INNOVATION OHIO

EXECUTIVE SUMMARY

Senate Bill 271 was introduced in December of 2011 and is designed to free regulated telephone carriers from their obligation under state law to provide basic landline telephone services to customers living in the territories the companies serve. It is pending in the Ohio General Assembly.

After careful analysis of SB 271—including the claims made on its behalf by telephone industry spokespeople, as well as the claims those spokespeople made on behalf of the *last* "reform" (SB 162), enacted into law just two years ago—Innovation Ohio has concluded that the bill is unnecessary and should not become law for the following reasons:

- Current law already provides a mechanism for telephone companies experiencing financial hardships to escape their obligation to provide basic landline service;
- SB 271 is anti-consumer;
- Industry estimates of the number of new jobs that would be created by SB 271 are highly dubious, especially since similar claims for the last reform bill (SB 162) failed to materialize;
- SB 271 would allow telecommunications companies to eliminate service standards they committed to upholding just two years ago;
- The so-called "failsafe" provision in SB 271 (which industry supporters claim will protect consumers from a loss of basic service) is inherently faulty;
- SB 271 is premature and should not be rushed through the General Assembly before the Select Committee established under the last reform reports back on the effectiveness of SB 162.
- SB 271 is likely to hurt our state's most vulnerable citizens: elderly, sick, low-income and rural Ohioans.

Instead of enacting SB 271, Innovation Ohio proposes four alternative recommendations be adopted by the Ohio General Assembly. These recommendations will ensure that all Ohio consumers retain access to low-cost basic telephone service, as well as to life-saving emergency phone service.

INTRODUCTION

It would be helpful to begin with some definitions and an explanation of some commonly-used acronyms in telecommunications policy.

Ohio is divided geographically into service territories, made up of local telephone exchanges, each served by an incumbent local exchange carrier (ILEC). Historically, in exchange for being granted the exclusive right to offer service within its assigned territory, ILECs were obligated under Ohio law to provide basic local exchange service (BLES). This mandate of providing service is known as Carrier of Last Resort (COLR). In basic terms, COLR requirements ensure that a provider offers BLES service to all customers in its service territory. This requirement represents the State's means of ensuring the universal availability of telephone service, something that has become a basic necessity of modern life.

BLES represents the lowest-cost way to purchase landline telephone service, available without extras such as long distance calling, call waiting and voice mail. Purchased as a standalone service, it can cost less than $15 per month, representing an affordable option for low-income or even savvy middle and upper-income individuals seeking the peace of mind that comes with a landline phone, not reliant on electricity and offering location-based 9-1-1 services.

The legislation currently under consideration — SB 271 — represents the culmination of years of lobbying efforts by traditional phone companies, and is the third package of legislative reforms to be introduced in the past three General Assemblies[1].

WHAT DOES SB 271 DO?

SB 271 allows the Public Utilities Commission of Ohio (PUCO) to waive a local carrier's obligation to provide BLES if the exchange meets a "competitiveness test" in which two alternate voice services exist somewhere in the exchange, and provides advance notice to affected customers, regulators and the Ohio Consumers' Counsel (OCC).

According to the Legislative Services Commission, five ILECs covering 232 local exchanges across Ohio already meet this competitive test. The companies are AT&T (192 exchanges), CenturyTel (6 exchanges), Cincinnati Bell (6 exchanges), Conneaut (1 exchange) and Pattersonville (1 exchange)[2]. These 232 exchanges, already deemed "fully competitive" according to the bill's definition, include the cities of Cincinnati, Cleveland and Columbus in their entirety, as well as a large swath of Eastern and Southeastern Ohio.

The bill further eliminates the remaining customer service standards that exist in Ohio law for all carriers doing business in exchanges defined as competitive by the legislation.

If passed, SB 271 would allow carriers to either stop offering service, impose unlimited price increases on basic service, or force BLES customers to switch to a higher-cost service or more expensive bundled voice and data offerings.

2010, SB 162 AND DÉJÀ VU

The precursor to SB 271 was Senate Bill 162 in the 128th General Assembly, enacted into law in September of 2010. Similar to the current legislation, SB 162 aimed to streamline the process for local carriers to exit from their obligation to provide basic landline service in Ohio.

