**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, DC 20554**

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| In the Matters of | ) | |
| | ) | |
| Business Data Services in an Internet Protocol Environment | ) | WC Docket No. 16-143 |
| Special Access for Price Cap Local Exchange Carriers | ) | WC Docket No. 05-25 |

**COMMENTS OF THE DIGITAL POLICY INSTITUTE AND SUBMISSION OF A REPORT TITLED "BUSINESS DATA SERVICES: IMPLICATIONS OF THE RAPID GROWTH OF CABLE BUSINESS SERVICES"**

For some time the Commission has been addressing – in the above-captioned proceedings – a range of issues relevant to "Business Data Services" ("BDS") and the market into which they are offered to customers. The issues are complex and have been the subject of a wealth of comments and *ex parte* presentations, some of the latter filed recently.

In order to ensure that the FCC's records in these proceedings reflect the latest thinking on some of these issues, the Digital Policy Institute ("DPI") [1] takes this opportunity to submit a newly-completed report on these matters. Authored by Anna-Maria Kovacs and titled "Business Data Services: Implications of the Rapid Growth of Cable Business Services," this report reexamines the state of competition in the BDS market and the status of the cable industry in that market. Among other things, Kovacs suggests that the Commission apply its BDS rules to all of cable, including "best-efforts services." The prior FCC decision in its BDS proceeding that cable best-efforts broadband should not be considered as a competitor to traditional BDS services is bewildering, according to Ms. Kovacs.

A copy of the Kovacs report is submitted with these brief DPI comments.

Respectfully submitted,

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[1] DPI is an independent digital communications research and policy organization established in 2004.

*Regulation in Financial Translation*

# Business Data Services: Implications of the Rapid Growth of Cable Business Services

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# Business Data Services: Implications of the Rapid Growth of Cable Business Services

## Executive summary

As the Federal Communications Commission (FCC) decides on the extent to which business data services (BDS) still need to be regulated, one of the most important trends it must consider is the growing success of cable providers in the business services market. Now that 2016 financials have been reported, it is clear that cable is the fastest growing segment of business services and is very profitable. Cable's strength is particularly striking in the small- and medium-sized business market, where its best-efforts services are taking substantial share from the incumbents (ILECs). Traditional business competitors (CLECs), who are more focused on the enterprise market, are also growing profitably, while the ILECs' business operations shrink.

## Cable business services are growing very rapidly

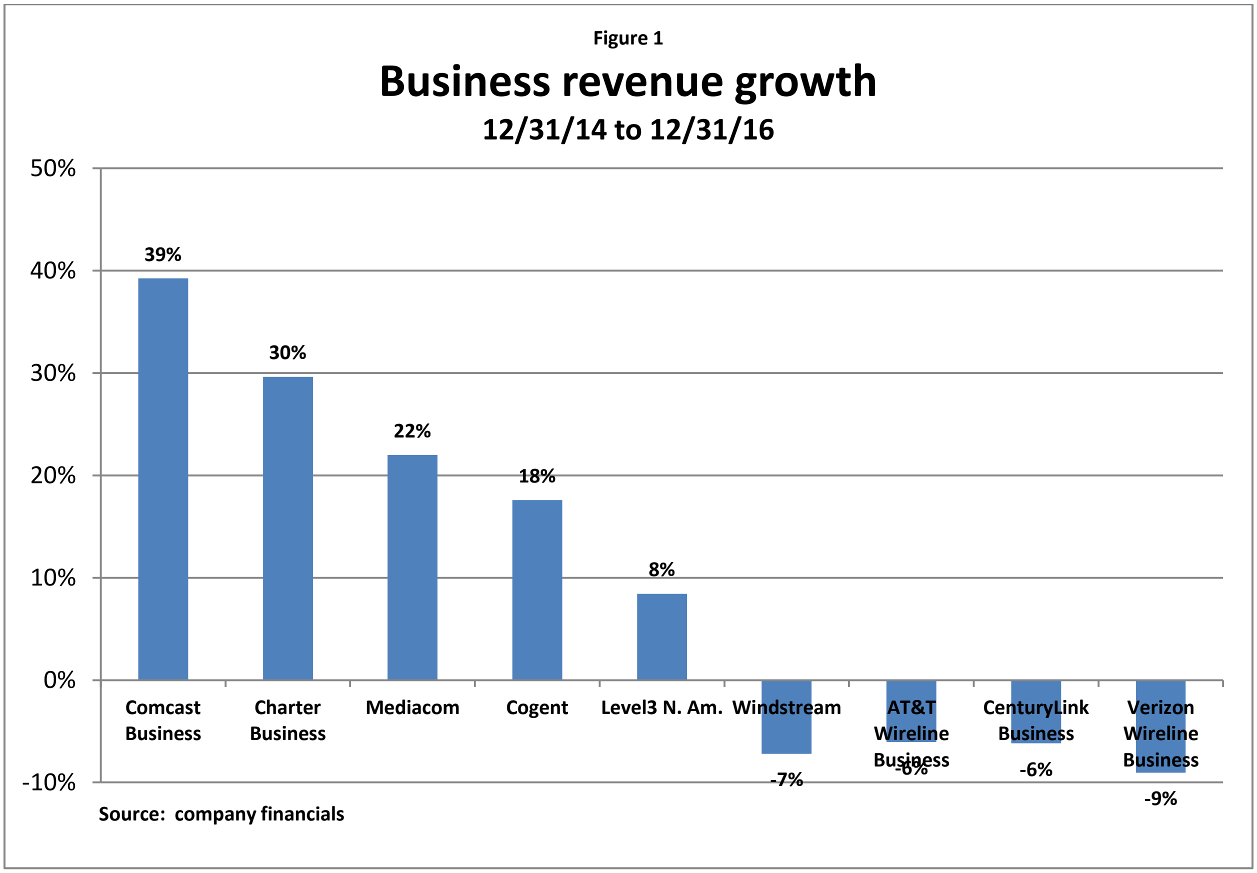
As Figure 1 below shows, in the past two years, Comcast Business grew revenues by 39%, Charter Business by 30% and Mediacom Business by 22%.[1] Indeed, Comcast Business grew revenues by an astounding 70% in the last three years and 182% in the last five years. Mediacom grew revenues by 38% in the last three years. These rates exceed those of the CLECs, but those are also growing. In the last two years, Cogent grew 18% and Level3's North American operations grew 8%. In contrast, during those two years, the business revenues of AT&T and CenturyLink each shrank by 6% and those of Verizon shrank by 9%. Windstream, which combines incumbent and competitive business operations, shrank revenues by 7%.[2]

