THE RELATIONSHIP BETWEEN GOVERNMENT REGULATION AND COMPETITION

CHARLES CUTLER*

There has been, and is, a battle of remarkable proportions being waged in the field of computer-related communications. Essentially, the protagonists are: the telephone industry, new "specialized" communications common carriers, independent equipment manufacturers, and major users of communications. This is merely an outline of the complex controversy.

The established telephone industry offers increasingly sophisticated transmission services, "smart" terminal equipment, and unique combinations of equipment and service. Its services are supported by the highly respected research and development organizations, Bell Laboratories. The Bell System offers unified, nationwide end-to-end service. If something goes wrong, it provides competent maintenance and service people to fix it. Even the telephone industry's harshest critics admit that we have the best telephone system in the world. Who could want more?

Many large, sophisticated users of communications say *they* need something more. They argue that when Bell became the best, it slowed down. It has unamortized investment in older equipment and does not offer consumers the *use* of technological advances which Bell Labs has developed. Critics note that private industry has turned to independent sources because Bell could not or would not offer "state of the art" service. And, of course, independent equipment manufacturers wanted to enter the market.

Thus, in the past decade, there has been a major push for "competition." It was argued that "specialized" carriers in the private line

* Member of the firm of Kirkland, Ellis & Rowe, Washington, D.C.; officer and director of the Computer Law Association.

field would force Bell to maintain quality service. The need for competition has been forcefully urged with respect to terminal equipment also. In the past six or seven years, therefore, the FCC has decreed that transmission service in the private line field (as distinguished from message telephone service) shall be subject to open-entry competition. The usual showing by each aspiring entrant that there is economic justification for his entry need not be made.[1] As a result, Bell is now competing with MCI Telecommunications Corporation, Southern Pacific Communications, and others. The principle that others can duplicate the routes and services of the Bell System, however, came about only after years of litigation and the fight is not over; it has been shifted to Congress.[2]

As to terminal equipment, the FCC has decreed that users may connect any type of terminal equipment to the end of telephone network lines as long as the equipment meets certain minimal technical standards.[3] The general test is whether the connection is privately beneficial but not publicly detrimental, *i.e.*, detrimental to the public telephone network.[4] Implementation of these interconnection principles rests upon the FCC's declaration that *it*, rather than state regulatory commissions, will decide what the nation's "interconnection" policy shall be, even though a major portion of the traffic is intrastate.[5]

---

1. Establishment of Policies & Procedures for Consideration of Application to Provide Specialized Common Carrier Services in the Domestic Public Point-to-Point Microwave Radio Service and Proposed Amendments to Parts 21, 43 & 61 of the Commission's Rules, 29 F.C.C.2d 870, 921-27 (1971), *reconsideration denied*, 31 F.C.C.2d 1106 (1971), *aff'd sub nom.* Washington Util. & Transp. Comm'n v. FCC, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975) (First Report & Order, Docket No. 18920) [hereinafter cited as Specialized Common Carrier Decision].

2. The telephone industry-sponsored Consumer Communications Reform Act, H.R. 8, S. 530, 95th Cong., 1st Sess. (1977). This bill is discussed by Marks & Bell, *Computer Communications: Government Regulation*, 1977 WASH. U.L.Q. 479.

3. Proposals for New or Revised Classes of Interstate & Foreign Message Toll Telephone Service (MTS) & Wide Area Telephone Service (WATS), 56 F.C.C.2d 593 (1975) (First Report & Order, Docket No. 19528), *amended*, 58 F.C.C.2d 736 (1976) (Second Report & Order, Docket No. 19528), *aff'd sub nom.* North Carolina Utils. Comm'n v. FCC, 552 F.2d 1036 (4th Cir. 1977).

4. Hush-A-Phone Corp. v. United States, 238 F.2d 266, 269 (D.C. Cir. 1956).

5. Telerent Leasing Corp., 45 F.C.C.2d 204 (1974) (Memorandum Decision & Order, Docket No. 19808), *aff'd sub nom.* North Carolina Utils. Comm'n v. FCC, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976).

Although the courts upheld the FCC in this preemption of interconnection jurisdiction,[6] the telephone industry and state regulatory commissions have also taken this issue to Congress.[7]

This policy of competition is presumably beneficial to users because rates will decrease, and service will be better; diversity will bring optimum results. In fact, however, the newly authorized specialized carriers, in a battle for survival, expended a major part of their efforts before the FCC urging increases in telephone rates and have been fairly successful. When Bell finally offered a data service—data-phone digital service (DDS)—that employed the unused portion of the radio spectrum of voice circuits, the independent data communications equipment manufacturers and a specialized carrier opposed it, and succeeded in forcing an AT&T rate increase.[8] When Bell offered its sophisticated "smart terminal" Dataspeed 40/4, independent computer manufacturers succeeded, initially, in preventing it from being marketed.[9] That ruling was later reversed by the Commission itself[10]—but the issue is now in the courts.[11]

The battles have swirled before the Commission, in the hearing rooms, in the courts, and now are in the halls of Congress. Fundamental questions remain: To what extent do we need a unified,

---

6. 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976).

7. Consumer Communications Reform Act, H.R. 8, S. 530, 95th Cong., 1st Sess. (1977).

8. AT&T (DDS), 62 F.C.C.2d 774 (1977) (Final Decision & Order, Docket No. 20288). The Commission concluded that AT&T had understated its costs for DDS and therefore held, as the specialized carrier DATRAN and the equipment manufacturers had urged, that the original DDS rates were unreasonably low and anticompetitive.

