INCENTIVES TO SPEAK HONESTLY ABOUT INCENTIVES:

THE NEED FOR STRUCTURAL REFORM OF THE LOCAL COMPETITION DEBATE

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INTRODUCTION

This essay marks the occasion of my fourth trip to Boulder to participate in one of Phil Weiser's justly celebrated conferences on the state of the telecommunications industry. I'm happy to report that all is well in the industry for lawyers, because the same basic arguments rage on in all the usual forums and show little sign of abating. All is well for academic commentators too, because the arguments that keep the lawyers busy are as theoretical and interesting as they are intractable.

The problem is that what is good for lawyers and academics is not necessarily good for the public at large. The very debates that prove so intriguing to telecommunications professors impose enormous costs on society as a whole. Those costs include not just the expense of all the lawyering about implementation of the Telecommunications Act of 1996 ("1996 Act"),[1] but also the more insidious costs that regulatory uncertainty inflicts on us all. For example, since the passage of the 1996 Act, participants in the greater telecommunications community—lawyers, lobbyists, academics, economic consultants, and the like—have been arguing about whether it is appropriate to make incumbent local exchange carriers (ILECs) lease out to their competitors, at low regulated rates, all network elements needed for the provision of basic telephone service. This arrangement is known as the "unbundled network element (UNE) platform." We are no closer to a resolution of that question than we were in 1996. Indeed, as I write this, the FCC has just gravely

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1. Pub. L. No. 104-104, 110 Stat. 56 (codified in scattered sections of 15, 18, and 47 U.S.C.).

exacerbated the problem by shifting the debate about the availability of the platform away from itself, as a unitary national decision-maker, to each of several dozen state commissions, which will be free to disagree with one another on basic regulatory questions—and ultimately to scores of federal district courts on appeal, which will undoubtedly diverge on those questions as well.[2]

The debate about the UNE platform and other such issues focuses on what I will call "first-order" incentives—the incentives that various regulatory measures are said to engender for telecommunications carriers in their capacity *as carriers*. When we argue about first-order incentives, we address such questions as whether the UNE platform gives CLECs the necessary incentives to develop a broad customer base before deploying facilities of their own, as the CLECs claim, or whether it simply undermines the incentives of incumbents and CLECs alike to invest in new facilities, as the incumbents claim.[3]

My objective in this essay is not to answer those questions about first-order incentives, but to shift the inquiry up a notch and focus instead on what I will call the "second-order" incentives of regulators and market participants to behave responsibly *as political actors*. Questions about second-order incentives take the following forms: When arguing about first-order incentives, does each side in a regulatory dispute have any incentive to imagine itself in the shoes of the opposing side and try to reach consensus? Or does each side perceive the dispute as a zero-sum game between eternal antagonists? Do *regulators* have adequate incentives to take extreme care in tinkering with the incentives of market participants? Will market forces hold regulators swiftly and publicly accountable when they misjudge the incentive effects of their regulations? Or will the consequences of those mistakes be difficult to trace back to particular regulatory decisions? Do regulators have incentives to disregard diffuse long-term costs in pursuit of more visible short-term benefits?

As discussed below, these questions about second-order incentives should be just as important to policymakers as the familiar questions about first-order incentives. This essay discusses two possible ways to repair broken second-order incentives: first, by relaxing the "successor or assign" provision of the 1996 Act[4] to make it easier for incumbents to exit markets subject to excessive regulation; and, second, by permitting

2. Report and Order, *Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, etc.*, CC Dkt No. 01-338, at ¶¶ 179-196 (2003) [hereinafter *Triennial Review Order*].

3. *See* United States Telecom Ass'n v. FCC, 290 F.3d 415, 424-25 (D.C. Cir. 2002) (*USTA*).

4. *See* 47 U.S.C. § 251(h)(1)(B)(ii).

the merger process to create carriers that defy easy characterization as "incumbents" or "competitors." The details of these proposals, and the steps needed to ensure that they do not lead to re-monopolization of local markets, are less important than their common objective: to fix the broken second-order incentives of carriers and regulators and thereby replace today's climate of trench warfare with the welcome prospect of regulatory consensus.

