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Electronically Filed

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: CC Docket Nos. 01-337, 02-33

Dear Ms. Dortch:

I am writing on behalf of AT&T Corp. to respond to the January 7, 2004 *ex parte* letter filed in the above-referenced dockets by William P. Barr of Verizon Communications ("*1/07/04 Barr Letter*"). Mr. Barr claims to have identified the issues that are "most critical" to "near term deployment" of "next generation broadband networks." Of course, the *Triennial Review Order* just granted Verizon the sweeping relief from § 251 unbundling obligations that Mr. Barr had previously identified as "most critical" to broadband deployment. Mr. Barr now suggests that the Commission must take additional steps that would scrap not only central aspects of its most recent broadband rulings, but also the Act's core nondiscrimination requirement.

Mr. Barr first contends that the Commission must "clarify" ambiguities in the *Triennial Review Order*, which, he claims, left open whether: (i) § 271 unbundling obligations even apply to "broadband" elements; (ii) the "mass market" label and "fiber-to-the-home" unbundling restrictions apply to businesses with *48* telephone lines; and (iii) fiber that stops well short of customer premises should be treated as if it were fiber to the premises.[1] As AT&T and others have demonstrated in their oppositions to the Bell's reconsideration and forbearance petitions, there are no such ambiguities. Verizon, in truth, asks the Commission to reverse express

[1] *Id.* at 2-4.

findings in the *Triennial Review Order* and to adopt new rules that, in each instance, are foreclosed by the plain text and pro-competitive purposes of the Act.[2]

Mr. Barr next contends that the Commission should conclude its *Wireline Broadband Classification* proceeding (CC Docket No. 02-33) by promulgating regulations that provide for "the same regulatory classification to telephone company-provided broadband services that the Commission already has applied to cable broadband."[3] But, as Mr. Barr recognizes, *Brand X Internet Services* v. *FCC*[4] expressly *rejected* the regulatory service classification that the Commission applied to cable broadband. Mr. Barr contends that the Commission would "enhance" its "litigation posture" by thumbing its nose at the Ninth Circuit and applying the same rejected regulatory classification to the telephone-company provided broadband services that Verizon claims are identical to cable broadband services in all relevant respects.[5] It should be obvious that such reckless action would have precisely the opposite effect, inviting an embarrassing rebuke from the Ninth Circuit that could only further limit the Commission's ultimate policy discretion. As detailed below, Mr. Barr's suggestions on how the Commission might parse the *Brand X* decision in an attempt to justify the same result on different grounds are equally meritless.

There is, moreover, absolutely nothing pressing about Verizon's issues that could justify such injudicious action. Although this latest volley in Verizon's crusade to perpetuate voice monopoly and broadband duopoly sounds the familiar broadband deployment refrain, Mr. Barr stops well short of any claim that the Bells' deployment plans are influenced in the slightest by the few remaining broadband consumer protections that Verizon would like repealed. As Bell executives have let slip more than a few times, their broadband investment pleas were hollow political rhetoric even when focused on broad § 251 unbundling at TELRIC rates. It would be quite preposterous to claim that the much more modest obligations at issue here make a difference in real world deployment plans. Verizon, for example, having pledged to the

[2] These arguments have been fully addressed in pleadings filed in the *Triennial Review* and other dockets. *See*, *e.g.*, Opposition of AT&T Corp. to BellSouth Petition for Reconsideration, CC Docket No. 01-338 (filed November 6, 2003); Reply Comments of AT&T Corp. to Petitions for Reconsideration, CC Docket No. 01-338 (filed November 17, 2003); Opposition of AT&T Corp. to Petition for Forbearance of the Verizon Telephone Companies, CC Docket No. 01-338 (filed November 17, 2003); Comments of AT&T Corp. on Petition of Bellsouth Telecommunications For Forbearance, CC Docket No. 03-220 (filed November 10, 2003); Reply Comments of AT&T Corp., CC Docket No. 03-220 (filed November 25, 2003).

[3] *Id.* at 4.

