# **Telecom Regulatory Reform: Indiana Update 2012**



The Digital Policy Institute Ball State University Muncie, Indiana 47306

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# **NOTICE**

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# **Indiana: The Evolution of Telecom Reform 2012**

#### **Executive Summary**

History shows us the issue of telecommunication regulatory reform at the federal level can be cumbersome at best. Shifts in federal regulatory policy, new broadband technology and evolving competitive pressures often create imbalances in the telecommunications landscape at the state level that require periodic review and action. Fortunately, Indiana has been proactive over the past few years in eliminating unneeded legacy regulations and crafting pro-competitive legislation.

In 2006, absent meaningful reform legislation at the federal level, Indiana acted on Digital Policy Institute (DPI) recommendations to remove outdated legacy regulations and correct imbalances caused by increased competition in the telecommunication industry since 1996. In 2006, Indiana led the way and passed the most comprehensive telecom reform bill in over two decades with strong bi-partisan support.

Drawing upon deregulation legislation in Texas, Indiana's 2006 reform statutes included statewide video franchising, and has since been recognized, even by Texas, as the legislative template for other states to follow.<sup>2</sup> Since that time a number of other Midwestern states soon followed Indiana's lead.<sup>3</sup>

Now, five years after deregulation in Indiana, competition in the market has held consumer prices in check, and as a recent IURC report to the General Assembly suggests, new capital investments has occurred, there have been increased build-outs of infrastructure using fiber optics and digital transmission technology, and consumer complaints about redlining are non-existent. As impressive as this snapshot is, the review process is dynamic and ongoing.

Looking back, in 1996 Congress passed the Telecommunications Act of 1996 and established the preconditions for efficient competition in the telecommunications marketplace. What Congress didn't do, as economist Alfred E. Kahn suggests in his 1998 book, is prescribe a regulatory off ramp as the deregulated marketplace rapidly changed the competitive landscape.<sup>5</sup> Later, in a

<sup>2</sup> The Texas Policy Institute recognized Indiana's progressive, "light regulatory" stance recently by stating, "Indiana has gone far beyond Texas in deregulating its telecommunications market, eliminating all rate regulation and tariffs. This has resulted in tremendous growth in telecommunications investment and services." See <a href="http://www.senate.state.tx.us/75R/senate/commit/c510/handouts11/0315-BillPeacock.pdf">http://www.senate.state.tx.us/75R/senate/commit/c510/handouts11/0315-BillPeacock.pdf</a>

<sup>&</sup>lt;sup>1</sup> HEA 1279, P.L. 27-2006

<sup>&</sup>lt;sup>3</sup> Ohio, Michigan and Missouri. See <u>www.bsu.edu/digitalpolicy</u>.

<sup>&</sup>lt;sup>4</sup> See "Report to the Regulatory Flexibility Committee of the Indiana General Assembly," Indiana Utility Regulatory Commission (2010), available at:

http://www.in.gov/iurc/files/Report to the Reg Flex Committee 2010.pdf

<sup>&</sup>lt;sup>5</sup> Kahn, Alfred E. Letting Go: Deregulating the Process of Deregulation, or: Temptation of the Kleptrocrats and the Political Economy of Regulatory Disingenuousness, (Institute of Public Utilities and Network Industries, Michigan State University, 1998).

2007 speech before the Federal Trade Commission, Kahn stated that continued comprehensive regulation of the telephone industry is not only unnecessary, but will likely "harm ratepayers by inhibiting competition and diminishing investment."

Since 1996, the Federal Communications Commission (FCC) has been under mandate to conduct a biennial review of existing regulatory statutes to identify those legacy telecommunication regulations that are ripe for review and, where merited, removal. Unfortunately, meaningful outcomes from that federal process are often delayed or derailed when the review takes a back seat to partisan politics and debate over ancillary issues like net neutrality. Individual states, like Indiana, have often been left to chart their own course in the digital age.

The year 2010 signaled the implementation of the final phase of deregulation under HEA 1279. The General Assembly is wise to continuously revisit Title 8 of the Indiana Code to identify regulatory statutes that should be eliminated, or revised to level the regulatory playing field, encourage competition, innovation and outside capital investment. The major reform findings and recommendations of this paper are as follows:

- The implementation of the 2006 HEA 1279 requirements that eliminated all regulatory authority of the IURC over rates and service quality for retail phone service, and the creation of a state-wide video franchising mechanism are now complete.
- For Indiana, the benefits of this "light regulatory" approach are increased capital investment, new competition, and continued rollout of new fiber optic and digital technology in select areas of the state. To date, no redlining complaints have been received by the IURC.
- Onta continue to support deregulation where appropriate, and the traditional rationale for telecom utility regulation -i.e., fixed landline telephone service as a natural monopoly is now gone.
- o The traditional landline telephone business in Indiana continues to decline with consumer adoption of competing technology. Today, there is no basis to claim that incumbent landline providers are, per se, "dominant" entities requiring the same, close government scrutiny of past decades.
- Upon review, Indiana should continue to modernize its provider-of-last-resort (POLR)<sup>8</sup> requirements to eliminate unnecessary duplication with federal law, eliminate regulations which unfairly benefit some providers at the expense of others, and have a negligible impact on consumers, and sunset the remaining POLR state provision as soon as practicable.

