STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on April 11, 2006

COMMISSIONERS PRESENT:

William M. Flynn, Chairman
Thomas J. Dunleavy
Leonard A. Weiss
Neal N. Galvin
Patricia L. Acampora

CASE 05-C-0616 – Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services.

STATEMENT OF POLICY ON FURTHER STEPS TOWARD COMPETITION IN THE INTERMODAL TELECOMMUNICATIONS MARKET AND ORDER ALLOWING RATE FILINGS

(Issued and Effective April 11, 2006)

BY THE COMMISSION:

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Introduction and Executive Summary

The telecommunications infrastructure is the backbone of the information age. The rapid growth of information technologies is altering the financial aspects of the industry in New York State and throughout the nation. Technology is changing the nature of telecommunications services and accelerating the rate and level of competition in a historically monopolistic industry. Failure to adapt New York's regulatory regime to these changing dynamics will place the State at a competitive disadvantage by stifling investments and upgrades to the telecommunications infrastructure that is supporting the State's economic activities.

The efficient exchange of information and data is critical to economic development in New York State. The ability of corporations to outsource jobs to foreign countries is evidence that proximity to markets is less relevant in today's economy than in the past. Rather, the information economy requires widespread access to broadband, wireless, and flexible telecommunications applications that facilitate economic development and investments in jobs from the private sector. Achieving that objective requires a level playing field where all telecommunications service providers have the proper market-based incentives to invest in infrastructure.

With that need in mind, we seek to maintain New York as the most competitive market in the nation for new telecommunications services by eliminating unnecessary, bureaucratic and anachronistic requirements that hamstring investment and the expansion of competition. While fair treatment of customers and the state of the underlying public switched telephone network remain primary concerns, the traditional methods used to achieve those ends are increasingly ineffective. This policy statement and order provide our view of the appropriate level of regulation needed to maintain basic consumer protections while supporting advances in telecommunications technologies and increased customer choice, value and quality of service offerings for New Yorkers.

Historically, telephone companies were natural monopolies that owned the infrastructure needed to place a call, and regulatory oversight was necessary to ensure that they charged reasonable prices and delivered adequate service. There was one way to make a telephone call – and one company through which to make it, with little to no flexibility afforded to consumers.

Today, cable providers, using the infrastructure that they constructed over the past several decades to provide video services, now offer telephone and internet services as well. Companies are also providing internet-based phone services that enable customers to call anywhere in the world at dramatically reduced prices, or, in some cases, for free. These services are generally less expensive for customers and incorporate value-added innovations ranging from caller ID to the ability to use one's home telephone at any internet connection. Wireless networks have also evolved and some consumers have adopted cell phones and other wireless communication devices as a replacement for their traditional wireline voice service. In short, the provision of telephone service is no longer a natural monopoly.

Our experience and the record in this proceeding reveal that competition in New York's telecommunications markets has evolved dramatically over just the past few years. Cell phones and high-speed internet services offered by multiple providers enable flexibility and diverse services such as e-mail, instant messaging, and VoIP services that expand consumers' telecommunications options, competing with traditional telephone services. Businesses often combine voice and data communications onto a single (IP-based) platform and residential customers increasingly have that same capability. Every month tens of thousands of customers in New York switch from their incumbent local exchange service providers to intermodal competitors to obtain savings and innovative, value-added services. A White Paper prepared by our Staff in this proceeding correctly observes that "Plain Old Telephone Service" won't mean a wireline telephone much longer."[1]

Indeed, Staff estimated that 90% of New Yorkers have the choice of at least two intermodal alternatives to the incumbents' wireline networks. Many consumers are taking advantage of these options and, as a result, former monopoly providers are losing customers, lines, usage, and revenues. For example, the White Paper observes that

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1 Telecommunications in New York: Competition and Consumer Protection (September 21, 2005) (hereinafter "White Paper") p. 7.

Verizon New York Inc.[2] (Verizon or Verizon New York) has lost almost three million access lines (about 25%) in the past five years and the pace of that loss is increasing -- from about 40,000 lines per month in early 2004 to about 94,000 per month in June-August 2005. Frontier Telephone of Rochester[3] is reported to have lost about 23% of its access lines in recent years. Further, Staff estimated that the remaining 38 independent incumbent local exchange companies (incumbents), which account for about 8 % percent of New York's incumbent telephone service customers are predominantly located in smaller markets where intermodal competition is not yet as prevalent, collectively have lost almost 3.5% of their access lines in the past five years.

We conclude that Verizon-NY and Frontier Telephone of Rochester, Inc. (Frontier of Rochester), in particular, have lost significant market share and are losing dominance and market power. This circumstance is apparent from the fact that they are experiencing dramatically lower earnings and in the case of Verizon operating losses. Verizon has not come to the Commission for major rate changes to redress the situation since the end of the Verizon Incentive Plan in March 2004. Moreover, we expect the facilities-based competitors, given their substantial network investments, will strive tenaciously to expand and defend their market shares. It is clear that the various forms of intermodal competition are constraining incumbent pricing. Although the smaller incumbents are also dealing with the effects of growing intermodal competition, as evidenced by decreasing access minutes,[4] it is not clear that they all face sufficient direct competition to serve as an adequate check on their potential to exercise market power.

Given the significant and growing level of intermodal competition in urban and suburban areas, we believe the incumbents' reduced market power and the resultant loss of customers and revenues obligates us to lighten our regulatory requirements on those carriers if they are to remain viable telephone service providers in the future.

[2] Formerly known as Bell Atlantic and, before that, as New York Telephone Company.

[3] Formerly known as Rochester Telephone Corporation (Rochester Telephone).

[4] Rural incumbents Initial Comments, Exhibit 5.

Increasingly, consumer education and market-based initiatives will substitute for regulatory requirements to achieve traditional consumer protection goals.

As we continue to transition to an environment where network platforms, devices, and software applications converge to blur the lines between traditional voice telephone and other more advanced and integrated products, our long-standing belief that competition is the most efficient way to ensure quality telecommunications at reasonable rates is now being realized as well as tested. We have pursued competitive telecommunications markets because competition spurs innovation, promotes investment, encourages efficiency, and maximizes customer choice. Competition also disciplines providers' behavior, reducing the need for governmental regulation. Indeed, some regulations, particularly when applied asymmetrically, can be detrimental to the innovation in pricing and services that occur as a result of true competition.

It is in this context that we initiated this proceeding to conduct a broad review of our telecommunications policies. In so doing, we expressed our intention to eliminate, consistent with the public interest and to the extent practicable, the asymmetrical aspects of regulation so as to treat each telecommunications provider—wired and wireless, Internet Protocol-enabled (IP-enabled) or traditional circuit-switched, voice, data, or video, as even-handedly as possible given the legal framework. We sought input from all concerned on the appropriate changes to our regulatory framework.

This statement of policy and order provides our response to these developments.

In the **Status of Competition** section, we conclude, after a survey of the various alternatives to wireline service that are now available, that the residential market for non-basic service is adequately competitive, rejecting claims that for various reasons, such as the assertion that cellular service is not totally substitutable or that Voice over Internet Protocol (VoIP) is not generally available, incumbent telephone companies still have market power. Given the pace of change in the industry, we direct Staff to monitor and report back to us in one year on the development of competition so that we would be able to take additional needed action.

In the **Pricing** section, we determine that incumbents should continue to offer a "basic service" and that such service should continue to be subject to a regulated cap. This order authorizes increases for basic rates to better align basic rates with underlying cost and realign the balance between customers (who benefit from choice) and incumbents (some of which are experiencing sub par financial results). Verizon and Frontier of Rochester shall be allowed to retain the increase in revenues. We require that any increases by the independent incumbents be offset by access charge decreases, unless they can make individual showings to support a net revenue increase request.

For services other than basic services, with a few minor exceptions, we grant Verizon-NY and Frontier of Rochester unlimited flexibility, subject to service territory price uniformity to protect customers in non-competitive areas.

In **Universal Service** we find no need to establish a state universal service fund now.

The **Service Quality** section signals our intention to move from a focus on <u>end-user</u> standards to concern over reliability <u>of the network</u>, although, for the interim period, we continue existing standards. We will also institute a proceeding to consider streamlining service quality standards, while, at the same time continuing our efforts to assure service quality pursuant to the Public Service Law.

In **Consumer Protections,** we require the continuation of current protections and we urge all companies to provide similar protections. We also direct Staff to create a "consumer report card" in order to equip consumers with objective information on which they can make informed choices and we will institute a proceeding to determine the appropriate regulations for a more competitive environment.

Finally, in the **Level Playing Field** section, we recognize that wholesale services generally are not sufficiently competitive to provide the flexibility sought by the incumbent providers and that continued price and service regulation is needed. We note especially that regulation is important where incumbents control monopoly bottleneck facilities and we establish a proceeding to consider pole attachment issues.

We expect competition ultimately will be sufficient to allow us to reduce regulation to the minimum extent needed. We believe it is time to grant incumbent telephone companies the flexibility to respond to competition in a manner that protects against monopoly abuses while ensuring reasonable basic access and continued service quality for customers. We expect to reduce regulation and rely more on market forces to achieve just and reasonable rates and maintain adequate service quality, consistent with today's environment and our statutory constraints. Where competition is not yet pervasive, or on matters of public safety, network reliability, and essential consumer protections, certain regulatory protections and oversight remain necessary and we will continue employing a more traditional regulatory approach subject to a showing that sufficient competition exists to allow an alternative. We also state our intention to establish a rulemaking to modify our regulations to eliminate outdated regulations and, when possible, harmful regulatory asymmetries. A more level playing field will spur investment in new technologies and service offerings in New York to the greater benefit of consumers and the State's economic health.

Procedural History

Commission Order and Comments

On June 29, 2005, we issued an Order Initiating Proceeding and Inviting Comments (June Order) on the transition to intermodal telecommunications competition.[5] Our order was inspired by the rapidly developing competition for traditional wireline telephone service that wireless and voice-over-internet protocol (VoIP) technology has created, and the associated need to reexamine our regulatory approach in light of this progress. As a general matter, the June Order discussed five distinct areas[6] that could be affected by this increased competition and raised a number of questions in each area to solicit the input of interested parties.

The procedural schedule established by the Commission and the Administrative Law Judge called for comments on the June Order by August 15, 2005, a

[5] "Intermodal telecommunications" refers to cable, wireless, and internet-based competitors to the existing public switched telephone network (PSTN).

[6] The areas addressed were consumer protections, universal service, market power and regulatory flexibility, service quality, and level playing field. The order also addressed the status of competition in New York.

Staff White Paper based on those comments by September 21, 2005, and comments on the White Paper by October 21, 2005.[7] In addition, seven public statement hearings and educational forums, and four roundtables were held.[8]

On August 15, 2005, 29 parties[9] submitted comments in response to the June Order and on September 21, 2005, Staff filed its White Paper addressing market power and regulatory flexibility, universal service, service quality, consumer protections, and level playing field and wholesale markets. On October 28,[10] 27 parties filed comments on Staff's White Paper.[11]

This statement of policy and order will first summarize the input we have received from the public at public statement hearings and round tables, by e-mail, and through the Department's web site and telephone comment line. Next, a summary of our previous decisions which have fostered the development of telecommunications markets will be provided. The White Paper recommendations in each subject area will be summarized together with the comments of the parties in each area.[12] Finally, the

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7 By e-mail notification dated October 21, 2005, the Secretary granted Assemblyman Brodsky's request to delay the October 21 reply filing date to October 28.

8 Combined educational forums and public statement hearings were held in Binghamton (September 28), Syracuse and Rochester (September 29), Lake Placid (October 6), Albany (October 11), New York City (October 20), and Smithtown, Long Island (October 21). Roundtables were held in New Paltz (October 18), Fredonia (September 27), Elmira (September 28) and Watertown (October 7).

9 The parties submitting comments are listed in Appendix A.

10 Three parties (The Department of Defense, PULP, and DOL) filed reply comments on the original filing date of October 21. Following extensions granted by the Secretary, CPB filed comments on October 30. The New York Farm Bureau, Inc. (Farm Bureau) filed late comments on November 1.

11 The parties commenting on the White Paper are listed in Appendix A. In addition, on November 23, 2005, Cablevision provided a notice to the parties regarding a November 18 meeting it had with Staff and included with the notice a summary of the issues discussed.

12 The volume of the parties' comments renders impractical a detailed statement of each party's position on every issue. A written summary of those positions has been prepared and is available from the Office of the Secretary or our web site. All comments have been considered in rendering this decision.

policies and conclusions that we believe will foster the further development of the competitive market are set forth in each subject area.

Public Statement Hearings

At the seven public statement hearings, 54 speakers placed their comments on the record.[13] The speakers included members of the Assembly, including the Assembly Standing Committee on Corporations, Authorities and Commissions, members of the New York City Council, representatives from chambers of commerce and other business and economic development groups, members of the Communications Workers of America, large and small profit and nonprofit enterprises, a number of service organizations providing assistance for low-income persons, families, and recent immigrants, and a representative of the Attorney General. As a general matter, the speakers' comments reflected two opposing conclusions: (1) that intermodal competition has resulted in the loss of incumbent market power in the Verizon-NY and Frontier of Rochester territories, thereby justifying the relaxation of incumbent regulation, or (2) that there is insufficient competition to constrain the incumbent's market power, leading to the conclusion that relaxed regulation would inadequately protect the public.[14]

Those concluding that there was robust competition[15] noted the substantial benefits that were provided by the diverse competitive services now available and strongly suggested that if regulation were relaxed, these benefits would be multiplied. In essence, this group believes that the market has worked; robust competition has already provided substantial benefits; and loosening regulation wherever possible would provide even greater benefits.

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[13] The transcript (Tr.) in this proceeding, consisting of the public statements and a procedural conference, totals 296 pages.

[14] In considering the public interest, we are considering the interests of consumers of utility services, at both wholesale and retail, the interests of intermodal competitors, and the interests of the incumbents. Our goal is to reasonably balance these interests while allowing the market to function.

[15] This group included end-user, profit and nonprofit organizations, service organizations, chambers of commerce, and economic development organizations. The reader is directed to the transcript for a verbatim record of each speaker's specific statements.

Those opposing a finding of ubiquitous competition[16] generally argue that there is insufficient evidence of a competitive market that would justify the recommendations made by Staff and that the decision to make substantial changes to the regulatory scheme is the province of the Legislature and the Governor, not an executive agency. If relaxed regulation is implemented, this group contends, the quality of telecommunications services in New York would suffer and the costs of those services would increase. Both of those results would severely handicap the New York economy they contend, imposing a burden that would fall hardest on the poor and elderly. This group also argued that even with relaxed regulation, certain fundamental consumer protections should be retained for wireline companies, and those protections should be extended to intermodal competitors. Some speakers expressed concern that Staff had not recommended the expansion of universal service to include broadband service, resulting, it was alleged, in an exacerbation of the "digital divide."[17] Finally, DOL opposed the rate proposals in the White Paper, arguing that a full financial and competitive analysis should first be undertaken.

Round tables

Staff conducted four round table discussions with individual consumers and representatives of businesses, community-based organizations and government agencies seeking input in regions of the state where competitive choices may be limited. A total of 15 people participated in the discussions. Round tables were held in Fredonia, Elmira, Watertown, and New Paltz during September and October 2005.

At each round table, a Staff team presented an overview of the White Paper and then facilitated a discussion among the round table participants in four issue areas: competition and consumer choice, consumer protections, universal service, and service

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16 This group included the Assembly Standing Committee, members of the Assembly, CWA, and DOL, among others. The reader is directed to the transcript for a verbatim record of each speaker's specific statements.

17 The digital divide generally refers to the "divide" between those who have access to computers and broadband and those who do not. Generally, where broadband access does not exist, it is due to economic reasons or the lack of availability (e.g., rural areas). One speaker described it as a "tale of two cities".

quality. Major themes that emerged during the discussions included: competition provides some inherent level of consumer protections, but there is still a need to continue a basic level of regulation to fully protect customers; a government entity will always be needed to ensure a fair means of dispute resolution; a level playing field for competitors is needed; most communities have access to at least one other form of telephone service, in addition to landline service; and there was strong support for providing consumers with useful information that would be helpful in making decisions about options. Several consumers stressed the importance of having complete and accurate information when selecting another company.

The participants also noted concerns about the lack of service during a power outage when switching from a landline telephone to an internet telephone; strong support for continued broad based funding for 911 and Lifeline; the belief that internet access has become a form of "basic service" and, as such, it should be reasonably priced, especially for retired and low-income people; and the recommendation that all new houses be built to include fiber.

Other Communications

In addition to the above, we received about 420 printed and e-mail letters and seven telephone calls offering opinions on the issues raised by the June Order and the White Paper. Of the letters received, over 390 were similar or identical e-mails from members of the CWA. As a general matter, these comments also fell into two general categories, either favoring or opposing a reduction of regulatory constraints on the incumbents (especially Verizon-NY).

Those opposing the White Paper recommendations argued that: deregulating telecommunications will result in the loss of jobs and a loss of service quality; no further deregulation should take place without direction from the Legislature; people cannot afford a substantial price increase for basic service; rates will increase and service quality will decrease; continued deregulation threatens universal service, especially in rural areas where competitive choices are limited; the proposal seems to help only Verizon-NY, which is unfair; access to the internet is essential (contrary to the White Paper's conclusion) and the absence of universal service goals in rural and poor areas will result in a reduction in universal telephone service.

Those supporting the White Paper argue that: the playing field among providers must be levelized by the establishment and oversight of uniform quality-of-service standards; artificial regulatory restrictions make no sense in the new marketplace; increased competition leads to expanded choices and better quality products; the artificial regulation of premium services (as opposed to basic service) has had a negative effect on local competition; wireless should not be subject to additional taxation or regulation; Verizon-NY's technology, service bundles, and prices have all improved as the result of competition; and competition is preferable to regulation, but the importance of maintaining the legacy plant for the poor who cannot upgrade their technology (or for those living in areas where nothing else is available) must be considered in directing changes to existing regulation.

Regulatory Background

Our order today builds on many decisions that have responded to technological and market developments in telecommunications. In 1985, with our decision to allow Teleport Communications to compete with the then New York Telephone Company in providing local private line service, we began to allow market forces to replace regulation.[18] The following year, we instituted our first competition proceeding,[19] and we proceeded to make a series of decisions regarding competitive

[18] Case 28710, Bypass of Local Exchange or Toll Network, Opinion No. 85-16 (issued October 3, 1985). Prior to 1985, the Commission encouraged competition through a number of other decisions, including, but not limited to, those related to inside wire and customer premises equipment.

[19] Case 29469, Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Order Instituting Formal Proceedings (issued October 22, 1986) (Competition I Proceeding).

access to segments of the telecommunications system and appropriate pricing of competitive services in that case and others.[20]

In 1994, we initiated the Competition II proceeding in response to the development of competition in the local exchange market. Under the "Universal Service" topic, we undertook to evaluate what "basic service" comprised,[21] how to make it available and affordable, how to fund such availability, and how to make such service available to customers with various disabilities. Under the topic of "Level Playing Field," we looked at ways that regulation could create or eliminate bottlenecks and barriers to entry, and examined directory assistance, white pages listings, data bases, technical interconnection requirements, signaling, number portability, and inter-carrier compensation. The third topic, "PSC Regulation," examined issues surrounding stranded costs and recovery thereof, requirements for financial, service quality and other forms of reporting, the appropriate degree of price regulation of various services, and the

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[20] E.g., Case 29469, supra, Opinion No. 89-12 (issued May 16, 1989) (allowing "comparably efficient interconnections" i.e., virtual collocation by Teleport and other competitors of New York Telephone for transport of private line services, accompanied by pricing flexibility allowed to New York Telephone for private line service); Cases 29469, et al., Order Regarding OTIS II Compliance Filing (issued May 8, 1991) (requiring physical collocation for provision of private line services); Case 28425, Access Charges, Opinion No. 92-13 (issued May 29, 1992) (expanding collocation requirements to include switched services and reducing interexchange access charges in the face of increasing competition).

[21] As a consequence of our inquiry into basic service, the case defined the elements that all carriers would be required to offer to residential customers. The Commission order listed nine such elements: a single party access line, access to local/toll calling, local usage, tone dialing, access to emergency services, access to assistance services, access to telecommunications relay services, directory listing, and privacy protections. We concluded that availability of such basic service was sufficiently widespread, with all carriers subject to common carrier obligations, that it was unnecessary to designate a "carrier of last resort" to guarantee continued service availability. We encouraged automatic enrollment of low-income customers in Lifeline service programs implemented by New York Telephone Company and Rochester Telephone, and encouraged the expansion of such programs to other telephone companies. We endorsed the concept of the Targeted Accessibility Fund for the funding of Lifeline, 911 service, and the Telecommunications Relay Service. We noted the need to continue to explore rate design changes, including access charge reductions that might create a universal service funding issue.

appropriateness of creating different levels of regulation and criteria for differentiation among such levels. Finally, in examining "Service Quality and Network Infrastructure," we examined appropriate benchmarks for monitoring service quality, the means to maintain our oversight, and the application of service quality standards to various providers.

In order to establish a level playing field between incumbents and new, competitive entrants, we announced eleven foundation principles addressing numbering, directory listings, interconnection, unbundling, bottleneck facilities, exchange of traffic and data, and cost-based inter-carrier compensation, all designed to promote competitive neutrality and equity. During the transition to competition, we proposed that carriers under similar circumstances be regulated in a similar manner and that differential treatment should be limited to instances where market power remains.

The Competition II Order articulated four overarching principles that guided our actions. We remain committed to the basic principles established in that case:[22]

1. The goal of ensuring the provision of quality telecommunications services at reasonable rates is primary.

> The primacy of this particular goal is of fundamental importance. While other goals in this proceeding may be important, even critical to various parties, their attainment must not come at the expense of this primary goal.

2. Where feasible, competition is the most efficient way by which the primary goal may be achieved.

> We have a long and successful history of enabling the development of competitive markets and seek here to establish a framework for further competitive development.

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[22] Case 94-C-0095, Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Opinion No. 96-13 (issued May 22, 1996) (hereinafter after “Competition II Order”).

3. Regulation should reflect market conditions.

> Our regulatory framework must be designed for the present transitional market, not for yesterday's monopoly or for the fully competitive market that may ultimately develop. As such, rules should not be imposed which perpetuate or assume monopoly conditions; neither should regulatory protections be abandoned merely on the promise that the market may eventually provide them.

4. Providers in like circumstances should be subject to like regulation.

> Similar regulation should be expected for providers with similar market power. Differential regulation may be appropriate and necessary where significant market power differentials exist.

A number of the competitive issues raised in the Competition II proceeding had been addressed in other regulatory proceedings at the state and federal level. For example, our order establishing a Performance Regulatory Plan (PRP) for New York Telephone, issued in August of 1995, provided for the negotiation of carrier-to-carrier interconnection agreements between New York Telephone and competitive local exchange carriers.[23] The company's earnings were substantially deregulated and it was provided pricing flexibility for new competitive services. At the same time, the order imposed a freeze on basic service rates, reduced access rates, and limited rate increases for other existing services.

We also established the Open Market Plan (OMP) of incentive regulation for Frontier of Rochester by order issued November 10, 1994.[24] The OMP gave then-

[23] Case 92-C-0665, New York Telephone Company – Performance-Based Incentive Regulatory Plan, Opinion No. 95-13, (issued August 16, 1995).

[24] Cases 93-C-0103, Rochester Telephone Corporation - Restructuring Plan, and 93-C-0033, Rochester Telephone Corporation - Multiyear Rate Stability Agreement, Opinion No. 94-25, (issued November 10, 1994). The OMP was modified and extended in Opinion 00-04 (issued March 30, 2000).

Rochester Telephone Corporation a degree of freedom from rate-of-return regulation, no earnings cap, and authorized reorganization into a holding company structure. The OMP reduced and froze basic service rates, placed other non-competitive services under indexed price caps, and allowed competitive services to be flexibly priced.

During the pendency of the Competition II proceeding, Congress passed the Telecommunications Act of 1996.[25] By August of that year, the Federal Communications Commission (FCC) had issued its first report and order implementing the local competition provisions of the Act.[26] New York continued to proceed in a manner consistent with the federal developments toward fostering inter-carrier competition in providing telecommunications services.

In considering the transition to local exchange competition in Competition II, we decided that, while all local exchange carriers should remain equally subject to the administrative, operational, and performance requirements of our service quality regulations,[27] the measurement of performance and reporting requirements should vary depending on company size and performance history. Service quality reporting and measurement were streamlined. Nevertheless, we remained interested in monitoring all carriers so as to monitor the extent to which competition has developed in the State. Therefore, some additional market monitoring and reporting requirements were instituted.

Since Competition II, and in the wake of the Telecommunications Act of 1996, we have continued to take steps to promote competition and to level the playing

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[25] Telecommunications Act of 1996, Public Law 104-104,110 Stat. 56, codified at 47 U.S.C. §§151 et seq. (February 8, 1996).

[26] CC Docket 96-98, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, et al., FCC 96-325, First Report and Order (released August 8, 1996).

[27] 16 NYCRR Parts 602 and 603.

field. Many of these steps have been taken in conjunction with the process for allowing Verizon-NY to offer long distance service, conditioned upon its opening its network to competitors pursuant to §271 of the Telecommunications Act.[28] For example, in conjunction with that process, we implemented a Performance Assurance Plan (PAP), through which Verizon-NY provides rebates to Competitive Local Exchange Carriers (CLECs)[29] if Verizon-NY's provision of wholesale service to them falls below defined standards.[30] Building on the protocols established for ordering and provisioning customer migration from Verizon-NY to CLECs in these proceedings, we also established business rules and protocols for transferring customers between CLECs and

[28] Case 97-C-0271, Petition of New York Telephone Company for Approval of Its Statement of Generally Available Terms and Conditions Pursuant to §252 of the Telecommunications Act of 1996 and Draft Filing of Petition for InterLATA Entry Pursuant to §271 of the Telecommunications Act of 1996, Pre-Filing Statement of Bell Atlantic-New York (filed April 6, 1998); FCC CC Docket No. 99-295, Application by Bell Atlantic New York for Authorization Under §271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York, Evaluation of the New York Public Service Commission (filed October 18, 1999); CC Docket No. 99-295, FCC 99-404, Memorandum Opinion and Order (released December 22, 1999).

[29] Incumbent Local Exchange Carriers are referred to as incumbents.

