

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

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

**COMMENTS OF
ELIOT SPITZER
ATTORNEY GENERAL
OF THE
STATE OF NEW YORK**

Mary Ellen Burns
Special Counsel
Public Advocacy Division

Jay L. Himes
Chief, Antitrust Bureau

Thomas G. Conway
Chief, Consumer Frauds and Protection Bureau

Keith H. Gordon
Assistant Attorney General
Telecommunications & Energy Bureau
Of Counsel

120 Broadway
New York, NY 10271
Tel No.: (212) 416-6343
Fax No.: (212) 416-8877
E-mail: keith.gordon@oag.state.ny.us

August 15, 2005

CONTENTS

I. INTRODUCTION	1
II. THE NEW YORK ATTORNEY GENERAL’S INTEREST	2
III. DISCUSSION	3
A. New Intermodal Competitors Lack The Ability To Check Market Power Exercise By Dominant Providers	3
B. The Commission Should Continue To Enforce Essential Consumer Protections And Should Eliminate Only Those Rules That Are No Longer Necessary	7
C. The Commission Should Ensure That Adequate Service Is Provided By All Competitors	12
V. CONCLUSION	16
APPENDIX: Discussion of DPS Staff’s Proposed Competition Index	
1. The DPS Staff Proposed Competition Index	1
2. The Index Points Lack An Empirical Foundation	2
3. The Index Weights Are Insensitive To Which Alternatives Are Present In Each Market	4
4. The Index Does Not Adequately Consider Consumer Resistance To Switching From Wirelines	5
5. The Index Fails to Consider Regional Differences in Service Quality and Consumer Preferences	6
6. The Index Does Not Consider Potential Market Failure, Consolidation or Exit	8
7. Recommendations	9

I. INTRODUCTION

On June 29, 2005, the Public Service Commission (“PSC” or “Commission”) initiated “a broad review of [its] telecommunications policies, practices and rules in light of the fast changing telecommunications environment.”¹ The Commission seeks to evaluate the degree and kind of regulatory oversight appropriate to the current state of telecommunications competition. The PSC appended a number of questions to “seek input from the industry and the public on our broad principles and appropriate changes to our regulatory framework.”² The New York State Attorney General (“AG”) submits these comments in response to the Commission’s invitation.

As New York attempts to move away from the historical monopoly enjoyed by the Bell Companies and other incumbent local exchange carriers (“ILECs”), it is reasonable to re-examine how telecommunications services should be regulated. In undertaking this review of regulatory policy, the Commission sets forth a “flexible” approach to regulation of voice services, which would vary the level of regulatory oversight according to the degree to which the market remains dominated by a monopoly provider or has transitioned to a more competitive structure. Under the Commission’s approach, the availability of alternative choices by customers would lower the requirement for regulatory supervision by the PSC, because customers could “vote with their feet” if they were unsatisfied with their current provider’s price or service terms.

The Commission first needs to assess the actual current state of New York’s telecommunications markets and the realistic potential for their lasting competitive

¹ Case 05-C-0616, *supra*, *Order Instituting Proceeding and Inviting Comments*, June 29, 2005, at 4.

² *Ibid.*

transformation. Only if markets are no longer dominated by any one provider would the Commission be justified in taking major steps to lighten its regulatory oversight. But even where robust competition exists, now or in the future, and no participant wields market power, the Commission needs to ensure that all providers afford consumers critical protections and that the advent of intermodal competition does not jeopardize maintenance of a reliable public switched telephone network (“PSTN”) upon which all providers rely to carry their customers’ calls. As with any industry, competitive markets alone do not guarantee adequate consumer protection, especially for residential and small business customers.

The AG therefore recommends that, the Commission refrain from deregulating at this point in time. Given the current state of competition in the telecommunications industry and recent trends in consolidation, substantial deregulation is premature. Instead, the Commission should establish a minimum threshold of consumer protections and service quality measures, and apply them to all providers regardless of the mode of entry. Moreover, while the PSC Staff’s competition index is a useful first effort to assess the level of competition in each market, it nevertheless needs refinement in several significant respects.

II. THE NEW YORK ATTORNEY GENERAL’S INTEREST

The Attorney General is charged with enforcing state and federal antitrust and consumer protection laws. The Attorney General advocates in Commission proceedings primarily on behalf of New York State, consumer and small business interests, and the public interest generally.

III. DISCUSSION

A. **New Intermodal Competitors Lack The Ability To Check Market Power Exercise By Dominant Providers.**

The Commission's implementing Order lacks an evidentiary basis to justify a wholesale reduction of existing regulation of providers of telecommunications services. According to the PSC's 2002 evaluation of New York's local markets, at the end of that year ILECs retained a 76% market share of New York access lines, with Verizon's individual share at 67%.³ Since the 2002 PSC assessment, the ability of competitive local exchange carriers ("CLECs") to increase or even maintain their 24% share of local markets in New York has been seriously curtailed by judicial and Federal Communications Commission ("FCC") policy changes regarding the availability of unbundled network elements ("UNEs") at discounted prices.⁴ Moreover, the Department of Public Service Staff's ("DPS Staff") recent assessment of New York's markets

³ *Analysis of Local Exchange Service Competition in New York State*, pp. 6, 7.

