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

JOINT COMMENTS OF COMPTEL, COVAD COMMUNICATIONS COMPANY, GILLETTE GLOBAL NETWORK, INC., D/B/A EUREKA NETWORKS, A.R.C. NETWORKS, INC., D/B/A INFOHIGHWAY COMMUNICATIONS, INTELECOM SOLUTIONS, INC., AND TRANSBEAM INC.

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CompTel, Covad Communications Company, Gillette Global Network, Inc. d/b/a Eureka Networks, A.R.C. Networks, Inc., d/b/a InfoHighway Communications, Intelecom Solutions, Inc., and Transbeam Inc., appreciate the opportunity to file comments in response to the Order Initiating Proceeding, and encourage the New York Public Service Commission to comprehensively evaluate the status of competition in each particular market and ensure that all customer classes have – and continue to have – competitive choice.

The Commission should, in this proceeding, consider all available facts and set policy goals in accordance with those facts, resisting the temptation to act upon presumptions about current market conditions or predictions as what the future may hold. The Commission must exercise extreme care before considering any policies that may limit customer's options. Thus, instead of setting in stone policies that may be harmful to competition, the Commission should ensure that wireline competition has the opportunity to grow. In other words, the PSC's "regulatory policies must remain flexible."[1] New York has been a leader in promoting

[1] In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Comments of the New York State Department of Public Service, WC Docket No. 04-313, CC Docket No. 01-338 (filed October 4, 2004), at page 2 ("NY DPS Comments").

competitive choice, and should continue policies that promote full competition for the benefit of the state's telecom consumers. Given the importance of the business telecom market to the state's economy, the Commission must continue to enable facilities-based wireline competition so that this critical market segment has the maximum amount of competitive providers from which to choose.

Of course, the two primary inputs into agency policymaking are governing law and prevailing fact. When considered here, governing law requires continued wireline competition, through access to essential network components – such as the "last mile" loop facility. Similarly, consideration of the realities of the communications marketplace leaves no other conclusion but that pro-competitive wireline policies confer tremendous benefits and must continue unabated. These conclusions apply with particular force when the subject of the analysis is the all-important business communications market. Facilities-based competitors, such as the undersigned carriers, serve this critical market, having made significant capital investments, and are thus an important component of the state's economic engine.

A. The Outcome Of The Proceeding Must Serve The Public Interest and Comply with Applicable Law

"New York has long been on record stating its strong preference for competitive markets as the most effective approach to ensure the provision of reasonably prices and reliably provided telecommunications services."[2] In other words, competition is better than regulation, as "competition is the most efficient way by which the primary goal [of ensuring quality service at reasonable rates] may be achieved."[3] However, the Commission takes care to recognize its

[2] Order Initiating Proceeding and Inviting Comments, Issued and Effective June 29, 2005, at page 2 ("Initiating Order").
[3] Id.

raison d'être – that regulation is necessary "to protect consumers from abuses by dominant suppliers of essential services."[4]

The primary goal, then, is to have multiple independent companies aggressively competing for customers, each providing a substitutable service and none having dominant market power. There can be little doubt that this is a very difficult objective – and even less doubt that we are anywhere close to that today. Thus, the regulators must continue to regulate in order for the Commission to meet its statutorily-imposed duty to serve the public interest.[5]

Even in a world in which multiple competitors compete using their own or predominantly own facilities, each competitor would at a minimum still have to interconnect its respective network, and no one (other than the incumbent) would overbuild an entire network – relying instead on facilities leased from one another or possibly neutral third parties.

Indeed, even wireless providers are still dependent on the Verizon transport infrastructure for a critical input – special access. Since the Bells are largely unregulated with respect to special access, they can easily increase costs to any wireless firms that may, for example, set aggressive retail prices. Similarly, cable firms, to the extent they choose to provide circuit switched telephony, are also somewhat dependent on Verizon interoffice transport. Thus, even where some firms or technologies have the ability to bypass Verizon for last-mile access, it would be very unusual for an "intermodal" competitor to have a fully independent network or cost structure.

In addition to the transport circuits that wireless providers and cable companies need, facilities-based wireline competitors need loops as well. There was good reason for the

[4] Id.
[5] See, e.g., NY Public Service Law, §1 et seq., and Initiating Order at page 2.

telephone network to have been a publicly-funded natural monopoly. The fact is that it remains uneconomical to duplicate much of the network, particularly the "last mile" loop. Despite advances in technology, the incumbent maintains its historic position as the gatekeeper to the customer. That simply has not changed.

None of this is to say that, over various periods of time, vast improvements in technology (in the hands of parties other than the ILECs) will not decrease the importance of access to the existing communications grid. Indeed, the stated goal of the proceeding is to review "policies, practices and rules in light of the fast changing telecommunications environment."[6] This is an important point, since outside forces – such as changes in technology, FCC rulings and court decisions – can dramatically shift the landscape quite quickly. Care must therefore be exercised to ensure that predictions about the future are not accepted as fact, for picking winners and losers is not within the Commission's purview. Instead, the Commission must maintain the flexibility noted above, to modify its regulation as changes actually take place and sufficient, verifiable facts are firmly established.

The Commission must, of course, abide by applicable law in setting its policy goals, as acknowledged in the Order Initiating Proceeding.[7] Applicable law still requires, for example, access to network elements where a carrier would be otherwise impaired, at just, reasonable, nondiscriminatory and forward looking rates, terms and conditions.[8] While the FCC is charged with the initial implementation of these provisions (except for the rate-setting), considering where the failure to provide access would "impair the ability of a carrier to provide

[6] Initiating Order at page 4.
[7] Acknowledging, for example, that a desire to eliminate certain policies, practices and rules may be limited by "current statutory constraints." Initiating Order at page 4.
[8] See, e.g., NY PSL §91-92, 47 U.S.C. §201-202, 251-252, 271. Federal law requires, inter alia, access to network elements on an unbundled basis at just and reasonable terms [47 U.S.C. §251(c)(3)] and forward-looking rates [47 U.S.C. §§251(c)(3), 252].

the services that it seeks to offer,"[9] the federalist scheme established in the Communications Act (and continued in the TRRO) requires appropriate state commission action in order to apply and enforce the FCC's broad determinations. Most significantly, however, is the Act's instruction that the FCC may not preclude the enforcement of any state commission order or policy that establishes access to elements consistent with section 251 and does not substantially prevent implementation of section 251.[10]

The New York Public Service Law requires that ILEC rates be "just and reasonable," and set by the Commission.[11] The PSL also requires the Commission to ensure that the "rules, regulations or practices" of each LEC are not "unjust, unreasonable or unjustly discriminatory or unduly preferential or in anywise in violation of law[.]"[12] The Commission may not assume that, in the absence of its rate regulation, the marketplace will always force the ILEC to charge rates that are just and reasonable, or avoid improper rules or practices, as required by law. Since the law requires such oversight by the Commission, the PSC may not avoid that responsibility.[13]

The law also requires that carriers have access to loops, transport, and other items that Verizon must offer in exchange for interLATA authority[14] – unless and until that is no longer the law. It was for that reason that the Commission required the Performance Assurance Plan – to ensure that Verizon continued to meet its obligations under the competitive checklist

[9] 47 U.S.C. §251(d)(1). In its fourth attempt to implement this portion of the Telecom Act, the FCC established general criteria to determine where carriers might be prevented from accessing broadband loops and transport as UNEs under section 251(c)(3). See Triennial Review Remand Order – Unbundled Access to Network Elements, WC Docket No. 04-313, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338, Order on Remand (rel. February 4, 2005) (hereinafter, TRRO).
[10] 47 U.S.C. §251(d)(3).
[11] See, e.g.,NY PSL §92.
[12] NY PSL §97.
[13] See, e.g., NY Public Service Commission v. Federal Power Commission, 511 F2d 338 (DC Cir. 1975). Furthermore, to the extent the PSC desired to take action that caused a rate change, it would be required to adhere to the requirements of the law that mandate hearings and other appropriate due process. See,
[14] See, e.g., NY PSL §90, et seq., 47 U.S.C. §271.

after receiving interLATA authority and not simply turn around and close the very market just declared "open to competition." It was this Commission and not the FCC that mandated what was originally termed the "anti-backsliding plan," in recognition of the importance of the items on the competitive checklist and their continued provision on adequate terms. It is noteworthy that a very complex and detailed set of measures were taken to ensure compliance with each item on the checklist, but that no such effort was ever made to ensure compliance with section 251.

These statutory provisions still carry the force of law, and must be honored and enforced. Put simply, the Commission may not permit Verizon to avoid obligations created by Congress or the Legislature, and signed into law by the President or Governor.[15] Although the Order Initiating Proceeding references the existence of the federal antitrust laws as a constraint upon anti-competitive behavior, the Commission cannot rely on antitrust remedies to replace its own enforcement of the law. Despite the clear and unmistakable presence of an antitrust savings clause in the Telecom Act of 1996, and Verizon's own acknowledgement to this Commission and the FCC that the antitrust laws remain applicable,[16] the U.S. Supreme Court has stated its intention to rely on the pervasive statutory and regulatory scheme, and enforcement thereof, in weakening the application and enforcement of the antitrust laws in this arena.[17]

With the changes taking place at the federal level, competition will flourish or perish on a state-by-state basis, as certain commissions act to preserve wireline competition. In setting policy, the Commission should consider the impact such competition has had on the state.

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[15] See, e.g., Federal Power Commission v. Texaco, Inc., 417 US 380, 400 (1974) ("It is not the Court's role, however, to overturn congressional assumptions embedded in the framework of regulation established by the Act.").
[16] See, In the Matter of Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In- Region, InterLATA Service in the State of New York, CC Docket No. 99-295 (rel. Dec. 22, 1999) ("Verizon-NY 271 Order"), at para. 430 and note 1320 ["See Bell Atlantic Application at 71 (recognizing that competitive carriers could seek 'private remedies under generally applicable statutes, including the treble-damages remedy of the federal antitrust laws.')."]
[17] See Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

By one estimate, a study by the Consumer Federation of America released in 2003, New Yorkers are saving nearly one Billion dollars per year from telecom competition.[18] Similarly, another quantification of savings, focusing more directly on the small and medium business market, indicates that New York businesses could see their bills increase by $464 Million per year if competitors were to lose reasonable access to DS1 circuits.[19] Thus, in states that act, businesses and consumers will continue to reap the benefits of aggressive price and service competition, and their economies will be reflective of those benefits, as businesses are attracted to the state and they and consumers alike cycle the savings back into the economy through expansion, hiring, and purchases of goods and services.

In the final analysis, the outcome of the proceeding should be a fostering of facilities-based wireline competition. There is no reason why a state would not want to. When competitors see an acceptable regulatory environment, and invest in a state, the state receives part of the return on that investment through cost savings that competition confers, the spending and reinvestment of those savings, and in terms of attractiveness of the state to other businesses. Failure to promote competition, on the other hand, facilitates monopoly rents that benefit the ILEC and its shareholders (wherever in the world they may be) to the detriment of in-state telecom consumers.

[18] See Competition at the Crossroads: Can Public Utility Commissions Save Local Phone Competition?, October, 2003, at page 8 ("CFA Study"). See also, Study Shows Incumbents' Arguments For Higher Wholesale Prices, Reduced Access to UNEs Don't Stand Up to Scrutiny, CFA Press Release dated October 7, 2003 ("The tremendous gains that competition and consumers have made recently will be short-lived if the incumbent carriers succeed in undermining UNE-based competition, and forcing weakened competitive carriers to build redundant telecommunications networks. If this happens, it will spell the end of local phone competition, and the real savings being enjoyed by consumers across the country will disappear.").

[19] The Economic Impact of the Elimination of DS-1 Loops and Transport as Unbundled Network Elements, Micra Microeconomic Consulting & Research Associates, Inc., dated June 29, 2004, at page 11.

B. Accurate Competitive Analysis Must be Done on a Market-by-Market Basis

As the Commission is well aware, the market for telecom services is not one giant market. It is an aggregation of sub-markets, defined in broad terms as residential, small business, mid-sized business, and enterprise. Filed along with these comments is a White Paper produced by Susan Gately and Colin Weir of Economics and Technology, Inc., that analyzes competition in the business markets and explores these critical issues in great detail.

As discussed more fully below, the prospects for non-wireline competition in the business market are very low – and the concern for continuing wireline competition that much greater. It is simply not possible (and even if it were, it would be unwise) to generalize across market segments. Competitors in one segment may not be able to compete for customers in another group, for a variety of reasons, such that one segment may enjoy much higher levels of competitiveness than another, even within the same geographic area. Since it is essential for each market to have competition – meaning multiple, independent competitors – the Commission's analysis must likewise focus on the specifics of each.

As the Commission analyzes the level of competition in each market segment, it should note the irony of the Bell argument in this proceeding that competition has reached a sufficient level that unbundling, interconnection, and other pro-competitive measures can now be relaxed. Even if competition were to reach irreversible levels, which it clearly has not today, such competitive entry in New York has resulted from those specific market-opening measures so painstakingly undertaken by the Commission and its staff. Were the Commission to eliminate those obligations, it would be eliminating the purported predicate for such removal — the loop unbundling and interconnection that makes local competition possible.

C. The Prospects for Intermodal Competition in Key Markets are Dim

"Where feasible, competition is the most efficient way by which the primary goal [of ensuring quality service at reasonable rates] may be achieved."[20] What is "competition?" Recall the mantra "irreversibly open to competition," that came into fashion during the section 271 proceedings. As the originator of the concept, the U.S. Department of Justice explained that "this standard seeks to determine whether barriers to competition that Congress sought to eliminate in the 1996 Act have in fact been fully eliminated and whether there are objective criteria to ensure that competing carriers will continue to have nondiscriminatory access to the facilities and services that they will need from the incumbent BOC."[21] The concept underlying the standard were markets open to multiple providers utilizing various modes of entry, with clear and reasonable opportunities for ongoing competition, that could not be easily thwarted by actions of the incumbent. Facilities-based competition, in turn, requires that the independent competitors utilize their own or a mix of owned and leased facilities.