[30] Cases 97-C-0271 & 99-C-0949, supra,Order Adopting the Amended Performance Assurance Plan and Amended Change Control Plan (issued November 3, 1999). The current version of the PAP was approved in Cases 99-C-0949 & 02-C-1425, supra,Order Establishing Modifications to the Performance Assurance Plan and Change Control Assurance Plan for Hot Cut Measurements and Standards (issued March 17, 2005); see also Cases 99-C-0949, et al., Staff Report on the Performance Assurance Plan and Change Control Assurance Plan filed by Verizon-NY on April 19, 2005 (filed June 15, 2005). Verizon's performance is measured in accordance with metrics developed collaboratively by the Carrier Working Group in Case 97-C-0139, the Carrier-to-Carrier ("C2C") Proceeding.

from CLECs back to Verizon-NY.[31] We have also addressed provisioning and rates related to line sharing[32] and performance of loop hot cuts.[33]

Throughout the transition to a more competitive market, we have attempted to balance the needs of consumers for protection from business practices that might endanger their health, safety and welfare against the adequacy of market forces to provide those protections. In doing so, we continue to endorse and uphold the Privacy Principles issued in 1991[34] and have continued to impose rules governing the release of customer information,[35] consistent with federal regulations issued by the FCC.[36] New York has undertaken to resolve slamming complaints consistent with federal and state slamming legislation.[37] We have also adopted cramming guidelines developed by the New York

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[31] Case 00-C-0188, Migration of Customers Between Local Carriers, Order Adopting Phase II Guidelines (issued June 14, 2002).

[32] Case 98-C-1357, Line Sharing Rates, Opinion No. 00-07 (issued May 26, 2000).

[33] Case 02-C-1425, Loop Migrations – Bulk Hot Cuts, Order Setting Permanent Hot Cut Rates (issued August 25, 2004). (When customers change service to providers that provide their own switching facilities, the incumbent telephone company changes the wiring in its central office to accomplish the migration, a process known as a "hot cut". This proceeding was designed to set the prices for that process.)

[34] Case 90-C-0075, Issues Concerning Privacy in Telecommunications, Statement of Policy on Privacy in Telecommunications (issued March 22, 1991).

[35] E.g., Case 00-C-0188, supra, Order Adopting Phase II Guidelines (issued June 14, 2002) (requiring customer consent before account information can be shared with another carrier).

[36] See, e.g., 47 CFR Part 64, Subpart U-Customer Proprietary Network Information, §§64.201-209, Subpart CC-Customer Account Record Exchange Requirements, §64.4000-4006 (October 1, 2005).

[37] See 47 U.S.C. §258; New York PSL §92-e; 47 CFR §§64.1100-1190. New York has elected to administer the federal slamming rules through notification to the FCC under 47 CFR 64.1110.

State Telephone Association[38] and have required all carriers to give consumers the ability to block access to local chatlines and pay-for-call phone numbers.[39]

While thus continuing to protect consumers, we have streamlined other regulations to recognize the increasingly competitive environment. For example, in 2000, we revised our service quality standards, finding that some regulations were obsolete due to technological changes or no longer necessary to protect the health, safety and welfare of consumers, given the presence of market forces.[40]

In 2002, Verizon-NY was granted even greater rate flexibility under the Verizon-NY Incentive Plan (VIP).[41] Under the VIP, Verizon-NY's pricing flexibility was limited by a cap on the overall revenue increase for any given plan year and was conditioned on compliance with a service quality plan. The rate provisions of the VIP expired February 28, 2004, although the service quality provisions extended an additional year, through February 28, 2005.

Most recently, we had an opportunity to consider the proper ratemaking treatment of various gains realized by Verizon-NY in a series of orders. In one of those orders we explained:

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[38] The cramming guidelines are included as part of the CLEC-to-CLEC Migration Guidelines, Case 00-C-0188, supra, Order Adopting Phase II Guidelines (issued June 14, 2002).

[39] Cases 98-C-1273, et al., ACC National Telecom Corp.'s Blocking Obligations for Chatline Services, Order Directing Carriers to File Tariffs for Chatline Services and Related Actions (issued February 4, 1999); Case 04-C-1297, Local Exchange Carrier Compliance with Chatline Blocking Requirements, and Case 04-C-1276, RNK Inc.'s Blocking Obligations Concerning Chatline Service, Order Resolving Compliance Issues and Authorizing Outreach Program (issued January 21, 2005).

[40] Case 97-C-0139, Service Quality Standards for Telephone Companies, Memorandum and Resolution Adopting Revision of Parts 602, 603 and §644.2 of 16 NYCRR (issued October 6, 2000).

[41] Cases 00-C-1945, et al., Verizon New York Inc. – Cost Recovery and Modification of Performance Regulatory Plan, Order Instituting Verizon Incentive Plan (issued February 27, 2002).

> To properly apportion the gain from these transfers, we must balance the interests of the company's customers and shareholders. That balancing has changed, over time, to reflect changed circumstances.
> . . . Verizon is now subject to significant competition and our regulation should reflect that reality. In such markets there is less need for economic regulation – such as specific regulatory accounting. The environment the company operates in today is dramatically different than that which existed only a few years ago and we need to decide the appropriate treatment for the gain in that context.[42]

While relying on the competitive market increasingly, particularly to discipline prices, we have remained vigilant in protecting the reliability of the telecommunications network. A new proceeding was opened in 2003 to reexamine reliability issues.[43] That proceeding has examined issues such as the requirement of geographic route diversity for central offices.[44]

This Policy Statement and Order is the logical next step in this line of opinions and orders.

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[42] Case 05-C-0510, Petition of Verizon New York, Inc. Pursuant to Section 99 of the Public Service Law for Approval to Sell a Portion of An Office Building, Order Approving Transfer (issued June 15, 2005).

[43] Case 03-C-0992, Telephone Network Reliability, Order Instituting Proceeding (issued July 21, 2003).

[44] Id., Order Concerning Network Reliability Enhancements (issued July 28, 2004), Order Granting in Part and Denying in Part Requests for Exemption (issued February 23, 2006, and Order Directing Filings Concerning Network Reliability Enhancements (issued June 15, 2005).

Status of Competition

White Paper

The White Paper concluded that our pro-competitive regulatory decisions, coupled with advances in technology, have resulted in New York State being one of the most competitive markets for telecommunication services in the nation. That conclusion was based on a wide range of data, including our review of the availability of alternative platforms and the many options now available to customers, the changes in technology, and the loss of customers (i.e., telephone or access lines) by Verizon-New York.[45] Those results have also been experienced in comparable proportions by Frontier of Rochester, which the White Paper notes lost approximately 16% of its access lines between 2000 and 2004. The remaining 38 independent wireline companies in New York lost a combined 25,423 (3.4%) access lines over that same time period.[46] Most of these losses resulted from migrations to competitive carriers that relied on UNE-based competition and wireless substitution.[47] The introduction of intermodal telecommunications facilities and offerings of cable telephone likely now explain a sizeable portion of these losses. The White Paper cites Time Warner Cable's adding close to 15,000 new telephone customers per week and Cablevision adding approximately 7,000 per week as examples supporting this conclusion.[48]

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[45] In the second quarter of 2005, the company's access lines declined by an average of 87,000 lines per month (White Paper, p. 28). For the last quarter of 2005 the company lost an average of 72,000 lines per month. In January 2006, the company lost over 100,000 lines.

[46] White Paper, Appendix C.

[47] UNE refers to unbundled network elements which incumbent carriers like Verizon were required by the 1996 Telecommunications Act to lease to competitive carriers at favorable prices to facilitate local telephone competition. Today, one of the most significant mass market UNEs, namely the UNE-Platform, is no longer required based on the Federal Communications Commission's Triennial Review Remand Order issued in 2005.

[48] The figures for cable telephone subscription additions are national. State data is not publicly available.

The White Paper also refers to comments the Department of Public Service filed with the FCC in October 2004.[49] In those comments, the Department noted that over 50% of Verizon's wire centers offered customers access to alternative wireline offerings, and these wire centers represented 85% of Verizon New York's access lines.[50] The comments also included a competitive index designed to determine whether competitive companies were "impaired" in their ability to offer mass market local switching without reliance on Verizon's switches.[51] The Department concluded in those comments that the FCC should analyze impairment considering both intramodal and intermodal competition.[52]

The White Paper notes that there is now broad support for the conclusion that the New York telecommunications market is workably competitive. However, it also concludes that it may not be productive at this juncture to use the competitive index set forth in the 2004 FCC comments to develop granular findings about the extent and strength of competition.[53] (Parties had argued that the index measures the wrong factors, weights them incorrectly, and misstates the extent of competition.) The practical difficulties of applying such an index on a wire-center by wire-center basis and continuing or relaxing economic regulation on such a basis were also noted. According

[49] Comments of the New York State Department of Public Service in the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338 (filed October 4, 2004).

[50] White Paper, p. 30, , In the Matter of Unbundled Access to Network Elements, Review of Section 251 Obligation of Incumbent Local Exchange Carriers, WC Docket No. 04-313, Comments of the New York State Department of Public Service.

[51] "Impairment" is the standard for determining an incumbent LEC's obligation to give competitive LECs access to its switching services, and other network elements, as a UNE under the Telecommunications Act of 1996.

[52] In the Matter of Unbundled Access to Network Elements, Review of Section 251 Obligation of Incumbent Local Exchange Carriers, WC Docket No. 04-313, Comments of the New York State Department of Public Service, p. 19.

[53] White Paper, p. 30.

to the White Paper, broadly assessing the extent and strength of choice, judging competitive trends, and assessing competition as an overarching constraint on competitive behavior is a more productive approach, than examining competitive choice on a wire-center by wire-center basis.

Accordingly, the White Paper revised the index used in the 2004 FCC comments to produce a broader-based "competitive indicator."[54] Specifically, the White Paper concluded that the existence of three platforms, one traditional landline plus wireless[55] and broadband, in any market would indicate that the market is sufficiently competitive to constrain anti-competitive behavior of the market participants. Instead of relying on wire centers, it used FCC-based zip code data to determine broadband availability and FCC wireless antenna databases to determine wireless availability.[56]

While intermodal options are widely available, the White Paper recognizes there can be wire centers in an incumbent's territory that do not meet the three-platform test.[57] To determine whether prices are constrained in these non-competitive areas, the White Paper calculated whether a hypothetical 5% increase on a $50/month bill across the incumbent's territory would result in a net revenue gain (prices are not constrained) or a net revenue loss (price constraints are working). It found that with competitive platforms available to 93% of Verizon customers and 87% of Frontier of Rochester customers, it would not be possible under most elasticity assumptions for these utilities to raise rates across their service territories and thereby raise net revenues. The White Paper therefore concludes that Verizon's and Frontier's prices are being effectively constrained by the competitive markets, thereby justifying additional regulatory flexibility.

The White Paper recommends that this competitive indicator be used on a case-by-case basis to review the extent of competition and competitive pressures in each of the remaining incumbents territories to determine whether additional pricing flexibility

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[54] White Paper, Appendix E.

[55] To be considered a competitive alternative, a wireless carrier must not be affiliated with an incumbent.

[56] White Paper, Appendix E.

[57] The appropriate pricing for those areas is discussed below under "Pricing."

is warranted. It should also be used, it says, in a competitive review that should be completed within a year.

Responding to claims that cellular and VoIP services are not, or are not fully, substitutable for wireline (i.e., are not in competition with wireline), the White Paper states that the services need not be perfectly substitutable because only a small portion of the wireline customers need to consider them substitutable and exercise their option to change services in order to constrain wireline rates. In the White Paper's example, only 7% of wireline customers have to choose a different provider to render a hypothetical Verizon rate increase ineffective. It also notes that the provision of intermodal services are having profoundly negative effects on the incumbents' financial health, even if those services are not perfect substitutes for wireline.[58]

The White Paper also notes that competitive measurements such as the Herfindahl-Hirschman Index (HHI) or other examinations of competitors' market shares are a static analysis which fail to recognize the dynamic nature of the market. It argues that markets are contestable in most of the State because competitors can quickly enter and eliminate any supra-normal profit-seeking by the incumbents. Apart from the market shares of the competitors, the White Paper argues, the threat of imminent competition already serves as a significant constraint on incumbent behavior.

Parties' Comments

A number of the CLECs and incumbents applaud the White Paper's acknowledgement of the existence of significant and rapidly increasing competition in New York State, especially in the residential retail market. Those parties generally agreed with the White Paper's recommendations regarding increased regulatory flexibility. A number of the CLECs additionally argue that, while reduced regulation may be appropriate at the retail level, increased oversight of the wholesale market is essential given that the incumbent's do not offer their wholesale services in a fair and non-discriminatory manner.

[58] The companies' financial positions are discussed below.

Parties representing consumers, on the other hand, while generally approving the goals and principles set forth in the White Paper, dispute the conclusion that a sufficiently robust competitive market exists today. Accordingly, these parties argue that any substantial change in the existing level of regulation should await a more detailed examination of the degree of competition. These parties also point to the recent mergers,[59] suggesting that such transactions raise additional concerns about the future competitiveness of the market.

More specifically, the DOL contends that the White Paper fails to respond to its initial, lengthy critique of Staff's competitive index, and believes the White Paper's competitive indicator is equally flawed. For example, the DOL argues that without sufficient evidence that intermodal services will displace the incumbents in the near future and without an adequate grounding in the economic analysis of customer demand elasticities, Staff's competitive indicator is seriously flawed. It says that the research shows that there is some substitution among services, but not so much as to permit the conclusion that wireless service actually constrains wireline price. "In fact," it goes on, "some evidence suggests that increased wireless usage actually stimulates demand for wireline service . . ."[60]

The DOL argues as well that the index weights assigned by the Department in its FCC comments do not reflect the various alternatives present in each market and that customers will respond differently to a particular alternative depending on their other options. The DOL argues that the index also needs to consider customer resistance to switching, and regional differences, and the possibility of market failure, consolidation or exit (as for example, through mergers).

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[59] Case 05-C-0237, Joint Petition of Verizon Inc. and MCI, Inc. for Merger Approval, Order Asserting Jurisdiction and Approving Merger Subject to Conditions (issued November 22, 2005), as revised in Errata Notice (November 28, 2005), and Case 05-C-0242, Joint Petition of SBC Communications Inc., AT&T Corporation, together with its Certified New York Subsidiaries, for Approval of Merger, Order Approving Merger (issued September 21, 2005).

[60] The DOL's comments on the Order Initiating Proceeding, Appendix, p. 3 (citing studies).

Others argue that Staff's approach in the Verizon and SBC merger cases used a more rigorous application of market power tests than was used in this proceeding, also suggesting that a more detailed review of the market should be or must be undertaken prior to making any final decisions on the relaxation of regulations or the deregulation of any carrier.

The evidentiary underpinning of Staff's proposal is exceedingly thin, according to the Assembly Standing Committee. If there is a rationale for the proposed rate increases for Verizon and Frontier of Rochester, the Committee contends that it is not reflected in the record.

CPB states that the White Paper overestimates the extent of competition by assuming that the mere availability of intermodal alternatives will ensure high quality services and just and reasonable prices and by incorrectly treating often expensive bundles of related telecommunication services as a competitor to stand-alone telephony. Staff has no data, according to the CPB, regarding the extent to which New Yorkers substitute intermodal services for their primary wireline. It says that the availability of intermodal alternatives does not create a competitive market.

CPB concludes that a detailed and accurate measure of the extent of actual competition should be made before implementing any regulatory changes.

The Farm Bureau disagrees with the White Paper's conclusion that true competition exists in many areas of the State, contending that in rural areas there is a lack of adequate infrastructure to support high speed internet access.

Time Warner Telecom argues that there is an inadequate evidentiary record upon which to determine the extent of competition in New York. It agrees with the DOL's comments in that regard and suggests that the Commission undertake a more detailed assessment of the actual state of the markets. It remains to be seen, according to Time Warner Telecom, whether intermodal entrants can garner a sufficient market share to constrain the exercise of market power. Time Warner agrees with the need to undertake a further competitive review,[61] but it argues that such a review should be undertaken before any additional pricing flexibility is granted.

Cablevision submits information challenging the Staff competitive analysis by arguing that there cannot be a market as robust as described because Verizon has raised its basic service prices by more than 13% in the past year.[62] It also argues that the White Paper failed to consider the impact of the loss of UNE-P[63] competition or the impact on competitive markets of the recent merger approvals. Cablevision therefore concludes that the market assessment in the White Paper lacks rigor and a theoretical foundation, is untested, and is methodologically flawed. In Cablevision's view, the competitive market conclusions are no more than unsubstantiated suppositions about how the market might evolve. The presence or potential presence of competitors, according to Cablevision, is not the same as the presence of actual competition.

Cablevision also challenges Staff's assumption that VoIP service is the equivalent[64] of wireline service and is a more important form of competition than CLECs' services. As of the end of 2004, Cablevision argues, in New York State the CLECs had 3.6 million lines and wireless had 10.8 million lines, while the VoIP lines and growth rates yield at best hundreds of thousands of VoIP subscribers. To treat VoIP as an equal competitor with wireless and the CLECs misstates current market realities, according to Cablevision, and leads the White Paper to overestimate the amount of competition.

Cablevision also suggests that Verizon's service quality has not been disciplined by competition as evidenced by the Commission's suspension of Verizon's pricing flexibility under the VIP and the Commission proceeding regarding an independent audit of Verizon's service quality. It cites as support Verizon's 2004 Annual

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61 Time Warner Telecom comments, p. 3, citing White Paper, p. 49.

62 Cablevision's comments, p. 2, citing Verizon tariff leaves.

63 UNE-P refers to the unbundled network element platform and refers to the combination of unbundled elements that allow a competitor to provide full service.

64 Cablevision markets its Optimum Voice (its VoIP product) as "high-quality home phone service." (see www.optimumvoice.com)

Report to stockholders, indicating that approximately $900 million of capital spending was reallocated away from "traditional products to growth products."[65]

Cablevision and others also attack the competitive indicator proposed in the White Paper[66] contending that it is an unnecessary invention. According to these parties, more traditional measures of market power are available and should be relied upon. Staff's measure of competitiveness continues to significantly overstate the level of competition posed by wireless and VoIP services, according to these parties. Because the indicator attempts to quantify competition by the number of potential competitors rather than by the market concentration of actual suppliers, they say it overstates the extent of market competition and deregulating markets based on such measures would not be in the public interest.

Cablevision also argues that neither wireless nor VoIP services are in the same market (i.e., are substitutable) with the services offered by the incumbents. If these are not substitutable products, Cablevision argues, there is no true competitive market.

The Department of Defense also disagrees with the White Paper's assertion that competition has constrained the pricing flexibility of incumbents, as an example, the fact that a small business line is more expensive than a residential line, despite the fact that the costs to serve those customers are virtually identical. The Department of Defense acknowledges a slight reduction in the incumbents' market power due to recent wireline losses, but concludes that the reduction is not sufficient to constrain the incumbents' facilities-based competition, it concludes, the incumbent wireline and cable companies will maintain an effective duopoly.

CompTel argues that not all market segments have available true local competition. In particular, it contends that the business marketplace does not generally accept wireless or VoIP/cable telephony as acceptable substitutes for wireline service. Accordingly, it argues that there is no intermodal competition for business customers.

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[65] Cablevision comments, p. 13, quoting Verizon Communications 2004 Annual Report, p. 14.

[66] Cablevision comments, pp. 18-26, discussing White Paper, pp. 28-34.

CompTel joins the criticisms of the DOL and CPB of the White Paper's competition indicator. It also concludes that the regulatory policies and technological advances of the past few years have not harmed Verizon's financial position.

The Joint CLECs emphasize the fact that the White Paper primarily addressed residential consumers, noting that the conclusions would not be the same for the small to medium-sized business market.

Frontier of Rochester suggests that Staff's competitive indicator understates the extent of actual competition and needs to be adjusted to reflect the actual level of wireless competition. Staff's analysis only considers cell service as available if the cell tower is located in the wire center, but Frontier argues that the coverage of such a tower is much larger than a wire center and a single tower could be providing cell service in more than one wire center. Staff's approach, according to Frontier of Rochester, results in a significant underestimate of competition in the independent company territories. also requests that a competitive market be found with the existence of a cable company offering voice or broadband services without the need for a wireless platform. In other words, Frontier suggests that only one other alternative platform is needed to determine an area competitive. It further objects to the White Paper's failure to consider Verizon wireless as a competitor in Verizon's wireline territory. According to Frontier, all of these factors underestimate the extent of cellular competition.

Frontier also argues that there is no reason for the distinction the White Paper makes between providing Verizon and Frontier of Rochester with increased pricing flexibility and not providing the same relief for the remaining incumbents. Most or all of the remaining incumbents, according to Frontier of Rochester, face the same or nearly equal competition that Frontier and Verizon face, especially if the cellular adjustments to the Staff competitive indicator are incorporated. It accordingly contends that all incumbents who can meet the White Paper's standards, as adjusted to reflect the true impact of wireless, be provided the same flexibility the White Paper recommends for Verizon and Frontier.

NYSTA contends that a natural monopoly in the wireline market no longer exists. It, therefore, concludes that no competitive indicator is necessary. It also expresses its concern that line losses and loss of access minutes by the smaller incumbents will place them in serious financial difficulty, and it contends that those incumbents should be accorded at least the pricing flexibility and increased revenues contemplated for Verizon and Frontier of Rochester.

Verizon generally supports the White Paper's conclusion that the market is sufficiently developed to discipline prices. It also points to alleged errors in the White Paper's competitive indicator, the effect of which is to render Staff's analysis overly conservative. While it believes Staff's competitive indicator is a workable and useful tool, Verizon points to its failure to consider Verizon wireless as a competitor to Verizon-NY, thereby rendering the indicator's measure of competition unduly conservative. Verizon, like Frontier, also raises the point that a single cell tower can serve more than one wire center, making the indicator overly conservative. It also notes that multiple wireless carriers can co-locate on a single tower, but the indicator considers the tower as a single competitive provider rather than as multiple providers. Finally, Verizon notes that the data Staff used to construct the competitive indicator were for 2004 and therefore do not fully reflect market dynamics and the very rapid growth of cellular and VoIP services in the past year.

Verizon also challenges the assertions made by some of the parties that wireless and VoIP competition with wireline are not robust. It notes the discounted package offerings it has tariffed in recent months,[67] contending that they reflect the potent competitive threat offered by VoIP-based products. Challenging the arguments by CLECs and others regarding the competitiveness of the small and mid-size business customer market, Verizon says that small businesses have access to broadband (and,

[67] Case 05-C-1303, Petition of Cablevision Systems to Reject or Suspend and Investigate Verizon's Proposed Tariff Amendment to Establish a Regional Value and Regional Essential Plan, Order Denying Petitions Requesting Suspension of and Hearing on Tariff Filings (issued December 6, 2005).

therefore, access to VoIP-based services) and that cable companies and VoIP providers offer customized solutions for large business customers.[68]

Discussion

Our experience and the record in this proceeding reveal, as noted above, that competition in New York's retail telecommunications markets has evolved dramatically over just the past few years, especially in the residential portion of the mass market. Many more people now carry mobile devices to maintain constantly available telecommunications capabilities, and rising numbers of consumers are abandoning wireline services altogether. High-speed internet access services, offered by multiple providers, enable e-mail, instant messaging, and VoIP services that expand consumers' telecommunications options, competing directly and indirectly with traditional telephone services. Every month thousands of customers in New York switch from their incumbent local exchange service providers to intermodal competitors to obtain savings, innovative services, and other value added offerings. The Staff White Paper correctly observed that "Plain Old Telephone Service (POTS) won't mean a wireline telephone much longer."[69]

The vast majority of New Yorkers now have the choice of obtaining voice services from different providers via alternative platforms.[70] Staff estimated that 90% of New Yorkers have the choice of at least two intermodal alternatives to the incumbents'

68 Verizon's Comments, p. 22.

69 White Paper, p. 3.

70 Analysis of data compiled from the Numbering Resource Utilization/Forecast (NRUF) 502 Reports, filed semi-annually with the FCC and the North American Numbering Plan Administrator, further illustrates this trend. Numbers assigned to carriers in New York have increased 12% over the last three years (2002 – 2005). There has been significant growth in numbers assigned to competitive carriers and wireless providers, 46.7% and 47.2%, respectively, while the numbers assigned to incumbents have decreased by 7%. The increasing popularity of VoIP is one contributing factor to the increase in numbering resources for competitive carriers, as the VoIP providers obtain numbers through partnering with competitive carriers (i.e., Time Warner Cable partners with Sprint and Cablevision partners Cablevision Lightpath).

wireline networks.[71] CPB argues that Staff has no data regarding the extent to which New Yorkers substitute intermodal services for their primary wireline, but it misses the point. It is clear, even from advertisements aimed at the general public that cable, wireless and IP service companies are competing with wireline companies to provide telecommunication services. CPB's emphasis on historical data does not capture the prospective environment upon which competitors' business plans must be made. Establishing our policy for the future based on that history is unwise.

Based on the availability of these platforms, customers could choose a number of different service providers currently marketing services in New York. In general, these services fall into three categories: facilities-based digital phone service (i.e., cable phone), application based phone service (e.g., Vonage) and wireless service. We find that these services are widely available in New York and that from the perspective of customer demand they are sufficiently close substitutes for traditional wireline local service.[72] Cable companies (Cablevision and Time Warner) are actively

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[71] Our responsibility is to ensure just and reasonable rates for all New Yorkers and we will continue to do so even for the minority that does not have competitive choice. As explained below in the pricing section, even those customers not located in an area where there is vibrant competition will enjoy the benefits of the New York markets because incumbents will be constrained from increasing prices in noncompetitive areas.

[72] We note that the FCC also recently concluded that facilities-based digital phone and wireless are sufficiently close substitutes for wireline local service. In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No 05-75, Memorandum Opinion and Order, 20 FCC Rcd 18433 (2005) ¶¶ 83-91 (Verizon/MCI Merger Order). Although the FCC found the record inconclusive regarding application based VOIP services (i.e., "over-the-top" VOIP), in part because customers must separately obtain broadband access, it noted that some proportion of mass market consumers may view these services as substitutes for wireline local service. Id. at ¶ 89.

marketing a digital phone service to a large number of customers in New York.[73] Their offerings provide E911 connectivity similar to traditional wireline services and is priced between $30 and $49 per month.[74] This is comparable to Verizon's Freedom Value package ($29.95 downstate and $34.95 upstate) and its Freedom Essentials package ($34.95 downstate and $39.95 upstate)[75] In our judgment, consumers view these offerings as close substitutes to wireline local service.

Regarding application-based VoIP services, we recognize that they have different service characteristics, like self installation, and may not be viewed widely as close substitutes. But given that in excess of 35% of New Yorkers already subscribe to some kind of high speed broadband service,[76] these customers could subscribe to an application based VoIP service being offered by a number of providers such as Vonage without an additional subscription to broadband. Moreover, the FCC recently required that these interconnected VoIP services provide E911 capability similar to that offered by traditional carriers.[77] Vonage, for example, offers an unlimited calling plan for $24.99 per month.[78] In view of the potential significant cost savings, and the FCC's requirement

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[73] Time Warner Cable's December 5, 2005 press release reads: "By the end of 2004, the Company had successfully rolled out Digital Phone to all of its divisions, across 27 states. Having achieved its unprecedented goal of fully deploying phone service within 18 months, Time Warner Cable has turned its focus to rapidly signing up new phone customers." Cablevision's website states that "Optimum Voice is currently available to Optimum Online customers in most areas of New York, New Jersey and Connecticut for one low, flat rate of $34.95 per month without any additional monthly charges or fees."

