

**U.S. Senate Committee on Commerce, Science, and Transportation  
“Telecommunications Policy: A Look Ahead”**

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Mr. Chairman, members of the Committee, thank you for the opportunity to speak with you this morning. My name is Ray Gifford. I am President of The Progress & Freedom Foundation, a think tank that explores legal and policy issues of the digital age. Also relevant to my testimony here today, from 1999-2003, I served as chairman of the Colorado Public Utilities Commission, which means I had to try and implement what Congress thought the 1996 Telecommunications Act meant, and what the FCC told me Congress meant in the Act.

The topic here today is what a reworked Communications Act should look like. I have some thoughts about that. First, however, before thinking about a new Communications Act, we need to think about the current Act and what we have learned.

I believe that the Telecommunications Act of 1996 should be judged a qualified failure. It may have been a failure of concept or of implementation, but it certainly did not live up to the hope of its framers. The current Act is a failure because it does not provide a framework that anticipates the packetized, broadband Internet age; it is a failure because it presumes that two mutually incompatible goals -- market competition and universal service -- can be seamlessly reconciled; it is a failure because it added a pervasive layer of wholesale regulation to an already encompassing retail regulatory layer; it is a failure because of statutory ambiguity and self-contradiction. Finally, it is a

failure because the competitive successes of the past eight years – in wireless, in broadband and now-emerging Voice over Internet Protocol (VoIP) services – happened *despite* the Telecommunications Act of 1996, not because of it. That failure is qualified, though, because the sectors the Act left relatively unregulated, wireless and cable, provide a roadmap of how to allow markets to emerge, regulation to recede and consumers to benefit.

I understand that you are always supposed to have three overarching points to make, but I'll consider my testimony a success if I convince you of two. My first point is that law and regulation should not -- indeed, cannot -- contain the dynamic, multi-platform competition of the broadband Internet Age. This premise counsels a recognition that regulatory burdens need to be minimized, and, more importantly, that the incentives for special interests to manipulate regulation to preordain a given market outcome need to be written out of the next Act.

My second point is that the institutions charged with implementing the legislative vision you enact are in need of fundamental reform and redesign. These progressive-era institutions – the FCC and state commissions, which have in many ways served us reasonably well in the age of the circuit switched, copper network – must have a different charge in the age of spectrum and the photons.

### **The System Is No Longer Closed**

The Communications Act of 1934 was written when the country had a unified, closed platform, the twisted-copper-pair-based Public Switched Telephone Network (PSTN). Every consumer needed access to that platform. People who wanted to communicate were locked-in to that platform. Because it was distance-sensitive, the

regulatory apparatus could encompass the entire communications universe. There was a single product. It was voice communications. State commissions could set retail and intra-state rates; while the FCC could handle inter-state long distance. Rates could be manipulated to serve the social goals of keeping rural and residential rates low by making business and long distance rates high.

Of course, technology started to erode this hermetic world. First, competitive entry came in the long distance market, where artificially high long distance rates attracted entry. Next, gradually, competition came to the business market in the late-1980s and early 1990s, where artificially high business rates induced new competitors to enter under the incumbents' price umbrella. This world, interrupted only slightly by the Modification of Final Judgment (MFJ), led us to the Telecommunications Act of 1996, which aimed to bring competition into the local *voice* communications market.

That single-platform voice world had some defining characteristics that made it necessary and relatively easy to regulate. First, it was localized, meaning that it was divisible into distinct local and long distance parts, and the infrastructure on which the communications traveled followed a knowable geographic path. Second, it was self-contained, meaning that the regulator could accomplish social goals by manipulating rates to accomplish desired ends. Third, this world had a single product – voice – integrated onto a single platform, the PSTN, and therefore could be regulated distinctly as a “telecommunications service.”<sup>1</sup> Finally, that world could be regulated according to the broadest of broad standards, the “public interest.”

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<sup>1</sup> See 47 U.S.C. § 153(46). The legal counterpart to a “telecommunications service” is an “information service,” defined at 47 U.S.C. § 153(20).

This age is at an end. Today multiple existing and emergent platforms compete for consumers' communications dollars. Along with traditional PSTN-based service, consumers can choose between wireless PCS, e-mail and instant messaging, circuit-switched cable telephony and emerging VoIP technologies. VoIP in particular promises to bring a torrent of choice and progress that will rush over, through and past the old legacy regulatory rules. Moreover, these emerging platforms will only thrive so long as they avoid the old legacy regulatory quagmires and classifications.

