

**Tauzin-Dingell: Helping to Disable  
The 1996 Telecommunications Act**

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# **Tauzin-Dingell: Helping to Disable The 1996 Telecommunications Act**

*By Judi Clark*

## **Introduction**

This paper summarizes the current state and likely prospects of proposed legislation to advance incumbent local Bell telephone company interests by cutting back on their pro-competitive obligations under the Telecommunications Act of 1996 ("1996 Act"). My principle conclusion is that, while imminent passage of pro-Bell legislation is not likely, the stakes are sufficiently high that competitive interests will face continual battles in Congress, with State regulatory bodies, and in the courts to prevent the rollback of the rights originally granted to them in the 1996 Act and FCC interpretations of it.

## **Ma Bell and The 1996 Telecommunications Act**

The original Bell Telephone Company, formed in 1877, begot in 1885 the American Telephone and Telegraph Co. (AT&T).<sup>1</sup> Since that time, the communications industry has engaged in a cycle of mergers and judicially enforced divestments<sup>2</sup> leaving us today with four remaining regional

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<sup>1</sup> Sheldon Hochheiser, AT&T Corporate Historian, *A Brief History, Origins*, (Dec. 2002) at <http://www.att.com/history/history1.html> (last visited Mar. 4, 2003).

<sup>2</sup> Sheldon Hochheiser, AT&T Corporate Historian, *A Brief History, The Bell System*, (Dec. 2002) at <http://www.att.com/history/history3.html> (last visited Mar. 4, 2003).

monopoly Bell telephone companies:<sup>3</sup> SBC, Verizon, BellSouth, and Qwest, currently offering most of our nation's local phone service.<sup>4</sup>

Making use of evolving communications technologies, in 1969 MCI first challenged AT&T's monopoly for long distance service.<sup>5</sup> As more long distance competitors entered the market, prices for long distance calls fell.<sup>6</sup> However, the market was far from competitive. AT&T enjoyed a market share of more than 90% well into 1984.<sup>7</sup>

The growing desire for marketplace competition and concerns about AT&T's continuing monopoly led the federal government to file an antitrust suit against the Bell System in 1974. This suit was settled in 1982 with an

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<sup>3</sup> Various called Regional Bell Operating Companies (RBOCs) or Bell operating companies (BOCs). The term Incumbent Local Exchange Carriers (ILECs), a term invented in the 1996 Act, applies to any and all then-existing LECs who were part of the monopoly industry. That included the RBOCs, but also GTE (always a separate company, until Verizon was formed) as well as ~1500 small "independent" telephone companies, serving mainly rural areas. Here, ILEC refers primarily to the incumbent Bell Operating Companies.

<sup>4</sup> These four entities together provided more than 91% of all lines in service as of June 30, 2001. *FCC Releases Study on Telephone Trends*, FCC (May 22, 2002) at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/trend502.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend502.pdf). (*This is the most recent data as of July 11, 2003.*)

<sup>5</sup> "In 1969, the FCC approved MCI's application to provide private microwave service between Chicago and St. Louis, marking the beginning of the end of AT&T's 70 year monopoly." Taken from *Milestones*, MCI WorldCom, at [http://www.mci.com/about\\_mci/Milestones.jsp](http://www.mci.com/about_mci/Milestones.jsp) (last visited Mar. 26, 2003).

<sup>6</sup> *FCC Study on Long Distance Telecommunications*, at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/ldrpt101.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/ldrpt101.pdf).

<sup>7</sup> Eli M. Noam, *Media Concentration in the United States: Industry Trends and Regulatory Responses*, at <http://www.vii.org/papers/medconc.htm> (last visited July 12, 2003).

agreement<sup>8</sup> to break the Bell System into two parts: a set of local operating companies controlling local exchange facilities (at that time still viewed as likely “natural monopolies”) and essentially all the rest of AT&T, including Long Lines, Western Electric (equipment manufacturing) and Bell Labs (research). State laws typically protected the right of the divested Bell companies to provide local service on a monopoly basis; at the same time, the terms of the divestiture decree kept those companies out of the long distance and equipment manufacturing markets.

Both sectors were, to some extent, dissatisfied with this arrangement. AT&T, MCI and other long distance companies wanted more competitive alternatives to reach their customers—particularly their large business customers. The divested Bell companies wanted to be able to provide long distance and other forbidden services.

In passing the Telecommunications Act of 1996<sup>9</sup> (“1996 Act”), Congress was attempting to encourage additional competition in telecommunications services, including local phone service, thereby improving services and lowering prices.<sup>10</sup> The 1996 Act introduced the

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<sup>8</sup> The famous “consent decree” describing AT&T’s divestiture is found at *U.S. v. American Tel. and Tel. Co.*, 552 F.Supp. 131 (D.D.C. 1982), *aff’d sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

<sup>9</sup> Telecommunications Act of 1996, Pub. LA. No. 104-104, 110 Stat. 56 (1996), *codified at scattered section of 47 U.S.C.*; available at <http://www.fcc.gov/telecom.html> (last visited Mar. 1, 2003). References in this paper to “Section \_\_\_” refer to sections of 47 U.S.C.

<sup>10</sup> The Congressional Record and Committee Hearings are full of this discussion. See, for example, “...bringing competition to the wireline telephone network, one of the

concept of an “Incumbent Local Exchange Carrier,” or ILEC, which was defined, essentially, as any existing monopoly telephone company as of the date of passage of the 1996 Act.<sup>11</sup> Although not a defined term in the Act, over time, the many competitors who were positioned to provide local phone services were deemed Competitive Local Exchange Carriers (CLECs). The CLECs were mainly rival telephone companies affiliated with long distance carriers or pre-existing competitive providers of interstate access services, but also included cable TV providers, utility companies and municipalities.

### **The 1996 Act, Provision 1: Reciprocal Compensation**

Under the 1996 Act, ILECs are required to enter into “interconnection agreements” with CLECs, embodying the Act’s requirements. One of those requirements is that local exchange carriers who send traffic to each other pay each other for completing the calls.<sup>12</sup> As a result, the competing telephone service providers (including both ILECs and CLECs) developed contracts to financially account to each other for calls beginning and ending on their various networks. These payments are referred to in the act as “reciprocal compensation.” Section 251(b)(5) identifies “the duty to establish reciprocal compensation arrangements for the transport and termination of

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key goals of the Telecommunications Act.” in Congressional Record, 142 Cong Rec s2000 (March 13, 1996).

<sup>11</sup> See 47 U.S.C. § 251(h) (1996).

<sup>12</sup> 47 U.S.C. § 251(b)(5) (1996).

telecommunications."<sup>13</sup> With regard to those arrangements, Section 252(d)(2)(A) then states that,

...for the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless-- (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls.<sup>14</sup>

In determining the rules of engagement, many CLECs sought a "bill and keep" system in which traffic would be exchanged between carriers for free. The ILECs opposed this on statutory and policy grounds, arguing that when one carrier terminates traffic from another, the terminating carrier should be compensated for its efforts.<sup>15</sup>

When the FCC issued rules in August 1996 to implement the 1996 Act, it determined that section 251(b)(5) should apply to "traffic that originates and terminates within a local area," and "is intended for a situation in which

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<sup>13</sup> The text of the Telecommunications Act of 1996 is at <http://www.fcc.gov/Reports/tcom1996.txt> (last visited on Mar. 1, 2003).

