

The 2005 Communications Act of Unintended Consequences

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Communications policy has been a parade of grand themes. At the start of the last century, universal affordable service by AT&T, the dominant provider, became the overriding theme in telephony. It led eventually to the demise of competition from numerous local urban exchanges, creating a vast monopoly network and independent companies dependent on AT&T long lines for intercity and international connections.

Broadcasters, whose issues would generate the lion's share of federal regulatory attention for the Federal Communications Commission's ("FCC") first forty years, initially sought government intervention to eliminate the chaos of interference supposedly ungovernable by market forces.¹ Intervention arose in the form of limited-term licensing using the standard of the public interest.² The FCC generally defined this broad term through compliance with content-based rules such as the fairness doctrine, fines on offensive speech, and structural limits on local, national, and cross-media ownership. Your experience may differ, but the greatest moments in broadcast programming don't seem to have been connected to these behavioral and structural efforts. Rather, artistic creativity and editorial courage can make a difference, and government intervention may

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1. See *Hoover v. Intercity Radio Co.*, 286 F. 1003 (D.C.Cir. 1923); *United States v. Zenith Radio Corp.*, 12 F.2d 614 (N.D. Ill. 1926).

2. A commentator at the time described the expression as meaning "about as little as any phrase that the drafters of the Act could have used and still comply with the constitutional requirement that there be some standard to guide the administrative wisdom of the licensing authority." Caldwell, *The Standard of Public Interest, Convenience or Necessity as Used in the Radio Act of 1927*, 1 J. AIR L. 295, 296 (1930).

do more harm than good in these areas.

The 1970s saw the start of a revolution in communications regulation. Most of the new thinking can be tied to regulators addressing the demands of new competitors. But other developments resulted from regulator dissatisfaction with both the process and results of the earlier regimes. These two strains are interrelated because new competitors made regulators think hard about why rules were in place and whether their application made any sense to newcomers. Then the regulator could consider whether the status quo made sense, even in the absence of a competitor.

For instance, price caps, which look at the price paid by the customer and not the rate of return earned by the provider, arose not because of competition but because of dissatisfaction with the rate of return process.³ Deregulation of commercial time limits and deletion of minimum percentages of public affairs programming in radio (and later TV) resulted from recognition that existing competition—to say nothing of new competitors—would suffice to address market failures better than FCC rules.

Technology was changing nearly every assumption and inducing more competition. Long distance competitors had cheaper microwave facilities which formed a facilities-based challenge to AT&T's high quality but more expensive wires. Non-Bell equipment came onto the market, lower-cost and feature-rich. The Commission tried to accommodate the competition eventually, despite the monopolists' resistance.

Meanwhile, cable television, once a mere repeater of hard-to-receive TV stations, began in 1975 to offer satellite-delivered networks that competed for viewers and induced viewers with perfectly fine off-air reception to subscribe.

To skip a whole lot of history, by the 1996 Act, Congress was convinced more than ever that inducing competition, not perfecting regulation, best served the public. The success of long distance and customer-premises equipment (e.g., handsets and answering machines) competition could, it was hoped, be extended to local telephone exchange service. More choice and lower prices would result in the last remaining monopoly redoubt of the residential market.

Incumbent phone companies could themselves be incipient competitors elsewhere. The Act anticipated that competition from telco video service could exercise a restraint on cable prices and provide service

3. Policy and Rules Concerning Rates for Dominant Carriers, *Second Report and Order*, 5 F.C.C.R. 6786 (1990) (applying price caps to local exchange carriers). "Incentive regulation will reward companies that become more productive and efficient, while ensuring that productivity and efficiency gains are shared with ratepayers." *Id.*

competition. Congress, in 1996, partially deregulated cable prices and changed the definition of effective competition.⁴ Broadcast ownership was freed up to strengthen that industry's competitive stance.

Today, some of the results that Congress anticipated have occurred, but the path has not been exactly as the Act foretold. Local telephone service, the most hotly fought battleground in the Act, emerged from some facilities competitors. But many were irrationally funded during the Internet bubble, ran out of running room or, like Worldcom, got consumed in the fires of corporate greed and misconduct.

The Bell incumbents fought many conclusions drawn by the FCC about how to interpret the Act. Ambiguities in the 1996 Act became so many shuttlecocks lobbed between the FCC and the courts, particularly the question of when the lack of access to an element of the incumbent's network became so necessary that its absence would "impair" the newcomer.⁵ In 2004, the Bells won the battle between themselves and AT&T and others who relied on a combination of elements leased from the incumbents at rates far below what straight resale provides.⁶ AT&T announced it would leave the circuit-switched residential market as a result—a few months later its acquisition was proposed by its former rival SBC.

