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F I S C A L I M P A C T R E P O R T

SPONSOR HCPAC **DATE TYPED** 3/5/05 **HB** 256/HCPACS/aHTRC/aHFI#1

SHORT TITLE Terminate Rural Extension Funds **SB**

ANALYST Rosen

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	FY06			
	($1,000.0)	($1,000.0)	Recurring	See Narrative

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates SB470/SCONCS/aSCORC

Conflicts with Public Regulation Commission orders in Case Nos. 03-00190 and 03-00213

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public Regulation Commission (PRC)
Economic Development Department (EDD)
Qwest Corporation (Qwest)
Sacred Wind Communications (Sacred Wind)

FOR THE ECONOMIC AND RURAL DEVELOPMENT AND TELECOMMUNICATIONS COMMITTEE

SUMMARY

Synopsis of HFI#1 Amendment

House Floor Amendment #1 to House Consumer and Public Affairs Committee substitute for House Bill 256, as amended, reduces Qwest annual obligation to one half of the original and terminates that obligation on December 31, 2008 or when Qwest and PRC agree to terminate the obligation.

Synopsis of HTRC Amendment

The House Taxation and Revenue Committee amendment adds language that one-half of the obligation of a telecommunication company accruing additional money to a rural extension fund will terminate on July 1, 2005, and the remaining obligation on July 1, 2010.

Synopsis of Original Bill

House Consumer and Public Affairs Committee substitute for House Bill 256 terminates Qwest's obligation to pay into the Rural Extension Fund (REF) for the extension of lines or facilities to serve customers in rural or other low-density service areas, mandates that any unspent balance in the fund as of July 1, 2005 be applied to extend local exchange service to qualifying rural customers as described in the company's PRC-approved tariff, and then if any unspent balance remains the PRC may establish a plan directing how that unspent balance shall be applied to the installation of telecommunications infrastructure for basic exchange service, digital subscriber lines or other advanced services in the company's certificated service area or in the company's certificated service area transferred to a successor company established to serve tribal lands in the state. Residential or commercial real estate developers shall not benefit directly from telecommunications projects funded pursuant to this bill. Nothing in the bill shall remove a telecommunication company's requirement to comply with a PRC-approved tariff.

Significant Issues

The REF exists only because of a federal tax change in 1986 that resulted in a revenue windfall to most telecommunications carriers and utilities in the state. Qwest was forced to make some form of adjustment to its rates as a result of its "over earnings." Qwest (then Mountain Bell) proposed PRC (then the State Corporation Commission) allow Qwest, in lieu of a consumer rate reduction, to instead set aside $2 million each year in a liability account to provide financial assistance to new rural customers who would otherwise have to pay for a line extension. PRC approved this solution instead of a rate decrease. Qwest indicates it agreed to this solution and also reduced its rates.

PRC, in Case Nos. 03-00190 and 03-00213, last year ordered Qwest increase the amount of REF support per customer from $5,000 to $15,000 and, in answer to Qwest's request that it be allowed to terminate the REF, endorsed a staff/Qwest stipulation that stated the stipulating parties "will attempt to address any outstanding REF issues in the next Alternative Form of Regulation (AFOR) negotiations." Qwest indicates it filed its latest AFOR proposal in December, 2004, and PRC indicates the next AFOR negotiations are to begin later in 2005.

Qwest maintains that the REF is not a requirement of its AFOR and that its investment and service-quality obligations will not be diminished in any respect if the REF is terminated. Qwest also believes the current AFOR does not allow for rate reductions and maintains that rates for residential customers are significantly less now than they were at the time the REF was established.

Qwest's current AFOR expires in April 2006 and states, in part:

> "Nothing in this Plan shall affect Qwest's commitments to or administration of the Rural Extension Fund… absent future Commission Order modifying the Rural Extension Fund."

