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October 14, 2004

**VIA ELECTRONIC FILING**

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 Twelfth Street, S.W.  
Room TWB-204  
Washington, D.C. 20554

**RE: NOTICE OF EX PARTE COMMUNICATION**

***In the Matter of Section 272(f)(1) Sunset of BOC Separate Affiliate and Related Requirements, WC Docket No. 02-112***

Dear Ms. Dortch:

On October 13, 2004, Dorothy Attwood, Michelle Thomas, Jim Longua and Brett Kissel of SBC Communications Inc. (SBC), and Jeff Spruell of Deloitte Consulting, met with Jeff Carlisle, Michelle Carey, Rob Tanner, Bill Dever, Jane Jackson, Pamela Megna, Pamela Arluk, William Kehoe, Kimberly Jackson, Brad Koerner, Jon Minkoff, Tom Navin, Ben Childers and Michael Carowitz of the FCC Wireline Competition Bureau (WCB). At the meeting, SBC presented a business perspective view of the changing residential communications market in light of current marketplace realities and trends using independent third-party market research and forecast data. Per the attached presentation titled *Perspectives on the Competitive Consumer Communications Marketplace*, SBC showed how the business no longer relies on traditional measures of the communications market based on access (or POTS) lines in light of the increasing competition that exists in the market today.

In accordance with section 1.1206 of the Commission's rules, this letter is being filed in the above referenced proceeding via the Commission's ECFS system. Should you have any questions regarding the attached, please do not hesitate to contact me by whatever means are most convenient for you.

Sincerely,

A handwritten signature in blue ink that reads "Brett A. Kissel". The signature is written in a cursive, flowing style.

## ENCLOSURES

cc: Pamela Megna ([pamela.megna@fcc.gov](mailto:pamela.megna@fcc.gov))  
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# **Perspectives on the Competitive Consumer Communications Marketplace**

October 11, 2004

## Executive summary

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Consumers today are not only looking to different communications providers, but are also changing the services they select based on the features and functions that are most valuable to them, including price. Four dynamics challenge the traditional approaches that have focused on POTS as the touchstone for measuring providers' shares of the communications market:

1. Changing consumer behavior: Consumers increasingly use multiple forms of devices, networks, connections and applications to communicate with one another. As they seek out convenient and cost effective methods of communication, wireless voice and data/text communication services are rapidly growing in availability and functionality to meet this evolving consumer trend. Resulting from these converging forces is a growing acceptance of wireless and the Internet as preferred communication methods, and the subsequent adoption and increased usage of and reliance upon these services.
  - Over the past two years, household penetration of POTS has declined by 3.6% as the number of wireless-only households continues to rise and penetration of wireless and internet continues to grow, increasing from 45% to 56% and 48% to 53% respectively.
  - Consumers are expected to continue increasing their demand for new services, such as VoIP and broadband, as demand for older technologies (POTS and dial-up internet) continues to decline at -3% and -12% respectively.
  - Relative to 2000 levels, usage of POTS has dropped by more than 20% while the usage of other communications media (wireless and text) more than doubled.

## *Executive summary (continued)*

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2. Revenue shares: Consumers continue to spend more on new communications services at the expense of POTS; this increased consumer spending occurs across a broader array of providers.
- At the national level, 22 providers have a revenue share of the consumer communications market of greater than 1%; no service provider has more than 9% of the revenue in the market; within SBC's franchise area, 18 vendors capture 1% or more of household communications spend.
  - Over the seven years ending 2002, US telecom expenditures per household have grown at over 5% annually. That growth has come entirely from wireless, despite lower wireless prices, as the average household expenditure per month increased from \$7 to \$35 and average expenditures for POTS declined from \$51 to \$48; overall telephone expenditures as a percentage of disposable income has remained relatively unchanged, accounting for roughly 2% of total disposable income.
  - The growth in SBC region households' overall communications spend over the past three years from \$139 to \$155 is the result of increasing purchases of wireless, video and internet products more than offsetting declining spend for POTS products.
  - Including SBC's wireline operations and the partially-owned Cingular, the percentage share of consumer spending in SBC's franchise area that can be considered SBC-related has dropped in three years from 39% down to 33% at the end of 2003.

## *Executive summary (continued)*

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3. POTS displacement : This changing consumer behavior is expected to accelerate the decline in consumers' demand for and usage of POTS as VoIP, wireless and other advanced services become more familiar, cost efficient and ubiquitous. Consumers increasingly displace POTS lines with VoIP service, wireless and data services.
- The potential market for VoIP services is 90 million homes, i.e. any household addressable by broadband service; the current market research forecast is that VoIP will capture more than 17 million households by 2008.
  - Third party surveys indicate that about 5% of households in SBC's franchise now use only wireless for their voice service, i.e. a one-way substitution in which wireless voice replaces wireline voice
  - The convergence of market dynamics results in an expected 3% annual decline in POTS lines in service for the next several years, as consumers continue to substitute other products that provide the same—or better—utility.

## *Executive summary (continued)*

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4. Pricing trends: Competition in the communication market prevents any one provider from being able to exercise control over the market price, which has been reflected in decreasing average revenue per customer.
- The average household bill for POTS and wireline data products has dropped considerably over the past two years, from \$52 to \$45 for POTS (local + LD) and \$51 to \$31 for broadband data products.
  - Unlimited/all-distance offers from the ILEC, CLECs and cable carriers offering circuit switched and VoIP service constrain any competitor's ability to raise price; the emerging VoIP competitors offer even lower price points and suggest lower market pricing as VoIP marketing effort grows. For example, Vonage offers an all-distance, unlimited plan at \$24.99, a significantly lower cost than the plans that competitors provide for \$30 to \$50, which also incorporates new features such as web-based voice mail.

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- **Changing consumer behavior**

- Revenue shares

- POTS displacement

- Pricing trends

- Appendix – Additional slides

## Changing consumer behavior: Provider and services competitive landscape

	Services					
	Wireline voice		Wireless voice	Internet access (e.g., e-mail, IM & SMS)	Video and entertainment	
ILECs	Established POTS	VoIP plans	Bundled offerings through affiliates		DBS resale	Video over fiber
CLECs	Established POTS	VoIP plans				
IXCs	Established POTS	VoIP deployment	Bundled offerings through affiliates			
Cable MSOs	Established POTS	VoIP deployment	MVNO arrangements to offer wireless-wireline bundles			
Wireless carriers				Web access and internet messaging over 2.5/3G <sup>1</sup>	Adding gaming features and streaming video	
ISPs					Games and other content (e.g. AOL)	
Pureplay VoIP providers	Fast growth among broadband users					
Satellite video providers				DirectPC		

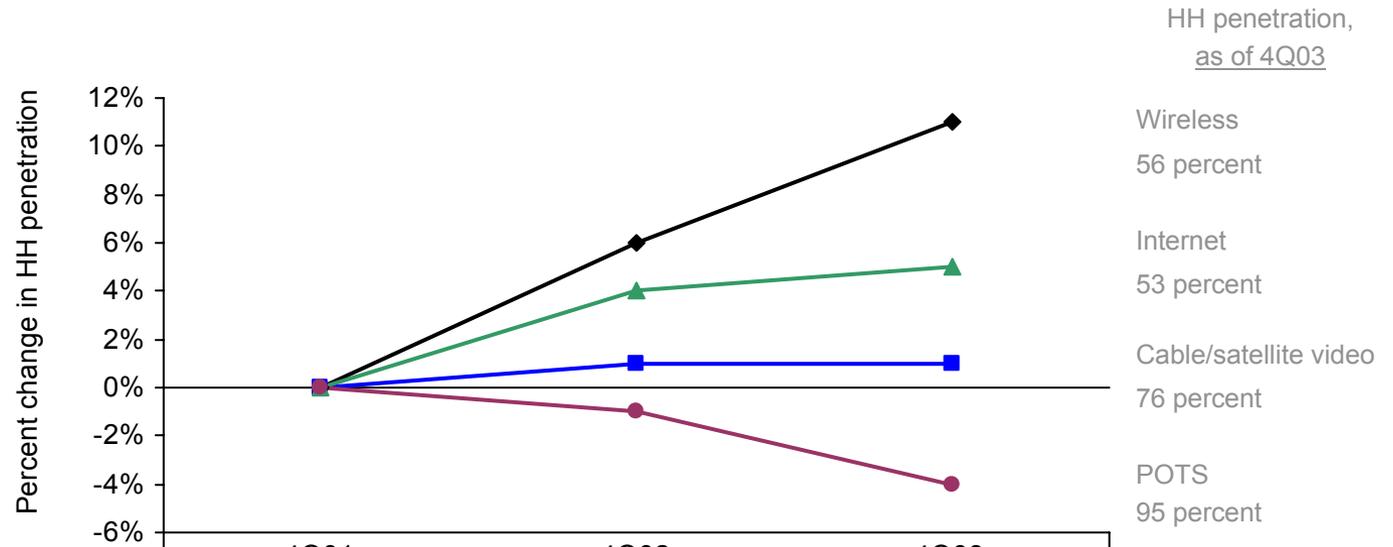
<sup>1</sup> 3G services are currently offered by Sprint and Verizon Wireless using CDMA; 3G service roll-out will likely accelerate following the Cingular/AT&T Wireless merger using the combined companies' spectrum and scale.

Established  
 Emerging

Consumers have become more sophisticated in looking to different products to fulfill the functionalities they need, with the features they value most, from the providers offering the best price and convenience.

# Changing consumer behavior: Growing and declining services history

Change in household penetration of communications services in SBC's franchise area



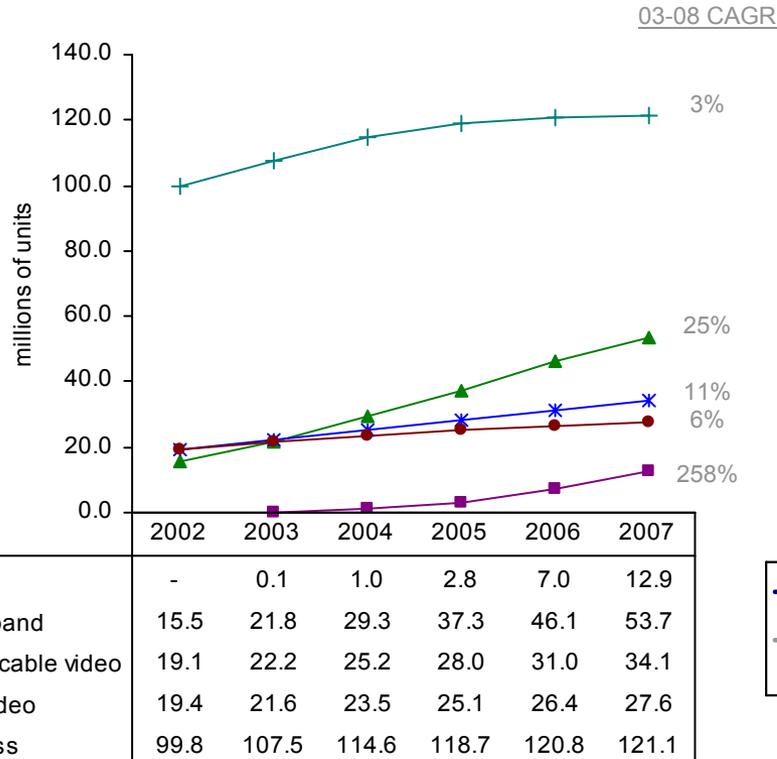
	4Q01	4Q02	4Q03
◆ Wireless penetration	0%	6%	11%
■ Cable/satellite video penetration	0%	1%	1%
▲ Internet penetration (dial up and broadband)	0%	4%	5%
● POTS penetration	0%	-1%	-4%

Over the past two years, the penetration of internet and wireless continued to grow, while cable/satellite video has been largely flat and POTS household penetration has declined.

