



Consumer Federation of America



Testimony of

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on behalf of

**Consumer Federation of America
Free Press
Consumers Union**

before the

**United States Senate
Committee on Commerce, Science and Transportation**

Regarding

Competition and Convergence

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SUMMARY

In amending the Communications Act we do not have to abandon a pro-competitive vision for the future, but we must understand the failures of the anti-competitive past and get back to traditional principles of communications networks that have served the nation well.

First, the commitment to universal service is more important than ever because access to communications is increasingly vital in the digital information age. Second, universal service is an evolving concept that must ensure that Americans can participate in the digital future. Policies that attempt to segregate the “legacy” network from the future network and “ghettoize” universal service are unacceptable. Third, at its heart, communications is local. Global networks are useless without last mile facilities -- the local switches/routers and transport facilities that connect the consumer to the world. Fourth, competition is an operational means to serve public interest ends; it is not the end in itself.

Prospects for last mile competition in the converging world of 21st century U.S. communications are not good. There are only two local, last mile communications networks that can provide a fully functional broadband network to the residential consumer and prospects for a third or fourth are bleak. This feeble duopoly we will not accomplish the goals of a ubiquitous, nondiscriminatory network available to all Americans at reasonable rates. America has been falling behind in the global race to the broadband future, not because there is inadequate incentive to invest, not because we are less densely populated than other nations, but because there is inadequate competition to push the “cozy duopoly” to deploy attractively priced services and unleash the Internet economy to develop consumer-friendly services.

We urge the Congress to begin from the successful principles of past policies and to learn from the problems and failures of past mistakes.

- Nondiscrimination in interconnection and carriage should be the explicit legal obligation of communications networks that provide last mile connectivity and local network access, as it has been for the last century.
- The commitment to universal service should be strengthened, not weakened, and we should apply the program beyond the dial-tone to broadband capabilities. We support legislation introduced by Members of this Committee to meet this need.
- Congress can promote the goals of competition and universal service simultaneously by making available more spectrum for unlicensed uses and protecting the right of local governments to build last mile networks. We applaud Members of this Committee who have introduced legislation to accomplish both of these goals.
- Congress should recognize the economic reality of the communications market and direct public policy to correct for the abuses of a duopoly market structure. Without explicit, pro-competitive policy, we cannot expect it to grow of its own accord.

Mr. Chairman and Members of the Committee

The Consumer Federation of America,¹ Free Press², and Consumers Union³ appreciate the opportunity to testify on the issue of competition and convergence in the telecommunications market. My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America.

This year, the Committee has now heard from dozens of witnesses in a score of hearings about the current state of telecommunications policy and the need for reform. It is not a pretty picture for consumers. Previous hearings have dealt with specific details of the failure of the competition policy under the Telecommunications Act of 1996 (the 1996 Act). The 1996 Act promised an explosion of competition voice, video, and data communications, and yet today we are witnessing the reconstitution of Ma Bell and the crystallization of a cozy duopoly of cable and telco. The Committee has been told of skyrocketing cable rates and the plummeting position of the United States in the global race to the broadband future. It has been presented with examples of anticompetitive and anti-consumer behaviors of the giant communications companies that now dominate the market. Despite the perverse anti-competitive results of the “pro-competition” policies in 1996 Act, these companies come before you to demand that you legalize discrimination in the provision of access to the communications network of the future, an approach that Congress has rejected for a century.

If future prospects are determined by our success in the broadband market (which few analysts deny), our current position is untenable. We are now 16th in the world in broadband penetration. Virtually none of our broadband lines can sustain even 1 megabit per second of speed in both directions—up and down the network. We pay \$15-\$20 a megabit for download speed—20 times more than the global leaders. We have a pervasive rural/urban digital divide that is *increasing* as time passes. Our universal service policies have not been updated and reformed to efficiently address our broadband woes. Insufficient spectrum has been opened to facilitate a legitimate, independent wireless broadband competitor. All we are left with is the false promise of competition from 1996 and the farcical declarations from cable and telephone giants that a duopoly market is vigorously competitive.

¹ The Consumer Federation of America is the nation’s largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than 50 million individual members.

² Free Press is a national, nonpartisan organization with over 225,000 members working to increase informed public participation in crucial media and communications policy debates.

³ Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with more than 5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

The parade of horrors with which you have been presented goes on and on and I will not regurgitate them in detail today. I have attached a half a dozen Appendices to this testimony which contain detailed analyses prepared by our organizations of the failure of competition under the 1996 Act. I believe that we have been brought to this sorry condition because:

- (1) the 1996 Act tried to do the impossible in some markets, aiming to build competition where conditions could not sustain sufficient competition to protect the public from abuse (e.g. local, last mile access);
- (2) the Federal Communications Commission (FCC) and the antitrust authorities mishandled the introduction of competition in markets where it was sustainable, allowing the incumbents to drag their feet, engage in all manner of anti-competitive behaviors, and mergers (e.g. network opening, program access and mergers); and
- (3) the FCC misread the 1996 Act in other markets, undermining and threatening competition that actually existed (e.g. Internet access and services).

In amending the Communications Act (the Act) we do not have to abandon a pro-competitive vision for the future, but we must fully understand the failures of the anti-competitive past. A competition-friendly, consumer-friendly future requires that we return to certain key traditional values and fundamental principles that made the American communications network the envy of the world throughout most of the last century.

SOCIAL, TECHNOLOGICAL AND ECONOMIC PRINCIPLES FOR COMMUNICATIONS POLICY

In order to evaluate competition and convergence in the communications sector in the context of a legislative hearing on amendments to the Communications Act of 1934, there are four basic principles that must be kept in mind.

First, the Act has a specific purpose laid out clearly in the first sentence of Title I, Section I: “to make available, so far as possible, to all people of the United States, without discrimination on the basis of race, color, religion, national origin or sex, a rapid, efficient, nationwide and world-wide wire and radio communications service with adequate facilities at reasonable charges.” This commitment is more important than ever because access to communications is increasingly vital in the digital information age.

Second, today’s analysis must be forward-looking, in the spirit of the Act, focusing on the broadband communications network that will be the dominant means of communications in the 21st century. Looking to the future does not mean we should ignore the problems or the progress of the past. On the contrary, the right combination of correcting past mistakes and evolving successful policies for the digital era is the only means of satisfying the public interest. Certainly, the track record of competition and the past behavior of market participants are relevant, especially if the same actors play similar roles. These market patterns can give a good indication of what is likely to happen under the various policy regimes under consideration. However, policies that attempt to segregate the “legacy” network from the future network and “ghettoize” universal service are unacceptable. The

commitment to universal service needs to include a commitment to an evolving level of service to ensure all Americans participate in the future, as the Telecommunication Act of 1996 (the 1996 Act) explicitly recognized in Section 254.

Third, at its heart, communications is local. Communications starts and ends with a local transmission medium and a local network. In order to make a call from Los Angeles to anywhere in the world, you need a wire or spectrum in Los Angeles. In order to terminate a call in New York from anywhere in the world you need a wire or spectrum in New York. The network in between may be national or global, but the last mile is local. Global networks are useless without last mile facilities -- the local switches/routers and transport facilities that connect the consumer to the world. The Act recognizes this as well, in the first two sections of Title II, which establish the obligation to provide interconnection and carriage of communications on nondiscriminatory rates, terms and conditions. Technology has not changed this basic fact.

Fourth, competition is an operational means to serve public interest ends; it is not the end in itself. Further, the state of competition is an empirical question, not a theoretical statement of belief or desire. There is an expression in economics used to describe competition in markets -- "four is few, six is many." When there are fewer than the equivalent of roughly six, equal competitors, a market is considered highly concentrated because economic theory, empirical evidence and a century of practical experience shows that markets that are this concentrated do not perform well. In highly concentrated markets, prices are set above costs and innovation declines. With so few competitors, it is easy to avoid vigorous, head-to-head competition, especially when each uses a different technology, specializes in a different service, or concentrates on a different geographic area or user sector. Where competition is lacking, there is little chance that markets will accomplish the goals of the Act. Even where there is vigorous competition, there are circumstances in which the market will not accomplish the broader goals of the Act. It is the responsibility of legislators to conduct a fair assessment of competition thresholds in order to maximize the effectiveness of public interest communications policy. We must not place our trust in the rhetoric of special interests without facts on the ground.

