SENATE COMMITTEE
ON
ECONOMIC DEVELOPMENT

IMPLEMENTATION OF SB 560,
76th LEGISLATURE

INTERIM REPORT TO THE
77TH TEXAS LEGISLATURE

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EXECUTIVE SUMMARY

Federal and state governments are embracing the future of telecommunications by moving from a highly-regulated industry to a competitive one. The shift in the way that states view telecommunications service presents a challenge to lawmakers and agencies when they consider how to maintain oversight of a competitive marketplace that is safe for consumers.

Most notably, the move from strict regulation to competition among telecommunications service providers is changing the way that the state regulatory agency, the Public Utility Commission (PUC), approaches its job. Because of major provisions in the Federal Telecommunications Act of 1996, states are required to foster the spread of telecommunications service by abandoning some of the rate-making and regulation that previously addressed this public service. In Texas, lawmakers are also making these changes in accordance with HB 2128, 74th Legislature, which began the movement away from rate of return regulation and toward competition.

SB 560 extends the Public Utility Regulatory Act (PURA) until September 1, 2005 and provides major changes in telecommunications policy. In light of these changes, the Senate Committee on Economic Development (Committee) was charged with monitoring SB 560 implementation. In particular, Lt. Governor Rick Perry charged the Committee as follows.

> The Committee shall monitor the implementation of SB 560, 76th Legislature, Regular Session regarding the regulation of telecommunications utilities by the PUC and the provision of telecommunications service.

This report provides information about rules created and actions taken by the PUC to help carry out the requirements of SB 560. The report contains information about the current status of the telecommunications industry in Texas. It also provides the findings and recommendations of the Committee. Each section of the report contains a discussion of the implementation of issues addressed by SB 560. A table at the end of each section gives the current disposition of the projects implemented regarding the subject discussed in the section. The information contained in the report is summarized below.

PUC IMPLEMENTATION

SB 560 required switched access rates for origination and termination of calls to be lowered by three cents. This requirement was met on July 1, 2000, after an initial rate reduction of one cent in September 1, 1999. When considered with the rate reduction that occurred with the implementation of the Texas Universal Service Fund (TUSF), switched access rates have been reduced by approximately six and a half cents per minute.

Long distance carriers are required by SB 560 to pass through savings resulting from switched access rate reductions to residential customers. The PUC has reported that AT&T, WorldCom and Sprint have begun passing through rate reductions from the initial September 1 rate reduction of one cent.

It also has held meetings that allowed stakeholders to discuss their concerns about rate reductions. The PUC will provide this and further information in a report on the status of pass through rate reductions in December, 2000.

SB 560 contains provisions to prohibit excessive switched access rate charges. To address this prohibition, the PUC has adopted a rule which prevents a Certificate of Operating Authority (COA) holder or a Service Provider Certificate of Operating Authority (SPCOA) holder from charging a Certificate of Convenience and Necessity (CCN) holder a switched access rate in excess of the rate charged in the CCN holder's territory.

In addressing the authorization of pricing and packaging flexibility in SB 560, the PUC adopted seven substantive rules. These rules accurately reflect the pricing flexibility provisions contained in the bill. As well, on October 23, 2000, the PUC adopted a pricing flexibility rule for services offered by Chapter 58 electing companies. The rule defines pricing flexibility, establishes pricing standards for the pricing of services and provides guidelines for customer contracts. Before the adoption of the rule, the PUC had interim regulations regarding the notification provisions contained in SB 560. In response to the restructuring of telecommunications service baskets, the PUC has implemented guidelines to determine what services are categorized as Basic and Nonbasic.

SB 560, along with SB 86, prohibits the practices of "slamming" and "cramming" and seeks to simplify telephone bills. In order to curtail the practice of "slamming," the PUC has adopted rules that include stronger verification requirements to ensure that customers have given consent to the switching of their phone service providers. To help eliminate the practice of "cramming," the PUC has adopted rules that include requiring a phone service provider to obtain a customer's consent for any charge on their telephone bill and include a record of verification. Finally, to help ensure that telephone bills would be simplified, the PUC has adopted rules that require telephone companies to consolidate fees and surcharges into the local service charge on a bill. The changes in billing must be implemented in early 2001.

To address the entry of Southwestern Bell (SWB) into the long distance service market, the PUC has established performance measures to monitor and evaluate the effectiveness of the ongoing performance of SWB. SWB has implemented long distance rate plans that are highly competitive with those offered by other long distance providers in the state.

The PUC has implemented the TUSF. The assessment for TUSF now appears on telephone bills. Implementation of the TUSF has reduced switched access rates by approximately three cents per minute. TUSF funds have been allocated to various programs, including the Small and Rural Service Plan and the Texas High Cost Universal Service Plan.

SB 560 requires telecommunications utility companies to file five-year plans to enhance workforce diversity. The PUC has adopted rules as to what these plans must include, such as initiatives that the utility company will pursue to achieve diversity. It has also adopted rules concerning annual reports to be filed by utility companies detailing how their diversity programs are progressing.

