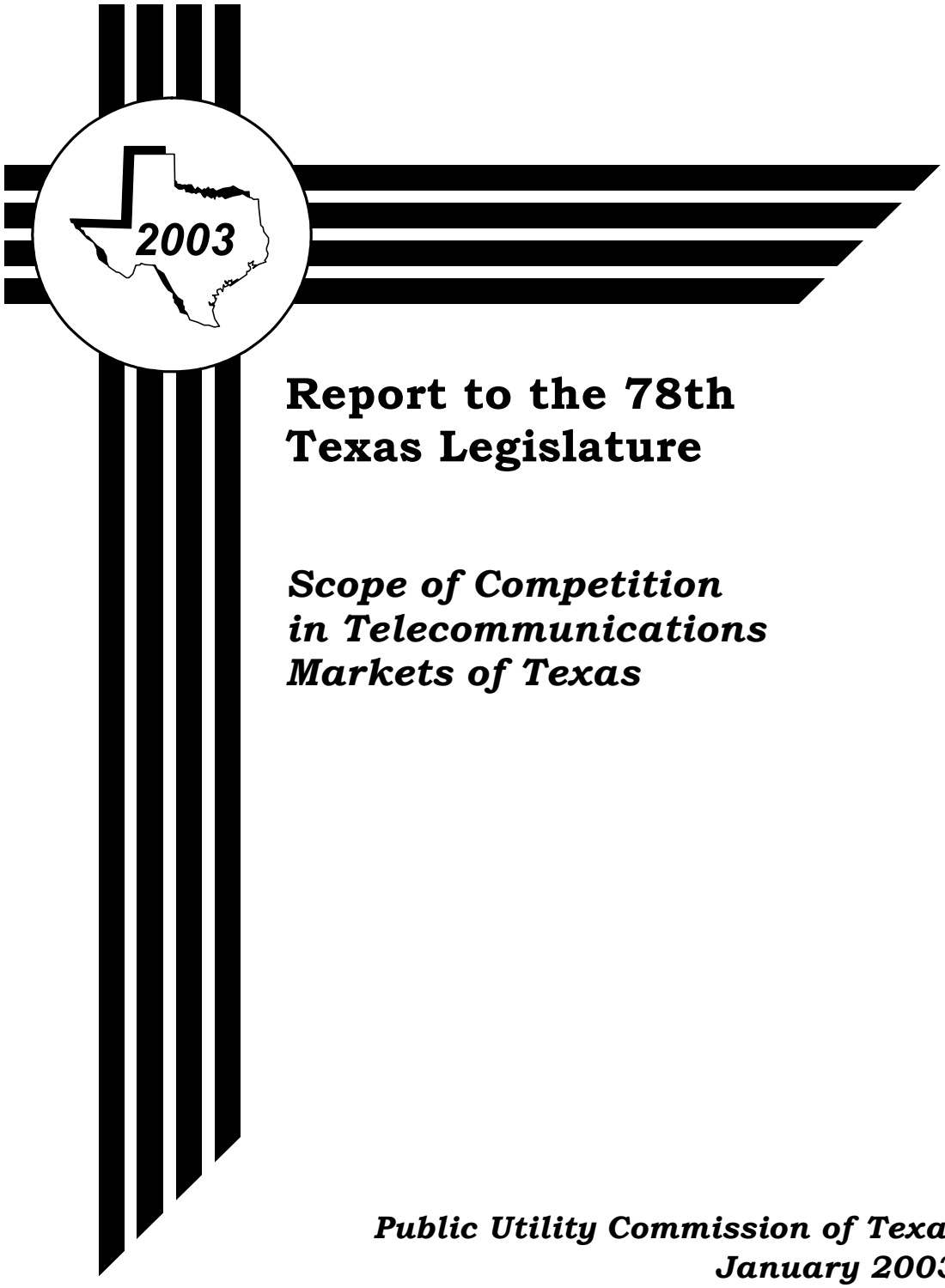

Report to the 78th Texas Legislature

Scope of Competition in Telecommunications Markets of Texas

Public Utility Commission of Texas
January 2003

Rebecca Klein
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Public Utility Commission of Texas

January 15, 2003

Honorable Members of the Seventy-Eighth Texas Legislature:

We are pleased to submit our 2003 Report on the Scope of Competition in Telecommunications Markets, as required by Section 52.006 of the Public Utility Regulatory Act (PURA).

Since the previous report on telecommunications in January 2001, the Commission has continued to make significant progress in managing the transition to competitive local telecommunications markets during difficult economic times. New providers have entered the market, some competitive providers have left the market or struggled to remain, and the market share held by competitive providers increased to a point, but appears to have begun to level out or decline. Over roughly the same time period, since SBC's entry into the Texas long distance market, "the big three" long distance providers (AT&T, WorldCom, Sprint), have gone from 77% market share in 2000 to 59% in 2002. This report examines the existing condition of competition in the local, long distance, and broadband telecommunications market at both a national and state level.

In the last Scope Report, the Commission reported that competitive providers were capturing more customers in the larger metropolitan and suburban areas, but the Commission noted that competition in rural areas was limited. That situation has changed. As of June 2002, CLECs serve 16 percent of the local customers in rural and urban areas and 13 percent in suburban areas.

It is not clear that such competition is sustainable. The ability of CLECs to sustain themselves in the local telecommunications market is uncertain due partly to pending actions at the FCC concerning the continuous availability of access to the ILECs' networks. The ILECs still serve 85 percent of the local market and own the underlying facilities and therefore may still possess market power.

Chapter 7 highlights some of the emerging issues in the telecommunications market, and provides an analysis of the debate surrounding these issues. With regard to the wholesale provision of the incumbents' network to CLECs, any changes that limit access to that network should be scrutinized to avoid adding further uncertainty to the competitive market. With regard to the retail market, this Commission believes regulatory oversight of rates, quality of service, and other customer protections are critical elements to sustain a competitive landscape. The report concludes with a Commission recommendation for the Legislature to consider in the 78th legislative session.

We look forward to continuing to work with you on this and other policy objectives. If you need additional information about any issues addressed in the report, please call on us.

Sincerely,

Rebecca Klein
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ACKNOWLEDGEMENTS:

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Executive Summary

In the Report to the 77th Texas Legislature on the *Scope of Competition in the Telecommunications Markets*, the Public Utility Commission (Commission) reported that competitive local exchange carriers (CLECs) "now have the regulatory framework to challenge Southwestern Bell and Verizon for market share in Texas." At the time of the *2001 Scope Report*, CLECs had captured 12% of the local telecommunications market in Texas. In the intervening time period, CLECs have gained an additional three percent market share. In roughly the same time period, Southwestern Bell Telephone Company (SWBT) has captured over 30% of the long-distance market in the areas where Southwestern Bell Corporation (SBC) has the authority to provide long-distance service.

Pursuant to Public Utility Regulatory Act (PURA) Section 52.006(a), the Commission submits this Report to the 78th Texas Legislature, *Scope of Competition in Telecommunications Markets in Texas.* This Report examines the existing condition of competition in the local, long-distance, and broadband telecommunications markets at both the national and state level. Over the past several years, the Texas Legislature, Congress, and the Commission have successfully laid the groundwork for competitors to enter the local telecommunications market. In the *2001 Scope Report*, the Commission reported that competitive providers were capturing more customers in the larger metropolitan and suburban areas of Austin, Dallas, Houston, and San Antonio, but the Commission noted that competition in rural areas was very limited. That situation is changing. As of June 2002, Texas CLECs serve 16% of the local customers in rural areas, 13% in suburban areas, and 16% in urban areas. In the *2001 Scope Report*, the Commission also reported that competitive providers were capturing more business customers than residential customers. The gap is narrowing in that area as well. CLECs currently serve 14% of residential customers and 17% of business customers, a difference of only three percent.

While the advent of competition in rural areas is a welcome sign, it is not clear that such competition is sustainable. The same can be said of the overall CLEC capture of customers in the Texas local market. This uncertainty is due partly to pending actions at the Federal Communications Commission (FCC) concerning the continuous availability of access to the incumbent local exchange carriers (ILECs') networks. Even though ILECs have lost 15% of the access lines to competitors, they still serve 85% of the local market and own the underlying facilities. ILECs, therefore, may still possess market power. With regard to the wholesale provision of the incumbents' network to competitive providers, any changes that minimize access to that network should be scrutinized carefully to avoid adding further uncertainty to the competitive market. With regard to the retail market, the Commission believes regulatory oversight of rates, quality of service, and other customer protections are critical elements to sustain a competitive landscape.

Since the *2001 Scope Report*, the Commission has continued to implement policies that foster a competitive local market. The Commission has also focused increased resources on customer protection and enforcement of cramming and slamming and is preparing to file its first violation report under the 2001 No-Call list statute. These issues and others will be explored in depth in this Report.

Chapter I of this report reacquaints the reader with brief highlights of relevant state and federal statutes. Chapter II provides a summary of the financial and economic profile of the telecommunications industry on a national basis. The nationwide status of competition in local and broadband service markets contained in Chapter II provides a richer context and a broad discussion of the current trends in competition. This overview of national issues provides a context for the activities occurring in Texas as outlined in Chapter III. Chapter IV delineates the activities the Commission has taken over the last two years to further the evolution of competition in Texas, facilitate deployment in broadband, and embrace customer protections. Federal initiatives pending before Congress and stirring within the FCC will undoubtedly affect the current dynamics within the telecommunications industry in Texas and could significantly change the business plans and the business relationships among ILECs, CLECs, internet service providers (ISPs), and other related industry participants. Chapter V delineates some of the bills that gained significant discussion in Congress and highlights the prospective and profound FCC decisions that affect the aforementioned dynamics. Chapter VI describes the homeland security initiatives that are occurring at both the federal and state levels to ensure the preparation of the telecommunications infrastructure in the event of an emergency, and provides a synopsis of the Commission's involvement in these activities. Chapter VII highlights some of the emerging issues in the telecommunications market, and provides an analysis of the debate surrounding these issues. The Report concludes with a legislative recommendation for the Legislature's consideration in the 78th legislative session.

Chapter I. Legislative Parameters for Local Telephone Competition

To provide a backdrop for this Report, following is a brief overview of key legislation related to telecommunications that was enacted in prior sessions, as well as highlights of the Federal Telecommunications Act of 1996 (FTA). [1]

A. Key Legislation

1. Texas House Bill 2128

In 1995, the Texas Legislature adopted House Bill (H.B.) 2128, which significantly amended the Public Utility Regulatory Act (PURA) with regard to telecommunications. It mandated the opening of local exchange telecommunications markets in Texas, particularly in areas served by Southwestern Bell Telephone Company (SWBT) and GTE Southwest Incorporated (now Verizon Southwest). The law provided a framework for competitive local exchange carriers (CLECs)[2] to obtain authority from the Commission to provide local exchange service through any of three avenues, including the building of network facilities,[3] leasing local loops,[4] or reselling another company's telecommunications services.[5] Additionally, H.B. 2128 established the duty of telecommunications providers to "interconnect" their networks with each other.[6]

2. Federal Telecommunications Act of 1996

On February 8, 1996, Congress enacted the FTA, which paralleled H.B. 2128 in numerous ways, and fundamentally changed telecommunications markets for the entire nation. The FTA was the most dramatic change in telecommunications law since

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 15 and 47 U.S.C.), the Federal Telecommunications Act (FTA).

[2] Perspectives on CLEC market share in Texas are discussed in Chapter III of this Report.

[3] TEX CIV. STATS. ANN. art 1446c-0 (*referred to as* PURA95) repealed by Act of May 12, 1995, 74th Leg., R.S., ch. 231, 1995 Tex. Gen. Laws 2017; and *repealed by* Act of May 8, 1997, 75th Leg., R.S., ch. 166 §9, 1997 Tex. Gen. Laws 1018. PURA95 § 3.2531 (repealed). The remaining part of this section is recodified in the Public Utility Regulatory Act (PURA), TEX. UTIL. CODE, Ch. 54, Subchapter C (Vernon 1998 & Supp. 2003).

[4] PURA95 § 3.453, recodified as PURA Ch. 60, Subchapter C (Vernon 1998 & Supp. 2003). *In addition*, PURA95 § 3.453, recodified as PURA § 60.021 (Vernon 1998) directed ILECs to unbundle their networks to the extent ordered by the FCC.

[5] PURA95 § 3.453 (repealed), recodified as PURA Ch. 60, Subchapter C (Vernon 1998 & Supp. 2003).

[6] PURA95 § 3.458 (repealed), recodified as PURA Ch. 60, Subchapter G (Vernon 1998 & Supp. 2003).

Congress passed the Communications Act of 1934. Three principal goals established by the 1996 Act were:

1. opening the local markets to competitive entry;
2. promoting increased competition in telecommunications markets that were already open to competition, including the long-distance services market; and
3. reforming the system of universal service so that universal service would be preserved and advanced as the local exchange and exchange access markets moved from monopoly to competition.

3. Texas Senate Bill 560 and Senate Bill 86

In 1999, the Texas Legislature revised PURA by enacting two bills dealing with the provision of local exchange telephone service. Senate Bill (S.B.) 560 increased flexibility for ILECs in pricing and packaging telecommunications services. The Texas Legislature also passed S.B. 86 to ensure customer choices and protections.

B. Key Features of the FTA

1. The Trilogy: Local Competition, Universal Service, and Access Charges

The Federal Communications Commission (FCC) views the FTA as a trilogy, *i.e.* a three-pronged plan. The first prong of the trilogy consisted of opening local exchange and exchange access markets to competition.[7] The FTA requires all local exchange carriers (LECs), not just incumbents, to interconnect so that competing carriers can provide service.[8] The FTA also requires incumbents to provide CLECs with access to their networks. The second prong of the trilogy is universal service reform. Consistent with FTA Section 254, *Universal service*, the FCC believes the universal service support system must guarantee affordable telephone service to all Americans in an era in which competition will be the driving force in telecommunications. The third prong of the trilogy is access charge reform.[9] Because a competitive market drives prices toward cost, the then-existing system of access charges was unsustainable because access charges were widely believed to be significantly higher than the cost of providing access.

[7] Opening local markets was accomplished primarily through the Federal Telecommunications Act of 1996 (FTA), 47 U.S.C.A. § 251 (West 2003), relating to *Interconnection,* and 47 U.S.C. § 252 (West 2003), relating to *Procedures for negotiation, arbitration, and approval of agreements*. Additionally, special provisions for opening local markets contained in 47 U.S.C.A. § 271 (West 2003), relating to *Bell operating company entry into interLATA services*, pertain only to Bell Operating Companies.

[8] 47 U.S.C.A. § 251(a)(1) (West 2003).

[9] Access charges are per-minute charges billed by LECs to long-distance companies for access to the local exchange network so that long-distance companies can originate and terminate long-distance calls.

2. Methods of Competitive Market Entry

Section 251(a)(1) of the FTA requires all telecommunications carriers to interconnect with the facilities and equipment of other telecommunications carriers, allowing competitors three ways to serve customers.

a. Resale

Under this entry method, competitors have the option to purchase telecommunications services from another LEC at wholesale rates and resell those services to their own customers at retail rates.[10] Although resale was initially a mode of entry, its use has been declining rapidly as an entry strategy. In the early years after passage of the FTA, competitors sometimes used resale as a transitional entry strategy while building a proprietary network over a period of months or years.

b. Access to Unbundled Network Elements

This entry method enables competitors to lease discrete parts of an incumbent local exchange company's (ILEC's) network— facilities and equipment that are used to provide telephone service—at cost-based rates. These leased parts of the ILEC network are referred to as "unbundled network elements" (UNEs). Competitors can combine leased UNEs with their own facilities and/or resold services or they can provide local service using entirely ILEC UNEs, which is referred to as the UNE Platform (UNE-P or UNEP).[11] If the CLEC leases the ILEC loops, but provides at least some of its own facilities (typically a switch), this is known as UNE – Loop (UNE-L). UNE prices are set by State commissions, including the Texas Commission, based on costs — specifically total element long-run incremental costs (TELRIC). Many competitors now use UNE-P as a transitional entry strategy to establish a presence in the market until they have the customer volume to justify investing in facilities.

c. Construction of New Facilities

A competitor may enter a local telephone market by building entirely new facilities. Under a full "facilities-based" method of entry, a competitor builds the entire network that it needs to serve customers, including the "last mile" or "local loop" — the connection to a customer's premise. Because telecommunications networks are capital-intensive, there are relatively few full facilities-based carriers compared to the number of resellers, UNE-based carriers, or carriers that offer their services using a combination of their own facilities and the ILECs' UNEs.

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[10] All LECs are required to make their telecommunications services available for resale pursuant to 47 U.S.C.A § 251(b)(1) (West 2003). However, only *incumbent* LECs are required, pursuant to 47 U.S.C.A. § 251(c)(4) (West 2003), to make their retail telecommunications services available for resale at a wholesale rate.

[11] NEWTON'S TELECOM DICTIONARY at 727 (17th ed. 2001) (UNE-P includes the loop from the incumbent's central office to the customer's home or business, the switch, transport, and any necessary cross connects.)

3. The Section 271 "Carrot"

Section 271 of the FTA allows a Bell Operating Company (BOC) to enter the long-distance market after the BOC proves that it has opened its local network to competition.[12]

BOCs were created in 1984 with the divestiture of AT&T, and were granted monopoly status to provide local service, subject to regulation by the States.[13] At that time, BOCs were prohibited from competing in the interLATA long-distance market to prevent them from committing anti-competitive practices against long-distance providers.

After lengthy proceedings and negotiation at the state and federal levels, SBC/SWBT was granted Section 271 approval in Texas by the FCC in June 2000, and began providing long-distance service in Texas in July 2000.

4. Federal-State Shared Responsibility for Implementation

The FTA's blueprint for encouraging local competition placed great responsibility on the FCC and state commissions to implement the law.[14] Only six months after adoption of the FTA, the FCC produced two comprehensive documents charting a course for implementation. Some of the FCC's interpretations were challenged in federal court, and many of the FCC's interpretations of FTA requirements were affirmed. If specific FCC findings were not affirmed, federal and state regulators adjusted through regulatory rule and other processes.[15]

Implementation of the FTA was and continues to be a phenomenal undertaking—the magnitude of which could not have been foreseen at the time the FTA was adopted.

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[12] 47 U.S.C. § 271.

[13] In 1984, there were seven Regional BOCs.

[14] Although the FCC establishes nationwide guidelines, state regulators play a major role in implementing key provisions of the FTA. For example, state commissions must approve or reject interconnection agreements, and they have primary responsibility for arbitrating and mediating such agreements if asked to do so by the negotiating parties. State regulators are also charged with developing and implementing cost-based prices for interconnection and UNEs.

[15] In its initial Order implementing the local competition provisions of the FTA in August 1996, the FCC established rules to accomplish interconnection between incumbent and competitive carriers, allow competitors to collocate equipment in the incumbent's structures, establish which parts of the incumbent's network would be open to competitors, and set out which States would be able to establish rates for competitors' interconnection. After the FCC released its ruling, several parties, including some state regulators, challenged the decision in *Iowa Utilities Board v. FCC,* 120 F.3d 753, 795, 800, 819 (8th Cir. 1997) (vacating 47 C.F.R. §§51.601-51.611). The Eighth Circuit overturned many of the FCC's rules on the grounds that the FCC had exceeded its authority and misinterpreted the FTA. In *AT&T Corp. v. Iowa Utilities*, 525 U.S. 366 (1999), the U.S. Supreme Court issued a decision that noted that the FTA was vague in some respects, affirmed the FCC's rulemaking authority to implement the local competition provisions of the FTA, and upheld most of the FCC's rules. The case was remanded to the lower court for further proceedings consistent with the Supreme Court's decision. While court challenges raged on, state regulators and the FCC moved forward with the implementation of competition in local exchange markets.

Chapter II. Status of the National Telecommunications Industry

This Chapter broadly addresses the status of the telecommunications industry from a national perspective in order to provide context for the Texas-specific discussion in Chapter III. The telecommunications industry has been center stage in the financial turmoil currently affecting Wall Street and the corporate and accounting scandals that have emerged in the last year. While financial news has dominated the headlines, many trends indicate that the industry is undergoing a significant competitive transition that continues to revolutionize the provision of telecommunications services.

This Chapter provides an overview of how these trends have affected the economic conditions of the industry, by describing the local, broadband, long-distance and wireless markets, and by providing competitive data on those markets. From a combination of Commission-gathered data and information gathered from public sources, the following conclusions can be reached:

1) nationwide the competitive local exchange carriers' (CLECs') local market share is growing, but the rate of growth has slowed since October 2001;
2) the broadband market is growing rapidly, and broadband service can be provided via the traditional telephone network, cable, or wireless technology;
3) the traditional long-distance market faces intense competition as a result of Regional Bell Operating Company (RBOC) entry and wireless substitution; and
4) the wireless market has high demand.

A. Financial Markets and the Telecommunications Industry

There is no question that the telecommunications industry has been severely affected by turmoil in the financial markets and by the corporate and accounting scandals that have emerged in 2001.

The current telecom downturn is, in terms of money lost, one of the largest business crises in U.S. history, surpassing the dot-com crash of 2000-01, the savings and loan crisis of the 1980s, and even the collapse of the railroads in the 1890s.[16] Worldwide, more than $2 trillion in telecom stock value has been lost over the past two years.[17]

During his speech at the Goldman Sachs Communicopia XI Conference in October 2002, the Chairman of the Federal Communications Commission (FCC), Michael Powell, stated that "Corporate governance scandals, over-capacity, hyper-

[16] Kevin Maney, *Future not so bright for telecoms*, USA TODAY, July 15, 2002.

[17] *Id.* (In comparison, the savings and loan crisis wiped out $250 billion (in 2002 dollars) in value.

competition in some markets, a retrenchment of capital, continuing credit-rating downgrades, continued cuts in work force and capital expenditures and bankruptcies sadly characterize the day."[18]

Stakeholders, regulators, the investment community, and commentators disagree as to the cause of the downturn. Some point to faulty mergers and over-consolidation.[19] Others lay the blame on a glut of fiber in the ground. Incumbent local exchange carriers (ILECs) blame CLECs, asserting poor management and faulty business plans, while CLECs cite the allegedly intransigent, anti-competitive behavior of the ILECs from whom the CLECs must gain access to the network. Still others point to reduced reciprocal compensation revenues.[20] Others state that it may simply be that the perfect confluence of events—capital expenditures outpacing revenues and net income, corporate misbehavior, the natural monopoly characteristics of the last mile of phone lines to the home, enthusiastic mergers and acquisitions—created the perfect storm.

Seemingly, all sectors of the market have been affected by the decline in the telecommunications market: (1) over 47 CLECs have filed for bankruptcy in the United States since 2000;[21] (2) the value of the RBOCs' stock has declined;[22] (3) interexchange carriers are struggling financially; and (4) WorldCom stands accused of perpetrating the most expensive corporate fraud case in history.[23] The sixth largest cable company, Adelphia, filed for bankruptcy and the owners were arrested on fraud charges.[24]

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[18] Remarks of Michael K. Powell, Chairman of the Federal Communications Commission, at the Goldman Sachs Communicopia XI Conference, New York, NY, October 2, 2002.

[19] Jim Krane, Once-Thriving Telecoms Felled by Faulty Mergers: Acquisition Mentality, Changing Technology Aided Decline, ASSOCIATED PRESS (May 5, 2002).

[20] *Shrinking Intercarrier Compensation Continues to Hurt Time Warner Telecom*, TR DAILY (May 8, 2002). (Reciprocal compensation involves arrangements between carriers for the transport and termination of telecommunications traffic. The originating carrier typically pays the terminating carrier for completing the call. Reciprocal compensation is the program by which the company doing the billing and collecting the money pays over some of those monies to the other phone companies in the chain.)

[21] ALTS, *Progress Report on the CLEC Industry* at Appendix A (Oct. 17, 2002).

[22] Sanford Nowlin, *SBC stock drops after layoff news: Analysts say firm is struggling because sales aren't growing*, EXPRESS-NEWS at D1 (Sept. 28, 2002); ASSOCIATED PRESS, Web Posted: 12/05/2002 7:16 AM.

[23] Simon Romero and Riva Atlas, WorldCom Files For Bankruptcy; Largest U.S. Case: Market is Expected to Reverberate after $107 Billion Collapse, NEW YORK TIMES at A1 (July 22, 2002).

[24] *Cable TV Giant Adelphia Files For Bankruptcy*, HC at 2B, (June 21, 2002). The fallout has also spread to telecommunications equipment manufacturers and vendors. Corning, the industry's largest fiber-optic manufacturer, reported revenues in the first quarter 2002 that were half of what it earned in the first quarter of 2001. Dennis Berman and David Pringle, *Telecom-Equipment Earnings Fall: Declines at Larges Firms Viewed as Sign That Crash of the Sector is Deepening*, WALL STREET JOURNAL at A3 (April 23, 2002). Corvis, a major fiber optic backbone provider for interexchange carriers, saw its revenue decline 90 percent from the prior year. Yuki Noguchi, *Corvis Revenue Drops Almost 90%: Lack of Demand in Telecommunications Brings Quarter Loss of $71 Million*, WASHINGTON POST at E05 (April 26, 2002); *see also Corvis Corporation Reports Financial Results for the Second Quarter: Continued Focus on Streamlining Business to Meet Current Market Conditions*, www.corvis.com (July 25, 2002).

Appendices B through E provide further explanation of external factors and trends that have affected the economics of the telecommunications industry in the United States, such as capital markets, bankruptcies, layoffs and capital expenditures, and consolidation.

1. Capital Markets

Since the peak in March 2000, telecom stocks, as measured by the American Stock Exchange index of 16 North American companies, have fallen more than 74%.[25] For further detail, please see Appendix B.

2. Bankruptcies

In speaking before the Senate Commerce Committee on July 30, 2002, FCC Chairman Powell commented that the telecom industry collectively owes a trillion dollars, "much of which will never be repaid and will have to be written off by investors."[26] Appendix C contains more detailed information on these bankruptcies.

3. Layoffs and Capital Expenditures

The job market in Texas has been affected by the industry's national decline: since the beginning of 2002, Southwestern Bell Corporation (SBC) and Alcatel (among others) have announced that thousands of workers in the State will be laid off.[27] Appendix D contains in-depth further information regarding these layoffs and reduced capital expenditures.

4. Consolidation

Upon divestiture in 1984, the Bell System was divided into seven local service providers, also known as the RBOCs, and one company to house the long-distance company (AT&T) and equipment manufacturing arm (which has subsequently spun off as Lucent in 1996). By 2002, just six years after the Federal Telecommunications Act (FTA), only four RBOCs—Verizon, BellSouth, SBC, and Qwest—remain, having bought out or merged with the other three, as well as with GTE. Appendix E contains more detailed information on consolidations.

Independent suppliers of last-mile fiber, such as MFN, Espire, Telergy and DTI, have all filed for bankruptcy protection. Dan Sweeney, *Did MFN Bury Fiber in all the Wrong Places?*, AMERICAN'S NETWORK WEEKLY (May 24, 2002). Equipment manufacturers Lucent and Ericsson have reported massive losses, and both have cut their workforce to control expenses. Vikas Bajaj, *Telecom Is Still Melting Down: Ericsson, Lucent Join Industry List of Firms Facing Tough Times*, DALLAS MORNING NEWS at D1 (April 23, 2002).

[25] Michael A. Hiltzik and James F. Peltz, *Did Telecom Reformers Dial the Wrong Number?*, LOS ANGELES TIMES, July 24, 2002.

[26] Paul Starr, *The Great Telecom Implosion*, THE AMERICAN PROSPECT, September 9, 2002, available at http://www.prospect.org/print/V13/16/starr-p.html/.

[27] Vikas Bajaj, *Texas' SBC, Alcatel Shedding More Jobs*, DALLAS MORNING NEWS at 1-A (May 12, 2002).

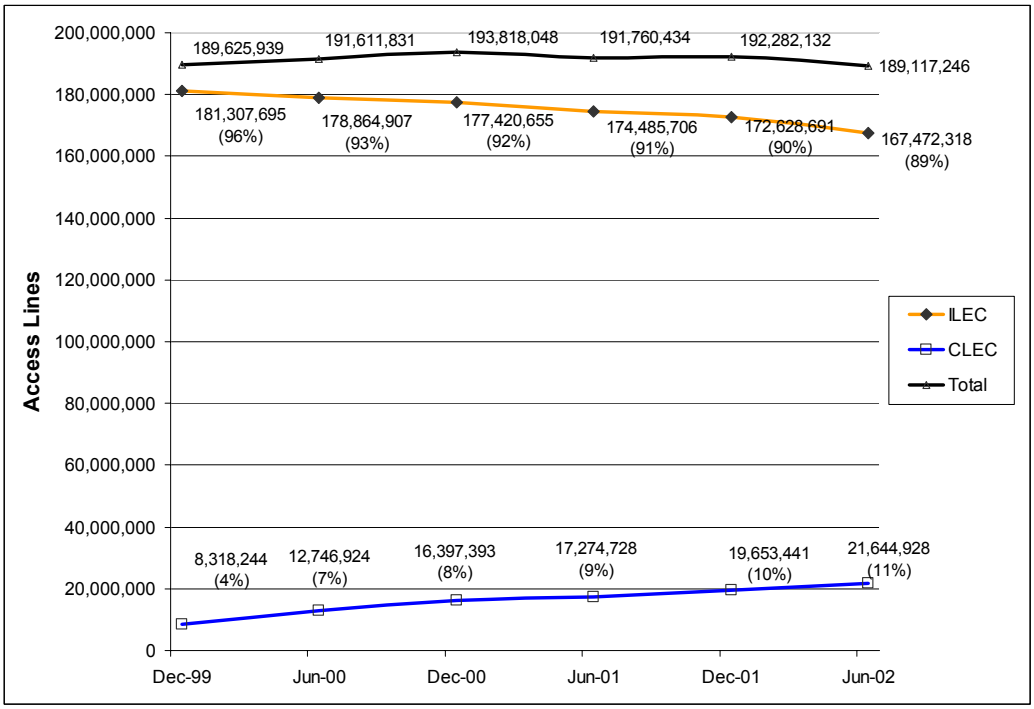
B. Telecommunications Industry Trends

While the telecommunications industry has been affected by Wall Street's financial crisis, the industry continues toward a significant competitive transition. Local telecommunications competition continues but at a slower rate of growth. Wireless demand remains high and some consumers have begun to substitute wireless phones for traditional landline phones. Consumers have benefited significantly from strong competition in the long-distance market. Broadband internet demand has also grown. Taken together, these trends indicate that the telecommunications industry is undergoing significant competitive transition that will bring more choices to consumers.

1. Local Telephone Competition

As shown in Figure 1, as of June 2002, the total number of access lines reached a peak in December of 2000, declined in June of 2001, increased again in December of 2001 and decreased again as of June 2002. During the same period, the CLECs' share of those access lines has increased, while the ILECs' share has decreased. As of June 2002, CLECs had approximately 21.6 million local lines nationwide, representing 11% of the total market.

Figure 1 — Nationwide Growth of Access Lines



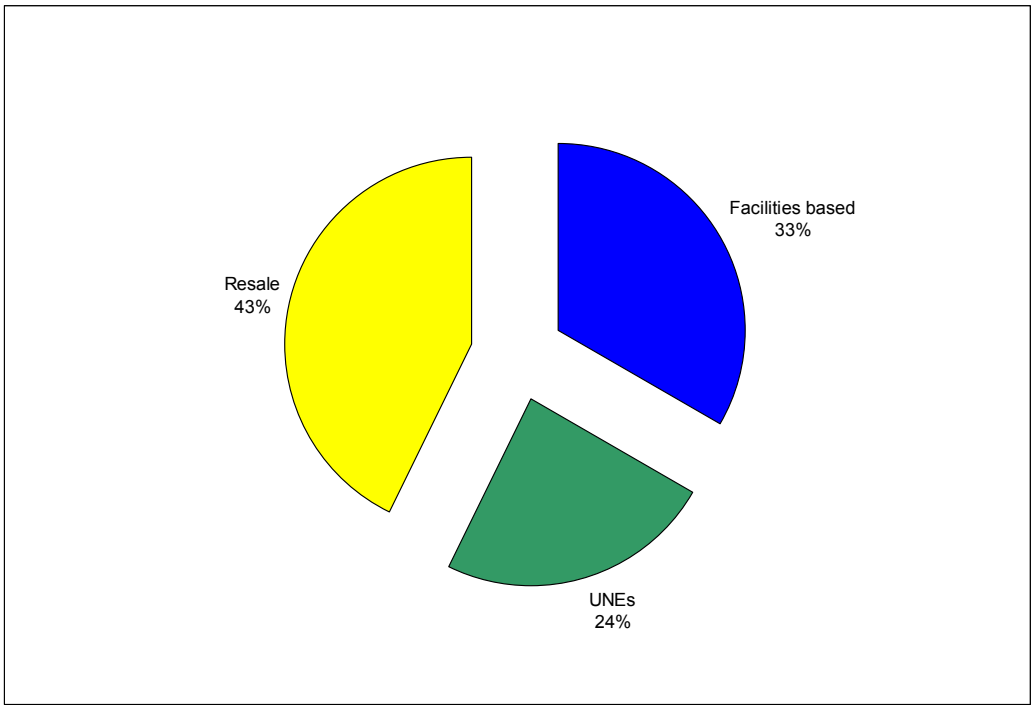
SOURCE: *Local Telephone Competition Reports,* FCC (Aug. 2000, May 2001, July 2002, Dec. 2002).

CLECs may enter the local market by (1) purchasing the ILEC's retail service and reselling that service to the CLEC's own end-use customers, (2) building their own

facilities, or (3) purchasing unbundled network elements from the ILEC, and using those elements, either alone or in conjunction with their own facilities, to provide service to their end-use customers.[28]

As shown in Figures 2 and 3, the CLECs' primary entry vehicle has changed from total service resale in December 1999 to use of unbundled network elements (UNEs) in June 2002.

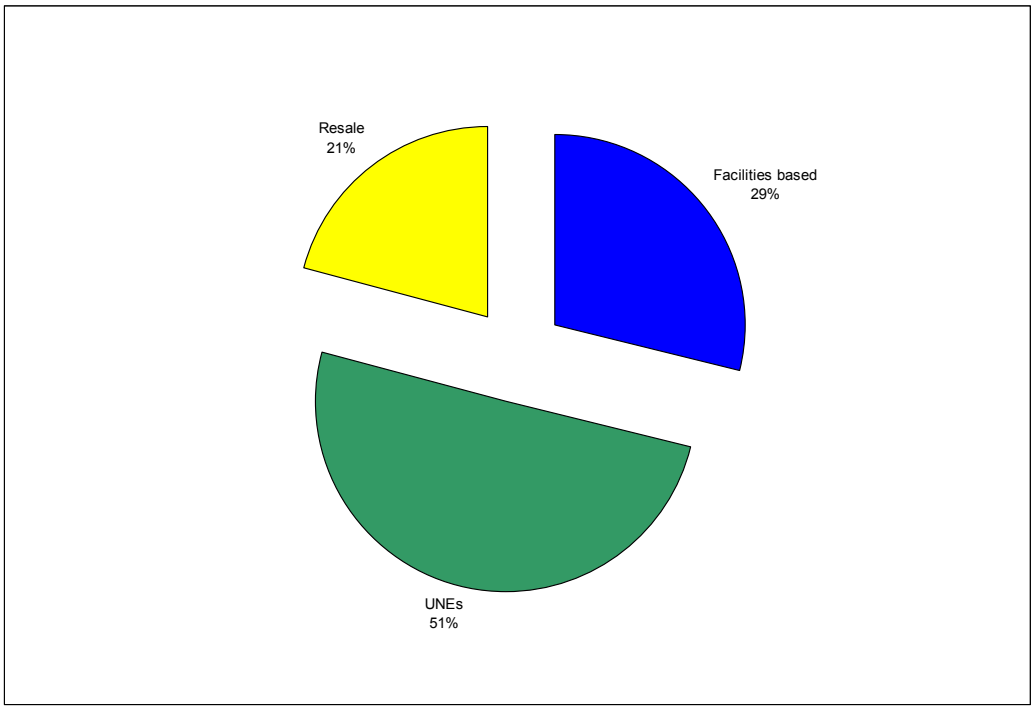
Figure 2 — CLEC National Entry Strategy by Access Line, as of December 1999



SOURCE: FCC, *Local Telephone Competition Report at Table 3* (July 2002).

[28] Please see Appendix I for a detailed explanation of CLEC entry strategies.

Figure 3 — CLEC National Entry Strategy as of June 2002



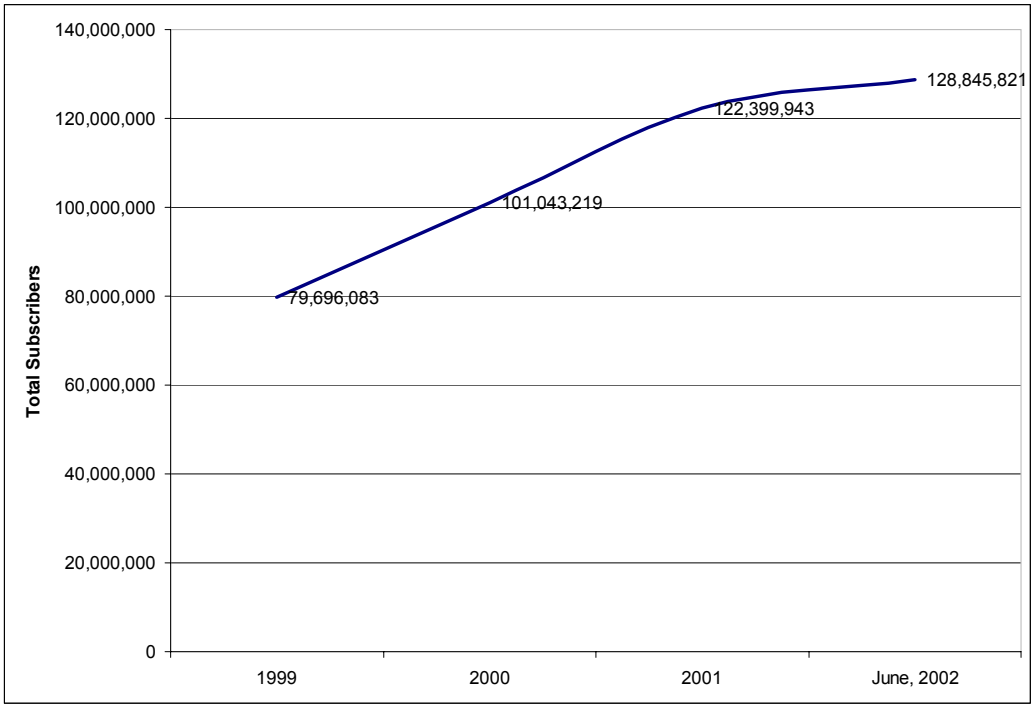
SOURCE: FCC, *Local Telephone Competition Report at Table 3* (Dec. 2002).

Many of the RBOCs are attempting to remove their obligations to provide CLECs with access to UNEs, as described more fully in Chapters III-V.

2. Wireless Market

Demand for wireless phones remains relatively high and continues to grow. As shown in Figure 4, the number of mobile wireless subscribers at the national level has increased 65% since 1999.

Figure 4— Wireless Subscribers by Year



SOURCE: *Local Telephone Competition Reports,* FCC (Aug. 2000, May 2001, July 2002, Dec. 2002).

The price for wireless phone service has dropped by 30% between December 1997 and June 2001.[29] The average wireless customer paid only 5% more in 2001 than in 2000 for service, but used that service 50% more.[30]

3. Long-Distance Market

The long-distance market has probably been most heavily influenced by the competitive transition. Competition has increased as the RBOCs have received authority to enter the market. The long-distance service offered as part of many wireless phone plans allows consumers to substitute wireless service for traditional long-distance usage. In addition, "instant messaging" and even email are affecting long-distance.

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[29] Shelley Emling, *Telecom pain: No long-distance gain*, AUSTIN AMERICAN-STATESMAN, June 28, 2002, p. 1C.

[30] *Bad Connection*, FORBES, August 12, 2002, p. 85.

In July of 2000, SBC entered the Texas long-distance market after its grant of Section 271 authority. In February of 2001, SBC also entered the long-distance markets in Kansas and Oklahoma. In December of that year, SBC entered the long-distance markets in Arkansas and Missouri. Although SBC has been in the long-distance market for a relatively short period, SBC states that it has 5.9 million customers in the six states where it provides long-distance service, out of a total of 19 million access lines. SBC's share of the long-distance market in those six States is, therefore, over 30%.[31] In January of 2002, less than two years after SBC had been granted the authority to provide long-distance in Texas, and less than one year after SBC's entry into Kansas and Oklahoma, SBC estimated that it served over 35% of long-distance consumers in those three States.[32] In December 2002, SBC was granted Section 271 authority in California: "with the launch in California, SBC will be in a position to provide long-distance service to approximately two-thirds of its local lines."[33]

Other RBOCs have experienced rapid growth in the long-distance market as well. For instance, Verizon has captured approximately 30% of the long-distance market in New York and Massachusetts.[34] In New Jersey and Maine, Verizon gained 9% of the consumer market within three months of introducing long-distance service. Contrast these numbers with CLEC penetration in the local market; it took CLECs almost six years in the local market to gain a 10% share. As of December 2002, Section 271 approvals have been granted in 35 states and there are pending applications for an additional three states. RBOC entry into the long-distance market should therefore continue to gain momentum over the coming years.

As noted above, wireless phone plans may offer low-cost long-distance, which can substitute for traditional long-distance usage. According to Forrester Research, wireless companies will take as much as $3 billion in revenue away from long-distance companies by 2006, while costing local carriers $8.8 million in that same time.[35]

Between December 1997 and June 2001, the price for wireless phone service dropped more than 30% per minute, while the long-distance charges related to traditional wireline phone service dropped more than 10% and the price of local phone service rose 12%.[36] In an effort to combat the loss of long-distance minutes from wireless usage and to respond to the long-distance plans offered by SBC and other RBOCs, many traditional long-distance providers are offering packages that include unlimited long-distance for a fixed rate.[37] Some long-distance companies have tried to offset high costs by adding

[31] Southwestern Bell Corporation, SBC INVESTOR BRIEFING (October 24, 2002) at 5.

[32] Southwestern Bell Corporation, SBC INVESTOR BRIEFING (January 24, 2002) at 7.

[33] *Id*. at 6.

[34] VERIZON INVESTOR QUARTERLY (October 25, 2002) at 5.

[35] Shelley Emling, *Telecom pain: No long-distance gain*, AUSTIN AMERICAN-STATESMAN, June 28, 2002, p. 1C.

[36] *Id.*

[37] Ryan Chittum, *Phone Service On the Cheap*, WALL STREET JOURNAL, July 2, 2002, p. D1.

monthly fees to long-distance. MCI WorldCom, Sprint, and AT&T have all added fees of $1.95-$1.99 to the price of their long-distance services, presumably to cover the costs of in-state access charges (about $0.057 per minute in Southwestern Bell Telephone (SWBT) areas in Texas).[38] Further information on the long-distance market, pertaining specifically to AT&T, WorldCom, and Sprint, may be found in Appendix F.

4. Broadband Deployment

"Broadband" is a term used to describe high-speed access to the internet. Modes of broadband include digital subscriber line (DSL) service provided by phone companies over telephone lines; high-speed access via cable typically provided by cable television providers; and satellite and wireless service. As illustrated in Tables 1 and 2, the number of broadband users nationwide has steadily increased since 1999, more than tripling in the last two years.

Table 1 — Number of Broadband Users Nationwide (1999-2002)

Broadband Technology	Dec. 1999	June 2000	Dec. 2000	June 2001	Dec. 2001	June 2002
Cable Modem	1,411,977	2,284,491	3,582,874	5,184,141	7,059,598	9,172,895
Asymmetric Digital Subscriber Line (ADSL)	369,792	951,583	1,977,101	2,693,834	3,947,808	5,101,493
Other Wireline	609,909	758,594	1,021,291	1,088,066	1,078,597	1,186,680
Fiber	312,204	307,151	376,203	455,593	494,199	520,884
Sat./Fixed Wireless	50,404	65,615	112,405	194,707	212,610	220,588
Total	**2,754,286**	**4,367,434**	**7,069,874**	**9,616,341**	**12,792,812**	**16,202,540**

SOURCE: *High-Speed Services for Internet Access: Subscribership as of December 2001*, FCC (Dec. 2002).

Table 2 — Growth of Broadband Users Nationwide (1999-2002)

Broadband Technology	% Growth Dec. 1999 – June 2001	% Growth June 2000 – Dec. 1999	% Growth Dec. 2000 – June 2001	% Growth June 2001 – Dec. 2001	% Growth Dec. 2001 – June 2002
Cable Modem	62%	57%	45%	36%	30%
ADSL	157%	108%	36%	47%	29%
Other Wireline	24%	35%	7%	-1%	10%
Fiber	-1.6%	23%	21%	8%	5%
Sat./Fixed Wireless	30%	71%	73%	9%	4%
Total	**59%**	**62%**	**36%**	**33%**	**27%**

SOURCE: *High-Speed Services for Internet Access: Subscribership as of December 2001*, FCC (Dec. 2002).

[38] Vikas Bijaj, *MCI to add long-distance fee in Texas*, DALLAS MORNING NEWS, August 6, 2002, p. D6.

As shown in Tables 1 and 2, the FCC reports that broadband nationwide usage increased by 27% during the first half of 2002, from 12.8 million to 16.2 million lines, compared to a 33% increase, from nearly 9.6 million to 12.8 million lines, during the first half of 2001. Of the 16.2 million high-speed lines, residential and small business subscribers grew 27% from 11 to almost 14 million users reported six months earlier.

DSL lines increased by 29% during the first half of 2002, from nearly 3.9 million to over 5.1 million lines, compared to a 47% increase, from 2.7 million to 3.9 million lines, during the preceding six months.[39] Cable modem service increased by 30% during the first six months of 2002, from 7 million to 9.1 million lines.[40] By comparison, cable modem service increased by 36%, from nearly 5.2 million to 7.1 million lines, during the last half of 2001.[41]

SBC reported an increase in broadband subscribers of 14% in the second quarter of 2002.[42] BellSouth signed up 74,000 DSL customers in the second quarter of 2002 for a total of 800,000 DSL customers.[43] AT&T also reported growth in broadband (most of which is cable) in the second quarter of 2002.[44] The internet research firm Nielsen/NetRatings reported in March 2002 that the amount of time spent online by broadband users has surpassed the amount of time spent online by dial-up users in January 2002. The firm also reported that the total amount of time spent online by broadband users had risen 64% between January 2001 and January 2002.[45]

[39] *High-Speed Services for Internet Access, Status as of June 30, 2002*, Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, December 2002. Available online at: www.fcc.gov/wcb/iatd/comp.html.

[40] *Id.*

[41] *Id.*

[42] SBC Communications reports lower earnings for 2nd quarter, ASSOCIATED PRESS, July 23, 2002.

[43] Seth Schiesel with Simon Romero, *Regional Bell Giants No Longer Invulnerable*, NEW YORK TIMES, July 23, 2002, sec. C, p. 6.

[44] Bruce Meyerson, *AT&T Posts $12.7 Billion Loss*, ASSOCIATED PRESS, July 23, 2002.

[45] *Broadband Usage Surpasses Dial-Up*, LOS ANGELES TIMES, March 6, 2002.

Chapter III. Status of the Texas Telecommunications Industry

In June 2000, Southwestern Bell Telephone (SWBT) was granted approval by the Federal Communications Commission (FCC) to enter the long-distance market in Texas. As determined by the Commission and the FCC during SWBT's Section 271 approval process, SWBT had met the statutory requirements to open its local markets to competition.[46] SWBT entered the long-distance market in July 2000. Two years later, Southwestern Bell Corporation (SBC) has made significant progress in the long-distance market while competition in the local market is still emerging, and many competitors of SWBT are struggling to remain financially viable. As competition in the telecommunications market continues to take hold in Texas, several issues and matters have been brought to the forefront for the Commission's consideration.

Chapter III examines competitive issues relating to the local service market in Texas. The discussion begins with an assessment of the data regarding the overall industry revenue and market share for incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs) in Texas. The discussion then turns to how ILECs and CLECs compete in the marketplace. This analysis includes a discussion of the CLECs' methods of entry and geographic market.

Additionally, the Chapter examines competitive issues relating to the long-distance market, including the disparity between intrastate and interstate access rates and the pass-through of access rate reductions by long-distance carriers. The Chapter ends with a look at competitive issues relating to broadband.

A. Local Telephone Market in Texas

1. Texas CLEC Certifications

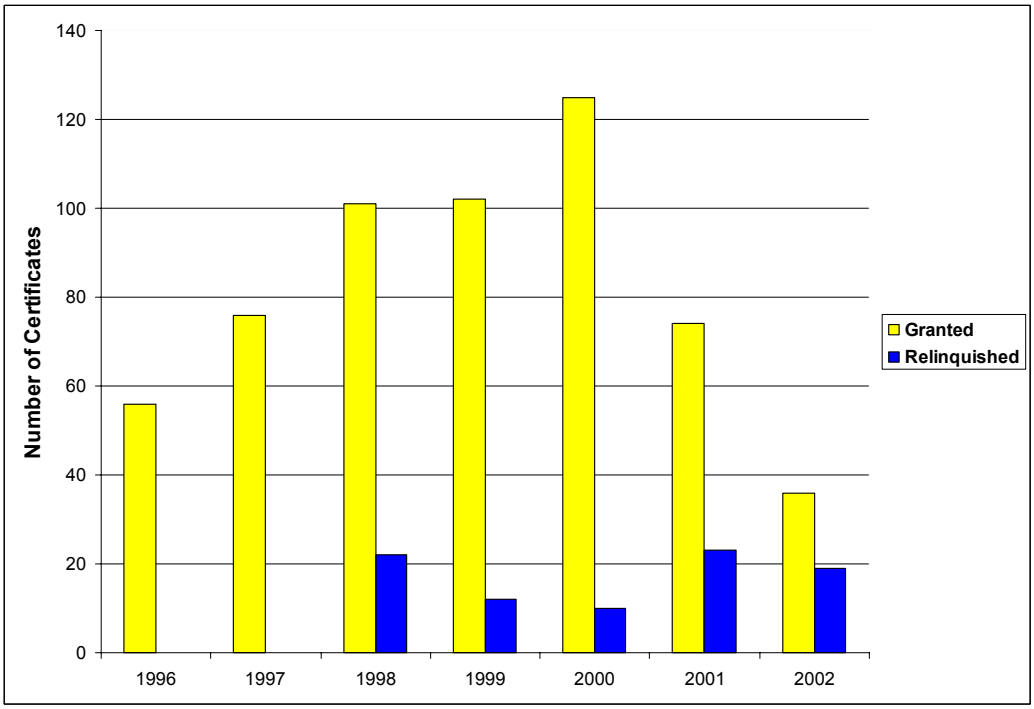
From the passage of the FTA until 1999, Texas saw a huge influx of CLECs seeking to serve markets throughout the State. Under the Public Utility Regulatory Act (PURA) § 54.001, a CLEC must have a certificate issued by the Commission to operate and provide telecommunications service in Texas.[47] As illustrated by Figure 5, the number of service provider certificates of operating authority (SPCOAs) and certificates of operating authority (COAs) applied for and granted annually has declined steadily since 2000. For the year 2001, the Commission awarded 73 SPCOAs and 1 COA; and as of October 23, 2002, the Commission had awarded 34 SPCOAs and 2 COAs. This represents a noticeable decline from the year 2000 when 106 SPCOAs and 6 COAs were

[46] *Application by SBC Communications Inc, Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas*, CC Docket 00-65, Memorandum Opinion and Order, at 395 (rel. June 30, 2000).

[47] PURA § 54.001 (Vernon 1998 & Supp. 2003).

awarded. In addition, the number of SPCOAs and COAs relinquished by CLECs has increased from 10 in 2000 to 23 and 19 in 2001 and 2002, respectively.

Figure 5 — Number of SPCOAs and COAs Certifications Granted and Relinquished in Texas, by Year



SOURCE: PUC filings

As shown in Table 3, there are 490 CLECs certified to operate in Texas. Of the 554 certificated telecommunications utilities in Texas, 202 submitted data responses to this year's scope of competition data request, 138 of them CLECs, compared to 128 CLECs in 2000.[48] In addition, 76 CLECs filed letters stating that they did not provide services in Texas during the requested time period.[49]

Table 3 — Number of Texas CLECs

	1996	1998	2000	2002
Approx. Number of Certificated CLECs	70	200	432	490
Approx. Number of CLECs filing Data Responses	n/a	50	128	138

SOURCES: *Report to the Seventy-Fifth Legislature on the Scope of Competition in Telecommunications Markets* at 2 (January 1997), *Report to the Seventy-Sixth Legislature on the Scope of Competition in Telecommunications Markets* at 55, 92 (January 1999), *Report to the Seventy-Seventh Legislature on the Scope of Competition in Telecommunications Markets* at 37 (January 2001); Texas PUC 2003 Scope of Competition Data Responses.

This decline in the number of CLECs in Texas is consistent with trends at the national level. The number of CLECs in Texas declaring bankruptcy and discontinuing services has steadily increased; between 1999 and 2002, 47 CLECs declared bankruptcy. Seven of those went into Chapter 7 bankruptcy, which resulted in the liquidation of the company's assets. A complete list of all carriers with operations in Texas that have filed for bankruptcy is available in Appendix G.

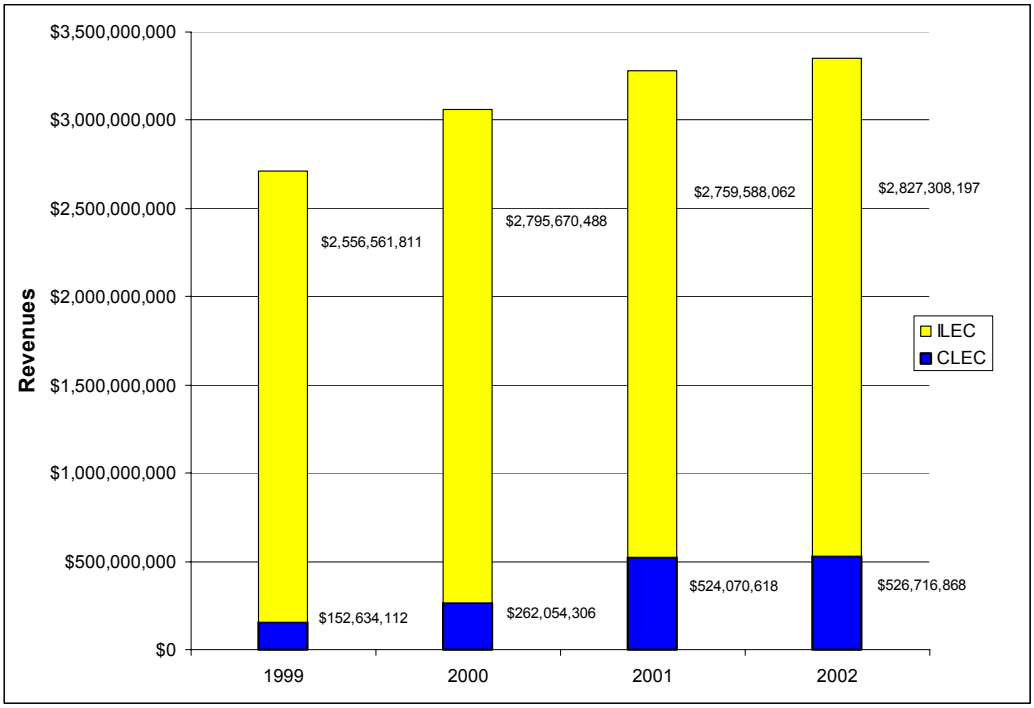
[48] The data compiled for this year's scope report includes self-reported data from 202 ILECs and CLECs. The Commission estimates that this represents at least 95% of the access lines served in Texas.

