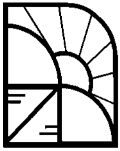

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THE BROADBAND LOOPHOLE: IS SYMMETRICAL REGULATION IN THE FACE OF ASYMMETRICAL MARKET POWER GOOD PUBLIC POLICY?

I. Introduction

With the thorny issue of Unbundled Network Element Platform ("UNE-P") generally resolved by the Federal Communication Commission's decision to preserve primary implementation of UNE-P with the States in its Triennial Review[1], the policy debate at both the Federal and State level[2] is now turning to how to develop sufficient incentives to promote new "broadband" deployment – in particular, how to provide sufficient incentives for Bell Operating Company ("BOC") "broadband" deployment. However, as explained more fully below, because the concept of "broadband" has become nothing more than a smokescreen that provides a massive loophole for the BOCs to retain and exploit their market power over "last mile" facilities, "symmetrical" regulation in the face of asymmetrical market power is bad public policy and fundamentally adverse to U.S. consumer welfare.

II. Case Study: The FCC's Triennial Review

A. *Understanding the "Regulatory Symmetry" Argument*

The central thrust of the "regulatory symmetry" argument goes as follows: Government should remove BOC "broadband" facilities from the list of UNE-P and (de)regulate them as an "information service" because UNE-P entry is ostensibly so easy in the "last mile" that (a) the BOCs will never invest in "new" advanced broadband facilities if they have to give it away to their rivals at "subsidized" rates; and, conversely, (b) with such abundant and "subsidized"

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[1] Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers (CC Docket No. 01-338), Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 (CC Docket No. 96-98), and Deployment of Wireline Services Offering Advanced Telecommunications Capability (CC Docket No. 98-147), ___ FCC Rcd ___ (adopted 20 February 2003).

[2] "Broadband parity" bills have been introduced in Connecticut, Indiana, Kansas, Missouri, South Carolina, Tennessee, and Texas so far this year.

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local access available, new entrants will never build their own local access facilities but will instead always choose to free-ride at the BOCs' expense.[3] Proponents of this position further argue that such action should not be cause for policy concern because the BOCs lack market power in this nascent and severable market for "broadband" services and, therefore, asymmetrical regulation is unwarranted[4] (and is, in fact, detrimental to the realization of so-called "inter-modal competition"[5]). While such a pedantic argument might sound attractive for the uninitiated, there is only a small hitch – *i.e.*, the fact that this argument is wholly inapposite to nearly twenty years of FCC precedent[6], Supreme Court precedent and empirical data[7],

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[3] *See, e.g.*, remarks of FCC Chairman Michael Powell on CNBC's "Kudlow & Kramer" show (26 February 2003) ("Because BOCs are a more unsympathetic class of regulatory player, people are more content to subsidize the competitive experiment on their infrastructure. And so I think sometimes it's political competition, not economic competition.")

[4] *See, e.g.*, Robert Crandall, J. Gregory Sidak and Hal Singer, *The Empirical Case Against Asymmetrical Regulation of Broadband Internet Access*, 17 BERKLEY TECHNOLOGY LAW JOURNAL 953 (2002).

[5] On March 15, 2002, the FCC issued a declaratory order classifying all cable modem services as "information services." *In re Inquiry Concerning High Speed Access to the Internet Over Cable and Other Facilities*, FCC 02-77, __ FCC Rcd __, Declaratory Ruling and Notice of Proposed Rulemaking (rel. March 15, 2002). While this action is consistent with the FCC's attempt to create a level playing field for "inter-modal" broadband competition, because of the radical nature and technical capabilities of cable and public switched telephone networks, it is unlikely that in the U.S. cable companies will be providing voice or phone companies offering multi-channel video programming any time soon. The BOCs discovered this reality more than six years ago with their failed TeleTV experiment, where all they managed to produce was a weak competitor to the local video store by offering old re-runs of sitcoms on a video-on-demand basis.

