

Point-and-click democracy

Voting on the Internet: Promise and Problems

Public officials and interest groups increasingly are frustrated by dwindling participation at the polls. According to the Federal Election Commission, for example, nationwide voter turnout in presidential elections has fallen from 63 percent of the voting-age population in 1960 to less than 50 percent in 1996.

Online voting, the newest proposal for boosting voter turnout, is gaining support in many circles. Some observers say it is only a matter of time before voters will be able to cast secure and secret electronic ballots from the comfort of their own homes or offices. Making voting more convenient, they say, will encourage more people to vote.

The move toward online voting has its detractors, however. Opponents warn that security breaches and fraud could threaten the integrity of elections conducted online and that electronic voting could tilt the electoral process in favor of people with greater access to technology.

Proposals for online voting include voting from home via secure

email, from home or another location through a Web link to the ballot, and from a traditional polling place with Internet access. State and federal laws mandate equal access to the voting process, so any online voting system must be accessible to all voters.

It is important to distinguish Internet-voting systems from direct recording equipment (DRE) systems. With DRE systems, voters also make their choices on a computer. Votes are

stored and tabulated in the computer in the precinct for later retrieval by election officials, but the computer offers no access to the Internet. Localities in many states — including Dallas, El Paso, and Upton counties in Texas — already use such systems.

In January 2000, the Brookings Institution and Cisco Systems held a [symposium in Washington, D.C.](#), on

(See Internet voting, page 2)

Hazy Future for Tobacco-Settlement Funds

Texas' award of \$17.3 billion over the next 25 years from the tobacco industry originally seemed to offer a large, long-term budget cushion of roughly \$1 billion per biennium. But tobacco-settlement receipts may turn out to be a declining source of revenue over the long haul.

Last session, state lawmakers appropriated all \$1.8 billion of the tobacco-settlement funds that the state originally expected to receive

through fiscal 2001. However, new estimates by the comptroller indicate that tobacco receipts could fall short of the budgeted amount by between \$75 million and \$90 million, depending on various assumptions, largely because of a nationwide drop in tobacco sales.

Determining payments

In 1996, Texas filed a 10-count federal lawsuit accusing the tobacco industry of violating conspiracy, racketeering, consumer protection, and other provisions of state and federal law, seeking to recover

**Graph: Percent of
Households with a
Computer by Income**

3

**The debate over
access to broadband
Internet platforms**

6

(See Tobacco, page 10)

(Internet voting, from page 1)

the future of Internet voting. Participants — including Governors George Pataki of New York and Gray Davis of California, a panel of state and federal elections officials, and high-tech industry representatives — agreed that any Internet voting system must be private, prevent fraud, avoid crashes, and deter hackers. The electronic transmission system must be secure, with a verifiable audit trail that does not violate voters' privacy.

The symposium reached no consensus on how or when Internet voting will become widely available, although John Chambers, chief executive officer of Cisco Systems, predicted that the vast majority of states will have Internet voting options by 2004. Most agreed with Gov. Pataki that the impetus will not come from the federal government but from the states. Besides implementing laws and election rules, states must ensure that the "digital divide" — the gap between technological haves and have-nots — does not widen and that online voting does not discourage from voting people who do not have access to a computer or who are not computer-savvy.

Online voting experiments

In the first legally binding public election over the Internet, the Arizona Democratic Party allowed its members to vote electronically in their March 2000 primary. Voters with a personal identification number could cast ballots over the Internet from their homes or offices between March 7 and 10. Those without Internet access at home could vote from libraries or community centers with online access. At the polls on March 11, voters could cast their ballots online at a computer terminal or by traditional paper ballot. Democrats made at least one Internet polling place available in every legislative district and county throughout the state.

According to an Associated Press report, the primary drew about 78,000 ballots — double the previous record for turnout in a primary — slightly more than half of which were cast electronically. However, people who used older Web browsers experienced crashes, and many others had difficulty executing their votes because the telephone lines were tied up.

The Voting Integrity Project, a Virginia-based nonprofit civic group, had filed a lawsuit in federal court to block online voting in this primary on the grounds that it violated the federal Voting Rights Act by discriminating against minority and low-income voters, who are not as likely to have access to the Internet. The online voting system, the group alleged, created a disadvantage for those without access. The suit also contended that the Democratic Party could not administer a new voting system until the U.S. Department of Justice had cleared it. Because of past discrimination against minority voters, Arizona is one of 16 states (including Texas) required to get federal approval of any change in election rules. The Justice Department precleared Arizona's Internet election in February. The lawsuit has not been dismissed, however, and the election results could be nullified if it is proved that the vote was biased against minorities and poor citizens.

