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August 15, 2005

BY HAND

Honorable Jaclyn A. Brilling
Secretary
New York Public Service Commission
Three Empire State Plaza
Albany, New York 12223

Re: Case 05-C-0616

Dear Secretary Brilling:

Pursuant to the Commission's June 29, 2005 "Order Initiating Proceeding and Inviting Comments," enclosed please find an original and fifteen (15) copies of the Initial Comments of Verizon New York Inc.

Respectfully submitted,

Sandra DiIorio Thorn

cc: Hon. Jeffrey E. Stockholm, Administrative Law Judge (By Hand and By E-Mail)
Active Party List (By E-Mail)
Peter McGowan, Esq. (By Hand and By E-Mail)
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Mr. Robert Mayer (By Hand and By E-Mail)

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services	**Case 05-C-0616**

INITIAL COMMENTS OF VERIZON NEW YORK INC.

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August 15, 2005

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INITIAL COMMENTS OF VERIZON NEW YORK INC.

I. INTRODUCTION

Verizon New York Inc. ("Verizon") wholeheartedly endorses the *Instituting Order*'s recognition that competition in telecommunications has entered a new era,[1] and that the Commission needs to take a fresh look at its regulatory framework in order to ensure that it reflects the new realities of that era. The Commission's goal should be to move towards a regulatory environment that is streamlined, forward-looking, and fundamentally market-based, by eliminating all forms of regulation that impose unnecessary and unduly burdensome requirements on some providers but not on others. In an intermodal world, there is no longer any justification for heavy-handed, differential regulation of Verizon as the "dominant" provider of telecommunications services. Consumers now have a variety of alternatives available to them — alternatives that compete with Verizon not only on the basis of price but also on the basis of the functionalities offered — and those competitive offerings do not depend, as UNE-P and resale-based competition did, on the use of Verizon's network. The assumptions on which much of current regulation was based — that Verizon is a monopolist at the retail level and a provider of "bottleneck" inputs to its competitors at the wholesale level — are simply no longer true.

[1] The *Instituting Order* itself clearly demonstrates that the Commission has a firm grasp of the profound changes that have occurred in the competitive landscape as a result of the emergence of intermodal competition. Nevertheless, because the significance of these changes has been minimized or questioned in other proceedings, and will undoubtedly be denied by other parties, Verizon provides a summary of relevant developments in the Appendix to these comments. *See also* Case 05-C-0237, "Petitioners' Comments on Department of Public Service Staff White Paper" (August 5, 2005), at 15-20, and *id*., "Petitioners' Reply Comments" (May 13, 2005), at 4-28, which provide additional detail.

The markets in which Verizon operates are now subject to competition that is greater in amount, and fundamentally different in kind, than any that existed in the past. These competitive forces are driving Verizon, and all other service providers, to offer services in the way customers want them, and at prices they are willing to pay, at the risk of not getting their business. This competitive environment, and the regulatory environment that has not yet caught up with it, has exposed Verizon to significantly increased market risks — risks that are demonstrated by the fact that Verizon has sustained an aggregate net income *loss* of hundreds of millions of dollars in this state since 2003.[2] Moreover, Verizon no longer operates under a regulatory framework that limits its risks by setting rates designed to make it whole for its capital-related costs and expenses.[3] Any rate levels that might be authorized by the Commission in a rate-of-return proceeding would simply be irrelevant to the prices that customers are willing to pay in today's highly competitive environment. Thus, regulations based on the assumptions of rate-of-return regulation are as obsolete and unnecessary as regulations based on the assumption of a monopoly market, and should also be eliminated by the Commission.[4]

This should not be seen merely as a matter of eliminating regulations that are unnecessary but harmless. The current regulatory framework actively *interferes* with competition by imposing costs on one competitor — Verizon — that other competitors are not required to bear, by stifling innovation, by limiting Verizon's ability to respond flexibly and rapidly to price and product changes by its competitors, and by restricting Verizon's ability to manage its business as it sees fit. This thumb on the competitive scales hurts Verizon, of course; but it harms consumers as well by distorting the competitive process and denying them the full range of competitive choices they would otherwise have.

[2] Verizon's net income for 2003 and 2004, as shown on the company's Form 10-Ks for those years, were negative $372.1 million and negative $231.0 million, respectively.

[3] Verizon's last true rate case in New York, Case 90-C-0191, was filed more than fifteen years ago.

[4] Regulations should not be maintained merely because of uncertainty as to whether a need for them exists. Rather, if regulation burdens competition, the Commission should adopt a "zero-based" approach which would decline to maintain regulatory burdens unless a clear and compelling need for regulation exists.

In a competitive environment, regulatory parity must be a high priority. Competitors should compete based on the pricing, quality, and capabilities of their service offerings, on the level of customer care that they provide, and on the reputations they and their brands enjoy. The competitive playing field should not be tilted by differential regulation. Disparate regulation was a significant problem even in an era dominated by wireline competition between Verizon and UNE-based or resale-based CLECs, and it is even more serious now in light of the fact that virtually all intermodal competitors are exempt as a matter of law from many of the statutes under which Verizon is regulated.[5] Applying the same heavy-handed regulation to these competitors as is applied to Verizon is not the answer — both because it would be contrary to law and because it would in any event be bad policy in a competitive market. This disparity must be addressed by freeing Verizon of *its* regulatory shackles.

The growing importance of intermodal technologies also underlines the need for policy changes that recognize that network investment and innovation should be driven by the demands of the competitive marketplace, not dampened by asymmetric, costly regulations. Regulatory policies that weigh heavily on traditional wireline providers, and thus impair their ability and incentive to innovate, or that limit their flexibility to liquidate non-productive assets and to invest in new ones, or that depress incentives for innovation by imposing arbitrary price ceilings, do not advance that goal. Verizon looks forward to continuing to be a significant contributor to New York's technologically advanced, multi-modal telecommunications environment of the future. Nevertheless, the Commission must realize that the continued imposition of disparate regulatory burdens on Verizon is reducing its ability and its incentive to make such investments.

[5] *See, e.g.,* 47 U.S.C. § 332(c)(3)(A) ("[N]o State or local government shall have any authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service, except that this paragraph shall not prohibit a State from regulating the other terms and conditions of commercial mobile services . . . ."); Public Service Law § 5(6); *Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission,* WC Docket No. 03-211, Memorandum Opinion and Order, 19 FCC Rcd 22404 (rel. November 12, 2004) ("*Vonage Order*") (preempting certain state regulation of VoIP services).

In response to these concerns, Verizon proposes a number of specific changes in the Commission's current practices and rules:[6]

- The retail tariffing process should be streamlined so that Verizon has the ability to change its retail prices, and the non-price terms and conditions of its retail service offerings, on one day's notice. With the exception of a small number of services that would be offered free or subject to a specified price ceiling for reasons of law or social policy, there would be no price ceilings or price floors for retail services. Changes in the terms and conditions of retail service offerings, the introduction of new offerings, and the discontinuance of existing offerings, would be presumed to be reasonable, and the Commission would not seek to suspend them.

- The Commission should issue regulations permanently adopting its current policy of allowing Verizon to retain the benefit of tax and other refunds, as well as gains on sales and transfers of works and systems. Except where prohibited by statute, proposed sales, transfers, or leases of works and systems should be presumed to be reasonable.

- Current requirements related to the filing of annual reports and reports on capital expenditures should be eliminated or substantially streamlined.

- Voice Messaging Service ("VMS") should be de-tariffed.

- Verizon should be exempted from regulations related to the procurement process.

- Wholesale and retail service quality regulations should be streamlined and certain regulations should be eliminated altogether.

- Consumer complaints should be resolved more expeditiously, and interest payments on award amounts should be limited.

- Current "bucketing" requirements related to bill payment should be eliminated, and in general, Verizon should be permitted to discontinue service to customers who fail to pay all outstanding charges.

- Verizon should have the flexibility to increase its late payment charge and other similar charges to competitive levels.

- As a "safety net," consistent with Verizon's commitment to meet concerns about underserved areas, Verizon would commit to offer Lifeline and a tariffed residential Basic Service Offering, described in greater detail below, throughout its service area.

[6] We discuss these proposals in greater detail in Sections II through VI, below. We do not explicitly address each of the individual questions set forth in the *Instituting Order*, since many of them would be obviated by the general approach that we take. However, those questions generally frame the scope of the discussions in these comments.

In addition to the affirmative proposals outlined above, Verizon recommends that the Commission *not* seek to adopt new regulatory requirements in some of the areas discussed in the *Instituting Order*. In particular, there is no need to create new universal service funding mechanisms or to modify the Targeted Accessibility Fund ("TAF"), and consideration of certain "level playing field" issues should be deferred at least until federal proceedings in these areas are concluded.

The changes proposed by Verizon are required by the competitive market, but they are in no sense tantamount to total deregulation. Our approach is a balanced one that gives due recognition both to the need for change and the value of the Commission's oversight in many areas. In most respects, our proposals simply adopt regulatory reforms that have long since been granted by the Commission to competitive providers, whether by formal regulation, order, or simply through regulatory practice. They would, moreover, leave most current consumer protections intact, as well as virtually all current requirements relating to construction and environmental matters, the issuance of securities by telephone corporations, public safety, customer privacy, and numerous other matters.

The Commission has the power to implement all of Verizon's proposals within the current statutory framework, either by changing its own regulations, or by overruling orders that introduced now-outmoded regulatory requirements, or by changing its regulatory practices.[7] Most of the relevant state statutes empower, but do not compel, the Commission to regulate in particular ways. Accordingly, the Commission should recognize the flexibility and discretion that it enjoys, and should exercise that flexibility and discretion in the public interest, to reduce or eliminate disparate and unnecessary regulatory burdens. Making decisive and permanent changes in its practices and regulations, in the manner proposed in these comments, is well within the Commission's power.

[7] Verizon recognizes that in the longer run, statutory changes will be necessary to ensure that the benefits of intermodal competition are fully realized. However, we believe that legislative proposals would most appropriately be presented and considered outside of the context of this proceeding, the focus of which should be on actions that can be taken *by the Commission*.

Finally, the Commission should not try to "fine-tune" the regulatory reform process by using an index to measure the degree of competitive presence in individual geographic areas, or by adopting different levels or types of regulation in each such area based on the value of any such index. Such "metrics-based" approaches would impose substantial administrative costs on the Commission itself and on Verizon, and would establish a "crazy-quilt" regulatory regime that would engender confusion, discourage investment, and make monitoring difficult and implementation virtually impossible.[8]

More importantly, by treating competition as a local phenomenon rather than one that takes place in arenas of regional or national size, such approaches systematically understate the significance of competitive presence and the resulting need for regulatory change. They are based on the false premise that unless there is a certain level of competitive presence in a particular town or neighborhood, service providers are not constrained in the prices and level of service that they can offer in that particular area. But a company such as Verizon that offers service in a particular town is constrained not only by the competitors who are currently offering service in that town, but also by those that are offering services in the larger competitive arena in which the town is located, and that could readily extend their service to requesting customers within the town.

Metrics-based approaches also hand a powerful tool to those who would seek to use process to obstruct or delay reform, and to prevent effective competitive response by Verizon. Finally, even if such approaches were desirable in principle — which they are not — fine-tuning is simply not feasible in the real world of imperfect information and regulatory lag.

The Commission must recognize that this proceeding is not about detailed fact-finding. The existence of intermodal competition is not in doubt: the *Instituting Order* explicitly recognizes that such

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[8] Verizon's marketing and operational systems are simply not designed to implement the sort of patchwork regulatory scheme that Staff apparently contemplates and that many parties will undoubtedly advocate. Even if it were feasible to do so, seeking to require Verizon to incur the truly enormous costs that would be associated with rebuilding its support systems — costs that would not be faced by its intermodal competitors — would be a move in the direction of decreased rather than increased regulatory parity. The Commission should reject out of hand proposals that would make Verizon a *less* efficient and *higher*-cost competitor.

competition has emerged and is growing. The goal of this proceeding is to develop a forward-looking regulatory *policy* that will create a regulatory environment that can foster and maintain such competition now and in the future. The opening of competitive markets over the last two decades — and the resulting benefits to consumers — have resulted precisely from such bold and transformative policy initiatives at both the federal and state levels, none of which was based on fine-grained indexing of the need for change in particular wire centers. Rather, they were based on bold *policy* judgments about the direction in which regulation should move, and bold initiatives — many of them on the part of this Commission — to implement those judgments. It is precisely such initiatives that should be put in place in this proceeding — despite the protests of those with a vested interest in inaction or a taste for lengthy process. This proceeding should not be treated as an academic exercise in drawing fine distinctions. The Commission must remember that it is a *policy* that it is developing.[9]

II. MARKET POWER AND REGULATORY FLEXIBILITY

A. THE DEFECTS OF A METRICS-BASED APPROACH

The Commission should *not* adopt a "metrics-based" approach that seeks to manage or fine-tune regulatory reform by tying the type and degree of regulation in specific geographic areas to the value of some "competitive index" in those areas. Far from facilitating needed reforms, such an approach would ignore competitive realities, understate the need for reform, and introduce new costs, burdens, and inefficiencies — all of which would be imposed disproportionately, if not exclusively, upon Verizon.

1. Metrics-Based Approaches Ignore the Fact that Intermodal Competition Is Regional or National in Scope

Tests based on current market shares or numbers of customers in particular areas fail to measure the true need for, and benefits of, regulatory reform. Intermodal competition is not a local phenomenon, but a national one. Individual wire centers are simply not the arena in which competition takes place —

[9] *Cf. McCulloch v. Maryland*, 17 U.S. 316, 407 (1819) ("[W]e must never forget, that it is a *constitution* we are expounding.").

they are a minuscule part of that arena. The marketing plans of Verizon's competitors are not wire-center based, and wire centers do not define the reach of the technology that those competitors utilize. Intermodal competitors do not need to access Verizon wire centers to originate calls on their networks — wireless competitors can originate calls anywhere within the reach of their nationwide facilities, and VoIP can be provided wherever broadband service is available.[10] Tying regulatory reform to the extent to which particular competitors are currently providing service within a particular wire center ignores this competitive and technological reality, and underestimates Verizon's *current* need for flexibility in the overall, integrated geographic market of which the wire center is just a small part.

For example, the fact that no customer currently purchases service from an independent VoIP provider in a particular upstate town does not mean that Verizon's prices and service quality are not subject to competitive discipline in that town as a result of the existence of the VoIP alternative. There are a number of major VoIP providers that offer service on a nationwide or near-nationwide basis, such as Vonage, Packet8, BroadVoice, and Lingo. As long as underlying broadband facilities are available in a particular area (as they are, ubiquitously, in New York State[11]), a customer in that area *could* order that competing service, and Verizon therefore would have an incentive to maintain or reduce its prices and to

[10] Intermodal competitors are national in scope. Although wireless providers including Cingular, Sprint, T-Mobile, and Nextel each have slightly different geographic coverage, each competes nationally. Moreover, any customer with a broadband connection can purchase VoIP services from a number of competitors. Although individual cable companies operate regionally, cable networks themselves span close to the entire country and are already, or imminently, being used to offer consumer voice services. Thus, consumers today have similar competitive choices regardless of their geographic location. In these circumstances, the geographic market is properly treated as national in scope.

