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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Service

No. 05-C-0616

COMMENTS OF THE CABLE TELECOMMUNICATIONS ASSOCIATION OF NDEW YORK, INC. IN RESPONSE TO SEPTEMBER 21, 2005 STAFF WHITE PAPER

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STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE
Albany, New York 12223-1350

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REPLY COMMENTS OF THE CABLE TELECOMMUNICATIONS ASSOCIATION OF NEW YORK, INC.

INTRODUCTION

The Department of Public Service Staff White Paper[1] does not sufficiently consider the many preemptive, jurisdictional, and timing questions inherent in this proceeding. For example, the New York Public Service Commission cannot redesign interstate intercarrier compensation and has no jurisdiction to deregulate Verzion services. If the Commission were to complete this proceeding now, it would create more confusion than clarity by acting before the conclusion of several pending and active FCC proceedings. In addition, there is pending federal legislation[2] that will sculpt the landscape of telecommunications regulation for the foreseeable

[1] Staff of the Department of Public Service issued a White Paper on September 21, 2005 (hereinafter "Staff White Paper").
[2]See Senate Bill 1504 introduced on July 27, 2005 by Senator John Ensign (R-NV)and entitled "Broadband Investment and Consumer Choice Act." The bill seeks to establish a new regulatory framework for all services currently regulated under the common carrier and cable titles of the Communications Act, as well for commercial mobile radio services. The Bill also establishes a new framework for "communications services" and "video services" that eliminates rate and entry regulation for these services but applies a number of the social obligations currently imposed on common carriers and cable operators.

future. These proposals indicate strong Congressional desires to act in the near term or at least in the first quarter of 2006.

When the time is appropriate for the Commission to consider these issues, there are areas where the Commission can and should act to safeguard fledgling competition. The key to sustained retail competition depends on the ability of competitors to obtain nondiscriminatory access to the wholesale services that remain available only from incumbent local exchange companies, such as Verizon. Nondiscriminatory access must be preserved, and wholesale regulation must continue and made even more robust in select areas. These areas include number porting, pole attachments, intrastate intercarrier compensation, processing of customer orders, and access to trunks and interconnection. Incumbent providers should not be able to use their historical market power to deny access to these fundamentally important and non-substitutable items.

Appropriate regulatory protections ensure that competitors will receive access to incumbent wholesale services that are the same price and quality as the wholesale services that incumbents provide to their own retail operations.[3] The Commission and FCC regulations requiring nondiscriminatory wholesale practices certainly will not skew the incumbents' power to compete on the retail level, nor will they fully blunt the competitive advantages incumbents enjoy as a result of controlling the network. If done properly, however, they may allow new entrants to function in the retail marketplace.

See Also The House Energy and Commerce Committee chairman, Joe Barton, R-Texas, and ranking minority member, John Dingell, D-Mich. released a draft bill that would provide sweeping changes to the 1996 Telecommunications Act. The House draft bill's approach to municipal broadband largely tracks language used in the Community Broadband Act of 2005 (S. 1294), which Sens. Frank Lautenberg, D-N.J., and John McCain, R-Ariz., introduced in June. The Barton-Dingell draft and the Lautenberg-McCain bill stand in contrast to bills introduced by Sens. Jeff Sessions, R-Ala., and John Ensign, R-Nev.

[3] See, United States v AT&T, 524 F Supp 1331 (DDC 1981) (wherein the court noted that predation through cross subsidization of product lines appeared likely to occur and was in need of regulation). See also Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104 (1986)(defining predatory pricing

CTANY agrees that the public switched telephone network (PSTN) must be preserved and made more reliable as a critical component of our economy, public health and safety.[4] However, we disagree with Staff's analysis that the solution to this problem is to allow rate flexibility, especially when such flexibility is premature and could allow Verizon and Frontier to engage in predatory pricing. The importance of the PSTN to facilities-based competitors requires that regulators remain vigilant regarding a market that is characterized by a still-dominant provider controlling a ubiquitous bottleneck facility. Service quality measures for ILECs, especially as they relate to wholesale provisioning, remain vital regulatory considerations as this market begins to mature.

There is a continuing misimpression by Staff and others that facilities-based providers are not reliant on the incumbents' network. While such reliance is certainly less than that of unbundled network element platform (UNE-P) competitors, the PSTN remains indispensable to all competitors. As described in more detail below, incumbents retain the ability to thwart competition by delaying porting, abusing customer data, delaying interconnection, and complicating pole attachments. In addition, as Staff points out, so called 'intermodal competitors' also use ILECs for transport and interoffice trunking.[5]

Notwithstanding the scant amount of time that Staff had to consider these weighty issues, there is much in the White Paper that is worthy of commendation. In particular, Staff appropriately recognizes the vital role that interconnection plays for facilities-based carriers. CTANY agrees that the Commission has an integral role to play in providing a backstop when fair commercial agreements are difficult to achieve. We also agree with Staff's recommendation to continue and expand the Carrier-to-Carrier Working Group, monitor special service

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[4] See Staff White Paper, p.3.