To encourage participation in its presidential straw poll in January, the Alaska Republican Party allowed an estimated 3,000 Republicans to cast their ballots by computer. By logging onto *VoteHere.net*, a data security company that makes voting systems, voters in remote districts in rural Alaska could cast ballots with a single click of a computer mouse. Only 35 Alaskans cast their ballots electronically, however.

On February 29, Thurston County, Wash., held an Internet test vote in conjunction with a special school district election and the presidential primary. The nonbinding ballot was aimed at helping the county auditor's office and *VoteHere.net* evaluate Internet voting. Any registered voter in the county could vote early from a remote computer or from one of 10 polling places on election day. Of the 3,605 voters who responded to the associated survey, 94 percent said they would use Internet voting if it were available in their area.

The U.S. Department of Defense's Federal Voting Assistance Program has established a pilot project to allow 250 armed-forces personnel to cast their ballots online. DoD has selected Texas, Florida, South Carolina, Utah, and Missouri to participate. The voters, stationed either overseas or in other states, will cast online ballots in the 2000 presidential election. Texas military personnel chosen to participate are registered voters in Dallas County. The Texas Election Code, Chapter 105, allows

any active overseas military personnel serving in a combat zone and eligible to receive hostile-fire pay, as well as their spouses and dependents, to vote electronically, including by the Internet.

Texas efforts to boost voter turnout

In 1987, Texas took a pioneering step toward making voting more convenient by allowing early voting in person. Essentially, election day begins 17 days before an election. Any registered voter can vote at any early-voting site in the county. The Legislature's goal was to make voting more accessible by allowing people to vote while going about their daily activities at shopping centers and malls, grocery stores, and other retail establishments. Texans also may vote early by mail under certain circumstances. For more background, see House Research Organization Focus Report Number 74-21, May 21, 1996, *Can Voting by Mail Deliver Results?*

Early voting is very popular, according to Ann McGeehan, director of elections in the Secretary of State's Office. "We can't say that it's actually increased turnout," she said. "It has not. About one-third of the people who vote, vote early. But voting rates in Texas have gone down just as in every other state in the country." In 1998, the governor's race drew only 32.5 percent of eligible voters.

Citizens already are showing interest in online voting, according to McGeehan. She predicts that as more voters become Internet-savvy, they will want to be able to vote online.

Texas voters may register to vote by mail, and the Secretary of State's Office and some counties allow people to order voter registration forms over the Internet. The Internet site www.netvote98.mci.com allows voters in all states to apply for registration forms. In 1997, the

75th Texas Legislature authorized electronic voting from outer space for astronauts. A Texas astronaut from Harris County voted from space in the 1997 constitutional amendments election.

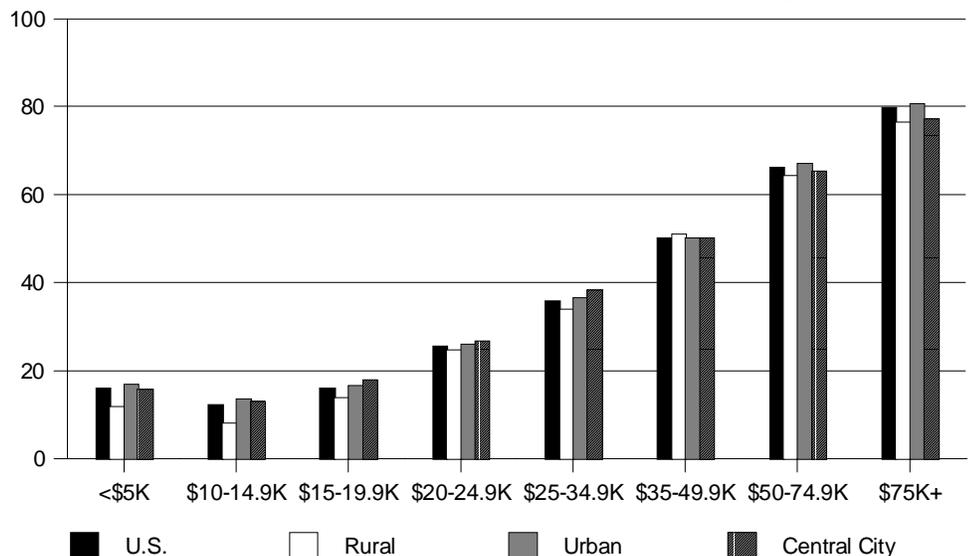
Oregon has gone furthest in trying to make voting easy by abolishing polling places and relying exclusively on voting by mail. Voters there wanted the convenience of being able to vote from home. Voter turnout in Oregon, however, has not increased.