<sup>&</sup>lt;sup>6</sup> Remarks of Alfred E. Kahn before the Federal Trade Commission (Feb. 13, 2007). Available at http://www.ftc.gov/opp/workshops/broadband/presentations/kahn.pdf

<sup>&</sup>lt;sup>7</sup> Section 11 of the Communications Act, 47 U.S.C. § 161.

<sup>&</sup>lt;sup>8</sup> The term "Provider of Last Resort" (POLR) is used extensively within Title 8 of the Indiana Code, and is similar to the term "Carrier of Last Resort" (COLR) used in the literature, but is considered more inclusive.

## **Indiana: The Evolution of Telecom Reform 2012**

### The Digital Policy Institute Ball State University Muncie, Indiana 47306

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#### 1.0 Five Year Review of HEA 1279

#### 1.1 Introduction

This is the fourth in a series of independent biennial reviews by the Digital Policy Institute of Title 8 of the Indiana Code, and the regulations that impact the provision of telecommunication services, competition, and outside investment in broadband infrastructure in Indiana.

The first report in 2006<sup>10</sup> provided members of the Indiana General Assembly with necessary documentation to support the most comprehensive deregulation of outdated telecommunication rules in over two decades. Included were recommendations for a "light" regulatory approach after federal deregulation in 1996, plus estimates on the impact of telecom reform on growth in capital investments and jobs in the state. Further, the report made the case for statewide franchising of video services. The resulting legislation, HEA 1279, <sup>11</sup> was passed with strong bipartisan support and signed into law by Governor Mitch Daniels on March 14, 2006.

The second report in 2008<sup>12</sup> took a look at the early measurable results of telecom deregulation in Indiana. That report highlighted Indiana's leadership as 20 other states passed similar telecom reform measures. After nearly two years, over \$516 million in new capital investments were reported by telephone companies as they built out infrastructure to provide new and expanded services once risk and uncertainty was eliminated under HEA 1279. Most telephone carriers, both large and small, plus most incumbent cable firms, have opted for statewide franchising.

<sup>&</sup>lt;sup>9</sup> The authors are all senior research fellows in the Digital Policy Institute, Ball State University. Dr. Hicks is communication economist, Prof. Umansky is a communication attorney, and Dr. Yadon is a communication policy analyst. Information about the authors is available at <a href="https://www.bsu.edu/digitalpolicy">www.bsu.edu/digitalpolicy</a>.

<sup>&</sup>lt;sup>10</sup> The Economic Impact of Telecom Reform in Indiana: 2006, <u>Digital Policy Institute</u>, Ball State University (February 14, 2006). Available at www.bsu.edu/digitalpolicy.

<sup>&</sup>lt;sup>11</sup> Public Law 27-2006

<sup>&</sup>lt;sup>12</sup> An Interim Report on the Economic Impact of Telecommunications Reform in Indiana, <u>Digital Policy Institute</u>, Ball State University (February 15, 2008). Available at <a href="https://www.bsu.edu/digitalpolicy">www.bsu.edu/digitalpolicy</a>.

The third report in 2010<sup>13</sup> was the presentation of an econometric model that evaluated the national impact of statewide franchising in broadband adoption. Evidence was provided that shows that statewide franchising had a significant effect on the adoption of broadband telecommunications, accounting for almost 6 percent of new subscriptions in those states which had the longest history of statewide market access by providers.

Now, after five years, the implementations of all requirements mandated under HEA 1279 are complete. It is time to revisit Title 8 and ascertain the impact of reform legislation in Indiana and continue the review the existing administrative regulations of the Indiana Utility Regulatory Commission (IURC)<sup>14</sup> to assure fairness and applicability under Indiana's "light" regulatory approach.

#### 1.2 Post Divestiture

The decision to deregulate telecommunications in the United States began first at the federal level and evolved over a number of years based on a number of factors. First, there was the general recognition that the regulatory and economic landscape of the telecommunications industry had changed drastically since the divestiture of AT&T in 1984. The dramatic shift in the competitive landscape was evident by the fact that in 1996, some 90 percent of the telecommunications market was voice, while wireless and data each were only five percent. Nine years later, those numbers shifted to where voice was only 40 percent of the total telecom market, while wireless and data increased to 30 percent each. 15

The opportunity for regulatory relief finally came with the passage of the Telecommunications Act of 1996<sup>16</sup> which required the FCC to examine tariff rules and forebear enforcement if it found that the rules were not necessary to (1) ensure that carrier rates remain just and reasonable; (2) not necessary for consumer protection; and (3) the public interest would be served by eliminating the tariffing provisions.<sup>17</sup>

In its 1996 Detariffing Order, the FCC finally concluded that it was no longer necessary to allow long-distance carriers to file tariffs because it would decrease incentives for innovation, make it harder to offer discounts and customized service arrangements, and increase the potential for coordination in price setting. On April 28, 2000, the U.S. Court of Appeals (D.C. Circuit) upheld the Commission's orders requiring detariffing of interstate, domestic, interexchange services, and the FCC's detariffing rules went into effect.

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<sup>&</sup>lt;sup>13</sup>Telecommunication Deregulation: A Policy Progress Report, <u>Digital Policy Institute</u>, Ball State University (March 2010). Available at <a href="https://www.bsu.edu/digitalpolicy">www.bsu.edu/digitalpolicy</a>

<sup>&</sup>lt;sup>14</sup> 170 IAC 7.