<sup>14</sup> *Id.*

<sup>15</sup> Bill and Keep is discussed in the FCC's First Report and Order, *In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, FCC 96-325 (Aug 8, 1996), especially ¶ 1096-1118, at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Orders/1996/fcc96325.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Orders/1996/fcc96325.pdf).

two carriers collaborate to complete a local call.”<sup>16</sup>

Originally believing the incoming calls would terminate in their favor, ILECs argued for and often received<sup>17</sup> a terminating-cost rate favorable to themselves, *i.e.*, a high rate relative to their costs. They didn't anticipate the number of ILEC-originated calls that would be terminating at CLECs, whose customers were ISPs. As the bills started adding up, however, the debate began.

The disputes typically arose in the context of fights over whether a particular ILEC-CLEC interconnection agreement required payment of compensation as stated in contracts with the originating carrier for ISP-bound calls. CLECs argued to the relevant state commissions that they should receive compensation for calls originating with ILECs and terminating at the modems of the ISPs whom the CLECs served.<sup>18</sup> In contrast the ILECs

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<sup>16</sup> *Id.*, FCC 96-325, ¶ 1034 (Aug. 1996). Note that the term “local” is not defined in the Act, although it is widely used in the industry. The ambiguity of the term came back to haunt the FCC in its efforts to deal with reciprocal compensation for calls to ISPs. *See infra*. While it is beyond the scope of this paper to cover this topic in detail, note that a simple phone call to anywhere in the world can be merely a local connection from a home telephone, through a service provider (who may be an ILEC or a cable, wireless, or satellite company), to the Internet. This means that, in a sense, all calls are local. Increasingly, the telephone companies are an expensive specialty, and no longer required as monopoly telephone service providers. Indeed, they can be replaced today by software and one of many kinds of Internet-connected devices. This is referred to as Voice over IP, defined below.

<sup>17</sup> The ILECs don't unilaterally set these rates. They negotiate them with the CLECs (see 47 U.S.C. § 251(c)(1)), and if they can't come to an agreement the issue is arbitrated by state commissions (see 47 U.S.C. § 252(b)).

<sup>18</sup> This situation was favorable for the CLECs because as dial-up service became increasingly popular with a mass residential customer base, people used their local phone lines to call their ISPs. This effectively meant the ILECs owed

argued that the ISPs are merely a pass-through point for communications bound not for the ISP but for distant points on the Internet, rendering calls to ISPs interstate (non-local) and therefore not compensable under Section 251(b)(5). However, "more than two dozen state commissions concluded that the interconnection agreements that incumbent LECs had entered into with CLECs required the payment of reciprocal compensation for ISP-bound traffic."<sup>19</sup>

The Bells learned a quick lesson: be careful what they ask for. "Thirty-four out of 39 States have found that CLECs deserve to receive reciprocal compensation for Internet traffic, and 12 courts out of 12 have upheld those decisions. The rates for reciprocal compensation were set by the Regional Bell Operating Companies (RBOCs) themselves...."<sup>20</sup>

Ironically,

Many incumbent local exchange carriers insisted on reciprocal compensation rates as high as \$.01 per minute in agreements they entered into with competitive entrants in 1996, based on the apparent expectation that they would be the net beneficiaries of these payments. These agreements are expiring, however, and some of these same carriers are now

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termination charges to CLECs for the imbalance of those calls.

<sup>19</sup> Before the House Telecom Subcommittee Hearing on HR 4445 IH, House Commerce Committee (June 22, 2000) (Statement by Larry Strickling, FCC Common Carrier Bureau) *at* <http://www.techlawjournal.com/cong106/recipcomp/20000622str.htm> (last visited March 3, 2003).

<sup>20</sup> Before the House Commerce Committee (Sept. 25, 2000) (Letter from John Windhausen, Jr., President, Association for Local Telecommunications Services (ALTS)) *at* <http://www.alts.org/Filings/092500TauzinResponse.pdf> (last visited Mar. 5, 2003).

negotiating dramatically lower reciprocal compensation rates for all traffic, including ISP-bound traffic -- as low as \$.00175 per minute. Consumers will be better off and local competition will be fostered as parties continue to negotiate rates that more accurately reflect the actual costs of transport and termination.<sup>21</sup>

Answering industry calls to clarify whether ISP-bound calls were local and therefore subject to reciprocal compensation under Section 251(b)(5) and the FCC's implementing regulations, the FCC in February 1999 issued a decision: they are not.<sup>22</sup> However, the FCC made clear that this generic interpretation of its rules did not resolve the payment problem. Instead, the FCC concluded (a) that there was no specific federal rule applicable to this traffic, and (more troublesome for the ILECs) (b) that even though existing rules did not require payment, ILECs may have agreed to make such payments in contracts with CLECs referring generally to compensation for "local" traffic without identifying ISP-bound traffic as a separate category.

To address the first issue, the FCC initiated a proposed rulemaking. To address the second, it confirmed "parties were bound by their interconnection agreements as interpreted and enforced by state commissions."<sup>23</sup>

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<sup>21</sup> Id.

<sup>22</sup>In *The Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 Inter-Carrier Compensation for ISP-Bound Traffic*, 1999 WL 98037, 14 F.C.C.R. 3689, 14 FCC Rcd. 3689, 17 Communications Reg. (P&F) 201, FCC (Feb 26, 1999).

<sup>23</sup> *Supra*, letter from John Windhausen. More specifically, 47 U.S.C. §§ 252(a)(1) and (e) indicate that interconnection agreements are to be "binding" (in the words of subsection (a)(1)). Additionally, the FCC said in 1999, and again in 2001, that

While the rulemaking was in progress, the D.C. Circuit Court of Appeals vacated and remanded the FCC's ruling. Although Section 251(b)(5) requires reciprocal compensation for all "telecommunications," the FCC initially construed reciprocal compensation as being limited to "local" traffic, leaving intercarrier compensation for long-distance calls to be treated as it was before the 1996 Act. In *Bell Atlantic Telephone Companies v FCC*, 206 F.3d 1 (C.A.D.C., 2000), the court found the FCC's treatment of calls to Internet Service Providers (ISPs) was inconsistent with the statute, stating "The issue at the heart of this case is whether a call to an ISP is local or long-distance. Neither category fits clearly." The court also found that the FCC's decision did not constitute "reasoned decisionmaking" on several critical points, including the FCC's notion that calls CLECs deliver to ISPs are "not properly seen as "terminat[ing] ... local telecommunications traffic," and the agency's failure to address whether such traffic falls into the statutory categories of "exchange access" or "telephone exchange service".<sup>24</sup> The case was vacated and remanded for clarification of the definitions and their applications.

On remand in 2001, the FCC took to heart the court's focus on "local" versus "long distance" calls and concluded that its initial limitation of the

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interconnection agreements on this topic are binding.

<sup>24</sup> *Bell Atlantic Telephone Companies v FCC*, 206 F.3d 1 (C.A.D.C., 2000) (On Petitions for Review of a Declaratory Ruling of the Federal Communications Commission), *at* <http://www.ll.georgetown.edu/federal/judicial/dc/opinions/99opinions/99-1094a.html> (last visited Mar. 4, 2003).

reciprocal compensation obligation to “local” traffic — a term not used in the statute — had created ambiguities and had therefore been a mistake. It concluded, however, that calls to ISPs were still excluded from reciprocal compensation because they were a form of “information access.” This and other types of traffic specifically mentioned in another section of the Act, Section 251(g), were deemed excluded from reciprocal compensation.

