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January 21, 2004

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PUBLIC SERVICE COMMISSION

VIA HAND DELIVERY

Mr. Thomas M. Dorman
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602

RE: Contract Service Arrangements
Case No. 2002-00456

Dear Mr. Dorman:

Enclosed for filing please find an original and eleven (11) copies of the Brief on behalf of Kentucky ALLTEL, Inc. and ALLTEL Kentucky, Inc. in the above-referenced case. Please return a date-stamped copy to me in the enclosed self-addressed stamped envelope.

Thank you for your assistance in this matter. If you have any questions, please do not hesitate to call.

Sincerely,

WYATT, TARRANT & COMBS, LLP

Stephanie R. Conn

Stephanie R. Conn
Legal Secretary to James H. Newberry, Jr.

Enclosures
Brief (original and eleven copies)
SASE
cc: Parties of Record
30316680.1

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INQUIRY INTO THE USE OF CONTRACT SERVICE ARRANGEMENTS BY TELECOMMUNICATIONS CARRIERS IN KENTUCKY	**) ADMINISTRATIVE) CASE NO. 2002-00456**

BRIEF ON BEHALF OF KENTUCKY ALLTEL, INC. AND ALLTEL KENTUCKY, INC.

Filed January 21, 2004

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On December 19, 2002, the Kentucky Public Service Commission ("Commission") initiated Administrative Case No. 2002-00456 for the purpose of examining the use of contract service arrangements ("CSAs") by telecommunications carriers in Kentucky. ALLTEL Kentucky, Inc. ("ALLTEL Kentucky") and Kentucky ALLTEL, Inc. ("Kentucky ALLTEL") (collectively herein, "ALLTEL"), pursuant to a petition for confidential treatment, responded to the Commission's Requests for Information on March 24, 2003. ALLTEL and other participants herein filed direct testimony on or around April 30, 2003 and rebuttal testimony on or around May 21, 2003. Thereafter, Cincinnati Bell Telephone Company ("CBT") moved for an informal conference, which was held on August 11, 2003. The Commission conducted a final hearing in this matter on October 23, 2003, at which time witnesses for BellSouth Telecommunications, Inc. ("BellSouth"), CBT, and ALLTEL testified with respect to the need for relaxed regulation of contract service arrangements ("CSAs") and in support of their amended Joint Proposal. ALLTEL now files this Brief in support of its position with respect to the issues in this proceeding.

I. Introduction

Telephone utilities, including both incumbent local exchange carriers ("ILECs") and competitive local exchange carriers ("CLECs") must be allowed to use CSAs and pricing flexibility in order to quickly respond to customer demand and sustain real competition throughout their respective territories. However, current CSA administrative procedures are too cumbersome and prevent CSAs from being readily utilized by telephone utilities. Minimizing existing regulatory processes with respect to CSAs is in consumers' best interests and is consistent with Kentucky law. Eliminating existing filing requirements and approval processes

with respect to CSAs would allow all competitors to respond to customer demands in a timely manner and therefore engage in a true competitive exchange with other competitors.

The legislative findings in KRS §278.512 acknowledge the changing telecommunications environment and a utility's corresponding need for regulatory flexibility in order to better serve its customers, and the public interest criteria set forth therein provide a mechanism through which the Commission can achieve the flexibility utilities are requesting. Kentucky law further recognizes in KRS §278.170 that it is sometimes reasonable for a utility (whether it is an ILEC or CLEC) to differentiate between persons, localities, or classes of service that are not similarly situated. The Commission has successfully relied on KRS §278.512 in the past with respect to granting certain regulatory exemptions and should again invoke that authority with respect to CSAs to allow utilities to better serve their customers.

II. In order to best serve customers and sustain real competition, all telecommunications carriers must be allowed to quickly and effectively respond to consumers' demands.

In order to quickly respond to customer demand and to sustain real competition throughout their respective territories, all telephone utilities, including ILECs like ALLTEL, CBT, and BellSouth, must be allowed to use mechanisms to develop, bundle, and price services in a timely and flexible manner. (Steve Mowery Direct Testimony, page 3, lines 15-17; John Ruscilli Direct Testimony, page 2, lines 11-13; Scott Ringo Direct Testimony, page 5.) Accordingly, in order for Kentucky telecommunications consumers to realize the benefits of true, unencumbered competition, telephone utilities must be afforded relaxed CSA regulations and pricing flexibility. (Steve Mowery Direct Testimony, page 3, lines 13-23.)

