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The Failure of Competition Under the 1996 Telecommunications Act

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I. INTRODUCTION

The Telecommunications Act of 1996 (“1996 Act”) replaced the regulatory framework of a monopoly era with a radical deregulatory approach that promised new consumer benefits through competitive market forces. This new competition has never arrived, in large part because politicians, regulators, and antitrust officials have allowed the telephone

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and cable companies to kill it. As a result, consumers are faced with few choices and high prices for many telecommunications services in today's marketplace.

Supporters of the 1996 Act assumed that deregulation would spur competition—even in markets where competition has never existed or was just unfolding—and prematurely relaxed ownership limitation, while regulators allowed mergers based on theoretical and potential competition that never materialized.¹ This anticompetitive atmosphere has led to consolidation in the form of mergers that most recently eliminated the two largest competitors of the already consolidated Bell giants and possibly permanently undermined the last vestige of good intentions behind the 1996 Act. Instead of the predicted nirvana of a free and open market with numerous options for consumers and flourishing technology, we have concentration and little marketplace choice.

Today, virtually all consumers have at most two choices for a full package of telecommunications services: the local telephone company or the cable company.² After more than a decade, the cable and telephone industries remain highly concentrated, and the numbers tell the story. Cable operators still have a seventy-two percent market share of the multichannel video market.³ Telephone companies have an eighty-five percent share of local telephone subscribers,⁴ seventy-five percent of long distance,⁵ and more than fifty percent of wireless customers.⁶ High-speed Internet appears to be split more evenly between the local cable and telephone companies 60–40, but if one takes into account advanced services, it is closer to 80–20 in favor of cable.⁷

The “cozy duopolies” that have been created have not brought

1. *Consolidation in the Telecommunications Industry: Has It Gone Too Far?: Hearing before the Subcomm. on Antitrust, Business Rights and Competition of the S. Comm. on the Judiciary Comm.*, 105th Cong. 24 (1998) (written testimony of Gene Kimmelman) [hereinafter *Hearing*].

2. *SBC/AT&T and Verizon/MCI Mergers: Remaking the Telecommunications Industry Part II—Another View: Hearing before the Subcomm. on Antitrust, Business Rights and Competition of the S. Comm. on the Judiciary Comm.*, 109th Cong. 68 (2005) (written testimony of Gene Kimmelman).

3. Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, *Eleventh Annual Report*, 20 F.C.C.R. 2755, para. 4 (2005), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-13A1.pdf.

4. FCC, Trends in Telephone Service 8-11 tbl. 8.7 (2005), available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend605.pdf.

5. See *id.* 9-11 tbl. 9.6.

6. Proprietary data on file with author.

7. DEREK TURNER, FREE PRESS, BROADBAND REALITY CHECK: THE FCC IGNORES AMERICA'S DIGITAL DIVIDE 3, 13–17, (2005), available at http://www.hearusnow.org/fileadmin/sitecontent/broadband_report_optimized.pdf.

benefits to large segments of the consumer market on price or innovation.⁸ In video, consolidation and anticompetitive bundling of programming has led to cable rates increasing almost three times faster than the rate of inflation.⁹ Even satellite subscriber growth has failed to check these huge increases. For the first time since the 1984 AT&T break-up, long-distance prices for low-volume phone users have been on the rise. The enormous price reductions for all phone revenue may be coming to an end as long-term contracts, early termination fees, and stagnating prices for low-volume options persist.¹⁰

Each cable or telecommunications giant has protected its own base of services while staying out of others' service territory. In addition, they have bundled services (e.g., cable with broadband) in order to keep potential competitors, such as satellite service providers, at bay. This has resulted in a lack of service options for consumers. Instead of paying and getting the exact services they want, they must instead purchase packaged services—Digital Subscriber Line (“DSL”) tied to local phone service, or cable modem service tied to a cable video package. Getting the benefits of a discounted bundle causes the average household to expend much more for a cluster of services, some of which they may or may not use. This is definitely not the competitive landscape that Congress intended when it passed the 1996 Act.

