

## **Regulatory Gridlock and the Telecommunications Act of 1996**

Ben Compaine

NCTA Academic Keynote Address

Atlanta, GA, May 2, 1998

The objective of this brief paper is to answer one question: Why has so little changed in telecommunications since the passage of the Telecommunications Act of 1996? This is a regularly voiced complaint in both mass media and political circles. The Telecoms Act, after all, was heralded by Congress with the hype of a major tax cut bill. It had as its stated objective the opening up of heretofore protected, regulated, bottleneck markets to competitive forces.

My conclusion is that anyone who expected substantial change in only a year or two probably believed that the Titanic could have turned fast enough to avoid that iceberg.

A simple content analysis of the wording of the Telecommunications Act tells a tale. "Deregulation" is mentioned twice, More ominous, however:

Regulation (and its derivatives) -- 202 times.

Fair or unfair -- 35 times.

Reasonable or unreasonable -- 37 times.

The "FCC shall" -- 94 times and

The "FCC may" -- 30 instances.

The Act called for 80 proceedings to be initiated by the FCC.

The 1996 Act has been promoted by many in the media, by academics, within the financial analysis community, and among the telecom players themselves, as the resolution to decades of uncertainty about telecommunications regulation. It was written to end the reign of a single judge in making telecommunications policy. It was to tie up the loose ends created by that previous resolution to the telecommunications labyrinth, the MFJ of 1982.

The fact is, in communications regulation there are rarely clear cut beginnings and even rarer are there definitive endings. The Telecommunications Act of 1996 is a step in a process. And given its proclivity for such nondefinitive language as fair and reasonable, it was, depending on where one sits and when one makes their evaluation, either a brilliant work of wordsmanship or the Communications Attorneys' Full Employment Act.

The issues that the Telecommunications Act wanted to address are drawn brightly enough:

- Under what conditions could the local Bell operating companies engage in such competitive businesses as interexchange service, local video service?
- When could cable companies shed the restriction on the pricing of all pieces of their services?

- When could broadcasters grow their companies with the same criteria of economies of scale and scope that apply to most other businesses?

The Act of course goes well beyond such a condensed characterization. But most of the rest, such as addressing universal service issues or Federal-State relationships in telecom regulation are largely the fallout from having to address these central concerns.

What has happened in the telecommunications industries since the passage of the Act?

About what one should expect given the language of the Act.

There have been any number of legal maneuvers: at the FCC, in the Courts, in the States. But this is what was going on pre-Act, where weekly petitions to Judge Green, and court appeals of FCC decisions were precisely the reason that Congress stepped in. It is also exactly what you would expect when any ruling of the FCC could be challenged as being *unfair* or *unreasonable* to one party or another.

A few feints have been made into competitive local exchange services, the largest arena and the primary area that deregulators wanted to open to competition. But potential competitors to the local exchange carriers, cable operators among them, have been stymied by the pricing that the incumbent carriers want to charge for reselling or interconnecting their services. And the cost for duplicating the local switches by potential competitors have proven too great given the uncertainties involved.

On the video front, competition at the local franchise level has also been minimal. Continued regulation -- egged on by vested broadcaster and cable interests -- has been a factor. The telephone companies, which made all sorts of noises pre-1996, have largely retreated. Ameritech has started offering a competitive video service in a few communities and promises more. US West's MediaOne is a major player (largely through its acquisition of Continental Cablevision). But rather than overbuilds or video via upgraded telephone networks, it has largely become a conventional MSO.

DBS was underway pre-Telcom Act and was aided more by the 1992 Cable Act, which required that cable-owned programmers provide them with programs at equitable rates. Although DBS, with roughly 7% of TV households, is a real player, its potential as a true alternative to cable is undercut foremost by its statutory inability to offer local broadcast stations to its otherwise powerful programming lineup. There are some technical issues as well, but these are being overcome. EchoStar has been willing to provide a reasonable start in offering local stations to many customers, but cable and broadcast industry lobbying at the FCC and in Congress has so far blocked their way.

Finally, a third hoped-for outcome of the Telecommunications Act was further competition in the interexchange market by the RBOCs. This was the carrot that was supposed to entice them to open up their local exchanges to competition. Although the

RBOCs would like to get into this business, they have recognized that giving up market share in their local monopoly will likely cost them more than anything they are likely to gain in the long distance business. Look at the numbers: the local exchange business is roughly \$100 billion annually. Each local carrier has almost 100% of their own territory's business. The interexchange business is \$70 billion. Given the formidable incumbents in long distance, what market share might the RBOCs be expected to get in five or 10 years? They would be entering an already competitive business. If several RBOCs jump in, the pie gets sliced even further. Meanwhile, they can only go down in market share of the currently protected and comfortable local exchange business. No, there is not much of a financial incentive to move fast in opening up their local markets.