[6] Specifically, this "broadband exemption" guts entirely the whole rationale behind the FCC's successful *Computer II* paradigm (*In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry*), 77 FCC 2d 384, 419 (1980) (*Computer II Final Decision)*, where the Commission recognized that in order to create sufficient non-incumbent demand to warrant the construction of new networks, it had to ensure that dominant local exchange carriers could not leverage their market power over the "last mile" into ancillary and enhanced services. *Thus, while the FCC declined to impose traditional public-utility price regulation on new entrants by classifying them as Information Service providers under Title I of the Communications Act rather than as common carriers under Title II, the Commission never sought to remove regulation where market power concerns over "last mile" facilities persisted; to the contrary it was the very presence of narrowly-tailored structural regulation on incumbents (e.g., utilizing structural regulation to carve out data processing and CPE markets away from the Bell monopoly) that allowed the Internet to flourish.*

[7] To wit, the United States Supreme Court in *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646 (2002) expressly found that, among other things: (1) the Bells are monopolists and, as such, Congress intended to treat them differently and impose asymmetrical regulation to mitigate their market power; (2) "Convergence" of networks (*i.e.*, so called "inter-modal" competition") is ephemeral at best, and consumers generally do not view other distribution technologies as close substitutes for the Bells' local access networks; (3) BOC sabotage against their rivals for wholesale "last mile" access remains real and must be addressed; (4) Because the local market is far from competitive (just as when the Bell system was first broken up), the BOCs today can still leverage their market power in the last mile into the ancillary markets such as long distance, terminal equipment and data; and (5) Rivals who enter via unbundled network elements are *not* "parasitic competitors" and that any notion that TELRIC stymies facilities-based competition "founders on fact." For a full discussion of the *Verizon* Opinion and the current FCC broadband

(Footnote Continued….)

Notwithstanding, this anticompetitive "regulatory symmetry" argument unfortunately found fertile ground in the FCC's recent Triennial Review, where Commission decided that, among other things:

(1) The BOCs are not required to unbundle Fiber-to-the-Home (FTTH) Loops for both (a) "new build/greenfield FTTH loops" for both broadband and narrowband services; as well as (b) for "overbuild/brownfield FTTH loops" for broadband services; and

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initiatives, *see* Lawrence J. Spiwak, *The Telecoms Twilight Zone: Navigating the Legal Morass Among the Supreme Court, the D.C. Circuit and the Federal Communications Commission*, PHOENIX CENTER POLICY PAPER SERIES NO. 13 (August 2002) (http://www.phoenix-center.org/pcpp/PCPP13Final.pdf); COMMUNICATIONS WEEK INTERNATIONAL, *Opinion: U.S. Competition Policy – The Four Horsemen of the Broadband Apocalypse* (01 April 2002) (available at http://www.phoenix-center.org/commentaries/CWIHorsemen.pdf).

Moreover, the record simply does not support the BOCs' position. PHOENIX CENTER POLICY PAPER NO. 16 reveals that the States have been extremely careful to ensure that TELRIC rates accurately reflect the Bells' forward looking costs. Moreover, the States have actually preserved some BOC profit in a politically-sensible "50/50" split between the desired outcomes of new entrants and the incumbents. Accordingly, the fact that BOC margins are declining is an intended consequence of the Telecommunications Act 1996 and a rational public policy that, deliberately, does not incorporate the monopoly rents the Bells have traditionally enjoyed in the wholesale prices for unbundled network elements. T. Randolph Beard and George S. Ford, *What Determines Wholesale Prices for Network Elements in Telephony? An Econometric Evaluation*, PHOENIX CENTER POLICY PAPER NO. 16 (September 2002) (http://www.phoenix-center.org/pcpp/PCPP16.pdf).

