PROJECT NO. 32169

PUC RULEMAKING PROCEEDING TO ADD P.U.C. SUBST R. 26.134 - REGARDING THE MARKET TEST TO BE APPLIED IN DETERMIING IF MARKETS WITH POPULATIONS LESS THAN 30,000 SHOULD REMAIN REGULATED	**§**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ADOPTING NEW §26.134
AS APPROVED AT THE JUNE 20, 2006 OPEN MEETING

The Public Utility Commission of Texas (commission) adopts new §26.134, relating to the Market Test to be Applied in Determining if Markets with Populations Less Than 30,000 Should Remain Regulated after January 1, 2007 with changes to the proposed text as published in the March 24, 2006 *Texas Register* at 31 TexReg 2352. The new rule, implementing PURA §65.052(f), establishes the market test to be applied in determining whether a market with a population of less than 30,000 should remain regulated after January 1, 2007. Project No. 32169 is assigned to this proceeding.

The new section applies to all incumbent local exchange carriers (ILECs). The market test is based upon the number and type of competitors providing service in the market. In many of the markets with a population less than 30,000, the rural exemption as provided for in Section 251(f)(1) "Exemption for Certain Rural Telephone Companies" of the Federal Communications Act of 1934 is effective. In those markets, the new rule requires that exemption to be removed. In addition, the new section provides the schedule for implementation of the new provisions.

The commission received initial comments on the proposed rule from Southwestern Bell Telephone, L.P. d/b/a AT&T Texas (AT&T Texas), Verizon Southwest (Verizon), Texas Telephone Association (TTA), office of the Attorney General of the State of Texas (State), and Office of Public Utility Counsel (OPC). Additionally, the commission received reply comments from AT&T Texas and the State. A Public Hearing was held in this matter on May 5, 2006. In attendance were representatives of the State, TTA, AT&T Texas, John Starulakis, Inc. (JSI), OPC, Verizon, and Texas Statewide Telephone Cooperative, Inc.

A summary of the stakeholders' filed comments and commission responses are set forth hereafter.

In the publication preamble, the commission asked a question regarding how the commission should account for any situations in which robust telecommunications competition exists in a market, but the type of competitors in the market does not completely mirror the types of competitors delineated in subsection (c).

Commission Response

The State and OPC responded to the commission's preamble query and made specific recommendations applicable to Section 26.134(c) of the proposed rule that addressed their concerns. Given that the responses to the question were specific to Section 26.134(c), the summary of comments and the commission's responses appear in that section of the preamble.

Subsection 26.134(c) of the new rule outlines the market test for exchanges with populations less than 30,000 (hereinafter sometimes referred to as "small markets").

Verizon, the State, and OPC commented on the number and type of competitors required in each market.

Verizon commented that, at the very least, the proposed rule should be modified to require only two competitors to the ILEC to satisfy the market test: a wireless competitor and a facilities-based wireline competitor. Verizon justified this proposed modification by stating that it believed the Legislature intentionally refused to apply the same test to small markets that it applied to large markets, thus recognizing that small markets generally attract fewer competitors, but are still subject to deregulation under Senate Bill 5.

Commission Response

The commission declines to modify the rule based upon Verizon's comment. The commission finds that a list of two competitors does not provide customers with sufficient choice.

The State described the proposed rule as an attempt to modify the law applicable to mid-sized markets (30,000-100,000 in population), which simply required the existence of three different, statutorily established, type competitors in a market to deregulate it. The State proposed language in subsection (c)(1) to increase the number of competitors from three to four or more of the types listed in (c), without a specific requirement of any particular mix of the four types of competitors listed.

Commission Response

The commission declines to make either suggested change. The State's suggestion could result in deregulation of an exchange where there are four competitors of any type. The commission finds that this approach would provide some customer choice, but because all four of the competitors could be the same type, this approach would not provide sufficient customer choice to justify deregulation of that exchange. Customers should have choice, not only among a certain number of competitors, but also among different types of providers. The commission believes that the test outlined in the rule, based upon the requirements for markets 30,000 to 100,000 in population, is the appropriate market test.

OPC supported the inclusion in the commission's proposed rule of the requirement that at least one of the three competitors be an entity providing residential service using facilities that the entity or its affiliate owns. However, OPC recommended "tightening" this subsection by including the requirement that the facilities-based provider either hold a certificate of operating authority or service provider certificate of operation authority, or clarifying that the facilities-based provider is not to be counted towards meeting the criteria of the competitors in subsection (c)(2).

