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# DIVESTITURE II: IS THE LOCAL LOOP RIPE FOR COMPETITION?

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In 1975 the Department of Justice ("DOJ") began an antitrust action that ultimately resulted in the divestiture of the Bell Operating Companies ("BOCs") from AT&T.<sup>1</sup> Divestiture created a structure for the telephone industry, which aside from recent changes, still exists in 1995.<sup>2</sup> However, in the age of competition, the dividing lines drawn by the Modified Final Judgment ("MFJ") may be obsolete. MFJ restrictions prohibit local exchange carriers ("LECs") from offering interLATA<sup>3</sup> or inter-exchange telephone service. Likewise, AT&T, the dominant interexchange carrier ("IXC"), is restricted from providing traditional wireline local telephone exchange service.<sup>4</sup> Divestiture and the resulting regulations did not solely affect AT&T and the

BOCs. The separation of the BOCs from AT&T created an environment in which a smaller, less powerful company could challenge AT&T for its long distance market share.<sup>5</sup> For the first time, competition in the long distance telephone industry was possible. MCI became AT&T's first true competitor,<sup>6</sup> followed soon after by companies, such as Sprint and LDDS.<sup>7</sup> While AT&T currently holds the majority share of the long distance telephone market, its share has dropped to a historically low level in recent years.<sup>8</sup>

Similarities between AT&T's past battles with MCI and the current battles between the Regional Bell Operating Companies ("RBOCs") and their competitors have prompted commentary on the pos-

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<sup>1</sup> United States v. AT&T, 552 F. Supp. 131 (D.C. Cir. 1982), *aff'd sub. nom.* Maryland v. United States, 460 U.S. 1001 (1983). The original action was an antitrust suit filed in the U.S. District Court for the District of Columbia in November, 1975. *Id.* In the suit, the DOJ sought an injunction to stop AT&T's monopolistic activities and AT&T's divestiture of the Bell Operating Companies ("BOCs"), Bell Labs, and Western Electric. David A. Irwin, *Court Decisions: AT&T/Dept. of Justice Settlement*, TELECOMMUNICATIONS REG. MON., Nov. 1988, at 2-15. The case resulted in a settlement between the DOJ and AT&T known as the 1982 Consent Decree. *Id.* The 1982 Consent Decree was later modified and affirmed by Judge Harold H. Greene, and became known as the Modified Final Judgment ("MFJ"). The MFJ modified a 1956 consent decree limiting AT&T to regulated common carrier services. United States v. Western Electric Co., Civil Action No. 17-49, C.A. 82-0192 (D.C. Cir. 1956).

<sup>2</sup> AT&T, 552 F. Supp. at 131. The MFJ separated the BOCs from AT&T and created seven separate and independent Regional Bell Operating Companies ("RBOCs"): NYNEX, Pacific Telesis, Bell Atlantic, SouthWestern Bell, U S West, Ameritech, and BellSouth. The seven RBOCs now own and control the twenty-two BOCs that existed before Divestiture under AT&T. See Irwin, *supra* note 1. However, other communications companies such as GTE and Airtouch have become powerful players in the local telephone market. See e.g., *Airtouch Disputes Claim That It Is BOC 'Successor'*, TELECOMMUNICATIONS REPORTS, Feb. 20, 1995, at 23-24.

<sup>3</sup> AT&T, 552 F. Supp. at 131. LATAs are Local Access Transport Areas. LATAs are the contiguous geographical areas

which the BOCs are restricted to for the provision of local exchange telephone service. Irwin, *supra* note 1, at 2-17 - 2-18. LATAs define areas of common interest in which the BOCs are permitted to provide intraLATA or local telephone service. *Id.* InterLATA and long distance service is restricted to inter-exchange carriers ("IXCs") such as AT&T. *Id.* at 2-19.

<sup>4</sup> AT&T has re-entered the local exchange market through cellular telephone service. See, e.g., Edward Warner, *With Conditions, Greene Gives AT&T Waiver To Buy McCaw*, FCC REPORT, Sept. 8, 1994, at 7. In 1994, AT&T purchased McCaw Cellular one of the largest cellular phone carriers in the nation. AT&T's purchase of McCaw was opposed by the DOJ on the grounds that AT&T needed to obtain a waiver of the 1982 consent decree before re-entering the local exchange market. *Id.*

<sup>5</sup> Harold H. Greene, *AT&T Divestiture and Consumers*, 5 U. BRIDGEPORT L. REV. 251, 252 (1984). Prior to Divestiture, AT&T had the ability to prevent competitors from gaining market share in the telecommunications market through cross-subsidization. *Id.* at 253. By raising prices in the local exchange market, where it held a monopoly, AT&T could afford to drop its long distance prices lower than the amount that smaller companies could afford to drop their prices and still operate. This "predatory pricing" effectively ran competitors out of business.

<sup>6</sup> See MCI Telecommunications Corp. v. FCC, 561 F.2d 365 (D.C. Cir. 1977)[hereinafter *Execunet I*].

<sup>7</sup> See, e.g., *LDDS Joins "Big Three" to Make "Big Four"*, COMM. DAILY, Feb. 2, 1995, at 3.

<sup>8</sup> *Id.*

sibility of "Divestiture II."<sup>9</sup> Much like MCI's presence in the late seventies and early eighties, the presence of competition in the local telephone exchange market is causing regulators to re-evaluate the "natural monopoly" status of local telephone service. Competitive access providers ("CAPs") and other competitors such as cellular, new wireless technologies and cable are competing for areas of the LECs' market in the local exchanges.<sup>10</sup> The success of these competitors spurred the Federal Communications Commission ("FCC" or "Commission") and legislators to consider the advantages of competition in the local exchange market.<sup>11</sup>

This Comment addresses the benefits and problems competition in the local exchange market creates for the industry, legislators, and regulators. Part I explains the development of the local telephone industry after the MFJ. Part II introduces the LECs' competitors and their significance to the local exchange market. Part III outlines recent industry, regulatory, and legislative movements in relation to local exchange service. Part IV analyzes the effects of new state and federal regulatory initiatives and the proposed telecommunications legislation on the local market. This Comment concludes that federal, legislative reform is necessary to control competition in the local loop and to meet the public interest.

