

What about Telecommunications Deregulation?

By Robert Loube

Director, Economic Research
Rhoads and Sinon, LLC

34th Annual PURC Conference
Studies Program
February 16, 2007

bobloube@earthlink.net

California Findings

- Wireless service is a substitute for wireline service
- The increase in mobile lines and the decrease in wireline lines implies that wireline service and mobile service are not complements
- The Commission refused to rely on HHI results or other traditional measures of market power
- VoIP is an available substitute for traditional telephone service
- ILECs do not retain market power due to the ubiquity of UNE-L

California Rule Changes

- Price cap regulations are eliminated
- Basic residential service rates are frozen until January 1, 2009.
- There is pricing freedom for all other services
- The geographic averaging requirement shall be lifted for all services that are not subsidized
- The decision does not apply to special access

Texas Chapter 65 Deregulation

- Stand Alone Basic Local Telephone Rates were capped until September 1, 2007
- Basic local service bundles have increased by \$2 to \$3 per month
- After September 1, 2007
 1. Markets with populations greater than 100,000 are deregulated
 2. Markets with populations greater than 30,000 and less than 100,000 are deregulated if the market meets a test specified in the law
 3. Markets with populations less than 30,000 are deregulated if the meets a test specified by commission rule.
- 74 percent of the residential market is deregulated

New York State Staff White Paper

- Pricing flexibility for all bundles
- Maximum state-wide rate of \$24.95 for basic local residential service
- Carriers with rates below \$24.95 are permitted to increase their rate to this cap in three years, with a maximum annual increase of \$5.00 per month.

Pennsylvania Chapter 30 Regulation

- Pricing flexibility for non-protected services
- Price Cap Regulation for protected services
- Broadband build-out requirement

An example of Pennsylvania Price Cap Regulation

Access Revenue	\$150 million
Basic Service Revenue	<u>\$200</u> million
Total Revenue	\$350 million
Price cap increase	<u>3</u> percent
Allowed Revenue Increase	\$10.5million

The entire revenue increase is assigned to basic service

AFOR Rate Freezes

- Qwest-MN: A three year freeze on residential basic local service rates with a \$1 increase in the fourth year.
- Qwest-Co: A freeze on residential basic local service rates
- Qwest-Az: A freeze on residential and business basic local service rates

AFOR Broadband Initiatives

- SBC-IN: extend DSL to 77 percent of its customers by 2008
- Verizon-IN: extend DSL to 75 percent of its customers by 2008
- Qwest-NM: high-speed Internet capability to 83 percent of its customers in three years, including at least 50 percent of customers in rural areas.
- In Ohio, several ILECs provide financial support to the Ohio community computing network

Use of the Horizontal Merger Guidelines to Determine if a Market is Competitive

- A HHI that is greater than 1,800 is an indicator of the existence of market power.
- A firm can exercise market power if it can sustain a small but significant non-transitory price increase.
- A common measure of a small but significant price increase is a 5 percent increase.

HHI Comparisons

Effective Competition

$$20^2 + 20^2 + 20^2 + 20^2 + 20^2 = 2000$$

Dominant Firm

$$50^2 + 10^2 + 10^2 + 10^2 + 10^2 + 10^2 = 3000$$

Residential Telephone Markets

$$80^2 + 5^2 + 5^2 + 5^2 + 5^2 = 6500$$

June 2006 Florida Wireline Lines		
	ILEC	CLEC
Switched Lines	84.8%	15.2%
Business Lines	70.1%	29.9%
Residential Lines	94.0%	6.0%

CLEC lines include cable lines

**Increasing the Size of the Residential Market to include
Wireless Cut-the-Cord Customers and Independent VoIP
and eliminating ILEC second lines**

	Industry	Market Share		
	ILEC	83%		
	CLEC	6%		
	Wireless	9%		
	VoIP	2%		
	Total	100%		

How to count:

93 ILEC lines

7 cell phones at a group house

100 total lines

- The ILEC has lost 7 percent of its market

93 ILEC lines

1 cable line at a group house

94 total lines

- The ILEC has lost 1 percent of its market

93 ILEC lines

7 cell phones

1 cable line

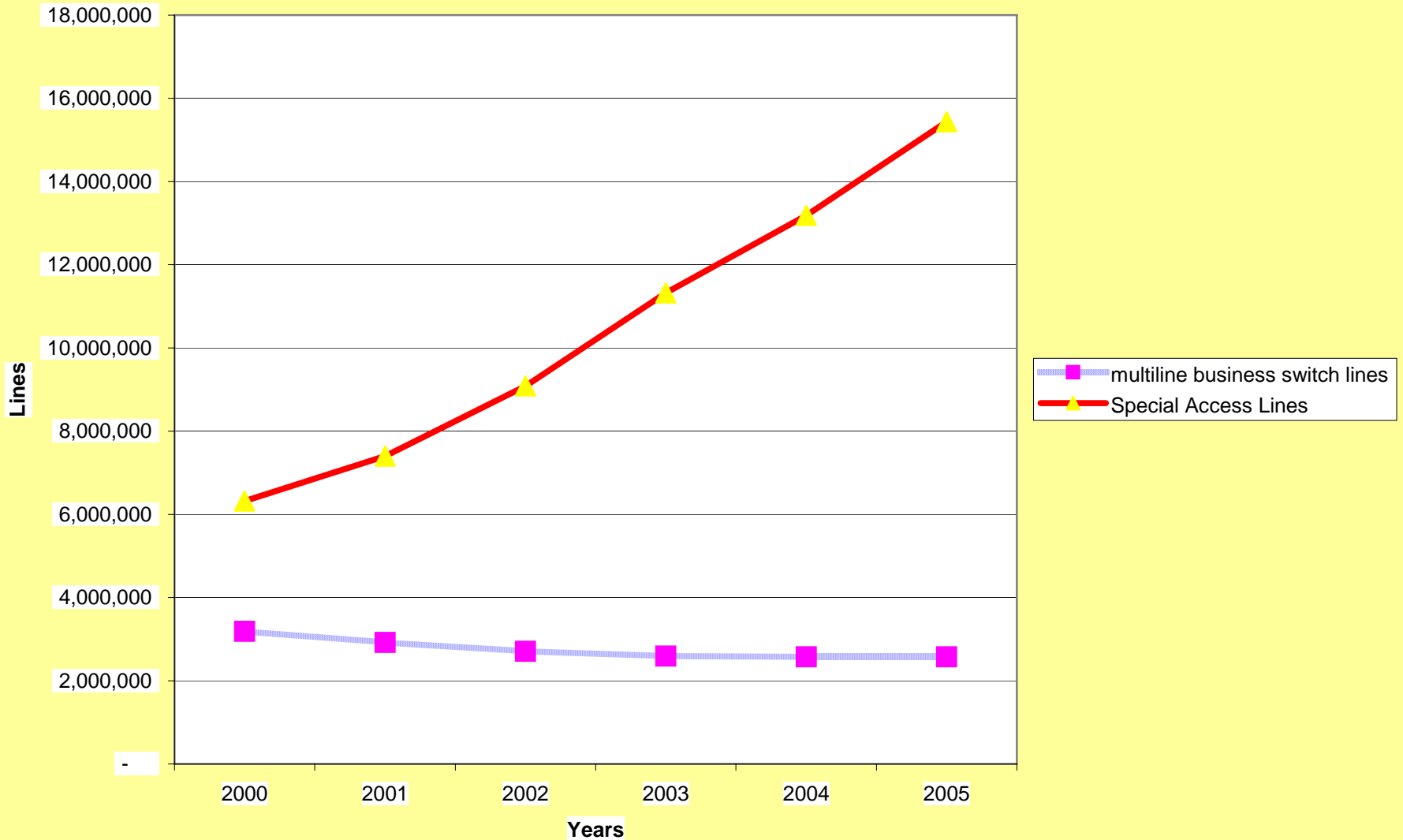
101 lines

- The ILEC has lost 8 percent of its market

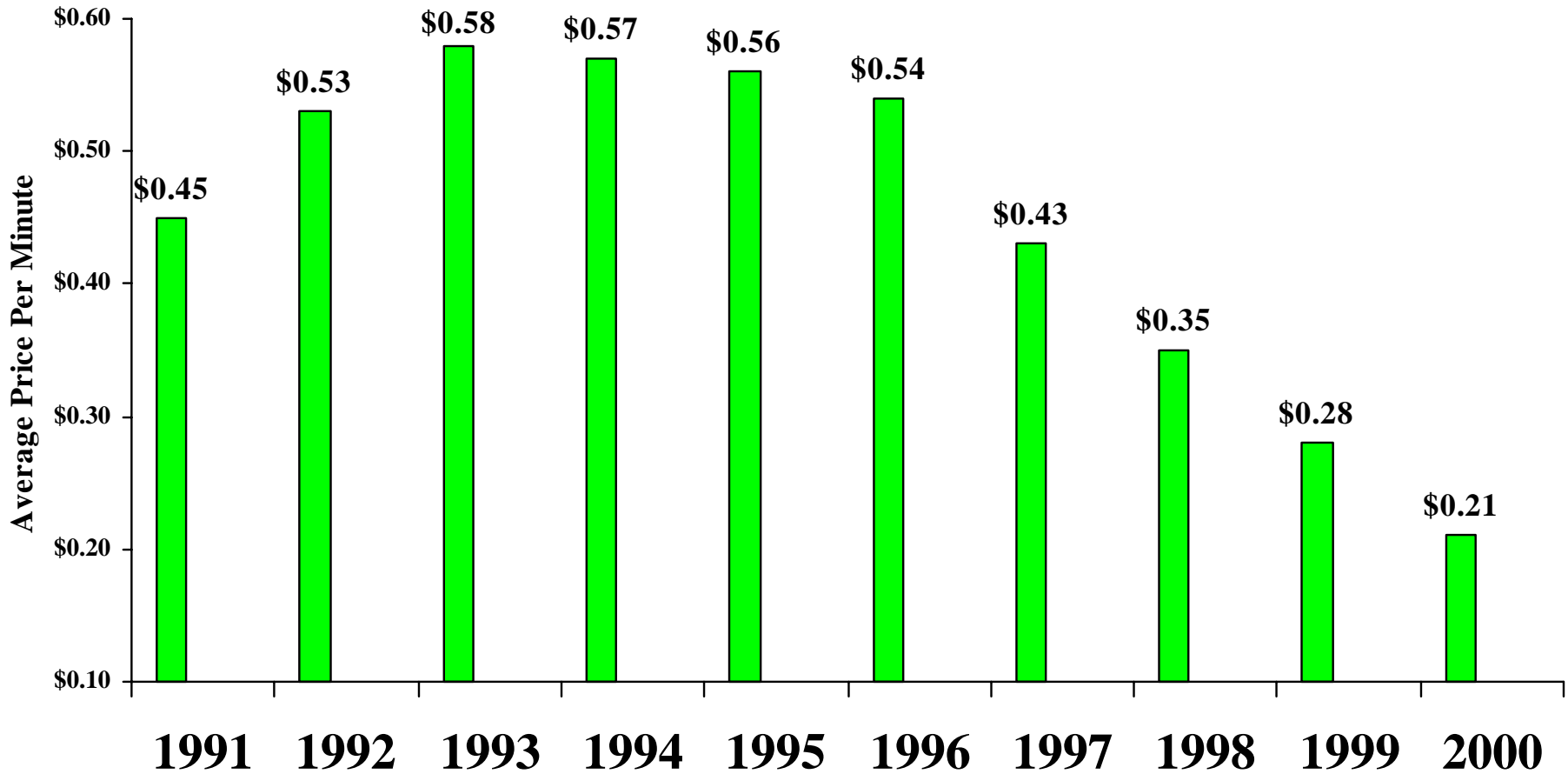
Loube

PURC Conference

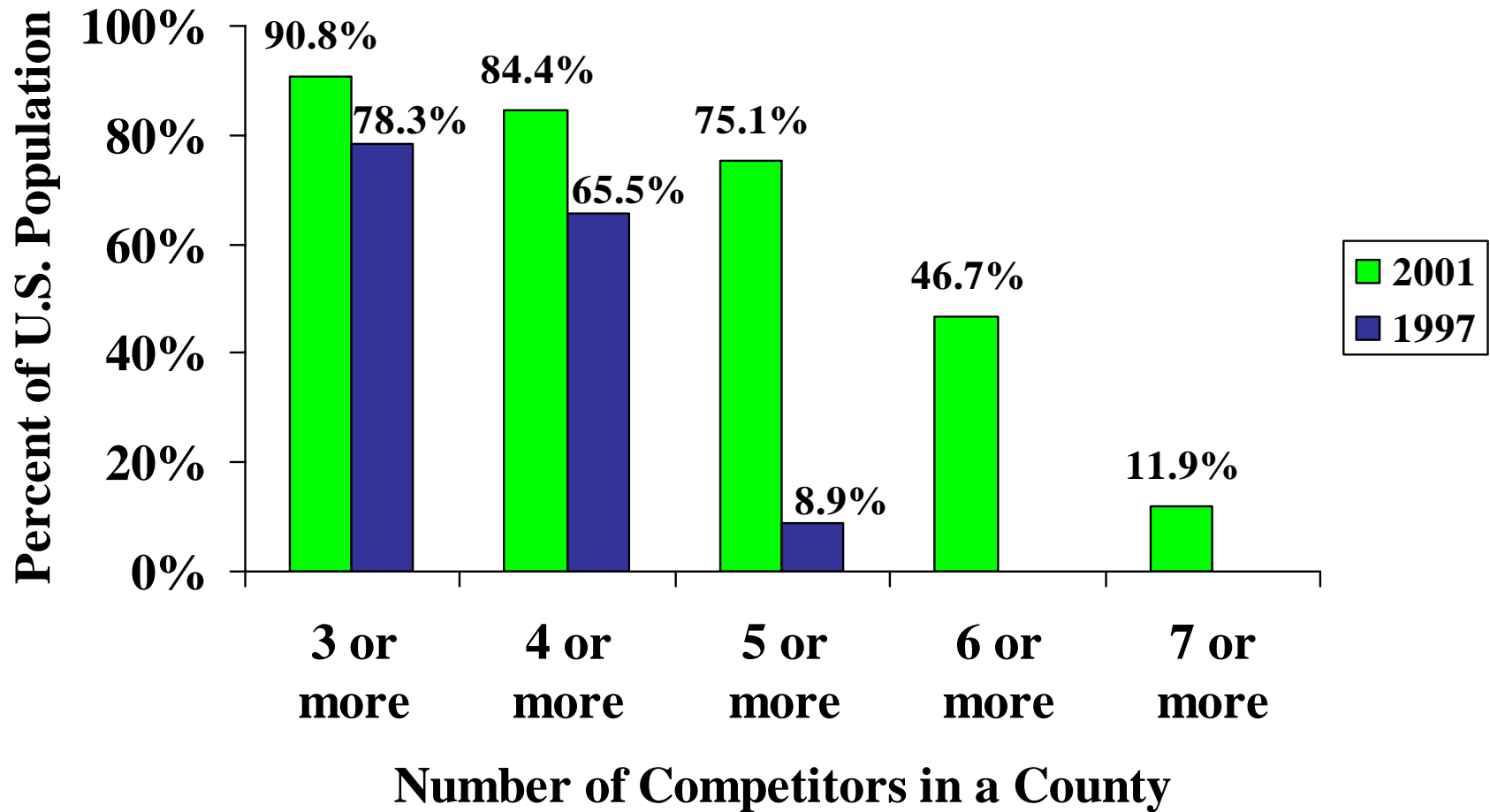
Multiline Business Access Lines and Special Access Lines for ARMIS filing Florida ILECs



Average Price Per Minute for Mobile Telephone Service



Mobile Telephone Competition



The Hirschman-Herfindahl Index - HHI for Wireless Markets

Year	2003	2004	2005
National Average of FCC Listed Markets	2,100	2,410	2,684
