

VIDEO DIALTONE: REFLECTIONS ON CHANGING PERSPECTIVES IN TELECOMMUNICATIONS REGULATION

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INTRODUCTION

The Federal Communications Commission's ("FCC" or "the Commission") recent decision on the provision of video dialtone services¹ highlights ongoing changes in the Commission's approach toward telecommunications regulation. Two aspects of the decision, in particular, are noteworthy. First, the decision represents the first attempt by the federal government to provide a comprehensive set of incentives for the deployment to the home of technologically advanced, high-capacity communications facilities, such as fiber optic cables, promoting the development of an array of informational and entertainment video services.² The deployment may lead to the "convergence" of all audio and video communications services onto "one wire" into the home. Second, the decision demonstrates the ability of a federal agency to navigate its way through a remarkably technology-restrictive statute in order to promote the principle of allowing market forces, rather than government plan, to be the engine of technological change and innovation. This Article will examine the impact of these perspectives on the

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1. Telephone Company-Cable Television Cross-Ownership Rules, §§ 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 F.C.C.R. 5781 (1992) [hereinafter Second Report]. Petitions for reconsideration of the Second Report are pending. See, e.g., Petition for Reconsideration of the National Cable Television Association, Inc., FCC Common Carrier Docket No. 87-266 (filed Oct. 9, 1992). An appeal to the U.S. Court of Appeals for the District of Columbia Circuit is anticipated.

2. This effort is continuing under the current Democratic administration. See WILLIAM J. CLINTON & ALBERT GORE, JR., TECHNOLOGY FOR AMERICA'S ECONOMIC GROWTH 28-30 (1993) (discussing efforts to promote the "information infrastructure" that "has as its lifeline a high-speed fiber optic network"); see also Phillip Elmer DeWitt, *Take a Trip into the Future on the Electronic Super Highway*, TIME, Apr. 12, 1993, at 50.

video dialtone decision as well as survey several of the issues that will have a major bearing on the development of video dialtone but that remain to be addressed by the FCC.

The focus of Section I is an overview of the video dialtone decision itself, including the interests of the various parties and an examination of the FCC's analysis of the issues. Section II further examines the technological incentives created by the FCC and also concludes that the FCC's statutory interpretation flowed from a creative, yet well-grounded, analysis of the relevant statutory provisions. This interpretation reflects the importance of adopting a perspective that gives a greater role to technological forces and market-driven solutions in setting telecommunications policy. Finally, Section III analyzes the major issues in implementing video dialtone that the FCC left unresolved in its ruling and the approaches being taken by local telephone companies as video dialtone moves from the drawing board and into the living room.

What is video dialtone? Conceptually, video dialtone, as its name implies, is best compared to the familiar audio dialtone of a telephone. A telephone consumer typically picks up a telephone handset, dials a telephone number, is switched and routed over the facilities of one or more common carriers, and reaches the number dialed—all in a matter of seconds. Similarly, as the FCC envisions video dialtone, a consumer could turn on a television, receive a menu of available services, dial the correct code, and access computer data bases, sporting events, movies, shopping guides, interactive services, and a multiplicity of other video services provided by various programmers (who are customers of the telephone company) ("customer-programmer") or by telephone companies themselves. Ultimately, the FCC envisions that video dialtone "could be offered over a broadband network" so as to enable any subscriber to transmit and receive a video signal to or from any other subscriber.³

3. Telephone Company-Cable Television Cross-Ownership Rules, §§ 63.54-63.58, Further Notice of Proposed Rulemaking, First Report and Order, and Second Further Notice of Inquiry, 7 F.C.C.R. 300, 306-07 (1991) [hereinafter First Report].

I. VIDEO DIALTONE PROCEEDINGS AND DECISION

A. Historical Background

Before examining the video dialtone decision, it is necessary to set it in the proper historical perspective. The relationship of telephone companies and cable system operators has been a concern of the Commission for the last twenty-five years. In the *General Telephone* decision,⁴ the Commission determined that telephone companies were compelled by § 214 of the Communications Act⁵ to seek the FCC's approval before the telephone company could provide channel service⁶ to a cable system. In examining the § 214 applications that followed, the Commission became concerned about the potential anti-competitive effects from telephone company ownership of cable systems in the same service area.⁷ As a result, the Commission concluded that a ban on such cross-ownership was necessary.⁸ Therefore, regulations prohibiting cross-ownership were established.⁹ Several years later, recognizing that

4. See *General Tel. Co. of Cal.*, 13 F.C.C.2d 488 (1968), *aff'd*, 413 F.2d 390 (D.C. Cir. 1969).

5. See 47 U.S.C. § 214 (1988). Generally, common carriers must show that it will serve "public convenience and necessity" before the Commission will grant permission under § 214 for the carrier to construct and operate new lines. *Id.* This is known as "214 authority."

6. "Channel service," referred to in 47 C.F.R. § 63.55 (1992), occurs when telephone companies construct and maintain cable television distribution networks that are leased to cable operators within the same area in which the telephone companies provide telephone service. See Telephone Company-Cable Television Cross-Ownership Rules, §§ 63.54-63.58, Notice of Inquiry, 2 F.C.C.R. 5092, 5097 n.15 (1987) [hereinafter Notice of Inquiry].

7. See Applications of Telephone Common Carriers for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems, 21 F.C.C.2d 367 (1970) [hereinafter Applications for Certificates], *aff'd sub nom.* *General Tel. Co. of S.W. United States*, 449 F.2d 846 (5th Cir. 1971).

