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

In the Matter of	)	
	)	
Petition of Verizon Telephone Companies for	)	WC Docket No. 08-49
Forbearance Pursuant to 47 U.S.C. § 160(c)	)	
in Cox's Service Territory in the Virginia Beach	)	
Metropolitan Statistical Area	)	
	)	

TELECOM INVESTORS' OPPOSITION TO VERIZON'S PETITION

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SUMMARY

The Telecom Investors are a group of investment firms that, since enactment of the Telecommunications Act of 1996, collectively have invested several billion dollars in companies that compete with incumbent cable and telecommunications companies. The past twelve years have been challenging for the Telecom Investors and their contemporaries, given the boom and bust experience of the industry and 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 in some fashion or another. While this confidence was somewhat shaken in the wake of the *Omaha Order*, the Commission demonstrated its commitment to the Omaha standard in unanimously and categorically rejecting Verizon's six forbearance petitions in December 2007 that would have battered investor confidence. That confidence, and the confidence of investors in the Commission's commitment to maintaining regulatory stability to foster new investment is again challenged by Verizon's premature petition for Virginia Beach, filed virtually three months after the Commission affirmed adherence to the standard established in Omaha.

While Verizon labels its latest attempt to obtain premature deregulation of local telephone markets it still controls as a new forbearance petition, this labels masks Verizon's intent to belatedly petition the Commission for reconsideration of its already rejected forbearance petition for the Virginia Beach MSA. The Commission should not sanction this brazen abuse of the statutory forbearance provision.

An important overall requirement of Section 10 of the Communications Act is that forbearance promote competitive market conditions and enhance competition. However, just the opposite will occur if Verizon is granted any of the relief it seeks. Rather than enhancing competition, the Commission will solidify an entrenched duopoly for consumers in Virginia Beach 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 of the first mover advantages that both enjoy as result of their historical monopolies. It is only through access to 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.

It is most unfortunate that the Commission undertakes this proceeding at this time. Competitors have enjoyed considerable new investment in the last eighteen months, in many instances helping defray the substantial investment CLECs have made to deploy innovative new services (such as Ethernet and IPTV) over legacy copper loops. These investments are the product of a deliberate policy choice the Commission made in the *Triennial Review Order* and it is folly to turn back from that choice here. Doing so would only send a chilling signal to CLECs and investors alike that the Commission will not support investment to deploy innovative technology to use the nation's ubiquitous legacy copper infrastructure.

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. Already, Verizon has raised rates in the near-duopoly environment in which it currently operates, notwithstanding the purported competition with which it must contend. 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 grants forbearance.

While Verizon again requests "substantially the same regulatory relief that the Commission granted in the *Omaha Forbearance Order,*"[1] it is self- evident that Verizon hopes to gain forbearance without meeting the evidentiary bar established in *Omaha* and applied in December's *Six MSA Order*. However, the Commission declared up front in the *Omaha Order* that this was not a reasonable expectation, stressing that its decision there was based on the totality of the record evidence particular to the Omaha MSA. In fact, Verizon's request is not based on the same circumstances that the Commission found in Omaha, because Verizon has ignored the Commission's two step test, again urging the Commission to adopt a different and more relaxed standard for the Virginia Beach petition.

Section 10(a) of the Act contains three prongs, each of which must be met in order for the Commission to forbear from enforcement of a rule or provision of the Act. If so, the effective result is a finding of non-dominance in the market for the products or services at issue. Verizon has not—indeed cannot—establish that it has met this standard. It clearly remains dominant in the local exchange market, and is by far the major supplier of last-mile connectivity for Virginia Beach businesses.

In its Petition, Verizon describes a number of purported competitors, but in all cases its evidence is general in scope and shallow in depth. Cable (and by extension, DOCSIS-based VoIP) represents competition in the area of residential voice service, but it is unrealistic to expect that it can meet the needs of most businesses and emergency services operations in terms of quality, features and reliability. The same is true of wireless service (either mobile or fixed), and it is yet to be established as to whether it is a substitute or a complement to existing wireline

[1] *Petition of Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach MSA*, WC Docket No. 08-49 at p. 1. (filed Mar. 31, 2008) ("Petition").

service. To the extent that VoIP is offered over non-cable broadband, it is most likely that the underlying facilities-based carrier is either Verizon itself, or a competitor providing broadband using an unbundled copper loop that will be eliminated if forbearance is granted. Moreover, while Verizon bases its plea on purported competition for switched voice services, the Commission has a broader obligation to foster competition in broadband and other advanced telecommunications capabilities, including multichannel video delivery, which can be provided over UNE loops but not over the substitute services that Verizon claims will pick up the slack. Finally, it is nonsense to base forbearance on the presence of competitors who use Verizon's wholesale services, because once Verizon is relieved of its obligation to provide UNE-L it no longer has an economic incentive for providing the UNE-P substitute through its Wholesale Advantage agreements, likely leading to the elimination of such services or the introduction of more anti-competitive rates, terms and conditions that will weed out competition.

It is clear that Verizon retains its dominance in virtually all areas, as the Commission recognized several months ago in rejecting similar relief in the Virginia Beach MSA in the *Six MSA Order*. The Commission's unanimous rejection of Verizon's petition in that order indicated that competition was insufficient to discipline Verizon's substantial market power in Virginia Beach. Threats to competition are great enough as it is. The Commission should not increase them by granting forbearance.

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Columbia Capital and M/C Venture Partners (together the "Telecom Investors") by their counsel, respectfully submit this opposition in the above-captioned proceeding as it pertains to Verizon's Petition for forbearance from its obligation to provision Section 251(c)(3) loop and transport unbundled network elements ("UNEs") throughout Virginia Beach.[2] For the reasons explained below, Verizon has not made a *prima facie* case that it is entitled to unbundling relief, and the Commission therefore should dismiss its Petition summarily.

I. Introduction

Verizon has asked for forbearance from its loop and transport obligations, rules related to interstate switched access[3] and rules related to transactions and operations under Section 214 of the Act.[4] Verizon has also requested relief from "the Computer III requirements, including

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2 *Pleading Cycle Established for Comments on the Verizon Telephone Companies Petition for Forbearance In the Virginia Beach MSA*, Public Notice, WC Docket No. 08-49, DA 08-878 (WCB rel. April 15, 2008).

3 Verizon expressly asks for the "same relief that Verizon sought in the Six MSA proceeding." Petition at n.4.

4 *Id*.

Comparably Efficient Interconnection ('CEI') and Open Network Architecture ("ONA')."[5] Ordinarily, this would be a terrifying prospect, except that it is obvious that Verizon is not serious about this and it is meant as a worthless concession. CEI and ONA embody a large collection of Commission rules, but Verizon has not gone to the effort to cite to any of them. Accordingly, the Commission must dismiss at least this portion of Verizon's request, for lack of specificity. As it explained in the *Omaha Order*, the Commission is not compelled "to comb through its rules to infer which other regulations are encompassed by [Verizon]'s general request, and as our precedent … indicates, this lack of specificity alone warrants dismissal."[6]

In regard to the requests that still stand, Section 10(a) states that the FCC "shall forbear from applying any regulation or any provision [of the Act] … to a telecommunications carrier or telecommunications service" if it determines that:

> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations, by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.[7]

In making the determination under subsection (a)(3), the FCC also must "consider whether forbearance from enforcing the provision … will *promote competitive market conditions*, including the extent to which such forbearance will *enhance competition* among providers

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[5] *Id*.

