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Written Comments of the Office of Public Utility Counsel to the Senate Business and Commerce Committee October 8, 2012

Senate Bill 980, enacted last session, directed the Public Utility Commission (PUC or Commission) to review and evaluate whether or not the state universal service fund (USF) accomplishes its purposes. The Commission has begun work on multiple rulemakings in response to this directive. The Office of Public Utility Counsel (OPUC), representing residential and small business telecommunications customers, has been active in the two rulemakings related to the high cost program—one to adjust the amount of funding for the Large Company Area High Cost Program, and another to adjust the amount of funding for the Small Company Area High Cost Program. OPUC has participated in the rulemakings with two primary goals: to ensure that providers do not exit high cost markets and to ensure that consumers pay a reasonable rate for basic local telephone service.

The high cost programs for large companies and small companies represent just two of the programs supported by the state USF. These programs are designed to work in tandem with the federal high cost programs administered by the Federal Communications Commission (FCC). As you may be aware, the FCC is in the process of reforming intercarrier compensation and the federal USF. In its recent order related to these reforms, the FCC articulated its understanding of the concepts of universal service and rate comparability: the USF program should ensure that rates in rural areas are not significantly higher than rates in urban areas. This means that while a rural exchange may be very costly to serve, federal (and state) high cost subsidies should keep the rate paid by the rural customer lower than the cost of serving that customer, and the rate paid by a rural customer should not be much higher than the rate paid by an urban customer.

In Texas, however, the opposite is true. The rates charged in urban areas for basic local telephone service are as high as $21 per month, yet rural rates are consistently lower than $21. The Universal Service Administrative Company (USAC), the independent, non-profit administrator for the federal USF fund, provided a report of carriers across the nation charging less than $10 per month for basic local telephone service. The report shows that rates in 15 USF study areas in Texas fall below this benchmark, with one carrier charging just $1 per month.

High-cost support subsidizes local rates in high-cost exchanges and is funded by consumers statewide who pay into the USF fund. When the amount of the subsidy leads to local rates that are *lower* than rates in the unsubsidized exchanges, it puts a burden on the USF fund that is borne by all who pay into it. OPUC does not believe that urban consumers should pay for a subsidy that keeps rural customers' rates lower than the rates urban customers pay for their own telephone service. Reducing the level of high-cost subsidies from the state fund reduces pressure to increase the state USF surcharge.

To this end, in both Commission rulemakings related to the high cost funds, OPUC has supported reductions to the high cost support subsidy through rate rebalancing. What do we mean by rate rebalancing? Carriers are given the ability to raise rates over time to a level the Commission deems reasonable. Paired with the ability to increase rates, the carriers' high cost support is reduced over the same time period. Because the size of reductions to high cost support is targeted to the amount of additional revenue available through rate increases, reductions are achieved in a fashion that is revenue-neutral to the utility.

Rate rebalancing also aligns carriers' rates with the goal of the FCC: to restore rural rates to a level that is reasonably comparable to urban rates. The aforementioned FCC order adopted a rule to limit federal high-cost support in areas where local rates fall below a specified rate floor. This floor ratchets up on an annual basis to $14 for the period July 1, 2013 to June 30, 2014, with future values of the floor based on an annual survey of national rates for basic local telephone service. By increasing rates as a way of reducing state universal service support, we can prevent the carriers from losing federal universal service support because rates are too low.

Of course, rate increases are always a concern to a ratepayer representative. In addition to supporting a phased-in approach to rate increases, OPUC advocated for an increase in the Lifeline discount. Lifeline is the program by which low-income households receive discounted phone service. For each $1 increase in local rates, OPUC has advocated for a $0.25 increase in the Lifeline discount to help maintain the value of the Lifeline discount for low-income customers.

While the Commission works toward reducing the draw from the state USF, it is important to note that changes at the federal level could have a countervailing effect. The FCC has stated that networks providing only voice service are no longer adequate. Instead, the FCC wants universal service to include access to broadband networks. Eligible telecommunications carriers, those carriers eligible to receive universal service support, will be required to offer broadband services. Funding from the "legacy" high-cost mechanisms are capped at fiscal year 2011 levels for the next six years. The new Connect America Fund (CAF) will ultimately replace all high-cost mechanisms at the federal level. The FCC wants to target funding to those areas that truly need it while at the same time requiring broadband commitments from ILECs. While the overall effect of these initiatives remains to be seen, we expect that the FCC's reforms to universal service will result in an overall reduction in federal universal service support to carriers.

Why would this matter? Section 56.025 of the Public Utility Regulatory Act (PURA) sets forth certain mechanisms by which the state USF fund can be expanded for each incumbent local exchange carrier (ILEC) serving less than 30,000 lines and each cooperative. The Commission is required to implement a mechanism to replace a utility's revenue lost as a result of an FCC order that reduces the federal USF revenue of a local exchange company, or as a result of any changes to costs or revenue allocated at the intrastate level. Additionally, the Section requires that the Commission implement a mechanism to replace a reasonably projected increase in costs or decrease in intrastate revenue caused by another governmental agency's order, rule, or policy. Such a mechanism could be an increase in rates, if the increase does not affect universal service, or could be a disbursement from the state universal service fund in the alternative. Thus, reductions to federal high-cost support could result in additional funds being drawn from the state USF fund. This would increase pressure on the surcharge and obviate the work being done at the Commission on this issue.

To summarize, OPUC supports rates that are reasonably comparable across rural and urban exchanges. Any movement in rates to obtain this comparability should be done over time, in order to prevent rate shock, with appropriate protections for low-income consumers. The increased revenue to carriers from these rate changes can be used to reduce the size of the state universal service fund in the short term, which in turn reduces the amount of USF surcharges paid by Texas consumers. In the long term, the state USF should be revisited so that it is synchronized with federal policy. Otherwise, the state USF system could be counterproductive to the methods of the FCC to achieve broadband in rural areas. We could be giving subsidies to carriers that have refused to accept federal subsidies and who may refuse to make broadband commitments. Additionally, the revenue replacement mechanisms could reverse the reductions in the size of the Texas USF currently underway.