Peter Bluhm testimony before Vermont PEG Access Study Committee

August 22, 2019

I. Introduction

Madam Chair, members of the committee; thank you for the opportunity to speak today. My comments today relate primarily to the history and legal structure of the Vermont Universal Service Fund, as well as to prospects for finding additional financial support for community PEG systems, with particular reference to broadband services.

I will be reading prepared comments, which I will file later if you wish.

I will first introduce myself.

- Early in my career, I worked for a decade with the Vermont Legislative Council. I staffed numerous committees during those years, at a time when there were relatively few attorneys in the office.
- For two years, serving under Governor Kunin, I was the Deputy Secretary of Administration.
- Beginning in 1990, I worked for seventeen years as Policy Director at the Public Service Board (now the Public Utility Commission). During these years, I served as a hearing officer on numerous telecommunications investigations. I also testified frequently before legislative committees and drafted the bill that in 1994 created the Vermont Universal Service Fund. I subsequently managed that fund for about a decade.
- After retiring from Vermont state employment in 2007, I worked at the National Regulatory Research Institute, first as Telecommunications Principal and later as Research Director. Among other work, I authored a national survey of state universal service funds.
- Beginning in 2009, I began work as an independent telecommunications consultant. I have worked for a range of clients, including state utility commissions and public advocates, as well as a small telephone company in the Midwest.

II. Universal Service Historically

The concept of universal service dates back to the early part of the 20th century when rural areas of the country were unable to get either electricity or telephones. Vermont

worked hard, in cooperation with federal agencies, to solve this problem. It created VELCO and it allowed municipal electric companies and coops to form. But Vermont's efforts to expand telephone service were not quite as aggressive. Instead, the FCC pulled most of the load in helping to get costly service in rural areas.

Until the 1990s, the chief support for universal telephone service took the form of implicit transfers that arose from regulator-set rates. Monthly local service rates were low and were nearly the same in the cities and in the countryside. The costs were vastly different, however, so the regulators increased other charges. Business rates were higher than residential rates, and toll usage rates were quite high. Many people criticized these policies as "implicit subsidies" from urban areas to rural areas. In the 1990s, these subsidies looked vulnerable to competition, and there was an effort to replace these pricing mechanisms with "explicit" mechanisms consisting of explicit support payments.

Vermont also took several important local initiatives to enhance universal service. First we adopted a "lifeline" program that was funded by having the Vermont telephone companies pool the subsidy monies using an industry-wide pool.

In the 1990s, it became apparent that local exchange competition was coming and that cross-subsidies between urban and rural areas were doomed. If there was "cream" to skim in Burlington and Rutland in the form of above-cost rates, it would increasingly go to the new competitors, and incumbent carriers would no longer be able to overcharge some customers for the benefit of others who imposed higher costs.

The 1994 VUSF statute thus created a system of explicit universal service charges and authorized distributions primarily aimed at reducing rate and service disparities that disadvantaged the state's many rural customers. The Vermont Legislature has adjusted that system this year by passing Act 79, which increased the VUSF charge and which created some new spending programs for broadband.

Vermont's VUSF law is 25 years old. In the intervening years, telecommunications technology has changed dramatically. Cell phones are one big change. Cellular service lines have now far eclipsed landline service lines. Many households with both services available have even terminated their landline service. Fortunately, cellular companies contribute to the VUSF, just as do the wireline companies.

Broadband is an even more dramatic development. In 1994 Internet service was almost entirely provided as a dial-up service over the telephone network, and it was slow. Broadband service was something that big companies bought at great cost from the telephone company in the form of "special access" circuits.

The universal service problem persists today, even after these changes. The problem still is that it costs a lot to string cables to houses in rural areas that are widely separated. It doesn't matter whether those cables are copper pairs of wire or optical fiberglass strands. The average distance between customers is still the most compelling variable.

Now PEG funding has been added to the problem list as well. Like E-911 and rural network deployment, PEG is yet another communications-related program that has an eroding funding base due in part to ever increasing usage for broadband.

III. Legal Structures

I agree with the Vermont Access Network memo already in your record that telecommunications policy historically has comprised a mixture of benefits and burdens. The benefits have included the right to use public ways, pole attachment rights, and exemption from antitrust laws. The obligations have been many, but have often included unique and intrusive regulatory systems and unique taxation burdens. Those obligations also classically included the obligation to extend existing lines to serve new areas, the so-called "carrier of last resort" obligation. Later, we added the duty to pay the VUSF surcharge, a revenue stream devoted solely to promoting benefits in the telecommunications space.