The PUC is currently working on three reports required by SB 560. The reports are: the "Report to the 77th Legislature on the Availability of Advanced Services in Rural and High Cost Areas," the "Report to the 77th Legislature on the Scope of Competition in the Telecommunications Market" and the "Report to the 77th Legislature on Intrastate Switched Access Rates." The expected completion date for these reports is December 2000.

COMMITTEE RECOMMENDATION

In addition to studying the implementation of SB 560, the Committee also investigated the effect that state and local sales tax levies have on the fees and surcharges faced by telecommunications companies and customers. The Committee discussed and heard testimony regarding telecommunications fees and surcharges at hearings held on November 1, 1999 and on October 17, 2000.

A customer's telephone bill may include as many as twelve fees or surcharges subject to state and local sales tax. With a myriad of uses and beneficiaries, the revenue derived from these fees may fund either public programs or be returned to private companies as a subsidy. The Committee investigated whether assessing sales tax upon these fees may be considered duplicative based on the eventual use of the fee revenue.

The Committee evaluated the revenue stream of each fee and determined the beneficiary of each revenue source. It concluded that requiring customers to pay sales tax on fees that directly benefit federal, state or local government unnecessarily increases the price of telecommunications service. For example, the Telecommunications Infrastructure Fund (TIF) surcharge is a state fee that is also subject to the sales tax. Revenue from the TIF surcharge is distributed to schools, libraries and not-for-profit hospitals. The assessment is state mandated and has a defined public use. Thus, the Committee recommends that it should not be taxed.

The Committee also determined that certain fees or surcharges may show considerable public benefit, although the revenue generated is returned to private companies as a subsidy rather than being returned to government coffers. For example, revenue derived from the TUSF charge assists local telephone companies in providing service to rural and high-cost areas of the state; local companies receive the monetary benefit, but the general public receives affordable service. In such instances, further taxation of the charge through the sales tax may be counter to the purpose of the charge.

PROPOSED CHANGE

The Committee concludes that further taxation of the TIF, the Public Utilities Gross Receipts Tax, and Municipal Franchise Fees is duplicative. It recommends, therefore, that the amounts charged to consumers for each fee not be subject to sales tax.

The committee recommends that both the TUSF and the Federal Universal Service Fund (FUSF) charges be further studied to determine whether these charges merit exemption from the sales tax.

BACKGROUND

In 1995, the 74th Legislature passed HB 2128 (PURA 95) in order to promote improvements in the speed and functionality of the telecommunications infrastructure in Texas. PURA 95 represented the first telecommunications deregulation legislation in the state. It was designed to create a new, less-intrusive form of regulation for existing local phone companies and to allow competitors to enter the market to offer local phone service. The reforms associated with HB 2128 reflected a legislative goal of encouraging full and open competition in the telecommunications marketplace and reflected a legislative determination that managed competition was the means by which transition to a truly competitive telecommunications marketplace would be achieved.

The dynamic nature of the telecommunications industry, combined with the passage of sweeping telecommunications reform at the federal level, changed the face of telecommunications significantly between 1995 and 1999. In 1999, the 76th Legislature recognized the compelling need to address the changing face of the telecommunications industry and did so through SB 560. The passage of SB 560 presented the first major revisit of telecommunications regulation in the state since the passage of PURA 95. SB 560 extends PURA until September 1, 2005. However, it also includes significant amendments to the Act in light of changes within the industry.

In an attempt to address recent issues surfacing in telecommunications policy, Senator David M. Sibley, the Senate author of the bill, filed SB 560 on February 17, 1999. As the 76th Legislative Session progressed, Committee hearings were held, extensive public testimony was presented, negotiations were continued, and on June 19, 1999, the bill was signed by the Governor. SB 560 became effective on September 1, 1999. Shortly after passage of the bill, the PUC began its work implementing the numerous provisions of SB 560.

SWITCHED ACCESS RATES

SB 560 AND SWITCHED ACCESS RATES

SB 560 addressed three separate topics regarding switched access rates paid by long distance carriers to local phone companies for origination and termination of calls. These areas are:

- switched access rate reductions;
- long distance carrier switched access rate reduction pass through; and
- the prohibition of excessive switched access rates.

Switched Access Rate Reductions

SB 560 required switched access rates, which are paid by long distance carriers to local phone companies for origination and termination of calls, to be lowered by three cents over a one-year period. The three cent reduction took place in two stages. On September 1, 1999, switched access rates were lowered by one cent. On July 1, 2000, access rates were lowered by two cents. The total switched access rate charge in the state is now around six and a half cents per minute when calculated with rate reductions that occurred pursuant to implementation of the TUSF and with the SB 560 rate reductions.

All switched access rate reductions mandated by SB 560 have been implemented.

Long Distance Carrier Switched Access Rate Reduction Pass Through

Long distance carriers with greater than six percent of the total intrastate access minutes are required to pass on a proportionate amount of savings to residential customers, as mandated by SB 560. These flow-through reductions are to be accomplished within six months, following each reduction in switched access rates. The PUC is charged with determining whether the total amount of reductions is being passed through to consumers and whether those reductions have been passed through proportionately pursuant to law.