I. THE BROKEN POLITICS OF TELECOMMUNICATIONS REGULATION

Much of the debate about telecommunications competition policy focuses on the question of what incentives carriers should be given, *as carriers*, to act in ways that promote the larger public interest. The FCC's pricing methodology, known as "TELRIC," is theoretically designed to give CLECs appropriate incentives to build new facilities when, and only when, doing so would produce greater social welfare than leasing existing facilities from incumbents.[5] The "impairment" standard of section 251(d)(2)—which limits the network facilities subject to unbundling—is likewise said to preserve the necessary incentives of both CLECs and ILECs to invest in new, socially beneficial facilities.[6] Section 271—the mechanism that keeps the largest ILECs, the Bell companies, from competing in the long distance market until they open their local markets to competition—is said to give those companies appropriate incentives to cooperate in the efficient provision of network facilities to their competitors.[7] Performance assurance plans are said to preserve such incentives after section 271 approval is granted.[8]

Regulators are obviously right to focus on these sorts of incentive questions. The problem, however, is that massive uncertainty surrounds the question of exactly how all of these incentives should be calibrated. For example, at what point do the self-executing penalties in a performance assurance plan *over*deter ILECs and produce competitively biased windfalls for CLECs? At what point do the rates for network elements fall so far that incumbents and competitors lose appropriate incentives to build socially valuable new facilities? And by what measure should we define when it would be socially valuable, rather than wasteful and needlessly disruptive, for CLECs to duplicate existing facilities?

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5. *See* Verizon Communications, Inc. v. FCC, 535 U.S. 467 (2002).

6. *See USTA*, 290 F.3d at 424-25; 47 U.S.C. § 251(d)(2).

7. 47 U.S.C. § 271; *see* AT&T Corp. v. FCC, 220 F.3d 607, 632-33 (D.C. Cir. 2000).

8. *See, e.g.,* Memorandum Opinion and Order, *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York*, 15 FCC Rcd. 3953, 3959, 4164-73 (1999), *aff'd on other grounds by* AT&T Corp., 220 F.3d 607.

Each of these questions has, at once, no answer and infinitely many answers. For example, the states have generated, all in the name of TELRIC, vastly different pricing regimes—*i.e.*, mutually inconsistent answers to the key incentive questions TELRIC is supposed to answer.[9] As for the "impairment" inquiry, the FCC has delegated to the states some of the most basic questions about the optimal list of network elements subject to unbundling.[10] The states sought that authority not just, or even primarily, to accommodate different *factual* circumstances from place to place, for the FCC could address those on its own, just as it has done in the pricing flexibility context.[11] To the contrary, the states wanted to experiment with mutually inconsistent *regulatory philosophie* —with warring intuitions about what incentives are needed to promote competition in the public interest.[12]

This state-by-state experimentation may have much to commend it from a purely academic perspective. One of Phil Weiser's key contributions to this field is his use of the "states as laboratories" concept as a rallying cry for greater "cooperative federalism" in the telecommunications context.[13] But, from a practical perspective, widespread regulatory experimentation can carry enormous costs. First, by dispersing decision-making authority, it increases the costs of regulation and litigation—potentially by a factor of more than 50. As the FCC explained to the Supreme Court in 1998:

> Congress did not intend for 50 state commissions to diverge on such basic federal issues as whether 'cost' means forward-looking economic costs or historical costs. . . . The question is whether the federal

9. *See AT&T Corp.*, 220 F.3d at 616 ("[E]normous flexibility is built into TELRIC.").

10. *Triennial Review Order*, *supra* note 2, at ¶¶ 179-196.

11. *See*, *e.g.*, WorldCom, Inc. v. FCC, 238 F.3d 449 (D.C. Cir. 2001) (upholding FCC "pricing flexibility" regime).

12. Ironically, AT&T—now a chief exponent of greater "states' rights" in the telecommunications context—put it best in 1999, when it still trusted the FCC more than the states to adopt pro-CLEC positions:

> [T]he reality is that the principal differences in the outcomes that will emerge from [delegating unbundling decisions to the states] will reflect not market variations but philosophical ones. . . . Any process that involves individualized decisions by state commissions would inevitably give free play to [state policy] differences, and would create a patchwork of decisions on the availability of network elements that would reflect not the application of the congressional standards to different sets of facts, but the application of radically different standards that would subvert the national policy established by Congress.