[49] It is important to note that the number of SPCOAs and COAs overstates the actual number of entrants into the market. While the Commission has certified many carriers to provide service, some have yet to offer any service to the public. A carrier who does not have any customers to date is only a potential competitor. In addition, some carriers with certificates no longer provide service.

2. Overall Industry Revenues and Market Share

After three years of rapid growth, CLEC revenues and access lines ceased to grow in 2002. As shown in Figure 6, CLEC revenues from basic dial-tone service in Texas have also flattened out to approximately $527 million in June 2002, compared to $2.8 billion for the ILECs.

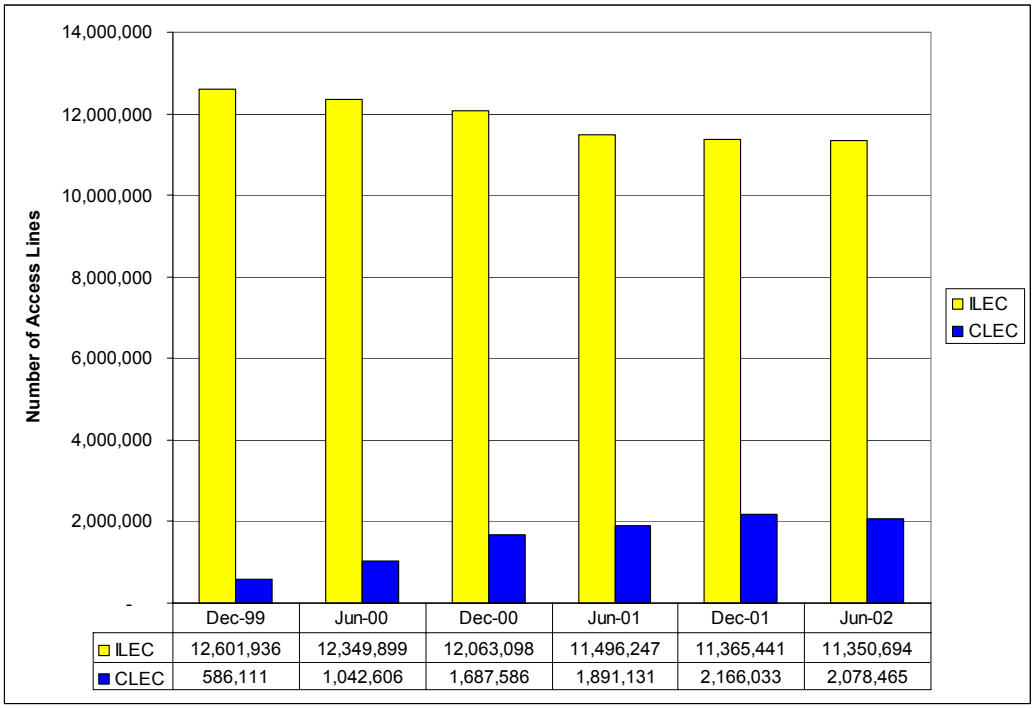
Figure 6 — ILEC vs. CLEC Basic Local Service Revenues in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The June 2002 revenue as reported has been doubled to estimate year-end 2002 revenues.

From December 2001 to June 2002, the number of ILEC lines decreased from 11,365,441 to 11,350,694, while the total number of CLEC lines decreased from 2,166,033 to 2,078,465 during that same period.[50] This represents a decrease of CLEC market share from 16% to 15% during that same period and a corresponding increase in ILEC market share from 84% to 85%, despite the overall decrease in ILEC lines.

Figure 7 — ILEC vs. CLEC Lines in Texas



	Dec-99	Jun-00	Dec-00	Jun-01	Dec-01	Jun-02
ILEC	12,601,936	12,349,899	12,063,098	11,496,247	11,365,441	11,350,694
CLEC	586,111	1,042,606	1,687,586	1,891,131	2,166,033	2,078,465

SOURCES: *Local Telephone Competition Reports,* FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.

The rate of overall CLEC market-share growth, which measures the momentum of competitors in the local exchange market, has shown a sharp downward trend over the last two-year period.

Table 4 — CLEC Market Share and Growth Rates in Texas

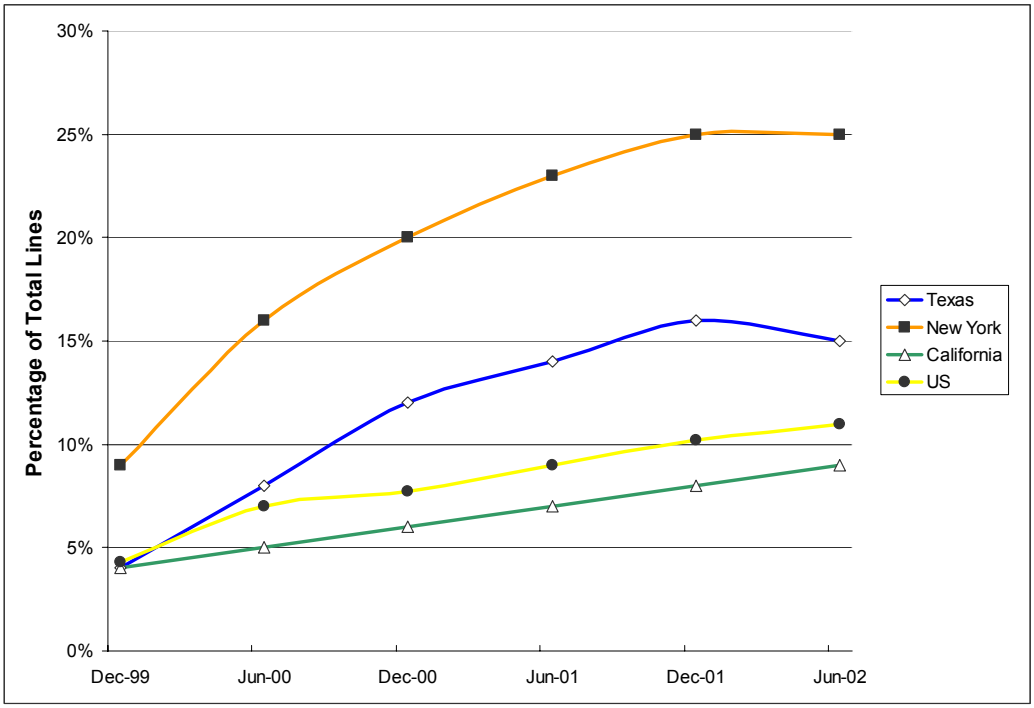
	Dec. 1999	June 2000	Dec. 2000	June 2001	Dec. 2001	June 2002
Market Share	4%	8%	12%	14%	16%	15%
Growth Rate	—	75%	58%	15%	13%	-3%

SOURCES: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.

[50] For additional data regarding ILEC and CLEC Retail lines in Texas from December 1999 to June 2002, please see Appendix H.

To put the data in a national context, CLEC line growth in Texas (approximately 15% at the end of June 2002) was higher than both the national average (approximately 11%) and the CLEC share in California (approximately 9%). As shown in Figure 8, CLECs in New York, the first state to gain Section 271 approval in 1999, had 25% of the lines.

Figure 8 — CLEC Line Growth in Texas Compared with Nationwide and Other States



SOURCES: *Local Telephone Competition Reports,* FCC (Aug. 2000, May 2001, July 2002, Dec. 2002), Texas PUC 2003 Scope of Competition Data Responses. The FCC reported 2,170,914 CLEC access lines in Texas as of June 2002, which is 92,449 more lines than CLECs reported to the Texas PUC for the same reporting period.

3. CLEC Business Strategies

a. CLEC Modes of Entry

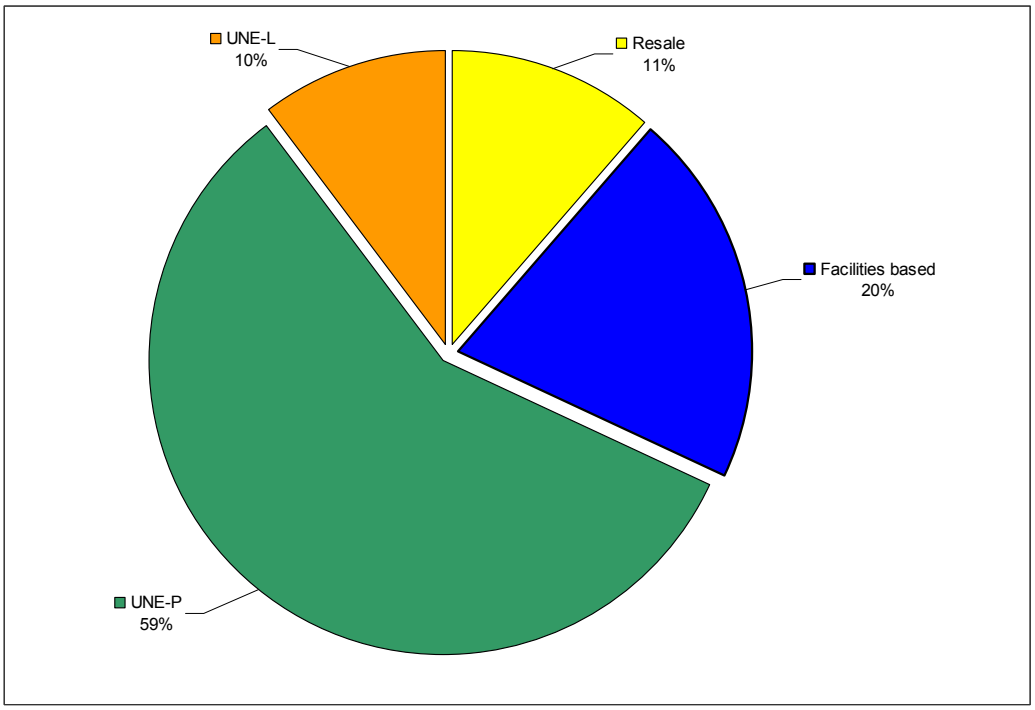
As explained in Chapter II of this Report, Section 251 of the Federal Telecommunications Act (FTA) envisioned three basic modes of entry by CLECs: [51] (1) facilities-based; (2) unbundled network elements (UNEs);[52] and (3) resale.

[51] Please see Appendix I for a detailed explanation of CLEC entry strategies.

[52] The leasing of UNEs typically occurs in one of two fashions, via UNEs (also known as UNE-Loop or UNE-L, which is the lease of one or more of the network components required for the provision of a telecommunications service), or UNE-Platform (UNE-P, which is the lease of a complete set of network elements that allows the provision of an end-to-end circuit). Individual or combinations of UNEs are available pursuant to the parties' relevant interconnection agreement, such as the Texas 271 Agreements (T2A).

As illustrated by Figure 9, Texas CLECs serve customers primarily through unbundled network element platform (UNE-P). As noted earlier, many incumbents are attempting to restrict or limit the CLECs' ability to provide service to end-use customers through UNE-P by seeking changes at the federal level. Because Texas CLECs rely heavily on the use of UNE-P as an entry mechanism, such a decision could have a widespread effect on the competitive market for local telecommunications services in Texas. As is also shown in Figure 9, CLECs serve 30% of their customers using some or all of their own facilities. This includes CLEC-owned and unbundled network element loop (UNE-L) entry strategies.

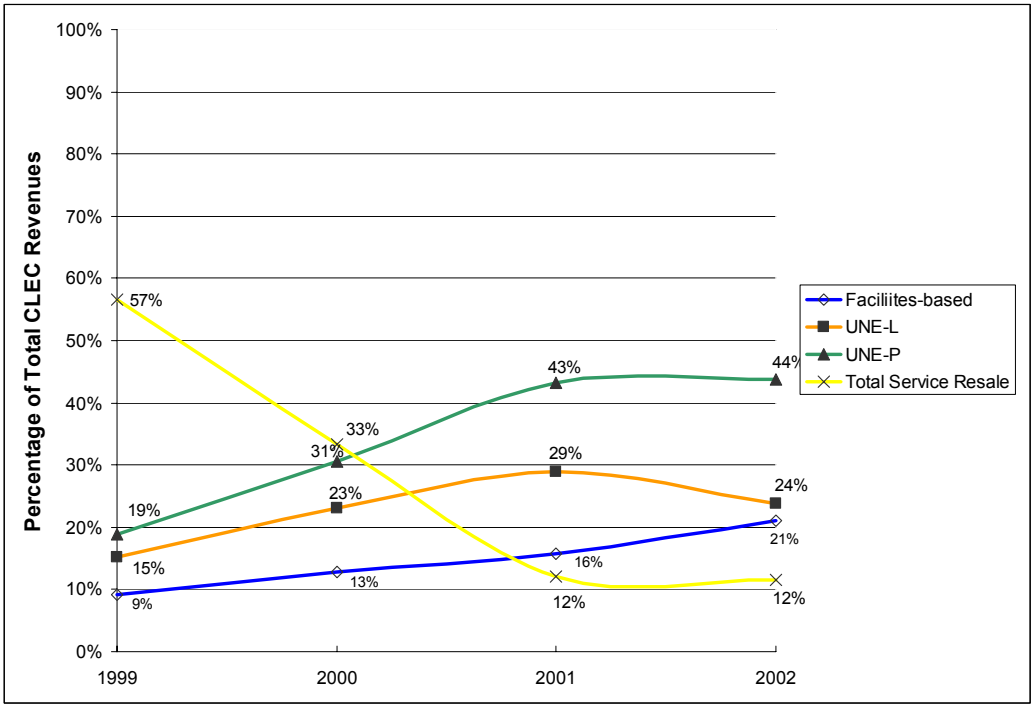
Figure 9 — CLEC Lines by Entry Strategy in Texas, as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Revenues from total service resale (TSR) have sharply dropped since 1999, and seem to have bottomed out. Revenues reported from the use of unbundled network elements (UNEs) in combination with the CLEC's own switch (known as UNE-L) have also recently shown a downward trend. In contrast, revenues from providing service entirely through the CLEC's own facilities (facilities-based) have steadily increased in the past six months. CLECs using the UNE-P reported revenues that almost doubled between 2000 and 2001, and have since flattened out.

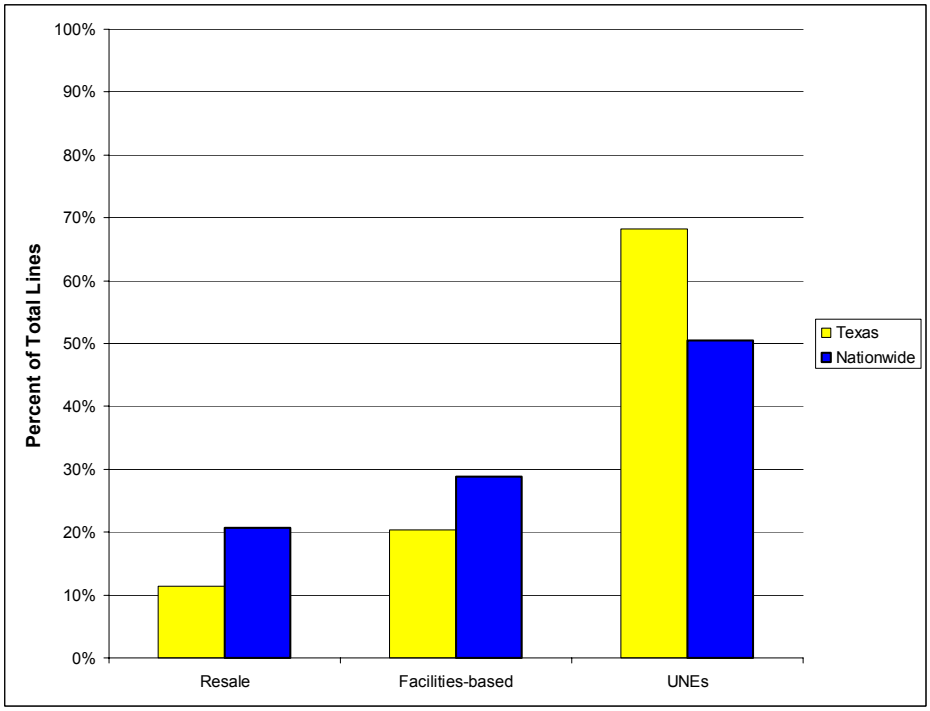
Figure 10 — Revenue by CLEC Entry Strategy in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The June 2002 revenue as reported has been doubled to estimate year-end 2002 revenues.

As reflected in Figure 11, the CLECs in the Texas market rely on UNEs more than CLECs in other States. Texas is second only to New York in the number of lines served via UNEs.

Figure 11 — Texas CLEC Entry Strategy vs. Nationwide



SOURCE: June 2002 national data reported in *Local Telephone Competition Reports,* FCC (Dec. 2002), compared with June 2002 Texas data from the Texas PUC 2003 Scope of Competition Data Responses.

b. CLEC Geographic Markets

Overall, CLECs serve Texas customers in all areas of the State, although CLECs serve more customers in urban than in rural areas in absolute terms.

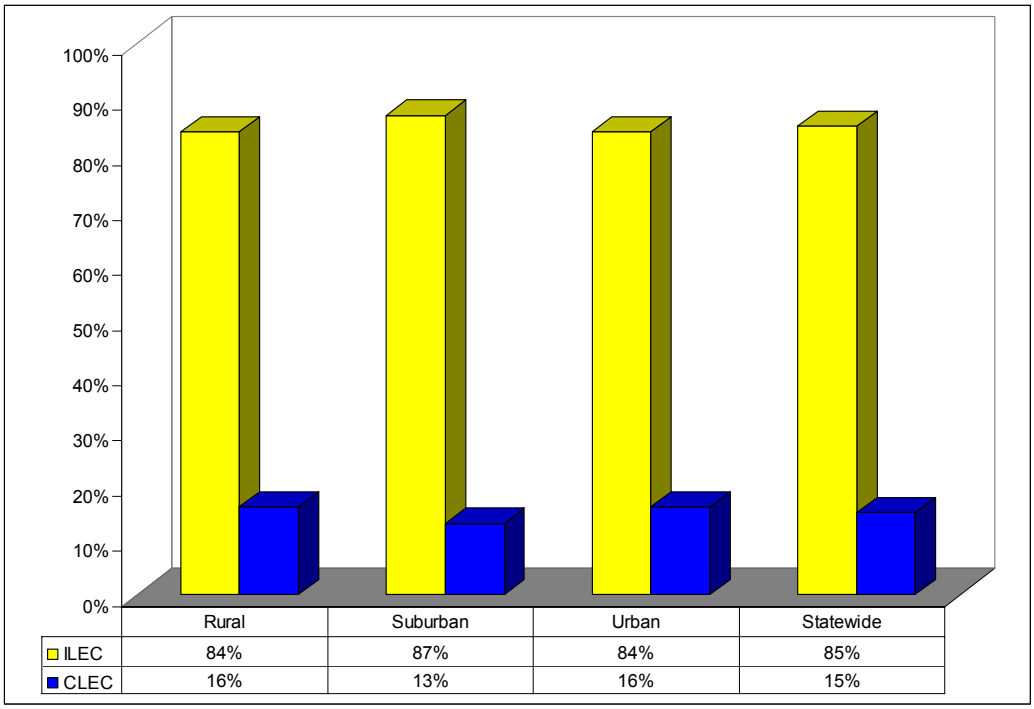
Table 5 — Total Access Lines by Geography

	Rural	Suburban	Urban	Total
ILEC	2,918,097	2,287,050	6,145,547	11,350,694
CLEC	564,413	330,484	1,182,759	2,077,656
Total	3,482,510	2,617,534	7,328,306	13,429,159

SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The CLEC line total excludes 809 access lines for which exchange information was not provided by the carrier.

On a percentage basis, CLECs now serve the same percentage of the access lines in rural areas as in urban areas, as shown by Figure 12. CLECs actually serve a smaller percentage of the access lines in suburban areas than they do in urban or rural areas.

Figure 12 — ILEC versus CLEC Lines in Texas by Geography as of June 30, 2002



	Rural	Suburban	Urban	Statewide
ILEC	84%	87%	84%	85%
CLEC	16%	13%	16%	15%

SOURCE: Texas PUC 2003 Scope of Competition Data Responses

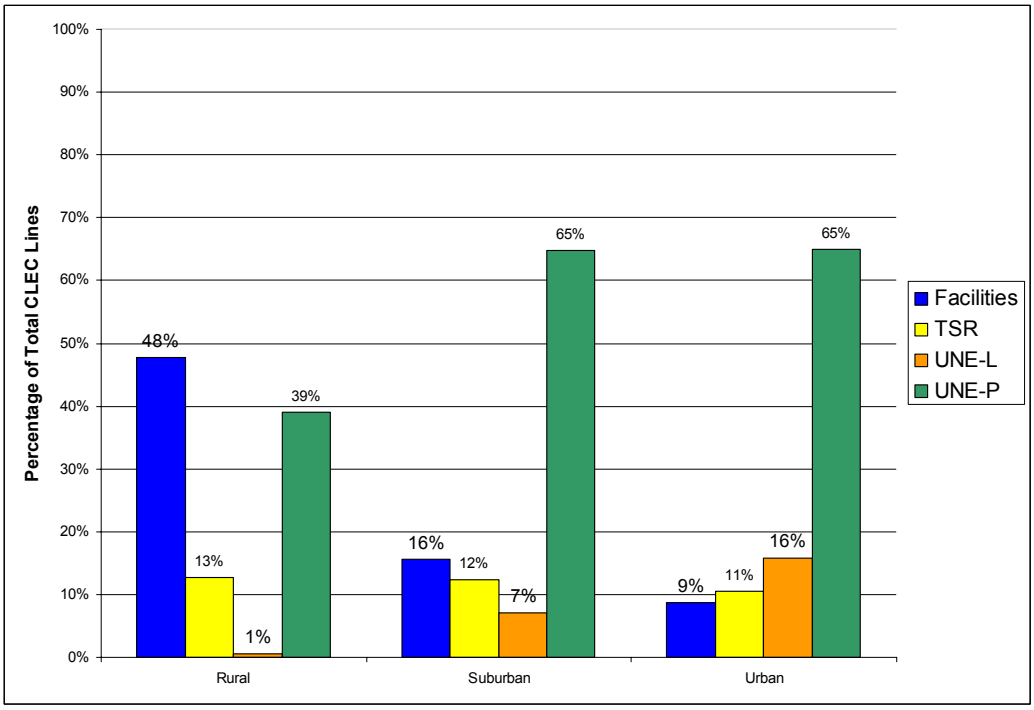
While many CLECs continue to focus their competitive efforts in urban areas, a few niche players have remained strong by serving suburban or rural customers. Sage Telecom, for example, serves rural residential and business customers exclusively through UNE-P, without using any of its own facilities.[53] Using market entry strategies such as UNE-P, UNE-L, TSR, and facility deployment, CLECs have acquired some level of penetration in virtually all areas of the State.[54]

[53] *Petition of MCI Metro Access Transmission Services, LLC, Sage Telecom, Inc., Texas UNE Platform Coalition, McLeod USA Telecommunications Services, Inc. and AT&T Communications of Texas, L.P. for Arbitration with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996*, Docket No. 24542, Direct Testimony of Gary P. Nuttall at 7 (Dec. 7, 2001).

[54] *See* maps contained in Appendices J-M.

As shown in Figure 13, of June 2002, a higher percentage of rural than urban or suburban customers were served by CLECs using the CLEC's own facilities.[55]

Figure 13 — CLEC Lines by Geography and by Entry Strategy in Texas, as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

As shown in Table 6, CLECs serve far fewer lines in suburban areas than in rural or urban, and more than twice as many customers by their own facilities in rural than in urban areas.

Table 6 — CLEC Lines by Entry Strategy and Geography in Texas

	Facilities	TSR	UNE-L	UNE-P	Total
Rural	269,300	71,684	3,036	220,393	564,413
Suburban	51,681	40,877	23,615	214,311	330,484
Urban	102,741	124,401	186,345	769,272	1,182,759

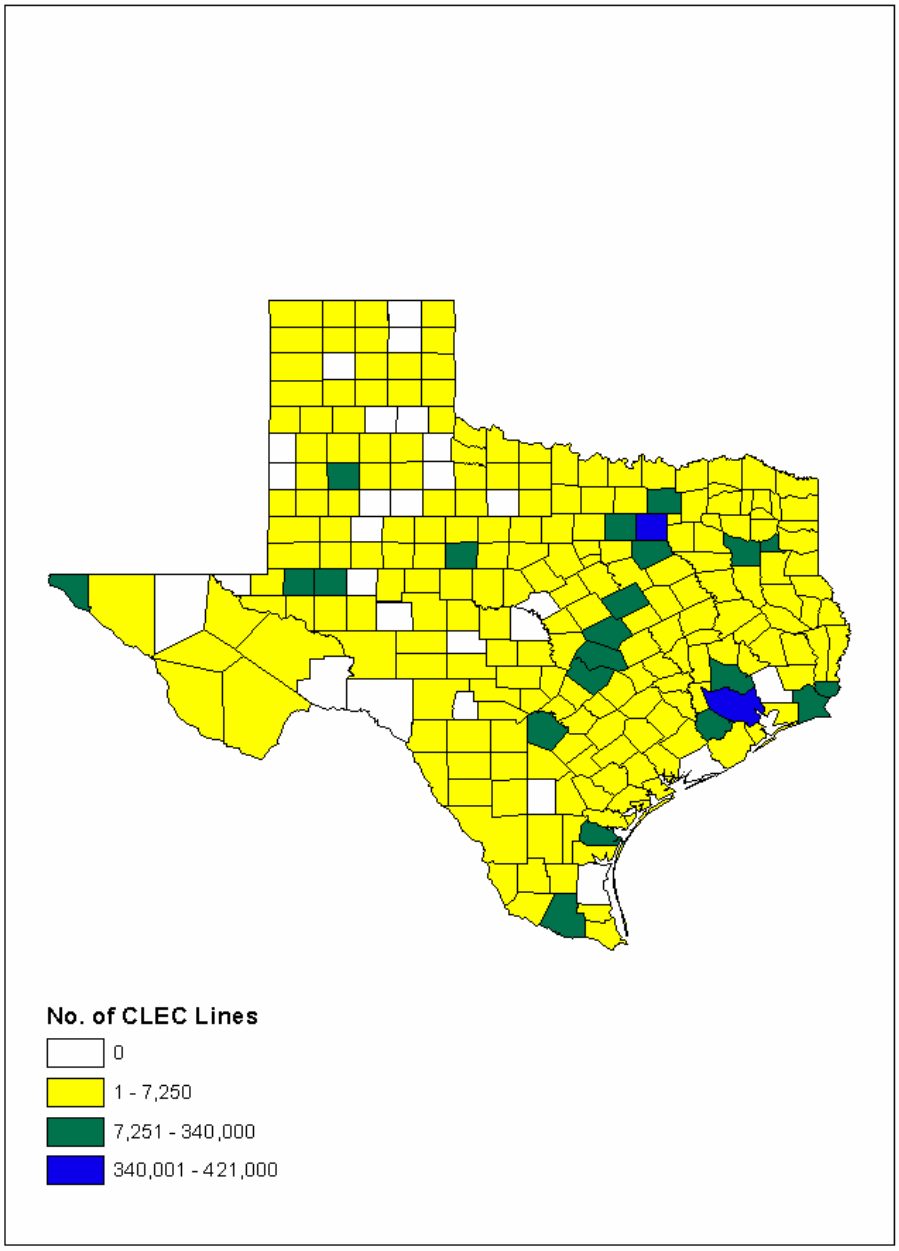
SOURCE: Texas PUC 2003 Scope of Competition Data Responses

As illustrated by Figure 14, CLECs have obtained more lines in urban areas, primarily in downtown and other business districts.[56] This could be attributed to high investment costs and small customer bases in rural areas, resulting in smaller profit margins.

[55] Appendix A, Research Methodology, contains the definition of rural, suburban, and urban that was used to collect data for the 2003 Scope of Competition Report.

[56] *See also* maps contained in Appendices J-M.

Figure 14 — Total Number of CLEC Lines by County, as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

c. CLEC Business and Residential Customers

As of June 2002, CLECs served more residential than business lines in all markets throughout the State. However, it is important to note that the statewide ratio of residential versus non-residential lines is 1.75 to 1, whereas the CLEC ratio is 1.5 residential lines to 1 non-residential line.

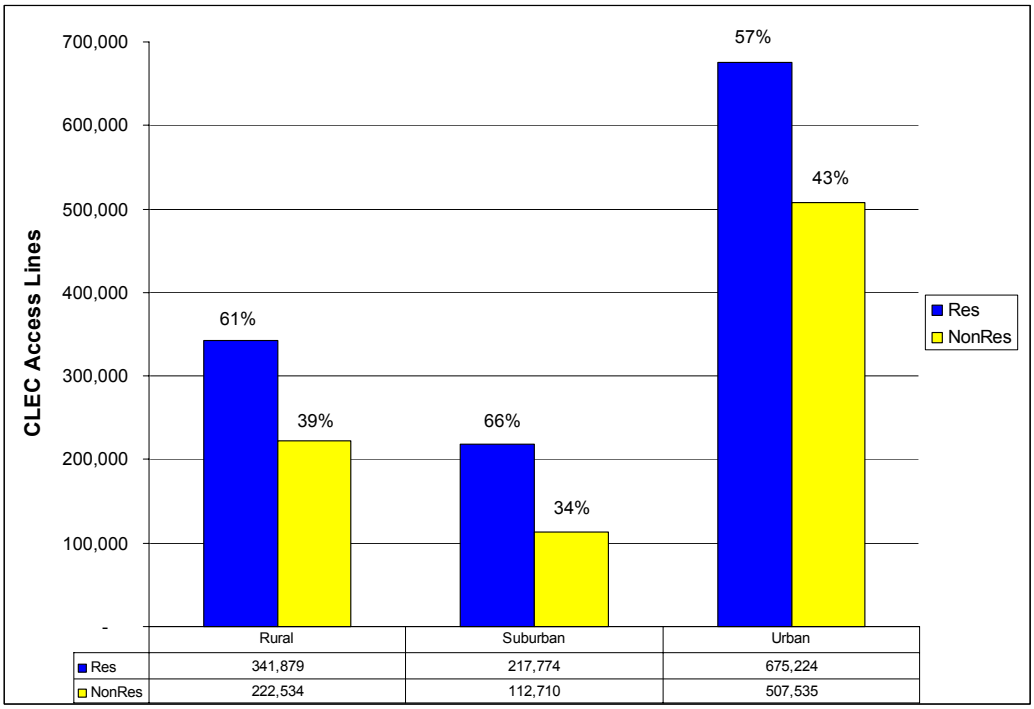
Table 7 — Total ILEC and CLEC Residential and Non-Residential Lines in Texas, as of June 2002

	ILEC	CLEC	TOTAL
Residential	7,319,140	1,235,214	**8,554,354**
Non-Residential	4,031,554	843,251	**4,874,805**

SOURCE: Texas PUC 2003 Scope of Competition Data Responses, excludes ILEC-reported wholesale lines.

A further breakdown of the CLEC residential and non-residential lines in Texas reveals that in all three zones of the State (rural, suburban, and urban),[57] CLECs have more residential lines than non-residential.

Figure 15 — CLEC Lines by Geography and Type of Customer in Texas

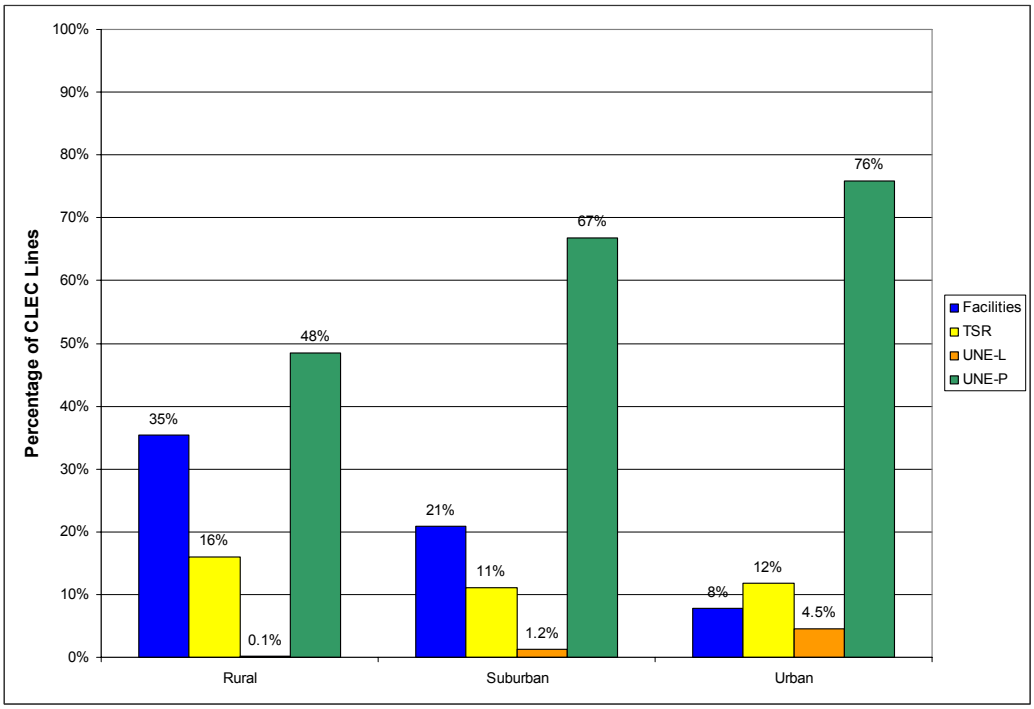


SOURCE: Texas PUC 2003 Scope of Competition Data Responses. Excludes ILEC-reported wholesale lines, and 809 CLEC access lines for which exchange information was not provided.

[57] Appendix A, Research Methodology, contains the definition of rural, suburban, and urban that was used to collect data for the 2003 Scope of Competition Report.

UNE-P remains the entry strategy of choice for CLECs to serve residential customers in any of the three zones.

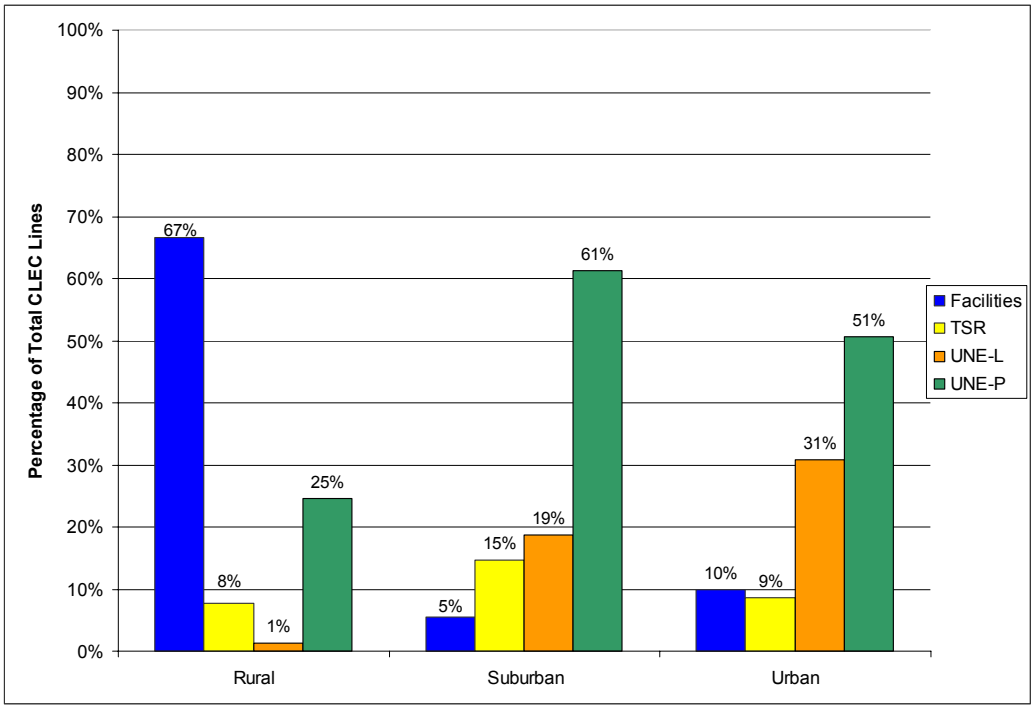
Figure 16 — CLEC Residential Lines by Entry Strategy in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

However, as shown in Figures 17 and 18, CLECs have made deeper inroads into the non-residential market. CLECs serve three times as many non-residential customers in rural areas (148,190 lines) than in urban areas (49,899 lines) using their own facilities to provide service.

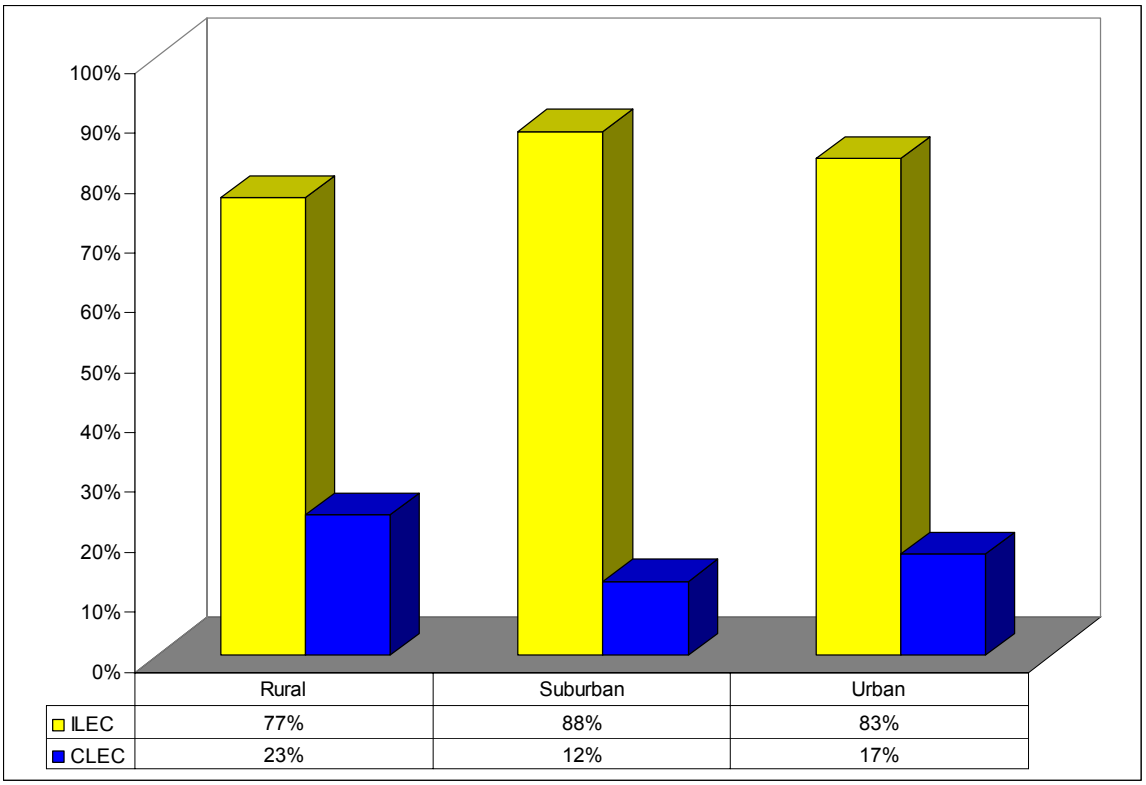
Figure 17 — CLEC Non-Residential Lines by Entry Strategy in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

In addition, CLECs serve 23% of the business customers in rural areas of the State, compared to 17% market penetration in urban areas, and just 12% in suburban areas.

Figure 18—LEC Non-Residential Lines in Texas by Geography as of June 30, 2002



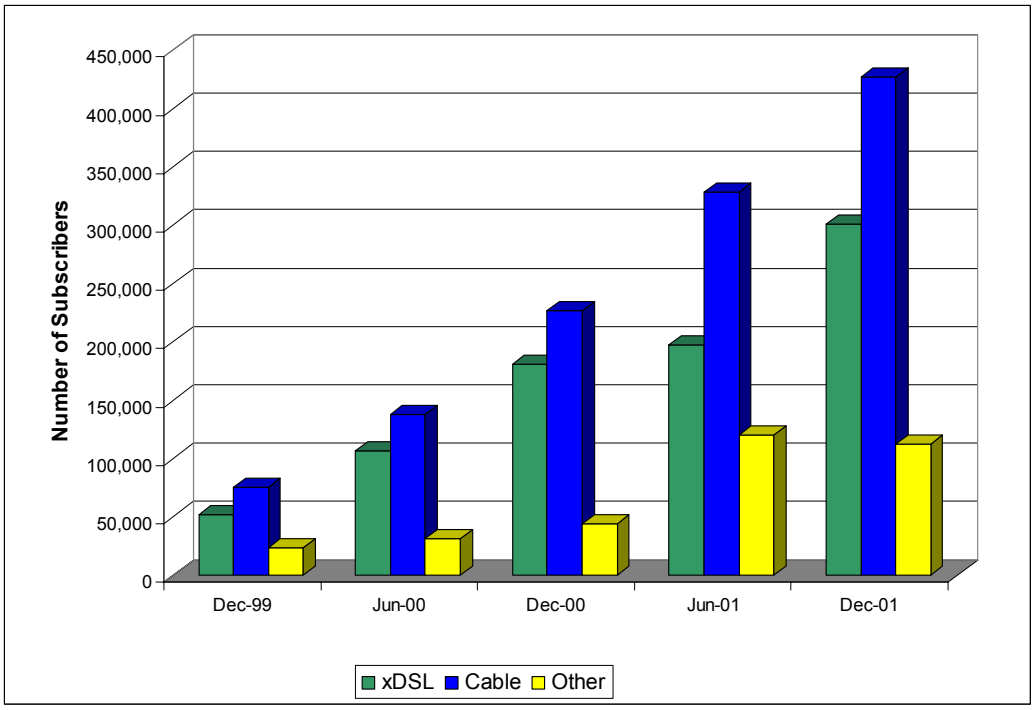
	Rural	Suburban	Urban
ILEC	726,338	796,921	2,495,478
CLEC	222,534	112,710	507,535

SOURCE: Texas PUC Scope of Competition Data Responses. Excludes ILEC-reported wholesale lines, and 809 CLEC access lines for which exchange information was not provided.

B. Broadband Market in Texas

Since the *2001 Scope Report*, broadband subscribership in Texas has grown from 152,000 customers in December 1999 to over one million customers as of June 2002.

Figure 19 — Broadband Subscribers in Texas



SOURCE: *High Speed Services for Internet Access,* FCC (Dec. 2000, August 2001, Feb. and July 2002).

FCC data reveals that of the high-speed lines in Texas, 89% were for residential and small business use; the remaining 11% were lines in service connecting to medium and large business, institutional, or government end-user customers.[58]

With respect to technology deployed in the last mile, 55% of high-speed services were delivered over coaxial cable; 35% were delivered over asymmetric digital subscriber line (ADSL); and 10% included wireline technologies other than asymmetric digital subscriber line (ADSL), optical fiber to the subscriber's premises, satellite, and terrestrial, fixed wireless systems.[59]

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[58] Federal Communications Commission, Industry Analysis and Technology Division, *High-Speed Services for Internet Access, Status as of June 30, 2002*. WIRELINE COMPETITION BUREAU, December 2002. Available online at: www.fcc.gov/wcb/iatd/comp.html.

[59] Federal Communications Commission, Industry Analysis and Technology Division, *High-Speed Services for Internet Access, Status as of July 30, 2002,* WIRELINE COMPETITION BUREAU, December 2002. Available online at: www.fcc.gov/wcb/iatd/comp.html.

With respect to other States, Texas was ranked fourth for the number of high-speed lines. For the period 1999 to 2002, Texas's broadband growth rate exceeded the national average and that of many other large States.[60]

Table 8 — Broadband Subscribers in Texas Compared to Other States

STATE	1999 TOTAL	JUNE 2000 TOTAL	DEC. 2000 TOTAL	JUNE 2001 TOTAL	DEC. 2001 TOTAL	JUNE 2002 TOTAL	% CHANGE 1999 TO 2002
Texas	152,518	267,087	522,538	646,839	840,665	1,050,511	589
California	547,179	910,006	1,386,625	1,705,814	2,041,276	2,598,491	375
Massachusetts	114,116	185,365	289,447	357,256	505,819	583,627	411
New York	186,504	342,743	603,487	893,032	1,199,159	1,460,894	683
North Carolina	57,881	81,998	136,703	205,616	357,906	461,736	698
Pennsylvania	71,926	79,892	176,670	263,236	376,439	516,488	618
Nationwide Total	2,754,286	4,367,434	7,069,874	9,616,341	12,792,812	16,202,540	488

SOURCE: *High Speed Services for Internet Access,* FCC (December 2002).

Broadband providers continue to offer new products and services to attract additional customers. In August 2002, SBC Communications released plans to roll out additional lower-speed, lower-priced digital subscriber line (DSL) options in certain markets in Texas in an attempt to compete with the cable modem market.[61] For example, in a co-branding arrangement with Yahoo, SBC rolled out a slower, less expensive DSL service for $42.95 per month in September 2002.[62]

Cable continues to capture market share, and with the addition of video-on-demand platforms, the cable industry is expected to continue to perform well.[63]

As reflected in Figures 20 and 21 below, in general, there are more broadband providers in counties with higher population densities. However, Figure 21 demonstrates that while several counties in Texas lack cable or DSL providers altogether, a few somewhat sparsely populated counties of the State actually are served by one or more providers.

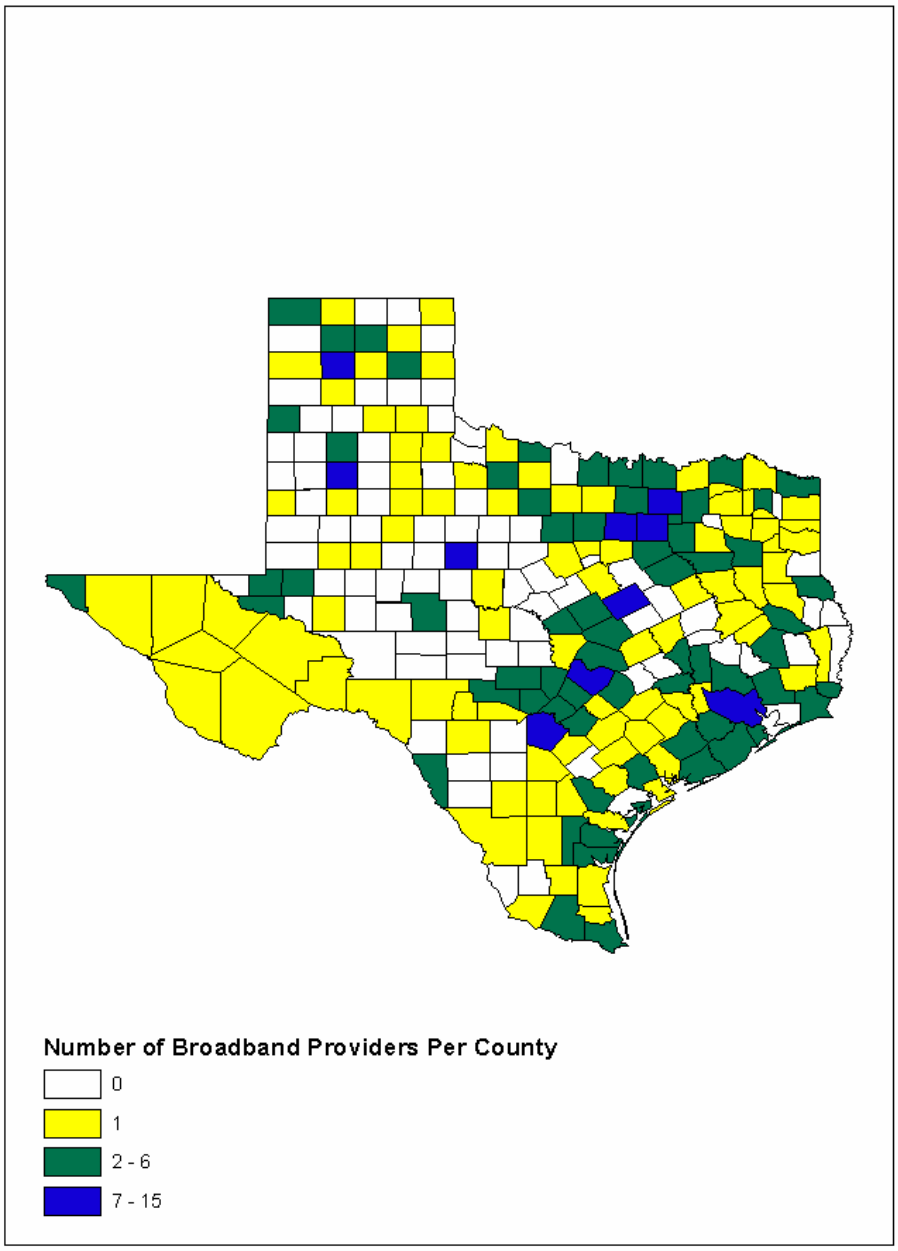
[60] *Id*.

[61] Andrea Ahles, *Quick studies*, FORT WORTH STAR-TELEGRAM, August 22, 2002, p. C1.

[62] Andrea Ahles, *SBC Communications offers co-branded broadband service*, STAR-TELEGRAM at 2C (Sept. 19, 2002).

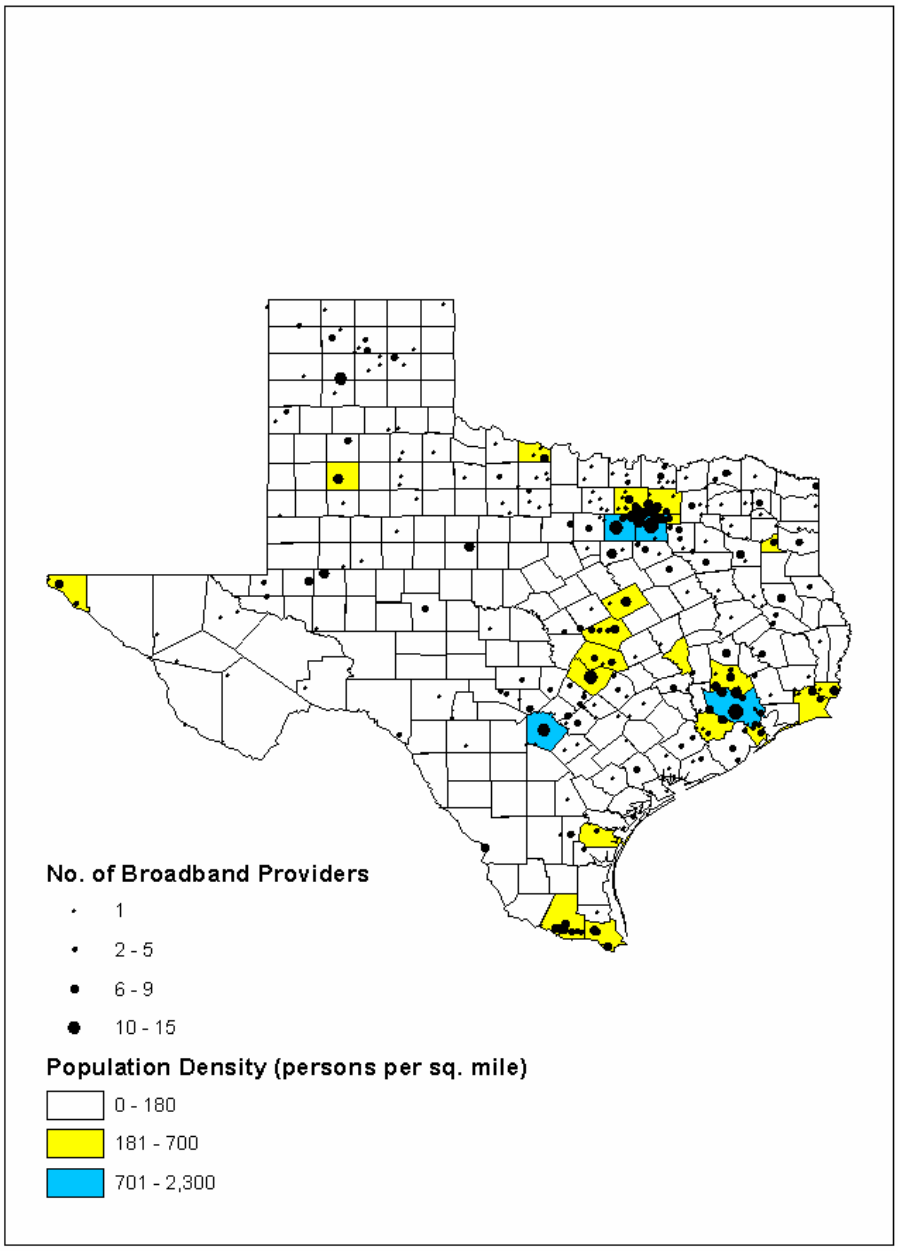
[63] Roben Farzad, *Telecom-Mess Survivors*, FWST (May 5, 2002); Dan Sweeney, *Cable's Plumb Position*, AMERICA'S NETWORK at 32 (July 1, 2002).

Figure 20 — Number of Broadband Providers per County as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Figure 21 — Number of Broadband Providers by Population Density of County



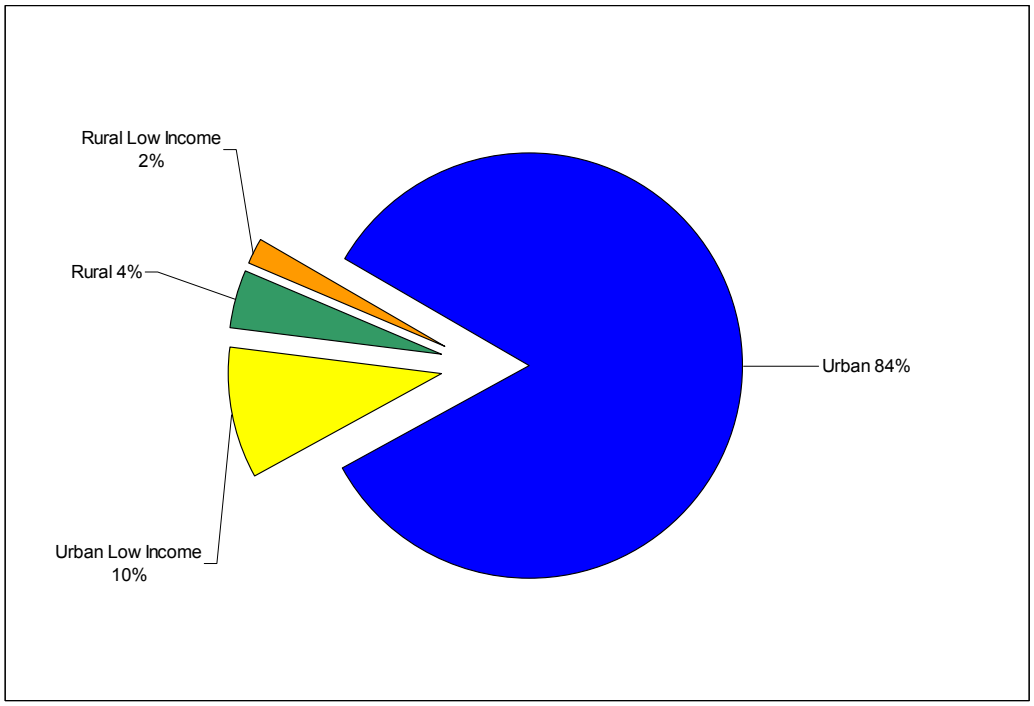
SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Project Pronto

SBC offers a DSL product—referred to as Project Pronto—that it launched in the Fall of 1999.[64] By placing remote terminals further into residential neighborhoods, SBC is able to overcome distance limitations to bring DSL service within the reach of the vast majority of its customers. SBC's goal at the outset was to have DSL available to 80% of its customer base by 2002. By October 2001, SBC had scaled that number back to 58% and was announcing a further slowdown in towns with lower population densities.[65] This slowdown was intended to cut capital expenditures by $1 billion.