[74] Cablevision Optimum voice service costs $29 per month; Time Warner's digital plan costs $39 when bundled or $49 as a stand alone service.

[75] Both of these packages (as well as Verizon's Regional Value and Regional Essentials packages) reflect significant price decreases from prior similarly packaged services. As one example, Verizon's Freedom Essentials Package was previously priced at $59.95 just six months ago.

[76] FCC Report on High-Speed Services for Internet Access: Status as of December 2004.

[77] <u>E911 Requirements for IP-Enabled Services</u>, WC Docket No. 04-36, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245 (2005).

[78] www.vonage.com

that such providers offer E911, we believe these services can also serve as a close substitute for traditional wireline service for a significant number of New York consumers.

Subscriptions to wireless services have increased dramatically in the past few years. Although the White Paper recognized that not all customers will view wireless service as a complete substitute for traditional wireline service, we agree with the White Paper that a growing number of customers are willing and able to consider wireless as a close substitute for wireline service.[79] A recent survey reported that about 9.4% of US wireless subscribers already use a wireless phone as their primary phone.[80]

Many consumers are taking advantage of these options and are reaping the benefits of technology and competition;[81] as a result, former monopoly providers are losing customers, lines, usage, and revenues.

Since the White Paper was issued, the incumbents have continued to lose access lines. Through 2005, the twelve-month rolling average of Verizon's monthly line losses exceed 80,000, a rate of almost 1% of its access lines each month or approximately 12% annually. In January 2006, Verizon lost more than 100,000 access lines. Frontier of Rochester lost almost 38,000 lines in 2005, approximately 8 % of its total lines. These continuing and increasing losses do not suggest a slowing of the residential, intermodal

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[79] Morrisville State College in New York eliminated land lines in dorm rooms and handed out cell phones to each of its students living in its residence hall. Colleges Catch Phone Wave, USA Today, October 29, 2003.

[80] In-Stat, "Cutting the Cord: Consumer Profiles and Carrier Strategies for Wireless Substitution." (October 2005). In its recent Verizon/MCI Merger Order the FCC found that approximately 6% of households have chosen to rely on wireless services for all of their communications needs. Verizon/MCI Merger Order, supra ¶ 91.

[81] Between December 2004 and December 2005, Cablevision's and Time Warner's phone subscriber base had significant growth. Cablevision's phone subscriber base grew by 457,000 from 282,000 to 739,000. (Cablevision Systems Corporation Reports 4th Quarter 2004 and 4th Quarter 2005 Results.) Similarly, Time Warner's phone subscriber base grew by 880,000 from 220,000 to 1.1 million customers. (Time Warner Inc. Reports 4th Quarter 2004 and 4th Quarter 2005 Results.) Vonage's February 8, 2006 S-1 Filing with the SEC states: "We are a leading provider of broadband telephone services with over 1.4 million subscriber lines as of February 8, 2006."

competitive market, as some parties have suggested. If anything, technological advances and the development of new products and features suggest that intermodal competition with landline service will only increase at an accelerating pace in the next few years.

Verizon and Frontier of Rochester in particular are experiencing real losses in market share and revenues as a result of this dynamic market competition. Given the substantial network investments of facilities-based competitors, we expect that they will tenaciously expand and defend their market shares. It is therefore clear that the various forms of intermodal competition are undermining the incumbents' ability to set rates in excess of relevant costs.[82]

Although the other incumbents are also dealing with the effects of growing intermodal competition as evidenced by decreasing access minutes and access lines,[83] it is not clear that all incumbents face sufficient direct competition to serve as an adequate check on their exercise of market power. The White Paper notes[84] that the other incumbent telephone companies in New York have also lost lines. Frontier of Rochester is reported to have lost 16% of its lines from 2000 to 2004, while the remaining 38 incumbents have lost approximately 3.4% of their access lines over that same timeframe (2000-2004).[85] While there may be individual companies that have suffered concomitant competitive revenue losses comparable to Verizon and Frontier of Rochester, that fact cannot be determined from this record. Staff's White Paper notes a significant variance in line loss across the independents, with some companies actually reporting an increase in access lines over the 2000 to 2004 timeframe.[86] Accordingly,

[82] The financial impact of this competition is discussed in the following section on pricing flexibility.

[83] Rural Telephone Companies, Initial Comments, Exhibit 5.

[84] White Paper, p. 28.

[85] Taking Frontier together with the remaining 38 independents, the white paper reports that these 39 companies have lost 8.7% of their access lines, about one-third the losses of Verizon (25%).

[86] Staff White Paper, Appendix C.

we will examine the relative competitive positions of these incumbents on a case-by-case basis to determine if increased pricing flexibility or other regulatory flexibility is warranted. Whenever an incumbent can demonstrate that its prices are constrained by competition, we will consider granting pricing and other flexibility.

A number of parties have challenged the basis of our finding that a robust competitive market exists today sufficient to constrain the incumbents' prices. Some argue that the recent Verizon and AT&T mergers raise serious concerns regarding the future competitiveness of the market, and others note that more traditional market power tests, such as HHI,[87] would show the incumbents with considerable market power. Others contend that the mere existence of competitors does not mean that there is a robust competitive market, especially in rural or less affluent areas. Further, CompTel argues that not all markets have intermodal options, specifically mentioning business customers. Finally, Cablevision argues that competition has not been effective in ensuring Verizon's service quality.

Arguments that the degree of competition is exaggerated or is not supported by the facts are not correct. The degree of competition is clearly reflected in the continuing incumbent line losses, the current availability and rapid expansion of wireless and VoIP services, and the competition-driven revenue losses, as well as declines in earnings and, in some instances, losses. While the recent Verizon/MCI and SBC/AT&T mergers (as well as FCC rulings[88]) may reduce UNE-based CLEC competition, those mergers will have little, if any, negative impact on intermodal retail competition and may spur its growth as UNE-based options become less available. In response to CompTel's argument, we note that VoIP products, initially introduced and focused on the residential market, are being marketed to business customers and Vonage markets to business

[87] The Herfindahl-Hirschman Index (HHI), the sum of the squares of the market shares of each firm in a market, is a measure of how concentrated a market is.

[88] TRRO.

customers as well.[89] Finally, Cablevision is correct in noting the Commission's close monitoring of service quality as reflected in both our suspension of Verizon NY's pricing flexibility and our directing an independent audit of Verizon retail service quality. There are several different indices that we review to gauge service quality. With one exception, Verizon-NY's service quality performance has generally met or exceeded our standards. (For the one exception, the Out of Service Greater than 24 Hours metric, we expect Staff to continue to engage the Company on its improving this performance.) We are confident that competitive pressures will provide Verizon sufficient incentives to improve this metric. Importantly, nothing in this order removes our continued rigorous oversight of service quality, and we continue to monitor and ensure adequate service quality pursuant to the Public Service Law.

We also conclude that, in view of the dynamic nature of the telecommunications market, Staff's competitive indicator and observations of market trends provide a more meaningful picture of the state of the intermodal competitive market than does the simple look at recent actual market shares that is embodied in the HHI. The HHI is a proper analytical tool, but it is just the starting point in any assessment of the competitiveness of a market. As is discussed in the Merger Guidelines of the United States Department of Justice and Federal Trade Commission, other factors, especially those associated with entry by competitors, can overcome a market power presumption that might otherwise be indicated by a simple look at the HHI.[90] While we are aware of the high HHI for wireline mass market voice calling in New York that one can derive from recent actual market shares, the evidence is clear that other factors, including entry by new competitors, play a more crucial role than starting-point HHIs in any analysis of this market. In fact, Staff's competitive indicator focuses on exactly this – the extent of the presence in New York of the newer modes of entry.

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89 For example, Dell Computer Small and Medium Business Magazine for February 2006 contains an ad for Vonage ("Switch to Vonage for Your Small Business"). Likewise Cablevision provides Optimum Voice to small businesses.

90 Horizontal Merger Guidelines, United States Department of Justice and the Federal Trade Commission (issued April 2, 1992 and revised April 8, 1997), http://www.usdoj.gov.

Deviation from reliance on HHIs is appropriate here. The broadly defined telecommunications market is expanding at an unparalleled rate, and change is constant. The adoption of internet protocol and the advancement of computer technology cause new entrants to experience lower costs. This allows intermodal competitors rapid and inexpensive entry into the voice market and permits them to contest quickly any monopoly-based pricing of these services by the incumbent. The market is continually expanding, both in scale and scope, causing an ever changing measurement of the size (or total demand) in the market. Static measures of market share such as HHI's do not reflect this reality. Accordingly, measurements of competitor's historic market shares as considered in HHI calculations are of limited significance and provide limited guidance in determining the ability of the intermodal competitive market to constrain monopoly behavior. This market, suitably monitored, can be considered adequately competitive to support the actions we are taking.

We are also not convinced that our actions should be restrained by a concern that the telephone market is or is becoming a duopoly. There are three, not two, major pathways into the customer's premises: traditional wire, wireless, and broadband via cable. Furthermore, within each pathway there are multiple providers of telephone services, especially so for providers of telephone service over broadband. Third, as we look to the future, it would be unwise to assume a duopoly. Future modes, including those we know of such as broadband over power line (BPL) and those we cannot yet conceive of, may well emerge.

And, in any event, concern about duopoly is not something that should unduly constrain us in the decisions we take today. (Even if the market were a duopoly, the goal of establishing just reasonable rates could be well served by our actions, because the new entrants are able to enter at such low costs.) A new company, even if there were only one, can place significant competitive pressure on the incumbent – enough to constrain the incumbent's ability to raise price – if the new company's cost of providing the service is dramatically lower than the incumbent's existing price. Finally, we reserve the right to take the appropriate action in the event that abuses occur or seem imminent.

Nor are we convinced that the lack of complete substitutability of intermodal services for wireline services renders the White Paper's estimate of the extent of competition unreliable. As Staff notes,[91] only a small proportion of consumers need to react to an incumbent's price increases to render futile the incumbent's efforts to raise revenues. Telecommunication services are purchased both as a substitute for and a complement to other telecommunications services, and, given the uniformity rule discussed below[92], the issue of complete substitutability is of lesser consequence. Similarly, while the mere existence of potential competitors does not create a market, given the facts here, actual and potential competitors are constraining the ability of incumbents to exercise market power in setting prices. Finally, we agree with the White Paper's conclusion that bundled telecommunication services, VoIP, and wireless are all in competition with unbundled wireline services, as the incumbent's continuing loss of lines and access minutes strongly suggests.

The data we now have fully support our conclusion that Verizon's and Frontier of Rochester's prices are being constrained by actual and potential intermodal competitors.[93] Cablevision's argument that a Verizon-NY increase in basic rates of 13% in the past year undermines Verizon NY's statements on its inability to profitabty run its wireline business is flawed. Verizon's last rate increase in basic rates was in March 2003, as part of the Verizon Incentive Plan. That increase, and the increases allowed here are more an indication of the need to better align basic rates with underlying costs than the absence of competition for non-basic services. Verizon continues to price local exchange

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[91] White Paper, p. 34.

[92] See Pricing, <u>infra</u>. The uniformity rule – by requiring one price across a service territory or a part thereof – insures that customers in an area that may not be competitive get the benefit of a competitive price.

[93] "Contestable market theory indicates that dominant providers will refrain from monopoly pricing and cost cutting on service quality if competitors can quickly enter and take away a significant share of the incumbent's customers in response to such supra normal profit seeking behaviors." (White Paper, p. 40).

service competitively.[94] Finally, individual reviews of the franchise areas of the independent local exchange carriers is required to determine whether additional pricing flexibility is appropriate for the balance of the incumbents, and we will grant them flexibility if they are able to make an adequate showing.

Turning to Staff's competitive indicator, we recognize that additional adjustments and more refined assumptions can always improve results, but we are satisfied that Staff took a conservative approach, which might be more accurately characterized as underestimating the extent of competition. For example, the indicator does not consider the extent of UNE-based CLEC competition (currently millions of lines), fails to consider Verizon Wireless as a competitor to wireline, and does not consider that multiple providers can be co-located on the same tower. Even assuming arguendo that the criticisms of the White Paper's competitive indicator have merit, the failure of the indicator to consider the above factors suggest that it under-estimates rather than over-estimates the level of competition. Accordingly, we find the Staff indicator an appropriately cautious way to proceed and see no need for further adjustments.

We will also use the indicator, subject to future refinements as appropriate, when we reevaluate the competitiveness of the market. Among the other things we will consider in that review are:

- service quality results in competitive areas as compared in noncompetitive areas;
- price changes that have occurred;
- entry and exit of competitors, and,
- additional line and minutes of use losses.

We direct Staff to perform this evaluation and report back to us in twelve months. We expect that it will find the competitive indicator a useful tool in that endeavor and, if it does, it should use it.

[94] Case 05-C-1303, Petition of Cablevision Systems Corporation Concerning Verizon's Regional Value Plan and Regional Essentials Plan, Order Denying Petitions Requesting Suspension of and Hearing On Tariff Filings (issued December 6, 2005).

In conclusion, we find that the telecommunications market in New York State is, in aggregate, adequately competitive.[95] Perfect competition, which is the ideal, is not needed; the market need only be adequately competitive. Given the inefficiencies inherent in economic regulation, a market need not be perfect, or even near-perfect, to produce better outcomes for consumers than traditional regulation, given the well-documented inefficiencies of the latter, and its shortcomings in an increasingly competitive market. Therefore, despite the lack of the ideal of a perfectly competitive telecommunications market in New York, we find that the forces of competition are sufficiently strong, both now and for the foreseeable future, to easily be considered an adequately competitive market. Alternative facilities-based platforms and viable substitute services are available in the market sufficient to constrain most residential prices such that we can and should rely more heavily on market forces to set prices. The approach we outline in this Policy Statement and Order – discussed below in the Pricing section – is the best approach for setting just and reasonable rates in this environment.

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[95] The qualifier "in aggregate" is important. While there may well be geographic pockets in which intermodal competition has not yet fully emerged, the aggregate nature of our pricing rule (see the uniformity requirement discussed below in the Pricing section), creates an aggregate setting for the incumbent's pricing decisions, and therefore, protects consumers in such pockets.

Pricing

White Paper

Where companies face significant competition, Staff argues, a new regulatory approach is warranted. In such markets, less economic regulation is needed, as price abuses are constrained by competition. The White Paper concludes that firms become price takers under such circumstances and no longer have the ability to ensure that prudently incurred costs will be recovered.

The White Paper posits that regulated rates of return have become less relevant, and traditional regulatory accounting, especially the establishment of regulatory assets, is no longer viable. Reviewing the actions we have taken under the 1995 Performance Regulatory Plan (PRP)[96] and under the Verizon Incentive Plan (VIP),[97] the White Paper echoes our 2003 statement that the PRP was the first step away from traditional cost-based regulation and the VIP was the second step.[98] In this proceeding we are taking a third step.

Because competitive forces are constraining prices and undermining the incumbents' ability to charge revenues sufficient to cover costs, the White Paper asserts that the incumbents should be allowed additional flexibility to price and provide services for which there is a public demand. While competition may not be uniform statewide, the interests of all citizens will nevertheless be protected by the provision of a fully regulated basic service rate, according to the recommendations in the White Paper. This dual approach -- providing the incumbents pricing flexibility and reexamining the need for other non-economic regulation, together with providing the public a fully regulated rate for basic service - - results in a reasonable balance between the interests of the regulated carriers and the interests of the public.

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96 PRP order, supra.

97 In both cases, the Commission balanced customer and investor interests in establishing a more flexible regulatory atmosphere.

98 Case 02-C-0959, Petition filed by Verizon, New York, Inc. for Approval, Pursuant to PSL Section 113(2) of a Proposed Allocation of a Tax Refund from the County of Nassau, Order Allocating Property Tax Refund (issued March 12, 2003) p. 4.

The White Paper recommends that a basic service offering at a regulated, tariff rate be maintained.[99] Staff proposes that this basic service be flexibly priced up to a statewide uniform maximum price, noting that both competitive offerings and incumbent bundled offerings are often priced at uniform rates across service territories. All incumbents would be permitted to increase their current basic service rates up to this cap over a three year period with annual increases limited to $5.00 per month.[100]

In calculating the proposed state-wide rate cap, the White Paper begins with a package rate that Verizon introduced in New York City in 2003. In Manhattan, Queens, Brooklyn and the Bronx, the only type of tariffed local service offered by Verizon was "message rate" service. Under message rate service, a customer pays a basic access line charge of $8.61 per month and then pays 9 cents per call for local calls; there was no "flat rate service" that includes unlimited local calling. However, in 2003, in response to the competitive pressure of other carriers' offering an array of unlimited call packages, Verizon introduced a single price for unlimited calls of $16.34 to be paid in addition to the $8.61 basic access line charge. The combined total of $24.95 thus represents an "all-in" local basic service rate for the most competitive areas in the state.

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[99] The White Paper defines that service as "a single, residential line without features, offered as a stand-alone service universally throughout all exchanges. The service would include flat rate local calling where the local calling area is no less than the current area, including extended area service adjacencies, touch tone, the ability to place and receive calls to and from any PSTN telephone number, long distance equal access, full backup power for the minimum hours consistent with what is currently required of the incumbent, full 911/E911, CALEA and other public safety compliance, full call signaling compliance, compliance with applicable industry standards for sound quality and availability, and the consumer protections provided by Commission regulations." (White Paper, p. 41.)

[100] The increase would be to the monthly bill, which could increase by no more than that amount each year (so that the largest annual total increase a customer could pay would be $60). In response to a CPB inquiry, Staff subsequently clarified that message rate basic service could also be raised to the statewide uniform price over a three year period with the message rate charges being reduced as the basic rate is increased. Staff assumed that when the message rate service reached the statewide cap, message rate charges and message rate basic service would be eliminated. In a similar manner, Staff expected that rate groups will also be eliminated as basic service rates are moved to the rate cap.

The White Paper selected this $24.95 as an appropriate state-wide cap for basic local service. It concludes that $24.95 is a just and reasonable rate because Verizon's underlying offering was priced in response to competitive market pressures and because each of the components of the rate had previously been determined to be just and reasonable.

Using forward-looking cost studies, the White Paper also concludes that the cost of serving metropolitan areas is less than the cost of serving less densely populated areas of the state. It therefore finds that a competitively constrained rate in a metropolitan region (i.e., the $24.95 rate) would be just and reasonable in other areas of the state where the utilities' underlying costs are even higher.

Verizon's recently filed tariff offering basic service plus three features for $17.00 downstate and $22.00 upstate was also addressed by the White Paper. It declined to recommend the adoption of those prices as set by the competitive market because the service was only recently offered, and Staff was unsure how long the new offering would remain available. The White Paper concluded that these prices should not be used without more extensive experience. It further noted that if market forces push competitive prices below the $24.95 ceiling, competition has done its job and consumers will reap the advantages.

Addressing the range of current basic service offerings priced lower than $24.95, the White Paper explains that those rates stem from legacy regulation. Under that system, local rates were subsidized with higher margins from previously more lucrative although now more competitive markets. Such an approach is no longer workable, and, as a general matter, rates must be better aligned with costs. Allowing the incumbents to move to a uniform, statewide, basic service rate of $24.95 will help accomplish that goal, according to the White Paper.

Turning to the incumbents other than Verizon and Frontier of Rochester, the White Paper again notes significant line losses, albeit less than those for Verizon and Frontier of Rochester. In addition, the White Paper notes a significant loss of access minutes from these carriers, and both losses result in reduced revenues for the incumbents. For these carriers, the White Paper proposes the same $24.95 basic service rate cap and similarly allows local basic service rates to increase at "the higher of $5.00 per access line per month or 2.5% up to the rate cap of the basic service offering…."[101]

The White Paper indicates that the incumbents would be required to charge customers a uniform basic rate throughout their service territories, thereby precluding discriminatory pricing. To address in part the loss of revenues from access minutes, the White Paper also recommends that the base rate increase for these other independent incumbents be implemented together with an offsetting reduction to intrastate access charges to bring those charges more in line with each company's interstate access rates and related costs. Any further earnings deficiencies of these incumbents would, according to the White Paper, be dealt with in the context of a traditional rate case. The White Paper states that adopting such an approach will move the independent incumbents closer to the access rate structure of Verizon and Frontier, will ease the financial pressures due to the loss of access minutes, and will move base rates closer to costs.

Turning to non-basic services, the White Paper recommends that Verizon and Frontier of Rochester have full pricing flexibility for all services other than basic service. Under the White Paper's approach, uniform prices on a service territory-wide basis would be required for non-basic offerings, and Verizon and Frontier of Rochester would be provided the ability to rapidly change those rates to any desired level in response to competitive pressures. The basis for the White Paper's uniform pricing recommendation is to provide just and reasonable rates for non-basic offerings by requiring offerings to be uniformly priced in both competitive and noncompetitive areas.[102] The theory is that the incumbents will need to price services competitively in areas where they are subject to competition, and uniformity of such a competitive pricing structure will carry over to and protect consumers in noncompetitive areas. As explained by Staff, "even when not all customers have three platforms, if a sizeable majority of them do, the aggregate demand facing the incumbent that serves them can be sufficiently

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[101] White Paper, p. 46.

[102] The White Paper also sought comments on how to resolve the problem of allowing price discounts (desirable in the market), which it says appears to be prohibited by the Public Service Law (PSL) Section 92(5).

price elastic to constrain the incumbent's ability to profitably raise prices."[103] Given the extent of competition for non-basic services, the White Paper concludes that there will be no need to review prices in advance.

The flexibility recommended for Verizon and Frontier of Rochester is not recommended for the remaining independent incumbents because it remains unclear whether competition has impacted each of the independent companies to the same extent it has effected Verizon and Frontier of Rochester. The White Paper recommends the use of Staff's competitive indicator to review the level of competition experienced in each of the independent companies' areas on a case-by-case basis. Based on that review, the White Paper recommends that each company be given the opportunity to demonstrate what additional flexibility or increased rates are needed to meet the level of competition they are experiencing.

The White Paper also notes the importance of continuing to monitor incumbent behaviors and the extent of competition. As the market continues to grow and mature, additional regulatory requirements may need to be eliminated. It accordingly recommends that a more granular competitive review be conducted within a year of the conclusion of this proceeding with the results of that review used to further streamline regulatory requirements. The Commission should move quickly, according to the White Paper, to reduce or eliminate any additional economic regulation imposed on dominant traditional carriers and to make those regulations more consistent with the requirements for non-dominant carriers, when appropriate.

Finally, the White Paper notes that there are various categories of reporting requirements regarding economic regulation which should be reviewed in a separate rulemaking. More specifically, the White Paper discusses streamlining merger or sale conditions and expresses the opinion that the process of approving acquisitions for small telephone companies can be improved. It also suggests that it would be reasonable to consider financial incentives to encourage the acquisition of small telephone companies in a manner similar to the policy we instituted for small water companies.

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[103] White Paper, p. 33.

Parties Comments

The DOL, Dr. Bronner, Cablevision, CTANY, the Assembly Standing Committee, CWA, and CPB argue that the proposed $24.95 rate cap for basic service is not supported by the record in this proceeding

According to the DOL, the parties have not been allowed to adequately examine the rates and the record is insufficient to support an across the board increase. The need for the increase is based solely on Verizon's assessment of Verizon's financial condition, he goes on, and raising rates due to financial concerns is contrary to the decision made by the Commission and Verizon to divorce earnings from rates. The DOL notes as well that the Staff proposal is nothing more than a vague concept upon which the parties cannot meaningfully comment. Rates should not be reset, according to a number of the parties, without undertaking a comprehensive review.[104]

A number of different challenges are raised to the proposed rate cap. Dr. Bronner agrees with the concept of a basic service price cap, but contends that the suggested price needs to be further justified.[105]

The CTANY contends that the $24.95 basic service rate could be reasonable in Manhattan, but there is no basis for assuming the rate would be just and reasonable elsewhere. Cablevision challenges the rate by pointing to the more recently filed $17/$22 Verizon rate for services that exceed those provided in a basic service offering. This suggests, The Cable Association claims, that the cost of providing basic service is considerably lower than the White Paper's $24.95, rendering the rate not reasonable.

The Assembly Standing Committee argues that if there is evidence of the need for rate increase, it should be presented on a record. It also notes that, from a statewide pricing perspective, rate groups are becoming increasingly anachronistic.

Cablevision and others also challenge the conclusion in the White Paper that Verizon's overall financial health has been substantially impacted by its loss of

[104] The DOL charges that the rate increases proposed here are an improper shortcut around a formal rate proceeding.

[105] Dr. Bronner also suggests that multiple price caps could be appropriate.

access lines in New York. They say that the Verizon New York earned returns estimated in the White Paper (p. 38) are not reflective of Verizon's financial health. These parties point to the parent corporation's 2nd quarter of 2005 profit of $2.1 billion on revenues of $18.6 billion, suggesting that Verizon is doing quite well. Cablevision also points to Verizon Wireless, noting that it added 1.9 million new customers in the 2nd quarter of 2005 with an equal increase in the 3rd quarter, for a total increase in wireless customers of more than seven million in the last 12 months. These parties allege that the dismal view of Verizon's financial position is not supported by the financial results, and that there is no evidence of Frontier of Rochester's financial condition that would justify a rate increase.

The Joint CLECs support the argument that Verizon's loss of access lines in New York does not mean that it is suffering financially. According to the Joint CLECs, FCC data indicate that cable telephony's new subscriber sign-ups have slowed to a trickle. Thus, they conclude that Verizon's primary competitive threat in residential markets is Verizon itself. CWA opposes the increase in basic rates, calculating expected increases ranging from 58% to 190%. Such increases constitute rate shock, according to CWA, and it contends that the shock will fall disproportionately on those customers least able to afford it. CWA and CPB also suggest that the universal availability of affordable telephone service could be negatively impacted by such rate increases, an impact which the White Paper allegedly did not explore. CWA and CPB further argue that the White Paper failed to analyze the impact of the proposed price increases on consumers generally.[106] CWA requests a formal hearing at which a factual record could be developed.

CPB also challenges whether the $24.95 rate is just and reasonable today, pointing to the fact that it was a rate established in 2003. Assuming the rate was just and reasonable in 2003 in New York City, does not establish, according to CPB, that it is reasonable now in different locations with different characteristics.

[106] CPB also notes that no information of any kind was presented with regard to the recommended increase for Frontier of Rochester.

