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FISCAL IMPACT REPORT

SPONSOR Griego DATE TYPED 2/15/05 HB _____

SHORT TITLE Telecommunication Provider Competition SB 672

ANALYST Rosen

APPROPRIATION

| Appropriation Contained | | Estimated Additional Impact | | Recurring or Non-Rec | Fund Affected |
|-------------------------|------|-----------------------------|------|----------------------|---------------|
| FY05 | FY06 | FY05 | FY06 | | |
| | NFI | | NFI | | |

(Parenthesis () Indicate Expenditure Decreases)

Duplicates HB750

SOURCES OF INFORMATION

LFC Files

Responses Received From

Economic Development Department (EDD)
 Attorney General's Office (AGO)
 Public Regulation Commission (PRC)
 General Services Department (GSD)
 Qwest

SUMMARY

Synopsis of Bill

Senate Bill 672 amends, repeals and enacts various sections of the New Mexico Telecommunications Act (NMTA) to change the way the state regulates telecommunications and protect consumers and small businesses. This bill deletes or modifies key sections of NMTA designed to promote competition in telecommunications markets.

Section 1 amends the Definition Section of NMTA to delete any reference to "competitive telecommunications service", "effective competition", and "noncompetitive telecommunications service" because Section 4 of the bill repeals the statute (current Section 63-9A-8) that sets out a regulatory process and consequences of a PRC determination that a particular service, in a particular geographic area is subject to "effective competition".

Section 2 adds new language dictating the regulatory procedure PRC will employ in regulating rates for retail public telecommunications services. This replaces the current procedure set out in Section 63-9A-8, which is repealed in Section 3, by which PRC determines on a service by service and market by market basis whether a service is subject to “effective competition”. The process is as follows: (1) Rates for basic residential and business local exchange service will be set or modified in accordance with the incumbent local exchange carrier’s alternative form of regulation (“AFOR”); (2) Decreases in retail business services, other than basic business local exchange service, will be effective three days after they are provided to PRC with no possibility of PRC review; (3) Decreases in retail residential services, other than basic residential local exchange service, will be effective three days after provision to PRC and posting to the telecommunications company’s public web site with no possibility of PRC review; (4) Increases in retail services, other than basic business and residential service, will be in accordance with the AFOR. Rates for local exchange services must cover the average variable cost for the provision of service; however, there is no similar requirement for covering the costs of non-local exchange services. The current prohibition in Section 63-9A-8 of cross-subsidization of competitive services by non-competitive services is repealed in Section 3 of the bill. In Subsection 3E, the telecommunications company is specifically given the right to offer or discontinue offering special incentives, discounts, packaged offerings, temporary rate waiver or other promotions or to offer individual contracts.

Section 3 repeals Section 63-9A-8 NMSA 1978, the “Effective Competition” section of NMTA. Under the current system, as reflected in Section 63-9A-8, PRC is given the responsibility and authority to determine whether an individual service is subject to “effective competition” in a relevant market area and upon a finding of such, “modify, reduce or eliminate rules, regulations and other requirements applicable to the provision of such service, including the fixing and determining of specific rates, tariffs or fares”. Certain statutory considerations are to be applied by PRC in making the determination whether a individual services are subject to effective competition: (1) the extent to which services are reasonably available from alternate providers in the relevant market area; (2) the ability of alternate providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions and (3) existing economic or regulatory barriers. As stated above, there is also a provision in 63-9A-8 prohibiting cross-subsidization of competitive services by non-competitive services. In the process and scope of the current statutory provision, PRC, after notice and hearing, considers whether there is effective competition for a particular service in a particular market area. Interested parties have access to relevant data and are able to cross-examine witnesses and assumptions in a record-based hearing. Under the current system, as reflected in Section 63-9A-8, the burden of proof is on the telecommunications company to prove that there is effective competition. These procedures and the determination of competition by PRC, on a case-by-case basis, would be repealed under this bill.

Significant Issues

According to PRC, by repealing the effective competition statute this bill assumes there is effective competition for all services (except basic residential and business service) in all areas of the state and, by legislative mandate, removes PRC and other interested parties (such as AGO) and competitors (such as competitive local exchange carriers (CLECs)) from having a role in the regulation of those services.

PRC indicates there is some question as to which telecommunications companies are covered by the proposed new procedures in Section 2. Although rural telecommunications carriers and mid-size carriers have their own sections of the statute, the definition in NMTA is broad enough to cover them and they may be implicated because this would be a later enacted statutory provision.

PRC notes only incumbent carriers such as Qwest have AFORs. It is difficult to ascertain what procedure and what timing would be applicable to interexchange carriers (IXC's) and CLECs if they wish to raise their rates. This is particularly true in light of the fact that PRC already has rules that include timing, procedure and effective dates for IXC's and CLEC's proposed rate increases.

According to PRC, only in the situation where incumbent local exchange carriers are wholesale providers and retail competitors is there a danger of cross-subsidization of competitive services by monopoly services. The provision in the statute that provides that local exchange services (which are often the monopoly services) must cover the average variable cost does not prevent cross-subsidization of competitive services. Average variable cost is not a term of art and is not defined in the bill, thus there may be subjective ideas of what those costs would be.