## I. THE MFJ: BACKGROUND OF THE LOCAL LOOP

In the early 1900s, it became evident to regulators

that AT&T, under the leadership of company president Theodore Vail, was attempting to create a monopoly in the telephone market.<sup>12</sup> In 1913, the DOJ and AT&T<sup>13</sup> entered into the Kingsbury Commitment ("the Commitment").<sup>14</sup> Under the Commitment, AT&T agreed to divest the recently acquired Western Union, stop buying independent telephone companies, and allow full interconnection with independent telephone companies.<sup>15</sup> The Kingsbury Commitment was ineffective in curtailing AT&T's construction of a telephone monopoly. AT&T had already established market dominance and was able to underprice all of its competitors.<sup>16</sup>

In 1956, a second DOJ attempt to control AT&T culminated in a consent decree that limited AT&T to providing regulated telecommunications services.<sup>17</sup> AT&T's market power also made this agreement of limited value in curtailing its development of a monopoly. However, in 1982, a DOJ antitrust action begun nearly a decade earlier produced the 1982 consent decree and shortly thereafter the MFJ.<sup>18</sup> Under the MFJ, AT&T agreed to divest itself of the BOCs and function independently in the inter-exchange market.<sup>19</sup>

Pursuant to the 1982 consent decree, seven Regional Bell Operating Companies were formed.<sup>20</sup> The seven RBOCs now own and operate the twenty-two BOCs.<sup>21</sup> The MFJ imposed restrictions on the BOCs' provision of interLATA and interexchange services. It required the BOCs to provide equal access to their networks for both IXCs and enhanced service providers ("ESPs").<sup>22</sup> The MFJ also prohibited BOCs from providing information services and

<sup>9</sup> See, e.g., Paul Keleher, *Local Exchange Competition: Are Users Ready for Another Divestiture?*, TELECOMMUNICATIONS, Dec. 1994, at 45. The term "Divestiture II" is actually a misnomer used to refer to the RBOCs restructuring in order to accommodate competition in the local market and removal of MFJ line of business restrictions rather than a government action divesting the BOCs from the RBOCs.

<sup>10</sup> Currently, most CAPs merely provide alternative access to IXCs. However many CAPs are expanding to offer alternatives to other LEC offerings. See Joseph S. Kraemer, *Local Competition; Changing Ground Rules for Network Access*, BUS. COMMUNICATIONS REV., Sept. 1994, at 4. Cable companies have made alliances which could result in dangerous local telephone competitors. See *infra*, § II B.

<sup>11</sup> See Reed Hundt, *Toward Regulation that Fosters Competition*, 39 FED. COM. L.J. 265 (1994)(Special Issue on the Sixtieth Anniversary of the Communications Act of 1934).

<sup>12</sup> See Kenneth A. Cox & William J. Byrnes, *Title II The Common Carrier Provisions-A Product of Evolutionary Development*, in A LEGISLATIVE HISTORY OF THE COMMUNICATIONS ACT OF 1934 (Max D. Paglin ed., 1989).

<sup>13</sup> For the purpose of simplicity, the term "AT&T" is used

throughout this comment to refer to not only the modern corporation but also the early Bell System.

<sup>14</sup> Cox & Byrnes, *supra* note 12, at 49.

<sup>15</sup> *Id.* at 49 n. 182.

<sup>16</sup> Cox & Byrnes, *supra* note 12, at 49.

<sup>17</sup> 552 F. Supp at 135-36.

<sup>18</sup> *AT&T*, 552 F. Supp. at 139.

<sup>19</sup> *Id.* See also Irwin, *supra* note 1, at 2-15.

<sup>20</sup> *AT&T*, 552 F. Supp. at 142 n. 41. Although the decree did not assign names to the seven RBOCs, as of April 1995, the names of the RBOCs were, Ameritech, Pacific Telesis, Bell Atlantic, BellSouth, Southwestern Bell, NYNEX and U S West.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* See also California v. FCC, 104 F.C.C.2d 958 (1986)(*Computer III*)(modifying *In re* Amendment of Section 64.702 of the Commission's Rules and Regulations, *Final Decision*, 77 F.C.C.2d 384 (1980), (*Computer II*) to remove structural separation requirements where a BOC sought to provide information services). The Computer series of cases attempts to define the line between "information services" as defined by the MFJ and "enhanced services" as defined by the Commission. *Id.* The court in *Computer III* held that the two categories over-

manufacturing telecommunications products and customer premises equipment ("CPE").<sup>23</sup>

While the BOCs were restricted to a highly regulated market, AT&T was allowed to enter into lines of business they had previously been prohibited from entering.<sup>24</sup> However, AT&T's provision of telecommunications service was restricted to the interexchange market. In 1971, the Commission decided that new carriers could enter into the interexchange market.<sup>25</sup> Pursuant to this decision, MCI filed for permission to provide microwave communications services that would compete with AT&T's Message Telephone Service ("MTS") and Wide Area Telecommunications Service ("WATS").<sup>26</sup> AT&T opposed MCI's application arguing that MCI's tariff revisions were in violation of the *Specialized Common Carrier Decision*. In *Execunet I*,<sup>27</sup> the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") held that MCI could provide voice telephone service via microwave transmission.<sup>28</sup> The D.C. Circuit held that in order for the FCC to restrict MCI from providing such service the Commission must find that such a ruling would be in the interest of public convenience and necessity. Despite this ruling, AT&T refused to provide MCI with the interconnections necessary to provide the voice telephone service.<sup>29</sup> In *Execunet II*,<sup>30</sup> the D.C. Circuit once again held in MCI's favor, ordering AT&T to provide interconnection for MCI's private line and long distance services.<sup>31</sup>

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lapped, "but may not be identical." *Id.* at 962. Some examples of "enhanced service" providers are Compuserve, Prodigy, and America Online. The D.C. Circuit vacated and remanded the *Computer III* decision in *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990).

