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Proposed BDS Rate Controls Are Anti-Investment, Arbitrary, and Fact-Challenged

by

Seth L. Cooper *

On November 17, the FCC plans to vote on new price controls that threaten investment in broadband infrastructure deployments and upgrades. Its proposal to subject certain special access or so-called business data services (BDS) to new rate controls will divert financial resources from construction of new facilities. The Commission's proposal is not supported by evidence.

By proposing to impose a price cap on all TDM-based BDS facilities nationwide rather than conducting local market analyses, the Commission effectively throws away its comprehensive BDS data collection. As importantly, proposed rate controls are also arbitrary and contrary to agency precedent. The proposal should be rejected – or, if unwisely adopted, repealed by a newly-constituted FCC.

BDS services use broadband network facilities dedicated to delivering high-volume data with performance quality guarantees. BDS services are used by business enterprises, not ordinary residential consumers. Sophisticated businesses typically negotiate at arms-length with BDS providers for service terms and prices.

The Free State Foundation
P.O. Box 60680, Potomac, MD 20859
info@freestatefoundation.org
www.freestatefoundation.org

The FCC eased up on rate controls for copper wire TDM-based BDS facilities in its *Pricing Flexibility Order* (1999). Since that time, incumbent BDS providers have deployed Ethernet fiber-based facilities. Cable operators have also entered the market and are now pervasive BDS competitors. Today, business enterprises enjoy better choices among BDS providers, including superior service quality and higher data traffic capabilities.

Fiber upgrades are crucial to supplying growing data volume demands. And fiber-based facility deployments are essential to meeting backhaul capacity needed to support 5G wireless networks.

But the FCC has persistently been lobbied by certain BDS competitors seeking gains by reselling services over rival facilities at regulated prices instead of investing in their own facilities. As FSF President Randolph May and I have written previously, the BDS proceeding is infected with special interest pleading. Unfortunately, the FCC's pending rate control proposal would confer rent-seeking privileges long sought by lobbying competitors.

Under Chairman Tom Wheeler's proposal, providers of BDS services would be required to lease their TDM facilities to competitors at below-market rates. This would reverse fifteen years of deregulatory policy that has fostered investment in infrastructure upgrades and market entry by new competitors. All TDM-based BDS services nationwide offering 50 Mbps speeds or less would be subject to price cap regulation. Incumbent BDS providers would face at least 11% rate cuts, to be phased in over three years. Both last-mile connections and dedicated transport components of BDS services would be subject to the new rate controls. Although not subject to fixed rates, fiber-based Ethernet BDS facilities would be subject to FCC supervision regarding prices and terms of service according to as-yet-undefined standards.

New BDS price controls are counterproductive. Requiring that BDS providers lease their facilities at below-market prices to competing providers discourages those providers from investing in their own facilities. By artificially incentivizing resale rather than new facilities deployment, the FCC's rate controls will induce scarcities in fiber-based BDS capacities. That would drive up BDS costs and limit choices for business enterprises. Scarcities in the supply of wireless backhaul would be particularly detrimental to 5G wireless services.

Requiring incumbent BDS providers to give rivals access to their facilities at below-market prices denies those providers the ability to recover their costs. By cutting into incumbent BDS provider revenues, FCC rate controls would likewise reduce available resources for investment in new fiber-based facilities.

The FCC's proposed rate controls are factually unjustifiable. The Commission ignores all facts about local market competition by declaring non-competitive all TDM-based BDS services. By blanketing TDM-based BDS services nationwide with rate controls and by eschewing particularized analysis of local geographic market conditions, the Commission all but throws its extensive BDS data collection efforts out the window.

Indeed, the Commission required BDS providers to submit onerous amounts of highly detailed information about facilities and business dealings. Its *Notice of Proposed Rulemaking* (2016) even called it the "most comprehensive collection of information ever assembled for a

Commission rulemaking proceeding." Given such a massive assemblage of data, the Commission is without excuse for making disregard of actual competitive conditions in local markets a staple of its new BDS policy.

