Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition of Qwest Corporation for Forbearance	)	WC Docket No. 04-223
Pursuant to 47 U.S.C. § 160(c) in the Omaha	)	
Metropolitan Statistical Area	)	

COMMENTS OF TELECOM INVESTORS IN SUPPORT OF MCLEODUSA PETITION FOR MODIFICATION OF *OMAHA FORBEARANCE ORDER*

Andrew D. Lipman
Joshua M. Bobeck
BINGHAM MCCUTCHEN LLP
2020 K Street, NW
Washington, D.C. 20006
(202) 373-6000

Attorneys for Columbia Capital and M/C Venture Partners

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Columbia Capital and M/C Venture Partners (together the "Telecom Investors") by their counsel, respectfully submit these comments in the above-captioned proceeding.

SUMMARY

The Commission should immediately reinstate Qwest's unbundling obligation throughout the Omaha MSA. No sooner did the Commission apparently achieve the regulatory stability necessary to foster investment in local telecommunications competition than the *Omaha Forbearance Order* pulled the rug from underneath existing and potential investors. By relieving Qwest of its obligation to provide unbundled loop and transport facilities in much of the Omaha MSA, the Commission froze the market for investment in competition in Omaha.

The Commission's stated rationale for granting Qwest unbundling relief rested on vague predictions about the competitive pressures on Qwest from the presence of a single facilities-based competitor — the region's predominant cable company. In short, the Commission believed (despite a contrary finding in the *Triennial Review Remand Order*) that the presence of competition from Cox *alone* would discipline's Qwest's innate tendency to deny competitors reasonable access to last mile facilities.

Of course the inevitable followed: McLeodUSA, the CLEC with the most significant presence in Omaha, sought to obtain the reasonable access the Commission predicted would be forthcoming from Qwest. None materialized. McLeodUSA now is asking the Commission to correct its mistake, as it promised it would if needed. In addition, Qwest and Verizon have filed petitions asking the Commission to repeat and expand on the Omaha mistake but in much larger markets.

The consequences of failing to act swiftly on this Petition are grave. Investors do not throw good money after bad. McLeodUSA's staged withdrawal form the Omaha market serves as a prime example of basic economic theory. If McLeodUSA is unable to price its services

competitively, its sunk investment in fiber and collocation in Omaha is irrelevant. As any rational investor would do, McLeodUSA is scaling back its presence to a level where it can compete regardless of the sunk investment left behind. If McLeodUSA is unable to continue competing in Omaha, no rational investor would fund another competitors leaping into that fray. Integra, for example, scrapped its plans to compete in Omaha in the wake of the *Order*. No further investments will flow towards competitors in Omaha unless the Commission breaks the continued last mile bottleneck and reinstitutes unbundling in the Omaha MSA.

Forbearance effectively ceded control of the Omaha local telecommunications market to dueling incumbents — the incumbent LEC Qwest and the incumbent cable operator Cox. The harm to competition in markets with two dominant sellers is well documented. Rather than compete vigorously, firms in such markets have an incentive to maximize joint profits, at the expense of competition. Interdependent behavior between the two firms is inevitable because their strategic decisions will have a direct effect on each other. Each firm knows that if takes an action to the detriment of its competitor the other must and will respond. For this reason, the Commission has directed its policy at encouraging a broader range of competitive alternatives. And Congress did so as well in the 1996 Act, mandating unbundling despite the well accepted premise that cable companies had facilities in place to compete with the incumbent LECs. But the Commission prematurely abandoned the unbundling regime in Omaha.

Omaha is just the tip of the spear. The BOCs are poised to obtain similar relief in much larger markets where much larger competitive investments are at stake. The Commission must not repeat the mistake of Omaha and should correct it immediately by restoring Qwest's unbundling obligation.

INTRODUCTION

The Telecom Investors are a group of investment firms that, since enactment of the Telecommunications Act in 1996, collectively have invested several billion dollars in companies that compete with incumbent cable and telecommunications companies. The past ten years have been challenging for the Telecom Investors and their contemporaries, given the unsettled nature of the underlying regulatory scheme. In spite of this, the Telecom Investors have generally been confident throughout that time that the Commission has been committed to furthering competition in the telecommunications industry. That confidence, however, was shaken in the wake of the FCC's *Omaha* forbearance decision,[1] which, unless revisited, threatens to undermine the growth of competition Congress mandated through the 1996 Act.