The scope of intermodal competition is demonstrated by the fact that VoIP and wireless providers advertise in national media (*e.g.*, the Wall Street Journal and USA Today), and have an active presence on the World Wide Web. Vonage, for example, states on its web site that "[e]ven if we don't offer an area code in your city or town you can get exceptional Vonage service and savings today. Then, when we do add your area code, we'll switch your Vonage phone number for free." (http://www.vonage.com/avail.php?lid=nav_avail)

[11] *See* discussion in Appendix, *infra*.

improve the quality and range of services it offers. This is particularly true in view of the fact that VoIP providers advertise and offer their service on a nationwide basis.[12]

2. Metrics-Based Approaches Are Not Forward-Looking, and Do Not Create a Regulatory Environment That Will Encourage the Growth of Competition

Metrics-based approaches are backward-looking in that they focus on market shares that have resulted from the policies of the past, and ignore the role that regulatory reform itself plays in creating and maintaining a regulatory environment that will foster goals such as competition, investment, and innovation — now and in the future. As the Commission aptly observed, "our goal [in this proceeding] is to establish a flexible regulatory framework that promotes innovation and encourages economic investment in this state's telecommunications infrastructure."[13] For example, freeing Verizon from pricing constraints that do not apply to its competitors will promote true competition by ensuring that consumers will (or will not) purchase Verizon's products based on the customer service it provides, the nature of its products, the prices it is willing to offer, and the reputation it enjoys — and not because regulatory lag impairs Verizon's ability to change its prices to rapidly meet those being offered by a competitor. It is only in a parity-based regulatory environment that competition can "do its thing" by ensuring that goods and services are provided to consumers at the highest possible quality and the lowest possible cost.[14] Thus, parity regulation is an important forward-looking goal *regardless* of the precise market share that has already

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[12] The ubiquity of VoIP as a real competitive threat even where it is not currently utilized is illustrated by one of Verizon's competitive responses — the offering of its own VoIP alternative under the name VoiceWing. VoiceWing is available anywhere in the nation, and a Voice Wing customer can obtain a number with an NPA from anywhere within Verizon's 31-state footprint. Verizon would obviously prefer not to have its own VoIP offering cannibalize its own wireline offerings — but it nevertheless offers VoiceWing ubiquitously because it perceives other carriers' VoIP offerings as a ubiquitous competitive threat.

[13] *Instituting Order* at 5-6.

[14] The forward-looking approach recommended here is not inconsistent with the Commission's statement that "[o]ur regulatory framework must be designed for the present transitional market, not for yesterday's monopoly nor for the fully competitive market that may ultimately develop. As such, rules should not be imposed which perpetuate or assume monopoly conditions; neither should regulatory protections be abandoned merely on the promise that the market may eventually provide them." (*Instituting Order* at 2-3.) Verizon's proposed approach does not rely on conditions "that may ultimately develop," but on conditions that are here, now, including the emergence and rapid growth of wireless services, cable telephony, and VoIP; the independence of those services from Verizon's

(continued …)

been attained by competitors in particular areas. Similarly, as demonstrated below, many existing regulations were developed to meet the needs of rate-of-return ratemaking, and are unnecessary today. Regardless of the precise degree of competition, there is no justification for retaining such regulations, and their elimination should not be deferred.

3. Metrics-Based Approaches Create a Variety of Practical Problems

Even if metrics-based approaches had some theoretical merit — and they do not — implementation would be impossible because of imperfect information and regulatory lag. What a "fine-tuned" regulatory response would be fine-tuned to in the real world is a competitive situation that existed in the past — or that was assumed to exist because of lack of adequate information.[15] In an environment of rapid-paced change in technology, and the rapid entry and exit of competitors, these practical realities would enhance the systematic understatement of competitive presence that is inherent in a metrics-based approach.

The implementation of a metrics-based approach would also be costly and burdensome for the Commission and for the parties. Judging by past experience (for example, with carrier-to-carrier metrics), we would expect even the process of *developing* such an index to entail numerous rounds of written comments and "collaborative" meetings between the parties, engendering endless debate on a variety of issues, including competing statistical methodologies, how often the index should be updated, the level of geographical disaggregation at which it should be applied, etc. Many parties would undoubtedly clamor for discovery, creating further costs and burdens — burdens that would, moreover, be imposed disproportionately on Verizon. Verizon would have to make experts available to attend meetings, prepare propos-

(…continued)

network; and the ubiquity of broadband service as an enabler for independent (non-cable-company-provided) VoIP.

[15] As Verizon discussed in its comments on the "White Paper" that Staff filed in the Verizon-MCI merger proceeding (Case 05-C-0237), that analysis gave too little significance to intermodal competition in assessing the competitive effects of the merger — in part because systematically reported data on intermodal competition was not as readily available as data on traditional wireline competition.

als, and react to other proposals, while Staff, and ultimately the Commission, would bear the burden of analyzing and ruling on those proposals. Yet once an index is developed, it would almost immediately be out of date.

Even if this process could be successfully managed, and brought to a conclusion within a reasonable period of time — a significant challenge even under the most optimistic assumptions — implementation would create difficulties of its own. Complying with a disaggregated, wire-center-by-wire-center patchwork of regulations would impose significant administrative costs on Verizon, including, in all likelihood, the need for substantial changes to its operations support systems. To the extent that this patchwork of regulation applied to Verizon's retail products, effective marketing would become impossible, because the differing restrictions applicable to adjoining wire centers could not be reflected in mass-market advertising that, by its very nature, spills across wire centers regardless of their metrics classifications. These costs and limitations would not be imposed on Verizon's competitors, which would either be beyond the Commission's jurisdiction or else would simply decline to provide service in the "highly-regulated" areas because of insufficient margins.[16] Monitoring and enforcing such a crazy-quilt regulatory scheme would also make considerable demands on the Commission and its Staff.

A confusing patchwork of regulatory regimes would disserve the interests of customers, as well as competitors and the Commission. CLECs have on numerous occasions argued for the need for uniformity to reduce the costs they incur in interfacing with Verizon as its customers.[17] The same considera-

[16]The fact that geographic disparities in regulation would deter providers within the Commission's jurisdiction from entering "highly regulated" areas at all, or from extending existing services in those areas by introducing new service options, shows that a metrics approach could actually be counterproductive to the Commission's goal of fostering the emergence of competition in underserved areas.

[17] *See, e.g.,* Case 97-C-0271, "Affidavit of Jonathan M. Askin on Behalf of the Association for Local Telecommunications Services in Response to Bell Atlantic – New York's April 13, 1999 Checklist Update" (April 28, 1999), ¶ 52; *id.* "Joint Affidavit of Annette Guariglia, Robert Lanier, Sherry Lichtenberg, Rodney Sampson, and Clifford Dinwiddie on Behalf of MCI WorldCom Inc." (September 28, 1999), ¶ 43. These concerns led to the inclusion of OSS uniformity as a condition of FCC approval of the NYNEX-Bell Atlantic merger. *See Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer Control of NYNEX Corporation and its Subsidiaries*, File No. NSD-L-96-10, Memorandum Opinion and Order (rel. August 14, 1997), ¶ 195.

tions apply to retail business customers that seek to purchase services from Verizon in more than one wire center, and for that matter to residence customers that move from one location to another within Verizon's service area.

Aside from all of these theoretical and practical factors, tying competitive reform to the outcome of a metrics process would give Verizon's competitors a powerful incentive — and, experience has shown, considerable ability — to delay reform by dragging that process out. That is precisely what CLECs did in the proceedings relating to the supposedly straightforward "trigger tests" put in place pursuant to the FCC's *Triennial Review Order*, here and in other states.

B. THE PROBLEMS CREATED BY A METRICS-BASED APPROACH WOULD ONLY BE INCREASED IF STAFF'S COMPETITIVE INDEX WERE ADOPTED

Adoption of a regulatory scheme based on the impairment index discussed in the Department's comments in the FCC's *Triennial Review Remand* proceeding[18] would not resolve the problems and concerns discussed above — it would enhance them. In that proceeding, the index had considerable value in that it explicitly recognized the importance of intermodal competition in determining whether CLECs were impaired for mass-market local circuit switching — a recognition that the FCC itself was slow in reaching. However, the utility of the index in 2005, as a basis for determining the need for or appropriateness of retail regulatory reform in specific wire centers, is far less convincing. For current purposes, the index measures the wrong factors, weights them incorrectly, and systematically understates the extent of intermodal competition.[19]

Staff's wire-center-based approach awards points for various forms of competition in a wire center: 1.0 points for the presence of cable telephony; 1.0 points for residential service provided by a wireline CLEC; 0.5 points where such a CLEC provides business service (18 lines or less) but not residential

[18] *Unbundled Access to Network Elements*, CC Docket No. 01-338, Comments of the New York State Department of Public Service (October 4, 2004) ("DPS Triennial Comments").

[19] We are aware that Staff is in the process of modifying this index (*see* Staff Response to Initial Information Request of the New York State Consumer Protection Board), and we expect to provide further comment on the modified index in our reply filing.

service; 0.5 points for the presence of at least two wireless providers; and 0.75 points for VoIP.[20] These points are added up and a wire center is declared to be competitive (or "unimpaired") if it has 2.75 or more points, and if there are "at least three alternatives to the ILECs wireline service and at least three different platforms to protect against market concentration."[21] Based on an analysis performed by Staff in 2004 using this index, 276 (out of 520) wire centers — collectively accounting for over 85 percent of the access lines in Verizon's service area — were deemed to be unimpaired for local switching.[22] Thus, even this understated index demonstrates the widespread existence of competition within the state.

The following lists some of the principal flaws of Staff's index, beyond the general flaws shared by all metrics-based approaches:

Problem 1. ***The index is applied to too small a geographic market.*** Staff's index is designed to be applied on a wire-center basis. However, a wire center is a unit of plant, not a unit of market. As we have already discussed, the serving areas and marketing strategies of intermodal competitors are not limited by wire-center boundaries.

Problem 2. ***The index overemphasizes wireline competition.*** The weights used in the index (*i.e.*, the points awarded for different types of competitive presence) are set so that no wire center can be competitive unless it is served by a wireline CLEC. This is wrong. As the *Instituting Order* recognizes, the most important changes in the telecommunications markets have resulted from the emergence and growth of intermodal providers. Under Staff's index, no matter how widely utilized these competitive alternatives are, without a wireline CLEC present, the market remains presumptively non-competitive. If a market were served equally by third-party VoIP, wireless, cable telephony, and Verizon, few would argue that it would require continued price regulation. Yet under the Staff's index, it would not qualify for regulatory relief.

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[20] *See generally* DPS Triennial Comments, Appendix A.

[21] DPS Triennial Comments at 11.

[22] *Instituting Order* at 9; DPS Triennial Comments at 7 & Appendix D, Map 1.

Problem 3. ***Staff's numerical standard is essentially arbitrary.*** Of course, any threshold value test, whether the threshold is 2.75 or something else, is necessarily somewhat arbitrary. Nevertheless, Staff's choice of that particular threshold is unrelated to economic reality. In order to reach a score of 2.75 on the index, a combination of at least three — and sometimes four — of the alternatives described above is required. The choice of three networks as a bright line test is arbitrary and devoid of economic justification. There is no economic reason to support the notion that three facilities-based alternatives indicate lack of market power on the part of Verizon but that two does not.

Because broadband access is ubiquitous in New York State, every VoIP provider can provide a full range of mass-market local and long distance telecommunications services anywhere in the state. Moreover, Staff's assignment of a weight of 0.75 to VoIP was based in part on the fact that VoIP providers did not make E911 services available.[23] Since new FCC rules require VoIP providers to offer E911,[24] and in view of the ubiquity of broadband in New York, assigning VoIP a weight of 0.75 vastly understates VoIP's competitive significance and the geographic scope of VoIP's presence.

The weight of 0.5 assigned to wireless is equally inadequate. In addition to the households that have "cut the cord" and are now *exclusively* wireless, there is massive displacement of wireline calling by wireless usage, and wireless prices constrain Verizon's ability to raise wireline prices above the competitive market level.[25]

C. AN ORGANIC APPROACH DEMONSTRATES THE NEED FOR AND APPROPRIATENESS OF REGULATORY REFORM

In view of the defects of metrics-based approaches, the Commission should adopt an "organic" approach to regulatory reform — that is, one that focuses on such overarching issues as:

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[23] DPS Triennial Comments at 11.

[24] *See IP-Enabled Services*, WC Docket No. 04-36, and *E911 Requirements for IP-Enabled Service Providers,* WC Docket No. 05-196, First Report and Order and Notice of Proposed Rulemaking (rel. June 3, 2005).

[25] *See* Appendix.

- The existence of alternative providers that are standing ready to provide service — using traditional and alternative technologies — within the state;
- The fact that such alternative providers are growingly rapidly, and that their services are accepted by consumers in lieu of the conventional wireline service provided by Verizon;
- The absence of legal or regulatory barriers to entry; and
- The deployment of competitive "enablers" — such as broadband DSL or cable modem service — which provide the underlying platform that is used by independent VoIP providers.

Where these criteria are met, there is an actual competitive threat to Verizon and a clear and present likelihood of the rapid expansion of that threat through an extension of service areas of existing competitors and the entry of new competitors. Thus, competitors will have the potential to win significant amounts of telecommunications business from Verizon, and the price and service-quality discipline associated with competitive markets will be ensured. It is therefore unnecessary to require that additional criteria, such as threshold market shares in a particular geographic area, be met *before* regulatory requirements are reduced throughout the competitive arena encompassing that geographic area. As the Commission quite correctly recognizes in its *Instituting Order*, the relevant question is whether there is "sufficient actual *and potential* competition for residential retail telecommunications service, including basic local telephone service, to prevent a firm from raising its price or providing poor quality service without consequential competitive losses."[26]

An organic approach provides a better indication of the presence or absence of competitive constraints on pricing and service, and better serves the goals of this proceeding by creating a regulatory environment that will foster — rather than merely reacting to — the growth of competition. Moreover, it avoids the transaction costs and regulatory overheads that are inevitably associated with implementing a metrics-based approach.

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[26] *Instituting Order* at 14 (emphasis supplied).