The digital divide

A major concern with Internet voting is unequal access by potential voters. It is estimated that half of the American public now has access to the Internet. However, that percentage is much lower among minorities.

Urban households with annual incomes above \$75,000 are 20 times more likely to have Internet access than are those with lower incomes, according to a recent study by the U.S. Department of Commerce. (See chart below.) Single parents, rural residents, Native Americans, Hispanics, and African-Americans lag behind other groups in computer ownership and Internet access. The report

Percent of Households with a Computer by Income



Source: U.S. Department of Commerce, National Telecommunication and Information Administration.

concludes that minorities will continue to confront this digital divide because of factors that include income, race, geography, and education.

Some experts see the digital divide as a “have-now, have-later” issue. They say that while all new technologies have a time lag, information technology has spread faster than any other new technology in history. Internet costs are falling and more libraries and community centers are offering free access, they say, so a rapidly increasing number of Americans will gain access to the Internet.

The White House has called for the National Science Foundation to conduct a year-long study on the feasibility of online voting. Also, President Clinton plans to seek up to \$50 million in grants to help low-income families get online.

Aside from the “digital divide,” the biggest challenges to Internet voting may be network security and data encryption.

Benefits and drawbacks

Supporters of online voting say it is not intended to replace ballot-box voting but to complement traditional means of casting ballots. They see it as a tool to boost turnout by engaging nonvoters because of its ease and convenience. It also has the potential to attract many more voters in the 18-to-34 age group, supporters say. If people could vote from their home computers, supporters argue, inclement weather or long lines at the polls would not deter people from voting. Internet voting at home would improve access dramatically for disabled voters, they maintain.

Aside from the issue of possible discrimination against those on the wrong side of the digital divide, some say the biggest challenges to Internet voting are network security and data encryption, the method by which data are modified into an unintelligible mathematical code.

The most important step in ensuring voting-system security is authenticating and verifying individual voters. Election officials must determine that each person trying to vote is eligible, that each person gets only one vote and that the vote is secret, and that tabulation is accurate. Some experts say that creating the complex system and

infrastructure needed to prevent attacks on Internet voting machines and election computer systems while protecting voters’ privacy is the most difficult programming and cryptographic challenge ever attempted.

The California Internet Voting Task Force, a panel of technology experts, political scientists, and civic leaders, warns against allowing voters to cast their ballots from home via the Internet in the near future because of security risks. In its [January 2000 report](#), the panel said that despite advanced security software, an electronic terrorist who was a skilled “hacker” would not find it hard to install viruses on people’s computers without their knowing it, perhaps with the aim of altering votes. The panel recommended a phased-in approach to developing an Internet voting system that will enable election officials and voters to identify possible pitfalls before they occur.

Skeptics maintain that voting is not like e-commerce. Problems with commercial transactions usually can be remedied through a traceable name or credit card number or an address used for delivery. Having to overturn an election and order a new one because of fraud could undermine the credibility of those ultimately elected.

The Voting Integrity Project’s August 1999 report entitled [“Are We Ready for Internet Voting?”](#) warned states against jumping onto the Internet-voting bandwagon without full public debate and thorough examination. System overloads and security breaches could affect election outcomes seriously, according to the report. Online voting from home lends itself to fewer safeguards than voting in a public place and could present more opportunities for fraud, the report said.

Another potential issue: Most states have laws prohibiting electioneering within a certain distance of a polling place. Voters may take voting material but not campaign material into a polling place. Could someone voting at a kiosk retrieve voting information and also view a candidate’s Web site while voting? Advocates of online voting note, however, that the same concern

already applies to those voting at a location other than a polling place, such as absentee voting by mail.

Will the Internet increase voting?

The main issue still looming is the underlying cause for nonvoting. Would easier access increase voter turnout or simply make it easier for individuals who already vote to cast their ballots?

Advocates say using the Internet can have a huge impact on increasing participation and creating a more informed electorate. They say the Internet is the fastest and easiest way for people to gain access to information about candidates and their campaigns. Advocates claim that the Internet is helping to strengthen representative government by bringing candidates closer to the voters than could a 30-second television commercial.

