Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Biennial Regulatory Review of Regulations Administered by the Wireline Competition Bureau	WC Docket No. 04-179

COMMENTS OF THE VERIZON TELEPHONE COMPANIES

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SUMMARY

The current regulatory regime—created on the assumption that the only way to achieve "competition" would be to rely on, or duplicate, LECs' copper, wireline networks—simply does not work in the current real-world environment. In recent years, intermodal competition has flourished in both the market for broadband Internet access service and the market for local telephone service. Cable operators dominate the broadband market with almost a 60% market share and currently boast penetration levels as high as 40% in certain local voice markets. ILECs such as Verizon are faced with significant additional competition in the broadband market from both CLECs and wireless carriers, not to mention burgeoning new technologies, such as fixed wireless, power lines, satellite, and 3G mobile wireless, which are continuing to develop and provide ever-increasing competition. ILECs similarly face significant competition in all segments of the local telephone market from wireless carriers, cable companies, VOIP providers, CLECs, and other new entrants. The advent of VOIP, for example, presents cable companies themselves, as well as other providers who can offer voice telephony to any of the 85-90 percent of U.S. homes with access to cable modem service, to continue and expand their competitive assault on traditional wireline carriers in the voice telephony market. And wireless carriers continue to displace millions of lines, and, just as significantly, billions of minutes that once would have been served by traditional wireline carriers.

Rather than promoting competition, current regulations are undermining it by inhibiting investment by ILECs and their competitors alike. Verizon has announced it plans to spend $1 billion during 2004 to invest in next-generation broadband deployment, in order to compete with the dominant (and largely unregulated) cable providers. However, it still faces the specter of the Title II requirements – including the requirement that ILECs offer services separately under tariff on cost-based terms and conditions, broadband unbundling obligations under Section 271,

uncertainty about definitional rules of "mass market" and "fiber to the home" ("FTTH") that invite CLECs to push for additional unbundling requirements, *Computer Rules,* and growing attempts from state regulators to impose conditions that cable competitors do not face. Similarly, retention of the TELRIC pricing regime for unbundled network elements ("UNEs") will only discourage competitors from investing in their own facilities-based competition in the provision of voice services, or LECs from upgrading existing networks.

The Public Notice in this proceeding kicks off the "comprehensive 2004 biennial review of telecommunications regulations." Public Notice, The Commission Seeks Public Comment in the 2004 Biennial Review of Telecommunications Regulations, FCC 04-105, at 1 (rel. May 11, 2004) ("*Notice*"). At Exhibit B to these comments, Verizon responds to the Commission's request that it "identify with as much specificity as possible the rule or rules that should be modified." *Id.* However, the Commission should not take merely a rule-by-rule approach, but should instead use this process as an opportunity to undertake a more thorough reform of the way that telecommunications carriers will be regulated in this age of unsurpassed intermodal competition. There are a number of significant regulatory burdens imposed by the Commission's existing rules which are unnecessary under current and future market conditions and that should be eliminated under the standards in the Act. In particular, the Commission should act expeditiously to eliminate the regulatory burdens on wireline broadband Internet access services and should forbear from any broadband unbundling obligations that Section 271 may be construed to impose in order to better reflect the realities of today's competitive broadband market. In addition, the Commission should promptly reform its TELRIC pricing regime to restore correct investment incentives and to preserve the constitutional rights of local exchange carriers, who are entitled to non-confiscatory rates for the provision of their services.

The Commission should move toward the elimination of all economic rate regulation, which is not necessary given the state of competition, as market forces effectively constrain the prices carriers can charge for their services.

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The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) ("1996 Act"), requires the Commission to eliminate outdated rules that are no longer necessary due to increased competition and allows it to forbear from applying other requirements of the Act when it is in the public interest to do so. *See* 47 U.S.C. §§ 160, 161. The Public Notice asks the public to identify the rule or rules that should be modified or repealed as part of the Commission's "comprehensive 2004 biennial review of telecommunications regulations." *Notice*, at 1. If the biennial review is to have any teeth, the Commission must use it to undertake the kind of thorough changes that are needed in order to reflect the significant developments that have occurred in the competitive landscape over the past several years. Indeed, these reforms are long overdue. Verizon's comments in this proceeding largely echo the proposals that Verizon made in the 2002 biennial review, and involve changes that have been already proposed in several proceedings currently pending before the Commission.[2] There already exists a more than adequate record to eliminate many legacy regulations that are no longer necessary.

[1] The Verizon telephone companies ("Verizon") are the local telephone companies affiliated with Verizon Communications Inc. These companies are listed in Exhibit A.

[2] *See* Verizon Comments, WC 02-313 (filed Apr. 19, 2002).

Specifically, the Commission should eliminate the regulatory burdens on wireline broadband Internet access services, forbear from any broadband unbundling obligations that Section 271 might be construed to impose, and reform its TELRIC rules. These rules fall squarely within the statutory category of regulations that are no longer needed due to competitive developments and are exactly the types of rules that Congress intended for the Commission to repeal or modify as part of its biennial review and forbearance activities.

The rules that currently apply to wireline broadband Internet access services are vestiges of a regulatory regime that was reflexively extended from the narrowband context, without regard to competition in the broadband market. In light of competitive developments, these rules can no longer be justified. Indeed, in the 2002 Biennial Review, the Staff of the Wireline Competition Bureau found that the rules governing wireline broadband services "may no longer be necessary in the public interest as a result of meaningful economic competition," but the Commission has yet to take any action to eliminate or change them.[3] As confirmed by the *Triennial Review Order* and the D.C. Circuit's decision affirming the Commission's decision in that order not to require broadband unbundling under Section 251, broadband unbundling rules under Section 271 also have no place in today's competitive environment. The Commission's TELRIC pricing regime similarly requires reform because competition has developed to an even more robust state than Congress envisioned and because the continued availability of network elements at below-cost rates will only impede further competitive developments.

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[3] *2002 Biennial Regulatory Review*, 18 FCC Rcd 4410, ¶¶ 34-39 (2002) (discussing Part 64, Subpart G, which includes the *Computer Rules*). Although the Staff recommended that changes to the *Computer Rules* be considered in separate proceedings, *see id.* at ¶ 39, the Commission has had a complete record before it in two separate proceedings regarding the appropriate classification and regulation of wireline broadband Internet access services that have been pending for over two years now and has yet to act. *See generally Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 17 FCC Rcd 3019 (2002) ("*Wireline Broadband NPRM*"); *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, 16 FCC Rcd 22745 (2001) ("*ILEC Broadband NPRM*").

The Commission's regulations in the areas of broadband Internet access, any broadband unbundling obligations that Section 271 might be interpreted to impose, and the TELRIC regime are not only no longer *necessary* in the current competitive marketplace, but are affirmatively *harmful* to competition and investment. Indeed, beyond just eliminating the TELRIC regime, the Commission should consider how to eliminate economic regulation altogether. Given the competition wireline carriers face from cable companies, wireless carriers, VOIP providers, and others, the marketplace effectively constrains the prices carriers can charge, and thus economic regulation is no longer necessary. Removal of these onerous regulatory requirements will help to send the correct economic signals to all participants—incumbent carriers, competitive carriers, intermodal competitors, and end-users alike—in the competitive broadband and local exchange markets, thereby helping to remove disincentives to investment and clearing the way for the development of additional competition. Moreover, to the extent that the Commission has committed through this proceeding to simply eliminate needless regulations, it should undertake the specific reforms outlined in Exhibit B.

I. THE COMMISSION BEARS A STATUTORY OBLIGATION TO REPEAL OR MODIFY RULES THAT ARE NO LONGER NECESSARY IN THE PUBLIC INTEREST IN LIGHT OF THE PRESENCE OF MEANINGFUL ECONOMIC COMPETITION.

The 1996 Act was primarily intended "to promote competition and reduce regulation." 1996 Act, Preamble. The federal courts, including the Supreme Court, and the Commission have recognized the 1996 Act's overarching goals of "reduc[ing] regulation"[4] and "promot[ing] competition in the communications industry."[5] As part of the statute's deregulatory program,

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[4] *Reno v. ACLU*, 521 U.S. 844, 857-58 (1997); *see, e.g., 2000 Biennial Regulatory Review; Policy And Rules Concerning The International, Interexchange Marketplace*, 15 FCC Rcd 20008, ¶ 1 (2000).

[5] *2002 Biennial Regulatory Review*, 18 FCC Rcd 4726, ¶ 5 (2003) ("*2002 Biennial Review Report*"); *see, e.g., United States Telecom Ass'n v. FCC*, 359 F.3d 554, 561 (D.C. Cir. 2004)

Congress "included provisions to ensure that the agency would monitor the effect of . . . competition . . . and make appropriate adjustments to its rules to modify or eliminate those rules" as competition developed. *2002 Biennial Review Report*, ¶ 5.

Among other things, Congress "directed the Commission to undertake biennial assessments of its rules to determine whether they should be repealed or modified."[6] Section 11 of the 1996 Act—entitled "[r]egulatory [r]eform"—requires the Commission to review, on a biennial basis, its rules governing telecommunications carriers and to determine whether any such rules are no longer necessary in the public interest as the result of meaningful economic competition. 47 U.S.C. § 161(a). In evaluating particular regulations, the Commission must, as it has acknowledged and as the D.C. Circuit has affirmed, "reevaluate rules in light of current competitive market conditions."[7] Under the statute, once the Commission determines that a rule is no longer necessary in the public interest based upon competitive developments, repeal or modification must follow.[8] This obligation, as the D.C. Circuit has made clear, "extends *beyond*

("*USTA II*"); *see also Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 502-03 n.20 (2002) (noting the "deregulatory and competitive purposes of the [1996] Act"); H.R. Conf. Rep. No. 104-458, at 113 (1996), reprinted in 1996 U.S.C.C.A.N. 124, 124 (explaining that the purpose of the Telecommunications Act is "to provide for a pro-competitive, deregulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services . . . by opening all telecommunications markets to competition").

[6] *Cellco Partnership v. FCC*, 357 F.3d 88, 91 (D.C. Cir. 2004); *see id.* at 90 (noting Congress' "deregulatory purpose" in enacting Section 11); *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, 1033, *reh'g granted in part*, 293 F.3d 537 (D.C. Cir. 2002) (Congress intended the biennial review to "continue the process of deregulation" that the 1996 Act commenced).

