likely be a great deal of controversy concerning where the precise line is drawn between federal and state regulation. According to the congressional explanation of the Cable Act, interaction with data at an off-premises computer is a "non-cable" service, while calling up generally available data, such as the Dow Jones average or sports scores, is a "cable service." A catalog service that only allows the customer to select information about potential purchases is a cable service, but one that lets the customer order the item over the service is a "non-cable" service. Similarly fine lines are drawn by the extensive legislative history.⁵³

Either a state or the FCC may require the filing of informational tariffs for any communications service provided by a cable system, unless that service, if offered by a common carrier, would have been subject to FCC or state regulation under Title II of the Communications Act. The FCC has so far declined to do so,⁵⁴ but it is likely that the states will require such informational tariffs to be filed as a means of alerting the telephone companies to the introduction of cable-delivered competitive services. This will allow those companies to appear before state PUCs to object and slow, if not stop, the process.

The Cable Act's legislative history shows clearly that Congress intentionally avoided the sensitive issues raised by cable's provision of two-way data services. The House Report explicitly refers to the New York, Nebraska, and California proceedings, but declares that the House bill "addresses only a small fraction of the issues raised in these proceedings."⁵⁵ Rather, the bill simply "preserves the regulatory and jurisdictional status quo with respect to non-cable communications services [It reserves] for state and Federal officials the authority they

50. H.R. REP. NO. 98-934, 98th Cong., 2d Sess. 41-44, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS 4655, 4678-81 [hereinafter cited as HOUSE REPORT].

51. Cable Act, *supra* note 9, § 2, § 621(c) (codified at 47 U.S.C.A. § 541(c) (West Supp. 1985)).

52. *Id.* § 2, 621(d)(2) (codified at 47 U.S.C.A. § 541(d)(2) (West Supp. 1985)).

53. See HOUSE REPORT, *supra* note 50, at 41-44, 1984 U.S. CODE CONG. & AD. NEWS at 4678-81.

54. Implementing the Provisions of the Cable Communications Policy Act of 1984, 49 Fed. Reg. 48,765 (1984).

55. HOUSE REPORT, *supra* note 50, at 29, 1984 U.S. CODE CONG. & AD. NEWS at 4666.

need to address the issue of competition between telephone and cable companies"⁵⁶ Congress stated it would monitor state and federal proceedings to determine whether future legislative action might be required.

Thus, the issue was thrown back to the FCC. Unless the FCC acted on the *Cox Commline* petition and preempted state efforts to block the provision of cable data transmission services, cable would have had to defend its activities before numerous state commissions. This would chill the expansion of cable data transmission and retard diversity, innovation, and possibly deny lower costs to data customers.

When the FCC finally decided the *Cox Commline* case,⁵⁷ it clearly preempted any state regulation that has the effect of impeding cable's entry into the provision of either data or voice services, so long as the specific cable facilities are used to carry interstate communications, even if the facilities are also used for intrastate communications. The practical effect of the ruling is to encourage any cable operator that wants to provide intrastate data services also to use the facilities to originate and terminate interstate traffic. This can be done by using the system for interstate MCI or AT&T calls or by creating its own satellite links. The Cox/Commline institutional cable plant in Omaha terminated MCI, GTE/Sprint, and its own DTS system.

The FCC's analysis first held that Commline was not acting as a traditional "common carrier" because it set individual terms for each customer, and did not indiscriminately hold itself out to deal with the general public. Commline, it noted, had little or no market power because so many alternative methods were available to provide similar services for high speed data transmission. The primitive switching capacity of Cox's cable plant also could not provide a complete alternative to traditional telephone exchange switched access service.

The FCC found that it had authority over Commline's institutional cable as a communications service by wire, even though the facilities were not being operated on a common carrier basis. It also found that, even if Cox had been acting as a common carrier, the FCC could preempt state regulation using its "ancillary to Title II and Title III" powers.