This decision, too, was appealed, and, while the FCC’s rules were allowed to stand, the court rejected the agency’s reasoning. In *WorldCom, Inc. v FCC*, 288 F.3d 429 (C.A.D.C.,2002), the court stated,

“In the order before us the Federal Communications Commission held that under § 251(g) of the Act it was authorized to “carve out” from § 251(b)(5) calls made to internet service providers (“ISPs”) located within the caller’s local calling area. It relied entirely on § 251(g). Because that section is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act, we find the Commission’s reliance on § 251(g) precluded. Thus we remand the case.”

More recently, in *Verizon Md. Inc. v. RCN Telecom Servs.*, 248 F.Supp.2d 468 (D.Md., 2003), a case that started in 1996 and found its way to the Supreme Court and back, the 4<sup>th</sup> District Court held that Verizon owes MFS (now a part of MCI) for the termination of local calls dating back to April 1997. These interconnection contracts, even if entered into by the ILECs under statutory compulsion and subject to specific regulatory review and oversight, were again confirmed as binding on the parties.

But, back to 1999. Responding to the timing and uncertainty of the

growing compensation imbalance, the ILECs' Congressional champions stepped in to introduce legislation to protect the ILECs' interests.

## **Tauzin and Dingell Stroll In**

Louisiana representative Billy Tauzin has a long history of support for corporate private property rights, in this case representing the interests of the Bells.<sup>25</sup> He should—he's long been the recipient of soft-money, lobbying, industry and personal contributions from the Bells.<sup>26</sup> Michigan representative John Dingell, also an advocate of corporate private property rights, is similarly situated in financial favor.<sup>27</sup> It was no surprise that these two men have championed bills over the last two congressional sessions that position FCC regulations as unjust governmental “takings,” contrary to the 5<sup>th</sup> Amendment, and which are worded strongly in the Bell's favor.

In the 106th Congress (1999-2000), Tauzin and Dingell teamed up for

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<sup>25</sup> Some of the more notable bills sponsored by Tauzin in favor of the Bells, since the passage of the Telecommunications Act of 1996, include: 105<sup>th</sup> Congress: HR 1872, HR 4324, HR 4801; 106<sup>th</sup> Congress: HR 1746, HR 2420, HR 4445; 107<sup>th</sup> Congress: HR 1542, HR 1697, HR 1698, HR 3268, HR 3484, HR 4560.

<sup>26</sup> Tauzin's PACs received contributions from Telephone Utilities amounting to: \$45,000, of which \$26,500 (58.9%) was from Bell Atlantic, SBC, and Verizon (3 of the 4 Bells) (1999-2000 cycle), and \$35,500, of which \$26,000 (73.2%) was from the same group (2001-2002 cycle). Verizon and SBC Communications were Tauzin's #1 and #4 (respectively) contributors for 1999-2000, having donated \$24,000 between them. Taking turns, Bell South was Tauzin's #1 contributor in 2001-2002, having donated \$34,800. *From* <http://www.opensecrets.org/politicians/summary.asp?CID=N00005372&cycle=2002>.

<sup>27</sup> Dingell's #3 and #4 contributors in 1999-2000 were Verizon and SBC, having a combined donation of \$31,800. Bell South stepped up in 2001-2002 to the #2 position with \$55,325, ahead of Verizon's \$18,000 and SBC's \$16,024.

the first Tauzin-Dingell bill, HR 4445: Reciprocal Compensation Adjustment Act of 2000: to exempt from reciprocal compensation requirements telecommunications traffic to the Internet.<sup>28</sup>

This bill would have exempted the ILECs from paying termination fees to CLECs, while the CLECs would still be required to pay fees to the ILECs.<sup>29</sup> "In other words, it changes the Act so that a business is required to provide a service for free to its competitors,"<sup>30</sup> reported Joan Smith, Commissioner of the Oregon Public Utility Commission and chairman of the National Association of Regulatory Utility Commissioners (NARUC) Committee on Telecommunications. In her testimony at the legislative hearing before the Subcommittee on Telecommunications Trade & Consumer Protection, she continued,

Without revenues to offset the costs of providing telecommunications service, a company terminating calls (often a competitive local exchange carrier rather than an incumbent Bell company) would have to increase prices to offset the loss in reciprocal compensation revenues. This may choke the flow of investment in broadband services and new technologies. The increase in rates would make the company less competitive, and

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<sup>28</sup> Reciprocal Compensation Adjustment Act of 2000, HR 4445 (May 15, 2000) at <http://thomas.loc.gov/cgi-bin/query/z?c106:H.R.4445:>.

<sup>29</sup> "...no local exchange carrier shall be required to make any payment for the transport or termination of telecommunications to the Internet or any provider of Internet access service." See *supra* HR 4445 § 2(3)(A).

<sup>30</sup> Before a legislative hearing on HR4445, the Subcommittee on Telecommunications Trade & Consumer Protection (June 22, 2000) (prepared statement of the Honorable Joan Smith), at <http://com-notes.house.gov/ccheat/hearings106.nsf/a317d879d32c08c2852567d300539946/282119bb64fe9550852569060056a2ad?OpenDocument> (last visited Mar. 5, 2003).

it would, in turn, raise the ISP's costs, which, in turn, would raise the cost to consumers who access the Internet. Congress should not create a special exemption for the Bell companies who are seeking a legislative fix to system they fought hard to have in 1996.<sup>31</sup>

HR 4445 bill died in committee, but that was not to be the end of the Tauzin-Dingell efforts to legislatively skew the market in favor of the ILECs and their property interests.

### **Dismantling The 1996 Act: Tauzin Struts Back In**

The 107<sup>th</sup> Congress saw renewed life in favoring ILECs when Tauzin and co-sponsor Dingell introduced HR 1542: The Internet Freedom and Broadband Deployment Act of 2001.<sup>32</sup> Among other things, this bill would have amended The 1996 Act to give ILECs a way around the federal regulations requiring them to share parts (called unbundled network elements, or UNE)<sup>33</sup> of their extensive telephone network with CLECs on cost-based rates (as required by the 1996 Act):

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<sup>31</sup> Id.

<sup>32</sup> Internet Freedom and Broadband Deployment Act of 2001, HR 1542, at <http://thomas.loc.gov/cgi-bin/query/z?c107:H.R.1542:>.

<sup>33</sup> The "parts" are referred to in the 1996 Act as unbundled network elements (UNE). From the revised 1934 Act, 47 U.S.C. 153 § 3:

Definitions. (29) NETWORK ELEMENT.--The term "network element" means a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment, including subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service.

(E) SCOPE.—Notwithstanding any provision of law, neither the Commission nor any State shall—

(i) require an incumbent local exchange carrier to provide unbundled access in accordance with subsection (c)(3) to any packet switching network element;

(ii) require an incumbent local exchange carrier to provide, for the provision of high speed data service, access on an unbundled basis in accordance with sub-section (c)(3) to any fiber local loop or fiber feeder subloop; or

(iii) require an incumbent local exchange carrier to provide for collocation in accordance with subsection (c)(6) in a remote terminal, or to construct or make available space in a remote terminal.<sup>34</sup>

The United States Telecom Association, backed by the ILECs and others,<sup>35</sup> claim this bill is necessary because of the imbalance in rules and regulations governing broadband services, specifically resulting in cable companies having about 70 percent of the residential market.<sup>36</sup>

At the heart of the issue is competition between the four so-called "Baby Bells" ... and the cable companies. The Baby Bells have long complained that cable, satellite and wireless broadband providers do not face the same regulatory hurdles as sellers of digital subscriber line (DSL) and other telephone-based broadband delivery services.

In order to better compete against cable, the local phone companies say, they need a level regulatory playing field. Currently, cable television companies control about 68 percent of the broadband market. ... "There's a firestorm going on out there" ... "Everybody, regardless of the future potential for profits or meeting customer requirements, is hell-bent on

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<sup>34</sup> *Supra*, HR 1542 § 232(j)(1)(E).