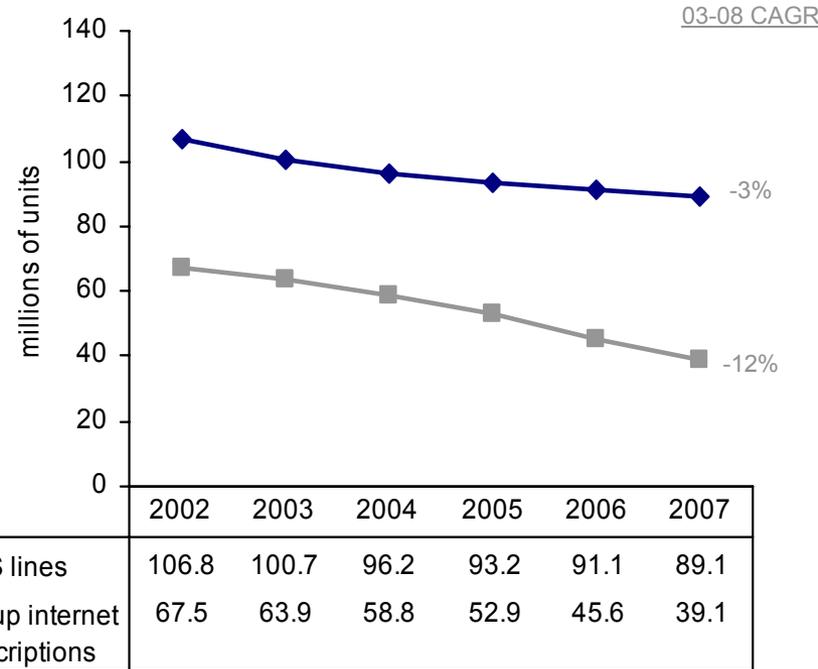
Source: TNS Telecoms bill harvesting data of SBC region households; includes only households with a voice service, i.e. excluding the ~4-5% of US households without telephone service.

# Changing consumer behavior: Growing and declining services projection

## US units in service, growing services



## US units in service, declining services

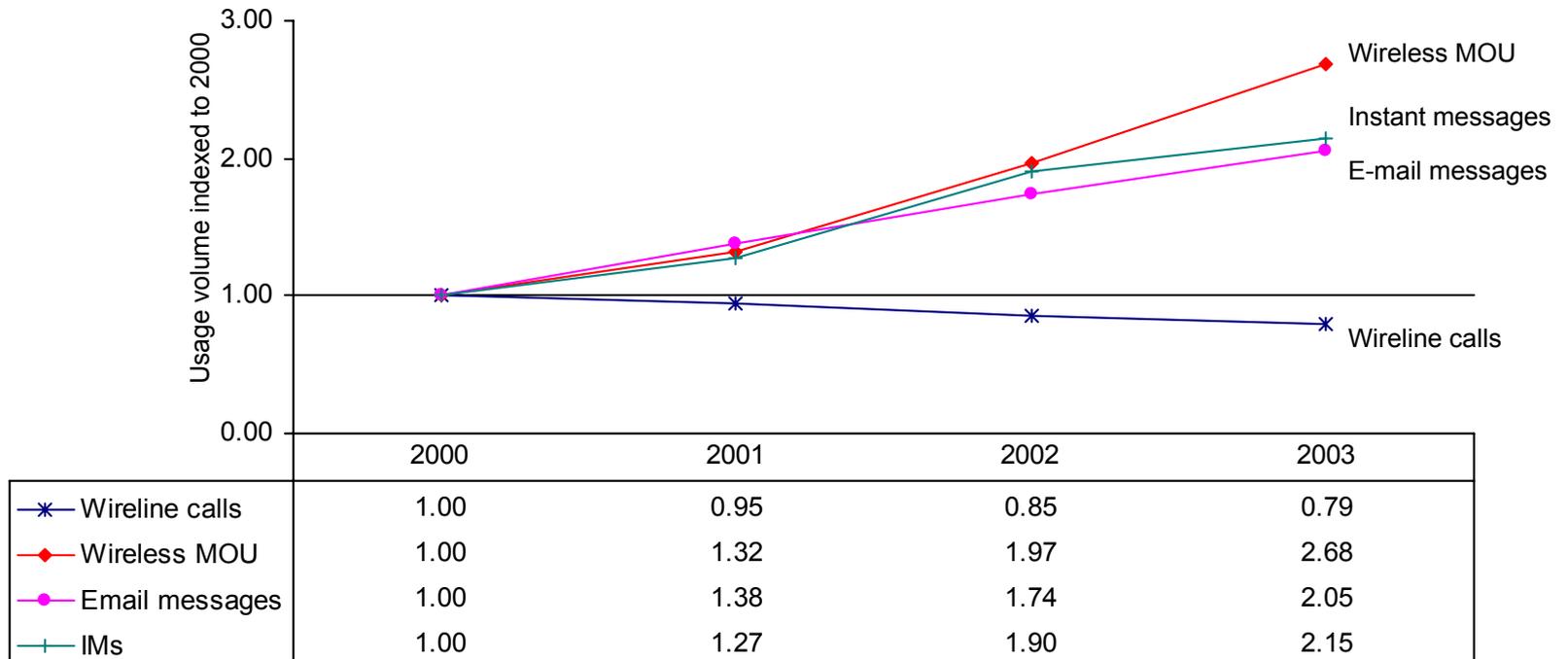


Consumers are expected to continue increasing their demand for new services, such as broadband and VoIP, as demand for older technologies (POTS and dial-up internet) continues to decline.

Source: IDC, Yankee Group.

## Changing consumer behavior: Indexed usage trends

US usage trend of two-way communications applications



Relative to 2000 levels, usage of traditional wireline products has dropped by more than 20% while the usage of other communications media has more than doubled.

Source: FCC, IDC, Wachovia Securities.

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- Changing consumer behavior

- **Revenue shares**

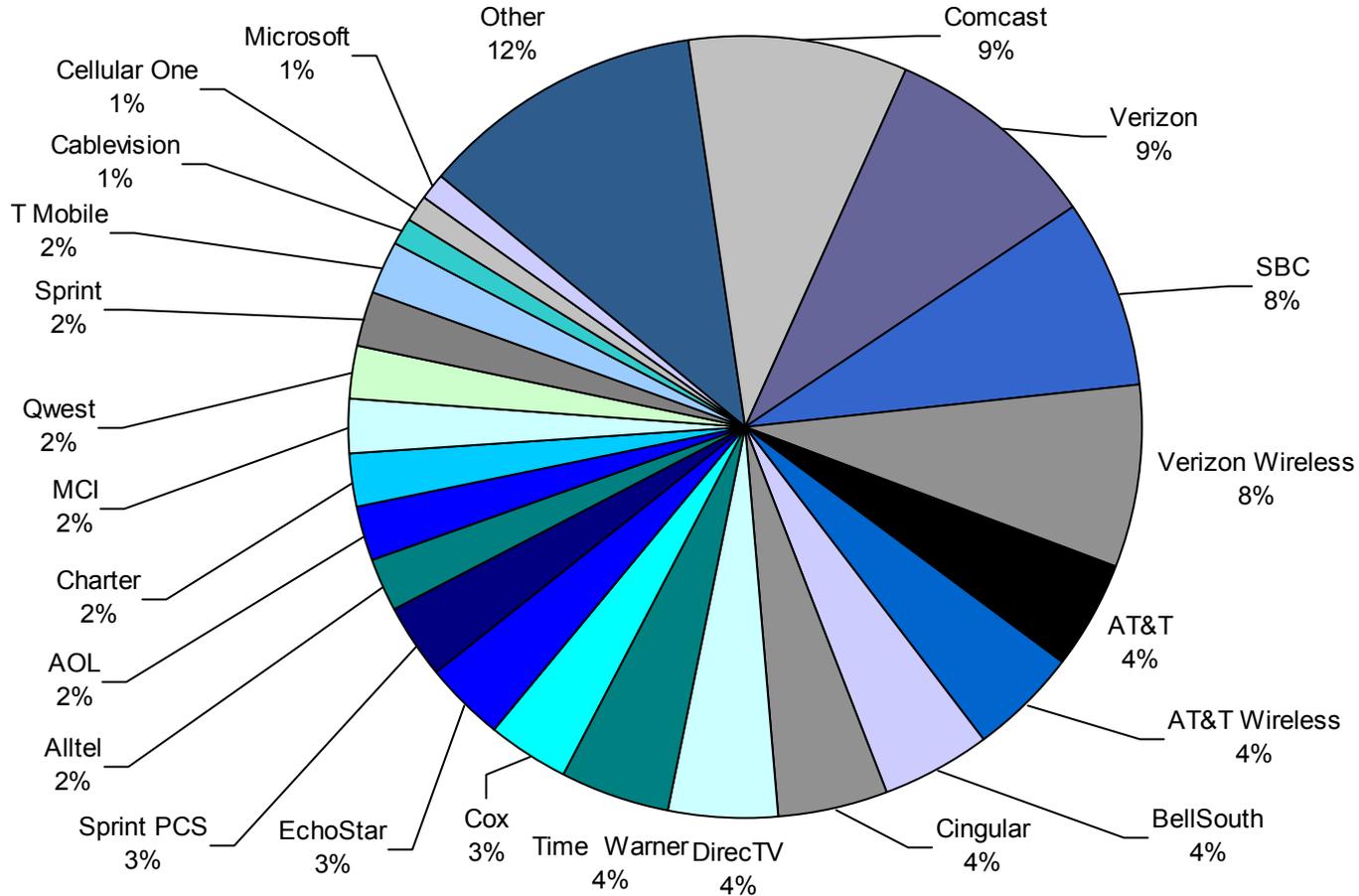
- POTS displacement

- Pricing trends

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# Revenue shares: Overall national distribution of household communications spend

