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

In the Matter of:	)	
	)	
Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming	)	MB Docket No. 05-255
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REPLY COMMENTS OF VERIZON ON THE STATUS OF COMPETITION IN THE VIDEO MARKETPLACE

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I. Introduction

In its initial comments on the status of competition in the video market, Verizon explained its plans to expand consumer choice for video services with its new FiOS TV services that will be delivered over its advanced fiber-to-the premises (FTTP) network. Since the filing of those comments three weeks ago, Verizon made FiOS TV commercially available for the first time in Keller, Texas. This was an important step towards the introduction of widespread competition for wireline video services. As the GAO has found, such competition – which is nearly completely lacking now – will have dramatic effects on the price and quality of service available to video consumers.[2] The offering of video services by providers like Verizon is also

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

[2] U.S. General Accounting Office, *Telecommunications: Subscriber Rates and Competition in the Cable Television Industry*, GAO-04-262T, at 6 (March 25, 2004) *available at* http://www.gao.gov/new.items/d04262t.pdf; U.S. General Accounting Office, *Telecommunications: Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, GAO-04-8, at 3-4 (Oct. 24, 2003) *available at* http://www.gao.gov/new.items/d048.pdf.

significant because it will encourage the deployment of advanced broadband networks, like Verizon's FTTP network, thereby furthering the important policy of promoting the availability of broadband services for all Americans.

In Verizon's earlier comments, it focused largely on the regulatory impediments to competitive entry into the video market including, most notably, franchise requirements and program access issues. The comments filed by other parties in response to the Commission's NOI largely supported Verizon's views concerning the important problem areas that make it more difficult for new entrants to successfully compete. And the few defenses of the anticompetitive policies addressed by Verizon should be recognized as self-interested efforts to delay competition. Accordingly, the Commission should immediately take the available steps to reduce or eliminate barriers to entry. For example, the Commission should exercise its authority under Section 621(a) to ameliorate some of the worst features of the local franchising process that at best delay the availability of innovative and competitive offerings that benefit consumers and should close the "terrestrial loophole." And to the extent the Commission determines that it lacks authority to provide a complete solution to the issues raised by Verizon, it should encourage Congress to do so.

Effectively removing the barriers to entry identified by Verizon will not only benefit the consumers of video services, who will gain more choice, better service, and better value, but also will further the national policy of encouraging the ubiquitous deployment of broadband networks by increasing the incentives for deployment of fiber and other advanced broadband networks over which video can be transmitted.

II. Update: Verizon Is In the Video Market

In 2004, Verizon began a massive rollout of its FTTP network, installing a new, all-fiber network with sufficient capacity to meet consumers' voice, data, and video communications needs for decades to come. By the end of this year, Verizon already will have passed three million homes and businesses with FTTP, the world's most advanced network, extending fiber all the way to customers' premises. This advanced FTTP network will allow these customers to receive Verizon's FiOS Internet access service with speeds of up to 30 mbps downstream and 5 mbps upstream, in addition to voice service, and Verizon is now in the process of rolling out video services over these networks. As of September 21, 2005, residents of Keller, Texas became the first in the nation to have available to them FiOS TV provided over Verizon's FTTP network. Verizon also announced at that time that it intends to offer FiOS TV in at least six additional communities by the end of this year. Moreover, in light of the streamlined franchise process now available in Texas, Verizon has announced plans to offer FiOS TV in 21 additional communities in that state by the end of 2006.

The unveiling of FiOS TV showed its potential to bring strong competition to the cable incumbents. Verizon's initial offering in Keller includes 330 total digital channels, with a lead offer of 180 video and music channels, including 20 HD channels and over 600 video-on-demand titles (and three times that by the end of the year), for only $39.95 per month. As one analyst noted of FiOS TV, "Verizon's video service offers better value than cable at the low, mid and high ends." Credit Suisse First Boston Equity Research, *VZ Launches FiOS TV; Who's Most Exposed?,* at 3 (Sept. 26, 2005)). Another telecom analyst recognized that "[i]f the telephone companies are unleashed and they can compete head to head with the cable companies, the customers will be the winners. . . .The prices will come down, the quality of service will go up, and the variety of services to choose from will go up."[3]

Furthermore, since filing its comments, Verizon has obtained four additional cable franchises—two in Virginia, one in New York, and one in Massachusetts—bringing its total so far to 13. As previously mentioned, Verizon is currently in various stages of franchise negotiations with scores of other local franchising authorities ("LFAs") throughout its service area. But that is just the tip of the iceberg – even Verizon's initial wave of FTTP deployment will require franchise negotiations with hundreds of separate LFAs in order for Verizon to offer video service, and that number could easily reach into the thousands as the FTTP rollout continues in coming years.