Regulatory reform is clearly justified in New York under such an approach. Three categories of alternative intermodal services — wireless, cable telephony, and third-party VoIP — currently exist as actual, actively marketed service offerings. Multiple providers have entered the market in each category. All three modes have gained widespread customer acceptance, and are widely regarded as providing capabilities comparable to (or more robust than) conventional wireline service. Cable and wireless service are available virtually ubiquitously. Independent VoIP service is already being provided in large portions of the state and the underlying VoIP enabler — broadband service, including cable modems — is available ubiquitously. The demonstrated ability of all three classes of providers to grow their businesses shows that there are no barriers to entry or to the acquisition of new customers.[27]

These circumstances provide ample justification for the *statewide* regulatory changes proposed by Verizon — changes that will reduce the costs associated with regulation, eliminate unnecessary rules that burden competition, and help the state make a substantial move towards regulatory parity — all while maintaining a social safety net.

D. SPECIFIC PROPOSALS FOR REGULATORY REFORM

Specific regulatory proposals in each of the four categories identified in the *Instituting Order* (Universal Service, Service Quality, Consumer Protection, and Level Playing Field) are discussed in Sections III through VI, below. In the remainder of this section, Verizon addresses a number of additional issues generally related to regulatory flexibility.

1. The Retail Tariffing Process Should Be Streamlined

Greater flexibility to rapidly introduce new services, and to modify existing ones, is critical to Verizon's ability to succeed in a competitive market — and to its ability to promptly provide consumers

[27] *See generally* the data on intermodal competition marshaled in the Appendix to these comments. As the *Instituting Order* notes, Verizon lost approximately 37% (4 million) of its retail lines between 1999 and 2004, of which at least 1.2 million lines were apparently lost to intermodal competition. (*Instituting Order* at 21 & n.25.)

with the services they want at the competitive prices they deserve. As the Commission recognized in its 1996 *Framework Order*:

> The freedom to change rates rapidly to best reflect demand and costs is consistent with a competitive market. As the transition to competition continues, pricing flexibility must be accorded companies in competitive circumstances. Pricing flexibility, defined as the ability to change rates rapidly with the minimum of regulatory review, should be commensurate with the degree of competition.[28]

Although the Public Service Law imposes a variety of requirements relating to tariff filings,[29] these requirements obviously do not apply to services or providers beyond the Commission's jurisdiction, whether because of federal preemption or because the Public Service Law simply does not reach them. Thus, VoIP and wireless services, and traditional wireline services that are jurisdictionally interstate, are not subject to the tariffing requirements of the Public Service Law. Moreover, the Commission has broad power to waive those requirements, either on a case-by-case basis or categorically,[30] and in practice it has used that power in a way that has left competitive wireline providers — but not Verizon — free to change their prices on minimal notice and with little or no substantive review.[31] For example, in the 1996 *Framework Order*, the Commission discussed the circumstances under which it would allow "rate flexibility," defined as allowing a tariff:

> to define a range between relevant incremental costs and the 25% per annum cap [*i.e.*, a limit on rate increases of 25% per year] as presumptively reasonable rates, rather than stating any rates whatsoever. The company's currently effective rate is

[28] Case 94-C-0095, "Opinion and Order Adopting Regulatory Framework" (Op. No. 96-13) (issued and effective May 22, 1996) ("*Framework Order*"), at 29.

[29] The basic requirement of stating rates and other terms and conditions of service in a tariff is set forth in Public Service Law §§ 92(1) and 92(2)(d). Changes to tariffs cannot become effective earlier than ten or thirty days after filing, depending upon the category of service involved. (*Id.* § 92(2)(a).) Additionally, the public must be notified of the change through an advertisement published in a general circulation newspaper in each county affected by the change. (*Id.*) Where a tariff filing would result in a "major change," defined roughly as a rate change that would increase a telephone corporation's revenues by more than 2.5%, a hearing is required. (*See id.* §§ 92(2)(e), 92(2)(c).)

[30] Under Public Service Law § 92(2)(b), "[t]he commission, for good cause shown, may, except in the case of major changes, allow changes in rates, charges or rentals to take effect prior to the end of such thirty-day period or such ten-day period and without publication of notice to the public under such conditions as it may prescribe."

[31] *See, e.g.*, 16 NYCRR § 720-2.6.

> disclosed in a separate administrative schedule and may be changed within the range on as little as one day's notice.[32]

The Commission concluded that even such limited flexibility should be granted to "dominant carriers" only for "competitive" services," although "changes in the rates of bottleneck services must also be accompanied by appropriate cost support." Additionally, the Commission recognized that dominant providers should be granted the right to individual case basis pricing.[33] In contrast, the Commission concluded in the same order that "[n]on-dominant companies should have pricing flexibility for *most* services, with the exception of those required by the public interest to protect consumers (*e.g.*, operator surcharges), or to maintain affordable, basic rates . . . ."[34]

The competitive environment has changed drastically since 1996, and whether because Verizon can no longer be considered a "dominant" carrier, or because *all* retail services should now be deemed to be "competitive," the Commission should carry forward the policies set forth in the *Framework Order* by implementing, through order or regulation, the following reforms:

- The ten- and thirty-day notice periods of the statute, and all newspaper publication requirements, should be waived for all retail tariff filings, regardless of whether the filing introduces a new service, withdraws an existing one, changes the price of an existing service, or changes some other term or condition of the service.[35] Tariff amendments related to retail service should be allowed to become effective on one-day's notice.

- Verizon should be allowed to file flexible pricing tariffs, as defined in the *Framework Order*, for all of its retail services. Such tariffs should allow price changes within the presumptively reasonable range specified in the tariff on one-day's notice, without the necessity of a new tariff filing.

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[32] *Framework Order* at 29 n.2.

[33] *Id.* at 29 & n.2 (footnotes omitted). Verizon's current individual case basis ("ICB") pricing authority is set forth in its Tariff PSC No. 1, § 1(A)(15).

[34] *Id.* at 30 (emphasis supplied).

[35] The purposes of the newspaper publication requirement for price and service changes — to the extent that it serves any at all in a competitive environment — are amply served by competitive marketing.

To the extent that the Commission wishes to exclude from these reforms services "required by the public interest to protect consumers,"[36] such exclusions should be specifically identified for the guidance of all carriers and Staff, and should be applied even-handedly to all carriers within the Commission's jurisdiction. Beyond such exclusions, these reforms should apply to *all* retail filings, including the Basic Service Offering discussed later in these comments.[37]

As noted previously, a hearing is required by statute for "major changes" in rates. In the past, the Commission has tended to equate "major changes" with filings in formal rate-of-return proceedings, but in fact the two are distinct concepts. Verizon has not filed a traditional rate case in over fifteen years, and is extremely unlikely to file one in the future; yet Verizon has filed and may well file in the future rate changes that are "major" within the meaning of the statute. It is important, therefore, to understand that although a "hearing" may be required for a major change, that hearing need *not* conform to the extensive body of regulations, policy statements, and practices — in sum, law and lore — that were developed almost thirty years ago to govern formal rate-of-return proceedings in which a utility could expect to be made "whole" for its expenses and capital costs — an expectation that a telephone corporation cannot reasonably have today.[38] The courts have emphasized the Commission's broad discretion to adopt hearing procedures suited to particular circumstances.[39] Accordingly, in its order in this proceeding, the

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[36] *Framework Order* at 30.

[37] In particular, promotional filings are almost by definition a response to competition. Accordingly, Verizon should be able to file a general promotional tariff that will specify a broad min/max range of promotional discounts, and that would permit discounts within the specified range to implemented on one-day's notice by filing a tariff attachment page setting forth the terms of the promotion.

[38] Procedures relating to formal rate cases are set forth, *inter alia*, in the Commission's November 23, 1977 "Statement of Policy on Test Periods in Major Rate Proceedings," and in Part 61 of the Commission's regulations.

[39] On the Commission's general discretion to utilize appropriate procedures, *see, e.g., Executone/Monroe County v. Public Service Commission*, 71 A.D.2d 138, 142, 422 N.Y.S.2d 148, 151 (3d Dep't 1979); *Air Call New York Corp v. Public Service Commission*, 62 A.D.2d 1127, 404 N.Y.S.2d 429 (3d Dep't 1978); *Legislature of County of Rockland v. Public Service Commission*, 49 A.D.2d 484, 489, 375 N.Y.S.2d 650, 654 (3d Dep't 1975); *Leroy Fantasies, Inc. v. Swidler*, 44 A.D.2d 266, 270-71, 354 N.Y.S.2d 182, 187 (3d Dep't 1974). In *New York Telephone Co. v. Public Service Commission*, 59 A.D.2d 17, 397 N.Y.S.2d 223 (3d Dep't 1977), the court concluded that *rejection* of a proposed major rate change without a hearing was impermissible, that "merely a review by [the Commission] and its staff of petitioner's written filing and a summary dismissal thereof" were inadequate to meet

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Commission should indicate that it does not intend to utilize rate-case type procedures for major changes, but rather will utilize procedures suited to the circumstances of the particular change at issue. Given the fact that the rate changes will take place in a highly competitive market, and that Verizon is not seeking to justify the rate change through a rate-of-return filing, procedures that will result in material delays in putting a filing into effect, or that will create an opportunity for obstructionist or dilatory tactics by Verizon's competitors, should not be utilized.[40] In particular, "paper hearing" procedures should be utilized to the maximum extent possible. At a minimum, discovery, if permitted at all, should be strictly limited; summary-judgment-type procedures should be utilized to eliminate irrelevant issues, and matters of policy or law should be addressed through briefs, not through testimony.

The Commission should also eliminate the numerous other antiquated requirements related to tariffs that are set forth in its regulations. For example, now that Verizon's tariffs are available on the World Wide Web,[41] there is no justification for requiring Verizon to provide consumers with information on its rates or other terms and conditions of service.[42]

2. Substantive Constraints on Pricing and Other Terms and Conditions of Service Should Be Reduced or Eliminated

Procedural streamlining of the tariffing process will not achieve its objective if the Commission suspends tariff filings in order to conduct detailed reviews of pricing or service issues. Section 91(1) of

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(…continued)

the statutory hearing requirement, and that "all interested parties must be permitted to call and cross-examine witnesses and to rebut adverse claims . . . ." (59 A.D.2d at 19, 397 N.Y.S.2d at 224-25.) However, the proceeding at issue in *New York Telephone Co.* was a traditional rate-of-return proceeding, and the court's decision thus does not determine the type of process that would be needed for a major rate change that the utility does not seek to justify through rate-of-return considerations, and that is made in a fully competitive retail environment. Indeed, such an environment was quite beyond the boundaries of what utilities, courts, and the Commission contemplated in 1977.

[40] It is not clear to what extent, if at all, formal hearings are currently demanded by the Commission for "major change" filings by CLECs.

[41] *See* https://retailgateway.bdi.gte.com:1490. Even customers who do not have Internet connections at home can generally access the Internet at public libraries.

the Public Service Law requires that all charges be "just and reasonable and no more than allowed by law or by order" of the Commission. The non-specific nature of this requirement necessarily gives the Commission broad discretion in its interpretation and application, a discretion that has been recognized by the courts.[43] In the *Framework Order*, the Commission concluded that in light of the competitive realities of 1996 — when intermodal services had not yet emerged as significant competitive alternatives and implementation of the Telecommunications Act had barely begun — price floors should be imposed on the traditional wireline providers and that flexible pricing should be allowed only for those services deemed "competitive." However, the competitive realities have changed since 1996, and the Commission did not contemplate that the specific recommendations of the *Framework Order* would remain in place forever. Just as the Commission recognized the competitive realities of 1996 in the *Framework Order*, it must now bring the policies of that order forward to 2005 and beyond. Specifically, in recognition of the fact that in a competitive market prices should be set by the market itself, not by regulation, the Commission should determine in this proceeding that changes in Verizon's retail rates are presumptively just and reasonable and will not be subject to suspension — a declaration that would conform to the Commission's current practice with respect to rate changes filed by competitive providers.

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[42] *See, e.g.,* 16 NYCRR §§ 89.1, 602.4, 720-1.3. Alternatively, the availability of Verizon's tariffs on the Web should be deemed compliance with any such regulations.

[43] *See, e.g., Kessel v. Public Service Commission,* 136 A.D.2d 86, 92, 525 N.Y.S.2d 717, 720 (3d Dep't 1988) ("Setting [public utility] rates presents 'problems of a highly technical nature, the solutions of which in general have been left by the Legislature to the expertise of the [PSC]' . . . . The PSC's authority to establish public utility rates has been recognized as '"the very broadest of powers"' . . . . In keeping with this principle, we said in [a prior decision] that 'The [PSC] "is not bound to entertain or ignore any particular factor in discharging its primary responsibility to determine rates that are just and reasonable" * * * Nor must the [PSC's] determination be "wholly free from error in the process, or quite in accord with a judicial view of how the procedure before the [PSC] should be managed in detail" * * * "The scope of judicial review in these matters is, of course, very limited * * * The question before us is whether there is a rational basis for the [PSC's] finding that the rates in question are just and reasonable."'").

a) Price Ceilings

In the current competitive environment, there should be no fixed price ceilings, since the competitive market itself provides adequate price discipline. In short, the Commission would be relying, as it is certainly permitted to do, on a *process* — competition — to ensure that rates are just and reasonable, rather than on a substantive review of each filed rate.[44] (This is the approach that the Commission currently applies in exercising its responsibility to ensure that *CLEC* rates are just and reasonable.) To the extent that specific price ceilings are deemed necessary for a small number of "socially necessary" services — and we see no need to extend this doctrine beyond Call Trace, E911, Lifeline, Telecommunications Relay Service, and Caller ID blocking — these services should be specifically identified, the need for a ceiling should be specifically justified, and the ceiling should be applicable to all carriers.

b) Price Floors

In addition to limiting Verizon's ability to *raise* its prices, the Commission has also sought to constrain its ability to *lower* its prices by implementing price floors and imputation requirements. A price floor is a mandated minimum price for a retail product or service. An imputation requirement is a requirement that the *price* of a particular wholesale input be treated, for retail pricing purposes, as a component of the cost of a retail product or service. Since Verizon generally cannot price its products below (incremental) cost, imputation has the effect of setting (or raising) a price floor.

Imputation requirements are sometimes assumed to be necessary to prevent a "price squeeze." A price squeeze refers to a situation in which a competitor is precluded from competing effectively at the retail level with an integrated provider of retail products and wholesale inputs. Two circumstances are essential to a "price squeeze." First, provision of the retail products must depend upon the use of "bottleneck" wholesale inputs that can only be obtained from the integrated provider. Second, the integrated

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[44] *See Kessel*, *supra*, 136 A.D.2d at 92, 525 N.Y.S.2d at 721 (concluding that Court of Appeals has "recognize[d] that included in the PSC's broad rate-making powers is the authority to fashion reasonable solutions to the problems in prospective rate setting caused by the pressures and demands of a fluctuating economy"; "[t]he question,

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provider must maintain an insufficient price differential between the price it charges for its retail products and the price that it charges retail competitors for the "bottleneck" wholesale inputs. Imputation rules are intended to ensure that a sufficient gap exists between the price of the retail product or service and the price of the wholesale bottleneck inputs that retail competitors must purchase.

