The Public Utility Commission of Texas (commission) adopts new §26.226 relating to Requirements Applicable to Pricing Flexibility for Chapter 58 Electing Companies with changes to the proposed text published in the May 19, 2000 *Texas Register* (25 TexReg 4439). New §26.226 will clarify the substantive requirements relating to pricing flexibility for services offered by Chapter 58 electing local exchange companies. New §26.226, which results from the enactment of Senate Bill 560 during the Legislature's 76th Session, is adopted under Project Number 21155.

New §26.226 implements provisions of Senate Bill 560 (SB 560), 76th Legislature, Regular Session, related to pricing flexibility available to Chapter 58 electing companies. First, §26.226 defines pricing flexibility. Second, §26.226 establishes pricing standards for flexible pricing of services offered by Chapter 58 electing companies, including individual services and packages of services. Third, §26.226 provides Chapter 58 electing companies with guidelines for the introduction of customer-specific contracts in a manner consistent with SB 560. Through the adoption of new §26.226, the commission makes its rules consistent with the Public Utility Regulatory Act (PURA) and clarifies the standards required of Chapter 58 electing companies for exercising pricing flexibility. The new pricing flexibility provided by SB 560 and the commission's new rules provide an incentive for electing companies to introduce new and innovative services and packages of services for telephone customers. As a result, the commission anticipates that telephone customers will benefit from lower prices and a broader selection of service choices.

Comments on §26.226

On June 19, 2000, the commission received written comments on the proposed rule from AT&T Communications of Texas, L.P. (AT&T), the CLEC Coalition, GTE Southwest, Incorporated (GTE) and Southwestern Bell Telephone Company (SWBT). A public hearing on proposed §26.226 was held at commission offices on June 27, 2000 at 9:30 a.m. whereupon representatives from AT&T, the CLEC Coalition and SWBT attended the hearing and commented on the proposed rule. On July 3, 2000, the commission received written reply comments on this project from AT&T, the CLEC Coalition, Sprint/Centel and Sprint/United, and SWBT. On July 5, 2000, the commission received written comments from GTE. All timely filed comments, including any not specifically referenced herein, were fully considered by the commission.

Clarification of §26.226(c)(5)

Subsection (c)(5) states that, "except as provided by subsection (f) of this section, an electing company may flexibly price a package that includes a basic network service in any manner provided by paragraph (1) of this section." Subsection (f) contains two sentences. For reasons discussed under subsection (f), the first sentence in subsection (f) is obsolete and the second sentence in subsection (f) is unnecessary. The commission deletes subsection (f) and clarifies subsection (c)(5) by deleting any references to subsection (f).

Comments on §26.226(d)(3)

Subsection (d)(3) contains a proposal for an anticompetitive standard, *i.e.* a rebuttable presumption that the price of a service or package of services is anticompetitive if it is lower than the sum of the total element long run incremental cost (TELRIC)-based wholesale prices of components needed to provide the service or package. The commission requested comments regarding whether it is appropriate to include such an anti-competitive standard in this rule or, alternatively, whether such a standard should be developed through the facts determined in individual cases.

SWBT opposed the adoption of subsection (d)(3) largely because subsection (d)(3) is without statutory authority, and it is inconsistent with the requirements of PURA, relevant antitrust law and sound public policy. SWBT provided a total of eleven reasons why subsection (d)(3) should not be adopted, including (1) subsection (d)(3) is not based on PURA; (2) subsection (d)(3) conflicts with PURA §58.152(a); (3) subsection (d)(3) is inconsistent with PURA §51.004(b) and proposed §26.226(d)(2); (4) the long run incremental cost (LRIC) is the appropriate standard for considering whether an electing company's retail prices are anticompetitive or predatory, not TELRIC; (5) the proposed rule is inconsistent with PURA §58.063(b); (6) the proposed rule would lead to absurd results; (7) the rule has no evidentiary basis; (8) the proposed rule is wrong under antitrust laws; (9) the rule cannot be valid on the argument that it is the converse of PURA §51.004(b); (10) the rule is confusing; and (11) the proposed rule is not in the public interest because it will chill procompetitive pricing. At the public

hearing, SWBT reiterated its concerns. In reply comments, SWBT recommended that if an anti-competitive standard is developed, it be developed through the facts determined in individual contested cases. SWBT raised concerns about subsection (d)(3) related to jurisdiction, the concept of price squeeze and the practical impediments of implementation.

