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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

**Order Instituting Rulemaking on the Commission's
Own Motion to Assess and Revise the Regulation of
Telecommunications Utilities.** R.05-04-005

OPENING COMMENTS OF SUREWEST TELEPHONE (U 1015 C).

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May 31, 2005

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I.

INTRODUCTION

Pursuant to the Order Instituting Rulemaking mailed on April 14, 2005 ("OIR"), SureWest Telephone ("SureWest") provides these opening comments addressing revisions to regulation of telecommunications utilities proposed in the OIR. As explained in more detail below, SureWest supports a uniform regulatory framework that tracks, with minor modification, the framework identified in Appendix A, Issue 10. The telecommunications marketplace has transformed itself in the last decade; the Commission must modify its 16 year old regulatory framework to take advantage of those changes or find California lagging behind the rest of the country and the world in the delivery of telecommunications services.

In these opening comments, SureWest describes the advances made in the telecommunications marketplace that set the stage for the work that must be done to reform the Commission's regulation. SureWest then addresses the Phase 1 issues as they pertain to the regulatory framework proposed in Appendix A, Issue No. 10 of the OIR.

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II.

**DEVELOPMENTS IN THE TELECOMMUNICATIONS MARKETPLACE HAVE MADE
THE NEW REGULATORY FRAMEWORK DECIDEDLY OUTDATED.**

SureWest currently operates under the Commission's New Regulatory Framework ("NRF"), which was applied to SureWest beginning in 1997. Since entering NRF regulation, competition has grown rapidly in SureWest's territory. The following provides a picture of the competitive landscape in SureWest's service area. The picture describes a vibrantly competitive landscape. Therefore, the rules that apply to SureWest require attention from the Commission to ensure its regulatory policies do not hinder SureWest's ability to effectively compete in this intensely-competitive telecommunications marketplace.

When the NRF was originally adopted in 1989, very little of the local exchange business in California was open to competition. In 1996, the Telecommunications Act ("Act") opened the gates to competition in the telecommunications industry, including SureWest's market. The Act was adopted just before the Commission adopted NRF for SureWest. Thus, NRF and its requirements were adopted for SureWest when competition was in its infancy. Since then, competition has grown steadily and rapidly. Yet, the basic NRF scheme made applicable to local exchange carriers such as SureWest has not evolved to reflect the ever-more-competitive environment. SureWest faces actual or potential competition from many existing and emerging service providers, including: long distance carriers, CLECs, wireless carriers, cable providers, satellite providers, Internet service providers, broadband-over-powerline companies, and, perhaps most significantly, Voice over Internet Protocol ("VoIP") providers. Additionally, SureWest's service territory is uniquely suitable for these competitors to easily challenge and compete with SureWest because of the service area's limited size, compact nature and robust network infrastructure. With relatively little additional investment, SureWest's competitors can use existing facilities to reach most or all of SureWest's customers. In most cases, the competitors that SureWest faces are enormous companies, many with both a national and international presence. These companies enjoy numerous business advantages over smaller market participants like SureWest. These advantages include size, financial resources, and brand

1 recognition, each of which dwarfs the equivalent attributes of SureWest. In addition, many of these
2 competitors have a favorable regulatory position in comparison to SureWest.

3 The fact that NRF is now outdated relative to the vibrant competition that SureWest faces in
4 its service area is evident from prior Commission decisions. In the decision placing SureWest under
5 NRF, the Commission stated:

6 We considered the extent to which the telecommunications market has changed in Phase I
7 of our second triennial NRF review. (D.95-12-052 in I.95-05-047.) We there heard and
8 considered many predictions of vigorous future competition. While there may be
9 uncertainty regarding the breath [sic] and depth of future competition, we concluded the
10 trend is towards increasing competition. We also stated our belief that competition will
11 arrive in bursts, and will appear unevenly geographically and across services. We made
12 some modifications to NRF for Pacific and GTEC, but we concluded that "it is not
13 prudent to base today's policies as if all these predictions [of competition] were certain to
14 come true." See D.96-12-074, *mimeo*, p. 86 (quoting D.95-12-052, *mimeo*, p. 44.).

15
16 Accordingly, the NRF that currently applies to SureWest was developed in the context of the limited
17 local exchange competition that existed during 1994 and 1995 when such information and testimony
18 was submitted for the Commission to arrive at its 1995 decisions on the issues. A decade has passed
19 in which the breadth of competition has changed immensely in the telecommunications marketplace—
20 including the local exchange. It is now no longer a question as to what competition is or will be.
21 Significant convergence in the marketplace is occurring that facilitates robust intermodal
22 competition. Cable companies' networks can now support local and other telephone services, and
23 many of the large cable companies are offering this service currently to large portions of their
24 customer base and will be offering local telephone service to the rest of their customers within the
25 next year. Wireless phones now exceed the number of wireline phones, and many consumers are
26 using wireless services as a complete substitute for wireline service.

27 These market dynamics make it clear that the competitive landscape has changed. The NRF
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1 structure must change to account for these significant changes in the industry. A healthy competitive
2 market, such as now exists in telecommunications, will produce outcomes superior to those imposed
3 by the regulatory process. To allow current and potential competition to flourish without artificially
4 disadvantaging some competitors over others, the Commission should clear away the regulatory
5 underbrush of the NRF structure and adopt the plan proposed by SureWest. This plan is discussed in
6 further detail below.