[6] *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160 in the Omaha Metropolitan Statistical Area*, 20 FCC Rcd 19415 (2005) at n.51 *aff'd*, *Qwest Corp. v FCC*, 482 F.3d 471 (D.C. Cir. 2007) ("*Omaha Forbearance Order*").

[7] 47 U.S.C. § 160(a)(1)-(3).

of telecommunications services."[8] All three prongs of this standard must be afforded a plain meaning interpretation[9] and all three must be satisfied before the Commission grants a petition for forbearance. While Verizon's petition fails on all three prongs, the most obvious defect in its Petition is that it fails to establish that real competition exists. On the contrary, it is clear that forbearance will, at best, freeze the market at its current state of development.

In addition to relief from loop and transport unbundling obligations, Verizon has also requested that the Commission expressly find it non-dominant for interstate switched access services;[10] *i.e.*, it "does not possess market power."[11] Verizon claims that its forbearance request meets "any possible forbearance standard, including the one recently applied in the *Six MSA Order*."[12] Satisfying "any possible standard," however, is not the same as satisfying the standard applied across the Qwest Omaha, ACS UNE and Verizon six MSA proceedings. As discussed below, Verizon misstates the applicable standard applied in those proceedings and is attempting an end-run around the Commission's applicable precedent.

II. Verizon's Virginia Beach Petition Fails To Meet The Commission's Threshold Market Analysis

In its line of forbearance decisions, the Commission has sought to assess whether "competition [in the relevant MSA] … is adequate to ensure that the 'charges, practices classification, classifications, or regulations… for [] or in connection with that … telecommunications service are just and reasonable and not unjustly or unreasonably discriminatory' absent the regulations at

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[8] *Id.* § 160(b) (emphasis added); *see also AT&T v. FCC*, 452 F.3d 830 (D.C. Cir. 2006) (quoting same).

[9] *AT&T*, 452 F.3d at 836.

[10] Petition at n. 4.

[11] *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271 ¶ 19 (1995) ("*AT&T Non-Dominance Order*").

[12] Petition p. 1.

issue."[13] The *Six MSA Order* unequivocally established that Verizon failed to satisfy this threshold analysis with respect to the Virginia Beach MSA.[14] The Commission further determined that "Verizon is not subject to a sufficient level of facilities-based competition in the 6 MSAs to grant relief under the Commission's Qwest Omaha and ACS UNE precedent."[15]

Having failed to demonstrate compliance with the statutory forbearance test, consistent with the Commission's guidance in the *Omaha* and *Anchorage* forbearance decisions, Verizon now urges the Commission to reject its own precedent and grant Verizon unbundling relief in Virginia Beach. Such broad relief simply is not justified.

First, consistent with the Commission's decisions in its UNE forbearance decisions, Verizon has failed to demonstrate that facilities based competitors have successfully taken significant market share from Verizon. Instead, Verizon's market share analysis relies on the presence of competition from its affiliated wireless company Verizon wireless, and CLECs that rely on Verizon for last mile access and switching through Verizon's UNE-P replacement Wholesale Advantage service. Verizon also mistakenly continues to include over the top VoIP and other non-facilities based competition in its market share calculations. Second, Verizon refuses to acknowledge that the Commission's market share test must be applied on an MSA wide basis. Instead, Verizon seeks to distort the geographic market by limiting it just to Cox Cable's territory in the Virginia Beach MSA, conveniently gerrymandering the geographic market to exclude

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[13] *Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. Section 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, WC Docket No. 06-172, Memorandum Opinion and Order, FCC 07-212, 22 FCC Rcd 21293 at ¶ 27 appeal pending sub nom *Verizon Telephone Companies v. FCC*, No. 08-1012, (D.C. Cir. filed Jan. 14, 2008) ("*Six MSA Order*").

[14] *Id.* ¶ 27 ("in seeking forbearance Verizon does not satisfy section 10(a)(1) in any of the 6 MSAs.")

[15] *Id.* ¶ 36.

areas where it continues to face little facilities-based competition. Third, Verizon urges the Commission to adopt a new second part of the test, distinct from that applied in all of its UNE forbearance decisions to date, that instead of assessing the level of facilities deployment on a wire center basis would measure such deployment on a rate center basis. Of course, Verizon, not surprisingly, avers that it meets the standard it has created for itself. The Commission should not allow Verizon to rewrite the rules here and should continue to hold Verizon to the forbearance test, however flawed it may be, that it has applied since the *Omaha Forbearance Order*.

A. Verizon Improperly Includes Competition From Non-Facilities Based Competitors.

The Commission's UNE forbearance decisions have consistently limited the relevant market share analysis to "facilities-based competitors."[16] Now in its late filed reconsideration petition, Verizon asks that the Commission alter its threshold analysis and include a host of competitors that are clearly not "facilities-based" and thus cannot offer a sufficient check on Verizon's market power in the absence of regulation.

Instead of focusing on competition from facilities-based competitors, Verizon's market share analysis relies on the presence of competition from its affiliated wireless company Verizon wireless, and CLECs that rely on Verizon for last mile access and switching through Verizon's UNE-P replacement Wholesale Advantage service in order to satisfy the Commission's threshold test. Verizon also mistakenly continues to include over the top VoIP and other non-facilities based competition in its market share calculations.

The Commission's analysis in the *Six MSA Order* quite clearly focuses on facilities based competition. The Order reflects that "competition from cable operators … does not present a

[16] *Id.* ¶ 36 (finding Verizon not subject to sufficient level of facilities based competition.)

sufficient basis" to justify forbearance.[17] The Order acknowledged "the comparatively limited role of the cable operator in serving enterprise customers" in the markets at issues.[18] And the Commission further explained that the record in the 6 MSAs at issue, including Virginia Beach did not show that "other competitors… have deployed their own extensive last mile facilities for use in serving the enterprise market."[19] The Commission explained that the evidence — including that supplied by Verizon, demonstrated "much of the competition from competitive LECs… instead depends on access to Verizon's own facilities, including UNEs."[20] Because Verizon could not show "the type of last mile facilities-based competition the Commission relied on in the Qwest Omaha and ACS UNE forbearance" decision the Commission found that Verizon had failed to satisfy the statutory forbearance criteria.[21]

Verizon's Virginia Beach petition suffers the same flaw, as it based on a mere subset of the Virginia Beach MSA data offered and found inadequate in the *Six MSA Order*. In particular, Verizon seeks to justify relief by suggesting that the Commission deviate from its reliance on evidence of facilities-based competition from independent providers.[22] Verizon claims that the Commission counted competition from UNE-P and resale CLECs in a addition to facilities-based cable competition. This is wrong. The Commission, as discussed above, focused exclusively on the presence of facilities-based competitors such as cable companies. While acknowledging, but not agreeing with Verizon's argument that UNE-P and resale be included the Commission stated that "even including" such competitors the threshold standard was not met. The Commission's

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[17] *Id.* ¶ 37.