A. Intrastate and Interstate Telecommunications

One key decision made in 1994 by the Vermont Legislature was that since the VUSF would support programs that benefited both intrastate and interstate telephone service, both of those services would be surcharged equally. This decision, intended to secure the benefit in the fairest possible way, also created legal risk.

The legal fiction of intrastate and interstate is almost as old as the telephone itself. "Intrastate" were mainly the calls that originated and terminated in a single state; interstate calls crossed state lines. Telephone companies had to live in both worlds, and this greatly complicated rate setting. Telephone companies were treated as dual entities, each with two revenue streams and two separate sets of costs. The states and the FCC each tried to avoid intruding by setting rates only within their own regulatory "jurisdiction." The division worked because "calls" were the unit of nearly all communications, and for billing purposes the network kept track of where each call originated and terminated.

Today there is very little equipment or traffic in the telecommunications network that one can fairly characterize as inherently intrastate or interstate. The reason is as primarily

technological. The digital packet has replaced the call as the basic unit on the network, and nobody tracks where these packets originate or terminate.

Nevertheless, the jurisdictional fiction still powerfully influences regulatory policy including universal service and even taxation. For example, federal USF charges apply only to "interstate" telecommunications,[1] and the FCC asserts broad jurisdictional power over those interstate telecommunications. Thus what is "interstate" has virtually no surviving technological significance, but it is still legally paramount, especially as a rationale for federal preemption.

B. Internet Tax Freedom Act

As of yet there is no VUSF surcharge on broadband. This may have made sense 25 years ago when the Internet was still a young technology needing shelter. By contrast, today's broadband service is the dominant stream. It carries both voice telephone and video as mere applications. But Vermonters today are paying for extra broadband deployment under a telephone surcharge that was designed 25 year ago before many people even knew that broadband existed.

And broadband is a large market to overlook. Most customers, even in Vermont, have broadband available at their locations, and most subscribe. My own cable provider charges 150% more for my Internet service than for my telephone service. Moreover, customers increasingly are cutting their cable service and rely on Internet video streaming. Imposing substantial charges on only a portion of a market can create competitive distortions over time. Moreover, such a system can be unfair, especially to poor or elderly customers who may be unable to afford broadband but who still need telephones.

In sum, broadband has become the key telecommunications goal for the 21st century, and the broadband dog wags the telephone tail. Broadband has also begun to affect cable television revenues as more and more customers terminate their traditional video subscriptions and rely instead on Internet streaming from companies like Hulu and Netflix.

I recommend below several options that might allow for increased PEG funding by altering charges on broadband. Before offering them, however, I will discuss the terms of the Internet Tax Freedom Act (ITFA)[2], which is a possible barrier to any such step.

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[1] 47 U.S.C. § 254(d).

[2] 47 U.S.C. § 151, note, (ITFA) § 1101 et.seq.

The basic provision of the ITFA is to prohibit state and local taxes on "Internet access."[3] This today includes broadband access, although originally it mostly meant such dial-up services as America Online. The ITFA was first enacted in 1998 as a temporary moratorium, but it has now become a permanent feature of federal law. The ITFA has four exceptions I will mention here.

1. Grandfather USFs

First, there is a broad grandfather clause that protects the existing VUSF. It exempts from the federal act all state universal service funds "in effect on February 8, 1996."[4] Vermont's VUSF surcharge was initially imposed before this date, but has never applied to Internet access. Thus this exemption is likely of little value to current Vermont law. If Vermont were to amend the VUSF to include broadband, the courts would likely hold that Vermont had dissolved whatever grandfather protection exists today.

2. Benefit Fees

Two kinds of fees are exempt from the ITFA prohibition. The first is a fee "imposed for a specific privilege, service, or benefit conferred."[5] As noted in the VAN memo in your record, this was the basis on which the Oregon Supreme Court upheld the license fee in Eugene Oregon. The court held that this fee was not preempted by the ITFA because it was a fee entitling the cable company to use the city's rights-of-way. *City of Eugene v. Comcast of Oregon II, Inc.,* __Or.___ (2016) (https://law.justia.com/cases/oregon/supreme-court/2016/s062816.html).

Under this model, a fee could be imposed on broadband providers (and other utilities) who use the public rights-of-way. There are other legal issues with this approach, however, involving the terms of existing cable franchises, and implications for various forms of property taxation. I do not offer opinions on those issues.

3. 911 Fees

At the tail end of the ITFA, one finds some other exemptions. One is a relatively broad exemption for 911 charges. *(handout)*

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[3] ITFA § 1101(a)(1).

[4] ITFA § 1107(a).

[5] ITFA § 1105(8)(i).