8. Applications for Certificates, *supra* note 7, at 325.

9. 47 C.F.R. § 63.54 (a)-(b) (1992). In an effort to maintain competition within each of these submarkets, the same policy makers have erected a complex network of ownership restrictions that have frequently caused competitors to choose among video delivery systems. For example, ownership barriers were erected between cable systems and local television stations and the national television networks, such as ABC, CBS, and NBC, 47 C.F.R. § 76.501(a) (1992). The Cable Act itself prohibited some of cable's most potent potential competitors, local telephone companies, from owning cable systems within their service areas. Cable Communications Policy Act of 1984, 47 U.S.C. § 533(b) (1988); see also 47 C.F.R. § 63.54(b) (1992) (implementing the Cable Act restriction). Outside the region where they provide telephone service, the telephone companies are permitted to own cable systems. For example, Southwestern Bell recently purchased two cable systems in metropolitan Washington, D.C. See Paul Farhi & Cindy Skrzjicki, *Southwestern Bell To Buy*

the cross-ownership ban was preventing any cable service in some situations, the Commission established an exception for "rural" areas.¹⁰

This general ban was codified in the Cable Act of 1984.¹¹ Specifically, the statute prohibited "any common carrier provid[ing] video programming directly to subscribers in its telephone service area"¹² and maintained the rural exemption.¹³

B. Prior Proceedings on Video Dialtone

As federal regulatory time goes, video dialtone is a very new concept and grew out of proceedings that were not aimed at working within the ownership restrictions of the Cable Act, but aimed at doing away with them. In fact, it was not until 1991 that the structure of video dialtone began to take specific form.¹⁴ That year the Commission proposed for

Arlington, Montgomery Cable, WASH. POST, Feb. 10, 1993 at C1. Adding an additional layer of complexity, as part of the consent decree that resulted in the AT&T break-up, the local telephone companies that were once part of AT&T are prohibited from providing "interexchange" services, which involve transmitting information across certain geographical boundaries known as LATAs. See *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

10. See *Elimination of the Telephone Company-Cable Television Cross-Ownership Rules*, §§ 63.54-63.56, 88 F.C.C.2d 564, 576 (1981) ("In rural areas, we have determined that the costs of imposing the cross-ownership rules outweigh their benefits. Those costs include foreclosure or delay of cable television service to rural residents and wasted administrative resources at the Commission [processing waivers]."); 47 C.F.R. § 63.58 (1992) (defining the rural exemption).

11. 47 U.S.C. § 533(b) (1984). In addition, AT&T and its affiliates were barred from providing cable television service as part of a 1956 antitrust settlement. *United States v. Western Elec. Co.*, 1956 Trade Cas. (CCH) ¶ 68,246 (D.N.J. 1956). See Notice of Inquiry, *supra* note 6, at 5096 n.22 (recognizing this interpretation of the decree). The later decree governing the break-up of AT&T maintained this ban on the former Bell System operating companies. *United States v. AT&T*, 552 F. Supp. 131, 180-86, 189-90 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983) (establishing a prohibition on providing "electronic publishing" and "information services," which encompasses cable television service). However, more recent court action has freed these companies from the prohibition. *United States v. Western Elec. Co.*, 767 F. Supp. 308 (D.D.C.), *stay lifted*, 1991-92 Trade Cas. (CCH) ¶ 69,610 (D.C. Cir.), *aff'd sub nom. American Newspaper Publishers Ass'n v. United States*, 112 S. Ct. 366 (1991).

12. 47 U.S.C. § 533(b)(1). Congress intended to adopt the then existing FCC rules on this point. See H.R. REP. NO. 934, 98th Cong., 2d Sess. 56 (1984) ("It is the intent of section 613(b) to codify current FCC rules concerning the provision of video programming over cable systems by common carriers, except to the extent of making the exemption for rural telephone companies automatic.").

13. 47 U.S.C. § 533(b)(3). In light of changed market place conditions from those which many years ago prompted the Commission to impose the ban, the Commission has now advocated that Congress repeal the cross-ownership ban. Second Report, *supra* note 1, at 5847-51.

14. In 1987, the Commission issued a Notice of Inquiry to explore the continued need for

the first time, to allow telephone common carriers to provide what the FCC denominated "video dialtone service."¹⁵ As initially envisioned by the agency, video dialtone would not be limited to the transport function that had been traditionally associated with common carriage and allowed by the cross-ownership restriction but that had limited appeal to telephone companies. Rather, the FCC proposed that telephone companies could provide "additional non-programming services and enhanced video gateways including detailed menus, information search capabilities, and subscriber-driven data processing."¹⁶ Thus, the Commission said, video dialtone will "provide a 'platform' through which subscribers can access video and other information services."¹⁷