Yet, that is not the case today as current CSA procedures are subject to tariffing and filing requirements, which require all utilities to file tariffs and copies of all special contracts

setting out rates or conditions of service not included in their general tariffs. (See, KRS §§278.160 and 278.180 and 807 K.A.R. 5:011 Sections 2 and 13; Steve Mowery Direct Testimony, page 5, lines 1-4.) Such regulations require utilities to give the Commission thirty days' notice (an extraordinarily long time in a competitive environment) of any rate changes. (Id. at line 5.) Additionally, the Commission has generally interpreted the regulations as excluding CSA filings from any confidential protections which results in a "one-stop shopping database" for other utilities. (Transcript of Scott Ringo Examination, page 16, lines 1-5 and page 21, lines 19-23.) Further, as CSAs must be approved in advance by the Commission, utilities (particularly, ILECs) are forced to wait before being able to respond to customers' demands. (Steve Mowery Direct Testimony, page 6, lines 17-19.) Finally, there is some ambiguity with respect to whether all telephone utilities are even subject to the same CSA regulations.[1] (Transcript of John A. Ruscilli Examination, page 51, lines 1-6.)

In ALLTEL's case, it currently uses CSAs in its markets only on a very limited basis. (Steve Mowery Direct Testimony, page 6, line 15.) In the past year, ALLTEL has filed only one CSA but would have used more CSAs had the process been less burdensome. (Transcript of Charles Harwood Examination, page 193, line 17.) The existing CSA filing and approval processes noted above are much too time consuming to be effective in responding to customers' needs in a competitive market. (Id. at page 194, lines 16-19.)

Notwithstanding the shortfalls inherent in the existing CSA procedures, the Commission has an opportunity in this proceeding to ensure that CSAs become effective tools for all

[1] The Commission's previous orders can be interpreted as exempting CLECs from all tariffing requirements except the general requirements to provide tariffs and revisions thereto upon 30 days' notice to the Commission. At least one CLEC has interpreted the Commission's decision as nullifying CSA filing requirements for CLECs and admitted that similarly situated CLEC customers are afforded competitive offerings and are not discriminated against in terms of price *because the market will not support such discrimination*. (*See*, Cinergy Communications Company Response dated May 21, 2003 in Case No. 2002-0456, pages 2 and 5.)

telephone utilities to better serve customers by approving the Joint Proposal offered by the participating ILECs. Specifically, all telephone utilities should be permitted to use CSAs for any service in lieu of tariff offerings in order to timely meet individual customers' needs and respond to competitive circumstances. (Steve Mowery Direct Testimony, page 8, lines 8-12.) Rates, terms, and conditions should be permitted to be developed on an individual case basis and provided to customers in writing. (Id. at page 5, lines 11-12.) While prior Commission review or approval of CSAs is too time consuming and should not be required, CSAs and the services thereunder may continue to be subject to Commission complaint and investigative procedures. (Id. at page 5, lines 13-15.) Finally, CSAs should not be required to meet the long run service incremental cost ("LRSIC") price floor if they are offered by a telephone utility to meet a competitor's equally low price. (Id. at page 5, lines 15-17.)

Importantly, CSAs should not be required to be publicly filed as it is not in the best interests of consumers and does not facilitate long-term competition. (Steve Mowery Direct Testimony, page 14, lines 1-4; John Ruscilli Direct Testimony, page 13, lines 9-14.) By forcing carriers (namely ILECs) to publicly file CSAs, competitors need only match or slightly improve another carrier's rate(s) in order to lure away a customer; however, there is no economic incentive for a competitor to provide any further price variance to the customer. (Steve Mowery Direct Testimony, page 14, lines 5-8.) Thus, the competitive process stops short without any ability by another carrier to respond. (Id. at lines 8-9.) Additionally, publishing CSAs may also violate the Federal Communications Commission's ("FCC") customer proprietary network information ("CPNI") rules by revealing customer proprietary information such as service conditions and descriptions. (Steve Mowery Direct Testimony, page 14, lines 13-15.) Such a requirement further appears to be inconsistent with Kentucky law, which provides that a utility

does not have to disclose special contract provisions that are not filed in its general schedule if same are otherwise excluded from the Kentucky Open Records Act, which grants such provisions confidential protection if their disclosure would allow competitors an unfair commercial advantage. (See, KRS §61.878.)

Minimizing existing filing requirements and approval processes with respect to CSAs would allow all competitors to respond to customer demands in a timely manner and therefore engage in a true competitive exchange with other competitors. (Id. at page 5, lines 9-11.) Customers should not be forced to (and in fact usually will not) endure delays in receiving competitive pricing arrangements while ILECs seek regulatory approval. (See, Transcript of Charles Harwood Examination, page 193, lines 15-17.) Additionally, the current CSA process stops prematurely after a CLEC merely offers a price lower than the ILEC. If given the opportunity to timely match such an offer via the use of CSAs, all competitors could respond in a timely manner to other competitors' offers to a customer, thereby fostering more of a true competitive exchange. Eliminating administrative burdens would allow all competitors to develop in a timely manner competitively priced services that are tailored to better meet customers' needs. (Steve Mowery Direct Testimony, page 7, lines 9-15.)