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] Petition p. 10.

use of the term "even" belies the fact that it does not consider resale and UNE-P competition within the scope of the facilities based competition analyzed under the forbearance standard. There are good reasons why the Commission should maintain this aspect of its UNE forbearance analysis.

1. Verizon's Wholesale Advantage

Verizon's request to revise the Commission's threshold market analysis seeks to include competitors that rely entirely on Verizon's own facilities to provide their services.[23] In the case of Verizon's Wholesale Advantage offering, this "competition" exists solely at Verizon's caprice and may be terminated at the end of the agreement term. With Wholesale Advantage, Verizon is only losing market share to itself, and thus cannot include this as an example of the competitive pressure it faces.

Further, Verizon's argument that its UNE-P replacement service is not affected by the availability of UNEs is simply wrong. First, the Wholesale Advantage Agreement is predicated on the availability of voice grade loops at cost-based rates. And even if Wholesale Advantage could be considered a competitive alternative, Verizon does not describe exactly what it will be like after forbearance. Verizon's petition fails to disclose what terms and conditions it would propose to offer in these commercial agreements if its petition were granted to any extent. This is particularly important because Verizon has omitted any reference to how it would offer DS0 (voice grade) loops. While Verizon's six MSA petition stated that its DS1 and DS3 special access rates will be capped for 30 months pursuant to the Verizon/MCI Order,[24] it said then and says now, nothing about ensuring the availability of DS0 loops. DS0 loops are essential to

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[23] Petition p. 13.

[24] This 30-month price freeze, however, will be over before the anticipated date of Commission action on Verizon's petition.

CLECs who use dry copper loops to provision complete packages of affordable video and voice services with more features than comparable Verizon service offerings. Verizon's vagueness regarding its wholesale offerings eliminates any support they provide for its request for forbearance.

In addition, the availability of UNE copper loops for use in a UNE-L arrangement provides Verizon an incentive to offer its wholesale advantage service that combines the loop with switching and transport. If Verizon, freed from the obligation to offer voice grade loops, raises the price of its Wholesale Advantage service, competitors cannot compare the cost of migrating customers to a UNE-L platform because such option is no longer available. Thus, the ability to keep the revenues from switching and not lose those to UNE-L competitors currently constrains Verizon from raising the Wholesale Advantage prices to an anti-competitive level. Absent the availability of UNE loops however, Verizon's incentive to maximize its profit is not subject to any competitive discipline, as the Commission has acknowledged that there are "no significant alternative sources of wholesale inputs" in the relevant market.[25] Thus, the Commission should adhere to the principle that "competition that relies on Verizon's own facilities is not a sufficient basis to grant forbearance from UNE requirements."[26]

Even if Verizon is losing market share for voice services,[27] this does not justify unbundling forbearance. Voice grade services are almost an inconsequential portion of all services that CLECs can provision over Section 251(c)(3) loop and transport UNEs. These facilities can be used to provision high-capacity point-to-point DS1, DS3, and xDSL broadband services that

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[25] *Six MSA Order* ¶ 38.

[26] *Id.* ¶ 42.

[27] Petition pp. 17-18.

require wireline facilities and cannot be provisioned over other mediums. Verizon has not made any showing of significant competition in these services.

Consequently, in the case of competitors and resellers that rely on wholesale services, Verizon's analysis is nonsense. It is relying on competition that will be eliminated if its Petition is granted.

2. Wireless Competition and Verizon's Wireless Affiliate

Despite the Commission's consistent principle that "competition that relies on Verizon's own facilities is not a sufficient basis to grant forbearance from UNE requirements,"[28] Verizon urges the Commission to treat Verizon wireless customers as it would treat Sprint wireless customers. This is nonsense and plainly undermines the Commission's analysis that focuses on facilities-based competitors not facilities-based affiliates. As the *Six MSA Order* indicates, the attribution of wireless customers to its wireline affiliate is consistent with other Commission precedent counting market share in general, and specifically, wireless market share.[29] There is no reason to depart from the Commission's practice as Verizon proposes.

Verizon's reliance on purported wireless competition ignores the fact that the Commission has suggested that these services do not meet its standard of reliability. Thus, wireless service is *not* appropriate to include in forbearance analysis. First, Verizon provides no specific wireless substitution data from Virginia Beach, nor does it provide evidence of a reasonable correlation between the decrease in its wireline base and the expansion of wireless service. Verizon fails to present any kind of cross-elasticity study demonstrating that customers in general will discontinue their primary wireline local telephone service in favor of wireless service.

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[28] *Six MSA Order* ¶ 42.

[29] *Id.* App. B n. 6.

The fact is that wireless phones are frequently poor substitutes for traditional wireline phones. It is common knowledge that wireless phone service, while superior in terms of mobility, is inferior to wireline service in terms of sound quality and reliability.[30] While a small minority of users may accept wireless phones as a replacement for wireline, this should not be mistaken for a trend. It is impossible to imagine that any end user (particularly an enterprise user) would tolerate a competitive wireline service that exhibited the sound quality, intermittent availability and interrupted service of wireless, at least at the current rates for wireless service.

Even the Commission understands that wireless is "primarily a complementary technology to narrowband because connections in general do not yet equal traditional local loops in their quality, their ability to handle data traffic, and their ubiquity."[31] Moreover, wireless cannot begin to be considered as addressing the market for switched access services. Consequently, it is a wasted exercise to evaluate wireless services as a competitive alternative.

3. Over the Top VoIP

In the *Six MSA Order*, the Commission continued to hold that "over-the top" or nomadic VoIP services are not included in the Commission's competitive analysis because such services are not "close substitutes" for the facilities based services offered by Verizon or incumbent cable

[30] "CMRS connections in general do not yet equal traditional landline local loops in their quality, their ability to handle data traffic, and their ubiquity." *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978 ¶ 230 (2003) *aff'd in part, remanded in part, vacated in part sub nom. United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied sub nom. Nat'l Ass'n Regulatory Util. Comm'rs v. United States Telecom Ass'n*, 125 S. Ct. 313 (2004). ("*TRO*"). In regard to the enterprise market, the Commission also determined in the *TRRO* that the record "does not indicate that other intermodal options, such as fixed wireless and satellite, offer significant competition in the enterprise loop market." *Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Order On Remand, 20 FCC Rcd 2533, n.508 (2005), *aff'd sub nom. Comm'ns Co v. FCC*, 450 F.3d 528 (D.C. Cir. 2006) ("*TRRO*") (emphasis added).

[31] *TRO* ¶ 230.

companies. Verizon's petition now challenges this precedent, claiming that they are "an added source of competitive discipline on Verizon." Again, the Commission should deny Verizon's blatant request for reconsideration of the Commission's UNE forbearance precedent. As discussed repeatedly, Verizon misses the point that the Commission's market share analysis correctly centers on "facilities-based" competition because non-facilities based competitors are not as effective at disciplining Verizon's incentive to maximize profits by engaging in anti-competitive conduct.

Verizon provides no data on how widespread this phenomenon is within the Six MSAs. And, as with wireless services, its evidence, such as it is, concerns almost exclusively the residential marketplace. Like wireless, it is in no way applicable to switched access services, nor does Verizon provide any information about its use in the enterprise marketplace.