Commission Response

The commission does not add the requirement suggested by OPC. The commission anticipates that the competitors "providing residential service using facilities that the entity or its affiliate owns" often will be cable companies utilizing VOIP technology. The commission believes that such competitors should be counted in the market test. Depending upon future action by the Federal Communications Commission, such entities may or may not be required to hold certificates. Therefore, the commission is concerned that requiring certification may preclude these entities from being considered a competitor for the purposes of demonstrating competition within small market areas.

OPC commented that the rule is not sufficiently clear if a subsection (c)(1) competitor, the facilities based provider, could be considered as a competitor for the purposes of subsection (c)(2) as well.

Commission Response

The commission acknowledges OPC's concern and revises subsection (c) to include the word "separate" before competitors to clarify that three separate competitors must exist in the market.

Subsection (c)(2)(C) requires that a satellite telecommunications provider, in order to be counted under the market test, must be certified as an eligible telecommunications carrier for the entire market pursuant to Section 26.418 of this chapter.

AT&T Texas stated concern with this provision, arguing that because the ETC requirements of Section 26.418 are probably foreign and burdensome to satellite providers, it is highly unlikely that such providers will pursue certification under Section 26.418. Thus, left as written, the rule would require the commission to hold that a competitive satellite provider could not be considered a competitor if the satellite provider did not seek ETC status. Further, AT&T Texas noted that no such requirements were imposed on cable providers or wireless providers when the Legislature enacted PURA Subchapter B of Chapter 65. AT&T Texas suggested for the above reasons, the ETC requirements should be removed from subsection 26.134 (c)(2)(C) of the proposed rule.

In its reply comments, the State noted that both satellite and wireless providers have sought and likely will continue to seek ETC designation due to both favorable market conditions and the current existence of universal service subsidies in those areas. The State noted that the ETC designation requirement is a useful proxy to measure penetration into markets in which only one or two competitors are present.

Commission Response

The commission declines to make the change requested by AT&T Texas. The commission agrees with the comments of the State that the fact that satellite providers have sought ETC designation, the requirements must not be foreign and burdensome to this type of carrier.

The commission, however, rejects the State's argument that the ETC designation is a proxy to measure market penetration. Rather, the commission finds it appropriate to require that a satellite provider be designated as an ETC in order to be counted in the market test because, unlike other types of providers, a satellite provider could provide service in most areas of the state and does not have facilities located in one geographic area. The ETC designation requires a provider to advertise its services in the geographic area in which it is designated as an ETC. The commission is concerned that eliminating this requirement would allow a satellite provider to be counted for the market test while no potential customers would be aware of that competitive choice.

In contrast to AT&T Texas's position, both OPC and the State recommended extending the ETC requirement to other types of providers.

OPC proposed a change to subsection (c)(2)(C) to require any telecommunications provider, not just a satellite telecommunications provider, to be certified as an eligible telecommunications carrier for the entire market pursuant to §26.418. OPC maintained the commission would be ensuring that the carrier would eventually be serving the entire market and established service standards would be met. According to OPC, this modification would create a technology neutral rule and might ensure the rule would not need to be reopened to address any new technology that was excluded.

The State proposed to add additional rule language at subsection (c)(2)(B) that would require commercial mobile service operators to be certified as an eligible

telecommunications carrier for the entire market pursuant to §26.418, relating to *Designation of Common Carriers as Eligible Telecommunications Carriers to Receive Federal Universal Funds,* in order to be considered a qualifying competitor.

Commission Response

The commission declines to require any telecommunications provider, other than a satellite provider, to be designated as an ETC in order to be counted as a competitor pursuant to the market test. For providers with facilities in a particular geographic area, the commission believes that such providers will generally advertise to sell their services to customers.

The State, OPC, and TTA suggested alternative market tests or significant modifications to the proposed market test.

In addition to the changes proposed to subsection (c), the State suggested an alternate market test would be appropriate for markets that could not meet the first test. Such a test would require a public interest finding by the commission when the requisite competitors are not present, but where there is a ubiquitous presence by fewer competitors, and which measures, at least to some degree, the amount of penetration of competition in small markets when fewer competitors are present but there is ubiquitous presence by such competitors.