As the Petition of McLeodUSA explains, reality has undermined one of the principal bases on which the Commission relied for granting Qwest relief from its unbundling obligations. Where the Commission predicted Qwest would continue to offer competitors access to loop and transport elements necessary to compete, Qwest has done so in name only. Instead, Qwest has offered McLeodUSA terms and conditions under which no competitors could compete. In effect, McLeodUSA's petition demonstrates that Qwest has effectively withdrawn reasonably priced access to its bottleneck facilities from the market.

An important overall requirement of Section 10 of the Communications Act[2] is that forbearance promote competitive market conditions and enhance competition.[3] In the *Omaha Order*, however, rather than enhancing competition, the Commission's premature deregulation of

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[1] *See e.g. Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area,* 20 FCC Rcd 19415 (2005) ("*Omaha Order*").

[2] 47 U.S.C. § 160.

[3] *Id.* § 160(b).

Qwest serves only to solidify an entrenched duopoly (and in some cases a monopoly) that will permanently resist competition and repel further investment in competitive alternatives. The Commission is well aware that incumbent cable and wireline providers control a vast majority of the local telecommunications market, and the first mover advantages that both enjoy. It is only through loop/transport unbundling and disciplined special access rates that new entrants can hope to carve out a place in the market. Without these, there is little hope of any significant competition for the future.

In the *Omaha Order*, the Commission recognized that the entrenched cable company could not immediately provide alternative services to enterprise markets customers in the nine wire centers where the Commission granted forbearance. Recognizing the lack of ubiquitous facilities and facilities needed to meet customer demand, the Commission predicted that Qwest would continue to make wholesale access available to competitors. As McLeodUSA has demonstrated, this "prediction" was mistaken.

Although the Commission often finds it necessary to render predictive judgments in performing its statutory duties, it is also obligated to take corrective measures when the marketplace fails, proving its predictions incorrect. McLeodUSA's petition affords the Commission a rare chance at a "do-over": to remedy its predictive judgment and to restore Qwest's unbundling obligations in the Omaha MSA until real competition is entrenched and Qwest no longer controls bottleneck transmission inputs necessary for competitors to serve their customers.

The Commission is long on record as having grave concerns about the dangers of duopoly, agreeing with economists that duopolies in any telecommunications market tend to create significant anticompetitive effects and to generate supracompetitive rates. McLeodUSA's difficulties obtaining reasonably priced access to last mile facilities in the Omaha market underscore the dangers of duopoly as neither Qwest nor the incumbent cable operator has an incentive to facilitate access to customers by a third entrant. Regardless of the Commission's predictive powers, the Commission has a duty to correct its erroneous predictions when market failure results. And the McLeodUSA Petition serves notice to this Commission that Omaha is an abject market failure that must be remedied immediately.

I. The Commission is Obligated to Revisit the Forbearance Relief Granted in the *Omaha Order*

In the *Omaha Order* the Commission recognized that it retained the power to "reconsider" or modify the relief granted to Qwest if justified by new information.[4] But this is only partly accurate because when "the FCC's predictions about the level of competition [do] not materialize, then it will of course *need* to reconsider its [regulations] in accordance with its continuing obligation to practice reasoned decisionmaking."[5] In other words, under well-settled principles of administrative law, "an agency may be forced to reexamine its approach if a significant factual predicate of a prior decision … has been removed."[6]

The courts have also emphasized that, where, as here, the Commission has based its existing regulatory regime on a predictive judgment, it is absolutely imperative that "the Commission … vigilantly monitor the consequences of its … rules."[7] "If, in light of the actual market developments, the Commission determines that competition is not having the anticipated effect," it must "revisit the issue."[8]

4 *Omaha Order*, 20 FCC Rcd at 19456, ¶ 84 n.204.

5 *Cellnet v. FCC*, 149 F.3d 429, 442 (6th Cir. 1998).

6 *Bechtel v. FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992).

7 *American Civil Liberties Union v. FCC*, 823 F.2d 1554, 1565 (D.C. Cir. 1987).