Interestingly enough, Verizon had claimed just several years ago that true competition required at least four or more major competitors – and that was in the context of a market with numerous parties and very low barriers to entry.[22] In fact, Verizon ridiculed what it suggested was the lack of competitiveness in the long distance market, despite the fact that the market share Verizon enjoys today in the local market rivals that of the largest competitor in the

[20] Initiating Order, at page 2.

[21] See generally, Application by New York Telephone Company, Bell Atlantic Communications, Inc., NYNEX Long Distance, and Bell Atlantic Global Networks, Inc., for Authorization to Provide In-Region, InterLATA Service in New York, CC Docket No. 99-295, Evaluation of the United States Department of Justice, at page 7 (Nov. 1, 1999) (This was the standard promulgated by the US DOJ for recommending interLATA entry by a Bell company in a particular market, which was adopted, generally, by the states and the FCC.).

[22] See Application by New York Telephone Company, Bell Atlantic Communications, Inc., NYNEX Long Distance, and Bell Atlantic Global Networks, Inc., for Authorization to Provide In-Region, InterLATA Service in New York, CC Docket No. 99-295, Application by Bell Atlantic – New York Authorization to Provide In-Region, InterLATA Service in New York, at page 72, et seq. (Sept. 29, 1999).

long distance market at that time, and certainly none of the IXCs had the bundled service offerings that Verizon can now offer. In Verizon's parlance, there was a "cozy cartel" of carriers operating in an oligarchic fashion, that could be upset only by the entry of another major player. With that in mind, Verizon could not credibly challenge the notion that anything less than five, six or more real alternatives would be necessary in order to enable true all-services competition today.

To reach the correct conclusion, it is critical to be asking the right question. The right question is not how "vulnerable" Verizon is to competition, or whether "traditional competitors" are "losing ground."[23] This proceeding cannot concern itself with protecting Verizon's market share, just as the Justice Department would not concern itself with ensuring Microsoft's continued dominance of the PC operating system market.

Rather, the right question, properly posed by the Commission already, is how to "establish a framework for further competitive development."[24] The short answer is reasonable access to loops and transport. Loops, as the quintessential bottleneck, must be made available on reasonable, lawful terms. Access to loops is the key to true facilities-based competition in the business market since, as discussed in the Gately/Weir paper, "intermodal competition" simply does not exist in this space.

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[23] Initiating Order, at pages 8 and 21. Indeed, even Verizon's own public statements reveal a change in its "revenue mix" as its shifts its corporate focus away from traditional wireline and what it terms "growth wireline," wireless, and other businesses. Although not relevant to the ongoing analysis, since the subject is raised in the Initiating Order it should be noted that the loss of access lines by Verizon is due to factors other than the growth of competition. One factor, noted by Gately and Weir, is the elimination (primarily by residential customers) of second lines as they are replaced with DSL. See Gately/Weir at pages 8-9. Another factor, of course, is the quid pro quo of long distance entry in exchange for opening the local market, under which ILECs were expected to trade local lines for long distance and bundled-service customers. As the FCC reports indicate, however, growth in the number of lines served by competitors has leveled off, and is now declining. See http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0705.pdf.

[24] Initiating Order, at page 2.

Intermodal competition "encompasses those unique and separate arrangements" that provide service[25] – wireline, cable and wireless. As Gately and Weir point out, however, these theoretical "alternatives" are not true alternatives at all since business consumers do not view wireless as a substitute for their wireline service, and cable plant does not reach the majority of business locations.

With regard to wireless substitution in general, factual data does not support that notion that many wireless users are relying solely on wireless service. Rather, most view wireless as a useful supplement to their landline – which is precisely how companies market the wireline/wireless bundle.[26] There were, for example, more than five million new wireless phones added in New York between 2001 and 2004, as compared to a reduction in landline phones of only 1.4 million.[27] In other words, despite the explosion in the number of wireless phones, there has been no corresponding reduction in the number of wireline subscribers. Even among the limited number of New Yorkers who view wireless as a replacement for wireline, most fall into very limited demographic categories. While roughly 7% of young adults 18-24 may rely solely on wireless, 93% do not. For those aged 45-65, just 1.6% are wireless only – meaning 98.4% are not. Age aside, households with children are generally much less willing to rely solely on wireless service than those without.[28]

Similarly, the great majority of businesses view wireless as a supplement to their landline service, rather than a replacement. Businesses need reliable and secure phone service, that provides them with various functionalities not often available through wireless providers.

[25] See Gately/Weir at 10.
[26] Gately/Weir at page 22.
[27] Gately/Weir at page 18.
[28] Id.

Since the great majority of businesses operate from a fixed address, they do not share the same desire for portability that 18-24 year olds do, nor do they change addresses as frequently.

Finally, even among those subscribers who see the two services as substitutes rather than complements, their actions are unlikely to have any impact in terms of competitive discipline. With Verizon as the largest wireless provider, any move to wireless-only would likely mean more as opposed to less revenue to Verizon as many cease being (or never become) residential customers and instead become generally more profitable wireless customers. In other words, Verizon Wireless cannot be considered to be a competitor of Verizon.

Cable telephony, as noted above, simply does not reach many business customer premises and is thus not an option.[29] In those instances where a business customer could possibly be served, cable may still not prove to be a substitutable option. According to Gately and Weir, business customers may perceive shortcomings in the areas of security and reliability, since cable networks use a shared platform, and do not generally have the same level of electrical power back-up as the wireline networks.[30]

VoIP as an ostensible intermodal competitor is also fraught with many issues that call into question that presumed status. As an initial matter, VoIP requires a broadband connection to the customer – either a high-speed, wireline loop or a cable modem. In the myriad business locations without cable connections, the loop is the sole pipe over which VoIP can be provided, meaning that non-competitive high-speed service drives up the price of broadband/VoIP bundle. Reasonable competitive access to high-speed capable loops is thus

[29] See, e.g., Gately/Weir at page 12, citing Inquiry Concerning the Deployment of Advanced Telecommunications Capability, CC Docket No. 98-146, Third Report, 17 FCC Rcd 2844 (2002).
[30] Gately/Weir at page 12.

essential, for without the pipe, VoIP is like a technologically-advanced car without the road on which to drive it.

In light of the Supreme Court's Brand X decision[31] and the FCC's subsequent ruling[32] that enable broadband providers to limit access to their pipe, much of the access afforded to independent VoIP providers will likely be curtailed or foreclosed entirely. Even today, customers cannot obtain DSL from the largest in-state provider unless they also purchase Verizon's voice service (the PSC's assumption that "Verizon will make stand-alone DSL available"[33] has not (yet) become reality). As a result, non-facilities based VoIP providers are foreclosed from serving the millions of Verizon DSL subscribers since those customers will, by Verizon's dictate, already have Verizon voice service and thus no real need for VoIP. The Commission has already acknowledged that "the unavailability of stand-alone broadband could be an impediment to the proliferation of VoIP telephony."[34] Even with naked DSL, however, non-facilities based VoIP providers are simply providing a service over someone else's network – not providing one of the facilities-based alternatives that the PSC ostensibly seeks.

Carriers such as those filing these comments, however, become the critical "second pipe" to business customers – providing independent broadband and VoIP over their own network (comprised of owned and leased facilities). These companies therefore become the sought-after intermodal competitor. Covad, for example, services businesses using DS1-level access facilities. Significantly, DS1-level access facilities include not only DS1 circuits, but also DS0 circuits used to provide xDSL services with DS1-type speeds, features and support to

[31] NCTA v. Brand X Internet Services, Nos. 04-277 and 04-281, 545 U.S. ___ (2005) (released June 27, 2005; complete cite not yet available)
[32] See Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers, CC Docket No. 02-33, Report and Order (adopted August 5, 2005).
[33] NY DPS Comments, at page 10.
[34] Initiating Order, at page 8.

businesses. Furthermore, when conditions permit such providers to compete in a given market, the competitors do not generally enter one at a time, but instead constitute multiple alternative providers offering business customers a range of services, options and prices. Where such providers cannot economically compete, on the other hand, businesses would be left with no choice at all.

In order to provide a competitive option, the undersigned facilities-based carriers need reasonable, ongoing access to loops – at both the DS0 and DS1 level, and interoffice transport. While these companies have spent tens of millions of dollars deploying facilities in the state, they cannot provide service to customers without the last-mile connection. Where feasible, these carriers build and manage their own loops. Oftentimes, however, it is simply infeasible – from an operational or financial perspective (or both) – to self-provision facilities, in which case they need to lease and manage loops. In those instances they will evaluate all wholesale alternatives, including the lawful right to obtain access from Verizon.

D. The Commission Must Act to Ensure Facilities-Based Competition

Since the Commission places a premium on facilities-based competition, it must ensure reasonable access, through appropriate rates, terms and conditions on the front end, and enforcement of rights and responsibilities thereafter. An un-exercisable right, after all, is a right not worth having. The non-rate issues with which this Commission has had to wrestle are legion – ranging from access to collocation, OSS and hot cuts to billing and dispute resolution. With the ongoing issues surrounding access to loops under the federal unbundling regime (such as fiber/copper availability, Tier determinations), this Commission has a very important role to play in setting the rules. How it does so will determine whether New York State's business customers have competitive choice.

This Commission already has appropriately determined that Verizon must include its proposed Tier determinations (identification of the geographic areas within which it would prohibit access to high capacity loops and transport[35]) in its PSC tariff.[36] In so doing, the Commission cited the need for the "review and approval process inherent in tariffing"[37] and exercised, appropriately, its jurisdiction over these issues. The New York Public Service Law provides that all carrier rates, regulations and practices must be just, reasonable and nondiscriminatory, that carriers maintain rate schedules, and that the Commission may suspend the proposed effective date of tariff schedules while it reviews such filings.[38] It is essential that the Commission continue to evaluate Verizon's network element offerings, for compliance with both state and federal law.

Most importantly, however, the Commission should decide where it wants New York to be in the nationwide competitive landscape. New York has been an acknowledged leader in competition, to the benefit of its telecom users.[39] The state should decide, based on the facts, how to ensure that each market class continues to benefit from the competition for which New York has been so notable and for which this Commission strives.[40]

In considering the future of regulation, the Commission questions the impact of intermodal competition in constraining market power. Naturally, in market segments such as the

[35] The FCC has determined, for example, that carriers will not be considered impaired and therefore may not obtain UNE access to DS1 loops in wire centers that have more than 60,000 business lines and four or more fiber-based collocators. 47 C.F.R. §51.319.
[36] Case 05-C-0203, Order Implementing TRRO Changes, issued March 16, 2005.
[37] Id., at page 9.
[38] NY PSL §§ 97 and 92. Since the basis of the list of geographic wire centers submitted by Verizon is unclear and the methodologies established by the FCC are subject to interpretation, several of the undersigned carriers (and others) asked for the opportunity to participate in the tariff review process, and sought suspension of such tariffs in order to permit lawful, comprehensive reviews.
[39] See, generally, Verizon-NY 271 Order at para. 6; CFA study, at page 15 ("CFA supported the early New York model for opening competition because it was consumer-friendly and CFA hoped that it would serve as the basis for other state models").
[40] See CFA study, at page 15 ("Since New York's markets were opened, however, the stringency of market opening conditions has been relaxed and the results have been less spectacular.")

business market, where there is minimal intermodal competition, its ability to constrain the exercise of market power is de minimis. The impact of whatever little intermodal competition there is becomes further weakened when one considers that a primary source of such "competition" is other Verizon entities, such as Verizon Wireless (the nation's largest wireless carrier). Thus, intermodal competition will have little or no effect on the exercise of market power in the business market, if left unchecked by the agency charged with that responsibility.

In the final analysis, the Commission must decide, independent of external determinations, whether it desires a level of competition that provides businesses with true alternatives. With that decision made, the Commission can decide how to best achieve the desired outcome, utilizing all lawful authority. The Commission might decide, for example, that multi-provider competition is important in the business market, and that it will ensure such competition by promoting broad access to DS0 and DS1 loops at forward-looking cost-based rates, calling upon its broad authority under the Public Service Law, and Sections 201, 202, 251, 252 and 271 of the Communications Act.

Within the FCC's 251(c)(3) framework, the Commission may see a need to revisit the initial central office Tier lists to ensure access is provided where carriers remain impaired. The Commission might even disagree with an FCC interpretation of ILEC obligations under section 251 or section 271, and if necessary defend such action pursuant to the explicit preservation of state authority in, inter alia, section 251(d)(3), just as the Commission disagreed with the FCC's TELRIC holding[41] and last year's VoIP preemption order[42] and pursued those disagreements in federal court.

[41] AT&T Corp. v. Iowa Utils. Bd. 525 U.S. 366 (1999).
[42] See Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, WC Docket No. 03-211, Memorandum Opinion and Order (rel. Nov 12, 2004).

In sum, the Commission has an essential, ongoing role in the protection and promotion of facilities-based wireline competition, grounded in both state and federal law. The Commission should, upon consideration of the factual evidence, adopt policies that encourage rather than discourage further facilities-based wireline competition.

D. Conclusion

WHEREFORE, CompTel, Covad Communications, Eureka Networks, InfoHighway Communications, Intelecom Solutions, and Transbeam respectfully request that the Commission adopt policies that encourage further facilities-based wireline competition, in the public interest.

Respectfully submitted,

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HOLD THE PHONE!