⁴ Until this year, the FCC required ILECs to lease their UNE facilities to CLECs based on a forward-looking total element long run incremental cost ("TELRIC") standard. *See United States Telecom Assoc. v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) (rejecting the FCC's delegation to state regulators the determination of CLEC eligibility for discounted UNEs). Following the D.C. Circuit's remand, the FCC sharply limited the availability of discounted UNEs. *See FCC WC Docket No. 04-313; CC Docket No. 01-338 - In the Matter of Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Release DA 05-675, March 14, 2005. On August 11, 2005, the PSC approved UNE tariff changes submitted by Verizon declaring numerous wire centers "ineligible" for discounted UNEs. Cases 05-C-0203 - *Ordinary Tariff Filing of Verizon New York Inc. to Comply with the FCC's Triennial Review Order on Remand*, 05-C-0363 - *Compliance Filing of Verizon New York Inc. Pursuant to Order Issued on March 16, 2005 in Case 05-C-0203, filed in C 98-C-1357*, and 05-C-0487 - *Compliance Filing of Verizon New York Inc., Order Approving Tariff Revisions*, issued August 11, 2005.

reveals that they are currently highly concentrated, and likely to become far more so if the pending applications for merger by Verizon-MCI and SBC-AT&T were to gain approval.⁵

The PSC's evaluation of telecommunications competition in New York could be viewed as analogous to the FCC's weighing of AT&T's dominance in long distance markets. In 1995, the FCC found that AT&T remained dominant until its market share had dropped below 40%, which took eleven years following the 1984 antitrust settlement that helped start long distance competition. As long as AT&T retained a 40% market share, the FCC concluded that "AT&T, as a dominant carrier, should be subject to the 'full panoply' of then-existing Title II regulation."⁶

The FCC's approach suggests that, in assessing the viability of deregulation, the PSC should undertake a typical antitrust market analysis. Instead, the Commission has proposed an index to measure the potential of alternative voice services to compete effectively with Verizon. The DPS Staff has assigned each alternative service a value based on its availability and substitutability with Verizon's wireline service. The goal of this index is to determine which markets have sufficient competition to discipline participants so that regulatory oversight can safely be lightened. However, the Staff's proposed index does not take into account market dominance by incumbents as the FCC did with the long distance market.

⁵ Cases 05-C-0237 - *Joint Petition of Verizon New York, Inc. and MCI, Inc. for a Declaratory Ruling Disclaiming Jurisdiction over or in the Alternative for Approval of Agreement and Plan of Merger* and 05-C-0242 - *Joint Petition of SBC Communications, Inc. AT&T Corporation, together with its Certificated New York Subsidiaries for Approval of Merger*, Department of Public Service Staff White Paper, July 6, 2005. See also August 5, 2005 AG's Comments on Staff's White Paper.

⁶ *In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order adopted October 12, 1995, 11 FCC Rcd 3271, ¶ 4.

In particular, as set forth by AG economists in greater detail in the attached Appendix, the analysis fails to:

- Base provider weights on empirical measurements of customer demand sensitivity to price changes.
- Make provider weights sensitive to which alternatives are present in each market
- Adequately consider consumer resistance to switching from wirelines.
- Consider regional differences in service quality and consumer preferences.
- Consider potential market failure, exit and consolidation.

The current development of intermodal competition does not justify deregulation. Competition from voice over Internet protocol (“VoIP”) and cable telephony is only in its infancy. It remains to be seen whether these new intermodal entrants can garner sufficient market share to preclude incumbent providers from exercising market power. While such changes as the PSC is contemplating in this proceeding may be appropriate in the future, they are premature at this point in time.

Although wireless service is more established than other intermodal entrants, and exhibits some competition among wireless carriers, it is not today a true substitute for wireline service, in either the mass market or business sectors. These intermodal providers are not yet ubiquitously available, and thus do not currently serve as replacements for traditional wireline providers.⁷ In the past, optimistic expectations that UNE-P would produce robust competition for local service, and would evolve into full-fledged facilities-based competitors who could check the market

⁷ VoIP, which depends on a DSL broadband connection, is not even an option for customers located more than three miles from their incumbent local telephone provider’s switching center. Cable telephony is not available to all New York residences, and is only rarely an option to small business customers.

power of incumbents, proved inaccurate.

The state of competition in this industry is highly dynamic, and currently undergoing a wave of mergers and acquisitions that may alter significantly the future market power of those competitors who survive.⁸ Because the two largest wireless providers (Verizon Wireless and Cingular) are owned by three of the incumbent Regional Bell Operating Companies (“RBOCs”),⁹ it is not a simple matter of direct competition between the dominant wireline and wireless providers. Common ownership of Verizon-New York and Verizon Wireless is not the same as competition between unrelated entities.