THE CURRENT STATE OF COMPETITION AND CONVERGENCE

In the emerging, converging world of 21st century communications, prospects for vigorous competition in the local segment of the industry are not good. At present, there are only two local, last mile communications networks that can provide a fully functional broadband network to the residential consumer -- the incumbent local telephone companies and the incumbent cable operators. Two is not a sufficient number to ensure vigorous competition, and both sets of incumbents have a miserable record of anticompetitive, anti-consumer behavior.

The best hopes for a third, last mile alternative were undercut when regulators allowed the most likely candidate -- wireless -- to be captured by dominant wireline firms through ownership or joint ventures. It stretches credible expectation to assume that a wireless

provider owned by an ILEC, or in partnership with a cable giant, will market a wireless broadband product that directly competes with its wired product. They will offer premium, supplementary services to be sure—but it will not be a true third broadband competitor. Hope and hype surrounding other technologies cannot discipline anticompetitive and anti-consumer behavior. Mergers such as that proposed by AT&T and BellSouth will only make matters worse. No company with sufficient market power to set monopoly rents will fail to do so absent proper public policy protections.

On the current trajectory, consumers are falling into the grip of a “cozy duopoly” of cable and telephone giants, which will abuse its market power, abandon its social responsibility and retard the development of our 21st century information economy. We can debate whether a regulated monopoly is better or worse than an unregulated duopoly, but we believe the evidence shows beyond any doubt that the feeble duopoly we have will not accomplish the broad Communications Act goal of a ubiquitous, nondiscriminatory networks available to all Americans at reasonable rates.

The danger of relying on a “cozy duopoly” is already apparent. The harm has already been done, and its impact is severe. America has been falling behind in the global race to the broadband future, not because there is inadequate incentive to invest, not because we are less densely populated than other nations, but because there is inadequate competition to push the “cozy duopoly” to deploy attractively priced services and unleash the Internet economy to develop consumer-friendly services. The current jostling for upscale consumers with big bundles of services leaves the majority of Americans behind. On a per megabit basis Americans pay five to twenty times as much for high-speed services as consumers in many other nations. Is there any doubt that the primary cause of the broadband digital divide is price? Now, after leaving the American consumer in a serious predicament, the network giants are insisting on the right to discriminate against content, applications, and services on the Internet, as blackmail for building broadband networks. (See Appendix A)

The failure of penetration resulting from high prices and the threat of discrimination in network access drives innovation out of the American Internet space and overseas. We should take note that the world’s most advanced broadband nations have instituted policies that are based on last-mile competition, strategic direct investment in infrastructure, and free market principles of non-discrimination on the network to drive innovation. Not only has the FCC failed to institute pro-competitive policies, the Commission has done precisely the opposite, masking it in rhetorically glowing but substance-less reports on the state of the broadband market.

THE PAST AS PROLOGUE: SUCCESSES AND FAILURES ON THE ROAD TO CONVERGENCE

Telecommunications

The idea behind the break up of AT&T in 1984 was to separate those parts of the industry that could be competitive from those parts of the industry that could not and use

public policy to advance competition in the competitive sector. It worked in the long distance industry for most consumers. Requiring the local companies to provide “equal access” to their networks and shifting fixed cost recovery onto consumers, federal regulators created an environment in which long distance companies eventually commoditized long distance – as long as consumers took large bundles – and competed the price down.

The Telecommunications Act of 1996 sought to introduce more competition into last mile markets in telecommunications and cable. In telecommunications, it sought to promote competition by identifying the various elements of the local exchange network and making them available to competitors on terms that would allow competition. The idea was that new entrants would invest in competing facilities where they could, while the monopoly elements were rented from the incumbents. Billions of dollars were invested, but this experiment failed. In the decade since the Telecommunications Act of 1996 was passed, the Federal Communications Commission (FCC) and the antitrust authorities failed to enforce the communications and competition laws of this nation to promote a consumer-friendly competitive environment. The FCC allowed the incumbent local telephone and cable companies to avoid their obligations under the law to promote entry into the communications field, while the Department of Justice (DOJ) and the Federal Trade Commission (FTC) allowed them to buy up their actual and potential competitors. (See Appendix B)

