

ORIGINAL

Docket No. 050693-TL

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

Staff Recommendation

December 12, 2005


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Under S 364.164, F.S., the commission shall consider whether 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.

Issues 1a, 1b, 1c

(b) Induce enhanced market entry.

Issue 2

(c) Require intrastate switched network access rate reductions to parity over a period of not less than 2 years or more than 4 years.

Issue 3

(d) Be revenue neutral...

Issue 4

Other considerations for approval.

Issue 7 – 364.01(4)(a), Florida Statutes – reasonable and affordable prices

Fallout of other Issues:

Issue 5 – approve/deny

Issue 6 – IXC flow through

Issue 8 – close docket

ISSUE 1: Will Alltel's rebalancing proposal remove the current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential consumers?

(A) What is a reasonable estimate of the level of support provided for basic local telecommunications services?

Although the record does not contain evidence from which a reliable estimate of the overall level of support provided to basic local telecommunications service can be derived, it is reasonable to conclude that there currently is at least \$6 million in support.

Alltel offered three estimates of the cost of basic local services, none of which is sufficiently reliable to determine Alltel's current overall level of support for basic local service

The first estimate was a forward-looking cost estimate of \$66.37 per line per month derived using the BCPM 3.1 cost proxy model.



ISSUE 1(A): (cont'd)

This estimate is from the Commission's 1999 order in Docket No. 980696-TP, the Universal Service proceeding.

In addition to being almost eight years old, this estimate did not reflect Alltel-specific inputs but instead used inputs for the large Florida ILECs.

The second estimate was an embedded cost of \$41.32 per line per month.

This estimate is also from the Commission's 1999 order in Docket No. 980696-TP, the Universal Service proceeding.

Being eight years old, this estimate is outdated and does not reflect Alltel Florida's current number of access lines, or its investment and expense levels.

The third estimate was prepared by an Alltel witness for this proceeding using the HAI 5.0a forward-looking cost proxy model; this version of the HAI model was last modified in February 1998. The model's estimate is \$48.44 per line per month.

Certain of the model's default inputs were modified – notably, cost of capital inputs, depreciation values, and material prices for various network components.



ISSUE 1(A): (cont'd)

However, the majority of the inputs are not Alltel-specific. Moreover, in addition to the number of access lines not being Alltel-specific, they consist of 1995-1996 proxy values.


The HAI 5.0a model also derived an estimate of the cost of intrastate switched access. However, staff does not recommend unqualified endorsement of this result.

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, and instead represent proxy values circa 1995-1996.

The HAI 5.0a model assumes a forward-looking network that includes tandem switches. However, Alltel Florida has no tandem switches in its network; staff believes in this instance to assume otherwise conflicts with the TELRIC costing standard.

Hearing Exhibit 59 consists of calculations of the amount of support for residential basic local service based on each of these three cost estimates.

These annual support estimates range from \$20,205,092 to \$41,008,115.



ISSUE 1(A): (cont'd)

Assuming that the cost estimates are overstated by 25%, yields a range of \$15,153,819 to \$30,756,086.

Staff thus believes it is reasonable to conclude that there currently is at least \$6 million in support provided to basic service.

ISSUE 1: Will Alltel's rebalancing proposal remove the current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential consumers?

(B) Does the current level of support prevent the creation of a more attractive competitive local exchange market for the benefit of residential consumers?

Existence of support impedes, in part, competition in Alltel's residential local exchange market.

Alltel's residential basic rates are artificially low.

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.



ISSUE 1(B): (cont'd)

Below average cost pricing by Alltel may constitute an impediment for certain types of competitors.

Wireless and VoIP providers largely are unaffected by current distortions in Alltel's pricing; rebalancing provides negligible benefits for these competitors. (see Issue 1(c))

ISSUE 1: Will Alltel's rebalancing proposal remove the current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential consumers?

(C) Will Alltel's rebalancing proposal benefit residential consumers as contemplated by Section 364.164, Florida Statutes? If so, how?

No, Alltel's rebalancing proposal will not benefit residential customers as contemplated by Section 364.164, Florida Statutes.

