STATE OF VERMONT
PUBLIC SRVICE BOARD

Docket No. 7044

Petition of City of Burlington d/b/a/ Burlington Telecom)
To amend condition No. 17 of its Certificate of Public)
Good, enlarging the date by which it must complete)
Its system building out)

PREFILED TESTIMONY

OF

NICHOLAS P. MILLER

September 30, 2009

Mr. Miller's testimony provides a discussion of the concept of competitive neutrality and its application to the particular conditions at issue in Burlington Telecom's Petition.

TESTIMONY OF NICHOLAS P. MILLER

Q1. Please state your name, position and qualifications.

A1. My name is Nicholas P. Miller, and I am a Member at the Washington, D.C. law firm of Miller & Van Eaton, P.L.L.C. I have more than 34 years experience in the field of telecommunications law and policy. I have a national practice that focuses primarily on providing advice on federal communications law issues to local governments located in states all across the country. This experience has made me deeply familiar with the issues and arguments related to "competitive neutrality" in the cable and telecommunications industry, and in particular with respect to competition between government-owned and private sector communications service providers. My detailed qualifications are set forth in the attachment labeled Exhibit NPM1.

Q2. What is your relationship to Burlington Telecom?

A2. I have provided legal advice on telecommunications and cable television issues to Burlington Telecom (BT) over the past 5 years, and I serve as BT's agent for service for Federal Communications Commission (FCC) matters. I was recently asked to lend my expertise in this proceeding by providing this testimony.

Q3. What are the purposes of your testimony?

A3. My testimony generally addresses "competitive neutrality" concerns raised by Comcast in this proceeding. I would like to begin by presenting what I believe is a useful analytical framework for thinking about competitive neutrality issues.

Then I will provide my analysis and view of the specific conditions that are at issue in this proceeding, and the allegations generally raised by Comcast.

Q4. Please begin with your analytical framework.

A4. Certainly. First, let me start by describing what is usually meant by "competitive neutrality". Simply put, it refers to the idea that competitors should compete based on merit, and the competition should not be skewed in favor one or the other competitor by somehow giving one competitor special privileges that the other does not have. To give an example from federal telecommunications law, the FCC has adopted the principle of competitive neutrality in the development of universal service support mechanisms and rules, defining the concept as follows:

> "COMPETITIVE NEUTRALITY -- Universal service support mechanisms and rules should be competitively neutral. In this context, competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another." *In the Matter of Federal-State Joint Board Universal Service*, Report and Order, Para. 47, FCC 97-157. CC docket No. 96-45 (rel'd May 8, 1997).

What this example illustrates, in terms of the need for an analytical framework, is that it is useful, when discussing whether a certain situation might give rise to competitive neutrality concerns, to begin by determining what is the context for the rules. In other words, what is nature of the competition that one is trying to ensure is not influenced by non-neutral rules? And then to ask whether the condition or requirement being reviewed will cause some advantage relevant and significant to that competition, and finally to ask whether that result is unfair in light of the overall goal of furthering sustainable competition.

It is important to emphasize that "competitive neutrality" does not automatically equate to identical treatment. It bears repeating the FCC's careful language quoted above --- the objective is that rules "neither *unfairly* advantage nor disadvantage one provider over another, and neither *unfairly* favor nor disfavor one technology over another." *Id*. (emphasis added).

When a factor is relevant to the context of the marketplace, and is determined to significantly influence competitive behavior, the factor may still be applied unequally in order to further *fair* competition. This is the notion of "leveling the playing field" which is just another name for "competitive neutrality". If one market participant has strong and inherent monopolistic advantages, such as a near monopoly market share, it may be necessary to give the new entrant countervailing benefits to overcome the otherwise daunting challenges that may inhibit potential competitors from trying to enter the market at all.

It was exactly this concern that led the FCC in a long series of decisions to establish *different* requirements for new entrant telephone companies as compared to incumbent telephone companies. *See, e.g., In re Allocation of Frequencies in the Bands Above 890 Mc.*, 29 F.C.C.2d 825 (1960); *In re Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof*, 85 F.C.C.2d 1 (1980); *In re Competitive Common Carrier Service*, 91 F.C.C.2d 59 (1982); *In re Competitive Common Carrier Service*, 98 F.C.C.2d 1191 (1984). The FCC knew it had to give special benefits to the new entrants "to level the playing field" and to make up for the overwhelming

advantages enjoyed by the incumbent, AT&T. The affirmative FCC-imposed restraints and requirements were explicitly NOT equivalent for the incumbent and new entrants. But they had as their purpose achieving "competitive neutrality". The FCC was willing to look at the totality of competitive context, determine which factors were relevant, and then to determine which relevant factors had to be affirmatively NOT equivalent in orderr to maintain competitive neutrality.