[7] *2002 Biennial Review Report*, ¶ 21; *Cellco*, 357 F.3d at 98; *see also 1998 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, 15 FCC Rcd 11058, 11151 (2000) (Separate Statement of Commissioner Michael Powell) ("I start with the proposition that the rules are *no longer necessary* and demand that *the Commission* justify their continued validity") (emphases added).

[8] 47 U.S.C. § 161(b); *see Cellco*, 357 F.3d at 94 (the 1996 Act mandates that the Commission identify rules that are no longer necessary "followed by their repeal or modification").

[the Commission's] normal monitoring responsibilities."[9] Indeed, as the Commission itself has stated, "if we cannot identify a federal need for a regulation, we are not justified in maintaining [it]." *2000 Biennial Regulatory Review—Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2*, 16 FCC Rcd 19911, ¶ 207 (2001) ("*Phase 2 Order*").

Congress also provided a mechanism for forbearance from "any regulation or any provision of th[e Communications] Act." 47 U.S.C. § 160(a)(1)-(3). Section 10 allows a carrier to request forbearance and requires the Commission to justify retention of a regulation or statutory requirement subject to such a request under a specific, three-factor test, which asks: (1) whether the regulation or requirement is "necessary to ensure" just and reasonable charges, practices, classifications and regulations; (2) whether the regulation or requirement is "necessary for the protection of consumers;" and (3) whether forbearance from the regulation or requirement is "consistent with the public interest." *Id.* The statute further specifies that in assessing the public interest, the Commission "shall consider whether forbearance . . . will promote competitive market conditions." *Id.* § 160(b). The D.C. Circuit has made clear that in justifying a refusal to forbear from a particular requirement, the Commission must demonstrate that there is

[9] *Cellco*, 357 F.3d at 99 (emphasis added). Even under the Commission's "ordinary monitoring responsibilities," *id.*, it is required to "evaluate its policies over time to ascertain whether they work—that is, whether they actually produce the benefits the Commission originally predicted they would," *Bechtel v. FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992); *see, e.g.*, *Am. Trucking Assocs., Inc. v. Atchison*, 387 U.S. 397, 415-16 (1967) ("Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy."); *NBC v. United States*, 319 U.S. 190, 225 (1943) (the Commission cannot retain a rule if "time and changing circumstances reveal that the 'public interest' is not served by application of the Regulation[ ]"); *Bechtel v. FCC*, 10 F.3d 875, 880 (D.C. Cir. 1993) ("[t]he Commission's necessarily wide latitude to make policy based upon predictive judgments deriving from its general expertise implies a correlative duty to evaluate its policies over time to ascertain whether they work—that is, whether they actually produce the benefits the Commission originally predicted they would."). The rules discussed here are subject to repeal or modification under that basic requirement as well.

a "strong connection" between a rule and its purported public interest basis. *Cellular Telecomms. & Internet Ass'n v. FCC*, 330 F.3d 502, 512 (D.C. Cir. 2003).

Under these prevailing legal standards, the time has long passed for the Commission to eliminate the burdens applicable to wireline broadband Internet access services under the Title II regulations, such as tariffing, cost justification, and common carrier and *Computer Rules*, to forbear from any broadband unbundling obligations that Section 271 may be construed to impose. *See* Section II. It also should and to reform its TELRIC rules, and move toward elimination of economic rate regulation entirely. *See* Section III. The Commission also should undertake the other specific rule change suggestions Verizon has identified in Exhibit B.[10]

II. IN LIGHT OF THE DOMINANT POSITION THAT CABLE OPERATORS OCCUPY IN THE BROADBAND MARKET, THE CONTINUED IMPOSITION OF TITLE II REGULATIONS UNIQUELY ON TELCO-PROVIDED BROADBAND SERVICES IS NOT ONLY UNNECESSARY BUT AFFIRMATIVELY HARMFUL.

A. The Broadband Market Is Vibrantly Competitive And ILECs Are Not Dominant In Any Segment Of That Market.

Early in the development of the broadband mass market, cable companies emerged as the clear market leaders.[11] Today, cable has entrenched itself as the market leader and is such a significant force in the broadband market that the D.C. Circuit recently found that because of the "robust intermodal competition from cable providers[,] . . . even if all CLECs were driven from

[10] In addition to the broader reforms described in sections II-III below, these include elimination of the continuing property records rules, streamlining of accounting and ARMIS reporting requirements, elimination of the Open Network Architecture ("ONA")/Comparably Efficient Interconnection ("CEI") Reporting requirements, and other miscellaneous changes. *See* Exhibit B.

[11] *E.g.*, *Wireline Broadband NPRM*, ¶ 37; *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 14 FCC Rcd 2398, ¶ 47 (1999) ("*First Section 706 Report*").

the broadband market, mass market consumers will still have the benefits of competition." *USTA II*, 359 F.3d at 581.

According to the Commission's latest *High-Speed Services Report*, as of December 2003, cable controlled nearly *two-thirds* of all high-speed lines provided to residential and small-business customers,[12] which is the primary segment of the broadband market targeted by cable operators.[13] As of that same date, cable also controlled more than *83%* of the most rapidly growing segment of mass-market broadband lines—those capable of over 200 kbps in both directions.[14] In the top 25 Verizon MSAs, on average, 92% of the population has access to cable modem service.[15]

The Commission has repeatedly recognized that, in addition to cable and DSL, there are numerous additional platforms and technologies already competing in or poised to enter the broadband mass market.[16] Although cable is, as noted above, the market leader, the Commission

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[12] Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *High-Speed Services for Internet Access: Status as of December 31, 2003* at Table 3 & Chart 6 (June 2004), available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/hspd0604.pdf ("*High-Speed Services Report*").

[13] *Compare id.* at Table 3 (Cable provides 16,416,364 high-speed lines to residential and small-business customers) *with id.* at Table 1 (Cable provides a total of 16,446,322 high-speed lines).

[14] *See id.* at Table 4 & Chart 8.

[15] *See* Letter from Dee May, Verizon, to Marlene H. Dortch, FCC, "Technological and Market Developments Since the Triennial Review Further Demonstrate that Competitors Are Not Impaired Without Access to Unbundled Mass Market Switching", CC Docket Nos. 01-338, 96-98, 98-147, at Attachment 2 (filed June 24, 2004) ("*TRO Switching Ex Parte*"), excerpts attached hereto as Exhibit C.

[16] *See, e.g.*, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 17 FCC Rcd 2844, ¶¶ 79-88 (2002) ("*Third Section 706 Report*"); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978, ¶ 263 (2003) ("*Triennial Review Order*") ("[T]he Commission also has acknowledged the important broadband potential of other platforms and technologies, such as third generation wireless, satellite, and power lines.") (citing *Third Section 706 Report*, ¶¶ 79-88); Roy Mark, *Broadband over Power Lines: FCC Plugs In*, Internetnews.com (Apr. 23, 2003), at http://dc.internet.com/news/article.php/2195621 (Chairman Powell: "[t]he development of

has found that both cable and DSL face "significant actual and potential competition from . . . alternative broadband providers"[17] and that "the preconditions for monopoly appear absent" in the broadband market.[18] The federal courts too have acknowledged the presence of "robust intermodal competition" in the broadband market and have found that the significant level of competition is "supported by very strong record evidence."[19]

A variety of technologies compete with cable operators and wireline carriers in the broadband mass market. First, wireless carriers are deploying new fixed wireless broadband services every day and are well-positioned to increase their already significant position as competitors in the broadband market.[20] Second, as Chairman Powell recently noted, "Broadband over Power Line [("BPL")] has the potential to provide consumers with a ubiquitous third broadband pipe to the home,"[21] and recent evidence confirms the near-term promise of this emerging broadband alternative.[22] Third, analysts predict that satellite broadband "will be on the

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multiple broadband-capable platforms—be it power lines, Wi-Fi, satellite, laser or licensed wireless—will transform the competitive broadband landscape").

[17] *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee*, 15 FCC Rcd 9816, ¶ 116 (2000).

[18] *First Section 706 Report*, ¶ 48; *see Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services*, 15 FCC Rcd 11857, ¶ 19 (2000) (explaining that "no group of firms or technology will likely be able to dominate the provision of broadband services").

[19] *USTA II*, 359 F.3d at 581; *see United States Telecom Ass'n v. FCC*, 290 F.3d 415, 428 (D.C. Cir. 2002) ("*USTA I*") (emphasizing that "robust competition" exists "in the broadband market").

[20] *See Broadband Competition: May 2004*, originally Appendix A to Competition in the Provision of Voice Over IP and Other IP-Enabled Services, Prepared for and Submitted by BellSouth, Qwest, SBC, and Verizon, WC Docket 04-36, at A-9 to A-13 (filed May 28, 2004) ("*Broadband Competition May 2004*")(attached at Exhibit D).

[21] *Inquiry Regarding Carrier Current Systems, including Broadband over Power Line Systems*, 18 FCC Rcd 8498, 8514 (Separate Statement of Chairman Michael K. Powell) (2003).

[22] *Broadband Competition May 2004, A-13 to A-15.*

upswing again in 2004."[23] And fourth, 3G wireless service has taken another step closer to becoming a full-fledged competitor in the broadband market, with both Verizon Wireless[24] and AT&T Wireless[25] launching 3G wireless networks across the country and other wireless carriers testing various 3G technologies. *Broadband Competition May 2004, at A-17 to A-19.* Nextel also recently announced similar plans.[26] Broadband competition is, moreover, continuing to thrive for small-business customers just as it is for residential customers.[27]

Extensive broadband competition for large business customers also exists.[28] Recent data confirm that it is AT&T and the other large interexchange carriers—not the ILECs—that dominate this segment of the market. *Broadband Competition May 2004, at A-19 to A-21.* In addition, the availability and use of alternative last-mile broadband facilities for large businesses is rapidly increasing, just as it is for other segments of the broadband market, with growing

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[23] *Id.* at 22 (quoting Roger Brown, et al., *Smooth Sailing or the Perfect Storm?*, CED (Jan. 1, 2004)); *see id.* at 22-23.

[24] Verizon Wireless, Press Release, *Wireless Broadband Data Service Introduced in Major Metro Areas* (Sept. 29, 2003), http://news.vzw.com/news/2003/09/pr2003-09-29.html; *Broadband Competition May 2004,* at A-18.