<sup>23</sup> *AT&T*, 552 F. Supp. at 186-93.

<sup>24</sup> *Id.* at 178-86. However, AT&T was restricted from entering electronic publishing for at least seven years. *Id.*

<sup>25</sup> *In re Establishment of Policies and Procedures for Consideration of Application to Provide Specialized Common Carrier Services*, *First Report and Order*, 29 F.C.C. 2d 870, 920 (1971)[hereinafter *Specialized Common Carrier Decision*]. "We further find and conclude that a general policy in favor of the entry of new carriers in the specialized communications field would serve the public interest, convenience, and necessity." *Id.*

<sup>26</sup> *MCI v. FCC*, 561 F.2d 365 (D.C. Cir. 1977) [hereinafter *Execunet I*] (holding that the FCC made no public interest determination that MCI could not provide voice telephone service). MTS is long distance telephone service in which the IXC charges the customer per message, based on the time of day, distance of the call, or length of the call. *Id.* WATS is discount, bulk-rate long distance service that IXCs offer to high volume customers. *Id.*

<sup>27</sup> *Id.* at 365.

<sup>28</sup> *Id.* at 370.

<sup>29</sup> *MCI v. FCC*, 580 F.2d 590 (D.C. Cir. 1978)[hereinafter

Soon after the *Execunet I & II* decisions, the Commission found that competition in the long distance market was in the public interest.<sup>32</sup> The MFJ mandated that the BOCs provide equal access to all IXCs.<sup>33</sup> The BOCs are permitted to charge the IXCs access fees for interconnection to their networks. This results in the proverbial "bottleneck," which is so often referred to in local exchange service.<sup>34</sup> Until recently, the IXCs had no choice but to deal with the BOCs. The local loop was exactly what the Commission and the court had expected it to be at the time of Divestiture, a monopoly controlled by the BOCs.<sup>35</sup>

## II. LEC COMPETITORS AND THEIR STRATEGIES

Recent changes in the telecommunications industry have made it impossible for LECs to ignore the threat of competition in the local exchange. The success of CAPs, the FCC's attempt to forward competition through collocation,<sup>36</sup> and the threat of wireless technologies, such as cellular and Personal Communications Services ("PCS"), illustrate that competition in the local exchange is a reality.<sup>37</sup>

### A. Competitive Access Providers

CAPs, usually fiber-based carriers, connect end-users directly to IXCs or other locations, such as

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*Execunet II*] (holding that the decision to allow MCI to provide private line and interexchange service in *Execunet I* was based in part on the fact that AT&T would be required to provide access to its facilities; therefore AT&T could not subsequently refuse to provide such access).

<sup>30</sup> *Id.* at 590.

<sup>31</sup> *Id.* at 596-97.

<sup>32</sup> *In re Expanded Interconnection with Local Telephone Company Facilities*, *Report and Order and Notice of Proposed Rulemaking*, 7 FCC Rcd. 7369, para. 2 (1992)[hereinafter *Expanded Interconnection II*].

<sup>33</sup> See *In re Expanded Interconnection with Local Telephone Company Facilities*, *Notice of Proposed Rulemaking*, 6 FCC Rcd. 3259 (1991)[hereinafter *Expanded Interconnection*] (ordering LECs to supply equal access to all, but allowing BOCs to use AT&T where a customer did not express a preference for any particular long distance carrier).

<sup>34</sup> Gail Garfield Schwartz & Jeffrey H. Hoagg, *Virtual Divestiture: Structural Reform of an RHC*, 44 FED. COM. L.J. 285, 286-88 (1991).

<sup>35</sup> *Id.*

<sup>36</sup> *Expanded Interconnection II*, *supra* note 32, para. 270. (requiring physical collocation as the means by which LECs must allow CAPs to interconnect into LEC Central Offices).

<sup>37</sup> Kraemer, *supra* note 10, at 5-6.

other LEC Central Offices ("COs"), in competition with the access services and network service offerings of LECs.<sup>38</sup> CAPs usually target large commercial customers and seek to bypass their area LEC either by interconnection directly to an IXC or to another LEC.<sup>39</sup> The BOCs are the largest group of LECs. They have the most metropolitan business and therefore stand to lose the most to CAPs.

Many IXCs use CAPs to diversify their networks. CAPs provide an opportunity for an IXC to bypass LEC access charges which often are an IXC's greatest expense.<sup>40</sup> This also gives IXCs leverage in their ongoing battle to force the LECs to reduce access charges.<sup>41</sup> LECs' access charges are extremely important to their cost structure. A loss in these revenues could cause a LEC to reduce investment in research, development and implementation of new technologies.<sup>42</sup> If LECs are forced to reduce investment in research and development, their competitors will reap a strong advantage because most are constructing their facilities with the latest technologies.

Aside from offering diversification to the IXCs and commercial end-users, CAPs are usually ten-to-twenty percent cheaper than the LECs in providing comparable services.<sup>43</sup> This is due in part to the regulatory restrictions that affect LECs, but not CAPs. LECs are often the "carrier of last resort."<sup>44</sup> They are therefore required to offer services to all subscribers in their service area including high-cost low-return users.<sup>45</sup> This is a financial burden with which CAPs do not have to cope.

