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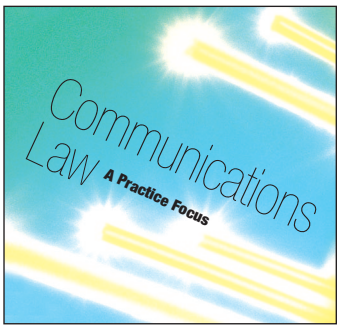
Reject Demands for Unbundling

The FCC ought to choose a market vision for new OpenCable platform.



BY RANDOLPH J. MAY

If the "unbundling" advocates have their way, the Federal Communications Commission might as well change its name to the Federal Unbundling Commission.

These advocates are pushing the FCC to adopt new rules to require more intrusive supervision of cable operators' interactive digital products. Unless a majority of the five-member commission indicates clearly that it rejects the injurious notion that broadband service providers must engage in ongoing unbundling of their networks—separating the provision of Internet access service from Internet content—the agency should start printing new stationery.

The latest salvo in what has become a concerted unbundling holy war was launched in June, when a group of organizations asked FCC Chairman Kevin Martin to consider further unbundling of the cable industry's transition to new digital-ready technology.

Cable operators, working with unaffiliated consumer electronics companies and applications and content providers, have developed a platform called OpenCable. OpenCable is a standardized interface that will enable consumers to enjoy through their television a wide array of new two-way services such as video on demand, interactive programming guides, shopping, banking and other e-commerce activities, e-mail, and TV instant messaging chat. Consumers will be able to get these new applications without leasing separate set-top boxes from the cable companies. Independent equipment manufacturers and applications and content providers will be able to develop new interactive products and services using the OpenCable platform.

The organizations arguing for a greater degree of FCC-supervised "openness" of the OpenCable platform are groups that claim to be forward-looking in a way that will benefit consumers. Yet at bottom, the unbundling advocates want to reinstitute the FCC's 1980s *Computer II* regime for all broadband providers. *Computer II* enforced a strict separation between the provision of transmission capacity and the applications, content, and equipment that use the transmission capacity. Put another way, these advocates want all broadband providers, whether they be cable, telephone, satellite, or wireless, to be "dumb pipes" without any network intelligence.

The unbundling advocates oppose all vertical integration of broadband transmission with applications, content, or equipment because they assert that cable operators and other broadband providers still exercise monopolistic power. They claim that unless strict unbundling is enforced, the broadband providers will "discriminate" in favor of their own content and equipment.

The *Computer II* rules may have served a purpose during the earlier analog era, when AT&T could exercise monopoly power. But not now. At least three of the five FCC commissioners must decide that they believe what a commission majority has repeatedly declared for more than five years now: The broadband market is competitive and is becoming more so each day.

If a majority believes this, it must answer this question: Does it want to revert to the regulatory micromanagement that characterized the *Computer II* era, which will be required to supervise unbundling regimes? Or, instead, is it willing to rely on marketplace competition to protect consumers?

A COMPETITIVE MARKET

As early as February 2002, in its *Wireline Broadband* proceeding, the commission determined that "broadband services should exist in a minimal regulatory environment that promotes investment and innovation in a competitive market." This conclusion was based on the already-emerging competition among broadband providers employing different technological platforms.

Since 2002, competition among broadband providers has become increasingly more intense. Telephone companies have invested billions in upgrading their network facilities with fiber-to-the-home and Internet protocol technologies to compete more vigorously with cable operators. Verizon alone says it is investing $23 billion between 2004 and 2010 to build a fiber-to-the-home network that will reach 18 million homes. AT&T recently said it is increasing its investment in its new Internet protocol

network to $6.5 billion by 2008, when it hopes to reach 13 million homes with its broadband offering.

Thus far, cable operators have held the lead in market share among broadband providers, at least partly because, since 1996, they collectively have invested more than $100 billion upgrading to digital networks. But the most recent FCC data show that cable's market share has dropped from approximately 60 percent in 2002 to less than 45 percent today, with the wireline telephone companies now garnering 36 percent. Significantly, the FCC data show that wireless broadband providers, with more than 11 million high-speed lines, are achieving the most rapid subscriber growth.

