TELECOMMUNICATIONS MODERNIZATION ACT OF 2012:
IS THE COST OF DeregULATION WORTH THE COST OF “KEEPING UP WITH THE KARDASHIANS”?

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EXECUTIVE SUMMARY
A bipartisan group of lawmakers have introduced Senate Bill 157, titled the “Telecommunications Modernization Act of 2012.” The 71-page bill deregulates some local phone service and makes new assumptions about public policy. It redefines service providers and eliminates some corporate subsidies. It also repurposes an existing funding mechanism to achieve newly assumed public policy goals, and reshuffles winners and losers in the telecommunications industry.

While the deregulation of some local phone service may be tempting and long overdue, the cost of SB 157 as it is currently written is quite high. This well-meaning bill has some troubling unintended consequences:

• The creation of a broadband fund from phone service customers at least violates the spirit of Colorado’s Taxpayer’s Bill of Rights (TABOR), and may prompt a court challenge.
• Subsidizing broadband service with money once intended for a 911 lifeline assumes that Internet download speeds are on par with emergency services.
• With the new fund being administered through the Governor’s Office of Information Technology (OIT) rather than the Public Utilities Commission (PUC), the potential exists for grant money to become a political slush fund for favored corporations.
• Exchanging subsidies to CenturyLink for subsidies to Comcast is still corporate welfare and still bad public policy.

CONTEXT OF THE BILL
Universal telephone service including access to 911 emergency services has been an accepted goal of public policy at both the federal and state level.

To achieve this goal, both the federal and state governments have collected fees from phone customers to help pay for infrastructure that otherwise would have made service very expensive for consumers in areas with very low population density, forbidding terrain or both.

In Colorado, the state funding stream is known as the Colorado High Cost Support Mechanism (CHCSM). The Public Utilities Commission (PUC) serves as the fund’s administrator. According to the PUC, “the goal of the CHCSM is to promote and support universal service by helping to make basic local exchange service available and affordable within high cost areas of the state. The Commission has augmented and strengthened the CHCSM program through the issuance of regulation, rules, and other directives.”

A provider must apply for appropriate designation before it receives monies from the fund:

A local exchange carrier (LEC) must be designated as an Eligible Telecommunications Carrier (ETC) in order to receive Federal Universal Service Funds and be designated as an Eligible Provider (EP) and an ETC to receive funds from the CHCSM.

The CHCSM provides financial support to local exchange carriers who qualify as EPs so that basic local exchange service may be more affordable to consumers in certain areas where the cost to provide such service is high.

According to a 2011 PUC report, “an average of 91 carriers” contributed to the CHCSM, which raised close to $57 million through a 2.9 percent user fee on all phone bills. Roughly $54 million, or about 95 percent, was distributed to nine
different providers. CenturyLink received the lion’s share of $50,228,617. The second largest amount, $2,779,916, went to Fort Morgan-based Northeast Colorado Cellular, Inc., doing business as Viaero.¹

Also receiving funds in 2011 were Agate Mutual Telephone Company; Delta County Telecommunications, Inc.; Nucla-Naturita Telephone Company; Nunn Telephone Company; Peetz Co-op Telephone Company; Phillips County Telephone Company; Pine Drive Telephone Company; Roggen Telephone Cooperative; and Willard Telephone Company.²

SB 157 is an ambitious and complicated effort to overhaul the rules governing Colorado’s telecommunications.

PURPOSE OF SB 157
SB 157 is an ambitious and complicated effort to overhaul the rules governing Colorado’s telecommunications. In the Legislative Declaration, sponsors state the bill will enhance competition in telecommunications by:

- “Phasing out price caps on basic local exchange services in competitive markets;”
- “Limiting and phasing out the Colorado High Cost Support Mechanism (CHCSM) to rural providers;”
- “Limiting regulations over telecommunications services using the public switched telecommunications network where competitive choices do not exist.”³

The same declaration also indicates that both regulation and deregulation will be selective, as follows:

To foster, encourage, and accelerate the continuing emergence of a competitive telecommunications environment, the General Assembly declares that it is appropriate to establish different methods of regulations for, or fully deregulate, different telecommunications services.⁴

With SB 157 state lawmakers and supporters want to expand broadband service across the state and create a new funding mechanism known as the “broadband capital fund.”

WHAT SB 157 DOES
I. Deregulates, Defines, Defunds

In areas with “sufficient competition,” SB 157 deregulates basic phone service, i.e., a traditional landline with a dial tone that connects to a local exchange with emergency and operator services. Along with deregulation comes the phase-out of the CHCSM to certain rural providers by 2025, which could save consumers millions of dollars.

“Sufficient competition” is defined as 90 percent or more of the population having a choice of five or more telecommunications service providers of any kind, including wire and wireless services.

But some Coloradans, especially in rural areas, still rely on “providers of last resort” or rural providers. Previously, those areas have been defined by size of population. Under SB 157, the definition is changed to provider size. Larger providers with more than 75,000 access lines would be deregulated. This change only affects CenturyLink.

