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Forbearance Follies: What the FCC's New Framework Portends for the "Third Way"

by

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The FCC recently issued its anticipated order in the Qwest forbearance proceeding for the Phoenix metropolitan statistical area (MSA). The Commission denied the petition. But as significant as the order's immediate result is the FCC's method for reaching that result and what that method portends for the future of regulatory forbearance at the FCC. The Commission's order in the *Qwest Phoenix MSA* proceeding appears to set new standards that, if consistently applied to future petitions, could make forbearance relief virtually impossible to obtain.

The problems from a policy perspective plaguing FCC Chairman Julius Genachowski's "Third Way" proposal to regulate broadband Internet services are well known. But the problematic nature of the Chairman's proposal from a legal perspective is almost certainly further compounded by the Commission's new, tougher forbearance standards. A near-insurmountable forbearance standard applied to all Title II services likely would further undermine the legal basis for the "Third Way" plan's heavy reliance on forbearance. Conversely, subjecting prospectively reclassified Title II broadband Internet services to a separate forbearance standard is conceptually at odds with Title II reclassification itself. Even Harry Houdini, were he a lawyer, would find it difficult to extricate himself from the legal knots in which the FCC is tying itself.

FCC's New Framework: Putting Forbearance Relief Out-of-Reach?

The *Qwest Phoenix MSA Order* employs what the Commission calls a "traditional market power framework" based primarily on its *Competitive Carrier* proceedings to evaluate telecommunications market competition in forbearance proceedings.[1] The Commission describes its framework as "a more analytically precise method for evaluating predictive claims that competition in a market is sufficient to satisfy the section 10 criteria."[2] According to the Commission, its analysis defines the relevant product and geographic markets and identifies market participants, examines market share, and evaluates potential entry to counteract the exercise of market power by an individual carrier or by collusion.[3]

However, the Commission's market power framework is more conceptual and less empirical than one might initially think. It's essentially an analytical framework for assembling and interpreting different pieces of evidence relating to the telecommunications market in a given MSA. As a footnote in the *Qwest Phoenix MSA Order* acknowledged: "Because the record does not contain data necessary to perform the hypothetical monopolist test quantitatively, we use the conceptual framework of the traditional approach as 'a methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition' as a way to measure competition."[4] So nowhere does the *Order* demonstrate the existence of market failure according to a rigorous examination of the overall telecommunications market or of specific markets. This doesn't mean the Commission's framework is without value. Yet it certainly raises a doubt as to just how much that framework deserves the "data-driven" label.

In adopting its traditional market power framework the Commission shucks what it calls the "abbreviated analysis" it employed in prior forbearance proceedings — particularly the *Qwest Omaha MSA Order*.[5] The Commission insists that the *Qwest Omaha MSA Order* "inappropriately assumed that a duopoly always constitutes effective competition and is necessarily sufficient to ensure just, reasonable, and nondiscriminatory rates and practices and to protect consumers."[6] But this seems to present a straw man reading of the *Qwest Omaha MSA Order*. The *Qwest Phoenix MSA Order* itself later acknowledges — and rejects — the *Qwest Omaha MSA Order*'s reasoning that other regulatory requirements and its predictions about future competition would alleviate duopoly concerns.[7]

Nonetheless, a shallow duopoly/oligopoly theme persists throughout the rest *Qwest Phoenix MSA Order*. Here duopoly has some initial – but ultimately ill-founded – plausibility because Qwest is the incumbent wireline voice services provider in the Phoenix MSA and Cox Communications is the MSA's primary cable company, also offering a variety of VoIP services. The duopoly theme receives added surface plausibility by narrow market definitions in the *Order* that ignore the broader, dynamic nature of today's competitive communications landscape where voice services are no longer isolated to incumbents' copper lines. But even though economic scholarship and antitrust jurisprudence certainly identify circumstances in which two or perhaps a few competitors can collude to fix price and harm consumer welfare, the Commission nowhere demonstrates any such collusion taking place in this instance. With something less than empirical rigor, the *Order*'s statement that "mass market consumers *effectively* face a duopoly for these services in the Phoenix MSA" seems to use the term "duopoly" for hand-waving purposes to move its analysis along.[8]

