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December 13, 2004

Ms. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602

RECEIVED

DEC 13 2004

PUBLIC SERVICE
COMMISSION

RE: The Petition of ALLTEL Kentucky for an Increase in Rates,
Case No. 2004-00193

Dear Ms. O'Donnell:

Enclosed for filing in the above-referenced matter is an original and eleven (11) copies of ALLTEL Kentucky's Response to November 22, 2004 Order. Please file-stamp the extra copy and return it to me in the self-addressed, pre-stamped envelope I have enclosed for your convenience.

Thank you for your cooperation in this matter. Please do not hesitate to contact me with any questions you may have.

Sincerely,

WYATT, TARRANT & COMBS, LLP

Noelle M. Holladay

Enclosures

cc: Kimberly K. Bennett
James H. Newberry, Jr.

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

DEC 13 2004
PUBLIC SERVICE
COMMISSION

In the Matter of:

THE PETITION OF ALLTEL KENTUCKY FOR) CASE NO.
AN INCREASE IN RATES) 2004-00193

RESPONSE TO NOVEMBER 22, 2004 ORDER

On November 22, 2004, the Commission issued an Order acknowledging ALLTEL Kentucky's prior filing in this matter regarding ALLTEL Kentucky's continuing compliance with K.R.S. §278.516 ("the Statute") and requiring ALLTEL Kentucky to submit any additional legal arguments or other comments, request a hearing, and describe what information would be presented at a hearing. ALLTEL Kentucky states as follows in response to the Commission's Order.

INTRODUCTION

In 1992, the Kentucky Legislature articulated clear policies *in support of alternative regulation* and anticipated the need for *expanded regulatory flexibility* for companies that met the access line criteria set forth in the Statute as well as for companies that satisfy certain public interest criteria. In 2004, Kentucky Governor Ernie Fletcher implemented a program with similar ideals of strengthening Kentucky's business economy and benefiting consumers by encouraging investment in new technologies. The Kentucky Legislature, with the Governor's support, also enacted House Bill 627 which opened the door for expanded technology investment throughout the Commonwealth. In the federal arena, both the FCC and telecommunications industry are seeking to update telecom regulation to promote market-based competition and encourage investment.

This proceeding gives the Commission an opportunity to benefit Kentucky's consumers by expanding alternative regulation and updating the Commonwealth's communications rules to more effectively represent the realities of today's telecommunications market. Those realities include consumer demand for immediate response to service needs, carriers' needs to address quickly and effectively competitive pressures, and marketplace mandates for investment and innovation in telecom services to benefit customers.

ALLTEL Kentucky clearly satisfied the requirements to elect alternative regulation under the Statute in 1998 and continues to operate in compliance with the Statute today. Most important, consumers have benefited and continue to benefit from this alternative regulation plan. As explained in greater detail below, since ALLTEL Kentucky elected alternative regulation, its customers have continued to enjoy low rates, excellent service quality, and increased availability of advanced services. In fact, existing alternative regulation plans should not only be continued, they should be expanded in response to the increasingly competitive and diverse communications market. The emphasis in this proceeding and all other proceedings before the Commission, therefore, should be on ways the Commission can further benefit consumers by extending more regulatory flexibility to companies like ALLTEL Kentucky.

FACTS AND POLICIES IN SUPPORT OF CONTINUED AND EXPANDED ALTERNATIVE REGULATION

In its June 1, 2004 Order in this case, the Commission framed the issue as whether ALLTEL Kentucky may "*still be defined* as a 'small telephone utility' pursuant to KRS 278.516(2) such that the alternate regulation provisions of the statute *still* apply to it." (Emphasis added.) The Commission further predetermined that withdrawal of

ALLTEL Kentucky's tariff filing would cause the Commission's initial legal conclusions to become final. This approach not only ignores the provisions of the Statute but also overlooks the clear pro-alternative regulation policies enumerated by the Legislature in establishing alternative regulation, the Governor's platform, the dramatic changes in the telecommunications industry since the passage of the Kentucky alternative regulation Statute, and contradicts the progressing national trend to substitute market-based competition for government-managed competition, which makes the Statute's policy justifications even more compelling today than in 1992 when the Statute was enacted.

