

Internet, phone and TV service by up to 20 percent, to as low as \$80 per month in 2008, according to *Consumer Reports*.²

If broadband providers were offering static or declining value, we could expect to see flat or declining subscribership. But it's just the opposite. A recent survey shows the number of adults who now have broadband connects increased 15 percent over the previous year.³ Even Free Press concedes that no technology compares with the pace of broadband adoption – “not the telephone, television, the automobile, cable TV, cellphone, or even the computer itself.”⁴

The broadband market is not a duopoly, but it wouldn't really matter if it was. Even the EU has concluded that wherever there is competition between at least two facilities-based broadband providers there is no market failure.⁵

Approximately 92 percent of the U.S. population lives in census blocks with at least one provider delivering 3G mobile broadband service.⁶ CTIA reports that 88

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² “Fiber-Optic Providers Are Leading Choices for Internet, Television, and Telephone Service,” news release (Jan. 5, 2009) (“intense competition for cable and satellite customers between AT&T U-verse and Verizon FiOS high speed fiber providers has driven down rates for Internet, phone and TV service and is likely the reason that companies allow these savings to continue past the promotional period. In the past year, bundles of the three services have dropped in price by up to 20 percent, to as low as \$80 a month.”) available at <http://pressroom.consumerreports.org/pressroom/2009/01/consumer-reports-fiber-optic-providers-are-leading-choices-for-internet-television-and-telephone-service.html>. See also: “Price War Erupts for High-Speed Internet Service,” by Vishesh Kumar, *Wall Street Journal* (Sept. 2, 2008) available at <http://online.wsj.com/article/SB122031009737388555.html>.

³ John Horrigan, “Home Broadband Adoption 2009,” *Pew Internet & American Life Project* (Jun. 17, 2009) available at <http://www.pewinternet.org/Reports/2009/10-Home-Broadband-Adoption-2009.aspx>.

⁴ Comments of Free Press (Jun. 8, 2009) at 130, available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6520219926.

⁵ “Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks,” *European Commission* (May 19, 2009) at 9, available at http://ec.europa.eu/competition/consultations/2009_broadband_guidelines/.

⁶ “Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,” WT Docket No. 08-27 (rel. Jan. 16, 2009) (Wireless Competition Report) at 9, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-09-54A1.pdf.

percent of the wireless devices used by the 270 million subscribers served by its members are broadband-capable.⁷ Consumers with these devices can use broadband on an as-needed basis, yet this is not captured in broadband adoption statistics.

If wireless broadband isn't a credible source of competition, why do CFA-CU and its allies want to include it in Title II?

The cellphone industry was deregulated by a Democratic Congress – with Al Gore's tie-breaking Senate vote – and signed into law by President Clinton in 1993.⁸ The cellphone market is wildly competitive. More than 95 percent of the U.S. population lives in census blocks with at least three mobile telephone operators competing to offer service, and more than 60 percent of the population lives in census blocks with at least five competing operators.⁹ And no carrier has a market share exceeding 27 percent.¹⁰ Gore recently referred to the industry as “the most competitive wireless industry of any nation in the world – because of competition, we're seeing the continued pulse of investment to expand the capacity of our networks.”¹¹

⁷ □ Remarks of Christopher Guttman-McCabe, Vice President, CTIA-The Wireless Association, at *Broadband Nation: Where Does the U.S. Really Stand in the World Rankings?* *Free State Foundation*, Washington, D.C. (Jun. 5, 2009) at 36-37, *transcript available at* http://www.freestatefoundation.org/images/Broadband_Nation_Transcript_Edited.pdf.

⁸ Hundt, Reed E. *You Say You Want a Revolution: A Story of Information Age Politics* (Yale Univ. 2000) at 15 (“in the Omnibus Budget Reconciliation Act, passed by Al Gore's tie-breaking Senate vote, the Democratic Congress gave the FCC authority to dissolve this oligopoly by auctioning new licenses”) and 98 (“by auctioning spectrum with no rules attached and preempting all state regulation, we had totally deregulated the wireless industry.”)

⁹ Wireless Competition Report at 5.

¹⁰ *Id.*, at 16.

¹¹ “Uncle Sam Should Leave Wireless Companies Alone,” by James K. Glassman, *Forbes* (Jul. 16, 2009) available at <http://www.forbes.com/2009/07/16/wireless-telecom-government-opinions-contributors-james-glassman.html>.

Since the wireless industry is a textbook example of effective competition, it is one of the least likely candidates for additional regulation of any of the Commission's client sectors.