Allowing ILECs to competitively price services in only those geographic areas or to those customers targeted by competitors would continue the development of true competition. (Steve Mowery Direct Testimony, page 7, lines 19-21.) In fact, many carriers other than ILECs do not typically offer services to everyone in a geographic market. For example, many CLECs "cherry pick" customers by offering services to only the most profitable customers like large businesses, multi-tenant dwellings, or customers in areas adjacent to where the CLECs already have existing facilities. (Steve Mowery Direct Testimony, page 16, lines 1-5.) A policy that

defines a geographic area or market differently for ILECs than for other competitors arbitrarily restricts ILECs and impedes their ability to compete to the detriment of the very customers they are attempting to serve. (Id. at lines 15-18.) Therefore, the "geographic area" for the ILEC should be equal to the area targeted by its competitors.

In fact, many state regulatory commissions have demonstrated a clear movement toward eliminating the burdens on carriers in filing and/or seeking approval of CSAs. (Steve Mowery Direct Testimony, page 13, lines 1-3.) Outside of Kentucky, ten of the fourteen states in which ALLTEL ILEC affiliates operate do not require commission approval of CSAs. (Id. at lines 3-5.) Seven of the ten states do not require CSAs to be filed. (Id. at lines 5-6.) For instance, the Florida Public Service Commission significantly reduced the regulatory burdens imposed on CSAs by eliminating filing requirements for periodic CSA reports and specifically concluded that the reports did not offer a mechanism for determining the existence of anti-competitive or discriminatory behavior in the marketplace (e.g., below-cost contract arrangements, discriminatory contracts among similarly-situated customers, and imposition of onerous terms). (Id. at lines 6-12.) Similarly, the Missouri Public Service Commission concluded that its Reporting of Bypass and Customer Specific Arrangements Rules were obsolete given the implementation of the Federal Telecommunications Act of 1996 and the increase in telecommunication competition in Missouri and subsequently rescinded the rules. (Id. at lines 12-16.) Additionally, Georgia, Nebraska, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, and South Carolina do not require commission approval of CSAs. (Id. at lines 16-18.) Specifically, the Oklahoma, North Carolina, and Ohio state commissions allow CSAs to be filed after they become effective. (Id. at lines 18-20.)

To be clear, such relaxation of CSA regulations should not be misconstrued as deregulation of CSAs. (Steve Mowery Direct Testimony, page 4, lines 14-16.) Although the status of telecommunications competition in Kentucky is changing (as contemplated under KRS §278.512) and may at some future point justify such deregulation (See, Direct Testimony of John Ruscilli, page 8, lines 1-3), telephone utilities participating in this proceeding have only proposed to minimize or streamline the existing CSA regulations. (Steve Mowery Direct Testimony, page 4, lines 16-21.) Again, CSAs would not be subject to burdensome processes such as prior Commission review and approval or filing requirements, but CSAs may continue to be subject to Commission complaint and investigative procedures. (Steve Mowery Direct Testimony, page 4, lines 16-18.)

Relaxing CSA regulations does not hinder competition and does not insure any telephone utility's survival or retention of customers, although subjecting the CSA process to unnecessary regulations stifles and denies customers the benefits of true competition. (Steve Mowery Direct Testimony, page 4, lines 1-4.) While CSAs are one tool (albeit an important one) that telephone utilities need to be able to compete fairly, ILECs in particular also need the ability to competitively price services at some geographic level less than company- or exchange-wide just as other competitive carriers do. (Steve Mowery Direct Testimony, page 4, lines 4-7. See also, John Ruscilli Direct Testimony, page 6, lines 1-8.) Arbitrarily denying select market participants (in this case, ILECs) the tools they need to timely compete to meet customers' demands stifles true competition and also jeopardizes their ability to offer universal services at affordable rates and to maintain their carrier of last resort obligations. (Steve Mowery Direct Testimony, page 4, lines 7-10.)

III. Minimizing existing CSA regulation requires that the Commission waive application of KRS §§278.160 and 278.180 and 807 K.A.R. 5:011 Sections 2 and 13, all of which is within the Commission's authority to do.

In order to minimize or eliminate existing administrative burdens with respect to CSAs to allow telephone utilities to better respond to customers' demands, the Commission must waive application of KRS §§278.1602 and 278.180 as well as 807 K.A.R. 5:011 Sections 2 and 13. Currently, under KRS §278.160, the Commission is authorized to prescribe rules under which utilities must file schedules showing all of their rates and conditions for service, and KRS §278.180 requires utilities to give the Commission thirty days' notice of any rate changes. Additionally, the Commission's regulations, in 807 K.A.R. 5:011 Sections 2 and 13, require all utilities to file tariffs containing schedules of all of their rates, charges, tolls, and their rules and administrative regulations and copies of all special contracts entered into governing utility service which set out rates, charges or conditions of service not included in their general tariffs.

