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The Federal Unbundling Commission?

by

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If the "net neutrality/open access/unbundling" advocates have their way, the Federal Communications Commission might as well change its name to the Federal Unbundling Commission. A majority of the five-member commission needs to indicate clearly, and soon, that it rejects the injurious notion that broadband service providers must engage in ongoing unbundling of their networks in one fashion or another under the FCC's supervision.

The latest salvo in what is now a concerted openness holy war was launched on June 13, 2007. A group of organizations wrote to FCC Chairman Martin asking the FCC to commit to the regulatory micromanagement of the cable industry's transition to new digital-ready technology. Cable operators have developed what they call the OpenCable platform, a standardized interface that will enable consumers to enjoy an amazing array of new two-way interactive television services, such as video-on-demand, interactive programming guides, shopping, banking, and other e-commerce activities, polling, email and TV chat, and the like. All of these new applications will be available without consumers having to lease set-top boxes supplied by the cable companies. Independent equipment manufacturers and applications and content providers are able to use the platform to develop new interactive products and services that presently are not available.

The organizations arguing in the June 13 letter for an ever-greater degree of FCC-mandated and supervised "openness" of the OpenCable standard are: Consumer Federation of America, Consumers Union, Electronic Frontier Foundation, Free Press, Knowledge Ecology International, Media Access Project, New America Foundation, Public Knowledge, and the U.S. Public Interest Group. Not surprisingly, most, if not all, of these organizations are also urging the FCC to adopt net neutrality and openness mandates on the ground and in the air.

They take their targets of regulatory opportunity wherever they find them, most recently mounting an aggressive campaign to have the Commission set aside a chunk of the soon to-be-auctioned 700 MHz spectrum for operation only on an unbundled, open access, net neutralized basis. Frontline has argued that the FCC needs to impose a strict wholesale/retail split, decoupling the connectivity and retail layers." I have explained why this is not a good idea in a recent essay, "Sideline Frontline."[1]

In essence, the open access advocates want to reinstitute the FCC's *Computer II* unbundling regime for all broadband providers, regardless of the technology used by the provider. They want the FCC to enforce a strict separation of the transmission function from the provision of any applications, content, or equipment. In other words, to the maximum extent possible, they want broadband providers, whether they be cable, telephone, wireless, or whatever, to be "dumb pipes."

While the *Computer II* —and earlier *Carterfone*— unbundling regulations to which the openness advocates harken back may have served a purpose during the monopolistic analog era that prevailed at the time those decisions were rendered a quarter century or more ago, in today's competitive digital broadband environment, requiring broadband providers to be dumb pipes is just plain dumb. In "Back to 1968? No Way!" and "Blue Jeans, Vodka, and Wireless Services,"[2] I wrote about how the nostalgia for *Carterfone*, however well-intentioned, is misplaced, and harmful, in today's very different market environment.

In a posting on the Public Knowledge website supporting the openness groups' June 13 letter, John Bergmeyer repeats the groups' mantra that network operators "should not seek to parlay their control over communications bottlenecks into control of related area." According to Bergmeyer: "Openness is good for consumers. Monopolistic practices and vertical control are not." And to make very explicit the extent of the groups' own understanding of their cross-cutting, wide-ranging agenda, Bergman declares openness "is the idea animating Net Neutrality, wireless *Carterfone*, and similar matters," including the attack on the cable industry's next-generation digital cable platform for interactive services.

The FCC Commissioners, at least three of them, are going to have to decide whether they truly believe what a commission majority has been declaring for a long time now: *The broadband market is competitive and becoming more so each day.* If a majority of Commissioners believe that the broadband market is competitive and becoming more so each day, as the agency consistently has found under the leadership of FCC Chairmen Michael Powell and Kevin Martin, then they must ask and answer this question: *Do they really want to revert to the regulatory micro-management required to supervise unbundling regimes that may have been appropriate in the earlier Carterfone/Computer II era but are no longer so?* Or, instead, are they willing to rely on marketplace competition to protect and enhance consumer welfare?