Teleport Communications Group ("TCG") and other large CAPs envision themselves offering more

services than the typical alternative access to IXCs and LEC COs. CAPs want to become "the other local phone company."<sup>46</sup> TCG has telecommunications networks in nineteen major markets and is constructing networks in five additional markets.<sup>47</sup> In the summer of 1994, TCG entered into a ground breaking agreement with NYNEX in which the two agreed to interconnect their networks and exchange local telephone traffic.<sup>48</sup> This agreement makes TCG the first CAP to be treated as an equal by an RBOC.<sup>49</sup> While TCG has been able to make great strides toward supplying a full service telecommunications network to customers in New York, it is definitely the exception to the rule. New York was the first state to allow competition into the local exchange telephone market.<sup>50</sup> While other states are beginning to follow New York's lead, New York City remains the only major city to allow local exchange competition.<sup>51</sup>

## B. Cable as a Local Exchange Competitor

Cable companies are another potential competitor for the LECs. Since 1984, cable's penetration rate has grown significantly. At the end of 1993, approximately sixty million households received cable.<sup>52</sup> Some cable companies are already involved in the provision of telecommunications services. TCG is owned by a consortium of cable companies, including Cox Cable and TCI.<sup>53</sup> The merger of a cable company with a CAP results in an entity that, theoretically, could cover a LEC's subscriber area, providing access to the IXC POP without utilizing the LEC

<sup>38</sup> *Id.* at 6.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* See also John S. Harrison, *The Information Superhighway: Assault on a Stronghold*, *FORTNIGHTLY*, June 15, 1994, at 38, 39. (stating that LEC access charges are often arbitrary, varying drastically from one LEC to another for the same type of access).

<sup>41</sup> Kraemer, *supra* note 10, at 6.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> 47 U.S.C. § 201 (1988) provides: "It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therefor . . ."

<sup>45</sup> 47 U.S.C. § 202 provides:

It shall be unlawful for any common carrier to make any unjust and unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality or to

subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

<sup>46</sup> Keleher, *supra* note 9, at 47.

<sup>47</sup> *Teleport Communications Group Deplores Ameritech's Latest Reciprocal Compensation Proposal*, *FINANCIAL NEWS*, Jan. 10, 1995, at 2. TCG opposed Ameritech's proposal on the ground that waiver of the 1982 Consent Decree restrictions for Ameritech should not be attached to opening the local exchange to competition.

<sup>48</sup> Keleher, *supra* note 9, at 48 (showing TCG's relationship with NYNEX as the most advanced CAP/LEC relationship in the country).

<sup>49</sup> *Id.* at 49. NYNEX has issued TCG its own NXX or exchange identifiers and has agreed to treat TCG's customers equal to its own customers.

<sup>50</sup> Schwartz & Hoagg, *supra* note 34, at 319-24 (discussing the reform of NYNEX and the New York local telephone exchange as a model).

<sup>51</sup> Keleher, *supra* note 9, at 48-49.

<sup>52</sup> Kraemer, *supra* note 10, at 6-7.

<sup>53</sup> Harrison, *supra* note 40, at 39.

facilities.<sup>54</sup> This possibility combined with the facts that cable companies target residential areas and CAPs target large businesses, make a CAP/cable merger a formidable competitor in the local loop.

However, most cable companies' current network architecture, which is designed for video transmission, would not be able to support two way voice and data communications even if they had the switching that they currently lack.<sup>55</sup> The cable companies would have to alter their systems and run fiber, which could prove to be too expensive to make the transformation worthwhile.

### C. Wireless Technologies: Competition from the Future

Wireless communications systems also present competition for LECs. Cellular Telephone Networks ("Cellular") are currently strong competitors in the local exchange market for a number of reasons. Cellular systems offer expanded calling areas sometimes encompassing an entire LATA.<sup>56</sup> The incredible growth rate and increasing popularity of cellular, since its inception in 1984, have made it possible for cellular companies to lower rates while expanding calling areas.<sup>57</sup> In some instances it is possible for a cellular carrier to provide what normally would be an interLATA toll call without an additional per minute charge.<sup>58</sup>

Currently, LECs benefit in part from cellular and wireless use. Since most wireless calls either originate or terminate from wireline end-users, traffic on landline local exchange systems is increased.<sup>59</sup> However, with the advent of radio based PCS on the horizon, many IXC's and cable companies are viewing wireless systems as an alternative to LECs for access

to the local exchange.<sup>60</sup> Both Sprint and AT&T have merged with and acquired cellular phone companies, respectively, and both have to bid for PCS licenses.<sup>61</sup>

## III. INDUSTRY, REGULATORY AND LEGISLATIVE INITIATIVES TOWARDS COMPETITION

### A. Collocation

Some CAPs compete with LECs for the transport of regular switched long distance calls between either the end-user and the LEC CO, or between the LEC CO and the point of presence ("POP") of an IXC.<sup>62</sup> These services require direct connection to the LEC with which the CAP is competing. This interconnection raises the issue of collocation.<sup>63</sup> Connections that require access to the LEC CO are crucial in the provision of interstate long distance network access.<sup>64</sup> There are two methods for the interconnection of CAPs to LEC COs: physical collocation and virtual collocation.<sup>65</sup>

To achieve physical collocation, the interconnecting party, i.e. the CAP, usually leases a space inside the LEC CO. The interconnecting party places the equipment it needs to terminate transmissions in that space.<sup>66</sup> Typical termination devices are multiplexers, demultiplexers and digital cross connect switches.<sup>67</sup> The LEC allows the employees of the interconnecting party to have access to the LEC CO to install and maintain its equipment. This method of connection has raised questions of space availability, security, and ultimately, the constitutional rights of the LEC.<sup>68</sup>

To achieve virtual collocation, the interconnecting

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> Kraemer, *supra* note 10, at 7-8.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> Terence L. Barnich & Craig L. Clausen, *Pulling the "Reverse Trigger": A Way to Define Local Competition*, FORTNIGHTLY, June 15, 1994, at 34.

<sup>61</sup> See Warner, *supra* note 4, at 7.

<sup>62</sup> Kraemer, *supra* note 10, at 6.

<sup>63</sup> *Expanded Interconnection*, *supra* note 33, paras. 19-20.

<sup>64</sup> David A. Irwin, *It's Not Paranoia - Competition is Coming to Your Local Exchange*, ROUNDTABLE, Fall 1993.

<sup>65</sup> See *Expanded Interconnection*, *supra* note 33, paras. 19-20 (1991).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* These devices are used to send multiple signals over a single circuit and distinguish between those signals once they

reach their destination. This expands the overall capacity of a telecommunications network.