SB 162 established a "fast-track" waiver under which local carriers had to demonstrate to the PUCO that exiting from their landline business was just, reasonable and not contrary to the public interest[3]. If passed, SB 271 would simplify the regulatory process even further, allowing carriers to cease offering basic landline service after demonstrating only that two competing carriers offer service somewhere – but not everywhere – in the exchange

Also like SB 271, SB 162 provided a mechanism for telephone companies to raise rates for basic landline service. The legislation granted providers the authority to raise monthly rates by $1.25 each year on BLES by showing that two or more competitors exist anywhere within the exchange, regardless of price or technology and even if they are not available everywhere in the exchange. Previously, carriers sought PUCO approval to raise rates for local BLES service by showing a rate increase was necessary to keep up with the increased cost of providing service. Now, under SB 271, rates would effectively go up as carriers could stop offering basic landline service, forcing consumers to switch to a higher priced service or bundle, or purchase a competing service such as wireless.

Additionally, SB 162 eliminated Ohio's Minimum Telephone Service Standard, but instituted a handful of very limited customer protections exclusively for customers of basic landline service, including low-income Ohioans eligible for the Lifeline program. Among the service standards that were preserved are timeframes within which carriers must install, repair or reconnect service, timeframes for billing due dates and reconnection for nonpayment and billing credits for customers experiencing extended outages[4]. Under SB 271, all remaining customer service standards existing in law would be eliminated for providers operating in exchanges designated as "competitive" under the legislation.

Importantly, SB 162 established the Select Committee on Telecommunications Regulatory Reform, an eight-member panel charged with the study of the bill's effects on such issues as employment, telephone rates, quality of service, rural markets and broadband availability. The Select Committee is required to report back to the General Assembly with its findings by September 13, 2014. At the time of this report, the Committee had not yet convened.

THE (SHAKY) CASE FOR REFORM

SB 271 was written at the urging of telecommunications companies, led in Ohio by industry giant AT&T. The company, along with Verizon, is actively promoting or has succeeded in enacting similar legislation in a number of other states[5]. The *Washington Post* notes that similar bills are expected to emerge "eventually" in other states served by the companies, "according to industry officials and consumer advocates"[6].

More Déjà vu: Bogus Jobs and Investment Claims

A key argument for passage of SB 162 in 2010 was that it would allow companies to free up capital which they would invest in new technology and thus create jobs. Similar arguments are currently being made in support of passage of SB 271.

Industry representatives and the bill's sponsor say that the legislation will free telecommunications companies of the burden to serve current and future customers in their coverage area with landline technology that, they say, is expensive and antiquated. Continuing to do so, they claimed, was the equivalent of "burying money" in "coffee cans in the backyard"[7] instead of deploying it on new technologies such as broadband and mobile services, creating jobs in the process.

> *"In summary, Senate Bill 271 represents a modest step, intended to bring Ohio into line with other states that have recognized that similar public policy changes can have a dramatic positive impact on the efforts to attract investment, preserve and expand high-tech jobs, and to compete in a global economy.[8]"*

Rhetoric vs. Reality

We've heard this story before. Here is AT&T Ohio President Tom Pelto, testifying on behalf of SB 162 just over two years ago:

> *"It [SB 162] will also stimulate additional investment in Ohio and both preserve and create new jobs by removing regulatory risk and cost.[9]"*

If, as the industry argued at the time, the reforms contained in SB 162 were essential for the preservation and creation of Ohio jobs, what were the results? We need only return to Mr. Pelto's testimony from then and now.

Pelto in 2009:

> *"Nearly 10,000 Ohioans work for AT&T and Senate Bill 162 is a shot in the arm for all of them.[10]"*

Pelto in 2012:

> *"It is an honor to be here today representing AT&T, and more than 7,000 Ohioans who work for AT&T across our great state.[11]"*

In other words, following the passage of SB 162—which AT&T argued was necessary to "preserve and create jobs"—Ohio actually saw a **reduction of up to 3,000 AT&T employees**. Yet legislators are now asked to believe AT&T's promise that its latest "reform" will somehow create the new jobs that its last "reform" failed to produce.