[5] See Staff White Paper p. 97.

provisioning, and to enforce the Performance Assurance Plan (PAP). CTANY also agrees that Universal Service policies should not be changed at this time, especially in light of ongoing federal policymaking activity. However, Staff's request for comments regarding assessing non-jurisdictional entities for various funds is addressed in our initial comments, and remains problematic for CTANY members on jurisdictional and policy grounds.

CTANY also agrees with Staff's recommendation that rural ILEC rate increases should be used to fund intrastate access reform. The goal of driving these rates down to their lower interstate counterparts is laudable. In addition, we recommend that Verizon's and Frontier's intrastate access rates should also be addressed as they remain well above cost.

CTANY also supports Staff's observation regarding municipally owned networks. Such networks tilt the playing field, and public investment can provide a disincentive to private investment and shift financial risk to taxpayers.

Finally, CTANY agrees with Staff's assessment that, "As long as dominant carriers have market power, we recommend these carriers continue to be subject to more economic regulatory oversight than the non-dominant carriers and providers of wireless, cable digital voice and VoIP services."[6] Most importantly we continue to urge the Commission to temper its desire for sweeping policy initiatives with a recognition of current federal proceedings, the policy implications of adding burdensome regulations to new entrants, and the limitations of the Commission's jurisdiction over certain market participants.

CTANY does believe, however, that more work remains to be done. These issues will have a profound effect on both competitors and consumers alike. The best means to serve the consumers of New York is to take a more measured approach, one that recognizes the realities of

[6] Staff White Paper p. 50.

pending federal regulatory and legislative activity. Such approach necessarily demands that the Commission suspend this proceeding until at least the most sweeping changes expected at the federal level take place.

POINT I

VERIZON'S AND FRONTIER'S CLAIM THAT WHOLESALE REGULATION SHOULD BE REDUCED IS WITHOUT MERIT

History has shown that if left to their own devices, owners of upstream, monopoly services will discriminate against competitors in order to defeat retail competition. Now, more than ever, retail competition in New York State is contingent on effective regulation of Verizon's and Frontier's wholesale services. The Commission should resist the requests by the incumbent providers to reduce regulation of the "wholesale" ILEC services upon which most retail providers rely to compete with ILECs' retail services. Although Frontier does not elaborate on its request, Verizon contends that: 1) retail competition is irreversible; 2) retail competitors of Verizon do not rely significantly on Verizon's network; and 3) regulating Verizon's wholesale services places an undue burden on Verizon's retail services. These assumptions made by the incumbent providers are necessarily misguided and false.

A. Past Anticompetitive Behavior of Bell Companies

Prior to the AT&T ("Ma Bell") divestiture in 1984, long distance competition depended on Baby Bells, including New York Telephone, complying with their obligation to carry the long distance traffic of AT&T's competitors as quickly and efficiently as it completed the calls of AT&T's customers. AT&T's competitors were vulnerable because AT&T could stifle competition by prejudicing the quality and price of service to competitors at the monopoly stage of the product line. AT&T could impede long distance telephone competition by instructing its operating companies --- through contract negotiations, operations or regulatory actions -- to undercut long distance competitors' ability to deliver their customers' calls. This was no different than a timber company that owns trucking companies upon which rival timber companies rely for delivery of their product could destroy competition in the timber market for a particular region by instructing its trucking companies to delay deliveries of competitors' timber.

AT&T's competitors initially complained about AT&T's anticompetitive practices and were accused by some of paranoia. Soon, however, federal regulators and the Justice Department concluded that AT&T was, in fact, engaging in subtle and not so subtle anticompetitive schemes.[7] In the final of several antitrust suits brought against the Bell System companies, the Justice Department charged that AT&T, New York Telephone Company and the 21 other Bell Operating companies had co-conspired to monopolize various telecommunications markets in the United States, to the detriment of the American consumers.[8] In the face of these claims, AT&T agreed to divest itself of New York Telephone and the other Bell System operating companies so that it could continue to provide long distance, business and other communications services.[9]

B. Today's Retail Voice And Data Markets Are Vulnerable To Anticompetitive Behavior At The Wholesale, Bottleneck Level

Verizon and Frontier (with wholesale and retail services under a single corporate entity) in many ways resemble their Bell System predecessors. As incumbent landline telephone companies, they have extensively deployed network facilities and built in public rights-of-way using rate-of-return financing. The destruction of today's retail voice and data markets in New

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[7] See, e.g., In the Matter of the use of the Carterfone Device in Message Toll Telephone Service, 13 FCC 2d 429 (1968)(finding that the tariff was unreasonable because it prohibited the use of interconnecting devices that did not adversely affect the telephone system).

[8] See, United States v. American Telephone and Telegraph Co., 461 F. Supp. 1314 (D.D.C., 1978).

[9] United States v American Telephone and Telegraph Co., 552 F. Supp 131 (D.D.C., 1982) aff'd sub nom. Maryland v United States, 460 U.S. 1001 (1983).

York State, however, would not require the sort of affiliate conspiracies as those alleged against the Bell System because Verizon and Frontier, as single entities, control all the wholesale bottleneck services that retail competitors depend upon for survival. Retail competition cannot be sustained unless Frontier and Verizon provide bottleneck services such as pole attachments, number porting, and interconnection to retail companies as quickly and well as they provide these services to their own retail divisions.

