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Press Release

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FCC's New "Market Power" Analysis Makes Regulatory Forbearance an "Impossible Dream"

Phoenix Center Shows that FCC's Forbearance Standard Perpetuates Regulation by Ignoring the Fundamental Economics of Telecom Markets

WASHINGTON, D.C. — Under Section 10 of the Communications Act, the Federal Communications Commission must forbear from regulation when certain conditions are met. To help clarify its responsibilities in this regard, the Commission recently promulgated a new "market power" test to evaluate forbearance petitions. In a new study released today entitled *The Impossible Dream: Forbearance After the Phoenix Order,* the Phoenix Center reviews the agency's new "market power" analysis and concludes it effectively renders Section 10 of the Act moot by establishing a forbearance threshold—price equals short-run marginal cost—that is impossible to satisfy in communications markets. Notably, the study focuses solely on methodology and does not address the merits of any particular forbearance petition.

As detailed in the report, the FCC's new market power framework explicitly places the burden on the regulated firm seeking forbearance to provide convincing evidence that its prices are not above "competitive levels." The competitive level of price is clearly defined by the agency to equal short-run marginal cost. Yet, as the Phoenix Center explains by referencing established economic theory and Commission precedent, because the construction and operation of communications networks requires significant fixed and sunk costs, marginal cost pricing in telecom markets is unprofitable because it fails to recover the predominant fixed costs of providing the services. Thus, by ignoring the most rudimentary economic realities of the markets it regulates, the FCC has developed an inherently defective framework for evaluating the need for regulation. In fact, under its new standard, the agency's Total Element Long Run Incremental Cost (or TELRIC) price standard for unbundled network elements is, by definition, unjust, unreasonable, and above the competitive level.

After clearly demonstrating the critical flaws in the agency-proposed market power framework, the Phoenix Center recommends that the agency move away from a naïve market power framework and instead follow the clear mandates of the statute to determine whether the costs of a particular regulation outweigh its benefits. As the study explains, "Most markets, and certainly most if not all communications markets, are unlikely to ever resemble anything like the equilibrium of the textbook nirvana of perfect competition, but, as Congress observed in the

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statute, this fact does not imply regulation is desirable. Regulation can be harmful even in the presence of monopoly, especially if the regulation has the effect of deterring competitive entry." Thus, argues the Phoenix Center, "The hypothetical experiment relevant to Section 10 forbearance is *not* the presence or absence of market power, but the presence or absence of regulation."

"A plain reading of the statute indicates that forbearance is not about the presence or absence of market power, but about the costs and benefits of regulation" said Phoenix Center President and study co-author Lawrence J. Spiwak. "Regulation may be harmful even in the presence of monopoly, but the FCC's proposed 'market power' standard precludes such a finding. The Commission has completely missed the mark with its 'market power' test, contradicting the statute and ignoring the economics."

"Every first year student of telecommunications law and economics learns that marginal cost pricing is infeasible, indeed irrational, in communications markets, yet the FCC requires evidence of such pricing as the forbearance threshold," says Phoenix Center Chief Economist and study co-author Dr. George S. Ford. "As such, the Commission disregards the economic realities of the market at the most rudimentary level. By establishing an impossible hurdle for regulated firms, the agency fails to foster a 'pro-competitive, deregulatory national policy framework' as required by the Act and inevitably perpetuates outdated and unnecessary regulations prone to reduce economic efficiency, curb efficient investment, and impede innovation in the communications industry. A sound forbearance framework is needed for sound forbearance decisions. Unfortunately, the FCC's proposed framework is profoundly defective and incomplete."

PHOENIX CENTER POLICY PERSPECTIVE NO. 10-08: *The Impossible Dream: Forbearance After the Phoenix Order*, may be downloaded free from the Phoenix Center's web page at: http://www.phoenix-center.org/perspectives/Perspective10-08Final.pdf.

The Phoenix Center is a non-profit 501(c)(3) organization that studies broad public-policy issues related to governance, social and economic conditions, with a particular emphasis on the law and economics of telecommunications and high-tech industries.

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