[25] AT&T Wireless, Press Release, *AT&T Wireless Outlines Actions It Will Take to Meet 2003 Goals* (Jan. 28, 2003), http://www.attwireless.com/press/releases/2003_releases /012803_actions.jhtml (announcing plans to rollout W-CDMA in four cities (Dallas, San Diego, San Francisco, and Seattle) by year end 2004); *Broadband Competition May 2004, at A-18.*

[26] *See* Nextel, News Release, *Nextel Expands Successful Broadband Trial to Include Paying Customers and Larger Coverage Area* (Apr. 14, 2004), http://phx.corporate-ir.net/phoenix.zhtml?c=63347&p=irol-newsArticle&t=Regular&id=514459&.

[27] *See* Letter from Dee May, Verizon, to Marlene H. Dortch, FCC, WC Docket Nos. 01-337, 02-33, 98-10, 98-20 at 10-17 (filed Nov. 13, 2003) ("*Verizon November 13, 2003 Ex Parte*"); *see also* Letter from Edward Shakin, Verizon, to Marlene H. Dortch, FCC, WC Docket Nos. 01-338, 96-98, 98-147, 02-33, 01-337 (filed Jan. 15, 2003); *Broadband Competition May 2004,* at A-A-3 to A-5 & Table 3.

[28] The large business segment of the broadband market differs from other segments both because it is more mature, with competitors having first entered the market two decades ago, and because it is national in scope. *Verizon November 13, 2003 Ex Parte* at 17. As the Commission has found, it is comprised of customers that typically demand end-to-end services provided across LATAs, states, and often countries. *See, e.g.*, *Triennial Review Order*, ¶ 302 ("Enterprise market customers . . . prefer a single provider capable of meeting all their needs at each of their business locations which may be in multiple locations in different parts of the city, state or country").

numbers of companies using cable modem service, fixed wireless, and/or satellite technologies in place of or in addition to other alternatives such as high-speed ILEC lines. *Id.* at A-20.

In short, many new technologies are already being used to provide service offerings that compete with DSL and cable modem service for residential customers and business customers of all sizes, and still other new technologies with significant potential to become powerful forces are emerging. *See Broadband Competition May 2004,* at A-8 to A-21 & Tables 5 & 6. Under the Commission's own well-settled precedent, it must take all of these alternatives into account in its analysis of broadband competition,[29] particularly given that that the broadband market is still "in the earliest stages" and is evolving rapidly.[30]

B. The Significant Intermodal Competition In All Segments Of The Broadband Market Makes It Impossible For The Commission To Justify Retention Of Regulatory Restrictions Born Of Concerns Over Bottleneck Control On ILECs, Who Are Distant Second Players In That Market.

1. The Commission Should Complete the Reform of Broadband Regulations Begun in the Triennial Review Order, Including Forbearance From Applying Any Broadband Unbundling Obligations That Section 271 Might Be Construed To Impose.

The Commission should complete the deregulatory approach to broadband services that it started in the *Triennial Review Order*, and clean up a number of issues that were left unresolved

[29] The Commission has held that a proper market analysis must "examine not just the markets as they exist today," but must also take account of "future market conditions," including technological and market changes, and the nature, complexity, and speed of change of, as well as trends within, the communications industry. *Applications of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, for Consent To Transfer Control of NYNEX Corp. and Its Subsidiaries*, 12 FCC Rcd 19985, ¶¶ 7, 41 (1997) ("*Bell Atlantic/NYNEX Merger Order*"); *Applications of Teleport Communications Group Inc., Transferor, and AT&T Corp., Transferee*, 13 FCC Rcd 15236, ¶ 19 n.65 (1998); *Applications for Consent to the Transfer of Control of Licenses from Comcast Corp. and AT&T Corp., Transferors to AT&T Comcast Corp., Transferee*, 17 FCC Rcd 23246, ¶ 27 (2002); *see also Triennial Review Order*, ¶ 263 ("[T]he fact that broadband service is actually available through another network platform and may potentially be available through additional platforms helps alleviate any concern that competition in the broadband market may be heavily dependent upon unbundled access."); *FCC v. RCA Communications, Inc.*, 346 U.S. 86, 96-97 (1953); *FCC v. WNCN Listeners Guild*, 450 U.S. 582, 594-95 (1981).

[30] *Bell Atlantic/NYNEX Merger Order*, ¶¶ 40-41.

in that proceeding. In particular, it should (1) clarify that there are no obligations to unbundled broadband pursuant to Section 271; (2) provide a definition of "mass market" customers; and (3) clarify that fiber to the premises loops built to multi-unit premises ("MUPS") are, like other FTTH deployment, not subject to unbundling obligations.[31]

As both the *Triennial Review Order* and the D.C. Circuit's recent decision in *USTA II* confirm, there is no basis founded in competitive reality for imposing broadband unbundling obligations under Section 271.[32] The Commission unequivocally found, based upon the existence of robust intermodal competition in the broadband market, that ILECs "do not have to offer unbundled access" to broadband facilities. *Triennial Review Order*, ¶¶ 7, 23. This conclusion adopts all of the legal and factual findings needed to justify forbearance from any unbundling obligations that Section 271 might be construed to impose for broadband elements, including fiber-to-the-premises loops, packet-switching, and the packetized functionality of hybrid loops.

In the *Triennial Review Order*, the Commission specifically concluded that "broadband services [] are currently provided in a competitive environment," and that cable companies have "a leading position in the marketplace," while other "important [broadband] platforms and technologies, such as third generation wireless, satellite, and power lines" provide additional competition. *Triennial Review Order*, ¶¶ 262-63, 292. The D.C. Circuit affirmed that the Commission's finding of "robust intermodal competition" in the broadband market was

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[31] *See* Verizon Petition for Forbearance, CC Docket No. 01-338 (filed July 29, 2002); Verizon Response to Petitions for Reconsideration, CC Docket Nos. 01-338, 96-98, and 98-147 (filed Nov. 6, 2003).

[32] *See* Letter from Dee May, Verizon, to Marlene H. Dortch, FCC, WC Docket Nos. 01-337, 01-338, 02-33, 02-52, Attachment 1 (filed March 26, 2004) ("*Verizon March 26 Ex Parte*"); *see also* Letter from Susanne A. Guyer, Verizon, to Chairman Powell and Commissioners, FCC, CC Docket No. 01-338 (filed Oct. 24, 2003); Reply Comments of Verizon on Petition for Forbearance of the Verizon Telephone Companies, CC Docket No. 01-338 (filed Nov. 26, 2003).

"supported by very strong record evidence," and viewed that finding as "*[m]ore important*" than any other factor justifying the Commission's decision not to require unbundling for broadband elements under Section 251.[33]

These conclusions reached by both the Commission and the D.C. Circuit with respect to competition confirm that there is no basis for imposing any broadband unbundling obligations under Section 271 and that forbearance is appropriate. Indeed, the Commission itself has previously determined that "competition is the *most effective means* of ensuring that . . . charges, practices, classifications, and regulations . . . are just and reasonable, and not unjustly or unreasonably discriminatory" in compliance with Section 10(a)(1). *Petition of US West Communications Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, 14 FCC Rcd 16252, ¶ 31 (1999). So, too, is the presence of abundant competition sufficient to ensure that enforcement is not necessary to protect consumers and that forbearance is in the public interest.[34]

In addition to concluding that unbundling was unnecessary due to competition, the Commission found in the *Triennial Review Order* that imposing unbundling obligations in the broadband context was affirmatively harmful, stating that such obligations "would blunt the deployment of advanced telecommunications infrastructure by incumbent LECs and the incentive for competitive LECS to invest in their own facilities." *Triennial Review Order*, ¶ 288. In contrast, the Commission determined that declining to impose unbundling requirements would promote competition by "giv[ing] incumbent LECs the incentive to deploy fiber . . . and develop new broadband offerings" and by "stimulat[ing] competitive LEC deployment of next generation

[33] *USTA II*, 359 F.3d at 582 (emphasis added); *see id.* at 585 (stating that "intermodal competition from cable ensures the persistence of substantial competition in broadband").

[34] *See* 47 U.S.C. §§ 10(a)(2)-(3); *see also Verizon March 26 Ex Parte*, Attachment 1, at 10-22.

networks, . . . including the deployment of their own facilities necessary for providing broadband services to the mass market." *Id.* at ¶ 290. The D.C. Circuit affirmed the Commission's findings on this score as well, agreeing, for example, that imposing unbundling requirements on hybrid loops "would deter CLECs themselves from investing in deploying their own facilities, possibly using different technology" while declining to impose unbundling requirements would provide ILECs with "greater incentives . . . to deploy the additional electronic equipment needed to provide broadband access over a hybrid loop." *USTA II*, 359 F.3d at 581. The Court reached similar conclusions with respect to the other broadband elements at issue in the *Triennial Review Order*.[35]

Because of the competitive harm that would have been caused by broadband unbundling obligations, the Commission found in the *Triennial Review Order* that such requirements would stand "in direct opposition to the express statutory goals authorized in section 706." *Triennial Review Order*, ¶ 288.[36] The D.C. Circuit agreed in *USTA II*, finding that "an unbundling order's impact on investment" must be considered given Section 706's goal of moving beyond "competition piggy-backed on ILEC facilities . . . [by] removing barriers to infrastructure investment." *USTA II*, 359 F.3d at 579.

[35] *USTA II*, 359 F.3d at 584 (finding, with respect to FTTH loops, that: An "unbundling requirement . . . seems likely to delay infrastructure investment, with CLECs tempted to wait for ILECs to deploy FTTH and ILECs fearful that CLEC access would undermine the investments' potential return. Absence of unbundling, by contrast, will give all parties an incentive to take a shot at this potentially lucrative market."); *id.* (affirming Commission's conclusion that requiring unbundled access to the high frequency portion of copper loops to provide broadband DSL services had "skewed CLECs' incentives").

[36] The Commission has made clear elsewhere that Section 706 "direct[s] the Commission to use the authority granted in other provisions, *including the forbearance authority under section 10(a)*, to encourage the deployment of advanced services." *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 13 FCC Rcd 24011, ¶ 69 (1998) (emphasis added).

