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Testimony of Charles D. Land, P.E.

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Mr. Chairman and committee members, thank you for the opportunity to present testimony before your committee.

I am Executive Director of TEXATEL, a trade association of competitive telecommunications providers doing business in Texas.

You have two somewhat related topics today, which are philosophically simple, but fraught with complex details. TEXATEL has two simple recommendations: (1) There should be a needs test for any ILECs that expect to continue to draw from the Texas High Cost Universal Service Fund to assure that every dollar that is paid from that fund is necessary for the provision of reasonably priced telecommunications services, and (2) Provider of Last Resort (POLR) should be changed to focus support for customers, not providers.

Why do we have Texas High Cost Universal Service payments today?

The costs of providing wired telephone services (as opposed to wireless) are very much a function of customer density. Cost models show that monthly costs per customer vary from under \$30 in urban exchanges to an average of several hundred dollars a month in many rural exchanges. Some rural line extension costs exceed \$10,000 (on a one-time basis). In the past, it was decided that good public policy would be to subsidize rural telephone rates to keep them “reasonable”, and thus affordable to most rural residents and businesses. For many years, this was done by subsidizing rural rates with long distance revenues. With the advent of competition, those subsidies were eliminated and Federal and State USF subsidies replaced them.

Why is a needs test necessary?

TEXATEL has recommended for quite some time that there should be a needs test – a test based on accounting and financial analysis that determines if a rural ILEC needs Texas High Cost USF support in order to be able to offer reasonably priced telephone service. Today, most ILECs have never had to justify their USF draws. This does a disservice to the vast number of Texans that are paying these subsidies through their telephone bills.

The money the ILECs receive has evolved over time. The short version is that today's USF draws for most ILECs are roughly based on their costs and traffic patterns that existed approximately 20 years ago and some arbitrary allocation factors that evolved over the last 80 years. There have been times when earnings from USF draws and other sources were an embarrassment. One cooperative manager complained that he had to hire another employee to keep track of all of their certificates of deposit and that he had run out of banks in Texas where he could make deposits within the FDIC insurance limits. Some cooperatives were reporting margins (profits) that exceeded what their members spent with them during the year – in effect they were paying people to take their service. There have been many changes in USF draws since that time, but never an examination as to what is needed. Ultimately, it is the responsibility of the PUC and the Legislature to be good stewards of the funds that Texans pay into the USF. Assuring that every dollar of subsidy is needed and spent wisely is what every Texan expects.

How would a needs test be performed?

There are several different approaches that could be utilized. The PUC has a lot of expertise and should have no problem deciding the best method. Cash flow is a simple test – does the ILEC have enough money to pay its bills. Some companies have indenture or other financial requirements. As long as the method ultimately chosen by the PUC is robust, reasonable, transparent, and with an open process, the Commission should have flexibility in choosing the approach.

What is the PUC doing to reform USF at this time?

The Commission has started proceedings intended to reform Texas HCUSF. There are proceedings to rebalance rates – to move rural local rates up to a level where they equal or exceed the rates charged to urban, lower cost consumers. This rebalancing should end the infuriating practice of the past that urban consumers, paying \$20+ per month for service, are paying into USF funds to subsidize rural consumers whose rates may be \$10 or less. The PUC has also initiated proceedings to establish a needs test for ILECs.

Is any change of law required to enable a needs test?

We would urge two changes of law, one to eliminate any restrictions on the PUC's discretion for determining the best means for determining a carrier's need for continuing subsidies¹, and, second, to require that the PUC perform such needs tests periodically. Presently, the PUC faces a lot of push back from the USF recipients. These carriers do not want to have to go through a process to demonstrate that they continue to need the subsidies they receive. Some subsidized ILECs have suggested that needs tests are unnecessary, unlawful, or both. A change/clarification of law would provide some momentum to the PUC and clear one legal roadblock.

¹ Presently, Sec. 56.026(a) states

(a) A revenue requirement showing is not required for a disbursement from the universal service fund under this subchapter.

TEXALTEL urges striking this provision in order to allow the PUC broad flexibility in conducting a needs test.

Please explain the Provider of Last Resort requirements that exist today.

