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Lessons for Modern Regulators from Hippocrates, Schumpeter and Kahn

by

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Introduction

More than 70 years ago John Maynard Keynes lamented that accepted economic theory was not up to the task of responding to the pressing economic problems of the day. The most fundamental challenge, he thought, was not in developing new ideas, "but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds."[1] The same challenge confronts the modern-day regulator in overseeing the market and technological upheavals that have transformed the telecommunications marketplace.

The New Webster Encyclopedic Dictionary of the English Language defines the terms "regulate" and "regulator," respectively, as follows:

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[1] JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY viii (New York, Harcourt Brace and World 1935).

To adjust by rule or established mode; to govern by or subject to certain rules or restrictions; to direct; to put or keep in good order; to control and cause to act properly.

One who or that which regulates; a device or contrivance of which the object is to produce uniformity of motion or action.

The term "regulator" probably describes fairly accurately what was traditionally asked of public utility commissioners. We wanted them to "keep the trains running on time"—to ensure that consumers had reliable access to public services (e.g., electric power, natural gas, telephone, and water) of acceptable quality at reasonable prices. The homogeneity of the service itself mapped well into the uniformity of action attribute, and there was probably limited scope for *innovation* in the sense in which we use that term today. The problem is that the uniformity of action that we valued in regulators of the past is increasingly at odds with what is required of "regulators" today in addressing the pressing issues of the times.

The centripetal model of command-and-control regulation of the past that put in place strict rules to elicit a uniformity of market outcomes must now yield to a centrifugal model of regulation in which the regulator becomes less of a controller and more of an enabler. We have transcended the limited objective of keeping the trains running on time; the present regulatory challenge is to enable competing technological platforms that are increasingly capable of providing the requisite discipline from within—competitive discipline of the real kind rather than the emulation thereof at the hand of the regulator.[2, 3] This necessarily entails a corresponding shift in regulatory emphasis from one of controlling market power to one of unleashing the power of markets.[4] The centrifugal regulatory model must be fluid in interpretation and yet rigid in the principles that inform that interpretation. The new "centrifugal regulator" must be prepared to referee the struggle between competing interests while recognizing that his role is a limited one.[5]

In learning just what that limited role is we suggest our regulator take some guidance from three inspirational teachers of medicine, economics and regulation, Hippocrates, Schumpeter, and—in our own day—Alfred Kahn. No doubt it will seem paradoxical that in advocating the need to escape from "habitual modes of thought

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[2] Professor Kahn observes that "the single most widely accepted rule for the governance of the regulated industries is regulate them in such a way as to produce the same results as would be produced by effective competition, if it were feasible." ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS Vol. I, 17 (New York, John Wiley and Sons 1970).

[3] Professor Bonbright observes that "Regulation, then, as I conceive it, is indeed a substitute for competition; and it is even a partly imitative substitute." JAMES C. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 107 (New York, Columbia University Press 1961).

[4] See Dennis L. Weisman, *On Market Power and the Power of Markets: A Schumpeterian View of Dynamic Industries in* PERSPECTIVES FROM FSF SCHOLARS Vol. 3(5) (The Free State Foundation, February 26, 2008) at http://www.freestatefoundation.org/images/Power_of_Markets.pdf.

[5] Joel I. Klein, *The Importance of Antitrust Enforcement In The New Economy*, 12 before the New York State Bar Association, Antitrust Law Section Program, New York, NY, January 29, 1998.

and expression" we should draw on one teacher who died more than two millennia ago, and another who died nearly 60 years ago. We take comfort in the knowledge that our third teacher is still actively teaching the lessons of the other two. Some lessons endure.

Hippocrates, the father of modern medicine, is popularly known today for his famous oath, "First, do no harm."[6] It is a wise admonition not only for physicians but for all persons charged with responsibility for the well being of others, public regulators included. For the regulator we translate the lesson from Hippocrates into a basically conservative admonition not to invent a solution to a problem that doesn't exist (or at least one that will persist long enough to justify the investment of energy to solve it).

Joseph Schumpeter is best known today for his theory of dynamic capitalism, reflected in his famous description of competition as a struggle among firms to capture the market by a process of "creative destruction." [7] Schumpeter believed that regulators should seek to foster the competitive process rather than mandate the competitive outcome.

Alfred Kahn is one of the foremost contemporary scholars of regulated industries, as well as one of the most distinguished regulators (both at state and federal levels).[8] In both capacities he has been a leading proponent/practitioner of deregulation.[9] In his scholarship and in his practice as a regulator Kahn has built on the principles of Hippocrates and Schumpeter. Borrowing from the former he has emphasized that regulatory intervention in the competitive process could create more harm than good, and from the latter Kahn viewed competition within a framework of dynamic processes over time.

Admittedly the lessons to be learned from these three luminaries are at a very high level of generality, which means that it is not a simple matter to know how to translate them into guidance on specific policy issues. Even so, we think it is possible to point to concrete examples where they tell us something interesting and useful about contemporary regulatory issues in the field of communications regulation. To illustrate, in the next three sections, we address, respectively, the FCC's inertial tendencies toward centripetal regulation in implementing the 1996 Telecommunications Act, the slippery slope of the network neutrality debate, and the shifting rationales for regulating broadcast media ownership.

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[6] The currently known phrase is slightly inaccurate. What Hippocrates said was that physicians should regulate their treatment so as "to do good, or at least do no harm." FRANCIS ADAMS, THE GENUINE WORKS OF HIPPOCRATES, (translated from the Greek), Vol. I, 20 (London, Sydenham Society, MDCCCXLIX).

[7] JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 81-86 (New York, Harper Torchbooks 1975) (1942). For more on Schumpeter, his life, his theory of capitalism and his place in modern economics, see THOMAS K. MCCRAW, PROPHET OF INNOVATION (2007).

[8] His two-volume treatise on the economics of regulation remains a classic reference. ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS Vol. I, Economic Principles; Volume II, Institutional Issues (1970 and 1971).

[9] THOMAS K. MCCRAW, PROPHETS OF REGULATION 222-299 (1984).

Opening Local Telecommunications Markets to Competition

The Paradigm Shift in Telecommunications Markets

It is commonplace knowledge that the telecommunications industry has undergone a radical transformation in the past score of years. Today, consumers can choose from a number of different technological platforms for their telecommunications services,[10] including broadband and wireless.[11] The black rotary-dial telephone that was big and heavy enough to use as a doorstop (and which until the 1970s could only be leased from AT&T), has morphed into an array of multi-purpose information and communications devices that can be put in a pocket (and purchased at grocery stores). Providing a dial-tone is almost the least of the functions provided by the modern cell phone. And the telecommunications service providers have morphed into multi-purpose entertainment and information companies.

The technology has changed, the business culture and philosophy have changed, even the organization of the industry has changed. AT&T once strode the world of telecommunications like a colossus. Until at least the late 1970s, the U.S. telecommunications industry for all practical purposes *was* AT&T. AT&T is still a huge firm, to be sure, but it no longer dominates the industry as it once did.[12] The introduction of competition, along with the growth of new technologies, has seen to that. In this new environment the once colossus of the industry initially proved to be less adroit than in the heyday of regulated natural monopoly—an elephant on ice skates, as it were. The business model that enabled AT&T to thrive under the yoke of regulation proved to be particularly ill-suited for a marketplace that requires its managers to work without a net. This is not all that surprising; managing the regulatory process requires different skill sets than managing the competitive process. The old AT&T rarely hired senior managers from outside its ranks, and when it did the cultural barriers were seemingly impenetrable for these foreign born.[13] Today, growing up in the "Bell System" (and many employees had parents

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[10] See, for example, JONATHAN E. NUECHTERLEIN AND PHILIP J. WEISER, DIGITAL CROSSROADS, AMERICAN TELECOMMUNICATIONS POLICY IN THE INTERNET AGE (2005).