## Cable has gained 35%-40% market share in the small business market

Cable's impact is particularly striking in the small and medium business markets, where it offers primarily best-efforts options. In 2016, Comcast's revenues from businesses totaled $5.5 billion. Based on details provided by Neil Smit, Comcast Cable's CEO, at the recent Deutsche Bank conference, we estimate that small business amounts to about $3.9 billion, medium business to about $1 billion, and enterprise to about $0.7 billion.[3] He noted that Comcast's share of the small-business market within its footprint is 40%, in the medium-business it is 20% and it is 5% in enterprise, which Comcast entered in late 2015.[4] It is worth noting that Verizon's small business revenue in 2016 was less than half the size of

[1] We limit our discussion to providers whose financial results are publicly available. These growth rates are on a pro-forma basis for acquisitions and divestitures, e.g. the Charter results include those of the acquired Time Warner Cable and Bright House. From the discussion above and Figure 1, we are omitting Zayo's growth, which was 66%, because much of that growth came from acquisitions and we have not found pro-forma comparisons for this period. Similarly, we are omitting Altice and Frontier, for which we have no pro-forma figures before 2015.
[2] Windstream figures are before the Earthlink acquisition.
[3] *Comcast Corporation at Deutsche Bank Media, Internet and Telecom Conference*, Thomson Reuters Transcript, March 6, 2017, p. 7.
[4] Comcast Corporate News, *Comcast Announces New Unit Targeting Fortune 1000 Enterprises*, September 16, 2015.

Comcast's and was shrinking, at $1.65 billion, down from $1.8 billion in 2014.[5] Windstream's small-business revenue, combining its incumbent and competitive operations, was also shrinking, at $0.8 billion in 2016 down from $1 billion in 2014.




Charter's 2016 results show success similar to Comcast's. Charter has roughly $5.4 billion in business revenues, of which it categorizes $3.4 billion as small- and medium-business and $2 billion as enterprise. According to Chairman and CEO Tom Rutledge at the Deutsche Bank conference, Charter's market share in the small and medium business in its footprint "is in the mid-30s" and in enterprise its market share is about 10%. Unlike Verizon and Windstream, Charter grew its small and medium business revenues by 30% from 2014-2016.

