HOUSE
RESEARCH
ORGANIZATION bill analysis 5/11/2011

HB 2603
Smithee
(CSHB 2603 by Cook)

SUBJECT: Universal service fund payments to small and rural telephone companies

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 11 ayes — Cook, Menendez, Craddick, Frullo, Gallego, Harless, Hilderbran, Huberty, Oliveira, Smithee, Turner

0 nays

2 absent — Geren, Solomons

WITNESSES: For — Weldon R. Gray, Eastex Telephone Cooperative and Texas Statewide Telephone Cooperative, Inc.

Against — (*Registered, but did not testify:* Velma Cruz, Sprint; Sheri Hicks, Texaltel; Kristie Ince, TW Telecom of Texas)

On — Pam Whittington, Public Utility Commission

BACKGROUND: The Utilities Code directs the Public Utility Commission (PUC) to regulate phone companies based on their rates of return. It provides a framework for deregulation where the market establishes rates, and it creates incentive-based regulation for companies that do not wish to be deregulated but desire flexibility to make certain investments and business decisions not available under ch. 53.

The current Texas High Cost Universal Service Fund and the Small and Rural Incumbent Local Exchange Company Universal Service Fund were established in 1999. They provide assistance to local telephone companies that provide lines in high cost of service areas based on the number of high cost lines a provider serves. Under Utilities Code, sec. 56.031, the PUC has the power to revise these per line support amounts.

DIGEST: CSHB 2603 would allow small or rural incumbent telephone companies to request the that the PUC change the formula and amount of Universal Service Support Fund (USF) support payments they receive.

The bill would allow small or rural incumbent telephone companies that are regulated under ch. 58 or 59 that receive monthly per line support amounts to elect that the PUC issue them USF support payments at the same level they received in 2010.

The bill would allow small or incumbent telephone companies regulated under ch. 53 to elect that the PUC set their USF support for the next 12 months and the years after that based on formulas that increase with inflation.

The monthly support amounts for the first 12 months would be determined by the annualized support amount calculated in 1999 when the modern TUSF was created. That amount would be adjusted at the beginning of each calendar year by the change in the consumer price index (CPI) in that year beginning with 1999 and ending in the year the company made an election under the bill.

The support amounts for second and subsequent 12-month periods would be calculated by adjusting the past year's support payments by the percentage change in the CPI for the most recent 12-month period.

The bill would take effect on September 1, 2011.

SUPPORTERS SAY:

CSHB 2603 would implement a new and necessary system for distributing USF payments to small and rural telephone companies that provide phone lines that are expensive to install and serve in regions with low customer density. Current USF payments are too low to provide adequate support to small and rural telephone companies. The purpose behind the USF is to ensure that people in all regions of Texas have access to reliable and affordable phone service at rates that are comparable with what is offered in urban regions of the state.

The USF supports companies based on the number of high-cost lines served. The current formula for supporting these goals is broken. Land line subscriptions are declining because of the depopulation of rural areas and because of increasing adoption of cell phones and other telecommunication technologies. However, small and rural companies still must recover investments made in existing infrastructure and provide new lines to new clients. CSHB 2603 would provide a temporary fix by allowing small and rural companies the choice of either freezing the amount of support payments they currently receive or of adjusting them to meet inflation as measured by the CPI.

The bill would change the way USF support is distributed in a way that would have little effect on customers. USF funds are generated by assessments on the phone bills of Texas customers. Projections show that the change in USF payments to small and rural companies that CSHB 2603 would implement could result in an increase of 11/100s of 1 percent.

The changes in CSHB 2603 would be temporary. The PUC is expected to examine and rework the USF programs in the future. CSHB 2603 would provide a needed funding bridge from the current broken funding system to the reforms the PUC will implement in upcoming years.

The annual payments under CSHB 2603 still would meet the federally mandated, competitively neutral test for USF support payments because any support would still be transferable between competitors. In the very few rural areas of the state where there is competition, if one company picked up a customer from another, the company would gain support payments for the new customer. If there was a problem with the competitively neutral test, it is de minimus because there are so few areas in rural Texas where there is competition for telephone customers. Any overpayments would be minor compared to the benefits of making USF payments that would keep rural and small telephone companies providing service.

CSHB 2603 is necessary because even though the PUC can raise payments on its own authority, it cannot move away from the statutory requirement the funds be distributed on a per line basis on its own. CSHB 2603 would direct them to do so.

OPPONENTS SAY:

CSHB 2603 would move away from distributing USF support on a per line basis and would allow companies to draw down USF support payments without showing they are needed. The bill should incorporate a needs test.

The PUC already has the power to change the amount of USF payments to small and rural providers. If a change really is needed, the PUC is empowered to increase payments as necessary without legislative change.

The bill would increase USF payments to recipient companies, depleting a fund that already is spending more than it is taking in. Under current law, payments made from the USF in fiscal 2010 were $82.5 million. Under CSHB 2603, these payments could increase by $10 to $15 million a year.

CSHB 2603 could be difficult to administer under a federal law requiring that USF payments be distributed on a competitively neutral basis. The current method of payments is on a per-line basis where a company receives a sum for every expensive line in an area with low customer density. If a customer switches to a competitor, then that subsidy goes with the customer. Under CSHB 2603, payments would be switched from a per line basis to one that was either frozen at year 2010 levels or one adjusted for inflation. To be competitively neutral, USF support must still be made to a customer's new provider, but the bill would not provide a methodology for reducing the original provider's support payment. This could result in multiple support payments for the same customer, which would deplete the USF even faster.