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TECHNOLOGY CONVERGENCE AND FEDERALISM: WHO SHOULD DECIDE THE FUTURE OF TELECOMMUNICATIONS REGULATION?

Daniel A. Lyons*

This Article critically examines the division of regulatory jurisdiction over telecommunications issues between the federal government and the states. Currently, the line between federal and state jurisdiction varies depending on the service at issue. This compartmentalization might have made sense fifteen years ago, but the advent of technology convergence has largely rendered this model obsolete. Yesterday's telephone and cable companies now compete head-to-head to offer consumers the vaunted “triple play” of voice, video, and internet services. But these telecommunications companies are finding it increasingly difficult to fit new operations into arcane, rigid regulatory compartments. Moreover, services that consumers view as near-perfect substitutes—such as cable and satellite television—face different regulatory treatment largely due to historical accident. This Article proposes that Congress instead allocate jurisdiction in a platform-neutral manner based upon the relative strengths of federal and state regulators. The federal government is best positioned to regulate economic issues that, if left to the states, would generate substantial spillover effects and disrupt economies of scale. By comparison, state regulators are best qualified to make decisions that turn upon local knowledge. The Article recommends a hybrid model for consumer protection, whereby states bring local issues to the FCC's attention, and the FCC adjudicates these issues from an appropriately national scope.

When it was enacted in 1996, the Telecommunications Act was widely considered a landmark achievement. President Clinton hailed the Act as "truly revolutionary legislation" and boldly declared that "with the stroke of a pen, our laws will catch up with our future." In the span of nearly one hundred pages, the Act sought a complete overhaul of one-sixth of the economy, aiming "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new

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telecommunications technologies.” It was, one influential commentator proclaimed, “likely [to] be remembered as the most important piece of economic legislation of the twentieth century.”

Yet in hindsight, perhaps the most remarkable aspect of the Telecommunications Act is how small these policymakers had dared to dream. While the Act purported to promote technological development and competition, Congress largely left intact the preexisting framework of jurisdictional separation between the federal government and the states. This compartmentalized, or “silos,” model draws different lines between federal and state authority depending on the type of service at issue. For example, the Act grants the federal government primary jurisdiction over interstate telephone service, wireless communications, and internet service. But the states remain the primary nexus of regulation over local landline telephone and cable television service—just as they have throughout most of the industry’s history.

Retention of this legacy model may have made sense in 1996, when landline telephone companies and cable television providers dominated the industry landscape, wireless technology was in its infancy, and most of the 12 million Americans who had internet service accessed the “Information Superhighway” via dial-up modems. But the myriad technological innovations since 1996 have rendered this segmented worldview largely obsolete. First came diffusion, the ability to deliver voice and video communications on platforms other than traditional landline telephone and cable lines. Today, Americans talk more minutes on cellular phones than landlines each month, while voice-over-internet-protocol (VOIP) service and satellite television continue to make inroads into the voice and video market, respectively. The second, and arguably more significant, innovation is convergence, the ability to offer multiple telecommunications services on a single network platform. Yesterday’s monoline telephone and cable companies have grown into sophisticated full-service telecommunications providers, each offering customers the “triple play” of voice, video, and internet-based services on a single platform.

Each step the industry takes toward convergence demonstrates further the brittle obsolescence of the silo-based regulatory model.

5. See, e.g., § 302(b), 110 Stat. at 124 ( repealing 47 U.S.C. § 533(b), which had prevented local exchange carriers from offering video services in markets where they held a monopoly on telephone services).
The retention of this artificial regulatory divide distorts competition by requiring different companies to overcome different regulatory obstacles to offer the same bundle of services to consumers. Sometimes this distortion is unintentional: for example, companies that are unsure how to classify a new service must spend time and money seeking clarification from various federal and state authorities, which do not always reach a uniform conclusion. Other distortions are intentional, such as when incumbent monopolies use local government allies to insulate themselves from competition. Either way, this artificial jurisdictional divide increases the costs of providing telecommunications service, arbitrarily favors some networks over others, and prevents customers from fully realizing the competitive benefits that convergence could bring.

This Article recommends that Congress allow convergence to blur the regulatory lines that the Telecommunications Act has struggled in vain to keep distinct. Rather than isolating telecommunications services into individual silos with varying levels of state regulatory control, Congress should recognize a unitary federal interest in maintaining a nationwide telecommunications network that delivers multiple services over a variety of competing platforms. Both consumers and telecommunications companies benefit from a regulatory framework that encourages companies to offer as many services as possible to as many potential customers as possible. By viewing this network in a service- and platform-neutral fashion, Congress can determine which aspects of telecommunications service are best regulated at the national level, and which are best regulated at the local level, without fear of distorting competition through regulatory disparity.

This Article unfolds in three parts. Part I places the silo model in historical context, showing how telephone and cable companies developed as largely local services that were gradually subjected to regulation partly due to concerns that each could constitute a natural monopoly. Part II discusses the myriad problems that face today’s telecommunications providers as they struggle to fit new products and business models into the obsolete silo-based regulatory structure. The artificial contours of the silo-based model create uncertainty and regulatory disparity that discourage investment in new technologies and infrastructure improvement. State regulators often fail to appreciate the costs their rules impose beyond their borders, and new entrants struggle to overcome local barriers to entry.
Part III outlines an alternative approach to telecommunications regulation that allocates jurisdiction in a content- and platform-neutral manner based upon the relative strengths of federal and state regulators. The federal government is in the best position to regulate issues that, if left to the states, would create substantial spillover effects that could unreasonably disrupt national economies of scale. By comparison, state regulators are best qualified to make decisions that turn upon local knowledge. Federal preemption of economic regulation such as rates and market entry places these decisions in the hands of regulators with a national perspective, able to assess all of the costs and benefits of a proposed rule. But states should retain regulatory authority over local issues such as public rights-of-way access, decisions that the FCC lacks both the ability and the inclination to adjudicate properly. In the more difficult arena of consumer protection, this Article recommends a hybrid model whereby states rely on local knowledge to prosecute cases before the FCC, while the FCC adjudicates these issues from an appropriately national scope.

I. LOCAL TELECOMMUNICATIONS REGULATION: A SHORT PRIMER

Before analyzing what the proper divide ought to be between federal and state authority, it is helpful to examine the forces that gave rise to the existing model. Both telephone and cable television service began as primarily local services, providing improved communications capabilities within small communities and focusing very little on services that crossed state boundaries. State-by-state regulation of these services flowed naturally from this local orientation and from the reality that most regulatory issues related to the deployment of the physical infrastructure into local communities. By conscious design, federal regulation primarily governed activities that were beyond the capabilities of states to regulate, and did so in a manner that expressly reinforced state supremacy over intrastate services.

A. Local Telephone Service

The first telephones were simple point-to-point systems that linked two individual calling stations. In the late nineteenth century, telephone companies developed local exchanges, which allowed all telephones connected to a local switchboard to communicate with one another. Gradually, thousands of local exchange carriers developed across the country, each coordinating the telephone traffic for its local community. But calls outside one’s city were difficult, initially because signal quality deteriorated rapidly over longer distances, and later because the local exchanges refused to interconnect with one another.

Gradually, state lawmakers became concerned that local exchange service was a natural monopoly that could have deleterious effects on consumers. A substantial fixed capital investment was necessary to provide telephone lines throughout a community and to build an exchange to process calls; the installation of a second network to compete against an incumbent provider was seen as both expensive and wastefully duplicative. But while the economics suggested that a local market might be most efficiently served by a single provider, natural monopolies carry the risk that the monopolist would abuse its position by charging inefficiently high rates, neglecting customer service, or leveraging its advantage to unfairly compete in other markets.

These concerns magnified as the Bell Telephone Company began aggressively combating local competition in those markets where a rival network had developed. Bell, the nation’s first telephone provider, owned regional affiliate companies which controlled local exchanges throughout the country, and also owned key patents, most notably on the technology that facilitated high-quality long-distance communication between local exchanges. Under the slogan “One Policy, One System, Universal

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7. Huber, supra note 4, § 1.2.2.
8. Id.
9. Specifically, in the late 1890s, George Campbell, an engineer for Bell Telephone Company, discovered that by concentrating inductance in coils along telephone lines, a procedure known as “loading the lines,” one could improve transmission quality. Id. § 1.2.3. Shortly thereafter, Lee DeForest developed a vacuum tube electronic amplifier, the “audion,” which amplified electric signals and could be placed at intervals along a telephone line to act as “repeaters” for a long distance call. Id. Together, Campbell’s procedure and DeForest’s audion (the patent for which Bell purchased in 1913) allowed Bell Telephone to deploy interexchange transmission lines that could carry long-distance calls between communities and ultimately across the country. Id.
10. Id. §§ 1.2.3, 3.2.1.
11. Id.
12. Id. § 3.2.1.
Service," Bell leveraged its long-distance advantage by refusing to interconnect with non-Bell-affiliated local exchanges, which caused many independent telephone companies to fold. As Bell increasingly became communities' sole telephone company, state regulators stepped in to regulate local telephone service, typically by granting the telephone company a franchise to offer monopoly local telephone service at reasonable rates and with universal access.

Ultimately, Bell's dominance of long-distance service proved an obstacle insurmountable even to state regulatory commissions. As a result, state lawmakers joined the few remaining independent telephone companies to call for federal regulation of the Bell monopoly. In 1934, Congress passed the Communications Act, which sought to "make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." Among other provisions, the 1934 Act determined that interstate telephone service should be subject to common carrier regulation as administered by a new Federal Communications Commission ("FCC"). This classification meant that Bell had to offer its long-distance service at just and reasonable rates pursuant to interstate tariffs filed with the Commission, and could not unreasonably discriminate between customers in the provision of services.

But states sought assurance that regulation of long-distance telephone services would not become a federal camel's nose under

13. Id. §§ 1.3, 3.2.1. Bell's aggressive tactics may lead one to wonder whether telephone service was in fact a "natural" monopoly at the time. But natural or not, Bell was unquestionably a monopolist entity by the early 1900s.
14. Id. § 3.2.5.
15. Id. § 3.2.5 n.34.
16. Technically, the Mann-Elkins Act granted the Interstate Commerce Commission federal regulatory authority over telephone networks as early as 1910. Id. § 3.2.2. And at least initially, the Justice Department sought to monitor Bell's monopolistic behavior, even bringing an antitrust action against the company in 1913. Id. § 4.4.1. The following year, Bell and the Justice Department signed the Kingsbury Commitment, which required Bell to interconnect with independents and to refrain from further acquisitions. Id. § 4.4.1. But the ICC soon became preoccupied with managing the abuses committed by the nation's railroad system, the antitrust case was dropped, and the Kingsbury Commitment was at least partially abrogated by statute. See id. §§ 1.3.3, 3.2.2. As a result, the Bell monopoly was effectively permitted to grow unchecked by federal authority until the arrival of the Communications Act. See id.
the states' regulatory tent. 20 When the 1934 Communications Act was adopted, intrastate calls comprised ninety-eight percent of telephone traffic, and 45 of the 48 states had created regulatory commissions to oversee local exchange services. 21 States feared that a power-hungry FCC would eventually displace their control over this local telephone market. Their concerns were not unfounded: the Supreme Court had just recently upheld the Interstate Commerce Commission's authority to regulate intrastate railroad rates, because intrastate railroad activity had an incidental effect upon its regulation of interstate rates. 22 To prevent the FCC from assuming similar jurisdiction, Congress included within the Communications Act a clear provision that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to . . . intrastate communication service." 23 As the Supreme Court has explained, the Act sought "to divide the world of domestic telephone service neatly into two hemispheres—one comprised of interstate service, over which the FCC would have plenary authority, and the other made up of intrastate services, over which the states would retain exclusive jurisdiction." 24

Under this regulatory scheme, the vertically-integrated Bell System, doing business as AT&T and several regional Bell affiliates, dominated the telecommunications industry for nearly fifty years. But by the late 1960s and early 1970s, economists and policymakers began to realize that some aspects of telecommunications service might not exhibit the behavior of a natural monopoly. It soon became clear that AT&T was exploiting its monopoly over local exchange service to prevent new entrants from challenging its control of related markets for telephone equipment, 25 computer-based "enhanced" telecommunications services, 26 and even long-distance service. 27 Eventually the Justice Department's Antitrust Division

20. See Geoffrey Nunberg, Going Nuclear: Language, Politics, and Culture in Confrontational Times 118 (2004) (explaining origins of fable wherein an Arab miller allows a camel to stick its nose into his tent, then other parts of its body, until the camel is entirely inside and refuses to leave).
21. HUBER, supra note 4, § 3.2.5.
27. In 1970, MCI received FCC approval, over AT&T's fierce opposition, to provide private point-to-point communication service between Chicago and St. Louis using microwave
sued AT&T, prompting eight years of litigation that ended with the voluntary breakup of the Bell System. Under a 1984 consent decree, AT&T spun off its local telephone operations into seven regional holding companies known as Regional Bell Operating Companies or "Baby Bells," which in turn owned the Bell System's twenty-two local telephone companies.