Carriers with fewer than 75,000 lines are still considered to be rural providers. Concerning rural providers, the bill instructs the PUC to “employ price flexibility, in which the carrier is authorized to raise and lower its price for stand-alone basic service within a range established by the commission.”⁵

In other words, rural CenturyLink is deregulated while rural non-CenturyLink customers may be subjected to a minimum/maximum rate structure, which means the cost of basic phone service may not go any lower or any higher than what is set by the PUC.

Furthermore, CenturyLink no longer will be eligible for CHCSM funds, even though it services rural areas. But other rural carriers will still be able to get the subsidies.

Consider, for example, a CenturyLink customer in
Weldona, and a Roggens Telephone customer in Roggens. Located on Colorado’s Eastern Plains, Weldona and Roggens are roughly 30 miles apart, and each has a population well under 1,000. Under current law, both towns are considered rural areas for service providers, and providers receive subsidies through federal and CHCSM funds. Both companies offer customers local phone and broadband services.

In 2011 Roggens Telephone received $51,614 in CHCSM funding and another $478,215 in federal funding for the 211 lines it provides. In total Roggens Telephone received $2,511.04 per phone line while charging customers $13.50 for basic residential service and $15.50 for business service.\(^8\)

CenturyLink received in total $64,898,819 for 433,573 lines, or $149.55 per line.\(^9\) Under SB 157, CenturyLink would not be eligible for any of the nearly $50 million in CHCSM subsidies it has received to service areas such as Weldona. But Roggens Telephone remains eligible.

**CREATION OF NEW CORPORATE WELFARE SYSTEM FOR BROADBAND**

Not all of the nearly $50 million goes back to ratepayers, because SB 157 assumes a new public policy goal.

The legislation puts expanded broadband service in a position equal to what universal phone service was previously. At least one member of the Senate Business, Labor and Technology Committee questioned the development during the committee hearing on the bill.\(^10\)

Under SB 157, the definition of broadband service is not limited to just Internet service and connection speed. It includes any service offered over cable, digital wire, satellite, cellular or wireless, fiber optics, and power lines.

To accomplish this newly assumed public policy goal, SB 157 authorizes the transfer of $5 million from the CHCSM fund to OIT as “seed money for the Broadband Capital Investment Fund.”

Beginning on January 1, 2014, the PUC will make an annual determination of areas deemed to enjoy “sufficient competition,” and non-rural providers (CenturyLink) will lose their CHCSM funding. Fifty percent of the reduction in the CHCSM fee will be returned to ratepayers. The other half “shall be transferred to the Office of Information Technology on a quarterly basis for the purpose of the broadband capital investment fund for underserved areas until the elimination of both funds on January 1, 2025.”\(^11\)

There is no definitive estimate as to how large the broadband fund may grow. We do know that 50 percent of CenturyLink’s 2011 estimated $50 million payout from the CHCSM would be used to fund the broadband capital fund. That means $25 million per year for the next 12 years, or $300 million, to pay for the build-out of broadband services.

Just in case public policy goals have not been achieved more than a decade hence, the bill also requires a study in 2023 to determine whether or not the CHCSM fund should be eliminated in 2025.

While the PUC controls the CHCSM fund, OIT will control the broadband fund. It will determine “underserved areas” and will dole out grant money based on “Requests for Proposal” (RFP). Any broadband provider registered in good standing with the Colorado Secretary of State’s Office as of December 31, 2012, is eligible to bid on any RFP.

SB 157 requires OIT to prioritize projects according to “the most potential broadband customers that can be served by qualified broadband service providers at the least cost.” But the bill does not require OIT to enter into contracts for all underserved areas. After 12 years of promoting and funding broadband service, some parts of the state still may not enjoy this important technology.
**Analysis**

Deregulation is generally a positive development, but in the case of Senate Bill 157, at what cost?

I. **TABOR and the “Slush Fund”**

A particularly problematic part of SB 157 is the repurposing of CHCSM funds. Although the Colorado State Supreme Court in its 2008 *Barber v. Ritter* decision allows for a very loose interpretation of “fees,” the taking of $5 million in fees from one cash fund to establish another for a different purpose seems at the very least a violation of the spirit of the Taxpayer’s Bill of Rights (TABOR).

Taking that argument a bit further, continuing a fee on phone service to provide a different service, in this case broadband, may be considered a direct violation of TABOR.

In testimony for SB 157, Committee member Senator Ted Harvey expressed concern about the broadband fund’s lack of oversight, even referring to it as a “slush fund.”

While the Public Utilities Commission has traditionally been regulatory rather than political, SB 157 creates a new level of well-funded bureaucracy, the OIT. The head of OIT is a cabinet-level position within the executive branch. It is reasonable to have concerns that politically well-connected entities with deep pockets may also apply for and receive multi-million dollar “grants” from OIT with little accountability.

