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Convergent Market Calls for Serious Intermodal Competition Assessments

by

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An expert regulatory agency should have a high-level, up-to-date understanding of the markets it regulates, right? That would seem only logical, especially when technologies and consumer trends undergo successive sea-changes. But in the face of these changes, the FCC appears remarkably uninterested in taking a hard look at the effect of intermodal competition. Its shallow consideration of the data available concerning the competitive effects of wireless-wireline rivalry is a good example of this disinterest.

Substitute services and alternative platforms are indicators of dynamic competition. Their availability is consumer welfare-enhancing. As a matter of public policy, evidence of intermodal competition renders many types of regulation unnecessary and potentially harmful. So in many instances, the proper policy response to intermodal competition should be reductions in regulatory burdens.

The FCC can respond to newly competitive conditions by forbearing from enforcing old rules or by eliminating them. But unjustifiable disregard for such competition only serves to preserve the regulatory status quo. This can create a disconnect between regulatory policy based on outdated monopolistic assumptions and one based on currently competitive market conditions.

For a recent manifestation of the FCC's apparent disinterest in consumer welfare dynamics of wireless-versus-wireline competition, look no further than the agency's *16th Wireless Competition Report*. Its intermodal competition section cited updated numbers on wireless-only households – now exceeding 35% – and described some new technologies. Yet the *16th Report* contained no analysis to speak of regarding wireless substitutability for wireline. Most of its observations were recycled from prior reports, shedding no real light on cross-platform competitive effects. Likewise, the FCC's *14th Video Competition Report* contained some descriptions of consumer behavior trends and new technologies relevant to intermodal competition, but no insights to inform regulatory policy.

The FCC needs to give intermodal competition more than short-shrift treatment. In this digital age of all-IP broadband networks, services are increasingly characterized by cross-platform convergence and competition. Consumer behavior is increasingly dispersed across services and platforms through multi-screening and multi-homing. Understanding the competitive effects of wireless substitution and rivalry with wireline and satellite alternatives through cord-cutting or cord-shaving is critical to an informed digital age communications policy. A proper assessment of intermodal competition helps ensure that policy tracks with actual market conditions.

Transformative market changes, and the FCC's seeming inattention to them, should prompt reconsideration of modest reform legislation. One commendable near-term modest approach is to require a single FCC report on the communications market that seriously assesses intermodal competition across platforms. A unified competition report would be better suited to capturing the competitive effects of substitutes and cross-platform rivalry that are essential to informed policymaking.

While Markets Change, FCC Report Assessments Stay The Same

The FCC's annual reports on wireless, video, satellite, and broadband deployment are fitting occasions for the agency to analyze proper market definitions of those services, the presence of likely substitutes, the existence of cross-platform alternatives, as well as how competing products and service choices likely impact consumer welfare. The wireless market's dynamism and disruptive impact on different cross-sections of the communications landscape makes the FCC's *Wireless Competition Reports* a particularly strong candidate for analysis of intermodal competition. To date, however, the FCC's reports on wireless competition have had little to say on the matter.

Congress charges the FCC to annually "review competitive market conditions with respect to commercial mobile services" and include an analysis of those conditions in a report. As I explained in a March 27 blog post, data in the *16th Report* "[Reconfirms the Reality of Wireless Innovation and Competition](#)." This despite the FCC's declining to say whether or not the wireless market is "effectively competitive."

The FCC also declined to include any serious assessment of intermodal competition in the *16th Report*. It does cite the National Health Institute Survey's updated numbers on wireless-only households: "[A]pproximately 34.0 percent of all adults in the U.S. lived in wireless-only households during the first half of 2012...compare[d] to 27.8 percent of all adults in the second

half of 2010 and 22.9 percent in the second half of 2009." Technologies for blending and combing usage across platforms are also briefly described. It suggests the substitutability of text messaging or other Internet-based messaging services for voice service. And it observes that "[i]n some cases mobile broadband networks are being used as a replacement for wireline last-mile solutions, where location makes deployment of wireline facilities inefficient." But such observations are only cursory.