The Commission's conclusion, affirmed in *USTA II*, that unbundling creates severe investment disincentives for both ILECs and CLECs and therefore affirmatively harms competition and conflicts with Section 706 further demonstrates that forbearance from any broadband unbundling requirements that Section 271 might be construed to impose is appropriate. Indeed, given the Commission's findings in the *Triennial Review Order*, a determination that unbundling of broadband elements is necessary to ensure just and reasonable rates and conditions and nondiscrimination, would be arbitrary and capricious. Moreover, the Commission has already affirmatively found that "[t]he end result" of removing unbundling obligations is that "*consumers* will benefit from this race to build next generation networks and the increased competition in the delivery of broadband services,"[37] requiring a conclusion that unbundling is *not* necessary to protect consumers and that removing unbundling requirements is in the public interest.[38]

As Verizon has previously demonstrated, imposing unbundling obligations on next-generation broadband facilities would dramatically increase the costs of deploying those facilities, raise a host of intractable administrative and regulatory problems, and provide disincentives for the widespread deployment of such facilities. In particular, new FTTP networks are not designed for unbundling. The one incentive to deploy these facilities is the increased efficiencies that would result. However, any unbundling requirement would significantly undermine these efficiencies. Verizon does not know how such unbundling would be done, but it would require new operating support systems and other modifications, which

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[37] *Triennial Review Order*, ¶ 272 (emphasis added).

[38] *See* 47 U.S.C. §§ 160(a)(1)-(2); *see also Verizon March 26 Ex Parte*, Attachment 1, at 10-22.

would cause delay in deployment and add significant costs, therefore ultimately impacting the incentive to roll out such new networks.[39]

In sum, the Commission's findings in the *Triennial Review Order*, which were affirmed by the D.C. Circuit in *USTA II*, that the broadband market is competitive and that the application of unbundling obligations to broadband elements is detrimental to the development of further competition, establish that forbearance from any broadband unbundling obligations that Section 271 might be construed to impose is appropriate. In order to complete the job the Commission started, it should resolve the remaining issues regarding 271 unbundling, multi-unit premises, and definition of "mass market" customers, to remove the regulatory uncertainty that can act as a disincentive to the extraordinary investment necessary to bring these facilities to customers.

2. The Commission Should Modify, Or Forbear From Applying, Title II Retail Requirements That Currently Apply To Wireline Broadband Offerings Because Wireline Carriers Are Not "Dominant" In The Broadband Market.

Under the Commission's existing domestic common carrier regulations, ILECs are generally treated as dominant carriers, and their broadband transmission services are subjected to the full panoply of common carrier regulations under Title II. *ILEC Broadband NPRM*, ¶ 5. And, absent further Commission action, ILEC provision of broadband services is treated the same. Thus, ILECs are subject to tariff filing, cost support, and pricing requirements in their provision of broadband service—regulations to which *none* of their competitors are subject, particularly the dominant providers of broadband, who continue to be allowed under current

[39] *See* Declaration of Jerome Holland, CC Docket No. 01-338 (filed Mar. 29, 2004); Supplemental Declaration of Jerome Holland, CC Docket No. 01-338 (filed May 18, 2004) (together attached hereto at Exhibit E).

rules to offer service on a private carriage basis under Title I. *See, e.g.*, 47 U.S.C. §§ 201-204, 214.[40]

As the Commission itself has observed, however, "[t]he basic elements of the existing regulatory requirements for the provision of broadband services by incumbent LECs were initially developed in a prior era of circuit-switched, analog voice services characterized by a one-wire world for access to communications" that existed "well before the development of competition between providers of broadband services" and were based upon a perceived need to curb the exercise of anti-competitive market power. *ILEC Broadband NPRM*, ¶¶ 4, 38. As shown above, this "one-wire" world simply does not exist in today's broadband market[41] and, as

[40] The Ninth Circuit's decision in *Brand X Internet Services, Inc. v. FCC*, 345 F.3d 1120 (9th Cir. 2003), presents no obstacle to the establishment of a comprehensive broadband regulatory policy. First, the *Brand X* decision expressly left intact the Commission's authority to classify broadband transmission services as private carriage arrangements under Title I or to waive or forbear from any common carrier regulations that might otherwise apply. *See id.* at 1132 n.14. Indeed, the panel expressly said that it was *not* addressing the ability of cable companies to offer broadband on a private carriage (as opposed to common carriage) basis, leaving those issues for consideration by the Commission on remand. *See id.* Second, the *Brand X* panel relied entirely upon the Ninth Circuit's prior decision in *AT&T v. City of Portland*, 216 F.3d 871 (9th Cir. 2000), to reach its determination, concluding that it was bound to do so, *Brand X*, 345 F.3d at 1129-32, but the Supreme Court will not be so bound. The facts that DSL "is a high-speed competitor to cable broadband" and that the Commission subjects DSL to common carrier obligations had been important to the Ninth Circuit's decision in *City of Portland*. *See* 216 F.3d at 879. By eliminating the regulatory disparity between the broadband services provided by cable operators and wireline carriers, the Commission would remove a primary obstacle to the federal courts' adoption of the Commission's own policy determinations, not only for cable companies, but for telephone companies as well. Indeed, the Commission can help the courts to avoid the mistake made in *City of Portland* by adopting a technologically neutral broadband policy, founded in the competitive realities of the marketplace, that allows cable companies and telephone companies alike to provide broadband services on a private carriage basis.

Moreover, the order is not even effective. The Ninth Circuit stayed the mandate of the order pending July 29, the date on which petitions for certiorari to the United States Supreme Court are due. If the FCC decides to seek certiorari, it also may seek to extend the stay, and may obtain modification of the order.

[41] *See supra* Section II.A.

the Commission has recognized in other contexts, the presence of intermodal competition is sufficient to eliminate any risk of anti-competitive behavior.[42]

In addition, the Commission's refusal to exempt ILEC broadband services from Title II regulations is inconsistent with the repeated recognition of both the federal courts and the Commission that a carrier may appropriately be treated as a common carrier with respect to some services but not others[43] and that, in the absence of a *voluntary* undertaking to serve all customers indiscriminately, common carrier duties may only be imposed upon a service based on a finding that "the public interest . . . require[s] the carrier to be legally compelled to serve the

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[42] *See, e.g., Comsat Corporation, Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier*, 13 FCC Rcd 14083, ¶ 76 (1998) ("Intermodal competition leads us to believe that fiber-optic cables represent a substitute for satellites in the transmission of switched voice service").

[43] *See, e.g., Southwestern Bell Tel. Co. v. FCC*, 19 F.3d 1475, 1481 (D.C. Cir. 1994) (quoting *Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 533 F.2d 601, 608 (D.C. Cir. 1976) ("*NARUC II*")); *see also Computer & Communications Indus. Ass'n v. FCC*, 693 F.2d 198, 207, 208 (D.C. Cir. 1982) (upholding Title I classification of enhanced services and customer premises equipment ("CPE") because "the market for enhanced services is 'truly competitive'" and "charges for CPE provided by carriers need no longer be regulated … because of the competitive market conditions now prevailing"); *Licensing Under Title III of the Communications Act of 1934, as amended, of Non-Common Carrier Transmit/Receive Earth Stations Operating With the Intelsat Global Communications Satellite System*, 8 FCC Rcd 1387, ¶¶ 7-19 (1993) (satellite services including mobile voice, data, facsimile); *Loral/Qualcomm P'shp, L.P., for Authority to Construct, Launch, and Operate Globalstar, a Low Earth Orbit Satellite System to Provide Mobile Satellite Services in the 1610-1626.5 MHz/2483/5-2500 MHz Bands*, 10 FCC Rcd 2333, ¶ 22 (1995) (same); *AT&T Submarine Sys., Inc.*, 1¶¶ 6-11 (submarine cables); *Gen. Tel. Co. of the S.W.*, 3 FCC Rcd 6778, ¶¶ 7-11 (1988) (for-profit microwave systems interconnected with public switched telephone network); *Int'l Communications Policies Governing Designation of Recognized Private Operating Agencies, Grants of IRUs in International Facilities and Assignment of Data Network Identification Codes*, 104 FCC 2d 208, ¶¶ 56-57 (1986) (digital optical-fiber cable); *NorLight*, 2 FCC Rcd 5167, ¶¶ 12-19 (1987) (interstate fiber optic systems); *Amendment of the Commission's Rules to Establish New Personal Communications Services*, 6 FCC Rcd 6601, ¶ 7 (1991) (mobile services); *Amendment of Subpart C of Part 90 of the Commission's Rules*, 5 FCC Rcd 3471, ¶¶ 5-7 (1990) (certain paging services).

public indifferently" because an operator "has sufficient market power."[44] Here, the competitive status of the broadband market *precludes such a finding*.

Like the continued application of the *Computer Rules*, the maintenance of Title II common carrier requirements in the age of abundant broadband competition is not just "no longer necessary" but also violates the Commission's statutory duty to promote broadband development and deployment through reduced regulation. *See* 1996 Act, § 706 (*codified at* 47 U.S.C. § 157 note). For example:

- The Title II costing rules contribute significantly to the delay in introducing new broadband services to consumers. Unlike their competitors, ILECs often must develop and file detailed cost support data, provide extensive analyses of charges assessed by their competitors for similar services, develop and file rebuttals to challenges to their filings by third parties, and respond to Commission staff questions.

- Mandatory tariffs reduce carriers' ability to make efficient responses to customer demand and cost; impose substantial administrative costs; limit the ability of customers to negotiate and obtain service arrangements specifically tailored to their needs; and inhibit carriers from introducing new services and responding to new offerings by rivals, who obtain advance notice of tariffed carriers' services and promotions and can respond by undercutting the new offerings even before the tariff becomes effective.

- The requirement that broadband rates be cost-justified or be comparable to traditional narrowband wireline benchmarks prevents ILECs from experimenting with market-based pricing models, such as pricing based on revenue sharing or on the number of visits to a given Web site. These methods are already available to non-telco broadband competitors, and prohibiting ILECs from using them deters innovative pricing arrangements that ultimately would benefit competition.

