Telecommunications Competition: Where is it and Where is it Going?

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36TH ANNUAL PURC CONFERENCE

FEBRUARY 5, 2009

Where Have We Been?

- A series of telecom market-opening actions since the 1960's
- Entity later known as MCI allowed to interconnect with AT&T and resell AT&T's WATS and private line services
- Deregulation of customer premises equipment
- Deregulation of inside wiring
- Long distance entry/equal access/presubscription
- "Open Network Architecture" to facilitate local service entry

Where Have We Been?

- Telecommunications Act of 1996
  - Intended to open “all” telecommunications markets to competition
  - Designed to foster rapid development of competition in local markets served by incumbent providers
  - Three Modes of competition/entry visualized:
    - Resale of service
    - Unbundled network elements
    - Owned facilities
  - Intended to provide competitive marketplace “across the board”

Where Have We Been?

- What have we seen in the subsequent 12 years?
  - Huge rush into placement of fiber optic network facilities
  - Large numbers of start up resellers and CLECs
  - Bell company entry into long distance markets
  - State by state regulatory and court battles over the definition, cost and price of Unbundled Network Elements (UNEs)
  - Emergence and growth of the "UNE Platform" (UNE-P), up to June 2004
    - Related significant growth in CLEC market share
  - Demise of UNE-P and other aspects of FCC UNE regime due to Court of Appeals decision (USTA II)

Where Have We Been?

- What have we seen in the subsequent 12 years? (Continued)
  - Closely related demise of the two largest, nationwide mass-market CLECs (AT&T and MCI) and their absorption by the two largest ILECs—SBC and Verizon
  - Transition from UNE-P to "commercial agreements" between ILECs and CLECs
    - "UNE-P-like" offering appears to cost more, and has limitations including restriction to copper facilities (no fiber)
    - Declining CLEC residential market shares since that point

Where Have We Been?

- AT&T and MCI immediately ceased residential marketing following UNE-P elimination
- AT&T and MCI quickly lost ability to exist independently and were absorbed by SBC/Verizon
- Commercial agreement prices replacing UNE-P appear to be higher, with no marketplace alternative.
- There does not appear to be active marketing of former AT&T and MCI residential offerings by the new owner, in region or out of region. It appears the former subscriber base is declining by attrition.

Where Have We Been?

- What have we seen in the subsequent 12 years? (Continued)
  - Other technologies
    - Dramatic growth in the number of wireless subscribers such that the wireless market is at or near saturation
    - Splashy entrance by Vonage/Voice over IP (VoIP) providers, followed by legal/patent and financial difficulties
    - Increasing mass market penetration by the cable companies' internet telephony product
  - Bundling of Services— "Triple Play" and "Quadruple Play"
    - Voice/Wireless/Internet access
    - Voice/Video/Wireless/Internet Access—U-verse and FiOS

Where Are We Now?

- Has the promise or expectation of the Telecommunications Act of 1996 been met?
  - Do we have effective competition in telecommunications markets? If not, is it at least on the horizon?
  - Have markets been restructured from monopoly to effectively competitive?
  - Can it be said that lower prices and higher quality service have been the result of the market opening policy?
- This presentation is from the perspective of the residential/small business consumer—the larger business perspective may be different.

Where Are We Now?

- CLEC Mode of Entry—Most Recent FCC Local Competition Report (12/31/07 data) (CLEC reporting)
  - Resale: Total (Bus/Res) resale lines peaked in late 2005/early 2006, and have since receded from 6.7m level
  - UNE: Total UNE lines peaked June 2004 – June 2005, and have substantially receded from 19.6m to 10.6m, due to UNE-P elimination
  - Owned Facilities: Total (Bus/Res) lines have steadily increased year by year, greatly influenced by growth of cable telephony
  - Data Reporting
    - Inclusion of "commercial agreement" lines?
    - Former AT&T and MCI lines?
    - Full reporting of cable telephony?

Where Are We Now?

- CLEC Mode of Entry—Most Recent FCC Local Competition Report (12/31/07 data) (ILEC reported)
  - Resale: Declining total line counts
  - UNE: relatively flat UNE loop counts, dramatic decline in UNE-P, from 17.1m in June 2004 to 5.5m in December 2007
  - Data Reporting:
    - Treatment of "commercial agreement" lines?
    - Former AT&T and MCI lines are "ILEC" in-region, and "CLEC" out of region.

Where Are We Now?

- CLEC mode of entry (resale/UNE) for mass market residential service is in significant decline, with no evident prospects of substantial reversal
- CLECs are reliant on ILEC for local loop facilities
- ILEC controls prices & terms for both UNE-P “like” offering, and retail services against which CLEC must compete
- CLECs are precluded from using ILEC fiber loops, and restricted to ILEC copper loops, which is a very significant restriction in the marketplace

Where Are We Now?

- CLECs are pinned into a “double play” market niche of voice service and copper loop-based DSL
- CLECs cannot compete with the triple play offerings and much higher speeds of the cable companies and AT&T/Verizon (including U-verse and FiOS, respectively)
- CLECs are not able to provide more than fringe competition in residential mass markets

Where Are We Now?