Overall Customer Benefit Lacking

Unlike petitions of large LECs, evidence in this case does not support a finding that approval of Alltel's petition will generate material customer benefits in the form of a wider choice of competing providers and service offerings and lower long distance rates.

Alltel's commitment to spend an additional \$15-20k annually over the rebalancing period to promote Lifeline is helpful, but does not negate staff's concern that approval of Alltel's petition will not generate an overall benefit for customers.



ISSUE 1(C): (cont'd)

Nature of Competition

Current Situation:

Alltel cites CLEC resellers, wireless carriers, VoIP providers, and cable telephone providers as competitors of interest.

CLEC resellers do not currently receive a discount, and a specific discount rate was not proposed in this proceeding.

Alltel's current policy of not offering stand-alone DSL limits the attractiveness of VoIP alternatives.

Alltel currently does not provide unbundled network elements (UNEs) and collocation, and no rates were proposed in this proceeding.

ISSUE 1(C): (cont'd)

Future Changes:

UNEs, collocation, and a resale discount would be required under Alltel's commitment to terminate its Section 251(f)(1) rural exemption if the petition is approved.

Plan to provide UNEs and collocation through contract negotiation may delay future UNE-based competitors, particularly if issues (e.g., pricing) must be arbitrated.

Market entry decisions will not be isolated to Alltel FL territory.

Empirical Studies

Studies by Ros and McDermott and Eisner and Lehman 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.

Re. these studies, Alltel witness Blessing "did not intend for them to . . . relate to the situation here in Florida on a point-by-point basis."

With exception of CLEC resellers, studies do not address competitors of interest.



ISSUE 1(C): (cont'd)

Effect of Rebalancing on Competitors' Economics

Pricing:

VoIP, wireless, and cable telephone providers consider rates of various competitors and services beyond Alltel's rates for basic local service.

Providers competing with Alltel's bundled offerings are unlikely to change prices since Alltel is not increasing its rates for bundled packages.

VoIP and wireless providers set prices on a national level rather than based on the LEC's price; therefore, rebalancing will not affect pricing decision for these competitors.

Cable telephone pricing may be based on LEC's price or constrained by pricing of other competitors (especially VoIP).

Pricing practices of UNE-based providers were not addressed.



ISSUE 1(C): (cont'd)

Cost of Providing Service:

Lower access charges don't benefit VoIP and cable telephone providers since they bypass Alltel's public switched network and the associated originating access charges.

Wireless, VoIP, and cable telephone providers "potentially see a reduction in access charges" if they terminate toll traffic on Alltel's network.

The percentage of Florida toll traffic terminating on Alltel's network would be very small since Alltel serves less than 1% of the residential customers in the state. Thus, any cost savings would be extremely small in the aggregate.

Effects of lower access charges on UNE-based providers were not addressed.



ISSUE 1(C): (cont'd)

Per Customer Margin:

Evidence in large LEC case indicated that residential service could be offered at a higher rate, and bundled local and long distance providers would realize a cost savings from the decrease in the terminating access rate, generating a better margin for UNE and other facilities-based providers.

Evidence in Alltel case does not support a similar conclusion, based on the competitors of interest in Alltel's FL territory and the relatively small percentage of Florida customers served by this LEC.



ISSUE 1(C): (cont'd)

Required IXC Rate Reductions (Flow-Through)

Consumer benefit from ancillary long distance rate reductions may be considered in evaluating Alltel's petition.

IXCs flow through access charge savings on statewide basis.

Alltel serves less than 1% of the residential customers in the state.

Approx. 1/3 of Alltel FL's intrastate access charges (or \$2M of the \$6M in access charge reductions) are paid by Alltel's long distance affiliate; the affiliate does not operate solely in Alltel FL territory.

For large LECs, access charge reductions are expected to total more than \$300M, as compared to \$6M for Alltel.

Unless an end user is served by Alltel's long distance affiliate, the flow-through will be negligible.



ISSUE 2: Will the effects of Alltel's rebalancing proposal induce enhanced market entry? If so, how?


Alltel has failed to establish that enhanced market entry will result from approving and implementing Alltel's petition.

Theoretical evidence is not in balance with empirical evidence. The empirical evidence does not clearly support the theoretical evidence.