## Cable is nearly ubiquitous and very profitable

Rutledge also discussed the advantages of Charter's network: "We have a fully distributed high-capacity network everywhere. We have 700,000 miles of infrastructure out in the streets and byways in front of 50 million homes and businesses."[6] In other words, Charter's network passes most businesses that it

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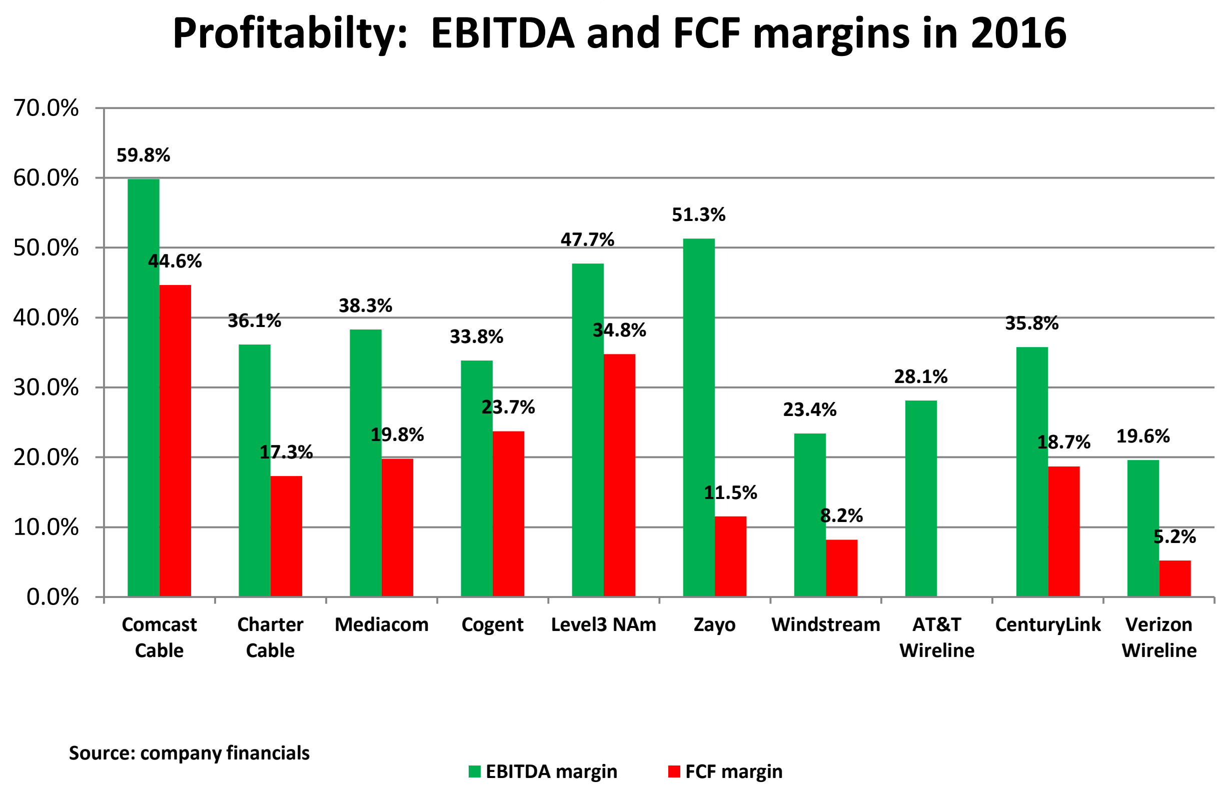
[5] Of the three largest ILECs, only Verizon breaks out its business revenues by customer size.

[6] *Charter Communications at Deutsche Bank Media, Internet and Telecom Conference*, Thomson Reuters Transcript, March 6, 2017, p. 10 and p. 6.

might want to address in its territory.  Comcast passes 56.4 million homes and businesses in its territory.[7]

As we discussed in detail in a paper in March 2016, *Business Broadband:  Assessing the Case for Reregulation*,[8] ubiquity comes at a cost, especially for networks that are losing penetration from the level for which they were engineered.  As of 2013, according to the a report by an economist hired by the FCC,  the ILECs had lost more than half the BDS market, and they have continued to lose share since, as we have shown.[9]  On the consumer side, the ILECs have lost 47% of their voice penetration and have added roughly 33% broadband penetration and very little video penetration.  By contrast, the cable providers are growing their share of the BDS market, have retained almost all of their peak video penetration, and added to that roughly 40% of the consumer voice market and 60% of the consumer broadband market.[10]  As a result, the cable networks are very profitable.

