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May 31, 2005

Honorable Jennifer M. Granholm
Governor of Michigan

Honorable Members of the Senate Technology and Energy Committee
Secretary of the Senate

Honorable Members of the House of Representatives Energy and Technology Committee
Clerk of the House of Representatives

The enclosed annual report, *Status of Telecommunications Competition in Michigan*, is submitted on behalf of the Michigan Public Service Commission in accordance with Section 103 of the Michigan Telecommunications Act as amended in July of 2000. This report will be available on the Commission website at www.michigan.gov/mpsc.

The purpose of this report is to describe the status of competition in telecommunications service in Michigan, including, but not limited to, the toll and local exchange service markets in the state. This is the fifth report of this nature.

During 2004, competition in the telecommunications market in Michigan has experienced continued growth although it is the smallest increment of growth since our monitoring program began. This indicates that competition in the basic local exchange industry in Michigan is undergoing some changes. The percentage of competitive lines serving customers is now at a 27.5% share. Competition has been fostered with oversight to ensure that competitors are able to obtain the access to needed elements of the incumbent's network without incumbent interference or obstruction. Competition for basic local exchange service in Michigan, however, is mainly based on the competitors using local switching via SBC's unbundled network element platform (UNE-P) to provision customers.

UNE-P accounted for 66% of the competitive lines used to serve customers in 2004. This method of serving customers is in a state of transition as the Federal Communications Commission (FCC) and the courts overturned portions of the FCC's Triennial Review Order, and eliminated the incumbent's obligation to provide UNE-P to the competitors at a regulated price. This transition away from UNE-P is to take place over the next year (12 months from the March 11, 2005 effective date of the FCC order). The Commission is actively participating in the negotiations to transition customers in a timely and efficient manner.

This Commission is very mindful of the effects on the competitors of losing UNE-P at a reasonable price as a way of provisioning customers and it has been very active in an effort to protect and preserve competition in Michigan. This Commission will continue to attempt to balance the interests of incumbents, competitors, and customers while promoting competitive choice in the telecommunications market in Michigan. The Commission will apprise the Governor and the Legislature of any developments that may require action.

Respectfully yours,

MICHIGAN PUBLIC SERVICE COMMISSION



J. Peter Lark, Chairman



Robert B. Nelson, Commissioner



Laura Chappelle, Commissioner

Status of Telecommunications

Competition in Michigan



May 2005

Submitted by:
MICHIGAN PUBLIC SERVICE COMMISSION
Michigan Department of Labor and Economic Growth

In Compliance with
Public Act 179 of 1991 as amended

**Annual Report on the Status of Competition
in Telecommunications Service in Michigan
May 2005**

Section 103 of the Michigan Telecommunications Act (MTA), as amended in July of 2000 (MCL 484.403), directs the Michigan Public Service Commission (Commission) to submit an annual report describing the status of competition in telecommunications service in Michigan, including, but not limited to, the toll and local exchange service markets in the state. The report required under this section shall be submitted to the Governor and the House and Senate standing committees with oversight of telecommunications issues. This is the fifth report filed by the Commission pursuant to Section 103.

Toll Markets

The toll market is commonly referred to as long distance and the providers of such services are referred to as interexchange carriers (IXCs). IXCs that own their own facilities are required to provide very little information to the Commission related to their operations. The Commission does not license IXCs and they are required only to file tariffs with the Commission that are consistent with the provisions of the MTA. IXCs providing toll service via resale¹ are exempt from this tariff filing requirement as well. As a result, there is little information available regarding market share, customer numbers, or revenues for IXCs.

The FCC concluded that detariffing would enhance competition among providers of interstate, domestic and interexchange services, and promote competitive market conditions. In 2001, IXCs began providing service without filing tariffs with the Federal Communications Commission (FCC). They provide information to consumers via other means, such as their websites.

¹ Resale is buying long distance phone lines in quantity at wholesale rates and then selling them to someone else, hopefully at a profit.

In Michigan, there were 10 carriers registered as facilities-based toll carriers for 2004. While the reselling of toll services is unregulated, the Commission had registered 223 carriers as resellers of toll service in Michigan at the end of the first quarter of 2005. This is a self-registration process but it does indicate that there are numerous providers of this service. The Commission's website provides a link for rate comparisons among providers. Additional information is available in the report of the FCC issued on May 6, 2004, [*Trends in Telephone Service*](#). This report indicates that from the end of 1999 to the present, the FCC has approved all the section 271 applications by the Bell Operating Companies (BOCs) to provide in-region interLATA service throughout the United States.² The FCC has chosen to rely on competition, rather than regulation, as much as possible. Thus the FCC forbears from regulating most aspects of long distance service.