Nonetheless, some parties believe regulation is justified because faster broadband service or higher adoption can be found in certain foreign countries. But these comparisons are highly misleading. Scott Wallsten points out,

Because average household sizes differ across countries, when every household in every country is connected to broadband the U.S. will rank 18th among OECD countries and much lower when compared to all countries in the world. Consider, for example, country rankings of the number of landline telephone subscribers per capita. In 2006 (before consumers started cutting their landlines in significant numbers), the U.S. ranked 45th in the world by this metric, despite 95 percent of all U.S. households having a telephone.¹²

Wallsten also predicts that the U.S. and nearly all wealthy OECD countries will reach a saturation point within the next few years if current trends continue.¹³

Another analysis by Robert D. Atkinson, Daniel K. Correa and Julie A. Hedlund finds that non-policy factors such as population density explain about three-quarters of the difference between nations in broadband performance.¹⁴ They caution that given the significant differences in economic, social, geographic and political factors between

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¹² Scott Wallsten, "Understanding International Broadband Comparisons – 2009 Update," *Technology Policy Institute* (Jun. 2009) at 3, available at <http://www.techpolicyinstitute.org/files/international%20broadband%20comparisons%202009%20update%20final.pdf>.

¹³ *Id.*, at 2, 4.

¹⁴ Robert D. Atkinson, Daniel K. Correa and Julie A. Hedlund, "Explaining International Broadband Leadership" *Information Technology and Innovation Foundation* (May 1, 2008) at 18-40, available at <http://www.itif.org/index.php?id=142>.

nations, it may not be simple to successfully transfer policies from one nation to another.¹⁵

With respect to requiring networks to be open to competition, for example, Atkinson, *et al.* note:

A number of European Union (EU) nations with similar unbundling regimes as France—for example, Italy and Spain—rank below the United States in terms of broadband adoption. Furthermore, most EU nations adopted unbundling regulations because they had almost no intermodal broadband competition—in part because their cable regulations significantly limited investment in cable modem service. Moreover, although proactive unbundling policies may have spurred broadband DSL adoption in some countries, aggressive unbundling policies, particularly of next-generation networks (e.g. fiber and high-speed cable), run the risk of limiting investment by both incumbents and competitors in these networks and may result in what might be termed modest-speed “DSL cul-de-sacs” on their relatively short copper loops.”¹⁶

The Sherman Act does not “give judges *carte blanche* to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition.”¹⁷ By the same token, the Commission would be wise not to insist that broadband providers alter their way of doing business just because it hopes some other approach might yield more consumer benefits. Who knows, the pursuit of the “perfect” may prove elusive. Meanwhile, the “good,” which presently exists, could be destroyed.

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¹⁵ *Id.*, at VII.

¹⁶ *Id.*, at VIII.

¹⁷ *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLC*, 540 U.S. 298 (2004).

II. THE COMMISSION SHOULD PURSUE NON-REGULATORY STRATEGIES TO PROMOTE BROADBAND ADOPTION

In fact, at least 91.8 percent of American households – and perhaps more – have access to broadband services, according to one expert.¹⁸ And according to the Pew Research Center, 63 percent of adult Americans now have broadband Internet connections at home.¹⁹ But a large number of Americans don't subscribe to broadband because they don't see the need for it or because they are concerned about the price. According to Pew, 50 percent of dial-up and non-online users fall into the former category and 19 percent fall into the latter category.²⁰

An innovative public-private partnership in Kentucky has shown how broadband deployment can be deployed nearly ubiquitously without a universal service subsidy mechanism.

“When we began, 60 percent of the households in Kentucky had the ability to subscribe. Today it's about 95 percent,” says Brian Mefford, executive director of Connected Nation. “That means about 600,000 new households have been able to subscribe to broadband who could not before.” The number of people actually using broadband jumped from 22 percent to 44 percent.²¹

¹⁸ □ Jon M. Peha, “Bringing Broadband to Unserved Communities,” *Brookings Institution* (Jul. 2008) at 11-12, available at http://www.brookings.edu/~media/Files/rc/papers/2008/07_broadband_peha/07_broadband_peha.pdf.

¹⁹ *Home Broadband Adoption 2009* at 9.

²⁰ *Id.*, at 8.