8 *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313, 325 (5th Cir. 2001).

The Commission itself limited the scope of the forbearance relief it granted to Qwest in Omaha because, "[t]he merits of the Petition warrant forbearance only in locations where Qwest faces sufficient facilities-based competition to ensure that the interests of consumers and the goals of the Act are protected under the standards of section 10(a)."[9]

That "sufficient facilities-based competition" also included "actual and other potential competition," that the FCC found "either present, or readily could be present," in the Omaha MSA.[10] In particular, the Commission's finding of sufficient competition included an assessment of "other statutory and regulatory provisions designed to promote the development of competitive markets," that remained applicable in the Omaha MSA.[11] Specifically, the Commission noted that competitors would continue to have access rights to Qwest's loops and transport at just and reasonable rates under Section 271(c)(2)(b)(iv)-(vi).[12]

However, the Commission admitted that the "record does not reflect any significant alternative sources of wholesale inputs for carriers" in the Omaha MSA.[13] Despite this finding, the Commission theorized that Qwest's wholesale offerings to potential competitors would be adequate to sustain competition, even in the absence of cost-based UNE loop and transport offerings.[14] "Qwest has provided evidence that a number of carriers have had success competing for enterprise services using DS1 and DS3 special access channel terminations obtained from Qwest, presumably in addition to loops at least some of these competitive carriers self-provision

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9 *Omaha Order,* 20 FCC Rcd at 19445, ¶ 61.

10 *Id*. at 19446, ¶ 62.

11 *Id*. at 19444, ¶ 64.

12 *Id*. at 19446, ¶ 62.

13 *Id*. at 19448-49, ¶ 67.

14 *Id*.

where economically feasible."[15] The FCC hypothesized that this "competition," using special access facilities, "in conjunction with" potential and existing facilities-based competition from Cox, supported the conclusion that continued unbundling of loops and transport in the enterprise market was also unnecessary.[16]

Lastly, the Commission made the "predictive judgment" that Qwest would not curtail wholesale access to its loop and transport facilities upon forbearance. Specifically, the Commission asserted that "competition that relies on Qwest's wholesale inputs — which must be priced at just, reasonable and nondiscriminatory rates and is subject to Qwest's continuing obligations under section 251(c)(4) [resale] and section 271(c) [271 UNEs] — supports our conclusion that section 251(c)(3) [cost-based] unbundling obligations are no longer necessary to ensure that the prices and terms of Qwest's telecommunications offerings are just and reasonable and nondiscriminatory under section 10(a)(1)."[17].

Integra Telecom, Inc. ("Integra") has also emphasized that it entirely abandoned its plans to enter the Omaha market as a result of the *Omaha Forbearance Order*.[18] It found that it was substantially less attractive economically to enter the Omaha market without access to unbundled network elements at TELRIC rates "in the entire Omaha market" and decided that "the investments it was prepared to make to provide service in the Omaha market would be better" utilized

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15 *Id*. at 19449, ¶ 68.

16 *Id*. at 19450 ¶ 68.

17 *Id*. (emphasis supplied).

18 Comments of Integra Telecom, Inc., WC Docket No. 06-172, at 5 (filed March 5, 2007) ("The Commission's 'predictive judgment' that the ILEC will have an incentive to offer wholesale facilities at reasonable rates to its competitors has proven to be flawed in Omaha. The prediction "that Qwest will not react to our decision here by curtailing wholesale access to its analog, DS0, DS1, or DS2-capacity facilities turned out to be wrong.").

in other markets.[19] It emphasized the infeasibility of Omaha market entry via deployment at special access rates, noting that it would be extremely difficult for a CLEC to serve small and medium business customers in competition with the ILEC if loops and transport were priced at special access rates.[20]

The McLeodUSA petition coupled with Integra's comments demonstrates that the Commission's prediction was wrong. The Commission would be shirking its responsibilities to faithfully implement the act as well its obligation to engage in reasoned decision decisionmaking if it fails to take this opportunity to correct and obvious market failure. Because "the FCC's predictions about the level of competition [did] not materialize, then it will of course need to reconsider its [regulations] in accordance with its continuing obligation to practice reasoned decisionmaking."[21] The new information provided by McLeodUSA's petition should be sufficient for the Commission to revisit the *Omaha Order* and correct its mistake.