Similarly, the BOCs' argument is particularly odd under any scenario because the BOCs will lose *more money* if they lose a customer to a facilities-based competitor outright. As PHOENIX CENTER POLICY PAPER NO. 15 demonstrates, when losing a customer to a facilities-based provider, the BOCs would: (1) receive no revenue for that last line; and also (2) would continue to incur the sunk costs of building their respective networks out to that customer in the first instance. With UNE-P, however, the BOCs still receive a steady revenue stream from that line that covers their forward-looking costs of these facilities plus a reasonable rate of return. The only plausible explanation of this apparently economically irrational behavior is that the BOCs' fully understand that facilities-based competition will be nascent for the foreseeable future and, as such, eliminating UNE-P virtually assures the BOCs' ability to recover monopoly rents from their dominance of the "last mile." See George S. Ford, *A Fox in the Hen House: An Evaluation of Bell Company Proposals to Eliminate their Monopoly Position in Local Telecommunications Markets*, PHOENIX CENTER POLICY PAPER NO. 15 (September 2002) (http://www.phoenix-center.org/pcpp/PCPP15%20Final.pdf); *see also* Thomas W. Hazlett & George S. Ford, *The Fallacy of Regulatory Symmetry: An Economic Analysis of the "Level Playing Field," in Cable TV Franchising Statutes*, 3 BUSINESS AND POLITICS 21 (2001) (available for download at: http://www.egroupassociates.com/Reports/fallacy.pdf) (incumbents understand all too well the economics of facilities-based entry, and therefore "strategically compete in the political realm to create legislation that protects rents of established operators").

Finally, PHOENIX CENTER POLICY PAPER NO. 17 finds that the Bells are, in fact, profitable wholesale suppliers of unbundled network elements as required by the 1996 Telecommunications Act. T. Randolph Beard and Christopher C. Klein, *Bell Companies as Profitable Wholesale Firms: The Financial Implications of UNE-P*, PHOENIX CENTER POLICY PAPER NO. 17 (November 2002) (http://www.phoenix-center.org/pcpp/PCPP17Final.pdf). Specifically, PHOENIX CENTER POLICY PAPER NO. 17 estimates that: (a) wholesale operating costs are about $10 per line across the BOCs; (b) EBITDA (earnings before interest, taxes, depreciation and amortization) margins are positive and average over $14 per line per month; and (c) operating margins (or EBIT, earning before interests and taxes) are also positive, and average 40% of revenues.

(2) The BOCs are not required to unbundle "Hybrid Loops", which the FCC describes "the packet-switching features, functions, and capabilities of incumbent LEC loops."

Accordingly, the policy question at hand is whether such player-specific regulatory relief will maximize or harm overall U.S. consumer welfare.

B. *Understanding the Economics of the "Last Mile"*

To evaluate whether regulatory relief will incentivize the BOCs to construct new fiber to the home, it is important to take an honest evaluation of the entry decisions of firms.[8] Putting aside the basic economic maxim that no monopolist will ever seek to invest or innovate absent competitive pressures (unless, of course, it enjoys a state-protected monopoly with guaranteed rates of return from captive ratepayers), the BOCs' decision to deploy new fiber is roughly *pari passu* to any other new entrant's decision to lay new fiber.

First among all incentive considerations is whether firms will be willing to risk the huge amount of sunk costs they must commit to construct a competitive "last mile" infrastructure. As both PHOENIX CENTER POLICY PAPERS NOS. 10[9] and 12[10] demonstrated, entry into the local exchange market requires large fixed and sunk costs, making entry risky and necessitating scale economies for new entrants on one hand, and providing a constant incentive for the incumbents to sabotage the new entrants on the other. Consequently, economic realities mean only a *few* local access networks can be sustained to supply the market. These few local access networks cannot be small, however, because a large market share is required to realize sufficient scale economies to effectively compete with the Incumbent Local Exchange Carrier or "ILEC" and survive.

Secondly, acquiring sufficient market share in network services to realize scale economies may be difficult for entrants who either attempt to purchase unbundled network elements from the incumbent or attempt to build their own network from the ground up.[11] Indeed, as many

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[8] For an explanation of the "Entry Condition", *see* PHOENIX CENTER POLICY PAPER NO. 6: *Do the FCC Policies Promote or Deter Entry? That is the ONLY Question* (October 1999) (available at: http://www.phoenix-center.org/pcpp/PCPPPNo.6Final.pdf).

