SEPTEMBER 20, 2019

The More Things Change, The More Things Need to Change: Why New Realities Require New Rules

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I. INTRODUCTION

The regulation of telecommunications networks in the U.S. was initially grounded in the "regulatory compact," a tacit understanding between the regulator and regulated that traces its roots to the early days of railroad regulation. Founded on the premise that certain networked industries are natural monopolies, regulators protected providers from "damaging" competition and provided subsidies, directly or indirectly, to support the provision of service in difficult and expensive areas in exchange for providers agreeing to accept a "reasonable" rate of return and the obligation to deliver universal service to all Americans. This regulatory compact was embodied in several key provisions of the Communications Act of 1934 ("1934 Act"), the law that has served as the basis of U.S. telecommunications regulation for 85 years.[1]

...while ILECs no longer benefit from the protections of the regulatory compact, they continue to be subject to many of its burdens. They are subject to antiquated rules that govern provider entry and exit — and even grant regulators the right to compel providers to offer service — that affirmatively harm investment and competition in competitive markets.

In the face of dramatic change in the telecommunications marketplace, the elements of the regulatory compact withered over time. The incumbent local exchange carriers ("ILECs") are now subject to fierce competition. The Telecommunications Act of 1996 ("1996 Act")[2] established a "pro-competitive, de-regulatory national policy framework" that exposed ILECs to direct intramodal competition,[3] and the market has supplied even greater competition from intermodal sources — cable and fixed and mobile wireless providers. Recognizing, however, that ensuring universal service remains an important public policy goal, the 1996 Act and the Federal Communications Commission's ("FCC") implementing regulations have provided for new systems of explicit subsidies. With the creation of these new explicit subsidy mechanisms, the statute and the FCC have dismantled regulations permitting the former regime of implicit subsidies, under which the ILECs set artificially high rates for urban and business users to subsidize the rates for their more expensive-to-serve rural customers, to a regime of explicit subsidies.[4] Most recently the FCC has gone further, putting many of those explicit subsidies up for auction to the lowest bidder.[5]

There can be no doubt that these changes in the telecommunications landscape have resulted in tremendous benefits to the American consumer. However, regulation is still in the process of catching up with the dynamism of the industry. Despite the competitive pressures faced by today's ILECs, they continue to be subject to many of the burdens of legacy regulation. They are subject to antiquated rules that govern provider entry and exit — and even grant regulators the right to compel providers to offer service — that affirmatively harm investment and competition in competitive markets. And they continue to be subject to mandatory universal service obligations even when the subsidies that make it possible for them to meet those obligations are

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1 Communications Act of 1934, 47 U.S.C. §§ 151 *et seq.*

2 Telecommunications Act of 1996, Pub. LA. No. 104-104, 110 Stat. 56 (1996), 47 U.S.C. §§ 151 *et seq.*

3 H.R. Conf. Rep. No. 104-458, at 113 (1996), reprinted in 1996 U.S.C.C.A.N. 124.

4 47 U.S.C. § 254(e); *Verizon Commc'ns, Inc. v. FCC,* 535 U.S. 467, 480 (2002).

5 *See, e.g., Connect America Fund et al.,* WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17725, para. 156 (2011) (*USF/ICC Transformation Order*), *aff'd sub nom. In re* FCC 11-161, 753 F.3d 1015 (10th Cir. 2014); *Rural Digital Opportunity Fund; Connect America Fund*, WC Docket Nos. 19-126, 10-90, Notice of Proposed Rulemaking, FCC 19-77 (rel. Aug. 2, 2019) (*RDOF NPRM*).

redirected to alternative providers.

Against this backdrop of competition in the marketplace, the FCC is poised to introduce competition into the process by which it awards high-cost universal service funding to price cap ILECs nationwide. Namely the next stage of the FCC's Connect America Fund — the Rural Digital Opportunity Fund ("RDOF") — will for the first time make billions of dollars ($20.4 billion over ten years) available through a competitive auction in areas where it has previously awarded funds to price cap ILECs. Completely shutting off access to federal universal service support to an incumbent in favor of a competitor is a new frontier in the evolution of the support mechanism. In many areas the ILEC will compete successfully and continue to receive funds to serve those areas. In other areas, the FCC will award funds to a competitor to overbuild the previously government-funded network.