II. The Commission Should Modify the Omaha Order and Restore Qwest's Obligation to Provide UNEs Throughout the Omaha MSA

Although the *Omaha Order* erred insofar as it granted Qwest's request for forbearance from UNE obligations in Omaha, the Commission correctly declined to find Qwest nondominant in provision of high capacity loops and transport even though it also found that Cox was a significant intermodal competitor.[22] The Commission should remedy this apparent inconsistency by modifying the forbearance relief granted to Qwest. Restoring Qwest's obligation to provide cost-based UNEs throughout the Omaha MSA will encourage further investment in competitive

[19] *Id.* at 4.

[20] *Id.* at 5.

[21] *Cellnet*, 149 F.3d at 442.

[22] *Omaha Order*, 20 FCC Rcd at 19439 ¶ 51.

alternatives and will stimulate competition rather than stimulate the profits of cable and telephone duopolists.

The Commission has historically identified the dangers of undue concentration in communications markets and used regulatory tools available under the Act to discipline anticompetitive behavior. In the AT&T Non-Dominance Proceedings, the Commission established a standard that dominant carrier regulation remains necessary unless there are least two full-fledged facilities-based competitors offering fully substitutable services, along with other carriers offering less robust competitive services.[23]

In recent decisions, the Commission has explained the dangers of prematurely deregulating incumbents that control bottleneck last mile facilities. In the *Qwest Section 272 Sunset Forbearance Order*, the Commission found that Qwest maintained "control of bottleneck facilities" which Qwest could use to "raise its rivals costs" and thus forbearance from regulation of long distance services for which such facilities remained a critical input would be premature.[24] Similarly, in an order released last week, the Commission noted the need to "analyze separately the extent of competition for wholesale special access services" because these services "serve as such an important input for other carriers' provision of retail enterprise services."[25] Under that analysis the Commission found that it "cannot assume the continued availability of such inputs

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[23] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, 3308 ¶ 70 (1995).

[24] *Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules as They Apply After Section 272 Sunsets*, 22 FCC Rcd 5207, 5216 ¶ 14 (2007).

[25] *Petition of ACS Anchorage, Inc Pursuant to Section 10 of the Communications Act of 1934, as amended (47 U.S.C. § 160(c)) for Forbearance from Certain Dominant Carrier regulation of its Interstate Access Services, and for Forbearance form Title II regulation of Its Broadband Services, in the Anchorage, Alaska Incumbent Local exchange Carrier Study Area*, WC Docket No. 06-109, Memorandum Opinion and Order, FCC 07-149, rel. Aug. 20, 2007, at ¶ 31. ("*ACS Anchorage Forbearance Order*").

on prices, terms, and conditions to allow competitors to increase their supply in response to attempts by ACS to exercise market power" in the event the deregulation requested was granted.[26] The Commission further found that even if rates could be controlled, the incumbent controlling bottleneck facilities "would still have the incentive ad ability to increase its rivals' costs by manipulating the terms and conditions under which it offered and provisioned such service,[27] and that this would harm consumers.[28]

The Commission is long on record as having grave concerns about the dangers of duopoly, agreeing with economists that duopolies in any telecommunications market tend to have significant anticompetitive effects and to generate supracompetitive rates. Qwest's rates in the near-duopoly environment in which it currently operates in Omaha, notwithstanding the purported competition that it must contend with, supports this hypothesis. Given this, great predictive powers are not necessary – the Commission need only extrapolate from the present to envision the damage to competition, investment and the public interest if it refuses to revisit its Omaha forbearance decision.

McLeodUSA's Petition demonstrates that in the Omaha MSA, Qwest, at most, faces a single facilities-based competitor offering a comparable telephone exchange service – and only in the nine wire centers where the Commission granted relief can Qwest realistically suggest that the majority of its subscribers have this option. In other words, Qwest is, at best, a duopoly provider, and as evident from its dealings with McLeodUSA still retains substantial market power.

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[26] *Id.* ¶ 54.

[27] *Id.* ¶ 87

[28] *Id.* ¶ 90.