The consent decree placed certain restrictions on the Baby Bells but left their core local telephone operations within the states' purview. Under the court's modified final judgment ("MFJ"), the country was divided into 163 Local Access and Transport Areas, or "LATAs," whose boundaries largely corresponded to metropolitan statistical areas. The consent decree largely assumed that the Baby Bells would have monopolies over local exchange service within each LATA. To prevent the Baby Bells from abusing that power, the MFJ prevented them from providing interLATA (or "long-distance") telephone service and also forbade their entry into markets for various non-telephone services. Within these broad restrictions, however, the Baby Bells continued to offer local exchange service pursuant to state tariffs and the terms of their state franchise agreements. Thus throughout the telephone's regulatory history, the notion that local telephone service was a natural monopoly distinct from long-distance service justified state-by-state regulation of the industry under such terms and conditions as state regulators saw fit to impose.

B. Local Franchising of Cable Television Service

Like telephony, cable television was originally developed as a largely local service. In the late 1940s, community antenna television technology. Microwave Commc'ns, Inc., 18 F.C.C.2d 953 (1969), reh'g denied, 21 F.C.C.2d 190 (1970). Shortly thereafter, MCI and others built out nationwide networks with the FCC's approval with the goal of competing directly against AT&T for long-distance business. When AT&T refused to permit these rivals to interconnect with its local exchange facilities, MCI brought, and won, a suit alleging violations of the Sherman Act. MCI Commc'ns Corp. v. AT&T, 708 F.2d 1081 (7th Cir. 1983).

28. For an excellent discussion of the consent decree and its effect on post-breakup telecommunications regulation, see Joseph D. Kearney, From the Fall of the Bell System to the Telecommunications Act: Regulation of Telecommunications under Judge Greene, 50 Hastings L.J. 1395 (1999).

29. Id. at 1418. The decree did not take effect until January 1, 1984. Id. at 1418–19.

30. See Kearney, supra note 28, at 115–17.

31. Huber, supra note 4, § 9.6.1.2. Notably, because LATAs followed natural population boundaries, some LATAs crossed state boundaries. Id.

32. See Kearney, supra note 28, at 1415–17.

33. See id. at 1419.
sion ("CATV") service was introduced to improve signal reception for broadcast television stations.\textsuperscript{34} In certain valleys and outlying areas, residents found it difficult to receive quality over-the-air television broadcasts using a set-top or rooftop antenna. To remedy this problem, a CATV provider could place a large antenna on a nearby mountaintop, which could pick up local broadcast signals and retransmit them through cables that ran from the antenna to these signal-challenged residents.\textsuperscript{35} These initial cable systems generally did not offer programs beyond those already broadcast over-the-air, because technology limited the number of channels available and the customer base was too small to support development and distribution of original content.\textsuperscript{36}

By the 1960s, local governments began franchising these cable systems. Their authority stemmed from municipal control of public rights-of-way, access to which cable companies needed to deploy their networks.\textsuperscript{37} As a condition of granting that access, municipalities imposed franchise conditions "in the public interest"\textsuperscript{38} ranging from simple permit costs to more substantial franchise fees, construction of public, educational, and governmental ("PEG") access channels, and even requirements wholly unrelated to cable television operation.\textsuperscript{39} Many cities and states also began regulating rates out of fear that cable, like local telephone service, was a natural monopoly requiring consumer protection.\textsuperscript{40}

The FCC also asserted jurisdiction over cable services in fits and spurts, which generated substantial confusion regarding the scope of federal and state jurisdiction. The Commission was initially content to abstain from regulating cable, believing that it lacked the authority to do so under the Communications Act.\textsuperscript{41} But as cable

\textsuperscript{34.} See Robert W. Crandall et al., Does Video Delivered Over a Telephone Network Require a Cable Franchise?, 59 FED. COMM. L.J. 251, 259 (2007).
\textsuperscript{35.} Id.
\textsuperscript{36.} Id.
\textsuperscript{37.} See Thomas Hildebrandt, Note, Unplugging the Cable Franchise: A Regulatory Framework To Promote the IPTV Cable Alternative, 42 GA. L. REV. 227, 234 (2007).
\textsuperscript{38.} American Civil Liberties Union v. FCC, 823 F.2d 1554, 1558 (D.C. Cir. 1987).
\textsuperscript{39.} See Hildebrandt, supra note 37, at 234.
\textsuperscript{40.} See Crandall, supra note 34, at 260; Thomas W. Hazlett, Cable TV Franchises As Barriers To Competition, 12 VA. J.L. & TECH. 2, 10 (2007) [hereinafter Hazlett, Cable TV Franchises].
\textsuperscript{41.} See Frontier Broad. Co. v. Collier, 24 F.C.C. 251, 255–56 (1958). In Frontier, broadcast stations filed an FCC complaint seeking Commission regulation of cable systems as common carriers under Title II of the Communications Act. The FCC dismissed the action, stating that it did "not believe that . . . [cable] systems are engaged in performing the service of communications common carriers within the contemplation of the applicable provisions of the Communications Act." Id. at 253–54. It confirmed this ruling the following year in Impact of Community Antenna Systems, TV Translators, TV "Satellite Stations" & TV "Repeater" Servs. on the Orderly Dev. of Television Broad., 26 F.C.C. 403, 428–29 (1959), noting that Congressional action would be required before the Commission could assert general jurisdiction.
service proliferated, the Commission stepped in to protect the interests of over-the-air broadcasters that it did directly regulate. In the 1960s and 1970s, the Commission experimented with regulations requiring cable operators to carry all local channels in a market, preventing them from retransmitting distant signals from other markets, and developing, then scuttling, a labyrinthine scheme to regulate original content. By the 1970s, the Commission also sought to regulate both the fees that cable operators could charge and those that municipalities could charge for cable franchises. This overlapping jurisdiction left cable in an "ill-defined... state of regulatory uncertainty" that stifled competition and prevented innovation.

The 1984 Cable Act resolved this uncertainty by providing Congressional imprimatur of local franchising. The Cable Act prohibited companies from providing multichannel video services through cable lines without a franchise from state or local government. The terms of these franchise agreements were largely left in the hands of the local franchising authority, but the Act adopted some broad restrictions such as a cap on franchise fees and rules that largely eliminated rate regulation of cable companies. In response to concerns that the 1984 Act had spawned a precipitous rise in cable rates, Congress amended the Act in 1992 to prohibit over cable. See also Alliance for Cmty. Media v. FCC, 529 F.3d 763, 767 (6th Cir. 2008) (tracking history of cable regulation).

42. The Supreme Court found that the FCC had limited jurisdiction over cable services pursuant to its Title I authority, because such regulation was "reasonably ancillary to the effective performance of the Commission's various responsibilities for the regulation of television broadcasting." United States v. Southwestern Cable Co., 392 U.S. 157, 178 (1968).

43. See Rules and Regulations Relating to the Distribution of Television Broad. Signals by Cmty. Antenna Television Sys., 2 F.C.C.2d 725 (1966) (second report & order). Notably, the Commission approached the jurisdictional question with some concern and explained that it sought no general regulatory authority over cable. "Rather, we view our role as one of cooperating with local franchising authorities and State regulatory commissions to the maximum extent possible, such as by making information available to them, consulting with respect to technical standards for CATV operations, etc." Rules and Regulations Relating to the Distribution of Television Broad. Signals by Cmty. Antenna Television Sys., 1 F.C.C.2d 453, 466 (1965) (notice of proposed rulemaking).

44. See Crandall, supra note 34, at 259. For example, these regulations limited premium programming "to one feature film more than two years old and less than ten years old per week for one week of each month" and precluded broadcast of most live sporting events. Id. The stated purpose of such regulations was to prevent pay television from "siphoning" away popular programming that otherwise would be available to the public for free. Home Box Office, Inc. v. FCC, 567 F.2d 9, 25 (D.C. Cir. 1977).

45. See American Civil Liberties Union v. FCC, 823 F.2d 1554, 1559 (D.C. Cir. 1987).

46. See Alliance for Cmty. Media v. FCC, 529 F.3d 763, 767 (6th Cir. 2008) (quoting American Civil Liberties Union, 823 F.2d at 1559).


48. See id.
exclusive franchise agreements and to reinstitute local authority to engage in rate regulation. Thus by the mid-1990s, Congress had explicitly decentralized effective regulation of cable services to state and local governments, which acted within the Cable Act’s broad scope of authority.

C. The Telecommunications Act of 1996

The Telecommunications Act of 1996 sought to revolutionize the industry by adapting legacy regulations to meet twenty-first-century challenges. The centerpiece of the Act was the creation of a competitive market for local telephone service. To accomplish this goal, the Act preempted state-granted monopolies over local telephone service and required the Baby Bell local exchange carriers to offer their networks for use by a new category of phone companies known as Competitive Local Exchange Carriers (“CLECs”). Under this scheme, a CLEC could enter the local telephone market in one of three ways: it could purchase local telephone services from a Baby Bell at wholesale rates for resale to end users, lease elements of the Baby Bell’s network on an unbundled basis, or interconnect its own facilities with the Baby Bell’s network. Congress hoped that through this complex regulatory scheme, a new generation of telephone companies would emerge to challenge the Baby Bells and stimulate competition in the provision of local exchange service.

But the Act consciously preserved the Communications Act’s jurisdictional divide between interstate and intrastate telephone service. Local competition was a federally-mandated scheme but was to be executed primarily by the states against a backdrop of broad FCC guidelines. State public utilities commissions were to review interconnection agreements between the Baby Bells and new market entrants and to arbitrate disputes when the parties failed to reach an agreement. State regulators also explicitly retained authority to regulate local telephone companies to promote universal service, protect the public safety and welfare, ensure the continued quality of communications service, safeguard the rights...

52. See Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 549 (2007).
of consumers, and manage local rights-of-way. Through this mixture of "dual federalism" and "cooperative federalism," it was thought that Congress could achieve its broad policy objectives while still respecting the states' interest in local telephone regulation that had justified Section 2 of the 1934 Act.

Similarly, the Act added a layer of broad federal policy objectives to cable regulation while preserving traditional local control over the service. Most notably, the Act lifted preexisting restrictions on telephone company entry into the cable market. It also reimposed restrictions that effectively prevented rate regulation of cable companies. But the Act largely left intact the preexisting system of local regulation of cable through franchise agreements, subject to an amorphous requirement that local franchise authorities not "unreasonably refuse to award an additional competitive franchise" to compete against an incumbent provider.

Thus the Telecommunications Act of 1996 generally retained the states' preexisting authority to regulate local telephone and cable service, subject to certain broad federal guidelines. This preservation of local control stands in stark contrast to other telecommunications services, such as wireless communications, which the Act placed primarily in the Commission's hands.

The silo-based model of telecommunications federalism stemmed in part from historical accident: because telephone and cable service began as local services and were largely considered local monopolies,
they were regulated primarily at the local level. By 1996, however, each service had become part of a large nationwide network in a manner that should have, but did not, prompt greater reflection upon the continuing relevance of this model. The next Part examines the problems that this historic segmented regulatory structure has created for the modern telecommunications industry.

II. Modern Flaws in the Historical Model

The Telecommunications Act's preservation of the silo-based model of regulation is built upon two related assumptions about the telecommunications industry. First, the Act assumed without much discussion that local telephone and cable service were still properly considered “local” services. By continuing to locate jurisdiction over these services at the state level, the Act endorsed the premise that the states’ interest in regulation should trump that of the Federal Communications Commission. Second, it assumed that monoline telecommunications service would continue to dominate the industry for the foreseeable future. Although the Act dreamed of telecommunications convergence, the thrust of its reforms was to increase intramodal competition. For example, the Act attempted to break up local telephone monopolies not by encouraging telephone service over cable lines, but by creating a new class of monoline local exchange carriers, the CLECs, that could compete head-to-head against the Baby Bells in the market for voice services.