III. <u>The Local Franchising Process Impedes Competition in the Video Market</u>

The single biggest obstacle to widespread competition in the video services market is the requirement that a provider obtain an individually negotiated local franchise in each area where it intends to provide service. In its comments, Verizon highlighted some of the many problems with the current local franchise regime. Although a few parties who benefit from being shielded from additional competition brush off these arguments as a "red herring,"[4] the record in this docket clearly reveals that Verizon is not alone in its concerns. As explained earlier, the Commission already has considerable authority to address many of these problems with the existing franchise system, in part through enforcement of Section 621(a). And to the extent the

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[3] Terry Maxon, *TV War Opens in Keller, Verizon is the First Big Phone Company to Sell Fiber-Optic Service*, Dallas Morning News, Sept. 22, 2005, *available at* http://www.dallasnews.com/ sharedcontent/dws /bus/stories/DN-kellertv_22bus.ART0.State.Edition2.18c0ddac.html.

[4] *See, e.g.*, Comments of RCN at iii.

Commission lacks sufficient authority to fully address these concerns; it should encourage Congress to do so.

Locality-by-Locality Franchising Requirements Are Inherently Flawed. As Verizon pointed out in its comments, the current locality-by-locality franchising process is inconsistent with the development of competitive video markets. Indeed, the current process inherently results in anticompetitive effects by requiring a new entrant into the market to give notice to the incumbent cable operator that competition is coming, thereby giving the incumbent the opportunity to delay the process and to take other steps to entrench its position. Several commenters agreed with Verizon on this point. For example, SBC agrees that "[t]he longer the delay, the higher the barrier to entry becomes" because the "cable incumbents become more entrenched and tie up more subscribers with triple play offerings." Comments of SBC at 12.

In particular, several parties agreed with Verizon that franchising requirements are especially senseless when the would-be video provider seeks to transmit video services over a network that it already has authority to build and operate for other types of services. As Alcatel notes, a local cable franchise is "superfluous" in the case of a provider who will transmit its video service over a network that it already has authority to deploy and operate. Comments of Alcatel at 9. Consumers for Cable Choice ("C4CC") likewise recognized that the "outmoded franchise process" harms consumers, and that the need for such regulation "has been eclipsed by the rate of technological innovation." Comments of C4CC at 3-4. And the Telecommunications Industry Association ("TIA") stated that "[t]he local franchise process is a regulatory barrier to entry that impedes timely investment in new facilities and capabilities, slowing delivery of competitive and innovative services to consumers." Comments of TIA, at attachment.

As Alcatel reminds the Commission, many video consumers have benefited from satellite-delivered video services, despite the lack of local regulatory involvement. Comments of Alcatel at 9. The Commission and Congress likewise should benefit consumers by making it easier for wireline video competitors to enter the market.

The Burden Associated with Franchising Deters Competition. Verizon also explained earlier that the very process of going town-to-town to negotiate video franchises is inherently expensive and slow, and creates enormous entry costs for any provider who wants to compete against the cable incumbents – particularly for a provider who intends to compete on a large scale. Again, numerous parties voiced these same concerns and provided additional evidence of the costs and delay that necessarily result from the local franchise regime. CenturyTel, for example, described the costs and delay it experienced when obtaining one recent franchise, and noted that even under the "ideal conditions" that it experienced, with no opposition from the incumbent, "the complex process of obtaining franchising lasted several months and required significant resources." Comments of CenturyTel at 3. BellSouth recounted similar experiences, noting that, in its experience, it took an average of 11 months to navigate the franchise process. Comments of BellSouth at 3-12. Numerous other commenters described similar experiences in obtaining franchises.[5] As Alcatel correctly observes, "[t]he size and scope of the local video franchise process alone is a barrier to entry that results in regulatory disparity