[9] Jerry B. Duvall and George S. Ford, PHOENIX CENTER POLICY PAPER NO. 10, *Changing Industry Structure: The Economics of Entry and Price Competition* (2001) (http://www.phoenix-center.org/pcpp/PCPP10Final.pdf).

[10] T. Randolph Beard, George S. Ford and Lawrence J. Spiwak, *Why ADCo? Why Now? An Economic Exploration into the Future of Industry Structure for the "Last Mile" in Local Telecommunications Markets*, PHOENIX CENTER POLICY PAPER SERIES NO. 12 (2001) (http://www.phoenix-center.org/pcpp/PCPP12.pdf); *reprinted in* 54 FED. COM. L. J. 421 (May 2002) (http://www.law.indiana.edu/fclj/pubs/v54/no3/spiwak.pdf).

[11] This economic prerequisite stands in stark contrast to the BOCs' and cable industry's experience, which did not have to worry about achieving scale economies because they enjoyed government-protected monopolies. *See, e.g.*, Hazlett & Ford, *supra* n. 7.

CLECs discovered to their peril, given the substantial scale economies required in the local exchange network, it may not be possible for a single carrier to acquire sufficient retail market share in a timely manner to exhaust economies of scale in its wholesale network, and therefore additional new network entry may not occur.

Recent press reports are now confirming the obvious: Because of the huge sunk costs required for entry (discussed *supra*), BOC deployment of new fiber to the home (much less the neighborhood) is a very long way off. As an excellent expose by telecoms journalist Jonathan Krim in the WASHINGTON POST recently noted:

> *[M]any telephony experts, financial analysts and some phone company officials say that even if the former Bell telephone companies get the regulatory relief they seek, fiber to people's homes will remain a far-off dream. Not only does stringing fiber to the home remain enormously expensive, but advances in technology allow significantly faster connection speeds to be squeezed out of the country's 1.5 billion miles of existing copper lines.*[12]

As such, it is highly unlikely that consumers can expect their local BOC to deploy new fiber to their home (along with the extremely expensive optronics to light this fiber) anytime soon.

C. *The Thorny Issue of "Hybrid" Loops*

As the issue of BOC fiber to the home is an economic non-starter at this time, it is important to focus on the BOCs' other victory – *i.e.*, the de-regulation of "hybrid" loops. Given the impetus of this policy decision (*i.e.*, the BOCs), it is appropriate to ask whether de-regulation of BOC hybrid loops will benefit consumer welfare by increasing output, or whether the de-regulation of BOC hybrid loops will simply provide a mechanism for the BOCs to foreclose competitors and evade the new pro-entry thrust of the 1996 Act and perpetuate their monopoly over the "last mile." Based upon the technical and economic realities of running a modern

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[12] Jonathan Krim, *Copper Lines Regaining Luster* THE WASHINGTON POST (07 February 2003) (emphasis supplied). *See also* Mark Wigfield, *Martin Chides Bells for Shirking New Investment in Broadband* DOW JONES NEWSWIRES (21 February 2003) (reporting that "the Bells said they would likely not increase their investment in broadband even though the FCC deregulated those services."); T.A. Badger, *DirecTV Could Add to SBC's Challenges*, ASSOCIATED PRESS (12 February 2003) (rather than proceed with its long-announced plan ("Project Pronto") to deploy fiber to every home in its vast region, SBC is attempting to purchase DirecTV, the nation's No. 2 pay-television company, even though "many telecom analysts say purchasing … would dilute SBC's earnings and would not create synergies with the company's existing phone-oriented businesses.").

telecoms network, it unfortunately appears most likely that the BOCs will use this ruling as a way to extend their hold over the "last mile."[13]