[11] See, for example, U.S. DEPARTMENT OF JUSTICE, VOICE, VIDEO AND BROADBAND: THE CHANGING COMPETITIVE LANDSCAPE AND ITS IMPACT ON CONSUMERS (2008), *available at* http://www.usdoj.gov/atr/public/reports/239284.pdf .

[12] The succession of mergers among the Bell Operating Companies, and the 2005 acquisition of AT&T by SBC in 2005, followed by the 2007 acquisition by AT&T (formerly SBC) of BellSouth has led to speculation that the old AT&T is being reconstructed. While the acquisition by SBC did rescue a declining if not dying AT&T, it did not come close to restoring its former dominance. In 1983 AT&T accounted for 82.3% of the telecommunications service industry's operating revenues of $84.175 billion. U.S. STATISTICAL ABSTRACT, Tables 926-927 (1985). In 2005 the industry's revenues were $449.3 billion. *Available at* http://www.census.gov/svsd/www/services/sas/sas_data/51/2005_NAICS51.pdf. In that year the combined revenues of AT&T and BellSouth were $64.5 billion or 14.3% of the total. *Available at* http://money.cnn.com/magazines/fortune/fortune500/2006/snapshots/1182.html, and http://money.cnn.com/magazines/fortune/fortune500/2006/snapshots/191.html. So, even after the AT&T-BellSouth merger AT&T remains a shadow of its former self.

[13] PETER TEMIN, THE FALL OF THE BELL SYSTEM 93-94, 151-2, 329 (1987) (describing the difficulties that Archibald McGill, who had been brought in from IBM as Director of Market Management, encountered in attempting to implement market-based thinking at AT&T).

and grandparents that worked for Ma Bell) has arguably become more of a liability than an asset. The centripetal thought process of the old Bell System has been cast aside in favor of the centrifugal thought process—the thinking outside the box, or at least outside the mindset of the proverbial Bell-shaped head.[14] There was a day when a position in the regulatory department of the Bell System was a considered a plum position, a fast track up the corporate ladder.[15] Today, when you open the annual report of a Bell Operating Company, one of the first facts you will read is how successful the company was in reducing the percentage of revenues subject to regulation. The transformation of the business culture in the telecommunications industry is all but complete.

In a very real sense, AT&T's fall parallels the error that we ascribe to the centripetal regulator—an inordinate preoccupation with the static rather than the dynamic (or regulating through the rearview mirror). When AT&T Chairman John de Butts delivered his famous *cris de cour* against the perils of competition at the 1973 National Association of Regulatory Utility Commissioners (NARUC) meetings,[16] he sought to hold back the competitive forces that technology and liberalized entry rules had unleashed.[17] He succeeded only in strengthening the policymakers' resolve to move forward in opening telecommunications markets to competition.[18] A decade later, AT&T sealed its fate when it elected to retain the "profitable" long-distance business rather than the subsidized ("bottleneck") local exchange business at the divestiture.[19] (AT&T was in essence running backwards at full speed through a minefield.) From this decision there would be no recovery, for AT&T spent the next two decades in countless, futile attempts to re-enter the very markets that it had "voluntarily" exited.[20]

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[14] "Managers who had internalized the corporate culture were said to have 'Bell-shaped heads." *Id*. at 58.

[15] As Temin observes, "Leaders of the Bell System often acted as if the regulators were their customers – as if they got revenue from regulators, not customers." *Id*. at 58.

[16] John D. deButts, *An Unusual Obligation*, Speech before The National Association of Regulatory Utility Commissioners (September 20, 1973).

[17] In the end, it could be argued that AT&T mismanaged both the regulatory process and the political process. De Butts did not expect his 1973 NARUC speech to have the effect that it did, though other senior managers at AT&T had raised concerns about how it would be received. In addition, AT&T's backing of the Consumer Communications Reform Act of 1976, commonly referred to as the "Bell Bill," had a similar effect in strengthening policymakers' resolve to liberalize entry in telecommunications markets. Peter Temin, *supra* note 13, at 113-133.

[18] *Id.*at 96-112.

[19] Some industry observers thought that AT&T had pulled off a major coup in jettisoning its local exchange business. See, for example, Paul W. MacAvoy and Kenneth W. Robinson, *Winning by Losing: The AT&T Settlement and Its Impact on Telecommunications*, 1 THE YALE JOURNAL ON REGULATION, 1- 42 (1983). Other industry observers were less than convinced that this was a coup on the part of AT&T. See, for example, *Telecommunications In Turmoil* by Gerald R. Faulhaber 5 YALE JOURNAL ON REGULATION 530-531 (1988). It did not take long for the market to reveal that the "bottleneck" local exchange business was, as Willy Sutton famously quipped when asked why he robbed banks, "where the money is." See, for example, Paul W. MacAvoy and Kenneth W. Robinson, *Winning By Losing: The First Year of the AT&T Divestiture*, 2 THE YALE JOURNAL ON REGULATION 225-262 (1985) (explaining why the predictions made in their first article, that AT&T had pulled off a major coup in exiting the local exchange business, did not come to pass).

[20] LESLIE, CAULEY, END OF THE LINE: THE RISE AND FALL OF AT&T (2005).

The operational mindset at AT&T that enabled it to excel in keeping the trains running on time never managed to escape the "habitual modes of thought and expression" that were the *sine qua non* for its survival. As Peter Temin observes, "The Bell engineers were not interested in what the salesmen reported that customers wanted … The two groups were in two different worlds, speaking two different languages. They couldn't (or wouldn't) hear each other."[21, 22]

Thomas McCraw argues that "Almost all businesses, no matter how strong they seem to be at a given moment, ultimately fail—and almost always because they failed to innovate."[23] In this respect, AT&T is a remarkable study in contrasts—AT&T's Bell Laboratories, a research and development organization that was second to none, and AT&T's management culture that seemed perennially unable to negotiate the turns in the road.[24] AT&T would ultimately succumb, with a little help from the government,[25] to what Joseph Schumpeter referred to as the "perennial gale of creative destruction."

For all these changes in the technological and economic environment of the telecommunications industry it is remarkable how much of the older regulatory institutions and policies remain in place. To be sure, there have been some regulatory innovations. Incentive regulation, increasingly in the form of price caps,[26]

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[21] PETER TEMIN, THE FALL OF THE BELL SYSTEM 150-151 (1987).

[22] This view contrasts sharply with the perspective of the great industrialist and innovator, Charles Franklin Kettering, who was second only to Thomas Edison in the number of inventions to his credit, and served as head of NCR's inventions department and later served as research chief at General Motors. As reported by Bernstein, Kettering observed that "I didn't hang around much with other inventors or the executive fellows. I lived with the sales gang. They had some real notion of what people wanted." See Mark Bernstein, *A Self-Starter Who Gave Us The Self-Starter* SMITHSONIAN July 1988, at 126, 128.

[23] THOMAS K. MCCRAW, PROPHET OF INNOVATION 495-496 (2007). McCraw observes that, "Only through innovation and entrepreneurship can any business except a government-sponsored monopoly to survive over the long term." Ironically, in the case of AT&T, it could be argued that it was the "government-sponsored monopoly" and the centripetal way of thinking that it propagated that was the source of its undoing.

[24] Nothing better illustrates the contrast between Bell Labs' innovation and AT&T's staid management than in how the latter initially regarded the former's cellular technology. As part of the 1984 reorganization plan implementing the antitrust breakup of the Bell System, AT&T agreed to have its newly developed cellular business assigned to the Bell Operating Companies in the belief that cellular telephony would remain a minor supplement to the basic wireline service, growing to no more than a million American users. (Cauley, *supra* at 36-37). The one-million subscriber estimate proved to be short by more than two orders of magnitude. (Today the number of cellphone subscribers in the United States exceeds 240 million.) In time AT&T would recognize its mistake and reenter the wireless business by acquiring McCaw Cellular. Subsequently, the wireless business was spun off as part of a financially induced reorganization. Ultimately the wireless business would return again to AT&T when SBC acquired AT&T and assumed its name.