[5] Comments of Qwest at 9-18 ("[l]ocal franchising rules are often implemented and enforced in a manner that operates to protect incumbent CATV providers and discourage competitors . . . from entering the video market"); Comments of Cincinnati Bell at 6-9 (explaining barrier to entry posed by franchising requirements); Comments of SBC at 10-14 (explaining the "significant barrier to entry" posed by franchising requirements); Comments of the United States Telecom Association ("USTelecom") at 14-16 ("Franchising imposes substantial delay and transaction costs; the uncertainty generated by the process raises the cost of capital for prospective entrants"); *see also* Comments of BellSouth at 3-12 (noting "there can be no doubt that the local franchising process constitutes . . . an impediment" to competitive entry).

and will delay the benefits of competitive wireline video services for consumers throughout the U.S." Comments of Alcatel at 8-9.

Unreasonable Demands Exacerbate the Problem. Moreover, as Verizon explained earlier, many LFAs use the franchising process as a method for forcing prospective video providers to furnish a municipality with a variety of goodies completely unrelated to video services or to the purposes of the franchising requirement. The result of these tactics is to further increase costs and delay entry by competitive video providers. As SBC notes, "the incumbent franchising laws permit municipal authorities to demand a host of onerous requirements that could radically change the financial calculus for . . . network deployment." Comments of SBC at 13. Permitting LFAs to continue these practices will deter deployment generally, and likely will delay or deprive the residents of some areas a competitive alternative that would otherwise be available.

So-Called "Level Playing Field" Requirements Prevent Competition. Finally, Verizon explained earlier that the burdens heaped onto new entrants are further increased by so-called "level playing field" and build-out requirements, which serve to increase the costs of new entrants and shield incumbents from competition.

The incumbents take issue with Verizon on the effect of franchising requirement in general, and with "level playing field" and build-out requirements in particular, arguing that so long as new entrants "simply agree to the same franchise obligations as existing cable operators, a franchising authority would be hard pressed not to grant a franchise expeditiously." Comments of NCTA at 19-20. In their primary defense of the franchising system, the incumbents argue that so-called "level playing field" and build-out requirements enforced by LFAs are necessary in order to protect incumbents from unfair competition. Comments of NCTA at 16-24.

The incumbents' arguments in favor of these anticompetitive, so-called "level playing field" and build-out requirements are flawed, both as a matter of economic theory and in practice. Their far-fetched hypotheticals would suggest that markets need protection from those who would bring competitive choice. But as Verizon and several other commenters previously explained,[6] build-out requirements and other "level playing field" requirements primarily serve to create a substantial barrier to competitive entry that protects incumbents, not consumers.

As an economic matter, the ostensibly equal burdens that they seek to impose on new entrants in fact weigh more heavily on new entrants than on incumbents, and thus create barriers to entry. Exactly contrary to most economic regulation, these requirements are concerned with constraining a would-be competitor with a current market share of zero. One noted commentator, and former FCC chief economist, has explained why so-called "level playing field" requirements actually do just the opposite of what their name would suggest:

> Labeling nominally symmetric obligations borne by entrants and incumbents as "equal" burdens ignores the greater likelihood that the residual profits anticipated by the entrant will be insufficient to cover fixed costs, relative to the incumbent that entered without rivals.[7]

And build-out requirements, which are just one species of "level playing field" requirements, have the same effect because requiring a new entrant to serve all households in the market

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[6] *See* Comments of Broadband Service Providers Association ("BSPA") at 19 ("Requiring a new entrant to replicate an incumbent network is inherently anticompetitive"); Comments of Qwest at 10-12 (noting that "'build-out' rules are being established as the primary focus of efforts by incumbent CATV companies to restrict or avoid competition"); Comments of USTelecom at 8-14 ("In practice, build-out requirements are also perverse as they deter entry when the stated objective is likely to occur without such requirements because it appears likely to be profitable in nearly all neighborhoods to add video services to a broadband network").

[7] *See* Thomas W. Hazlett & George S. Ford, *The Fallacy of Regulatory Symmetry: An Economic Analysis of the 'Level Playing Field' in Cable TV Franchising Statutes*, 3 Business & Politics 21, 24 (2001) *available at* http://www.manhattan-institute.org/hazlett/the_fallacy _of_regulatory_symm.pdf..

"reduces the operator's degrees of freedom, raising the risk premium on a cable overbuild investment." *Id.* at 25.