As shown in Figure 22, 94% of SBC's DSL deployment in Texas is in urban areas, including low-income urban areas.

Figure 22 — Urban vs. Rural SBC Wire Centers with DSL Deployment, 4th Quarter 2001



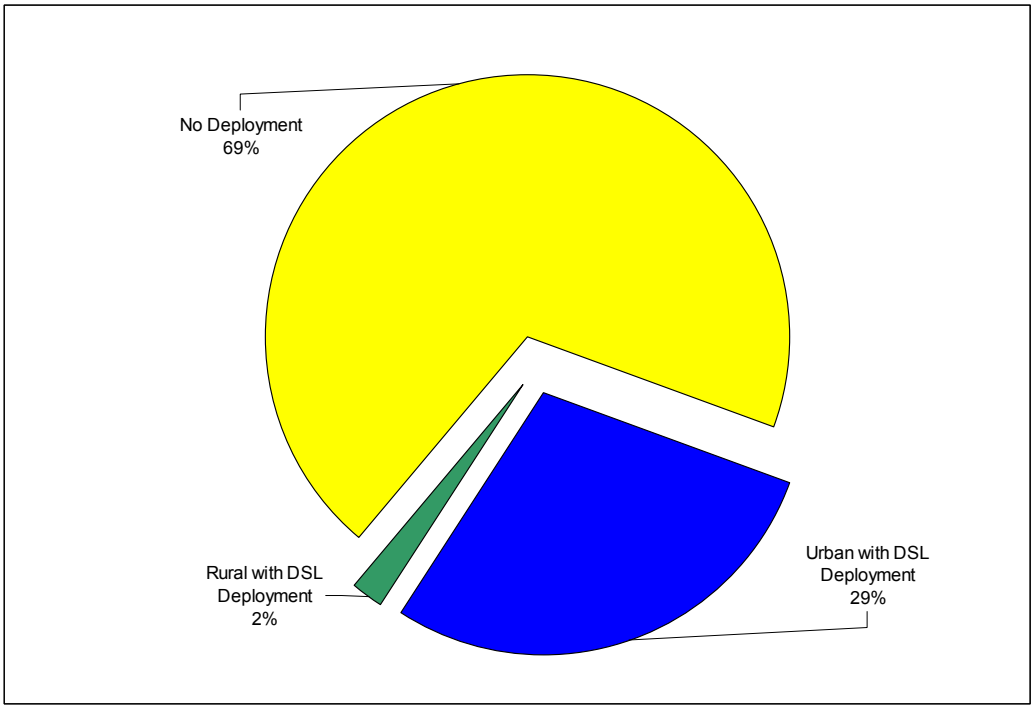
SOURCE: SBC/Ameritech Merger xDSL Deployment,
http://www.fcc.gov/wcb/mcot/SBC_AIT/xDSL_deployment (October 30, 2002)

[64] Karen Brown, *SBC Takes Pronto Out Of DSL Buildout Pace*, BROADBAND WEEK, October 29, 2001.

[65] *Id.*

Figure 23 shows that as of the fourth quarter of 2001, 69% of SBC wire centers in Texas had no deployment of DSL.

Figure 23 — xDSL Deployment in SBC Wire Centers, 4th Quarter 2001



SOURCE: SBC/Ameritech Merger xDSL Deployment, http://www.fcc.gov/wcb/mcot/SBC_AIT/xDSL_deployment (October 30, 2002)

SBC has argued that while DSL could be one of its key growth enterprises, it is unwilling to invest further substantial capital in it under current regulations.[66] According to SBC, on a nationwide scale, although 70% of high-speed internet access consumers use a cable modem and only 30% use DSL, the cable industry remains virtually unregulated while SBC faces what it calls "pervasive regulation."[67]

[66] Vikas Bajaj, *SBC says industry policies need to change*, DALLAS MORNING NEWS, July 9, 2002, p. D1.

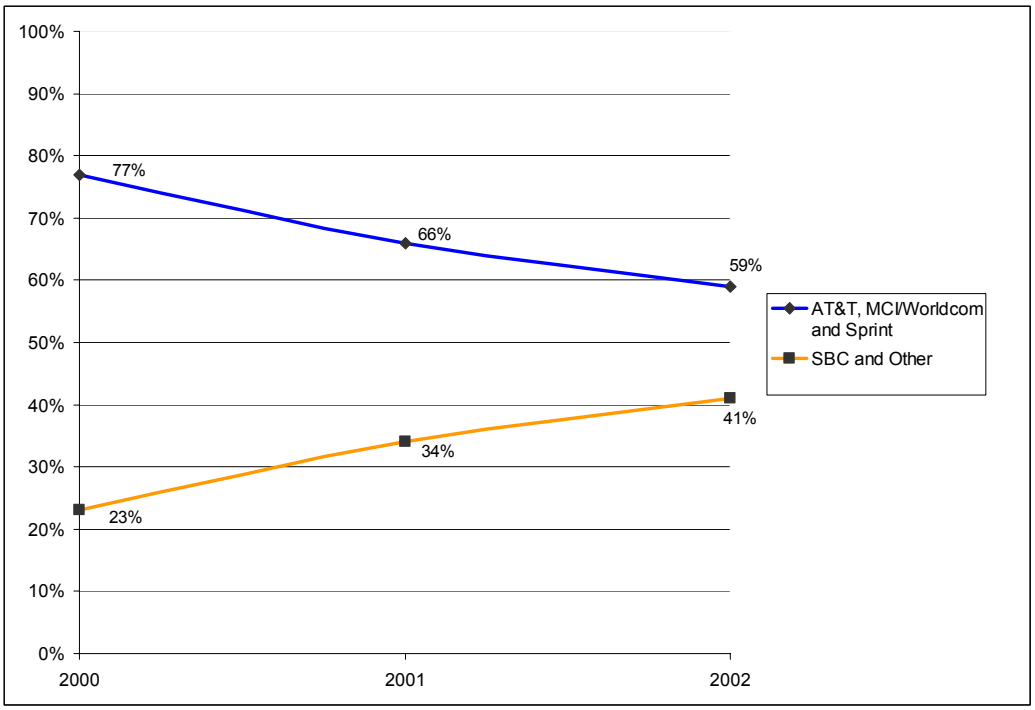
[67] *Id.*

C. Long-Distance Market in Texas

1. Market Share

Since entering the interLATA telephone markets in 2000, SBC's share of the Texas long-distance market has grown. Comparing the long-distance market share (measured in minutes-of-use) jointly held by AT&T, MCI/WorldCom, and Sprint with that of SBC and other carriers, the market share of SBC and others grew from 23% in 2000, to 34% in 2001, and reached 41% in 2002.[68]

Figure 24 — Long-distance Market Share Over Time



SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The other category includes facilities-based IXCs, such as Williams Communications and Broadwing, Inc., as well as resellers.

Increased long-distance competition has resulted in substantial savings for customers. A recent analysis of Texas long-distance rates indicated that Southwestern Bell's entry into the long-distance market lowered peak long-distance prices by 11%, weekday off-peak prices by 18%, and weekend off-peak prices by 9%.[69] The same study found that the average Texas consumer would have paid $17.52 for long-distance prior to SWBT's entry and would have paid $15.72 in the post entry period, implying a savings of $1.80 or 10.3%.

[68] Texas PUC 2003 Scope of Competition Data Request.

[69] Hausman, Leonard, and Sidak, Does Bell Company Entry Into Long Distance Telecommunications Benefit Consumers?, 70 ANTITRUST L.J. (2002) at 463.

2. Long-Distance and Wireless Comparison

As discussed in Chapter II of this Report, the wireless market is growing while the long-distance market seems to be shrinking. Table 9 demonstrates that there is some correlation between the growth in the wireless market and the decline in the long-distance market. This comparison was done by comparing the number of mobile subscribers in Texas, which has nearly doubled in the last two years, with the number of switched access minutes-of-use in Texas, which increased slightly between 1999 and 2000 and has subsequently fallen off by about 3%. Table 9 also includes the number of basic dial tone lines, which expanded in 2000 from 1999 levels, but fell in 2001.

Table 9 — Comparison of Wireline and Wireless in Texas

	1999	2000	2001
Mobile Wireless Subscribers	5,792,453	7,548,537	9,062,064
Long-distance (Switched Access) Minutes of Use	11,397,493,545	11,495,969,512	11,137,023,457
Total Basic Dialtone Lines	13,188,047	13,750,684	13,531,474

SOURCES: *Local Telephone Competition Reports,* FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.

Chapter IV. Commission Activities: 2001 - 2003

This section provides an overview of the Commission's activities since the *2001 Scope Report*. These activities represent the Commission's continued efforts to enhance competition, usher in broadband deployment, and promote and protect consumer interests. The Chapter begins with a discussion of the Commission's activities under the Federal Telecommunications Act of 1996 (FTA), and then leads into a synopsis of Commission activities under the Public Utility Regulatory Act (PURA).

A. Commission Activities Under the FTA

The Commission has participated in a number of activities to implement the regulatory mandate regarding fair access to the monopoly's network as required by the FTA. This includes key arbitration cases, and monitoring of Southwestern Bell Telephone Company's (SWBT)'s performance with respect to allowing access to its network by competitors.

1. Arbitrations and Dispute Resolution

The Commission plays a critical role in fostering local competition, by playing a key role in the negotiation and arbitration of interconnection agreements. The FTA allows competing carriers to choose the most efficient points at which to exchange traffic with incumbent local exchange carriers (ILECs). Initially, the requesting carrier and the ILEC will seek to negotiate mutually agreeable rates, terms and conditions governing the competing carrier's interconnection to the incumbent's network, access to the incumbent's unbundled network elements (UNEs), or the provision of services at wholesale rates for resale by the requesting carrier. FTA Section 251(c)(1) imposes on ILECs the "duty to negotiate in good faith in accordance with section 252 the particular terms and conditions of agreements to fulfill the duties described" in sections 251(b) and (c).[70] Section 251(c) provides that "(t)he requesting telecommunications carrier also has the duty to negotiate in good faith the terms and conditions of such agreements."[71]

[70] 47 U.S.C. § 251 (c)

[71] *Id.*

Parties have several options under FTA Section 252 for securing an interconnection agreement. In many instances, parties successfully reach agreement through voluntary negotiations. As reflected in Table 10, carriers in Texas conduct substantial numbers of voluntary negotiations for interconnection, services, and network elements.

Table 10 — Type and Number of Interconnection Agreements in Texas

TYPES OF INTERCONNECTION AGREEMENTS	FROM SEPTEMBER 1, 2000— JULY 2002
Negotiated Agreements	197
Amendments	287
Texas 271 Agreements	103

a. Texas 271 Agreement

Although carriers are free to negotiate unique, individualized contracts, many have chosen to adopt the standardized Texas 271 Agreement (T2A). The T2A is a Commission-approved interconnection agreement that, with the collocation tariff, contains SWBT's commitments made during SWBT's Section 271 application. The creation of this standard interconnection agreement reflects pro-competitive policies and terms that a few competitive local exchange carriers (CLECs) may have had difficulty negotiating on their own.

The T2A also allows a competitive carrier to enter the market quickly because it provides an expedited Commission approval. In many instances, negotiation can be avoided altogether. A competing carrier that wishes to interconnect with SWBT notifies SWBT in writing. Within five days, SWBT must provide a signed interconnection agreement that is substantively identical to the T2A. Within five days, the CLEC signs the agreement and files it with the Commission. By operation of law, the agreement becomes effective upon filing, without the need for public notice.

Pursuant to FTA Section 252(i), carriers can also choose to "opt-in" only a portion of the T2A. As such, negotiations can be targeted to address fewer issues. Within the negotiated agreements referred to in the chart above, a significant number use extensive T2A "boilerplate" and tailor selected contract terms to fit individual business plans.

Although the four-year term of the T2A expires on October 13, 2003, some benefits of this standardized agreement are likely to continue, perhaps in a different form. The FTA provides that carriers can "opt-in" to other carriers' agreements under FTA Section 252(i). Specifically, a local exchange carrier (LEC) must make available "any interconnection, service, or network element provided under an agreement…to which it is a party to any other requesting telecommunications carrier upon the same terms and

conditions as those provided in the agreement."[72] Accordingly, uncontested contract terms from past contracts are often carried over into subsequent agreements. On the other hand, contested terms and conditions that resulted from Commission decisions, or which were the subject of negotiated tradeoffs, both of which are true of the T2A, are likely to again prompt extensive negotiations. However, the Commission has noted on numerous occasions that the T2A interconnection language reflects the Commission's policy decisions. As noted in more detail below, the Commission has already begun examining successor agreements to the T2A, building upon its prior decisions.

b. Compulsory Arbitration

When voluntary negotiations are unsuccessful, FTA Section 252(b) allows parties to seek arbitration as early as 135 days after an ILEC receives a request for negotiation under section 252. The FTA gives state commissions responsibility for arbitrating open issues. State commissions must ensure that resolution of any open issues and the imposition of appropriate conditions on the parties meet the requirements of FTA Section 251 and Federal Communication Commission (FCC) regulations.[73] Either party may also ask the Commission to mediate specific issues to facilitate an agreement during the negotiation process.

Under its procedural rules, the Commission distinguishes between arbitration proceedings that address existing terms and conditions and those that are developing new terms and conditions. The former, post-interconnection disputes, may involve interpretation or enforcement of existing terms and conditions. Negotiations of new terms or entirely new agreements give rise to arbitrations. As reflected in the Table 11, far fewer interconnection agreements are developed through arbitrations or dispute resolutions than through voluntary negotiations.

Table 11 — Type and Number of Arbitrations in Texas

TYPES OF DISPUTE RESOLUTION	FROM SEPTEMBER 1, 2000 THROUGH JULY, 2002
Arbitrations	26
Post-Interconnection Dispute	19
Mediation	2

Over the last two years, the Commission has been involved in several important decisions. These include decisions on issues regarding (1) policies and pricing for UNEs, and (2) line sharing. Following are brief descriptions of arbitrations in each of these issue areas and the federal decisions, which have had an effect on these proceedings. For a more detailed description of other Commission arbitration decisions, please see Appendix N.

[72] 47 U.S.C. § 252(i).

[73] 47 U.S.C. § 251.

Before discussing the MCI and Rhythms arbitrations, it is necessary to lay the groundwork by briefly discussing the FCC orders and federal case law underlying those decisions, specifically with reference to the network elements that must be unbundled by the ILEC, the extent to which the ILEC must "combine" elements, and the cost standard used to set prices for those elements.

i. Unbundling of Network Elements

In the *First Report and Order*,[74] in determining which ILEC-owned network elements should be made available to CLECs under the FTA,[75] the FCC broadly interpreted the "necessary" and "impair" standards contained in the FTA to require unbundling of the following elements: circuit switching, local loops, subloops, the network interface device, directory assistance, operator services, signaling systems, interoffice transport, and operations support systems (OSS). ILECs challenged this rule and, in 1999, the United States Supreme Court vacated 47 C.F.R. § 51.329, and criticized the FCC for a standard it considered so broad that it required ILECs to give CLECs blanket access to their networks.[76]

Pursuant to the Supreme Court's directive, the FCC revisited the "necessary" and "impair" standards and established relevant factors.[77] When applying those factors, the FCC modified the list of UNEs by narrowing the requirement for providing two of the elements: switching and databases. With the exception of those two elements, the FCC otherwise found, without doing any geographic analysis, that elements originally unbundled in the *First Report and Order* should continue to be provided. The ILECs again challenged the rule in court, and in a 2002 decision, the United States Court of Appeals for the D.C. Circuit vacated the rule.[78] The court held that the FCC's adoption of a uniform national rule regarding UNEs failed to take into account the differences

[74] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, First Report and Order*, CC Docket. No. 96-98, CC Docket No. 95-185, FCC 96-325 (rel. Aug. 8, 1996) (Local Competition Order).

[75] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in 15 and 47 U.S.C.) 47 U.S.C. § 251(d)(2) states:

ACCESS STANDARDS — In determining what network elements should be made available for purposes of subsection (c)(3), the Commission shall consider, at a minimum, whether—(A) access to such network elements as are proprietary in nature is necessary; and (B) the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.

[76] AT&T Corp. v. Iowa Utilities., 525 U.S. 366 (1999).

[77] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238 (rel. Nov. 5, 1999) (*UNE Remand Order*).

[78] *United States Telecom Association v. Federal Communications Commission*, 290 F.3d 415 (D.C. Cir. 2002) (Order staying issuance of mandate till 7 days after disposition of any timely motion for rehearing entered on May 24, 2002; petition for rehearing filed on July 8, 2002) (*USTA*).

among the many markets covered by the FCC's general rule.[79] The court also found that the FCC failed to consider and take into account cost advantages CLECs might enjoy, such as freedom from the duty to provide under-priced service to rural customers.[80] Finally, the court found that the FCC failed to focus on the distinction between cost disparities attendant to the market structure and those disparities that would be faced by virtually any new entrant into any sector of the economy without regard to the existing level of competition.[81] With respect to the *Line Sharing Order*, discussed below, the court concluded that the FCC had failed to consider the relevance of competition in broadband services from other sources (*e.g.*, cable and, to a lesser extent, satellite).[82]

On December 20, 2001, the FCC released a Notice of Proposed Rulemaking (NPRM) relating to its first triennial review of its policies on UNEs.[83] This review provides the FCC with an opportunity to examine the framework under which ILECs must make UNEs available to competing carriers. Among other things, the FCC examined in this NPRM the ILECs' wholesale obligations under Section 251 of the FTA to make their facilities available as UNEs to CLECs for the provision of broadband services. The NPRM also sought comment on whether the FCC should apply unbundling requirements based on type of service, facility, geography, or other factors (*i.e.*, "more granular statutory analysis"). Additionally, the FCC requested comment on whether to retain, modify, or eliminate its existing definitions and requirements for UNEs, and on the role of state commissions regarding UNEs.

ii. UNE-P or other combinations of UNEs

In the *First Report and Order*, the FCC required that ILECs combine network elements at the request of entrants who cannot combine the UNEs themselves. The ILECs challenged this portion of the rule and the United States Court of Appeals for the Eighth Circuit vacated the FCC's regulations regarding the combining of UNEs (47 C.F.R. § 51(315(c)–(f)).[84] On appeal, the United States Supreme Court reversed the Eighth Circuit, holding that 47 C.F.R. § 51.315(c) requires an ILEC to "perform the functions necessary to combine unbundled network elements in any manner"—not necessarily to complete the actual combination—"even if those elements are not

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[79] *United States Telephone Assoc., et. al, v. FCC*, 290 F.3d 415, 423-26 (D.C. Cir. 2002) (USTA).

[80] *Id* at 424.

[81] *Id* at 426-28.

[82] UNE Remand Order at 428-29.

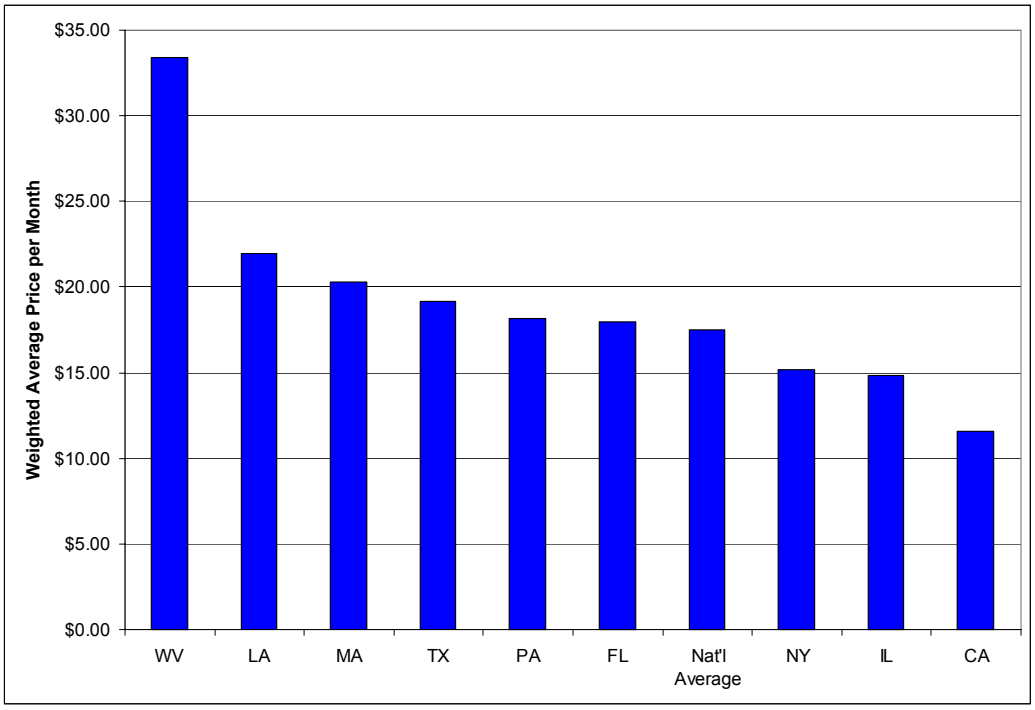
[83] *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, and 98-147, Notice of Proposed Rulemaking, FCC No: 01-361. (rel. December 20, 2001)

[84] *Iowa Utilities Board v. FCC*, 120 F.3d 753, 795, 800, 819 (8th Cir. 1997) (vacating 47 C.F.R. §§ 51.601-51.611).

ordinarily combined in the incumbent's network," provided such combination is "technically feasible" and neither places the ILEC at a competitive disadvantage nor impairs the ability of other carriers to interconnect with the ILEC's network.[85] In reinstating the rules, the Court deferred to the FCC's construction of Section 251(c)(3).[86] In exchange, the entrant must pay a reasonable cost-based fee for whatever the ILEC does.[87]

In comparison with other States, the weighted average unbundled network element platform (UNE-P) price in Texas of $19.17 per month is slightly higher than the national average of $17.48 per month.[88]

Figure 25 — National UNE-P Rate Comparison



SOURCE: *A Survey of Unbundled Network Element Prices in the United States*, West Virginia Public Service Commission (July 2002).

[85] 41 C.F.R. § 51.315(c). *Verizon Communications, Inc. v. Federal Communications Commission,* 535 U.S. 467, 122 S.Ct. 1646, 1683 (2002) (*Verizon*) ("Combining" refers to the "mechanical connection of physical elements within an incumbent's network, or the connection of a competitive carrier's element with the incumbent's network 'in a manner that would allow a requesting carrier to offer the telecommunications service.) (*cited In the Matter of the Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, FCC 96-325 ¶ 294, n. 620 (August 8, 1996) ("*First Report & Order"*).

[86] *Verizon* at 1684-87 (citing Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-45 (1984) and *Local Competition Order* at ¶ 294).

[87] *Id*.

[88] West Virginia Public Service Commission, *A Survey of Unbundled Network Element Prices in the United States*, at Appendix 3 (July, 2002).

iii. Costing of UNEs

In the *First Report and Order*, the FCC also established the standards that state commissions would use to determine a "nondiscriminatory," "just and reasonable rate for network elements."[89] The FTA required the FCC to establish the cost methodology without "reference to a rate-of-return or other rate-based proceeding."[90] In the *First Report and Order*, based upon the direction given in the FTA, the FCC chose to determine cost by looking at the total element long-run incremental cost (TELRIC), a "forward-looking economic cost" methodology.[91] The ILECs challenged the TELRIC methodology on appeal. That appeal was final when the United States Supreme Court issued its decision is *Verizon Communications, Inc v. Federal Communications Commission.*[92] The Supreme Court upheld the FCC's requirement that the States set ILECs' UNE rates based upon TELRIC, not based on the ILECs' historical costs. The Court rejected ILECs' arguments that "cost" can only mean historical cost. Further, the Court held that the ILECs' arguments that the use of TELRIC rates would be a disincentive to development of facilities-based competition were contrary to fact.

c. MCIm Arbitration

Before the United States Supreme Court issued the Verizon decision upholding TELRIC and the ILECs' requirement to combine network elements, MCIMetro Access Transmission Services filed a petition for arbitration with Southwestern Bell Telephone Company. [93] Subsequently, Sage Telecom, Inc. Texas UNE Platform Coalition, Mcleod UST Telecommunications, Services, and AT&T Communications of Texas, LP joined the proceeding. The primary issues addressed were the continued availability of certain UNEs, such as unbundled local switching and certain combinations, given that SWBTs promise to provide such UNEs was lapsing under the Texas 271 Agreement. (UNE costing was also brought up, and is being developed in a separate costing docket, Docket No. 25834.) This Award was issued in April 2002. The Commission made the following major determinations in the Award.

i. Unbundled Local Switching

In the UNE Remand Order, the FCC required ILECs to provide local switching as a UNE, except local switching used to serve end users with four or more lines in density zone 1 in the top 50 Metropolitan Statistical Areas (MSAs), provided that the ILEC provides nondiscriminatory, cost-based access to the enhanced extended loop (EEL)

[89] 47 C.F.R. §51.317.

[90] 47 U.S.C. 252(d)(1).

[91] 47 C.F.R. §51.505.

[92] *Verizon Communications, Inc. v. Federal Communications Commissio*n, 535 U.S. 467, 122 S.Ct. 1646, 1683 (2002) (Verizon).

[93] *Petition of MCIMetro Access Transmission Services, LLC, Sage Telecom, Inc., Texas UNE Platform Coalition, Mcleod USA Telecommunications Services, Inc., and AT&T Communications of Texas, LP for Arbitration with Southwestern Bell Telephone Company under the Telecommunications Act of 1996, Docket No. 24542*, Final Order (Dec. 19, 2002). ("MCIm Arbitration").

throughout density zone 1.[94] In the MCIm arbitration, the Commission found that SWBT failed to prove that it provides nondiscriminatory cost-based access to the EEL. The Commission, therefore, found that SWBT is required to continue providing unbundled local switching in density zone 1 until SWBT has demonstrated in a Commission proceeding that it is providing nondiscriminatory, cost-based access to the EEL. Consistent with the FCC's finding in the UNE Remand Order, the Commission held that CLECs would be impaired without access to unbundled local switching in zones 2 and 3, as well. The Commission also construed the requirements of PURA § 60.021 for the first time, finding that it is in the public interest and there is competitive merit for local switching to remain an unbundled network element in Texas.

ii. UNE-P or Combinations of UNEs

The Commission held that Section 251 of the FTA, as interpreted by the FCC, requires SWBT to provide CLECs with nondiscriminatory access to UNEs in a manner that allows CLECs to combine UNEs for themselves without having to collocate. Because SWBT was not providing CLECs with nondiscriminatory access that would allow CLECs to combine UNEs for themselves, the Commission ruled that SWBT must continue combining UNEs for CLECs. SWBT is obligated to continue making new combinations of UNEs until SWBT has demonstrated in a Commission proceeding that it is providing nondiscriminatory access to UNEs in such a manner that allows CLECs to combine UNEs for themselves without needing to collocate.

iii. Costing Issues

The cost issues severed from Docket No. 24542 are addressed in a follow-on proceeding, which was initiated in May 2002, and include loop rates, switching rates, line port rates, input/output port rates, daily usage feed rates, and digital cross-connect system rates, among others.[95] As a preliminary issue, the Commission determined that the three zones (urban, suburban, rural) for deaveraging of SWBT's rates would be maintained rather than disaggregated further to match USF disaggregation.

d. Rhythms' Line Sharing Arbitration

On December 9, 1999, the FCC released the *Line Sharing Order*, amending the FCC's unbundling rules to require ILECs to provide unbundled access to a new network element, the high frequency portion of the local loop, and encouraging state commissions to set interim rates for quick implementation of the Order. In early 2000, various parties petitioned to establish expedited Commission oversight concerning line sharing.[96] An

[94] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking at ¶12, FCC 99-238 (rel. Nov. 5, 1999) (*UNE Remand Order*).

[95] *Proceeding on Cost Issues Severed from P.U.C. Docket No. 24542*, Docket No. 25834 (May 1, 2002).

[96] *Petition of Rhythms Links, Inc. Against Southwestern Bell Telephone Company for Post-Interconnection Dispute Resolution and Arbitration Under the Telecommunications Act of 1996 Regarding Rates, Terms, Conditions and Related Arrangements for Line Sharing*, Docket No. 22469 (April 26, 2000).

arbitration award was issued finding that SWBT is required to continue providing ILEC-owned splitters for purposes of line sharing, and that SWBT must provide access to "Project Pronto" functionality. On an interim basis, the cost for the high frequency portion of the loop was set at $0, based on an assumption that all of the ILEC's costs for the loop were recovered via other charges; therefore, any amount above zero would amount to double recovery of costs.

Prior to a final Commission decision in this docket, as discussed above, the *USTA* decision was issued, vacating the FCC's *Line Sharing Order*. Subsequently, SWBT made written commitments to continue to provide line sharing under its existing terms and conditions through July 2003 or until the FCC issues its Triennial Review, whichever occurs first. Accordingly, the Commission abated the decision as to line sharing.

Because the *USTA* decision was issued before the Commission made its final decision on Docket No. 22469, the Commission voted to reopen the proceeding to more fully examine the unbundling of Project Pronto functionality in accordance with the guidance of the *USTA* standards.[97] The Commission determined that it would need to conduct a full "necessary" and "impair" analysis, giving consideration to the standards outlined by the court in *USTA*. However, after taking into account the amount of time needed to fully address this evolving legal issue and the fact that the FCC's pending Triennial Review may dispose of certain questions regarding line-sharing, the Commission chose instead to abate this proceeding. Upon issuance of the Triennial Review, this docket is expected to be reopened.

2. SWBT Performance Measures

In the *2001 Scope Report*, the Commission concluded that "competitive telecommunications providers now have fair access to networks to provide local exchange service in Texas."[98] This statement was made on the heels of SWBT's Section 271 approval and its subsequent entry into the interLATA long-distance market.

As detailed in Chapter 2 of the *2001 Scope Report*, after a lengthy proceeding at the Commission and an extensive application to the FCC, on June 30, 2000, the FCC released its order determining that SWBT had satisfied the 14-point checklist in Section 271 of the FTA, thereby allowing SWBT to enter the interLATA long-distance market. In its Section 271 application, SWBT relied upon the T2A to establish that it had met the 14-point checklist. The T2A is a Commission-approved interconnection agreement[99] that, together with SWBT's collocation tariff, contains the commitments made by SWBT during the Section 271 proceeding. It is effective until October 13, 2003.

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[97] *P.U.C. Proceeding for Resolution of Certain Issues Severed From P.U.C. Docket No. 22469*, Docket No. 26635. (pending).

[98] 2001 Scope of Competition Report at 7.

[99] The T2A was approved by the Commission on October 13, 1999 in Order No. 55 in Project No. 16251. The Commission issued two other orders addressing the T2A, Orders No. 50 and 53.

The T2A provides a comprehensive set of performance measures (PMs) and a performance remedy plan; the performance measures and performance remedy plan are contained in Attachment 17 to the T2A. The Plan, through the PMs, is designed to measure the wholesale performance of SWBT and compare that wholesale performance to SWBT's retail performance to determine whether SWBT is providing wholesale performance at parity with the performance it provides to itself, its retail customers and/or its affiliates, or at a benchmark level that provides CLECs with a meaningful opportunity to compete.[100] Because the performance remedy plan is part of the T2A, it is scheduled to expire on October 13, 2003.

The Plan sets forth the details for SWBT's payment of liquidated damages to the CLECs (Tier 1 payments) and SWBT's payment of penalties to the State (Tier 2 payments) for performance that does not meet the necessary standards.[101] Various measures have different levels of Tier 1 and/or Tier 2 classification (high, medium, or low) depending on the severity of the measure's effect on competition and/or customer satisfaction. Tier 1 payments are intended to compensate the CLECs for below-par performance that is customer affecting, thereby impairing the CLECs' ability to compete. Tier 2 payments are intended to compensate the citizens of this State for substandard performance that inhibits competition.[102] In establishing Tier 1 and 2 payments, the Commission intended to ensure that the payments made because of subpar performance to the CLECs were not simply included within the cost of doing business for SWBT. The Plan is designed to be self-executing. SWBT provides the Commission and the CLECs with monthly data for each measure, calculates its payments, and remits those amounts to the appropriate parties.

As a part of the ongoing management of SWBT's post-Section 271 performance, the Commission conducts periodic reviews of the effectiveness of the PMs and the Plan. These reviews are intended to be an opportunity for SWBT, the CLECs and the Commission to reevaluate the PMs and determine whether existing measures continue to be necessary and whether new measures should be added or modified.

At its inception, the T2A contained 131 PMs with multiple subparts or disaggregations. After completing the third review on October 23, 2002, the Commission approved the deletion of 19 PMs and the addition of three new PMs, so that the Plan now contains 106 PMs with multiple subparts or disaggregations.[103] Overall, many of the

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[100] Pursuant to 47 U.S.C. §251 and incorporated into the market-opening conditions in 47 U.S.C. §271, a BOC must offer interconnection and access to network elements on a nondiscriminatory basis.

[101] For various reasons, some measures are diagnostic and result in no penalties.

[102] 2001 SCOPE OF COMPETITION REPORT, at 11, (The goal of Tier 2 is to incent parity performance and to disincent anti-competitive behavior; that is, to make the cost of non-compliance more than the 'cost of doing business.)

[103] *Section 271 Compliance Monitoring of Southwestern Bell Tele. Co,* Project No. 20400, Order No. 13 Approving Modifications to Performance Remedy Plan and Performance Measurements (July 19, 2000), Order No. 33 Approving Modifications to Performance Remedy Plan and Performance Measurements (June 1, 2001), Order No. 45 Approving Modifications to Performance Remedy Plan and Performance Measurements (Oct. 17, 2002).

original PMs have been deleted in part or in whole and many PMs have been added to reflect the changing needs of competitors and customers.

After working through the intensive process of three PM reviews, and seeing the results through the implementation of new measures and the resolution of collateral issues, the Commission believes the current review process has been an effective tool to provide the flexibility necessary to ensure that the PMs capture relevant and useful data and that the Plan continues to operate as intended.

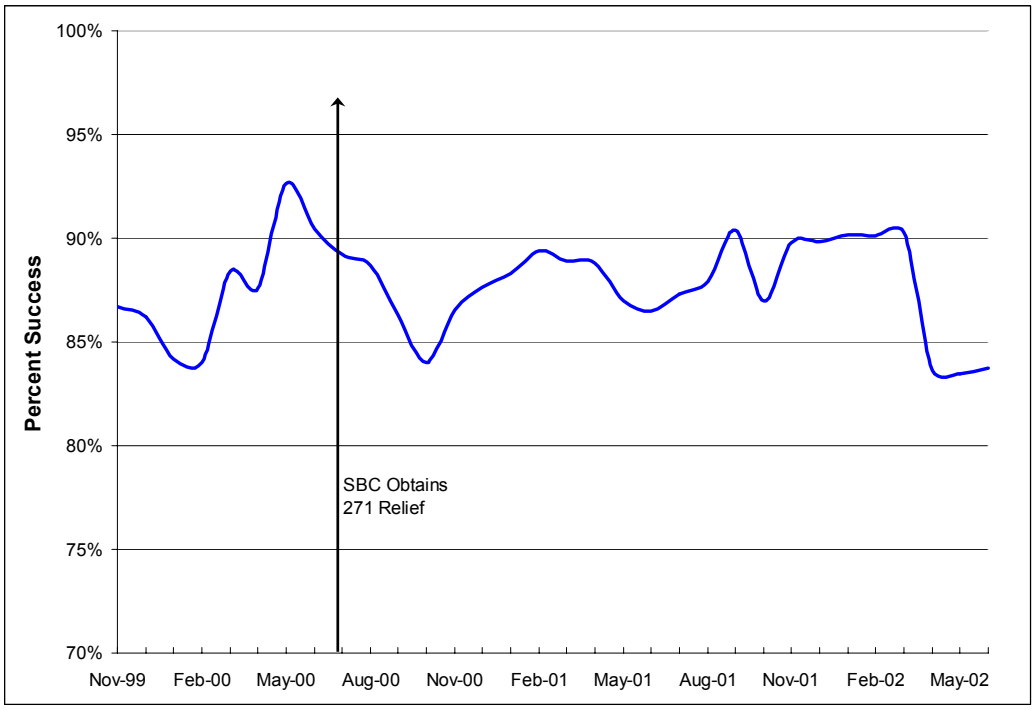
a. Percentage of Performance Measures Met

The PMs measure several different areas relating to SWBT's provisioning of wholesale service[104] to CLECs versus its provisioning of service to its affiliates and or to itself. As indicated above, the total number of PMs and submeasures or disaggregations fluctuates with the Commission's PM reviews. To get a snapshot of SWBT's performance, this subsection examines the percentage of PMs that SWBT has met over time.

During the Section 271 process, SWBT and the Commission signed a Memorandum of Understanding on April 29, 1999, stating a goal of 90% of measures met two out of three consecutive months. Figure 26 illustrates SWBT's overall percentage of PMs met for each month since the inception of the Plan.

[104] Wholesale service includes Operation Support Systems (OSS) elements applicable to pre-ordering, ordering, and billing; provisioning and maintenance; trunking; 911; collocation; and coordinated conversions.

Figure 26 — SWBT Success Ratio for Performance Measures in Texas



SOURCE: SWBT Monthly Hit or Miss Reports (HOMR), provided to Texas PUC Staff upon request.

From November 1999 to June 2002, SWBT's performance has been above the 90% goal six months out of 31 months. A further review of this data indicates that SWBT's performance has generally been in the 86%-89% range with a high of 92.6% in May 2000 and a low of 83.4 % in May 2002. It should be noted that during July 2000, the first month after SWBT obtained Section 271 approval, SWBT's performance slipped below 90% and continued to decline until November 2000. During this time, SWBT was implementing 20 new measures ordered by the Commission during the first PM review.[105] Once these measures were in place, and SWBT began collecting data and making that data available for review to affected CLECs and the Commission, as well as making those measures subject to damages and penalties, SWBT's performance improved.

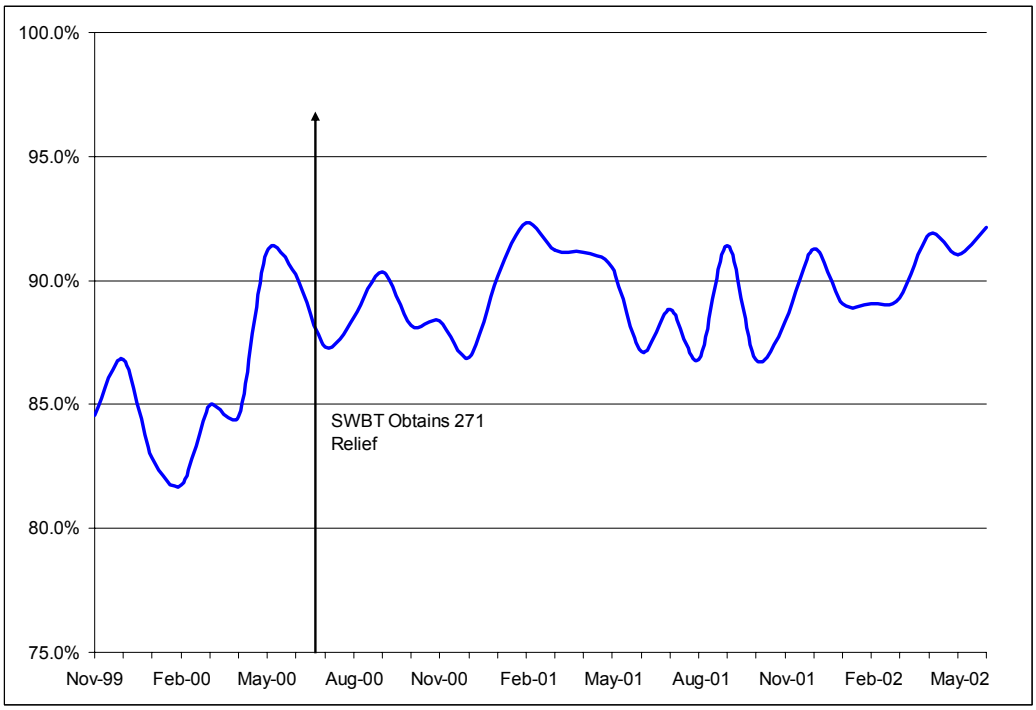
The decline in performance shown for the period of April through June 2002 was addressed in the most recent PM review completed by the Commission in October 2002. At the conclusion of the PM review, the Commission ordered modifications to the Performance Remedy Plan, as well as the PMs, to address this decline in performance.

[105] Project No. 20400, *supra note 103*, Order No. 13 Approving Modifications to Performance Remedy Plan and Performance Measurements (July 19, 2000).

The modifications included changes to the calculation of liquidated damages intended to encourage SWBT to improve wholesale performance.[106]

As discussed above, the various PMs are classified as diagnostic or Tier 1 (customer affecting) and/or Tier 2 (competition affecting). Within the Tier 1 and Tier 2 designations, the various PMs, or even disaggregations among the PMs, are weighted, high, medium, or low. Figure 27 indicates the performance delivered by SWBT to CLECs for Tier 2 PMs that are designated "high" measurements, and are considered to be most competition affecting.

Figure 27 — Percentage of Performance Measurements Met – Tier 2



SOURCE: SWBT Monthly Hit or Miss Reports (HOMR) , provided to Texas PUC Staff upon request.

Figure 27 illustrates that the percentage of compliance for Tier 2 measurements is close to, or higher than, the 86.5% level SWBT had achieved in June 2000, the month of its Section 271 application approval at the FCC.

b. Damages and Penalties

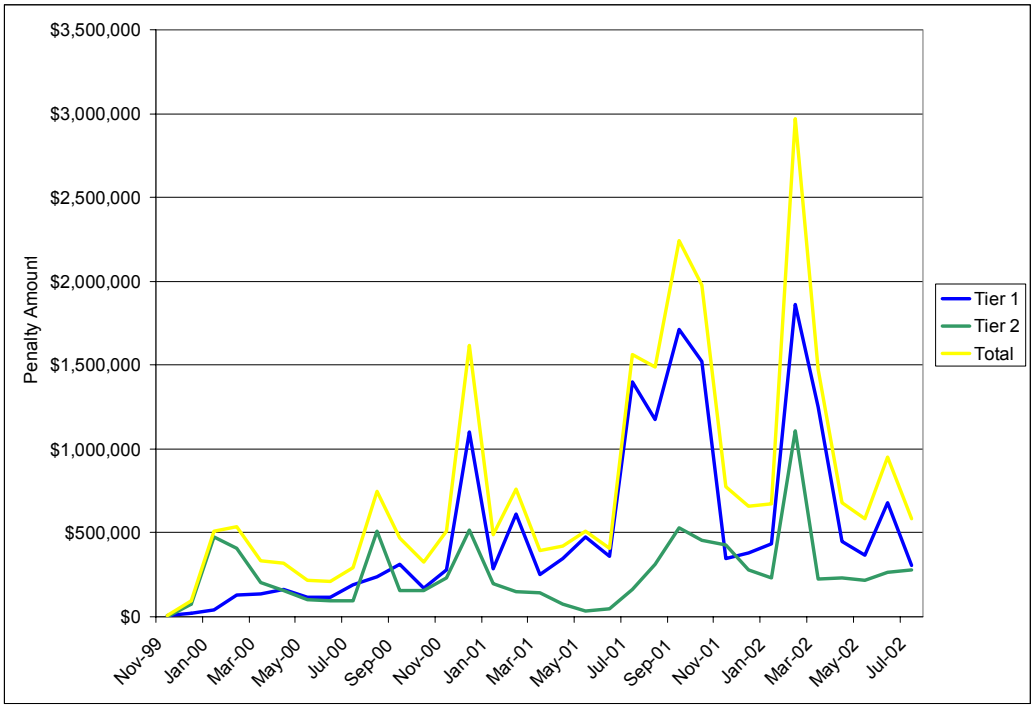
The Plan dictates that Tier 1 and Tier 2 payments be calculated according to a scheme that places a greater dollar amount on PMs or disaggregations designated "high" than on those designated "low." The severity of the "miss" and the volume of the transactions measured by a particular PM are also taken into account by the Plan and are another basis for the calculation of payments. The severity and volume, and the

[106] Project No. 20400, *supra note 103,* Order No. 45 Approving Modifications to Performance Remedy Plan and Performance Measurements and Order No. 46 (Supplement to Order No. 45).

designation of high, medium, or low illustrate the weight and the relative importance of each PM or disaggregation. Therefore, an examination of the actual Tier 1 and Tier 2 payments helps to further focus on SWBT's performance and the impacts on customers and competition in this State.

Figure 28 includes all performance measures and summarizes all payments paid by SWBT for performance violations since November 1999, the first month that payments were made. The total amount of Tier 1 and Tier 2 payments made through July 2002 by SWBT is $25,803,788. It should be noted that various measures include caps on payments, and some dollar amounts would be significantly higher in some months were it not for these caps.

Figure 28 — SWBT Texas 271 Tier 1 and Tier 2 Payments – November, 1999 through July, 2002



SOURCE: SBC

Significant spikes in payments occurred in December 2000, July through October 2001, and February 2002. These spikes in December 2000 and July-October 2001 are attributable to SWBT missing a higher than average number of PMs. Additionally, among the PMs that were missed was a higher-than-average number of high-volume transaction PMs and high per-dollar-amount PMs. The source of the spike in February 2002 was the payment by SWBT of $900,000. As instructed by the Commission, SWBT restated and recalculated the Tier 2 payment amount for PM 13 and certain maintenance

related loop maintenance operations system (LMOS) PMs and made one lump sum payment to cover the difference between what had been paid and what was owed pursuant to the recalculation.[107] Therefore, it seems that the spike in February actually included payments for many months of subpar performance. Below is a further discussion of the independent audit of PM 13 and LMOS issues.

A further, more granular, review of the damage and penalty payments focuses on the specific PMs that demand the greatest dollar amounts. For the period of June 2000 through December 2001, SWBT remitted Tier 1 and/or Tier 2 payments on 76 performance measures.[108] The total amounts paid for that period ranges from a high of $3,224,779 (PM 13) to a low of $25 (PMs 63 and 76). The average total amount for this time period is $203,295.[109]

Many of the highest dollar amount PMs are such because the penalty amounts are calculated on a volume basis versus a per-measure basis. During the periodic PM reviews, the Commission is able to focus on the high dollar amount PMs and determine the root causes for the payments. For instance, the PM that has demanded the greatest amount of SWBT resources is PM 13, Order Process: Percent Flow Through. During the second PM review, it was revealed that SWBT had not implemented the business rule for PM 13 consistent with the Commission's order. As a result, consistent with the T2A, an audit of SWBT's flow-through processes, as well as its calculation of PM 13 data, was initiated.[110] The Audit Report was issued in November 2002. Following the review of the Final Audit Report, the Commission will determine appropriate actions to address SWBT's performance.

B. Commission Activities under PURA

This section begins with an assessment of House Bill (H.B.) 2128 and Senate Bill (S.B.) 560, and leads into an analysis of the tools that assist the Commission in the creation of a level playing field in an ever-changing competitive market. This includes an analysis of ILEC pricing flexibility and earnings review. This is followed by a discussion of the Texas Universal Service Fund (TUSF). Other key issues discussed include an update on regulatory developments in Texas on access charges and advanced services, customer protection initiatives, municipal rights-of-way (ROW) franchise rates,

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[107] Project No. 20400, *supra note 103,* Order No. 33 Approving Modifications to Performance Remedy Plan and Performance Measurements, Attachment at 32 (June 1, 2001). *See also* Order No. 39 Denying in Part and Setting Aside in Part Southwestern Bell Telephone Company's Motion for Rehearing and Clarification of Order No. 33 and Approving Modifications to Performance Remedy Plan (Dec. 21, 2001).

[108] This total does not include disaggregations or submeasures. For instance, if SWBT paid penalties on disaggregations of PM 13, such as PM 13-01, PM 13-02, and PM 13-03, it is included in the total as 1 measure.

[109] See Appendix O for further discussion and details.

[110] Project No. 20400, *supra note 103,* Order No. 36 Approving Proposed Texas Public Utility Commission Audit Plan to Address PM 13 Flow-Through and LMOS Issues (Sept. 5, 2001).

building access, payphones, area codes, border issues, automatic dialers, 211, and 911 activities.

1. Assessment of the H.B. 2128 and S.B. 560 Regulatory Framework

During the 1995 and the 1999 sessions, the Texas Legislature enacted major changes to the regulatory structure governing incumbent carriers in anticipation of increased competition in Texas's local telecommunications marketplace.

a. H.B. 2128: 1995 Legislative Session

During the 1995 Legislative Session, the Legislature established Chapters 58 and 59 of PURA, which allowed incumbent telecommunications providers the option of electing into a reduced regulatory framework. In return, the electing companies were required to make certain infrastructure investments (primarily providing digital switching) and to establish and fund the Telecommunications Infrastructure Fund. The reduced regulatory framework provided electing companies with immunity from rate regulation, established a price cap for basic network service, and provided for additional flexibility to adjust the prices of other telecommunications services.

b. S.B. 560: 1999 Legislative Session

During the 1999 Legislative Session, Chapters 58 and 59 of PURA were amended to allow electing ILECs the flexibility of modifying certain prices within ten days of notice to the Commission. The amendments also replaced the previous process that required advanced Commission approval of price changes with an informational notice filing process that required notice of the price change instead of Commission approval.

ILECs sought the amendment in order to respond to competitive challenges without having to go through the extended process reserved for tariff revisions. Sections 58.063 and 59.031 of PURA, and P.U.C SUBST. R. 26.226, 26.227, and 26.229 allow Chapter 58 and Chapter 59 "electing ILECs" to exercise pricing flexibility for basic network services,[111] including the packaging of basic network services with any other regulated or unregulated service or any service of an affiliate. Chapter 52 ILECs can also exercise pricing flexibility. Ten days after filing an informational notice with the Commission, the ILEC may exercise this ability, provided that the price is set above the lesser of either the long run incremental cost (LRIC) of the service or bundle of services, or the tariffed price of the basic service or bundle of basic services plus the LRIC of any nonbasic service.

[111] TX. UTIL. CODE §51.001 (Vernon 1998, Supp. 2003). Basic Network Services include: (1) flat-rate residential local exchange telephone service, including primary directory listings and the receipt of a directory and any applicable mileage or zone charges; (2) residential tone dialing service; (3) lifeline and tel-assistance service; (4) service connection for basic residential services; (5) direct inward dialing service for basic residential services; (6) private pay telephone access service; (7) call trap and trace service; (8) access for all residential and business end users to 911 service provided by a local authority and access to dual-party relay service; (9) mandatory residential extended area service arrangements; (10) mandatory residential extended metropolitan service or other mandatory residential toll free calling arrangements; and (11) residential call waiting service.

Currently SWBT, Verizon, Valor, Sprint/United, and Sprint/CenTel are electing Chapter 58 companies. Sugar Land, TXU Communications, Fort Bend Telephone, Kerrville Telephone, CenturyTel of Lake Dallas, CenturyTel of Port Aransas, CenturyTel of San Marcos, Texas ALLTEL, and Big Bend Telephone Cooperative are electing Chapter 59 companies.

c. Pricing Flexibility

As mentioned earlier in this chapter, informational filings provide notice, instead of approval, to the Commission regarding a Chapter 58 or 59 company's intent to change pricing. These have encompassed promotions (*e.g.*, waiver of installation charges), packages (basic service with a combination of vertical services), increases in late payment fees, and, by far the greatest number of filings, changes to vertical service rates. Approximately 74% of Texans have telephone service through SWBT or Verizon, and could be affected by their informational filings. For this reason, the filings of SWBT and Verizon are representative of the general trend in informational notice filings.

i. SWBT's Use of Pricing Flexibility

Since September 1, 1999, SWBT has submitted over 230 informational filings.[112] Table 12 compares a list of common and popular SWBT vertical services rate changes before and after the availability of informational filings.[113]

Table 12 — Sample of Changes in SWBT's Pricing for Vertical Services in Texas

Service	Texas Residential Retail Price		
	Before September 1999	As of December 2002	% Increase
Three-Way Calling	$2.10 for first and $1.40 for each additional	$5.00 for first and $4.00 for each additional	138% for first and 186% for each additional
Call Forwarding			
Speed Calling 8			
Anonymous call rejection	$1.00	$1.50 for first and $0.75 for each additional	At least 50%
Auto Redial	$2.00	$4.00	100%
Call Waiting	$2.80	$2.80	No change
Call Waiting ID	$3.00	$4.50	50%
Caller ID Name	$4.95	$7.00	41%
Caller ID Number	$4.95	$7.00	41%
Caller ID Name and Number	$6.50	$9.50	46%
Call Blocker	$2.00	$5.00	150%
Priority Call	$2.50	$2.00	-20%
Personalized Ring	$4.00	$5.00	25%
Call Return	$0.50 each use ($4 cap)	$0.95 each use (no cap)	At least 90%
Three-Way Calling	$0.75 each use	$0.95 each use	27%
Call Trace	$8.00 each use	$7.00 each use	-13%
Directory Assistance	$0.30 each use	$1.25 each use	317%
Rate for Nonpublished Numbers	$1.10/month	$2.95/month	168%
Call Completion	$0.30 add'l each use	$0.05 add'l each use	-83%

SOURCE: Texas PUC filings

[112] As of October 1, 2002, 232 informational filings had been received from SWBT.

[113] Note that many informational notice filings concern term changes for vertical services such as phasing out contracts for specified time periods.

ii. Verizon's Use of Pricing Flexibility

Similarly, though Verizon does not face the number of competitors in its territories that SWBT does and has not sought changes to the exact services or combinations as SWBT, there is still a pattern evident from Verizon's informational notice filings. Again, Verizon has used informational filings to create packaged services and to affect expeditious rate increases for popular services. Verizon filed approximately 136 informational notice applications between September 1999 and September 2002. Table 13 provides a similar representative summary of common and popular vertical services for Verizon.

Table 13 — Sample of Changes in Pricing in Verizon's Vertical Services in Texas

Verizon Service	Texas Residential Retail Price		
	Before September 1999	**As of December 2002**	**% Increase**
Three-Way Calling – Per Event	$0.75	$0.95	27%
Automatic Busy Redial – Per Event			
Automatic Call Return – Per Event			
Three-Way Calling - Monthly	$2.70	$4.00	48%
Automatic Call Return - Monthly	$3.00	$4.00	33%
Remote Call Forwarding - Monthly	$14.50	$17.00	17%
Caller ID Name and Number	$6.50	$7.75	19%
Caller ID Name and Number with Automatic Call Block	$6.75	$7.95	18%
Operator Verification – Per Event	$1.35	$2.50	85%
Operator Interrupt – Per Event	$2.20	$5.00	120%
Local Directory Assistance – Per Event	$0.25	$1.25	400%
National Directory Assistance – Per Event	Not Available	$1.25	New Service & Charge
Additional Directory Listing – Per Listing	$.55	$1.10	100%
Return Check Charge – Per Event	$10.00	$25.00	150%
Rate for Nonpublished Number	$1.65/month	$1.65/month	No change

SOURCE: Texas PUC filings

The sample of changes in pricing of SWBT's and Verizon's vertical services provides assistance in understanding the effect that these filings have had upon ratepayers and competition. The bulk of these have been for the introduction of service packages

(primarily business), and price changes to vertical services. Many of the more popular or frequently used vertical services have seen significant increases in price.

d. Rate Group Reclassification

In December 1997, SWBT filed an application to reclassify a number of telephone exchanges into different rate groups pursuant to Section 58.058 of PURA, which would have raised local rates in several cities, including Austin and Dallas. The Commission approved in part and denied in part SWBT's request. [114]

Specifically, the Commission rejected reclassification of certain exchanges, leaving those exchanges in their current rate group. [115] SWBT appealed the Commission's order and in June 2002, the Texas Supreme Court issued an opinion reversing and remanding the Commission's order. [116] In August 2002, SWBT filed a revised tariff with the Commission to institute the rate group reclassification for those exchanges that had been previously disallowed.[117] For example, the monthly rate increased from $10.40 to $11.05 in Dallas, $9.35 to $9.85 in Austin, and $8.15 to $8.35 in Sweetwater. Those revised tariffs were approved by the Commission in an order entered on October 25, 2002.[118] SWBT recently filed an application to levy a surcharge to collect the amounts SWBT would have received between December 1997 and October 2002 if the Commission had initially allowed the rate group reclassification proposed by SWBT.[119] SWBT's proposed surcharge, including interest, totals $142.7 million.

