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The FCC Cannot Proceed in the BDS Proceeding with a Flawed Analysis

by

Michael J. Horney *

On April 28, 2016, the FCC adopted a [Notice of Proposed Rulemaking](#) (NPRM) regarding the investigation and subsequent regulation of what it now calls Business Data Service (BDS), formerly “special access” services. In the “Competition Analysis” section of the NPRM, the FCC asks many questions about how it should define the BDS market. The NPRM cites a number of declarations that attempt to analyze the market for BDS. But, as much as anything else, these questions and declarations raise still further questions that will be difficult for the Commission to answer.

For some time, the FCC has purported to define the relevant BDS market by discrete “location,” which generally means a single office building or cell site. In other words, each building with a BDS connection is considered by the FCC to be its own market. Under this view, the BDS price at any building is not impacted by nearby consumers or nearby BDS providers. FSF scholars have [always rejected](#) this building-by-building market definition as improperly narrow.

The market definition apparently stems from CLECs that claim it is impossible for them to compete in markets that are connected only by an ILEC. But as Fred Campbell explains in an April 2016 [Forbes article](#), the “impossibility” of CLECs to connect to ILEC-only buildings comes down to a mere 88 feet.

According to data the FCC just released, CLECs’ claimed “impossibility” amounts to 88 feet (or less) for at least half of ILEC-only buildings circa 2013. The FCC data show that 50% of ILEC-only buildings are [within 88 feet of the nearest CLEC network](#) (and the average distance between CLEC networks and *all* such buildings is only 364 feet). In

other words, CLECs argue that price regulation is necessary because, for at least half of all ILEC-only buildings, it's "impossible" for CLECs to extend their fiber networks an additional 88 feet.

In the FCC's April 2016 white paper entitled "[Empirics of Business Data Services](#)," Dr. Marc Rysman explains how data was collected on "locations."

For the location data, a goal of the FCC was to assign locations to buildings, in part to determine competitive overlap within buildings. Identifying when two competitors are in the same building is a non-trivial problem with these data. Some data providers reported latitudes and longitudes, while others reported addresses, and even then, slightly different latitude and longitudes or slightly different addresses may actually be part of the same building for our purposes. In order to determine which customers were in the same building, the FCC assumed that locations less than 50 meters (approximately 164 feet) apart were the same building (unless the geocoded address reported that they were in distinct buildings). Naturally, this requires a procedure to address sequences of locations that are less than 50 meters apart each, but together are more than 50 meters apart. In practice, each customer in the data appears in only one building. We assign each building to a census block, which then implies its census tract and county.

How can the FCC assume that two BDS providers within 164 feet of each other are located in the same building, but at the same time claim that 88 feet is too distant for a CLEC to obtain its own connection? Not only is the FCC's BDS market analysis flawed in this regard, but so is its data collection on building locations. The FCC should not make assumptions about building locations based on inadequate data if it will be using that data to analyze the competitiveness of each individual "market."

Although the FCC's NPRM asks many questions concerning how it should analyze and define competition in the BDS market, based on recent experience the FCC likely will define the market at the building location level. Doing so will make the BDS market look less competitive than it actually is. Then, the agency will claim a need for new regulations. As I stated above, CLECs want the FCC to define the BDS market by building location. On behalf of Sprint, which operates as a CLEC in some areas, Stanley M. Besen and Bridger M. Mitchell filed a declaration asserting that "analyzing competitive conditions for special access service in [Metropolitan Statistical Areas] MSAs can be highly misleading because these large areas often contain smaller geographic areas across which competitive conditions are widely disparate." They also claim that "the appropriate geographic market for analyzing special access channel terminations is the building location."

Notably, however, Dr. Marc Rysman concludes, correctly in my view, in an FCC April 2016 white paper that there are problems with analyzing data at the building level:

There are some problems inherent in analyzing the data at the building level. It is possible that providers in nearby buildings exert competitive pressure even if they cannot immediately serve the building in question. A further problem is that many buildings may

contain only one customer, and thus we will observe only one provider regardless of how competitive the market to serve that customer is.

Dr. Rysman says that at the census block level “there is evidence that local competition affects BDS prices” and that “the effect of competition is larger in regions with regulatory pricing flexibility.” In his white paper, Dr. Rysman estimates how competition affects BDS prices, but he only analyzes competition among BDS providers and does not take into account competition among businesses who buy BDS. Although Dr. Rysman does acknowledge that demand impacts price and competition, the impact of demand on BDS prices is not the focus of his white paper. The FCC’s NPRM says that the Commission will assess business density and demand when analyzing each individual market. But analyses should be performed to estimate how consumer demand affects BDS prices throughout the United States. The price of BDS is a product of both supply *and* demand, and, therefore, it is very important to understand the effect of consumer demand on BDS prices.

As the number of consumers in any market increases, the price of one unit in that respective market will increase with all other things being equal. As the price increases due to more consumer demand, additional suppliers will be incentivized to enter the market. Therefore, however the FCC defines the BDS market, it must recognize the impact that the number of consumers has on other market outcomes, such as price and the number of BDS providers. If the FCC’s building-by-building definition were accurate, assuming BDS providers sell the same level of service to all consumers and with all else being equal, one consumer in one building would pay significantly less for one unit of BDS than what two or more consumers in another building would pay for one unit of BDS. Also, under the FCC’s building-by-building definition, a “market” with one BDS provider and one consumer should be considered a bilateral monopoly. Bilateral monopolies create a price lower than what would exist in a normal monopoly market because the single consumer has bargaining power. If the FCC is serious about its building-by-building definition of the BDS market, it should have addressed bilateral monopolies in the NPRM. But it did not.

Most importantly, as Dr. Rysman states in his white paper, nearby competition impacts BDS prices. Additionally, it would be wrong to think that the demand for BDS does not have an impact on BDS prices. The FCC should not impose regulations on BDS providers without fully understanding the competitiveness of the BDS market, and it cannot understand the competitiveness of the BDS market until it acknowledges and properly assesses the impact consumer demand has on BDS prices and the number of BDS providers.

In sum, before the FCC moves forward in this proceeding, it must be able to answer the following question: With all else being equal, is the price of BDS in buildings with only one consumer less than the price of BDS in buildings with multiple consumers? This will be a difficult, if not impossible, question to answer, given the flaws in the FCC’s building location data. But if the answer is no (and I think it will be), then it is clear that nearby providers impact price, and, therefore, BDS competition is effective.

* Michael J. Horney is a Research Associate of the Free State Foundation, an independent free market-oriented think tank located in Rockville, Maryland.