9. Ruling of Chief, Common Carrier Bureau, Mimeo 61760 (March 3, 1976) (unpublished). The Bureau Chief held that the Dataspeed 40/4 terminal was essentially used for data processing functions rather than communications. Because the FCC does not regulate data processing, it will not accept filed "tariffs" covering activities which are primarily data processing. This ruling, if upheld, would have effectively barred AT&T from the market because a consent decree restricts AT&T to rendering communications services subject to public regulation. United States v. Western Electric Co., [1956] Trade Cas. 71,134 (D.N.J. 1956).

10. AT&T, 62 F.C.C.2d 21 (Memorandum Opinion & Order, Transmittal No. 12449), *appeal docketed*, No. 77-4005 (2d Cir. Jan. 4, 1977). The full Commission reversed the Bureau Chief, holding that the service rendered pursuant to the Dataspeed 40/4 offering was essentially communications, not data processing.

11. IBM, The Computer and Business Equipment Manufacturers Ass'n (CBEMA), and AT&T have sought review of the FCC's Dataspeed 40/4 ruling in the Second Circuit. *Id.*

single supplier of communications, providing end-to-end service? Should public policy favor nationwide averaged rates throughout the country, even in rural areas where unit costs are clearly higher? The FCC has allowed competition in the private line field,[12] but has endeavored to preserve the monopoly of the established telephone industry in public message toll service.[13]

Another major question remains in the transmission field where there is competition in offering private line services. What are the rules of the game? Can the newcomers survive against the Bell System? Will Bell be permitted to compete, or will it have its rates forced up by the FCC—in the form of umbrella pricing—to protect the newborn competitive "infants" which the Commission sponsored? This issue remains unresolved despite the FCC's attempt to establish pricing principles for AT&T in the *Private Line Rate Case*.[14]

As to terminal equipment, it is now accepted, even in North Carolina,[15] that telephone users can attach their own terminal equip-

---

12. Specialized Common Carrier Decision, *supra* note 1. The Commission said: "Where services may be in direct competition, departure from uniform nationwide pricing practices may be in order . . . ." *Id.* at 915. The Commission also concluded:

> [T]here is a public need and demand for the proposed facilities and services and for new and diverse sources of supply, competition in the specialized communications field is reasonably feasible, there are grounds for a reasonable expectation that new entry will have some beneficial effects, and there is no reason to anticipate that new entry would have any adverse impact on service to the public by existing carriers such as to outweigh the considerations supporting new entry. 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. at 920.

13. MCI Telecommunications Corp. (Execunet Decision), (Docket No. 20640), 60 F.C.C.2d 25 (1976), *rev'd on procedural grounds*, No. 75-1635 (D.C. Cir. July 28, 1977). In *Execunet*, the Commission reaffirmed its policy regarding the role of specialized common carriers in domestic communications stated in *Specialized Common Carrier Decision, supra* note 1. 60 F.C.C.2d at 35-36. The *Specialized Common Carrier* decision clearly allowed competition *only* in private line services. *See* 29 F.C.C.2d at 911-14.

14. AT&T 61 F.C.C.2d 587 (1976) (Memorandum Opinion & Order Docket No. 18128). This complex and lengthy decision, rendered after some 15 years of litigation on rate-making principles, rejected AT&T's contention that it should be permitted to base its rates for private line services on its long run incremental costs (LRIC) rather than fully distributed costs (FDC). The Commission also enunciated guidelines which AT&T must follow if it seeks to reduce rates to meet competition, *i.e.* the "competitive necessity" test.

15. In the early 1970s, several state regulatory commissions, including North

ment to telephone equipment if they have connecting arrangements or registered equipment. This principle, however, could be overturned *de facto* if the following question is answered the wrong way: Who is going to decide interconnection policies and practices? The Federal Communications Commission, or the 50 states? The Commission, supported by the courts, has said it will determine the policies.[16] However, there is a proposal in Congress to reverse the Commission. If state regulation is permitted, the North Carolina Utilities Commission could again propose a rule that only telephone company equipment can be attached to telephone lines.

Finally, where will the FCC draw the line between the regulation of communications, on the one hand, and data processing, on the other? As indicated earlier,[17] the FCC has come close to abandoning attempts to draw the line. In the supplemental notice of its new computer inquiry (Docket 20828),[18] it said, in effect, "Let us know if the distinction between data processing and communications is so vague, that it is no longer a useful regulatory tool." If the Commission concludes that the distinction can no longer be maintained, it may decide to eschew regulation of all terminal equipment, leaving pricing policies to the mercy of the market and antitrust laws.

The FCC has made an admirable effort to provide regulatory guidance in the expanding field of computer communications, but the only certainty is that the contest among the contending factions will continue.

Carolina, "planned to forbid inter-connection of non-carrier supplied terminal equipment with local exchanges, except where such equipment was used exclusively for interstate communication." North Carolina Utils. Comm'n v. FCC, 552 F.2d 1036, 1043 (4th Cir. 1977).

16. Telerent Leasing Corp., 45 F.C.C.2d 204 (1974) (Memorandum Decision & Order, Docket No. 19808), *aff'd sub nom.* North Carolina Utils. Comm'n. v. FCC, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976).

17. *See* Marks & Bell, *supra* note 2.

18. 42 Fed. Reg. 13029 (1977). Commission's Rules and Regulations, Docket 20828, Supplemental Notice of Inquiry and Enlargement of Proposed Rulemaking, F.C.C. 77-151 (March 1, 1977).