The FCC found the Cable Act no barrier to its preemption, and it relied on court decisions upholding its past preemption of pay cable, MDS, and telephone customer premises equipment, and the pro-competitive policies of its *Competitive Carrier* rulemaking. It also cited sec-

56. *Id.*

57. *In re Cox Cable Communications, Inc.*, Memorandum Opinion, Declaratory Ruling, and Order, FCC File No. CCB DFD 83-1, FCC 85-455 (released Sept. 5, 1985) (available on LEXIS, Fedcom library, FCC file).

tion 7(a) of the Communications Act, requiring the FCC to encourage the provision of new technologies to the public. Cox got extra points for its linkage with DTS, a new technology favored by the FCC. But the agency also noted that it had been attempting to encourage use of cable for nontraditional interactive services ever since the early 1970s.

The FCC dismissed the bypass threat pressed by the telephone companies in a single footnote. It said that its policy is not to limit all bypass, but only bypass not justified by service or cost considerations.

The FCC specifically did not preempt state entry barriers where cable companies propose to provide solely intrastate service. It also limited its preemption to cases where the ability to provide intrastate service would substantially affect a cable system's ability to provide an interstate communications service. The FCC likewise did not deal with preemption of state rate regulation of services offered by cable, only with entry conditions. It noted a factual dispute between Cox and the Nebraska PUC on the feasibility of separating intrastate and interstate traffic for rate making purposes, but postponed rate and other post-entry regulation questions to future case by case decisions. Nevertheless, the decision was quickly appealed by the trade association for the state public utility commissions.⁵⁸

Ironically, the District of Columbia Circuit's affirmance of the FCC's SMATV preemption order may help cable achieve FCC preemption of cable delivered interactive services. The New York State Cable Commission presented a very bleak picture to the court concerning the potential financial harm to consumers of franchised cable from unrestricted SMATV competition. Because of such "cream skimming," the New York Commission estimated that franchised cable systems would have to increase their rates to their remaining subscribers who did not have SMATV by \$7.00 to \$11.00 per month. The court, however, backed the FCC's view that it was not "an economic guarantor of competing communications technologies which may offer similar services to subscribers."⁵⁹

In the *Cox Commline* appeal, the telephone companies are likely to raise similar arguments concerning the adverse result of this analogous "bypass" by a competing technology. If the courts are consistent, arguments that telephone company customers may have their rates in-

58. National Ass'n of Regulatory Util. Comm'rs v. FCC, Nos. 85-1565, 85-1567 (D.C. Cir. filed Sept. 17, 1985). A second petition, asking that the Cox decision be extended to Colorado's PUC entry and tariff requirements, was subsequently filed by four cable operators. Joint Petition for Expedited Declaratory Ruling, Preemption of Colo. Regulation of Cable Television, Institutional and Non-video Servs., FCC File No. CCB DFD 85-35 (filed Nov. 12, 1985).

59. New York State Comm'n on Cable Television v. FCC, 749 F.2d 804, 814 (D.C. Cir. 1984).

creased as a result of FCC preemption of state barriers to cable's entry into data and other two-way services should not carry significant weight. Moreover, the District of Columbia Circuit broadly relied on the *Crisp* decision's affirmation of the FCC's broad powers to encourage diversity in satellite signal carriage to consumers. This diversity would also be spurred by the greater financial viability that carriage of ancillary services, like data transmission, home security, or shopping or banking at home, could provide to cable systems with excess capacity.