The Congress ratified this approach directly in the Telecommunications Act of 1996, Pub. Law. No. 104-104, 110 Stat. 56 (1996). By adding Section 251(c) (additional obligations of Incumbent Local Exchange Carriers re: interconnection), 47 U.S.C. § 251(c), and Title II, Part III (special provisions concerning Bell Operating Companies), 47 U.S.C. §§ 271-276, Congress explicitly imposed more burdensome requirements on Incumbent Local Exchange Carriers than it imposed on Competitive Local Exchange Carriers.

It is this approach that I believe should be used in analyzing competitive neutrality claims and obligations: What is the context for competition? Is the factor under discussion relevant and significant? In the overall context, is the requirement fair in light of the goals of competition?

Q5. Using the analytical framework you have just outlined, how then would you describe the context for competition in the Burlington cable services market?

A5. In the cable services market in Burlington, the context has two separate competitive aspects that are relevant, and both are evident in Burlington's City Charter 24 V.S.A. App. § 3-438(c), as well as in BT's Certificate of Public Good

(CPG) issued by the Public Service Board (PSB) in 2005. The first is the concept of "competitive neutrality" as applied in a competition between a municipally-owned entity and a private sector entity. The second is the concept of "competitive neutrality" as applied in a competition between an incumbent and a new entrant.

Q6. Can you expand on your discussion of what "competitive neutrality" means for a competition between a municipally-owned entity and a private sector entity?

A6. Yes. The concept has its roots in the notion that public sector entities have some inherent advantages over private sector entities which enable them to compete unfairly with private sector entities. An oft-cited example is the payment of taxes. The argument goes that private companies must pay taxes, and in most cases municipally-owned entities are not required to pay taxes. So in order to neutralize this so-called competitive advantage, the public sector entity should be required to make payments in lieu of taxes.

I do not believe, in my experience, that the premise underlying the notion is correct. In other words, I don't think it is fair to say simply that a private entity's obligation to pay taxes affects competition at all. While taxes do affect the after-tax rate of return an investor may expect on an investment, taxes do not normally directly affect an entity's behavior in the market-place. Taxes apply after the behavior and do not restrain the behavior. Now obviously, this depends on the specific type and incidence of the tax. But to illustrate, a capital gains tax on the owners of the enterprise will not put the enterprise at a competitive

disadvantage to a public entity whose owners (the general public) are not subject to the capital gains tax. On the other hand, applying a sales or excise tax to the private entity may well disadvantage the private entity's prices if the public entity is not subject to the same sales tax on its competing product line.

My point is, just because public sector entities have different requirements, these are not necessarily inherent competitive advantages. They must be directly relevant to the context of the marketplace and must significantly influence competitive outcomes. Not every difference is a relevant or significant factor for competitive neutrality analysis.

Let me expand on my point about relevance of the factor. Private sector and public sector entities have different purposes and they each have specific requirements related to fulfilling those purposes. Those different requirements may not be relevant to competitive neutrality. And when they are, the requirements do not flow only in favor of the public sector entities. In fact, many public sector entity requirements create real competitive disadvantages over private sector providers. For example, public entities are normally subject to extensive public meetings and public records disclosure requirements that are not applicable to private sector entities. This often means that a private provider will have access to competitively sensitive information about its public entity competitor's business plans and operational data without having to publicly disclose its own data. Another example is labor force issues. Government retirement and health benefit programs are often more generous than those

provided by private sector providers to their employees. This difference may burden the public entity with much higher labor costs.

But even if one were to accept at face value the absurd notion that every difference always benefits the public provider over a private competitor, the concept is too often turned on its head and used as a device to prohibit competition from the public sector provider rather than used to require adjustments in market-place behavior to achieve competitive neutrality. I have witnessed examples of state legislative proposals introduced, with the full support and heavy lobbying efforts of large private sector cable operators, that purport to "level the playing field" between private and public sector entities but in reality are intended only to thwart the introduction of legitimate competition from municipally owned entities. A recent example arose in the state of North Carolina earlier this year. The short title of the bill was *Level Playing Field/Cities/Service Providers*, N.C. Gen. Assembly, Senate Bill 1004, Session 2009. Had that bill passed, municipal entities would have been saddled with complex and burdensome restrictions on their financing options, the pricing of their services, and the like, as well as additional auditing and reporting obligations. The bill even gave private competitors the right to seek injunctive relief to enforce its provisions. The overall impact would have been effectively to prohibit competitive entry from municipal providers. With the support of pro-competitive forces, including private sector entities such as Google Inc., Intel Corporation and Alcatel-Lucent, the bill was defeated. But it is worth noting that this was the second time such legislation was introduced in as many years. The 2007 bill,