As the Commission has concluded, "deregulation or reduced regulation may lower administrative costs, encourage investment and innovation, reduce prices and offer consumers

[44] *AT&T Submarine Sys., Inc.*, 13 FCC Rcd 21585, ¶¶ 7-9 (1998), *aff'd*, *Virgin Islands Tel. Corp. v. FCC*, 198 F.3d 921, 925-27 (D.C. Cir. 1999); *Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 525 F.2d 630, 642 (D.C. Cir. 1976) ("*NARUC I*"); *NARUC II*, 533 F.2d at 608.

greater choice."[45] The Commission's maintenance of Title II regulatory requirements for ILEC broadband services is having precisely the opposite effect. Moreover, as is the case with the *Computer Rules*, cable operators, who are the only participants in the broadband market that could conceivably be considered "dominant," remain entirely free from Title II regulatory burdens. *Cable Broadband Ruling*, ¶¶ 34-41, 48-58. The current competitive disparity is only further impeding the development of additional broadband competition.

In sum, competitive developments have rendered the maintenance of Title II requirements for broadband "no longer necessary in the public interest," thus obligating the Commission to repeal or modify those requirements in compliance with its biennial review mandate.[46] By contrast, allowing ILEC broadband services to be offered on a private carriage basis, free from the regulatory strictures of Title II, will enable carriers to offer broadband services that can better compete against their well-financed, entrenched competitors and will encourage investment in next generation broadband networks and services, thereby promoting Congress' statutory goal of fostering broadband competition.

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[45] *ILEC Broadband NPRM*, ¶ 39; *see Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 84 FCC 2d 445, ¶ 12 (1981) (noting that even in a market that is not yet fully competitive, the costs of regulatory compliance "can have profound negative implications for consumer welfare" such that a reduction in regulatory burdens is appropriate).

[46] 47 U.S.C. § 161(b). To the extent that the Commission views the application of Title II requirements to ILEC broadband offerings to be statutorily required (*i.e.*, because wireline broadband transmission service must be classified as a "telecommunications service"), forbearance pursuant to Section 10(a) of the Communications Act, 47 U.S.C. § 160(a), is fully justified based upon the same analysis set forth above.

3. The Commission Should Eliminate The Requirement That The Bell Companies[47] Comply With The *Computer Rules* With Respect To Their Broadband Offerings.

In the late 1990s, without any market analysis at all, the Commission reflexively extended regulatory strictures on wireline providers from the narrowband world of the 1970s and 1980s to broadband services offered by the Bell companies.[48] Thus, under the Commission's *Computer Rules*, the Bell companies are subject to Comparably Efficient Interconnection ("CEI") and Open Network Architecture ("ONA") requirements that force them to unbundle their broadband transmission services, and also to separate out and offer the transmission component of their broadband Internet access services pursuant to tariff, on cost-based terms and conditions. *Wireline Broadband NPRM*, ¶ 42.

The Commission itself has acknowledged that the *Computer Rules* were adopted at a time when "very different legal, technological and market circumstances" existed. *Id.* at ¶ 35. Most relevant to the biennial review inquiry—that is, whether the application of these rules to the broadband offerings of Bell companies remains necessary in light of current levels of competition—"the core assumption underlying the *Computer Inquiries* was that the telephone

[47] The former structural separation requirements applied only to the former Bell companies and AT&T. The Open Network Architecture requirements initially applied only to the former Bell companies, but they were later extended to GTE, which is now part of Verizon. *Application of Open Network Architecture and Nondiscrimination Safeguards to GTE Corporation*, 9 FCC Rcd 4922 (1994). The Comparably Efficient Interconnection requirements apply to the former Bell companies, but not GTE. *Wireline Broadband NPRM*, ¶ 41 n.85. On the other hand, *all* common carriers owning transmission facilities and providing enhanced services must unbundle and offer transmission capacity to other enhanced service providers pursuant to tariff. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review—Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Market*, 16 FCC Rcd 7418, ¶ 40 (2001). Verizon uses the term "Bell companies" in this filing to refer to the entities that are subject to the various *Computer Rules*.

[48] *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 14 FCC Rcd 19237, ¶ 21 (1999); *GTE Tel. Operating Cos.*, 13 FCC Rcd 22466, ¶ 32 (1998); *see also* 47 U.S.C. §§ 202(a), 203.

network is the primary, if not exclusive, means through which information service providers can obtain access to customers."[49] As shown above, no category of competitors in the broadband market, and certainly not the wireline telephone companies, enjoy "bottleneck" control over broadband transmission facilities. *See supra* Section II.A. Thus, that "core assumption" regarding the necessity of the *Computer Rules* simply does not exist for broadband.

In addition, the 1996 Act "introduced a mandate that the Commission promote competition, deregulation and innovation wherever possible in the communications market." *Wireline Broadband NPRM*, ¶ 35. Congress specifically expressed its policy to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans" by, among other things, directing the Commission to utilize "regulatory forbearance" and to "remove barriers to infrastructure investment and promot[e] competition" in the provision of broadband services.[50] The Commission, furthermore, has recognized that "the widespread deployment of broadband infrastructure has become the central communications policy objective of the day."[51] This is at least partially because, as Chairman Powell has stated,

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[49] *Wireline Broadband NPRM*, ¶ 36; *see Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Ruling*, 17 FCC Rcd 4798, ¶ 34 n.139) (2002) ("*Cable Broadband Ruling*") (stating that the *Computer Inquiries* were directed at "*bottleneck* common carrier facilities"). Indeed, in *Computer II*, the Commission expressly found that carriers that had no control over local bottleneck facilities, and therefore "d[id] not have . . . market power," would not be in a position to act anti-competitively. *Amendment of Section 64.702 of the Commission's Rules and Regulations*, 77 FCC 2d 384, 468-69 (1980) ("*Computer II*") (subsequent history omitted); *see California v. FCC*, 39 F.3d 919, 923-24 (9th Cir. 1994) (*Computer Rules* responded to the belief that "the telephone industry could use its monopoly of the [telephone] lines to prevent competition from developing in the enhanced services industry").

[50] 1996 Act, § 706(a) (*codified at* 47 U.S.C. § 157 note); *see* 47 U.S.C. §§ 230(b)(1), 230(b)(2) (stating that the policy of the United States should be "to promote the continued development of the Internet and other interactive computer services and other interactive media" and "to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation").

[51] *Wireline Broadband NPRM*, ¶ 1; *see IP-Enabled Services*, 19 FCC Rcd 4863, ¶ 3 (2004) ("*VOIP NPRM*") (recognizing "the paramount importance of encouraging deployment of broadband infrastructure to the American people").

"[w]ith broadband access, worker productivity increases, jobs are created and wages grow."[52] In addition, the Commission has repeatedly acknowledged that a reduction in the regulatory burdens on wireline broadband providers is necessary to "encourage market participants to deploy broadband networks more expeditiously and increase facilities-based competition."[53] Individual members of the Commission also have recognized that excessive regulation only thwarts the development of new services.[54]

The continued application of the *Computer Rules* to the broadband offerings of the far distant second players in the competitive broadband market conflicts directly with Congress's clearly expressed desire to promote broadband development and deployment through reduced regulation. The *Computer Rules* are actually hindering the development of new services and

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[52] Michael K. Powell, Chairman, FCC, *Rural Lands of Opportunity: Broadband Deployment in America's Heartland*, Remarks at the Kansas Rural Broadband and Telemedicine Summit at the University of Kansas, Lawrence, Kansas (Feb. 20, 2004); *see* Kevin J. Martin, Commissioner, FCC, *A New Framework for Broadband Deployment*, Remarks to the TIA Regulatory Session at Supercomm, Atlanta, Georgia (June 3, 2003) (stating that broadband is the Commission's "top priority" and that "broadband deployment will lead to a new period of economic growth.").

[53] *Wireline Broadband NPRM*, ¶ 51; *see VOIP NPRM*, ¶ 1 (noting that the Internet has been able to develop into "one of the greatest drivers of consumer choice and benefit, technical innovation, and economic development in the United States in the last ten years" because it has been "free of many of the regulatory obligations applied to traditional telecommunications services and networks"); *Triennial Review Order*, ¶ 3 ("[E]xcessive . . . [regulation] tend[s] to undermine the incentives . . . to invest in new facilities and deploy new technology. The effect of unbundling on investment incentives is particularly critical in the area of broadband deployment, since incumbent LECs are unlikely to make the enormous investment required if their competitors can share in the benefits of these facilities without participating in the risk inherent in such large scale capital investment").

[54] *VOIP NPRM*, (Separate Statement of Chairman Michael K. Powell) (stating that "[c]ompetitive market forces, rather than prescriptive rules, will respond to public need much more quickly and more effectively than even the best intentioned responses of government regulators," and that the "best hope" for furthering the development of new services is to "limit[] to a minimum the labyrinth of regulations and fees that apply to the Internet" because "these edicts can thwart competition even among traditional telecommunications providers"); *id.* (Separate Statement of Commissioner Kathleen Q. Abernathy) (cautioning against "reflexively extending [] legacy regulations to VOIP providers" and recognizing that those rules may no longer "make sense for *any* providers, including incumbents") (emphasis in original).

network and service arrangements that customers want and leading to unnecessary costs that discourage investment. For example:

- The requirement that the Bell companies separate out and offer separately the physical components of their services hampers the development of new services and applications and forces adoption of less-than-optimal network designs. Manufacturers are designing next generation equipment for other providers that do not face similar regulatory constraints (*e.g.*, cable operators).

- The CEI and tariffing rules render it difficult for the Bell companies to tailor solutions to customer needs. The Bell companies must offer "one-size-fits-all" products and services, impeding their ability readily to respond to ISP requests for more efficient network solutions.

- The *Computer Rules* require the Bell companies to waste resources by mandating that they offer mass-market solutions even when there is no market demand for such products and services. For instance, new technology is available that allows certain enhanced functions to be performed closer to the end user customer, enhancing the ISP's overall service capabilities. However, the *Computer Rules* would require the Bell companies to develop a new generic service offering that could be made available to any other requesting ISP, and potentially create new access points within its network for that service offering, even if only a limited number of ISPs are interested in the configuration, and tariffs would have to be filed in accordance with the Commission's review process. This effectively restricts the Bell companies to offering a limited set of service configurations.

- The requirement that the transmission component of Bell company broadband services be separated and offered under tariff at cost-based rates is interfering with the development of innovative and beneficial arrangements for ISPs to deliver content and applications to consumers.