The Competitive Local Exchange Carriers (CLECs) were strangled by the failure of the FCC to force the incumbent local exchange carriers (ILECs) to open their local markets. And when the possibility of voice over Internet protocol (VOIP) arose, the ILECs slammed the door by tying high speed Internet to VOIP service. In essence, forcing consumers to pay twice, if they wanted an unaffiliated VOIP provider. The two largest CLECs were recently absorbed by the two largest ILECs. The same two dominant local companies also absorbed the two players in largest long distance service and enterprise market, reconstituting the old Bell system as two huge regional entities that dominate their home territories with about a 90 percent share of local service, an 80 percent share of long distance, and over a 50 percent share of wireless service. (See Appendix C)

Cable

The 1984 Cable Act ended local regulation under the promise of competition. Overbuilders were supposed to enter to compete head-to-head, and satellite providers were supposed to provide intermodal competition. It never happened. The last mile market for cable proved too difficult to crack. Cable rates skyrocketed and the industry was subject to conditions of nondiscrimination in access to programming in 1992. Rates stabilized because of regulation, not competition.

As in telecommunications, the 1996 Act sought to stimulate head-to-head competition in multichannel video programming distribution (MVPD), but failed. Overbuilders could not crack the market – taking a scant 2 or 3 percent of subscribers. Satellite grew, but could not discipline cable’s market power nor effectively discipline prices. The local telephone companies were invited into the cable business in a variety of ways, but chose not to enter.

Cable operators still account for about 85 percent of all MVPD subscribers. Regional concentration has reinforced market power at the point of sale. Monthly cable rates have doubled since the 1996 Act and consumers are offered massive, monthly packages which afford them little choice in what to buy (see Appendix D). Geographic consolidation has created a huge obstacle to entry into the programming sector. Cable operators control the programming that reaches the public and discriminate against unaffiliated programmers. The results of these market trends have left consumers and independent programmers at the mercy of the cable giants. (See Appendix E)

Internet

When cable rolled out a telecommunications service – cable modem service – the FCC moved the goal posts, redefining cable modem service into a different regulatory category. It abandoned one of the vital underpinnings of the success of the Internet, the “Computer Inquiries.” This was the digital age expression of the principle of nondiscrimination that the FCC applied to computer and data services starting in 1968. As telecommunications in this country have evolved, the FCC established the policy of keeping the network neutral – allowing the intelligence in the network to stay at the edge. This dovetailed with the end-to-end principle of the Internet and provided an arena for free market innovation, competition and consumer choice, that was unparalleled in recent experience.

When the FCC abandoned this policy for cable modem service, America’s slide from Internet leadership began. This allowed the cable operators to discriminate against Internet service providers – forcing consumers to pay twice if they preferred an Internet service provider other than the cable affiliate (See Appendix F). They have imposed all manner of anti-consumer, anti-innovation restrictions in their customer agreements, which have driven applications developers away from this space. More importantly, the decision to remove common carrier regulations from cable modem service paved the way for a total cashing in of a century of communications policy. The immediate result will be nothing short of the destruction of the Internet if the Congress does not move to hold the line on the last remaining safeguard—network neutrality. The fundamental mistake in communications policy, which we have made over and over in the last two decades, is to allow a very small number of network owners to control the physical communication system. If we duplicate that mistake again, the result will be the destruction of the vibrant, vigorous competition and burgeoning innovation of the Internet economy.

THE FUTURE

The telephone companies now say they are ready to compete with cable in video, and the cable companies now claim to be ready to compete with telephone companies for voice. But they have demanded the elimination of the fundamental social obligations of the Act – universal service and nondiscrimination. The notion that Congress anticipated or would ever have enacted the 1996 Act under belief that we would end up with a duopoly is not believable. The hope was for vigorous competition among many providers.

Two competitors are simply not enough to discipline pricing, as the new entrants just match the high priced bundles of the incumbents. Two are not enough to ensure nondiscriminatory access to the communications network, as the new entrants demand to be allowed to discriminate and exclude Internet service providers and rival services. By traditional economic standards, three or four market players are not enough to assure competition, certainly not when access to the means of communications are at stake. If both network giants in a market adopt the same anti-competitive practices, where will consumers go? They are trapped.

The fundamental importance of nondiscriminatory access to networks and services embodied in the Communications Act was reaffirmed just this month by key members of the “cozy duopoly.” Time Warner, the second largest cable company, has petitioned the Federal Communications Commission to impose an obligation of nondiscriminatory interconnection on the incumbent local telephone companies, under Section 251 of the Act. Verizon, the second largest telephone company, has petitioned the Commission to impose an obligation of nondiscriminatory access to video programming under Section 628 of the Act. Yet, both of these entities directly and indirectly through their trade associations, are lobbying the Congress, and have pushed the FCC, to eliminate all such obligation with respect to Internet access and services.