It is unclear whether these two assumptions remained valid even in 1996. Even by then, voice and video services had departed significantly from their local roots and were beginning to break free from the architecture of their underlying platforms. But any vestigial credibility these assumptions may have carried then has been destroyed by technological developments in the twelve years since, as diffusion and convergence have redefined the telecommunications landscape. The next Section explores these twin fallacies in greater detail.

A. The Legal Fiction of “Local” Services

1. Telephone

Even by 1996, the label of “local” telephone service was something of a legal fiction. Ten years earlier, the Supreme Court had
noted that while the 1934 Communications Act sought to "divide the world of domestic telephone service neatly into two hemispheres," the "realities of technology and economics belie such a clean parceling of responsibility."\(^\text{59}\) Typically, local telephone service was no longer delivered by a small community-based switchboard operator, but by one of seven multistate Regional Bell Operating Companies.\(^\text{60}\) While these companies could only provide intraLATA service pursuant to the terms of the 1984 consent decree, the LATA boundaries were not drawn neatly along state lines.\(^\text{61}\) The LATA map sought to reflect the calling patterns of statistic metropolitan areas, many of which are multistate in nature. For example, LATA No. 236 covers the Washington, DC metropolitan area, including the entire District of Columbia and substantial portions of adjoining Maryland and Virginia. LATA No. 358 includes Chicago and adjoining suburbs in both Illinois and Indiana. And LATA No. 546 covers both the Texas and Oklahoma panhandles.\(^\text{62}\) In these and other LATAs, many ostensibly "local" intraLATA calls are in fact interstate in nature, yet are connected by local exchange carriers and regulated by state public utilities commissions rather than by the FCC.

Even when a customer places a purely intrastate landline call (i.e., between two residents of the same state), it is quite possible that the signal crosses state lines on the way to the recipient. Technological advances have lowered the carriers' cost of transporting a call along telephone lines, which allows carriers to move switching equipment and ancillary services out of the local office and into more centralized locations.\(^\text{63}\) This "delocalization"\(^\text{64}\) of back-office equipment means, for example, that a local call placed in Connecticut may travel to a switch in New York before being connected

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60. It is worth noting that several independent telephone companies also offered local telephone service in 1996, largely in areas unserved by the Baby Bells. General Telephone (GTE), the largest of these independent non-Bell-affiliated entities, was a multistate service provider whose size rivaled those of the Baby Bells.
61. See Cooper & Koukoutchos, supra note 6, at 917–18.
62. See id. Regional LATA maps can be found at http://www.latamaps.com/Telecom_Maps/Regional_LATA_maps/regional_lata_maps.html (on file with the University of Michigan Journal of Law Reform).
64. See id. As Sicker explains, this phenomenon is commonly described as "decentralization" because it moves facilities out of the "central" offices in each community. But this term is a misnomer, as decentralization implies the diffusion of control rather than concentration. As a result, this Article endorses Sicker's term "delocalization," which more appropriately captures the essence of the phenomenon.
back to a Connecticut recipient. Ancillary "local" services such as directory assistance and voicemail storage and retrieval are even more centralized, often processed by a handful of call centers nationwide and therefore routinely cross state lines despite being regulated as "local" services. The Telecommunications Act recognizes some of these jurisdictional oddities: for example, the Act explicitly labels interLATA calls that cross state lines as "intrastate" for regulatory purposes, which is nothing more than creative statutory labeling that disregards the obvious fact that such calls are in fact interstate.

Notably, customers are increasingly unlikely to see a distinction between intrastate and interstate calls in a way that justifies separate regulatory regimes. As the Supreme Court noted, the customer uses the same telephone, local loop, and local exchange equipment to call next door as he does to call across the country. While the interstate call usually travels farther to get to its destination, the connection is virtually instantaneous and therefore the additional distance is imperceptible to the communicating parties. From the customer's perspective, a local call looks like an interstate call, and therefore there is no reason to subject them to two different regulatory regimes determined by the accident of geographic proximity between the calling parties.

2. Cable

Similarly, the reality of modern cable networks undermines the assumption that such activities are primarily local in scope. Cable long ago evolved from its roots as a community-antenna retransmission service for local broadcasts. Today, local rebroadcasts are ancillary to cable's primary value proposition, the delivery of hundreds of nationwide channels that provide original content unavailable through over-the-air broadcasters. A cable television station beams content from a fixed studio location to a satellite system, which distributes the signal to receivers nationwide for dissemination to cable subscribers. Even the local broadcasts that cable operators provide are retransmissions of channels available

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65. See Cooper & Koukoutchos, supra note 6, at 317–18.
66. See id. at 318.
68. Of course, there is no constitutional concern with Congress determining that, as a policy matter, a service that crosses state lines should nonetheless be subject to state rather than federal regulatory jurisdiction. The objection is to the labeling exercise hiding that this is in fact what Congress is choosing to do.
Consolidation of cable operators has reinforced the national scope of cable service. Even before the Telecommunications Act, the locally-owned, standalone cable franchisee was an endangered species. In 1994, two years before the Telecommunications Act, the top four cable operators accounted for forty-seven percent of all cable subscribers.\(^7\) By June 2004, that figure had climbed to sixty percent.\(^2\) Notably, this concentration has largely occurred in clusters, meaning that a single company acquires geographically contiguous local franchises to serve larger areas: the FCC estimates that by 2003, over eighty percent of cable customers received service from a system that was part of a larger cluster of franchises.\(^7\) Consolidation has concentrated the cable industry in a handful of national networks that typically do not compete against one another in a given area and that broadcast mostly national content in the same manner to customers nationwide.

### B. Diffusion and Convergence: The Destruction of the Monoline Business Model

#### 1. Technology Diffusion

The astounding technological advancements in the years since the Telecommunications Act have challenged the second assumption underlying local control, the continued dominance of monoline service providers within a segmented telecommunications landscape. At first, this challenge came in the form of technological diffusion, the provision of telephone and video service through alternative network platforms that are not regulated by states and localities. As increased tower density has improved the quality of wireless communication, the cellular phone has risen to be a formidable rival to traditional landline telephone service. By 2007, wireless penetration reached eighty percent of the tele-
From the consumer's perspective, a wireless call to another customer within the state is an almost perfect substitute for a landline call between the same parties. The FCC notes that many regional wireless companies are competing directly against landline local exchange carriers by offering unlimited local calling for a flat fee each month just as local exchange carriers do. This competition has had an effect on the traditional landline market: between 2001 and 2006, the Baby Bells saw a twenty-three percent decrease in the number of landlines they serviced, a phenomenon that the FCC attributes in part to wireless substitution. Unlike local landline service, however, wireless service is regulated primarily at the federal level, with local authority mostly limited to cell phone tower siting and consumer protection issues.

Like wireless service, Voice-Over-Internet-Protocol ("VOIP") service has challenged the notion that local calls must be made over a local exchange. VOIP delivers intrastate (and interstate) voice communications across the internet in the same way that email and other data travel to one's computer. The voice transmission is broken into small packets of data, each of which travels over the most efficient path available at a given instant, making it nearly impossible to determine whether a call has crossed state lines en route to an in-state recipient. Moreover, customers can send and receive calls anywhere in the world that an internet connection is available, meaning that one cannot tell from a caller's address or phone number whether the caller is in fact in-state for any given call. Because it is impossible to distinguish intrastate from interstate calls, the FCC has held that VOIP service is jurisdictionally interstate and has preempted state and local regulation of the service.

Traditional cable service has also faced diffusion, in the form of direct broadcast satellite ("DBS") television systems. DBS is not the first technological rival to challenge cable's monopoly: in the 1980s both wireless cable and direct-to-home ("DTH") satellite systems developed as ultimately unsuccessful cable alternatives. But DBS systems have recognized success where their predecessors failed, due to technological advances and congressional action that...
facilitated cost-efficient retransmission of local broadcast stations and delivery of cable content.\textsuperscript{81} Because DBS systems do not need access to local public rights-of-way, they may deliver video content to customers without having to seek a cable franchise agreement from the city and thus escape many of the regulations that local governments place upon traditional cable service.

Thus, through wireless service, VOIP service, and DBS systems, consumers can, and increasingly do, receive near-perfect substitutes for ostensibly local services, even though the substitutes are almost entirely regulated at the federal level. This growing flight of local telecommunications services to federally-regulated platforms casts significant doubt upon the Telecommunications Act’s implicit premise that intrastate telephone and multichannel video services are inherently local and must be regulated at the local level.

2. Technology Convergence

A related, and equally disruptive, phenomenon is technology convergence, the ability to offer multiple telecommunications services on the same platform. The Telecommunications Act’s long-term aspirations of convergence are rapidly becoming a reality, most notably in the cable segment. Cable networks are no longer merely the providers of subscription-based video services to customers. For example, cable companies have become the nation’s leading providers of high-speed internet access: the FCC estimates that just over fifty percent of residential high-speed internet lines, and thirty-four percent of total high-speed lines in the United States, rely upon cable modems to deliver internet content over the cable industry’s coaxial networks.\textsuperscript{82} As of 2007, high-speed cable modem service was available to ninety-six percent of households

\textsuperscript{81} See Hildebrandt, supra note 37, at 238–39. Specifically, the advent of pizza-box-sized satellite dishes allowed satellite customers to receive signals without erecting the behemoth, and less reliable, receivers necessary for DTH satellite service. Similarly, the discovery of “spot beams” made it feasible for DBS providers to rebroadcast local channels like cable. Through the Satellite Home Viewer Improvement Act of 1999, DBS satellite providers received the right to retransmit these stations under a compulsory licensing scheme. 17 U.S.C. § 122 (2006).

\textsuperscript{82} See Fed. Commc’n Comm’n, High-Speed Services for Internet Access: Status as of June 30, 2007 (2008) (on file with the University of Michigan Journal of Law Reform), available at [link]. The study defined “high-speed” access as achieving download speeds in excess of 200 kilobytes per second. Id. at 1 n.1. These statistics are based upon twice-annual reports on end-users that all facilities-based internet providers must supply to the Commission pursuant to the FCC’s jurisdiction over internet services. Id. at 1 & n.2.
that could receive cable television. Cable companies are also increasingly offering telephone service by leveraging VOIP technology over their broadband lines.

Similarly, the Baby Bells and today's other local telephone service providers offer much more than just local phone service. Most telephone companies offer Digital Subscriber Line ("DSL") Service, which uses the telephone network's copper wires to carry high-speed internet content alongside voice service. DSL is cable's primary rival in the broadband access market, available in eighty-two percent of U.S. households and constituting twenty-seven percent of total high-speed internet lines. Verizon Communications and AT&T, the two largest telephone companies and owners of much of the Baby Bell infrastructure spun off under the 1984 consent decree, have also begun to offer video services to rival that of cable operators. Over the past ten years, the telephone companies have spent billions of dollars to replace their traditional copper wires with fiber-optic cable, an upgrade that dramatically improves the quantity and quality of transmissions and was necessary to facilitate the delivery of video services throughout the network.