[25] In the interest of fairness, we point out that AT&T was forced to do battle simultaneously with both competitors and competitive-handicapping regulatory policies. It was also hamstrung by antitrust remedies that discounted the importance of economies of scope and failed to fully anticipate the nature of market/technological convergence. On this latter point, see William F. Baxter. *Questions and Answers with the Three Major Figures of Divestiture*, in BARRY G. COLE, ED., AFTER THE BREAK-UP: ASSESSING THE NEW POST-AT&T DIVESTITURE ERA 30 (1991). Hence, if competitive handicapping and antitrust polices did not bring about the demise of AT&T, they were at the very least unindicted co-conspirators.

[26] See David E. M. Sappington, *Price Regulation*, in Vol. 1 *HANDBOOK OF TELECOMMUNICATIONS ECONOMICS* 225-293. (M.E. Caves, S.K. Majumdar and I. Vogelsang eds., 2002)

has largely supplanted traditional rate-of-return regulation. And there has been some streamlining of regulation and even forbearance for certain services in selected markets. But the old habits of regulation are still in full display over too much of the domain of regulated communications. Nowhere is this better illustrated than in the recent attempts to implement the Telecommunications Act of 1996,[27] designed to overturn the last vestiges of natural monopoly in telecommunications markets.

The FCC's Tortured Implementation of the 1996 Telecommunications Act

The 1996 Telecommunications Act was a watershed event in the history of telecommunications policy in the United States. While it aspired to reform many different areas of telecommunications, a core concern was the opening of local service markets to competition. In essence, it envisioned substituting a policy of "competition-enabling" for direct regulation as the central constraint on the market power of the incumbent providers. The FCC's journey to implement the 1996 Act in line with congressional intent proved to be both a halting and tortuous one. The basis for the FCC's difficulties was its failure to distinguish clearly and consistently between its traditional regulatory, rate-making role and the "competition-enabling" role with which it had been charged with under the Act. As explained by Justice Breyer:

An agency engaged in traditional ratemaking will seek to protect consumers by mandating low prices as an end result. In doing so, the agency will sometimes try to mimic the prices that it believes (hypothetically) the regulated firm (often a legal monopoly) would have set had it been an unregulated firm in a competitively structured industry. .. [28]

But that regulatory objective—low, competition-mimicking prices—is not the objective of the relevant statutory provision here. The Telecommunications Act is not a ratemaking statute seeking better regulation. It is a deregulatory statute seeking competition. . . . It finds the competitive process an indirect but more effective way to bring about the common objectives of competition and regulation alike, namely low prices, better products, and more efficient production methods.[29]

The blurring of these two roles ultimately led the FCC to commit errors reflective of what might be characterized as unprecedented regulatory presumption.[30] The FCC's single-minded pursuit of a "competitive outcome" led it to adopt overly broad network sharing rules that encouraged imitation at the cost of innovation and brought

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27 Telecommunications Act of 1996, 110 Stat. 56 (codified in scattered sections of 47 U.S.C.).

28 Verizon Communications v. FCC, 535 U.S. 467, 543 (2002). (Breyer, J. dissenting)

29 *Id.* at 543, 544.

30 Alfred E. Kahn, Timothy J. Tardiff and Dennis L. Weisman, *The 1996 Telecommunications Act at Three Years: An Economic Evaluation of Its Implementation by The FCC*, 11 INFORMATION ECONOMICS AND POLICY 328-329 (1999).

investment in the telecom sector to a virtual halt.[31] We have critiqued the FCC's sharing rules for so-called "unbundled network elements" (UNEs) elsewhere.[32] Here it is enough to note simply that the FCC's policies were largely based on an attempt to ensure certain fixed levels of competition. Such an approach is doomed to disappoint for the simple reason that regulators do not have enough information to define what a satisfactory level will be.[33] Not least of the problems is that changing technology and economic conditions inevitably change the character and degree of competition. Trying to establish the right competitive outcome is at best an invitation to endless regulatory tinkering to keep pace with changing conditions. The FCC's error was to confuse mandating the competitive outcome with fostering the competitive process,[34] a confusion noted by Justice Breyer when the FCC's first efforts to implement the 1996 Act were reviewed by the Supreme Court.[35]

After being repeatedly rebuked and reversed by the courts, the FCC has finally revised its onerous unbundling rules and sought to place increased reliance on market forces. But there is an important difference between finding religion in setting sound competition policy and pinball policymaking in which regulatory agencies change their policies only when they encounter an immovable obstacle in the form of the review courts. And although the FCC has more recently signaled some willingness to be guided by general competitive trends in the industry rather than whether sellers have monopoly power at a specific moment in time,[36] there remain strong inertial tendencies toward traditional market share/market power analysis despite their well-known shortcomings in technologically dynamic industries.[37]

In the end, the implementation of the 1996 Act has suffered from the fact that a centrifugal regulator was required when the FCC was more comfortable in its

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31 See, for example, ROBERT W. CRANDALL, COMPETITION AND CHAOS: U.S. TELECOMMUNICATIONS SINCE THE 1996 TELECOM ACT (2005); Thomas W. Hazlett, *Rivalrous Telecommunications Networks With and Without Network Sharing*, 58 FED. COMM. L.J. 477 (2006).

32 Glen O. Robinson and Dennis L. Weisman, *Designing Competition Policy for Telecommunications*, THE REV. OF NETWORK ECON., 2008 (forthcoming).

33 Dennis L. Weisman, *The (In)Efficiency of the 'Efficient-Firm' Cost Standard*, THE ANTITRUST BULL., Spring 2000, at 210.

34 *Id*. at 197.

35 Iowa Utilities Board v. FCC, 525 U.S. 366, 424 (1999) (concurring in part and dissenting in part).

36 See In the Matter of Petition of AT&T for Forbearance, 22 F.C.C.R. 18,705, ¶¶ 20, 23, 34-35 (2007).

37 This probably explains why the FCC has approved only two applications (Omaha, Nebraska and Anchorage, Alaska) requesting it to forbear from requiring incumbent providers to share network elements with rivals at regulatory prescribed rates. Regardless of how competitive these two markets may be, they hardly seem like hotbeds of competitive activity compared to the major metropolitan areas for which a slew of forbearance applications was recently rejected by the FCC. A careful reading of these decisions confirms that the FCC has retreated to the myopic calculus of "market-share-equals-market-power" to inform its decision-making. See, e.g., Petitions of Verizon Telephone Companies for Forbearance, 22 F.C.C.R. 21,293 (2007). It remains to be seen whether the courts will exercise the same level of critical scrutiny of the FCC's forbearance decisions as they have in the case of its unbundling decisions. The *Verizon* case is currently before the court of appeals. Reportedly the court, in oral argument, intimated some dissatisfaction with the FCC's cautiousness on the forbearance petition. See, for example, *Judges Question FCC's Reasoning in Verizon Forbearance Order*, TR DAILY, Nov. 17, 2008.

traditional, centripetal mode. That is to say, the FCC defaulted to its traditional regulatory mode in which it substituted its judgment for the marketplace when its task was to unleash the power of these burgeoning markets in a manner that would enable market forces to provide the requisite discipline. In doing so, it basically ignored the Hippocratic injunction by intervening in markets in a manner that discouraged investments in new facilities that would have put competition on a more secure footing. It could also be fairly described as “contra-Schumpeterian” in failing to think of competition as a dynamic process rather than a static outcome. For Schumpeter, competition was first and foremost a process of discovery and learning played out over time. His great insight was to recognize that while the regulator was fixated on the “snapshot,” virtually all of the relevant market information was contained in the “movie.”