For example, in the toll context, it has been assumed that switched carrier access service is a "bottleneck" input to retail toll service. Consistent with this view, Verizon has been required to impute into its retail toll rates the equivalent of the price of two ends (originating and terminating) of switched access. These rules have proven in practice to be a significant constraint on toll pricing, precluding reasonable competitive price reductions.

Under Verizon's first detailed alternative regulation plan — the Performance Regulation Plan ("PRP") — Verizon agreed to adhere to the Commission's imputation policies for toll services. Verizon also agreed in that Plan to a price-floor formula for "new" services that was based on an imputation construct. In 2000, the Commission began considering a successor alternative regulation plan — the Verizon Incentive Plan ("VIP"). In the proceeding relating to the successor plan, Verizon challenged the continuing need for imputation requirements. The VIP was approved in early 2002, and remained in effect for two years. The only price floor commitment in the VIP stated that "[d]ownward pricing flexibility is limited only to a rate equal to Verizon's incremental cost and usage offerings must pass an imputation standard." The VIP expired on February 29, 2004.

The expiration of the imputation commitments of Verizon's two alternative regulations plans opens the door for a reconsideration of the principles underlying imputation rules. Notwithstanding the lapse of the VIP, however, Staff continues to expect price floor or imputation showings for certain types of tariff filings. In particular, Staff continues to adhere to the Commission's 1996 statement that "local

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then, is not whether the PSC has the authority to fashion such solutions, but whether there is a rational basis for the PSC's finding that the use of a particular solution will result in rates that are just and reasonable.").

exchange carriers are directed to charge prices for intraLATA usage that meet appropriate imputation standards during the transition in accordance with our prior rulings."[45] Also, Verizon's individual case basis pricing tariff has an imputation requirement built into it.[46]

With intermodal competition a reality, the concept of a "bottleneck" input whose rates must be imputed into Verizon's retail costs makes no sense. Intermodal competitors use their own networks — not Verizon's — to originate calls (and in many cases to terminate them). Their costs are therefore independent of Verizon's wholesale rates. In a wide variety of situations intermodal providers can terminate calls to Verizon's customers at TELRIC-based reciprocal compensation rates, not at access rates. Under these circumstances, imputation requirements simply do not make sense. They are not needed to protect Verizon's competitors from a price squeeze, and — because they assume that competitors incur "bottleneck" costs that they can in fact avoid — they provide comfortable "price umbrellas" under which firms can raise their prices to supracompetitive levels that Verizon is nevertheless not permitted to meet or undercut.[47]

Under these circumstances the Commission should eliminate its imputation requirements altogether. Further, although a requirement that prices exceed incremental costs (without any imputations) may be theoretically justifiable, as a practical matter pricing below that level would make no economic sense for a company in an environment of active competition and low entry barriers.[48] Accordingly, there is no need for the Commission to routinely require cost studies to accompany tariff filings for new ser-

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[45] *Framework Order* at 26.

[46] Verizon Tariff PSC No. 1, § 1(A)(15); *see* particularly *id.* § 1(A)(15)(c) ("Any ICB offering must be priced at a level above the applicable price floor, as determined pursuant to the Commission's order in Case 92-C-0665, or any subsequent Commission order.").

[47] Even if bottleneck inputs did exist, an integrated wholesale/retail provider has no economic incentive to price its retail products below a properly computed price floor, since by doing so it would be losing wholesale customers for its bottleneck services, and thus reducing its combined profits in the wholesale and retail markets. As with other alleged forms of "predatory pricing," imputation violations would be their own punishment, and therefore would be infrequent and short-lived. (*See* Case 00-C-1945, "Initial Panel Testimony of Verizon New York Inc. on the Verizon Incentive Plan for New York" (May 15, 2001), at 74-75.)

vices, or price-change filings for existing services. Again, this would comport with the practices that are currently applied to Verizon's competitors.

c) Non-Price Terms and Conditions

In a competitive market, purchasers should decide (by "voting with their feet") whether products meet their needs. Thus, there is no need for Commission oversight of the nature of the services provided by Verizon, or over the non-price terms and conditions on which those services are offered. Commission intervention should only be considered where extraordinary circumstances (*e.g.*, third-party privacy impacts) may be involved.

Further, the Commission should explicitly declare that providers are *not* required to offer their services (except for the "safety net" services referred to previously) in all parts of their service areas. Rather, the roll-out of products should be governed by competitive-market, operational/cost, and other business and customer considerations.

Finally, in a competitive environment, there is no need for the provisions of the Commission's common carrier regulations that require the separate provision of "segregable services and functions requested by users . . . to the extent technically and economically practicable,"[49] and of "[e]nd-user initiated blocking . . . for content services, to the extent technically and economically feasible."[50] To the extent that these features are important to customers, the competitive market will supply them in response to marketplace demand.

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[48] *See, e.g.*, W. Kip Viscusi, John M. Vernon & Joseph E. Harrington, Jr., "Economics of Regulation and Antitrust" (1995), at 273-74.

[49] 16 NYCRR § 605.2(a)(3).

[50] *Id.* § 605.2(b)(2); *see also id.* § 605.3(c).

3. Verizon Should Be Allowed to Retain Refunds and Gains on the Sale of Assets

Section 113(2) of the Public Service Law gives the Commission the power to require Verizon to apply refunds (such as tax refunds) for the benefit of its ratepayers, *e.g.*, by using those gains to reduce existing rates.[51] Moreover, under § 99(2) of the Public Service Law, Commission approval is required for the transfer of a telephone corporation's franchise, or, with certain exceptions, for the transfer or lease of its "works and systems." In numerous cases in the past, the Commission has conditioned such approval on the application of the gains from such transfers to the benefit of ratepayers.[52]

Commission actions seeking to recapture, for the benefit of ratepayers, the value of refunds or gains resulting from sales of works and systems were based on the assumption that Verizon was operating in a revenue-requirement environment, and that the Commission therefore needed to ensure that possible over-earnings were addressed and captured. But that environment no longer exists, and accordingly such recapture is no longer justified. Moreover, such recapture requirements reduce Verizon's ability and incentive to liquidate non-productive property and to use the proceeds to fund forward-looking investments, thus impairing the efficient movement of capital from one asset to another, and creating "stranded asset" problems. The Commission has recognized these realities in three recent decisions.

First, in 2003, the Commission approved Verizon's request to retain a refund of real property taxes previously paid to the County of Nassau in light of the "significant steps" that Verizon had taken away from a "traditional cost of service regulation towards a competitive marketplace," and in light of the risks that it faced in the new environment.[53] Further, in two orders issued just this year, the Commission approved transfers of certain garage and warehouse property, and of two office buildings, and allowed

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[51] *See also id.* § 89.3 (reporting of tax refunds).

[52] *See, e.g.*, Case 29407, "Order Approving Sales to an Affiliate at No Less Than $25.42 Million" (issued December 18, 1987).

[53] Case 02-C-0959, "Order Allocating Property Tax Refund" (issued and effective March 12, 2003); *see id.* at 1.

Verizon to retain the gain from those transactions in light of the emergence of intermodal competition.[54] The Commission's explanation of its actions is worth quoting at length:

> Where a company faces significant competition, a new approach is warranted. In competitive markets consumers benefit by being able to choose a provider that best meets their needs. Firms in competitive markets have strong incentives to continually enhance efficiency and provide attractive and innovative service offerings. In such markets, there is less need for economic regulation (such as price controls or specific regulatory accounting) and the treatment of the gain will be controlled by the market. Firms become price takers and are no longer assured of recovering all of their prudently incurred historic costs. Because outcomes in a competitive environment are more directly driven by market forces and are less directly affected by regulatory accounting, the firm's regulated rates of return become less relevant and traditional regulatory accounting (i.e., establishing regulatory assets for future recovery) is no longer viable.[55]
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> Given the shift to a more competitive market and the concomitant risks it imposes on Verizon, we think it is reasonable to allow Verizon's shareholders to keep the gain through the accounting treatment it proposed here. Today, competitive alternatives are widely available throughout New York. As a result, many millions of Verizon's customers have benefited from being able to choose alternative suppliers, as well as from being able to choose more attractive service offerings from Verizon. Since 1999, Verizon has lost approximately 6.8 million (more than 35%) of its access lines. Approximately 3 million customer lines shifted to competitive local exchange carriers and the remaining lines shifted to, among other things, cable modems and digital subscriber lines replacing second lines, cellular service and telephony over the internet. The environment the company operates in today is different than that which existed only a few years ago, and we need to decide the appropriate treatment for the gain from the sale of two properties in that context. Just as Verizon assumed the (much larger) burden of pension write offs that might have been recovered from customers but for our decision to require GAAP accounting, so should it be allowed to keep the gain that adherence to GAAP would allow. Permitting ratepayers to keep the gain . . . does not recognize the need to allow the company to retain the cash proceeds for its continuing operations. Forcing the company to use the cash as a rate base offset is not appropriate in light of the diminished relevance of rate of return regulation and the increased risks of operating in a competitive environment, including possible non-recovery of costs. Ac-

[54] *See* Case 05-C-0510, "Order Approving Transfer" (issued and effective June 15, 2005) (approving sale of 80% of Verizon's interest in office building at 1095 Avenue of the Americas in Manhattan); Cases 05-C-0091 and 05-C-0092, "Order Approving Transfers" (issued and effective May 20, 2005) (garage and warehouse property in Manhattan and Willoughby Street office building) ("*Willoughby Street Order*").

[55] *Willoughby Street Order* at 6-7 (footnote omitted).

> cordingly, we will not preclude Verizon from booking the gain on the sales of land to income as it proposes.[56]

The policies set forth in these orders should be embodied in permanent regulations. Such regulations should set forth the Commission's determination that it would be reasonable for Verizon and any other company not subject to rate-of-return regulation to retain all gains from any tax or other refunds, or resulting from the sale of works or systems.[57]

4. Capital Program Filings Should Be Streamlined to Reflect Their More Limited Justification in a Competitive Environment

Commission-imposed reporting requirements are a major source of disparate regulatory treatment and unnecessary regulatory costs. The Commission has generally held Verizon to burdensome reporting requirements that were tailored to the era of rate-of-return regulation and that serve little purpose in the modern marketplace. In contrast, reporting requirements for "non-dominant" companies have been eliminated or greatly scaled back.[58]

Under the Commission's regulations,[59] local exchange carriers are required to make annual filings setting forth their capital expenditures, budgets, and projections, as well as "[o]ther capital expenditure and accomplishment data to be specified by the director of the communications division." "The level of detail and the reporting format will be prescribed by the director of the communications division."

Verizon's 2005 Construction Program Filing is 183 pages long and includes highly detailed engineering and financial data — including information set forth in the regulation and additional or more specific information requested by Staff. Moreover, Staff's request letter also contemplated a number of fol-

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[56] *Id.* at 9-10.

[57] For similar reasons, the Commission should treat transfers of works and systems under Public Service Law § 99 to be presumptively reasonable, and should streamline the formal approval process.

[58] *See Framework Order*, *supra*, at 29 (footnote omitted) (in general, "non-dominant companies need only be required to report information sufficient to ensure that overall service network quality will be maintained and the development of competition can be monitored").

[59] *See* 16 NYCRR § 644.3. Although § 94 of the Public Service Law gives the Commission to *power* to "keep informed" as to various aspects of a telephone corporation's operations, the statute certainly does not *require* it to exercise that power by compelling Verizon to produce an annual construction program filing.

low-up meetings to review and discuss the filing. Substantial effort and time are required to prepare these reports and to discuss them with Staff, well beyond that required internally for the development of functional capital budgets. No other carrier is expected to provide such detailed data.

The capital filing requirement was adopted by the Commission in the early 1970's — after a major service crisis that was caused, it was believed, by the failure of Verizon to invest in its network. Of course, the current competitive environment now gives Verizon a strong incentive, independent of Commission oversight, to invest in its network. Yet there has been no corresponding streamlining of the capital filing. If anything, the size of the filing has grown in the intervening years, in response to increased Staff requests for additional data.

The Commission should change its internal policies and amend its regulations as necessary to eliminate the capital filing requirement, which imposes unnecessary and disparate burdens on Verizon.

5. Other Reporting Requirements Should Be Eliminated or Streamlined

Additional reports originally designed to support the Commission's special oversight of Verizon are no longer relevant in an era of intense intermodal competition. These unnecessary requirements should be eliminated or substantially streamlined.

a) Annual Reports

Under § 95(1) of the Public Service Law, telephone corporations must file an annual report, whose form and contents are to be determined by the Commission. The Commission is authorized, "when it deems it advisable," to exempt any telephone corporation from the reporting requirement.[60] Pursuant to these provisions, we have been advised that the Commission has generally eliminated the annual report requirement for competitive carriers. Instead, such carriers' obligations can be satisfied by the filing of a Telecommunications Competition Monitoring Report (discussed below). In contrast, the annual report that Verizon is required to submit is quite detailed.

[60] This requirement is implemented in Part 641 of the Commission's regulations.

In a competitive, post-rate-case era, Verizon should be held subject to the same streamlined reporting requirements as competitive carriers.[61]

b) Competition Monitoring Reports

In 1997, the Commission began requiring carriers to file Telecommunications Competition Monitoring Reports ("TCMRs"), intended to collect information that could be used by the Commission to monitor the emergence of competition in the state.[62] TCMR reporting requirements were reduced in 2000, and long distance providers were exempted from those requirements.[63] The Commission is currently considering further changes in TCMR reporting requirements.[64]

The Commission has properly recognized that the monitoring of competition could provide useful policy guidance. However, as it also recognized in a recent notice:

> The vision [of competition monitoring] espoused in the February 18, 2000 order, which limited the applicability of the reporting requirements, reflects a now discredited notion that local exchange carriers and their then-existing competitive brethren would be the heirs to telephone's future. Events have made it clear that technology and the market are so dynamic, the predominant providers of telecommunications in the coming decades may not be those providing these services just a few years ago.[65]

Although the Commission has proposed to address this issue by including cable in its reporting requirements, a meaningful view of competition in New York cannot be obtained without considering wireless, independent VoIP service providers, and other carriers that are international or nationwide in scope. But given the Commission's limited (or non-existent) jurisdiction over such providers, it has no means of compelling their participation in the process. Any report based merely upon jurisdictional pro-

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[61] Even if its own reporting requirements were streamlined or eliminated, the Commission would still be able to obtain a wide variety of information concerning Verizon by reviewing Verizon's FCC ARMIS filings. ARMIS data are readily retrievable on the FCC's web site, and include state-specific and carrier-specific data.

[62] *See* Case 96-C-0647, "Order Adopting Telecommunications Competition Monitoring Report" (issued and effective May 20, 1997).

[63] *See* Case 96-C-0647, "Order Adopting Modified Telecommunications Competition Monitoring Report" (issued and effective February 18, 2000).

[64] *See* Case 04-C-1637, "Notice Requesting Comments" (issued February 3, 2005).