AT&T UNE Remand Reply Comments, CC Dkt. No. 96-98, at 57-58 (filed June 10, 1999).

13. *See* Philip J. Weiser, *Federal Common Law, Cooperative Federalism, and the Enforcement of the Telecom Act*, 76 N.Y.U. L. REV. 1692 (2001); Philip J. Weiser*, Towards a Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663 (2001); Philip J. Weiser, *Chevron, Cooperative Federalism, and Telecommunications Reform*, 52 VAND. L. REV. 1 (1999).

> courts will decide the parties' core substantive disagreements on the merits in a single proceeding on direct review of the FCC's rules or . . . in piecemeal [state-by-state] review proceedings under Section 252(e)(6) stretching well into the next century. The latter approach would inflict anticompetitive uncertainties and severe transaction costs . . . . Congress gave the Commission the rulemaking powers at issue here precisely because it wanted a smooth and expeditious transition to open competition, not a chaotic and dilatory one.[14]

The FCC's Chairman appealed again to this concern in 2003, but this time in dissent from his own Commission's decision to defer resolution of the UNE platform dispute to the varying discretion of the states:

> I believe this decision will prove too chaotic for an already fragile telecom market. . . . The nation will now embark on 51 major state proceedings to evaluate what elements will be unbundled and made available to CLECs. These decisions will be litigated through 51 different federal district courts. These 51 cases will likely be decided in multiple ways—some upholding the state, some overturning the state and little chance of regulatory and legal harmony among them at the end of the day. These 51 district court cases are likely to be heard by 12 Federal Courts of Appeals—do we expect they will all rule similarly? If not, we will eventually be back in the Supreme Court of the United States to resolve any conflicts—the same Court that vacated our excessively permissive unbundling regime in 1999. This process will take many years and will hardly be the quieting and stabilizing regime that was so craved by a rocky market.[15]

The second reason that regulatory experimentation carries enormous costs brings us back to the question of incentives—and, this time, second-order incentives. All regulators, state and federal, confront

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14. Reply Br. for the Fed. Pet'rs at 16-17, AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999) (Nos. 97-826 *et al.*). The Supreme Court agreed:

> [T]he question in these cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has. The question is whether the state commissions' participation in the administration of the new *federal* regime is to be guided by federal-agency regulations. If there is any 'presumption' applicable to this question it should arise from the fact that a federal program administered by 50 independent state agencies is surpassing strange . . . . This is, at bottom, a debate not about whether the States will be allowed to do their own thing, but about whether it will be the FCC or the federal courts that draw the lines to which they must hew. To be sure, the FCC's lines can be even more restrictive than those drawn by the courts—but it is hard to spark a passionate 'States' rights' debate over that detail.

AT&T, 525 U.S. at 378 n.6.

15. Separate Statement of Chairman Michael K. Powell, Dissenting in Part, at 4, in *Triennial Review* proceeding (Feb. 20, 2003).

incentives to produce (or preserve) immediate and tangible benefits, even if doing so requires risking longer-term costs in industry stability. Examples of this phenomenon span the range of regulatory issues, including the glacial pace of access charge reform (particularly on the intrastate side) and an engrained reluctance to "rebalance" retail rates in the face of increasing competition.[16] The incentive to favor short-term benefits over long-term stability is particularly acute where regulators can concentrate the benefits within their jurisdiction and disperse the long-term costs more broadly. For example, any given state may have an incentive to ratchet up the numbers for competition within its borders, even if the result is the "completely synthetic competition"—*i.e.,* UNE-platform competition—disparaged by the D.C. Circuit.[17] To accomplish that end, the state might err on the side of keeping network element rates low and disputed elements (such as switching) on the statewide unbundling list.

