HOUSE
RESEARCH
ORGANIZATION bill analysis 4/18/95

HB 2128
Seidlits et al.
(CSHB 2128 by Black)

SUBJECT: Regulating telecommunications

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 15 ayes — Seidlits, S. Turner, Alvarado, Black, Bosse, Carter, Craddick, Danburg, Hilbert, Hochberg, B. Hunter, D. Jones, McCall, Ramsay, Wolens

0 nays

WITNESSES: (*On original bill*)
For — David Cole and Joseph E. Cosgrove, Jr., Southwestern Bell Telephone Company; Calvin Weinheimer, Texas Telephone Association; Texas Statewide Telephone Cooperatives, Inc.; Brad Streit and Ann Arnold, Texas Association of Broadcasters; Brita D. Martin-Lindsey, and Jo Nell Knight, teachers; Ceola Curley III and Chidozie Drake, students; Paula Kay Montoya; Texas Association of Mexican American Chambers of Commerce; Anthony J. Trujillo, Yselta Independent School District; Royce J. Holland, MFS Communications Co.; J. Ron Cross, Northern Telecom, Inc.; Don Simons, GE Capital Rescom; John Mitchell; Karen D. Sitton; Hubert Daughery, network engineer; Francis Fisher; Ron Harris, Advisory Commission on State Emergency Communications-911; D. L. Dally Willis, Communications Workers of America Union; Joe D. Gunn; Elizabeth Crabb, Texas Library Association

Against — Phillip L. Gaddy, Pres Sheppard, W. Gray Bryant and Ray Marshall, AT&T; James Henry Sturges and Rayford Price, US One Communications Corporation; Janee Briesemeister, Consumers Union; Neal R. Larsen, MCI Telecommunications Corporation; Melvin Reams, VALUline; Tim Curtis, Texas Citizen Action;

On — Peter J. Stapp, Tele-Communications, Inc.; Ellen A. D'Amato, Sprint Long Distance; Walter Washington, Office of Public Utility Counsel; Thomas J. Morrow, Time Warner Communications; Robert W. Gee, Patrick Wood III and Sarah Goodfriend, Public Utility Commission; Steve Tolen, City of The Colony; Bill Magness, Communications Coalition of Texas; Kenneth F. Melley and Charles D. Land; TEXALTEL; Jep Hill, Texas ISDN Users' Group; Richard E. Burk, American Telco Inc.; Madelon Kuchera, Teleport Communications Group.

BACKGROUND: **Public Utility Commission (PUC).** Since its creation in 1975 the PUC has had regulatory authority over telecommunications utilities in Texas. As of mid-1994 the utilities included 61 local exchange companies (LECs) such as Southwestern Bell and GTE, nine competitive access providers (CAPs) that provide customers access to long-distance carriers bypassing the local LEC, 14 facilities-based interexchange carriers (IXCs) such as AT&T, MCI and Sprint that carry calls between local service areas (LATAs), and about 200 resellers of telecommunication services.

According to the PUC report *Scope of Competition in Telecommunications Markets* (January 1995), in 1993 telecommunications revenues in Texas totaled about $6.643 billion. LECs earned $4.863 billion, with Southwestern Bell capturing 75 percent ($3.636 billion) of the LEC total; CAPS revenues were $5.3 million; IXCs earned $1.559 billion, with AT&T holding nearly 60 percent of the long-distance market, and resellers earned $216 million.

LECs charge for access to the local exchange network. The access charges are part of the rate-setting process. According to the PUC total access charges by LECs in 1993-94 exceeded $2 billion.

The PUC does not regulate long-distance carriers, but has authority over intraLATA (long-distance within a local exchange area) competition. Texas law and PUC policy allow intraLATA (local long-distance) competition. An intraLATA call automatically defaults to the LEC if the caller uses 1+ dialing.

The PUC consists of three full-time commissioners, appointed by the governor with the advice and consent of the Senate, who serve staggered six-year terms. Commissioners serve in a quasi-judicial capacity in reviewing utility rate cases and other proceedings that have completed the administrative hearings process. Commissioners may not have been employed or had financial ties to a utility for two years prior to appointment and may not be employed by a utility for two years after leaving the commission.

The PUC has four basic functions:

• The PUC issues certificates of convenience and necessity permitting utilities to operate in the state or construct new facilities;

• The PUC sets rates for all local telephone companies (LECs), investor-owned utilities and electric cooperatives running outside city limits and the electric operations of river authorities;

• The PUC monitors compliance with statutory requirements, agency policies, rules, orders and service standards. The PUC also monitors utility earnings and conducts management audits;

• The PUC helps consumers resolve complaints against regulated utilities.

The Public Utility Regulatory Act (PURA) requires that telephone rates be set at a level that allows the utility the opportunity to earn a reasonable rate of return. The PUC monitors LEC earnings quarterly. The rates are set by utility revenue and rate design. LEC rates are based on the cost of providing service.

The seven Regional Bell Operating Companies (RBOCs) are prohibited by federal law from providing information services, manufacturing telecommunications equipment or entering the long-distance market. They are required to provide equal access to local exchange facilities to any long distance carrier. Cable companies and wireless communications are also federally regulated.

Office of Public Utility Counsel. The Office of Public Utility Counsel (OPUC) represents the interests of residential ratepayers and small business consumers before the hearings examiner in PUC hearings.

After sunset review the 73rd Legislature continued the PUC and OPUC until September 1, 1995.