Therefore, the State recommended an additional new market test as a stand-alone subsection (d) (and the requisite re-lettering and re-numbering of the ensuing provisions) that would

deregulate a small market when: (1) one to three competitors exist, (2) a market penetration test can be met which demonstrates each competitor offers to provide service to at least fifty percent (50%) of the market, and (3) the commission finds that deregulation of such market is in the public interest. The State suggested that the market penetration portion of the proposed test can be determined by using a percentage of total square miles, number of wire centers, or number of census blocks as the denominator, and the square mileage, number of wire centers, or number of census blocks in the market in which service is offered as the numerator.

OPC also supported a market penetration test; however, OPC commented that such a test should be included in subsection (c). OPC commented that a minimum market penetration criterion requiring each qualifying competitor to serve no less than one percent of the market and that all three combined provide service to no less than 25% of the market.

TTA believed that some small markets may never experience the conditions described in subsection (c), and argued that there should be a mechanism whereby the commission could exercise discretionary authority to deregulate such small exchanges without a predetermined market test. TTA argued the commission should allow companies within such exchanges to produce evidence demonstrating a sufficient level of competition. TTA argued that markets served by two providers (including the ILEC), where each is designated as an ETC, should be deregulated because under those conditions the commission will know that the competitive ETC offers (and advertises) myriad telecommunications services throughout the market.

AT&T Texas, in its reply comments, opined that the Legislature expected future deregulation proceedings and argues that Senate Bill 5 provides a clear path to deregulate markets with populations below 30,000, knowing that the commission has the authority to re-regulate should that be appropriate under PURA §65.055. The ability to re-regulate, according to AT&T Texas again, provides a "safety valve" should deregulation harm the market place. AT&T Texas argues that the timeframes imposed by the legislature - the sequence of timeframes contained in Subchapter B of Chapter 65 - when combined with PURA §65.055, make it clear that complex tests are unnecessary and contrary to the intent of the Legislature. According to AT&T Texas, given the November 30, 2006, statutory deadline, only a simple market test can be utilized. According to AT&T Texas, complex or vague tests should be rejected, as the commission and the parties need to know precisely what evidence will be used in the deregulation analysis. AT&T Texas notes that uncertainty could confuse and delay the commission's statutorily-imposed decision-making responsibility and that a clear test will allow the commissioners to receive and digest the evidence with all deliberate speed.

Commission Response

The commission agrees with AT&T that complex or vague tests should be rejected. Therefore, the commission declines to modify the rule to include the additional market penetration test suggested by the State, the market penetration test offered by OPC, or the comment from TTA that the market test should, in effect, be discretionary. The commission is concerned about the time and resource constraints for the parties as well

as the commission associated with determining the contentious and complex issues associated with any market penetration test or a more discretionary know-it-when-you-see-it test.

TTA and AT&T Texas argued that this new rule should apply only to the markets to be deregulated in 2006.

TTA urged that in the event the commission does not believe it can examine some of these exchanges on a case-by-case basis before the statutory deadline of 2006, the commission should allow for discretionary deregulation authority after July 1, 2007.

AT&T Texas argued in its reply comments that this project should be limited to creating the market test used to meet the requirements of PURA §65.052(f) and should not limit what evidence might be appropriate under PURA §65.054(a), which, according to AT&T Texas, contemplates future dockets. AT&T Texas asserted that as customer choice develops due to advances in technology, the market test for small and medium-sized markets may need to evolve accordingly. Therefore, according to AT&T Texas, the market test developed in this project should not foreclose consideration of additional technology and competitors in the future.

Commission Response

The commission has a statutory deadline of November 30, 2006, to make the initial findings of whether markets under 30,000 population are deregulated. After the initial

finding in 2006 and beginning July 1, 2007, ILECs can request that the commission determine the status of the remaining regulated markets. The commission declines to make the changes requested by TTA and AT&T Texas. The commission finds that the market test adopted in this proceeding is the appropriate test. If, at a later date, the commission finds it necessary to modify the market test, it can do so through another rulemaking proceeding. If a party believes that the market test should be revised, it can file a petition for rulemaking. The commission finds that the market tests applicable to ILEC requests filed pursuant to PURA §65.054(a) are as follows: (1) for markets with populations between 30,000 and 100,000, the appropriate market test is provided in PURA §65.052 ,and (2) for markets with populations under 30,000 population, the appropriate market test is the one set forth in this rule.

