The Rise of Shadow Common Carriers: Confronting the Legacy of Deregulatory Policies Based on Faulty Concepts

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Overview

- We need to look to other industries for insights as to the consequences of deregulatory policies that create *shadow* versions of regulated activities.
- Lessons can be learned from deregulatory banking policies, under which shadow banking activities negatively affected certain classes of individuals and created or exacerbated *systemic risks* for the financial sector.
- Deregulatory policies have created *shadow common carriers,* and created/exacerbated systemic risks among critical infrastructures that are compounded by a less adaptability U.S. policymaking system .

What Are Shadow Activities?

- "Shadow activities" refers to those actions that meet the definition of the "activity" but fail to be recognized or regulated by public or government instructions as such.

- Why do shadow activities develop?
  - To avoid regulatory rules, either legally or illegally.
  - As a matter of law through deregulatory policies, dismantling prior regulation or prohibiting regulation of new activities
  - As unintended consequences of deregulatory policies.

What is Systemic Risk?

- Systemic risk refers to risk of breakdowns in an entire system, as opposed to individual parts or components, and is evidenced by comovements (correlation) among all or most parts.
- Concepts of systemic risk include
  - Macro shocks to the entire system (with unspecified contagion).
  - Microlevel events and transmission of shock and potential spillover from one unit to another.
    - Chain reactions (direct causation)
    - Common shocks (correlation without direct causation)

How Have Systemic Risks Grown in Financial Markets?

- There has been a rise in systemic risk --both new from innovation and recurring from deregulatory policies.
  - Problems posed by new complex, off-balance sheet activities and financial instruments.
  - Dismantling of prior rules that had been imposed to promote financial stability.
- The rise in systemic risk has changed the emergent properties of the financial systems in the U.S. and internationally.
  - Financial markets have become more dynamic and unstable.

The Creation of Shadow Common Carriage And the Growth of Systemic Risks

What is (Original) Common Carriage Under the Common Law?

- Duties imposed under tort law are *relational norms* that enjoin persons from acting toward certain other persons in certain ways.
- Under common law, common carriers bear the tort obligations:
  - To serve upon reasonable request
  - without unreasonable discrimination
  - at just and reasonable prices
  - and with adequate care.
- Common carriers bear these obligations merely based on their economic relationship with customers (i.e. status), *independent of any requirement or finding of monopoly or market power*.

Why Did Statutory Common Carriage Develop?

- As explained in the Cullom Report of 1886, federal statutory regime of common carriage developed because
  - The common law remedies were inadequate;
  - States lacked jurisdiction over interstate commerce;
  - Reliance on competition was insufficient to protect customers.

- Congress enacted the Interstate Commerce Act of 1887
  - To regulate railroads through ICC agency oversight;
  - Was amended in 1910 to apply to telegraphy and telephony;
  - Provided the framework for Title II of the Communications Act of 1934 (creating the FCC).

How Did Common Carriage Initially Apply to Information Services?

- The FCC developed a classification scheme through the *Computer Inquiry* proceedings.
- Enhanced service is offered over transmission facilities employing computer processing applications that act on the subscriber's transmitted information.
  - Classified as not common carriage.
  - But has a separable telecommunications service component, i.e. basic service, classified as common carriage.
- Basic service is the transmission capability over a communications path.
  - Classified as a Title II common carriage service to endusers, and available to ESPs on a Title II common carriage basis per FCC rule.

… And to DSL?

- After enactment of the Telecommunications Act of 1996, the FCC applied the same framework to DSL in 1998.
  - DSL is a Title II common carriage service to endusers.
  - The telecommunications component of DSL must be available on a Title II common carriage basis to ISPs per FCC rule.

What was the Radical Policy Departure for Broadband Services?

- Classification of broadband Internet access services as title I information services
  - FCC Cable Modem Declaratory Ruling (2002)
  - FCC Wireline Broadband Order (2005)
- These rulings have created *shadow common carriers for broadband services*.
  - VOIP is also shadow common carriage where the FCC has failed to classify such service.

How Does the Growth of Shadow Common Carriers Create Systemic Risk?

- (1) Disrupts the legal interrelationships among industry-specific and general business legal regimes.
- (2) Creates or exacerbates problematic, inter-infrastructure effects.
  - (a) Within the communications sector.
    - Unavailability of any common carriage communications service.
  - (b) With the U.S. Postal Service (USPS) system.
    - Threatens financial viability of USPS.
  - (c) With the transportation and electricity sectors.
    - Cascading failures among infrastructures.

How is Systemic Risk Compounded By A Less Adaptable Policymaking System?

- Deregulatory policies create *mechanisms of entrenchment* that make the U.S. policymaking system less adaptable.
  - (1) Through policies of federal preemption.
    - Which blocks state policy experimentation.
  - (2) Through recognition of constitutional rights of communications providers (particularly Free Speech).
    - Which blocks federal policy experimentation.
  - (3) Through combinatorial effects with subsequent legal developments in other bodies of law.
    - *E.g. Citizens United v. FEC further elevates free speech rights of corporate broadband providers to block federal policy experimentation.*

Concluding Comments

- Growth of shadow common carriers creates or exacerbates systemic risks through creation of legal gaps among bodies of law as well as negative inter-infrastructure effects.
- Systemic risk is further compounded by mechanisms of entrenchment - enabled by deregulatory policies - that block policy experimentation and render the U.S. policymaking system less adaptable to respond.