The Commission has, moreover, determined that these rules should *not* apply to cable operators, who are, as noted above, by far the market leaders in broadband. *Cable Broadband Ruling*, ¶¶ 42-47. The continued maintenance of rules that inhibit the Bell companies' ability to compete in the broadband market while the dominant players in that market are free from similar regulatory requirements simply cannot be justified under *any* standard of review, whether the "necessary in the public interest" test of the biennial review or the "arbitrary and capricious" test of the Administrative Procedure Act.

Because the application of the *Computer Rules* to the broadband offerings of wireline telephone companies is "no longer necessary in the public interest as the result of meaningful economic competition," and because the continued maintenance of these rules is affirmatively harming competition and impeding achievement of the 1996 Act's goal of encouraging broadband development and deployment, the Commission should act promptly to free the Bell companies from these regulatory requirements. *See* 47 U.S.C. §§ 161(a), 161(b). Time is, moreover, of the essence in this area. As Chairman Powell has stated: "There is no greater threat to an entrepreneur, or any business, than uncertainty. A key government decision that hangs in suspended animation will kill the best-laid business plan." Michael K. Powell, Chairman, FCC, Remarks at the Association for Local Telecommunications Services, Crystal City, Virginia (Nov. 30, 2001).

III. COMPETITIVE DEVELOPMENTS IN THE LOCAL TELEPHONE MARKET HAVE ELIMINATED ANY POSSIBLE RATIONALE FOR TELRIC PRICES OR ECONOMIC RATE REGULATION.

A. Current Market Conditions Demonstrate That Economic Regulation Is Both Unnecessary And Affirmatively Harmful.

The Commission has justified pricing rules either as a way to keep end-user consumer prices reasonable, or, in the case of TELRIC, as a way to jump start local telephone competition. Regardless of whether such economic price constraints were ever necessary, under current market circumstances it is clear that those rules are both unnecessary and harmful. Indeed, as in other investment-intensive industries such as transportation, competition has developed in the telephone industry from intermodal competitors with their own extensive infrastructure expanding into the local telephone business. As a result, ILECs face significant (and increasing) competition from alternative providers of local telephone service.[55] Wireless telephone service has become a viable substitute for wireline telephone service, and competes both for millions of minutes of traffic that previously traversed the local telephone network and for lines as well.

Wireless has already replaced over 19 million wireline access lines, and that number is expected to reach 34 million by 2007.[56] According to one analyst, "the higher losses [of ILEC primary access lines] are due to an acceleration in the movement toward wireless services and away from wireline telephony."[57] Indeed, as the Commission itself noted in its most recent *CMRS Competition Report*, "wireless substitution [is] a significant factor" in the ILECs' substantial decline of both business and residential lines. *Eighth Annual CMRS Report*, WT Docket No. 02-379, FCC 03-50, ¶ 103 (rel. July 14, 2003). There are now 85 providers of wireless telephone service and 147.6 million wireless telephone subscriptions in the United States, up 13% since June of 2002.[58] This number is closely approaching the total number of telephone landlines in service—182.8 million—and a growing number of Americans consider

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[55] Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, Local Telephone Competition: Status as of June 30, 2003 at Tables 14, 15, 16 (Dec. 2003), *at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom1203.pdf ("*Local Competition Report*"); *TRO Switching Report*, at 1-2.

[56] *See* Letter from Michael E. Glover, Verizon, to Marlene H. Dortch, FCC, CC Docket Nos. 01-338, 96-98, and 98-147, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching", at 13 (filed July 2, 2004) ("*Verizon July 2 Ex Parte*"); *Id.*, Declaration of Michael K. Hassett and Vincent J. Woodbury, ¶ 52, Att. 7; *see also* S. Ellison, IDC, *U.S. Wireless Displacement of Wireline Access Lines, Forecast and Analysis, 2003-2007* at 16, Table 9 (Aug. 2003) (cumulative lines displaced since 1995).

[57] Statement of Michael J. Balhoff, CFA, Legg Mason Wood Walker, Inc., before the House Committee on Energy and Commerce Subcommittee on Telecommunications and the Internet, "In the Matter of 'The Current State of Competition in the Communications Marketplace'" 5 (Feb. 4, 2004), http://energycommerce.house.gov/108/Hearings/02042004hearing1164/Balhoff1850print.htm.

[58] *Local Competition Report* at Table 13. Data from the Cellular Telecommunications & Internet Association indicates that wireless subscribership is, in fact, much higher, at nearly 159 million. *See* CTIA, *Semi-Annual Wireless Industry Survey Year End 2003*, http://www.wow-com.com/pdf/CTIA_Semiannual_Survey_YE2003.pdf.

their wireless phone to be their primary phone. Michelle Kessler, *18 % See Cellphones as Their Main Phones*, USA Today, Feb. 1, 2002, at B1. At least 6% of consumers in the top 35 markets have canceled landline service at some point, up from 3.4% in 2002. Dow Jones News Service, *Americans Cut Their Wires, Threatening Carriers*, Sept. 24, 2003. Approximately 2 to 3 million additional wireless subscribers are now giving up their phone each year. In addition, 14% of U.S. consumers now use their wireless phones as their primary phones.[59]

Wireless services also compete directly with the local voice telephony offerings of wireline telephone companies in terms of pricing and package offerings. Indeed, the significant competition provided by wireless carriers has caused ILECs to introduce and competitively price their own package services to compete with wireless service offerings. In eastern Massachusetts, for example, wireless carriers offer bundled voice packages ranging from $39.99 to $49.99 per month, which include up to 700 minutes of local and long distance calling as well as voicemail. *Verizon July 2 Ex Parte,* Declaration of Michael K. Hassett and Vincent J. Woodbury. In response to competition from wireless, wireline carriers and cable telephony providers are now offering unlimited local, toll, and long distance calling plans for $48.95 to $55.99 per month, and Vonage—a VOIP provider—is offering its "Premium Unlimited" service for $29.99 per month. *See Verizon July 2 Ex Parte,* Declaration of Michael K. Hassett and Vincent J. Woodbury, Attachment 2.

There also is significant and rapidly growing competition from competing voice telephone services offered over cable networks. As an initial matter, there has been rapid growth

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[59] *See Verizon July 2 Ex Parte*, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching" at p.13, Declaration of Michael K. Hassett and Vincent J. Woodbury at ¶ 52, Att. 7; see also S. Ellison, IDC, *U.S. Wireless Displacement of Wireline Access Lines, Forecast and Analysis, 2003-2007* at 16, Table 9 (Aug. 2003) (cumulative lines displaced since 1995).

in the availability of circuit-switched cable telephony. That technology is currently available to more than 20 million homes[60] and half a million businesses[61] and has captured between 25% and 40% of the local telephone market where it is available.[62] Cable operators are, moreover, adding tens of thousands of new telephone subscribers each month.[63]

These figures do not even take into account the dramatic impact that the rollout of VOIP by cable operators and other providers will have on competition for local voice telephony. Every customer of cable modem service can now receive local telephone service over their cable modem connection, either because their cable operator itself has rolled out VOIP, or because

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[60] Bernstein Research Call, *U.S. Telecom & Cable: Faster Roll-out of Cable Telephony Means More Risk to RBOCs; Faster Growth for Cable* Exhibit 1 (Dec. 17, 2003) ("*Risk to RBOCs*").

[61] *See, e.g.*, Charter Communications, Press Release, *Charter Announces 2002 Operating Results and Restated Financial Results for 2001 and 2000; Company Will Extend Filing of Form 10-K* (Apr. 1, 2003), http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=CHTR&script=460&layout=-6&item_id=396550; RCN, Press Release, *RCN Announces Fourth Quarter and Year-End 2002 Results* (Mar. 13, 2003), http://www.rcn.com/corpinfo/earnings.php?id=145; Comcast, Press Release, *Comcast Full Year and Fourth Quarter Results Meet or Exceed All Operating and Financial Goals* (Feb. 27, 2003), http://www.cmcsk.com/phoenix.zhtml?c=118591&p=irol-newsArticle&t=Regular&id=445837&; Insight Communications, Press Release, *Insight Communications Announces Fourth Quarter and Year-End 2002 Results* (Feb. 25, 2003), http://www.insight-com.com/PR/read_releases.asp?Year=2003&rID=39; Cox Communications, Press Release, *Cox Communications Announces Fourth Quarter Financial Results for 2002; Strong Demand for Cox's Digital Services Builds Solid Foundation for Continued Growth in 2003* (Feb. 12, 2003), http://www.cox.com/about/NewsRoom/; Cablevision Systems, Press Release, *Cablevision Systems Corporation Reports Fourth Quarter 2002 Financial Results* (Feb. 11, 2003), http://www.cablevision.com/index.jhtml?id=2003_02_11.

[62] *See, e.g.*, Dan Somers, President and CEO, AT&T Broadband, *Operational Overview*, AT&T Broadband, Investor Presentation, at 16-17 (July 2001) ("Some [Chicago] suburbs have 40 % penetration."); James Granelli, *Expanding Cable Telephony Is New Kid on SBC's Block*, L.A. Times (Jan. 21, 2003) ("As of the end of September, Cox provided telephone service for 30% of the 304,000 households it has wired in 14 south Orange County cities, where nearly all the homes are hooked up. It has a similar share in the San Diego County communities it serves."); AT&T, News Release, *AT&T Broadband -Comcast Merger Will Create More Competitive Marketplace* (Apr. 23, 2002), http://www.att.com/news/item/0%2C1847%2C10302%2C00.html (reporting that AT&T chairman C. Michael Armstrong said in testimony before Congress that "AT&T Broadband has already gained 25 % or higher cable telephony penetration in 55 communities").

[63] *See* Reply to Comments and Petitions to Deny Applications for Consent to Transfer Control of AT&T Corp. and Comcast Corp., MB Docket No. 02-70, at 11 (filed May 21, 2002) ("AT&T Broadband is capable of serving approximately seven million households, has enrolled over 1.15 million cable telephony customers, and is adding approximately 40,000 customers per month").

they can receive service over their broadband connection from one of the numerous alternative providers of VOIP such as Vonage. Or, to put it another way, every household that now has cable modem service available to it also has available an alternative source of voice telephone service.