7 **A. Competition from Competitive Local Exchange Carriers (CLECs).**

8 As mentioned earlier, the Act came into existence in 1996 and opened the gates to
9 unrestricted local competition in California. In 1997, the Commission authorized facilities-based and
10 resale competition in SureWest's local exchange market effective January 1, 1998 and February 2,
11 1998, respectively. See D.97-09-024. Thus, there were no CLECs certified to provide service in
12 SureWest's territory when it was first placed on NRF. As of today, however, over 200 wireline
13 carriers are certificated to do business in California with specific authorization to provide CLEC
14 service in SureWest's service area at any time.

15 Some of the wireline CLECs who are not just authorized but are actually competing in
16 SureWest's territory include:

- 17 1. Pacific Bell (SBC California) CLEC
- 18 2. AT&T
- 19 3. MCI
- 20 4. XO
- 21 5. ELI
- 22 6. Pac West
- 23 7. OI
- 24 8. ICG
- 25 9. Teleport
- 26 10. Sprint
- 27 11. Quality Telephone

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12. Level 3

13. TCAST

14. CF Communications

As CLECs have entered SureWest's service area, many have constructed substantial fiber routes to facilitate their efforts. Attachment A to these comments provides two maps of SureWest's service area reflecting known fiber routes placed by competitors. One is from 1995; the other reflects information from 2004. The difference is remarkable. There are significantly more fiber routes within SureWest's service area today than there were ten years ago, which translates into greater competition for SureWest.

Other indicia reflect the substantial competition SureWest faces from CLECs. The number of SureWest trunks connecting to CLECs has increased significantly since NRF regulation was first applied to SureWest. At the time NRF regulation first became applicable to SureWest, there were approximately 3,100 trunks interconnected between SureWest and the CLECs operating within SureWest's service territory. The number of trunks connected has increased to 6,456 today, an increase of more than 100%.

In addition, the number of local access lines served by CLECs has dramatically increased. CLECs began porting local telephone numbers in 1999. Since that time, the number of local access lines ported has increased to 3,535 in 2002 and 4,672 as of the end of April 2005. Customers have also initiated telephone service by going directly to competitors for services. Although SureWest does not have complete data on this topic, SureWest estimates that it has lost approximately 15.3% of its existing business access lines to competitors through 2004. This does not include the loss of opportunities to add new business lines that never came to SureWest in the first place.

Ironically, the lucrative telecommunications-intensive business customers and employers that SureWest has helped attract to its service territory over the years are especially receptive to competition, both due to their sophistication and also to their understanding and existing use of alternatives to SureWest's services. For example, XO has built a central office switch in SureWest's service area and constructed fiber plant and a fiber ring through the area. SBC provides service today

1 in SureWest's service area through a combination of leased lines and its own facilities. In a recent
2 arbitration proceeding with SBC on right-of-way prices (A.03-10-039), SBC testified:

3 Q6. Does SBC California, in its CLEC operations, intend to construct facilities in
4 SureWest's territory?

5 A6. Yes. In SureWest territory, SBC California OOF ["out-of-franchise"] plans to
6 provide service to end user customers by connecting them to SBC California central
7 offices (COs). This can be done in several ways: (1) SBC California may collocate in
8 a SureWest central office or remote terminal and lease a loop to the customer premise.
9 The collocation facilities in the SureWest CO's would be connected to the SBC CO
10 via leased transport or via fiber SBC builds between the SureWest CO and the SBC
11 CO. (2) SBC California could construct fiber by placing it in conduit leased from
12 SureWest or lease circuits from SureWest to connect the end user directly to an SBC
13 California central office.

14 SBC is a particularly great competitive threat to SureWest. SBC's service area surrounds
15 SureWest's approximate 83 square mile service area. Most notably, SBC enjoys certain business
16 advantages, including its size, financial resources, brand recognition and an already established
17 customer base throughout and outside of California, giving it economies of scale and scope that
18 SureWest lacks. Additionally, SBC has significant facilities in and around SureWest's service area.
19 SBC has leased conduit and has placed its own fiber facilities that traverse SureWest's service area.
20 SBC has multiple fiber routes through and around SureWest's service area, and SBC has stated in
21 A.03-10-039 that it plans to use these ILEC facilities to provide CLEC services to customers in
22 SureWest's service area. The most recent route constructed by SBC was specifically built by its
23 ILEC company so that SBC's CLEC would be able to serve customers in SureWest's service area.
24 As testimony in A.03-10-039 revealed, it was not a coincidence that the fiber route that SBC ILEC
25 constructed in SureWest's service area passes directly by some of SureWest's largest business
26 customers. SBC has demonstrated the ease with which it will quickly enter SureWest's market
27 through use of its existing ILEC facilities in SureWest's service area.

