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## A Brief History of American Telecommunications Regulation

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## **A Brief History of American Telecommunications Regulation**

Tim Wu

While the history of governmental regulation of communication is at least as long as the history of censorship, the modern regulation of long-distance, or “tele,” communications is relatively short and can be dated to the rise of the telegraph in the mid-19<sup>th</sup> century. The United States left the telegraph in private hands, unlike countries and as opposed to the U.S. postal system, and has done the same with most of the significant telecommunications facilities that have been developed since. The decision to allow private ownership of telecommunications infrastructure has led to a rather particularized regulation of these private owners of public infrastructure -- similar to other laws governing “regulated industries,” yet also influenced by the U.S. First Amendment and antitrust law.

### *Prototypes for Regulation*

Broadly speaking, the regulations have been of three main types: 1) common carriage requirements; 2) interconnection requirements; and 3) scarcity management. Each of these types of regulation can be illustrated through the examples of the three main telecommunications industries of the Nineteenth and early Twentieth century: the telegraph, the telephone and broadcast radio.

The first commercial telegraph was constructed in 1839 in Great Britain. In the United States, by the 1850s the industry was intensely competitive, with multiple carriers frequently serving identical routes. The lack of integration between systems and the low profits for providers prompted a process of consolidation that culminated in Western Union’s gaining a monopoly on long-distance telegraph service by 1866. At the time, no federal antitrust law was available as a tool for regulation, so Congress responded to criticisms of Western Union by

passing the United States' first telecommunication regulatory statute, the Telegraph Act of 1866. The Telegraph Act was intended to foster competition by allowing any company to erect telegraph lines along post roads, and it also included a provision whereby the United States could buy out telegraph companies if it so chose. In practice, the Telegraph Act had little practical effect, as it failed to create effective competition for Western Union, and Congress never exercised its option to buy out the company and nationalize the industry. As a result, through the latter half of the Nineteenth century, Western Union was able to charge monopoly prices, support a newswire monopoly (the Associated Press) and discriminate against disfavored customers through its pricing. The firm was also able to use its monopoly to exert substantial political influence by, among other things, refusing to give certain news organizations access to its system to transmit their reporting. For example, in the contested Presidential Election of 1876, Western Union's backing of Presidential candidate Rutherford Hayes gave the candidate important advantages both in reaching newspaper and detecting the plans of his rival.

In the Mann-Elkins Act of 1910, Congress declared both telegraph and telephone companies (including AT&T, which at the time not only owned Western Union but also had its own monopoly in long-distance telephone lines) to be common carriers. The act placed communications, for the first time, under the jurisdiction a federal agency: the Interstate Commerce Commission (ICC). Being a common carrier meant that telephone and telegraph companies had to offer their services without discrimination to all willing customers who were able to pay, and that they had to charge reasonable rates set by the ICC. In return, the telegraph and telephone companies received certain benefits, such as immunity from liability for the content they carried. The "common carriage" concept, originally a product of English common law remains the basis for the regulation of telephone carriers today.

Shortly after the Mann-Elkins Act, the United States addressed a different but related aspect of AT&T's business practices. In addition to its long-distance monopoly, AT&T provided local phone service, where it faced competition in local markets. In an attempt to eliminate this competition, AT&T routinely refused to allow non-affiliated local carriers to use its long-distance lines, thereby limiting the value of the services they could provide. In response to pressure from the Justice Department, in 1913 AT&T entered into what became known as the "Kingsbury Commitment," which required it to allow competing local providers to interconnect with AT&T's long-distance services.

While important, the Kingsbury Commitment was not a full anti-discrimination remedy. It did not require that AT&T, for instance, connect its local service to that of its competitors, nor did it require AT&T to interconnect its long distance or local networks with competing long-distance carriers, should they arise in the future. The Kingsbury Commitment did not hinder AT&T from creating the phone service monopoly that it enjoyed for most of the Twentieth century, and in the view of many, it represented the U.S. acceptance of an AT&T monopoly.

Scarcity management, the third major form of communications regulation in the United States, became an issue with the rise of broadcast radio in the 1920s. The first commercial station in the country, KDKA in Pittsburgh, Pennsylvania, began broadcasting in 1920. By 1924, the United States had over 1,000 radio stations broadcasting in a state of anarchy under the *ad hoc* supervision of Herbert Hoover, the then-Secretary of Commerce. Throughout the mid-1920's, Hoover managed the station's mutual interference by making case-by-case decisions to have broadcasters either shift their frequencies or share them by operating only limited hours in a day. Ultimately, the courts held that Hoover lacked the legal authority to

impose even this minimal level of order, and the ensuing broadcast free-for-all prompted Congress to pass the Radio Act of 1927.