Wireless services are increasingly becoming a third potential platform for the vaunted "triple play" of bundled telecommunications services. As noted above, wireless voice communication is increasingly supplanting landline telephone service as the medium of choice for voice communication. Companies such as Research in Motion, maker of the ubiquitous BlackBerry device, have pioneered the delivery of e-mail, web

83. Id. at 3.
84. Id.
85. Verizon was formed by the 2000 merger of two RBOCs, NYNEX and Bell Atlantic, plus General Telephone, the largest non-Bell-affiliated local telephone company in the United States. Verizon, Corporate History, http://investor.verizon.com/profile/history/ (on file with the University of Michigan Journal of Law Reform). In 2005, Verizon acquired MCI, the second-largest long distance provider in the United States. Id. The company currently known as AT&T stems from the late 1990s mergers of the Southwestern Bell, Pacific Telesis, and Ameritech RBOCs, plus independent Bell system franchise Southern New England Telephone. AT&T Investor Relations, http://www.att.com/gen/investor-relations?pid=5711 (on file with the University of Michigan Journal of Law Reform). The combined company, known as SBC Communications, acquired the AT&T long-distance company in 2005, and RBOC BellSouth in 2006, and currently does business under the AT&T name. Id.
86. Through Project U-Verse (formerly known as Project Lightspeed), AT&T has embarked upon a fiber-to-the-node (FTTN) model that uses fiber-optic cable from the local exchange office to neighborhood nodes, then traditional twisted-pair copper wire from the neighborhood node to individual homes. AT&T U-verse, http://www.att.com/gen/press-room?pid=5838 (on file with the University of Michigan Journal of Law Reform). Verizon's FiOS program is centered upon a more ambitious, and more expensive, fiber-to-the-home (FTTH) system that relies on fiber-optic cable exclusively throughout much of the FiOS footprint. See Verizon FiOS TV, http://www22.verizon.com/residential/fiostv (on file with the University of Michigan Journal of Law Reform).
browsing, and other data services through wireless handsets; wireless companies such as AT&T Mobility and Verizon Wireless increasingly offer this capability as well, and have introduced adapters that allow consumers to use their wireless networks to receive internet service on their laptops. And while wireless video service is not yet a perfect substitute for traditional cable, MobiTV currently streams multiple broadcast channels to the cell phones of over four million subscribers. 87

C. The Distortive Effects of Continued State-by-State Regulation

The diffusion of telecommunications services across multiple platforms, and the convergence of multiple services on an individual platform, undercuts what residual justification remains for the existing silo-based model of telecommunications federalism. To the extent that states have an interest in regulating telephone or cable service, its authority to do so is limited by the fact that customers may now purchase nearly identical services through federally-regulated networks such as DBS satellite television. And to the extent that states' interest lies in regulating the underlying landline telephone and cable networks, their regulatory authority reaches only a portion of the networks operating within their jurisdiction. Furthermore, any interest in continued regulation of these networks cannot justify the extension of authority to regulate some (but not all) services traversing those networks.

Given these developments, continued state-by-state regulation of some telecommunications services offered over some networks distorts modern competition in at least four related ways:

- The need to classify new services and business models within the existing jurisdictional framework leads to uncertainty, which can increase both the cost and the delay of deploying these new services for customers;
- Disparate regulatory schemes for similar services distort competition by indirectly subsidizing less regulated market players;
- Local regulation of national networks generates negative externalities; and

• Local barriers to entry insulate incumbent providers from competition.

The balance of this Section explores these issues in turn.

1. Regulatory Uncertainty

The division of regulatory authority creates uncertainty when telecommunications companies seek to offer new services that do not fit within the clearly defined silos of federal and state jurisdiction. Unless the FCC quickly resolves this uncertainty, state and local decisionmakers will take it upon themselves to do so, and often generate inconsistent decisions in the process. This uncertainty can discourage capital investment in telecommunications services and delay the provision of new services to customers as companies struggle to determine which rules they must satisfy.

The regulatory history of cable modem service demonstrates this phenomenon. The FCC was quick to classify DSL as a "telecommunications service" subject to common carrier regulation under the Telecommunications Act. But the Commission refused to provide similar guidance with regard to cable modem services. Some local franchising authorities rushed to fill the regulatory vacuum by declaring cable modem services to be "cable services" subject to local regulation under the Act. With this label, local franchise authorities could attach myriad conditions upon the provision of cable modem service, such as requirements that the service be made available to all interested customers, including resellers, on reasonable terms and conditions. Cable operators sued to enjoin

88. See Deployment of Wireline Services Offering Advanced Telecommunications Capability, 13 F.C.C.R. 24012, 24030–31, ¶¶ 35–37 (1998). The FCC explained that high-speed Internet access via DSL is actually two bundled services: access to the Internet, which is a largely unregulated Title I information service, and underlying transmission of information over the DSL line, which is a Title II common carrier service. Id. The upshot of this holding was that common carrier obligations required telephone companies to sell the underlying transmission service on an unbundled basis to other internet service providers, which could package it with their own Internet service. Id. This regime ended when the FCC reconsidered its earlier ruling in 2005. See infra note 94.


90. See, e.g., AT&T Corp. v. City of Portland, 216 F.3d 871, 875–76 (9th Cir. 2000); MediaOne Group, Inc. v. County of Henrico, 97 F. Supp. 2d 712, 715 (E.D. Va. 2000).

91. AT&T Corp., 216 F.3d at 871; MediaOne Group, Inc., 97 F. Supp. 2d at 712.
the conditions, and the adjudicating courts reached inconsistent
decisions regarding the proper classification of the service.92

The uncertainty regarding how cable modem service should be
treated under the Act generated a wide range of ill effects. Cable
operators and municipalities invested substantial resources in liti-
gating these issues in district courts across the country. And would-
be investors that sought to achieve greater economics of scale
through consolidation of the cable industry found their efforts
thwarted by the inability to determine whether cable modem ser-
vice would be scalable.93 The FCC did not resolve this issue until
2002, when it declared that cable modem service is an interstate
information service not subject to local regulation under Title VI.94

2. Regulatory Disparity

The adoption of disparate regulatory schemes for similar ser-
vices can also distort consumer behavior by indirectly subsidizing
the network subject to the least amount of regulation. Absent regu-
latory disparity, consumers faced with the option of receiving
similar services from multiple vendors will choose the option that
best suits their needs. But if the government burdens one vendor
with regulations that increase the price or decrease the quality of
that vendor’s service, consumers are likely to flock to the unregu-
lated competitor, even if they might have selected the regulated
vendor in the absence of the regulation. In this way, regulatory
disparity can distort competition, channel consumer behavior to-
ward suboptimal products, and ultimately lead to inefficient
allocations of shareholder capital.

92. Compare MediaOne Group, 97 F. Supp. 2d at 715 (finding cable modem service is
“cable service”), with AT&T Corp., 216 F.3d at 878–80 (holding cable modem service is “tele-
communications service” delivered over cable network), and Gulf Power Co. v. FCC, 208
F.3d 1263, 1277–78 (11th Cir. 2000) (concluding Internet service provided by cable compa-
nies is not cable service, and that Internet service is not telecommunications service).

93. See AT&T Corp., 216 F.3d at 874–75; MediaOne Group, 97 F. Supp. 2d at 713.

94. See Cable Modem Order, supra note 89, ¶ 7. Various parties challenged the order in
the Ninth Circuit, which considered itself bound by its earlier determination in AT&T Corp.
that cable modem service was a telecommunications service. Brand X Internet Servs. v. FCC,
345 F.3d 1120, 1125 (9th Cir. 2003). The Supreme Court granted certiorari, reversed the
Ninth Circuit and affirmed the FCC’s classification, in the process not only resolving uncer-
tainty about the proper regulatory classification but also about the FCC’s ability to
administratively overrule judicial decisions at odds with its interpretation of statutory ambi-
The FCC later reclassified DSL service as an information service as well, in part to assure that
similar services faced the same regulatory treatment regardless of the network architecture
underlying the service. Appropriate Framework for Broadband Access to the Internet over
Diffusion and convergence give rise to numerous examples of this phenomenon in the telecommunications industry. One commentator has suggested that wireless telephone use has surpassed landline use in part because wireless companies can offer customers bulk-minute monthly plans that do not distinguish between local and long-distance use. The regulatory divide between local and interstate landline telephone use, and residual state rate-regulation of local service in many states, prevents landline companies from offering a comparable bundle.

Similarly, the regulatory disparity between traditional cable and DBS satellite service distorts the market for video services. As noted above, traditional cable companies cannot provide service in a community without agreeing to a franchise, which typically requires them to pay franchise fees and agree to other concessions that can consume five percent or more of gross revenues. DBS satellite companies provide a nearly identical bundle of goods, and many consumers see satellite service as a near-perfect substitute to traditional cable. But because satellite companies need not access public rights of way to deliver service, they are not subject to the franchising process. The overall result is to make satellite service relatively less expensive, leading more customers to choose satellite service (and more investors to dedicate capital to satellite companies) than would do so in the absence of regulatory disparity.

3. Negative Externalities of Local Regulation

The silo-based model of telecommunications regulation can also create negative externalities. By their nature, state regulators seek to maximize the social welfare of in-state residents: it is the local population that they are charged to protect, and the local population that will remove them from office if they fail to do so. While they respond to the impact their rules will have on their constituents, they lack both the expertise and the incentive to consider the...

95. See Cooper & Kouloutchos, supra note 6, at 338. Of course, the mobility advantage that wireless services maintain over their landline counterparts is another, likely more significant, factor. Id.
97. Cable companies are also routinely required to fund public, educational, and government access channels as a condition of receiving a franchise, a purpose explicitly permitted under the Telecommunications Act. Id. § 531. Satellite networks are required to set aside between four and seven percent of their channels for "noncommercial programming of an educational or informational nature." Id. § 335(b)(1). It is unclear whether these restrictions impose more of a burden on cable or satellite operators, which is why they are excluded from the discussion above.
effects that those rules may have on entities outside their jurisdiction. This myopic focus can lead to overregulation, as policymakers adopt rules that benefit their local constituencies but impose costs on the nation as a whole. Sometimes it can also lead to underregulation, as policymakers are tempted to avoid regulation that is beneficial to the nation but would impose a substantial burden upon state residents.98

Students of constitutional law are familiar with the negative externalities of parochial economic legislation; these concerns animate the dormant commerce clause doctrine.99 This doctrine prohibits states from enacting legislation that improperly burdens or discriminates against interstate commerce. “A discriminatory law is virtually per se invalid and will survive only if it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.”100 In the classic dormant commerce clause case, the Supreme Court invalidated a New York order banning an out-of-state milk dealer from establishing another dairy in New York for export. The order had shielded local businesses from competition and protected New York consumers from milk shortages, while the costs of the rule fell on out-of-state shippers and consumers who have no input into the New York political process.101 In such cases, the dormant commerce clause denies the state the power “to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.”102

As telecommunications companies achieve national economies of scale, the same concerns befall many state regulations aimed to protect discrete segments of the local community. For example, a state may require customer bills to include a clear explanation of the state’s consumer complaint procedures. This additional disclosure benefits in-state customers by clarifying the mechanism for disputing a charge. But it generates administrative costs, as the company must reconfigure its systems to provide the required information. These costs are typically spread across the network, falling on both in-state and out-of-state customers, meaning that state regulators do not fully appreciate, or care to appreciate, the

100. Dept. of Revenue of Ky. v. Davis, 128 S. Ct. 1801, 1808 (2008) (internal quotation marks, alteration, and citations omitted).
101. Id.
true cost of their requirements to society as a whole. When this phenomenon is multiplied by the countless potential parochial interests animating each of fifty individual regulatory entities, the collective overregulation can substantially burden the nationwide provision of telecommunications service.

4. Local Barriers to Entry

Finally, state and local regulators serve as gatekeepers to the markets they regulate, which allows them to demand unreasonable concessions as conditions of market entry. This distortive behavior is most obvious in the realm of cable regulation, where the local franchise process—originally conceived in part to protect consumers from monopoly practices—today largely serves to insulate incumbent cable providers from competition. The public choice concerns with local cable franchises have been exhaustively canvassed by the existing literature, perhaps most comprehensively by Professor and former FCC Chief Economist Thomas Hazlett. The Telecommunications Act forbids the delivery of cable service without a franchise from a local franchise authority, which is authorized to charge a franchise fee of up to five percent of local cable revenues and place other reasonable restrictions on the franchise. In practice, local franchise authorities use this power to discourage competitors from entering a market, allowing the incumbent monopolist to charge supra-competitive profits that are shared with the local government through the franchise fee and other conditions.

The anecdotal tales of abuse of discretion over local franchise authority are legendary. In a recent report to the Commission, Verizon listed conditions including the purchase of street lights, wiring of all houses of worship, subsidized or free cellular phone service for all city employees, the opening of a Verizon-owned parking lot to library parking, and the connection of 220 traffic signals with fiber-optic cable. Similarly, one municipality demanded that AT&T fund a local recreation center and pool, while

103. See generally Hazlett, Cable TV Franchises, supra note 40.
104. 47 U.S.C. §§ 541, 542 (2006). Technically, the Telecommunications Act only prohibits local franchise authorities from "unreasonably refus[ing] to award an additional competitive franchise." Id. § 541 (emphasis added). Local franchise authorities are therefore free to impose even greater conditions upon the first franchisee in a territory, as long as the franchise agreement does not grant an exclusive franchise over the territory.
another would-be cable provider was forced to provide a $1 million upfront application fee and a $50,000 scholarship fund with $7,200 in additional annual contributions. Local franchise authorities typically do not count the cost of these additional conditions toward the five percent cap that the Telecommunications Act imposes on franchise fees. Yet by discouraging entry and increasing the cost of service—costs that are passed on to cable customers—these concessions distort the video market and lead to anticompetitive results.

