

## Interim Rules Buck Telecom Act

New FCC regs improperly threaten to 'veto' unbundling mandates.

BY LAWRENCE J. SPIWAK

**E**ight years ago, the 104th Congress overwhelmingly passed the Telecommunications Act of 1996. The Solomonic central bargain of the act was simple: In exchange for the opportunity to get back into the long-distance business, the Bell monopolists had to make unbundled elements of their network infrastructure available to their rivals at cost-based wholesale rates. The expected result would be more telecom competition leading to lower prices and better services for consumers.

Now, say what you will about the 1996 act, it worked. Empirical research proves conclusively that consumers are saving more than \$10 billion annually. Employment levels in the traditional wireline sector of telecom services remain 17 percent above historical trends. Net investment by the incumbent carriers has increased by about 6.4 percent per year. And, surprise, surprise, new research backs up the obvious proposition that where the rates for unbundled network elements are lower, the deployment of new and much-desired broadband services is higher.

So it should come as no shock that the Supreme Court in *Verizon Communications Inc. v. Federal Communications Commission* (2002) declared that any argument contending that unbundling stymies new investment “founders on fact.” The Court soundly dismissed the notion that the legislative paradigm explicitly set forth by Congress creates some “sort of parasitic free-riding incapable of stimulating . . . facilities-based competition.”

Notwithstanding the above, FCC Chairman Michael Powell has a long record of open hostility toward the unbundling provisions of the 1996 act. Events had been able to constrain his anti-competitive agenda for the last three years. But now, using two analytically flawed D.C. Circuit decisions as legal cover, Powell is improperly attempting to exercise an administrative veto of the 1996 act via a set of interim rules issued Aug. 20. The interim rules set out a two-phase “transition” period that would effectively sunset the mandatory unbundling requirements—a dismal prospect for U.S. consumers.

BAD CASES MAKE BAD REGS

The current telecom fight boils down to pricing of and access to unbundled network elements for Bell competitors.

As to pricing, the FCC had chosen to use a methodology known as TELRIC, for “total element long-run incremental cost.” The details are complicated, but the debate is simple: Despite constant protestations by the Bells that the rates produced by TELRIC are “below cost,” the Supreme Court specifically found in *Verizon* that TELRIC did not produce confiscatory rates. Nor has any state commission, fortified by trial-type evidentiary hearings and full judicial review, found otherwise.

With the issue of pricing more or less settled, opponents of unbundling have focused on limiting access. Under the 1996 act, in order to determine what elements the Bells must unbundle, the FCC needs to determine whether access is “necessary” and whether the failure to provide such access would “impair” the rival’s ability to provide services. The commission accordingly wrote rules, and the Bell companies sued within a matter of days.

And then, in two startling cases of judicial activism in 2002 and 2004, the U.S. Court of Appeals for the D.C. Circuit struck down those rules with decisions that flagrantly ignored Supreme Court precedent in *Verizon*, basic economic principles regarding the investment incentives of monopolists, and, perhaps most egregious, the obvious market structure of the industry.

Having found an ally in the D.C. Circuit, Chairman Powell has now employed a cute procedural maneuver to put the final nail in the 1996 act’s coffin: According to the set of interim rules just released by the commission and designed to respond to the D.C. Circuit’s decisions, if the FCC does not issue final rules within six months, then unbundling obligations under the Telecom Act will cease to exist for key network elements—even if the rules covering those particular elements were not among those remanded to the FCC by the D.C. Circuit.

The FCC has also adopted a “transition” plan for consumers already served by the non-Bell carriers. The rates that the Bell monopolists may charge the non-Bells for use of unbundled network

elements are frozen for six months. Then the Bells may—and surely will—increase their rates by 15 percent for most elements and by as much as 20 percent for the switching element. And after a year, their rates may be increased without limitation. No wonder dissenting FCC Commissioner Michael Copps said that Powell’s plan would “butcher the pro-competitive vision of the 1996 act.”

These new rules amount to nothing less than an administrative veto of the 1996 act. Like it or not, the incumbent Bells’ obligation to unbundle does not exist at the pleasure of the FCC. Yet if the commission does not write rules within a certain period of time (arbitrarily set by the commission itself), then these unbundling obligations disappear entirely and incumbents are free to deny access or to charge competitors monopoly prices.