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1 Furthermore, since large business customers have branch offices, headquarters or other
2 facilities located throughout SBC territories, SBC has a significant advantage in being able to take
3 such customers away from SureWest and provide an interconnecting package of telecommunication
4 services. Additionally, as SureWest's own experience is showing, corporate headquarters offices are
5 now more likely to be making the major purchasing decisions on telecommunications services on a
6 centralized basis. While SureWest maintains solid customer relations and provides high-quality
7 service to business customers in its service territory, SureWest does not have business relationships
8 with the headquarters offices of many business customers. These offices are usually located outside
9 of SureWest's service territory. In addition, these businesses often make company-wide
10 telecommunications decisions. As a result, they are more likely to already have a business
11 relationship with SBC or another large carrier. SureWest is finding itself more on the "outside" with
12 its own customers, competing with a giant, nationwide telecommunications firm that has the inside
13 track because of its relationships with the headquarters location. Additionally, in December 2002,
14 SBC received authorization to provide long distance services and now markets complete
15 telecommunications packages including interstate and intrastate long distance services.

16 A recent Commission report, "The Status of Telecommunications Competition in California,"
17 submitted to the California State Legislature on October 31, 2003, describes existing sources of
18 competition in the telecommunications market and concludes that SureWest faces the same level of
19 competition as that faced by the larger ILECs. As submitted in the Report for California's local
20 business markets, ILECs hold 84.7% of the access lines. While CLECs represent 15.3% of the access
21 lines, CLEC market share based on revenue is 23%, demonstrating that CLECs have focused on
22 lucrative customers in their business plans.

23 Similarly, ILEC market share of local toll (i.e. intraLATA toll) identified in the Commission's
24 report stood at 48%, while competitors had captured 52%. SureWest's market share of local toll is
25 actually less than the 48% figure for ILECs as a group, weighing in at 42%. However, even this
26 figure overstates SureWest's share of local toll, because it does not reflect local toll originated on
27 other competitors' networks. Taking those minutes into account, SureWest's share of the local toll
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1 market is likely to be significantly less.

2 **B. Competition from Wireless Carriers.**

3 There are ten wireless carriers competing in SureWest's territory. They consist of:

- 4 1. Verizon
- 5 2. Cingular / AT&T
- 6 3. Sprint
- 7 4. Nextel
- 8 5. T-Mobile
- 9 6. SureWest Wireless
- 10 7. Virgin Mobile
- 11 8. Metro PCS
- 12 9. Boost
- 13 10. Tracfone

14 Until recently, wireless carriers were not perceived as a replacement for wireline service.
15 Such a view no longer belongs in the present-day telecommunications environment. Wireless entities
16 are significant competitors to wireline carriers. The number of wireless phones in service is now
17 greater than the number of wireline phones. Wireless penetration is many times the expectations of
18 even a few years ago. Many customers now rely exclusively on wireless service, and this trend is
19 continuing. The younger generation has grown up accustomed to the mobility of the wireless world.
20 As they move out on their own, many younger customers are only purchasing wireless phones.
21 Further, a number of wireless carriers offer unlimited calling service plans for between \$29 and \$40
22 per month, making these plans even more attractive as an alternative to the highly regulated wireline
23 offering. As a result, wireless service offerings are in direct competition with wireline phone service,
24 and can make wireline phones unnecessary in the eyes of customers. Even where customers do elect
25 to have both a wireless and a wireline phone, many customers now shift their usage to the wireless
26 service. This has led to significant decreases in toll minutes, which in turn diminishes toll and access
27 revenues for wireline companies. According to one analyst, wireless voice minutes increased from

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1 7% to 23% of total voice minutes from 2000 to 2003.¹

2 In its own service territory, SureWest has observed that customers are increasingly using
3 wireless voice services as a replacement for wireline service. Based on studies performed by
4 SureWest, in the first quarter of 2002, approximately 6% of the occupied apartment units in
5 SureWest's service area were not served by a SureWest access line. By the fourth quarter of 2003,
6 that percentage had increased to almost 25%. By the fourth quarter of 2004, that number had grown
7 to more than 34% of apartment units no longer subscribing to wireline phone service. This is a
8 significant number since one-quarter of the residential dwelling units in SureWest's service area are
9 multi-family dwelling units. Such a significant jump over such a short period of time demonstrates
10 the formidable competitive threat presented by largely unregulated wireless carriers.

11 Other empirical statistics support the conclusion that wireless service is gaining ground as an
12 alternative to the telephone network. SureWest's residential access line growth has historically been
13 between 6-8% per year. Indeed, from 1994 through 1999, access lines grew 6-8% per year.
14 However, residential access line growth flattened to approximately 1% a year for 2000 through 2002,
15 turned negative in 2003 at an approximate 1% loss, and declined even further in 2004, with a 4% loss
16 in access lines. Even though SureWest's residential access line growth has reduced significantly over
17 this time period, the growth in population within its service area continues to grow at a rate of
18 approximately 3%. SureWest believes the divergence between the growth in SureWest's residential
19 access lines and SureWest's population is mainly attributable to wireless competition. SureWest
20 estimates that it has lost approximately 18% to 22% of its residential customers entirely to wireless
21 carriers. SureWest expects such trends and losses to continue, particularly with the dynamic changes
22 in the marketplace and the requirement of wireless local number portability.

23 Wireless has become a significant competitor to SureWest's wireline service in the period
24 since NRF was originally adopted for SureWest in 1996. There is a significant need for parity among
25 competitors, and fairness dictates an end to disparate regulatory treatment.