At some point, such regulation carries serious costs, some (but not all) of which the states may hope to disperse beyond their boundaries. For example, artificially low wholesale rates or excessive enforcement penalties may threaten the financial health of the ILEC as a whole and its ability to perform the maintenance functions needed for basic network integrity, but those harms are borne throughout the incumbent's region.[18]

16. *See, e.g.,* Access Charge Reform, *Sixth Report and Order*, 15 F.C.C.R. 12962, 12965-74 (2000), *aff'd in part and vacated in part on other grounds by* Tex. Office of Pub. Util. Counsel v. FCC, 265 F.3d 313 (5th Cir. 2001); Application by Qwest Communications International, Inc. for Authorization to Provide In-Region, InterLATA Services in the States of Colo., Idaho, Iowa, Mont., Neb., N.D., Utah, Wash. and Wyo., *Memorandum Opinion and Order*, 17 F.C.C.R. 26303, 26543-44 (2002). Retail rates are "rebalanced" when regulators free an incumbent of obligations to provide some services below cost on the expectation that it will be able to recover above-cost rates for other services. The development of competition makes such implicit cross-subsidies unsustainable over the long term, because competitors will cherry-pick the customers that had been paying above-cost rates. *See USTA*, 290 F.3d 415, 422-23 (D.C. Cir. 2002); *see also* 47 U.S.C. 254 (laying groundwork for replacing implicit subsidy mechanisms with explicit tax-like scheme).

17. *USTA*, 290 F.3d at 424.

18. The same is true of ruinous penalties that state commissions may seek to impose on ILECs for violation of their regulatory obligations. For example, with the encouragement of the Minnesota Department of Commerce, the Minnesota Public Utilities Commission gave serious consideration to fining Qwest $75 million for "privately" negotiating special contractual terms with certain CLECs within Qwest's 14-state region, even though other state commissions within that region imposed no fine at all upon reviewing those same transactions. *See* Order Requiring Plan and Authorizing Comments, *Complaint of the Minnesota Department of Commerce Against Qwest Corporation Regarding Unfiled Agreements*, Dkt. No. P-421/C-02-197 (Minn. Pub. Utils. Comm'n Dec. 18, 2002), at 2; *cf.* Order Making Tentative Findings, Giving Notice for Purposes of Civil Penalties, and Granting Opportunity to Request Re-Hearing, *AT&T Corp. v. Qwest*, No. FCU-02-2 (Iowa Utils. Bd. May 29, 2002), at 17-18 (declining to issue fine so long as Qwest submitted certain agreements to Board). The Minnesota commission eventually imposed on Qwest both a $25 million dollar penalty and other, non-monetary penalties. *See* Order After Reconsideration on Own Motion, *Complaint of the Minnesota Department of Commerce Against Qwest Corporation*

At the same time, some costs of excessive wholesale regulation *are* specific to the state, such as the tendency of low network element rates to compromise incentives for ILECs and CLECs to invest in new facilities over the long term. But, again, those costs tend to reveal themselves only after a substantial period of time, and even then they are not easily attributed to misguided regulation.

These are examples of flawed "second-order" incentives: *i.e.*, the factors that can lead regulators—both state and federal—to miscalculate or simply disregard the incentive effects of their own regulations. The most pernicious of these may be the simple *absence* of adequate incentives to induce a regulator to exercise due care when deciding how or whether to regulate a given market. The consequences of mistaken regulation, while severe, can be so difficult to trace to particular regulatory decisions that the errant regulator is never held accountable for them—and is therefore free to focus on short-term objectives at the expense of long-term consumer welfare.[19]

Compounding this problem are the distorted second-order incentives of the regulated parties themselves: not as market actors, but as *political* actors that lobby regulators and legislators to turn the rules in their favor. These second-order incentives are obvious to anyone who has paid the slightest attention to the telecommunications debate in this country. For many years, that debate was characterized by trench warfare between evenly matched and mutually antagonistic "sides"—specifically, in the wireline context, between ILECs and CLECs. Because neither side believes that it will ever stand in the shoes of the other, neither side has any incentive to take seriously the regulatory concerns of the other. This intractable zero-sum game plays itself out in Congress, on the eighth floor of the FCC, in each of 50 state commissions, and ultimately in dozens of courts. The result is regulatory gridlock.

II. ELEVATING THE DEBATE THROUGH REFORM OF SECOND-ORDER INCENTIVES

If we are to substitute sound telecommunications policy in place of seven years of political gamesmanship, we will need to do more than

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Regarding Unfiled Agreements, Docket No. P-421/C-02-197 (Minn. Pub. Utils. Comm'n Apr. 30, 2003) at 12-13.