As for the claim that further deregulation is necessary for the industry to expand advanced services, there is nothing preventing companies from investing in wireless and broadband today. AT&T alone reported over $30 billion in profits last year, $10 billion of which it reinvested into capital projects while sending over $20 billion to investors in the form of dividends. Clearly, the company's landline obligations are not getting in the way of profitability and continued investment.

SB 271 is Not Necessary

Arguments for SB 271 don't hold up to scrutiny because current law *already* provides multiple remedies for companies experiencing financial hardships as a result of providing landline service as part of their COLR obligations.

SB 162, passed into law in 2010, granted carriers in territories deemed "competitive" according to the same test found in SB 271—the presence of two or more voice services anywhere in the territory, regardless of technology—the ability to raise monthly rates by $1.25 each year without need for action on the part of the PUCO. This is *in addition* to longstanding law authorizing providers to come to the PUCO for the authority to raise rates based on a demonstration that landline services are a money-loser[12].

But secondly, the 2010 legislation established a fast-track mechanism for companies to waive their COLR status entirely, allowing them to cease providing landline services, while maintaining minimal customer service standards[13]. In order to qualify for a fast-track waiver under SB 162, a carrier must provide a reasonable explanation of its intent to withdraw to the PUCO, including the number of customers who would be affected and a list of alternative service providers in the area. They must also publish a notice in a local newspaper and hold a public hearing where customers can voice their concerns. The Public Utilities Commission then must find that the rationale for withdrawal is "just, reasonable, and not contrary to the public interest," which a carrier can show by demonstrating financial hardship or unusual technical limitation.

If a carrier can meet just these very modest standards, the PUCO must respond within 120 days of the filing. In other words, if a provider is losing money as a result of offering BLES, the PUCO already has the authority to act and relieve the provider of a money-losing obligation under current law.

However, *Innovation Ohio* has learned that since the fast-track waiver was created in SB 162, no carrier has taken advantage of this newly-created authority. Here is the response we received from the PUCO:

> *"The PUCO has not received any waiver filed pursuant to OAC 4901:1-6-27 Section G since the inception of this rule"*[14]

It is hard, then, to understand why we should go even further toward eliminating COLR obligations when no companies have yet utilized the latest tool they argued for just two years ago. If the reason no companies have sought a waiver is that they could not clear even this small hurdle (i.e., showing financial hardship, technical limitation or that the waiver is otherwise in the public interest), then, SB 271 — which moves to a nearly automatic exit from COLR — is clearly not in the public interest.

THE BILL IS ANTI-CONSUMER

While SB 271 is portrayed as both consumer-friendly and necessary to bring critically needed new technology to the market, the truth is that the bill is actually *unfriendly* to consumers. The legislation actually erodes consumer protections, and forces residents to seek alternative service providers or purchase higher-cost service plans.

Industry Seeks to Eliminate Service Standards They Lauded Two Years Ago

The provisions in SB 162 that prohibit companies from abandoning their customers without demonstrating that it is in the public interest are effectively eliminated in SB 271. Companies that meet the weak standard for competition can bypass the PUCO waiver process and withdraw service after 90 days[15]. They need only notify PUCO, OCC and the affected customers, with no obligation to show the move is in the public interest. Customers will not have the opportunity to voice their opposition and the company will be absolved of its duty to identify alternative providers.

Alternatively, even in the case of providers who elect not to pull up stakes and stop serving a service area designated as "competitive" under the act, no-frills landline service need no longer be offered — or its price may be raised without limit. As a result, consumers who depend on BLES for an affordable local calling option will be forced to pay more, switch to a higher-cost service plan or bundle, or seek out a new provider that may not offer the same services for a comparable price.