To declare all TDM-based BDS services to be non-competitive and subject them to rate controls is to disregard evidence of strong competition in local markets throughout the nation. Indeed, there is extant evidence of market competition for BDS services in many local markets. For starters, the *Notice* made an important geographic market finding:

> Potential competition is important, that is, nearby suppliers can constrain BDS prices. For example, we find that fiber-based competitive supply within at least half a mile generally has a material effect on prices of BDS with bandwidths of 50 Mbps or less, even in the presence of nearby UNE-based and HFC-based competition. (para. 161)

Ethernet BDS services – including those provided by cable entrants – exert competitive pressures on TDM-based BDS services. Market analysts have named Charter Communications the third largest Ethernet BDS provider nationwide, and cable entrants such as Comcast and Cox also have significant competitive Ethernet BDS offerings. Many major metropolitan areas are served by multiple BDS providers, including both cable and non-cable competitors. Moreover, even if the Commission had actual data to support a finding that a BDS provider offering TDM-based services possessed market power in a particular geographic market, that exercise of power would hasten business enterprise migration from increasingly obsolete TDM services to technologically superior Ethernet services.

The FCC's proposal to subject BDS interoffice dedicated transport to rate controls is profoundly arbitrary. BDS services include both a last-mile termination component – connections between a BDS provider's facility and the business customer's building – and a transport component – connections between an incumbent's wire center and the competing BDS provider's facility. Importantly, the Commission's BDS-related *Suspension Order* (2012) zeroed in on competitive conditions regarding last-mile BDS terminations. Its 2016 *Notice* even recognized that "non-cable operators typically do not ubiquitously deploy connections to locations in a local geographic area… They instead invest in transport within a local area based on potential demand and then rely on a mix of facility-based deployments and leased lines to connect end-user locations to their network facilities" (para. 54).

Last mile BDS competition is also reflected by the focus of Dr. Marc Rysman, the FCC's hand-picked expert, on decidedly narrow geographic market definitions, including building-by-building markets. For that matter, Dr. Rysman's regression analysis did not specifically analyze BDS transport. As he wrote on page 6 of his Revised White Paper: "My approach of aggregating to the level of the circuit rules out separate analysis of the transport market. In this paper, I focus only on the market for circuits provided to customers (sometimes called the channel termination market), although the transport market may also be interesting to study.)"

Simply put, the FCC has established no evidentiary basis for subjecting BDS transport to rate controls. Further, agency precedent – including its *Pricing Flexibility Order* – treats last-mile and transport as separate products. If its new BDS rate control proposal was adopted, the FCC would likely run afoul of administrative law requirements. An agency must offer a reasonable explanation for its departure from precedent. Given (1) the proceeding's prior focus on last-mile BDS connections; (2) the lack of record evidence supporting transport BDS price controls; and (3) strong reliance interests of incumbent BDS providers in the Commission's precedent of treating last-mile separately from transport, the FCC's apparent plan to sweep in BDS transport and last-mile terminations for new rate controls appears arbitrary rather than reasonable.

Although the FCC's proposal would refrain from imposing *ex ante* regulation on Ethernet, it nonetheless raises serious concerns. By declaring Ethernet fiber packet-switched BDS a Title II service under the Communications Act, the FCC lays the jurisdictional groundwork for future *ex ante* price controls. (Its proposal indicates a forthcoming rulemaking will spell out its regulatory framework for Ethernet BDS in further detail.) Moreover, the Commission's proposal appears to restrict building-specific pricing arrangements. This is nonsensical given the pervasiveness of arms-length contractual negotiations that characterize the BDS market.

Broadband traffic is projected to skyrocket in the years ahead. But capacities of copper-based legacy facilities are too limited to meet growing data volume needs. Without widespread deployment of advanced fiber-based broadband facilities, backhaul capacity will be woefully unable to support 5G wireless networks. But the FCC's BDS rate control proposal will undermine investment in next-generation infrastructure build-out.

Unsupported by evidence, arbitrary, and contrary to agency precedent, the FCC's rate control proposal should be discarded. And if unwisely adopted, new BDS rate controls should be promptly repealed by an FCC under new leadership.

* Seth L. Cooper is a Senior Fellow of the Free State Foundation, an independent**,** nonpartisan free market-oriented think tank located in Rockville, Maryland.

Further Readings

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