<sup>35</sup> USTA Carrier Members list, at <http://usta.org/fullmem.html>.

<sup>36</sup> *Four Reasons to Support Tauzin-Dingell*, United States Telecom Association, at [http://www.usta.org/four\\_reasons.pdf](http://www.usta.org/four_reasons.pdf) (last visited Mar. 5, 2003).

hanging on to what they've got."<sup>37</sup>

The Heritage Foundation's James Gattuso goes further, concluding "Broadband technologies hold great promise for American consumers, as well as for the U.S. economy. Thus far, progress toward realizing that promise has been good, but unless policymakers reduce the regulatory barriers to investment, it will be limited."<sup>38</sup>

While de-regulation does support the property rights model of corporate ownership, it does not generally address monopoly-based power and market inequalities such as between ILECs and their competitors. Furthermore, it does not address problematic or fraudulent methods used to account for what one's property is.<sup>39</sup> More importantly, the private property

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<sup>37</sup> Tim McDonald, *Analysts: Broadband Competition a 'Firestorm'*, E-Commerce Times (June 27, 2002), at <http://www.ecommercetimes.com/perl/story/18412.html>.

<sup>38</sup> James Gattuso, *The Tauzin-Dingell Telecom Bill: Untangling the Confusion*, Thomas A. Roe Institute for Economic Policy Studies, The Heritage Foundation (February 25, 2002), at <http://www.heritage.org/library/execmemo/em802.html> (last visited Mar. 5, 2003).

<sup>39</sup> One example of this is an accounting methodology called Total Element Long-range Incremental Cost, or TELRIC, which sets prices that ILECs charge for interconnecting to their network. ILECs charge that it doesn't allow the incumbent to recover their actual network costs. In *Verizon Comm., Inc. v FCC*, No. 00-511, slip op. at 54-55 (8<sup>th</sup> Cir. May 13, 2002), the court stated,

This challenge must be assessed against the background of utilities' customary preference for extended depreciation schedules in ratemaking (so as to preserve high rate bases), see n. 8, *supra*; we have already noted the consequence of the utilities' approach, that the "book" value or embedded costs of capital presented to traditional rate-making bodies often bore little resemblance to the economic value of the capital. See FCC Releases Audit Reports on RBOCs' Property Records, Report No. CC 99-3, 1999 WL 95044 (FCC, Feb. 25, 1999) ("[B]ook costs may be overstated by approximately \$5 billion"); Huber et al. 116 (We now know that "[b]y the early 1980s, the Bell System had accumulated a vast library of accounting books that

rights of government-granted monopolies have always been subject to regulation and supervision. Common carriers have long been charged with the obligation to act in a reasonable and non-discriminatory manner. Here, the 1996 Act and FCC interpretations are designed to put constraints on the monopoly players in order to correct market failure (including that induced by monopoly). "No monopolist is entitled to be protected from the effects of technological change. The policy of the 1996 Act is to assist the forces relying on new technology to undermine the traditional monopoly."<sup>40</sup>

A very different House of Representatives from the one that helped design and approve the 1996 Act voted to pass HR 1542. The votes were split among financial lines: those that supported the bill had, for the most part, accepted greater campaign and PAC contributions from the ILECs than from their competitors.<sup>41</sup> The bill, however, did not fare as well in the Senate where Senator Fritz Hollings, the Ranking Democrat on the Commerce, Science and Transportation Committee and a principal author of The 1996

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belonged alongside dime-store novels and other works of fiction. . . . By 1987, it was widely estimated that the book value of telephone company investments exceeded market value by \$25 billion dollars"). TELRIC seeks to avoid this problem by basing its valuation on the market price for most efficient elements; when rates are figured by reference to a hypothetical element instead of an incumbent's actual element, the incumbent gets no unfair advantage from favorable depreciation rates in the traditional sense.

<sup>40</sup> Chris Savage, from Cole, Raywid & Braverman, in personal email, June 20, 2003.

<sup>41</sup> *Money Talks in the Tauzin-Dingell Bill Contributions Correlate Strongly with Final Vote* (Feb. 28, 2002) at [http://www.opensecrets.org/alerts/v6/alertv6\\_44.asp](http://www.opensecrets.org/alerts/v6/alertv6_44.asp) (last visited Mar. 3, 2003). Also see: *Issue Profile: Telecommunications*, The Center for Responsive Politics (Feb. 27, 2002) at <http://www.opensecrets.org/news/telecom/index.asp> (last visited Mar. 2, 2003).

Act,<sup>42</sup> opposed it. Tauzin has vowed to continue his work.

## **Dismantling The 1996 Act: The FCC “Deregulates”**

On Feb. 20th, 2003, the FCC culminated its second Triennial Review by announcing its plan<sup>43</sup> for the telephone and DSL-based broadband networks. In essence,<sup>44</sup> the plan allows competition in narrowband local phone services, but denies all but the wish for meaningful competition in broadband connectivity.<sup>45</sup> The effect is that we are likely to have even fewer ISPs and less choice in broadband providers, more restrictions and less innovation in DSL service, and no real hope for faster (fiber) deployment.<sup>46</sup>

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<sup>42</sup>Senator Fritz Hollings’ biography, at <http://www.senate.gov/~hollings/bio.html> (last visited Mar. 5, 2003).

<sup>43</sup> *FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers* (FCC Press Release, Feb. 20, 2003) at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-231344A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A1.pdf) (last visited Feb. 20, 2003).

<sup>44</sup> The plan’s details have not been released as of this writing. The FCC normally announces its major decisions at a formal public meeting, with the actual written ruling implementing a decision coming later—sometimes much later.

<sup>45</sup> Ray Le Maistre, Editor, and Jo Maitland, Senior Editor, *Covad Bends Commissioner Martin’s Ear*, Boardwatch (Apr. 16, 2003) explained the situation this way:

To recap, on Feb 20, the FCC announced a decision that four regional Bell operators in the U.S. ... should no longer be obliged to provide competitors with cheap line-sharing access to their broadband networks. That decision, regarded by many in the U.S. telecom industry as a death knell for ISPs that rely on cheap access to the RBOCs’ networks, was made on a three-to-two vote by the five FCC commissioners....

<sup>46</sup> “The immediate response of all the RBOCs [to the FCC’s Feb. 2003 announcement] was that they’re not going to spend until they win on UNE-P.” *Quoted from* Eugenie Larson, *Will RBOCs Spend More on Broadband?*, Light Reading (Feb. 26, 2003), at [http://www.lightreading.com/document.asp?doc\\_id=28972](http://www.lightreading.com/document.asp?doc_id=28972) (last visited May 17, 2003). This is supported by the Bells’ own statements, e.g., “...today’s

Much of the controversy centers on rules for Unbundled Network Elements (UNEs). Four main points are of interest (each discussed in more detail below) are:

- 3-year phase out of line sharing
- expanded role of states in assessing which UNEs will be available
- elimination or phasing out of ILEC unbundling requirements for fiber-related resources
- likely impact on consumers, non-profits, and small businesses

### **3-year phase out of line sharing**

Under 47 USC § 251(d)(2)(B), the FCC must decide which network elements should be unbundled (and which ILECs must make available to CLECs). In 1999, the FCC had redefined “market impairment” as a basis for unbundling elements.<sup>47</sup> In *United States Telecom Ass’n v FCC*, 351 U.S. App. D.C. 329, 290 F.3d 415 (May, 2002), the court considered the FCC’s implementation of the Local Competition Order (requiring ILECs to lease a variety of network elements, explained below, to competitors) and the Line Sharing Order (requiring unbundling of parts of the copper loop for DSL

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switching decision will mean that regulation continues to stifle capital investment and research and development in the telecom industry.” (Duane Ackerman, Chairman & CEO, BellSouth Corporation (Feb. 20, 2003).) “This ‘worst of both worlds’ situation is forcing SBC and others to carefully consider how they will invest, where they will invest, how many people to employ and even what kind of consumer services to deliver.” (William Daley, President, SBC Communications (Feb. 25, 2003).)