19. Of course, this phenomenon is by no means confined to the world of telecommunications regulation. Most policymakers, in most contexts, have incentives to overweight the short-term benefits of their decisions and underweight any associated long-term costs. *See, e.g.,* Michael Abramowicz, *Speeding Up the Crawl to the Top*, 20 YALE J. ON REG. 139, 158-159 (2003); Jonathan R. Macey & Geoffrey P. Miller, *Deposit Insurance, the Implicit Regulatory Contract, and the Mismatch in the Term Structure of Banks' Assets and Liabilities*, 12 YALE J. ON REG. 1, 18-19 (1995).

continue haggling about the right way to address the first-order incentives of carriers as market actors. We will also need to adjust the second-order incentives of *regulators* to *regulate* responsibly and of *regulated entities* to *lobby* responsibly. In this essay, I describe two possible ways in which we could help align those second-order incentives with the public interest. What follows is no more than an exercise in outside-the-box thinking; I harbor no illusions that either of these proposals will become reality, particularly the first. Nonetheless, whatever the merits of these specific examples, my larger point is that it is not enough to worry about the substance of regulation; we must also worry about the very *form* of regulation. What the telecommunications world needs is some systemic mechanism that would facilitate consensus by blurring today's distinctions between mutually antagonistic "sides" (e.g., ILECs v. CLECs)—and, specifically, by giving each side appropriate incentives to imagine itself in the shoes of the other.

A. Peremptory Strikes Against Overzealous State Regulators

One such mechanism would involve congressional relaxation of the "successor and assign" provisions of the 1996 Act. Under current law, if an ILEC sells its operations in a particular state to another carrier, that new carrier generally assumes the regulatory burdens previously shouldered by the ILEC itself.[20] One practical consequence is that, within the state, ILECs and CLECs view themselves as adversaries locked in eternal struggle: whatever is good for one is bad for the other. Because no CLEC would *want* to purchase an ILEC network subject to excessive wholesale regulation, particularly if the CLEC can simply live off of low UNE rates instead, neither the ILEC nor the CLEC has any incentive to worry about what would happen if their roles were suddenly reversed.

Now suppose that the "successor or assign" language in section 251(h) were relaxed so that not all regulatory burdens imposed on an ILEC are necessarily imposed on a non-ILEC purchaser of the network. In particular, suppose that Congress enabled each ILEC to exercise, in carefully defined circumstances, a "peremptory strike" against a particularly problematic state commission by selling its local exchange operations in that state to an unaffiliated carrier *without passing along all of the ILEC-specific regulatory obligations under section 251(c)*. The scheme I imagine would take precautions to ensure that this limited right does not become a mechanism for re-monopolization of the local market: a game of musical chairs through which ILEC investors eliminate local

20. *See* 47 U.S.C. § 251(h)(1)(B)(ii); *see generally* Ass'n of Communications Enters. v. FCC, 235 F.3d 662 (D.C. Cir. 2001).

competition rules simply by swapping their respective networks. For example, Congress could limit the exercise of "peremptory strikes" to one or two states per ILEC; it could limit the class of potential buyers to carriers that maintain substantial operations as CLECs in other states to ensure that they retain continuing incentives to behave like hybrid carriers rather than pure ILECs; and it could continue subjecting such CLEC buyers not just to the obligations of all LECs under sections 251(a) and (b), such as interconnection, but also to the most critical requirements of section 251(c), including obligations to unbundle legacy loop facilities and to permit collocation at the central office.

Suddenly, the ILEC's network would seem much more attractive to a potential CLEC purchaser. Likewise, the sale of that network would seem much more attractive to the ILEC itself *if* it is currently subject to a distorted set of regulatory obligations that seem to favor the interests of short-term UNE-platform competition over the long-term benefits of facilities investment and network integrity. Tweaking the "successor or assign" language in the 1996 Act would enable an ILEC, without incurring enormous losses on sunk investment, to move its business elsewhere if it concludes that UNE regulation in one or two of its states has made continued business in those states a losing proposition for any carrier subject to the full panoply of section 251(c)(3) leasing obligations.

