

MINUTES OF THE House COMMITTEE ON Communication, Computers and Technology

The meeting was called to order by Representative Mike Meacham at
Chairperson

3:30 ~~am~~/p.m. on February 22, 1983 in room 522-S of the Capitol.

All members were present except:

Representative Chronister (excused) Representative Rolfs (excused)
Representative Aylward (excused)
Representative Ramirez (excused)

Committee staff present:

Marlin L. Rein, Chief Legislative Fiscal Analyst, Committee Staff Director
Sherry Brown, Fiscal Staff, Research Department
Chris Stanfield, Fiscal Staff, Research Department
Betty Ellison, Secretary to the Committee

Conferees appearing before the committee:

Ed Whitacre, Vice President of Southwestern Bell for Kansas Operations

Jeffrey M. Russell, Director, Governmental Affairs
United Telephone Company of Kansas

Chairman Meacham recognized Mr. Ed Schaub of Southwestern Bell, who introduced Mr. Whitacre. Mr. Whitacre stated that he did not wish to take issue with the technical parts of the Department of Administration's proposal. What he did want to do was to clarify Southwestern Bell's position as a provider of state telecommunications services . . . KANS-AN, Centrex, etc.

Referring to three points made by Secretary Hurley of the Department of Administration on February 17, Mr. Whitacre said that:

1. He had no problem with the state seeking competitive bids, but he was concerned about the state designing bid specifications so as to foreclose certain vendors out of the bidding process. He also had concerns for overall quality when interconnecting telephone terminals are furnished by multiple vendors with the lowest bid.
2. He commended the Department of Administration for savings it had effected for such items as copy machines and large computers.
3. Regarding savings the Department of Administration had achieved through the purchase of several telephone terminal equipment systems, he commented that the terminals described had been purchased from companies in foreign countries. He said that until January 1, 1984, Southwestern Bell had faced that competition as a fully regulated company. He stated that in buying terminal equipment from multiple vendors, the state has fragmented the responsibility for the maintenance of these interconnecting terminals, thus increasing the need for a larger staff at the Office of Telecommunications. Mr. Whitacre said that these savings apply only to terminal equipment--not to an integrated, statewide telecommunications network. He stated that the issue is not a few hundred thousand dollars for terminal equipment, but millions of dollars for a total statewide network.

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Communication, Computers and Technology
room 522-S, Statehouse, at 3:30 ~~xxx~~ p.m. on February 22, 1983

Mr. Whitacre commented that Southwestern Bell knows the state's operation better than any other supplier and has responded quickly to fix problems when they occur. He said that Southwestern Bell invested large amounts of capital in building the KANS-A-N network, then trained the technicians who maintained it. The conferee stated that this system is capable of meeting the needs of the state and can be enlarged or changed to meet future needs. (Printed copy of Mr. Whitacre's remarks, Attachment 1)

Chairman Meacham introduced Mr. Jeffery Russell of United Telephone Company. Mr. Russell stated that his company serves 65,000 customers in 109 Kansas communities. United is the largest independent or non-Bell telephone company in Kansas. Mr. Russell explained the effect that the proposed state telecommunications network would have on United Telephone, an independent telephone company. United receives toll revenues, rather than local revenues which are charges for basic monthly service. The toll revenues received by United are pooled while local revenues billed are kept by them. The conferee said that the proposed Kansas state network would negatively impact United's toll revenues. (Printed copy of Mr. Russell's remarks, Attachment 2)

The chairman reminded the committee that instructional television was on the agenda for February 23 and a round table discussion on the telecommunications plan for February 24.

The meeting was adjourned at 4:20 p.m. by the chairman.

The next meeting of the committee will be held at 3:30 p.m. on February 23, 1983.

REPORT TO
THE KANSAS HOUSE
COMMUNICATION, COMPUTERS & TECHNOLOGY COMMITTEE

EDWARD E. WHITACRE
SOUTHWESTERN BELL
FEBRUARY 22, 1983

Attachment 1

House Communication, Computers and Technology 2/22/83

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU AGAIN--- THIS TIME TO SHARE WITH YOU MY CONCERNS REGARDING THE PROPOSAL FOR A STATE-OWNED TELECOMMUNICATIONS SYSTEM FOR KANSAS. AND FRANKLY, I'M PLEASED THIS COMMITTEE IS GIVING THE PROPOSAL THE SERIOUS ATTENTION IT DESERVES.

MY PURPOSE TODAY IS NOT TO TAKE ISSUE WITH THE TECHNICAL PARTS OF THE DEPARTMENT OF ADMINISTRATION'S PROPOSAL. TECHNICALLY AND OPERATIONALLY, THE PROPOSED SYSTEM WILL DO WHAT IT'S DESIGNED TO DO.

WHAT I DO WANT TO DO THIS AFTERNOON IS TO CLARIFY SOUTHWESTERN BELL'S POSITION--NOW AND IN THE FUTURE--AS A PROVIDER OF STATE TELECOMMUNICATIONS SERVICES... THE KANS-AN NETWORK, CENTREX AND OTHER SYSTEMS.

OF EQUAL IMPORTANCE TO ME, IS THAT WHEN I AM FINISHED THIS AFTERNOON YOU'LL AGREE WITH ME THAT THERE ARE TOO MANY UNANSWERED QUESTIONS ABOUT A STATE-OWNED SYSTEM.

LAST THURSDAY, THE SECRETARY OF ADMINISTRATION APPEARED BEFORE YOU TO MAKE A SECOND CLOSING ARGUMENT. LET ME BRIEFLY SUMMARIZE HIS MAIN POINTS, AS I UNDERSTAND THEM, AND THEN CLARIFY SOUTHWESTERN BELL'S POSITION ON THESE POINTS.