<sup>47</sup> Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 , Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696 (1999).

competitors). Both orders were remanded to the Commission for reconsideration. The court determined that the guidelines didn't take into account "alternative elements outside the incumbent's network."<sup>48</sup> Furthermore, "the Commission decided to make its unbundling requirements (except for two elements) applicable uniformly to all elements in every geographic or customer market."<sup>49</sup>

As to almost every element, the Commission chose to adopt a uniform national rule, mandating the element's unbundling in every geographic market and customer class, without regard to the state of competitive impairment in any particular market. As a result, UNEs will be available to CLECs in many markets where there is no reasonable basis for thinking that competition is suffering from any impairment of a sort that might have the object of Congress's concern.<sup>50</sup>

The FCC's 1999 order had defined a copper wire (like the kind coming into most homes and many businesses) as having two parts: a lower-frequency portion used to carry analog circuit-switched voiceband transmissions, and a high-frequency portion, above the voiceband, which allows a digital signal to travel on the line at the same time.<sup>51</sup>

The FCC didn't take into account, however, the broadband competition

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<sup>48</sup> USTA v FCC, *supra*, p. 9.

<sup>49</sup> Id.

<sup>50</sup> Id, at p. 17.

<sup>51</sup> USTA v FCC, *supra*, p 14-15, notes the frequencies as typically between 300 hz and 3.4 khz for the voiceband, 20 khz and above for the high-frequency part. For comparison, the range for human hearing is typically between 20 hz – 20 khz, *cited in* Clinton Colmenares, *Research explores how we hear, how to hear better*, The Reporter, Vanderbilt University Medical Center (May 21, 2003) at <http://www.mc.vanderbilt.edu/reporter/?ID=2036> (last visited May 21, 2003).

from non-LECS such as cable, and to a lesser extent, satellite. The DSL market, according to this court, is already competitive in many areas (therefore not impaired), and the FCC didn't properly explain why unbundling the high-speed portion of copper lines was needed. The DC Circuit ruled that the FCC's generic UNE rules did not do a sufficiently detailed "impairment analysis."

Over-reacting to this and other conservative court decisions, and choosing to ignore the needs of the high-speed access market it just helped to create,<sup>52</sup> the FCC's Order on Remand<sup>53</sup> has a presumptive finding of no economical or operational market impairment, defined by whether "the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer."<sup>54</sup>

The states can rebut this finding within 90 days; if they do not, local circuit switching ("a key ... element for business customers served by high-

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<sup>52</sup> In *Telecom Investment Bonanza*, author Bruce Fein cites the Phoenix Center Policy Bulletin No. 4 as associating the 1996 Act with a boost of \$267 billion in investment over a 5 year period. As to UNE prices, Fein points out that "the marketplace behavior of the Baby Bells convincingly discredits the theory of below-cost pricing of UNEs." He concludes, "to jettison the winning UNE formula would smack of regulatory irresponsibility." The article is from TechCentral, at <http://www.techcentralstation.com/1051/techwrapper.jsp?PID=1051-250&CID=1051-071103D> (last visited July 14, 2003).

<sup>53</sup> *Attachment to Triennial Review Press Release* (Feb. 20, 2003) at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-231344A2.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A2.pdf) (last visited Feb. 20, 2003).

<sup>54</sup> *Supra*, 47 USC § 251(d)(2)(B)

capacity loops"<sup>55</sup>) will no longer be unbundled. Under the FCC's new rules, DSL-based ISPs like Covad and Earthlink, will be transitioned off of their use of the high-capacity portion of the network within three years. This translates to higher rates and/or unavailable access for competing DSL-based ISPs. Of the 19M current broadband subscribers, 6.8M use DSL; and of those, the four RBOCs control 87.8% of the market.<sup>56</sup> Given past ILEC behavior, it's hard to imagine a reason why the ILECs wouldn't put competing DSL providers out of business in short time.

The FCC's direction under Commissioner Powell supports "Intermodal" competition, a facilities-based view of telecommunications. The 1996 Act does not specify a facilities-based market:

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States, ... a rapid, efficient, nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges...<sup>57</sup>

Rather, it encourages the idea of promoting competition and free markets, not protecting one industry at the expense of another. "Intermodal"

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<sup>55</sup> From the *Attachment to Triennial Review Press Release*, FCC (Feb. 20, 2003), at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-231344A2.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A2.pdf) (last visited Feb. 20, 2003). Loops are defined as "a telephone line that runs from the customer's premises to the ILEC 'end office,' which houses switches used to route calls to their destination." *In Competitive Telecoms. Ass'n. v FCC*, 309 F.3d 8 (Oct. 2002).

<sup>56</sup> *Broadband Internet Grows to 19 Million in the U.S.*, Leichtman Research Group at <http://www.leichtmanresearch.com/press/051603release.html> (May 16, 2003).

<sup>57</sup> 47 USCS § 151 (1997), from *Purposes of Chapter* section.

refers to competition between cable operators, wireline telephone companies, providers of wireless telecommunications services and satellite communications firms.<sup>58</sup> Commissioner Powell hails this free market concept: "Thus, if you are truly committed to serving the public interest, bet on a winner and bet on market policy."<sup>59</sup> Citing Powell's view of the public interest, however, Robert McChesney said,

He is a nice, sincere guy. He is also a figure resolutely opposed to the very notion of the public interest. I think he believes that government is evil and that business will automatically regulate itself. It's a free-market faith, and since it is a faith, it requires no empirical verification.<sup>60</sup>

Indeed, when asked at his first news conference for his definition of "the public interest,"

Powell joked, "I have no idea." The term can mean whatever people want it to mean, he said. "It's an empty vessel in which people pour in whatever their preconceived views or biases are." His job, he claimed, is making sure that the public benefits, "and not necessarily the industries or the barons" who have a stake in FCC decisions. Beyond that, he said, "I don't know. I am still trying to figure it out."<sup>61</sup>

Responding to the FCC's proposal for intermodal competition, several

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<sup>58</sup> Defined in *FCC Court Brief Underscores Consumer Benefits from National Internet Policy of Unregulation; Urges Narrow Judicial Resolution*, Aug. 16, 1999, at [http://ftp.fcc.gov/Bureaus/Miscellaneous/News\\_Releases/1999/nrmc9060.html](http://ftp.fcc.gov/Bureaus/Miscellaneous/News_Releases/1999/nrmc9060.html) .

<sup>59</sup> Janine Jackson, *Their Man in Washington: Big media have an ally in new FCC chair Michael Powell*, FAIR, Sept-Oct. 2001, <http://www.fair.org/extra/0109/powell.html>.

<sup>60</sup> Neil Hickey, *Unshackling Big Media*, Columbia Journalism Review, July-Aug. 2001, <http://www.cjr.org/year/01/4/fcchickey.asp>.

