

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of:

Review of Regulatory Requirements for
Incumbent LEC Broadband
Telecommunications Services

CC Docket No. 01-337

**REPLY COMMENTS OF
THE PEOPLE OF THE STATE OF CALIFORNIA AND
THE CALIFORNIA PUBLIC UTILITIES COMMISSION**

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The People of the State of California and the California Public Utilities Commission (“California”) hereby submit these reply comments on the Federal Communications Commission’s (“FCC”) Notice of Proposed Rulemaking (“NPRM”) regarding regulatory requirements for incumbent Local Exchange Carrier (“LEC”) broadband telecommunications services, CC Docket No. 01-337, released December 20, 2001.¹

¹ These reply comments are in response to the opening comments of SBC Communications Corporation, Sprint Corporation, AT&T Corporation, Alliance for Local Telecommunications Services and Public Service Commission of Wisconsin.

I. SUMMARY

California submits that it is premature to undertake substantial revisions to the regulatory requirements for incumbent LECs' provision of broadband services. Some limited intermodal competition such as cable modem, satellite and wireless broadband services are available to customers. However, such alternatives are not pervasive enough to eliminate the need for intramodal competition from competitive wireline broadband providers. Because the broadband market is just developing and because incumbent LECs control the local loop to almost all current and potential broadband customers,² incumbent LECs have the ability to raise competitors' costs and thus have market power that goes far beyond what might be indicated if one were to look only at current market share data.³ While the incumbent LECs argue otherwise,⁴ their control of the local loop makes continued regulation of incumbent LEC broadband services essential to the development of intramodal competition.

² See, Comments of Sprint Corporation at 2; Comments of AT&T Corp. at 9.

³ The FCC recognizes that market share data for the provision of broadband services to residential end users may not indicate whether any particular market participant is dominant (para. 47). California submits that the use of market share data as an indicator of market power is flawed for all market segments, not just for residential customers.

⁴ See, Comments of SBC Communications at 48-50.

The FCC questions whether deregulation of incumbent LEC broadband services would further the goal of the Telecommunications Act of 1996 (“the Act”) to spur investment, innovation, and lower prices. California cautions that the opposite could be true. It can be expected that the incumbent LECs, if released from broadband regulation, would prohibit potential competitors from gaining access to the advanced network components needed to provide competing services. Due to these competitive restrictions, one would expect market prices to increase, rather than decrease. Further, experience has shown that, absent competitive pressures, incumbent LECs did not rush to invest in and offer new broadband technologies such as ISDN or DSL, finding it more profitable to serve demand for broadband services through their existing data services. Even if the incumbent LECs were to invest and provide DSL services in a deregulated environment, there is no reason to think that they would do so at lower prices than would exist under regulation. To the contrary, they could be expected to maximize profits by taking advantage of their market power to charge higher prices. This would be contrary to the 1996 Act’s goal of price reductions.

California questions the FCC’s ability to establish a clear and lasting demarcation between broadband and narrowband services, and notes that the FCC did not define broadband services in the NPRM. Instead, the NPRM acknowledged that there is no widely recognized demarcation between broadband and narrowband services. The line will become increasingly blurred.

Increasingly, voice traffic may be carried over broadband connections. Thus, any regulatory demarcation that tries to differentiate high-speed data transmission from voice transmission is fraught with complications, ambiguity, and on-going enforcement problems. Indeed, significant amounts of voice service may migrate over to the broadband media. As long as the incumbent LECs remain dominant providers of local telecommunications services, deregulation of their broadband services would be premature and would jeopardize the continued ability of the FCC and the States to ensure that services used for the transmission of voice telecommunications continue to be available at high quality and reasonable rates.

In summary, California believes major modifications to the FCC's regulation of incumbent LEC broadband services, such as declaring the incumbent LECs to be non-dominant, to be premature. No party has established that current regulatory approaches are achieving results contrary to the public interest. Only if alternative broadband technologies such as satellite, point-to-point wireless, or cable modems become ubiquitous enough to eliminate incumbent LECs' market power, the FCC can revisit the issues raised in the NPRM.

