

**Report to the Joint Utility Review Committee
(Commission on Governmental Operations)**

The State of AT&T North Carolina's Operations

In An Open and Competitive Retail Market

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Senate Bill 343, "An Act Establishing The Communications Regulatory Reform and Investment Act of 2011," was ratified by the North Carolina General Assembly on April 18, 2011, and signed by the Governor on April 26, 2011. This Bill represented the next step in the continuing evolution of telecommunications regulation in North Carolina, enabling companies to elect a market-based regulatory approach for all retail services and to gain exemption from historical carrier of last resort obligations. In exchange for this market-based regulatory approach, delineated in G.S. 62-133.5(m), telecommunications companies making a subsection (m) election must forgo receipt of any funding from a State funding mechanism, other than interconnection rates, that may be established to support universal service.

Recognizing the continuing evolution of the telecommunications industry, Senate Bill 343 removes retail telecommunications regulations that were left in place by House Bill 1180, An Act Establishing "The Consumer Choice and Investment Act of 2009", for any telecommunications company making a "subsection (m)" election. Though House Bill 1180 removed most Commission oversight of retail services, it left in place carrier of last resort obligations for local exchange companies and retail price controls for standalone residential service lines offered by companies electing to be regulated under the provisions of G.S. 62-133.5(h).

The reporting mechanism to the Joint Legislative Utility Review Commission, put in place by House Bill 1180, continues for companies making a subsection (m) election. The report, delineated in G.S. 62-133.5(k), requires both subsection (h) and subsection (m) electing Local Exchange Companies (LECs) or Competing Local Providers (CLPs) who offer basic local residential service to make an annual report to the General Assembly on the state of its company's operations. The Joint Legislative Utility Review Committee has been given the task of reviewing these reports and determining whether to recommend that the General Assembly take corrective action in response to the reports. Subsection (k) stipulates that the reports shall include the following:

- I. An analysis of telecommunications competition by the Local Exchange Company or Competing Local Provider, including access line gain or loss and the impact on consumer choices from the date the local exchange company makes its election to be subject to alternative regulation under the terms of subsection (h) or (m) of this section.
- II. An analysis of service quality based on customer satisfaction studies from the date the local exchange company makes its election to be subject to alternative regulation under the terms of subsection (h) or (m) of this section.

III. An analysis of the level of local exchange rates from the date the local exchange company makes its election to be subject to alternative regulation under the terms of subsection (h) or (m) of this section.

On October 14, 2011, AT&T North Carolina (AT&T) filed its subsection (m) election letter with the North Carolina Utilities Commission in Docket P-55, Sub 1013M which included a sworn statement that (1) its territory is open to competition from Competing Local Providers; (2) that, it has a statewide rate of \$20.00 for residential basic local exchange service; (3) that, should the Commission establish a state funding mechanism, other than interconnection rates, to support universal service as described in G.S. 62-110(fl), AT&T North Carolina would not withdraw from any such fund. As stipulated in G.S. 62-133.5(k), AT&T now submits its third annual report for the year 2013 to the General Assembly on the state of its company's operations since making its subsection (m) election. Prior to making its subsection (m) election, AT&T North Carolina was operating under the provision of G.S. 62-133.5(h) (subsection h) which it elected on October 5, 2009.

I. Analysis of Telecommunications Competition in North Carolina for 2013

All aspects of the telecommunications market in North Carolina continue to be extremely competitive. In the local exchange market, AT&T faces competition in the Consumer and Business markets from traditional competitors, such as Competing Local Providers (CLPs), and from wireless companies, cable companies and others offering voice, data and video services. As a result, AT&T experienced a 14% reduction in total access lines in 2013. Total residence lines declined at a higher rate during the same period, dropping by over 19.5%.

