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Public Utility Commission of Texas

November 09, 2020

The Honorable Trent Ashby
Texas House of Representatives
Capitol Office E2.806

The Honorable Drew Darby
Texas House of Representatives
Capitol Office GW.17

The Honorable Ken King
Texas House of Representatives
Capitol Office E2.822

The Honorable Chris D. Paddie
Texas House of Representatives
Capitol Office E2.502

Dear Representatives Ashby, Darby, King, and Paddie:

Thank you for your letter, dated September 25, 2020, in which you posed questions to the Commission related to the Texas Universal Service Fund. I sincerely appreciate your concern on behalf of your constituents. I know we share a common goal of finding the best solution for Texans to the financial shortfall in the Texas Universal Service Fund. Your letter and many of your questions were directed towards the PUCT Commissioners. To avoid communications among PUCT Commissioners that might violate the letter and spirit of the Open Meetings Act and provide you with a timely response, I am providing this response as the Executive Director of the PUCT.

Fundamental shifts in the telecommunications marketplace have led to the problem we find ourselves in today. Revenue into the fund is based on a certain number of people paying a certain amount for voice telephone service. More Texans are no longer paying for multiple phone lines in favor of only having a mobile device, so there are fewer lines paying into the fund. This is a phenomenon called "line loss" that has caused the fund to gradually lose money over the years. The recent, drastic decline in funding is also due to the fact that customers no longer use their mobile devices as telephones in the way they used to. Increased focus on data services and decreased use of voice services means that the TUSF fee is levied against a smaller

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portion of each customer's bill. Any solution that seeks to address this revenue shortfall will have to raise an estimated \$85 to 95 million in FY 2021 and \$164.0 million in FY 2022.

Over the past ten years, the citizens of Texas have paid over \$2.7 billion into the Texas Universal Service Fund and \$2.8 billion has been paid to telecommunication companies. These numbers are substantial, and the Commission was reluctant, in the midst of a pandemic and economic downturn, to further burden the Texans who pay into the fund. The Commission felt that the Legislature would want to set the policy and direct the future of the fund. There are some fundamental policy issues regarding the fund and its use that the Commission respectfully recommends be addressed in the 2021 legislative session.

In response to your specific questions:

1. *TUSF has helped rural and high cost telephone providers to keep rates affordable so that telephone service can be provided universally. Does the Commission both agree with the state's policy of universal service, and that the TUSF is fulfilling its purpose?*

The Legislature has set a policy of universal service and directed the PUCT to enact that policy so there is no room for agency disagreement. Because of fundamental changes in the telecommunications marketplace, however, the funding mechanism for the TUSF no longer provides enough revenue from the citizens of Texas to fund the subsidies to the telecommunication companies and achieve the policy set forth by the Legislature.

2. *The Commission has stated it believes that the Legislature needs to address TUSF. [a] Does the Commission have a stated position on the future of TUSF or similar high cost support? [b] Does the Commission have a plan in case the Legislature is unable to pass a bill addressing these matters? [c] The Commission has projected TUSF funding will run out in as little as about three months, and a year or more before any rule could be implemented after a bill - Won't some companies that depend on TUSF have gone bankrupt or have to reduce services before then?*

[a] The Commission does not have a stated position on the future of the TUSF or similar high-cost support other than previous statements that there are some underlying policy issues that the Legislature may choose to address as to the fund. Those policy issues should be decided by the Legislature with input from all segments of the industries and consumers impacted by the collection and disbursement of the TUSF assessment.

[b] At this point, the Commission has not developed a contingency plan in case the Legislature does not pass a bill addressing these issues, however we are in the process of collecting information from the companies that receive the TUSF subsidy so the Commission and the Legislature can make the most informed decisions.

[c] There is insufficient information available to the Commission to determine whether companies would have to file for bankruptcy or reduce services without payments from the TUSF.

Many of the companies at issue have installed fiber in order to not only provide telecommunication services but also their affiliate companies use that same fiber to provide unregulated services such as cable television, the internet, and security systems. Many of the companies have already invested in the fiber cable used to provide the services. We can assume that a company will use that fiber cable investment to continue to provide the services that it currently offers.