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[114] *Application of Southwestern Bell Telephone for Rate Group Reclassification, Docket No. 18509*, Final Order (Jan. 28, 1999).

[115] Application of Southwestern Bell Telephone Company for Rate Group Reclassification Pursuant to Section 58.058 of the Texas Utility Code, Docket No 18509. Order at 3-4 (Jan. 27, 1999). (The Commission has used rate reclassification as a rate-design tool, implemented after establishing the telephone company's revenue requirement. The Commission priced rate bands by value of service rather than by cost. Value of service assumes availability of the access line to the public switched network. Because a customer in a larger exchange is able to call or receive calls from a greater number of lines at no cost than can a customer in a smaller exchange, the larger exchange has more value and should be priced higher.); and Docket No. 18509, Order Granting Appeal of Order No. 7 (May 7, 1998) (In addition, in its Order Granting Appeal of Order No. 7, the Commission concluded that SWBT was not entitled to benefit from pre-1995 access-line growth and should not consider any pre-1995 growth for purposes of this rate-group reclassification. In this case, SWBT initially requested reclassification of 52 exchanges; after the Commission's order eliminating growth from November 29, 1990, to September 1, 1995, the number of exchanges was reduced to 25.)

[116] *Cities of Austin, Fort Worth and Hereford v. Southwestern Bell Telephone Company*, 2002 WL 1205185; 45 Tex. Sup. Ct. J. 767 (June 6, 2002), ___ SW3d ____ (Tex. 2002 unpublished).

[117] *Compliance Filing of Southwestern Bell Telephone Company Resulting From District Court Remand of Docket No. 18509*, Docket No. 26516 (Oct. 25, 2002).

[118] Docket No. 26516, Order on Remand (October 25, 2002).

[119] *Southwestern Bell Telephone Company's Tariff Filing to Establish Rate Group Reclassification Surcharge Resulting From District Court Remand of PUC's Final Order in Docket No. 18509*, Docket No. 26719 (pending).

SWBT's proposal has been contested by several parties and is currently pending before the Commission.

On October 26, 2001, Verizon filed two applications to reclassify rate bands for its exchanges.[120] On April 22, 2002, however, the parties entered a Unanimous Stipulation and Settlement Agreement that resolved all issues for all but two exchanges, Plano and Irving. In that settlement, Verizon agreed to withdraw its request to reclassify the exchanges of Reno, Falfurrias, and Grand Saline. The Cities of Plano and Irving contested the reclassification of the two remaining exchanges. The contested issue related to whether the exchanges should be reclassified to Rate Group 5, because although Verizons' tariff contained that rate group, it did not have a corresponding rate. Ultimately, the Commission determined that both the Plano and the Irving exchanges should be classified in Rate Group 4 because that was the highest rate band for which Verizon has a Commission-approved rate. The Commission further held that for Verizon to reclassify the exchange to Rate Group 5, Verizon must first apply for a tariff rate for Rate Group 5 pursuant to PURA § 58.057.

The new rates for both SWBT and Verizon resulting from the above-referenced proceedings represented an increase for customers in exchanges, which were moved to a higher rate-group classification. Higher rate-group classifications represent areas with higher populations. With the "value of service" retail pricing in Texas, phone rates are set higher for areas with larger populations. For detail on the exchanges reclassified, and the amount of rate increase, see Appendix P.

e. Earnings Review

By May 15 each year, ILECs file with the Commission earnings reports on Commission-prescribed forms that contain the company's pertinent financial information. The Commission Staff prepares an analysis comparing a reasonable rate-of-return (ROR) for each company with the company's actual ROR.[121]

That difference results in the excess earnings analysis, as shown below in Table 14 for year-end 2000 and 2001. Staff also develops a range (High to Low) for each

[120] *Application of Verizon Southwest TXC to Reclassify Exchanges to the Proper Rate Bands*, Docket No. 24917 (October 26, 2001).

[121] The *reasonable* rate of return is the Commission Staff's current estimate of what would be the company's appropriate rate of return given prevailing market conditions. This estimate is analogous to the a*llowed* rate of return granted by the commission in a rate case as that part of a company's cost of service that provides a return to the company's providers of debt and equity capital. The rate of return is a weighted-average rate — i.e., it is a composite rate that reflects the cost of each type of capital weighted by that capital component's proportion of the total capital structure. For a company's cost-of-service determination in a rate case, the allowed (i.e., reasonable) rate of return is applied to the company's rate base (invested capital) to prospectively calculate the amount of return dollars that should be included in the cost of service. In contrast, the *earned* rate of return refers to the accounting rate of return that a company actually earns on its books. It is an historical calculation that reflects the amount of return dollars — expressed as a percentage of invested capital — that a company has earned over and above the amount of operating expenses.

company's excess earnings, as well as calculates the average excess earnings per line. As discussed above, certain carriers that have elected into PURA Chapters 58 and 59 are immune from a rate review by the Commission and are not subject to having their rates reduced when earnings exceed a regulated rate-of-return.

Table 14 — Review of Earnings Reports for FY Ending 2000 and 2001 for Investor-Owned Telephone Utilities and Cooperatives

REVIEW OF EARNINGS REPORTS SUMMARY OF STAFF FINDINGS INVESTOR-OWNED TELEPHONE UTILITIES										
Company	Access Lines		Excess Earnings - High ROR		Excess Earnings - Low ROR		Average Excess Earnings/Access Line		PURA Election	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
Alenco	1,967	2,030	1,053,810	1,326,345	1,098,330	1,365,774	626	663		
Big Bend	5,695	5,691	(495,167)	(1,441,216)	(307,203)	(1,229,677)	(135)	(235)		Chapter 59
Blossom	1,469	1,530	(382,789)	(400,732)	(373,322)	(391,274)	(260)	(259)		
Border to Border	82	78	59,005	(92,245)	65,248	(85,715)	(125)	(1,141)		
Brazoria	6,665	6,708	516,805	818,502	628,388	943,206	118	131		
Brazos Telecom	4,560	4,639	212,104	130,429	233,263	150,193	42	30		
Cameron	1,308	1,316	(132,202)	(65,548)	(117,928)	(47,841)	(63)	(43)		
Century Lake Dallas	12,623	12,987	1,878,419	2,781,701	1,957,418	2,882,234	192	218		Chapter 59
Century Port Aransas	4,997	5,140	503,875	268,030	524,252	302,294	83	55		Chapter 59
Century San Marcos	33,765	33,324	6,085,722	5,504,291	6,286,378	5,736,851	178	169	Chapter 59	Chapter 59
Central Telephone	238,634	235,283	2,309,373	11,494,186	3,749,936	13,100,999	35	52	Chapter 59	Chapter 58
Comanche County	5,688	5,685	(1,050,978)	(655,757)	(1,028,142)	(632,077)	(146)	(113)		
Community	1,908	1,843	(97,257)	(198,017)	(83,432)	(185,762)	(71)	(104)		
Electra	2,032	1,824	(539,242)	(184,835)	(514,367)	(163,063)	(167)	(95)		
Fort Bend	44,390	47,990	(5,801,806)	(6,517,906)	(5,513,441)	(6,146,050)	(131)	(132)		Chapter 59
GTE (Verizon)	2,604,281	2,630,240	(95,346,251)	(809,176)	(83,829,748)	9,840,894	(14)	2	Chapter 58	Chapter 58
Ganado	3,158	3,182	(493,690)	27,843	(422,687)	105,216	(50)	21		
Industry	2,225	2,346	(579,205)	(353,341)	(545,662)	(318,948)	(194)	(143)		
Kerrville	26,194	26,849	1,782,059	1,925,035	2,020,971	2,183,535	80	77		Chapter 59
La Ward	1,267	1,290	(2,521)	(66,073)	16,729	(45,069)	(11)	(43)		
Lake Livingston	1,167	1,163	57,132	28,423	72,595	49,211	52	33		
Lipan	1,469	1,543	138,163	166,768	155,450	185,197	116	114		
Livingston	7,879	7,947	439,840	98,809	480,741	148,130	40	16		
Muenster/Nortex	4,171	4,307	894,137	1,247,145	940,932	1,298,022	268	295		
North Texas	953	959	(260,247)	(228,272)	(252,946)	(221,538)	(249)	(235)		
Riviera	1,265	1,298	(376,938)	(283,737)	(347,126)	(252,164)	(237)	(206)		
Southwest Texas	4,475	4,562	917,904	921,780	980,329	998,748	221	210		
Southwestern Bell	10,422,876	10,121,985	820,708,143	429,212,020	862,442,793	477,238,501	64	45	Chapter 58	Chapter 58
Sugarland	83,296	82,062	10,870,034	13,861,367	11,323,068	14,338,362	154	172	Chapter 59	Chapter 59
Tatum	1,134	1,148	(36,676)	158,916	(23,749)	170,817	65	144		
Texas ALLTELL	31,978	32,599	1,136,913	1,167,510	1,406,472	1,446,179	45	40		Chapter 59
TXU Communications	118,732	120,829	8,256,034	10,296,625	9,167,291	11,203,842	86	89	Chapter 59	Chapter 59
United	170,208	171,385	4,623,957	11,799,382	5,947,581	13,215,432	56	73	Chapter 59	Chapter 58
Valor	300,899	308,853	(39,000,011)	9,751,097	(36,648,729)	11,378,911	(42)	34		Chapter 58
West Plains	5,951	5,342	362,459	334,944	384,192	354,639	62	65		

SOURCE: PUC Earnings Reports, FY 2000 and 2001

REVIEW OF EARNINGS REPORTS SUMMARY OF STAFF FINDINGS TELEPHONE COOPERATIVES								
Company	Access Lines		Operating Margin		Equity/Capitalization		Instrastate ROR	
	2000	2001	2000	2001	2000	2001	2000	2001
Brazos Telephone Cooperative, Inc.	1,291	1,323	12.93%	17.76%	72.53%	76.10%	23.85%	30.10%
Cap Rock Telephone Cooperative	4,973	4,945	25.70%	24.26%	75.93%	78.73%	18.71%	18.91%
Central Texas Telephone Cooperative	7,543	7,821	23.68%	22.90%	58.71%	61.03%	7.85%	5.86%
Coleman County Telephone Coop.	2,295	2,218	23.63%	35.99%	49.09%	46.87%	5.85%	15.78%
Cumby Telephone Cooperative, Inc.	944	972	1.91%	11.08%	100.00%	100.00%	16.23%	10.78%
Dell Telephone Cooperative, Inc.	714	804	16.58%	24.70%	38.03%	39.85%	4.64%	7.72%
Eastex Telephone Cooperative	31,314	33,418	18.30%	14.37%	84.87%	86.14%	9.89%	6.02%
Etex Telephone Cooperative, Inc.	15,814	972	22.68%	33.32%	67.91%	65.93%	14.71%	1.19%
E.N.M.R. Telephone Cooperative	917	16,457	27.24%	19.18%	63.00%	70.94%	-6.83%	14.61%
Five Area Telephone Cooperative	1,474	1,444	24.06%	23.84%	84.31%	86.55%	15.41%	20.16%
Guadalupe Valley Telephone Coop.	38,436	40,032	30.02%	28.90%	86.19%	89.31%	18.55%	17.32%
Hill Country Telephone Cooperative	16,291	16,839	24.31%	25.18%	85.99%	89.89%	15.26%	16.33%
Mid-Plains Rural Telephone Coop.	3,418	3,417	25.66%	18.85%	98.40%	98.68%	12.20%	11.21%
Peoples Telephone Cooperative, Inc.	13,036	13,626	20.27%	19.77%	49.41%	47.13%	9.75%	8.61%
Poka-Lambro Rural Telephone Coop.	3,855	3,562	16.33%	13.44%	36.06%	75.66%	-2.54%	-4.28%
Santa Rosa Telephone Cooperative	2,416	4,133	0.50%	8.10%	59.55%	48.09%	8.59%	-0.06%
South Plains Telephone Cooperative	5,488	5,573	17.91%	13.54%	93.09%	95.41%	13.52%	14.53%
SW Arkansas Telephone Coop.	576	591	11.11%	13.41%	56.08%	59.98%	2.31%	1.78%
Taylor Telephone Cooperative, Inc.	7,668	7,698	18.21%	21.29%	81.12%	85.92%	7.72%	12.91%
Valley Telephone Cooperative, Inc.	6,375	6,573	24.30%	30.03%	70.94%	73.12%	12.05%	14.64%
Wes-Tex Telephone Cooperative, Inc.	3,403	347	13.76%	11.91%	100.00%	99.50%	4.26%	0.51%
West Texas Rural Telephone Coop	2,114	2,120	8.40%	8.27%	65.49%	66.92%	8.23%	9.00%
XIT Rural Telephone Cooperative	1,385	1,586	25.51%	30.66%	56.56%	60.60%	9.85%	8.30%

SOURCE: PUC Earnings Reports, FY 2000 and 2001

As discussed in Chapter I, Chapters 58 and 59 of PURA allow incumbent telecommunications providers the option of electing into a reduced regulatory framework—including immunity from rate regulation, price caps for basic network service, and pricing flexibility for other services—in return for making certain infrastructure investments (primarily providing digital switching) and supporting the Telecommunications Infrastructure Fund.

2. Texas Universal Service Fund

The purpose of the Texas Universal Service Fund (TUSF), established by statute in 1987, is to implement a competitively neutral mechanism that enables all residents of the State to obtain basic telecommunications service needed to communicate with other residents, businesses, and governmental entities.

a. TUSF Programs

The size of the TUSF is based on program costs. The fund total was approximately $613 million in fiscal year 2001. The cost to administer the TUSF in fiscal year 2001 was approximately $1.5 million. Since the *1999 Scope Report*, the programs funded by the TUSF have not been significantly changed. However, in 2001, the Legislature passed H.B. 2156, which eliminated the Tel-Assistance program and established automatic enrollment procedures for the program's members into the Lifeline

program.[122] In addition, in 2001, the Legislature passed H.B. 2388, which grants the Commission the authority to designate a telecommunications provider to provide voice telephone services to permanent residents or business premises outside the provider's certificated area.[123] The Commission will reimburse the designated telecommunications provider via TUSF support for providing the service.

The TUSF program, described in Chapter 56 of PURA, consists of the following major components:

- ***Texas High Cost Universal Service Plan (THCUSP)*** – provides financial assistance via TUSF support to eligible telecommunications providers (ETPs)[124] that serve high cost, rural areas of the State. The program seeks to ensure that all customers throughout the State have access to basic local telecommunications service at just, reasonable, and affordable rates.
- ***Small and Rural ILEC Universal Service Plan*** – establishes guidelines for financial assistance via TUSF support to ETPs that provide service in the study areas of small and rural ILECs within the State. The program seeks to ensure that all customers throughout the State have access to basic local telecommunications service at just, reasonable, and affordable rates.
- ***Relay Texas*** – establishes a Statewide telecommunications relay service to allow individuals that are hearing-impaired or speech-impaired to communicate via specialized telecommunications devices and operator translations.
- ***Lifeline*** – retail local service offering in which an ETP provides a discount of up to $7.00 per monthly bill on its local service rates and waives the Federal Subscriber Line Charge (SLC) for qualifying low-income customers.
- ***Specialized Telecommunications Assistance Program*** – provides reimbursement via TUSF support to vendors and service providers that offer reduced rates for telecommunications equipment and services for hearing-impaired customers.
- ***Implementation of PURA § 56.025*** – provides reimbursement via TUSF support to ILECs serving fewer that five million access lines due to a reduction in the amount of the Commission's high cost assistance fund, a change in the federal universal service fund (FUSF), a change in the Commission's intraLATA dialing access policy, or other governmental agency action.
- ***USF Reimbursement for Certain intraLATA Services*** – provides reimbursement via TUSF support to ILECs that are not electing companies under PURA Chapters

[122] Tex. H.B. 2156. 77th Leg., R.S., 1451 Tex. Gen. Laws 5160 (2001) Danburg, *relating to the Eligibility Process for Certain Utility Customer Discounts*. Under H.B. 2156, if an individual receives a greater benefit under the Tel-Assistance service program immediately before the effective date of the Act than would be received under the Lifeline program, the telecommunications provider would be required to continue to provide the higher benefit. The telecommunications provider is required to continue to provide that service until the person discontinues basic local service in the exchange in which service is being received.

[123] Tex. H.B. 2388, 77th Leg., R.S., 651 Tex. Gen. Laws 1217 (2001) Chisum, relating to the Provision of Telecommunications Service to an Area not Included in a Certificated Service Area.

[124] An ETP is a telecommunications provider designated by the Commission to receive support from the TUSF pursuant to P.U.C. SUBST. R. 26.417.

58 or 59 and provision intraLATA interexchange high capacity (1.544 Mbps) service at reduced rates for entities described under PURA § 58.253(a).

- ***Additional Financial Assistance (AFA)*** – provides additional financial assistance via TUSF support in addition to the TUSF reimbursement received under the THCUSP, Small and Rural ILEC Universal Service Plan, and implementation of PURA
  § 56.025 to ILECs serving high-cost, rural areas throughout the State. The program seeks to ensure that all customers throughout the State have access to basic local telecommunications services at reasonable rates.
- ***Service to Uncertificated Areas*** – provides financial assistance via TUSF support to ETPs that provide voice-grade services to premises that are not included within its certificated areas. The program seeks to enhance the availability of basic local telecommunications service throughout the State, especially in areas where service has not otherwise been provided.
- ***Administrative Costs*** – permits certain agencies, such as the Commission, the National Exchange Carrier Association (NECA), the Texas Department of Human Services (TDHS), and the Texas Department of Housing and Community Affairs (TDHCA) to recover their costs incurred in implementing the provisions of Chapter 56 of PURA.

The Texas High Cost Universal Service Plan (THCUSP) and the Small and Rural ILEC Universal Service Plan have by far the largest level of disbursements at approximately $440.5 million and $98.8 million respectively in 2001. After these two programs, the remainder of TUSF disbursements for all other programs combined, totals approximately $30 million. The disbursements of the THCUSP grew by about $55 million from 2000 to 2001, an increase of 12.5%. The disbursements for all of the programs are listed in Appendix Q.

b. TUSF Assessment

The TUSF is funded by a Statewide uniform charge or assessment rate payable by each telecommunications provider, *i.e.*, local, long-distance, and wireless carrier that has access to the Texas customer base. TUSF contributions are determined by multiplying the assessment rate by a telecommunications provider's monthly taxable telecommunications receipts[125] reported to the Texas Comptroller of Public Accounts.

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[125] TEX. TAX CODE ANN. §151.0103 (Westlaw 2002) –

> Taxable telecommunications services include electronic or electrical transmission, conveyance, routing, or reception of sounds, signals, data, or information utilizing wires, cable, radio waves, microwaves, satellites, fiber optics, or any other method now in existence or that may be devised, including but not limited to long-distance telephone service. Taxable telecommunications services do not include: (1) the storage of data or information for subsequent retrieval or the processing, or reception and processing, of data or information

As of January 1, 2001, the assessment rate is 3.6 percent. Beginning September 1, 2001, pay telephone services became exempt from the TUSF assessment.[126]

c. TUSF Administration

The Commission is the official governing agency of the TUSF; however, it has delegated the ministerial functions of administering the TUSF to another entity through a contractual agreement. In accordance with P.U.C. SUBST. R. 26.420(c)(4), the Commission recently initiated a project to select a TUSF administrator via a competitive bidding process.[127] The Commission received proposals from bidders that were evaluated in light of factors such as technical capability, competence, and resources needed to perform the duties of the TUSF administrator, which are set forth in P.U.C. SUBST. R. 26.420(d)(2). On August 16, 2002, the Commission selected the NECA as the TUSF administrator. NECA has been the TUSF administrator since January 1, 1999. The Commission has the authority to monitor and audit the TUSF administrator's activities related to the operation and administration of TUSF. In addition, the Commission has the authority to initiate annual performance audits and financial audits of the TUSF at its discretion.

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intended to change its form or content;(2) the sale or use of a telephone prepaid calling card; or (3) Internet access service.

[126] Tex. H.B. 1351, 77th Leg. R.S., 404 Tex. Gen. Laws 738 (2001) Brimer and Armbrister, *relating to the Funding and Operation of the Universal Service Fund*.

[127] *Request for Proposals for Provider of Administrative Services for the Texas Universal Service Fund*, Project No. 26178 (July 1, 2002).

d. TUSF Revenue

Table 15 shows the amounts of TUSF revenue as reported by the companies in the Commission's Earnings Reports for the fiscal years ending in 2000 and 2001. Table 15 represents those companies receiving over $1 million in TUSF revenues. A complete list of all companies receiving TUSF can be found in Appendix Q. The two top recipients of TUSF funds for FY 2000 and 2001 were Southwestern Bell Telephone Company and GTE Southwest Inc. d/b/a Verizon Southwest. Southwestern Bell Telephone Company received $150,271,965 in FY 2000 and $135,731,792 in FY 2001. GTE Southwest Inc. d/b/a Verizon Southwest received $166,090,944 in FY 2000 and $108,391,493 in FY 2001.

Table 15 — TUSF Revenues to Companies, FY 2000 and FY 2001

Company	2000	2001
Southwestern Bell Telephone Company	**150,271,965**	**135,731,792**
GTE Southwest Inc. d/b/a Verizon Southwest	**166,090,944**	**108,391,493**
Valor Telecommunications of Texas	**33,641,489**	**101,410,317**
Central Telephone Co. of Texas	**22,660,496**	**24,279,583**
United Telephone Company of Texas	**19,152,399**	**17,933,754**
Lufkin-Conroe Telephone Exchange	**13,525,854**	**14,444,569**
Century Telephone of San Marcos, Inc.	**5,821,972**	**5,846,107**
Valley Telephone Cooperative, Inc.	**5,197,880**	**5,310,125**
Guadalupe Valley Telephone Coop.	**4,984,619**	**5,279,799**
Eastex Telephone Cooperative	**5,058,058**	**5,207,352**
Fort Bend Telephone Company	**4,140,807**	**4,392,906**
Hill Country Telephone Cooperative	**3,213,694**	**3,346,456**
Big Bend Telephone Company of Texas	**3,087,809**	**3,202,592**
Etex Telephone Cooperative, Inc.	**2,919,248**	**3,082,637**
Kerrville Telephone Company, Inc.	**2,719,544**	**2,797,514**
Brazoria Telephone Company	**2,439,400**	**2,383,873**
Central Texas Telephone Cooperative	**1,992,014**	**2,085,623**
Southwest Texas Telephone Company	**1,967,656**	**2,021,228**
ALENCO	**1,835,515**	**1,949,061**

SOURCE: Texas PUC Earnings Reports

e. TUSF Rulemaking Proceedings

The Commission adopted rules to change the equitable sharing mechanism for the TUSF where UNEs are used to provision the service.[128] This rule was appealed and the parties entered a settlement that requested a remand to the Commission to reconsider on a

[128] *Rulemaking to Amend the USF Rules Regarding the Unbundled Network Element Sharing Mechanism*, Project No. 24526, Order Adopting Amendments to §26.403, as Approved at the July 11, 2002 Open Meeting (July 19, 2002). SWBT filed an appeal on August 12, 2002 in the Travis County District Court.

stand-alone basis or in the context of the forthcoming proceeding to re-evaluate the entire TUSF.

The Commission also adopted two new rules to provide voice-grade services to permanent residential or business premises that are not included within the certificated area of a certificate of convenience and necessity (CCN) holder by providing reimbursement for costs from the TUSF. In one project, the Commission established procedures for residential or business customers in uncertificated areas to petition the Commission for voice-grade telecommunications services.[129] In another project, the Commission established guidelines to provide high cost assistance for the voluntary provision of voice-grade telecommunications service in uncertificated areas of the State.[130]

Furthermore, the Commission has also initiated a rulemaking project to establish procedures for the automatic enrollment of qualifying individuals in Lifeline and Link-Up programs to save such individuals the extra paperwork. [131]

f. TUSF Review

In accordance with P.U.C. SUBST. R. 26.403, beginning on September 1, 2002, the Commission began its review of the definition of services to be supported by the Texas High Cost Universal Plan (THCUSP), forward-looking cost methodology, revenue benchmark levels, and/or base support amounts associated with the TUSF.[132] In this project, the Commission is reviewing these specific issues and considering other issues related to the TUSF. The Commission conducted a public workshop on November 13, 2002, to discuss such issues and the processes in which these issues will be addressed.

3. Switched Access Charges in Texas

Last session the Commission provided the Legislature with a report on Intrastate Switched Access Charges. This section provides additional information on developments since that time.

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[129] *Rulemaking to Implement H.B. 2388, 77th Legislature, Provision of Telecommunications Services to an Area not Included in a Certificated Service Area*, Project No. 24519, Order Adopting New §26.421 and §26.422 Concerning Designation of ETPs to Provide Service to Uncertificated Areas, as Approved at the April 5, 2002 Open Meeting (Apr. 22, 2002).

[130] *Rulemaking Regarding High Cost Assistance to a Telecommunications Provider that Volunteers to Provide Voice-Grade Service to an Uncertificated Area*, Project No. 24527, Order Adopting New § 26.423 Regarding High Cost Assistance for the Voluntary Provision of Basic Local Telecommunications Service, as Approved at the April 18, 2002 Open Meeting (May 3, 2002).

[131] *Rulemaking to Implement H.B. 2156 as it Concerns Enrollment in Telephone Discount Programs*, Project No. 24900 (pending).

[132] *P.U.C. Review of the Texas Universal Service Fund (TUSF) Pursuant to Substantive R. § 26.403(d)(2)(A)(i) and § 26.403(e)(2)(A)(i)*, Project No. 26647 (pending).

a. Developments Since the 2001 Legislative Session

Switched access charges are the wholesale rates paid to local exchange telephone companies by long-distance companies to originate and terminate long-distance calls over the public switched network. Between 1999 and 2000, as prescribed by PURA and, in part, effected by implementation of the TUSF, rates for switched access charges in Texas were reduced—from approximately 12 ½ cents per minute to less than 6 cents. No changes to either the rate structure or rate level of Texas switched access charges have been made since that time.

Switched access charges remain a contentious issue. Even though the "Midland to Marfa" argument has not reached the fevered pitch of years past, the fact remains that in-state long-distance calls usually cost more than state-to-state long-distance calls, due in large measure to the much higher intrastate switched access charges.

The cost disparity between in-state and state-to-state long-distance will not likely diminish since interstate switched access charges continue to decline toward cost, while Texas intrastate access charges remain stagnant. Interstate switched access charges are currently about $0.01, while intrastate rates are in the $0.055–$0.06 range for Southwestern Bell Telephone (SWBT). Thus, the differential between the two has now climbed to 500%.

The *2001 Switched Access Report*, which was prepared in response to Section 58.303 of PURA, discussed various restructuring and/or rate reduction options, the objective of which was to establish cost-based rates, or at a minimum move rates closer to cost. While intrastate switched access charges have not changed since the issuance of that report, usage-sensitive interstate access charges continue to decline, thereby exacerbating the rate differential between intrastate and interstate switched access charges. Included in Appendix R are excerpts from the *2001 Switched Access Report*. This continues to represent the state of affairs regarding switched access charges.

b. Switched Access Charge Case

On September 22, 2002, AT&T Communications of Texas, L.P. (AT&T) complained against SWBT and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long-distance (SWB-LD) for allegedly engaging in intra-corporate cross-subsidization,[133] which creates a price structure aimed at creating a price squeeze that is anti-competitive, predatory, discriminatory, and unreasonably preferential.[134] The primary remedy sought by AT&T was the reduction of SWBT's switched access charges.

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[133] Cross-subsidization may be defined as the use of proceeds from the sales of one set of products or services to subsidize below-cost prices of another set of products or services.

[134] *Complaint of AT&T Communications of Texas, L.P. against Southwestern Bell Telephone Company and Southwestern Bell Long Communications Services, Inc. d/b/a Southwestern Bell Long Distance*, Docket No. 23063 (pending).

During the pendency of the proceeding at the State Office of Administrative Hearings (SOAH), SWBT sued in the Travis County District Court, seeking a declaratory order, mandamus against the Commission, and temporary and permanent injunctions against the Commission to prevent the consideration of a reduction in its switched access rates or a hearing for that purpose. On March 14, 2001, the District Court denied SWBT's request for a temporary injunction. SWBT filed an interlocutory appeal of the District Court's decision with the Third Court of Appeals.

On July 26, 2001, the Third Court of Appeals held that the District Court should have granted a temporary injunction to preserve SWBT's right to immunity from Commission regulation of its switched access rates.[135] The Court of Appeals remanded the case back to the District Court for issuance of a proper temporary injunction consistent with its opinion. On August 20, 2002, the District Court issued an order granting SWBT's motion for summary judgment, and granting a permanent injunction against the Commission from proceeding on any matter relating to the validity of SWBT's current switched access rates.[136] The District Court held that the Commission could not make any changes to switched access charges of ILECs who have elected into incentive regulation under Chapter 58. Based upon this court decision, the Commission is effectively barred from redressing the differential between intrastate and interstate switched access charges. Both AT&T and the Commission have appealed this ruling.[137]

4. Advanced Services

While the availability of advanced services continues to increase, a continuing challenge for Texas is how to encourage widespread deployment and adoption of these services, especially in rural areas of the State. Factors such as population density, income levels, and distance challenges may lead to slower rates of deployment in these areas. In January 2001, the Commission reported to the Legislature on the availability of advanced services in rural and high-cost areas.[138] Since the *2001 Advanced Services Report*, some increases in broadband deployment have occurred across the State.[139]

The public policy goals of the Commission continue to support a technology neutral, pro-competitive approach to encouraging the deployment of broadband services. In other words, the Commission does not favor any particular technology as a delivery

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[135] *Southwestern Bell Tele. Co. v. Public Uti. Comm.;* Max Yzaguirre, Chair of the Public Utility Commission of Texas, Rebecca Klein, Commissioner of the Public Utility Commission of Texas; Brett A. Perlman, Commissioner of the Public Utility Commission of Texas; and AT&T Communications of Texas, L.P., No. 03-01-00114 CV, 72 S.W.3d 23, (Tex. App. Austin July 26, 2001, writ dism'd w.o.j.).

[136] *Southwestern Bell Tele. Co. v. Public Util. Comm.*. 72 S.W.3d 23 (Tex. App. – Austin 2001 pet. filed).

[137] *Public Util. Comm'n, et al. v. Southwestern Bell Tel.Co.,* No. 03-02-00602-CV, (Tex. App. – Austin 2002) Court of Appeals, Third District (Docket No. 23063) (pending).

[138] Public Utility Commission of Texas: Report to the 77th Legislature on the Availability of Advanced Services in Rural and High Cost Areas (January 2001).

[139] For an overview of Advanced Services Technologies, please see Appendix S.

platform for advanced services. However, it should be noted that the Commission's authority is limited to regulating telecommunications services, which would not include cable. These goals also include encouraging local solutions, and avoiding a "one size fits all" solution. As the pace of technological change increases, the Commission believes it important to avoid excessive regulation; however, where competitive service is not available, appropriate regulation may be needed. Although the supply of and demand for any service may be affected by many variables, the Commission believes population demographics, distance, and technology factors currently are the principal elements that influence the supply of and demand for broadband services. The Commission has undertaken action in several areas to encourage the deployment of advanced services to all areas of the State.

a. DSL Service in Texas

As discussed in Chapter III, digital subscriber line (DSL) services continue to grow rapidly in Texas. Most subscribers to DSL service are residential customers and small businesses. Because DSL service uses the high frequency portion of the "loop" or phone line and voice service uses the low frequency portion of the loop, DSL and voice service are nearly always provisioned together over a single loop. In fact, SBC and other ILECs have instituted a policy that requires an end-use customer to subscribe to their voice service on a line in order to obtain DSL service on that line.

SBC and other ILECs have also refused to provide DSL service over a loop used by a CLEC to provide voice service to the customer. This is true whether the CLEC uses resale, UNE-P, or unbundled network element loop (UNE-L) to provide the voice service. The effect of this policy is to keep customers who wish to retain SBC's (or another ILEC's) DSL service from switching to a CLEC for voice service. Customers desiring a CLEC's voice product must give up their SBC (or other ILEC) DSL service in order to switch voice providers. CLECs view SBC's policy as anti-consumer and anti-competitive. Because of the proliferation of DSL, this policy affects a growing number of residential and small business customers who cannot change their local voice provider without giving up their DSL service, something few customers are willing to do. SBC asserts that refusing to provide DSL service to CLEC voice customers is a business decision, which it has the right to make under federal law. The Commission has commenced an investigation, Project No. 26943,[140] to examine this issue in greater detail.

b. Advanced Services in Rural Texas

In response to the Legislature's enactment of section 55.014 of PURA[141] during the 77th Legislative Session, the Commission has adopted a new rule regarding the

[140] *PUC Investigation into the Availability of SBC's DSL Service to End Users Subscribing to CLEC Voice Service*, Docket No. 26943 (pending).

[141] Public Utility Regulatory Act, TEX. UTIL. CODE ANN. § 55.014 (Vernon 1998 and Supp. 2003)

provision of advanced services in rural areas of Texas, P.U.C. SUBST. R. 26.143.[142] This rule was promulgated to promote deployment of advanced services in rural areas of Texas and to promote the Texas policy that customers in all regions of the State have access to advanced telecommunications and information services that are reasonably comparable to those services provided in urban areas and that are available at prices reasonably comparable to those prices charged for similar services in urban areas.[143] The rule applies to all of Chapter 58 electing companies[144] and holders of a certificate of operating authority or service provider certificate of operating authority. As depicted in the map in Figure 4.5, numerous cities that meet the criteria of the advanced services rule have providers of broadband services located in their area. [145]

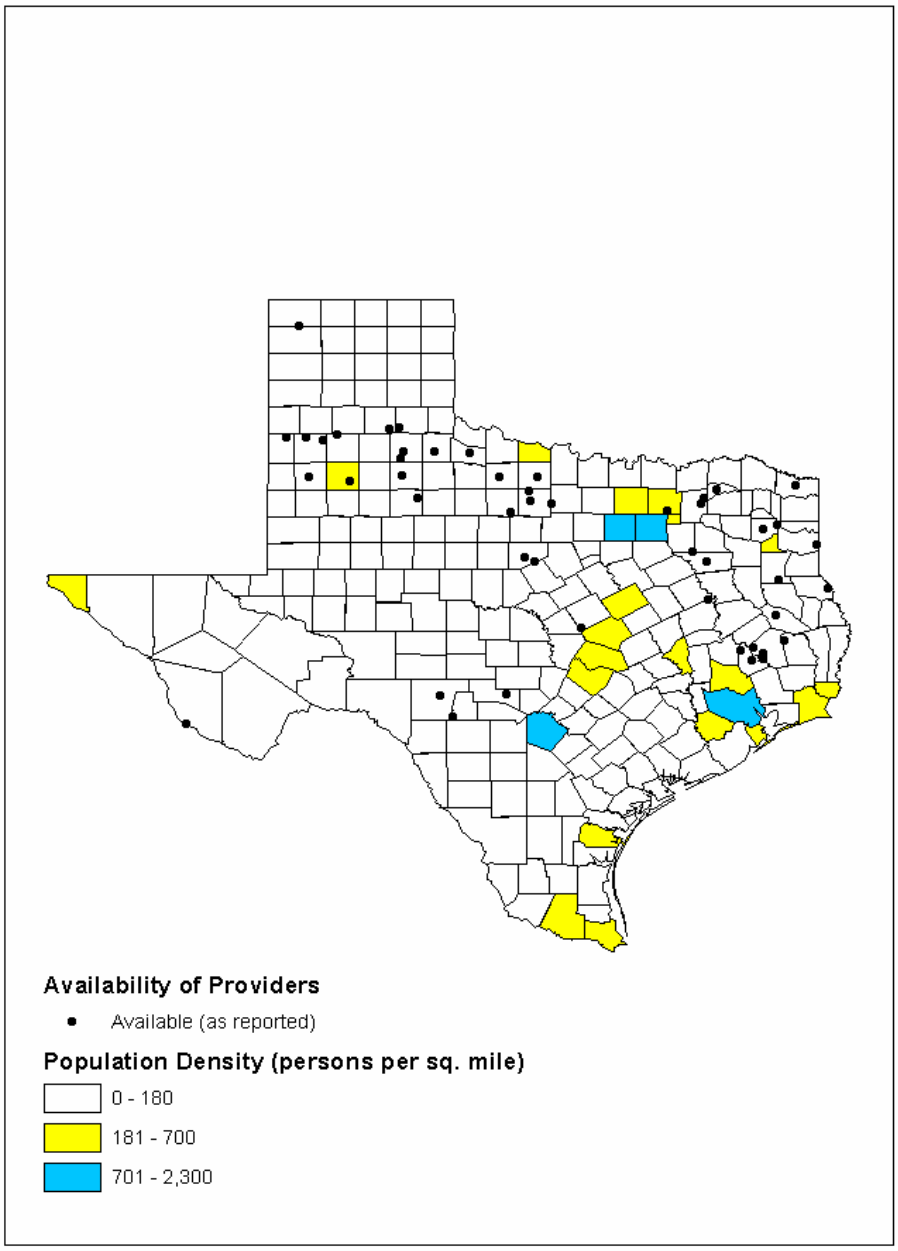
[142] *Rulemaking to Address the Provision of Advanced Services by Electing Companies, COA or SPCOA Holders in Rural Service Area*, Project No. 21175, Order Adopting New P.U.C. SUBST. R. 26.143, relating to Provision of Advanced Services in Rural Areas (April 18, 2002).

[143] PURA § 51.001(g).

[144] Electing companies are companies that elect incentive regulation pursuant to P.U.C. SUBST. R. 26.143, and make the corresponding infrastructure commitments under Chapter 58 of PURA (SWBT, Verizon, Sprint/United, Sprint/CenTel, and Valor) or Chapter 59 of PURA (Kerrville Telephone, CenturyTel of San Marcos, CenturyTel of Lake Dallas, CenturyTel of Port Aransas, Texas ALLTEL, Big Bend Telephone Cooperative, TXU Communications, Sugar Land Telephone Company, and Fort Bend Telephone Company).

[145] P.U.C. SUBST. R. 26.143(c)(6) defines a rural community as: "Any community located in a county not included within any Metropolitan Statistical Area (MSA) boundary, as defined by the United States Office of Management and Budget, and any community within an MSA with a population of 20,000 or fewer not adjacent to the primary MSA city."

Figure 29 – Availability of Broadband Providers in Communities Subject to the Advanced Services Rule



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

The advanced services rule sets forth procedures whereby a retail customer within a rural service area may seek advanced services in order to access the internet. The rule establishes a "competitive response process" for retail customers in a rural area to seek advanced services from any advanced services provider. Under this portion of the rule, rural retail customers may submit a written request to the Commission for advanced services. The Commission will post relevant portions of the request on the Commission website so that providers become aware of the customer demand. Within 50 days after posting, any advanced services provider may submit a proposal to the rural area's contact person for provision of advanced services. Based on submitted proposals, the persons seeking the advanced services would then negotiate and select a provider for service. This market-based process allows the rural area and the provider to develop an appropriate strategy for deployment, including prices, terms, and conditions of service.

If, however, no advanced services agreement is reached in the competitive response process, the rule provides a mechanism whereby retail customers in the rural area may secure access to services that are reasonably comparable to the advanced telecommunications services offered by companies within urban service areas via a Bona Fide Retail Request (BFRR). The rule addresses the specific parameters for determining reasonably comparable advanced telecommunications services, including reasonably comparable prices, terms, and conditions. The rule outlines the requirements of service and establishes Commission proceedings for selection of serving companies pursuant to a BFRR.

The Commission has established a website for posting advanced services requests and information about the Commission activities.[146] While the agency has received inquiries regarding the rule, to date, only one formal written request has been submitted to the Commission for advanced services. The Commission received the request from the City of Sealy on December 2, 2002.[147]

c. LBJ School Pilot Project

In the fall of 2001, the Commission funded a graduate policy research project at the Lyndon Baines Johnson School of Public Affairs at the University of Texas at Austin to investigate facilitation of deployment of advanced services in under-served and remote communities, particularly in rural Texas. Selected rural communities participated with students to investigate policies, techniques, innovations, and information that may be used by state and local officials to accelerate the deployment broadband services in rural Texas. From these case studies, the students created a "toolkit" for potential users to consider when developing broadband connections in their communities. The project culminated in the creation of the Lonestar Broadband website, which provides information, guidelines, educational material, case studies, and contacts for use by community leaders in Texas communities to help deliver broadband services to their

[146] This information can be found at http://www.puc.state.tx.us/telecomm/advserv/index.cfm.

[147] *See Request for a Competitive Response for Advanced Services for the City of Sealy*, Project No. 27041 (December 2, 2002).

communities. The website, http://www.lonestarbroadband.org,[148] was launched in May of 2002. The website describes Lonestar Broadband as "a toolkit for rural leaders and officials interested in securing high-speed telecommunications services essential for economic development, education and health care in their communities."[149]

d. Broadband Work Team

Due to the emerging and complex issues involved with advanced services, the Commission has created a Broadband Team to better address customer questions and to facilitate interaction with other State agencies in the hopes of more continuity and consistency for State policy. Members of the broadband team are available to answer customer questions regarding the Commission's rule concerning the deployment of advanced services, to participate in inter-agency working groups, and to serve as resources regarding broadband data inquiries.

In July of this year, the Commission Staff participated in an inter-agency working group meeting sponsored by the Office of Rural Community Affairs (ORCA). The purpose for establishing this inter-agency group is to coordinate state, federal, and non-profit entities dealing with rural issues and efforts. In addition, there have been meetings between the Commission's Broadband Team and ORCA's Technology and Telecommunications Program Specialist on matters primarily dealing with high-speed internet availability in Texas, and the Commission's recently adopted advanced services rule. These meetings serve as a way for ORCA Staff to become familiar with Commission initiatives that are geared towards deployment of advanced services.

e. Governor's Broadband Forum

The Commission has also participated in the Governor's Policy Broadband Forum, which was convened by staff of the policy office of Governor Rick Perry to provide stakeholders with an opportunity to explore broadband deployment issues. The policy forum was asked to examine (1) whether "the market is deploying broadband in an efficient, effective manner," and (2) if not, does "broadband deployment merit

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[148] *Disclaimer:* The students developed and created this site including all of the content, associated recommendations, and the selection of live links to other internet addresses. The PUC hopes that the public will find the work of the students to be useful and instructive in developing broadband opportunities through out Texas. However, PUC staff did not participate in the development of the Lonestar Broadband site or the decisions about its content. Accordingly, the PUC does not endorse, approve, certify, or control the content of this site or the content found at the external internet addresses. The PUC does not guarantee the accuracy, completeness, efficiency, or timeliness of information located on this site or at the linked external addresses. Use of any information obtained from such addresses is voluntary, and reliance on it should only be undertaken after an independent review. Reference herein to any specific service provider, commercial product, process, or service by trade name, trademark, service mark, manufacturer, or otherwise does not constitute or imply endorsement, recommendation, or favoring by the PUC.

[149] *See* L.B.J. School of Public Affairs at the University of Texas, *About Us, PRP Objective,* (2002), http://loanstarbroadband.org.

government intervention." The Commission was a participant in this forum and along with over 100 individuals and 55 organizations joined in an effort to discuss nascent broadband matters important to all Texans.[150]

f. TIF Board

The Texas Infrastructure Fund (TIF) was established in 1995 to promote the deployment of equipment and telecommunications infrastructure for distance learning, information sharing programs of libraries, and telemedicine services. Since its creation in 1995, the TIF Board has awarded over $1.1 billion in grants to public schools, institutions of higher education, public libraries, and not-for-profit health care entities. TIF will award an additional $400 million in order to reach its legislatively mandated cap of $1.5 billion. These funds have been used to provide hardware, connectivity, and training in an effort to help Texas become a leader in telecommunications infrastructure.

In October 2002, the TIF Board approved and authorized funding for a scoping study to "identify the elements and issues to be addressed by a major follow-on study that will evaluate alternatives and develop recommendations for a statewide infrastructure to serve the long-term (15-20 years) telecommunications needs of Texas."[151] At the time of publication of this Report, the scoping study was expected to be presented to the TIF Board in December 2002, and discussions were to occur with higher education institutions regarding implantation of a broader "follow-on" study.[152]

This broader study is expected to include an examination of the following topics:[153]

- Current and projected demand for telecommunications services Statewide;
- Current and projected private and public investment in telecommunications infrastructure;
- Projected gaps that could be met by public investment or services;
- Alternatives for bridging the gaps identified, with discussion of related design, cost, governance, legislative, and regulatory issues;
- Review of national, regional, and other states' infrastructures and plans; and
- Recommendations.

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[150] The forum culminated with a Broadband Stakeholder Report to Staff of the Governor's Policy Office. The paper can be viewed at: http://www.puc.state.tx.us/about/commisioners/perlman/perlman.cfm.

[151] Internal documents were provided by TIF that summarize the scoping study initiative, which was approved by the TIF Board in October 2002, as cited in the House State Affairs Interim Report to the Texas House of Representatives 78th Legislature, December 17, 2002, page 96. Online available: http://www.house.state.tx.us/committees/reports/77interim/state_affairs.pdf.

[152] House State Affairs Interim Report to the Texas House of Representatives 78th Legislature, December 17, 2002, page 96. Online available: http://www.house.state.tx.us/committees/reports/77interim/state_affairs.pdf.

[153] *Id.*

5. Customer Protection

PURA Section 64.001 required the Commission to adopt rules to establish customer protection standards and to protect customers from fraudulent, unfair, misleading, deceptive, or anti-competitive practices. The Commission adopted customer protection rules pursuant to mandates established by S.B. 86,[154] which was passed during the 76th Texas Legislature.

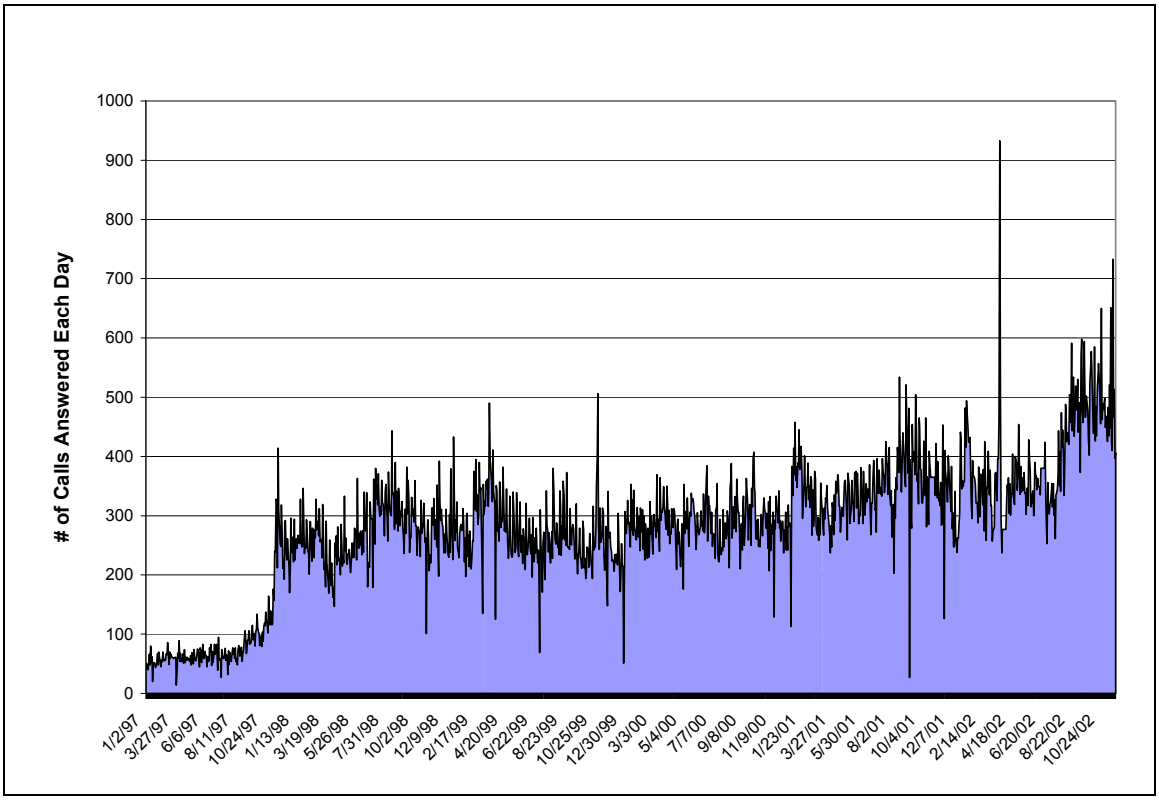
a. Complaint Handling

The Customer Protection Division (CPD) of the Texas Public Utility Commission was created in 1997 in response to an increased need to respond to complaints against telecommunications and electric service providers. CPD answers public inquiries through a toll-free customer assistance hotline, investigates and resolves complaints, and develops and disseminates customer education material. Since its creation, CPD has increased in size to 15 complaint investigators, 11 call center representatives, and five information and education employees. CPD also oversees the Relay Texas program, the Statewide telephone interpreting service for the hearing-and speech-impaired.

[154] Tex. S.B. 86, 76th Leg. R.S. (1999) Senator Jane Nelson and Representative Debra Danburg, 1579 Tex. Gen. Laws 5421.

CPD receives complaints and inquiries by mail, fax, email, and telephone. The average time to investigate and resolve a customer complaint is 38 days. Even given the large volume of calls received by the CPD each day, CPD staff are handling customer complaints in a timely manner.

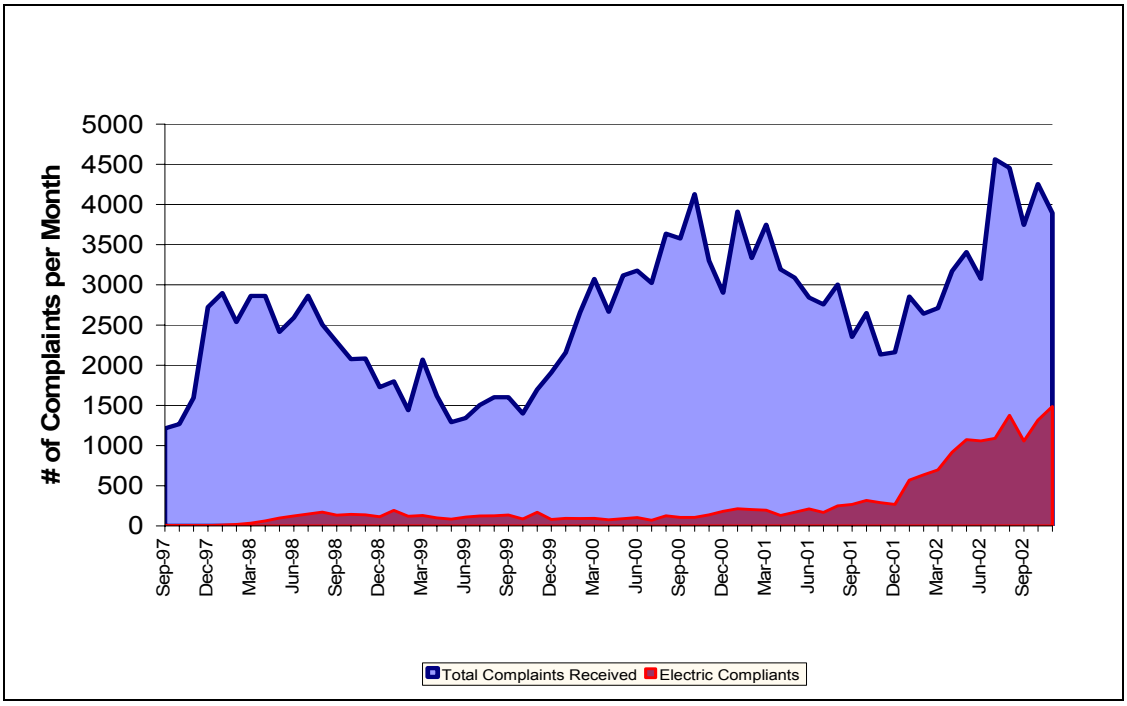
Figure 30 — Number of Calls Answered Each Day in Customer Protection



SOURCE: Texas PUC Customer Protection Division

Complaint volumes have steadily increased since September 1997, especially over the past two years. In 2002, the Commission increased the number of customer service employees to handle this increase in the number of inquiries and complaints. While the majority of complaints are telephone or service related, there has been a noticeable increase in complaints related to electric service since the beginning of 2002 when retail electric competition began in most areas of the State. In addition, a large increase in July 2002 was attributable to the effective date of the "No-Call list."

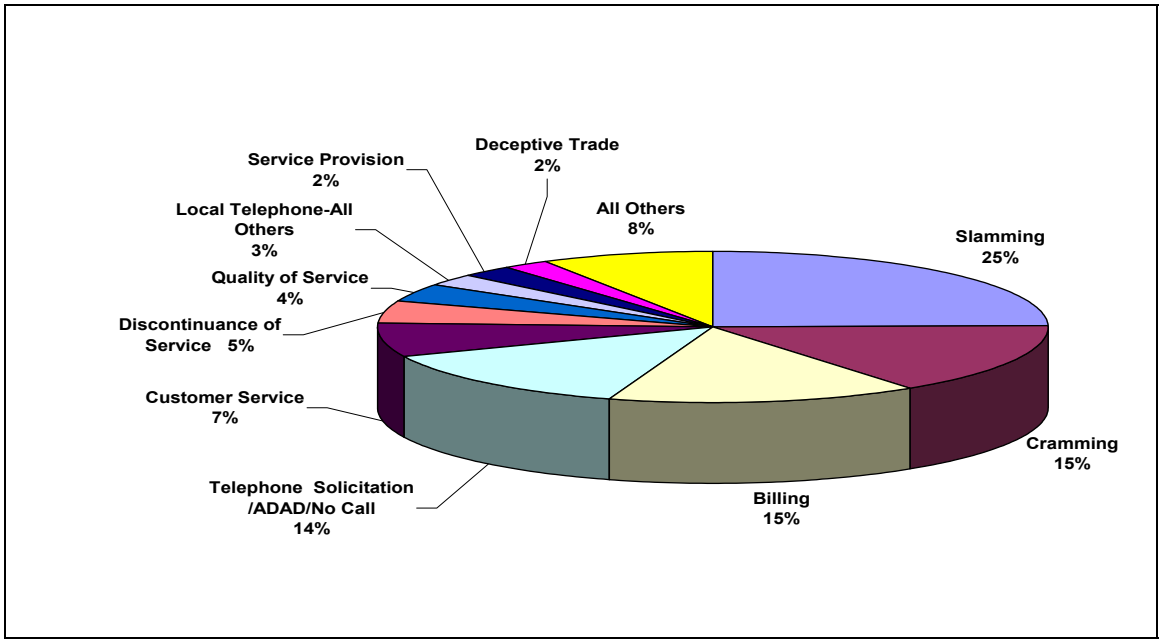
Figure 31 — Total Complaints Received by the Commission



SOURCE: Texas PUC Customer Protection Division

As shown in Figure 32, the majority of telecom complaints received by CPD are for slamming (25%), cramming (15%), and billing (15%) allegations for FY 2002.