Information available to the Commission indicates the same situation as in previous years: that despite an increase in the number of toll providers, the prices of basic toll service have in fact increased in the last several years. Effects of competition continue to be more evident in the number of optional toll package alternatives available, the number of providers who offer them and the declining prices for higher usage customers who do not utilize basic toll rates. Innovative bundling of services and new pricing plans are blurring the distinction between toll and local services. Many providers are offering unlimited local and long distance services, plus unregulated features, at one combined price. In some cases, these bundled services include wireless and internet access services, as well as satellite television.

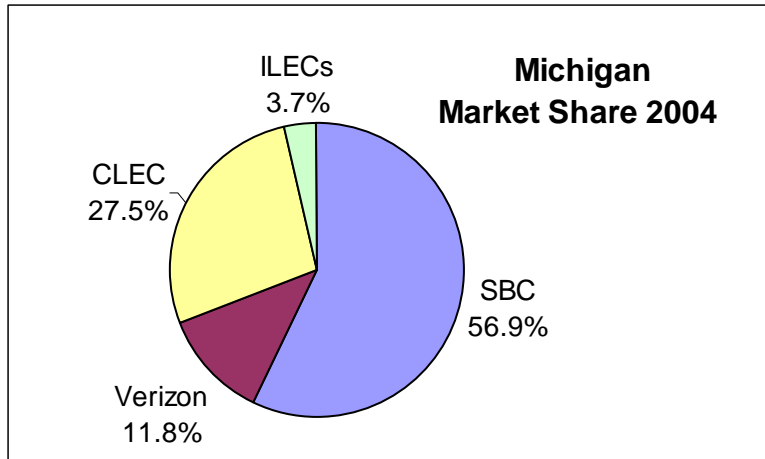
² Section 271 of the Federal Telecommunications Act of 1996 describes the conditions which a Bell Operating Company (BOC) may enter the market to provide interLATA services, long distance in particular, within the region where they operate as the dominant local telephone service provider.

Basic Local Exchange Market

To obtain an accurate picture of the competitive marketplace in Michigan for basic local service, the staff of the Commission has conducted annual surveys of SBC, Verizon and all licensed Competitive Local Exchange Carriers (CLECs) from 1999 – 2004, which include incumbent local exchange carriers (ILECs) that also operate as CLECs in Michigan. CLECs are providers that compete in the same geographic area as ILECs. This year's survey was sent out to 202 CLECs in the state of Michigan that were licensed as of January 1, 2005. The data collected through the survey was for the year ending December 31, 2004. The information was gathered to assist the Commission staff in evaluating the scope of local competition in Michigan.

The survey was developed through a collaborative process set forth in the Commission's order in docket U-12320. This docket was initiated to review SBC's application for authority to provide in-region long distance service pursuant to Section 271 of the Federal Telecommunications Act of 1996. Some of the information requested in the surveys is considered confidential by the companies. The results of most portions of this survey are reported as total CLEC numbers to maintain the confidentiality of the individual company numbers. For 2004, 127 companies of the 202 CLECs that the survey was sent to filed a response, with 77 of those companies reporting that they were actually providing local service.

From the data compiled for 2004, staff found that the number of lines provided by CLECs (including over their own facilities, through UNE-P, UNE-L and through resale of incumbent providers services) was 1,681,173. The staff report indicates that the total number of lines provided in Michigan (ILECs including SBC and CLECs) was 6,103,253. CLEC lines accounted for 27.5% of the total lines. SBC's share is 56.9% (3,473,371 lines) while Verizon's



share is 11.8% (721,193 lines). The small independent telephone companies represent the remaining 3.7% (227,516 lines) of the total lines in Michigan.

The survey responses indicate that the geographic areas

covered by CLEC lines continues to encompass primarily the Detroit, Grand Rapids, Lansing and Saginaw areas with the majority of the competitive lines being provided in the Detroit vicinity. From the data that SBC submitted, 62% of the competitive lines are provided in the Detroit area, 23% of the competitive lines are provided in the Grand Rapids area, 6% of the lines are provided in the Lansing area, 6% of the lines are provided in the Saginaw area, and 3% of the lines are provided in the Upper Peninsula area. It should be noted that virtually all of the CLEC activity is in geographic areas that are served by SBC. As a percent of the SBC market, the CLEC market share is approximately 32.6% of SBC lines.

