TELECOM REGULATION FOR THE 21ST CENTURY: AVOIDING GRIDLOCK, ADAPTING TO CHANGE

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INTRODUCTION[1]

Is the regulatory system established by the Communications Act of 1934, as amended by the Telecommunications Act of 1996, suitable for the 21st century? There seems to be a growing consensus that it is not, and that "something must be done." Bills have been introduced in Congress and hearings will be held in the 2006 session.

A major reason for the current dissatisfaction with the existing regulatory system is that the 1996 amendments were obsolete when they were enacted. Because the 1996 Act was a backward-looking attempt to fix problems that had become apparent in the decade from 1985-95, it did not (and realistically could not) foresee the challenges that have resulted since 1996. These include the effects of the rapid evolution of the Internet and broadband communications, the displacement of wireline telephones by wireless, the convergence of telecom and television, and the boom-bust-consolidation of the industry.

Just as the Congress of 1995-96 was unable to perfectly foresee the future, it is unlikely that Congress will be more prescient in 2006-07. Indeed, the speed and uncertainty of change in telecom has increased dramatically in recent years compared to the relatively stable and predictable decade that preceded the 1996 law, so today's lawmakers will have an even more difficult time trying to write forward-looking policies and "future-proof" statutes.

This article suggests in Part II an approach to developing a regulatory system that will be compatible with the rapid changes and uncertainty which are likely to characterize telecommunications for the foreseeable future. It starts with the proposition that much of the dissatisfaction with the current system is due to the regulatory gridlock that, among other things, has seriously hampered the recovery of the telecom industry. Gridlock results because it is difficult for the Federal Communications Commission (FCC) to adapt rules, regulations, and

1. This article is based on a report released on October 29, 2004 at CITI's conference on "Remedies for Telecom Recovery: One Year Later." *See* Robert C. Atkinson, Dir. of Policy Res., Columbia Inst. for Tele-Information, Report at Remedies for Telecom Recovery II: What Can the Government Do to Help Recovery? (Oct. 29, 2004), http://www.citi.columbia.edu/research/recovery2/CITI_RegulatoryUpdate04.pdf. That report, in turn, incorporated recommendations made in October 2003 at CITI's initial "Remedies for Telecom Recovery" conference. *See* Robert C. Atkinson, Dir. of Policy Res., Columbia Inst. for Tele-Information, Report at Remedies for Telecom Recovery: Regulation & Government Policy (Oct. 3, 2003), http://www.citi.columbia.edu/CITI_Regulation_advisorycomm.pdf.

policies to address fast-developing and changing issues in a timely fashion. This difficulty is compounded because the 1996 Act creates a logjam that makes it difficult to resolve localized issues locally, so matters that can and should be handled at the state level clog the federal system. In Part III, the article suggests ways to reduce gridlock, including some solutions that would not need new legislation and some that would.

However, the article then suggests in Part IV that the existing regulatory system, even if less gridlocked, will still be too rigid and inflexible to accommodate fast-changing technological and marketplace circumstances. It therefore proposes the legislative solution of replacing the existing static regulatory system with one that can adapt with greater ease to different and ever-changing circumstances. The article concludes in Part V that a "future-proof" regulatory system can be achieved by a simple, flexible new statute that relies on market forces wherever possible and, for matters where the regulation is necessary, simple regulatory principles and procedures rather than gridlock-inducing statutory micromanagement of the sort included in the 1996 Act. The article suggests many of the principles and procedures that should be included in such a law.

I. AVOIDING GRIDLOCK: A FUNDAMENTAL PROBLEM FOR THE TELECOM INDUSTRY IS A GRIDLOCKED REGULATORY PROCESS

A great challenge facing policymakers and telecom industry managers and investors is whether critical government policies and regulations can be changed rapidly enough to stay in step with the rapid, unpredictable changes of a volatile and fundamentally unstable telecom industry.[2] If management and investors don't know what the basic government rules are, there will be a natural tendency–exacerbated by the historic 2000-01 financial crash of telecom investments–to hesitate and to wait until the rules get clearer.[3] Such hesitation is bad for the

2. From the time of the consolidations that created the telephone monopolies that gave rise to the Communications Act of 1934 until quite recently, the telephone business was very stable and predictable. CITI's "Remedies for Telecom Recovery" project, *supra* note 1, recognized that the recent "boom and bust" might be the beginning of a long period of fundamental instability in telecommunications and that regulators, managers and investors have little or no experience in dealing with such a radically different environment. The CITI project reports are available at http://www.citi.columbia.edu/hold.html. For other materials based on the project *see* Eli Noam, *How to Cope with the New Volatility*, AMERICA'S NETWORK, Oct 1, 2003, http://www.americasnetwork.com/americasnetwork/article/articleDetail.jsp?id=71237; Eli Noam, *The Effect of Deregulation on Market Concentration,* 4 COLUM. SCI. & TECH. L. REV. 8 (2003); Eli Noam, *How Telecom Is Becoming a Cyclical Industry, and What to Do About It* (June 28, 2002) (unpublished manuscript, available at, http://www.citi.columbia.edu/elinoam/articles/cyclicality.htm).

3. Therefore, once an important issue is "teed up" on the regulatory or government policy agenda, the substance of the subsequent decision may be less important to the health of

economy, innovation, competitiveness, and consumer welfare.

Two broad categories of regulatory decisions that are of great interest to telecom managers and investors are revenue regulation and competition policy. The level of interest is high because these are the sorts of regulations which most directly affect business rewards and risks (e.g., profits). Since the passage of the Telecom Act, revenue regulation and competition policy have been intertwined at the Federal level in five areas: access charges,[4] reciprocal compensation,[5] Universal Service,[6] Bell

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the telecom sector than the speed at which a reasonably final decision can be reached.

4. Access charges are fees paid by long distance telephone companies to local telephone companies to originate or terminate a long distance call. They were created as the result of the 1984 break-up of the Bell system to maintain the flow of subsidies from long distance to local services and from urban areas to rural areas in order to keep the prices of local services lower than they otherwise would be, particularly in the rural areas. Since the Bell System break-up, the FCC has issued a series of "access charge" Orders, the trend of which has been to lower the charges and move responsibility for paying the charges from carriers to customers to encourage a more economically rational system. *See, e.g.*, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure & Pricing End User Common Line Charges, *First Report & Order*, 12 FCC Rcd. 15,982 (1997); Access Charge Reform, *Fifth Report & Order*, 14 FCC Rcd. 14,221 (1999); Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, & Federal-State Joint Board on Universal Service, *Sixth Report & Order*, 15 FCC Rcd. 12,962 (2000); Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers, *Eighth Report and Order and Fifth Order on Reconsideration*, 19 FCC Rcd. 9108 (2004). However, changes in access charges have complex interactions with Universal Service and competition policy so the "access charge" Orders tend to be tentative, muddy compromises. *See, e.g.*, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board On Universal Service, *Sixth Report & Order*, 15 FCC Rcd. 12,962, 12,971-72, 12,974-77 (2000).

5. "Reciprocal compensation" is the fee paid by one local carrier to another local carrier when one carrier originates a call and the other terminates it. Prior to the advent of local telephone competition in the early 1990s, local traffic was exchanged between adjacent local telephone service monopolies under a long established system known as "separations and settlements" that often involved little or no exchange of cash. When new local competitors sought to exchange traffic with the incumbent local telephone companies using the "separations and settlements" system, the incumbents refused and instead proposed to exchange traffic on the basis of the "access charges" used for long distance calls, *supra* note 4. Because "access charges" included various subsidies, they were higher than the retail prices of the local telephone service, making it difficult or impossible for a new entrant to offer a profitable competing local service if access charges were applied. The disputes between local incumbents and new entrants were resolved with varying degrees of success by State regulators. The Telecommunications Act attempted to make the better State solutions national policy by requiring local traffic to be exchanged at rates that reflect only "a reasonable approximation of the additional costs" of terminating the call. 47 U.S.C. § 252(d) (2)(A)(ii) (1996). Even with this clear pricing standard, "reciprocal compensation" has remained as a point of major dispute since 1996.