Skeptics say that while access to more information is always good, it is unclear how the Internet can be harnessed to raise interest in voting and to motivate people to seek out information. They point out that the National Voter Registration Act of 1993 — the so-called “motor voter” initiative allowing citizens to register to vote at various businesses and governmental agencies, including driver’s license registration sites — was supposed to increase turnout through easier registration. But since that program was implemented in 1995, nationwide voter turnout has declined. Also, some believe that requiring at least some minimal effort to vote helps ensure that those voting will have made some attempt to cast an informed ballot.

Other policy issues

Proponents say Internet voting may be the quickest, cheapest, and most efficient way to administer elections, and that it would reduce the number of geographic polling places and consolidate the counting process. Texas’ decentralized election system involves more than 3,200 separate local jurisdictions, each of which can use its own voting system. Ninety counties still use paper ballots that are counted by hand. Skeptics note that it is unclear who

would pay the cost of converting to a new system and that not all counties may have adequate funds to do so.

Most Internet-voting systems now being developed would require each voter to have a digital certificate or digital signature. Some have suggested that digital signature technology is the key to secure online voting, but the technology is expensive, and questions about funding need to be addressed. Texas now has more than 11 million registered voters, each of whom would need a digital signature.

Many states have adopted or are considering legislation that would make electronic signatures legally binding for certain transactions. In Texas, digital signatures are legally binding only for certain commercial transactions. HR 1714 by U.S. Rep. Tom Bliley (R-Va.) would adopt a national standard for making electronic signatures as legal as paper signatures. Now in a House-Senate conference committee, the bill would not require anyone to conduct electronic transactions but would set a benchmark for states that have not set a policy regarding electronic signatures.

For any type of Internet voting to go forward in Texas for official state and local government elections, the Legislature would have to authorize online voting and the use of digital signatures in elections. Also, the state would have to resolve the issue of how counties would fund the costs of converting to a new voting system.

Under the federal Voting Rights Act, the U.S. Justice Department would have to preclear Internet voting or any other electoral changes made by any governmental entity in Texas. The Texas Secretary of State’s Office also would have to review and certify any new equipment or process, including ensuring that any new system complied with Federal Election Commission guidelines. Procedures that relate to present-day balloting would have to be modified to include Internet voting. Also, lawmakers would need to address the potential problem of “hacking” an Internet voting system and extend to Internet voting the laws pertaining to voter fraud, vote tampering, and interfering with a voter’s right to a secret ballot.

— by Rita Barr

House State Affairs Committee Examines Broadband Internet Access Issues

On March 2, the House State Affairs Committee met to examine telecommunications and cable issues, including an update on implementation of SB 560. Enacted in 1999, SB 560 builds on existing law aimed at opening local telephone service competition in Texas. Among other provisions, the law sets rules for fair billing and for pricing flexibility, establishes consumer-protection measures, and requires incumbent local exchange carriers (ILECs) like Southwestern Bell and GTE to reduce the rates they charge long-distance carriers to use their lines.

The committee spent most of the meeting hearing testimony on a topic that has raised a host of policy issues for federal, state, and local lawmakers — requiring cable companies to provide open access to their broadband, or high-speed, networks to unaffiliated and competing Internet service providers (ISPs).

An estimated 6,000 ISPs are competing for Internet users in the United States. Many commentators argue that lower costs and higher quality and diversity of services result directly from this competition and that the only way to ensure continued competition and timely deployment of broadband technology is to mandate “open” access to *all* broadband platforms, including cable modems. Opponents of “forced” or “regulatory” open access, however, claim that any new regulations will stifle the burgeoning industry.

Broadband benefits

Broadband Internet access enables users to send and receive data as much as 100 times faster than with *narrowband* Internet access over traditional telephone lines. With faster data transmission, an Internet user can download lengthy files in seconds or browse through Web pages faster. Broadband Internet access also provides a continuous connection, unlike traditional telephone lines, which require a user to “dial up.” Broadband access enables users to download and upload data at high speeds, which

is useful for interactive applications such as online classrooms or health clinics. Internet telephony (traditional phone service over the Internet) and “streaming” video also require broadband’s higher-speed transmission rates. Streaming video lets Internet users view video programs as they are transmitted to their personal computers.