The *16th Report's* overall observations about intermodal competition – which should ultimately reflect the FCC's approach to the subject for communications policy purposes – are largely copied-and-pasted from the prior two reports. Consider first the *16th Report's* executive summary statement on intermodal competition:

The extent to which wireless broadband services can impose competitive discipline on wireline providers depends on many factors, including technologies, prices, consumer preferences, and the business strategies of providers that offer both wireless and wireline Internet access services. Mobile wireless Internet access service could provide an alternative to wireline service for consumers who are willing to trade speed for mobility, as well as consumers who are relatively indifferent with regard to the attributes, performance, and pricing of mobile and fixed platforms.

Interesting, if inconclusive. But that's hardly a new insight. Compare it with the *15th Wireless Competition Report's* section on intermodal competition:

For reasons first elaborated in the *Fourteenth Report*, it is still not yet clear whether mobile wireless Internet access services can substitute completely for fixed wireline Internet access technologies such as cable modem, DSL, or fiber. The extent to which mobile wireless services can impose some competitive discipline on wireline providers will depend on how technology, costs, and consumer preferences evolve, and on the business strategies of providers that offer both wireless and wireline Internet access services. Mobile wireless Internet access service could provide an attractive alternative to wireline offerings for consumers who are willing to trade off speed for mobility, and also consumers who are relatively indifferent with regard to the attributes, performance, and pricing of mobile and fixed platforms. Moreover, while mobile wireless service currently is not competitive with wireline for those consumers who value high speeds over other attributes, advances in wireless technologies, coupled with increases in the supply of spectrum, have the potential to make mobile wireless service a more viable competitor at higher data speeds at some future date.

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Sounds familiar by now. Of course, the *16th Report's* high-level pronouncements on what it considers the inconclusive impact of intermodal competition and wireless substitutability on consumer welfare aren't even original to the FCC's earlier *Wireless Competition Reports*. All of the above-cited passages ultimately cite to and largely repeat portions of a 2009 *ex parte* filing by the U.S. Department of Justice in the *National Broadband Plan* proceeding.

For its part, the *14th Video Competition Report* contained no section devoted specifically to intermodal competition. That report also fits a pattern of repeating inconclusive findings from prior occasions. Perhaps the closest it comes to discussing competition between new types of video services and established multichannel video programming distribution services, is the following passage:

In the Comcast-NBCU Order, the Commission found that, while the amount of online viewing is growing, cord-cutting of traditional video programming service is relatively infrequent, and most consumers consider OVD service to be a complement to, rather than a substitute for, their MVPD service. While recognizing that the Internet has evolved into a powerful method of video content distribution, the Commission did not determine whether or not online video competes with MVPD services. Instead, the order concluded that, regardless of whether online video currently is a complement to or a substitute for MVPD service, it is potentially a substitute product. The state of the current market suggests no reason to revisit this conclusion for purposes of this Report.

Now there's nothing wrong with citing or repeating prior reports or orders where points previously made still ring true. To the FCC's credit, the *16th Report* simply states that "Intermodal Services are discussed" in the relevant section, thus dropping the *15th Report's* claims that the FCC "regularly assess[es] whether services provided using other technologies, such as wireline, fixed wireless, and satellites, can or will place competitive pressure on mobile wireless service providers." But this only goes to show the FCC's apparent lack of interest in providing itself and the public with a better understanding of cross-platform competitive effects.

A Cord-Cutting, Cord-Shaving Multi-Homing Digital Communications Market

Since 2009, the digital communications marketplace has undergone rapid growth and disruptive change. From a wireless-centric standpoint, this includes deployment of next-generation wireless broadband networks, improving home networking and public Wi-Fi options, dramatic spikes in smartphone adoption, introduction of tablet devices and Internet-connected e-readers, and explosive growth in mobile app stores. As next-generation broadband network deployment and the IP-transition continue, we should expect even more breakthroughs, including services like Broadcast LTE or VoLTE.