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¹ WT Docket No. 04-111, Ninth Report, Released September 28, 2004, NextGen VIII, at 40.

1 **C. Competition from Cable Providers.**

2 Cable providers can offer a variety of voice and data services to customers over their own
3 coaxial cable network. Residential telecommunication customers are a prime market segment
4 targeted by cable providers, because these companies already pass and serve many homes with their
5 facilities. SureWest's service area is served primarily by two cable companies, Comcast and
6 Starstream. Comcast provides service to the majority of SureWest's customers, approximately 93%,
7 while Starstream provides service within the Granite Bay community, approximately 7% of
8 SureWest's customers.

9 Over the past few years, Comcast has completed work on \$27 million of improvements to its
10 375 mile network in the City of Roseville. Accordingly, it is well entrenched and capable of
11 supplying a variety of services to its customers, from traditional video programming to voice to high
12 speed Internet. Comcast touts its technology platform as giving it a powerful competitive advantage
13 as these services rapidly converge within the digital home. (*See* Comcast 2004 Annual Report, at
14 10). According to Comcast's 2004 Annual Report, the company launched its Digital Voice service in
15 three markets in 2004, and will be marketing this service to 15 million homes in 20 markets by the
16 end of 2005. In all, Comcast's digital telephone service will be available to 40 million homes across
17 its national footprint by the end of 2006. (*Id.*) Comcast has established a goal of delivering "a
18 superior phone service – one that delivers the quality, reliability, and simplicity of traditional wireline
19 service, plus all of the exciting features that an IP-based service makes possible." (*Id.*) Over time,
20 Comcast will roll out "services that integrate video, data and voice – such as videophone and unified
21 messaging – to continuously differentiate Comcast Digital Voice and create a unique digital
22 communications experience in the home." (*Id.*)

23 Comcast is a formidable competitor to California's ILECs. Indeed, because of its size,
24 national footprint, and extensive resources including its network management, field operations, back
25 office support and customer care teams, Comcast now can compete intensely with SureWest in the
26 Sacramento area market. Comcast has resources, facilities, and a customer base that dwarfs that of
27 SureWest, and may equal some of the larger traditional carriers. Further, as discussed above,
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1 Comcast is the primary incumbent cable provider in the Sacramento area, covering over 90% of
2 SureWest's service territory. Accordingly, SureWest faces a facilities-based provider that has the
3 ability to reach the vast majority of SureWest's customer base, and that will have the freedom and
4 flexibility to compete under what is most likely to be a deregulatory (or even deregulated)
5 framework. Comcast's telephone service is based on a VoIP platform, and therefore is highly
6 unlikely to be regulated by the Commission in any way comparable to the way local exchange carrier
7 services are currently regulated. This alone provides Comcast with a significant competitive
8 advantage over NRF ILECs like SureWest. To level the competitive playing field with respect to
9 largely-unregulated competitors like Comcast, SureWest should be released of its economic pricing
10 restrictions to the greatest extent possible, and should be relieved of many other restrictions inherent
11 in the NRF structure.

12 **D. Competition for Local Toll Services.**

13 SureWest implemented intraLATA equal access effective September 23, 1997, which allowed
14 customers to pre-subscribe to their intraLATA carriers of choice. IntraLATA presubscription
15 allowed SureWest customers to have non-discriminatory access to toll services from any toll carrier
16 electing to participate in intraLATA presubscription. In 1997, SureWest had more than 90% of the
17 intraLATA toll market share; in 2001, SureWest's intraLATA toll market share was 68%; today,
18 SureWest's market share is 46%. From 2000 to 2003, SureWest's intraLATA toll usage decreased
19 approximately 58%. SureWest notes that these figures are based on the intraLATA toll minutes of
20 use that are originated on SureWest's network. This data does not account for the significant volume
21 of minutes that are now placed on other competitors' networks, including wireless networks, which
22 would reduce SureWest's market share figures even further. Specifically, in 1996, SureWest's
23 intraLATA toll minutes of use totaled approximately 93 million. Now just eight years later,
24 SureWest's 2004 intraLATA minutes of use has dropped to below 40 million. This illustrates the
25 competition and changes that have occurred in the intraLATA toll market and the significant drop in
26 SureWest's market share that has occurred since SureWest's NRF was implemented in early 1997.

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1 **E. Competition for Broadband Services.**

2 High speed Internet services, also referred to as "broadband", while served primarily by DSL
3 and cable modem technology, is also available over broadband technologies like satellite, mobile
4 wireless data, fixed wireless, WiFi, fiber-to-the-premise (FTTP) and broadband-over-power lines.
5 The Commission's recently-adopted Broadband Report provides significant data on the various
6 broadband competitors in California that demonstrate the extent of broadband competition. (See
7 D.05-05-013, and attached report entitled "Broadband Deployment in California"). SureWest will
8 not attempt to repeat the Broadband Report data herein, but will instead focus on broadband
9 competition within its service area.

