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OPINION: U.S. COMPETITION POLICY – THE FOUR HORSEMEN OF THE BROADBAND APOCALYPSE

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If policymakers ask the wrong public policy questions, it is inevitable they will get the wrong policy answers. The current broadband debate is perhaps the greatest example of where policymakers are asking the wrong questions.

Rather than focus on how to promote new entry and mitigate incumbents' market power for the last mile, policymakers apparently are more concerned about promoting broadband deployment, regardless of the source. The problem with this approach is that it boldly neglects the fundamental principles on which telecoms policy has been based for the last twenty-five years.

In the view of policymakers, the issue is not about the incumbents' ability to raise prices or restrict output over the last mile, but whether incumbents can provide ancillary broadband services in competition with other providers, such as cable, satellite and mobile operators. But while this "inter-modal" or "inter-platform" competition sounds nice in concept, the reality is that it has absolutely no effect on dominant firms' strategic behavior for their core products and services. As such, the concept of broadband is rapidly becoming a shibboleth to mask the fundamental structural monopoly problem of the last mile.

Unfortunately, the regional Bell operating companies (RBOCs) in the United States, with their huge resources, are finding sympathetic ears in Washington to this "inter-platform" competition story: witness the popularity of the so-called Tauzin-Dingell bill, which passed the U.S.

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House of Representatives in February (*see* CWI, 4 March 2002, p. 6); and, in particular, the priorities of the Federal Communications Commission (FCC) and its chairman Michael Powell.

Indeed, the RBOCs have long argued that while they may be dominant for voice services, they are only nascent players in the burgeoning broadband market. They say the pro-competitive provisions of the U.S. 1996 Telecoms Act - unbundling, collocation, interconnection, pricing and so on - hinder their incentive to compete against the other players who are not saddled with such asymmetrical regulatory burdens.

Mr. Powell seems to have bought the RBOCs' arguments: the FCC recently issued three Notices of Proposed Rulemaking (NPRM) and one Notice of Inquiry (NOI) designed to promote "regulatory certainty" and spur RBOC investment in broadband networks. By nakedly seeking to benefit incumbent monopolists exclusively, however, these "four horsemen of the broadband apocalypse" threaten to eviscerate twenty-five years of FCC precedent and cut off the remaining lifeblood of the competitive local exchange carrier (CLEC) industry.

Horseman No. 1: *The FCC's NPRM to Determine the Relevant Market for Broadband.*

The operative word here is "*relevant.*" While there may be a market for broadband, it is *not relevant for public policy purposes.* The market for broadband is about as relevant as the market for global seamless service or video dial tone.

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. Therefore, 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.

Accordingly, focusing the debate on converging "inter-platform" broadband competition - when "inter-platform" competition has absolutely zero effect on dominant firms' core products and services, multi-channel delivered video programming, voice and so on - is a political ruse of the worst sort.

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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.

Horseman No. 2: *The FCC’s NPRM to Take a Fresh Look at What Falls Under the Classification of an Unbundled Network Element (UNE).*

Since the passage of the 1996 Act, both sides of the debate have argued vociferously over which UNEs satisfy the 1996 Act’s “necessary and impair” standard – in other words, those “necessary” elements that, if withheld by the RBOC, “impair” the CLEC’s ability to provide service. Regardless, what few battles have been won, including access to such basic inputs as special access lines, are now in danger of being lost.

Similarly, it is unlikely that the FCC will restore unbundled switching in the top 50 metropolitan statistical areas (MSAs) to the UNE list, even though the rampant CLEC bankruptcies have decimated the survivors’ ability to obtain competitive switching.

Horseman No. 3: *The FCC’s NPRM to Classify all RBOC Broadband Services as Information Services Under Title 1 of the Communications Act.*

Many years ago, when the Internet was just a gleam in someone’s eye, the FCC in its *Computer II* paradigm 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.

For this reason, using stringent structural regulation, the FCC carved out the now-competitive terminal equipment and CPE markets via standard interfaces and separate subsidiary requirements. Moreover, the

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FCC also knew that it had to reduce entry costs for new firms, so it declined to impose price regulation over ancillary service providers.

Over the last several years, however, the FCC has engaged in an incredible act of revisionist history. See, for example, FCC OPP WORKING PAPER 31, *The FCC and the Unregulation of the Internet* (1999), in which it deliberately ignored the issue of market power and instead focusing exclusively on the cost of entry. Now, the FCC plans to codify this analytically flawed view of history and sacrifice these crucial structural safeguards all on the false altar of promoting “inter-platform” competition.

Just as CWI went to press, the FCC issued a declaratory order classifying all cable modem services as “information services.” While this action is consistent with the FCC’s attempt to create a level playing field for “inter-platform” 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 RBOCs 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.

But wait, there’s more. By proposing to reclassify the RBOCs 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 RBOCs’ obligation to pay into the U.S. Universal Service Fund. The current fund already acts as a major barrier to entry. Firms have to pay up to 10% of their gross revenues into the fund, but the RBOCs are essentially spared from harm because they are the ones that generally receive the funds to provide the USO. 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 RBOCs, Powell’s “de-regulatory” FCC taxes the Internet.

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Horseman No. 4: The FCC's Notice of Inquiry to Determine the Relevance of Equal Access and Non-Discrimination Interconnection Obligations on Incumbent Local Exchange Carriers.

For more than twenty years, the concepts of non-discriminatory interconnection and equal access to rival local and long distance networks have been a cornerstone of U.S. telecoms policy.

Moreover, these obligations are one of the central principles contained in the 1997 WTO Regulatory Reference Paper.

By removing these obligations, the FCC removes all incentives for an incumbent, with its disparate advantage in bargaining power, from ever entering into an interconnection agreement with competitors. It also threatens to open the U.S. to a WTO complaint. As such, the mere fact that the FCC has placed the potential eradication of these competitive cornerstones on the table casts disturbing light on how the RBOCs have the FCC in their pocket.

As a pre-emptive measure, Powell's FCC has sought to assure nay-Sayers by pointing out that they are attempting to get Congress to increase the penalties they can impose on incumbents, and that they have initiated an NPRM to beef up RBOC performance criteria and compliance.

However, it is difficult to have confidence in the FCC's commitment to enforcement when all of their actions to date have involved settlements wherein the incumbents' admit to no wrong doing in exchange for making *de minimis* (relative to overall earnings) "voluntary contributions to the U.S. Treasury."

And why not? As the FCC has very deliberately refused to make explicit findings of fact, these settlements as a legal matter have little or no probative weight in a subsequent criminal or civil court of law, much less have any material impact on incumbents' bottom lines.

In sum, while regulatory certainty is always nice, it does nothing to alter the fundamental economics of the last mile. The only certainty that Powell's broadband initiative will provide is the obvious: the RBOCs monopoly for the last mile will continue, and they will have the ability and

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incentive to raise process and restrict output (the textbook definition of market power) for the foreseeable future.

Who would have thought that broadband could be so antithetical to consumer welfare?