The PUC has determined that long distance carriers required to demonstrate compliance with the pass through requirements of SB 560 file sworn affidavits with the Commission that include:

- the long distance carrier's intrastate switched access revenue per minute of use (MOU) before the access reductions, less its intrastate switched access revenue per MOU after the access reductions;
- the revenue derived from toll service for residential customers compared with the revenue derived from toll service for all customers (This would indicate a logical proportion of revenue derived from the residential base of customers.); and

- a statement that the long distance carrier has reduced the rates it charges under its basic rate schedules in compliance with SB 560.

AT&T, Sprint and Worldcom long distance carriers have passed savings resulting from the September 1, 1999 one cent access rate reduction and the rate reductions arising from the implementation of the TUSF through to consumers. The PUC reports that they are confident that the companies began passing through rate reductions to residential customers six months after the initial September 1, 1999 switched access rate reduction. There will be an additional report on the status of pass through rate reductions given to the PUC in December, 2000. Exact amounts regarding pass through rate reductions are confidential. However, the three dominant long distance companies in Texas are estimated to have passed through an aggregate amount of $500 million in savings to consumers since the first access rate reduction was implemented in September, 1999[1] (*See Appendix* D).

The table on the following page illustrates the access rate reduction pass through implemented by AT&T, WorldCom and Sprint.[2]

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1 PUC testimony to House State Affairs Committee, May 10, 2000.

2 (1) AT&T Communications Custom Network Service Tariff - Price schedules and AT&T Communications Message Telecommunications Service Tariff - Section 1 (2) MCI Telecommunications Corporation, Texas Pricing Schedule (3) Sprint Intercity Telecommunications Services, Message Telecommunications Services, Texas Price List

Summary of Reductions to Basic Rates[3]

Service Category or Element	Old Rate ($/min.)	New Rate ($/min.)
AT&T (1)		
InterLATA Residential Dial Station Rates		
Day	$0.29	$0.23
Evening	$0.22	$0.17
Night/Weekend	$0.20	$0.15
AT&T Commercial Long Distance		
Day	$0.0865-$0.3400	$0.2195
Evening	$0.0635-$0.2515	$0.2195
Night/Weekend	$0.0520-$0.2100	$0.2195
WorldCom (2)		
Execunet Basic Rate Schedule		
Peak/InterLATA	$0.30	$0.25
Off Peak/InterLATA	$0.25	$0.20
Peak/IntraLATA	$0.25	$0.20
Off-peak/IntraLATA	$0.15	$0.10
Sprint (3)		
Residential SPRINT Service		
Last 5 rate bands (67+ miles)		
Day	$0.27-$0.32	$0.25
Evening	$0.24-$0.30	$0.20
Night/Weekend	$0.24-$0.32	$0.17

Filings to determine whether further pass through rate reductions resulting from the two cent rate reduction have been accomplished are due to the PUC from affected companies on January 1, 2001.

3 Source: PUC June, 2000, Status Report for Project No. 21173.

Prohibition of Excessive Access Rate Charges

The PUC adopted a rule addressing excessive switched access rates assessed by a COA holder or a SPCOA holder on June 7, 2000. According to the rule, the COA/SPCOA holder may not charge a CCN holder a switched access rate in excess of the rate charged in the CCN holder's territory. This rule applies to originating and terminating intrastate switched access calls.

There are two conditions which allow for the switched access rate to be higher than it is in the CCN holder's territory. The two conditions are: 1) if the PUC approves the higher rate after a proceeding; or 2) when the COA/SPCOA establishes an average statewide originating and terminating access rate based on the rates of all CCN holders in the state as calculated by the PUC. The second condition is a result of review by the PUC.

The PUC will establish weighted statewide average composite rates based on statewide CCN holders' rates and minutes of use. These rates will be recalculated every two years. CCN holders may also request a recalculation of these rates.[4]

DECREASE IN SWITCHED ACCESS RATES PURSUANT TO THE TEXAS UNIVERSAL SERVICE FUND

Long distance carriers pay switched access rates to local telephone companies for the use of local lines and equipment needed to connect long distance calls. In the past, local phone companies have used money collected from these fees to keep local phone rates artificially low, thus providing "universal service," or service available at all income levels and in rural locations throughout the state.

These switched access rates were decreased during the same time period that SB 560 was being implemented, although independent of the bill's requirements. To maintain a subsidy for "universal service," payments from the TUSF are used by local telephone companies in place of money collected from switched access rates. The payments from the TUSF provided a dollar for dollar offset to the decrease in switched access revenue.

ACCESS RATES AT THE FEDERAL LEVEL

Federal switched access rates for large telecommunications companies are still significantly lower than switched access rates in Texas. The federal rate is one cent per call for origination and termination while the rate in Texas is around six and a half cents per call.