<sup>68</sup> *Expanded Interconnection II*, *supra* note 32, paras. 227-40. LECs claimed that the Commission's requirement that LECs allow CAPs to physically collocate in the LECs' COs constituted an unlawful taking in violation of the Fifth Amendment of the United States Constitution. *Id.* para. 227. The Commission argued that the physical collocation requirement was not a taking due to the Commission's specific authority under section 201(a) of the Communications Act to order common carriers to establish physical connections. 47 U.S.C. § 201(a) (1988). The Commission also argued that since it had proposed a compensation system by which LECs would be compensated for CAPs use of LEC facilities there would be no Fifth Amendment violation even if there was a taking. *Expanded Interconnection II*, *supra*, para. 238. However, in *Bell Atlantic Telephone Cos. v. FCC*, 24 F.3d 1441 (D.C. Cir. 1994) the D.C. Circuit found that the FCC's authority under section 201(a) of the Act did not expressly authorize orders of physical collocation. *Id.*

party connects with a LEC CO from an adjacent location, such as a nearby office space or manhole.<sup>69</sup> Virtual collocation differs from physical collocation in that any equipment located on the LEC CO premises is owned or leased by the LEC. The employees of the interconnecting party have no entry rights into the LEC CO. The LEC is responsible for maintaining the equipment.<sup>70</sup> The interconnecting party chooses the type of equipment to be used and, in some instances, is the party leasing the equipment to the LEC.<sup>71</sup> In an ideal virtual collocation agreement, the LEC and the interconnecting party negotiate price arrangements to more closely approximate the results that physical collocation would produce.<sup>72</sup>

In 1992, the FCC ordered LECs to provide expanded interconnection to their networks for interstate special access.<sup>73</sup> This order facilitated CAPs' provision of special access long distance services.<sup>74</sup>

In the same order, the Commission attempted to mandate physical collocation as the means for the LECs to provide interconnection to their competitors.<sup>75</sup> However, in *Bell Atlantic Telephone Cos. v. FCC*,<sup>76</sup> the D.C. Circuit vacated the FCC order mandating physical collocation.<sup>77</sup> The court applied strict scrutiny in assessing the FCC's authority to require the LECs to give up space in their COs and found that the Communications Act of 1934 ("the Act") did not grant the Commission specific authority to require physical collocation.<sup>78</sup> The FCC order, intended to enhance competition, excused physical collocation in only two circumstances: 1) where the floor space in the LEC CO would not accommodate physical collocation; or 2) where state regulatory policy favored virtual collocation.<sup>79</sup>

The Commission contended that it had the power to order physical collocation under section 201(a) of the Act, which empowers the FCC to order carriers to "establish physical connections with other carri-

ers."<sup>80</sup> However, the court held that physical collocation amounted to an allocation of property rights unrelated to "physical connection."<sup>81</sup> The court found that, if implemented, the Commission's order mandating physical collocation would constitute an unconstitutional taking of LEC property in violation of the Fifth Amendment.<sup>82</sup> In effect, the ruling in *Bell Atlantic* gave the LECs a choice whether or not to allow physical collocation.<sup>83</sup>

In 1993, the Commission ordered LECs providing expanded interconnection for special access to also provide expanded interconnection for switched transport service and equal access to the signalling information necessary for switching.<sup>84</sup>

On December 15, 1994, virtual collocation replaced physical collocation as the FCC's standard for required interconnection into the LEC networks.<sup>85</sup> However, in recent filings to the FCC, the two largest CAPs protested LEC interconnection tariffs on the basis of cost justification and the requirements that the tariffs imposed on CAPs.<sup>86</sup> TCG and Metropolitan Fiber Systems ("MFS") complained that the LECs were interfering with competition by keeping prices for CAPs high.<sup>87</sup> In some cases, prices for interconnection via virtual collocation were reported in excess of 260% greater than interconnection through physical collocation.<sup>88</sup>

As of April 1995, the Commission was awaiting replies to the CAPs' complaints from the RBOCs and other LECs.<sup>89</sup> Some of the CAPs' complaints charge that the RBOCs proposed tariffs are in violation of the Commission order that requires the LECs' rates for virtual collocation to simulate as closely as possible the cost of physical collocation.<sup>90</sup>

## B. RBOC Restructuring

The RBOCs are looking to expand their lines of

access to their networks. The two RBOCs maintain they have done so in the interest of local competition. TCG and MFS maintain that the RBOCs chose to keep physical collocation because it is more cost efficient for them. See Keleher, *supra* note 9, at 48.

<sup>69</sup> *In re Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd. 7341 (1993). [hereinafter *Expanded Interconnection III*]

<sup>70</sup> *Virtual Collocation Rates Hit; Bell Atlantic's Said Worst of Lot*, FCC REPORT, Nov. 3, 1994, at 6.

<sup>71</sup> *Id.*

<sup>72</sup> David Rohde, *Bells Flout Collocation Rules: CAPs Complain*, NETWORK WORLD, Oct. 24, 1994, at 38.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>69</sup> *Expanded Interconnection*, *supra* note 33, para. 20.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* paras. 20-22.

<sup>72</sup> *Id.* paras. 23-26.

<sup>73</sup> *Expanded Interconnection II*, *supra* note 32, para. 29.

<sup>74</sup> *Expanded Interconnection*, *supra* note 33, paras. 13-16.

<sup>75</sup> *Expanded Interconnection II*, *supra* note 33, para. 270.

<sup>76</sup> 24 F.3d 1441 (D.C. Cir. 1994).

<sup>77</sup> *Id.* at 1446.

<sup>78</sup> *Id.* at 1446-47.

<sup>79</sup> *Bell Atlantic*, 24 F.3d at 1443.

<sup>80</sup> 47 U.S.C. § 201(a) (1988).

<sup>81</sup> 24 F.3d at 1446.