PRC reports Qwest has a current AFOR that addresses such issues of packaged offerings, special incentives, waivers and individual contracts that are essentially de-regulated in Subsection 2E of this bill. However, in contrast to this bill, the AFOR imposes procedural, notice, unbundling and bundling restrictions and cost coverage requirements. Subsection 2E would give a local telecommunications company carte blanche to price these offerings on a case by case basis for different markets, different customers, and different situations, thereby potentially putting the captive monopoly customer and the potential competitor at a disadvantage. This subsection is also in potential conflict with Section 63-9A-9 which governs the regulation of individual contracts to facilitate competition.

Business and residential customers get no notice of potential increases in rates and only residential customers get minimal notice of decreases if they check the company's website. The three-day filing of a price list does not allow PRC to verify that decreases in rates cover costs (see above). In addition, there is no provision for PRC, a customer or a competitor to challenge the proposed rates as being below costs, anti-competitive or not just and reasonable.

According to AGO, this bill creates a regulatory environment that could undermine the growth of competitors to Qwest. If this bill results in predatory pricing, the practice of providing services at prices that are low enough to drive competitors out of a market, it could create a *de facto* monopoly. Once a competitor is driven from the market, the remaining monopoly provider of the service has much greater ability and incentive to neglect investment and raise prices. Such a situation is common in cases where a company controls an essential facility needed for service provision, such as the telecommunication network's central offices.

AGO notes generally, the following elements must exist to constitute predatory pricing:

- The predator must have market power (power to unilaterally decrease or increase its prices, or terms of service). In telecommunications, market power is conferred by virtue of controlling the network's "central offices."
- The predator must charge prices that fall below a predatory price standard.

AGO believes telecommunications market conditions and regulation determine that prices must usually be below the “Long Run Incremental Costs” or “Total Service Long Run Incremental Costs.” For example in New Mexico, the *retail* rate for POTS is \$12.50 per line. However, to obtain access to the infrastructure necessary to supply POTS, a competitor would have to pay a *wholesale* rate of approximately \$16.00 per line. Normally, there must be a reasonable expectation that the predator will be able to recoup its losses after its predation ends (e.g. after competitors are driven out of the market).

AGO indicates predatory pricing is a particularly difficult type of conduct to prove in the telecommunications industry. As previously discussed, the industry is characterized by substantial joint and common costs, which are difficult to assign to particular services. The economic cost tests used to determine predatory pricing, such as Average Variable Costs and Log Run Incremental Costs, are difficult to apply to many types of telecommunications prices. This is especially true where the term “average variable costs” can be used without precision. Since the current bill does not define “average variable costs” it is impossible to determine exactly what costs the drafter intends to address in the bill. Passage of this bill could also result in litigation because of the arguable vagueness of undefined terms in the bill.

AGO reports, as a general matter, many of the definitions in this bill may potentially conflict with definitions found in the Federal Telecommunications Act of 1996. The bill’s definition of ILEC would apply only to Qwest.

According to AGO, deleting §63-9A-8 NMSA (1978) will eliminate a key portion of New Mexico’s laws designed to promote competition in telecommunications markets, removing PRC’s ability to make determinations of effective competition. Currently the PRC is authorized to make specific, market-by-market determinations of “effective competition.” Such authority is important because it recognizes that providing service in a place like Cuchillo, NM, is different from providing service in Albuquerque. This section also prohibits “cross subsidization” of competitive telecommunications services with services deemed non-competitive. The practical effects of such a deletion would mean that an ILEC such as Qwest could use revenues obtained from its “captive costumers” to subsidize services in markets that may have more competition. Such a situation would make it impossible for PRC to create a “level playing field” for effective competition.

PERFORMANCE IMPLICATIONS

Indeterminate

FISCAL IMPLICATIONS

Indeterminate.

ADMINISTRATIVE IMPLICATIONS

Indeterminate

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates HB750

TECHNICAL ISSUES

PRC indicates the title of the bill does not accurately reflect the content of the bill, which repeals the Effective Competition statute (Section 63-9A-8).

AGO indicates many of the definitions in this bill may potentially conflict with definitions found in the Federal Telecommunications Act of 1996.

OTHER SUBSTANTIVE ISSUES

GSD reports the bill will allow for competition in the “business customer environment.”

PRC questions whether sufficient competition exists in all services in all parts of the state to ensure the procedures set out in this bill will not conflict with the purpose of NMTA to promote competition.

Qwest sees robust state-wide competition for wireless phone service and believes this “pricing flexibility” bill will allow Qwest to better compete in the market place.

ALTERNATIVES

PRC suggests changing the title of the bill to indicate it repeals the Effective Competition statute (Section 63-9A-8).

PRC suggest streamlining or revising current PRC procedures associated with the Determination of Effective Competition rather than repealing the entire statute.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

Status quo maintained, with continued PRC oversight and consumer protection provisions to determine effective competition in the marketplace.

JR/lg