The Commission is aware that duopoly between the cable operator and the incumbent LEC remains the status quo in many local markets across the country—including Omaha. For example, in the FCC's most recent data on advanced services, 96% of all high-speed lines in the U.S. were provided either by the incumbent LECs or the cable operators.[29] What is worse, this actually represents an increase over the last few years, from 94% of the market.[30]

The Commission recognizes that cable providers and ILECs have advantages that other entrants cannot hope to match. "[B]ecause of their unique economic circumstances of first-mover advantages [*i.e.*, these companies had the advantages not available to other entrants of beginning with exclusive franchises and a captive market] and scope economies, have access to the customer that other competitive carriers lack."[31]

For competitors with no existing distribution facilities and no captive customers from monopoly telephone or video services, construction of a ubiquitous distribution infrastructure from the ground up requires massive amounts of capital as well as protracted lengths of time making pure facilities-based competitive entry uneconomic.[32]

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[29] FCC, High Speed Services for Internet Access: Status as of December 31, 2005, Table 6 – High-Speed Lines by Type of Provider (rel. July 26, 2006).

[30] FCC, High Speed Services for Internet Access: Status as of December 31, 2003, Table 5 – High-Speed Lines by Type of Provider (rel. June 8, 2004).

[31] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978, 17164, ¶ 310 and n.905 (2003) ("*TRO*").

[32] GAO, Telecommunications - FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, GAO-07-80 at 26 (November 2006) ("*GAO Report*") ("the high sunk costs … of constructing local networks, the cost of local government regulations, and limited access to buildings … [a]ll … can increase competitors' cost to deploy facilities and provide dedicated access services to locations within an MSA. Constructing a local telecommunications network is extremely capital intensive. Most communications equipment has no other use and therefore can not be reused for alternative purposes. Because these investments would have virtually no alternative value if the business fails, competitors must have a certain level of expected revenue to extend their networks.")

In order to compete, a competitor requires access to existing Section 251(c)(3) bottleneck loop and transport UNEs at TELRIC-based rates. As McLeodUSA has shown, without the essential cost-based UNE pricing safeguard, there is nothing to prevent the ILEC from raising prices on wholesale services to something "close to or equal to" the retail rate, creating price squeezes.

The Commission recognized as much, when it determined that "[w]e do not believe that the Act's general provisions designed to guard against anticompetitive behavior are sufficient to protect competitive carriers from potential abuses of special access pricing on a timely basis."[33] Rather, the Commission determined that the availability of cost-based UNEs functions as a critical check on special access pricing, and that elimination of cost-based UNE availability to CLECs using tariffed alternatives might preclude competition using those tariffed services going forward.[34] It concluded that a bar on cost-based UNE access wherever CLECs could use special access,

> would diminish the facilities-based competition that is the most effective discipline to anticompetitive price squeezes. Such a rule would allow an unacceptable level of incumbent LEC abuse because incumbent carriers could strategically manipulate the price of their direct competitors' wholesale inputs to prevent competition in the downstream retail market. Moreover, we believe that the uncertainty and risk associated with even the possibility of such abuse would chill competitive entry ….[35]

This rationale of course was not followed in the *Omaha Order*, based on the Commission's belief that the threat of enterprise competition from Cox would prevent Qwest from

[33] *Unbundled Access to Network Elements,* 20 FCC Rcd 2533, 2569 ¶ 62 (2005) ("*TRRO*").

[34] *Id*. at 2574, ¶ 65.

[35] *Id.* at 2570, ¶ 63.

"strategically manipulat[ing] the price of their direct competitors' wholesale inputs….",[36] McLeodUSA's subsequent experience, however, shows that the Commission was correct in the *TRRO*.[37] Without access to unbundled loops and transport, CLECs wishing to compete in Omaha must choose either to purchase Qwest's special access at supracompetitive — and effectively unregulated — levels or exit the market.[38] In order to continue to compete using special access, competitors will most likely need to increase their rates or reduce their margins (to the extent there was any margin to reduce). Reducing margins will retard investment because funds needed for capital expenditures to develop competitive networks would instead be used to pay Qwest's inflated special access rates, benefiting Qwest's investors rather than those of competitors, to the ultimate detriment of end users.