Kahn has offered the same instruction, cautioning against the regulatory temptation to meddle with the competitive process. Kahn has been particularly outspoken in his criticism of the FCC’s pricing policies, but more generally he has criticized the infant industry policy of protecting fledgling firms in the hope that they will grow up to become strong competitors. While the FCC has never explicitly endorsed an infant-industry justification for its policies implementing the 1996 Act, a close examination of those policies—particularly those concerned with unbundled network access—strongly suggests that something like infant-industry protectionism is animating them.[38] The experience with infant-industry protection in the telecommunications industry (and in most other regulated industries, for that matter) confirms that such policies will be abused and ultimately serve to impede rather than promote competition—to the detriment of consumers. Infant-industry protection tends to become a self-fulfilling prophecy because “fledgling firms raised in a protected market environment are often incapable of surviving outside of it.”[39] Indeed, as Robert Crandall has observed, “regulators inevitably find themselves hostage to inefficient competitors.”[40, 41] Essentially this is a public policy counterpart to the Heisenberg’s uncertainty principle in physics: The presence of economic regulation invariably alters the course of the market’s competitive transition.[42]

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[38] The FCC’s past embrace of the stepping stone theory certainly has the flavor of infant-industry protections. For a brief summary of the stepping stone model, see Robinson and Weisman, *Designing Competition*, *supra* note 32.

[39] Dennis L. Weisman, *Asymmetrical Regulation*, 18(7) TELECOMMUNICATIONS POLICY 502 (1994).

[40] Robert Crandall, *Telecommunications Policy in the Reagan Era*, 3 REGULATION 31 (1988).

[41] The problem is exacerbated by the short-term perspective of most regulators. When regulators reduce entry barriers artificially in order to jump-start competition and commoditize the market, they tend to attract an inferior breed of competitor—arbitrageurs rather than innovators. By definition, the type of competitor that enters requires constant nurturing, and regulators comply because they believe that this type of competitor is all they can get. In this manner, the regulator’s paternalistic policy becomes a self-fulfilling prophecy. The result is a bad equilibrium in which the weak competitors crowd out the durable competitors. It is in this sense that the centripetal regulator trades off innovation (dynamic efficiency) for imitation (static efficiency).

[42] One implication of the uncertainty principle is expressed as follows: "The notion of the observer becoming a part of the observed system is fundamentally new in physics. In quantum physics, the observer is no longer external and neutral, but through the act of measurement he becomes himself a part of observed reality. This marks the end of the neutrality of the experimenter."
Available at http://www.thebigview.com/spacetime/uncertainty.html.

By way of summary, economic regulation of the telecommunications industry has failed to keep up with the technological/market upheavals that have irrevocably transformed the telecommunications marketplace. The traditional "command-and-control" model of regulation must defer to a forward-looking model that focuses less on emulating competitive market outcomes and more on enabling the competitive process *a la* Professors Schumpeter and Kahn.[43]

The Internet and "Net Neutrality"

Despite its importance, the business of enabling competition in telecommunications markets after 1996 has been largely invisible to the general public. All told, the number of persons who know anything about the controversies in this field might equal the number of the politically energized party members who attend one of the two national political conventions. It's a number that is non-trivial for some purposes (arranging catering, for example), but it would surely pale beside the number of persons who know "something" about the famous "net neutrality" controversy. Which is ironic, for what there is to know about the net neutrality issue is itself controversial. Among the unknowns is what net neutrality means, whether there is a problem to be addressed, and whether, if there is a problem, the FCC has jurisdiction to address it.[44]

As to the first unknown, the neutrality issue arose to prominence in the wake of a so-called "open access" rule, which involved a question that somewhat overlapped the telecommunications network sharing issue we discussed earlier. Basically the open access issue was whether cable broadband Internet service providers should be required to lease to independent Internet service providers ("ISPs") access to their networks. In opposition to some local communities that sought to force such access, the FCC took the position that cable operators could not be required to provide access to their "pipes" because the cable operators were not common carriers. The Supreme Court agreed with that position.[45] This produced a somewhat awkward differential treatment between cable service providers and telephone carriers because the latter were, for a time, required to provide such nondiscriminatory

[43] As Thomas Kuhn observed in his classic study: "Political revolutions are inaugurated by a growing sense, often restricted to a segment of the political community, that existing institutions have ceased adequately to meet the problems posed by an environment that they have in part created. ... Their success therefore necessitates the relinquishment of one set of institutions in favor of another . . . ."
THOMAS KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS, 92-93 (1962).

[44] The literature on this subject is large and, alas, growing larger by the day. A recent and very helpful overview of net neutrality, what it means and what, if anything, should be done about it is provided by Jonathan E. Nuechterlein, *Antitrust Oversight of an Antitrust Dispute: An Institutional Perspective on the Net Neutrality Debate*, AEI Center for Regulation and Market Studies, Working Paper 08-07, February 2008. Representative of the protagonists in the debate, for and against, neutrality regulation are Tim Wu, *Network Neutrality, Broadband Discrimination*, 2 J. OF TELECOMMUNICATIONS AND HIGH TECH. LAW 141 (2003); and Christopher Yoo, *Would Mandating Broadband Net Neutrality Help or Hurt Competition: A Comment on the End-to-End Debate*, 3 J. OF TELECOMMUNICATIONS AND HIGH TECH. LAW, 23 (2004); Tim Wu and Christopher Yoo, *Keeping the Internet Neutral? Tim Wu and Christopher Yoo Debate*, 59 FED. COMM. L. J.. 575 (2007).

[45] National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967 (2005).

access (via DSL facilities) to independent ISPs. The FCC, to its credit, recognized the problem and removed the access obligation from telecom carriers as well.[46]

This disposition of the issue didn't end the controversy over open access. In effect it proved to be just a warm up for a more general type of access question that has emerged under the rubric of network neutrality. This new "access" issue is different from the earlier open access issue in a couple of important respects. The open access debate was driven by independent ISPs such as EarthLink and AOL seeking to use the broadband transport facilities of cable and telephone providers. The net neutrality debate is not about giving independent ISPs a right of access to broadband transport facilities in order to provide a competing Internet access service. Rather, it is about allowing Internet content or applications providers—such as Amazon or Vonage—to reach their customers without unreasonable restrictions or discrimination by the owners of the broadband facilities. And, at the other end of the line (both figuratively and literally), it is about allowing end subscribers to access the Internet content or applications of their choice without unreasonable restriction. For example, AT&T may have an incentive to make it more difficult for its subscribers to access Vonage, whose VoIP technology makes it a competitor to the voice service that AT&T provides over the public switched telephone network.[47] Or, Comcast might have an incentive to discriminate against use of broadband for video downloads that compete with its cable service.

On the face of it the net neutrality issue seems a legitimate concern. If the providers of broadband service do have dominance, one might be reasonably fearful of their ability to discriminate against certain uses and/or users for strategic, anti-competitive purposes. But even without the aid of a newspaper or a blog to fix one's attention on them, possible problems that need "attention" by regulators/legislators can be imagined without end. From the beginning, the real core of the debate over net neutrality has been over whether the potential problems of discrimination by dominant providers has reached the point where an actual problem can be expected with sufficient probability to justify the cost (including the potential error costs associated with false positives) to warrant regulatory intervention.

For its part the FCC initially took a guarded stance. It announced a set of vague principles of network neutrality,[48] but despite the urging of net neutrality advocates

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[46] See Time Warner Telecom, Inc. v. FCC, 507 F.3d 205 (3d Cir. 2007) , *aff'd*, Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, 20 F.C.C.R.14853 (2005)("Wireline Broadband Order").

[47] By focusing on what happens at the two ends of the network, some forms of the neutrality argument resemble the old controversy about competitive equipment supply and consumer use of "foreign attachments." This latter issue became salient when cell phone customers demanded the right to use their new iPhones with any network service provider. The problem is that Apple designed its phone in a manner that required the network to be configured in a way that apparently only AT&T found suitable for its network.

