

# **The Free State Foundation**

**A Free Market Think Tank For Maryland...Because Ideas Matter**

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## **SIDELINE FRONTLINE**

**By**

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If Ronald Reagan were still alive, with nothing more important to do than contemplate the Federal Communications Commission's 700 MHz proceeding, you can bet he would give that trademark shake of his head, while proclaiming: "There you go again, Reed."

In his book, *You Say You Want a Revolution—A Story of Information Age Politics*, Reed Hundt, chairman of the FCC from 1993-1997, recounts that "during that long and famous night" at Woodstock in August 1969, he learned if Jimi Hendrix could play "The Star Spangled Banner" his way, then, as FCC Chairman, he "could rewrite the rules."<sup>1</sup>

Woodstock is becoming an ever more distant memory. (For some who were there, it was a distant memory the very next day!) And Reed Hundt's pro-regulatory FCC chairmanship is becoming a fading memory too. But now, as the key upfront player for Frontline Wireless, Hundt is trying to "rewrite the rules" once again.

The FCC ought to just say no. In the interest of sound public policy, Frontline should be sidelined.

There are certainly many important decisions the Commission confronts in deciding on a "band plan" in the 700 MHz rulemaking proceeding. Debated back and forth by any number of interested parties, these include matters such as the size of the geographic areas of the licenses to be awarded, the size of the spectrum blocks, and technical rules such as power limits. But, in the larger scheme of things, no decision the Commission will confront in deciding the 700 MHz rules

will be more important than the one put in play by Frontline's proposal. Frontline has asked the FCC to adopt a band plan that includes a spectrum block ("E Block") set aside only for "wholesale" and "open access" operations. In other words, operators would be required to conform to Frontline's version of the "non-discrimination" principle that has been advocated by Net Neutrality proponents for the past several years. As Frontline put it in its recent comments filed with the FCC, the open access non-discrimination rule will require "decoupling the retail layer from the connectivity layer."<sup>2</sup>

In essence, Frontline's proposal embodies the notion of the FCC managing competition by requiring "unbundling" of a service provider's wholesale and retail operations and implementing a non-discrimination mandate. Counterpoised against Frontline's managed competition vision is a very different vision-- one that embodies the establishment of market-oriented rules that allow private sector firms more freedom to make decisions about how best to invest their money and respond to consumer marketplace demands. The managed competition vision rests on an assumption, rarely stated this bluntly, of course, that the regulators, through their supervision and control of unbundling decisions, can do better than the marketplace in promoting consumer welfare. The managed competition vision tends to view the communications marketplace as static rather than dynamic, and it almost never acknowledges the degree to which the marketplace already has become competitive and contestable. This static marketplace view is used by the advocates of mandatory unbundling to justify ongoing managed competition. The market-oriented vision requires more regulatory modesty, of course.

In determining the 700 MHz rules, something the Commission needs to do in a matter of weeks, the FCC once again will be forced to choose between the two competing—and very different—visions.

It should not be surprising that Reed Hundt's Frontline proposal embraces the managed competition vision. As FCC Chairman, in the name of fostering competition, Mr. Hundt led the agency to adopt network "unbundling" rules for the local telephone companies that three times were held unlawful by courts, including the Supreme Court, because they exceeded the Commission's authority. In each instance, the courts found that the agency's Unbundled Network Element rules required an excessive amount of unbundling. Towards the end of this long and painful saga, Judge Stephen Williams, in *United States Telecom Association v. FCC*, explained why the "completely synthetic competition" created by unbundling rules deters investment and innovation: "If parties who have not shared the risks are able to come in as equal partners on the successes, and to avoid payment for the losers, the incentive to invest plainly declines....Each unbundling of an element imposes costs of its own, spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities."

Of course, unbundling proposals such as Frontline's are always accompanied by pleas that, this time, the unbundling rule will be simple to administer and

enforce, that the management of the shared facilities in a wholesale/retail split regime will not, in fact, be complex. But a cursory review of Frontline's comments belies any claims of simplicity. For example, Frontline suggests rule requirements spelling out the amount of wholesale capacity that may be made available to any single entity and proposed definitions for determining whether an entity is "affiliated" and, therefore, prohibited from using the wholesale spectrum. But the real complexities would arise in the day-to-day micromanagement of the rule prohibiting "unreasonable discrimination." Such ongoing regulation imposes real costs.