The Commission has authority to waive application of these statutes and its own regulations. First, pursuant to 807 K.A.R. 5:011 Section 14, the Commission may deviate from Sections 2 and 13 of its rules upon a showing of good cause. Second, KRS §278.512 allows the Commission to exempt from other statutes telecommunications services or products and the persons who provide them and provides as follows:

> § 278.512. Legislative findings -- Exemption of telecommunications product or service from regulation
>
> (1) The legislature finds and determines that:
>
> (a) Competition and innovation have become commonplace in the provision of certain telecommunications services in Kentucky and the United States;

[2] Kentucky Revised Statute §278.160 generally embodies the "filed rate doctrine." ALLTEL contends that CSAs should not be *regularly* filed and should be subject to proprietary treatment. However, such a policy is not inconsistent *per se* with KRS §278.160, as ALLTEL has also proposed that CSAs would need to be maintained in writing and made available to the Commission or its Staff upon request.

(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.

(2) Notwithstanding any other statute to the contrary, the commission may, on its own motion or upon motion of a telecommunications utility, after notice and opportunity for comment, and hearing if requested, *exempt to the extent it deems reasonable, services or products related to telecommunications utilities or persons who provide telecommunications services or products from any or all of the provisions of this chapter, or may adopt alternative requirements for establishing rates and charges for any service by a method other than that which is specified in this chapter, if the commission finds by clear and satisfactory evidence that it is in the public interest*. No exemption shall be granted under this statute which preempts, without notice and without hearing, if requested, the existing rights and obligations of a local exchange company to serve a territory under a tariff approved by the Public Service Commission. Any party which seeks an exemption shall certify to the commission at the time of the filing that he has notified the affected local exchange company by registered mail of the filing of a petition for exemption, and of the right of the local exchange company to request a hearing within thirty (30) days of the notification.

(3) In determining public interest, the commission shall consider 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 unregulated providers of functionally similar telecommunications services or products;
>
> (h) The overall impact on customers of a proposed change to streamline regulatory treatment of small or nonprofit carriers; and
> (i) Any other factors the commission may determine are in the public interest....
>
> (5) The Public Service Commission shall retain jurisdiction over persons and services which are exempted from regulation under this section, or for which alternative regulatory requirements have been established pursuant to this section....
>
> (6) In granting or vacating exemptions, the Public Service Commission shall not be discriminatory or preferential but may treat services and utilities differently if reasonable and not detrimental to the public interest.... (Emphasis added.)

Therefore, KRS §278.512 allows the Commission to exempt CSAs and the carriers that provide them from other statutes, including without limitation KRS §§278.160 and 278.180, and to adopt alternative requirements for establishing rates and charges upon consideration of the enumerated public interest criteria. As discussed in greater detail below, the record in this proceeding clearly supports findings that there is good cause to waive the Commission's rules and that the statutory public interest criteria are met with respect to minimized CSA regulation.

IV. Minimizing existing CSA regulation does not require that the Commission waive application of KRS §§278.170, although it is within the Commission's authority to do so if the Commission deems it necessary.

A waiver of KRS §278.170 is unnecessary. This statute provides the following in pertinent part:

> (1) No utility shall, as to rates or service, give any *unreasonable* preference or advantage to any person or subject any person to any *unreasonable* prejudice or disadvantage, or establish or maintain any *unreasonable* difference between

> localities or between classes of service for doing a like and contemporaneous service *under the same or substantially the same conditions*....
>
> (4) The commission may determine any question of fact arising under this section. (Emphasis added.)

Therefore, conduct that is reasonable does not violate KRS §278.170, nor does differentiating between persons, localities, or classes of service that are not similarly situated. Kentucky Revised Statute §278.170 only prohibits utilities from giving any unreasonable preference or advantage or establishing or maintaining any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions.

Simply put, a customer with competitive opportunities is not similarly situated to a customer without competitive opportunities such that differentiating between the two is reasonable. (Steve Mowery Direct Testimony, page 17, lines 2-4; John Ruscilli Direct Testimony, page 10, lines 13-15.) The presence of competition necessarily creates different conditions under which a utility must operate, and it is reasonable and in compliance with KRS §278.170 for a utility to respond differently with respect to certain customers who have competitive alternatives. (Steve Mowery Direct Testimony, page 17, lines 4-9.) Non-uniform pricing is not anti-competitive and is entirely reasonable in a competitive environment. (Id. at lines 9-10.)

Such a reading of KRS §278.170 (enacted in 1976) is most consistent with the legislative findings set forth above in KRS §278.512 (enacted in 1992), which reflect what is "reasonable" given the changing telecommunications environment and a utility's corresponding need for regulatory flexibility. (See, KRS §§278.170 and 278.512.) Alternatively, if the Commission believes a waiver of KRS §278.170 to be necessary, the Commission may rely upon the record in

this matter to find that, pursuant to the public interest criteria set forth in KRS §278.512, application of KRS §278.170 may be waived with respect to telephone utilities using CSAs to respond differently to customers presented with different competitive offers.