Merely offering customers alternative providers is not enough when barriers exist that inhibit customer exercise of choice. For example, in the wireless industry, meaningful customer choice was significantly impaired, until recently, by a lack of telephone number portability.¹⁰ Other barriers remain, such as long-term service contracts containing large penalties for early termination, which exceed potential customer savings from switching providers, and which thus curtail the effectiveness of markets to discipline providers. Boilerplate “take it or leave it” wireless contracts indicate the prevalence of unequal bargaining power between customer and

⁸ To name just the major mergers in the last two years, Cingular has acquired AT&T Wireless, Sprint is merging with Nextel, and MCI exited the wireless market entirely.

⁹ SBC and Bell South jointly own Cingular, while Verizon Wireless is owned by Verizon Communications and Vodaphone.

¹⁰ *FCC Reports on Status of Local Number Portability: Process for Ports Has Improved; Pace of Complaints Has Slowed; Nationwide Number Portability Begins on May 24 [2004]*, May 13, 2004 FCC release. http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-247162A1.pdf.

provider.¹¹

Because VoIP, cable telephony and wireless providers rely on the PSTN to complete a majority of calls placed by their customers, the service quality that incumbent wireline carriers provide substantially affects not only on their own subscribers, but also those of competitors using alternate modes of entry to develop a customer base. Bottlenecks, such as the local loop, will hinder competition unless regulatory action is taken to address such conditions.

B. The Commission Should Continue To Enforce Essential Consumer Protections And Should Eliminate Only Those Rules That Are No Longer Necessary.

New York's telecommunications markets have not yet developed far enough to justify discontinuing regulatory oversight. The continued market dominance of ILECs in New York, and the early stage of development of intermodal competitors, counsel against major relaxation of consumer protection rules.

Consumers will most benefit if competitors vie with each other to offer superior service and terms. The AG supports establishing a baseline level of essential consumer protections that would not be unnecessarily burdensome to providers. Without such protective regulations, consumers can fall prey to abuses practiced by a few new entities seeking to scam the public. The Commission and AG both have ample experience with abusive conduct by slammers,¹²

¹¹ Where such contracts become overly onerous, contract terms can be found unconscionable. *See e.g. Uniform Commercial Code* § 2-302.

¹² Slamming is unauthorized changing of subscribers' provider of choice, usually involving long distance or regional service.

crammers,¹³ pay-per-call services,¹⁴ customer-owned coin telephone and operator service providers.¹⁵ More reputable entrants can stint on basic consumer protections. For example, some recent intermodal entrants are not providing New York customers with basic protections consistent with the PSC's requirements for intrastate telephone providers, such as impartial dispute resolution, pre-termination notice, pay-per-call and caller ID blocking, handicapped access, and E-911.¹⁶ Competition should not become an excuse to allow providers to race to the bottom by removing consumer protections and degrading service quality. This would harm the industry as a whole as the barrel of honest providers becomes tainted in consumers' minds by the deceptive acts and practices of some "rotten apples."

Even if competition were to become well established, experience with other competitive industries teaches that regulation often remains necessary to protect consumers from fraudulent, deceptive and misleading business practices. This is why the Truth In Lending Act was enacted to ensure that finance companies disclose the rate of interest and other essential terms in a clear,

¹³ Cramming involves putting unauthorized charges for non-telecommunications products or services on customer's telephone bills.

¹⁴ Some area code 900 and similar services fail to disclose the fee for such calls or allow customers to terminate such unintended calls without incurring a charge.

¹⁵ Many independent payphones fail to disclose unusually high operator charges or do not permit customers to make toll calls without incurring such fees.

¹⁶ See Case 03-C-1285 - *Complaint of Frontier Telephone of Rochester, Inc. Against Vonage Holding Corp. Concerning Provision of Local Exchange and Inter-Exchange Telephone Service in New York State in Violation of the Public Service Law, Initial Comments of Eliot Spitzer Attorney General of the State of New York*, Oct. 31, 2003, pp. 16-20.

consistent and meaningful manner.¹⁷ Similarly, automobile dealers and manufacturers, are required to adhere to basic warranty protections.¹⁸ The discipline that comes from competitive markets is not necessarily sufficient to afford all customers a minimum level of fair treatment.

There are important customer rights and protections that a competitive market is unlikely to ensure. One vital example is the need for an impartial means to resolve billing and service disputes. Traditionally, the PSC has played an important role in investigating and, where informal resolution between provider and customer was not possible, adjudicating such disputes involving intrastate telecommunications.¹⁹

When there is a regulatory vacuum, providers such as long distance carriers and VoIP companies have sought, for example, to impose mandatory arbitration clauses in their customer agreements. Too often, the costs of arbitration exceed the amount in dispute, or the arbitration body lacks the regulator's expertise to properly handle service quality issues that may arise. Because customers cannot, when choosing their provider, evaluate possible problems in resolving a future dispute market forces alone are unlikely to provide adequate protection. Regulatory oversight is essential. The wide disparity in market power between all but the largest customers and providers means that once a customer is involved in a dispute with a provider, the

¹⁷ See 15 U.S.C. §§ 1601 *et seq.* and Regulation Z, 12 CFR § 226. See also Real Estate Settlement Procedures Act, 12 U.S.C. § 2607 (requiring accurate disclosures of closing costs in home mortgage transactions) and Fair Credit Reporting Act, 15 U.S.C. §§ 1681 *et seq.* (entitling consumers to examine and correct errors in their credit scores).

