

## **The Fight For Telecom Reform – Reforming the 1996 Telecommunications Act is going to be a mammoth battle**

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The good news is all the combatants realize it's a war that needs to be fought.

There's good news and bad news in the wonky world of telecom reform. The good news is that everyone involved—members of Congress, the Federal Communications Commission and state regulators—realize reform is inevitable. The current communications law is woefully ill-suited for the ever-changing communications market and ongoing Internet revolution. The bad news is the wheels of legislative reform grind slowly—and in this case, unpredictably.

So what's a would-be reformer to do?

The path toward reform begins with the admission of a problem. The basic quandary in telecommunications regulation lies in the legislature's attempt to classify different types of communications services. Current telecom law uses two major categories to classify communications technologies: a "telecommunications service," such as your local and long-distance phone service, is the most highly regulated category; an "information service," currently defined as involving the transmission of data that requires manipulation (including the breaking up of data into packets), refers to such services as Internet access, e-mail and cable television and is lightly regulated.

These technology-based categories create distinctions that no longer make sense in our technologically converged world. Thanks to VoIP (Internet telephones), local phone service is no longer just an analog transmission over the telephone network. In addition, cable services can include two-way voice transmissions that resemble telecommunications services. Artificial regulatory distinctions have created market disparities that have hurt consumers and set an unbalanced playing field for communications companies.

Recognizing the need for reform leads to the inevitable question—how do we go about doing it? There are numerous proposals under debate among telecom policy wonks, and each one is a variant of two major reform scenarios—"big bang" or "slice and dice." A "big bang" scenario involves the comprehensive overhaul of the Communications Act of 1934 (as well as the Telecommunications Act of 1996). The "slice and dice" approach examines discrete issues based on technology or service sector.

### **Coming to grips with the reality of the communications market**

Responding to new technology and consumer demand, the telecom market has outgrown the strictures imposed by Congress in the Telecommunications Act of 1996. The legal distinctions do not embrace the reality of the marketplace and the way that consumers use their communications devices.

AT&T, for years known as your local phone company, has gradually shifted its focus away from providing “traditional” phone service. AT&T made an announcement in July 2004 that it will stop investing in residential local and stand-alone long distance phone service. Instead, it will put its resources into VoIP (Voice over Internet Protocol), where it recently extended its offering into 100 major markets in 32 states. This is not a statement of defeat by AT&T but rather a declaration of its vision for the future of communications.

Likewise, Verizon Communications is the first of the former Bell companies to deploy a nationwide consumer VoIP service. Along with AT&T, it is now competing against other, smaller companies such as Primus, Skype and Vonage.

Wireless continues to grow as a substitute for traditional land-line phones. Verizon’s 2004 second-quarter financial data shows that the majority of its revenue came from wireless, data and long-distance services. The number of its residential phone lines and revenue from traditional residential service is declining.

BellSouth, SBC and Verizon are investing billions of dollars into fiber, potentially offering consumers a media triple-play—telephone, Internet and television service. At the same time, cable television providers now compete against the phone companies by offering telephone service in addition to Internet and television.

New technologies create new competition. However, current telecom regulations do not account for these forms of cross-technology “intermodal” competition because the rules are technology-specific.

### **National telecom reform requires consensus of the states**

The communications market continues to evolve despite a lack of massive regulatory certainty. *This uncertainty is caused, oddly enough, by the 1996 Telecom itself.* The 1996 Telecom Act instituted a form of cooperative federalism in the regulation of local wireline phone service—that is, it attempted to decentralize regulation by devolving responsibility to the states. The FCC’s role was to create broad policy objectives. State regulators would manage a system of wholesale price controls over “unbundled network elements” to try to stimulate competition by facilitating entry of new companies into the field; that would then set the stage for deregulating local markets entirely. It was envisioned that federal and state regulators would interact harmoniously, but it hasn’t worked out that way. Instead, the past eight years has seen the telecommunications industry stuck in the midst of a state and federal governmental power grab.

Federalism is codeword for the shifting of power between the federal government and states. For much of the last century, the trend was to transfer power from the states to the federal government. However, thanks to the conservative revolution and beginning with the Reagan era, the process began to reverse itself. Since then, the power to regulate has increasingly shifted back to the states. But there are certain areas, particularly network industries, which are uniquely suited to federal regulation because they transcend geographical boundaries. This is true for telecommunications.

Recognition that the communications industry deserves a unified body of law is not new. In the 1970s, the FCC liberalized its regulations regarding dial-up information services and preempted the ability of state regulators to regulate it. Wireless phone service has never had FCC regulated prices and, in 1993, Congress made sure that state regulators couldn't enact price controls either. Since 1984, federal law has drastically limited the ability of the states to regulate cable rates, and in 2002, the FCC preempted state regulation of cable-modem service.