II. DISCUSSION

A. Identification of Incumbent LEC-provided Broadband Services Markets

In opening the discussion of market definition, the FCC sidesteps the initial crucial step of defining broadband services and demarcating those services from

other telecommunications services. The FCC explains that it “uses” rather than “defines” the term “broadband service” with the intent to avoid pre-judging, which services belong in a product market (ftn. 37). However, an underlying assumption of the NPRM is that there is a clear demarcation between broadband services and other telecommunications services. This assumption is fallacious.⁵ Technology is developing that increasingly allows voice traffic to be carried using broadband technologies. Any attempt to carve out broadband as a technology or service distinct from voice telecommunications is fraught with complications, ambiguity, and on-going enforcement problems. Indeed, significant amounts of voice services may migrate over to the broadband media as the Internet becomes more reliable for voice transmission and as carriers deploy their own packet-switched networks.

1. Relevant Product Market (paras. 18-26)

The FCC has asked parties to identify the relevant product markets that include incumbent LEC-provided broadband services. In seeking comments on the relevant product market, the FCC cites its prior identification of two broad categories of markets for telecommunications services: the mass market, and the larger business market (para. 20). It references SBC’s view that these same

⁵ See, Comments of AT&T Corp. at 9; Comments of Alliance for Local Telecommunications Services at 5.

product markets exist for broadband services and that four service platforms exhibit sufficient substitutability to be included within the mass market for broadband services—xDSL, cable modem, satellite, and fixed wireless services (para. 21). California is concerned that this market analysis oversimplifies the relevant markets and overestimates the substitutability of the various broadband platforms.

The determination of a product market is based on an assessment of whether customers would switch to alternative products in response to a price increase in the product being examined. For antitrust purposes, products that are close substitutes for the examined product such that customers would switch to the alternative products in sufficient numbers to defeat a price increase would be considered to be in the same product market.⁶ The FCC uses a standard that products are in the same product market if they are “reasonably substitutable” (para. 18), which appears to be a much less stringent standard than the antitrust standard. While addressing the issue of market definition according to the FCC’s standard, California stresses that the fact that some consumers may substitute one product for another in some situations does not indicate that the products are close substitutes for all customers or that the market is fully competitive.

California submits that there are not two but at least three separate product markets that include broadband services: 1) residential and home office, 2) small

to medium sized businesses, and 3) large to enterprise businesses. Each product market has distinct telecommunications needs that may be met by broadband services, and customers in each product market have very few alternatives other than the incumbent LEC's services. As a result the incumbent LEC retains market power in all of the three product markets.

The residential and home office product market requires inexpensive Internet access and typically seeks faster download than upstream speeds but cannot afford the high cost of DS1 services. Cable modem service can be an alternative but, due to the need for costly cable plant upgrades, cable modem service availability is limited.

Small to medium sized businesses seek symmetrical speeds and may require an integrated voice and data solution to cut costs. This market can usually afford DS1 prices but cannot afford a DS3. Cable modem service is generally not an alternative and, due to limited availability and service needs, fixed wireless may not be a substitute. CLECs' DS1 service can be an alternative but these CLECs typically lease DS1 UNEs from the incumbent LEC, which allows the incumbent LECs to retain market power.

Large to enterprise businesses have greater bandwidth needs such as dedicated frame relay or ATM networks to connect multiple sites and may require integrated solutions of voice/data/video services at DS3 or OC3 speeds. Cable

⁶ United States Department of Justice Horizontal Merger Guidelines, Section 1.11.
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modem service is not an alternative in this market, fixed wireless is not an option for many businesses due to the line of sight issues, and satellite is not a prominent substitute. CLECs are the only alternatives but once again they typically lease facilities from the incumbent LEC.

In assessing incumbent LECs' market power, the FCC should include in the relevant market only those services that are directly substitutable for the incumbent LECs' services in the geographic areas where the incumbent LECs provide such services. There is no reason to believe that market conditions for other services or in other geographic areas have any bearing on whether the incumbent LECs possess market power for the services they are authorized to provide.