Consumer behavior has likewise altered in response to dynamic changes in the market. Many voice consumers have "cut the cord" and eliminated their landlines to rely exclusively on wireless services. Economist Kevin Caves provided important insights in this regard in a study published in *Telecommunications Policy* in December 2011 titled "[Quantifying price-driven wireless substitution in telephony](#)." In particular:

Our results provide evidence that wireline and wireless voice service are economic substitutes, and indicate that changes in relative prices drive economically significant intermodal substitution. Specifically, we estimate that a one percent decrease in the price of wireless service leads to a decline in the demand for traditional wireline service of approximately 1.22 - 1.28 percent.

As Caves' study pointed out, "[t]he household surveys upon which so much prior research has relied are now a decade old." Conclusions in Caves' study were based on data through 2009, when only 24.5% of households were estimated by the CDC survey on wireless substitution to be wireless-only. The latest [CDC survey on wireless substitution](#) indicates that "[m]ore than one-third of American homes (35.8%) had only wireless telephones (also known as cellular telephones, cell phones, or mobile phones) during the first half of 2012—an increase of 1.8 percentage points since the second half of 2011." This number of wireless-only households constitutes another increase year-over-year increase, not to mention exceeding levels cited in the *16th Report*. By relying on updated data, there is reason to conclude that future analyses of wireless substitutability would reveal stronger economic evidence of intermodal competition.

Meanwhile, consumers are increasingly accessing apps and other services from different platforms and devices. Those who have both mobile data subscriptions and wireline broadband service are effectively "multi-homing" consumers who can allocate their media consumption among different platforms. Professor Christopher Yoo, a member of Free State Foundation's Board of Academic Advisors, has explored what he calls "the myth of the one screen," which assumes consumers will rely on a single Internet connection for services. In his book, [The Dynamic Internet](#), Prof. Yoo describes the tendency for users to "multi-home" or subscribe to more than one connection. Maintenance of more than one connection could potentially restrict any market power one broadband service provider could exercise against consumers. At the same time, multi-homing can allow consumers to use different applications on whichever respective platform's design characteristics provide optimal support.

As comScore's "[U.S. Digital Future in Focus 2013](#)" white paper puts it, "[w]ith smartphones and tablets completely reshaping the way we connect with content and experience media, audiences are fragmenting even further and attention is getting shared across platforms." By relying on the capabilities offered by fixed wireless, consumers of video services can now access content through laptops or tablets, enjoying a "multi-screening" experience.

Caves' study cited empirical research published by other scholars in 2004 that separately analyzed wireless usage-substitution and access-substitution. In the case of video consumer trends, one type of usage-substitution is frequently referred to as "[cord-shaving](#)." Management consulting firm Altman Vilandrie & Co. released a survey in early 2012, finding that some 20 percent of video consumers in 2011 chose to "shave" or spend less money on cable video services compared to the year before, apparently increasing their usage of online video services. Cord-cutting for consumers who still want access to video services is certainly possible, enabled by over-the-air TV broadcast and wireless options. But instances of actual cord-cutting [appear to be uncommon](#) when it comes to video services. Cord-shaving and multi-homing therefore appear to be increasingly characteristic of the video consumers' experience.

FCC Reports Need to Take Intermodal Competition Seriously

The digital communications market is fast-changing. And *prima facie* evidence of substitutability and cross-platform competition exists in the form of consumer trends like cord-cutting for voice services and cord-shaving for video services. Accordingly, a more searching assessment is required. Repetition of boilerplate will hardly suffice.

Scattered among a small handful of FCC notices and orders are passing acknowledgments that wireless services compete with wireline. And recent iterations of the FCC's *Wireless* and *Video Competition Reports* have expanded in scope to describe new services, products, and consumer trends. Yet, there is no concrete evidence that the FCC's communications policy is in any way informed by wireless or online substitutability or competition.

In this respect, the FCC would do well to seriously consider the refreshing observations on wireless substitutability of Commissioner Robert McDowell (recently departed from the FCC). During a panel on "[The Right Regulatory Approaches for Wireline and Wireless Broadband Providers](#)" at the Free State Foundation's Fifth Annual Conference, Commissioner McDowell remarked:

Consumers are telling us that wireless broadband is a substitute – not in every case, not for every market. But it is a substitute. The fastest growing segment of the broadband market is wireless, with the vast majority of consumers having a choice of at least four wireless broadband providers. And that number will increase as we see the build out of LTE continue.