6. "Universal Service" is a policy to ensure that every citizen has access to reasonably priced basic telephone service, regardless of the actual cost of providing the service or the citizen's ability to pay. Central to this policy is the subsidization of high cost areas and low income consumers and, more recently, assistance to schools, libraries and rural health care facilities. When telephone service was a monopoly, the support of universal service was embedded in a complex system of subsidies approved by State and federal regulators. Business

company entry into long distance,[7] and unbundled network elements[8] (particularly the UNE-Platform[9]). And in the ten years since 1996, the first three of these areas remain unresolved, the fourth (Bell long distance entry) was completed in late 2003 and the fifth (UNEs) was largely (but not completely) resolved only in 2004. The inability of the existing regulatory system to achieve final, clear decisions on these (and other) critical decisions within a short period of time can best be described as

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services and services for consumers in urban areas were priced above costs to generate a surplus that would subsidize retail rates in high cost rural areas and for low income individuals. Long distance services were priced higher than costs to provide a subsidy to local rates. New competitors naturally focused their efforts on offering business services in low cost urban areas, the very services and geographic markets generating the subsidies to residential consumers and rural areas. This presented regulators with a dilemma: authorizing and encouraging competition might have an adverse impact on politically-sensitive local telephone rates. Incumbent telephone companies used the prospect of huge local telephone rate increases to encourage regulators to slow or even halt the development of competition. The never-ending disputes over the level of access charges and reciprocal compensation were largely about the preservation of the subsidy flows.

§ 254 of the Telecommunications Act of 1996 sought to maintain universal service subsidies without impeding the development of competition by substituting explicit subsidies for the implicit subsidy system used in the monopoly era. The goals of Universal Service, as mandated by the Telecommunications Act of 1996, are: to promote the availability of quality services at just, reasonable, and affordable rates; to increase access to advanced telecommunications services throughout the Nation; and to advance the availability of such services to all consumers, including those in low income, rural, insular, and high cost areas at rates that are reasonably comparable to those charged in urban areas *See* 47 U.S.C. § 254 (2006). Despite the Telecom Act's admonition that all subsidies must be explicit, implicit subsidies remain in 2006.

7. The 1982 Modifications of Final Judgment MFJ was an antitrust consent decree that broke up the Bell System into seven Regional Bell Operating Companies (RBOCs) and AT&T, which provided long distance service and manufactured telecommunications equipment. United States v. AT&T Corp., 552 F. Supp. 131 (D.D.C. 1982). The MFJ prohibited a Bell Operating Company (BOC) from providing long distance service until local competition developed sufficiently to neutralize the BOCs' local market power. No BOC qualified to offer long distance service under the MFJ. § 271 of the 1996 Act superseded the MFJ and established a "14 point checklist" and some other criteria which RBOCs would have to satisfy in order to qualify to provide long distance service. 47 U.S.C. § 271(c)(2)(B) (1996).

8. Unbundled Network Elements or "UNEs" are piece-parts of one carrier's telecom network that are provided to other carriers so that the second carrier can augment its own network. The Telecommunications Act includes provisions concerning the duty of incumbent local telephone companies to make UNEs available and when that duty attaches. 47 U.S.C. §§ 251(c)(3), 251(d)(2) (2005).

9. The Unbundled Network Element Platform or "UNE-P" consists of all the network elements needed to provide basic telephone service. The FCC's approval of the UNE-P was extremely controversial. Incumbents argued that the UNE-P could not have been intended by Congress because it made the Act's resale provisions, § 251(c)(4), irrelevant since the UNE-P provided the same functionality at considerably lower cost. They also argued that the UNE-P did not satisfy the "necessary and impair" standard established by § 251(d)(2) that determines when unbundled elements must be offered. New entrants, on the other hand, argued that the UNE-P was an essential first step in the development of competitive residential telephone service. *See generally* JONATHAN E. NUECHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS 99-108 (2005).

regulatory gridlock.

A. General Reasons for Regulatory Gridlock

There are at least three general reasons for regulatory gridlock in telecommunications. First, the telecom industry itself is composed of fractious and competing segments that are so inordinately suspicious of each other that any change thought to benefit one segment will be opposed ferociously by that segment's competitors. Since it is much easier to block a change than to make a change in a legislative or regulatory proceeding, the industry itself often gridlocks the regulatory and public policy process.

Second, many policy changes that might benefit the overall telecom industry are likely to be at the expense of consumers. This is particularly true with respect to changes that reduce competition or increase retail prices. Consumers have benefited greatly from competition and innovation during recent years and it will be difficult to convince regulators or legislators that there is a need to make changes that disadvantage consumers simply to help multi-billion dollar enterprises.

Finally, even without industry and consumer interests blocking changes, the due process that the Constitution imposes on changing fundamental law or regulations (including seemingly inevitable appellate litigation) is a slow, ponderous, and uncertain process.[10]

B. Telecom Act As a Specific Cause of Gridlock

The 1996 amendment of the Communications Act seems to be a particular cause of the current gridlock. For all its well-meaning intentions about loosening the grip of government, the Telecommunications Act of 1996 ended up centralizing all fundamental telecommunications policy in the FCC, effectively federalizing the 50 states with respect to local competition[11] and preempting the judicially-supervised modification of final judgment (MFJ) with respect to Bell entry into long distance.[12] Among other objectives, this centralization was intended to satisfy investors' supposed desire for greater certainty

10. *See, generally,* U.S. CONST. amend. XIV ("No State shall. . .deprive any person of life, liberty, or property, without due process of law. . ."); *see also* Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 939 (2001) ("The law is committed to principles of due process that limit the scope for summary proceedings, and the fact that litigation is conducted by lawyers before tribunals that are not technically trained or experienced inevitably slows the process.").

11. *See, e.g.*, Roy E. Hoffinger, *Cooperative Federalism Gone Wrong: The Implementation of the Telecommunications Act of 1996*, 2 J. TELECOMM. & HIGH TECH. L. 375 (2003); Gary J. Guzzi, *Breaking Up the Local Telephone Monopolies: The Local Competition Provisions of the Telecommunications Act of 1996*, 39 B.C. L. REV. 151 (1997).

12. 47 U.S.C. § 271 (2005).

and predictability.[13]

However, the Telecom Act did not simply establish broad policy goals – such as competition in all markets and less regulation – and then leave it to the FCC to achieve them. Rather, the statute itself sought to micromanage the implementation of specific regulatory policies. For example, the Act dictated the FCC's work schedule by imposing numerous decisional deadlines;[14] specified three pricing methodologies for carrier interconnections;[15] established nebulous concepts such as "necessary" and "impair" as decisional standards for determining when dominant local carriers are required to offer unbundled network elements;[16] constructed a detailed system for negotiating, mediating, and arbitrating interconnection agreements (with substantial regulatory involvement in the arbitration process);[17] and specified a 14-point checklist to be satisfied before a Bell company could offer long distance services.[18]

This statutory micromanagement, in turn, has led to gridlock as evidenced by the seven years (1996-2003) it took for Bell company entry into long distance services,[19] eight years (and counting) to unbundle network elements to facilitate local entry,[20] and the continued existence

13. *See* Hoffinger, *supra* note 11 at 377, 387 n.53.

14. *See, e.g.*, 47 U.S.C. § 251(d)(1) (2005) (requiring FCC to complete implementation of § 251 within 6 months), 47 U.S.C. § 254(g) (2005) (requiring FCC to adopt rules requiring rates for long distance service in rural and high cost area be no higher than rates charged in urban area within 6 months). Shortly after it was enacted the FCC prepared a voluminous "Implementation Schedule for the Telecommunications Act of 1996" which noted all the statutory tasks and timelines. *See* FEDERAL COMMUNICATIONS COMMISSION, DRAFT IMPLEMENTATION SCHEDULE FOR THE TELECOMMUNICATIONS ACT OF 1996 (1997), http://www.fcc.gov/Reports/implsched.html.

15. 47 U.S.C. § 252(d)(1)-(3) (2005).

16. 47 U.S.C. § 251(d)(2) (2005).

17. 47 U.S.C. § 252 (2005).

18. 47 U.S.C. § 271(c)(2)(B) (2005).

19. The first § 271 application was filed in January 1997 but was withdrawn. The next five applications were denied. The first successful application was approved in December 1999 with the final application granted in December 2003. *See* FEDERAL COMMUNICATIONS COMMISSION, RBOC APPLICATIONS TO PROVIDE IN-REGION, INTERLATA SERVICES UNDER § 271 (2005), http://www.fcc.gov/Bureaus/Common_Carrier/in-region_applications/.