Historically, Incumbent Local Exchange Carriers were certificated to geographic areas, and were required to provide service to all applicants within that area. Rural ILECs incurred costs for expensive line extensions that could not be recovered from customers and were provided subsidies from Federal and State Universal Service Funds.

Have circumstances changed recently, and how does that affect and Provider of Last Resort (POLR) obligations?

POLR requirements evolved at a time when wired services were the only viable answer to rural telephony needs. Wireless services were not reliable in rural areas and could not provide internet services. Today, rural wireless coverage has improved, internet services are available over wireless service and much of the public has accepted wireless service for residential voice service needs. In addition, VOIP services are available to any consumer who has broadband internet service.

Legislation has focused on public policy that is “technology neutral” – does not prejudice for or against various technologies that could be used to provide service, so that service providers can offer quality and economical choices, and the market place, not legislators, can select the “winners”. POLR requirements today require ILECs to build out of wired services, even if those services are not the lowest cost or highest quality. POLR requirements should be changed to eliminate requirements to provide wired services where customers have lower cost options that are of acceptable quality.

Would your proposal affect customers of AT&T and Verizon?

This would not be much of a change for customers of AT&T and Verizon. Those companies no longer have a POLR requirement in deregulated exchanges. Those two companies have already deregulated exchanges with most of their customers and are expected to have deregulated all exchanges within the next 4 years. These two companies are largely built out throughout their services areas, and expensive line extensions are rare. They have had line extension tariffs throughout their history and in rare cases where a long line extension is required to provide service, they may require the applicant to pay a portion of the cost.

How would your proposal work for smaller ILECs?

When a line extension is required to serve an applicant, the rural ILEC can provide service if it makes business sense to do so and would not be prohibited by state law from requiring a line extension charge of the applicant, or the carrier may direct the applicant to wireless options. If there are not other options to provide the services the customer needs, then the excess costs of the build-out would be paid by the Texas High Cost USF fund.

Would this apply only to residence customers?

This would be the PUC’s discretion, but I would envision that it would be an avenue open to all applicants. For example, a school, rural hospital or rural library might not be quite as rural as many residents but might have bandwidth needs that cannot be met by the available wireless services and wired service may be the most economical answer.

Would the changes you suggest for POLR eliminate the need for Texas High Cost Universal Service funding?

My proposal would reduce the THCUSF needs of rural ILECs. Eventually it may eliminate the need for THCUSF for some rural ILECs. More importantly, it would put an end to waste of public (THCUSF) money by ending requirements on a rural ILEC to incur huge costs, perhaps tens of thousands of dollars in some cases, to install line extensions where wireless or other service options exist that can meet the customer's needs.

Would your proposal prohibit rural ILECs from making line extensions?

No. Rural ILECs would be able to make line extensions wherever they choose. But they would not be able to recover new line extension costs from the THCUSF if the applicants had other service choices available. What would be new is that they would be empowered to require construction charges or to say "no" when the applicant has other acceptable service choices available.

What is Competitive Parity and is it an issue?

Texas law provides that to the extent that there are THCUSF subsidies in an exchange, all providers in that exchange are eligible for the same subsidies per line. There are not any proposals on the table to change that and thus no issues for the legislature or the PUC at this time on this subject. Should any party attempt to remove parity access to the THCUSF, TEXALTEL would oppose such a change.

Are there other issues on the table regarding THCUSF?

At the federal level, there is a transition to stop subsidizing Plain Old Telephone Service (POTS) and to encourage the build-out of broadband by subsidizing it. Build-out of broadband is extremely expensive in very rural areas, and policy makers are struggling to decide how to proceed. Of even greater controversy (as is not surprising), is how to pay for it or whether such subsidies are appropriate. With POTS revenues declining sharply, the only way to sustain a federal USF is to assess USF fees on other services such as broadband. Policymakers realize there is no free lunch here, and this dilemma continues to be debated. The development of wireless technologies may make the provision of greater speeds of broadband to more rural areas more economically feasible. TEXALTEL is not advocating that Texas begin subsidizing rural broadband. Instead, Texas should monitor federal regulations as they evolve and technological developments to find a balanced, least cost solution.