called the *Local Government Fair Competition Act*, N.C. House Bill 1587, Session 2007, had been even more ambitious in the hurdles it attempted to establish to prevent local governments from launching competitive communications services. These included the restrictions that would later appear in the 2009 bill, but also others that would have imposed costly and time consuming procedural obligations such as requiring the local government to conduct multiple public hearings at which it would have to present a detailed business plan, and the requirement to also hold a special referendum to gain voter approval of the project. These failed legislative efforts were a predictable industry response to the threat of real competition in North Carolina – the launch of some highly publicized municipal broadband projects, including the acquisition of an Adelphia cable system out of bankruptcy by a consortium of three towns and a county, and the launch of several new municipal fiber projects in the state.

In other states, the private sector lobbyists have been more successful at getting legislation passed ostensibly designed to create competitive neutrality or to level the playing field, but effectively creating additional barriers to entry by municipal competitors. In all, nearly half the states have passed some form or another of legislation to address "competitive neutrality" issues in relation to the provision of communications services. In my experience, it is commonplace for the dominant cable industry player in a particular region to engage in lobbying efforts to get legislation passed whenever its near monopoly provision of services comes under threat from would-be competitors, particularly those that are municipally owned.

Q7. And what do you mean by competitive neutrality in a competition between an incumbent and a new entrant?

A7. Practically speaking, no two competitors are exactly the same in all respects. For example, two private sector competitors may have very different costs of capital or a distinctive technology advantage through a patent. Because one starts off with advantage, should government policy intrude to "level the playing field"? Normally, the answer is no. In a free market economy, each entity should be allowed to consolidate its own competitive advantages. Only when those advantages may rise to the level to eliminate competition or to monopolize the market is government intervention such as direct regulation warranted. This answer should not vary whether the entities in question are public or private. Fair competition, not equal treatment is generally the goal of competitive neutrality. In the context of a competition between an incumbent and a new entrant, sometimes competitive neutrality is achieved not by treating the competitors the same, but by treating them differently, at least for a time.

For example, in the proceedings which led to the granting of BT's CPG, the Hearing Officer rejected the Cable Companies' argument that the incumbent and the new entrant should be treated equally in their obligations to support public access educational and governmental channel providers, stating:

"The competitive neutrality provision of the City Charter should not result in identical public access requirements where services are provided by both operators in a circumstance where only one is needed. In addition, while the different technologies employed by BT and Adelphia present some new challenges for the BAMOs, they also present some new opportunities for efficiencies that have the potential to benefit the BAMOs, both cable operators, and all cable subscribers in the community.

On balance, I recommend that the Board not include specific requirements in the CPG equivalent to those in Adelphia's but rather leave these terms for negotiation." *Petition of City of Burlington, d/b/a Burlington Telecom, for a certificate of public good to operate a cable television system in the City of Burlington, Vermont*, Docket No. 7044, Page 32 (12 September 2005).

I have seen similar compromises in state franchise legislation which was enacted in numerous states over the past several years to encourage the large telephone companies to enter into the video services market. Just the fact that new entrants would be permitted to obtain a state-wide franchise rather than local franchises is another example of how new entrants and incumbents are sometimes treated differently. Incumbents have tremendous first mover advantages and sometimes the best way to overcome these is through treating new entrants differently.

Another example is the problem created by exclusive contracts for access to Multi-dwelling Units ("MDU"). For years, competitive cable operators have complained that incumbent cable operators often had exclusive contracts with apartment owners and condominium associations which prevented those MDUs from entering into contracts with competitive cable service providers. As discussed in Mr. Burns' testimony, this restricted access to MDUs in the Burlington market has been a particular problem for BT as it has been frustrated in providing service to every household in the community. The FCC finally struck down these exclusive contracts. *In re Exclusive Service Contracts for Provision of Video Services in Multiple Dwelling Units and Other Real Estate Developments*, Report and Order and Further Notice of Proposed Rulemaking, MB 07-51, 22 F.C.C.R. 20,235 (2007); affirmed, *NCTA v. FCC*, 567 F.3d 659

(D.C. Cir. 2009). In its analysis, the FCC made clear that these contracts unfairly protected the incumbent from competition and the change was needed to level the playing field for new entrants.

Q8. Now, let's turn to the specific allegations of Comcast in the present proceeding. First, I would like to discuss Condition 17. Are you familiar with that condition?

