Competition Policy Institute Forum:
Keeping Telecom Competition on Track
Address by Commissioner Kathleen Q. Abernathy
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I. Introduction

Thank you for your kind invitation to speak here this morning and that generous introduction. My focus today will be what the FCC can do to further local wireline competition based on the lessons learned in the wireless and long distance markets. However, before jumping into the wireline debate, let's look for a minute at our success in promoting competition in the wireless and long distance sectors. Competition is thriving in these markets, and by and large the best thing the FCC can do now to keep competition on track is to stay out of the way. But how did we get there? And what lessons can be drawn from those experiences that will inform our consideration of the more difficult issues we face when it comes to local wireline competition policy?

The wireless and long distance experience persuades me that relying on market forces — to the greatest extent possible — offers the best means of delivering innovative services and lower prices to consumers. As I'll describe, relying on a small number of clear and narrowly tailored ground rules, backed by stringent enforcement mechanisms, will do more to boost competition than a heavy-handed regulatory approach.

But before we get these issues, I'd like to talk a bit more about wireless and long distance competition, where most everyone agrees that the FCC ought to continue on a deregulatory path.

II. Wireless Competition

I enjoy talking about wireless competition, because this is an area in which I've spent a good part of my career, and because it's a great success story.

First, let me share with you some of the information gathered in the FCC's most recent CMRS report, which says quite a lot about where we are today. The wireless marketplace is a hotbed of competition. There are six virtually national providers of mobile telephony in this country: AT&T, Cingular, Nextel, Sprint, Verizon, and VoiceStream. There are also a number of large regional competitors, such as Western Wireless, U.S. Cellular, Dobson Communications, and ALLTEL; and there are many other niche players such as Leap Wireless, which offers an innovative all-you-can-eat local calling plan that is has 57% of their users identifying their Leap wireless phone as their primary phone service. With regard to resellers, or the non-facilities-based competitors, their market share in this highly competitive landscape remains low — less than 3% of the market — despite the current resale obligation, and despite the fact that the number of subscribers for this sector continues to rise. When you have a robust facilities-based competitive market there is less of a market niche for resellers.

Now, as a result of all this competition, an overwhelming majority of Americans have a choice of providers. In fact, 259 million Americans, or over 91% of the population, live in counties where three or more operators provide service. And Americans have continued to enjoy declining prices, more flexible pricing plans, better service, more innovative features, and other benefits.

Given these beneficial effects of competition, it's no mystery why wireless providers were able to add nearly 17 million new customers in 2000, for a total of nearly 110 million. That represents an increase of more than 28% over the 1999 figures. Therefore, despite falling prices, companies have increased their revenues per unit by 15% over the last two years as minutes of use have increased. So this really is a win-win situation for consumers and providers.

What is responsible for this success, and how can we duplicate it in other contexts? Well, certainly one important piece of the puzzle is that wireless services offer tremendous advantages that improve our daily lives, which of course stimulates strong demand for these services. So indeed this success is based, at least in part, on the existence of strong market demand. But marketplace demand is not enough; regulators had to create policies that allowed competition to flourish while also intervening when necessary to achieve important public policy goals.

When Congress passed Section 332 in 1993, the Commission was at a key crossroads: It could have heeded calls to impose strict Title II common carrier regulations on incumbent cellular providers, based on their supposed entrenchment. That is, it could have imposed price regulation, service quality controls, mandated certain technologies or demanded tariffing. But the FCC instead let go of the reins and relied on market forces to govern pricing and service terms for PCS and other mobile services.

This is not to say, however, that there was no regulatory intervention. At the federal level, the FCC continued to place additional spectrum into the marketplace — thus allowing multiple players to pave their own wireless last mile and to compete with existing providers. Included in this policy was a spectrum cap that guaranteed, at least initially, that there would be at least 4 distinct providers in each market. The Commission also developed and enforced strict interference rules that prevented competitors from externalizing costs by interfering with their competitors. And the FCC continued to look to the states to ensure compliance with state and local zoning requirements as well as important consumer protection laws.

So while the approach to wireless was largely deregulatory, the Commission also engaged in limited interventions to ensure, for example, that there was a diversity of providers of the "last wireless mile" and to prevent competitors from externalizing costs onto one another or consumers. In sum, the wireless experience illustrates how Commission policy ought to work: We establish policies that encourage entry into the marketplace; firms compete in the marketplace; and consumers make choices that maximize their welfare. In the end, some firms succeed while others fail, and it is the role of regulators to referee between carriers and consumers and among providers, not to pick winners and losers.