C. OTHER FCC ATTEMPTS TO PREEMPT

Cable has been strengthened by other recent FCC victories in its efforts to preempt conflicting state regulatory schemes. In 1984, for example, the Fourth Circuit held that if telephone facilities are used to provide both interstate and intrastate services, the FCC can preempt state methods of computing depreciation. The fact that the Communications Act reserved the authority to prescribe intrastate rates to the states, according to that court, cannot "be read as preserving the states' sphere of intrastate jurisdiction at the expense of an efficient, viable interstate telecommunications network."⁶⁰ "Frustration of federal objectives" was underlined by the court as a valid ground for FCC preemption of state regulation.⁶¹

Similar FCC efforts to preempt intrastate tariff restrictions on the resale of WATS services used to terminate interstate calls were also upheld by the District of Columbia Circuit.⁶² Previously, the FCC successfully preempted inconsistent state regulation Digital Termination Systems ("DTS"), also known as Digital Electronic Message Service ("DEMS"), which competes with both cable and telephone companies.⁶³ One of the planned uses of the Cox Cable Omaha two-way cable data facility was to provide an end loop for the DEMS links between several cities served by Cox Cable.

Another substantial boost to the cable industry has been the FCC's recent willingness to open radio broadcast subcarrier frequencies and spare lines of the television signal to use for new common carrier services. The FCC has preempted state entry barriers throughout this pro-

60. *Virginia State Corp. Comm'n v. FCC*, 737 F.2d 388, 392 (4th Cir. 1984), *cert. granted sub nom. Florida Pub. Serv. Comm'n v. FCC*, 105 S. Ct. 3498 (1985).

61. *Id.* at 396.

62. *National Ass'n of Regulatory Util. Comm'rs v. FCC*, 746 F.2d 1492 (D.C. Cir. 1984).

63. *In re Amendments of Parts 2, 21, 87, and 90 of the Commission's Rules To Allocate Spectrum For, and To Establish Other Rules and Policies Pertaining to, the Use of Radio in Digital Termination Systems for the Provision of Digital Communications Services*, 86 F.C.C.2d 360 (1981), *aff'd on reconsideration*, 90 F.C.C.2d 319 (1982), *petitions for review dismissed sub nom., Alascom, Inc. v. FCC*, 727 F.2d 1212 (D.C. Cir. 1984).

cess, despite the admittedly intrastate nature of these transmissions.⁶⁴ The FCC has boldly asserted that it has an obligation to promote new technologies under Title I of the Communications Act, and that it has the power under Title III of the Act to preempt all state statutes that conflict with its diversity, competition, and efficiency goals for use of the broadcast spectrum.

These statements could also be made about efficient and effective use of cable for delivery of these very same services. In January 1985, the FCC directly addressed the "bypass" argument in the context of allowing data and other telecommunications services to be carried over television stations. In answering the telephone company opponents of this plan, the FCC stated that such new entrants offering competitive telecommunications services over television facilities would not cause sufficient harm to justify a total ban on their entry.⁶⁵

D. ALTERNATIVE TELEPHONE COMPANY STRATEGIES TO BLOCK CABLE AND OTHER COMPETITIVE SERVICES

The telephone companies have adopted alternative strategies to try to block cable data services at the state PUC level. First, they are increasingly "bypassing" themselves. The Bell Operating Companies are not only setting up separate fiber optic Local Area Data Transport networks to serve business users, but also are acquiring cable's competitors for data traffic. These include DTS or "digital termination systems," which use a combination of satellite and terrestrial microwave to avoid the telephone company's local loop.

Secondly, they are seeking, with the aid of the FCC, to impose "access charges" on all customers and to lower some of their rates to meet competition. In addition, they seek to place special surcharges on lines leased to others that might be connected to bypass facilities, and subsidize discounts to major users that might otherwise be lost to bypass. In December 1984, the FCC agreed to a Joint Federal-State PUC Board recommendation that a one dollar per month "subscriber line charge" be imposed on residential and single line business customers. Furthermore, state regulators could impose a thirty-five cent surcharge to combat "localized bypass problems."

64. Use of Subsidiary Communications Authorization, Memorandum Opinion and Order, 49 Fed. Reg. 19,659 (1984) (codified at 47 C.F.R. pt. 22), *reconsideration denied*, FCC 84-531 (Jan. 25, 1985), *appeal pending sub. nom.*, *Telocator Network v. FCC*, No. 84-1190 (D.C. Cir. May 18, 1984); Amendment to the Commission's Rules To Authorize the Transmission of Teletext by TV Stations, Report and Order, 48 Fed. Reg. 27,054 (codified at 47 C.F.R. pts 2, 73, and 74), *reconsideration denied*, Memorandum Opinion and Order, FCC 84-529 (Jan. 24, 1985) (available on LEXIS, Fedcom library, FCC file).