Figure 32 — Composition of Telecom Complaints Received, FY 2002 (September 1, 2001 – August 31, 2002)



SOURCE: Texas PUC Customer Protection Division

i. Slamming/Cramming

Slamming is the switching of a customer's long-distance service without proper authorization and verification, in violation of PURA §§ 55.303-306 and P.U.C. SUBST. R. 26.130. The Commission adopted P.U.C. SUBST. R. 26.130 to "ensure that all customers within the State are protected from an unauthorized change in a customer's local or long-distance telecommunications utility."[155] The Commission, like the FCC, maintains a zero tolerance policy regarding the prevention and elimination of slamming.

Cramming is the result of an unauthorized charge on a customer's telecommunications utility bill without proper consent and verification of the authorization from the customer. This constitutes a violation of PURA §§ 17.151–.158 and P.U.C. SUBST. R. 26.32. The Commission's rule includes requirements for billing authorized charges, verification requirements, responsibilities of billing telecommunications utilities and service providers for unauthorized charges, customer notice requirements, and compliance and enforcement provisions.

[155] P.U.C. SUBST. R. 26.130(a).

While the Commission has assessed penalties for slamming and cramming in the past, those penalties were paid based on settlements with service providers against whom complaints had been filed.

In 2002, for the first time, the Commission assessed an administrative penalty against a company after a fully litigated proceeding at the SOAH. Specifically, Commission Staff alleged that Axces, Inc. violated PURA[156] §§ 55.303-.306 and P.U.C. SUBST. R. 26.130 by switching the long-distance service of 186 customers without proper authorization and verification. Staff recommended $930,000 in administrative penalties and the revocation of Axces's registration as an interexchange carrier. At the November 7, 2002 open meeting, the Commission adopted in part and reversed in part the proposal for decision (PFD) and supplemental proposal for decision (SPFD) issued by the SOAH on November 19, 2001 and July 23, 2002, respectively. The Commission ruled that a total of $360,000 in administrative penalties should be assessed against Axces. The Commission is expected to issue a final order outlining these rulings in early 2003. There are three other cases alleging slamming violations currently pending against Axces.

This case is significant because it was the Commission's first opportunity to consider important issues concerning the type of proof required to establish a violation of the statutes and rules prohibiting slamming. The Commission's rulings in this case will have an influence on virtually all enforcement actions undertaken in the future.

In many cases, customer complaints are solved through the informal complaint process, obviating the need for a formal contested proceeding. In addition, Commission Staff routinely monitors service providers' compliance with Commission rules, and in most cases, service providers quickly remedy non-compliance when it is brought to their attention. The Commission also utilizes calls and complaints received in its call center in assessing whether a more formal investigation and/or enforcement action is warranted against a particular service provider.

ii. Texas "No-Call" List

On January 1, 2002, Texas joined 24 other States with statutory "No-Call" lists intended to shield telephone customers from unwanted telemarketing sales calls. Texans may now register their telephone number for one or both of two "No-Call" lists maintained by the Commission. Customers may place their name, address, and telephone number on these lists to identify themselves as individuals who do not want to receive unsolicited telemarketing calls at home.

(a) Statewide "No-Call" List

The statewide "No-Call" list was established by H.B. 472 enacted by the 77th Legislature in 2001, and applies to all telephone marketers operating in Texas. A

[156] Public Utility Regulatory Act, TEX. UTIL. CODE §§ 11.001-63.063 (Vernon 1998 & Supp. 2002).

registered residential telephone numbers remains on the list for three years. Business telephone numbers cannot register for this list.

(b) "Electric No-Call" List

The "Electric No-Call" list was established by S.B. 7, the electric restructuring utility bill enacted in 1999. The "Electric No-Call" list prevents calls only from retail electric providers and telemarketers calling about electric service. Both businesses and residential numbers can be added to the list, and numbers remain on the list for five years.

(c) "No-Call" Registration

The first registration period for the "No-Call" list closed on March 27, 2002. The first "No-Call" list was published on April 1, 2002, and included 386,046 telephone numbers. The second registration period closed on June 26, 2002. The second list was published on July 1, 2002, bringing the total registered telephone numbers to 658,749. As of November 30, 2002, 769,540 telephone numbers have been included in the no-call registry.

(d) Complaints

The Commission is authorized to investigate complaints and to assess administrative penalties for violations of the Texas "No-Call" list involving all entities except state licensees.[157] From July 1, 2002 through November 30, 2002, the CPD received 4,965 customer contacts related to the Texas "No-Call" list. The Commission is currently investigating these complaints to determine if formal enforcement action is warranted.

iii. Rulemaking on Fraudulent Collect Calls

The portion of Texas bordering Mexico faces several service issues that are unique to this region, including collect call fraud.[158] In June 2001, the Attorney General of Texas filed suit against an Austin-based telecommunications company for perpetrating a collect call scam in which Texas customers were excessively billed when they accepted collect calls from people in Mexico representing themselves as long-lost relatives.[159] Thereafter, on February 28, 2002, the Commission amended its substantive rules to specifically address collect call fraud.[160] The Commission's amended rule requires that

[157] Tex. Bus. & Com. Code Ann. § 43.102(b).

[158] For purposes of this report, the Texas Border Region includes the following counties: Brewster, Brooks, Culberson, Duval, El Paso, Crockett, Cameron, Dimmit, Edwards, Ellis, Hidalgo, Hudspeth, Jeff Davis, Jim Hogg, Kenedy, Kinney, La Salle, Maverick, Pecos, Presidio, Real, Reeves, Starr, Terrell, Uvalde, Val Verde, Webb, Willacy, Zapata, and Zavala.

[159] *State of Texas vs. Southwest Intelecom, Inc. d/b/a Intelecom, Inc., et. al* No. 6V1-01601 (201st Jud. District Ct., Travis County, Texas) (April 12, 2002).

[160] *Rulemaking to Amend Subst. R. 26.315 to Discourage the Practice of Unscrupulous Collect Calls*, Project No. 24105, Order Adopting Amendments to § 26.315 (Feb. 28, 2002).

carriers more closely monitor their billing charges and effectively discontinue business with entities that continually exceed a complaint threshold.

b. Service Quality

P.U.C. SUBST. R. 26.54 establishes retail performance objectives for dominant certificated telecommunications utilities (DCTUs) or dominant carrier. These retail performance objectives establish company-wide and individual exchange performance benchmarks that a dominant carrier should meet or exceed when providing basic telecommunications services. Following is a summary of retail service quality for the study period consisting of the Third Quarter 2000 through First Quarter 2002 for SWBT, Verizon, Valor, and Sprint.

i. Performance Objectives

- **Installation Related** - Objectives related to the length of time it takes to respond to a customer's request for telephone service. To meet these objectives a dominant carrier must complete: 95% of Primary Service Orders in 5 days, 90% of Regular Service Orders in 5 days, 90% of its installation commitments, 99% of Service Orders in 30 days, and 100% of Service Orders in 90 days.

- **Maintenance Related** - Objectives related to the number of trouble reports received from customers having problems with their telephone service. To meet these objectives a telephone company must be able to clear 90% of the out-of-service complaints within eight working hours. In addition, a dominant carrier must maintain its network so that its trouble report rate does not exceed 3% per 100 lines, and receive no more than 22% repeat trouble reports on residential and singe business lines.

- **Miscellaneous** - Objectives related to the length of time it takes for a customer service representative to answer a call from a customer. To meet these objectives a dominant carrier's customer service center must answer 90% of business office calls in 20 seconds and 90% of repair service calls within 20 seconds.

ii. Recent Service Quality Review

P.U.C. SUBST. R. 26.54(c) requires dominant carriers to comply with the service objectives and performance benchmarks, as well as file with the Commission quarterly reports on performance indicators. The report must include the monthly performance for each category of performance objectives and a summary of the corrective action plan for each exchange in which the performance falls below the benchmarks identified previously for three consecutive months. Moreover, the corrective action plan must include, at a minimum, details outlining how the needed improvements will be implemented within three months and result in performance at or above the applicable benchmark. The report provides a summary and analysis of the data reported by

dominant carriers for the study period beginning third quarter of 2000 through first quarter of 2002.

In general, the performance data related to provisioning and maintenance show improvement, although not total compliance, for the study period for all four companies. The performance related to business office answer time was missed for six or more months by SWBT, Sprint, and Valor. However, Valor's business office answer time performance was compliant for three consecutive months in the Second Quarter of 2002.

The performance related to repair service answer time was missed for six or more months by Sprint and Valor. However, Valor has met the benchmark for the last five months of the study period. Following is a detailed analysis of the performance data reported by each dominant carrier during the quarterly review, as required by P.U.C. SUBST. R. 26.54(c).

Installation Related Standards

- **95% of Primary Service Orders Completed in Five Working Days**

SWBT's and Verizon's company-wide performance met the benchmark for the entire study period. Sprint's and Valor's company-wide performance missed the benchmark for seven and ten consecutive months, respectively. Sprint and Valor have shown improvement through out the study period.

- **90% of Regular Service Orders Completed in Five Working Days**

SWBT's, Verizon's, and Sprint's company-wide performance exceeded the Commission benchmark for the entire study period. Valor's company-wide performance exceeded the Commission benchmark for all but two months of the study period.

- **90% of Installation Commitments Should Be Met**

SWBT's, Verizon's, and Sprint's company-wide performance exceeded the Commission benchmark for the entire study period. Valor's company-wide performance missed the Commission benchmark for thirteen consecutive months. However, Valor's performance was compliant throughout the First Quarter of 2002.

- **99% of Service Installation Orders Completed in 30 days**

SWBT's, Verizon's, and Sprint's company-wide performance exceeded the Commission benchmark for the entire study period. Valor's company-wide performance missed the Commission performance objective for nine consecutive months. However, Valor's third quarter performance in 2001 shows compliance.

- **100% of Service Installation Orders Completed in 90 Days**

SWBT's, Verizon's, and Sprint's company-wide performance exceeded the Commission benchmark for the entire study period. Valor missed the Commission performance benchmark for ten consecutive months. However, Valor's fourth quarter performance in 2001 shows compliance.

Maintenance Related Performance

- **90% Out-of-Service Complaints Cleared Within Eight Working Hours**

SWBT's company-wide performance was below the Commission performance level for three consecutive months during both the Third Quarter of 2000 and the First Quarter of 2001. Verizon's company-wide performance exceeded the Commission benchmark for all months except for one in the study period. Sprint's company-wide performance met the Commission benchmark for all months except for two in the study period. Valor missed the Commission performance benchmark for the entire study period.

- **Trouble Report Rate Shall Not Exceed 3%**

SWBT's and Verizon's company-wide performance exceeded the Commission benchmark for all months of the study period. Sprint's company-wide performance missed the Commission performance benchmark for six consecutive months. Valor missed the company wide performance for all but one month in the study period.

- **Not More Than 22% Repeat Trouble Reports on Residential and Single Business Lines**

SWBT's, Verizon's, and Sprint's company-wide performance exceeded the Commission benchmark for all months in the study period. Valor missed the Commission performance benchmark for five months in the study period.

Miscellaneous Standards

- **90% of Business Office Calls Answered in 20 Seconds**

Verizon's company-wide performance met the benchmark for all months during the study period. SWBT has missed this measure for all but two months of the study period. Sprint has missed this performance objective for all but one month of the reporting period. Valor has missed this performance for eleven of the fifteen months of data reported. However, Valor's company-wide performance met the Commission benchmark in the Second Quarter of 2002.

- **90% of Repair Service Calls Answered in 20 Seconds**

SWBT's and Verizon's company-wide performance met the Commission benchmark for all months in the study period. Sprint missed the performance objective for this measure for all but five months in the study period. Although Valor missed the performance measure for numerous months, it met the objective for the last five months of the study period.

Additional information on the procedures for calculating and processing administrative penalties for violations of P.U.C SUBST. R. 26.54(c), relating to telephone service quality standards, may be found in Appendix T.

6. Municipal Rights-of-Way

As part of an ongoing effort to bolster competition in the telecommunications industry by removing barriers to entry, the 76th Legislature enacted House Bill 1777, which became Texas Local Government Code, Chapter 283, *Management Of Public Right-Of-Way Used By Telecommunications Provider In Municipality* (Chapter 283). This law established a uniform method for certificated telecommunications providers (CTPs) to compensate municipalities for the use of public ROWs, and charged the Commission with implementation of the bill.[161]

By establishing this uniform method, this legislation intended to reduce barriers to competition by allowing easier entry into municipal markets for CTPs. Historically, telecommunications companies paid franchise fees to cities for the use of the public ROWs based on varying scales. With this legislation, all CTPs use the same methodology to calculate their municipal fees.

The stated goal of this legislation is to establish a uniform method for compensating municipalities that: (1) is administratively simple for municipalities and CTPs; (2) is consistent with state and federal law; (3) is competitively neutral; (4) is nondiscriminatory; (5) is consistent with the burdens on municipalities created by the incursion of CTPs into a public ROW; and (6) provides fair and reasonable compensation for the use of a public ROW.

The FCC and numerous other state legislatures are considering legislation similar to the Texas law.[162]

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[161] 154 TEX. LOC. GOV'T CODE ANN. §§ 283.001-283.058 (Vernon 1998 & Supp. 2003); Tex. H.B. 1777 76th Leg., R.S., 840 TEX. GEN. LAWS, 3499.

[162] Andrew Caffrey, *States Limit Cities' Street Fees*, WALL STREET JOURNAL, April 10, 2002, p. B7.

a. Implementation Projects

The Commission began the ongoing process of implementing Chapter 283 of the Local Government Code in the summer of 1999. In the initial round, the Commission adopted rules, which established categories of access lines (P.U.C. SUBST. R. 26.461), established a uniform method for calculating and reporting of a municipality's base amount (P.U.C. SUBST. R. 6.463), established a uniform method for counting and reporting access lines by CTPs (P.U.C. SUBST. R. 26.465), and established rate determination, default allocation, base amount and allocation adjustments, municipal compensation, and associated reporting requirements (P.U.C. SUBST. R. 26.467).[163]

In addition, the Commission adopted a rule in fall of 2001 to clarify how lines passing through multiple jurisdictions should be compensated, and set limits on those fees a municipality can charge a CTP for use of public rights-of-way.[164]

In early 2002, the Commission adopted a new rule that ensures that quarterly access line reporting will be performed in a uniform and timely manner, and applies the Commission's already-existing enforcement procedures for failure to comply with quarterly reporting requirements.[165]

Currently, the Commission has proposed a new rule to address the issue of municipal authorized review of CTP line-count information and an amendment to consolidate the reporting requirements into a single place. The proposed new rule outlines the documentation that municipalities should be able to access from the CTPs in order to conduct an authorized review and how the issues of confidentiality and proprietary information should be handled.[166]

Chapter 283 requires that by September 1, 2002, the Commission "determine whether changes in technology, facilities, or competitive or market conditions justify a modification in the Commission-established categories of access lines, or if necessary, the adoption of a definition of 'access line'."[167] Under a rulemaking to address this requirement, the Commission solicited written comments, held a workshop for

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[163] *See Municipal Rights of Way, Implementation of H.B. 1777*, Project No. 20935, Order Adopting New § 26.461 (October 28, 1999); Order Adopting New § 26.463 (October 28, 1999); Order Adopting New § 26.465 relating to Methodology for Counting Access Lines and Reporting Requirements for CTPs (December 20, 1999); Order Adopting New § 26.467 relating to Rates, Allocation, Compensation, Adjustments, and Reporting (February 10, 2000).

[164] *See Rulemaking Relating to Outstanding H.B. 1777 Implementation Issues*, Project No. 22909, Order Adopting Amendments to § 26.465 (September 25, 2001).

[165] *See Rulemaking to Implement Enforcement Procedures Relating to Quarterly Access Line Reports*, Project No. 24639, Order Adopting New §26.468 (July 17, 2002).

[166] *See Rulemaking to Address Municipal Authorized Review of Access Line Reporting*, Project No. 25433 (pending).

[167] *See Rulemaking to Address the Redefinition of "Access Line" and Other Related Outstanding Access Line Implementation Issues*, Project No. 25450 (July 25, 2002).

stakeholders, and considered the issues, law, Commission rules, current state of technology, market conditions, and stakeholders' positions.[168] In July 2002, the Commission determined that no amendment was justified at that time. However, the comments indicated that the Commission should undertake a modification in the definition of "transmission path," for which the Commission proposed a rule amendment in late 2002.[169]

On an ongoing basis, the Commission establishes access line rates for newly incorporated and newly participating municipalities on an ad hoc basis.[170] Other participating municipalities may modify their existing rates in September of each year. Additionally, the Commission has streamlined both the reporting process by CTPs and the line count retrieval process for municipalities by automating this process with an internet application that collects access line count information and allows municipalities to have online access.[171] The Commission has also initiated a forum for providers and municipalities to address all Alternative Dispute Resolution cases brought to staff for mediation of issues related to Chapter 283.[172]

b. Outstanding Issues

In implementing Chapter 283 of the Local Government Code, there are two areas in which the Commission has had some difficulty in finding administratively efficient solutions: 1) how to deal with carrier's carriers; and 2) how to distinguish between long-haul and local exchange facilities.

The carrier's carriers are companies that install facilities in the ROWs, but that have minimal or no plans to start offering local exchange service over these lines. Because the current certification rules give newly certificated providers up to four years to launch their service, the carrier's carriers appear to be CLECs. However, the carrier's carriers often have different business plans from CLECs, and having their numbers among the CLECs inflates the apparent scope of competition in Texas and could flood the ROWs with lines for which municipalities receive no compensation. A new category of certification could allow the Commission to distinguish these carriers from retail-service-based companies, thus providing a more accurate assessment of the scope of

[168] *Rulemaking to implement H.B. 1351, 77th Leg., Funding and Operation of the Universal Service Fund as it Applies to Pay Telephone Providers*, Project No. 24520 (July 25, 2002)

[169] *See Rulemaking to Amend P.U.C. SUBST. R.. 26.465*, Project No. 26412 (pending).

[170] *See Issues Related to Annual Revisions to Access Line Rates for Texas Municipalities*, Project No. 24640 (pending).

[171] The online reporting application is called the Municipal Access line Reporting System (MARS) per the designation in P.U.C. SUBST. R. 26.468. Public information is available online: http://www.puc.state.tx.us/HB1777/application/app_frame.asp.

[172] See *Forum to Address Municipal and Provider Concerns Relating to ROW Issues*, Project No. 23557 (pending).

competition in Texas and allowing greater ease in establishing appropriate municipal compensation for use of the ROW.

Chapter 283 includes only facilities designed to deliver local exchange service. Long-haul facilities are specifically excluded. However, many companies today provide local exchange and interexchange service over the same facilities, leading to municipalities having to rely on carriers themselves to accurately report how a facility is to be used before it is even in the ground. Because carriers cannot accurately assess how their business plan will change over time, some facilities intended for long-distance use and some facilities intended for local exchange have been misclassified. The Commission has no way to change the status of a facility such as this, as providers indirectly compensate municipalities for these facilities. The cost of facilities was included in the municipal base amounts, and is distributed over the rates for all end-use access lines in the municipality. Without a legislative reassessment of the calculation of the initial base amount to now include all of the supporting facilities that use a ROW within a municipality in Texas, there would be no question as how to classify particular lines.

7. Building Access

The first case in which the Commission has been petitioned to resolve a dispute under P.U.C. SUBST. R. 26.129, *Standards for Access to Provide Telecommunications Services at Tenant Request*, was brought before the Commission in September 2001. This case involves a telecommunications carrier's request for access to space in a building for the purpose of providing high-capacity telecommunications services to a tenant who has requested these services.

Specifically, on September 5, 2001, Time Warner Telecom of Texas, L.P. (TWTC) filed a complaint against Emissary Group and Tanglewood Property Management seeking non-discriminatory access on reasonable terms and conditions to an office building in Houston for purposes of providing high-capacity telecommunications services to a tenant of that building.[173] TWTC sought immediate access to the building to enable it to serve its customer and ultimate resolution by the Commission of the parties' negotiation of license fees. PURA §§ 54.259-54.261, enacted in 1995, and P.U.C. SUBST. R. 26.129, adopted in 2000, are designed to promote competition in the telecommunications market by allowing a tenant under a real estate lease to choose the provider of its telecommunications services.[174] This is the first proceeding in which the Commission has been petitioned to resolve a dispute under the rule.

As the case was proceeding at SOAH, the Texas Association of Building Owners and Managers (BOMA) challenged the constitutionality of PURA §§ 54.259-54.261.

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[173] *Complaint of Time Warner Telecom of Texas, L.P. Against Tanglewood Property Management and Emissary Group*, Docket No. 24604 (pending).

[174] The relevant provisions of PURA, as well as Commission rules are necessary to promote competition because ILECs often have pre-existing access to buildings due to their status as the incumbent.

BOMA, in conjunction with Emissary and Tanglewood argued that the statutory provisions on their face were an unconstitutional taking. On June 3, 2002, the Travis County District Court issued an order upholding the constitutionality of PURA §§ 54.259-54.261.[175] That decision has been appealed to the Third District Court of Appeals.[176]

Currently, the case is pending at SOAH. On September 18, 2002, the Commission issued an interim order and order remanding compensation issues. On October 10, 2002, the SOAH Administrative Law Judges (ALJs) denied Tanglewood's motion to abate the proceeding.

8. Pay Telephone Service in Texas

a. Registration

To promote further competition in the payphone industry, the FCC in 1996 deregulated coin rates for all local calls made from payphones. That same year, the Commission began to register and certify pay telephone service (PTS) providers as required under the PURA. In that year, the Commission registered 539 providers, including many already doing business in the State.

To date, the Commission has registered 1,616 PTS providers, with the number of new registrants decreasing each year. (See Table 16 for the number of payphone providers registered each year in Texas since 1996.) As of November 7, 2002, there were 271 registered pay phone providers. This includes new and re-registered providers and does not include those whose re-registration is incomplete. Of the 271 registered providers, 22 have headquarters out-of-state; 10 provide service to inmate facilities; 127 are corporations; 6 are government agencies, including cities and counties are tabulated; 16 are limited liability companies; 24 are limited partnerships; 3 are non-profits; and 96 are sole proprietors.

Table 16 — Payphone Providers Registered in Texas

YEAR	NUMBER OF PROVIDERS
1996	539
1997	315
1998	251
1999	192
2000	142
2001	105
2002	271

SOURCE: PUC filings

[175] *Texas Building Owners and Managers Ass'n , Inc., et al v. Public Util. Comm., et al.,* No. GN2-0014, Travis County District Court.

[176] *Texas Building Owners and Managers Ass'n v. Public Util. Comm.*, Cause No. 03-02-00611, (Tx. App. – Austin 2003) (pending).

Approximately half the registered providers have five payphones or fewer. To better monitor and understand this segment of the telecommunications market, in 2001 the Commission amended P.U.C. SUBST. R. 26.102 to require all PTS providers to re-register by July 31 of each year to retain their status.

In 2001, SWBT informed the Commission that it was reducing the number of payphones in public buildings and in other locations, which is allowed under deregulation. However, SWBT is not the only telephone company removing payphones; others, such as Verizon, are also removing payphones, which they have deemed unprofitable. This decision, based on economics, has resulted in the loss of payphones that could be designated as public interest payphones. Those individuals most affected by the removal of these payphones are people without residential telephone service or a cell phone.

Private property owners, cities, and counties have begun to fill the void. In the past year, payphone registrations have been approved for Texas cities and counties—such as the cities of Bonham, Brownwood, and Weatherford, and the Department of Airports for the City of Midland—needing to offer payphone service at public facilities. Hill County recently registered in order to place payphones in the county courthouse.

b. Providers Sue SWBT

A case in which nineteen Texas payphone providers are alleging SBC used its monopoly power to thwart competition is scheduled to go to trial in December of 2003.[177] At issue is whether SBC coerced payphone location owners into restrictive long-term contracts with severe termination penalties in an anti-competitive manner, in order to lock down the payphone market. In September 2002, the United States Court of Appeals for the Tenth Circuit in Denver upheld a decision that awarded nine payphone companies in Oklahoma approximately $29 million. In the Texas case, the nineteen payphone operators are now seeking a summary judgment based on the precedent of the Oklahoma ruling. The amount at stake could exceed $300 million, as the Texas case involves 16,000 payphones, ten times as many payphones as were at issue in the Oklahoma case.

[177] Vikas Bajaj, *Texas pay-phone firms applaud ruling on SBC*, DALLAS MORNING NEWS, September 26, 2002, p. 5D.

9. Area Code Relief

As shown in Figures 33 and 34, Texas utilized 24 area codes across the State as of 2002. Area code relief is one means of conserving telephone numbers. In the past two years, Texas has enacted an overlay of the 903 area code and a geographic split of the 915 region as numbering relief measures.

Figure 33 — Texas Area Codes - 2002

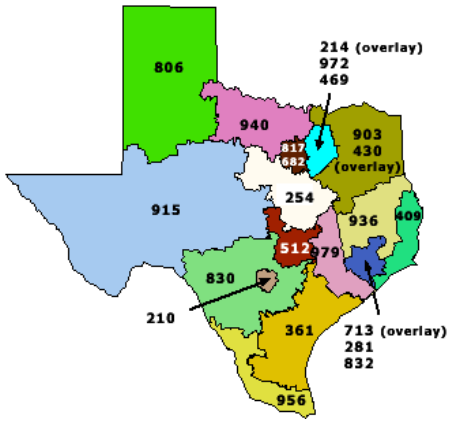
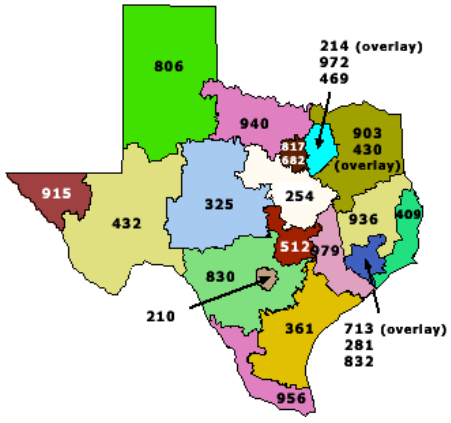


Figure 34 — Texas Area Code - 2003



a. 903 — Northeast Texas

On December 17, 2001, the Commission approved an all-services overlay for the 903 area code, which encompasses the Cities of Sherman, Texarkana, Longview, and Tyler.[178] An all-services overlay requires that customers dial ten, instead of seven, digits

[178] *Numbering Plan Area Code Relief Planning for the 903 Area Code*, Project No. 22749, Order Adopting Numbering Plan Area Relief (Dec. 17, 2001).

for all local calls (the area code + seven digits). Beginning February 15, 2003, ten-digit dialing will be required for local calls in the 903 region.

b. 915 — West Texas

Rather than utilizing an overlay, a geographic split was selected for the 915 region, which includes the cities of El Paso, Midland, Odessa, Abilene, San Angelo, and Llano.[179] In a geographic split, one region retains the 915 area code, while new area codes are assigned to the other regions. The geographic split adopted for the 915 area divides the entire region into almost proportional thirds. It is estimated that the lifetime for the new area codes will be 20 years. The new area codes will become effective on October 5, 2003.

c. Texas's Area Code Outlook for the Future

A recent FCC decision enables the Commission to explore the use of service-specific overlays, which would allow for a specific service—such as ATM machines, pagers, cell phones, or other wireless services—to be designated a specific area code.[180] The Commission's number conservation approach will now include service-specific overlay options as well as overlays and area code splits.

10. Cross Border Toll-Free Calling

In December 1999, Elizabeth G. Flores, Mayor of the City of Laredo, appealed to then-PUC Chairman Pat Wood to exert jurisdictional authority over SWBT's southbound traffic into Mexico for the purposes of building a "border-free telecommunications zone."[181] The Commission initiated a proceeding to investigate the possibilities for a flat-rate expanded area calling plan between Laredo and Nuevo Laredo.[182]

The Cities of Laredo and Nuevo Laredo jointly filed a "collaborative agreement" with the FCC requesting that the cities be considered a local calling area.[183] In its Declaratory Ruling issued on February 4, 2002, the FCC stated that while it fully

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[179] *Numbering Plan Area Code Relief Planning for the 915 Area Code*, Project No. 24546, Order (Feb. 28, 2002).

[180] *Numbering Resource Optimization*, Third Report and Order and Second Order on Reconsideration in CC Docket No. 96-98 and CC Docket No. 99-200, CC Docket Nos. 99-200, 96-98, 95-116 (Rel. Dec. 28, 2001).

[181] Discussion and possible action regarding operating budget, appropriations request, agency business plan, project assignments, correspondence, staff reports, agency administrative issues, fiscal matters and personnel policy, Letter from Elizabeth G. Flores, Mayor – City of Laredo, to PUC Chairman Pat Wood (Dec. 8, 1999).

[182] *Request for the City of Laredo for a Pilot Project for Extended Area Service between Laredo and Nuevo Laredo*, Project No. 21951 (pending).

[183] *Collaborative Agreement Between the Municipality of Nuevo Laredo, Tamaulipas (Mexico) and the City of Laredo, Texas* (USA), DA 01-554 (filed Nov. 30, 2000).

supported the initiative, its jurisdictional authority was limited in scope.[184] The FCC encouraged the relevant carriers to petition for a negotiation of alternative traffic settlements between the U.S. and Mexico, and to involve COFETEL (Mexico's equivalent to the FCC) in the negotiations.[185] To date, the carriers have not filed such a request with the FCC.

COFETEL also ruled on the Cities' joint petition explaining that, at this time, such an arrangement cannot be done across the border because it would be counter to Mexico's current telecommunications laws.[186]

As a follow up to telecommunications trade barriers between the U.S. and Mexico, when the U.S. Trade Representative solicited comments on such, the Commission took the opportunity to comment. On May 29, 2002, the Commission filed comments with the U.S. Trade Representatives outlining the telecommunications border concerns that Texas has experienced.[187]

11. ADADs in Texas

An Automatic Dial Announcing Device (ADAD) is the mechanism that automatically dials a telephone number and then plays a recorded message or leaves a recorded message on voicemail. As of October 25, 2002, there were 167 ADAD permit holders in Texas.

The Commission began issuing ADAD permits for a fee in June 1986. During the 16 years, the Commission has collected these fees, an average of 30 ADAD permits have been issued every 12 months. The ADAD permit fee of $500, and renewal fee of $100, remained unchanged until July 2002, when the Commission amended P.U.C. SUBST. R. 26.125 to reduce the permit fee to $50 and renewal fee to $15. The Commission reduced the fee in an attempt to increase compliance with its rules, and provide a clearer picture of the market segment that uses ADADs to dial telephone subscribers in Texas.

12. 211 Implementation in Texas

In July 2000, the FCC assigned the 211 dialing code to social service information and referral providers in order to allow centralized referrals to social service resources, such as housing assistance, maintaining utility service, obtaining food aid, finding counseling, hospice services and services for the aging, substance abuse programs, or

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[184] *Proposal by City of Laredo, Texas, and Nuevo Laredo, Mexico, To Create a Cross-Border Local Calling Area*, Declaratory Ruling at 1, FCC 02-14 (Feb. 4, 2002).

[185] *Id.,* Declaratory Ruling at 6.

[186] May 20, 2002 Letter from COFETEL President Jorge Arredondo Martinez to C.P. Jose Manuel Suarez Lopez, City Manager of Nuevo Laredo, Tamaulipas, Mexico.

[187] Comments of the PUC filed with the U.S. Trade Representatives on Docket No. WTO/DS-204 (May 29, 2002).

dealing with physical or sexual abuse.[188] The FCC found that there was a need for an easy to remember, easy to use abbreviated dialing code that enables callers to obtain free information and referrals to community service organizations. [189]

In April 2001, the Commission amended its rules to allow 211 implementation.[190] In this rulemaking, the Texas Information and Referral Network (TIRN), a public private partnership administered by the Texas Health and Human Services Commission, was designated as the administrative body for 211 development, coordination, and implementation. During the last session, the Legislature provided funding for the establishment of a statewide 211 network.

Texas is at the forefront of implementing 211 services as a result of the Legislature's efforts in the last session. Texas currently provides 211 services to more of its citizens than any other state. As of December 2002, fourteen of the 211 sites are currently operating, covering 83% of the Texas population, serving 139 of 254 counties, and accounting for about 50% of Texas geography. In fiscal year 2004-2005, 11 additional sites are scheduled to become operational, contingent upon funding from the legislature.

These sites allow Texans to obtain access to a one-stop, comprehensive source of social service resources in Texas, including federal, state, and local government agencies, community-based organizations, and private non-profits. Dan Williams, the National 211 Director, has commented that "Texas's significant efforts in establishing strong public private partnerships, utilization of a common statewide community based approach and deployment of advanced technology systems has positioned 211 Texas to consistently be viewed as a national leader."[191]

13. 911 Initiatives

New competitors' entrance into the local telecommunications market and the FCC mandate to implement and deploy wireless Enhanced 911 (E911) services have required upgrades to the existing 911 wireline infrastructure and 911 databases. These upgrades have caused many technical and operational 911 issues. The Commission has been focused on addressing these issues to maintain the integrity and reliability of Texas's emergency 911 systems.

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[188] Federal Communications Commission, *FCC Fact Sheet on "Abbreviated Dialing Codes-N11."* (Abbreviated dialing codes enable callers to connect to a location in the phone network that otherwise would be accessible only via a seven or ten-digit telephone number. The network must be pre-programmed to translate the three-digit code into the appropriate seven or ten-digit telephone number and route the call accordingly.) Available at: http://ftp.fcc.gov/Bureaus/Common_Carrier/News_Releases/2000/nrc0036a.html.

[189] *Id.*

[190] PUC SUBST. R. 26.127 (Abbreviated Dialing Codes).

[191] PUC, Public Hearing, Testimony by Dan Williams, National 2-1-1 Director, (Sept. 5, 2002)

In addition to the new competitors, the emergence of an alternative statewide 911 database provider has raised issues related to the disclosure of proprietary customer information, unbundling of 911 network and database services, establishing an uniform cost recovery mechanism, and purchasing of network and database services at reasonable prices. To address these issues the Commission adopted P.U.C. SUBST. R. 26.433 and 26.435. P.U.C. SUBST. R. 26.433 (Project No. 19203) established specific reporting and notification requirements and mandated standards related to interoperability, service quality, and database integrity. This rule required dominant certified telecommunications utilities (CTUs) to unbundled 911 network and database services. P.U.C. SUBST. R. 26.435 (Project No. 24305) developed uniform cost recovery mechanisms for 911 dedicated transport for incumbents as well as all CTUs.

In 1996, the FCC mandated the implementation and deployment of wireless E911 service in two phases. Under Phase I, the 911 service routes the emergency wireless caller to the appropriate 911 center and delivers the call back number of the wireless phone for responding to the emergency call. Under Phase II, the 911 service not only routes the caller and delivers the call back number to the appropriate 911 center but also provides the location information of the wireless telephone for responding to the emergency call. The Commission on State Emergency Communications (CSEC) is responsible for implementing Phase I and Phase II service. The Commission worked closely with CSEC on the deployment of Phase I service. CSEC has implemented Wireless Phase I capability at all of the 354 911 centers under its jurisdiction. CSEC is just beginning to implement Wireless Phase II. About one-third of the 911 centers within CSEC jurisdiction have begun to implement the capability to display caller location information graphically. Implementation of the Wireless Phase II service by the wireless service providers is expected to occur within six months of the 911 centers being ready to display the location information. The upgrades to the wireline infrastructure database in order to implement and deploy wireless E911 have prompted dominant CTUs to revise existing 911 tariffs and in some cases file brand new 911 tariffs. The Commission is in the process of reviewing and approving these filings.

As a result of the Commission's efforts over the last few years, Texas citizens will be protected through both wireline and wireless 911 networks that work efficiently and effectively in a competitive market. However, more work needs to be done. The recent events that occurred on September 11, 2001 reinforce the requirement for effective and reliable 911 service and for awareness of threats to the security of 911 systems. CSEC has identified potential single points of failure in the wireless and wireline telephone switches, 911 circuits, 911 routing switches, and circuits to the 911 centers responsible for delivering 911 calls in Texas. The Commission will work with CSEC to identify and address the problems associated with the single points of failure in the telecom network, in addition to completing the approval process of outstanding E911 tariffs and working to maintain the integrity and reliability of the 911 system in Texas.

Chapter V. Prospective Federal Initiatives Affecting Texas

Actions at the federal level will likely have a significant effect on Texas. First, several bills that could affect broadband services are pending in Congress. Second, the Federal Communications Commission (FCC) is considering a number of different important issues that may directly affect broadband and local competition in the telecommunications market.

A. U.S. Legislative Activity

1. Tauzin-Dingell Bill

Several legislative initiatives aimed at spurring broadband deployment in rural areas have been introduced at the federal level.[192] Most prominent among these is a bill sponsored by Representatives Billy Tauzin (R-LA) and John Dingell (D-MI) called "The Internet Freedom and Broadband Deployment Act of 2001." The legislation would make far-reaching changes to the telecommunications regulatory structure by relieving Regional Bell Operating Companies (RBOCs) (*e.g.*, Southwestern Bell Telephone Company) of their obligations under the Federal Telecommunications Act of 1996 (FTA) to unbundle their data network to competitors. The bill would also eliminate the requirement to offer any high-speed data service for resale at wholesale rates. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

2. Breaux-Nichols Bill

A similar bill in the Senate Bill (S.B.) 2430 would also have far-reaching effects on the broadband industry. Sponsored by Senators John Breaux (D-LA) and Don Nickles (R-OK) in May 2002, this legislation would impose the same regulations on all broadband platforms, whether digital subscriber line (DSL), cable modem or wireless. In particular, Section 271 of the FTA prohibits a Bell Operating Company (BOC) from entering into the long-distance market without first opening up its markets according to the 14-point checklist, and Section 251 establishes unbundling requirements for the incumbent local exchange carrier (ILEC). Under the proposed legislation, the four RBOC companies would no longer be required to share their DSL infrastructure with competitive companies.

Proponents, like Southwestern Bell Corporation (SBC), of imposing similar regulations on all broadband platforms have argued that:

> Regulators have taken a hands-off approach to cable modem services offered by cable giants like AT&T Broadband, AOL, Time

[192] A detailed analysis of the each bill discussed in this section is available Appendix U.

> Warner, Comcast and others. Cable operators have been free to design their broadband services and to conduct their broadband business as any other company would in a competitive market, which has contributed to their dominant share of the market.[193]

Those opposed have asserted a counterargument to the ILECs' claims that they should be treated the same as cable. In particular, AT&T, in its comments to the FCC in *In the Matter of Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities,* has asserted that the RBOCs' claims that they bear more regulatory costs than cable ignores the regulatory burdens on cable.[194] AT&T argued that

> Cable companies must comply with local franchising requirements and pay billions of dollars in franchise fees. They must build and donate 'institutional networks' to franchising authorities. They are subject to 'must-carry,' Public and Educational and Government (PEG) access channels, and other regulations that require them to share their networks – and, unlike the Bells' network sharing obligations, these cable sharing obligations are uncompensated.[195]

The broadest changes to the telecommunications industry would come through a bill recommending "structural separation" of the current telephone network, sponsored by Senator Ernest Hollings (D-SC), Chairman of the Senate Commerce Committee, in August 2001. The "Telecommunications Fair Competition Enforcement Act of 2001," S.B. 1364, was introduced in response to the Breaux-Nickles bill. The bill requires incumbent carriers to structurally separate their wholesale operations from their retail operations for violating the competitive provisions (Sections 251, 252, 271 and 272) of the FTA, and would amount to a sea change in the way telephone networks are owned and operated. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

3. Small Business and Farm Economic Recovery Act

In early 2002, Senators Max Baucus (D-MO) and Charles Grassley (R-IA) sponsored the "Small Business & Farm Economic Recovery Act" to address broadband provisioning in rural areas. The proposed bill, S.B. 88, would establish a tax credit to encourage the use of broadband technology. It provides a 10% investment tax credit for current generation broadband services to subscribers in rural and underserved areas. It also provides a 20% credit for next generation broadband services to subscribers in rural areas or underserved areas, and to residential subscribers. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

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[193] *SBC, Public Affairs, Broadband Policy Statement, "Opening our Markets"*, available online at: http://www.sbc.com/public_affairs/broadband_policy/0,5931,218,00.html.

[194] *See In the Matter of Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket No. 02-33. Comments of AT&T Corp., May 3, 2002 at 73.

[195] *Id.*

4. Rural Issues Advisory Board Act

In October 2002, Representative Lee Terry (R-NE) introduced H.R. 5602, which would create a Rural Issues Advisory Board within the FCC. The purpose of the Board would be to assist the FCC in developing polices and procedures for rural customers and carriers, and to ensure that the FCC takes into consideration the size and the resources of affected parties in rural America. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

B. FCC Activities

The FTA continues to place great responsibility on the FCC and State commissions to implement the Act. When the FTA was crafted, Congress was concerned with creating requirements that facilitated competition in the local telecommunications marketplace while providing RBOCs with a strong incentive to comply with these requirements quickly. The provisions dealing with local competition included preemption of some state restrictions that prohibit other entities from providing local telephone service; interconnection and unbundling requirements; negotiation of interconnection agreements; a competitive checklist for RBOC interLATA entry; universal service reform; and infrastructure sharing. In addition to requiring non-discriminatory access and interconnection to the RBOCs' local facilities, the FTA also sought to accelerate the deployment of advanced telecommunications and information services to all Americans by opening all telecommunications markets to competition. Deemed one of the most comprehensive overhauls of the telecommunications laws in more than 60 years, the sweeping regulatory changes embodied in the new law required extensive revisions to the FCC's rules and regulations. This process of rule revision is ongoing and entering a critical new phase.

Over the past two years, the FCC has launched a number of key local competition and broadband proceedings focused on the clarification of regulatory treatment of broadband infrastructure and services. Key proceedings at the federal level include the following: (1) Triennial Review of unbundled network elements (UNEs); (2) broadband over wireline facilities; (3) investigation of Performance Measures for UNEs; (4) line sharing; (5) consideration of dominant/non-dominant status; and (6) high-speed access to the internet over cable modems. In light of the knowledge gained from arbitrations, rulemakings, and contested case proceedings in Texas, the Commission submitted comments to the FCC in some of these proceedings. A summary of those proceedings and the Commission's comments are outlined below.[196]

[196] For additional information regarding the Commission's comments in the specific proceedings, please see Appendix V.

1. Local Competition Proceedings

a. UNE Triennial Review

On December 20, 2001, the FCC released an Notice of Proposed Rulemaking (NPRM) relating to its first triennial review of its policies on UNEs.[197] This review provides the FCC with an opportunity to examine the framework under which ILECs must make UNEs available to competing carriers. Among other things, the FCC examined the ILECs' wholesale obligations under Section 251 of the FTA to make their facilities available as UNEs to competitive local exchange carriers (CLECs) for the provision of broadband services. The NPRM also sought comment on whether the FCC should apply unbundling requirements based on type of service, facility, geography, or other factors (*i.e.*, "more granular statutory analysis"). Additionally, the FCC requested comment on whether to retain, modify, or eliminate its existing definitions and requirements for UNEs, and on the role of State commissions regarding UNEs.

In its comments, the Commission cautioned the FCC against focusing primarily on facilities-based competition at the expense of alternative entry strategies for competitive carriers, such as the UNE platform (UNE-P). The Commission pointed out that UNE-P has proven to be an important entry strategy for many competitors in the local market for telecommunications services, and that the competition that does exist in Texas relies heavily on the use of UNEs as a means of offering customers the benefits of competition in markets for telecommunications and broadband services.

Further, the Commission urged the FCC to rely on the knowledge base within state commissions regarding the characteristics of markets and ILECs within their states, and the entry strategies that have worked best. The Commission urged the FCC to allow states to retain the authority to impose additional unbundling obligations on ILECs, provided they meet the requirements of § 251 of the FTA, the policy framework of the UNE Remand Order,[198] and any subsequent FCC policy. Should the FCC decline to let state commissions modify the national UNE list, the Commission recommended that all UNEs now on the list should remain in place. Further, should the FCC pursue a national standard, the Commission strongly recommended that the FCC give consideration to the

[197] *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, and 98-147, Notice of Proposed Rulemaking, FCC No: 01-361. (rel. December 20, 2001)

[198] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238. (rel. Nov. 5, 1999) (*UNE Remand Order*).

Performance Measures (PMs) already in place in Texas,[199] and suggested convening a Federal-State Joint Conference on UNEs to inform and coordinate this review.

b. Wireline Proceeding

On February 15, 2002, the FCC released an NPRM regarding the appropriate statutory classification and regulatory framework for broadband access to the internet provided over domestic wireline facilities.[200] In this NPRM, the FCC tentatively concluded that wireline broadband internet access services, whether provided over a third-party's facilities or self-provisioned facilities, are information services, with a telecommunications component, rather than telecommunications services.[201] This proceeding investigated how Title I regulation applies to broadband services provided as information services.

While the Commission expressed support for the FCC's policy goals of ensuring the ubiquitous availability of broadband service and a regulatory environment that encourages investment, deployment, competition, and innovation within the broadband market, the Commission cautioned against the classification of wireline broadband internet access service as an information service. The Commission explained that such a classification could remove wireline broadband internet access services from numerous competitive, customer protection, and quality of service requirements imposed at the state and federal level on common carriers that provide telecommunications services, thereby risking both the options available to the customer and the quality of those options.

Further, the Commission urged the FCC to avoid adopting a rule that diminishes the State's authority to encourage advanced services deployment or to implement its own legislatively enacted policies, and that affects the State's traditional role in overseeing customer protection and service quality standards.

On the related topic of state enforcement authority to prevent anti-competitive behavior within the broadband market, the Commission also expressed concern that modification or elimination of existing access obligations on providers of self-provisioned wireline broadband internet access services could have negative effects. This concern was based on extensive evidence gathered by state commissions through hearings.

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[199] *See Notice of Proposed Rulemaking In the Matter of Performance Measurements and Standards for Unbundled Network Elements and Interconnection*, CC Docket No. 01-318, Comments of the Public Utility Commission of Texas (Jan. 22, 2002) (UNE Performance Measure NPRM).

[200] *In the Matter of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers; Computer III Further Remand Proceedings (et al)*, CC Docket No. 02-33, and Nos. 95-20, 98-10, Notice of Proposed Rulemaking, FCC 02-42. (rel. February 15, 2002).

[201] The definition of telecommunications services means that under federal and state law, those offerings are subject to traditional common carrier obligations–that is, they must be offered to all customers, including ISPs, on nondiscriminatory rates, terms, and conditions.

c. Performance Measures Review

On November 19, 2001, the FCC issued an NPRM regarding Performance Measurements and Standards for UNEs and Interconnection.[202] In this NPRM, the FCC requested comment on whether it should adopt a limited number of measurements and standards for evaluating ILEC performance with respect to pre-ordering, ordering, provisioning, repair, and maintenance functions. The NPRM also requested comment on the use and scope of any national performance measurement standards, and the appropriate review or sunset mechanism should the FCC adopt national standards. The FCC was also interested in learning how to balance CLECs' concerns about poor provisioning of UNEs, interconnection trunks, and collocation with the ILECs' concern about the number and cost of state and federal measurements and standards.

The Commission filed comments in the response to the FCC's NPRM, emphasizing the important role states play in creating, implementing, and monitoring the performance of ILECs, and asserting that states should be involved with federal efforts to reform and minimize performance measures and standards. In addition, the Commission emphasized that action by the FCC that establishes consistent, minimum requirements or supplements the state plans will further facilitate competition, as long as the FCC ensures that any requirements it ultimately adopts are (1) at a minimum, as stringent as the strongest state plans, and (2) do not preempt the states from adopting additional measures to the extent they are necessary.

2. Broadband Proceedings

a. Line Sharing

As discussed above, the FCC's Triennial Review of UNEs may have implications on the future of competitive entry into the broadband market because most CLECs provide broadband service through line sharing. As mentioned in Chapter IV, the DC Circuit's decision in *United States Telecom Association v. Federal Communications Commission*,[203] remanded the *Local Competition Order* and *Line Sharing Order* to the FCC after concluding that the FCC had committed errors in its reasoning regarding the creation of a uniform national list of UNEs and the unbundling of the high frequency spectrum of the copper loop, respectively.[204] With respect to the *Line Sharing Order*, the

[202] *In the Matter of Performance Measurements and Standards for Unbundled Network Elements and Interconnection, Performance Measurements and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance, Deployment of Wireline Services Offering Advanced Telecommunications Capability, and Petition of Association of Local Telecommunications Services for Declaratory Ruling*, CC Docket No. 01-318, No. 98-56, No. 98-147, No. 98-147, 96-98, 98-141, FCC No. 01-331. (Rel. November 19, 2001).

[203] 290 F.3d 415 (D.C. Cir. 2002) (order staying issuance of mandate till 7 days after disposition of any timely motion for rehearing entered on May 24, 2002; petition for rehearing filed on July 8, 2002) (*USTA*).

[204] *Id.* at 430.

court concluded that the FCC had failed to consider the relevance of competition in broadband services from other sources (*e.g*., cable and, to a lesser extent, satellite).[205]

b. ILEC Broadband (Dominant/Non-Dominant)

This FCC proceeding would consider whether to develop a comprehensive and coherent means of measuring market power in the provision of services. In general, this proceeding would establish a new framework that could be used to deregulate on a carrier-specific or service-specific basis depending on the level of competition and market power. This framework may then be used to make determinations relating to the deregulation of advanced services and the appropriate point for sunsetting § 272 long-distance requirements.

c. Cable Modem Proceeding

On March 14, 2002, the FCC released an NPRM and Declaratory Ruling regarding cable modem services.[206] The FCC concluded in its Declaratory Ruling that cable modem service is properly classified as an interstate information service and is subject to FCC jurisdiction, and that cable modem service is not a "cable service" as defined by the Communications Act. Further, the FCC concluded that cable modem service does not contain a separate "telecommunications service" offering and is not subject to common carrier regulation. Further, in the NPRM the FCC is seeking comment on whether there are legal and policy reasons as to why it should reach different conclusions with respect to wireline broadband and cable modem service; whether there are constitutional limitations on the FCC's authority to regulate cable modem services; whether it is appropriate to require multiple ISP access; and what is the role of state and local franchising authorities in regulating cable. While the Commission did not submit comments, the Commission is monitoring the development of this proceeding at the FCC.

3. Other FCC Activities

In addition to the core broadband proceedings, the Commission has been actively involved with FCC proceedings and activities related to accounting reform, customer proprietary network information, competitive access to multi-tenant environments, equal access and nondiscriminatory safeguards, numbering resource optimization, and sunset of RBOC's separate affiliate and related requirements.[207]

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[205] *Id*. at 428-29.

[206] *In the Matter of Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities; Internet over Cable Declaratory Order Proceeding; Appropriate Regulatory Treatment for Broadband Access to the Internet over Cable Facilities*, GN Docket No. 00-185; CS Docket No. 02-52, Notice of Propose Rulemaking and Declaratory Ruling, FCC 02-77 (rel. March 14, 2002) .

[207] For additional information regarding the Commission's comments in these proceedings, please see Appendix V.

Chapter VI. Homeland Security Measures

Since September 11, 2001, homeland security has been a priority in the United States and the State of Texas. Homeland security efforts are primarily divided into three areas: federal, state, and the agency level.

At the highest level of direction, the federal government develops the broad national policies regarding homeland security. On the State level, the Governor's Office has established several new committees to guide the State in developing partnerships among local, state and federal agencies, volunteer organizations and the private sector. At the agency level, the Commission's Emergency Management Response Team (EMRT) continues to participate in homeland security policy planning, while monitoring procedures in use by the telecommunications utilities.

A. Federal Homeland Security

On October 8, 2001, President George W. Bush's Executive Order established the Office of Homeland Security and the Homeland Security Council to develop and coordinate a comprehensive national strategy to strengthen protections against terrorists' threats or attacks in the United States. The President appointed Tom Ridge, former Governor of Pennsylvania, to head The Office of Homeland Security. The focus of the Office of Homeland Security is to coordinate all federal government terrorist prevention and protection activities within the U.S., and to interact with state and local governments on issues related to detection, preparedness, prevention, protection, response and recovery, and incident management. On November 25, 2002, President Bush signed the "Homeland Security Act of 2002" into law. The Act created the Department of Homeland Security—the Federal department whose primary mission will be to help prevent, protect against, and respond to acts of terrorism.[208]

Securing the United States' communications infrastructure and enhancing emergency response through communications are integral component of homeland security. On the federal level, the Federal Communications Commission (FCC) is responsible for securing the communications infrastructure. In response to the events of September 11, 2001, the FCC has adopted these two principal objectives: (1) to secure the nation's communications infrastructure, and (2) to enhance emergency response through communications.[209] In order to accomplish these objectives the FCC created the Homeland Security Policy Council (HSPC). The HSPC is comprised of senior staff from each of the FCC's bureaus.

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[208] For more information, see White House, Department of Homeland Security, http://www.whitehouse.gov/homeland/.

[209] Michael K. Powell, Chairman, Federal Communications Commission, Press Conference, October 23, 2001.

The HSPC's missions are as follows:

- to assist the FCC in evaluating and strengthening measures for protecting U.S. communications services;
- to assist the FCC in ensuring rapid restoration of communications services and facilities that have been disrupted as the result of threats to, or actions against, United States's homeland security; and
- to ensure that public safety, health and other emergency and defense personnel have effective communications available to them to assist the public as needed.

B. State Homeland Security

Texas has been involved with homeland security, defense, and disaster recovery since as early as 1975 when the Division for Emergency Management was created to reduce the vulnerability of citizens and communities to damage, injury, loss of property, and loss of life by providing a system for the mitigation of, preparedness for, response to, and recovery from natural or manmade disasters.[210]

In response to the acts of terrorism of September 11, 2001, the Governor's Office created the Governor's Task Force on Homeland Security, the Homeland Security State Agency Operations Group (HSSAOG), and the Governor's Report on Strategies for Texas First Responder Preparedness.

The State Infrastructure Protection Advisory Committee (SIPAC) was created prior to the attack of September 11, 2001 to recommend ways to safeguard key components of the telecommunications infrastructure, including computer-linked water, utility, communications, transportation and financial networks.[211]

The Commission staff attends, participates, and provides resources on various levels for all of the committees and groups listed.

[210] The Department of Public Service Website is located at: www.txdps.state.tx.us - Introduction

[211] State Infrastructure Protection Advisory Committee, The Texas Infrastructure Protection Center: "A State Model for Information Assurance and Information Sharing to Protect Critical Infrastructures" (SIPAC Report), at 1. (March 25, 2002).

1. Governor's Task Force on Homeland Security

The Governor charged the Task Force on Homeland Security with the following initiatives:

- assuring Texans of state and local preparedness to respond to threats;
- facilitating coordination among federal, state and local agencies;
- improving Texas's ability to detect and to deter and coordinate response to any terrorist events;
- assessing the ability of state and local government agencies to respond to threats and to effectively provide victims assistance; and
- coordinating Texas activities with those of the federal government, the federal Office of Homeland Security, Texas's neighboring states, and Mexico.[212]

On October 1, 2001, Governor Rick Perry appointed PUC Chairman Rebecca Klein to the Governor's Task Force on Homeland Security.[213]

As requested, the Commission staff provides technical information, utility inventories, utility preparedness reports, utility security conditions, and utility disaster status reports.

