Senate Committee on Business and Commerce

Testimony of Michael Shultz

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On issues regarding the Texas Small and Rural Incumbent Local Exchange Company Universal Service Plan

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Mr. Chairman and members of the Committee, my name is Michael Shultz and I am the Vice President of Regulatory & Public Policy for Consolidated Communications, which is a publicly traded company offering voice, data, internet and video in its service areas. As a premier provider of communications services, our purpose is to connect people and enrich lives. We have a continuing commitment to offer innovative products; reliable, high-quality services and exceptional customer care. We also are dedicated to maintaining strong local ties in the same communities where our employees live and work.

Our exchanges are 95% DSL capable and under the FCC's broadband eventual target goal of 6Mbps downstream and 1.5Mbps upstreamwould cost over $50 million to implement. We have two local exchange companies:Consolidated Communications of Fort Bend Company and Consolidated Communications of Texas Company. Both companies elected chapter 58 regulation in 2003 and each are recipients of the Texas high cost fund (small plan fund) and high cost assistance fund.

Consolidated Communications of Fort Bend Company (CCFB) serves approximately 32,000 access lines in Brazoria, Fort Bend, Harris and Waller counties. We serve the communities of Beasley, Brookshire, Damon, Katy, Needville and Pattison. The Katy exchange is migrating toward suburban characteristics where 67% of lines served are residential and there is a density level of 181 lines per square mile. The Beasley, Brookshire, Damon and Needville exchanges are rural in nature: over 80% of the lines are residential with adensity of 16 lines per square mile.

Consolidated Communications of Texas Company(CCTX) serves approximately 86,000 access lines in Angelina, Cherokee, Grimes, Montgomery and San Augustine counties. We serve two distinct markets: 1) The Conroe market area serves Conroe, Cut-N-Shoot, Grangerland, Lake Conroe, Montgomery, Riverbrook and Walden. The Conroe, Riverbrook and Walden exchanges have suburban characteristics with 56% of lines served are residential and a density level of 291 lines per square mile. The Cut-N-

Shoot, Grangerland, Lake Conroe and Montgomery exchanges are rural in nature: over 85% of the lines are residential and density is 52 lines per square mile. 2) The Lufkin market area serves Apple Springs, Alto, Central, Diboll, Etoile, Fuller Springs, Hudson, Lufkin and Wells. Lufkin is the main town for services for the surrounding counties, 56% of the lines served are residential and the density for the market area is 29 lines per square.

Competition

Competition does exist in Consolidated's market areas, both wireline based and wireless. Cable competition is present with Comcast and Entouch in the Katy exchange, Comcast in the Needville and Riverbrook exchanges and SuddenLink in the Conroe, Hudson, Lufkin and Montgomery exchanges. Cable franchise areas fall mainly within the municipality limits or where a subdivision provides enough economies of scale to invest in. Cable competition isn't in the sparsely populated areas outside of the franchise limits, nor do they have carrier of last resort obligation to serve them like the ILEC.

Texas Universal Service

Consolidated's two ILECs receive Texas universal service funding from two sources, the Texas Small and Rural Incumbent Local Exchange Company universal service plan and the Texas high cost assistance fund. Our current funding is frozen, please see chart below:

	Rate per Line	**TX HCF – Small Co Plan**
CCFB	$9.60	$ 3,528,096
CCTX	$12.02	$10,782,420
Total		$14,310,516

The Texas and Federal universal service support is used for operating expenses (maintenance of the network) and capital expenditures. We invest, both capital and maintenance expense, over 4 times what we collect in funding and these monies help bring voice service to rural areas. The funding also helps brings jobs to the communities we serve.

FCC order on Intercarrier Compensation and Universal Service Reform
On November 28th, the FCC issued its reform order on intercarrier compensation and universal service. The order took effect on December 27, 2011 and the first major change of the order was effective July 1, 2012. The order dramatically alters the way ILEC's will have to do businessand will greatly impact rural residential consumers. The order has seven to nine steps depending of if you are a price cap or rate of return. Consolidated is under price cap regulation for its two Texas ILECs. By 2018 all switched access rates will be at Bill and Keep.