PRC notes two significant issues with this bill:

1) This substitute bill allows Qwest to stop setting aside $2 million dollars each year and keep the money instead. This is directly contrary to PRC's 2004 order that any change to the REF be negotiated as part of the next AFOR, when revenue reductions and or customer refunds can be considered together.

Qwest reports it has not given up its right to seek elimination of the REF through legislation and has previously notified PRC of its intention to pursue legislative relief from this obligation.

2) This substitute bill will allow surplus REF balances to be transferred from Qwest to a successor company on tribal lands. The "successor" language may have competitive ramifications. In the largest tribal area served by Qwest, the Navajo Nation, PRC has just approved the certificate for a competitive local exchange carrier (CLEC), who would not have access to these funds since it did not buy lines from Qwest, but instead plans to serve customers by constructing a new wireless network. This substitute bill may have the effect of favoring one technology over another and may give any successor company to Qwest a financial advantage over other competitive local exchange carriers entering tribal areas.

Qwest notes this CLEC is the same carrier presently engaged in negotiations with Qwest regarding the sale of wirelines on tribal lands and that the wireless application would be an adjunct, not a competitive offering, owned by the same organization.

Sacred Wind indicates it is in the process of acquiring all of Qwest's "last mile" facilities on and proximate to the Navajo reservation, and the acquisition includes assumption of some of Qwest's liabilities, particularly more than 400 held orders for Navajo households. Sacred Wind reports these held orders are to be resolved using REF monies. Sacred Wind indicates that a critical part of its acquisition agreement with Qwest is that a corresponding portion of these REF monies will be transferred to Sacred Wind for resolution of its newly acquired held orders.

According to Sacred Wind, Qwest maintains that PRC cannot dictate the use of this money by any other carrier without its expressed approval. Sacred Wind believes the "successor" language in this bill (line 8, page 2) will allow PRC to approve the transfer of a *specific amount* of these Rural Extension Funds to Sacred Wind, pursuant to the contract that will exist between Qwest and Sacred Wind. Sacred Wind reports that any deviation from this may jeopardize the agreement it has with Qwest.

PRC reports it will have to certificate any successor company and approve the transfer of the certificated services area from one company to the other before any successor company would be eligible to use these Rural Extension Funds.

In an updated analysis of this bill, PRC provided the following:

> In Case Nos. 03-00190-UT and 03-00213-UT PRC opened an inquiry into the REF to address several questions, including the following: whether Qwest's ratepayers, in the future, can better use the approximately $12.6 million in the Fund (as of 2003); whether the Fund should be terminated and, if so, the impact on customers; what revisions to Qwest's tariff would be in the public interest; and any other issues relevant to whether the Fund should continue to exist and, if so, under what conditions. After considering public

comment from interested parties, expert testimony, transcripts and briefs from 7 parties, PRC concluded that: (1) the REF Should Not Be Terminated Now (pp 14 – 16 of Final Order in the consolidated cases dated Feb. 14, 2004) ; (2) PRC Has Authority, Without Qwest's Concurrence, to Spend the Accrued Balance of the REF under an Expanded Tariff (pp. 17-22 of the Final Order); and (3) the REF Can Be Better Used (pp. 22 and 23 of the Final Order).

Underlying PRC's decision to "better use" the REF was Qwest's proposal in this case to use $7.5 million to provide plain old telephone service ("POTS") to 553 potential customers through the use of "cluster projects". However, the existing tariff limited the REF assistance to $5,000 per customer for distribution. In response to Qwest's request to expand the program and tariff to include the customers in the "cluster project", PRC expanded the amount of REF assistance to $15,000 per residential customer and to include feeder as well as distribution. That compliance tariff was filed in August 2004. Although PRC did not require Qwest to carry out its proposed cluster projects, PRC expected that "under the modified tariff, Qwest will provide basic telephone service to the estimated 553 customers in Qwest's service territory without service, for which the average estimated per customer cost to provide phone service is $14,000, including feeder costs." (Final Order p. 23) Qwest has testified that there is approximately $15 million in the REF currently (as opposed to $12.6 million in the Fund as of June 13, 2003); <u>since the Fund balance has increased, it would be safe to assume that little or none of the $7.5 million that Qwest committed to spend on the cluster project has been expended.</u>