It is, in fact, disingenuous of Verizon to clutter the record with the VoIP example. In announcing its own VoIP service, Verizon acknowledged that it is not worried about VoIP service cannibalizing traditional wireline offerings, but instead sees the technology only as an alternative for users such as college students, as well as a "win-back" for customers who have switched carriers.[32]

B. Verizon Improperly Seeks to Change the Geographic Market Under the Threshold Market Analysis.

Instead of identifying a local telecommunications market based on some reasonable economic criteria and then providing credible evidence to justify forbearance in that area, Verizon gerrymanders itself a so-called geographic "market" area in which it thinks it has calculated the

[32] Teal, Kelly, M., "Verizon enters VoIP Market," Xchange, July 22, 2004, available at: http://www.x-changemag.com/hotnews/47h22124954.html, accessed December 6, 2006.

best chance to meet the forbearance test that it wants that the Commission to apply. Verizon admits this approach, stating that:

> In prior decisions, the Commission has determined that forbearance is appropriate only in those areas where cable voice services are widely available. [citing Omaha Forbearance Order ¶¶ 28. 69]. This petition is accordingly tailored to those areas in the Virginia Beach MSA where this is the case ….[33]

This approach would permit Verizon, and other ILEC forbearance petitioners, to pick and choose any area, defined by any criteria it prefers, for requesting forbearance. Verizon could propose forbearance for a street, a building, or perhaps the area served by a particular cell site, if it thinks that area could meet the Commission's applicable market share threshold. While this might serve Verizon's exceedingly narrow interests, the Commission's selection of a geographic market should be rooted in rational economic analysis.

Verizon's claim that its proposed "market" definition is reasonable is undermined by the inconsistent reasoning underlying Verizon's distinct approaches in Rhode Island and Virginia Beach. In the Rhode Island petition, Verizon averred that the entire state of Rhode Island was an appropriate geographic market because it was a state and/or because the state had a tenuous relationship to a study area.[34] Although that reasoning is faulty, Verizon abandons that criterion here without explanation because the "market" Verizon proposes in the instant petition has nothing to do with study areas.

The Rhode Island and Virginia Beach petitions, however are superficially consistent in requesting forbearance for portions of an MSA served by a cable operator. But the economic market in which Verizon competes for voice service is not defined by the video franchise areas

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33 Petition p. 4.

34 *Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Docket No. 08-24, at 3-4 (filed Feb. 14, 2008).

of cable operators. Verizon does not initiate service, provide, or price voice service based on cable franchise areas, which are not, therefore, suitable for measuring whether Verizon in its market faces sufficient competition to warrant forbearance. Although not necessarily a definitive guide for this proceeding, the criteria of the DOJ Horizontal Merger Guidelines for defining geographic markets would not employ a cable video franchise area as a geographic market for Verizon's voice services.[35]

But even if a cable operator's franchise area otherwise made sense as a way to define Verizon's voice market, the Commission could not accept that as a reasonable market definition in this application because Verizon does not actually request forbearance in the Cox portion of the Virginia Beach MSA. Instead, Verizon conveniently omits portions of the MSA where Cox does not provide voice service.[36]

Verizon's proposed geographic "market" is also unreasonable because it omits without explanation New Kent County, which is adjacent to, but not in, the Virginia Beach MSA and is served by Cox. If Verizon were to argue that New Kent County should be excluded because it is within the boundaries of a different MSA, that would contradict the premise of its Petition that MSA boundaries can be ignored whenever convenient in delineating a forbearance area. In the

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[35] Horizontal Merger Guidelines, United States Department of Justice, Revised April 8, 1997. In particular, the Guidelines, reflecting sound economic theory, require that the following factors (at a minimum) be considered in determining geographic market definition: "(**1**) evidence that buyers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables; **(2)** evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables; **(3)** the influence of downstream competition faced by buyers in their output markets; and **(4)** the timing and costs of switching suppliers." Verizon's Petition provides no evidence whatsoever as to how the arbitrary market boundaries it has proposed relate to these criteria.

[36] Petition n. 7.

absence of any consistent explanation, Verizon's omission of adjacent Cox service areas is arbitrary and dooms its geographic market definition.

Verizon is wrong that "MSAs themselves are simply a collection of counties and independent cities…."[37] An MSA, as determined by the U.S. Bureau of the Census and the Office of Management and Budget ("OMB"), is not a random aggregation of political jurisdictions. It is defined as a metropolitan area comprised of a large population nucleus, together with adjacent communities having a "high degree of social and economic integration[.]"[38] Because an MSA has a high degree of internal economic and social coherence, it is more likely that any estimation of competition, or application of a single competitive test to the entire area, if otherwise accurate, will be correct anywhere in the MSA.

The Commission has found that:

> MSAs best reflect the scope of competitive entry, and therefore are a logical basis for measuring the extent of competition. Because competitive LECs generally do not enter new markets on a statewide basis, we reject proposals to define the geographic scope of pricing flexibility on the basis of states or study areas.[39]

And, the Commission found that using MSAs:

> appears to meet the requirements of clarity and ease of use. MSAs are precisely defined and easily understood by both technical and non-technical personnel. Equally important, MSA information enjoys wide distribution, is used for many different purposes, and is periodically updated. This attribute is very attractive because it

[37] Petition p. 4.

[38] The most recent OMB definition of metropolitan areas is contained in OMB Bulletin No. 07-01 (Dec. 18, 2006). *See* http://www.whitehouse.gov/omb/bulletins/fy2007/b07-01.pdf.

[39] *Access Charge Reform*, CC Docket No. 96-262 *et al.*, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd 14221, 14260, ¶ 72 (1999) (citations omitted).

> does not require expenditure of any additional resources on the part of the Commission or the industry to implement.…[40]

An MSA, therefore, appears to be a reasonable geographic area to which the Commission may apply its threshold market analysis.

But using only part of an MSA is arbitrary. Forbearance in only part of an MSA would likely lead to marketplace dysfunctions because critical economic inputs to competitive tele-communications services would be unavailable in part of an area that otherwise has a high degree of social and economic integration. This could lead to pricing distortions and dislocations within the MSA and potentially result in significant harms, including reductions in growth and productivity. Competitors have explained that it is not economically feasible for competitors to provide service in only those wire centers in an MSA to which unbundling forbearance does not apply.[41] Forbearance in part of an otherwise cohesive economic unit would constitute undue government interference in marketplace dynamics. The Commission acknowledged related concerns in the *Six MSA Order*.[42] The fact that a different cable operator may serve the omitted parts of the Virginia Beach MSA merely shows the expedience of Verizon's proposed geo-graphic area aimed at removing areas of the economic unit that may have a lesser degree of cable penetration.

Although Verizon's choice of a gerrymandered geographic area is invalid, it assumes, but has not attempted to justify, application to such an area of the same market share threshold that

[40] *Definition of Congested Areas in the Broadcast Auxiliary Services and the Cable Television Relay Service*, MM Docket No. 90-500, *Notice of Proposed Rulemaking*, 5 FCC Rcd 6687, 6687, ¶ 5 (1990).

[41] Declaration of Pritesh D. Shah, McLeodUSA Telecommunications Services, Inc., July 23, 2007, ¶ 8, attached to Petition for Modification of McLeodUSA Telecommunications Ser-vices, Inc., WC Docket No, 04-223, filed July 23, 2007.