GTE also argued that the anticompetitive standard should be struck in its entirety. GTE posited that anticompetitive concerns should be addressed on an individual case-by-case basis. First, GTE argued that TELRIC is an average cost and an inference that a price is anticompetitive is more reliably drawn if it falls below marginal costs, not average costs. Second, GTE contended that not all components of a service may be essential to the provision of like services by competitors. Accordingly, it would be anticompetitive or could potentially retard the offering of new and more complicated nonbasic services if the incumbent local exchange company (ILEC) has to bear the burden for shared and common costs included in the TELRICs of any non-essential components, even when alternatives to these components would be available to competitors.

GTE cited a California rulemaking that rejected the calculation to establish price floors that summed all the TELRICs of a service and instead used a "contribution method" whereby only those costs competitors are required to pay (i.e., those associated with the "Monopoly Building Blocks" of loop, switching, and white page listings) are imputed in the establishment of price floors. GTE commented that the phrase "need to provide the service or package of services" may be interpreted to include all components of a service or just the essential components not available elsewhere. GTE commented

that the commission should not limit its discretion in testing price floors by codifying an ambiguous criteria that is admittedly rebuttable. Instead, GTE urged the commission to strike the rebuttable presumption from the rule in its entirety and to establish the mechanics of testing for anticompetitive pricing as individual cases arise. GTE stressed the fact that when determining a price floor, it must not only be determined what network elements are necessary for the competitor to provide the service, but what elements must be provided by the ILEC. GTE offered alternative language in the event the commission chose to retain the rebuttable provision. GTE suggested that the phrase "needed to provide service or packages" be replaced with "unavailable from alternative sources and necessary and essential for the provision of the nonbasic service or package of services."

AT&T and the CLEC Coalition supported the anticompetitive standard**.** AT&T endorsed the use of a rebuttable presumption as an initial measure rather than requiring the development of an evidentiary record in a contested case. AT&T noted that there is no clear standard by which an ILEC will be found to have rebutted that presumption. AT&T argued that the standard should be extremely rigorous, but was unable to articulate a specific standard. AT&T anticipated that the Chapter 58 electing ILECs will argue that the availability of the retail offering for resale will rebut the presumption, but took the position that resale should not be permitted as a basis for rebutting the presumption. AT&T stated that it would be anti-competitive to relegate an ILEC's competitor to a resale option as their only means of competing against ILEC pricing that undercuts wholesale costs.

In reply comments, AT&T noted that in spite of SWBT's eleven reasons for not adopting subsection (d)(3), AT&T urged the commission to adopt subsection (d)(3) for the single reason that PURA "explicitly supports it." AT&T opined that the commission is on very good grounds to adopt a rule that creates a rebuttable presumption regarding when the price of a service is anticompetitive. At worst, according to AT&T, the commission has not chosen its words carefully enough, insofar as the price of a "service" (or package of services) is at issue, and the proposed rule applies a cost method specific to elements (i.e. TELRIC), but the concept is the same. AT&T urges that any price that does not meet the imputation standard in PURA §60.064 is anticompetitive. Regardless of whether the price SWBT would charge would be "predatory," it is clearly anticompetitive and prohibited by PURA if it does not satisfy PURA's imputation requirements, according to AT&T.

The CLEC Coalition stated that it is necessary and appropriate for the commission to impose standards that address the most obvious forms of anti-competitive pricing, and that the most essential is the requirement that the ILECs not price retail services below the wholesale prices that CLECs must pay, a situation commonly referred to as price squeeze. Further, an ILEC's wholesale prices need not exceed its retail prices for a price squeeze to exist; a price squeeze may exist if there is only a small margin between retail and wholesale prices. The CLEC Coalition supported the rebuttable presumption because it places the ILEC on notice that if a complaint is filed, the ILECs will have to demonstrate that a retail price that is less than the price of wholesale components does not violate PURA.