There are several reasons why PRC chose not to terminate the REF at this time in Cases 03-00190-UT and 03-00213-UT:

(1) Absent definitive evidence that the REF was excluded from consideration of the rates, terms and conditions set out in Qwest's AFOR, and in light of the significant revenue increase that would result to Qwest from termination of the Fund, "the REF cannot be terminated, for any of the reasons advanced by Qwest without reexamining the AFOR itself.", PRC concluded that the REF should continue until further order of PRC and may be addressed as part of the continuation or replacement of the current AFOR. (Final Order, p.16) It was this language in the Order that prompted the later stipulation between PRC staff and Qwest to address outstanding REF issues in the negotiations for the next AFOR; the stipulation was adopted by PRC in an Order dated 8/17/04. While Qwest indicates that "Qwest did not give up its right to seek elimination of the fund through legislation", PRC staff does not recall that type of reservation in its discussion with Qwest about the stipulation. Further, PRC staff and Qwest have not met on the new AFOR since Qwest filed its proposal, pursuant to PRC Order, on December 1, 2004; perhaps the "attempt" by Qwest to get a commitment from Staff to eliminate the requirement to accrue Rural Extension Funds would be more appropriate in the context of discussing all of the various factors that will be considered in the AFOR.

(2) In addition to the $7.5 million that PRC expects Qwest to spend on its cluster project, PRC would like to see if Qwest's utilization of the new provisions of the REF tariff would make the Fund more effective in providing POTS to Qwest's rural customers. Assuming aggressive information dissemination and aggregation of customer requests by Qwest, it is hoped that the period remaining from August 2004 (the effective date

of the new tariff) through March 2006 (the termination of the current AFOR) will provide PRC with sufficient time and information to assess the impact of the new tariff provision and the need for continuing the Fund.

In concluding that PRC has authority, without Qwest's concurrence, to spend the accrued balance of the REF under an expanded tariff, PRC made it clear that the "REF is not a Qwest asset", "the final 87-21-TC Order which created the REF was not a contract between PRC and Qwest, and it did not create a right of Qwest to the REF funds," and "Qwest is not entitled to keep the accrued REF funds simply because it has not spent them." (Final Order, p. 21) For that reason, Subsection B of the bill does not give PRC any additional authority to direct how REF balances may be spent than it has already. The REF is not Qwest's money, and it is irrelevant as to whether Qwest maintains "that the PRC cannot dictate the use of this money by any other carrier without its expressed approval."

The bill specifically includes digital subscriber lines or other advanced services as an item that the Commission **may** include in its plan for the unspent balance. In the Qwest REF proceeding, PRC recognized that the public comments demonstrated a great demand in New Mexico for advanced services such as DSL; Qwest also proposed to use nearly $2 million to provide advanced services, such as DSL. However, PRC concluded that the REF should continue to be used only to provide POTS to rural customers, because it was their observation that hundreds of persons within Qwest's service territory still lack POTS, and that providing service to those persons is the most appropriate use of the Rural Extension Fund. (Final Order, p. 22) PRC noted that Qwest committed to deploy advanced services as part of the AFOR and encouraged Qwest to move ahead with that commitment." (Final Order, p. 23)

There were approximately 175 potential customers for which Qwest estimated an average per customer cost of $46,000 to provide service. Although PRC acknowledged that the $15,000 per customer would not cover the full cost of providing POTS to these customers, it encouraged "Qwest to make every effort to serve such customers, perhaps through use of new technologies such as Qwest's Wireless Solution to provide service to the Navajo Nation." (Final Order, p. 23) The inference from PRC's statement is that the "wireless solution" would be a less expensive way of providing POTS; the logical conclusion is that Qwest, through the use of wireless technology and $15,000 from the REF could provide service to these very high cost customers.