2. State Infrastructure Protection Advisory Committee (SIPAC)

SIPAC recommended the creation of the Texas Infrastructure Protection Center (TIPC), to be a State model for information assurance and information sharing to protect critical infrastructures. On March 25, 2002, SIPAC published its report stating that three subcommittees would be established: Information Assurance, Information Sharing, and Legal and Legislative issues.[214]

The Information Assurance Subcommittee was charged with the development of State information operations that will protect and defend information and information systems by ensuring their availability, integrity, authentication, confidentiality, and non-repudiation.

The Information Sharing Subcommittee was charged with the development of a State information sharing network that will coordinate the efforts of interested parties to share important information about vulnerabilities, threats, intrusions, and anomalies to one another.

The Legal and Legislative Subcommittee was charged with the development of legal solutions to the constraints that law and the market currently place on information assurance and information sharing efforts.

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[212] *Governor's Task Force on Homeland Security, January Report to the Governor* (January 31, 2002) at 1, http://www.governor.state.tx.us/homelandsecurity/TaskForceReport0102.htm

[213] Governor Perry Creates Task Force on Homeland Security, Panel to Coordinate Efforts to Detect, Defer Threats, PRESS RELEASE: October 1, 2001.

[214] SIPAC REPORT, *supra note 211,* at 6.

The SIPAC Report made the following two primary and sixteen secondary recommendations for the State of Texas:[215]

The Governor's Office should create a Critical Infrastructure Protection Board (CIPB), modeled after the President's CIPB, to advise the Governor on public policy matters affecting homeland security and critical infrastructure protection and assist with the implementation of a Texas infrastructure protection center (TIPC).

The TIPC should be created to design and implement aggressive and sophisticated information assurance and information sharing programs. The TIPC should be the central point of contact in Texas for federal, state, and local government private sector business; and individual transmission of information to protect physical and cyber assets that are critical to the health, safety, and welfare of Texas residents.

The 16 secondary recommendations were more specific recommendations dealing with information sharing and security. [216] Of the 16 secondary recommendations that the Commission's Information Technology (IT) Manager reviewed, three of the recommendations were found to apply to the Commission's network. It was determined that the Commission had already accomplished two of the recommendations (#2 and #15) and the third recommendation (#10) is an ongoing process, requiring the Commission to file periodic reports with the Texas Department of Information Resources (DIR). Those recommendations that apply to the Commission's information network are as follows:

- Recommendation #2 - Have a qualified systems security point of contact with the ultimate responsibility for monitoring the security status of their networks and servers.
- Recommendation #10 - Agencies and their contractors report significant server penetrations or intrusion detection alerts to the TIPC.
- Recommendation #15 - Adopt procedures for the proper disposal of personal computers and servers to ensure sensitive data are erased.

The Commission's computer network is in compliance with both the security requirements of DIR and the applicable TIPC recommendations. The Commission maintains and updates its network security policies and procedures when updates are available from its software vendors.

In December 2000, Sprint Enterprise Network Services, under contract with DIR, performed a cyber penetration test on the Commission's information network. The results indicated that the Commission has adequate perimeter security (firewalls) and access controls in place. IT network system administrators proactively manage information systems preserving the integrity, confidentiality and availability of data.

[215] SIPAC REPORT, *supra note 211,*at 6 and 7.

[216] SIPAC REPORT, *supra note 211,* at 7 and 8.

3. Homeland Security State Agency Operations Group

The Homeland Security State Agency Operations Group (HSSAOG) meets with representatives from over a dozen immediate response agencies, including the Commission. The group exists to plan, implement, and facilitate homeland security initiatives, as well as to coordinate and avoid duplication of security measures. HSSAOG requested information from the Commission in its homeland security survey to help determine the Commission's role in homeland security. The results of the survey indicated that the Commission was exceptional in gathering information and facilitating activities of regulated utilities.

In an effort to better serve local jurisdictions, HSSAOG requested utility information be collected by Council of Government (COG) regions. The collection of information by COGs is proving to be helpful in security and disaster planning. The Texas First Responder Preparedness Program requires the development of regionally based, interlocking, and mutually supporting terrorism preparedness programs.

4. Texas First Responder Preparedness Program

In August of 2002, the Governor's Office presented a State agency strategic framework for addressing terrorist attacks. Strategies for the Texas First Responder Preparedness Program (TFRPP) were released to help develop policies, plans and procedures to maximize the ability of local and regional organizations to work together effectively in response to an act of terrorism.[217] The primary objectives of the TFRPP are as follows:[218]

- Enhance Texans' capability and capacity to respond to acts of terrorism.
- Enhance local emergency response capabilities by encouraging the adoption of interlocal (mutual aid) agreements for emergency response.
- Improve the capability of local governments to prepare for and respond to terrorist and all other hazardous incidents by enhancing emergency planning, procuring emergency response equipment, providing suitable training for emergency responders, and conducting exercises to assess plans and procedures, training, and equipment.
- Support the collaborative efforts of local governments to develop regional, interlocking, and mutually supporting plans and responses to terrorist or other mass casualty events.
- Improve the capability of State agencies to assist local governments in responding to all hazards, including terrorist incidents.
- Identify resources that would provide local responders the ability to protect themselves and save lives in a chemical, biological, or radiological

[217] Letter from the Office of the Governor from the "STRATEGIES FOR TEXAS FIRST RESPONDER PREPAREDNESS" REPORT, August 9, 2002.

[218] *Id* at 3 and 4.

environment until additional resources arrive to provide increased response capabilities.

- Help local governments develop an effective frame work coordinated emergency response in the form of comprehensive local and regional emergency management plans.
- Facilitate coordinated efforts by multiple local, state, and federal response organizations by encouraging the adoption of the Incident Command System with unified command structure as the standard local and state incident management system in Texas.
- Promote training and the procurement of equipment that has "dual use" (*i.e.,* enhances terrorist incident response capability and improves the local jurisdiction's ability to respond to other hazards).

The Commission will take a proactive approach to the development of policies, plans, and procedures that concern disaster recovery and preparedness. The State Division of Emergency Management will take the lead role in the TFRPP providing planning guidance, proficiency standards, training, and assistance to local jurisdictions.

5. Homeland Security Efforts at the Commission

The Commission actively participated in security and emergency operations policies and procedures for regulated utilities long before the September 11, 2001 attack. However, post September 11, 2001, the Commission is taking a closer look at security measures used by both incumbent (ILECs) and competitive local exchange carriers (CLECs). The Commission issued a survey to determine the level of security and disaster preparedness of utilities providing telecommunications services. Results of the survey are described below. In addition, the Commission has a response team to respond in cases of telephone and electric utility emergencies.

a. Service Quality Oversight Project

The Commission established Project No. 24729, *Service Quality Oversight as it Relates to the Emergency Plans*, filed by Telephone and Electric Utilities and National Security.[219] The Commission sent out two surveys requesting information on the state of security measures among telecommunications utilities. The first survey was sent to the major ILECs to evaluate how a Weapons of Mass Destruction (WMD) situation would affect their disaster recovery plans. The second survey was sent to both ILECs and CLECs to determine the preparedness of telecommunications companies in the event of a WMD situation.

The Commission issued surveys to determine the level of security and disaster preparedness of utilities providing telecommunications services. The first survey demonstrated that all of the major ILECs had tightened security procedures and were closely checking identification, performing background personnel checks, changing

[219] Responses to Project No. 24729 were received in December 2001 and February 2002.

security codes, and passwords, and limiting access to essential personnel in critical facilities. As a result of the September 11, 2001 attack, all of the major ILECs had activated their emergency operations centers and evaluated their emergency procedures.

A heightened sense of security was also focused on the Crawford Ranch (utilized by President Bush as the Western White House) and military installations. The major ILECs all reported that their current emergency procedures and equipment seemed adequate with only a few additional electronic security devices being installed. The emergency procedures and equipment of the ILECs encompass major outages such as hurricanes, tornadoes, floods, forest fires, ice storms, vehicle accidents, and other occurrences. Due to the ongoing security warnings coming from the White House, ILECs implemented rigid network security measures to protect their infrastructure from cyber intrusions.

All of the major ILECs normally run anti-virus software and intrusion monitoring software as a part of their security procedures. Copies of system software are kept in secure areas in case of virus infections. Cyber protections (or firewalls) are reviewed and updated on a regular basis. Utilities have reinstituted personnel background checks and identification card monitors and have restricted entrance to key personnel in critical areas. Emergency generators and battery backup systems have been strategically placed to handle complete power outages. Utilities performed reviews of their contingency and emergency procedures for major outages or disruptions and found them to be adequate. ILECs run emergency drills once or twice a year and also evaluate their performance after every disaster affecting them as standard practice. Only the ILECs that were directly affected by the September 11, 2001 attack took an active public relations role after the attack. The unaffected ILECs did respond to inquiries, but refrained from making proactive public statements.

The second survey was sent to all ILECs and CLECs. This survey requested more information, which included estimated costs of additional security actions and the details of emergency operations plans. CLECs were also asked if any measures implemented by the ILECs were causing any barriers to competition. The results of this second survey were gathered in the first quarter of 2002. The active ILECs and CLECs stated that they reviewed their current emergency procedures, and about 40% of them are planning to upgrade their security monitoring systems. The newer CLECs stated that they were installing electronic monitoring systems, such as cameras, key cards, identification badges, locks, and other types of devices.

About 70% of both ILECs and CLECs stated that their emergency operations plans were adequate for major outages or disruptions. About 75% of both ILECs and CLECs stated that they had either established or upgraded firewalls and virus protocols. Very few ILECs and CLECs had estimates for additional security actions concerning emergency operations. Most stated that upgrades to security would be part of their standard operating budget.

b. Emergency Management Response Team

The mission of the Commission's EMRT is to provide information regarding telephone and electric utility outages and restoration efforts to the State Emergency Operation Center during emergency situations. This information, in turn, is used for determining resource allocation during the course of the emergency situation. Emergency situations include but are not limited to wildfires, floods, tornadoes, hurricanes, ice storms, and matters concerning homeland security.

The EMRT consists of a dozen staff members representing nearly every division of the Commission. The EMRT also has two representatives on the State Emergency Response Team that provides first responder support during emergency situations. The EMRT has been part of the Governor's Emergency Management Council (EMC) since The Texas Disaster Act of 1975 was amended by the Texas Legislature in 1997. The Commission is one of 34 State agencies serving on the EMC.

Although the EMRT does not administer physical recovery to the utilities during emergencies, the EMRT actively monitors the total number of customers or/and communities affected, critical loads affected, and the estimated duration of outages or realistic restoration schedules. Furthermore, the EMRT proactively interfaces with utilities and EOC management, looking for solutions to facilitate the restoration process.

As a result of the September 11, 2001 attack, EMRT training has evolved to address biochemical and terrorist situations. The EMRT is periodically evaluating its role and how it can improve its response time to emergency events. The most recent improvement has been the creation of an Intranet page dedicated to facilitating the dissemination of information to team members. The EMRT's Intranet page can be reached from any location via the use of security passwords and user identification. The information stored on the Intranet page includes all electric and telecommunications utility contacts, service areas by county and COG, and a new feature that allows for the Commission to send direct notification to the utilities via email in the event of an emergency.

6. Summary

The telecommunications utilities in Texas are relatively secure and will continue to be so with the ongoing emergency operations procedure reviews, procedures reviews, emergency drills, and disaster performance reviews. The heightened level of security awareness, from Federal, State, and local agencies, and the utilities themselves, instills confidence that the telecommunications infrastructure will survive most natural or man-made disasters. Even if the worst disaster scenario actually occurs, the utilities have comprehensive emergency operations plans that will ensure the quickest possible recovery time.

The Commission will continue to participate in Federal, State, and local homeland security councils and emergency operations councils to ensure that industry and regulatory expertise will have a voice in the mitigation, preparedness, and recovery from natural and man-made disasters.

Chapter VII. Emerging Issues

This section of the Report discusses various issues that are significant to competition in the telecommunications market currently and will continue to be in the near future, both in Texas and nationally. The focus is on two primary areas. First, the wholesale market is addressed. This is done in terms of the interrelationship between the incumbent carriers, which primarily own the local network, and the competitive carriers, which enter the market using the incumbents' networks, building their own, or a combination of the two. Second, the retail market, or retail rates and rate structure, is addressed. This area is discussed in terms of appropriate and viable rate-making policy. These two broad areas, wholesale and retail, are the subject of ongoing debate in the industry, and of attention by legislative and regulatory entities.

A. Structural Separation

Currently, incumbent local exchange carriers (ILECs) are structured so that they have both retail and wholesale operations together in one company. An ongoing debate in the industry is the issue of whether the ILECs (or, specifically the Regional Bell Operating Companies (RBOCs) such as Southwestern Bell Telephone Company (SWBT) and Verizon) should be required to separate their wholesale and retail operations into separate companies in the interest of competitive neutrality. In fact, this concept of divestiture or structural separation in the telecommunications industry has been the topic of discussion, on and off, for the last fifty years.[220] Over the past several years, it has been examined in detail in Pennsylvania, Florida, and New Jersey, although no State has yet implemented structural separation.

The argument for structural separation is that the anti-competitive behavior of the ILECs has adversely affected the competitive local exchange carriers (CLECs). CLECs allege that the RBOCs provide discriminatory service to the CLECs' customers, resulting in a substandard quality of service for CLECs and their customers. CLECs assert, just as the Department of Justice (DOJ) did in the early 1980s, that if the RBOCs are separated into a wholesale and retail company, the inherent economic and financial incentive to discriminate against the CLECs will be removed. After structural separation, both the RBOCs retail entity and the CLECs would purchase access to the local network from the wholesale entity, whose sole responsibility would be wholesale provisioning. The logic is that the separated wholesale companies will respond to their CLEC customers because there is a business interest in doing so that does not exist for the ILEC at present—when

[220] *United States v. American Tele. & Telegraph,* 552 F.Supp. 131 (1982) ("Modification of Final Judgment or MFJ"). The MFJ is based on a 1956 consent decree, which was the result of the government's 1949 antitrust lawsuit proposing divestiture. On November 20, 1974, the government filed the suit that resulted in the MFJ, alleging monopolization of telecommunications services and equipment in violation of the Sherman Act. The MFJ divested AT&T and Western Electric, the long-distance and manufacturing operations, from the 23 local Bell Operating Companies.

retail customers make up a major revenue stream and the CLEC may be seen as a threat to that revenue.

The RBOCs, in their opposition to structural separation, assert that they are not engaging in anti-competitive conduct and that their assertion is supported by performance measurement data that shows that they are actually providing superior service in many cases to their CLEC customers. The RBOCs counter that CLECs fail for a variety of reasons, including poor business planning. The RBOCs further assert that the current regulatory approaches contribute to CLEC failure by encouraging poor CLEC planning.[221] Opponents of structural separation further note that the CLECs that have succeeded have a number of things in common, the main one of these being a strong facilities-based business plan that eliminates many of the dependency problems experienced by CLECs engaging in resale of ILEC services. The RBOCs also claim that separation would actually result in increased costs to the ILECs' wholesale divisions, which will ultimately drive out all smaller CLECs.

This general debate has now emerged more pointedly in Texas with the filing of a complaint by Birch Telecom of Texas with the Commission alleging end-user service disruption, and a petition to open an investigation into structural separation of SWBT.[222] The case is currently pending before a Commission administrative law judge.

B. Third-Party Administrator

Under current federal law, incumbents are required to provide CLECs with access to all the electronic and manual systems necessary to support a customer service environment (including preorder, order, provisioning, repair, and billing). These systems are called operations support systems or OSS. The OSS systems are linked to all of the incumbents' back office systems and databases that contain the historic customer service information gathered in connection with the provision of local service. After the incumbents' OSS systems were unbundled by the Federal Communications Commission (FCC), the incumbents and CLECs worked together to establish connections between the incumbents' OSS systems and the CLECs' own computer systems. When CLECs entered the local market, they initially captured customers from the incumbent; therefore, many of the orders processed in the past several years were conversion orders from SWBT to a CLEC. As competition has evolved, customers are still migrating from the incumbent but, with increasing frequency, customers are converting from one CLEC to another or from a CLEC to the incumbent. The incumbents' OSS systems are not designed to handle this type of transaction and, although most CLECs have connected

[221] Comments of SBC Communications Inc. Before the Federal Communications Commission, In the Matter of CC Docket Nos. 01-338, 96-98, and 98-147 (April 5, 2002) (RBOCs assert that federal and state regulatory approaches to unbundled network elements (UNEs) have been too generous, thereby discouraging CLECs from aggressive independent business plans and encouraging a deferment of investment.)

[222] *See Birch Telecom of Texas, LLP'S Complaint of End User Service Disruption and Petition to Open Investigation into SWBT Structural Separation*, Docket No. 26817 (pending).

their systems to the incumbent, they have not connected their systems to each other, making the transfer of information from one CLEC to another problematic.

The Commission is working with the telecommunications industry to develop guidelines that dictate how the stakeholders will process conversion orders from a CLEC to another CLEC or back to an incumbent. In conjunction with that project, the Commission is also considering the prospect of moving all, or a portion of, the responsibility for OSS functions to an independent third-party administrator.[223] The services performed by the third-party may vary, but the central premise is that a third-party administrator would perform all or part of the OSS functions in lieu of the incumbent. In addition to resolving the current operational problems caused by the transition of customers away from a CLEC, proponents of an independent third-party administrator assert that such a system would discourage anti-competitive conduct by the incumbent, much the same as structural separation would.

A third-party administrator could operate as a clearinghouse system that serves as the central point of contact for all carriers. Opponents of a third-party administrator contend that such a system is unnecessary and would require an investment in time and money that is not available to carriers at this time.[224] Proponents, however, maintain that this system would eliminate the need for a carrier to maintain separate interfaces with other carriers[225] and would accommodate multiple competitors with divergent systems, requiring few or no changes to existing carriers' operation systems, thereby reducing expenses. Proponents further maintain that the clearinghouse has the added benefit of providing a single database that can produce reports that will allow better tracking of competitive markers, such as the number of local service requests (LSRs) or frequency of customer service record (CSR) queries. The Commission is moving forward in exploring the propriety of using a third-party administrator. The Commission is exploring this concept in workshops and will be prepared to make a final decision in the spring of 2003.

C. Performance Measures

As discussed in Chapter III of this Report, a Performance Remedy Plan (Plan) and Performance Measures were implemented in 1999 to measure the performance of SWBT's wholesale operations (provisioning of UNEs to CLECs) and to compare that performance to SWBT's performance internally to its own retail operation. The goal is to ensure that SWBT is providing wholesale services to CLECs at parity with the service SWBT provides to itself, or, where no retail analogy exists, at a benchmark level designed to afford the CLECs a meaningful opportunity to compete. The Plan also

[223] *Proceeding Regarding Third-party Administrator*, Project No. 26839 (pending).

[224] At present, no state has ordered the establishment of a third-party administrator to serve some or all of the roles discussed above.

[225] A third-party administrator could operate as a centralized data store for customer account information or just a subset of that relating to preferred interexchange carrier (PIC) information; or the third-party could serve as a clearinghouse for customer service records (CSRs) or local service requests (LSRs). In addition to other services, the third-party could provide the third-party verification services often used by carriers who chose to use oral letters of authorization (LOAs).

provides for payment of liquidated damages to the CLECs or, in certain situations, penalties to the State for failure to meet a measure. While the Commission believes the Plan has been an effective tool to date, the Commission also believes it is critical to set penalties at a level that encourages SWBT to meet the performance goals of the Plan.

The establishment of performance penalties should deter anti-competitive or discriminatory behavior, if set at the proper level. As discussed in Chapter IV, SWBT continues to miss more than 10% of its performance measures a majority of the past reporting months. The Commission is concerned with the perception that potential penalty amounts may be seen as merely acceptable business expenses that do not serve as a true incentive to proper wholesale performance. SWBT disputes the Commission's ability to significantly modify the Plan.

D. Winback and Code of Conduct for Telecommunications Providers

In response to industry comments, the Commission established a rulemaking regarding restrictions on retention and winback activities by Chapter 58 Electing Companies.[226] The new proposed rule was intended to prohibit Chapter 58 electing companies from making retention[227] and winback[228] offers directly to soon-to-be-former customers or former customers during a certain waiting period[229] when those offers would tend to have an anti-competitive impact. The prohibition during the waiting period does not apply to customer-initiated communications with the electing company or to business customers subscribing to five or more access lines or an equivalent level of service. The public benefit anticipated as a result of the section would be to encourage a fully competitive telecommunications marketplace and promote diversity of telecommunications providers by preventing certain activities that would tend to have an anti-competitive impact. In December 2002, the Commission held a public hearing regarding the proposed rule. Competitive providers do not believe the winback restrictions go far enough to prevent anti-competitive behavior by the incumbent, while

[226] *See Rulemaking to Address Winback/Retention Offers by Chapter 58 Electing Companies*, Project No. 25784 (pending).

[227] In the proposed rule approved at the October 10, 2002 open meeting, retention offers are defined as any service offering, including any form of pricing flexibility as defined by PURA § 51.002(7) (i.e., customer specific contracts, packaging of services, volume, term and discount pricing, zone density pricing, and other promotional pricing) involving any basic network service or nonbasic service, as defined by PURA §§ 58.051 and 58.151, that is made available by an electing company to a soon-to-be former customer (I.e., a customer for which another certificated telecommunications utility's (CTU's) local service request (LSR) is pending before the electing company.)

[228] In the proposed rule approved at the October 10, 2002 open meeting, winback offers are defined as any service offering, including any form of pricing flexibility as defined by PURA § 51.002(7), involving any basic network service or nonbasic service, as defined by PURA §§ 58.051 and 58.151, that is made available by an electing company to a former customer.

[229] In the proposed rule approved at the October 10, 2002 open meeting, the waiting period is defined as the period of time that begins on the day that a CTU submits a local service request (LSR) to an electing company and ends 30 days after the service order completion (SOC) date.

the incumbents believe the winback restrictions have the potential of dampening competitive responses by the incumbents.

In a related matter, in October of 2002, the Commission initiated an investigation into the business/marketing practices and conduct of local exchange companies.[230] This investigation was followed by a rulemaking to create a marketing code of conduct. The marketing code of conduct will likely address matters relating, but not limited, to false, deceptive and misleading advertising, as well as false, deceptive, and misleading communications between employees of the local exchange companies and their current and former customers.[231]

E. Rates

There are essentially three types of rates currently at issue in the telecommunications market: basic local retail, local wholesale unbundled network elements (UNEs), and wholesale switched access charges. Universal service funding, which is an explicit support for basic local service rates, constitutes a fourth rate-affecting issue.

ILEC basic local service rates in Texas have been capped for some ILECs (including the largest companies) by State legislation and regulation for the public-policy purpose of maintaining "affordable" basic phone service. Many are set well below the ILECs' costs. In addition, basic local rates are grouped into retail rate bands based on a "value of service" theory. In other words, local retail rates are set higher in areas with higher populations on the premise that more value is received from the ability to call and receive calls from more people locally. The value-of-service retail pricing scheme typically leads to pricing direction being the inverse of costs—basic local retail rates are higher in lower cost areas and vice versa. Vertical services are those retail local services beyond basic dial tone, i.e., Caller I.D., call waiting, three-way calling, etc. Since the ILECs received pricing flexibility resulting from legislation in 1999, many of the more popular or frequently used vertical services have seen significant increases in price.[232]

UNE prices, unlike basic local retail rates, are cost-based. Both the level of the costs and rates, and the costing methodology, are subject to disagreement in the industry. UNE costs are determined using cost models based on "total element long run incremental costs" (TELRIC) methodology, which was recently upheld by the Supreme Court.[233] Members of the telecommunications industry disagree about the current level of UNE prices. In general, ILECs argue the many UNE prices are set too low and are below their actual costs. Conversely, CLECs in general argue that many UNE prices are

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[230] *See Audit of Existing Business/Marketing Practices and Conduct of Chapter 58 Electing Companies*, Docket No. 26868 (pending).

[231] *See Rulemaking to Establish Marketing/Business Code of Conduct for Local Exchange Companies*, Docket No. 26955 (pending).

[232] *See* Chapter IV, *infra.*

[233] Verizon Communications, Inc. v. Federal Communications Commission, 535 US 467 122 S.Ct. 1646 (2002) (Verizon).

set too high and are above appropriate TELRIC costs. UNE rates are current being reevaluated in Texas in Docket No. 25834.[234] A hearing in this docket is expected to begin in early 2003.

Intrastate switched access charges are the wholesale rates paid to local exchange telephone companies by long-distance carriers to originate and terminate long-distance calls within Texas over the public switched network. The current differential between intrastate and interstate access charges in Texas is approximately 500%,[235] an indication that the intrastate charges are well above costs (assuming interstate charges are near costs, not below). At issue in Texas is whether the intrastate charges should be lowered to the level of interstate charges or need to be left at current levels to serve as an implicit subsidy to basic local rates for high costs not recovered by the explicit subsidy of Texas Universal Service Fund (TUSF).

F. Voice-Over IP

One sector expected to emerge over the next two years is voice-over-internet protocol (VoIP) technology. This technology transmits voice conversations over a data network using internet protocol (IP).[236] Southwestern Bell Corporation (SBC) and the cable industry are actively exploring deployment of VoIP throughout their networks.[237]

The regulatory implications of this new technology are wide-ranging and complex, from the potential impact on reciprocal compensation traffic arrangements between carriers, to ensuring that customers receive the same quality of service standards as those customers using traditional analog wires, to access the public switched telephone network (PSTN). In addition, the nature of VoIP is undefined in both the state and federal regulatory arenas, and it is unclear whether VoIP calls would be subject to federal or state regulation, or both.

The first issue to emerge will be whether VoIP traffic, which can be used to make long-distance, local, and internet-based telephone calls, should be exempt from the interstate and intrastate access charge regime. AT&T has recently filed a petition at the FCC requesting that AT&T's Phone to Phone VoIP traffic continue to be exempted from access charges.[238] In its complaint, AT&T states that several ILECs have been refusing to accept VoIP traffic from AT&T. There are several competing policies, which must be examined.

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[234] *Proceeding on Cost Issues Severed from Docket No. 24542*, Docket 25834 (pending).

[235] Report to the 77th Texas Legislature on Intrastate Switched Access Charges (January 2001).

[236] NEWTON'S TELECOM DICTIONARY, (17th ed. 2001), published by CMP Books, New York, NY, at 757.

[237] Keeping It Real: IP Centrex, IP PBX Address Today's Requirements, Paula Bernier, XCHANGE at 12 (August, 2002); Vendors Assess Cable VoIP Opportunity, Paula Bernier, XCHANGE at 30 (August 2002).

[238] *AT&T's Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361 (Nov. 18, 2002).

First, federal and state policymakers have traditionally exempted all information and enhanced service providers (ESPs) from the requirement that they pay access charges, even if the enhanced or information service meets some of the traditional definition of access. Nearly all VoIP providers currently claim this exemption. The general purpose of this exemption policy is to promote invention, investment, and innovation by allowing adoption of new technology into the marketplace, which in turn leads to a better, more cost effective, multi-dimensional public network.

Indeed, the Commission has applied a similar policy through various proceedings concerning reciprocal compensation issues, as it upheld ESP exemptions, and required calls to and from ESPs to be treated as local calls for CLEC/ILEC mutual compensation purposes. The Commission's policy has consistently been to stimulate an efficient market by approving mutual compensation rates that are reflective of the cost of interconnecting the networks and not historical classification rules.

Second, the appropriate regulatory treatment of IP telephony may hinge upon the FCC's current proceedings to define whether broadband is an "information service" (for which access charges are not paid) or a "telecommunications service" (for which access charges are paid).

The FCC has recently concluded that cable modem service is an information service and has reached the tentative conclusion that broadband services provided over telecommunications infrastructure is also an "information service."

On the other hand, the FCC earlier had concluded on a tentative and non-binding basis in the Stevens Report that VoIP is a telecommunications service. In fact, the FCC only reached a preliminary conclusion in the so-called "Stevens Report" that phone-to-phone IP telephony is likely to be classified as a "telecommunications service."[239]

> The record before us suggests that certain 'phone-to-phone IP telephony' services lack the characteristics that would render them 'information services' within the meaning of the statute, and instead bear the characteristics of 'telecommunications services.' We do not believe, however, that it is appropriate to make any definitive pronouncements in the absence of a more complete record focused on individual service offerings.[240]

Thus, the FCC and state regulatory commissions are faced with several possibilities in relation to VoIP. They could follow the public policy behind the ESP exemption and not apply access charges. The FCC instead could find in its current broadband proceeding that all broadband services, including VoIP, are "information services" and are therefore exempt from access charges under Title I of the Federal Telecommunications Act (FTA). The effect of either ruling, however, would be to

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[239] *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket 96-45, Report to Congress at 88 (rel. April 10, 1998) (STEVENS REPORT)

[240] STEVEN'S REPORT, at ¶ 83, emphasis supplied.

continue large opportunities for regulatory and economic arbitrage between VoIP services, which would have cost-based mutual compensation charges, and traditional long-distance calls, which would pay access.

G. Broadband Policy

Broadband deployment continues to be an important area of policy discussion. During the last two years, there has been a growing consensus regarding the important role for consumer demand in stimulating broadband deployment and continued controversy over the state of broadband supply and regulatory framework governing broadband deployment.

1. Demand

Customer demand for broadband services has been strong, but still lower than many had expected. On the other hand, customer adoption of broadband service has been faster than the adoption of other technology services, such as cell phones, in their early stages of availability. There is a general belief that the lack of a "killer application" (*i.e.,* a compelling reason to purchase) may be inhibiting consumer adoption of broadband services.

The key challenge to broadband deployment in urban areas may relate to issues surrounding the "digital divide," since many low-income, older, or less-educated Texans are less likely to have or know how to use computers or have the desire to have access to the internet. In rural areas, deployment appears to be occurring at a slower rate and there is concern that those areas and citizens were being "left behind" the rest of the State.

2. Supply

As discussed in this Report, cable and telecommunications companies are in the process of upgrading facilities in urban and rural areas, although there remain significant gaps in coverage.

There has been much discussion regarding whether existing regulatory policies spur or hinder broadband deployment. Incumbent telecommunications providers have generally argued that imposing unbundling obligations on broadband diminishes their incentives to invest in new network infrastructure and is inconsistent with the regulatory framework applied to cable companies. These providers argue that cable, wireless, and satellite will provide "intermodal" competition. Competitive telecommunications providers have argued in contrast that "intramodal" competition created through regulatory access to telecommunications infrastructure brings lower prices, better quality, and induces ILECs to increase investment in their networks.[241]

[241] Compare Willig, et. al., Stimulating Investment and the Telecommunications Act of 1996,(unpublished and available upon request from files of PUC), and Crandall, et. al, The Empirical Case against Asymmetric Regulation of Broadband Internet Access, 17 BERKELEY TECH. L.J., 953 (Summer 2002)

3. State Policies

In addition to the Commission's efforts to accelerate broadband deployment described in this Report, the State has a number of other policies, and programs that impact broadband technology deployment. These programs include the Telecommunications Infrastructure Fund (TIF), the State telecommunications discounts for schools and libraries (H.B. 2128 discounts), the statewide telecommunications network (TEX-AN), and other state-supported university and educational networks. These programs were adopted in the mid-1990s prior to widespread internet deployment and there is widespread stakeholder agreement that these policies should be re-examined although no consensus exists as to the future role of these programs.

4. Broadband Policy Recommendations

The Commission extensively examined the state of broadband deployment in its *2001 Advanced Services Report* and many recommendations suggested in the report could still be adopted by the Legislature. In the *2001 Advanced Services Report*, the Commission made several "best practice" recommendations, including the following:[242]

- **Establish a Statewide goal for widespread Broadband deployment –** States such as Michigan and North Carolina have recently established goals for broadband deployment. North Carolina's goal, for example, is to provide every State resident with broadband internet access by the end of 2003.
- **Explore New Deployment Models, such as Demand Aggregation and Anchor Tenancy –** Using large customers or aggregated customer demand of small customers may create sufficient demand to encourage telecommunications providers to make infrastructure investments. The TIF community networking initiative is an example of such demand aggregation.
- **Education and Training –** Education and training can increase computer usage, particularly among low-income, less-educated, and older Texans.
- **Economic and Tax Incentives –** States such as Michigan and North Carolina have used tax and other economic incentives to spur deployment of broadband infrastructure.

H. Towards a New Framework for Telecommunications Competition

This Report has discussed many significant policy issues currently facing the telecommunications industry that may be raised during the coming Legislative Session.

In past Sessions, various stakeholders have requested that the Legislature address some particular issue that affects their specific financial or business interest but that might negatively affects some other group's interest or goal. As a result, this piecemeal

[242] Report to the 77th Texas Legislature, Report to the Legislature on the Availability of Advanced Services in Rural and High Cost Areas, January 2001.

approach generally has been contentious in past sessions. It can be expected that the issues raised by the stakeholders during the coming session will again be focused solely on their particular concerns and will cause similar divisive debates.

Another approach, however, would be to address State telecommunications policy in a more comprehensive manner. A comprehensive framework would need to be constructed not only to address every stakeholders' interests but with the goal of creating a sustainable, competitive local telecommunications market and thereby lessening the need for regulatory oversight. This approach was successfully used during the 1999 Session to create a new framework for retail electric competition, which, by most accounts, has been successfully implemented over the past three years.

The debate regarding retail electric restructuring spanned both the 1997 and 1999 Legislative Sessions. A similar approach may benefit the telecommunications industry since the Commission will approach Sunset Review in 2005.

The framework described in Table 17 is a first attempt to demonstrate what policy issues a new State telecommunications law might address and to illustrate how the policies adopted in that framework would be consistent with the Legislature's general policy objective of creating competitive telecommunications markets, as expressed in H.B. 2128 during the 1995 Legislative Session and S.B. 560 during the 1999 Legislative Session. In keeping with prior legislative initiatives, these different issues taken as a whole create a market design that continues a policy of movement to a market, which is less regulatory in nature. The framework outlined in Table 17, taken as a whole, could allow regulatory measures to decrease as competition increases over time.

Table 17 — Towards a New Telecommunications Framework

Issue	1995	1999	Emerging Issues for 2003/2005
Retail Pricing	Basic Service Rate Caps Tariffed Vertical Services	Packaging and Pricing Flexibility Informational filings	Rebalance local rates through transition to market-based rates No other retail pricing restrictions
Access Charges	High (12 cents) with implicit subsidies	Moderate (6 cents) removes some implicit subsidies	Cost-based with no implicit subsidies
USF	Small USF fund	Moderate-sized USF fund	Support for only true high cost areas Lifeline for low income
Network Element Access		UNE-P under FTA This includes loop, line port, end-office usage, signaling, and transport	**Legacy (ILEC) infrastructure:** Market-based prices for UNE-P Other UNEs at TELRIC prices as conditions warrant **New infrastructure:** No regulation except as it relates to customer protection, service quality, and continued necessary access to the network by competitors
Wholesale pricing	Chapter 60 of PURA	TELRIC under FTA	Primarily market-based, especially with structural separation (see row below)
Affiliate Relationships		Not addressed (vertically integrated)	Structural separation or Use third-party administrator
Enforcement		Performance Measures under FTA	Affiliate Code of Conduct Complaint Driven
Interconnection Obligations	Required	Required	Required

Chapter VIII. Legislative Recommendations

A. Access to Information

Each biennium in preparation of this report for the Legislature, Commission staff requests data from telecommunications providers that can be used to provide a meaningful view of the state of telecommunications service and competition in Texas. Telecommunications service providers consider access line count information and other data to be confidential, commercially valuable information.

The Legislature has recognized the sensitive nature of competitive information supplied to the Commission by holders of certificates of operating authority (COAs) and service provider certificates of operating authority (SPCOAs) in PURA § 52.207(b) by excepting reports from those providers from the Texas Public Information Act, Chapter 552 of the Texas Government Code. However, there is no similar protective provision for information provided to the Commission by other types of telecommunications service providers. With the growth of competition, there is a greater resistance than ever before by telecommunications providers to providing detailed information for staff review because of the risk that the Commission will not be able to protect the confidentiality of the information if a request is received under the Texas Public Information Act. Without the ability to guarantee that certain information can be maintained as confidential many carriers are willing to provide requested data in only an aggregated form, which is less useful for analysis of telecommunications competition in the State.

Under current law, the Commission has no argument of its own to support the need to maintain the information as confidential. Therefore, the Commission cannot even join forces with the companies that are seeking a favorable ruling from the Attorney General to protect commercially sensitive information. Under earlier interpretations of § 552.110 of the Texas Public Information Act using the "National Parks" test,[243] the Commission could assert an argument for the protection of requested third-party confidential data if the release of such information would hamper the Commission's ability to obtain the data in the future. That interpretation, however, is no longer recognized as a legitimate reason to withhold third-party data from the public under the Information Act.[244] Further, in 1999 the Texas Legislature added a requirement to

[243] *National Parks & Conservation Comm'n v. Morton,* 498 F.2d 765 (D.C. Cir 1974). The *National Parks* case set forth a test for the federal statutory counter-part to the Tex. Gov't Code § 552.110 exception from disclosure for third-party confidential information. The test excepted financial information from disclosure if the disclosure was likely to either impair the government's ability to obtain the information in the future, or to cause substantial harm to the competitive position of the party from whom the information was obtained.

[244] *Birnbaum v. Alliance of American Insurers*, 994 S.W.2d 766 (Tex. App.—Austin 1999, pet. denied).

§ 552.110 requiring a party asserting confidentiality over commercial and financial information to provide specific factual evidence of substantial competitive harm. Generally, the Commission does not have access to specific factual evidence of competitive harm to support an assertion that the information should be maintained as confidential.

In 1995 the Attorney General, responding to a request from former PUC Chairman Robert Gee, opined that, in order to protect data provided by telecommunications providers for development of the Telecommunications Scope of Competition Report, the Commission should publish the information in a manner that avoids explicitly or implicitly identifies any of the responding utilities.[245] For that reason, this Report provides data in the aggregate in order to conceal the identities of the reporting entities.

With regard to the privacy interests of Texans, the Commission is concerned about the availability of the no-call database pursuant to a Public Information Act request. Although the current statutes TEX. UTIL. CODE ANN. § 39.1025 and TEX. BUS. & COM. CODE, Chapter 43, implicitly express a legislative intent to restrict access to the "no-call" databases, there is no explicit exemption for the database information from disclosure under the Texas Public Information Act.

B. Specific Legislative Recommendations

If the Public Utility Regulatory Act (PURA) were amended to protect data provided to the Commission by all telecommunications carriers as it does for data provided by holders of COAs and SPCOAs in PURA § 52.207(b), Commission staff could conduct and provide a better analysis of the state of competition in the Texas telecommunications market.

If the legislature did not intend for consumer data collected for the purpose of implementing the no call provisions of TEX. UTIL. CODE ANN. § 39.1025 and TEX. BUS. & COM. CODE, Chapter 43, to be made publicly available under Chapter 552 of the TEX. GOV'T CODE, the Commission recommends that those statutory provisions be amended to explicitly except the data from disclosure under the Texas Public Information Act.

[245] Tex. Attorney Gen. LR-043 (1995).

Appendix A. Research Methodology

This appendix discusses the methodology used by the Commission for collecting data for the 2003 Scope of Competition Report. A data collection form was developed to obtain information about a telephone company's service offerings, revenues, lines, and minutes-of-use.[246] By Commission Order, all incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs) operating in Texas were required to complete the survey form.[247] In addition, non-regulated data affiliates of ILECs and CLECs, and cable companies operating in Texas, were urged to voluntarily submit information about their operations.

Of the 554 certificated telecommunications utilities in Texas, 202 carriers responded to the Commission's data request. Of those responses, 138 were from CLECs (compared to 128 CLECs that reported for the 2001 data request), while the rest of the responses were from ILECs. In addition, about 76 CLECs filed letters stating that they were not providing services at the time of the data request or had yet commence operations in Texas.[248] The certified telecommunications utilities (CTU) responses were cross checked with information submitted to the Commission pursuant to the Municipal Access line Reporting System (MARS) and with filings made to the Federal Communications Commission (FCC) by Texas carriers pursuant to the FCC's Form 477. Based on this analysis, the Commission estimates that carriers representing at least 95% of the access lines served in Texas have responded to the Commission's data request.

Most of the sections on the data collection form requested information as of June 30, 2002. Information on switched access revenues and minutes-of-use were requested for the following time periods: 1999, 2000, 2001, and the first half of 2002.

The data collection form collected both aggregated and disaggregated information on the number of retail "plain old telephone service" (POTS) lines provided over local loops owned, leased, and resold, and the number of wholesale lines. CLECs were required to provide disaggregated information at an exchange level while both ILECs and CLECs were required to provide information aggregated as urban, suburban, and rural exchanges. The urban group consists of exchanges that have a population of more than 100,000. A total of 14 exchanges were in this category. The suburban group consists of exchanges that have a population of more than 20,000 but less than 100,000. A total of

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[246] The Commission's 2003 Data Collection Form can be found on the project's website, REPORT TO THE 78TH LEGISLATURE ON THE SCOPE OF COMPETITION IN TELECOMMUNICATIONS MARKETS, Project #24727: http://www.puc.state.tx.us/telecomm/projects/24727/24727.cfm.

[247] This group consists of Certificated Telecommunication Utilities (CTUs) in the State of Texas, *i.e.*, holders of SPCOA, COA and CCN certificates. Only those providers who receive these certificates are eligible to offer basic local exchange services in Texas.

[248] *Note:* The total number of Texas ILECs reporting to the FCC was 13, as compared to 64 who reported to the Texas Commission's Data Request for 2003 Scope of Competition Report. The total number of Texas CLECs reporting to the FCC was 26, as compared to 138 who reported to the Texas Commission's Data Request for 2003 Scope of Competition Report.

57 exchanges were in this category. The remaining 1092 exchanges were classified as rural, and were under 20,000 in population.

In addition to classifying lines based on the type of exchange, carriers were also required to identify whether those lines were provided to residential or non-residential customers. Non-residential customers consist of businesses, school districts, universities, churches, and non-profit organizations. Residential lines consist of those lines that serve single-family or multi-family dwelling units.

To obtain a historical context, the 2002 data was supplemented with data from the previous Scope of Competition Reports (2001 and 1999) and the Local Competition and Broadband Reports published by the FCC semi-annually.[249] Combining data has enabled the Commission to develop time-series charts and perform historical analysis. However, it should be noted that while the Commission's data request requires all CTUs operating in Texas to report data to the Commission, the FCC only requires those CTUs with 5,000 or more lines to report data to the FCC. As a result, the FCC data may not be as comprehensive as the state-reported data.

Finally, due to issues associated with providing competitive-sensitive information to the Commission, CLECs and ILECs were allowed to use aggregators to represent various companies and report the requested information to the Commission in an aggregated form (aggregated across all carriers of an aggregator). Since most major carriers responded to the Commission's data request using an aggregator, it was not possible to determine how many CTUs offered choices or provided a type of service in a given exchange.

[249] Federal Communications Commission, Industry Analysis and Technology Division, WIRELINE COMPETITION BUREAU, LOCAL TELEPHONE COMPETITION REPORTS, FCC (Aug. 2000, May 2001, July 2002), and HIGH-SPEED SERVICES FOR INTERNET ACCESS, FCC (July 2002). Available online at: www.fcc.gov/wcb/iatd/comp.html.

Appendix B. Capital Markets

Since March 2000, the Dow Jones communication technology index has dropped 86%, and the wireless communication index has fallen 89%.[250] Many analysts are predicting that the telecom market will continue to fall in 2003. They argue that more companies, including smaller telecom equipment companies, will go bankrupt without access to capital, while big equipment makers will shelve innovative products and survive on contracts to maintain and upgrade already-installed switches and software.[251] William Kirsch, a mergers-and-acquisitions lawyer at Kirkland and Ellis, says that the uncertainty in the underlying industry and the questions about accounting are standing in the way of most new telecom deals.[252]

Despite the decline in the telecom market, some Wall Street analysts continue to remark on the staying power of the Baby Bells. Verizon, Southwestern Bell Corporation (SBC), and BellSouth made a combined $20 billion profit last year and have a collective market value of $240 billion.[253] As demonstrated in Table 18, despite high capital expenditures, regional Bell operating companies (RBOCs) have had minimal to no revenue growth and are losing local lines.

Table 18 — The Cost of RBOCs Remaining Solvent

	Total local phone lines	Lines lost August 2001-August 2002	Lines lost, percent of total 2001	Capital expenditures per year	Revenue Growth
Verizon	61 million	1.7 million	2.7%	$15 billion	0%
SBC	59 million	2.2 million	3.6%	$10 billion	2.5%
BellSouth	25 million	0.5 million	2.0%	$6 billion	6%

SOURCE: "Bad Connection," *Forbes*, August 12, 2002, p. 85.

[250] Paul Starr, *The Great Telecom Implosion*, THE AMERICAN PROSPECT, September 9, 2002, available at http://www.prospect.org/print/V13/16/starr-p.html/.

[251] Stephanie N. Mehta, *Is there any way out of the telecom mess?,* FORTUNE, July 22, 2002, p. 84.

[252] Kara Scannell and Robert Frank, *Buyout Firms Find Telecom Too Risky*, *WALL STREET JOURNAL*, July 9, 2002, p. C1.

[253] "Bad Connection," *Forbes*, August 12, 2002, p. 85.

As shown in Table 19, SBC, Verizon, and AT&T stock values, as well as revenue, have decreased. In the second quarter of 2002, SBC Communications reported $1.84 billion in profits, down 11% from the same period in 2001, while Verizon reported a second-quarter loss of $2.11 billion, and AT&T posted a $12.7 billion loss, mainly due to the drop in market value for cable TV.[254]

Table 19 — Comparison of Largest Texas Telecom Firms' Capital Markets

	2nd quarter revenues, 2001[255]	2nd quarter revenues, 2002[256]	2nd quarter 2002 loss or profit[257]	Drop in stock price, Jan - July 2002[258]
SBC	$13.6 billion	$13.1 billion	+$1.84 billion	38.8%
Verizon	$16.91 billion	$16.84 billion	-$2.11 billion	39.6%
AT&T	$13.27 billion	$12.1 billion	-$12.7 billion	51%

In addition, AT&T Business had a revenue decline of 3.8% from the previous year, mainly due to a 12% decline in long-distance voice revenue, while AT&T Broadband's revenue fell 1.5%. AT&T Consumer revenue dropped 22% from $3.72 billion to $2.91 billion.[259]

Some telecom companies had positive news to report at the end of the second quarter of 2002. Sprint received $1.5 billion in credit in late July, despite being cut to the lowest investment-grade ratings by Moody's Investors Service and Standard & Poor's earlier in the month.[260] Nokia had a second-quarter profit jump of 46%, despite a decline in sales of 6%.[261]

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[254] *SBC Communications reports lower earnings for 2nd quarter*, ASSOCIATED PRESS, July 23, 2002. Andrea Ahles, *Verizon reports $2.11 billion loss*,"FORT WORTH STAR-TELEGRAM, August 1, 2002, p. 1C. Bruce Meyerson, *AT&T Posts $12.7 Billion Loss*, ASSOCIATE PRESS, July 23, 2002.

[255] *SBC Beats Analyst's Expectation*, ASSOCIATED PRESS, July 24, 2002. Andrea Ahles, *Verizon reports $2.11 billion loss*, FORT WORTH STAR-TELEGRAM, August 1, 2002, p. 1C. Jesse Drucker, and *AT&T Posts a Loss of $12.7 Billion*, WALL STREET JOURNAL, July 24, 2002, p. M9.

[256] *Id.*

[257] *SBC Communications reports lower earnings for 2nd quarter,* ASSOCIATED PRESS, July 23, 2002. Andrea Ahles, *Verizon reports $2.11 billion loss*, FORT WORTH STAR-TELEGRAM, August 1, 2002, p. 1C. Bruce Meyerson, *AT&T Posts $12.7 Billion Loss*, ASSOCIATE PRESS, July 23, 2002.

[258] Seth Schiesel with Simon Romero, "Regional Bell Giants No Longer Invulnerable," *New York Times*, July 23, 2002, p. C6. AT&T data from Seth Schiesel, "AT&T, Writing Down Cable Assets, Posts Big Loss," *New York Times*, July 24, 2002, p. C4.

[259] Jesse Drucker, *AT&T Posts a Loss of $12.7 Billion*, WALL STREET JOURNAL, July 24, 2002, p. M9.

[260] Tom Barkley, *Sprint Allays Fear of Cash Crunch With New Credit*, WALL STREET JOURNAL, July 31, 2002, p. B5.

[261] Elizabeth Douglass, *Losses Pile Up at Battered Telecom Firms*, LOS ANGELES TIMES, July 19, 2002.

Other telecommunications companies are not faring as well. Despite gains in its local and long-distance markets, Sprint posted a loss of $68 million during the second quarter, mainly due to losses in its wireless unit.[262] In July 2002, Broadwing's stock was down 92% from its peak in October 2000, and had a debt load of $2.8 billion from losses in its broadband unit.[263] In August 2002, Standard & Poor's announced that it was reviewing Broadwing for a possible downgrade in its credit rating.[264] Despite second quarter revenues of $184.4 million, up $60 million over the same quarter in 2001, Allegiance Telecom Inc. posted a second quarter loss of $226.8 million, far greater than its second quarter 2001 loss of $103.3 million.[265] Lucent reported a fiscal third quarter loss of $7.9 billion, and a revenue of $3 billion, down 50% from the previous year.[266]

[262] Amy Shafer, *Sprint Loses $68M in Second Quarter*, ASSOCIATED PRESS, July 18, 2002.

[263] Elizabeth Douglass and Karen Kaplan, *More Firms on Brink?*, LOS ANGELES TIMES, July 22, 2002, available from http://www.latimes.com/business/la-fi-whonext22jul22.story.

[264] *S&P might cut Broadwing corporate credit rating*, CINCINNATI BUSINESS COURIER, August 29, 2002.

[265] Vikas Bajaj, *Allegiance loss widens, but revenue improves*, DALLAS MORNING NEWS, July 31, 2002, p. 4D.

[266] Michelle Kessler, Telecom earnings tell tale of sector's struggles, USA TODAY, July 24, 2002.

Appendix C. Bankruptcies

Some analysts argue that most companies emerging from bankruptcy will be unable to raise the necessary capital to continue functioning. The other major problem of overcapacity is that these companies suddenly have worthless assets. Since companies tended to overbuild the same network, most competitors of bankrupt companies will not need another long-haul facility or transatlantic cable. Three of the regional Bell operating companies (RBOCs)—Verizon, SBC, and BellSouth—have relatively healthy prospects in capital markets despite the current scrutiny of their credit ratings, and will likely be able to simply outlast the competition.[267]

The bankruptcy of WorldCom was sudden. WorldCom declared bankruptcy on July 21, 2002, with $107 billion in assets making this the largest bankruptcy in history.[268] WorldCom received a $2 billion loan to keep operating under bankruptcy protection.[269] Equipment companies such as Lucent Technologies Inc. and Nortel Networks Ltd., which supplied hundreds of million of dollars worth of networking gear on credit to WorldCom, may be the next to suffer from WorldCom's bankruptcy.[270] WorldCom pays local phone companies about $750 million a month for access to their networks.[271] Opinions vary widely regarding whether WorldCom owes access charges to carriers. Southwestern Bell Corporation (SBC) and BellSouth have discussed potentially retaining long-distance revenue collected.[272]

The Teacher's Retirement System of Texas, the State's largest public investment fund, reports that it has lost at least $93 million on investments in WorldCom.[273] The Employees Retirement System of Texas has not released how much it has lost in WorldCom, but it held $50 million in investments as of December 30, 2001.[274] The

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[267] Stephanie N. Mehta, *Is there any way out of the telecom mess?,* FORTUNE, July 22, 2002, p. 84.

[268] Simon Romero and Riva D. Atlas, *Worldcom Files For Bankruptcy; Largest U.S. Case*, NEW YORK TIMES, July 22, 2002, p. A1.

[269] Christopher Stern, *WorldCom Gets $2 Billion Bankruptcy Loan*, WASHINGTON POST, July 17, 2002, p. E02.

[270] Elizabeth Douglass and Karen Kaplan, *More Firms on Brink?*, LOS ANGELES TIMES, July 22, 2002, available from http://www.latimes.com/business/la-fi-whonext22jul22.story.

[271] Seth Schiesel with Simon Romero, "*Regional Bell Giants No Longer Invulnerable*, NEW YORK TIMES, July 23, 2002, p. C6.

[272] Sanford Nowlin, *SBC nervous about money it is owed*, SAN ANTONIO EXPRESS-NEWS, July 23, 2002, p. 9A.

[273] Rod Kurtz, *State's WorldCom losses mount*, AUSTIN AMERICAN-STATESMAN, July 9, 2002, p. A1.

[274] Anuradha Raghunathan, *Angry bondholders assess damage,* DALLAS MORNING NEWS, June 28, 2002.

University of Texas System Fund lost $50 million in WorldCom bonds, which was about 0.3% of the fund's entire holdings.[275]

The Commission has established Project No. 23998, *PUC Proceeding For Filing Notification(s) of Bankruptcy by COA and SPCOA Holders*, to address bankruptcy filings by Texas telecom carriers. In Project No. 23998, carriers file notice as they enter into bankruptcy, and Commission staff files further information as needed. Unlike the electric side, the Public Utility Regulatory Act (PURA) is silent as to how the Commission should address bankruptcy filings for telecom customers, although the Commission does have a few guidelines in its substantive rules in the event that an investigation is needed or customers need to be transitioned to other carriers. The Commission is mindful of 11 U.S.C. §§ 101-1330, which govern bankruptcies, and especially 11 U.S.C. § 525, Protection Against Discriminatory Treatment, which precludes a governmental body from denying, revoking, suspending, or refusing to renew, the license of a bankrupt company solely on account of its bankruptcy.

[275] Anuradha Raghunathan, *Angry bondholders assess damage*, DALLAS MORNING NEWS, June 28, 2002.

Appendix D. Layoffs and Capital Expenditures

Southwestern Bell Corporation (SBC) has stated that its 2003 capital expenditures for its 13-state area will be reduced to $5-6 billion, down from $7.5 billion in 2002[276] and the $11.2 billion spent on its network in 2001.[277] Small, rural incumbent local exchange carriers (ILECs) are also predicting that the loss of access revenues from WorldCom may affect their bottom line.[278] Telecommunications providers and equipment vendors laid off 17,028 Texas workers between January 2001 and September 2002, according to data from the Texas Workforce Commission. Nationwide, telecommunications providers and telecom equipment providers laid off about 500,000 people in the same time period.[279] Table 20 below breaks down the total layoffs in Texas by type of company from 1998-2002.

Table 20 — Annual Texas Layoffs by Telecom Providers and Equipment Vendors

	1998	1999	2000	2001	Jan – Sept 2002
Equipment Vendors	924	48	271	8,187	4,230
Telecom	-	250	837	3,887	724
Total	**924**	**298**	**1,108**	**12,074**	**4,954**
Austin Area	407	-	320	1,688	1,779
Dallas-Fort Worth Area	517	298	279	8,192	2,590
Other Areas (including Houston, El Paso, San Antonio, and others)	-	-	509	2,194	585
Total	**924**	**298**	**1,108**	**12,074**	**4,954**

SOURCE: Texas Workforce Commission

More telecommunications layoffs are coming in 2003, and some of those layoffs may affect Texas. After reporting second quarter losses, SBC indicated in July 2002 that it would cut 3,000 more jobs nationwide, on top of the 13,000 cut since October 2001.[280]

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[276] Simon Romero, SBC to Lay Off 11,000 Workers; Loss of Phone Customers Is Cited, NEW YORK TIMES at C6 (Sept. 27, 2002).

