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Kenneth A. Nickolai

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THE AT&T DIVESTITURE: FOR WHOM WILL THE BELL TOLL?

KENNETH A. NICKOLAI†

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I. INTRODUCTION

The breakup of the American Telephone & Telegraph Company¹ (AT&T) has caused a revolution in the structures used to

† Special Assistant Attorney General for the State of Minnesota, Mr. Nickolai received his B.A. from Carthage College and his J.D. from Duke University. He formerly served as a staff attorney for the Nebraska Public Service Commission and has authored several articles including *The Nebraska Public Service Commission: Avenues for Reform*, 9 CREIGHTON L. REV. 175 (1975). Mr. Nickolai has also co-authored *Banks and Industrial Revenue Bond Financing*, 93 BANKING L.J. 306 (1976) and *Railroad Abandonment: The Disappearing Railroad Blues*, 8 CREIGHTON L. REV. 391 (1974).

The author would like to acknowledge the substantive contributions made to this Article by Mr. L. J. Rotman.

1. Prior to the breakup, AT&T was composed of many companies which provided all aspects of telephone service. These companies included Bell Operating Companies (local service and intrastate long-distance), AT&T Long Lines (interstate long-distance and manufacturing), Western Electric (research and development), and Bell Laboratories (research and development). See *United States v. American Tel. & Tel. Co.*, 461 F. Supp. 1314, 1317 n.1 (D.D.C. 1978). In 1982, Judge Harold Greene approved an antitrust consent decree entered into between the Department of Justice and AT&T. See *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 103 S. Ct. 1240 (1983); see also AMERICAN TELEPHONE & TELEGRAPH CO., 1982 ANNUAL REPORT 3-4 (1983) (AT&T's version of events culminating in divestiture).

provide telecommunications service to American families and businesses. The image of everybody's nanny, "Ma Bell," is rapidly being replaced in the Midwest by Frederick Remington paintings of American cowboys taming the West—compliments of the public relations department of U.S. West, the new parent of Northwestern Bell Telephone Company² (NWB). Although attention has focused on new concepts arising out of competition, such as end-user access charges, premium access, bypass, and interconnecting companies, it must turn to the inevitable result of the divestiture—higher local rates.

In the wake of this revolution, one particular group stands to suffer—the economically disadvantaged. Minnesota must act to protect the ability of these individuals to have access to the telephone network. To provide accessibility, the state must examine its existing statutory framework governing telephone companies after carefully delineating the social policy of providing universal telephone service. The state must then ascertain the appropriate market structure that best accommodates the concept of universal service within the statutory framework. This Article addresses each of these aspects in turn, concluding with a recommendation of the appropriate market structure to accommodate the need of all Minnesotans to have access to telephone service.

II. THE EFFECTIVENESS OF THE EXISTING STATUTORY FRAMEWORK

Telephone companies in the state are governed by Minnesota Statutes chapter 237,³ which was first enacted in 1915.⁴ Chapter

2. See Arenson, *U.S. West: Building an Image*, N.Y. Times, Nov. 11, 1983, Business Day, at 1.

3. MINN. STAT. §§ 237.01-47 (1982 & Supp. 1983). Some form of regulation of the telephone industry occurs in nearly every jurisdiction. See, e.g., ALA. CODE §§ 37-2-1 to -184 (1975 & Supp. 1983); ALASKA STAT. §§ 44.21.300-.330 (Supp. 1983); ARIZ. REV. STAT. ANN. §§ 40-201 to -442 (1974); ARK. STAT. ANN. §§ 73-1801 to -1820 (1947 & Supp. 1979); CAL. PUB. UTIL. CODE §§ 7901-7907 (West 1965 & Supp. 1983-1984); COLO. REV. STAT. §§ 29-11-101 to -104 (Supp. 1983); CONN. GEN. STAT. ANN. §§ 16-228 to -262m (West 1960 & Supp. 1983-1984); DEL. CODE ANN. tit. 26, §§ 901-907 (1974 & Supp. 1982); D.C. CODE ANN. §§ 43-201 to -1711 (1981 & Supp. 1983); FLA. STAT. ANN. §§ 362.01-.02 (West 1968); GA. CODE §§ 93-305 to -307 (1977 & Supp. 1982); HAWAII REV. STAT. § 205-4.5(7) (Supp. 1981); IDAHO CODE §§ 62.801-05 (1983); ILL. STAT. ANN. ch. 134, §§ 1-21 (Smith-Hurd 1964 & Supp. 1983-1984); IND. CODE ANN. §§ 8-1-17-1 to -29 (West 1982 & Supp. 1983-1984); IOWA CODE §§ 476.1-.21 (West Supp. 1983-1984); KAN. STAT. ANN. §§ 66-104 to -1186 (1980 & Supp. 1982); KY. REV. STAT. §§ 278.510-.540 (1981 & Supp. 1982); LA. REV. STAT. ANN. tit. 45, §§ 781-804 (West 1982 & Supp. 1984); ME. REV. STAT. ANN. tit. 36, §§ 2683-2689 (1964 & Supp. 1983-1984); MD. ANN. CODE art. 78, §§ 1-

237 is implemented by both the Public Utilities Commission (Commission) and the Department of Public Service (Department).⁵ Chapter 237 has remained virtually unchanged since its enactment nearly seventy years ago. In 1978, the Minnesota Supreme Court commented on the inadequacy of this statutory structure in *Arvig Telephone Company v. Northwestern Bell Telephone Company*:⁶

In fairness to the litigants, it must be observed that at the heart of the difficulty posed by this case is the somewhat antiquated nature of the statutes with which we must deal. It seems plain to us that much of the language in the existing statutes is descended directly from a time when the structure of the telephone industry in Minnesota was vastly different from its present state.⁷

Radical changes have occurred in the telecommunications industry since *Arvig*, yet the vintage statutory structure generally remains intact.

An illustration of the inadequacy of the statutory framework to

107 (1957 & Supp. 1980); MASS. GEN. LAWS ANN. ch. 166, §§ 1-44 (West 1976 & Supp. 1983-1984); MICH. COMP. LAWS ANN. §§ 484.1-124 (West 1967 & Supp. 1983-1984); MISS. CODE ANN. §§ 77-3-401 to -425 (1982); MO. ANN. STAT. §§ 392.010-360 (Vernon 1949 & Supp. 1984); MONT. CODE ANN. §§ 69-1-101 to -4-604 (1981); NEB. REV. STAT. §§ 75-601 to -616 (1981 & Supp. 1982); NEV. REV. STAT. §§ 704.010-645, 707.300-320 (1983); N.H. REV. STAT. ANN. §§ 378:1-31 (1966 & Supps. 1981 & 1983); N.J. STAT. ANN. §§ 48:17-1 to -21 (West 1940 & Supp. 1983-1984); N.M. STAT. ANN. §§ 63-9-1 to -19 (1978 & Supp. 1983); N.Y. PUB. SERV. LAW §§ 90-103 (McKinney 1955 & Supp. 1983-1984); N.C. GEN. STAT. §§ 117.29-.35 (1981); N.D. CENT. CODE §§ 49-21-01 to -21 (1978 & Supp. 1983); OHIO REV. CODE ANN. §§ 4931.01-.99 (Page 1977 & Supp. 1982); OKLA. STAT. ANN. tit. 17, §§ 131-138 (West 1953 & Supp. 1983-1984); OR. REV. STAT. §§ 757.010-758.550 (1973 & Supp. 1979); PA. STAT. ANN. tit. 66, §§ 1101-1562 (Purdon 1959 & Supp. 1983-1984); R.I. GEN. LAWS § 7-1.1-3 (1969 & Supp. 1983); S.C. CODE ANN. §§ 58-9-10 to -2320 (Law. Co-op. 1976 & Supp. 1983); S.D. CODIFIED LAWS ANN. §§ 49-30-1 to -32-16 (1983); TENN. CODE ANN. §§ 65-29-101 to -132 (1982); TEX. UTIL. CODE ANN. art. 1528c, §§ 1-34 (Vernon 1980); UTAH CODE ANN. §§ 54-2-1 to -3-24 (1974 & Supp. 1983); VT. STAT. ANN. tit. 30, §§ 2701-2706 (1970 & Supp. 1983); VA. CODE §§ 56-485 to -508 (1981); WASH. REV. CODE ANN. §§ 80.36-.270 (1962 & Supp. 1983-1984); W. VA. CODE § 24-2-46 (1981 & Supp. 1983); WIS. STAT. ANN. § 196.01 (West 1957 & Supp. 1983-1984); WYO. STAT. § 37-1-101(vi)(B) (1978).