As stated above, it is PRC's opinion that it currently has the authority, without Section B of this bill, to determine how the remaining REF balance may be spent. It is also the PRC's opinion that the it has existing authority to place whatever conditions it deems "in the public interest" in considering whether to approve the abandonment of Qwest's certificated area and transfer/sale to a "successor company"; those conditions may include transfer of moneys from the REF, along with currently held orders for primary service, so long as the result is the provision of POTS in rural areas of Qwest territory, or former Qwest territory. Pursuant to current PRC authority, the "successor company" would not be limited to one established to serve tribal lands. Therefore, this legislation is not necessary to PRC utilization of the REF to provide telecommunications service on tribal lands.

PERFORMANCE IMPLICATIONS

Indeterminate

FISCAL IMPLICATIONS

This bill terminates the REF and eliminates $2 million in annual accruals to the fund. Any remaining balances in the REF shall be applied to extension of local exchange services to qualifying rural customers and then to provision of infrastructure for advanced services. The REF, like the state's Unemployment Compensation Fund, is not held in the state treasury or subject to legislative appropriation. Qwest maintains that the fund does not exist and is merely a series of accounting accruals on Qwest Corporation's books.

There is currently a $14 million surplus in the fund. EDD reports low-density rural areas of New Mexico that are still underserved by telecommunication services may need more funds than are currently available through the fund and these rural areas may also require further assistance in the future.

ADMINISTRATIVE IMPLICATIONS

Indeterminate

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates CS/470/ SCONCS/aSCORC
Conflicts with Public Regulation Commission orders in Case Nos. 03-00190 and 03-00213

TECHNICAL ISSUES

It is not clear how real estate developers would be prevented from benefiting directly from applications of unspent balances, or who would monitor and enforce such prevention.

OTHER SUBSTANTIVE ISSUES

State government agencies may have received a rate cut in 1987 if Qwest and state regulators had not settled the "over earnings" case by establishing this Rural Extension Fund. If the fund is terminated as this bill proposes, the Legislature may wish to consider requiring a commensurate rate reduction for all customers who may have otherwise received one in 1987, including state government. However, Qwest believes that such a commensurate rate cut would be a small amount.

Qwest is attempting to revise other of its obligations to the state of New Mexico as well. Qwest's current AFOR, approved by PRC in 2001, requires the company to invest $788 million over five years in the state's telecommunications infrastructure. Qwest agreed to this investment obligation in exchange for approval of a 30 percent rate increase in basic telephone service rates. PRC and the Attorney General's Office have raised questions concerning Qwest's compliance in this matter; Qwest may be including investments in wireless services as part of this total, contrary to the AFOR. Qwest continues to maintain that declining overall sector performance, decreases in hardware costs and increases in consumer preference for wireless services justify revi-

sions in the terms of its investment obligations under the current AFOR but not its increase in basic service rates. Sacred Wind notes that since 1987 Qwest has experienced changes to its business, including a 40 percent reduction in its rates.

PRC notes it may have generated some confusion in its discussion of the competitive ramifications of the "successor" language. To clarify the issue, the wireless telecommunications carrier that recently received PRC approval of "ETC status" on Navajo land was Smith Bagley. However, the issue raised in its original analysis is still valid.

ALTERNATIVES

Negotiate termination of this REF in parallel with resolution of Qwest's outstanding investment obligations under the current AFOR during the next Qwest AFOR negotiations this year.

Amend this bill to require Qwest to reduce its rates for basic service, allowing all state agencies and other Qwest residential consumers to benefit from a rate reduction as they may otherwise have in 1987, in return for allowing termination of the REF.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

Qwest will continue to specifically set aside $2 million per year to help rural customers obtain telephone service in lieu of reducing customers' basic service rates, as Qwest agreed in 1987.

JR/yr:njw:lg:yr