The CTANY argues that there is no rational basis for increasing basic rates and revenues for Verizon and Frontier while only allowing rural incumbents to raise basic rates on a revenue neutral basis. It also argues that deregulating Verizon and Frontier rates for all but one basic service, as recommended by the White Paper, is a violation of the Public Service Law. According to those comments, such an approach would not fulfill the statutory obligation that ratepayers be charged only just and reasonable rates for utility services. In particular, it contends that the Public Service Law (Sections 91, 92, and 97) prevents the Commission from allowing incumbent rates to float unconstrained with the market and that statutory tariffing and notice requirements cannot be waived in any event.

The Joint CLECs express their support for the uniform pricing of non-basic services arguing that without that requirement, non-competitive areas would not be provided the protection of market constrained pricing.

Frontier agrees with the assessment of a widespread competitive market for telecommunication services, but indicates that the White Paper falls well short of addressing that factual situation. Frontier argues that all incumbents should be granted true pricing flexibility, and that all non-basic services should be completely deregulated.

Frontier agrees with the recommended $24.95 basic service rate cap, but does not agree with limiting the revenue relief to just Frontier of Rochester and Verizon. Other Frontier affiliates are also facing the same challenges being experienced by Verizon and Frontier of Rochester, and there is no reason not to allow all incumbents the same level of pricing flexibility and revenue increases.

Frontier opposes the White Paper's recommendation for a uniform, service territory-wide rate for non-basic services. It is manifestly unfair, according to Frontier, to require uniform statewide prices for non-basic services without regard to the differing competitive circumstances faced by its affiliates.

The Rural Telephone Companies are concerned with the recommendation that incentives be provided for the acquisition of small telephone companies. They note that not all such companies desire to be sold, nor is there any evidence that the existing operations are not efficient or reliable. Unless clarified, it says, this recommendation may be inconsistent with the policy of the state to encourage the maintenance and growth of small businesses.

The Farm Bureau supports the $24.95 basic service rate cap but expresses concern about price spikes. It recommends that where basic service prices are to increase by more than 100%, the phase-in period should be no less than five years. It also urges that incentives for the acquisition of small telephone companies be provided only if it is established that such mergers will reduce costs to the consumer, increase choice, and improve reliability.

Verizon suggests that a number of modifications are required to Staff's pricing recommendations. It notes that backup power is not useful in fiber loops and suggests that a clarification of the definition of basic service is therefore required.

Verizon agrees with the $24.95 rate cap for statewide basic service, but disagrees with the recommendation that it be directed to design a rate transition plan. It views the basic service option set forth in the White Paper as an addition to all other basic service offerings and argues that it should have the flexibility to withdraw or amend the price or terms of the other basic services as market conditions and other considerations require. Under Verizon's approach no customer's rate would be increased immediately as all would be allowed to retain their existing basic service at their existing rate until new tariff leaves are filed and accepted. Verizon therefore concludes that a rate transition plan is not required.

Verizon also objects to the proposed territory-wide rate uniformity requirement for non-basic services. This proposal would limit Verizon's existing flexibility, it claims, which now allow rates to vary by geography. For example, it asserts that effective competition in Manhattan would not be possible if Verizon had to offer the same Manhattan-constrained prices in areas where the cost of servicing customers is higher than in New York City. Verizon also asks for a clarification regarding whether the pricing flexibility for non-basic services would be subject to price ceilings or limits on allowed annual percentage increases. Finally, Verizon argues that an anti-competitive price squeeze will not be effective in a competitive market. Therefore, it concludes that there is no need to impute a price floor for any non-basic service.

Discussion

We will discuss below our conclusions concerning the additional regulatory flexibility we are implementing for basic and non-basic service, but we first address those comments which characterized the White Paper's recommendations as the "deregulation" of the telephone utilities. This is not an accurate description of either the recommendation in the White Paper or of the actions we take here. We have previously granted the regulated carriers significant flexibility where that flexibility is required to allow the incumbents an opportunity to compete.[107] Clearly, market conditions have changed significantly since we last examined these issues,[108] and, based on these changes, we conclude that an incremental expansion of that flexibility be granted for Verizon and Frontier of Rochester. The changes we are adopting here represent measured, incremental changes in the regulatory framework which we have been successfully adjusting over the years to encourage the development of a competitive market. We are fulfilling our regulatory responsibility by relying more on competition and less on regulatory mandates, consistent with the Public Service Law.

Basic Service

The White Paper and many of the parties support the establishment of a single basic service priced at a uniform statewide rate under a rate cap. No party opposes the idea of having the incumbent carriers continuing to provide a basic service offering. Before turning to the disputed issues, we agree that incumbent carriers should continue to offer a basic service offering. The basic service offering will be provided at a regulated

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[107] PRP Order, supra; Case 29469, Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Opinion No. 89-12 (issued May 16, 1989)(Competition I); Case 94-C-0095, Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Opinion No. 96-13 (issued May 22, 1996)(Competition II); and 02-C-0959, Petition of Verizon New York, Inc., for Approval, Pursuant to Public Service Law §113(2) of a Proposed Allocation of a Tax Refund from the County of Nassau, Order Allocating Tax Refund (issued March 12, 2003).

[108] PRP Order, supra.

tariff rate and should ensure the continued universal availability of telephone service to New York's citizens.[109]

The White Paper focused its basic rate protections on ensuring that flat rate service would continue to be available at a rate no higher than an established statewide cap. To the extent the White Paper could be interpreted as allowing incumbents to eliminate existing message rate offerings in favor of a flat rate type service, we do not agree with the White Paper. Because we do not want to restrict customer choice, we believe it is essential to retain the message rate option. Thus, the message rate option, which is comprised of a fixed charge for an access line and a per call usage charge, will be deemed to be part of the basic service offering definition and is, therefore, a required offering for Verizon and Frontier of Rochester. This means that customers will continue to have two options to maintain a connection to the telephone network: a flat rate calling option and a message rate calling option.

As the White Paper acknowledges, the competitive market offers products and services often priced on a uniform basis throughout a territory, state, or region. However, Verizon's flat rate basic service rates in New York vary broadly depending on the customer's rate group. Rates also vary among the 40 incumbents in the state and between basic flat rate and basic message rate service. While these rate structures were appropriate in a monopoly environment, they may not be viable given the competitive intermodal market. For example, our forward-looking cost studies show that rural areas (where rates are low) are more expensive to serve than urban areas (where rates are higher).[110] Yet regulated rates have suppressed rural rates to levels below those in urban areas, thereby discouraging investment in the telephone infrastructure. We believe it imperative to change this rate structure to reflect the realities of the market and to better

[109] We intend that the basic service offering protections we are adopting today will be available to customers taking basic service on a stand-alone basis or when they purchase basic service along with other services or features on an a la carte basis.

[110] Case 05-C-1303, supra, Order Denying Petitions Requesting Suspension of and Hearing on Tariff Filings, p. 7.

reflect the cost of providing service. To accomplish this purpose, we adopt the recommendation to allow the incumbents to file tariffs to provide for a basic service offering subject to the limitation described below. Existing rates differ and may continue to differ; incumbents will be allowed to charge any rate up to the limitation.

One aspect of the White Paper that drew considerable attention was the recommendation that Verizon and Frontier of Rochester be allowed to benefit financially from increasing their basic service rates, while requiring all other incumbents to make any desired basic service rate changes on a revenue neutral basis. Those opposing this approach also generally argue that there is no evidence of serious financial impacts on the incumbents from intermodal competition.

Our actions here are driven primarily by our recognition of the availability of real competitive alternatives and actual competitive gains that competitive carriers are achieving. These market forces are constraining incumbent prices and indeed are forcing incumbent prices down.[111] This, in turn, reduces financial margins on previously more profitable products and requires, for long-term viability purposes, that basic rates be adjusted to align more closely with underlying costs. These actions are supported by our view of market conditions and the relationship of basic rates to underlying costs. Our consideration of financial results tends to corroborate these primary findings, which demonstrate that the strength of competitive inroads is greatest in the Verizon and Frontier markets.

The White Paper reported that over the past five years (2000 thru 2004), Verizon New York lost almost 3 million access lines (about 25%), and Frontier Telephone of Rochester lost approximately 80 thousand access lines (about 16%). Over this period, Verizon's annual local service revenues declined by nearly $1 billion, and

[111] Based on a Bureau of Labor Statistics index of wireline telecommunications service provider prices, prices for telecommunications services have decreased at an average annual rate of 1.8% over the period 1996 to 2006 (http://data.bls.gov/cgi-bin/surveymost?pc).

Frontier's annual local service revenues declined by some $12.5 million.[112] As demonstrated below, these revenue losses have resulted in the companies' reported rates of return declining, and being much lower than what these companies would be allowed in a traditional rates case.

Verizon New York, Inc.
Intrastate Rate of Return and Return on Common Equity
Reported in PSC Annual Reports, Schedule 10

Year	Rate of Return	Return on Common Equity
2000	4.06%	-0.07%
2001	2.61%	-4.38%
2002	1.19%	-10.99%
2003	-6.30%	-40.26%
2004	-0.03%	-36.24%

Verizon New York has also seen a precipitous drop in its Moody's unsecured debt rating, falling a total of five levels, from Aa3 in 2002 to Baa2 (April 2004). During the same timeframe, the parent's (Verizon Communications, Inc.) corporate rating only fell one level, from A1 to A2. On December 21, 2005, Moody's dropped both by another level, Verizon New York down to Baa3 and Verizon Communications, Inc. to A3.[113]

[112] We also note based on PSC Annual Reports that total company revenues for both Verizon New York, Inc. and Frontier of Rochester declined over the period from 2000 to 2004 consistent with their intrastate revenue declines. Some parties suggest that Verizon's wireline competitive losses in New York should only be considered in the context of profits made in other competitive lines of business and regulated profits made in other states by Verizon New York Inc.'s parent company. This would be a significant departure from the traditional approach of reviewing jurisdictional costs and associated revenues. See Brooks-Scanlon Co. v. Railroad Comm'n, 251 U.S. 396 (1920) and City of New York v. United States, 337 F. Supp. 150 (E.D.N.Y. 1972). Investors do not typically continue to support one project simply because another unrelated project is profitable. We decline to rely on non-jurisdictional earnings to offset jurisdictional losses.

[113] Standard and Poor's only uses a top-down approach. Verizon- NY's shares are thus rated the same as its parent – A (which was lowered from A+ on January 13, 2006).

Frontier Telephone of Rochester
Intrastate Rate of Return and Return on Common Equity
Reported in PSC Annual Reports, Schedule 10

Year	Rate of Return	Return on Common Equity
2000	8.25%	8.75%
2001	9.61%	11.02%
2002	10.47%	12.45%
2003	4.04%	1.73%
2004	4.13%	1.89%

Since being acquired by Citizens Communications in 2001, Frontier Telephone's debt rating has been that of its parent. That rating of Ba3 by Moody's has remained unchanged since the acquisition. Although Moody’s affirmed Citizen’s rating and upgraded its ratings outlook from negative to stable, it expects that competition will increase in the future, and given Citizens weak credit profile Moody's sees little flexibility for the company to develop new services or to respond to increased competition. We also note that Citizen’s has been able to offset access line loss in large part through the sale of higher priced non-jurisdictional products such as DSL, and bundled products.[114]

The data also show that incumbent LECs other than Verizon and Frontier of Rochester have experienced smaller access line losses as a percentage of total access lines. This strongly suggests that the smaller incumbents may not have been as exposed to the new intermodal market to the extent Verizon and Frontier have and may not yet have experienced the level of financial losses experienced by Verizon and Frontier of Rochester. It is possible that some incumbents may be able to demonstrate a material competitive loss from competition.[115] Wherever that may be the case, a filing by the incumbent seeking additional pricing flexibility or additional revenues will be reviewed.

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[114] Under existing rules and regulations much of the revenue from these new product lines do not contribute to intrastate earnings, and are not available to offset state regulated revenue deficiencies.

[115] Several smaller incumbents have experienced large declines in access lines from 2000 to 2004 (e.g., Dunkirk and Fredonia lost 12%, Cassadaga and Ontario each lost 9%).

However, we have not been able in the context of this proceeding to examine the specific competitive circumstance of every incumbent, and, accordingly, we are limiting our grant of additional flexibility and additional revenues to Verizon and Frontier of Rochester.

It is our responsibility to balance interests in setting rates, and despite comments to the contrary, New York's wireline business is under substantial competitive financial pressure. It thus seems clear that the arrival of intermodal competition has affected the customer/investor balance to the detriment of the legacy carriers. The wireline losses cannot long continue before serious problems will arise in the maintenance and operation of the legacy infrastructure. Accordingly, we believe the appropriate balance in this instance is to permit Verizon and Frontier of Rochester to raise the monthly charge for the access line portion of message rate service. Similarly we will allow Verizon to gradually raise existing flat rate basic service rates up to a statewide cap rate, and to retain any additional revenues generated by the increases from both the message rate and flat rate services. (As we explain below, considerations of impact on customers leads us to a similar but more limited conclusion for Frontier.)

The pricing flexibility that we are authorizing will help ensure that high quality telephone services continue to be available, while also providing regulated carriers better incentives to maintain and upgrade their networks. Providing incumbent pricing flexibility to meet the market while protecting consumers with a regulated basic service also restores a more equitable balance between the interests of consumers and investors.

Message rate service is available throughout Verizon's and Frontier of Rochester's territories. A customer subscribing to message rate service pays a number of different rate elements on each monthly bill. For example, Verizon's message rate service consists of a fixed access line charge ($8.61), a per call usage component (approximately $5),[116] as well as a Federal Subscriber Line Charge ($6.39) for a total bill of approximately $20 per month, excluding taxes and mandated surcharges. Frontier's message rate service recovers even less revenue. Based on the cost studies we adopted in

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[116] This assumes a customer makes approximately two local calls per day at 9¢ per call.

Case 98-C-1357,[117] we determined the total long-run incremental costs that an efficient provider utilizing the most efficient available network elements would incur in order to provide telephone services. These forward-looking costs were used to establish wholesale prices for unbundled network elements. While that standard is appropriate for providing competitors a needed input, it does not allow a company to recover its actual historic costs. Use of forward looking costs accordingly represents an aggressive (i.e., below actual historic levels) cost estimate, a fact we will recognize in balancing ratepayer and investor interests in this case.

As we described in Case 05-C-1303,[118] forward-looking costs for a basic offering, including forward-looking retailing costs, range from $22 downstate to $26 upstate. We recognize that these estimates of forward looking costs allow for more usage than the average message rate customer actually consumes.[119] But we also acknowledge that our forward looking costs were determined based on the most efficient telecommunications technology currently available and the lowest cost network configuration given the existing location of incumbent's wire centers.[120] Because of ongoing technological improvement (among other things), such forward looking estimates fall well below the costs the incumbents had actually historically incurred in constructing their network.[121] Thus, these costs do not always allow the incumbents to

[117] Case 98-C-1357, Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements, Order on Unbundled Network Element Rates (issued January 28, 2002).

[118] Order Denying Petitions Requesting Suspension and Hearing on Tariff Filing (issued December 6, 2005).

[119] Approximately $5 of usage costs are included in the forward looking cost estimate, which is consistent with average usage for UNE-Platform customers. Forward looking usage costs for message rate customers, who do not use the phone as often, would be closer to $1.

[120] 47 CFR §51.505(b)(1).

[121] See, USTA v. FCC, 359 F.3d 554 (D.C. Circuit 2004).

recover the costs of the actual network that is being used to serve basic customers.[122] For these reasons, the use of forward looking costs to constrain prices is overly aggressive and rates above that level can still represent a fair balancing of customer and shareholder interests.

Those costs do, however, provide a critical indicator of the need to increase rates. Rates below identified forward looking costs are not only anti-competitive, but they suggest that rates are not even contributing to recovery of the costs of a hypothetical forward-looking network, let alone the one that actually exists. In this connection it is a concern that many rates (e.g., Verizon upstate and Frontier) are currently below those costs. In contrast, rates above forward looking costs present much less of a concern. In areas of the state where rates move above forward looking costs we expect that competitive pressures will act as a constraint.[123]

Accordingly, we believe it is reasonable to move rates to and above forward looking costs and will authorize an increase in the access line portion of the monthly message rate by $2 now and an additional $2 one year from now. These increases will give the companies (Verizon and Frontier of Rochester) the flexibility to align retail rates more closely with underlying costs. There is no basis to conclude that the usage component of the message rate service is not covering costs. Therefore, we will not authorize an increase in the usage component of the message rate offering.

Turning to flat rate service, a number of parties challenge the reasonableness of the $24.95 rate cap for basic service recommended in the White Paper and some have suggested that Verizon's recent offering of basic service plus three additional services ($17 downstate; $22 upstate) should be used as the basic service rate cap. First, we conclude that the $24.95 rate cap would be a just and reasonable rate cap for all the reasons described in the White Paper. It was competitively determined and had

[122] The financial results noted above are based on historic plant costs. We recognize that competition may preclude pricing at some point above incremental cost and may compel continued underearnings by the incumbent carriers.

[123] For example, Verizon recently introduced its Regional Value Plan at $17 per month in the Metro LATA.

previously been found to be just and reasonable. Further, it is a rate cap and competitive pressures may well limit the price to a level well below $24.95.

In addition to being a competitively determined price, establishing a territory-wide basic service price supports our views on universal service. As noted above, rural rates have been lower than urban rates, despite rural service being more costly to provide, as demonstrated by TELRIC studies. Moving rural rates closer to their costs makes these customers more attractive to incumbents and enhances their ability to serve these customers. Allowing rural rates to increase to urban levels produces a more equal sharing of responsibility between urban and rural customers for high cost areas. Moving the rates to cost also encourages other intermodal competitors to enter the market and bring the benefits of competition more directly to rural customers.

Notwithstanding the above, we also agree with those contending that Verizon's recent tariff may also reflect a market determined price. Market prices change often, and the mere fact that they have no track record does not render them unreliable as a measure of the market price. We also note that AT&T Communications of New York, Inc. provides a basic local offering in New York. The offering has been provided relying on Verizon's wholesale Unbundled Network Element Platform (UNE-P) at forward looking Total Element Long Run Incremental Cost (TELRIC) prices. This competitive offering is analogous to basic service and has been available for $22.95, before surcharges. Our understanding is this offering is among the lowest price offered by competitive local exchange carriers in New York. Accordingly, we have different measures of market determined prices ($24.95, $22.95 and $22.00) and have decided to set the basic service offering rate cap between these prices at $23.00. This reflects both an established competitive price and a new competitive price and we therefore conclude that a $23.00 rate cap is just and reasonable. We decline to rely on the recently introduced $17 downstate price because that price does not reflect the cost characteristics that are more prevalent in most areas of the state.[124]

We therefore conclude that based on competitive offerings, cost, our interest in ensuring incumbent carriers are able to maintain a secure and reliable network, and our goal of maintaining universal service, a flat rate basic service offering with a statewide basic service rate cap of $23.00 is justified. We are required, however, to balance shareholder interests with customers' interests, and that balancing requires that we modify the recommendation in the White Paper. We depart from the White Paper's recommendation with respect to both the increase in the monthly charge and the three-year transition period.

We do not see a need for a three-year transition period because some rates are already close to $23 and others are well below costs. However, rather than a $5 increase in the charge, we believe a lower limitation of $2 is appropriate to moderate the increase. Verizon may increase its existing flat rate basic monthly service rates up to the $23.00 with annual increments limited to a $2 increase in the charge effective each year.[125]

Verizon will be allowed to retain the increase in revenues. We estimate that if the full basic rate increase were implemented by Verizon the revenue increases would be about 2.44% (1.25% in the first year). Balancing customer and shareholder interests, as required by the statute, leads us to conclude that the burden on customers is not so extreme that the company's shareholders should be denied the benefits of moving these rates closer to where they should, in theory, be.

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[124] Case 05-C-1303, supra, Order Denying Petitions Requesting Suspension of and Hearings on Tariff Filings (issued December 8, 2005). Unlike other parts of Verizon's territory, New York City has not had a long-standing flat rate offering. But the availability of the recently introduced Regional Value Plan at $17 per month in the MetroLATA satisfies our requirement to have a flat rate offering available at or below $23.

[125] We do not adopt Verizon's proposal to offer a new basic service offering that could supplant all existing basic service offerings. As we understand it, Verizon's proposal would add a new, regulated basic service offering and enable it to price existing basic service offerings flexibly.

A different result is warranted for Frontier because the increases that would be authorized produce more revenues as a proportion of overall revenues and would occur over a longer period of time and have a greater impact on customer bills because of Frontier's relatively lower rates. Even though the flat rate parameters we are establishing are justified, we will establish a two year check point for Frontier and require Frontier to demonstrate to the Commission's satisfaction that the competitive impacts and trends that we have identified are continuing and that there is a continuing financial need for the relief prior to implementing basic rate relief beyond year two. We will also consider customer rate impacts in that assessment. Thus, we will allow the basic rate increases for two years, at which time we will reconsider the balance of shareholder and customer interests and evaluate whether modification of our decision is warranted.

Finally, we require that any increases by the other independent incumbents be offset by access charge decreases, unless they can make individual showings to support a net revenue increase request.

We do not believe the basic rate increases we are authorizing will have an unreasonable impact on consumers or on our universal service goals. Customers taking Verizon's message rate may, if the full flexibility authorized is exercised, see a bill increase of approximately ten per cent per year over the next two years.[126] Further, Verizon's existing flat rate service for its Rate Group 9 costs $22.61 per month. Rate Group 9 is generally offered in more populous areas (Albany, Buffalo and Syracuse), and represents a significant portion of Verizon's flat rate customers. The substantially similar rate cap we impose today will enable customers to retain a basic connection to the public switched network, just as the Rate Group 9 price has. (In effect, customers in less densely populated areas will be paying rates that are comparable to those in more densely

[126] Similarly, Frontier's current message rate service and flat rate services are priced substantially below Verizon's. Frontier's current message rate access charge is $4.53 (versus $8.61 for Verizon). Frontier's current flat rate service ranges from $6.23 to $11.71 (versus $15.81 to $22.61 for Verizon). Thus, if Frontier instituted the full increase for message rate in the first year, these customers would see their bills increase by approximately 14.0% while the average flat rate bill increase in the first year would be about 12.6% (versus 5.7% for Verizon flat rate customers).

populated areas[127].) The rate increases for those consumers who subscribe to basic flat-rate or basic message rate service will be in areas where current rates are not aligned with the cost to serve, a pricing structure that cannot be allowed to continue. Moreover, our required Lifeline service for low-income consumers should maintain affordability and further our goal of universal service. Finally, rates for customers who qualify for Lifeline shall not increase as a result of our actions in this Order.[128]

Raising rates toward costs in areas where rates are set well below costs will result in substantial long-run benefits to consumers. If wireline service is priced below forward-looking or actual costs (as it is in many rural areas), the ability of existing carriers to maintain and upgrade their plant to provide service is undermined and other carrier's ability to compete is seriously limited. This may well explain a few of the comments which noted less infrastructure development in rural areas. If rural rates more accurately reflect service costs, competitors may be able to extend their infrastructure and services to these areas. If nothing is done to adjust these subsidized rates, however, competition will be impeded and the benefits of intermodal services may be delayed or even denied in certain areas.

We disagree with those who argue that additional procedures and a more detailed review of the facts (including a formal evidentiary hearing) are required before any rate increases are granted. We are authorizing rate increases under section 97 of the Public Service Law, which does not require a formal, trial-type evidentiary hearing. The order initiating this proceeding provided notice to all parties concerning the broad objectives of the proceeding as well as the specific objectives, including retail pricing flexibility and allowing rates in less densely populated areas to increase to their

[127] Former toll pool members will, however, be eligible for assistance from the transition fund in instances where their basic rate would exceed the $23 statewide benchmark rate cap (or the appropriate rates as each rate cap is increased to that level).

[128] To ensure that rates to Lifeline customers do not increase, Lifeline rates will be frozen. Increases authorized for flat rate service will be effectuated via the access line portion of the rate and not the usage portion. Where Lifeline bills would increase as a result of the implementation of the basic rate flexibility authorized here, an offset modification to Lifeline rates shall be made to avoid increases to Lifeline rates.

underlying cost levels. All parties were given an opportunity to comment on these issues. Specific proposals to address the issues raised in the Commission's initiating order were then set forth in an extensive White Paper prepared by the Department of Public Service staff and all parties were afforded an opportunity to provide comments on those proposals. The process that we have followed has provided adequate notice and opportunity to comment on the issues that we are now addressing and we do not believe evidentiary hearings are necessary.

Verizon asks for a clarification regarding the basic service offering. It asks us to clarify the White Paper's definition of basic service, especially with regard to the requirement that it include "full backup power for the minimum hours consistent with what is currently required of the [incumbent] . . . ."[129] Verizon notes that backup power is not effective with fiber cable, and, accordingly, we will accept the White Paper's definition, except for the backup power requirement where the service is being provided over fiber.[130]

For incumbents other than Verizon and Frontier of Rochester, any increase in basic service rates consistent with the limitations described here shall be matched by a reduction of intrastate access charges (unless they make a showing that other treatment is warranted). Any increase must be applied uniformly for similarly situated customers consistent with existing rate groups.[131]

Non-Basic Services

The White Paper recommends that Verizon and Frontier of Rochester be provided full pricing flexibility for all non-basic service offerings,[132] subject to the requirement that the price established for each service be uniformly charged throughout

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[129] White Paper, p. 41.

[130] In these cases a battery back-up is used. Maintenance of the battery, however, is a consumer responsibility.

[131] We agree with Frontier that each of its affiliates should not be treated as a single territory. Our ruling in this Order addresses Frontier of Rochester. Each of the other Frontier affiliates will be handled as independent LECs and are subject to the same limitations as the independent telephone companies.

[132] We are referring here to non-basic, residential retail services only.

the utility's territory. Verizon and Frontier challenge the uniformity requirement and other parties argue that the flexibility we are granting is not justified by the market or is not permitted under the Public Service Law. Before proceeding to a discussion of these issues, a brief review of our long history in granting pricing flexibility in competitive circumstances will provide a context for the incremental actions we are taking here.

Beginning in 1970, we have granted substantial pricing flexibility to incumbent local exchange carriers for special services, Centrex, and custom calling features. Many custom calling features are now bundled into packages which offer discounts over individually priced features, and the company offers these packages in flexibly-priced ranges. Incumbents can also offer contracts targeted to meet any specific customer's unique needs through limited service offerings or on an individual case basis, without the need to seek prior approval (a tariff filing after the fact is still required). As a practical matter, individual case basis pricing is limited to non residential offerings and our grant of such rate flexibility has usually been conditioned on the availability of competitive options.

