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TELECOMMUNICATIONS COMMENTS

PREPARING FOR TELCO-CABLE CROSS-OWNERSHIP: ARE EXISTING AND PROPOSED REGULATORY SAFEGUARDS SUFFICIENT TO DETER ANTI-COMPETITIVE CONDUCT?

INTRODUCTION

Telecommunications technology is rapidly changing. Television, telephone, and computer services are converging and creating an information revolution.¹ In fact, the Clinton Administration recently released a national telecommunications policy statement² detailing a plan to modernize the national information infrastructure and create an advanced information superhighway.³

Two pressing questions confront lawmakers as they contemplate the future of the telecommunications industry. First, should local telephone companies ("telcos") be allowed to enter the market for video services, such as cable television? Second, should the monopoly for local telephone exchange service be opened to competition?⁴

As part of its telecommunication policy statement, the Clinton Administration committed to introducing legislation by the end of 1994 that will repeal the current telephone company-cable television cross-ownership restrictions ("telco-cable cross-ownership restrictions").⁵ These restrictions

1. National Cable Television Association, Building a Competitive Local Telecommunications Marketplace: Summary in Brief (Oct. 1993) (unpublished manuscript, on file with the *California Western Law Review*).

2. Information Infrastructure Task Force, The National Information Infrastructure: Agenda for Action (Sept. 15, 1993).

3. The policy statement described the information superhighway as "a seamless web of communications networks, computers, databases, and computer electronics that will put vast amounts of information at users' fingertips." *Id.* at 3.

4. National Cable Television Association, Building a Competitive Local Telecommunications Marketplace 1 (Oct. 1993) (unpublished manuscript, on file with the *California Western Law Review*) [hereinafter NCTA Position Paper].

5. Information Infrastructure Task Force, *supra* note 2, at 8. The Administration is proposing Title VII, an amendment to the 1934 Communications Act that would create a new regulatory scheme for multimedia companies. Vincente Padeloup, *Telcos, Clinton, Congress Lining Up on the On-Ramp*, CABLE WORLD, Jan. 31, 1994, at 1, 4.

Under the plan, cable television companies could deliver local telephone exchange services and telcos could deliver video programming services. In addition, video programmers would have non-discriminatory access to cable television and telco distribution systems. Furthermore, telcos would not be permitted to buy cable television systems in their local telephone exchange service areas. Finally, telecommunications companies that offer two-way broadband interactive switched video services to 20 percent of the customers in their state could opt to be regulated under Title VII. Rates for these companies would be unregulated unless the Federal

prohibit telcos from offering cable television services to customers in their local telephone exchange service areas.⁶ By repealing the cross-ownership restrictions, the Administration seeks to expand competition in the information services market and promote private sector investment in the national information infrastructure.⁷ The Administration believes the expanded competition will encourage companies to invest in building the information superhighway and to develop new information services for consumers and businesses.⁸

While lawmakers and industry experts are generally in favor of repealing the cross-ownership restrictions,⁹ they are concerned about the effect of the repeal on the telecommunications industry.¹⁰ This article considers the implications of telco-cable cross-ownership and whether existing and proposed regulatory safeguards are sufficient to deter anti-competitive conduct. Section I of the article reviews the history of the current cross-ownership restrictions. Section II examines the benefits of telco-cable cross-ownership. Section III describes pending legislation aimed at repealing the telco-cable cross-ownership restrictions. Section IV explores the potential for telcos to engage in anti-competitive conduct if the cross-ownership restrictions are repealed. Section V analyzes the effectiveness of existing and

Communication Commission finds the company monopolizes a market where it supplies some kind of service. Matt Stump, *Gore's Speech: Devil's in Details*, CABLE WORLD, Jan. 17, 1994, at 1, 47. As of April 1994, Title VII has not been sponsored or supported by a single legislator.

6. 47 U.S.C.A. § 533(b) (West Supp. 1993). Specifically, the Act provides: "It shall be unlawful for any common carrier . . . to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier." *Id.*

7. Information Infrastructure Task Force, *supra* note 2, at 7-8.

8. *Id.* Although it is too early to predict the scope of the services that will be available on the information superhighway, consumers can look forward to home shopping, home banking, interactive television, and access to libraries and educational institutions nationwide. Mike Mills, *Spirit of Cooperation Breaks Media Industry Gridlock*, CONG. Q., Jan. 15, 1994, at 64, 64.

The information superhighway will allow business users to connect with customers and suppliers easily and inexpensively, gather competitive data, and improve communications among employees. Andy Reinhardt, *Building the Data Highway*, BYTE, Mar. 1994, at 46, 46. Applications facilitated by the highway, such as video conferencing, could reduce business travel expenses and encourage telecommuting. *Id.*

9. Mills, *supra* note 8, at 64. See also Kim McAvoy, *Markey's Goal: Two Wires in Every House*, BROADCASTING & CABLE, Nov. 15, 1993, at 26, 26; Kim McAvoy, *Markey Invites Telco Entry*, BROADCASTING & CABLE, Oct. 11, 1993, at 47, 47; Daniel Pearl, et al., *First White House Signal Has Look of a Green Light*, WALL ST. J., Oct. 14, 1993, at A6.

10. Kim McAvoy, *Telco Bill Divides Cable, Broadcasters*, BROADCASTING & CABLE, Oct. 11, 1993, at 47, 47; Geoffrey Foisie, *There's Space for All on the Superhighway*, BROADCASTING & CABLE, Nov. 15, 1993, at 27, 27-28.

One specific concern of legislators is how to preserve "universal service," the social compact of the 1934 Communications Act which promises all people access to communications services regardless of income or geography. Mills, *supra* note 8, at 67, 68. As part of any new regulatory scheme, legislators must determine how and when to expand the definition of universal service in such a way that it includes new technologies which are vital to an individual's participation in society. *Id.*

proposed regulatory safeguards designed to deter anti-competitive conduct. Finally, Section VI argues that competition for local telephone exchange services is the only adequate deterrent to telco anti-competitive conduct.

