Economic Policy Vignette

The FCC's BDS Proposal and the Dangers of Skewing Investment

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"*In the dynamic telecommunications market, which relies heavily on private-sector investment, regulators and policymakers must be keenly aware that their policy decisions can affect not only the level of investment but can also skew investment decisions. Such skewing of investment across firms, technologies, or geographic areas harms economic efficiency and threatens the future economic vitality of not only the industry but also the larger economy*."[1]

A prime case of such danger is the Federal Communications Commission's (FCC) Business Data Services (BDS) proceeding. A summary of a proposed order to reform BDS regulation was issued by Chairman Thomas Wheeler on October 7, 2016. The summary explains that BDS, also known as special access, "are enterprise data services that are a fundamental part of the U.S. economy."[2] The Further Notice of Proposed Rulemaking (FNPRM)[3] issued in May 2016, which sought comment on the approach the FCC was then considering, pledged reform that is technology neutral. The Chairman's recent proposal, however, is very much technology specific. It targets legacy circuit-switched DS1 and DS3 services[4] for ex ante rate reductions. For modern packet-based services, it proposes extensive new regulations but not ex ante rate reductions. For both circuit- and packet-based services, it prohibits some contract terms and conditions.

The summary states that the Chairman's intent is to "Promote Competition and Investment in Packet-based Services": "The Order applies a light-touch regulatory approach that promotes continued investment."[5] In other words, the summary recognizes that regulation is likely to reduce investment, and apparently attempts to skew investment toward packet-based services by avoiding immediate rate regulation of those services. Even if one were to accept the premise that it is the FCC's job to skew investment from an obsolete technology to its state-of-the-art successors, the implementation suggested by the summary is deeply flawed.

First and foremost, forcing providers of DS1 and DS3 services to lower the price of those services is likely to increase demand for those services and slow the current rapid migration of customers away from them.[6] While ex ante rate regulation may make the providers of the obsolete DS1 and DS3 services

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[1] John W. Mayo, *Regulation and Investment: Sk(r)ewing the Future for 21st Century Telecommunications?*, Economic Policy Vignette, June 2016.

[2] Federal Communications Commission, *Chairman Wheeler's proposal to promote fairness, competition, and investment in the business data services market*, October 7, 2016, p. 1. [Hereafter referred to as summary.]

[3] Federal Communications Commission, *Tariff Investigation Order and Further Notice of Proposed Rulemaking*, in dockets WC 16-143, WC 15-247, WC 05-25, RM-10593, adopted April 28, 2016, released May 2, 2016, ¶6. [Hereafter referred to as FNPRM.] BDS has traditionally been called "special access." As the title of the document indicates, the FCC released an order at the same time that modified various terms and conditions in some incumbent carriers' contracts. In this paper, however, we deal only with the FNPRM.

[4] DS1 and DS3 are two low-speed versions of TDM and operate at 1.5 Mbps and 45 Mbps (megabits per second) respectively. TDM stands for time division multiplexing, a form of circuit switching. Packet-based services include Ethernet, Internet Protocol (IP), and wave division multiplexing. The latter operates at bandwidth that range from 1 Mbps per second to multiple gigabits per second.

[5] Summary, p. 2.

[6] Danielle Young, *Leverage Declining U.S. Telecom Prices to Control Enterprise IT Spending*, Gartner Research, July 1, 2015.

even more eager to abandon these than they have been in recent years, the proposed order leaves them helpless to act on that desire. If customers want to continue buying DS1 and DS3 at the newly lowered rates, the providers have no means to dissuade them. If the FCC wants to shift investment from circuit-switched to packet-based technologies, the last thing it should do is lower the price of circuit-switched services.[7]

Second, the proposed order's sweeping of all BDS into the Title II classification and its threat of ex post review of BDS pricing is creating deep concerns for providers of packet-based services who are among the largest new competitors against the incumbents. Charter, Comcast and Cox, which have become the third, sixth, and eighth largest providers of carrier Ethernet in the U.S.,[8] have made it clear that they are concerned about the FCC's attempt to reclassify services they have provided on a private-carriage basis into common carriage. Mediacom also states that reclassification would inhibit its ability to invest in packet-based BDS.[9] It explains that BDS entails investment in fiber and other facilities that require long periods to recover that investment. The threat that the FCC could change the prices on which investment assumptions for various projects were based radically changes the risk of participating in the BDS market.

The advantages that the proposal claims are dubious. Lowering the price of TDM, a technology wireless carriers have either already abandoned or are in the process of abandoning as an input to 4G wireless deployment, is at best irrelevant to the deployment of 5G several years from now and at worst deleterious.[10] Anchor institutions can be helped more directly via the Universal Service Fund. Even if financial institutions pass through their savings from lower TDM prices to consumers at ATMs and credit-card readers, those savings constitute a small fraction of 1% of financial institutions' prices. The harm to consumers of discouraging competition and investment in the modern technologies on which they have come to rely far exceeds potential benefit of lowering the cost of ATM and point-of-sale networks for the financial giants.

When regulators act, the danger is often that their actions will have harmful consequences that were unintended and unforeseeable. In this case, however, it is foreseeable that the proposal will skew the marketplace in the opposite direction from its author's intent. It is likely to induce customers to cling to DS1 and DS3 at the new lower prices. It is already frightening some of the largest entrants into the packet-based market with its threat of ex post price regulation under Title II. This proposal is, indeed, a perfect illustration of regulation with potential to harm economic efficiency and threaten future economic vitality.

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[7] Not only the incumbents who are the primary providers of DS1 and DS3 are concerned about this issue. Comcast's October 14th ex parte in dockets WC 05-25, 15-247, and 16-143, urges the FCC to tread "lightly in applying rate regulation to incumbent local exchange carriers' TDM offerings."

[8] Vertical Systems Group, *Mid-Year 2016 U.S. Carrier Ethernet LEADERBOARD*, August 18, 2016.

[9] Mediacom, *ex parte*, in dockets WC 05-25, 16-143, and RM-10593, October 13, 2016. Charter, *ex parte*, in dockets WC 05-25, 16-143, 15-247, and RM-10593, October 3, 2016. Cox Communications, *ex parte*, in dockets WC 05-25, 16-143, and 15-247, September 14, 2016.

[10] Anna-Maria Kovacs, *Business data services: The potential harm to competitive facilities deployment*, October 2016.