But competition aplenty arrived from wireless as cellular and cellular-like products like Nextel phones became must-have consumer appliances. New providers like cable, and companies like Vonage riding on the broadband platforms of cable and DSL, began to provide Voice over Internet Protocol ("VoIP")—forms of competition hardly contemplated in 1996.⁷

Video competition developed sprightly as well—but not from telcos, at least not yet. Instead, direct broadcast satellite ("DBS"), launched in earnest in 1994⁸ with the advent of DirecTV and joined a few years later by DishTV, accounts for over a quarter of all homes that pay for TV service. Telcos are again talking about entering video, this time with fiber to the

4. "Effective competition" is the term used by the Communications Act to determine when a cable operator's rates could be completely deregulated to include telco competition. 47 U.S.C. § 543(l)(1)(D) (2004).

5. 47 U.S.C. § 251(d)(2) (2004). The elements must also be "necessary" for a competitor to provide telecommunications service. § 251(c)(3).

6. U.S. Telecom Ass'n v. FCC, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied*, 125 S. Ct. 313 (2004).

7. See Vonage Holdings Corporation Petition, *Memorandum Opinion and Order*, 19 F.C.C.R. 22,404 (2004).

8. D. Brenner et al., *Cable Television and Other Nonbroadcast Video*, § 15.21 (2004 ed.) (discussing DBS commercial development).

curb or node architectures in an evolving form of VoIP. But with over 85 percent of homes already subscribing to DBS or cable, and the remaining homes likely unable or uninterested in paying for TV, telcos have a steep hill to climb to make video a realistic business. What the telco moves may represent is a realization that the cable platform is simply superior for the broadband era and that it is never too late to change course and build networks the right way.

Broadcasting? It is the best of times for some. Despite shrinking audiences (drawn to cable channels or non-TV-based entertainment) many networks and stations can nevertheless charge more for each minute of advertising, year after year. When you are launching a prescription drug or a new Chevrolet model, you need the biggest audience you can find, and broadcasters still operate the biggest tents.

But it is the worst of times for some, too. Network compensation paid to affiliates has shriveled or even started flowing in the opposite direction. The National Association of Broadcasters, the most influential trade group for decades at the FCC, finds itself without the networks (or their owned stations) as members. Meanwhile, broadcast and cable program networks have merged into large groups, and the historic schism between broadcasting and cable as to program suppliers has been reduced.

The communications center of the earth increasingly is not ABC or Verizon or T-Mobile. It is the Internet, however the customer gets there, whether by cable modem, wi-fi, dial-up, or T-1 line at work. Whether as a direct source of linear entertainment like eBay or a distributor of stored material, like movie downloads, its centrifugal pull affects all the communications businesses. Yet, except for brief mention in Sections 230 and 706 of the Act—and those sections were hardly the centerpiece of legislative deliberations—the 1996 Act missed the Internet.

The Internet has already wreaked harm on the music business, and motion pictures see a tornado in the distance. Free, over-the-air TV has attempted to insure high quality programming in its digital future by insisting that equipment suppliers and distributors like cable pass along a broadcast flag that will prevent such material from being transferred wholesale to the Internet.⁹ Yet, the Internet is potentially a TV set with infinite channels. Telcos fear it as a VoIP end run to circuit switched service. Cable and DBS see it as a possible middleman eliminator (even though cable still benefits from being in the broadband connections business—DBS, a downstream distributor, has no such luck). Cannot wireless also expect some combination of Wi-Max (with radii of thirty

9. Press Release, FCC, FCC Adopts Anti-Piracy Protection for Digital TV (Nov. 4, 2003), at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-240759A1.pdf.

miles, not 300 feet of wi-fi) and broadband VoIP to also compete with cellular service?

The lesson of the 1996 Act is that communications policy is particularly susceptible to the law of unintended consequences. Just when you think you can accurately forecast what adjustments to market forces government can best make to improve policy, technology overwhelms the assumptions and recasts the playing field.

Technology has disrupted the status quo and met with resistance before. Incumbents, invested in older technologies, resist authorization of newcomers. AM stifled FM in the 1940s. Hollywood movie companies boycotted early, free TV in the 1950s. DSL was bottled up by telcos desirous of selling customers more expensive ISDN and T-1 service in the 1990s.

Free TV restricted cable's reach through importation restrictions and competition through rules to prevent siphoning of popular programming. In a Museum of Communications Regulatory Oddities, the first exhibit might be these antisiphoning rules, struck down in 1977,¹⁰ which allowed cable programmers like HBO a brief window for first-run movies and then froze that content market for several years so that broadcast TV alone could access it.

The rate of adoption of newer technologies, however, appears to be increasing. FM's dominance over AM radio arrived after only decades. TV's challenge to movie theaters did not become fully realized until the advent of home video over thirty years later; theatrical exhibition is, as a matter of film revenues, the tail that wags the home video dog. Satellite networks on cable TV, first introduced in the mid-1970s, did not become a significant ratings competitor to broadcasting until the 1980s. On the other hand, deployment of broadband internet access occurred nationally in less than a decade (although adoption rates are not quite as rapid). Wireless phone substitution, particularly among younger customers, appears to be much faster than a twenty-year cycle.

So far, the new technologies have generally been additions, not replacements. AM still dominates sports radio. Movie theaters keep reinventing the experience: fifty years ago theaters gave away free gravy boats on weeknights; twenty-five years ago theater owners introduced surround-sound; now theaters offer stadium seating, cupholders, and nineteen screens as the latest lures.