First, because at the time of this writing the FCC has yet to release its final order in the Triennial Review, it is unclear exactly what constitutes a "hybrid loop"? The pedantic definition would be a combination of any "new" BOC fiber pushed out to the neighborhood (*e.g.*, to the central office or subloop terminal) with the "last mile" still transported by the existing copper loop. Such a definition lends itself to two possible interpretations that are adverse to competition: In the first scenario, if there are there are no competitive alternatives to the central office, or subloop terminal, then – regardless of whether there is UNE-P still available for the "last mile" – the incumbent BOC will be able to impede or foreclose rivals' ability to access consumers. In the second scenario, if the exemption of the fiber portion *a fortiori* exempts the entire facility – including the copper – then the BOC can again foreclose rivals ability to access consumers. And, according to a recent speech by FCC Chairman Michael Powell, this is the precise interpretation the FCC intends to adopt when it releases its final order.[14]

A similar foreclosure occurs by de-regulating the "packet-switching features, functions, and capabilities of incumbent LEC loops." That is to say, as noted *supra*, given the huge sunk costs of laying new fiber, firms will initially try to maximize the capabilities of the existing copper network before incurring such huge cap-ex costs. Most likely, this maximization will occur by installing new electronics at the customer premises equipment and using "Intelligent" or "Internet" Protocol (IP) to digitize and prioritize the customers voice, data and video traffic so that they can use their existing aggregated bandwidth over installed copper plant more efficiently. (For example, if a consumer has one standard copper telephone line, then their total bandwidth is 64 kbs; however if they have two lines, then they have a total aggregated

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[13] *See, e.g., Verizon v. FCC, supra* n. 7 at 1661:

> *[Incumbent LECs have] an almost in-surmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the markets for terminal equipment and long-distance calling as well. A newcomer could not compete with the incumbent carrier to provide local service without coming close to replicating the incumbent's entire existing network, the most costly and difficult part of which would be laying down the "last mile" of feeder wire, the local loop, to the thousands (or millions) of terminal points in individual houses and businesses. The incumbent company could also control its local-loop plant so as to connect only with terminals it manufactured or selected, and could place conditions or fees (called "access charges") on long-distance carriers seeking to connect with its network. In an unregulated world, another telecommunications carrier would be forced to comply with these conditions, or it could never reach the customers of a local exchange.*

(Emphasis supplied.)

[14] *See* remarks of FCC Chairman Michael Powell on CNBC's "Kudlow & Kramer" show, *supra* n. __ ("But the concern that has been expressed by the BOCs and others as to whether we obligated them to [provision copper when the incumbent builds fiber], I think we haven't, and we're going to try to make sure that's clear when the final order comes out.")

bandwidth of 128 kps; if then they have four lines a total aggregated bandwidth, they have 256 kps of bandwidth, *etc.*) However, because IP is *not* a service in and of itself, but rather only a way of managing network facilities in a very efficient way, the BOCs' monopoly over "last mile" facilities remains.[15] Accordingly, by again improperly confusing "services" with "facilities", the FCC's decision to deregulate the "packet-switching features, functions, and capabilities of incumbent LEC loops" in fact forecloses rivals' ability both: (a) to have the BOCs transmit and route telephone exchange service and exchange access; and (b) interconnect at any technically feasible point with the BOCs' networks as expressly required by the 1996 Act.[16]

Preventing these various avenues of foreclosure is exactly why Congress rejected a technology-specific standard – much less a "new" versus "old" standard – in favor of the adopted "necessary" and "impair" standard. The Congressional instinct was well founded because any "granular" determination of what constitutes a "new" broadband plant or technology facility will act as yet another significant entry barrier for new firms. Indeed, Congress deliberately rejected both "newness" and "technology"-specific tests in the 1996 Act in favor of the "necessary and impair" standard, because Congress understood from experience (*e.g.*, reconditioning of nuclear or coal-fired power plants) that any test that bases regulation upon a "new" versus "old" distinction provides fertile ground for firms to game the system by making just the right amount of modifications to existing plant to either grandfather themselves into more favorable regulation or, alternatively, to escape onerous legacy regulation to protect profits. Thus, adopting such a subjective "newness" or "technical" exemption will not incentivize the BOCs to invest in broadband facilities. Rather, it will only provide them with an easy mechanism to engage in a classic example of regulatory evasion for current legal obligations.