In addition, these companies state that they have used the payments from TUSF to invest in the fiber used to provide these services. Companies are not required to disclose how much revenue derives from their unregulated business that also utilize the same fiber used for telecommunication services that was funded through the TUSF. As stated above, the Commission is in the process of requesting the underlying costs and revenues for all of the businesses and services provided by these companies – both regulated and unregulated. Once the information is received, the Commission and the Legislature will be in a better position to determine how the TUSF payments have been used to support regulated telephone service as well the effect on unregulated businesses.

There are other mechanisms available to companies to address funding for services. The companies have the ability to file rate proceedings or to adjust their costs.

3. *Does the Commission have a specific plan of how it intends to reduce/remove or allocate TUSF funding when funds fall short?*
 - a. *If so, please describe the that plan and the timeline for its rollout.*
 - b. *How will the Commission decide which programs to fund and which to cut?*
 - c. *Does the Commission have a plan for communicating that plan to telephone companies that receive support, or the Texans they serve?*
 - d. *If there is not yet a plan in place, when will the PUC develop a plan and how will that plan be communicated?*

The Commission has stated at an open meeting that the Commission staff should begin paying out of the TUSF “to only fund Lifeline projects so that those continue to be funded but to leave everything else as is.” The timeline for implementing any disbursement changes is dependent on when the fund balance is reduced such that it would no longer be able to fully fund all programs.

The TUSF balance, as of the end of August, is approximately \$51 million. Monthly revenues are approximately \$9 million dollars. Monthly expenditures are about \$18 million. So, the fund balance is decreasing by about \$9 million each month, or \$108 million annually. Approximately \$3 million or 20% of the fund expenditures is paid monthly to the social programs, which include the Lifeline Program, Relay Texas, and the Specialized Telecommunications Assistance Program. One solution would be a pro-rata distribution of the remaining balance. Thus, paying first for the social programs of \$3 million will leave an

approximate monthly balance of \$6 million to be disbursed on a prorated basis to the eligible companies.

4. *Currently the regulated companies that receive TUSF have expensive service and quality obligations that the PUC oversees, such as:*
- *Provider of Last Resort obligations ("POLR"),*
 - *Construction connection times, and*
 - *Service quality / reliability metrics.*
- If the PUC is not going to fully support these companies, do they intend to waive any of these requirements to avoid burdensome unfunded mandates? Has the PUC ever waived any of these requirements before?*

The TUSF does not fully support these companies. In addition to the subsidy received from the TUSF, regulated companies charge their customers rates that are set by the Commission. Regulated companies can request rate changes at any time to cover their ongoing expenses.

Providing timely connections within 90 days of a request for service or a time agreed upon by the customer and the utility as well as meeting well-established service and reliability metrics are fundamental customer protections that have been in place for many years. The obligations to serve as a provider of last resort are contained in the Public Utility Regulatory Act (PURA) § 54.251; and the Commission does not have the authority to waive a statutory requirement. If a telecommunication utility needs to request waiver of any Commission rules, then the Commission will consider the request at the time under the facts presented for each independent company. I have no knowledge on whether the Commission has ever waived any of the stated requirements in the 45-year history of the Commission.

5. *If the Commission won't increase the TUSF surcharge to ensure funding to support for the telephone network that provides voice services to rural customers, how will affordable service to rural customers continue?*
- a. *How will the companies meet POLR obligations?*
 - b. *How does the Commission expect rural telephone providers to meet their debt obligations? Fund their ongoing investment(s)? Pay their employees?*
 - c. *From the perspective of a Chief Operating Officer, what do you do if you have insufficient revenues to pay for the aforementioned costs?*

The Commission does not have enough information about the internal finances and operations of these companies to make a prediction as to how rural telephone companies will be able to continue to provide service without the TUSF subsidy. The Commission does not have any transparency into how much revenue is generated by the unregulated businesses, including broadband, of these companies. A recent request for information to these companies from the Commission should provide greater insight into the use of the public funds by these companies, so that the Commission and Legislature is better informed.

6. *Does the Commission expect rural telephone companies to increase their rates for telephone service to make up the lost TUSF support?*
 - a. *If so, does the Commission understand that rural telephone customers could be paying three or four times more for their phone service than customers in urban areas, or that companies will not be able to afford to continue to provide service at all?*
 - b. *Would higher rural rates violate the state's policy of "universal service"?*
 - c. *If not, how can companies stay afloat if their losing an average of 60% of their intrastate revenues?*

For the same reasons stated above in response to question 5, the Commission also does not have sufficient information on the regulated and unregulated income and expenses to know how much telephone rates may increase because of a decrease in TUSF subsidy. The financial impact to each company will be different, dependent in part on their unregulated business model.