Universal service funding transitions from a voice based fund to a broadband fund (Connect America Fund (CAF)), with initial requirements to have broadband speeds of 4Mbps downstream and 1Mbps upstream. The FCC created multiple funds to implement between wireline, wireless and alternative technologies. Effective January 1, 2012, all federal support for price cap companieswas frozen at 2011 levels.

CAF Phase 2 - Federal support for price cap carriers migrates to a cost based model in 2013 which eliminates support in areas with wireline competition as well as areas that cost more than $256 per line to serve. If you accept the money you then have 5 years to complete the build out. The projected impact of the FCC implementing phase 2 is a significant reduction in federal universal service support for Consolidated Communications Texas ILECs.

CAF ICC Replacement – This temporary fund is to help mitigate a portion of the switched access reductions. The fund reduces over time and phases out completely in 2020.

In addition the FCC is requiring all companies to raise their residential local rates to a national benchmark (see below). A company must increase their local rates to the benchmark or forgo a portion of their federal funding.

7/1/12 - $10.00
7/1/13 - $14.00
7/1/14 - TBD

PUC plan

The PUCT, per SB980, was tasked to review Texas universal service. Their plan is to effectively eliminate the small company fund. The PUCT is planning to implement an urban floor to offset a company's state funding and phase it in over 4 years. The urban benchmark is suggested to be around $24, which is $10 higher than the national urban benchmark.

Texas Benchmark	$24
National Benchmark	$14
Difference	$10

The $10 would reduce the Company per line funding over a 4 year period or $2.50 per year.

So for illustration purposes, CCFB currently receives $9.60 per line and this would ratchet downward with the new effective rate as follows:

1/1/14	$7.10
1/1/15	$4.60
1/1/16	$2.10
1/1/17	$0.00

Impact of this proposal would significantly impact the rural consumer in the CCFB serving area. The same could be said for any rural area in Texas.

Consolidated's Recommendation

The Legislature should require the PUC to delay any changes to the Small and Rural Incumbent Local Exchange Company Universal service fund for a two year period until there is a better understanding of the impact from the FCC order. Due to the FCC order Texas local rates in rural areas are going to increase significantly over the next 2-3 years. Let's not compound the negative impact to consumers by making wholesale changes in Texas funding as well. If changes are made to the fund then let's makeschanges that are reasonable with minimalimpact on consumers. In addition, we should hold off on any additional funding changes to eliminate support in areas where you have cable competition, because conversely you would have to adjust the funding per line in areas where competition does not exist. We believe doing that would actually increase the size of the fund not make it smaller. The combined changes proposed by the PUC with the FCC Order could increase rates to over $30 for voice service and the likelihood that areas that receive service today may not be as viable to serve in the future.

A simpler solution would be to continue funding under the current plan January 1, 2011 per line rate time current access lines. Task the PUC to develop a new funding mechanism that addresses the impact of the FCC order to be effective September 1, 2015.We should view the state fund as a way to augment what the federal fund is not doing for our state by shifting the fund to a voice and broadband fund; eliminate funding for areas that have wireline based competition and augment the funding necessary for Texas service providers to meet or exceed the national broadband target of 6.5M downstream and 1.5M upstream. Upgrading the Texas telecommunications infrastructure will help the state's wireline competition for small and rural companies.We should look at the TELRIC is above the Texas benchmark and the areas where wireline competition does not exist.

The consumer, state and community benefits to keeping the fund far outweigh the elimination of the fund. The PUC proposed funding changes will reduce investment in rural areas of the state and potentially reduce the services offered.

Thank you for allowing me to provide testimony on this issue. We look forward to working with members of the Committee and other industry participants on this matter.