

BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition to reduce intrastate switched access rates in revenue-neutral manner pursuant to Section 364.164, Florida Statutes, by ALLTEL Florida, Inc.

DOCKET NO. 050693-TL
ORDER NO. PSC-06-0036-FOF-TL
ISSUED: January 10, 2006

The following Commissioners participated in the disposition of this matter:

RUDOLPH "RUDY" BRADLEY, Chairman
J. TERRY DEASON
LISA POLAK EDGAR

FINAL ORDER DENYING ALLTEL FLORIDA, INC.'S PETITION

BY THE COMMISSION:

I. INTRODUCTION AND HISTORY

The telecommunications industry is in transition from an industry characterized by regional monopolies to one characterized by national competition. For most of its history, telephone service was furnished on a monopoly basis by a single provider. In exchange for a statutory monopoly, the telephone company was subject to economic regulation that gave it the opportunity to earn a fair rate of return on its investment. In this monopoly regime, prices for long distance and other premium services were set substantially above cost based on value of service principles. At the same time, local telephone service was priced residually to advance the social policy goal of providing universal service. In a monopoly environment this was sustainable. However, competition has changed the industry, and there has been and continues to be, increased pressure on this pricing approach that undermines its sustainability.

FLORIDA'S TELE-COMPETITION ACT

Against this backdrop, the Florida Legislature, during the 2003 Regular Session, enacted the Tele-Competition Innovation and Infrastructure Enhancement Act (2003 Act), which became effective on May 23, 2003. In broad terms, the 2003 Act allows the Commission to consider whether allowing the ILECs to reduce their intrastate access charges to interstate levels, and to make offsetting increases in local service rates, will further the Legislature's goal of increasing competition in the local telephone market. By returning some regulation of intrastate access charges to the Commission, the Legislature has given us the tools to address the question of whether access charges in fact support artificially low local service rates that may be impairing development of competition in the local telephone market.

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A key provision in the 2003 Act, Section 364.164, Florida Statutes, provides a process by which ILECs may petition this Commission to reduce their intrastate switched network access rates in a revenue-neutral manner. We are required by law to issue our final order granting or denying any such petition within 90 days of the filing. In reaching our decision, Section 364.164(1), Florida Statutes, sets forth four mandatory criteria we must consider. Those criteria are:

[W]hether granting the petition will:

- (a) Remove current support for basic local telecommunications services that prevents the creation of a more attractive competitive local exchange market for the benefit of residential consumers.
- (b) Induce enhanced market entry.
- (c) Require intrastate switched network access rate reductions to parity over a period of not less than 2 years or more than 4 years.
- (d) Be revenue neutral as defined in subsection (7), within the revenue category defined in subsection (2).

The parties' to this proceeding focus on subsections (a) and (b) of the statute, and not (c) and (d). Our focus, in this decision and Order, is on subsections (a), (b) and (c). We do not find it necessary to focus on subsection (d).

Finally, the 2003 Act amended Section 364.10 to provide increased protection to economically disadvantaged customers. This section, as further amended in 2005, requires any ILEC that reduces its access charges (and increases its local rates) pursuant to Section 364.164 to make its Lifeline Assistance Plan available to customers with incomes at or below 135% of the federal poverty level, up from 100% or less under the prior law. This is the first petition for rate rebalancing pursuant to Section 364.164, Florida Statutes, by a rural carrier.

Our jurisdiction in this matter arises from the above statutory provisions.

II. CASE BACKGROUND

On September 29, 2005, Alltel Florida, Inc. (Alltel), filed a petition pursuant to Section 364.164, Florida Statutes, and this docket was opened to address the petition in the time frame provided by Section 364.164, Florida Statutes. Alltel has committed to terminating its rural exemption under Section 251(f)(1) Telecommunications Act of 1996 (47 U.S.C. § 151) if the petition is approved.¹ By Order Nos. PSC-05-0959-PCO-TL and PSC-05-1130-PCO-TL, the

¹ Section 251(f)(1) of the Act provides that a rural telephone company is exempt from the requirements of section 251(c) (including the requirement to allow competitors to purchase services for resale at a wholesale

matter was set for hearing. The Office of Public Counsel intervened on October 4, 2005, and a hearing on the matter was held on December 1, 2005. Both parties filed post-hearing briefs on December 6, 2005, and we rendered our decision on the matter at the December 12, 2005, Special Agenda.