Given the history of the Bell System, and the numerous holding companies in similar positions, it is highly likely that they would engage in predatory practices if given the opportunity to do so.[10]

C. Wholesale Regulation of Verizon and Frontier is Particularly Crucial

ILECs today need not collude with affiliates to stifle retail competition. Also, retail competitors have fewer tools today to oppose anticompetitive behavior of ILECs than long distance companies had to oppose AT&T and the Regional Bell Companies. When FCC regulation failed to halt the anticompetitive actions of New York Telephone and other operating Bell Companies, long distance competitors were able to turn with confidence to the antitrust laws. As Judge Harold Greene, who presided over the breakup of AT&T, noted, divestiture of the Bell System by the Justice Department ended the incentive of operating companies to favor AT&T. In the words of Judge Greene:

> For a great many years, the Federal Communications Commission has struggled, largely without success, to stop (anticompetitive) practices ... through the regulatory tools at its command. A lawsuit the Department of Justice brought in 1949 to curb similar practices ended in an ineffectual consent decree. Some other remedy is plainly required; hence the divestiture of the local Operating Companies from the Bell System. The divestiture will sever the relationship between this local monopoly and the

[10] See, Otter Tail Power Company v United States, 410 US 366 (1973) (finding Otter Tail violated the Sherman Act by refusing to sell power or wheel power for potential competitors).

> other, competitive segments of AT&T , and it thus will insure -- certainly better than any other type of relief -- that the practices which allegedly have lain heavy on the telecommunications industry will not recur." US v AT&T, 552 F Supp 131, at 223 (D.D.C. 1982).

Divestiture of Verizon's wholesale business would dramatically advance competition, but it does not yet appear likely that the antitrust laws will readily be available to bring about that result – or deter the action that would warrant divestiture. Recently, the Supreme Court held that Verizon's duty to deal with competitors lies mainly in the Telecommunications Act, as opposed to the antitrust laws.[11] Entities challenging a Verizon refusal to deal with them may therefore be more inclined to limit themselves to the FCC and state administrative agencies, which may not be empowered to order divestiture. Hence, Verizon faces less risk from anticompetitive behavior and the fate of retail competition rests principally with the FCC and state regulators.

Regulators must remember that facilities-based competitors require access to the incumbents' network in order to provide communications services. Facilities-based competitors do not depend on unbundled network elements in the comprehensive manner associated with UNE-P competitors. However, facilities-based competitors remain acutely dependent upon access to the PSTN, which can be gamed by incumbent providers. However, incumbents have the practical ability to thwart competition by delaying porting, misappropriating competitive and customer data, delaying interconnection and complicating pole attachments.

Thus regulators must remain vigilant to ensure that incumbents do not inappropriately capitalize on their control over the interconnection bottleneck to protect their market advantage from competitive threats. Consequently, service quality measures applicable to incumbents, especially measures that relate to wholesale provisioning, remain important regulatory considerations, even as competition in the retail market matures.

[11] Verizon v Trinko, 540 U.S. 398 (2004)

D. Pole Attachment Regulation Should be Designed to Assure Equal Access to All Users

As noted in the staff White Paper, CTANY and its members are concerned about the ability to access poles, ducts and conduits as essential facilities. Because many of these are owned by telephone utilities, a bottleneck often results inhibiting the ability of cable operators and CLECs to access these facilities in a timely and reasonable manner. Local franchises, environmental restrictions, and economic barriers preclude cable operators and CLECs from placing additional poles in areas where poles already exist.[12] Redundant aerial plant structures are therefore neither legal nor feasible. Moreover, in most instances underground installation of the necessary cables is impossible or impracticable. Thus ILEC and electric utility company poles provide virtually the only practical physical medium for the installation of television cables.[13]

The Commission instituted a proceeding in March, 2003 which recognized that access to utility poles, ducts, and conduits is essential for cable operators and other attachers, and that changes to the pole attachment procedures were necessary to reflect the new communications marketplace and to reduce barriers to competitive entry.[14] Cable operators and others with pole attachments need accelerated access to poles and conduits to complete upgrades and new builds for the deployment of important new services, including broadband, digital television, local exchange service, and VoIP. Pole attachers cannot fairly compete for customers if the attachers cannot swiftly access poles and conduits. This proceeding provided an important forum for

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[12] *See* S. Rep. No. 721, 95th Congress, 1st Sess. 2 (1977) ("Use is made of existing poles rather than newly placed poles due to the reluctance of most communities, based on environmental considerations, to allow an additional duplicate set of poles to be placed.").

[13] *FCC v. Florida Power Corp.*, 480 U.S. 245, 247 (1987).

[14] *See e.g. Proceeding on Motion of the Commission Concerning Certain Pole Attachment Issues,* Order Instituting Proceeding, Case 03-M-0432 at 5 (issued and effective Mar. 27, 2003).

discussing these issues and resulted in an Order resolving many issues.[15] The final step in the proceeding is to create a generic pole attachment agreement to implement the order set forth by the Commission. The proceeding focused on access to poles, ducts and conduits and thus the proceeding did not address the pole attachment rental rate paid to pole owners.