It is critical that the Commission clarify that any regulatory obligations placed on a service provider in a particular territory no longer apply to that provider when it stops receiving an associated subsidy. A "winner takes all approach" to the RDOF auction should mean the winner does, in fact, take "all."

The policy ramifications of this change are significant. Among the implications that should be clear is the following: when the ILEC is no longer receiving support and the FCC has sanctioned a new company to serve in its place, the ILEC should be relieved of all federal *and state* obligations to provide service in such areas. As government provided benefits are eliminated, associated government mandates to provide service must also fall by the wayside.

While not the focus of this paper, beyond the universal service mandate, the changes wrought by the 1996 Act and substantial competitive forces should compel action to balance the scales more globally. Just as universal service mandates should fall away absent government support, the elimination of the competition-shielding benefits from the earlier regulatory compact should be accompanied by appropriate deregulatory measures in the face of competition.

II. EARLY TELECOMMUNICATIONS REGULATION IN THE UNITED STATES

The Regulatory Compact and Early Telecommunications Marketplace

State and federal regulators' authority over the communications marketplace has its roots in the Interstate Commerce Act of 1887, which, among other things, formed the Interstate Commerce Commission (ICC) to both stabilize the railroad industry and protect consumers from the potential harms of unregulated railroad monopolies.[6] The regulatory compact that developed between the railroads and the ICC had three key features:

- **Protection from competition**, including the requirement that any new entities would need government permission to enter the marketplace;
- **Rate regulation**, including both the obligation to charge reasonable rates and a guarantee those rates would provide a reasonable rate of return; and

6 Interstate Commerce Act, ch. 104, 24 Stat. 379 (1887) (codified as amended throughout 49 U.S.C. 1982); U.S. National Archives and Records Administration, Interstate Commerce Act (1887), *available at* https://www.ourdocuments.gov/doc.php?doc=49

- **Universal service**, including both the obligation for a provider to serve all of the customers in its service area and the opportunity to build implicit subsidies into the rate design in order to meet that obligation.

Recognizing the benefits that the regulatory compact could provide to a telecommunications carrier, Theodore Newton Vail espoused these very concepts when he was reinstated as the president of the Bell System in 1907; while changing the company's primary focus from competition to consolidation, AT&T notably adopted a new slogan: "One Policy, One System, Universal Service."[7]

Congress subsequently extended the authority of the ICC to telecommunications through the Mann-Elkins Act of 1910,[8] and the regulatory compact was effectively cemented in the telecommunications industry in 1913, when AT&T Vice President Nathan Kingsbury helped negotiate the terms of the Kingsbury Commitment, an agreement under which AT&T agreed to allow its competitors to interconnect with its system in exchange for an agreement not to acquire additional companies.[9]

The Enactment of the 1934 Act and Shifting Telecom Marketplace in the U.S.

In the years that followed, policymakers embraced the notion that telecommunications is a natural monopoly, and that competition was "duplicative," "destructive," and "wasteful,"[10] and when Congress enacted the Communications Act of 1934 and established the FCC, it clearly contemplated that the FCC would continue to adhere to the regulatory compact.

The Commission should streamline or eliminate rules that prevent carriers from discontinuing service and exiting the market where competitive alternatives exist, particularly when the competitor is being funded by the government with support previously earmarked for the incumbent.

Section 214 of the 1934 Act provided existing service providers protection from any new competition by giving the Commission the authority to control entry into the marketplace. At the same time, incumbents were prevented from exiting the marketplace without the FCC's permission. Section 214(a) provides in relevant part that, before a carrier may "discontinue, reduce, or impair service to a community, or part of a community," it must obtain approval from the Commission.[11] This particular provision of Section 214 was first enacted during World War II, when competitive forces threatened domestic telegraph carriers and Congress allowed for them to merge.[12] As the Commission has previously recognized, Section 214(a)'s legislative history "reflects 'a strong desire' on the part of Congress 'to protect Americans' continued access to the nation's communications networks while also preserving carriers' ability to upgrade their services without the interruption of federal micromanaging.'"[13] A previous Senate

7 *See* Adam D. Thierer, *Unnatural Monopoly: Critical Moments in the Development of the Bell System Monopoly*, 14 Cato J. 267, 271-72 (1994), available at https://object.cato.org/sites/cato.org/files/serials/files/cato-journal/1994/11/cj14n2-6.pdf; Richard Gabel, *The Early Competitive Era in Telephone Communication*, 1893-1920, 34 Law and Contemporary Problems 340-359 (Spring 1969), *available at:* https://scholarship.law.duke.edu/lcp/vol34/iss2/8.