Because the broadcast spectrum is a physically scarce commodity, the Radio Act made plain that the spectrum would be publicly owned, that the government would regulate entry into the business of broadcasting, and that it would grant broadcasting licenses only “if public convenience, interest or necessity will be served thereby.” To this end, the Radio Act established a commission charged with dividing the spectrum into different classes of stations and issuing licenses to broadcast at particular frequencies, times, locations and power levels. The law also barred the government from censoring broadcasts and required any broadcaster who gave time to a political candidate to “afford equal opportunities to all other such candidates for that office.” The newly created Federal Radio Commission would also declare the first version of what would be called the “Fairness Doctrine”-- requiring that broadcasters give notice and time for advocates on both sides of an issue to be heard.

The provisions of the Radio Act of 1927 were folded into the Communications Act of 1934, which established the Federal Communications Commission and gave the Commission authority to regulate not only radio but interstate and international telegraph and telephone services as well. Its authority eventually extended to broadcast and cable television, as well as internet services. The Communications Act continues to this day to form the foundation for the regulation of these industries.

At the time of the Communications Act, and indeed as early as the Kingsbury Commitment, regulators generally believed that telephone services were a natural monopoly. That is, they thought that even if there were competition in the market, the nature of the underlying technology and business were such that it was highly likely that a dominant firm

would emerge to control the industry and, moreover, that this was the most efficient result. Rather than insist on what was viewed as detrimental competition in the industry, then, until the 1970s regulators supervised the Bell monopoly and regulated matters such as the rates it could charge, the quality of services it provided, and its areas of service coverage.

### *The Era of Deregulation*

For most of the 20th century the main telecommunications carriers were classic regulated industries. Monopoly was tolerated, and even encouraged, by government limits on market entry and exit. In exchange government set prices at reasonable rates of return, and imposed various public interest duties (such as the fairness doctrine discussed above). However, beginning in the late 1960s and continuing through the 2000s, a deregulatory movement transformed telecommunications policy.

By the 1920s the AT&T telephone monopoly was complete enough that the company was able to control vertically integrated markets. For instance, AT&T in the 1930s promulgated a tariff that precluded consumers from attaching any device to their phone lines that was not specifically approved by the company. This “foreign attachments” rule effectively extended AT&T’s phone service monopoly into the market for phones themselves, with the result that customers could only obtain equipment from AT&T. While this vertical integration may have represented a high watermark for AT&T’s monopoly, it became the site of the first cracks in the company’s monopoly.

In the word of Richard Vietor, “deregulation began more or less with a rubber cup.” In the 1950s a company called Hush-a-Phone contested AT&T’s foreign attachments rule, seeking permission to market what a special cup that attached to a phone and made conversations more private. The FCC, at the behest of AT&T, precluded the sale of the attachment, but the

Court of Appeals for the District of Columbia reversed the decision and set forth, for the first time, the rule that a consumer had a “right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental.” In 1968, in the *Carterphone* decision, the FCC adopted this principle, and over time promulgated the Part 68 Rules, which allowed users to connect whatever they wanted to the system as long as it did not harm either the network or other users. While it would take until 1981 for the FCC to create a full consumer right to attach devices to the network, the *Carterfone* and *Hush-a-Phone* decisions represented the first introduction of competition against AT&T, and the first limiting of its extended monopoly. Eventually, the *Carterfone* decision was extended into a general quarantine on AT&T’s involvement in consumer equipment. It also, importantly, led to rules that forced AT&T to allow others to provide “information services” over its phone lines (which would later mean “internet services”) and to support the rise of the internet service provider industry.

At the same time, several other deregulatory initiatives were underway. In the 1970s, the firm Microwave Communications Inc. (MCI) took advantage of regulatory loopholes and non-enforcement to begin offering limited long-distance services between St. Louis and Chicago, offering AT&T the first long-distance competition it had faced in decades. AT&T took various measures to try to destroy and block its rival, leading to MCI filing an important private antitrust suit. On November 20, 1974, the Justice Department began its own antitrust action against AT&T, alleging that it monopolized the markets for a broad range of telecommunications services and equipment. While the Justice Department had brought antitrust actions against AT&T previously, this suit for the first time sought as a remedy the actual break-up of the company, and in particular the divestiture of the Regional Bell Operating Companies (RBOCs) from AT&T.

On January 8, 1982, AT&T and William Baxter of the U.S. Justice Department reached an agreement that forced AT&T to divest the RBOCs by January 1, 1984. Thus as of that date the twenty-two RBOCs were formed into seven regional holding companies (Bell Atlantic, NYNEX, BellSouth, Ameritech, U.S. West, Pacific Telsis, and Southwestern Bell). These divested companies were not allowed to provide long-distance services in their territories or manufacture telecommunication equipment, both of which were businesses that remained with AT&T. Likewise, AT&T was precluded from providing local telephone service in competition with the RBOCs and from acquiring stock in any of the RBOCs.