4. See Act of Apr. 16, 1915, ch. 152, 1915 Minn. Laws 208 (current version at MINN. STAT. §§ 237.01-47 (1982 & Supp. 1983)).

5. Minnesota Statutes chapter 216A vests the Commission with legislative and quasi-judicial functions while granting the Department the administrative function connected with the regulatory process. See MINN. STAT. §§ 216A.05, .07 (1982 & Supp. 1983); see also *id.* § 237.02 (Commission and Department both vested with jurisdiction over telephone companies). For a comprehensive analysis of the Commission's role, see *Public Utilities Symposium*, 8 WM. MITCHELL L. REV. 297 (1982).

6. 270 N.W.2d 111 (Minn. 1978).

7. *Id.* at 115.

respond to the modern telephone industry is its inability to mitigate the local network bypass threat. Local network bypass can be accomplished either through private networks built by large customers or through services based on new technology, such as interactive cable television.⁸ Bypass poses a threat to the Commission's ability to create an appropriate market structure when the Commission is unable to regulate bypass providers. The Commission's inability to regulate every provider of telephone service precludes full implementation of an appropriate market structure for the entire state.

Under the present statutory framework, some providers of bypass systems effectively avoid the Commission's scrutiny, since the Commission's jurisdiction extends only to "telephone companies." A "telephone company" is defined by statute as "any person, firm, association, or any corporation, private or municipal, owning or operating any telephone line exchange for hire, wholly or partly within this state, or furnishing any telephone service to the public."⁹ There are two important aspects of this definition—telephone service and telephone service for hire.

In *Minnesota Microwave, Inc. v. Public Service Commission*,¹⁰ the Minnesota Supreme Court clarified the meaning of the term "telephone service." The court reversed the Commission's attempt to assert jurisdiction over a one-way microwave transmission system offered by a telephone company:

[T]he system proposed in the instant dispute is not designed to operate in conjunction with ordinary telephone service and involves no *two-way communication*. It is not even designed to supplement such communication. . . . Under such circumstances,

8. See Johnson, *Why Local Rates Are Rising*, REG., July-Aug. 1983, at 32-33 (concise discussion of bypass technologies). Interactive cable television essentially is pay television which "allow[s] subscribers to send as well as receive information. This technology makes possible such services as impulse buying, pay-per-view, viewer polling, home security, and medical emergency alarms." D. DELSON & E. MICHALOVE, DELSON'S DICTIONARY OF CABLE, VIDEO & SATELLITE TERMS 40 (1983). See generally T. BALDWIN & D. McVOY, CABLE COMMUNICATIONS 140-62 (1983); Branscomb, *Telecommunications for the Future*, in AFTER THE AT&T SETTLEMENT: THE NEW TELECOMMUNICATIONS ERA 143 (P.L.I. Patents, Copyrights, Trademarks And Literary Property No. 155, 1982).

The use of other exchange services and exchange accesses by new technologies such as cellular radio, cable, and optical fiber was not prevented in the AT&T breakup. See *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 227-28 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 103 S. Ct. 1240 (1983); Lavey & Carlton, *Economic Goals and Remedies of the AT&T Modified Final Judgment*, 71 GEO. L.J. 1497, 1501 (1983).

9. MINN. STAT. § 237.01, subd. 2 (1982).

10. 291 Minn. 241, 190 N.W.2d 661 (1971).

the nexus between such a system and the commission's mandate to regulate telephone service is not apparent.¹¹

Under the court's requirement of two-way communication, many providers of new technologies will fall within the statutory definition of telephone companies and under the auspices of the statutory framework.¹² Thus, the Commission's jurisdiction extends to providers of these forms of two-way communication and the threat of network bypass is effectively controlled.

The second requirement of the statutory definition is that telephone companies offer telephone service "for hire." This aspect of the statutory definition arises where a large corporation finds it cost efficient to construct its own internal telephone network, linking its various facilities together and avoiding the local network. In this context, the corporation may effectively bypass the local network monopoly, because it will not offer telephone services "for hire." Since the large corporation would not be a "telephone company" under the statute, the Commission would be without jurisdiction to include the corporation in its regulatory scheme. On the other hand, a developer of an office or apartment building, constructing an internal communication network, operating it on behalf of the occupants, and charging the occupants for the service, would fall within the definition of a telephone company and therefore under the auspices of the statutory framework.¹³

11. *Id.* at 249, 190 N.W.2d at 666-67 (emphasis added). The court's focus on the lack of two-way communication represented a new position in Minnesota. In 1965, former Minnesota Attorney General, Robert W. Mattson, addressed the issue of whether or not a cable television provider was a "telephone company" within the definition set forth in the statutory framework and held: "Since these businesses [cable providers] operate under different methods of transmission than telephone companies, and perform different services, they do not appear to be 'telephone companies' as defined in Sec. 237.01, and thus are not subject to state regulation." Op. Att'y Gen., June 28, 1965, at 3 (citations omitted).

12. Although cable companies are still not viewed as telephone companies today, they do fall under the auspices of state regulation. *See, e.g.*, MINN. STAT. §§ 238.01-.35 (1982 & Supp. 1983); 4 MINN. CODE AGENCY R. §§ 4.001-.231 (1982). For an articulate discussion of the federal and state regulation of cable, see Note, *The Federal Communications Commission and Interactive Cable Technology: The Case for Minimal Regulation*, 97 HARV. L. REV. 565 (1983).

The ability to switch is essential in handling any type of two-way communication. On June 28, 1983, Intelx, a Wisconsin partnership, applied for a Certificate of Public Convenience to provide a guided light-wave public common carrier public switched network in Minnesota. *See In re Application of Intelx*, Docket No. P436/M-83-359 (Minn. P.U.C. 1983).

13. *See* MINN. STAT. § 237.01, subd. 2 (1982). In 1981, the legislature amended chapter 237 in order to enhance the Commission's jurisdiction over smaller telephone networks, offering a new definition of "independent telephone companies": "a telephone company

In determining whether a provider of telephone service is subject to regulation, statutory reliance on the term "for hire" may threaten the Commission's ability to create a market structure that will properly serve the state. The distinction between the regulation of the developer and the corporation based on whether a charge is levied for the service must be eliminated to prevent network bypass and to preserve the Commission's ability to regulate the telephone industry. Once the threat of local network bypass is ameliorated, the Commission can implement an appropriate market structure which will ensure the availability of telephone service to everyone.