A8. Yes, I am. That is the 100% build-out condition that BT is seeking to amend in this proceeding.

Q9. Comcast suggested in its "Motion to Compel Burlington Telecom to Respond to Information Requests", dated April 13, 2009, that Comcast is suffering competitive harms due to BT's non-compliance with that condition. What is your assessment of the situation?

A9. I would begin by noting the competitive context. This is a condition that has nothing at all to do with BT's status as a municipally-owned entity. The relevant context for considering this condition is the effect on competition between an incumbent and a new entrant. Viewed in that context, my first conclusion is that the condition itself is somewhat unusual for a new entrant, and based on my experience with competitive cable franchises and with legislation adopted in other states to promote cable services competition, I would say I have to agree with the Hearing Officer's assessment that the construction schedule was "aggressive" (*Id*, p.14) particularly for a small over-builder like BT. I believe it is an unrealistic condition to impose on a new entrant like BT if the state is interested in sustainable competition in the cable television market in Burlington.

Within my experience, I have seen numerous overbuild franchises where the new entrant was allowed to build less than the entire area served by the incumbent. There is common recognition in the cable television industry that an overbuild operation must achieve a certain number of subscribers per plant mile to have any hope of economic success. This number will vary with the nature of the construction required. If there are difficult or underground areas to build, the number goes up substantially. This requires the neighborhoods served to have sufficient household densities that both the incumbent and the new entrant have sufficient potential subscribers to survive. So it is not normal in an overbuild franchise to require 100% build out of the entire jurisdiction.

For this same reason, in numerous states where state franchise legislation was introduced in recent years to try to foster cable competition, less onerous build out requirements were imposed for new entrants. The prevailing view has been that lesser requirements were necessary to introduce competition and that this was the essence of *fair* "competitive neutrality". This is essentially a balancing act -- recognizing all of the factors at play, including the market power of incumbents and the financial burden on a new entrant of an overly aggressive build out requirement.

For example, in California where Comcast has extensive operations as an incumbent, the state franchise law, the *Digital Investment and Video Competition Act of 2006*, Cal. Pub. Util. Code § 5800 et seq., set different build-out thresholds depending on the size of the new entrant (i.e., fewer than or, more than 1,000,000 telephone customers in the state), and on the type of technology being deployed

(i.e., primarily fiber-to-the-home or, not primarily fiber-to-the-home). For example, if BT would have launched its service as a new entrant in California, it would have been subject to a much lower build out standard, only being required to offer video service to all customers within its telephone service area "within a reasonable time, as determined by the [California Public Utilities] Commission" and with the additional caveat that "the Commission shall not require the holder to offer video service when the cost to provide video service is substantially above the average cost of providing video service in that telephone service area." Cal. Pub. Util. Code § 5890(c)). To give some context as to what the Commission may find to be a "reasonable" timetable, the largest new entrants to the video services market in California (i.e., those with more than 1,000,000 telephone customers) have build out requirements that top out at 50%. Moreover, if the large new entrant is, like BT, "predominantly deploying fiber optic facilities to the customer's premise" then the requirements are lower still (i.e., provide access to video service to at least 25 percent of the customer households in the new entrant's telephone service area within two years after it begins providing video service, and to at least 40 percent of those households within five years. Cal. Pub. Util. Code § 5890(e)(1). These reduced targets may be further delayed or reduced if the customer acquisition is slow, because the 40 percent target does not have to be met until two years after at least 30 percent of the households with access to the holder's video service subscribe to it for six consecutive months, and can be delayed indefinitely. Cal. Pub. Util. Code § 5890(e)(3) and (4), and 5890(f).

I believe that BT made a business mistake to have offered to comply with an ambitious 100% build out in three years. For a small, new entrant it was too ambitious. BT should be applauded for very nearly achieving it. But now, in my view, it is important to alter the condition in the interests of preserving the competition that has been achieved in the City of Burlington. Continuing to impose the burden will not achieve competitive neutrality. And it may cause the re-emergence of monopoly service.

The second thing I wish to note is that the BT request is fully consistent with the Commission's previous decisions recognizing the problems associated with a universal buildout of every home in an operator's franchise areas. In 2001 the PSB determined that Adelphia had violated certain of its CPG conditions that required it to calculate the density (in homes per mile) and build line extensions to qualifying areas. PSB Docket No. 6445, Order dated 8/21/2001. And a settlement was reached on similar allegations just before Comcast took over the Adelphia system in 2006, PSB Docket No. 7178, Order dated 6/29/2006. Comcast took over responsibility for constructing the "Remaining Docket No. 6445 Line Extensions" and agreed to complete them by the end of 2008. Comcast later petitioned the PSB for additional relief due to some landowner refusals to grant access, and eventually the PSB entered an order approving an MOU that established an orderly process for finally ensuring that the obligations were met which the Hearing Officer described as the result of "Adelphia's long history of failure to build promised line extensions". PSB Docket No. 7077, Order dated 10/16/2008.