[65] *Id.* at 2.

viders is more likely to be misleading than to provide helpful policy guidance. Moreover, filling out the reports is burdensome, and the Commission has resisted attempts to protect the information filed by carriers from disclosure under the state Freedom of Information Law.[66] The Commission's competition monitoring requirements should therefore be eliminated.

6. Voice Messaging Service Should Be De-Tariffed

Contrary to the practices in virtually every other state that has addressed the issue, and in the federal jurisdiction,[67] the Commission continues to regard Voice Messaging Service ("VMS," or voice mail) as "a regulated service"[68] and has required Verizon to tariff it. This treatment is not required by statute; indeed, the opposite conclusion — that voice messaging is *not* subject to the Public Service Law's tariffing requirement — is much more in harmony with the statutory language and intent.

The tariffing requirement under § 92(1) of the Public Service Law applies only to services provided by a telephone corporation "over its line . . . ." Under Public Service Law § 2(18), the term "telephone line" means property "used, operated or owned by any telephone corporation to facilitate the business of affording *telephonic communication* for hire . . . ." (Emphasis supplied) While the term "telephonic communication" is not defined in the statute, the Commission has not sought to apply tariffing requirements to providers of information services (*e.g.*, dial-up Internet access services, chatlines, audiotext services, etc.) — thus by its practice excluding such services from the definition of "telephonic com-

[66] *See, e.g.*, June 19, 2000 letter from Steven Blow, Esq. re: Status of Information Included in Telecommunications Competition Monitoring Reports (TCMR) for 1999 (Trade Secret 00-2); June 22, 2001 letter from Steven Blow, Esq. re: Status of Information Included in the Telecommunications Competition Monitoring Reports for 2000 (Trade Secret 01-4); June 14, 2002 Letter from Steven Blow, Esq. re: Status of Information Included in the Telecommunications Competition Monitoring Reports (TCMR) for 2000 (Trade Secret 02-3).

[67] Voice messaging has long been classified as an enhanced service/information service under federal law, and is thus exempt from common carrier regulation. *See Implementation of the Telecommunications Act of 1996; Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Information,* Second Report and Order and Further Notice of Proposed Rulemaking, 13 FCC Rcd 8061 (rel. February 26, 1998), ¶ 46; *see also id.* ¶¶ 45, 72. On the federal regulatory framework for information services, *see National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 125 S. Ct. 2688, 2708-09 (2005).

[68] *See* Case 01-C-0095, "Order on Rehearing" (issued and effective December 5, 2001); *id.*, "Order Resolving Arbitration Issues" (issued and effective July 30, 2001).

munication," even when they are accessed through telephone lines. Although the Commission has continued to assert jurisdiction over the line and over any intrastate calling services used to access the information service, it has not done so with respect to the information service itself.[69] Voice messaging is clearly an information service, since it entails the "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."[70] Accordingly, consistent with the Commission's practice, tariffing requirements should not be imposed for VMS.

This change in current regulatory treatment would have a number of advantages. First, it would move in the direction of consistency between the state and federal regulatory frameworks, since under federal law, VMS is treated as an information service not subject to common carriage regulation. Further, it would make New York law consistent in this respect with the determinations of virtually every other state that has addressed the issue.[71] Second, it would reflect the fact that VMS is a highly competitive

[69] However, in some cases, the access to the service may be regarded as an inseparable component of the information service itself. *See Brand X, supra.*

[70] 47 U.S.C. § 153(20).

[71] Numerous state commissions, for example, have concluded that voice messaging is an information service and not a telecommunications service, and therefore is not subject to mandatory resale at wholesale rates. *See, e.g., Complaint of RCN Telecom Services of Massachusetts, Inc.*, No. 97-101 (Mass. Dep't of Telecomms. & Energy Nov. 9, 1998); Order Resolving Non-Pricing Issues, *Petition of MCI Telecommunications and MCImetro Access Transmission Services of Virginia, Inc.*, Case No. PUC960113 (Va. Corp. Comm'n May 8, 1997); Decision, *Application of New York Telephone To Withdraw Voice Messaging Service to Residence and Small Business*, No. 98-02-21 (Conn. Dep't of Pub. Util. Control Mar. 25, 1998); Arbitration Order, *AT&T of the Mountain States, Inc.*, 1998 WL 855420, at *31 (Utah Pub. Serv. Comm'n Apr. 28, 1998) ("[W]e conclude that our decision turns on whether or not inside wire maintenance and voice mail are deemed 'essential facilities and services,' as defined [by state statute]. We previously concluded and now affirm that they are not. Neither service rises to the level of being essential insofar as they can be reasonably duplicated, are not necessary for AT&T/MCI to provide public telecommunications services, and represent services for which economic alternatives exist in terms of quality, quantity and price."); Decision No. 60043, *GST Tucson Lightwave Inc.*, 1997 WL 153781, at *6 (Ariz. Corp. Comm'n Feb. 5, 1997) ("Voice mail and inside wire maintenance are not telecommunications services, and also are presently available on the open market."); Arbitration Decision, *MCI's Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Central Telephone Company of Illinois*, No. 96 AB-009, 1997 Ill. PUC LEXIS 61, at *40 (Ill. Commerce Comm'n Feb. 5, 1997) ("Voice Mail does not fall within the Act's definition of a telecommunications service. Voice Mail is predominantly a service that involves the recording of information that has been sent through the use of a telecommunications service. Thus, it does not have to be made available for resale at this time."); Arbitration Order, *AT&T Communications of Nevada, Inc.*, Docket No. 97-5014, ¶ 85 (Nev. Pub. Serv. Comm'n Aug. 28, 1997) ("Because voice mail services involve the storage and retrieval of information which is accessed 'via telecommu-

(continued …)

service in which Verizon has a decidedly non-dominant share of the market.[72] Third, it would help to move towards increased competitive parity between Verizon's VMS service, VMS services provided by independent providers, and other products and services that can substitute for VMS but that are manifestly beyond the Commission's jurisdiction, such as e-mail and answering machines. Finally, detariffing voice messaging would be consistent with the Commission's general treatment of information services such as chatlines or dial-up Internet access services, and with the Commission's decision to detariff the non-bottleneck aspects of billing and collection.[73]

7. Substantive Review of Procurements Should Be Eliminated

Section 115 of the Public Service Law authorizes the Commission, "whenever it is of the opinion that the public interest so requires," to require that certain contracts be let to the lowest responsible bidder, as determined through a public offering. In a competitive, market-driven, non-rate-of-return world, Verizon, like other carriers, should take responsibility for its own procurements. In an environment in which rates are set by the competitive marketplace rather than traditional rate-base/rate-of-return regulation, there is no need for Commission oversight to ensure that Verizon gets the best possible price from its

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nications,' the Commission finds that voice mail is an 'information service' and thus, Nevada Bell has no obligation under the Act to provide such service to AT&T for resale."); Order, *AT&T Communications of the Southern States, Inc.*, Docket No. P-140, Sub 51, Issue No. 23 (N.C. Utils. Comm'n July 3, 1997) ("[V]oice mail is not a telecommunications service under the Act . . . "); Commission Order Modifying Arbitrator's Decision and Arbitrator's Recommendations, and Approving Interconnection Agreement with Modifications, *AT&T Communications of the Pacific Northwest, Inc.*, 1997 Wash. UTC LEXIS 49, at *22-*23, ¶ 14 (Wash. Utils. & Transp. Comm'n July 11, 1997) ("Voice mail is an enhanced service, and not a telecommunications service. Although voice mail is often bundled with telecommunications services, it is not involved in the transmission of information. Insofar as voice mail is not part of the transmission of information by the public switched telephone network, it is not a 'telecommunication service' as defined in federal law.").

[72] *See* Case 95-C-0810, "Order Allowing Tariff to Become Effective" (issued and effective March 20, 1996), at 2 (Verizon estimated that its share of the voice mail market was about six to seven percent; Commission concluded that "[t]here is merit to [Verizon's] arguments that it is not a dominant provider in the messaging market . . . ."). Verizon's VMS service competes not only with the offerings of other voice messaging providers, but also with CPE alternatives and with intermodal services such as e-mail.

[73] *See* Case 89-C-191, "Order Instituting Proceeding" (issued and effective December 19, 1989); Case 89-C-191 and 90-C-0165, "Opinion and Order Concerning the Regulation of Billing and Collection Services" (Op. No. 90-33) (issued and effective December 28, 1990).

contractors. Accordingly, the Commission should decline to exercises its powers under § 115. For similar reasons, the Commission should determine that Verizon is exempt from Part 685 of the Commission's regulations (requiring filing of procurement procedures), as well as from Part 686 (requiring filing of certain cost-plus contracts and giving the Commission the power to require public bidding).

III. UNIVERSAL SERVICE

The universal service goals articulated by the Commission in its 1996 *Framework Order* remain valid in 2005, but the best means for achieving those goals must be reassessed in light of today's intermodal market. As the Commission noted in 1996, "competition is the most efficient way" to "ensure the provision of quality telecommunications services at reasonable rates."[74] The regulatory framework should be designed for today's and tomorrow's market, rather than for "yesterday's monopoly," and "should reflect market conditions."[75] The fully competitive market envisioned in 1996 is here. The best way to recognize and foster that competition is to reduce existing regulations, not increase them.

As discussed below, a single residential Basic Service Offering, plus Lifeline, is all that is needed to ensure universal service availability in today's highly competitive environment, and Verizon is willing to commit to make such an offering available ubiquitously throughout its service area. We see no need for any change in the way the Targeted Accessibility Fund ("TAF") is currently funded and administered; or for the creation of new universal service funding programs (*e.g.*, for "high cost" companies).

A. A BASIC SERVICE OFFERING, PLUS LIFELINE, IS SUFFICIENT TO ENSURE BASIC SERVICE

An adequate social safety net could be provided without maintaining the full panoply of current regulations, via a single residential Basic Service Offering, plus Lifeline. The Basic Service Offering would contain the basic services referred to in the Commission's *Instituting Order* — one single-party access line, access to local/toll calling, local usage (which would be priced on a usage-sensitive, not flat-

[74] *Framework Order* at 2.

[75] *Id.*

rated, basis), TouchTone dialing, access to emergency services, access to directory assistance services, access to Telecommunications Relay Services, directory listing, and privacy protections — and would be priced pursuant to tariff at a recurring monthly charge for dial tone plus per-minute or per-call rates for local usage.[76] The Basic Service Offering should not contain any other service beyond the basic services set forth in the *Instituting Order* — that is, the services that are required to permit the subscriber to make and receive calls and to ensure public safety. (The availability, functionality, and pricing of additional "value added" services should be determined by the competitive market.) In addition to the Basic Service Offering, Verizon would continue its commitment to the Lifeline program, and would continue to make that service available throughout its service area.

With the current competitive market, no more is needed to support universal service. With increased competition have come increased options, and a variety of packages now provide customers many services in one reduced price bundle. Indeed, many customers who are eligible for Lifeline nevertheless choose such packages rather than opting for Lifeline. Therefore, the Commission need no longer rely on regulation to "ensure the provision of quality telecommunications services at reasonable rates,"[77] — competition provides sufficient assurance.

B. A STATE "HIGH COST" FUND IS UNNECESSARY

The Commission should decline to implement a state "high cost" fund for rural ILECs. High-cost funding is provided through existing federal programs, and is therefore not necessary on the state level. In a competitive market, carriers should not be required to subsidize each other, and in any event there is no reason to assume that claimed revenue problems of high-cost LECs cannot be addressed through the rate case mechanisms.[78] Moreover, a high-cost fund would undoubtedly require Verizon to subsidize en-

[76] For the present, Verizon intends to continue offering existing flat-rated local service options where currently available, in addition to the service-area-wide Basic Service Offering.

[77] *Id.*

[78] Currently, many of these so-called high cost companies charge their customers less than Verizon for local service. The use of a high cost fund in New York should not even be contemplated as long as this continues to be true.

tities that actually compete with it, since many independents have CLEC affiliates that provide a variety of services outside of the independents' traditional service areas. Because such a subsidy would increase Verizon's overall costs of operation, requiring Verizon to provide subsidies to rural areas would impede its ability to compete in non-rural areas with entities that will not be subject to any Commission-adopted subsidy requirement.

IV. SERVICE QUALITY

The Commission has recognized that Verizon is subject to intense competition in New York. "[A]n ever-increasing number of Verizon customers are choosing other providers, such as cable companies or other modalities, such as wireless providers, to obtain their plain old telephone services," and this "trend will continue."[79] As a result, "Verizon's incentive to maintain appropriate levels of service quality no longer need be primarily driven by fear of regulatory penalties."[80] Because "the market penalties for failure to retain and grow their business are much more severe — that is, loss of its customers"[81] — Verizon's incentive to provide good service is "no different than other providers in a competitive market."[82]

Because "the regulatory tools used previously no longer reflect the realities of the emerging market," "[a] new approach is needed."[83] That new approach must "recognize that regulation needs to reflect market conditions by permitting market forces to work and avoiding asymmetrical requirements, allow the company to concentrate on its longer objectives of modernizing its infrastructure for the market of tomorrow."[84]

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[79] Comments of Robert Mayer, Department of Public Service Director of Telecommunications, at the February 9, 2005 Public Service Commission Public Session ("Mayer Comments"), at 28.

[80] Testimony of William M. Flynn, Chairman of the New York State Public Service Commission, Before the New York State Standing Committee on Corporations, Commissions and Authorities, Regarding Verizon Service Quality (March 7, 2005) ("Flynn Testimony") at 7.

[81] *Id.*

[82] *See* Mayer Comments at 28.

[83] *Id.* at 34.

[84] *Id.*

Setting service standards in a competitive market is not in the public interest. In a competitive environment, if a carrier does not provide service quality commensurate with the prices it charges, customers (both retail and wholesale) will switch to other options that provide their preferred combinations of price, features, and quality.[85] Therefore, competition provides the best incentive for carriers to improve service, reduce prices and expand the market base. Moreover, imposition of service quality standards on Verizon would undermine the Commission's goal of regulatory parity.

As discussed more specifically below, the amount of wholesale and retail service quality regulation should be reduced and in many cases eliminated, and should not be extended to intermodal competition such as wireless and VoIP.[86] Service quality should be determined by the consumer, not the government. Therefore, the Commission need not and should not require carriers to submit time-consuming service quality reports that are a vestige of the old rate-regulated monopoly regime. Rather, service quality oversight should be "reactive" — *i.e.*, it should focus on responses to specific complaints.

A. REGULATION OF WHOLESALE SERVICE QUALITY SHOULD BE REDUCED

The current panoply of wholesale service quality regulations was adopted on the assumption that other carriers were dependent on the use of Verizon's network. This is less and less true as the competitive focus shifts from UNEs and resale to intermodal competition. Moreover, imposing regulations on one mode of service (*i.e.*, provision of traditional wireline services by Verizon), while other modes (*e.g.*, wireless, cable, and VoIP) are free of such requirements, impairs intermodal competition by artificially increasing the costs of one provider. Regulation of wholesale service quality (Carrier-to-Carrier metrics and the Performance Assurance Plan ("PAP")) should accordingly be eliminated.