III. POLICY CONSIDERATIONS—PROTECTION FOR THE ECONOMICALLY DISADVANTAGED

While the universal telephone service concept continues to be debated in Washington,¹⁴ the continued availability of telephone service to low-income customers¹⁵ must be a primary concern in Minnesota. Medium and high-income customers will be able to absorb the increased cost of basic residential telephone services; large businesses will also fend for themselves. The question, however, is how the customer who lives on limited income will be able to absorb substantial increases in the cost of basic telephone service

organized under chapter 301 and providing service to less than 2,500 subscribers within the state." Act of May 21, 1981, ch. 248, § 1, 1981 Minn. Laws 1041, 1042 (current version at MINN. STAT. § 237.01, subd. 3 (1982)). The legislature also provided that independent telephone companies were not subject to rate regulation unless they elected to fall under the auspices of the Commission's authority. *See id.* § 2, 1981 Minn. Laws at 1042 (current version at MINN. STAT. § 237.075, subd. 9 (1982)).

14. *See Universal Telephone Service Preservation Act of 1983: Joint Hearings before the Committee on Commerce, Science, and Transportation, United States Senate, and the Committee on Energy and Commerce, House of Representatives, 98th Cong., 1st Sess. (1983) [hereinafter cited as Joint Hearings].*

Senate Bill 1660 and House Resolution 3621 comprised the Universal Telephone Service Preservation Act (Act). Senate Bill 1660 is presently tabled in committee, as discussion centers on the FCC's Access Charge Order. House Resolution 3621 was consolidated with a number of other resolutions into House Resolution 4102 which was adopted by the House on November 10, 1983. *See* 129 CONG. REC. H9701 (daily ed. Nov. 10, 1983); *see also id.* at H9823 (clerk authorized to make corrections in H.R. 4102); *cf.* H.R. 4102, 98th Cong., 1st Sess., H.R. REP. NO. 479, 98th Cong., 1st Sess. 1-13 (1983).

15. The concept of universal service encompasses not only a concern for persons of low-income levels, but also reflects a concern over rural consumers, who by their geographic proximity, reside in less cost-efficient areas. *See* 129 CONG. REC. H9643 (daily ed. Nov. 10, 1983) (statement of Rep. Wirth); *id.* at H9650 (statement of Rep. Ford); *id.* at H9652 (statement of Rep. Harkin). Although the concerns expressed over the economically disadvantaged are equally applicable to consumers in rural areas, specific aspects of the rural problem are beyond the scope of this Article.

without reducing his already minimal standard of living.¹⁶ Recent reports showing a sharp growth in poverty levels underscore the need to address telephone service affordability for the economically disadvantaged.¹⁷

The concern over low-income customers is demonstrated by the telephone industry's attempt to redefine the notion of universal telephone service, traditionally perceived as telephone service for everyone.¹⁸ The Chairman of the Board of AT&T, Charles Brown,

16. Perhaps the largest, most readily identifiable group within the expansive category of "the economically disadvantaged" is the aged—those over 65. Congressman Roybal, Chairman of the House Select Committee on Aging, addressed his concerns over the effect of the AT&T breakup and the FCC proposed access charges on the aged. In supporting House Resolution 4102, he stated:

The proposed increase in telephone rates as outlined by the Federal Communications Commission (FCC) will eliminate phone service for those who need it the most—the rural, low-income, and elderly who are forced to rely on fixed incomes for their existence. Almost 4 million persons 65 years of age and older are below the poverty line in this country. For these individuals, the projected long-term increase of as much as \$16 per month in some rural areas will cause a serious hardship. A CBS/New York Times news poll, shows that approximately 50 percent of those persons age 64 years believe they will no longer be able to afford phone service if rates are doubled.

Id. at H9652 (statement of Rep. Roybal); see also Weier, *Utility Services for Seniors: One Example*, PUB. UTIL. FORT., Dec. 22, 1983, at 35 (utility services must be modified to accommodate the growing number of elderly persons). Congressman Wirth, one of the sponsors of House Resolution 4102, also expressed concern for the aged: "What about the aged, so many of whom live a very lonely existence? Are we going to make their lives even more lonely because they cannot reach out and talk to a friend or a relative, a doctor or a druggist?" 129 CONG. REC. H9643 (daily ed. Nov. 10, 1983) (statement of Rep. Wirth). Expanding on Congressman Wirth's comments, Congressman Leland emphasized that "[p]hone service is literally a matter of life and death for many older Americans who depend on a telephone as their only contact with the outside world." *Id.* at H9650 (statement of Rep. Leland).

17. See *By any calculation, poverty grows*, St. Paul Pioneer Press, Feb. 24, 1984, at 9A, col. 1 (discussing census bureau's report that 15% of American population lived in poverty in 1982). The Bell Telephone Company of Pennsylvania may be required, for example, to exclude low-income persons from access charges after a recent ruling by an administrative law judge on the matter. See *The March of Events: ALJ Recommends No Access Charge For Budget Customers*, PUB. UTIL. FORT., Dec. 22, 1983, at 51.

18. The traditional notions of universal service were succinctly described by Senator Packwood, Chairman of the Senate Committee on Commerce, Science, and Transportation and co-sponsor of Senate Bill 1660, see *supra* note 14, in his opening statement at the Joint Hearings:

[F]or the better part of 200 years, this country has had a policy of attempting to make . . . communications available to everybody in this country. . . . [I]t has been the policy of this Congress, administered by the Federal Communications Commission . . . that we would use long-distance charges to help defray the cost of rural and residential rates, and that we would not require rural and residential users to pay the full cost of providing their own telephone service. We thought if we did that, there would be many areas of this country that could not afford telephone service, and many people within even some areas of the country that could afford it could not afford telephone service.

proffered the telephone industry's definition of universal service:

Although the concept of universal telephone service is a familiar one, it is important to reiterate what the concept does and does not embrace. Universal service means broad public access to the telephone network. The goal of maintaining universal service depends on *keeping access affordable for those who would otherwise leave the network*. In contrast, universal service does not require that subsidized basic telephone service be provided to those who can afford to pay its cost. Nor does it require unlimited calling at flat monthly charges within any specified geographic areas.¹⁹

Brown's definition inherently excludes those already unable to afford telephone service and fails to comport with the traditional concept of universal telephone service because it easily excludes the economically disadvantaged.

The local telephone industry's definition of universal service also disregards the concern over telephone service affordability for Minnesota's low-income residents. In recent state access charge proceedings, Dr. John Wenders, testifying on behalf of NWB, narrowed the scope of the traditional universal service concept. He stated that universal service is "[w]here everybody has a chance to choose to come on the network or not at a price equal to marginal cost."²⁰ On further questioning, Wenders testified that a customer would need an income of at least twenty dollars per month to afford telephone service; thus, a customer would have the choice of telephone service.²¹ NWB's definition of universal telephone service is analogous to providing universal physical access to pay telephones, regardless of whether hopeful callers actually have quarters in their pockets. Since Wender's definition of universal service ignores the effect of pricing changes on a consumer's decision to remain connected to the system, it falls below the universal service standard enunciated by Chairman Brown.²² Furthermore, NWB's definition fails to satisfy the universal service objective set forth by the FCC: "avoiding actions that would cause a signifi-

Joint Hearings, supra note 14, at 1-2.

19. *Joint Hearings, supra* note 14, at 279 (emphasis added).

20. 6 Transcript at 102, *In re* Investigation Into Intrastate Access Charges of Twenty-Three Tel. Cos. Operating in the State of Minn., Docket No. PUC-83-102-HC (Minn. P.U.C. 1983) (testimony of Dr. John T. Wenders, Professor of Economics, University of Idaho).

21. *See id.* at 103 (testimony of Dr. John T. Wenders).