At the beginning of June, 2000, the Federal Communications Commission (FCC) decreased federal switched access rates, while increasing the Federal Subscriber Line Charge (SLC). The change was

[4] PUC Rule §26.223, sections a-e.

implemented in July, 2000. While long distance companies have promised to pass on the rate reductions to consumers, the FCC has no mechanism in place to verify that this occurs.

PUC Switched Access Report

The PUC will elaborate on switched access rate reform in their “Report to the 77th Legislature on Switched Access Rates.” This report is mandated by SB 560 and will be completed at the end of 2000. The report will study:

- whether alternative rate structures for recovery of switched access revenues are in the public interest and competitively neutral; and
- whether disparities in intrastate switched access rates between local exchange companies are in the public interest.

PUC Projects Implementing Switched Access Rate Provisions of SB 560

Project Number	**Description**	**Date Approved**
Project #21174	Addressing COA/SPCOA switched access rates, PURA 52.155.	06/00
Project #21172	Declaratory order addressing interexchange carriers access charge reduction pass through filings.	09/99
Project #21173	Compliance project addressing interexchange carriers access charge reduction pass through filings.	10/00
Project #21183	Compliance project addressing interexchange carriers access charge reduction pass through filings.	04/00
Project #21184	SWB notice of intent to file amended tariff sheets to implement reductions in its switched access service tariff in compliance with SB 560.	09/99
Project #22302	Application of SWB for approval of switched access service rate reduction pursuant to PURA 58.301 (2).	07/00
Project #21158	Compliance project to implement switched access service rate reductions, PURA 58.301.	Project not used

PRICING AND PACKAGING FLEXIBILITY

SB 560 authorizes electing companies under Chapters 52, 58 and 59 of PURA to exercise pricing and packaging flexibility. In general, they may do so ten days after providing an informational notice to the PUC, to any person who holds a COA in the electing company's certificated area or to any person who has an effective interconnection agreement with the electing company. The packaging flexibility that is authorized by SB 560 includes the packaging of regulated services with non-regulated services, or services of an affiliate. The additional flexibility granted by SB 560 has been utilized widely by many telecommunications utilities across Texas.

PROMOTIONAL OFFERINGS

SB 560 allows electing companies to offer a promotion for regulated services for up to 90 days in any 12-month period. According to the statute, companies do not have to obtain PUC permission to launch these promotions, but they must inform the Commission about the details of their packages. Companies may offer a promotion for the combination of regulated and unregulated services.

Customer promotional offerings may consist of a waiver of installation charges, service order charges or both, for not more than 90 days in a 12-month period; or a temporary discount of not more than 25 percent from the tariffed rate for not more than 60 days in a 12-month period.

BASIC AND NONBASIC SERVICES

Another form of flexibility that SB 560 offers Chapter 58 electing companies is the restructuring of service baskets. Prior to enactment of SB 560 there were three service baskets: basic network services, discretionary services and competitive services. Services are now divided into two baskets: basic and nonbasic services. The PUC has promulgated rules which categorize services as basic or nonbasic.

Basic Services

1. Flat rate residential local exchange telephone service, including primary directory listings, the receipt of a directory and any applicable mileage or zone charges.
2. Lifeline and tel-assistance service.
3. Residential tone dialing service.
4. Service connection for basic residential services.
5. Direct inward dialing service for basic residential services.
6. Private pay telephone access service.
7. Call trap and trace service.
8. Access for all residential and business end users to 911 service provided by a local authority and access to dual party relay service.
9. Mandatory residential extended area service agreements.

10. Mandatory residential extended metropolitan service or other mandatory residential toll-free calling arrangements.
11. Residential call waiting service.[5]

Nonbasic Services

1. Flat rate business local exchange telephone service, including primary directory listings, the receipt of a directory, and any applicable mileage or zone.
2. Business tone dialing service.
3. Service connection for all business services.
4. Direct inward dialing for basic business services.
5. Public pay telephone services, 0+ and 0- operator services and directory assistance services.
6. Call forwarding, call return, caller identification, call waiting and other custom calling services and call control options, except that residential call waiting is a basic network service.
7. Speed dialing and three-way calling.
8. Central office-based PBX-type services.
9. Billing and collection services, including installment billing and late payment plans for electing company customers.
10. Integrated services digital network (ISDN).
11. New services.
12. 1-plus intraLATA message toll services (MTS).
13. Services described in the WATS tariff of an electing company as the tariff existed on January 1, 1995.
14. 800 service and foreign exchange service.
15. Private line services and mobile services (IMTS).
16. Paging services and mobile services, if the service is available.
17. 911 service provided to a local authority if the service is available from a provider other than an electing company.
18. All other services subject to the Commission's jurisdiction that are not specifically classified as basic services.
19. Any basic network service reclassified by the Commission as a nonbasic service.[6]

PUC IMPLEMENTATION

The PUC, at the September 7, 2000 open meeting, adopted seven rules pertaining to pricing flexibility. These rules reflect the pricing flexibility provisions contained in the bill (See *Appendix A).* As well, on October 23, 2000, the PUC adopted a pricing flexibility rule for services offered by

[5] PUC Rule § 26.224c(1)(a-k).