Theoretical evidence suggests petition will induce enhanced market entry:

Reducing access charges should induce enhanced market entry by reducing price distortions created by support flows from access charges to basic local service rates that deter market entry.

Increasing basic local service rates should induce enhanced market entry by increasing the price point which competitors must match in order to induce Alltel customers to switch providers.



ISSUE 2: (Cont'd)

Empirical – Pro


Residential basic rates are artificially low and supported by above average cost access charge revenues and other Alltel services priced at greater than average cost.

UNEs, collocation, and a resale discount would be required under Alltel's commitment to terminate its Section 251(f)(1) rural exemption if the petition is approved.

With rebalancing and a resale discount, margins would improve for resellers.

Empirical – Con

Wireless, VoIP, and cable telephone providers are primary competitors of interest in this case. Alltel's basic local service rates and intrastate switched access charges have minimal impacts on those types of providers.



ISSUE 2: (Cont'd)

Alltel is not currently providing UNEs, collocation, or a resale discount; contract negotiations and possible arbitrations may delay entry of providers that may enter using these methods.

VoIP, wireless, and cable telephone providers consider rates of various competitors and services other than Alltel's rates for basic local service.

Providers competing with Alltel's bundled offerings are unlikely to change prices since Alltel is not increasing its rates for bundled packages.

Most market entry decisions will not be isolated to Alltel's Florida territory.

VoIP and wireless providers set prices on a national basis rather than based on the LEC's price (TR 16, 55-57); therefore, rebalancing will not greatly affect pricing decision for these competitors.

Petitions not supported by empirical evidence from facility-based CLECs that supported the petitions of the large ILECs.

ISSUE 2: (Cont'd)


Summary:

Approval will reduce support flows from Alltel's intrastate switched access charges to its basic local service rates thus reducing incentives to bypass switched access charges. Substantial support remains for Alltel's basic local service rates even after completion of the rebalancing implementation. Enhanced market entry evidence is largely theoretical.

Denial of the petitions maintains status quo and continues minimal residential competition in Alltel's territory. Inefficiencies will remain in Alltel's service territory as a result of continued support flows to Alltel's basic local service rates.

However, the expected benefits from enhanced market entry are largely theoretical. Providers identified by Alltel as the primary beneficiaries of rebalancing are wireless providers, VoIP providers, and cable VoIP providers whose underlying costs are not directly affected or only marginally affected by Alltel's basic local service rates and intrastate access charge rates.

Therefore, staff believes that Alltel has failed to establish that enhanced market entry will result from approving and implementing Alltel's petition.



ISSUE 3: Will Alltel's rebalancing proposal reduce intrastate switched network access rates to interstate parity over a period of not less than two years or more than four years?

No. Staff believes that Alltel's proposal to reduce its intrastate switched network access rate to below 8 cents per minute in less than 2 years fails the statutory requirement.

Definition of Parity – Section 364.164(5), Florida Statutes:

If the company has 1 million or fewer access lines in service, the term "parity" means that the company's intrastate switched network access rate is equal to 8 cents per minute. This section does not prevent the company from making further reductions in its intrastate switched network access rate, within the revenue category established in this section, below parity on a revenue-neutral basis, or from making other revenue-neutral rate adjustments within this category.

ISSUE 3: (Cont'd)

Statutory Requirements on Timing:

Section 364.164 (1)(c), Florida Statutes, requires “intrastate switched network access rate reductions to parity over a period of not less than 2 years or more than 4 years.”

Does Alltel’s petition meet the parity and timing requirements of Section 364.164(5), Florida Statutes?

Staff’s prehearing statement in Order No. PSC-05-1167-PHO-TL stated that “Alltel’s rebalancing petition will reduce intrastate switched network access rates to a level below ‘parity’ as defined in Section 364.164(5), F.S., over a period of not less than two year or more than four years;” Staff, however, has changed its position and recommends that Alltel has not met the parity and timing requirements of Section 364.164(5), F.S., in light of a re-examination of the statutory language.

ISSUE 3: (Cont'd)

Table 1 displays Alltel's current and proposed switched network access rates.