Once the local franchising authority grants an initial franchise, the franchise fee creates a strong incentive to discourage competition. The local franchising authority receives five percent of the gross cable revenues throughout the territory, meaning regulator and regulated entity each has incentives to maximize the annual revenue generated within an area. The monopoly prices extracted by the incumbent also fund the numerous other perks attached as conditions upon the franchise, such as public access channels. FCC studies show that the introduction of competition within a franchise territory reduces cable rates by an average of sixteen percent. Although the local franchise authority would presumably receive the same five percent franchise fee from a new competitive cable provider as it does from the incumbent, the reduced rates lead to lower overall cable revenues generated within the franchise territory, which leads to lower aggregate franchise fees collected by the local franchising authority.

Thus local franchising authorities have strong incentives to preserve incumbent monopolists, and routinely use a wide range of tactics to restrict competition. Perhaps the most obvious is simply to delay the processing of the application for a competitive franchise: the Telecommunications Act does not set a time frame within which local franchise authorities must approve an applica-

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106. Id.
107. Id.
109. Assuming that competition does not grow the number of subscribers sufficiently to offset the decline in revenue from existing subscribers. The FCC estimated that in 2000 the price elasticity of cable was 1.31, which "indicates that the demand for cable services is somewhat price elastic." Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, 15 F.C.C.R. 10927, ¶ 44 (2000) (report on cable industry prices). But given that, by FCC 2005 estimates, only fourteen percent of U.S. households do not subscribe to a multichannel video service to receive television signals, there simply are not that many potential subscribers left to entice with lower rates. See In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 21 F.C.C.R. 2503, ¶ 96 (2006).
tion, so the municipality can, and often does, take as much time as possible to review an application. One report estimates that the franchising process takes an average of eight to sixteen months to complete.\textsuperscript{110} Verizon reported to the FCC that of the 113 franchise applications that were pending in March 2005, only ten had been granted by March 2006.\textsuperscript{111} As the FCC has noted, these delays are especially unjustified when the competitive applicant is a telephone company, which already has access to rights-of-way in the franchise territory and has already installed most of the infrastructure necessary to deliver video service.\textsuperscript{112}

Local franchise authorities also routinely enforce “level playing field” restrictions that seek to guarantee that the competitive entrant receives a franchise on terms no more favorable than those enjoyed by the incumbent, but in effect raise the costs of entry sufficiently to preserve the municipality’s monopoly interest in the existing franchise.\textsuperscript{113} Sometimes these restrictions require the applicant to construct an entirely duplicative studio for public, educational, and governmental access, or to reimburse the incumbent for half of the costs it had incurred in satisfying its public access requirements.\textsuperscript{114} These restrictions also routinely include a “buildout” requirement, ostensibly to prevent the incumbent from “redlining” lower-income neighborhoods by requiring the applicant to provide service in all franchise areas currently served by the incumbent provider.\textsuperscript{115} Of course, such requirements ignore the fact that the incumbent established its footprint over time, funded by monopoly profits that are unavailable to the competitive service provider.\textsuperscript{116}

These buildout requirements are particularly problematic for telephone companies seeking to enter the video market, since the incumbent cable company’s footprint likely does not precisely map the telephone company’s existing footprint.\textsuperscript{117} Therefore, to

\begin{itemize}
\item[110.] See Cable Franchise Order, supra note 105, ¶ 22.
\item[111.] Id.
\item[112.] Id. ¶ 23.
\item[113.] In some states, incumbent cable operators have successfully lobbied to get level playing field restrictions adopted within the state’s code. See id. ¶ 47.
\item[114.] See id. ¶ 46.
\item[115.] Id. ¶¶ 31–32. Of course, true red-lining restrictions are important, as customers should not be denied the benefits of competition on the basis of their income. But buildout requirements are both over- and under-inclusive when it comes to preventing red-lining: wiring the incumbent’s footprint mandates service to all customers, not just low-income ones, while the requirement may actually encourage red-lining if the incumbent has itself avoided providing income to low-income residents. It is also worth noting that the Telecommunications Act explicitly prohibits red-lining. 47 U.S.C. § 541(a)(3) (2006).
\item[116.] See Hazlett, Cable TV Franchises, supra note 40, at 125, 130–46.
\item[117.] See Cable Franchise Order, supra note 105, ¶ 33.
\end{itemize}
provide video service to existing telephone customers in a community, the telephone company must expand its telephone franchise and build telephone lines to the balance of the community who are already served by one or more telephone providers—an act which could necessitate the approval of (or even be barred by) the separate regulatory entity governing local telephone service. And where the telephone company’s footprint spans that of two or more incumbent cable franchisees, the buildout requirement could force it to install new infrastructure throughout both incumbents’ service areas in order to provide video service to its existing customers.

Concerned about the effects of this behavior on video competition, the FCC intervened in 2007 to rein in many of these abuses. The Telecommunications Act prohibits local franchise authorities from “unreasonably” refusing to award a competitive franchise. To enforce this prohibition, the FCC promulgated several franchise guidelines, departure from which is presumptively unreasonable under the Act. These guidelines include the approval of franchise applications within ninety days for companies with existing access to city rights-of-way and six months otherwise, a prohibition on “unreasonable” buildout mandates and PEG requirements, including forcing a telephone company to build out beyond its existing footprint, and the deduction of the cost of all non-cable-related conditions from the statutory five percent cap on franchise fees.

In essence, the Commission has federalized the local franchise process, reducing the opportunities for local rent-seeking by cabining the discretion that local officers hold over market entry. Commissioner Jonathan Adelstein’s dissent clearly stated just how much this order infringes upon the traditional prerogatives of the states. These rules helped solve the most egregious abuses of the local franchising process, and likely represent the outer boundary of the Commission’s current authority to address the problem.

But the Commission’s efforts to layer federal guidelines upon an antiquated state regulatory model are reminiscent of the “epicycles upon epicycles” posited to preserve Ptolemy’s geocentric model

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118. 47 U.S.C. § 541(a).
119. See Cable Franchise Order, supra note 105, 53-120.
120. See id. at 5193–95 (Adelstein, Comm’r, dissenting) (“[T]oday’s Order is legislation disguised as regulation... . It is a clear rebuke of [our] storied relationship with local government... . [and] breathtaking in its disrespect of our local and state government partners... .”).
121. The Sixth Circuit recently upheld the Commission’s order as a reasonable interpretation of an ambiguous statute. Alliance for Cmty. Media v. FCC, 529 F.3d 763, 786–87 (6th Cir. 2008).
from mounting counterevidence. Ptolemy theorized that all planets orbited the Earth in perfect circular orbits. But as the planets failed to appear in the places that Ptolemy’s model predicted, scientists modified the model, first by suggesting that perhaps planets moved in epicycles upon these orbits, then by suggesting that perhaps they moved in epicycles upon those epicycles. In reality, of course, these increasingly complex efforts to save the Ptolemaic model were misplaced, because it was the model itself that was flawed: Copernicus explained that science was better served by eliminating Ptolemy’s geocentric model completely and instead working from a heliocentric worldview.

Similarly, effective telecommunications reform must involve a comprehensive review of the outdated scheme perpetuated by the Telecommunications Act. The tendency toward incremental reform is largely responsible for the flaws in the current silo-based model: “lawmakers simply wrote a new law for each new network as it arrived” without considering how new technologies affect existing networks or whether changes in the network over time affect the initial allocation of jurisdiction between the federal government and the states. Today’s telecommunications marketplace makes multiple services available over a variety of competing platforms. Continuing to entertain the fiction that some subset of these services are “local” when offered over certain networks (but not others) distorts consumer choice and hinders the development of an efficient nationwide telecommunications network.

Comprehensive reform is necessary to permit telecommunications law to catch up to the realities of the modern network. Congress should replace the existing silo-based model of telecommunications federalism with a model that conceives of the industry as a single telecommunications network that offers a variety of potential services over multiple competing platforms. Jurisdictional separation should be accomplished on a platform-neutral basis to minimize the regulatory uncertainty and disparity that plague the

123. Id.
124. Id.
125. Id.
126. Tim Wu, Why Have a Telecommunications Law? Anti-Discrimination Norms in Communications, 5 J. TELECOMM. & HIGH TECH. LAW 15, 19 (2006). Of course, there was sometimes a significant gap between the development of technology and its immolation in the Telecommunications Act: for example, the 1984 Cable Act came thirty years after the first community antenna systems developed and twenty years after the FCC’s myriad forays into regulation without authority. The point is that when determining how to regulate a given segment of the communications industry, Congress typically considered the segment in isolation without a view toward a more comprehensive communications policy.
current regime. And regulators should divide authority between the federal government and states in a manner that limits the opportunities for negative externalities and the erection of local barriers to entry. The next Part sketches a framework for this new model.

III. TOWARD A NEW COOPERATIVE MODEL OF TELECOMMUNICATIONS FEDERALISM

A. Defending the Purpose of Telecommunications Regulation

Before outlining a framework for the appropriate division of regulatory authority between the federal government and the states, it is useful to identify the purpose that such regulation should serve. In this respect, the purposes of both the 1934 Communications Act and its 1996 counterpart remain valid today, even if their execution was somewhat flawed. Then, as now, telecommunications policy should seek "to make available, so far as possible, to all the people of the United States... a rapid, efficient, Nation-wide... wire and radio communication service with adequate facilities at reasonable charges."127 To this end, the proper jurisdictional arrangement should minimize restrictions upon the rapid deployment of existing and new technologies to customers while promoting competition as the primary vehicle to bring inexpensive telecommunications service to as much of the population as possible.

Telecommunications service is more than simply one among many goods vying for a share of a consumer’s wallet. The telecommunications network is the primary conduit through which an individual interacts with the broader community. Through voice, video, and internet service, one can learn about topics ranging from politics to pop culture and participate in individual and national dialogues. Telecommunications networks are the arteries and veins through which information flows in society; the ability to participate in that network is so integral to life in the information age that Mira Burri Nenova describes access as a modern human right.128

Individuals connected to the network have an incentive for as many others to join as possible. Naturally, the value of a subscriber’s network connection increases with each additional person

that this connection can reach. One sees this logic in advertisements by wireless companies that tout the size of their respective networks: subscribers can reach in-network subscribers on better terms than customers of rival carriers, so it is advantageous to sign up with the network that grants preferential access to as many potential subscribers as possible (or at least, as many people as possible that one is likely to talk to). But more metaphysically, each new individual added to the network contributes a unique perspective to social dialogue. Just as individuals benefit from being able to learn from and contribute to the exchange of information in society, the community is enriched by a wide range of voices each adding a unique contribution to national culture. Advanced telecommunications lowers information costs, which reduces barriers to the exchange of knowledge and allows individuals greater opportunities to accumulate the social capital that forms the basis of a larger community.\footnote{See generally ROBERT PUTNAM, BOWLING ALONE (2001).}

With the advent of convergence, intermodal competition among carriers has become a powerful force in pursuit of this statutory end. Like most network industries, telecommunications is an industry with significant fixed costs stemming from the development and maintenance of nationwide network infrastructure. Because fixed costs are high and variable costs are small, each telecommunications company seeks to serve as many consumers as possible within its footprint, to spread those fixed costs over as broad a subscriber base as it can and lower the average cost of service to all customers.\footnote{This discussion sets aside, for the moment, the special case of certain rural customers who cannot be connected without significant additional capital investments to build out to their communities. For these customers, the variable cost of reaching these customers can be greater than the revenue they would generate, and other subscribers are unlikely to voluntarily make up the gap in increased fees. One may note that diffusion and convergence have the potential to reduce the number of customers to whom it is cost-inefficient to provide service, because it offers a variety of potential network architectures that might be able to profit from outlying customers. For example, a particular rural area may be so far removed from the existing telephone network that building a landline telephone connection to the community is cost-prohibitive. But the installation of a cell phone tower may provide much of the same service via wireless platforms at a much smaller cost. Nonetheless, this Article recognizes that even in a converged world there may exist certain pockets of the nation who are unlikely to receive telecommunications service without the aid of a universal service program. The special case of universal service is discussed in Part III.C.4 below.} At the same time, pressure from competing telecommunications providers keep prices low, particularly now that intermodal competition has increased the opportunities for customers to purchase near-perfect substitutes for a given company's product.
B. The Jurisdictional Principle of Neutrality

It flows from this overarching purpose that the line between federal and state jurisdiction should be drawn in a way that leverages the institutional strengths of each level of government while minimizing disruption on intermodal competition. To accomplish this goal, Congress should adopt a jurisdictional principle of neutrality. Rather than simply tweaking the current silo-based model, Congress should conceive of the telecommunications industry as a single unified network that offers multiple services over several competing platforms. It should then ask what aspects of this network are best regulated at the national and local levels and draw jurisdictional boundaries in a content- and platform-neutral manner.