Although the Commission insists in the *Qwest Phoenix MSA Order* that potential competition from new entry is a part of its market power framework, the *Order*'s analysis doesn't appear to take it seriously. For starters, the Commission strongly asserts that its unbundling regulations are essential to reducing the barriers to new entry —*i.e.*, it's essential to allowing new entry that the Commission nonetheless insists is not taking place and is unlikely anytime soon in the Phoenix MSA. As the Commission declared in the *Order*: "We see nothing in the record to indicate that, in the years since the passage of the 1996 Act, these barriers have been lowered for competitive LECs that do not already have an extensive local network used to provide other services today."[9]

The *Order* contains no hint that the unbundling network elements (UNE) regulation was conceived as a temporary measure designed to spur competition in the immediate aftermath of the Telecommunications Act of 1996. Nor does the *Order* appear to take seriously the disincentive for facilities-based investment posed by mandatory, rate-regulated resale of UNEs. Rather, the Commission considers its previous relaxation of unbundling regulation for advanced services sufficient to alleviate investment disincentive problems. (A string of federal court decisions ordered the elimination of those other unbundling regulations.)

Defining Competition Out of Existence by Ignoring Close Substitutes

The disciplining effect of potential competition from new entry is also given short shrift by the Commission's easy dismissal of substitutes for wireline voice. For instance, concerning the Phoenix MSA market for wholesale loops, the Commission stated: "[W]e also find that Qwest's special access services, section 271 access arrangements, Qwest's Local Services Platform (QLSP) wholesale service, and section 251(c)(4) resale are not adequate alternatives to section 251(c)(3) unbundled loops for competitive LECs."[10] And concerning the Phoenix MSA retail market the Commission concluded that the record was insufficient to determine if over-the-top or "nomadic" VoIP services such as Vonage or Skype should be included in the relevant product market.[11]

Most important in this regard is the *Qwest Phoenix MSA Order*'s renewed rejection of wireless voice services as a substitute for wireline voice services. In the *Order*, the Commission admits that "[w]hether mobile wireless services should be included in the same relevant product markets as fixed wireline service is a complicated issue, and one that is evolving over time."[12] The Commission acknowledges that "most subscribers to wireline and wireless engage in some usage substitution,"[13] and that "[t]he increasing percentage of residential customers that rely solely on mobile wireless voice service suggests that an increasing percentage of voice customers view wireless and wireline services as close substitutes, increasing the likelihood that wireless services may materially constrain the price of residential wireline service."[14] However, the Commission again rejects treatment of mobile voice services as a substitute for wireline services, asserting that the record doesn't support treating both services as part of the same relevant product market. The Commission insists that "[k]nowing the percentage of households that rely exclusively upon mobile wireless is insufficient to determine whether mobile wireless services have a price-constraining effect on wireline access services."[15] And it suggests that "the choice to rely exclusively upon mobile wirleless services could be driven more by differences in consumers' age, household structure, and underlying preferences than by relative price differentials."[16]

If the Commission now refuses to consider wireless voice services as a substitute unless it finds evidence, to its own satisfaction, that wireless constrains wireline prices the *Qwest Phoenix MSA Order*, it also disregards agency precedents such as the *Qwest 4 MSA Order* that recognized wireless as a substitute for "cut the cord" consumers.[17] This is clearly a step in the wrong direction.

From an everyday commonsense perspective, wireless voice services are a ready substitute for wireline voice services. The Commission's recent *Wireless Competition Report* cites studies showing that a fast-growing number of households — now approximately one-quarter of all households — have "cut the cord" and rely exclusively on wireless.[18] The significance of wireline/wireless substitution and the extent to which cutting the cord can constrain prices of residential wireline services cuts across geographic lines and has industry-wide implications. It is past time for the Commission to stop addressing the wireline/wireless substitution question only sporadically through forbearance orders or merger reviews. The Commission now has ample reason to simply declare wireless a ready substitute for wireline voice services for *all* customers.