In their briefs, the parties explicitly or implicitly assert that Issue Nos. 1(a), 3, 4, 6 and 8 are not in dispute. Issue No. 1(a) addresses a reasonable estimate of the level of support provided by basic local telecommunications services. Issue Nos. 1(b) and (c) address whether removal of current support will create a more attractive market for the benefit of residential customers. Issue 2 addresses whether the petition will induce enhanced market entry. Issue 3 addresses whether the proposed rate reductions will reach parity over a period of not less than two years or more than four years. Issue 7 addresses whether Alltel's proposed rate increase for residential service is reasonable and affordable. Issues 5, 6 and 8 are fallout issues that would be addressed if Alltel establishes, by a preponderance of the evidence, Issues 1(a)(b)(c), 2, and 4.

III. SUMMARY OF DECISION

Alltel petitions this Commission to allow it to reduce Alltel's intrastate access charges in a competitively neutral manner under Section 364.164, F.S. In short, Alltel wishes to reduce its access charges and increase its charges to customers for local exchange service. We cannot grant the petition unless we find that the explicit statutory criteria are satisfied. Specifically, Alltel must establish by a preponderance of the evidence that granting the petition will create a more attractive local market for the benefit of residential customers and will induce enhanced market entry.

Upon consideration of the arguments and the record before us, we deny Alltel's Petition because it fails to establish by a preponderance of the evidence that granting the petition will create a more attractive local exchange market for the benefit of residential consumers and induce enhanced market entry as required by Section 364.164, Florida Statutes. Specifically, Alltel fails to produce evidence in the record of sufficient competence and weight to support a finding that granting the petition would induce market entry from competitors and that rebalancing would benefit residential customers.

In reaching this decision, we recognize that Alltel's residential basic rates may be artificially low. We also recognize that pricing should be free of distortions and should reflect the carrier's cost of providing service. However, we find that competing providers are not

discount and to purchase unbundled network elements at cost-based rates) unless the state commission finds that the rural carrier has received a bona fide request for interconnection, services, or network elements, and the state commission determines that the request "is not unduly economically burdensome, is technically feasible, and is consistent with section 254 (other than subsections (b)(7) and (c)(1)(D) thereof)." Section 251(f)(2) of the Act permits LECs "with fewer than 2 percent of the Nation's subscriber lines installed nationwide" to petition a state commission for suspension or modification of application of one or more requirements of sections 251(b) or 251(c). Alltel has committed to waiving this exemption if its petition is granted.

significantly affected by current distortions in Alltel's pricing and that rebalancing would provide negligible benefits for these competitors.² Further, market entry from these competitors would not be significantly affected by Alltel's pricing. We also note that CLEC resellers' profit margin would improve with rebalancing, but the record in this proceeding is clear that CLEC resellers currently do not receive a discount from Alltel and a specific discount rate was not proposed. In addition, Alltel's rebalancing proposal would not technically meet the "parity" requirement of Section 364.164(1)(c)(5), F.S., because Alltel's rate reduction is below \$.08 before two years.

We also recognize that Alltel likens the evidence in its rebalancing petition to that offered in support of the rebalancing petitions approved in Docket Nos. 030867-TL, 030868-TL and 030869-TL. However, evidence in the large LEC cases indicated that residential service could be offered at a higher rate, and providers of bundled local and long distance service would realize a cost savings from the decrease in the terminating access rate. These facts generated a better profit margin that created a more attractive market for local competition. In the instant proceeding, the evidence in the record does not support the same conclusion. This is largely due to the competitive climate in Alltel's territory and the relatively small percentage of Florida customers served by Alltel. In addition, the evidence in this proceeding does not support a finding that approval of Alltel's petition will generate material customer benefits in the form of lower long distance rates, or a wider choice of competing providers and service offerings.

In light of our decision to deny the petition, we need not reach a decision on the IXC flow-through procedures or whether Alltel's petition is consistent with Section 364.01(4)(a), F.S.