[42] *Six MSA Order* n.102.

the Commission previously applied to an MSA. Because the proposed forbearance area omits portions of the MSA sharing a high degree of social and economic integration with areas covered by the Petition, the Commission could not be confident based on the MSA-wide threshold that independent facilities-based competition has become deeply rooted in the arbitrary geographic area selected by the ILEC. Because Verizon proposes to use only part of the economic unit for the threshold forbearance analysis, it is possible that economic factors at work throughout the MSA will undermine whatever degree of independent-facilities-based competition has developed in Verizon's designated geographic area. Thus, if the Commission were, (even though it should not) to employ a subset of an MSA as a geographic area in which to apply its threshold market analysis, the Commission would certainly need to apply a considerably higher market threshold to justify forbearance in that area. Verizon's petition is deficient because it has neither justified the geographic area it has chose nor has it justified the application of the Commission's MSA-wide threshold used in the *Omaha* and *Six MSA Orders* to its proposed geographic area.

Further, Verizon's proposal that the Commission "should analyze coverage at the level of the individual rate exchange areas (or rate centers), rather than at the wire center serving area level as the Commission has done in previous forbearance orders,"[43] is no more than a fishing expedition. It states that "rate centers equally reflect the areas in which competing carriers and Verizon provide local telephone service."[44] But the Commission has already examined and denied Verizon's earlier application for Virginia Beach in which data was presented at the wire center level. Therefore, assuming that rate center and wire center information "equally reflect" competition, no useful purpose would be served by now considering the same competitive situation viewed on a rate center basis.

[43] Petition p. 7.

[44] *Id*.

Accordingly, the Commission should reject Verizon's arbitrary proposals for the geographic areas in which to apply the Commission's threshold market analysis and wire center coverage test.

III. Forbearance from the Act's Unbundling Provisions Will Undermine the Commission's Goals of Promoting Competition, Investment and Innovation in the Virginia Beach MSA

It is important for the Commission to recognize that granting Verizon forbearance will not only impede investment in innovation in Virginia Beach but will effect the investment decisions of carriers and investors nationwide. Private equity and venture capital firms have made considerable investments in CLECs in the last year, providing, for instance the necessary capital to deploy infrastructure to make use of legacy copper loops.[45] Investors will not sit idly by as the Commission signals that its policies fostering investment in local competition are no longer worth the paper on which they are printed, but will scale back their investments accordingly and redirect capital to those sectors of the economy where market conditions are more hospitable to new investment. The Telecom Investors therefore urge the Commission to maintain the stability it finally has achieved in its unbundling regime and allow the capital markets to invest in further competition and innovation that will benefit American businesses and consumers.

In conducting the public interest analysis under its forbearance standard, the Commission should evaluate the impact of forbearance on innovation in the affected markets. Competitors using UNEs have brought substantial innovations to the market that have benefited consumers.

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[45] *See e.g.* Press Release, *Platinum Equity Completes Acquisition of Covad Communications Group, Inc.*, at p.1, (April 15, 2008); *Domestic Section 214 Applications Filed For The Transfer Of Control Of Integra Telecom Holdings, Inc., Eschelon Telecom, Inc., Electric Lightwave, LLC, and other Subsidiaries of Integra Telecom Holdings, Inc. to Subsidiaries of Warburg Pincus & Co, Banc of America Capital Investors V, L.P., and Boston Ventures L.P.*, WC Docket No. 07-206, Notice of Domestic Section 214 Authorization Granted, DA 07-4658 (Nov. 19, 2007).

The Commission must evaluate whether a market without UNEs would result in a similar level of innovation. Because the Commission has recognized that innovation — the "provision of new technologies and services to the public" — best serves the public interest, a reduction in the level of innovation in a market is contrary to the public interest and grounds to reject Verizon's petitions.[46]

The potential for dramatic retrenchment of investment and innovation by competitors is most ably illustrated by examining the likely impact of forbearance on CLECs using unbundled copper loops to deploy innovative services or bring new services to historically underserved markets. Delivering such innovative services requires substantial expenditures of capital. In order to use UNE copper loops in delivering services, competitors must make substantial investments in equipment to bring the copper loop to life and transmit information — whether it is voice, video or data — to the consumer. Recognizing this fact, the Commission crafted its unbundling policy "to promote the deployment of equipment that can unleash the full potential of the embedded copper loop plant so that consumers can experience enhanced broadband capabilities before the mass deployment of fiber loops."[47]

Verizon, however, does not provide a special access analogue for copper loops and has utterly refused to engage competitors in any discussions regarding terms for providing such copper loops on a commercial basis. Without UNEs, CLECs relying on copper loops will no longer have the last mile copper needed to serve their customers. The lack of certainty regarding access to last mile copper will chill further investment in any infrastructure that relies on copper loops. Thus, the absence of UNEs would squelch further investment in "equipment that can

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[46] *Time Warner Entertainment Co. and US West Communications, Inc.*, 8 FCC Rcd 7106, 7107-8 (1993).

[47] *TRO* ¶ 244.

unleash the full potential of the embedded copper loop plant" now on the market or coming to market, undermining policy established in the *TRO*.

The Commission has every reason to maintain, rather than abandon this policy — as it seems to be working. Since the *TRO*, great strides have been made in squeezing higher bandwidths out of copper, belying the derogatory connotation of "narrowband" facilities. ILEC copper plant is an enormous, national asset that has taken over a century to deploy and is still capable of serving the needs of businesses and consumers with ADSL, VDSL, 2BaseTL, DS1 and other copper-based services.[48]

It is now clear that currently deployed copper plant can efficiently be employed to provide new communications services to business and consumers. For example, the VDSL2 standard permits 50 and even 100 Mbps on loops less than 1000 feet. Further advances, such as Digital Spectrum Management and multi-pair bonding, are making it possible to squeeze higher bandwidth at even greater distances.[49] The 2BaseTL Ethernet standard, for instance, will permit 40 Mbps and deployment to over 90% of loops with multiple pair bonding.[50]

CLECs are innovating and deploying these new technologies in the market to the benefit of consumers and businesses. Cavalier, for example, is offering IPTV services using xDSL copper loops. Cavalier's IPTV service provides consumers another choice for video services and also brings video services to sectors of the market other providers have historically ignored.[51]

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[48] Comments of Isfan Solutions, *Policies and Rules Governing Retirement of Copper Loops by Incumbent Local Exchange Carriers*, RM-11358, at pp. 2, 14 (March 1 2007).

[49] Isfan Solutions Comments, RM-11358 at p. 9.

[50] *Id.* at p. 10.

[51] Ex Parte Letter from Philip J. Macres, Counsel to Cavalier, to Marlene H. Dortch, FCC, WC Docket No. 06-172, (filed Nov. 14 2007) at Attachment p. 2; *See* Light Reading, Cavalier Launches MPEG-4, May 25, 2006 at http://www.lightreading.com/document.asp?doc_id=95796.