FIRST, I'M TOLD THE SECRETARY SAID STATE LAW MANDATES THAT HIS DEPARTMENT SEEK COMPETITIVE BIDS WHEN CONSIDERING ANY LEASE OR PURCHASE -- INCLUDING TELEPHONE EQUIPMENT AND FACILITIES.

SECOND, I'M TOLD HE CITED EXAMPLES OF SAVINGS HIS ADMINISTRATION HAD EFFECTED FOR SUCH ITEMS AS COPY MACHINES AND LARGE COMPUTERS.

THIRD, I'M TOLD HE CITED EXAMPLES OF SAVINGS HIS ADMINISTRATION HAD EFFECTED THROUGH THE PURCHASE OF SEVERAL TELEPHONE TERMINAL EQUIPMENT SYSTEMS.

FINALLY, I'M TOLD HE MADE IT CLEAR THAT THE QUESTION BEFORE THE LEGISLATURE IS NOT WHETHER TO PROCEED WITH THE STUDY OF THE STATE'S TELECOMMUNICATIONS NEEDS, BUT RATHER HOW TO PROCEED WITH SUCH A STUDY.

TO THE SECRETARY'S FIRST POINT...

SOUTHWESTERN BELL HAS NO PROBLEM WITH THE STATE SEEKING COMPETITIVE BIDS. IT'S NOT ONLY THE LAW, IT IS SOUND PRACTICE. SOUTHWESTERN BELL DOES HAVE A PROBLEM, HOWEVER, WHEN THE STATE DESIGNS BID SPECS SO AS TO FORECLOSE CERTAIN VENDORS OUT OF THE BIDDING PROCESS.

SOUTHWESTERN BELL ALSO HAS GRAVE CONCERNS FOR OVERALL QUALITY WHEN INTERCONNECTING TELEPHONE TERMINALS ARE FURNISHED BY MULTIPLE VENDORS WITH THE LOWEST BID.

TO THE SECRETARY'S SECOND POINT...

I COMMEND HIS DEPARTMENT FOR THE SAVINGS IT HAS HELPED THE STATE ACHIEVE. AS AN OFFICER OF SOUTHWESTERN BELL WHICH IS ONE OF THE STATE'S LARGEST SOURCES OF TAXES, I'M PLEASED TO KNOW HE IS WORKING TO SPEND THOSE TAX DOLLARS EFFICIENTLY.

TO THE SECRETARY'S THIRD POINT...

I CAN ONLY SAY THAT HE'S DONE A GOOD JOB OF SAVING MONEY IN THE SELECTION OF TELEPHONE TERMINAL EQUIPMENT. THE SAVINGS DON'T SURPRISE ME, ESPECIALLY CONSIDERING WHERE THE EQUIPMENT WAS MANUFACTURED.

THE TERMINALS HE DESCRIBED INCLUDE AN OKAI FROM JAPAN, AN SL-1 SYSTEM FROM CANADA, A SIEMENS FROM SCANDINAVIA AND AN HITACHI PURCHASED FROM SUNCOM, INC., WHICH HAS SINCE GONE OUT OF BUSINESS. SOUTHWESTERN BELL HAS FACED THE SAME FOREIGN COMPETITION MOST OTHER BUSINESSES HAVE FACED.

UP TO JANUARY 1, 1984, WE HAVE HAD THE BURDEN OF FACING THAT COMPETITION AS A FULLY REGULATED COMPANY WHICH WAS REGULATED IN SUCH A WAY TO SUBSIDIZE LOW BASIC SERVICE RATES FROM LONG DISTANCE AND BUSINESS TELEPHONE SERVICE AND EQUIPMENT.

SO THE PRICE DIFFERENCES THE SECRETARY QUOTED SHOULDN'T COME AS ANY GREAT SURPRISE. I ASK YOU TO KEEP IN MIND THAT IN 10 MONTHS, SHOULD SOUTHWESTERN BELL GET INTO THE TERMINAL EQUIPMENT MARKET, IT MAY DO SO THROUGH AN UN-REGULATED SUBSIDIARY.

WHILE WE'RE STILL ON THIS POINT, LET'S TAKE A LOOK AT A PROBLEM CAUSED BY AWARDING CONTRACTS FOR TERMINAL EQUIPMENT TO SEVERAL VENDORS. THESE TERMINALS TIE INTO AN OVERALL NETWORK, SO IT'S DIFFERENT FROM BUYING A XEROX COPY MACHINE HERE AND A SAVIN THERE AND A KODAK FOR ANOTHER LOCATION.

IN BUYING TERMINAL EQUIPMENT FROM MULTIPLE VENDORS, THE STATE HAS FRAGMENTED THE RESPONSIBILITY FOR THE MAINTENANCE OF THESE INTERCONNECTING TERMINALS.

THE DIRECTOR OF TELECOMMUNICATIONS NOW GOES ONE PLACE FOR MAINTENANCE ON ONE TERMINAL AND GOES ANOTHER PLACE FOR MAINTENANCE ON ANOTHER. THIS INCREASES THE NEED FOR A LARGER STAFF AT THE OFFICE OF TELECOMMUNICATIONS.

THE FINAL -- AND MOST IMPORTANT -- POINT TO MAKE ABOUT SAVING MONEY ON THIS TERMINAL EQUIPMENT IS THAT THOSE SAVINGS APPLY ONLY TO TERMINAL EQUIPMENT - NOT AN INTEGRATED, STATEWIDE TELECOMMUNICATIONS NETWORK.