III. Long Distance Competition

Let's now turn to the long distance market. It is also robustly competitive — so much so, in fact, that many market observers have identified declining margins as a threat to the continued viability of long distance as a stand-alone business.

AT&T's market share has fallen from over 90% in 1984 to about 38% last year; WorldCom's share was 23% in 2000, Sprint's was 9%, and more than 700 other long distance carriers together served the remaining 30% of the market. As a result of this competition, prices have fallen to approximately 11 cents a minute on average, or almost 50% less than the average price from the early 1990s.

In order to keep competition on track for long distance, I believe the FCC should continue with its deregulatory course, just as it should in the wireless context. I don't expect there will be much argument on this point, but I have heard some calls for increased regulation of the long distance market, and I am inclined to resist them. We have moved to deregulate long distance rates, streamline filings, and subject the marketplace to the same disciplining forces of other markets. For example, I support the Commission's decision to detariff long distance service, which lets competitors change prices and service terms without filing tariffs with the Commission. Instead, carriers must contract with their customers explicitly and directly, just as other service providers do. One possible downside of detariffing, though, is that some carriers may give their customers little advance notice of pricing changes. Yet it is difficult for me to believe that, under the tariffing regime, consumers were monitoring the thousands of pages of tariff filings the Commission used to receive each year and were then able to detect any change to their particular service. Moreover, I was deeply skeptical of the legal regime under the filed-rate doctrine that insulated carriers from liability based on the presumption that tariffed rates were just and reasonable. Deregulation opens the door to better public information and eliminates the shield of the filed-rate doctrine against consumer complaints.

I believe we should resist calls to re-regulate the industry, particularly at a time when the RBOCs are finally entering the long distance marketplace, and consumers will have more choices than ever. Nonetheless, here as in the wireless arena, we must vigorously enforce our rules to prevent carriers from externalizing costs onto consumers or competitors. Thus, it is essential that the Commission and the states aggressively enforce our slamming rules. It is essential to good competition policy to squelch such anticompetitive behavior.

Its also worth emphasizing that most of the successful long distance actors are also facilities-based providers. Although resellers have had some success in this market, by and large the low margins fostered by increased facilities based competition have squeezed the margin for resellers even more tightly and diminished the attractiveness of that business strategy.

It is also important to note that long distance services do not have the same last mile bottleneck barriers that exist in the local wireline market and to a lesser degree in the wireless world. So the wireless and long distance experiences are not analogous in all respects, but they still provide valuable insights.

IV. Local Competition

Well, this brings me to local competition, which is undoubtedly one of the most difficult problems facing the FCC. It is difficult for a number of reasons. First, an obvious obstacle to competition is that the last-mile connection to consumers' homes appears to be a true bottleneck. Another major barrier is that residential rates in many areas — particularly in high-cost rural areas — continue to be set well below cost, which makes entry economically irrational unless universal service support is set at very high levels.

Before I discuss some ideas on how to address these issues, let me first review some of the latest data on local competition to provide a backdrop for my remarks. At the end of 2000, CLECs served about 8.5% of all local access lines, which is nearly double their share from a year earlier. The CLEC share of the residential and small business market was about 4.6% at the end of 2000, which again was double the previous year's penetration. This encouraging CLEC growth rate of 100% is often overshadowed by the headlines about CLEC failures, but we should not overlook its significance. Despite such growth, however, incumbent LECs still serve more than 95% of *residential* customers. And the numbers probably won't improve as dramatically this year, given what has occurred in the capital markets.

As Congress recognized in section 251 of the Act, and as these number reflect, incumbent LECs' control over the last-mile infrastructure clearly requires some regulatory intervention for robust intra-platform competition to develop.

But we cannot ignore the fact that there are also risks associated with *too much* regulation as well. If we micromanage every aspect of negotiations between competitors and incumbents, and we force incumbents to share each and every element of their networks, we'll get stuck in a regulatory morass so thick that competition will *never* emerge. And it's a regulatory morass that we largely avoided in the wireless and long distance markets by focusing on narrow market intervention and vigorous enforcement. But it's the danger of *over*regulation that I think the FCC lost sight of in its initial efforts to implement the 1996 Act.