22. *See supra* note 19 and accompanying text (AT&T's definition of universal telephone service).

cant number of local exchange service subscribers to cancel that service."²³

Dr. Wenders indicated that customers will discontinue their telephone service, by choice rather than through necessity, as the price of the service increases.²⁴ Residential service and single-line business service customers have a very inelastic demand.²⁵ Dr. Wenders conceded, however, that low-income consumers have a high elasticity of demand and are faced with a different set of choices.²⁶ For example, as telephone prices increase, a middle-income customer may have to choose between paying higher telephone rates or having optional leather seats in his next car purchase. The choice for the low-income customer, on the other hand, becomes one between higher telephone rates and groceries.²⁷

Dr. Wenders implied that low-income customers should not have telephone service if they cannot afford it. He testified that the person with a medical problem who needs a telephone to reach help in a medical emergency has a personal problem; a problem that the telephone rate structure is not bound to remedy.²⁸ This view represents a denial of the social obligation to assure that all persons are afforded basic services and the social benefit derived from open communications. If a segment of society is excluded

23. *In re MTS & WATS Mkt. Structure*, 93 F.C.C.2d 241, 266 (1983) [hereinafter cited as *Access Charge Order*], *recon. granted*, CC Docket No. 78-72, FCC 83-356 (released Aug. 22, 1983) [hereinafter cited as *Reconsideration Order*]. The FCC's definition of universal telephone service in the Access Charge Order was adopted in the Reconsideration Order. *See Reconsideration Order, supra*, at 2 n.2.

24. *See* 6 Transcript at 102-03, Docket No. PUC-83-102-HC (testimony of Dr. John T. Wenders).

25. Elasticity of demand refers to the change in the amount of goods purchased in response to the change in the price of the goods. *See* P. SAMUELSON, *ECONOMICS: AN INTRODUCTORY ANALYSIS* 364 (7th ed. 1967). Residential and single-line business customers do not have readily available and affordable alternatives to the existing local telephone network. As a result, when the price of telephone service increases, these customers will be slow to leave the network. On the other hand, large businesses can create affordable alternatives to local network service by constructing their own internal networks. *See supra* notes 8-13 and accompanying text (discussing local network bypass). Therefore, large businesses will leave the local network when the price of service increases.

26. 6 Transcript at 103-04, Docket No. PUC-83-102-HC (testimony of Dr. John T. Wenders).

27. Another example of the hard choices low-income consumers will be forced to make if telephone rates are increased was expressed as follows: "My husband has a breathing problem, so we have to run the air conditioner . . . [if] we have to choose between the two, the telephone will have to go!" 129 CONG. REC. H9652 (daily ed. Nov. 10, 1983) (statement of Rep. Harkin reading letter from a constituent).

28. *See* 6 Transcript at 110, Docket No. PUC-83-102-HC (testimony of Dr. John T. Wenders).

from the ability to contact others through telephone services, the traditional concept of universal service is disparaged.

A cutback in basic telephone services would dramatically affect the traditional concept of universal service that society has come to expect. As Congressman Leland testified at the Joint Hearings on the subject of universal service: "It is clear to all of us that in modern society telephone service is not a luxury but a necessity. For many Americans, the telephone is the principal or only communications link to the outside world."²⁹ Congressman Harkin, testifying at the same hearings, underscored the "necessity" of access to the telephone network, as he read from a constituent's letter: "'We need our telephone very badly. How can we get emergency help, call our doctor and druggist? Most of us have children and friends living many miles from us.'"³⁰

Congressman Harkin's constituent raised concerns which parallel the rationale underlying the "911" emergency telephone service system now available in Minnesota.³¹ The "911" system is designed to provide convenient access to all emergency services. The telephone network was selected as the appropriate means to implement this objective. Although the legislature mandated the establishment of an emergency telephone system,³² it failed to ensure that everyone had access to the system.³³ A cutback of basic

29. 129 CONG. REC. H9649 (daily ed. Nov. 10, 1983) (statement of Rep. Leland). Judge Harold Greene, in addressing the FCC's access charge decision, noted that:

This access charge decision undermines one of the assumptions underlying the Court's approval of the decree—that there would be no impairment of the principle of universal service—that is, that everyone, regardless of income, would have access at least to a minimum of telephone service, in recognition of the fact that this service is a *necessity* rather than a luxury.

United States v. Western Elec. Co., 569 F. Supp. 1057, 1091 (D.D.C. 1983) (emphasis added) (footnotes omitted).

30. 129 CONG. REC. H9652 (daily ed. Nov. 10, 1983) (statement of Rep. Harkin reading from letter of constituent); see United States v. Western Elec. Co., 569 F. Supp. at 1091 n.146. According to Judge Greene:

One might consider, for example, such uses as the ability to reach fire, police, and other emergency services; the need of the elderly to reach physicians, close relatives, or others who might give them aid; and the desire of those in isolated areas of the country for contact with others.

Id.

31. In 1977, the legislature authorized implementation of an emergency telephone system. See Act of May 27, 1977, ch. 311, 1977 Minn. Laws 627 (current version at MINN. STAT. §§ 403.01-.12 (1982)). Pursuant to section 403.07, the Department of Administration promulgated standards supplementing the statutory framework. See 2 MINN. CODE AGENCY R. §§ 1.6101-.6115 (1982).

32. See Act of May 27, 1977, ch. 311, § 1, 1977 Minn. Laws 627, 628 (current version at MINN. STAT. § 403.01, subd. 1 (1982)).

33. In a rather superficial effort, the legislature required that "[b]y December 15,

telephone services would further erode the ability of the state's residents to utilize the "911" system to obtain emergency services. Without the telephone at his ready disposal, Alexander Graham Bell may well have been left without assistance when he uttered: "Mr. Watson—come here—I want to see you."³⁴

Restricting the availability of basic telephone services may seriously impair economic efficiency. As Congressman Wirth observed during the Joint Hearings on universal service:

[O]ne major contributor to economic efficiency is universal service. The fact that 91 percent and hopefully 100 percent of households would have a telephone contributes . . . to the economic well-being of this society . . . tying everybody together. But beyond that, [it ensures] that people can call a Sears and Roebuck, or that . . . Citibank is in touch, can be in touch with all of the consumers in New York City, for example.³⁵

Cutbacks in telephone service would not only have an immediate impact on economic efficiency, but the "drop in phone use would also create a ripple effect in which the fixed costs would have to be shared by fewer users, resulting in further rate increases and still more residents forced to do without a telephone."³⁶

Thus, at a minimum, the traditional concept of universal service must be preserved to protect the economically disadvantaged. Universal service confers not only individual benefits but societal

1986, each *public utility* providing telephone service within a 911 service area shall convert every pay station telephone to permit dialing of the 911 number without coin or other charge to the caller." *Id.* § 4, 1977 Minn. Laws at 629 (current version at MINN. STAT. § 403.04, subd. 2 (1982)) (emphasis added). Adequate service to urban areas, however, would require that every block be equipped with its own pay phone; rural areas, on the other hand, would require a pay phone outside each residence. The Commission regulations, however, provide:

In each exchange located in an incorporated village the telephone utility shall supply at least *one coin telephone* that will be available to the public on a 24-hour basis. This coin telephone shall be located in a prominent location in the exchange and shall be lighted at night. The utility may also establish other public telephone service locations where the public convenience will be served. This requirement may be waived by the Commission in cases of abusive vandalism or damage.

4 MINN. CODE AGENCY R. PSC 210 (1982) (emphasis added). The public utilities' monopoly over public pay phones is currently being challenged in Minnesota. Therefore, the reference to "public utilities" in section 403.04 may circumvent the legislative intent of ensuring comprehensive 911 service where practical.

34. See DeMott, *Click! Ma Bell Is Ringing Off*, TIME, Nov. 21, 1983, at 61.

35. *Joint Hearings*, *supra* note 14, at 90-91; see 129 CONG. REC. H9643 (daily ed. Nov. 10, 1983) (statement of Rep. Wirth) ("Businesses will lose if the poor, without telephones, are unable to dial those 800 numbers to order a product.").