THE SAVINGS ARE COMMENDABLE, BUT THE ISSUE IS NOT A FEW HUNDRED THOUSAND DOLLARS FOR TERMINAL EQUIPMENT. THE ISSUE IS MILLIONS OF DOLLARS FOR A TOTAL STATEWIDE NETWORK.

TO THE SECRETARY'S LAST POINT ABOUT THE QUESTION NOT BEING IF TO PROCEED BUT HOW TO PROCEED...

I AGREE 100%.

LET'S NOW TAKE A LOOK AT WHAT YOU HAVE, THEN LET'S TAKE A LOOK AT WHAT THE DEPARTMENT OF ADMINISTRATION PROPOSES AND SEE IF YOU HAVE ENOUGH INFORMATION TO PROCEED INTO A MULTI-MILLION DOLLAR CAPITAL INVESTMENT...OR, IF THE BEST PROCEDURE WOULD BE TO GET ANSWERS TO SOME IMPORTANT, CRITICAL QUESTIONS BEFORE LAUNCHING INTO SUCH A MASSIVE VENTURE.

HERE'S WHAT YOU HAVE NOW.

(CHART)

A PROVEN TRACK RECORD OF SUCCESS
WITH SOUTHWESTERN BELL

SOUTHWESTERN BELL HAS A PROVEN TRACK RECORD OF SUCCESS WITH THE STATE OF KANSAS.

THE QUALITY OF THE STATE'S TELECOMMUNICATIONS SYSTEM IS WIDELY ACKNOWLEDGED. IN FACT, NO OTHER STATE HAS A FINER COMMUNICATIONS SYSTEM. IT'S MET THE STATE'S NEEDS. IT'S MET THE NEEDS OF THE AGENCIES THAT USE THE SYSTEM. AND IT HAS BEEN RESPONSIVE TO THE CHANGING NEEDS OF THE STATE AGENCIES. THE QUALITY OF SERVICE THROUGH KANS-AN IS EXCELLENT. IT'S CONSTANTLY MAINTAINED.

AS THE PROVIDER OF YOUR STATE SYSTEM, SOUTHWESTERN BELL KNOWS THE STATE'S OPERATION BETTER THAN ANY OTHER SUPPLIER. MY COMPANY AND THE STATE OF KANSAS HAVE A HISTORY OF WORKING VERY WELL TOGETHER. THE STATE HAS BEEN ABLE TO GET MAINTENANCE THROUGH ONE VENDOR -- SOUTHWESTERN BELL -- WHICH HAS RESPONDED QUICKLY TO FIX PROBLEMS WHEN THEY OCCUR.

ALMOST SEVEN YEARS AGO, SOUTHWESTERN BELL INVESTED HUGE AMOUNTS OF CAPITAL IN A GOOD FAITH EFFORT TO BUILD THE KANS-AN NETWORK. AFTER WE BUILT IT, WE TRAINED THE

TECHNICIANS WHO MAINTAINED IT. WE DEDICATED FULL-TIME MAINTENANCE AND ADMINISTRATION RESOURCES TO IT.

THE ADVANTAGES TO THE STATE WITH THIS ARRANGEMENT ARE MANY. THE STATE DID NOT HAVE TO RAISE THE CAPITAL TO BUILD THE SYSTEM. THE STATE DOESN'T HAVE TO MAINTAIN IT; DOESN'T HAVE TO ADMINISTER IT. THE ONLY THING THE STATE NEEDS IS A SMALL STAFF TO WORK WITH A SINGLE VENDOR -- SOUTHWESTERN BELL -- WHO PROVIDES THE ENTIRE SYSTEM. NOW, THERE IS A PROPOSAL TO BUILD A SYSTEM WHICH CANNOT BE FURNISHED BY ANY ONE VENDOR -- BELL OR OTHERWISE -- AND WILL CAUSE THE NEED FOR A LARGER STAFF IN THE OFFICE OF TELECOMMUNICATIONS. ALSO, THE PROPOSED SYSTEM CANNOT FULLY REPLACE THE KANS-AN NETWORK.

THE BOTTOM LINE IS THAT THE TELECOMMUNICATIONS SYSTEM YOU HAVE TODAY IS CAPABLE OF MEETING STATE AGENCY NEEDS. IT IS A FLEXIBLE SYSTEM. IT CAN BE ADDED TO. IT CAN BE ENHANCED. IT CAN GROW.

YOU MAY REMEMBER A CHART PRESENTED BY THE STATE WHICH LISTED SPECIAL SERVICES THAT COULD BE PROVIDED OVER THE PROPOSED NETWORK. THAT CHART LISTED DATA COMMUNICATIONS SERVICES, SERVICES FOR LAW ENFORCEMENT, WEATHER AND THE UNIVERSITIES.

REPRESENTATIVES, ALL OF THOSE SERVICES ARE BEING PROVIDED BY KANS-AN NOW, TODAY. THE ONLY THING ADDITIONAL WAS SERVICE VIA SATELLITE. DOES THE STATE NEED TO GET INTO SATELLITES?

THE STATE ALSO PRESENTED A CHART OF SYSTEM CAPABILITIES-- IN OTHER WORDS, WHAT THE SYSTEM CAN DO IF EVER THERE IS A NEED FOR IT. NO ONE I KNOW IN THE TELECOMMUNICATIONS BUSINESS OVERBUILDS SYSTEM CAPABILITIES TODAY. THE REASON IS, NEW TECHNOLOGY IS DEVELOPING TOO RAPIDLY FOR ANY BUSINESS TO AFFORD THAT RISK.