Distribution of US voice, data and video household communications spend\*, 1Q04



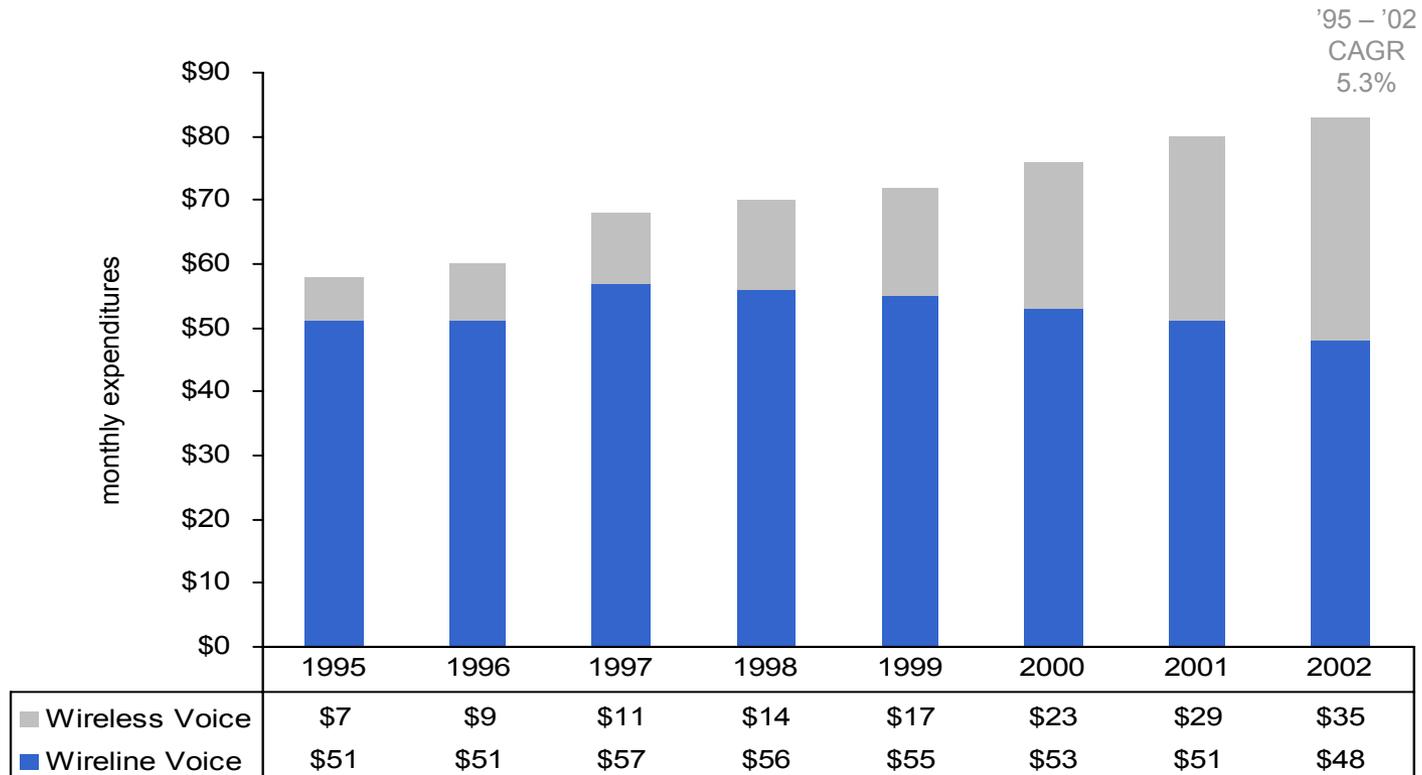
\*TNS defines "Communications Spend" as average household telecom expenditures on wireline voice, wireless voice, video and Internet services

At the national level, 22 providers have a revenue share of the consumer market of greater than 1%; no service provider has more than 9% of the revenue in the market.

Source: Analysis of TNS Telecoms bill harvesting data, national 1Q04 survey results; "Other" is adjusted from the TNS reported summary by removing from the TNS reported figure of 21% "Other" an estimated 10% of total spend across all categories for which the provider is not identified (i.e., adjusting Other to represent true "Other" and to exclude Unidentified; the 10% is estimated from analysis of revenue attributed to Unidentified providers within the detailed SBC-region portion of TNS bill harvest data).

## Revenue shares: National monthly voice telecommunications expenditures

Monthly Voice Telecommunications Expenditures per Household



Compound Annual Growth Rate (CAGR)

During the past seven years ending in 2002, telecommunications expenditures have grown at over 5% annually, with the growth coming entirely from wireless as wireline declines.

Source: FCC Trends in Telephone Service, May 2004.

\*Telephone expenditures include service fees for local, long distance and cellular.

# Revenue shares: SBC region average household spend on communications services

Average household spend by service



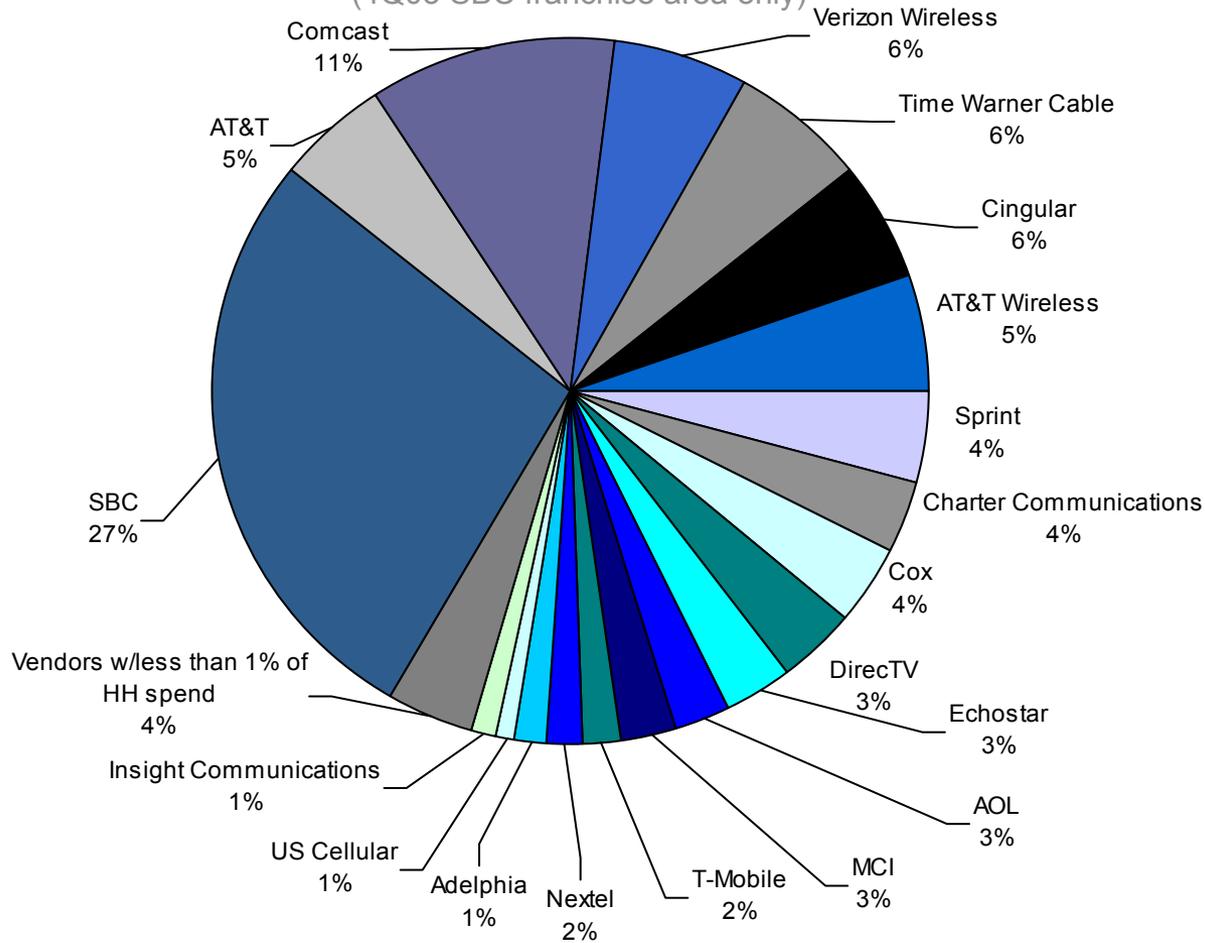
Compound Annual Growth Rate (CAGR)

The growth in household communications spend over the past three years is the result of increasing purchases of wireless, video and internet products more than offsetting declining spend for wireline voice products.

Source: TNS Telecoms bill harvesting data of SBC region households.

# Revenue shares: SBC region shares of monthly household communications spend

Distribution of household voice, data and video communications spend  
(4Q03 SBC franchise area only)



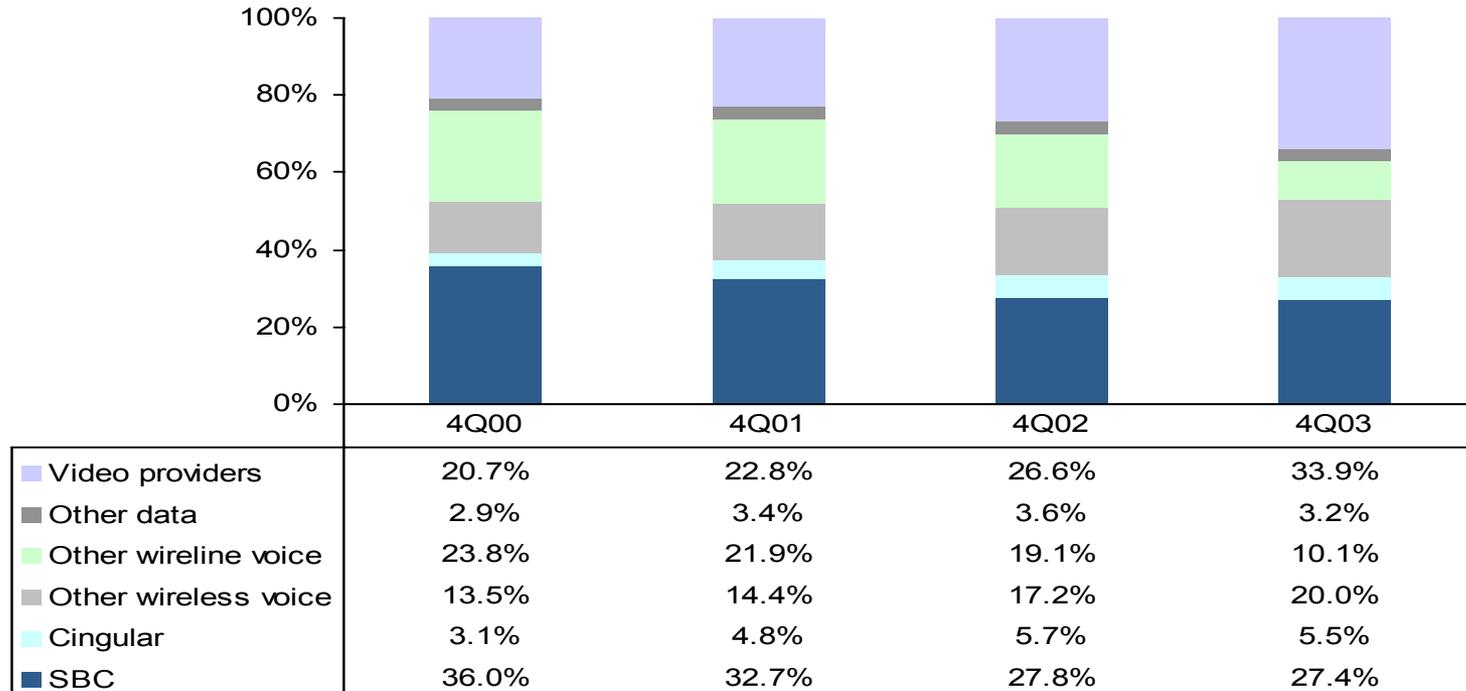
Within SBC's franchise area, 18 vendors capture 1% or more of household communications spend.

