Whither The "CAPS"?

Presentation given by Bob Annunziata, President, TCG, for Telecommunications Reports' Sixth Annual Conference: "Redefining Local Exchange Competition," on April 8, 1994

June 1994

TCG

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The following is the text from the presentation given by Robert Anrunziata, President of Teleport Communications Group and founder of the Competitive Access Provider ("CAP") industry, for Telecommunications Reports' Sixth Annual Conference: "Redefining Local Exchange Competition," on April 8, 1994. Whither The "CAPS"? was the topic addressed.

Thank you for inviting me to address the topic: "Whither The CAPS?" It is a particularly appropriate theme. This year TCG is celebrating its tenth anniversary. As the oldest "CAP", it's only natural for TCG to look ahead and consider possibilities for the next decade. These possibilities face TCG and the entire "CAP" industry. I'm pleased with the opportunity to share some thoughts with you on what lies ahead.

Let me say right from the start: I am very proud of the fact that TCG is responsible for founding in 1984 what has become known as the "Competitive Access Provider" industry. I'm also proud that TCG has maintained its leadership position throughout a decade of turmoil and change. Finally, I am very proud of all the talented and inventive people who chose to join TCG and achieved so much in what has been ten short years.

**TCG's First Decade Of Success**

- First "Competitive Access Provider"
- Ten Years Later...Largest and Most Successful Competitive Local Carrier

But as I initially said, rather than looking back and reliving the past, let's look ahead.
Tremendous forces are shaping the telecommunications environment. Whether it is technology, regulations or the marketplace, they are changing the "CAP" business and the way TCG must be positioned for the future. TCG will adapt, evolve, grow and remain the industry leader ten years from now. Now, on to the topic of this panel: "...Whither the CAPS?"

My short answer is that "CAPS" are an endangered species. There are compelling reasons to believe that there will be no such thing as a "Competitive Access Provider" five years from now, never mind ten years. For some, this view may seem heretical, and certainly not what you'd expect to hear from me. But that is how our industry's future looks to me as I survey the market, regulatory and legislative changes that are creating a new telecommunications landscape.

Although "CAPS" are endangered, let me hasten to add that TCG and a few of the other companies thought of as "CAPS" are not endangered. Why? They are no longer "CAPS". They are already evolving well beyond merely providing competitive access services, as this chart demonstrates:

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It shouldn't be surprising that "CAPS" (or AAVS, as noted on the chart) are endangered... "CAPS" have been at risk from day one. The simple truth is that a company can't survive on "access services" alone -- private lines, special access lines, the local transport element of switched access -- provided over a few miles of fiber optic cable in a city's central business district.

To be viable in the local telecommunications market, a company must develop a product line as broad as the traditional LECs' -- that means switched services, data services, payphones... you name it -- and serve an entire metropolitan area.

As you can see, TCG is well on its way to matching the LECs' range of services. And our relationships with the leading cable television companies will give us the unique ability to match the LECs' geographic coverage as well.

This chart also demonstrates why "CAPS" are an endangered species:

![Local Telecommunications Services - 1992](chart)

Right now, most "CAPS" play only in the private line / special access market. And after ten years, all the so-called "CAPS" have less than
five percent of that market, or about $250 million. In the early days, the LECs virtually ignored this market. They provided mediocre service at high prices. So being a "CAP" was easy. But at the hint of competition, the giants slowly awoke. They improved their quality, lowered their prices and introduced services that customers wanted. So it isn't so easy being just a "CAP" anymore.

TCG recognized that "CAPS" were endangered nearly five years ago by recognizing that being just a "CAP" was a dead end. We started to branch out into local switched services. And three years ago we began to develop relationships with the leading cable television companies so we could match the LECs geographically.

And I think that other "former CAPS" have also realized that "CAPS" are endangered. Like TCG, they are branching out in different directions. Some, for example, are evolving into long distance carriers. But, if "CAPS" are no longer the future, then what are we now? And where are we going?

My view is that each "former CAP" will take a somewhat different evolutionary path in recognition of the different circumstances each finds itself in; so I can speak only for TCG's future.

