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June 24, 2008

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: *Petitions of Qwest Corporation for Forbearance Pursuant to 47 U. S. C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas,* WC Docket No. 07-97

Dear Ms. Dortch:

A small group of competitors are proposing a convoluted forbearance standard upon which they hope the Commission will evaluate and deny the Qwest petitions.[1] Their proposal would unnecessarily deprive consumers of the benefits of more vigorous competition. Not only should the proposal be rejected, but the Commission should be vigilant as to the unintended long-term damage that this or any other ill-conceived evaluation tool can have on competition, innovation and consumer choice.

Specifically, the competitors want Qwest to prove with respect to each product category and in every particular wire center that there are at least *two* facilities-based competitors who:

(1) Don't rely on Qwest loops or transport.

(2) Provide a "full range of services that are substitutes" for Qwest's local service offerings – even though the competitors maintain that "[s]ubstitutability cannot be known with certainty" – to 75% of the end user locations accessible from a wire center.

[1] Letter from Covad Communications Group, NuVox Communications, XO Communications, LLC and CAVALIER TELEPHONE to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 07-97 (Apr. 24, 2008).

(3) Have achieved a significant market share, roughly equal that of Qwest.[2]

For starters, the Commission should refer to its 1999 decision granting pricing flexibility to incumbent LECs in which competitors proposed that relief should be withheld until competitors are in a position to serve every consumer. The Commission unanimously concluded that such an approach might allow competitors to "game the system," in that they could prevent an incumbent from obtaining pricing flexibility indefinitely by choosing not to serve certain customers.[3] The inescapable logic which guided the Commission then also applies here.

By requiring at least two facilities-based competitors, the competitors are asking the Commission to ignore the competitive significance of cable VoIP services. By requiring that neither facilities-based competitor rely on loops or transport furnished by Qwest, the competitors are hoping the commission will overlook wireless competitors who typically rely on incumbent LEC transport facilities to some extent.

The substitutability and market share tests are inherently subjective and obviously are meant to enmesh the Commission in intractable controversy. The Commission observed in the *Pricing Flexibility Order* that market share analyses "require considerable time and expense, and they generate considerable controversy that is difficult to resolve."[4] Though not irrelevant,[5] certainly, market share analysis is far less relevant than many people realize.

> Competition is not a matter of many sellers or low prices or frequent changes in prices or market shares. It is properly regarded as the state in which resources are deployed with maximum efficiency, and it is not so much the existence of actual

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2 One commenter suggests that the Commission has already all but established a *de facto* market share threshold. *See:* Letter from Thomas Jones and Nirali Patel, Attorneys for Integra Telecom, Inc., One Communications Corp., and Time Warner Telecom Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 07-97 (Jun. 16, 2008) ("The Commission Has Made Public Its Preference For 50 Percent As The Cut-Off Point.").

3 Access Charge Reform, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking (rel. Aug. 27, 1999) (*Pricing Flexibility Order*) at 75-76.

4 *Id.* at 50. The FCC also considered a "competitive checklist" like the one Congress wrote into the 1996 law to govern entry by the Regional Bell Operating Companies into what was then a highly profitable long-distance market (47 U.S.C. §271) and concluded that the benefits weren't worth the administrative burden ("As a result of our review of several BOC 271 applications, the Commission has found that ascertaining whether the BOC adequately has demonstrated that it is providing these checklist items on a nondiscriminatory basis is not administratively simple or easily verifiable. These applications produce voluminous records in which the parties hotly contest BOC compliance with the checklist, and resolution of these disputes within the ninety days permitted by the statute imposes considerable burdens on both industry and the Commission.") at 47.