36. 129 CONG. REC. H9650 (daily ed. Nov. 10, 1983) (statement of Rep. Leland).

benefits as well. Once access to the telephone network is hindered, universal service is impossible. Therefore, to prevent the loss of universal service and to promote the public welfare, the Commission must ensure access to the telephone network. Alternative models of industry structure can accommodate the concern for providing this access and must therefore be closely examined.

IV. ALTERNATIVE FORMS OF INDUSTRY STRUCTURE

The industry model best suited to meet the needs of Minnesota telephone customers must be selected before the adequacy of the existing legal framework and its ability to provide universal service can be evaluated. Three readily identifiable models of the intrastate telecommunications industry are unfettered competition, regulated competition, and restricted competition. An examination of each of these industry models precedes a recommendation to combine the models to serve Minnesota in the wake of the AT&T divestiture.

A. *Unfettered Competition*

The unfettered competition model, or deregulation, assumes that regulation is no longer necessary since the efficiency of the marketplace will provide adequate communication services to the public.³⁷ The theory of competition is premised on Adam Smith's notion of the "Invisible Hand," guiding individual firms to act freely and pursue their own self interests, achieving the best for all.³⁸ Smith's notion, when carried forward today, is based on the belief that competition, or at least the threat of competition, will ensure the availability of telephone service at a reasonable price to the consumer.

Competition, or potential competition, exists for all forms of communication services. If the existence of actual or potential

37. Since the AT&T breakup was the result of an antitrust case, the unfettered competition model reflects the fundamental goal of the antitrust laws. See Lavey & Carlton, *supra* note 8, at 1498. See generally 1 P. AREEDA & D. TURNER, *ANTITRUST LAW* ¶¶ 103-12 (1978) (goals of antitrust laws are to maximize economic efficiency and promote public welfare). For a comprehensive discussion of the causes and effects of deregulating the telephone industry, see Baker & Baker, *Antitrust and Communications Deregulation*, 28 *ANTI-TRUST BULL.* 1 (1983); Katz & Willig, *The Case for Freeing AT&T*, *REG.*, July-Aug. 1983, at 43.

38. See F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 8 (1973); P. SAMUELSON, *supra* note 25, at 41-42 (discussing Smith's *WEALTH OF NATIONS*).

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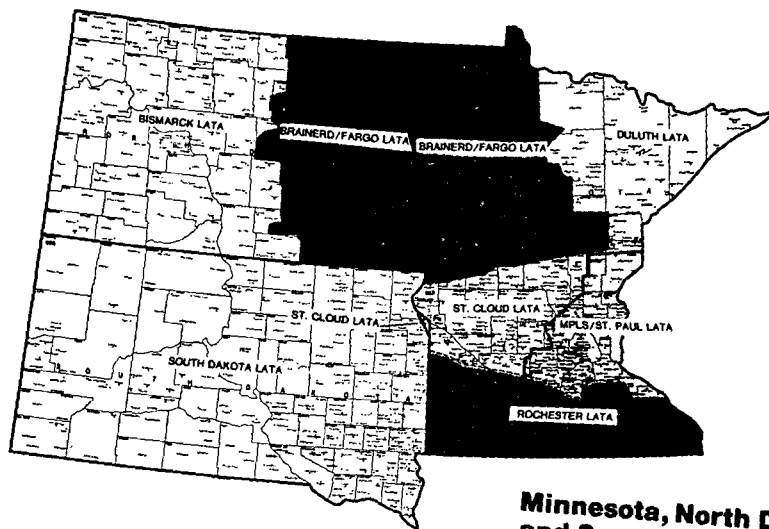
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competition restrains the pricing priorities of existing providers of telephone services and benefits the public welfare, then regulation is misplaced. Thus, for five dollars per month and a touch tone phone, the consumer can enter the world of competitive communications by subscribing to long-distance services offered by companies such as MCI and GTE.³⁹

Total deregulation, however, has not been formally proposed in Minnesota.⁴⁰ Nevertheless, the groundwork is being laid for such a

39. One aspect of the AT&T breakup was to create calling areas, known as Local Access Transport Areas (LATAs) in which local operating companies are permitted to provide telephone service. See *United States v. Western Elec. Co.*, 1983-1 Trade Cas. (CCH) ¶ 65,333, at 69,970 (D.D.C. 1983). LATA approval occurred in 1983. See *United States v. Western Elec. Co.*, No. 82-0192, slip op. at 104-16 (D.D.C. July 8, 1983); *Western Elec. Co.*, 1983-1 Trade Cas. (CCH) ¶ 65,333. The following diagram portrays the five LATAs which are contained in Minnesota.



**Minnesota, North Dakota
and South Dakota LATAs**

3 TELENEWS (Minnesota ed.) (reprinted with the permission of Northwestern Bell Telephone Co.). Local operating companies cannot provide inter-LATA services. See *Western Elec. Co.*, 1983-1 Trade Cas. (CCH) at 69,970. Therefore, calls between LATAs must be carried by an inter-LATA carrier such as AT&T, MCI, or Sprint. See *id.*

40. NWB, however, has proposed price deregulation on certain central office and long-distance services in filings with the Commission. See *In re Three Tariffs Filed By Northwestern Bell Tel. Co. Requesting the Repricing of CENTREX & the Detariffing of CENTRON*, Docket Nos. P-421/M-84-24, P-421/M-84-25, P-421/M-84-26 (Minn. P.U.C. 1983); see also Besen & Woodbury, *Regulation, Deregulation, and Antitrust in the Telecommunications Industry*, 28 ANTITRUST BULL. 39 (1983) (proposing total deregulation of AT&T after divestiture as the appropriate FCC response); Carideo, *Bell chief says market should set phone rates*, *Minneapolis Star & Trib.*, Feb. 27, 1984, 1J, at col. 2 (NWB Chief Executive Officer, Gene Bier, proposed total deregulation).

proposal. In a recent hearing concerning the development of intrastate access charges, Dr. John Wenders, testifying on behalf of NWB, stated that, although actual competition in many markets was unwarranted, potential competition operated to keep rates down to cost levels.⁴¹ Wenders also noted that Minnesota's future should hold a deregulated telephone industry.⁴²

Deregulation could be secured in Minnesota by repealing the entire existing statutory structure. If the statutory framework were repealed, telephone service providers, such as NWB, could be subjected to the basic consumer protection laws with which all competitive firms must comply.⁴³ Moreover, repeal of Minnesota's statutory framework would eliminate the costs of regulation⁴⁴ and allow competition to function freely.

Deregulation assumes that competition will provide service on terms suitable to all portions of society.⁴⁵ This assumption, however, is premised on the theory that consumers will be able to pay the marginal cost⁴⁶ of basic necessities. This theory overlooks consumers at the poverty level.

Another pitfall of the deregulation theory is the assumption that true competition will result. In a recent article, Dr. Lee Selwyn

41. See 6 Transcript at 112-13, Docket No. PUC-83-102-HC (testimony of Dr. John T. Wenders).

42. See 7 Transcript at 29, Docket No. PUC-83-102-HC (testimony of Dr. John T. Wenders).

43. See, e.g., MINN. STAT. §§ 325D.01-.16 (1982).

44. The Department alone employs twenty-eight persons in its Utilities Division and is represented by five attorneys from the Attorney General's Office in discharging its statutory responsibility.