¹⁸ See Magnuson-Moss Warranty Act, 15 U.S.C. § 2308; New York General Business Law § 198-a (Lemon Law); and Federal Odometer Act, 49 U.S.C. § 32701.

¹⁹ The Commission's rules for hearing and deciding consumer complaints is found at 16 NYCRR Part 12.

option to change carriers is unlikely to be of any avail in resolving the pending dispute. Therefore, the PSC should continue adjudicating consumer complaints as set forth in its *Consumer Complaint Procedures* published at 16 *NYCRR* Part 12.

The AG recognizes the importance of regulatory parity for competing providers, regardless of technology employed, so that some will not be disadvantaged by legacy regulation adopted before the onset of new intermodal competition. However, the proper response to the development of intermodal competition is to apply basic protections to all providers – not to release those already regulated from affording the protections that consumers need and expect.

A good example of the need to treat consumers similarly, regardless of the type of provider they use, is found in the history of wireless development. At its outset, regulators chose to relieve wireless providers of various rules applied to traditional wireline providers. That made considerable sense when the wireless industry was just getting established. The popularity of wireless phones has since grown enormously and now complements wireline telephone service, although still not generally substituting for it. As a result, the FCC has required wireless carriers to provide such features as 911 and enhanced 911 (“E-911”) emergency services, similar to the wireline emergency features adopted at the state and local level in New York and elsewhere.²⁰

At present, however, neither the FCC nor the PSC is exercising jurisdiction to adjudicate wireless consumer disputes. Given the substantial growth of wireless services, the time is ripe for the PSC to apply its consumer complaint resolution process to this segment of the

²⁰ Recently, the FCC has taken similar steps requiring VoIP providers to effect E-911 service comparable to that of wireline and wireless providers. See FCC WC Docket No. 04-36 and 05-196, *In the Matters of IP-Enabled Services E911 Requirements for IP-Enabled Service Providers, First Report and Order and Notice of Proposed Rulemaking*, rel. June 3, 2005.

telecommunications industry.²¹ In 1993, the Legislature authorized the Commission to take this step “to the extent found necessary to protect the public interest because of a lack of effective competition.”²² The need for Commission oversight is demonstrated by the large number of consumers complaining about their wireless providers.

According to the Council of Better Business Bureaus, customers filed 28,000 complaints about cell phones in 2004 — more than for new car dealers, credit card companies, collection agencies or any other industry. Billing problems figured in nearly two of every three complaints registered with the Better Business Bureaus in 2003. Other common concerns about carriers: repeated failures to fix reported problems, inconsistent advice and miscommunication.²³

The AG’s Bureau of Consumer Fraud and Protection, which mediates consumer complaints involving many businesses, addressed more complaints about wireless providers during the first six months of 2005 than about all other telephone services combined.²⁴ The AG mediates consumer telecommunications complaints and, where appropriate, brings enforcement actions. The AG’s authority rests on its power to address enforcement of violations of state laws

²¹ See 16 NYCRR Part 12, *Consumer Complaint Procedures*.

²² New York Public Service Law § 5.3, *Jurisdiction, powers and duties of the public service commission*. Federal statute permits the PSC to address wireless providers’ “terms and conditions of service.” 47 U.S.C. 332(3)(a). The AG is not suggesting that the PSC seek to regulate wireless carriers’ rates.

²³ June 24, 2005 *Initial Comments of AARP, Asian Law Caucus, Consumers Union, Disability Rights Advocates, National Association of State PIRGs, National Consumer Law Center* at 2, filed in FCC CC Docket No. 98-170 and CG Docket No. 04-208 - *In the Matter of Truth-in-Billing and Billing Format National Association of State Utility Consumer Advocates’ Petition for Declaratory Ruling Regarding Truth-in-Billing: Further Notice of Proposed Rulemaking*.

²⁴ During the first half of 2005, 1,012 customers lodged complaints with the AG about wireless services compared with 925 complaints about all other telephone services. To date, wireless complaints have thus grown to comprise 52.2% of total telecommunications complaints received by the AG’s office in 2005, compared with 47.7% of all telecommunications complaints received in 2004.

prohibiting false advertising and other deceptive acts and practices by dishonest businesses, including telephone providers.²⁵ Given the number of customer complaints in the telecommunications field, it is essential that both the AG and the PSC each exercise their jurisdiction to protect consumers.

C. The Commission Should Ensure That Adequate Service Is Provided By All Competitors.

Important economic, health and safety interests depend on a modern, reliable phone network. New York's business sector is highly reliant on telecommunications, and degraded service would threaten the state's economic stability and growth. Emergency access to police, fire, and medical assistance is of vital importance, and must not be put in jeopardy by poor service, regardless of the technology used.