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[85] There is no need for the Commission to perform a periodic survey of customer satisfaction. If customers are not satisfied with a carrier, they will move to another carrier, as high churn rates in the telecommunications markets demonstrate. The competitive market provides the best incentive for carriers to ensure customer satisfaction, and the market and customer complaints provide an adequate remedy for customers if they are not satisfied.

[86] Similarly, while the Commission should maintain and expand its Commendation Program for excellent service, it should not extend that program to wireless and VoIP providers.

1. The Performance Assurance Plan Should Be Eliminated Or Reduced

The PAP adopted in Cases 99-C-0949 and 97-C-0271 should be eliminated. This is the appropriate proceeding to direct the elimination of the PAP.

The PAP, which was initiated in 1999, provides for the automatic payment of bill credits for particular wholesale services when Verizon's wholesale performance drops below measures set out in the plan. The purpose was to "provide the basic assurance that the local telecommunications market remains open after the company obtains long distance approval."[87]

The bill credit amounts at risk in the PAP were based on projections that are now outdated and do not reflect the current telecommunications market in New York. Today, the telecommunications market is irreversibly open, and there is no longer any need for the PAP. With the proliferation of intermodal competition that already exists today and which will certainly increase, it no longer makes sense to impose performance obligations and penalties on Verizon.

As the Commission's Chairman noted in his recent testimony before the New York State Standing Committee on Corporations, Commissions and Authorities,[88] regulatory penalties are not needed when, as here, the market penalties are more severe. It is Verizon's business interest to retain its CLECs customers on its network. Indeed, to that end, Verizon has offered its CLEC customers commercial agreements that go beyond Verizon's legal obligations to provide wholesale local service. In an era of intermodal competition, it is a competitive necessity for Verizon to provide CLECs with excellent service so that CLECs will continue to use Verizon's network.

To the extent the Commission directs that the PAP be reduced (rather than eliminated) to reflect the realities of the current market place, specific implementation issues should be addressed in the PAP

[87] Cases 97-C-0271 and 99-C-0949, "Order Adopting the Amended Performance Assurance Plan and Amended Change Control Plan" (issued and effective November 3, 1999), at 32.

[88] *See* Flynn Testimony at 7.

proceeding rather than addressed in this proceeding. As with the Carrier-to-Carrier metrics, it would be too time-consuming and complicated to address such individual implementation issues in this proceeding.

2. Carrier-to-Carrier Metrics Should Be Eliminated

The Commission should eliminate the Carrier-to-Carrier Guidelines adopted in Case 97-C-0139 (the "Carrier-to-Carrier Proceeding") since the Guidelines impose unnecessary and anticompetitive obligations on Verizon. Carrier-to-Carrier metrics have outlived their usefulness, since intermodal carriers operate without relying on Verizon's wholesale services, and there is no therefore need to continue such metrics to preserve effective competition. If the Commission determines to temporarily retain the Carrier-to-Carrier Guidelines, the number of metrics reported should be drastically reduced and should parallel the number of retail metrics. Because there are over 500 Carrier-to-Carrier metrics, it would be too complicated and time-consuming to address all 500 in this proceeding. Therefore, specific discussion of which metrics should be reduced and/or eliminated should be deferred to the Carrier-to-Carrier proceeding rather than addressed in this proceeding.

B. RETAIL SERVICE QUALITY REGULATIONS SHOULD BE ELIMINATED OR SIGNIFICANTLY REDUCED

As discussed below, certain of the existing retail service quality regulations in Part 602 and 603 of the Commission's regulations may have some continuing merit, but many should be eliminated or significantly reduced, and contrary to what some parties may argue, there is no basis for the Commission to reinstitute any retail service quality penalty plans. As the Commission's Chairman noted, the market penalties for failure to retain and grow their business are more effective than regulatory penalties. Moreover, no service quality requirements should be extended to wireless or VoIP providers.

1. Certain Part 602 Regulations Should Be Reduced or Eliminated

The Commission should eliminate 16 NYCRR § 602.3, which deals with customer service centers. In a competitive market, if customers are dissatisfied with customer service, they have other options.

The Commission should also eliminate the requirements of 16 NYCRR § 602.7(b) (requiring availability of representatives to receive trouble reports), § 602.7(d) (requirement to clear troubles within

24 hours) and § 602.7(e) (requirement to keep repair commitments). These requirements are unnecessary in a competitive market, and eliminating them would be consistent with allowing the market to address service quality issues. The Commission should retain the regulations addressing consumer complaints (§ 602.7(a)), emergencies (§ 602.7(c)), major service outages (§ 602.7(f)), and obscene or threatening calls (§ 602.7(g)), which remain relevant in today's market.

The Commission should eliminate the requirement of 16 NYCRR § 602.5(d) that customers be given a 60-day grace period to select a different type of service without incurring installation charges. There is no reason, in a competitive market, for one group of competitors to be subject to such requirements while intermodal competitors are free of them.[89] The remaining regulations in Part 602 — *i.e*, §§ 602.5(a), (b), (c), (e) and (f) (dealing with service orders), § 602.6 (dealing with billing), § 602.8 (dealing with operator service), and § 602.9 (dealing with intercept) — should remain intact at this time. These provisions provide an adequate safety net for consumers in today's intermodal market, without burdening wireline carriers with unnecessary regulations.

2. Part 603 Regulations Should Be Reduced or Eliminated For All Carriers

The Commission should eliminate the regulations in § 603.2 (dealing with measurements), § 603.3 (dealing with metrics and performance thresholds), and § 603.4 (dealing with reporting requirements) in their entirety for all carriers. As discussed above, in a competitive market, customers can react to perceived service quality issues by switching to other providers. The Commission will retain its jurisdiction to investigate consumer complaints, and this is sufficient to protect consumers in a competitive market. However, the Commission should retain the regulations contained in § 603.5 (dealing with service interruptions), which still have value in today's market.

[89] In addition to the provisions discussed in this subsection, the Commission should also eliminate § 602.4, which deals with public information (*see* discussion in Section II(D)(2), above), and § 602.10, which deals with directories. In a competitive market, these requirements are not necessary.

None of the regulations in Part 603 (including § 603.5) should be extended to VoIP and wireless carriers. As discussed above, the Commission is limited in its ability to regulate such carriers, and moreover, in today's intermodal market, the Commission should reduce regulation rather than increase it.

V. CONSUMER PROTECTION

Verizon is not opposed to leaving in place certain "core" consumer protection regulations designed to discourage fraudulent practices, ensure that telecommunications services are accessible to special needs customers, and provide other basic protections. Nonetheless, in light of the proliferation of competitive alternatives available to consumers of telecommunications service in New York, and since "market forces diminish the need for regulatory protections,"[90] the Commission should ease consumer protection-based restrictions that impose onerous and unnecessary burdens on Verizon and place Verizon at an unfair disadvantage vis-à-vis its competitors.

As in the other areas previously discussed, in considering what consumer protection rules and regulations warrant revision or elimination, the Commission should not and cannot expand their application to wireless and VoIP providers. To move towards regulatory parity, the Commission should instead reduce existing restrictions on traditional wireline carriers such as Verizon, rather than attempt to extend those restrictions to other intermodal competitors.

A. VERIZON DOES NOT OPPOSE THE RETENTION OF CERTAIN "CORE" CONSUMER PROTECTIONS.

Slamming and cramming rules, which discourage fraudulent practices, should remain intact. Just as it does now, New York should continue to follow federal guidelines prohibiting slamming and cramming. Similarly, as a general matter, Verizon is not proposing changes to current regulations that support social needs, such as those relating to hearing-impaired equipment and relay services, even though they disparately impact Verizon. Finally, Verizon does not object to maintaining existing regulations concerning termination notices, privacy, and 911.

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[90] *Instituting Order* at 10.

With respect to termination notices, however, Verizon proposes one modest change: the Commission should permit Verizon to send termination notices via e-mail or in other electronic form, rather than by mail, to customers who have consented to receive communications through electronic means. In addition to respecting customer requests for electronic communications, issuing such notices by e-mail will provide these customers with faster notice of potential termination of service, thus giving them more time to respond before the termination date.

B. THE COMMISSION SHOULD EASE UNDUE BURDENS ON VERIZON THAT DO NOT SERVE VALID CONSUMER PROTECTION INTERESTS

The regulations described below should be revised or eliminated because they are unduly restrictive — either on their face or as applied in practice — and inconsistent with the Commission's goal of promoting fair competition through even-handed regulatory oversight over providers of telecommunications service.

1. Consumer Complaints Should Be Resolved More Expeditiously, and Interest Payments on Award Amounts Should Be Limited

The Commission's procedures for handling consumer complaints should be revised and streamlined to support the efficient and timely resolution of customer disputes. Section 96(4) of the Public Service Law provides that complaints should be resolved within 60 days of the final submission of papers to the Commission. But, under the three-stage procedure currently provided for in Part 12 of the Commission's regulations, it can take four or more years to resolve a complaint. Moreover, under existing regulations, if a customer prevails in a billing dispute against Verizon, the amount awarded is subject to interest, which can accrue to a significant amount.[91] Since a complaint can take years to resolve — for reasons that are beyond Verizon's control — this can result in the imposition of substantial interest charges that are tantamount to severe penalties.[92] Such penalties are imposed on Verizon absent any finding of bad

[91] *See* 16 NYCRR § 634.1 *et seq.*

[92] However, when customers fail to pay their bills on time, late payment charges do not continue accruing for an indefinite period of time. Verizon stops assessing a late payment charge against a customer once a final bill is is-

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faith or other wrongful conduct on Verizon's part. And permitting interest to accrue fails to give customers the proper incentive to resolve pending disputes promptly. Moreover, because resellers are not subject to Part 634 of the Commission's regulations, and because intermodal competitors are not subject to Commission regulations at all, the onerous levels of interest that can accrue in connection with customer billing disputes amount to penalties that disparately affect Verizon. Accordingly, in the interest of fairness, interest on any subsequent award amount should stop accruing once the customer's complaint is filed with the Commission, and complaints should be resolved within 60 days of the final submission of papers.

2. Billing and Collection Regulations Should Be Amended to Eliminate the Requirement That Payments Be Allocated into "Buckets"

The introduction of optional bundles of telecommunications services in recent years has provided significant pricing innovation and value to consumers. These optional offerings, which have been met with overwhelming demand from consumers, enable customers to limit the monthly amount they pay for domestic local and long distance service while obtaining value-added features such as voice mail and Caller ID. But the way in which billing and collection regulations concerning service disconnections[93] are currently interpreted undermines the very concept of bundled offerings. Pursuant to these regulations, the Commission requires carriers like Verizon to allocate partial payments in a specified order to various categories known as "buckets," thus preventing the disconnection of all services (and, in particular, of local service) provided to delinquent customers. Although bundles, by design, typically combine an assortment of basic and non-basic services, the entire bundle is treated as a non-basic service and placed in the bucket for that category. As a result, customer failures to pay for the bundles to which they subscribe

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sued, even though additional time may pass before the customer makes payment. *See* Verizon Tariff PSC No. 1, § 1(H)(5)(b)(2). Thus, if a customer whose service has been disconnected for non-payment seeks to have service reconnected years later, for example, that customer will not be confronted with years of steadily accruing late payment charges.

do not result in the disconnection of basic local service. Since this significantly increases the amount of uncollectibles associated with bundles and adversely impacts Verizon's financial condition, the bucketing requirement undermines Verizon's ability to continue offering customers bundled services and the attractive pricing they provide.[94]

There are also other reasons for eliminating the bucketing requirement. Requiring Verizon to allocate partial payment among various buckets — whether for customers subscribing to bundles or for customers ordering services a la carte — permits (indeed, encourages) customers to delay paying overdue bills, which, in turn, leads to greater balances that customers must pay before service may be fully restored. Greater balances place larger financial strains on customers. And restricting Verizon's ability to terminate service to customers who fail to pay their entire bills undermines parity between Verizon and its competitors, such as VoIP providers and cable telephony providers, that are not subject to bucketing requirements.

To ameliorate these problems and eliminate the unfairness that results from applying bucketing requirements to Verizon, the Commission should amend existing billing and collection regulations applied pursuant to Part 606 to remove the bucketing requirement as to all customers (whether they subscribe to bundles or not).[95] When a customer opts to purchase bundled service offerings and uses those

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[93] *See* 16 NYCRR §§ 606.4, 606.5.

[94] Nor does it make sense to require Verizon to unbundle the bundled service the customer actually ordered before disconnecting the local calling component(s) of the formerly bundled service. That only generates customer confusion and dissatisfaction since unbundling results in services defaulting to pay-per-minute or pay-per-call charges and higher "a la carte" rates for value-added features.

[95] If the Commission decides to maintain the practice of allocating partial payments to buckets (which it should not do), the number of buckets should be simplified and reduced from four to two (basic local exchange service and all other services). When the existing categories were established some time ago, Verizon was billing for most of the interexchange carriers, and placing toll revenues in a separate category was preferred by all parties. Today, however, Verizon's competitors now provide both intraLATA and interLATA toll services, and Verizon does very little billing for other carriers. As a result, it is no longer necessary to have separate non-basic payment categories. Reducing the number of categories will reduce training expenses and result in less customer confusion as it will help simplify the bill.

services but fails to pay for them, Verizon should be permitted to disconnect all service — including local service — to that customer.[96] The concern that customers be virtually guaranteed access to basic local exchange service is no longer a compelling reason for maintaining bucketing requirements in today's environment, in which a host of competitors offer basic phone service to customers who are willing to pay for such service.

3. Verizon Should Not Be Required to Provide Service to Customers Who Have Failed to Pay All Outstanding Charges

The Commission should further address the problem of non-payment by permitting Verizon to demand full payment of outstanding charges prior to restoring or providing new service to a customer whose service previously has been disconnected. Under current regulations, Verizon is required to provide basic local exchange service to an applicant requesting service unless the applicant owes Verizon money for basic local exchange service provided to a prior account in that applicant's name.[97] The principle underlying these regulations — that a carrier should not be required to provide further service to a customer with a delinquent account — applies with equal force to other types of telecommunications service. Accordingly, the regulations should be revised to provide that Verizon need not provide service to customers with outstanding charges, regardless of whether those charges pertain to local exchange service or to other service provided by Verizon.

4. Verizon's Late Payment Charge Should Be Set at a Competitive Rate

Under the Commission's regulations, Verizon is prohibited from "charg[ing] any residential customer a late payment charge, penalty, fee, interest or other charge of any kind without the approval of the commission for any late payment, collection effort, service termination or deferred payment agreement

[96] The customer will be continue to be entitled to, and will receive, notice of the failure to pay and will be given ample opportunity to make payment (if there has been an oversight by the customer), to dispute the bill (if there has been an error), or to revise the list of services purchased. If the customer does not respond to the notice and continues to use the bundled services without payment, then the bundled service may be disconnected. Legitimately disputed bills will be resolved before the disconnection process proceeds.

