WRITTEN STATEMENT

of

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on

Health of the Telecommunications Sector: A Perspective from the Commissioners of the Federal Communications Commission

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SUMMARY

My diagnosis of the health of the telecommunications sector is decidedly mixed. While competition is thriving in many respects, and the FCC has recently taken important steps to restore incentives to deploy new broadband facilities, the telecom sector has been mired in a prolonged slump. The industry also has been plagued by regulatory uncertainty, caused in large part by successive reversals of the FCC's local competition rules by the courts of appeals.

Faced with these challenges, I believe that regulators have an important role to play in creating a stable and predictable regulatory environment and removing regulatory obstacles to investment. In pursuing these policy objectives, the Commission must faithfully adhere to the text, structure, and purpose of the Communications Act.

I am pleased that our decision to refrain from unbundling new broadband investment provides clear direction to the markets and also creates strengthened incentives to invest in new infrastructure. By contrast, I am disappointed that, in the UNE-P context, a majority of the Commission voted to establish an unbundling regime that fails to meet these key objectives. The decision to give state commissions virtually unlimited discretion to preserve UNE-P seems

destined to perpetuate uncertainty and retard investment for years to come. I support carefully prescribed delegations of federal authority to the states, and I believe that the states must play a key role in implementing any federal unbundling regime. But I could not agree to a wholesale abdication of the federal responsibility to make impairment findings.

While the recent Triennial Review decision therefore was a mixed result, I hope that the Commission will have additional opportunities in upcoming proceedings to promote regulatory certainty by adopting clear rules that more faithfully implement the intent of Congress.

STATEMENT OF COMMISSIONER KATHLEEN Q. ABERNATHY

Mr. Chairman and distinguished members of the Subcommittee, thank you for the opportunity to appear before you this morning. It is my distinct privilege to testify before the Subcommittee for the first time during my term as a Commissioner and to discuss the health of telecommunications sector. The diagnosis I would give is mixed: Competition is thriving in some respects, but at the same time the telecommunications industry is facing enormous challenges. Investment has stagnated, companies have laid off thousands of workers, and many carriers and equipment manufacturers have been forced into bankruptcy. I will begin by providing background information on the state of competition as well as my assessment of key challenges confronting competitors. I will then explain my views on the appropriate role for regulators in this environment, including a brief discussion of key issues decided in the recently adopted *Triennial Review Order*.

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. Market forces have prompted carriers to lower prices sharply and to introduce a broad array of innovative new calling plans, features, and services. On the wireline side, competition has been slower to take hold because of the difficulties replicating the last mile. Nevertheless, the number of access lines served by competitive local exchange carriers (CLECs) continues to increase. Broadband services also have become increasingly competitive, with cable modem and DSL services expanding at a rapid clip, and with promising developments in the area of wireless and satellite technologies.

II. Economic and Regulatory Challenges

Despite the growth of competition in most telecommunications markets, the last few years plainly have been a tumultuous time for service providers and consumers. 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 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 left providers with little guidance about the network elements that will be available at regulated cost-based rates and put at risk some current business plans that were developed around the now-vacated rules. While I am pleased that the Commission's Triennial Review Order creates a clear, pro-investment framework for broadband facilities, I am very disappointed that the majority's decision on unbundled switching (UNE-P) will prolong the paralyzing uncertainty and investment disincentives that have been plaguing the sector.

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.

Viewed from the perspective of regulatory certainty, the Commission's Triennial Review Order is a decidedly mixed blessing. On the positive side, the Order brings much-needed certainty to the broadband marketplace. After years of seeing investment chilled by questions about whether regulators would require newly upgraded broadband facilities to be unbundled at deeply discounted TELRIC rates, the Commission has put that concern to rest. The Commission made clear that, while competitors will have unfettered access to existing infrastructure — copper loops and subloops, and digital circuits over TDM pathways — incumbents will *not* have to provide unbundled access to new fiber capacity at higher data rates.

In contrast to this decisive, pro-investment ruling, however, a majority of the Commission adopted a UNE-P regime that is a major setback for the cause of regulatory certainty and facilities-based investment. The majority has effectively turned over to the states the entirety of the decision regarding the availability of unbundled switching. Apart from the legal flaws in this course of action (which I discuss below), the policy will be destabilizing for the entire industry. Carriers will be unable to craft sound business plans and instead will be forced to litigate the merits of UNE-P before 51 separate jurisdictions, and then take this battle to 51 separate district courts. It is hard to imagine a less stable regime.

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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).

1. Adhere to the Text of the Statute

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.

Not surprisingly, as the Commission considered new unbundling rules, my paramount goal was to ensure that our decisions would comport with the statute and with the directives we had received from our reviewing courts. With respect to the recent FCC decision on unbundled switching, I am deeply troubled that the majority's approach appears to be clearly at odds with our statutory obligations. Section 251(d)(2) of the Act directs *the FCC* to apply the impairment standard, and the Supreme Court confirmed the Act's shift of ultimate authority and responsibility to the federal jurisdiction. While I believe that the FCC may appropriately delegate some authority to state commissions to make more granular findings regarding impairment, we may not abdicate our responsibility. To remain faithful to the statutory scheme, the FCC must retain the *primary* decisionmaking authority, and we must establish *clear* standards for the states to apply.

The majority perhaps could have shored up its sweeping grant of authority to the states by establishing a right of appeal to the FCC, so that the ultimate decisionmaking authority resided at the Commission. But it refused to do even that. And while the majority relies on the ability of incumbent LECs to pursue appeals in federal district court under section 252(e)(6), it remains to be seen how a reviewing court can gauge a state's compliance with the federal regime when the FCC has refused to provide any specific guidance on what that regime should be.

An equally significant legal vulnerability is that the majority made no real effort to adopt a meaningful limiting principle regarding switch unbundling. The Commission has twice been reversed on this exact ground, and I fear this may be strike three. The Supreme Court and the D.C. Circuit have made clear section 251(d)(2) permits the Commission to unbundle an element only when we can affirmatively justify doing so. Turning this mandate on its head, the majority decided that switching must be unbundled because they cannot rule out that some impairments may exist. The fact that states *may* impose some limitations, based on their subjective evaluation of various nonbinding factors, imposes no real constraint on the availability of unbundled switching. Moreover, the majority made no attempt to square its decision with the record evidence showing extensive switch deployment by competitive LECs, including a number of carriers serving mass market customers on a UNE-L basis. I do not believe that this approach is remotely consistent with the direction we have received from the court of appeals.

2. *Ensure Swift and Stringent Enforcement*

Another crucial element 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. The broadband relief granted in the Triennial Review proceeding recognizes the difference between new and legacy networks, and accordingly adheres to this principle.

For similar reasons, I also have been a strong proponent of addressing gaps in the law and developing a coherent regulatory framework for broadband *services* (in addition to the regulation of the underlying *facilities*, which we have just addressed). 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 universal service contribution 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 bundled service offerings 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.

My desire to keep pace with technology and marketplace changes also leads me to support examining our media ownership rules. 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.