7. *In 2020, the Commission has approved numerous TUSF adjustment dockets, one of these as recent as July 15, 2020. One of these was Cumby Telephone Cooperative, Inc., an over 60-year-old, very small, member-owned, not-for-profit telephone cooperative that serves customers in rural farm and ranchland in northeast Texas. In Docket No. 50699, Cumby obtained an order on July 15, 2020:*
 - a. *Does the Commission intend to comply with this order and keep paying Cumby this total of \$36,188.92 per month?*
 - b. *Why would the Commission issue an order on July 15, 2020, if it had decided not to pay the specified support amount listed therein?*
 - c. *Does the Commission intend to comply with other similarly worded orders for other small and rural telephone providers issued in 2020? What about those issued in prior years? Does the Commission have legal support for letting the TUSF diminish to the point that the support amounts ordered will not be paid out as they are due? If so, what legal support?*

It is correct that the Commission has continued to process requests for TUSF adjustments despite the uncertainty of the solvency of the fund. Even though the total funding of the TUSF subsidy has issues, the Commission has not stopped work on the TUSF. In developing a path forward for the TUSF, the Commission and the Legislature will need to have a clear picture of the extent of the TUSF subsidy payments. Not processing these requests would make the situation even harder to address.

8. *Did all three of the current PUC Commissioners sign the orders adopting the new small and rural provider report and TUSF adjustment rule, Tex. Admin. Code § 26.407, at the end of 2018 (Project No. 47669)? Doesn't that rule require continued funding for participating small and rural providers?*

Yes, the Commission did adopt a new rule on adjusting TUSF support in October 2018 before the precipitous drop in revenue that occurred at the end of 2019.

9. *For many years, the Commission received annual earnings reports from telephone providers. In the past two years, hasn't the Commission also:*
 - a. *Received and processed 129 annual reports, with more information about expenses/investments/allocations than any other utilities provide annually (as of Sep. 15, 2020); and*
 - b. *At least 20 TUSF support adjustment applications under a recent law that specifically allow for support increases for under-earning providers?*
 - c. *In reviewing these reports and adjustment applications, has the Commission identified any major error, unreasonable expense, imprudent investment, improper allocation or denied any applications?*
 - d. *Have there been any over-earnings that have not been properly addressed? Has any third party intervened in the TUSF application dockets to oppose the requested relief?*

The information contained in the annual reports only provides insight into the regulated voice services provided by the subsidized companies. The subsidized companies have been clear that the regulated voice services are connected to the unregulated broadband and other services and that decreases in TUSF subsidies threaten broadband service. The Commission does not have any transparency into the unregulated broadband and other services and therefore does not have a clear picture of the overall financial standing of these companies.

In addition, a rule adopted by the Commission severely limits the time allowed for the Commission to review the filings and request additional information. The rule was adopted prior to the now-known impacts to the revenues of the TUSF and with past Commission staff members advising the Commission.

10. *Haven't all the mid-sized telephone companies or cooperatives that receive high-cost TUSF support already undergone financial needs tests?*
 - a. *Did their financial needs test dockets specify specific per-month, per-exchange support amounts the Commission must pay?*
 - b. *Was Commission Staff a party to the settlements in those proceedings?*
 - c. *Were those settlements unopposed?*
 - d. *Were those proceedings found to be consistent with universal service policy, Commission rules, and Texas law?*

There have been a number of cases at the Commission to set the amount of subsidy for individual companies. The statute sets forth how the Commission is to determine those amounts. The current issue with the TUSF is not about the amount of subsidy authorized by statute, but that the mechanism to fund that subsidy has become insufficient because of fundamental changes in the marketplace.