The FCC does not have the right to override Congress’ plan like this. As the Supreme Court said in *Immigration and Naturalization Service v. Chadha* (1983), legislation may be essentially vetoed only “in accord with a single, finely wrought and exhaustively considered procedure” pursuant to Article I of the Constitution. The FCC cannot override that process and pretend that the unbundling provisions of the 1996 act are no longer applicable simply due to its own failure to act. To do so would be a manifest violation of separation of powers.

#### TRUTH AND CONSEQUENCES

The damage from these interim rules is now spreading like the plague: Companies large and small are choosing to exit the business of providing consumer or small business telecom service, and layoffs are imminent. Some Wall Street analysts predict that by the end of 2005 the Bells will have recaptured 16 million of the approximately 20 million unbundled access lines now used by their competitors.

Several major private investment firms, including Kohlberg Kravis Roberts & Co., Centennial Ventures, Columbia Capital, Madison Dearborn Partners, and M/C Venture Partners—who all hold major stakes in Bell competitors—recently wrote to Powell to say that because most competitors “operate on thin margins in highly price sensitive markets . . . they simply [can] not absorb such dramatic cost increases or pass them along to customers in the form of increased rates.” As such, they warned Powell that the expected increase in the price of some network elements “likely would cause some [competitors] to violate loan covenants.”

But is Powell concerned? Based on his public statements, absolutely not.

Despite the empirical evidence, Supreme Court precedent, and pleas from Wall Street, Powell in his separate statement on the FCC’s interim rules dismissed unbundling as “a synthetic form of competition that would never have proved sustainable, or have provided long-lasting consumer benefits.”

#### COMPETITION WILL FALTER

In Powell’s view, the demise of the FCC’s open access rules will not undermine competition in the industry. According to Powell, “There is competition, there is going to be more competition, it’s going to be better than what we had before, and I’ll even go so far as to say: This isn’t a prediction, it’s a promise.”

But it’s not so much a promise as wishful thinking. The truth is that the current industry structure is rapidly returning to a vertically integrated monopoly (albeit on a regional rather than national basis)

and so-called intermodal competition from other technologies may be more hype than substance.

For example, real competition from wireless services simply doesn’t exist. There is no empirical evidence that the majority of consumers view their mobile phones as a substitute for fixed-line service. Indeed, Cingular’s economic expert addressing its proposed takeover of AT&T Wireless conceded this very fact under oath at the FCC. (Cingular, one of the major wireless providers, is, of course, owned by two Bells—SBC and BellSouth.)

As SBC President Edward Whitacre once admitted at an investor conference, wireless is “not going to displace the wireline network. It’s certainly going to be a big product, but it’s never going to be the substitute. Reliability is one reason.”

Equally as important, you can’t have meaningful fixed/mobile competition when, in the glib words of BellSouth President Duane Ackerman, “We tend to own both.” Indeed, should the FCC approve Cingular’s proposed acquisition of AT&T Wireless, then about 70 percent of wireless subscribers served by national wireless carriers will be in the hands of the Bells. Intermodal competition? How about intermodal collusion?

Similarly, claims that voice service over the public Internet, or VoIP, is going to mitigate the incumbents’ market power are premature at best, and may also be overstated. VoIP is not a facilities-based competitor that owns its own local telecom infrastructure; it’s merely a service provided over someone else’s broadband facility. Even if VoIP takes off soon, consumers will have a choice of only two facilities-based broadband providers—the incumbent Bell monopolist or the incumbent cable operator. Thus, absent meaningful “net neutrality” to prevent broadband owners from discriminating against third-party content providers, we are back to the same anti-competitive vertical integration problem that led to the break-up of the old Bell system in the first instance.

#### HOBSON’S CHOICE

Justice Byron White once wisely observed what he described as the legislator’s Hobson’s choice: Congress can either decide to “refrain from delegating the necessary authority, leaving itself with a hopeless task of writing laws with the requisite specificity to cover endless special circumstances across the entire policy landscape, or in the alternative, to abdicate its law-making function to the executive branch and independent agencies. To choose the former leaves major national problems unresolved; to opt for the latter risks unaccountable policymaking by those not elected to fill that role.”

Unfortunately, the current FCC has put us squarely in the latter situation.

The Supreme Court recognized in *Verizon* that the primary goal of the 1996 act was “to reorganize markets by rendering [the Bells’] monopolies vulnerable to interlopers.” But Powell refuses to heed Congress’ wishes on that score. So it’s time for legislators to stand up and insist that their duly enacted directions be executed and implemented—not ignored.

Regardless of who wins the election in November, a regime change at the FCC is clearly in order.

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