DIGEST: CSHB 2128 would continue the PUC and OPUC until September 1, 2001, and make major changes in telecommunications utility regulation including:

• reducing regulation of existing local exchange companies (LECs) on September 1, 1995, in exchange for a six-year commitment for a telecommunications facilities program to support education and medicine and limits on basic telephone service prices for four years;

• creating a Regulatory Transition Fund (RTF) for existing local exchange companies to be reimbursed through surcharges imposed on services, other than basic telephone service, or increased rates, for reducing access charges (the amount charged long-distance companies to connect with the local exchange) and LECs' intraLATA toll rates;

• expanding the Universal Service Fund to reimburse incumbent LECs, other than Southwestern Bell and GTE, for revenue losses or increased costs from regulatory changes or access charge and intraLATA toll charge changes to maintain reasonable basic telephone rates;

• permitting companies to provide local telephone service in established service areas by acquiring a Certificate of Operating Authority (COAs), which would require building network facilities, or a Service Provider Certificate of Operating Authority (SPCOA), which would allow companies other than the four largest long-distance companies (AT&T, MCI, Sprint, and LDDS) to resell telephone service through the existing network;

• allowing existing LECs to be the automatic default carrier for intraLATA 1+ (local long distance) calls until the federal government allows Southwestern Bell to enter the long-distance market;

• requiring the PUC to complete its study on the cost and price of telephone services by April 1, 1997;

• establishing certain requirements regarding competition such as resale tariffs, telephone number portability and interconnection;

• prohibiting Southwestern Bell from engaging in electronic publishing, except through separate affiliates or joint ventures until June 30, 2001;

• making Southwestern Bell and GTE submit to certain conditions regarding broadcasting audio and video programming;

• allowing Southwestern Bell and GTE to offset any losses resulting from consolidated tax-related issues involved in any pending judicial appeal against their infrastructure commitment;

• reducing regulation for small telephone companies and telephone cooperatives;

• limiting requests for toll-free boundary areas to five exchanges and increasing the fee by $1.50 for each exchange over three;

• requiring private-pay telephones to register with the PUC and allowing them to charge 25 cents for five-minute increments; and

• requiring LECs and COAs to provide certain minimum services by December 31, 2000, including single-party service, touch-tone dialing, equal access for long-distance carriers, and digital switching upon request.

Incentive regulation. CSHB 2128 would allow local exchange companies (LECs) to elect an incentive form of regulation based on service category and competition for the service, in exchange for a six-year infrastructure investment commitment and a four-year basic service price freeze based on June 1, 1995, prices. The six-year infrastructure commitment would be $1.1 billion for Southwestern Bell and $300 million for GTE. Smaller LECs would have a smaller proportionate commitment. Any unspent balances would go to the Telecommunications Infrastructure Fund, which would provide grant or loan funds to public schools or libraries to support distance learning and telemedicine.

LECs electing incentive regulation would not be subject to any complaint, hearing or determination as to the reasonableness of their rates, overall revenues, return on invested capital or net income, except with regard to competitive safeguards. Consumers would have the right to complain to the PUC about quality of service and an ambiguous tariff, and the PUC would have the authority to enforce quality-of-service standards and correct ambiguous tariffs.

The PUC would be required to review and evaluate the effects of reduced regulation and competition beginning January 1, 2000, and report the findings to the Legislature by January 1, 2001.

Telecommunications services would fall into three "baskets," which could be reclassified upward by the PUC:

• Basket I, basic services, would include flat rate residential and business local service, a phone book, directory assistance, touchtone service, access to 911, and interconnection to competitive providers. Basket I rates could only be increased with PUC permission in the initial four-year period, and only on certain conditions, including increased charges to fund the Regulatory Transition Fund. Rate changes would have to be published once in the local newspaper. Basket I rates could be decreased at any time, but could not be lower than the long run incremental cost (LRIC) or "at cost" cost of providing the service.

• Basket II, discretionary services, would be those telephone services not granted pricing flexibility and not listed in Basket I or Basket III, such as billing and collection services, call waiting and new services. Prices for Basket II services would have be set above the LRIC. The PUC would set the Basket II services ceiling at the rate in effect on September 1, 1995. The ceiling could be raised by the PUC only after competitive safeguards were in place, but could not be raised more than 10 percent a year;

• Basket III, competitive services, such as speed dialing, three-way calling, and paging and mobile services would be priced competitively, but could not be increased if there were no competition for the service.

Incentive regulation for rate-of-return LECs. The bill would allow companies serving less than 5 percent of the access lines that remain under rate-of-return regulation to invest an amount equal to 15 percent of their intrastate revenues earned in the year they elect to begin investing in the telecommunications infrastructure. Companies could not ask for a rate increase for six years except under certain circumstances, such as supporting the Universal Service Fund or the Regulatory Transition Fund. The infrastructure commitment would be similar to that of incentive regulated companies.

In exchange for the infrastructure commitment, these companies would not be subject for six years to any complaint or hearing as to the reasonableness of their rates, overall revenues, return on invested capital or net income, except regarding competitive safeguards. Consumers would have the right to complain to the PUC about quality of service, and the PUC would have the authority to enforce service standards, except that it could not require a service standard that would require a company to invest in any one year more than 10 percent of the its average annual intrastate capital additions for the previous five years.

These small companies could opt-out of the infrastructure commitment for good cause and opt-in to incentive regulation at any time. Rate-of-return company infrastructure investments would be those made in addition the company's average annual capital investment made in the previous three years.

Infrastructure commitment. The bill would require companies electing incentive regulation to invest in telecommunications infrastructure over six years. Upon request, companies would be required to provide broadband service (up to 45 megabits per second capable of providing increased audio and video transmission) to school districts and institutions of higher education, public libraries and nonprofit and public hospitals.

Special construction and installation charges could not be assessed against schools, libraries and hospitals. The bill would require a 35 percent discount rate for distance learning and telemedicine customers with fewer than 10 locations. On request Southwestern Bell would be required to provide schools and libraries with toll-free access to the Internet. Southwestern Bell and GTE would be required to prioritize infrastructure investment in rural areas, areas that are medically and educationally undeserved and in schools with a high percentage of low-income students.