<sup>61</sup> Id.

public interest groups charged the FCC with violating the 1996 Act and creating bad public policy that would “allow facilities owners to discriminate against rivals or among content providers, deregulate the Bells allowing them to withhold access to advanced telecommunications functionalities of their networks, and perpetuate broadband monopolies that would subject consumers to higher prices and fewer choices.”<sup>62</sup>

Pitting one monopoly ILEC against one monopoly cable company (in many geographic areas) for broadband services denies real broadband competition such as that which we’ve seen over the last few years. To be sure, the little guys’ days are numbered.

### **Expanded role for states**

Who decides if a CLEC would be economically or operationally impaired without access to a particular UNE? Under the new plan, states do.

Commissioner Kevin J. Martin, in his press statement about this Review, hailed,

During my time at the Commission, I have witnessed first hand the helpful role that the states have played in our mutual goal of implementing the Telecommunications Act. I believe that the states are best positioned to make the highly fact intensive and local "impairment" determinations required by the Court of

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<sup>62</sup> Cited from Consumer Federation of America’s press release, *Consumers Assail FCC Broadband Proposal, Cite Threat to Net, Consumers: FCC Proposal Violates the Law*, May 2, 2002, <http://www.consumerfed.org/wirelinereleasefinal.pdf> . The groups filing comments include Consumer Federation of America, the Texas Office of Public Utility Counsel, Consumers Union, Media Access Project, the Center for Digital Democracy and other state and local groups.

Appeals.<sup>63</sup>

Commissioner Martin refers the states to the FCC guidelines and roadmaps (to be published soon) for analyzing their markets,<sup>64</sup> but Chairman Michael K. Powell expressed concern that the guidelines won't help.<sup>65</sup>

Two consequences are clear: First, the states and Public Utility Commissions (PUCs) are often ill-funded and not entirely ready to properly deal with this sudden increase in responsibilities.<sup>66</sup> They will need to develop rules and procedures for dealing with UNE issues.

Second, the implementation of standards and access will vary widely from state to state. This is divergent from an earlier-stated intent: "Major objective of 47 USCS §§ 151 et seq. is to grant Commission sufficient authority to insure that regulatory policies relating to common carrier services will be developed and administered in uniform, consistent manner. Re Establishment of Interstate Toll Settlements, FCC 83-180 (Adopted Apr. 27, 1983)."<sup>67</sup>

Some states fully support the monopoly stronghold of the ILECs (e.g.,

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<sup>63</sup> Commissioner Kevin J. Martin's Press Statement on the Triennial Review (FCC Press Release, Feb. 20, 2003) at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-231344A7.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A7.pdf).

<sup>64</sup> *id.*

<sup>65</sup> Separate Statement of Chairman Michael K. Powell (Dissenting in Part, Feb. 20, 2003) at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-231344A3.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A3.pdf).

<sup>66</sup> Headlines are filled with stories about states' budgets in crisis. See e.g., <http://news.google.com/news?hl=en&q=national+state+%22budget+crisis%22&btnG=Search+News>.

<sup>67</sup> *Supra*, 47 USCS § 151, at §§ I(2): Purpose.

IL,<sup>68</sup> SC<sup>69</sup>). In contrast, other states have taken active roles in setting the terms and conditions on which incumbent telecom carriers must provide access to their networks to CLECs, including municipalities. Chairman Powell perhaps summed this situation up best when he said,

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<sup>68</sup>In a move particularly reminiscent of Chicago's corrupt political past, the Illinois State Senate, in May 2003, overrode the FCC and the state PUC, by allowing SBC to double UNE-P cost to competitors, ostensibly to "protect jobs." Of particular note: Chicago mayor Richard Daley's brother is William Daley, recently hired SBC president. William is well paid in his new position: \$612k salary, \$809k in bonuses, plus a \$1M signing bonus (from SEC filings last March). The new law was passed within hours of its proposal by state legislators including one whose wife is an SBC lobbyist. *For more on this, see local coverage at <http://www.chicagotribune.com/news/chi-0305100057may10,1,6811803.story>. A motion for a preliminary injunction was granted one month after the bill passed. *Voices for Choices v. Ill. Bell Tel. Co.*, 2003 U.S. Dist. LEXIS 9548 (May 9, 2003), based on a finding that the IL Legislature did not have the expertise to pass this bill, and that the rates allowed by the bill were in conflict with the earlier TELRIC decision in *Verizon*, supra.*

<sup>69</sup> See H3344 (Rat # 0011, Act # 0006): *An Act To Amend Section 58-9-10, As Amended, Code Of Laws Of South Carolina, 1976, Relating To Definitions Pertinent To The Regulation Of Telephone Companies, So As To Provide A Definition For "Broadband Service"; And To Amend Section 58-9-280, As Amended, Relating To The Circumstances Requiring A Telephone Company To Obtain A Certificate Of Public Convenience And Necessity, So As To Exempt Broadband Service From Regulation By The Public Service Commission And To Provide An Exception For Facilities Used By Rural Telephone Companies For The Provision Of Broadband Service, To Clarify That This Act Does Not Affect The Commission's Authority With Respect To Services Other Than Broadband Service And Does Not Relieve An Incumbent Local Exchange Carrier Of Its Obligations Under Federal Law To Provide New Local Exchange Carriers With Unbundled Access To Network Elements Or Interconnection, To Specify Information That The Commission Must Compile In Order To Monitor The Status Of Local Telephone Competition In The State, And To Provide That This Act Does Not Preclude The Commission From Assessing Broadband Service Revenues For Purposes Of Contributions To The USF.* (Ratified title, exempting broadband service from regulation by the public service commission, signed by Governor Mar. 12, 2003) at [http://www.lpittr.state.sc.us/sess115\\_2003-2004/bills/3344.htm](http://www.lpittr.state.sc.us/sess115_2003-2004/bills/3344.htm). South Carolina legislature and BellSouth cite myriad benefits of their newly passed legislation in Marcia Purday's article, *BellSouth announces major investment in broadband technology in South Carolina; Passage of State Broadband Bill makes new technology offer possible*, Swamp Fox (Apr. 9, 2003), at <http://www.swampfox.ws/velocity.nsf/0/0050c57319d90df185256d03008003ed>.

The nation will now embark on 51 major state proceedings to evaluate what elements will be unbundled and made available to CLECs. These decisions will be litigated through 51 different federal district courts. These 51 cases will likely be decided in multiple ways—some upholding the state, some overturning the state and little chance of regulatory and legal harmony among them at the end of the day. These 51 district court cases are likely to be heard by 12 Federal Courts of Appeals—do we expect they will all rule similarly? If not, we will eventually be back in the Supreme Court of the United States to resolve any conflicts—the same Court that vacated our excessively permissive unbundling regime in 1999. This process will take many years and will hardly be the quieting and stabilizing regime that was so craved by a rocky market.<sup>70</sup>

Indeed. The legal battles began almost immediately. The Washington Post reported that:

The major regional phone companies yesterday promised a court fight to overturn rules governing competition for local telephone service that were approved last week by the Federal Communications Commission.

Two of the four former Bell companies, SBC Communications Inc. and BellSouth Corp. also renewed promises made after the vote that they would not invest in new, high-speed Internet networks unless the local telephone rules are scuttled.<sup>71</sup>

The Bells are seeking a complete, unregulated monopoly which would allow them to limit the effects of changing technology, indefinitely avoid meaningful quality improvements (such as the faster, better and cheaper computing technology that much of today's communication relies on), and reducing costs for home and business customers. It's hard to imagine a

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<sup>70</sup> *Supra*, Separate Statement of Chairman Michael K. Powell.