Table 1: Alltel's Current and Proposed Composite Switched Network Access Rates

Composite Rate	Current (EXH 49)	Year 1 (EXH 51) April 1, 2006	Year 2 (EXH 52) April 1, 2007	Year 3 (EXH 53) April 1, 2008
Intrastate Network Switched Access Rate	\$0.1132294	\$0.0978447	\$0.0790820	\$0.0603194

ISSUE 3: (Cont'd)

At the hearing, Alltel witness Willis stated, “[I]f Alltel’s proposal is approved by the Commission, Alltel will implement its first installment around April 1st, 2006. The second and third installments will be implemented April 1, 2007, and April 1, 2008, respectively.”

Alltel proposes to reduce its Intrastate Switched Network Access Rate to \$0.0978447 on April 1, 2006, with a reduction on April 1, 2007 to \$0.0790820. Section 364.164(5) defines parity as 8 cents per minute, while Section 364.164(1)(c) defines 2 years as the minimum period over which Alltel can reduce its intrastate switched network access rate. Therefore, staff believes that Alltel’s proposal to reduce its intrastate switched network access rate to below 8 cents per minute in less than 2 years fails the statutory requirement.



ISSUE 4: Is Alltel's rebalancing proposal revenue neutral, as defined in Section 364.164(2), Florida Statutes?

Yes. Alltel's proposal meets the statutory requirements for revenue neutrality.

Test of Section 364.164 (2), Florida Statutes;

“If the commission grants the local exchange telecommunication’s company’s petition, the local exchange telecommunications company is authorized, the requirements of s. 364.051 (3) notwithstanding, to immediately implement a revenue category mechanism consisting of basic local telecommunications service revenues and intrastate switched access revenues to achieve revenue neutrality...”



ISSUE 4: (Cont'd)

Definition of revenue neutral per the statute.

Section 364.164 (7) defines revenue neutral as “the total revenue within the revenue category established pursuant to this section remains the same before and after the local exchange telecommunications company implements any rate adjustments under this section. Calculation of revenue received from each service before implementation of any rate adjustment must be made by multiplying the then-current rate for each service by the most recent 12 months’ actual pricing units for each service within the category without any adjustments to the number of pricing units...”



ISSUE 5: Should Alltel's rebalancing proposal be granted or denied?

■ Alltel's rebalancing proposal should be denied.

- Based on staff's recommendation on other issues, the criteria of the statute have not been met. Therefore, the petition should be denied.



ISSUE 6: Should the IXC flow through procedures addressed in Docket No. 030961-TI and ordered in PSC-03-1469-FOF-TL, be applied to Alltel's rebalancing proposal?

Yes, IXCs should be required to flow through access charge reductions, if any, approved by the Commission for Alltel consistent with the flow-through requirements established in Order No. PSC-03-1469-FOF-TL.

All Parties agree that the IXCs should flow through Alltel's annual intrastate switched access rate reductions, if any, consistent with Order No. PSC-03-1469-FOF-TL.



ISSUE 7: Would the Commission's approval of Alltel's rebalancing proposal be consistent with the section 364.01(4)(a), Fla. Stat.?

Statute 346.01(4)(a) states: "The Commission shall exercise its exclusive jurisdiction in order to protect the public health, safety, and welfare by ensuring that basic local telecommunications services are available to all consumers in the state at reasonable and affordable prices."


Yes, approval of Alltel's rebalancing proposal would be consistent with Section 346.01(4)(a), Florida Statutes.

At Alltel's average proposed residential rate of \$16.49, phone service would still be a small percentage of the household budget.

.5% of median household income in FL

.1% to 2.2% of household income over all income ranges

Indexing Alltel's residential rates to inflation beginning in 1984 (when last set by rate case) produces a rate of \$19.92, which is greater than the rates proposed by Alltel.



ISSUE 7: (cont'd)

Alltel's proposed residential rates are compatible with pricing decisions in other states.

Alltel's proposed residential rates and rate changes are comparable to those approved for the large FL LECs.

Lifeline provides effective, targeted assistance; proposed residential rate increases should not adversely affect subscribership trends.



ISSUE 8: Should the docket be closed?

Yes, this docket should be closed if the commission denies Alltel's petition as recommended by staff.