V. The Commission may waive application of its regulations as there is good cause to do so, and the Commission may waive application of relevant statutes as it is in the public interest.

The record in this proceeding demonstrates that it is in the public interest (pursuant to the criteria in KRS §278.512) to allow all telephone utilities the means with which to respond to the significant competition that currently exists and thereby waive application of KRS §§278.160 and 278.180 (and 278.170 if necessary). Further, the record also supports a finding of the less stringent standard under 807 K.A.R. 5:011 Section 14, that there is good cause to exempt CSAs from the Commission's tariffing regulations in 807 K.A.R. 5:011 Sections 2 and 13.

The Commission may grant the requested flexibility with respect to CSAs by finding that it is in the public interest to exempt CSAs from any relevant statutory tariffing or filing processes. Kentucky Revised Statute §278.512 sets forth the following public interest criteria to be considered:

> (1) the extent to which competing services are available from competitive providers in the relevant market;
>
> (2) the existing ability and willingness of competitive providers to make functionally equivalent or substitute services readily available;
>
> (3) the number and size of competitive providers of service;
>
> (4) the overall impact of the proposed regulatory change on the continued availability of existing services at just and reasonable rates;
>
> (5) the existence of adequate safeguards to assure that rates for regulated services do not subsidize exempted services;

(6) 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;

(7) whether the exercise of Commission jurisdiction inhibits a regulated utility from competing with unregulated providers of functionally similar telecommunications services or products;

(8) the overall impact on customers of a proposed change to streamline regulatory treatment of small or nonprofit carriers; and

(9) any other factors the Commission may determine are in the public interest.

Clearly, these criteria have been satisfied.

With respect to the **first, second,** and **third** criteria, services such as basic local exchange service, non-basic custom calling features, and advanced services (e.g., Call Waiting and Caller ID, voice mail services, Internet, high speed data services, digital video services, etc.) are readily available from various competitive sources. (Steve Mowery Direct Testimony, page 8, lines 21-23 and page 9, lines 1-2; Transcript of John Hullings Examination, page 124, lines 23-25 and page 125, lines 1-12; Transcript of Charles Harwood, page 198, lines 10-12.) These sources include, but are not limited to, competitive local exchange carriers ("CLECs"), wireless providers, cable providers, and Internet service providers ("ISPs"). (Steve Mowery Direct Testimony, page 9, lines 1-2.) These competitive carriers bundle residential telephone service with video service and restrict the bundled offers however they choose. While it may appear that they charge tariffed rates for those services, they indirectly discount tariffed non-recurring charges by heavily discounting non-telephone services (e.g., essentially waive installation charges through deep discounts on cable service). (Id. at lines 10-15.) Additionally, ALLTEL experiences "targeted competition" whereby competitors focus on specific businesses and

segments and not broad-based competition (in response to which a general tariff change would be helpful). (Transcript of Charles Harwood Examination, page 199, lines 2-5.)

At least one CLEC has attempted to refute the presence of such competitive alternatives by claiming that "consumers have no competitive alternative to the [ILECs] for local service in most areas of the state," apparently basing this belief on the ILECs' "market power and large base of residential and small business customers." (Edward Hancock Direct Testimony, page 2.) Additionally, in its Order issued in Case No. 2002-00276 with respect to the Petition of BellSouth for Presumptive Validity of Tariff Filings, the Commission applied this same logic and denied the petition based largely on a report published by the FCC. Relying on this FCC report (which the Commission acknowledged did not contain data on wireless carriers), the Commission found that as BellSouth had lost only 7.3 to 9.3 percent of its access lines to Kentucky CLECs, it continued to exercise market power. The Commission further seemed to find that as BellSouth possessed "market power" as measured only in terms of access lines lost to CLECs, there were not sufficient levels of competition to reasonably justify BellSouth's petition. However, competition is not measured in terms of access lines or market share. (Steve Mowery Rebuttal Testimony, page 4, lines 4-5.)[3] Competition is measured by customer choice, and

