WRITTEN STATEMENT

of

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on

The State of Competition in the Telecommunications Industry

Before the
Committee on Commerce, Science, and Transportation
United States Senate

Tuesday, January 14, 2003
9:30 a.m.

Good morning, Mr. Chairman and distinguished members of the Committee. I appreciate the opportunity to appear before you to discuss the state of telecommunications competition. Competition is thriving in many respects, but at the same time the telecommunications industry is facing enormous challenges. I will begin by providing background information on the growth of competition as well as my assessment of key challenges confronting competitors. I will then discuss my views on the appropriate role for regulators in this environment.

I. State of Competition

The telecommunications marketplace is more competitive than at any time in history, with the wireless sector enjoying the most robust competition. We have six national wireless providers and many regional players. Consumers have benefited from the fruits of this competition, as providers have been forced to lower prices sharply and to introduce a broad array of innovative new calling plans, features, and services. Indeed, as wireless providers struggle to achieve or maintain a positive cash flow, some analysts have argued that the wireless sector may be *too* competitive — that is, that some consolidation may be necessary to restore its fiscal health.

On the wireline side, competition has been slower to take hold because of the historical market strength of the incumbent wireline providers. Nevertheless, the number of access lines served by competitive local exchange carriers (CLECs) continues to increase. CLECs serve more than 11% of the nation's lines — including approximately 8% of residential and small business lines. These carriers have employed a broad range of entry strategies: Some rely entirely on their own facilities; some deploy their own switches but rely on the incumbent carrier's loops; some provide service exclusively through unbundled network elements; and some rely on total service resale. Consumers have a choice of at least two local carriers in 67% of the nation's zip codes, and about 93% of all households are located in those zip codes. This data suggests that we are headed in the right direction competitively but the incumbent LECs' market strength requires continued regulatory intervention.

Broadband services also have continued their ascension and have become increasingly competitive. There are now more than 16 million high-speed lines in service, including more than 14 million to residential and small business subscribers. Cable modem and DSL providers both increased their penetration by about 30% in the first half of 2002 alone. Perhaps most importantly, the gap between urban and rural deployment appears to be narrowing. While cable modem and DSL providers serve the vast majority of the broadband market today, there have been promising developments with respect to wireless and satellite technologies. For example, wireless carriers are beginning to introduce third-generation data services, WiFi networks are becoming increasingly robust and are expanding their range, and several companies and joint ventures have announced plans to launch the next generation of satellite broadband services in the near future.

II. Economic and Regulatory Challenges

While these statistics and technological developments in the abstract present a positive portrait of the overall competitive landscape, the last few years plainly have been a tumultuous time for the telecommunications marketplace. Overly optimistic projections of data growth spurred companies to invest enormous amounts of capital to

boost network capacity. While demand for telecommunications services grew briskly, it did not grow at a sufficient pace to justify the massive build-out of fiber capacity. Eventually, when the dot-com bubble began to burst, the financial community realized that there was a wide gulf between the supply of network capacity and the demand for data transmission. Investors responded by insisting that network owners retrench and demonstrate profitability over a much shorter time horizon than initially projected. A downward spiral ensued, as many telecommunications carriers went bankrupt after failing to generate sufficient revenues to service their accelerating debt loads. The resultant slowdown in capital expenditures ultimately left equipment manufacturers with surplus inventory and personnel. No segment of the industry was left unscathed. Not only did the economy suffer from devalued businesses and widespread layoffs, but several companies — most notably, WorldCom — appear to have resorted to financial deception to mask poor performance. This fraud compounded the downturn by shaking investors' confidence in the truthfulness of financial statements.