Debunking the Myth of Intermodal Alternatives for Business Telecom Users In New York

prepared for
the UNE-L CLEC Coalition by

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Preface

DEBUNKING THE MYTH OF INTERMODAL ALTERNATIVES FOR BUSINESS TELECOM USERS IN NEW YORK STATE

The UNE-L CLEC Coalition is a comprised of Competitive Local Exchange Carriers (CLECs) that provide telecommunications services to business subscribers in the state of New York: XO Communications Services, Inc., Conversent Communications, LLC, Covad Communications Company, Broadview Networks, Inc. and BridgeCom International, Inc and CTC Communications, Corp.

In a recent Order investingating the impact of intermodal alterntatives on incumbent local service provider market power, the NY PSC states that among the principles governing this policymaking proceeding is that "[r]egulation should reflect market conditions" and that the "regulatory framework must be designed for the present" not for 'the fully competitive market that may ultimately develop."[1] Realizing that most of the discussions in both regulatory circles and the popular and trade press to date have focussed upon residential markets we have undertaken this study in an effort to inform the decisionmaking process relative to the conditions that exist at this point in time in the business market.

The UNE-L CLECs have asked Economics and Technology, Inc. (ETI) to prepare this report in order to provide a realistic assessment of the actual extent of intermodla competition for business local telecommunications services in New York.

This paper was prepared by Susan M. Gately, Lee L. Selwyn and Colin B. Weir. The authors gratefully acknowledge the contributions and valuable assistance provided by the members of the UNE-L CLECs in the preparation of this report. The views expressed herein are, however, those of the authors.

Boston, Massachusetts
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1. *Order* at 2.

Executive Summary

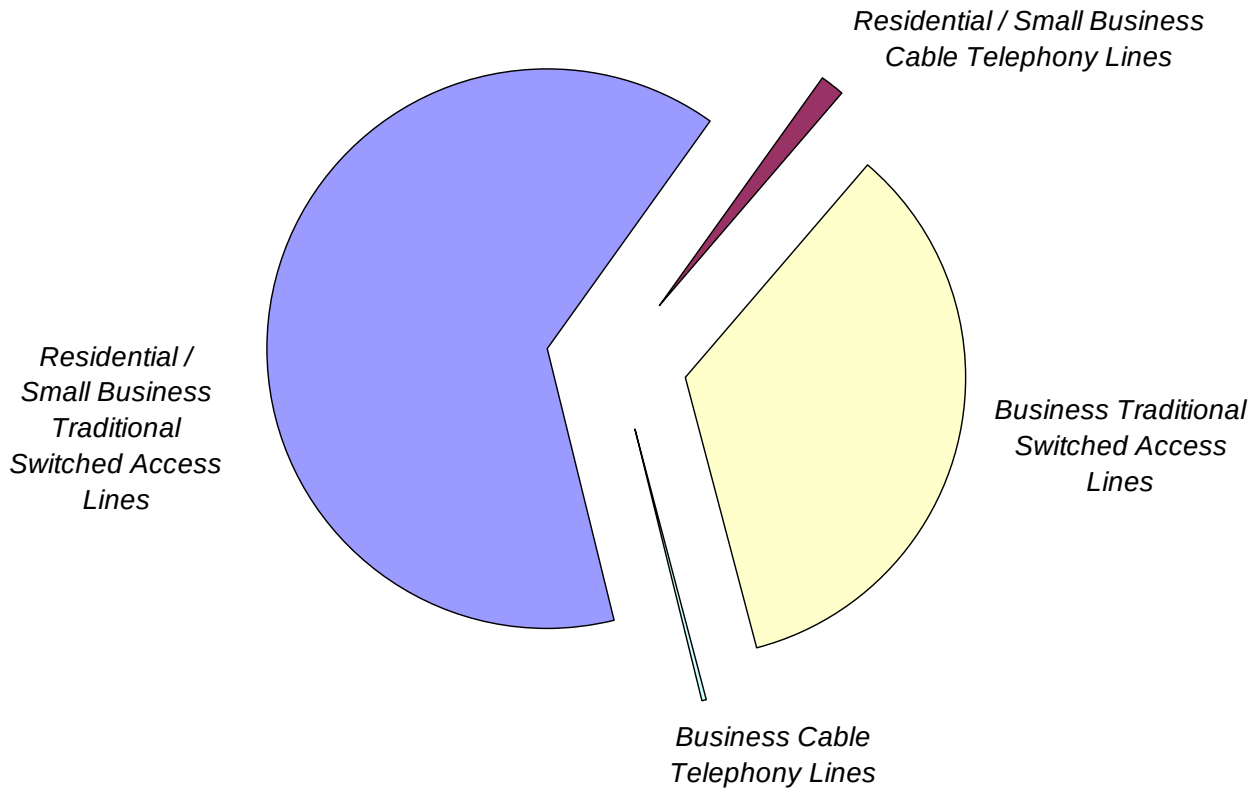
DEBUNKING THE MYTH OF INTERMODAL ALTERNATIVES FOR BUSINESS TELECOM USERS IN NEW YORK STATE

In its ongoing investigation of the impact of "intermodal competition" in the consumer market in New York upon the market power of incumbent local exchange carriers (ILEC), the New York regulators have included "small business" customers in the "consumer" market. Contrary to popular opinion, for the vast majority of business subscribers in the state of New York, intermodal telecommunications services do not represent a viable *substitute* for the traditional landline offerings of the incumbent local exchange carriers and, as such, do nothing to diminish or to constrain the market power of the incumbent provider (which, in most cases, is Verizon).

Evaluation of the impact of intermodal telecommunications alternatives upon a market requires, as a threshold matter, defining the relevant market correctly. Therefore, as an initial matter, it is necessary to evaluate residential and business markets (even very small business customers) separately because they are not in the same "relevant product market." The telecom needs of business users are sufficiently different from those of household users so as to more than overcome any superficial similarities between residential and small business telephone services that may exist with respect to the technical nature of those services.

Once the focus has been shifted to *business* telecommunications users it becomes clear that the intermodal telecommunications *alternatives* that are available in New York today do not represent *competitive substitutes* to traditional landline local exchange services. In order for the intermodal alternatives being evaluated by the PSC to constrain the market power of the incumbent LECs in New York, those services need to be *available to business users*, and they need to be viewied as and used by business customers as *substitutes* to traditional local services.

Cable telephony services (offered over coaxial cable plant) fall short of meeting this mark for business subscribers in large part because they simply are not available to them. The truth of this statement is borne out by the data on the Figure below that reveals that even with the most generous interpretation of the data possible, something less than 2% of business switched access lines in New York are reported as being provided over cable telephony services.



All available evidence demonstrates that *wireless* service, while much more generally available, is used by business subscribers as an adjunct to, rather than a replacement for, traditional landline local exchange services. While even less empirical analysis has been done on *business wireless substitution* than on residential, a 2003 study commissioned by the New Jersey BPU of 801 small businesses in New Jersey found that only one percent of businesses use wireless service as their "primary" means of communication. Corroborating this finding and extending its applicability to larger business users, Verizon, (New York's largest ILEC and largest wireless service provider), filed comments with the FCC just two months' ago estimating its share of the total market for "retail enterprise telecommunications business of large and mid-sized customers". In that analysis, Verizon *included* all of its business retail revenues, and the revenues of services far removed as "customer premises equipment (CPE), network management, and IP hosting, storage and security" but *excluded* wireless services. We are aware of no evidence that would support a finding that business users are using wireless services as a substitute for traditional landline services.

As with wireless, we are unaware of any evidence that business users have in fact begun to substitute *VoIP* for landline local services. VoIP services require a high speed internet

connection. Our analysis reveals fewer than 200,000 DSL or cable-modem high speed internet connections being used by business subscribers in the New York as of the end of 2004. Verizon does not make DSL service available to subscribers that are not subscribing to another local service line (be it Verizon's or a CLEC competitor's), meaning that small business subscribers can use VoIP with Verizon DSL only to *complement* other local service options, not as a replacement thereof. Cable modem services would provide another option, if cable service were generally deployed and available to business subscribers – but it is not.

One day, technology may truly permit businesses to utilize intermodal alternatives – those available today and those still on the drawing board or to be invented, and regulators may find it appropriate at the time to adjust regulation of incumbent service providers that provision business local services (including high speed internet access), but that day has yet to arrive in New York.

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DEBUNKING THE MYTH OF INTERMODAL ALTERNATIVES FOR BUSINESS TELECOM USERS IN NEW YORK STATE

1 INTRODUCTION

Evaluation of the effect of so called "intermodal" telecom alternatives upon the market power of an incumbent landline provider (in this case Verizon) must by informed by examination of those alternatives in terms of both availability and substitutability for relevant market segments.[2] Throughout this paper, the focus will be upon business, not residential, market segments. Contrary to popular opinion, for the vast majority of business subscribers in the state of New York, *intermodal* telecommunications services do not represent a viable *substitute* for the traditional landline offerings of the incumbent local exchange carriers and, as such, do nothing to diminish or to constrain the market power of the incumbent provider (which, in most cases, is Verizon).

To date, most discussions of *intermodal* competitive alternatives as they exist for residential, small, medium and large businesses have presumed both that intermodal services are generally *available* to subscribers in most geographic locations, and that the alternatives are viewed by purchasers as *substitutes* for traditional ILEC circuit-switched wireline phone services. Generally, these discussions fail to differentiate between residential services furnished for household use and services furnished to business purchasers of all sizes. With respect to *business* subscribers, large and small (including those the PSC has included in its "consumer" market)[3], each of the intermodal alternatives falls short of satisfying the communications needs of virtually all businesses in New York state, either because they are not *available* at the geographic locations where businesses require connectivity, or because they do not represent functionally equivalent alternatives, or both.

The FCC has recognized that intermodal alternatives are not always reasonable substitutes for ILEC wireline services due to the lack of comparability in availability, quality, price, or the

2. The *intermodal* telecommunications alternatives being evaluated by the PSC include cable telephony services, wireless services and Voice over Internet Protocol-based services (VoIP).

3. *Order Initiating Proceeding and Inviting Comments*, NY PSC Case No. 05-C-0616, *Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, Issued and Effective June 29, 2005, at 3. ("*Order"*)

maturity of the alternative provider.[4] Moreover, specific customers (or customer classes), particularly business customers, may have specialized requirements (e.g., data security or full-time reliability) that effectively preclude the use of non-ILEC non-wireline alternatives. As detailed below, at least for the present, it is clear that intermodal providers are not capable of supplying a sufficient quantity or quality of service to represent a serious competitive choice for the access needs of business customers. That being the case, intermodal alternatives cannot be relied upon to constrain the market power of the incumbent wireline service provider.

In the instant case, the NY PSC is investigating the impact that these so-called intermodal competitive alternatives have upon the market power of the incumbent local service providers in New York. The *Order* specifically focuses upon what are described as "consumer" services – both residential and small business. Combining residential and "small business" subscribers (however small business is defined) together into a single group may have had some utility when it comes to evaluating whether or not it was economically viable for facilities-based competitors to deploy owned-facilities for the last-mile connection to a customer, or whether the UNE-Platform should be available, but when evaluating the use of *intermodal* alternatives by "consumers," these two very different groups of "consumers" must be evaluated separately.

In the chapters that follow, we discuss the following:

- Why it is important to properly define the market for use of intermodal communications alternatives by business customers and distinguish that from the residential market (*Chapter 2)*.

- Why cable telephony, wireless services, and VoIP are not viable *substitutes* for business customers' use of traditional landline local services (*Chapter 3*).

- Why cable telephony, wireless services and VoIP have not reduced the incumbents market power in the markets for business local services and high speed internet access. (*Chapter 4)*

4. *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338; Federal Communications Commission, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-989; *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, *Report and Order on Remand*, 18 FCC Rcd 16978 ("*TRO*") at para. 97.

2 DEFINING THE RELEVANT PRODUCT AND GEOGRAPHIC MARKETS

Different markets exist for business and residential local exchange customers

Evaluation of the impact of intermodal telecommunications alternatives upon a market requires, as a threshold matter, correctly defining the relevant market in question. Business customers, regardless of size, depend upon and utilize telecom services differently than residential subscribers. Regardless of whether a "business" is small (perhaps a medical office with four telephone lines, or even a beauty shop with just one line) or mid-sized (such as a law firm, a brokerage office, a school, a hotel, or a publishing company) with anywhere from 10 to 100 or more telephone lines, on up to a large corporate headquarters, financial institutions or university campuses with thousands of lines, the requirements for reliable and high quality communication with the outside world are the same – and are almost always *mission-critical* from the business user's standpoint. No phone service, no orders or reservations. No phone service, no credit card authorizations. No phone service, no means of communicating with customers and addressing their inquiries and needs. No phone service, no means of efficiently communicating with suppliers and vendors. In short, no phone service, no revenues.

The PSC's *Order* talks abut the "consumer market" and includes both residential and small business subscribers in that market definition, but it is important to note that both the availability and utility of intermodal alternatives to business users (large or small) is very different than that for residence customers. Market power across the broad base of telecommunications users cannot be based upon the services available to and used by residential consumers when those residential customers' needs are not the same as the needs of other users. If, and to the extent that the PSC finds that intermodal choices available to residential consumers have reduced ILEC market power (which we do not believe to be the case), it does not follow that the ILECs will not maintain market power in the provision of service to business users, large or small.

This is not to suggest that *all businesses* of whatever size fall within the same product market with respect to their telecom needs. However, what can certainly be said is that the

telecom needs of business users are sufficiently different from those of household users so as to more than overcome any superficial similarities between residential and small business telephone services that may exist with respect to the technical nature of those services. Telecom requirements of business of all sizes are actually more similar than different, and it is far better to group large and small businesses together for purposes of market definition than it is to group those small businesses users with residential users.