The bill would allow Southwestern Bell and GTE to offset certain income-tax losses against their infrastructure commitment. In addition, GTE could offset any investments and expenses made between September 2, 1995, and December 1, 1998, to provide digital switching central offices in exchanges with fewer than 20,000 lines against its infrastructure commitment of $300 million;

Universal Service Fund. The bill would allow the PUC to expand the use of the Universal Service Fund (which is used to keep basic service affordable in rural areas and to reimburse LECs for revenues lost in providing tel-assistance service for low-income, disabled elderly persons and hearing-impaired and speech-impaired service) to maintain reasonable basic local telephone rates.

The bill would require the PUC to make rules allowing the universal fund to reimburse all LECs except Southwestern Bell and GTE for revenue loss or increased costs resulting from a PUC or FCC regulatory change in long-distance access charges or intraLATA 1+ access. The LECs would not have to show a revenue requirement to receive money from the universal fund. The bill would require timely payment from the fund to the LECs so they would not experience unnecessary cash flow changes as a result of the government policy. The PUC could raise basic rates, if the increase did not adversely affect universal service, to replace lost revenues from changes in governmental regulations.

Telecommunications providers receiving money from the universal fund would have to, at a minimum, offer service to every consumer within their operating area.

Regulatory Transition Fund. The bill would create the Regulatory Transition Fund (RTF) outside the state treasury, which would refund money LECs lose as a result of lowering all long-distance access rates on July 1, 1996, to the interstate access rate levied on January 1, 1995. RTF payments would be used to offset LEC losses from decreasing long-distance access rates.

All telecommunications providers in Texas, except COAs or SPCOAs operating in an area where the LEC had declined to participate in the transition fund, would be required to pay into the fund an assessment based on their billed retail revenues. Revenues from local exchange telephone service, which includes local telephone service and basic directory assistance, could not be assessed. The amount to be assessed would be set by the PUC on or before November 1 of each year. The bill would permit a telecommunications provider to impose a surcharge, except on local exchange telephone service, or increase rates to collect the assessment owed

the fund.

The PUC would administer the fund and would be required to transfer funds promptly so that telecommunications providers and LECs did not have unnecessary cash flow changes as a result from replacing access revenues with fund revenues. RTF recipients would not have to show a need in order to receive RTF funds.

The bill would require all LECs electing incentive regulation to receive funds from the RTF. On July 1, 1996, LECs receiving RTF funds would have to lower intrastate long-distance access charges to the interstate access charge in effect on January 1, 1995. LECs would also be required to lower their intraLATA toll (local long-distance) rates proportionately. The bill would require the PUC to reduce RTF payments to an LEC after the basic local telecommunications service has been deregulated in a certain area. RTF funds could be reduced after a COA had completed a build-out and if the reduction was revenue neutral to the LEC. In the fourth and fifth years, the PUC could permit the LEC to restructure rates for basic local exchange service and would be required to reduce the funds received from the RTF proportionate to the increase in rates. The PUC could not increase the rates by more than 5 percent a year, and the rate could not exceed the national rate average.

The PUC would be required to disburse RTF funds on a revenue neutral basis to incumbent LECs beginning July 1, 1996, to replace revenue lost from repricing the long-distance access charges. The bill would allow the PUC to make additional assessments to cover revenue reductions that could come about by costing and pricing.

Telecommunications Infrastructure Fund. The bill would create the Telecommunications Infrastructure Fund (TCF) to be used to award grants and loans on a competitive basis to school districts, regional education centers, institutions of higher education and certain libraries supporting distance learning and telemedicine. Grants and loans would be made for equipment and infrastructure, course development, and training to use material and equipment. Priority would be given to collaborative proposals, to match funds from other sources, and to rural areas and school districts with large numbers of at-risk youth and high drop-out rates.

The fund would be administered by a nine-member board with three members each appointed by the governor, by the lieutenant governor and by the governor from a list submitted by the speaker of the House of Representatives. The Texas Higher Education Coordinating Board and the Texas Central Education Agency would be required to adopt policies and procedures to help the board in making awards.

The fund would be financed by an annual assessment based on taxable receipts on all telecommunications providers in Texas. The comptroller would be required to collect $75 million a year for five fiscal years beginning September 1, 1995.

Alternative entry, COAs, SPCOAs. The bill would allow companies to provide local exchange telephone service by acquiring a certificate of operating authority (COA) or a service provider certificate of operating authority (SPCOA) instead of a certificate of convenience and necessity (CCN) required of incumbent LECs from the PUC.

COAs. An application for a COA would have to include a six-year infrastructure build-out plan for an area with a minimum three-mile radius (27 square miles). This requirement could be waived in counties with fewer than 500,000 residents under certain conditions. A COA could not be granted in a small LEC area (31,000 lines or fewer) before September 1, 1998 and then only for the entire area served by the incumbent LEC.

The six-year build-out plan would require the infrastructure facilities to be completed according to the following schedule: 10 percent by the end of the first year, 50 percent by the end of the third year and 100 percent by the end of the sixth year. COAs would be prohibited from using cellular phone service to meet the build-out requirement, but could use Personal Communications Service (PCS), a new form of cellular technology that has a smaller range than cellular and uses different radio frequencies.

No more than 40 percent of the COA's service could be service resold from the incumbent LEC's facilities. The PUC could, for good cause, temporarily waive compliance with the six-year build-out plan.

The PUC could make rules dictating the time period in which a COA must be able to serve a customer. However, a COA would be required to serve a customer in the build-out area within 30 days of a customer's request. The PUC could not require a COA to build-out to every customer's premises or to activate fiber optic facilities prior to a customer's request.