I. HISTORY OF THE TELCO-CABLE CROSS-OWNERSHIP RESTRICTIONS¹¹

A. Origins

The telco-cable cross-ownership restrictions are comprised of federal regulations, federal legislation, and provisions contained in the Modified Final Judgment, the consent decree between AT&T and the Department of Justice.¹²

1. Federal Regulations

The Federal Communications Commission ("FCC"), the agency which regulates both the telephone and cable television industries, first imposed cross-ownership restrictions in 1970.¹³ The restrictions were designed to encourage the development of a cable television industry separate from the telephone industry.¹⁴ At the time, the FCC was particularly concerned with preventing telcos from discriminating against unaffiliated cable television operators, who required access to utility poles and underground conduits to build their cable television distribution systems.¹⁵

11. See generally Nicholas W. Allard & Theresa Lauerhass, *Debalkanize the Telecommunications Marketplace*, 28 CAL. W. L. REV. 231 (1992); Philip J. Boeckman, *The Effects of Recent Developments on the TELCO/CATV Cross-Ownership Prohibitions*, 56 MO. L. REV. 1069 (1991); Donald J. Boudreaux & Robert B. Ekelund, Jr., *The Cable Television Consumer Protection and Competition Act of 1992: The Triumph of Private Over Public Interest*, 44 ALA. L. REV. 355 (1993); Daniel Brenner, *Telephone Company Entry Into Video Services: A First Amendment Analysis*, 67 NOTRE DAME L. REV. 11 (1991); Allen S. Hammond, IV, *Regulating Broadband Communication Networks*, 9 YALE J. ON REG. 181 (1992); Jane A. Strachan, *Untangling the Regulatory and Legal Wires to Telephone and Cable Television Technology*, 11 BRIDGEPORT L. REV. 599 (1991); Laurence H. Winer, *Telephone Companies Have First Amendment Rights Too: The Constitutional Case for Entry Into Cable*, 8 CARDOZO ARTS & ENT. L.J. 257 (1990); Shaun Christensen, Comment, *Cable Television: Competition and the First Amendment*, 37 S.D. L. REV. 566 (1992).

12. The Modified Final Judgment settled an antitrust suit brought against AT&T by the Department of Justice. It led to the divestiture of AT&T in 1986. See generally *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom*, *Maryland v. United States* 460 U.S. 1001 (1983).

13. JAMES C. GOODALE, ALL ABOUT CABLE § 2.15[3], at 2-70 (1993).

14. *Id.* at 2-71.

15. Rather than construct their own, cable television operators lease space on telco utility poles and underground conduits. See generally John P. Morrissey, Comment, *Equal Access to Pole Attachment Agreements: Implications of Telephone Company Participation in the Cable Television Market*, 18 BALT. L. REV. 165, 165 (1988).

Prior to the promulgation of the cross-ownership restrictions, the FCC conducted rule-making proceedings. Evidence presented during those proceedings suggested that some telcos were using their control over the utility poles and underground conduits to deter competition. Some of the anti-competitive practices noted included: arbitrarily refusing to lease space to

2. The Cable Communications Policy Act of 1984

The FCC's cross-ownership restrictions were codified in The Cable Communications Policy Act of 1984 ("The 1984 Cable Act").¹⁶ The Act prohibits telcos or their affiliates from offering cable television service in their local telephone exchange service areas.¹⁷ However, the Act permits telcos to construct cable television distribution systems for lease to cable television operators on a common-carrier basis.¹⁸ In addition, the Act provides for a waiver of the cross-ownership restrictions in rural areas where cable television service would otherwise be unavailable and for other good cause.¹⁹

3. The Modified Final Judgment

The Modified Final Judgment placed additional restrictions on the Regional Bell Operating Companies ("Regional Companies").²⁰ Specifically, the consent decree prohibited the Regional Companies from engaging in three lines of business: long-distance telephone exchange service, information services,²¹ and telecommunications equipment manufacturing.²² The court approving the consent decree imposed the line of business restrictions to prevent the Regional Companies from using their local telephone exchange service monopolies to impede competition in industries, such as cable television, which are dependent on access to their facilities.²³

cable television operators for their distribution networks, charging excessive rents, placing unreasonable restrictions on the use of cables attached to poles, and pressuring cable television operators to lease distribution networks built by telcos in lieu of constructing their own. Daniel Brenner, *supra* note 11, at 18 n.20.

16. 47 U.S.C.A. § 533(b) (West, Supp. 1993). *See supra* note 6 for the specific language of the statute.

17. *Id.*

18. *Id.*

19. Whether good cause exists is determined by the FCC in its discretion. *Id.* The FCC determined that "good cause" may include "public interest and need showings which may demonstrate in particular cases the general benefits which could flow from joint operation of cable television and telephone facilities." 69 F.C.C. 2d 1097, 1110-11 (1978).

20. Under the terms of the Modified Final Judgment, AT&T was required to divest its 22 affiliated local telephone companies. The local telephone companies were grouped into seven Regional Companies. The Regional Companies (in order of size) are: Bell Atlantic, BellSouth, Ameritech, NYNEX, Pacific Telesis, U S West Communications, and Southwestern Bell. NATIONAL CABLE TELEVISION ASSOCIATION, TELEPHONE COMPANY PRIMER 2-3 (1991).

21. "Information services" includes cable television services. *Id.* at 4.

22. *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 189-190 (D.D.C. 1982), *aff'd sub nom*, *Maryland v. United States*, 460 U.S. 1001 (1983).

23. *Id.*

B. Recent Developments Affecting the Cross-Ownership Restrictions

Recent changes in federal regulations, federal legislation, and the Modified Final Judgment have foreshadowed the repeal of the cross-ownership restrictions.

1. New Federal Regulations

In the late 1980's, the FCC began to reevaluate the need for the cross-ownership restrictions.²⁴ In 1988, the FCC granted a temporary waiver of the restrictions to General Telephone Company of California to construct and maintain a fiberoptic cable television system for a cable television operator in Cerritos, California.²⁵ The terms of the waiver permitted General Telephone to lease back half of the system's channel capacity to test new video delivery services.²⁶ Although the arrangement was barred by the cross-ownership restrictions and did not meet the usual requirements for a waiver, the FCC approved the waiver based on the potential technological benefits of General Telephone's testing.²⁷

In 1992, the FCC made an interim move toward lifting cross-ownership restrictions by allowing telcos to offer video dialtone service²⁸ to customers in their local telephone exchange service areas.²⁹ Although video dialtone service is similar to cable television service, video dialtone service does not

24. Goodale, *supra* note 13, at 2-74.

25. *Id.* § 2.15[4], at 2-82.

26. *Id.*

27. *Id.* at 2-83. Because General Telephone financed the construction of the project, the National Cable Television Association and the California Cable Television Association appealed the waiver. The United States Court of Appeals for the District of Columbia Circuit reversed the FCC's decision and remanded the case to the FCC to explain why "good cause" existed for such financing arrangements. See *National Cable Television Ass'n v. FCC*, 914 F.2d 285 (D.C. Cir. 1990). Unable to justify the financing arrangements, the FCC rescinded the waiver on November 9, 1993, seven months before it was scheduled to expire. Vincente Padeloup, *FCC Pulls Plug on Cerritos*, CABLE WORLD, Nov. 15, 1993, at 4, 4.

28. Video dial service allows consumers to dial into such services as video programming, videotext, video gateways, and video processing. Goodale, *supra* note 13, §2.15[4] at 2-77. See also NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION, VIDEO PROGRAM DISTRIBUTION AND CABLE TELEVISION: CURRENT POLICY ISSUES AND RECOMMENDATIONS (1988).

