

## Getting Their Wires Crossed

*The FCC's plan to unshackle the Baby Bells is bad policy based on bad economics.*

By Lawrence J. Spiwak

The great thing about a Washington regulatory practice is that it requires you to balance a variety of complex legal and economic factors to develop cohesive and well-reasoned public policy. Yet an administrative practice simply is no fun when regulators nakedly permit politics to trump law and economics to the detriment of consumer welfare.

Unfortunately, such analytical malfeasance is running rampant at the Federal Communications Commission today under Chairman Michael Powell.

In this case, Powell's FCC has sent clear signals that it appears hellbent, in its "Triennial Review" next month, on

### Points of View

unshackling the Baby Bell telephone companies from congressionally mandated policies designed to promote competition. The FCC's motivation appears to be its naive belief that these monopolists will not raise prices and restrict output, but that they will have a crisis of conscience and instead innovate, invest, and cut costs.

Please.

In the early 1980s, the Ronald Reagan administration's Justice Department pulled off probably one of the greatest antitrust remedies since the adoption of the Sherman Act itself: It forced the old Bell system to disaggregate itself into local and long-distance components.

When the Telecommunications Act of 1996 was enacted, policy-makers decided that with improvements in technology and a more mature industry, it was acceptable to re-vertically integrate the market (i.e., permit dominant firms to once again provide

both local and long-distance services) so long as the Bells make key elements of their local network (such as local loops, switching, network interfaces, operations systems, and support) available to rivals on a wholesale, a la carte basis, commonly referred to as Unbundled Network Element Platform (UNE-P).

The purpose of this law is twofold. First, unbundling is necessary to mitigate the Baby Bells' still very real ability to exercise market power both in their core local business as well as in related markets, such as long distance, data, and terminal equipment. Second, due to the incredibly high entry costs of installing the "last mile" to a subscriber's home or office, unbundling is necessary to allow entrants to create new demand to warrant the construction of competitive networks.

### POWELL'S PECULIAR POLICIES

Yet, if Chairman Powell has his way next month, then the number of unbundled elements will be so small so as to render the key cornerstone of the 1996 act meaningless. Equally as important, the FCC will also strip the states of their ability to implement and enforce the federal law, even though the individual states are in the best position to account for different local economic conditions.

How did we get to this point? When the FCC began to implement the 1996 act, the commission, after much deliberation, decided that the Bells should be required to make these unbundled network elements available at their forward-looking Total Element Long Run Incremental Cost (TELRIC), to reflect the fact that telecoms is a declining-cost industry, and therefore new entrants should not pay for the Bells' mistakes of the past. When the Supreme Court reviewed and upheld the FCC's decision in *Verizon Communications Inc. v. FCC* (2002), the Court explicitly held that the wholesale rates calculated at the Bells' TELRIC

were neither confiscatory to the Bells (i.e., a constitutional takings) nor a subsidy to the new entrants.

More importantly, the Court took the significant step of explicitly dismissing each and every one of the specious arguments the Bells have used around Washington for the last seven years. It held:

- The Bells are monopolists and, as such, Congress did not intend to have “regulatory parity” between the incumbents and new entrants, but instead intended to impose asymmetrical regulation on the Bells to mitigate their market power.
- “Convergence” of network technologies, such as making voice phone calls over the Internet, is ephemeral at best, and consumers generally do not view other distribution technologies as close substitutes for the Bells’ local access networks.
- Bell sabotage against their rivals for wholesale “last mile” access remains real and must be addressed.
- Because the local market is far from competitive (just as it was when the Bell system was first broken up), the Bells today can still leverage their market power in the “last mile” into related markets.
- Rivals who enter via unbundled network elements are *not* “parasitic competitors,” and any notion that TELRIC stymies competition “founders on fact.”

The record bears out the majority’s wisdom. For example, there is no evidence that any state regulatory proceeding—proceedings that are open for public participation and described by the majority in *Verizon* as “smoothly running” affairs—has found to date that the Bells’ wholesale rates for UNEs are confiscatory. To the contrary, state commissions have found the majority of these UNE rates to be excessive and ordered these rates *reduced*.

Moreover, the Bells’ contention that these wholesale pricing policies are the root cause of their purported financial demise is not supported by the Bells’ own filings with either the Securities and Exchange Commission or the FCC. To wit, after nearly seven years, new entrants have only been able to secure 10 million lines nationwide via unbundling, but Verizon alone has matched that by picking up more than 10 million long distance subscribers and moved past Sprint to become the third largest long-distance provider nationwide. In the meantime, the Bells have lost billions in poor investments in the unregulated/competitive segments of their businesses.

Yet, less than two weeks after the Supreme Court issued its opinion in *Verizon*, in a startling example of judicial activism, the D.C. Circuit issued its opinion in *United States Telecom Association, et al. v. FCC (USTA)* (2002), where it deliberately dismissed the majority’s opinion in *Verizon*. Most notably, the D.C. Circuit held in direct contrast to the majority’s opinion in *Verizon* that:

- TELRIC improperly forces the Bells to subsidize their competition; and
- Entry via unbundled network elements produces nothing more than “completely synthetic competition.”

In light of this naked disregard of Supreme Court precedent, one

could reasonably assume that the FCC would file a petition for certiorari to resolve this conflict and clarify its authority.

Nope. Because (1) the majority’s opinion in *Verizon* would bring the FCC’s anti-competitive agenda to a screeching halt, and (2) the D.C. Circuit’s opinion in *USTA* provides the FCC with the perfect legal and political cover to adopt the Bells’ anti-unbundling agenda, we have an unprecedented situation. Specifically, the chairman of a major federal agency is deliberately choosing to ignore Supreme Court precedent supporting his agency, and to follow instead a lower court ruling criticizing his agency because it enables the commission to proceed with a skewed vision of industrial planning. (Although several private parties have asked for Supreme Court review of *USTA*, the Court probably won’t grant certiorari absent the FCC’s presence.)

The FCC’s flagrant disregard of congressional intent, core principles of federalism, and overall drive toward industrial planning has not gone unnoticed. While liberal organizations such as Consumers Union have been typically quick to criticize the Republican-controlled FCC’s policies, it is important to note that conservative and pro-business organizations are even more critical.

#### AND FROM THE RIGHT

For example, more than 20 major conservative groups, including Americans for Tax Reform and the American Conservative Union, signed a letter complaining that by eviscerating UNE-P—which, in their view, is the “most effective means of injecting competition into this key market”—the FCC is violating “the founding principle of federalism.”

Similarly, the Small Business Administration’s Office of Advocacy—an office that the White House’s Web site calls a centerpiece of the Bush administration’s small business program and which has been given expanded powers by executive order—also filed public comments demanding that the FCC keep its unbundling rules in place.

As a recent *BusinessWeek* editorial so aptly opined: “Deregulation should not mean anarchy, deceit, and greed hiding behind a twisted interpretation of Chicago School economic theory.”

Unfortunately, judging by the FCC chairman’s apparent desire to implement such a peculiar vision of what the telecoms market should be rather than what the law requires and economics support, it is clear that this twisted interpretation of the Chicago School has found fertile ground. Before taking on the Herculean task of fixing the telecoms meltdown, however, someone over at the FCC should have signed up for the second semester.

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