

Net Neutrality Overreach

by

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The battle over “net neutrality” and “open access” — two catchy labels that, in reality, both mean traditional public utility regulation — is moving from the ground to the air. Until recently, net neutrality and open access advocates have focused on getting Congress and the Federal Communications Commission (FCC) to adopt new government regulations that would prohibit wireline broadband Internet service providers, such as Verizon, Comcast or AT&T, from “discriminating” against unaffiliated content providers.

Having largely, but not completely, failed in their effort to straight-jacket the wireline companies, open access advocates now have targeted wireless broadband providers. This might seem illogical because competition in the wireless world generally is more intense than in the wireline marketplace, although in both environments, competition is now the rule.

But logic does not drive net neutrality advocates. Targets of regulatory opportunity do. And the current juicy target of opportunity is the FCC’s fast-track proceeding to devise rules for the agency’s upcoming 700 MHz spectrum auction. This is prime spectrum that will be freed up when television broadcasters transition to digital-only broadcasts in February 2009. Suitable for high-speed broadband wireless operations, the spectrum could bring the government between \$10-20 billion in revenues if the auction rules are not jerry-rigged to favor particular business plans.

Enter a company called Frontline Wireless, newly-created for the purpose of participating in the 700 MHz auction. Anytime the FCC writes rules with big financial stakes, it naturally invites regulatory gaming from all sides. Frontline’s auction proposal, though, is loaded with more than the usual number of special requests tailored to its own interests, such as a proposal for bidding credits for “small business entities” like it claims to be.

But the aspect of Frontline’s proposal that stands out as especially problematic is its request that the agency set aside a sizeable chunk of the spectrum for those — again, like itself — who agree to abide by an “open access” nondiscrimination mandate. To render this mandate enforceable, it says the FCC needs to impose a strict wholesale-retail unbundling regime, “decoupling the connectivity and retail layers. Frontline claims decoupling of wholesale and retail operations of wireless providers will provide “greater certainty for capital investment, innovative services, and risk taking.”

If recent telecom history has taught anything at all, we know Frontline’s proposal will have the opposite effect. And Frontline should know this, too, because one of its up-front lead investors is Reed Hundt, the Clinton administration’s FCC chairman. Under Mr. Hundt’s leadership, the

FCC imposed a wholesale-retail unbundling regime on wireline telephone companies that three times was thrown out by the courts before it was finally jettisoned. Each time the courts held the unbundling regime, which was akin to Frontline's wholesale-retail proposal, unlawful because it was excessively regulatory.

Recall the speculative telecom bubble of the late 1990s. Hundreds of newly created companies, without any network facilities of their own, rushed to take advantage of Mr. Hundt's unbundling rules that granted access to the wireline incumbents' networks at below-market, FCC-controlled prices. Now recall the spectacular bursting of the telecom bubble in 2001 when it became clear, in the court's words, that the "completely synthetic competition" created by the rules could not be sustained. As the court explained, "if parties who have not shared the risks are able to come in as equal partners on the successes, and to avoid payment for the losers, the incentive to invest plainly declines." Mandatory unbundling always "imposes costs of its own, spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities."

Frontline's proposal is not materially different in effect from the ill-fated wireline unbundling rules implemented by Reed Hundt's FCC. Were the FCC to accept his new proposal to import open access and unbundling requirements into the wireless world, the result likely would be the same: the creation of synthetic competition leading to foregone investment and innovation. A network operator relegated to wholesale open access operations lacks entrepreneurial incentives to invest because any rewards reaped from the investment must be shared with those — including competitors — who are granted government-regulated access to its facilities. In short, network operators lack incentives to risk their capital to find new, less costly ways to better serve consumers through efficiencies of integration.

What's more, open access advocates always ignore the ongoing tangible and intangible costs associated with enforcing open access mandates. There are endless disputes concerning whether a particular practice or offering of the network operator is discriminatory in one way or another. These disputes inevitably require the FCC to get involved in pricing the operator's service because discrimination claims generally turn on whether price differentials for allegedly different services are justified. The courts then have their say in seemingly endless litigation to decide whether the FCC's judgments were reasonable. All the while, the business environment for planning and operating networks requiring billions of dollars in investment remains unstable.

The FCC should put the 700 MHz spectrum to auction unencumbered by net neutrality and open access rules that will only diminish its utility to those who otherwise would value it most highly. If the commission allows the net neutrality advocates to prevail in the air when they largely have failed to prevail on the ground, in the short term America's taxpayers will suffer a hit from the reduction in revenues realized from a jerry-rigged auction. As importantly, in the longer term, America's consumers will suffer from the reduced innovation and investment that result from a counterproductive, government-mandated open access regime.

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