Source: TNS Telecoms bill harvesting data of SBC region households. Excludes revenue for which provider is unidentified



## Revenue shares: SBC region communications revenue trend

Share of communications spend by provider, SBC franchise area



1. Other wireline voice providers include AT&T, MCI, Sprint, Vartec, Excel
2. Other wireless voice providers include AT&T Wireless, Verizon Wireless, Sprint PCS, Nextel, T-Mobile, US Cellular
3. Other data providers include AOL, Earthlink
4. Video providers include Charter Communications, Comcast, Cox, DirecTV, Dish Network, Insight, Time Warner

Including SBC's wireline operations and the partially-owned Cingular, the percentage share of consumer spending in SBC's franchise area that can be considered SBC-related has dropped in three years from 39% down to 33% at the end of 2003.

Source: TNS Telecoms bill harvesting data of SBC region households.

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- Changing consumer behavior

- Revenue shares

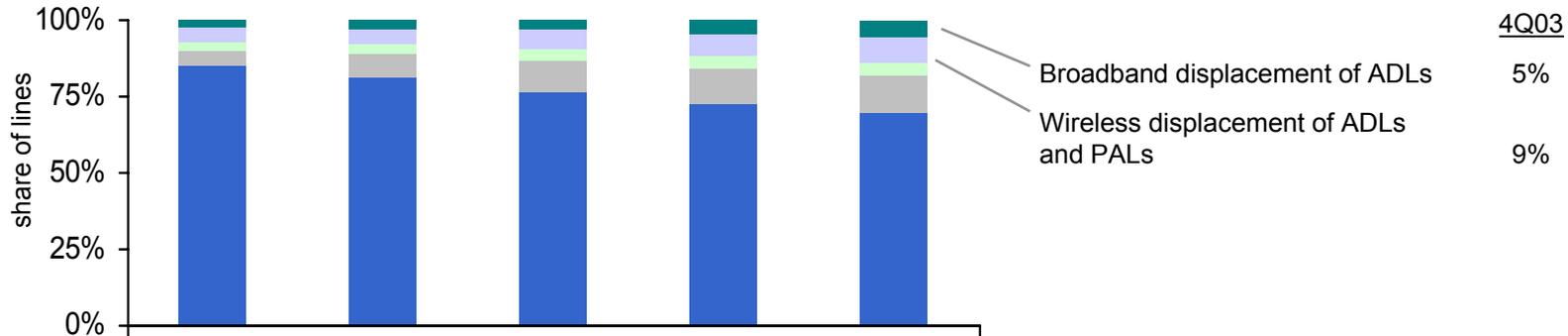
- **POTS displacement**

- Pricing trends

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# POTS displacement: Wireless and broadband displacement of POTS lines

Share of residential lines in SBC franchise area



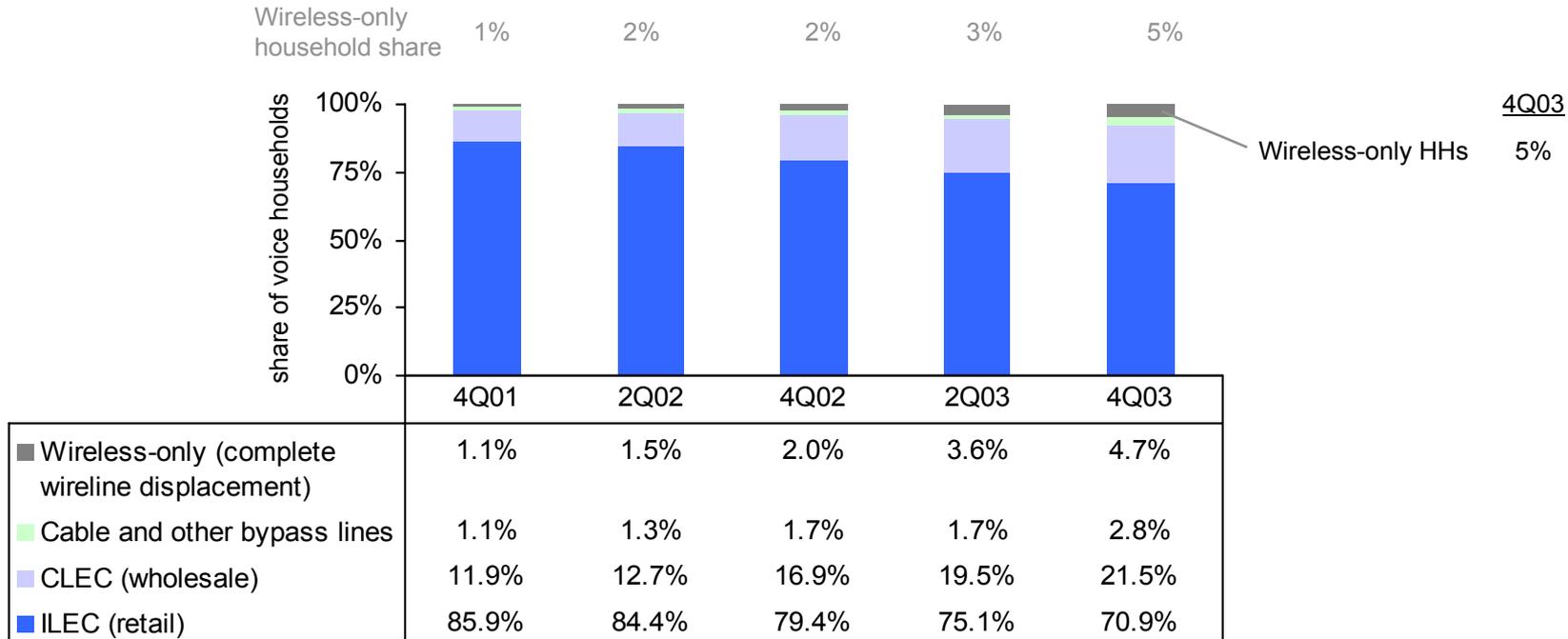
thousands of lines	4Q01	2Q02	4Q02	2Q03	4Q03
■ Broadband displacement	895	1,129	1,382	1,777	2,287
■ Wireless displacement	1,887	2,099	2,518	3,103	3,682
■ Cable and other bypass lines	1,197	1,367	1,509	1,481	1,484
■ CLEC lines (wholesale)	2,193	2,986	4,222	5,054	5,388
■ ILEC lines (retail)	34,517	33,168	31,359	29,890	28,843

Change in consumer preferences is evident in POTS displacement, i.e. consumers disconnecting primary and additional voice lines in favor of broadband and wireless services.

Source: SBC internal analysis.

# POTS displacement: Wireless displacement of POTS primary lines

Provider shares of household voice in SBC franchise area

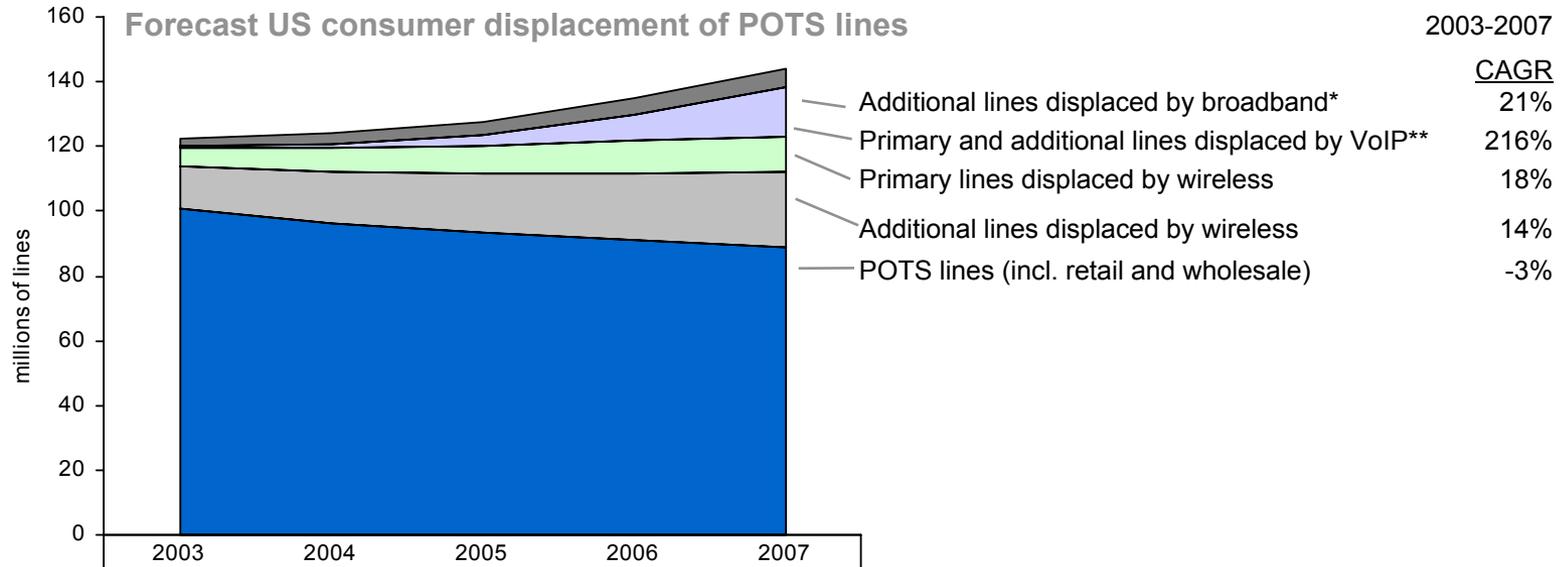


Third party surveys indicate that about 5% of households in SBC’s franchise now only use wireless for their voice service, completely displacing wireline voice in the household.