<sup>82</sup> *Id.*

<sup>83</sup> In fact, both NYNEX and Pacific Telesis have chosen to maintain physical collocation as their means of allowing CAPs

business in response to competition from the CAPs and other alternative access sources. They are expanding into cable service outside their service areas, competing directly with RBOCs and LECs in other telephone service areas, and expanding into new technologies such as Video Dialtone.<sup>91</sup>

Ameritech Corporation ("Ameritech") and Frontier Corporation ("Frontier"), formerly Rochester Telephone Corporation, are planning to restructure their corporations.<sup>92</sup> The plans proposed are quid pro quo arrangements with state and federal regulators. The RBOCs hope to be allowed into businesses currently restricted to them, such as long distance service, in exchange for opening up their local loops to competition.<sup>93</sup> Several CAPs have criticized these plans as RBOC attempts to bargain for something that is inevitable.<sup>94</sup>

Ameritech's elaborate restructuring plan proposed to create twelve individual business units, each dedicated to a specific task.<sup>95</sup> All of the companies would work and sell under the single Ameritech name.<sup>96</sup>

Under Ameritech's proposed regulatory scheme, competitors would have greater flexibility to install their own equipment. Rather than unbundling and offering the package which they now offer to competitors on an individual basis, Ameritech proposed to make it easier for competitors to come in, set up, and offer whatever services they could.<sup>97</sup> This plan differs from an Open Network Architecture ("ONA") plan in which the LEC unbundles its service offerings so that a competitor seeking access could pick and choose what services it needs and is willing to pay for.<sup>98</sup> Ameritech's plan has met with mixed opinions and approval was still pending with

the FCC as of April 1995.

Until recently, Ameritech argued that the unbundling of their network offerings and a waiver of the 1982 Consent Decree restrictions banning their participation in interLATA service, must be linked.<sup>99</sup> In a recent proposed order, however Illinois Commerce Commission hearing examiners rejected this notion and proposed a plan for the implementation of local exchange competition in Illinois, which was not related to the waiver of the 1982 Consent Decree restrictions. Ameritech supported the proposal.<sup>100</sup>

Frontier has implemented an unbundling plan of its own. In an order on November 10, 1994, the New York Public Service Commission ("PSC") adopted a Joint Stipulation Agreement ("the Agreement").<sup>101</sup> The Agreement authorized Frontier's Open Market Plan ("OMP") temporarily as of January 1, 1995.<sup>102</sup> Under the agreement, Frontier had to report to the PSC on February 1, 1995 to show that the corporation was executing the OMP pursuant to the Agreement. The PSC reserved the right to alter the Agreement and to revoke it if they find that Frontier is not executing it in the public interest.<sup>103</sup>

The OMP divides Rochester Telephone Corporation into a wholesale and a retail branch.<sup>104</sup> R-Net, the wholesale branch, owns the company's local exchange network and offers exchange access services previously offered by Rochester Telephone Corporation. R-Com<sup>105</sup> offers local interLATA services at a retail level through resale of services obtained on a competitive basis from R-Net.<sup>106</sup> Frontier also seeks admission into the long distance market in light of its

<sup>91</sup> See, e.g., *Bell Atlantic Files Tariffs for Two VDT Systems*, TELECOMMUNICATIONS REPORTS, Feb. 6, 1995, at 25.

<sup>92</sup> *Asking for 'Fair Fight'; Ameritech Proposes Opening Local Loop for Competition*, COMM. DAILY, Feb. 23, 1993, at 1; See also, *Compared with Ameritech Plan; Rochester Regulatory Relief Criticized*, COMM. DAILY, Jul. 23, 1993, at 6.

<sup>93</sup> See, e.g., *Ameritech Proposes Opening Local Loop*, supra note 92, at 1.

<sup>94</sup> *Ameritech Supports Interconnection Proposals, Suggests Timetable for Unbundling, Presubscription*, TELECOMMUNICATIONS REPORTS, Feb. 13, 1995, at 5.

<sup>95</sup> The twelve units are: consumer, small business, enhanced services, customer business, long distance, information services, telephony, pay phones, advertising, cellular, leasing and network. See *FCC Approves Rochester Plan Waivers, Supports Local Competition 'Experiment', Telco Competition Report*, Mar. 16, 1995, at 5-7.

<sup>96</sup> *Id.* at 5.

<sup>97</sup> *Id.*

<sup>98</sup> The Commission has proposed Open Network Architecture as a possible way of unbundling LEC services in order to

allow competition. See, e.g. Chris L. Kelley, Comment, *The Contestability of the Local Network: The FCC's Open Network Architecture Policy*, 45 FED. COM. L.J. 89 (1992).

<sup>99</sup> See *Ameritech Supports Interconnection Proposals*, supra note 94, at 5.

<sup>100</sup> *Id.*

<sup>101</sup> *In re* Petition of Rochester Tel. Corp. for Approval of Proposed Restructuring Plan, 160 Pub. Util. Rep. 4th (PUR) 554 (N.Y.S.2d Nov. 10, 1994).[hereinafter *Rochester Petition*].

<sup>102</sup> *FCC Approves Rochester Plan*, supra note 95, at 5-6.

<sup>103</sup> The PSC held that local exchange competition was in the public interest and that if Frontier was not acting in a way that would hinder competition, the PSC could revoke the Agreement. *Id.* at 7.

<sup>104</sup> See *Rochester Petition*, supra, note 101, at 554.

<sup>105</sup> R-Net and R-Com are not the actual names of the divisions of the corporation. They are titles used by the corporation in its proposal, and the PSC in the order, for the purpose of identifying the divisions. The actual names of the divisions may vary. See *Rochester Petition*, supra, note 101, at 554.