(CHART)

"HIGH TECH" OWNERSHIP CARRIES HIGH RISK

THE STATE PROPOSAL EMPHASIZES DIGITAL AND FIBER OPTICS TO DELIVER HIGH-SPEED DATA TRANSMISSION. HOWEVER, THE PROPOSED SYSTEM ONLY BUYS THE CAPABILITY OF INCREASED TRANSMISSION SPEED. IN OTHER WORDS, IT'S LIKE BUYING THE CAPABILITY TO TRANSMIT ALL THE INFORMATION IN A PHONE BOOK IN 4 MINUTES INSTEAD OF 7. I ASK YOU, WHAT IS 3 MINUTES WORTH?

THE BASIC QUESTION TO ME SEEMS TO BE -- HOW ADVANTAGEOUS IS A FULLY DIGITAL SYSTEM COMPARED TO THE PRESENT SYSTEM?

AND I WOULD REMIND THE DIRECTOR OF TELECOMMUNICATIONS THAT SOUTHWESTERN BELL TODAY PROVIDES DIGITAL DATA TRANSMISSION SERVICE CAPABILITIES IN THE STATE OF KANSAS.

YOU HAVE BEFORE YOU AN IMPORTANT FINANCIAL BUSINESS DECISION. IF THIS WERE YOUR BUSINESS -- AND IT IS -- WITH THE PRESENT UNCERTAINTY AND RISK...WOULD YOU MAKE THE KIND OF LONG-TERM FINANCIAL COMMITMENT THE DEPARTMENT OF ADMINISTRATION IS ASKING YOU TO MAKE?

(CHART)

PRICE STABILITY

LET'S TURN OUR ATTENTION FOR A FEW MINUTES TO COST.

THE DEPARTMENT OF ADMINISTRATION ASSUMES SOUTHWESTERN BELL'S COSTS WILL INCREASE 15% A YEAR FOR THE NEXT 14 YEARS, THEN IT ESTIMATES ITS OWN STATE-OWNED SYSTEM COSTS WILL INCREASE ONLY 10% A YEAR. I SEE NO EVIDENCE THAT OUR COSTS ARE GOING TO INCREASE AT A FASTER RATE THAN ANY OTHER BUSINESS, INCLUDING THE STATE. IN FACT, WITH DIVESTITURE AND COMPETITION FOR LONG DISTANCE, INCREASES MAY BE MUCH LESS THAN 10%.

FURTHER, THE OFFICE OF TELECOMMUNICATIONS HAS MADE THE POINT THAT OUR PRICES FOR KANS-AN HAVE GONE UP 130% IN THE PAST FOUR YEARS. THAT'S ONLY HALF THE STORY. WHAT HAS NOT BEEN SAID IS THAT THE STATE DOUBLED ITS USE OF THE KANS-AN SYSTEM,

THAT'S LIKE SAYING MY GASOLINE BILL WENT UP \$400 LAST YEAR WITHOUT MENTIONING THAT I DROVE 8,000 MORE MILES,

FACT IS, THE ACTUAL YEARLY RATE OF INCREASE OF OUR COSTS -- BASED ON MINUTE-OF-USE -- HAS ONLY BEEN 5% -- NOT 15%.

LADIES AND GENTLEMEN, THE WHOLE IDEA OF A STATE-OWNED AND OPERATED NETWORK IS BASED ON SAVING MONEY. THESE PROJECTED SAVINGS ASSUME SOUTHWESTERN BELL'S LOCAL COSTS OR AT&T'S OR WHOEVER'S NETWORK COSTS WILL INCREASE 15% A YEAR. UP TO NOW THEY'VE ONLY GONE UP AT A RATE OF 5% A YEAR. GIVEN THAT PAST RECORD, THE DEPARTMENT OF ADMINISTRATION IS ASKING YOU TO MAKE AN AWFULLY BOLD ASSUMPTION.

SO WHAT DOES THE FUTURE HOLD FOR THE PRICE OF BUSINESS TELEPHONE SERVICE? LET ME BRIEFLY DISCUSS TWO ITEMS TO GIVE YOU A GLIMPSE OF FUTURE RATES AND PRICING STRUCTURES.

THE FIRST ITEM IS LONG DISTANCE. THE INDUSTRY IS ON THE THRESHOLD OF A NEW TECHNOLOGY THAT USES SOFTWARE DESIGN NETWORKS TO REPLACE EXISTING PRIVATE LINE NETWORKS. THE INDUSTRY IS ALSO ON THE THRESHOLD OF NEW COMPETITION FOR LONG DISTANCE SERVICE WHICH MOST EXPERTS INCLUDING THE FCC PREDICT WILL REDUCE LONG DISTANCE RATES BY 30 TO 40%. BECAUSE OF THIS NEW TECHNOLOGY AND NEW COMPETITION COMING NEXT YEAR, PRUDENT MANAGERS OF LARGE BUSINESSES ARE NOT BUILDING PRIVATE LINE NETWORKS SUCH AS THE ONE BEING PROPOSED.

THE SECOND ITEM IS STABILIZATION OF CENTREX RATES. THIS IS CRITICALLY IMPORTANT SINCE CENTREX DRIVES THE KANS-AN NETWORK. I BELIEVE THE STATE SHOWED YOU A CHART TO DEMONSTRATE THAT THE RATES FOR TELEPHONES ON CENTREX SYSTEMS WOULD INCREASE TO \$48. THAT DEMONSTRATION WAS TOTALLY WRONG.