The Commission continues to license new CLECs, and as of the end of 2004, the CLECs were serving 27.5% of the lines provided to customers by telecommunications carriers in Michigan. This is a marginal increase over the previous year and is the smallest annual increase in the level of competition since the Staff has been conducting the surveys over the last six years for the basic local service market in Michigan. These numbers are consistent with the information represented in an analysis done by the FCC on information gathered through June of 2004. On December 22, 2004, the FCC released its report on [Local Telephone Competition: Status as of June 30, 2004](#). For the Michigan companies that are required to report this data to the FCC, the ILECs reported 4,487,619 lines, and the CLECs reported 1,575,261 for a total of

6,062,886 lines. From the FCC's data, the CLEC share was reported at 26% which is the same percentage as this Commission's reported 2003 year end figure. This data gathered by the FCC is from 7 reporting ILECs and 17 reporting CLECs in Michigan, representing the larger providers and a majority of the lines.

The 2004 Michigan Survey Results Show That:

CLECs With No Lines	50
CLECs 1 – 1,000 Lines	26
CLECs 1,001 – 10,000 Lines	29
CLECs over 10,000 Lines	22
Total CLECs Responding to Survey	127

The preceding chart categorizes the CLECs according to the number of customer lines that they served in 2004. The data indicates that of the 127 CLECs reporting, 50 were serving no customers in 2004 and this represents approximately 40% of the group, while the second group served between 1 line and 1,000 lines, a group of 26 CLECs or almost 20%. The third group served between 1,001 and 10,000 lines each and is comprised of 29 CLECs for a 23% share, and the last group of CLECs served over 10,000 lines each and represents 22 CLECs for a 17% share.

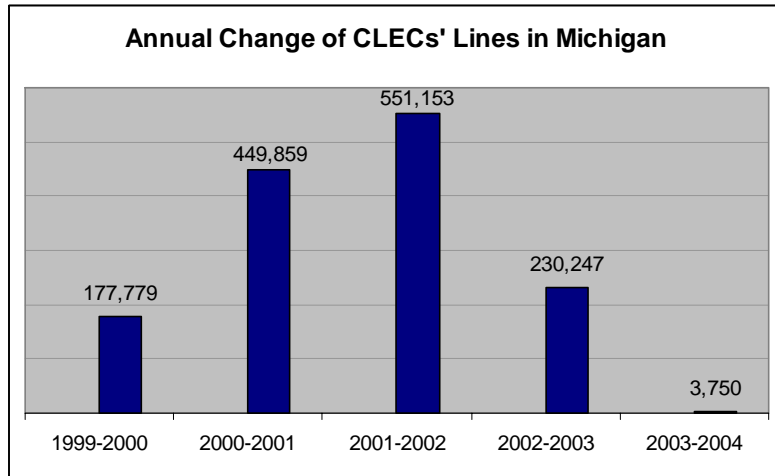
The CLECs that report no line activity represent a number of newly licensed providers that are not yet providing service or they are providing services other than local, like resold long distance. The Commission has a process in place to review any license that is not actively being used over a reasonable period for possible revocation of the license.

A portion of the data gathered by the Commission for the last six years is presented in the following page in a table format.

Michigan Public Service Commission CLEC Survey Results:

	1999	2000	2001	2002	2003	2004
Licensed CLECs	120	167	173	219	192	202
CLECs respond to survey	59	69	102	113	112	127
CLECs with line counts	23	31	42	54	70	77
Lines Provided by CLECs	268,385	446,164	896,023	1,447,176	1,677,423	1,681,173
Total Lines in Michigan	6,726,971	6,901,813	7,014,263	6,668,124	6,334,114	6,103,250
CLEC %	4 %	6.5 %	12.8 %	21.7%	26.5%	27.5%
SBC %	81 %	78 %	72.2 %	62.9%	57.7%	56.9%
Verizon %	11.5 %	12 %	11.5 %	11.9%	11.2%	11.8%
ILECs %	3.5 %	3.5 %	3.5 %	3.6%	4.5%	3.7%