On top of these economic factors, the telecommunications marketplace is beset by regulatory uncertainty as a result of successive court reversals of the FCC's core local competition rules. When the FCC first adopted unbundling rules pursuant to section 251(c), the U.S. Supreme Court remanded the Commission's interpretation of the "necessary and impair" standard in section 251(d), holding that the Commission had failed to develop a meaningful limiting principle. After the FCC adopted new rules on remand, the D.C. Circuit Court of Appeals reversed those rules on the grounds that the Commission's analysis was not sufficiently "granular," the Commission disregarded the costs associated with unbundling obligations, and the Commission failed to consider the significance of intermodal competition. These court setbacks have left providers with little guidance about the network elements that will be available at regulated cost-based rates and have put at risk some current business plans that were developed around the now-vacated rules.

III. Regulatory Responses

A. Promoting Regulatory Certainty

The Telecommunications Act of 1996 was enacted to "promote competition and reduce regulation," and there is no question that regulators play a pivotal role in overseeing the transition to the fully competitive markets envisioned by Congress. As I have emphasized since taking office,[1] one critical role for the FCC in furthering the development of competition is to promote regulatory certainty. In an economic environment where carriers would have a difficult time raising capital even under the best of regulatory circumstances, the absence of clear rules can deal a crushing blow. Even where capital is available, incumbents and new competitors alike put investments on hold when they cannot reliably assess the regulatory risks they will face. It is no exaggeration to say that a company may prefer receiving an adverse ruling to having no rules at all; in the former case, the company can adjust its business strategy and move on consistent with the regulatory parameters, while in the latter the result is often paralysis.

1. Adhere to the Text of the Statute

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[1] For a full explanation of my guiding regulatory principles, see *My View From the Doorstep of FCC Change*, 54 Fed. Comm. L. J.199 (March 2002).

One of the best ways to promote regulatory certainty is to adopt rules that are consistent with congressional intent as set forth in the statute. While appellate risks are endemic in the administrative rulemaking process, they can be diminished significantly by ensuring that rules adhere closely to the statutory text, structure, and purpose.

The costs of regulatory uncertainty are significant. Carriers develop business plans based on the FCC's regulations, and when those regulations are subsequently found to violate the statute, business plans must be scrapped. In a worst-case scenario, a company may be unable to survive under the new regulatory regime. The risk of such outcomes can be diminished in the future through the exercise of greater discipline and conservatism in our interpretation of the statute. Therefore, as the Commission considers new unbundling rules, my paramount goal is to ensure that, irrespective of my own policy preferences, our decisions will comport with the statute and with the directives we have received from our reviewing courts.

The Commission's initial efforts to develop unbundling and interconnection policies were largely theoretical, by necessity. We now have the benefit of several years of real-world experience under the Telecommunications Act of 1996. We therefore have a better understanding of which facilities competitors truly need at regulated, cost-based prices, and those they can self-provision or obtain at market-based rates. The D.C. Circuit Court of Appeals also has instructed us to bear in mind that unbundling imposes significant costs (it can deter investment in new facilities and impose substantial transaction costs) in addition to benefits (stimulating competitive entry), and I will attempt to strike an appropriate balance in our pending rulemaking.

2. Ensure Swift and Stringent Enforcement

Another crucial part of promoting competition in a stable regulatory environment is pursuing a strong enforcement policy. Market-opening mandates are worth little to competitors unless they are swiftly and stringently enforced. Indeed, a record of poor enforcement can deter competitive entry and investment just as surely as an absence of rules can. This goal requires a concerted effort by the FCC and our colleagues at the state level. I am pleased that this Commission has aggressively punished violations through forfeitures and consent decrees that have imposed the maximum fines allowed by law. The state commissions also have a good track record in policing the marketplace. I strongly support Chairman Powell's call for increased enforcement authority to ensure that the maximum forfeitures are sufficient to deter anticompetitive conduct by even the largest entities. I also support the adoption of national performance standards for unbundled network elements, and potentially for special access services as well, to ensure that the Commission is able to detect and respond to discrimination and other rule violations.