Various technologies or *platforms* can be used to provide broadband access. These include cable, an enhanced telephone service called digital subscriber line (DSL), satellite technology, land-based wireless, and others. Because cable television and telephone lines already are connected to people’s homes, most observers consider cable and DSL the most likely means of expanding access to residential broadband services.

While many businesses already have broadband Internet access, most residential Internet users still connect through their telephone wires. Many companies in the telecommunications and information industry, however, believe that broadband represents the future of the Internet, and they have positioned themselves for entry into the residential market through mergers, acquisitions, and substantial investments of money and resources.

For example, AT&T acquired cable giant Telecommunications Inc. (TCI) for \$55 billion in 1999, becoming the largest U.S. cable operator. TCI offers broadband Internet access through its affiliated ISP, @Home. AT&T also plans to acquire another large cable company, MediaOne Group, pending regulatory approval. Also, in January 2000, media conglomerate Time Warner, the nation’s second largest cable provider, agreed to merge with America Online (AOL), the largest ISP.

Broadband platforms and ISPs

A broadband transport platform provides the physical means by which a user gains access to the Internet through a connection provided by an ISP such as AOL or

Mindspring. The ISP helps a user navigate for information on the Internet, provides email service, and may provide additional content, news services, chat rooms, special online shopping areas, and other services.

Currently, customers using cable broadband must sign up with an ISP affiliated with or owned by their cable company. Customers who want to use another ISP must pay extra — one monthly fee to the cable company's service (which includes the cable ISP) and another to their ISP of choice. A customer might be opposed to changing to the cable ISP because of the change in email address or the loss of customized content.

DSL lines, the other most prevalent means of broadband access, are open to any ISP that wishes to provide Internet services. The Federal Communications Commission (FCC) recently ordered ILECs to grant any data carrier access to their DSL lines, as required by the federal Telecommunications Act of 1996. ILECs must grant competitive local exchange carriers (CLECs) access to individual elements of their networks, such as a DSL line, and sell them at below-retail rates to spur competition in local telephone service. Under the act, CLECs are not subject to such a requirement.

During the 1999 legislative session, Rep. Kim Brimer introduced HB 3393, which would have required any broadband Internet transport provider, including cable companies, to provide access to broadband services to any requesting ISP at rates and on terms and conditions at least as favorable as those the transport provider offers itself, its affiliate, or any other person. HB 3393 was left pending in the State Affairs Committee. Several bills introduced during the current session of Congress also would require cable companies to provide open access.

Open access issues

Much private-sector investment in broadband technology has taken place in the past few years, even

though important regulatory and legal decisions have yet to be made regarding government's role, if any, in widespread deployment of broadband access — particularly with respect to the issue of open access.

In opening the March 2 hearing, State Affairs Committee Chairman Steve Wolens noted that the committee's initial task with respect to cable issues is to explore the nature and extent of state and federal power to regulate services offered by cable companies, such as broadband Internet transport or even traditional telephone services. The committee also will address the policy considerations behind mandating that cable companies provide open access to their broadband networks, Wolens said.

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State level. According to Public Utility Commission (PUC) Chairman Pat Wood, the PUC traditionally does not regulate cable companies and their operations. Rather, under the federal Cable Communications Policy Act of 1984 (Cable Act), the FCC authorizes local

franchising authorities (LFAs), which can be either state or local entities, to grant nonexclusive cable franchises to companies seeking to serve a particular area. LFAs have certain limited price-control and consumer-protection powers and can impose certain conditions on the franchise. Most importantly, LFAs are charged with renewing and modifying franchise agreements. Texas has delegated franchise authority to cities. According to Wood, the PUC retains jurisdiction over traditional telephone services provided by cable operators.

If mandating open access were determined to be within the LFAs' authority, Wood said, the Legislature could make open access a statewide requirement. The PUC has no authority under current law to mandate open access to cable broadband, he said. Because the Texas Public Utility Regulatory Act (PURA) applies only to telecommunications utilities, the commission could not mandate access through a rulemaking process. Rather, a statutory change to PURA would be necessary, should the Legislature determine that federal law did not preempt this.

Local level. As in Texas, the cable LFA in most other states is the city and/or county. In response to complaints from unaffiliated ISPs, several cities and counties have begun to consider whether they will try to enforce open-access requirements on local cable franchises when modifying or renewing franchise agreements.

In June 1999, a federal district court in Oregon ruled that the City of Portland could require open access to TCI's broadband network as a condition for transferring its local cable franchise to AT&T after the latter acquired TCI. Pursuant to TCI's franchise agreement with the city and Multnomah County, the city and county had to approve any changes in TCI's corporate control.