29. Telephone Company-Cable Television Cross-Ownership Rules, 7 F.C.C.R. 5781 (1992) (Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking) (hereinafter Video Dialtone Order).

As part of the Video Dialtone Order, telcos choosing to offer video dialtone service are required to make the service available to video programming suppliers on a nondiscriminatory common-carrier basis. In addition, the order permits telcos to provide some additional enhanced, non-common-carrier services to video programming suppliers. These services include: billing and collection, order processing, video customer premises equipment, and inside wiring. Federal Communications Commission, Action in Docket Case Local Telephone Companies to be Allowed to Offer Video Dialtone Services; Repeal of Statutory Telco-Cable Prohibition (CC Docket 87-266), Report No. DC-2174 (1992), available in LEXIS.

allow telcos to provide cable television services directly to the subscriber.³⁰ Instead, telcos act as a common-carrier by connecting an independent video programming supplier to the subscriber.³¹

In 1992, the FCC also permitted Cox Enterprises, Inc., a large cable television operator, to purchase a 50.1% interest in Teleport Communications Group, Inc., a company which provides various telephone and data transmission services.³² In reaching its decision, the FCC interpreted the cross-ownership restrictions to apply solely to dominant local telcos, specifically the Regional Companies.³³

2. The Cable Television Consumer Protection and Competition Act of 1992

At the same time the FCC was reevaluating the cross-ownership restrictions, the cable television industry was facing growing consumer dissatisfaction with escalating cable rates and poor service quality.³⁴ In response to this consumer dissatisfaction, Congress passed The Cable Television Consumer Protection and Competition Act of 1992 ("The 1992 Cable Act").³⁵ The Act's purpose is "to provide increased consumer protection³⁶" and "to promote increased competition in the cable television and related markets."³⁷ The FCC, the Department of Justice, and other industry experts recommended that Congress repeal the cross-ownership restrictions and permit telcos to compete with cable television operators.³⁸

30. Video Dialtone Order, *supra* note 29, at 5817.

31. *Id.* The Video Dialtone Order was intended to accomplish: (1) increased investment opportunities for the development of an advanced telecommunications infrastructure; (2) additional competition in the video and communications markets so that free market forces, rather than government regulation would determine the success or failure of new services; and (3) a diversity of video services in order to create additional opportunities for consumer choice. *Id.* at 5787. However, without assurances that they would be more than a common-carrier conduit for video programming, telcos have been reluctant to enter the video services market. Andrew C. Barrett, *Shifting Foundations: The Regulation of Telecommunications in an Era of Change*, 46 FED. COMM. L.J. 39, 52 (1993).

32. Goodale, *supra* note 13, §2.15[3] at 2-76. Cox owns 50% of the cable television system serving Staten Island, New York. Teleport provides telecommunications services to the same area. *Id.*

33. *Id.*

34. *Hill Enacts Cable TV Law Over Veto*, CONG. Q. ALMANAC, 1992, at 171. The Government Accounting Office documented that since deregulation of the cable industry in 1984, the rates for cable television service and equipment increased at more than three times the rate of inflation. Edward J. Markey, *Cable Television Regulation: Promoting Competition in a Rapidly Changing World*, 46 FED. COMM. L.J. 1, 2 (1993). See also S. Rep. No. 92, 102 Cong., 2d Sess. (1992), reprinted in 1992 U.S.C.C.A.N. 1133.

35. Pub. L. No. 102-385, 106 Stat. 1460 (codified at 47 U.S.C. §§ 521-609).

36. *Id.*

37. *Id.*

38. See generally Brenner, *supra* note 11; Winer, *supra* note 11. See also Video Dialtone Order, *supra* note 29, at 5847; *United States v. Western Electric Company, Inc.* 767 F. Supp. 308, 321-322 (D.D.C. 1991), *aff'd*, 993 F.2d 1572 (D.C. Cir. 1993).

These industry experts believe that competition in the cable television industry would lower prices and improve service, and that telcos were in the best position to offer competition to cable television operators.³⁹

Despite these recommendations, Congress declined to include such a provision in the Act. Instead, Congress decided to regulate cable rates and impose horizontal⁴⁰ and vertical⁴¹ ownership restrictions.⁴² Through these regulations, Congress intended to foster other methods of delivering video programming such as: wireless cable systems,⁴³ direct broadcast satellite systems,⁴⁴ and satellite master antenna television systems.⁴⁵

39. See generally Allard & Lauerhass, *supra* note 11; Boeckman *supra* note 11; Christensen, *supra* note 11; Strachan, *supra* note 11. Cf., LELAND L. JOHNSON, TELEPHONE COMPANY ENTRY INTO CABLE TELEVISION: COMPETITION, REGULATION, AND PUBLIC POLICY 9-11 (Rand Corp., 1992) (Suggesting that cable television operators have an inherent advantage over telcos in the video programming services market, and that direct broadcast satellite service providers pose stronger competition for cable television operators).

For more information on direct broadcast satellite service and its threat to cable television operators see Leslie Ellis, *Direct Broadcast Satellite: Cable's Worst Nightmare*, CED, Mar. 1994, at 28.

40. Horizontal ownership refers to the share of subscribers served by individual cable television operators through their ownership or control of local cable television systems. In the Matter of Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal and Vertical Ownership Limits, FCC NO. 93-456, available in WESTLAW (Oct. 22, 1993), at 3 [hereinafter Cable Television Ownership Limits].

At the time The 1992 Cable Act was passed, the top five cable television operators served almost half of the nation's cable television subscribers. *Id.* By requiring horizontal ownership restrictions, Congress sought to prevent large cable television operators from "creating barriers to entry for new video programmers, and from causing a reduction in the number of media voices available to consumers." *Id.*

The horizontal ownership restrictions established by the FCC prohibit any one company from providing cable television service to more than 30% of the homes passed nationwide. *Id.* at 1. To promote diversity, the FCC permits the ownership of additional cable television distribution systems, up to 35% of homes passed nationwide, if the additional systems are minority-controlled. *Id.*

41. Vertical ownership refers to common ownership of both video programming and distribution systems. *Id.* at 11.

The FCC noted that large cable television operators own equity interests in thirteen of the top twenty national basic cable networks and in six of the top eight pay channels. *Id.* By requiring vertical ownership restrictions, Congress sought to ensure "non-cable affiliated or competing programmers [can] secure carriage on vertically integrated cable systems." *Id.* at 11.

