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Testimony provided by Brian G. Fedotin, Deputy General Counsel and Chief Appellate Counsel of the Kansas Corporation Commission on SB 346

Chairman Olson and members of the Senate Utilities Committee:

Good afternoon. Thank you for allowing me to appear before you this afternoon. I am here to provide an overview of recent Court decisions and pending cases that are likely to be affected if Senate Bill 346 is enacted.

The Kansas Universal Service Fund was established in 1997 to preserve and enhance universal service and promote the development of telecommunications infrastructure throughout the state. As we approach the twentieth year of the KUSF, the assessment rate has grown to 6.53%. In other words, there is a surcharge on nearly every landline and cellphone monthly bill paid by Kansas consumers. The assessment rate continues to climb as the demands for KUSF support continue to rise. In reaction to the growth of the KUSF, the 2013 Kansas Legislature passed HB 2201, which was signed into law on April 17, 2013. In relevant part, HB 2201 created a Legislative Telecommunications Study Committee, directed the Department of Revenue to audit the efficiency and effectiveness of the KUSF by November 2014, and made changes to distributions from the KUSF. Specifically, HB 2201 amended K.S.A. 66-2008(e)(3) to create a hard cap on the amount of annual KUSF support distributed to all local exchange carriers operating under traditional rate of return regulation:

> Notwithstanding any other provision of law, the total KUSF distributions made to all local exchange carriers operating under traditional rate of return regulation pursuant to subsection (b) of K.S.A. 66-2005, and amendments thereto, shall not exceed an annual

> $30,000,000 cap. A waiver of the cap shall be granted based on a demonstration by a carrier that such carrier would experience significant hardship due to force majeure or natural disaster as determined by the commission.

While HB 2201 created a $30 million cap on annual KUSF distributions, the legislature did not provide any instruction on how to implement the cap. After receiving numerous inquiries regarding HB 2201, the Commission opened a docket[1] to investigate how to implement the cap on rate of return carrier support enacted in HB 2201. In its investigation, the Commission solicited comments from industry on two options recommended by Commission Staff for implementing the cap: (1) a moratorium on the fund once the cap is reached or (2) follow the Federal Communications Commission's (FCC) approach and reduce support proportionally. The Commission also sought suggestions for other options to address the cap. After input from Verizon, AT&T, the Rural Local Exchange Carriers (RLECs), Wireless Competitive Eligible Telecommunications Carriers, and Cox Kansas Telcom, LLC, the Commission issued its Order finding in relevant part, once the $30 million cap on rate of return carrier KUSF support is met: (1) KUSF will be distributed on a pro-rata basis, (2) the annual cap on KUSF support should coincide with the KUSF fiscal year, and (3) Kansas Lifeline Support Program support will not be counted towards the $30 million cap.

Once the cap is met, the Commission will reduce all rate of return carriers' support proportionally to ensure the cumulative KUSF distributions do not exceed the $30 million cap for the KUSF fiscal year. If a new request for KUSF support is granted after the cap is met, the Commission will adjust the reduction factor it applied to ensure

[1] Docket No. 13-GIMT-736-GIT.

compliance with the cap. Under this pro-rata approach, the Commission may set a new reduction factor at the beginning of each KUSF fiscal year, and adjust it throughout the year to reflect changes to rate of return carrier support made during the KUSF fiscal year.

The RLECs have challenged the Commission's decision to distribute KUSF on a pro-rata basis once the cap is reached. On September 4, 2015, the District Court of Nemaha County affirmed the Commission's Order. On or about October 1, 2015, the RLECs appealed the Nemaha County Court's decision to the Court of Appeals. The parties have fully briefed the appeal[2] and expect to have oral argument before the Court in the near future.

Essentially, the RLECs are asking the Court of Appeals to find the $30 million cap is inoperative and void. The RLECs' claim that reducing all carriers' support proportionally to ensure the cumulative KUSF support received does not exceed the annual $30 million cap violates K.S.A. 66-2008(e)(1)'s requirement that KUSF support "shall be based on embedded costs, revenue requirements, investments and expenses". The RLECs' claim is designed to create an irreconcilable conflict between statutory provisions in hopes of having the Court declare the $30 million statutory cap inoperative and void.