Figure 2

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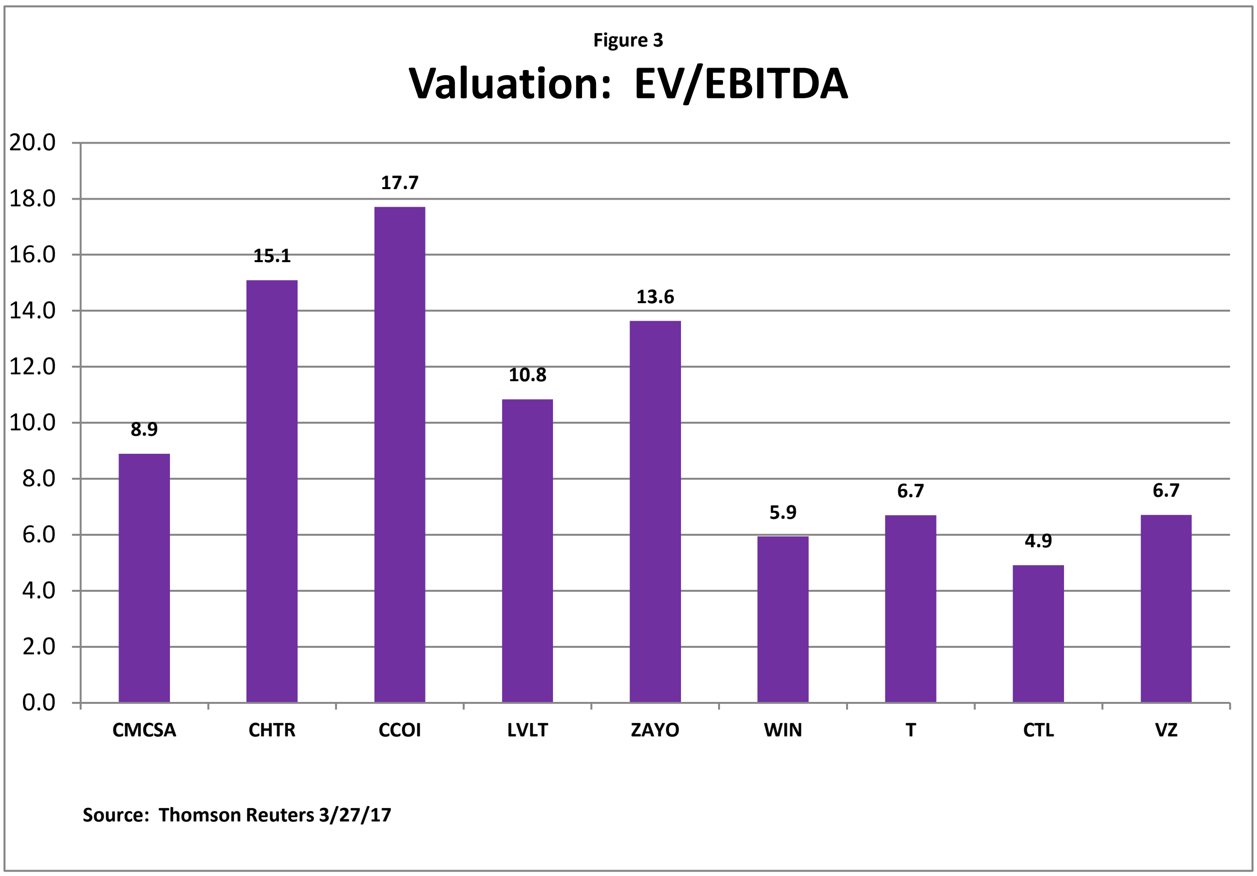
[7] Comcast Corporation, *Trending Schedule, Customer Metrics, Q4 2016*.
[8] It can be found on the website of the Georgetown Center for Business and Public Policy here: http://cbpp.georgetown.edu/sites/cbpp.georgetown.edu/files/Regulation%20in%20Financial%20Transaction%20Business%20Broadband%20Assessing%20the%20Case%20for%20Reregulation%20Kovacs%203.14.16.pdf
[9] Dr. Marc Rysman, *Empirics of Business Data Services*, June 2016, p. 7.
[10] Federal Communications Commission, *Voice Telephone Service:  Status as of December 31, 2015*, November 2016, Figure 2, p. 3 and Federal Communications Commission, *Internet Access Services:  Status as of December 31, 2015*, November 2016, Figure 14, p. 17.  Assumes non-ILEC interconnected VOIP that is not over-the-top and broadband over coax are cable services.