²¹ “High speed to the Hinterlands: Getting high-speed Internet to the remaining 6 percent of the population that lacks it takes a concerted effort,” by Gary Boulard, *State Legislatures Magazine* (Jan. 2008) available at <http://www.ncsl.org/IssuesResearch/TelecommunicationsInformationTechnology/StateLegislaturesMagazineHighSpeedtotheHin/tabid/13427/Default.aspx>; .see also, “Faster and Stronger,” by Ann Carrns, *Wall Street Journal* (Jul. 28, 2008) available at <http://online.wsj.com/article/SB121676442873775111.html>.

ConnectKentucky identified and addressed a number of factors affecting both supply (e.g., availability of market research) as well as demand.

For example, our research indicated that while industry assumed that the monthly fee was a primary barrier to the adoption of household broadband the lack of a computer at home ranked even higher. We developed No Child Left Offline as a partnership based solution. No Child Left Offline has facilitated cooperation among private partners, corporate foundations and state governments to place computers and printers into the homes and schools of disadvantaged children.²²

Clearly, broadband adoption is a bigger problem than broadband availability.

According to Jon Peha, the number of unserved households is in the neighborhood of 9 or 10 million; if most of these households are rural, approximately one-third of rural households are unserved.²³ Free Press estimates that it could cost as much as \$45 billion on a one-time basis to connect 7 million to 9 million homes with fiber-to-the-home technology.²⁴

Existing Universal Service support mechanisms at the federal and state levels should be examined and reformed as necessary to promote broadband deployment and adoption.

So should taxes and regulatory fees, which account for a substantial portion of the prices consumers pay for communications services. Consumers pay approximately \$37 billion a year in communication taxes and fees.²⁵ Although broadband Internet access

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²² Testimony of Brian R. Mefford, CEO of Connected Nation, before the Committee on Small Business of the U.S. House of Representatives (May 9, 2007) available at <http://www.house.gov/smbiz/hearings/05-09-07-sub-broadband/testimony-05-09-07-connect-kentucky.pdf>.

²³ *Bringing Broadband to Unserved Communities* at 11-12.

²⁴ Free Press at 283-84.

²⁵ "Taxes and Fees on Communication Services," by David Turek, Paul Bachman, Steven Titch and John Rutledge, *Heartland Institute* (May 2007) available at

services are generally not subject to state and local taxation, most communications services are transmitted over broadband networks and the excessive level of taxes and fees applicable to communications services in the aggregate decreases overall demand for broadband and the services delivered over broadband networks.

Affordability of broadband services is key to the Recovery Act's goal of ensuring "that all people of the United States have access to broadband capability." Taxes and fees increase prices, which is the second highest concern of most consumers who don't subscribe to broadband, according to the Pew survey.

Taxes and fees currently generate revenues almost equal to the cost of connecting 7 million to 9 million homes with fiber-to-the-home technology, according to Free Press. Increasing taxes and fees will reduce the affordability of broadband services. Reducing taxes and fees will make broadband services more affordable for more Americans, reducing the need for government subsidies.

III. COMMON CARRIER REGULATION WOULD BE COUNTER - PRODUCTIVE

CFA-CU urge the Commission to "reject all efforts by network operators to impede the flow of data with private practices such as, but not limited to filtering, deep packet inspection, throttling, blocking, or other forms of degradation."²⁶

Net neutrality is not related to the Recovery Act's goal of ensuring that all people

□ http://www.heartland.org/article/21104/No_113_Taxes_and_Fees_on_Communication_Services_full_text_pdf.html.

²⁶ CFA/CU at 2, 18.

of the United States have access to broadband capability. Net neutrality may actually inhibit the deployment of broadband by limiting the ability of broadband providers to experiment with innovative business models – as yet unimagined – to increase the appeal of broadband services.

Net neutrality may also thwart legitimate network management practices.

According to one expert,

The Internet is a system built on the dynamic sharing of network bandwidth, but it lacks a general-purpose mechanism of allocating it across user accounts fairly. Because the Internet lacks this vital mechanism, it's necessary for network operators to supply it themselves, as they have since the first deployment of Internet Protocol in a wide-area network by Ford Aerospace in 1981.

While the network engineering community is acutely aware of the limitations of the Internet's architecture and protocol design, advocates for open access and related causes often gloss over this issue in their search for the perfect network....

The lesson to be learned about traffic engineering is that the realities of business and the shortcomings of the Internet as a global system for multiple uses often collide with utopian desires for the more perfect network.²⁷

The Commission's Principles are appropriately consumer-focused, protecting competition, not individual competitors.