LATER THIS YEAR, SOUTHWESTERN BELL PLANS TO OFFER A THREE-YEAR STABILIZATION OF CENTREX RATES WHICH WILL FREEZE THE MAJOR PORTION OF THE RATE.

THE STATE HAS SAID TO THIS COMMITTEE THAT AT THE END OF THE THREE-YEAR PERIOD OF STABILIZED RATES, SOUTHWESTERN BELL INTENDS TO RAISE RATES IN THE FOURTH YEAR TO A DEGREE THAT WILL OFFSET ANY FOREGONE PRICE INCREASES.

THAT STATEMENT INDICATES A LACK OF UNDERSTANDING OF THE REGULATED RATE PROCESS.

THE KEY POINT IN DISCUSSING PRICING STRUCTURES IS THAT THE OFFICE OF TELECOMMUNICATIONS IS OPERATING ON THE ASSUMPTION WE'LL KEEP THE STATUS QUO AS WE BECOME AN INDEPENDENT, PARTLY DEREGULATED COMPANY NEXT YEAR. THE DEPARTMENT OF ADMINISTRATION SUPPOSES OUR PRICING STRUCTURES WILL REMAIN UNCHANGED. AGAIN, THAT IS AN INCORRECT ASSUMPTION. THE NEW ENVIRONMENT AND THE NEW RULES WILL GIVE US AND OTHERS THE FREEDOM TO BE MORE COMPETITIVE -- MORE FLEXIBLE. THAT WILL WORK TO THE STATE'S ADVANTAGE IF GIVEN THE CHANCE.

(CHART)

WHO REALLY KNOWS WHAT A NEW SYSTEM WILL COST?

WHO REALLY KNOWS WHAT A NEW SYSTEM WILL COST? THAT'S ANOTHER KEY QUESTION. IT'S INTERESTING TO ME THAT LESS THAN A YEAR AFTER ONE STUDY ESTIMATED THE COST OF A NEW STATE SYSTEM TO BE \$32 MILLION, A SECOND STUDY BY THE SAME FIRM SAID NOW IT WILL COST \$26 MILLION FOR A STATE SYSTEM...\$6 MILLION LESS.

IT'S ALSO INTERESTING TO ME THAT THE DEPARTMENT OF ADMINISTRATION HAS SAID THE MORE YOU DELAY STARTING A

NEW SYSTEM, THE MORE IT WOULD COST. THE STUDIES COMMISSIONED TEND TO SHOW JUST THE OPPOSITE. PERHAPS WITH ONE MORE STUDY NEXT YEAR, IT CAN BE SHOWN A SYSTEM CAN BE BUILT FOR \$20 MILLION!

IT IS SIGNIFICANT TO NOTE THAT THE COSTS PROPOSED ARE FOR A BACKBONE NETWORK ONLY. NOT INCLUDED ARE THE ADDITIONAL COSTS TO PUT IN COMPATIBLE SYSTEMS AT KU, K-STATE, FORT HAYS, EMPORIA STATE, AND ON AND ON.

IT'S ONE THING TO HAVE A BACKBONE NETWORK, BUT TO REALIZE SPEED AND ENHANCED SERVICES WILL REQUIRE A CHANGE OUT OF YOUR TELEPHONE SYSTEMS THROUGHOUT KANSAS. CONSERVATIVE ESTIMATES WOULD MEAN SPENDING...ABOUT \$5 MILLION MORE.

THAT'S \$5 MILLION WHICH NEEDS TO BE ADDED TO THE \$26 MILLION ESTIMATE -- AND EVEN THEN IT WOULD NOT BE A COMPLETE REPLACEMENT OF THE KANS-AN NETWORK YOU HAVE TODAY.

WHAT YOU WOULD HAVE IS A SYSTEM DESIGNED TO PROVIDE NEW AND ADDITIONAL SERVICES, YET NO ONE HAS ADDRESSED THE COST OF THESE ANCILLARY SERVICES. FOR EXAMPLE, YOU CAN BUILD A BACKBONE NETWORK WITH VIDEO CAPABILITIES, BUT TO ACTUALLY USE THIS CAPABILITY, YOU MUST GO OUT AND BUY TV

CAMERAS, MONITORS, TAPE EDITING EQUIPMENT, STUDIOS,
LIGHTING AND HIRE THE PEOPLE TO RUN THIS OPERATION.

THE POINT IS...\$26 MILLION IS NOT THE PRICE TAG OF A
STATE-OWNED NETWORK. IT'S THE DOWN PAYMENT!

(CHART)

HOW MUCH WILL IT COST THE TAXPAYER?

THE COST OF A NEW SYSTEM ON THE TAXPAYER IS, I KNOW, A
BIG CONCERN OF YOURS...JUST AS IT IS OF OURS.

ALSO, AS YOU KNOW, THE GOVERNOR AND OTHERS ARE TRYING TO
BRING NEW BUSINESS TO KANSAS TO BROADEN THE TAX BASE AND
CREATE NEW JOBS.

I CAN TELL YOU THAT THE PROPOSED NEW TELECOMMUNICATIONS
NETWORK WILL MEAN HIGHER COSTS TO THE TAXPAYERS OF
KANSAS, AND RUNS COUNTER TO THE OBJECTIVE OF INCREASING
THE TAX BASE BY BRINGING NEW BUSINESS TO KANSAS.

WHAT WE HAVE HERE IS A PROPOSAL THAT WOULD -- IN EFFECT
-- RUN OFF A \$10 MILLION A YEAR BUSINESS WHICH GOES TO
SUPPORT LOCAL GOVERNMENT THROUGH AD VALOREM TAXES AND
THE STATE GOVERNMENT THROUGH STATE INCOME TAXES.