Source: TNS Telecoms phone survey of over 9,000 households per quarter in SBC franchise area.



# POTS displacement: POTS line displacement forecast



2003-2007

CAGR

- Additional lines displaced by broadband\* 21%
- Primary and additional lines displaced by VoIP\*\* 216%
- Primary lines displaced by wireless 18%
- Additional lines displaced by wireless 14%
- POTS lines (incl. retail and wholesale) -3%

■ Cumulative access lines displaced by broadband	2.6	3.4	4.2	5	5.6
■ Access lines displaced by VoIP	0.2	1.2	3.4	8.4	15.5
■ Cumulative primary access lines displaced by wireless	5.7	7.2	8.5	9.8	10.9
■ Cumulative secondary access lines displaced by wireless	13.4	16.1	18.5	20.7	22.9
■ POTS lines	100.7	96.2	93.2	91.1	89.1

Compound Annual Growth Rate (CAGR)

\* Assumes that 12% of broadband adds result in a POTS line disconnect in 2003 (based on TNS survey responses), diminishing to 8% in 2007

\*\* Assumes that each VoIP household add displaces 1.2 access lines

The convergence of the market dynamics results in an expected 3% annual decline in POTS lines in service, as consumers continue to replace traditional wireline with other products that provide the same—or better—utility.

Source: IDC, Yankee Group and assumptions noted above.

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- Changing consumer behavior

- Revenue shares

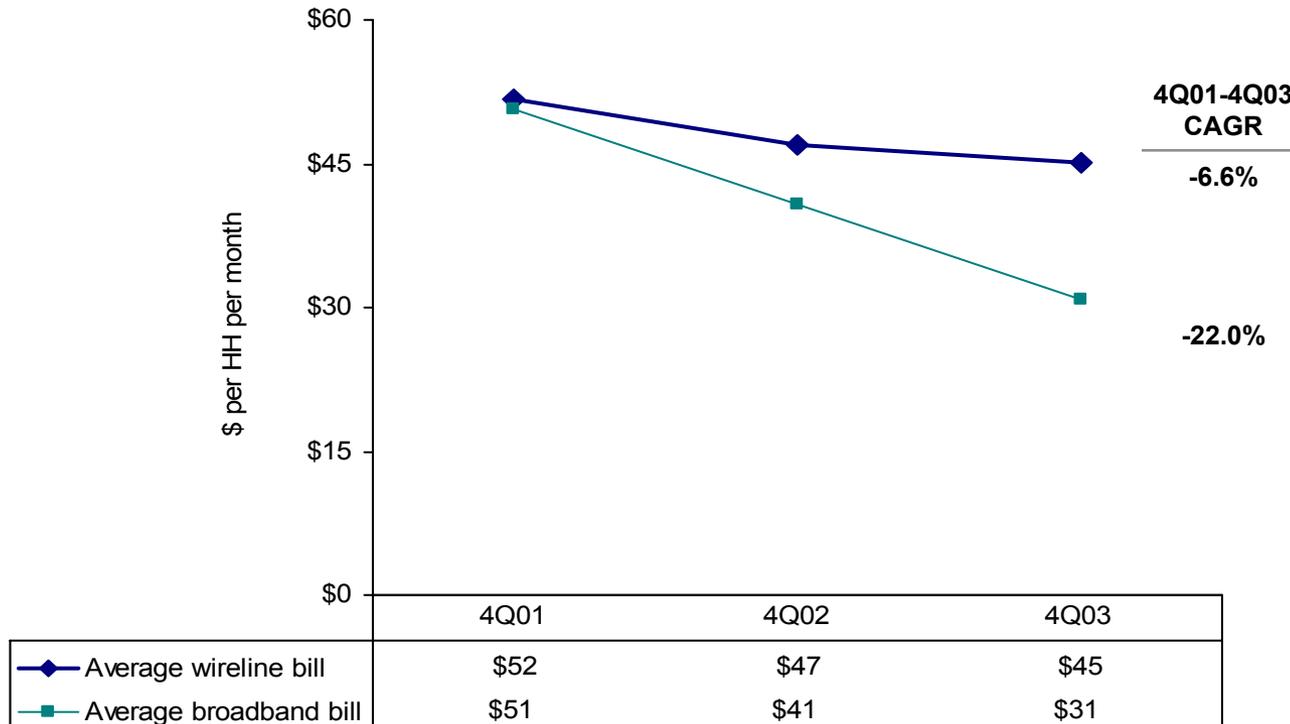
- POTS displacement

- **Pricing trends**

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## Pricing trends: Household wireline voice and data bill

Average wireline voice household bill, all providers in SBC region



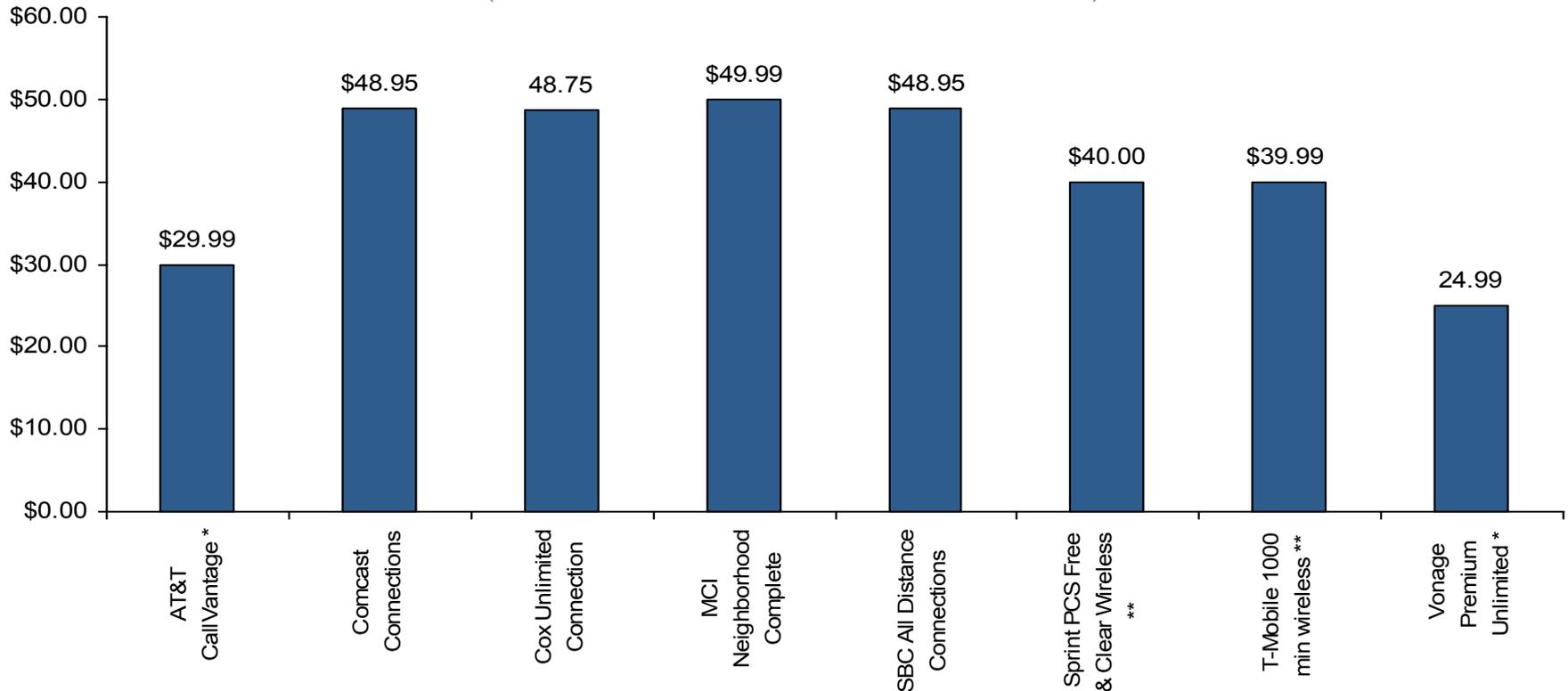
Compound Annual Growth Rate (CAGR)

The average household bill for wireline voice and data products has dropped considerably over the past two years.

Source: TNS Telecoms bill harvesting data of SBC region households.

## Pricing trends: Competitive pricing in unlimited POTS, VoIP and wireless bundles

Sample pricing comparison: voice “unlimited” offers in a single area  
(SBC franchise area in California, October 2004)



\* Requires a broadband connection with Internet access (average cost \$31).

\*\* For low-volume usage consumers, 500-1000 MOU wireless allows them to choose a service that is effectively unlimited from their perspective and gain the benefit of mobility

Unlimited/all-distance offers from the ILECs, CLECs, wireless carriers and cable constrain any competitor’s ability to raise price; the emerging VoIP competitors offer even lower prices and suggest lower market pricing as VoIP penetration grows.

Source: SBC survey of offers posted on company websites.