11. *Is the Commission aware that there is one hybrid network that is used to provide wireline voice service, wireless voice service, and advanced services like broadband, and that the costs of the investment are allocated among these services?*
- a. *Does the Commission believe changes to the TUSF of telephone providers who build/maintain the network also impact the financial viability of other services, such as broadband, that rely on the singular hybrid network?*
 - b. *If small rural companies serving 55% of the State of Texas are unable to stay in business because of arbitrary reductions in support that the Commission has already found to be reasonable, how does the Commission propose for students who are attending online school in those areas to receive an education?*

Regarding the use of a single hybrid network to provide regulated voice service and unregulated broadband service, the Commission does not have transparency into the unregulated broadband and other services provided by companies. The Public Utility Regulatory Act is clear that TUSF funds can only be used to support basic local phone service. At the time the TUSF was created, the expansion of broadband internet over a hybrid network was not contemplated. The Commission does not know how much revenue the unregulated broadband and other services generate. This makes it impossible for the Commission to verify the allocation of costs between the regulated and unregulated sides of a company. The Commission is in the process of requesting the necessary information to make such determinations and provide more transparency into the use of public funds for these subsidies.

12. *The Commission waited until funds almost ran out before even considering increasing the assessment rate. Mr. Gleeson indicated that staff estimates that the assessment rate would need to increase to 8% in October, but in June staff only recommended an increase of 6.4%.*
- a. *Did the delayed response require a higher increase to maintain funding?*
 - b. *Does statute require that the Commission continuously monitor the Fund balance to ensure there are sufficient funds to pay all the TUSF programs outlined in PURA?*
 - c. *Won't the assessment rate have to be increased even more sharply the longer the Commission waits to increase the TUSF assessment rate?*

The timing of the response to the decline in the revenues of the TUSF was mainly based on the fact that the telecommunication companies who fund the TUSF did not provide any insight into the drastic declines in revenues that abruptly occurred. When Commission staff estimated the fee needed to support all the requested TUSF subsidies, they had to account for the downward trends in revenue and a depleting fund balance. These trends continue to worsen and the fund balance continues to deplete. As time goes on, this increases the amount of the assessment needed to match the level of requested TUSF subsidies.

- d. *The Commission acknowledged the need for support and their obligation to make the Fund work in May, and then denied staff's recommendation to increase the assessment rate in June? What changed during that month?*

The Commission did not take any action in May.

13. *What happens to the companies and cooperatives and their funding if the Legislature fails to pass a bill in 2021?*

Please see the response to question 2.

14. *Mr. Gleeson said there had been no telephone rate cases since the mid-late 1990s, and Chairman Phelan suggested that the lack of rate increases in the last 30 years might contribute to funding issues.*

a. *In fact, while there have not been any full telephone rate case in over 20 years, there have been many telephone rate increase, correct?*

As Mr. Gleeson stated, there have not been any telecommunication company rate cases in almost 30 years. However, in the past, the companies adjusted their rates without a full rate review of the companies' expenses and income, including impacts from affiliated companies. Whether the companies' rates are cost based and reasonable and necessary is unknown at this time due to a lack of information. The Commission is requesting information for all companies that receive public funds, so that there is greater transparency into the use of the TUSF.

b. *Aren't local telephone rates in rural areas generally on par with local telephone rates in urban areas for comparable services?*

In most cases, rates in rural areas served by small and rural ILECs are less than the rates charged by larger ILECs serving customers in more urban areas. For example, Eastex Telephone Cooperative, Inc., an ILEC serving customers in small and rural areas in East Texas, offers residential landline service at a rate of \$22.50, subsidized by the TUSF. Conversely, AT&T provides service in most large urban areas throughout Texas and offers residential landline service at a rate of \$31.00 per month. AT&T is a fully deregulated company and the rates in all AT&T Texas exchanges, except for certain grandfathered rates, are uniform throughout AT&T Texas' deregulated service territory.

Similarly, the rates for single-line business service by small and rural ILECs are often less than the rates charged by ILECs providing single-line business service in urban areas. For example, Frontier charges a single-line business rate of \$49.99 in its exchanges found in larger urban areas. Conversely, West Plains Telecommunications, Inc. offers single-line business service in small and rural areas, subsidized by the TUSF, at a rate of \$22.18. Frontier is a deregulated company with pricing flexibility not available to a Chapter 52 companies like West Plains Telecommunications, Inc.

