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MEMORANDUM

March 25, 2003

FROM: Gardner F. Gillespie
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RE: S.B. 400

S.B. 400 would audaciously eliminate the few competitors of Nevada Bell and Sprint, the two largest incumbent local telephone monopolies ("ILECs") in Nevada, while reducing alternatives and raising prices for consumers. The bill would immediately and permanently remove any regulatory oversight and control over most telecommunications services the ILECs offer in Nevada, including all business services. The 22-page bill is extraordinarily complicated and convoluted. But a careful analysis of the provisions reveals that the bill would afford the ILECs a "belts and suspenders" plan for immediate deregulation that does not depend in the slightest way on a showing of effective competition in Nevada.

The bill reneges on agreements previously made by the ILECs in the administrative and legislative arenas – agreements that created a carefully tailored mechanism for managing the transition from monopoly to competitive provision of telecommunications services. These agreements, which are contained in the NAC and the NRS, have allowed the ILECs to enter into Plans of Alternative Regulation ("PARs"). The PARs have permitted the ILECs regulatory flexibility in the pricing of certain services in return for caps on basic telephone rates and obligations to undergo thorough examinations of overall earnings when entering, exiting or extending a PAR. The agreements reflected in the statute and regulations also set forth carefully considered standards for determining when services are sufficiently competitive to warrant deregulation.

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The bill would blow up these agreements with overlapping provisions that effectively guarantee the immediate removal of PUC control over virtually all business telecommunications services. The ILECs' most successful profit centers would be removed from regulation. At the same time, the ILECs would be able to break their price-cap commitments and raise prices for basic services on an individual-service basis without consideration of overall earnings or rate of return. The ILECs would be permitted to selectively lower prices in small geographic areas and to individual customers to drive out the small amount of competition that exists or might spring up in the future. In short, the telecommunications marketplace in Nevada would take a huge step backwards and come under the total control of unregulated monopolists.

Only Residential Service (Maybe) Would be Subject to Any PUC Regulation.

- For all practical purposes, "competitive" services would be freed from all regulation by the PUC (all requirements under Chapters 704 and 707 of the NRS).
- The NAC, as previously agreed to by the ILECs, defines when a service may be classified as "competitive" and free from regulation – when competitors hold 15% of the market share for an exchange or a 30% share of a smaller area. NAC 704.6807.3. To the best of our knowledge, the PUC has never denied an ILEC request to reclassify an individual service. Nevertheless, S.B. 400 would eliminate this standard. Instead, the PUC would be required to classify as competitive any service for which there are two or more competitive suppliers who serve any portion of the market (geographically defined at the discretion of the ILEC).
 - In Clark County, any service would be considered to be "competitive" if offered by two telecommunications providers who have a telecommunications switch anywhere in the market. 1/

1/ The provision also requires that the "competitive suppliers" of the service hold certificates of public convenience and necessity, have an interconnection agreement with the ILEC and have been assigned numbers (unless the competitors are resellers). S.B. 400 § 25. Necessarily, any wireline telecommunications providers will meet those meaningless requirements.

Under the FCC's decision announced on February 20, 2003, ILECs will no longer be required to supply a switch to competitors as unbundled elements under 47 U.S.C. § 251. Accordingly, all competitors in the provision of telecommunications services (other than resellers) will necessarily have their own switches.

- In all other counties, the two competitors need only resell the ILEC's service to a total of 500 business or residential lines. S.B. 400 § 25, amendment to NRS 704.6896.2(b).

Despite the lack of any substantial or sustainable competition in Nevada today, it is believed that Sprint in Clark County and Nevada Bell in its service area would be able to make out a case for immediate deregulation of all business services under these relaxed standards.