5 According to the Commission's ARMIS data, Qwest is probably close to the 50% threshold in the four cities in any event. Since the beginning of the decade, Qwest's line losses are 38% in Arizona, 32% in Colorado, 41% in Minnesota and 35% in Washington. Competitors normally target metropolitan areas, so it is likely that the line losses in Denver, Minneapolis-St. Paul, Phoenix and Seattle are considerably higher than the statewide averages.

rivalry, let alone any specific market structure or behavior, as the potential for rivalry, that assures competition.[6]

Richard Rahn points out that market gerrymandering of the type proposed here can be used to make something which is not a monopoly appear otherwise: "If you define products and markets too narrowly, you will see all types of monopolies where, in fact, none exist. You may find Ford Motors has a 90 percent market share for 4X4 pickup trucks in a certain weight category in the color red in Albany County, GA."[7]

The salient facts are that cable phone service is presently available to over 100 million homes and more than 15.1 million currently subscribe, according to the National Cable and Telecommunications Association.[8] Cable voice subscribership has been growing by more than one million per quarter.[9] One study estimates that the market potential for cable voice service over the next 15 years to be 38.8 million residential and 1.6 million small business subscribers.[10]

And a growing number of cell phone customers are "wireless-only" or "mostly-wireless." Almost one-third of the nation's households fell into one of these two categories in 2007, according to a study conducted by the Centers for Disease Control of the U.S. Department of Health and Human Services.[11]

Cable VoIP and wireless providers are actual rivals for millions of consumers and potential rivals for the remainder. It would be short-sighted for the Commission to fixate on evolving variances in pricing, features and service quality when the recent history of innovation in VoIP and wireless offerings reveals unmistakably that the gaps are rapidly eroding and that a significant number of consumers already regard these as superior. It is not enough to assert that businesses may still rely to a greater extent than consumers on traditional landline service: This pattern could change abruptly, particularly if incumbent LECs use forbearance freedom to unreasonably raise prices.

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[6] Richard A. Posner, "Effects of Deregulation on Competition: The Experience of the United States," 23 Fordham Int'l. L.J. 7 (2000).

[7] "Obsolete regulators," by Richard W. Rahn, *Washington Times* (Jul. 28, 2005).

[8] "Digital Phone / Cable Telephony - Full Brief ," National Cable and Telecommunications Association (NCTA) available at http://www.ncta.com/IssueBrief.aspx?contentId=3023&view=2.

[9] "Digital Phone / Cable Telephony (VoIP - Voice over Internet Protocol)," NCTA, available at http://www.ncta.com/IssueBrief.aspx?contentId=3023.

[10] "Consumer Benefits from Cable-Telco Competition," by Michael D. Pelcovits, PhD and Daniel E. Haar (Nov. 2007) at 10, 24.

[11] "Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, July-December 2007," by Stephen J. Blumberg, Ph.D., and Julian V. Luke, Division of Health Interview Statistics, National Center for Health Statistics (May 13, 2008) ("Preliminary results from the July-December 2007 National Health Interview Survey (NHIS) indicate that nearly one out of every six American homes (15.8%) had only wireless telephones during the second half of 2007. In addition, more than one out of every eight American homes (13.1%) received all or almost all calls on wireless telephones despite having a landline telephone in the home.").

Economists have long observed that "perfectly competitive" markets, particularly in an industry characterized by rapidly improving technology, are rare.[12] The question is whether the Commission's repeated intervention in this market is justified whenever the Commission feels that a particular approach might yield greater competition but when the evidence strongly suggests that the Commission is honestly wrong or might even be engaging in good politics but bad policy.

The competitors in this proceeding are really asking the Commission to deny forbearance until new entrants utilizing their own 1990s landline technology and speculative business plans achieve a market position roughly equal to that of the incumbent. This is highly self-serving, but not surprising.

> In the post-1996 era of telecom regulation, considerable effort was put into creating an environment conducive to the entry of new carriers into the fixed-wire local markets. The entrants this attracted offered little in the way of innovation or new services. They were mainly interested in exploiting the arbitrage opportunities created through the regulation of wholesale and retail rates, and most of them failed with a vengeance when the telecom stock market bubble burst in 2000-02….
>
> these policies simply transferred billions of dollars from incumbent telephone companies to fund marketing campaigns required to sell the same service under a different name. Instead, competition has developed in ways totally unanticipated by regulators, namely through unregulated wireless providers and cable broadband platforms.[13]

Since the new entrant competitors can offer high-revenue customers only limited facilities and a limited array of services, they "have to offer extremely steep discounts off the Bells tariff price in order to win any modest portion of the customer's business."[14] This does not sound like a recipe for productive or sustainable competition, and it furnishes a possible explanation why competitors want the Commission, among other things, to continue regulating the prices incumbent LECs charge for loops and transport.

