Citizens' Utility Ratepayer Board

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Testimony on Behalf of the Citizens' Utility Ratepayer Board
By Steve Rarrick, Staff Attorney
Before the Senate Utility Committee
Re: Senate Bill 72
February 8, 2011

Chairman Apple and Members of the Committee:

Thank you for the opportunity to appear before you this afternoon on behalf of the Citizens' Utility Ratepayer Board (CURB) to testify in opposition to Senate Bill 72. My name is Steve Rarrick and I am an attorney with CURB.

CURB opposes Senate Bill 72 for the following reasons:

- The Kansas Corporation Commission's 2011 Report to the Kansas Legislature on Price Deregulation does not support further deregulation in Kansas, but instead questions the effectiveness of competition in deregulated exchanges and recommends that the Legislature consider remedial steps for exchanges that exceed the statewide, weighted average rate adjusted for inflation comparison;
- The bill price deregulates small rural exchanges without any showing of competition, simply because the majority of AT&T's access lines have been price deregulated in its larger exchanges;
- The bill eliminates the existing annual price increase cap for residential and small business basic local service tied to the consumer price index;
- The bill eliminates the exchange-wide pricing requirement for deregulated exchanges;
- The bill abandons Kansas and federal universal service goals by eliminating the carrier of last resort obligation, yet still allows AT&T to receive universal service subsidies from the KUSF;
- The bill places Lifeline, low income, and elderly customers at risk for any resulting price increases;
- The bill contains a temporary and ineffective price cap for rural exchanges; and
- The bill does not allow the KCC to resume price cap regulation for violations of minimum quality of service standards or changes in the status of competition.

In 2005, AT&T (formerly Southwestern Bell) filed for price deregulation at the Kansas Corporation Commission (KCC or Commission) and the application was fully litigated. Extensive evidence and testimony was presented regarding whether sufficient and sustainable competition existed in the State's three largest exchanges (Kansas City, Topeka, and Wichita) to justify price deregulation. For the majority of AT&T's services, the KCC determined that sufficient and sustainable competition was not present, and declined AT&T's request for price deregulation for the majority of its services, including stand-alone residential and single line business service.

Notwithstanding the KCC's determination, the 2006 Legislature price deregulated the Kansas City, Topeka, and Wichita exchanges (exchanges with over 75,000 access lines) with no evidence of increased competition. In addition, the 2006 legislation changed the rules for price deregulation in all other exchanges, eliminating the requirement of sufficient and sustainable competition for comparable services. To obtain price deregulation, a local carrier must now merely demonstrate that two unaffiliated carriers, one which is facilities-based, provide local service to more than one customer in the exchange.

Under this much lower threshold, AT&T has obtained price deregulation in 59 exchanges, or 44% of its exchanges in Kansas. However, the majority of AT&T's access lines are price deregulated because the majority of the price deregulated exchanges are larger exchanges with more access lines. The remaining 75 AT&T exchanges that have not been price deregulated are small rural exchanges with fewer access lines.

Importantly, the 2006 Legislature included an annual price cap for basic residential service and up to four business lines for small business service based on the consumer price index for urban consumers. The Legislature also required exchange-wide pricing to prevent discriminatory pricing. Both of these provisions provide essential consumer protections for Kansas consumers. The annual price cap is one of the reasons AT&T has not increased its rates any more than $1.00 per line for residential basic local service and $1.75 per line for business basic local service since the 2006 deregulation legislation was enacted in Kansas.[1]

Finally, the 2006 Legislature also required the Commission to annually compare the weighted average rate for basic local service in each price regulated exchange to the weighted, statewide average rate, adjusted for inflation, <u>as an indicator of the effectiveness of competition</u>. The Commission is required to report its findings in a report to the governor and the Legislature prior to February 1st each year. If the Commission finds that the weighted average rate of basic local service in price deregulated exchanges exceeds the weighted statewide average rate of basic local service, adjusted for inflation, or if the Commission believes that changes in state law are warranted due to the status of competition, the Commission shall recommend to the governor and the Legislature such changes in state law as the Commission deems appropriate.[2]

The Commission's 2011 Price Deregulation Report contains significant findings and recommendations that weigh heavily against passage of Senate Bill 72. Rather than support further price deregulation in AT&T's service territory, the Commission's findings and recommendations support resuming price deregulation in exchanges that have been price deregulated. The Commission included in its 2011 Report on Price Deregulation other indicators of competition it examined in its evaluation of the status of competition. The Commission concluded:

> "These indicators reviewed and reported <u>cast doubt on the effectiveness of competition</u>. Thus, the Commission makes the following recommendations to the Legislature:
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> - Change the CPI index utilized in the statute;
> - The Legislature should consider requiring a carrier to resume price cap regulation if the weighted average rate for the price deregulated exchange exceeds the

[1] 2011 Report to the Kansas Legislature on Price Deregulation (2011 Price Deregulation Report), p. 35.
[2] K.S.A. 66-2005 (q)(7); 2011 Price Deregulation Report, p. 9.

inflation-adjusted statewide, weighted average rate for a specified period, such as two, three, or four consecutive years, in the absence of evidence that the carrier has rates in price deregulated exchanges that have increased by an amount equal to or less than the change in the CPI for telecommunications services; and,

- The Legislature should consider including a "Safe Harbor" provision in price deregulated exchanges for those customers subscribing to stand-alone voice service ("basic local service").”[3]

Supporting the Commission’s recommendations were the following findings:

- For the third consecutive year in a row, the weighted average rate in numerous price deregulated exchanges is higher than the inflation adjusted statewide, weighted average rate for the study period (statutory measure of effectiveness of competition).[4]
    - For residential service, the statutory measure of competition fails in thirty-seven of the fifty-eight price deregulated exchanges. (64%).
    - For business service, the statutory measure of competition fails in twenty-six of the forty-nine price deregulated exchanges (53%).[5]
- Most of the price deregulated exchanges resemble a dominant-firm oligopoly market, where one firm dominates the market and many other small firms compete for the remaining fraction of the market. Market share information shows that AT&T is the dominant firm in 79.3 percent of the residential markets and 64.6 percent of the business markets in the price deregulated exchanges. AT&T has greater than 50 percent share of the market and there is no other firm that is a close rival in terms of market share.[6]
- A current Herfindahl-Hirschman Index (HHI) analysis for each of the price deregulated exchanges for both residential and business services exceeds the level considered to be highly concentrated market by the Department of Justice.[7] Any measure over 1,800 is considered highly concentrated, and economic theory links higher market concentration to a greater likelihood of market power. The KCC’s study finds market concentration well above the Department of Justice’s standard indicator for highly concentrated markets, as all price deregulated exchanges had indicators in excess of 3,600 for residential markets and in excess of 3,000 for business markets.[8]
- “Even with an adjustment to account for competition from wireless carriers, it would be difficult to conclude that there is effective competition in any of the deregulated exchanges.”[9]

AT&T seeks to eliminate the remaining critical consumer protections for residential and small business consumers in Kansas that apply to AT&T’s 59 deregulated exchanges and the 75 exchanges that remain price cap regulated. I will address below the critical consumer protections that AT&T seeks to eliminate in SB 72:

[3] Cover letter to 2011 Report on Price Deregulation, pp. 1-2; *see also,* 2011 Report on Price Deregulation, pp. 46-50.
[4] 2011 Report on Price Deregulation, p. 49.
[5] *Id.,* pp. 9-10.
[6] *Id.,* p. 22.
[7] *Id.,* pp. 23-24.
[8] *Id.,* p. 23-26.
[9] *Id.,* p. 46 (emphasis added).

- Senate Bill 72 price deregulates small rural exchanges without any showing of competition. The bill eliminates all pretence of demonstrating the existence of competition in its remaining 75 price capped exchanges to obtain price deregulation, but simply requires that the majority of AT&T's access lines have been price deregulated.
  - The current statutory test for competition is already woefully low (2 alternative carriers serving just 2 customers with one carrier being facilities-based).
  - Rather than concede that competition simply does not exist in these small rural exchanges, AT&T seeks passage of Senate Bill 72 to eliminate any required showing of competition in its remaining 75 rural exchanges to achieve price deregulation;[10] instead, AT&T seeks deregulation of these small exchanges simply because it has achieved deregulation for the majority of its access lines in other larger exchanges.
  - Customers in AT&T's remaining 75 price-capped rural exchanges will find no comfort in learning their exchanges were deregulated under this bill simply because AT&T has met the statutory test for price deregulation in other, larger, exchanges.
  - Unlike current law, Senate Bill 72 doesn't distinguish between residential and business lines, but instead deregulates all services simply because AT&T has achieved price deregulation for the majority of its lines in the State.