A study conducted in 2003 by Rutgers University for the new Jersey Board of Public Utilities ("BPU") makes this abundantly clear. The Rutgers study surveyed 801 businesses in New Jersey as to the relative importance to them of various attributes of telecommunications service:

> The survey results also indicate that smaller businesses are not looking for anything radically different than large businesses in terms of their local telephone service. [5]

Interestingly, the survey found that *price* ranked fourth in importance to small business users in choosing a local phone service provider, and the availability of optional features (one of the purported hallmarks of VoIP services) ranked last among the factors measured. Most of the survey respondents were small businesses.[6]

> Survey participants were also asked to rate the importance of six factors in choosing local telephone service. Ratings were given on a ten point scale, with 10 being the highest. While cost is the major consideration of companies that would actively consider switching their local telephone service provider, it ranks lower than quality and service among all New Jersey small businesses.
>
> Of the six factors measured, quality (mean=9.2) and service (mean=9.1) rank the highest, both receiving a greater than 9 average rating (Table 3.5). These are followed by convenience (8.6) and price (8.5). Flexibility (7.5) is in the next tier and the package of optional services available (6.4) is considered the least important of the six factors asked about in the survey.

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5. *Local Business Telephone Service in New Jersey: A Survey of Small Businesses*, Conducted for the New Jersey Board of Public Utilities by the Eagleton Institute of Politics, Center for Public Interest Polling, The State University of New Jersey, Rutgers ("Eagleton Survey"), at 11, and footnote 3. Available online at http://www.bpu.state.nj.us/wwwroot/telco/NJBPU_LPB_REPORT.pdf (accessed August 12, 2005).

6. The survey was designed to represent all small businesses in New Jersey with 250 or fewer employees. *Id.*, at 2.

> These rankings are basically the same regardless of the size of the business, number of telephone lines serviced, annual local telephone expenditures, and current local exchange provider. [7]

Business is in its own "relevant product market"

Market definition is a central issue in competition and antitrust analysis, and formal methods have been developed to facilitate this process. The US Department of Justice/Federal Trade Commission *Horizontal Merger Guidelines*[8] describes a "relevant product market" as consisting of

> a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.[9]

In other words, products (or services) are considered to fall within the same "relevant product market" if consumers thereof consider them sufficiently close substitutes that a price increase in one product would result in a sufficiently large shift in demand to the substitute product as to make the price increase unprofitable.

The *Guidelines* suggest the following analytical process for making this assessment:

> In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following:

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7. *Id.*., at 23.

8. U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, ("*Horizontal Merger Guidelines*") available at: http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html (accessed July 12, 2005).

9. *Horizontal Merger Guidelines*, at §1.11.

(1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables;

(2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables;

(3) the influence of downstream competition faced by buyers in their output markets; and

(4) the timing and costs of switching products.[10]

The outcome of these analytical determinations is influenced by both demand and supply conditions. If alternative services are simply not available to a particular market segment, then the (monopoly) supplier will be able to increase its price without a consequential loss of demand. If such substitutes as may be available are not viewed by the purchasers as providing functional parity with the (monopoly) product and will not be influenced to purchase it merely because it is slightly less expensive, the (monopoly) supplier will be able to increase its price. Except for those businesses that by their nature operate out of a mobile vehicle (such as building contractors, real estate agents, and the like), businesses of all sizes have thus far demonstrated no willingness to use wireless services in place of wireline, even though an extremely small percentage of households have "cut the cord." Indeed, the mission-critical nature of business telecommunications may, if anything, induce firms to purchase intermodal "alternatives" not as substitutes but rather to achieve redundancy if their wireline service fails. There is little doubt that even for the smallest business customers, the incumbent LEC *will* be able to impose at least a "small but significant and nontransitory" increase in price without losing so much demand as to make that increase unprofitable. Whether or not this is also the case for the residential segment (and it most likely is) there is no doubt but that virtually all small and medium-size customers either have no access to so-called "intermodal" alternatives, or where such "alternatives" are present they are not sufficiently close functional substitutes for wireline telecommunications services as to materially constrain the prices charged by the incumbent LEC. For this reason, the small and medium sized business segment cannot be grouped with residential customers into the same relevant telecommunications product market.

10. *Id.*

3 DEBUNKING THE MYTH OF INTERMODAL ALTERNATIVES: THE BIG PICTURE

Substitutes or Complements?

In order for *intermodal* alternative services to be "competitors" to traditional wireline local access services, they must fall within the same relevant product market, which means that they must be perceived by consumers as providing sufficiently similar functionality to local wireline service as to be viewed as substitutes for local wireline service. Substitutability among products or services (which can be expressed quantitatively in terms of cross-elasticities) is at best a *relative* concept. Two products or services may be substitutable under certain conditions and for certain purposes, and yet be entirely non-substitutable for other purposes.

For example, automobiles and airplanes both provide transportation between two points, and may be substitutes for one another in certain cases. A trip from New York City to Albany takes about three hours door-to-door either by car or by plane, and, cost differences aside, people making such a trip might well see cars and planes as close substitutes for this purpose. On the other hand, airplanes are not particularly practical for very short distances, such as 10 or 20 mile commutes, and cars may not be practical for short business trips exceeding 300 or 400 miles. The fact that consumers view these two alternative modes of travel as close substitutes for trips of 150 to 300 miles provides no basis whatsoever for an inference that as a general matter cars and planes are close substitutes. Those who advance the claim that wireless and VoIP are substitutes for wireline telephone service identify limited, anecdotal instances of intermodal competition, and, from that, leap to the absurd conclusion that if direct competition occurs *somewhere*, then it must be possible *everywhere*.

"Intermodal Competition" – a rationalization for deregulation?

"Intermodal competition" in telecommunications, as that term is generally used, consists of services – principally wireless and cable telephony – provided over alternative media (i.e., not incumbent telco "loop" plant) that allegedly represent *substitutes* for basic local exchange

telephone service[11]. More recently, Voice over Internet Protocol (VoIP) has been added to the short list of putative intermodal alternatives although, as we discuss below, access to VoIP services often involves the very same incumbent telco "last mile" facilities as traditional phone service. Yet for business users, large or small, it is not clear that these services are *substitutes* at all.

As explained below, the identification of cable telephony, wireless service and VoIP as *substitutes* for business subscribers' use of traditional ILEC wireline telephony often rests upon a seriously flawed and largely subjective or anecdotal analysis. The theory is that the incumbent wireline providers (in this case Verizon) do not have market power because their customers will substitute wireless service or VoIP for their wireline telephone service. Economists do not think of "substitution" as an absolute concept: Products or services may be substitutes under certain circumstances but not in others, based on customer perceptions, price points, and technical considerations. In addition, there are service quality and safety issues – in particular the lack of reliable E911 service from many VoIP and wireless providers – that raise questions about their substitutability for traditional wireline service.

Viewed solely through anecdotal evidence, these "intermodal" services may appear to be sufficient substitutes for some uses of traditional wireline telephone services: but being a *substitute* for some functionalities of the overall traditional wireline service is not the same as being a *substitute* for the entire offering. When the effect of these intermodal alternatives in constraining the continued market power of the incumbent telcos is examined in a comprehensive and analytical manner, it becomes evident that their relative importance is minimal at best. Moreover, to the extent that the very same incumbent telcos or their corporate affiliates are themselves the *source* of the putative "intermodal" alternative, characterizing these services as "competitive" with traditional wireline telephony is disingenuous (see discussion of wireless at pages 23 - 28 below).

It can't be a substitute if it isn't available

Regardless of how perfect a substitute a particular service might otherwise be, it cannot be used as a substitute if it is not available to the subscribers that might otherwise purchase it. Unfortunately for the business subscribers in New York, there is really very little need to evaluate whether cable-telephony represents a viable substitute for traditional landline services because cable telephony services are, for the most part, not deployed to the locations where businesses operate. While there may be *some* cable telephony (and high speed cable-modem

11. See the discussion in the *Order* of the need to re-examine and rationalize what is described as the "wholly inconsistent approach to the regulation of *substitute* services based on the types of technology employed." [*emphasis added*] *Order* at 4.

internet access) available to *some* business users located in mixed use (residential and business) neighborhoods, cable service is not generally available at most business locations. As is discussed in more detail in Chapter 4, cable infrastructures generally do not "pass" business locations and thus cannot readily serve the vast majority of business customers.

Even in cases in which a cable company's coaxial plant may run past a business address in mixed business/residential neighborhoods, cable telephony services may not be available to the businesses located at that address. If cable service is not already being provided within a building, cable companies frequently look to potential cable telephony subscribers to pay the costs associated with bringing cabling into the building and installing inside wiring. While a bar or restaurant located within a commercial building in a mixed use location may view delivery of cable for purposes of video programming as warranting expenditure of capital to pay for a cable provider to bring facilities into an otherwise unserved building, a small business looking only for cable telephony or high speed cable modem internet access is likely to find the up-front costs of $1000 or more to be prohibitively expensive. Corroborating what everybody knows, in the 2003 New Jersey survey of 800 small business, not one business reported using a cable company for the provision of its local service.[12] While cable deployment in New Jersey may not be identical to New York, many of the players are the same, and it is unlikely that the business subscribers in New York find themselves in a position to utilize cable-based telephony service offerings any more than those in New Jersey.

Recent announcements by cable companies of their entry into the business service market have clouded the issue somewhat. While companies such as Cablevision (through its Lightpath brand name) and TimeWarner Cable have indeed begun to develop and deploy business data services, those services *are not provided over coaxial cable facilities.* These services are being provided over fully fiber-optic networks and differ in no respect from the services offered by other facilities-based CLECs. As such, their operations will face the same hurdles as other CLECs in providing services to business customers, and their existing *cable* infrastructure will not help in the least.

The much heralded Cablevision project in Westchester County is decidedly *not* an example of cable-based telecom services being provided to business customers. Cablevision Lightpath is an *affiliate* of Cablevision, but Lightpath is a CLEC, not a cable TV company. Cablevision Lightpath describes its network as follows: "Lightpath uses fiber optic cable throughout its infrastructure, even in the coveted local loop or "last mile."[13] The services being offered by Lightpath do not involve the use of Cablevision's coaxial (video distribution) cable, and as such

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12. *Local Business Telephone Service in New Jersey: A Survey of Small Businesses* at Table 2.2.

13. See description of "LightPath's Network Advantage" on the Cablevision Lightpath website www.optimumlightpath.com/Interior84.html.

Lightpath is a traditional facilities-based CLEC and decidedly *not* an "intermodal competitor" to Verizon or any other ILEC in the business telecom services market.

Intermodal alternative services such as VoIP and Wireless lack features critical to business users

While some portions of voice service provided by intermodal alternatives are very similar to traditional wireline voice service, wireless and VoIP service differ with respect to several key elements required by business customers. Business subscribers to wireless and VoIP services, for example, are in some cases unable to obtain white pages directory listing services.[14] Historically, cable telephony services (which, as discussed above, are not generally available to business subscribers) have included white pages directory listings, but the newest VoIP based cable telephony offerings, like Cablevision's "Optimum Voice" do not include directory or directory assistance listings. Wireless service customers not only do not automatically receive a white pages listing, and they may even be prohibited from getting one.[15] For many intermodal businss customers the only option available is a separate purchase of yellow pages advertising, but a yellow pages ad won't help customers dialing directory assistance or looking up "Betty's Beauty Spot" in their local white pages directory.

An inquiry to Vonage customer service revealed that, for both Residential and Business customers, Vonage does not provide its customers with a white pages listing. The Customer Service representative referred the customer to their incumbent local phone company (Verizon) to inquire about such a listing, but was not sure if the local phone company was actually capable of providing such a service. As discussed below, in point of fact, Verizon does not make white pages directory listings available to Vonage or any other VoIP service providers' customers.[16]

Business customers who choose to use a wireless phone exclusively will find themselves in a similar bind. A representative from Verizon Wireless indicated that both residential and business customers do not receive white pages listings in their local phone books. When asked whether Verizon would provide a white pages directory listing to a Verizon Wireless subscriber

14. It is worth noting that customers of CLECs and some cable providers are able to obtain directory listings in the white pages. It is unclear whether VoIP services associated with a CLEC (e.g., AT&T's CallVantage service) would be able to provide customers with a white pages listing. However, if the pending mergers between AT&T and SBC, and MCI and Verizon are completed, the level of CLEC-affiliated VoIP service will drop precipitously.

15. *See* footnote 20 *infra*.

16. It is possible that Vonage does offer directory listing to some of its subscribers, but even if that is the case, the inability of its customer service representatives make a listing available to a new business subscriber in the case of our trial means that the at least some, if not most, Vonage customers do not have directory listings.

who wanted one, the Customer Service representative explained that Verizon expressly prohibits wireless customers from obtaining white pages listings.

Indeed, an examination of Verizon-New York's local service tariff reveals that there is no tariffed stand-alone white pages directory listing offering available to customers that are not purchasing Verizon local services.[17] Business customers of both VoIP and Wireless services would have to forgo the opportunity of having a white pages business listing if they choose to use one of these intermodal alternatives exclusively.

In large part, the inability of the existing intermodal alternatives to provide the level of service that would be necessary for business subscribers to be able to use them as *substitutes* for the traditional local services, is the fact that they are, by design, residential services. Generally, as a matter of *design* they have lower reliability indexes and a longer mean-time-to-repair (MTR) than traditional landline services, because those service levels are acceptable for the targeted product market. In other words, to the extent that any of these services have longer MTRs, or lower service quality levels, it is not necessarily a matter poor service, they simply offer a different level of service. And while a level of service that includes service outages of one or more days may be frustrating, it is possible that it is none-the-less acceptable, for *residential* home computer users. The same service levels *are not acceptable for business users*. A Dr.'s office, for example can't depend upon VoIP for its local service that rides a Verizon DSL line, because it can't have its phone service out for multiple days.