[97] *See* 16 NYCRR §§ 609.3(a)(1), 609.3(a)(2).

occasioned by the customer's failure to make timely payment for services."[98] Verizon is also required to obtain Commission approval before imposing charges for restoral of service, dishonored checks, and the like.[99]

These regulations should be revised or eliminated to permit Verizon flexibility in setting and adjusting its late payment charge and other fees charged to its customers, such as a charge for a dishonored check. As long as Verizon provides adequate notice to its customers of the changes it plans to make, Verizon should have the ability to change these rates without having to seek Commission approval.

Verizon's tariffed late payment charge is not competitive. A late payment charge of 1.5% per month currently applies to amounts previously billed on customers' bills that remain unpaid at the time the next bill is prepared, excluding the previous month's local service charge, but including arrears and previous late payment charges.[100] This is less than the late payment charges some of Verizon's competitors are allowed to assess and also less than the late payment charges assessed by creditors like credit card companies, whose outstanding bills often are paid off with priority due to the large, fixed late payment charges and other finance charges they are at liberty to assess.

As the Commission recognized by permitting providers of telecommunications service to assess late payment charges in the first instance, charges collected by regulated companies should be set at levels sufficient to assure that customers do not feel free to pay their bills for telecommunications services only after other bills are paid. A higher charge would encourage Verizon's customers to make timely bill payments and help recover costs imposed by late-paying customers. For these reasons, the Commission should permit Verizon the flexibility to determine when and how to adjust its late payment charge — for example, by setting the charge as the greater of either a selected percentage rate or a minimum flat

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[98] 16 NYCRR § 609.11.

[99] *Id.*

[100] It is not Verizon's practice to assess late payment charges indefinitely. Rather, Verizon stops assessing a late payment charge once a final bill is issued to a customer. *See supra* n.92.

amount to be determined by Verizon — to bring it in line with the higher late payment charges that Verizon's competitors already are permitted to assess.

In addition, the Commission should eliminate the provision in its regulations that ties the interest rate Verizon is required to remit to its customers in instances of overbilling to the late payment charge Verizon assesses.[101] While an increase in Verizon's current tariffed late payment charge is warranted, any credits or refunds issued by Verizon should not be subject to a correspondingly higher charge because the reasons for increasing the late payment charge for customers — *e.g.*, to encourage timely bill payments — do not apply to Verizon. Verizon has ample incentive to guard against overbilling since chronic problems with overbilling would subject Verizon to the risk of losing customers to its competitors.[102]

VI. LEVEL PLAYING FIELD

In its *Instituting Order*, the Commission refers to general principles previously articulated by the Commission in its "Competition II" docket and asks whether these principles remain pertinent in today's intermodal environment.[103] While principles supporting a level playing field generally remain apt, that does not lead to the conclusion that the Commission should direct its efforts in this proceeding towards devising new regulations with respect to numbering administration, intercarrier compensation, and the interconnection of networks between Verizon and independent LECs — the major areas of inquiry mentioned in the *Instituting Order*. That is because areas like numbering administration and intercarrier compensation already are being regulated on the federal level or involve complex issues affecting all states. The industry (together with representatives of state regulatory commissions) already is working with the

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[101] *See* 16 NYCRR § 634.3.

[102] The incorrect view that the late payment charge must be equal to the interest rate on overpayments may be based on a belief that there should be "parity" between Verizon and its retail customers. However, there is an important asymmetry between Verizon and those customers — Verizon is required to provide service to requesting customers in accordance with its tariffs, and to make the investments and incur the expenses necessary to support such services, but customers are not required to purchase from Verizon. In light of this overarching asymmetry, setting the late payment rate higher than the refund rate is not unreasonable.

[103] *See Instituting Order* at 18.

FCC to determine the best way to handle these issues. Nor should the Commission seek remedies for "potential" issues; it has ample authority to address serious concerns as they arise.

A. THE COMMISSION SHOULD NOT DEVISE NEW REGULATIONS FOR AREAS THAT ALREADY ARE BEING APPROPRIATELY ADDRESSED UNDER FEDERAL LAW

As the Commission recognized in the *Instituting Order*, federal law already "plays a significant role in numbering administration."[104] Since most issues concerning the provision of numbers to IP-based providers are not specific to New York but affect incumbents and IP-based providers across all states, it is appropriate for federal regulators to continue to handle numbering issues on a national basis. The Commission provides input through its representation on several committees that formulate numbering policy recommendations to the FCC and numbering requirements for the industry. Accordingly, there is no need for the Commission to devise New York-specific regulations to address numbering issues.

Likewise, there is no need at this time for the Commission to commence a review of intercarrier compensation rules. The FCC is already conducting a proceeding in order to develop a unified intercarrier compensation regime across all states.[105] Any further consideration of intercarrier compensation issues by this Commission should await the conclusion of the pending FCC proceeding in this area.

B. COMMISSION INTERVENTION ON "POTENTIAL" PROBLEMS IS NOT WARRANTED

The *Instituting Order* vaguely asks whether the Commission's processes are "adequate to remedy *potential* bottleneck issues."[106] Such an inquiry would be premature and misplaced since there are no actual bottleneck issues for the Commission to review at this time.

As the Commission already has acknowledged, the telecommunications market in New York is not marked by "market dominance" by one player but by widespread intermodal competition. Nor is there any indication that there are actual problems concerning the availability of bottleneck facilities in

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[104] *Instituting Order* at 18.

[105] *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (FCC).

[106] *Instituting Order* at 19 (emphasis added).

New York. Verizon offers access to its facilities to CLECs, as well as to intermodal competitors like VoIP providers. For example, Verizon makes its operator services and directory assistance services available for purchase by VoIP providers. And it is evident that VoIP providers — including cable companies — have not had difficulty attracting and providing services to large numbers of former Verizon customers. Since there are no pending complaints that competitors are experiencing actual bottleneck problems, it would be speculative for the Commission to presume that "potential" bottleneck problems exist. The Commission should address real bottleneck issues if and when such issues actually arise.

Similarly, to the extent that there are any outstanding issues concerning the interconnection of networks between Verizon and other independent LECs in New York, such issues should be addressed in the first instance in business-to-business discussions among the carriers, with the Commission intervening only as necessary based on the commencement of complaint proceedings.

VII. CONCLUSION

The competitive environment has changed significantly in New York, and the Commission properly instituted this proceeding to assess the regulatory changes that the new environment requires. The Commission should adopt the changes recommended above on a statewide basis.

Respectfully submitted,

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VIII. APPENDIX: THE CURRENT STATE OF INTERMODAL COMPETITION[107]

Intermodal competition has had profound consequences — both quantitative and qualitative — on competition in New York.

Quantitatively, Verizon has continued to lose market share, whether measured by access lines, minutes, or other guideposts. As the Commission recognized, "as intermodal competition flourishes, traditional competitors are losing ground. We estimate that between 1999 and 2004 Verizon lost approximately 37% of its retail access lines."[108]

Qualitatively, the focus has shifted from competition based on the use of Verizon's network to competition based on alternative networks utilizing different technologies (intermodal competition). Verizon's most significant competitive constraints come from such competitors. Intermodal competitors do not rely on Verizon's facilities, and their sales gains result in a complete revenue loss for Verizon. Because consumers increasingly view wireless, cable telephony, and VoIP as viable alternatives to wireline service, industry experts forecast that in five years 45% of U.S. households will either be wireless only or will use VoIP to make their calls. [1]

A. CABLE COMPANIES

As the Commission observed, cable telephony "provides an option that is rapidly being accepted as an equivalent to traditional wireline services."[109] Cable companies began providing mass market voice telephone service over their networks using circuit switches and are now aggressively rolling out VoIP service to their customers in almost all their service territories. As Attachment 2 to these comments demonstrates, cable-provided voice telephony is available to some 95% of the homes passed by cable systems in this state. Some major cable operators, including Time Warner Cable and Cablevision, already offer

[107] Attachment 1 to these comments lists a number of recent reports prepared by financial analysts that shed light on the current state of intermodal competition, together with additional relevant material from recent FCC orders and reports, SEC filings, and other sources. These materials are cited here by bracketed codes (such as "[14]") that refer to the sources listed in that Attachment.

[108] *Instituting Order* at 21 (footnote omitted).

telephony services in their entire footprint, while others, including Cox and Comcast, plan to reach that milestone by year-end 2006 at the latest. [2] One Wall Street analyst has noted: "By the end of 2006, [VoIP] will be offered almost ubiquitously by cable operators." [3]

The surging availability of cable telephony service has been accompanied by rapid growth in the number of cable telephony subscribers. According to FCC data, as of January 2004, approximately 13 percent of customers that were offered cable telephony were subscribing to the service. [4] Some cable operators report that, in some areas, their telephony services have been purchased by as much as 20-40 percent of their cable subscribers. [5] Collectively, cable companies are expected to serve nearly six million lines by the end of 2005 and more than 10 million by year-end 2006. [6] Analysts expect that cable companies will achieve an overall penetration rate of 15-20% within the next five years. [7]

The cannibalization of traditional wireline residential service is particularly pronounced in Verizon's service territories. Analysts have noted that Verizon is particularly exposed to competition from Time Warner and Cablevision, two of the most aggressive cable competitors for telephony service. [8] Although state-specific data are unavailable, Time Warner added 150,000 net new subscribers in the first quarter of 2005, while Cablevision added nearly 100,000 during that period. [9] Verizon's "worse-than-peer access line trend is at least partly reflective of its overlap with cable telephony;" as a result, "Verizon is again likely to lead the access line declines" in 2005 among incumbent carriers. [10]

B. INDEPENDENT VOIP PROVIDERS

In addition to obtaining VoIP service from a cable company, any customer with broadband access can obtain voice service from multiple independent VoIP providers.[110] Vonage, for example, provides service to 600,000 customers and continues to add 15,000 customers per week. [11] Skype, a service that allows customers to make ***free*** computer-to-computer calls "has now enabled more than 7 billion high-

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(…continued)

[109] *Id.* at 6.

quality minutes of talk time for Skype users worldwide." [12] AOL, the country's largest Internet service provider, is now providing VoIP service [13], and industry experts expect that other Internet companies will soon follow: "It's pretty evident that you are going to have Yahoo, MSN, Google, all within the next six months, their entry into this marketplace. These guys own the desktop, and the desktop is the highway out of your house. Anybody who's got real stickiness with their target audience can drop [a VoIP] application right into their code." [14] Analysts estimate that these non-cable VoIP providers are adding 400,000 subscribers per quarter and will reach 8-10 million users by 2009. [15]

Customers are starting to view VoIP service as a replacement for their telephone line. Approximately 50 percent of Vonage customers bring their old phone number when they sign up. [16] This substitution is driven in large measure by price. As analysts have noted, third-party VoIP providers offer service "at rates significantly below comparable RBOC prices" and "significant price degradation is becoming evident." [17]

Notably, a third-party VoIP service provider can provide service anywhere that broadband facilities are available, and does not require the provider to deploy additional network facilities in the customer's area. This greatly simplifies the process by which providers introduce their service in a particular area, and virtually eliminates any arguable "barriers to entry."

Since VoIP can be provided wherever broadband service (including cable modem service) is available, it is significant that some 99% of New York zip codes had high-speed lines in service as of December 31, 2004, with 86% of zip codes having three or more providers.[111] As the Commission noted in

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(…continued)

[110] *Instituting Order* at 8.

[111] FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, "High-Speed Services for Internet Access: Status as of December 31, 2004" (July 2005), Table 13. This report presents data gathered by the FCC on subscribership to high-speed services as of December 31, 2004. Since subscribership increased by 17% during the second half of 2004, it likely increased by at least a comparable amount in the first half of 2005. (*See* Charts 1 and 3 to the report, which show growth at an increasing rate since 1999 for both high speed lines and advanced services lines.)

the *Instituting Order* on the basis of a report issued in early 2003, "[a]pproximately 95% of New Yorkers have access to the latent broadband capability necessary to avail themselves of VoIP telephony".[112] That percentage is undoubtedly higher now, almost three years later. Thus, broadband — the fundamental "gateway" to VoIP-based competition — is virtually ubiquitous in New York.[113]

C. WIRELESS PROVIDERS

Wireless service is increasingly competitive with conventional landline telephony. As the Commission noted, "[w]ireless services are almost ubiquitously available in New York and exhibit very high subscription rates," and "serve as the basic telephone service for an increasing number of New Yorkers."[114] As wireless services displace landline traffic, they are providing competitively discipline for wireline services. As a result, wireless companies continue to increase their minutes of use and subscriptions

[112] *Instituting Order* at 8 (footnote omitted), citing New York State Department of Public Service, "Study of Rural Customer Access to Advanced Telecommunications Services" (February 1, 2003). *See also* DPS Triennial Comments at 10.

[113] Although the Commission has expressed concern about the availability of "standalone" broadband service (*see Instituting Order* at 8), that concern is unwarranted. First, more than 90 percent of U.S. households are now able to obtain a broadband connection from a provider other than their incumbent local telephone company, principally cable modem service. Consumers can use those broadband connections to obtain VoIP either from cable companies or independent providers such as Vonage, regardless of the availability of "naked DSL" from Verizon. Second, Verizon is already offering in New York several forms of "stand-alone DSL" services now and expects to be able to offer nearly all varieties in New York by September. Verizon realizes that offering such a product is imperative as a business matter, as customers are increasingly relying on broadband services to communicate and, in the process, are rapidly subscribing to VoIP services provisioned over broadband lines. (Thomson StreetEvents, VZ – Q2 2005 Verizon Earnings Conference Call, Final Transcript at 7 (July 26, 2005) ("In the next few months we will be more actively marketing 'DSL over dry loop,' or 'naked DSL.' We believe this presents a significant new opportunity for us to provide a data solution for the large number of wireless-only households.") (statement of Doreen Toben, Verizon CFO).) Verizon has moved to respond to this demand and is working on overcoming the technical issues that have thus far prevented it from offering stand-alone DSL service to all customers, as it wants to do.

In April 2005, Verizon began offering stand-alone DSL service to existing New York customers who port their voice line to a facilities-based carrier (including a VoIP provider) or wireless carrier but who want to retain their DSL service without the voice service. In June, Verizon expanded its offering to New York customers who have never had voice service with Verizon. (*See* FCC Tariff No. 1, Access Services, § 16.8(D)(4)(b); FCC Tariff No. 20, Communications Services, § 5.1.2(D)(2).) Therefore, for example, Verizon's DSL customers can cancel voice service from Verizon, obtain voice service from an independent VoIP provider such as Vonage, and retain their DSL line provided by Verizon. And new customers who do not currently have Verizon voice service can purchase stand-alone DSL and, for example, obtain service from an independent VoIP provider. The last principal type of stand-alone service — for those using the commercial replacement for UNE Platform – should be implemented by September.

