A Free Market Think Tank for Maryland......Because Ideas Matter

Perspectives from FSF Scholars
August 16, 2016
Vol. 11, No. 29

Can a Single Building Really Be Its Own BDS Market?

by

Tim Brennan *

The FCC currently has a proposal to regulate what it regards as "non-competitive" services in the overall "business data services" [BDS] sector, previously known as "special access" services. Although competition overall in this sector seems to be pretty vibrant, I do not know the facts well enough to refute claims that some providers within that sector may not face adequate competition. Nor can I speak authoritatively to the impermeability of circuit-switched services to competition from IP-based services, as the FCC claims. So I leave these issues to others.

However, one other aspect of this debate has long caught my eye: claims that the relevant geographic market may be a single building. The FCC is not specifically proposing this approach, but it has used it in the past and could be open to it in the future.

The argument for defining customer location as the market is essentially because, as the FCC quotes Jonathan Baker, "it is difficult to imagine [a BDS customer] responding to a small increase in price of dedicated services at one location by moving their business to another location where prices are lower." Those advocating a broader market definition cite the possibility that any given building could be readily served by BDS providers at nearby locations, perhaps any within the same Census block.

Purely as a conceptual matter, Baker has the better of this argument. But it leads me to a quite different conclusion. The vulnerability of a tenant in an office building does depend on its willingness to move in response to price. But that applies to the price of any amenity that comes with that particular building, not just to however many telecommunications services happen to be available there. Most notable of these prices is the rent on the building itself.

Consequently, the issue comes down to competition in the market for locations – that is, the relevant local market for office space. The "customer location" claim is equivalent to saying that each building owner is a monopolist with regard to its tenants. For if a tenant wouldn't leave if its BDS provider raised the BDS price by $20/month, it wouldn't leave if the building owner raised the rent by $20/month. And because market power inheres in the building, the building owner will generally have the ability and incentive to exploit competition in the actual local BDS market to get BDS on favorable terms.

Of course, if the tenant would stay if the building owner would raise the rent by $20/month, the building owner would presumably do so – and keep raising it until tenants were thinking about relocating. But at that point, the potential competition from relocating limits the ability to raise the price for anything – cafeterias, exercise center, garage – that comes with the office building. On this "customer location" account, regulation of BDS service is no more justified than regulating prices of gym memberships or parking in those buildings.

Moreover, competition in office building markets will complement competition for BDS services. If particular tenants find high-speed IP broadband significantly more valuable than circuit-switched service, the building owner can include such service among the amenities it offers. If a building owner believes that tenants would want to switch BDS providers within the time period of their lease, it can write contracts and absorb the expense necessary to provide that option to those tenants willing to pay for the ability to switch as they consider where to set up their offices.

A focus on building locations can be relevant. If a BDS provider has contracts with a dominant share of buildings – dominant in the market for office buildings, that is – then it may be able to exploit that dominance. That kind of dominance could be inherited if the BDS provider had been a monopolist in a local telecommunications service market only recently opened to competition. If the evidence supports a finding that a BDS provider possesses this kind of dominance, regulators (or antitrust courts) could consider whether the benefits of competition exceed the risk of service disruptions that might result from eliminating some of those contracts or requiring that the BDS provider divest wiring inside the building to facilitate entry by others.

Antitrust analogies may help. Suppose that a building owner said to prospective tenants that if one wants to lease space in my building, you have to use BDS Provider X. In antitrust terms, the building owner is tying Provider X's BDS service to leasing space in that office building. People can and do bring and win all sorts of antitrust cases, so I don't want to say that bringing a case on such a theory is impossible. But because the underlying market for office space is competitive, it seems like it would be pretty hard to argue that such a tie had a significant adverse effect on competition.

Perhaps one might claim that office tenants are vulnerable to exploitation by the building's BDS provider after they move in. Such a myopic vulnerability seems unlikely for businesses evaluating potential office space as they take all sorts of factors and amenities into account in making their choices. If that kind of after-the-fact exploitation is a foreseen possibility, the

building owner can contract with the BDS provider for terms and conditions of service and offer this as a benefit to potential tenants. Building owners already offer contracts to limit this sort of exploitation – they are called "leases."

This isn't the first time I've run into this "customer location as geographic market" idea. When working in Canada on local telephone deregulation about a decade ago, I ran across a contention that the relevant geographic market for telephone service was the customer's house. It seemed more sensible and accurate then, and now, to consider the relevant geographic market to be the locations of the providers who could offer service to that house and, generally, the city or county as a whole.

To say that the particular location is the market made about as much sense to me then as saying that the relevant geographic market when I recently considered purchasing a car was my driveway. This is a little different, to be sure – the BDS example is as if the car came with the driveway. But the underlying absurdity is similar – if I really didn't like the car, would I have chosen that house if similar houses were available? And if we are talking about mobile services where the customer location moves with the customer, are we to define each customer as its own geographic market?

In sum, defining a geographic market as a building location makes no more sense to me now than did focusing on a customer's house in Canada a decade ago. The FCC may (or may not) have good reasons for finding competition inadequate in the BDS market. However, in doing so, I hope that the agency continues to show a willingness to break precedent with past views and not adopt a view of the building as the market that would likely be unsustainable in any other context.

* Tim Brennan is a member of the Free State Foundation's Board of Academic Advisors and a professor of public policy at the University of Maryland, Baltimore County. He was Chief Economist at the Federal Communications Commission (2014).

The Free State Foundation, an independent free market-oriented think tank located in Rockville, Maryland.