20. *See generally*, NUECHTERLEIN & WEISER, *supra* note 9, at 80-82, 99-108. The history of this period of repeated FCC attempts to regulate "UNE" unbundling (and the subsequent judicial invalidation of each) is a complex and tortured one. Beginning with its August 1996 *Local Competition Order*, the FCC attempted to comply with the 1996 Telecom Act's impairment standard as mandated by § 252(d)(1), which limited the number of network elements subject to unbundling under § 251(c)(3). *See* Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, *First Report & Order*, 11 FCC Rcd 15,499 (1996) [hereinafter "*Local Competition Order*"]. In 1998, the Supreme Court rejected this *Order*, remanding the matter back to the FCC. *See* FCC v. Iowa Utilities Board, 525 U.S. 366 (1999). The FCC addressed the matter again in Nov. 1999, issuing its *UNE Remand Order* and increasing the scope of unbundling to include previously ignored elements such as dark fiber. *See* Implementation of the Local Competition Provisions of the

of implicit subsidies in telecom rates despite the Telecom Act's directive to eliminate them.[21]

Recently, the nature of the long standing intra-industry conflicts that caused so much gridlock may have changed as AT&T and MCI, the two largest long distance carriers, have been absorbed into SBC (renamed AT&T) and Verizon, respectively, and as competitive local exchange carriers (CLECs) virtually disappear. As a result, the surviving Bell-based telephone companies won't have to contend with (be gridlocked by) traditional industry rivals. However, as the telephone industry evolves into broadband communications services, it is bumping into new and powerful rivals that will have the capability to continue the gridlock for the foreseeable future. On one hand, the cable television industry is rapidly becoming a new counterweight to the ILECs as cable companies become serious rivals in the telephone business and as the major telecom companies begin to enter the television business. On the other hand, both the telephone and cable industries are beginning to clash with powerful adjacent information industries—such as Internet

Telecommunications Act of 1996, *Third Report & Order*, 15 FCC Rcd. 3,696 (1999) [hereinafter "*UNE Remand Order*"]. This effort was also rejected by the courts in the 2002 *USTA I* decision, in which the D.C. Circuit chided the FCC for failing to meet the § 251(d)(2) unbundling standards. *See* U.S. Telecom Ass'n v. FCC, 290 F.3d 415, 429 (D.C. Cir. 2002) [hereinafter "*USTA I*"] ("[U]nbundling is not an unqualified good. . .(it) comes at a cost. . ."). The Commission tried once more to address "UNE" unbundling rules pursuant to § 251(d)(1), issuing its monstrous *Triennial Review Order* in 2003, but in 2004 was once again rejected by the D.C. Circuit in *USTA II.* S*ee* Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, *Report & Order & Order on Remand & Further Notice of Proposed Rulemaking*, 18 FCC Rcd. 16,978 (2003) [hereinafter "*Triennial Review Order*"]; U.S. Telecom Ass'n v. FCC, 359 F.3d 554, 360 U.S. App. D.C. 202 (D.C. Cir. 2004) [hereinafter "*USTA II*"]. At the time, the industry gave little regard to *USTA II*, anticipating a successful appeal to the Supreme Court, which appeared to be leaning in a favorably pro-competition direction. NUECHTERLEIN & WEISER, *supra* note 9, at 104. Against industry expectations, however, Solicitor General Olson decided in June 2004 not to appeal *USTA II.* The FCC's most recent attempt at "UNE" regulation came in its December 2004 *Order on Remand*, responding to *USTA II* with interim rules (which, not surprisingly, were subsequently challenged in the D.C. Circuit.) *See* Unbundled Access to Network Elements, *Order & Notice of Proposed Rulemaking*, WC Dkt. No. 04-313 et al., 2004 WL 1900394 (Aug. 20, 2004). The net effect of this swinging pendulum, from attempted regulation to judicial invalidation and back again, was clear: the "UNE" regulatory waters were sufficiently muddied to the point of detrimentally affecting business strategies. Lacking clear, consistent, reliable guidance from either the FCC or the courts, companies became understandably hesitant to dive into these dark, turbulent waters, and telecom investors (and the tech industry in general) suffered. In July 2004, for example, following the publication of *USTA II*, AT&T announced it would no longer seek new customers for conventional telephony services. NUECHTERLEIN & WEISER, *supra* note 9, at 108; FCC v. Iowa Utilities Board, 525 U.S. 366 (1999).

21. 47 U.S.C. § 254(k) (2005) (prohibiting cross-subsidization by carriers); 47 U.S.C. § 254(b)(5) (2005) (requiring universal service support mechanisms to be "specific, predictable and sufficient. . .").

content providers like Google and Microsoft[22]—which will inevitably further gridlock resolution of controversies submitted to regulators. Thus, despite the consolidation of the traditional telecom industry, the potential for gridlock is still great.

II. REDUCING REGULATORY GRIDLOCK WILL ENCOURAGE TELECOM RECOVERY

If the gridlock of the existing regulatory system is a substantial obstacle to recovery and expansion of the telecom and information sector, what are the remedies for regulatory gridlock? There are two obvious solutions: first, reduce opportunities for gridlock by reducing the scale and scope of regulation wherever possible, and second, streamline regulatory processes and procedures wherever and whenever regulation is required so that final decisions can be reached quickly.

Some of the anti-gridlock solutions described below may require changes in the federal and State statutes.[23] However, many process and procedural changes can be implemented by regulatory agencies without legislation, so some rapid self-reform is feasible.

A. Reduce Gridlock By Adopting And Then Following Guiding Principles And Policies

One way to reduce gridlock is to minimize the tendency for regulators to spread their resources too thinly by allowing themselves and their staffs to become entangled in non-essential matters. In the absence of legislative micromanagement that requires regulators to perform specific duties within certain timeframes,[24] regulators can reduce gridlock by only initiating proceedings which are consistent with a small but clearly described set of fundamental guiding principles — the regulatory agency's "strategic plan." Articulating and then adhering to a clear strategic plan will make regulatory decision-making quicker, more consistent, and more predictable, which, in turn, will engender investor confidence and minimize the likelihood or success of appellate litigation.

Each regulatory agency will have to develop and publish its own

22. *See, e.g.*, John Markoff, *Coming Soon to TV Land: The Internet, Actually*, N.Y. TIMES, Jan. 7, 2006, *available at* http://www.nytimes.com/2006/01/07/technology/07video.html?ei=5090&en=afe0c357a1b1d976&ex=1294290000&partner=rssuserland&emc=rss&pagewanted=print; W. David Gardner & Laurie Sullivan, *Google, Microsoft At It Again—This Time It's VoIP*, INFORMATIONWEEK, Sept. 5, 2005, *at* http://www.informationweek.com/story/showArticle.jhtml?articleID=170700308&tid=5979.

23. Statutory changes that would reduce regulatory gridlock are included in Section V, *infra*, which suggests what should be included in a new telecom law.

24. This is one way that the Telecommunications Act of 1996 created gridlock. *See supra*, note 19.

strategic plan within the requirements of its governing law. Developing such a plan would also identify areas where the governing law would need to be changed to accommodate it. Fundamental guiding principles might include the following examples:[25]

Competition is to be the preferred regulatory mechanism in every market to encourage fair prices, innovation, and efficiency.

In markets where competition is demonstrably insufficient to achieve these goals, regulation should be applied to the minimum extent required to protect consumers from pricing and service abuses.

The allocation of regulatory authority and responsibility between States and the Federal government should be based not on the increasingly unknowable jurisdiction of the traffic but on the basis of which agency is best positioned and best equipped to handle each specific regulatory responsibility.

Policies based on the outdated and now erroneous assumption that the traditional voice telephone business is stable and a foundation for all other services will not be sustainable. The emergence of wireless and Internet telephone services is but the latest example of the fallacy.

No industry structure can be assumed to be stable, permanent or universal: sustainable policies must be able to accommodate different industry structures in different geographic areas, ranging from multiple competitive infrastructures to duopoly and even monopoly.

Since competing infrastructures may not be economically sustainable (particularly in smaller markets) if infrastructure operators are limited to providing only commodity transport services, infrastructure operators should be able to offer value-added content. However, regulation of the infrastructure would be appropriate if the infrastructure operator has unfairly restricted consumers' ability to access content provided by others, including discriminating between content providers.[26]

"Essential facilities" might need to be regulated if consumer abuse occurs in the absence of regulation. For example, the ILECs' ubiquitous copper loop systems cannot be duplicated as a practical matter, and yet they are essential for competing circuit-switched voice-grade services. The copper loop will become less essential and then non-essential as

25. Many of these possible principles are included in the Progress and Freedom Foundation's "Digital Age Communications Act" (DACA) proposal and the "Digital Age Communications Act of 2005" introduced in the Senate on Dec. 15, 2005 by Sen. James DeMint. *See* PROGRESS & FREEDOM FOUNDATION, THE DIGITAL AGE COMMUNICATIONS ACT PROJECT, http://www.pff.org/issues-pubs/books/051207 daca-usf-2.0.pdf; Digital Age Communications Act of 2005, § 2113, 109th Cong. (2005), *available at* http://www.pff.org/issues-pubs/other/other/051215dacabill.pdf. Although the author of this article participated in some aspects of the PFF project, the guiding principles included in the article were first published in the report referenced in Note 1 and therefore predated the DACA work.

26. This is sometimes called "net neutrality" or "open access."

wireless and Internet telephone services become widespread alternatives to traditional telephone service. But new facilities may become essential to future services and might need to be regulated if an operator's control of the essential facility results in consumer abuse.