IV. REMOVAL OF CURRENT SUPPORT IN ALLTEL'S INTRASTATE SWITCHED ACCESS CHARGES (Issue No. 1(a))

Parties' Arguments

Alltel presented three different cost estimates, but acknowledges that none of the studies present "THE" cost of basic local service. However, one can reasonably conclude from these estimates that \$6,000,000 is a conservative estimate of the support provided by switched access to basic local telecommunication service. In its brief, the Office of Public Counsel did not take a position on this issue.

² Providers identified by Alltel as actual or potential competitors are cable telephony, CMRS providers and VoIP providers. Neither party disputed that these competitors would ultimately compete with Alltel's bundled offerings if the petition were granted. However, we find that these types of competitors are unlikely to change prices since Alltel is not increasing its rates for bundled packages. Further, VoIP and wireless providers set prices at a national level rather than based on a given LEC's price; therefore, rebalancing will not affect pricing decisions for these competitors. As for cable telephone pricing, it may be based on a LEC's price or it may be constrained by pricing of other competitors -- especially VoIP providers.

Alltel's first estimate was a forward-looking cost estimate of \$66.37 per line per month. This estimate was derived using the BCPM 3.1 cost proxy model from our 1999 Universal Proceeding Order in Docket No. 980696-TP. Alltel's second estimate was an embedded cost of \$41.32 per line per month, also from the Universal Service Proceedings. The record shows that the cost estimates are outdated or contain numerous inputs that are not specific to Alltel.

Alltel's third estimate was prepared by an Alltel witness for this proceeding using the HAI 5.0a forward-looking cost proxy model. The model's estimate is \$48.44 per line per month. We note that this version of the HAI model was last modified in February 1998. Further, while certain default inputs in the model were modified – notably, cost of capital inputs, depreciation values and material prices for various network components – the majority of the inputs were not and are not specific to Alltel. Moreover, in addition to the number of access lines not being Alltel-specific, they consist of 1995-1996 proxy values. We also note that a key input required to estimate the cost of switched access is Alltel's number of dial equipment minutes (DEM), by wire center. However, like the number of access lines used in the model run, none of the DEMs are Alltel-specific, but rather proxy values circa 1995-1996. Last, the HAI 5.a model assumes a forward-looking network that includes tandem switches, however, Alltel Florida does not have tandem switches in its network. Accordingly, we do not offer an unqualified endorsement of the HAI cost per line, or cost per minute of switched access.

As stated above, the Office of Public Counsel took no position on this issue.

Decision

Upon consideration and review of the record, we find the estimate of a minimum of \$6,000,000 in support provided to basic service is reasonable despite the deficiencies in each of the estimates. We note that the estimates are outdated and not specific to Alltel. Furthermore, the estimates do not reflect Alltel Florida's current number of access lines, or investment and expense levels. Even assuming that the estimates are overstated by 25%, however, they yield a range of \$15,153,819 to \$30,756,086. Thus, we find it reasonable to conclude that \$6,000,000 is a conservative estimate, and that this estimate meets the statutory requirement contained within Section 364.164, Florida Statutes.

V. ALLTEL'S PETITION WILL NOT BENEFIT RESIDENTIAL CUSTOMERS AND WILL NOT INDUCE ENHANCED MARKET ENTRY (Issue Nos. 1(b)(c) and 2)

Parties' Arguments

In its brief, Alltel likens its rebalancing petition to the rebalancing petitions approved in Docket Nos. 030867-TL, 030868-TL and 030869-TL ("rebalancing dockets"). At the outset of its argument, Alltel cites our prior Rebalancing Order³ noting that below-cost rates and the

³ Order No. PSC-03-1469-FOF-TP, issued December 24, 2003.

historical practice of pricing access charges above cost to hold down the price of basic local service discourages competitive entry and innovation. Alltel further asserts in its brief that the company has presented evidence in this proceeding - except for testimony from a potential competitor - similar to evidence that the large ILECs submitted in the previous proceeding. Further, Alltel claims that its witnesses made the same theoretical points that the witnesses made in the rebalancing dockets. For example, witness Blessing testified Alltel's basic local residential service rates are priced significantly below cost, and that intrastate access charges are priced above cost, thereby creating artificially low local residential service rates which in turn discourage competition. The witness supported his testimony by citing to empirical studies in the record.

