

Harmonizing Unequal Telecom Regulations

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Now that the national debate on unbundled network elements (UNEs) appears to be winding down, what's left on the regulatory agenda? We'd like to propose harmonization across platforms (i.e., mobile, wireline telephony and cable) and protocols (i.e., POTS telephony and TCP/IP) as an important step in fostering free market competition. Clearly, this is not the state of affairs today:

■ **Access Fees:** Interexchange carriers (IXCs) pay \$20 billion in long distance access fees to local exchange carriers (LECs), while local/mobile carriers and VOIP providers interconnect at effectively no charge.

■ **Universal Service:** Telecom service providers pay \$5 billion in universal service fees based on end-user interstate revenues. Due to these rules, 65 percent of universal service fees are paid by IXCs, 20 percent by LECs, and zero by cable TV and VOIP providers. As interLATA revenue continues to decline, the universal service fee as a percentage of carrier revenues will continue to increase (from 8.9 percent in 4Q04 to possibly 13.25 percent or more in 1Q05), accelerating the demise of long distance.

■ **Local rate regulation:** Local incumbent telephone rates continue to be regulated (generally on a price cap basis). As a result, high business rates subsidize residential rates and urban areas subsidize rural. New entrants, mobile and CATV providers have no restrictions.

■ **Unbundling requirements:** Telephone LECs are required to provide telecom services on a common carrier basis

to information service providers (such as Internet service providers), at the same prices that they charge themselves. In addition, incumbent LECs (ILECs) are required to provide selected access to last-mile facilities on an unbundled network element (UNE) basis, priced at long-run incremental cost.

In contrast, CATV providers have no unbundling requirements. While a 2003 Ninth U.S. Circuit Court decision found that CATV providers provide separable telecom and information services, the FCC so far has been resisting harmonization. Last month, the U.S. Supreme Court decided it would hear the appeal, so the question should be settled sometime this year.

**It's time
for rules
that reflect
contemporary
market realities**

■ **Interconnection requirements:** Telecom carriers are required to interconnect. Instant messaging systems such as AOL's, Yahoo's and MSN's do not need to interconnect—and they don't (at least not yet). Ditto for alternative VOIP technologies, such as voice-enabled IM. As these other technologies gain share, we could end up with mutually incompatible communications systems.

■ **Franchise rules:** CATV operations pay franchise fees; telcos do not. ILECs do not pay right-of-way fees; CLECs do. The result: substantial cost differentials across platforms doing some of the same functions. We see the need to deal with 35,000 separate municipalities as a huge legal and accounting barrier to entry, making it difficult for startups to compete broadly.

Arguably, the telecommunications market needs harmonization. In the past, this wasn't important, since each telecom platform and protocol largely competed in separate markets from the others.

That's clearly going to change, as the major competition for incumbent telcos becomes CATV, mobile and VOIP providers, not CLECs and IXCs; and as VOIP and IM represent increasing competition for voice telephony.

Proposals For The Future

So what would a harmonized set of regulations look like?

■ We would begin by separating all networks into physical telecommunications carriers (in telecom lingo, layers 0–3), and layer 4–7 information services providers, who use the telecom carrier physical connection as the basis for providing a value-added service. With respect to cable, the physical plant would be considered a telecom service, while content provision would be considered an information service. For wireline and mobile telephony, the physical plant would be a telecom service, while any value added services and marketing markups would be information services.

■ Telecom carriers would be regulated. Information service providers would not (since the barriers to entry are lower). Carriers that offer both functions would need to separate them via some mechanism akin to the local/long distance separation methodologies established over the past century.

■ Telecom carriers would be required to sell their services to third-party information service providers at the same rates that they charge their own info service providers. This means that CATVs would be required to wholesale access to their network to competing CATV and cable modem providers, as information service companies.

■ We would apply UNE requirements equally across telecom carriers based on an equivalent "necessary" and "impair" test (i.e., that access to a UNE is necessary for competition and failure to provide the UNE would impair competition). In applying the UNE test, we would explicitly consider the economic feasibility of cross-platform competition. Prices for UNEs would be set via the TELRIC (Total Element Long-Run Incremental Cost) methodology, but

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applied in a just manner that allows a fair return on investment (see our article in *BCR*, July 2003, pp. 54–58)

■ All telecom carriers would be required to interconnect various identification schemes—North American Numbering Plan (NANP)—IP, IM on a reciprocal/incremental cost basis. To develop and standardize the method(s) for this, organizations such as the Internet Engineering Task Force (IETF), Cellular Telecommunications and Internet Association (CTIA), CableLabs and Telcordia would have to participate.

■ Telecom carriers (including CATV-based voice service providers) would pay a value-added fee to support national universal service goals. This fee would be based on value-added rather than end-customer revenues (so as not to double-count revenues where one service provider is wholesaling services to another carrier who has the retail account), and it would be levied on interstate as well as intrastate services.

■ For telecom carriers, there would be no retail price regulations. If wireline telcos try to gouge customers, those customers will flee to VOIP, telephone over cable or mobile. The Department of Justice will still be able to prosecute anyone who attempts predatory pricing.

■ Telecom carrier franchise fees negotiated on a town-by-town and case-by-case basis would be prohibited. Having to deal town by town, rather than dealing with state-level regulatory organizations, is a huge barrier to entry. Local municipalities would be allowed to charge reasonable right-of-way fees that would apply equally to all telecom carriers—incumbent and new entrant.

Conclusion

In sum, what we now have is more than 100 years of accumulated regulations that are specific to individual physical platforms. These different rules made sense when there was minimal competition across platforms. Now that competition increasingly is going to come from cross-platform moves, asymmetrical regulation makes little sense, and will distort free market economics. It's time that the FCC (and, where necessary, Congress) clean house and create a consistent and level playing field□