<sup>&</sup>lt;sup>15</sup> See www.fcc.gov.

<sup>&</sup>lt;sup>16</sup> Telecommunications Act of 1996, Pub. L. No 104-104, 110 Stat. 56. The 1996 Act amended the Communications Act of 1934, 47 U.S.C. 151 et seq.

<sup>&</sup>lt;sup>17</sup> Indiana is under a similar mandate for the IURC to examine and eliminate telecom rules that are no longer necessary. This statutory language is located at IC 8-1-2.6-4.1(a)(2)

<sup>&</sup>lt;sup>18</sup> Policy and Rules Concerning the Interstate, Interexchange Marketplace Implementation of Section 254(g) of the Communications Act of 1934, as amended, 11 FCC Rcd 20730, 20779 (1996).

<sup>&</sup>lt;sup>19</sup> MCI WorldCom, Inc. et al. v. FCC, 2000 WL 390520, No. 96-1459 (D.C. Cir. 2000).

While the FCC provided an open window of opportunity for Indiana to address the removal of tariffs at the state level, it took 10 years and a supportive political environment to mount a comprehensive deregulation agenda that would gain wide bipartisan support.

#### 1.3 Post Telecom Act of 1996

According to Sen. Brandt Hershman, co-sponsor of HEA 1279, Indiana's comprehensive deregulation had its origins in legislation in Iowa (telephone rate deregulation) and Texas (statewide video franchising) and followed reform actions taken in Ohio and Michigan.<sup>20</sup>

Texas is credited with being the first out of the gate in the race toward telecom reform and statewide franchising. On September 7, 2005, Texas Governor Rick Perry signed into law Senate Bill No. 5, an "Act Relating to Furthering Competition in the Communications Industry" which many believed would significantly reform telecommunications regulations in Texas. This Act also served as an early model for legislators in other states, like Indiana, who were seeking to reshape their telecommunications markets to meet the economic challenges of the 21st century.<sup>21</sup>

In response, the Digital Policy Institute (DPI) at Ball State University issued a report entitled, *The Economic Impact of Telecom Reform in Indiana: 2006.*<sup>22</sup> This report substantiated earlier research, including independent studies by federal agencies, major universities and think tanks, all of which came to a similar conclusion. Only direct, head-to-head competition would lead to increased capital investment, increased broadband services, new jobs, and potential lower costs for Indiana consumers.

On March 14, 2006, Indiana became the second state to enact statewide franchising when Governor Mitch Daniels signed into law the state's most comprehensive telecom bill (HEA 1279) in more than two decades. With strong bipartisan support, Indiana's new reform legislation, including statewide video franchising, became the new legislative template that over 20 other states would follow. A major reason for this notoriety is that Indiana didn't simply copy reform measures by other states; it attempted to improve upon them.

Unlike Texas, Indiana lawmakers were the first to ensure that cable television incumbents were allowed to fairly take advantage of the state's new franchise terms upon competitive entry. Also, Indiana is one of the few states to encourage long-term, outside capital investment by reducing risk and uncertainty from unwarranted sunset provisions. But Indiana's reform legislation went much further than simply statewide franchising.

Following the example set under the federal Detariffing Order, Indiana lawmakers also concluded that it was no longer necessary to demand intra-state carriers to file tariffs. The

<sup>&</sup>lt;sup>20</sup> See http://www.csg.org/knowledgecenter/docs/slmw0606telecomm.pdf

<sup>&</sup>lt;sup>21</sup> "Act Relating to Furthering Competition in the Communications Industry," S.B. 5, 79th Legislature, 2d Session, Texas 2005. See also Donald L. Alexander, Ph.D., "Telecommunications Deregulation in Texas: An Analysis of the 2005 Competition Act," Tax Foundation (December 2005)

<sup>&</sup>lt;sup>22</sup> See www.bsu.edu/digitalpolicy.

reasons ran parallel to federal thinking, because it would decrease incentives for innovation, make it harder to offer discounts and customized service arrangements, and increase the potential for coordination in price setting. Thus, Indiana's approval of HEA 1279 ended state authority to regulate landline telephone service rates for business and most residential customers.

While the impact of Indiana's telecom reform legislation continues to be evaluated over time, the early effects of reform were documented in a second report by DPI entitled, *An Interim Report on the Economic Impact of Telecommunications Reform in Indiana*, <sup>23</sup> released on February 15, 2008. In the nearly two years since passage of HEA 1279, the report uncovered a number of positive post-HEA 1279 events that, collectively, help to gauge the impact of deregulation for Indiana citizens and the Indiana economy.

These early findings included the accelerated deployments of digital subscriber line (DSL) services in more than 100 new rural Indiana communities, collective capital expenditures of more than \$516 million in new infrastructure, new competition for video in multiple markets in Indiana, more than 2,200 new jobs created for Hoosiers, and, finally, a positive impact on price in the marketplace.

Today, after five years, Indiana's reform legislation is still considered the most comprehensive deregulation package by most other states, including Texas. The Texas Public Policy Foundation recently observed in their *Legislators Guide to the Issues 2011/2012*:

"Indiana has gone far beyond Texas in deregulating its telecommunications market, eliminating all rate regulation and tariffs. This has resulted in tremendous growth in telecommunications investment and services."<sup>24</sup>

#### 1.4 IURC Report to General Assembly - 2010

Deregulation of telephone service in Indiana was phased in over a three-year period starting in 2006, when the Indiana General Assembly approved HEA 1279, declaring that "competition has become commonplace in the provision of telecommunications services in Indiana and the United States."