Burden of Proof: Tie Goes to the Regulator

Significantly, the *Qwest Phoenix MSA Order*'s result is bolstered by the Commission's recently adopted procedural rules governing forbearance petition proceedings. One of the new rules adopted by the Commission was a formal burden of proof.[19] Forbearance petitioners must now meet burdens of production and persuasion to satisfy the Commission's requirements for regulatory forbearance relief. In the *Order*, the burden of proof seems to do a lot of the heavy lifting by which the Commission reached its final result concerning the Phoenix MSA. The Commission finds it doesn't need to establish the existence of market failure or make any other positive findings about competitive conditions in the Phoenix MSA based on the data. Instead, under its procedural rules the Commission considers it sufficient to reject Qwest's petition by finding that Qwest has failed to provide evidence along several lines that prove competitive conditions exist requiring forbearance relief. This is not to say, with this Commission's pro-regulatory bent, that if the Commission had simply considered Qwest's petition *de novo — i.e.,* without any formal burden of proof shifting one way or the other — that the Commission would have found competitive conditions sufficient to grant forbearance relief. But the placement of the burden on forbearance petitioners makes the denial of relief easier to justify, particularly in close cases.

What the FCC's Forbearance Framework Portends for the "Third Way"

In a blog post titled "Third Way Theory Meets Forbearance Reality," I questioned whether the Commission's then-forthcoming *Qwest Phoenix MSA Order* might impact

Chairman Genachowski's "Third Way" proposal for imposing network neutrality regulation on the Internet.[20] According to the "Third Way" plan, the Commission proposes to reclassify broadband Internet from a lightly regulated Title I "information service" to a highly regulated Title II "telecommunications service" subject to common carrier restrictions.[21] And in order to stave off declines in infrastructure investment and innovation due to burdensome Title II restrictions and attending regulatory uncertainties, the "Third Way" proposes to forbear from imposing several Title II provisions on broadband Internet — all in one fell swoop. In so doing, the "Third Way" would nonetheless still subject advanced broadband networks to old monopoly-era regulation and undermine the longstanding policy consensus favoring light-touch treatment of such networks.[22] But the forbearance result envisioned in the "Third Way" plan seems highly implausible under the new forbearance framework set out in the *Qwest Phoenix MSA Order*.

As I wrote in the earlier blog post, a high barrier to forbearance relief could create conceptual and legal difficulties for the Commission's proposed plan to reclassify broadband as a Title II telecommunications services while simultaneously forbearing from subjecting broadband to several Title II regulatory provisions. To protect the "Third Way" from legal pitfalls, I surmised the Commission might attempt a bifurcated forbearance standard, adopting a market power test for wireline telecommunications services — but not for reclassified broadband Internet telecommunications services.

In fact, the *Qwest Phoenix MSA Order* insists "a different analysis may apply when the Commission addresses advanced services, like broadband services, instead of a petition addressing legacy facilities."[23] But as I also wrote in that earlier blog post, subjecting Title II wireline voice services and Title II broadband Internet to different standards makes reclassification of broadband especially counterintuitive and strange: "After all, the need for disparate treatment of voice and broadband was precisely the point behind the FCC's classification of broadband as a Title I information service that should be free from outdated and burdensome regulation."[24] So the *Order* doesn't definitively establish a forbearance standard for broadband Internet providers. It only implies that the Commission sees no problem with making forbearance relief more difficult in wireline voice services, on the one hand, while making "Third Way" "superforbearance" a piece of cake for broadband Internet services, on the other hand. It may be difficult for the Commission to supply a reasoned explanation for giving special forbearance treatment to the "Third Way" on judicial review.

If the Commission pushes ahead with the approach it uses in the *Qwest Phoenix MSA Order*, denial of future forbearance petitions may be a foregone conclusion for wireline voice services. And establishing a forbearance standard so difficult to meet in the Title II setting could spell trouble for the "Third Way" plan to reclassify broadband Internet service providers as common carriers under Title II while, simultaneously, granting extensive forbearance relief from Title II provisions. This is just another reason – and an important one – why the Commission should abandon its current course.

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[1] Memorandum Opinion and Order ("*Qwest Phoenix MSA Order*" or "*Order*"), Petition of Qwest Corporation for Forbearance in the Phoenix, Arizona Metropolitan Statistical Area, WC Docket No. 09-135 (June 22, 1010) at 25, para 42, available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-113A1.pdf.