The PUC would have to grant a COA 60 days after receipt of the application, except that with good cause the time could be extended another 60 days. The PUC would also have to consider the technical and financial qualifications of the applicant. If the application was for the area serviced by a small LEC, the bill would require the PUC to consider such factors as the effect of the COA on the LEC and if the area would warrant two local phone providers.

After six years, or when an area had been built-out by a COA, the PUC could waive the build-out requirements for additional applicants.

After September 1, 1997, the PUC could conduct hearings to determine if the build-out requirements have proved an impediment to competition in counties with population of more than 500,000 and the effect of the resale provisions on competition. If the PUC determined that the build-out and resale requirements had affected competition, it could reduce the build-out area to no less than a two-mile radius or allow resale of LECs services to increase from 40 percent to 50 percent. These rules would only apply to those applying for a COA after the rule change.

SPOCAs. SPOCAs would be reserved for companies with 4 percent or less of the long-distance calls in the state in the last year (all companies except AT&T, MCI, Sprint and LDDS). SPOCAs would have no build-out requirements and could resell 100 percent from the LEC. CCNs and COAs could not become SPOCAs and vise versa. The bill would allow LECs to sell flat-rate basic local telephone service and other services, including caller ID, to SPOCAs for a rate lower than the general tariff. The SPOCA could not resell its services to long-distance, cellular, competitive access providers or other retail telecommunications providers.

The bill would allow the LEC to retain long-distance access service and 1+ intraLATA service on the SPCOA service.

Non-discrimination provisions. The bill would require COAs and SPCOAs to apply for permits or franchises to provide service in a city. The bill would prohibit cities from discriminating generally against telecommunications utilities regarding right-of-ways, access to buildings and use of utility poles. It would also prevent property owners from discriminating against telecommunications utilities.

Market power tests. The bill would authorize the PUC to determine when a specific telephone service was considered deregulated in a geographic market area. The bill sets out a list of conditions the PUC would have to consider before fully deregulating the price of a service. The PUC would also be authorized to re-regulate.

IntraLATA 1+ access. The bill would require that as long as Southwestern Bell is prohibited from entering the long-distance market (interLATA), LECs would continue to have the O+ and 1+ default for local long-distance (intraLATA) calls. If Southwestern Bell is allowed to enter the long-distance market, then the PUC would be required to consider allowing customers to designate a carrier for 0+ and 1+ local long distance calls.

Competitive safeguards. The PUC would be required to ensure that rates and regulations of LECs were equitable and would have exclusive jurisdiction to implement competitive safeguards. The bill would establish a number of competitive safeguards including:

• requiring that incumbent LECs "unbundle" (separate out basic services so they can be resold individually) their services as required by the FCC;

• requiring GTE and Southwestern Bell and companies electing incentive regulation to file their "usage sensitive loop resale tariff" (measured rate for use of telephone facilities between the telephone switchbox and the customer's premises) resale rate with the PUC by September 1, 1995;

• requiring the PUC to determine the rate, terms and conditions for a resale tariff and generally limit the resale tariff to CCNs, COAs or SPOCAs;

• prohibiting telecommunication providers from restricting the resale or sharing of any competitive service beginning September 1, 1995;

• requiring COAs and SPOCAs to resell their loop (local distribution channel) to the LEC;

• requiring the PUC to eliminate all resale restrictions on incentive-regulated LECs on completion of the pricing and costing study (April 1, 1997) and funding of the Regulatory Transition Fund (RTF), the rate rebalancing of LECs is complete, and when Southwestern Bell is permitted to enter the long-distance market;

• requiring the PUC to adopt imputation rules by December 1, 1996, that would prevent a company from selling a service to another company for more than it cost the company to provide the service;

• requiring the PUC to adopt guidelines on telephone number portability; and

• requiring the PUC to adopt rules for expanded interconnection between LECs by September 1, 1996.

Costs and pricing. The bill would require the PUC to adopt a pricing rule by April 1, 1997. Companies would be required to submit necessary cost data to the PUC by November 1, 1996.

The pricing rule adopted by the PUC would have to:

• ensure that prices for monopoly services remain affordable;

• that competitive prices could not be subsidized directly or indirectly by noncompetitive services or be predatory or anticompetitive and;

• require that each service cost include all costs used to provide the service.

Interconnection. The bill would require the PUC to require all telecommunications providers to maintain interoperable networks. It would allow the PUC to make rules and set policies for interconnection

arrangements. The bill would require telecommunications providers to negotiate interconnection rates (cost of connecting to another companies facilities). If companies could not agree on an interconnection rate, the rate would be free for nine months, while the PUC decided the rates for them.

Broadcaster safeguards. The bill would prohibit a telecommunications utility from using Customer Proprietary Network Information (CPNI) — information telephone companies have about their customers such as billing and account information — for commercial purposes, without consent. The PUC would be required to adopt rules consistent with FCC regulations regarding CPNI by September 1, 1996.

The bill would require Southwestern Bell and GTE to create separate corporate entities to provide audio (AM or FM radio) and video (television broadcasting) programming. The bill sets out specific requirements for operation and programming of the corporate affiliates involved in audio and video programming.

The bill would prohibit incumbent LECs from selling advertising agency services to nonaffiliates in Texas. The bill would set out requirements under which LEC affiliates would operate.

The bill would require Southwestern Bell or GTE, if they provided broadcast video programming, to permit local television stations access to the telecommunications services at similar rates. Video programmers that use GTE or Southwestern Bell to transmit 50 or more channels would be required to carry at no charge at least six broadcast television stations in every market and up to nine stations in Houston, Dallas and San Antonio until August 31, 1999. Audio programmers broadcasting 12 or more channels over GTE or Southwestern Bell lines would be required to designate up to one-third of their programming for local radio station broadcasts until August 31, 1999.