> Nothing in this Act [probably means "this title"] shall prevent the imposition or collection, on a service used for access to 911 or E–911 services, of any fee or charge specifically designated or presented as dedicated by a State or political subdivision thereof for the support of 911 or E–911 services if no portion of the revenue derived from such fee or charge is obligated or expended for any purpose other than support of 911 or E–911 services.[6]

The only limitation here is that the funds so raised must be "expended" only for that purpose. Some but not all current VUSF proceeds are used for E-911 purposes. Therefore, under any revised Vermont statute, so long as the 911 portion of a broadband access charge were separately imposed and deposited into a special fund used only for E-911, the statute would be exempt from ITFA.

4. Universal Service Exemption

Another exemption in the ITFA applies to all state universal service funds "authorized by section 254 of the Communications Act of 1934 or in effect on February 8, 1996."[7] (*handout*) The relevant portion is subsection (f) and is shown below. I have italicized the most problematic language. *(handout)*

> (f) State authority. A State may adopt regulations *not inconsistent with the Commission's rule*s to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on *an equitable and nondiscriminatory basis*, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional *specific, predictable, and sufficient mechanisms* to support such definitions or standards that *do not rely on or burden Federal universal service support mechanisms*.

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[6] ITFA § 1107(b).

[7] ITFA § 1107(a) (state surcharge must be "authorized by" USF provision of the 1996 act, which in turn prohibits any state action that burdens federal support mechanisms. 47 U.S.C. § 254(f).)

Regrettably, subsection 254(f) is such a complex statute that it offers many possible avenues for a legal challenge. It is even more complex because Vermont may not be free to define for its own purposes such terms as “telecommunications.”

The statute requires telecommunications “carriers” that provide intrastate telecommunications service” to pay USF charges. Those charges must be “equitable and nondiscriminatory," a standard that is open to wide interpretation.

Historically, subsection 254(f) has been interpreted by the courts narrowly to mean that states can impose a USF surcharge only on intrastate service and therefore not on interstate services. Fortunately, Vermont avoided a challenge to its current USF statute, notwithstanding this statute, because Vermont’s USF is an exercise of its sovereign taxing power and not of delegated authority under section 254.

The statute creates authority only to collect funds from certain “telecommunications carriers.” Under recent FCC decisions, broadband access providers neither provide telecommunications services nor are they carriers.

State laws must be “not inconsistent” with FCC rules. I am not aware of any FCC formal rules on the question of imposing state USF charges on internet access. Nevertheless, as discussed below, the FCC has seemingly signaled an intention to do just that in an appropriate case.

The statute also allows states to “provide for additional definitions and standards to preserve and advance universal service.” The language is obscure, but in context it is understood to authorize additional, supplemental state USF funds. Regrettably, this delegated power is subject to two important limitations itself.

- “specific, predictable, and sufficient mechanisms”
- “do not rely on or burden Federal universal service support mechanisms.”

Federal courts have repeatedly overturned state efforts to broaden the base for their universal service programs, using a variety of rationales based in this statute.

- In 2004, a federal court invalidated Texas’s effort to include interstate revenues in its universal service base failed to be “equitable and nondiscriminatory” because the result was that companies providing both intrastate and interstate services in Texas would pay more than companies providing only interstate service.[8]

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[8] *AT&T Corp. v PUC* 373 F3d 641 (2004, CA5) (Multi-jurisdictional carriers would have paid an approximate 11% fee on their revenue derived from interstate

- Another federal court invalidated Oregon's effort on the ground that a state universal service fund surcharge on interstate telecommunications revenues "burdened" federal universal support mechanisms.[9]
- The South Carolina Supreme Court has taken the opposite view and has upheld that state's charge on intrastate and interstate revenue.[10]
- Vermont's statute has never been challenged on the basis of section 254(f), possibly because it was drafted to emulate the Illinois Telecommunications Sales Tax law upheld by the Supreme Court in 1989.[11]

IV. <u>Options</u>

A. <u>Add Broadband to the VUSF Base</u>

An obvious option is to extend the VUSF to cover all retail communications passing over public rights-of-way, specifically including broadband. This option is consistent with the intent of the 1994 legislature, which insisted that all telecommunications, no just intrastate telecommunications, should contribute to the VUSF. This option raises considerable litigation risk, however.

I discussed above the traditional legal fiction that divides telecommunications regulatory jurisdiction into intrastate and interstate regimes. The FCC has repeatedly insisted that broadband is exclusively "interstate" for purposes of regulation. This policy not only precludes state regulation of rates and terms of service for broadband, but, in its arrogance, the FCC also supposes that it has control over which state and local taxes may be applied to interstate traffic. In a 2015 decision the FCC said this: (handout)

> [W]e conclude that the imposition of state-level contributions on broadband providers that do not presently contribute would be inconsistent with our decision at the present time to forbear from mandatory federal USF contributions, and therefore we preempt any state from imposing any new state USF contributions on broadband—

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telecommunications calls, while their pure-interstate-provider competitors would have paid only the 7.28% federal fee on interstate revenues.)