As discussed above, Qwest and the incumbent cable company are the only providers with ubiquitous last-mile networks to most of the mass market and small business customers in the nine wire centers in Omaha, and it is now apparent that neither company will provide reasonable access to their last mile facilities absent a statutory mandate.[39] Competitor costs for deploying their own last mile facilities are prohibitive.[40] Wireless and VOIP services do not provide substitutes for local wireline telephone services for most end users. Therefore, if the Commission

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[36] *See id.*

[37] McLeodUSA Petition at pp. 8-9 (Qwest proposal to charge McLeodUSA nearly 30% more for a stand alone DS0 loop then when the same loop is bundled with switching).

[38] *See id.* at p. 14.

[39] *See id.* at pp. 8-10.

[40] *See* Declaration of Pritesh D. Shah, attached to McLeodUSA petition at ¶ 5 ("it is not economically feasible for McLeodUSA to build last mile loop facilities to the vast majority of small and medium business customers, given the capital and resources required to provision last mile access loops, and the return on that capital that could be realized given the monthly revenue generated by small and medium sized business customers, and even by many large business customers.")

fails to act, no additional local service competitors will emerge in the Omaha market. The ultimate result would be to condemn customers in Omaha to a Qwest/cable duopoly for mass market and small business customers.

A. Modifying the *Omaha Order* is Necessary to Encourage Investment in Competition in Omaha

In the *Omaha Order*, the Commission concluded that forbearance was in the public interest because regulatory intervention results in reduced incentives to invest in facilities as well as creating the additional problem of regulating the sharing of facilities.[41] Unfortunately, this analysis was only concerned with impediments to BOC investment, as if no other entity can invest in the industry. BOC investment, however, fosters monopoly, not competition.

This view of investment incentives also undermines and retards CLEC investment even where substantial investments have already been made.[42] The Commission recognizes that the primary role of sunk costs is to act as an entry barrier.[43] Investors do not continue to pour capital into a losing business, and the Commission should not base policy on the assumption that they will.

Refusing to undo its *Omaha Order* mistake will indeed deter investment, not only in the Omaha MSA but industry-wide by sending a resounding negative signal to the investment

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[41] *Omaha Order*, 20 FCC Rcd at 19454, ¶ 76.

[42] *See e.g. id.*

[43] "The costs of local loops serving the mass market are largely fixed and sunk…. That is, local loop facilities are not fungible because they cannot be used for any purpose if the investment fails.… A carrier will not deploy mass market loops unless it knows in advance that it will have customers that will generate sufficient revenues to allow it to recover its sunk loop investment…. Incumbent LECs also enjoy first-mover advantages that work with the steep costs noted above *to compound the entry barriers* associated with local loop deployment. When the incumbent LECs installed most of their loop plant, they had exclusive franchises and, as such, the record shows that they secured rights-of-way at preferential terms and at minimal costs. By contrast, our record shows that new entrants have no such advantage. Even if a competitive LEC obtains speedy resolution of right-of-way issues, it may still experience delays involved with constructing new loop plant." *TRO*, 18 FCC Rcd at 17122-124, ¶¶ 237-238 (emphasis supplied).

community. While the Commission sanctions a protected duopoly, investment will flow to the duopoly providers and away from new entrants. This is particularly true in the local exchange market, given the high barriers to entry that tend to strengthen duopolies.[44] McLeodUSA has sunk investments in switches and feeder networks to serve their customers in Omaha premised on the continued availability of UNE loops at TELRIC-based rates, particularly high capacity loops.[45] As McLeodUSA market exit shows, when the Commission undermines this premise, investments will be redirected, and the duopolists will tighten their stranglehold on the market. If the Commission is truly committed to innovation and competition, it cannot continue to undermine facilities-based competition.

B. Modifying the *Omaha Order* is Necessary to Thwart Development of a Duopoly Market

In the Omaha Order the Commission postulated that "the facilities-based competition between Qwest and Cox," coupled with "actual and potential competition from established competitors" relying on "wholesale access rights … under sections 251(c) and section 271 … minimizes the risk of duopoly."[46] The Commission further found, however that finding a fully competitive market (i.e a market that is not a duopoly) was not necessary under the statutory forbearance standard.[47] This claim, however ignores the uniformly held view of economists and

[44] *Application of Echostar Communications Corp.*, 17 FCC Rcd 20559, 20625-626, ¶ 174 (2002) ("*Echostar*") (explaining that factors which increase the possibility of collusion include, among other things, high barriers to entry.)