In addition to preventing carriers from swiftly and inexplicably depriving customers of essential telephone service, the 2010 legislation notably preserved in law a number of customer service standards for BLES providers. Testifying before the 128th General Assembly, industry officials took time to emphasize the preservation of these standards:

> *"Service quality requirements, similar to those in the PUCO's rules today, are carried over into the bill and would apply to basic local exchange service. These include intervals for installation and repair, requirements that apply to disconnection and reconnection of service, limits on deposits, and "warm line" access to 9-1-1. These are another example of the safety net the bill provides for customers who only want the most basic service."*
>
> *"This bill takes the moderate step of retaining some aspects of regulation on basic local exchange service, what some in the industry refer to as "plain old telephone service," or POTS. Thus, it provides a "safety net" for consumers whose only need or desire is for "plain old telephone service," provided by the incumbent "telephone company" that has served their community for 100 years."*
> ***Jon F. Kelly, General Attorney, AT&T Ohio, October 20, 2009. Testimony before House Public Utilities Commission***

Just two years ago, this "safety net" represented by very minimal service quality standards were important priorities for AT&T and legislators when they revised Ohio's laws governing telecommunications. Now the same companies are advocating a law to eliminate those standards.

Faulty Failsafe

The bill allows incumbent carriers to pull out of a service area and no longer requires them to serve existing or future households. While industry representatives and the legislation's sponsor insist that there would be no financial reason for companies to simply pull up stakes and stop serving existing customers, the legislation nevertheless allows them to do just that.

New residential properties built after a company is allowed to exit its landline obligations could be bypassed by the company's landline infrastructure and only offered more expensive internet-based or bundled voice service. Moreover, the bill allows companies to withdraw service from low-income urban and rural customers, typically less profitable to providers than their more affluent counterparts living in desirable suburban communities, thus effectively enshrining redlining practices into state law.

Finally, the bill does not require providers to notify customers or the PUCO of comparable service offerings available to them if they elect to cease providing services. And it also allows a provider to stop providing service to existing customers even when no competitor exists or is willing to serve those customers.

To combat these criticisms, proponents point to what they term the bill's "failsafe" provision. They highlight federal Connect America Funds (CAF), administered by the Federal Communications Commission (FCC), aimed at expanding broadband deployment by carriers regulated by the FCC. SB 271 creates a requirement for the PUCO to "prioritize" CAF spending to areas that lose service as a result of the legislation.

As a failsafe, CAF is inherently faulty, because the PUCO does not receive CAF monies directly, nor could it apply for funds on behalf of carriers. While the law implies that the PUCO could weigh in on behalf of providers with the FCC, it has no formal role in the grant process. The best that Ohio customers who lose landline service under this plan can hope for is that the PUCO will urge the FCC to award funds to another provider. But those providers can elect not to apply or conclude that serving those homes or businesses is not in their economic interest. The PUCO has no authority under CAF to require a provider to offer service to customers who lose it under SB 271.

To further illustrate the limitations of this approach, AT&T is eligible for $47.9 million in 2012 from CAF[16] for its 4,500 wire centers nationwide. Just 6% of those are in Ohio. At those levels, and with the FCC estimate that it costs $775 to serve each additional household or business, very few customers could expect to see new service deployment as a result. And because CAF is aimed at expanding fixed broadband deployment, it is only available to FCC "price cap" carriers (which excludes satellite, wireless and cable) in areas where no terrestrial broadband options exist[17].

Once providers indicate whether they will accept CAF support, not required before June of this year, they have three years in which to deploy service. The 2012 round of awards was a Phase 1 allocation, targeted at large incumbent carriers. It is unclear whether the same carriers will be eligible for future rounds of funding, when those funding rounds will occur, or how much will be available. In short, reliance on CAF as a sure source of funding to replace local phone service lost through SB 271 is misguided, given the program's uncertain future and limits on eligibility.

The bottom line: Ohio customers who lose service as a result of the bill could remain without affordable and reliable phone service for months or years to come without seeing any deployment as a result of this federal subsidy program.

SB 271 IS PREMATURE

Telephone providers in Ohio sought and received regulatory relief in 2010 in the form of SB 162, which became effective little over a year before the introduction of SB 271. At the time, that legislation was identified as necessary to ensure the expansion of advanced technologies and the preservation and creation of jobs. While there has been little time to determine its impact, it is already clear from company testimony in support of SB 271 that jobs have **not** been preserved.

Further, SB 162 established a Select Committee of eight appointees charged with determining the bill's impact. The Committee is not set to report back to legislators until 2014. By moving before the findings are due back, SB 271 effectively serves to short-circuit the very tool that its predecessor legislation created to measure its own effectiveness.