If we have moved from a closed to an open system of competing platforms, what does this mean for law and regulation?

As an initial matter, communications is no longer local, but instead national and even international in scope.<sup>2</sup> A packet-ized communication, be it voice or data, does not followed a prescribed geographic path. The traditional jurisdictional distinctions cannot hold.

Second, the self-contained regulatory world and the legal distinctions that sustained it no longer signify. Further, maintaining these distinctions into the future will do serious harm to consumers and producers. Legal definitions of "information service" and "telecommunications service" – such as are fought about endlessly in the *Brand X Internet* case, the FCC's VoIP proceedings, and the FCC's title I Broadband proceeding – have no relation to today's underlying technological reality. Thus, while the legal fights remain, to quote my colleague Randy May, mired in "metaphysics," the underlying technological reality remains that a "bit is a bit is a bit," and should therefore be regulated as such in the next Act.

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<sup>2</sup> See Douglas C. Sicker, "Delocalization of Communications Networks," *Progress on Point* 11.2 (The Progress & Freedom Foundation, Jan. 2004).

Third, it is no longer necessary for carriers to integrate facilities and services at the physical layer of the communications platform. The regulatory regime needs to adapt to the architecture of today's networks. Thus, the physical layer should be regulated the same across all platforms, and the remaining logical, applications and content layers may or may not be integrated depending on the preferences of consumers. The layered conception of regulation means voice is merely another application running over a physical network, and thus cannot be distinguished for special regulatory purposes.

Just because a layered conception of an Internet communications world is helpful, that does not mean it dictates given regulatory outcomes. We simply do not know the optimal degree of bundling and integration that will best serve consumers. In a competitive broadband, packetized world, there is reason to believe the market will drive to an optimal result of integration and bundling that is beneficial to consumers. A premature "common carriage" requirement on all physical layer connections could destroy the integration that serves consumers best, and there is reason to believe that an unregulated market will drive to this result.

Further, this equally-regulated, multi-platform world means that regulators loosen their control over pricing decisions. The old regulatory system allowed rates to be set to effectuate a vast cross-subsidy mechanism. In the new world, technologies like VoIP will evade the regulators' attempts at special regulatory treatment. In the end, just as now, the costs of networks must be borne by consumers. A freer, more explicit pricing system will serve them best. Related to this, the intercarrier compensation system must be radically reformed so that access arrangements between carriers are rationally related

to cost, or better yet, left to the market, as is done currently with the Internet backbone market.

Last but not least, the flourishing of networks means that universal service policy needs to be rethought and refocused. What is universal service for? Will it subsidize a basic, local voice line or a broadband connection? If you are going to subsidize connections, who is eligible to receive compensation and at what rate?

Rural America need not be left behind, but recognize that the traditional means of universal service values -- rate averaging, cross-subsidies -- are not sustainable. Rural America then needs a universal service policy that encourages innovation, scale and competition. The viability of programs such as reverse auctions, which would create competition for universal service support and encourage low cost innovators, need to be studied. Likewise subsidy mechanisms that spur competitive innovation rather than protect legacy industry structure need to be encouraged.

### **The Institutions Must Reform**

The Committee also needs to think about what sort of institutions need to implement the next Communications Act. The FCC is slow; technology is fast. The FCC is riven by muddled political compromises and legal uncertainty; capital markets that will finance the next generation networks need certainty and legal clarity. Because of its tendency toward political, as opposed to legal, determinations, the FCC has a dismal record in the courts on appeal.

Put broadly, there are two sorts of regulation—"mother may I" and "wait 'til your father gets home." Administrative regulation, such as is currently practiced by the FCC and state commissions, is "mother may I" regulation. "Mother may I" regulation relies

on advance permission for engaging in this practice or that. Thus, companies have to get permission from the regulator to do business, get permission from the regulator to define the terms of a contract, and get permission from a regulator to charge a given price for a given set of services. This regulation was devised for an era of regulated monopoly, when there was a single provider and a limited set of services.