Alltel also argues in its brief that the evidence put forth in this proceeding meets the statutory requirement of Section 364.164, F.S. Alltel argues that the theoretical and economic testimony in this proceeding is similar to the testimony filed in Docket Nos. 030867-TL, 030868-TL and 030869-TL. Alltel argues that its economic testimony is supported by empirical, real world evidence from the rural state of Wyoming. Alltel argues in its brief that rebalancing rates for Wyoming's ILECs resulted in new competitors entering the local telephone market in that state, and allowed competitors to offer better bundles of services at lower prices. Alltel asserts that this empirical evidence is similar to the evidence submitted in Docket Nos. 030867-TL, 030868-TL and 030869-TL. In those dockets, an economic witness testified that rebalancing in Maine and Massachusetts resulted in more competitors entering the telecommunications market.

In addition, Alltel put forth evidence that if its petition is granted, it will raise its R1 rate by six dollars per month. Alltel argued at hearing and in its brief that this will create a more attractive market by giving all competitors the opportunity of increasing their profit margin by an additional six dollars per customer. As a safeguard, Alltel committed to spend an additional fifteen to twenty thousand dollars annually, over the rebalancing period, to promote Lifeline.

The Office of Public Counsel argues in its brief that Alltel's rebalancing proposal does little, if anything, to enhance market entry by the intermodal competitors identified by Alltel witness Blessing. According to the OPC, these same competitors offer packages of services that typically include a host of custom calling features, and local and long distance. Witness Willis testified that Alltel competes with a similar package called Connect Unlimited. She explained that Alltel's bundle consists of the residential line, a package of features and unlimited long distance calling. Witness Blessing testified that Alltel does not plan to increase the price of Connect Unlimited. OPC therefore argues that Alltel's plan to raise R1 prices by six dollars will not add additional margin to competitors' business plans.

In addition, OPC argues in its brief that Alltel's Connect Unlimited is already priced higher than the bundles offered by competitors, "so whatever impetus high prices by the incumbent local carrier might provide toward fostering competitive entry is already in existence." Witness Blessing testified that Connect Unlimited, inclusive of tax, was priced somewhere between \$60 and \$70. OPC is quick to point out that the bundles of potential competitors identified by witness Blessing offer similar features as Connect Unlimited but their prices are set at a national level. Therefore, OPC argues in its brief that rebalancing will not

induce enhanced market entry because the opportunity to enter the market already exists, and it will not change as a result of rebalancing.

OPC also argues that most of these potential competitors will not experience access cost reductions if Alltel's petition is granted. OPC argues that resellers and VoIP providers do not pay access charges. Cellular telephone calls made within the local calling area do not incur access charges. Only intrastate long distance calls from cell phones to a wireline subscriber in Alltel Florida's territory may incur terminating access charges, but not originating charges.

OPC distinguishes this proceeding from that of the petitions approved in Docket Nos. 030867-TL, 030868-TL and 030869-TL. Unlike those dockets, OPC argues in its brief that no competitor intervened in the instant docket to support Alltel's rebalancing proposal. In the prior proceeding, OPC points out that AT&T, MCI and Knology all intervened to support rebalancing in Sprint's, BellSouth's and Verizon's territory. Conversely, no potential competitor identified by Alltel has intervened in support of Alltel's proposal.

Further, OPC argues that the large ILECs presented a more attractive environment to compete due to these companies' greater wireline density. OPC identifies Alltel witness Willis' testimony wherein she states that Alltel Florida has a wireline density of 25 access lines per square mile. This is very unattractive compared to Verizon's 465 access lines per square mile, BellSouth's 341 per square mile and Sprint's 94 access lines per square mile. OPC concludes that we should deny Alltel's petition in light of an unattractive market, because it does not make economic sense for companies to compete in Alltel's territory even if rates are rebalanced.

Last, OPC argues that Alltel's rebalancing proposal hinders the ability of subscribers to use VoIP as an alternative because Alltel currently requires DSL customers to also buy Alltel local service. Witness Blessing testified that Alltel currently does not offer stand-alone DSL to Alltel customers. Therefore, OPC concludes that Alltel's business practice relegates VoIP to the role of an extra line instead of the primary line for Alltel's DSL customers.