[2] *Id.* at 24, para 41.

[3] *See id.* at 25, at para 42

[4] *Id.* at 27, para 46, fn. 146 (quoting *Draft Revised Horizontal Guidelines*, § 4.1.3).

[5] *See* Memorandum and Order, Petition of Qwest Corporation for Forbearance in the Omaha Metropolitan Statistical Area ("*Qwest Omaha MSA Order*"), WC Docket No. 04-223, 20 FCC Rcd 19415 (2005).

[6] *Id.* at 14, para 29 (citing *Qwest Omaha MSA Order*).

[7] *See Qwest Omaha MSA Order*, 20 FCC Rcd at 19445, paras. 79-83 (cited in *Qwest Phoenix MSA Order*, at 18, para. 33).

[8] At 44, para 81 (emphasis added).

[9] *Id.* at 46, para 84.

[10] *Id.* at 41, para 75.

[11] *Id.* at 29, para 54.

[12] *Id.* at 30, para 55.

[13] *Id.* at 30, para 55

[14] *Id.*

[15] *Id.* at 33, para 50.

[16] *Id.* at 33-34, para 59.

[17] *See id.* at 35, para 61; Memorandum Opinion and Order, Petitions of Qwest Corporation for Forbearance in the Denver, Minneapolis-St. Paul, Phoenix and Seattle Metropolitan Statistical Areas, WC Docket No. 07-97, 23 FCC Rcd 11729, 11743, para 20 (2008) ("*Qwest 4 MSA Order*"), remanded, Qwest Corp. v. FCC, No. 08-1257 (D.C. Cir. Aug. 5, 2009).

[18] *See* Annual Report and Analysis of Competition Market Conditions With Respect to Mobile Wireless, including Commercial Mobile Services "*Fourteenth Report*"), WT Docket No. 09-66 (May 20, 2010), available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-81A1.pdf.

[19] *See* Report and Order, Petition to Establish Procedural Requirements to Govern Proceedings for Forbearance Under Section 10 of the Communications Act of 1934, as Amended, WC Docket No. 07-267 at 12 *et seq.*, para. 20 *et seq.* (June 29, 2009), available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-56A1.pdf. *See also* Seth L. Cooper, "Giving Forbearance the Red Tape Treatment," *FSF blog* (July 1, 2009) (discussing the FCC's report and order concerning new forbearance petition procedures), available at: http://freestatefoundation.blogspot.com/2009/07/giving-forbearance-red-tape-treatment.html.

[20] *See* Seth L. Cooper, "Third Way Theory Meets Forbearance Reality," *FSF Blog* (June 11, 2010), available at: http://freestatefoundation.blogspot.com/2010/06/third-way-theory-meets-forbearance.html.

[21] *See* Notice of Inquiry, *Framework for Broadband Internet Service* ("*Title II NOI*"), GN Docket No. 10-127, at 30 *et seq.*, paras. 67 *et seq.* (June 17, 2010), available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-114A1.pdf.

[22] *See, e.g.*, Randolph J. May, "The Third Way's Fundamental Disconnect," *FSF Blog* (June 29, 2010), available at: http://freestatefoundation.blogspot.com/2010/06/third-ways-fundamental-disconnect.html; Randolph J. May, "Notes on the Right Way," *FSF Blog* (June 1, 2010), available at: http://freestatefoundation.blogspot.com/2010/06/notes-on-right-way.html; Seth L. Cooper, "Critiquing the So-Called Consensus on FCC Internet Regulation," FSF Blog (May 13, 2010), available at: http://freestatefoundation.blogspot.com/2010/05/critiquing-so-called-consensus-on-fcc.html. *See also* Dennis L. Weisman, "The 'Third Way' for Broadband Regulation: Goldilocks or the Big Bad Wolf?" *Perspectives from FSF Scholars*, Vol. 5, No. 16 (June 9, 2010), available at: http://www.freestatefoundation.org/images/The_Third_Way_for_Broadband_Regulation_060810.pdf.

[23] *Qwest Phoenix MSA Order*, at 23, para. 39.

[24] Cooper, "Third Way Theory Meets Forbearance Reality," *FSF Blog*.