But technologies do go away. The per-minute long distance charge— itself largely a noncost-based invention of AT&T to subsidize low cost

10. Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir. 1977).

universal local service—may go the way of the telegram or telex. Musical audiocassettes (and the iconic 8-track) are nearly gone. Laser discs, early picture phones, C-band satellite dishes—are almost no more.

In approaching a communications legislative process, then, it is good to remember how little success the 104th Congress had in predicting communications futures.

What does work? Undoing unnecessary regulation will often prove the test of time, such as the 1993 deregulation of mobile services.¹¹ Or take the 1996 deregulation of upper tier cable rates. Done with the expectation that incumbent telcos would enter video via cable franchises, cable convinced investors to finance an \$86 billion rebuild of the nation's cable systems.

The initial motivation was to upgrade channel capacity to provide a product competitive with the 100-plus channels offered by DBS. But the rebuild also permitted sufficient upstream quality and capacity to launch cable modem service, redundancy to reduce outages, and system reconfiguration (accompanied by regional consolidation) to reduce the number of headends necessary to provide service. This restructuring of the industry led to greater competition from an otherwise fractured cable competitor in local and regional advertising. It produced the greatest success story of the 1996 Act, residential broadband cable modem service and it induced competition from the telcos' DSL.

In contrast, new regulatory ideas did not fare so well. The 1996 Act's complicated yet ambiguous blueprint to generate local phone competition did not quite work. For instance, the Act's explicit resale requirements¹² led to little new entry (despite the success of resale as a competitive strategy in the early days of cellular). Millions of customers did switch to competitors who created a platform using the more deeply discounted unbundled network element-platform ("UNE-P"), but that arrangement proved unsustainable. The future of lasting, local, substantial phone competition may depend on VoIP, a form of competition not addressed by the Act. Likewise, the comprehensive scheme for open video systems created by the Act¹³ has had little impact on the video services market.

The 1992 Cable Act had some interesting misfires as well. One could credibly argue that the retransmission consent scheme, which allows a broadcaster to withhold its signal from a cable (or, as added later, DBS) operator has strengthened only broadcasters who have had a cable-related program service with which to negotiate (or take price controls). Even the

11. See 47 U.S.C. § 332(c) (2004).

12. *Id.*; § 251(c)(4) (2004).

13. § 573 (2004).

most fervent 1992 Act advocates have not called for return of the Act's rate regulation scheme, which managed to damage cable programmers and operators and probably retard introduction of residential broadband deployment by half a decade while actually reducing consumer welfare in video programming.

The point here is not especially original; legislatures sometimes get it terribly wrong. That is as true for communications law as elsewhere. But where technology has a staggering capacity to quickly undo legislators' vision of the competitive landscape, any regulatory fixes that depend on the accuracy of that vision merit a healthy, but not lethal, dose of skepticism.

Much of the focus of the coming legislative season (and who knows how many in the future) will be on telephone company cost recovery: whether directly collected in subscriber monthly payments, or indirectly collected through universal service support payments or compensation paid when exchanging, originating, or terminating telephone calls for another carrier. The urgency of this matter will likely take precedence over other issues.

The cost recovery knot has remained tied for years, despite recent efforts by industry groups to address it. A pure market approach would mean that a rural phone customer more directly pays the costs of service. It is believed that such a monthly bill would lead to disconnecting large number of Americans.¹⁴ So there is going to be some fix, either by Congress or the FCC, especially as VoIP and other newer communications services come online or take share away from traditional contributors.

Beyond those items that must get fixed, however, it is not clear on what Congress should focus with respect to each regulated industry—cable included. Surely each has a wish list, and industry critics have theirs too. As each industry seeks its fair advantage in the process, it is hard to believe that a very coherent, shared communications vision would emerge.

That is why a general rewrite of the Communications Act of 1934 and 1996 should be approached with trepidation. Will the country really benefit by a fresh version of ambiguous congressional guidance to the FCC, borne of legislative compromises, as was the case in 1996? Some might say the third time is the charm. Others might conclude that the alternative seen in the UNE-P wars—from the FCC, to court, and back to the FCC—has not been any better. Congress, not the FCC even as aided by the courts, is assigned by the Constitution to make laws.

14. “[A Senator’s telecommunications aide] recently noted that a dial tone in Eskimo villages in Alaska would cost \$900 without support from [universal service].” Terry Lane, *Telecom Act Reform Only Part of Upcoming Congressional Agenda*, COMM. DAILY, Dec. 2, 2004.

The hurdle to enacting communications legislation should be high and the aim of the legislation should be targeted. Specifically, and in conclusion, the Author offers a little four-part test. One, legislation should do as little damage as possible to market forces that actually produce the benefits of the communications revolution both here and abroad. Two, legislation should require the predicate of demonstrated market failure. Three, advocates should be confident that the solution will do less damage than the failure has produced. Four, even then, legislation should not try to cabin the forces of technology that will inevitably find a way free anyway.