[48] As stated in a recent notice of inquiry, In the Matter of Broadband Industry Practices, 22 F.C.C. R. 7894 (2008), the principles are: (1) To encourage broadband deployment and preserve and promote the open and interconnected nature of the public Internet, consumers are entitled to access the lawful Internet content of their choice; (2) To encourage broadband deployment and preserve and promote the open and interconnected nature of the public Internet, consumers are entitled to run applications and use services of their choice, subject

adopted no rules.[49] Its reluctance to go further was based on the fact that, with one widely noted exception—which was quickly remedied by the Commission[50]—there was no evidence that a problem existed in the marketplace that warranted a kind of Rubicon-crossing venture into regulation of Internet services—an area that has been treated as presumptively off limits for (administrative) regulation.[51] For starters there was a question whether any provider really enjoyed such dominance in the market that it could adopt a policy of discriminating against uses or users without effective discipline from disaffected customers. Next there was the vexing problem of how to identify what practices were engaged in for strategic purposes as opposed to legitimate business purposes of network management (for example routing or caching arrangements or priority of traffic based on time sensitivity). Last, but by no means least, there was a problem of regulatory jurisdiction: Does the FCC have direct jurisdiction over Internet services?

The Commission was suddenly jolted from its cautious, hands-off approach in 2008 when a complaint was filed against Comcast for secretly interfering with its customers' peer-to-peer uploading of high-volume files using BitTorrent and similar technologies. Initially, Comcast denied any such interference.[52] Later it admitted to doing so but claimed that it was only for the purpose of managing traffic to avoid congestion on its network. The FCC found that the intentional downgrading of traffic breached its Internet principles, and that those principles were directly enforceable even in the absence of a set of duly promulgated rules. It did not impose any penalty, but directed Comcast to disclose to the Commission and to the public the contours of its network management practices and to submit a compliance plan showing how it intends to adopt nondiscriminatory management practices.[53]

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to the needs of law enforcement; (3) To encourage broadband deployment and preserve and promote the open and interconnected nature of the public Internet, consumers are entitled to connect their choice of legal devices that do not harm the network; and (4) To encourage broadband deployment and preserve and promote the open and interconnected nature of the public Internet, consumers are entitled to competition among network providers, application and service providers, and content providers.

[49] It did impose de facto rules by making these principles conditions for the mergers involving AT&T and MCI. They were rules in the sense that if they did not follow them the mergers would not be granted. See Nuechterlein *supra* note 44, at 8.

[50] In the Matter of Madison River Telephone Co., 20 F.C.C.R.19173 (2005) (a local telephone carrier entered into a consent decree with the FCC after it reportedly blocked the ability of its DSL customers to use an independent VoIP service).

[51] Internet services have not hitherto completely escaped FCC regulation. For example VoIP service providers have been subjected to a number of regulatory obligations, such as 911 services, assistance to law enforcement and universal service contributions. See IP-Enabled Services; E11 Requirements for IP-Enabled Service Providers, 20 F.C.C.R.10245 (2005); Communications Assistance for Law Enforcement Act and Broadband Access and Services, 20 F.C.C.R 149889 (2005); Universal Service Contribution Methodology, 21 F.C.C.R. 7518 (2006). All of these cases dealt with Internet services that are essentially indistinguishable from regulated telecommunications services. The regulatory precedent they provide is thus quite limited.

[52] For our present purposes the manner of interference is not important, but basically it consisted of falsifying the address of targeted peer-to-peer traffic running through its services in a manner that made it undeliverable, at least until the sender reinitiates the uploading.

[53] In the Matters of Formal Complaint of Free Press and Public Knowledge Against Comcast Corporation for Secretly Degrading Peer-to-Peer Applications, 23 F.C.C.R. 13028 (2008). Comcast has appealed the FCC's order to the Court of Appeals for the District of Columbia Circuit.

Does the Comcast episode show that the potential problem of discrimination is now actual? We doubt it. This looks to us like a case for invoking (our version of) the Hippocratic oath: Don't try to solve a problem unless you know there is a problem to solve. It is, admittedly a close call. With a degree of managerial clumsiness that is difficult to explain, Comcast from the beginning gave the appearance of strategic discrimination by hiding what it was doing, then when confronted by evidence of what it was doing, denying it. (History teaches that in cases like this the cover-up is almost always more problematic than the offense itself.) Still, managerial clumsiness is not itself a crime and it ought not to be a regulatory offense either unless it manifests itself in plainly illegal practices.

Although the Commission noted the possibility that Comcast's practices were anticompetitive (in order to protect its own video-on-demand service), it did not find that this was Comcast's purpose, and in fact it cited no evidence to support such a conclusion—as a dissent by Commissioner McDowell emphasized. Rather the Commission concluded that the practices were not narrowly tailored to achieve the claimed purpose of minimizing network congestion since other means are available besides targeting certain applications.[54] No doubt there are; the pertinent question is whether the FCC should decide what is and is not acceptable management, and should decide that on the basis of a thin factual record and tenuous jurisdictional basis.[55]

We see two major harms from FCC intervention here. One is the immediate problem of interfering with private management of Internet traffic without clear standards for doing so. The second is the more long-term harm of establishing a precedent for regulatory intervention in an area that has traditionally been largely outside the regulatory arena. Even the FCC previously has been mindful of the benefits of an unregulated Internet.

Which brings us to the third unknown, regulatory jurisdiction. The jurisdictional issue has been somewhat muddied by a separate question as to whether the FCC's policies of net neutrality were directly enforceable. That involves a complicated question of administrative law that we want to finesse in order to address the more fundamental question of whether the FCC has any jurisdiction at all.

Title VI of the Communications Act gives the FCC jurisdiction over cable "communications."[56] But Internet services are classified as "information services."[57] Information services fall within the purview of the agency only to the extent of an

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[54] See Matters of Formal Complaint, *supra* at ¶¶ 47-51.

[55] Arguably, Comcast might be charged with consumer deception. The Commission criticized Comcast for not only failing to disclose but for misleading consumers, *Id.* at ¶53. However, this was not the basis for the Commission's intervention. If consumer deception was the concern a declaratory judgment would be an odd and inappropriate way to address it.

[56] See 47 U.S.C. § 521 ff.

[57] See National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967 (2005). It upheld the FCC's classification of cable modem Internet service as an information service.

amorphous concept called "ancillary jurisdiction," a concept invented by the Commission itself in the early 1960s as a basis for regulating cable in the absence of express statutory authority.[58] Ancillary jurisdiction has always been a slippery notion to say the least. Comcast argued that for the Commission to exercise this jurisdiction (such as it is), the subject at hand must be ancillary to something that is otherwise squarely within the agency's power. The Commission rejected any such limitation:

Peer-to-peer TCP connections provided through Comcast's broadband Internet access service are undoubtedly a form of 'communication by wire,' so the subject matter at issue here clearly falls within the Commission's general jurisdictional grant under Title I. And though our exercise of authority must be 'reasonably ancillary to the effective performance' of the Commission's responsibility for 'something,' first and foremost, the 'something' Comcast is looking for is right in the Act itself—it is the national Internet policy enshrined in section 230(b) of the Act" and "six other separate statutory provisions.[59]

The FCC's remarkably expansive (and flexible) views of its jurisdiction have always been a matter of concern to those who think that agencies do not possess their own political sovereignty.[60] For twenty years the FCC regulated cable television—under its concept of ancillary jurisdiction—without a shred of guidance from the statute. Eventually Congress caught up with its responsibilities and enacted the Cable Communications Policy Act of 1984, which confirmed that the FCC had the power to do what it had been doing for two decades. In the case of the Internet, section 230(b) does provide some general principles, for example, "promote the continued development of the Internet . . . preserve the vibrant and competitive free market that presently exists for the Internet . . . encourage the development of technologies which maximize user control over what information is received by individuals. . . ."[61] To derive from these principles authority or meaningful standards for regulating Internet traffic management or Internet service providers generally requires a very creative legal imagination. And no such purpose appears to have been contemplated by the congressional draftsmen, as evinced by the title of section 230: "Protection for private blocking and screening of offensive material." Section 230 was part of an effort to enable private users to control Internet porn, not a grant of general power to the FCC to regulate Internet service in general. Even when coupled with scattered other statutory references to the Internet, this section does not seem to be a sufficient basis for asserting what could be a far-reaching regulatory control over the Internet.[62]

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[58] Southwestern Cable Co. v. United States, 392 U.S. 157 (1968).

