

March 25, 2004

The President
The White House
1600 Pennsylvania Avenue, N.W.
Washington, DC 20500

Dear Mr. President:

We urge you to support moving forward to adopt a new national telecommunications policy that promotes investment, creates jobs, and restores America's position as the most advanced telecommunications infrastructure in the world, rather than continuing litigation over the rules that were recently vacated by the United States Court of Appeals for the District of Columbia.

The current regulatory regime is a continuation of the policies adopted by the Federal Communications Commission ("FCC") in 1996, which today require local telephone companies to permit competitors to provide service entirely over existing networks at rates that do not even purport to reflect the actual costs of the incumbent firms, but that are instead designed to be well below these costs. The telecommunications industry as a whole has fared poorly under this regime. Since 2000, telecommunications service providers and the equipment manufacturers that supply them have lost several hundred thousand jobs and have lost over \$1 trillion in market capitalization, while annual investment declined by more than \$70 billion and the United States lingered at 11th in the world in deployment of advanced broadband networks.

The recent decision by the D.C. Circuit invalidating, for a third time, certain key aspects of the current regime provides a unique opportunity to take a fresh look at these past policies. The court's decision comes amid enormous technological and economic upheaval in the telecom industry. In the past year alone, there have been a number of significant developments that were not anticipated by the FCC when it adopted its latest rules in early 2002, let alone when it adopted the original version of those rules in 1996. This makes it especially critical that the FCC begin focusing on developing economically rational new rules that reflect the state of the industry today, rather than continuing its fight over eight-year old rules that do not reflect current economic realities.

Focusing on the facts as they exist today will enable the FCC properly to take account of the "intermodal" competition that is rapidly transforming the telecommunications industry. Just as trucks and planes emerged to compete with the railroads, wireless, cable, and Internet-based services now compete with the wireline telephone companies that were the mainstay of the industry in the past century. More than 90 percent of U.S. households with access to a cable network – which pass more than 96 percent of all homes – can get access to a high-speed cable modem connection that can now be used to obtain traditional local and long distance voice services. Indeed, cable operators themselves are now offering telephone service to more than 15 percent of

U.S. households (expected to rise to approximately 35 percent by year-end), while a variety of new Internet-based providers and established firms like AT&T are using these networks to provide telephone service even more broadly. More than one in two Americans also now owns a wireless phone, and for an increasing share of these consumers it has become their primary (or only) phone. And still further traditional telephone traffic has been replaced by new services such as e-mail and instant messaging.

Moving forward to adopt a new telecommunications policy consistent with the D.C. Circuit's decision also would remove the cloud of uncertainty that has plagued the industry for the last eight years and that would be perpetuated by continuing litigation. If the government were to pursue a Supreme Court appeal, and the Court agreed to hear the appeal, it would perpetuate the current state of uncertainty for *at least* another year, while the Court reached its decision. The uncertainty is particularly acute here, because the current regime allows state regulators to establish the critical rules, which means there will be 50 different and frequently inconsistent telecommunications policies with which to comply, rather than just one. The problem is that uncertainty deters investment.

Policies that promote investment in new infrastructure, new technologies, and alternative platforms are particularly important because they provide meaningful and sustainable competition – unlike the current FCC regime, which favors the resale of existing networks and harms the interest of new entrants that have invested in their own facilities. Using the transportation analogy again – consumers benefit more from a choice between trucks, planes, and railroads, all of which are capable of shipping goods, albeit at different speeds and costs, than from a “choice” between a railroad and a company that pays a discount to use that same railroad's network and sells the same shipping service under a different brand name.

Some have nonetheless argued that the FCC's scheme of subsidized piggyback “competition” should remain in place in order to promote innovation in the industry. Those arguments defy basic economics. Innovation in a network industry occurs when competing providers with their own facilities invest in new capabilities that their competitors have not provided. If that innovative feature proves desirable to consumers, other competitors then must invest to provide similar features or even better ones, and that in turn forces the first competitor to invest in still better features. So when telephone companies invest to provide better high speed services, cable companies in turn invest to provide better services themselves, and then telephone companies invest to provide even better services, and so on. This is the virtuous cycle of investment and innovation that is characteristic of a free market, and which promotes economic and job growth.

In contrast, the FCC's current regime deters investment and innovation by both incumbent and competitive telephone companies. Competitive providers have little incentive to invest when they can use the existing network risk-free, at rates deliberately set below what any real-world company could achieve, and that therefore assure them a large margin. Indeed, AT&T has admitted that, under the current regime, it receives a minimum margin of 45 percent simply to provide local service over the existing network,

and AT&T and other competing carriers openly tout the fact that little investment is required to achieve these returns. As FCC Chairman Powell has explained, this has led to a sharp rise in the use of resale modes of entry, which in turn has caused a decline in facilities-based competition. And a number of empirical economic studies have similarly found that unbundling at rates that are non-compensatory does not stimulate competitive investment.

Nor is it realistic to suggest that the customers who have switched to these resellers will be shut off, or be left without competitive alternatives, unless the FCC proceeds ahead and is successful with its appeal. As an economic matter, local telephone companies rationally will choose to keep customers on their networks at reasonable wholesale rates that can be privately negotiated, rather than risk losing these customers entirely to other competitors such as cable and wireless companies that have their own facilities. While any such negotiated, market-based rates may mean somewhat reduced margins for companies that chose to provide service merely by leasing the entire local telephone network of the incumbent at below actual cost, it does not follow that it will result in price increases to consumers given the numerous available alternatives that constrain those prices. These are precisely the kinds of circumstances under which a market-based solution is preferable to government regulation.

Finally, restoring certainty to the industry and eliminating policies that deter investment is essential to ensuring that carriers move forward in deploying the next generation of broadband infrastructure, such as fiber to the premises, that is already being deployed in some countries like Japan. Economic studies have shown that investment in new forms of broadband infrastructure could generate up to nearly \$500 billion in consumer surplus, and create 1.2 million new jobs over the next decade. Even if the benefits turned out to be only some fraction of these estimates, they still would be an enormous plus for the economy, for job creation, and for this country's international competitiveness.

For the foregoing reasons, we urge you not to support the FCC's efforts to appeal the D.C. Circuit's decision. An economically wise national telecommunications policy that promotes job growth, investment, and the deployment of broadband infrastructure is long overdue.

Sincerely,

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The President
March 25, 2004
Page 5

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