The CLEC Coalition commented that if ILECs are following the Federal Communications Commission (FCC) pricing mandates, retail prices necessarily will be above the wholesale or unbundled network element (UNE) prices CLECs pay to acquire the elements necessary to provide the same retail service and that it is these wholesale prices that the ILEC should be charging itself. The CLEC Coalition contended that it would be rare for an ILEC to be charging less for a retail service than it imputes for wholesale components, and if such a situation did legitimately occur, it is the ILEC that possesses all of the cost information necessary to refute the presumption established by the rule. The CLEC Coalition also supported the TELRIC standard. The CLEC Coalition noted that SB 560 uses LRIC, but LRIC is defined by the commission through rule, so the disparity could be resolved by simple modification of the commission rule to add the same percentage markup for the ILECs costs as adopted in SWBT and GTE arbitrations. If costs are not being recovered in retail prices, the CLEC Coalition argued, then it is probable the ILEC is violating PURA §51.004. The CLEC Coalition supported adoption of the rule because leaving development of any implementing standards to individual contested cases would be costly, time-consuming, and unnecessary; individual adjudication should be used only in very fact-specific inquires. The CLEC Coalition argued that the anti-competitive effect is so clear and so likely to occur, a contested case should not be required to set this standard; instead, it should be explicit in the rule.

The CLEC Coalition responded to each of SWBT's eleven concerns about the anticompetitive standard. Key points made by the CLEC Coalition include: (1) the commission has the power to enforce all of PURA through its rules, and can fashion a rule that accomplishes its overall statutory

directive using its knowledge of economic principles and its regulatory experience and expertise; (2) the wholesale shared and common costs incurred in the provision of services should obviously be included in the price floor; (3) predation is technically distinct from the price-squeeze issue that has been the vital concern of CLECs; (4) the Legislature left the definition of LRIC up to the commission; (5) the foundation of SWBT's objection is its belief that LRIC and TELRIC are different cost concepts and that one of those concepts – LRIC – would be more generous or advantageous to SWBT in its pricing decisions; (6) it is possible to interpret PURA, particularly sections of PURA reflecting the Legislature's policy decision to maintain low rates for basic services even if the rates are below cost, without creating an absurdity; (7) there is no requirement that a rule be based on findings made through an evidentiary hearing; (8) nothing in PURA requires that it be interpreted with antitrust law as the guide and nothing in PURA states that a price is anticompetitive only if it is predatory; (9) the rule language is a necessary protection against a price squeeze and is both grounded in sound economic theory and logic on that basis; (10) SWBT's concern is based upon the false assumption that LRIC and TELRIC differ; and (11) there is nothing inconsistent with recognized economic principles in a rule that requires the dominant service provider to price its retail offerings at a level that exceeds the rates it charges for its wholesale products. The CLEC Coalition opposed deletion of this subsection. Similarly, at the public hearing, Allegiance Telecom supported adoption of subsection (d)(3) as proposed.

In its reply comments, GTE refuted the CLEC Coalition's concerns that insufficient margins between the ILEC's retail prices and the wholesale prices constitute a form of price squeeze. GTE asserted that the cost of essential and necessary services should be the test for determining anti-competitive behavior, not

potential competitor's margins. GTE commented that ILECs should not be penalized by incorporating such considerations in its assumed price floor. GTE and SWBT contended that the availability of service resale rebuts any presumption of anti-competitive pricing and the resale option provides an effective alternative in those cases where the retail price is below the sum of the component wholesale UNE prices. GTE commented any price floor that is more stringent than the LRIC is not in compliance with the statute and codifying this requirement in a rule would reinstate additional ILEC burdens contrary to Legislative intent and virtually assure that every product roll-out will result in a contested proceeding.

The commission agrees with GTE and SWBT that an anticompetitive standard is more appropriately developed on a case-by-case basis. The commission finds that circumstances surrounding allegations of anticompetitive behavior may vary significantly from case to case, and therefore a single rebuttable presumption may not adequately address the range of anticompetitive behaviors over which the commission has jurisdiction pursuant to PURA §51.004 and other sections of PURA.

Notwithstanding the fact that the rebuttable presumption is removed from this rule, the commission remains committed to ensuring that discounts or other forms of pricing flexibility are not "preferential, prejudicial, discriminatory, predatory or anticompetitive," as required by PURA §51.004. The extensive debate in the comments regarding the appropriateness of an anticompetitive standard in the rule, the use of TELRIC in such a standard and whether such TELRIC and LRIC actually differ clearly indicates that the process of making a determination of anticompetitiveness is highly fact-intensive and

should be developed in contested cases before it is codified in a rule. Because the rebuttable presumption is being removed from the rule, the commission will not further address the comments made by the parties. The commission notes that the filing requirements in §26.227 of this title (relating to Procedures Applicable to Nonbasic Services and Pricing Flexibility for Basic and Nonbasic Services for Chapter 58 Electing Companies) for informational filings require electing companies to furnish information about the list of relevant TELRIC based wholesale and retail prices for the service or package of services being offered. An interested party may rely on this information to initiate a complaint to investigate potential anti-competitive behavior on part of the electing company. Thus, the commission deletes §26.226(d)(3).