In 1992, even before the federal Telecommunications Act of 1996 was passed, the Kentucky Legislature had the foresight to set forth the following policies in support of alternative regulation:

(a) *Competition and innovation have become commonplace* in the provision of certain telecommunications services in Kentucky and the United States;

(b) *Flexibility in the regulation of the rates of providers of telecommunications service is essential* to the well-being of this state, its economy, and its citizens; and

(c) The public interest requires that the Public Service Commission be authorized and encouraged to formulate and adopt rules and policies that will permit the commission, in the exercise of its expertise, to regulate and control the provision of telecommunications services to the public in a *changing environment*, giving due regard to the interests of consumers, the public, the providers of the telecommunications services, and the continued availability of good telecommunications service.

(Emphasis added.) (K.R.S. §278.512.) Additionally, the Legislature set forth the following policies supporting alternative regulation specific to small telephone utilities:

(1) The legislature finds and determines that:

(a) *Small telephone utilities lack the resources to fully participate in the existing regulatory processes, particularly under traditional rate of return and certificate of public convenience and necessity regulation;*

(b) *Regulation, if not tailored specifically to the needs of small telephone utilities, can retard the growth and development of small telephone utilities by requiring the expenditure of excessive time and money responding to and addressing regulatory processes instead of devoting those resources to customer service and more productive business concerns* and issues; and

(c) *It is in the public interest to provide regulatory flexibility to small telephone utilities to better enable them to adjust to the competition and innovation that has come and is coming to the telecommunications industry* as found and determined by the legislature at KRS 278.512(1).

(Emphasis added.) (K.R.S. §278.516.)

All of these policies clearly favor increased regulatory flexibility. In 1992, the Legislature also established multiple ways for companies to elect alternative regulation. First, a small telephone utility having at the time of election not more than 50,000 access lines in Kentucky can elect under K.R.S. §278.516(7) to be regulated under the provisions set forth in the Statute. Second, utilities which do not meet this access line criteria or which desire flexibility beyond that in the existing statutory plan can petition the Commission to adopt an alternative regulation plan upon demonstration that the plan is in the public interest pursuant to the criteria set forth in K.R.S. §278.512.¹

¹ The public interest criteria include the following: (a) The extent to which competing telecommunications services are available from competitive providers in the relevant market; (b) The existing ability and willingness of competitive providers to make functionally equivalent or substitute services readily available; (c) The number and size of competitive providers of service; (d) The overall impact of the proposed regulatory change on the continued availability of existing services at just and reasonable rates; (e) The existence of adequate safeguards to assure that rates for services regulated pursuant to this chapter do not subsidize exempted services; (f) The impact of the proposed regulatory change upon efforts to promote universal availability of basic telecommunications services at affordable rates and upon the need of telecommunications companies subject to the jurisdiction of the commission to respond to competition; (g) Whether the exercise of commission jurisdiction inhibits a regulated utility from competing with

Indeed, the "changing [communications] environment" recognized by the Legislature in 1992 has expanded and accelerated significantly in the decade since 1992. Since enactment of the Statute, competition from competitive local exchange carriers, wireless carriers, cable providers, and providers using technologies such as voice over Internet protocol ("VoIP") has proliferated. Consumers today make phone calls over the Internet and access high-speed data services over their wireless phones. VoIP subscribers are forecasted to total one million by year end 2004 (versus only about 130,000 in 2003). Some of these forms of competition were not even contemplated by the Legislature in 1992, but as they have occurred, the need for regulatory parity and flexibility has increased exponentially.

The Kentucky Legislature's recognition twelve years ago that regulatory flexibility was "essential" is more true today than ever. Telecommunications carriers must be able to respond quickly and effectively to customers, who generally have no patience for delays or regulatory constraints. Customers demand that carriers immediately respond to their individual needs and requests; carriers must be allowed to develop rates, terms, and conditions in a timely manner and on an individual-case basis in response to competitive circumstances. Consumers benefit when competitive responses result in additional choices.

Indeed, the progressing trend across the country is to expand the availability of regulatory flexibility and alternative regulation options. State utility commissions in Arkansas, Georgia, and North Carolina allow carriers to flexibly price services in order to respond to competition, and states such as South Carolina, North Carolina, and

unregulated providers of functionally similar telecommunications services or products; and (h) The overall impact on customers of a proposed change to streamline regulatory treatment of small or nonprofit carriers.