HOWEVER, UNLIKE A BUSINESS THAT MOVES ITS OPERATIONS SOMEWHERE ELSE OUTSIDE OF KANSAS, OUR INVESTMENT STAYS HERE IN KANSAS ALONG WITH OUR NEED TO RECOVER THE CAPITAL COSTS ON THAT INVESTMENT. SO KANSAS TELEPHONE USERS WILL PAY TWICE FOR A STATE-OWNED SYSTEM, AS TAXPAYERS AND AS TELEPHONE CUSTOMERS.

I MUST ALSO ACKNOWLEDGE TO YOU THAT THE PROPOSED SYSTEM IS THE VERY THING THAT IS A REAL THREAT TO REGULATORS AND TO ALL TELEPHONE COMPANIES -- BELL AND INDEPENDENT -- AND THAT IS THE BYPASS OF THE LONG DISTANCE NETWORK AND ALSO BYPASS OF THE LOCAL EXCHANGE BY LARGE USERS OF TELEPHONE SERVICES.

WHAT DO I MEAN BY BYPASS?

HERE'S AN EXAMPLE FROM THE OFFICE OF TELECOMMUNICATIONS' PROPOSAL. THE PROPOSED NETWORK LINKS THE STATE HOSPITAL, SRS, KNI AND OTHER TOPEKA LOCATIONS. IT BYPASSES SOUTHWESTERN BELL FACILITIES. IT BYPASSES THE LOCAL EXCHANGE. IT ALSO BYPASSES THE LONG DISTANCE NETWORK.

THE FACILITIES, THE INVESTMENT IN THAT LOCAL EXCHANGE REMAIN. WE CAN'T BOARD UP OUR OFFICE AT 812 JACKSON. IT SERVES OTHER CUSTOMERS. THE DIFFERENCE IS, ONE OF OUR BIGGEST CUSTOMERS IS NO LONGER SHARING IN THE PROCESS OF RECOVERING THE COST OF THAT INVESTMENT.

WHEN BYPASS HAPPENS, THE REVENUE TO ANY TELEPHONE COMPANY... SOUTHWESTERN BELL OR AN INDEPENDENT...DROPS EVEN FURTHER. AND WHEN THOSE REVENUES DISAPPEAR...IN ORDER FOR THE COMPANY TO EARN A FAIR RETURN ON THE INVESTMENT STILL IN PLACE...LOCAL RATES PAID BY KANSANS MUST BE INCREASED.

SIMPLY PUT, IF THE STATE BUILDS ITS OWN TELEPHONE NETWORK, KANSANS WILL PAY MORE FOR THEIR LOCAL SERVICE.

ROBERT ELLIS, PRESIDENT OF THE HAVILAND TELEPHONE COMPANY AND PRESIDENT OF THE KANSAS TELEPHONE ASSOCIATION WHICH REPRESENTS MORE THAN 30 INDEPENDENT TELEPHONE COMPANIES IN KANSAS, CALLED ME TO EXPRESS THE CONCERN OF ALL KANSAS TELEPHONE COMPANIES OVER THE IMPACT OF THE OFFICE OF TELECOMMUNICATIONS' PROPOSAL ON THE KANSAS TELEPHONE INDUSTRY. WE STAND TOGETHER IN THE KNOWLEDGE THAT THE PROPOSAL WILL CONSTITUTE BYPASS OF EXISTING TELEPHONE NETWORKS AND EXCHANGES AND WILL ULTIMATELY INCREASE THE RATES OF ALL KANSAS TELEPHONE CUSTOMERS.

(CHART)

TALK ABOUT IRONY!

THE DEPARTMENT OF ADMINISTRATION HAS SAID, IT'S IRONIC THAT THE STATE MUST LEAVE SOUTHWESTERN BELL TO GET SERVICE IN THE FUTURE.

LET ME TELL YOU WHAT I THINK IS IRONIC.

I THINK IT'S IRONIC THAT THE OFFICE OF TELECOMMUNICATIONS SAYS THE STATE MUST...

- GET AWAY FROM THE REGULATED TELEPHONE COMPANIES
- THAT IT MUST GET OUT ON ITS OWN
- THAT IT MUST GET AWAY FROM THE FCC AND THE KCC
- THAT IT MUST GET AWAY FROM REGULATORS AND CONTROLLED TELEPHONE COMPANIES
- THAT IT MUST GET INTO A SITUATION WHERE THERE IS NO DEPENDENCE ON REGULATORS.

THOSE ARE STATEMENTS THE DEPARTMENT OF ADMINISTRATION HAS MADE. I THINK IT'S IRONIC THAT THE OFFICE OF TELECOMMUNICATIONS WANTS TO GET AWAY FROM THE REGULATORY POLICY PRACTICED BY THE STATE REGULATORY AUTHORITY WHOSE OBJECTIVE IS TO PRICE TELEPHONE SERVICE TO THE BENEFIT OF ALL KANSAS TELEPHONE CUSTOMERS.

IT'S ALSO IRONIC THAT AFTER YEARS OF REGULATORY POLICY THAT KEEPS RESIDENCE RATES LOW WITH SUBSIDIES FROM HIGHER LONG DISTANCE AND OTHER SERVICES...THE STATE ITSELF IS NOW TRYING TO AVOID THOSE RATES.

AND IT'S IRONIC TO ME THAT THE STATE WANTS TO AVOID THE EFFECTS OF REGULATION, BUT EXPECTS REGULATION TO KEEP PHONE RATES LOW.