That outcome would have several highly beneficial effects on the second-order incentives of regulators and market participants. First, it would make negotiations between ILECs and CLECs more constructive than the intractable zero-sum game that characterizes many of today's negotiations. For example, CLECs would perceive that they no longer derive straightforward advantages from regulation that systematically disadvantages ILECs, because at some point such regulation would induce ILECs to exit the market—and thereby deprive *all* CLECs of the ability to avail themselves of full-blown ILEC regulation under the 1996 Act. And even a CLEC contemplating the purchase of ILEC facilities would arguably have incentives to ensure sound regulation of the existing ILEC, because at least *some* of the rules adopted for that ILEC would subsequently apply to the CLEC if and when it purchases the network.

Just as important, this approach would create a market-based mechanism for correcting the incentives of regulators to engage in regulatory overkill when trying to ratchet up the numbers for UNE-based competition, no matter how politically attractive they may be. The market itself would hold those regulators accountable for excessive disregard for the long-term health of the network, because at some point too much regulation would drive ILECs out of the market and trigger the end of full-blown ILEC regulation. As noted, regulators ordinarily face perverse incentives to overweight the short-term benefits of regulation and underweight the long-term costs, particularly when the latter are dispersed beyond their jurisdiction. Relaxation of the "successor or assign" rules would diminish the risks of such a state-by-state race to the bottom, because it would subject each individual state to the prospect of losing many of its current regulatory powers if it exercises them imprudently.

B. ILEC-CLEC Mergers

Now consider a second possible mechanism for correcting flawed second-order incentives, one that would not require congressional intervention: mergers between (i) one or more major ILECs and (ii) one or more major CLECs/long-haul transport carriers such as AT&T or WorldCom. Not long ago, the prospect of such a merger was "unthinkable," in Reed Hundt's familiar phrase.[21] He reasoned:

> When we evaluate mergers in communications markets, we need to determine whether the parties in question fall into the category of competitors that have been precluded from entering a market. It may aid clarity of thought to call firms precluded competitors instead of potential competitors when law, or the lack of pro-competitive rules, not inclination or capability, is the reason they have not yet become actual competitors. In any event, under potential competition theory and under our newly named 'precluded competition' theory, the result is essentially the same: an AT&T-RBOC merger is not thinkable.[22]

But what a difference the industry's recent financial collapse has made for regulatory thinking on this issue. Citing the "utter crisis" in the telecommunications sector, Chairman Michael Powell told the financial community in July 2002 that "[t]here are plenty of doctrines in antitrust and competition policy that would take into consideration the duress and

21. Reed Hundt, *Thinking About Why Some Communications Mergers Are Unthinkable*, Address to the Brookings Institution, June 19, 1997, *available at* http://www.fcc.gov/Speeches/Hundt/spreh735.html [hereinafter *Hundt Speech*] (last visited Oct. 8, 2003).

22. *Id.* The competitive issues presented by an AT&T-RBOC merger are similar to those raised by so-called "convergence mergers" in other industries: *e.g.*, between electric and gas companies in the power industry. *See*, *e.g.*, Dominion Res., Inc. v. FERC, 286 F.3d 586 (D.C. Cir. 2002). Among those issues are threshold disputes about whether a given merger is properly characterized more as "horizontal" or "vertical," with all attendant consequences for the level of regulatory scrutiny they draw. *See, e.g.*, Tim Brennan, *"Vertical Market Power" as Oxymoron: Getting Convergence Mergers Right* (Aug. 2001), *available at* http://www.rff.org/disc_papers/PDF_files/0139.pdf. Particularly if the merger has important horizontal components, the merging companies may be asked to divest assets to mitigate concerns about market concentration.

state of the market . . . . If a Bell company brought a deal to us, that would certainly be part of the consideration."[23]

Of course, neither Chairman Powell nor anyone else seriously suggests that our nation's antitrust enforcers should simply step back and allow such mergers to happen without first scrutinizing the impact of consolidation on competition. Those antitrust authorities may consider asking the merging parties to divest certain assets within the ILEC's traditional service region as a precondition to formal regulatory authorization. For example, AT&T might well be expected to divest, to another capable CLEC, some of its operations within the traditional service territory of any Bell company merger partner.[24] That and other steps may sometimes be needed to ensure that such mergers do not impair the prospects for continued local competition within a Bell company's region. After all, no fair-minded person wants an oligopolistic partition of this industry into three or four regions, each dominated by a single carrier.