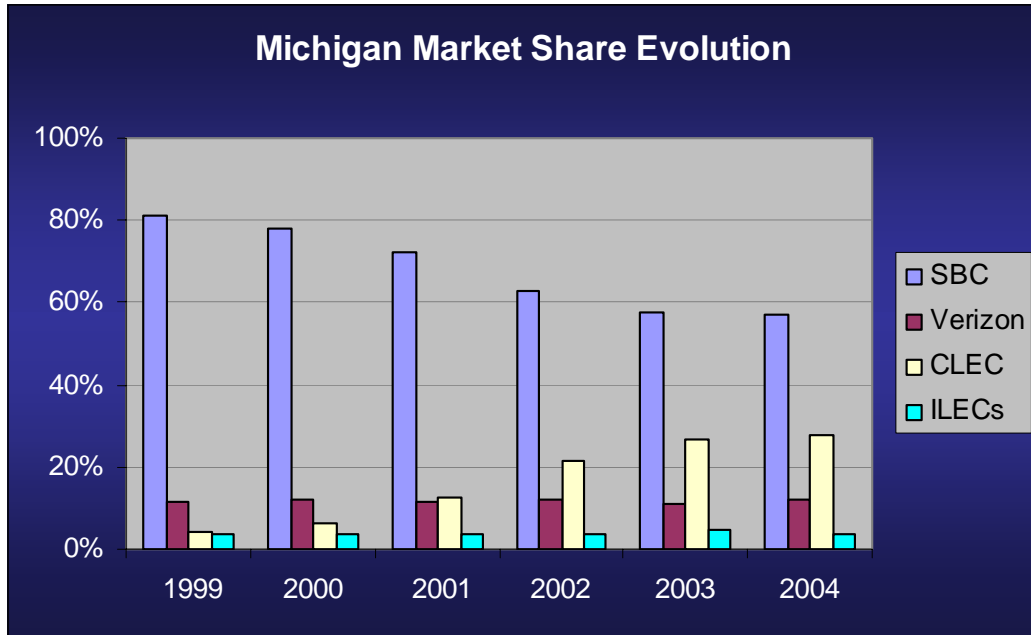
As is shown, while total wireline lines have consistently decreased since 2001, the actual number of CLEC providers and CLEC lines in Michigan has grown over the last six years that this information has been gathered; the CLEC market has grown from a 4% share to a 27.5%



share at the end of 2004. However, for 2004, Michigan is seeing the smallest annual increase since it has conducted the surveys. There was only a gain of 3,750 competitive lines in 2004.

The graphical representation of the evolution of the market share over the last six years is shown on the following page. The chart indicates growth for the CLECs while at the same time declining market share for SBC. The market share for the small ILECs and Verizon remained fairly constant over the survey period. Also of interest is that in 2004, the total number of

customer lines decreased, reflecting a continued loss to wireless and other types of telephony including voice over internet protocol³ (VOIP).



SBC Michigan InterLATA Approval

The FCC granted SBC’s 271 approval to offer interLATA toll service in Michigan on September 17, 2003. Since SBC’s long distance approval was granted late in 2003, the FCC does not at this time have any current data on long distance market share to determine the impact of this approval. In addition, SBC is not required to report this information to the Michigan Commission, so there is no information available to us to review.

Wireless Market

The Michigan Public Service Commission does not regulate wireless providers; however, information gathered by the FCC on the wireless industry pertinent to Michigan from its report on [Local Telephone Competition: Status as of June 30, 2004](#) is included here. The FCC reported that by June 2004, Michigan had 5,430,637 wireless subscribers, an 11% increase from June of

³ The technology used to transmit voice conversations over a data network using the internet protocol.

2003. The FCC reported that nationwide wireless subscribers increased 13% during the 12-month period ending June 30, 2004. The FCC's report also indicated that Michigan had 13 wireless carriers with over 10,000 subscribers each as of June 2004.

New Emerging Technologies

The Commission monitors the development and advancement of new emerging technologies in the broadband area such as VOIP, Wi-Fi⁴ technology, Wi-Max⁵ and broadband over power lines.⁶ The Commission opened an investigation on VOIP on March 16, 2004 and issued an order on April 28, 2005 recommending that the legislature amend the MTA so as to specifically empower the Commission to assess the effect of VOIP service on Michigan citizens. The Commission is in favor of non-intrusive registration mechanisms so that customer complaints can be forwarded to the appropriate companies, and has a level of assurance that citizens have access to enhanced 911 services. The Commission supports emerging technologies introduced into the market, as long as these new technologies do not harm the existing public switched network or its customers. Some of the issues related to VOIP are the impact on the federal universal service fund, 9-1-1 emergency calling capabilities and compensation among providers.