II. BY THE NUMBERS: FEEBLE COMPETITION

After passage of the 1996 Act, it was assumed that competition would flourish among telecommunications companies. As explained in the *Wall Street Journal*, “By sweeping away decades of regulation, Washington thought it was paving the way for a free-for-all among the [Bell companies], long-distance carriers, cable operators and other telecommunications providers.”¹¹ Instead, it left an opening for companies that were looking to merge in order to gain even more market share, thus setting the stage for the union of SBC with AT&T and Verizon with MCI.

The SBC-AT&T and Verizon-MCI mergers mark the abandonment of the competition model envisioned by the 1996 Act. AT&T and MCI were the two largest non-Bell competitors in the local market (i.e., both the residential and business markets).¹² They were also the largest long-

8. *Hearing, supra* note 1, at 24–25.

9. *Id.* at 26.

10. *Id.*

11. Bryan Gruley et al., *Is This Really What Congress Had in Mind With The Telecom Act?*, *WALL ST. J.*, May 12, 1998, at A1.

12. MARK COOPER, CONSUMER FEDERATION OF AMERICA, *BROKEN PROMISES AND STRANGLER COMPETITION: THE RECORD OF BABY BELL MERGER AND MARKET OPENING*

distance companies, with over half the market nationwide.¹³

In fact, prior to the mergers, AT&T and MCI pursued various approaches to providing services in the market and were the best competitors to the Bell Operating Companies ("BOCs").¹⁴ "MCI played a key 'maverick' role in the industry for decades. . . . Not only did it break open the long distance monopoly for residential customers, but it also pioneered local competition" ¹⁵ MCI and AT&T provided a valuable service to the industry that was important for true competition. Their lack of presence will surely deal a "severe blow to the competitive fabric of the telecommunications industry."¹⁶

Similar to the aforementioned phone mergers, the pending Comcast, Time Warner, and Adelphia transactions mark a similar milestone in the cable industry. The two dominant cable operators will control close to fifty percent of the national multichannel video programming distributor ("MVPD") market, which includes all pay-TV providers and sixty percent of the cable market.¹⁷ It is simply impossible for a cable channel to succeed without getting carriage from both of these cable operators. This deal also highlights the problems caused by creating large regional clusters where cable operators are allowed to dominate.

The impact of the 1996 Act on consumer prices has been mixed at best. Indeed, since its passage, cable rates have soared. Measured on a per channel basis, they have increased by sixty-four percent.¹⁸ This cable rate increase is two and a half times the rate of inflation.¹⁹ However, since consumers do not get to buy cable service on a per channel basis, but are forced to buy the whole bundle on a take-it-or-leave-it basis, one should measure the impact as the increase in the monthly bill. Using that analysis, we see that cable rate hikes have led to a near-doubling of the cost of the average monthly cable bill. As a total monthly bill, they have increased

BEHAVIOR 4 (2005), available at http://www.consumerfed.org/telco_broken_promises.pdf.

13. *See id.*

14. *Id.*

15. *Id.* at 5.

16. *Id.*

17. *See generally* National Cable and Telecommunications Association, Industry Statistics, http://www.ncta.com/industry_overview/indStats.cfm?statID=17 (last visited Mar. 12, 2006) (providing basic statistical information regarding the state of the cable industry).

18. U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index: December 2005; Consumer Price Index, All Urban Consumers, database, all items v. cable and satellite. The Bureau of Labor statistics measures rate increase based on the additional number of channels offered to consumers.

19. *Id.*

eighty-six percent since 1995.²⁰ This means that the true cost of cable has increased at a rate that is almost four times the rate of inflation.²¹

These swelling rates are not just affecting consumers who buy cable. Local phone rates, which are still regulated, increased at just about the rate of inflation.²² Because competition never took much hold, there was some discounting for big bundles of local service, but that was extinguished when AT&T and MCI were gobbled up by SBC and Verizon.²³ In markets where prices were deregulated prematurely, like special access, profits have soared.²⁴

Wireless service charges, on the other hand, did not initially follow the trend of increased prices. In fact, wireless service charges dropped in price for a few years after the passage of the 1996 Act, due to new entrants into the provider market.²⁵ However, in the past several years, as market shares have stabilized, so too has pricing.²⁶ This trend in pricing demonstrates how fewer providers and deregulation eventually leads to a consolidated market and higher prices for consumers. Now that the three largest national wireless providers are integrated with the dominant wire companies by merger or joint venture (e.g., Verizon with Verizon Wireless, AT&T with Cingular, and Sprint/Nextel with major cable companies), prospects for price competition for stand-alone wireless service seem even dimmer.