Universal Service is an important national goal but, because Universal Service subsidies have little to do with telecommunications service and much to do with social issues, they should be managed not by telecom regulators but by government agencies experienced with administering social programs.

B. Reduce Gridlock By Deregulating Retail Services

Historically, one obvious gridlock-causing sticking point has been the regulation of retail rates and service quality. State public utility commissions regulated basic local telephone services for two reasons: 1) to prevent abusive pricing of essential services by monopoly or dominant suppliers; and 2) to make basic service more affordable in high cost areas and to residential consumers through an elaborate system of cross-subsidies.[27]

Both rationales are artifacts of the monopoly era; they are much harder to justify in an environment which is more competitive, at least for the immediate future. The elaborate rate proceedings themselves can cause uncertainty for considerable periods of time and are massive drains on regulatory resources. But just as importantly, the social subsidy ripple effects of rate regulation, such as Universal Service and access charges,[28] create their own gridlock and uncertainty.

If a market is reasonably competitive, there would be little consumer protection justification for retail service regulation. This principle worked well in the long distance market: once there was enough competition from MCI, Sprint, and others so that AT&T was determined to be "non-dominant," the FCC eliminated retail price regulation of long distance services.[29] Similarly, prices of wireless telephone services have

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27. *See* Philip J. Weiser, *The Ghost of Telecommunications Past*, 103 MICH. L.R. 1671, 1677-78 (2005); *see generally* M. L. MUELLER, JR., UNIVERSAL SERVICE: COMPETITION, INTERCONNECTION, AND MONOPOLY IN THE MAKING OF THE AMERICAN TELEPHONE SYSTEM (1997).

28. As explained in notes 4, 6 and 27, *supra*, the access charge and universal service issues have been an unending source of dispute and litigation since 1996 and even before. That is because access charges–fees charged by local carriers to originate and terminate long distance calls–have been the source of much of the implicit subsidies that support universal service. Thus, a proposed reduction in access charges raises the specter of reduced subsidies and concomitant increases in politically-sensitive local telephone rates, leading to litigation and temporary compromises but not to final resolution.

29. Motion of AT&T Corp. to Be Reclassified as Non-Dominant Carrier, *Order*, 11 F.C.C. Rcd. 3,271 (released Oct. 23, 1995). "Dominant" carriers were subject to regulation because they have "market power" (the ability to control process)). *See*, Policy and Rules

not been regulated since no cellular carrier has (so far) been able to dominate that market.

If there is sufficient actual and potential competition in a geographic market for every retail telecommunications service, including basic local telephone service, regulation should be unnecessary for consumer protection. The reality is that basic telephone service consumers in most (but certainly not all) geographic markets currently have alternatives to the ILEC through wireline resellers, numerous wireless services providers, and, increasingly, from VoIP[30] provided over telco and cable broadband services.[31] While competitive alternatives from CLECs using the UNE-Platform will disappear as the result of FCC action,[32] consumers' opportunity for having VoIP service from cable TV companies, as well as from independent service providers such as Vonage, is increasing rapidly. Therefore, in most significant markets it is difficult to imagine that ILECs could abuse their customers by raising prices or offering poorer quality service without suffering substantial competitive losses.

Of course, there will be a few geographic markets where there is insufficient competition to protect consumers from abuse.[33] However, market-by-market deregulation proceedings should be avoided. Hundreds (or even thousands) of deregulation proceedings would all but guarantee gridlock and the entire regulatory system would grind to a halt. Rather, it would be better to "flash cut" retail rate deregulation in all markets and then observe whether and where any abuse of consumers actually occurs. There are plenty of competitors and consumer advocates to bring any suspected abuse to state and federal regulators' attention. Where consumer abuse is demonstrated, swift (and even harsh)[34] re-regulation would be appropriate and necessary.

Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefore, *First Report & Order*, 85 F.C.C.2d 1, 20 (1980).

30. Voice over Internet Protocol.

31. According to the FCC's Local Competition Report for calendar year 2004 (the most recent available): "At the end of 2004, end-user customers obtained local telephone service by utilizing approximately 145.1 million incumbent local exchange carrier (ILEC) switched access lines, 32.9 million competitive local exchange carrier (CLEC) switched access lines, and 181.1 million mobile wireless telephone service subscriptions." Press Release, Fed. Commc'ns Comm'n, Federal Communications Commission Releases Data on Local Telephone Competition (July 8, 2005) http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0705.pdf.

32. Unbundled Access to Network Elements, *Order on Remand*, 20 F.C.C. Rcd. 2533 (2004); *see also* Press Release, Fed. Commc'ns Comm'n, FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers (December 15, 2004), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-255344A1.pdf.

33. *See, e.g.*, Mountainsage.org, *infra* note 51.

34. If the reaction to the first few instances of consumer abuse were harsh, abusive behavior by other service providers would be deterred.

Since local, intrastate telephone service is currently regulated by each State, Federal preemption of State regulation, presumably through Federal legislation, would be required to assure retail rate deregulation on a national basis. Such legislation should empower the FCC, in consultation with the States, to determine a "flash cut" date (perhaps within one year of enactment) and establish the criteria that would justify re-regulation in particular markets.[35] State Commissions would then be responsible for applying the FCC's re-regulation criteria and the FCC would hear any appeals of a State's decision to re-regulate.

In the absence of Federal legislation, or perhaps as experiments to justify a national policy (see discussion below regarding the value of experimentation), some States could implement retail rate deregulation by decision of the State's regulatory commission under existing State law. In other States, legislation would be required to de-regulate or give State Commissions the authority to deregulate.

Since retail rate regulation is one means for artificially keeping basic service rates below cost in some markets and for favored classes of consumers, abolition of retail rate regulation would mean that Universal Service objectives would have to be achieved by means other than implicit cross-subsidies within a carrier's rate structure. This would be consistent with the thus-far-ignored Congressional mandate of eliminating such implicit subsidies.[36]

If complete retail rate deregulation is too radical and consideration of such an action would itself cause more gridlock, the regulation of cable television rates might provide a more conservative model. Cable rate regulation has been eliminated, except for "basic" cable, with remaining regulation focused on regulating "access" to the cable television system. Analogously, only the most basic "lifeline" telephone service would be rate-regulated.

C. Reduce Gridlock By Resolving All Carrier-to-Carrier Issues Only Through Interconnection Agreements and Commercial Arbitration, Never By Regulators

Another major source of regulatory gridlock is related to the resolution of carrier-to-carrier business issues, including: reciprocal compensation, access charges, UNEs and UNE pricing, and performance standards. Not only do these matters consume much of the resources at regulatory agencies, they pit industry sectors and companies against each

35. Consumer abuse should be the touchstone of regulation and re-regulation. Abuse of competitors can and should generally be addressed in antitrust and commercial law. Generally, regulators should not become entangled in disputes between competitors over commercial arrangements if such involvement is not needed to avoid a secondary abuse of consumers.

36. *See* 47 U.S.C. § 254(k) (2005).

other, with the usual result that each side neutralizes the other so much that little progress (but more gridlock) is made despite prodigious exertion.

Resources could be saved and the issues removed almost entirely from the regulatory process (and therefore gridlock) if service providers had to resolve ***all*** of these complex business issues in the same manner as "normal" businesses: through bilaterally negotiated contracts and agreements. Then, at most, communications regulators would only have to be involved in matters which the parties have been unable to resolve.

Under Sec. 252 of the Communications Act,[37] if carriers can't negotiate interconnection agreements, they are entitled to have state regulators arbitrate the dispute. The Act doesn't specify how the arbitrations should be conducted, presumably leaving it up to each state to develop an arbitration procedure. Unfortunately, many states treated the arbitrations as normal regulatory proceedings despite the Congressional intent to establish a deregulatory means for resolving carrier-to-carrier interconnection disputes.[38] As a result, the arbitrations often become just another regulatory proceeding and are likely to be gridlocked like one.

To avoid becoming entangled in commercial issues (for which they have no particular experience or expertise) and to avoid the gridlock that normally occurs in a contested regulatory proceeding, state regulators should appoint experienced commercial arbitrators (paid for by the parties) to conduct the arbitration. This is appropriate: where the disputes are with respect to commercial arrangements, not regulatory principles, it would be best to let people experienced in resolving business matters make the commercial decision.

Additionally, unless the parties to the arbitration agree on some other procedure (and to avoid gridlock), the default arbitration process should be "baseball arbitration," where the arbitrator can only choose between the parties' final package of offers: one side will win *all* the disputed issues and the other side will lose on *every* issue. The prospect of baseball arbitration should raise the risk to both parties and encourage both parties to be more reasonable (approach the middle) in their final offers since the arbitrator will generally choose the most reasonable final offer.[39] Ideally, baseball arbitration would result in a settlement between

37. 47 U.S.C. § 252 (2005).