To clarify, this Article does not necessarily endorse a regulatory principle of neutrality that would bind the FCC or its state analogues. There may be important policy reasons for the FCC to regulate some telecommunications services differently than others. For example, it may adopt a universal service program for voice or internet communication but not video service upon determining that voice and internet service are more integral to participation in the information economy than video is. Similarly, local government may adopt different rules for permitting cell phone towers than laying cable lines, because each affects the community differently. This Article does not focus upon the policy choices that federal and state regulators should make within their respective spheres of authority. Rather, it focuses upon where the boundaries of those spheres should be drawn: in essence, it answers the question who decides a particular issue of telecommunications law, while leaving open the question of what the decision should be.

The jurisdictional principle of neutrality reduces the first two problems discussed above with the current silo-based model of telecommunications federalism. Under a content- and platform-neutral regime, the FCC would be responsible for determining all questions about a particular aspect of network regulation, while states would be responsible for others, regardless of which platforms those services traverse on their way to the consumer. Therefore, companies suffer less regulatory uncertainty: they need not guess whether a new idea is more like cable, video, or internet service before knowing which governmental authority will set the rules. Regulatory disparity would also largely be eliminated, as the same entity would craft the rules without regard to the accident of the platform over which the service is to be provided.
C. Regulation at the Federal Level: Controlling Spillover Effects and Preserving National Economies of Scale

The jurisdictional principle of neutrality is only part of the solution: one must still determine which activities should be regulated at which levels of government. The answer to this question turns upon the relative strengths of federal and local regulation. As Charles Cooper and Brian Koukoutchos note, "[o]ne does not lightly displace the regulatory powers of sovereign states."\(^1\) Decentralization of authority and institutional respect for state sovereignty are widely considered to be the hallmarks of "Our Federalism"\(^2\) and promote important values such as policy experimentation, responsiveness to local concerns, and accountability by public figures who are closer to the subjects they govern.\(^3\) But as illustrated above, local regulation can harm society as a whole if local action generates spillover effects that the state does not consider when weighing the cost and benefits of an initiative.\(^4\) In this sense, it is important to remember that the framers added the Commerce Clause precisely to eliminate economic trade barriers that had grown up between the states under the Articles of Confederation.\(^5\) "The Constitutional Convention was held in 1787 precisely because the states had shown themselves to be, by their very nature as separate and competing sovereigns, incompetent to regulate interstate and foreign commerce."\(^6\) The optimal model of jurisdictional separation captures the benefits of decentralization as much as possible, while controlling the spillover effects that Our Federalism can otherwise generate.\(^7\)

It flows from these observations that federal preemption is most appropriate over activities that, if left in the hands of the states, would threaten to generate negative externalities that would unreasonably disrupt a broader national objective. Preemption's primary benefit is uniformity: by replacing a patchwork of myopic

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131. Cooper & Koukoutchos, supra note 6, at 299.
135. Cooper & Koukoutchos, supra note 6, at 300–01.
136. Id.
137. See Hazlett, Preemption in Cellular Phone Regulation, supra note 98, at 177 ("Selection of the optimal jurisdiction largely reduces to a search for the smallest unit of government (lowest tier) that substantially avoids 'beggar thy neighbor' outcomes from decentralized policy making.").
state regulators with a single federal decisionmaker, preemption eliminates spillover effects, at least in the sense described above, because the regulator presides over a polity large enough to internalize most costs of regulation. Preemption also has the added benefits of reducing uncertainty: a company can plan to deploy a service nationwide because it knows with certainty the legal framework that will govern the service in all places it is offered. And preemption could lower the transaction costs of regulatory activities: a company need only go to a single federal authority to seek regulatory action, guidance, or exemption, whereas those costs are multiplied fifty-fold (or more) under a state-regulated system.

In network industries such as telecommunications, preemption is often appropriate when inconsistent state laws generate spillover effects that prevent companies from achieving interstate economies of scale. Economies of scale allow a company to deliver a good cheaper and more efficiently by expanding its scale of production. Through expansion, the company can spread its fixed costs over a larger volume of sales, which reduces the average cost of each unit and therefore lowers the price of its goods for consumers. State regulators often undervalue interstate economies of scale, and can enter inconsistent regulations that prevent companies from achieving efficient growth. An identical regulatory structure throughout the country allows companies in these industries to avoid these state regulatory hurdles.

Through this analytical lens, it becomes clear that Congress should preempt most economic regulation of telecommunications networks. State and local regulation of economic activity often has spillover effects that prevent telecommunications companies from achieving economies of scale. As noted above, telecommunications companies incur substantial capital costs to build and upgrade their networks and benefit from national economies of scale by spreading those costs over as many customers as possible. Indeed, the push for convergence is itself an effort to achieve greater economies of scale by increasing the amount of revenue

138. Of course, it is conceivable that a national regulation could impose negative externalities on residents of other countries. These concerns lay beyond the scope of this Article.
139. See Hazlett, Preemption in Cellular Phone Regulation, supra note 98, at 177 (citing David F. Welsh, Comment, Environmental Marketing and Federal Preemption of State Law: Eliminating the "Gray" Behind the "Green", 81 CAL. L. REV. 991, 1004 (1993)).
140. See id. at 176 ("Importantly, it occurs not just when property rights are ill-defined (the Coasian sense of 'externality'), but when economies of scale extend across states. Then the highly complementary nature of supplying consumers in multiple political jurisdictions produces costs and benefits which may largely go unnoticed by regulatory authorities." (internal citation omitted)).
141. See supra text accompanying note 3.
derived from each dollar invested in the network. Federal preemption of state economic regulations will help telecommunications companies achieve Congress's objective of providing telecommunications services to the largest number of people at the lowest cost.

1. Rate Regulation

Under the Telecommunications Act of 1996, the states retain jurisdiction to regulate rates for intrastate telephone service and, under very limited circumstances that rarely vest, cable television service. Historically, as discussed above, this rate regulation was justified to assure that these utilities did not charge supra-competitive rates due to their monopoly positions. But historically, state public utility commissions have used their telephone ratemaking authority not to assure that rates remained closely tied to costs, but as a mechanism to fund universal service by cross-subsidizing rural telephone service with above-cost rates in more populated areas. While the Telecommunications Act sought to encourage new competitors to challenge the Baby Bells, this artificial rate structure "offered distorted price signals to new market entrants" which made it difficult to determine how, or where, new entry would be profitable. These distortions also likely skewed consumer behavior once wireless and VOIP technology arrived to compete directly against landline service, by overstimulating customers to adopt new technology in areas where rates were artificially high, and understimulating such behavior where rates were artificially low.

To correct these distortions and allow intermodal competition to flourish, Congress should repeal the prohibition on federal regulation of intrastate communications service, preempt state rate regulation of telecommunications services, and vest authority over any continued rate regulation in the FCC. Rate regulation is the classic example of an activity which, if decentralized, is likely to distort competition by imposing negative externalities on the rest of the system. In a national telecommunications system, most costs

143. Id. § 543.
144. See supra text accompanying note 40.
146. Id.
147. See supra text accompanying notes 74–80.
are borne at the national level, including network building and upkeep, the maintenance of centralized support services such as call centers and corporate offices, and national advertising campaigns. As a result, pricing is most efficiently set at the national level as well, to make sure that the company adequately recovers its national costs.

State-by-state interference with this pricing mechanism is likely to distort competition, even if we assume that states manage to set rates on a platform-neutral basis. A statewide price cap will cause companies to raise prices throughout the remainder of their footprint to compensate for lost revenue. Similar behavior by multiple states will artificially depress companies' rates of return, causing them to underinvest in new network capabilities in order to recover the foregone revenue. Even if states cross-subsidize rates within the state to control externalities as they have done historically, the result will be overconsumption of telecommunications services in some areas and underconsumption in others, which distorts the incentives of potential competitors who seek to enter the business.

As a simple hypothetical, assume that the New Hampshire Public Utilities Commission determines that wireless telephone rates are too high and adopts a state-wide cap on prices per minute of use to New Hampshire subscribers at a rate below that which wireless companies currently charge. In the short run, this measure may benefit New Hampshire consumers, who receive cheaper wireless phone service. But this rate regulation has an adverse effect on wireless subscribers outside New Hampshire, who now must pay higher wireless rates to fund what is, in effect, a subsidy to New Hampshire consumers. Out-of-state customers must also shoulder the additional administrative costs of identifying, tracking, and billing New Hampshire customers separately from the rest of the customer base. If these costs are too high, one or more wireless companies may decide to abandon the New Hampshire market. This would have an adverse effect on New Hampshire residents, who would no longer benefit from wireless service and the competitive pressures that wireless services place upon other forms of voice communication.

Professor Hazlett has shown empirically how federal preemption of state rate regulation over wireless carriers allowed these companies to achieve greater economies of scale and to offer service to more customers at lower prices.\textsuperscript{149} Congress preempted state regu-

\footnote{149. See generally Hazlett, Preemption in Cellular Phone Regulation, supra note 98.}
lation of wireless rates in 1993, over the objection of many state public utility commissions that preemption would lead to anticompetitive rates and discriminatory practices. In reality, total wireless minutes of use grew dramatically in the following decade, while rates have declined. Preemption of state rate authority, coupled with the lifting of other restrictions on the industry, allowed wireless companies to build efficient national networks and offer nationwide calling plans, while promoting competition among wireless carriers. The FCC has noted that "operators with larger footprints can achieve certain economies of scale and increased efficiencies compared to operators with smaller footprints" and that "[o]ne of the driving forces behind [industry consolidation] has been the desire of large regional carriers to enhance their ability to compete with existing nationwide operators that offer attractive nationwide pricing plans."

The Digital Age Communications Act ("DACA") working group has also generally endorsed preemption of state rate regulation. DACA was a draft bill proposed in 2005 to revolutionize telecommunications regulation, although Congress did not act on the proposal. Borne of the collective deliberation of several luminaries in the field of telecommunications regulation, the DACA project sought to replace the Telecommunications Act with a broad, platform-neutral prohibition on unfair competition in telecommunications, thus transforming the FCC into an adjudicatory agency similar to the Federal Trade Commission. As part of this proposed shift, DACA envisioned a smaller role for state regulation of economic activity going forward, although it provided for continued rate regulation of basic service as a type of universal service subsidy, at least for an initial transition period. This retention

151. See Hazlett, Preemption in Cellular Phone Regulation, supra note 98, at 207.
152. Id. at 213. Hazlett notes that:

The proconsumer improvements may not be due to deregulation, and FCC reports tend to attribute the rate declines beginning about the time of federal preemption to the anticipated entry of PCS competitors. What can be said, however, is that the prediction of several state public service commissions is rejected by marketplace evidence. State regulation did not generally lower rates or benefit consumers.

153. See id. at 198.
154. See id. at 198-99 (quoting Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, 17 F.C.C.R. 12985, 12998 (2002)).
155. See Dixon & Weiser, supra note 145, at 334-35, 357.
157. Id.
would be problematic for numerous reasons, particularly if the
Commission permitted it to continue beyond DACA's suggested
interim period. First, these existing rate plans affect only local
landline service, and thus perpetuate the competitive disadvantage
that landline providers face against wireless and VOIP providers.\textsuperscript{58} They also retain the somewhat artificial distinction between local
and long-distance service, which competitive forces may otherwise
seek to eliminate.\textsuperscript{59} Congress can better address the universal ser-
vice concerns animating this carveout through a Commission-
administered universal service program, as described below.\textsuperscript{60}

2. Market Entry and Legacy Conditions on Cable Franchises

Congress should also eliminate the existing franchise system and
preempt existing state and local authority to regulate market entry.
As discussed in detail above, local control over market entry has
led to significant distortions in the video market. Local franchising
authorities routinely demand concessions in exchange for a fran-
chise, which artificially increases the cost of video service.\textsuperscript{61} It then
splits near-monopoly profits with the incumbent and uses the fran-
chise power as a barrier to entry to limit the effects competition
may otherwise have on overall video prices.\textsuperscript{62} The combined effect,
as with rate regulation, is to deter investment in video services and
lock consumers in to artificially high video rates.