High-speed Internet service has also been affected, although in a unique way. Pricing for high-speed Internet service has become bifurcated.

20. Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, *Report on Cable Industry Prices*, 20 F.C.C.R. 2718, att. 5 (2005), http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-12A1.pdf [hereinafter *Report on Cable*]. For eighty-six percent, divide 45.56 (Jan. 2004) by 24.43 (July 1995). See *id.* The Federal Communications Commission ("FCC") measures rate increases based on a total monthly bill.

21. Taking the eighty-six percent price increase compared to CPI numbers from January 2004 (the date of the latest FCC statistics), cable bills rose almost four times that of inflation.

22. See PAUL R. ZIMMERMAN, INDUS. ANALYSIS & TECH. DIV., REFERENCE BOOK OF RATES, PRICE INDICES, AND HOUSEHOLD EXPENDITURES FOR TELEPHONE SERVICE tbl. 3.1, cht. 2 (2005), available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/ref05.pdf.

23. See COOPER, *supra* note 12, at 7, 30 (describing how big the big telcos bundle Internet and local service in an anticompetitive manner).

24. See *id.* at 17–19.

25. Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, *Tenth Report*, 20 F.C.C.R. 15908, para. 154 (2005).

26. See *id.* paras. 155–57 (indicating a conflict of wireless price studies in 2004: one of which claims that there has been a decrease in wireless prices, while another claims prices have risen).

The BOCs have discounted their slow-speed DSL service.²⁷ At \$15 per month, the cost is \$20 per megabit download and over \$100 per megabit upload.²⁸ Cable has kept its prices high—about \$60 per month on a stand alone basis—but upped its speed.²⁹ However, it continues to cost about \$10 per megabit download and well over \$100 per megabit upload.³⁰ The Japanese and Koreans enjoy high-speed Internet service at one-tenth the price per megabit.³¹ In fact, there are almost half a dozen nations around the world where prices are substantially lower and penetration of high-speed Internet is higher.³² Thus, America is losing ground to other countries where competition is creating a more innovative and consumer-friendly industry.

III. THE FUTURE

Since the 1996 Act has failed to produce the vigorous, head-to-head competition that was originally promised, policymakers and the industry are engaged in a major effort to redefine success. Currently the two dominant companies argue that they are ready to compete with one another, and that is all we need or can hope for. The policy they push in Congress and at the FCC as a response to the failure of the 1996 Act proposes not only to give up on the model of promoting new entrants into communications, it aims to repeal the fundamental principles on which telecommunications were built in the past century.³³ Now that there are two, end-to-end networks instead of one, they propose to repeal the obligation of nondiscriminatory interconnection and carriage, which was first written into the U.S. communications law almost 100 years ago.³⁴

27. Dawn Kawamoto, *Yahoo, Verizon Launch Co-branded DSL*, CNET NEWS.COM, Aug. 23, 2005, http://news.zdnet.com/2100-1035_22-5841915.html.

28. On a per megabit basis, Verizon offers a \$14.95 plan of 768 kbps download and 128 kbps upload. The offer is available at <http://www22.verizon.com/ForHomeDSL/channels/dsl/packages/default.asp> (last visited Apr. 4, 2006).

29. See TURNER, *supra* note 7, at 5–6. Prices for cable modem broadband service are roughly \$45, prices for basic cable have risen to \$13.80. *Id.* at 6 fig. 3. For \$13.80, see *Report on Cable*, *supra* note 20, at tbl. 1.

30. Based upon advertised speeds of 6 megabits download and .75 megabits upload speeds.

31. See *id.* at 6.

32. See INTERNATIONAL TELECOMMUNICATION UNION, *ITU INTERNET REPORTS: THE INTERNET OF THINGS 15* (2005), http://www.itu.int/dms_pub/itu-s/opb/pol/S-POL-IR.IT-2005-SUM-PDF-E.pdf.

33. *Staff Discussion Draft of the Broadband Bill: Hearing Before the H. Subcomm. on Telecomm. and the Internet*, 109th Cong. 2 (2005) (testimony of Gene Kimmelman, Senior Director of Public Policy and Advocacy Consumers Union), http://www.natoa.org/public/articles/CU-CFA_Testimony.pdf.