The Commission is now engaged in an effort to restore the incentives for *facilities-based* investment that Congress intended. The same facilities-based competitive model that has driven the success of the wireless and long distance marketplaces. This means a shift away from policies that actively encourage resale as a long-term business strategy and force the unbundling of virtually every network element at TELRIC rates. As the Supreme Court recognized in the *Iowa Utilities Board* decision, too much sharing destroys the investment incentives of both incumbents *and* CLECs: Incumbents have little incentive to deploy fiber to the curb, for example, if they will have to turn around and hand that fiber to their competitors at TELRIC rates. And CLECs will have little incentive to deploy their own networks when they can get access to incumbents' facilities at cost-based rates. With open market incentives — like those indicative of the wireless and long distance markets — competitors will have to choose a facilities-based strategy in order to compete over the long term.

The FCC appropriately recognized this risk of overregulation when it declined to force the unbundling of packet switches. But in other respects, I think the FCC's initial implementation of the 1996 Act was focused too much on the purported benefits of unbundling and did not adequately consider the long-term consequences on investment incentives and the growth of viable long-term competitors. The Commission is preparing to launch a comprehensive review of UNEs, which will carefully consider the impact of our regulations on carriers' investment incentives, particularly with respect to broadband facilities. The

Commission also will explore whether a more granular approach is warranted — one that conducts the impairment analysis on a service-by-service and market-by-market basis, to ensure that we do not order more unbundling than is necessary to enable competitive entry.

I think such a circumspect approach to intervention in the marketplace is the central teaching of the wireless and long distance competition revolutions. Had the Commission chosen a heavily regulatory route in 1993 (for wireless) or 1984 (for long distance), I don't think we'd have the widespread deployment or low prices that we enjoy today.

That is not to say we should walk away from market intervention. Quite the contrary, we must remain engaged. Unlike in the wireless context, where our bright-line rules prevented incumbents from gaining exclusive access to each last mile (through the cap and eligibility restrictions), here we are statutorily and, quite frankly, practically obligated to pry the last mile open. My point is that we'll do more to facilitate competition if we resist the urge to micromanage *every* aspect of the relationship between incumbents and new entrants — and instead, as in wireless, focus our attention on that very last mile.

Thus, we should limit ourselves to promulgating a small number of core rules, and we should enforce them vigorously. The complaint I hear most from CLECs isn't that we need more rules; it's that we don't enforce the basic nondiscrimination requirements we do have. Our recently released NPRMs on performance metrics should aid our enforcement policy significantly. If we establish a core set of performance metrics concerning ordering, provisioning, and maintenance and repair, that should make enforcement far more straightforward than it is today, when allegations of discrimination are difficult to substantiate. Once we make the costs of noncompliance significant enough, ILEC provisioning delays and other impediments to competition should decrease markedly.

I don't want to give you the impression that the FCC can bring about vigorous residential competition simply by narrowing the scope of its unbundling regulations and adopting performance metrics. I do think, however, that such measures should have substantial competitive benefits in the long run. But the states also need to take significant steps, including rebalancing local rates and providing explicit and portable universal service support. And we must work together — the Commission, the states, and consumers — to ensure nondiscriminatory access at just and reasonable rates, and that incumbents cannot externalize costs onto consumers or their competitors without the hammer of enforcement.

Finally, another important piece of the puzzle — the "carrot" in the "carrot and stick" model Congress created — is the section 271 process. I think we're finally beginning to see what Congress originally envisioned: As RBOCs attempt to demonstrate their compliance with the various checklist items, they exhibit an increased willingness to solve competitors' problems. In New York, within a year after Verizon took the steps required to gain authorization to provide long distance service under section 271, competitors had quickly increased their market share to more than 20%. This no doubt reflects the high margins available in New York City, but it also reflects the procompetitive impact of the Section 271 process. Another encouraging development involves the Section 271 workshops that Qwest and other BOCs have been holding with the state commissions and CLECs. This collaborative approach to establishing workable operating support systems offers real promise of removing additional impediments to competition — and moving closer to fuller and complete implementation of the Act.

Clearly, encouraging the growth of wireline competition presents unique obstacles not encountered in the wireless and long distance markets, and unique challenges to regulators. But I believe that we will increase our chances of creating the appropriate regulatory environment — one that stimulates competition and delivers benefits to consumers — by incorporating lessons learned from our success in promoting competition in the wireless and long distance sectors.