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"Great Branding, Bad Policies: The Flaws of Open Access Regulations."

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Great Branding, Bad Policies: The Flaws of Open Access Regulations

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Whoever handles branding for consumer groups deserves a bonus for conceiving a brilliant telecom strategy. How could anyone oppose proposals with names like net neutrality, Internet freedom, and open access? (Take that, “Patriot Act!”)

But to paraphrase an old cliché, don’t judge an idea by its slogan. These proposals, if implemented, would create a regulatory hell of complicated rules and endless lobbying while undermining incentives to invest in critical wireless and wired broadband infrastructure.

Nearly everyone in today’s telecom debates shares the same objective: ensuring competition, promoting innovation, and improving broadband access. The debate is over how to do those things.

The underlying ideology of the open access crowd is that the best way to promote innovation on the Internet is to keep the “intelligence” of the network at the edge—that is, computers that use the Internet should be intelligent and connect over dumb pipes or spectrum.

To be sure, innovation at the edge has brought benefits. But such advancements would be useless if they are not combined with incentives to invest and innovate in the Internet infrastructure, as well. Open access proposals would undermine those incentives and ultimately harm consumers.

Consider the most recent salvo from open-access advocates. Several groups, including Consumers Union, the Media Access Project, Public Knowledge, and others, have petitioned the FCC to require winners of an upcoming spectrum auction to allow open

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access to new wireless broadband networks. Only through such regulations, these groups contend, will this valuable spectrum truly benefit consumers.

Despite the populist appeal of the call for “open access,” the proposal is fundamentally flawed.

The petitioners contend that the regulations needed to implement their plans would be simple. They state that “[i]n broad terms, open access in the wireless broadband environment means that content, application, service providers and consumers are able to reach one another on a transparent basis...”¹ The petition contends that they “would not propose that licensees necessarily be limited to a ‘wholesale only’ business model....”

Their claims contradict all of our experience with telecom regulations, which suggests that such rules would be far from simple to create or enforce.

For example, their proposal is meaningless without rate regulation. Presumably even open access advocates recognize that a network operator must charge something for its service. They must then further realize that if the government does not set a rate then operators will simply set a rate high enough to prevent this ‘open access’ use.

The history of rate regulation in telecommunications is not a happy one. Rate regulation is intended primarily to set prices in markets that are not competitive to levels that competition would have generated. It turns out to be a Herculean and highly controversial task to figure out what those prices would be. Any good-faith effort to set those rates will be constantly challenged, just as previous rate regulation was. It proved to be nearly impossible to come up with defensible regulated rates when the industry evolved more slowly, and would be even more difficult today as technology changes so quickly.

Regulatory complexity would extend beyond price regulation. If the licensee were required to lease its spectrum to non-affiliated retailers, as the petitioners request, how would those leases be structured? Would the FCC regulate how long a lease should be in effect? How many leases could any particular firm hold at a given time? Answering such questions would be anything but simple.

Even if, in principle, such rules were simple to determine, competing interests—including, no doubt, the petitioners themselves—would descend on the regulator to convince it to adhere to their particular viewpoints. After all, the petitioners are already lobbying the FCC for what they believe to be the best solution. What makes them think that such lobbying would end once the regulations were in place?

Another problem with the proposal is that it would undermine incentives to invest in these critically important next-generation networks. Indeed, it would undermine

¹ Ex Parte Comments of The Ad Hoc Public Interest Spectrum Coalition. Appendix: Open Access Principles for 700 MHz spectrum.

investment both by large companies the consumer groups fear and also by small companies these groups want to help.

Investments are risky, especially in such dynamic industries, and investors need some expectation that they will be allowed to earn a competitive return to their investment. Requiring companies to lease their spectrum to their competitors reduces the returns to these investments and thus also reduces the incentive to invest. Companies that would otherwise build out these costly networks would be less likely to sink capital into new networks if the government then forces them to share those investments at regulated rates.