Like ratemaking, market entry is a quintessentially national ac-
tivity. Entry into new markets is an important way that
telecommunications providers can increase economies of scale and
reduce the overall cost to consumers of providing telecommunica-
tions service. With few exceptions, telecommunications providers
offer essentially the same service across markets. A Comcast sub-
scriber is likely to get a near-identical package of channels to
choose from whether he is in San Francisco or Nashville, because it
is in the broadcasters' and the cable companies' interests to dis-
tribute particular content as widely as possible. Local regulation of
market entry can impose negative costs on out-of-state subscribers
by disrupting economies of scale and perpetuating the rent-seeking
behavior discussed in depth above. Therefore any restrictions
should be administered solely by the Commission.

\textsuperscript{158} See supra text accompanying notes 74–80.
\textsuperscript{159} See supra text accompanying note 95.
\textsuperscript{160} See infra Part III.C.4.
\textsuperscript{161} See supra text accompanying notes 105–107.
\textsuperscript{162} See supra text accompanying notes 108–109.
Losing the power of the franchise means that local authorities will lose the power to mandate the numerous conditions they place on incumbent and would-be competitor cable companies, such as buildout requirements and public, educational, and government access channels. But given the distortive effects these requirements have had on the cable market, this loss is likely to be a boon to consumers and to Congress’s overarching objectives. To the extent that buildout requirements act as a surrogate for a type of video universal service program, these concerns are better addressed at the Commission level through a federal universal service program as discussed below. With regard to public access channels, if the local franchise authority finds these resources are useful to the community, they should fund the channels directly instead of foisting the cost of an inherently local good on the entire telecommunications network.

A more difficult question arises when one realizes the loss of local revenue that is likely to result from this transfer. Local governments increasingly rely on the funding that they receive from cable franchise fees to support any number of general purposes. John Lindsay, former mayor of New York, once described cable franchises as “urban oil wells beneath our city streets.” The preemption of local franchise agreements would leave a significant gap in municipal budgets nationwide. For this reason, DACA proposed a three-to-five year phase-in period whereby existing franchises will remain in force while local governments begin to plan for the eventual loss of cable revenue. Although this transition period would perpetuate the distortive effects that franchising places upon the telecommunications market, it may be politically necessary to achieve the scope of reform necessary to adapt to a converged industry. But this rationale does not support DACA’s supplemental recommendation that new entrants, such as telephone companies, pay a similar franchise fee before offering competing services during this interim period. DACA proposed this additional fee to maintain competitive neutrality during the transition. But this interim retention is a concession to the political reality of dramatic change and should distort the market no more

164. See Dixon & Weiser, *supra* note 145, at 352. Cities may try to recover this revenue simply by imposing a tax on video (or all telecommunications) services in an amount necessary to offset the foregone revenue. This is a suboptimal solution, as it simply relabels the distortive effects of the current regime. Perhaps anticipating this eventuality, DACA recommends anticipatorily preempting any state or local tax on any telecommunications service. See id. at 354.
165. See id. at 352.
than necessary to soften the financial blow of preemption. A gradual phase-out of existing franchise fees gives cities time to find new funding sources, but foisting similar requirements on new entrants would constitute an unjustified additional municipal windfall at consumers' expense.

3. Access Issues

At least with regard to telephone service, the Telecommunications Act granted states authority over interconnection agreements between the Baby Bells and new competitive local exchange providers and the arbitration of interconnection-related disputes, pursuant to a scheme that the Commission would decide. Delegating this responsibility to the states made sense in 1996, when Congress anticipated a rush of interconnection agreements that would destroy the old state-regulated monopoly system. Because the states were the historic rate regulators of the incumbent local exchange carriers, they understood local markets better than the Commission and therefore were in a superior position to decide local interconnection-related disputes.

But now that the initial wave of CLEC interconnection has passed, that local knowledge is less relevant. Therefore, authority over future interconnection or other issues regarding access to an individual company's network should be vested with the Commission. At its core, interconnection and other access-related disputes are simply versions of a market entry problem, and should be regulated by the Commission for precisely the reasons that entry generally should be. The Commission will take an appropriately national view of a local access dispute, determining whether the incumbent carrier's actions are reasonable in light of the costs and benefits to society as a whole. Otherwise, continued local regulation of interconnection disputes carries the risk of local favoritism and other negative externalities that plagued the development of cable competition.

4. Universal Service

Universal service poses a somewhat more difficult problem. Universal access is currently a hybrid program, administered largely by individual states through surcharges on state bills but supple-

mented by a modest federal universal service fund funded by surcharges on interstate calls.\textsuperscript{167} Both state and federal programs serve to subsidize telecommunications service for low-income consumers and consumers who live in high-cost areas such as rural counties where fixed costs are spread over fewer people.

Though the case is somewhat closer, responsibility for administration of the universal service program should similarly be vested in the Commission. States may argue that the demand for universal service turns upon the number of low-income and high-cost households, a figure that varies by jurisdiction. As a rural state, Iowa likely has a greater demand for universal service funds than New Jersey, and state regulators are in a better position to quantify that demand. But ultimately, universal service is a national, not a local, goal. The need for a universal service program stems directly from Congress’s goal of encouraging deployment of telecommunications services to as many residents as possible. And the benefits of universal service accrue nationally by allowing all existing customers to reach underserved segments of society through the national telecommunications network. To minimize the distortion that universal service places upon competitive markets, it should be funded nationally rather than locally, so the costs of universal service are internalized by all who benefit. Allocating responsibility to states instead risks inconsistencies in the definition of universal service eligibility, the types of service to which one is entitled, and the costs imposed on the rest of society. A national standard for eligibility promotes uniformity and predictability and minimizes the market distortions of this important goal.

There are also lower transaction costs associated with a unified federal program. A single central node for the collection and distribution of universal service funds reduces the administrative costs of the program on the industry. The value of these administrative economies of scale is evident even in the present regulatory environment: at least thirteen state USF funds have delegated administration of their programs to Solix, the same vendor that manages portions of the existing federal universal service program.\textsuperscript{168} This outsourcing demonstrates the value of scale and undermines, to an extent, the states’ interest in executing the day-to-day management of a universal service program.

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D. Regulation at the State Level: Leveraging Local Knowledge and Experimentation

Of course, the uniformity and predictability that preemption provides do not come without cost. A uniform federal scheme has difficulty adapting to the demands of unique local circumstances. Federal regulators lack familiarity with the idiosyncrasies of local markets, and even when they become aware of the need for a localized rule, they may lack the incentive to take action that would benefit only a small segment of the national population.

Not surprisingly, the merits of decentralization largely offset the problems posed by preemption (and vice versa). A decentralized regime brings decisionmaking closer to the people affected by regulation. Local governments are responsible for a much smaller polity than their federal counterparts, and therefore are in a better position to know and respond to local concerns. This greater responsiveness encourages public participation and accountability, and more broadly may foster the development of social capital that helps make a community greater than the sum of its parts.

Decentralization of authority also promotes regulatory diversity that, under certain circumstances, can lead to improved policy outcomes. As Justice Kennedy aptly summarized, when "considerable disagreement exists about how best to accomplish [a] goal," "the theory and utility of our federalism are revealed, for the States may perform their role as laboratories for experimentation to devise various solutions where the best solution is far from clear." The benefits of this diversity are two-fold: first, regulators are free to tailor individual policies to the unique circumstances of their localities rather than suffer from a one-size-fits all policy mandate. And second, citizens who disagree with a policy are free to "vote with their feet" by relocating to a more hospitable regulatory climate; as jurisdictions modify their policies to compete for such residents, society arrives at an efficient level of provision of public services.

169. See Young, supra note 133, at 58.
170. See id. at 59 ("Officials ought to look their constituents in the eye on the street and see them in the grocery store." (quoting Barry Friedman, Valuing Federalism, 82 Minn. L. Rev. 917, 935 (1997))).
173. See Young, supra note 133, at 53.
174. See Charles Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956). Of course, voting with one's feet is expensive. Tiebout's model only really affects those pub-
Of course, these benefits are not universally applicable to all policy questions. "Public participation and accountability" could alternatively be described as "myopic focus on local needs," while "regulatory diversity" could be a euphemism for "piecemeal regulation." As noted above, there is substantial risk that the state regulator's overt focus on local preferences can generate negative externalities that impose costs on other states. As Judge Michael McConnell notes, "[e]xternalities present the principal countervailing consideration in favor of centralized government." 175

It follows from these observations that decentralized authority is best where the issue in question is primarily local in scope. Or in Professor Hazlett's terms, "the advantage of differentiation lies in the informational efficiencies local regulators enjoy relative to the advantages of scale economies they sacrifice (or disrupt)." 176 Where markets are largely idiosyncratic and the costs of regulation fall primarily upon those being regulated, state regulation is superior because the state regulator can craft tailored rules with limited negative externalities. 177 This approach allows society to benefit from policy experimentation among jurisdictions to find the optimal solution to a problem.

1. Access to Local Rights-of-Way

Access to local rights-of-way is a quintessentially local issue and should be administered by state or local authorities. The question of when, how, and under what circumstances a company should be permitted to lay cable or install a facility in a local community depends almost completely upon local information regarding the impact of the access on the surrounding environment. The FCC has neither the resources nor the inclination to gather and process the information necessary to determine whether Verizon should be permitted to dig a hole on the corner of Main and Third Streets, or if so what conditions should apply. By comparison, state and especially local officials can easily discover which businesses are lic goods that consumers determine are important enough to relocate. Public education is a quintessential example; it is far from clear that a choice of cable companies, for example, rises to this level.


176. Hazlett, Preemption in Cellular Phone Regulation, supra note 98, at 175.

177. See id.
be affected, and which hours the company should be permitted to dig in order to limit the impact of the disruption on the community.

Moreover, when a local official approves, modifies, or rejects an individual proposal, both the benefits and the costs are borne largely by his or her constituency. A permit denial may impose some infinitesimal cost on the national subscriber base due to a temporary setback, and approval may generate some minuscule benefit to the public at large. But this incremental amount pales in comparison to the benefits that flow to the local community upon completion of the installation, or the costs of local disruption caused by the company's construction.

Of course, the Commission should prevent local officials from using their control of rights-of-way as a lever to secure additional regulatory control or unrelated concessions. The Telecommunications Act currently preserves state authority to "manage the public rights-of-way," including the power to "require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis." Congress should tighten this language to assure that the costs, if any, of applying for and receiving a permit to access the public rights-of-way do not exceed the actual cost of the action to the city and its residents. Permit fees should not serve as a post-transition substitute for existing cable franchise fees. And any non-pecuniary conditions that the state regulator places upon access must be reasonably related to the company's activities. Companies that feel they were unreasonably denied a permit should be allowed to bring a proceeding before the Commission to review the reasonableness of the local government's action. This oversight will help assure that any restrictions upon rights-of-way access appropriately reflect legitimate local concerns and are not simply a mechanism for states and communities to engage in rent-seeking behavior.

2. Zoning, Undergrounding, and Other Network Restrictions

Similarly, state and local authorities should retain jurisdiction to place reasonable restrictions upon the installation of network facilities in a given community. There are a variety of local concerns

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179. See Dixon & Weiser, supra note 145, at 345–46 (citing as an example CAL. GOV'T CODE § 50030 (West 2009), which provides that permit fee to access rights-of-way "shall not exceed the reasonable costs of providing the service for which the fee is charged and shall not be levied for general revenue purposes").
that could affect where or how a particular portion of the network is installed in a local community. For example, a locality may wish to require that a cell phone tower be placed in an area other than that sought by the telecommunications company, or it may desire that a landline be placed underground rather than on above-ground poles. These restrictions may flow from safety or aesthetic concerns, or simply to assure that the utility's actions fit the locality's master plan for development. Local government should have the authority to address these concerns as long as such restrictions do not unduly burden telecommunications companies' ability to deliver services to the community.

The Telecommunications Act's provisions regarding cell phone tower siting offer an example of how this discretion may be regulated. Section 332 preserves local authority over "decisions regarding the placement, construction, and modification of personal wireless service facilities," but allows wireless companies to challenge a locality's decision if the decision "unreasonably discriminate[s] among providers of functionally equivalent services" or "prohibit[s] or ha[s] the effect of prohibiting the provision of personal wireless services." Section 332 allows wireless companies to file a complaint in district court, but Congress should instead vest such jurisdiction in the FCC. Unlike the district court, the FCC has the expertise and broad national perspective over telecommunications policy that is necessary to determine whether a locality's restrictions unreasonably burden the network.