The remarks by Mr. Hundt's successor, FCC Chairman William Kennard, on the costs imposed by mandated unbundling are instructive. Although Mr. Kennard, at the end of the last century, was addressing then-fashionable proposals to impose "open access" requirements on cable operators, his admonition is relevant to Mr. Hundt's current open access proposal:

It is easy to say that government should write a regulation, to say that as a broad statement of principle that a cable operator shall not discriminate against unaffiliated Internet service providers on the cable platform. It is quite another thing to write that rule, to make it real and then to enforce it. You have to define what discrimination means. You have to define the terms and conditions of access. You have issues of pricing that inevitably get drawn into these issues of nondiscrimination. You have to coalesce around a pricing model that makes sense so that you can ensure nondiscrimination. And then once you write all these rules, you have to have a means to enforce them in a meaningful way. I have been there. I have been there on the telephone side and it is more than a notion. So, if we have the hope of facilitating a market-based solution here, we should do it, because the alternative is to go to the telephone world, a world that we are trying to deregulate and just pick up this whole morass of regulation and dump it wholesale on the cable pipe. That is not good for America.<sup>3</sup>

So here we go again. As is the case with Frontline's proposal, pleas for imposing unbundling mandates are always offered in the name of fostering "competition". And they almost always ignore or downplay the extent to which competition, or at least contestable markets, already exist, and the extent to which unbundling mandates will deter new investment that is needed to stimulate even more competition. This is indeed an old story for Mr. Hundt. In his *Revolution* book, in justifying the excessive UNE unbundling regime, Mr. Hundt stated that he "aspire[d] to give the new entrants a *fairer* chance to compete than they might find in any explicit provision of the law."<sup>4</sup> Not a fair chance, mind you, but a *fairer* one. While this aspiration led to the creation of hundreds, if not thousands, of new "competitors" under an intricate and complex managed competition regime, we know that the experiment did not turn out well. The competitors lacked any incentive to invest in their own facilities, and so did the telephone company incumbents. And the UNE managed competition regime led Wall Street

to look with disfavor on support for cable's investment in providing facilities-based voice competition.

When the unbundling regime went away, so did the Potemkin-like competitors, and so did billions of dollars in inflated market cap stimulated by artificial competition. As Mr. Kennard might say: "That was not good for America."

So, now, in the context of the 700 Mhz proceeding, the FCC Commissioners are faced once again with a choice between very different, competing visions. On the one hand is the managed competition vision. The names of the unbundling proposals sometimes change, perhaps based on focus groups or recommendations of marketing firms that test new brand names for the same old bar of soap. The proposals may fly under the name of "open network architecture", "unbundled network elements", "open access", "network neutrality", or now, again, Frontline's "open access." No matter the label. The import is the same.

This Commission, at this time, in today's environment of technological dynamism, should sideline Frontline's unbundling proposal. It should opt for a market-oriented vision that gives any entity that wishes, regardless of status, a fair—not fairer—opportunity to compete in an auction based on rules unencumbered by managed competition precepts. Only in this way will the auction provide a non-rigged test of the willingness of interested entities to put their money where their mouths are by investing in the future of the wireless marketplace. An auction that is not subject to regulatory gaming will put the auctioned spectrum in the hands of those who will have every economic incentive to use it in ways that most efficiently and effectively enhance its value by responding to consumer demands. And an auction not subject to regulatory gaming will maximize the revenues that go to the Government for the benefit of the nation's taxpayers.

By teeing up the Frontline proposal, the Commissioners have set up for themselves a real test of their commitment to market-oriented policies and the greater consumer benefits they deliver. Let's hope the Commission has learned from history.

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<sup>1</sup> Reed E. Hundt, *YOU SAY YOU WANT A REVOLUTION—A STORY OF INFORMATION AGE POLITICS* 88 (Yale 2000).

<sup>2</sup> Initial Comments of Frontline Wireless, LLC, May 23, 2007, at 21.

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<sup>3</sup> “Consumer Choice Through Competition,” Remarks of William E. Kennard, Chairman, FCC, at the National Association of Telecommunications Officers and Advisors 19<sup>th</sup> Annual Conference, Atlanta, GA, September 1999.

<sup>4</sup> Hundt, *supra* note 1, at 154.

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