More recently, we synthesized our various policy determinations regarding pricing flexibility:

> The freedom to change rates rapidly to best reflect demand and costs is consistent with a competitive market. As the transition to competition continues, pricing flexibility must be accorded companies in competitive circumstances. Pricing flexibility, defined as the ability to change rates rapidly with the minimum of regulatory review, should be commensurate with the degree of competition. After careful review, we find that our existing pricing flexibility policies (a ceiling of no more than a 25% increase per annum, and a floor of relevant incremental costs) and individual case basis pricing (rates based on costs to an individual customer) are appropriate for dominant providers for competitive services during the transition period.[133]

Flexibility was also granted in 1996 when Public Service Law §92 was amended to exempt services other than "regulated basic services, switched carrier access

[133] Case 94-C-0095, supra, Opinion No. 96-13, p. 29.

services, charges for interconnections between local exchange carriers, and toll services" from publication and to reduce the notice requirements for those changes from 30 days to 10 days. Little review of these changes has been undertaken other than to ensure that any maximum limitation on rate increases is not violated because the services that may have prices changed on 10 days notice are non-basic and competitive.

Verizon's more recent pricing flexibility was established in its last rate settlement, the Verizon Incentive Plan (VIP). In that plan, Verizon was granted the ability to change virtually any retail rate up or down (but to a level no lower than incremental costs) as long as the net change did not produce a revenue increase in excess of 3% per year based on the prior year's volumes. Basic residential rates, however, were capped.

The Verizon VIP tariffs, which had been redesigned to facilitate the administration of retail pricing flexibility, reverted back to what they were before the plan when the VIP ended in 2003. Today, Verizon's pricing flexibility for retail non-basic services allows it to change rates by up to 25% per year. In addition, we have also long allowed Verizon's business exchange access service prices to vary between wire centers on a geographic basis. This authority only permits flexibility in wire centers that are deemed subject to competition and has not been exercised by carriers.

More recently, we have permitted Verizon to charge different prices for the same service in different areas when justified by cost differences. We found that:

> The Commission can distinguish between customers and can allow different prices based on demand elasticities of service in competitive situations, as long as the resulting differentiation is rational and not unduly discriminatory where justified by a balancing of shareholder and ratepayer interests.[134]

[134] Case 05-C-1303, supra, Order Denying Petitions Requesting Suspension of and Hearings on Tariff Filings, p. 8.

Accordingly, we allowed a $17 rate downstate and $22 rate upstate rate for the same service.[135]

In this proceeding, Verizon challenges the White Paper's non-basic service pricing recommendation, contending that the requirement to charge a uniform price for each service throughout its territory actually reduces its existing pricing flexibility. It also argues that imputing a rate floor to preclude predatory pricing is unnecessary because it could not benefit from predatory pricing in the existing market

Considering first the argument about price floors, we find that the cost of entry for intermodal competitors is less than the wireline LECs embedded costs and is falling. Further, given the uniform pricing rule for non–basic services and price cap for basic services that we are establishing, it would be virtually impossible for Verizon to price below its costs in competitive areas and to make up the difference by raising prices in non-competitive areas. Accordingly, we see no need to impute a specific price floor which would only serve to limit the incumbent's ability to compete and to limit the economic benefits consumers could enjoy. As always, we will continue to monitor price behavior to guard against pricing that is truly predatory or anticompetitive.

Concerning Verizon's second argument that the uniformity rule reduces existing pricing flexibility, the purpose of the White Paper's uniformity recommendation was to ensure that just and reasonable rates are maintained as rate flexibility is expanded, in particular to ensure that rates in areas with less competition are constrained by areas where competition is robust. This is a critical element in the White Paper's proposal to ensure the protection of the public, especially in areas where competition is less robust, and we are accordingly adopting this protection in principle. As a practical matter carriers do not use individual case basis pricing for mass market residential customers

[135] Id. Another basis we have long used to approve different rates for the same service in different areas is the number of local, non-toll phone numbers available to the customer. Rate groups have been based on this value-based approach where the service rate increases with the number of local phones that can be contacted.

and the actions we are taking do not affect existing flexibility for non-residential pricing. Further, our flexibility policies for residential services did not envision the authority to offer non uniform prices for areas with differing levels of competition, and we do not authorize discounts herein. Accordingly, our actions do not as a practical matter reduce existing pricing flexibility.

We also agree with the incumbents that different prices may be justified if cost or competitive differences between areas are significant. Our recent approval of Verizon's upstate and downstate Regional Value and Regional Essentials offerings is an example of such an approach. Therefore, we will require non-basic service rates to be uniform unless a rational basis to charge different rates in particular regions is established and approved by the Commission. The record that has been compiled in the proceeding thus far establishes that Verizon and Frontier of Rochester have sufficient competitive constraints territory-wide to constrain non-basic residential prices. Thus, where price changes pursuant to flexibly priced tariffs are implemented they must be implemented territory-wide. If carriers want to implement flexibility on a more disaggregated basis (i.e., upstate/downstate), they must first demonstrate that competition within the more disaggregated areas is sufficient to constrain prices in the aggregate.

With that safeguard we will allow Verizon and Frontier unlimited pricing flexibility for most non-basic services.[136] While the rates must still be tariffed pursuant to the Public Service Law, the competitive market and the pricing constraints it imposes eliminate the need to review in advance the reasonableness of non-basic service rates.

Finally, we are aware that there might be a few incidental services other than basic service that might not be sufficiently constrained by competition. These might

[136] Based upon our review of Verizon's current tariffs, we found that a number of Verizon's top non-basic products are not currently flexibly priced (although Verizon could have filed to incorporate such flexibility, subject to our review). Thus, our action today expands the class of non-basic services that we have determined have sufficient competitive alternatives to justify pricing flexibility. Further, our ruling with few exceptions, removes the maximum price for non-basic services. Non-basic prices will, however, be subject to the uniformity rule.

include for example, additional directory listings, non-published numbers, PIC changes, and restoral charges. We will not authorize flexible tariffs for these services, unless it can be demonstrated that competition is effective in constraining such service. Parties may also demonstrate that other non-basic services are also so incidental as to not be constrained by competition and should therefore not be permitted pricing flexibility.

Universal Service

Introduction

Universal service is the goal of ensuring that all residents have access to affordable basic telephone service, access to public safety, health, education, and assistance services, and are able to participate in society.[137] We have established principles to guide the transition to a competitive market in our prior orders and have stated that the goal of ensuring quality service at reasonable rates is primary. We have implemented various mechanisms to help achieve this goal, including a Transition Fund to address high cost service areas for small companies previously members of the New York State Toll Pool,[138] and a Targeted Accessibility Fund (TAF) to fund public benefit programs such as Lifeline rates, E911 service, and the Telecommunications Relay service. While wireless services are now exempt from contributing to TAF, we have noted that we would be willing to revisit this exemption in the future.[139]

White Paper

The White Paper asserts that TAF provides valuable benefits and contends that all voice providers should be required to contribute to it in a competitively neutral manner. The White Paper acknowledges, however, the existence of jurisdictional issues relating to authority to require contributions from all competitors. It also suggests consideration of an alternative funding method, perhaps on the basis of telephone numbers. The White Paper sought comments on such a mechanism.

The White Paper and the majority of the parties saw no need for the creation of a high cost fund in New York, noting that the existing Transition Fund is available to a company whose local service rates are insufficient to meet its intrastate

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[137] Competition II Order, p. 9.

[138] Case 02-C-0595, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the New York Intrastate Access Settlement Pool, Inc. for Traffic Sensitive Access Rates, Comprehensive Plan, Phase II, Order Adopting Comprehensive Plan (issued December 23, 2003).

[139] Cases 95-C-0095, et al., supra, Opinion No. 98-10, p. 2.

revenue requirement. In addition, the White Paper notes that allowing basic rates to align more closely with underlying costs would reduce the need for universal service funding.

The White Paper also reviews the FCC's universal service plan, which establishes funding for high cost areas, provides for low-income customer programs, and offers discounts to schools, libraries and rural health care providers. To be eligible for these funds, carriers must be designated as eligible telecommunications carriers by state commissions or the FCC. The services that are supported by the federal program include single party service, voice grade access to the public switched network, dual tone multi-frequency signaling, toll limitation services, and access to emergency services, operator assistance, inter-exchange services and directory assistance. These services must be provided by a carrier in order to be designated as eligible for funding. The White Paper notes that the incumbents were certified in 1997 and subsequently nine competitive companies have been designated as eligible for universal service fund (USF) funding.

The FCC's low income mechanism assists eligible consumers by discounting telephone installation and monthly fees. The "Link up America" program helps consumers with telephone installation costs, and "Lifeline" provides credits toward monthly telephone service. The FCC's program also includes a school and library discount.

The FCC's high cost support mechanism provides funds to those carriers in high cost service areas. The purpose of this mechanism is to hold down rates and preserve universal service.

Under the FCC's rural health care providers program, discounts on interstate services for rural health care providers as well as Internet service are available. Additional funds are provided for this purpose by the rural health care corporation.[140]

The White Paper notes that we have defined basic service as that telephone service deemed essential for minimally acceptable access to and use of the public

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[140] Case 95-C-0095, Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Determine a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Order Adopting Discount Program for Rural Health Care Providers (issued November 4, 1997).

switched telecommunications network. According to the White Paper, the Commission has determined that basic services should include: a single party access line, access to local/toll calling, local usage, tone dialing, access to emergency services, access to assistance services, access to telecommunications relay services, directory listing, and privacy protections. The White Paper notes that we have agreed with the Federal State Joint Board that high speed or advanced services do not meet the criteria for a supported service.[141] According to FCC data, while subscription to high speed lines is increasing rapidly, there is no evidence to suggest that a substantial majority of households currently subscribe to that service. The FCC has concluded that the use of the Internet, while valuable, is not "essential." The White Paper accordingly concludes that our existing definition of basic service remains appropriate.

The White Paper also concludes that universal service remains a critical goal but that there is no need to establish a state universal service funding mechanism to ensure reasonable rates in high cost areas. It notes that the Transition Fund has been established from which most small independents may draw should we determine that the companies' local rates would otherwise have to increase beyond the Verizon-NY benchmark rate for the area.

Parties' Comments

A number of parties support the recommendation that all providers be required to contribute to the TAF, and, if necessary to accomplish this end, the Commission should seek authority from the Legislature.

The CTANY challenges the recommendations of the Rural Independent Telephone Companies that a fee be assessed upon providers of all voice services with proceeds used to subsidize the provision of rural service. There is no jurisdiction to levy such an assessment, according to The CTANY, and, in any event, new entrants should not be required to subsidize incumbents.

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[141] In the Matter of Federal-State Joint Board on Universal Service – Notice of Proposed Rulemaking, CC Docket No. 96-45, Comments of the New York State Department of Public Service (April 14, 2003).

Generally, parties who are not subject to a TAF assessment now oppose its extension to other intermodal competitors. Wireless companies point to existing taxes and surcharges required under various provisions of New York State Law, arguing that their contribution to E911 service, for example, is already substantially above and disproportionate to assessments demanded from other carriers.

The Assembly Standing Committee and others contend that the Commission needs to take affirmative action to protect universal service. Most intermodal competitors do not pay into the TAF, the Committee notes, but they are attracting customers away from the incumbents. Unless action is taken, a crisis in the infrastructure of New York's copper-based telephone network could arise, says the Committee. Finally, it argues that the rate increases proposed by Staff will only deepen the universal service crisis.

The CWA emphasizes the growing digital divide and the relationship of affordable high speed broadband access to the provision of universal service. According to the CWA, this issue is critical to the future of the state, its economic development, and the flow of information needed for a democracy to function effectively.

CWA and PULP also note the reduction in the telephone penetration rate which has occurred over the last five years, noting that "the decline in telephone service penetration rates in New York between 2000 and 2005 represented an estimated <u>300,000 households</u> which lacked basic telephone service but who would have had such service if penetration rates had not declined."[142] PULP goes on further to state that "there are at least 250,000 households in New York today that are eligible for the Lifeline assistance, but do not receive it."[143] The parties strongly argue that this trend should be reversed.

PULP expresses concern that its initial comments regarding the significant decline in telephone service penetration rates and Lifeline subscription rates were largely ignored. Overall policies can only be adopted, according to PULP, when meaningful

[142] PULP's comments, p. 4.

[143] PULP's comments, p. 4.

strategies are developed to address the decline in telephone subscribership and the level of participation in the Lifeline program.

Frontier supports the continuation of the TAF and the recommendation that it be applied to all intermodal competitors, but argues that we do not have the jurisdiction to accomplish that result. It also urges caution in examining an alternate assessment mechanism based on telephone numbers.

Nextel Partners opposes extending TAF to the wireless industry. It argues that if such collections are implemented, Nextel Partners should be able to examine the appropriateness of TAF expenditures, the authority for TAF, and the parity among telecommunications carriers for funding 911 and related expenditures.

T-Mobile and others contend that universal service funding must be competitively and technologically neutral and must remain fully portable and available to all carriers. The current imbalance of universal service payments, according to T-Mobile, has the potential to stymie intermodal competition by encouraging the use of legacy networks. Funding must be spread evenly among all service types, according to T-Mobile, and all providers should be eligible to receive funds.

The Rural Telephone Companies argue that it is essential to adopt policies that err on the side of maintaining universal service. A state universal service fund is required, according to these providers, to encourage state-of-the-art rural infrastructure deployment. According to the rural providers, however, the White Paper fails to address these incumbents' need for proper rate designs, regulatory flexibility, or for recovery of carrier of last resort costs. The failure to take these considerations into account leads, according to these providers, to the improper conclusion that there is no immediate need for a state universal service fund.

The Farm Bureau supports the proposal to require all network companies to contribute to the TAF. It also expresses its disappointment with the White Paper's conclusion that the Internet is not essential and that the definition of universal service should not be expanded. The Commission should adopt a goal of encouraging the development of high speed Internet access to every resident, according to the Farm

Bureau, and it recommends a rural services task force be created to advise on ways to promote high speed access to rural residents.

Time Warner Telcom expresses concerns about the inequity, acknowledged in the White Paper, related to the calculation of contributions for social programs. According to Time Warner Telcom, facilities-based carriers that make limited use of UNEs, pay proportionally more into the TAF than carriers using other forms of entry. It recommends that this anomaly be corrected, noting that the White Paper offered no solution.

Verizon-NY specifically supports the White Paper's recommendations to leave the current definition of basic service unchanged rather than redefining basic service to include broadband, concluding that broadband is not essential. Verizon-NY also supports the White Paper's recommendation not to extend universal service to business customers; and not to create a new state universal service fund.

Discussion

Contrary to the concerns expressed by some of the parties, we remain fully committed to ensuring that affordable and reliable telecommunication services are universally available to all residential customers. To that end, we continue to regulate basic rates.

We agree that the TAF funding assessment ideally should be applied to all providers,[144] perhaps based on the use of phone numbers from the North American numbering plan. We therefore direct Staff to examine the relevant issues and report back to us.

We agree with the observations of a number of parties that, if TAF contributions are required of all providers, both the collection and disbursement of TAF funds should be competitively neutral, funded equitably across all service types and available to all providers. We also agree with the White Paper's conclusion that a state

[144] We note that Time Warner Cable pays into the fund voluntarily.

high cost universal service fund is unnecessary at this point, and that any further decision on this issue should await the conclusion of the FCC's pending dockets examining universal service, universal service funding, and intercarrier compensation.[145] If there is a further requirement to address an individual incumbent's allegedly high costs, it should be addressed first in a rate proceeding.

We agree with the recommendation not to expand the definition of universal service to include broadband, as numerous parties have urged. While we agree that broadband is an increasingly valuable tool with a variety of social, political, and economic applications, we remain convinced that competitive markets are the best tool to ensure appropriate, widespread deployment. The markets are generally providing broadband access throughout the state, and we remain convinced that markets are the best tool to achieve full deployment. Moreover, because broadband services are already available to the vast majority of New Yorkers,[146] with prices declining and the number of customers steadily increasing, it is not yet clear that governmental intervention is needed to achieve ubiquitous access to broadband.

With regard to parties' comments concerning the lowered penetration rates for telephone service and Lifeline, we would certainly share these concerns if the magnitude of such a decline could be confirmed and its cause identified. PULP contends that telephone penetration rates (i.e., the percentage of households with telephone service) have declined precipitously in New York since 2000 and that the Staff White Paper fails to even acknowledge this decline, much less propose ameliorative responses. In particular, PULP asserts that New York's telephone penetration rate dropped from

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[145] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, and In the Matter of Developing a Unified Intercarrier Compensation Regime CC Docket No. 01-92. It should be noted that the federal universal service fund is more expansive than the limited purpose, state high cost fund discussed here.

[146] New York State Department of Public Service, "Study of Rural Customer Access to Advanced Telecommunications Services" (February 1, 2003). As noted above, 92% of Verizon-NY's customers have a choice of three different platforms for telecommunications services.

96.1% in 2000 to 91.3% in March 2005.[147] These data are from the FCC's annual Universal Service Monitoring Report.

While we would certainly share PULP's concern if the magnitude of such a decline could be confirmed and its cause identified, we question whether the decline cited actually reflects a change in New Yorkers' access to telephone services, a change in the method by which the data were collected, or some other data anomaly. We observe that the data cited by PULP are not entirely consistent. The 96.1% figure for the year 2000 represents the average penetration level in New York for that year. The March 2005 figure of 91.3%, however, is not an annualized figure and reflects only data collected in the proceeding 4 months. The prior full year (2004) penetration rate for New York was 94.5%. While lower than the year 2000 level, it hardly represents the dramatic decline cited by PULP, and is consistent with changing penetration levels at the national level. We do not know why the March 2005 figure was so much lower than the 2004 annual figure, but we note that the FCC reports that the survey questions used to collect the data changed in November 2004.[148]

Furthermore, in November 2005, the FCC's Industry Analysis and Technology Division issued its updated Telephone Subscribership Report, 11, which includes subscribership information through July 2005. In this report, New York's telephone penetration rate had increased to 92.7 percent, almost 1.5 percentage points higher than the previous period. Absent a fuller analysis, including subsequent period data, we think there is little basis to assume major failure of our universal service policies on the basis of this single datum point.

In its October 21, 2005 comments on the Staff White Paper, PULP stated that "we [PULP] estimate that there are at least 250,000 households in New York that are eligible for Lifeline assistance, but do not receive it." We have not seen specific data from PULP which supports this number. We have, however, taken and will continue to

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[147] PULP's comments on the Order Instituting Proceeding, p. 3.

[148] Universal Service Monitoring Report 2005, prepared by Federal and State Staff for the Federal Joint Board on Universal Service, CC Docket No. 98-202, (released December 2005) p. 6-2, footnote 4.

take positive steps to increase the awareness of Lifeline in New York which should ultimately lead to greater enrollment. During 2005, Staff partnered with the Office of Temporary and Disability Assistance (OTDA) to distribute Lifeline Counter Displays and approximately 20,000 Lifeline brochures to 62 county offices throughout New York. This was in an effort to ensure that all OTDA clients have immediate access to information on Lifeline when applying for social services benefits. Staff is also part of a joint FCC/NARUC task force set up to increase outreach and education efforts for Lifeline on a national and statewide basis by providing a dedicated web site, a survey on best outreach practices, and specific outreach materials which will target consumers who are eligible but not receiving Lifeline. Finally, we direct the Director of our Office of Consumer Services to review with other agencies opportunities for improving Lifeline enrollment and outreach, and report back to us in sixty days.

We anticipate that the rate increases that might result from the pricing flexibility we authorize here will not undermine universal service. The rate increases to message rate service has been limited and should not undermine universal service. We have mitigated what is already only a nominal impact. Those increases are reasonable, especially when considered in the context of the benefits that will accrue as rates more closely reflect the costs of providing service and for income eligible customers, Lifeline service remains available. Accordingly, we view the Farm Bureau's slower phase- in as unnecessary.

Moreover, in light of Verizon-NY's existing basic rate offerings, our $23.00 rate cap will ensure universal service. Verizon-NY's existing Rate Group 9 flat rate basic service is currently priced at $22.61 and is widely subscribed to in communities across the state (e.g., Albany, Syracuse, and Buffalo). Rate Group 9 flat rate customers represent a significant number of Verizon-NY's flat rate customers overall. In effect, our decision will result in customers in less densely populated areas paying rates that are comparable to those in more densely populated areas. We believe that even if rates do rise to the level of our ultimate rate cap customers will still retain an affordable connection to the public telephone network because the current flat rate in Rate Group 9 has not prevented customers from obtaining a basic connection to the public switched network. Moreover, customers taking message rate service may, if the full pricing flexibility authorized here is exercised, see a bill increase of approximately 10% (for Verizon customers) to 12.6% (for Frontier customers) per year over the next two years.

Retail Service Quality and Network Reliability

Retail Service Quality

In response to telephone service problems of the late 1960's and early 1970's, and recognizing that consumers had no other telephone service options, we established retail service quality standards. These standards include both consumer relations-type measures, such as customer service center requirements, billing rules, requiring the provision of information on rates, and customer complaints procedures,[149] and specific metrics and reporting requirements, such as customer trouble report rates, percent installation appointments met, percent final truck group blockages, and percent out-of-service over 24 hours).[150]

The standards have been modified over the years to reflect changes in the telecommunications market, most notably in response to the introduction of local exchange competition. In 1996 we determined that, while all local exchange carriers should remain equally subject to the entire general administrative, operational, and performance requirements of Parts 602 and 603, performance measurement and reporting requirements should vary depending on company size and performance history.[151] In 2000, we further modified the standards to recognize increased movement away from a monopoly environment. Importantly, a number of regulations (e.g., Directory Assistance Answer Time, Percent Missed Repair Appointments, and Maintenance Service Incentives) were deemed unnecessary because market forces should ensure adequate service.[152] Several of our service quality standards were designed to gauge the health of the network, but

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[149] 16 NYCRR 602.

[150] 16 NYCRR 603.

[151] Case 94-C-0095, Proceeding on Regulatory Framework, Opinion No. 96-13 (issued May 22, 1996).

[152] Case 97-C-0139, Proceeding on Motion of the Commission to Review Service Quality Standards for Telephone Companies, Memorandum and Resolution Adopting Revision of Parts 602, 603 and Section 644.2 of 16 NYCRR (issued October 6, 2000).

the importance of these standards and network reliability became vivid in the wake of September 11, 2001.

Network Reliability

In response to the disruptions in the telecommunications network experienced on September 11, 2001, we revisited efforts associated with network reliability and released a Staff report in November 2002. That report summarizes the importance of vigilant oversight of the network:

> September 11th 2001 redefined "telecommunications disaster" and underscored the importance of the public telecommunications network. Telecommunications network reliability, increasingly viewed through a prism of national security and public safety considerations, is no longer a luxury, but a political and economic mandate.[153]

In light of Staff's report, we began an examination into the reliability of the State's telecommunications network and to seek enhancements where necessary to promote the reliability of the network.[154] We ordered all facilities-based local exchange carriers to identify which of their central office buildings are equipped with dual cable entrances. We also required the carriers to provide an estimate of what it would cost to add a dual cable entrance to those central office buildings in Manhattan that lack such a facility.[155] We ordered carriers to file data concerning costs and practices related to the federal Telecommunications Service Priority system and procedures regarding the identification of priority circuits when more than one carrier is involved.[156] Additional

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[153] Network Reliability After 9/11 - A Staff White Paper on Local Telephone Exchange Network Reliability, (November 2002), p. 2.

[154] Case 03-C-0922, Telephone Network Reliability, Order Instituting Proceeding (issued July 21, 2003).

[155] Case 03-C-0922, supra, Order Concerning Network Reliability Enhancements (issued July 28, 2004), Order Denying Petition for Rehearing and Clarifying Order of July 28, 2004 (issued October 26, 2004).

[156] Case 03-C-0922, supra, Order Directing Filings Concerning Critical Facilities Administration and Telecommunications Service Priority Services and Requesting Public Comment on this National Security Program (issued June 15, 2005).

comments were sought from the public. Facilities-based local exchange carriers were also ordered to offer Critical Facilities Administration Service.[157] More recently, we ordered selected facilities-based local exchange carriers to provide route diversity for certain end offices based on a critical needs analysis.[158] When implemented, the number of central offices with diversity will increase substantially.

White Paper

The White Paper discusses a range of issues concerning service quality including some service characteristics that are critical to monitoring network reliability. It recognizes that as competition more fully develops, we should narrow service quality reporting requirements to focus on network reliability (a subset of service quality).[159] It recommends that service quality requirements be re-examined in one year when reliability-focused reports may be substituted for existing reports. The White Paper contemplates that such a review will determine whether the market can adequately drive performances to the point where the Commission can remove certain service quality regulations and transition them into best practices while at the same time allow us to monitor and facilitate resolution of network reliability issues.

The White Paper discusses and recommends a specific three-pronged approach for the reliability-focused reporting, and notes that such reporting should apply

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[157] Id., CFA provides Telecommunications Service Priority subscribers with route-specific detail of their circuits.

[158] Case 03-C-0922, supra, Order Granting in Part and Denying in Part Requests for Exemptions (issued February 23, 2006).

[159] The White Paper suggests a review of service standards including our Special Services Guidelines (White Paper, p. 74). These guidelines address non-basic services while 16 NYCRR 603 addresses basic service quality.

to all competitors (irrespective of delivery platform) despite jurisdictional issues in some areas. This three-pronged approach, according to Staff, would include two standards[160] (customer trouble report rates[161] and mean time to repair) and a new Annual Report on Network Reliability.[162] The Annual Report on Network Reliability would include the requirement that companies address existing levels of diversity in, and resiliency of, their networks, as well as plans to improve network reliability.

Parties' Comments

Local exchange companies generally sought to reduce service quality regulation; others parties generally sought to maintain or increase it.

Verizon, for example, asserted that the time was now ripe to eliminate, or at least reduce very substantially, the Commission's service quality requirements. It asserted that the Commission's approach should be guided by experience regarding the regulation of cellular carriers where, by statute, Commission regulation of carriers was suspended. It suggested that subjecting wireline companies to regulations while the competitors remain free from those requirements artificially increases the costs of wireline competitors.

Turning to Staff's proposal, Verizon urges the Commission to go further than Staff, asserting that while Staff properly recommended that the Commission eliminate certain sections of Part 602 now, Staff's White Paper should have gone further

[160] White Paper, pp. 72-74. The recommendation is to make the Customer Trouble Report Rate a company-wide (instead of switch-specific) metric. The Mean Time To Repair metric would be a combination of the existing Out-of-Service Greater Than 24 Hours and Percent Service Affecting Greater Than 24 Hours metrics. The White Paper also proposes that reporting be on a quarterly basis as opposed to the current monthly basis and that Staff would consult with providers and others in defining how these network reliability metrics would be measured.

[161] 16 NYCRR 603.3.