38. *See*, H.R. Rep. No. 104-204, at 48 (1995), *reprinted in* 1996 U.S.C.C.A.N, Legislative History 10, 11; H.R. Rep. No. 104-458, at 113 (1996) (Conf. Rep.), *reprinted in* 1996 U.S.C.C.A.N. Legislative History 124.

39. *See* Charles E. Rumbaugh, *Having Trouble Getting to the Negotiation Table? Try Baseball Arbitration*, 49, 2002 CONTRACT MGMT. 48, (Oct. and Nov. 2002), available at http://www.rumbaugh.net/docs/ADR_BB_Part1.pdf and http://www.rumbaugh.net/docs/ADR_BB_Part2.pdf.

the parties, as it usually does in baseball.

This proposal does *not* mean that regulators and regulatory policy wouldn't be involved in establishing a framework for arrangements between carriers. Regulators would have three roles: establishing arbitration principles; reviewing arbitrators' decisions for conformance with those principles; and adopting conforming arbitration decisions as agency decisions.

Instead of becoming entangled in the micromanagement of countless specific business disputes, regulatory policies and objectives would be incorporated into the arbitration standards to be utilized by the commercial arbitrators. Indeed, by knowing the regulator-approved arbitration standards, parties would be better able to assess what the arbitrator's decision is likely to be, making it more likely that there would be more settlements and fewer unresolved issues to arbitrate (i.e., less gridlock) in the first place.

To avoid gridlocking the process of determining arbitration standards, regulators should set a few simple policy goals rather than engaging in predictive micromanaging. These principles might include maximizing network interconnectivity, economic efficiency, retail competition, consumer benefits, and network reliability. Regardless, the essential charge to the arbitrator should be to pick the most commercially reasonable and sensible result.

If the State Commission rejects the arbitrator's decision as being incompatible with the arbitration standards or the law, it should *not* try to insert its judgment and rewrite the decision. That would be a gridlock-inducing step. Rather, the State Commission should send the issue back to another arbitrator with an explanation of why it rejected the earlier decision.

Another way to minimize gridlock involving interconnection agreements is to allow carriers to adopt (or "opt in") to other carriers' existing agreements rather than negotiating and arbitrating their own. Sec. 252(i)[40] requires ILECs to provide interconnection and unbundled network elements included in an Interconnection Agreement to other competing carriers. This is an excellent provision in theory: it prevents collusive or unreasonably discriminatory deals and saves smaller carriers from the expense of negotiating and arbitrating their own deals if another carrier's arrangements are satisfactory. But even this provision was embroiled in its own longstanding controversy. The FCC initially permitted other parties to "pick and choose."[41] In response, incumbents

40. 47 U.S.C. § 252(i) (2005).

41. "Pick and choose" means that a CLEC can assemble its own Interconnection Agreement with an ILEC by "picking" provisions from various Interconnection Agreements previously entered into by the ILEC. The FCC's interpretation of the statute was approved by

refused to make individual bilateral arrangements for fear of being picked to death. More recently, the FCC reversed itself and determined that Sec. 252(i) doesn't require "pick and choose" and that an "all-or-nothing" rule will promote real negotiation.[42]

By fixing the interconnection agreement process, there would be no need for endless speculation about whether UNE-P is good, bad, or indifferent or whether "bill & keep" is a better access charge and reciprocal compensation system. The real-world results of a variety of interconnection agreements – the results of private, commercial experiments – would speak for themselves. The real-world experience can then be applied to subsequent negotiations, arbitrations, and the few regulatory decisions that still might be needed.

Even though regulators would be, at most, minimally involved in carrier-to-carrier issues, it is important to note that anticompetitive behavior by one carrier (such as leveraging bottleneck facilities) would be subject to private antitrust action and civil antitrust enforcement by the US Department of Justice and State Attorneys General.

D. Reduce Gridlock By Developing Better Evidence Through Experiments

Better evidence results in better decisions. This truism applies as well to telecom regulatory decisions as any other. So, what is the best evidence for telecom regulatory decision-making?

Much of the regulatory gridlock can be attributed to the dueling theories, studies, and expert opinions submitted by opposing parties in attempts to "prove" the future. This leaves regulators—particularly the FCC—to choose from this predictive evidence whatever supports the policy outcome they prefer. This is risky decision-making and subject to seemingly endless appeals because it looks (and inevitably is) arbitrary and capricious.

Experimental evidence (as distinguished from predictive evidence) is more reliable and of much higher quality, making regulatory decisions based on such evidence both less risky and more sustainable.

To illustrate the value of experimentation to investors and regulators, consider local telecom competition. With respect to local

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the Supreme Court. *See* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, *First Report & Order*, 11 F.C.C. Rcd. 15,499, 16,137 (1996); AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 395-96 (1999).

42. "Opt in" or "all-or-nothing" means that a CLEC would be able to select one of the ILEC's other Interconnection Agreements in its entirety (rather than "picking and choosing" provisions from all prior agreements) as its Interconnection Agreement with that ILEC. *See generally* Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, *Second Report & Order*, 19 FCC Rcd. 13,494 (2004).

competition, it is important to recognize that the Telecom Act of 1996 was neither revolutionary nor innovative. Rather, the Act largely codified into national law and policy the results of many local competition experiments that had been conducted by State public utility commissions between 1985 and 1995.[43]

Many observers claim that this state-by-state experimentation — with its admittedly untidy look of "muddling through"— did not provide the certainty and predictability sought by investors. Ironically, and not appreciated by investors at the time and perhaps even today, "muddling through" was and is much less risky than a single federal policy, particularly when the federal system gets gridlocked in interminable due process. That is because "muddling through" in the States allowed for a continuous and low-risk iterative process of field experimentation, testing, and fine tuning of business strategies and public policies before irrevocable, major investment bets were placed on a national scale.

Historically, when State experiments were deemed to be successful, other States and then the FCC made similar decisions.[44] But when State experiments were judged to have failed, they were rarely repeated by other States and, fortunately, did not become national policy under the FCC.

The advent of the Telecom Act virtually halted State experiments as the States waited, and waited, and waited for some final guidance from the FCC and the Courts about the new law. At the same time, the Act did not empower or encourage the FCC to undertake its own experiments. As a result, after 1996 every major regulatory issue became a single high-risk roll of the federal dice. Every FCC decision – because it had national application – literally became a multi-year federal case and led not to finality but to litigation, with fundamental decisions often being made not by an expert agency but by judges and their law clerks.

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43. For example, the FCC outlined New York State's leading role in the development of local competition prior to the 1996 Telecom Act in its New York § 271 decision. Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York, *Memorandum Opinion & Order*, 15 FCC Rcd. 3,953, 3,989-4,077 (1999).

44. Consider, for example, the FCC's landmark "collocation" decision through which the FCC first encouraged local telecom competition by requiring ILECs to allow CLECs to interconnect to the ILECs' local networks inside the ILEC's central offices. The FCC's Order cited the success of a number of earlier interconnection decisions by State public utility commissions. *See* Expanded Interconnection with Local Telephone Company Facilities, *First Report & Order*, 7 FCC Rcd. 7,369 (1992); *First Reconsideration*, 8 FCC Rcd. 127 (1993), *Second Reconsideration*, 8 FCC Rcd. 7,341 (1993), *Second Report & Order*, 8 FCC Rcd. 7,374 (1993); vacated in part and remanded, *See also* Bell Atlantic Telephone Co. v. FCC, 24 F.3d 1,441 (D.C. Cir. 1994); *Remand Order*, 9 FCC Rcd. 5,154 (1994), remanded for consideration of 1996 Act, Pacific Bell v. FCC, 81 F.3d 1147 (D.C. Cir. 1996). Indeed, the FCC refused to act on an earlier CLEC petition for a collocation order until a number of major States had issued similar orders.

The FCC should use the States as laboratories, particularly on matters where a decision needs to be tailored to address local or regional circumstances. As they did in the past, a few States will make decisions that the FCC will regard as "good" and a few others will make "poor" decisions. Then it is likely that other States will copy and improve the "good" results and, when the evidence is clear and convincing, the FCC (or Congress) can quickly and confidently make national policy based on real-world experimental evidence (the best evidence) rather than on warring studies and sheer speculation about the future (the worst evidence). The result is less gridlock and fewer risky rolls of the regulatory dice.

E. Reduce Gridlock By Streamlining Remaining Regulatory Processes

One cause of gridlock is that the regulatory process itself invites it. While some of the gridlock-inducing process is required by fundamental Constitutional requirements of due process and fairness, much of it is self-inflicted by regulators and regulatees. Consequently, many of the streamlining reforms could be implemented by the agencies rather than by legislation. However, to the extent that regulators are unwilling or unable to implement reforms, legislation can and should require them to do so.