The big winners so far from the 96 Act have been the broadcasters. First, the radio industry has had virtually all limits on group ownership revoked. In television, new limits have opened the door to vastly expanded chains and the development of new networks. The TV broadcasters also dodged a bullet on HDTV when former Sen. Dole's efforts to charge broadcasters for new digital spectrum was put off and ultimately killed.

The stakes in the telecommunications business are so high, capital needed to break in to any new sectors so great, and opportunity costs so numerous that we should in fact be pleased that anything has happened. Several of the telephone companies have shown some effort to meet the FCC's checklist for opening their markets prior to their branching out into new ones themselves. The MCI/WorldCom merger appears to be part of a substantial strategy to create a firm that provides both interexchange and new local services.

The cable industry, after a period of retreat and self doubt in 1996 has recovered. It is moving ahead to make the investments to provide expanded digitally-based services for their customers.

The regulatory morass is far from settled. Will Internet telephony providers be subjected to Universal Service Fund payment obligations? Will broadcasters be permitted to use digital spectrum for multi-channel video? Even after the RBOC local exchange carriers get their checklists approved, it's a safe wager that competing providers will complain to the FCC and the Courts that the telephone companies are not living up to their agreements. The telcos will find enough ambiguities to contest the contesters. Communications attorneys will continue to rake it in.

The current telecommunications environment is the product of 85 years of telephony regulation, 75 years of broadcasting regulation, and 40 years of cable regulation. These were cumbersome enough when each of these services and technologies appeared distinct. That is not now the case and the boundaries will only get fuzzier: text, voice, video and audio and available over the Internet, which is, after all part of what we have called the telephone network. Data comes via cable. Telephone calls are wireless and television is wired. Satellites can switch phone calls and beam music or video to homes.

They can send data to the home or business as well. Is it reasonable to continue to regulate these technologies differently?

The reality is that most of the players are relatively happy with the *status quo*. They would be glad to branch out into another sector, but only if the terms of entry are “fair and reasonable.” As one U.S. Senator has been quoted as saying, “All anyone wants from me is a ‘fair advantage.’” They will do their best to assure that opening their own markets to new competitors be as unfair and unreasonable as possible. That is, competition is great, but not on “my” turf. None of the players would, of course, say this in public. And they don’t even have to say it to each other in private. But they know: lower the barriers elsewhere, try to keep the barriers up where they are. It’s a natural and logical reaction. And the Telecommunications Act of 1996 gives all parties plenty of wiggle room for the delays they want.

In the meantime, each of the traditional industries are finding plenty of opportunity for expansion and investment on the turf they know best. Cable is laying fiber to the curb, going digital, adding data. They have their plates full. The BOCs, having missed the boat with ISDN, now hope that some flavor of xDSL will get them into the data game big time and maybe into video as well. Meanwhile, they are busily selling second and third home lines. The long distance carriers are probably the most in need of new markets but see the local exchange business, at least at the residential level, as a financial sinkhole under present conditions. They believe it’s competitive enough out there. They are in no hurry to have Bell Atlantic and SBC leaping onto their turf. The broadcasters are spending billions in the switch to digital TV and are hopeful that either HDTV or ATV will provide new opportunities for advertising, data services and even subscription TV.

Can anything break the logjam?

### **Breaking Out of Regulatory Gridlock**

In *The Gordian Knot*, a book published this year, Russ Neuman and his colleagues have boldly proposed that the only way out of this long-running legal soap opera is a radical change to deregulation. The legend of the Gordian Knot is that in ancient Turkey King Gordius tied a large knot of tangled rope. He took special pleasure in challenging visitors to untie the Gordian Knot. Everyone who tried failed. When Alexander the Great passed through, he took on the challenge. His response to this puzzle: he drew his sword and in one stroke cut the Gordian Knot.

Neuman argues that the MFJ and the Cable Communications Policy Act of 1984 and the Cable Television Consumer Protection and Competition Act of 1992 and the Telecommunications Act of 1996 and the numerous reports and orders that implement these laws are like trying to untie the knot one strand at a time. They propose instead a drastic and complete stroke that breaks with the regulatory approach of the past and present.

The gist of their proposal is an Open Communications Infrastructure. In brief, OCI would create in the telecommunications business what has worked so well in the computer industry. In computing, using a strategy whose impact it did not foresee, IBM's open standards for its original PC undid the monopolistic competition of proprietary computer systems. It started a process which swept DEC, Prime, Data General, Wang, Apple and almost IBM itself away. The Internet also has proven the value of open architecture. Now it is time for Congress and the FCC to truly get out of the way of the telecommunications players. Let the Justice Department and FTC use the threat of antitrust to keep the lid on illegal anticompetitive behavior. And watch the true head banging begin.

Regardless of what happens in Washington, competition will eventually come across these boundaries. But it will come despite the 1996 Act -- or the 2002 Act or...., not because of it. And it will come slower and at a higher cost.

Neither Congress nor the FCC can micromanage the telecommunications business. The old and current approach is a swamp. It's time to look at how to drain it and let the animals have at it on their own strengths.