The FCC seeks comment on whether separate product markets should be defined for broadband services sold on a stand-alone basis and for those sold as part of bundled service packages (para. 24). As described more fully in comments submitted on April 5, 2002 in CC Docket 01-228, if an incumbent LEC bundles their broadband services with other services such as internet access and customer premises equipment, they must be required to also unbundle broadband service to competitors. It is California's position that incumbent LEC provisioning of broadband services should be unbundled to ensure that the rate

charged for these services is just and reasonable, and that access to bottleneck network elements is available to competitors at TELRIC-based rates.

Without unbundling and other regulatory safeguards, innovations in broadband services will be stymied. An ISP that uses an incumbent LEC's DSL service to provide Internet access services is competing directly with the incumbent LEC's Internet access services. The ISP tries, therefore, to offer value-added services that customers would not get otherwise from the ILEC directly. Without the unbundling requirement and the ability to add its own value to the DSL service, the ISP will only be able to resell the incumbent LEC's Internet access service. This will strip the ISP of the only area where it can hope to compete against the incumbent LEC.⁷

2. Relevant Geographic Market (para. 27)

The FCC seeks comment on the appropriate geographic market for each of the relevant product markets that include broadband services. California agrees with the FCC's earlier determination that the geographic scope of the markets for broadband services is local.⁸ Customers seeking competitive alternatives cannot choose services other than those offered in their immediate area. And the services

⁷ According to an NRRI report, consumers are generally more satisfied with the quality of service received from competitive DSL providers than with the quality of service received directly from Bell companies. Compared to competitive DSL providers, Bell customers waited longer for service to be initiated, received more premature bills prior to DSL being installed, and were less satisfied with technical support and customer service call assistance. There were only slight differences in the quality experiences related to speed and service disruption, with most DSL users receiving promised speeds and with service disruptions not being reported as a significant issue. Regulation of Service Quality for Advanced Service, May 2001.

offered in different locales, sometimes even within the same exchanges, can vary widely. The regional nature of broadband service providers, whether incumbent LECs, competitive LECs, or cable companies, coupled with customers' inability to take advantage of services offered elsewhere, makes it very unlikely that one carrier's pricing patterns would be constrained by competitive conditions outside its service area. For these reasons, the relevant geographic market is local in nature.

California does not believe it is fact-based or proper or to base the classification of incumbent LECs' DSL offerings based on statewide or nationwide statistics. Instead, we must look at broadband service conditions on a local level. Customers who have DSL as their only broadband choice should not lose the protection that comes with DSL being designated as a dominant broadband service on the basis that some other communities in the state or nation may be enjoying broader broadband alternatives. Further, while customers with access to only DSL may currently receive some protection due to regional tariffs that encompass areas where broadband alternatives may exist, such benefit would be lost if DSL services are detariffed. Reliance on the existence of those regional tariffs to justify deregulating DSL would be misplaced, since the tariff protections would then disappear.

⁸ See, Comments of Public Service Commission of Wisconsin at 4.

In Table 6 of the instant NPRM CC Docket 98-146, the FCC reports that California “has the largest reported number of high-speed lines” and the highest number of providers. California does not question the FCC’s findings but is concerned that the FCC may conclude on that basis that the broadband market is competitive. According to our research, hundreds of communities have access to, at most, only one mode of broadband service, leaving the majority of consumers without the ability to choose among broadband technologies. The number of broadband lines at the state level does not reflect the structure of the market at the more telling municipal and smaller levels. While the 1996 Act clearly states that advanced telecommunications services should be deployed reasonably, timely, and across all geographic regions, hundreds of thousands of consumers in California can not choose their means of broadband internet access or, worse, have no broadband internet access options at all.

3. Market Power Analysis (paras. 28-32)

The FCC seeks comment on whether incumbent LECs possess individual market power and are likely to be able to exercise such power, either by restricting their own output (“Stiglerian” market power)⁹ or by raising their rivals’ costs or restricting access to bottleneck facilities (“Bainian” market power)¹⁰ (para. 28).

⁹ A carrier may be able to raise prices by restricting its own output, which usually requires a large market share. See para. 28, fn 66.