As early as February 2002, in its *Wireline Broadband Notice*, the Commission concluded that "broadband services should exist in a minimal regulatory environment that promotes investment and innovation in a competitive market."[3] This conclusion was based on the then still-emerging competition among broadband providers using different technological platforms. Since then, of course, the competition has become increasingly more intense. Telephone companies have invested billions to upgrade their network facilities with fiber-to-the-home and other IP technologies to compete more vigorously with cable operators. Verizon says it alone is investing $23 billion between 2004 and 2010 to build a fiber-to-the-home network that will pass 18 million homes. AT&T has said recently that it is increasing its invest in rolling out its IPTV services to $6.5 billion by 2008 when it hopes to pass 13 million homes with its U-verse broadband product.[4] At least partially as a result of the fact that they collectively invested over $100 billion upgrading their networks with digital broadband facilities post-1996, cable operators thus far have held the market share lead among broadband providers. But the most recent FCC data show that the cable high-speed market share has dropped from approximately 60% in 2002 to less than 45% today, with the wireline telephone companies now garnering over 36%. Significantly, the most recent FCC data show that wireless broadband providers, already with more than 11 million high-speed lines, are now achieving the most rapid subscriber growth.[5]

In today's competitive environment, cable operators, like other broadband providers, are attempting in many instances to meet consumer demand by bundling video, voice, and Internet access into packages—the so-called "triple play" or, with wireless, a "quadruple play." This is the natural evolution of a digital marketplace and technological environment in which a "bit is a bit is a bit," one in which the traditional service distinctions no longer have meaning from a consumer's perspective or serve valid regulatory purposes. Absent regulatory constraints that no longer make sense, how much longer will we continue to call Verizon a "telephone" company or "Comcast" a cable television operator?

If one nevertheless insists on segmenting the broadband market by examining only "video," here too this sub-market segment is effectively competitive. The FCC's series of annual Video Competition reports show the steady progression of increasing competition. The most recent report, released in March 2006, concluded: "The market for the delivery of video programming services is served by a number of operators using a wide range of distribution technologies."[6] Based on its collection of a comprehensive set of data, the Commission summarized its findings this way:

> We find that almost all consumers have the choice between over-the- air broadcast television, a cable service, and at least two DBS providers. In some areas, consumers also may have access to video programming delivered by emerging technologies, such as digital broadcast spectrum, fiber to the home, or video over the Internet. In addition, through the use of advanced set-top boxes and digital video recorders, and the introduction of new mobile video services, consumers are now able to maintain more control over what, when, and how they receive information. Further, MVPDs of all stripes are offering nonvideo services in tandem with their traditional video services.[7]

The two leading satellite providers have approximately 30% of the MVPD part. In July 2006, when the FCC approved the transfer of control of Adelphia to Comcast and Time Warner, the agency rejected contentions that the proposed transaction would increase incentives for either Comcast or Time Warner to engage in conduct harmful to either consumers or competitors. The Commission concluded that "competition among providers of broadband services is *vigorous*."[8] Since then, Verizon and AT&T have begun to make significant inroads in the video market segment.

So, the FCC concluded over five years ago that the competitiveness of the broadband marketplace warranted a "minimal regulatory environment," and it concluded a year ago that competition among broadband providers is "vigorous." With these determinations, it makes no sense for the Commission to consider adopting new rules that would require it to engage in even more intrusive supervision of unbundling of cable operators' two-way digital cable ready products. Cable operators have every incentive to be responsive to consumer marketplace demands in order to remain competitive. At times, given the regulatory flexibility, this may mean integration of transmission and applications, equipment, and content. At other times, it may mean working with independent equipment, application, and content vendors. This is because it may be more efficient to use the services and equipment of unaffiliated vendors. In a competitive market, the broadband provider cannot afford to forego efficiencies that will reduce its costs or inhibit the availability of innovative products demanded by consumers.

As Professors Joseph Farrell and Philip Weiser have explained, "even a *platform monopolist* often has incentives to make efficient choices about when to maintain modularity and when to get involved in an adjacent market."[9] A leading regulatory economics text explains the trade-offs regarding unbundling this way:

> The potential cost to such a [separation] policy is the wasted resources due to preventing the most efficient firm from competing. Such inefficiencies would tend to raise price. The social optimality of separation then depends on the ability of the *regulated monopolist* to pursue anticompetitive practices in an unregulated market and the degree of economies of scope that may exist between the regulated and unregulated products.[10]

In this instance, whatever the case once may have been with respect to cable operators or telephone companies, and despite whatever loose rhetoric is still thrown about, cable operators are not "platform monopolists." Today, broadband providers, as they strive to attract and retain subscribers, always have incentives to make efficient choices, whether that means procuring services from unaffiliated vendors, integrating operations, or some combination of the two. If they don't make efficient choices, they will lose in the marketplace.