<sup>71</sup> Jonathan Krim, *Bell Firms Pledge to Fight New FCC Rules: Voice-Network Sharing To Be Fought in Court*, The Washington Post, p E01 (Feb. 25, 2003), at <http://www.washingtonpost.com/wp-dyn/articles/A62234-2003Feb24.html> (last visited Mar. 5, 2003).

better way to discourage a lively, competitive telecommunications future.

### **Elimination or phasing out of ILEC unbundling requirements for fiber-related resources**

Ostensibly to encourage the investment in and development of broadband (DSL and fiber-to-the-home) services, the FCC says that the fiber lines—which ratepayers have long been funding and which ILECs have long promised to deliver<sup>72</sup>—don't have to be shared. Furthermore, as fiber elements are incorporated into the copper network, these hybrid networks don't have to be shared either.<sup>73</sup> Here again, the FCC is supporting the monopoly advantage over competition mandated by the 1996 Act.

One might reasonably ask how a DSL competitor will survive if they don't have access to the existing phone network. It is unrealistic to assume that competitors will be willing or able to invest in building entirely new infrastructure. This is a daunting task in the best of circumstances, and is simply not practical given the capital markets' current view of telecom ventures. The Bells' networks were funded by regulated rates during a time

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<sup>72</sup>See e.g., *The Tell-The-Truth Broadband Challenge to Verizon vs "The Verizon 100 Megabit Challenge,"* NewNetworks (Mar. 28, 2003) at <http://www.newnetworks.com/tellthetruthverizon.htm>. This report cites Bell Atlantic, now Verizon, considered DSL a temporary technology, and that "in Bell Atlantic's 1993 Annual Report, the company stated it would spend \$11 billion and have 9 million households wired [with fiber optic lines] by 2000." Additionally, Bruce Kushnick published a report, *How The Bells Stole America's Digital Future*, holding that "Consumers have already paid over \$45 billion in extra telephone charges, and continue to pay over \$8 billion annually." (June 2000) at <http://www.netaction.org/broadband/bells/> .

<sup>73</sup> *Supra*, FCC Adopts New Rules.

when competition was not a realistic threat. Competitors today, however, have no such regulatory protection and, therefore, vastly inferior access to the necessary capital. Additionally, they don't have a strong basis for resale or UNEs guaranteed by the 1996 Act to offset the ILEC's monopoly advantages.

### **Likely impact on consumers, non-profits, and small businesses**

The Office of Advocacy of the Small Business Administration, in February 2003, warned that the FCC's announced actions would have "a drastic effect on small businesses,"<sup>74</sup> especially competitive local carriers (CLECs). In a paper called "The Future of the Regional Bells,"<sup>75</sup> consumer advocacy group NetAction examined the monopolistic abuses and consequent failure of competition to arise in such an environment. Furthermore, pro-consumer groups such as TeleTruth and others have pointed out that the ILECs have long charged ratepayers for broadband networks and services that we will never receive.<sup>76</sup> State PUCs may well be required to increase

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<sup>74</sup> Letter from SBA's Office of Advocacy to Chairman Michael K. Powell, *Ex Parte Presentation in a Non-Restricted Proceeding, Initial Regulatory Flexibility Analysis for Triennial Review of Unbundled Network Elements*, CC Dkt. No. 01-338; CC Dkt. No 96-98, CC Dkt. No. 98-147 (Feb. 5, 2003) at [http://www.sba.gov/advo/laws/comments/fcc03\\_0205.html](http://www.sba.gov/advo/laws/comments/fcc03_0205.html) (last visited Mar. 4, 2003).

<sup>75</sup> Judi Clark, *The Future of the Regional Bells*, NetAction (May 2002) <http://netaction.org/futures/BellsFuture.htm> (last visited Mar. 6, 2003).

<sup>76</sup> Bruce Kushnick, *How Much Money Did the Bell Companies Collect From Customers for Broadband Networks They Will Never Receive? : Teletruth Finds that the FCC's Broadband Analyses Are Seriously Flawed and Calls for a "Broadband True-Up", Not a "Customer Takings"*, Complaint to the FCC, TeleTruth (Feb. 19, 2003) at <http://www.newnetworks.com/FCCbroadbandcomplaint.htm> (last visited 4 March 2003).

staff to handle growing administrative duties imposed by the FCC, but staff increases will not begin to equal the layoffs from CLECs, ISPs, and equipment manufacturers to come.

We don't have an entirely unregulated communications monopoly yet; but the Bells are working on it. For example, SBC has already begun disconnecting user DSL services when they chose another local phone provider; tying services (a common monopoly strategy) is in their plans. This isn't new: SBC has a long history of being uncooperative,<sup>77</sup> as do other ILECs.<sup>78</sup>

We have learned over time that monopoly incumbents must be regulated more than new entrants if we want to encourage competition to take hold. (Examples: trucks vs. trains, cellular vs. landline telephones, digital broadcast satellite vs. cable...) Under the guise of promoting competition, the FCC is enabling the telecommunications industry to stand still. The FCC is operating as if technology is static and the existence of a monopoly doesn't change a market's competitive nature. Bottom line: We can expect to get less in terms of services and choices, and expect to pay more (monopoly rents) for it.

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<sup>77</sup> Marc Ferranti, *Stall Tactics: A telecom case study: SBC illustrates how RBOCs are thwarting competition*, Network World (Dec. 8, 1997) at <http://www.nwfusion.com/news/1997/1208rboc.html> (last visited Feb. 21, 2003).

<sup>78</sup> Kim Sunderland, *Competitive Covenants: Are BOCs Promising Too Much Too Soon?* Phone Plus Magazine (Nov. 2000) at <http://www.phoneplussmag.com/articles/0b1rnew1.html> (last visited Mar. 4, 2003).

## There Once Was A Market

Telecommunications technology has undergone rapid change and improvement over the last several decades.<sup>79</sup> Users in large corporate settings to small home offices follow the improvements, though users don't adopt new technology as fast as it changes.<sup>80</sup> Responding to the problems resulting from this technological evolution, the courts meander slowly behind, interpreting laws variously but overall in a positive direction. Federal law is subject to infrequent but significant changes,<sup>81</sup> and has been directly affected by corporate financial influences. Finally, the FCC, empowered to oversee and implement the changes of the 1996 Telecom Act, moves generally as Congress and the laws do. This includes set backs to the FCC and Congress in the form of judicial holdings signaling a change in approach is needed.

One might imagine, given these characteristics that the changes to

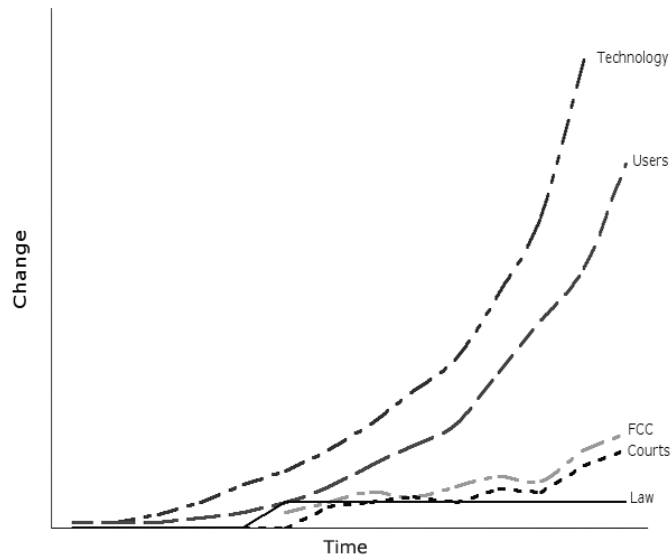
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<sup>79</sup> One of many stories exploring how telephony is transforming from a hardware-based industry to a software application that works over the Internet. Rachel Konrad, *Yahoo: Net will rattle phone industry*, Cnet News.com (May 10, 2000) <http://news.com.com/2100-1033-240390.html>. Also see Voice over IP, defined below.