65. Data Transmission on the Vertical Blanking Interval by TV Stations, FCC 84-530 ¶ 20 (Jan. 24, 1985) (available on LEXIS, Fedcom library, FCC file).

Cable interests have vigorously opposed these "discount bypass tariffs." They argue that, as the telephone industry envisions them, these tariffs are not targeted solely to block attrition from the local loop that might occur solely because of cost. These discount rates also may deter so-called "economic bypass" when there are sound technological or service reasons why high-capacity broadband cable may outperform telephone wire for certain purposes.⁶⁶

In this effort to stop special discounted tariffs, cable has been supported by the FCC's January 1985 "Bypass Study."⁶⁷ This study determined that to some extent large users have already left the local telephone company network, and that most "bypass" of the public network will in fact be created by the use of private lines provided by local telephone companies themselves. The FCC's own report states that neither intra-office communications nor local area network services, which comprise a large portion of experimental cable I-NET service in most markets, fall under the proper definition of "bypass." The report also contends that high speed data, which cannot easily be sent over telephone lines, and which is well suited for cable, does not really fall within the proper definition of "bypass."⁶⁸

Finally, the telephone companies are trying to enter the cable business. Since the local Bell Operating Companies were divested from AT&T, they have been looking for new ventures in which to invest. One is cable television. Barred by FCC rules from owning cable systems in the communities they serve, in several markets telephone companies have made bids directly to the city or to cable companies for franchises under so-called "leaseback" arrangements. The telephone company builds the system, then leases it back to a cable operator to manage, or leases it directly to a municipality.

Most alarming to the cable industry was the proposal made by Pacific Bell in 1983 to construct a cable distribution system for lease, not to a cable operator, but directly to the city of Palo Alto, California. Pacific Bell also proposed to construct a separate fiber optic institutional business network in the area to handle all of the lucrative data traffic, for which a competing cable operator might otherwise bid. If adopted, this proposal would have vested control in the municipality over cable programming, and encouraged Palo Alto to bypass cable operators altogether.

Opponents of the Pacific Bell plan, such as the California Cable

66. See, e.g. Reply Comments of NCTA, Commline, Inc., and Cal. Cable Television Ass'n, CC Docket Nos. 78-72, 80-286 (Jan. 23, 1985) (available on LEXIS, Fedcom library, FCC file).

67. FCC Report, Bypass of the Public Switched Network, CC Docket No. 78-72 (released Jan. 18, 1985) (available on LEXIS, Fedcom library, FCC file).

68. *Id.* at 8.

Television Association ("CCTA"), claimed that the proposal would encourage cross-subsidy by telephone ratepayers of the cable system, and adversely affect competitive video and non-video services. Combining telco-cable media power with the ownership by the municipality itself was the ultimate cable industry nightmare. The first amendment concerns of any exclusive cable franchising scheme were magnified by this potential union of the state and a vital speech medium like cable, with the monopoly power of telephone companies.

Palo Alto rejected the Pacific Bell proposal, but Pacific Bell left its section 214 application on file at the FCC until CCTA successfully won its dismissal.⁶⁹ Other more traditional leaseback arrangements made with third party cable operators, not the cities, in Brookfield, Wisconsin, and Washington, D.C., have, however, been approved by the FCC.⁷⁰

Eventually, a spirit of cooperation rather than confrontation may emerge between telephone carriers and cable operators. In a number of fields, telephone companies could pool their resources with cable's subscriber base and marketing expertise to deliver expanded services to consumers more efficiently than either could independently. For example, cable operators could offer pay-per-view movies to their subscribers, and telephone carriers could provide upstream signaling functions. Customers could order a program by dialing certain digits on a touch-tone telephone, triggering the automatic processing of the order. In fact, Pacific Bell has developed and is marketing a pay-per-view ordering system to California cable operators.