<sup>106</sup> *Id.* at 556.

unbundling.<sup>107</sup> AT&T and TCG, along with other CAPs and IXCs, have expressed concerns that an FCC decision on this matter is premature. They stated that there is no evidence as of yet that competition will develop in Frontier's service area.<sup>108</sup>

### C. Legislative Initiatives

While consistently more RBOCs, including Pacific Telesis and U.S. West, are petitioning state and federal agencies to foster competition in their local exchanges,<sup>109</sup> legislators have begun to formulate plans to introduce competition into the local loop.<sup>110</sup> Many states have taken New York and Illinois' lead and have changed their telecommunications legislation. Virginia and California recently passed bills that will open their local telephone markets to competition in 1996 and 1997, respectively.<sup>111</sup>

However, partially due to strong opposition on the part of the RBOCs, telecommunications legislation has met great resistance on the federal level.<sup>112</sup> At the end of 1994, despite strong support from many in the industry, including the Chairman of the FCC and the Assistant Secretary of Commerce for Communications,<sup>113</sup> Congress failed to pass Communications Reform Bills S. 1822 and H.R. 3626.<sup>114</sup> Many viewed the death of these bills as a significant victory for the RBOCs over competitors in the local exchange market.<sup>115</sup> The subsequent change in Congress to a Republican majority served to deepen the discouragement felt by proponents of telecommunications reform.<sup>116</sup> However, predictions that Republican majority leaders would put telecommunications reform on a back burner have been proven wrong.<sup>117</sup>

Senator Larry Pressler, Chairman of the Senate Commerce, Science, and Transportation Committee released a draft of his proposed "Telecommunica-

tions Competition and Deregulation Act of 1995" ("1995 Act") in early February. The 1995 Act lays out rules for the introduction of competition into the local exchange market.<sup>118</sup> Under the 1995 Act, RBOCs would be required to form a separate subsidiary for the purpose of entering into lines of business currently prohibited to them.<sup>119</sup> RBOCs would be allowed to enter in-region interexchange service three years after enactment of the bill. They could provide interLATA service and out of region interexchange service after one year. The RBOCs would be permitted to enter into equipment manufacturing three years after the enactment of the bill.<sup>120</sup>

Before an RBOC could begin providing interLATA service, it would have to submit a detailed application to the Commission.<sup>121</sup> The Commission would review the applications on the basis of whether or not the service would be in the public interest, and whether or not the applicant had fulfilled the interconnection requirements.<sup>122</sup> The Commission could impose up to a six month delay on any RBOC's entry into the interLATA market if the Commission felt that the RBOC had not met the interconnection requirements.<sup>123</sup> However, for five years after the enactment of the bill, the FCC would be prohibited from seeking injunctive relief, under any law, to stop RBOCs from providing interexchange service through a subsidiary.<sup>124</sup>

Senator Pressler stated that the committee wanted severe penalties to govern RBOCs entry into currently prohibited markets under the 1982 Consent Decree.<sup>125</sup> The draft contains a one million dollar, per offense penalty provision for RBOCs that fail to meet the interconnection requirements within the first three years after enactment.<sup>126</sup> After three years, RBOCs found to be "willfully, knowingly and without good cause" violating the separate subsidiary requirement, could be fined up to 500 million dollars

<sup>107</sup> *Id.*

<sup>108</sup> *AT&T Unhappy with Rochester Open Market Plan*, COMM. DAILY, Mar. 7, 1995, at 1.

<sup>109</sup> See, e.g., *Colorado Consumer Office Withdraws from U S West Settlement Pact*, TELCO COMPETITION REPORT, Mar. 30, 1995, at 10; *Pacific Telesis Requests InterLATA Relief; California Moves Toward Competition by 1997*, TELCO COMPETITION REPORT, Feb. 16, 1995, at 7.

<sup>110</sup> See Hundt, *supra* note 11, at 265.

<sup>111</sup> *Id.* at 265-66.

<sup>112</sup> *Id.* at 270. (discussing the consequences of the lack of effective telecommunications legislation on the development of competition in the local loop).

<sup>113</sup> See *infra*, note 139.

<sup>114</sup> Hundt, *supra* note 11, at 266.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Pressler Releases Telecom 'Discussion Draft'; VDT Applications Would Undergo One-Year Freeze*, TELECOMMUNICATIONS REPORTS, Feb. 6, 1995, at 1.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

<sup>121</sup> The application must contain the nature and scope of the proposed service, each type of product or service market, and each geographic market the RBOC proposes to serve. *Id.*

<sup>122</sup> *Id.* at 2.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Prepared Statement by the Honorable Larry Pressler, Committee Chairman; Before the Senate Committee on Commerce, Science and Transportation, 104th Cong., 1st Sess. (1995).*

<sup>126</sup> *Id.*



initially, and 250 million for each additional violation within three months thereafter.<sup>127</sup> Private parties would be allowed to seek treble damages against a violation. A U.S. District Court would impose these penalties.<sup>128</sup>

Under the Act, the cable-telco cross ownership prohibition would be lifted.<sup>129</sup> Common carriers would be able to provide video programming directly to subscribers in their telephone service area.<sup>130</sup> Common carriers providing video programming through VDT services would not be required to file for a franchise license. Carriers providing traditional cable television service on a non-common carrier type system would be required to obtain a franchise.<sup>131</sup>

The Democratic Leaders of the Senate proposed an alternative plan.<sup>132</sup> The Democratic proposal would require FCC and DOJ approval before an RBOC could enter into the competitive long distance market. LECs would be able to provide cable television service immediately upon passage of the bill. Under this proposal, price cap regulation would not be mandatory for any company competing in the local market. RBOCs are opposed to the Democratic proposal, whereas IXC's support it.<sup>133</sup>

On June 8, 1995, the United States Senate began debate on the telecommunications reform bill (S-652) which developed from the 1995 Act.<sup>134</sup> One week later, on June 15, the bill was passed by a resounding 81-18 vote.<sup>135</sup> In relation to local telephone competition, much of the bill followed the proposals in the 1995 Act. The senate voted down an amendment which would give the DOJ an equal say in approval or denial of RBOC entry into MFJ restricted services.<sup>136</sup> However, the senate did pass an intraLATA dialing parity amendment.<sup>137</sup> The amendment delays a requirement that the RBOCs offer intraLATA dialing parity for three years.<sup>138</sup> The same agreement restricts the three dominant IXCs, AT&T, MCI and Sprint, from offering both local and long distance

service in the same area for three years. The senate rejected an amendment that would have forced the RBOCs to sell services to competitors at below cost.<sup>139</sup> The fact that the bill was passed in one week despite controversial issues illustrates the great need for legislative reform in the telecommunications industry.