Cable operators, like other broadband providers, often attempt to attract consumers by bundling video, voice, and Internet access into packages—the so-called triple play or, with wireless added, quadruple play. Bundling is the natural evolution of a digital world in which "a bit is a bit is a bit," one in which traditional service distinctions such as "voice," "video," or "data" no longer make sense from a regulatory perspective.

Nevertheless, if one insists, as the openness advocates wrongly do, on segmenting the broadband market by examining only video, this submarket is effectively competitive. The FCC's series of annual video competition reports show the steady progression of increasing competition over the years. The most recent video competition report, released in March 2006, concluded, "The market for the delivery of video programming services is served by a number of operators using a wide range of distribution technologies."

Based on the collection of comprehensive data, the commission concluded that "almost all consumers" have choices among broadcast television, a cable service, and at least two satellite providers. In some areas, consumers also may have access to video programming such as digital broadcast spectrum, fiber to the home, and Internet video. In addition, through set-top boxes, digital video recorders, and new mobile video services, consumers now have "more control over what, when, and how they receive information." In addition, multichannel video providers of all stripes are offering nonvideo services.

The two leading satellite television providers currently have approximately 30 percent of the multichannel video market. In July 2006, when the FCC approved the transfer of Adelphia's cable systems to Comcast and Time Warner, it determined that "competition among providers of broadband services is vigorous," rejecting contentions that the transaction would allow Comcast or Time Warner to engage in anticompetitive conduct. Since then, Verizon and AT&T have made further inroads into the video market segment.

No New Rules Needed

In light of these FCC determinations, there is no basis for adoption of new rules requiring more intrusive FCC supervision of the unbundling of cable operators' two-way digital-cable-ready products.

As Joseph Farrell of the University of California at Berkeley and Philip Weiser of the University of Colorado explained in a 2003 article in the *Harvard Journal of Law and Technology*, "even a platform monopolist often has incentives to make efficient choices about when to maintain modularity and when to get involved in an adjacent market." Whatever the case once may have been, cable operators or telephone companies today are not "platform monopolists."

To compete effectively, cable operators already have every incentive to be responsive to consumer marketplace demands. At times, this may mean integration of transmission with applications, equipment, and content. At other times, it may mean voluntarily entering into business arrangements with independent vendors because it is more efficient to use their services and equipment. In a competitive market, a provider cannot afford for more than a short time to forgo efficiencies that will reduce its costs or inhibit the availability of products demanded by consumers. If providers do not make efficient choices, they will lose in the marketplace.

The advent of interactive "television" capabilities through the OpenCable platform—as well as the platforms of competing broadband providers—promises to bring consumers exciting, new interactive applications. The OpenCable platform is sufficiently appealing that many independent consumer electronics firms, including industry leaders Samsung, Panasonic, and LG, are already designing digital-ready television sets to the OpenCable standard.

These companies have determined that building to the platform's specifications offers opportunities to benefit from the market demand for new digital-ready sets with interactive capabilities. No doubt these same companies also will be looking as well to work with noncable broadband platform providers, such as Verizon, AT&T, and wireless companies. In a competitive, technologically dynamic marketplace, there can be no sustainable involuntary lockups.

Whether the current OpenCable standard, or any succeeding version, satisfies all consumer electronic companies is not the point. Given their druthers, any one of the companies almost certainly would prefer to design its own standard. The point is not even whether cable operators or other broadband providers at times may prefer integrated operations to unbundled ones. They might. The point, rather, is whether, in today's marketplace, as business models and technologies continue to evolve rapidly, there is any justification for the commission dictating further unbundling of the OpenCable standard, with the ongoing regulatory micromanagement that always follows unbundling mandates. There is none. The harm to consumers from diminished incentives for investment and innovation outweighs any possible benefits.

The FCC should explicitly reject the pleas to require ongoing unbundling of not only the OpenCable platform but also other broadband network platforms, regardless of whether they are wireline or wireless. For example, the FCC is now considering whether to require unbundled operation in a portion of the soon-to-be-auctioned 700 MHz spectrum**.** By clearly choosing a market-oriented vision, the agency can avoid becoming known as the Federal Unbundling Commission.

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