Kansas Senate Utilities Committee
Testimony of Steve Hahn, President - AT&T Kansas
January 22, 2013

Good afternoon, Mr. Chairman and members of the Committee. My name is Steve Hahn. I am the President of AT&T Kansas.

Today I'll provide an overview of the communications industry, touch on the history that impacted where our industry stands today and provide a brief description of the forms of regulation that govern voice services in the state of Kansas.

Brief History

In the early days of the communications industry, policymakers deemed it prudent to divide up territory and grant monopolies to companies so those companies could better recover costs. The government set the prices and guaranteed a reasonable rate of return. In the monopoly era, regulation served as a substitute for competition.

Over time, many began to view the monopolies as a hindrance to innovation as telephone service became more ubiquitous and other companies began developing new technologies that could provide new and better ways of communicating.

Deregulation – Divestiture (1984)

A major event in the evolution of the communications industry occurred with the divestiture of the Bell System in 1984.

Divestiture created seven Regional Bell Operating Companies (RBOCs) that remained monopolies offering local telephone (voice) service and opened long-distance service to competition. Our own Southwestern Bell was one of the RBOCs.

The former AT&T parent company pursued the "long-lines" long-distance business. Competition in long-distance soon flourished, while local voice service remained closed to competition.

Deregulation – 1996 Federal Telecommunications Act

The next frontier for competition was to break up the monopolies in the local voice service market. The passage of the 1996 Federal Telecommunications Act and the Kansas Telecommunications Act that followed did away with the local monopolies of the RBOCs and began the transition from an industry of monopolies and regulation to one of competition and free markets.

Like divestiture, the '96 law had special regulations for the local Bell companies designed to allow competitors to enter their markets to offer voice services.

Early competitors included cable television companies, which already had infrastructure in place, and with some investment, learned how to provide a compelling "triple-play" that included voice service and internet service, along with TV.

Competition may have been slow out of the blocks in the late '90s, but I would submit to you that more innovation has happened in the communications industry in the past decade than happened in the previous century, all of which has benefitted Kansas consumers and businesses. Today, many companies offer communications and connectivity services in Kansas through a multitude of technologies and devices, many with new and innovative business models. A very simple but impactful statistic tells the story: from 2000-2012, AT&T residential landline subscriptions dropped 77%.

In general, three important components contributed to this explosion in innovation. Public Policy Changes, Technological Advancements, Consumer Preference and Demand:

1) Public Policy:
Public policy played a big role in stimulating competition. The '96 Telecom Act was designed "to promote competition and reduce regulation." Companies like AT&T remained more heavily regulated while new market entrants were lightly regulated.

With monopoly barriers removed and light regulation for new entrants, free market enterprise did what free market enterprise does best. Operating under light regulation, new service providers engulfed what had been a monopoly for more than 100 years.

2) Technological Advancements:
Network providers (cable and telecom) invested heavily to upgrade their networks with fiber optics to carry vast amounts of data traffic in Internet Protocol (IP) format.

In the IP world, voice communications is just one of many applications that can "ride" on the network in addition to data and video. Many cable and telecom companies offer IP-based voice service while still more, like Skype, Vonage or magicJack, utilize any existing internet connection to provide voice service.

Similarly, wireless phone usage exploded with stiff competition among nationwide and regional providers, to the point that in late 2011, the total number of wireless service subscriptions exceeded the population of the U.S.

What began as a voice-only service expanded to text messaging with limited data use and now includes full internet access at faster and faster speeds for video, data and voice on feature and application-rich smartphones.

For many consumers and certainly for most business customers, mobile voice and internet has quickly moved from a "nice to have" tool to a must-have necessity.

3) Customer Preference:
The evolution of the internet, the expansion of advanced networks and the proliferation of mobile applications now allow consumers to communicate by a number of means, including video chat, texting, email, social media and good old voice conversation; as a result, the very notion of "local service" or "long distance" is unfamiliar to a large number of consumers. New generations of consumers will never own a landline for voice service, but instead will use wired or wireless IP-based services.

Investing for the Future
Today's communications industry is driving a new economy – one that is based on IP broadband networks and wireless technology. One in which speed, mobility and instant connectivity are driving virtually all sectors of our economy - agriculture, health care, manufacturing, financial services and many more.

The companies building and investing in these IP broadband and wireless networks, including AT&T, operate on a level-playing field – and are largely free to design and build these networks without unnecessary regulation. During the depths of our recent recession, when many industries were struggling to stay solvent or were sitting on capital dollars hoping economic conditions would improve, the communications industry was pouring money into infrastructure and service at a rate of more than $60 billion a year.

The '96 Telecom Act's goal of reducing regulation on traditional landline service as competition flourished has seen varying degrees of progress around the nation, with many states having already removed the old monopoly rules for competitive providers to create an environment that encourages investment by AT&T and a broad array of communications companies.

Since 1996, the Kansas Legislature has made sensible updates to state telecommunications policy to reflect changes in the marketplace, technology, and customer demand. While much progress has been made, monopoly-era regulations still remain, even in the most competitive areas of the state. These rules divert resources and investment into the legacy network that Kansas consumers are abandoning in droves when public policy should be encouraging investment in the new networks and services customers demand.

Kansas Telecommunications Carriers – A Snapshot
Currently, there are several statutory designations for voice communications companies in Kansas, as shown on the attached chart. I'll describe them briefly and others will provide more information on the individual categories.

<u>Rate of Return Carriers</u>:
Rural Local Exchange Carriers (RLECs) serve mostly rural exchanges and are generally still regulated as monopoly providers. They are referred to as rate of return carriers because the Kansas Corporation Commission sets their rates and manages other factors to ensure they earn a guaranteed rate of return.

Price Cap Carrier:
CenturyLink, as the state's only price-cap carrier, has rates subject to a cap based on inflation as well as other monopoly-era regulation.

Electing Carrier:
AT&T is the only carrier to elect this type of regulation, which allows pricing flexibility and automatic effectiveness of tariffs, yet is still subject to other monopoly-era regulation.

Telecommunications Carrier:
Competitive Local Exchange Carriers (CLECs) provide local voice service throughout the state and have limited regulation.

Wireless & Voice over Internet Protocol (VoIP):
Many wireless and VoIP companies provide voice service throughout the state and are subject to only very limited or no regulatory oversight.

Each category of communications company is subject to different rules. In general, the rate of return carriers are more heavily regulated and the companies to the right (on the chart) are subject to lighter forms of regulation. For example, only the rate of return carriers, price-cap carriers, and electing carriers are subject to the carrier of last resort (COLR) obligation that requires them to provide traditional voice service to any customer in their territory that requests service.

The other presenters will now provide more information about their particular category. I look forward to visiting with you more about policy reform in the coming weeks, and I am happy to stand for questions at the appropriate time.