> The X industry is sick. The X industry is dying. It must be saved. It can be saved only by a tariff, by higher prices, or by a subsidy. If it is allowed to die, workers will be thrown on the streets. Their landlords, grocers, butchers, clothing stores and local motion pictures will lose business, and depression will spread in

[12] Kahn, Alfred E. Lessons from Deregulation (AEI-Brookings Inst. 2004) at 29.
[13] Crandall, Robert W. Competition and Chaos (Brookings Inst. 2005) at 157.
[14] Comments of Comptel, WC Docket No. 05-25 (Aug. 8, 2007) at 10-11 (footnote omitted).

> ever-widening circles. But if the X industry, by prompt action of [the Federal Communications Commission], is *saved*—ah then! It will buy equipment from other industries; more men will be employed; they will give more business to the butchers, bakers and neon-light makers, and then it is prosperity that will spread in ever-widening circles. [15]

This is a populist argument. But one of the problems of taking a populist approach here is the impossibility of gauging the impact on genuine, productive and sustainable competition. That is, if the Commission continues to try to ensure that Covad, NuVox, XO and Cavalier can profitability undercut Qwest in Denver, Minneapolis-St. Paul, Phoenix and/or Seattle it risks distorting competition in the competitive arena which really matters now – the rivalry between ILECs, Cable VoIP and wireless providers.

What about this? One cable operator has a profit margin of 55% in video but 70% in phone, according to one analyst.[16] Is a 70% profit margin in phone pro-consumer? (In the short run yes, because it summons investment; in the long-term, not if it is the result of a regulatory pricing umbrella which prevents incumbent LECs from adjusting their prices in response.) If the Commission constrains the flexibility of incumbent LECs to lower their prices it is *de facto* guaranteeing the profit margin of competitors such as the cable operator who makes a 70% margin on phone. That isn't pro-consumer, it is pro-(favored) producer, who gets to maintain its current pricing. As Crandall points out, "[t]he pressure for regulation today derives from a political demand to keep rates *high*, not to restrain monopoly behavior."[17]

In a perfect world, it would be nice if benevolent regulators could surgically adjust market realities without picking winners and losers. In reality, regulatory intervention usually results in unintended consequences like delaying the benefits to consumers from vigorous competition. These benefits include expanded choices; better features and services and, ultimately, lower prices. It is usually not possible to foresee when or from where these benefits will accrue, so the best course is for regulators to not to erect or maintain barriers such as asymmetrical regulation.

> In order that new industries may grow fast enough it is usually necessary that some old industries should be allowed to shrink or die … Paradoxically as it may seem to some, it is just as necessary to the health of a dynamic economy that dying industries be allowed to die as that growing industries be allowed to grow. The first process is essential to the second … Improved methods of production

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[15] Hazlitt, Henry. Economics In One Lesson (Three Rivers 1979) at 98.
[16] "When Is the Cable 'Buy' Set to Come?" by Vishesh Kumar, *Wall Street Journal* (Apr. 3, 2008).
[17] Crandall at 166.

> must constantly supplant obsolete methods, if both old needs and new wants are to be filled by better commodities and better means.[18]

Considering the enormous competitive pressure that Qwest and other incumbent LCEs are under at the moment, it would be difficult if not impossible to fathom a decision by the Commission to deny Qwest's request for forbearance from significant, burdensome regulation, particularly loop and transport unbundling and dominant carrier regulation throughout the Denver, Minneapolis-St. Paul, Phoenix and Seattle MSAs.

Respectfully Submitted,

/s/

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[18] Hazlitt at 102.
[19] The views expressed herein are those of the author and do not necessarily reflect the views of the Discovery Institute, its directors, fellows or staff.