

Bell Break-Up Proposal Raises Concerns For National Telecom Policy, Consumers

Commentary by

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Saying he wants to accelerate competition in local telephone markets, AT&T CEO C. Michael Armstrong has called on state regulators and the Federal Communications Commission to split the operations of the nation's four major providers of local telephone service (what's left of the "Baby Bells") into separate wholesale and retail arms. He asserts that this approach, called "structural separation," will help companies like his offer local telephone service over the incumbent phone companies' own lines, providing the benefits of competition to consumers. Competition is certainly a desirable outcome, but the question is whether adopting this particular proposal will ultimately help or hurt consumers. Some important questions remain unanswered.

Do we want to have a national telecommunications policy?

After extensive hearings and consideration, in 1996 Congress passed the Telecommunications Act. It was a carefully crafted law with many interconnected provisions that balanced the interests of all the parties. It envisioned competition both in local and long-distance telephone markets. It defined processes for the FCC and the states to address issues of access by competitors to local telephone companies' facilities. "Structural separations" was not among them. The rules set by Congress seem to be working in many places – and if they are not, isn't it up to Congress to revise them?

The alternative is to proceed on a state-by-state basis. The result of that could well be a patchwork of fifty different sets of rules, and, since it is clear the proposal raises many legal issues, perhaps fifty different protracted litigations, with fifty (or more) different courts setting telecommunications policy within their jurisdictions. What would the effect of this be on efforts to have a uniform national telecommunications policy?

Has the Congressional process failed?

Before imposing nationally a draconian remedy usually reserved for convicted antitrust violators (e.g., Microsoft), it is important to be sure of the facts. There are states where the Congressional process is working very well, such as New York and Texas. Are consumers in states where competition is working overall better off than those in Pennsylvania, which is still tied up in regulatory and legal proceedings over "structural separations"? Data from studies done by the Telecommunications Research & Action Center in Washington suggests that consumers are benefiting from the competition that has been generated in that state by Verizon's entry into long distance.

¹ The opinions in this Commentary are those of the author, and do not represent the views of The Pennsylvania State University or any other organization.

And, in places where a competitive environment is yet to emerge, what are the reasons? The complex issue of interconnection pricing could be part of that mix, but so could poor business decisions on the part of competitors, local economic factors, inherent flaws in the regulatory process, and the desire of competitors to "game the system" and use court and regulatory agencies to handicap competitors rather than compete in the marketplace. Isn't it important to seek the answers to such questions before imposing potentially disruptive regulatory "solutions"?

And looking at the broader picture, is it relevant that projections by respected market analysts currently show a predicted sharp growth curve in the actual penetration of high-speed digital services in consumer markets – hardly a sign that provision of such services to consumers is being stifled. If the goal of Congress' telecommunications policy is to make such advanced services widely and rapidly available, would a "structural separations" policy help or hinder it?

Do structural separations work?

"Structural separations" is not a new idea in the telecommunications industry. In the past, it has been proposed – and rejected – by the Congress, the FCC, and the courts. Still, there are precedents in some utility industries for dividing companies into regulated and unregulated operations. The restructuring of the electricity industry in California is a prime example of how this process can have unforeseen consequences. Before rushing to adopt an uncertain remedy, state regulators – if they even wish to consider it should seek a better understanding of just how it would operate. This would function both to protect consumers under the unique conditions in their respective states, and help address concerns that such policies might appear backward-looking and anti-business.

Is more regulation the answer?

The very nature of this proposal calls for a far more activist approach on the part of state and federal regulators, which will engage them in overseeing the details of an enormously complex undertaking, leading to strong temptations to micromanage the process. This would be a reversal of the current policy, supported by both political parties, of deregulation. There is no telling where this road leads. Mr. Armstrong's own company faces issues about opening up its broadband² cable systems to unrelated ISPs and others – how would he feel about splitting his cable business into wholesale and retail arms? Why might not regulators, encouraged by this kind of thinking, go further and ask for a complete separation of content from conduit? Is this a direction AT&T really wants to go?

What will it cost and who will pay for it?

The only state where this approach has been seriously proposed (and is in the final stages of consideration) is Pennsylvania, which is served primarily by Verizon. Although it has yet to be implemented, it has presented an occasion to think seriously about its costs and effects. There is a difference of opinion about the exact amount of the cost. Whatever the correct amount turns out to be, however, such a division would inevitably consume large amounts of executive time and organizational attention. The history of the 1984 AT&T break-up (under an anti-trust consent decree) suggests that the

² The FCC defines "broadband" as having the capability of supporting, in both the provider-to-consumer (downstream) and the consumer-to-provider (upstream) directions, a speed (in technical terms, "bandwidth") in excess of 200 kilobits per second (kbps) in the last mile. It defines "high-speed" those services with at least 200 Kbps capability *in at least one direction*.

result could be substantial disorder in the organization for years. Since the Baby Bells serve most residential telephone customers, these costs would be passed on to them one way or another, whether in increased rates, decreased service, or the failure to upgrade and innovate. This would come at a time when these companies are being encouraged to upgrade their systems to offer residential broadband services. In a larger sense, it could be asked whether such a regulatory-based disruption of the telecommunications market would impact the growth of the "New Economy" sector and the Internet economy, already under siege. Would it be yet another drag on a slowing economy?

Will fair deliberation or self-serving rhetoric prevail?

Not surprisingly, the "structural separations" proposal is vigorously opposed by the companies subject to this plan, such as Verizon, which points out that AT&T itself is in a desperate state, and may be trying to divert attention from its own well-reported financial and policy troubles. However, in the end, the question of the public's interest in this issue will not be resolved by companies challenging each other's motives. The merits of the various positions – and the underlying facts about the emergence of competition – must be objectively considered, analyzed, and acted on. Wouldn't the public ultimately be better served by a clear, consistent national policy in this regard?

This is not to say that competition under the 1996 Telecommunications Act is working perfectly. There are many diverse voices to be heard on that subject, some wanting to strengthen their own position and weaken their competitors. While competitive rhetoric is tempting, all parties must keep in mind that the ultimate goal is to serve consumers well, and companies will be richly rewarded for doing that. Whether further breaking up the "Baby Bells" serves this end appears at this point to be very much in question. Given the magnitude of the changes that structural separation would impose, it is surprising that even the most basic questions about its impacts remain unanswered. Without such answers, making any changes is at best very dangerous and at worst reckless.