Comments on §26.226(d)(4)

Subsection (d)(4) requires that a package of services which includes unregulated products or services or the products or services of an ILEC affiliate be priced in a manner that recovers the costs to the electing company of acquiring and providing the unregulated product or service or the product or service of an affiliate. While subsection (d)(4) does not appear to address the pricing of packages that include regulated products or services, the inclusion of regulated products and services is implied by a reference to the pricing standard in subsection (d)(1).

The CLEC coalition opposed deletion of this subsection. However, the CLEC coalition expressed a preference for the "strawman" version (meaning the previous working draft) of subsection (d)(4), rather

than the published version, because the "strawman" version required the ILEC to price the unregulated or affiliate product or service above the standalone cost. Specifically, the CLEC coalition proposed rule language that modified subsection (d)(4) to require that the total package offering must exceed the cost the ILEC would have incurred had it purchased the unregulated product or its affiliate's services at the retail price in order to include them as a component of the package. The CLEC Coalition's proposed language was intended to address concerns that the rule, as written, would not address situations where an electing company's affiliate makes the product or service available to the electing company at no cost or significantly below cost.

The CLEC Coalition pointed out that the Legislature recognized the ability of a monopoly to drive competitors from the market with below-market pricing and, therefore, determined that ILECs must price their products and services above the LRIC. According to the CLEC Coalition, the same ability to undercut competitors is possible when an ILEC bundles services that are not subject to commission oversight, such as unregulated services and the services of an ILEC's affiliate. The CLEC Coalition acknowledged that the commission cannot regulate the price of unregulated services or affiliate services; nevertheless, the CLEC Coalition asserted that the commission has oversight of ILECs and can prevent an ILEC from engaging in anticompetitive behavior – even if the behavior encompasses the sale or joint marketing of unregulated or affiliate products. Importantly, the CLEC Coalition stated that the commission's responsibilities cannot be performed if the commission lacks the basic data and information necessary to review and evaluate an ILEC's proposed service offerings. The CLEC Coalition expressed particular concern that an affiliate of an electing company might make a product or

service available to an electing company at no cost and that such a transaction might avert the FCC's affiliate rules.

GTE recommended subsection (d)(4) be struck in its entirety because subsection (d)(4): (1) is inconsistent with PURA §58.063(b), (2) unlawfully seeks to exert regulatory authority over 'unregulated' products, (3) inappropriately links unregulated costs in establishing package price floors in a manner that is anticompetitive, (4) militates against providing Texas consumers the benefits of economies of scale, and (5) is overly concerned with potential ILEC cross-subsidization of regulated and non-regulated service offerings.

SWBT agreed with GTE's recommendation to strike subsection (d)(4) in its entirety. Furthermore, SWBT asserted that subsection (d)(4) is unlawful with or without the revision proposed by the CLEC Coalition. SWBT indicated that the CLEC Coalition's proposed revision to subsection (d)(4) violates PURA §60.165 because it would create an affiliate rule that is more burdensome than federal law.

The commission agrees with the CLEC Coalition that regulated products or services which are packaged with or jointly marketed with unregulated products or services or the products or services of an electing company's affiliate merit scrupulous attention. A heightened level of scrutiny is necessary to protect competitors and customers. Therefore, the commission expands the provisions in subsection (d)(4) to address concerns of the CLEC Coalition.

The commission finds that PURA §51.004(a) provides the commission with authority to adopt the expanded provisions. (Note: The expanded provisions include former subsection (d)(4), which will become subsection (d)(3) upon adoption, and new subsections (d)(4) and (d)(5).) PURA §51.004(a) states "A discount or other form of pricing flexibility may not be preferential, prejudicial, discriminatory, predatory or anticompetitive." The commission interprets the phrase "or other form of pricing flexibility" to include the packaging or joint marketing of services described in the expanded provisions, consistent with the definition of "pricing flexibility" in PURA §51.002(7). Pricing flexibility includes the packaging of services as well as other types of promotional pricing such as joint marketing.