C. Establishing the Regulatory Structure for Video Dialtone

Based on this vision, last summer, the Commission decided on an initial regulatory structure and established broad definitions for video

a cable-telephone company cross-ownership ban. Notice of Inquiry, *supra* note 6. The Notice sought comment on the continuing validity of the rationale for the cross-ownership rules in light of changing marketplace conditions and technology. *Id.* at 5093. The possibility of video dialtone grew in part from the National Telecommunications and Information Administration's ("NTIA") belief at the time that telephone companies should themselves be allowed to provide programming in light of cross-subsidization concerns. NATIONAL TELECOMMUNICATIONS & INFORMATION ADMIN., NTIA REP. NO. 88-233, VIDEO PROGRAM DISTRIBUTION AND CABLE TELEVISION: CURRENT POLICY ISSUES AND RECOMMENDATIONS (1988). Following that report, the Commission suggested that there might be a policy somewhere between the mere provision of transport, which was generally conceded to be allowable under the Cable Act, and the ownership and provision of full-blown cable service, which seemed clearly prohibited by the Cable Act. In a Further Notice, Telephone Company-Cable Television Cross-Ownership Rules, §§ 63.54-63.58, 2 F.C.C.R. 5849 (1988), the Commission referenced NTIA's discussion of "video dial tone" and solicited comments "generally on whether the existing definitions under the Cable Act of cable operator and associated franchise and other obligations can reasonably accommodate such switched video networks and whether legislative recommendations would be warranted." *Id.* at 5874 n.57. The Commission also sought comment on whether, under a video dialtone-type regime, telephone common carriers or their customer-programmers were required to secure a local cable franchise. *Id.* at 5863. Still, even at this stage the Commission's focus continued to be on the necessity of any cable-telephone company cross-ownership restriction. The FCC proposed that it would recommend to Congress the repeal or modification of the cross-ownership restrictions put in place by the Cable Act. *See id.* at 5865-66 (discussing the restriction in 47 U.S.C. § 533(h)).

15. First Report, *supra* note 3, at 306-21. The FCC decided that local telephone companies would not need to obtain a cable television franchise in order to provide video dialtone service. The agency also asked further questions regarding the need for a cable-telephone company restriction. *Id.*

16. *Id.* at 307.

17. *Id.*

dialtone in its Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking ("Second Report")¹⁸ and a Memorandum Opinion and Order on Reconsideration of the First Report ("Reconsideration Order").¹⁹ The Second Report modified FCC regulations to enable local telephone companies to provide video dialtone services and set out a regulatory structure for the provision of those services.²⁰ The Reconsideration Order clarified why local telephone companies did not need to obtain local cable television franchises to offer video dialtone service.²¹

1. Defining Video Dialtone

The Commission stated that video dialtone "is an enriched version of video common carriage under which [local telephone companies] will offer various non-programming services in addition to the underlying video transport."²² If only the underlying video transport were provided, video dialtone would not differ from the already permissible "channel service" capability. What distinguishes video dialtone is that the FCC conceives of it as "facilitating the provision of additional non-programming services and of enhanced video gateway including detailed menus, information search capabilities, and subscriber-driven data processing."²³

Essentially, channel service, video dialtone, and cable service form a hierarchy relating to the degree of control an entity has over the content being transported. When providing channel service, the telephone company acts purely as a conduit, not interacting in any way with the transported content. Video dialtone envisions the provider contributing to and enhancing the content by providing non-programming services and gateways. Finally, cable service itself is distinguished by an entity's ability to have complete editorial control over content, as well as control over the selection and pricing of programming.

The Second Report established a two-tier framework to govern the provision of video dialtone services.²⁴ In the video dialtone context, the

18. See *supra* note 1. Petitions for reconsideration of the Second Report are pending.

19. Telephone Company-Cable Television Cross-Ownership Rules, §§ 63.54-63.58, Memorandum Opinion and Order on Reconsideration, 7 F.C.C.R. 5069 (1992) [hereinafter Recon. Order].

20. Second Report, *supra* note 1, at 5783.

21. Recon. Order, *supra* note 19, at 5069.

22. First Report, *supra* note 3, at 306.

23. *Id.* at 307.

24. Second Report, *supra* note 1, at 5810-11. In 1980, the FCC adopted a similar

FCC stated that the first tier would contain a basic video dialtone platform as a basic regulated service. The second tier would contain services such as an optional gateway, owned and operated by the telephone company, that constituted an enhanced or nonregulated service.²⁵ The first-tier offerings would be subject to traditional common carrier obligations—the local telephone companies will need to make available to all service providers the same service offerings on the same terms and conditions.²⁶

2. *Ownership Restrictions and Local Franchises*

In authorizing telephone companies to engage in video dialtone services, the Commission had to overcome two major legal impediments. First, many commenting parties argued that the provision of video dialtone by telephone companies was prohibited by the Cable Act's cross-ownership ban.

In deciding that the Act did not prohibit the provision of video dialtone, the FCC recognized that the Cable Act prohibits local telephone companies from providing video programming directly to subscribers within the local company's service area.²⁷ Yet the Commission also recognized that, even under the Cable Act proscriptions, telephone companies are able to construct and provide the physical transport facilities necessary to link programmers with individual consumers.²⁸

The Commission's ability under the Cable Act to authorize something more than a transport function hinged on relatively narrow readings of three defined terms in the Cable Act: "cable operator,"²⁹ "cable service,"³⁰ and "cable system."³¹ These definitions were critical because

framework designating basic and enhanced services in the context of computer services and common carriers. See Amendment of Section 64.702 of the Commission's Rules and Regulations, 77 F.C.C.2d 384 (1980) ("Computer II"), *modified*, 84 F.C.C.2d 50 (1980), *modified*, 88 F.C.C.2d 512 (1981), *aff'd sub nom.* Computer & Communications Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

25. Second Report, *supra* note 1, at 5811.

26. *Id.* at 5810-11.

27. *Id.* at 5786 (citing 47 U.S.C. § 533(b)(1)).

28. *Id.* at 5787.