Verizon and the smaller ILECs still own the vast majority of the loops connecting customers to the PSTN. Thus, not only do ILEC customers rely on their provider's maintenance of network facilities, but so too do those customers who have switched to alternative providers. VoIP, wireless and cable providers still terminate most subscribers' calls on Verizon's facilities and are likely to continue to do so for years. Indeed, DSL-based VoIP is entirely dependent on

²⁵ See e.g. New York General Business Law §§ 349, 350 and Executive Law § 63(12). Examples of AG enforcement actions include: Jun. 2004 AT&T Assurance of Discontinuance (erroneous long distance bills for minimum monthly charge) http://www.oag.state.ny.us/telecommunications/filings/Att_assurance.pdf; Jul. 2001 RCN Assurance of Discontinuance (slamming, marketing practices) http://www.oag.state.ny.us/telecommunications/filings/rcn_slamming_assurance.html; Nov. 1999 AT&T Assurance of Discontinuance (advertising claims) <http://www.oag.state.ny.us/telecommunications/filings/att/index.html>; 1999 MCI Assurance of Discontinuance (misrepresentation of bill charges) http://www.oag.state.ny.us/telecommunications/filings/MCI_discontinuance_index.html; Aug. 1999 Qwest Communications Assurance of Communications (deceptive marketing practices) <http://www.oag.state.ny.us/telecommunications/filings/qwest/index.html>. See also *Oncor Communications v. State*, 165 Misc. 2d 262 (Albany Co. Supreme Ct. 1995), *affirmed* 218 A.D.2d 60 (3rd Dep't 1966) (slamming).

the ILECs' maintenance of their copper loop network. If a subscriber to VoIP or to another intermodal provider is unable to make calls due to inadequate service from an ILEC, the source of the defective connection will not be apparent to the customer, who is likely to blame the intermodal alternative provider and thereafter view it as unreliable. Thus, the quality of service that ILECs provide directly affects the viability of new entrants.

The most effective way to ensure the PSTN's reliability is to measure providers' actual performance, and to enforce existing objective service quality standards.²⁶ The PSC should assure adequate service by all providers so that the public can be confident that they are not risking their safety or communications reliability by switching to a newer mode of telephone service offered by a cable or VoIP provider.

The Commission should not further streamline the existing service quality regulations unless and until intermodal competition is sufficiently advanced. Current predictions are no guarantee of future performance. For example, the Commission made revisions to the telephone service quality standards in 2000 expecting CLECs to develop, using the UNE-P mode of entry.²⁷ As noted in Point A above, this assumption proved inaccurate. The pending applications for approval of Verizon's acquisition of MCI and SBC's merger with AT&T portend further concentration, if approved. Additional "regulatory streamlining" is inappropriate at this time.

²⁶ See 16 NYCRR §§ 602-603. The AG was an active participant in the Commission's collaborative process that began in 1997 and produced the telephone service standards revisions adopted in 2000.

²⁷ See Case 97-C-0139 - *Proceeding on Motion of the Commission to Review Service Quality Standards for Telephone Companies* which amended 16 NYCRR Parts 602, 603 and § 644.2 on September 20, 2000.

The AG recognizes that service standards need to take into account technological differences between wireline, wireless, VoIP and cable providers. Thus relevant telephone service standards may need modifying to accommodate differences between competing technologies.²⁸ As noted in Point B above, high levels of complaints about wireless service quality demonstrate customer dissatisfaction and disappointment with “dead zones” and dropped calls, occurrences that do not fit readily into existing wireline service standards. Likewise, VoIP providers differ from wireline services in that VoIP cannot function when electricity service fails unless the customer has access to backup power. Accordingly, pre-subscription disclosures appropriate for VoIP providers may differ from those required of traditional wireline providers. Nevertheless, there are key common measures, such as expected repair intervals, which the PSC could apply across modes of entry to ensure adequate service for all customers, regardless of chosen provider.

There is no empirical basis for varying the degree of service quality required based on the number of providers available in a given market or region. Indeed, although local telephone competition is greatest in LATA 132 (comprising New York City, Long Island and the lower Hudson Valley), this is also the region where Verizon’s timeliness of repair performance is the worst, and this inadequate performance is chronic.²⁹ Clearly, the availability of alternative providers has not assured customers in Queens, Westchester, Nassau and East Hudson that, when an outage occurs, Verizon will restore telephone service within 24 hours.

Finally, the PSC should not substitute customer satisfaction surveys for objective

²⁸ See e.g., 16 *NYCRR* Parts 602 and 603.

²⁹ See e.g., *Verizon New York First Quarter 2005 Service Quality Report*, filed at May 18, 2005 PSC Session, pp. 3-4, 6-7.

measures of performance, as it seems to be considering. To do so would not protect consumers or assure the high quality telecommunications services business and residential customers require.

Moreover, the PSC's current method for counting the rate of customer complaints does not accurately reflect customer satisfaction and should be improved. Currently, the PSC sends all complaining customers back to the utility for initial resolution and only counts as a "complaint" a customer's subsequent contact with the Commission to report that the matter is still unresolved. The PSC's methodology does not determine how many initial callers receive adequate resolution and how many simply give up on the PSC as a source of assistance. The Commission cannot be confident that failing to hear back from the consumer signifies satisfactory resolution with the provider. To more accurately gauge customer satisfaction levels, the Commission should count all initial complaints received which are properly within its jurisdiction to address.

