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The Unbundling Panel?

by

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This year saw the Federal Communications Commission act at times as if it were "The Federal Unbundling Commission." Were it to continue, the harm to investment, innovation, competition, and consumer welfare likely would be significant.

First some history. When Congress passed the Telecommunications Act of 1996, it declared the law was intended "to provide a pro-competitive, deregulatory, national policy framework." President Clinton captured the spirit of what was thought to be a sea-change in communications policy at the Act's signing ceremony, calling it "truly revolutionary legislation"

In truth, the 1996 Act was not as revolutionary as this rhetoric suggested. It left considerable discretion to the FCC to carry out its often ambiguous provisions. And it carried forward a regulatory tool — government-directed unbundling of networks — employed by the FCC back when the ubiquitous Bell System possessed monopolistic power. During the 1960s, the FCC adopted rules which required the Bell System to allow non-Bell telephone equipment to be attached to local telephone networks on a nondiscriminatory basis. Then, in the 1980s the agency ordered the Bell System's local telephone companies to provide unbundled network access to emerging online service providers such as CompuServe, predecessors of modern Internet services.

The 1996 Act's key unbundling provision required the incumbent local telephone companies to provide competitors with unbundled access to certain elements of their networks at a regulated price. The FCC used its considerable discretion to construe this provision too broadly by including virtually all network elements within its sweep. It adopted a pricing methodology all but guaranteeing new

entrants would use the incumbents' networks to provide service rather than build their own.

Now, a decade later, despite a radically different communications marketplace, pro-regulation advocates press to extend the same unbundling approach to the broadband world of wireless telephony, cable television, and the Internet. The FCC already has adopted some policies that accept unbundling as a key regulatory premise.

Specifically, it has required future providers of the new wireless Internet to provide a degree of "net neutrality" by unbundling applications and devices from network transmission services. It has required cable operators to unbundle the security and program navigation functions from analog set-top television boxes provided to subscribers, and it is considering imposing a greater degree of unbundling of the new platform cable operators are implementing to deliver a host of new two-way interactive television services to digital television sets.

FCC Chairman Kevin Martin continues to advocate other unbundling proposals, such as requiring cable operators to offer all channels "a la carte" so subscribers pay only for those individual channels they choose.

One cannot evaluate the likely success of the current spate of unbundling proposals without understanding how much the marketplace has changed and why previous unbundling regulations have been so problematic. Earlier unbundling mandates were imposed at a time when the existing local telephone network represented the only effective way to reach consumers.

Today's competitive landscape is quite different. Wireless providers have emerged as such vibrant competitors that 14 percent of American adults have abandoned landline telephone service altogether. Cable companies now offer Internet-based telephone services that have increased competition still further, with cable-based voice subscribers reaching 6.3 million in 2006, an increase of more than 60 percent over the year before.

On their traditional video offerings, cable operators face continued competition from satellite companies, which have about 30 percent of the market. Consumers increasingly use their wireless devices to receive "television" content. And now the telephone companies, having invested billions of dollars in upgrading their networks with high-capacity fiber, are fast becoming significant competitors in the video market. The competitiveness that characterizes today's marketplace undercuts the justification for unbundling regulations because the various providers are forced to respond to consumer demands.

Moreover, by requiring networks to provide services, applications and devices on an unbundled basis, regulators inevitably end up establishing standardized interfaces, regulated prices or both. This limits service providers' freedom to adapt their offerings to the unique needs of their customers, restricting the ways

in which networks can compete.

And unbundling regulations prevent network owners from making changes to the standardized interfaces and approved prices unless those changes have been sanctioned by regulatory authorities. The communications industry's constant technological change causes natural interface points to move or to disappear altogether. The need to obtain advance regulatory approval threatens network owners' ability to adapt.

In practice, unbundling mandates have proven difficult to administer. This is especially so when the unbundling is complex and requires close coordination, as is the case with most modern communications networks, applications and devices. It took the FCC eight years before it could implement the network unbundling provisions of the 1996 Act in a way that withstood judicial scrutiny. The inevitable result is nearly incessant disagreements that can only be resolved through government micromanagement of the providers' business relationships.

Most importantly, unbundling can have a devastating effect on incentives to invest in alternative network technologies. Competitors that obtain access to key portions of the existing network facilities and functions at regulated rates have little motivation to invest on their own. At the same time, requiring that networks be shared dampens incumbents' incentive to invest.

Thus, unbundling mandates limit network operators' ability to react to technology changes and consumer demand and are difficult to implement. The increasingly competitive environment renders them unnecessary, as rivalry between different network providers can ensure access and foster innovation in content and applications. And the investment disincentives created by unbundling impede development of even further competition.

The FCC should reject persistent calls to extend unbundling mandates to various portions of our communications infrastructure. Instead, it should adhere to the policy prescription it announced five years ago when it declared broadband services should exist in a "minimal regulatory environment." History teaches that such a free market-oriented policy is best in a marketplace that is now convergent, dynamic and complex.

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