- Senate Bill 72 eliminates the existing annual price increase cap for residential and small business basic local service tied to the consumer price index in price deregulated exchanges.[11]
  - This protection was provided to protect seniors, low income, and small business owners who just want basic local service, and has prevented substantial price increases in AT&T's 59 price deregulated exchanges since 2006.
  - Eliminating this annual price increase cap will allow prices for residential and small business basic local service to skyrocket in Kansas as they have in California (22% in 2009, 23% in 2010)[12] and Missouri (47% in the past 3 years) after price deregulation.
  - If the Committee goes forward with this bill, CURB urges you to amend the bill to include the existing annual price increase cap for basic residential and up to four business lines tied to the consumer price index, or the Safe Harbor recommended in the KCC's 2011 Report on Price Deregulation. The current annual price increase cap has prevented AT&T from significantly raising basic local service rates in deregulated exchanges since 2006. If you pass this bill without providing an annual price increase cap, there will be no price protection to Kansas residential and small business customers for basic phone service.

- SB 72 eliminates the exchange-wide uniform pricing requirement for deregulated exchanges. Current law requires AT&T to price uniformly exchange wide, prohibiting different prices for customers with competition and those without competition. This places customers at risk of paying higher prices than similarly situated neighbors. Senate Bill 72 will allow AT&T to charge different rates, use contracts, or attach "term" lengths (and related penalties) to residential customers residing in the same exchange.

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[10] AT&T has been denied price deregulation in several small exchanges because it was unable to demonstrate there were two unaffiliated carriers that served two customers.

[11] K.S.A. 66-2005a(q)(1)(F). CURB sought and supported this cap in deregulated exchanges on annual price increases to basic residential service and up to four business lines – tied to the consumer price index.

[12] Since California deregulated vertical services in 2006, significant price increases have occurred, including price increases of 345% for an unlisted number, 226% for directory assistance, and 85% for call waiting.

- SB 72 abandons Kansas and federal universal service goals by eliminating the carrier of last resort (COLR) obligation in large and medium sized exchanges, yet retains AT&T's right to receive universal service subsidies from the KUSF.
  - The bill eliminates AT&T's obligation to run wireline service to new homes or developments in large and medium[13] exchanges.
  - The provision allowing AT&T to use "any technology" (wireless) to fulfill its COLR obligation for medium sized exchanges through 2014 is ineffective.
    - AT&T can simply offer new or existing customers wireless or VoIP service with the service quality and reliability problems associated with those technologies.
    - The bill is silent as to what price AT&T may charge for the substitute for wireline service. Cell phone rates are typically much higher than landline rates.
    - The bill is silent as to usage limitations. Cell phone service typically limits the number of minutes, where landlines have unlimited local calling.
    - Because AT&T will not be subject to service quality requirements when it uses alternative technology,[14] if the cell phones provided do not provide reasonable voice quality, the consumer will have no remedy at the KCC.
  - The bill does not prohibit AT&T from discontinuing traditional wireline service to existing consumers and offering VoIP or wireless as an alternative.
  - The KCC will have no ability to resume price regulation for quality of service problems with cell phones provided under modified COLR obligation.
  - There is no requirement that the voice service provided by the electing carrier is functionally comparable to wireline circuit switched service. Examples of concerns in this area include:
    - Unlimited local calling. While the monthly charge for the alternative technology voice service may or may not be the same as AT&T's wireline service, the usage charges for calling beyond a designated monthly usage allotment will result in unaffordable rates for some consumers.
    - Actual voice quality problems associated with wireless service. Wireline phone service remains clearer and rarely disconnects.
    - Reliability concerns during times of power outages.
    - Access to 911 services. While 911 services have improved for wireless and VoIP, neither is as reliable as wireline 911 services.
  - If the market is truly competitive and an electing carrier will no longer have carrier of last resort obligations to provide traditional landline voice service, then should that carrier continue to receive any further universal service support? The carrier of last resort responsibility imposed by State law on incumbent carriers is a key justification for continuing universal service support.
  - Why is the modified COLR obligation for medium-sized exchanges eliminated in 2014?
  - Why is it more important to retain the COLR for rural exchanges? Universal service and new construction needs are not different rural vs. urban exchanges – both require build-out to ensure universal service is available to all Kansans.

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[13] AT&T's COLR obligation for medium-sized exchanges (6,000 to 74,999 local access lines) may be met "using any technology that offers voice communications service, and using such alternative technology will not subject the alternative technology, service, or AT&T affiliate to the jurisdiction of the KCC. SB 72, p. 12, lines 45-46, p. 13, lines 1-9.

[14] SB 72, p. 13, lines 7-9.

- Senate Bill 72 places Lifeline, low income, and elderly customers at risk for any resulting price increases. While the bill may still require AT&T to continue to provide Lifeline service, Lifeline customers will be negatively impacted by this legislation because a recent KCC decision changed the way Lifeline is provided. The current Lifeline discount no longer insulates low income customers from price increases,[15] so price increases resulting from this bill will directly impact Lifeline customers, as well as other elderly and low income customers.