First, with respect to the cable companies themselves, every major cable operator has either deployed IP telephony or is in final testing of that service, with firm plans to roll out the technology in 2004.[64] The cable companies' IP telephony plans are so aggressive that at least one industry analyst has "revis[ed its] joint long-term consumer cable telephony forecast to reflect the intentions of all the major MSOs to offer cable telephony to nearly 100% of their in-franchise homes over the next two-to-three years." *Risk to RBOCs*, at 1. Cable companies now offer voice telephone service to millions of additional homes using VOIP, and have announced plans to offer VOIP to more than 24 million homes by the end of 2004 and at least 20 million more the following year. And the number of lines is even greater because many homes have more than one line. The result is that, within two years, "roughly 82% of total US households" will have access to voice telephone service from their cable operators."[65]

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[64] *See, e.g.*, Matt Richtel, "Time Warner Deal Raises Ante in Cable's Bid for Phone Market," *New York Times*, Dec. 9, 2003, at A1, C7; *Risk to RBOCs* at 5; Peter Grant and Shawn Young, *Time Warner Cable Expands Net-Phone Plan*, Wall St. J., Dec. 9, 2003, at A19; *Cox Communications Delivers Cox Digital Telephone to 12th Market; Roanoke, Va. Marks Cox's First Market Launch of VoIP Technology*, Business Wire, Dec. 15, 2003; P. Bernier, *Cablecos Set Sights on VoIP*, Xchange Mag., Feb. 1, 2004; Charter Communications, Presentation at the Smith Barney Citigroup Entertainment, Media & Telecommunications Conference 22 (Jan. 7, 2004); Comcast, Presentation at the UBX 31st Annual Media Week Conference (Dec. 11, 2003), http://media.corporate-ir.net/media_files/irol/11/118591/presentations/cmcsk_121103c/sld016.htm.

[65] *See Verizon July 2 Ex Parte*, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching" at 2 and 6, Declaration of Michael K. Hassett and Vincent J. Woodbury at ¶ 17; see also Bernstein Research Weekly Notes, *US Telecom and Cable:Faster Rollout of Cable Telephony Means More Risk for RBOCs, Faster Growth for Cable*, at 4 (Jan. 9, 2004).

Second, VOIP deployment is not limited to cable companies. Anyone with a broadband connection (including both cable modem and DSL subscribers) can obtain VOIP capabilities from a wide range of competitors, none of whom needs a carriage agreement with the underlying platform owner. AT&T is currently offering VOIP to consumers in approximately 72 metropolitan markets throughout the country and, in addition, recently announced plans to expand deployment of IP telephony to the top 100 metropolitan areas within the next three months.[66] AT&T projects that it will have at least one million mass market customers by 2005.[67] There are currently a number of other VOIP providers, including Vonage, 8x8, VoicePulse and Pulver.com, among others, who offer cheap calling over any broadband connection.[68] These competitive VOIP providers can take advantage of new broadband platforms as quickly as they emerge, because customers may connect to a voice-over-broadband server as easily as they may browse the Internet on any platform. And, as discussed in Section II.A., *supra*, the underlying market for broadband transport is vibrantly competitive.

Text-based Internet services such as e-mail and instant messaging also compete directly against traditional voice telephony services in both the residential and business sectors.

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[66] Bernstein Research Note, Jan. 9, 2004, at 6. AT&T has announced plans to make its VOIP network available through "Bring Your Own Access," wireless, BPL, and municipal fiber to the home. *See AT&T Plans a Vonage-style Consumer VoIP Service*, Converge! Network Digest, http://www.convergedigest.com/Bandwidth/newnetworksarticle.asp?ID=8669 (last visited Apr. 14, 2004) , AT&T, *CallVantage Market Availability*, https://www.usa.att.com/callvantage/order/upcoming_markets.jsp (last visited Apr. 14, 2004); Tim McElligott, *AT&T Steals Show With VoIP Launch*, Telephony Online, Apr. 5, 2004; *Verizon July 2 Ex Parte*, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching" at 10, Declaration of Michael K. Hassett and Vincent J. Woodbury at ¶ 33.

[67] *Verizon July 2 Ex Parte*, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching" at 10, Declaration of Michael K. Hassett and Vincent J. Woodbury at ¶ 33; see also AT&T News Release, *AT&T's CallVantage Service Expands To Serve the Western United States* (May 17, 2004).

[68] *See* Will Wade, *A Game of Phone Catch-Up on the Net*, New York Times, Dec. 18, 2003, at E8; Jesse Drucker, *Vonage, TI Plan a Web Phone Deal*, Wall St. J., Jan. 9, 2004, at A8.

Customers are sending approximately 25 billion person-to-person email messages and IM messages per day.[69] If only two percent of the 25 billion daily e-mail and instant messages substitute for a voice call, that is equivalent to about 900 billion minutes per year, or roughly one-third of all voice traffic that passes through the incumbents' networks.[70]

In sum, ILECs face substantial competition from a broad variety of alternative providers of local voice telephony services or substitutes for such services. And that competition is on an upward trajectory. The Commission cannot continue to conduct its analysis of whether its TELRIC pricing regime remains appropriate with blinders on to the competitive realities of the marketplace.

B. Real-World Market Developments Since 1996 Demonstrate That TELRIC Must Be Reformed.

In response to the development of significant competition in the market for local telephone service, the Commission should abandon the assumption of a hypothetical network with efficiencies that no real-world carrier can match that underlies the TELRIC pricing regime for UNEs. As the Commission itself recognized in the *TELRIC NPRM*, the core problem with the TELRIC rules is directly traceable to the fact that they are not tethered to *any* real-world network, but instead are based on a hypothetical network construct that assumes false

[69] *Verizon July 2 Ex Parte*, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching" at 15, Declaration of Michael K. Hassett and Vincent J. Woodbury at ¶ 68; see also AXS-One News Release, *MONY Group Implements SEC and NASD Compliant Instant Messaging and E-mail Archival Solution from AXS-One and EMC* (Jan. 26, 2004).

[70] *Verizon July 2 Ex Parte*, "Technological and Market Developments Since the Triennial Review Further Demonstrate That Competitors Are Not Impaired Without Access To Unbundled Mass Market Switching" at 15, Declaration of Michael K. Hassett and Vincent J. Woodbury at ¶ 68; see also Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *Trends in Telephone Service* at Table 10.1 (Aug. 2003) (Total 2001 Dial Equipment Minutes of 4.8 trillion divided by 2 yields 2.4 trillion conversation minutes; 913 billion/2.4 trillion = 38%).

efficiencies that no actual carrier can achieve. *Review of the Commission Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Services by Incumbent Local Exchange Carriers*, 18 FCC Rcd 18945, ¶¶ 49-50 (2003) ("*TELRIC NPRM*"). The theoretical nature of the rules also results in a standardless "black box" approach to setting prices that can be manipulated to produce any desired result. *Id.* at ¶ 7. That process has produced rates well below any rational measure of the incumbent's, or any other carrier's, real-world costs, forward-looking or otherwise.[71]

The Commission's current TELRIC pricing rules were adopted shortly after the passage of the 1996 Act with the avowed purpose of "jump start[ing]" competition.[72] When the Commission adopted the rules, it committed to review them after states had implemented the first round of pricing decisions. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, ¶ 620 (1996) ("*First Local Competition Order*"). More than seven years have passed without any action, and as Chairman Powell has noted, "[s]even years is a long time in the telecommunications industry." *TELRIC NPRM*, (Separate Statement of Chairman Michael K. Powell). As discussed above, there has been an explosive growth in intramodal and intermodal competition in the local voice telephony market in recent years. *See* Section III.A, *supra*. In view of the significant competition that now exists in the market for local telephone service, artificially low UNE rates clearly are not "necessary in

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[71] *See, e.g.*, *Triennial Review Order*, ¶ 517 n.1581 (stating that "the costs of self-providing . . . elements [are] likely much higher than obtaining them from the incumbent priced at TELRIC"); David M. Mandy and William W. Sharkey, Dynamic Pricing and Investment from Statis Proxy Models 17, 40 n.48 (Sept. 2003) (FCC OSP Working Paper Series, No. 40) (concluding that successive repricing based on a hypothetical network results in rates that understate costs); Jeremy Pelofsky, *FCC Chief Denies Leaving, Outlines Media Agenda*, The Star-Ledger, Aug. 19, 2003 (noting that Chairman Powell has stated that TELRIC produces UNE rates that are "subsidized and below costs").

[72] *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 488 (2002) (quoting 141 Cong. Rec. 15572 (1995) (Statement of Sen. Breaux)); *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999).

the public interest" and the TELRIC rules must therefore be repealed or modified. 47 U.S.C. § 161(b).

In the context of the competition that has already developed, the TELRIC pricing rules not only make no sense, but are causing damage. TELRIC affirmatively discourages new investment by ILECs and other facilities-based providers, on the one hand, and eliminates any incentive for CLECs to construct their own networks altogether, on the other. *See* Comments of the Verizon telephone companies, WC Docket No. 03-173, at 8-18 (filed Dec. 16, 2003) ("*Verizon TELRIC Comments*"). The Commission itself recognized this in the *Triennial Review Order*, stating that "unbundling requirements tend to undermine the incentives of both incumbent LECs and new entrants to invest in new facilities and deploy new technology." *Triennial Review Order*, ¶ 3.

Indeed, between 2000 and 2003, as previously prescribed TELRIC rates were further slashed, overall investment by wireline telecommunications carriers declined by more than $70 billion in three years (from $104.8 billion to $33.4 billion).[73] One analyst has estimated that total capital expenditures by the Bell companies declined by approximately 35 % from 2001 to 2002 alone.[74] It has long been recognized that "[i]f the incumbent LEC, the putative owner of the local network, no longer can recover the costs of investments that it would make on a forward-looking basis—let alone keep any economic rents accruing to such investments—then entrants become free riders and the incumbent LEC's incentive to make further investment in the local

[73] Skyline Marketing Group, CapEx Report: 2002 Annual Report, Carrier Data Sheet 1, Summary Overview (June 2003); Skyline Marketing Group, CapEx Report: 2003 Annual Report, Carrier Data Sheet 1, Summary Overview (April 2004).