Pennsylvania have recently passed expanded alternative regulation laws. In South Carolina, the state legislature recently enacted legislation that empowered consumers and carriers by allowing alternatively regulated local exchange carriers to bundle services on an individual-customer basis free from "any requirements related to the terms, conditions, rates, or availability of any bundled or contract offering" imposed by the South Carolina Commission. (S.C.A. §58-9-285.)

The Federal Communications Commission ("FCC") endorsed marketplace regulation when it issued letters on March 31, 2004 urging carriers to enter into market-based negotiations with respect to continued use of unbundled network elements following multiple unproductive attempts at historical governmental regulation which failed and resulted in extensive litigation. Similarly, on November 17, 2004, the United States Telecom Association ("USTA"), like other industry groups, adopted legislative principles advocating, among other things, a fundamental modernization of federal telecom regulation to encourage investment in and rapid deployment of advanced communications. A key aspect of these principles is the replacement of government-managed competition with market-based competition.

The existing regulatory framework in the Commonwealth is outdated. Local exchange carriers (even those with existing statutory alternative regulation plans) can only achieve rate changes - even if for the specific benefit of customers - upon tariff filings submitted thirty (30) days in advance of the requested effective dates. Promotional offerings require thirty (30) days advance notice. Legacy local exchange carriers cannot set prices or terms on a location-specific or market-specific basis without being forced also to establish the same prices and terms across their entire service territories - a

burden not placed on new entrants that have the freedom to set rates on a “door-to-door” basis. Most local exchange carriers cannot serve customers through contract service arrangements without filing the contracts for Commission approval thirty (30) days in advance; indeed carriers cannot even file the contracts with guaranteed confidentiality protection. Local exchange carriers are also subject to service quality standards that are not applicable to their broadband, VoIP, and wireless competitors. These constraints make it difficult, bordering on impossible, for local exchange carriers (especially legacy carriers that also bear carrier-of-last-resort obligations) to respond adequately to customer demand, the effect of which is that their customers are denied the benefits of market-based competition.

This Commission should support modernizing Kentucky's outdated regulatory framework to fit more appropriately with today's competitive communications environment. Declining to require the merger of ALLTEL Kentucky and Kentucky ALLTEL - an action that would have resulted in "additional expenses and regulatory burdens" - was a very positive step; more is needed. (*See*, November 24, 2004 Order in Case No. 2004-00302.) The Commission should now, at a minimum, preserve existing regulatory flexibility for small telephone utilities.

Alternative regulation benefits consumers, incents investment, and encourages providers to offer expanded service offerings. In the years following ALLTEL Kentucky's election of alternative regulation, its basic service rates have remained among the lowest in the state, and ALLTEL Kentucky continues consistently to meet or exceed Commission-required service quality standards. ALLTEL Kentucky also has reinvested for its customers and achieved expanded availability of DSL in its three exchanges

(between 91% and 98%). Such availability of advanced services complements the efforts of Kentucky Governor Ernie Fletcher and the Kentucky Legislature in their efforts to expand the availability of broadband across the Commonwealth. The Governor's "Prescription for Innovation" recognized that Kentucky ranks 44th in the nation in its proportion of high-tech companies, 45th in household computer use, and 43rd in citizen Internet use. The Governor's solution – *ease regulatory roadblocks*, create supply-side incentives, and invest in demand-side policies. His vision of economic development - "Welcome to Kentucky. We are Open for Business." - acknowledges the benefits to consumers and Kentucky's economy of enacting policies that encourage businesses to invest in new technologies and predicts that full broadband deployment in Kentucky will result in 14,000 jobs and \$5 billion added to the Gross State Product annually. FCC Commissioner Jonathan S. Adelstein was right in line with such efforts when he noted that the FCC should "encourage broadband deployment by increasing incentives for investment and promoting competition." He said that the FCC "can do both with a policy framework that is flexible and keeps pace with rapid technological changes." (*See*, November 18, 2004 [TRDaily](#).) This is the same vision for which the Kentucky Legislature laid a foundation in 1992 and on which the Kentucky Commission should now set the stage for freedom from unnecessary regulatory restraints and movement of the Commonwealth into the new millennium.

The Commission should embrace the changing telecommunications environment and support the delivery of robust services to consumers by making greater regulatory flexibility available to companies which have elected alternative regulation under the Statute and offer similar regulatory alternatives to other companies.