The myth of widespread access line substitution

The decline of the second line market

The recent decline in ILEC access lines has been attributed by many to the growth of competition generally and, more recently, to intermodal competition from wireless and other services. Verizon reported a decline of 1.4-million switched access (local service) lines in service in New York for the period from the end of 2 Q 2003 to the end of 2 Q 2005 representing

17. Verizon New York, Inc., PSC New York No 1., Communications, Section 9. Listings are provided without charge for "each individual line," "each PBX or intercommunicating system," "each order equipment installation with direct central office connections," "each subscriber to two-party or four-party line service." Additionally, "Access Service customers, as defined in Section 16 of this tariff, and each mobile unit or pocket receiver provided by a Radio-Telephone Utility, as described in Section 1 of this tariff, may have a billed main listing and additional listings in the alphabetical directory, subject to the same regulations as the listings of Telephone Company subscribers."

12.96% of the total 2003 base.[18] However, no substantive evidence that competitive alternatives are the only – or even the primary – source of the decline in demand for ILEC access lines has ever been presented. There have unquestionably been other economic and market forces that have contributed more significantly to access line erosion. One source may have been the economic downturn that began in 2001. The largest influence, however, is undoubtedly the substantial *growth* in the demand for high-speed Internet access via DSL and cable modem services. Beginning in the mid-1990s, the growing interest in dial-up Internet access stimulated the demand for additional residential access lines; by 2000, some 26% of all US households had at least one additional phone line.[19] DSL and cable modems *replace* those additional dial-up access lines that had been installed principally for the purpose of accessing the Internet. And, of course, the ILECs themselves provide a substantial share of these alternative (high-speed) Internet access arrangements.

Corroborating this interpretation is the fact that residential access line attrition occurred at a much greater rate than business line attrition (residential users having made up the bulk of the "2nd line for internet access" market). During the same time frame discussed above (2003 to 2005) residential access lines declined by 15.6%, while the rate of business line loss was half that at 7.7%.[20] Table 1 below demonstrates that between 2000 and 2004, the total loss of traditional access lines (whether provided by ILECs or CLECs) was less than the number of DSL and high speed cable lines that were added.

Once the transition from dial-up to high-speed Internet access has been completed, the outlook for the ILECs with respect to their basic core local telephone services is not one of continually declining demand. In fact, in New York, Verizon's share of the local wireline primary access line market remained relatively unchanged during the period 2002-2004.[21]

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18. Verizon Investor Relations website, http://investor.verizon.com/business/xls/access_lines-2q-05.xls (accessed August 15, 2005).

19. The SEC 10K Annual Reports of all of the RBOCs note significant growth in "additional residential lines" during this period. SBC Communications, filed March 10, 2000; Bellsouth Corp., filed March 2, 2000; Qwest Corporation, filed March 3, 2000; Bell Atlantic Corp., filed March 30, 1999.

20. Verizon Investor Relations website, http://investor.verizon.com/business/xls/access_lines-2q-05.xls (accessed August 15, 2005).

21. From 2002-2003, primary access lines in New York actually *increased* by 4.6%, while the most recent ARMIS data shows that lines decreased 5.6% during 2004. FCC, ARMIS Report 43-08, Operating Data Report: Table III, YE 2002-2004. Available at http://www.fcc.gov/wcb/eafs/ (accessed April 11, 2005).

Table 1
ILEC DSL is keeping pace with Cable-based High-Speed Internet Services and Growth in both combined is outpacing Access Line Losses
NEW YORK

	Number of High Speed Lines (000's)		**ADSL as % of ADSL/Coax High Speed Lines**	**Traditional Access Line Losses (000's)**
Date	**ADSL**	**Coaxial Cable**		
2000	124	378	32.8%	144
2001	286	780	36.7%	146
2002	392	1,185	33.1%	364
2003	497	1,592	31.2%	500
2004	641	1,977	32.4%	608
TOTAL '00-'04	n/a	n/a	n/a	1762

Source:Industry Analysis and Technology Division, Wireline Competition Bureau reports: *High Speed Services for Internet Access: Status as of December 31, 2004*, June 2005 at Tables 9 & 10 and *Local Telephone Competition: Status as of December 31, 2004*, July 2005 at Tables 8 & 9.

4 DEBUNKING THE MYTH OF INTERMODAL ALTERNATIVES: THE DETAILS

Cable telephony

The Commission notes that "cable telephony with its managed network and E911 capabilities, provides an option that is rapidly being accepted as an equivalent to traditional wireline services."[22] And, of the various intermodal alternatives, cable telephony, of the circuit switched variety, does track most closely to the traditional ILEC wireline service. For *residential subscribers*, the primary shortcomings vis-a-vis traditional ILEC services are the lack of power in the event of an electrical outage and, in some cases the lack of a white pages directory listing – elements that a reasonable consumer could decide to do without. For *business customers* of all sizes, however, these issues may not be so easily overlooked. For *business customers*, cable telephony is really not an option at all, because it is simply not available.

Regardless of cable telephony's merits or prospective potential as a full-fledged substitute for plain old telephone service (POTS) for residential subscribers, the substitutability of these alternatives for most *business* uses is close to nonexistent. As discussed above, most of the *business service* offerings being made by the big cable companies and their affiliates today, offerings prominently covered in the press, are not cable telephony offerings at all -- instead they are the offerings of traditional wireline CLECs, provisioned over fiber optic facilities, not coaxial cable – there is nothing *intermodal* about these offerings at all.[23]

22. *Order* at 6.

23. The most recent Cablevision 10K annual report indicates that Lightpath, the subsidiary that provides its "Commercial" telephony offerings, is a CLEC. Cablevision Systems Corp., 2005 10K Annual Report, March 16, 2005. Time Warner Cable does not appear to offer any business voice telephony service http://www.twcnyc.com/index2.bus.cfm?c=new_bus/overvw (accessed August 12, 2005). Time Warner Cables latest Quarterly Report indicates that its residential "Digital Phone" program is its only voice service. All *business* telecommunications services are provided over TimeWarner Cable's all fiber network. http://www.twcnyc.com/index2.bus.cfm?c=new_bus/privatenetwork (accessed August 12, 2005).

The three largest cable providers in New York state are Adelphia, TimeWarner, and Cablevision.[24] Of these three, only TimeWarner Cable and Cablevision presently offer voice services.[25] The voice offerings of both TimeWarner Cable and Cablevision are described as and specifically directed at *residential* customers.[26] As discussed in Chapter 3 above, cable telephony as an intermodal alternative is, quite simply, not available to business subscribers large or small.

Despite this fact, cable telephony services continue to be portrayed as, and perhaps are, the most significant facilities-based alternative to the ILECs, *even though, if true, it is true only with respect to mass market (principally residential and "home business") services*.[27] Cable is not

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24. New York PSC website, http://www.dps.state.ny.us/cable.html (accessed August 12, 2005).

25. In its last 10k (for the year ended December 31, 2003) Adelphia disclosed that its was in the process of developing a VoIP-based service for use by its cable modem subscribers that it hoped to begin offering sometime in 2005. Adelphia 10K at 6. As of August 10, 2005, no voice offering is listed among available services on Adelphia's website.

26. Time Warner Cable describes its Digital Voice offering as a "NEW Residential Phone Service." http://www.twcdigitalphone.com/newyork/index.htm (accessed August 12, 2005). Cablevision, in its latest Quarterly report to the SEC differentiates its "Consumer" VoIP voice offering (Optimum Voice) which is marketed with its traditional Cablevision offerings from its "Commercial" voice offering, which is marketed separately under the "Lightpath" brand. *See* http://www.optimumvoice.com and http://www.cablevision.com (accessed August 12, 2005); and Cablevision Systems Corp. 2nd Quarter 2005 10Q Report, August 9, 2005.

27. Throughout this report various references are made to FCC-reported competitive metrics that are disaggregated between categories of "residential and small business" and "business." The actual label for the "business" category in the FCC's reports is "other" and is described as including "medium and large business, institutional and government customers."(see *Local Competition Report: 2004* at Table 2, footnote 1.) From our review of the FCC Form 477 used by service providers to report their information, the instruction sheets that accompany those forms, and the FCC's Rules, it is our belief that the vast majority of – if not all – business lines are being reported in the "Other" category, and that the data labeled as "Residential and Small Business" likely includes *only* residential lines. The FCC had originally instituted the reporting requirements for Form 477 (the collection instrument underlying the FCC's *Local Telephone Competition* and *High Speed Services for Internet Access* reports) in an order issued on March 30, 2000. (see *Local Competition and Broadband Reporting*, CC Docket No. 99-301, *Report and Order*, 15 FCC Rcd 7717 (2000) at para 77) In that same March 2000 order the FCC states that form 477 filers providing local service telephony data should delineate residential and small business users from others "to be identified by separate billing addresses to which fewer than four lines are in service." It is this initial description found *only* in the Commission's order, not its Form 477 or its accompanying instruction sheets, that appears to be the basis of the data descriptions found and reported upon in the current FCC reports. The FCC adopted the distinction previously adopted in the *UNE Remand Order*, at paras. 292-294. The discussion in this *Order* relative to what carriers should report as "residential and small business" high speed internet access lines specifically states that carriers treat "for purposes of this information collection, the percent of total broadband lines and wireless channels used by residential and small business customers, as a group, to be synonomous with the percent of total broadband lines and wireless channels used to deliver those broadband service offerings that are, in the judgement of the respondent, used *primarily* by residential consumers." (at para. 69) In that Order, the FCC announced its desire to "monitor developments affecting certain broad categories of customers," such as residential

(continued...)

well positioned to meet the connectivity needs of business users, for several reasons.[28] First, the networks constructed by cable companies are largely designed to reach residential dwellings, not business locations. With the possible exception of local retail shopping areas interspersed within or adjacent to residential neighborhoods, cable infrastructures generally do not "pass" business locations and thus cannot readily serve the vast majority of office buildings and other business sites. In the context of its monitoring of advanced services deployment, the FCC found that:

> Residential and small business subscribers, not surprisingly, account for over 96 percent of the reported high-speed lines delivered over cable systems. This is consistent with our understanding that most cable systems are currently deployed in primarily residential areas.[29]

In addition, because cable companies are primarily oriented towards a mass-market customer base, their coaxial-based telephony and data (*i.e.*, cable modem) offerings generally fall short of ILEC offerings in the areas of service reliability and security. Cable networks do not have the same degree of back-up electrical power as do the ILEC networks, and the "shared platform" nature of cable modem service raises data security and transmission performance issues that are particularly important to business customers, who routinely transmit highly sensitive or mission-critical financial and commercial data.[30]

Given the shortcomings of CATV-provided business services, it is not surprising that cable providers reported supplying fewer than 16,000 coaxial cable modem connections to medium and large businesses *nationwide* at the time the FCC reached its conclusions in the *Triennial*

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27. (...continued)
and large business users. Although no new rules have been adopted to change the delineation of residential and small business users, the current Form 477 instructions provided by the FCC do not explicitly reference nor instruct carriers to use the "fewer than four lines" test, and in fact suggest a much more open and ambiguous test including in the definition of "residential" end user premises as places where the carrier markets service primarily designed for residential use. The Forms themselves have columns headed "residential lines" (in the case of the telephony lines) and "residential premises" (in the case of high speed internet access). As such, while it is possible that some small business lines are included in the categories identified as "residential and small business," it is far more likely that *all* business lines are included in the "other" category (which we have reported as "business" throughout this report). The FCC makes Form 477, including instructions available on its website at http://www.fcc.gov/Forms/Form477/477.pdf. *See* internal pages 52-53.

28. A group of large business users, The Ad Hoc Telecommunications User's Committee has discussed these issues in greater detail in comments it has filed in the FCC's broadband services proceeding, CC Docket No. 01-337. See, *01-227 Ad Hoc Comments,* at 17-19; and *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *Reply Comments of Ad Hoc Telecommunications Users Committee*, filed April 22, 2002, at 4-6.

29. *Inquiry Concerning the Deployment of Advanced Telecommunications Capability*, CC Docket 98-146, *Third Report*, FCC No. 02-33, 17 FCC Rcd 2844 (2002) at 2864, para. 45 (footnotes omitted, emphasis supplied).

30. This may be precisely why the cable companies are developing non-cable business platforms.

Review proceeding, and report only 87,000 such connections today.[31] Considered in relation to the roughly three million commercial buildings nationwide, these connections represent approximately 3 percent of potentially addressable business locations. Clearly, cable has thus far had minimal impact upon the ILECs' virtual monopoly on connectivity supplied to businesses, and this situation appears unlikely to change any time soon.[32]

Upgrading cable systems from their traditional one-way analog video distribution capability to a network architecture capable of supporting digital video and two-way services such as high-speed Internet access and circuit switched telephony is a costly undertaking. Moreover, the rate at which the cable systems have been adding new telephony customers has clearly been slowing nationally (see Figure 1). While New York-specific numbers are not available, the trend in New York is likely no different than the national trend. Up to now, at least, the bulk of the required investment has been directed at upgrades to support digital cable services (on-demand, pay-per-view, etc.) and Internet access, and it is not at all clear that substantial additional investment in

31. *Triennial Review Order* at 18 FCC Rcd 17010, para. 41. Citing, FCC Industry Analysis and Technology Division, Wireline Competition Bureau, *High Speed Services for Internet Access: Status as of June 30, 2002*, rel. December 2002 ("*High Speed Services for Internet Access: 2002"*). Analysis of the most recent IATD report reveals that for the period ended December 31, 2004, 2.7-million high speed coaxial cable connections serving new "residence and small business" cable high speed connections were added, and that only approximately 20,000 new coaxial cable connections were added that served business subscribers, with the total number of connections to high speed cable connections to business users still less than 90,000 in total. See, Industry Analysis and Technology Division, Wireline Competition Bureau, *High Speed Services for Internet Access: Status as of December 31, 2003*, rel. June 2004 ("*High Speed Services for Internet Access: 2003*"); *High Speed Services for Internet Access: 2002*; and, *High Speed Services for Internet Access: 2004*

32. A report issued by Cahners In-Stat Group claims that businesses account for only 5% of cable modem subscribers, and penetration is only expected to increase to 10% by 2005. *See, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *AT&T Comments*, filed April 22, 2002, at p. 41 (citing Cahners In-Stat Group, *Despite Service Provider Pratfalls, Cable Modem Subscriber Growth Remains Robust*, December 1, 2001, at p. 1).