10 Satellite broadband is provided by both Direct TV and Dish. Dish has also partnered with
11 Earthlink to provide its high speed internet services. Mobile wireless data is becoming increasingly
12 more popular as it delivers data in real time to customers on their PDAs or cell phones. There are six
13 different providers of mobile wireless data service in SureWest's service territory. Fixed wireless
14 data carriers provide a stationary DSL service to a home from a nearby radio tower. There are three
15 such providers within SureWest's service territory. WiFi is a wireless broadband technology
16 promoted and championed by major industry players such as Intel, Cisco and Microsoft. There are
17 eight different providers in SureWest's area, and this type of service is growing rapidly. Broadband
18 over powerline is similar to the DSL service that SureWest offers, except that the broadband data is
19 carried over the electric company's powerline into homes. Broadband over powerline is an important
20 new entrant, because it opens a third wired pipe into every home in the typical LEC service area.

21 Although data regarding market share for broadband services is not readily available,
22 SureWest possesses some information that paints a picture of the market share for such services.
23 SureWest's own market penetration for DSL to its residential customers has reached 28%. In the
24 Commission's Third Report For the Year 2003 on the Status of Telecommunications Competition in
25 California, the Commission reported that the DSL market share is 49% and the cable modem market
26 share is 39%.² Based on this data, cable modem customers would approximate 22% penetration to

27 ² The Status of Telecommunications Competition in California, Third Report for the Year 2003, California Public
28 Utilities Commission, Submitted October 31, 2003, p. 40.

1 residential customers, for a total of up to 50% broadband penetration between DSL and cable modem
2 in SureWest's service area. Furthermore, as the recent trends have shown, the shift to broadband is
3 accelerating. With the advent of VoIP services, which are offered at a substantially-reduced price
4 compared to traditional wireline services provided by NRF companies, broadband and VoIP use is
5 expected to grow even more.

6 **F. Competition from Voice over Internet Protocol.**

7 The substantial penetration rate of broadband access in SureWest's service area has
8 competitive implications for the voice market, as well. VoIP continues its rapid gain in prominence
9 and is perceived as a replacement of the standard ILEC telephone line. VoIP is believed by many to
10 be the "killer application" that will fuel even greater competition in the DSL market and which will
11 significantly impact voice telecommunications competition. VoIP provides competitors significant
12 new advantages, allowing them to offer services beyond the reach of conventional phones. VoIP
13 offers callers new flexibility such as allowing users to program their phones to do such things as
14 redirect calls to other phone numbers, only take messages during certain hours, give messages to
15 certain callers, and send a text message or an e-mail in response to a voice call. Some predict that
16 VoIP will eventually replace circuit-switched technology.

17 SureWest currently competes with VoIP providers for voice customers. Some customers have
18 ported their SureWest residential telephone numbers through CLECs, who then provide the number
19 to Vonage or another VoIP provider. AT&T announced in December 2003 that it would deliver a
20 full complement of VoIP services to business and residential customer starting in 2004.³ AT&T has
21 stated that its plans are more ambitious than those of its rivals because they are national in scope and
22 will be offered to consumers with cable or DSL broadband.⁴ AT&T accomplished this, and in
23 September 2004, AT&T rolled out a new product called "Simple Reach" that provides as many as 10
24 different phone numbers, each from a different city, to customers using its VoIP service.⁵ AT&T's

25 ³ Telecom A.M., Warren Communications News, AT&T Plans Nationwide Residential Voice Over IP Services,
26 December 12, 2003.

27 ⁴ USA Today, AT&T to add Internet phone service, December 12, 2003.

28 ⁵ Sacramento Bee, Single Phone is a Local Call from 10 Cities, September 17, 2004.

1 service allows all of those numbers to be answered by a customer's phone in a single location. This
2 service allows friends or relatives who live in other parts of the country to dial a local number to
3 reach this customer without incurring long distance fees. Given the substantial penetration of
4 broadband access in SureWest's service area, SureWest faces stiff competition from these giant
5 telecommunications companies for the provision of voice services.

6 Cable companies are also entering the VoIP arena. In presentations to Wall Street analysts
7 and investors, cable executives said they were in a better position to deliver VoIP because startup
8 costs would be minimal given that most have already upgraded their cable plant, had excess capacity
9 and could ride voice on top of their successful broadband offerings.⁶ As discussed earlier in these
10 comments, Comcast is already rolling out its VoIP service offering, and will be able to provide such
11 service to all customers in 2006.

12 VoIP has also entered the consumer consciousness. News stories and advertisements
13 concerning the availability of VoIP have been widespread in the newspapers and in television reports.
14 Vonage advertisements regularly appear as "pop-ups" on many popular web sites. Retail outlets like
15 "Best Buy" and others sell VoIP starter kits from AT&T. Many network routers now include phone
16 ports and sales information for Vonage's broadband phone service. One survey in early 2004 found
17 that 37% had heard of telephone services that use the Internet to connect telephone calls, and 28%
18 were familiar with VoIP services.⁷

19 VoIP voice services take many forms, but they can be loosely classified into two different
20 categories: 1) those services that utilize the Public Telephone Network (PTN) and its numbering
21 system (exemplified by carriers such as Vonage, Packet8, and AT&T); and 2) those that do not (such
22 as Pulver's Free World Dialup ("FWD") and Skype). VoIP services that utilize the PTN and its
23 numbering system are catching on quickly, offering customers low cost nationwide flat rate calling,
24 the ability to have a telephone number from any part of the country, and the ability to take a phone

25 _____
26 ⁶ Telecom A.M., Warren Communications News, Cable Companies Tout New Push Into Telephony on Wall St.,
December 12, 2003

27 ⁷ Telecom A.M., Warren Communications News, Consumer Awareness of VOIP Could Spur Cable Voice Services,
28 CTAM says, March 11, 2004

1 wherever one travels and connect it to any broadband service to receive and make telephone calls.