It is important to understand that most State regulatory commissions aren't as gridlocked as the FCC. This observation leads to an obvious thought: could the FCC adopt any of the procedural techniques which seem to prevent gridlock at the State level? The chief distinguishing procedural difference between the FCC and State Commissions is that the FCC rarely holds contested evidentiary hearings while States generally rely on such trial-type hearings.

The FCC should use contested hearings before Administrative Law Judges ("ALJs") for fact-finding and adjudication instead of the current "paper hearing" processes. This recommendation is based on the successful process used in most, if not all, States. State proceedings often utilize a combination of paper filings (pre-filed testimony) and on-the-record hearings with cross-examination of witnesses before a hearing officer/administrative law judge or the Commissioners themselves. This can be quicker, less expensive, more transparent, and more sustainable[45]

45. The appellate judges are comfortable with and give credit to evidence tested during lower court trials. In contrast, they are likely to be more suspicious of evidence and decisions based on such "evidence" in the unfamiliar "paper proceedings" used by the FCC. As a result, the FCC's decisions are likely to get less Chevron deference from the Courts of Appeal. *See* Chevron U.S.A. v. Natural Res. Def. Council, 467 U.S. 837 (1984). This explanation for the FCC's rather poor appellate record has been advanced for many years in Telecommunications

than the current FCC process of relying exclusively on paper proceedings augmented by private lobbying.

The FCC currently has ALJs on its payroll,[46] but they aren't utilized: the ALJs' website indicates they issued just one three-page decision in 2005.[47] Greater utilization of ALJs is within the management purview of the FCC Chairman and would not require legislation (other than appropriations).

Another gridlock-reducing procedural change would be to reduce the number of Commissioners at the FCC from five to one. This would eliminate the process of having to find complex and often confusing compromises that are needed to get the votes of a majority of five Commissioners. Compromises, by their very nature, take time to develop, are less clear, and are less predictable. They are also more difficult to defend in appellate litigation, meaning that a compromise decision is often less final. A glaring example of this problem was the FCC's Triennial Review unbundling decision which featured six months of public wrangling among the Commissioners between the adoption of an Order at the FCC's monthly meeting and the release of the text of the Order.[48] The Commission's voluminous and complex Order was then vacated by an appeals court.[49]

The chief benefit of a multi-member regulatory commission is the natural check and balance of the compromise process. However, checks and balances can be achieved with other mechanisms. A short, renewable term for a single commissioner would keep the decision-maker on a short leash and provide a reasonable check and balance through the reappointment process. Judicial appeals of the single Commissioner's

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Policy Review, a private Washington, DC-based weekly newsletter.

46. The FCC's website lists two ALJs with a staff of three assistants and describes their function as:

> The Office of Administrative Law Judges (OALJ) of the Federal Communications Commission is responsible for conducting the hearings ordered by the Commission. The hearing function includes acting on interlocutory requests filed in the proceedings such as petitions to intervene, petitions to enlarge issues, and contested discovery requests. An Administrative Law Judge, appointed under the APA, presides at the hearing during which documents and sworn testimony are received in evidence, and witnesses are cross-examined. At the conclusion of the evidentiary phase of a proceeding, the Presiding Administrative Law Judge writes and issues an Initial Decision which may be appealed to the Commission.

Federal Communications Commission, FCC Office of Administrative Law Judges, http://www.fcc.gov/oalj/ (last visited Mar. 26, 2006).

47. *Id.*

48. The FCC adopted the Order at a public session on February 20, 2003. The text of the Order was finally released on August 21, 2003, approximately six months later. *See Triennial Review Order*, *supra* note 20, at 6,978.

49. U.S. Telecom Ass'n v. FCC, 359 F.3d 554 (D.C. Cir. 2004).

decisions as well as the normal legislative oversight process also provide additional checks and balances.

There may be some concern that the FCC's regulation of mass media content is not suitable for a single decision-maker and should continue to be regulated by a multi-member Commission. This is a legitimate concern which could be addressed, for example, by splitting the "telecommunications" and "content" responsibilities, perhaps leaving content to a multi-member Commission like the current FCC and transferring telecommunications to a new agency headed by a single decision-maker.[50]

Gridlock can also be reduced by imposing meaningful penalties for dilatory abuse of process. Companies with great financial resources who desire to maintain the *status quo* can use those resources to support the endless proceedings and litigation which contribute to gridlock. Penalties for abusing the process need to be sufficiently large in relation to the abuser's resources that they would deter the abuse. As such, large companies would be subject to larger penalties than smaller companies. Legislation may be required to permit the imposition of substantial penalties.

Another means for reducing gridlock, this time at the judicial level, would be to require that all appeals of FCC decisions would be heard in the same court (presumably the D.C. Circuit). This would streamline the judicial process in two ways. First, it would eliminate the forum shopping that frequently accompanies the appeals of FCC decisions as different appellants seek to have appeals heard in different Circuit Courts of Appeals. Second, by designating one appeals court to hear all telecom cases, the Court will develop telecom expertise, resulting (hopefully) in quicker, more consistent, and better grounded decisions.

III. ADAPTING TO CHANGE: REGULATION MUST ADAPT QUICKLY TO DIFFERENT AND CHANGING MARKET CIRCUMSTANCES

Because the technological and market changes affecting the broad telecommunications industry will happen at different times and at different speeds, and will go in different directions in different markets, the ideal government policy response will be tailored (and constantly re-tailored) to the particular circumstances of each market.

Managers, investors and users need to know quickly and with reasonable assurance what the government's rules and policies are going to be in each market so that they can adapt their activities accordingly. If

50. An obvious difficulty with that approach is that having two separate regulatory bodies would be somewhat inconsistent with the "convergence" that is blurring the distinction between "transmission" and "content."

the government policy or regulation doesn't precisely fit the ever-changing situation, the result is gridlock, as parties continually try to find a "one size fits all" solution, and suboptimal decisions, which harm consumers, investors, and the industry.

It is useful to remember that a principle rationale of regulation is to protect consumers from abuse by dominant suppliers of essential services. Therefore, determining what kind of regulation should be applied to which kind of service, and whether all services should be regulated identically, should be done from the perspective of consumers. Unfortunately, the perspective of consumers on these issues will depend largely on the specific circumstances of the market in which the consumer finds him or herself.

A. Circumstances Vary Widely By Geographic Market

Consider, for example, the vastly different demographic circumstances of two Manhattans: the well-known one in New York and the virtually unknown one in Nevada.[51]

	Manhattan, New York[52]	Manhattan, Nevada[53]
Population	1,537,195	1,841
Area (sq. miles)	23 sq. mi.	1,801 sq. mi.
Population Density	66,940.1/sq. mi.	1.02/sq. mi.
Per Capita Income	$42,922	$20,881

Note: Data based on 2000 Census

51. According to the Manhattan, NV town librarian, the nearest grocery store is 25 miles in one direction and 50 in the other; the nearest Wal*Mart is 300 miles from the town. Telephone interview with Librarian, Manhattan Town Library, in Manhattan, Nev. (Apr. 2005);

> ". . . once a flourishing mining community of 30,000 people, Manhattan is now populated with vacation homes and just a sprinkle of year-round residents. The town of Manhattan sprang up, almost overnight, in 1905, after a ranch hand named Humphrey discovered gold during his lunch break. . .There have been a few other mining operations in recent years, and a small number of people make their home in Manhattan today. There is a post office and public library, as well as one or two bars open for business. . .the landscape still contains old mining artifacts scattered here and there. The surrounding countryside is attractive, with rough hillsides and forests of juniper and pinion trees. Manhattan and the surrounding area is a great destination for sightseers and history buffs."

Mountainsage.org, Belmont, *available at* http://www.mountainsage.org/Belmont.htm (last visited Mar. 25, 2006).

52. U.S. CENSUS BUREAU, UNITED STATES CENSUS 2000 SUMMARY FILE 3 (2002), *available at* http://www2.census.gov/census_2000/datasets/Summary_File_3/.

53. *Id.*

In addition to these demographic differences—and probably because of them—the residents of the two Manhattans enjoy vastly different telecommunications circumstances.

	Manhattan, New York	Manhattan, Nevada
ILEC (market cap[54])	Verizon ($89B)	Citizens ($4.1B)
CLECs[55]	14-23 per Zip Code[56]	0
Cellphone Carriers	4 nat'l + resellers	No service[57]
Cable Television	Ubiquitous	None[58]
Broadband service	8-18 per Zip Code[59]	Satellite only[60]
Public WiFi[61]	1,000+	None

Considering the vastly different circumstances of Manhattan, NY and Manhattan, NV, it is likely that a national telecommunications regulatory system that is reasonably well-suited to one would not be optimal for the other.[62] Every community in the United States,

54. Market cap (market capitalization) is based on the closing price of the company's stock multiplied by the number of outstanding shares. These market caps are as of January 13, 2006, as reported at http://finance.yahoo.com/.