Today's communications market continues to be transformed as consumers increasingly use wireless and Internet services as an alternative to traditional wireline voice lines. It is estimated that nationally, 500,000 consumers replace their wireline voice service with wireless or internet-based networks each month. CLPs, wireless, cable, satellite and alternative voice and data providers, including Vonage and Skype, compete with Incumbent Local Exchange Companies (ILECs) like AT&T to provide communications options in North Carolina. North Carolina consumers have a wide variety of services, technologies and bundles available to them and these ever-expanding options continue to have a significant effect on the decline in access lines for AT&T and other ILECs.

Wireless - Improvements and innovations in wireless service, wireless devices, pricing and availability have contributed to a continued upward trend in wireless growth and a simultaneous decline in landline connections. According to the FCC, as of December 2012, wireless connections in North Carolina totaled 9 million, compared to 3.1 million ILEC and CLP switched access lines.

Nationwide, by December 31, 2012, the number of wireless subscriber connections totaled 326.4 million, a 5.0% year over year increase. As a result, the number of wireless subscriber connections surpassed the entire population of the United States and its territories yielding a wireless penetration rate of 102 percent. According to the FCC's 16th Wireless Competition Report, virtually everyone in the United States now has access to wireless voice and broadband services. It is estimated that 99.9% have access to wireless voice services and 99.5% have access to wireless broadband. Further, 82% of Americans have the ability to choose between at least four facilities based mobile broadband providers. Americans are enjoying the wireless revolution in record numbers as, prices for minutes and megabytes continue to fall, mobile data traffic continues to grow exponentially and 67% chose smartphones during 2012. Older Americans are also enjoying the wireless revolution as 31% of Americans between the ages of 55 to 64 use smartphones in their daily lives. Landline access line decline can be substantially explained by the growing number of consumers disconnecting their wireline connections in favor of wireless phones. Preliminary results from National Health Interview Survey (NHIS) indicate that two in every five American homes (39.4%) only had wireless telephones during the first half of 2013 and nearly one in six (15.7%) households received all, or the vast majority, of their calls on wireless telephones despite also having a landline telephone. The switch to wireless service spans all income levels as lower income Americans are also choosing to disconnect their wireline services. During this same period, 54.7% of adults living in poverty and 47.5% of those living near poverty, lived in wireless only households

Broadband – In addition to wireless, internet communications services are also expanding rapidly. According to the latest available FCC data, as of December 31, 2012, North Carolina consumers had in place 2.8 million fixed broadband connections, representing 71% of NC households. Total broadband connections including DSL, cable and mobile wireless were 6.2 million residential connections and 1.3 million business broadband connections. As broadband connections have grown, so have Voice over IP (VoIP) services and applications which serve as an alternative to traditional wireline local telephone service. Historically a telephone connected you to a place where now services that run on IP networks connect you to anyone in anyplace. The latest FCC data indicates that by December 2012 VoIP lines in North Carolina had grown to approximately 1.09 million lines, with over 85% of these being residential lines. This represents an increase in VoIP lines of 10.4% over December 2011 and 22.4% over December 2010.

Bundled Services – Bundled services, which can include any combination of voice, broadband, television/cable and wireless, continue to provide a means for consumers to take advantage of significant savings when they use one service provider for many of their communications services. Consumers no longer view “plain old telephone service” (POTS) as the single technology for communications. As they have for the past several years, consumers continue to mix different technologies, providers, and services to meet their communications needs.

Bundles continue to evolve based on changing consumer preferences and technological advancements in North Carolina's telecommunications marketplace. AT&T offers a wide variety of voice, data, wireless and video packages, including our feature-rich U-verse service, which provides advanced television, high-speed Internet access and voice service delivered using VoIP technology. AT&T provides advanced television service through either its IP based U-verse service or through its partnership with DirecTV. During 2013, we continued to grow our U-verse footprint throughout North Carolina. AT&T's flexibility in bundling video with these other services was enabled by the North Carolina Legislature's passage of HB 2047, The Video Service Competition Act, in 2006. Passage of the Act streamlined the video franchise process to encourage AT&T and other companies to provide home television service through a wired, non-satellite connection.