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- Changing consumer behavior

- Revenue shares

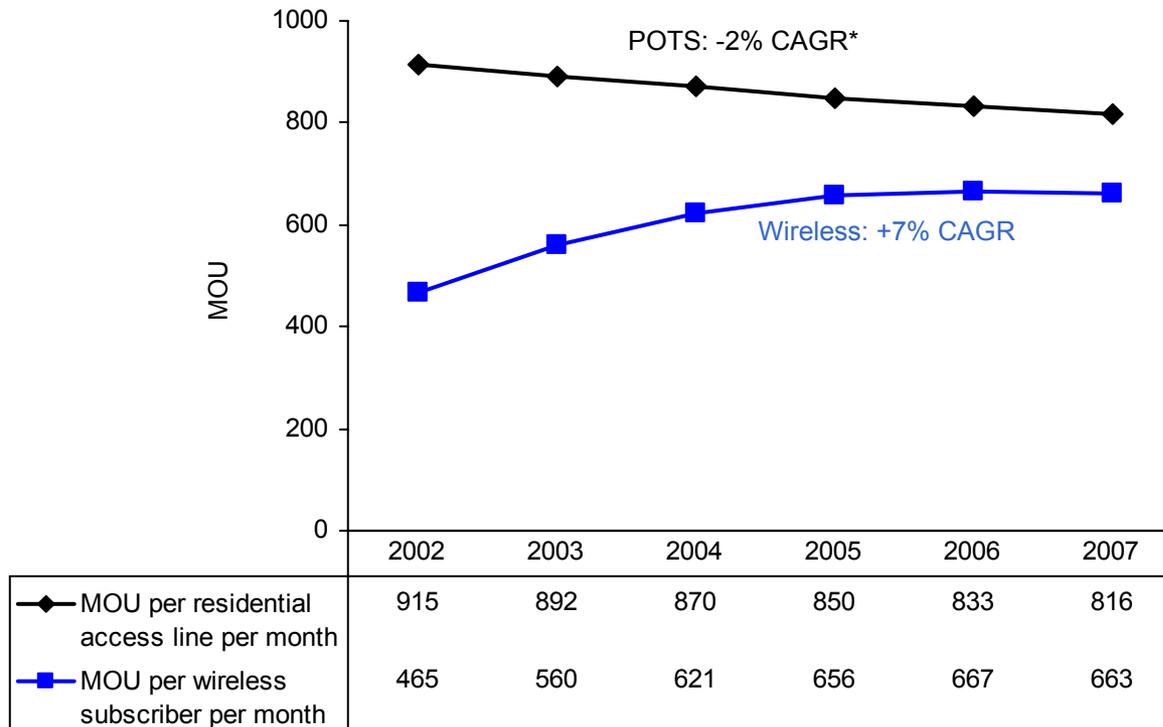
- POTS displacement

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# Changing consumer behavior: Shift of consumer voice usage from wireline to wireless

Average US consumer minutes of use per month



Compound Annual Growth Rate (CAGR)

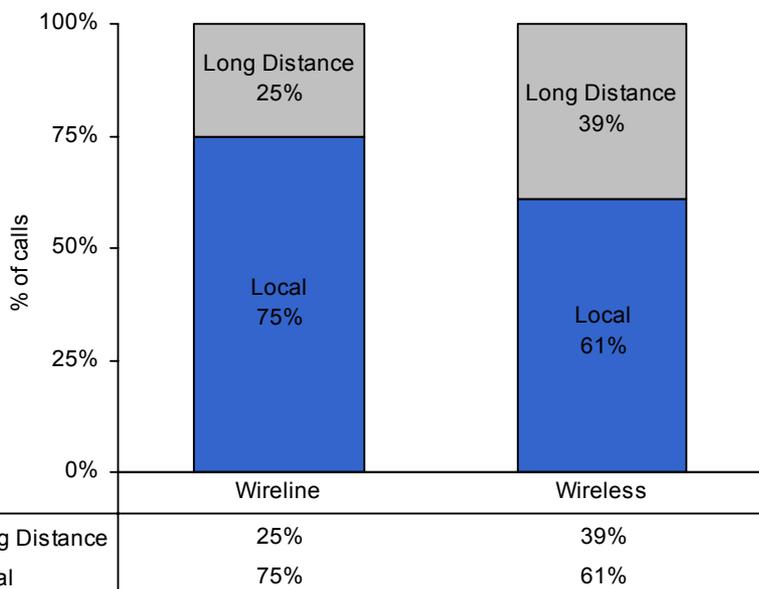
Consumers have been using POTS less and less in favor of wireless service, and this trend is expected to continue.

\* Compound annual growth rate. Sources: wireline MOU from IDC, wireless MOU from Deutsche Bank; both MOU are all-distance.

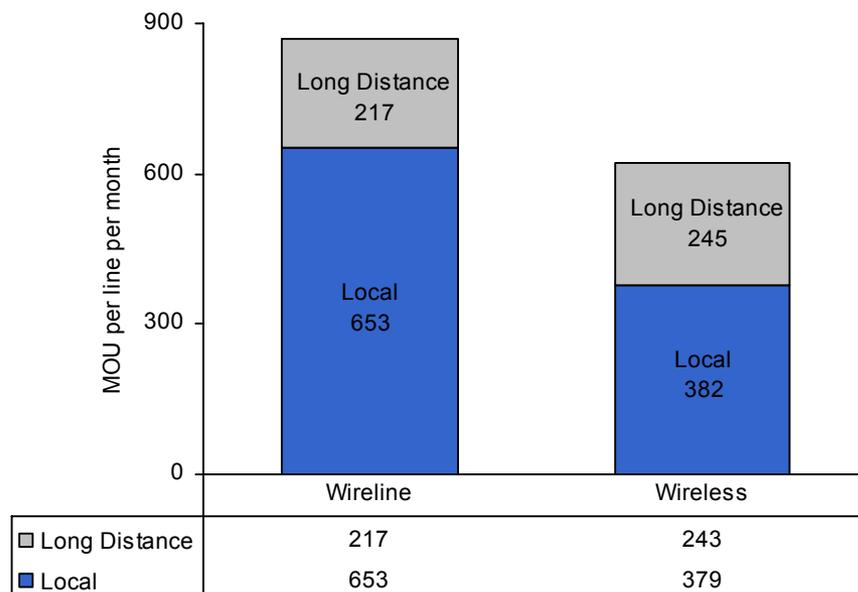
# Changing consumer behavior: Consumer local and long distance moves from wireline to wireless

US consumer usage distribution of wireline vs. wireless, June 2004

Percent of MOU



Estimated total MOU

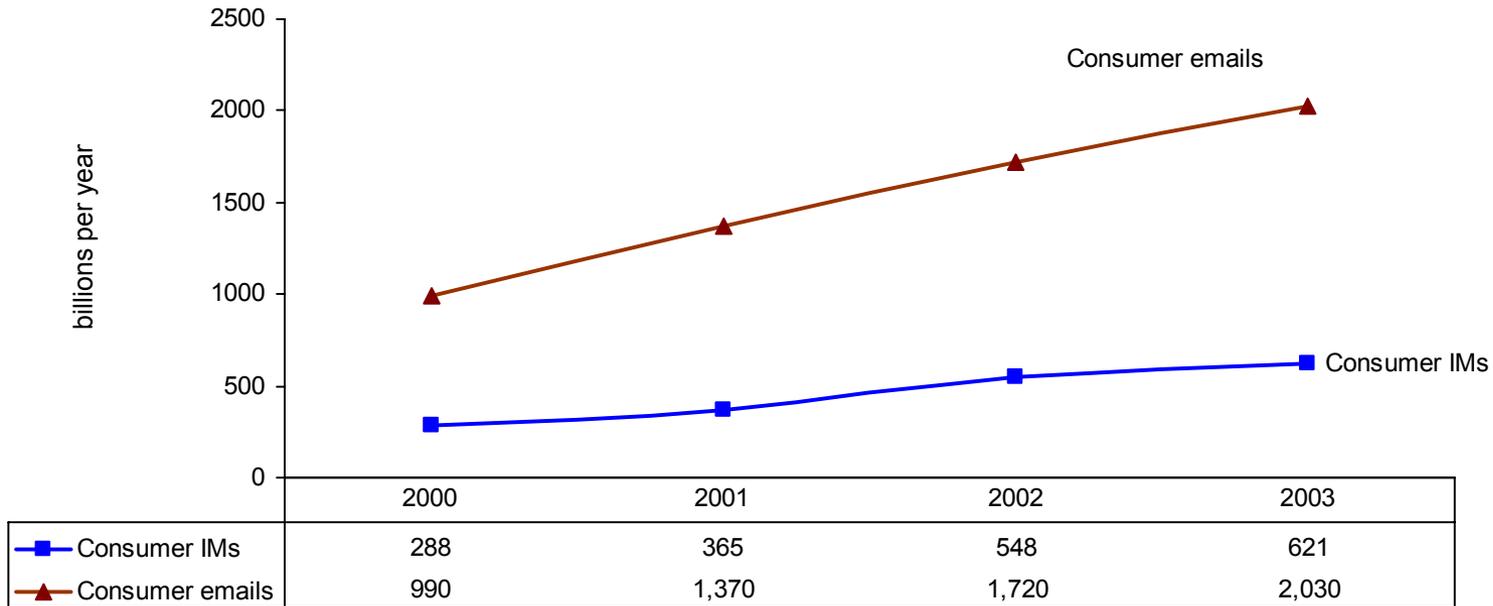


The MOU shift to wireless encompasses both local and LD usage.

Source: Left chart from InStat/MDR survey published June 2004; right chart represents IDC and Deutsche Bank estimates of wireline and wireless usage from the previous slide times the distribution of MOU from InStat/MDR.

## Changing consumer behavior: Growth of text communications applications

US volume of text-based communication applications

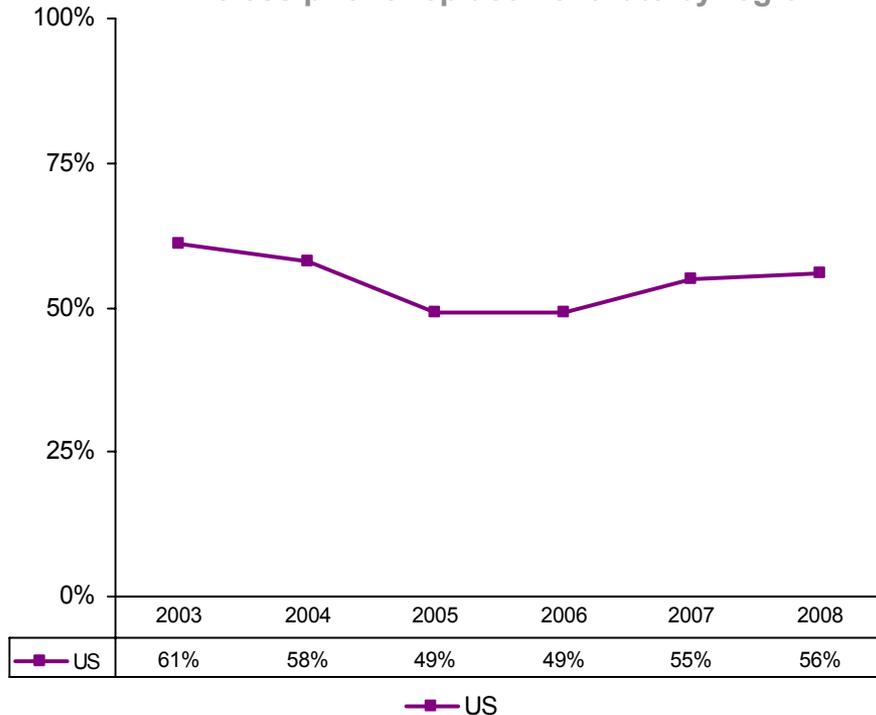


Third party research indicates that these “text conversation” applications supplement or substitute for voice conversations; the extent of that phenomenon has not yet been documented authoritatively

Source: Yankee Group, IDC.