Future FCC annual reports should include more detailed intermodal competition assessments. More rigorous, empirical analyses should be attempted to take stock of the marketplace developments we are witnessing and the likely impact of substitutability and cross-platform rivalry on consumer welfare.

The FCC already has all the power it needs to improve understanding of cross-platform competition on consumer welfare and to apply that understanding to its regulatory activities. But the agency's pattern of reluctance to inquire into intermodal competition's competitive effects makes the case for Congressional action.

Reconsidering Modest Reform to FCC Competition Reporting

Legislation considered in the last Congress would have combined and streamlined eight different FCC reports into a unified and comprehensive bi-annual report. The [FCC Consolidated Reporting Act](#) (H.R. 3310/S. 1780) would direct the FCC to:

assess the state of competition in the communications marketplace, including competition to deliver voice, video, audio, and data services among providers of telecommunications, providers of commercial mobile service (as defined in section 332), multichannel video programming distributors (as defined in section 602), broadcast stations, providers of satellite communications, Internet service providers, and other providers of communications services.

This legislation would expressly require the FCC's assessment to:

consider all forms of competition, including the effect of intermodal competition, facilities-based competition, and competition from new and emergent communications services, including the provision of content and communications using the Internet.

The U.S. House of Representatives passed H.R. 3310 on a voice vote. But the Senate version was never voted on.

The FCC Consolidated Reporting Act is ripe for reintroduction. The case should continue to be made for replacement of the Communications Act with a new framework fit for the digital age. But we should welcome modest reform legislation to ensure better competition assessments that include the competitive effects of substitutes and cross-platform rivalry.

Combining disparate competition reports would structurally conduce to intermodal competition assessments. It should come as no surprise if the current system of separate FCC reporting on specific services results in largely silo-like analyses. That is what current law all but invites. A more comprehensive approach to digital age communications services – combined with a specific directive regarding intermodal competition assessment – could offer a better perspective on the competitive state of voice, video, audio, and data services as well as the substitutability of wireline, wireless, satellite, and other platforms. It could even shed light on the unnecessary and outdated regulatory burdens that now saddle communications services on a variety of platforms. Combined FCC reporting could also reduce the administrative burdens.

Conclusion

In the digital age, video, voice, and other advanced communications services are increasingly characterized by cross-platform convergence and competition. Intermodal competition benefits consumers by offering a broader variety of product and service choices, in some cases putting downward pressure on prices. Where substitute services and alternative platforms exist, the resulting market competition makes reductions in legacy regulations the proper public policy response. The FCC has tools to recalibrate its regulatory policies to more competitive conditions, through forbearance or elimination of old rules through its biennial review process.

Regulation that has outlived the market conditions upon which it was based can become a drag on existing providers. This can include limiting marketplace freedom to meet changing consumer demands or imposing unnecessary administrative compliance costs. But unjustifiable disregard for such competition preserves the regulatory status quo. And it furthers a disconnect between regulatory policy based on uncompetitive competitions and actual market conditions where competition prevails.

The *16th Wireless Competition Report* provides perhaps the latest example of the FCC's apparent disinterest in consumer welfare dynamics of wireless versus wireline competition. Likewise, the FCC's *14th Video Competition Report*, lacking a hard look at increasingly common cross-platform competitive effects, contained few meaningful insights to inform regulatory policy.

The FCC needs to take a more rigorous and empirical approach to intermodal competition. It has ample authority to do so. Yet, the agency's apparent reluctance to apply intermodal competition insights in its regulatory policymaking suggests the need for a Congressional response. One modest reform proposal would be to require a single FCC report on the communications market that seriously assesses intermodal competition. A unified competition report would be better suited to capturing the competitive effects of substitutes and cross-platform rivalry that should be essential to informing digital age communications policy.

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Further Readings

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Seth L. Cooper, "[FCC Report Reconfirms the Reality of Wireless Innovation and Competition](#)," *FSF Blog* (March 27, 2013).

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[Testimony of Randolph J. May](#), Hearing on "Reforming FCC Process," Subcommittee on Communications and Technology, Committee on Energy and Commerce, U.S. House of Representatives (June 22, 2011).

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