¹⁰ A carrier may be able to raise prices by increasing its rivals’ costs or by restricting its rivals’ output through the carrier’s control of an essential input, such as access to bottleneck facilities, that its rivals need to offer their services. See para. 28, fn 67.

California does not believe that the current state of intermodal broadband competition can be described as effective, price constraining competition. At best, there currently is a duopoly of the incumbent LEC and the cable modem provider.¹¹ But for many customers, i.e., residential customers who do not have access to cable broadband and the majority of small and medium sized business customers, the incumbent LEC is the sole provider of broadband services. As a result of active regulatory actions in California,¹² competitive LECs were able to provide DSL services in California earlier than elsewhere. However, in the last two years, much of that competition has evaporated as competitors offering DSL services in competition with the incumbent LEC have exited the market. While there were three major wholesale providers of DSL service in competition with Pacific Bell/SBC in 1997, currently only one major non-ILEC provides DSL service in California, and SBC/Pacific owns equity in that company.¹³

¹¹ See, Comments of Alliance for Local Telecommunications Services at 3.

¹² Beginning almost 15 years ago, the California PUC and the California State Legislature envisioned a fully competitive telecommunications market in California and began to analyze what it would mean to the state's consumers. California Public Utilities Code 709, declaring specific telecommunications policies promoting competition in California in 1994. In April 1995, the California PUC opened a generic Investigation and Rulemaking proceeding into local competition, R.95-04-043/I.95-04-044.

¹³ Pacific Bell/SBC, through SBC's subsidiary SBC Advanced Solutions, Inc. (ASI), is by far the largest provider when it comes to DSL market share. ASI's DSL service offerings were initially provided by Pacific Bell and, as a result, ASI has been able to gain and hold market share.

Unlike other states of the nation, or the country as a whole, DSL has outpaced cable modem services in market share in California. The DSL market is dominated by the incumbent LECs in California and in other states. Satellite broadband services are available but cost substantially more than DSL cable access, and face increasing odds in attracting funding in a currently conservative financial market. Wireless broadband services are in retreat. Sprint has stopped accepting new customers for its wireless broadband service in California, and the future for its existing customers is not clear. Hopefully, the next generation of wireless may hold promise in the future.

The only genuine intermodal broadband competition is between DSL and cable modem services. However, this competition is very limited geographically for two reasons. One reason is the high level of investment and upgrades required to make cable TV systems capable of delivering broadband service. According to a 2001 NetAction report¹⁴, it would take \$21 billion to upgrade 50% of existing cable networks nationally, and another \$31 billion to upgrade the remaining networks. One factor contributing to the high cost of upgrading cable systems is the fact that upgrades often require ripping out and replacing the old one-way cable with two-way cables. The cost of upgrading California's cable network may be higher than national averages since, as one of the earliest pioneers in adopting

¹⁴ NetAction is a national nonprofit organization dedicated to promoting use of the Internet for effective grass-roots citizen action campaigns, and to educate the public, policymakers, and the media about technology policy issues.
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cable TV, our cable network is older and may require more investment to upgrade. Additionally, California's many densely populated communities substantially increase the time and construction costs associated with upgrades. Because of these resource constraints, there are many communities whose only broadband choice is DSL. By contrast, incumbent LECs can offer DSL services to the majority of their customers simply by installing a DSLAM in the central office and conditioning the individual loop as necessary after a customer has placed an order for DSL. SBC's Project Pronto would allow it to provide DSL to additional customers not currently accessible due to local loop constraints.

Another reason that cable modems are not ubiquitously available is that, while there are only two major incumbent LECs in California, many of cable companies have come to their cable modem strategies and decisions differently, which has resulted in an uneven roll-out of cable modem services. The fragmented ownership of cable systems makes a comprehensive and coordinated statewide cable modem deployment very difficult.