Electronic publishing. The bill would prohibit Southwestern Bell (SWB) or its affiliates from engaging in electronic publishing distributed by telephone service until June 30, 2001. It would allow separate affiliates of SWB or joint ventures to provide electronic publishing in certain instances

and would allow SWB or its affiliates to provide electronic publishing not distributed by their basic telephone service under certain conditions.

It would give SWB one year to comply with the electronic publishing provisions of the bill and would sunset the electronic publishing provisions on June 30, 2001.

The bill would define "electronic publishing" as disseminating, providing, publishing or selling information such as news, editorials, columns, advertising, research materials and educational, technical, professional, trade or other literary materials, but would exclude rental movies on demand or video programming.

Private pay telephones. The bill would limit local phone call charges to 25 cents for each five-minute portion with a maximum charge of 50 cents for each local call. It would prohibit any charge for local directory assistance or 911 calls. It would limit the amount charged for credit cards, calling cards, and operator-assisted calls. It would require all non-LEC pay phones providers to register with the PUC in order to do business in Texas.

Automatic Dial Announcing Devices (ADAD). The bill would allow an ADAD to be used for debt collection if it complied with federal law and was used by a live operator for automatic dialing or hold announcement purposes.

Partial deregulation of small LECs and telephone cooperatives. The bill would allow partial deregulation of small LECs (31,000 access lines or fewer) and telephone cooperatives. It would allow them to offer extended local calling services or new services on an optional basis or make minor changes in their rates or tariffs if the company filed a statement of intent and affidavit with the PUC and provided timely notification to affected customers.

The bill would require the PUC to review and revise or eliminate any policies, reporting requirements and rules that place unnecessary burdens or expenses on rural and small local exchange companies and cooperatives.

The PUC could collect fees from local exchange companies to cover the regulatory costs associated with the partial deregulation of telephone cooperatives. The bill would allow small companies to provide free or reduced rates to board members, officers, employees, and agents.

The bill would allow partial deregulation of a cooperative LEC with approval of a majority of the cooperative membership. A cooperative could begin offering extended local calling services or optional new services or change rates if it provided notice to all customers and cities and filed with the PUC. The partial deregulation could be reversed by majority vote of the membership initiated by the board or by 10 percent of the membership.

The bill would require the PUC to review a proposed change under certain conditions, such as receiving complaints from the lesser of five percent or 1,500 customers. The PUC could suspend the proposed tariff during the review.

Rural scholarship fund. The bill would allow a telephone cooperative or small telephone company to deposit unclaimed property money that otherwise would have been deposited in the state treasury beginning September 1, 1995, into a rural scholarship fund created by these companies to help needy rural students attend college or technical school.

The bill would allow persons whose property had been claimed under this provision to file suit against the fund in district court.

Effective date. The bill would repeal all laws or parts of law that conflicted with the bill beginning September 1, 1995, the bill's effective date.

SUPPORTERS SAY:

CSHB 2181 would provide the state the framework to move from a regulated telecommunications market to a fully competitive market. The bill recognizes the rapid technological changes in the telecommunications industry and allows for competition in the telecommunication market, while assuring continued affordable rates and quality service. It would protect consumers in noncompetitive markets and encourage competition in a partially regulated environment. It would allow local exchange companies (LECs) to go to price regulation, instead of cost-of-service regulation, and

in exchange the LECs would be required to make infrastructure commitments totaling more than $1.4 billion over six years that would benefit schools, libraries and public hospitals and make the telecommunications system in Texas among the most advanced in the world.

Competition in local exchange market. The bill would introduce competition at the local level by creating two new classes of certification to allow new players to enter the market, but stipulates entry provisions that would balance the competing economic interests of the existing local exchange company and the newcomer. The bill would do this by creating two classes of competitor: one for the four largest long-distance companies and one for cable companies and other communications companies. Large companies wishing to enter the local market would have to receive a COA, which would require they invest in facilities and provide true competing physical networks, as well as invest in the Texas economy. True competition exists only if at least two facilities-based interests compete.

Competition will breed innovation to create new services at the local level. If the build-out provisions are too onerous and do not encourage competition, the PUC would have the authority to lower the requirements, and once a second network is built, the PUC could waive further build-out requirements. The SPCOA would allow resellers to enter the local exchange market.

Build-out requirements are fair. The COA build-out provisions would not create an unreasonable financial burden. The area to be served would be relatively small, only 27 square miles. The competitor could determine the exact location and place it within reach of prime customers. Forty percent of the service area could be served through resale of the LEC network, which would not require COAs to build-out to areas expensive to reach.

The build-out schedule is considerate and fair — by the first year only 2.7 square miles of facilities would be required, and by year six the minimum would be only 16 square miles of physical network. The bill would permit local exchange competitors to form alliances; for example, a long-distance carrier could become partners with a cable company to meet the 60 percent

build-out requirement. Finally, the build-out requirement would not require a competitor to build facilities to the "doorstep" of the potential customer. Prior to a customer's order the competitor could build only parts of the network facilities it considers appropriate. With PUC permission the competitor would not have to serve a new customer for 30 days, so the customer's order would represent immediate revenue.

The build-out requirements would ensure that new competitors serve all classes of customers, not just the choice ones. If total resale was permitted, large long-distance companies would be encouraged to "cherry pick" the best customers by offering them local service at little or no cost that would be subsidized from their long-distance revenues. Southwestern Bell could not offer such a package because it is prohibited from entering the long-distance market. The loss of revenues from these prime customers would be enormous because more than half of Southwestern Bell's revenues comes from only 5 percent of its customers. This situation would ultimately require that Southwestern Bell increase its rates to its other customers to make up the loss.

Job creation and economic development. The build-out provisions would encourage the telecommunications industry to invest in Texas and Texans. In addition the $1.4 billion in infrastructure commitment by Southwestern Bell and GTE alone will create an estimated 70,000 new Texas jobs. Competition also means jobs, and this bill provides the necessary transition to a fully competitive telecommunications market.