Cavalier has made substantial investments to roll out these services in new markets across its footprint.[52] Cavalier and other CLECs, including DSL.net and Penn Telecom, are using copper loops and xDSL transmission technology to provide "Mid-band" Ethernet services, filling a gap in the market for data intensive business that need more than the 1.544 Mbps of a DS1 but neither need nor can afford the 44.736 Mbps available from DS3 service.[53] If Verizon's forbearance petitions are granted it would not only strand the significant investments these CLECs have already made, but would deter other CLECs in other markets from making similar investments.

These CLEC innovations delivered using unbundled legacy copper loops are the outgrowth of the deliberate policy course the Commission established in the *TRO* declaring that the "obligation to encourage infrastructure investment tied to legacy loops is more squarely driven by facilitating competition and promoting innovation."[54] The Commission explained that its unbundling rules should "encourage both intramodal and intermodal carriers (*in addition to incumbent LECs*) to enter the broadband mass market and *make infrastructure investments in equipment*."[55] Companies like Cavalier, Covad, DSL.net, Penn Telecom and others are acting on that incentive and the Telecom Investors will continue to provide capital for such infrastructure investments as long as the copper loops remain available at efficient prices.

In a time when complaints abound that this nation lags behind in broadband deployment, the Commission should encourage *greater* investment in making use of this valuable resource.

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[52] *See Ex Parte* Letter from Philip J. Macres, Counsel to Cavalier, et al, to Marlene H. Dortch, FCC, WC Docket No. 06-172, at p. 3 (filed Nov. 16, 2007).

[53] *See* Craig Matsumoto, *Copper Ethernet Makes Strides*, Light Reading, in Unstrung.com, June 6, 2006, at http://www.unstrung.com/document.asp?doc_id=96236; *See e.g.* Ex Parte Letter from Phillip J. Macres, Counsel to Cavalier, *et al*, to Marlene H. Dortch, FCC, *supra* n.50, at Attachment p. 2. (filed Nov. 14 2007).

[54] *TRO* ¶ 244.

[55] *Id.* (emphasis supplied).

While it is unlikely that copper loops will be able to compete with multiple gigabytes per second speeds possible over fiber-optic cable, it is also unnecessary — the fact remains that most users currently do not need 1 Gbps, and for most mass-market consumers copper remains a powerful economic alternative to fiber-based services that they may never receive. Unfortunately, if Verizon is no longer obligated to make available unbundled loops and transport, CLECs would likely have no other choice than to exit the market or abandon services and customers served over copper loops.

Of course if CLECs exit markets because they can no longer economically access bottle-neck transmission facilities such as copper loops, innovation will suffer and consumers will suffer. Recent history suggests that "innovations have been more rapidly deployed in telecom-munications networks" where there are more competitors not fewer.[56] Innovation thrives and advances more rapidly in less concentrated markets.[57] Facing less competition through innova-tion, a company with market power such as Verizon "might be able to slow its own innovative efforts … thereby entrenching its monopoly power in the future."[58]

IV. Granting Forbearance Will Result in A Duopoly Market and Drive Away Invest-ment.

If the Commission grants forbearance, notwithstanding the weak showing described above, then it will have declared once and for all that duopoly—or even the mere suggestion of competition against a dominant carrier—is the "robust competition" that Congress envisioned in the Act and which the Commission has spent ten long and contentious years purportedly con-

[56] Howard Shelanksi, *Competition and Deployment of New Technology in U.S. Tele-communications*, 2000 U. Chi. Legal F. 85 (2000).

[57] Brett M. Frischmann and Mark A. Lemley, Spillovers, 107 Colum L Rev 257, 281 (2007) ("[i]nnovation … is generally spurred by decentralized competition.").

[58] Steven C. Salop, R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, And Microsoft*, 7 Geo. Mason L. Rev. 617, 623 (1999).

structing. Whether it has fortitude to admit it or not, the Commission will have declared, once and for all, the industry finalists in this long contest. The Telecom Investors and the investment community, which are attuned to signals of much greater subtlety, will accept this decision for what it is and cede the field to the duopolists of the Commission's choice. The harm to the public, who will be whipsawed between two market behemoths, will take decades to remedy.

A. Forbearance Will Result in Duopoly.

Verizon's petition shows that for most any given end user it faces, at best, a single facilities-based competitor offering a comparable telephone exchange service – and only in New York can it honestly claim that almost all of its subscribers have this option. In other words, Verizon is a duopoly provider, still with substantial market power.

The Commission has previously observed that, at least in regard to the mass market, 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."[59] The DOJ has also noted that that because Verizon controls the vast majority of last mile connections, "competing carriers typically must lease the connection from Verizon" in order to serve customers in those buildings.[60]

For any other competitor with no existing distribution facilities, construction of a ubiquitous distribution infrastructure from the ground up requires massive amounts of capital as well as

[59] *TRO* ¶ 310, n.905.

[60] *United States v. Verizon Comms., Inc. and MCI, Inc.*, No. 1:05CV02103 (HHK), Department of Justice Competitive Impact Statement at 7 (D. D.C. filed Nov 16, 2005) ("*DOJ Impact Statement*") (available at <http://www.usdoj.gov/atr/cases/f213000/213028.pdf>).

protracted lengths of time. As the GAO recently concluded, "a variety of factors" make pure facilities-based competitive entry uneconomic including,

> the high sunk costs—that is, costs that once incurred cannot be readily recovered—of constructing local networks, the cost of local government regulations, and limited access to buildings. All of these factors 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.[61]

To establish itself, a competitor requires access to existing Section 251(c)(3) bottleneck loop and transport UNEs at TELRIC-based rates. Without the essential cost-based UNE pricing safeguard, there is nothing to prevent Verizon from raising prices on wholesale services to something "close to or equal to" the retail rate, creating a price squeeze.

Nor can competitors expect to rely on special access services to meet these needs. The Commission observed in the *TRRO* 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."[62] Rather, the Commission found that the availability of cost-based UNEs is itself 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.[63]

[61] 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*").

[62] *TRRO* ¶ 62.

[63] *Id*. ¶ 65.

The Commission recognizes that the availability of UNEs priced at cost-based rates provides downward pricing pressure on Verizon's special access rates.[64] Hence, if the Commission were to relieve Verizon of its obligation to offer Section 251(c)(3) loop and transport facilities in the MSAs at issue, Verizon's special access rates for DS1 and DS3 facilities in these areas would increase beyond their already inflated levels. Similarly, Verizon's obligation to offer Section 271 DS1 and DS3 loop and transport facilities would not discipline Verizon's anticompetitive instincts to further raise prices, since Verizon's maintains that its Section 271 obligation is fulfilled by making Section 271 checklist items available at special access rates.

In any event, to the extent that sufficient competition exists or is otherwise justified in a particular wire center based on the *TRRO's* non-impairment tests,[65] the Commission's unbundling rules already provide Verizon with requisite unbundling relief it seeks. Hence, where loops and transport remain available as Section 251(c)(3) UNEs based on the *TRRO's* wire center tests, the public interest demands that these facilities remain available until these tests are met. Moreover, such facilities need to remain available so that downward pressure on special access and 271 rates is maintained until such time.