The Staff White Paper presents a misunderstanding of the rental rate paid to utility companies in the form of pole attachment rates. Although the Commission laudably adopted the FCC cable formula in 1997, there have been numerous inconsistent applications of the FCC cable rate formula. This apparent lack of understanding is reflected in the staff White Paper that refers to the FCC rate formula as a "discounted rate."[16] This is simply not accurate.

Although the Staff White Paper seeks to essentially freeze the rate paid to Verizon, at $8.97 per pole, Verizon's rate is almost double that permitted by the FCC formula, resulting in millions of dollars of monopoly overpayments to Verizon annually, to the detriment of cable operators, CLECs and New York consumers alike.[17] Considering Verizon's dominance in the communications industry, its position as a bottleneck facility, and its entry into new services such as video, it is hard to find a compelling scenario whereby Verizon's competitors should continue to subsidize Verizon's monopoly operations in the form of pole rental overcharges.[18]

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[15] Order Issued August 6, 2004.

[16] Staff White Paper p. 102.

[17] Indeed, as the United States Supreme Court has recognized, monopoly pricing of pole attachments contravenes Congress' "instruction to the FCC to 'encourage the deployment of broadband Internet capability by removing barriers to infrastructure investment.'" *National Cable & Telecom. Ass'n v. Gulf Power Co.*, 122 S.Ct. 782, 789 (2002).

[18] On October 27, 2005, Verizon Communications reported its third quarter earnings and wireless revenues were up 23%. Some of the of the highlights include: 7 million net customer additions (42.1 million total customers); $7.3 billion in revenue; Average monthly service revenue per customer increased 3.1% year-over-year to $51.58; 22.5% operating income margin; and Churn (customer turnover) of 1.5 percent per month . Also this week Verizon Wireless became the second largest wireless company in the US, behind Cingular (Cingular completed its buyout of AT&T Wireless and became #1).

However, if the Commission seeks to maintain the present rate paid to Verizon, CTANY urges the Commission to consider a pole attachment rate freeze on all rates paid to all utilities. Such a rate freeze will provide some measure of certainty for new competitors and prevent monopoly pole owners from increasing these subsidies further.

POINT II

REGULATION OF NETWORK RELIABILITY, SERVICE QUALITY, AND UNIVERSAL SERVICE WARRANT NEW APPROACHES

A. Network Reliability

CTANY recognizes the importance of the redundancy and resiliency of New York's telecommunications network to the security and economy of the State. In fact, the significant private investments that New York cable companies have made to the State's critical infrastructure has helped make New York's network one of the most diverse and modern networks in the world. CTANY appreciates, however, that coordination and recovery of a network controlled by multiple owners with differing layers of state regulation present a challenge to state officials responsible for the reliability of the network.

The answer to this challenge, however, is not to apply the kind of 'command and control' regulation that fit a monopoly telecommunications regime and that ignores the opportunities for retail consumers to choose from among competing providers, when such choice is available. For example, data collection on a granular basis that imposes costs on the system and creates the proverbial 'recipe book' for those who would utilize this information for destructive purposes is a 20th Century answer to a 21st Century problem. Similarly, imposing capital investment requirements on monopoly providers to ensure that they reinvest in their networks is clearly inappropriate for entities such as cable providers that have proven that market demand is sufficient to drive investment that improves marketability and also adds to the vitality of the network.

Rather, CTANY encourages the kind of 'public-private partnership' that has characterized the State's cyber-security regime. A task force of key state security people, Commission personnel and private sector representatives has added to the security of the infrastructure without skewing investment decisions or raising issues about proprietary or competitively sensitive data being gathered in the public domain. Key to this partnership is a spirit of voluntary cooperation that is necessary both in times of prevention and times of crisis.

Recently, Governor Pataki convened the New York Telecommunications Reliability Advisory Counsel (NYTRAC) comprised of top industry leaders, government officials, economists and others working together to ensure the viability and reliability of the State's telecommunications network. This structure may present the kind of forum needed to address these sensitive issues. CTANY recommends that the Commission work with NYTRAC on meeting these critical policy goals before adding new layers of regulatory burdens.

B. Service Quality

The Staff White Paper expresses a great interest in service quality, especially to the extent that service quality is perceived as impacting network reliability. As new competitors of voice communications, cable operators are interested in the quality of their service as well as the reliability of the backbone network in order to both attract and retain customers. Even though cable operators use private network facilities to deliver non-nomadic VoIP services to retail customers, these services depend upon interconnection with and transmission of calls through the PSTN.

The Performance Assurance Plan (PAP) developed by the Department staff in the Commission's § 271 proceeding was intended to safeguard the ability of Competitive Local Exchange Companies (CLECs) to use Verizon's network to serve retail customers. The erosion of UNE availability and cost-based pricing may drive some of these companies from the retail market. However, cable companies, having invested over $95 billion to rebuild their infrastructure to provide leading-edge services, promise sustainable, facilities-based competition in the local market. This competitive opportunity, however, remains contingent on the continued availability of wholesale interconnection and associated services. The PAP covers many of these services. Therefore, the PAP should therefore be revamped and strengthened. Specifically, carrier-to-carrier metrics should be combined with the PAP, penalties for discriminatory conduct should be increased, and Verizon's rate of return should be tied to its wholesale service. In the absence of such measures, carrier-to-carrier relations will remain the Achilles' heel of local competition.