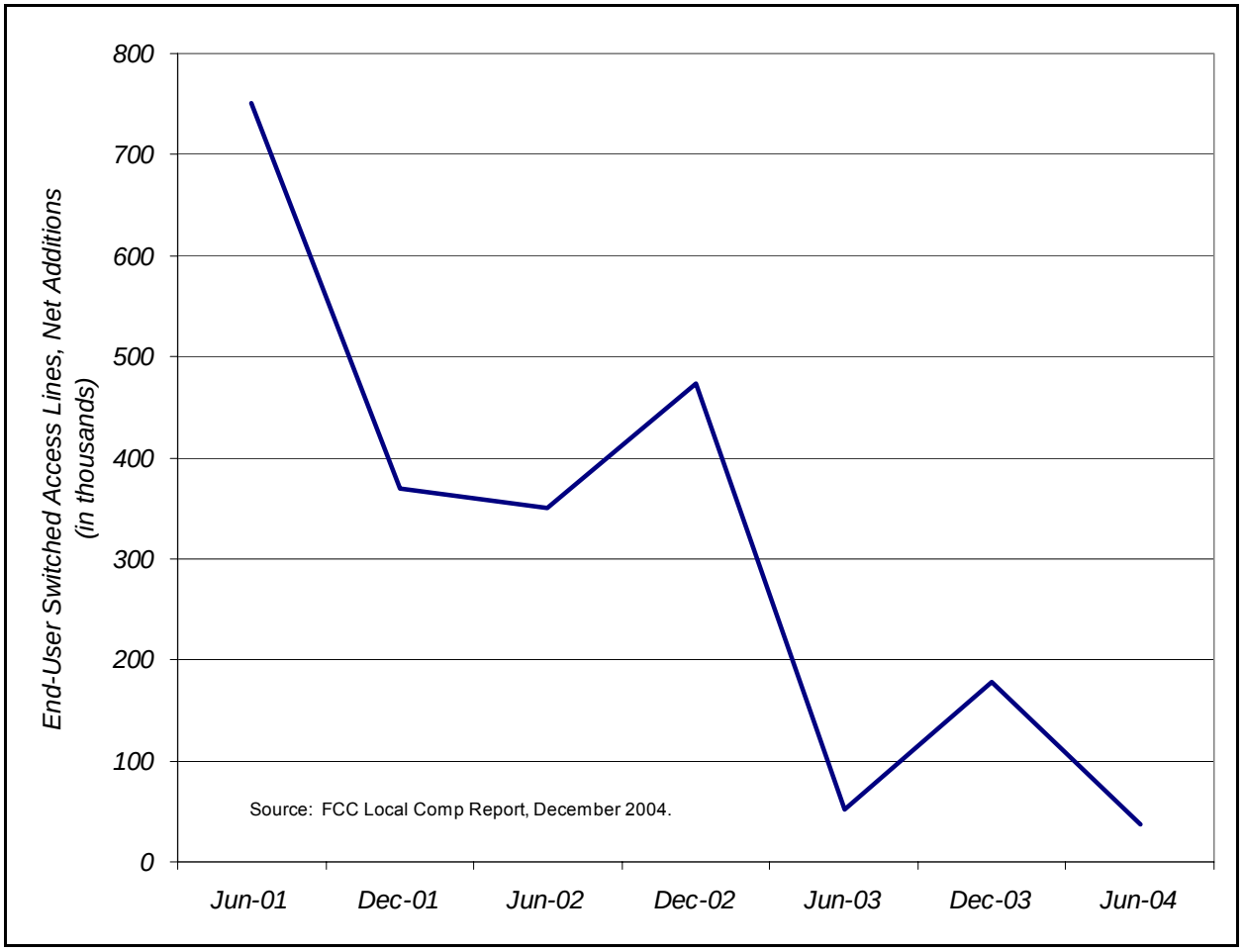

Figure 1. The rate at which cable systems have been adding new telephony customers has slowed to a trickle.

circuit-switched telephony will occur.

Cablevision, for example, a provider specifically identified in the *Order* as offering cable telephony services,[33] has implemented a VoIP offering in place of the circuit switched cable telephony offering it provided in the past (we discuss VoIP in more detail below). In fact, a review of Cablevision's most recent SEC 10-Q filing reveals that as of June 30, 2005 it had only *8,592 residential voice customers remaining across its entire operating territory, including those in New York.*[34] All other Cablevision voice customers receive service over Cablevision's

33. *Order* at 6.

34. Cablevision News Release, "Cablevision Systems Corporation Reporting Second Quarter 2005 Results" August 9, 2005, available at http://www.Cablevision.com/index.jhtml?id=2005_08_09 (accessed August 12, 2005).

Optimum Voice platform -- a VoIP-based service available *only in conjunction* with subscription to Cablevision's *Optimum OnLine* high speed cable modem service[35] Cablevision's *Optimum OnLine* cable modem service is priced at $44.95 for cable subscribers and $49.95 stand-alone. *Optimum Voice* is priced at $34.95, but requires the subscriber also to order *Optimum Online*, for a total monthly bill of $79.90 (plus the cable TV charge) or $84.90 (without cable). TimeWarner Cable (the second provider identified in the *Order* as offering cable telephony services)[36] has also announced plans to switch to a VoIP-based alternative, although it is unclear as to what extent, if at all, it has begun migrating customers in the New York area. There continues to be no indication that cable telephony's utility to or use by business customers is in any material sense increasing or operating to constrain ILEC prices and market power.

As far as medium and large business use of cable telephony services to meet data transmission needs, following an investigation, the FCC expressed skepticism of claims about cable alternatives to traditional ILEC services for enterprise customers. In the recent *Triennial Review Remand Order*, the FCC noted the following fallacies in the ILECs' assertions regarding intermodal competition from cable providers and other intermodal sources with respect to high-capacity loop facilities used by enterprise customers:

- "First, the record before us contains little evidence that cable companies are providing service at DS1 or higher capacities. ... [M]ost of the businesses served by cable companies are not large enterprise customers, but mass market small businesses that would never generate enough traffic to require a high-capacity loop."[37]

- "In addition, the record suggests that where cable companies do provide service to business customers, they provide cable modem service, rather than service that is comparable to service provided over high-capacity loops. Competitive LEC commenters explain that bandwidth, security, and other technical limitations on cable modem service render it an imperfect substitute for service provided over DS1 loops. Commenters also note that businesses that do require DS1 loops are willing to pay significantly more for them than the

35. Optimum Voice is marketed as a "exclusively for Optimum Online Customers." The Legal Disclaimer states "Optimum Voice[SM] is a cable modem service available exclusively to residential Optimum Online® customers and requires Internet access via Optimum Online to complete activation." It also states that "Optimum Voice does not support directory listed numbers, pay services or third-party billing" that it "Optimum Voice uses household electrical power to operate and will not function in the event of a power outage" and that Cablevision does not support the use of Optimum Voice as the connection between emergency medical alert systems and central station monitoring." See, Cablevision website at: http://www.optimumvoice.com/index.jhtml?pageType=legal_disclaimer (accessed August 12, 2005).

36. *Order* at 6.

37. *TRRO*, at para. 193, footnotes omitted.

cost of a cable modem connection, which also indicates that the two are not interchangeable."[38]

- Finally, at least two competitors maintain that, based on their internal data, they rarely lose enterprise customers to cable providers.[39]

Our own discussions with both CLECs and business end user customers confirms the FCC's findings. CLECs report that they rarely, if every face competition from cable telephony for business subscribers, and business customers report that cable telephony is generally not considered among the solution set when evaluating competitive local service options.

Competition from cable telephony in New York

The hype about the level of competition to traditional wireline services offered by cable telephony in New York overstates its real importance in the market. Consider the following:

- At the end of 2004, there were approximately 12-million switched access (local service) land lines in New York state, including cable telephony lines.[40]

- Of those 12-million land lines, less than 450,000 (3.75% of total lines) were provided over facilities *owned* by a CLEC,[41] including cable telephony lines.

- New York-specific data on the split of the 450,000 CLEC-owned lines between traditional telephony and cable telephony lines is not reported. Nationwide, however, cable telephony lines account for 43.6% of total CLEC-owned switched access lines (11.3% of total CLEC switched access lines).[42] Assuming the split between CLEC traditional telephony and cable telephony lines is the same in New York as in the rest of the country, that translates into approximately 195,000 cable telephony lines or 1.6% of the total switched access lines in the New York state.

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38. *Id.*

39. *Id.*

40. *Local Competition Report: 2004*, Table 6.

41. *Local Competition Report: 2004*, Table 10.

42. *Local Competition Report: 2004*, at Tables 3 and 5. Cable telephony lines as a percentage of total CLEC-owned lines determined using data from both Tables 3 and 5. Cable telephony lines as a percentage of total CLEC lines comes straight from Table 5.

- Bottom line – at the end of 2004, cable telephony lines represented something between 1.5% and 3.75% of all landlines in the state of New York.

- The story for business lines is even less compelling. 4.2-million of the 12.1-million switched access (local service lines) in New York are reported as belonging to "business" subscribers.[43] Starting with the total number of cable telephony lines in New York calculated above (roughly between 200,000 and 450,000 lines), and applying the typical residential/business split for cable telephony lines found nationwide to that total (81% residential, 19% business),[44] results in an estimate of between 35,000 and 85,000 business lines. Taken together, the data reveals cable telephony penetration into the business local exchange service market in New York is between 1% and 2% at the end of 2004.

43. *Local Competition Report: 2004* at Tables 6 and 11.

44. *Local Competition Report: 2004* at Table 5 and NCTA Industry Overview, Statistics and Resources, available at http://www.ncta.com/docs/pagecontetnt.cfm?pageID=86 (accessed August 12, 2005).

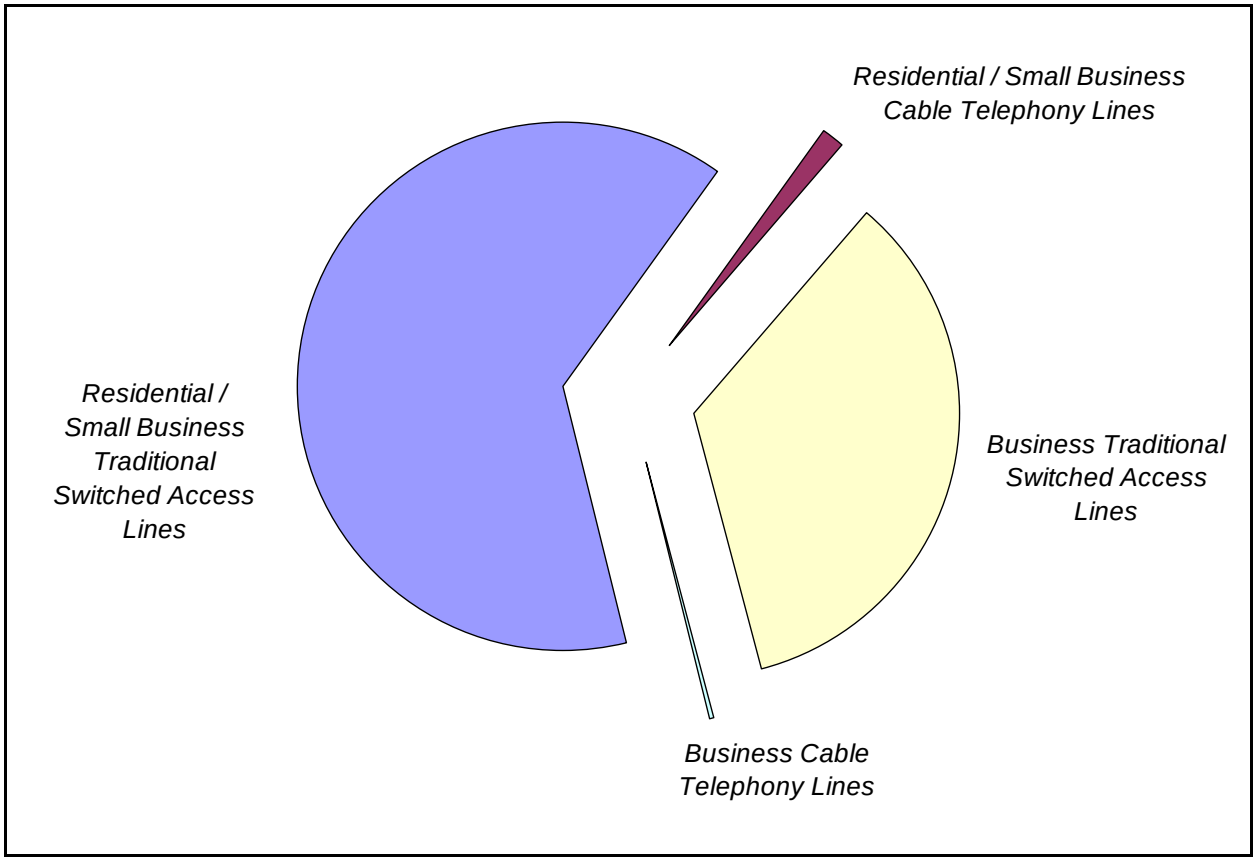

Figure 1. Cable telephony represents a small fraction of the overall end-user access lines in New York.