[6] PUC Rule § 26.225c(1)(a-s).

Chapter 58 electing companies.[7] The rule defines pricing flexibility, establishes pricing standards for the pricing of services and provides guidelines for customer contracts. Before the adoption of the rule, the PUC had interim regulations regarding the notification provisions contained in SB 560.

During the interim processes, more than 200 applications were filed by electing companies for packaging and pricing flexibility. Out of that number, only five have been protested by competitors who believe the proposed practices in the applications are anti-competitive or have some infirmity with price offerings. Beyond the Chapter 58 electing companies, twenty other companies have filed applications to offer promotions (See *Appendix E*).

PUC Projects Implementing Pricing and Packaging Flexibility Provisions of SB 560

Project Number	**Description**	**Date Approved**
Project #21156	Requirements applicable to basic network services for Chapter 58 electing companies.	09/00
Project #21157	Requirements applicable to nonbasic network services for Chapter 58 electing companies.	09/00
Project #21155	Requirements applicable to pricing flexibility for Chapter 58 electing companies.	09/00
Project #21161	Procedures applicable to nonbasic services and pricing flexibility for basic and nonbasic services for Chapter 59 electing companies.	09/00
Project #21156	Procedures applicable to Chapter 58 electing incumbent local exchange companies and telecommunications pricing.	09/00
Project #21159	LRIC methodology for services provided by certain ILECs.	09/00
Project #21159	Requirements applicable to Chapter 52 companies.	09/00
Project #21159	Requirements applicable to Chapter 59 electing companies.	09/00

[7] Chapter 58 electing companies refers to those local exchange companies who have elected to be under the incentive regulation provisions of PURA found in Chapter 58.

CONSUMER PROTECTIONS

SB 560 and SB 86 created several new consumer protections in telecommunications. Among these are provisions to eliminate "slamming" and "cramming" complaints, efforts to simplify telephone bills and new service rules that will make it easier for customers to communicate with their own telephone companies.

PROVISIONS TO ELIMINATE "SLAMMING"

"Slamming" is the unauthorized switching of a customer's long distance phone service. During its most recent fiscal year, the PUC dealt with about 4,000 slamming complaints.[8]

On June 14, 2000, the PUC adopted new rules concerning "slamming," which afford customers more protection and recourse if the action occurs. Provisions in the new rule include:

- refunds to telephone customers of any charges paid during the first 30 days after a slam, plus any amount greater than what would have to be paid to the original phone company after the first 30 days;
- stronger verification requirements to ensure that customers consent to the switching of their phone service providers; and
- requirements that phone companies provide "freeze" information to customers on how to keep from being slammed, including a customer notice, along with a prohibition on charges to impose or lift a freeze (a freeze prevents a change in a customer's long distance provider unless the customer gives consent to the customer's local phone company).[9]

PROVISIONS TO ELIMINATE "CRAMMING"

"Cramming" occurs when unauthorized charges are placed on a customer's bill without their knowledge or consent.

The rules to prevent cramming, which became effective in November, 1999, specify four basic requirements that must be met before a phone service provider can charge for any product or service on a customer's phone bill. The requirements are:

- the company must inform the customer about the product and all associated charges;
- the company must obtain the customer's consent for any charge and include a record of verification;
- the company must provide contact information and customer access to a toll-free informational line; and

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[8] *Dallas Morning News*, June 14, 2000.

[9] PUC press statement released on June 14, 2000.

- the company must get consent from the billing telephone company to bill for new charges.[10]

The rules require companies to make a refund or give credit to customers who have paid unauthorized charges. Violations of the cramming rules result in administrative penalties of up to $5,000 per day.

All telecommunication providers were mandated by the PUC to provide a cramming bill of rights to customers either by mailing a notice by January 17, 2000, or by publishing a notice in the utility's phone directory after January 17, 2000.

TELEPHONE BILL SIMPLIFICATION

On July 12, 2000, the PUC adopted new rules pertaining to telephone bill simplification. SB 560 notes that a proliferation of charges on telephone bills has increased in complexity to such an extent that, in some cases, bills have become difficult to comprehend. SB 560 mandates that charges be separated into three categories to make them easier for customers to read: basic services and charges, optional services and taxes.

To further reduce the complexity of telephone bills, the PUC held a number of meetings with focus groups where consumers were asked to determine their preferred telephone bill format.[11]

As a result, the PUC adopted rules that require telephone companies to consolidate fees and surcharges into the local service charge, which appears on every phone bill. Phone companies also have to detail the different components of the total local service charge in footnotes to the bill or on a separate page. The companies do not have to disclose the individual price for each fee or surcharge. They must, however, provide a toll-free number on the bill, which customers can call to receive more information about fees and surcharges. The local service charge includes the 911 service fee, the Texas Poison Control surcharge and the TUSF fee. Most changes must be implemented by January 1, 2001.

[10] PUC press statement, accessed on July 27, 2000.

[11] PUC testimony to House State Affairs Committee on May 10, 2000.