Consumer protection and benefits. Basic local exchange services would be capped for at least four years and could not be raised except under one condition involving the FCC-imposed separation changes (changing allocations between state and federal portions of the networks). Southwestern Bell, which has the lowest local rates in the country and has not received a rate increase since 1984, could not increase basic local rates until September 1, 1999. After the four-year period, it would be unlikely that Southwestern Bell could increase basic rates in light of developing competition. In addition Basket II rates would be subject to a PUC rate ceiling and Basket III rates would be fully competitive. Consumers would be assured of continued good quality, low-cost service, and could complain to the PUC if quality drops.

The new telecommunications infrastructure for schools, libraries and hospitals would give Texans better educational opportunities, medical treatment, jobs and economic growth. Competition in local exchange service should create more consumer choice and new and innovative services.

The competitive safeguards in the bill, such telephone number portability, which would allow customers to keep their numbers when they move or change carriers, and the minimum service requirements, including touch-tone dialing and digital switching capability that must be in place by the beginning of the year 2001, would all benefit the consumer.

Intrastate access rates would be reduced to match interstate access rates, which would benefit consumers if long distance carriers pass-through the reductions. Furthermore local-long distance (intraLATA) toll rates would be reduced.

Regulatory Transition Fund (RTF). The RTF is necessary to assure that Texans continue to have the lowest prices for basic telephone services. PUC-approved high access charges paid by long-distance companies in the intrastate market have been used to subsidize low basic rates and promote universal service. (The access rates are a toll paid by long-distance companies to connect their long-distance callers to the local telephone network.) The bill would require the LECs to lower intrastate access charges and intraLATA toll charges, which would reduce LEC revenues by about $474 million a year at the same time rates are capped for four years. The RTF would reimburse the LECs for the lower access charges while local rates remain capped during the four years. The RTF would be discontinued when the competitive market is established.

All telecommunications providers would pay into the RTF fund, not just long-distance carriers and LECs. Spreading the cost of the RTF over all providers would spread the cost over a much broader group. Contributions to the RTF would be based on retail revenues, but not on revenues from local exchange service. Estimates show that Southwestern Bell, GTE and Continental Telephone Company would lose about $398 million from lowered access charges and about $76 million from lower intraLATA tolls. Contributions to the RTF would be divided between long-distance carriers,

LECs and cellular companies, with each segment putting in one-third of the fund's revenues or about $158 million each. The long-distance carriers would benefit from this arrangement and would see an overall savings of about $240 million ($398 million minus $158 million), which could be passed on to their customers. On the other hand cellular companies and LECs would have to pay the assessment with increased prices or surcharges.

Competitive safeguards. The competitive safeguards — including resale, unbundling, number portability, price imputation and interconnection — are designed to open the local exchange network, create balanced regulatory treatment and protect consumers in the transition between a regulated economy and a competitive market.

Costing and Pricing. The bill would require the PUC to complete the costing and pricing study and adopt a pricing rule by April 1, 1997. Determining the cost of services and network functions is the foundation for telecommunications competition. Universal service — affordable basic telephone service for all — is a primary policy goal, and uncovering the true costs of providing services would end the long-standing debate regarding the extent to which affordable residential rates have been subsidized by rates from other services and determine precisely what the size and the nature of the subsidy should be.

In addition, the costing and pricing information would be used to determine the appropriate cost for interconnection and resale rates, and the price floor and ceiling of services in Baskets II and III

Infrastructure commitment. The infrastructure investment would assure that schools and hospitals will soon have state-of-the-art telemedicine and distance-learning capabilities. Distance-learning allows schools in rural and urban areas to link up with each other in one classroom and students and teachers to interact over long distances, allowing educational resources to be shared more effectively. Telemedicine allows rural areas to have access to medical experts not otherwise available and facilitates long-distance consultation and diagnosis. The Telecommunications Infrastructure Fund would provide schools, libraries and public medical institutions the necessary equipment and training to use the network.

Broadcasting and electronic publishing safeguards. The bill provides necessary transitional safeguards to protect the interests of audio and video broadcaster and newspaper publishers from deregulated local phone companies and would assure that LECs do not have an unfair market advantage.

Consumer privacy network information. The bill would prevent LECs from using customer privacy network information (CPNI) — billing and accounting information such as names, address and phone numbers — for commercial purposes and would assure that the private information would be protected. Also, it would prevent LECs from using such information to give them an edge in a competitive market.

Small telephone companies and telephone cooperatives. The bill would give small telephone companies regulatory flexibility to offer extended local calling service, make minor rate changes and offer new services without PUC review. On December 1, 1994, the PUC by rule allowed small companies greater regulatory flexibility, which recognized the vast differences between small and large phone companies. The bill would address some of the statutory changes needed and put the PUC policy into law.

Telephone cooperatives should be partially deregulated because they are non-profit LECs owned by their customers. This structure does not require the same level of regulation as for-profit utilities require.

Offset to infrastructure commitment. Unless GTE is assured rate stability, it is unlikely to elect incentive regulation and fulfill its infrastructure commitment of $300 million. GTE's $300 million infrastructure commitment has always been predicated on the understanding that the investment could be offset against any consolidated-tax issue losses, which could amount to more than $100 million against its $300 million infrastructure commitment. GTE cannot afford to pay $100 million to $140 million in addition to the $300 million infrastructure commitment. The Texas Supreme Court agreed with and ruled in favor of GTE last week on the consolidated-tax issue, and this provision of the bill would now serve as legislative affirmation of the Supreme Court's decision.

The $55 million GTE will spend to put digital switches in small exchanges was part of the original $300 million infrastructure commitment. The new provision would require that these switches be installed sooner, by December 1998.