Relying on their authority under the federal Cable Act to determine whether a change of ownership or control would eliminate or reduce competition, the city and county determined that AT&T's affiliated ISP had no viable competitors in the local market and that AT&T's cable modem platform was an "essential facility" that could not exclude competitors without a legitimate business reason. In antitrust law, an "essential facility" means a facility that competitors cannot duplicate in practice. AT&T had argued that the Cable Act preempts local attempts to mandate open access. The Portland case, *AT&T Corp. et al. v. City of Portland and Multnomah County*, 43 F.Supp. 846 (D. Or. 1999), is now before the 9th U.S. Circuit Court of Appeals.

According to Monte Akers, legal services director for the Texas Municipal League, the recent AOL-Time Warner merger, like the AT&T-TCI deal, presents change-of-ownership issues for LFAs. Provisions like those in the *Portland* case are common for many cities in Texas and across the country. Akers told the State Affairs Committee that Time Warner has sent a letter to its franchisers in Texas detailing the terms of the merger, under which Time Warner and AOL have become wholly-owned subsidiaries of a new holding company. Because of the structure of this transaction, Time Warner asserts that no transfer of ownership has occurred. Akers said that, while the validity of Time Warner's argument depends on the specific language of each city's agreement, at this time, no Texas city plans to challenge Time Warner because of the potential for expensive litigation.

Federal level. Sec. 706 of the federal Telecommunications Act of 1996 requires the FCC to determine whether "advanced telecommunications capability [broadband or high-speed access] is being deployed to all Americans in a reasonable and timely fashion." If not, the FCC may act to remove barriers to investment and to promote competition.

In January 1999, the FCC adopted a report pursuant to Sec. 706 concluding that broadband Internet access was still in the early stages of development and that, while it was still early to draw definite conclusions, it appeared that broadband technology was being deployed in a timely fashion. Therefore, the commission chose not to intervene.

The FCC has opposed local efforts to regulate open access to cable broadband, citing the confusion that could arise should each of 30,000 local franchises seek to impose different technology standards for cable broadband infrastructure. Also, such efforts would be limited to cable broadband without reference to other broadband technologies such as DSL or wireless. Following the *Portland* decision, the FCC's Cable Services Bureau issued a staff report in October 1999, again stating that "vigilant restraint" was necessary to foster competition and continued growth among all broadband providers and that the commission would continue to monitor the market for any anticompetitive developments.

Attorney Paul Glist, testifying on behalf of the Texas Cable and Telecommunications Association, said the FCC affirmatively has preempted the broadband field to facilitate the growth of a new industry, much as the commission did in the past with other pioneer technologies, leaving state and local LFAs no authority to mandate open access. Although the commission has not yet determined the exact regulatory classification of cable broadband, extensive regulation of any broadband technology would not be appropriate when the market is producing high-quality competitive services on its own, Glist said.

Policy considerations

Aside from these jurisdictional issues, the State Affairs Committee also discussed various policy considerations raised by an industry panel that included

Dale Bennett, vice president of AT&T Broadband and Internet Service's Texas Metro Region; William C. Carey, president of Time Warner Cable's Austin Division; and Ed Shimizu, director of GTE's National Regulatory Relations Department.

According to Bennett and Carey, while certain contractual and technical issues must be resolved, their companies have made public commitments to provide access to multiple competing ISPs with whom they can reach contractual agreements. Both said the regulatory process would retard open access because cable companies would have to stop their current efforts to provide access in order to determine their role under a new regulatory scheme. Also, they said, government regulation would create uncertainty in the market and would make companies hesitant to make the huge capital investments necessary to continue the explosive growth in e-commerce — exactly the effect the FCC's current "hands-off" policy is designed to avoid.

Cable broadband is not a monopoly justifying regulations like those imposed on ILECs such as Southwestern Bell and GTE, who complain that their DSL lines are open to competing ISPs, Bennett said. Under current law, ILECs can be regulated in such a manner because of their monopolistic status. The majority of Internet connections today are dial-up lines offered by ILECs because of their traditional position in the marketplace.

According to Bennett, cable companies had about 4 percent of the residential Internet access market at the end of 1999. That figure is expected to rise to 7 percent by the end of this year and to 22 percent by 2004, according to an analysis by Morgan Stanley Dean Witter & Co., "[The Internet Data Services Report](#)," August 11, 1999. By 2004, 71 percent of the market still will be served by dial-up or DSL, and satellite providers are expected to serve the remaining 7 percent.