V. CONCLUSION

The Commission's effort to adjust the regulations applicable to wireline providers to bring them into line with those applicable to new intermodal competitors is premature. There is no basis as yet to find that these nascent competitors have enough market power to challenge the control wielded by the dominant incumbents. Instead of deregulating wireline providers, the PSC should establish a level regulatory platform that includes essential consumer protections applicable to all providers, regardless of their technology.

Dated: New York, NY
August 15, 2005

Respectfully Submitted,

ELIOT SPITZER
Attorney General of the
State of New York

By:

Mary Ellen Burns
Special Counsel

Mary Ellen Burns
Special Counsel
Public Advocacy Division

Jay L. Himes
Chief, Antitrust Bureau

Thomas G. Conway
Chief, Consumer Frauds and Protection Bureau

Keith H. Gordon
Assistant Attorney General
Telecommunications & Energy Bureau
Of Counsel

120 Broadway
New York, NY 10271
Tel No.: (212) 416-6343
Fax No.: (212) 416-8877
E-mail: keith.gordon@oag.state.ny.us

APPENDIX

Discussion of DPS Staff's Proposed Competition Index

By:

Hampton Finer, Division-Wide Economist
Lisa Vura-Weis, Economic Research Analyst
Division of Public Advocacy
Office of the New York State Attorney General

1. The DPS Staff Proposed Competition Index

The Department of Public Service (“DPS”) Staff has proposed an index to measure the potential of alternative voice services to compete effectively with Verizon. Staff has assigned each alternative service a value based on its availability and substitutability with Verizon’s wireline service. But neither the values assigned to individual alternatives nor the aggregate index derived from those values accurately measure actual consumer substitution patterns. Similarly, the index does not measure the degree to which alternative voice services constrain Verizon pricing.

As proposed, the index would score the maximum value of 3.25 when the following alternatives are present:

- one or more UNE provider (1 point if offering residential service and 0.5 points if offering business-only service),
- one or more packet-cable providers (1 point),
- two or more wireless carriers (0.5 point),
- VoIP service via DSL or cable internet (0.75 point).

Any wire center with an index value of 2.75 would be considered “unimpaired” and thereby eligible to trigger an end to various regulatory provisions. For practical purposes, a wire center

must have at least three land-based modes of service to reach the trigger value.

The DPS index attempts to measure future competition from relatively recent voice service entrants. But the new alternative services have not yet proven themselves to be complete substitutes for wireline services. Accordingly, applying regularly-used economic tools to available data, one cannot confidently predict enduring changes in market structure.

The DPS index does not fill this gap. As discussed below, neither the 2.75 standard, nor the scores assigned to the index components, has a clear economic or empirical rationale. Moreover, the index fails to consider several factors that could lead the index to overstate the degree of actual competition in local markets and to understate the persistence of Verizon's market power.

2. The Index Points Lack An Empirical Foundation.

The DPS Staff, quite appropriately, seeks to measure the potential erosion in Verizon's market power that so-called "intermodal" competition in the telecommunications industry can produce. The index offered, however, is not based on the available body of empirical research. In consequence, it does not measure the extent to which real-world users select various voice alternative services as substitutes for Verizon wireline services. Without this foundation, the index scores lack any marketplace anchor.

A growing body of professional and academic research undertakes empirically to measure intermodal competition using price, access and usage data. In particular, researchers have estimated the extent to which customer demand for wireline service changes in response to price changes for alternative voice services.³⁰ The most persuasive economic research has examined

³⁰ For a good review of the economic literature on local network competition, especially competition from wireless modes, *see* Glenn Woroch, "Local Network Competition," chapter in

the interaction of wireline and wireless service.³¹ The research shows some consumer substitution among wireline and wireless use, but not so much as to permit the conclusion that wireless service constrains wireline price.³² In fact, some evidence suggests that increased wireless usage actually stimulates demand for wireline service by wireline call recipients. In such case, wireline and wireless services complement each other rather than compete to satisfy consumer demand.³³

To date, there has been little empirical research into the competitive effects of the other voice alternatives on wireline demand, largely because these alternatives are still embryonic. Cable telephony and VoIP, in particular, are new service modes. As a result, there is only a limited time period over which to observe consumer switching behavior. At this point, there are still too few subscribers to VoIP and cable phone services to judge their ultimate competitive effects. According to the FCC, at the end of 2004, only around 3% of residential and small business lines were provided through coaxial cable connections.³⁴ Vonage, the largest VoIP

Handbook of Telecommunications Economics, edited by Martin Cave, Sumit Majumdar and Ingo Vogelsang, Elsevier, 2002

³¹See, eg., Rodini, Mark, Michael Ward and Glenn Woroch (2003), "Going Mobile: Substitution between Fixed and Mobile Access," *Telecommunications Policy*, 27, 457-476.