The Staff White Paper seeks to employ a three-pronged reporting process: Quarterly reports on Customer Trouble Report Rate, quarterly reports on Mean-Time-to Repair, and an Annual Report on Network Reliability.[19] The White Paper suggests that these reports would help to identify problems and seek corrective action if needed even as the White Paper readily acknowledges that the Commission lacks the regulatory authority to impose rules and regulations on some providers such as cable operators. The White Paper expects that despite the lack of jurisdiction, providers such as cable operators will be willing to provide "any and all information necessary, on a proprietary basis where requested" so that "vital information is available under any and all circumstances." This recommendation is overly broad and could lead to unnecessary

19 Staff White Paper p. 73.

litigation over jurisdiction. Indeed, the White Paper concludes that such "vital" information is necessary from "those providing the backbone facilities of the telecommunications network."

The White Paper incorrectly presumes that cable operators, as providers of VoIP services, are providing the backbone facility of the telecommunications network. CTANY would like to clear up this misunderstanding by reiterating that the delivery of VoIP services by cable operators relies in large measure on the reliability of the PSTN.

The reporting requirements envisioned by the Staff White Paper are not necessary to ensure that our companies will provide a secure and reliable network to end users. We believe that consumers are the best arbiters of reliable service and service quality provided that they have access to competitive alternatives. We believe the Commission's regulatory authority is best used to support the ability of competitors to fairly enter and remain in a local service market that has long been dominated (and continues to be dominated) by a single carrier. Consumers will thus help to dictate the types of services that are most important to them as well as whether a particular carrier is meeting these consumers' needs.

The quality and integrity of wireline services must be maintained as so many alternative modes of service are heavily dependent on the incumbent providers. Verizon's claim that wholesale regulation will encumber its retail service is baseless. Just as timber companies needed untethered trucking companies to deliver their product to market, cable companies and other retail competitors need nondiscriminatory provision of the services that are controlled by Verizon in order to compete in New York State.

C. Universal Service

The recommendation by the Rural Independent Telephone Companies (RITC) should also be summarily rejected. The RITC asks the Commission to assess a fee upon all providers of voice service and to submit the proceeds to the RITC to subsidize their provision of telephone service in rural areas. As discussed in our initial comments, the Commission also lacks jurisdiction to levy such an assessment. The RITC proposal is contrary to the public interest because requiring new entrants to subsidize incumbent RITC members creates a disincentive to competitively enter rural markets. Thus rural customers would not enjoy the benefits of competition. Such subsidies could also reinforce substandard operational practices by inoculating the management of RITCs from the competitive consequences of their decisions. Finally, such assessments, albeit presumably minor, would increase the prices charged by all voice providers and ripple into the products of businesses throughout the State.

In a comment that held broader truth than perhaps intended in this proceeding, one party noted:

> "In a competitive market, carriers should not be required to subsidize each other, and in any event there is no reason to assume that claimed revenue problems of high-cost LECs cannot be addressed through the rate case mechanisms."[20]

POINT III

THE WHITE PAPER'S SUGGESTION THAT THE COMMISSION ESSENTIALLY DEREGULATE THE RATES THAT VERIZON CHARGES FOR ALL BUT ONE SERVICE RUNS CONTRARY TO THE PUBLIC SERVICE LAW AND IS AN INVITATION TO PREDATORY PRICING

Without analyzing either case law on the ratemaking duties of regulatory agencies or the risks of dominant carriers using excess profits from some services to defeat competitors for other services, the Staff White Paper suggests that the Commission deregulate the prices Verizon charges for all services except those described as basic service. With regard to basic service, the White Paper recommends that Verizon be allowed a discretionary rate ceiling but no floor.

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[20] Initial Comments of Verizon New York, Inc., p. 35

Further, unlike its recommendation that small rural companies offset added revenues from basic service rate increases with intrastate access charge reductions, the White Paper recommends that Verizon be allowed to keep the profits from its increases – to use as it wishes. As discussed below, the White Paper recommendation runs contrary to the Public Service Law and is an invitation to predatory pricing by Verizon.

A Public Service Law Section 91 Requires The Commisison To Set The Rates That Verizon Will Charge For Non-Basic Services

The Commission's interpretations of the Public Service Law should be assessed under a realistic appraisal test, which asks whether Commission action reasonably promotes the Legislature's fundamental intent in enacting the provisions under dispute. [21] The Commission's most fundamental duty is to assure that ratepayers pay "just and reasonable rates" for utility service.[22] Sections 91, 92 and 97 of the Public Service Law (PSL), for example, obligate the Commission to assure that telephone companies such as Verizon charge only "just and reasonable" rates.

Staff's White Paper assumes the Commission needs to set Verizon's rates for only one service. The Commission has apparently concluded that its ratemaking duties no longer apply to remaining services because a competitive marketplace allegedly exists for all non-basic services and the marketplace will bring customers of Verizon just and reasonable rates. In addition to its failure to demonstrate a competitive marketplace, the White Paper's reasoning ignores a wealth of relevant case law.

