SUMMARY

Incumbent phone companies are facing significant competitive pressure from voice-over-Internet Protocol (VoIP) services provided by cable operators and from wireless services. A prime example of this competitive pressure is the 2.7 million net access lines AT&T lost in the first half of 2008 nationwide. It is estimated that AT&T and Verizon are losing residential lines at a rate of about 10 percent per year. One analysis projects that by 2012 the market share of incumbent telephone companies will have dwindled to 51 percent.

The traditional rationale for utility regulation – that fixed landline telephone service was a natural monopoly – is gone. Lawmakers must face the reality that continued reliance on utility regulation not only is unnecessary but will distort competition in ways that will harm consumers. So far, few states have faced up to this challenge.

Indiana moved confidently into this new competitive era in 2006 by reforming utility regulation which inhibits competition and innovation. Specifically, it significantly reduced intrastate access charges, barred possible utility regulation of competitive VoIP and wireless services, provided pricing flexibility and eliminated tariff filing requirements, and transferred responsibility for consumer protection and promoting broadband deployment from the utility commission to agencies better suited to perform those tasks.

These changes enable phone companies to offer more competitive services, attract capital to fund broadband expansion, and remove obstacles to investment that reduce asset values of all telecom suppliers.

A survey of neighboring Midwest states indicates that significant and harmful vestiges of legacy regulation remain. These include:

- Hidden subsidies intended to hold some prices at or below cost. These subsidies cannot be maintained in a competitive market where competitors can choose to serve profitable customers and ignore everyone else.

- Tariff filing requirements which ensure that rivals will always have advance notice of an incumbent's intentions. This reduces the incumbent's incentive to improve its products or services and it relieves rivals of pressure to consistently offer the best value proposition they can as the only defense against competitive surprises which may cause them to lose sales.

- Requirements to offer similar terms to all customers. These rules prevent incumbents from developing customized offerings, such as volume and term discounts, which are necessary to retain valuable customers who will contribute to the cost of maintaining service for everyone else.

- No constitutional or statutory prohibitions on imposing utility regulation on competitive providers. To the extent a utility commission may attempt to assert jurisdiction to regulate competitive services it is a target for commercial rivals seeking a regulatory advantage, activists seeking to promote a policy agenda or even a formerly regulated entity seeking protection.

- Rules which impose costs on some providers but not others, such as the requirement to act as a provider of last resort where the market is competitive and consumers can choose between multiple providers. These obligations are anticompetitive.

- The absence of restrictions on utility commissions from intervening in the marketplace to promote broadband deployment. This risks recourse to unnecessary and inefficient subsidies and overlooks the more valuable role that state economic development and education departments can play in promoting broadband deployment.

- Utility commission jurisdiction for consumer protection. This is redundant since the attorney general, commerce department or some other state agency already protects consumers. Redundant jurisdiction can lead to different consumer protection rules according to the type of service or provider. This could have anticompetitive implications.

Even when pursued in the name of "competition," legacy regulation restricts service strategy flexibility and creativity needed for real competition in the Internet age. By resisting regulatory reform, legislators will limit customer choice, increase prices, and cripple the broadband expansion necessary to economic growth and technological progress.

This is a moment of truth for Midwest states facing contraction of their traditional manufacturing industries. By removing the "statewide cobwebs" of regulations that afflict telecom, they can open up new technological opportunities and economic efficiencies that promise a direct economic stimulus of at least $20 billion over the next five years. By simple reforms of outmoded laws, they can ignite a new spiral of innovation and revival based on new technologies and services tapping into new worldwide webs of glass and light and air.

"More Broadband, Increased Choice and Lower Prices Begin With Regulatory Reform," by Hance Haney and George Gilder (Aug. 2008) *available at:* http://www.discovery.org/a/7371.