Other telephone companies are offering interconnects or "video-paths" to link independently owned cable systems in metropolitan regions to facilitate shared programming, advertising, or data transmission efforts. Telephone companies could also offer billing or repair services on a subcontract basis to cable operators. Pacific Bell is seeking agreements with cable companies under which Pacific Bell would market cable services on a contracted-out basis to new telephone customers as part of their normal new order intake mechanism. In Atlanta, a cooperative venture between cable, telephone, and utility companies, called TranstexT, began in January 1985 to offer an interface box for those three lines into the home.⁷¹ The box is connected to a remote computer

69. Pacific Bell, Letter from James R. Keegan, Chief, FCC Domestic Facilities Division, to Steven M. Harris, No. W-P-C-5384 (Oct. 29, 1984).

70. See Wisconsin Bell, Inc., No. W-P-C-5348 (released Aug. 30, 1984), *review denied*, FCC 84-618 (released Dec. 13, 1984) (available on LEXIS, Fedcom library, FCC file); C&P Tel. Co., No. W-P-C-5511, FCC 85-48 (Jan. 30, 1985) (available on LEXIS, Fedcom library, FCC file). Palo Alto subsequently decided to approve this form of leaseback between one of its local cable applicants and Pacific Bell.

71. See *Cable, Telephone, Utility Companies Launch TranstexT*, CABLEVISION, Jan. 28, 1985, at 25.

offering a complete range of energy management, home security, information, and entertainment services.

With a large and growing market for sophisticated video and data transmission services at stake, however, neither side is likely to move to rapid accommodation without a signal from either Congress, the FCC, or the courts. Until one of these bodies finally determines the appropriate balance between state and federal regulation of cable data services, both cable and telephone interests can be expected to press their cases for entry into the other's business, and to try to block entry into their own field.

V. THE NEWEST COMPETITIVE BATTLEGROUND: "SMART" BUILDINGS AND TELEPORTS

While cable and telephone interests have been opposing each other before Congress, the courts, the FCC, and the state PUCs during the past several years, a similar battle has started at the state level. This confrontation is between the telephone companies and two new "bypassers"—shared multi-tenant communications services in office buildings, and teleport facilities allowing city-wide direct access to multiple satellites.

Teleport facilities, also known as "satellite antenna farms," receive and deliver data from business users by microwave, fiber optic link, or cable. Sometimes they are created in conjunction with an office park real estate development. At other times they are placed in an area outside city limits to reduce frequency interference. The larger teleports built or proposed for areas outside major metropolitan centers, such as Washington, D.C., New York, and Dallas, are already facing competition from developers who have decided to repackage the concept in a more modest form and adapt it for individual buildings.

Office developers are creating "smart" buildings by installing a large, feature-packed Private Branch Exchange ("PBX"), and offering high-tech services to tenants. These tenants might not otherwise be able to afford the enhanced high speed data links, teleconferencing, electronic messaging, automatic billing, and least cost routing of long distance calls offered by the developer, along with total maintenance of the shared tenant services ("STS") facility. In effect, the sophisticated PBX of the developer acts as a mini-central telephone office for these tenants. This reduces the number of local access circuits required to be purchased from the telephone company. The developer makes a profit by a mark-up on the resale of communications services obtained at bulk rates.

These recent developments have increased concern among state regulators, just as cable has since an earlier time. Because teleports and

STS operators are "resale carriers," they are removed from detailed FCC entry and tariff oversight under the "competitive carrier" concept.⁷² The system configurations of these operators may require microwave licenses from the FCC, but otherwise they will escape FCC scrutiny. From the state PUC point of view, however, there is simply no such thing as a good "bypassers" to the local telephone company, even though "bypassers" really only increase competition in the field.