By comparison, the reform issues directly covered under Indiana's HEA 1279 were best brought out when DPI examined the state of telecom reform in Ohio in October 2009.<sup>25</sup> As indicated in Table 1 below, across seven high impact reform issues, Indiana had completely deregulated all

<sup>&</sup>lt;sup>23</sup> Ibid

<sup>&</sup>lt;sup>24</sup> Bill Peacock, "Telecom Deregulation," Texas Public Policy Foundation: Legislators Guide to the Issues 2011/2012. Available at http://www.texaspolicy.com/pdf/2011-TelecomDeregulation-CEF.pdf

<sup>&</sup>lt;sup>25</sup> The Evolution of Telecom and the Ohio Template for Reform: 2009, <u>Digital Policy Institute</u>, Ball State University (October 2009). Available at www.bsu.edu/digitalpolicy.

# Table 1 Telecom Reform Issues Cross-Comparison Indiana v. Ohio<sup>26</sup>

Reform Issue	Indiana	Ohio
Eliminate Tariffs	No action needed.	Basic local exchange services to businesses with less than 4 lines and to residential consumers require detariffing.
Extend Pricing Flexibility	No action needed.	Primary basic residential service requires pricing flexibility.
Protect Against VoIP Regulation	No action needed.	No action needed.
Protect Against Wireless Regulation	No action needed.	Commission jurisdiction to impose utility regulation on wireless services should be eliminated.
Reform Provider of Last Resort Standard Obligation	Eliminate POLR requirement in competitive markets other than multitenant nonresidential settings. Allow option for provider to become POLR in high cost markets and receive support from explicit funding mechanism, if necessary.	Eliminate POLR requirement in competitive markets. Allow providers of last resort flexibility to utilize most efficient technology. Allow option for provider to become POLR in high cost markets and receive support from explicit funding mechanism, if necessary.
Broadband Deployment	No action needed.	No action needed.
Provide for Uniform Consumer Protection	No action needed.	Streamline existing regulations and assign sole jurisdiction for consumer protection to agency with responsibility for consumer protection in competitive industries.

Table adapted from Hance Haney and George Gilder, "More Broadband, Increased Choice and Lower Prices Begin With Regulatory Reform," Discovery Institute, August 2008, p. 34. Available at: http://www.discovery.org/scripts/viewDB/filesDB-download.php?command=download&id=3321.

but one issue (**Provider of Last Resort**), while Ohio still had some work to do to match Indiana's "light" regulatory approach.

By the time of the Ohio study, rates and charges for retail telecommunications services and residential landline customers in Indiana were fully deregulated (July 1, 2009), and the state had successfully transitioned to statewide video franchising.

In 2010, the Indiana Utility Regulatory Commission issued its *Report to the Regulatory Flexibility Committee of the Indiana General Assembly for 2010.*<sup>27</sup> Within that report the IURC clarified which reform issue were directly related to deregulation under HEA 1279. Some issues in Table 1 above have never been under IURC jurisdiction. For example, the IURC has never exercised jurisdiction over rates and charges for:

- Wireless/cellular telephone services
- Internet telephone services (voice over Internet protocol)
- Internet service
- Cable and video services

Further, rates and charges for any landline telephone service including non-basic features (such as caller ID, voice mail, call forwarding, or any other additional service) as well as bundled service packages have been exempt from IURC jurisdiction since 2006. Between July 2006 and July 2009, the only telephone service rates and charges that remained under Indiana Utility Regulatory Commission (IURC) jurisdiction were for stand-alone basic local services (BLS) for residential landline customers.

On June 24, 2009, the IURC issued a General Administrative Order (2009-5) which identified which sections of its rules<sup>28</sup> would no longer be enforced as of July 1, 2009. Rates and charges for retail telecommunications services in Indiana were fully deregulated as of July 1, 2009, as were sections of the code dealing with operator services, telephone directories, extension of services, maintenance of plant equipment and trouble reports.

Areas where the Commission retains or gains jurisdiction include:

- Slamming and Cramming
- Universal Service support programs
- Service matters regarding hearing- and speech-impaired customers (dual-party relay)
- Dialing code administration (including dialing codes, area codes and number conservation)

<sup>28</sup> 170-IAC-7.

<sup>&</sup>lt;sup>27</sup> Available at: http://www.in.gov/iurc/files/Report\_to\_the\_Reg\_Flex\_Committee\_2010.pdf.

- Interconnection agreements and resolution of carrier-to-carrier disputes
- "Providers of Last Resort" matters, to ensure that landline telephone services are available to all customers who request them
- IURC as the sole video franchise authority in the state as of July 1, 2006, and will enforce all specific customer service standards.

The IURC's report to the Regulatory Flexibility Committee of the Indiana General Assembly also reflects on the industry landscape and a four-year study on video service availability. Major findings include the following general observations:

- With the deregulation of the communications industry, Indiana has seen competition increase and new technology be deployed in certain areas of the state.
- The IURC has received no complaints regarding economic redlining under the code by video providers with state-issued franchises.
- Concern over FCC action on the National Broadband Plan that may reduce or eliminate
  access charge payments or high-cost (universal service) funding for traditional voice
  services, and the negative impact this may have on **Provider of Last Resort** (POLR)
  status by small to medium telephone firms.