2 VoIP providers are even beginning to introduce portable Wi-Fi phones that will allow
3 subscribers to make and receive phone calls within range of Wi-Fi wireless access points found in
4 homes, airports, cafes, fast food restaurants and other areas. Further, long distance company IDT is
5 introducing a semi-mobile phone service that works in areas equipped with WiFi.⁸

6 The FWD and Skype service offering allows a person to make free phone calls on any
7 broadband connection using devices that follow Internet standards. This can be a 'regular' telephone
8 connected to a packetizer, an IP Phone or any number of free soft-phones (software for your PC or
9 PDA). However, these services have their own unique numbering protocol different than the North
10 American Numbering Plan. There is now even a WiSIP mobile IP phone which has been optimized
11 for use with FWD and allows users to dial and receive calls from any WiFi connection. Further,
12 companies offering free services like Skype and FWD are now interconnecting with the public
13 switched network and allowing their customers to make regular phone calls for a nominal charge per
14 minute. Skype calls its plan "Skypeout" and advertises the service as "not free but pretty cheap."⁹ In
15 addition, Skype recently announced that it will launch new VoIP-based services this year, including
16 video calls, reduced-rates for corporate services, and dedicated Wi-Fi telephony.

17 VoIP is no longer a nascent industry. As of May 2005, over 115 million computer users had
18 downloaded Skype's free software to take advantage of free calling.¹⁰ The number of downloads a
19 little over one year ago was only 8 million,¹¹ which is a testament to the voracity of the basic demand
20 for these low-cost alternative services that can compete with NRF company service offerings.
21 Further, the latest version of Skype's software reportedly works well over fast dial-up connections,¹²
22 thus providing an alternative voice service to a far greater number of customers. Even America

23
24 ⁸ USA Today, IDT uses Wi-Fi to offer cheaper cell service, April 21, 2004.

25 ⁹ www.skype.com/products.

26 ¹⁰ www.skype.com.

27 ¹¹ Business Week Online, "Microsoft: Your Next Phone Company," March 2, 2004.

28 ¹² *Ibid.*

1 Online ("AOL") has entered the market for voice services. AOL announced at the 2005 VON
2 conference that it will offer an easy-to-use VoIP offering aimed at the masses.¹³ AOL's proposed
3 service offering is just the exclamation point on the obvious statement that VoIP has "gone
4 mainstream."¹⁴

5 Microsoft has also set its sights on the telecommunications marketplace. In August 2003,
6 Microsoft launched its Live Communications Server. This software allows corporations to leverage
7 their PCs to form a unified communication system on the desktop which can connect Microsoft
8 Office and Windows Messenger to create audio connections for PCs and groups of PCs.¹⁵ Most
9 recently, an IT analysis firm stated that Microsoft's release of Microsoft Speed Server 2004 R2
10 represents the latest step in Microsoft's ongoing campaign to evolve the company beyond its
11 dominant software status into a telecommunications vendor.¹⁶ In this step, Microsoft is tying
12 together all of its multimedia-capable messaging assets into a cohesive strategy to penetrate and
13 dominate the burgeoning VoIP market.¹⁷ Further, Microsoft's new Internet Explorer will include a
14 VoIP component. A Microsoft presentation stated that VoIP technology integrates voice and data
15 technology, blurring the lines between phones, desktop computers, television and wireless handheld
16 devices.¹⁸

17 A further indication of the competitive state of the telecommunications industry is the fact
18 that IP-based PBX shipments in the U.S. crossed the 50% threshold during the 3rd quarter of 2004,
19 edging Time Division Multiplexing (or "TDM") shipments for the first time as a function of total
20 PBX shipments.¹⁹ What is truly remarkable about this statistic is that this technology has taken only

21 ¹³ Telephony Online, "AOL helps usher in VoIP's growth spurt," March 14, 2005.

22 ¹⁴ *Ibid.*

23 ¹⁵ *Ibid.*

24 ¹⁶ Business Intelligence Network, "VoIP Strategy positions Microsoft to Compete in Telecom Market," May 27, 2005.

25 ¹⁷ *Ibid.*

26 ¹⁸ Telecommunications Report, Focus On..., VON Ends with Note of Exuberance with Sector Ready for Breakthrough,
27 April 15, 2004.

28 ¹⁹ Telephony Online, "VoIP enterprise shipments crack 50%," January 19, 2005.