Remaining for preemption is local phone service. While the 1996 Act envisioned the eventual withdrawal of state regulatory control on local phone service, state public utility commissions are seeking to expand their authority to new technologies. VoIP phone services have been the subject of regulatory inquiries in such states as California, Minnesota, New York and Washington. These states have tried to determine whether internet telephony is a "telecommunications service" that allows for state regulation or an "information service" that mostly closes the door on state regulators.

The VoIP debate highlights the fundamental problem of both state and federal telecommunications law. Historically, "telecommunications" has meant "voice" —and the structure of current law is built around the provision of voice services and who pays for them. The commercialization of IP-based telephony means a world where voice services are just another application that can travel over any medium that can carry an electronic message. For state regulators, the impact of VoIP has less to do with competition than it does with diminishing revenues from taxes for social services like universal service and 911—all which derive from voice "telecommunications" services.

State legislators are beginning to recognize the dynamic telecommunications market and acknowledge the need for regulatory change. At its annual meeting in July, the National Conference of State Legislators (NCSL) consented to a telecom policy position that is, for a state regulatory association, remarkably market-focused. A telecommunications policy committee report acknowledged that current regulation has hurt infrastructure development. It recognizes that the innovation and convergence of technologies creates cross-platform competition and that it was the market that created this competition, not the 1996 Act. The NCSL advocates a policy framework that "allows consumers and the marketplace to determine winners and losers" instead of government regulation.

But, as we all know, breaking up is hard to do and, for cash-strapped state governments, letting go of a potential cash cow is even harder. The NCSL report still advocates for a significant role for the states in telecom policy. It still argues for a federal act regulating all providers of telecommunications (i.e. cable and VoIP) in the name of regulatory parity, but even on these issues it appears to call for "similar and minimal" regulation.

A more progressive organization for state utility commissioners was formed earlier this year as an alternative to the NCSL. The Federation for Economically Rational Utility Policy (FERUP) is a bipartisan group of state regulatory commissioners with a deregulatory mission. The group states that it desires to remove "those regulations that serve only to preserve the jurisdiction of regulators, without providing real benefit to the economy and to consumers." The group has a powerful co-chair in Susan Kennedy, a commissioner that serves on the California Public Utilities Commission.

The changing perspective of state regulators is a positive development. State legislatures should more actively monitor their state telecom regulatory commissions. Getting the state legislators to build a consensus for telecom reform is essential to meaningful national reform. Without key state support, the fear is that backyard politics, not sound policy, will drive a new communications bill.

### **Two paths of reform**

How will Congress respond to these developments? Congress could consider a comprehensive overhaul of the Communications Act of 1934, as amended by the Telecom Act of 1996. Or it could operate in a piecemeal fashion, addressing telecom policy issues based on technology or service sector.

### **The Big Bang**

According to the Big Bang Theory, the universe was created sometime between 10 billion and 20 billion years ago from a cosmic explosion that hurled matter in all directions. A regulatory big bang would work in a similar way. Instead of an explosion of a primeval atom, we would have the implosion of a regulatory regime that has become a black hole for the telecommunications industry. There are two types of regulatory big bangs—one that “reinvents” the laws and regulatory structure and one that “de-invents” the administrative agency by abolishing it or severely curtailing its power.

One wide-sweeping proposal that has gained some attention is based on reinventing and reforming telecommunications law according to the operation and structure of the Internet. Dubbed the “Network Layers Model,” it is a proposal formally published by MCI. Rather than regulate by service categories, the network layers approach utilizes the structure of the Internet as the model for deciding what and how to regulate.

On its face, the layers model is a seductive analytical tool that improves upon the current lack of cohesiveness in telecom regulation. It breaks down policy goals by network layers—physical, logical, application and content—and advocates for regulation that is specific to each, regardless of the technology used or service provided. The telecom correlatives of these layers are as follows: physical (wires and fibers), logical (domain names, IP addresses, routing), application (Internet browsers, e-mail software, etc.) and content (streaming video, voice or text). However, what is a superior analytical tool for network engineers is not necessarily a good legal structure for network regulators.

The layers model is burdened with the same regulatory traps of current law—it retains too much faith in the capability of government regulators to beneficently intervene in the market. In particular, it places an inordinate amount of emphasis in antitrust law to improve consumer welfare. Antitrust law has not been very good at solving this problem, as much as its proponents would like to proclaim that it has.

Instead of just reinventing telecommunications law, which risks repeating the same regulatory traps of old, another approach would be to just do away with the FCC as we know it. There is precedent for this kind of radical reform in the airline industry, and it has strong parallels with telecommunications. Both markets are network industries, were

heavily regulated by government using “public interest” rationales, and have a perceived safety component requiring the need for continued government involvement.