Without authority to review the pricing of joint marketing efforts and packages of services that include regulated, unregulated or affiliated components, PURA §51.004(a) would be rendered meaningless with respect to those types of pricing flexibility (i.e. packaging of services and joint marketing). Indeed, to be able to assess whether a package or a joint marketing effort is priced in an anticompetitive, preferential or prejudicial manner, the commission must be able to ascertain whether the cost to an electing company of acquiring and providing an unregulated service or the service of an affiliate is recovered from revenues generated by a regulated service. PURA §52.051(1)(C) underscores the commission's authority to exercise oversight in this area. PURA §52.051(1)(C) directs the commission to balance the public interest in adopting rules and establishing procedures by considering, in part, the prevention of subsidization of competitive services with revenues from regulated monopoly services. Considering the commission's responsibility with respect to the issue of subsidization, the commission is sympathetic to the CLEC Coalition's concern regarding situations where the electing company

purchases the affiliate product or service at or near a rate of zero. But, the CLEC Coalition's proposed solution goes too far because requiring packages to recover retail prices of individual unregulated or affiliated products or services defeats the pricing benefits normally associated with packaging and joint marketing. The commission addresses this concern and other CLEC Coalition concerns, in part, by referencing the FCC's requirements in the adopted rule.

For telephone companies subject to the FCC's affiliate transaction rules, it is not possible for an affiliate transaction to be valued at or near a rate of zero. In its March 8, 2000 Order in CC Docket Number 99-253, *In the Matter of Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase I,* the FCC modified FCC rule §32.27(c) to reflect its policy that affiliate transactions be valued at publicly available rates. Publicly available rates, in order of precedence are (1) an existing tariff rate, (2) a publicly-filed agreement, or (3) a qualified prevailing price valuation. If no publicly available rate exists, an affiliate transaction must be valued at either fully distributed cost or fair market value. Services provided by an electing company to its affiliate must be valued at the higher of fair market value and fully distributed cost. Services received by an electing company from its affiliate must be valued at the lower of fair market value and fully distributed cost. There are two notable exceptions to these guidelines. First, services received by an electing company from its affiliate that exists solely to provide services to members of the carrier's corporate family are valued at fully distributed cost. Second, where the total annual value of transactions for a service is less than $500,000, the service is valued at fully distributed cost. Although the commission's discussion centers on the FCC's affiliate transaction rule modifications adopted in its

March 8, 2000 Order, the rule language adopted by the commission, which references FCC's requirements, is necessarily broad because the commission recognizes that there may be other relevant rules or orders, existing or produced in the future, relevant to the implementation of subsections (d)(3)-(5).

The CLEC Coalition's concerns regarding cross-subsidization are also addressed by referencing PURA §52.051(1)(C) which prohibits an local exchange company from using revenues derived from regulated monopoly services to subsidize services subject to competition. The commission interprets the reference to services subject to competition to include unregulated products or services and the products or services of an electing company affiliate as well as certain regulated products and services. The expanded provisions in the rule address packaging and joint marketing of regulated services with services subject to competition.

PURA §60.165 prescribes that the commission may not adopt any affiliate rule, including any accounting rule, cost allocation rule, or any structural separation rule, that is more burdensome than federal law or applicable rules or orders of the FCC, except as prescribed in PURA, Chapters 61, 62 and 63. The commissions expanded provisions, which incorporate by reference the FCC's requirements, meet the requirement of PURA §60.165. In conclusion, the commission finds the expanded provisions to be in the public interest and, therefore, adopts new subsections (d)(3)-(d)(5).

Comments on §26.226(e)

Subsection (e) provides the substantive requirements for ILECs to offer customer-specific contracts for basic network services and nonbasic services that are not otherwise addressed via §26.211 of this title, Rate Setting Flexibility for Services Subject to Significant Competitive Challenges. The provisions in §26.211 commemorate sections of PURA that existed before the Chapter 58 election existed, particularly PURA §52.056, *Specifically Authorized Regulatory Treatments,* and §52.057, *Customer-Specific Contracts.*

The CLEC Coalition suggested the references to §26.211, in subsection (e), be clarified to refer specifically to §26.211(d)(1). SWBT opposed the CLEC Coalitions suggested modification pertaining to subsection (e) because, according to SWBT, the Coalition's suggestion could cause confusion.