A prohibition of network management practices could also frustrate cybersecurity. Even Free Press acknowledges that “[a]ppropriate uses of DPI technologies do exist.”²⁸

²⁷ □ Testimony of Richard Bennett, Hearing on Communications Networks and Consumer Privacy: Recent Developments, Subcommittee on Communications, Technology, and the Internet, House of Representatives (Apr. 23, 2009) at 5-6, *available at* http://energycommerce.house.gov/Press_111/20090423/testimony_bennett.pdf.

²⁸ □ M. Chris Riley and Ben Scott, “Deep Packet Inspection: The End of the Internet As We Know It?” *Free Press* (Mar. 2009) at 5, *available at* http://www.freepress.net/files/Deep_Packet_Inspection_The_End_of_the_Internet_As_We_Know_It.pdf.

IV. THE COMMISSION SHOULD NOT RE-REGULATE SPECIAL ACCESS

According to Free Press,

If the Commission is going to make intermodal competition a centerpiece of its national broadband plan, then it is going to have to be aggressive about helping new providers build viable businesses. New entrants can put up wireless antennas, but they have to be able to carry traffic back-and-forth to the Internet. In many cases, the only available transport option is highcapacity lines offered by the local incumbent phone company. First and foremost, this means the Commission must take a close look at the special access, middle-mile and enterprise transport markets. As discussed above, the Commission's past deregulatory actions in these markets have been disastrous for competition. Special access rates of return are above 700 percent in some markets, and there is little data to suggest competition is any more effective in the enterprise market.²⁹

George S. Ford and Lawrence J. Spiwak at the Phoenix Center conclude in a new paper that government intervention is not warranted in the market for special access services purchased by businesses and institutions.³⁰ They note that the rates of return a prominent study estimated AT&T, Qwest and Verizon are currently earning either are similar to or less than the rates of return these companies used to earn when the market was fully regulated.

NRRI bases this analysis on ARMIS rates of return, a perplexing approach once one calculates ARMIS rates of return from the period in which all special access services were price regulated. In 1999, for example, the average rate of return for special access computed using ARMIS data was 32% for Qwest, 37% for AT&T, and only 4.5% for Verizon. For Qwest and AT&T, the returns under complete price regulation are not much different than the "adjusted" returns computed in the NRRI Study. The conclusion, then, is the pricing flexibility has had no effect. For Verizon, its rate of return prior to the Pricing Flexibility Order was substantially lower than the other Bell companies and even below any reasonable estimate of the firm's cost of capital. One interpretation, then, is that a more deregulatory approach has provided for more reasonable returns on investment for

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²⁹ Free Press at 267.

³⁰ George S. Ford, Ph.D and Lawrence J. Spiwak, Esq. "The Need for Better Analysis of High Capacity Services," *Phoenix Center* (Jun. 2009) available at http://www.freepress.net/files/Deep_Packet_Inspection_The_End_of_the_Internet_As_We_Know_It.pdf.

the firm. (footnote omitted.)³¹

There is always a high risk well-intentioned regulators will fall victim to lobbyists or simply guess wrong. Ford and Spiwak point out that in the current environment the risk is heightened due to the impairment of credit markets.

In the current financial and economic crisis, [the] costs and risks of regulation are even more pronounced, particularly with regard to rate regulation. At the most basic level, one cost of rate regulation is the risk that regulators will establish an incorrect rate. If regulators set a rate too high, then they might redirect investment inefficiently and also whittle away any prospective welfare gains by that intervention. If regulators set a rate too low, then investment will be squelched and entry will be deterred. It is important to note that not only would investment by incumbents be squelched and deterred, but that investment by entrants might be similarly affected. With fixed and sunk costs, regulatory-mandated reductions in prices or profits may very well dissuade new entrants from offering service.

The risk of a regulator setting a rate incorrectly is particularly acute in the current environment, because any form of rate regulation requires the regulator to examine and establish a cost of capital. In a normal rate case, a regulator can obtain reasonably valid estimates of the cost of capital by observing borrowing and equity costs for other firms exhibiting “comparable” risk characteristics.

But today, the Federal Reserve Board of Governors and the Department of the Treasury have concluded that the financial markets are currently so dysfunctional that the public authorities must step in and recapitalize banks, large insurers, and so on. Future taxpayers are being used as a source of capital-of-last-resort for many of these institutions, a process that is necessarily distorting the standard methods in which a regulator may establish a cost-of capital for the industry. Stated simply, if it is true that even economically worthwhile projects are now unable to obtain funding under any conditions, what is the true cost of capital? Once credit is being rationed, the risks of establishing an incorrect rate for a service are very high, and policymakers ought to take this into account when reviewing proposals for immediate regulation of special access rates, at least until the financial markets return to normalcy. (footnotes omitted.)³²

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³¹ *The Need for Better Analysis of High Capacity Services* at 28-29.