III. Moving the Process Forward Constructively: Why Focus on "Broadband" at All?

If we are ever to move from "one" to "many", then policymakers must approach the complex economics of the "last mile" with analytical honesty and rigor – something that the overwhelming majority of stakeholders have deliberately and continuously refused to do over

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[15] Equally important to recognize is that simply because a carrier uses IP does *not a fortiori* mean that this traffic will be delivered over the *public* Internet (which is a best efforts network that was never intended to carry voice traffic). Instead, this traffic, like all other traffic, will be "managed" from origination through transport and eventual termination to ensure quality of service. This "public" versus "private" network distinction is crucial to understand the hype surrounding "Voice over the Internet." Moreover, even if we assume *arguendo* that "free" "Voice over the Net" takes off and drives all of the existing long distance firms out of business, absent competitive alternatives for local service, consumers will still have to pay their incumbent for local service and then an additional fee for Internet access (just as both the BOCs and the cable companies (*i.e.*, video *and* high-speed access) do today).

[16] See 47 U.S.C. § 251(c)(2) *et seq.*

the past seven years – because we cannot ignore the laws of economics just as we cannot ignore the laws of gravity.[17]

There is absolutely no reason for policymakers to focus on a severable market for "broadband," because while there may be a "market" for "broadband", it is *not relevant for public policy purposes*.[18] The relevant market for policy inquiry is, and will continue to be for the foreseeable future, last-mile access, because this is where the incumbents' market power remains.[19] "Broadband" is simply a "service" provided over network components, and with regard to the unbundling decision, the FCC's clear mandate under the 1996 Act is *not* to determine what service can be provided over a UNE but to write rules so that incumbents provide unbundled access to those network components in a just, reasonable and non-discriminatory fashion. Focusing on the technology that converts traffic into ones and zeros capable of carrying voice, video and data – especially as the digitalization of the traffic continues to creep up to the customer premises equipment (CPE) – makes no analytical sense.[20] Accordingly, concentrating the policy debate on converging "inter-modal" broadband competition – when "inter-modal" competition has absolutely zero effect on dominant firms'

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[17] Take for example the recent speech by Verizon Chief Executive Officer Ivan Seidenberg criticizing Congress' "'command and control' rules that require [the BOCs] to share broadband investments with competitors at prices that drain them of value and profits and – ultimately – constrain investment". According to Mr. Seidenberg, the FCC needs to abandon unbundling and instead:

> … break out of the insular, echo-chamber rhetoric of "telecom economics" and connect with the larger debate about how to stimulate the investment and innovation that will move our industry, and our economy, forward. * * * Policy-makers have long given lip service to the importance of mass deployment of broadband technologies. But the current regulatory framework ignores economic laws of nature and creates the wrong environment for investment. The truth is, "telecom economics" should operate on the same principles that apply to other technology-intensive and infrastructure businesses.

Comments of Ivan Seidenberg at the Precursor Investor Conference (24 February 2003, Washington, D.C.) (http://newscenter.verizon.com/proactive/newsroom/release.vtml?)

[18] Indeed, the market for "broadband" is about as relevant as the markets for "Global Seamless Services" or "Video-Dial-Tone", two other completely arbitrary and artificial markets gerrymandered by regulators to achieve pre-determined outcomes.

[19] Last mile access, however, epitomizes what the FCC has described as a "policy-relevant" barrier to entry. *See* In re Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming, 9 FCC Rcd 7442, App. H at ¶ 31 (1994).

[20] By comparison, "inter-platform" broadband competition is not like the airline industry, where various providers' products are close substitutes and price wars frequently break out, thus driving competitors from the market. As such, the recent wave of CLEC bankruptcies was not caused by too much competition. These carriers were driven out of the market because they could not achieve scale economies in sufficient time to cover their debt loads, due to unjust and unreasonable entry costs and sabotage in the last mile as a direct result of incumbents' market power.

core products and services (and to which the FCC has failed to produce any evidence contrary to this fact), multi-channel delivered video programming, voice and so on – is a political ruse of the worst sort.[21]