Sprint suggested that the language in subsection (e) is incorrect. Sprint believes the commission was attempting to mirror the language in PURA §58.003(a), which cites PURA §58.051(a)(1)-(4) and §58.151(a)(1)-(4) as the only services which cannot have customer-specific contracts until September 1, 2003. Sprint believes this section includes a greater variety of services for which the electing company can offer customer-specific contracts than does §26.211.

The commission acknowledges the concerns of the CLEC Coalition and Sprint. The published language in subsection (e) could be misinterpreted to mean that an electing ILEC must rely first upon §26.211 to offer services via customer-specific contract and, only if a service is not identified under

§26.211, may an ILEC use the provisions of subsection §26.226(e). Such a misinterpretation was not intended.

The commission's reference to §26.211 was an attempt to fully recognize the options available to electing companies. Section 26.211 primarily reflects the provisions of PURA §52.057 which permit customer-specific contracts for services listed under §52.057(a) and prohibit customer-specific contracts for services listed under §52.057(e). Alternatively, §26.226 reflects the provisions of PURA §58.003, which conditionally permit customer-specific contracts for basic network services and nonbasic services except for services listed in PURA §58.051(a)(1)-(4) and §58.151(1)-(4).

With respect to customer-specific contracts, the provisions of Chapter 58 take precedence over the provisions of Chapter 52 for an electing company. In other words, PURA §58.003 restricts an electing company from entering into customer-specific contracts for services listed in PURA §58.051(a)(1)-(4) and §58.151(1)-(4). Consistent with PURA §58.003, an electing company may enter into customer-specific contracts pursuant to §26.226. Additionally, for certain services, an electing company may enter into customer-specific contracts pursuant to PURA §52.057 and §26.211 only if the contract is not inconsistent with PURA Chapter 58 and §26.226. Because subsection (e) as written could be misinterpreted, the commission modifies subsection (e) to clarify its intended purpose.

The commission modifies subsection (e) to permit an electing company to offer customer-specific contracts pursuant to PURA Chapter 58. Additionally, for services listed in PURA §52.057(a), the

commission modifies subsection (e) to permit an electing company to offer customer-specific contracts pursuant to §26.211, as long as such contracts are not inconsistent with Chapter 58.

With these modifications, electing companies must provide the commission with informational notices for all customer-specific contracts, except for customer-specific contracts for services listed in PURA §52.027(a). For services listed in PURA §52.057(a), an electing company may choose either to provide the commission with an informational notice in accordance with the procedures in §26.227 or to provide the commission with quarterly reports in accordance with the procedures in §26.211.

Comments on §26.226(f)

Subsection (f) describes requirements for packages offered by an electing company with more than five million access lines. The CLEC Coalition suggested the provisions in PURA §60.042(c), which distinguish between promotions of basic and nonbasic services that last 90 or fewer days and promotions that last more than 90 days, be added to subsection (f). Further, the Coalition prefers the rule address whether "a duration of more than 90 days" refers to the time period during which the electing company was marketing the promotion or the time period during which the retail customer received the promotional rate. SWBT opposes the CLEC Coalition's suggestion to recite the requirements of PURA §60.042(c) in the rule.

The commission agrees with the CLEC Coalition that the 90-day duration must be clarified through a rulemaking. The commission believes a more appropriate avenue to address these concerns is in the context of a rule addressing resale issues.

As a separate matter discussed under subsection (c)(5), subsection (f) contains two sentences. The first sentence is a reiteration of PURA §58.004(a) which imposes a restriction on the services to be included in packages *until* the switched access rate reductions in PURA §58.301(2) are implemented. The commission notes that the first sentence is now obsolete because all of the reductions to switched access rates described in PURA §58.301(2) were implemented on July 1, 2000. Therefore, because the restriction established under PURA §58.004(a) expired on July 1, 2000, the first sentence in subsection (f) serves no purpose and, therefore, the commission deletes it.