AT&T Texas argued that the first sentence in proposed Section 26.134(c), which dictates that *"only if" the ILEC "submits evidence" that meets the substantive requirements shall the market be deregulated*, is contrary to the statutory language that gave rise to this rulemaking. AT&T Texas quoted PURA §65.051(b) as stating that a market with a population of less than 30,000 "*is* deregulated" on January 1, 2007, "unless the commission determines under Section 65.052(f) that the market should remain regulated." According to AT&T Texas, this statute assigns the commission the responsibility to take affirmative action to reach a conclusion with regard to deregulation. AT&T Texas further argued that the statute does not authorize the commission to require that any party come forward with evidence as to whether a particular area should be deregulated. Even though AT&T Texas noted that it is entitled to and will provide relevant evidence, should that evidence somehow

fail to persuade the commission, it argued that the commission still has the ability and responsibility to examine whatever information is available to it and decide whether the area should remain regulated under the statute.

Commission Response

The commission notes that the requirement that the ILECs bring forward the necessary evidence to demonstrate that they meet the market test is not novel. The ILECs, including AT&T Texas, that participated in Docket No. 31831 for the deregulation of markets with populations of 30,000 or more were subject to the same requirement. The requirement is necessary partly because, as indicated in earlier responses, the commission is faced with considering and processing a substantial amount of information in a very limited amount of time. Moreover, the commission does not, as AT&T Texas's comments suggest, possess in any readily available form, the information that would demonstrate that any given market fulfilled the requirements of this test. Simply put, if the burden of proof is on the commission, then the commission will be compelled to rely on the information it has, which would indicate at this time that sufficient competition does not exist in any small market.

The commission believes a more practical approach is for industry participants seeking to be deregulated in specific markets, known only to them, to submit evidence specific to those markets upon which the commission can then decide if the competitive threshold requirements of the rule have been met. The commission finds this approach to be the only practicable solution to this issue, considering the limited time

it has to examine and process the information that will be required to determine the competitive status of these small markets.

Section 26.134(d) provides that in addition to meeting the requirements of subsection (c), an ILEC seeking deregulation of a market area for which the rural exemption as provided for in Section 251(f)(1) of the Communications Act of 1934 applies must meet an additional requirement. The rural exemption effectively prevents certain wireline competitors from entering a market. Such ILEC seeking deregulation must have that rural exemption removed by the commission in order for that market not to remain regulated.

TTA maintained that small markets should be eligible for deregulation without regard to the status of the rural exemption. It suggested that most rural ILECs are more subject to intermodal competition than intramodal competition, such as facilities-based providers as prescribed by PURA §65.052(b)(2)(B). Further, TTA pointed out that rural telephone companies with markets between 30,000 and 100,000 are allowed to deregulate those markets without regard to the status of the rural exemption.

The State, in both its initial comments as well as its reply comments, supported the inclusion of the requirement that any existing exemption be removed prior to deregulation of a market. In its reply comments, the State opined that it is counterintuitive to deregulate a market but maintain restrictions on wireline market entry by failing to remove the ILEC's rural exemption.

Commission Response

The commission agrees with the State and declines to make the change requested by TTA. The commission believes that if a market is deregulated, all market entry barriers should be lifted, including the rural exemption.

At the public hearing, a representative of JSI requested that subsection (d) of the commission's proposed rule to be modified to clarify that rural exemptions for small markets will be lifted on a market-by-market basis.

Commission Response

The commission agrees with the request made by the representative of JSI. The rural exemption pursuant to Section 251(f)(1) applies to all of an ILEC's markets. The requirement that the rural exemption be lifted should apply only to the markets in which the ILEC is seeking deregulation, not to all of the ILEC's markets. Therefore, the commission has revised its proposed rule to reflect its market-by-market approach to lifting the rural exemption.

In addition, the commission removes the phrase "filed by the ILEC" from section (d). The commission finds that the operative language is the phrase "approved by the commission" and that the entity actually filing the request is immaterial.

Section 26.134(e) sets forth the time frame requirements for submitting evidence for markets deregulated on January 1, 2007 and for markets deregulated after January 1, 2007.

AT&T Texas suggested that subsection (e) of the proposed rule should be eliminated in its entirety. According to AT&T Texas, eliminating subsection (e)(1) would avoid a situation where the commission is forced to choose between ignoring evidence and violating its own rule. AT&T Texas asserted subsection (e)(2) should be eliminated as it unnecessarily ties two events together, i.e., that which must occur before November 30, 2006 and that which may occur after July 1, 2007. According to AT&T Texas since the statutory basis for these two events is different, any rule based on these statutes should not necessarily be identical. AT&T Texas opined that the commission has the responsibility to affirmatively take certain action by November 30, 2006. According to AT&T Texas, under PURA §65.054, the commission shall react to a petition filed with it. According to AT&T Texas, this distinction allows for different treatment of parties' burdens of providing evidence and, further, according to AT&T Texas, it is unclear that procedural requirements are needed now to address a petition filed under PURA §65.054. For these reasons, AT&T Texas suggested that subsection (e)(2) be stricken from the proposed rule.