[59] Matters of Formal Complaint, *supra* note 53, at paras. 15-16.

[60] For a discussion of the proposition regarding the tendency of regulation to spread, see Kahn, *supra* note 8, Vol. 2, pp. 28-32. See also Robinson and Weisman, *Designing Competition Policy*, *supra* note 32.

[61] 47 U.S.C. § 230(b).

[62] To the extent Section 230 says anything about regulating the Internet, the most relevant part of the section is this: "It is the policy of the United States -- to preserve the vibrant and free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation." 47 U.S.C. § 230(b)(2).

At the very least the absence of a clear expression of statutory authority or formal legislative guidance should be reason to pause before proceeding—particularly when industry participants appear to be actively pursuing resolution of outstanding issues. Due deference to the Hippocratic Oath would suggest that regulation be imposed only in the case of a market failure that poses a risk to consumer welfare that is neither transitory or self-correcting in nature. In our view, that standard has not been met. We noted at the outset of this discussion that the term net neutrality is not well-defined. The *Comcast* case involved allegedly inappropriate blocking of traffic, which is high on the list of concerns for which neutrality advocates seek regulation. However, it is not the only concern. Some define neutrality more broadly and seek restrictions on *any* differential treatment of Internet traffic, such as differential pricing of different types of Internet services. We think this is wholly unwarranted. First of all there is nothing discriminatory about different treatment/pricing of different services that impose different costs on the provider.[63] It is not only efficient but entirely equitable that Internet applications should pay according to the marginal costs that they impose on the system—most notably in this case the congestion costs that heavy users impose on other users. Nor by the same token is it discriminatory to price according to the costs of providing special services. "Access tiering" of Internet services—providing faster or higher quality of service—is no more objectionable here than it is in other markets where it is a ubiquitous practice. Those who object to any such tiering (which is probably a minority of neutrality advocates) seem to do so either from a reflexive concern that it will be used to enhance monopoly rents or that it will handicap some applications/content providers at the expense of others. With respect to the first, even if monopoly power is shown, differential pricing may be socially benign. [64] But even if it is not, the proper remedy is to attack the monopoly problem itself.[65] As to the second, the objection to access tiering is tantamount to eliminating competition based on superior services that some firms can afford and others cannot. Alice (of Wonderland fame) had three words for this kind of thinking: "stuff and nonsense."

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[63] This principle is such a commonplace one that it hardly warrants citing authority, but as is often the case, a cite to Alfred Kahn is appropriate. Alfred E. Kahn, *Telecommunications, the Transition from Regulation to Antitrust*, 18-21 AEI-Brookings Joint Center for Regulatory Studies (2006).

[64] As a matter of economic theory the welfare effects of price discrimination are ambiguous depending generally on whether the positive effect on output trumps the maldistribution of resources or, in the case of intermediate purchasers, causes secondary distortion in downstream markets. For a brief summary of the effects of price discrimination see DENNIS W. CARLTON AND JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 289–91 (Third Ed. 2000). (The maldistribution of resources refers to the possibility that price discrimination through market segmentation can lead to a misallocation of resources – some consumers that purchase the service due to the relatively low price in their submarket value it less than other consumers that do not purchase the service due to the relatively high price in their submarket.)

[65] Neuchterlein, *supra* at note 44, argues that if intervention is warranted, it is basically for reasons of antitrust policy and enforcement ought to be assigned exclusively to the antitrust agencies. There is much to be said for an antitrust perspective, but we are agnostic over whether it would necessarily produce results superior to regulation. It very much depends on the specific type of remedy one thinks should be adopted for the problem, if there is a problem.

It is somewhat ironic that two of the leading protagonists in the net neutrality debate, Tim Wu and Christopher Yoo, have each invoked Schumpeterian arguments in support of their respective positions for and against neutrality mandates. Wu argues that net neutrality rules will promote competition among and encourage innovation by *applications* (content) providers.[66] Yoo, on the other hand, worries that such rules will stifle investment in infrastructure development, that is, the development of new competitive *service providers*. Both arguments are Schumpeterian in character, and we would say that both are worth evaluating. However, we do have some evidence of the malign effect of burdensome regulatory mandates on incentives for new investment in network infrastructure that should be the foremost concern,[67] while the benign effect on investment in new applications is a matter of speculation.

Multiple Ownership in Media Markets

Limitations on the number of media that can be held in common ownership (both at the local and at the national level) were among the earliest rules adopted by the FCC. As with most FCC rules, the multiple ownership rules are complex and have undergone many changes over the years. In general the changes have been in the numerical limits on ownership (usually, but not invariably, in the direction of liberalizing the limits). In one important instance, however, the change has been in the underlying rationale. This is the case with the so-called "group ownership" or national ownership caps on the number of broadcast stations that can be held, nationwide, in common ownership. The rules have a long history; they were first imposed on FM radio in 1940 and thereafter extended to television and AM radio in 1941 and 1943, respectively. The original limits varied by service, six for FM, seven for AM, three for television, but after a series of adjustments each service received a cap of seven, with the condition that, for television at least, two of the stations had to be UHF. The "seven station" rules remained in effect for twenty years.

After a major review of the rules, the Commission in 1984 decided they were unnecessary and should automatically sunset after six years.[68] As a transitional measure it raised the limit to twelve stations nationwide. The transition proved to be indefinite. Congress expressed its displeasure at the FCC's decision to open up national ownership by declaring a temporary moratorium on implementing the decision. Responding to Congress's disapproval, the FCC reversed its decision eliminating the rule, though it did retain the increased limit of twelve, supplemented by an additional limit that prohibited ownership of television stations reaching more than 25 percent of the country's television households.[69]

Two decades on, congressional opposition to relaxing the multiple ownership rules changed. In 1996, Congress was in a deregulatory mood. While most of that mood

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[66] Tim Wu and Christopher Yoo, *supra* note 44.

[67] See, for example, Thomas W. Hazlett and Anil Caliskan, *Natural Experiments in U.S. Broadband Regulation,* 7 REVIEW OF NETWORK ECONOMICS 460 (2008) and sources cited in note 31 *supra*.

[68] Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C. 2d 17 (1984).

[69] Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C. 2d 74 (1985).

concentrated on reforming telecommunications policy, some of it targeted broadcast regulation as well, including several of the broadcast ownership rules. For radio, Congress eliminated the national ownership limit altogether. With respect to television, Congress directed the Commission to eliminate the numerical limit and to raise the audience percentage cap from 25 percent to 35 percent. It also directed the FCC to conduct a biennial review of all of its broadcast ownership rules, with a view to eliminating any that were deemed unnecessary.[70] In its 2002 Biennial Report (released in 2003) the FCC raised the ownership cap to 45 percent.[71] Congress, which was apparently no longer in the deregulatory mood that it was in 1996, responded with attempts to legislate a return to the old caps. In the face of a threatened presidential veto, it compromised and reduced the cap from 45 percent to 39 percent.[72]

If the number 39 appears arbitrary, it was and it wasn't. It was not based on any obvious economic principle or policy, and even as a compromise figure, it is odd; the conventional heuristic of splitting the difference between the high and low marks would have produced an audience cap of 40 percent not 39 percent. As it happens, however, 39 percent was just enough to allow two networks, Fox and CBS, to avoid divesting stations that they had acquired in contemplation of a new limit. (The FCC had given them a temporary waiver of the old limit pending the outcome of the rulemaking proceeding to reconsider the limit.)