[3] Access line or market share calculations are not good indicators of competition because they do not measure consumer choice, and do not account for lost access line *growth* which has been significant. (Steve Mowery Rebuttal Testimony, page 4, lines 11-14.) Additionally, access lines lost to CLECs do not provide any indication of disconnected lines or decreased minutes of use ("MOUs") resulting from wireless alternatives, which have been substantial. In fact, one report states that wireless telephone subscribers spend, on average, more minutes talking on cellular phones than on traditional landline telephones, with the average American subscriber logging 490 minutes of use per month on his or her mobile phone compared to 480 minutes per month of residential landline usage. (*See*, April 28, 2003 News Release based on The Yankee Group's latest quarterly Wireless/Mobile North American Carrier Tracker, at www.yankeegroup.com.) The Commission should not base its decision in this case on reports that fail to acknowledge the availability of competitive alternatives from cellular systems and Internet-based communication sources which pose "the most serious threat to traditional providers." (*See*, "Is America Exporting Misguided Telecommunications Policy?" at www.cato.org.) (The *Wall Street Journal* also considers wireless cellular service and cable television providers, who are increasingly offering voice telephone service over their systems, to be significant threats to ILECs. See, "More Consumers Answer Cable's Call on Phone Service," by Peter Grant, September 5, 2002.) Similarly, an April 2003 study by Ernst & Young considered the potential replacement

customers throughout Kentucky (both residential and business) have a wide range of choices and competitive alternatives with respect to telecommunications services. (*Id.* at lines 5-7.)

Notwithstanding the fact that use of loss of market share or access line calculations overlooks the existence of real competition and could lead this Commission to reach the "wrong" decision with respect to the regulation of CSAs (Steve Mowery Rebuttal Testimony, page 6, lines 22-23), throughout ALLTEL's territories, there are over forty CLECs and numerous wireless providers operating, while cable providers also offer residential telephony service. (Steve Mowery Direct Testimony, page 9, lines 4-7.) ALLTEL is losing a significant amount of business (Transcript of Charles Harwood Examination, page 195, line 14) has even lost upwards of 50 percent of its business in its smaller communities that have intense competition (*Id.* at page 199, lines 10-12) such as the Glasgow market (*Id.* at page 202, lines 18-20). Since assuming control of the properties from Verizon South, Inc., Kentucky ALLTEL has lost approximately 25,000 access lines and is currently anticipating a loss of approximately 5% of its customers in 2003 (*Id.* at page 202, lines 10-14), although the Lexington market expects the loss to be as high as 7% to 8% (*Id.* at lines 16-17). Additionally, BellSouth has lost approximately 1,800 lines in the Frankfort market area (Transcript of Michael Hayden Examination, page 182, lines 7-10) and has approximately 32 to 36 viable CLECs operating in the Frankfort market (*Id.* at page 154, lines 20-24). As one witness noted, CLECs have acquired over 175,000 access lines in Kentucky, approximately 85,000 of which are business lines. (Direct Testimony of John Ruscilli, page 3.)

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of the primary residential wireline phone with a wireless alternative and found the threat posed by wireless service to wireline telephone companies to be "staggering." Some attribute the popularity of such wireless alternatives to that sector's ability to offer bundled pricing programs. (*See*, "20 Million Access Lines Lost to Wireless," MobileInfo.com, January 2002.) Equally as important are competitive alternatives offered by cable telephone service providers and broadband Internet protocol networks. Notwithstanding any access line calculation or FCC CLEC report, services such as basic local exchange service, non-basic custom calling features, voice mail services, Internet, high speed data services, and digital video services are widely available throughout Kentucky from various competitive sources.

Although these numbers are overwhelming, the reality is that using concepts like market dominance or market share to insist on the continuation of "traditional regulation" in the midst of competition will necessarily harm all local exchange carriers. (Steve Mowery Rebuttal Testimony, page 7, lines 4-6.) To avoid such harmful consequences in this proceeding, the Commission should find that the criteria have been met (with respect to the existence of competition) based on the availability of consumer choice, rather than on some measure of access lines lost to CLECs or division of market share (even though the record supports a finding on those criteria as well).

Not only are competitive alternatives available, but customers are also generally well aware of the existence of such competitive alternatives. (Transcript of John Ruscilli Examination, page 52, lines 1-5.) One ILEC witness explained:

> [C]ustomers talk to each other in their own unique industry forums. They're aware of contracts that are being passed around and prices that they get from other buyers. In addition, most of [BellSouth's] CLEC competitors that compete, as an example, in the business market have got what we would call feet on the street. They've got account executives going out and contacting these customers and making proposals. So they're aware of a variety of competitive alternatives. (*Id.* at lines 6-14.)

As demonstrated above, competing entities widely provide Kentucky residential and business telecommunications customers the same services (or the functionally equivalent or substitute services) as those offered by various Kentucky ILECs. As noted best by one BellSouth witness, "The customer can call today and say, 'I don't like [the ILEC's] service that I'm getting. I don't like the price. I want an offer.' The customer has been empowered for quite some period of time." (Transcript of John Ruscilli Examination, page 99, lines 1-4.)