[162] This report would be a substitute for, not an addition to, the current capital program report required under 16 NYCRR 644.3. Major outage reporting and emergency planning would continue in addition to these three reporting processes.

and reduced and eliminated other requirements.[163] Verizon asserts as well that the Commission should eliminate Part 603 in its entirety now. Alternatively, in the event that the Commission decides to accept Staff's proposal to reexamine Part 603 in a proceeding a year from now, the Commission should immediately eliminate all of Part 603 except for consumer complaints and regulations contained in 16 NYCRR 603.5 regarding service interruptions. Verizon also recommends that Special Services reporting requirements be eliminated. Finally, Verizon states that Staff's proposal for quarterly reporting is preferable to the current monthly reporting.

Frontier of Rochester similarly suggests that the Commission should make changes now instead of waiting to review the issue in a year. It says that the service standards are not relevant in today's marketplace and that continuing to require full service standard reporting no longer provides an accurate measurement of service quality levels because the local exchange company's competitors report nothing. It says the White Paper's assumption that unregulated providers "should nonetheless be willing to provide any and all information necessary (e.g. major service outage notification) on a proprietary basis where requested is far from valid".[164] Frontier of Rochester says that waiting for another proceeding to be concluded could mean that New York's incumbent carriers will have lost another two million access lines and that they could become irrelevant. It renews its proposal – made in comments to the instituting order – to replace the current service standard reporting regime with a single measure of "justified" complaints. It also proposes elimination of the major outage reporting requirements on a theory that such information is not provided by its competitors and is not likely to be provided by them on a voluntary basis. It says that at the very least the Commission

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[163] Verizon's comments, p. 40, citing 16 NYCRR §602.3(a), (requiring service providers to "ensure that customers have convenient access, by a toll free number or in person, to customer service centers"), §602.3(e) (requiring service providers to strive to provide trained and qualified customer contact to personnel"), §602.7(b) (requiring the availability of representatives to receive trouble reports), §602.7(d) (requiring providers to clear troubles within 24 hours), and §602.10 (directories).

[164] Frontier's comments, p. 15, quoting White Paper, p. 6.

should immediately eliminate the near real time reporting requirement (within one hour) and allow regulated carriers to report major outages monthly.

NYSTA asserts that competition will prove the best regulator of the telecommunications marketplace and that the Commission should rely on that principle in its determination about the shape of service quality rules. It disagrees with Staff's suggestion that the Commission wait a year before investigating the issues and instead recommends that the Commission include in its findings here which regulations should be eliminated. NYSTA states as well that the three-pronged reporting mechanism proposed in the White Paper may prove burdensome and that requiring small incumbents to file a quarterly mean time to repair report would be a new, additional regulatory obligation. It says it makes little sense to incur additional costs to create new systems, processes, and procedures to comply with the requirement. NYSTA is also concerned about the specific detail that would be required in Staff's annual report and notes that the costs associated with carriers having to prepare these reports should be weighed against the benefits associated with providing them.

The companies competing with the incumbents also have concerns about the White Paper. The CTANY questions the White Paper's assumption that competitors will be willing to provide information voluntarily as overly broad and creating the possibility of unnecessary litigation over jurisdiction.

Time Warner Telecom supports the White Paper's call for streamlining various Commission regulations and Staff's proposed review of the service quality standards, but suggests the review occur immediately.

Conversent comments that the Commission should adopt the White Paper's recommendation to maintain the current degree of service quality reporting and to undertake a more nuanced review in one year. It says that it would be a mistake to eliminate the current service quality requirements that would cause customers to suffer unnecessarily, "as demonstrated by a review of Verizon's abysmal record of repairing even basic two-wire XDSL copper loop problems within 24 hours."[165]

CWA says the White Paper's service quality proposals are too vague, inadequately supported, contradicted by empirical evidence and that they undermine the White Paper's proposal for a comprehensive review in 12 months. It asks whether the recommendations in the Staff White Paper are to be considered even before the proposed review takes place a year from now or whether they are merely suggestive comments. CWA claims as well that the White Paper fails to define the recommended meantime to repair standard or to indicate any target or benchmark and that there can be, therefore, no basis for judging whether the recommendation would provide an adequate substitute for the current standards.

More broadly, CWA says the most troubling aspect of the entire discussion is the basic assumption that competition necessarily will lead to improved service quality. It says that the assumption is never supported and that Verizon had to pay $70 million in penalties for substandard service delivered over the three-year period of the Verizon Incentive Plan. It provides a chart that it says shows that Verizon provided substandard service in 21 of its 35 installation maintenance centers for significant periods of time.[166] CWA concludes that removing or relaxing standards places an inordinate amount of risk on customers and that all New Yorkers should obtain a high level of service regardless of where they live. It recommends that the Commission explore any and all means of imposing service quality and public safety regulatory standards on all providers.

The Assembly Committee comments that Staff's beliefs do not provide sufficient detail for an exhaustive public interest analysis and that the White Paper's proposal is vague and lacking in specific goals. It says that reliance upon competition to force providers to do anything other than decrease prices seems misplaced and that the

[165] Conversent's comments, p. 19.

[166] CWA's comments, p. 10.

issue of whether intermodal providers will voluntarily choose to proffer service quality information to the Commission is important. It states that "one could . . . surmise that faced with failure by the intermodal competitors to voluntarily comply with service quality regulations, the Commission might propose completely eliminating such regulations. Such an action would be contrary to the public interest."[167] It says that the Commission should not only retain outcome-oriented service quality standards, but should extend that approach to all telephone carriers because there is a continuing need for a regulatory regime with the discipline of automatically levied fiscal penalties.[168] It states its belief that the Commission should require local exchange companies to continue submitting construction budgets and, where necessary, that the Commission should require targeted capital expenditures and adequate staffing levels and network maintenance and construction, with the goal of protecting the public interest in adequate service and in the health and survivability of the network. It reiterates its suggestion that the Commission study the desirability of flexibility in outcome oriented service quality measures where adequate competition and adequate service can be objectively demonstrated. It asserts that such flexibility would most likely best protect the public interest if it were presumptively revocable but renewable for cause adduced at an evidentiary proceeding.

The DOL comments that Staff's proposal is too vague to evaluate now, that it would need to know the new target for mean time to repair and that while shifting from monthly customer trouble reports to quarterly ones might be worth considering, any plan to aggregate all central office performance data into one company-wide measurement would mask chronic poor service in some localities by averaging them with better-served regions of the state. The DOL also notes that Staff's assumption of voluntary compliance by the providers may be overly optimistic, especially in light of Vonage's challenge to the Commission's assertion of jurisdiction.

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[167] Assembly Committee's comments, p. 8.

[168] Id.

CPB states that the White Paper's proposals concerning service quality are generally consistent with its main recommendation that no relaxation of service standards is appropriate now. It says that, rather than reduce service quality reporting, measures to enhance service quality may be appropriate. CPB notes that it made recommendations in the Verizon/MCI merger proceeding to help offset the risks to Verizon's service quality that might be posed by the merger, such as prompt implementation of recommendations stemming from an service quality audit and approaches to ensure rapid identification of service quality deficiencies. It says that, in the absence of such measures, the current procedure is unwieldy and that the extent to which CPB service quality recommendations were not considered in the merger proceeding, they should be adopted here.

CPB also asserts that because of the importance of quality telecommunication services to the health and safety of customers, as well as the state's economy, any proposal to relax service quality standards, particularly for basic access line service, must be thoroughly and carefully considered by the Commission as well as all parties. It says that it is in the public interest for all service providers to submit the information requested by Staff and that consumers should have access to information regarding the relevant aspects of service quality regardless of the technology used to deliver the service. Finally, it disagrees with the suggestion that information regarding actual and planned capital expenditures is not necessary, noting that such information is needed to help the Commission identify trends that may lead to significant service quality degradation in the future.

Nextel states that the wireless industry is competitive, that current policy works well and that new regulatory initiatives involving the wireless carriers are not necessary or appropriate at this time. Cingular states it takes its public safety and homeland security obligations very seriously and believes that information wireless carriers currently provide the FCC and the U.S. Department of Homeland Security is more than adequate to fulfill Staff's proposed network-reliability reporting requirements and, it asserts, that this information is available to Staff.

Discussion

Our oversight of basic and non-basic retail service quality includes a broad array of measures covering many aspects of a utility's service performance, including the service the customers receive when they call their service provider (answering time performance), how expeditiously they are served (installations completed within 5 days), how often they perceive a problem (customer trouble report rate), the sound quality of the service (service affecting greater than 48 hours), and how quickly service is restored (out of service greater than 24 hours). While we continue to ensure adequate service quality pursuant to the Public Service Law,[169] many service quality indicators are intended to meet end user expectations and the importance of some service quality metrics diminishes with the availability of choice. Customers not satisfied with how quickly their calls are answered or how long it may take to get service installed may choose another provider.[170] In an environment with such choices, service quality becomes more sensitive to competitive pressures in meeting consumer service needs, and related regulatory mandates must be more carefully tailored.

In this new and evolving competitive environment, companies should compete on the basis of satisfying customer needs and expectations. In such circumstances, we expect local exchange companies to work aggressively to respond to customer expectations. Their incentive to maintain appropriate levels of service quality no longer need be primarily driven by fear of regulatory action because the market penalty for failure to retain and improve their business – the loss of their customers – is much more severe.

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[169] See, e.g., Public Service Law §§ 91, 94, 96, 97 and 98.

[170] "Quality of service…metrics will become less important indicators of…spending adequacy. Moody's believes that an increasing number of consumers have more than one option for telecommunication services provider. Consumers are therefore more likely to vote with their feet should the quality of service not meet their needs." Moody's Investors Service, ILEC Capital Investment II: Why Wireline Telephone Capital Spending Has Not Been As Low AS Metrics Suggest (December 2005) p. 6.

However, the existence of competition, even if it is effective and thriving, may not ensure reliable networks, and there is too much at risk for the people and the State to conclude otherwise. Protecting public health, safety and welfare remains essential and requires that we continue monitoring and enforcing network reliability, consistent with our responsibilities under the Public Service Law. As we move forward, we need to monitor reliability and be aware of major service outages to ensure that public health and safety continue to be protected, while promoting a competitive environment that encourages investment in New York State.[171]

A number of service quality metrics used to assess retail service quality are also critical indicators of network reliability. Trends in Customer Trouble Report Rate (CTRR), for example, provide indications of improvement or deterioration of the network. Results from the out-of-service over 24 hours and service affecting over 48 hours metrics indicate how quickly services are restored, which reflects the ability of the network to be restored quickly. Similarly, information contained in capital budget filings on network redundancy and diversity (reported in annual capital construction filings pursuant to 16 NYCRR 644.3 for companies subject to our regulations) provides broad indications of the resiliency of the network. These filings, however, are not provided by all service providers. The importance of network reliability and a robust telecommunications network for New York State is simply too great to be driven solely by market forces. Certain service quality standards and reporting remain critical, irrespective of the extent of competition or the regulatory classification of the service provider itself.

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[171] The Department routinely tracks and analyzes the performance of the State's telecommunications carriers by analyzing performance data collected by the carriers and conducting routine field investigations. It analyzes outage reports to better understand the causes of outages and how they can be avoided, and imposes fines for violation of facilities protection requirements. It also drafts and promulgates emergency reporting protocols for use by the State's telecommunications carriers. The Department also represents the State in local, regional, or national contexts related to telecommunications reliability. The Department also serves as the single point-of-contact for reporting and monitoring of telecommunications disruptions, and provides staffing and expertise to the State's Emergency Management operations and disaster planning efforts.

Networks serving the public should be constructed and maintained to minimize major service outages, particularly those that may affect emergency services and facilities that carry critical and/or significant traffic. Despite the best efforts to avoid such outages, they can and do occur. As intermodal competition brings forth new and technologically different networks, and as consumers transition to these intermodal competitors, we believe it critical that these networks be similarly reliable. We encourage all providers to assist us to ensure that these networks are not only reliable, but remain so over time to help us fulfill our previously described state disaster planning and response activities.

We affirm the White Paper's conclusion of our continued need to monitor overall network reliability in order to protect the public's health, safety, and welfare. This is an overarching and critical government interest. We further endorse the White Paper's discussion of actions we have taken, and will continue to take under the Public Service Law, to address service quality.[172] In addition, while we have historically monitored specific service quality metrics,[173] we believe that if competition is sufficiently vigorous, certain service quality requirements may be relaxed, or, in some cases, eliminated.[174] The question becomes one of determining the appropriate level of carrier service quality reporting and oversight given a rapidly developing intermodal competitive market.

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172 Under the Public Service Law, the Commission can initiate an investigation, call for testimony, direct that companies make specific improvements, and if necessary, institute a penalty proceeding. Public Service Law §§ 96, 98, and 24. The Commission's Order directing an independent audit of Verizon NY Service Quality Program in July 2003 is illustrative of such actions at the Commission's disposal. Case 03-C-0971. Consideration of the Adequacy of Verizon New York Inc.'s Retail Service Quality Processes and Programs, Order Instituting Verizon New York Service Quality Proceeding (issued July 11, 2003). These avenues remain available.

173 Telecommunications reliability is associated with the operation of the network rather than the operation of equipment (e.g., computers, phones, etc.) connected by customers at the edge of the network.

174 We also expect competition to increasingly force all providers to identify and meet consumers' service quality expectations.

The Department serves as the single point-of-contact for the reporting of both physical and cyber events disrupting telecommunications within the State. The outage reporting requirements provide that telephone companies report any major service interruptions[175] as soon as possible, but not later than one hour after the outage is first recognized by the company. Staff is always prepared to receive such reports. Frontier's recommendation to eliminate or revise such reporting on the basis that it is not provided by its intermodal competitors is inconsistent with our responsibilities. We believe it critical that these reporting requirements remain in place. Rapid reporting of a telecommunications outage can immediately and profoundly affect the public welfare. For example, access to 911 might be interrupted and alternative means of communicating immediate needs for emergency assistance (e.g. police, fire) must be established and made known to the public. Outage reporting is part of an overall state effort to coordinate responses to emergencies and can save lives.

Review of our outage reporting protocols reveal they are based on old, outdated models. For example, cable companies provide one level of reporting while telephone companies provide another. Other service providers provide no outage reporting. The interconnectedness of telecommunications networks, plant, and users is undeniable, and the implications of an event on one platform often influences other, interconnected platforms. For these reasons, we ask the Office of Telecommunications to investigate and explore what steps may be undertaken to make emergency outage-type reporting requirements consistent for all telecommunications providers.

The continued deployment and increased availability and acceptance by end users of intermodal competition justifies examining a transition from the existing, broad service quality reporting requirements to a more focused regime that emphasizes network

[175] The term "major interruption" is defined in the Office of Telecommunications Emergency Plan and is generally defined as any of the following conditions, and includes both physical and cyber incidents that affect the company's network, facilities, services or operations. Included, for example, would be service problems affecting 911, major storms, cable failures affecting interoffice routes or 1, 000 or more local subscribers and service problems affecting fire departments, or emergency services.

reliability. The White Paper's recommends that this effort be delayed for a year. Frontier of Rochester, Time Warner and NYSTA all believe such a review should be expedited. We agree and conclude that we should reexamine the issue immediately. We will begin the process that is required for us to change our regulations.[176]

We believe the review of service quality standards (that is, both retail service quality for basic and non-basic service and network reliability generally) should be guided by two primary factors. First, service quality reporting is critical to monitoring network reliability and to ensuring reliable and resilient telecommunications for New York State. Those service quality metrics or standards critical to network reliability should be identified notwithstanding our willingness to rely more heavily on intermodal providers. Second, the need for "non-critical" retail service quality standards should be reevaluated in light of competitive alternatives and consumer expectations.

These two factors should provide the foundation for a general review of service quality standards. The White Paper's basic approach reflects a reasonable starting point for re-examining and revising our regulations in order to realign our regulatory focus toward an increased emphasis on network reliability. Service indicators similar to the customer trouble report rate and a measure of how quickly services are restored would likely serve as reasonable indicators of overall network reliability for now.[177] Further, we agree with the White Paper's proposal discussed earlier that quarterly reporting of network reliability data, rather than monthly, could reduce the administrative

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[176] We also agree with the White Paper's recommendation to include Special Services Guidelines in this review.

[176] We recognize that traditional outage metrics may not be applicable to all service providers. For example, VoIP providers may have indicators of network congestion/failure that differ from circuit switched providers.

[177] With respect to NYSTA's concern centering on possible increased reporting requirements associated with the White Paper's mean time to repair metric, we note that this should be the subject to review in the proceeding, but that overall we expect regulatory obligations will be lessened.

burden placed on providers while still meeting our public safety mandate.[178] We anticipate that we will be able to simplify and streamline our regulations in a rulemaking and that we will be able to develop standards that may be applicable to companies over which we do not assert jurisdiction.

The White Paper's proposed Annual Report on Network Reliability is also consistent with our emphasis on that topic. As envisioned by the White Paper, this Annual Report on Network Reliability should assist us in determining whether networks are being maintained to provide an acceptable level of reliability and demonstrate whether existing levels of network diversity and compliance with industry standards and best practices are being met. We expect Staff to consult with all providers, including those facilities-based providers over which we do not assert jurisdiction, and other interested parties, in defining how the Annual Report on Network Reliability should ultimately be designed.

Separately, we expect providers over which we do not assert jurisdiction to voluntarily cooperate with our network reporting requirements, in particular the Annual Report on Network Reliablity[179] We direct Staff to discuss how best to meet our service quality goals with these and any other interested parties. We expect this effort to begin immediately and expect a status report from Staff by December 31, 2006. We expect Staff to work with the parties to address these concerns and balance the providers' reporting requirements accordingly. The goal is to develop network reliability measures that will meet our public interest goals, be relevant to the business needs of providers, and produce meaningful comparative information for all significant providers. We expect that this process will inform the effort to modify and streamline our service quality standards.

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[178] The report, submitted quarterly, should contain data disaggregated by month.

[179] We will not consider such cooperation an admission of jurisdiction, but rather public corporate responsibility and/or a courtesy consistent with the need to continue providing safe and reliable services and promoting the public safety.

This information, along with Commission complaint data[180] and our field investigations, allow us to identify problems, seek corrective action from the appropriate service providers, and confirm compliance if a need is indicated. If this information is received from all providers, it should provide a safety net for identifying network reliability issues that could affect public heath and safety that a competitive market may not identify on its own. To the extent we do not have authority to impose reliability rules and reporting requirements on some providers (the lack of which compromises our ability to address public safety and other mandates), we would expect such providers to be willing to voluntarily provide any necessary information (on a proprietary basis where necessary) to ensure that the health, safety, and welfare of the citizens of New York are adequately protected.[181]

The safety and welfare of New Yorkers rises above the need of any single provider or any category of providers. The Commission is responsible for oversight of not only the telecommunications network, but the electric network as well.[182] The interdependencies between networks are increasingly critical:

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180 In addition to the service metrics of Part 603, the number, type and rate (per 1,000 lines) of complaints to the Department of Public Service are also used to judge overall service quality performance. These complaints are taken directly by the Department of Public Staff from consumers and they serve as an independent measure of service quality apart from the service quality performance metrics reported under Part 603. No formal minimum performance threshold exists for complaints, but we have established a complaint performance expectation associated with our annual commendation process that provides letters of commendation to individual companies (and/or operating divisions of companies) for providing excellent service quality during the previous year.

181 The CTANY believes the answer to the challenge of monitoring network reliability controlled by multiple owners is not to apply "command and control" regulation or imposing capital investment requirements on monopoly providers. Rather, the CTANY encourages a "public-private partnership with voluntary cooperation." We believe our directive in this matter is consistent with the CTANY's views.

182 For example, we recently adopted mandatory New York State Reliability Council (NYSRC) Rules applicable to electric utilities in New York State.

> Because of growing interdependence among the various critical infrastructures, a direct or indirect attack on any of them could result in cascading effects across the others…Critical infrastructures rely upon a secure and robust telecommunications infrastructure. Redundancy within the infrastructure is critical to ensure that single points of failure in one infrastructure will not adversely impact others.[183]

The stakes are simply too high to rely solely on markets, or to presume critical infrastructures operate wholly independently of one another. Without this vital information from those providing the facilities-based backbone of the telecommunications network, we risk the possibility that, under extreme conditions, networks may fail and that other networks on which they depend may too be compromised.

We will continue to require that telephone service be provided consistent with the Public Service Law. The intention of our service standards has been to ensure high quality service and provide consumer protections when service quality declines. While we are not implementing changes in this order, we propose to eventually move away from the full breadth of existing service quality standards toward a more focused set addressing network reliability standards. We will examine the appropriate changes to our regulations in a rulemaking, and we will continue to monitor service quality as we currently are to ensure the appropriate levels of service. We will also develop an Annual Report on Network Reliablity to enable us to monitor jurisdictional companies as well as companies over which we do not assert jurisdiction.

[183] National Strategy for The Physical Protection of Critical Infrastructures and Key Assets: Telecommunications, p. 49**.**

Consumer Protections

Introduction

All aspects of the companies' provision of telephone service – not just price – are affected by the competitive environment in which they now operate. Just as competition has required that we reassess price regulation of the local exchange companies, so too must we consider the other aspects of the provision of service to customers. This section provides our analysis of these non-price aspects of service that relate to consumer protections.

We expect companies will find new and innovative ways to serve customer needs in a competitive market. Our overarching intention is to allow market forces to operate to find the most effective and efficient ways to respond to consumers. However, this process of innovation should occur within a zone of acceptable operating practices to ensure that consumers are protected against undue harm that could result from inadequate knowledge and also to ensure that basic health and safety interests are maintained even in a competitive environment. Therefore, we retain important consumer safeguards for traditional telephone companies and modify those that can be changed without undue consumer impact. Our goal is to provide the consumer protections needed to ensure New Yorkers have access to quality service without imposing undue burdens on providers. We will require these protections of those companies which we regulate (although, as discussed below, we will attempt to make them less burdensome), and we expect that the market will require others to emulate this approach. It bears mention that while we will continue to require the appropriate safeguards, the competitive market is not entirely without risk for consumers. On balance, however, while consumers will bear more of a burden to understand the offerings of the various service providers, the benefits of competition are dramatic and substantially outweigh that risk.

In competitive markets, carriers have strong incentives to respond reasonably to customer needs. While certain basic protections remain necessary, detailed prescriptive mandates for governing many aspects of the relationship between carrier and customer are not necessary. Indeed, as telephone markets become more competitive, we believe market forces should be given an opportunity to reshape the relationship in order to develop more effective and efficient ways to provide just and reasonable rates and adequate levels of service quality. Continuing to adhere to legacy requirements stifles innovation, and when the regulatory mandates bind only the legacy wireline competitors, those carriers are put at a competitive disadvantage. The need for these mandates is being rapidly eroded by the explosive development of competitive markets. The White Paper discussed various consumer protection related requirements that may benefit from streamlining or elimination, and appended a list of current requirements with recommendations to streamline, eliminate, or continue each of them. Most of these regulatory requirements are codified in our rules, and, therefore, a proceeding will be required to examine appropriate changes. In several instances, discussed below, we conclude that the requirements could be inappropriate in the current environment and that it may be unfair and unnecessary to impose them on incumbent carriers, and our expectation is that they will be eliminated in the rulemaking proceeding. That proceeding will be immediately commenced.

Background

The White Paper identified several consumer protections as essential for the health and safety of all New Yorkers subscribing to voice services, regardless of the service provider. It placed E911 service and compliance with federal wiretap rules in this "essential" category, noting that the provision of these services is now required by the FCC.[184] In addition, we have required blocking capabilities for pay-per-call and chat line

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[184] In the Matters of IP-Enabled Services E911 Requirements for IP-Enabled Service Providers, First Report and Order and Notice of Proposed Rulemaking (Adopted May 19, 2005, Released June 3, 2005), specifies that interconnected VoIP service providers must provide E911 service. See also Case 26443, Proceeding on Motion of the Commission as to the Provision of Universal Emergency No. 911 by Telephone Companies, Order Establishing the Framework for 911 Services (issued November 20, 1973); Case 28358**,** New York Telephone Company – Enhanced Emergency Telephone Service (E911), Opinion Number 84-7 (issued April 11, 1984). Responding to a petition from the Department of Justice, the Federal Bureau of Investigation, and the Drug Enforcement Agency, the FCC determined, on August 5, 2005, that facilities-based broadband internet access service providers and PSTN-interconnected VoIP providers must be prepared to accommodate law enforcement wiretaps.

numbers, which the White Paper notes are also essential,[185] because many, but not all, wireless and VoIP companies provide these blocking services.[186] The White Paper sought information on the availability of these blocking services and an explanation of why these protections are not provided by those who have chosen not to offer them. The White Paper also noted that other important consumer protections were identified by the parties, including slamming and cramming rules; access to Statewide Relay Service; appropriate termination notification; special protections for elderly, blind or disabled consumers; annual notification of rights including the customer complaint handling process; disputed billing process; full disclosure; and the provision of a directory and directory listing. These protections are set forth in detail in Part 600 of our regulations, and they reflect a long history of protecting the public as the technological evolution of the telecommunications marketplace has evolved.

White Paper

The White Paper recommended that we encourage all companies to adopt the essential consumer protections. It also suggested that the public be provided with

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[185] Cases 98-C-1479, End-User Blocking Requirements, Order Directing Carriers to File Tariffs for Chatline Services and Related Actions (issued February 4, 1999) and Case 04-C-1276, et al., End User Blocking Requirements, Order Directing RNK Inc. to Show Cause (issued October 20, 2004); Order Resolving Compliance Issues and Authorizing Outreach Program (issued January 21, 2005); Order on Rehearing (issued May 19, 2005).

[186] We note that many wireless companies voluntarily adhere to the CTIA customer code which provides ten standards: 1) For every rate plan or contract consumers will be given specific disclosures regarding rates and terms of service; 2) coverage maps will be provided, illustrating where service is generally available; 3) when initiating or changing service, carriers will clearly state contract terms to customers and confirm changes in service; 4) each service plan will provide every new customer a 14 day trial period for new service during which they can terminate service with no early termination fee; 5) in every advertisement that mentions pricing, rates and terms of service will be specifically disclosed; 6) on billing statements, carriers will separately identify carrier cost recovery from taxes; 7) customers will be provided the right to terminate service for significant changes in contract terms; 8) ready access to consumer service will be provided; 9) consumer inquires and complaints received from government agencies will be responded to promptly; 10) each company will agree to abide by policies for the protection of customer privacy.

information about the carriers' offering of consumer protections through a non-binding certification process, a provider consumer report, or an annual consumer report, and that the annual service quality commendation process for wireline companies be expanded to all providers. It also sought comment on the value of creating incentives, such as whether the certification of a carrier as a "preferred" or "certified" carrier would be helpful.