The legacy issues surrounding the maintenance and administration of Provider of Last Resort (POLR) regulations remain perplexing at the state level in this era of deregulation. Identified as a regulatory area ripe for review in earlier Digital Policy Institute research papers, the question of should "landline" telephone services be available to all customers who request them, while addressing any issues of uncertainty and inequity in a deregulated landscape seem paramount. The Indiana Utility Regulatory Commission is required, in each odd numbered year, to identify and eliminate telecommunications rules and policies that are no longer necessary, in the public interest, or for the protection of consumers. Under this mandate, additional discussion on this topic seems warranted.

# 2.0 Challenges of a Changing Landscape

Firms in the telecommunications industry and their regulators at the federal and state levels continue to confront significant challenges in many areas, including how service best will be provided to consumers in urban, rural and now unserved geographic areas. Technological changes, including the development of broadband and IP services, have cast new light on old assumptions on how consumers can and should best be served. Moreover, several decades of judicial, legislative and regulatory actions have provided a new framework for service and for evaluation and fulfillment of public needs for telecommunications service.

As noted in the Section 1 of this paper, one regulatory area left untouched in Indiana's legislative and regulatory reform of its telecommunications law is that addressing the obligations of the

<sup>&</sup>lt;sup>29</sup> IC 8-1-2.6-4.1(a)(2).

"provider-of-last-resort (POLR)." Although the continuation, modification or elimination of this concept will be influenced by federal and state legislation, rules and policies affecting "universal service (USF)" and "Inter-Carrier Compensation ("ICC")" – and the impact of the new federal "Connect America" plan – deciding the fate of POLR in Indiana lies exclusively with the Indiana Legislature. Indeed, the FCC's most recent pronouncement on USF and ICC states specifically that POLR matters are still to be addressed at the state level and not preempted by federal law.<sup>30</sup>

State POLR requirements had their genesis decades ago, when competition for voice telephony was at or near zero. POLR requirements traditionally were assigned to wired "public switched telephone network (PSTN)" providers, a class which included former "Bell System" companies and, in some cases, independent local exchange firms. Moreover, these requirements were based on the notion that a company receiving a government franchise to provide service should take on a set of obligations in return for that government benefit.

Today, the competitive environment is vastly different. Rather than having voice service provided by a monopoly or near-monopoly local company, the landscape of voice service – in Indiana and elsewhere – is marked by robust competition of firms using not just traditional, wired voice technology but a range services based on internet protocol and wireless technologies.

Spurred on by the terms of the Telecommunications Act of 1996 and other federal and state statutory reforms, competition for voice and non-voice telecommunications services has been marked by federally-encouraged and state-encouraged entry of myriad new firms and the expanded service offerings of existing firms. Indeed, a policy designed only to ensure voice service in an era of limited providers is of questionable relevance to the situation we have today: active and often fierce competition among a multiplicity of providers and with a growing array of communications technologies.

Indiana's telecommunications competition is typical of that found in many other part of the country. Indeed, based on Indiana telecommunications reforms adopted in recent years, the levels of competition have been increasing at a fast pace. A clear picture of this growing competition is found in the FCC's Report titled "Local Telephone Competition:

Status as of December 31, 2010." Here we find an up-to-date and compelling showing as to the vast array of switched access, VOIP and mobile services offered by a growing number of firms throughout the Hoosier state.

Clearly, the premises upon which Indiana's POLR requirements were framed are no longer evident as one surveys the number of competitors and the range of services (including the multiple ways of providing voice communication) offered residential consumers in their homes and while they are on the move. Incumbent carriers are now facing an onslaught of competition. In fact, continuing to impose voice-only POLR requirements on incumbent carriers only serves to place them at an artificial competitive disadvantage and to distract them from providing more broad-based telecommunications services that include but go well beyond voice-only offerings.

<sup>&</sup>lt;sup>30</sup> Report and Order and Further Notice of Proposed Rule Making ("R&O/FNPRM") in WC Docket No. 10-90, et al., FCC 11-161, released November 18, 2011.

<sup>31</sup> Industry Analysis and Technology Division, Wireline Competition Bureau, October 2011.

Efforts of the Indiana legislature to retain, modify or eliminate POLR requirements clearly must be undertaken with full awareness that we are in an era of changed circumstances. That is, the basis for existing state regulation is shaky at best. Moreover, the Indiana legislature also must take into consideration how the goals of state POLR requirements will be met through the interplay of other regulatory requirements. As set forth below, Indiana should work to eliminate what now may considered to be not only duplicative requirements but also archaic mandates that actually may work against the interests of consumers desiring voice service, let alone the range of other services now offered by a variety of telecommunications carriers.

As well articulated in the 751-page FCC R&O/FNPRM, 32 there now is a new set of federal regulatory provisions – some effective now and some others becoming effective shortly – aimed at ensuring that all consumers, including those in rural and "high cost" areas, access not only to voice communications but to the entire panoply of telecommunications services made possible in the digital, Internet-protocol age.

Key to this regulatory transformation is the "Connect American Fund (CAF)." The CAF is intended to ensure support not for mere voice communications but for a wide range of voice and data services. For now coupled with, and building upon, the concept of USF and ICC funding of carriers providing service in high-cost areas, the CAF mechanism is designed carry out federal policies of universal access to contemporary communications services.