The fact that the anti-competitive and anti-consumer policies come and go, as political pressure or public attention ebbs and flows, is not a justification to abandon the principles of nondiscrimination. On the contrary, when innovation depends on the whims of network gatekeepers it is stunted and chilled. As Vint Cerf has said: the Internet is about “innovation without permission.” When the choices are few and the switching costs for consumers are large, innovative activity will go elsewhere.

Current arguments against obligations to provide nondiscriminatory access are based on the claim that competition exists between two networks and that is all the American economy needs. That claim is wrong as a matter of historical fact and practical experience. The obligation of nondiscrimination came to this country under English common law. From the founding of the Republic, public roads competed against privately owned canals, but they were both subject to obligations of nondiscrimination. Private railroads were added to compete with canals and roads, and when they began to brutally discriminate, refusing to be bound by their common law obligations, they brought common carrier down upon themselves with the Interstate Commerce Act of 1886. Telegraph and wireline telephone were also expected to behave in a nondiscriminatory manner, but when AT&T refused to interconnect with independent companies, common carrier obligations were extended to that industry in the Mann Elkins Act of 1910, thus ensuring nondiscrimination in communications.

In other words, one of the enduring principles of communications in America has been nondiscrimination. We have layered alternative modes of communications one atop another, each using a different technology, each optimized for a somewhat different form of communications and still we imposed the obligation of nondiscrimination. We have

accomplished this through both a liability approach and a regulatory approach. The layering of networks subject to the obligation of nondiscrimination makes even more sense when the importance of the free flow of information is magnified as it is in our digital economy.

CONCLUSION

As this Committee moves forward to construct a new regime of communications policy, we urge the Congress to begin from the successful principles of past policies and to learn from the problems and failures of past mistakes.

- Nondiscrimination in interconnection and carriage should be the explicit legal obligation of communications networks that provide last mile connectivity and local network access, as it has been for the last century.
- The commitment to universal service should be strengthened, not weakened, and we should apply the program beyond the dial-tone to broadband capabilities. We support legislation introduced by Members of this Committee to meet this need.
- Congress can promote the goals of competition and universal service simultaneously by making available more spectrum for unlicensed uses and protecting the right of local governments to build last mile networks. We applaud Members of this Committee who have introduced legislation to accomplish both of these goals.
- Congress should recognize the economic reality of the communications market and direct public policy to correct for the abuses of a duopoly market structure. Without explicit, pro-competitive policy, we cannot expect it to grow of its own accord.

APPENDICES SUBMITTED FOR THE RECORD

Appendix A: Broadband Penetration

Expanding the Digital Divide and Falling Behind on Broadband: Why a Telecommunications Policy of Neglect is Not Benign – October 2004

Broadband Reality Check: The FCC Ignores America's Digital Divide – August 2005

Appendix B: Local Competition

Competition at the Crossroads: Can Public Utility Commissions Save Local Competition – October 2003

Broken Promises and Strangled Competition: The Record of Baby Bell Merger and Market Opening Behavior – June 2005

Appendix C: Wireless

Petition to Deny of the Consumer Federation of America and Consumers Union, *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services, Inc. and its Subsidiaries to Cingular Wireless Corporation*, Federal Communications Commission, WT Docket No. 04-70, May 3, 2004

Reply Federation of America and Consumers Union, *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services, Inc. and its Subsidiaries to Cingular Wireless Corporation*, WT Docket No. 04-70, May 3, 2004

Appendix D: Cable

Time to Give Consumer Real Cable Choices: After Two Decades of Anti-Consumer Bundling and Anti-Competitive Gatekeeping – June 2004

Reply Comments of the Consumer Union and the Consumer Federation of America, *In the Matter of Comment Requested on a la Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, Federal Communications Commission, MB Docket No. 04-207, August 13, 2004.

Appendix E: Cable

Comments of Consumer Federation of America, Consumers Union and Free Press, *In the Matter of the Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules*, Federal Communications Commission, MM Docket No. 92-264, August 8, 2005.

Appendix F: Internet

The Public Interest in Open Communications Networks, July 2004.