Miami	1,524	2,080	2,418
Orlando	1,646	2,288	3,028
Tampa	1,578	1,727	2,018
Washington DC	1,881	2,283	2,739

2005 Rate of Returns using ARMIS filing equations			
Carrier	Regulated	State	Interstate
BellSouth	22.4%	16.6%	31.0%
Verizon	16.4%	6.6%	35.3%
Sprint	11.5%	4.6%	36.1%

Requests for Rate Increases:

- Verizon-Va: \$1 per year for three years
- Qwest-Wa: \$0.50 per year for four years
- The Missoula Plan: Increase the SLC by \$3.50 and tie future increases to inflation
- Verizon-ME: Increases of 10 percent per year over five years such that rate would increase from \$19.29 to \$31.06

Service Quality – New York State Staff White Paper

“At the same time, we expect competition will increasingly force all providers to identify and meet consumers’ service quality expectations. We propose eventually moving away from service quality standards and toward a limited set of network reliability indicators as competition becomes more pervasive.”

Page 6.

Service Quality Issues

The need to prevent a race to the bottom where competitors reduce their service quality to match the lower service quality provided by others.

Example: The reduction of service reliability associated with the Verizon FiOS network.

Summary

- Traditional carriers are facing more competition in the markets for high-end customers
- Wireless providers are increasing their share of the total communications industry market
- ILECs are using the threat of competition as an excuse to exercise monopoly power in the basic residential local exchange market