PUC Projects Implementing Consumer Protection Provisions of SB 560

Project Number	**Description**	**Date Approved**
Project #20787	Payphone compliance.	03/00
Project #21006	Protection against unauthorized billing charges.	10/99
Project #21030	Limitations on local telephone service disconnections.	12/99
Project #21419	Customer's right to choose.	06/00
Project #21420	Administrative penalties.	02/00
Project #21422	Automatic dial announcing devices.	01/00
Project #21424	Prepaid calling card disclosures.	07/00
Project #21456	Certification, registration, and reporting.	06/00
Project #22130	Rulemaking to implement PURA Sect. 55.012 regarding telecommunications bill format.	07/00

SOUTHWESTERN BELL ENTRY INTO INTRASTATE LONG DISTANCE COMPETITION

SB 560 was drafted with the knowledge that SWB and its parent company, SBC Communications, would apply to the FCC to enter the long distance market. According to Section 271 of the Federal Telecommunications Act of 1996, a regional bell operating company (RBOC) may enter into the long distance market once it is deemed that there is irreversible competition in the RBOC's regional service area.

In early 2000, SWB applied for such entry with the FCC. The PUC sent a statement to the FCC on February 21, 2000 in support of the company's entry into the long distance market.

Due to concerns communicated to the FCC by the Justice Department, SWB withdrew in April, and then subsequently resubmitted, its application to the FCC. On May 11, 2000, the Justice Department revised its statement to the FCC, stating that SWB had made progress in opening up its market to competitors.

SWB was given FCC approval to enter the long distance market on June 30, 2000. The PUC has implemented rules relating to the company's entry into that market. It has established a set of requirements and performance benchmarks, called "performance measures," to monitor and evaluate the effectiveness of the ongoing performance of SWB.[12]

Every six months, the PUC will review the measures agreed to by SWB and its competitors. SWB has agreed to pay penalties if it does not meet the measures. Since the beginning of 2000, the monthly amount paid by SWB has dropped from $472,600 to $102,000.

SWB LONG DISTANCE RATE PLANS OFFERED

Advertising and marketing for SWB long distance service began July 9, 2000. Since then, SWB has implemented long distance rate plans that are highly competitive with those offered by other long distance providers in the state. The plans offer no monthly fees, same rates for in-state calls as state-to-state calls and one rate 24 hours a day, seven days a week. SWB offers six calling-plan packages to residential customers for long distance service, four plans to small business customers and four additional plans to medium to large business customers.

MARKET EFFECTS OF SWB'S ENTRY INTO THE LONG DISTANCE MARKET

Shortly after launching their advertising campaign in July, SWB informed the PUC that about one million customers had changed their service to a SWB long distance calling plan. Because of SWB's relatively recent entry into the long distance market, it will be difficult to gauge their effect on

[12] Public Utility Commission of Texas--press statement released on July 12, 2000.

overall market conditions. The PUC will gather data about long distance rate plan competitiveness, the turnover status of customers from other companies to SWB and other effects on the telecommunications market in Texas.

TEXAS UNIVERSAL SERVICE FUND

The TUSF was created to maintain affordable rural telephone rates and services for low income and disabled customers. It supports programs including the High Cost Fund, Tel-Assistance Service, Lifeline Assistance, Linkup Texas, Telecommunications Relay Service and the Specialized Telecommunications Device Assistance Program. Details about these programs are provided below.

Ninety percent of TUSF funding is spent on programs to create and maintain rural phone service. Less than six percent is spent on low income and disabled customer programs and the remaining amount is spent on administrative costs.[13]

Subsidization of these programs was initially paid for by long distance carriers and passed through to consumers. This "implicit subsidy" ended in 1999. At that time, access rates were reduced and a TUSF charge to offset the reduction began appearing on customers' phone bills.

The first part of the fund was implemented in January, 1999 and led to a 0.787 percent assessment on telephone bills. In August, 1999, the PUC implemented the second part of the assessment. The current TUSF charge on telephone bills is 3.96 percent but will be reduced to 3.6 percent effective January 1, 2001. The PUC did not implement the TUSF until these charges could be offset by access rate reductions implemented in 1999 and 2000 (*See Appendix F*).

Below is a list of programs to which TUSF funds are allocated and the amount of funds allocated to each program.

- The Texas High Cost Universal Service Plan, which provides affordable telephone service in high cost rural areas served by large phone companies: **$405 million/73%**.
- The Small and Rural Service Plan, which helps small and rural phone companies provide affordable telephone service to customers who live in high cost rural areas: **$90.3 million/16.4%**.
- The Telecommunications Relay Service, which allows deaf customers and those with speech or hearing disabilities to communicate using specialized devices and operator translations: **$11.4 million/2.1%**.
- The Lifeline Link Up, which reduces monthly local phone rates by $10.50 for eligible low-income customers and/or reduces phone installation charges for eligible low-income customers: **$9 million/1.6%**.
- Tel-Assistance lowers monthly phone rates by 65 percent for disabled, low-income customers: **$6.45 million/1.2%**.
- The Specialized Telecommunications Assistance Program, which reduces the cost of telephone equipment for customers who are deaf or hard of hearing: **$2.25 million/.41%**.