With respect to the **fourth** and **sixth** criteria, increased flexibility with respect to CSAs would positively impact the ability of all telephone utilities to respond to customer's competitive needs, provide for true competition at just and reasonable rates, and preserve universal service. With respect to impacts to rates, lessening existing CSA administrative burdens would positively impact end users by allowing them to receive a fully competitive rate instead of merely a slight reduction of the ILEC's rate. (Steve Mowery Direct Testimony, page 10, lines 10-11.) Carriers do not typically choose to lower prices without some type of market pressure (e.g., the threat of not satisfying customer demand or the loss of a customer to a competitor). (Id. at page 15, lines 9-11.) However, if a carrier is forced to offer a below-cost rate for a select CSA in order to meet customer needs and competition, then the carrier has an opportunity to retain some contribution toward its sunk costs which minimizes upward rate pressure for its remaining customers. (Id. at page 10, lines 11-14.) However, failure to grant the requested CSA and pricing flexibility for ILECs in particular would negatively impact their ability to provide universal service at affordable rates (Id. at page 11, lines 20-23.), since restricting their effectiveness in responding to market demands serves only to erode their customer base due to regulatory restraint (and not any competitive innovation). (Id. at page 12, lines 2-4.) Such a decision places in jeopardy an ILEC's ability to perform its carrier of last resort obligations, to maintain a quality network, and to provide universal service at affordable rates throughout its service areas. (Id. at lines 4-6.)

As to the **fifth** criterion, adequate safeguards exist to assure that rates for regulated services do not subsidize exempted services. By statute (KRS §278.514), revenues derived from nonexempted, regulated telecommunications services, whether essential or nonessential, shall not be used to subsidize or otherwise give advantage to any person providing an exempted service. No utility herein has requested a waiver of KRS 278.514. Additionally, BellSouth expressed that

it has a policy against subsidizing its non-regulated services with its regulated services. (Transcript of John Hullings, page 117, line 25 and page 118, line 1.)

As long as a CSA covers the costs of the service, then there can be no cross-subsidization. (Steve Mowery Direct Testimony, page 11, lines 13-14.) Pricing below cost to match a competitor's price, however, is economically sound policy as its allows a carrier to retain contribution from the customer. (*Id.* at lines 14-16.) Allowing *all* market participants to match competitive offerings fosters true competition rather than merely encouraging a select group of market participants to "cherry pick" only high profit or high volume customers. (*Id.* at lines 16-18.) As one CLEC indicated that it adjusts its terms or prices as necessary to attract particular customers in an increasingly competitive marketplace and that these deviations from its tariff are closely analyzed to insure that an acceptable profit margin is maintained (*See*, Cinergy Communications Company Response dated May 21, 2003 in Case No. 2002-00456, pages 2 and 5), then to the extent then that CLECs such as that one are not pricing below cost, no harm results when an ILEC (or any other competitor) merely matches a competitor's price. (Steve Mowery Direct Testimony, page 11, lines 6-11.)

Further safeguards include the facts that regulated telephone utilities are subject to the Commission's audit and complaint processes and alternatively regulated companies have limitations on basic rate increases. (Steve Mowery Direct Testimony, page 10, lines 20-22.) Additionally, CSAs may continue to be subject to Commission investigation and complaint processes. (Id. at page 11, lines 3-4.) Based on the above safeguards, therefore, the fifth criterion has clearly been met on the facts in this case.

With respect to the **seventh** public interest criterion, failure to grant the requested flexibility will inhibit regulated telephone utilities from competing with unregulated providers of

functionally similar telecommunications services or products. As CSA and pricing restrictions are enforced only as to one set of market participants (for instance the ILECs or even CLECs), such regulatory restraint precludes those participants from competing with other market participants (such as cable or cellular providers). (Steve Mowery Direct Testimony, page 12, lines 11-13.) Streamlining the regulatory treatment of CSAs would allow all carriers and other providers in a given territory to fairly meet customers' demands in a timely manner. (Id. at lines 14-15.) Real, unencumbered competition also frequently results in increased technological innovations and service quality improvements. (Id. at lines 15-17.) A market where all participants do not have the same ability to respond to consumers' demands cannot be said to truly be competitive. (Id. at lines 17-19.)

As to the **eighth** criterion, granting CSA and pricing flexibility would positively impact customers by streamlining regulatory treatment for small carriers. Even small carriers cannot escape the onset of cable and wireless competition. (*See*, Transcript of John Ruscilli Examination, page 105, lines 15-25.) BellSouth's response time to such competitive pressures is impacted by the CSA administrative processes, including keeping and filing records. (Transcript of John Hullings Examination, page 142, lines 14-18). Small carriers are no exception. Just as BellSouth's responsiveness to customers would be enhanced by streamlining the CSA process (*Id.* at lines 18-23), so would the ability of small carriers to meet their customers' needs be improved thereby benefiting those customers.

Finally, the **ninth** criterion specifies that the Commission may consider other factors it determines to be in the public interest. To this end, the Commission should consider all other testimony set forth by the many witnesses for BellSouth, ALLTEL, and CBT, which taken

together demonstrate further that the Commission should adopt those carriers' Joint Proposal with respect to streamlined CSA regulation.