TCG will remain focused on the local telecommunications market. But each local telecommunications market is and will be very different. Each geographic area we serve will be shaped by a number of unique environmental factors:

**Local Telecom Market Environmental Factors**

- Incumbent LEC...Good? Bad? Ugly?
- State and Local Regulatory Policies...Encourage Competition? Protect the LEC?
- Market Distribution...Dense and Compact? Multiple Clusters?
- Current LEC Prices...What Is Overpriced? Underpriced?
TCG now operates networks serving 18 metropolitan areas that include more than 150 communities. Each of our networks is different because each of these 18 markets is different. As each TCG network evolves from being a simple CAP, each will become more different. And I want it to be that way. One of our major competitive strengths versus the traditional local telephone companies is our ability to better focus on satisfying the increasingly unique needs of each market and each customer in each market. So I cannot predict the exact course of the evolution of each company or any other "former CAP." But I do expect that each "CAP" network will follow one of two evolutionary paths:

**Evolution Of "CAPS"**

![Diagram](image)

If a local "CAP" is to be a major player in the local telecommunications market, it must evolve into either a National "CAP" (or "NatCAP") or a Competitive LEC (or "CompLEC"). Let me describe each briefly:

### National CAP ("NatCAP")

- Focused on "High End" Business Customers and IXCs
  - Operational Security
  - Strategic Security
- Serving Numerous Local Markets, Nationwide
- Offering Broad Range of Switched and Specialized Services
- Providing Coverage in Each Market
In many ways, a "NatCAP" will be a larger and more sophisticated version of today's "Competitive Access Provider." Like today's "CAPS", a "NatCAP" will focus on providing the operational security and strategic security that a LEC simply cannot provide or cannot provide very well.

I believe that there will be a sustained and growing demand from telecommunications-dependent businesses to obtain a full range of telecommunications services from at least two high quality local carriers in order to obtain the operational security that comes with route, switch and vendor diversity. At the same time, monopoly LECs will create great huge demands for "strategic security" as they continue to expand into the businesses of their largest customers -- the interexchange carriers, information services providers, etc. LECs drive their biggest customers off the LEC networks by competing with them. "NatCAPS" such as TCG will be there to save them.

TCG is already far along the path of evolving all its "CAP" networks into "NatCAP" systems. We have Class 5/access tandem digital switches operating in five networks today and I expect we'll have switches in 12 networks by year-end. And, thanks to our relationship with the cable companies, our ability to match the LECs' geographic scope is expanding rapidly.

If TCG is already a "NatCAP", what is a "Competitive LEC" or "CompLEC"?

**Competitive LEC ("CompLEC")**

- Focuses on Masses of Dissatisfied Consumers
  - Better prices, service, features than LEC

- Same Legal/Regulatory Status as LEC
  - Eligible for same subsidies, privileges as LEC

- But Less Regulated Due To Absence Of Market Power
A Competitive LEC is a "NatCAP" which has the opportunity to serve a much broader range of customers and to compete with the incumbent LEC in almost every market. A "NatCAP" can become a viable Competitive LEC only if the incumbent LEC is badly serving the broad mass of consumers who don't care about "operational security" or "strategic security" and only care about quality service, low prices and a broad range of features and functions.

Serving business? Certainly. Residential? Maybe. It all depends on demand. In other words, good telephone companies have nothing to fear from competition; phone companies providing poor service will find themselves confronting a CompLEC.

This view of the evolutionary future of "CAPS" is consistent with TCG's traditional view about the likelihood of local exchange service competition. For the last three years, we have suggested that there are three principle prerequisites for viable local exchange service competition:

Requirements for Local Telecommunications Competition

- Technical and operational feasibility
  - Interconnections, unbundling
- Legality
  - PUC authorization
- Economic viability
  - Market demand
  - Interconnection costs
  - Universal service

Within the next few months Congress will have a great opportunity to "level" the local telephone exchange service "playing field." They can draw from a decade of TCG's experience to see where the real obstacles to local telephone service competition lie. After years of
regulatory effort, TCG secured improved physical interconnection with the local telephone companies in several areas, including New York, Boston and Chicago.

The physical interconnection provided the basis for recent technical trials between TCG Chicago and Ameritech that demonstrated the viability of seamless switched network interconnections.

The success of the technical trials with Ameritech demonstrated that we could interconnect with any LEC. While the technical aspects are resolved, the question of legality remains: Are "CAPS" legally permitted to provide local telephone service? The answer in most places is "no."

Could legislators correct this? Absolutely. And, in fact, that possibility may emerge from proposed congressional legislation: HR3636 and S1822 which, if passed this year¹, will require unbundled interconnection in all states and pre-empt state and local laws and regulations that prevent local competition.