15. *Mr. Gleeson said TUSF was created in 1987, and Chairman Phelan seemed to understand that the current funding mechanisms were over 30 years old.*

a. *Weren't the two high-cost funds that make up the majority of the TUSF payments first created in the year 2000?*

- b. *And haven't they been addressed in legislation numerous times since 2000, including as recently as 2017?*

As stated by Mr. Gleeson, the TUSF was created in 1987. There have been numerous changes to the TUSF statutes over its existence. As highlighted in your questions, most of those changes have addressed additional subsidies to be paid to the telecommunication providers. The statutory changes have not addressed the current need for additional funding. As previously stated, in 2019, there was a precipitous and unpredictable decline in the revenue. Therefore, the current funding mechanisms have been in place for many years; it has been the issue of the level of subsidies that has changed over the years through the Legislature.

16. *Mr. Gleeson said in response to Chairman Phelan's question that PURA does not define "rural areas." But the referenced provision of PURA actually state "high-cost rural areas." The Legislature or the Commission would need to define what a "high-cost rural area" is, correct? Not a "rural area"?*

Section 56.021 of the Public Utility Regulatory Act states the following: "The Commission shall adopt and enforce rules requiring local exchange companies to establish a universal service fund to: (1) assist telecommunications providers in providing basic local telecommunications service at reasonable rates in high cost rural areas under two plans: (A) the Texas High Cost Universal Service Plan (16 T.A.C. Section 26.403); and (B) the Small and Rural Incumbent Local Exchange Company Universal Service Plan (16 T.A.C. Section 26.404)." The Commission will defer to the Legislature on how to address all issues related to the TUSF. Therefore, it will be for the Legislature to determine whether changes in definitions of "rural" or "high cost rural areas" would need to be addressed in the next session. It is clear that certain areas in Texas, such as Katy, Sugar Land, and Denton do not qualify as either "rural" or "high cost rural areas." However, TUSF funds are used to subsidize service in these areas based on the current statutory provision that is quoted above.

17. *Chairman Phelan asked if there is any auditing done of high-cost TUSF expenditures, specifically with regard to cross-subsidization and allocation between regulated and unregulated facilities. Mr. Gleeson said there is not, that the Commission has to rely on the companies and cooperatives' sworn statements.*
- a. *Do most small and rural providers submit annual reports to the Commission every year that include their Cost Allocation Manuals (CAMs)?*

Yes.

- b. *Aren't these CAMs required by FCC rules, submitted to National Exchange Carrier Association (NECA), and subject to Universal Service Administrative Committee (USAC) audit already?*

The Commission believes this to be true.

c. *Do all other providers submit earnings monitoring reports to the Commission annually?*

No.

d. *Do companies verify the accuracy and completeness of their reports to the PUC at least once every year?*

The companies sign a written statement that they have verified the accuracy and completeness of the reports.

e. *Are most companies or cooperatives' reports based on audited financials?*

The companies sign a written statement that the reports are based on audited financials.

f. *Can the Commission submit Requests for Information on any of these annual reports if it needs any more information about allocations or any other aspect of a provider's report?*

g. *If the Commission does not or cannot analyze potential cross-subsidization or allocations in annual reports, then why does the Commission ask for hundreds of pages in reporting each year, including CAMs?*

h. *If the Commission does analyze this information in annual reports, couldn't it initiate a rate case if it suspected a provider was not correctly allocating or reporting? Aren't rate cases how the Commission would address cross-subsidization in any other industry?*

The Commission requests information in support of its statutory obligations and has the ability to perform any of the stated functions. However, a rule adopted by the Commission severely limits the time allowed for the Commission to review the filings and request additional information. It was adopted prior to the now-known impacts to the revenues of the TUSF and with past Commission staff members advising the Commission.

In addition, it has become apparent that the various companies do not use a uniform method for allocating expenditures between the regulated and unregulated business. This makes it very difficult to determine if the allocation is valid or to compare companies to each other. In addition, it is impossible for the Commission to verify these allocations because the Commission has not been able in the past to review the unregulated broadband and other affiliated revenues and expenses of these business. Recently, the Commission has asked for information to be able to provide the Commission and the Legislature more insight into the revenues and expenses of the companies receiving the public funded subsidies.

Thank you for the opportunity to respond to the questions posed by you on behalf of your constituents. I am grateful for your attention to this issue, and I look forward to helping the Legislature find a resolution.

Sincerely,

A handwritten signature in black ink, appearing to read 'J.P. Urban', with a large, stylized flourish at the end.

John Paul Urban
Executive Director

Cc: Chairman Dade Phelan