According to Bennett, dramatic growth in the Internet has occurred because vigorous competition already exists among various technologies, including cable, DSL, and satellite. Forced open access is not necessary to bring about competition, he said. For example, Bennett noted, the rise in cable modem access has spurred recent advances

in DSL residential deployment, such as "Project Pronto," through which SBC (Southwestern Bell's parent company) aims to make DSL available to about 80 percent of its customers by the end of 2002.

Unlike AT&T and Time Warner Cable, GTE fully supports mandated open access, GTE's Shimizu told the committee. Without open access, he said, the competition that has caused the Internet to flourish will be stifled as cable companies and their affiliated ISPs attempt to monopolize cable broadband access, providing only indirect access to independent ISPs, many of whom are the customer's first choice. Consumers should not have to pay extra for the ISP of their choice simply because they want high-speed Internet access, he said. Shimizu cautioned that the AT&T-TCI and AOL-Time Warner commitments to open access are not legally binding and are subject to the expiration of current contractual agreements with certain ISPs. Open access is good policy for all cable providers, he said, noting that while these two companies represent a large part of the cable market, they do not represent the whole industry.

Shimizu also discussed regulatory parity between telephone and cable companies. Given that current law requires GTE to provide open access to all ISPs, he asked why cable companies or other CLECs should not be subject to the same requirements, since the two types of companies are in direct competition for broadband business.

Without the threat of federal and state or local regulation, Shimizu said, AT&T-TCI and Time Warner-AOL would not be agreeing to open access, and regulation would bring about that access faster than would the marketplace. For example, although these companies have stated that they will implement open access in the future, nothing prevents them from starting the planning process now, Shimizu said. Thus, he said, it is important for the Legislature to continue to show a commitment to this issue.

The committee will meet next on May 2 to discuss more fully the state and federal statutory and jurisdictional issues relating to cable telecommunications and Internet services.

— by Hope E. Wells

(Tobacco, from page 1)

billions of tax dollars the state had spent to treat tobacco-related illnesses. In settling the lawsuit, the industry agreed to pay the state \$15 billion over the next 25 years and to pay \$2.3 billion through fiscal 2003 to Texas counties and hospital districts that had intervened in the settlement. Actual payments under both parts of the settlement are subject to “adjustment” formulas related to consumption, inflation, and profitability.

Under the settlement terms, Texas’ payments from the tobacco industry rise or fall in proportion to the consumption of cigarettes in the United States each year as compared to consumption in 1997. The tobacco industry reported that in 1999, consumption fell by about 14 percent from 1997 levels.

If industry profits adjusted for inflation are higher than in 1997, Texas will receive an additional payment that would help counter payment reductions related to declining cigarette consumption. However, Texas payments will not be reduced further if industry profits are lower than or equal to the 1997 levels. Information on the tobacco industry’s profitability for 1999 is not yet available. An inflation factor of 3 percent is to be used for calendar 1999.

Adding to the uncertainty of future payment levels, the industry is contesting the interpretation of a part of the consumption adjustment formula that takes into account any decline in consumption related to a decline in teenage smoking. The industry claims that the formula as stated in the agreement with the State of Texas does not conform to the industry’s intent at the time the agreement was made. Payments to Texas could be reduced further if the formula is interpreted according to the industry’s claims. The Attorney General’s Office is analyzing the industry’s request against provisions the industry has agreed to in its settlements with other states to determine if Texas could gain any benefit as a trade for changing the formula.

Cigarette sales are declining in the United States, and many warn that the industry may not remain profitable enough to meet its multibillion-dollar payment agreements.

The money granted to counties and hospital districts is that which accrued to Texas due to the “most favored nation” provision in the settlement, which awarded Texas increased payments comparable to Minnesota’s subsequent settlement on somewhat more favorable terms. Following the terms of the agreement and the direction of HB 1161 by Junell, part of the tobacco money goes directly to counties and hospital districts, and another part is deposited in a permanent trust

account. According to the Comptroller’s Office, the expected \$1.5 billion to Texas counties and hospital districts in fiscal 2000-01 could fall short by between \$128 million and \$154 million, depending on assumptions.