1 three years to gain a 50% market share, since shipments of VoIP-based PBX products began in
2 2002.²⁰

3 * * *

4 SureWest clearly faces significant competitive pressures in its service area, pressures that
5 have grown significantly since SureWest entered the NRF regime in 1997. The Commission's
6 regulation of SureWest must change to keep up with these changes in the telecommunications
7 marketplace. An excerpt from an article entitled "Free up telecommunications" published in The
8 Washington Times sums it up well:

9 (Regulatory reform) will involve redesigning the entire spider web of regulations
10 that have dominion over traditional local and long-distance phone service,
11 wireless service, the Internet, broadband and cable TV. These networks all
12 intersect and now essentially compete with each other on price, speed and
13 convenience for customers. In fact, the telecom industry, which was once thought
14 to be a natural monopoly, and thus a natural candidate for price regulation, is now
15 arguably the most cost-competitive industry in America.

16 Seventy-five years ago it cost \$300 to make a 3-minute phone call from San
17 Francisco to New York. That same call now costs roughly 30 cents. That isn't a
18 result of price controls but of technological innovation and fierce competition for
19 telephone customers. And now that the phone companies compete with the
20 Internet, wireless technology and cable companies for communications services,
21 competitive price pressures are more, not less, intense than ever.

22 The old regulatory rationale is no longer really relevant to this new market in
23 communications. More important, because its effects are now demonstrably anti-
24 consumer, the current regulatory structure should be scrapped almost entirely.

25 Why not deregulate the entire communications industry and let unfettered
26 competition, innovation and new investment continue to drive down consumer
27 costs, expand choices and grow the economy.

28 The telecommunications marketplace has clearly changed, and the Commission's regulatory
paradigms must shift to respond to those changes. To avoid perpetuating the outdated regulatory
distinctions between SureWest and its many vibrant competitors, the restrictions of the NRF structure
must be lifted, and a new, balanced regulatory framework that permits Sure West to function like

²⁰ *Ibid.*

1 other competitors in today's market should be adopted in its place. Absent such action, SureWest
2 would be further handicapped against an increasing array of competitors, and its customer base – and
3 its customers – would be detrimentally affected.

4 5 III.

6 THE COMMISSION SHOULD REFORM ITS REGULATION OF NRF CARRIERS.

7 Appendix A provides a list of issues to consider relative to a new uniform regulatory
8 framework. For purpose of responding to Issue Nos. 1-9, SureWest supports adoption of a uniform
9 regulatory framework that tracks the features identified in Issue No. 10, with modifications. The
10 following responds to the issues raised in Appendix A.

11
12 Issue No. 1: Is there a uniform regulatory framework that can be applied to all providers of
13 regulated intrastate telecommunications services? If so, every element of the uniform
14 regulatory framework should be identified and described in detail. Any party that
15 recommends a specific framework should provide adequate information for the
16 Commission to implement the framework.

17 In general, SureWest believes that the Commission should pursue the adoption of a "uniform
18 regulatory framework" for similarly-situated competitors. Since ILECs currently shoulder the most
19 onerous regulations, reform of the NRF ILEC regulatory structure is a logical place to begin crafting
20 this uniform framework. With some exceptions discussed below, SureWest believes that the
21 regulatory framework applied to NRF ILECs must move toward the level of regulation currently
22 applied to CLEC, wireless carriers and other modern telecommunications competitors.

23 More specifically, SureWest proposes adoption of a regulatory framework that relies on the
24 elements identified in the OIR as the starting point, with some modifications and additions. Changes
25 to the elements as stated in the OIR are noted with ~~strikeout~~ or underline for ease of reference.
26 Specifically, such a framework should incorporate the following elements:

27 A. No price regulation except for the basic, primary local exchange access line.

1 along with the set of basic services that companies provide with a basic access line,
2 provided by the large and medium-sized ILECs to residential and business customers.

3 B. No imputation rules except for the primary residential basic local exchange
4 access line services provided by the large and medium-sized ILECs. Imputation for
5 primary residential basic local exchange access line services would be set at the UNE-
6 L floor.

7 C. Use advice letter filings to revise prices for all services provided by the large
8 and medium-sized ILECs, except residential basic local exchange services. Price
9 changes/decreases could be implemented on one day's notice after filing an advice
10 letter, but and price increases could occur only after 30 day's written notice to
11 customers.

12 D. No limitations on promotions.

13 E. Adopt FCC resale requirements.

14 F. Allow ILECs to keep gain on sale.

15 G. Decouple Yellow Page revenues from ILEC telephone operations.

16 H. Refrain/Forbear from price regulation of new services and new technologies.

17 I. Forbear from separate intrastate reporting requirements. Conform financial
18 reporting requirements to ARMIS as those reporting requirements apply to a particular
19 carrier.

20 J. No limitations on the bundling of services, with the exception that any bundle
21 including a basic residential access line must equal or exceed the UNE-L or the
22 tariffed rate for that service.

23 K. Eliminate the requirements for companies to file contracts and allow contracts
24 to become effective upon signing.

25 L. Conform affiliate transaction rules to those promulgated by the Federal
26 Communications Commission. Eliminate affiliate transaction reporting requirements.

27

28

1 Except as to the primary basic residential local exchange service, NRF price controls, price
2 imputation, and other pricing restrictions are now unnecessary. As discussed in Section II, above, the
3 well-documented competitive forces currently impacting NRF ILECs have supplanted regulation as
4 the superior mechanism for ensuring reasonable rates and quality service for California customers.
5 For similar reasons, NRF reporting requirements, bundling limitations, and affiliate transaction rules
6 are now outdated. The proposal outlined above removes these unnecessary regulatory restrictions,
7 but retains Commission oversight of basic "primary line" residential local exchange service.
8

9 Issue No. 2: What specific steps are necessary to implement each element of the uniform
10 framework identified in response to Question No. 1?