The vertical ownership restrictions established by the FCC require cable television operators to limit channel occupancy by affiliated video programming suppliers to no more than 40% of a system's channel capacity. *Id.* at 2. To promote diversity, the FCC permits the carriage of two additional channels, or up to 45% of a system's channel capacity, if the video programming suppliers are minority-controlled. *Id.* These channel occupancy limits only apply to the first 75 channels. *Id.* Additional channel capacity is not subject to any channel occupancy limits. *Id.*

42. Pub. L. No. 102-385, 106 Stat. 1460 (codified at 47 U.S.C. §§ 521-609).

43. Wireless cable systems transmit an omnidirectional microwave signal to homes, hotels and apartment buildings equipped with directional microwave antennae. The signal is unscrambled by a decoder box, which is provided in return for a subscription fee. Wireless cable has a range of twenty-five to thirty-five miles. Until recently, the FCC allotted only a small portion of the microwave radio spectrum for wireless cable and permitted only two channels to operate in any given market. Goodale, *supra* note 13, § 5.02[1] at 5-6.

44. Direct broadcast satellite systems use high power satellites to deliver signals to satellite dish antennae at homes, hotels and apartment buildings. *Id.* § 5.02[2], at 5-8.

Congress thought that once these methods of delivering video programming services were sufficiently developed, they would provide adequate competition for cable television operators.⁴⁶

Since the Act's passage, experts have criticized its effectiveness. First, they argue that alternative methods of delivering video programming will never pose direct competition to cable television operators because these methods of delivery are utilized primarily by subscribers in rural areas who do not have access to cable television services.⁴⁷ Secondly, they argue the Act conflicts with the Administration's goal of creating an information superhighway because without direct competition cable television operators have no immediate incentive to construct fiberoptic distribution networks.⁴⁸ Similarly, unless telcos are permitted to provide cable television services, they also have no incentive to construct fiberoptic distribution networks.⁴⁹

3. Lifting the Information Services Restrictions in the Modified Final Judgment

While the FCC and Congress were contemplating the appropriate regulatory scheme for the cable television industry, the Regional Companies were challenging the continuing need for the line of business restrictions. In 1991, the court overseeing the Modified Final Judgment lifted the information services restriction.⁵⁰ The court's decision cleared the way for the Regional Companies to enter the cable television business once the cross-ownership restrictions are repealed.

45. Satellite master antenna television ("SMATV") systems use antennae and earth stations to capture UHF, VHF and domestic communications satellite signals and distribute them by wire to individual dwelling units in hotels and apartment complexes. *Id.* § 5.02[4], at 5-13. SMATV systems enjoy two significant regulatory advantages over cable television systems. First, SMATV systems are not subject to the same service requirements imposed by the FCC on cable television systems. Second, federal law often preempts state and local regulation of SMATV systems. *Id.*

46. *Id.*

47. Boeckman, *supra* note 11, at 1088-90.

48. *Id.*

49. Strachan, *supra* note 11, at 604.

50. *See* United States v. Western Electric Co. Inc., 767 F. Supp. 308 (D.D.C. 1991), *aff'd*, 993 F.2d 1572 (D.C. Cir. 1993). Although the presiding judge, Harold H. Greene, lifted the restrictions, he did so reluctantly. In his opinion he stated:

[T]he most probable consequences of such entry by the Regional Companies into the sensitive information services market will be the elimination of competition from that market and the concentration of the sources of information of the American people in just a few dominant, collaborative conglomerates, with the captive local telephone monopolies as their base. Such a development would be inimical to the objective of a competitive market, the purposes of the antitrust laws, and the economic well being of the American people.

Id. at 326 (footnote omitted).

4. Video Programming as a Protected Form of Speech

A recent judicial decision requires the repeal of the cross-ownership restrictions on constitutional grounds. The United States District Court for the Eastern District of Virginia held that telcos have a First Amendment right to compete with cable television operators.⁵¹ The court concluded that video programming was a protected form of speech under the First Amendment, and that a government grant of a monopoly to telcos is insufficient justification for the restraint of their first amendment right to provide video programming.⁵²

II. THE BENEFITS OF REPEALING THE CROSS-OWNERSHIP RESTRICTION

Repealing the cross-ownership restrictions should bring a host of benefits to the information services consumer. First, cross-ownership will generate robust competition in the information services market.⁵³ Telcos will be allowed to provide cable television service and cable television operators will be allowed to provide telephone service.⁵⁴ As telephone and cable television service monopolies⁵⁵ disappear, the price of telephone and cable

51. *Chesapeake and Potomac Telephone Company of Virginia v. United States*, 830 F. Supp. 909, 932 (E.D. Va. 1993). For a discussion of the decision as an impetus for legislative reform see Michael G. Oxley, *The Cable-Telco Cross-Ownership Prohibition: First Amendment Infringement Through Obsolescence*, 46 FED. COMM. L.J. 7 (1993).

52. *Chesapeake*, 830 F. Supp. at 918-19. In reaching its decision, the court determined that the cross-ownership restrictions were content-neutral and, consequently, applied the intermediate scrutiny test found in *United States v. O'Brien*, 391 U.S. 367 (1968), to determine the constitutionality of the restrictions. *Chesapeake*, 830 F. Supp. at 926.

To meet the intermediate scrutiny test, the statute must be narrowly tailored to serve a significant government interest and must allow ample alternative channels for communication. *Id.* The court found that telcos have alternative channels of communication, but held that the restrictions were not narrowly tailored to serve a significant government interest and were, therefore, unconstitutional. *Id.* at 926, 931-32.

The government asserted two justifications for the restrictions: (1) the promotion of competition in the video programming market; and (2) the preservation of diversity in the ownership of communications media. *Id.* at 927. The court concluded that the restrictions were not narrowly tailored to the first governmental objective because the restrictions barred entry to the market "by the one class of potential competitors that has exhibited an inclination to compete with entrenched monopolists." *Id.* The court further concluded that the restrictions were not narrowly tailored to the second governmental objective because the government had other regulatory alternatives short of a complete ban with which to preserve diversity. *Id.* at 927-28, 930.

53. Boeckman, *supra* note 11, at 1088-1091.

54. *Id.*

55. Cable television systems are considered to be monopolies under two different theories. The first theory is that they are "natural" monopolies because each individual market can only support one cable television operator. The second theory is that they are "unnatural" monopolies by virtue of exclusive franchising agreements with the municipalities they serve. Such exclusive franchising agreements were commonplace until they were recently abolished by the 1992 Cable Act. For more information on cable television systems as monopolies see Daniel L. Brenner, *Was Cable Television a Monopoly?*, 42 FED. COMM. L.J. 365 (1990); and Thomas W. Hazlett, *Private Monopoly and the Public Interest: An Economic Analysis of the Cable Television Franchise*, 134 U. PA. L. REV. 1335 (1986).

services should go down, the variety of services available to consumers should increase, and the service quality should go up.⁵⁶

Second, cross-ownership will permit telcos and cable television operators to form business alliances.⁵⁷ In fact, in anticipation of the repeal of the cross-ownership restrictions, telcos and cable television operators have already begun forming business alliances.⁵⁸ To date, the most notable of these alliances is U S West Communication's acquisition of a 25.51% interest in Time Warner Entertainment, Inc.⁵⁹