- Emergence and impact of Vonage-style VoIP providers?
- Vonage, et. al. do not own or operate underlying network facilities, especially local loop. Therefore over-the-top VoIP providers are reliant on broadband service of others—the ILEC or the cable company
- Service quality issues
- Essentially limited to “single play” (Voice and features)
- Financial picture of Vonage and others appears to reflect this limitation
- As implied by its name, over-the-top VoIP is not able to provide substantial price discipline in the marketplace

Where Are We Now?

- Impact of wireless service?
- Wireless service is near saturation in the U.S.
- Wireless subscribers have more than doubled from 12/01 to 12/07
- If wireless were a direct substitute for the landline connection, this growth implies elimination of two-thirds of ILEC landlines. This has not happened.
- Wireless service is used in addition to the landline
- Wireless service makes substantial use of affiliate's landline network
- Service plans/service quality comparability?

Where Are We Now?

- “Verizon Survey shows vast majority plan to retain their home phone service indefinitely”
- “an overwhelming majority—including those who have a cell phone—say they plan to keep and continue using their landline home phone indefinitely”
- Understandably, ILECs are using control over wireline and wireless services and networks to bring about a convergence of wireline and wireless services.

Where Are We Now?

- 12 years after TA96, residential consumers are still in the same place, from a deployed facilities perspective
- Then and now, there are just two broadly deployed connections to two networks—the ILEC and the cable company
- VoIP and CLECs require and use these two local facilities connections, wireless service is used in complementary fashion
- There is substantial current rivalry between ILEC and cable, particularly for bundles. VoIP and CLEC are on the fringe. This does not provide or equate to Effective Competition!

Where Are We Now?

- Recent Price Deregulation case in Maryland
  - ILEC view of "rampant" competition and "intense competitive pressure", including VoIP and CLECs
  - Claims 15-17% of households have "cut the cord" based on survey data
  - Continuing market share gains by cable telephony (Comcast is largest player)
  - Request to be allowed 10% annual price increases
    - Prices double in seven years at that rate
    - Much larger price increase than that used by DOJ in its merger guidelines for a "small but significant and non-transitory increase in price"—5%.

Where Are We Now?

- Recent Price Deregulation Case in Maryland
  - But, actual company data provides a much different view
    - HHI indicates “highly concentrated” marketplace
    - Ongoing decline in CLEC presence in residential market
    - AT&T is not competing in the residential market
    - Claim of 17% of households’ landlines abandoned for wireless is clear and substantial overstatement
  - Maryland is somewhat unique as a state served almost entirely by one ILEC (very small area served by one other ILEC)
    - Total households can be divided using confidential data regarding ILEC, CLEC and cable landlines, and no telecom service per FCC. Residual is maximum “cord cutting” figure.

Where Are We Now?

- Recent NASUCA survey indicates many places where intraLATA toll and non-basic services (Caller ID, CW, CF, etc.) are deregulated, price increases are occurring:
  - California: intraLATA toll increases “too numerous to mention”
  - Illinois, Nevada, Ohio, Pennsylvania: intraLATA toll increases
  - Illinois: non-basic services up 57-175%
  - Maine: non-basic services up 100% over ten years
  - Nevada: non-basic services up 20-50% in past year
  - Penn.: non-basic services up 6-175 in one year
  - Texas: non-basic services up 42-185% since 1999.

Where Are We Now?

- Recent NASUCA survey indicates rate increases for basic service under deregulation
  - $2.33 in Iowa
  - $2 in Illinois
  - $2.50 in Ohio (CBT)
  - $3.22 in Wisconsin
- Kansas experience
  - Many rural exchanges are being deregulated under statutory provisions, with subsequent price increases
  - “Urban” exchanges--$0.85/line residential increase November 2008

Where Are We Going?

- Market segmentation, migration strategy
- Current rivalry of bundles between cable and ILEC will cease once market shares have “settled” to an “equilibrium” (duopoly)
- Importance to many consumers of video and high speed internet services appears to be increasing, voice component of bundle is becoming more incremental
  - Cost efficiencies of VoIP
  - Direction of “Traditional telecom”?
- Cable and ILEC have both been increasing prices for non-bundled services
- Bundled service prices will begin to increase as well once rivalry has ceased, under duopoly

Where Are We Going?

- Providers of third facility for mass market?
  - Construction of third facilities based network?
    - Not likely.
    - AT&T and MCI could not make it happen even with increasing market shares, during credit boom
  - Broadband over Power line
    - Still questionable
      - Lack of scale economies?
      - Power companies have more pressing concerns in main business
  - Wireless/Clearwire
    - Extent of deployment? Required capital investment?
    - Ability to support “quadruple play”?

Where Are We Going?

- Deregulation should be premised on effective competition
- Market structure is currently duopolistic
- Further price increases should not be facilitated by deregulation policy, absent a cost basis, until duopoly structure is demonstrably supplanted by addition of facilities based providers which can constrain prices
- Prices should still be “just, reasonable and non-discriminatory”