The second sentence requires an electing ILEC to provide notice of promotional offerings of basic or nonbasic services, as required in PURA §58.153(b), in accordance with §26.227, a procedural rule for nonbasic services. The commission notes that the notice requirement in PURA §58.153(b) for promotions of basic network services is included in §26.224(k) of this title (relating to Requirements Applicable to Basic Network Services for Chapter 58 Electing Companies) and the notice requirement in PURA §58.153(b) for promotions of nonbasic services is included in §26.227(c)(1)(B) of this title (relating to Procedures Applicable to Nonbasic Services and Pricing Flexibility for Basic and Nonbasic Services for Chapter 58 Electing Companies.) Because §26.226(f) erroneously refers to §26.227 for notice of promotions of basic services and because the notice requirements are fully delineated in

§26.224 (basic network services) and §26.227 (nonbasic services), the commission deletes the second sentence in §26.226(f). Section 26.226(a) appropriately refers to both §26.224 and §26.227.

Modification to §26.226(g)

To aid the clarity and purposefulness of the rule, the commission deletes subsection (g). Subsection (g) imposes a restriction on the offering of term and volume discounts until September 1, 2000. Because §26.226 will be adopted after September 1, 2000, subsection (g), if adopted, would be obsolete before it became effective. Thus, subsection (g) serves no purpose and, therefore, the commission deletes it.

In addition to modifications described thus far, the commission makes other minor modifications for the purpose of clarifying its intent.

New section §26.226 is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2000) (PURA), which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, PURA §51.002(7) which defines pricing flexibility, PURA §52.054-§52.059 which describe pricing flexibility available to ILECs in addition to pricing flexibility available under PURA, Chapter 58, PURA §58.003 which delineates requirements pertaining to customer-specific contracts, PURA §58.004 which imposes certain restrictions upon term discounts, volume

discounts and other promotional offerings, PURA §58.063 which provides standards for pricing and packaging flexibility, PURA §58.152(b) which states that an electing company may flexibly price nonbasic services, PURA §58.153 which contain certain notice requirements for Chapter 58 electing companies and PURA §60.052 which prohibits restrictions on resale or sharing.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 51.002(7), 52.054-52.059, 58.003, 58.004, 58.063, 58.151, 58.152, 58.153, and 60.052.

§26.226. Requirements Applicable to Pricing Flexibility for Chapter 58 Electing Companies.

(a) **Application.** This section applies to any electing company as the term is defined in the Public Utility Regulatory Act (PURA) §58.002. Other sections applicable to an electing company, include, but are not limited to §26.211 of this title (relating to Rate-Setting for Services Subject to Significant Competitive Challenges), §26.224 of this title (relating to Requirements Applicable to Basic Network Services for Chapter 58 Electing Companies), §26.225 of this title (relating to Requirements Applicable to Nonbasic Services for Chapter 58 Electing Companies) and §26.227 of this title (relating to Procedures Applicable to Nonbasic Services and Pricing Flexibility for Basic and Nonbasic Services for Chapter 58 Electing Companies).

(b) **Purpose.** The purpose of this section is to establish requirements for Chapter 58 electing incumbent local exchange companies (ILECs) to exercise pricing flexibility.

(c) **Pricing flexibility.** An electing ILEC shall exercise pricing flexibility in accordance with this section and §26.227 of this title.

(1) Pricing flexibility includes:

(A) customer specific contracts;

(B) packaging of services;

(C) volume, term, and discount pricing;

(D) zone density pricing, with a zone to be defined as an exchange; and

(E) other promotional pricing.

(2) A discount or other form of pricing flexibility for a basic or nonbasic service may not be preferential, prejudicial, discriminatory, predatory or anticompetitive.

(3) This section does not prohibit a volume discount or other discount based on a reasonable business purpose.

(4) Notwithstanding PURA §58.052(b) or PURA, Chapter 60, Subchapter F, an electing company may exercise pricing flexibility for basic network services, including the packaging of basic network services with any other regulated or unregulated service or any service of an affiliate.

(5) An electing company may flexibly price a package that includes a basic network service in any manner provided by paragraph (1) of this subsection.

(6) An electing company may use pricing flexibility for a basic or nonbasic service.

(d) **Pricing standards.** An electing company exercising pricing flexibility shall price its offerings pursuant to this subsection.

(1) The electing ILEC shall set the price of a package of services containing basic network services and nonbasic services at any level at or above the lesser of:

(A) the sum of the long run incremental costs of any basic network services and nonbasic services contained in the package; or

(B) the sum of tariffed prices of any basic network services contained in the package and the long run incremental costs of nonbasic services contained in the package.