[114] *Id.* at 7, 21.

at a double-digit pace, while wireline services are experiencing not just a decline in their percentage of overall voice minutes but absolute declines in revenue and number of access lines. That trend is likely to accelerate as existing wireless companies continue to improve their service and reliability and new wireless entrants with new technologies offer competitive fixed wireless service. As the FCC recently noted, wireless service has grown so spectacularly that the most common way to obtain local telephone service now is to subscribe to wireless service: of 362 million voice lines counted by the FCC at the end of 2004, 181.1 million — more than 50% — are wireless. [18]

Both consumers and suppliers [19] view wireless and wireline services as comparable, resulting in wireless competitive pressure on wireline. First, wireless minutes can displace wireline minutes. Second, because of the prevalence of wireless phones, customers buy fewer second or third lines than they would absent competition from wireless. Third, an increasing number of customers decide to use only wireless minutes by "cutting the cord." Although discussions concerning the competitive pressure exerted by wireless often focus on this latter aspect, that is only part of the story. Even usage displacement at the margin has an effect on price, so there is no need for a large share of customers to "cut the cord," or even to reduce the number of wirelines they own, in order for wireless service to discipline wireline pricing.

Thus, wireless competes with landline pervasively and in all aspects of voice calling. As Keith Mallinson, head of the Yankee Group's wireless practice, explains, "[w]ireless displacement of local and long distance calling is already substantial and growing rapidly." [20] Consumer surveys reveal that wireless service has displaced 60 percent of long distance and 36 percent of local calling from landlines in households with wireless phones. [21] A Yankee Group survey found that approximately 10 percent of wireless users do not have a landline phone at all. [22] Industry trends and market demographics suggest that this competition will only intensify. [23]

The absolute increase in wireless minutes looks like the revenue projections from the business plan of an Internet start-up. By 2004, wireless minutes of use had risen to 1.1 trillion, an increase of 32.7

percent from 2003 and more than 300 percent since 2000. [24] This increased usage has been accompanied by a rapid erosion in traditional distinctions between the locations from which subscribers use fixed and mobile service, as subscribers increasingly use their mobile devices at stationary locations from which wireline alternatives would readily be used. Thus, for example, a Yankee Group survey found that the percentage of wireless usage in the home by mobile phone users grew from 11.6% to 24.1% of total usage between 2001 and 2005. And the percentages do not fully convey the magnitude of the actual growth in the use of wireless in the home. As the Yankee Group notes, the actual growth in minutes in lieu of home calling may be much greater, because many wireless users make calls from their cars that they otherwise would have made at home. [25]

Although wireline companies have followed the wireless industry's pricing innovation by introducing their own all-distance rate packages, they so far have failed to staunch the bleeding from wireless competition. The FCC's own data show that average residential wireline toll minutes have declined rapidly for the industry as a whole — from an average of 149 minutes per month in 1997, down to only 90 minutes per month in 2002 (and undoubtedly much less today, given the increase in wireless and decrease in wirelines). [26] In total, consumers reduced the number of long distance minutes of use on landline phones by 40 percent between 1997 and 2002. [27] Not surprisingly in light of these trends, data from the Telecom Industry Association reveal that revenue from wireless services has outpaced revenue from wireline long distance since 2003 and will surpass revenue from landline local exchange calls by 2007. [28]

A second form of the general trend of wireless substitution is customers' use of wireless phones in lieu of purchasing additional lines from local phone companies. With so many overall wired and wireless local lines, fewer customers need second and third wired phones. Many households make an economic decision that they would rather buy a phone that is mobile and can be used anywhere, knowing the household still has a primary line. [29]

A third manifestation of wireless displacement is that a growing share of wireless subscribers are abandoning their wireline phones altogether — "cutting the cord." As of year-end 2004, approximately 7-10 percent of wireless users had given up their landline phones altogether [30], up from approximately 2% in 2001. [31] Analyst estimates are that primary line displacement could total 5 million lines in 2005. [32] As a result, analysts predict that the number of wireless-only users will grow to 20-25 percent of the market by 2010. [33] A recent Harris Interactive survey found that 39% of current landline customers are interested in going wireless altogether in the next two years. [34] And even if they are not abandoning their landline phone altogether, at least 14 percent of U.S. consumers now use their wireless phone as their primary phone. [35]

Given that these trends are even more pronounced among younger households, they are certain to increase in the future. According to Census Bureau data from 2004, 18 percent of households headed by someone under the age of 24 had only a cellular phone, and the same was true for 9.6 percent of households headed by someone between the ages of 25 and 34. [36] Furthermore, wireless use among young people is on the rise: 9 out of 10 incoming college students owned a cell phone in 2004, compared to only 1 out of 3 in 2000. [37] A recent survey of teens found that almost half prefer to communicate with friends using wireless phones, text messages, e-mail, or instant messaging rather than a wireline phone. [38] This data strongly suggests that wireless displacement will increase going forward. [39]

Wireless carriers also have increased the quality of wireless services and expanded their geographic reach to the point where customers generally can choose whether to make the next call on the wireless or wireline phone at their home or small office. [40] The FCC noted in its Ninth CMRS Competition Report that carriers now compete on quality and have invested tens of billions to ensure that consumers get more reliable wireless service. [41] Carriers have invested a cumulative $174 billion in their networks and increased the number of cell sites to nearly 176,000, up 75% from the year 2000 alone. [42] Cingular, for example, is making substantial investments in denser cell sites and better quality networks. [43]

The result is high-quality wireless service that is in many respects becoming indistinguishable from landline calling. One key measure of quality on a wireless (or wireline) network is the call completion rate. A study by the GAO found that the "industry standard" in the wireless industry is a "98 percent call-completion rate" and that the vast majority of consumers experience few or no problems with dropped calls. [44] Another study by CTIA and Telephia similarly found that "on average wireless customers, in core and suburban areas, can expect to place, hold and complete a conversation of acceptable audio quality 96-99 % of the time." [45] In any event, to the extent consumers do experience problems with dropped calls, it is chiefly due to the subscriber moving locations during the call, [46] a feature that wireline networks do not offer in the first place.

Consistent with these developments, consumers now report high levels of satisfaction with the quality of their wireless service. For example, the GAO found that 83 percent of wireless users were satisfied with the call quality of their cell phone, while only 9 percent were dissatisfied. [47] A September 2004 survey by J.D. Power and Associates found that "[o]verall satisfaction with wireless service providers has increased 5 percent over 2003," and that satisfaction with call quality increased by 7 percent during that same period. [48]

D. OTHER TECHNOLOGIES

E-mail, instant messaging, and wireless text messaging also displace a significant fraction of traffic that used to travel on wireline networks, including revenue-producing traffic such as long distance calls. If only 5 percent of the estimated nine billion messages U.S. users send each day [49] substitute for a 90-second voice call, that data traffic displaces more than 10 percent of the voice traffic that would otherwise have been handled by wireline networks. [50] Although e-mail and instant messaging may not displace access lines, the diversion of traffic from wireline service to these technologies reduces the value of wireline service to consumers and therefore the price they are willing to pay.

Moreover, other technologies, such as broadband over powerline ("BPL"), are poised to become significant competitors for voice traffic. As the FCC observed, four utilities began offering BPL to customers in 2004. [51] Because power lines reach virtually every customer location, "[t]his new technology offers the potential for the establishment of a significant new medium for extending broadband access," [52] and therefore an additional avenue for obtaining VoIP, "to American homes and businesses." [53]

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In short, intermodal competition is now a major competitive force in the mass market for telecommunications service. Consumers regard these services as fully competitive with conventional service. The growth in intermodal penetration has been rapid. Intermodal competition is here to stay.

ATTACHMENT 1

Attachment 1

1 Frank G. Louthan, IV, Raymond James & Associates, Inc., *Reassessing the Impact of Access on Wireline Carriers* (July 11, 2005), at 2.

2 Craig Moffett, *et al.*, Bernstein Research Call, *Cable and Telecom: VoIP Deployment and Share Gains Accelerating; Will Re-Shape Competitive Landscape in 2005* (Dec. 7 2004); Thomson StreetEvents, *TWX—Q4 2004 Time Warner Inc. Earnings Conference Call*, Conference Call Transcript (Feb. 4, 2005); Cablevision News Release, *Cablevision Systems Corporation Reports First Quarter 2005 Results* (May 5, 2005); Comcast, presentation at the Bear Stearns 18th Annual Media, Entertainment & Information Conference (Mar. 2, 2005), at 10-11.

3 Craig Moffett, *et al.*, *supra* Item 2.

4 *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, MM Docket No. 92-266, Report on Cable Industry Prices (rel. Feb. 4, 2005), ¶ 37 & Table 10.

5 Chris Bowick, SVP Engineering & CTO, Cox Communications, *Cox Communications: Distribution at Its Best*, presentation at the Bear Stearns 17th Annual Media, Entertainment & Information Conference (Mar. 8, 2004), at 19; *Q1 2004 Cox Communications Inc. Earnings Conference Call—Final*, FD (Fair Disclosure) Wire, Transcript 042904as.714 (Apr. 29, 2004). *See also*, Morgan Stanley Equity Research North America, *Telecom Services: Cable Telephony Competition Hits Home* (Aug. 3, 2005).

6 Frank Governali, *et al.*, Goldman Sachs, *Americas: Telecom Services* (Jan. 12, 2005).

7 Douglas S. Shapiro, *et al.*, Banc of America Securities Research Brief, *Battle for the Bundle: Mapping the Battlefield*, *Our First Report from the Front* (June 14, 2005), at 3; Frank G. Louthan, IV & Ben Gordon, Raymond James Equity Research, *Reassessing the Impact of Access Lines on Wireline Carriers* (July 11, 2005), at 1; Jeffrey Halpern, *et al*., Bernstein Research Call, *Quarterly VoIP Monitor: The "Real" Price Gap for VoIP Driving Rapid Subscriber Growth* (July 15, 2005), at 1; Frank Governali, *et al*., Goldman Sachs, *Americas: Telecom Services* (Jan. 12, 2005).

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9 Thomson StreetEvents, *TWX – Q1 2005 Time Warner Inc. Earnings Conference Call*, Conference Call Transcript (May 4, 2005), at 3; Cablevision Presentation at the Deutsche Bank Securities Media Conference (June 6, 2005), at 29, available at http://library.corporate-ir.net/library/10/102/102703/items/154595/deutsche_final.pdf.

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11 Vonage Press Release, *Vonage Contracts with Verizon for Nomadic VoIP E9-1-1 Service* (May 4, 2005).

12 *SkypeIn and Skype Voicemail Beta*, BUSINESS WIRE (Apr. 15, 2005).

13 AOL Press Release, *America Online Introduces AOL® Internet Phone Service* (Apr. 7, 2005).

14 C. Wilson, *AOL Helps Usher in VoIP's Growth Spurt*, TELEPHONY (Mar. 14, 2005), at 10; Viktor Shvets & Andrew Kieley, Deutsche Bank, *VoIP: State of Play* (June 22, 2005), at 6.

15 Viktor Shvets & Andrew Kieley, *supra* Item 14, at 4, 6.

16 J. Hodulik, *et al.*, UBS Investment Research, *The Vonage Story: The Who, What, Where, and How* (Nov. 24, 2003), at 5; A. Quinton, *et al.*, Merrill Lynch, *US VoIP Update: Competitive, Regulatory, and Other Issues* (Nov. 25, 2003), at 9.

17 Jeffrey Halpern, *et al*., *supra* Item 7, at 5-6 & Exh. 5; Viktor Shvets & Andrew Kieley, *supra* Item 14, at 7.

18 FCC News Release, *Federal Communications Commission Release Data on Local Telephone Competition* (July 8, 2005), available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0705.pdf.

19 *Applications of Nextel Communications, Inc. and Sprint Corp for Consent to Transfer Control of Licenses and Authorizations*, WT Docket No. 05-63, Application for Transfer of Control (dated Aug. 8, 2005), at 30-31; AT&T Corp., Form 10-K (Mar. 15, 2004) (available at http://www.sec.gov/Archives/edgar/data/5907/000095012304003304 /y92576e10vk.txt) ("Consumer long distance voice usage is declining as a result of substitution to wireless services, internet access, and e-mail instant messaging services, particularly in the 'dial one' long distance, care and operator services segments."); MCI, Inc., Form 10-K (Apr. 29, 2004) (available at http://www.sec.gov/ Archives/edgar/data/723527/000119312504074088/d10k.htm) ("[W]ireless telephone companies . . . have increased their network coverage, improved service quality, started to provide bundled wireless products and lowered prices to end users"; as a result, wireless companies are gaining market share from providers of wireline voice communications); *Applications of SBC Communications Inc. and AT&T Corp. for Consent to Transfer of Control*, WC Docket No. 05-65, Petition to Deny of Qwest Communications Int'l, Inc. (dated Apr. 25, 2005), at 35.

20 Keith Mallinson, Yankee Group, *Wireless Substitution of Wireline Increases Choice and Competition in Voice Services* (July 27, 2005), at 1.

21 Keith Mallinson, *supra* Item 20, at 7.

22 Keith Mallinson, *supra* Item 20, at 5.

23 Blake Bath, Lehman Brothers, *Wireless Services: Industry Overview, Raising '06-'08 Wireless Net Adds by 50%* (June 16, 2005), at 3.

24 CTIA-The Wireless Association, *Background on CTIA's Semi-Annual Wireless Industry Survey* (2005), at 8 ("Reported Wireless Minutes of Use Exceed One Trillion in 2004"), available at http://files.ctia.org/pdf/CTIAYearend2004Survey.pdf; *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, WT Docket No. 04-111, Ninth Report (rel. Sept. 28, 2004) (available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-216A1.pdf).

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27 *Id.*

28 *U.S. Telecoms Services Revenue to Rise 3.6% in 2005—TIA*, TOTAL TELECOM (Mar. 4, 2005).

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ATTACHMENT 2

Attachment 2

Advanced Cable Services Are Widely Available in New York

	Homes Passed			**Percent of Homes Passed**	
Company	Total	Broadband Ready	Telephony Ready	Broadband Ready	Telephony Ready
Time Warner	3,959,520	3,959,133	3,959,520	100%	100%
Cablevision	2,429,359	2,429,359	2,429,359	100%	100%
Adelphia	623,708	470,503	326,560	75%	52%
RCN	310,000	310,000	310,000	100%	100%
Other	143,591	109,186	45,351	76%	32%
Total	7,466,178	7,278,182	7,070,790	97%	95%

Notes: Missing homes passed data is estimated based on the average penetration of other New York systems; Additional franchises have planned internet operations.
Sources: Television & Cable Factbook, Cable Volume, 2005; Time Warner Cable, *see* http://www.timewarnercable.com/Localization/Corporate.ashx (telephony ready), accessed August 10, 2005; and Cablevision Systems Corporation, SEC, Form 10-K, December 31, 2004, p. 6 (telephony ready).