Thus, these requirements increase the investment risks and make new entry less profitable by forcing a new entrant into the video business to incur – as a prerequisite to entry into a competitive market – the kinds of costs that the incumbent was able to recover over the years or even decades when it enjoyed a monopoly franchise and a captive consumer base. Such requirements blindly tax new video entrants without even taking into account the need for such expenditures and the considerably smaller upside to the provider after entering the market, given the presence of competition.

These requirements pose a particular, practical challenge for new video competitors, like Verizon, who will provide video services over networks that do not match neatly the jurisdictional franchise area boundaries. Rather than constructing a whole-new system to fit a particular franchise area, Verizon's FTTP network will be built out to overlay or replace the existing copper network that runs from a telephone wire center. When Verizon deploys FTTP, it typically builds out an entire wire center at one time, rather than picking and choosing parts of the service area served by any one center. Thus, the homes served by one wire center could very well be located in several different franchise areas. If each of these franchise areas were to require Verizon to offer video service to all locations in the jurisdiction, then the build-out requirement obligation could grow exponentially. Such requirements could mean that deployment of FTTP would be uneconomical in *any* of the franchise areas.

When considering the incumbent cable companies "level playing field" mantra, the Commission should also bear in mind the regulatory treatment that was extended when traditional cable providers entered the telephony market. In contrast to the burdensome obligations that cable incumbents seek to impose on new entrants, the Commission and the states have never required cable companies and other telecommunications services competitors to match all of the obligations imposed on the incumbent telephone companies ("ILECs"). Instead, as Alcatel points out, the cable companies enjoy "[s]treamlined entry and lighter regulatory oversight" when providing voice service. Comments of Alcatel at 10. No cable companies suggest that they should be required to build out to offer voice service to every customer in an ILEC's service area.

Moreover, the underlying factual premise of the incumbents' arguments – that new entrants will discriminate in favor of high-income areas in the absence of build-out requirements – is faulty, at least in the case of Verizon, and probably in the case of most if not all other new entrants.

Verizon has no intention of limiting its video services to high-income areas. Indeed, Verizon has a long history of making its services available to a wide range of customers. For example, Verizon now offers DSL to just under 80% of all access lines in its service area. And in 2003 and 2004, 57% of the increase in Verizon's DSL-capable lines was in rural areas. Therefore, Verizon has worked hard to make broadband services available to a wide range of customers of all income levels throughout its service area.

This is also true in the case of its new FTTP network. In fact, the very nature of Verizon's deployment belies any suggestion of discrimination. Verizon deploys its FTTP on a wire center-by-wire center basis, generally extending FTTP to all parts of the community served by the wire center, not picking and choosing particular neighborhoods. Even in the early stages of Verizon's FTTP rollout, it is clear that Verizon seeks to offer FiOS to a diverse range of subscribers throughout its service area. For example, communities like Lynn, Massachusetts, Fort Wayne, Indiana, and Passaic, New Jersey are now receiving the benefits of FTTP, even though the average income in those communities is lower than the average in their respective states. As Verizon undertakes the massive investment required to deploy FTTP, its goal is to include, not exclude, any group of potential customers.

Moreover, the approach that the incumbents ascribe to Verizon and other new entrants would be a bad business strategy. As the Commission has previously recognized, "the nature of the broad-based demand for cable services should minimize the prospect that in the long term new entrants would find it profitable to only serve limited groups of homes within a metropolitan area."[8] As such, new entrants into the video market have every incentive to make their services available to as many consumers as possible, not just the wealthy. And this is all the more true for a provider like Verizon who is already offering voice services to all consumers in its service area. In rolling out FTTP, Verizon's primary goals include marketing additional services such as video to these customers, while reducing day-to-day cost of operation by deploying an all-fiber network. Stopping short with a selective deployment in a market would not square with what Verizon seeks to accomplish in competition with cable and would be inconsistent with its core belief in diversity. Therefore, deploying fiber to only half of a market would simply make no sense given Verizon's business and goals.

IV. Effective Program Access Regulation Is Essential to Competitive Entry

In addition to obtaining franchises, Verizon explained in its earlier comments that access to programming content on fair and reasonable terms is an important issue facing new entrants into the video services market. As the Commission has previously recognized, programming is a

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[8] *See Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service*, MM Docket No. 89-600, 67 Rad. Reg. 2d (P & F) 1771, ¶ 139 n.198 (July 31, 1990).

