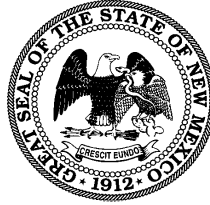


NEW MEXICO PUBLIC REGULATION COMMISSION

COMMISSIONERS

DISTRICT 1 JASON A. MARKS, VICE-CHAIRMAN
DISTRICT 2 DAVID W. KING
DISTRICT 3 BEN R. LUJAN, CHAIRMAN
DISTRICT 4 LYNDA M. LOVEJOY
DISTRICT 5 E. SHIRLEY BACA



1120 Paseo de Peralta/P.O. Box 1269
Santa Fe, NM 87504-1269
(505) 827-4084

Office of Commissioner Jason A. Marks
(505) 827-8015 Fax (505) 476-0474

State Universal Service Fund (SB 218) – Sounds good on paper....but price tag is too high

In the PRC Formal Opening Meeting of February 1, I joined a majority of the Commissioner in voting to express opposition to SB 218, providing for a State Universal Telephone Service Fund.* This bill is a well-intentioned effort to address a looming problem for rural telephone companies; however, it comes at too high a price tag for me to support at this time.

Background

Rural New Mexico is served by 15 small telephone companies, each having anywhere from 850 to 12,500 subscribers. Because of their small size and because of the distances between customers in rural areas, these companies have high costs per subscriber line – on average over \$150 per month. To provide rural homes and businesses with basic phone service at reasonable prices, the monthly fees charged by the rural telcos are subsidized. First of all, rural telcos receive around \$4 million in annual distributions from a federal Universal Service Fund; the source of this money is an assessment of around 80 cents per month on every telephone customer in the United States, there is also a small Federal USF percentage assessment on long distance charges.

On the state level, the rural telcos are subsidized through high access charges. These access charges are fees charged to companies providing in-state long distance services for the privilege of connecting to the local phone company's network. For example, if a customer in Albuquerque uses Sprint long distance to call Hobbs, Sprint needs to pay Leaco Telephone Cooperative 15 cents a minute, a cost it ultimately passes on the customer. New Mexico is one of only two states that continues to use the access charge method to subsidize its rural services, the others have switched to state USF mechanisms and lowered their access charges to inter-state levels (~3¢/minute).

The rural telcos are starting to see their access revenues decline as consumers increasingly use cell-phones with free long distance plans to call to and from rural areas.

* Since that vote, at least one Commissioner has changed his position on the legislation.

Wireless companies are exempted from paying the high access fees charged by the rural telcos. SB 218 would shift the subsidy mechanism from access fees to a state USF charge on every wire-line telephone bill and possibly every cell phone account in New Mexico.

Problem 1: A High Price Tag for Qwest Customers

The rural telcos aren't the only companies with high access fees built into their rate structures: Qwest and Valor, which both serve some rural areas, are also entitled to receive access fee charges. Qwest alone accounts for over 36% of the access charges being collected. The way SB 218 works, the first step is to make Qwest's "whole" for its lost access charge revenue by increasing all line charges by \$1.50 per month. Next, most of the access charge revenue going to Valor and the small companies is divided by the number of phone lines in the state to get the state USF amount. This is projected to be around \$0.80 per line per month, if wireless participates, or around \$1.60 if they don't. **Thus, the total monthly impact on a Qwest subscriber will be at least \$2.30 and very likely over \$3.00.**

Those customers who make in-state long distance calls from their wire-line telephones will save some money to offset their higher line charges – but only if they don't already have a low-cost long distance plan that includes in-state calls, such as Qwest's 5¢/minute long distance plan. This is an important point, because it suggests that in order to garner market share, Qwest is already absorbing part of the access fees it could be passing on to customers. If this bill passes, we'll be allowing Qwest to sidestep the competitive pressures that are causing it to offer good long distance deals to its customers and instead lock in \$1.50 per line per month, free and clear from any competition.

If, as I suspect, businesses use proportionally more in-state long distance than residential phone customers (the sponsors of the bill don't know, one way or another), passage of SB218 will also have the effect of shifting costs from business to residential customers.

