

Citizens' Utility Ratepayer Board

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Testimony on Behalf of the Citizens' Utility Ratepayer Board
By David Springe, Consumer Counsel
Before the House Utility Committee
Re: Substitute for Senate Bill 72
March 15, 2011

Chairman Holmes 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 Substitute for Senate Bill 72. My name is David Springe and I am the Consumer Counsel for CURB.

CURB opposes Substitute for 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 high cost subsidies from the KUSF. The provision denying AT&T access to KUSF funding for COLR obligations under K.S.A. 66-2009 is meaningless as no carrier has ever sought funding under this provision as it is already recovered in the high cost subsidy the carrier receives;
- The bill places Lifeline, low income, and elderly customers at risk for any resulting price increases;
- The price cap for rural exchanges tied to urban exchange prices is ineffective and illusory; 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, as an indicator of the effectiveness of competition. 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 Substitute for 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 cast doubt on the effectiveness of competition. Thus, the Commission makes the following recommendations to the Legislature:

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.

- 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 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

The proponents of this bill claim there are consumer protections provided in the bill. To the contrary, the provisions of Substitute for Senate Bill 72 eliminate the remaining critical consumer

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).

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 Substitute for Senate Bill 72:

- Substitute for 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 Substitute for 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, Substitute for 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.
- Substitute for 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 Safe Harbor annual price increase cap for basic residential and up to four business lines tied to the consumer price index for telephone services, as 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 the Safe Harbor annual price increase cap, there will be no price protection to Kansas residential and small business customers for basic phone service, and prices will increase substantially.
 - This "Safe Harbor" was added by the Senate Utilities Committee, on the motion of the Committee Chairman. This was publicly described as a "deal breaker" for AT&T, and stripped

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.

from the bill. Our question is, “what deal?” AT&T has made no firm commitments to deploy broadband in rural areas to lessen the “rural/rural” divide, the absence of broadband in AT&T’s rural exchanges versus other rural exchanges served by smaller rural companies. In fact, after a misleading telephone campaign into Senator Love’s district leading constituents to believe passage of this bill would result in broadband deployment to those called, the President of AT&T Kansas was not able to say that broadband would be deployed to any of Senator Love’s constituents as a result of this bill.

- Substitute for Senate Bill 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. Substitute for 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.
- Substitute for Senate Bill 72 abandons Kansas and federal universal service goals by eliminating the carrier of last resort (COLR) obligation in urban exchanges, yet retains AT&T’s right to receive high cost universal service subsidies from the KUSF.
 - The bill eliminates AT&T’s obligation to run wireline service to new homes or developments in urban exchanges. Kansans building new homes will not be entitled to have wireline service from AT&T because building infrastructure may not be consistent with its current business model, leaving those Kansans with only wireless service with the associated service quality and reliability problems.
 - Wireless is not available at a price comparable to wireline service. Cell phone rates are typically much higher than landline rates.
 - Wireless service typically limits the number of minutes, where landlines have unlimited local calling.
 - Because AT&T and other wireless providers are not subject to service quality requirements for its wireless service, 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.
 - The information provided by Commission Staff on KUSF support each carrier receives indicates that AT&T alone has received \$277 million in subsidies from Kansas ratepayers thru the KUSF, or 33.7% of the \$818 million paid since 1997. Century Link has received \$166 million, or 20.3% of the \$818 million paid since 1997. Combined, the 2 price cap carriers supporting this bill have received over \$442 million, or 54% of the KUSF subsidies paid since 1997. Now AT&T wants to be *able to raise their prices at will* **and** be relieved of its COLR obligations, yet continue to receive \$7 million annual subsidies from Kansas ratepayers.
 - A truly competitive market does not require continued subsidies, especially to the dominant carrier in the market. The carrier of last resort responsibility imposed by State law on incumbent carriers is a key justification for continuing universal service support. If AT&T receives no high cost KUSF support, competitive carriers will likewise receive no high cost KUSF subsidies, leveling the playing field for all carriers in what AT&T describes as a “competitive” market.

- Why is it more important to retain the COLR in exchanges under 75,000 access lines, but not in urban 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.
 - The provision denying AT&T access to KUSF funding for COLR obligations under K.S.A. 66-2009 is meaningless as no carrier has ever sought funding under this provision as it is already included in the high cost subsidy the carrier receives.
- Substitute for 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,¹³ so price increases resulting from this bill will directly impact Lifeline customers, as well as other elderly and low income customers.
 - Substitute for Senate Bill 72 contains an ineffective and illusory price cap for rural exchanges.
 - 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 medium-sized exchanges (between 6,000 and 75,000 access lines) receive the same urban price ceiling as rural exchanges? Are the consumers in the Dodge City, Emporia, Garden City, Great Bend, Hays, Hiawatha, Hutchinson, Junction City, Lawrence, Leavenworth/Lansing, Liberal, Manhattan, McPherson, Newton, Pittsburg, and Salina exchanges less deserving of the urban exchange price ceiling than rural AT&T exchanges?
 - The urban price ceiling will not apply to Century Link, which has no urban exchanges.¹⁴
 - If the Committee decides to go forward with this bill, it should amend the bill to include the Safe Harbor 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.
 - Substitute for 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 standards¹⁵ or changes in competitive environments.¹⁶ Substitute for 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.

¹³ 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.

¹⁴ 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.

¹⁵ K.S.A. 66-2005(b); K.S.A. 66-2005(q)(5).

¹⁶ K.S.A. 66-2005(r)(

We heard during Senate hearings 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, AT&T has failed to make any commitment for specific investments in Kansas. AT&T has also implemented a misleading telephone campaign, leading Kansans to believe passage of this bill would result in broadband deployment to those called. However, when Senator Love asked the President of AT&T Kansas about whether his constituents would actually receive broadband as a result of this bill, Mr. Hahn could not give him that assurance.

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 either the KCC or the Legislature.¹⁷ 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. Make AT&T specify what "deal" it is actually proposing for Kansans.

On behalf of CURB, I urge you to vote against passage of Substitute for 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 the Safe Harbor annual cap on price increases for basic residential and up to four business lines tied to a telecommunications market consumer price index 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 high cost universal service 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.

¹⁷ 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..."