[74] *See id.* (citing UBS Warburg, Fixed-Line Communications, Are the Bells Growing Less Profitable? 41 (Apr. 16, 2003)). Moreover, Verizon's own investments are consistent with this industry trend. From 2000 to 2003, Verizon's capital expenditures for its domestic wireline business dropped from approximately $12.1 billion to approximately $6.8 billion, a decline of over 40 percent. Verizon Communications Inc., Form 10-K 17 (filed Mar. 12, 2004).

exchange network evaporates." J. Gregory Sidak and Daniel F. Spulber, *The Tragedy of the Telecommons: Government Pricing of Unbundled Network Elements Under the Telecommunications Act of 1996*, 97 Columbia L. Rev. 1081, 1161 (1997).

The availability of UNEs at TELRIC rates also eliminates any incentive that CLECs might have had to construct their own networks. In point of fact, capital expenditures by facilities-based CLECs reportedly declined by 19% from 2000 to 2001, and by 56% from 2001 to 2002.[75] Industry analysts have explained that the incentives created by TELRIC for CLECs are clear: "[n]o company will deploy and scale facilities if it can achieve similar economics immediately by renting network elements from the ILECs—all with little up-front investment."[76] CLECs themselves have admitted that the availability of UNEs at TELRIC rates allows them to avoid any need to make investments to construct their own networks. Z-tel, for example, a company that admittedly was "formed around UNE-P," has told investors that its "UNE-P-based business model allows [it] to avoid significant capital investments in network facilities."[77] Simply put, TELRIC pricing provides CLECs with such substantial profit margins and windfall returns that it makes no sense for CLECs to invest in their own facilities.[78]

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[75] Association for Local Telecommunications Services, *The State of Local Competition 2003*, at 10 (Apr. 2003), http://www.alts.org/Filings/2003AnnualReport.pdf.

[76] *Verizon TELRIC Comments* at 10 (quoting McKinsey & Co. and JP Morgan H&Q, Industry Analysis: Broadband 2001, A Comprehensive Analysis of Demand, Supply, Economics, and Industry Dynamics in the U.S. Broadband Market 18 (Apr. 2, 2001)).

[77] Z-Tel Communications Inc., 2001 Annual Report ii, http://media.corporate-ir.net/media_files/NSD/ZTEL/reports/ztel_2001.pdf; *see* eLEC Communications Corp., Form 10-Q 7 (filed July 17, 2000) (stating that it "ha[s] chosen . . . [UNE-P] to grow our customer base *because* it allows us to rapidly enter new markets with *minimal capital expenditures*") (emphases added); *Verizon TELRIC Comments* at 11 (noting that CLEC Talk America stated that it "can now lease the necessary elements of the Bell network—without the need for costly network infrastructure, which allows us to earn attractive gross margins" and that it is "deploying very little capital" to provide UNE-P service) (quoting Talk America, 2000 Annual Report 7).

[78] *See Verizon TELRIC Comments* at 11-13. Attractively low TELRIC rates have, moreover, caused CLECs to curtail the use of their *existing* facilities in favor of the UNE platform. *See id.* at 13-14.

The decreased investment in the telecom industry that is caused by TELRIC not only harms the communications industry and consumers, but also threatens the entire U.S. economy. One analyst has estimated that TELRIC pricing of UNEs has contributed to an annual decline in economic output and national income equivalent to $101 per household.[79] Indeed, the "reduced incentives to invest in telecommunications infrastructure and services" that are caused by TELRIC have the potential to "result in considerable economic harm."[80]

Even apart from the Commission's obligation under the biennial review to update the TELRIC regime to reflect competitive developments, other sections of the Communications Act, as well as the Constitution, require the Commission to abandon TELRIC in favor of pricing rules that are based on the incumbents' actual forward-looking costs. The Communications Act requires that UNE rates be "just, reasonable, and nondiscriminatory." 47 U.S.C. § 251(c)(3). UNE rates that are below the ILEC's actual forward-looking costs cannot meet this standard because they provide the CLECs with an artificial cost advantage and thus discriminate against the ILEC in its provision of retail services. Accordingly, the statutory standard of Section 251(c)(3) *requires* that UNE rates recover the ILEC's actual forward-looking costs.

The Constitution mandates the same result. The UNE regime gives competitors the right to the use and enjoyment of a portion of the incumbent's network and, thus constitutes a taking of property within the meaning of the Fifth Amendment and gives rise to a constitutional

[79] Stephen B. Pociask, The Effects of Bargain Wholesale Prices on Local Telephone Competition: Does Helping Competitors Help Consumers? 20 (June 2003), http://www.newmillenniumresearch.org/ archive/wholesale-report-061603.pdf.

[80] *Verizon TELRIC Comments* at 16 (quoting Kenneth Arrow, Gary Becker, Dennis Carlton and Robert Solow, Report On Behalf of Verizon 12 (Nov. 18, 2003), http://lexecon.com/documents/Publications/1/9/5/VZTECH_Report_Nov_18.pdf).

requirement to provide just compensation.[81] Just compensation, in the context of a governmental requirement that a business provide a good or service to third parties, must, at a minimum, cover the unavoidable costs of producing the good or service the government has requisitioned—*i.e.*, the actual forward-looking costs of production—and not force the entity to operate at a loss.[82] Because TELRIC calculates compensation due the ILECs based upon numerous assumptions that are divorced from the actual costs of providing, operating, and maintaining those facilities, it does not compensate ILECs for their actual forward-looking costs[83] and thus violates the Takings Clause.

In sum, the Commission must reform its TELRIC rules to reflect the current state of competition and to ensure that the pricing methodology for UNEs does not affirmatively *decrease* competition by undermining the investment incentives for all facilities-based competitors and, in particular, handicapping the ability of facilities-based wireline carriers to be vigorous competitors in the world of intermodal competition. An approach that takes into account the abundant competition in the voice telephony market and the investment incentives of market participants is the only approach to UNE pricing that will send correct economic signals to all market players and thereby remove disincentives to investment and the development of

[81] *See Bell Atlantic Tel. Co. v. FCC*, 24 F.3d 1441, 1443-46 (D.C. Cir. 1994); *GTE Northwest, Inc. v. Public Util. Comm'n,* 900 P.2d 495, 501-07 (Or. 1995); *see also First Local Competition Order*, ¶ 740 (assuming that "unbundled facilities requirements do result in a taking"); *Verizon TELRIC Comments* at 31-34.

[82] *United States v. Pewee Coal Co.*, 341 U.S. 114, 117-18 (1951) (plurality opinion) ("When a private business is possessed and operated for public use, no reason appears to justify imposition of losses sustained on the person from whom the property was seized."); *United States v. General Motors Corp.*, 323 U.S. 373, 379-83 (1945) (holding that when property is occupied by government mandate, the owner is entitled to recover his actual costs based on his particular circumstances).

[83] *Verizon TELRIC Comments* at 34; Declaration of Patrick A. Garzillo, ¶¶ 37-38 (demonstrating that TELRIC rates in Massachusetts and New York have not compensated Verizon for its actual forward-looking costs) (attached to *Verizon TELRIC Comments*).

facilities-based competition. In addition to being required under the biennial review, this result is mandated by the Communications Act and the Constitution.

C. **The Commission Should Work To Eliminate Economic Rate Regulation Pursuant to Its Authority Under Sections 10 and 11**

The Commission already has before it evidence that there exists substantial competition for end-user customer services. As Verizon has demonstrated above, and in recent filings in the *Triennial Review Order* docket, there already exists widespread competition for end-user telephone services, which constrains the rates that carriers can charge for these services. Wireless has already replaced over 19 million wireline access lines, and that number is expected to reach 34 million by 2007. Cable companies now offer voice telephone service to millions of additional homes using VOIP, and have announced plans to offer VOIP to more than 24 million homes by the end of 2004 and at least 20 million more the following year. *See* Section III.A, supra. Competitors in various markets offer services that compete with Verizon's voice telephone offerings, at rates that are comparable or below Verizon's voice telephone package rate. *See TRO Switching Ex Parte*, at Attachment 4 thereto.

Given the advent of competition for end-user telecommunications services, the Commission should move toward elimination of economic regulation of these services, as it is no longer necessary. The Commission has the authority to remove such regulations pursuant to its powers under the biennial review, 47 U.S.C. § 161, or may forbear from applying them pursuant to Section 10. *See* 47 U.S.C. § 160.

As the Commission properly noted when deregulating mobile wireless services, "[c]ompetition, along with the impending advent of additional competitors, leads to reasonable rates." *Implementation of Sections 3(n) and 332 of the Communications Act*, *Second Report and Order*, 9 FCC Rcd 1411, ¶ 174 (1994) ("Wireless Deregulation Order"). The Commission's rationale was a simple one: "in a competitive market, market forces are generally sufficient to ensure the lawfulness of rate levels, rate structures, and terms and conditions of service set by carriers who lack market power." *Id.* at 173. *See also Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order*, 11 FCC Rcd 20730, ¶ 42 (1996) ("Just as we believe that competition is sufficient to ensure that nondominant interexchange carriers' charges for interstate, domestic, interexchange services are just and reasonable, and not unreasonably discriminatory, and to protect consumers, we believe that competitive forces will ensure that nondominant carriers' non-price terms and conditions are reasonable."); *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities, First Report and Order*, 85 F.C.C.2d 1, ¶ 88 (1980) ("firms lacking market power simply cannot rationally price their services in ways which, or impose terms and conditions which, would contravene Section 201(b) and 202(a) of the Act").

The same rationale applies today to end-user telephone services. Due to the existence of competition from wireless carriers, cable companies, VOIP providers, CLECs and other new entrants, competition in the marketplace constrains the rates that carriers can charge for their services. Thus, regulation of carriers rates is no longer necessary. The Commission should use its authority under Sections 10 and/or 11 to begin eliminating such regulation.

IV. CONCLUSION

As set forth above, the Commission should use the opportunity presented by the biennial review to: (1) finish the deregulatory approach to broadband started in the *Triennial Review Order*, by clarifying several outstanding issues in that docket, and forbearing from any unbundling obligations Section 271 may be construed to impose; (2) eliminate Title II obligations and *Computer Rules* requirements that currently apply to wireline broadband Internet access services; (3) reform TELRIC so that UNE rates are based on the incumbent's actual forward-looking costs rather than unverifiable hypotheses; and (4) move toward elimination of economic regulation. It also should repeal or modify the specific rules outlined in Exhibit B, including the continuing property record rules, the ONA/CEI requirements, and various accounting and ARMIS reporting requirements.

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