Parties' Comments

Parties representing consumers generally agreed that consumer protections should be provided by all intermodal competitors. A number of parties agreed with the idea of a consumer report, but consumer advocates warned that if the voluntary approach does not work, the Commission should consider further measures to ensure that these protections are being offered. CWA goes further than most and recommends imposing service quality and public safety regulatory standards on all providers, and suggests the development of a consumer bill of rights for all communications customers.

Verizon-NY comments that Staff's proposals would not be workable and that such initiatives would create additional information-gathering burdens for carriers and would not fairly reflect the extent to which individual carriers are or are not in fact conducting their business in a consumer friendly manner.

extel Partners and others oppose the suggestion made in the initial comments that the Commission extend its complaint resolution services to include wireless and other telecommunications providers. T-Mobile contends that no form of additional regulation for wireless and VoIP services should be considered at this time, noting that wireless and VoIP carriers are being regulated by the FCC. Finally, some parties go so far as to argue that our complaint handling process be completely eliminated, relying instead on the competitive market to provide consumer protections for all providers.[187]

Scope of Commission Regulation

Consumer protections remain vital even in a competitive market to ensure that markets function efficiently, that consumers have the information required to make

[187] White Paper, p. 80.

an informed choice regarding their service provider and that needs that may not be satisfied by the market but which are important to society (e.g., access to certain services for deaf customers) are met.

Certain consumer protections identified by Staff -- access to E911 and compliance with federal wiretapping statutes -- are required of all providers.[188] We also agree that the availability of end user blocking capability may be an important feature for customers. We have required that local exchange companies offer end user blocking options for pay per call numbers and chatline numbers.[189] The availability of end user blocking capability can be critical for certain end users, and as we have noted this can be a health and safety issue for parents with children. The FCC currently requires local exchange carriers to offer blocking of calls to 900 numbers. Our blocking requirements have gone farther to extend blocking protections to numbers dialed on a local basis to chatlines. It would be unfortunate if consumers were afforded less protection from competitive carriers, and we intend to pursue appropriate actions to guard against that. However, we also recognize that implementing effective blocking protections for local numbers has proven difficult. Thus we will first urge competitive carriers over which we do not assert jurisdiction to disclose to consumers whether they offer blocking protections and in particular chatline blocking. Second, we will explore implementing a requirement that all chatlines on local numbers be migrated to 900 numbers in order to more effectively provide blocking.

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[188] Supra

[189] Cases 98-C-1479, End-User Blocking Requirements, Order Directing Carriers to File Tariffs for Chatline Services and Related Actions (issued February 4, 1999) and Cases 04-C-1276 et al., End User Blocking Requirements, Order Directing RNK Inc. to Show Cause (issued October 20, 2004), Order Resolving Compliance Issues and Authorizing Outreach Program (issued January 21, 2005), and Order on Rehearing (issued May 19, 2005) In response to Staff's request for information about how call blocking is provided, Time Warner notes that it provides the service and NYSTA argues that it is unnecessary. We encourage those providers that are not subject to Commission oversight to provide call blocking as part of their standard service.

Other important consumer protections identified in the White Paper are required of the telephone corporations over which we assert jurisdiction, such as requirements:

- to discourage fraudulent practices (cramming, slamming),
- to maintain basic service protections (termination notices, service and contract disclosures), and
- to ensure that telecommunication services are is accessible to special needs consumers..

These requirements are based on our fundamental charge to provide all residents with reasonably priced and adequately provided telecommunications services, and, in so doing, to protect the public from unfair business practices, fraud, and market place abuses, and to ensure that services are provided under reasonable terms and with reasonable reliability. These protections will continue to be the obligation of the regulated wireline companies, although where appropriate, they may be modified in the rulemaking we are initiating to adapt our consumer protection rules to the competitive environment. We encourage all other companies providing communications services to also adopt these important consumer protections, although we recognize that the application of them might appropriately vary depending on the circumstances. That being said, we view these as important consumer protections that should be embraced by those providers not subject to Commission oversight. Wherever possible, every effort should be made to afford the same level of protection for all consumers.

It would be much less effective, in our view, to retain all the current wireline protections while leveling the playing field by extending those mandates to all intermodal competitors, as some parties have recommended.[190] However, we encourage all companies providing telecommunication services to the mass market to follow basic disclosure guidelines to inform consumers about the availability of certain terms of service.

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[190] Just as there may be jurisdictional constraints on our ability to extend the current requirements to all intermodal competitors, there are also statutory constraints on our ability to eliminate all regulatory mandates (e.g., our complaint handling process).

Given that the application of these protections by providers other than the regulated wireline company could very well result in a lack of uniformity, we direct Staff to design a voluntary process that would publicly identify the protections each intermodal provider agrees to offer. This can be effectuated by Staff's proposed consumer report. Cooperation from all service providers is important, and we encourage the companies to participate in this effort. In a competitive world, consumers will be best protected if they are aware of and can easily compare the differences among the protections and services provided by the various service providers, and Staff's proposals would help achieve that goal. The consumer report should also clarify the responsibilities of each governmental agency involved with resolving consumer complaints to further inform the consumer. We direct Staff to develop the consumer report in a way that will be most useful to customers.

We realize that consumers will need to acclimate to an environment where the Commission is not the primary forum, in some instances, for establishing consumer protections and resolving complaints, but we expect providers to be more responsive as they vie to obtain and retain customers. We will rely on our continuing oversight of the more traditional wireline carriers as well as our monitoring of all providers, together with enforcement of consumer protections laws by other government agencies (such as the more generalized statutes enforced by the DOL), to minimize customer harm. Some of the parties have expressed skepticism regarding our call for voluntary efforts, suggesting either they will not work or cannot work. We are not persuaded and conclude that a voluntary, cooperative approach can be successful and should be pursued.

Partial Payment Requirements

The Commission requires carriers like Verizon-NY to allocate partial payments in a specified order to various categories, thus preventing the disconnection of some services if partial payment is made.[191]

Verizon-NY asked that these "buckets" be eliminated, and the White Paper recommends that payments be allocated first to local service and that wireline companies then be allowed to apply the rest of payments in whatever way they deem appropriate. CTANY frames this issue as "Verizon's request that it be allowed to terminate monopoly services to obtain payment for competitive services should be carefully scrutinized."[192] It also alleges that because the requirements are in a regulation it needs to be the subject of a hard rulemaking. Verizon-NY claims that the bucketing requirements are anachronistic, that they encourage customers to delay paying bills and are in any event unnecessary inasmuch as customers have other options for obtaining access to local exchange service.

The purpose of the rule is to protect the consumer's access to basic service by first allocating the partial payment to that service, thereby minimizing the chance of disconnection due to non-payment. We disagree with Verizon-NY: that concern is not anachronistic, and we will continue to take steps to ensure that customers have access to the network. To address concerns about the complexity and usefulness of the existing

[191] 16 NYCRR 606.5 provides in part:

> Upon receipt of a partial payment from a telephone customer . . . [i]f the customer does not include directions on how to apply the payment to the bill . . . telephone corporations will apply such a payment in the following order:
>
> (a) . . . basic local exchange services, which, for purposes of these rules, include tone signaling and nonpublished listings, and exclude charges for other features and long distance calls.
>
> (b) . . . interLATA long distance services billed by the local exchange telephone corporation.
>
> (c) . . . other regulated services provided by the local exchange corporation. . . .
>
> 16 NYCRR § 606.5

[192] CTANY's comments, p. 26.

five category allocation, the White Paper recommends reducing the allocation categories to two: basic service and all other charges. That approach satisfies our fundamental concern that customers have access while allowing greater flexibility.

CTANY's arguments are too unpersuasive. The concern about Verizon-NY having lower uncollectibles for all of its services (including competitive ones) may be technically correct but likely to be so insignificant as to be outweighed by the benefits of simplifying this rule.

Accordingly, we believe that 16 NYCRR §606.5 can be eliminated, in a rulemaking, for all wireline providers, and replaced with a requirement that any partial payment without instructions from the customer be allocated so as to provide basic service for that customer (even if the customer takes another service as, for example, a package bundling access with other services). Our goal is to foster access to the network, and accordingly we believe that companies should be required to allocate payments in a manner that is most favorable to the customer retaining such access. So, for example, an incumbent could contact a customer to obtain permission to switch the customer from another service to basic service if that action would cause more of a customer’s partial payment to be directed toward maintaining access at the expense of not paying for other services. The specifics regarding the implementation of this change can be dealt with in the proceeding we are initiating to amend our rules.

Late Payment Charges

Verizon-NY claims that the current late payment charge is not set by a competitive market and is less than late payment charges of its competitors or credit card companies, with whom it competes for credit. Verizon-NY's current 1.5% per month charge on amounts unpaid at the time the next bill is prepared is less than the late payment charges of Verizon Wireless, AT&T, Cablevision, and Time Warner. In its comments, Verizon-NY asserts the Commission should grant it the flexibility to adjust this charge and asserts that the Commission should eliminate 16 NYCRR 609.11(b), thus giving Verizon-NY discretion to adjust similar types of charges (e.g., charges for restoration of service and dishonored checks) without Commission oversight. It says that it should be entitled to such fee levels that are high enough to discourage customers from bad payment practices.

The White Paper found that changes in our regulations were premature and unnecessary in part because there was no statutory limitation that would prevent Verizon-NY from increasing delayed payment charge to delinquent customers. The White Paper stated that Staff would be "inclined to support an increase in the late payment charge"[193] if those charges were not assessed on Lifeline customers, customers with serious illness or customers that have amounts in dispute.

Verizon-NY's point is reasonable; it should file a tariff to effectuate this change.

Termination Notice Modification

The White Paper stated that Staff "was amenable" to Verizon-NY's proposal to allow companies to send termination notices by e-mail or other electronic form to customers who have consented to receive communications that way.

The recommendations of the White Paper seem reasonable; we will consider them in the rulemaking we will commence.

The Interest Rate on Customer Overpayments

Our regulations set the rate of interest on customer overpayments at the greater of "the unadjusted customer deposit rate or the applicable late payment rate."[194]

Verizon-NY comments that paying interest at the customer deposit rate would properly compensate customers for the time value of their money and that the late payment charge rate would give customers an unjustified windfall. This issue should be addressed in the rulemaking.

The Commission's Complaint Handling Role

Verizon-NY has complained that the complaint handling process is too lengthy. Staff was "unconvinced", noting that the majority of consumer complaints are resolved within 60 days. In its comments, Verizon-NY asserts that the onerous levels of

[193] White Paper, p. 87.

[194] 16 NYCRR §634.3

interest that can accrue in connection with customer billing disputes amounts to penalties that disparately affect Verizon-NY but not its competitors who are not subject to this regulation. It says that to avoid such unfair results the Commission should resolve complaints more speedily and that interest on any subsequent award amount should stop accruing once the customer's complaint is filed with the Commission.

Turning to Staff's suggestion that complaints are resolved promptly, Verizon-NY notes that one complaint filed in February 1999, for example, was decided in 2004 and that Verizon-NY was required not only to issue a refund of approximately $15,000 but also to remit an additional $65,000 in interest.

The White Paper states that 80% of consumer problems are now resolved at the initial contact stage and the majority are resolved in 60 days. Given the limited number of cases that have required a longer review, the White Paper concluded that limiting the interest accrual or lowering the interest rate could unfairly penalize consumers.

We received 7,999 Verizon complaints from 2001 through the end of 2005, of which 36 remain outstanding. On average, these cases were resolved in 60 days. While delays are never desirable, this level of unresolved complaints does not indicate a need to modify our procedures. We conclude that our complaint handling procedures and our interest rate on customer overpayments do not create a financial risk for the company nor cause accrued interest to rise to the level of a severe penalty.

Payment Requirements Before Service Restoration

In comments submitted before the White Paper, Verizon-NY asked the Commission to amend its regulations to require full payment of outstanding charges prior to restoring or providing new service to delinquent customers. Verizon-NY reiterates its proposal, noting that it was not directly addressed in Staff's White Paper.

This aspect of the change could have a significant bearing on many customers and would benefit from further review in the upcoming rulemaking.

Level Playing Field

Introduction

A level playing field is ". . . arrangements among providers of communications services necessary for local competition to be effective."[195] In 1996, at the time of our Competition II order, the telecommunications market was highly concentrated and largely a monopoly. We stated in that order our objective to remove barriers to competitive entry and to establish a level playing field for competing providers of local exchange service.[196] We have taken a number of steps to provide a framework for incumbent carriers and new entrants that would allow all competitors a fair and reasonable opportunity to compete.[197] As discussed above, the market is now adequately

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[195] Competition II order, p. 15.

[196] Id.

[197] We have required an incumbent LEC to provide competitors with a form of central office interconnection (virtual collocation) for the provision of private line services, Case 89-C-099, Proceeding on Motion of the Commission to Consider the Applicability of the Common Carrier Concept to Modern Telecommunications, Opinion No. 90-9 (issued February 20, 1990); required that incumbents provide "physical collocation" for the provision of private line services, Cases 29469 et al., Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Order Regarding OTIS II Compliance Filing,(issued May 8, 1991); ordered loop unbundling for Centrex and private branch exchange services, Cases 88-C-004, et al., Open Network Architecture, and Comparably Efficient Interconnection, Opinion No. 91-24 (issued November 25, 1991); expanded physical and virtual collocation requirements to include switched services, Case 28425, Access Charges, Opinion No. 92-13 (issued May 29, 1992); authorized the negotiation of carrier-to-carrier interconnection agreements between Verizon and CLECs, with mediation and arbitration if necessary, PRP Order, supra; established a wholesale discount rate for all retail services offered by New York Telephone and Rochester Telephone, Cases 95-C-0657 et al., Determining Wholesale Discount, Opinion No. 96-30 (issued November 27, 1996); set line sharing rates and addressed provisioning issues related to line sharing, Case 98-C-1357, Line Sharing Rates, Opinion No. 00-07 (issued May 26, 2000); established carrier migration guidelines to facilitate the smooth transfer of consumers' services, Case 00-C-0188, Migration of Customers between Local Carriers, Order Adopting Phase II Guidelines (issued June 14, 2002); established loop hot-cut rates for basic, batch and project hot-cuts, Case 02-C-1425, Process for Loop Migrations, Order Setting Permanent Hot Cut Rates (issued August 25, 2004), and monitored Verizon's Industry Change Control process.

competitive, and much of the asymmetrical regulation should be relaxed so competitors can compete on a level playing field. At the same time, we will remain vigilant in those areas where incumbents retain monopoly power and may act to unfairly disadvantage their competitors. This section provides our discussion of these level playing field issues for the new environment.

The Incumbents' Role As A Wholesaler

Interconnection

The White Paper

> In the Competition II proceeding, the Commission found that "interconnection continues to be the linchpin of competition," and each firm's network must be interconnected to other networks in the market to provide service to customers. . . .The ability of each competitor in the intermodal market to have access to the features, functions and services of other competitors that it needs to interconnect is essential to the competitive telecommunications market.[198]

While efforts have long been made to eliminate monopoly bottlenecks by encouraging facilities-based competition, as contemplated under the Telecommunications Act of 1996, the White Paper notes that it would be premature at this time to eliminate mandatory access to all incumbent wholesale services because many intermodal and UNE-based competitors continue to rely on the incumbents for interconnection, transport, and interoffice trunking. Also, some services continue to be a bottleneck, even for facilities-based providers (e.g., pole attachments).

Mandatory access to high capacity loops and dedicated transport have recently been limited in areas where markets have become competitive,[199] but where

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[198] White Paper, p. 95 (citation omitted).

[199] Case 05-C-0203, Tariff Filing of Verizon New York Inc. to Comply with the FCC's Triennial Review Order on Remand, Order Implementing TRRO changes (issued March 16, 2005). The TRRO allows incumbent local exchange carriers to cease providing local circuit switching as an unbundled network element. In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, 2005 Lexis 912 (released February 4, 2005).

competitive wholesale markets do not exist, the White Paper argues, there is a continuing need to ensure access for competitive providers. In light of the efforts previously expended to address level playing field issues as they relate to such wholesale services, the White Paper concludes that there is no need to make any changes to wholesale interconnection requirements at this time.

The White Paper went on to also observe that interconnection problems in the wholesale markets have been and continue to be successfully addressed through negotiations, the ease of which may be further assisted if interconnection standards are adopted. In addition, the Telecommunications Act of 1996 provides for mediation or arbitration should negotiations fail.

The White Paper also mentions a number of processes we have established in New York to facilitate the working relationships of the parties in the wholesale market and to ensure reasonable terms and conditions for the provision of bottleneck services. The processes mentioned include our establishment of the Inter-Carrier Service Quality Guidelines in the Carrier Working Group (CWG) proceeding, the Change Management process, the Expedited Dispute Resolution (EDR) process for service affecting conditions, and the Alternative Dispute Resolution services provided by the Department. The White Paper recommends that all of these processes and services now be made available to all intermodal competitors to assist in the resolution of disagreements and disputes in the wholesale market.

In addition to the bottleneck and other interconnection services, the White Paper explains the importance to customers of being able to easily and seamlessly migrate from one provider to another. Staff urges all competitors to strive to operate under a common set of principles to achieve such migrations. Therefore, the White Paper recommends that all local service providers abide by our Migration Guidelines and Mass Migration Guidelines.

Parties' Comments

BestWeb and a number of other parties argue that the only way to ensure fair retail competition is to ensure non-discriminatory access to the incumbent's bottleneck facilities at UNE or other just and reasonable prices. The CTANY notes how critical these bottleneck facilities are to retail competition and cites the prior anti-competitive behavior of the Bell Companies as evidence that today's markets remain vulnerable. It also disagrees with the claims made by Verizon and Frontier of Rochester that wholesale regulations should be reduced or eliminated at this time. Finally, the CTANY notes that for facilities-based providers, electric and telephone utility poles are another bottleneck, access to which should be ensured on reasonable terms and conditions.

Cablevision argues that wholesale markets are not competitive, alleging that Verizon does act anti-competitively by imposing unnecessary costs and delays in the development of interconnection agreements and in other operational practices. Continued regulatory oversight, it concludes, is required.

CompTel joins those requesting that access for interconnection be ensured at just and reasonable rates.

Frontier of Rochester opposes the suggestion that wholesale pricing principles be established to help guide interconnection negotiations.

T-Mobile argues that no deregulation of the wireline wholesale market will be justified until multiple providers are able to offer what are now bottleneck services. It asks that we review the terms and conditions upon which special access circuits are delivered to competitors and that the Commission adopt the recommendation made by Staff in the Verizon-MCI merger proceeding for additional regulation of special services. T-Mobile suggests in the alternative that, rather than create more formal regulatory oversight of special access, the establishment of a neutral dispute resolution forum to address unresolved disputes could help prevent the incumbent's exercise of market power.

Verizon concurs with the White Paper's conclusion that new regulations regarding numbering administration, intercarrier compensation, and network interconnection are unnecessary.

<u>Discussion</u>

As we discussed above, competition has come a long way since our last generic proceeding. The market has developed to the point where, in some areas, regulatory involvement is not needed. In other areas, markets are not effective and safeguards are needed. From the comments received and the observations of the White Paper, it seems clear that wholesale products continue to include bottleneck services. Access to those bottleneck facilities on reasonable terms and conditions is essential to maintain and expand retail competition. We recognize, however, that the market is not static, and should services in certain wholesale markets become competitive (such as with high capacity loops and dedicated transport), there is no further need for economic or other regulation.

Under the Telecommunications Act of 1996, unbundled network elements must be made available to competitors on reasonable terms and conditions, whenever a finding of competitive impairment is made. Competitors have the right to negotiate interconnection arrangements under that Act, with arbitration or mediation available should negotiations fail.

In addition to the resources offered under the Federal Act, we have developed a number of additional processes to facilitate interconnection. As stated above, they are the Carrier Working Group, the Change Management process, the EDR process, and Alternate Dispute Resolution services. These procedures and groups have worked quite effectively in resolving many wholesale market problems, and the four will continue. We disagree, however, with the White Paper's recommendation[200] that all of our processes be made available to all intermodal competitors to the extent they choose to avail themselves of that assistance. Carriers that do not purchase products or services subject to the Inter-Carrier Service Quality Guidelines do not have a reasonable basis for claiming they should be part of the CWG and, likewise, CLECs that do not utilize Verizon OSS interfaces to order services as prescribed by the Change Management Processes and Procedures should not be involved in the change management processes, so it is not appropriate that they participate in those efforts. The EDR and the ADR processes, on the other hand, will remain available to all.

[200] White Paper, p. 99.

We also disagree with the White Paper's recommendation that generic interconnection terms and standards be established. In our view, the effort required to establish such standards beyond the extant ones, and the need to constantly review them as technology and other factors cause significant changes, renders this approach impractical. We will, as recommended in the White Paper,[201] continue to monitor bottlenecks, but the processes we have established to facilitate interconnection agreements and to resolve disputes where agreements cannot be reached should continue to be sufficient for the purpose of ensuring reasonable and non-discriminatory access to wholesale bottleneck facilities.

We agree with the theory underlying the White Paper's recommendation that all local service providers, even those over which we do not assert jurisdiction, should follow the approach of our Mass Migration Guidelines to achieve the seamless migration of customers between competitors. Those providers should have procedures in place that achieve the ends sought by our Guidelines.

Numbering

In Competition II we concluded that all customers must be able to call all valid telephone numbers and that telephone numbers are a common resource to be shared among all carriers,[202] and also that number portability is essential in a competitive local exchange market.[203]

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201 Id., p. 100.

202 Competition II order, supra, Case 94-C-0095, Number Portability Directory, and Intercarrier Compensation, Staff Report in Module 2 (issued February 15, 1995), pp. 14-15; Order Instituting Framework for Directory Listings, Carrier Interconnection and Intercarrier Compensation (issued September 27, 1995); Order Requiring Interim Number Portability Directing A Study of the Feasibility of a Trial of True Number Portability and Directing Further Collaboration (issued March 8 1995), Case 98-C-0689, Efficiency of Usage of Telephone Numbering Resources, Order Instituting State-wide Number Pooling and Number Assignment and Reclamation Procedures (issued March 17, 2000).

203 Case 94-C-0095, supra, Order Requiring Interim Number Portability as a Trial of True Number Portability and Directing Further Collaboration (issued March 8, 1995) p. 3.

The White Paper discusses the history of numbering issues and notes that the Department has petitioned the FCC to direct the Pooling Administrator to make number pooling mandatory for all local number portability-capable companies. It notes, however, a gap in number portability which could be seen as an impediment to choice for consumers. Currently, providers that are not state certified or otherwise federally licensed cannot obtain numbering resources directly from the North American Numbering Plan Administrator. Some VoIP providers who fall in this category may believe, according to the White Paper, that they are not covered by the FCC's policy requiring the porting of numbers. The White Paper indicates that such providers should not prevent consumers from porting their numbers. It sought comments from the parties on how to resolve this issue, including a request for a discussion of jurisdictional issues.

Cablevision argues that there is no need to impose number porting requirements on VoIP providers because those providers are already porting where their systems enable them to do so. It suggests that some numbers may not have been ported in the past because a carrier can only request a port on behalf of the customer of record. It also disagrees with the suggestion that LECs be required to include porting requirements in interconnection agreements with VoIP providers. It argues that such a significant requirement should not be imposed in the absence of a showing of market failure. More generally, Cablevision agrees with the absence of recommendations for any new regulation of VoIP services.

T-Mobile contends that porting rules and requirements are essential, especially in light of our increased reliance on competition. It says that Congress has granted plenary authority over numbering resources and portability to the FCC and that we lack authority to adopt state-specific rules.[204] It states, however, that it supports the goals of the Commission and urges us to work with the FCC to establish uniform porting rules.

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[204] T-Mobile's comments, p. 18, citing 47 U.S.C. 251(e).

Verizon agrees that this issue should await resolution at the FCC**.**

The White Paper explained the importance of mandatory number pooling for all local number portability capable companies to ensure broad number optimization interests, and the Department has petitioned the FCC to direct the pooling administrator to make pooling mandatory for all such companies in New York rate centers.[205] We agree with T-mobile that effective number porting rules are critical to effective competition. We will continue to coordinate this with the FCC.

Carrier-to-Carrier Service Quality

White Paper

The White Paper notes that we have addressed end-user and carrier-to-carrier service quality issues both generically in the Carrier-to-Carrier proceeding,[206] in our resolution of the issues presented by the Verizon PAP[207] and in ordering the Frontier Open Market Plan.[208] It says that monitoring of wholesale service quality performance will continue through the Carrier-to-Carrier and Verizon PAP proceedings, as well as the Special Services proceeding.[209] The White Paper further notes that the carrier-to-carrier

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[205] White Paper, p. 101, citing, Petition of the New York State Department of Public Service for Mandatory Number Pooling, CC Docket No. 99-200 (filed August 26, 2005)

[206] Case 97-C-0139, Review of Service Quality Standards for Telephone Companies, Order Establishing Modifications to the Inter-Carrier Service Quality Guidelines (issued December 1, 2005).

[207] Case 99-C-0271, et al., Petition of New York Telephone Company Concerning Sections 252 and 271 of the Telecommunications Act of 1996 Order Adopting the Amended Performance Assurance Plan and Amended Change Control Plan (issued November 3, 1999), Case 99-C-0949, et al., Petition of Bell Atlantic-New York for Approval of a Performance Assurance Plan and Change Control Assurance Plan, Order Granting In Part and Denying In Part Requests for Waivers of Service Quality Targets (issued June 7, 1991).

[208] Cases 93-C-0103, Rochester Telephone Corporation - Restructuring Plan, and 93-C-0033, Rochester Telephone Corporation - Multiyear Rate Stability Agreement, Opinion No. 94-25, (issued November 10, 1994). The OMP was modified and extended in Opinion 00-04 (issued March 30, 2000)Footnote

[209] Case 00-C-2051.

working group has been bridging the transition from government standard making to competitive industry standard setting, and it therefore concludes that wholesale service quality is being adequately addressed through these various efforts.

The White Paper also addresses a problem concerning the rating and routing information on terminating traffic that is being omitted by some companies, resulting in so-called "phantom traffic." The White Paper suggests that when current intercarrier compensation inequities are rectified by the FCC, the incentive for obscuring routing information will be lessened and this problem will be resolved.

Parties' Comments

AT&T disputes Staff's claim that wholesale service quality is being adequately addressed. It points to information allegedly showing Verizon-North's performance as the worst in the nation regarding special access provisioning. It contends that Verizon's actions substantially hinder a competitor's ability to offer competitive services.

Cablevision complains that the delays and expense of negotiating and renegotiating interconnection agreements and continuing difficulties regarding operational details (such as number porting and billing practices) leads it to conclude that the oversight of wholesale service quality needs to be strengthened.[210] Cablevision suggests that an accelerated docket procedure be adopted (citing FCC and Massachusetts procedures) to reduce the delays caused by Verizon's interconnection negotiation practices.