According to an internal study by the CPUC staff, 35% of Californians live in communities where DSL is the only broadband service choice, while 21% of Californians live in communities that have neither cable modem nor DSL service. Only 30% of the state's population live in communities where both DSL and cable modem services are available. Because of DSL's lower upgrade cost and faster upgrade time frames, incumbent LECs may continue to dominate in providing

broadband services in California. See Appendix A. Regarding incumbent LECs' ability to exercise market power, SBC/Pacific Bell demonstrated last year its market power by raising its retail DSL price to \$49.95, a 25% increase. This ability to dictate the direction and magnitude of price changes indicates SBC's market dominance. California notes also that SBC has halted the rollout of Project Pronto, purportedly because of uncertainty brought about by the various line-sharing proceedings at the state and federal levels. SBC's claim, and similar threats by other incumbent LECs that broadband development will cease if they do not receive favorable regulatory treatment, run counter to their on-going assertions that broadband services are fully competitive. One would think that the incumbent LECs would not delay their broadband investments at the risk of losing market share, if the market were as competitive as they claim.

California is also concerned about the ability of incumbent LECs to exercise their Bainian market power to restrict competitors' access to bottleneck facilities. In this case, the rivals are the intramodel DSL competitors, and the bottleneck facility is the local loop network controlled by the ILECs. For most customers, there is no feasible way for competitive LECs to provide competing DSL service other than through the incumbent LEC's local loop network, whether via line sharing or the use of dedicated loops. If the FCC deregulates the incumbent LECs' provisioning of DSL, they will have a green light to exercise their Bainian market power. The result would be the continued dominance of

incumbent LECs in providing DSL services. This would not bring the kind of reliable, low-cost and fast broadband services envisioned by the 1996 Act. The continued lack of intramodel broadband competition would further exacerbate the harm due to lack of intermodal competition by leaving people in many communities at the mercy of the local incumbent LEC for their broadband service.

Without viable intramodel broadband competition, an incumbent LEC can maximize its monopoly profits in areas without cable modem alternatives by selectively offering DSL service to only those communities or neighborhoods that it believes will generate maximum returns. This could create a form of economic redlining and further widen the digital divide since there would be no competitor(s) pushing the incumbent LECs to go after every possible customer.

B. Appropriate Regulatory Requirements

Existing regulatory structures, at both the state and federal level, distinguish between dominant carriers, which possess individual market power, and non-dominant carriers, which lack market power (para. 35). The FCC asks whether reduced regulation of incumbent LEC services, regardless of the extent of existing competition, may foster competition and the deployment of broadband facilities used in the provision of such services (para. 39). The FCC suggests either streamlining the traditional dominant carrier regulation of incumbent LECs' provision of broadband services (para. 41), or the reclassification of incumbent LECs as non-dominant, i.e., lacking market power, in the provision of broadband

services (para. 42). California submits that incumbent LECs are successfully promoting DSL service to customers under the current regulatory environment, so much so that in California, incumbent LEC provision of DSL surpasses cable modem service. Forty-five percent of California's population with broadband access (including vast majority of San Francisco, San Jose, Long Beach, Oakland, and Stockton) can only get DSL service and cannot get cable modem service. In terms of broadband market share in California, DSL has 43% and cable modems have 36% (based on FCC data through 6/01). See Appendix A, pie chart. The level of deployment of incumbent LEC DSL broadband service in California makes clear that the current regulatory environment is conducive to, or at least does not impede ILEC investment in broadband technology. The fact that incumbent LECs have been able to do so well under the current regulatory framework is evidence that there is no need to further relax their regulatory oversight or eliminate the unbundling requirement. To do so would seriously harm the interests of the people of California and this country for the foreseeable future.

California believes it is essential that the FCC maintain its existing unbundling, collocation, pricing, and other regulatory obligations for incumbent LECs if the 1996 Act's goals of competition, enhanced consumer choice, and lower prices are to be fully realized. California is very concerned that the current pricing trend for residential broadband services, namely one of increasing rates,

will make broadband services less affordable to residential customers. California is additionally concerned that even larger price increases could occur if incumbent LEC broadband services are declared non-dominant and regulatory restrictions eased. This could contribute to the creation of information rich and information poor populations despite the significant progress that has been made toward more universal Internet access, thus widening the digital divide among our residents.