Under federal law, in order for a telecommunications carrier to qualify for USF funding, it must be designated – usually the state; but in some cases by the federal government – as an "eligible telecommunications carrier (ETC)." <sup>33</sup> The authority of a state to identify and designate ETCs comes from provisions of federal law. <sup>34</sup> But, nothing in federal law now *requires* states to maintain traditional POLR requirements on specific, incumbent carriers. Indeed, the conditions attached to carriers seeking and obtaining ETC status well serve as a surrogate for familiar POLR obligations.

This conclusion that POLR reform is well overdue is not one limited to the views of the DPI; nor is it confined to the circumstances in the state of Indiana. Many observers have pointed out that increases in competition among telecommunications providers and telecommunications technologies compel a reassessment of traditional POLR requirements. And many states already have made these needed reforms.

Peter Bluhm, <sup>35</sup> in his February 2008, presentation to the NARUC Telecommunications Committee, argued that POLR duties should be reassessed. 36 His report, among others, notes the competitive unfairness of continuing to impose POLR requirements for serving outlying areas when an incumbent carrier's revenue potential (and, thereby, its financial capacity to provide

<sup>&</sup>lt;sup>32</sup> *Id*.

<sup>&</sup>lt;sup>33</sup> 47 U.S.C § 254(e) <sup>34</sup> 47 U.S.C. § 214 (e)

<sup>&</sup>lt;sup>35</sup> Mr. Bluhm is a lawyer and policy advisor on telecommunications issues. Most recently, Mr. Bluhm was Principal for Telecommunications at the National Regulatory Research Institute.

<sup>&</sup>lt;sup>36</sup> Carriers of Last Resort – An Evolving Concept, Peter Bluhm, National Regulatory Research Institute, February 28, 2008.

population center and outlying services) is now dropping due to the entry of competitors vying for and securing significant if not dominant shares of revenues from population centers. That is, competing carriers are allowed to "cherry pick" customers in densely populated areas only, with no regard for, nor desire to, serve customers in outlying areas.

Similar conclusions, as to the reduced revenues of incumbent carriers in population centers, were reached in the comments filed in May 2009, by the Independent Telephone and Telecommunications Alliance ("ITTA").<sup>37</sup> There too we find compelling documentation as to the need to reassess statutory and regulatory requirements imposed on a small set of a vastly growing number of telecommunications competitors.

More recently, Peter Bluhm and two of his colleagues -- Natelle Dietrich, and John Ridgway – again argued that "last resort" duties traditionally attached to telephone companies as conditions of their government franchise should only be imposed on carriers receiving federal support funding, and not as a state-imposed condition of a franchise to operate. Thus, a wide range of commentators have argued that the time is now for reassessment of these state "last resort" obligations.

We can look to the states of Wisconsin and Michigan as contemporary examples of how state legislatures have chosen to modify or eliminate POLR requirements in light of both the state of competition in the industry and the existence of federal programs that will ensure the provision of basic voice services to all citizens.

#### Wisconsin

On May 26, 2011, Wisconsin Bill SB 13 was signed into law. Section 117 of the bill provides for a new Section 196.503 of the Wisconsin Statutes and Annotations to establish an interim mechanism for waiver of state POLR requirements and a total elimination of those requirements as of April 30, 2013.

Specifically, the Wisconsin statute takes a revised approach to the provision of "basic voice services." The new law does require an ILEC – until April 30, 2013 – to make basic voice (defined as "two-way voice communication service within a local calling area") to all residential customers within the ILEC's local exchange area. However, the law now provides that the ILEC may provide such basic voice service through an affiliate and through the use of "any available technology or mode."

More importantly, the law provides that an ILEC may apply to the state Public Service Commission (PSC) for a waiver of these requirements. The PSC must grant a waiver if the waiver is "in the public interest" or if "effective competition" is found to exist in the local exchange area. If the PSC fails to decide on the waiver within 120 days of its filing, the waiver

<sup>&</sup>lt;sup>37</sup> Comments of ITTA in CC Docket No. 96-45 and WC Docket No. 05-337, filed May 8, 2009.

<sup>&</sup>lt;sup>38</sup> Carriers of Last Resort, Eligible Telecommunications Carriers and State Administrative Roles, A White Paper To The State Members Of The Federal-State Joint Board On Universal Service, Peter Bluhm, Natelle Dietrich, and John Ridgway, February 7, 2011

is deemed granted. After June 1, 2012, if a waiver request is based on an earlier finding of effective competition, the waiver is deemed granted unless the PSC issues a decision within 20 days of the waiver request's filing. The law also "grandfathers" all previous PSC rulings relieving particular ILECs' POLR obligations. As noted above, all Wisconsin POLR obligations will "sunset" as of April 30, 2013.

#### Michigan

Also instructive are the steps taken in Michigan's recent reform of its telecommunications laws. Signed into law on June 14, 2011, Michigan Public Act No. 58 (House Bill No. 4314) states that:

"...any telecommunications provider that provides either basic local exchange or toll service, or both, shall not discontinue either service to an exchange unless 1 or more alternative providers for toll service, or 2 or more alternative providers for basic local exchange service, are furnishing a comparable voice service to the customers in the exchange. A comparable voice service includes any 2-way voice service offered through any form of technology that is capable of placing and receiving calls from a provider of basic local exchange service, including voice over internet protocol services and wireless services."