29. The Act defines a cable operator as "any person or group of persons (A) who provides cable service over a cable system and directly or through one or more affiliates owns a significant interest in such cable system, or (B) who otherwise controls or is responsible for, through any arrangement, the management or operation of such a cable system." 47 U.S.C. § 522(4)(1992).

30. The Act defines cable service as "(A) the one-way transmission to subscribers of (i)

the Cable Act generally prohibited common carriers from acting as a cable operator or from providing cable service over a cable system.

Although it did not undertake an extensive analysis in the Further Notice of Proposed Rulemaking, First Report and Order, and Second Further Notice of Inquiry ("First Report"), the FCC found that video dialtone was different from any of the concepts described by these terms. Rather, the FCC said:

A [local telephone company] providing video dialtone service does not fall within th[e] definition [of a cable operator] because the [company] is not providing the video programming service directly to subscribers. Rather, the [company] is simply acting as a conduit in providing broadband common carrier-based service that enables its customer/programmers to provide video programming to subscribers.³²

In the Reconsideration Order, the FCC elaborated on its rationale. In considering video dialtone, it recognized that it was dealing with a mode of delivery that "the drafters of the Cable Act had not contemplated."³³

video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection of such video programming or other programming service." 47 U.S.C. § 522(5)(A)-(B).

31. The act defines a cable system as:

a facility consisting of a set of closed transmission paths and associated signal generation, reception, and control equipment that is designed to provide cable service which includes video programming and which is provided to multiple subscribers within a community, but such term does not include (A) a facility that serves only to retransmit the television signals of 1 or more television broadcast stations; (B) a facility that serves only subscribers in 1 or more multiple unit dwellings under common ownership, control, or management, unless such facility or facilities uses any public right-of-way; (C) a facility of a common carrier which is subject, in whole or in part, to the provisions of title II of this act, except that such facility shall be considered a cable system (other than for purposes of section 621(c)) to the extent such facility is used in the transmission of video programming directly to subscribers; or (D) any facilities of any electric utility used solely for operating its electric utility systems.

47 U.S.C. § 522(7).

32. First Report, *supra* note 3, at 327.

33. Recon. Order, *supra* note 19, at 5070. Of course, some commentators would consider that to be reason enough to dispense with interpretation of the Cable Act, on the premise that it was not addressed to the issue of video dialtone. See, e.g., Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533, 544 (1983) ("[T]he domain of

In part, the Reconsideration Order focused on the interpretation of "transmission" in the definition of cable service. Although some parties argued that the telephone companies were involved in the "transmission . . . of video programming," the FCC rejected a reading of "transmission" that involved the telephone companies falling under the Act for only passively transporting a signal generated by a programmer to a subscriber, as telephone companies do in providing channel service. Instead, it found that congressional intent was more consistent with a reading of "transmission" that required "active participation in the selection and distribution of video programming."³⁴ Because a telephone company was not participating in the selection of the programming, it was not providing "cable service." Furthermore, the ability of the local telephone company to provide services related to, but not consisting of, video programming, was firmly stated in the legislative history.³⁵ Thus, the provision of capabilities to search for movie titles or otherwise engage in interactive processes is not limited in any way by the Cable Act.

The Reconsideration Order then addressed whether local telephone companies were "cable operators," a decision that depended on the interpretation of "cable system." It found that all the telephone facilities involved in providing video dialtone would be covered by the exemption for common carrier services governed by Title II of the Communications Act.³⁶ Furthermore, the FCC reasoned that Congress did not intend to subject telephone companies to two sets of regulations for one facility.³⁷

The Commission also found two additional reasons why video dialtone facilities in its view were not a "cable system." First, the exemption exception did not apply because telephone companies were not actively involved in the selection of programming.³⁸ Second, video dialtone facilities owned by the telephone company would not ordinarily include the equipment for signal generation, reception, and control, which constitute necessary parts of a cable system.³⁹

the statute should be restricted to cases anticipated by its framers and expressly resolved in the legislative process."). Easterbrook's interpretive principle serves a great need in areas that are undergoing rapid technological change.

34. Recon. Order, *supra* note 19, at 5071.

35. See H.R. REP. NO. 934, 98th Cong., 2d Sess. 57 ("Nothing in this section shall be construed to limit telephone company provision of information services or other non-video programming, transmissions or communications services.").

36. Recon. Order, *supra* note 19, at 5072 (citing 47 U.S.C. § 522(6)(c)).

37. *Id.*

38. *Id.*

39. *Id.* at 5072-73.

In short, the Commission found that the customer-programmer's provision of video programming over a telephone company conduit and the telephone company's provision of video "platforms" and "gateways" were not "cable service" provided by a "cable operator" over a "cable system." Thus, under the FCC's view of the Cable Act, telephone companies were free to provide video dialtone and neither they nor their customer-programmers would need a local franchise to do so. The Commission anticipated wide variation in how different local telephone companies may choose to implement video dialtone.⁴⁰ Thus, the agency hoped to avoid molding of either the technology or the message to some government notion of what works best and what consumers want.