While the FCC has taken a leading role in overseeing broadband services, some applications, such as remote digital access to a corporate local area network (LAN), are explicitly intrastate applications. Even for broadband services that have been designated as interstate, the FCC should not take any action that would preempt state commissions from exercising their traditional regulatory powers to safeguard consumer health, safety and welfare and to enforce their own laws with regard to interstate services provided to their residents. There is a role for the state commissions to ensure that its residents are not left with massive service disruptions since such service disruptions could have the effect of crippling the economy of a state. For example, in March 2001, North Point communications (North Point), a Digital Subscriber Line (DSL) service provider to dozens of Internet service providers (ISPs) and an estimated 40,000 California customers, announced that it was going to cease operations because it had not obtained long-term financing or a strategic partnership to continue operations.

Under Appendix C of D.95-12-056, a competitive local exchange carrier like North Point must obtain CPUC approval before disconnecting service. North Point, however initiated a complete shutdown of its networks without such approval. Since California customers were not given sufficient time to make alternative arrangements for their DSL connections, the CPUC ordered in Decision 01-04-008, that North Point cease efforts to shut down their DSL service unless it first provided 30 days' to its customers notice of service termination.

California has recently opened an investigation into the operations, practices, and conduct of Pacific Bell and its affiliates SBC Advanced Solutions, Inc. ("ASI") and Pacific Bell Internet Services in response to numerous complaints regarding cramming and other allegedly improper billing practices.¹⁵ Protections against misleading, fraudulent, anti-competitive or discriminatory ILEC business practices will continue to be important as consumers come to rely on broadband networks for essential voice services and to access information. California does not intend to adjudicate or interpret interstate tariffs, but California fully expects to continue exercising concurrent jurisdiction and to adjudicate under the Public

¹⁵ See Investigation on the Commission's Own Motion into The Operations, Practices And Conduct of Pacific Bell Telephone Company, Pacific Bell Internet Services and SBC Advanced Solutions, Inc. (I.02-01-024, filed January 23, 2002.). Additionally, the Utility Consumers Action Network (UCAN), (UCAN v. Pacific Bell (C.02-01-007 filed January 7, 2002), has filed a complaint raising similar concerns against Pacific Bell. Also pending at the CPUC is the California ISP Association, Inc. (CISPA) complaint (C.01-07-027 filed July 26, 2001) alleging a long-standing pattern of discrimination by Pacific and ASI against ISPs unaffiliated with SBC.
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Utilities Code, federal law¹⁶ and relevant state law, consumer protection issues consistent with the California Public Utilities Code.

California agrees that additional investment in telecommunications infrastructure is desirable. However, new construction is not an end in itself and the FCC should not adopt policies in the hope of increasing investment if the result is that competition is reduced, consumer choice is limited, and prices are increased. Any changes in the FCC's regulatory framework should be undertaken in a manner that ensures the maintenance of consumer safety and service quality protections, including protections for voice services that may be provided through broadband platforms.

¹⁶ Moreover, the 1996 Act permits state's Commissions to impose requirements under state law that are not inconsistent with the Act. See 47 U.S.C. § 252(e)(3); *id.* § 253(b).

Respectfully submitted,

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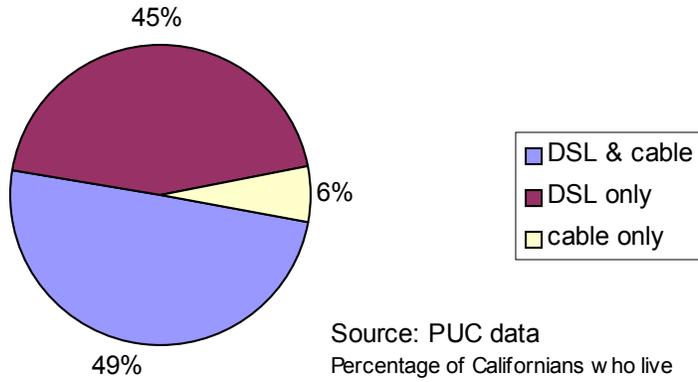
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APPENDIX A

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California Broadband Market by Platform



Source: PUC data
Percentage of Californians who live
in cities with broadband service