³² *Ibid.*

³³ See Lester Taylor, "Demand Analysis" chapter in *Handbook of Telecommunications Economics*, edited by Martin Cave, Sumit Majumdar and Ingo Vogelsang, Elsevier, 2002 for a discussion of the wireline demand stimulation effect of wireless competition. Ahn, Hyungtaik, and Myeong-ho Lee "An Econometric Analysis of Demand for Access to Mobile Telephone Networks," *Information Economics and Policy*, 11, pp.297-305 found that across 64 countries, the probability of subscribing to mobile telephone networks is positively correlated with per capita GDP and the number of fixed lines per person.

³⁴Federal Communications Commission, "Local Telephone Competition: Status as of December 31, 2004," Industry Analysis and Technology Division, Wireline Competition Bureau,

service, had only 800,000 active lines nationwide as of June 30th, 2005.³⁵

Equally important, in the telecommunications industry, price and quantity are notoriously difficult to measure accurately because of the number and complexity of the available calling plans and service bundles. This makes development of consumer demand models especially challenging. Moreover, the relative lack of available data means, more generally, that analysis of the willingness of users to substitute cable telephony or VoIP services for wireline is fraught with the potential for error.

3. The Index Weights Are Insensitive To Which Alternatives Are Present In Each Market.

The DPS index assumes that the competitive importance of a particular alternative to wireline service is unrelated to the availability and quality of other alternatives. However, most consumer choice research considers this assumption unlikely to reflect real-world product substitution behavior.³⁶ It is, instead, more realistic to assume that consumer preferences vary, depending on the quality and availability of alternatives, and so, therefore, does the competitive significance of the presence of a particular alternative.

For example, the Index assigns 0.75 points to the presence of VoIP, regardless of which other alternatives are available in a particular region. But we should expect consumers to respond to VoIP differently depending on the other available alternatives. The entry of a VoIP competitor into a market served by cable telephony might cause the DPS index trigger to be met,

July 2005.

³⁵Vonage, "Fast Facts," http://www.vonage.com/corporate/aboutus_fastfacts.php. Accessed 8/12/2005.

³⁶ See e.g., Hausman, J. and D. McFadden, "Specification Tests for the Multinomial Logit Model," *Econometrica*, Vol. 52, No. 5, pp. 1219-1240 (1984).

yet cause little consumer demand or price reaction. A more carefully-crafted index would take into account relative consumer preferences, varying the index point allotment, depending on the quality and availability of alternatives.

4. The Index Does Not Adequately Consider Consumer Resistance To Switching From Wirelines.

There is a significant part of the population that is unlikely to switch from fixed wirelines to another voice service alternative. By way of example, older individuals tend not to abandon the Verizon wirelines that form a part of the pattern of their lives. Hence, wireless-only consumers are typically young and single.³⁷

Available switching data demonstrates that, at this point, only a segment of the population is prepared to substitute an alternative voice provider for a wireline. Since wireless phone number porting started in 2003, 9 times more phone numbers have been ported from wireline to wireline than from wireline to wireless providers.³⁸ Over 631 times more numbers have been ported from wireless to wireless than from wireless to wireline.³⁹ These facts suggest that few customers are selecting wireless phones to replace their wirelines. Indeed, recent research further shows that attractive wireless offerings affect residential consumers' demand for secondary wirelines, not for their primary line. There are few indications, however, that typical wireline consumers are willing to "cut the cord" on their wired service by moving

³⁷ Rodini, Ward, Woroch at 457-476.

³⁸ Federal Communications Commission, "Trends in Telephone Service," April 2005, Table 8.10.

³⁹ *Ibid.*

exclusively to wireless service.⁴⁰

In short, some consumers are willing to switch from one wireless company to another. However, consumers in general are less apt to substitute alternatives for wireline service. Incumbent wireline companies know this. Insofar as they have the ability to price discriminate directly or through tariff design – that is, to charge more to consumers who are unlikely to switch – many consumers do not benefit at all from the mere presence of competitive alternatives. The DPS index ignores this data demonstrating reluctance to switch, and thus overstates the extent to which entry by alternatives can in fact drive competition in the market.

5. The Index Fails to Consider Regional Differences in Service Quality and Consumer Preferences.

The DPS index assumes that alternative voice services are equally competitive vis-a-vis Verizon wireline, despite differences in regional population or differences in the quality and characteristics of alternative services in particular locales. For instance, in college towns, many consumers may consider wireless and VoIP to be desirable substitutes for fixed landline service. By contrast, in regions with relatively more older or settled consumers, users are less likely to switch from wireline services to wireless or VoIP.

As these examples reflect, consumer preferences may vary by region because of population demographics. Studies suggest that such factors as income level, race, and age all affect consumer willingness to substitute wireless phones for wirelines.⁴¹ The DPS index ignores such differences, instead assigning the same points to alternatives, regardless of consumer taste.

⁴⁰ Federal Communications Commission, "Seventh Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services," Wireless Competition Bureau, July 3, 2002

⁴¹ Rodini, Ward, Woroch at 457-476.

Thus, the index erroneously tends to overstate or understate the degree of competition in any individual wire center area.