Meanwhile, profits for telephone companies continue to grow while personal income for Ohioans is down, poverty is up and unemployment remains high. *Policy Matters Ohio* reports that Ohio's inflation-adjusted median wage actually declined from 2000 to 2010, falling further than those of any other state. Ohioans today make an inflation-adjusted $15.16 per hour, compared to $16.02 in 2000[18]. 15.2 percent of Ohioans meet the federal poverty definition, up 10.6 percent from a decade earlier[19]. Given the current economic climate, and the short amount of time that has passed since the industry last received regulatory relief, legislation that may result in higher costs and fewer protections for Ohio consumers certainly seems premature.

SB 271 LOSERS

If SB 271 becomes law, its impacts will be felt most deeply by those who rely on landline service, particularly the elderly, infirm, low-income and rural Ohioans. Over 72 percent of Ohioans over 18 live in a household with landline service. But more critically, 9.1 percent of Ohio adults — over 800,000 people— live in households in which a landline phone is the *only* voice service present[20].

Seniors could lose reliable connections to 9-1-1 service; those with limited mobility could lose an important link to the outside world. Low income Ohioans will suffer as costs increase with service offerings shifting away from basic landline service toward bundles and internet-based calling. The loss of landline service could also jeopardize Lifeline service, a program offering discounts on basic telephone to very low-income Ohioans[21].

Coverage may decline in rural areas where cellular service offers the only alternative to landline phones. In parts of rural Ohio, cellular service—which the bill defines as a qualifying "competitor" to landline service—can be spotty at best. The bill provides no incentive for companies to expand service.

All BLES customers who expect reliable service, responsive installations and repairs, and compensation when standards are not met will also lose with SB 271. And those reliant on 9-1-1 emergency service may be cut off when electricity, essential for all internet-based calling plans, is unavailable.

INNOVATION OHIO RECOMMENDATIONS

Rather than passing SB 271, *Innovation Ohio* recommends the following policy solutions:

- Allow the industry review commission formed in SB 162 to do its work and report back about the need for further reform. The deadline for the Select Committee to issue a report of its findings is in 2014. The panel was charged with looking at the effects of SB 162, but its review was not limited in scope. It should move independently—or the General Assembly should require it—to expand the scope of its study to include the potential consequences of proposals contained in SB 271. The Committee should examine how many Ohioans depend on landline service, the cost of comparable service (offering unlimited local calling and location-based 9-1-1) provided via alternative technologies, the number of Ohio households covered by ILECs that would meet the competitiveness test in SB 271, the profitability of landlines and broadband deployment in the state.

- The competitiveness test used in SB 271 is insufficient. First it counts as a competitor providers that do not provide a similar service (unlimited local calling for a low, flat monthly rate) and only requires their availability somewhere (but not everywhere) within the affected service area.

  Second, confirm this is what 162 did the test was established in a prior law as a way to test whether sufficient competition existed to grant automatic rate increases in a territory served by multiple, unregulated competitors. It was never established to test for whether sufficient comparable service exists to justify allowing a competitor to pull up stakes and stop offering service.

  We recommend that, if SB 271 is to move forward, the provision be strengthened such that providers wishing to opt out of the provision of BLES as currently required in law should be required to demonstrate that access to comparable and similarly price service will continue in their absence. Copper wires may cease to be the technological standard, but access to basic telephone remains a basic necessity, and no changes that end its universality should be permitted in state law. Competitors should be in place at the time the company's BLES responsibilities are waived, and not dependent on hypothetical future federal funding.

- Even if the legislation is rewritten to limit the exit of carriers from truly competitive areas of the state, customer service standards should be retained. The bill's stated aim is to focus investments away from antiquated landline technology toward the latest capabilities such as mobile broadband and advanced telephony. Customer service standards are not dependent on technology, so their elimination has no place in the bill.

- Restore funding for the OCC to ensure Ohioans have representation in hearings at which PUCO is considering an application by a carrier to raise rates or withdraw service. The agency's funding was cut in half in the last biennial state budget, leaving it with fewer attorneys and less capacity to ensure consumers concerns are addressed in regulatory oversight hearings. While the second of two cuts was recently reversed, the agency's funding is still one third lower than it was prior to the current biennium.