Unfortunately, in the absence of unbundled loops and transport, CLECs would likely have no other choice than to purchase Verizon's special access at supracompetitive levels. CLECs will either need to increase their rates or, more likely, suffer margin degradation. This will drive away investment because funds needed for capital expenditures to develop competitive networks would instead be used to pay Verizon's inflated special access rates, benefiting Verizon's investors rather than those of competitors, to the ultimate detriment of end users.

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[64] *Id*. ¶ 63.

[65] *Id*. ¶ 66.

As discussed above, Verizon and the local cable company are the only providers with ubiquitous last-mile networks to most of the mass market and small business customers in the Six MSAs, and it is safe to assume that neither of will unbundled these facilities absent a statutory mandate. As explained earlier, competitors' costs for deploying their own last mile facilities are generally prohibitive. Moreover, although it is not clear if the Petition seeks forbearance of *all* Section 251(c) obligations, if such forbearance is granted, Verizon could also increase the cost of direct interconnection with its network. Section 251(c)(2) requires that ILECs interconnect with CLECs at any technically feasible point on the ILEC's network.[66] The Commission has interpreted this provision as permitting the CLEC to specify the location of such Points of Interconnection ("POIs") in each LATA.[67] Relieved of its Section 251 obligations, Verizon could require interconnection at points that are inefficient for the CLEC and involve substantial costs. Finally, wireless and VoIP services do not provide substitutes for local wireline telephone services for most end users. Therefore, if the Commission grant's Verizon's Petition there will be no significant local service providers to emerge in the retail market from this point on. The ultimate result would be a Verizon/cable duopoly for mass market and small business customers.

B. Investment in Competition Will Decline.

It is asking a great deal for new entrants to compete against internally generated war chests of BOCs who enjoy dominant status, and it is only intuitive that investment funds will flow toward duopoly providers and away from competitors.[68]

[66] 47 U.S.C. § 251(c)(2)(B).

[67] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15608 ¶ 209 (2006) ("*Local Competition Order*"); 47 C.F.R. § 51.321.

[68] As of September 30, 2006, Verizon had over $3.4 billion in cash and short-term investments. Verizon Form 10-Q, Q3 2006.

In the *Omaha Order*, the Commission explained 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.[69] Unfortunately, it appears from the *Omaha Order* that FCC is only concerned with impediments to BOC investment, as if no other entity can invest in the industry. BOC investment, however, fosters monopoly, not competition. Competitive investment since 1996 has been many billions of dollars, much of it lost. The Telecom Investors are not asking for sympathy, they are merely asking that the Commission demonstrate the same concern for competitors' investment returns as it does for the BOCs.

It can be difficult to sort out all the issues involving investment incentives. For example one analyst, Lawrence Spiwak, has observed that the Commission is confused about the role of sunk costs. On the one hand, the Commission understands that the primary role of sunk costs is to act as an entry barrier.[70] On the other hand, this aspect of sunk costs was completely ignored in the *Pricing Flexibility Order*[71] and, in fact, the Commission took the view that some sunk

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[69] *Omaha Forbearance Order* ¶ 76.

[70] "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* ¶¶ 237-238 (emphasis supplied).

[71] *Access Charge Reform*, 14 FCC Rcd 14221 (1999) ("*Pricing Flexibility Order*").

costs represent a commitment by a new entrant to continue to invest, no matter what—even if it means putting good money after bad.[72]

Notwithstanding the Commission's analysis in the *Omaha Order*, experienced investors who address these issues on a daily basis can assure the Commission that granting Verizon's Petition will indeed deter investment, not only in the Virginia Beach Market or the Verizon region but industry wide. A grant of Verizon's Petition will send a strong negative signal to the investment community. In the protected duopoly environment that the Commission will be sanctioning, 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.[73] Many CLECs have sunk investments in switches and feeder networks to serve their customers in Virginia Beach. These investments were premised on the continued availability of UNE loops at TELRIC-based rates, particularly high capacity loops.[74] If the

[72] "Perhaps the most puzzling aspect of the Commission's deregulatory paradigm is the decision to measure the extent of competition and the prospects for entry by the degree to which entry requires sunk costs. While economic theory does suggest that sunk investments represent a commitment by entrants thereby reducing the expected success of predatory actions by incumbent firms, the primary role of sunk costs in economic theory is to serve an entry barrier. Entry is the driving force of competition, and impediments to entry are not usually (or legitimately) associated with the prospects for effective competition. While the Commission recognizes this fact in other contexts, the entry deterring aspects of sunk costs were completely ignored in its *Pricing Flexibility Order*." George S. Ford, PhD & Lawrence J. Spiwak, Esq., Phoenix Center Policy Paper Number 18: Set It and Forget It? Market Power and the Consequences of Premature Deregulation in Telecommunications Markets (July 2003).

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

[74] 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* ¶ 298.

Commission weakens this premise, investments will be redirected, new entrants will be starved for funds and the duopolists will become further entrenched. If the Commission is truly committed to innovation and competition, it cannot continue to undermine CLECs business plans.

V. Duopoly Markets Will Be Non-Competitive.

Verizon argues that cable competition alone has eliminated its market power. Telecom Investors believe that this claim is frivolous—it ignores the uniformly held view of economists and 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."[75]

A. Prices Will Be Supracompetitive.

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."[76]

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[75] 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*").

[76] *Id.* § 1429a.

This interdependent decision making can produce 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 (perhaps with a vague “supplier surcharge,” see *infra* page 33). Even without any express collusion, the other firms may follow this lead. Though neither has gained market share, they have increased industry profits.[77] Results are likely to be particularly non-competitive when, like here, 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.[78]

The Commission has consistently expressed its concerns regarding the harms that result in this type of market concentration. Up until the unexpected *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 explained that a merger resulting in duopoly carries a “strong presumption of significant anticompetitive effects.”[79] 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.”[80]

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[77] *See id.* § 1429b.

[78] *Id.* § 404c9.

[79] *Echostar* ¶¶ 99, 102.

[80] *Id.*, 17 FCC Rcd at 20684, Separate Statement of Chairman Michael K. Powell.

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.[81] In its Report, the Commission revealed that cable rates in communities with a wireline competitor saw increases greater than the overall market in 2004. In those areas, cable rates increased 5.3% to $35.94.[82]

As a more specific example, it was recently reported that starting March 1, 2007, Comcast will increase its rates by 4.3 percent throughout the Washington, D.C. metropolitan region, notwithstanding the November 2006 approval for Verizon to enter the cable television business in Maryland's Montgomery and Prince George's counties.[83] Verizon, too, has raised its rates by 7.6 percent since its November approvals, to the disappointment of county officials who had been assured by Verizon of the "'benefits of choice,' including less expensive service." "So much for the idea that 'competition will bring down rates,' said Montgomery County Council President Marilyn Praisner…. 'That clearly hasn't happened.'"[84]

One analyst conjectured that the companies do not plan to compete over price, but instead over bundled services.[85] If so, this is contrary to the public interest as expressed by this Commission's Chairman. Chairman Martin has commented about the lack of choice inherent in bundling. "Cable companies explain away their skyrocketing prices by saying they are giving you more and more channels. At no time, however, have the cable companies actually asked if you want

[81] *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992: Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, 21 FCC Rcd 15087 (2006).

[82] *Id.* Table 1.

[83] Ann E. Marimow, *Cable War Fails to Offer Rate Relief in Montgomery*, Wash. Post, Feb. 18, 2007 at C11.