B. Keeping Pace with Technological and Marketplace Changes

Another key role for regulators is keeping up with the rapid pace of technological change and market developments. Otherwise, we run the risk of becoming irrelevant, or worse, implementing regulatory requirements that harm the public interest. I have accordingly been a strong proponent of addressing gaps in the law and developing a coherent regulatory framework for broadband services. Since the Communications Act does not specifically define broadband Internet access services, the FCC must select one of the existing service categories — information services, telecommunications services, and cable services. For several years, the Commission declined to resolve the fierce

debate over the appropriate classification of cable modem service. As the Commission remained on the sidelines, providers did not know which regulatory rules would apply, and some therefore were reluctant to invest capital. Making matters worse, courts began to step in to provide their own statutory interpretations, which unfortunately were not consistent.

I am pleased that the Commission last year classified cable modem service as an interstate information service and proposed a similar analysis for the DSL Internet-access services provided to consumers. I also support moving expeditiously to clarify the regulatory implications of our statutory classifications, including issues relating to ISP access, universal service contributions, access by persons with disabilities, and the scope of our discontinuance rules. Only by tackling these difficult questions head-on can we provide the kind of stable and predictable regulatory environment that encourages investment in new products and services. I also believe that the analytical framework the Commission has begun to construct ultimately will help harmonize divergent policy approaches to cable modem and DSL services, and, in doing so, promote efficient investment and deliver increased benefits to consumers.

This principle of keeping pace with change is equally important to our promotion of non-market-based public policy objectives, such as the preservation and advancement of universal service. That is why the Federal-State Joint Board recently took a fresh look at the services that should be eligible for support, and why the Commission and the Joint Board have made it a top priority to ensure that our contribution methodology for the federal support mechanisms responds to changes in the way people now communicate. I supported the interim measures the Commission recently adopted, but I remain concerned that our existing revenue-based contribution framework will not be sustainable long term in light of the increased prevalence of bundling and the difficulty distinguishing among revenues from interstate telecommunications services, local telecommunications services, information services, and customer premises equipment. It therefore remains my goal to promote more comprehensive reforms that will enable the Commission to protect universal service in this changing environment.

The same principles lead me to support examining our media ownership rules to ensure that we are keeping pace with changes in the media landscape. In addition, section 202 of the Act compels such a review, and recent court decisions have underscored the urgency of conducting a rigorous examination. We must ascertain whether the congressional objectives of promoting competition, diversity, and localism continue to be served by our existing ownership restrictions, or whether changes are necessary. Most of the rules at issue were established before cable television became the dominant form of entertainment, news, and information that it is today, and before the advent of the Internet, direct broadcast satellite service, and satellite digital audio radio service. Even within the traditional broadcast world we have had an expansion of programming and we are on the verge of another revolution as the DTV transition is gaining momentum. These dramatic changes compel us to analyze whether our existing rules best serve the public interest.

Finally, a related reason for keeping pace with technological change is that legacy rules may not merely be ill-suited to new services or technologies — those rules may actually harm consumers by curtailing the development of facilities-based competition. This is a critical concern, because we must encourage the development of new platforms

and services that will challenge incumbent providers if we are to fulfill the overarching congressional interest in substituting a reliance on market forces for regulation to the extent possible. I have therefore advocated a policy of regulatory restraint when it comes to nascent technologies and services. We should not reflexively assume that legacy regulations should be carried over to a new platform, but rather adopt rules that are narrowly tailored to the interests in protecting competition and consumers. For example, as wireless carriers and satellite operators strive to enter the emerging broadband market, we should avoid saddling them with regulations simply because other providers may be subject to them. The fact that cable operators pay franchise fees and that DSL providers are subject to detailed nondiscrimination requirements does not necessarily justify imposing identical measures on new broadband platforms.

In time, the Commission should pursue regulatory parity, because differential rules cause harmful market distortions. But a good way to achieve that end is to exempt incumbents from legacy regulations when new platforms take hold and diminish the need for market intervention, as opposed to regulating new platforms heavily during their infancy. The danger associated with the latter approach is that it threatens to prevent the nascent platform from developing at all — and in turn to prevent consumers from reaping the benefits of facilities-based competition.

I thank you for your time. I look forward to hearing your views and answering your questions on how the Commission should promote competition and consumer welfare in the telecommunications marketplace.