<sup>80</sup> For perspective, see "A Nation Online: How Americans Are Expanding Their Use of the Internet" (February 2001), showing, for example, that over 50% of households with incomes averaging \$35,000/year or more, and 85% of households with incomes averaging over \$75,000/year, have computers with Internet access. *Details can be found at* <http://www.ntia.doc.gov/ntiahome/dn/hhs/HHSchartsindex.html> (last visited Apr. 16, 2003).

<sup>81</sup> The 1996 Telecommunications Act was the first major update to the 1932 Telecommunications Act.

this market over time might look like this:<sup>82</sup>



The growing gap between the users' interests (based on technical capabilities) and the law (as interpreted by the Congress, the FCC, and courts) is problematic because it reflects a gap in consumer expectations, lost economic opportunity, lost benefits to society, and more.

If the FCC were truly seeking to support broadband competition, they would radically deregulate the wireless (in progress, albeit at a slowed pace) and voice-over-cable markets. Regulatory price discrimination in telecommunications would encourage arbitrage on the price of bits—whether for voice or data—which would cause the price of moving bits across a network to decrease. To the contrary, the FCC is seeking “regulatory parity” and a “level playing field” for existing ILEC and cable monopolies.

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<sup>82</sup>This non-scientific graph merely illustrates one view of changing trends over time.

## Tauzin Swaggers Up to the Bar, Again

Tauzin, one of the more vocal critics of the FCC, said its new UNE plan "again points out the urgent need for Congress to enact new legislation designed to promote real—not phony—competition in the marketplace. Given the FCC's lack of leadership, I am now prepared to immediately begin that debate."<sup>83</sup>

Tauzin and Dingell are working on a new version of the bill that should be introduced soon. Staff members didn't address what specifics the new version might contain, but several sources said it could evolve to the point of declaring the broadband market for all providers--not just cable and DSL but satellite, wireless and others--off-limits for regulation. ...

Bells just want to see all broadband services unregulated, said SBC Communications spokesman Matt Miller. Regulating a Bell's DSL service doesn't foster the spread of that service, he said, adding, "this is a regulatory environment that is plagued with uncertainty."<sup>84</sup>

The only uncertainty that Miller speaks of, however, is the future of the DSL-based ISPs.

The Bells' strategy, almost certainly, is to improve their broadband networks only enough to be able to exclude competitors from connecting to them. This is a sensible course. Monopolists always act to limit supply in a market with sustained demand. That way, they can raise prices with impunity - and without making costly investments. ...

"The only thing that's going to get the Bells to spend is if we

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<sup>83</sup> Roy Mark, *FCC Frees Bells of Broadband Restrictions*, InternetNews (Feb. 20, 2003) at <http://www.internetnews.com/bus-news/print.php/1588441>.

<sup>84</sup> Patrick Ross, *Remaking the Telecommunications Act*, CNet News (Feb. 5, 2003) at <http://news.com.com/2102-1033-252065.html>.

see cable companies launch more voice-over-IP<sup>85</sup> services that begin to take away customers from the RBOCs," said Pat Hurley, an analyst with the consulting firm TeleChoice, quoted in Network World.

Forget the technicalities of VOIP. Hurley is speaking the obvious. Businesses invest when they feel the hot breath of their competitors on their necks.<sup>86</sup>

Tauzin, FCC Chairman Michael Powell, and a host of others, cried foul following the FCC's Feb. 20, 2003 announcement, claiming that it caused the major RBOCs to lose over \$15 billion in market cap. This claim will certainly be used to support Tauzin's future proposals for deregulating the Bells. The claim is "outrageously—and in many cases, intentionally—misleading."<sup>87</sup>

More important than the Bells' market caps are their assets, profits and dividends. Those are real. The assets - the things of hard value that the companies own - didn't drop at all on Feb. 20. And, in its most recent analysis, the respected Value Line Investment Survey projects net profits this year for the four Bells at \$17.9 billion. SBC continues to raise its dividend each year, as it has since it was created, and its return on equity last year was a hefty 21 percent. In a struggling economy, the two largest Bells alone generated an incredible \$39 billion in cash flow on \$120 billion in revenues. They aren't hurting.<sup>88</sup>

Keeping track of accounting costs does not seem to be an ILEC

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<sup>85</sup> Voice over IP, mentioned supra, is "the transmission of telephone calls over a data network like one of the many networks that make up the Internet. While you probably have heard of VoIP, what you may not know is that many traditional telephone companies are already using it in the connections between their regional offices." *Explained by Jeff Tyson, How IP Telephony Works, HowStuffWorks*, at <http://www.howstuffworks.com/ip-telephony.htm>.

<sup>86</sup> James K. Glassman, *Multi-Billion Dollar Fib*, Tech Central Station (Mar. 11, 2003) at <http://www.techcentralstation.com/1051/techwrapper.jsp?PID=1051-250&CID=1051-031103C>.

<sup>87</sup> Id.

<sup>88</sup> Id.

strength. Moreover, the FCC seems to be willing to overlook this fact.<sup>89</sup> Nonetheless, scandalous accounting methods and monopoly-sustaining politics should not be a valid reason to deregulate this industry. The 1996 Act calls for competition. The wisdom of an entire legislature, and not the biased vocal minority, should see the Tauzin-Dingell games for what they are: well-funded lobbying efforts by a special interest.

## **Conclusion**

Representatives Tauzin and Dingell have proposed legislation over the past Congressional sessions aimed at rolling back competition as outlined in the 1996 Act, by deregulating the incumbent local telephone exchange carriers, primarily benefiting the four regional Bell telephone companies. Their bias is obvious: their efforts have been funded by the Bells in a self-interested move to restrain competition and maintain their historic monopoly status. The FCC, with their announcement of Feb. 20, 2003, is headed in the same direction albeit under the rubric of intermodal, or facilities-based

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<sup>89</sup> In a 1999 News Release, an FCC audit found that “[t]he audit reports found that the RBOCs’ book costs may be overstated by approximately \$5 billion.” *FCC Releases Audit Reports On RBOCs’ Property Records*, Report No. CC 99-3 (Feb. 25, 1999) at [http://www.fcc.gov/Bureaus/Common\\_Carrier/News\\_Releases/1999/nrcc9015.html](http://www.fcc.gov/Bureaus/Common_Carrier/News_Releases/1999/nrcc9015.html). (This is an unofficial announcement of Commission action. Release of the full text of a Commission order constitutes official action. See *MCI v. FCC*, 515 F.2d 385 (D.C. Cir. 1974).) More information can be found on the FCC audits at <http://www.fcc.gov/wcb/asd/audits/>. The audits were not pursued by the FCC, as Chairman Powell dissolved the audit teams and the entire Accounting Safeguards Division as one of his first acts. Perhaps the letter from Tauzin and Dingell to the FCC had an effect, (Text of the letter is found at [http://www.house.gov/commerce\\_democrats/press/106ltr5.htm](http://www.house.gov/commerce_democrats/press/106ltr5.htm).) but it’s beyond the scope of this paper to look more closely at this issue.

competition. This author believes these moves are imprudent and not in the public interest.

The challenges certain to be raised in the courts over the next few years will help define the future of this tumultuous industry. It will be an interesting time to watch: Can the FCC save a dying industry?

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