Figure 2 above illustrates the tiny percentage of total switched access lines accounted for by cable telephony services in the state of New York.

Wireless

The vast expansion of wireless phone subscribership in recent years has occurred with little corresponding drop in wireline service demand. This would *not be the case* if consumers (residential and business) *in general* viewed wireless as a substitute for their wireline phone. As Figure 3 demonstrates, during the 1999 to 2004 time frame, when the FCC reported a total drop of 1.8–million land lines in the state of New York, more than 6–million wireless phones were

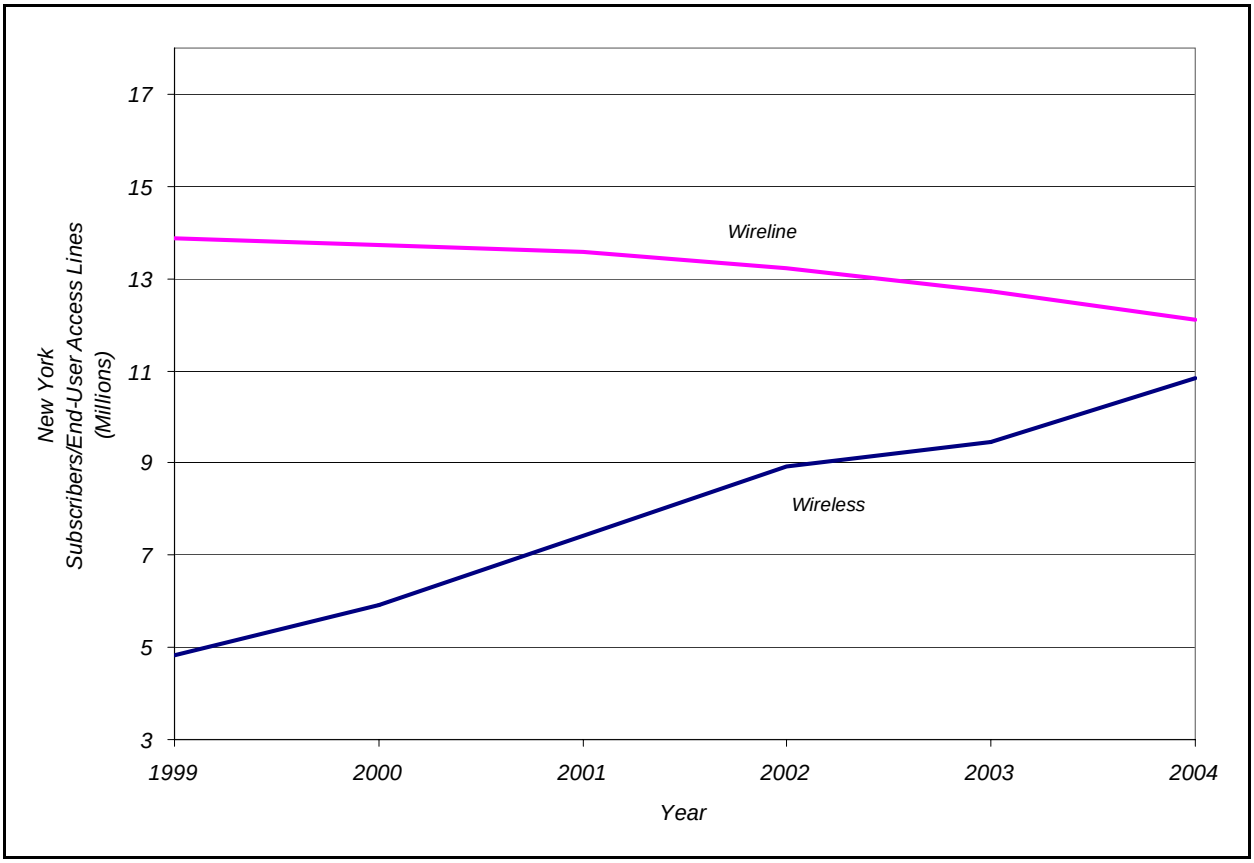

Figure 3. Complimentary Goods: Explosive growth in demand for wireless services has not been met with an equivalent drop in demand for wireline service.

added in New York.[45] Whatever intermodal substitution may be taking place is extremely limited. Consumers are subscribing to *both* services, and by doing so are confirming that they see the products as complements, not substitutes. Indeed, it is the utter *lack* of substitution of wireless for wireline by the vast majority (indeed, very close to all) of businesses and households that provide compelling, essentially *irrefutable* evidence that wireless and wireline are *not in the same relevant product market* and that *wireless is not an "intermodal competitor" or "substitute" for traditional wireline telephone service*.

A recent paper presented at the American Association of Public Opinion Research by Julian V. Luke, Stephen J. Blumberg, and Marcie L. Cynamon of the Centers for Disease Control and Prevention, National Center for Health Statistics presents an independent, unbiased view of the

45. *Local Competition Report: 2004* at Tables 7, 8 and 13.

extent of wireless substitution, and its demographics.[46] Using data from the National Health Interview Survey, January-December 2003, the authors determined that 3.1% of civilian, non-institutionalized adults have only a wireless phone, and 3.7% of all households are wireless-only.

Moreover, the small number of customers willing to substitute wireless for wireline service is by no means evenly distributed. 7.1% of adults between the ages of 18 and 24 years are "wireless-only" (and indeed, many may not have "cut the cord" so much as never had a wireline phone at all). Substitution rates are 4.3% for those 25 through 44 years, 1.6% for those 45 through 65 and 0.5% for those over 65 years old. Thus, even if 7.1% of young adults consider wireless a true substitute for wireline, 92.9% of that same demographic *do not*. Even larger percentages of older adults and senior citizens don't buy the "wireless substitution" story, and all but 2.6% of households with children were unwilling to substitute wireless for wireline services, with the highest percentage of substitution among rental households (7.5%) and adults living with roommates (8.7%) or alone (6.2%). Household size appears to play a large role in household substitution, with 6% of one person households identified as "wireless-only" but only 2.0-2.2% of households with three or more people identifying as such.

To be sure, some RBOCs, including Verizon, have cited studies (conducted by or for them) that purport to show somewhat higher, but typically still single-digit, substitution rates.[47] However, even these likely exaggerated statistics still confirm that well in excess of 90% of all households do not consider wireline and wireless to be substitutes, and hence not in the same

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46. Currently, health surveys done by these, and other, organizations use random digit dialing frames consisting of wireline-only telephone numbers. To ensure the accuracy of health surveys, researchers must control for "unreachable" customers who have substituted wireless for wireline services, including the specific demographics (and health characteristics) of the substituting populations. The authors of this paper utilized a series of questions added by the National Center for Health Statistics (NCHS) of the Centers for Disease Control and Prevention to the National Health Interview Survey (NHIS) to ascertain the prevalence and demographics of households that have substituted wireless telephone service for their residential landline telephones. Luke, Julian V., Blumberg, Steven J., and Cynamon, Marcie L., "The Prevalence of Wireless Substitution," presented at 59th Annual Conference of the American Association for Public Opinion Research, May 15, 2004; and updates from slide presentation.

47. *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review of the Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112 and CC Docket No. 00-175, Ex Parte Submission of Qwest Communications, filed October 28, 2003; *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review of the Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112 and CC Docket No. 00-175, Ex Parte Submission of Verizon Inc., filed October 15, 2003.

relevant product market.[48] Indeed, conservative estimates indicate that 94% of all wireless households also have a wireline phone.[49]

To the extent that consumers seem willing to shift their calling entirely or primarily to a wireless phone, but nevertheless retain their wireline service, there is cause for continued skepticism about whether such consumers truly perceive the two services as "substitutes." In any event, and whichever one of the various studies of wireless substitution are to be believed, the low single-digit substitution rates and skewed demographics indicated most consistently by the research on this subject cannot possibly impose any consequential constraints on the incumbent LECs' market power or prices, and there is no evidence that further growth in wireless/wireline substitution will come quickly enough, be widespread enough, or even ultimately be sufficient to discipline RBOC activities. This is especially true given E911 service location problems, and so-called "dead zones" with unreliable or no wireless coverage.

Little research has been conducted about businesses' propensity to use wireless services as a substitute or replacement for landline services. The 2003 Rutgers survey for the New Jersey DPU of 801 New Jersey small businesses found that while 45% of its respondents utilized wireless services, only 1% reported using wireless as their "primary" means of making calls.[50] Given the way the survey questions were asked, it is possible that even this 1% still maintained their traditional wireline phones. The use of wireless phones as *replacements* or *substitutes* for landline phones is unlikely to be any more prevalent with businesses in New York today,

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48. Former FCC Chairman Michael Powell, along with numerous ILECs, have cited to the substitution of wireless for wireline services as proof that the ILECs' bottleneck market power is eroding. This perception of substitution has been reinforced by the popular media, which have carried any number of stories about individuals who have "cut the cord" and now use only their wireless phone, both at home and away. Various studies have attempted to quantify this phenomenon, yet have presented widely varying results, with estimates of substitution varying from 2.5% to as much as 20% (the high end of the range is found in surveys of very limited geographic scope). Much of the variation is due to the study methodology and, where that involved customer surveys and interviews, the manner in which the specific questions were framed. For example, a study performed by RoperASW asked about households using cell phones only to make and receive calls. Other studies asked about the customer's "primary" phone, or where they make "most" of their calls. These surveys typically result in a higher rate of substitution – it is also likely that they pick up many respondents who maintain their wireline connections for incoming calls, emergencies, and occasional use.

49. TNS data indicates that 70% of US households have wireless phones, and 96% of US households have wireline phones. *See*, http://www.tnstelecoms.com/press-10-20-04.html (accessed August 12, 2005). Based upon US Census data, there are 108-million households in the country, from which we can estimate 76-million wireless households and 4-million households without wireline service. Even if we assume that 100% of all households without wireline service have wireless service, this still results in more than 94% of wireless households retaining wireline service.

50. *Local Business Telephone Service in New Jersey: A Survey of Small Businesses* at 11.

particularly given the inability of business subscribers to obtain white pages directory listings for wireless phones discussed in Chapter 2 above.

Even if the claimed wireless alternative is validly included within the same product market as basic wireline telephone service and viewed as a substitute – which it should not be – describing these services as "competitors" to ILECs – and to Verizon in particular – strains credulity to its limits. At the end of 2004, Verizon Wireless controlled some 30% of the national wireless market and it likely enjoys *substantially* larger shares within its home region in New York due to the historical grants to the RBOCs in the mid-1980s of the so-called "B-block" wireline set-aside cellular licenses and more recently to aggressive joint marketing efforts by the Verizon wireline and wireless affiliates. In the 2003 survey of small business users in New Jersey conducted for the NJ BPU, 44% of the small business respondents reported Verizon Wireless as the supplier of their wireless services.[51] Moreover, in its most recent 10 Q filing Verizon maintains that it "effectively" increased its market share again last quarter. Thus, a "loss" of a wireline phone to wireless in New York– even in the extremely limited number of cases where that actually occurs – in many, if not most instances is *not a loss* of the customer to Verizon.

Verizon offers its New York residential customers a $5 discount if they combine their wireline and wireless billing into a single account.[52] Called "One Bill," the service is expressly marketed to both residential and business subscribers.[53] Far from positioning themselves as substitutes, it appears that such joint marketing programs are more likely to stimulate additional demand for both wireline and wireless Verizon services. The fact that Verizon perceives a demand for these integrated service arrangements and benefits of joint wireline/wireless marketing programs cannot be squared with *unsupported* contentions that wireline and wireless are substitutes for the residential or business market segments.

Corroborating this finding and extending its applicability to larger business users, Verizon, (New York's largest ILEC and largest wireless service provider), filed comments with the FCC just two months' ago estimating its share of the total market for "retail enterprise telecommunications business of large and mid-sized customers". In that analysis, Verizon *included* all of its business retail revenues, and the revenues of services far removed as

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51. *Local Business Telephone Service in New Jersey: A Survey of Small Businesses* at 11.

52. Verizon New York, Inc., PSC NY No. 1, Section 2, Part AAA, 11st Revised Page 232, Effective January 20, 2005 and Section 30.1, Part AAA, Original Page 78, Effective January 20, 2005.

53. *See*, http://www.verizon.com/Business/fyb/Packages/Packages/Veriations+For+Business+/225/225_MA.htm (accessed August 12, 2005). Verizon "ONE–BILL".

"customer premises equipment (CPE), network management, and IP hosting, storage and security" but *excluded* wireless services.[54]

Use of wireless phones for long distance calling is not "intermodal competition"

The most common application in which customers may use their wireless phone from home is to originate long distance calls. Most wireless rate plans include long distance calling at no additional charge (as long as total usage stays within the block of time selected by the customer) and, where the rate plan provides "free" night and weekend calling or "free" on-net or "family" calling, or provides a block of time that significantly exceeds the customer's needs, customers would perceive wireless-originated long distance as "free." Not surprisingly, consumers have shifted substantial portions of their long distance calling to their wireless phones.[55] Despite that *usage substitution*, as noted, *very few consumers have actually disconnected their wireline service altogether*, and many still choose long distance wireline calling plans. In its financial disclosures to the SEC, Verizon provides insightful information – specifically that its revenue per wireline subscriber continues to *increase*, suggesting that Verizon continues to extract revenue from its long distance customers, including those with wireless phones which, according to believers in intermodal competition theory, constitute an easily accessible, cost-effective long distance substitute.