The relevant provisions of sections 91, 92 and 97 of the PSL have remained unchanged since 1970, long before competition existed for telephone service. There is no ground, therefore,

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[21] See, Crescent Estates v Public Serv. Comm'n , 77 N.Y.2d 611 (1991) (overturning a Commission rate decision); Citizens for an Orderly Energy Policy v Cuomo, 78 N.Y.2d 398 (1991).

[22] Matter of Niagara Mohawk v Commisison, 69 N.Y.2d 365 (1987).

to assume that the Legislature intended the Commission to stop setting rates under any circumstances, much less if Verizon lost customers for some services to competitors.[23] As the United States Supreme Court emphasized in Federal Power Commission v Texaco, Inc., economic theory cannot substitute for legislative mandate. In the Court's words:

> "In concluding that the Commission lacks statutory authority to place exclusive reliance on market prices, we bow to our perception of legislative intent. It may be, as some economists have persuasively argued, that the assumptions of the 1930's about the competitive structure of the natural gas industry, if true then, are no longer true today...It is not the Court's role, however, to overturn congressional assumptions embedded in the framework of regulation established by the Act."[24]

As long as the Commission is directed by the PSL to set the rates charged by Verizon and Frontier and to follow the ratemaking procedure prescribed by the Legislature in PSL sections 91, 92 and 97 (which preclude major rate increases or Commission initiated rate changes without formal evidentiary hearings), the Commission cannot allow ILEC rates to float with the market. Thus, the Commission may not deregulate ILEC rates for intrastate phone service.

Staff's White Paper also ignores the Public Service Law's hearing requirements. Even if the Commission could significantly reduce rate regulation of ILECs, it must first comply with the procedural requirements of the PSL for reviewing the reasonableness of rates.[25] If, as the court held, the Commission must afford all interested parties the procedural safeguards of sworn testimony and cross examination before it acts in individual rate cases, then the Commission

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[23] See, New York Public Serv Comm v Federal Power Commission, 511 F2d 338, 354 (DC Cir, 1975) ("There may be reason for the legislature to enact a deregulation for the natural gas industry, but so long as it prescribes a system of regulation by an agency subject to court review the courts may not abandon their responsibility by acquiescing in a charade or a rubber stamping of nonregulation in agency trappings").

[24] 417 US 380, 400 (1974)

[25] New York Telephone v Public Service Commission, 59 AD2d 17,19 (3rd Dept) lv to app denied, 42 NY2d 810 (1977): "(t)he statute contemplates a full public hearing (see Governor's Memorandum of Approval, NY Legis Ann 1970, pp 480-481) ... In our view, all interested parties must be permitted to call and cross-examine witnesses and to rebut adverse claims..."). Id at 19.

must provide interested parties the opportunity to present sworn testimony and cross-examine proponents of the theory that the market will result in just and reasonable rates for non-basic services before it decides to use the theory to allow rate changes.[26] For the White Paper to make consequential findings on market power without putting parties' positions to the test of formal evidentiary hearings would be arbitrary on its face.[27] .

Additionally, even if the Commission had authority to rely on the marketplace, rather than the ratemaking process mandated in the PSL, and even if it held formal hearings before allowing rate changes, the PSL continues to mandate ILEC tariffing and notice requirements that cannot be waived.[28] The White Paper's proposal would violate these mandates.

Finally, the Commission cannot circumvent its duty to review "mini" rate proposals by allowing increases below 2 and one half percent. The 2½% threshold avoids the need for hearings, although a Commission decision not to holdings hearings in some instances might be an abuse of discretion, but it does not avoid the statutory mandate of Commission review.

B The Commission Cannot Lawfully Grant Parties' Suggestions To Deregulate ILEC Rates

Requiring Verizon to charge the same rate statewide for competitive services is sound policy. Allowing pricing flexibility for noncompetitive services is not rational because it creates an opportunity for excess profits from some services that can cross-subsidize predatory prices for other services. The White Paper's proposal to give Verizon pricing flexibility for all but basic service is therefore not only unlawful but may encourage anticompetitive behavior on the most competitive non-basic services, which the White Paper would place beyond Commission review. For the Commission in this paper proceeding to make consequential findings on market power –

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[26] See, Chenango and Unadilla Tel Corp v Commission, 45 A.D.2d 409 (3rd Dept 1974).

[27] See New York v FPC, supra

[28] See, eg, MCI v Public Serv Comm, 169 A.D.2d 143, 145 (3rd Dept 1991).

the analysis of which will vary from service to service and place to place – without putting parties' positions to the test of formal evidentiary hearings would be arbitrary on its face. The Commission should reject the White Paper's proposal.

The Commission should also make clear that ILECs do not enjoy state action immunity from state and federal antitrust actions because New York's policy is to encourage – not displace – competition.[29] Finally, if the Commission decides to allow Verizon to increase its rates for basic service, the Commission should treat Verizon and Frontier as staff would treat the rural companies. There is no rational basis for offsetting rural companies' increases with access charge reductions and not do the same for Verizon and Frontier, whose access charges are also well above relevant costs.