[4] 345 F.3d 1120 (9th Cir. 2003)

[5] *1/07/04 Barr Letter* at 5.

Commission during the *Triennial Review* proceedings that it had every intention of *voluntarily* offering broadband transport subject to the § 201 requirements of just, reasonable and nondiscriminatory terms, can hardly claim now that its broadband plans are threatened by § 271 or *Computer Inquiries* obligations to grant access on just, reasonable and nondiscriminatory terms.

Verizon's Request That The Commission Ignore *Brand X*.

In *Brand X*, the court of appeals reversed and vacated the *Cable Modem Classification Order*.[6] In that order, the Commission ruled that cable modem services provided to retail customers were "information services" within the meaning of section 3(41) of the Communications Act and, therefore, were not subject to the "common carrier" requirements of Title II of the Communications Act.[7] The Court of Appeals disagreed, holding that cable broadband service was "part 'telecommunications service' and part 'information service.'"[8] Thus, under *Brand X*, the transmission component of retail cable modem service – *i.e.*, the physical transport of information between the end-user customer and the ISP – is subject to Title II.

Mr. Barr contends that principles of "regulatory parity" somehow demand that the Commission now hold in its ongoing *Wireline Broadband Classification* proceeding that Bell-provided DSL services are pure "information services" that are outside the ambit of Title II. What Mr. Barr is really advocating is regulatory *disparity*. Before the Ninth Circuit, Verizon stressed that "any entity offering telecommunications services – whether a local telephone network, an upgraded cable system, or an electric utility – is regulated as a provider of telecommunications services, 'regardless of the facilities used.'"[9] Verizon further stressed that cable modem and DSL service are "functionally equivalent communications services";[10] like cable modem services, Verizon's DSL service "consists of two elements: a 'pipeline . . . and the Internet service transmitted through that pipeline."[11] Thus, under *Brand X*, "to the extent that [a carrier] provides its subscribers Internet transmission over its [own] cable broadband facility" –

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6 Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities*, 17 FCC Rcd. 4798 (2002).

7 *Cable Modem Classification Order* ¶ 33 & n.139.

8 *Brand X*, 345 F.3d at 1132.

9 Brief for Petitioner Verizon, Nos. 02-70518 *et al.*, at 20 (9th Cir. Oct. 10, 2002) ("Verizon *Brand X* Br.").

10 *Id.*

11 *Brand X*, 345 F.3d at 1129.

as Verizon does when it offers DSL – "it is providing a telecommunications service as defined in the Communications Act."[12]

Disregarding the holding of *Brand X* in the manner advocated by Verizon would certainly not "enhance" the Commission's "litigation posture."[13] Rather such action would only invite an embarrassing rebuke by the Court of Appeals.[14] And the Commission should be particularly reluctant to flout the *Brand X* mandate given that the Commission has for nearly a decade been unable to provide the Ninth Circuit with a suitable justification for its *Computer II* elimination of structural separation in favor of the lesser nondiscrimination safeguards that Verizon now asks the Commission to repeal.[15]

Alternatively, Mr. Barr argues that the *Brand X* decision was quite "narrow" and that the Commission remains free to move ahead on other aspects of the Bells' deregulatory agenda – *i.e.*, repeal of the *Computer Inquiries* regime and elimination of Title II regulation of stand-alone broadband transport services provided to ISPs.[16] Again, the opposite is true. As the Commission has repeatedly recognized, the appropriate regulatory classification of wireline broadband services is a "critical" "first-step" in determining what regulation should apply to these

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[12] *Id.*

[13] *1/07/04 Barr Letter* at 5.

[14] For example, after the Eighth Circuit struck down the Commission's TELRIC rules on jurisdictional grounds, the Commission asserted that it would apply those rules in its review of Bell section 271 applications. Despite the Commission's undisputed jurisdiction over section 271 applications, the Eighth Circuit issued a writ of mandamus to prevent the Commission from "indirectly" applying its TELRIC rules in this manner. *Iowa Utils. Bd.* v. *FCC*, 135 F.3d 535, 537 (8th Cir. 1998).