Second, the Commission also decided that a local cable franchise was not necessary in order for telephone companies to provide video dialtone.⁴¹ This conclusion followed from two observations. First, the concerns about a cable television system's burden on public rights-of-way and the need for state and local entities to regulate that burden are not present. The local telephone companies' use of lines to provide video dialtone present no additional physical burdens on public rights-of-way.⁴² Second, requiring a cable franchise for the transport of video programming would run counter to the longstanding provision of channel service by local telephone companies.⁴³ At its core, after all, video dialtone is an enhanced form of channel service, one that envisions that the service is provided by multiple programmers instead of a single programmer.⁴⁴ The Cable Act gives no indication that Congress wished to alter this practice.⁴⁵

40. Second Report, *supra* note 1, at 5805 n.104.

41. Recon. Order, *supra* note 19, at 5070.

42. *Id.*

43. *Id.*

44. Second Report, *supra* note 1, at 5783 n.3 ("Video dialtone service at the basic platform level differs from the 'channel service' that local telephone companies currently may provide cable television operators in that we will require local telephone companies to provide sufficient transmission capacity to serve multiple video programmers.").

45. In addition, the Commission revised its rules governing financial relationships between local telephone companies and video programmers. Where the current regulations generally provided for no more than a one percent interest in video programmers held by telephone companies, 47 C.F.R. § 63.54, the new regulations permit up to a five percent interest when the programmer participates in the basic platform. Second Report, *supra* note 1, at 5801-02. This change brings the ownership standard in line with the existing five percent standard between cable and broadcast entities. See Re-examination of the Commission's Rules and Policies Regarding the Attribution of Ownership Interests in Broadcasting, Cable Television and Newspaper Entities, 97 F.C.C.2d 997 (1984), *recons. in part*, 58 Rad. Reg. (P & F) 604 (1985), *further recons.*, 1 F.C.C.R. 802 (1986). In addition to benefits such as providing start-up capital to increase the diversity of independent programming sources, raising the permissible level of interest also reduces the current

3. Safeguards

In response to traditional concerns about telephone company provision of unregulated services, the FCC established three measures to help prevent a telephone company from discriminating among customers and using its monopoly revenues to subsidize its second-tier video dialtone services. First, existing safeguards against discrimination and cross-subsidization will apply to video dialtone services.⁴⁶ Second, if appropriate, additional safeguards tailored to specific video dialtone proposals will be imposed as part of the § 214 certification process.⁴⁷ Third, a review of the adequacy of all safeguards will occur in three years to ensure that they are accomplishing the desired result.⁴⁸

II. THE FCC'S INTERPRETATION OF THE CABLE ACT IN THE CONTEXT OF CHANGING MARKETS AND TECHNOLOGY

The FCC explicitly recognized that its video dialtone decision heralded a new era of communications to the home—an era in which one connection could provide a multitude of video and audio services. As the Commission said, a video dialtone “basic platform would enable a potential large number of existing and new programming sources, with differing service forms and structures, to reach consumers . . . likely bringing those consumers more choice in content, more responsive customer service, and lower prices for video programming and video programming services.”⁴⁹ As such, the Commission’s decision served a number of communications policies—some traditional, some new—and prompted the Commission to interpret creatively the technology-restrictive provisions of the Cable Act.

For example, in its decision, the FCC furthered several traditional communications policies. Video dialtone clearly continues the Commission’s longstanding belief in creating choice for American consumers. Even in its most basic form, video dialtone provides yet another way to

regulatory burden that processing waivers from the current standard imposes. Second Report, *supra* note 1, at 5801.

46. Second Report, *supra* note 1, at 5823.

47. *Id.*

48. *Id.*

49. *Id.* at 5795-96.

deliver television programming to the home.

Because of this policy, American consumers are already offered a bewildering array of video channels. Indeed, particularly over the last two decades, both Congress and the FCC have encouraged more choice for video consumers, often over the objection of existing video providers. In particular, this impulse is reflected in the increased licensing of television stations;⁵⁰ the authorization of direct broadcast satellite service;⁵¹ the authorization of multipoint multichannel distribution systems (MMDS, also known as "wireless cable");⁵² and the "Open Skies" decision that paved the way for satellite-delivered programming, such as Home Box Office and the Cable News Network.⁵³

Video dialtone service promotes an important corollary policy as well: providing competition for existing delivery systems. This has proved particularly important because of the growth and perceived power of the cable television industry in the past few years. Indeed, while competition historically has been seen by the FCC on a station-by-station or channel-by-channel basis,⁵⁴ video dialtone is seen by the Commission as a means of providing a multi-channel competitor to cable systems. Remarkably, in the FCC's view, video dialtone may serve that goal at least in the short term more than the total elimination of the cable-telephone cross-ownership ban. That is, since telephone companies are prohibited from owning cable systems, they essentially are compelled to build their own broadband networks to compete with existing cable systems rather than simply acquiring those systems.

In addition to those traditional goals, the FCC's decision serves some more recent communications policies as well. Perhaps most significantly, the Commission also recognized the importance of free markets and technology in shaping its video dialtone policy—at least with regard to the scope of and services to be provided on video dialtone systems. Indeed,

50. From January 1, 1970 through January 1, 1992, the number of authorized television stations increased by almost 65%—from 1,038 to 1,688. R.R. BOWKER, *BROADCASTING & CABLE MARKETPLACE* 1992 E-110 (1992).

51. *Direct Broadcast Satellites*, 90 F.C.C.2d 676 (1982).

52. Amendment of Parts 2, 21, 74, and 94 of the Commission's Rules and Regulations in Regard to Frequency Allocation to the Instructional Television Fixed Service, the Multipoint Distribution Service, and the Private Operational Fixed Microwave Service, 94 F.C.C.2d 1203 (1983), *recons. denied*, 98 F.C.C.2d 68 (1984).