We recommend that lawmakers restore funding to the Consumers' Counsel to FY 2011 levels, eliminating the cut imposed for the current biennium. Funding is provided by a small assessment on monthly bills, paid for by carriers, and puts no strain on limited taxpayer resources.

CONCLUSION

If companies are losing money by providing landline service, laws already on the books ensure that they can seek relief through the PUCO today. But harming consumers by potentially raising rates for a basic necessity like local telephone service (in the middle of a recession, no less) simply to bolster what are already record-breaking profits for some key players is not well timed or an appropriate focus of a state legislature that claims to be focused on jobs and the economy.

ENDNOTES

[1] Am. Sub. S.B. 117, 127th General Assembly; S.B. 162, 128th General Assembly; S.B. 271, 129th General Assembly
[2] Marcus Benjamin, Legislative Services Commission, personal electronic communication in response to Innovation Ohio correspondence to Senator LaRose, May 10, 2012.
[3] Ohio Administrative Code 4901:1-6-27(G).
[4] Legislative Service Commission, Bill Analysis - Sub S.B. 162, 128th General Assembly, As Passed by the General Assembly.
[5] Similar legislation has passed in Indiana, Wisconsin, Florida, North Carolina, Texas and Kansas, and is pending in Alabama, Mississippi, Georgia and California. Similar legislation was introduced, but failed to pass in Kentucky, New Jersey and Colorado.
[6] Cecilia Kang, "Landline rules frustrate telecoms," *The Washington Post*, April 12, 2012.
[7] Tom Pelto, President, AT&T Ohio, Proponent Testimony for SB 271 in Ohio Senate Energy and Public Utility Committee, January 18, 2012.
[8] Ibid.
[9] Tom Pelto, President, AT&T Ohio, Proponent Testimony for SB 162 in Ohio Senate Energy and Public Utiity Committee, October 6, 2009.
[10] Ibid.
[11] Op cit, Pelto, 2012.
[12] Rate Case Process, Public Utilities Commission of Ohio website - http://www.puco.ohio.gov/puco/index.cfm/consumer-information/consumer-topics/rate-case-process/
[13] Ohio Revised Code 4927.11C
[14] Marianne Townsend, personal electronic communication in response to Innovation Ohio electronic inquiry with PUCO, April 23, 2012.
[15] Ohio Revised Code 4927 C(1) " (C)(1) Subject to the restrictions in division (C)(2) of this section, a fully competitive incumbent local exchange carrier may withdraw basic local exchange service if it gives at least ninety days' prior notice to all of the following"
[16] Federal Communications Commission Public Notice, "Wireline Competition Bureau Announces Support Amounts for Connect America Fund Phase One Incremental Support," April 25, 2012.
[17] Connected Nation, "FCC Begins Implementation of Connect America Fund: Price Cap and Rate of Return Carriers A Connected Nation Policy Brief," April 27, 2012
[18] Amy Hanauer, Policy Matters Ohio, "State of Working Ohio 2011," September, 2011.
[19] Ohio Department of Development, "Ohio Poverty Report," April 2011.
[20] Percentage relying on landline service was determined by Stephen J. Blumberg, Ph.D., and Julian V. Luke, Division of Health Interview Statistics, National Center for Health Statistics; Nadarajasundaram Ganesh, Ph.D., and Michael E. Davern, Ph.D., NORC at the University of Chicago; and Michel H. Boudreaux, M.S., and Karen Soderberg, M.S., State Health Access Data Assistance Center, University of Minnesota, *Wireless Substitution: State-Level Estimates from the National Health Interview Survey, January 2007-June 2010,* National Health Statistics Reports, Number 39, April 20, 2011, at 8. (Available at: http://www.cdc.gov/nchs/data/nhsr/nhsr039.pdf). Applied to total population of adults, 18 and over, in Ohio of 8,805,753, source: U.S. Census Bureau, 2010 Census.
[21] According to testimony from the Ohio Poverty Law Center, the FCC requires ILECs that receive universal service funds for Lifeline service to offer BLES. Passage of SB 271 would complicate this requirement, either preventing companies from withdrawing service or forcing them to end their Lifeline program. Michael Smalz, Senior Attorney, Ohio Poverty Law Center, Testimony Before the Senate Energy & Public Utilities Committee, February 8, 2012.