Of course, to ask why Congress did not split the difference between the old and the new is something of a tangent. It explains the politics of the matter, but it doesn't explain anything about the underlying issue. What is the right cap? Why, indeed, is there any cap at all? For most of the history of national ownership rules, the Commission avoided a coherent account of just how the national rules affect diversity.

When it first promulgated group ownership rules, the FCC explained their purpose as being "[t]o obviate possible monopoly, and encourage local initiative."[73] In 1953, in the course of raising the limit (from three stations in each service–AM, FM and TV–to seven stations), it elaborated on this rationale slightly by saying that the purpose was to "promote diversification of ownership in order to maximize diversification of program and service viewpoints as well as to prevent any undue concentration of economic power contrary to the public interest."[74] Then, thirty years after its adoption of the "seven stations rule" the Commission concluded that the national ownership caps were irrelevant to the central purpose of ensuring diversity of views—which was a function of ownership in particular markets not ownership of stations in different markets. In short, there was no such thing as a national market

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[70] Telecommunications Act of 1996, § 202, 110 Stat. at 110-12.

[71] 2002 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules, 18 FCC Rcd. 13,620 (2003).

[72] Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, § 629, 118 Stat. 3, 99 (2004).

[73] FEDERAL COMMUNICATIONS COMMISSION, SIXTH ANNUAL REPORT 68 (1941).

[74] Multiple Ownership of AM, FM and Television Broadcast Stations, 18 F.C.C. 288, 291-92 (1953), *aff'd sub nom.*, United States v. Storer Broadcasting, 351 U.S. 192 (1955).

for purposes of considering diversity.[75] As we noted, after Congress voiced its displeasure at the FCC's decision the FCC reconsidered, but it offered no explanation for its reversal.[76]

When the FCC next addressed the national ownership rules—as part of its first biennial review mandated by Congress—it declined to make any changes in the rules, but along the way it discovered a new rationale for them: The rules promoted localism by strengthening the bargaining power of independently owned (specifically non-network owned) stations, which in turn promoted local diversity. Neither the diversity or localism arguments convinced the court of appeals, which demanded an explanation for why the Commission had ignored the conclusions it had reached in 1984 about the lack of need for the rules.[77] The remanded proceeding was merged into the next biennial review proceeding. As part of that review, the Commission in 2003 still retained the rules but increased the audience cap to 45 percent, which, as we noted, Congress adjusted downward to 39 percent.

So the national ownership rule still stands. But what theory or purpose is it standing on? Congress didn't say what purpose it thought the rules served; it probably didn't know. The FCC's Biennial Report offered an expanded version of the localism *cum* diversity argument that it had earlier offered and that had been rejected by the court. The new purpose of the national ownership cap was not to confine the power of group owners generally, but the power of the *networks*. For most of its history, the national ownership rule was not conceived as a means of containing network power. No such rationale appears in the 1984 report, for example. But when the networks became the chief protagonists for eliminating the rule, it became apparent that one of the primary effects of doing so would be to shift the balance of power of networks *vis a vis* independently owned affiliates. The networks wanted to own more stations in order to lessen their dependence on independently owned affiliates for carrying ("clearing") network programs. The independently owned affiliates opposed for the same reason.[78]

What had originally been a concern about horizontal concentration (albeit an odd one since it dealt with concentration across markets) thus became a concern about vertical integration. This segues into another story, about the FCC's vertical integration policies, specifically its concerns about network dominance of affiliated stations. That story is too complicated to relate here.[79] It is enough to say merely that the FCC has been conflicted between, on the one hand, a regulatory mantra of local station responsibility for (and control of) program choices, and on the other hand, the unavoidable economic reality that the production of high-quality television

[75] Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C. 2d 17 (1984).

[76] Multiple Ownership of AM, FM and Television Broadcast Stations, 100 F.C.C. 2d 74, 96 (1985).

[77] Fox Television Stations, Inc. v. FCC, 280 F.3d 1027, 1044 (D.C. Cir. 2002).

[78] Interestingly, so did the National Association of Broadcasters. Although the NAB generally purports to represent the entire industry, in this case the industry was divided and the association allied with the stations over the networks.

[79] Further detail is provided in GLEN O. ROBINSON AND THOMAS B. NACHBAR, COMMUNICATIONS REGULATION, Chapter 4 (2008).

programming involves costs that can be recouped only by revenues derived from exposure to national audiences, which in turn can only be assured by allowing national networks substantial control over what programs are produced and distributed. Historically, the FCC has tacked back and forth between regulatory aspiration and economic reality, producing a mishmash of regulatory restrictions on network control of program choices that have proved an utter failure, even on the FCC's own terms.[80]

The saga of the national ownership rules is only the latest in this controversy over networks versus stations that originated in the dawn of communications regulations. Of particular interest here is how it illustrates the protean character of FCC regulations: when the original rationale for a rule is found to be wanting, keep the rule and find a different rationale. After all, the FCC in 1984 had found that the national ownership rule was not needed to promote diversity or localism. Somewhere in the new debate over networks versus local affiliates this finding was forgotten or ignored. We cannot know what Hippocrates would say about this regulatory episode, but we think he might be suspicious of a doctor who diagnosed an ailment based on conditions that were discovered not to exist, but who prescribed the same medicine to treat a new set of conditions. For his part Schumpeter would likely have declared the ownership rules generally to be a humbug—a misguided interference with what is by any measure a dynamic and competitive (diversified) market. Even assuming that national ownership does affect the bargaining relationship between networks and affiliated stations in the manner explained (which is quite plausible), there is no reason to think this adversely affects diversity of viewpoints generally or local content in particular. As to the former, the FCC's own findings in 1984 were that diversity is a function of the number of stations in a local market, which is not affected by national ownership. As to the latter, no evidence in the biennial report rulemaking proceeding showed that network-owned stations offer fewer local programs than non-network stations. Apart from local news, the amount of local programming is trivial in any case, so the only question left would be whether local affiliate choices of *national* programs were more suitable to their local audiences than those that were offered by their networks. As to that, the only evidence the FCC identified could only be described as proof of the well known dictum that in law "data" are the plural form of "anecdote." Absent a more robust concept of evidence that the competitive process is adversely affected to the detriment of the end consumer, regulatory intervention here is simply a matter of adjusting private relationships between the networks and their affiliates. As a matter

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[80] The best single example is the FCC's so-called "financial interest and syndication rules" (popularly labeled "fin-syn") that forbade networks from buying secondary distribution rights from program producers, which was coupled with a "prime-time access rule" that gave non-network distributors an exclusive claim on one hour of prime time. Both rules were designed to reduce the networks' control over program choices. The silliness of the rules came to be conceded even by the FCC, but for political reasons it found it difficult to extricate itself from them altogether until a court decision officially declared the fin-syn rules to be arbitrary and capricious. See Schurz Communications, Inc. v. FCC, 982 F.2d 1043 (7th Cir. 1992). The prime time access rules, which were always associated with fin-syn, were subsequently repealed by the FCC in 1995. Prime Time Access Rule, 11 F.C.C.R. 546 (1995).

of regulatory principle, Professor Kahn would counsel that the regulator has no business being in that business.[81]

Recommendations and Conclusion

Given the limited ambition of this essay, our critique of FCC regulation has been necessarily abbreviated, selective, and suggestive. Deriving grand lessons from such a thin selection of regulatory episodes will no doubt seem bold if not foolish. Still, we see some persistent patterns in these cases, repeated in other FCC actions not discussed.