"vital input" for a video services provider, and incumbents can "erect a potential entry barrier that impedes or deters competitive entry" by foreclosing a new competitor's access to desirable programming. *Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992 Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* 9 FCC Rcd 7442, at App. H ¶ 43 (1994). Therefore, the Commission should minimize this potential barrier to entry by revising the program access regulations to close the "terrestrial loophole," which allows large cable operators to shield certain must-have programming – most especially regional sports programming – from the program access rules. The Commission also should strictly enforce the current program access regulations to prevent other anticompetitive practices that have a discriminatory impact on competitors' ability to access content on fair and reasonable terms.

The comments filed by other parties overwhelmingly support Verizon's arguments concerning the importance of access to content, and the potential problem areas that require the Commission's attention. For example, numerous competitors agree that the "terrestrial loophole" creates an unfair exception that allows the large cable incumbents to avoid the program access rules.[9] Likewise, several commenters provide the Commission with additional evidence of other types of efforts by the incumbents to try to stave off competition through their

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[9] *See* Comments of BSPA at 13; Comments of RCN at 12-14; Comments of USTelecom at 16-17; Comments of Echostar Satellite L.L.C. at 4-5; Comments of DirecTV, Inc. at 5; Comments of Qwest at 21; Comments of SBC at 21.

control over content whether resulting from vertical integration market power.[10] In particular, the record contains abundant evidence that the incumbents use these anticompetitive approaches to deny competitors fair access to true "must-have" content like regional sports programming.

As Verizon explained in its own comments, the Commission has ample authority to address the various program access concerns, and to ensure that competition is not thwarted by the inability of new entrants to obtain access to content on fair and reasonable terms. The Commission should address these concerns now. And if the Commission concludes there is some aspect of the problems that it cannot remedy itself, it should encourage Congress to do so.

V. Cable Regulation Should Not be Interpreted in a Manner that Discriminates Against New Entrants

Verizon has pointed out several areas in which the Commission, Congress, and state and local governments could act in order to reduce barriers to entry for new video service providers, and could encourage the introduction of widespread wireline video competition and deployment of advanced broadband networks. At the same time, the Commission must reject attempts to impose additional regulation on new entrants, beyond those already imposed on incumbent cable operators.

Unfortunately, one commenter has asked the Commission to do just that. The Association of Public Television Stations ("APTS") asks the Commission to impose heightened

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[10] *See* Comments of National Telecommunications Cooperative Association at 3-10 (describing various practices engaged in by large incumbent cable companies that make it difficult for competitors to get access to content on fair terms); Comments of BSPA at 12-15 (noting heightened concerns with access to programming given increased creation of regional clusters by incumbents); Comments of RCN at 6-14 (describing actions of incumbents to restrict access to programming); Comments of Echostar at 3-13 (describing problem areas with program access, including ability of large cable companies to extract preferential treatment from unaffiliated content owners); Comments of DirecTV at 5-6 (noting "stealth discrimination" now being employed by incumbents in order to raise programming costs for competitors); Comments of Qwest at 19-24; Comments of SBC at 19-27.

multicast carriage requirements on Verizon and other providers who will be offering video services over advanced broadband networks. Comments of APTS at 31. APTS maintains that the additional capacity made available by such networks lessens one of the arguments against multicast carriage requirements that has previously been pressed by the traditional cable companies. *Id.*

APTS is correct that the capacity made available by Verizon's FTTP network far exceeds that of the traditional cable companies. Accordingly, Verizon has committed to carrying a diverse range of programming, and has expressed interest in working with the broadcast community on a voluntary basis to carry any programming – including multicast programming – that offers value to its subscribers. But what the Commission should not do is impose new regulation that discriminates against, and adds new burdens to, the new entrants in the video market. In particular, it should not adopt regulations that penalize new entrants like Verizon for investing in advanced networks that offer additional capacity. The result of such policies would be to discourage such investment in the first place.

VI. Conclusion

Congress and the Commission have long expressed an interest in encouraging competition in the video services market and deployment of broadband networks. In its opening comments, Verizon pointed to several areas where regulatory change could dramatically further those goals. The record in this proceeding overwhelmingly supports Verizon's arguments concerning the existing barriers to competitive entry. The time for the Commission and Congress to act on these issues is now.

Respectfully submitted,

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THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Southwest Incorporated d/b/a Verizon Southwest
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.