[13] "The Texas Universal Service Fund," PUC informational sheet.

1.58 million dollars (.28 %) of the fund are used to pay administration costs.

SMALL PHONE COMPANIES RECEIVE REIMBURSEMENT FROM TUSF

SB 560 includes provisions to allow small local exchange companies to be reimbursed from the TUSF if they extended high capacity (T-1) infrastructure to schools, libraries and hospitals. According to SB 560, contracts that were in place on January 1, 1998 may receive TUSF reimbursement. That rule has been implemented by the PUC, and it has received several requests for funding from small carriers under that program.[14]

PUC Projects Implementing Texas Universal Service Fund Provisions of SB 560

Project Number	Description	Date Approved
Project #21162	Project to establish procedures for providing USF support for schools pursuant to PURA 56.028.	09/99
Project #21163	Rulemaking to amend TUSF rules to comply with SB 560.	04/00

[14] PUC testimony before the House State Affairs Committee, May 10, 2000.

WORKFORCE DIVERSITY PLANS

SB 560 mandates that both electric and telecommunications utility companies file five-year plans to enhance workforce diversity. These companies must file annual reports no later than January 1, 2000. The reports must include comprehensive plans to enhance the diversity of their workforce in all occupational categories and to increase their small and historically underutilized businesses contracting.

According to PUC implementation, the plan must include:

- performance with regard to workforce diversity and contracting;
- initiatives that the utility company will pursue in these areas over the next five years;
- programs and activities that the utility company will undertake to achieve these initiatives; and
- a listing of business partnerships that the utility company will form to facilitate improvement in these areas.

Several considerations were reviewed at a PUC meeting held on May 4, 2000, including: whether an exemption is appropriate for utility companies that have fewer than a certain number of employees, utility companies that do not do any contracting in Texas, resellers only, utility companies whose workforce already is comprised of a certain percentage of minorities or utilities that were not formed before January 1, 2000.

The following rules governing the contents of the annual Workforce Diversity Reports were implemented by the PUC to comply with the new mandates set out by SB 560.

The reports must contain:

- an illustration of the diversity of the telecommunications utility company's workforce in Texas at the time of the report (if the telecommunications utility company is required to file an Equal Opportunity Report, a copy of that document may be attached to this report to satisfy this requirement);
- the specific initiatives, programs and activities undertaken to achieve diversity initiatives during the preceding year and an assessment of the success of those programs and activities;
- an explanation of how often the utility company contracts with small and historically underutilized businesses in the state;
- the extent to which the telecommunications utility company has carried out its initiatives to facilitate opportunities for contracts or joint ventures with small and historically underutilized businesses; and
- a description of the programs and activities the telecommunications utility company will pursue during the next year to increase the diversity of its workforce and contracting opportunities for small and historically underutilized businesses in Texas.

Affected companies filed their workforce diversity plans with the PUC on January 1, 2000 and are required to file annual reports before December 30 of each year hereafter (*See Appendix C*).

PUC Projects Implementing the Workforce Diversity Provisions of SB 560

Project Number	**Description**	**Date Approved**
Project #21170	Compliance proceeding for utilities' 5 year plan to enhance workforce diversity.	01/00
Project #22166	Project to establish procedures for utilities' annual report of workforce diversity.	06/00

TELECOMMUNICATIONS TAXES AND SURCHARGES

At the November, 1999 Senate Committee on Economic Development hearing, the Committee inquired as to the purpose of the fees and surcharges on telecommunications bills. A comprehensive explanation of fees and surcharges found on telecommunications bills is located in *Appendix B.*

The following telecommunications services are subject to sales tax.[15]

State and Local Sales Tax

- Basic local exchange service
- Installation and service connection fees
- Intrastate long distance phone calls
- Call waiting
- Call forwarding
- Other enhanced services
- Intrastate telegraphy services
- Paging services
- Coin-operated telephone service
- Mobile telephone service
- Facsimile (FAX) service
- Equipment which is sold or rented to the customer

State Sales Tax Only

- Interstate long distance phone calls
- Interstate telegraph service

Services and Charges Not Taxable

- Telecommunications services purchased for resale
- Calls that originate outside Texas
- Telegraph service that originates outside Texas

In addition to studying the implementation of SB 560, the Committee also investigated the effect that state and local sales tax levies have on the fees and surcharges faced by telecommunications companies and customers. The Committee discussed and heard testimony regarding telecommunications fees and surcharges at hearings held on November 1, 1999 and on October 17, 2000.

A customer's telephone bill may include as many as twelve fees or surcharges subject to state and local sales tax. With a myriad of uses and beneficiaries, the revenue derived from these fees may fund either public programs or be returned to private companies as a subsidy. The Committee

[15] Texas Comptroller of Public Accounts, "Sales Tax on Telecommunications Services" Accessed May 23, 2000.

investigated whether assessing sales tax upon these fees may be considered duplicative based on the eventual use of the fee revenue.