These alliances will allow telcos and cable television operators to pool their resources to speed the construction of fiberoptic distribution networks.⁶⁰ These alliances will also facilitate universal service because jointly telcos and cable television operators could service rural areas where individually it would be cost-prohibitive for them to do so.⁶¹ Furthermore, telco-cable cross-ownership allows telcos and cable television operators to combine their research and development efforts to bring new and innovative information services to consumers.⁶² Finally, consumers will benefit from the job creation and capital investments that will accompany a competitive approach to developing the national information infrastructure.⁶³

III. PENDING LEGISLATION

Two bills which would immediately repeal the telco-cable cross-ownership restrictions are currently pending before Congress: one house bill,⁶⁴ sponsored by Representatives Edward J. Markey (Democrat-Massachusetts) and Jack Fields (Republican-Texas); and one senate bill,⁶⁵

56. See *supra* note 55. See also Stanford L. Levin & John B. Meisel, *Cable Television and Competition: Theory, Evidence and Policy*, TELECOMMUNICATIONS POLICY, Dec. 1991, at 519, 523.

57. Telcos and cable television companies could be ideal business partners. Cable television companies have a large customer base and expertise in marketing video programming services. Telcos have large service areas, access to capital, technical expertise, and better customer relations. Levin & Meisel, *supra* note 56, at 522.

58. Six of the top ten cable television operators have business relationships with telcos. Chris Nolan, *Identity Crisis in D.C.*, CABLEVISION, Feb. 28, 1994, at 30, 30.

59. K.C. Neel, *Cable TV's New Order*, CABLE WORLD, Oct. 18, 1993, at 1. Other telco-cable alliances include: Southwestern Bell and Hauser Communications, NYNEX and Viacom, and BellSouth and Prime Cable. Bob Diddlebock, *The Bells' Learning Curve*, CABLE WORLD, Oct. 18, 1993, at 10, 11. For a discussion of the implications of these mergers see Barrett, *supra* note 31, at 43-53.

60. Boeckman, *supra* note 11, at 1071.

61. McAvoy, *supra* note 10, at 47.

62. Strachan, *supra* note 11, at 603. For examples of the services currently being contemplated see *supra* note 8.

63. NCTA Position Paper, *supra* note 4, at 14.

64. H.R. 3636, 103rd Cong., 1st Sess. (1993) [hereinafter Markey-Fields bill].

65. S. 1822, 103rd Cong., 2d Sess. (1994) [hereinafter Hollings bill]. The Hollings bill is a comprehensive revision of the 1934 Communications Act and addresses other areas besides telco-cable cross-ownership.

sponsored by Senator Ernest Hollings (Democrat-South Carolina). Because of the widespread goal of lawmakers to repeal the cross-ownership restrictions by the end of 1994,⁶⁶ it is likely that a compromise bill combining parts of each of these two bills will be passed by Congress and signed into law.

The Markey-Fields bill would permit telcos to enter the video programming services market on a common-carrier basis.⁶⁷ The bill prohibits telcos from buying cable television systems in their local telephone exchange service areas, and requires telcos to maintain separate subsidiaries and to keep separate books, accounts, and records for its telco and video programming services businesses.⁶⁸ In addition, the bill requires telcos to market their telco and video programming services businesses separately, except that telcos may engage in institutional advertising.⁶⁹ Finally, the bill requires telcos to offer 75% of the channel capacity on their video distribution systems to video programmers on a nondiscriminatory basis.⁷⁰

The Hollings bill is similar to the Markey-Fields bill in that it requires telcos to maintain separate subsidiaries and to keep separate books, accounts, and records for its telco and video programming services businesses.⁷¹ However, unlike the Markey-Fields bill, it does not require telcos to enter the video programming services market as common carriers.⁷² In addition, it permits telcos to purchase up to a 5% interest in cable television systems within their local telephone exchange service areas.⁷³

IV. POTENTIAL FOR TELCOS TO ENGAGE IN ANTI-COMPETITIVE CONDUCT IF THE CROSS-OWNERSHIP RESTRICTIONS ARE REPEALED

Despite the general desire to repeal the cross-ownership restrictions, many lawmakers and industry experts are concerned a repeal will lead to anti-competitive conduct by telcos.⁷⁴ Specifically, they are concerned about the potential for cross-subsidization and discrimination against unaffiliated companies.⁷⁵

66. Reinhardt, *supra* note 8, at 54.

67. Markey-Fields bill, *supra* note 64, §§ 201, 653.

68. *Id.* §§ 652, 656.

69. *Id.* § 652.

70. *Id.* § 654.

71. Hollings bill, *supra* note 65, § 236.

72. *Id.* § 501.

73. *Id.*

74. *How the Deal Played in Washington, D.C.: Administration Gives It a Cautious OK*, CABLE WORLD, Oct. 18, 1993, at 4, 48. See also National Cable Television Association, *The Never-Ending Story: Telephone Company Anticompetitive Behavior Since the Breakup of AT&T* (1991) [hereinafter *Telco Anti-Competitive Conduct*].

75. See *supra* note 74.

A. Anti-Competitive Conduct by Telcos Prior to the Modified Final Judgment

Prior to the Modified Final Judgment, AT&T and the local telcos associated with it (collectively known as the Bell System) comprised a massive, vertically integrated business.⁷⁶ The company enjoyed a monopoly in local telephone exchange services and also provided long distance exchange service.⁷⁷ An affiliated company, Bell Labs, designed and developed telephone equipment and a wholly-owned subsidiary, Western Electric, manufactured the equipment.⁷⁸

AT&T used its local telephone exchange service monopoly to promote its affiliated businesses.⁷⁹ In the long distance exchange market, the company forced competing long distance carriers, who were dependent on the company's local telephone exchange, to purchase inferior quality access at a higher price.⁸⁰ In the equipment market, the Bell System, which purchased eighty percent of the telephone equipment sold nationwide, favored Western Electric as its supplier.⁸¹ The Bell System and Bell Labs also favored Western Electric by giving it early and otherwise advantageous access to technical data and other information about their equipment requirements.⁸² Finally, AT&T subsidized the equipment prices offered by Western Electric using revenues from its local telephone exchange service.⁸³ This enabled Western Electric to undersell its competitors at the expense of telephone consumers, who were overcharged for their local telephone exchange service.⁸⁴

B. Anti-Competitive Conduct by Regional Companies Subsequent to the Modified Final Judgment

Subsequent to their divestiture from AT&T and prior to the implementation of the regulatory safeguards discussed in Section V, the Regional Companies also engaged in anti-competitive conduct.⁸⁵ Some examples of this conduct included:

76. *United States v. Western Electric Co., Inc.*, 900 F.2d 283, 289 (D.C. Cir. 1990).

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.* at 289-90.

81. *Id.* at 290.