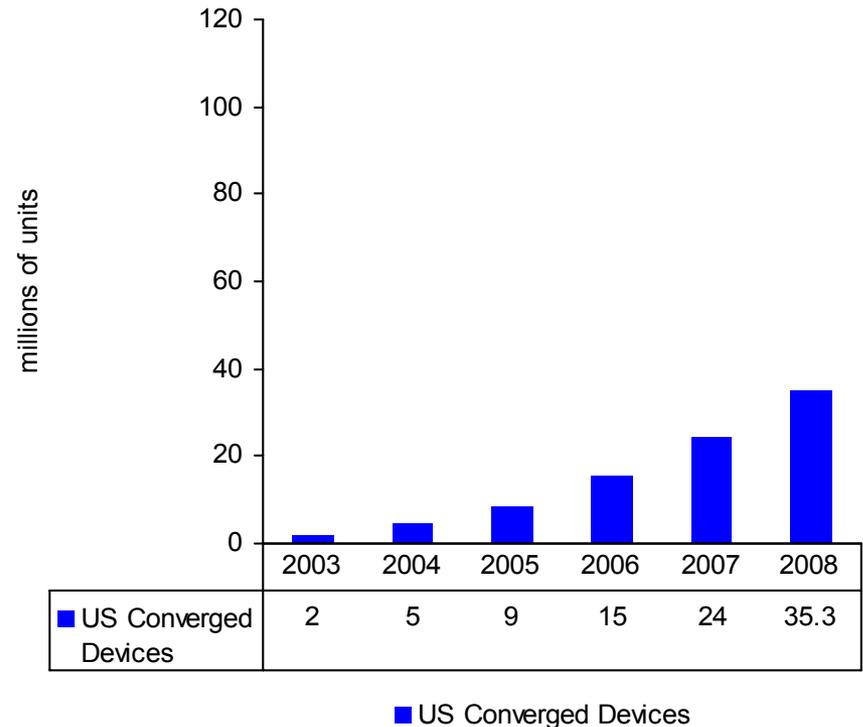
## Changing consumer behavior: Wireless device replacement rate

Wireless phone replacement rate by region



- Consumers will replace their wireless phones every 24-36 months to take advantage of higher megapixel cameras, higher resolution displays, advanced multimedia capabilities and new form factors.

Converged mobile device shipments



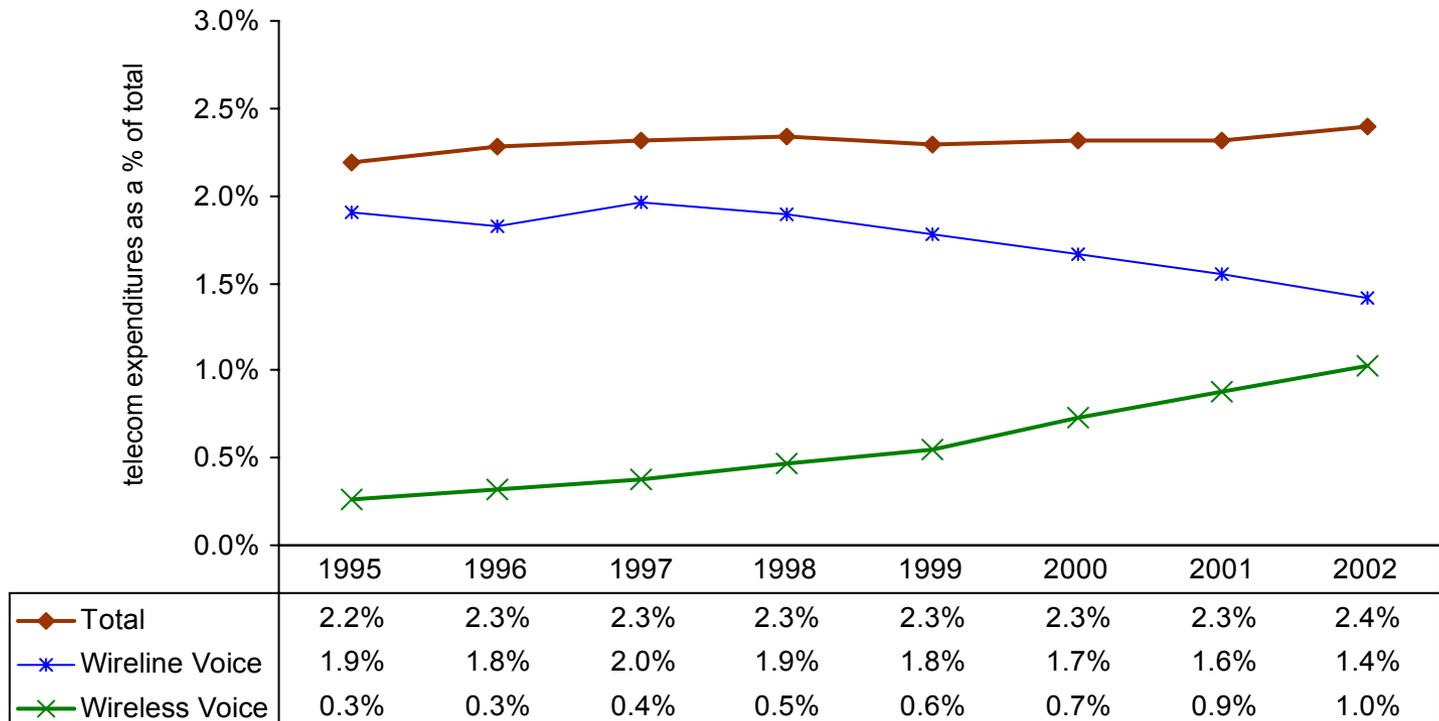
- Converged devices will offer broad application and content capabilities: voice, instant and short messaging, browsing, etc. A 67% CAGR from 2004-2008 results in 2008 annual shipments of 35M.

The rapid replacement cycle of wireless handsets (i.e. an average of about two years) means that greater proportion of the growing wireless population is gaining capabilities for new features bundling text/data communications.

Source: IDC.

# Revenue shares: National voice telephone expenditures as percent of disposable income

Voice Telecommunications Expenditures as a Percent of Household Disposable Income



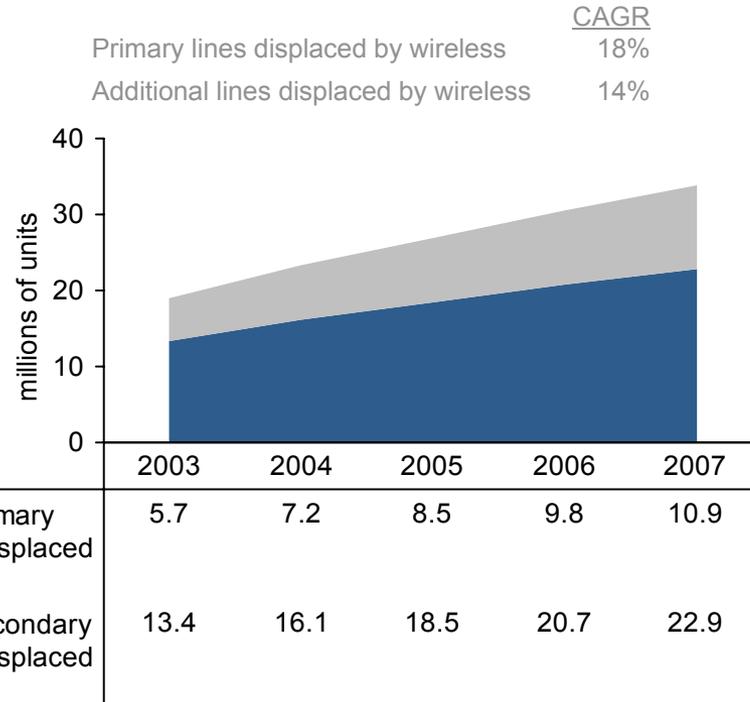
Despite major changes in the telecommunications industry, telephone expenditures as a percentage of disposable income has remained relatively unchanged, accounting for roughly 2% of total expenditures.

Source: FCC Trends in Telephone Service, May 2004.

\*Consumer expenditures include: food, alcoholic beverages, housing, apparel and services, transportation, health care, entertainment, personal care products and services, reading, education, tobacco products and smoking supplies, miscellaneous, cash contributions, and personal insurance and pensions.

# POTS displacement: Wireless-only forecast

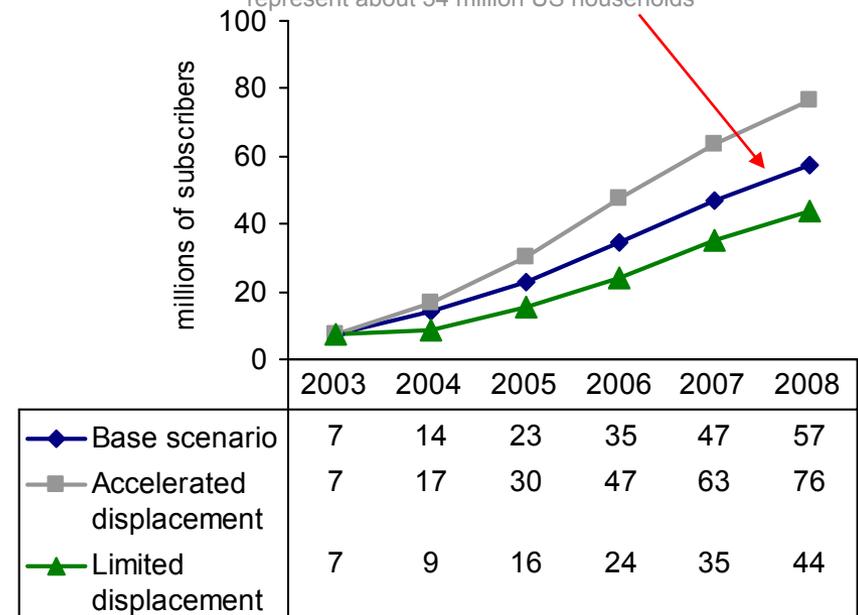
## Forecast US wireless displacement of POTS lines



Source: IDC  
 Compound Annual Growth Rate (CAGR)

## Forecast number of US wireless-only subscribers

On average, households today that have wireless have 1.7 wireless phones per HH; if the wireless-only group has the same ratio, the 57 million wireless-only subs in the 2008 base scenario shown here would represent about 34 million US households