[45] The Commission has previously found that it is generally not economically feasible for CLECs to self-provision below the DS3 level. "When competitive LECs self-deploy fiber they predominantly do so at the OCn level…. [T]he record contains little evidence of self-deployment, or availability from alternative providers, for DSl loops. As for DS3 loops, evidence of self-deployment and wholesale availability is somewhat greater than for DS1s and is directly related to location-specific criteria." *TRO*, 18 FCC Rcd at 17155-156, ¶ 298.

[46] *Omaha Order*, 20 FCC Rcd at 19452, ¶ 71.

[47] *Id*.

the Commission itself, as well as ample practical experience, that duopoly markets are not competitive. "Although virtually anything is possible, both the more plausible theories and the evidence suggest strongly that oligopoly pricing departs from competitive norms, often substantially."[48] It is hard to fathom how deregulation that condemns a market to a duopoly protect consumers, satisfies the public interest or is otherwise consistent with the forbearance standard.[49]

Economists have long taught that duopolies contribute to anticompetitive markets because both parties are reluctant to engage in mutually assured destruction. Any rate decrease or service enhancement must be met by the other. Consequently, both parties have an incentive to act so as to maximize joint profits, at the expense of competition. A duopoly makes interdependent behavior inevitable between the duopolists simply because their marketing decisions of one will have a direct effect on the other. Each firm knows that if takes an action to the detriment of the other, the other must and will respond. "Though each may independently decide upon its own course of action, any rational decision must take into account the anticipated reaction of the other … firm[]…. Because of their mutual awareness, oligopolists' decisions may be interdependent although arrived at independently."[50]

This interdependent decision leads to monopoly type results. One party might seek to increase sales through a price reduction, except it can assume that the other firm would respond accordingly. The result would be that neither will gain market share, but both will reduce their profits. In fact, this concept can work in reverse as "price leadership." One party might raise its prices. Even without any express collusion, the other firm may follow this lead. Though neither

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[48] Phillip E. Areeda and Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application § 404b (2d edition 1998-2006 and supp. Sep. 2006) ("*Areeda*").

[49] *See* 47 U.S.C. § 160(a).

[50] *Id.* § 1429a.

has gained market share, they have increased industry profits.[51] Results are likely to be particularly anti-competitive when, like in Omaha (and other local exchange markets), the number of firms is small, market shares are comparable, products are homogeneous, the buyers are homogeneous (particularly in size), and each provider can readily and quickly monitor actual prices.[52]

The Commission has consistently expressed its concerns regarding the harms that result in this type of market concentration. Up until *Omaha Order*, the Commission had held that duopoly markets are insufficiently competitive because duopolists tend to collude, even if tacitly, so as to achieve supracompetitive rates and restrict product offerings.

For example, the Commission has held that a merger resulting in duopoly carries a "strong presumption of significant anticompetitive effects."[53] In his separate statement, Chairman Powell emphasized "[a]t best, this merger would create a duopoly in areas served by cable; at worst it would create a merger to monopoly in unserved areas. Either result would decrease incentives to reduce prices, increase the risk of collusion, and inevitably result in less innovation and fewer benefits to consumers. That is the antithesis of what the public interest demands."[54] The Chairman's concerns were recently confirmed when the Commission reported that average cable rates actually *increased* from one year to the next in areas with wireline competition.[55] In its Report, the Commission revealed that cable rates in communities with a wireline competitor

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[51] *See id.* § 1429b.

[52] *Id.* § 404c9.

[53] *Echostar*, 17 FCC Rcd at 20604, ¶ 99 and 20605, ¶ 102.

[54] *Id.* at 20684, Separate Statement of Chairman Michael K. Powell.