As stated at the beginning of this essay, the advent of interactive "television" capabilities through the OpenCable platform-- and, to be sure, the platforms of competing broadband platform providers as well-- promises to bring consumers a host of exciting new interactive applications from video-on-demand to e-commerce applications to polling to communications applications. The OpenCable platform developed by the cable industry apparently is sufficiently appealing that many independent consumer electronics firms, including leaders like Samsung, Panasonic, and LG, are designing digital ready "television" sets to the OpenCable standard. These CE companies must have determined the platform offers opportunities for them to benefit from the market demand for new digital ready sets and applications with interactive capabilities. No doubt these companies will be looking to work with other platform providers like Verizon, AT&T, and the wireless companies. And the non-cable broadband providers will be looking to establish mutually-beneficial business arrangements with the same CE companies. There will be no unwanted lock-ups in this marketplace.

In any event, the point is not whether the current technological design iteration of OpenCable, or any succeeding version, satisfies all or the majority of consumer electronic companies. Given their druthers, any one of them might well prefer to design the platform standard to its own specifications. The point is not even whether cable operators, or other broadband providers, may at times wish to prefer integrated operations to non-integrated ones. Indeed, they might. The fundamental point rather is whether, in today's competitive broadband marketplace, there is any justification for the Commission to involve itself in dictating any further degree of "open access" and to undertake the ongoing supervision of the mandated unbundling, as the technology and business models continue to evolve. There is no justification. Indeed, were the FCC to embark on this course, the harm to consumer welfare that would result from the diminished incentives for investment and innovation would be most significant and counter-productive.

Here is the way that I framed the choice faced by the FCC in the 700 MHz proceeding in the recent Sideline Frontline essay:

> The managed competition vision rests on an assumption, rarely stated this bluntly, of course, that the regulators, through their supervision and control of unbundling decisions, can do better than the marketplace in promoting consumer welfare. The managed competition vision tends to view the communications marketplace as static rather dynamic, and it almost never acknowledges the degree to which the marketplace already has become competitive and contestable. This static marketplace view is used by the advocates of mandatory unbundling to justify ongoing managed competition. The market-oriented vision requires more regulatory modesty, of course.

The FCC faces the same choice between a managed competition and market-oriented vision as it confronts new pleas to become even more involved in micro-managing cable's transition to a digital-ready interactive television environment. It should reject the managed competition vision represented by ongoing supervision of unbundling. It should do the same with respect to the unbundling mandates sought in other contexts for other broadband providers. It should make a clear choice for the market-oriented vision.

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[1] Randolph J. May, "Sideline Frontline," Perspectives of FSF Scholars," Vol. 2, No. 15, May 30, 2007.

[2] Randolph J. May, "Blue Jeans, Vodka, and Wireless Services," Perspectives of FSF Scholars, Vol. 2, No. 8, February 14, 2007.

[3] Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities, CC Docket No. 02-33, para. 5, released February 15, 2002.

[4] George Winslow, "Placing Bets in the Bandwidth Battle," Multichannel News, June 18, 2007.

[5] FCC, "High-Speed Services for Internet Access: Status as of June 30, 2006," January 2007. Table 1 and Chart 2.

[6] Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Twelfth Annual Report, MB. Docket No. 05-255, FCC 06-11, released March 3, 2006, at para. 3.
[7] Id., at para. 5.
[8] Applications for Consent to Assignment and/or Transfer of Control of Licenses, 21 F.C.C.R. 8203, 8296 (2006) (Emphasis supplied).
[9] Joseph Farrell and Philip Weiser, *Modularity, Vertical Integration, and Open Access,* 17 HARVARD JOUR. OF LAW AND TECHNOLOGY 85, 97 (2003) (Emphasis supplied).
[10] W. Kip Vicusi, John M. Vernon, Joseph E. Harrington, Jr., ECONOMICS OF REGULATION AND ANTITRUST, THIRD EDITION, 2000, at 483 (Emphasis supplied).

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