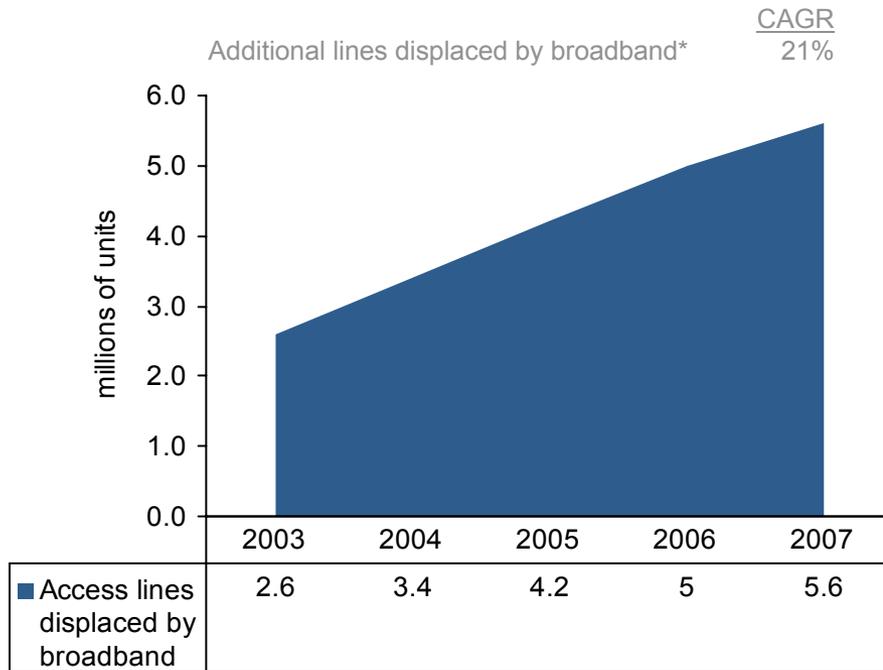


Source: InStat/MDR February 2004

Market research forecasts that the number of wireless subscribers who will use only a wireless phone in five years could range between 40 and 75 million subscribers depending on wireless carrier network investments and price plans.

# POTS displacement: Wireline to broadband substitution forecast

Forecast US broadband displacement of POTS lines

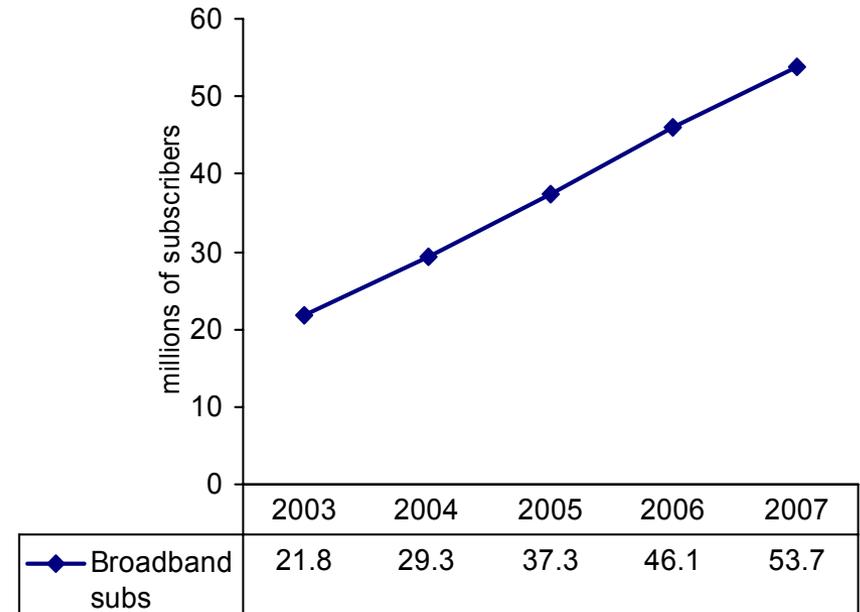


\* Assumes that 12% of broadband adds result in a POTS line disconnect in 2003 (based on TNS survey responses), diminishing to 8% in 2007

Source: IDC, assumptions above

Compound Annual Growth Rate (CAGR)

Forecast number of US broadband subscribers

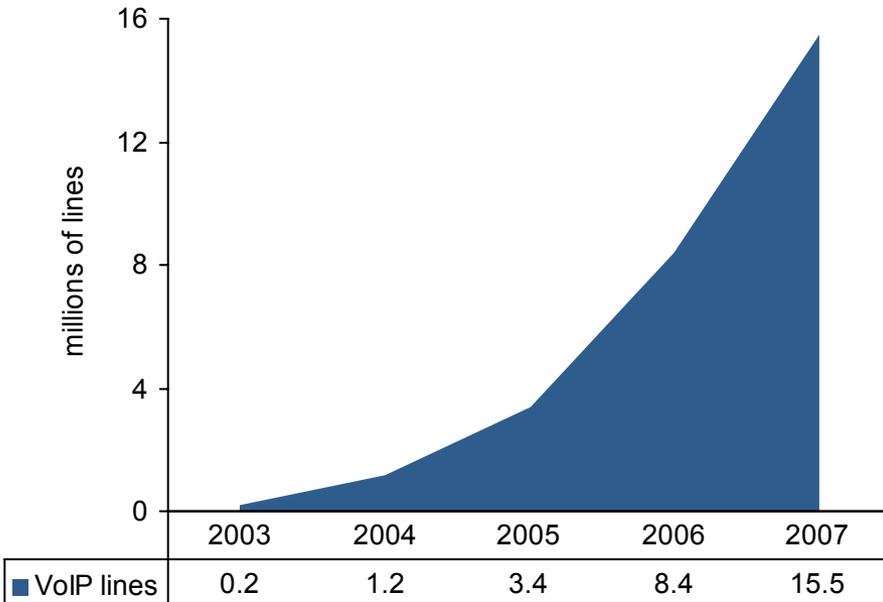


Source: IDC

The number of broadband subscribers could reach 60 million in three years; it is estimated that these broadband adds could result in the disconnection of about six million POTS lines over the period

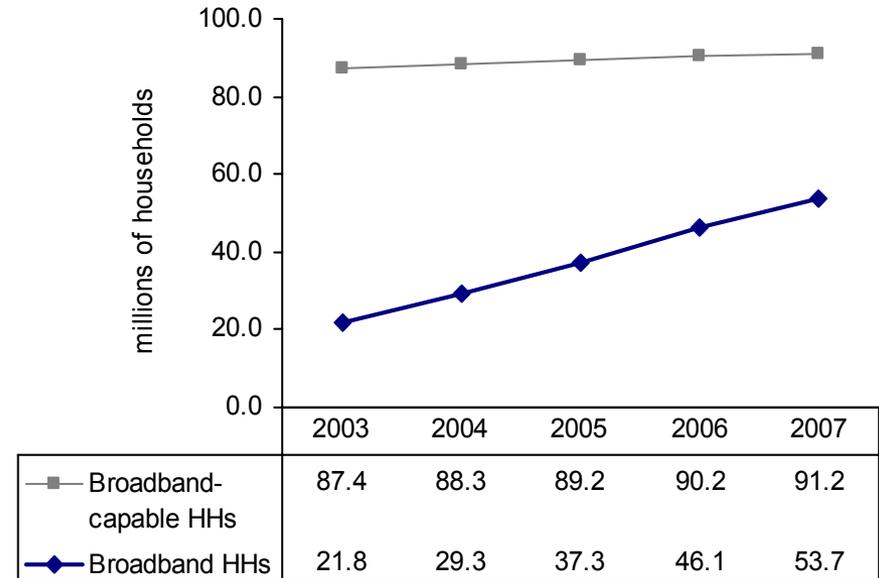
# POTS displacement: Wireline to VoIP substitution forecast

Forecast US residential VoIP penetration



\* Assumes that VoIP household add results in 1.2 access lines displaced per household  
 Source: Yankee Group VoIP residential subscriber forecast June 2004

Forecast of potential VoIP market



Broadband-capable HHs is a conservative estimate and does not factor in potential expansion of the broadband-capable footprint from future fixed wireless, powerline broadband, 3G cellular and other technologies  
 Source: IDC, U.S. Census Bureau, NERA

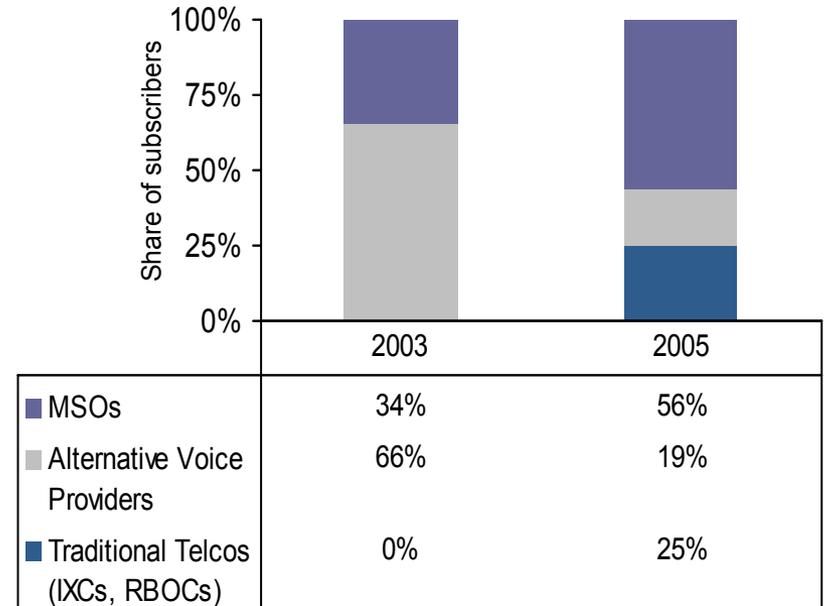
The potential market for VoIP services is any household that can get broadband, i.e. 90 million homes; the current market research forecast is that VoIP will capture about 15 million households (more than 17 million lines) by 2008.

## POTS displacement: VoIP market penetration

Two factors highlight the view that industry analyst forecasts of VoIP penetration may be conservative:

- The Time Warner cable telephony trial in Portland, Maine highlights rapid adoption potential for VoIP. The offering is a primary line substitute, with unlimited domestic voice and vertical services at \$39.99 per month:
  - Time Warner signed up 10,000 telephony subscribers in the first 10 months of deployment.
  - This represents a 25% penetration on a base of 44,000 cable modem subscribers and 10% share of the total fixed line voice market in Portland.
- Cable providers are not the only source of VoIP products (chart):
  - In two years, cable providers are expected to have only about half of all VoIP subscribers, as alternative voice providers like Vonage stay in the market and the traditional telcos bring out their own offerings to compete, such as AT&T's CallVantage offering.
  - AT&T has recently announced joint marketing agreements to offer CallVantage to broadband customers of Comcast, Time Warner and Cox.

US residential VoIP service provider shares



Given strong adoption in initial roll-outs and the expected increase in the number of providers offering VoIP services, VoIP penetration could easily exceed current forecasts.

Source: Yankee Group, Goldman Sachs.