But legislators and regulators should be on guard: they cannot let the incumbent local telephone monopoly be radically deregulated before the consumer has a choice of local carriers. And the choices must be real... so real, in fact, that a substantial number of customers have actually selected the alternative to the local monopoly.

But there is a third prerequisite that remains to be addressed which dwarfs the first two issues: yes, we have technical feasibility and we may soon have legality. What remains is economic viability.

If the day of the "level playing field" is to arrive, then inflated LEC fees imposed upon local "competitors" must be eliminated. Prices LECs charge "CAPS" for the technical interconnection will have to be cost-based; they cannot be more than the LEC charges itself. The financial terms will have to follow the guidelines drafted by the New York Public Service Commission which in its precedent-setting order set down very basic guidelines for collocation: the terms must be reasonable.

"...inflated LEC fees imposed on local 'competitors' must be eliminated."

¹ On June 28, 1994, The House of Representatives passed HR 3636. It provides for the following for all Local Exchange Carriers: equal access and interconnection, including physical collocation; unbundling; number portability; mutual compensation; imputation; franchise fee parity; a new universal service plan; and tariff filings.
Interconnection Costs Must Be "Reasonable"

The New York Public Service Commission ruled in 1989 that:

"...interconnection must be technically and economically comparable to actual colocation and the terms must be reasonable."

In addition, the concept of Universal Service must not be allowed to be used as an artificial burden that the local telephone companies can employ to hobble local competitors. Competitors are willing to support universal service. What they are unwilling to support is the local telephone company.

The only fair way to handle "Universal Service" in an environment served by multiple local carriers is through:

-- A "Universal Service Assurance" fund administered by an independent, neutral institution to which all carriers contribute
-- And from which all the carriers providing local telecommunications can draw to provide subsidized service.

There must be equal access to the subsidy if CompLECs are to develop and customers are to have choices.

Last year, TCG published a concept paper on Universal Service Assurance which explains in detail how competition and equal access to the subsidy system will improve local telecommunications services for all consumers.

Now, let me turn briefly to the future.

2. Universal Service Assurance: A Concept for Fair Contribution and Equal Access to Subsidies
"...local exchange service may become the orphan stepchild..."

With our strategic partners in the cable industry, TCG will continue to seek markets that are unserved or underserved by the local telcos. And those opportunities can be expected to grow significantly as the LECs go into even more businesses and industries unrelated to their core telephone businesses.

Big as the LECs are, even they cannot sustain simultaneous cash drains abroad, in competitive cable services and video, and other non-basic telco offerings. One possible consequence is that the monopoly local exchange service may become the orphan stepchild of local telco investments. Because LECs are unable to be all things, to all people, all the time, everywhere, perfectly, they will create even greater opportunities for "NatCAPS" and "CompLECs" the farther they remove themselves from the basic local telephone business.

Strategically, the LECs will drive entire industry segments to "NatCAPS" because businesses in these segments will not want to rely upon a competitor for local telecommunications services. TCG will be there, its strategic partnerships with cable companies allowing it to reach more places with larger and more sophisticated networks. And TCG will be rolling out new services from its competitive product pipeline.

Which scenario -- "NatCAP" or "CompLEC" -- will come to pass? I can't tell you.

In areas where the traditional telephone company fully satisfies the mass markets, you'll see a "NatCAP" addressing the significant segments of the business markets which the LEC can't serve well. In other areas where the traditional telephone company ignores the core markets, you'll see "CompLECs."

As the pioneer of the "CAP" industry, TCG has never been able to control its environment. It operates and will continue to operate on those principles that have been time tested and validated for a decade: recognize changes and opportunities and adapt to take advantage of them. So, whither TCG?
· Where the markets are
· Where the regulators allow us to be
· Where the local telephone company attempts to be all things to all people

TCG will go, as it has for the past decade, where opportunities lead it, and where we are allowed to go.

Prophecy is best left to prophets. While no prophet, I do have a perspective based on a decade of experience in the "CAP" industry. My only observation from this vantage point is this: Five years from now, I seriously doubt whether anyone here will be receiving an invitation to a conference about "CAPS." We will have left that term and that status far behind.

What will take its place? Something new, something bigger, something as untried and untested as was the "CAP" industry it replaces.

So, whither the "CAPS"? To paraphrase the victorious Winston Churchill after the Battle of Britain, 'For the 'CAPS' this is not the beginning of the end; it is the end of the beginning.'

Thank you.
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"Whither the CAPS?" is the sixth in TCG's Issue Paper series.

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