Figure 2 shows the EBITDA (earnings before interest, taxes, depreciation and amortization) and FCF (free cash flow)[11] margins of three cable providers, three ILECs, three CLECS, and one hybrid.[12] For both the cable companies and the ILECs, these are the combined results of their wired consumer and business operations, since that is the most granular level available. The cable EBITDA margins range between Comcast's astoundingly high 59.8% and Charter's 36.1%. The ILEC EBITDA margins range between CenturyLink's 35.8% and Verizon's 19.6%. Particularly notable among the FCF margins are Comcast's 44.6% and Verizon's 5.2%, Verizon's barely more than a tenth of Comcast's FCF margin. In 2016, AT&T did not provide a capex breakdown between wireless and wireline, so we could not derive its 2016 Wireline FCF. In 2015, AT&T's Wireline FCF was 13%, not as disastrous as Verizon's but far lower than any of the cable providers' FCF margins. In practical terms what this means is that Verizon devoted 73% of its 2016 Wireline EBITDA to capital expenditures (capex). The corresponding ratio for Comcast was 25% and for Charter was 36%.

The valuations these companies receive in the stock market reflect profound concern for the ILECs, and great optimism for both CLECs and cable providers, as Figure 3 below shows.[13] A standard measure of valuation is EV/EBITDA, i.e. enterprise value divided by EBITDA.[14] The ILEC valuations range from




[11] In other words, EBITDA = revenue minus cash cost and FCF = EBITDA minus capital expenditures (capex)

[12] While all ILECs have some CLEC operations, Windstream's mix is more heavily weighted to CLEC than the rest, so we characterize it as a hybrid.

[13] We are using the stock symbols to underscore that these valuations are for each company in its entirety, not just for its wireline or business segment.

[14] Enterprise value equals market cap plus debt, i.e. the current value of the company's equity and its debt.

5 times[15] for CenturyLink to 6.8 times for AT&T and Verizon. Cable valuations are substantially higher, with Comcast at 8.9 times and Charter at 15.1 times. The CLEC valuations range from 10.8 times for Level3, which is in the process of merging with CenturyLink (pending regulatory approvals), to 17.9 times for Cogent.

## Best-efforts cable is competing successfully against low-speed ILEC BDS

The cable industry plays an important role in the business market, moving up increasingly from the small and medium business segment to enterprise, while growing rapidly in all those segments. Its near ubiquity gives it access to most businesses, and its strong financials make it a particularly formidable competitor to the ILECs whose legacy business operations are shrinking. That makes the suggestion by the previous FCC[16] that best-efforts cable services might not be considered a BDS service worthy of reconsideration.[17]

It is true that some of the services offered by cable to small and medium businesses are not identical to T1 and T3 services, which offer symmetrical transmission at 1.5 mbps and 45 mbps respectively. However, the cable companies' high market share in the small- and medium-business market shows many businesses are willing to substitute best-efforts cable services for those. Given the pricing differentials, that should not be surprising. Comcast, for example, offers best-efforts Internet at $69.95 for 16 mbps down and 3 mbps up. For customers who do not need service level guarantees, that is an attractive alternative to a T1 which offers only 1.5 mbps in each direction for prices beginning at $179 or $199.[18] For some businesses, at least, Comcast's offer of a best-efforts service that provides 150 mbps down and 20 mbps up for $179.95 per month can replace at T3's 45 mbps in each direction which is offered anywhere from $1,000 to $12,000.[19]

When the two largest cable companies in the U.S. have market shares in the small business market in the 35%-40% range, it is not rational to argue that their best-efforts service should not even be considered as competition to the ILEC TDM[20] services that it is increasingly displacing.

## Summary

The cable industry is competing very successfully in the business market, especially in the small- and medium business segments where it is primarily offering best-efforts services. As the FCC reviews it

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[15] I.e. CenturyLink's enterprise value is 5 times its EBITDA.

[16] Federal Communications Commission, *Tariff Investigation Order and Further Notice of Proposed Rulemaking*, in WC Docket Nos. 16-143, 15-247, &05-25, RM-10593, released May 2, 2016, ¶191. Sprint Corporation, *ex parte*, in WC Docket Nos. 16-143, 15-247, &05-25, RM-10593, March 22, 2017, p. 13.

[17] For a more theoretical discussion of effective competition, see Amanda Delp and John Mayo, The Evolution of "Competition": Lessons for 21st Century Telecommunications Policy, July 22, 2016, which can be found here: http://cbpp.georgetown.edu/sites/cbpp.georgetown.edu/files/Delp-Mayo-Effective-Competition.pdf

[18] Prices quoted on the Comcast Business website, on the Bandwidth Solutions website, and on the Earthlink-Windstream website on March 27, 2017.

[19] Prices quoted on the Comcast Business website, on the T1 Shopper website (for T3), and in the IT Quotes website on March 27, 2017. T1 Websites cites $3,000 to $12,000, while IT Quotes cites $1,000 to $5,000.

[20] Time Division Multiplexing.

regulation of the BDS market, it should take the competitive effect of all cable business offerings—including best-efforts--into account.