At the national level, the costs of regulation are also considerable. Yet when commentators discuss these costs, they fail to take into account the benefits of regulation—telephone service for everyone. As two authors have noted:

The social costs of regulating AT&T's long-distance operations are very high. Currently, each AT&T rate change is subject to FCC approval on the basis of mechanistic criteria which, by their nature, are not flexible enough to reflect changing market conditions. These rates deter AT&T from aggressive pricing, marketing, and investment strategies that would benefit its customers. They also put it at a disadvantage that may cause it to lose business to less efficient but unencumbered competitors. . . . If regulation is continued, innovation will be dampened, and costs and prices will be higher industry-wide than they otherwise would need to be.

Katz & Willig, *supra* note 37, at 44.

45. See F. SCHERER, *supra* note 38, at 11-19.

46. Marginal cost is the incremental cost of producing the next unit without regard to the initial investment or fixed costs attributable to producing such unit. See P. AREEDA, ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES 195 (3d ed. 1981); R. PIERCE, JR., G. ALLISON & P. MARTIN, ECONOMIC REGULATION: ENERGY, TRANSPORTATION AND UTILITIES 7 (1980).

pointed out that AT&T controls over ninety percent of the inter-exchange market and that in the remaining ten percent, AT&T facilities are used by other carriers to provide telephone service.⁴⁷ Dr. Selwyn observed that “[a]s long as AT&T still maintains effective control of such facilities, the mere existence of other suppliers does not protect customers from excessive rates.”⁴⁸

B. Regulated Competition

Regulated competition provides another alternative industry model for the state to consider. Creating a market structure based on this model assumes that there are benefits to be obtained from competition, but that due to market imperfection or other social needs, regulatory intervention is necessary to obtain the desired objective.⁴⁹

Regulated competition in the telephone industry could take myriad forms. Rates for toll calls could be regulated by route,⁵⁰ by company, or by statewide averages. For example, the Commission could require a telephone company to charge rates based on its average cost per mile⁵¹ to all Minnesota customers or on its cost for each route. Alternatively, the price could be based on the average cost of all companies offering toll service. The revenues could then be pooled and divided among the companies. A regulated market structure could require, for example, that the price of a call from Minneapolis to Duluth over a company's facilities be based on either the average cost of all companies offering toll services, the

47. See Selwyn, *Managers Face Challenges in New Industry Created by Deregulation and Divestiture*, COM. NEWS, July 1983, at 66E.

48. *Id.*

49. See F. SCHERER, *supra* note 38, at 520. An example of regulatory intervention to satisfy objectives of fulfilling social needs is found in the health care industry, where hospitals are required to serve a particular number of indigent patients to qualify for certain federal benefits. See, e.g., 42 U.S.C. § 291c(e) (1976); see also *Wyoming Hosp. Ass'n v. Harris*, 527 F. Supp. 551 (D. Wyo. 1981) (indigent requirements are valid).

50. For example, telephone companies could be required to charge no more than \$.20 per minute for a phone call from Minneapolis to Duluth or each company could fix its price by route subject to a standard of reasonableness.

51. Under this approach, each company could charge its average cost for each mile of the call. Thus, rates would differ among companies depending on their average per mile costs. Rates, however, would be uniform within the particular company's route structure.

The FCC has adopted an approach whereby customers would be charged a flat rate for access to long-distance telephone service. See *Access Charge Order*, *supra* note 23, at 244. One commentator is sharply critical of this approach, arguing that telephone costs are usage sensitive and not conducive to a flat customer charge. See Wilson, *Telephone Access Costs and Rates*, PUB. UTIL. FORT., Sept. 15, 1983, at 19.

average cost of that company's intrastate Minnesota operations, or that company's cost of providing the service.

The combined effect of regulated competition's various choices yields one result—if all companies' costs were averaged, the customer would not perceive a difference between service providers. Thus, price competition, a primary purpose of competition, would be lost. As more providers were introduced into the regulated scheme, price competition would emerge, but not without creating further problems. For example, if prices were based on a telephone company's average Minnesota intrastate costs, that company would have an incentive to serve only high-density/low-cost routes. With pricing based on average intrastate costs, the company would gain much of the traffic over the high-density/low-cost routes. As the company gained more traffic, its customers would benefit. To the extent that NWB and AT&T, for example, provided universal service⁵² to all routes, regardless of cost or density, the higher cost routes would become their only sources of revenue. As a result, NWB and AT&T's needs would rise, which would, in turn, force their average rates to increase.

Even if the Commission were to allow rates set by route rather than by average costs, practical problems would remain. Allowing rates set by route for each firm would provide, in essence, that any firm that had a cost advantage on that route would have a price advantage. If, as is likely, one company's cost of capacity to serve the Duluth to Minneapolis route is less than the average cost of another company's service, customers served by the company with the lower cost of capacity would be better off. Should the company with the higher cost be permitted to base its rates on a pure marginal cost by route, however, such rates would probably force the other company out of business. Another alternative would be to price on a per route marginal cost basis, but with an additional charge to reflect a share of the historic average cost.⁵³

52. For an extended discussion of the universal telephone service concept, see *supra* notes 14-36 and accompanying text.

53. These rate alternatives are not merely academic. The proper cost standard for deaveraged prices in regulated competition was addressed by the United States Supreme Court in *American Commercial Lines v. Louisville & Nashville R.R.*, 392 U.S. 571 (1968). In *American Commercial Lines*, the Court upheld a decision of the Interstate Commerce Commission (ICC) that load rates based on an avoided cost standard were unreasonable. The Court reversed the decision of a three-judge court, 268 F. Supp. 71 (W.D. Ky. 1967), which had held that the ICC's determination was erroneous. See *American Commercial Lines*, 392 U.S. at 574.

The railroads sought to use an avoided cost standard to meet the rates being charged

Apparently, Minnesota's statutory framework allows a form of regulated competition, at least for toll and local rural services. The Commission has the power to authorize the construction of any number of facilities for furnishing "local rural or toll telephone" service,⁵⁴ despite the existence of an operating telephone system.⁵⁵ Pursuant to Minnesota Statutes section 237.16, the Commission must first hold a public hearing and find that the "public convenience requires such proposed telephone lines or equipment" be installed.⁵⁶

The Minnesota Supreme Court has examined the breadth of section 237.16 and determined that the Commission does not have a broad grant of power to authorize a monopolistic structure. In *Arvig*, the court stated that:

Section 237.16 . . . functions essentially as an antiduplication statute. Its purpose is to eliminate costly, inefficient duplication of equipment. . . . [A] telephone company desiring to take action which could conflict with the purpose of the statute

by barge-truck lines. *Id.* at 575-77. The Court required the railroads to use a fully distributed method of examining costs. *See id.* at 594. The Court adopted the ICC definition of *fully distributed costs* as the "'out-of-pocket costs plus a revenue-ton and revenue ton-mile distribution of the constant costs, including deficits, [that] indicate the revenue necessary to a fair return on the traffic, disregarding ability to pay.'" *Id.* at 575 n.3 (quoting *New Autos. in Interstate Commerce*, 259 I.C.C. 475, 513 (1945)) (brackets in original). The fully distributed cost to the railroads in *American Commercial Lines* was \$7.59 per ton. *Id.* at 575-76. Yet the joint rate charged by the railroads was \$5.19 per ton. *Id.* at 576.

Under the fully distributed method, the railroads' rates went up and potential railroad traffic went elsewhere. Thus, the question of the proper relationship between prices, costs, and competition in a regulatory environment is not merely speculative.