[55] Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment, 21 FCC Rcd 15087 (2006).

saw increases greater than the overall market in 2004. In those areas, cable rates increased 5.3% to $35.94.[56]

In respect to wireless service, it has held that "the duopoly market structure was established in full recognition of the fact that only two carriers to a market was not ideal in terms of promoting competition"[57] and that a "duopoly cellular market" is "imperfectly competitive."[58] Overall, the Commission has observed that only "a market that has five or more relatively equally sized firms can achieve a level of market performance comparable to a fragmented, structurally competitive market."[59]

With regard to the market for instant messaging, the Commission concluded that:

> From among all entrants into the IM business, AOL points especially to Microsoft as a significant rival. AOL claims that Microsoft's presence, and especially its recent growth in the market, demonstrates that AOL does not dominate IM…. However, Microsoft has not always been able to leverage its control of the Windows desktop into dominance of other applications. In addition, in IM today, AOL benefits from network effects and first mover advantages; and, as we discuss below, the proposed merger would give AOL significant, additional advantages over Microsoft, Yahoo!, and smaller IM providers. *And even if Microsoft's NPD did grow to rival AOL's, the result would be merely a duopoly, not the healthy competition that exists today in electronic mail and that we hope will exist in new IM-based services and AIHS in particular.*[60]

And, as the Commission explained in regard to ILEC/cable duopolies:

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[56] *Id.* at 15093, Table 1.

[57] *Petitions for Rulemaking Concerning Proposed Changes to the Commission's Cellular Resale Policies*, 6 FCC Rcd 1719, 1730 n.67 (1991).

[58] *Interconnection and Resale Obligations Pertaining to Commercial Mobile Radio Services*, 11 FCC Rcd 18455, 18470 ¶ 27 (1996).

[59] *2002 Biennial Review – Review of the Commission's Broadcast Ownership Rules Telecommunications Act of 1996*, 18 FCC Rcd 13620, 13731 ¶ 289 (2002).

[60] *Applications of Time Warner Inc. and America Online, Inc.*, 16 FCC Rcd 6547, 6617 ¶ 163 (2001) (emphasis added).

> We believe that Congress rejected implicitly the argument that the presence of a single competitor, alone, should be dispositive of whether a competitive LEC would be "impaired" within the meaning of section 251(d)(2). For example, although Congress fully expected cable companies to enter the local exchange market using their own facilities, including self-provisioned loops, Congress still contemplated that incumbent LECs would be required to offer unbundled loops to requesting carriers. A standard that would be satisfied by the existence of a single competitive LEC using a non-incumbent LEC element to serve a specific market, without reference to whether competitive LECs are "impaired" under section 251(d)(2), would be inconsistent with the Act's goal of creating robust competition in telecommunications. In particular, such a standard would not create competition among multiple providers of local service that would drive down prices to competitive levels. Indeed, such a standard would more likely create stagnant duopolies comprised of the incumbent LEC and the first new entrant in a particular market. An absence of multiple providers serving various markets would significantly limit the benefits of competition that would otherwise flow to consumers.[61]

The D.C. Circuit has similarly explained that "a durable duopoly affords both the opportunity and the incentive for both firms to coordinate to increase prices … above competitive levels"[62] and that "[t]he combination of a concentrated market and barriers to entry is a recipe for price coordination."[63]

The reality on the ground in Omaha underscores the well accepted policy rational against allowing duopolies. Even before the Commission's premature relief granted Qwest in Omaha, Qwest retained a natural incentive to raise rates. As professional investors, the Telecom Investors understand Qwest's duty to its shareholders to maximize its shareholders profits. This means that Qwest must, at all times, strive to direct cost savings to the benefit of shareholders in the form of higher margins instead of to its customers in the form of lower prices. Only if it is disciplined by

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[61] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 3696, 3727 ¶ 55 (1999).

[62] *F.T.C. v. H.J. Heinz Co.*, 246 F.3d 708, 725 (D.C. Cir. 2001).

[63] *Id.* at 724.

competitive forces will the latter occur. The question, then, is whether the Commission believes its duty to the public interest under Section 10(c) devolves to the benefit of Qwest shareholders or consumers in the Omaha MSA.

III. CONCLUSION

For the forgoing reasons, the Commission should grant McLeodUSA's Petition, and should reinstate Qwest's statutory unbundling obligations in the Omaha MSA.

Respectfully submitted,

Andrew D. Lipman
Joshua M. Bobeck
BINGHAM MCCUTCHEN LLP
2020 K Street, NW
Washington, D.C. 20006
(202) 373-6000

Attorneys for Columbia Capital and M/C Venture Partners

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