Those who offer these services claim to the PUCs that customers are not signing up just to get cheaper rates from the resale of long distance services. They stress that STS can provide greater privacy, convenience, reliability, response time to outages, and enhanced customer control. Tenants seek shared PBX or teleport services out of frustration from delays and lack of efficient technological options offered by the telephone companies.

Linking "smart" buildings with teleports can offer greater multiple satellite access and high band width/faster bit rate transmissions to STS building tenants. As in other areas, sometimes the distinction between the two categories is blurred. Is a large, internally cable-wired building complex, with its own sophisticated PBX and its own satellite farm on the roof, a "teleport," or is it still a "smart" building, or is it both?

Several PUCs have been forced to address these issues directly. The New York State PSC gave Teleport Communications a certificate of public convenience and necessity to resell services in that state, subject to the outcome of the PSC's pending omnibus "bypass" proceeding, which also involves cable.⁷³ Several states have approved local resale by "smart" building developers, including Arizona and Illinois, but require the STS provider to give tenants the option to hook up directly to the local exchange company.⁷⁴ The Texas PUC rejected a petition by Southwestern Bell, which sought a PUC declaration that certified local telephone companies were the only legal providers of local exchange, and to ban resellers including STS providers.⁷⁵ Southwestern Bell was more successful in Arkansas, which agreed to ban resale of local exchange.⁷⁶ California technically prohibits the resale of local service, but allows STS to operate informally under a Pacific Bell joint user tariff. This arrangement permits a mark-up for management and billing services, but no profit on resale of long distance service.⁷⁷ Colorado and

72. *In re* Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor. Second Report and Order, 91 F.C.C.2d 59, 61-63 (1982).

73. See *At the LATA Level 6* (Jan. 21, 1985).

74. *State Tel. Regulation Report 2* (Jan. 31, 1985).

75. *Tex. PUC, Final Order, No. 5827* (Nov. 21, 1984).

76. *Telecommunications Reports 17* (Jan. 7, 1985).

77. *State Tel. Regulation Report 2* (Jan. 31, 1985).

other states similarly ban resale, or are considering that position.⁷⁸

In response to such restrictive regulations either in place or under consideration by the states, IBM, in May 1985, filed a petition with the FCC asking that it preempt state regulation of STS services.⁷⁹ The petition argued that the competitive benefits of advanced communications systems should be extended to small users or occupants of buildings, just as they have been extended to large users who can afford their own systems. The petition also argued that preemption would be a logical extension of the FCC's policies preempting state regulation of customer premises equipment and intrasystem wiring. The petition pointed to the widely diverse approaches to STS systems taken by state regulatory authorities. Not surprisingly, many state PUCs, including some that currently allow provision of STS service, opposed federal preemption.⁸⁰ In January 1986, the FCC rejected IBM's request that it bar states from preventing STS resale of local service. It did, however, grant IBM's request that STS users have a right to connect to the public telephone network, and initiated a broad inquiry into the impact of STS on local telephone service.⁸¹

In many states, such as Indiana, South Carolina, and Georgia, the local telephone companies have ceased to take a hard line on "smart" buildings. Like King Canute, they have recognized that they cannot hold back the waves. Instead, they are filing usage-sensitive trunk tariffs seeking to recover a portion of their revenues from STS resellers. Building developers appear to be ready to compromise, but they seek a flat PBX rate only slightly higher than the rate for normal PBX trunks.⁸²

The former Bell Operating Companies are also entering the teleport business, or seeking to build their own "smart" buildings. Ohio Bell has already become a twenty percent owner/investor in the Ohio Teleport Corporation, which is building a Columbus facility.⁸³ Pacific Bell has announced its intention to compete "vigorously" in this market.⁸⁴ For a Bell Operating Company to become an STS provider, however, will require a waiver of the Consent Decree, since it is a new line of business that does not fit the Consent Decree criteria for allowed

78. At the LATA Level 2-3 (Jan. 14, 1985).

79. *In re IBM Corp., Request for Declaratory Ruling re State Regulation of Shared Telecommunications Services Systems*, FCC File No. ENF 85-45 (filed May 16, 1985) (available on LEXIS, Fedcom library, FCC file).