8 The Interstate Commerce Commission was granted jurisdiction over telecommunications by the Mann-Elkins Act of 1910, ch. 309, 36 Stat. 539, 544–45.

9 Thierer, *supra note* 7 at 272.

10 *Id.* at 273-74.

11 47 U.S.C. § 214(a).

12 *See* Brief for the Respondents, *Greenlining Institute et al. v. Federal Communications Commission*, Case Number: 17-73283, Docket Entry 48, at 5-6 (Nov. 30, 2018) (citing H.R. Rep. No. 78-69, at 3 (1943)).

13 *Id.* at 6

draft of Section 214, which was struck by the House of Representatives, would have taken Section 214 even farther, requiring permission from the Commission each time a carrier desired to abandon any "line, plant, office, or other physical facility."[14] Sections 201 and 202 gave the Commission the authority to govern rates and to ensure that any rates charged were just and reasonable. In particular, Section 201(b) dictated that "charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is … unlawful."[15] This section of the 1934 Act codified the preexisting understanding that protection from competition went hand in hand with the right to earn reasonable rates of return.

The Commission should also eliminate any ETC obligations where a provider is no longer receiving a subsidy through a Universal Service program.

The universal service component of the regulatory compact is embodied in the very purpose of the FCC as articulated in the 1934 Act, which is to make "available … to all the people of the United States … a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[16] Prior to the passage of the 1996 Act, the FCC enabled universal service through implicit subsidies, under which local exchange carriers were entitled to charge interstate long-distance carriers inflated rates in order to subsidize the provision of local exchange service to low-income households and high-cost areas.

The 1934 Act contemplated that states would retain jurisdiction over and implement comparable mechanisms governing intrastate rates and universal service obligations. Section 2(b) of the Act, codified as Section 152, provides that, in most cases, "nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier."[17] States therefore continue to assert ratemaking authority in connection with the provision of intrastate services, and generally impose comparable universal services requirements in the form of Carrier of Last Resort ("COLR") obligations.

III. THE ADVENT OF THE 1996 ACT — MODIFYING THE REGULATORY COMPACT

The belief that telecommunications was a natural monopoly began to come under pressure with the advent of competition in the long distance market in the late 1960s and early 1970s, which ultimately led to the breakup of the Bell System monopoly and AT&T's divestiture of its local exchange facilities under a Department of Justice antitrust consent decree in 1984.[18] The notion of "last mile" service as a natural monopoly prevailed for another decade, but by the mid-1990s calls began to allow for competition in the local exchange. In the 1996 Act, Congress revisited the underlying

14 *Id.* (citing H.R. Rep. No. 78-69, at 2 (1943) (quoting the Senate bill)).

15 47 U.S.C. § 201(b).

16 *See* 47 U.S.C. § 151.

17 47 U.S.C. § 152(b).

18 *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *affd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983); *see also MCI Comm's Corp. v. AT&T*, 708 F.2d 1081 (7th Cir. 1983); *see also* JONATHAN E. NUECHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS: TELECOMMUNICATIONS LAW AND POLICY IN THE INTERNET AGE 44-48 (2d ed. 2013)

premise of the regulatory compact, and chose to update the Communications Act to put in place a "pro-competitive, de-regulatory national policy framework" that eliminated many aspects of the traditional regulatory compact but left a number of its obligations in place.

Eliminating the Protections of the Regulatory Compact

The new Part II of Title II of the Act, entitled "Development of Competitive Markets," effectively marked the end of any effort the FCC might take to protect ILECs from competition in the local exchange market.[19] Two of the key provisions of Part II were sections 251 and 252, which were intended to facilitate the introduction of competition into the local exchange market by mandating interconnection between carriers and allowing competitors to lease or otherwise obtain access to incumbent carrier facilities.[20]

In the 1996 Act, Congress revisited the underlying premise of the regulatory compact, and chose to update the Communications Act to put in place a "pro-competitive, de-regulatory national policy framework" that eliminated many aspects of the traditional regulatory compact but left a number of its obligations in place.

