ALLEGHENY INSTITUTE FOR PUBLIC POLICY

HUNG UP: THREE YEARS IS TOO LONG FOR PENNSYLVANIA TO WAIT FOR LOCAL PHONE COMPETITION

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TABLE OF CONTENTS

KEY FINDINGS

- Three years after the passage of the Telecommunications Act, which was intended to bring competition to the local telephone market, effective monopoly control of local telephone continues in Pennsylvania.

- When a Pennsylvania consumer picks up the telephone to make a call, chances are they are doing business with the only choice available to them. This is true regardless of what part of the state they live in.

- Incumbent local service providers have a lock on local telephone lines, holding 8.1 million or 97 percent of all access lines in Pennsylvania. Incumbents control 93 percent of the access lines that serve businesses and 99 percent of the access lines that serve residences.

- The remaining 3 percent of lines are held by competitors. They hold 7 percent of the business access lines and less than 1 percent of residential lines.

- Incumbents vary widely in size. Pennsylvania's largest incumbent company, Bell Atlantic-Pennsylvania, controls 76 percent of phone lines. The next largest incumbent GTE North, holds 7 percent.

- Data for the 5 largest competitive providers show that the minimal penetration into the local telephone market has been mildly concentrated in urban areas in the eastern part of the state.

- In order to bring meaningful customer choice to Pennsylvania's phone users, the legislature or the Public Utility Commission must compel the incumbent providers to make their own network elements available to competitor at economically based rental rates. Regulators must also ensure that non-price lease terms do not deter competitive entry into the market.

INTRODUCTION

The purpose of this research is to examine the current state of incumbent control and competitive penetration into the local telephone market in Pennsylvania. Under the auspices of the Telecommunications Act of 1996, incumbent companies were directed to open their local markets to competition and allow for consumer choice of local provider. This goal has yet to be attained in large measure in the state. This research attempts to document the progress of local telephone competition so that the next logical steps toward arriving at competition will be clear.

This paper begins with a brief background on local telephone policy and the reasons why the requirements of Telecommunications Act of 1996 (referred to as the Telecom Act herein) have yet to be fulfilled. An examination of access lines and competitive entry follows. The paper concludes with recommendations to ensure full and free competition and choice in the local telephone market.

PUBLIC POLICY TOWARDS LOCAL TELEPHONE, 1984-1996

The terms "monopoly" and "telephone" have gone together for some time. No real curtailment of the monopoly occurred until 15 years ago. In 1984, an antitrust judgment in United States v. American Telephone and Telegraph led to the breakup of the monolith known as "Ma Bell". The company was separated into the long-distance and equipment manufacturing arm of AT&T, and seven regional providers of local telephone service, the "baby Bells". Since that ruling, AT&T has had to compete in the lucrative long distance market with MCI and Sprint, while the Bells have lived a quiet existence as regulated monopolies.

As the telecommunications industry moved toward a "packaged" future in which data, voice, and other technologies would come together through one provider, mergers became the primary means of survival, and, consequently, of competing. The Bells were no exception: after years of providing local service, they too desired to enter the more lucrative long distance market. Long distance providers sought to reach local customers without having to work through the Bell's infrastructure. The solution to this situation?: The Telecom Act of 1996.

THE TELECOM ACT OF 1996

The goal of the act was fairly straightforward: competition was to be achieved in all sectors of the telecommunications industry. In regards to local telephone, local incumbent providers (such as the Bells) had to satisfy a 14-point checklist that proved their local market was open to competition. Once this checklist was approved, the incumbents would be free to enter long-distance. Regulators, both at the state and federal level, would have the final say on the competitiveness of the market. Three years after the passage of the act, no incumbent local provider has entered long distance service.

The Lack of Competition

The Telecom Act provided three means by which competitive local exchange providers (CLECs) could reach customers served by incumbent local exchange providers (ILECs):

- Competitors could resell local service as part of their service package;
- Competitors could lease parts of the incumbent's network (unbundled network elements) and use them in combination with their own network;
- Competitors could construct their own network to reach customers.

To date, these methods have yet to produce a reliable and accessible alternative in local telephone. Incumbents still have a stronghold on the local market for three reasons.

First, the rates by which competitors lease unbundled network elements are high, and, therefore, are cost prohibitive. State regulators have yet to set a "fair" lease rate, and until this is resolved, large scale penetration into the infrastructure will not occur.

Second, incumbents are providers of "the last resort" and function under requirements to provide communications to all customers. This is referred to as "universal service" in industry jargon. Incumbents feel that competitors should live under these requirements and target all areas and all customers, including "high cost" ones, such as rural locales. The disagreement on this point has retarded competitive entry as well.