Likewise, because the index weights alternatives on an all-or-nothing basis, poor quality service or coverage is indistinguishable from ubiquitous, high quality service. Reliable cable telephony service in one region is worth the same point score as unreliable cable telephony service experienced in another. Yet, for real world consumers, reliable cable telephony service will make the alternative more attractive as a voice service substitute than will unreliable cable telephony service.

Similarly, the index does not distinguish areas with ubiquitous wireless coverage from areas with geographic features or tower density that make service spotty and inconsistent. Areas served by three or more wireless providers are not distinguished from areas served by two providers. This ignores the fact that the presence of multiple wireless carriers can, by providing off-network roaming options, improve general wireless service quality for users.

The index similarly does not capture well-documented variations in the service quality of all of the alternative modes themselves.⁴² The DPS index will overstate the extent of competition accordingly.

Further, the DPS index characterizes cable telephony as “more or less ubiquitous” in the Verizon service areas even though many consumers do not have access to both cable telephony

⁴²See Baker, Christopher and Kim-Sung, Kellie. “Understanding Consumer Concerns about the Quality of Wireless Telephone Service,” (July 2003). Research Report, AARP Public Policy Institute. <http://www.aarp.org/research/utilities/phone/aresearch-import-187-DD89.html>. Accessed 8/10/05.

See also Keynote: The Internet Performance Authority. “Where is the Dial Tone? Asks Keynote Study of Internet Telephone Service.” Press Release, July 12, 2005. http://www.keynote.com/news_events/releases_2005/05july12.html. Accessed 8/10/05.

and cable broadband capabilities. A recent FCC report indicated that, nationally, between 95 and 97.8 percent of homes were passed by cable at the end of 2003,⁴³ but other research shows that only 90 percent of homes passed by cable in fact have cable broadband available to them.⁴⁴ Thus, on a national basis, roughly 12 to 14 percent of homes may lack the ability to subscribe to cable broadband, a necessary prerequisite for cable phone services. In New York State, as a recent FCC filing indicates, less than 50 percent of homes in at least five rural counties, and less than 30 percent of homes in at least 15 rural counties, were passed by cable.⁴⁵ Bearing in mind the wire center-by-wire center analysis of “impairment” that the Staff properly envisions, cable ubiquity cannot simply be taken as given.

6. The Index Does Not Consider Potential Market Failure, Consolidation or Exit.

Finally, the index does not consider the impact on the alternatives to wireline service that changes in technology or market structure can produce. If a wire center were to attain the index trigger and regulation was, therefore, relaxed, the index does not take into account subsequent changes in the competitive environment, which could come from providers merging or exiting the market. These are readily foreseeable contingencies. The recent wave of wireless mergers, for example, has reduced the number of non-Verizon-owned wireless competitors serving New

⁴³ FCC *MVDP Eleventh Annual Report*, February 2005.

⁴⁴ Hazlett, Thomas W. “Rivalrous Telecommunications Networks With and Without Mandatory Sharing”(March 2005). AEI-Brookings Joint Center for Regulatory Studies Working Paper 05-07.

⁴⁵ FCC CS Docket No. 01-348 - *In re Consolidated Application of EchoStar Communications Corporation, General Motors Corporation, Hughes Electronics Corporation, Transferors, and EchoStar Communications Corporation, Transferee, For Authority to Transfer Control - Pegasus Communications Corporation’s Petition to Deny*, February 2, 2004, Appendix C.

York City from five (Sprint, Cingular, ATT Wireless, Nextel and T-Mobile) to three (Sprint/Nextel, Cingular/ATT Wireless and T-Mobile). In another consolidation move, Verizon has begun to acquire cable franchises in the Washington, D.C. area.⁴⁶

An index that is intended to calibrate the need for regulation should also recognize developments that reduce competition. The DPS index, however, does not envision any opportunity for index re-calculation, or for corresponding re-regulation if competition declines.

7. Recommendations

To remedy the shortcomings outlined above, we suggest an approach to measuring competition that follows conventional industrial organization and antitrust analysis. This approach would resemble the reverse of a typical merger review, which seeks to identify the potential for diminished competition due to consolidation. Here, the analysis would be directed to determining the potential for enhanced competition looking ahead.

A thorough review should first define the geographic and product markets, proceed to evaluate the competitive effects of entrants and, finally, consider potential future consolidation, market failure or exit. The extent to which intermodal alternatives compete in the same “market” as wireline services would not be assumed. Instead, it would need to be judged on the basis of empirical consumer demand and substitution patterns among alternatives. Competitive effects analysis evaluates the impact on consumer substitution, price, and Verizon’s market power as alternative voice service providers enter the market. Efforts should be made to measure market concentration, consumer switching, price changes, quality, reliability and other indications of

⁴⁶ “Verizon Pursues Local Cable Franchises,” *Washington Post*, 7/19/05, Dina ElBoghdady, p. D5.

competition. In predicting the durability of enhanced competition in the presence of alternative service providers, final regulatory decisions should also dynamically consider the interaction of such factors as service bundling, network effects, and market exit and consolidation trends.

August 15, 2005