IT'S ALSO IRONIC THAT STATE TELEPHONE USERS WILL SEE THE EFFECT ON THEIR BILLS...FOR THEY WILL GO UP.

DOESN'T ALL THIS SEEM IRONIC TO YOU?

(CHART)

TOMORROW'S UNKNOWNNS

LET ME SUM UP BY EXPRESSING TO YOU THE FOLLOWING CONCERNS.

FIRST, TOMORROW'S UNKNOWNNS ARE MANY. IT IS UNKNOWN WHO ALL THE PLAYERS WILL BE, WHAT ROLE THEY'LL PLAY, WHAT THE RULES WILL BE, AND WHAT THE COSTS WILL BE.

BEYOND THESE UNKNOWNNS ARE MORE QUESTIONS...LEGAL QUESTIONS.

FOR EXAMPLE, IT HAS BEEN REPORTED IN THE KANSAS CITY TIMES THAT THE STATE PLANS TO RESELL SERVICE FROM THIS SYSTEM. RESELLING SERVICE IS A LEGAL ISSUE WHICH I THINK SHOULD BE ADDRESSED BY THE ATTORNEY GENERAL.

SECOND, IT IS NOT PRUDENT TO MAKE A QUANTUM LEAP INTO THE AREA OF UNKNOWN TECHNOLOGY. THE SECRETARY OF ADMINISTRATION SAYS THE STATE NEEDS TO GET EXPOSURE TO THE TECHNICAL WORLD. QUESTION IS...CAN THE STATE AFFORD THE PRICE AND THE RISK THIS EXPOSURE BRINGS?

THE OFFICE OF TELECOMMUNICATIONS HAS SAID THERE WOULD BE NO FUNDING NEEDED OVER AND ABOVE TODAY'S LEVELS. I WOULD MAKE A POINT: THE SYSTEMS ON THE END OF THE PROPOSED BACKBONE NETWORK ARE NOT DIGITAL AND DO NOT POSSESS END-TO-END DIGITAL CAPABILITY. SO YOU WOULD BE FACED WITH A CHANGE-OUT OF THE SYSTEM.

SECOND, THE COST OF THE ANCILLARY SERVICES I MENTIONED EARLIER -- TV CAMERAS, MONITORS, TECHNICIANS AND SO ON -- ARE NOT INCLUDED.

ONCE YOU'VE STARTED THIS PROJECT, IT'S GOT TO BE COMPLETED... AND AT THE MOMENT ALL THE COSTS ARE NOT KNOWN.

THE ONLY THING YOU HAVE IS SOMEONE ELSE'S ASSUMPTIONS OF WHAT OUR FUTURE COSTS WILL BE. YOU HAVE ONLY PROJECTIONS OF WHAT STATE AGENCIES NEED. YOU HAVE ONLY ASSUMPTIONS AT HOW THE STATE WILL WORK WITH MULTIPLE VENDORS AND CONTRACTORS TO MAINTAIN A DELICATE NETWORK OF FIBER OPTIC CABLE.

ABI AND OTHER VENDORS SAY THE NEW SYSTEM IS A GOOD IDEA. THAT DOESN'T SURPRISE ME IN THE LEAST. SHOULDN'T SURPRISE YOU. PROBABLY DOESN'T. WHAT ANSWER WOULD YOU EXPECT IF YOU WENT TO AN OLDSMOBILE DEALER AND ASKED:

--"DO YOU THINK I NEED A NEW CAR?"

--AND, "WOULD YOU SELL ME ONE?"

THE QUESTION IS ONE OF HOW TO PROCEED. THE ANSWER IS TO OBSERVE THE TECHNOLOGICAL EVOLUTION NOW GOING ON, WATCH IT SHAKE OUT, SEE WHO THE PLAYERS ARE AND WHAT THEIR ROLES WILL BE, THEN MAKE INFORMED INVESTMENT DECISIONS.

MY THIRD CONCERN IS THAT KANSANS WILL PAY TWICE FOR A NEW SYSTEM.

KEEPING THAT IN MIND, I ASK YOU, SHOULD THE STATE BE IN THE TELEPHONE BUSINESS COMPETING AGAINST PRIVATE ENTERPRISE?

MY FOURTH CONCERN IS THAT EVEN THOUGH SOUTHWESTERN BELL IS PROVIDING WHAT STATE AGENCIES NEED, THE OFFICE OF TELECOMMUNICATIONS WANTS A STATE-OWNED SYSTEM,

THE QUESTION IS...WHAT DO ALL THE STATE AGENCIES WANT AND NEED?

THE QUESTION IS...IS IT NECESSARY TO SPEND MILLIONS JUST FOR A BACKBONE NETWORK WITH KNOWN ADDITIONAL COSTS YET TO BE DETERMINED?

A SECOND, INDEPENDENT OPINION MAY BE USEFUL, AND SUCH AN OPINION IS AVAILABLE. HERE -- FOR EACH OF YOU -- IS AN INDEPENDENT ANALYSIS OF THE PROPOSED SYSTEM, MADE AT OUR REQUEST, BY A WELL-KNOWN FINANCIAL FIRM -- NOT A CONSULTING FIRM HIRED TO SUPPORT A PROPOSED PLAN,

WHY SHOULD YOU GIVE UP THE BEST? THAT'S MY FIFTH CONCERN. WHY GIVE UP THE PRESENT SYSTEM? WHY TAKE ON RISKS? WHY GIVE UP SOMETHING THAT CAN HANDLE USER NEEDS?