By the early 1970s, a consensus was formed regarding the need for reform at the airline regulatory body, the Civil Aeronautics Board. The CAB was heavily involved in regulating the airline network through price controls, market entry and service routes, much as the FCC regulates local phone services. Economists almost universally agreed that instead of operating in the public interest, CAB rules kept prices high and routes inconvenient for most consumers. The pinnacle for reform was the 1978 Airline Deregulation Act, which instituted a gradual removal of the CAB from economic regulation of the airline industry. The Federal Aviation Administration retained power over aviation safety and various agencies had antitrust oversight authority.

A similar deregulatory action could occur in telecommunications. Gradually, the government could reduce the FCC’s role. Economic regulation would be phased out entirely, leaving such “public interest” social regulation as 911 and disability access with a much smaller FCC or with other agencies. Universal service funding would be allocated from the general treasury and not as taxes on consumer phone bills. As with the scuttling of CAB, any plan that reduces the role of the FCC in the dynamic telecommunications market would remove government from micromanaging the market, presumably creating a long-term win for consumers.

Neither big bang approach is likely to occur any time soon. Perhaps the most fundamental reason working against a big bang approach is one that was not apparent in the deregulation of airlines—the nature of property rights. Many policymakers view telecommunications network infrastructure as merely “dumb pipes,” not deserving of the full bundle of property rights afforded to other forms of less interconnected property. The result has been contentious “open access” requirements – laws that require telecommunications companies to share their networks and facilities with rivals in ways akin to that of a public utility. Until there is general agreement that network providers should have full ownership and control of their networks, radical reform will be highly controversial

### **Slice and Dice**

While the chances for radical telecommunications reform are slim, substantial reform is still likely. The “slice and dice” approach toward regulatory reform is similar to the culinary act of how slicing a vegetable and then cutting the slices up into dices leads to proportional heating and adds taste. In telecom policy, slicing and dicing involves breaking regulation down into smaller issues for examination, as each rule has its own flavorful rationale. Proponents of this targeted approach believe that it will allow for better independent analysis of economic and social issues and create a firewall that leaves new technologies and services unburdened by outdated regulation.

A VoIP bill sponsored by Sen. John Sununu (R-N.H.), the “Regulatory Freedom Act of 2004,” is an example of a piecemeal approach. It originally called for a light regulatory touch for VoIP and preemption of state and local governments. Senate Commerce Committee amendments to this bill have effectively killed it, expanding what was once a

very narrow bill to include obligations for state-regulated access charges and universal service taxation.

If it is easy to bloat a narrow VoIP bill (when many in Congress already agree that Internet telephony should be lightly regulated), it is easy to imagine how weighted down a broad sweeping act could become. Congress should instead begin to look at the most regulated components of telecommunications and institute a deregulatory course.

The most significant, and perhaps, controversial area for reform is universal service. This system of explicit and implicit subsidies was expanded by the 1996 Act. The FCC oversees the flow of money from taxes on consumer phone bills to local phone companies that service high cost (often rural) areas, rural health care and low-income telephone subscribers, and for advanced services for schools and libraries.

What was once a program for the truly needy has grown into one where \$7 billion is collected from phone bill taxes of the not-necessarily-rich and going to the not-particularly poor. Even those that wish to keep universal service realize that the program's revenues, from taxes on interstate calls, will soon diminish due to the Internet's affect on the use of traditional telephone long-distance usage. The congressional debate over universal service will likely focus on the efficacy of the program, whether to reduce its size, and which new technologies should be taxed.

Congress could also individually address "open access" rules – the economics of which have become increasingly fuzzy in light of new forms of competition from cable and wireless. These rules include those that determine prices (known as TELRIC prices) that the former Bell telephone companies must charge competitors for mandated open access to parts of their network. Congress could scrap these rules or pass legislation that prevents their applicability to new technologies like VoIP or high-speed broadband.

Other issues that need to be addressed include how to treat new technologies to such old rules regarding methods for the ways carriers compensate each other for sending traffic over their networks (intercarrier compensation), disability access requirements, and access and funding requirements for 911 emergency services. Within each issue area, Congress could instruct the FCC how to proceed in ways that provide guidance to the market without hindering the deployment of new services.

## **Conclusion**

From a public policy perspective, a revamp of the 1996 Telecom Act is necessary. The continued economic regulation of telecommunications is unnecessarily adding costs to consumer phone bills and delaying the deployment of important new technologies. Although there are complex issues of economic and social policies to resolve, most everybody agrees that the market has changed and telecom laws need some attention.

Now it's time to start building a new consensus—a consensus committed to ongoing deregulation. No matter what approach Congress takes to reform telecom, there must be recognition that current regulation is hurting consumers and deregulation must prevail.

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