Problem 2: The USF Bill Locks in High Subsidies, Insulating the Industry from Competitive Pressures

Although rural telco advocates talk a lot about the high capital costs they incur because their customers are so far apart, the truth is that they spend less on capital than they do on salaries and other operating costs, as shown in the chart on the following page.

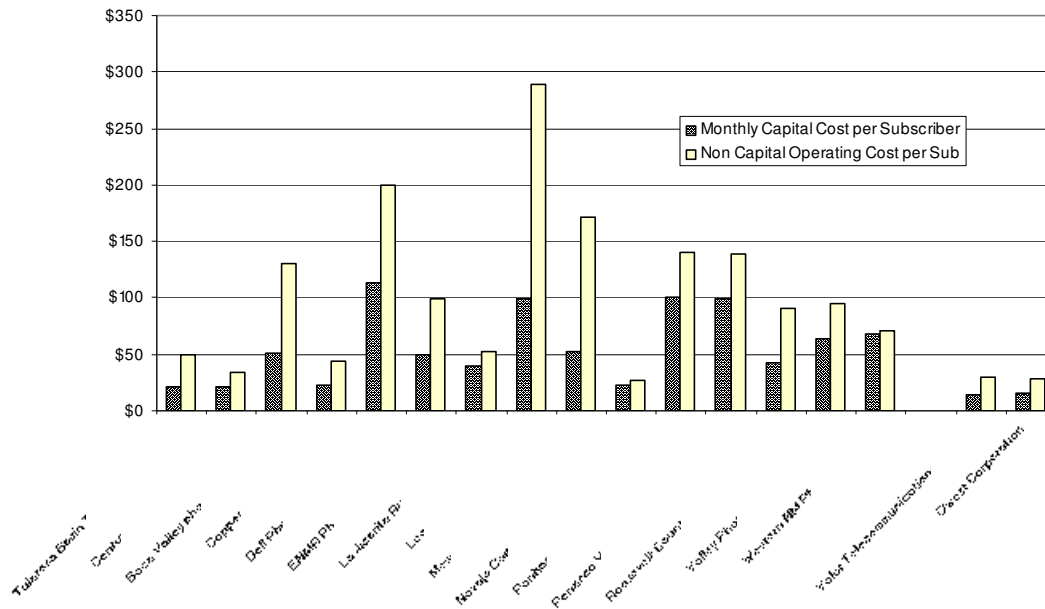
Presumably, high operating costs per subscriber are the result of spreading the overhead needed to run a telephone company over a small number of customers. The rural telcos also typically provide a higher level of service than companies like Qwest.

The rural telcos also generally make fairly healthy profits, most ranging from around 5% to 14% return on equity, after taxes. At least two New Mexico rural telcos reported returns of over 25%.^{*} About one-third of the telcos are cooperatives owned by their New Mexico subscribers, and their profits turn into annual dividends. In many cases,

^{*} Data from 2003 annual reports filed with the Public Regulation Commission.

these dividends offset the in-state long distance costs paid by the rural residents during the preceding year.

Rural Telcos Show High Operating Expenses



In New Mexico, the rural telephone companies have not had the PRC conduct a close examination of their costs and revenue requirements in at least 15 years. I am concerned passage of this bill now will lock in the current revenue streams to the incumbent companies without such an examination. Because the vast majority of the telco companies' revenues will be coming from non-subscribers (through USF surcharges), they will have little pressure from their customers to be efficient.

And, at the same time that most wireline rural telcos are requiring over \$100 per month in subscriber fees and subsidies to deliver service, we are beginning to see wireless plans offered in rural areas that have unlimited calling for \$50 - \$60/month, without subsidies. While many rural households are still beyond the reach of a cell tower, I believe we are seeing an indication that models other than the small wireline company may be a more efficient route to universal service in the long run.

Conclusion

In-State Access Charges are not a crisis: every New Mexico rural telco is making a profit, even with declining paid access minutes. Rather than lock in the current revenue streams, I suggest that we wait and see how the industry develops over the next couple of years in the face of competition, and at that time re-craft a USF bill, if it's still necessary. The ultimate beneficiaries of such a bill should be the rural and urban consumers, not the telephone companies.