The Committee evaluated the revenue stream of each fee and determined the beneficiary of each revenue source. It concluded that requiring customers to pay sales tax on fees that directly benefit federal, state or local government unnecessarily increases the price of telecommunications service. For example, the Telecommunications Infrastructure Fund (TIF) surcharge is a state fee that is also subject to the sales tax. Revenue from the TIF surcharge is distributed to schools, libraries and not-for-profit hospitals. The assessment is state mandated and has a defined public use. Thus, the Committee recommends that it should not be taxed.

The Committee also determined that certain fees or surcharges may show considerable public benefit, although the revenue generated is returned to private companies as a subsidy rather than being returned to government coffers. For example, revenue derived from the TUSF charge assists local telephone companies in providing service to rural and high-cost areas of the state; local companies receive the monetary benefit, but the general public receives affordable service. In such instances, further taxation of the charge through the sales tax may be counter to the purpose of the charge.

PROPOSED CHANGE

The Committee concludes that further taxation of the TIF, the Public Utilities Gross Receipts Tax, and Municipal Franchise Fees is duplicative. It recommends, therefore, that the amounts charged to consumers for each fee not be subject to sales tax.

The committee recommends that both the TUSF and the Federal Universal Service Fund (FUSF) charges be further studied to determine whether these charges merit exemption from the sales tax.

REPORTS TO THE 77TH LEGISLATURE

SB 560 requires that three reports concerning various telecommunications issues in the state be delivered to the 77th Legislature in 2001. The reports are: the "Report to the 77th Legislature on the Availability of Advanced Services in Rural and High Cost Areas," the "Report to the 77th Legislature on the Scope of Competition in the Telecommunications Market" and the "Report to the 77th Legislature on Intrastate Switched Access Rates." These reports will contain valuable discussions regarding some of the topics addressed by SB 560, as well as the current scope of competition in the Texas telecommunications industry.

Report to the 77th Legislature on the Availability of Advanced Services in Rural and High Cost Areas

This report discusses the availability of advanced telecommunications and information services throughout the state, with a special focus on the availability and pricing of such services in rural areas. The report is expected to be completed by year-end, 2000.

The issue of advanced services in rural areas has been discussed widely in Texas during the interim period. On June 13, 2000, members of the Select Committee on Rural Development devoted a meeting to the topic of providing these services to rural areas in the state. From this meeting, it became apparent that several agencies are reviewing the topic at the same time.

The Comptroller's Office is currently drafting a report titled, "Rural Texas in Transition," slated to be released in November. The draft highlights the fact that rural Texas is far behind urban Texas in growth, and far ahead in unemployment. Rural areas in Texas still depend predominantly on oil and gas and agriculture for income. Members of the Committee expressed interest in finding ways that advanced telecommunications could change the outlook and economy of rural Texas.

A Powerpoint demonstration was presented to the Committee on Rural Development by the PUC, which highlighted the challenge of "last mile" advanced telecommunications capability. Fiber optic infrastructure is available in rural communities for advanced services. However, connecting this fiber optic cable to homes and businesses (or linking the last mile) is a significant problem in rural communities and sometimes prohibitively expensive to companies. Additionally, the Committee heard testimony that there are several options available when connecting rural areas to advanced services. These include: cable modem, digital subscriber line, wireless services and satellite services.

Report to the 77th Legislature on the Scope of Competition in the Telecommunications Market

The purpose of this report is to evaluate the development of the competitive market place for telecommunications in Texas. The key issue to analyze during 2000 is the nature and extent of competition in the local service market. The report will be completed by the PUC in December, 2000.

The PUC gave its indication that telecommunications markets are competitive in the state by supporting SWB's bid to enter the long distance market in 1999. In December, 1999, the PUC gave unanimous support to SWB when the Commission formally declared that the local telephone market in Texas was open to competition.

On July 12, 2000, the PUC adopted and established requirements and performance benchmarks, called "performance measures," to monitor and evaluate the effectiveness of SWB's ongoing performance. Every six months, the PUC will review the performance measures agreed to by SWB and its competitors. SWB is required to pay penalties if it does not meet the measures. In January, 2000, SWB paid $472,600 to the Texas Comptroller. In May, 2000, the company paid $102,000.[16]

Report to the 77th Legislature on Intrastate Switched Access Rates

This report examines: 1) whether alternative rate structures for recovery of switched access revenues are in the public interest and are competitively neutral, and 2) whether disparities in intrastate switched access rates between local exchange companies are in the public interest. The report is slated to be completed by the end of 2000.

On June 29, 2000, the PUC reported that on two occasions, once in May and once in June, stakeholders interested in the access rate debate were invited to meetings in order to work out their differences. These stakeholders included representatives from major local exchange carriers, SBC, interexchange carriers (including AT&T, Sprint and Worldcom) and consumer groups. A consensus was not reached at these meetings on any future access rate reform.

[16] PUC press statement released on July 12, 2000.