[9] *AT & T Communs., Inc. v Eachus* 174 F Supp 2d 1119 (2001, DC Or).

[10] *Office of Regulatory Staff v S.C. PSC,* 374 SC 46, 647 SE2d 223 (2007).

[11] *Goldberg v. Sweet*, 488 U.S. 252, 109 S.Ct. 582(1989).

> at least until the Commission rules on whether to provide for such contributions.[12]

This FCC decision was issued in 2015 during the Obama administration. Much of the content of that order has been reversed by a subsequent FCC order during the Trump administration, but not the above preemption prediction. It is widely believed that the current FCC still subscribes to this policy and would quickly seek to preempt any state effort to subject broadband revenues to state universal service charges.

The last clause in the above quote suggests that the current federally-imposed moratorium might end when and if the FCC decides to expand the base of its own USF programs, which also are suffering from revenue erosion. This is a faint hope, as there seems to be little chance that the FCC will soon take such action.

As a legal matter, if the FCC were to preempt a state from imposing USF charges on broadband access, I think the legal outcome is in some doubt. Nevertheless, if Vermont were to go down this path, FCC preemption is highly likely and ultimate success would depend on the outcome of a long and costly appeal.

B. Broaden the Sales Tax

The second option would abandon the VUSF model entirely and apply the Vermont Sales Tax to telecommunications, including broadband. Thus the current VUSF surcharge and funding VUSF programs would be merged into the state's general tax structure, and VUSF programs would be funded from the General Fund, using the normal appropriations process.

I make this suggestion sorrowfully. First, it would be a huge change in state law. Second, it would be an admission of final defeat for one of the original objectives of the 1994 law. That law was passed at a time when the telephone industry provided many cross-subsidies that were invisible within rate designs. The VUSF was a state program, but we tried to keep the system as independent as possible from other state government programs and systems. We wanted to maintain the separation by which the telephone industry continued to raise funds that were spent only on telephone network benefits.

That goal has been frustrated in many ways. First, the accountants decided that, notwithstanding the language in the law, the VUSF is state funds and belongs in the state's accounting system. I'll skip the intervening chapters, but the big disappointment now is that VUSF spending provides benefits across the telecommunications network, it

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[12] FCC, *Open Internet Order*, FCC 15-24, ¶ 432 (Adopted: February 26, 2015).

seemingly can raise funds from only a small portion of that network. The tail is paying for the whole dog. If the sales tax can overcome this – can broaden the base to all retail telecommunications billed in Vermont – that could be a way to restore the original objective of getting the beneficiaries of the programs to all pay their fair share.

C. Connection Charges

This option focusses on the wires and fibers that deliver end user service, rather than the services themselves. It is widely understood as unlikely to provoke FCC preemption. Although I think the FCC is endlessly clever in finding ways to expand its own jurisdiction, I accept that connection charges stand a good chance of surviving a preemption effort.

The method is to stop looking at revenue from telecommunications services and focus instead on the wires and other facilities used to provide that broadband service. In most cases there is a monthly or yearly charge per "connection." A connection would be a telephone line or a broadband line. You might decide that a line that provides both is one or two unit connections.

Connection plans are not ideal because some connections have data rates thousands of times faster than household DSL or cable modem services. So any connection plan should consider whether all connections are equal and, if not, how to charge for fast connections.

A recent study by the National Regulatory Research Institute indicates that "connection charges" for universal service purposes have been instituted in Maine, Nebraska, New Mexico, and Utah.[13]

- Maine has imposed a fee of $0.21 per line or telephone number, per month (with no more than 25 lines per account being billable) for its telecommunications Education Access Fund. A parallel change is being considered for the state USF.
- Nebraska has applied a flat rate per connection charge of $1.75 per year to each residential line and small business line. Meanwhile, large customers will continue at least for the moment to pay on a percentage of revenue basis.
- New Mexico, responding to a continuing decline in intrastate telecommunications revenues, has prescribed a new connection charge of $1.24 per year per "communication connection."
- Utah has imposed a charge of $0.60 per month per "access line."

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[13] Lichtenberg, *State Universal Service Funds 2018: Updating the Numbers,* National Regulatory Research Institute, NRRI Report No. 19-02, 31 (2019).

That concludes my remarks. Thank you for the chance to speak today with your committee.

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