Approved April 23, 1983
Date

MINUTES OF THE House COMMITTEE ON Communication, Computers and Technology

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

3:30 ~~a.m.~~/p.m. on February 24, 1983 in room 522-S of the Capitol.

All members were present except:

Committee staff present:

Chris Stanfield, Fiscal Staff, Research Department
Betty Ellison, Secretary to the Committee

Conferees appearing before the committee:

(No Conferees)

Chairman Meacham announced to the committee that Chris Stanfield, of the research staff, would present a memorandum prepared by the Legislative Research Department on the development of the proposed state-owned telecommunications system. (Attachment 1). The chairman pointed out that the options in the memorandum were not listed in order of preference of staff or anyone else--they were there for the committee's discussion.

Staff led the group through the memorandum and committee members asked questions and discussed issues. The committee also asked staff to obtain more information on certain issues.

Some members expressed a desire to learn what other states are doing in this area. Several members expressed concern regarding fiber optics: reliability, if they might become obsolete, etc.

Representative Rolfs expressed concern about abandoning the single vendor philosophy on the use of transmission lines. Chairman Meacham explained that Option 4 was intended to give this legislature an ongoing year by year review of where they propose to go next. If they want to put in transmission lines at some point in the future, the policy question would arise at that time. Representative Rolfs suggested Option 5, which would be to reject the proposal on the transmission system and to give them encouragement but no money on an equipment acquisition system. He also asked for more information on switches and their funding.

The chairman asked if anyone was in favor of having vendors testify before the committee; several members spoke against this.

Representative Friedeman asked for verification of the figures on page 4, part a, of the memorandum.

Some committee members favored Option 2. Representative Chronister favored switches only, or a combination of Options 4 and 5.

Chairman Meacham noted that staff will try to get information together on both technical questions and policy considerations for sometime during the week of March 7.

The chairman announced that on March 16 and 17, the committee will be traveling to Wichita, arriving there at approximately 1:30 p.m. on the 16th and returning at about 5:00-6:00 p.m. on the 17th. The trip will be made in the state-owned plane and a private plane provided by Beech Aircraft Corporation in Wichita.

CONTINUATION SHEET

MINUTES OF THE House COMMITTEE ON Communication, Computers and Technology

room 522-S, Statehouse, at 3:30 ~~a.m.~~/p.m. on February 24, 1983.

Chairman Meacham asked for a motion on the minutes of February 8 and 9, 1983. Representative Green moved that they be approved. Representative Friedeman seconded the motion and the motion carried.

The meeting was adjourned by the chairman at 4:30 p.m.

The next meeting of the committee will be held on February 28, 1983 at 3:30 p.m.

Date: Feb. 24, 1983

GUEST REGISTER

HOUSE

COMMITTEE ON COMMUNICATION, COMPUTERS AND TECHNOLOGY

NAME	ORGANIZATION	ADDRESS
J. Carey Brown	DofA - DISC	Topeka
Jeff Russell	United Telephone	Topeka
Ed Schaub	SWBT.	Topeka

MEMORANDUM

February 24, 1983

TO: Committee on Communications, Computers and Technology

FROM: Kansas Legislative Research Department

RE: Proposed Development of a State-Owned Telecommunications System

Over the last three years the state has invested over $150,000 in the development of plans for a state-owned telecommunications system that would replace a portion of the telephone service that the state now acquires from the telephone company. These dollars were used primarily for consultant services to develop and evaluate options to current service. Since this initiative began, divestiture and deregulation have brought major changes to the telephone industry and have introduced new elements to be considered in the determination of how the state should proceed.

The Governor proposes that Kansas should invest in the major components of a state-owned telecommunications system and recommends that the Legislature appropriate $450,000 in FY 1984 to develop detailed engineering plans and bid specifications, primarily through consultant contracts. This would finance the final planning, preparatory to actual bid-letting, for major switches in Topeka, Kansas City and Wichita as well as a fiber optic transmission system from Kansas City to Wichita via Salina. The Office of Telecommunications estimates that these components would require a capital investment of $19 million, which could be financed either through issuance of revenue bonds or a lease/purchase arrangement, depending upon which option appears more advantageous at the time. This capital cost would be financed through charges to state agencies as part of their regular phone bill and a ten-year bond retirement or lease/purchase term is envisioned. If estimated savings are realized, state agencies would not have to increase their budgets to absorb this cost.