Third, the discrepancy between business and residential rates leads to an accusation of "cream skimming" by incumbents. Building upon the universal service argument, incumbents accuse competitors of targeting the high volume business customers while forsaking the residential consumers. Due to a system of complicated cross-subsidies, residential rates are kept low in order to maintain affordability. Thus, the rational actions of competitors are construed as a "get rich quick" scheme that deprives home-owners of choice in local telephone.

These seemingly theoretical arguments have significant practical ramifications, for the failure to resolve them leads to lingering questions of requirements and obligations on the parts of both incumbents and competitors. These unresolved issues have produced a stagnation of choice in local telephone in Pennsylvania and elsewhere.

The remainder of this research deals with local telephone competition in Pennsylvania. First, the methodology of the research is presented. Then, data on incumbents and competitors is displayed in order to measure the degree to which competition has progressed. Lastly, recommendations are made to help achieve a free market model of local telephone service.

METHODOLOGY

The data presented in this analysis was collected in large part from the Pennsylvania Public Utility Commission, the body charged with regulating utilities in the state. The data includes a summary of All Local Exchange Access Lines, both incumbent and competitive, sorted by company. This data was collected and assembled prior to December of 1998. Another piece of information from the Utility Commission is a listing of all tariffed exchange companies registered with the Commission, and a list of approved interconnection agreements (agreements that provide competitive access to incumbent networks).

Analysis of competitive penetration in Pennsylvania was provided by an examination of a survey conducted by Atlantic ACM titled "An Analysis of Local Switched Services Market Share Year End 1998 in the Bell Atlantic-Pennsylvania Region". This survey of 39 CLECs provided insight into the degree of competitive entry into incumbent markets.

Lastly, the five largest CLECs, (by business and residential access lines) were examined to produce a portrait of where the bulk of competition is taking place. This was done for two reasons: one, to prove or disprove the incumbent claim that competitors only target high-density areas, and two, to see where Pennsylvanians can choose their local provider.

MARKET SHARE--INCUMBENT LOCAL EXCHANGE CARRIERS

Control of the local telephone market by incumbent providers is as strong, if not stronger, in Pennsylvania as it is in every other state. The market share of dominant incumbents may be part of the reason why mergers, such as the proposed Bell-GTE merger, lead to charges of anti-competitiveness.

As of the end of 1998, the number of access lines serving businesses in Pennsylvania totaled 2,733,210. Of this total, incumbent providers held 2,545,541, 93 percent of all business access lines. The figures on residential access lines were even more staggering. The total number of residential access lines was 5,591,155. Incumbents controlled 5,582,533 residential access lines, or 99 percent of the entire market. For total lines, incumbents controlled a combined 8,127,984 or 97 percent of the 8,324,275 access lines.

INCUMBENT CONTROL OF ACCESS LINES-
YEAR END, 1998

Type of Company	# of Business Lines	# of Residential Lines	Total
Incumbent	2,545,541 (93%)	5,582,533 (99%)	8,127,984 (97%)
Total Lines in Pennsylvania	2,733,210	5,591,155	8,324,275

Within incumbent providers there were large discrepancies in the number of access lines controlled by company. For example, the largest incumbent, Bell Atlantic-Pennsylvania, held 2,097,925 business access lines and 4,159,621 residential lines. That was 76 percent of all the access lines in the state held by incumbents. The next largest incumbent, GTE, trailed far behind Bell with 7 percent of the market. That left 17 percent of the remaining incumbent market to 37 other companies.

The incumbent stronghold in Pennsylvania is perpetuated by all of the unresolved issues discussed earlier in the piece. Until lease rates are reasonably priced and universal service requirements are clearly defined, incumbents will control the local market to the detriment of competitive entry and consumer choice.

MARKET SHARE--COMPETITIVE LOCAL EXCHANGE CARRIERS

The alternative to incumbent control of the local telephone market is made possible through the selection of a competitive provider, or CLEC. The problem is that competitors have been prevented from making inroads into the local telephone market. As discussed earlier, lease rates to competitors to connect into the infrastructure need to be reduced in order to make competition feasible. Also, the requirements of universal service and extension into "high cost" areas must be clearly defined to ensure that all customers get the best service and there is no "digital divide".