AND FINALLY, MY SIXTH CONCERN IS THAT TODAY THERE ISN'T ANYONE WHO HAS ALL THE ANSWERS TO THE CRITICAL QUESTIONS.

WITHOUT THOSE IMPORTANT ANSWERS, I DON'T SEE HOW YOU CAN MAKE A PRUDENT FINANCIAL BUSINESS DECISION WITH SO MANY UNCERTAINTIES SURROUNDING THE CHANGES GOING ON IN THE TELECOMMUNICATIONS INDUSTRY TODAY.

YOU'VE HEARD AND SEEN A LOT OF DIFFERING VIEWS ON HOW THE STATE SHOULD BE SERVED FOR YOUR TELECOMMUNICATION NEEDS, AND AT THIS POINT THERE JUST HAS TO BE SOME QUESTIONS IN YOUR MINDS. HOWEVER, I THINK THE REAL QUESTION BEFORE YOU IS: CAN A STATE AGENCY PROVIDE TELECOMMUNICATION SERVICE WHICH IS AS DEPENDABLE AND FOR LESS MONEY (WITHOUT BUILDING AN EMPIRE) THAN THE PRIVATE SECTOR?

STATEMENT

BY

JEFFREY M. RUSSELL

GOVERNMENTAL AFFAIRS DIRECTOR

UNITED TELEPHONE COMPANY OF KANSAS

BEFORE

HOUSE COMMUNICATION, COMPUTERS, AND TECHNOLOGY COMMITTEE

REPRESENTATIVE MIKE MEACHAM

CHAIRMAN

FEBRUARY 22, 1983

Attachment 2

House Communication, Computers and Technology 2/22/83

GOOD AFTERNOON, MR. CHAIRMAN, MEMBERS OF THE HOUSE COMMUNICATIONS, COMPUTERS AND TECHNOLOGY COMMITTEE. I AM JEFFREY M. RUSSELL, GOVERNMENTAL AFFAIRS DIRECTOR FOR UNITED TELEPHONE COMPANY OF KANSAS. WE SERVE APPROXIMATELY 65,000 CUSTOMERS IN 109 KANSAS COMMUNITIES, AND WE ARE THE LARGEST INDEPENDENT OR NON-BELL TELEPHONE COMPANY IN KANSAS.

THE PURPOSE OF MY APPEARANCE BEFORE YOUR COMMITTEE TODAY IS TO EXPLAIN THE EFFECTS THAT THE PROPOSED STATE TELECOMMUNICATIONS NETWORK WOULD HAVE ON UNITED TELEPHONE.

IT IS IMPORTANT TO FIRST UNDERSTAND HOW UNITED RECEIVES ITS TOLL REVENUES. UNLIKE LOCAL REVENUES, WHICH ARE THOSE CHARGES FOR BASIC MONTHLY SERVICE, TOLL REVENUES FOR UNITED ARE POOLED. LOCAL REVENUES BILLED BY UNITED ARE KEPT BY UNITED.

IN THE TOLL REVENUE SHARING OR TOLL REVENUE POOLING PROCESS, TELEPHONE COMPANIES, SETTLING THEIR REVENUES ON A COST BASIS, PLACE ALL TOLL REVENUES BILLED TO THEIR CUSTOMERS IN A JOINT REVENUE POOL. THIS POOL IS ADMINISTERED BY THE APPROPRIATE BELL OPERATING COMPANY. TELEPHONE COMPANIES PARTICIPATING IN THIS PROCESS THEN WITHDRAW AN AMOUNT FROM THE POOL EQUAL TO THEIR TOLL EXPENSES AND AN AMOUNT TO PROVIDE THEM A RETURN ON THEIR TOLL INVESTMENT EQUAL TO BELL'S OVERALL RATE OF RETURN.

THE PROPOSED KANSAS STATE NETWORK WOULD NEGATIVELY IMPACT UNITED'S TOLL REVENUES IN TWO WAYS:

FIRST, UNDER CURRENT PROCEDURES, UNITED RECEIVES TOLL REVENUE BASED ON THE AMOUNT OF INVESTMENT AND EXPENSE ALLOCATED TO TOLL. THIS AMOUNT IS DETERMINED BY THE RATIO THAT ORIGINATING AND TERMINATING TOLL IS TO TOTAL USAGE (TOLL AND LOCAL).

PROPOSALS SUCH AS THE KANSAS STATE NETWORK, WHICH REDUCE ORIGINATING AND TERMINATING TOLL USAGE IN UNITED'S EXCHANGES WILL RESULT IN A LOWER PERCENTAGE OF TOLL TO LOCAL USAGE. THIS WILL CAUSE A DECLINE IN UNITED'S TOLL REVENUES AND RESULT IN AN INCREASE IN UNITED'S LOCAL REVENUE REQUIREMENT.

SECONDLY, THE PROPOSAL COULD ALSO CAUSE A DECLINE IN SOUTHWESTERN BELL'S OVERALL RATE OF RETURN. UNITED USES THIS RATE OF RETURN TO DETERMINE ITS RETURN ON ITS INTRASTATE TOLL INVESTMENT. A DECLINE IN BELL'S RETURN WOULD ALSO RESULT IN LOWER TOLL REVENUE FOR UNITED. THIS IN TURN WOULD CAUSE A REVENUE SHORTFALL WHICH MUST BE RECOVERED FROM LOCAL SERVICE.

THIS CONCLUDES MY FORMAL REMARKS. THANK YOU, MR. CHAIRMAN, FOR THE OPPORTUNITY TO ADDRESS THE COMMITTEE.

2-21-83