Like it or not, regardless of any naive desire to let the "market" dictate efficient outcomes[22], it is Economics 101 that monopolists *by definition* do not seek to innovate, cut costs or particularly seek to become efficient. Instead, it is monopolists' inherent nature to exercise their market power wherever possible by raising prices, restricting output, and engaging in strategic anticompetitive behavior against their rivals. *In other words, the presence of a monopolist prevents good economic market performance, and to expect otherwise is utter folly.* If policymakers want to encourage new infrastructure deployment, therefore, then they must understand that the key task is *not* pursuing the quixotic dream of promoting "broadband" deployment from the incumbent monopolists, but rather developing mechanisms to promote new entry in order to mitigate the incumbents' very real market power over "last-mile" access.[23]

For this precise reason, the same logic that dictates that economic regulation should not be based on out-moded regulatory distinctions like "local" versus "long-distance" or "voice" versus "data" applies equally to any attempt to distinguish between "broadband" versus "narrow-band", "digital" versus "analog", or simply "old versus "new" facilities. Indeed, as noted *supra*, "broadband" is simply a "service" provided over network components. And, as also noted *supra*, any focus upon the technology that converts traffic into ones and zeros capable of carrying voice, video and data – especially as the digitalization of the traffic continues to creep up to the customer premises equipment (CPE) – and its discussion of the level of "inter-

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[21] See the discussion in PHOENIX CENTER POLICY PAPER NO. 13, *supra* n. 7, regarding the need for policymakers to understand the difference between economic "substitutes" and "complements." Equally important, the FCC has produced absolutely no analysis or data showing that so-called "inter modal" competition has any contestable effect on BOC behavior. But wait, there's more. By proposing in this NPRM to reclassify the BOCs broadband services as an "information service" rather than a telecommunications service – even though broadband can be used to carry voice – the FCC is essentially removing the BOCs' obligation to pay into the U.S. Universal Service Fund. Although universal service certainly is a worthy social goal, the current fund already acts as a major barrier to entry and therefore acts as a self-defeating exercise. Firms have to pay up to 10% of their gross revenues into the fund, but the BOCs are essentially spared from harm because they are the ones that generally receive the funds to provide the USO. *See* Mark Naftel and Lawrence J. Spiwak, The TELECOMS TRADE WAR: THE UNITED STATES, THE EUROPEAN UNION AND THE WTO (Hart Publishing 2000), Chapter 15 *passim*. So the current proposal threatens both to double competitors' current contributions and to force Internet service providers (ISPs) to make up the shortfall. Thus, in an effort to appease the BOCs, Mr. Powell's "de-regulatory" FCC taxes the Internet.

[22] *See* remarks of FCC Chairman Michael Powell on CNBC's "Kudlow & Kramer" show, *supra* n. 3 ("And I think that you cannot have a commitment to competition, and not introduce the Adam Smith market dialog and market dynamics that help set the correct prices, set the right amount of production.")

[23] For an explanation of the effect of public policy on the entry decisions of firms, see PHOENIX CENTER POLICY PAPER NO. 6, *supra* n. 8 and citations therein.

modal" broadband competition may be interesting but has no basis in the requirement that the FCC enforce the unbundling provisions of the 1996 Act.

Until policymakers understand this basic fact and do something to promote – rather than deter – new non-BOC competitive entry, we will continue to march along the road back to monopoly we are now upon. It follows, therefore, that the policy inquiry must return to the FCC's core mandate under the 1996 Act and focus on those elements of the network – *old and new* – where the BOCs can and will exercise market power to raise prices, restrict output, and engage in strategic anticompetitive conduct against their rivals. Certainly, this is the very *raison d'être* of economic regulation and the primary thrust of the 1996 Act, and without such focus it is unclear how we will ever move from "one" to "many." Perhaps Professors Carl Shapiro and Hal Varian sum up the entire "broadband" shibboleth best in their book INFORMATION RULES – *i.e.*, "*Technology changes. Economic laws do not*."[24]

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[24] Carl Shapiro and Hal Varian, INFORMATION RULES (Harvard Business School Press 1999) at 1-2.