The Michigan Act goes on to provide a requirement for public notice of any request by a telecommunications provider to discontinue service and a deadline by which the Michigan Public Service Commission must act on the request. The act also requires a 60-day notice to customers of action by the Michigan PSC. Importantly – and underscoring how federal law exists to serve the interests of consumers – the Michigan Act states that "...discontinuance of basic local exchange service under this section by an incumbent local exchange carrier does not affect the requirements of that incumbent local exchange carrier under federal law."

#### **Next Steps for Indiana**

So, the path for similar regulatory reform in Indiana is now clear. Although the Indiana legislature certainly may adopt statutory language of its own choosing, the key elements of other states' actions should serve as useful guides. No longer is there a need for a state to require provision of voice service where that service and other telecommunications services are provided by other companies in the same service area.

The DPI envisions Hoosier state statutory reforms that acknowledge the merit of eliminating superfluous and redundant state laws in light of federal laws and regulations aimed at achieving the same result. Although Indiana still will be in the business of designating ETCs under the provisions of federal law, it is federal law that will serve as the mechanism for ensuring consumers' access to basic voice, among other services. ETCs' federal service obligations (keyed to ETCs' receipt of Universal Service or Connect American Fund support) will not be

<sup>&</sup>lt;sup>39</sup> Section 313 (1), Michigan Public Act No. 58.

<sup>&</sup>lt;sup>40</sup> Section 313 (4), Michigan Public Act No. 58.

affected by these incumbent carriers' decision to seek a waiver to opt-out of any Indiana POLR requirements on conditions (similar to those specified in the Wisconsin and Michigan revised telecommunications laws) when there is competition for voice and other services at the local level. But, the need for obtaining a waiver from Indiana POLR requirements should not be the ultimate goals of Indiana telecommunications reform in this area. Rather, DPI recommends that Indiana follow the lead of other states in adopting a near-term "sunset" of all Indiana-based POLR obligations.

#### 3.0 **Economic Impact of POLR Reform**

Robert W. Crandall, noted economist of the Brookings Institution, advised policymakers to deregulate completely in his 2005 book, Competition and Chaos. 41 The economic lesson from the history of regulation is that regulation and competition are a bad emulsion. Once the conditions for competition exist, it is best for regulators to abandon the field altogether. This is particularly true in a sector that is undergoing rapid technological change and therefore requires new entry and new capital. The politics of regulation favor maintaining the status quo, not triggering creative destruction.

Later, in a 2007 speech before the Federal Trade Commission, economist Alfred Kahn confirmed that the transition [in the telecom industry] is complete and that comprehensive regulation of landline phone services is both unnecessary and will likely harm consumers by inhibiting competition and diminishing investment.<sup>42</sup>

The provision of Provider of Last Resort requirements for regulated firms is predicated on the existence of a natural monopoly for a single product, with low substitutability across competing technologies. The POLR regulation was designed to prevent provider exit, and insure some minimal service would continue in all geographic regions to preserve local service and network externalities without regard to the changing regulatory landscape. POLR regulation is a common feature of the early stages of devolution from a regulated monopolist to a workably competitive market.

As described in earlier sections, the experience in Indiana is that POLR regulation continues in the face of widespread competition in the market for telecommunications services. POLR responsibilities are accompanied by Universal Service Fund subsidies for high cost areas and is limited to incumbent providers of wireline service.

Economic considerations surrounding POLR reform in Indiana's telecommunications markets hinge upon two issues. The first is the effect of deregulation within markets for telecommunications services in Indiana, including evidence regarding competition following HEA 1279. The second is the level of substitutability among competing technologies, the degree of competition within these markets and the role incumbent mandated POLR regulation

See, Crandall, Robert W. Competition and Chaos (Brookings Inst. 2005) at 166.
 Remarks of Alfred E. Kahn before the Federal Trade Commission (Feb. 13, 2007). Available at http://www.ftc.gov/opp/workshops/broadband/presentations/kahn.pdf.

generates asymmetry in the regulatory environment, reducing social welfare. We address these in turn.

Deregulation of telecommunications markets through the past decade and half have generated significant gains to telecommunications penetration. Indiana's House Enrolled Act 1279 crafted, among other things, statewide franchising for telecommunications services. Two subsequent analysis of this act attribute significant gains to telecommunications take rates as a result.

Two 2010 studies (DPI, 2010; Bohannon and Hicks, 2010) addressed the effect of statewide franchising legislation in the United States from the mid 1990's through 2009. Due to unavailability of data on private cable access TV take rates and prices for bundled service, these studies examined the effect of statewide franchising on broadband take rates. An empirical model that tested the effects of the legislative change along with factors that would influence take rates across states isolated the impact of statewide franchising rules. These effects ranged from broadband take rate increases from 1.66 percent to 5.32 percent, with the differences largely attributable to the date of enactment. In Indiana, a state which had only recently permitted statewide franchising, the legislation boosted broadband take rates by 2.47 percent, or by more than 226,000 households and businesses.

A separate review of actual investment and market penetration in Indiana, performed by the Indiana Utility Regulatory Commission in 2011 provides a similar story with respect to video provider services in Indiana. In 2006 (the year HEA 1279 was passed) saw three new video providers in the state, servicing 3,064 new Census Blocks. In 2007, when the legislation became effective, 6 new providers entered the market serving 18,911 new Census Blocks. This growth was sustained in both 2008 and 2009, with 7 and 9 new firms serving 31,962 and 35,861 new Census blocks respectively. The IURC study also reviewed expansion and service provision in MSA's in Indiana, finding significant new investment in both incumbent video providers and new entrants.