- All data services at a rate of over 125 kbps would automatically be deemed "competitive." Id. § 18.
- All services and their underlying facilities that are capable of transmitting information at a rate of over 150 kbps would automatically be deemed "deregulated." 2/ To the extent that the ILECs move toward packet switching technology for delivery of telephone services, those services would be deregulated – whether or not there is any meaningful competition.
- Anytime that the ILECs can invent a "new service" or figure out a new twist in offering an existing service, regardless of the state of competition, that service would be classified as "competitive." Id. §§ 4, 18. A service would be considered "new" so long as it has any different function, feature or compatibility that the ILEC has not previously offered, or if the service is a combination of other services previously deemed to be "new." Id.
- The bill would also allow the ILECs unilaterally to designate any service – whether business or residential – as totally deregulated merely by listing the service as "nonregulated" in its Cost Allocation Manual filed with the FCC. Under 47 C.F.R. § 64.903, the FCC only requires the carrier to describe its nonregulated activities. The ILECs could freely and accurately describe any service as nonregulated in the Cost Allocation Manual, because under Section 3 of S.B. 400 that service would automatically be fully deregulated in Nevada.

The ILECs Would be Relieved of Critical Obligations They Accepted When They Entered PAR.

- Despite the promises made by the ILECs on entering PAR to cap their rates for "basic services," see NAC 704.6841.2, the ILECs would be

2/ The services would be totally removed from regulatory oversight, except for consideration of revenues and expenses in a rate case on entry or exit from PAR (neither of which is likely to occur). Id. §§ 10.1, 10.3.

entitled to revise any rates, including the rates for basic service, during the PAR term if the services or packages of services are reclassified as competitive. As noted above, the PUC would be required to reclassify all business services as competitive, and thus subject to rate revision without any PUC review. S.B. 400 §§ 8(e), 25.

- When they entered PAR under NRS 704.040, both Sprint and Nevada Bell committed to file an analysis of operations – including the contributions made by discretionary, competitive and deregulated services to joint and common costs – at the conclusion of the PAR term, before commencing another term of PAR. See 704.68498. Such an analysis would permit review of cross-subsidies, as well as any support for basic services garnered from discretionary, competitive and deregulated services. The ILECs also agreed that if they desired to adjust basic rates at the conclusion of the PAR term, they would make a full rate-case filing. Id.; NAC 704.68476. S.B. 400 would relieve them of those obligations. S.B. 400 §§ 8.3(b); 23, amending NRS 704.68952.1(a).
- Under the bill, the ILECs would be required to file a report of their earnings at the end of the five-year PAR period, but the report would not include earnings from any deregulated services. ^{3/} The PUC's review of that report (in a proceeding that would not involve any members of the public or competitors) would be limited to determining whether existing rates for basic services are "just and reasonable" – not whether the level of earnings overall reflects monopoly rates or unfairness to consumers. S.B. 400 § 23.7. Furthermore, the PUC would be limited to granting the ILEC's request to continue its election for another 5 years or to denying continued participation in PAR. The PUC would not be permitted to require a reduction of rates. On the other hand, if the ILECs could make out a case that rates for services on an individual basis – without any consideration of overall earnings or rate of return – were not "just and reasonable," the PUC would be required to grant an increase in the rates for those individual services.
- If rates for residential service have not already been raised under a declaration of "competitiveness," they may be expected to be raised substantially upon the ILECs' extension of their participation in PAR. Any remaining elements of the ILECs' promised price caps will thus disappear at the end of the existing PAR terms.

^{3/} It is not clear whether the earnings of competitive services would be included; S.B. 400 § 25.4 would remove competitive services from the provisions of chapters 704 and 707 "for any purpose" except certain limited specified purposes that do not include earnings review.

The Bill Would Permit the PUC to Deregulate Any Service, Without Any Standards.

- The S.B. 400 also permits the PUC to establish any criteria for reclassification of ILEC services, without any statutory guidance, so long as the reclassification criteria are not more strict than the relaxed standards under the bill for determining whether a service is competitive. S.B. 400 § 25. No standards are mentioned that represent legislative guidance for the PUC to follow in making such a decision, except for the ceiling for regulation set forth in Section 25.
- The PUC would be permitted to exempt ILECs from any regulation under Chapter 704 solely on the basis of a finding that the carrier should be subjected to "an alternative plan of regulation." S.B. 400 § 8. No legislative guidance is provided for the PUC to follow in making such a decision.

In the event that any ILEC business services are not deregulated as described above, the bill eliminates in yet another way the protection to consumers and competitors is found in the existing regulatory scheme. The ILECs would be permitted to depart from their tariffs and lower rates on one day's notice by offering volume and term discounts and individual contracts to business customers to squelch competition. Id. § 28. This so-called "flexibility" would even permit the ILECs to lower rates of basic network services to businesses, on a spot basis, to stamp out competition wherever it appears. The ILECs are also permitted to exercise "flexibility in pricing and terms" for bundled residential services.