54. *See*, Declaration of Jeffrey E. Taylor, Appendix I to the Comments of Verizon Communications Inc., filed June 13, 2005, in the FCC Docket WC 05-25.

55. Because of the difficulty in pinning down the number of customers actually "cutting the cord," the issue of intermodal substitution for wireline local service is often cited in terms of declining wireline *minutes of use*. In fact, such statistics are extremely misleading as a means for measuring the effect of competition on local wireline incumbents. Statistics as to declining minutes of use do not provide any information as to *line* substitution of wireless (or other intermodal alternatives) for wireline services. Since most local wireline services provide flat rate outgoing local calling and unlimited inbound usage, ILEC revenues are impacted only to the extent that originating long distance calls are shifted to wireless, which is able to offer lower-priced (or "free") long distance calling precisely because wireless carriers *do not pay any originating access charges at all* and pay terminating access charges on only about half of the long distance calls that they carry. Moreover, the source of these wireless exemptions from access charges is FCC policy and not any inherent cost advantage unique to wireless carriers. It is, to say the least, disingenuous for the FCC to, on the one hand, confer an enormous competitive advantage upon the wireless industry with respect to access charge obligations and then, on the other hand, use the resulting usage substitution as a basis for portraying wireless as "competing" with wireline.

VoIP

Commercial VoIP services do not, at least today, represent a viable substitute for traditional landline local telephone access for business users, be they large or small, or somewhere in between. VoIP services require a high speed internet connection. Our analysis reveals fewer than 200,000 DSL or cable-modem high speed internet connections being used by business subscribers in the New York as of the end of 2004 -- limiting total use of VoIP by small business subscribers at that outside number.

That is not to say that business users are not experimenting with VoIP services, or using them as adjuncts to their more traditional telephony services. The hype over VoIP services has been escalating dramatically over the past several years, heightened by FCC and state commissions proceedings like this one that are attempting to grapple with unresolved regulatory concerns. Despite all of the trade press coverage and regulatory concern, VoIP deployment by businesses is still not, for the most part, being used to communicate with the outside world. At most, VoIP is being deployed in *internal* telecom systems supporting voice communication among multiple locations of the same company.

Some of the confusion over VoIP services arises from the use of the term to describe a technology and network protocol, and the use of the very same term to describe a commercial service offering utilizing that technology. When most business customers speak of "using VoIP" it is VoIP as a *protocol* utilized to transmit calls over their own internal networks. Conversely, when most residential customers speak of "using VoIP" it is using VoIP-based *services* like Vonage.

There are really only two reasons why a business subscriber would choose to utilize VoIP services in place of traditional wireline services: first, if it offered true cost savings relative to the purchase of the ILECs' circuit switched services, and second if it offered functionalities not available to voice subscribers. To be sure, some of the claims being made for VoIP are true – VoIP services do offer some functionalities that are not available with traditional voice services, and VoIP services *may* be less expensive to purchase than traditional voice services – *if a customer already subscribes to high-speed Internet access via DSL or cable modem services*. As At current rates, a small business customer has to expend $30-$40 for DSL or cable modem Internet access, *plus* $10 to $30 for VoIP service, for a total of $40 to $70 – putting the total service price for a customer that does not otherwise require high speed internet access in roughly the same range, or more as the traditional landline service. The enhanced functionalities most talked about as appealing to small business customers (the ability to have a local appearance at a location other then the customer's physical address, and the ability to utilize the same VoIP service from both an office and home location) may be compelling for a limited subset of small business subscribers, but not for most. In other words, VoIP has a long way to go before it

becomes a serious competitive threat to incumbent local carriers' provision of traditional circuit switched voice services to business subscribers..

Business customers needing less than three DS1's worth of access capacity at a given location generally find that the ILECs and cable companies are really the only show in town with respect to the "last mile" high-speed Internet access services that are essential for VoIP use.[56] This suggests that over time the prices of DSL and cable modem service are likely to drift upward. Second, as illustrated by a recent column in *PC Magazine*, VoIP lacks the quality and consistency necessary to permit widespread business adoption by business customers buying less than a full DS1 for high speed internet access (in other words, precisely the "small business" customers the PSC has combined in the "consumer" market basket in its investigation in this proceeding.) . As *PC*'s longtime technology columnist John Dvorak points out,

> [I]f you're sitting on a real T1 line rather than a DSL connection, the quality [of a VoIP call] is usually identical to the switched service. That's because the T1 line is a different level of service than flaky DSL. ... But the T1 is still the premium-level service, and the only line that appears to work flawlessly with VoIP systems all the time. ... [W]ith the current Internet slogging along under constant denial-of-service attacks and overloaded with spurious e-mail transmissions, the idea that VoIP is going to push aside land lines any time soon is wishful thinking. And now phonecos such as SBC are selling the VoIP equipment themselves, while indicating that if you use a VoIP phone that hooks to the company's switched network you are going to have to pay them – unless, of course, you use the company's VoIP service.[57]

To date, VoIP appears to have been adopted by somewhere around one to two million subscribers; however, there is no data as to the number of businesses that have *only* VoIP-based services – i.e., that have discontinued their primary wireline phone. In order for a business to use a VoIP service *in place of* traditional wireline telephone service, it would need to obtain a high-speed Internet connection independent of any wireline phone line.[58] Cable modem service would be a candidate if it were available. Otherwise, the business would typically need to order SDSL (symmetric DSL) from the ILEC or a third-party reseller, such as XO or Covad. SDSL service typically costs about $150 to $200 per month. If multiple VoIP access lines were required, a minimum of T-1 bandwidth (1.544 mbps) would be required, which typically

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56. This may change as CLECs roll-out DSL offerings of their own in the future.

57. Dvorak, John, "The Problem with VoIP Phones," *PC Magazine*, January 24, 2005.

58. Notably, Verizon does not offer so-called "Naked DSL" to its subscribers except in the limited circumstances where an existing Verizon customer that is already purchasing both local service and DSL from Verizon switches to an alternative circuit-switched local service provider. See, *Verizon Offering 'Naked DSL' After Voice Provider Switches*, TR Daily, April 18, 2005.

involves recurring rates of between $250 and $300 per month. VoIP will rarely be an economic choice as a *total substitute* for wireline telephone service for most small and medium-sized businesses, even if it were otherwise entirely equivalent in functionality, which of course it is not.

As discussed above because of VoIP's dependence upon high speed internet access connections, and the current limitations on the availability of those services VoIP as a intermodal alternative for business users remains unfulfilled. During the last 2 years only 61,000 business high speed cable connections were added nationwide: even if *all* of those new connections were added in New York (which is not plausible) they would represent only a small fraction (1.5%) of the total business lines in New York.[59] Our own analysis of high speed connections provided to business users in New York reveals similar results. Figure 4 below reveals that, of 2.8 – million high speed access lines in New York at the end of 2004, 2.6 – million of them were provided to what the FCC classifies as "residential and small business" customers – with only 186,000 high speed internet access lines (about 7% of the total) provided to the totality of "other" business, institutional and governmental users across the entire state.[60] The only conclusions that can reasonably be drawn are the following: either that high speed internet access at the speeds available through ADSL and cable modem connections are not available to business users at locations where they are needed (which is true), or that connections at those bandwidths do not meet the needs of business subscribers, or both. In either case, the very limited access high speed internet access available to date is in and of itself enough to limit VoIP's utility to small business users such that it be relied upon to offer any kind of restraint upon the pricing of ILEC services for higher bandwidth dedicated access services.

59. See footnote 16.

60. *High Speed Services for Internet Access: 2004*, at Table 11. As discussed in Chapter 2, it is appears that the "residential and small business" data is entirely residential, and the "other" category contains businesses of all sizes.

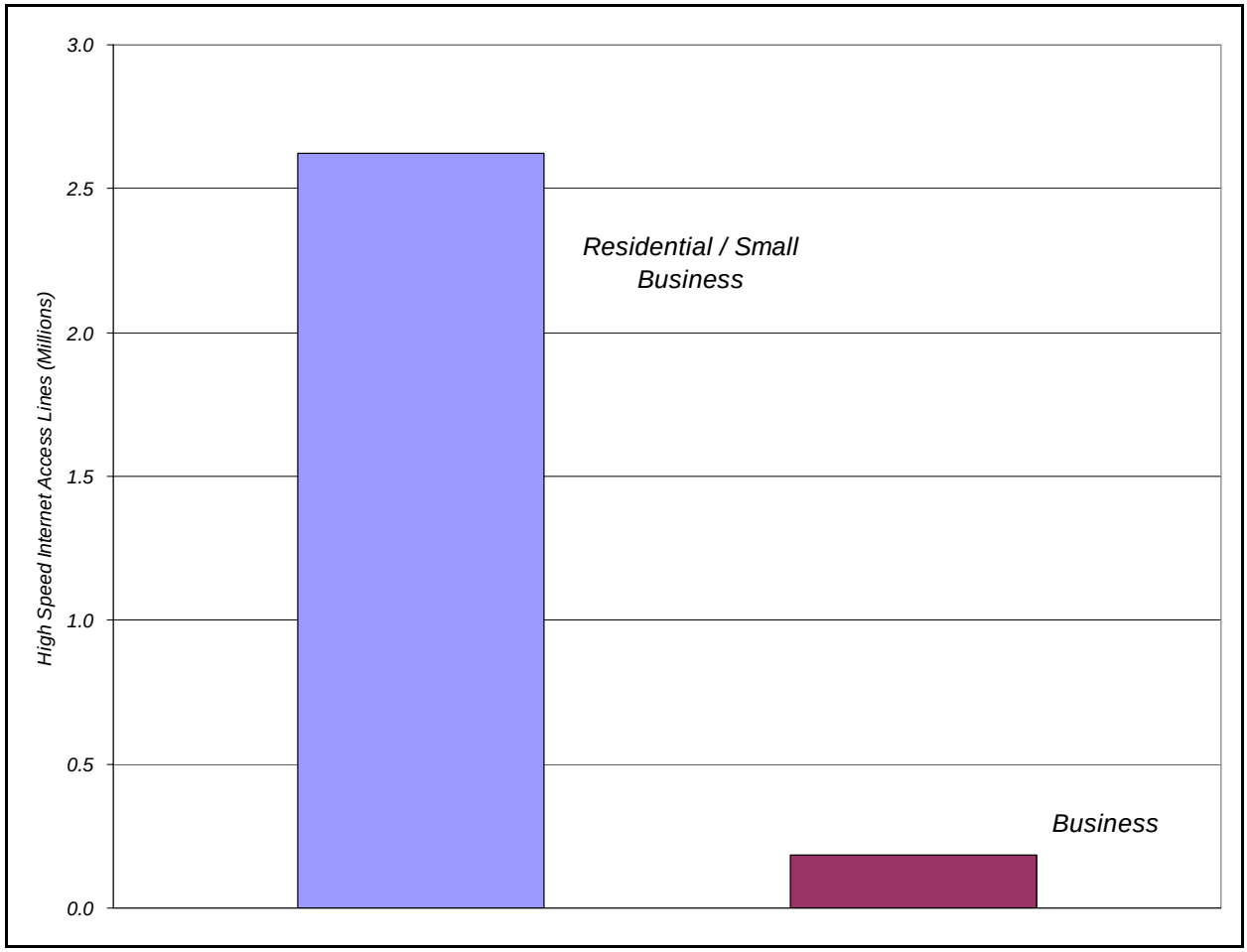

Figure 4. High Speed Internet Lines in New York are Primarily Provided to Residential Users.

Thus, it becomes clear on closer examination that the purchase of VoIP is primarily limited to a small number of computer-savvy early adopters who likely see it as a low-cost way of obtaining a second phone line, or as an inexpensive way of making long distance phone calls. VoIP is not serving as an outright alternative to traditional phone service, and there is no justification for the claim that VoIP is a sufficiently close substitute for basic wireline telephone service to constrain RBOC prices and market power.

In any event, all of the RBOCs have announced their own plans to offer VoIP services, as have cable companies such as Comcast. If, and when VoIP ever becomes a serious point-to-point voice telecommunications medium, it is the entities that control those critical last-mile

broadband links – the RBOCs and the cable operators – that will ultimately control this segment as well.

5 CONCLUSION

The future is not today

The PSC's *Order* states that among the principles governing this policymaking proceeding is that "[r]egulation should reflect market conditions" and that the "regulatory framework must be designed for the present" not for 'the fully competitive market that may ultimately develop."[61] One day, technology may truly permit businesses to utilize intermodal alternatives – those available today and those still on the drawing board or to be invented. At that time, business users of all sizes, from the local pizza parlor to the major banking conglomerates, will all have available to them a range of reliable, high-quality, and innovative telecommunications services at prices set by robust competitive market forces. Such an outcome would clearly be desirable, but it is not today's reality, and the repetitious claims as to *current* intermodal alternatives will not make it so. As we have demonstrated, neither wireless nor VoIP services are true substitutes for the business markets' use of wireline basic local exchange services, and cable telephony offerings are simply not available at the places where the vast majority of business customers are located: The evidence presented above demonstrates that these "alternatives" are not being perceived as such by business consumers because serious deficiencies in functionality, quality, reliability, and price are still present.

Most business consumers still must rely upon the wireline "last-mile" facilities provided by their local telephone company. Thus, for the present and for some time to come, wireless, VoIP may have some overlap with wireline local and long distance services, but they cannot fairly be viewed as substitutes capable of reducing an incumbent wireline providers market power.

61. *Order* at 2.