54. Minnesota's statutory framework implicitly requires some degree of monopoly authority, rather than regulated competition, for non-rural local service. The statutory framework provides for the issuance of a certificate of territorial authority by the Commission. *See* MINN. STAT. § 237.16, subd. 2 (1982). When more than one telephone company files competing maps, the Commission must determine which of the companies is entitled to a certificate. *See id.* Monopoly authority is also implied by subdivision 4 of section 237.16 which forbids construction of any line, plant, or system without first securing both a declaration of public convenience and a new certificate of territorial authority. *See id.* § 237.16, subd. 4. Subdivision 4 limits the requirements necessary for a telephone company already operating in Minnesota, providing that:

[T]his section shall not be construed to require a telephone company operating an exchange in Minnesota to secure a certificate for an extension within any territory within which such company has heretofore filed maps or for substitute facilities within such territories, or for extensions into territories contiguous to that already occupied by such company and not receiving similar service from another company if no certificate of territorial authority has been issued to or applied for by any other company.

Id.

55. *See id.* § 237.16, subd. 1.

56. *Id.*

must first persuade the Public [Utilities] Commission that the proposed action would further the public convenience.⁵⁷

In *Paul Bunyan Rural Telephone Cooperative v. Pierce*,⁵⁸ the court reversed a Commission decision which granted exclusive territorial rights to one company and directed another firm to remove its facilities from the area. The court held that:

[N]owhere in . . . § 237.16, is there any provision under which the commission would be authorized to grant *exclusive* rights in a given territory to any telephone company outside of a municipality. . . . Under that section as applied herein, the most the commission could do would be to authorize duplication of lines, equipment, and service in the area under question, and this only *after a public hearing* on the question of public convenience.⁵⁹

The statutory framework therefore allows duplication in local rural and toll service. The only remaining question is what evidence is necessary to establish that duplication meets the public convenience test.

The *Arvig* court implied broad Commission discretion in determining when the public convenience standard is met:

[T]he commission has been made the guardian of the public interest in continuity of service and nonduplication of facilities. . . . Since the statutes fairly indicate that the legislature intended the commission to rule on such questions, we find it unnecessary to restrict the commission to one provision or the other on the facts of this case.⁶⁰

Non-rural local services are thus, by implication, subject to the exclusive service provisions of section 237.16.⁶¹ Without statutory change, however, the Commission does not have the express authority to regulate the provision of non-rural local services.⁶² The

57. *Arvig*, 270 N.W.2d at 116.

58. 263 Minn. 14, 115 N.W.2d 661 (1962).

59. *Id.* at 19-20, 115 N.W.2d at 665 (emphasis in original).

60. *Arvig*, 270 N.W.2d at 116.

61. *See supra* note 54 and accompanying text (discussing implicit authority of Commission to permit monopoly structure for non-rural local service). The exclusive service provision of section 237.16 is contained in subdivision 4. *See* MINN. STAT. § 237.16, subd. 4 (1982).

62. The Commission is currently considering a matter which involves the issue of whether the resale of a coin operated telephone service is the resale of a local service, which should be prohibited, or whether it is an ancillary service which can be competitively offered by any provider. *See* *Air-Ports Sys. v. Northwestern Bell Tel. Co.*, Docket No. P-421/C-82-4645 (Minn. P.U.C. 1983).

The threat of local network bypass, *supra* notes 8-13 and accompanying text, may

Commission's authority to allow duplication of local rural and toll service and to select the form of pricing for regulated competition presently ensures that the economically disadvantaged receive telephone service.

C. *Intrastate Monopoly*

The third industry model for the state to consider is intrastate monopoly. This model is premised on the belief that:

[T]he minimum optimal scale of production is so large that there is room in a given market for only one or at most a very few firms realizing all production and distribution economies of scale. . . . A monopolist therefore can enjoy lower unit costs than a group of small-scale competitors could.⁶³

The intrastate monopoly model involves a single provider of local service as well as a separate provider of intrastate long-distance service.⁶⁴ The policies adopted by the Federal Communications Commission (FCC) in the AT&T divestiture reflect the goals of the antitrust laws, which are designed to encourage competition.⁶⁵ The state can, however, create local monopolies for intrastate, local exchange, and interexchange services.⁶⁶

mitigate any of the Commission's efforts to regulate the rate structure of telephone service. See Johnson, *supra* note 8, at 33-35.

63. F. SCHERER, *supra* note 38, at 519-20. See generally 2 P. AREEDA & D. TURNER, *supra* note 37, at ¶¶ 403b-c (discussing economic effects of monopoly structure).

64. There are two distinct long-distance markets: a market for intrastate intra-LATA calls and another for inter-LATA calls. See *supra* note 39 (discussing LATAs).

65. See Lavey & Carlton, *supra* note 8, at 1498. Areeda and Turner have commented on the policy underlying the antitrust laws:

The central thrust of the antitrust laws is preserving competition in those markets where competitive policy has not been displaced by direct governmental regulation or exemption. Preserving competition may promote some goals of an essentially non-economic nature. Competitive processes substitute impersonal and hence more tolerable market decisions for the dictates of private decision-makers, and for the governmental bureaucratic controls to which unchecked private power may otherwise lead. A competitive policy contributes to a wider dispersal of business assets and to a broadening of independent entrepreneurial opportunities, which may be thought to produce a more satisfactory social and political climate.

II P. AREEDA & D. TURNER, *supra* note 37, at ¶ 401 (footnote omitted). See generally R. POSNER & F. EASTERBROOK, *ANTITRUST CASES, ECONOMIC NOTES AND OTHER MATERIALS* 152-70 (2d ed. 1981) (discussing rationale underlying antitrust laws).

66. Historically, state public utilities commissions (PUCs) have had the authority to regulate telephone services within their states. See *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930). The allocation of jurisdiction between state PUCs and the FCC was not affected by the divestiture of AT&T. See Comment, *An Assessment of State and Federal Jurisdiction to Regulate Access Charges After the AT&T Divestiture*, 1983 B.Y.U. L. REV. 376, 383-84.

Although the Commission does not presently have the explicit statutory authority to authorize a monopoly market structure, implicitly, it can occur. The Commission may restrictively exercise its authority to grant approval for the construction of local services⁶⁷ and allow duplication of local rural and toll services only after a finding that the public convenience requires such duplication.⁶⁸ The Commission can then conclude, as a matter of policy, that such duplication is not in the public interest.⁶⁹ The grant of a local monopoly and an intrastate toll monopoly will not, however, prevent bypass of the network by a large business.⁷⁰ Some bypass will be inevitable, even if the Commission determines to require monopolization. Nevertheless, the Commission's scope of authority will allow it sufficient control over the providers of telephone service to ensure that the economically disadvantaged receive minimal telephone service.

V. RECOMMENDATIONS

The revolution in the telecommunications industry poses serious challenges to Minnesota regulators. The choices made will affect the price and quality of telephone service for years to come. Deregulation, regulated competition, and remonopolization affect different groups of consumers in various ways. The state must create a telephone service market structure to insure that low-income customers are not excluded from basic telephone services. To accomplish this objective, the market should be structured to permit monopolization of local exchange service and regulation of toll services.

A. Local Exchange Service as a Monopoly Service

A monopoly of the local exchange service is necessary to ensure that both high and low-cost areas receive local service.⁷¹ If dupli-

67. The Commission has "the *exclusive right* to grant authority to any telephone company to construct telephone lines or exchanges for furnishing local service to subscribers in any municipality of this state, and to prescribe the terms and conditions upon which construction may be carried on" MINN. STAT. § 237.16, subd. 1 (1982) (emphasis added).

68. *See id.*; *see also Arvig*, 270 N.W.2d at 116 (Commission has authority to determine "public convenience").

69. *See Paul Bunyan*, 263 Minn. at 19-20, 115 N.W.2d at 665.

70. *See supra* notes 8-13 and accompanying text (discussing effect of local network bypass).

71. Rural areas are considered high-cost areas because of the disparate geographic proximity of one rural residence to another and the distance to switching stations, which

ation is permitted in some local areas, the local telephone company will be left with an investment in unused facilities and customers only in high-cost areas. These results will drive up the cost of service even further for the customers remaining on the network.