[84] *Id.*

[85] *Id.*

those additional channels. You have to pay for them whether you want them or not."[86] It stands to reason that the benefits of unbundled availability would also extend to other services, like telephone and broadband. Otherwise, customers will not be able to avail themselves of lower prices for one service, *e.g.*, Internet access, without purchasing services that they do not want, *e.g.*, video or phone. Moreover, a customer that has to change all three services – phone, broadband and video – in order to switch providers for one service will find it much more burdensome. Chairman Martin has argued that "the solution to high cable bills isn't price controls or additional government regulation. It is more competition and more choice."[87] However, it is increasingly evident that a cable-telco duopoly will provide neither.

In respect to wireless service, the Commission 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"[88] and that "duopoly cellular market" is "imperfectly competitive"[89] 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."[90]

In regard to the messaging business, the Commission has stated:

> From among all entrants into the IM business, AOL points especially to Microsoft as a significant rival. AOL claims that Micro-

[86] John McCain and Kevin Martin, *Make Cable Go A La Carte*, L.A. Times, May 25, 2006.

[87] *Id.*

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

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

[90] *2002 Biennial Review — Review of the Commission's Broadcast Ownership Rules Telecommunications Act of 1996*, 18 FCC Rcd 13620 ¶ 289 (2002).

> soft'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.*[91]

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

> We believe that Congress rejected implicitly the argument that he 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.[92]

The D.C. Circuit agrees, explaining that "a durable duopoly affords both the opportunity and the incentive for both firms to coordinate to increase prices … above competitive levels"[93]

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

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

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

and that "[t]he combination of a concentrated market and barriers to entry is a recipe for price coordination."[94]

If the Commission grants Verizon's forbearance petition, Verizon will have a natural incentive to raise rates. As related later in this Opposition, Verizon raised its rates on special access services where it had been granted pricing flexibility. In another example, after broadband deregulation, with cable providers its only real competition, Verizon quickly raised prices on DSL, adding a "Supplier Surcharge" that essentially equaled the USF contribution that it was no longer subject to – notwithstanding its assurances to the Commission that deregulation would reduce its costs.[95] In essence, it appropriated USF savings for itself, not its customers. Granted, a move so incredibly obtuse could not be sustained, and this surcharge was soon rescinded after Verizon "listened to [its] customers."[96] (The Commission's Letter of Inquiry may have had some influence.)

More in this vein, Verizon has enacted rate increases in many of the services that are supposedly subject to competition. These include:

- a $5.00 increase in rates charged to an estimated 7.5 million subscribers to Freedom local/long distance calling plans, an increase of more than 10% over the previous $35-40 base;
- a $5.00 increase in rates charged to an estimated 2 million subscribers to 768 Kbps Lite broadband service, an increase of more than 30% over the previous $15 base;
- a $3.00 increase in FiOS Premier video tier, from $40 to $43.[97]

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[94] *Id.* at 724.

[95] Letter from W.S. Randolph of Verizon to Marlene Dortch, FCC, WC Docket No. 01-337, at 6 (June 26, 2003).

[96] Verizon Removes DSL Supplier Surcharge, New Release, August 30, 2006. < http://newscenter.verizon.com/press-releases/verizon/2006/verizon-removes-dsl-supplier.html> visited December 6, 2006.

[97] Buckingham Research Group, Research Note for December 22, 2006 at 1-2.

It is estimated that these rate increases will contribute over $500 million to Verizon's earnings in 2007.[98]

As investors, the Telecom Investors understand that that Verizon has a duty to its shareholders to maximize its profits *on behalf of its shareholders*. This means that Verizon will and 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 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 Verizon's shareholders or consumers in Virginia Beach.

B. Innovation Will be Stifled

In the *Omaha Order*, the Commission explained that forbearance was in the public interest because regulatory intervention results in reduced incentives to innovate.[99] What is particularly unfortunate is that, like with investment returns, the Commission appears to believe of late that only BOC innovation is of concern, and that the BOCs should be granted whatever relief that they claim will spur "innovation," as if the hopes of the industry rest solely on them. This is quite strange, because historically the BOCs have not been innovators, but merely buyers of existing technology and borrowers of others' ideas.

A good working definition of "innovation" is "the act of innovating" i.e. "to start or introduce something new: be creative."[100] Based on this, it is hard to identify any example of Verizon innovation in provision of telecommunications services (although it has distinguished itself lately in regard to *pricing* innovations spurred by regulatory relief). Verizon has no re-

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[98] *Id.* p. 2.

[99] *Omaha Forbearance Order* ¶ 76.

[100] Houghton Mifflin, *Webster's II New College Dictionary* 571 (1995).

search and development organization to speak of, nor does it have a manufacturing operation, notwithstanding its authority to do so subsequent to its relief under Section 271. Verizon was not the first to deploy fiber to the home in its region. RCN, for example, through its Starpower subsidiary was deploying fiber as early as the late 1990's,[101] at least five years before Verizon began its deployment in 2005.[102]

As one analyst has concluded,

> Unlike every other information technology industry, the ILECs engage in virtually no research and development. With the exception of 1999-2000, their network capital spending has remained flat for over a decade. However, their political spending has increased sharply; they spend up to half a billion dollars per year on lobbying, regulatory efforts, litigation, and political contributions, including multiple legal challenges to the 1996 Act and FCC regulations. They also cooperate extensively in purchasing, investing, litigation, regulatory proceedings, and politics. This pattern appears to be the combined result of rational monopolistic conduct, and of entrenched top managements unwilling to face modern high technology competition. The ILECs' top managements and boards of directors generally contain very little technical expertise.[103]

More recently, one Verizon Senior Vice President recently explained, "[w]e develop services, and we figure out how to use and deploy technology that many others are developing."[104] In that same article, the former President of Science and Technology for Verizon's predecessor, Bell Atlantic (and former Chief Engineer of the Commission) stated that "[t]hey [Verizon] do

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[101] RCN Corp. 2003 Form 10-K.

[102] Verizon 2005 Annual Report, available at <http://investor.verizon.com/financial/annual/2005/feature03.html>.

[103] Charles H. Ferguson, The Brookings Institution, The United States Broadband Problem: Analysis and Policy Recommendations 3 (May 31, 2002).

[104] Mark Gimein, *The Phone Companies Still Don't Get It*, BusinessWeek Online, July 31, 2006 (quoting Thomas J. Tauke, Executive Vice President - Public Affairs, Policy and Communications, Verizon) (available at < http://www.businessweek.com/magazine/content/06_31/b3995070.htm>).

very little fundamental research and very little advanced development. … Their view of the world is: 'We can buy it elsewhere.'"

Granting the Petition will spur innovation only to the extent that it will ensure Verizon the supra-competitive returns it believes must be ensured in order to keep pace with the innovations of others. It will send the message that investment should be directed at preserving the status quo, not in innovating. BOCs are not innovators. Any hope for innovation will be made through competition.

VI. Conclusion

For the forgoing reasons, the Commission should deny Verizon's request for forbearance from its obligation to provision § 251(c)(3) loop and transport on an unbundled basis as referenced in its Petition.

Respectfully submitted,

/s/

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