[15] *See California* v. *FCC*, 39 F.3d 919 (9th Cir. 1994), *cert. denied*, 115 S.Ct. 1427 (1995); *Further Notice of Proposed Rulemaking*, 13 FCC Rcd. 6040 (1998). Mr. Barr insists that the Ninth Circuit's earlier *Portland* decision, upon which the *Brand X* panel relied was "influenced" by the inconsistency between the Commission's treatment of cable modem services and other types of broadband services, and that the Commission would help itself on rehearing *en banc* by acting now to confirm that it views DSL services as subject to the same regulatory classification that *Brand X* rejected for cable modem services. But if the Ninth Circuit grants rehearing, the *en banc* court will be well aware that the Commission has *already* proposed to extend the same regulatory classification to DSL services that it applied to cable modem services. Acting on that proposal now could not therefore serve the purpose that Mr. Barr posits and would instead only invite the adverse consequences that traditionally accompany agency action that treats a reviewing court's opinion with contempt.

[16] *1/07/04 Barr Letter* at 5.

services.[17] This was also the Court's view in *Brand X*. The Court *reversed and remanded* the portions of the *Cable Modem Classification Order* that had purported to hold that Time Warner's dealings with AOL were "private carriage" and that had "waiv[ed] . . . *Computer II* requirements for cable companies who also offer local exchange service," finding that the appropriate resolution of these issues necessarily "revolve[s] around the FCC's central classification decision."[18]

But even if there were no logical relationship between the appropriate regulatory definition of DSL services and the additional relief requested by Verizon with respect to the regulations that govern "wholesale" access to its network by ISPs and competitive carriers, Verizon's request should still be denied.[19] Verizon's argument rests almost entirely on the simplistic observation that in many areas retail DSL offerings face competition from cable modem services with respect to which Title II sharing obligations are not today being enforced.[20] But the existence of duopoly competition is not a sound basis for elimination of bedrock nondiscrimination and unbundling requirements.

The *Computer Inquiries* rules grant ISPs *wholesale* access to Bell network facilities. Clearly, so long as there are no, or limited, alternatives to the Bells' last mile transport facilities, there is a danger of market power abuse by the Bells and existing wholesale access obligations remain necessary. And that is the case for ISPs today. Generally, ISPs have no alternative but the Bells to reach their customers. And although some cable companies have begun providing access to some ISPs in some markets, there is no cable alternative for most ISPs in most markets. Because there is no place else for ISPs or competitive carriers to turn, the Bells plainly have the ability to demand unreasonable and anticompetitive access terms (or to deny access altogether).

Mr. Barr argues that the existence of effective *retail* competition from cable providers removes the Bells' incentives to abuse that power.[21] Although not spelled out in any detail, Mr. Barr appears to be arguing that the Bells (like their cable competitors) will have incentives to grant third party access to their broadband facilities upon reasonable terms and conditions simply to please and attract retail consumers to their networks. This argument founders both as a matter

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[17] Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 17 FCC Rcd. 3019, ¶ 30 (2002); *see also generally Cable Modem Classification Order*, Separate Statement of Chairman Michael Powell.

[18] *Brand X*, 345 F.3d at 1132 n.14.

[19] *See 1/07/04 Barr Letter* at 5-7.

[20] *Id.* at 7.

[21] *Id.* at 6.

of theory and fact. The Bells have unique anticompetitive incentives, that in the context of existing and foreseeable levels of competition, clearly will *not* lead them to accommodate reasonable access requests from their competitors.

The Bells themselves have conceded, as they must, that broadband services "*cannibalize the traditional services offered by ILECs.*"[22] For example, DSL is a substitute for premium-priced T1, fractional T1, and ISDN services that the Bells provide to small businesses. Likewise, one "cost[]" of DSL is the fact that "about 30% of new DSL subscribers give up a second phone line" which earns the Bells higher margins than DSL.[23] Finally, with the advent of voice-over-Internet protocol ("VoIP"), increased deployment of DSL potentially threatens the revenues the Bells earn from primary lines and long distance services.