Such regulations could deter smaller companies from investing, as well. If a company knows that it will be able to use spectrum at a presumably regulated rate licensed by someone else it is less likely to bid for its own spectrum or invest in its own facilities. Why should it? It may be less risky from that company's point of view to simply lease access rather than build its own network.

Consider the AWS spectrum auction, completed last year. Proponents of the current plan like to point out that most of the spectrum went to incumbents, but neglect to point out how it improved the competitive position of many of the smaller, but important, players in the market. T-Mobile—the smallest nationwide wireless carrier—bought enough spectrum to be able to build out its own broadband network. Niche players MetroPCS and Leap Wireless, among others, also acquired enough spectrum to become national players.

Suppose that the current proposal had applied to that auction. Smaller companies like MetroPCS and Leap probably would not have bid billions of dollars for new spectrum and made plans to invest in their own facilities since they could have simply demanded access to other spectrum at regulated rates. The empirical research on telecommunications strongly demonstrates the importance of facilities-based, platform competition on spurring investment and innovation and lowering prices to consumers. Reducing incentives to build those platforms contradicts nearly everything we have learned about making competition in telecommunications work.

This analysis is not mere speculation. The U.S. spent the late 1990s and the first few years of this century experimenting with that model in the wired world. In particular, regulations required the incumbent telecommunications companies to lease access to their networks at regulated rates. It turned out to be less costly for competitors to lease access than to build any of their own facilities, and thus discouraged investment by both the incumbents and the entrants.

Open access advocates compare their proposal to the famous 1968 *Carterphone* decision, in which AT&T was finally required to allow consumers to attach non-AT&T devices to the telephone network. Comparing their proposal to *Carterphone* is a nice rhetorical tool for advancing their interests, but it's also completely inappropriate. Just

about the only thing today's wireless industry has in common with AT&T's 1960s-era wireline monopoly is the existence of devices with a microphone and an earphone.

A more accurate analogy to these open-access proposals might be a hypothetical regulation requiring web search companies to allow competitors to sell contextual ads at regulated rates near search results. So, for example, Google would have to allow Ask.com—a much smaller search company—to place ads that it sells alongside Google's search results and ads that Google sells.

That example may sound outrageous since Google has invested a fortune in its proprietary search technology. Indeed, it is outrageous—society has benefited tremendously from Google's investments and such a regulation would hamper the company's willingness to invest in the future. Yet that is analogous to what the proponents of mandatory open access and network sharing want.

Holders of spectrum licenses should be allowed to lease access to their spectrum if they choose. That business model is, in fact, common. Mobile companies frequently lease space to and from one another, and that practice should continue. Moreover, regulations on spectrum use should be loosened so that they do not arbitrarily specify which services and technologies can be used in different bands. If someone develops a new technology or application spectrum regulations should specify where in the spectrum it should be allowed to operate (except to the extent that interference is an issue).

Congress might, under some circumstances, wish to impose specific conditions on some parts of the spectrum to achieve very particular objectives. Public safety officials, for example, must be able to communicate with each other effectively and be able to call upon sufficient spectrum to handle emergency situations. Even in those cases, however, policymakers should be aware that any conditions built into licenses will reduce the amount likely to be bid for the spectrum, reflecting its lower commercial value.

Most network sharing proposals reflect a willingness to trade future investment for maximizing use of existing infrastructure. So, for example, mandatory sharing of copper lines into homes may increase competition for use of those lines today but deter investment and innovation in future infrastructure. In principle, such sharing rules could benefit consumers in the short run even if they prove costly in the longer term.

The proposal on the table, however, goes even further. This open access proposal would hurt consumers even in the short run, since it could discourage networks from being built in the first place.

Open access proposals sound nice, but are not based on sound economics. These proposals, if implemented, would discourage investment in the very infrastructure that proposal advocates—and indeed, we all—want to encourage, and would create a

complicated and costly new regulatory regime as well. Consumer groups might declare victory if such regulations pass, but it would be a victory over consumers, not for them.