Decision

Upon review of the record and the parties' briefs, we find that the existence of support impedes, in part, competition in Alltel's residential local exchange market. In reaching this decision, we note that Alltel's residential basic rates are artificially low, and to achieve the lowest-cost mix of technology in the market, pricing should be free of distortions and reflect the carrier's cost of providing service. While this below cost pricing by Alltel may constitute an impediment for certain types of competitors, we find that wireless and VoIP providers largely are unaffected by current distortions in Alltel's pricing. In addition, resellers are currently not offered a discount and likely will not benefit from the rebalancing proposal. Therefore, we conclude that rebalancing provides negligible benefits for these competitors and in turn will not create a more attractive market for the benefit of residential customers.

We do not find sufficient evidence in the record to support Alltel's argument that rebalancing rates in a small portion of this state will have the same effect as rebalancing in

Wyoming. Rebalancing in Wyoming was done state-wide and by large ILECs. We see this as comparing apples to oranges with a small rural LEC serving residential customers in a small portion of Florida. There are inherent economic differences between rebalancing in Alltel's small footprint here in Florida and rebalancing state-wide as was seen in Wyoming.

In addition, Alltel's use of empirical studies is misguided. The empirical studies in the record have a traditional wireline orientation, since they rely on factors such as collocation, UNE pricing, and the resale discount to explain development of local competition. Also, even Alltel's witness Blessing acknowledged the differences when he testified that he "did not intend for them to . . . relate to the situation here in Florida on a point-by-point basis." Further, with the exception of CLEC resellers, the empirical studies do not address potential competitors named by Alltel (cable telephony, wireless and VoIP). In light of these inherent differences, we do not find the empirical studies persuasive.

Last, Alltel's commitment to spend an additional fifteen to twenty thousand dollars annually over the rebalancing period to promote Lifeline is helpful, but is insufficient to demonstrate that approval of Alltel's petition will generate an overall benefit for residential customers.

VI. PARITY (Issue No. 3)

We find Alltel's rate reduction does not meet the standard set forth in Section 364.161(1)(c)(5), F.S. This section specifically requires intrastate switched network access rate reductions to parity over a period of not less than two years or more than four. Section 364.161(1)(c)(5), F.S. defines parity for a company such as Alltel as \$.08. We find Alltel's rate reduction goes below \$.08 prior to reaching two years. This rate reduction is therefore in violation of the plain language of Section 364.161(1)(c)(5), F.S. which allows a small LEC to reduce its rate below \$.08 after two years.

VII. CONCLUSION

In conclusion, we deny Alltel's Petition because it failed to establish by a preponderance of the evidence that removal of the company's current support will create a more attractive local market and induce enhanced market entry as required by Section 364.164, F.S. In reaching this decision, we recognize from review of the record that Alltel's residential basic rates are artificially low, and that pricing should be free of distortions the carrier's cost of providing service. However, we find that the potential competitors identified by Alltel (cable telephony, wireless and VoIP providers) largely are unaffected by current distortions in Alltel's pricing, and that rebalancing would provide negligible benefits for these competitors. Further, market entry from these competitors would not be significantly affected by Alltel's pricing. We also note that CLEC resellers' profit margin would improve with rebalancing, but the record in this proceeding is clear that CLEC resellers currently do not receive a discount from Alltel and a specific discount rate was not proposed. In addition, Alltel's rebalancing proposal would not technically

meet "parity" standard embedded in the statutory requirement of Section 364.164(1)(c)(5), F.S., because Alltel's rate falls below \$.08 before two years. Last, we note that because Alltel failed to meet Section 364.164(a) and (b), F.S., we need not address the remaining issues in this proceeding.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Alltel Florida, Inc.'s Petition to reduce intrastate switched access rates in revenue-neutral manner pursuant to Section 364.164, Florida Statutes is denied. It is further

ORDERED by the Florida Public Service Commission that the specific findings set forth in this Order are approved in every respect. It is further

ORDERED by the Florida Public Service Commission that this docket is closed.

By ORDER of the Florida Public Service Commission this 10th day of January, 2006.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

(S E A L)

JLS/AJT

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water and/or wastewater utility by filing a notice of appeal with the Director, Division of the Commission Clerk and Administrative Services and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.