The same problem has appeared in the Governor’s Energy Office (GEO). When the GEO became awash in federal stimulus dollars, it lacked policies and procedures to ensure the money was spent as intended. The problems were detailed in the Independence Institute paper “Governor’s Energy Office Needs a Dose of Sunshine,” and in an investigative report by CBS Channel 4 in Denver. As a result, the Legislative Audit Committee requested a complete audit of the Governor’s off-budget agency.

II. **Winners and Losers**

This bill certainly shakes up Colorado’s telecommunications industry, creating new classes of winners and losers. A good way to tell winners and losers is to check Colorado’s Secretary of State website to see which organizations are lobbying for and against any given bill. In the case of SB 157, Comcast, AT&T, Sprint, and the local phone providers are lobbying in favor. Lobbying against the legislation are CenturyLink and its unionized employees, the Communications Workers of America.

Among the winners will be customers who may benefit from competition for basic local phone service with lower rates because they no longer will have to subsidize all service providers for rural areas.

Comcast, the giant cable and Internet provider, will be a huge winner because phone users will subsidize Comcast’s infrastructure costs so it can expand broadband service into areas OIT deems “underserved.” Comcast hardly needs help from Colorado phone customers. According to its 2011 year-end financial statement, Comcast earned more than $55.8 billion in revenue, an increase of 47.2 percent from 2010, and $1.50 in earnings per share, a 16.3 percent increase.

Winners also include those rural providers, such as Roggens, that continue to receive CHCSM funds and don’t have to worry about competitors underpricing them on basic phone service, because the PUC will regulate a minimum price in many service areas.

There are other winners, such as AT&T and Sprint, which no longer will have to pay local access fees, but that part of the bill is outside the scope of this Paper.

Consumers who still will not have access to competitive phone service will be losers. No incentive will exist to offer competitive access, because the PUC still will regulate prices within a certain
range. Also deemed losers are those customers who must continue to pay a fee to subsidize lawmakers’ desire for expanded broadband service.

CenturyLink, which serves nine out of every 10 lines currently supported by CHCSM, is a huge loser. SB 157 kicks it out of the corporate welfare club. There is no sympathy for a major corporation losing millions of dollars in subsidies unless that corporation is being singled out, which is exactly what this bill does.

SB 157 appropriately could be titled “The Colorado Stops Subsidizing CenturyLink, Still Subsidizes Small Phone Carriers, and Begins Subsidizing Major Broadband and Wireless Corporate Giants Act of 2012.” CenturyLink is never mentioned by name in the bill, but definitions contained therein are constructed such that they only apply to the state’s largest provider. If corporate welfare is bad public policy when directed at CenturyLink, which it is, then it is bad public policy when directed at other corporations.

III. POLICY QUESTIONS
Should Coloradans be subsidizing faster Internet speeds for those who choose to live in rural Colorado? The speed at which someone uploads the latest episode of “Keeping Up with the Kardashians” is not the equivalent of universal phone access so that everyone has the ability to dial 911 in case of an emergency.

In committee testimony, some supporters stated that SB 157 serves a vital economic need. If the intent is to stimulate economic development, however, then the broadband fund is not a fee. It is a tax that requires voter approval under TABOR.

Even if SB 157 is a fee, the economic development argument does not justify the need for government meddling to expand broadband service because private investment already is doing it at a rapid pace. Colorado cell phone usage is nearly universal without subsidies, according to one SB 157 supporter. Tony Bradley of Coalition for a Connected West cites the statistic from the Federal Communications Commission in a press release on his Web site:

93% of Coloradans use a cell phone, many of which are transitioning to smartphones. Additionally, Colorado is home to a growing number of application developers, like iTriage and mGive, which depend on robust broadband networks and smartphones to deliver their products.13

Notably, Viaero has expanded its coverage without broadband capital subsidies.14

During testimony in favor of SB 157, Viaero officials proudly explained that the company’s recent expansion into the San Luis Valley netted more than 300 new subscribers in just one day.

If rural broadband service is necessary to the state’s general welfare, then broadband development should be paid for through general tax revenues, just like rural roads. A “fee” is a charge that offsets the cost of doing something (e.g., renting a towel at a public recreation facility.) If telephone users in Denver are going to be charged extra in order to subsidize low-cost broadband for people

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in Fremont, that extra charge should be frankly acknowledged as a tax. It is not a fee.

**Conclusion**

SB 157 takes positive steps. It deregulates some basic phone service and phases out the unnecessary CHCSM, but the bill also creates a host of new problems.

The creation of a new fund with little accountability has the potential to become a political slush fund instead of a lifeline subsidy. Choosing new favorites in the telecommunications industry is simply playing politics. And it may violate TABOR.

Meanwhile, forcing Colorado phone customers to fund faster Internet speeds and other services for those who choose to live mountain communities or rural Colorado is unfair.

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