82. *Id.*

83. *Id.*

84. *Id.*

85. *United States v. Western Electric Co., Inc.*, 767 F. Supp. 308, 322 (D.D.C. 1991).

- ▶ designing technical features incompatible with the standard equipment of their competitors;⁸⁶
- ▶ pricing such features in a manner designed to raise competitors' costs;⁸⁷
- ▶ making important and necessary features available only to their own affiliates;⁸⁸
- ▶ delaying implementation of features requested by competitors until they themselves were ready to enter the market;⁸⁹ and
- ▶ charging competitors' customers more for features than they charge their own customers.⁹⁰

C. Potential for Future Anti-Competitive Conduct by Telcos

1. Cross-Subsidization

Cross-subsidization refers to the practice of charging the costs of one business to another.⁹¹ The regulatory scheme governing local telephone exchange services permits telcos to recover their actual cost of doing business plus a fixed rate of return on their investment, subject to a price cap.⁹² Therefore, telcos have an economic incentive to assign the costs of their other businesses to their local telephone exchange business.⁹³

Telcos are able to cross-subsidize their businesses without detection because of their organizational complexity.⁹⁴ For instance, each Regional Company is a holding company comprised of the local telephone exchange business as well as a number of diversified businesses.⁹⁵ Each business is a subsidiary of the holding company.⁹⁶ The costs incurred by the holding company, such as executives' salaries, can be disproportionately allocated to the local telephone exchange service, and recovered through the prices charge for telephone services.⁹⁷ The resources of the holding company that

86. *Id.* at 323.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. Strachan, *supra* note 11, at 614-15 n.75.

92. *Id.* at 614-17.

93. *Id.* For an overview of other problems posed by traditional rate-of-return regulation see LELAND L. JOHNSON, PRICE CAPS IN TELECOMMUNICATIONS REGULATORY REFORM 1-2 (Rand Corp., 1989); Sutapa Ghosh, Comment, *The Future of FCC Dominant Carrier Rate Regulation: The Price Caps Scheme*, 41 FED. COMM. L.J. 401, 403-13 (1989).

94. *Telco Anti-Competitive Conduct*, *supra* note 74, at 6-7.

95. *Id.*

96. *Id.* at 7. For a discussion of eliminating telco anti-competitive conduct by divesting the Regional Companies from their holding companies see Gail Garfield Schwartz & Jeffrey H. Hoagg, *Virtual Divestiture: Structural Reform of an RHC*, 44 FED. COMM. L.J. 285 (1992).

97. *Telco Anti-Competitive Conduct*, *supra* note 74, at 7.

are used to benefit the other businesses are not fully paid for by those businesses.⁹⁸ This gives the businesses an advantage over their competitors, who must bear the full cost of their expenses.⁹⁹ Furthermore, the telephone customers pay higher bills without receiving either additional services or improved quality.¹⁰⁰

If the cross-ownership restrictions are repealed, telcos could potentially cross-subsidize their cable television businesses with their local telephone exchange service businesses.¹⁰¹ The practice would be particularly difficult to detect if telcos and their cable television subsidiaries share distribution facilities. The Regional Companies possess substantial economic power.¹⁰² Their annual revenues exceed those for the cable television, broadcasting, and motion picture industries combined.¹⁰³ Given this power, the anti-competitive impact of leveraging their resources through cross-subsidies would be overwhelming. As one legal commentator noted: "the potential for use of the companies' monopoly power to impede competition is enormous. This is not so much because the [Regional Companies] have deep pockets, which they do, but because their pockets are bottomless."¹⁰⁴

2. Discrimination in Access to Facilities

In addition to cross-subsidization, lawmakers are concerned that telcos will discriminate against unaffiliated companies by denying them access to necessary facilities.¹⁰⁵ As noted earlier, cable television operators require access to telephone poles and underground conduits to build their distribution systems.¹⁰⁶ Telcos could discriminate against competing cable television operators by denying them access to the poles and conduits or offering them access under unfavorable terms.¹⁰⁷ For example, Southwestern Bell in Missouri is charging pole attachment rates approximately sixty times higher than the normal cable pole attachment rates if a cable television company

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 9.

103. NCTA Position Paper, *supra* note 4, at 5.

104. *Telco Anti-Competitive Conduct*, *supra* note 74, at 9 (quoting Judge Harold H. Green, who presided over the Modified Final Judgment.)

105. *How the Deal Played in Washington, D.C.: Administration Gives It a Cautious OK*, *supra* note 74, at 48.

106. Morrissey, *supra* note 15, at 165.

107. *Id.* at 166. The Utilities Telecommunications Council, which represents 2,000 utilities, has asked the House Telecommunications and Finance Subcommittee to include a repeal of the Pole Attachment Act as part of lifting the telco-cable cross-ownership restrictions. Vincente Padeloup, *Telco-Entry Bills on Fast Track*, CABLE WORLD, Feb. 14, 1994, at 2, 2. The Pole Attachment Act permits the FCC to regulate the rates and terms under which cable television operators use utility poles. *Id.*

wants to use those poles to provide competitive services, such as alarm systems.¹⁰⁸

As the court noted in *U.S. v. Western Electric Co.*:¹⁰⁹ “[T]here does not exist any meaningful, large-scale alternative to the facilities of the local exchange networks, and the information services providers remain as dependent upon those facilities, and those who control them, as they did in 1984.”¹¹⁰

3. Other Potential Anti-Competitive Conduct

Marketing is another area where there is potential for telcos to engage in anti-competitive conduct.¹¹¹ Telcos possess detailed and updated information about their customers.¹¹² The information is compiled as an integral part of providing telephone service and is paid for by telephone customers.¹¹³ If a telco were to give a subsidiary cable television operator exclusive or cheaper access to customer information, the subsidiary cable television operator would have a competitive advantage in marketing its product.¹¹⁴

V. EFFECTIVENESS OF REGULATORY SAFEGUARDS DESIGNED TO DETER ANTI-COMPETITIVE CONDUCT

A. *Cost Accounting Procedures and the Requirement for a Separate Video Programming Subsidiary*

Because telcos have a history of anti-competitive conduct, the FCC has implemented safeguards to deter such conduct.¹¹⁵ The primary safeguard against telco cross-subsidization is an elaborate system of cost accounting procedures.¹¹⁶ This system consists of five principle components: (1) FCC accounting rules and cost allocation standards; (2) telco-cost allocation

108. *Telco Anti-Competitive Conduct*, *supra* note 74, at 13.

109. 673 F.Supp. 525 (D.D.C. 1987).

110. *Id.* at 564.

111. Strachan, *supra* note 11, at 619-20.

112. *Telco Anti-Competitive Conduct*, *supra* note 74, at 11.

113. *Id.* at 11-12.

114. *Id.* at 12.