But, if these concerns are adequately addressed, imagine the consequences for the national telecommunications debate. How would it affect that debate if the largest CLEC in Verizon's territory were the combined forces of BellSouth and AT&T? Or if the largest CLEC in BellSouth's territory were the combined forces of Verizon and WorldCom?[25] I suspect that, instead of the wooden "us versus them" advocacy that now passes for a national telecommunications dialogue, we would hear a more nuanced and constructive debate and a much greater emphasis on regulatory consensus. That is because each of those carriers would have very substantial operations as an ILEC *and* a CLEC; none of them would be pigeonholed into the narrow industry role to which legacy regulation has consigned them. Put differently, ILEC-CLEC mergers would succeed in giving many of the major industry players a stake in seeing not just one side, but all sides, of any particular telecommunications dispute.

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23. Yochi Dreazen, *FCC, Faced With Telecom Crisis, Could Let a Bell Buy WorldCom*, WALL ST. J., July 15, 2002, at A1.

24. *See generally* Memorandum Opinion and Order, *In the Matter of Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, 13 F.C.C.R. 18,025, 18,109-11 (1998) (noting merging companies' agreement to divest MCI's Internet backbone assets to assuage market concentration concerns); *see also* Memorandum Opinion and Order, *Application of GTE Corp. and Bell Atlantic Corp. for Consent to Transfer Control of Domestic and Int'l Sections 214 and 310 Authorizations, etc.*, 15 F.C.C.R. 14,032, 14,037 (2000) (requiring divestiture of GTE's Internet backbone assets to avoid section 271 concerns).

25. I cite these particular combinations only because the trade press has speculated about them. I have no more basis than anyone else for believing that they will actually happen. Nor do I have any basis for believing that they or similar mergers won't already have happened, or at least been announced, by the time this volume rolls off the old-economy presses.

That seismic shift in the second-order incentives for those carriers to behave responsibly *as political actors* could help break the current logjam in telecommunications regulation. Legislators and regulators would no longer confront a need to choose between mutually antagonistic "sides." Ironically, the civilizing effect of ILEC-CLEC mergers on telecommunications advocacy was a key consideration that led Reed Hundt to deem them "unthinkable." He asked rhetorically:

> Could the RBOC join AT&T in pressing for its legal rights as an entrant out-of-region to be upheld at the FCC or in court, while arguing in the same forums against AT&T when the dispute concerned an in-region issue? To implement a competitive entry strategy in today's transition period, a new entrant has to be an aggressive, albeit reasonable, advocate in all venues—in the marketplace, in negotiations, in state regulatory proceedings, in front of the FCC, and in court. The entrant may not be always right and it may not always win, but its shareholders will expect it to be always aggressive.[26]

Hundt's single-minded faith in the adversary system was understandable at the time, given his reliance on AT&T and other CLECs to help save his regulatory legacy in court after the initial success of the ILECs' challenges in *Iowa Utilities Board*.[27] But that faith seems quaint in retrospect: we now know, six years later, that too much entrenched adversity among warring camps leads to regulatory indeterminacy, not the inexorable triumph of reason. Perpetuating such adversity for the sake of "aggressive" advocacy seems especially counterproductive where, as in the telecommunications industry, the camps at issue are distinct primarily because regulation itself has made them so.[28]

The 2000 merger between Qwest (a CLEC, Internet backbone provider, and long distance company) and US West (an ILEC) helps illustrate the subtle value that mergers between traditional adversaries can bring to the national policy debate. Immediately after the merger, Qwest surprised both ILECs and CLECs by taking novel middle-ground

26. *Hundt Speech*, *supra* note 21.

27. Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), *rev'd sub nom.* AT&T v. Iowa Utils. Bd., 525 U.S. 366 (1999).