53. *Establishment of Domestic Communications-Satellite Facilities By Non-Governmental Entities*, 35 F.C.C.2d 844, *recons.*, 38 F.C.C.2d 665 (1972).

54. This historical perception lies at the heart of the numerous restrictions on the ownership of local broadcast stations—restrictions that allow the ownership of only one broadcast television station in each market.

the parameters of the service seem dictated much more by the constraints of the Cable Act's ownership restrictions than by the course of technological development. Even in creating a definition, the Commission sought only to be sufficiently detailed to allow a reviewing court to determine that video dialtone is not "cable service" provided by "cable operators" over a "cable system." Beyond that minimum, however, the Commission seems intent on allowing the service flexibility to adapt to changes in market conditions and technology. As it stated in the Second Report:

Given the rapid pace of technological development in this area, our policy initially sets only the necessary broad regulatory framework and relies upon the technical and market creativity of those in the private sector responding to market demand and economics to determine the substance of telephone company video dialtone offerings.⁵⁵

Ultimately, the video dialtone decision recognizes that technology moves faster than regulators. The decision embodies the concept that the government should encourage and serve technology, rather than try to shape technology to conform to any government-generated plan. The Second Report embodies this concept in designating only broad parameters within which video dialtone can develop.⁵⁶

Recognizing that the relevant technology is still in its infancy, the FCC wanted to "avoid premature service descriptions and regulatory classifications" because "video dialtone should be permitted to develop according to the dictates of the marketplace and technology[,] and . . . our regulatory policies should not constrain that development."⁵⁷ More explicitly, and in response to some commentators who urged the adoption of specific technical requirements, the FCC emphasized that it was

55. Second Report, *supra* note 1, at 5788-89.

56. Indeed, the Commissioners' statements accompanying the Second Report, *supra* note 1, explicitly recognized this limitation on regulation. Commissioner Marshall stated that "new technologies are rapidly rendering statutory industry separations—such as those between voice, video, and data transmissions—obsolete." Second Report, *supra* note 1, at 5881. Commissioner Duggan noted that "[a]s technology presses us toward the convergence of broadcasting, cable and telephony, our old rules may not make sense any longer." *Id.* at 5885.

57. *Id.* at 5812. See Comments of the National Cable Television Association, FCC Docket No. 87-266, at 3 (filed Feb. 3, 1992) ("There can be no blueprint for determining in advance the precise nature of these video dialtone functions and services That will depend upon future developments in network technology, the applications they make possible, and marketplace demand for those applications.").

designating a framework that was not biased to the implementation of any particular technology:

[W]e emphasize that we do not require or promote any particular technology or network architecture, nor do we stipulate any technical parameters or impose a minimum broadband switching requirement. Video dialtone is technology neutral; it addresses the barriers that hinder the development of a competitive video marketplace and the efficient deployment of new broadband technologies by the local telephone companies, and defines the regulatory guidelines for the local telephone companies' video distribution services, regardless of the technology used. In fact, we anticipate wide variation in how different local telephone companies may choose to implement video dialtone.⁵⁸

Thus, the agency hoped to avoid molding of either the technology or the message to some government notion of what works best and what consumers want. The agency also sought to provide minimal regulatory structure, focusing instead on an incentive scheme for the provision of video dialtone.

The same hands-off approach cannot be said to exist with regard to the basic construction of the underlying video dialtone infrastructure. Clearly the Commission sought to induce telephone companies to build high-capacity broadband facilities to the home.⁵⁹ In fact, the building of these facilities represents a conscious and significant price for participation in video dialtone.

In contrast to the respect for market forces in the provision of services, the FCC forbids telephone companies from acquiring the physical plant of cable companies for providing video dialtone service.⁶⁰ The FCC stated that the mere transfer of existing facilities, rather than promoting the construction of new facilities, would not be in the public

58. Second Report, *supra* note 1, at 5805 n.104.

59. Former FCC Chairman Alfred Sikes frequently urged domestic communications providers to make a greater commitment to research and development and the deployment of new technology, such as fiber optic cable. See, e.g., John T. Mulqueen, *RBOCs: Profligates or Tightwads?*, DATA COMM., Dec. 1989, at 69 (reporting Sikes' criticism of telephone companies on these issues); Gail Runnoe, *Users Angry as FCC Extends LECs' 12% Rate of Return*, NETWORK WORLD, Dec. 25, 1989, at 2.

60. Second Report, *supra* note 1, at 5837-38.

interest as such a policy would not further the FCC's overriding goals of promoting competition, encouraging diversity of programming, and improving telecommunications infrastructure.⁶¹

In the video dialtone area, the FCC cited several rapidly developing technologies as playing a role in its decision, in particular, fiber optic networks, multimedia applications, broadband digital switching technology, and video compression techniques.⁶² The Second Report noted that the development of infrastructure for video dialtone can lead to the convergence of what have previously been conceived of as separate services—the transmission of voice, data, and video.⁶³

None of these policy goals could have been furthered, of course, but for the Commission's interpretation of the Cable Act—an interpretation that demonstrated a good deal of regulatory flexibility in the reading of the statute and, most particularly, remarkable perseverance in the pursuit of its policy goals. In essence, the Commission used the Cable Act not as a barrier but as a starting point from which to find ways to serve the Commission's policy goals.