The withering of the regulatory compact continued as the Commission sought to implement the 1996 Act. In 1999, the Commission granted blanket authority to provide domestic interstate services and to construct or operate any domestic transmission line under Section 214, effectively eliminating the need for competitors to obtain permission to enter the market and voiding a key component of the regulatory compact.[21] In doing so, the Commission concluded "[b]lanket authority will promote competition by deregulating domestic entry, allowing carriers to construct, operate, or engage in transmission over lines of communication without filing an application with the Commission. At the same time, with blanket authority, unlike forbearance, we retain the ability to stop extremely abusive practices against consumers by withdrawing the blanket section 214 authorization that allows the abusive carrier to operate."[22] The Commission further concluded that "[r]ather than maintaining a regulatory regime that may stifle new and innovative services . . . we believe it is more consistent with the goals of the 1996 Act to remove this hurdle."[23]

The 1996 Act also marked a significant change in the relationship between the just and reasonable rates ILECs were entitled to charge and the subsidies they used to ensure the provision of service in high cost areas. Section 254 of the Act required the FCC to make universal support "explicit and sufficient,"[24] mandating the beginning of a process to eliminate the implicit subsidies embedded in the "above-cost rates for the 'access charges' that long distance carriers paid as intercarrier compensation to local telephone companies for originating and terminating their subscribers' long distance calls, above-cost business rates, and above-cost urban rates."[25] In 2011, the FCC went

19 47 U.S.C. §§ 251-262.

20 57 U.S.C. §§ 251, 252.

21 *Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996 et al.*, Report and Order, 14 FCC Rcd 11364, 11365–66, ¶ 2 (1999) ("Section 402 Report and Order"); *see also* 47 C.F.R. § 63.01.

22 Section 402 Report and Order, 14 FCC Rcd at 11372 ¶ 12.

23 *Id.* at 11372 ¶ 13.

24 47 U.S.C. § 254(e); Joint Explanatory Statement of the Committee of the Conference, H.R. Rep. No. 458, 104th Cong., 2d 14 Sess., at 131 (1996) (Congress intended that, to the extent possible, "any support mechanisms continued or created under new section 254 should be explicit, rather than implicit. . . .").

25 Charles B. Goldfarb, Telecommunications Act: Competition, Innovation, and Reform, *CRS Report for Congress*, at CRS-13 (Aug. 12, 2005).

further, transitioning the explicit subsidies offered to most carriers under the high-cost Universal Service program to the Connect America Fund, laying the groundwork for a move to awarding support via competitive auctions for the first time.[26]

The Impact of Competition

Whether as a result of these legislative and regulatory efforts to stimulate competition, changes in technology and markets, or both, there is no question that ILECs' monopoly position in the communications marketplace is a thing of the past. Today, there is pervasive intermodal competition for voice and broadband internet access.[27] It is this competition — from cable, wireless, voice over Internet protocol, wireless Internet service providers, and rural electric cooperative providers — that has given the Commission the confidence that it can provide access to federal subsidies through competitive reverse auctions.

Obligations that Remain

As aggressively as the new regulations unwound aspects of the regulatory compact, it left a number of the compact's obligations in place, much to the detriment of one class of competitors — ILECs.

When the ILEC is no longer receiving support and the FCC has sanctioned a new company to serve in its place, the ILEC should be relieved of all federal *and state* obligations to provide service in such areas.

First, although Congress and the FCC effectively eliminated statutory barriers to entry, barriers to exit remain in place. The FCC's discontinuance rules continue to require carriers to obtain government permission prior to exiting the marketplace — even where there are significant competitive alternatives available.[28] Furthermore, ILECs that have been designated as eligible telecommunications carriers ("ETCs") by state or federal Commissions — voluntarily or involuntarily — remain subject to some mandatory service obligations under sections 254(e) and section 214(e).[29] Under the existing rules, these obligations remain for up to a year, even in cases where the ILEC loses the subsidy in a competitive auction and seeks to relinquish its ETC designation.[30]

Likewise, ILECs remain subject to state COLR obligations, even in cases where they are subject to competition and no longer receiving a subsidy.[31] As the Commission has previously recognized, "incumbent LECs generally continue to have carrier of last resort obligations for voice services. While some states are beginning to re-evaluate those obligations, in many states the incumbent carrier still has the continuing obligation to provide voice service and cannot exit the marketplace absent state permission."[32]

26 *See, e.g., USF/ICC Transformation Order*, 26 FCC Rcd at 17725, para. 156; RDOF NPRM.