(2) A price that is set at or above the long run incremental cost of a service is presumed not to be a predatory price.

(3) The price of a package that combines regulated products or services with unregulated products or services shall, in addition to the requirements of paragraph (1) of this subsection, recover the cost to the electing company of acquiring and providing the unregulated products or services. In this section, unregulated products or services are products or services provided by an entity that is unaffiliated with the electing company.

(4) The price of a package that combines regulated products or services with the products or services of an affiliate shall, in addition to the requirements of paragraph (1) of this subsection, recover the cost to the electing company of acquiring and providing the affiliate products or services, which shall be greater than or equal to the cost to the affiliate of acquiring and/or providing the products or services. The cost to the electing company of acquiring or providing the affiliate's products or services shall be valued in a manner consistent with FCC requirements and with paragraph (5) of this subsection. A group of products or services that are jointly marketed by an electing company in conjunction with one or more of its affiliates shall be priced in a manner consistent with FCC requirements, if any, and with paragraph (5) of this subsection.

(5) Consistent with PURA §52.051(1)(C), an electing company shall not use revenues from regulated monopoly services to subsidize services subject to competition.

(e) **Requirements for customer-specific contracts.** Consistent with PURA §58.003, an electing ILEC may enter into customer-specific contracts for certain basic network services and certain nonbasic services as provided in this subsection. Additionally, for services listed in PURA §52.057(a), an electing ILEC may enter into customer-specific contracts pursuant to §26.211 of this title only if such customer-specific contracts are not inconsistent with the requirements of PURA, Chapter 58.

(1) An electing company serving fewer than five million access lines may offer customer-specific contracts in accordance with this subsection.

(A) An electing company serving fewer than five million access lines shall not offer customer-specific contracts until it notifies the commission of the company's binding commitment to make the following infrastructure improvements consistent with PURA §58.003(b):

(i) install Common Channel Signaling 7 capability in each central office; and

(ii) connect all of the company's serving central offices to their respective local access and transport area (LATA) tandem central offices with optical fiber or equivalent facilities.

(B) The commitments described by subparagraph (A) of this paragraph do not apply to exchanges of the company sold or transferred before, or for which contracts for sale or transfer are pending on, September 1, 2001. In the case of exchanges for which contracts for sale or transfer are pending as of March 1, 2001, where the purchaser withdrew or defaulted before September 1, 2001, the company shall have one year from the date of withdrawal or default to comply with the commitments.

(2) An electing company serving more than five million access lines may offer customer specific contracts in accordance with this subsection.

(A) Unless the other party to the contract is a federal, state, or local governmental entity, an electing company serving more than five million access lines may not offer in an exchange a service, or an appropriate subset of a service, listed in PURA §58.051(a)(1)–(4) or §58.151(1)–(4) in a manner that results in a customer–specific contract until the earlier of:

(i) September 1, 2003; or

(ii) the date on which the commission finds that at least 40% of the total access lines for that service or appropriate subset of that service in that exchange are served by competitive alternative providers that are not affiliated with the electing company.

(B) Pursuant to subparagraph (A)(ii) of this paragraph, the commission may find that the following subsets of services are served by an alternative provider that is not affiliated with an ILEC serving more than five million access lines:

(i) flat residential rate local exchange telephone service;

(ii) residential primary directory listings;

(iii) residential tone dialing service;

(iv) lifeline and tel-assistance service;

(v) service connection for basic residential services;

(vi) flat business rate local exchange telephone service;

(vii) business primary directory listings;

(viii) business tone dialing service;

(ix) service connection for all business services;

(x) direct inward dialing for basic business services; and

(xi) receipt of a directory.

(3) This subsection does not preclude an electing company from offering a customer-specific contract to the extent allowed by PURA as of August 31, 1999.

This agency hereby certifies that the rule, as adopted, has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §26.226 relating to Requirements Applicable to Pricing Flexibility for Chapter 58 Electing Companies is hereby adopted with changes to the text as proposed.

ISSUED IN AUSTIN, TEXAS ON THE 29th DAY OF SEPTEMBER 2000.

PUBLIC UTILITY COMMISSION OF TEXAS

Chairman Pat Wood, III

Commissioner Judy Walsh

Commissioner Brett A. Perlman