Given the numbers on incumbents, it should be clear that the degree of entry by competitors is miniscule. As of the end of 1998, of the 2,733,210 access lines to businesses, competitors serviced 187,669, or 7 percent of the total. Competitors' share of residential lines was even smaller; they held 8,622, or 1 percent, of the 5,591,155 residential access lines. When totaled, competitors served 196,291 of the 8,324,275 access lines in Pennsylvania. This totaled 3 percent of the entire market.

**COMPETITIVE CONTROL OF ACCESS LINES-
YEAR END, 1998**

Type of Company	# of Business Lines	# of Residential Lines	Total
Competitor	187,669 (7%)	8,622 (1%)	196,291 (3%)
Total Lines in Pennsylvania	2,733,210	5,591,155	8,324,275

Competitive Entry by Region

The next step in our research was to regionalize the competitors in Pennsylvania. We took the five largest competitors, measured by residential and business access lines, found out where they operated, and calculated their hold on the market.

The five largest business competitors held a combined 180,188 access lines. This represented 96 percent of the total amount of business access lines held by all CLECs.

The five largest residential competitors held 7,881 access lines, or 91 percent of all CLEC access lines to residences. This hold by the top five companies still averaged about 1 percent of all ILEC access lines.

These competitors are currently operating primarily in the eastern part of Pennsylvania in areas such as Philadelphia, Scranton, Allentown, and Lancaster. Western Pennsylvania has largely been insulated from these competitive efforts. Three of the CLECs operate anywhere in Bell of Pennsylvania territory, most likely the result of their resale of Bell's local service to their customers.

REGIONAL COMPETITION

5 LARGEST COMPETITORS BY BUSINESS ACCESS LINES

COMPANY	# OF ACCESS LINES	AREAS OF OPERATION IN PA
TCG	62,123	Anywhere in Bell of Pennsylvania Territory
CTSI	37,488	Wilkes-Barre, Scranton, Lancaster, Reading, Harrisburg
Adelphia Business Solutions	29,732	Pittsburgh, State College, Coudersport, Altoona, York, Lancaster, Allentown, Philadelphia, Erie, Scranton
ATX	29,108	Anywhere in Bell of Pennsylvania Territory
Nextlink	21,737	Harrisburg, Allentown, Lancaster, Scranton, Philadelphia

Total # of Access Lines for 5 largest companies = 180,188
Total # of Access Lines for all CLECs = 187,669
Total # of Access Lines for all ILECs = 2,545,451
Represents 96% of entire share of all CLEC access lines
Represents 7% of entire share of all ILEC access lines

5 LARGEST COMPETITORS BY RESIDENTIAL ACCESS LINES

COMPANY	# OF ACCESS LINES	AREAS OF OPERATION IN PA
Cellular Rentals	3,555	Johnstown, Harrisburg, Scranton, Philadelphia
CTSI	3,481	Wilkes-Barre, Scranton, Lancaster, Reading, Harrisburg
Full Service Computing Co.	332	Anywhere in Bell of Pennsylvania Territory
Conestoga Telephone	288	Douglasville, Boyertown, Lyons, Birdsboro
ATX	225	Anywhere in Bell of Pennsylvania Territory

Total # of Access Lines for 5 largest companies = 7,881
Total # of Access Lines for all CLECs = 8,622
Total # of Access Lines for all ILECs = 5,582,533
Represents 91% of entire share of all CLEC access lines
Represents 1% of entire share of all ILEC access lines

Source: Pennsylvania Public Utility Commission. Data shown was recorded as of 12/31/98

The Atlantic-ACM Survey

In 1998, a survey of CLECs was conducted by Atlantic-ACM, a consulting firm based in Boston. 39 competitors that resell Bell service or who are certified with the Utility Commission responded to the survey. The most notable findings of that survey included:

- Penetration of responding CLECs has been limited to a total of 39,685 customers;
- The number of certified CLECs has increased by 14 since 1997;
- Bell Atlantic-Pennsylvania owns 468, or 95 percent of the operational switches in its territory;
- CLEC share of access lines increased 2 percent from March, 1997 to December, 1998.

Obviously, the competitive entry into the local telephone market has not grown at the rate envisioned by the Telecom Act. Incumbent companies have jealously protected their infrastructure and have denied competitors the opportunity to access at a reasonable fee. This has perpetuated the discrepancy between incumbent and competitive control in the local telephone market.

RECOMMENDATIONS

In order to ensure a competitive system in local telephone, a few changes need to be made. First, lease rates need to be reduced so competitors can lease access to the incumbent network at a reasonable cost.

Second, unresolved issues of universal service definition and the disparity between residential and business rates must be addressed so that phone service reflects the true cost of its delivery and allows market forces to work properly.