This is not to say that the Commission has ignored the statutory proscription in the blind pursuit of its policy preferences. To the contrary, video dialtone was crafted around the proscriptions. However, it is clear that the Commission has not gone out of its way to imagine or to reason barriers to exist where none exists in the literal language of the statute. Thus, the Commission has put into practice the notion that statutes should not apply to questions unanticipated by those who enacted them.⁶⁴ Clearly, the FCC has not taken the most conservative, nor the most restrictive reading of the Cable Act, but has elected instead to take a calculated legal risk to promote fundamental policy goals.

This is a strategy the Commission knows well. This agency that is in the business of authorizing and encouraging the technologies of the future lives under an authorizing statute that is deeply attached to the past. The basic regulatory structure of the Communications Act has not changed since it was written in 1934 when local and long distance telephone service was provided by monopolies and AM radio was the only source of information and entertainment to American homes. Since fundamental change in the Act has more often than not proved to be extremely

61. *Id.*

62. *Id.* at 5793-94.

63. *Id.* at 5795.

64. *See, e.g.*, Easterbrook, *supra* note 33.

difficult to accomplish, the Commission has frequently been called on to find policy flexibility in an increasingly arthritic statute.⁶⁵

This search for policy flexibility clearly was not easy in the video dialtone decision, but it appears, almost by definition, that the Commission is correct in its interpretation. That is, the agency simply has not authorized telephone companies or their customer-programmers to engage in anything that is proscribed (or regulated) by the Cable Act. By the Commission's definition, neither telephone companies nor their customer-programmers can be "cable operators." They cannot provide "cable service." And they cannot operate a "cable system."

Of course, there are parties who contend otherwise. The FCC's decision has been subject to a variety of reconsideration petitions, many of which raise fundamental questions about the Commission's interpretation of the Cable Act. For example, the cable television industry, which would be expected to face multi-channel competition from video dialtone providers, has raised a number of objections. The National Cable Television Association, the major trade association for cable television operators, is seeking to have the FCC modify the Second Report in several significant respects.⁶⁶ The cable industry's argument concerning the carrier-user relationship focuses on the alleged codification of then-existing FCC rules into the Cable Act.⁶⁷ What the cable industry ignores in the legislative history, however, is that although there is support that Congress intended to codify the rules, it only did so to the extent that they concerned "the provision of video programming *over cable systems*."⁶⁸ If the FCC is correct that video dialtone is not provided over a "cable system," as defined in the Cable Act, the cable industry's argument fails.

Similarly, the cost-allocation issue raised by the cable industry is an important one, but in the end it is merely a disagreement with the FCC over when the issue should be addressed. The crux of the issue is to ensure that the costs of providing video dialtone are not shifted to the existing subscribers of the telephone company's telephone services. Such a cross-subsidy would result in those customers bearing a portion of the

65. This exercise is not always successful in court. See, e.g., *AT&T v. FCC*, 978 F.2d 727, 735 (D.C. Cir. 1992).

66. Petition for Reconsideration of the National Cable Television Association, Inc., FCC Common Carrier Docket No. 87-266 (filed Oct. 9., 1992) [hereinafter NCTA Petition].

67. *Id.* at 12-13 (citing H.R. REP. NO. 934, 98th Cong., 2nd Sess. 56 (1984)).

68. H.R. REP. NO. 934, 98th Cong., 2nd Sess. 56 (1984) (emphasis added).

cost of video dialtone services, while allowing the telephone companies to price the video dialtone service itself at less than its true cost. Such undercutting of prices understandably concerns existing cable operators. Indeed, the cable industry goes so far as to argue that the FCC has deprived the telephone companies of the information that they rationally need in order to develop video dialtone proposals.⁶⁹

The FCC, however, has shown no sign of failing to give the appropriate attention to cost allocation. It has merely stated that it will address the issue in conjunction with evaluating specific proposals.⁷⁰ If anything, this will result in a cost-allocation scheme that is tailored to each proposal to guard more effectively against cross-subsidies. In light of the expectation that diverse technologies will be proposed for implementing video dialtone, technologies that are certain to interact with existing telephone service facilities to varying degrees, it would be futile for the FCC to look into a crystal ball and announce one-size-fits-all cost-allocation guidelines. Such guidelines would be so general as to have little applicability. Instead, the FCC should make cost-allocation decisions on the basis of concrete proposals by the telephone companies.

The concern for a strong non-discrimination policy governing first-tier services is one that the FCC shares. As stated in the Second Report, the FCC will require that all service providers be offered the same transport services on the same terms and conditions.⁷¹ Therefore, the cable industry's concern that the telephone companies will be allowed to discriminate among different classes of programmers in providing first-tier services⁷² is merely a "straw man" argument that has already been addressed by the FCC.

The cable industry's objection to the decision barring telephone companies from acquiring existing cable company physical plants is based primarily on the concern that an existing cable operator would be prevented from recouping its investment by selling the facility to the local telephone company.⁷³ Obviously, the mere transfer of physical plant from one owner to another does nothing toward furthering the FCC's goal of promoting diversity and developing an advanced telecommunications infrastructure. The existence of a second delivery system, which the

69. NCTA Petition, *supra* note 66, at 9.

70. Second Report, *supra* note 1, at 5840.

71. Second Report, *supra* note 1, at 5810-11.

72. NCTA Petition, *supra* note 66, at 5-7.

73. *Id.* at 18.

cable industry calls "redundant and unnecessary,"⁷⁴ is precisely what will further the FCC's goal of enhancing competition in the delivery of video services and developing an advanced infrastructure.