115. In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards, 6 F.C.C.R. 7571 (1991) [hereinafter BOC Safeguards]. These safeguards were originally developed to protect enhanced telephone services providers from anti-competitive conduct by the Regional Companies. They were subsequently applied to video programming services by the Video Dialtone Order.

For background information on the history of the safeguards and their application in the telephone industry see Chris L. Kelly, *The Contestability of the Local Network: The FCC's Open Network Architecture Policy*, 45 COMM. L.J. 89 (1993); Robert M. Frieden, *The Third Computer Inquiry: A Deregulatory Dilemma*, 38 FED. COMM. L.J. 383 (1986).

116. BOC Safeguards, *supra* note 115, at 7576-97.

manuals reflecting the FCC rules and standards; (3) independent audits to determine telco compliance with their cost allocation manuals; (4) detailed reports by telcos to the FCC; (5) and on-site audits of telcos by the FCC to ensure compliance with the established rules and standards.¹¹⁷

Although this cost accounting system seems on its face to be sufficient to deter cross-subsidization, it is ineffective for two reasons. First, the FCC lacks adequate resources to properly audit the telcos.¹¹⁸ In fact, the General Accounting Office ("GAO") noted:

The FCC staff . . . is able to audit each relevant telco account only once every sixteen years The level of oversight [the] FCC is prepared to provide will not, in GAO's opinion, provide telephone ratepayers or competitors positive assurance that FCC cost allocation rules and procedures are properly controlling cross-subsidy.¹¹⁹

Similarly, FCC Commissioner Ervin Duggan said "he has a 'nightmare' about a 'sixty-story building in Gaithersburg [MD]' filled with FCC accountants that would be needed to monitor telco cross-subsidies if they were in the cable television business."¹²⁰

Second, the complexity of telco organizations make it difficult to detect cross-subsidization.¹²¹ Although both the Markey-Fields bill and the Hollings bill would require telcos to distribute video programming services through separate subsidiaries, this requirement only makes cross-subsidization easier to detect. It does not prevent cross-subsidization from occurring. If regulatory resources are not available to closely scrutinize telco accounting practices, cross-subsidization is still likely to occur.

B. Price Cap Regulation

Another safeguard against cross-subsidization is price cap regulation.¹²² Price cap regulation is an alternative to traditional rate-of-return regulation,

117. *Id.* at 7591.

118. *Telco Anti-Competitive Conduct*, *supra* note 74, at 22. See also John Major, Chairman, Telecommunications Industry Association, Statement to the House Subcommittee on Telecommunications and Finance (Feb. 8, 1994), available in LEXIS.

119. *Telco Anti-Competitive Conduct*, *supra* note 74, at 22 (citing General Accounting Office, Telephone Communications: Controlling Cross-Subsidy Between Regulated and Competitive Services 3 (1987)).

120. *Id.* at 23 (alteration in original) (citations omitted).

121. See Schwartz & Hoagg, *supra* note 96, at 297-300, describing how NYNEX's complicated organizational structure permitted it to engage in undetected cross-subsidization for several years after its divestiture from AT&T.

122. LELAND L. JOHNSON, TELEPHONE COMPANY ENTRY INTO CABLE TELEVISION: COMPETITION, REGULATION, AND PUBLIC POLICY 41 (Rand Corp., 1992).

and establishes a formula to provide a just and reasonable rate of return.¹²³ Price cap regulation is appealing because, in theory, it: (1) severs the regulatory connection between prices and costs, rewarding telcos with cost savings achieved through improved efficiency; (2) severs the connection between profits and rate base, eliminating the incentive to use excessive amounts of capital; and (3) imposes price ceilings on monopoly services to restrict telcos' ability to finance predatory undertakings in competitive markets.¹²⁴

Unfortunately, price-cap regulation suffers from two flaws. First, unless the price-cap formulas are such that monopoly services are grouped separately from competitive services, they still provide an opportunity to cross-subsidize.¹²⁵ Second, telcos can circumvent the price-cap regulation by incurring additional expenses for the benefit of an unregulated subsidiary and then petitioning the FCC for a revision to the price-cap formula.¹²⁶ In this manner, telcos are still able to cross-subsidize their businesses.¹²⁷ At most, price cap regulation is an administrative inconvenience to a telco intent on engaging in cross-subsidization.

C. Open Network Architecture¹²⁸

The primary safeguard against telco discrimination is open network architecture.¹²⁹ Under open network architecture,¹³⁰ telcos are required to provide nondiscriminatory access to basic network services, features, and

123. *Id.* at 39. Price caps are pricing ranges for various telco services. The prescribed pricing ranges are periodically adjusted to reflect changing economic conditions. Price cap regulation permits a telco to adjust the rates for capped services within the prescribed pricing ranges with little or no regulatory intervention. Ghosh, *supra* note 93, at 413.

124. JOHNSON, *supra* note 93, at 4.

125. *Id.* at 22.

126. JOHNSON, *supra* note 122, at 40-41.

127. *Id.* Former FCC Common Carrier Bureau Chief Gerald Brock conceded that the FCC has a hard time detecting the padding of the rate base. "There has to be some fairly clear evidence that costs are not fairly incurred Costs, like an extra vice president, we are probably never going to detect." *Telco Anti-Competitive Conduct*, *supra* note 74, at 41 (citing WALL ST. J., June 25, 1990, at 12).

128. This safeguard will only be applicable if telcos are required to provide video programming services on a common-carrier basis as proposed in the Markey-Fields bill, *supra* note 64. Otherwise, telcos would likely be subject the same horizontal and vertical ownership restrictions as cable television operators. See Cable Television Ownership Limits, *supra* note 40.

129. BOC Safeguards, *supra* note 115, at 7597-7605.

130. "Open network architecture" describes the process of unbundling the various features available over telephone lines. In theory, open network architecture provides independent information service providers with more complete information about network features and allows them to choose the specific features they need. *United States v. Western Electric Co., Inc.*, 757 F. Supp. 308, 319 (D.C.C. 1991).

For an overview of the impetus for and policy behind open network architecture see generally Kelly, *supra* note 115, at 104-12. See also Chris Nolan, *The Quest for Open Architecture*, CABLEVISION, Nov. 8, 1993, at 28, 29-30.

functions to their competitors.¹³¹ To enforce the nondiscriminatory access requirement, telcos must submit quarterly nondiscrimination reports to the FCC.¹³²

Proponents of open network architecture argue that it provides telcos with a strong monetary incentive to permit the use of their facilities.¹³³ In reality, telcos have a stronger monetary incentive to limit the use of their facilities. Telco facility usage costs account for only ten to twenty percent of the total cost of an information service.¹³⁴ Therefore, a telco would earn far more by providing its own information service than it would by acting as a conduit for another company's information service.¹³⁵

Furthermore, adequate policing of open network architecture regulations is hindered by the same problems that prevent adequate auditing of telco cost accounting procedures. The FCC simply does not have the resources available to detect abuses.