To ensure the continued monopoly of local exchange service, the Commission should exercise its statutory authority to prevent duplication of facilities.⁷² The Commission can apply the definition of communications found in *Minnesota Microwave*,⁷³ guaranteeing that two-way communication service is not duplicated through cable technology or satellite dishes.⁷⁴ Additional statutory clarification, including a specific prohibition on the public offering of switched two-way communication services, will aid in discouraging local bypass.

A local exchange monopoly is also necessary because it will allow the telephone service provider an opportunity to discriminate in its pricing. Price discrimination⁷⁵ is necessary to continue the availability of local telephone services at affordable prices. With a discriminatory pricing policy, the majority of telephone customers could provide a subsidy, ensuring the availability of telephone service to persons unable to pay the full cost. Price discrimination can thus ensure the continuation of traditional universal telephone service.⁷⁶

are logically located in urban areas. See 129 CONG. REC. H9650 (daily ed. Nov. 10, 1983) (statement of Rep. Leland); *id.* at H9652-53 (statement of Rep. Harkin).

72. See MINN. STAT. § 237.16 (1982).

73. 291 Minn. at 241, 190 N.W.2d at 661.

74. For a discussion of the potential of new technology to provide two-way, interactive communication, see *supra* note 10 and accompanying text. See generally *supra* notes 8-13 and accompanying text (discussing methods of local network bypass).

75. Price discrimination "is the sale (or purchase) of different units of a good or service at price differentials not directly related to differences in the cost of supply." F. SCHERER, *supra* note 38, at 495.

The FCC has already authorized states to price discriminate in permitting waiver of access charges for long-distance service in certain instances. See *Access Charge Order*, *supra* note 23, at 282; *Reconsideration Order*, *supra* note 23, at 9; see also Johnson, *supra* note 8, at 51 ("If [the access charge is waived] only [for] the poor (food stamp recipients, for example), the burden imposed on local calls might be small enough that uneconomic bypass would not be serious problem."); Cariedo, *supra* note 40, at 8J, col. 4 (Gene Bier, NWB Chief Executive Officer, stated that NWB should not be required to waive long-distance access charges for lower income customers).

76. The use of price discrimination operates as a subsidy for the economically disadvantaged and is a well known device to state and federal regulators. Two commentators have noted:

State and federal regulators have subsidized local service out of long-distance revenues on the theory that local customers should be allowed to 'share' in the

Price discrimination can be targeted through the mechanism used to implement the "cold weather" rule.⁷⁷ The cold weather rule offers protection from gas and electricity shutoffs during the winter months to persons meeting certain income criteria,⁷⁸ allowing them to spread their payments over the summer months. The cold weather rule is easily administered, since the Commission becomes involved only when a utility company appeals a customer's claim for eligibility.⁷⁹ Although the process used for invoking the cold weather rule is imperfect, it provides an efficient means of identifying needy customers.

Persons who meet the income tests used for the cold weather

productivity gains of AT&T's long-distance enterprise. Moreover, there appears to be an economic justification for subsidization of local rates: The addition of each new local subscriber benefits existing users by expanding the reach of their telephones; thus (long-distance) subscribers should subsidize others to stay on the system.

MacAvoy & Robinson, *Winning By Losing: The AT&T Settlement and Its Impact on Telecommunications*, 1 YALE J. REG. 1, 36 (1983) (footnote omitted). The rationale applied by MacAvoy and Robinson to support their position on a long-distance subsidy is equally applicable in providing telephone service to the economically disadvantaged through local exchange price discrimination. See Johnson, *supra* note 8, at 35-36; see also Cornell, Pelcovits & Brenner, *A Legacy of Regulatory Failure*, REG., July-Aug. 1983, at 42 (discussing the effect of subsidies on local rates).

77. See 4 MINN. CODE AGENCY R. § 3.0299 (1982). The cold weather rule is: prescribed by the Commission pursuant to Minn. Stat. ch. 216B, in its entirety and in particular §§ 216B.01, 216B.08, 216B.09 and 216B.23, and the Public Utilities Regulatory Policies Act of 1978, 15 U.S.C. §§ 3201 *et. seq.* and 16 U.S.C. §§ 2601 *et. seq.* to prohibit disconnection of a residential utility customer who is unable to pay for utility service during cold weather months.

Id. § 3.0299 A.

The procedure available to obtain relief under the cold weather rule is straightforward. A utility must, prior to disconnecting the service of any residential unit, serve upon the customer: "a. A commission approved Notice of Proposed Disconnection; b. A Notice of Residential Customer Rights and Possible Assistance; and c. A . . . postage prepaid form on which a residential customer . . . may declare his or her inability to pay." *Id.* § 3.0299 E. 1. Essentially, the utility cannot disconnect service for ten days following the initial mailing. See *id.* § 3.0299 E. 2. After this ten-day period, the utility may disconnect the service if the customer has not responded. See *id.* Actual disconnection is governed by a number of sections, each pertaining to specific circumstances. See, e.g., *id.* PSC 298 (§ 3.0298) (disconnection of service generally); *id.* § 3.0299 H. (disconnection of potentially unoccupied units); *id.* PSC 300 (§ 3.0300) (procedure for notice of disconnection generally); *id.* PSC 301 (§ 3.0301) (manner of disconnection).

78. See *id.* § 3.0299 F.

79. If the customer responds to the utility's notice within the prescribed time period, stating that he is unable to pay, the utility may accept the customer's declaration and refrain from disconnecting service. See *id.* § 3.0299 E. 3. Should the utility appeal the customer's declaration to the Commission, the customer must furnish proof of eligibility to the Commission which then rules on the customer's eligibility. *Id.* § 3.0299 G. 6.-7. The criteria for the Commission's determination of the customer's inability to pay covers many aspects of the customer's economic condition. See *id.* § 3.0299 F. 2.-3.

rule should be permitted to obtain basic access at one-half of the regular local access rate. The resulting revenue deficiency could be spread to the remaining residential and single-line business customers. The testimony in access charge cases revealed that residential and single-line business customers have the least elastic demand.⁸⁰ Therefore, these customers provide the most efficient means of spreading the cost of the subsidy. Since the legality of Commission-directed targeted rate discrimination could be subject to challenge, specific statutory language authorizing and directing the Commission to promulgate rules on such discrimination should be enacted.

B. Toll Services as Regulated Competition

Toll services should be subject, at least for a few years, to a regulated competition scheme. Eventually, these services could be deregulated. Continuing regulation, however, would ensure the state's ability to maintain a minimum service obligation and to guarantee that at least one carrier will serve every route. Deregulation of toll services on a route-by-route basis should be permitted after a sufficient period of regulation to allow the benefits of competition to flow to the users of high-density/low-cost routes. The statutory framework should be amended to guarantee that the Commission has specific authority to require firms to provide service to otherwise unserved routes; thus assuring that telephone service is available to all routes.

VI. CONCLUSION

The policy choices affecting the structure of the telecommunications industry in Minnesota require a balancing of economic efficiency and social policies. Economic efficiency arguments cannot always meet the greater social goals of interaction between every segment of society and the maintenance of a minimum quality of life for those who do not enjoy the fruits of a wealthy society. The structure proposed in this Article would allow the state to meet those minimal social goals while providing the benefits of a competitive market structure to a substantial segment of the telecommunications market.

80. See III Northwestern Bell Tel. Co. Additional Testimony & Exhibits, Sept. 30, 1983, at G.2-3, *In re* Investigation Into Intrastate Access Charges of Twenty-Three Tel. Cos. Operating in the State of Minn., Docket No. PUC-83-102-HC (Minn. P.U.C. 1983) (testimony of Clark D. Hammelman).