Mergers and Acquisitions

Other areas that will have an impact on competition levels in Michigan involve currently proposed mergers/acquisitions. One is a proposed acquisition whereby AT&T will become a wholly owned subsidiary of SBC. An application was filed with the FCC to transfer control of

⁴ Wi-Fi is a marketing phrase that is short for wireless fidelity. Wi-Fi uses an over-the-air interface between a wireless client and a base station, or between two wireless clients, that is often used to connect computers to the internet in airports, hotels and coffee shops.

⁵ Wi-Max, which stands for Worldwide Interoperability for Microwave Access, can carry data at a potential speed of 70 million bits per second in a radius of up to 31 miles.

⁶ Broadband over power lines refers to technologies for using electric utility companies' power lines to deliver broadband services.

AT&T to SBC and upon acquisition AT&T will become a wholly owned subsidiary of SBC. The FCC is reviewing this application at the present time.

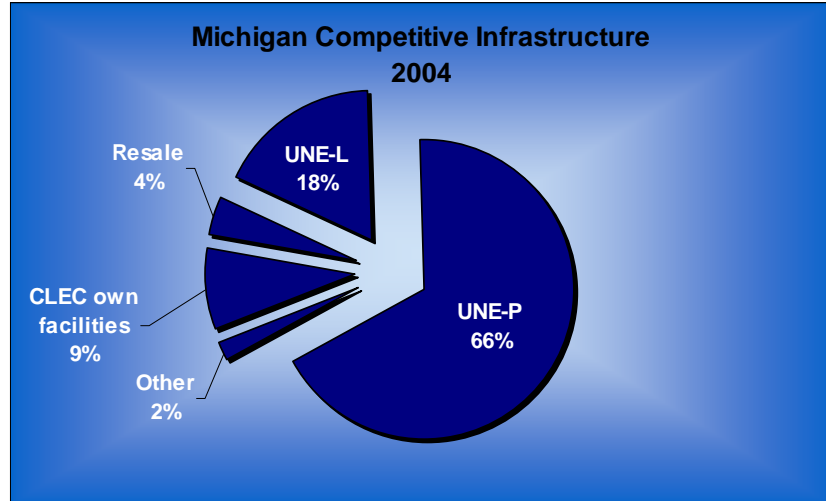
A second proposed merger with Verizon Communications, Inc. and MCI, Inc. has been filed with the FCC. This transfer of control will result from a proposed acquisition whereby MCI will become a wholly-owned subsidiary of Verizon. The filing lists more than a dozen competitors in the large enterprise segment, which it says is the core of MCI's business, and points out that MCI decided last year to exit the mass-market segment, where it previously competed with Verizon on a national level in the telephone company's local markets. This application is under review by the FCC.

This Commission has no regulatory review authority over mergers and acquisitions. If these mergers are approved as most industry sources expect, two of the largest CLECs in Michigan will no longer exist. They will be owned by the two largest incumbents in Michigan, SBC and Verizon.

Conclusion

Based on available data that the Commission has gathered through its surveys over the six-year period, there has been steady and continued growth in the percentage share of CLEC lines in Michigan from a 4% share in 1999 to a 27.5% share in 2004. The slight increase in 2004 indicates that competition in the basic local exchange industry in Michigan is undergoing some changes. Competition has been fostered with oversight to ensure that competitors are able to obtain the access to needed elements of the ILEC network without ILEC interference or obstruction. The process that the Commission has established under the guidelines of the MTA continues to provide a smooth transition of the telecommunications market for basic local exchange service in Michigan to a viable competitive one.

Competition for basic local exchange service in Michigan is based mainly on CLECs using local switching via SBC's unbundled network element platform (UNE-P) to provision customers. UNE-P accounted for 66% of the competitive lines used to serve customers in 2004. This method of serving customers is in a state of transition as the FCC and the courts overturned portions of the FCC's Triennial Review Order (TRO), and eliminated the ILEC's obligation to provide UNE-P to the CLECs at a regulatory price. Thus, effective March 11, 2005, the CLECs are no longer able to obtain UNE-P from the ILECs at



a regulatory price. This is significant because the current competition level in Michigan was predominantly reached through the use of UNE-P provisioning, which accounts for 66% of the competitive market. As a result of the FCC and court actions, it is conceivable that Michigan may see considerably smaller levels of competition in the future. This transition away from UNE-P is to take place over the next year (12 months from the March 11, 2005 effective date of the FCC order). The preceding chart depicts the competitive infrastructure make up in Michigan for 2004.

This Commission will continue to attempt to balance the interests of incumbents, competitors, and customers while promoting competitive choice in the telecommunications market in Michigan.