³² *Id.* at 41-42.

The paper confirms that re-regulating the special access market would be both unnecessary and highly risky.

According to an analysis prepared by Peter Bluhm with Dr. Robert Loube under contract with the National Association of Regulatory Commissioners (NARUC) ,

Buyers have criticized the FCC's current regulatory regime because it has apparently allowed excessive earnings. For their part, the RBOCs contend that the ARMIS figures are virtually meaningless. We agree with the RBOCs

Before 2000, special access investment was categorized by what is called "direct assignment." The purpose was to assign 100% of investment for interstate special access to the interstate jurisdiction and 100% of investment for intrastate special access to the state jurisdiction. In practice, direct assignment required carriers to perform studies on how their networks were used

In 2001, the FCC "froze" separations categories and factors for large companies. At that point, large carriers stopped performing direct assignment studies During [the ensuing] period, carriers greatly increased their sales of interstate special access, and all of that revenue was assigned to interstate. *As a result, interstate special access revenues increase every year, but not interstate special access costs. This imbalance has inflated ARMIS special access earnings reports and made them unreliable.* (emphasis added.)³³

Likewise, a paper by Harold Ware, Christian Dippon and William Taylor at NERA Economic Consulting concludes,

accounting profits generated from [ARMIS] data bear no relationship with economic profits and cannot serve any useful purpose in determining whether pricing flexibility has generated excessive rates of return.³⁴

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³³ Peter Bluhm with Dr. Robert Loube "Competitive Issues in Special Access Markets" *Revised ed.* (Jan. 21, 2009) at 70, available at http://nrri.org/pubs/telecommunications/NRRI_spec_access_mkts_jan09-02.pdf.

³⁴ Harold Ware, Christian Dippon and William Taylor, "Is More Special Access Regulation Needed? Reactions to the NRRI Report on Special Access Competition," *NERA Economic Consulting* (Mar. 4, 2009) available at http://www.nera.com/image/PUB_Special_Access_Regulation_03.2009_final.pdf.

In an effort to get to the bottom of this, Bluhm and Loube *estimated* the current actual cost and found that the carriers are probably earning substantially less than ARMIS indicates. Instead of earning a 138% return on special access investment, AT&T is more likely earning 30%. Qwest is probably earning 38%, not 175%. And Verizon, 15% instead of 62%.³⁵

The revised percentages are still more than a regulated utility would be allowed to earn. However, there are at least two points to consider.

First, absent cost studies there is no way to know how much the network providers are earning. According to Ware, *et al.*,

allocations and adjustments can produce wildly different results depending on what factors are used. This is why economists and regulators have long rejected use of cost allocations such as those in the ARMIS data. It is also why [Bluhm and Loube's] conclusions regarding profits for special access should be summarily rejected.³⁶

They point out that if different adjustments are chosen, the return on investment could be even *lower*.³⁷

Incidentally, Ware, *et al.* predict that the potential benefits of additional special access regulation are not worth the “potentially large costs.”³⁸

For another, competitors are entering the market and they are capturing market share. Bluhm and Loube concede that

Cable television and fixed wireless have low entry and exit costs where their networks are currently established, and each can provide substitutable dedicated services to many customers. Overall, these competitors are still acting on the fringes of special access markets, but they have larger roles in some locations and their market shares appear to be growing. Fixed wireless may hold a large market share in five years, particularly if WiMAX proves reliable and if these carriers can attract sufficient capital to expand. These newer technologies may be poised to

become major competitors and are increasingly constraining ILEC behavior, but they have not yet grown beyond fringe competitors in most markets.³⁹

Maybe these competitors are still “acting on the fringes” because profit margins afforded by the market aren’t fat enough.

If AT&T, Qwest and Verizon are earning excess profits, cable and fixed wireless competitors will be able to undercut their prices and capture market share. The higher the profits, the faster the entry.

If regulation pushed special access prices lower, that would reduce the revenue investors could expect to earn from new competitive facilities. If investment won’t be profitable, it won’t be made.

CONCLUSION

The broadband market is delivering better services at lower prices. There is no evidence of a market failure which would justify additional regulation.

The Commission should focus on non-regulatory strategies which have proven effective in promoting the adoption of broadband services.

Common carrier regulation could interfere with innovation and legitimate network management.

There is no compelling evidence of excessive profits which would justify re-regulation of the special access market.

Respectfully submitted,

/s/

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