[277] Sanford Nowlin, *Its Earnings Down, SBC To Cut More Jobs,* EXPRESS-NEWS at E1 (July 24, 2002).

[278] OPASTCO: Industry Problems Hit Small Carriers Hardest, TR DAILY (July 30, 2002).

[279] *Too many debts; too few calls*, THE ECONOMIST, July 20, 2002, p. 59.

[280] Vikas Bajaj, *SBC, Lucent to cut thousands of jobs*, DALLAS MORNING NEWS, July 24, 2002, p. D1.

Then, in September 2002, SBC announced forthcoming layoffs of another 11,000 jobs through the first quarter of 2003.[281] Lucent announced that it will cut 7,000 more jobs after its fiscal third quarter, in addition to the 95,000 jobs that it has already cut.[282] Lucent began 2002 with 62,000 jobs and expects to cut that number almost in half through layoffs, spin-offs, and attrition. The company expects to have about 35,000 employees by March 2003; three years ago, it had more than 150,000.[283] Nortel has also announced plans to cut 3,500 more jobs nationwide, even though its workforce has already been cut in half since the beginning of the recession.[284]

[281] Dan Piller, *SBC woes linked to ill economy*, FORT WORTH STAR-TELEGRAM, September 28, 2002, p. C1.

[282] Michelle Kessler, Telecom earnings tell tale of sector's struggles, USA TODAY, July 24, 2002.

[283] Christopher Stern, Washington Post Staff Writer, *Lucent Ends Dismal Year, CEO Optimistic for 2003 Despite 10 Straight Losing Quarters,* October 24, 2002; at E04 http://www.washingtonpost.com.

[284] Elizabeth Douglass, *Losses Pile Up at Battered Telecom Firms*, LOS ANGELES TIMES, July 19, 2002.

Appendix E. Consolidation

According to a study by the Consumers Union, the largest four local companies[285] that served 48% of all phone lines in the country in 1996 now serve more than 85% of all local phone lines nationwide.[286]

Despite the fact that the U.S. Department of Justice blocked a merger between WorldCom and Sprint in 2000, the Federal Communications Commission (FCC) indicated that it would consider a merger between WorldCom and a regional Bell operating company (RBOC) in July 2002, before WorldCom filed for bankruptcy.[287] However, the number of consolidations has dropped since the peak in 2000, when nationally, telecom companies completed or announced more than 20 large mergers and acquisitions totaling more than $100 billion.[288] One of these mergers in 2000 of special import to the Texas market was between TXU Communications and Fort Bend Communication Companies, an incumbent local exchange carrier (ILEC) based in Fort Bend, Harris, Waller, and Brazoria counties.[289] However, the only large national acquisition in 2001 was AT&T's purchase of NorthPoint Communications, a bankrupt digital subscriber line (DSL) provider, for $135 million, and there have been none of note in 2002.

On the State level, some smaller local exchange carriers (LECs) have continued to merge in 2002. Valor Telecommunications, which is based in Irving, acquired Kerrville Communications Corporation on February 5, 2002, bringing Valor's number of phone lines up to 585,000.[290] Grande Communications, a company offering phone, cable, and broadband, and based in San Marcos, bought Austin-based ClearSource on July 2, 2002.[291] With ClearSource, Grande has raised $450 million in equity and $70 million in loans since 1998, and has $100 million in annual revenue.[292]

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[285] These companies are known as the remaining RBOCs, and include SBC, BellSouth, Qwest, and Verizon.

[286] Michael A. Hiltzik and James F. Peltz, *Did Telecom Reformers Dial the Wrong Number?,* LOS ANGELES TIMES, July 24, 2002.

[287] Liane H. LaBarba, *Powell: WorldCom Stance Is In Line With FCC Policy*, TELEPHONY ONLINE, July 22, 2002. Aaron Pressman, "U.S. to Block Sprint-WorldCom Merger," *The Industry Standard*, June 27, 2000.

[288] Eric Moskowitz, *M&A Insight: Telecom mergers on hold*, RED HERRING, June 1, 2001.

[289] Dallas-based TXU buys Fort Bend Communication Companies, HOUSTON BUSINESS JOURNAL, March 13, 2000.

[290] *Valor Telecom buys Kerrville Communications*, DALLAS BUSINESS JOURNAL, February 5, 2002.

[291] *Grande wraps up ClearSource deal,* AUSTIN BUSINESS JOURNAL, July 2, 2002.

[292] Vikas Bajaj, *Slow and steady*, DALLAS MORNING NEWS, August 27, 2002, p. D1.

Appendix F. Long-Distance Market Effect on Profit Share

AT&T

In the first quarter of 2002, AT&T's profit margin in the corporate market was down by 3% from the previous year, but its long-distance business was more profitable than its current high-growth businesses, such as data services.[293] AT&T has introduced unlimited flat-rate long-distance in an attempt to keep customers from substituting cell phones or email for long-distance service.[294]

Sprint

Sprint's long-distance traffic dropped 10% in the second quarter of 2002.[295] Sprint passes through a 1.08% carrier property tax to customers with the intent of keeping it per-minute charges low.[296]

WorldCom

WorldCom has had a declining long-distance market for years, but its finances have been offset by more than 60 acquisitions over the last 15 years.[297]

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[293] Stephanie N. Mehta, *Is there any way out of the telecom mess?,* FORTUNE, July 22, 2002, p. 84.

[294] Shelley Emling, "Telecom pain: No long-distance gain," *Austin American-Statesman*, June 28, 2002, p. 1C.

[295] "Bad Connection," *Forbes*, August 12, 2002, p. 85.

[296] Ruth Simon, "Telecom Woes Hit Consumers," *Wall Street Journal*, May 7, 2002, p. D1.

[297] Shelley Emling, "Telecom pain: No long-distance gain," *Austin American-Statesman*, June 28, 2002, p. 1C.

Appendix G. Texas Companies Declaring Bankruptcy

Table 21 — Texas Companies Declaring Bankruptcy

PARTY	CHAPTER	BANKRUPTCY COURT	DATE FILED
@Link Networks, Inc.	11	Delaware	4/25/01
2ND Century Communications of VA, Inc.	11	Southern District of Florida	6/25/01
360 Networks USA, Inc.	11	Southern District of New York	6/28/01
Adelphia Business Solutions, Inc.	11	Southern District of New York	3/27/02
ATS Telecommunications Systems, Inc.	7	Southern District of Texas	3/30/01
Birch Telecom, Inc.	11	Delaware	7/29/02
Broadband Office Communications, Inc.	11	Delaware	5/09/01
Connectsouth Communications, Inc.	11	Western District of Texas	3/13/01
Convergent Communications, Inc.	11	Colorado	6/12/01
CoServ, LLC	11	Northern District of Texas	11/30/01
E. Spire Communications, Inc.	11	Delaware	6/04/01
Enron Broadband Services, Inc.	11	Southern District of New York	12/02/01
Essential.com , Inc.	11	Massachusetts	6/29/01
Global Crossing, Ltd.	11	Southern District of New York	1/28/02
GST Action Telecom, Inc.	11	Delaware	5/17/01
GST Texas Lightwave, Inc.	11	Delaware	5/17/01
ICG Communications, Inc.	11	Delaware	11/14/00
ITC ^DeltaCom	11	Delaware	6/25/02
Lightyear Communications, Inc.	11	Western District of Kentucky	4/10/02
Logix Communications	11	Southern District of Texas	2/28/02
Metromedia Fiber Network Services, Inc.	11	Southern District of New York	5/20/02
Mpower Communications Corporation	11	Delaware	4/08/02
Net2000 Communications, Inc.	11	Delaware	11/16/01
Northpoint Communications, Inc.	7	Northern District of California	1/16/01
Northpoint International, Inc.	7	Northern District of California	6/12/01
Omniplex communications Group	11	Eastern District of Missouri	2/28/02
OnlineChoice.com, Inc.	7	Western District of Pennsylvania	4/30/01
Onsite Access, Inc.	11	Southern District of New York	5/16/01
Onsite Access, LLC	11	Southern District of New York	5/16/01
Optel (Texas) Telecom, Inc.	11	Delaware	10/28/99
Pathnet, Inc.	11	Northern District of Iowa	4/20/01
PointeCom, Inc.	11	Delaware	4/27/01
Rhythms NetConnections, Inc.	11	Southern District of New York	8/01/01
Servisense.com, Inc.	11	Massachusetts	8/20/01
Star Net Paging, Inc.	7	Eastern District of Texas	7/01/01
TechTel, Inc.	11	Northern District of Texas	9/05/02
Teligent, Inc.	11	Southern District of New York	5/21/01
Telscape International, Inc.	11	Delaware	4/27/01
Twister Communications Network, Inc.	7	Southern District of Texas	5/23/00
Vectris Telecom, Inc.	7	Western District of Texas	1/18/01
Viatel, Inc.	11	Delaware	5/02/01
Western Integrated Networks of Texas Operating, L.P.	11	Colorado	3/11/02
Winstar Communications, Inc.	11	Delaware	4/18/01
WorldCom, Inc.	11	Southern District of New York	7/21/02
XO Communications, Inc.	11	Southern District of New York	6/17/02

SOURCE: Texas Workforce Commission

Appendix H. Total ILEC and CLEC Retail Lines in Texas

Table 22 — Total ILEC and CLEC Retail Lines in Texas

YEAR	ILEC	CLEC	TOTAL
Dec-99	12,601,936	586,111	13,188,047
Jun-00	12,349,899	1,042,606	13,392,505
Dec-00	12,063,098	1,687,586	13,750,684
Jun-01	11,496,247	1,891,131	13,387,378
Dec-01	11,365,441	2,166,033	13,531,474
Jun-02	11,350,694	2,078,465	13,429,159

SOURCES: *Local Telephone Competition Reports,* FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.

Appendix I. CLEC Entry Strategies

Facilities-Based

The question of what factors determine whether a competitive local exchange carrier (CLEC) is providing facilities-based services is currently unanswered. Some proponents argue that facilities-based competition is present when a CLEC owns the switch and thus offers service by means other than resale or unbundled network elements platform (UNE-P). However, on the other end of the spectrum, some argue that CLECs must offer service via wholly-owned facilities-based offerings, including the CLEC's own loop. While the industry has yet to reach consensus regarding the meaning of facilities-based competition, for purposes of gathering data for this Report, the Commission defines facilities-based as providing services entirely through the CLEC's own facilities. However, it is difficult to ascertain which carriers offer wholly versus partially facilities-based services. There is no information collected by the Commission on a regular basis that provides any certainty regarding facilities-based services provided by local exchange carriers (LECs). It is apparent that the capital investment required to establish a strictly facilities-based operation is beyond the reach of most CLECs today.

Resale

The resale mode of entry is the most simple, least investment-intensive approach. Simply put, the incumbent local exchange carriers (ILECs) offer all services and products at a 21.6% discount to resellers. Some CLECs provide resale service to high-risk customers by offering prepaid services. Other CLECs utilize resale upon entering a market and then combine resale with other options, such as unbundled network elements (UNEs) or facilities-based services.

Compared to the other modes of entry, CLECs choosing to provide service via resale are generally at the mercy of the ILECs. If the ILEC raises its prices, the resellers must respond accordingly or reduce their profit margin. Increases in rates resulting in a loss of customers can be better absorbed by the ILECs, who have much broader customer basis.

Unbundled Network Elements: UNEs/UNE-P

As discussed in Chapter III, leasing facilities via UNEs or UNE-P appears to be the predominant method of market entry in Texas since the inception of the Federal Telecommunications Act of 1996 (FTA). A great deal of public and private resources have been invested in facilitating this mode of entry. Many CLECs utilize UNEs, either alone or in conjunction with their own facilities, to provide innovative products or specialized customer service to business and residential customers.[298]

Compared to full facilities-based providers and resellers, CLECs utilizing UNEs are presented with the greatest deal of the uncertainty because of the ongoing debate at

[298] *See also* discussion of wholesale competitors in Chapter III.

both the state and federal levels as to what network components should be made available as UNEs.

At the state level, telecommunications providers present to the Commission requests for arbitration of interconnection agreements in an effort to address changes in technology, the market, and competition.[299] One recent arbitration of note, referred to as the MCIMetro Arbitration, involved multiple parties and addressed issues for the first time since the adoption of the Texas 271 agreement (T2A) regarding network elements. Among those debated was the issue of unbundling requirements of Section 251 of the FTA.[300] In the MCIMetro Arbitration, the Commission preserved the availability of UNEs for CLECs. However, in the Arbitration Award, the Commission noted that at a future time, the Commission may reconsider the possibility that the bundled switch and loop may be reexamined.[301] Additionally, at the federal level, the Federal Communications Commission (FCC) is currently undergoing its triennial review regarding the future availability of traditional UNEs.[302]

Although CLECs have access to the current list of UNEs approved at the state and federal levels, future circumstances may warrant a change in that list pursuant to relevant state and federal law. Unfortunately, these circumstances tend to promote a "wait and see" attitude among CLECs and disrupt a CLEC's ability to plan future investment and market-entry strategies. However, the Commission continues to attempt to address these concerns and provide CLECs with the tools necessary for effective competition.

[299] *See infra* Chapter IV, Arbitration Decisions and Dispute Resolutions.

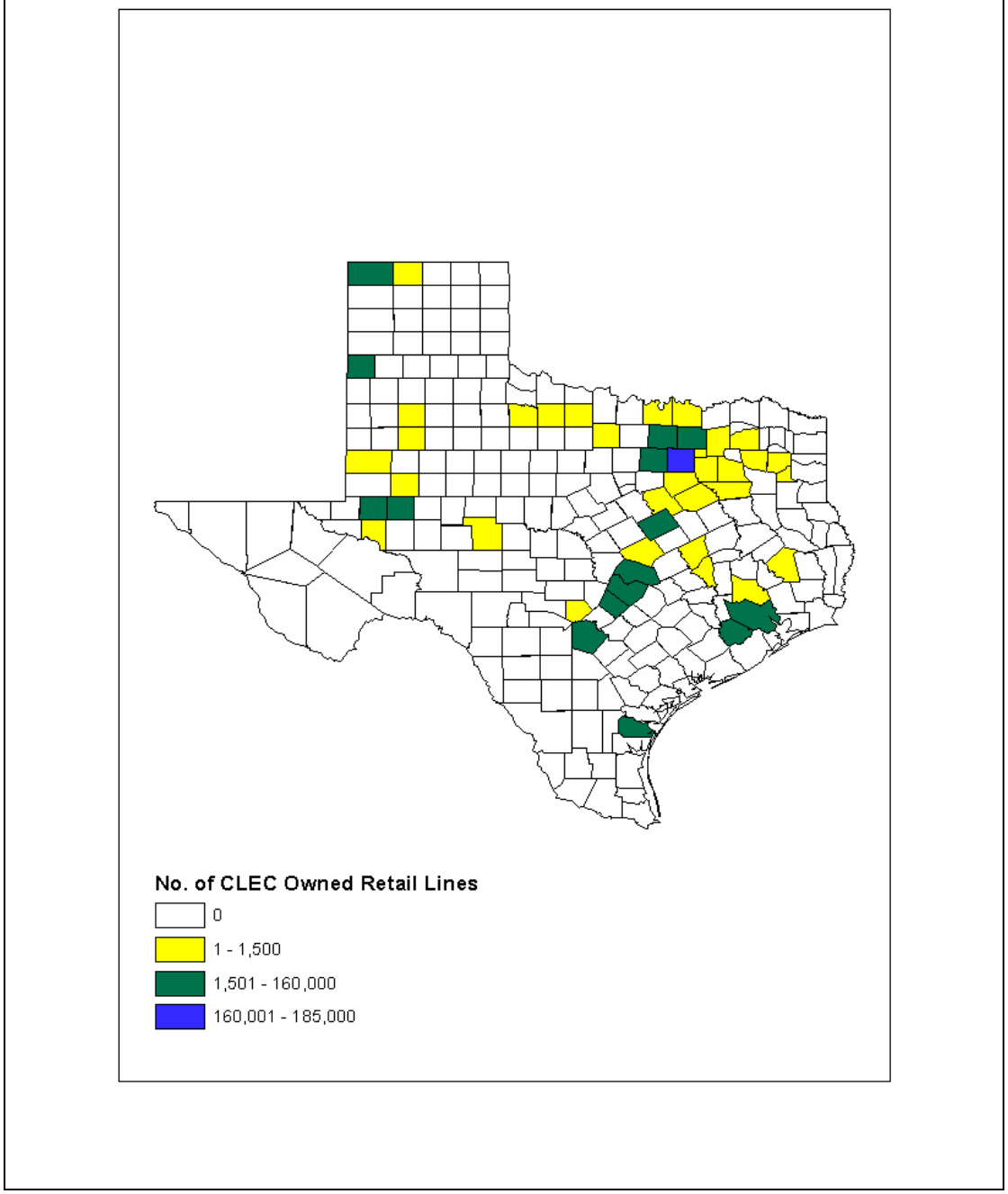
[300] *Petition of MCIMetro Access Transmission Services LLC for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996*, Docket No. 24542, Arbitration Award (Apr. 29, 2002) ("MCIMetro Arbitration").

[301] In the MCIMetro Arbitration, the Commission did not reconsider rates for UNEs or other services. Thos issues were severed into a second phase of the arbitration that is pending in Docket No. 25834, *Proceeding on Cost Issues Severed From Docket No. 24542*.

[302] The FCC is also reviewing the availability of line sharing, CLEC access to ILEC facilities necessary to provide xDSL service. *See infra* Chapter V, FCC Activities.

Appendix J. CLEC Facilities-Based Lines by County

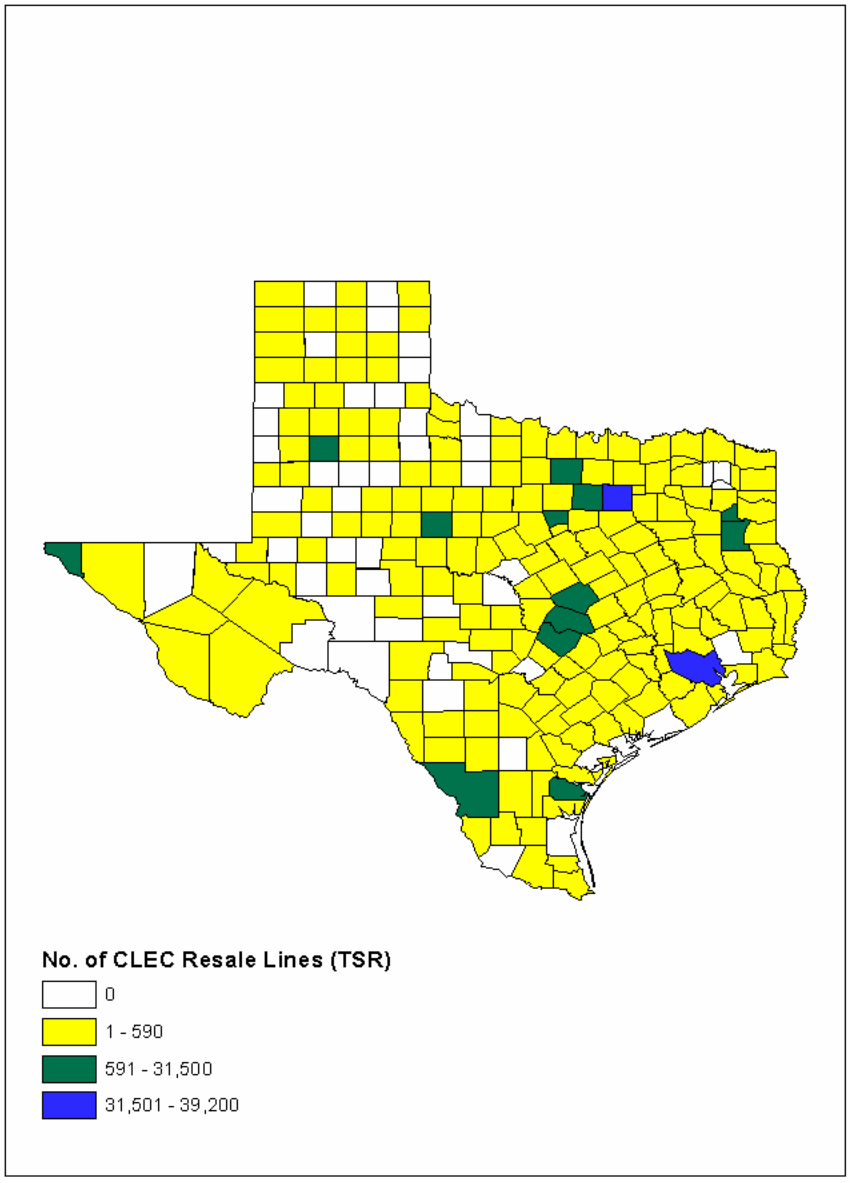
Figure 35 — CLEC Facilities-Based Lines by County



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Appendix K. CLEC Total Service Resale (TSR) Lines by County

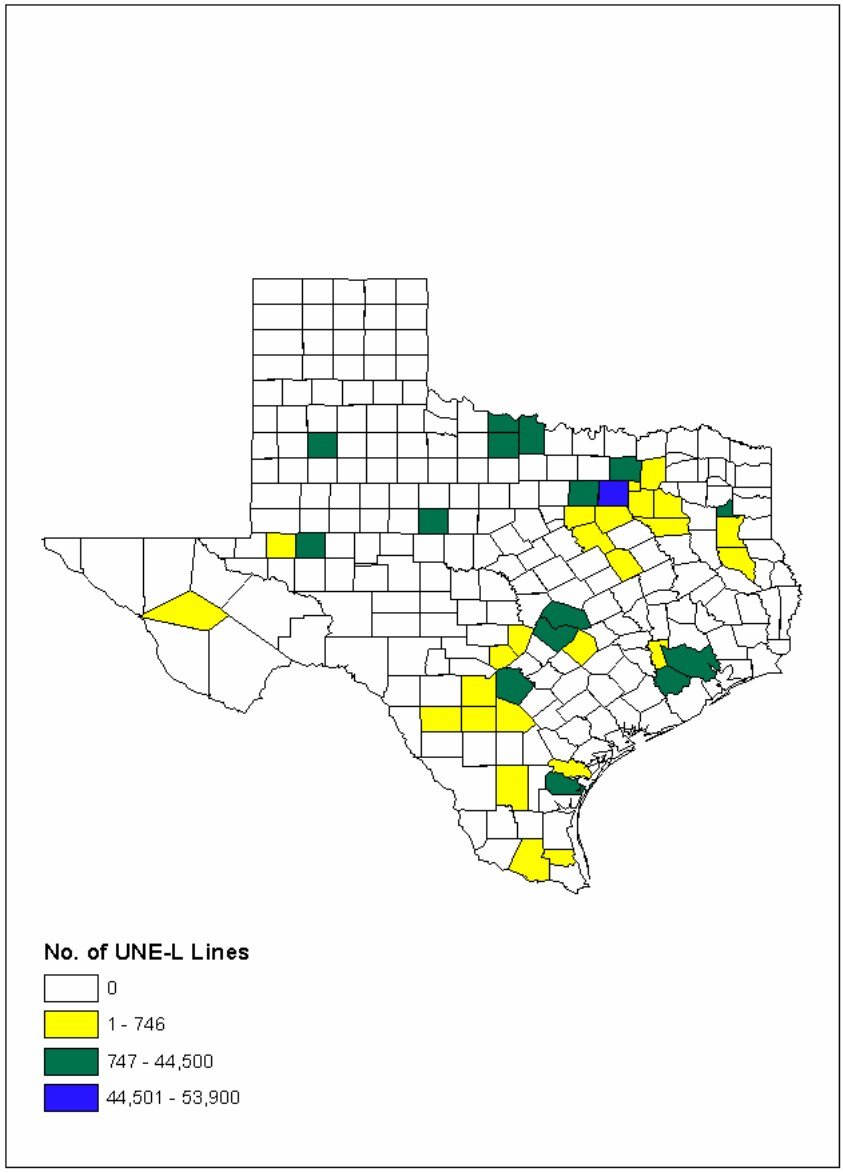
Figure 36 — CLEC Total Service Resale (TSR) Lines by County



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Appendix L. CLEC UNE-L Lines by County

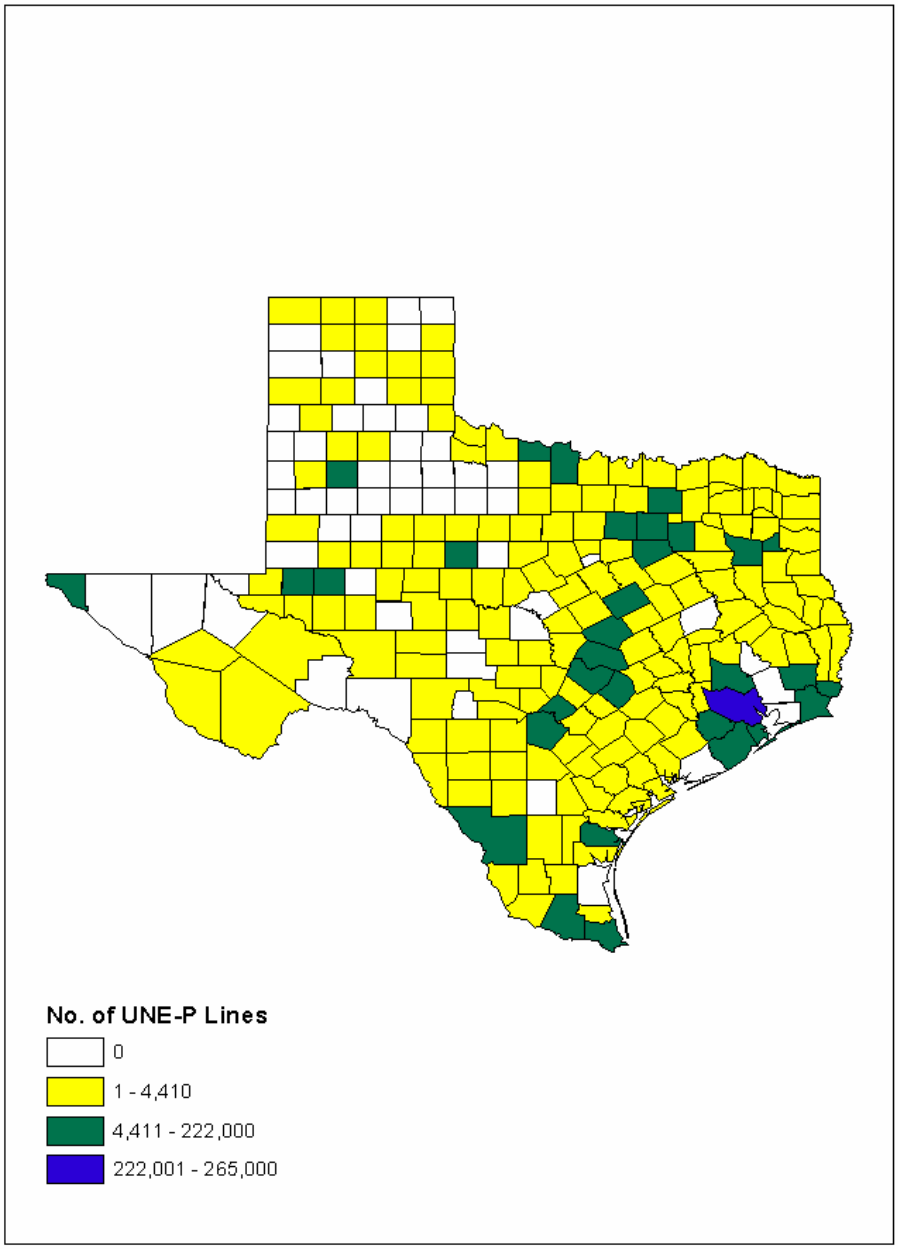
Figure 37 — CLEC UNE-L Lines by County



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Appendix M. CLEC UNE-P Lines by County

Figure 38 — CLEC UNE-P Lines by County



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Appendix N. Commission Arbitration Decisions

Points of Interconnection

DOCKET NO. 22315—*Petition of Southwestern Bell Telephone Company for Arbitration With AT&T Communications of Texas, L.P., TCG Dallas, and Teleport Communications, Inc. Pursuant to Section 252(b)(1) of the Federal Telecommunications Act of 1996.*

This was an arbitration dispute in which the Commission determined that AT&T has the option to connect at only one technically feasible point in each LATA. Although cost cannot be a determinant of technical feasibility, the Commission found that costs may be taken into consideration after technical feasibility has been established. Transport costs associated with interconnection are based on the assumption of a standard 14-mile distance for local transport. Because competitive local exchange carriers (CLECs) select the location of a point of interconnection (POI) in an incumbent local exchange carrier's (ILEC's) network, an alternative mechanism must be established to address local traffic that goes beyond the 14-mile limit. The Commission determined that until a *de minimis* traffic threshold is reached, reciprocal compensation rates will apply to all calls regardless of whether the call was transported across the local calling area boundary to the POI. However, after this threshold is reached, the compensation mechanisms will vary depending on whether the local call crossed that boundary.

DOCKET NO. 22441—*Petition of Level 3 Communications, LLC for Arbitration Pursuant to Section 252(b) of the Communications Act of 1934, as Amended by the Telecommunications Act of 1996, and PURA for Rates, Terms, and Conditions with Southwestern Bell Telephone Company.*

In this proceeding, the Commission determined that at least one POI is appropriate in any mandatory local calling area in which a CLEC offers service to customers. This determination can be distinguished from the Commission's decision in Docket No. 22315 that gave the CLEC the option to interconnect at *only one* technically feasible point *in each LATA*. Further, the Commission determined that a CLEC needs only one POI where it has end-use customers in a local calling area in a LATA. Similar to Docket Nos. 21791 and 22315, the Arbitration Award in this proceeding encourages the negotiation of additional POIs when call traffic levels reach a certain point in order to avoid network and tandem exhaust.

Collocation

DOCKET NO. 21333—*Proceeding to Establish Permanent Rates for Southwestern Bell Telephone Company's Revised Physical and Virtual Collocation Tariffs*

This was a proceeding to determine permanent rates and rate elements, as well as additional rate elements, rates, terms and conditions in the permanent cost proceeding for microwave systems and transmission, and interconnection arrangements for interfaces operating at speeds greater than DS-3 through Digital Cross-Connect Systems (DCS).

The Commission held that the cageless collocation should be modeled as a form of virtual collocation rather than common collocation to avoid potential problems of space unavailability and higher costs. The Commission also found that, to comply with the Section 271 requirements, promote competition in Texas, and remove barriers to entry, Southwestern Bell Telephone Company (SWBT) must provide off-site collocation arrangements to the extent space is unavailable in SWBT's central office.

Reciprocal Compensation

The Federal Telecommunications Act of 1996 (FTA) specifies that all local exchange carriers have the duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications. A telephone call may originate on one carrier's network but terminate on the network of another carrier. The *originating* carrier typically pays the *terminating* carrier for completing the call. Reciprocal compensation is the program by which the company doing the billing and collecting the money pays over some of those monies to the other phone companies in the chain. Typically, when amounts and direction of traffic is relatively balanced between the originating and terminating carriers, carriers often instituted *bill-and-keep* arrangements whereby no payments occurs between carriers.

However, internet calling patterns changed reciprocal compensation arrangements considerably. Reciprocal compensation arrangements were designed to compensate companies for their customers' traditional voice calls, which calls tended to be of approximately equal duration customer-to-customer and to be reasonably balanced carrier-to-carrier. Internet calls, on the other hand, tend to be of long duration and are often uni-directional, particularly when one company's customers are primarily, or even exclusively, internet service providers (ISPs).

DOCKET NO. 21982—*Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996.* [303]

The Commission reaffirmed its previous conclusions that ISP-bound traffic is local in nature and is eligible for reciprocal compensation. The Commission also reaffirmed its previous determination that reciprocal compensation arrangements apply to calls that originate from and terminate to an end-user within a mandatory single or multi-exchange local calling area, including the mandatory extended area service (EAS)/extended local calling service (ELCS) areas comprised of SWBT exchanges and the mandatory EAS/ELCS areas comprised of SWBT exchanges and exchanges of ILECs.

With respect to a hierarchical or two-tier switch network, the Commission found that if only an end-office switch is employed to terminate traffic, then the end-office rate shall apply, and if a tandem switch is used, then the tandem rate shall apply. For a network using multiple-function switches, the Commission adopted the "tandem blended rate." This rate is calculated by adding end-office switching to the percentage of the

[303] *Southwestern Bell Tele. Co. v. Public Util. Comm.,* No. W-00-CA-313, slip op. at 19 (W.D. Tex. Apr. 4, 2002)

tandem switch and interoffice transport. This rate reflects that only a percentage of the calls switched use tandem functions and are terminated in a geographically dispersed area.

The Commission acknowledged the lack of agreement among the parties with respect to billing issues, and concluded that, when technically feasible, the terminating carrier's records shall be used to bill originating carriers (excluding transiting carriers) for reciprocal compensation, unless both the originating and terminating carriers agree to use originating records. Terminating carriers shall be required to directly bill third parties that originate calls and send traffic over SWBT's network. On April 4, 2002, the federal district court in Waco issued a final judgment affirming the Commission's order in all respects. However, the cause remains pending before district court to address a SWBT motion seeking clarification of whether the judgment applies to CLECs that had previously declared bankruptcy.

CLEC Wholesale Provisioning of ILEC UNEs to Other CLECs

DOCKET NO. 25188—*Petition of El Paso Networks, LLC for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company*

In this arbitration proceeding between El Paso Networks (EPN) and SWBT, the Commission made a number of critical findings. First, with respect to Wholesale Service, the Commission confirmed an earlier arbitration decision (*see*, *Petition of Waller Creek Communications, Inc. with SWBT*, Docket No. 17922) that CLECs can use unbundled network element (UNE) dark fiber (or other UNEs) to carry traffic for any other telecommunications provider regardless of who is serving the retail, local end-use customer. Thus, in this case, the Commission found that EPN can use UNEs in combination with its own facilities to provide wholesale services to other providers.

With respect to UNE combinations, the Commission found that SWBT shall, upon request, perform the functions necessary to combine unbundled network elements in any manner, even if those elements are not ordinarily combined in its network, provided that such combination is: (1) technically feasible; and (2) would not impair the ability of other carriers to obtain access to unbundled network elements or to interconnect with the ILEC's network. This obligation on SWBT is consistent with the FTA § 251(c)(3), 47 CFR § 51.315(c) ("Rule 315(c)") and the United States Supreme Court's holding in Verizon v. Federal Communications Commission.

With respect to Dark Fiber, the Commission found that dark fiber is fiber that has not been activated through connection to the electronics that "light" it and render it capable of carrying telecommunications services. SWBT is obligated to provide dark fiber UNEs to EPN, but the dark fiber UNEs do not necessarily need to be terminated at both ends. The Commission found that the availability of fiber is governed by the 25% rule.[304] Further, SWBT has an obligation to provide unspliced dark fiber and shall splice the fiber upon request by EPN.

[304] A telecommunications provider may not, in a 24-month period lease more than 25% of SWBT's excess dark fiber capacity in a particular dedicated, interoffice transport segment.

Appendix O. SWBT T2A Fines (June 2000 through December 2001)

Table 23 — SWBT T2A Fines, June 2000 through December 2001

SWBT T2A Fines June 2000 Through December 2001				
PM	**Description**	**Total**	**Tier 1**	**Tier 2**
13	Order Process: Percent Flow Through	$3,224,779	$2,399,779	$825,000
35	% Trouble Reports Within 10 Days of Installation - Resale/UNE-P	$2,462,633	$1,244,133	$1,218,500
27	Mean Installation Interval for Resale/UNE-P	$2,368,701	$2,368,701	$0
29	% SWBT Missed Due Dates for Resale/UNE-P	$1,468,081	$1,057,081	$411,000
59	% Trouble Reports within 30 Days of Installation - UNEs	$965,448	$497,448	$468,000
37.1	Trouble Report Rate: Net of Install. & Repeat Rpts. - Resale/UNE-P	$927,594	$927,594	$0
58	Percent SWBT Missed Due Dates - UNEs	$705,479	$411,479	$294,000
97	Local Number Portability: % of Time SWBT Applies 10 Digit Trigger Prior to the LNP Order Due Date	$476,579	$102,579	$374,000
17	Billing Completeness	$409,227	$409,227	$0
39	Mean Time to Restore Service - Resale/UNE-P	$302,776	$86,276	$216,500
65	Trouble Report Rate - UNEs	$273,578	$189,078	$84,500
56	% UNEs Installed Within The Customer Requested Due Date	$261,731	$173,231	$88,500
38	% Missed Repair Commitments - Resale/UNE-P	$226,303	$130,303	$96,000
5	Percent Firm Order Confirmations (FOCs) Returned on Time	$160,173	$96,873	$63,300
101	Local Number Portability: % Out of Service < 60 Minutes	$98,476	$98,476	$0
67	Mean Time to Restore - Maintenance - UNEs	$96,025	$30,025	$66,000
65.1	Trouble Report Rate (Net of Install & Repeat Rpts) UNEs	$78,973	$56,973	$22,000
1.2	Accuracy of Actual Loop Makeup Information for DSL Orders	$78,315	$915	$77,400
73	% Installations Completed Within the Due Date - Trunks	$76,356	$76,356	$0
62	Avg. Delay Days for SWBT Missed Due Dates - UNEs	$74,693	$74,693	$0
45	% SWBT-Caused Missed Due Dates - Resale Specials	$68,644	$68,644	$0
2	% Response Within "x" Seconds - OSS Interfaces	$63,850	$33,850	$30,000
43	Average Installation Interval - Resale Specials	$60,128	$27,628	$32,500
12.1	% Provisioning Accuracy For Non-Flow Through Orders	$58,350	$58,350	$0
40	% Out of Service Less than 24 Hours - Resale/UNE-P	$49,591	$49,591	$0

SWBT T2A Fines June 2000 Through December 2001				
PM	**Description**	**Total**	**Tier 1**	**Tier 2**
111	Average Update Interval for DA Database	$42,300	$42,300	$0
41	% Repeat Reports - Maintenance - Resale/UNE-P	$36,471	$36,471	$0
73.1	% Held Interconnection Trunks	$34,327	$34,327	$0
32	Avg. Delay Days for SWBT Caused Missed Due Dates - Resale/UNE-P	$32,642	$32,642	$0
96	% Premature Disconnects for Stand Alone LNP Orders	$32,500	$32,500	$0
69	% Repeat Reports - UNEs	$25,436	$25,436	$0
70	% Trunk Blockage	$25,000	$25,000	$0
60	% Missed Due Dates Due to Lack of Facilities - UNEs	$19,975	$19,975	$0
55.1	Avg. Installation Interval - DSL	$18,171	$18,171	$0
12	Mechanized Provisioning Accuracy	$15,280	$15,280	$0
37	Trouble Report Rate - Resale/UNE-P	$14,565	$14,565	$0
49	Avg. Delay Days for SWBT Caused Missed Due Dates - Resale Specials	$13,728	$13,728	$0
75	% SWBT Missed Due Dates - Trunks	$12,700	$12,700	$0
46	% Trouble Reports within 30 Days - Resale Specials	$12,183	$12,183	$0
7.1	% Mechanized Completions Returned Within One Day	$8,165	$8,165	$0
112	% of Database Accuracy for Manual Updates	$8,102	$8,102	$0
10.1	% Manual Rejects Recorded Electronically and Returned Within Five Hours	$6,755	$6,755	$0
115.1	Mean Time to Restore - Coordinated Conversions	$5,605	$5,605	$0
66	% Missed Repair Commitment - UNEs	$5,000		$5,000
117	% NXXs Loaded/Tested Prior to LERG	$4,800	$4,800	$0
53	% Repeat Reports - Maintenance - Resale Specials	$4,611	$4,611	$0
99	Avg. Delay Days for SWBT Missed Due Dates - LNP	$4,536	$636	$3,900
74	Avg. Delay Days for Missed Due Dates - Trunks	$4,476	$4,476	$0
114	% of Premature Disconnects - Coordinated Conversions	$4,050	$4,050	$0
10	% Mech. Rejects Retd within One Hour of Receipt in LASR	$3,175	$3,175	$0
93	% of Customer Accounts Restructured Prior to LNP Due Date	$2,606	$2,606	$0
115	Percent Provisioning Trouble Reports - Coordinated Convs.	$2,100	$2,100	$0
113	DA Database % of Electronic Updates That Flow Through	$2,000	$2,000	$0
114.1	CHC/FDT LNP with Loop Provisioning Interval	$1,950	$1,950	$0
54	Trouble Report Rate - Resale Specials	$1,581	$1,581	$0
55.5	Loop Acceptance Testing (LAT Completed) - UNEs	$1,125	$1,125	$0
56.1	% Installed Within X Days for LNP with Loop	$1,063	$1,063	$0
55	Average Installation Interval - UNEs	$1,050	$1,050	$0

SWBT T2A Fines June 2000 Through December 2001				
PM	**Description**	**Total**	**Tier 1**	**Tier 2**
5.1	% FOCs Rec. Within x Hours - xDSL-capable Loops	$959	$959	$0
78	Avg. Interconnection Trunk Install. Interval	$750	$750	$0
100	Avg. Time of Out of Service for LNP Conversions	$750	$750	$0
107	% Missed Collocation Due Dates	$460	$460	$0
52	Mean Time to Restore - Resale Specials	$450	$450	$0
109	% of Collocation Requests within Guidelines	$449	$449	$0
17.1	Service Order Posting	$400	$400	$0
1.1	Avg. Response Time for Loop Make-Up Information	$330	$330	$0
5.2	% FOCs Rec. Within "x" Days on ASR Requests	$325	$325	$0
54.1	Trouble Report Rate Net of Installation and Repeat Reports	$325	$325	$0
118	Avg. Delay Days for NXX Loading and Testing	$206	$206	$0
103	% Errors for E-911 Database Updates	$175	$175	$0
108	Avg Delay Days for SWBT Missed Due Dates - Collo.	$127	$127	$0
30	% Missed Due Dates Due to LOF - Resale/UNE-P	$81	$81	$0
106	Average Days Required to Process a Request	$50	$50	$0
47	% Missed Due Dates Due to LOF - Resale Specials	$27	$27	$0
63	% SWBT Caused Missed Due Dates > 30 Days - UNEs	$25	$25	$0
76	Avg. Trunk Restoral Interval	$25	$25	$0
	TOTAL	$15,450,425	$11,074,325	$4,376,100
	AVERAGE	$203,295.07	$145,714.81	$57,580

Appendix P. Rate Group Reclassification

Table 24 — SWBT's Rate Group Reclassification by Exchange

Exchange	Previous Rate Group	Previous Rate	Reclassified Rate Group	Reclassified Rate
Allen	2	$8.35	3	$8.80
Austin	5	$9.35	6	$9.85
Bandera	1	$8.15	2	$8.35
Brownsville	3	$8.80	4	$9.10
Burkburnett	3	$8.80	4	$9.10
Carthage	1	$8.15	2	$8.35
Center	1	$8.15	2	$8.35
Dallas	7	$10.40	8	$11.05
Deadwood	1	$8.15	2	$8.35
Eastland	1	$8.15	2	$8.35
Edcouch	3	$8.80	4	$9.10
Ennis	1	$8.15	2	$8.35
Fort Worth	6	$9.85	7	$10.40
Henrietta	3	$8.80	4	$9.10
Hereford	1	$8.15	2	$8.35
Iowa Park	3	$8.80	4	$8.35
Laredo	3	$8.80	4	$9.10
Liberty Hill	1	$8.15	2	$8.35
Longview	3	$8.80	4	$9.10
McKinney	3	$8.80	4	$9.10
Medina Lake	1	$8.15	2	$8.35
Mercedes	2	$8.35	3	$8.80
Orange	2	$8.35	3	$8.80
Port Isabel	3	$8.80	4	$9.10
Roscoe	1	$8.15	2	$8.35
Spring	4	$9.10	5	$9.35
Sullivan City	2	$8.35	3	$8.80
Sweetwater	1	$8.15	2	$8.35
Tomball	4	$9.10	5	$9.35
Troy	2	$8.35	3	$8.80
Uvalde	1	$8.15	2	$8.35
Wharton	1	$8.15	2	$8.35

SOURCE: *Application of Southwestern Bell Telephone for Rate Group Reclassification,* Docket No. 18509

Table 25 — Verizon's Rate Group Reclassification by Exchange

Exchange	Previous Rate Group	Previous Rate	Reclassified Rate Group	Reclassified Rate
Arcola	1	$7.10	2	$7.30
Bacliff	1	$7.10	2	$7.30
Beach City	1	$7.10	2	$7.30
Boerne	1	$7.10	2	$7.30
Brady	1	$7.10	2	$7.30
Brownwood	2	$7.30	3	$7.50
Buda	1	$7.10	2	$7.30
Caldwell	1	$7.10	2	$7.30
Canton	1	$7.10	2	$7.30
Carrollton	3	$7.50	4	$7.65
Coleman	1	$7.10	2	$7.30
College Station	2	$7.30	3	$7.50
Denton	3	$7.50	4	$7.65
DFW Airport	1	$7.10	2	$7.30
Dripping Springs	1	$7.10	2	$7.30
Georgetown	2	$7.30	3	$7.50
Giddings	1	$7.10	2	$7.30
Grapevine	2	$7.30	3	$7.50
Hallsville	1	$7.10	2	$7.30
Huffman	1	$7.10	2	$7.30
Ingleside	1	$7.10	2	$7.30
Keller	2	$7.30	3	$7.50
Kernah	2	$7.30	3	$7.50
Kilgore	2	$7.30	3	$7.50
Kingsland	1	$7.10	2	$7.30
Kyle	1	$7.10	2	$7.30
La Grange	1	$7.10	2	$7.30
LaFeria	1	$7.10	2	$7.30
League City	2	$7.30	3	$7.50
Lewisville	3	$7.50	4	$7.65
Llano	1	$7.10	2	$7.30
Mont Belvieu	1	$7.10	2	$7.30
Palacios	1	$7.10	2	$7.30
Plano	3	$7.50	4	$7.65
Raymondville	1	$7.10	2	$7.30
Robstown	2	$7.30	3	$7.50
Roma	1	$7.10	2	$7.30
Rowlett	2	$7.30	3	$7.50
Rusk	1	$7.10	2	$7.30
San Angelo	3	$7.50	4	$7.65
Stafford	2	$7.30	3	$7.50
Weslaco	2	$7.30	3	$7.50
Whitesboro	1	$7.10	2	$7.30
Wimberly	1	$7.10	2	$7.30

SOURCE: *Application of Verizon Southwest TXC to Reclassify Exchanges to the Proper Rate Band*, Project No. 24917.

Appendix Q. TUSF Disbursements

Table 26 — TUSF Disbursements by Program

TUSF Program Disbursements	FY 1999 (Actual)	FY 2000 (Actual)	FY 2001 (Actual)	FY 2002 (Estimated)	% Change (2000-2001)
Texas High Cost Universal Service Plan (THCUSP)	0	385,629,821	440,486,990	445,673,998	12.5%
Small and Rural ILEC Universal Service Plan	38,084,091	95,223,141	98,810,923	100,582,125	3.6%
Texas Relay Service	6,816,004	10,034,792	13,151,160	12,700,482	23.7%
Lifeline	276,624	8,716,027	9,225,611	15,304,024	5.5%
Specialized Telecommunications Assistance Program	322,420	578,401	761,023	1,263,751	24%
Implementation of PURA § 56.025	2,965,448	4,448,171	4,448,180	4,448,674	.2%
USF Reimbursement for Certain IntraLATA Services	0	784,330	1,107,596	1,462,540	29.2%
Additional Financial Assistance (AFA)	0	0	0	0	0%
Service to Uncertificated Areas	0	0	0	0	0%
Tel-Assistance	2,210,432	2,921,220	2,210,735	0	(32.1%)
TCDHH	148,242	267,929	286,414	448,667	6.5%
PUC	103,872	149,327	203,506	154,273	26.6%
TDHS	286,870	397,391	277,440	12,367	(43.2%)
Other	186,350	0	9,192	0	(95.1%)
NECA	652,104	729,480	751,356	773,900	2.9%
TOTALS	$52,052,457	$509,880,030	$571,730,126	$582,824,799	10.8%

Table 27 — TUSF Disbursements to Companies

	2000	2001
ALENCO	1,835,515	1,949,061
Big Bend Telephone Company of Texas	3,087,809	3,202,592
Blossom Telephone Company	50,018	52,448
Brazoria Telephone Company	2,439,400	2,383,873
Brazos Telephone Cooperative, Inc.	575,086	585,592
North Texas Telephone Company	148,753	149,677
Cameron Telephone Company	422,397	428,935
Cap Rock Telephone Cooperative, Inc.	1,476,421	1,486,945
Central Texas Telephone Cooperative	1,992,014	2,085,623
Coleman County Telephone Coop.	557,009	518,087
Comanche County Telephone Company	519,924	525,460
Community Telephone Company, Inc.	593,432	602,632
Cumby Telephone Cooperative, Inc.	256,354	269,852
Dell Telephone Cooperative, Inc.	365,281	417,768
Eastex Telephone Cooperative	5,058,058	5,207,352
Electra Telephone Company	601,240	727,949
E.N.M.R. Telephone Cooperative	-	-
Etex Telephone Cooperative, Inc.	2,919,248	3,082,637
Five Area Telephone Cooperative	726,066	727,596
Fort Bend Telephone Company	619,936	4,392,906
Ganado Telephone Company, Inc.	681,654	765,778
GTE Southwest Inc. d/b/a Verizon Southwest	166,090,944	108,391,493
Guadalupe Valley Telephone Coop.	4,984,619	5,279,799
United Telephone Company of Texas	19,152,399	17,933,754
Hill Country Telephone Cooperative	3,213,694	3,346,456
Industry Telephone Company	872,802	986,214
Kerrville Telephone Company, Inc.	2,719,544	2,797,514
Century Telephone of Lake Dallas, Inc.	1,644,386	1,740,099
Lake Livingston Telephone Company	604,849	602,452
La Ward Telephone Exchange	419,355	428,202
Lipan Telephone Company	636,063	672,239
Livingston Telephone Company	485,593	508,488
Lufkin-Conroe Telephone Exchange	-	14,444,569
Mid-Plains Rural Telephone Coop.	635,455	646,802
Nortex Communications	1,636,308	1,728,606

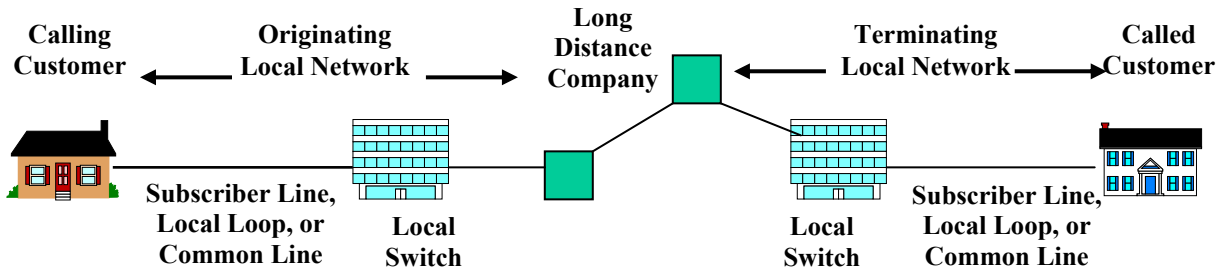
	2000	2001
Century Telephone of Port Aransas, Inc.	581,111	603,110
Peoples Telephone Cooperative, Inc.	1,449,751	1,559,926
Poka-Lambro Rural Telephone Coop.	1,928,416	1,911,296
Riviera Telephone Company, Inc.	1,126,845	1,157,139
Southwest Texas Telephone Company	1,967,656	2,021,228
Century Telephone of San Marcos, Inc.	5,821,972	5,846,107
Santa Rosa Telephone Cooperative	401,051	433,923
South Plains Telephone Cooperative	1,110,272	1,122,427
Southwest Arkansas Telephone Coop.	31,635	32,272
Southwestern Bell Telephone Company	50,271,965	135,731,792
Sugar Land Telephone Company	-	-
Tatum Telephone Exchange	555,196	642,847
Taylor Telephone Cooperative, Inc.	1,020,761	1,047,950
Texas ALLTEL	-	-
Valley Telephone Cooperative, Inc.	5,197,880	5,310,125
Wes-Tex Telephone Cooperative, Inc.	514,659	262,224
West Texas Rural Telephone Cooperative	984,938	985,733
XIT Rural Telephone Cooperative	651,431	656,367
Central Telephone Co. of Texas	22,660,496	24,279,583
Border to Border Communications	231,936	230,507
West Plains Telecommunications, Inc.	751,913	764,739
Brazos Telecommunications, Inc.	601,896	623,959
Valor Telecommunications of Texas	33,641,489	101,410,317

Appendix R. Background on Switched Access Charges

When a customer places a long-distance call, the call must use the local telephone company's network as well as the long-distance company's network to reach its destination. The long-distance company charges the customer for the call and the long-distance company must compensate the local telephone company (or companies) for the use of the local network on each end of the call.

Switched access charges are the wholesale rates paid by the long-distance companies to the local telephone companies—both incumbent and competitive—for access to the public switched network for the origination and termination[305] of customers' long-distance calls.[306] Competing local telephone companies also pay each other terminating switched access charges when their customers make long-distance calls to the other telephone company's customers.

The diagram below illustrates the transport and switching of a typical call from one customer's premise to another's:



Switched access charge elements can be both usage-sensitive and flat-rated. Usage-sensitive rates are developed on a per-minute of use basis where the wholesale customer pays "x" cents per minute to the incumbent or competitive local telephone company. Flat-rated means that the wholesale customer pays to the local telephone company the same amount per month regardless of the amount of time the service is used. Generally, long-distance companies develop the rates they charge to their long-distance customers based upon the wholesale structure and rates that they pay to the local telephone companies.

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[305] "Originating" applies to the caller's end of the public switched network. "Terminating" applies to the called party's end of the public switched network. For example, if a long-distance provider handles a call originating in Southwestern Bell's (SWBT) territory and terminating in GTE Southwest's (GTESW) territory, that long-distance provider pays the originating components of the call's switched access charges to SWBT and the terminating components of the switched access charges to GTESW.

[306] There are actually two types of access charges: switched access and special access. Special access charges, which are not the focus of this report, involve the use of dedicated non-switched circuits between customer locations.

Federal and state regulators share jurisdiction over telephone companies, and therefore over switched access rates. The Federal Communications Commission (FCC) sets the federal switched access rates that apply to interstate calls made from state to state (interstate). Pursuant to the Public Utility Regulatory Act (PURA), the Commission has jurisdiction over switched access rates applicable to long-distance calls made from point to point within Texas (intrastate).

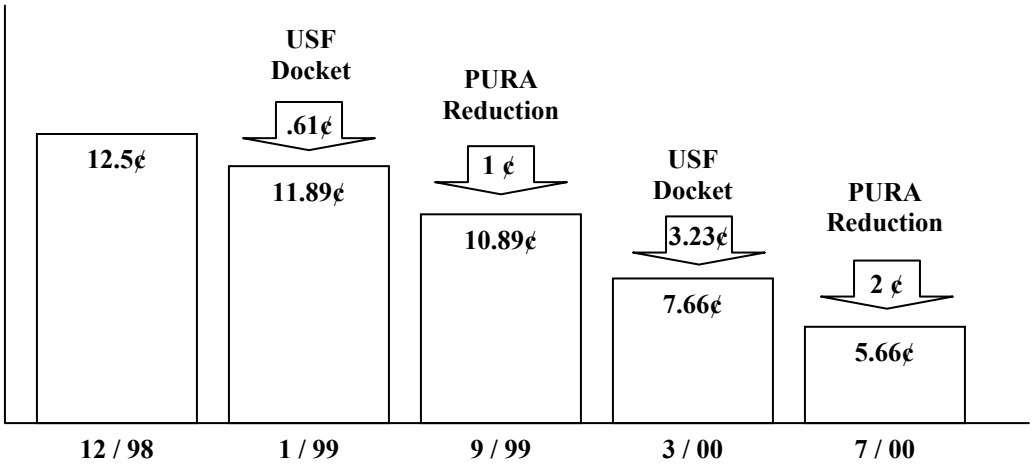
Why Are Access Charges Necessary?