- Senate Bill 72 contains a temporary and ineffective price cap for rural exchanges. Providing a three year urban price ceiling for rural exchanges is meaningless.
  - First, without the current annual price increase cap, AT&T will be able to raise the price of basic local service in urban exchanges, which will immediately raise the urban price ceiling for rural exchanges under this provision.
  - Second, why don't exchanges with between 6,000 and 75,000 access lines receive the same urban price ceiling? Are the consumers in Dodge City, Garden City, Hiawatha, Hutchinson, Junction City, Lawrence, Manhattan, McPherson, Salina, and other mid-size exchanges less deserving of the urban exchange price ceiling than rural AT&T exchanges?
  - In addition, why is there no similar price ceiling for small businesses with up to four business lines? Kansas small businesses continue to need and deserve the annual price increase protection provided in current law.
  - The urban price ceiling will not apply to Century Link, which has no urban exchanges.[16]
  - Finally, providing the urban price ceiling good for only three years will leave rural customers without any protection after 2014. If the Committee decides to go forward with this bill, it should amend the bill to include an annual cap on price increases for all basic residential and up to four business lines tied to the consumer price index or the Safe Harbor recommended by the KCC in the 2011 Price Deregulation Report.

- Senate Bill 72 does not allow the KCC to resume price cap regulation for violations of minimum quality of service standards or changes in the status of competition.
  - Current law allows the KCC to resume price cap or rate of return regulation if certain conditions occur, such as violation of minimum quality of service standards[17] or changes in competitive environments.[18] Senate Bill 72 does not include this important consumer safeguard.
  - Should the Committee decide to proceed with the bill, it should be amended to include authority for the KCC to resume price cap regulation for violation of quality of service standards or changes in the status of competition.

We heard yesterday that passage of this bill will lead to more private investment, spur job growth, and lead to the faster development of an advanced communications network. However, I didn't hear of any specific investments that AT&T is committing to. With all due respect, AT&T has a history in this State of making promises regarding infrastructure investment commitments, assuring the Legislature it would fulfill those commitments, then failing to meet the commitments without alerting

[15] In KCC Docket No. 07-GIMT-1353-GIT, the KCC abandoned the "hold harmless" basis for Lifeline support which insulated lifeline customers from rate increases. Under the current "equal credit" approach, Lifeline customers receive the same Lifeline credit (currently $7.77), which leaves them at risk to local rate increases.
[16] SB 72 defines "urban exchange" to "mean any exchange in which there are 75,000 or more local exchange access lines served by all providers." SB 72, p. 14, lines 15-16.
[17] K.S.A. 66-2005(b); K.S.A. 66-2005(q)(5).
[18] K.S.A. 66-2005(r)(

either the KCC or the Legislature.[19] If you intend to support this bill because of AT&T's indication it will invest in Kansas advanced telecommunication infrastructure, I strongly recommend you get specifics of that commitment amended into the bill itself. The only specific investment tied to telephone deregulation mentioned yesterday was the call center in Missouri, which is good in that it created jobs there, but it didn't demonstrate any actual investment in advanced telecommunications infrastructure.

On behalf of CURB, I urge you to vote against passage of Senate Bill 72 in its entirety. However, should the Committee decide to proceed with the bill, CURB urges you to amend the bill to: (1) include an annual cap on price increases for basic residential and up to four business lines tied to a telecommunications market consumer price index or the Safe Harbor recommended by the Commission; (2) include an exchange-wide pricing requirement; (3) require any carrier electing complete deregulation under this bill to decline to receive any further federal and State universal subsidies; and (4) include authority for the KCC to resume price cap regulation for violation of quality of service standards or changes in the status of competition.

[19] *See*, KCC Docket No. 98-SWBT-677-GIT, Response of Commission Staff to Southwestern Bell Telephone, L.P.'s Report Regarding DSL Deployment, ¶ 17: "Staff also finds it disturbing the declaration made by SWBT in this report that the company will not meet its commitment to complete the required deployment by the date required by the Stipulation and Agreement. This is the first indication that SWBT would not meet its deployment obligation. Through two legislative sessions, SWBT has touted that it would meet its commitment to deploy DSL in Kansas. Through the Stipulation and Agreement, SWBT is obligated to complete the DSL deployment by August 2003. It is not a mere "contemplation" or estimate of when SWBT could meet its obligation. It is a requirement…"