March 31, 2004

The President
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Mr. President:

Mr. President, in your recent speech in Albuquerque, you championed "the spread of broadband technology."[1] We share that goal. However, achieving it requires a less restricted telecommunication sector in which innovators and investors can expect a fair return on their investment. Consumers have for too long been denied the benefits of a less regulated, more dynamic industry. Unfortunately, the FCC has been working to delay those gains by imposing "unbundling" rules that are harmful to investors and consumers, and that delay the expansion of broadband access. Fortunately, the D.C. Circuit Court has again rejected the FCC's effort to impose these regulations. We urge the Administration not to delay the spread of broadband technology any further. Specifically, we urge that the Administration *not* seek Supreme Court review of the Circuit Court's ruling. We ask that you instruct the Department of Justice and the Solicitor General to deny any request from the FCC or other parties for such review.

There is no need to litigate this matter any further. The first steps toward freeing the telecommunication sector were taken over two decades ago. Since that time, the FCC has fought a fierce rearguard battle to delay further liberalization. Indeed, the current FCC rules were the brainchild of Reed Hundt, one of the most pro-regulatory FCC Chairmen. Rules similar to those now under consideration have *already* been struck down three times: once by the Supreme Court and twice by a unanimous D.C. Circuit panel.

Consumers have been denied the benefits of new investments in telecommunication networks by these years of legal ambiguity. An appeal of the court's decision to the Supreme Court would continue this uncertainty for at least another year. The damage inflicted by these contentious regulations is apparent. Telecommunications stocks have been one of the worst performing sectors, even as the rest of the economy has begun to recover. If current regulatory uncertainty is not resolved, the telecom sector will continue to underperform, and the telecom companies will continue to underinvest.[2] The result will be that the U.S. will fall even further behind other countries in modernizing its telecommunications infrastructure.

The FCC has assumed that the unbundling regulations would boost competition and increase total investment in the industry. The investment gains were assumed to come from new companies; the regulations were considered likely to depress investment among incumbent companies. This assumption of an increase in total investment was not supported by theory, and has failed in practice, because investment in the sector has been depressed overall.

The investment decline is not surprising. It is the perfectly predictable outcome of the assault on property rights inherent in the forced sharing of facilities required by the FCC's rules. A new entrant able to demand access to an incumbent's network (especially at the cheap regulated rates authorized by the FCC) has much less incentive to build its own network. Similarly, if an incumbent must share the benefits of any upgrades with its competitors, there will be less reason for it to invest in them. Professor Alfred Kahn, one of this nation's foremost regulatory

[1] Mike Allen, "Bush Sets Internet Access Goal," Washington Post, Saturday, March 27, 2004, p. A4.

[2] Thomas Hazlett, Arthur Havenner and Coleman Bazelon have found that the capital stock of incumbent telephone networks has fallen sharply from its 1996 peak. In 2003, investment as a percentage of revenues actually fell below the level believed necessary to maintain existing facilities. If regulatory uncertainty continues, networks will decline and services will deteriorate.

economists, has written: "It would be difficult to imagine an arrangement [the situation created by current FCC rules] more hostile to the risky and costly investments in modern telecommunications infrastructure and the development of the new products and services that it makes possible."[3]

Businesses now taking advantage of current FCC rules characterize themselves as free-market "competitors," but they would be more accurately labeled as resellers of telecommunication services created and provided by others. They exploit the FCC's rules to obtain forced access to all the necessary facilities, which have been created by other companies. Under current FCC rules, they often obtain that access at very steep discounts. Their customers continue to use the same facilities in the same way. The revenues, however, rarely are invested in new capacity or technology. Thus, such "competitors" are better viewed as unnecessary middlemen rather than serious innovators or investors in the telecommunication sector. Robert W. Crandall and Hal J. Singer have concluded that the inefficient FCC sanctioned "churning" of accounts encouraged by forced access rules destroys 1300 jobs for every million lines that are switched away from the incumbent's service.4

Whatever the logic of the original telecommunication regulatory structure, it is clear that FCC's current interference in the free market is excessive. There are already many competitive alternatives to traditional local phone service. Cable telephony is widespread. Many consumers use wireless phones instead of wirelines. Additional competition is rapidly developing in the form of *Voice over Internet Protocol* ("VoIP"). VoIP allows anyone with a broadband connection (either cable or wireline) to obtain high-quality local and long-distance voice service at extremely attractive rates. Because 89% of Americans now have access to broadband and more than 20% use it, there is an enormous potential market for this competitive alternative.[5]

The communications industry is at a historical turning point. New broadband networks are the future in voice (and data) communications. As broadband becomes ever more available and affordable, we can expect rapid growth in new products and technologies, creating gains in jobs and productivity that will benefit all Americans. We ask that this Administration focus on the gains to the American economy and the American consumer from encouraging new investment in broadband, rather than on defending the current regulatory regime. The first step is to reject further delays. We urge that this Administration take that decisive step.

Sincerely,

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[3] Alfred E. Kahn, *Regulatory Politics as Usual*, Policy Matters 03-3 (Mar. 2003) http://www.aei.brookings.org/policy/page.php?id=127.

[4] Robert W. Crandall and Hal J. Singer, *An Accurate Scorecard of the Telecommunications Act of 1996: Rejoinder to the Phoenix Center Study No. 7,* p. 1 (Jan. 2004) http://www.criterioneconomics.com/news/news29.php.

[5] S. Rosenbush, *et al.*, *Broadband: What's the Holdup?*, Business Week (Mar. 1, 2004); J. Halpern, *et al.*, Bernstein Research Call, *Broadband Update: DSL Share Reaches 40% of Net Adds in 4Q . . . Overall Growth Remains Robust* at Exhibit 1 (Mar. 10, 2004).

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Honorable Michael Powell, Chairman of the Federal Communications Commission
Honorable Kathleen Abernathy, Commissioner of the Federal Communications Commission
Honorable Kevin Martin, Commissioner of the Federal Communications Commission
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