Probably the most obvious pattern is the penchant for detailed controls designed to eliminate any unforeseen contingencies that the play of markets might produce. One sees this most sharply in the telecommunications area and the attempts by the FCC to fine tune competition in local service markets. We commented earlier on the FCC's attempts to define competition in those markets by fixed standards rather than seeking to ensure that the dynamic force of competition is not foreclosed by artificial barriers to entry or other market failure considerations. The appropriate recommendation here is simple: Once the minimum conditions for competition are in place, do not attempt to regulate certain outcomes. The Schumpeterian corollary to this is: The conditions for competition should be measured by a long-run perspective. We say this fully mindful of Keynes's famous edict about being dead in the long run.[82] By long run we don't mean a life term. But we do mean a period that may exceed the tenure of the regulator.

Admittedly the long versus short-run problem is not uniquely in control of the regulator. When Congress enacted the 1996 Telecommunications Act, it directed the FCC to adopt regulations to implement its local market competition provisions within six months. Dutifully responding, the FCC fell all over itself to put in place sharing rules and pricing rules that were incompletely considered (to put it charitably). These quickly promulgated rules produced more than a decade of litigation in the courts that defeated Congress' desire for quick action—and also immediate results. The FCC had to respond to the six-month deadline for rules, but it did not need to craft rules with a view to producing immediate, short-run results at the expense of a more sedulous, but ultimately more sustainable set of rules for the long run.

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[81] Alfred E. Kahn, *The Uneasy Marriage of Regulation and Competition*, TELEMATICS, Vol. 1, Number 5, 1984, at 15.

[82] JOHN MAYNARD KEYNES, A TRACT ON MONETARY REFORM 65 (1923). The relevant passage is worthy of quotation in full. "But this *long run* is a misleading guide to current affairs. *In the long run* we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again." (Emphasis supplied). For Keynes, much like Schumpeter, it was the process of disequilibrium in the market rather than equilibrium that should occupy economists' attention. See also P.J. McNulty, *Economic Theory and the Meaning of Competition*, LXXXII QUARTERLY JOURNAL OF ECONOMICS 648 (1968) (describing the difference between a condition of equilibrium and the behavioral pattern leading to it).

The disposition to control all contingencies leads naturally to an attempt to develop solutions for problems that have not manifested themselves.[83] A degree of anticipation is not a bad thing. It is one of the advantages of administrative regulation over other forms of government control, such as antitrust or other forms of ad hoc interventions. But this virtue can also be a vice of regulation when it leads to premature action, as we believe to be the case in the net neutrality controversy. Perhaps taking literary liberties with Hippocrates, we described this as a Hippocratic oath problem for the simple reason that premature intervention almost always produces more harm than good. We don't claim that it is wrong to anticipate problems; the harm lies in rules that are so anticipatory that the problems they seek to remedy are not well defined and may even serve unwittingly to produce additional problems.

In the case of net neutrality, admittedly, the FCC has not adopted any specific set of regulations. Indeed, as we saw, that was precisely one of the objections raised to its enforcement action in the *Comcast* case. However, the FCC's demand for accounting from Comcast will have the effect of inviting regulatory surveillance of managerial decisions by service providers without the benefit of any clear engineering or business standards—and all in order to stave off possible strategic behavior that has not been shown to be a significant threat to the normal, expected operation of the market. Again, the FCC was clearly responding to political pressures. There have been proposals for legislation to set standards of net neutrality.[84] In defense of the FCC's action one might argue that its intervention in the *Comcast* case might have the effect of heading off congressional action that would be more mischievous than the FCC's limited actions. Perhaps. However, given the previous history of FCC actions under the claim of "ancillary jurisdiction" (we have in mind the early history of cable television regulation), one must be anxious about entrusting a matter of this potential importance—the regulation of the Internet—to the agency's undefined, standardless discretion.

Choosing between an unfettered agency and an uncontrollable legislator is, we concede, a little like choosing between two equally loose cannons. Congress's action in the case of the broadcast group ownership rules is a case in point. In 1984 when the FCC decided that the rules were irrelevant to the ostensible purpose of promoting diversity, Congress cut off funds to implement the change. Fast forward a little more than decade, when Congress in 1996 directed the FCC to take a close look at its multiple ownership rules, including the group ownership rules, with a view towards relaxing or removing any that were not shown to be currently needed. Although slow to respond at first, the FCC under prodding from the courts made a number of far-reaching changes in all of its ownership rules in 2003, including raising

[83] We do not fault the regulator for this behavior *per se*. It is arguably a rational response to an environment that holds the regulator to account for performance metrics that are easily measured (e.g., prices, blocked Internet applications), but not for performance metrics that are less easily measured (e.g., products and services that do not find their way to market, but would have otherwise.) This explains why regulators are not predisposed to foster the type of dynamic competition that Schumpeter viewed to be the most important for consumer welfare.

[84] See, e.g., Internet Freedom Preservation Act, S. 215, 110th Cong. (2007).

the cap on the group ownership limits that it had attempted to remove in 1984. Congress immediately responded with what was basically a reprise of 1984: a demand to cease and desist from any changes in the cap, followed by a compromise solution to allow a slight increase in the limit in order to accommodate two of the national networks. Political scientists will no doubt shrug and say, well, Congress is run by politicians not philosophers.

As it happens so is the FCC, and here we suggest is the appropriate place to draw the line between politics and principles. The Communications Act does delegate to the agency a considerable degree of policy-making discretion, but it is not a "home rule" charter conveying independent political sovereignty. The lesson, and the correlative recommendation, is simple: Do not anticipate legislative commands or respond to the wishes of congressional members except where they are clothed in formal legislation. Make Congress do its own work. We cannot say that such a recommendation, if followed, would have changed the outcome of the national ownership rules, but it might have. When Congress in 1984 cut off funds to implement the elimination of the rules, it was only a one-year moratorium. At any time thereafter the agency could have acted on its 1984 judgment. It did not do so. Indeed, it did not do so even after the 1996 Act directed a review of its rules. Its failure to follow through on its 1984 conclusion could not be defended as principled; indeed, it was precisely on that score that the court of appeals reversed the agency in 2002 and forced it to confront the issue.

We began this essay with the idea that the collective wisdom of Hippocrates, Schumpeter, and Kahn could constructively inform the role of regulation in the rapidly evolving telecommunications industry. The objective of regulation in telecommunications, regulating the monopoly prices paid by consumers, is no longer the primary focus of regulation; competition has made that objective largely moot. Today regulators have shifted their focus to regulating that competition in order to ensure its success. While there may be some legitimate role for regulation to play in facilitating the transition from monopoly to competition, we think it is one that poses great risks of undermining the very competition it is supposed to foster. As a result, due deference to the Hippocratic oath calls for a more limited role for *ex ante* regulation going forward. Schumpeter believed that the regulators' efforts to control transitory market power were misguided because they interfered with the competitive process—dynamic efficiency always trumps static efficiency. It would be difficult to point to an industry more technologically dynamic than the telecommunications industry. Kahn recognized that the regulator's penchant for competitive handicapping interfered with market rivalry in a manner that served to harm rather than benefit consumers.[85] And both Schumpeter and Kahn would counsel that regulators should serve to protect the integrity of the competitive

[85] Indeed, as FCC staff officials Haring and Levitz long ago observed: "If one of the runners in a race is artificially handicapped, that may make the rivalry less intense and the contest less capable of producing a superior performance." John Haring and Kathy Levitz, *What Makes The Dominant Firm Dominant?* Office of Plans and Policy, Working Paper Series, No. 25, Federal Communications Commission, April 1989, note 10.

process rather than protect selected competitors. Their counsel, though often unheeded, is precisely on point.

The collective wisdom of these teachers serves to reinforce the fundamental theme of this essay that in refereeing the struggle between competing firms, the referee's role must be circumscribed. The referee must not be an active party to the contest. Nor should it seek to shape the outcome according to narrowly defined, pre-fixed outcomes. These ideas are not natural for those steeped in the centrifugal model of traditional regulation. And yet, it is only in escaping these traditional modes of thought and expression that we can complete the transition to the centripetal model of regulation that the times require—a model that is focused less on the control of market power and more on unleashing the power of markets.