**E. State Enforcement, Federal Adjudication:**

*The Case of Consumer Protection*

Consumer protection is the most difficult, and most controversial, part of the regulatory puzzle to parse between the federal government and the states. One can make a strong case for vesting jurisdiction over these issues with the states. Many consumer protection issues arise because of the unique vulnerability of a particular segment of the population whose circumstances would escape the notice of a national regulatory body. For example, the California Public Utilities Commission has recently developed special procedures for landline and wireless telephone companies to protect limited-English-proficiency customers.181 When

telecommunications carriers market their products in California in languages other than English, the CPUC requires that they take additional steps to protect the interests of customers targeted by the campaign, such as providing in-language customer service during business hours and annual in-language notification of the resources that the CPUC makes available to combat telecommunications fraud.\footnote{182 See Phase II Decision Addressing In-Language Market Trials, Fraud Notification and Reporting, and Consumer Complaint and Language Preference Tracking for Limited English Proficiency Telecommunications Consumers, Pub. Utilities Comm’n of Cal. Decision 08-10-016 (Oct. 6, 2008) (on file with the University of Michigan Journal of Law Reform), available at http://docs.cpuc.ca.gov/word-pdf/FINALDECISION/91818.pdf; Order Instituting Rulemaking to Address the Needs of Telecommunications Customers Who Have Limited English Proficiency, Pub. Utilities Comm’n of Cal. Rulemaking 07-01-021 (January 17, 2007) (on file with the University of Michigan Journal of Law Reform), available at http://docs.cpuc.ca.gov/word-pdf/FINAL_DECISION/63728.pdf.} Because California has a disproportionately high population of customers for whom English is a second language, this issue is of particular importance to the CPUC, which has the local knowledge necessary to identify the problem and craft a solution. But limited-English-proficiency customers are a much smaller proportion of the national population, which means that the FCC is unlikely to notice and address their concerns.

State regulation of consumer protection issues also reaps the benefits of regulatory diversity and state experimentation. Unlike interstate economic regulation, consumer protection typically falls within the scope of the state’s traditional police powers. One reason why policymaking is usually vested at the state level is to encourage interjurisdictional experimentation in a way that allows society to explore multiple potential policy solutions. Federal regulation of these issues imposes a single rule on all consumers, which can stymie alternative approaches before their benefits can be tested and evaluated. Because of the value of regulatory diversity and the traditional vesting of social issues with the states, the DACA working group has endorsed the continued preservation of state jurisdiction over consumer protection issues: “[t]he decision to leave the state agencies with the initial authority to address these matters reflects the judgment that their proximity and accessibility to the affected consumers make them the superior institution to address such matters in the first instance.”\footnote{183 Dixon & Weiser, supra note 145, at 343.}

On the other hand, regulatory diversity over consumer protection issues can give rise to substantial spillover effects and disrupt national economies of scale. Unlike rights-of-way access and local


\footnote{183 Dixon & Weiser, supra note 145, at 343.}
network management, consumer protection rules often impose costs on the national infrastructure. In California, for example, carriers have complained that the in-language rules will require significant changes to their customer service procedures. Because call centers are often regional or national in scale, these regulatory costs are borne by customers across the country, while the benefits flow primarily to a discrete subpopulation in California. Similarly, the annual notice requirement forces carriers to modify uniform national billing and notification procedures to satisfy California’s rules. At a minimum, these costs include the steps necessary to identify and segment limited-English-proficiency customers in California and prepare and deliver a supplemental notice to them. If this subpopulation cannot easily be identified, the carrier may simply mail the notice to all California customers, or even all customers nationwide, to guarantee compliance.

Standing alone, these costs may seem inconsequential in comparison to the additional protection they afford to a uniquely situated segment of the population. But when the forty-nine other states enact similar rules imposing costs on society to protect their own parochial interests, the cumulative result can significantly disrupt economies of scale. As Professor Hazlett notes, carriers facing these challenges have three options. First, they can provide customized services on a state-by-state basis, a solution which sacrifices the economies of scale otherwise achieved by regional or national networks. Alternatively, they may be able to identify the state with the strictest consumer protection requirements and tailor a national plan to meet that state’s needs. This option imposes unnecessary compliance costs on national subscriber networks to satisfy the toughest state’s concerns. Finally, they could adopt a hybrid model that adopts a national model for most markets but “customized local service where state regulation is onerous.” This eliminates some of the economies of scale of an otherwise national network, though not as much as complete customization would, and leaves open the possibility of simply exiting those markets where regulation has become too onerous.

State regulation of consumer protection also raises the possibility that states will use their authority to re-engage in backdoor rate...
regulation, due to the "hydraulic pressure" of government to "exceed the outer limits of its power." Several commentators have noticed this phenomenon in wireless services, where the Telecommunications Act explicitly preempted state regulation of rates and entry but retained state jurisdiction over "other terms and conditions." Cooper and Koukoutchos highlight Minnesota's attempt to enact a "Wireless Consumer Protection" statute that would have, inter alia, required carriers to notify and receive affirmative consent from customers sixty days before a rate increase went into effect. The Eighth Circuit found this to be an impermissible attempt to regulate wireless carrier rates by other means and held the statute preempted by the Telecommunications Act. The court noted the difficulty of navigating the line between permissible and impermissible state regulation:

Any measure that benefits consumers, including legislation that restricts rate increases, can be said in some sense to serve as a "consumer protection measure," but a benefit to consumers, standing alone, is plainly not sufficient to place a state regulation on the permissible side of the federal/state regulatory line.

Because of the significant likelihood of negative externalities and the difficulty of policing permissible versus impermissible state regulations, Hazlett, Cooper and Koukoutchos all argue for broad federal preemption of consumer protection issues. It is somewhat artificial to distinguish between the negative externalities of parochial economic regulation and those of parochial consumer protection regulation; both foist costs on the network that threaten to disrupt national economies of scale. But as noted above, this complete preemptive approach would sacrifice the local knowledge that state and local authorities possess about the idiosyncrasies of their discrete markets. Preemption sacrifices local needs to the greater good, and arguably forces local populations to internalize costs imposed upon them by national uniformity.

The solution is to replicate, on a smaller scale, the jurisdictional divide applied to the network as a whole in Sections C and D

191. See Cooper & Koukoutchos, supra note 6, at 355–56.
193. Id. at 1082–83.
194. See Cooper & Koukoutchos, supra note 6, at 357–58; Hazlett, Preemption in Cellular Phone Regulation, supra note 98, at 223–24.
above. Rather than conceive of consumer protection as a monolithic policy segment that must reside at either the federal or the state level, Congress should ask which aspects of consumer protection are best vested with the federal government, and which with the states. It can then devise a jurisdictional arrangement that leverages both the local knowledge of state regulators and the national perspective of the FCC.

1. Consumer Complaints

As an initial matter, state public utilities commissions should retain their traditional role as the locus for consumer complaints. Most state commissions maintain a consumer affairs division which receive and investigate complaints against telecommunications companies. These complaint mechanisms provide telecommunications customers an alternative venue to pursue individual concerns when the companies themselves are non-responsive. Typically the commission will process a complaint, seek a response from the carrier, and work to resolve the customer's concerns.

Individual complaint investigation is akin to a local service and is better handled at the state level. As noted above, state regulators tend to be more accessible than their federal counterparts. Institutionally, they also tend to be more attuned to local concerns: because they regulate a smaller population base, each individual voice carries more weight and therefore state regulators are relatively more likely to address an individual complaint. Moreover, many complaints relate to consumer protection issues, which as noted above are allocated to the states as a default rule. In the aggregate, significant numbers of similar complaints can serve as a red flag indicating a potential consumer protection concern in need of regulators' attention. Finally, locating this service at the state level leverages the infrastructure that states already possess rather than constructing a new federal apparatus to serve this need. The DACA working group notes former California Public Utility Commissioner Susan Kennedy's concern that "federal regulators would never be equipped to accept millions of calls from individual customers involved in billing disputes."

2. Consumer Protection Rulemaking

With regard to setting consumer protection standards, Congress should vest primary jurisdiction with the FCC but permit—indeed, encourage—states to bring proceedings before the Commission to address consumer protection issues. When a state notices unusually high numbers of consumer complaints regarding a particular problem or otherwise becomes aware of a potential consumer protection issue within its community, the state should determine whether, in its discretion, to petition the FCC to take action on an issue. For generally applicable consumer protection issues such as cramming or slamming, the Commission could adopt a uniform national policy that would address the problem at a national level. For more discrete issues that lack national implications, like the California limited-English-proficiency rules noted above, the Commission could decide to forebear from general regulatory authority and instead permit the petitioning state to adopt state regulations to address the practice, subject to Commission review to assure that the negative externalities of the rule do not unreasonably burden the national network. The Commission may also elect to forebear from general regulatory authority over an issue whose solution is not immediately apparent, and instead allow states to experiment with different potential rules against a backdrop of FCC oversight.

States are well-positioned to serve as the Commission's eyes and ears in the local community with regard to consumer protection concerns. One may posit instead a network of FCC field offices, but states are better equipped to fulfill this role. On a practical level, state public utilities commissions already exist; at least in the short run, it is more efficient to leverage existing resources than to construct a new infrastructure from scratch. And on a more theoretical level, state public utilities commissions remain more attuned to local needs than an FCC field office: the latter would still draw its pay from Congress and is ultimately accountable to national regulators rather than the local population. For this reason, state regulators are closer to the community than an FCC satellite and would be better positioned to act as the Commission's eyes and ears in a community.

This hybrid regulatory approach, wherein states serve as prosecutors and the FCC as adjudicator of consumer protection policy,

196. "Cramming" refers to the unauthorized placement of a charge on a customer's telephone bill.
197. "Slamming" refers to the practice of changing a customer's long distance service without that customer's authorization.
combines the best qualities of both levels of government and solves many problems created by vesting exclusive jurisdiction in one or the other. By bringing cases of local concern before the FCC, the states allow the FCC to leverage their local knowledge and assure that federal regulators address local issues that may not otherwise demand the FCC's attention. At the same time, federal regulators can address local consumer protection concerns from an appropriately national perspective, recognizing both the costs and benefits of a proposed rule to society as a whole and minimizing the risks of overregulation or underregulation that flow from state decisionmaking. State-filed adjudication then becomes a feedback mechanism by which the Commission can gauge the local effects of its national regulations and adjust its approach where necessary, without developing a duplicative and wasteful clearinghouse of its own for processing retail consumer complaints nationwide. Moreover, the FCC can judiciously partake of state experimentation to devise the optimal solution to a particular problem, while monitoring various state schemes to guard against excessive negative externalities that may otherwise occur in an unregulated federalist environment.

IV. CONCLUSION

The underlying purpose of the Telecommunications Act is both laudatory and timely. By eliminating outmoded regulations and consciously destroying the existing monopoly structure over local telephone service, the Act sought to unleash the power of competition on greater portions of the industry. Through this change, policymakers could trust markets to lower prices, expand service to more people, and encourage investment in new technology, with deliberate oversight by regulators to protect against the eventuality of market failures.

Unfortunately, although the Act sought to, in the president's words, "bring the future to our doorstep," Congress kept one foot firmly planted in the past by perpetuating silo-based regulation of services and continuing to rest jurisdiction over local telephone and cable networks in state hands. In essence, the Act focused on intramodal competition by encouraging the construction of more monoline service networks to compete against existing service providers. This framework not only turned a blind eye to existing distortions generated by parochial regulation of

198. See Clinton, supra note 1, at 215.
certain services, but failed to anticipate and adapt to technological developments that have effectively eliminated the monoline service model.

The next version of the Telecommunications Act must recognize the reality of intermodal competition and approach the industry as a single network that offers a variety of communications services over competing network platforms. The regulatory model sketched above recognizes that some elements of this network are national and some are local in scope, and vests jurisdiction in a manner that leverages the unique attributes of each institution. By uniting economic regulation under the Federal Communications Commission’s umbrella, Congress can prevent destructive parochial regulation from disrupting the economies of scale that the industry could otherwise achieve. And by leaving many non-economic issues in the hands of the states, subject to federal oversight, it can pay appropriate attention to the needs of local communities not large enough to demand national attention. Through this structure, Congress can avoid the fragmentation of markets that the Commerce Clause was designed to protect against, while allowing the telecommunications industry to continue to reap the unique benefits bestowed by Our Federalism.