VI. COMPETITION IN LOCAL TELEPHONE EXCHANGE SERVICE MARKET AS THE ONLY ADEQUATE SAFEGUARD TO DETER TELCO ANTI- COMPETITIVE CONDUCT

Telcos have the size and financial strength to control any market they enter.¹³⁶ They demonstrated this ability to achieve rapid domination in the cellular telephone services industry. In 1986, 50 percent of the top 20 cellular telephone companies were owned by the Regional Companies and GTE. By 1992, the percentage of cellular telephone companies owned by these telcos had risen to 75 percent.¹³⁷ Similarly, telcos have the capability of achieving rapid domination in the video programming services industry.

Despite the efforts of lawmakers, existing and proposed regulatory safeguards are not sufficient to deter telco anti-competitive conduct.¹³⁸ To prevent telcos from dominating the video programming services market, telcos and cable television operators must be on the same playing field. They must both be regulated as common-carrier monopolies or they must both face adequate competition.¹³⁹

131. BOC Safeguards, *supra* note 115, at 7598.

132. *Id.* at 7601-02.

133. *Telco Anti-Competitive Conduct*, *supra* note 74, at 12-13.

134. *Id.* at 13.

135. *Id.*

136. Decker Anstrom, President and CEO, National Cable Television Association, Statement before the House Subcommittee on Telecommunications and Finance (Feb. 2, 1994), *available in* LEXIS, News Library, Federal News Service File.

137. *Telco Anti-Competitive Conduct*, *supra* note 74, at 5.

138. *See supra* Section V.

139. Andrew C. Barrett, *Public Policy and the Advanced Intelligent Network*, 42 *FED. COMM. L.J.* 413, 426-30 (1990).

The first alternative, regulating both industries as common-carrier monopolies, is counter to the goal of rapidly constructing an information superhighway.¹⁴⁰ Regulated monopolies are economically inefficient and generally do not spur development of new products and services.¹⁴¹ The second alternative is more economically sound and would further the development of a national information infrastructure.¹⁴²

Unfortunately, local telcos are currently in a better position to compete with cable television operators in the video programming services market than cable television operators are to compete in the local telephone exchange services market.¹⁴³ Fortunately, this imbalance is changing. Cable television operators are creating new distribution networks or are retrofitting existing distribution networks which will enable them to provide local telephone exchange services in the near future.¹⁴⁴

If the local telephone exchange services and video programming services were fully competitive industries, the potential for cross-subsidization would be moot. The price of these services would reflect the market demands and the need for rate regulation would be eliminated. As unregulated industries, market pressure rather than cost accounting procedures, structural separation and price cap regulation would dictate pricing policies. Furthermore, as unregulated industries, telcos and cable television operators would be subject to existing anti-trust laws.¹⁴⁵

Despite the logic of equalizing telcos and cable television operators, neither the Markey-Fields nor the Hollings bills permit a sufficient lag time to allow cable television operators or other entities to enter the local telephone exchange services market. The National Cable Television Association recommends two alternative tests to determine when telcos should be permitted to enter the cable television market.¹⁴⁶

The first test is the "Effective Competition Test." Under this test, telcos could not enter the cable television market until they faced effective competition. Effective competition is defined as either: (1) the availability of an alternative multichannel video programming distributor or distributors reaching 50% of households, and 15% of households obtaining service from distributors other than the largest one; or (2) the availability of an alternative

140. *Id.* at 427.

141. *Id.* See also Mark S. Fowler, et al., "Back to the Future": A Model for Telecommunications, 38 FED. COMM. L.J. 145 (1986); Frank W. Lloyd, *Federal, State and Local Regulation of Video and Telecommunications Information Systems—the Actual and the Ideal*, 6 COMPUTER/L.J. 283 (1985).

142. Barrett, *supra* note 140, at 426-430.

143. Reinhardt, *supra* note 8, at 56.

144. *Id.*

145. See generally, Glenn B. Manishin, *An Antitrust Paradox for the 1990s: Revisiting the Role of the First Amendment in Cable Television*, 9 CARDOZO ARTS & ENTERTAIN L.J. 1 (1990); Eric T. Werner, *Something's Gotta Give: Antitrust Consequences of Telephone Companies' Entry into Cable Television*, 43 FED. COMM. L.J. 215 (1991).

146. *Telco Anti-Competitive Conduct*, *supra* note 74, at 7-8.

local telephone service provider or providers for 50% of all business and residential customers, and 10 percent of all customers obtaining service from the alternative provider(s).¹⁴⁷

The second test is the "Date-Certain" test. This test precludes telcos from being banned indefinitely and provides cable television operators an opportunity to prepare for competition from telcos. Under this test, if effective competition fails to materialize, telcos should be allowed to enter the cable television market after a fixed period of years. The National Cable Television Association recommends a period of seven years. They base this recommendation on three factors. First, cable television companies must have the opportunity to raise capital and invest in the telecommunications infrastructure before telcos enter the market. The seven year window allows them time to work through the current transition period and assure lenders they can achieve earnings on new investments before telcos enter the market. Second, the seven-year term will allow cable television companies to assume the expenses associated with new facilities after having depreciated their existing plants. Third, a similar term was effectively imposed on British Telecom when England deregulated its telecommunications industry.¹⁴⁸

Neither the "Effective Compensation" nor the "Date-Certain" test is ideal. Both tests are somewhat self-serving and the Date-Certain test permits too long a delay in telco entry into video programming. However, the tests illustrate the type of provision that is missing from the Markey-Fields and Hollings bills. Without competition to check their propensity for anti-competitive conduct, telcos with their vast resources will eventually control the local telephone exchange services, video delivery services, video programming services and, potentially, customer video equipment markets. Unless an appropriate lag time is included in whatever legislation eventually passes, several years from now these same legislators or their predecessors will be looking back and wondering how another situation like AT&T could have been prevented.

CONCLUSION

Repealing the current telco-cable cross-ownership restrictions will bring substantial benefits to the information services consumer. It will generate competition in the information services marketplace. It will spur the construction of an information superhighway. It will encourage the development of new and innovative information services such as: telecommuting, video telephones, and remote access to medical specialists and educational institutions.

Along with these benefits comes the potential for anti-competitive conduct by telcos, such as cross-subsidization and discrimination against

147. *Id.*

148. *Id.*

unaffiliated companies. Although there are existing and proposed regulatory safeguards to deter anti-competitive conduct, these safeguards are ineffective. First, the FCC does not have sufficient resources to enforce the cost-accounting procedures. Second, price-cap regulation does not remove the incentive for telcos to cross-subsidize their businesses. Finally, open network architecture is difficult to police and does not create a enough incentive for telcos to allow nondiscriminatory access to their facilities. The only safeguard which will adequately prevent telco anti-competitive conduct is competition in the local telephone exchange services market.

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