While the Commission has broad discretion in setting rates, those rates must be just and reasonable rates for regulated entities[30] and their discretion is not unlimited.[31] Requests for major rate changes must be subjected to formal evidentiary hearings.[32] Verizon's request to change rates, without limitation, on a single day's notice, would render § 91's hearing requirement meaningless and is impermissible.[33]

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[29] Contrast Capital Tel Co. v New York Telephone, 750 F2d 1154(2d Cir 1984)(which held that New York Telephone's allegedly anticompetitive activities were protected from federal antitrust scrutiny by state action immunity because New York policy favored regulatory controls over competition) with Capital Telephone v Pattersonville Telephone et al, 56 NY2d 11(1982) (wherein the New York Court of Appeals held that the Commission's approval of a practice challenged as anticompetitive would not preclude a private state antitrust claim contesting that practice).

[30] PSL 91.

[31] Nationwide Cellular Service, Inc. v Commission, 180 AD2d 234 (3rd Dept 1992) (Weiss, J). appeal denied 80 NY2d 234 (overturning a Commission rate order allowing rate discounts as arbitrary on its face); see also Matter of Lefkowitz v Public Service Commission, 40 NY2d 1047 (1976).

[32] New York Telephone v. Commission , 59 AD2d 17, 19 (3rd Dept lv to app denied 42 NY2d 810 (1977) ("all interested parties must be permitted to call and cross-examine witnesses and to rebut adverse claims").

[33] See, Tall Trees Constr. Corp. v Zoning Board of Appeals, 97 NY2d 86 (2001) (statutes cannot be read in a manner that renders provisions meaningless).

Furthermore, because incumbents can improperly use the advanced competitive information that they obtain through the provision of wholesale services to gain a retail advantage, we cannot support a broad grant of retail rate flexibility to Verizon and Frontier that is not counterbalanced by protections against anticompetitive practices and economic predation.

A $24.95 rate for basic service would – by staff's own admission – be based solely on the fact that Verizon charges that rate in Manhattan. There is no record basis in this case for assuming such a rate would be just and reasonable to customers outside Manhattan. Thus, the Commission would lack a rational basis for allowing such a rate.[34]

The above criticisms represent only a sampling of the legal and policy infirmities in Verizon's and Frontier's requests for financial and deregulatory benefits. As the Commission understands, the devil in such initiatives is always in the detail. The Commission should reject the ILECs' proposals or, at the very least, refer them to a separate proceeding for thorough analysis.

POINT IV

THE FINANCIAL AND DEREGULATORY WISH LIST PRESENTED BY FRONTIER AND VERIZON INCLUDES REQUESTS THAT ARE BEYOND THE COMMISSION'S JURISDICTION, OUTSIDE THE LAWFUL SCOPE OF THIS PROCEEDING AND CONTRARY TO SOUND POLICY

The Commission should not grant Verizon's and Frontier's expansive wish-list because to do so would skew the competitive playing field in their favor by, among other things, allowing ILECs to subsidize competitive service offerings with profits from asset sales or less competitive services. For example, Verizon asks that the Commission : 1) promulgate a

[34] Nationwide Cellular v Commisison, supra.

regulation entitling Verizon to keep all gains on asset sales; 2) allow Verizon to shut off (or threaten to terminate) dial-tone service in order to induce customers to pay other services; and 3) deregulate its rates by permitting "major" rate changes on one day's notice.[35] Frontier recommends similar measures and asks that the Commission detariff all ILEC offerings, except single line, unfeatured residential service.[36]

Although Verizon states that other, unspecified Commission action may be needed to "ensure that the benefits of intermodal competition are fully realized" and that such action would require amendments to the Public Service Law [37] it argues that the "Commission has the power to implement all of Verizon's proposals within the current statutory framework, either by changing its own regulations, or by overruling orders that introduced now outmoded regulatory requirements, or by changing its regulatory practices."[38] Neither Verizon nor Frontier, which offers a similar jurisdictional assessment, provides a single case in support of its position.

A. Verizon's Proposal For A Regulation Declaring That It Will Keep All Gains On Sales of Assets Is Inconsistent with PSL § 113(2), Relevant Case Law, or A Competitive Retail Market

Based on assumptions that the Commission has traditionally allowed ratepayers to receive the benefit of some or all tax refunds (and gains on sales) to avoid excess utility earnings and that its own rates are no longer subject to regulation – Verizon suggests that the Commission promulgate a regulation declaring that all income tax refunds and gains on asset sales belong to Verizon and that all Verizon sales are presumed prudent and reasonable. As a threshold matter, the undergirding of Verizon's proposal is a misstatement of both Commission jurisdiction of its

[35] Verizon Comments p. 4
[36] Frontier Comments pp. 11-19
[37] Verizon Comments pp. 5, 7
[38] Verizon Comments p.5

rates, which is unchanged, and the basis for the Commission's policy on income tax refunds and gains on assets. The Commission has not necessarily allocated gains and tax refunds to ratepayers in the past in order to avoid excess utility earnings. Rather, it has done so because inasmuch as ratepayers supported income tax filings and the carrying charges on assets that gave rise to utility profits, the Commission felt ratepayers deserved a portion of utilities' refunds and gains in asset value. Indeed, in its latest challenge to a Commission decision allocating gains to ratepayers, Verizon claimed the Commission's decision had to be overturned because the Commission had not examined whether Verizon's profits were excessive. The Court of Appeals in New York Telephone v Commission,[39] rejected Verizon's position and expounded at length on the Commission's broad discretion to protect consumer interests in such gains.