28. For example, the battle lines in many of today's regulatory disputes can be traced back to the 1984 consent decree that separated the Bell operating companies (today's largest ILECs) from AT&T (today's largest CLEC/long distance company). *See generally* 47 U.S.C. §§ 153(4), 271 (superseding decree but perpetuating these lines). In this respect, the "long distance market" is largely (though not entirely) a creature of regulation—and a threatened one at that, given the steady entry of local and long distance companies into each other's traditional markets.

positions on a variety of regulatory topics—from collocation[29] to UNE pricing[30] to intercarrier compensation[31]—that have traditionally divided the industry. Indeed, Qwest began its intercarrier compensation comments with an aspiration to neutrality through the wearing of many hats:

> In a rational telecommunications world, a carrier would be just a carrier and a call would be just a call. But this is not yet that world. Legacy regulation, rather than any underlying market necessity, is principally responsible for the balkanization of the telecommunications industry into specialized carriers providing specialized services. The existing crazy-quilt of intercarrier compensation schemes reflects and reinforces these artificial distinctions among carriers, and it creates unavoidable opportunities for economically irrational, regulation-driven arbitrage. Qwest's ambition, like the Commission's, is to shatter those artificial distinctions, and this proceeding is a critical step in the right direction. As an incumbent LEC, a CLEC, an [interexchange carrier], an Internet backbone provider, an [Internet service provider], and a wireless provider, Qwest transcends regulatory typecasting, and it appears here not as a representative of any particular industry segment, but as a representative of the industry as a whole.[32]

Of course, Qwest's deteriorating financial condition, which culminated in the replacement in 2002 of original CEO Joe Nacchio with former Bell company executive Richard Notebaert, caused Qwest to scale back many of its out-of-region activities and focus on its core local exchange operations. In some respects, the company is now less "the new Qwest" than "the new US West." But this does not mean that

29. *E.g.* Deployment of Wireline Servs. Offering Advanced Telecomms. Capability, *Fourth Report and Order,* 16 F.C.C.R. 15435, 15426 (2001) ("[W]e find Qwest's arguments in favor of [a pro-CLEC] approach to be persuasive in view of its market position as both an incumbent LEC and a competitive LEC."), *aff'd* Verizon Tel. Cos. v. FCC, 292 F.3d 903 (D.C. Cir. 2002).

30. In its Supreme Court brief in *Verizon v. FCC*, Qwest, unlike the other Bell companies, did not directly challenge the FCC's use of forward-looking cost rather than historical cost as the national pricing standard; instead, it challenged the Commission's use of a particular species of forward-looking cost: TELRIC. *See* Brief for Respondent Qwest Communications Int'l, Inc. (June 8, 2001), Verizon Communications, Inc. v. FCC, 535 U.S. 467 (2002).

31. In its filed comments, Qwest advocated universal bill-and-keep for all telecommunications traffic—including the access traffic from which the company, as ILEC throughout its 14-state region, currently derives substantial revenues. Qwest urged the FCC to "view with considerable skepticism any suggestion by incumbent LECs that bill-and-keep makes less sense for access traffic than for other kinds of traffic." Reply Comments of Qwest Communications Int'l, Inc., at 3, in *Developing a Unified Intercarrier Compensation Regime*, CC Dkt No. 01-92 (Nov. 5, 2001).

32. Comments of Qwest Communications Int'l, Inc., *Developing a Unified Intercarrier Compensation Regime*, CC Dkt. No. 01-92, at i (Aug. 21, 2001).

ILEC interests inevitably swallow CLEC interests soon after any ILEC-CLEC merger: as Jim Chen has observed, the pre-merger Qwest never occupied anything approaching the market position of AT&T or WorldCom even in its pre-merger glory days.[33] Subject to appropriate competitive safeguards, the combination of Bell companies with robust CLECs—AT&T or a post-bankruptcy WorldCom—could well clear the path towards a more constructive and balanced telecommunications debate over the long term. The ensuing consensus on various issues might be bad for telecommunications lawyers like me, but it would be very good for the average American consumer.

III. CONCLUSION

As I mentioned at the outset, my central objective in this article is not to advocate the particular mechanisms I have cited as possible ways to bring greater consensus to the telecommunications industry. My objective is simply to underscore the need to create *some* such mechanism. The industry will continue to spin its wheels if we perpetuate, for another ten years, the same timeworn disputes about the first-order incentives of ILECs and CLECs *qua* ILECs and CLECs. To break the impasse on those debates, we need to focus on fixing the second-order incentives that have systematically distorted the perspectives of both regulators and industry advocates.

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33. *See* Jim Chen, *The Magnificent Seven: American Telephony's Deregulatory Shootout*, 50 HASTINGS L.J. 1503, 1548 (1999).