The history of cable television has the same pattern of regulation and reregulation. The early cable systems were known as “Community Antennas,” and were constructed in the late 1940s to capture broadcast television signals and transmit them to consumers in remote towns where the broadcasts would not have reached otherwise. By the late 1950s, cable systems had grown into a potential competitor to broadcast televisions, and the broadcasters launched an effort to protect their markets against cable using state and federal lawsuits. After the lawsuits failed, the broadcasters turned to the FCC and convinced it to assert jurisdiction over cable in 1962. The broadcasters argued that cable systems would fragment the audience for broadcast television, destroy the economic viability of free television, and also, by importing distant signals, threaten the values of “localism.” Agreeing with the broadcasters, the FCC placed effective limits on cable’s growth in the late 1960s by requiring that cable operators receive special permission to enter urban markets, effectively blocking the further development of cable television. The hostile approach to cable changed during the deregulatory period of the 1970s, many of the most onerous restrictions on cable were gradually relaxed, in part due to an exchange for new copyright royalties payable to broadcasters.



Another chapter in the deregulatory movement of the 1970s and 1980s was the FCC's controversial repeal of the fairness doctrine, described above. First set forth by the FRC in 1928, and codified in 1949, the fairness doctrine had been upheld against a First Amendment challenge by the Supreme Court in the *Red Lion v. FCC*. However, in the mid-1980s the FCC stopped enforcing the fairness doctrine and eventually repealed most of it. The FCC argued that, *Red Lion* notwithstanding, the fairness doctrine was a violation of the First Amendment, and also claimed it failed to promote speech in the public's interest. Since that time Congress and numerous groups have attempted to have the Fairness Doctrine reinstated, but have not succeeded.

In the 1990s, the FCC also took its first steps away from the traditional model of spectrum management it had employed since the 1930s. Whereas previously the FCC allocated licenses either by lottery or to whomever it believed would "best serve the public interest," in 1994 it conducted the first spectrum auctions, granting the licenses to the highest bidder. While not free from controversy, the auctions have generally been thought to have been a success, as they led both to the market entry of new cellular phone firms, such as long-distance provider Sprint, and proved to be a more streamlined way of awarding licenses, which has encouraged the timely building of networks. The FCC has conducted several other spectrum auctions since 1994, frequently at Congress's direct command.

#### *The Contemporary Regulatory Framework*

The Telecommunications Act of 1996, the first major revision of the country's telecommunications laws since the Communications Act of 1934, altered some features of the basic telecommunications system just described. One of the foremost goals of the 1996 Act was to promote competition in local telephone service. AT&T was allowed to return to the local

service market, while local Bell phone companies were allowed to enter the long-distance market and to merge with each other. In addition, the 1996 law created a “line sharing” scheme whereby market entrants would purchase the rights to use the “local loop” facilities owned by the local Bell companies and sell competitive local services. The 1996 Act also preempted all state and local barriers to entering the local phone service market, and since the passage of the 1996 Act the FCC has forborne from enforcing any restrictions on building or acquiring long-distance lines. Despite these substantial changes to the law, most believe the 1996 Act’s effort to create local service competition was a failure. Whether due to the economics of local competition, or foot-dragging on the part of the local Bell company, few viable local phone service companies have emerged since the passage of the Act.

The 1996 Act also failed to address the challenge of internet and broadband internet services. Pursuant to existing rules, telephone companies have long been regulated as common carriers, as discussed above. That meant that providers of DSL service – which runs over phone lines – were common carriers, while the status of cable operators who sell broadband services remained unclear. In 2002 FCC deemed cable broadband an unregulated “information service” not subject to common carriage rules, and it later classified DSL broadband similarly. In 2005, in the case of *FCC v. Brand X*, the United States Supreme Court upheld the FCC’s right to categorize cable broadband providers as “information services.” The practical import of these technical classifications has been to release broadband services from most anti-discrimination, common carriage or line-sharing obligations.

The arrival of broadband in the 2000s led to the rise of the issue of “network neutrality” on the internet, and the more general topic of internet regulation. The Internet’s technologies were born mainly out of government-funded research in the 1960s and 1970s.

While no specific regime governed the internet, in the 1980s and 1990s, new “internet service providers” took advantage of quarantines placed on the Bells to offer dial-up internet services independent of the Bell system. In the early 2000s, as cable and DSL broadband providers replaced dialup ISPs, the issue of Bell and cable control over the vertical internet markets again arose. In the mid-2000s, the center of the network neutrality debate is a debate over the merits or problems with discriminatory carriage -- favoring some content or applications over others. Ironically, today’s debates over network neutrality and discriminatory carriage echo the same concerns that first prompted calls to regulate telegraph companies in the 19th century.