The CTANY contends that wholesale service quality metrics remain important regulatory tools. Cablevision notes that the wholesale markets are not competitive, and alleges that Verizon acts anti-competitively by imposing unnecessary costs, unwarranted delays, and difficulties in developing wholesale agreements.

Frontier of Rochester contends that we are falling behind the FCC with regard to the problem of carriers blocking Automatic Number Identification (ANI). It urges that we require carriers to disclose calling party numbers and other specified data

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[210] Cablevision’s comments, p. 41, See footnote 169 and Appendix.

on intrastate and local calls, in a fashion similar to what the FCC has required on interstate calls. It also agrees with the White Paper's description of the problems caused by so-called phantom traffic where some providers undertake ANI blocking.

Verizon argues that the market is irretrievably open and that regulatory penalties are not needed when market penalties are more severe. It says the PAP is asymmetrical and unneeded and that special services reporting should also be eliminated.

Discussion

The White Paper concludes that wholesale service quality is being adequately addressed in ongoing proceedings.[211] We agree.

We disagree with AT&T's contention that Verizon's wholesale service quality is hindering competition. AT&T has not shown that there is any discrimination or untoward practice.

We also disagree with Cablevision's suggestion that our oversight of interconnection agreements needs to be strengthened. Unreasonable delays can be prevented by either relying on the mediation and arbitration provisions of the Telecommunications Act of 1996 or by using the processes we have developed to assist in resolving disputes. In addition, we have had no complaints from Cablevision with regard to specific concerns.

We acknowledge the existence of the phantom traffic problem caused by the removal of rating information (i.e., ANI), as well as the White Paper's observation that a reformulated intercarrier compensation scheme may adequately address this problem. In the absence of specific complaints, we believe it premature to address this issue.

For the reason set forth above, we conclude that our existing wholesale service quality processes including the PAP are needed and are sufficient for ensuring wholesale service quality.

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[211] White Paper, p. 99.

Directory Listings

The White Paper notes that we have defined basic service to require all service providers to publish a directory or to cause their telephone numbers to be published.[212] It recommends that the Commission require all providers who want their customers' names, addresses, and telephone numbers to be published to provide them to the local exchange company for inclusion in a directory.

Verizon opposes the White Paper's recommendation that it be required to list other providers' customers' names and numbers in its own directory at no cost. It suggests that publishing a directory shouldn't be required at all and that the regulation should be eliminated. It also argues that it is inequitable to impose costs on Verizon for services to customers of its competitors. It is willing to reach commercially negotiated arrangements to publish competitors' numbers, but urges the Commission not to undermine such negotiations by adopting the White Paper's recommendations. Frontier of Rochester makes similar arguments in opposing this recommendation, and it additionally notes the potential for incumbent liability for mistakes made by competitors in their database and repeated in the incumbent directory.

In determining who should bear the cost for including customer telephone numbers in incumbent directories, it must be assumed that the cost of providing listings for its own customers is included within the incumbent's prices. Accordingly, we agree with Verizon that it should be permitted to charge intermodal competitors for printing their customers' information in the Verizon directory. In the absence of commercial agreements -- which is the preferred method of setting this charge -- it may be tariffed. Should Verizon desire to so proceed, it should file the necessary tariffs including appropriate cost support (e.g., incremental costs).

[212] White Paper, p. 100, citing, 16 NYCRR 602.10(a).

Wholesale Market Pricing

The White Paper recommends the adoption of a set of wholesale pricing principles to ensure that the monopoly pricing of wholesale products is not used to unreasonably raise competitors' costs. According to the White Paper, this should form the basis of the Commission's imputation rule[213] which is a key provision in the PRP, the OMP, and the Taconic QAP. An imputation rule is required, according to the White Paper, to avoid monopoly abuses that may result from remaining bottlenecks.[214]

Frontier of Rochester opposes these suggestions. It notes that the imputation rule makes no sense in a market where many services have been and continued to be priced below cost. It makes no sense to require an incumbent sell at a wholesale price below its retail price, when the retail price itself is below the incumbent's cost. According to Frontier of Rochester, the imputation rule is unreasonable and unnecessary.

T-Mobile urges us to review Verizon's pricing of special access services to determine whether Verizon is charging rates that enable competitors to compete in the retail market. It argues that the Commission should set those rates at the level that would prevail in a competitive market.

Cablevision also agrees with the White Paper's discussion of this issue. It provides the following "non-exhaustive list of suggestions:"

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[213] The imputation rule is designed to cure a problem that could exist when a company is both a wholesaler and a competitor at the retail level. An incumbent, for example, sells both access to its competitors as a wholesaler and then competes with those companies for telephone service on the retail level. To prevent a price squeeze – having the inputs priced so high that a competitor couldn't meet the incumbent's price – the imputation rule is that the price the incumbent charges its competitor for the bottleneck service must also be imputed into the incumbents' retail price. Alternatively, the price for the bottleneck could be reduced to reflect the price implied by the retail price.

[214] The White Paper also notes that the imputation rule will no longer be needed once all wholesale bottlenecks are eliminated through competition.

- Wholesale rates should be cost-based, to the extent possible, to approximate the rates that would be charged in a competitive market.

- Wholesale services should be made available to all similarly situated retail competitors on the same basis and at the same prices. Price differentials between interstate and intrastate wholesale services, as well as price differentials between wholesale services provided to wireline, wireless and VoIP providers, should be justified on the basis of cost differentials or eliminated.

- Vertically integrated retail competitors should be required to impute the price of their wholesale service into the price of their retail offerings.[215]

Verizon says any new investigations would simply duplicate existing proceedings.

We agree with the White Paper that to the extent there are remaining wholesale bottleneck facilities, an imputation rule is the theoretically appropriate means to ensure fair pricing. The ability of firms to compete in the retail market is a function of the price they pay for wholesale inputs, and those firms face an obvious problem when their wholesale supplier is also a retail competitor.

The pricing of a retail service below cost does not, contrary to Frontier's suggestion, obviate the imputation rule. The harm to competition comes from the difference between the wholesale price and the retail price, so the absolute level of the price is beside the point. The imputation rule is needed to ensure that a firm is not excluded from the market unfairly.

More broadly, T-Mobile’s and Cablevision’s arguments are generally reasonable, and we aim to achieve those goals to the extent practicable. We will do so, however, in the context of existing or other proceedings.

Pole Attachments

The White Paper notes that we have adopted the FCC approach for setting pole attachment rates. The FCC has two formulas for setting such rates: a cable formula (which includes only a portion of the costs of the pole) and a CLEC formula, which

[215] Cablevision’s Comments, pp. 40-41.

produces a higher rate. We have been using the cable formula for both cable company and CLEC attachers providing either voice or video.[216]

The White Paper recommends that we continue to use the cable rate "with one exception," and then notes that "[a]n argument could be made that cable should pay the higher CLEC rate for attachments where it competes with phone companies. In this circumstance, continuation of Verizon's current rate, which is higher than the cable formula but lower than the CLEC formula, is appropriate."[217]

The CTANY stresses the importance of proper pole attachment rates to effective competition. It says that there have been numerous inconsistent applications of the cable rate formula and that this "lack of understanding" is reflected in Staff's reference to the FCC rate formula as a "discounted rate."[218] It says Verizon's rate is almost double that permitted by the FCC, resulting in millions of dollars of monopoly overpayments to Verizon annually. In the event we maintain the present rate paid to Verizon, the CTANY asks that we consider freezing all pole attachment rates, arguing that such a course would provide a measure of certainty for new competitors and would limit the ability to exercise market power.

Cablevision urges that we reject Staff's suggestion "that cable should 'pay the higher CLEC rate for attachments where it competes with phone companies.'"[219] It asserts that the FCC cable rate formula has been upheld and that New York should opt to use it. It discusses Alabama Power Co. v. FCC, which it says stands for the proposition that the cable formula fully compensates utilities for their costs.[220]

Pole attachment rates are within our jurisdiction, and Alabama Power is beside the point because the issue here is the reasonbleness of the rate in a competitive

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[216] White Paper, p. 102, citing, Case 95-C-0341, Pole Attachment Rates, Order Denying Petitions for Reconsideration and Rehearing (issued March 8, 1995).

[217] White Paper, p. 103.

[218] The Cable Association's comments, p. 13, quoting White Paper, p. 102.

[219] Cablevision's Comments, p. 43, quoting White Paper, p. 103.

[220] Cablevision's Comments , p. 44, quoting Alabama Power Co. v. FCC, 311 F.3d 1357 (11th Cir. 2002).

environment, not whether it is confiscatory. These rates have the potential for significant bottleneck issues, and we believe it is appropriate to re-examine these rates to ensure they are properly aligned in today's competitive environment, particularly given the long standing relationship between incumbent telephone companies and the electric companies. We will institute a proceeding to determine the appropriate approach for setting these rates in a competitive environment.

Intercarrier Compensation

Intercarrier compensation is the mechanism by which firms compensate each other for origination, transportation, or termination of a call on interconnected networks. There are many differing prices based on the nature of the call and the provider that are not cost based. Staff noted the FCC is evaluating this issue.[221]

Verizon differs with Staff's suggestion that the Commission should strive to drive rates for terminating access toward costs. It states that access rates for interstate access and intrastate access differ, and that both of these charges differ from reciprocal compensation rates for terminating local calls.[222] It asserts that the issue should await resolution at the FCC.

We will await the FCC's resolution of this issue.

The Symmetrical Treatment of Competitors

Competition Monitoring Report

The White Paper notes that our Telecommunications Competition Monitoring Report (TCMR) was instituted in 1997 to collect information on and to monitor the status of competition in the state.[223] It opposed the recommendations of Frontier of Rochester and Verizon to eliminate the report, noting that the report provides

[221] White Paper, p. 104.

[222] Verizon's Comments, p. 56.

[223] White Paper, p. 106, citing, Case 96-C-0647, Proceeding to Monitor the Development of Competition, Order Adopting Telecommunications Competition Monitoring Report (issued May 20, 1997).

the Commission a guide to those markets where regulatory attention or the relaxation of regulation is most appropriate. Concluding that the elimination of the report is premature, the White Paper notes that we are considering improvements to the report in an existing docket.[224]

Frontier of Rochester notes that the TCMR is currently under suspension and should remain so until the report is required of all competitors. In fact, that is our current intention. The TCMR is under suspension because we are considering revisions to that report in a separate docket. We fully expect the suspension will remain until Case 04-C-1637 is decided.[225] In addition, one of the questions being examined in that separate proceeding is whether market monitoring data should be filed by all competitors. We will not prejudge that issue here.

Uniform System of Accounts

The White Paper recommended that we study the feasibility of adopting the FCC Uniform System of Accounts (USOA) for incumbents in New York. This recommendation was based on a comment from Frontier of Rochester that we should align the state and federal accounting systems to reduce the cost of record keeping. The White Paper also recommended that when companies are no longer able to seek rate relief based on cost of service regulation, that they be allowed to file financial data based on GAAP.[226]

In response to the White Paper, Frontier of Rochester argues that a feasibility study is unnecessary. It recommends that we immediately begin a process to align these systems of accounts.

[224] Case 04-C-1637, Simplified Telecommunications Annual Report, Notice Requesting Comments (issued February 3, 2005).

[225] The suspension is likely to continue until we determine that the competitive indicator proposed by staff is an effective monitoring tool. In constructing that indicator we expect staff will use whatever data – including that from the FCC – are available.

[226] White Paper, p. 107.

Both Frontier's and the White Paper's recommendations are premature. The Joint Board is now considering these questions and we believe it prudent to await the outcome of their review. Furthermore, the state system of accounts contains more detail in some areas than does the federal system (e.g., pension accounting depreciation). In addition, the White Paper's recommendation to streamline the PSC Annual Report must, as a practical matter, await any changes made in the USOA. While we recognize the need to streamline our accounting and reporting requirements, it is premature to address the USOA or the Annual Report at this time.

Regulatory Reserves

> Regulatory reserves occur when there are differences in accounting for rate regulated enterprises under FAS 71 and GAAP for enterprises in general. These differences relate to the timing [of] certain revenues and cost and result in regulatory assets and liabilities.[227]

We have allowed companies to eliminate regulatory assets and liabilities in conjunction with rate plans.[228]

The White Paper concluded that, if incumbents operate in a competitive market, it would be reasonable to consider proposals to write-off regulatory assets and liabilities because there would no longer be an assurance of recovering such costs.

In reply, Frontier of Rochester argues that permission to write-off regulatory reserves should be automatic when pricing flexibility is granted to a company. It argues that the company should not be required to enter into further rate plans in order to obtain such permission.

There is no requirement to enter into a rate plan in order to be granted permission to write-off regulatory assets and liabilities. Frontier of Rochester or any other company may file a petition for this purpose at any time, and we will consider them on a case-by-case basis.

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[227] White Paper, p. 107.

[228] E.g., Case 00-C-1945, Proceeding to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework, Order Instituting Verizon Incentive Plan (issued February 27, 2002).

Gains on Sale of Assets and Refunds

The White Paper observes under Public Service Law §113(2) that refunds (e.g., tax refunds) received by the utility may be credited to customers and/or the utility as determined to be just and reasonable. Citing recent Commission determinations, the White Paper concludes that it is reasonable to allow companies to retain such refunds when the companies operate in a competitive market and in a regulatory environment which eliminates nearly all of the vehicles for regulatory rate relief. A similar recommendation is made regarding the disposition of the gains on the sale of utility assets under Public Service Law §99(2), subject to specific conditions as contained in recent transfer orders.[229] The White Paper agreed with Verizon that such gains should be retained by the company.

The White Paper also addressed Verizon's request that all such asset transfers be deemed presumptively reasonable and that the transfer approval process be streamlined. The White Paper notes that petitions under Public Service Law 99(2) must be determined within 90 days and it rejects the suggestion that transfers be deemed presumptively reasonable. It recommends that we continue to scrutinize these transfers to ensure overall service network quality is not compromised and to guard against market power abuses.

As we have found in our recent transfer orders,[230] cost-of-service regulation can no longer function when competition successfully constrains market prices. Under those circumstances, companies cannot obtain net revenue relief by raising rates, and, accordingly, they can no longer be reasonably assured of the recovery of and on invested capital. While crediting tax and other refunds and gains on the sale of utility assets to customers may have been equitable under cost-of-service regulation, it no longer is. While we decline to conclude that these asset transfers are presumptively reasonable until we are convinced to the contrary, we expect to continue to allow utilities that we determine are facing significant competitive pressures to retain refunds and the gains on

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229 Id.

230 E.g., Case 05-C-0510, supra, Order Approving Transfer (issued June 15, 2005); Cases 05-C- 0091, et al., supra, Order Approving Transfers (issued May 20, 2005).

the sale of assets so long as cost-of-service based regulation for the company is no longer relevant.

Review of Procurements

The White Paper notes that Public Service Law §115, as well as Parts 685 and 686 of our regulations, allows us to require certain contracts be awarded by a telephone company to the lowest bidder following a public offering.[231] We may also require the filing of certain procurement procedures and cost plus contracts. The White Paper concludes that there is no need to review such processes or contracts, because prices are now being set in the competitive market rather than on the basis of an individual company's costs. The White Paper therefore recommends streamlining or eliminating the requirement to file procurement procedures and cost plus contracts.

Frontier of Rochester argues that the requirements of Parts 685 and 686 of 16 NYCRR be subject to an immediate proceeding to eliminate those filing requirements. While we tend to agree with the conclusions reached in the White Paper, we also agree that this and other issues concerning changes to our regulations should be the subject of an immediate proceeding to amend 16 NYCRR. We will, however, waive the requirements of Part 686 (the part of our regulations requiring the filing of a proposed contract). In view of the market pressure incumbents face, those requirements are unnecessary and unduly burdensome.

De-tariffing Voicemail

Verizon argued that it should not be required to tariff voice mail services because they are not telephonic communications within the meaning of Public Service Law §2(18). The White Paper recommends the rejection of the proposal because the tariff requirement is not burdensome. It also implies that the additional flexibility achieved by de-tariffing voice mail is unnecessary in light of the flexibility and streamlining otherwise proposed.[232]

[231] White Paper, p. 109.

[232] White Paper, p. 110.

We agree with the position taken by the White Paper. This service has been tariffed under the requirements and definitions of the Public Service Law, and we see no reason now to change that determination. We also agree that this tariff requirement is not burdensome.

Hearing Requirements

Verizon sought waivers of the notice periods in Public Service Law §92 to allow tariff amendments to become effective on one day's notice. It also sought a waiver of newspaper publication for all retail tariffs. The White Paper concluded that we should examine waiver requests at the time a case is filed.[233] It indicates that if a company can justify departing from existing policies, a petition for that departure should be filed.

The flexibility we are granting the larger incumbents for non-basic services should ameliorate much of the concern. Our legacy rate case Test Period Policy Statement[234] is no longer applicable for utilities which have been granted permission for filing financial statements using GAAP. Accordingly, we intend to consider an approach to be used in place of that policy statement for such utilities. We are, however, unwilling to have basic rate increases go into effect on just one days notice, and we will deny such request.

Municipally Owned Networks

The White Paper provided:

> We are not aware of any significant developments for the provision of municipally owned wire/wireless networks in New York. We agree . . . that such networks would unfairly tilt the playing field against incumbents which have to pay taxes and incur higher financing costs.[235]

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[233] White Paper, p. 111.

[234] Statement of Policy on Test Periods in Major Rate Proceedings, 17 NY PSC 25-R (1977).

[235] White Paper, p. 88.

Frontier of Rochester notes that there are in fact significant development efforts for such networks, citing, for example, the town of Canandaigua.[236]

We concur with the White Paper's view and the views of a number of parties regarding municipally-owned telecommunication systems. Such competitors have unfair advantages over the incumbent competitors, given their tax and financing status. Further, such systems constrain market development and the provision of new services and choices to consumers, a result that is not in the public interest, although, under certain circumstances (such as communities where the deployment of broadband is unlikely for several years) they could be justified. As a general policy matter we subscribe to the principle that government should support, rather than enter, a competitive market.[237]

We direct Staff to consider how municipalities that are underserved may be better served consistent with our goals of not undermining the competitive market.

Convergence Matrix

In its comments, Verizon asks that we define how the streamlining proposed in the convergence matrix attached to the White Paper is to take place. Cablevision and others recommend a new proceeding. Frontier of Rochester asks that we address in that review the continuing need to survey customers to determine whether to extend Extended Area Service (EAS[238]) areas. Frontier of Rochester argues that these polling requirements are a vestige of an older market. It notes that many providers already offer low cost flat rate nation-wide calling which renders EAS areas and the associated balloting irrelevant.

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[236] Frontier's comments, p. 24.

[237] A recent study on municipal broadband suggests a similar approach (See Municipal Broadband: Digging Beneath the Surface, Balhoff & Rowe, LLC, September 2005).

[238] Extended Area Service (EAS) is a service feature in which a user pays a higher flat rate to obtain wider geographical coverage without paying per-call charges for calls outside the users local calling area. To qualify for EAS, all routes (exchanges) which have a minimum call rate of 3.0 Customer Calls Per Month (CCM) in any direction and also have 50% of the customers making at least one call to the desired exchange. Once determined eligible, a simple majority of responding customers must vote affirmatively for the new routes to be established.

As previously noted, we intend to immediately commence a proceeding to examine changes to our rules. In addition to the matters discussed in Staff's convergence matrix and otherwise discussed herein, the Extended Area Service surveying requirements referenced by Frontier of Rochester should also be considered for streamlining or elimination.

Conclusion

Consistent with the principle that regulation should reflect market conditions, we find that the method we use to regulate telephone corporations needs to change to reflect the environment in which they now operate. It is clear that Verizon and Frontier are under sufficient competitive pressure to obviate legacy cost-of-service regulation,and that approach is increasingly questionable for the other telephone corporations as well. This policy statement and order is our response to those developments.

Therefore, we will require that incumbents continue to offer a "basic service" and that such service should continue to be subject to a regulated cap. To better align basic rates with underlying costs and realign the balance between customers who benefit from choice and incumbents, some of whom are experiencing sub-par financial results, this order authorizes increases for basic rates. The access line charge of the message rate offering will be allowed to increase up to $2 in year 1 and an additional $2 in year 2. We also allow Verizon's flat rate service to increase up to a cap of $23, but limit any increase in the charge to $2 ($2 x 12 = $24 per year total increase). Verizon and Frontier of Rochester shall be allowed to retain the increase in revenues. We estimate that if the full basic rate increase were implemented by Verizon and Frontier of Rochester, the revenue increases in year 1 would be approximately 1.25% for Verizon and 1.29% for Frontier of Rochester. Assuming the basic service rate flexibility is fully implemented, Verizon's intrastate revenues would increase by 2.44% and Frontier of Rochester's intrastate revenues would increase by 5.55%. In order to mitigate rate and revenue impacts, Frontier will be allowed such increases for two years, at which point it must demonstrate to our satisfaction that continued relief is warranted. Verizon and

Frontier will be allowed to retain the increase in revenues. We require that any increases by the independent incumbents be offset by access charge decreases, unless they can make individual showings to support a net revenue increase request.

For services other than basic services, with a few minor exceptions, we grant Verizon-NY and Frontier of Rochester unlimited flexibility, subject to service territory price uniformity to protect customers in non-competitive areas.

These actions are consistent with our long-standing commitment to rely on competition, where feasible, as the most efficient way of achieving just and reasonable rates. It also takes a significant step toward treating providers in like circumstances similarly.

We also find that it is appropriate to modify and streamline our service quality and consumer protection regulations applicable to telephone companies. We are commencing a proceeding to accomplish this objective and authorize the Secretary to the Commission to initiate process steps as appropriate to expedite this process. We will also continue to examine the issues discussed in the foregoing order in the universal service (possibility of expanding assessment base for the Targeted Affordability Fund), service quality (including the development of improved major network outage reporting and an Annual Report of Network Reliability) and consumer protection (including the development of a consumer report to assist customer's ability to make informed choices and methods for making chatline blocking more effective) sections and we will continue to monitor wholesale service pricing and quality as explained in the level playing field section. A proceeding to re-examine pole attachment rates is also being commenced to ensure these rates are properly aligned in the current competitive environment. We will also examine how municipalities that are not served well in terms of advanced telecommunications can be better served consistent with our goal of not undermining the competitive market. Finally, Staff will continue to evaluate the competitiveness of the market and will report back to the Commission in a year.

The Commission orders:

1. The policy framework described in the body of this order is adopted for our regulation of local exchange companies during the transition to a fully competitive local exchange market.

2. Local exchange companies are authorized to file tariff amendments designed to effectuate a residential basic rate rebalancing transition plan consistent with the requirements and limitations described in the foregoing order. Any such filings shall be effective on not less than 30 days notice and shall be served on all entities commenting on the staff White Paper in this proceeding. Such entities may file comments on the local exchange company filings with the Secretary (an original and five copies) within two weeks of the date they are served with the filing from the local exchange company.

3. Verizon New York Inc. and Frontier Telephone of Rochester are authorized to file tariffs to effectuate residential non-basic price flexibility consistent with the requirements and the limitations described in the foregoing order. Such filings shall be effective on not less than 30 days notice and shall be filed on all entities commenting on the staff White Paper in this proceeding. Such entities may file comments on the local exchange company filings with the Secretary (an original and five copies) within two weeks of the date they are served with the filing from the local exchange company.

4. The Secretary is authorized to take such steps as are necessary and appropriate to effectuate the Commission's objectives in the foregoing order.

5. This proceeding is closed.

By the Commission,

(SIGNED) JACLYN A. BRILLING
Secretary

PARTIES COMMENTING TO JUNE 29, 2005 ORDER

1. Attorney General of the State of New York (DOL)
2. AT&T Communications of New York, Inc. ACC Corp., TC Systems, Inc., Teleport Communications Group, Inc. and Teleport Communications of New York, Inc. (AT&T)
3. Cable Telecommunications Association of New York, Inc. (CTANY)
4. Cablevision Systems Corporation (Cablevision)
5. Cingular Wireless, LLC (Cingular)
6. Committee on Corporations, Authorities and Commissions (Assembly Standing Committee)
7. Consumer Protection Board (CPB)
8. Conversent Communications of New York, LLC (Conversent)
9. Communications Workers of America AFL-CIO (CWA)
10. First Avenue Networks, Inc. (First Avenue)
11. Frontier Telephone of Rochester, Inc., Citizens Telecommunications Company of New York, Inc., Frontier Communications of New York, Inc., Frontier Communications of Sylvan Lake, Inc., Frontier Communications of AuSable Valley, Inc., Frontier Communications of Seneca-Gorham, Inc. and Ogden Telephone Company (Frontier)
12. Broadview Networks, Inc., BridgeCom International, XO, Communications, Inc. and CTC Communications (Joint CLECs)
13. CompTel, Covad Communications, Gillette Global Network d/b/a Eureka Networks, A.R.C. Networks, Inc. d/b/a InfoHighway Communications, Intelecom Solutions, Inc. and Transbeam (CompTel)
14. Dr. Kevin Bronner (Dr. Bronner)
15. New York Coalition of Rural Independent Telephone Companies (Rural Telephone Companies)
16. Nextel Partners of Upstate New York (Nextel Partners)
17. New York State Telecommunications Association (NYSTA)
18. Omnipoint Communications Inc. d/b/a T-Mobile (T-Mobile)
19. Plug Power
20. Public Utility Law Project (PULP)
21. Sprint Communications Company, LP and Sprint Spectrum d/b/a Sprint PCS (Sprint)
22. The U.S. Department of Defense and all Other Federal Agencies (DOD/FEA)
23. Time Warner Telecom – NY (Time Warner)
24. United Online, Inc. (United)
25. USDataNet Corp d/b/a USA DataNet (DataNet)
26. Verizon New York, Inc. (Verizon)
27. Verizon Wireless
28. Vonage Holdings Corporation (Vonage)
29. WilTel Communications (WilTel)

PARTIES COMMENTING TO STAFF WHITE PAPER

1. Attorney General
2. AT&T
3. Bestweb CLEC, Ltd (Bestweb)
4. CTANY
5. Cablevision
6. Cingular Wireless
7. Assembly Standing Committee
8. CPB
9. Joint CLECs[239]
10. CWA
11. Farm Bureau
12. Frontier
13. CompTel
14. Dr. Bronner
15. Rural Telephone Companies
16. Nextel Partners
17. City of New York
18. NYSTA
19. T-Mobile
20. Plug Power
21. PULP
22. Qwest Communications Corporation (Qwest)
23. Sprint
24. DOD
25. Time Warner
26. Verizon
27. WilTel

[239] The Joint CLECs responding to the Staff White Paper were Conversent, Broadview, BridgeCom, XO and CTC. As indicated on page 1 of this Appendix, Conversent had submitted individual comments in response to the June 29, 2005 Order.