27 Charles B. Goldfarb, Telecommunications Act: Competition, Innovation, and Reform, CRS Report for Congress, at CRS-13 (Aug. 12, 2005) ("[Congress] did not envision the intermodal competition that has subsequently developed, such as wireless service competing with both local and long-distance wireline service, VoIP competing with wireline and wireless telephony, IP video competing with cable television."); *see also Communications Marketplace Report et al.*, Report, 33 FCC Rcd 12558, 12642-49 ¶¶ 171-78 (2018) (discussing the number of services availability today and evaluating the "effect of intermodal competition" as required by the Repack Airwaves Yielding Better Access for Users of Modern Services Act of 2018 (RAY BAUM'S Act), Pub. L. No. 115-141, 132 Stat. 348, 1095 (codified at 47 U.S.C. § 615 note).

28 *See* 47 CFR § 63.71.

29 *See* 47 U.S.C. §§ 214(e), 254(e).

30 *See* 47 CFR § 54.205.

31 *Connect America Fund*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17730 ¶ 175 (2011).

32 *Id.*

IV. REBALANCING THE SCALES — NO UNFUNDED MANDATES

As the Commission moves forward with the establishment of the Rural Digital Opportunity Fund and increases the extent to which universal service subsidies are awarded competitively, it must eliminate those vestiges of the regulatory compact that continue to treat ILECs as though they are natural monopolies.

It is critical that the Commission clarify that any regulatory obligations placed on a service provider in a particular territory no longer apply to that provider when it stops receiving an associated subsidy. A "winner takes all approach" to the RDOF auction should mean the winner does, in fact, take "all." Where a new entrant underbids the incumbent provider and wins the subsidy for a specific territory, the COLR obligations for that territory should automatically transfer to the new provider.

The Commission should streamline or eliminate rules that prevent carriers from discontinuing service and exiting the market where competitive alternatives exist, particularly when the competitor is being funded by the government with support previously earmarked for the incumbent. These rules were intended to protect consumers from the abrupt discontinuance, reduction, or impairment of their interstate service in cases where they may not have sufficient alternatives. In areas where competitive alternatives exist, these rules impose unnecessary and burdensome requirements on providers and divert resources away from the provision of new service.

State COLR obligations should be preempted where an incumbent provider loses the federal subsidy, unless the state steps in to make up the difference. Requiring an incumbent to continue to meet state COLR obligations where it no longer has access to the federal subsidies necessary to meet those obligations amounts to a regulatory taking by the state.

The Commission should also eliminate any ETC obligations where a provider is no longer receiving a subsidy through a Universal Service program. Continuing to impose such obligations when support ends is simply unfair. If a transition period is required before a new entrant can provide service, then the Commission should either provide a subsidy to the incumbent provider or require that the new winner provide service by reselling another provider's service during that transition period.

Finally, state COLR obligations should be preempted where an incumbent provider loses the federal subsidy, unless the state steps in to make up the difference. Requiring an incumbent to continue to meet state COLR obligations where it no longer has access to the federal subsidies necessary to meet those obligations amounts to a regulatory taking by the state. If states wish to ensure that incumbent providers continue to provide service in an area that is served by a different federally subsidized provider, that is a legitimate policy choice — so long as the state is willing to ensure that the incumbent provider is able to access a sufficient subsidy.

V. CONCLUSION

It is critical that the Commission take into consideration the changes that have taken place in the marketplace since the enactment of the 1934 Act. Immense competition exists today, but remnants of the regulatory compact continue to burden ILECs in ways that hinder and affirmatively harm their ability to compete. The Commission should eliminate these unnecessary, antiquated burdens as it moves forward with the RDOF as part of its overall goal closing the rural digital divide and connecting millions more rural homes and small businesses to highspeed broadband networks at lower costs.

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This work was supported by USTelecom. The views expressed are those of the authors alone.