Possible budget impact

The fiscal 2000-01 budget appropriates \$1.1 billion received by Texas from the tobacco industry during fiscal 1999 and about \$689 million that the state expected to receive for fiscal 2000 and 2001. Lawmakers used about \$1.5 billion of anticipated tobacco receipts to set up higher education endowments and health-related permanent funds. About \$306 million was appropriated directly to new state programs, such as the Children’s Health Insurance Program (CHIP), or to existing programs, and \$18 million was appropriated to three nonstate entities, the Texas Healthy Kids Corp., the Texas Municipal League Group Benefits Management Pool, and the Texas Association of School Boards Risk Management Fund, to pay for operational or health-related expenses. An additional \$149 million was appropriated for state programs based on anticipated interest returns of 10 percent from the newly created permanent funds. (See House Research Organization Finance Report 76-3, *Texas Budget Highlights*, October 21, 1999, for more details.)

The tobacco-receipt shortfall could affect the budgets of all agencies or entities slated to receive settlement funds. However, legislators have limited room to maneuver in covering the shortfall because CHIP has first claim on settlement receipts over every other program that receives tobacco funds. Also, \$18 million already was transferred

on September 1, 1999, to the nonstate entities that were appropriated settlement receipts.

To cover funding deficiencies in programs that receive tobacco-related funds, lawmakers could consider moving money out of the permanent funds and endowments or redirecting interest earned on those funds and endowments, especially any earnings higher than the anticipated rate of 10 percent. Permanent fund earnings were unexpectedly high in the first quarter of the fiscal year, though they have fallen below expectations in the second quarter.

Also, lawmakers could cover budget shortfalls by using surpluses left by lower-than-anticipated spending levels in any state agency, regardless of their appropriations of tobacco-settlement receipts, or by using surplus revenues. The projected \$75-90 million shortfall in fiscal 2000-01, while large in relation to tobacco receipt-funded program budgets, is relatively small in relation to the state's \$61 billion general revenue-related budget.

All agencies that received tobacco-related funds had to submit budgets by November 1, 1999, to the governor and the Legislative Budget Board describing their proposed use of the tobacco funds. The agencies reported planned expenditures totaling about 71 percent of the tobacco funds appropriated for fiscal 2000, leaving an estimated \$60 million to be carried forward to fiscal 2001. To give most agencies maximum flexibility in developing and implementing programs using tobacco-settlement receipts, the Legislature appropriated the entire biennial tobacco-receipt funding in fiscal 2000 and authorized agencies to spend unexpended balances in fiscal 2001.

Long-term prospects

Some say it should come as no surprise that cigarette consumption is declining in the United States, and many warn that the tobacco industry may not remain profitable enough to meet its multibillion-dollar payment agreements.

First, Americans have become increasingly concerned about the health risks of smoking and inhaling "second-hand" smoke. Also, over the past seven years, the tobacco industry has been the target of many lawsuits, investigations, and acts of legislation by states, Indian

tribes, tobacco growers and wholesalers, and the U.S. government, which have sought to limit tobacco sales and advertising, to restrict smoking in public places, to find the industry responsible for misleading and defrauding the public, and to receive compensation for tax dollars spent treating tobacco-related illnesses and for other causes. Finally, the tobacco industry for the first time could come under federal Food and Drug Administration regulation, which could reduce cigarette consumption further, depending on the U.S. Supreme Court decision in *FDA v. Brown & Williamson Tobacco Corp.*, which the court heard on December 1, 1999.

The industry already has agreed to a total of \$246 billion in payments to states under individual out-of-court settlements with Texas, Minnesota, Florida, and Mississippi and under a group settlement with the remaining states. Texas received the largest individual settlement. The settlements themselves may contribute to the future decline in tobacco consumption. In some settlements, the industry has agreed to measures to limit tobacco advertising. Several states, including Texas, are using at least a portion of the settlement funds to pay for antismoking campaigns.

Getting the money up front

Some states are considering selling all or part of their settlements to private investors now, rather than risk declining payment levels over the next 25 years from a besieged tobacco industry. Investors would bear the risk that, over the long haul, tobacco-settlement funds may drop below the discounted amount they paid the state up front, but investors would reap the benefits if the payments turned out to be closer to the original settlement amount.

For example, Louisiana is establishing a task force to evaluate whether the state should sell its \$4.6 billion settlement and perhaps set up trust funds with the proceeds to pay for health care and education. According to the *New Orleans Times-Picayune* of January 26, Wall Street investment companies have told state officials that Louisiana could get between \$1.8 billion and \$2 billion now by selling the state's full settlement as a lump sum.

— by *Kristie Zamrazil*

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