80. At the LATA Level 1-3 (June 3, 1985).

81. Memorandum Opinion and Order, FCC 86-25 (Jan. 14, 1986).

82. See At the LATA Level 2-3 (Jan. 21, 1985).

83. Holmes, *Teleports Catch On But Face Competition*, DATA COMMUNICATIONS, Oct. 1984, at 64, 66.

84. Communications Daily 8 (Aug. 23, 1984).

Bell Operating Company communications service offerings. Ameritech filed such a waiver request in August 1984, which was strongly opposed by the Justice Department.⁸⁵ In December 1984, Ameritech withdrew its request rather than risk rejection by the court.⁸⁶ In January 1985, however, Ameritech refiled its motion for clarification. The Justice Department again opposed the motion, arguing the provision of STS was prohibited by the Consent Decree and, thus, that a waiver request would be necessary. In January 1986, Judge Greene denied the motion for clarification, and held that Ameritech must file for, and be granted, a waiver in order to provide STS service.⁸⁷ Requests by two other Bell Operating Companies, U.S. West and Pacific Telesis, to enter the real estate market were approved under the condition that they not provide the STS in such buildings.⁸⁸

VI. THE FUTURE LANDSCAPE OF COMMUNICATIONS REGULATION

Since national public policy solidly favors innovation and technological growth in communications, it is unlikely that federal regulators will be convinced to turn back the clock to protectionist policies. These past policies favored making the broadcaster the sole provider of video services, and making the telephone companies the sole provider of non-video communications services. In exchange for these protective positions certain public policy requirements were imposed. The significant costs incurred in allowing competition to go forward means there is little chance of returning to traditional policies. It is also unlikely that federal regulators will allow the states to frustrate their movement toward allowing competition for both the video and data services sought by the new information society.

Thus, the final resolution will most likely be in favor of open entry of competitors in both fields. This will include letting all new video delivery systems flourish with minimal regulation. This resolution will also result in cable entry into data delivery. Teleports and "smart" building developers will begin to resell more communications services.

The tradeoff for this new competition is likely to be increased pres-

85. See Response of the United States to Ameritech's Request for Clarification and Waiver of the Decree Regarding the Offering of Shared Communications and Related Services to Tenants, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. Aug. 27, 1984).

86. Memorandum of Judge Greene, *United States v. Western Elec. Co.*, No. 82-0192, slip. op. at 6, n.14 (D.D.C. Dec. 14, 1984).

87. Memorandum of Judge Greene, *United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. Jan. 13, 1986).

88. Memorandum of Judge Greene, *United States v. Western Elec. Co.*, No. 82-0192, slip. op. at 14-16 (D.D.C. Dec. 14, 1984).

sure on the FCC and state PUCs to allow the former monopoly players to move into new fields from which they have been previously restricted. Broadcasters have already been allowed by the FCC to expand into new markets such as paging, data, and teletext. They also have been allowed to group themselves in more powerful combinations because of the abolition of the former FCC rule that restricted a single group owner to fewer than seven AM, seven FM, and seven television stations.⁸⁹ Group owners will now be allowed to own up to twelve television stations, so long as their interests reach no more than twenty-five percent of the national audience.

Despite their efforts over several decades to block cable, broadcasters today actually own much of the cable industry. While they are barred from owning cable outlets in communities where they own broadcast stations, broadcast chains have become major players in other cities. Nor have broadcasters been blocked from entering the MDS, SMATV, and DBS markets. Until noncross-owned new media outlets hold a much greater share of the video market, however, basic content and structural restraints on the dominant commercial television broadcasters should not be loosened further.