For these reasons, when the Bells raise prices for DSL, they both increase the margins on that service *and* diminish the incentives of current second line/T1 subscribers to switch to DSL, thereby increasing revenue from those legacy services (and overall Bell profits).[24] These same incentives mean that the Bells have little interest in offering competitively-priced access to their last-mile broadband transport to ISPs. The Bells know that if they give reasonable wholesale access, ISPs using that access will both undercut the Bells' bloated DSL charges and "overpromote" DSL in ways that could only accelerate the cannibalization of high margin Bell services.[25]

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[22] Reply Comments of BellSouth, Att. 1, NERA Reply Report ¶ 167 (filed CC Docket No. 01-338, July 17, 2002) ("BellSouth Triennial Review Reply") (emphasis added). *See also* Goldman Sachs, *Telecom Services*, at 15 (June 11, 2002) ("[A] negative side effect of adding a DSL subscriber is the potential loss of a second line that the customer had previously subscribed to. *SBC estimates that as much as one-half of customers with second lines that sign up for DSL service disconnect their second lines, Verizon estimates that this figure is closer to three-quarters.* . . . Second lines generate only $25 per month in revenue and come at a very low incremental cost to the provider, implying very high returns. Alternatively, DSL requires significant upfront acquisition costs as well as infrastructure costs. . . . *A DSL subscriber often comes at the expense of a disconnected second line, which means $25 in high-margin revenues are lost.*") (emphasis added).

[23] BellSouth Triennial Review Reply, Harris Reply Dec., Att. 2 (DSL Business Case) at 3.

[24] It presumably for this reason that the Bells have stated publicly that DSL is priced "too low." Vikas Bajaj, *Broadband Prices Too Low, Verizon Exec Says*, Dallas Morning News (June 5, 2002) ("Digital subscriber lines, which cost about $50 a month today, should be 40 percent to 50 percent more expensive, [Verizon's Vice Chairman and President] told reporters at a news conference.").

[25] This analysis also explains why the Commission could retain existing *Computer Inquiries* obligations on the Bells while not imposing such requirements on cable companies. *Cf. 1/07/04*

Moreover, economic theory – and Commission precedent – teaches that the Bells' strong incentives to price DSL at competitive levels and deny ISPs reasonable access arrangements is not overcome by mere duopoly competition.[26] In this regard, the mere fact that cable has a higher market share in some local markets does not mean that there is no competitive concern regarding Bell DSL services. Duopoly "competition" is problematic not just because the firm with the larger market share may exercise market power, but because *both* participants are likely to have the incentive and ability to maintain prices above competitive levels rather than attempting ruthlessly to compete with the other, as they would need to do in a market with multiple firms.[27] Notably, its *Mass Media Ownership Order*, the Commission held that "both economic theory and empirical studies" indicate that "five or more relatively equally sized firms" are necessary to achieve a "level of market performance comparable to a fragmented, structurally competitive market."[28]

Ultimately, the Commission need not guess as to whether the Bells' enjoy market power because there is hard evidence confirming it. The Bells' ability to retain – and gain – customers notwithstanding prior and continuing DSL price hikes that were unmatched by cable companies confirms that the Bells enjoy market power even where they face cable "competition."[29] Ironically, the Bells themselves have proffered evidence demonstrating that they do not face effective broadband competition. In responding to AT&T's recent petition that demonstrated that the Bells are earning extraordinarily high and increasing rates of return on special access, the

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Barr Letter at 6.

[26] *See EchoStar-DirecTV Merger Order*, 17 FCC Rcd. 20559, ¶ 103 (2002) ("[E]xisting antitrust doctrine suggests that a merger to duopoly or monopoly faces a strong presumption of illegality."); *id.*, Statement of Chairmen Powell ("At best, this merger would create a duopoly in areas served by cable; at worst it would create a merger to monopoly in unserved areas. Either result would decrease incentives to reduce prices, increase the risk of collusion, and inevitably result in less innovation and fewer benefits to consumers. That is the antithesis of what the public interest demands."). *Accord FTC* v. *H.J. Heinz Co.*, 246 F.3d 708, 717 (D.C. Cir. 2001).