The RLECs have unsuccessfully argued in an earlier Court of Appeals' case that the language in K.S.A. 66-2008(e)(1) that KUSF support "shall be based on embedded costs, revenue requirements, investments and expenses" requires the KUSF to fully subsidize all of their embedded costs, revenue requirements, investments and expenses.

[2] *Bluestem Telephone Company, Inc. v. KCC*

In *Bluestem Telephone Company, Inc. v. KCC*,[3] the Court of Appeals interpreted K.S.A. 66-2008(e)(1) explaining "RLECs operating on a rate of return 'must have their KUSF distributions *computed* on their embedded costs, revenue requirements, investments and expenses…[n]othing in *Bluestem I* mandates that KUSF be paid to fully fund an RLEC's embedded costs." The proposed revision to K.S.A. 66-2008(e)(1) would replace the "based on embedded cost" language, with the language "ensure recovery of such carrier's intrastate embedded costs".

Under that proposed language, courts could possibly interpret K.S.A. 66-2008(e)(1) to require KUSF support to fully subsidize all embedded costs. In other words, the KUSF and Kansas consumers would be responsible for covering all expenses incurred by the carriers. The revision language would arguably cover expenses that do not relate to providing safe and reliable service. Such a result would not only make it more difficult for the Commission to audit a carrier's spending, but would force Kansas consumers to subsidize all of the carriers' expenses and investments, regardless of whether those investments were prudent. Arguably, the Commission's authority to monitor carriers' spending and pass those costs on to Kansas ratepayers would be sharply limited.

Another important proposed revision to K.S.A. 66-2008(e)(1) would eliminate the phrase "until at least March 1, 2017". In HB 2201, the legislature passed language providing "[u]ntil at least March 1, 2017, any modification of such [KUSF] support shall be made only as a direct result of changes in those factors enumerated in this subsection."

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[3] *Bluestem Tel. Co v. Kansas Corp. Comm'n*, No. 112,364, 2015 WL 7566277 (Kan. Ct. App. Nov. 25, 2015) at *18.

Presumably, the purpose of the March date was to allow the carriers time to adjust to the FCC reforms and transition away from their dependence on universal service subsidies. If the Commission is bound to award KUSF support to ensure recovery of carriers' embedded costs, revenue requirements, investments, and expenses without any sunset date, the current system which creates a perverse incentive for carriers to drive up their costs to receive larger KUSF subsidies could remain in place indefinitely.

I also want to address the proposed revisions to K.S.A. 66-2008(e)(2), which would allow carriers to take a larger draw from the KUSF to make up any reduction in federal support. Essentially, any savings from FCC reforms would be paid by Kansas consumers through higher KUSF subsidies. The proposed revision to K.S.A. 66-2008(e)(2) appears to be an attempt to overturn the recent Court of Appeals' decision in *Moundridge Telephone Company, Inc. v. Kansas Corporation Commission*, No. 114,064, 2015 WL7693784 (Kan. Ct. App. Nov. 25, 2015) (unpublished). In that case, Moundridge unsuccessfully argued that K.S.A. 66-2008(e)(2) conflicts with K.S.A. 66-2005(b). Based on that faulty presumption, Moundridge advocated ignoring K.S.A. 66-2008(e)(2)'s prohibition of using KUSF to offset any losses in federal support. The Court of Appeals explained,

> [i]t is clear that K.S.A. 2014 Supp. 66-2005(b) and K.S.A. 2014 Supp. 66-2008(e)(1) establish the general rule for determining KUSF distributions. K.S.A. 2014 Supp. 66-2008(e)(2) creates an exception to the general principle that the Commission consider the RLEC's embedded costs and revenue requirement, *i.e.*, KUSF cannot replace funding lost as a result of FUSF changes. There is simply no conflict between the two provisions.[4]

[4] *Moundridge Telephone Company, Inc. v. Kansas Corporation Commission*, No. 114,064, 2015 WL7693784, at *12 (Kan. Ct. App. Nov. 25, 2015) (unpublished).

Moundridge has sought Supreme Court review of the Court of Appeals' decision. In the meantime, the RLECs' proposed language is designed to create a conflict between those two provisions in hopes of nullifying K.S.A. 66-2008(e)(2) and essentially removing any limitations on the RLECs' ability to collect KUSF to replace any lost federal support.

Thank you for the opportunity to appear before your committee today.