Verizon's suggestion that the Commission should promulgate a regulation declaring that all gains will go to Verizon and all sales will be deemed reasonable ignores, among other things, Public Service Law § 113(2). That provision mandates that when a telephone corporation in New York State, such as Verizon, receives a gain on an asset sale, or an income tax refund, the Commission must hold a hearing that balances ratepayer and shareholder interests. The Commission must then (and only then) determine how the gain or refund should be allocated between ratepayers and shareholders.[40] A regulation granting such gains to Verizon would ignore § 113(2)'s mandate that the Commission balance ratepayer and shareholder interests. Investors in rate-regulated companies cannot be automatically assigned gains in the value of utility properties simply as an incident of investor ownership.[41]

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[39] 95 NY2d 40 (2000)

[40] E.g., Niagara Mohawk v Commission , 66 NY2d 83 (1985) (wherein the Court of Appeals upheld a splitting of refunds between ratepayers and shareholders because the Commission had reviewed all relevant evidence and "recognized the valid competing interests of the consumers and the utility").

[41] Democratic Central Committee of D.C. v Washington Metropolitan Area Transit Commission, 485 F2d 786 (DC. Cir 1973), which was cited by the Court of Appeals in NYT v Commission, supra,

The proposed Verizon regulation would also defeat the Commission's ability to monitor and, in some cases, reject attempts by Verizon to sell assets to affiliates at improvident prices or predatory terms.[42] Therefore, for all the reasons stated, Verizon's proposal should be rejected.

B. Verizon's Request that It Be Allowed to Terminate Monopoly Services to Obtain Payment for Competitive Services Should Be Carefully Scrutinized

Allowing ILECs to use their monopoly services to reduce their rate of uncollectibles on competitive services would provide them a cost saving not available to new entrants. Thus, in requesting an end to regulation of how it uses threats to terminate one service in order to reduce its cost of providing another service, Verizon presents an attempt at a competitive advantage as a level playing field proposal.

Rather than assume that the ending of billing and collection "buckets" would be in the public interest because competitive providers do not face such buckets, the Commission should consider whether ending those buckets would tilt competition against companies lacking monopoly services. Such analyses, when they involve formal regulations, must follow notices of proposed rulemakings mandated by the State Administrative Procedure Act for "hard" rulemakings.[43]

Commission action as requested by Verizon and Frontier must also be grounded in express or implied Commission power, rather than – as Verizon and Frontier suggest – an extension of prior Commission decisions. An agency cannot rely on a principle underlying a

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[42] See, e.g., New York Telephone v Commission, 72 NY2d 419 (1988) (wherein the Court of Appeals upheld a Commission decision rejecting an attempt by New York Telephone to transfer its lucrative yellow pages business to an affiliate at terms prejudicial to consumers and yellow page competitors of New York Telephone).

[43] SAPA, § 102(2)(a)(i) and Executive Order #20.

prior rulemaking or policy decision as a basis for prospective action.[44] If monopoly customers are entitled to monopoly service when they pay their monopoly bills, an issue deserving of scrutiny, Verizon's proposal may be unlawful.

POINT V

THE COMMISSION MAY NOT AND SHOULD NOT REGULATE THE RETAIL VOICE SERVICE QUALITY OF CABLE PROVIDERS

The Attorney General (AG), Public Utility Law Project (PULP), and New York State Assembly Standing Committee on Corporations, Authorities and Commissions seek impermissibly broad action by the Commission to regulate the service quality of all providers of voice service in New York State. The Commission, however, lacks authority to regulate the service quality or rates of voice and data service provided by cable companies. The FCC and the New York Commission have both decided the issue of whether such regulation would serve the public interest.[45]

If a new competitor provides a service that is inferior to one offered by the incumbent, its customers will promptly return to the incumbent and the new competitor will fail. Regulation of the service quality or rates of such carriers are therefore unnecessary. Indeed, such regulatory burdens would increase the costs of nondominant carriers to do business, discourage competition and ultimately harm the public that regulation is duty bound to serve. Hence, the FCC and New York Commission have properly declined such regulation.

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[44] Allied v COMMISSION, 72 NY2d 271(1988) (administrative collateral estoppel does not apply to nonparties, rulemakings or policy considerations).

[45] See, e.g., Case 29469, Opinion No 89-12, Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition; 20 FCC RcD 3855, CC Docket 02-53, In the Matter of Presubscribed Interexchange Carrier Charges (February 17, 2005) n.20 (which summarizes numerous FCC proceedings on the degree to which there should be regulation of nondominant carriers).

The AG, PULP, Assembly Committee and RITC proposals for added regulation of nondominant providers are inconsistent with relevant case law on the Commission's authority and – in any event- would be contrary to the public good.

CONCLUSION

Given pending and active federal regulatory and legislative activity, CTANY urges the Commission to suspend this proceeding until such time as the legal framework within which the Commission may make sweeping change is clear. While we agree with some of the suggestions put forward in the White Paper, we believe that at the appropriate time more careful analysis of many issues should be undertaken in the manner as we have stated above.

Respectfully submitted,

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