[27] *See* United States Department of Justice/Federal Trade Commission, *Horizontal Merger Guidelines*, Section 2 (rev. Apr. 8, 1997).

[28] Report and Order and Notice of Proposed Rulemaking, *Review of the Commission's Broadcast Ownership Rules*, 18 FCC Rcd. 13620, ¶ 289 (2003).

[29] After the collapse of the data carrier industry, the Bells responded by raising their prices by 25% and ending the prior practice in which their retail services that used the lowest-speed Internet access service had been priced at the same level as cable modem service. *See* Comments of AT&T, Willig Dec. ¶¶ 21-23, 102-13, CC Docket No. 01-337 (filed Mar. 1, 2002).

Bells claimed that these returns were skewed due to the fact that the Bells book DSL revenues and costs in their interstate accounts. Specifically, the Bells contended that they can provide DSL at very low incremental costs, that they have experienced "dramatic increases in . . . earnings attributable to these [DSL] services," and that these "dramatic" profits have been driving up their reported rates of return.[30] In competitive markets, of course, revenues would be driven towards (low) incremental costs. And SBC just this month substantially increased the price of its DSL service – a move that analysts hailed as likely to have no impact on "DSL growth" while "higher prices, with no loss of demand, allows for higher profitability (*i.e.* the incremental $3 falls directly to the bottom line)."[31]

Second, even the Bells' duopoly premise is false in many respects. "[T]he geographic scope of the market for broadband access is local,"[32] and, as the Commission has recognized, what is true for "any technology" in the early stages of development is particularly true for broadband: deployment "is not uniform across the nation."[33] And in some residential areas, cable broadband service is not available to anyone.[34] This is particularly true for business customers. Cable is not generally available in business districts at all; virtually all small business customers of cable are in suburban areas that contain or are immediately adjacent to residences.[35]

Verizon also seeks the right to offer transport to preferred customers outside the Title II framework that would otherwise apply. Mr. Barr argues that all such voluntary offerings should be deemed "private carriage" governed by Title I (or, alternatively, that the Commission should simply waive application of core Title II regulation).[36]

The Commission cannot, as the Bells urge, fabricate a blanket Title II exemption for all stand-alone broadband transmission services – and thereby permit the Bells to offer stand-alone broadband transport as a "private carriage" service, provided on Bell-imposed terms only to Bell-selected customers. The Bells' networks were built for and have always been operated to

[30] Opposition of Verizon, Attach., Kahn-Taylor Dec., at 15, RM No. 10593 (filed Dec. 2, 2002).

[31] Goldman Sachs, *SBC: DSL Price Hikes Indicate Confidence In Demand At Higher Prices* (Feb. 2, 2004).

[32] Reply Comments of BellSouth, Harris Dec. ¶ 6, CC Docket No. 01-337 (filed Apr. 22, 2002).

[33] *Second Section 706 Report*, 15 FCC Rcd. 20913, ¶ 1 (2000).

[34] *See Third Section 706 Report*, 17 FCC Rcd. 2844, App. C, Table 9, (2002).

[35] *Ex Parte* Letter from David Lawson, AT&T, to Marlene Dortch, FCC, at 2-5, CC Docket No. 02-33 (filed Feb. 4, 2003).

[36] *1/07/04* Barr Letter at 5.

provide transmission to any customer who requests it. Common carriage is the wireline rule, and private carriage the rare exception that applies only to ancillary or specialized services.[37] Stand-alone broadband transmission is obviously neither. Deeming these stand-alone transport services to be private carriage is also inappropriate because regulation is necessary to protect the public interest and competition from Bell market power abuses.[38] As the Commission has held in the past, private carriage status is inappropriate when "the public interest requires common carrier operation of the proposed facility" – *i.e.*, where "alternative common carrier facilities" are not available.[39] As explained above, there are *no* "alternative common carrier facilities" to the Bells' DSL transport facilities that can be utilized by ISPs.