* * *

It is common knowledge that the competitive telecommunications industry in Nevada, as elsewhere in the United States, is struggling to survive. XO Communications and Mpower Communications, the largest of the few telecommunications competitors in Nevada, have only very recently emerged from bankruptcy. At this time, there is no effective competition in telecommunications services in Nevada. Yet, with its incredible sweep, the bill would allow these existing monopolists to subsidize their efforts to undercut any prices offered by competitors on an individualized basis, driving the last breath out of the few competitors who have thus far managed to survive. Once the competitors have been completely eliminated from the market, the PUC would be powerless to reinstate regulations to protect consumers or any future market entrants. At the same time, the ILECs would be permitted to renege on promises of price caps that were at the heart of the social compact they entered into PAR in the first place. Consumers would be the losers twice over. Passage of the bill would result in higher prices for consumers and the elimination of competition.

QUESTIONS TO BE ANSWERED BY THE ILECS ABOUT THE MEANING AND EFFECT OF S.B.400.

S.B. 400 bill raises a number of additional questions about its meaning and effect. Sprint and Nevada Bell should each be required to answer the following questions in writing and to submit the answers to the appropriate authorities as part of the legislative history of the bill:

1. What services do you offer today that you have any reason to believe would be deemed to be "competitive" under S.B. 400 § 25 in any "market" consisting of a central office or larger area?
2. Assuming that Mpower and XO Communications have switches in Clark County, what business services offered today by Sprint would be subject to treatment as "competitive" services under the bill?
3. How many competitive telecommunications suppliers in Clark County have a switch and offer any kind of residential services?
4. Do at least two competitive suppliers of business telecommunications services resell at least 500 residential or business lines from Nevada Bell in its overall service area in Nevada? If so, what business services offered today by Nevada Bell would be subject to treatment as "competitive" services under the bill?
5. Would the "written report" to be submitted by electing carriers under S.B. 400 § 23 at the conclusion of a term of PAR include earnings from competitive services?
6. What services are "identified as non-regulated in [your] cost allocation manual . . . as filed with the Federal Communications Commission pursuant to 47 C.F.R. section 64.903"?
7. What, if anything, limits your ability to list a service as "non-regulated" in your cost allocation manual filed with the FCC?
8. What do you believe is to be the standard under which the PUC should classify a service as "deregulated" under S.B. 400 § 3?
9. Under S.B. 400 § 8, once an ILEC is in PAR, what kind of a proceeding or process is necessary for the PUC to exempt the carrier from "all the provisions of this chapter"?
10. Under S.B. 400 § 8, would the PUC be able to exempt a carrier totally from regulation solely "upon a determination that such carrier should be

subject to an alternative plan of regulation"? If not, what is the meaning of the quoted language?

11. Would S.B. 400 § 10 exempt from PUC regulation all facilities used for Internet access, even at speeds slower than 150 Kbps?
12. How would S.B. 400 § 9 be enforced? What penalties would apply for violations?
13. What existing services do you offer that would be deregulated or treated as competitive under S.B. 400 §§ 10 or 18?
14. Would packet switched telephone service be deregulated or treated as competitive under S.B. 400 § 18?
15. Do you have any plans to offer packet switched telephony?
16. Would the PUC be permitted to require the rates for any basic services to be reduced before a PAR carrier enters into another term of PAR? If so, what standards would the PUC be permitted to use in making such a determination?
17. Would the PUC be permitted to block an increase in the price of a PAR carrier's basic service before the carrier was permitted to enter into another term of PAR? If so, what standards would the PUC be permitted to use in making such a determination? Would the PUC be permitted to consider anything other than the just and reasonableness of the rate for the individual service at issue?
18. What is the smallest geographic market that could be designated by the electing carrier or the PAR carrier under S.B. 400 § 25?
19. What limitations are imposed on an electing carrier or PAR carrier under S.B. 400 § 26 regarding the exercise by the carrier of flexibility of pricing or terms for basic network services?