Third, it is not uncommon for small providers to seek and be granted waivers of rules that compliance with which would otherwise cause financial hardship. The FCC has a history of granting waiver requests based on financial hardship. To cite just one recent example, when the deadline for the analog to digital television transition was extended earlier this year, the FCC permitted noncommercial educational stations to terminate their analog broadcasts earlier than the extended deadline if they could demonstrate that they needed to terminate early due to significant financial hardship. *In the Matter of Implementation of the DTV Delay Act DTV Consumer Education Initiative Third Periodic Review of the Commission's Rules and Policies Affecting the Conversion To Digital Television Digital Television Distributed Transmission System Technologies,* Third Report and Order and Order on Reconsideration, FCC 09-19 (March 13, 2009).

I do not believe Comcast's claims of "competitive harm" have merit when viewed in this broader context. I see this more as an incumbent trying to enforce what it knows to be an unusually burdensome condition on a new entrant in a difficult economy, not as a shield to protect itself from competitive harm, but rather as a sword, in order to try to handicap, and better yet, eliminate a competitor.

Q10. Thank you. Now let's turn to the conditions that the PSB adopted as specifically related to City Charter 24 V.S.A. App. § 3-438(c). These are Conditions 56 through 65. Are you familiar with those as well?

A10. Yes, I am. These conditions reflect the PSB's view as to the appropriate rules needed to implement the "competitive neutrality" requirement of the Burlington

City Code, which as I mentioned earlier, recognizes that the public sector entity will be a new entrant in a market where there is already an established incumbent. Unlike other states I discussed already, the Vermont legislature took what I view as a more flexible approach to implementing the principle of "competitive neutrality" by giving the PSB the discretion to determine appropriate conditions within certain limits rather than imposing hard and fast prerequisites which too often have the effect of prohibiting municipal broadband projects. The relevant context for evaluating these conditions is whether they are important for competitive neutrality between a municipally-owned entity and a private sector entity or whether they stifle competition between a new entrant and an incumbent.

Q11. I would like to draw your attention to Condition 60 which permits BT to participate in the City's pooled cash management system but requires it to "reimburse the City within two months of the City's expenditure for any expenses incurred or payments made by the City in support of services that BT provides to non-City entities." BT is asking the PSB to modify this condition. Can you comment on this request?

A11. Certainly. As I understand it, the purpose of Condition 60 was to implement the directive in Burlington City Code § 3-438(c)(1) to "ensure that any and all losses from these businesses, and, in the event these businesses are abandoned or curtailed, any and all costs associated with investment in cable television, fiber optic, and telecommunications network and telecommunications business-related facilities, are borne by the investors in such business, and in no event are borne by

the city's taxpayers, the state of Vermont, or are recovered in rates from electric ratepayers." I have several comments I wish to make.

First, the requirement in § 3-438(c)(1) reflects a particular policy view that the City's fiber optic project should not be considered a core function of a local government. That is a common view among opponents to municipal broadband projects, and one I believe is becoming more and more outdated. Access to broadband, once considered a luxury or a novelty, is increasingly viewed as an absolutely essential service in modern society and a prerequisite to economic development and prosperity, as well as the delivery of healthcare and education and other essential services. Where competition exists, citizens reap additional benefits of lower costs and greater innovation. Be that as it may, I recognize that the PSB cannot change the policy reflected in the City Code.

Second, it strikes me as the type of condition that may properly be waived, or modified, in times such as the present when there has been significant dislocation in credit markets and other sources of credit may not be readily available. I understand that BT is not seeking the permanent waiver of this condition, but rather a temporary waiver while it seeks a refinancing of its debt.

Finally, in my view an overly zealous enforcement of this condition may well drive BT out of business and result in precisely the kind of harm that the Legislature sought to avoid – that is, losses borne by city taxpayers. And, in addition, the city would lose the competitive benefits of BT's presence in the marketplace. Projects such as BT's require considerable upfront spending to build out the system and gain customers to become fully self-supporting. The

Legislature's mandate to protect taxpayers from losses does not have a strict time element. If implemented too restrictively, it will result in good projects going under before they have been given a chance to reach their true potential. That cannot be what the Legislature intended.

Q12. Does this conclude your testimony?

A12. Yes it does.

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