The precedent cited by the Bells makes clear that the Commission has no authority to insulate whole categories of transmission services that are generally demanded and used by large classes of customers and that have heretofore been provided on a common carrier basis from Title II regulation. In *National Ass'n of Regulatory Util. Comm'r* v. *FCC* ("*NARUC I*"),[40] the Court upheld the Commission's decision to grant "private carrier" status to new entrant mobile radio operators that were seeking to provide dispatch services to entities that *already* self-provided their own dispatch services (and, as such, were clearly private carriers). Thus, the Court upheld the Commission's "private carriage" determination on the grounds that that this type of mobile service had never been offered on a common carrier basis in the past and going forward it would continue to be offered exclusively on an individual case basis because the unique nature of the service and the lack of general demand for the service (as existing users generally self-provided their own service).[41] The Court also observed that common carrier status did not turn on whether the entity was serving the "whole public" and that "[o]ne may be a common carrier though the nature of the service rendered is sufficiently specialized to be of possible use to only a fraction of the total population."[42] Finally, the Court emphasized that the Commission had no "discretion . . . to confer or not confer common carrier status on a given entity, depending upon the regulatory goals it seeks to achieve" and that if "experience" demonstrated that the Commission's initial prediction that the new mobile services were in fact

[37] Reply Comments of AT&T at 26-28 (filed CC Docket No. 02-33, Jul. 1, 2002).

[38] *Cf.* 1/07/04 Barr Letter at 6.

[39] *Cable & Wireless, PLC*, 12 FCC Rcd. 8516, ¶ 15 (1997); *Japan-US Cable Order*, 14 FCC Rcd. 13066, ¶ 39 (1999) (holding that *National Association of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630, 642 (D.C. Cir.) "directs us to consider whether there is any legal compulsion to serve the public indifferently. In applying this prong of the test . . . the Commission has . . . generally focused on the availability of alternative facilities").

[40] 525 F.2d 630 (D.C. Cir. 1976).

[41] *Id.* at 639-40, 643.

[42] *Id.* at 641.

being offered on a common carrier basis, then the Commission was required to subject those services to Title II.[43]
Nor does *Virgin Island Tel. Corp.* v. *FCC*,[44] support Verizon's position. There, the Court upheld an order of the Commission granting private carrier status to a new submarine cable after finding that there was no general demand for services on the cable and that the cable operator only intended to deal with third-parties on an individualized basis. In this regard, both the Court and the Commission emphasized that under *NARUC I*, common carrier operation would be required to the extent that the cable operator may posses any "market power" because of the lack of "alternative[s]" to those facilities.[45] Similarly, in *Computer and Communications Indus. Ass'n* v. *FCC*,[46] rather than finding that the Commission has carte-blanche to reclassify common carrier transport services, the Court upheld the Commission's *Computer II Order* that mandated that when a dominant Bell company offers enhanced service, it must unbundle and tariff the underlying transmission facilities and offer access to those facilities on a common carrier basis – *i.e.*, upon non-discriminatory terms and at just and reasonable rates.[47]

In sum, both Title II regulation and the *Computer Inquiries* nondiscrimination and unbundling requirements remain continue to serve the public interest and remain necessary. Given the real world marketplace conditions that Verizon would have the Commission ignore, the Commission would, in any context, face an uphill battle in attempting to sustain an order that jettisoned those requirements. But the most irresponsible approach of all is the one that Mr. Barr urges here: *i.e.*, to disregard the *Brand X* decision and simply plow ahead as if the Ninth Circuit had never ruled.

Sincerely,

/s/ David L. Lawson

David L. Lawson

cc:

Scott Bergmann

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[43] *Id.* at 644.

[44] 198 F.3d 921 (D.C. Cir. 1999).

[45] *Id.* at 925.

[46] 693 F.2d 198 (D.C. Cir. 1982).

[47] *Computer II Order*, 77 F.C.C. 2d 384 (1980) (adopting 47 C.F.R. § 64.702).

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