34. For example, the Mann Elkins Act of 1910 amended the Interstate Commerce Act to include telecommunications. Mann Elkins Act, ch. 309, 36 Stat. 539, 539, 551 (1910).

Each of the networks would be allowed to discriminate or be given a virtual free hand to decide the terms and conditions of interconnection between networks and carriage of traffic on their networks. However, the same companies that predicted vigorous competition assure us that competition dissuades them from discriminating. There is nothing in their past behavior to support this claim.

There are some positive results that did occur within this deregulatory atmosphere. While new entrants into the telecommunications field were ultimately throttled by the incumbent network operators, they did make a major contribution to the telecommunications landscape. As theory predicted, they were the source of immense innovation. As the new competitors entered the industry, they sought to find niches in which they could survive. As a result, they introduced new business practices (e.g., electronic back office operations), led the way in deploying new facilities (e.g., DSL), and developed new applications (e.g., Voice over Internet Protocol ("VoIP"))³⁵ driving incumbents to emulate the innovations, but then were allowed to extinguish the competition.

The great danger is that Congress is being pressed to declare the new duopoly environment a victory and lock it in with policies that reinforce the power of the two incumbents. However, without the threat of new entry, the flow of innovation will stop.

In 1996, Congress assumed that new entrants could work their way into the market, thus forcing the incumbents to become more competitive outside their regions.³⁶ Whether it was the 1996 Act's design, as claimed by some, or faulty implementation, as thought by others, the current reality is that facilities-based competition for residential consumers is severely limited.³⁷ The incumbents have shown that they have a strong incentive to exclude competition and foreclose access to their networks.³⁸ Because network owners have market power and franchise services to defend, there is no reason to believe that they will change their behavior.

More than telecommunications networks are at risk. The open nature of the Internet could be undermined too. The Internet was conceived and administered as an open communications entity as a matter of policy.³⁹ The

35. Mark Cooper, *Making the Network Connection*, in OPEN ARCHITECTURE AS COMMUNICATIONS POLICY 136-44 (Mark Cooper, ed. 2003), available at <http://cyberlaw.stanford.edu/blogs/cooper/archives/openarchitecture.pdf>.

36. Telecommunications Act of 1996, 47 U.S.C. § 253 (2000)).

37. COOPER, *supra* note 12, at 10.

38. *See id.* at 30.

39. *See Inquiry Concerning Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, Notice*

FCC preserved the openness of the Internet when it required the telephone companies to carry data in a nondiscriminatory manner, in a series of decisions fittingly known as the *Computer Inquiries*. If the telephone companies had not been required to open their networks, they would not have acted so benevolently. AT&T and BellSouth have loudly declared their intention to extract rents from Internet service providers and pick and choose who can use their networks.⁴⁰ Cable operators have also declared their intention to be selective in offering quality of service guarantees.⁴¹ This statement of intent is the antithesis of the Internet principles of openness and neutrality.

IV. CONCLUSION

It would be a tragedy if policymakers conclude that vigorous competition is unattainable and abandon its pursuit at the same time it jettisons appropriate regulation. If Congress settles for a telecommunications market where there are a very small number of competitors and capitulates to the demand that private networks rule, consumers will pay higher prices and be given fewer real choices, while the economy is starved of innovation. Without aggressive public policies that promote increased competition and open returns, the market conditions necessary to foster affordable and open democratic networks for communications cannot survive.

of Inquiry, 15 F.C.C.R. 16641, para. 3 (2000); Joint Application of AT&T Corporation and Tele-Communications Inc. For Approval of Transfer of Control of Commission Licenses and Authorizations, *Petition to Deny of Consumers Union*, CS Dkt No. 98-178, Oct. 28, 1998, <http://www.consumersunion.org/other/1029filedc1098.htm>.

40. See *At SBC, It's All About "Scale and Scope,"* BUS. WK. ONLINE, Nov. 7, 2005, http://www.businessweek.com/@n34h*IUQu7KtOwgA/magazine/content/05_45/b3958092.htm.

41. See Peter Grant & Jesse Drucker, *Phone, Cable Firms Rein In Consumers' Internet Use*, WALL ST. J., Oct. 21, 2005, at A1.