**BACKGROUND AND SUPPORT FOR CONTINUATION OF ALLTEL
KENTUCKY'S ALTERNATIVE REGULATION PLAN**

ALLTEL Kentucky serves approximately 27,700 access lines in Zoneton, Mt. Washington, and Sheperdsville and is required to comply with the Commission's general service quality standards. ALLTEL Kentucky has received minimal Commission consumer complaints. Since October 13, 1998, ALLTEL Kentucky's intrastate operations have been regulated under the alternative regulation plan set forth in K.R.S. §278.516, the election of which was found by the Commission to be in compliance "with the requirements of the statute." (December 30, 1998 Order in Case No. 1998-00529.)

ALLTEL Kentucky satisfied the statutory requirements at the time of its election of alternative regulation in 1998. The Legislature did not provide any express authority or basis for the Commission to order electing companies to return to traditional rate of return ("ROR") regulation. Instead, the Legislature established a procedure entitling companies to elect under the plan and satisfy the requirements *at the time of election*. In other words, the Kentucky Legislature mandated that the decisions to *begin* and *end* being regulated under the Statute (as long as companies met the initial test of eligibility at the time of election) rested solely with the companies:

*A small telephone utility may elect, at any time, to be regulated by the provisions, in their entirety only, of this section by filing a verified resolution of the utility's board of directors, or other governing body, so electing with the commission. An election shall be effective immediately upon filing with the commission and shall remain effective until withdrawn by the filing with the commission of a verified resolution of the small telephone utility's board of directors or other governing body; provided, however, that all resolutions of election or withdrawal shall remain in effect for at least one (1) year from the date of their filing with the commission. A resolution electing to be regulated by the provisions of this section shall mean that the small telephone utility so electing shall be regulated by this section and *shall not be regulated by KRS 278.020(1) and 278.300*. Nothing in this section, however, shall be construed to alter*

the applicability of KRS 278.020(3) or 278.030(2) to small telephone utilities electing to be regulated by the provisions of this section.

(Emphasis added.)

In short, ALLTEL Kentucky satisfied the requirements at the time of its election in 1998. That election remains effective until ALLTEL Kentucky's Board of Directors determines (which it has not) that the election should be withdrawn and the Board's verified resolution to that effect is filed with the Commission.

HEARING

Pursuant to the Commission's November 22, 2004 Order, ALLTEL Kentucky requests a hearing in this matter and an opportunity to introduce testimony to substantiate the above facts consistent with the statements above supporting expansion of existing regulatory flexibility. ALLTEL Kentucky requests that its tariff filing, which is currently suspended until January 6, 2005, be suspended indefinitely pending resolution of these matters. As an alternative, ALLTEL Kentucky would be willing to withdraw the tariff filing if such action would resolve this matter without the Commission's predetermined conclusions becoming final. ALLTEL Kentucky further requests that, absent withdrawal of the filing and final resolution of this proceeding, the Commission establish a procedural schedule with direct testimony being due no sooner than February 15, 2005 and a final hearing being set no sooner than March 5, 2005.

CONCLUSION

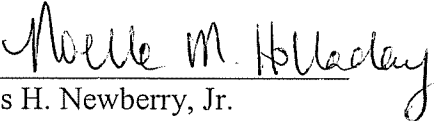
The policies set forth by the Legislature in support of expanded regulatory flexibility along with the efforts undertaken by the Governor and other state and federal telecommunication industry participants call for continuation and expansion of alternative regulation (not removal of existing regulatory flexibility). ALLTEL

Kentucky's intrastate operations have been regulated under the Statute for almost six years. Consumers have received the benefits of expanded investment in facilities to provide expanded and improved services under this plan. At the time of its election in 1998, ALLTEL Kentucky satisfied the requirements to elect under the statutory plan as acknowledged by the Commission. The Kentucky Legislature provided that electing companies like ALLTEL Kentucky may continue operating under K.R.S. §278.516 until their boards of directors decide to withdraw from the plan. The Legislature further provided that alternative regulation should be available to all carriers that satisfy the public interest criteria in K.R.S. §278.512. ALLTEL Kentucky's Board of Directors has not decided to withdraw from the plan, and removal of alternative regulation by the Commission would not be in the public interest and would be contrary to the public policy of the Commonwealth specified by the Legislature. Accordingly, ALLTEL Kentucky must be allowed, at a minimum, to remain governed by the Statute.

Dated this 13th day of December, 2004.

Respectfully submitted,

KENTUCKY ALLTEL, INC.

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