55. Federal Commn'cs Comm'n, *Report*, http://www.fcc.gov/Bureaus/Common_Carrier /Reports/FCC-State_Link/IAD/czip0604.pdf (last visited Mar. 25, 2006).

56. Manhattan, NY has 44 Zipcodes.

57. According to the Manhattan town librarian, the only place where "spotty" cellular phone service is available in Manhattan itself is at the library parking lot because the main highway, about five miles down the canyon, is visible from the there. The librarian explained that many residents of the town do have cellular phones for safety during the long drives, once they reach the highway. Interview with Librarian, *supra* note 52.

58. Telephone Interview with Operator, Nevada Cable Television Association, in Manhattan, Nev. (Apr. 2005). (stating that Manhattan, NV residents can get satellite TV and over-the-air television. ABC, CBS and NBC –and sometimes Fox–channels relayed from Reno and Las Vegas).

59. Federal Commn'cs Comm'n, *Report*, http://www.fcc.gov/Bureaus/Common_Carrier /Reports/FCC-State_Link/IAD/hzip0604.pdf (last visited Mar. 25, 2006).

60. Since there is no cable TV service, there is no cable modem service. Telephone Interview with Nevada Cable Television Association, *supra* note 58. A telephone company Customer Service representative stated that Citizens does not offer DSL broadband service in Manhattan, NV and that there are no plans to do so. Telephone interview, April 2005. According to the town librarian, a few Manhattan, NV residents do have satellite data service and the library itself is considering satellite data service. However, such services tend to be very expensive compared to DSL or cable modem broadband and are not suitable for VoIP due to propagation delays. Telephone Interview with Librarian, *supra* note 51.

61. CNET, Hot Spot Zone, *at* http://reviews.cnet.com/4520-6659_7-726628-1.html?tag=fs. (last visited Mar. 26, 2006).

62. For example, because consumers in Manhattan, NY have a wide range of competitive choices for their basic telephone service, little or no retail regulation is needed for consumer protection. By contrast, consumers in Manhattan, NV have no practical choice with respect to telephone services so it is likely that some form of economic regulation will be needed for the

including three other Manhattans (in Montana, Illinois and Kansas), have their own unique demographic and telecom circumstances that will lie somewhere between the extremes of Manhattan, New York and Manhattan, Nevada. It is not likely that a regulatory system that is ideal for one community will be optimal for any other.

B. Circumstances May Change Substantially Over Time

In addition to vastly different circumstances in each community at any given instant, the circumstances of each community are also changing constantly so that an optimal regulatory system will become suboptimal and possibly harmful if it does not adapt to the constantly changing circumstances.

How effective would a regulatory system be if it is predicated on the existence of vigorous marketplace competition but such competition does not develop (as seems likely in Manhattan, NV) or a once-competitive market become substantially less competitive due to bankruptcies, mergers, and consolidations (as could happen in Manhattan, NY)?

Consider a key question for forward-looking policymaking: Are multiple broadband infrastructures sustainable in *every* market? While multiple broadband systems may be sustainable in many markets, it is at least equally likely that the future structure of the telecommunications industry will be monopoly or oligopoly.[63] For example, in the absence of government intervention, the consolidation process that is well underway in the telephone, cable TV, and wireless industries could result in two infrastructures in many markets: one fiber-based "fat pipe" to every home and business for video and data services (with telephone being a VoIP data application)[64] and one wireless system providing "thinner pipes" for mobile and nomadic services. In very small markets such as Manhattan, NV, a single wireless broadband system may suffice for all applications, including video.

A regulatory system that assumes that the equilibrium state of the telecom industry is intense competition among multiple infrastructures will clearly be suboptimal—and perhaps totally ineffective—if the industry settles into a monopoly or duopoly structure.

It is impossible to predict the direction and pace of future evolution of the telecom industry in any market, never mind every market.

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foreseeable future.

63. Eli Noam, *Broadband and Wireless: The Next Telecom Crises*, in THE FUTURE OF TELECOMMUNICATIONS INDUSTRIES, (Arnold Picot, ed., forthcoming Apr. 2006), *available at* http://www.citi.columbia.edu/elinoam/articles/Noam_NextTelecomCrisis_2005

64. If the economics of a market dictate that it can only sustain one profitable fiber-based network, then either the traditional "telco" or the "cable company" (or both) would eventually have to exit the market.

Therefore, a "future-proof" regulatory system cannot be predicated on any particular set of circumstances or evolutionary expectation.

Why should any community be condemned to a suboptimal regulatory system and to the suboptimal telecom service that flows from suboptimal regulation? Wouldn't it be better to have a system where the kind and degree of regulation is dynamically and constantly adapting to the changing circumstances of each market? Such a system of circumstantial regulation is more likely to produce results that are always closer to the optimal for each market than a static, one-size-fits-all approach.

Of course, it is easy to suggest that regulation should be optimized for and be responsive to the circumstances of each market. But is such a system really practical and feasible? How will it work? Won't it be chaotic? Won't there be less regulatory certainty? Won't it be difficult?

For purposes of this article, it is sufficient to note that the current system doesn't seem to be working very effectively and one reason is that it is too uniform, too static, and too rigid. Perhaps it is simply time to try circumstantial regulation—that is, a flexible, adaptable, dynamic system—instead of tinkering with "one size fits all" regulation in the expectation that it can be made to work better. With circumstantial regulation the kind and degree of regulation will dynamically and constantly adapt to the changing circumstances of each market so that there would be a greater chance that regulation would be more optimal for every market.

As noted previously in this article, "muddling through" by State Commissions is one form of circumstantial regulation which would result in better, less risky, and more sustainable decisions.[65] One reason that "muddling through" by the States is less risky is that a Federal policy can never be optimal in all markets across this diverse nation. Policies that benefit the low density rural states, for example, may disadvantage the densely populated states, and *vice versa*. "Muddling through" in the States also reduces regulatory and financial risk by allowing for a continuous and low-risk iterative process of field experimentation, testing, and fine tuning of business strategies and public policies before irrevocable, major investment bets are placed. This was how local competition was developing before the Telecom Act upset the process.[66]

The regulatory system established by the 1934 and 1996 Acts inhibits the granular experimentation that could reduce risk in a dynamic industry and can make regulatory responses to industry problems faster and more effective. When the FCC attempted to delegate some decision-making to the States in its third attempt to define the network

65. *Supra* notes 43 and 44 and accompanying text.
66. *Supra* note 43 and accompanying text.

elements that should be unbundled as a result of the "necessary and impair" standard established by the Telecom Act,[67] the Commission's decision was overturned by the DC Circuit Court as an improper delegation of its authority.[68] Therefore, a statutory change may be needed to allow the circumstantial regulation that will produce more optimal results in every market. Congress should include in any new telecom law a provision that clearly empowers the FCC to delegate its authority to the States and to enlist the States in experiments.[69]

IV. IF NEW LEGISLATION IS NEEDED, REPEAL THE 1934 ACT AND START FROM SCRATCH WITH A SIMPLE, ADAPTABLE LAW

There seems to be a growing consensus that the Communications Act of 1934 as amended by the Telecommunications Act of 1996 needs to be revised. Members of Congress, pundits, and industry leaders have, to varying degrees, called for substantial changes to the Communications Act, a number of bills have been introduced, and discussion drafts are circulating on Capitol Hill.

One major reason for the dissatisfaction is that the 1996 amendments were obsolete when they were enacted because of the rapid changes in telecom technology and the telecom industry. At best, the 1996 Act was backward-looking, attempting to fix problems that became apparent in the decade from 1985-95. Whether or not the fixes were successful is debatable. But it is clear that the Act was not forward-looking and therefore did not (and perhaps could not) foresee the rapid evolution of the Internet and broadband communications, the displacement of wireline telephones by wireless, convergence of telecom and television, or the boom-bust-consolidation of the industry.

The 1996 Telecom Act was the product of at least 10 years of Congressional inquiry and activity. If the Pandora's Box of new legislation is opened in 2006-07, it must be closed as quickly as possible to prevent legislative uncertainty (a.k.a., gridlock) from further delaying the recovery of the telecom industry. Such delay would have adverse consequences for individual consumers as well as the United States' international competitiveness and overall economic growth.

Quick legislation means very simple and very short legislation. This also argues against attempting to amend the current law since the amending process will encourage every faction to try to preserve its special privileges— a sure recipe for legislative gridlock. Finally, to avoid the fast obsolescence that plagued the '96 act, a new telecom statute

67. Triennial Review Order, *supra* note 20, at 17,094.

68. *See* U.S. Telecomm. Ass'n, 359 F.3d at 554.