This data and analysis supports the view of Kahn (2007) who argued that the transition from natural monopoly to workably competitive markets in telecommunications is mature, and that continued comprehensive regulation of these services is not needed and will lead to reduced competition, loss of consumer welfare and lower levels of investment.<sup>43</sup>

The migration from natural monopoly to workable competition has occurred due to the high level of substitutability between differing technologies for a wide range of services. For example simple wireline telephony is no longer the dominant technology for voice telecommunications services in Indiana. Wireless, broadband enable voice, and other technologies have superseded, but not replaced traditional wireline services. The abundance of providers and the technology options available to consumers suggests a nearly complete migration of services to workable competition. For these regions, POLR regulation remains a legacy regulation which asymmetrically requires incumbent wireline services. It is not needed in these locations.

However, we argue without extensive new analysis that, in the interim, some portions of the state potentially may be beneath the threshold of workably competitive markets for telecom services.

<sup>&</sup>lt;sup>43</sup> Ibid.

In these markets, in the near term, at least federal POLR requirements should be continued, with changes only to the required technology for provision of telecommunications services. In such cases, incumbent providers, without regard to technology, should assume the role of POLR through IURC administration. This would also attenuate compensation for high cost areas. Examples of geographies for POLR continuation are those few census tracts with declining populations.

The economic argument for altering the regulatory landscape with respect to POLR is a familiar one. The state already recognizes that new technologies exist that can supplant traditional wireline telephone service of the incumbent local exchange. 44 Yet the current regulatory environment may unintentionally support incumbent wireline technology for POLR obligations without regard to the efficiency or cost effectiveness of alternative technologies. This can only result in low cost service by accident. A regulated environment which (1) constrains deployment of preferred telecommunications options due to outdated determination of the optimal technology, or (2) has no mechanism which allows the lowest cost technology to assume POLR obligations in a competitive environment, has several consequences which are incompatible with public welfare and consumer choice.

The current regulatory environment delimits investment in the least cost technology (unless that happens to always and everywhere be wireline telephony). The current POLR regulation can result in high prices, higher deployment costs, reduced access and therefore reduced consumer and producer surplus in every location where a lower cost technology than wireline telephony exists. While there may be places where incumbent wireline services offer the lowest marginal cost of a limited suite of telecommunications services, the changes proposed here permit continued POLR and USF support for those carriers. Elsewhere, in a competitive environment, it is cost, not legacy, that should determine the POLR firm in a region. Any alternative would result in less access, to a suite of telecommunications services, higher cost for services and reduced welfare for firms and consumers engaged in the production and consumption of telecommunications services.

### 4.0 Summary and Conclusions

In summary, the Digital Policy Institute (DPI) finds that data continues to support deregulation where appropriate, and the traditional rationale for telecom utility regulation -i.e., fixed landline telephone service as a natural monopoly - is now gone. The traditional landline telephone business in Indiana continues to decline with consumer adoption of competing technology. Today, there is no basis to claim that incumbent landline providers are, per se, "dominant" entities requiring the same, close government scrutiny of past decades.

The implementation of the 2006 HEA 1279 requirements that eliminated all regulatory authority of the IURC over rates and service quality for retail phone service, and the creation of a statewide video franchising mechanism are now complete. We concur with the IURC that benefits of

<sup>&</sup>lt;sup>44</sup> IC 8-1-32.4-11

this "light regulatory" approach are increased capital investment, new competition, and continued rollout of new fiber optic and digital technology in select areas of the state. To date, no redlining complaints have been received by the IURC.

The Digital Policy Institute (DPI) further concludes that based on industry trends and the changing competitive landscape of the telephone industry (voice) in Indiana, Title 8 of the Indiana Code should be modernized to reflect a transformation to a flexible service obligation. Where Provider of Last Resort (POLR) obligations are concerned, we recommend the elimination (1) of unnecessary duplication with federal law, and (2) those regulations that unfairly benefit some providers at the expense of others.

For example, under Title 8, a provider of last resort is required to offer local exchange service throughout a defined geographic area. Yet this same, redundant, service obligation also exists at the federal level and is tied to a carrier's status as an Eligible Telecommunications Carrier (ETC). A carrier must be designated an ETC to receive Universal Service Fund (USF) dollars. Thus, once the state designates a provider as an Eligible Telecommunications Carrier, former separate but redundant state service obligations are assumed and covered by federal law with a negligible impact on consumers.

Under Title 8, the state already recognizes that new technologies exist that can supplant traditional wireline telephone service of the incumbent local exchange. Yet provider of last resort obligations need not be strictly tied to the incumbent local exchange carrier. Where two or more communications service providers, regardless of technology, are in competition within a service area, and each holds a certificate of territorial authority issued by the Commission, the existing provider of last resort should be able to be relieved of the POLR obligations upon notice to the IURC. Looking ahead, as with Wisconsin, POLR obligations in Indiana should sunset in mid-2013. This would have no impact on the carrier's service obligations under federal law.

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<sup>&</sup>lt;sup>45</sup> IC 8-1-32.4-9

<sup>&</sup>lt;sup>46</sup> IC 8-1-32.4-11