Before the divestiture of the Bell companies from AT&T in 1984, the monopoly telephone companies pooled long-distance revenues and calculated payments to one another from those pools based upon minutes of use and mileage to compensate for the use of one another's networks. Simply put, switched access charges replaced the revenue sharing mechanisms of the monopoly telephone companies.

How Are Access Charges Structured and Calculated?

Access charges consist of several elements, as shown in the diagram below. The local loop facilities between the local switch and the customer's location are represented through an access charge element known as the Carrier Common Line (CCL) charge. The CCL element is charged on a per-minute basis, which is controversial. Because the cost of the customer's loop network does not vary with usage, most critics argue that the cost should be recovered through flat-rate charges rather than per-minute charges. The Local Switching (LS) element is based on usage-sensitive costs and is charged on a per-minute basis. Entrance Facilities and Transport elements are charged according to the needs of the long-distance company.

Southwestern Bell's Recent Access Rate Reductions
(Composite Originating and Terminating Charges; Excludes Transport Element)



Options Available to the Commission

The Commission generally agrees with parties who assert that usage-sensitive access charges such as the CCL should not be used to recover non-traffic sensitive costs. The originating and terminating CCL charge should be eliminated as soon as it is practical to do so. However, the CCL charge represents a significant amount of revenue for both large and small incumbent local exchange carriers (ILECs), and the elimination must be handled cautiously. One of the following options, or a combination of these options, could accomplish the elimination of the CCL:

A. Elimination, immediately or over time, of the originating and terminating CCL charges for all incumbent local telephone companies without providing for a specific new revenue stream to compensate the telephone companies for the elimination of the charges.

Advantages:

- Eliminates non-cost based minute-of-use charges.
- Directly reduces the cost of long-distance calls to long-distance companies, and reduces the total bills for customers that use long-distance, assuming access charge reductions are flowed through to reduce long-distance rates.
- Disparities that exist today between interstate and intrastate switched access rates and among local telephone companies would be greatly reduced.

Disadvantages

- Not all incumbent local telephone companies may be earning enough to absorb the revenue decrease, thereby requiring additional alternative methods for some companies to recover a revenue shortfall.

B. Implementation of a statewide Subscriber Line Charge (SLC) for all incumbent local telephone companies and reduce and/or eliminate any remaining originating and terminating CCL. This proposal is equivalent to the "Flat Rate Proposal" suggested by the parties. The new state SLC would appear on each customer's bill regardless of whether the customer makes long-distance calls.

Advantages:

- Eliminates the non-cost based minute-of-use charges.
- Reduces the cost of long-distance calls to long-distance companies, and reduces the total bills for customers that use long-distance, assuming access charge reductions are flowed through to reduce long-distance rates.
- Disparities that exist today between interstate and intrastate switched access rates and among local telephone companies would be greatly reduced.

Disadvantages

- For customers who do not use long-distance frequently, the SLC charge may exceed any savings on reduced long-distance charges, thus increasing the customer's total bill.
- As with the federal SLC, a disproportionately high amount of the loop cost is imposed on those who make very few long-distance calls.

- Not all incumbent local telephone companies need to participate in a Statewide SLC plan because some incumbent telephone companies do not have CCL charges.
- An additional surcharge (the State SLC) would be added to customer bills; existing surcharges are already the source of customer confusion and irritation.
- PURA Section 53.113 currently requires intrastate switched access service tariffs to include all rate elements in the company's interstate access tariff other than end-user charges.

C. Reduce and/or eliminate any remaining originating and terminating CCL charges, and instead establish a flat rate charge to be levied against the long-distance company carrying the call. The new charge would be assessed to the long-distance company each month based on the number of customers that the long-distance company has that month.

Advantages:

- Eliminates the non-cost based minute-of-use charge.
- Changes the wholesale charge to the long-distance company from usage-sensitive to a flat rate.
- Reduces the cost of long-distance calls to long-distance companies, and reduces the total bills for customers that use long-distance, assuming access charge reductions are flowed through to reduce long-distance rates.
- Disparities that exist today between interstate and intrastate switched access rates and among local telephone companies would be greatly reduced.

Disadvantages

- This option is similar to the Presubscribed Interexchange Carrier Charge (PICC) method used and then rejected by the FCC for interstate access charges because it resulted in higher customer bills.
- Local telephone companies that do not currently have CCL charges would not need to establish this wholesale flat rate, but may be required to do so in order to provide consistency for long-distance companies in all areas of the State. In that case, customers would be burdened with a charge they should not be paying.
- If the fixed charge is passed through to customers, then those customers who do not use long-distance frequently would have a higher bill than they currently do.

None of the options above, implemented individually, is likely to resolve the switched access charge conundrum. A reasonable solution that is in the public interest and is competitively neutral will likely consist of a combination of the options listed.

The Commission recommends that further evidentiary proceedings be conducted to determine the proper course of action in restructuring intrastate access charges. Many factors should be reviewed in these proceedings. Public policy issues surrounding the implementation of an intrastate SLC should be fully explored. The impact on customers of different incumbent local telephone companies may be significantly different. For

example, Table 28 shows the estimated monthly SLC that would likely result from reducing Southwestern Bell's and Sprint-United's CCL revenues by two-thirds.[307] A $1.50 Residential SLC and a $3.00 Business SLC would allow SWBT to eliminate their CCL charges, while Sprint-United would require SLCs of over twice that amount.

Table 28 — Example of Replacing CCL Revenue with Subscriber Line Charges

Company	Result	Residential SLC	Business SLC
SWBT	Eliminate all CCL revenues	$1.50	$3.00
	Reduce CCL revenues by 67%	1.00	2.00
Sprint-United	Eliminate all CCL revenues	3.55	7.10
	Reduce CCL revenues by 67%	2.38	4.76

[307] Estimates are derived from the Texas Telephone Association's PHONE FACTS 2000"REPORT and access line information on file at the Commission.

Appendix S. Advanced Services Technologies Overview: Development and Convergence

Traditional telephone lines remain the principal means of accessing the internet. Traditional high-speed services, such as Integrated Services Digital Network (ISDN) and T-1's, have been used for internet access, telemedicine, and other applications requiring high-speed connections. However, new technology alternatives that offer high-speed or broadband access are increasingly being used to access the internet and other applications.[308] Preeminent among these new technologies are digital subscriber lines (xDSL), cable modems, wireless technologies, and satellite access. Importantly, these various technologies will be major contributors to broadband deployment in rural areas.[309]

Different needs, geographies, and abilities to pay create necessity for all of these advanced services. In regard to the geography of both rural and urban areas, the "last mile" to the residential customer remains the largest constraint on the availability of broadband services.[310] Today, incumbent telephone and cable companies provide the majority of these "last mile" broadband connections. Increasingly, wireless technologies (including multi-channel (MMDS), local multi-point distribution systems (LMDS)), commercial mobile radio service (CMRS), and satellite technologies have provided a larger share of these "last mile" connections.

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[308] The FCC defines broadband or "advanced services" as transmission speeds greater than 200 Kbps in both the downstream and upstream path. "High-speed" is defined as transmission speed greater than 200 Kbps in only one direction, typically the downstream path with the upstream path being less than 200 Kbps.

[309] Gregory L. Rhode, Christopher A. McLean, Advanced Telecommunications in Rural America: The Challenge of Bringing Broadband Service to All Americans, at ii (Apr. 2000) (Advanced Telecommunications in Rural America).

[310] *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Third Report, FCC No. 02-33 at ¶ 16 (rel. Feb. 6, 2002) (Third Advanced Services Report). (The "last mile," albeit an imprecise term that is analogous to the local road between a larger, divided highway, and a traveler's driveway, has most recently been defined by the FCC as "the link between the middle mile and the last 100 feet to the end-user's terminal.)

Table 29 provides a breakdown of high-speed technology, distance limitations, and pricing for these services.

Table 29 — Types of High-Speed Connections to Residential Customers

	Marketed Residential			Price[311]
Technology	**Downstream Speed**	**Upstream Speed**	**Distance Limitations**	**Per Month (including ISP)**
Wireline Technologies				
Dial-up Modem	56 Kbps	34 Kbps	**N/A**	$0 – $21.95
ISDN-BRI	128 Kbps	128 Kbps	18k ft.	$57.50 -- $104.50
ISDN-PRI	1.5 Mbps	1.5 Mbps	N/A	$57.50 -- $104.50
ADSL	> 200 Kbps	< 200 Kbps	18k ft.	$ 29.95 -- $39.95
Cable Technology				
Cable Modem	1.5 Mbps	> 200 Kbps	N/A	$29.95 -- $99.95
Wireless Technologies				
MMDS	310 Kbps	310 Kbps	35 mi.	$39.95
LMDS	1.5 Mbps	> 200 Kbps	3 – 5 mi.	$125 -- $940
Satellite Technology				
Satellite – Today	400 Kbps	34 Kbps	N/A	$19.99 -- $49.99
Satellite – Future	40 Mbps	128 – 256 Kbps	N/A	Approx. $70

SOURCE: Adapted from An Executive White Paper on Telecommunications for the State of New Mexico Prepared for the Office of the Governor, Office of Science and Technology, New Mexico Economic Development Department at 48 (Dec. 1999).

Wireline Technologies

Two widely available high-speed wireline services are comprised of ISDN and xDSL technologies.

Integrated Services Digital Network

ISDN is a digital-based connection over the public telephone network that allows simultaneous voice and data transmission. ISDN can integrate voice, data, video, and image services. However, since ISDN is a switched service, both ends of the transmission must support the service. ISDN, as used today, comes in two well-defined interface standards: Basic Rate Interface (BRI), which operates at 128 Kbps, and Primary Rate Interface (PRI), a standard T-1 line offering speeds of 1.544 Mbps.

[311] Price does not include equipment and installation charges; per-month charges may vary considerably by location.

For a number of years, the Commission has had a rule requiring certain carriers to deploy ISDN. The Commission's rule seeks to balance the relatively high expense of ISDN deployment with low demand for the service, while at the same time recognizing that ISDN may be the only relatively high-speed service available in many rural areas.

ISDN penetration in Texas is currently very low. Texas Telephone Association (TTA) data shows that only 0.43% of access lines in Texas are ISDN-PRI,[312] while only 1.05% of access lines in Texas use lower speed ISDN-BRI.[313] On the other hand, ISDN demand has continued to grow. Federal Communications Commission (FCC) data shows that ISDN-BRI subscribership grew 42% between 1995 and 1999. Although ISDN is being supplanted by newer technologies, these statistics indicate its value, particularly where other technologies are unavailable.

Digital Subscriber Lines (xDSL)[314]

xDSL technology is the second most widely used broadband service.[315] The most common form of xDSL is asymmetric digital subscriber line (ADSL).[316] ADSL is capable of serving customers over the copper loop within 18,000 feet of specially equipped phone company central offices or remote terminals. Generally, ADSL only provides service at speeds in excess of 200 Kbps in the downstream path.[317] However, ADSL permits the customer to have both conventional voice and high-speed data carried over the same line simultaneously because it segregates the high frequency data traffic from the voice traffic.[318] Consequently, the internet connection is "always on" and permits simultaneous voice conversations without the need for a second phone line.[319]

Cable Technology

Advanced or high-speed cable services are currently limited to cable modems.

Cable Modem

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[312] P.U.C. Advanced Services Data Request (Aug. 2000) (53,134 of 12,721,474 total access lines).

[313] *Id.* (133,475 of 12,721,474 total access lines).

[314] xDSL is a generic name for a family of digital lines being provided by ILECs and CLECs including: Asynchronous DSL (ADSL), High Data Rate DSL (HDSL), Symmetric DSL (SDSL), and Very High Data Rate DSL (VDSL).

[315] Advanced Telecommunications in Rural America, *supra note 309,* at 12.

[316] Third Advanced Services Report, *supra note 310,* at ¶ 49.

[317] Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, Second Report, FCC No. 00-290 at ¶ 36 and 38 (rel. Aug. 21, 2000) (Second Advanced Services Report).

[318] *Id.* at ¶ 36.

[319] *Id.*

Cable modems are the most common source of broadband connections for residential users.[320] Cable modem service, while offered on the same basic network architecture used to provide multi-channel video service, typically requires significant equipment upgrades and enhancements to support advanced services.[321] Cable modem internet access is shared with other active users in the same neighborhood. Consequently, this results in a reduction in speed as the number of users increases.[322] Due to this shared architecture, cable speeds typically are below 1.5 Mbps.[323]

The significance of continuing to upgrade the cable network, and thereby allowing cable modems to compete in the advanced services market, is seen in the next generation of communication, information, and entertainment services.[324] Not only will broadband access continue to play a significant role in internet development, but the expansion of services such as cable telephony, video conferencing, and video on demand, which have been discussed in the communication industry for close to ten years, are now much closer to residential deployment.[325]

Wireless Technologies

Wireless technologies are another means for delivery of high-speed services to residential, rural, and otherwise under-served areas, and potentially may increase competition in the "last mile" in the near future.[326] For purposes of this Report, wireless technologies include fixed wireless (including both MMDS and LMDS), cellular, and broadband Personal Communications Services (PCS). Wireless technologies are important to rural Texans because they have the potential of cost effectively providing advanced services to sparsely populated geographic areas.

Fixed Wireless

Fixed wireless is a system, typically either MMDS or LMDS that provides advanced or high-speed services to customers by attaching to the customer's premises a "pizza box" sized radio transmitter/receiver (transceiver) that communicates with the provider's central antenna site. By doing so, the central antenna site acts as the gateway into the internet. In short, the radio signals serve as a substitute for the copper wire or cable strand that traditionally connects customers to the network.

MMDS

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[320] Second Advanced Services Report, *supra note 317,* at ¶ 96.

[321] SECOND ADVANCED SERVICES REPORT, *supra note 317,* at ¶ 29.

[322] NEWTON'S TELECOM DICTIONARY at 113 (17th ed. 2001) .

[323] THIRD ADVANCED SERVICES REPORT, *supra note 310,* at ¶ 47. (While downstream speeds can exceed 2 Mbps, upstream speeds rarely exceed 1 Mbps.) .

[324] Scott C. Cleland, Residential Broadband Outlook: Investment Implications of a Duopoly?, PRECURSOR GROUP (Aug. 11, 2000).

[325] Bill Michael, *Cable VoIP,* COMPUTER TELEPHONY.COM at 37 (Aug. 2000).

[326] Second Advanced Services Report, *supra note 317,* at ¶ 42.

MMDS is a high-speed system that can potentially provide service in a 35-mile radius with downstream internet speeds from 750 Kbps to 11 Mbps.[327] MMDS's larger service radius makes it ideal for deployment "in rural, under-served, and unserved areas, where the larger cell size substantially reduces the cost of providing service."[328] While MMDS does not degrade in adverse weather conditions, it does function best with direct line of sight between the transmitter and receiver.[329]

LMDS

LMDS is capable of very high-speed transmissions, but its geographic range is much smaller than that of MMDS. A single tower can provide service only in a three to five mile radius, similar to that of a cellular phone. LMDS generally provides data rates up to 1.55 Mbps, a speed adequate to support a host of multimedia applications.[330]

The most critical shortcoming of LMDS is that it is essentially a line of sight technology and is therefore more sensitive to adverse atmospheric conditions.[331]

Cellular and Mobile

Cellular technology is usually characterized by a low-powered, duplex radio/telephone. Cellular uses multiple transceiver sites that are linked to a central computer for coordination. The sites or "cells" cover a range of one to six or more miles in each direction. Each cell can accommodate up to 45 different voice channel transceivers.

Personal Communications Services

PCS is a lower-power, higher-frequency technology that is competitive with, and, in some respects comparable to, cellular. PCS phones are often less expensive, digital, and with less range. Broadband PCS services growth has been substantial, with subscribership increasing to 14.5 million customers who primarily use the service for voice communications.[332] Although cellular and broadband PCS technically support high-speed services, few licensees are using spectrum in this manner.[333]

3G Technology

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[327] *Id.* at ¶ 51-52. *See also* Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, Fifth Report, FCC No. 00-289 at E-8 (rel. Aug. 18, 2000) (Fifth Wireless Report).

[328] *Id.* at ¶ 52.

[329] *Id.*

[330] Second Advanced Services Report, *supra note 317,* at ¶ 50.

[331] FIFTH WIRELESS REPORT, *supra note 327,* at E-17.

[332] *Id.* (for PCS providers for whom information is publicly available).

[333] Second Advanced Services Report, *supra note 317,* at ¶ 53.

"3G technology promises internet access with speeds up to 2 Mbps from a fixed location, 384 Kbps at pedestrian speeds, and 144 Kbps at traveling speeds of 100 kilometers per hour."[334] Planned 3G services include video and audio streaming and location based services that could notify individuals of services in an area they are visiting.[335] Ultimately, 3G capabilities may allow vendors to build handsets that work anywhere in the world.[336]

Unlicensed Spectrum

Small wireless companies may choose to provide high-speed internet access by transmitting in unlicensed bands, or spread spectrum.[337] This unlicensed spectrum offers maximum downstream speeds in the 25 Mbps range.[338] This spectrum "offers a low-cost means for smaller companies to enter the wireless high-speed market."[339] However, because there is no licensing requirement, the potential exists for interference from other applications. Consequently, high-speed internet services provided over unlicensed spectrum may perform well in rural areas where there is limited interference from competing applications; however, due to power output limitations, the service cannot be provided over a wide area.

Satellite Technology

Traditional satellite networks have been limited to specialized private services and direct to home (DTH) video. However, new broadband satellite systems are offering service comparable to current broadband wireline and wireless services. Today, residential satellite offerings are capable of providing speeds in excess of 200 Kbps only in the downstream path with the upstream path provided by a standard dial-up telephone connection.[340] A few satellite providers — Hughes in particular — provide residential, high-speed, two-way service with downstream speeds ranging up to 400 kbps, and downstream speeds from 40 to 60 kbps.[341]

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[334] FIFTH WIRELESS REPORT, *supra note 327,* at 37.

[335] FIFTH WIRELESS REPORT, *supra note 327,* at 37.

[336] *Id.*

[337] *Id.* at E-10.

[338] *Id.*

[339] Second Advanced Services Report, *supra note 317,* at ¶ 55.

[340] *Id.* at ¶ 56.

[341] Third Advanced Services Report, *supra note 310,* at ¶ 85.

Appendix T. Penalty Matrix for Violations of Retail Service Quality Rules

Procedures for Calculating and Processing Administrative Penalties for Violations of P.U.C. SUBST. R. 26.54(c)

The methodology used by Commission Staff to compute recommended administrative penalties to be accessed by the Commission was established in Docket No. 23686 relating to Retail Service Quality. As approved by the Commission at the October 23, 2002 open meeting, the penalty matrix was established to provide a systematic and consistent policy for calculating and processing administrative penalty proceedings for companies violating P.U.C. SUBST. R. 26.54(c), *Relating to Telephone Service Quality Standards*. The process does not address when an enforcement action is initiated, but rather how the Commission Staff is to evaluate violations for the purpose of recommending administrative penalties to the Commission.

Statutory Authorizations

Section 15.023 of the Public Utility Regulatory Act (PURA) provides the Commission with the authority to assess penalties and sets forth factors that must be considered in determining the penalty amount. Section 15.023 states:

> (a) The commission may impose an administrative penalty against a person regulated under this title who violates this title or a rule or order adopted under this title.
> (b) The penalty for a violation may be in an amount not to exceed $5,000. Each day a violation continues or occurs is a separate violation for purposes of imposing a penalty.
> (c) The amount of an administrative penalty shall be based on:
> (1) the seriousness of the violation, including:
> (A) the nature, circumstances, extent, and gravity of a prohibited act; and
> (B) the hazard or potential hazard created to the health, safety, or economic welfare of the public;
> (2) the economic harm to property or the environment caused by the violation;
> (3) the history of previous violations;
> (4) the amount necessary to deter future violations;
> (5) efforts to correct the violation; and
> (6) any other matter that justice may require.

In order to fairly and consistently apply the factors established in Section 15.023, prior to issuing a Notice of Violation (NOV) to telecommunications companies for violations of P.U.C. SUBST. R. 26.54(c), Commission Staff must follow the three-step process outlined below.

Step 1

A proposed base-penalty amount shall be calculated according to the following penalty matrix:

Table 30 — Matrix for Calculating and Processing Administrative Penalties for Violations of P.U.C. SUBST. R. 26.54(c), Relating to Telephone Service Quality Standards

Penalty Amount Per Day in Dollars					
Violation Percentage					
Serving Exchange Access Line Range	>1% <= 5%	>5% <= 10%	>10% <= 15%	>15% <= 25%	>25%
1 to 2,500	100	200	300	400	500
2,501 to 4,000	200	400	500	600	700
4,001 to 6,000	300	600	700	800	900
6,001 to 8,000	400	800	900	1000	1100
8,001 to 10,000	500	1000	1100	1200	1300
10,001 to 20,000	600	1200	1300	1400	1500
20,001 to 30,000	700	1400	1500	1600	1700
30001 to 50000	800	1600	1700	1800	1900
50001 to 60000	900	1800	1900	2000	2100
60001or Greater	1000	2000	3000	4000	5000

Calculation of the proposed base-penalty amount is intended to reflect the seriousness of the violation identified in Section 15.023(C)(1)(A). The penalty amount per day increases based on the size of the exchange and the severity of the divergence from the established benchmark. For example, if a dominant carrier misses a performance measure that requires 95% of the installation to be completed within five days for six consecutive months, the per-day violation amount will be based on the performance delivered during each of those six months. Initially, the number of days to be used in calculating the penalty amount shall be the number of calendar days for each month of violation. This approach is intended to impose a per-day penalty based on the number of affected customers.

Step 2

Once a base-penalty amount is calculated, Commission Staff shall request an informal meeting with the carrier against whom penalties are proposed to be assessed. The purpose of the meeting is to inform the carrier of the calculated base penalty and to gather information relevant to: (1) prior violations, if any; (2) the amount necessary to deter future violations; (3) efforts to correct the violations; and (4) any other matter that justice may require. The additional information obtained in Step 2 shall be considered by Commission Staff and used to adjust the base-penalty amount.

Step 3

Staff shall revise the penalty amount consistent with Step 2 above and present its findings to the Commission's Executive Director or designee. The Executive Director may issue a proposed NOV. In the event the Executive Director issues a NOV, the proceeding shall proceed in accordance with the Commission's Procedural Rules.

Appendix U. U.S. Legislative Activity

Tauzin-Dingell (H.R. 1542)

The Tauzin-Dingell Bill, which passed the U.S. House of Representatives in February 2002, would release regional Bell operating companies (RBOCs) (*e.g.,* Southwestern Bell Telephone Company) from any requirement to unbundle their data network. The bill, known as "The Internet Freedom and Broadband Bill," sponsored by Representatives Billy Tauzin (R-LA) and John Dingell (D-MI), specifically exempts incumbent carriers of their line-sharing, unbundling, and resale requirements, as well as their obligations to comply with Section 271 of the Federal Telecommunications Act (FTA) of 1996.[342]

Incumbent carriers that support the bill argue that less State regulation and oversight of the incumbent network will spur growth and innovation in the broadband market and investment in broadband infrastructure. Competitive carriers, however, argue that the bill will impede competitors' ability to enter the market and all but cripple any opportunity for real choice in the telecommunications industry.

Essentially, the bill bars the Federal Communications Commission (FCC) and states from regulating the rates, charges, terms or conditions for, or entry into the provision of, any high-speed data, internet access, or internet backbone service. The FCC also may not impose or require the collection of any fees, taxes, charges, or tariffs on these services.

H.R. 1542 requires an incumbent local exchange carrier (ILEC) to provide competitive local exchange carriers (CLECs) only the high-speed service, if any, which the ILEC chooses to offer to its own customers. An ILEC can determine which central office it will use to provide the CLEC with access to the high-speed data service.

Additionally, H.R. 1542 bars the FCC from requiring ILECs to allow access to any packet switching network element or any fiber local loop or fiber feeder subloop, or to provide for collocation in a remote terminal or to construct or make available space in a remote terminal.

According to the bill, any high-speed service offered to CLECs must be offered on rates, terms, and conditions that are "just and reasonable" in accordance with § 201(b), but the service is deemed "non-dominant." Deeming the incumbents' high-speed service

[342] When the incumbent telephone companies upgrade their networks, there are not two sets of unbundled elements, one old and one new. Instead, the incumbents are gradually replacing portions of the older network with newer fiber optic cable. They use that network to provide both voice and data service to their customers. Thus, eliminating access to these "new" facilities is the same as putting the entire network off-limits to competitors that want to use it to provide any service to their customers, including basic voice service.

as "nondominant" allows the Bells to set the price of the service without any regulatory oversight.

The bill also prohibits the FCC from collecting any fees on high-speed services; the FCC may only "retain" existing universal service rules. Retaining existing rules does not ensure continued contributions to the universal service fund, because the FCC is only now considering whether it can require contributions from providers of broadband internet platforms. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

Breaux-Nickles (S. B. 2430)

Senators John Breaux (D-LA) and Don Nickles (R-OK) sponsored legislation in May 2002 that would impose the same regulations on all broadband platforms, whether digital subscriber line (DSL), cable modem or wireless. The FTA prohibits an RBOC from offering high-speed internet services until they meet provisions designed to increase competition among local telephone service providers.[343] In particular, Section 271 of the FTA prohibits monopoly entry into the long-distance market without first opening up their markets according to the 14-point checklist and Section 251 establishes unbundling requirements for the ILEC. Under the proposed legislation, the four RBOCs companies would no longer be required to share their DSL infrastructure with smaller, competitive companies.

This legislation is similar to the Tauzin-Dingell legislation (H.R. 1542). However, while Tauzin-Dingell would completely deregulate the Baby Bells, the Breaux-Nickles bill addresses only DSL service. The Breaux-Nickles bill leaves the other areas of telephone infrastructure regulated, and leaves it up to the FCC to set specific rules regarding regulations, stipulating that the FCC cannot impose any new regulatory restraints on any broadband provider.

Proponents of imposing similar regulations on all broadband platforms, like Southwestern Bell Corporation (SBC), have argued that:

> Regulators have taken a hands-off approach to cable modem services offered by cable giants like AT&T Broadband, AOL, Time Warner, Comcast and others. Cable operators have been free to design their broadband services and to conduct their broadband business as any other company would in a competitive market, which has contributed to their dominant share of the market.[344]

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[343] *Baby Bells Take Step Toward High-Speed Internet*, WASHINGTON TECHNOLOGY, May 2001, Vol. 6. No. 4, by Kerry Gildea. Available online: http://www.washingtontechnology.com/news/16_4/federal/16561-1.html.

[344] SBC, Public Affairs, *Broadband Policy Statement, Opening our Markets*, available online at: http://www.sbc.com/public_affairs/opening_our_markets/0,5931,218,00.html.

Those opposed have asserted a counterargument to the RBOCs claims that they should be treated the same as cable. In particular, AT&T in its comments to the FCC in the *Matter of Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities,* has asserted that the RBOCs' claims that they bear more regulatory costs than cable ignores the regulatory burdens on cable.[345] AT&T argued that:

> Cable companies must comply with local franchising requirements and pay billions of dollars in franchise fees. They must build and donate 'institutional networks' to franchising authorities. They are subject to 'must-carry,' public and educational and government (PEG) access channels, and other regulations that require them to share their networks—and, unlike the Bells' network sharing obligations, these cable sharing obligations are uncompensated.[346]

Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

Structural Separation Plan: "The Hollings Bill" (S. B. 1364)

Senate Bill 1364 Telephone Industry Enforcement Legislation was introduced by Senator Ernest Hollings (D-SC), Chairman of the Senate Commerce Committee, on August 8, 2001 in response to the Breaux-Nickles bill. The proposed legislation would require ILECs to structurally separate their wholesale operations from their retail operations for violating the competitive provisions (§§ 251, 252, 271 and 272) of the FTA.

The bill would require the FCC to settle complaints over enforcement violations of the FTA within 90 days and impose $10 million per violation and $2 million for each day of each violation. The bill would also give State public utility commissions the authority to implement a similar fining structure to the FCC's as a floor for any existing State authority. In addition, the proposed legislation would authorize the FCC to award a carrier prevailing in its suit against an RBOC 50% of the monetary fines imposed and award reasonable attorneys' fees and costs.

Other provisions of the bill include the reclassification of the RBOCs as nondominant by the FCC only after 40% of the existing access lines are served by competitors. Under the bill, RBOCs would also have to publish a list of remote terminals served by fiber and the FCC would establish performance metrics for unbundled network elements. The bill would also bar the FCC for five years from relaxing its accounting rules with respect to RBOCs. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

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[345] *See In the Matter of Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket No. 02-33. Comments of AT&T Corp., May 3, 2002 at 73.

[346] *Id.*

Small Business & Farm Economic Recovery Act

In early 2002, Senators Max Baucus (D-MO) and Charles Grassley (R-IA) sponsored the "Small Business & Farm Economic Recovery Act" to address broadband provisioning in rural areas. The proposed bill, S.B. 88, would establish a tax credit to encourage the use of broadband technology. It provides a 10% investment tax credit for current generation broadband services to subscribers in rural and underserved areas. It also provides a 20% credit for next generation broadband services to subscribers in rural areas, underserved areas, and residential subscribers. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

Rural Advisory Board at the FCC

In October 2002, Representative Lee Terry (R-NE) introduced H.R. 5602, which would create within the FCC a Rural Issues Advisory Board. The purpose of the Board would be to assist the FCC in developing polices and procedures for rural customers and carriers, and to ensure that the FCC takes into consideration the size and the resources of affected parties in rural America. Barring reintroduction during future Congressional sessions, this bill is no longer in line for Congressional consideration.

Broadband Deployment Language in the Senate Farm Bill

The farm bill was signed into law by President George W. Bush on May 13, 2002. Section 6103 of Title VI (Rural Development) of the Farm Bill authorizes the Rural Utility Service (RUS) of the U.S. Department of Agriculture (USDA) to administer hundreds of millions of dollars in technology-neutral loans and loan guarantees dedicated exclusively for rural broadband infrastructure projects in rural communities of 20,000 people or less. This is the largest rural broadband loan program in U.S. history.

The program also permits states and local governments to apply for funds, only if, within the first 90 days after publication of the regulation, no other party provides or has committed to provide, broadband service. The final funding levels for the program amounted to $100 million stretched over five years, or $20 million per year in budget authority funding. Budget authority funding means the program is funded through direct mandatory spending, not in appropriation. The RUS is responsible for crafting the rules governing the application process for the program.

Appendix V. Commission's Response to the FCC's Request for Comments relating to Core Broadband and Local Competition Proceedings

Special Access NPRM

On November 19, 2001, the FCC released a Notice of Proposed Rulemaking (NPRM) requesting comment on whether it should adopt a limited number of measurements and standards for evaluating incumbent local exchange carriers' (ILECs') performance with respect to the provisioning of special access services that competitive local exchange carriers (CLECs) use to compete for end-use customers.

Given a pending arbitration at the Commission regarding special access regarding performance measures,[347] the Commission could not directly comment on the questions raised in the NPRM. However, the Commission outlined for the Federal Communications Commission (FCC) the importance of reaching a determination of issues related to performance measurements and standards regarding special access given the challenges the Commission has faced in implementing performance measures under Section 271. In particular, the arbitration before the Commission challenges its authority to monitor ILEC performance in provisioning of interstate special access in lieu of unbundled network elements (UNEs).

The arbitration was the result of a decision the Commission reached in its first six-month review of the Texas Section 271 performance measures. Essentially, the Commission considered whether performance measures should apply to special access when a CLEC is required to order special access to provide local service. Specifically, the Commission determined, "to the extent a CLEC orders special access in lieu of UNEs, SWBT's performance shall be measured as another level of disaggregation in all UNE measures."[348] The practical result of this determination is that special access should be included under the Texas Performance Remedy Plan to the extent that Southwestern Bell Telephone Company (SWBT) requires CLECs to order special access services to obtain Enhanced Extended Loops (which are provided for under the Texas Section 271 Agreement).

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[347] *Petition of Southwestern Bell Telephone Company for Arbitration regarding the Implementation of Special Access Performance Measures*, Docket No. 24515, (pending) (Southwestern Bell Telephone Company requested arbitration regarding the appropriateness of requiring performance measures on the provisioning of special access services established in Texas PUC Project No. 20400, Section 271 Compliance Monitoring of Southwestern Bell Telephone Company of Texas) (Texas Special Access Arbitration).

[348] *Section 271 Compliance Monitoring of Southwestern Bell Telephone Company of Texas*, Docket No. 20400, Order No. 33, Approving Modifications to Performance Remedy Plan and Performance Measurements, Changes/Deletions to Version 1.7 at 88 (June 1, 2001).

On August 17, 2001, following the issuance of the Commission's determination in that proceeding, SWBT made two challenges to the addition of "special access" performance measurements. SWBT argued that the Commission did not have jurisdiction because of the nature of "special access" and that the Commission did not have the authority to order the additional performance measurements because the Remedy Plan did not allow it without SWBT's agreement.[349] Because of SWBT's arguments regarding the Commission's jurisdiction over special access, the Commission agreed to determine in an arbitration the extent to which CLECs are using special access as a substitute for transport in order to obtain Enhanced Extended Loops under the Texas 271 Agreement (T2A) or whether carriers are simply ordering special access as a wholesale service.

Performance Measures for Unbundled Network Elements

On November 19, 2001, the FCC issued an NPRM regarding Performance Measurements and Standards for Unbundled Network Elements (UNEs) and Interconnection. In this NPRM, the FCC requested comment on whether it should adopt a limited number of measurements and standards for evaluating ILEC performance with respect to pre-ordering, ordering, provisioning, repair, and maintenance functions. The NPRM also requested comment on the use and scope of any national performance measurement standard, and the appropriate review or sunset mechanism should the FCC adopt national standards. The FCC is also interested in learning how to balance CLECs' concerns about poor provisioning of UNEs, interconnection trunks, and collocation, with the ILECs' concern about the number and cost of state and federal measurements and standards.

The Commission filed comments in the response to the FCC's NPRM, emphasizing the important role that State's play in creating, implementing, and monitoring the performance of ILECs, and that State's should be involved in federal efforts to reform and minimize performance measures and standards. In addition, the Commission emphasized that action by the FCC that establishes consistent, minimum requirements or supplements the State plans will further facilitate competition, as long as the FCC ensures that any requirements it ultimately adopts are: 1) at a minimum, as stringent as the strongest State plan; and 2) do not preclude the States from adopting additional measures to the extent they are necessary. Should the FCC establish performance measures, the Commission urged the FCC to consider performance measures for unbundled network element platform (UNE-P), resale, and measurements to capture all loop types, including x-digital subscriber line (xDSL) capable loops.

First Triennial Review of Unbundled Network Elements

On December 20, 2001, the FCC released a NPRM relating to its first triennial review of its policies on UNEs. This review provides the FCC with an opportunity to

[349] Docket No. 24515, *supra note 347,* at 5 (Aug. 17, 2001).

examine the framework under which ILECs must make UNEs available to competing carriers. Among other things, the FCC examined in this NPRM the ILECs' wholesale obligations under § 251 of the FTA to make their facilities available as UNEs to CLECs for the provision of broadband services. The NPRM also sought comment on whether the FCC should apply unbundling requirements based on type of service, facility, geography, or other factors (*i.e.,* "more granular statutory analysis"). Additionally, the FCC requested comment on whether to retain, modify, or eliminate its existing definitions and requirements for UNEs, as well as the role of State commissions regarding UNEs.

In its comments, the Commission cautioned the FCC from focusing primarily on facilities-based competition at the expense of alternative entry strategies for competitive carriers, such as the UNE platform. The Commission pointed out that UNE-P has proven to be an important entry strategy for many competitors in the local market for telecommunications services, and that the competition that does exist in Texas relies heavily on the use of UNEs as a means of offering Texas customers the benefits of competition in market for telecommunications and broadband services.

Further, the Commission urged the FCC to rely on the knowledge base within state commissions regarding the characteristics of markets and incumbent carriers within their State, and the entry strategies that have worked best. The Commission urged the FCC to allow States to retain the authority to impose additional unbundling obligations on ILECs, provided they meet the requirements of Section 251 of the Federal Telecommunications Act of 1996 (FTA), the policy framework of the UNE Remand Order,[350] and any subsequent state commission policy. As part of a recent arbitration,[351] the Commission reexamined certain UNEs to evaluate whether there was a continued need for their availability, concluding that local switching should be available to CLECs on an unbundled basis without restrictions, as well as operator services and directory assistance. The Commission based its decision on Texas-specific market facts.

Should the FCC decline to let state commissions modify the national UNE list, the Commission recommended that all UNEs now on list should remain in place. Further, should the FCC pursue a national standard, the Commission strongly recommended that the FCC give consideration to the Performance Measurements (PMs) already in place in

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[350] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238, (rel. Nov. 5, 1999) (*UNE Remand Order*).

[351] *Petition of MCImetro Access Transmission Services LLC for Arbitration of an Interconnection Agreement with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996*, Docket No. 24542 (May 1, 2002) (UNE Pricing Arbitration). See Chapter V for a detailed analysis of this arbitration.

Texas,[352] and suggested convening a Federal-State Joint Conference on UNEs to inform and coordinate this review.

Broadband Access to the Internet over Wireline Facilities

On February 15, 2002, the FCC released a NPRM regarding the appropriate statutory classification and regulatory framework for broadband access to the internet provided over domestic wireline facilities. In this NPRM, the FCC tentatively concluded that wireline broadband internet access services, whether provided over a third-party's facilities or self-provisioned facilities, are information services with a telecommunications component, rather than telecommunications services.[353] This proceeding investigated how Title I regulation applies to broadband services provided as information services.

The Commission supported the FCC's policy goals of ensuring ubiquitous availability of broadband service and a regulatory environment that encourages investment, deployment, competition, and innovation within the broadband market. However, the Commission cautioned against the classification of wireline broadband internet access service as an information service, asserting that such a classification could remove wireline broadband internet access services from numerous competitive, customer protection, and quality of service requirements imposed at the state and federal level on common carriers that provide telecommunications services.

In particular, such a classification could affect the Commission's jurisdictional authority over existing broadband telecommunications services as the number of wireline broadband internet access service providers provisioning digital telecommunications services, such as voice-grade service, increases. The Commission urged the FCC to avoid adopting a rule that diminishes the state's authority to encourage advanced services deployment to implement its own legislatively enacted policies and that affects the state's traditional role in overseeing customer protection and service quality standards. Additionally, the Commission commented that the classification of wireline broadband internet access services as information services could possibly reduce the Commission's regulatory authority over municipal franchise fees for the use of public rights-of-way.

Given the evidentiary records developed by the States, the Commission also expressed concern that modification or elimination of existing access obligations on providers of self-provisioned wireline broadband internet access services could have extensive effects on state regulatory enforcement authority to prevent anti-competitive behavior within the broadband market.

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[352] *See Notice of Proposed Rulemaking In the Matter of Performance Measurements and Standards for Unbundled Network Elements and Interconnection*, CC Docket No. 01-318, Comments of the Public Utility Commission of Texas (Jan. 22, 2002) (UNE Performance Measure NPRM).

[353] Telecommunications services means that under federal and state law, those offerings are subject to traditional common carrier obligations—that is, they must be offered to all, including ISPs, on nondiscriminatory rates, terms and conditions.

Other FCC Activities

In addition to the core broadband proceedings, the Commission has been actively involved with FCC proceedings and activities related to the following:

- Accounting reform,
- Customer proprietary network information,
- Competitive access to multi-tenant environments,
- Equal access and nondiscriminatory safeguards,
- Numbering resource optimization, and
- Sunset of Bell Operating Companies (BOC) separate affiliate and related requirements.

Accounting Reform

In November 2001, the FCC issued a Report and Order (R&O) and Further Notice of Proposed Rulemaking (FNPRM) regarding the *Matter of 2000 Biennial Regulatory Review—Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, and Amendments to the Uniform System of Accounts for Interconnection* in CC Docket No. 00-199 and CC Docket No. 97-212.[354] In response to the FNPRM and the Phase 3 comments, the National Association of Regulatory Utility Commissioners (NARUC) asked the FCC to create a Joint Conference in this docket to facilitate the Phase 3 review. The FCC agreed with this suggestion and issued an Order on September 5, 2002 convening the Federal-State Joint Conference on Regulatory Accounting Issues, requesting that NARUC recommend five state representatives to the Joint Conference. In September 2002, Chairman Klein was appointed by Chairman Powell. The Joint Conference will be charged with ensuring that regulatory accounting data and related information filed by telecommunications companies are adequate, truthful, and thorough. Additionally, the Joint Conference will provide a forum for state and federal policymakers to consider, coordinate, and conduct initiatives that will ensure that the collection and exchange of regulatory accounting information are adequate and effective. One of the first tasks of

[354] In the R&O, the FCC: (1) consolidated Class A accounting requirements from 296 to 164 accounts; (2) eliminated cost allocation manuals and biennial audits for mid-sized carriers; (3) streamlined the information in each Automated Reporting Management Information System (ARMIS) report filed by large LECs; and (4) eliminated, for mid-sized carriers, three out of four financial ARMIS reports. The R&O also established new subaccounts for Circuit and Packet under Digital Switching, Electronic and Optical Subaccounts under Circuit Equipment, and Wholesale and Retail Subaccounts under Services. The FNPRM sought comment on the appropriate circumstances for elimination of accounting and reporting requirements for incumbent local exchange carriers (LECs); whether certain ARMIS information would more appropriately be collected through ad hoc data requests or the Commission's Local Competition and Broadband Data Gathering Program; and whether changes should be made to match amendments to the separations rules.

the Joint Conference will be to reexamine federal and state regulatory accounting and related requirements and make recommendations for improvements.[355]

Customer Proprietary Network Information (CPNI)

In January 2002, the Commission adopted modifications to its CPNI[356] rules to align them with changes made by the FCC to Title 47 of the Code of Federal Regulations (CFR), Part 64, Subpart U, §§ 64.2001 – 64.2009, Customer Proprietary Network Information, and those rules further refined by the FCC in the *Clarification Order and Second Further Notice of Proposed Rulemaking* (released September 7, 2001) (Clarification Order).[357]

On July 16, 2002, the FCC adopted a Third Report and Order, and Third Further NPRM regarding CPNI.[358] The FCC adopted rules focused on the nature of the customer approval required before a telecommunications carrier can use, disclose or permit access to CPNI. The Order applies an "Opt-out"/presumed consent procedures to carrier use of CPNI or disclosure of that information to "affiliated entities" providing communications-related services, as well as third-party agents and joint venture partners providing communications-related services. According to the FCC's Order, telecommunications carriers are free to use "Opt-In"/express consent procedures if they so choose. The FCC did require "Opt-In" procedures before a carrier can disclose CPNI to unrelated third parties or to carrier affiliates that do not provide communications-related services. With

[355] *In the Matter of Federal-State Joint Conference on Accounting Issues*, WC Docket No. 02-269, FCC 02-240, released September 5, 2002. p. 1.

[356] *See Review of P.U.C. Subst. R. §26.122 Regarding Customer Proprietary Network Information*, Project No. 22490, Order Adopting Amendment to PUC Subst. R. 26.122 (Jan. 23, 2002).

[357] At the time of adoption of this rule, the FCC was reviewing the most appropriate method by which carriers must secure their customers' consent to use the customer's CPNI in light of the Tenth Circuit's decision, which vacated a portion of FCC's Order on Reconsideration. The modifications made to the rule were constructed in such a way to allow flexibility once the FCC decides whether to adopt an "opt-in" or "opt-out" mechanism for consent to use a customer's CPNI.

[358] 47 C.F.R. §64.2003 (definition for CPNI)

(c) Customer proprietary network information (CPNI).

(1) Customer proprietary network information (CPNI) is: (i) Information that relates to the quantity, technical configuration, type, destination, and amount of use of a telecommunications service subscribed to by any customer of a telecommunications carrier, and that is made available to the carrier by the customer solely by virtue of the customer-carrier relationship; and (ii) Information contained in the bills pertaining to telephone exchange service or telephone toll service received by a customer of a carrier.

(2) Customer proprietary network information does not include subscriber list information.

(g) Subscriber list information (SLI). Subscriber list information (SLI) is any information:

(1) Identifying the listed names of subscribers of a carrier and such subscribers' telephone numbers, addresses, or primary advertising classifications (as such classifications are assigned at the time of the establishment of such service), or any combination of such listed names, numbers, addresses, or classifications; and (2) That the carrier or an affiliate has published, caused to be published, or accepted for publication in any directory format.

respect to existing state rules on CPNI, the FCC affirms their belief that the States are uniquely qualified to assess the local competitive landscape and determine whether additional safeguards are necessary.

The FCC also adopted a Further Notice of Proposed Rulemaking seeking comment on enforcement issues and issues related to customer information of carriers who go out of business or seek bankruptcy protection.

Multi-Tenant Environments

On November 30, 2001, the Wireless Telecommunications Bureau (WTB) of the FCC issued a Public Notice (Notice) seeking comment regarding the current state of the market for local and advanced telecommunications services in multi-tenant environments (MTEs). The Notice outlined twelve areas related to competitive local exchange carriers' access to MTEs. The Commission submitted limited comments regarding the State laws or regulations requiring or encouraging nondiscriminatory access and the nature of those laws or regulations; and the experiences of carriers, building owners, and end users in States that have promulgated nondiscriminatory access requirements, including the numbers and types of complaint and enforcement actions that have been filed.[359] In these comments, the Commission emphasized the principles regarding a customer's choice of telecommunications providers in a MTE as a vital component of a fully competitive telecommunications marketplace.

Equal Access

On February 28, 2002, the FCC released a Notice of Inquiry (NOI) initiating a review of the applicability of § 251(g) of the FTA, which imposes equal access and nondiscrimination obligations on ILECs. The FCC sought comment on what specific obligations remain in place today that apply to Bell operating companies (BOCs)—both with and without Section 271 authority to provide in-region long-distance services—as well as to ILECs and CLECs. In particular, the FCC was interested in finding out whether existing equal access and nondiscrimination requirements should be changed or eliminated in light of changes in market conditions, including the state of competition in the local market and BOC entry into the long-distance market. Further, the FCC required comment on the circumstances under which marketing arrangements between BOCs (those with Section 271 authority versus those without) and other carriers are permissible. The FCC also wanted input on the relationship between FTA Sections 272 and 251(g), and the marketing activities, such as outbound marketing, that BOCs with Section 271 authority may pursue.

The intent of the FTA's existing equal access and nondiscrimination safeguards was to provide ample opportunity and time for competition to develop in all markets and to prevent BOC discrimination in favor of their affiliates. The Commission noted that

[359] For additional information regarding Texas PUC's Building Access Statute (Docket No. 24604), see Chapter IV, Building Access.

while great strides have been made in the legislative and regulatory arena to encourage competition in these markets, the competitive telecommunications industry in Texas is still in its formative years and continues to evolve. The Commission expressed concern that elimination of equal access and nondiscrimination requirements could halt competition before it has had sufficient opportunity to take root, and may have an impact on market entry, as well as the market share of competitive carriers in these markets. The Commission reasoned that these obligations may provide needed market certainty that will ensure the continued development of competition in these markets.

The Commission is concerned that, without these equal access and nondiscrimination safeguards, the risk is greater that the local exchange, information services and long-distance markets may migrate to a vertically integrated intermodal model, as opposed to the current intramodal model that supports various competitors in each of these markets. For instance, it is conceivable that without these requirements, BOCs and other LECs could lack incentive to retain today's open networks, which allow competing LECs, interexchange carriers (IXCs), and internet service providers (ISPs) access to their customers. The foreseeable result could be a closed network platform so that customers purchase all of their services—*e.g.,* local, long-distance and internet access—from their LEC. Such vertical integration could in turn result in: (1) reduced competition in the information services and long-distance markets, as ISPs and IXCs would no longer be able to access the customer through the landline local network; and (2) only intermodal competition to the exclusion of intramodal competition, with various network providers, such as wireless, satellite, and cable, competing with the LEC for customers. In addition, it is unclear what impact a reduced number of competitors and intermodal competition would have on customer product pricing.

The Commission encouraged the FCC to be cautious in making any determination in light of current market conditions, and reiterated the importance of Federal-State cooperation to encourage competition in local markets and the deployment of next generation services to a broad cross-section of customers.

Numbering Resource Optimization

In May 2002, the Commission submitted comments to the FCC's Third Order on Reconsideration, Third Further NPRM, and Second Further NPRM regarding Number Resource Optimization and Telephone Number Portability.

The Commission supported extending local number portability (LNP) requirements and thousands-block number pooling (pooling) to all LECs and covered Commercial Mobile Radio Service (CMRS) carriers in the largest 100 MSAs. The Commission also emphasized that certain situations may have good cause for an exemption from LNP and pooling requirements (such as smaller carriers having few or no customers within the Metropolitan Statistical Area (MSA)). For these reasons, the Commission recommended that the FCC authorize the State commissions to grant exemptions from these requirements on a case-by-case basis.

The Commission also supported including all MSAs comprising the Consolidated Metropolitan Statistical Areas (CMSAs) as part of the FCC's list of the largest 100 MSAs, citing that any of the areas included in the top 100 as a result of the use of CMSAs will benefit from LNP and pooling. With respect to carriers in less competitive areas, the Commission recommended that the state commissions could address any concerns through a case-by-case exemption process.

Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements

On May 24, 2002, the FCC released an NPRM requesting comment on whether the structural separation, nondiscrimination safeguards, and the biennial audit of BOCs established in Section 272 of the FTA should be extended beyond the three-year sunset provision in the statute and, if so, what conditions, if any, should apply.

The Commission commented that the intent of the FTA's existing structural safeguards was to provide adequate opportunity and time for competition to develop in all markets (*e.g.,* local exchange and exchange access), and to prevent BOCs from discriminating against others in favor of their affiliates. To implement Section 272, the FCC created a set of nondiscrimination safeguards designed to discourage and detect improper cost allocation and cross-subsidization between a BOC and its affiliate.

The Commission argued that although some progress has been made toward leveling the field, SWBT's continued dominance over local exchange and exchange access services still hinders the development of a fully competitive market, especially given the current status of the financial markets, CLECs' access to capital, and the bankruptcy of many competitive carriers. Thus, SWBT retains both the incentive and ability to discriminate against competitors and to engage in anti-competitive behavior.

The Commission concluded that the sunset or modification of the Section 272 requirements on SWBT would be imprudent and untimely given that: (1) SWBT's continuing performance deficiencies in providing access to competitors, resulting in SWBT's payment of over $23 million in Tier 1 and Tier 2 damages from November 1999 to the present; (2) the lack of alternative access points to the network; and (3) the initial biennial audit of SWBT, as required by Section 272(d), had not yet been released by the FCC. Accordingly, the Commission urged the FCC to extend SWBT's Section 272 requirements for a minimum of one year past the July 10, 2003, and, preferably, until the second biennial audit of SWBT is completed and released by the FCC.

Appendix W. List of Acronyms

ADAD	Automatic dial announcing device
ADSL	Asymmetric digital subscriber line
AFA	Additional financial assistance
AOL	America On Line
BFRR	Bona fide retail request
BOC	Bell Operating Company
BRI	Basic Rate Interface
CCL	Carrier common line
CCN	Certificate of convenience and necessity
CIPB	Critical Infrastructure Protection Board
CLEC	Competitive local exchange carrier
CMRS	Commercial mobile radio service
CMSA	Consolidated metropolitan statistical area
COA	Certificate of operating authority
CPE	Customer premises equipment
COG	Council of Government
CPD	Customer Protection Division
CPNI	Customer proprietary network information
CTP	Certificated telecommunications providers
CSEC	Commission on State Emergency Communications
CTU	Certificated telecommunications utility
CSR	Customer Service Representative

DCS	Digital cross-connect systems
DCTU	Dominant certificated telecommunications utility
DIR	Department of Information Resources
DOJ	Department of Justice
DSL	Digital subscriber line
DTH	Direct-to-the-home
EAS	Extended area service
EEL	Enhanced extended loop
ELCS	Extended local calling service
EMC	Emergency Management Council
EMRT	Emergency Management Response Team
EOC	Emergency Operation Center
EOP	Emergency Operation Plan
EPN	El Paso Networks
E9-1-1	Enhanced 9-1-1
FCC	Federal Communications Commission
FNPRM	Further Notice of Proposed Rulemaking
FTA	Federal Telecommunications Act of 1996
FY	Fiscal Year
GTESW	GTE Southwest
HB	House Bill
HSPC	Homeland Security Policy Council

HSSAOG	Homeland Security State Agency Operations Group
ILEC	Incumbent local exchange carrier
IP	Internet protocol
ISDN	Integrated services digital network
ISP	Internet service provider
IT	Information technology
IXC	Interexchange carrier
LATA	Local access and transport area
LEC	Local exchange carrier
LMDS	Local multi-point distribution systems
LMOS	Loop Maintenance Operations System
LNP	Local number portability
LRIC	Long run incremental cost
LS	Local switching
LSR	Local service request
MARS	Municipal access line reporting system
Mbps	Mega bits per second
MMDS	Microwave Multi-point Distribution System
MSA	Metropolitan statistical area
MTE	Multi-tenant environment
NARUC	National Association of Regulatory Utility Commissioners
NECA	National Exchange Carriers Association
NOI	Notice of Inquiry

NOV	Notice of Violation
NPRM	Notice of proposed rulemaking
ORCA	Office of Rural Community Affairs
OSS	Operations support systems
PCS	Personal Communications Services
PEG	Public and Educational and Government
PFD	Proposal For Decision
PICC	Presubscribed Interexchange Carrier Charge
PM	Performance Measures
POI	Point of interconnection
PRI	Primary Rate Interface
PSAP	Public safety answering point
PSTN	Public switched telephone network
PTS	Pay telephone service
PUC	Public Utility Commission
PURA	Public Utility Regulatory Act
RBOC	Regional Bell Operating Company
R&O	Report and Order
ROR	Rate-of-return
ROW	Right-of-way
RUS	Rural Utility Service
SB	Senate Bill

SBC	Southwestern Bell Corporation
SERT	State Emergency Response Team
SIPAC	State Infrastructure Protection Advisory Committee
SLC	Subscriber line charge
SLI	Subscriber list information
SOAH	State Office of Administrative Hearings
SPFD	Supplemental Proposal For Decision
SPCOA	Service provider certificate of operating authority
SWB-LD	Southwestern Bell Long Distance
SWBT	Southwestern Bell Telephone Company
T2A	Texas 271 Agreement
TDHCA	Texas Department of Housing and Community Affairs
TDHS	Texas Department of Human Services
TELRIC	Total element long run incremental cost
THCUSP	Texas High-Cost Universal Service Plan
TIF	Texas Infrastructure Fund
TIPC	Texas Infrastructure Protection Center
TIRN	Texas Information and Referral Network
TFRPP	Texas First Responder Preparedness Program
TSR	Total services resale
TTA	Texas Telephone Association
TUSF	Texas Universal Service Fund
TWTC	Time Warner Telecom of Texas

UNE	Unbundled network elements
UNE-L	Unbundled network elements -loop
UNE-P	Unbundled network elements -platform
USDA	United States Department of Agriculture
USTA	United States Telephone Association
VoIP	Voice over internet protocol
WMD	Weapons of mass destruction
WTB	Wireless Telecommunications Bureau