69. A similar proposal is included in the proposed Digital Age Communications Act, *supra* note 25.

should not try to micromanage and it must not embed into law a static view of technology, the industry, or the market. Rather, a new law should allow telecom regulation to be tailored and re-tailored to the specific and constantly changing circumstances of each market.

To minimize legislative gridlock and to produce a "future-proof" law with lasting utility, a new telecom statute should focus almost exclusively on two subjects: *principles* that most stakeholders can support, so that regulators (and reviewing courts) are clear about the statutory goals and objectives; and *processes*, so that final, clear, and sustainable decisions can be reached in a short period of time.

Conversely, any new statute should NOT deal with "substance" in the sense of embodying in law Congressional micromanagement of the telecom industry, particularly to resolve current industry disputes or to specify a particular regulatory policy. Any such embodiment is likely to be wrong or obsolete or both.

A. Principles for a New Telecom Law

A new statute should begin with a clear and concise statement of the fundamental goal of the law, perhaps modeled on the similar provisions of the current Communications Act. Sample language may include the following:

> The purpose of this law is to establish and maintain an efficient and reliable nationwide and worldwide telecommunications system capable of providing all persons with access to affordable telecommunications services. The Commission hereby established shall rely, wherever reasonably feasible, on competitive market forces to achieve this purpose and shall regulate telecommunications services and facilities in each market only to the extent and only for so long as market forces are insufficient to achieve this purpose or are unable to prevent the abuse of consumers.

Next, an obsolescence-proof law will need to define "telecommunications" and "telecommunications service" very broadly so that it is technology-neutral and can accommodate rapid and unknown technological developments for decades. A new telecommunications statute should then empower and require the federal regulator (the Commission) to follow broadly written principles, such as those summarized in the following paragraphs. Competition is to be the preferred means in every market for encouraging fair prices, innovation, and efficiency.

To encourage competitive markets, networks must interconnect with each other upon request at any technically feasible location on commercially reasonable terms and conditions and consumers may attach

any devices to the network and use telecommunications services without restriction provided they cause no harm to the networks.

Where competition is demonstrated to be insufficient to achieve the statute's goals, regulation should be applied on a geographically granular basis to the minimum extent required to achieve the statute's purpose or to protect consumers from pricing and service abuses. Geographically granular regulation should be regularly reviewed and adjusted to accommodate the changing circumstances of each market, reduced or eliminated if there is less or no need, and increased if there is a greater need.

The Federal government has plenary authority over all telecommunications facilities and services. However, the Federal authority shall be delegated broadly to State commissions when the varying circumstances of each locality or region require varying regulatory responses or policies. The delegation to the States must include the directives and decisional standards needed to comply with Constitutional requirements and in most cases the Federal Commission would hear initial appeals of decisions made by State regulators pursuant to delegated authority.

States may exercise authority, particularly traditional police powers, over telecommunications, telecommunication facilities, and telecommunications services, provided that such exercise does not conflict with Federal law, policy, or regulations. The Federal Commission or courts shall preempt any conflicting State action.

The Federal Commission may conduct experiments of limited geographic scope and shall generally encourage States to experiment with regulatory policies by, *inter alia*, forbearing from applying Federal laws or regulations that conflict with a State's experiment. A State may petition the Commission for authority to conduct a regulatory experiment of up to two years duration, including any necessary forbearance. Unless the Commission denies the petition within 60 days, the petition shall be deemed granted. The best evidence in proceedings before the Federal regulator or other States is the results of relevant State or Federal experiments.

Neither Federal nor State regulators shall regulate the price, quality, or other characteristics of retail telecommunications services (those predominantly utilized by individual consumers) in the absence of demonstrated abuse of consumers. States have the initial responsibility for determining the existence of consumer abuse and for determining and applying the least regulation required to eliminate the abuse. The Federal Commission would act if States refused to consider petitions alleging consumer abuse. The Federal Commission may issue standards and guidelines for the States to apply in determining the existence of a

consumer abuse and for the regulation of abuses. The Federal Commission will hear appeals from State decisions to determine abuse and to regulate or to not regulate as a result.

All carrier-to-carrier issues (including but not limited to such matters as collocation, access charges, reciprocal compensation, performance standards, and all other interconnection matters) shall be resolved exclusively by bilateral negotiation and commercial arbitration.

The Commission shall allocate and assign all radio frequency spectrum not controlled by the Federal government for government use in the manner it deems most efficient and equitable. Regulators shall be prohibited from requiring telecommunications service providers to be involved in collecting or contributing funds to support universal service, and regulators shall not impose any implicit subsidies in any rate regulation.[70] The Commission may, after due process, revoke a service provider's operating, radio frequency or other licenses and authorizations for activities that constitute systemic untrustworthiness and may prohibit licensees from employing as managers persons who have a record of untrustworthiness in the telecom business.

B. Process and Procedures to Be Included in a New Telecom Law

After stating the broad objectives and principles, the telecom law should then specify process and procedures to be followed by the regulators to achieve the goals. The process and procedure should be simple and streamlined so as to minimize gridlock, expense and uncertainty. The following paragraphs provide some summary examples.

Federal and State regulators shall forebear from applying any statutory provision for entire geographic markets and all services, or on a more granular market-by-market, service-by-service basis, if they determine that such forbearance is likely to better achieve the statute's objectives than regulation.

The federal regulator will be a single Commissioner appointed by the President and confirmed by the Senate for two year renewable terms.

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70. Ideally, other legislation will deal with the important Universal Service issue. However, a new telecom statute could provide for a non-regulatory mechanism to support Universal Service. One approach would be that individuals eligible for the Department of Agriculture's food stamp program would also receive a telecom stamp from DoA. The dollar amount of the telecom stamp would be the difference between the unregulated retail rate for basic telephone service provided by the largest provider of service in the market (zip code?) and 115% of the national average retail price for such service. The telecom company providing the service selected by the consumer would redeem the stamp from DoA. Telecom stamps should be funded from: a) the 3% telephone excise tax (which shall not be increased); and b) if necessary, general revenues. *See also* the similar proposal provided by the author included as an appendix to the report of the DACA Universal Service Working Group. http://www.pff.org/issues-pubs/books/051207daca-usf-2.0.pdf.

All adjudicatory proceedings before the federal agency shall be conducted by Administrative Law Judges except where the Commissioner determines on a case-by-case basis that another process would be more efficient, fair and transparent. All appeals of the Commission's decisions will be made to the Court of Appeals for the District of Columbia Circuit. State decisions administering Federal statutes are to be appealed to an appropriate Federal District Court.

With respect to service provider interconnection arrangements, all matters not resolved through bilateral negotiations shall be resolved by a State Commission Order drafted by a commercial arbitrator and adopted by the Commission. Parties to the arbitration may agree to any commercial arbitration procedure, but "baseball" arbitration (where the arbitrator many only select the entirety of one of the party's best and final package of offers regarding all the unresolved issues) will be the default arbitration process. Parties can agree that an arbitration result will apply only to specified markets within a State or to any number of specified States but a state-wide scope will be the default.

The arbitration decision will be submitted to the affected State Commission for ratification and the State must accord the arbitration result substantial weight, with the opponent of the arbitration decision having the burden of demonstrating that, overall, the arbitration decision is inconsistent with law, Federal policies, or is likely to lead to significant harm to public interest. Where the arbitration covers more than one State, an *ad hoc* panel composed of one State Commissioner selected by a majority of the State Commissioners from each affected State will consider the ratification and the majority decision of the *ad hoc* panel will bind all affected States. If it does not ratify the arbitrator's decision, the State Commission's or *ad hoc* panel's only recourse is to order another arbitration. "Opt-in" or "all-or-nothing" would be available for similarly situated service providers that choose to avoid negotiation.

CONCLUSION

The current system for regulating telecommunications has two serious and related failings: it is unable to adapt quickly to the rapid changes in technology, business conditions, and market demands; and, it is unable to adapt with sufficient precision to the widely varying circumstances of each market. The result is that the current regulatory system fails both consumers and the telecom industry. Because the telecommunications-information industry plays such a major role in society and in every sort of business enterprise, suboptimal performance of the regulatory system adversely affects the entire nation.

These twin failings can be remedied. Regulators can act within existing laws to reduce some of the gridlock by reforming their practices

and procedures. However, other changes, particularly those that would encourage flexible and adaptive circumstantial regulation, probably require new legislation.

Trying to solve these problems by amending the existing law is likely to cause years of legislative gridlock and produce another complex, unsatisfactory and static compromise similar to the Telecommunications Act of 1996. A better approach for the 21st century would be to start at the beginning with a simple, short new statute that establishes broad policy goals and provides for flexible procedures and processes when regulation is required.