Commission Response

The commission declines to make the changes requested by AT&T Texas. The commission finds subsection (e) of the rule provides instructive guidance necessary for it to successfully examine existing competitive conditions in small markets. Further, the commission believes that AT&T Texas's arguments here are another attempt to raise the burden of proof issue, discussed ***ante*****, and the idea that a different market test would be appropriate for proceedings conducted in 2007 and later.**

The commission disagrees with AT&T Texas for the reasons articulated in the commission's response above to the burden of proof issue.

Further, as noted above, the commission disagrees with AT&T Texas that the statutory basis for the proceeding in 2006 is materially different from any proceedings in 2007 or later. The market tests, as outlined above, are applied in either situation. The only statutory difference is timing.

The commission acknowledges all of the comments filed by the parties and will continue to evaluate the need to conduct a comprehensive review of service objectives and performance benchmarks for all LECs in Texas.

All comments, including any not specifically referenced herein, were fully considered by the commission.

This rule is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998 & Supplement 2005) (PURA) which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction, §65.003, relating to commission authority, § 65.004, concerning collection of information, §65.051, regarding deregulation of markets, and §65.052(f), relating to applicable test for deregulation of certain markets.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 14.052, 65.003, 65.004, 65.051, and 65.052.

§ 26.134. Market Test to be Applied in Determining if Markets with Populations Less than 30,000 Should Remain Regulated on or After January 1, 2007.

(a) **Purpose.** The purpose of this section is to establish the market tests to be applied in determining if markets with populations less than 30,000 should remain regulated after January 1, 2007.

(b) **Application.** This section applies to all incumbent local exchange companies (ILECs), as defined in §26.5 of this title (relating to Definitions).

(c) **Market Test.** Markets as defined in §65.002 of PURA with a population of less than 30,000 shall be deregulated only if the ILEC providing services to such a market submits evidence demonstrating that the population in the market is less than 30,000 and in addition to the ILEC there are three separate competitors:

(1) of which at least one competitor is an entity providing residential telephone service in the market using facilities that the entity or its affiliate owns; and

(2) of which at least two competitors must be from two different categories of the following:

(A) a telecommunications provider that holds a certificate of operating authority or service provider certificate of operating authority and provides residential local exchange telephone service in the market;

(B) a provider in that market of commercial mobile service as defined by Section 332(d), Communications Act of 1934 (47 U.S.C. Section 151 et. Seq.), Federal Communications Commission rules, and the Omnibus Budget Reconciliation Act of 1993 (Pub. L. No. 103-66), that is not affiliated with the incumbent local exchange company; and

(C) a satellite telecommunications provider certified as an eligible telecommunications carrier for the entire market pursuant to §26.418 of this title (relating to Designation of Common Carriers as Eligible Telecommunications Carriers to Receive Federal Universal Service Funds.)

(d) **Rural Exemption Waiver.** In the event that an ILEC seeking deregulation of a market area with a population of less than 30,000 has a rural exemption as provided for in Section 251(f)(1) "Exemption For Certain Rural Telephone Companies" of the Communications Act of 1934, a petition for the removal of that rural exemption for that market must be approved by the commission in order for the market in question not to remain regulated. In addition, any such market must meet the conditions of the market test set forth in subsection (c) of this section.

(e) **Timing.**

(1) Markets shall be deregulated on January 1, 2007 only if the ILEC providing service to such a market(s) submits evidence on or before August 1, 2006 in

compliance with subsection (c) of this section and, if applicable, subsection (d) of this section.

(2) After July 1, 2007 an ILEC petitioning for deregulation of a market with a population of less than 30,000 shall submit with its petition the evidence in compliance with subsection (c) of this section and, if applicable, subsection (d) of this section.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §26.134, Market Test to be Applied in Determining if Markets with Populations Less than 30,000 Should Remain Regulated on or After January 1, 2007, is hereby adopted with changes to the text as proposed.

SIGNED AT AUSTIN, TEXAS on the _____ day of June 2006.

PUBLIC UTILITY COMMISSION OF TEXAS

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JULIE PARSLEY, COMMISSIONER

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BARRY T. SMITHERMAN, COMMISSIONER

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