Social Networking - The growth of broadband and wireless services has been largely driven by the explosive growth in applications, particularly social networking. According to statistics compiled by Qmee during 2013, every sixty seconds: 204 million emails are sent; 104 thousand photos are shared on Snapchat; 11 thousand professional searches are accomplished on LinkedIn; 571 new websites are created; 2 million searches take place on Google; 1.4 million minutes are consumed by individuals on Skype; 2.5 million posts are made to Facebook; and 72 hours of video are uploaded to YouTube. It's also interesting to note that according to the Pew Internet and American Life Project, social networking is not confined to the younger segment of the population. 47% of consumers between the ages of 55 and 64 use social networking sites. For Americans over the age of 65, 53% use the internet and email and 13% of those individuals visit social media sites every day. The manner in which we communicate is evolving at a tremendous pace and is moving rapidly away from traditional landline telephone services.

II. AT&T's Service Quality Results

AT&T contracts with a market research company to conduct surveys within 48 hours of a consumer's interaction with the company. Customers are asked a range of questions pertinent to their contact with AT&T. These questions address their overall experience in areas including installation, sales, service and repair. The rating scale provided to the customer is Very Satisfied, Satisfied, Neutral, Dissatisfied or Very Dissatisfied. The percentage of customers who were satisfied or very satisfied with their experience during 2013 was at 82%.

III. Analysis of the Level of Local Exchange Rates

In 2013, AT&T North Carolina's Basic Residence Local Exchange rates were \$23.00¹ statewide, only \$3.05 more than the same rate that was in effect at the time of its subsection (h) election filing on October 5, 2009.

Updated regulatory rules allow telecommunications companies to respond quickly to changing consumer preferences with creative pricing alternatives, including bundles, as driven by the market. This is a far cry from the days when Local Exchange Carriers had to file tariffs to receive approval from the North Carolina Utilities Commission to change rates or add services. Prior to the North Carolina Legislature opening markets to competition, consumers were given one choice for a residential line, and paid for each feature individually. Today, in a fully competitive market where Local Exchange Companies can compete on equal terms with other telecommunications service providers, thanks to the General Assembly enacting H1180 and S343, consumers continue to be the winners both in price and choice.

AT&T continues to work closely with state officials to increase awareness of Lifeline discounts available to low income households, making local telephone service more affordable for these consumers. During 2013, AT&T printed 130 posters for distribution throughout the state to promote customer awareness of the Lifeline program. Although SB 343 specifically retained the North Carolina Utilities Commission's jurisdiction over this service, the FCC has implemented substantial changes to the Lifeline and Link-Up programs over the past two years. During 2012, these changes included eliminating the Link-Up program in all areas other than on federally recognized tribal lands, expanding the eligibility programs to include consumers with household incomes at or below 135% of the Federal Poverty Guidelines and participants in the National School Lunch Program's free lunch program. The revised guidelines also required current Lifeline customers to recertify their participation in a qualifying program on an annual basis. 2013 brought further changes to the state supported portion of the program as HB 998 eliminated the state income tax subsidy funding a lifeline rate reduction and HB 112 eliminated the requirement to offer any reduction in rates funded by the repealed state income tax subsidy. In accordance with HB 112, the North Carolina Utilities Commission reviewed this matter and issued an Order eliminating any Commission requirement to offer a state Lifeline subsidy funded by the repealed state income tax credit effective January 1, 2014. As consumers continue to move away from traditional landline telephone service, Lifeline participants are no exception. During 2007, 98.5% of the Lifeline subscribers in nineteen states served by AT&T local exchange companies were served by traditional landline connections. By the end of 2012, that percentage had plummeted to 17% as these consumers now overwhelmingly select a wireless carrier as their Lifeline provider of choice.

¹ Rate is before taxes and surcharges