It is also likely that telephone companies, including the former Bell Operating Companies, will be allowed into competitive non-video markets on a deregulated basis. As noted previously, many Bell Operating Companies are already acquiring DTS or other competing systems.⁹⁰ Additional steps toward increased competition should be taken under close supervision until regulators can be certain that the Bell Operating Companies will not indulge in the types of predatory practices that marked their response to competition in the past.

Some of the Bell Operating Companies are already pushing hard for faster deregulation. Mountain Bell, for example, has had legislators introduce comprehensive deregulation legislation in most of the states it serves. The Colorado bill, which is a model for the other states, would exempt twenty-three services from any regulation, including data transmission, home banking and shopping, teletext, paging, and private line services. The PUC is mandated to permit more than one provider of intrastate telecommunications in any area except for "basic exchange service." Resale would be allowed only at "compensatory" rates. The Mountain Bell bill failed to be passed during the 1985 Colorado legislative session, but it is expected to be reintroduced in 1986.

It is fascinating to watch the Bell Operating Companies embracing

89. Multiple Ownership of AM, FM and Television Broadcast Stations, 50 Fed. Reg. 4666 (1985) (to be codified at 47 C.F.R. pt. 73).

90. See, e.g., DTS Applications of Pacific Bell, FCC File No. 1005 CDM-P-83 (released Nov. 8, 1984).

competition. The telephone companies are hardly paralyzed today, while their competitors, such as cable, DTS, teleports, cellular mobile radio, ancillary broadcast services, or STS, are just getting started. As FCC Commissioner Mimi Dawson noted at a recent meeting of the American Teleport Association:

For now, the local exchange carriers have entered the DTS and cellular markets; they're building cable systems and offering them on a common carrier basis and they're laying fiber I don't think it would be wise for any telecommunications competitor to assume that the BOCs will be left behind on a long term basis either in the area of technology or competitive pricing opportunities.⁹¹

But the "level playing field" cannot be created overnight. The telephone companies still have huge embedded advantages, including a captive monopoly ratepayer base, which produces a PUC-protected revenue stream. This gives the Bell Operating Companies a tremendous advantage in seeking capital financing for newer, more speculative ventures.

The Bell Operating Companies are not suffering in the interim. Despite all the new competitors for their markets, and all the complaints about "cream skimming" by cable, "smart" buildings, teleports, and other "bypassers," the Bell Operating Companies had an excellent fiscal year in 1984 by all financial standards. They still dwarf any new entrant. Thus, the approach taken by the Senate in its unsuccessful version of the Cable bill⁹² may be the best solution.

Under that bill, passed by the Senate in June 1983, states would have been barred from regulating or restricting offerings by competitors to telephone companies offering telecommunications services (in this case cable systems), except for "basic telephone service." Basic telephone service was defined narrowly as the actual provision of switched voice service. States could require the filing of informational tariffs for other intrastate telecommunications services offered by cable, but could not block the tariffs from going into effect.

The tradeoff in the Senate Cable bill was that the states were required to deregulate intrastate telecommunications services for all participants, including the telephone companies, if they eventually found that such services were subject to "effective competition." Unlike the approach of the Mountain Bell Colorado bill, however, "effective competition" meant a great deal more than simply the appearance of one additional provider of the service. To be subject to effective competition in a particular geographic area or market under the Senate Cable bill, there had to be "reasonably available alternatives."

91. M. Dawson, Remarks at the Meeting of the American Teleport Association (Jan. 28, 1985).

92. S. Res. 66, 96th Cong., 1st Sess. 8291-98 (1983).

In determining such "reasonably available alternatives," the state was required to consider the number and size of the other providers of services, and the extent that services were available from those providers at comparable rates, terms, and conditions to those of the telephone company. The Senate made it clear that this was far more than simply declaring the need for regulating the Bell Operating Companies at an end as soon as a single competitor appeared on the horizon.

The goals of totally competitive video and non-video markets are currently agreed upon by a larger proportion of the communications industry, the Congress, the FCC, and state regulators than ever before. But the debate over how far, how fast, and under what conditions the next steps should be taken is not likely to be soon resolved.