11 To implement this proposed regulatory framework, only minor steps are necessary. SureWest
12 would need to submit tariff filings to conform its tariff to the new framework. Second, as part of its
13 order in this proceeding, the Commission should make explicit its intention to amend the
14 requirements of General Order 96-A regarding the one day effective date of tariff filings submitted by
15 NRF LECs and CLECs. Finally, the Commission should include an explicit determination that the
16 framework adopted in this proceeding completely supersedes the NRF.
17

18 Issue No. 3: Which elements of the uniform framework identified in response to Question No. 1
19 can be implemented immediately and without hearings?

20 No hearings are necessary to implement any of the elements of the uniform framework
21 identified in SureWest's comments. That framework can be implemented immediately.
22

23 Issue No. 4: What specific implementation issues and details regarding the uniform regulatory
24 framework identified in response to Question No. 1 need to be addressed in Phase 2 of
25 this proceeding?

26 SureWest believes the changes outlined here could be implemented immediately, and that
27 Phase 2 of this proceeding should review the CPUC's rules and regulatory requirements, and revise
28

1 them to be in conformance with the outcome and findings in this proceeding. Accordingly, SureWest
2 proposes that the Commission adopt the regulatory framework detailed above in a decision
3 concluding Phase 1.

4
5 Issue No. 5: What criteria should be used to decide if current regulations should be replaced by a
6 uniform regulatory framework? Have these criteria been met?

7 In determining whether to replace current regulations, the Commission should evaluate
8 whether those regulations impede a carrier's ability to effectively compete in today's
9 telecommunications marketplace. The NRF ILECs are no longer monopoly providers, and they have
10 not been monopolies for some time now. As discussed above, cable companies, wireless providers,
11 and internet companies are now formidable competitors in the market for telecommunications
12 services. SureWest's comments demonstrate that it faces substantial competitive pressures in its
13 service area. Regulations that limit SureWest's ability to offer promotions, bundle services and
14 respond quickly to price changes interfere with SureWest's ability to compete and add costs to its
15 operations that competitors do not have to bear. This creates an unbalanced competitive framework.
16 Accordingly, the Commission has a compelling basis upon which to base its decision to replace
17 existing regulations with the structure that SureWest outlines in these comments.

18
19 Issue No. 6: Why is the uniform regulatory framework identified in response to Question No. 1
20 superior to current regulations?

21 The uniform regulatory framework identified in SureWest's comments is superior because it
22 permits NRF carriers to effectively respond to the competitive pressures in its service area. In
23 addition, it will allow all carriers to compete on a more balanced playing field, as opposed to the
24 historically-skewed framework that provided competitors with advantages in order to provide
25 incentives for them to enter the market. These regulatory disparities between competitors and
26 incumbent telecommunications carriers have existed for far too long. With the convergence of voice,
27 data, and video services, which can now be provide from a single network, it is time to make the shift
28

1 to a more balanced framework. Even as proposed herein, the framework will not be fully balanced,
2 as the NRF ILECs will continue to be the providers of last resort and the Commission will retain
3 pricing oversight of basic residential service. By contrast, CLECs will remain free to target only
4 those customers and areas that they choose, without facing allegations of "redlining." Overall,
5 SureWest's approach balances universal service interests with the need to give NRF carriers the tools
6 to compete effectively.

7
8 Issue No. 7: How does the uniform regulatory framework identified in response to Question No. 1
9 achieve the following objectives: (A) Ensure, to the extent feasible, that every person
10 and business in California has access to modern, affordable, and high quality
11 telecommunications services; (B) treat all competitors and technologies neutrally; and
12 (C) encourage technological innovation, economic development, and employment in
13 California?

14 The SureWest proposal does not modify the existing carrier of last resort obligation shared by
15 all NRF carriers. Accordingly, subscribers would continue to have access to service under the
16 proposed revisions. The Commission would retain pricing regulation over residential basic service,
17 allowing the Commission to set the rates for such service at levels that make telephone service
18 affordable to the largest number of subscribers. The competitive options available to businesses are
19 such that price regulation is not necessary for this service offering. The reduction in regulation
20 proposed in these comments will treat competitors more equally and will spur innovation and bring
21 customer benefits as NRF companies will be able to compete under similar levels of regulatory
22 restraint as those now enjoyed by CLECs and wireless carriers.

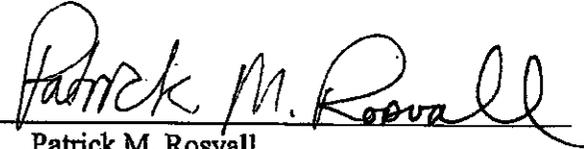
23
24 Issue No. 8: What criteria and procedures should be used to (A) determine which services should
25 remain subject to price regulation; (B) set and revise prices for services that remain
26 subject to price regulation; and (C) remove a particular service from price regulation
27 in the future?

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Dated this 31st day of May, 2005, at San Francisco, California.

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EXHIBIT A

OTHER CARRIERS FIBER ROUTES