Finally, the cable industry objects that the FCC's decision to permit telephone companies to provide video gateways for second-tier services results in the telephone companies engaging in the prohibited activity of providing video programming directly to subscribers.⁷⁵ This argument has two bases. First, the cable industry argues that in determining what service providers participate in the second-tier gateway, the telephone companies are involved in the selection of programming for the consumer.⁷⁶ Second, it argues that in retailing the gateway as a service, the telephone companies will be involved in the prohibited practice of providing video programming directly to consumers.⁷⁷

The first of these objections was already discussed in the Second Report. As the cable industry itself stated, the telephone companies are prohibited from performing the "traditional functions of a cable operator."⁷⁸ As the FCC noted, in designing the gateways, the telephone companies are prohibited from traditional cable operator activities involved in selection of programming such as the pricing of, owning of, or exercising editorial control over video programming.⁷⁹ The second objection, that the telephone companies are engaged in providing video programming because they will be involved in retailing the gateways, is even less convincing. This argument ignores the fundamental distinction that the FCC has drawn, and that the Cable Act dictates, concerning the provision of video programming directly to subscribers. The FCC has distinguished between the transport function and related activities permissibly performed by the telephone companies and the provision and ownership of the programming itself, which must be done by the video programmers. As the retailing function is clearly ancillary to the transport function, the telephone companies cannot reasonably be seen as engaging in the provision of the video programming in merely marketing the gateways.

74. *Id.* at 17.

75. *Id.* at 14-16.

76. *Id.* at 14.

77. *Id.* at 15.

78. *Id.*

79. Second Report, *supra* note 1, at 5818 n.180.

III. THE CHALLENGES IN IMPLEMENTING VIDEO DIALTONE

In the Second Report, the FCC indicated that video dialtone proposals would be individually evaluated through the application for a certificate of public convenience and necessity under § 214 of the Communications Act.⁸⁰ The FCC has already received several applications that reveal the various methods and scope of proposed video dialtone services. An examination of these applications reveals several issues that will continue to develop within the broad regulatory parameters established in the Second Report.

Two of the applications illustrate the various potential approaches in implementing video dialtone. New Jersey Bell Telephone Company ("New Jersey Bell") has filed an application to provide video dialtone service in Dover Township, New Jersey.⁸¹ Similarly, the Chesapeake and Potomac Telephone Company of Virginia ("C&P") has filed to provide video dialtone service in northern Virginia.⁸² The applications, however, detail drastically different approaches for implementing video dialtone.

The New Jersey Bell application proposes to offer sixty-four channels of video capacity at the outset, with "several hundred channels" available within thirty-six months of commencing construction.⁸³ A customer-programmer, which will compete with the local cable service operator, has made an agreement to use sixty of the initially available channels.⁸⁴ The proposed system would use fiber optic cable to the curb of the subscribers, with traditional copper and coaxial cable providing only the final link to the home or business.⁸⁵ New Jersey Bell will also provide ancillary services, such as video customer premises equipment that resembles contemporary cable service converter boxes.⁸⁶ At the outset, approximately 38,000 homes and businesses will have video dialtone services.⁸⁷

80. *Id.* at 5812.

81. Application of New Jersey Bell Tel. Co., FCC Docket No. WPC-6840 (filed Dec. 15, 1992) [hereinafter NJB Application].

82. Application of The Chesapeake and Potomac Tel. Co. of Virginia, FCC Docket No. WPC-6834 (filed Oct. 20, 1992) [hereinafter C&P Application].

83. NJB Application, *supra* note 81, at 2-3, 6.

84. *Id.* at 2.

85. *Id.* at 5.

86. *Id.* at 7.

87. *Futurevision to Offer Video Services Over Advanced Bell Network in New Jersey*. PR

In contrast, the C&P application envisions a trial of video dialtone over the existing copper wire network. Using Asymmetric Digital Subscriber Line ("ADSL") technology, the system will compress video signals in order to transmit them over copper wire.⁸⁸ The trial is scheduled to run for up to two years and involve 400 homes.⁸⁹ ADSL does not have all the capabilities of a fiber optic network. For example, it is currently limited to transmitting pre-recorded material and not live programming.⁹⁰ It does, however, offer substantial cost savings because it uses only the existing copper wire for transmission.

Although these pending applications demonstrate the variety of approaches that will be taken in constructing the infrastructure necessary for video dialtone, they do not even begin to reveal the myriad issues that will arise from the actual design of the service itself. For example, all the aspects of the design of the gateways and the various navigational aids will play a role in making the service "user-friendly." Although the Commission will surely continue to consider the importance of market forces concerning these aspects of the service, it is nevertheless crucial to recognize that the vast expenditures contemplated for installing the necessary hardware will be in vain if the software to run the system is not designed to facilitate the average user's access to the wealth of information that will soon be accessible from within the home.

CONCLUSION

With the decision to permit the implementation of video dialtone services, the FCC has brought the nation to the threshold of a new revolution in telecommunications. That decision was only reached, however, as the result of a willingness to interpret a statute drafted under a different technological structure in a creative manner so as to bring the benefits of ongoing technological change to the public. In engaging in such an interpretation with a keen awareness of both market realities and imminent technological advances, the Commission has discharged in the most effective manner its mandate to regulate telecommunications in the public interest while being faithful to the relevant governing statutes.

Newswire, Dec. 15, 1992, available in LEXIS, Nexis Library, PRNews File.

88. C&P Application, *supra* note 82, at 1.

89. *Id.* at 2.

90. *Id.* at 2 n.2.