#### IV. THE FUTURE OF LOCAL EXCHANGE COMPETITION

Telecommunications is a field driven by technology. Once the consumer realizes a new type of service is available or even possible, they will begin to think of ways to apply that service. Soon, a service that did not exist a short time earlier is not only in demand, but nearly indispensable. Ten years ago, cellular phone service was practically non-existent.<sup>140</sup> Today, many people rely on cellular service as an integral part of their business and personal affairs.<sup>141</sup> This is only one illustration of how quickly the telecommunications market changes.

A problem arises when the development of industry regulations fails to keep up with technological progress. Nowhere is there a more glaring example of this than the United States telecommunications industry, an industry that currently operates under a statute created in 1934.<sup>142</sup> While this statute affects a great deal more than the local loop its failings become apparent when addressing the barriers to local telephone competition.

The FCC order mandating physical collocation as the means for competitive interconnection to LEC networks was an attempt by the FCC to operate in the public interest and foster local competition.<sup>143</sup> The D.C. Circuit's decision to vacate the order on constitutional grounds need never have been reached if the FCC had a clear statutory power to order

<sup>127</sup> *Id.*

<sup>128</sup> See *Pressler Releases Telecom Draft*, *supra* note 117, at 2.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Senate Democrats Have Alternative Legislative Proposal Making it More Difficult for RHCs to Enter InterLATA Markets; Bipartisan Bill Sought*, TELECOMMUNICATIONS REPORTS, Feb. 20, 1995, at 4.

<sup>133</sup> *Id.* at 4-5.

<sup>134</sup> *Administration Opposes Pressler Bill as Senate Debate Starts*, COMM. DAILY, June 8, 1995, at 1.

<sup>135</sup> *Senate Passes Telecommunications Legislation*, COMM.

DAILY, June 16, 1995, at 1.

<sup>136</sup> *Senate Votes Small Role for Justice Dept. in Lifting MFJ*, COMM. DAILY, June 14, 1995, at 2.

<sup>137</sup> *Senate Passes Telecommunications Legislation*, *supra* note 135, at 3.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> See *Primers—Cellular Radio*, TELECOMMUNICATIONS REGULATORY MONITOR, Aug. 1986, at 3-27. (discussing the state and development of cellular radio as of 1986, two years after its inception).

<sup>141</sup> *Id.*

<sup>142</sup> 47 U.S.C. §§ 151-713 (1993).

<sup>143</sup> *Expanded Interconnection*, *supra* note 33, para. 16.

physical collocation.<sup>144</sup> While this decision did not bring competition in the local loop to a halt, it did serve to illustrate the incapacity of the 1934 Act to address modern telecommunications issues effectively. There is simply no way the drafters of the Act could have predicted the state of today's telecommunications industry in the 1930s.<sup>145</sup>

RBOCs have controlled the local exchange telephone market since the 1982 Consent Decree broke AT&T's monopoly into seven smaller monopolies.<sup>146</sup> Technology has made it possible to open the local market to competition, and has in fact already done so, in significant areas. Many regulations meant to foster competition at the time they were adopted have become burdensome to the development of competition in the local exchange market in light of economic and technological developments.<sup>147</sup>

The RBOCs still have market power in the local loop; however, it is inevitable that the increase in use of alternative communications systems will significantly detract from LEC revenues. If the LECs try to compensate by raising access charges, they will encourage the use of bypass systems and alternative local exchange carriers. In order to remain viable, the RBOCs need to be able to diversify. Some, like Frontier and Ameritech, are willing to concede their local monopoly in order to achieve diversification. Other RBOCs seem as though they would hold onto their monopolies and deter competition as long as possible, while expanding into fields not restricted to them. Whether they are willing to concede their local monopolies or not, federal telecommunications re-

form legislation stands to drastically alter the environment in which local exchange telephone service providers operate.

## V. CONCLUSION

The local telephone monopoly has become obsolete. There are a number of fast moving savvy competitors vying for a piece of the LECs market. The CAPs want equal access. Wireless technology is advancing quickly. Cable companies are positioning themselves to compete directly with the LECs. Some LECs want to exchange their local monopolies for a ticket into the long distance market. The IXC's would like to hold the LECs at bay for as long as possible.

It has become apparent that competition in the local telephone exchange is in the best interest of consumers. It has also become apparent, if only through viewing the legislative and regulatory proposals, that in order to succeed competition will have to be closely regulated. Congress, the FCC, and State Public Utility Commissions have drawn the perilous task of finding the right mix of regulation and competition to best serve the public interest and maintain a viable local telephone system. It has become imperative for the advancement of telecommunications into the twenty first century that these government entities work together to design a plan that will function practically and efficiently.

<sup>144</sup> *Id.*

<sup>145</sup> Larry Irving, *Steps Toward a Global Information Infrastructure*, 39 *FED. COM. L.J.* 271,272 n. 5 (1994); Secretary Irving states that while "piecemeal revisions" have been made to update communications legislation over the years no comprehensive revision has been made since 1934. *Id.*

<sup>146</sup> Paul W. MacAvoy & Kenneth Robinson, *Winning by Losing: The AT&T Settlement and Its Impact on Telecommunications*, 1 *YALE J. ON REG.* 1 (1983).

<sup>147</sup> One example of this proposition involves the 1984 Cable

Cross Ownership Ban. The legislatures' primary goal in prohibiting local telephone companies from owning a cable franchise in their service area was to keep the telcos from cross subsidizing and monopolizing the cable industry. However although cable companies have grown to the point where it would be very difficult for a telephone company to run them out of business through cross subsidization the prohibition is still intact. See, e.g., *In re Telephone Company-Cable Television Cross-Ownership Rules*, 71 *Rad. Reg. (P & F)* 70 (1992).