IntraLATA 1+ restriction. Existing telephone companies should be allowed to retain dominance over intraLATA 1+ calls until the federal government allows Southwestern Bell into the long-distance market; otherwise, Southwestern Bell would be put at an unfair competitive disadvantage.

Expanded local calling service areas. The bill would limit to five the number of expanded calling service areas that could be included in a petition. The 1993 legislation allowing expanded calling areas does not include any limitation. Although expanded service areas allow residents of rural and suburban areas to pay a flat monthly fee to call to neighboring exchanges where they conduct daily business, a reasonable limit should be imposed on this flat-rate long-distance service. Allowing consumers to have flat-rate long-distance in as many as five exchanges would provide a reasonable balance between the needs of the consumer and the phone companies.

Private pay telephones. The bill would protect consumers from abuses of private pay telephones by requiring private pay telephones to register with the PUC, prohibiting them from charging for local directory assistance and 9-1-1 calls and limiting the amounts they can charge for long distance calls.

Universal Service Fund (USF). The USF would be expanded to support affordable universal service for all consumers. It should be used to support companies that provide continuous quality basic service throughout their service area because they have the responsibility to provide service to all. When competitors meet these requirements, they would be able to participate in the fund.

OPPONENTS SAY:

CSHB 2128 purports to provide a framework for Texas to make the transition from local telephone service monopoly to a competitive market, but would really give Southwestern Bell, GTE and other local phone companies an unfair competitive advantage. This would actually hinder

real competition and the potential for technological innovation and affordable prices that are the stated intentions of the bill.

The bill would immediately reduce regulation of local telephone monopolies in exchange for a commitment to connect schools, public hospitals and libraries with fiber-optic cable over six years, which they will likely do anyway, and a four-year freeze on already overpriced basic telephone service. It sets up avenues for companies to compete for local telephone service, but makes the conditions for competition prohibitive, except for cable companies and some small resellers. In addition, the bill would create a special Regulatory Transition Fund to assure that Southwestern Bell and GTE maintain their current regulated-guaranteed income until markets are fully competitive, which is less likely to happen given the skewed transition framework of the bill.

Consumer rate increases. Consumers would not be adequately protected against increased prices, and the bill lacks mechanisms to lower rates when the cost of providing service falls. Although the bill would cap basic phone rates for incentive-regulated companies until August 31, 1999, there a number of "loopholes" under which these rates could be raised including:

• raising rates if the Federal Communications Commission (FCC) refigures the "separations" (costs assigned to state and federal portions of telephone costs) by 10 percent or more. "Separations" assign costs to the state or federal jurisdiction for ratemaking purposes and are tied to rate-of-return regulation. If the bill's intent is to deregulate rates, why allow the cost of basic service to rise based on "separations?"

• increasing prices to support the Regulatory Transition Fund. All telecommunications providers would be assessed a charge to make up for the money local telephone monopolies lose from lowering their intrastate long-distance and toll charges. This provision to assure these companies do not lose any revenue would be paid for by the consumer. The RTF is just a "make whole" subsidy for the phone companies, and consumers would not likely see any savings because reductions in access charges would merely be converted into surcharges.

• allowing companies other than Southwestern Bell and GTE that elect incentive regulation to ask the PUC to adjust rates based on market conditions in three and one-half years. Consumers in those areas could actually see their rates increase six months before the four-year cap expires.

The competition provisions of the bill are aimed at full competition in certain markets after six years. At a minimum the rate cap should be extended from four to six years.

In addition to the loopholes, rates may be frozen at levels that are already too high. Other states have *decreased* rates before setting a cap because the telephone industry is a declining cost industry.

Timing deregulation with competition. CSHB 2128 does not provide the necessary balance between regulatory control and competition control in the transition period. There would be 12 to 18 months between the time pricing flexibility is allowed and the competitive safeguards are in place. During this time Bell and GTE could totally dominate the marketplace to the detriment of the development of competition, which would ultimately harm the consumers who may never reap the promises of low prices, high quality, innovation and consumer choice that a healthy competitive market is capable of delivering.

The timing sequence in the bill is backwards. The bill would allow flexible pricing immediately in September 1995, which is 19 months before the PUC completes it costing and pricing study and at least 18 months before competitive safeguards are in place. Before rates are capped and ceilings imposed there should be full knowledge of the costs of providing services. Southwestern Bell has not had its rates adjusted since 1990 and clearly some prices are excessive.

Basket III services would be given immediate pricing flexibility without proof they are competitive services. Without competition, these prices could be raised before the consumer has a viable alternative.

Restricting competition for local exchange services. The bill has a number of provisions that would restrict entry into the local exchange market including facilities build-out requirements and restrictions on the use

of existing network facilities, which would effectively make it economically impossible for new entrants to get into the local telephone business, with the possible exception of cable or electric companies that already have an infrastructure in place.

The build-out provisions would require a company to build out to serve everyone in a three-mile radius in six years. This would be prohibitively expensive for any company but a cable or electric company. The result would be little competition and slow introduction of new technology. For example, MCI estimates it would cost $600 million to offer service in Austin alone, and AT&T says it could cost as much as $1.5 billion just to serve Houston.

The build-out provisions that dictate that a COA build a duplicate "local loop" (the line from the customer's home or business to the telephone company's central office) contradicts the economics of modern telecommunications networks and would be unnecessary, wasteful and unworkable. Investment in a switch supports thousands of customers, while investment in a line into a house or business can only be allocated to one customer. Recent advances in technology show there is no reason to overbuild the final loop. The disruption caused by several competing companies digging up streets to lay their lines would be an unwelcome public burden.

The amount of resale that a competitor could use would be limited to 40 percent during the six-year build-out period. The bill is not clear whether the 40 percent resale provision applies after the sixth year. Also, does the 100 percent build-out mean that a company would have to build out 60 percent and could use 40 percent resale or would it have to build out 100 percent, in which case it would have no need to purchase resale from the existing LEC?