This regulation is prone to high error costs because it presumes to set rules in advance. By its nature, mother may I regulation assumes the regulator knows best. But if the regulator does not, or even makes an honest mistake, then the whole industry can suffer.<sup>3</sup>

By contrast, “wait ‘til your father gets home” regulation occurs after the fact. This, for the most part, is what we empower agencies like the Federal Trade Commission and Antitrust Division with doing.<sup>4</sup> In this sort of world, the market and market players are free to do what they want, use what technologies they want, do business with whom they want and charge what they want, subject only to after the fact oversight for antitrust violations, consumer fraud or other breaches of legal or contractual obligations.

This, I submit, is the sort of regulatory model that is better suited for the next Communications Act. It is law-applying rather than law-making. It minimizes regulatory errors. “Wait till your father gets home” regulation has the added advantage

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<sup>3</sup> A shining example of how the law of unintended consequences applied to the Telecommunications Act came with the reciprocal compensation debacle. There, the prospect of garnering huge windfalls from Internet-bound reciprocal compensation distorted innumerable telecommunications business plans, all to no competitive benefit.

<sup>4</sup> This is not strictly true with functions such as merger reviews conducted by the Department of Justice or the Federal Trade Commission. The other salient difference between the FTC, DOJ and the FCC is that the former agencies are held accountable – by having to bring and prove their cases in court – to a rigorous standard of proof. By contrast, the FCC is subject only to after the fact review of their rulings under a deferential – but in recent years rarely met – administrative review standard.

of allowing technological ingenuity and entrepreneurial dynamism to take the market in places the regulators cannot have ever imagined.

State regulation, in its traditional role of regulating prices, dictating contractual terms and conditions, has no place in the next Communications Act. State agencies have proven politically attentive and possess skills and resources necessary to regulate franchised monopolies. But they are ill-suited to make competition policy. This is not to say that state regulation need be wholly tossed aside. States have adjudicative capabilities that the current FCC does not. So long as private carriers do not resort to private arbitration models for contracting and dispute resolution, there could be a state role here. Likewise, state regulators might be better prepared to assume a greater role in consumer protection.<sup>5</sup>

Finally, the size and structure of the FCC should be reconsidered. Congress needs to consider whether a single agency administrator, like Great Britain's communications regulator, would better serve the policymaking needs of the broadband Internet age. Congress should also consider making that administrator part of the executive branch, thus making communications policy – like antitrust policy – accountable to the President.

My experience with the FCC is of an agency of singularly dedicated and qualified individuals working tirelessly to follow the law and make sound policy. Yet, the FCC's record in the courts is dismal. The fluidity of the FCC's processes and the political nature of its compromises are designed for an agency charged with close-regulation. To become an agency geared toward implementing sound competition policy, the FCC must

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<sup>5</sup> But, finally, states themselves need to think about their willingness to allow their *state* resources to be conscripted into a federal statutory and regulatory scheme. The current clamor for more state involvement in federal communications law decisions belies that this is a federal mandate on the states, and an unfunded one at that.

be reformed to speak more singularly, adjudicate disputes lawfully and regularly, and become less of a forum for lobbying campaigns, than one of neutral legal disputations.

### **Conclusion**

The next Communications Act is of enormous import.

Congress cannot write a statute that means all things to all people. Congress will have to make unambiguous choices about what sort of laws it wants to govern the broadband Internet age. Those choices will dictate the nature and speed of the current and next-generation broadband networks. The choices will further determine the competitive station of the U.S. compared to the rest of the world. Thus, this is not merely a matter of which company “wins” with this provision or that provision of a rewritten Communications Act. It is a matter of international competitiveness and America’s role as the preeminent digital age economy.

On Monday, President Bush noted that “clearing out the underbrush of regulation, ...we'll get the spread of broadband technology, and America will be better for it.” President Clinton’s administration championed “the unregulation of the Internet.”

Unregulation and clearing out the underbrush should be the charge you accept. I do not deny that in lawmaking there is an element of predictive judgment in my testimony today. With the proper regulatory conditions in place, new technologies will eclipse what remaining pockets of market imperfection persist in the communications space. But your choice is not between correcting market imperfections with perfect regulation. Your choice is between slightly immature, but largely self-correcting markets and demonstrably imperfect regulation, regulation that does not self-correct and, to the contrary, often impedes progress and economic growth.

As you sit down to fashion our next Communications Act, remember what we have learned since the '96 Act. Competition and innovations flourishes where regulation retreats. I urge you to bring that to the whole communications sector.

Thank you again for the opportunity to speak with you this morning.