As the record herein clearly demonstrates that the public interest criteria set forth in KRS §278.512 have been met, it is, therefore, in the public interest to exempt CSAs from existing statutory burdens. Further, these same findings may be used to satisfy the less stringent standard that there is good cause to exempt CSAs from existing Commission regulations.

VI. The Commission has previously relied upon the authority granted to it in KRS §278.512.

By Order dated August 16, 1996, the Commission granted an application by BellSouth for exemption of its CSAs under KRS §278.512. (See, In the Matter of BellSouth Telecommunications, Inc. Tariff Revision to Price Regulation Plan in Section A36 of General Subscriber Services Tariff Concerning Contract Service Arrangements and Special Assemblies, Case No. 96-380.) In that proceeding, the Commission determined that exempting BellSouth's CSAs from full regulatory review was in the public interest and would enhance BellSouth's ability to respond effectively to market pressures. (Id.) Additionally, the Commission (in Case No. 2001-077) allowed BellSouth to deviate from existing regulatory burdens and file a report pursuant to KRS §278.512 of all of its CSAs within ten days following the end of each month.4 Similarly, the Commission utilized KRS §278.512 to grant CBT alternative regulation, including the flexibility to secure contracts with customers for competitive and unique situations. (Transcript of Scott Ringo Examination, page 15, lines 11-18.)

[4] The Commission also noted in Administrative Case Nos. 359 and 370 that it is bound by KRS §278.512 when evaluating the reasonableness of regulatory exemptions. In those cases, the Commission exempted interexchange carriers and competitive local exchange carriers from certain tariffing and other administrative requirements.

The Commission, through this present proceeding, has questioned its previous decisions to grant such statutory flexibility. One case giving rise to the Commission's concern involved a complaint by SPIS.net against BellSouth. (Case No. 2001-00099.) In this case, the complainant alleged that the terms upon which it received service subjected it to an unreasonable disadvantage because it was unable to obtain the same rate provided another competitor. (Id., December 19, 2002 Order at page 2.) Despite allegations that instances like these demonstrate an ILEC's abuse of CSA flexibility, ALLTEL contends that these cases actually support the ILECs' Joint Proposal calling for greater CSA flexibility. In these cases, customers investigated their competitive options, became aware of opportunities to which they believed they should be entitled, and upon failing to reach an understanding with a particular carrier, resorted to the Commission's complaint procedures to resolve the matter. Therefore, ALLTEL believes that these instances demonstrate further that a streamlined CSA process is necessary and reliable and in the public interest.

VII. Conclusion

Minimizing existing restrictions on CSAs would foster and strengthen competition, although failing to do so would have a chilling effect on true competition. Competition works best and customers benefit most when all carriers are allowed to timely respond to competitive entry and when there is subsequent and continual action and reaction by all providers. Only in this robust scenario do customers benefit. Denying any market participant the ability to respond and react curtails true market activity as no response/counter-response is allowed. Consumers are the losers in this limited process.

Lessening existing CSA regulatory restrictions is just one way in which the Commission may speed the effects of competition, namely customer choice for service offerings and competitive pricing from alternative sources. Doing so would also allow ILECs in particular to pinpoint competitive responses rather than being forced to respond with an overall rate decrease or to face the loss of all contributions previously provided by exiting customers. Such losses are ultimately supported by remaining customers, the effects of which can be particularly devastating to carriers responding to consumer demand and competitive pressures within residential telecommunications markets.

The public interest criteria in KRS §278.512 have been met, and it is, therefore, in the public interest to waive applicable statutory and Commission regulations in order to make the CSA process more flexible and useful for all telephone utilities. The Commission has invoked its authority under KRS §278.512 before and should invoke it again now to approve the Joint Proposal as prepared and amended by the ILECs participating in this proceeding.

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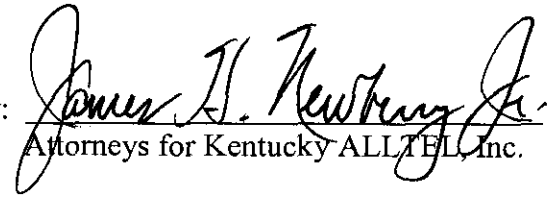
By: 
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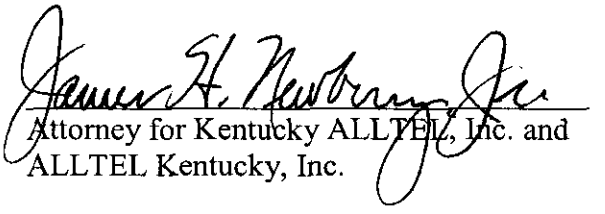
CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Brief was served upon the parties in the attached service list via regular U.S. mail postage prepaid this 21st day of January, 2004.



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