Regulatory Transition Fund (RTF). The RTF would be funded through an assessment on all retail revenues of telecommunications providers except local telephone service and would be given to Southwestern Bell and GTE to replace the funds lost by reducing their inordinately high long-distance access charges and intraLATA toll charges. In effect it would be a mechanism to allow these companies to maintain their current high

revenues at the expense of their potential competitors and ratepayers. Although Bell and GTE would also pay into the fund, they could impose a surcharge or increase non-basic rates to insure they lose no revenue. Consumers would pay higher prices, and potential competitors would have

to charge higher prices to pay what would be effectively a tax to Southwestern Bell and GTE.

Although long-distance carriers support reducing long-distance access charges in Texas, which are some of the highest in the nation, it should not be done with a regressive mechanism like the RTF. The RTF would require that LECs reduce their intraLATA tolls to allow them to be more competitive with cable TV and other potential competitors, but at the same time guarantees the current intraLATA toll revenue stream into the future with reimbursements from the RTF.

Resale tariffs. The resale tariffs would make it difficult for competitors to supplement their offerings by reselling portions of the LECs network features. The bill would require LECs to file usage sensitive (per-minute or per each call) resale rates for competitors using these services. Competitors would have to charge per minute local rates to their customers, while the local LEC would continue to charge customers a flat rate. No customer is likely to choose to pay per minute rates when they can get the same service at a flat rate.

IntraLATA 1+ restriction. The consumer should be able to choose its 1+ intraLATA carrier. To continue this monopoly by the existing LECs would be anti-competitive and protectionist.

Infrastructure commitment. The $1.1 million in fiber-optic cable capital investment by Southwestern Bell to link schools, hospitals and libraries may come at the expense of other capital investments. According to PUC documents, Bell is planning to cut its normal capital expenditures by nearly the same amount it is promising the state in its infrastructure commitment. Although Bell has spent about $3.5 billion on infrastructure from 1991 to 1994, Texas is still far behind other states in advanced communications technology in spite of promises Bell made in 1990 that it would provide the state 21st century technology in exchange for earning higher profits.

Southwestern Bell is near the bottom among the "Baby Bells" in spending on digital switching and ISDN technology.

While the promise of distance-learning and telemedicine is attractive, should it be traded for a telecommunications policy that benefits Southwestern Bell and GTE at the expense of true competition? There is some question whether school districts could afford the higher phone bills that would result for classes taught by videoconferencing. And many doctors are reluctant to practice telemedicine because most insurance policies do not cover consultation unless the doctor is physically present and because of the potential for medical malpractice suits.

Jobs and economic development. The infrastructure provisions of the bill would not necessarily bring the economic activity and jobs that are touted. Southwestern Bell and GTE have to make infrastructure investments in any case. Furthermore, if the bill's build-out and resale provisions were more reasonable, real competition would provide many more jobs and increased economic activity in an ongoing competitive market.

Municipal franchises. The city non-discrimination provisions of the bill are too broad and general and should be tightened to provide more specific guidelines to address franchises and permits of new applicants including how much cities can charge for franchises or permits and the parameters of franchises.

Expanded local calling service areas. The bill would arbitrarily limit to five the number of expanded calling service areas that could be included in a petition. Expanded local calling service areas allow communities in rural areas on the fringes of metropolitan areas to petition to have a flat rate charge for unlimited numbers of long-distance calls in participating exchanges. Of the 190 applications affecting Southwestern Bell now pending before the PUC, 50 involve more than five exchanges, which the bill would prohibit.

Phantom taxes. The bill would allow GTE and Southwestern Bell to apply any losses from consolidated income-tax or "phantom tax" judgments to their $1.4 billion infrastructure commitment. This means they could count money collected from ratepayers for income taxes but never actually

paid to the government by the utility's holding company because of tax losses incurred by other, nonregulated subsidiaries. GTE would be allowed to reduce its $300 million infrastructure commitment by as much as $150 million. Just because the Texas Supreme Court on April 13 ruled in favor of GTE in the phantom tax case does not mean that the result is fair to the consumer. This provision should be deleted from the bill, and the Legislature should by law forbid the collection of "phantom" utility taxes.

Universal Service Fund (USF). The USF should be used to assure affordable telephone service is universally available in a competitive market by focusing on customers rather than assuring a steady revenue stream for LECs. The bill would guarantee LECs (other than Southwestern Bell and GTE, which would be guaranteed their current revenue stream through the RTF) reimbursement for lost revenue or increased costs because of regulatory changes or intraLATA 1+ losses. At the very least, the fund should provide universal support to all telecommunications providers, not just to incumbent LECs. This type of telephone welfare would give LECs an unfair competitive advantage in what is supposed to be an increasingly competitive market. Furthermore, the PUC should determine the cost of basic services in each area and reimburse all providers accordingly.

NOTES: CSHB 2181 differs from the original bill in a number of ways including:

• allowing the PUC to issue rules for when a COA must be required to serve a customer and specifying that COAs must be able to service customers in their build-out area within 30 days of a customer request and that the PUC may not require certificate holders to build from the street to the premises before a customer request;

• changing the limitation on a COA resale of existing facilities in the build-out from 30 to 40 percent;

• specifying that SPCOAs could not be obtained by a company with more than 4 percent of the total intrastate switched access market, excluding AT&T, MCI, Sprint and LDDS;

• limiting expanded toll-free calling areas to five;

• adding the provisions allowing Southwestern Bell and GTE to apply any consolidated tax-losses against their infrastructure commitment;

• setting April 1, 1997, as the date the PUC must set a pricing rule for monopoly and competitive service prices; and

• deleting a provision requiring an interim reciprocal interconnection rate of 1.1 cent per minute for terminating local calls of another company.