The proposed timeframe projects that contracts could be let in early FY 1985 with service beginning in late FY 1986 or FY 1987. The complete plan developed by the Office of Telecommunications also includes installation of switches at other major centers of state government, e.g., Kansas University and Kansas State University, as well as the extension of transmission facilities. No timeframe has been proposed for these additions, which could be postponed indefinitely or phased in on a time schedule agreed upon at a later date.

The current proposal, however, is the one that this Legislature is asked to address and the Department of Administration states that the three switches plus the transmission system will serve approximately 50 percent of the current system dedicated to calls between state agencies. It would appear that the Legislature has at least four options in response to the proposal. Those options and a rationale for each are outlined below.

Option 1 - Reject the Proposal for a State-Owned System

The variety of changes taking place in the telephone industry could affect service and rates for years to come and the unpredictability of these changes make it impossible to conclude with certainty that it is to the state's advantage to purchase its own system. Since the Secretary of Administration is already obligated to acquire new customer premises equipment under competitive bid conditions and can also, as the occasion arises, bid the major switching components included in the plan, legislative rejection of the proposal may well mean only rejection of the transmission facilities. The state can save the proposed $450,000 expenditure in FY 1984 by letting staff in the Telecommunication's Office develop bid specifications as time and resources permit. The Legislature always has the option of reconsidering a transmission system at such time as rates have stabilized to the point that potential savings can be better evaluated.

Option 2 - Defer Development for One Year

The effects of divestiture and deregulation remain highly speculative. Until the state has had some experience in this new environment and until pending regulatory decisions are made by both the FCC and the KCC, it is difficult to assess the best course for the state to pursue. In general, it would appear that the proposal to acquire and operate portions of the telephone service that the state requires is a sound one. Furthermore, issues regarding maintenance contracts with multiple vendors and system integrity may favor a comprehensive approach as opposed to the piecemeal system that may develop if the first option is adopted. However, because of rate uncertainties and because of the need to reduce demands on the State General Fund in FY 1984, the best course at this time would appear to be a year's delay.

Option 3 - Fully Fund the $450,000 Proposal

Although uncertainties remain, there is considerable evidence to suggest that local service rates will raise significantly as a result of divestiture. Since the proposal will lead to replacement of much of this service, it is logical to proceed at this time in order to achieve savings as soon as possible. This would ensure that the system is engineered as a complete package, problems with multiple vendors can be reduced and a comprehensive system would be developed. If additional information should surface during the next year that indisputably refutes the feasibility of the project, the state is still not irrevocably committed to the actual letting of contracts. However, such an event is not anticipated and it is felt that further delay will only result in increased telephone costs. By beginning in FY 1984, the state should realize savings by FY 1987.

Option 4 - Separate the Project Into Components and Proceed Initially With Those for Which Cost Estimates Are Most Likely to be Reliable

As noted previously, the proposal to initiate a statewide telecommunications system includes both switches and a transmission facility. Since more certainty seems to exist with respect to local versus long distance rates, that is, there is general agreement that rates for local service will increase, there appears to be merit in proceeding with the switches only and delaying work on the transmission system. The option for developing the transmission system will remain, but can be evaluated at a later time when regulatory decisions regarding long distance rates and access charges have been made. This approach could also reduce the amount needed in FY 1984 to develop detailed plans and specifications.

This very brief delineation of options obviously does not take into account any of the detailed arguments for or against a state-owned telecommunications system nor does it reiterate the issues that revolve around divestiture and deregulation. The following is an attempt to list the more prominent issues, observations and questions that the Legislature might want to consider or keep in mind in its decision making.

1. Deregulation and divestiture, while clouding many cost projections, also provide the opportunity (and perhaps under competitive bid laws, the mandate) to proceed with acquisition of some elements of the proposed system that were heretofore available only through a single phone company. The cost of customer premises equipment, for example, is not relevant to consideration of the current proposal since it must, in any event, be acquired under the existing provisions of competitive bid statutes.

2. A considerable amount of the proposal and Southwestern Bell's arguments against the proposal are based on assumptions relevant prior to deregulation and divestiture.

3. The proposed timeframe would apparently accommodate a bid from Southwestern Bell along with other competitors for the switch components (not the transmission facilities) and alleviate much of Southwestern Bell's concerns.

4. The earlier the timeframe, the more favorable the bidding conditions for major corporations (e.g., American Bell) and the less favorable for the divested Bell Operating Companies.

5. The nature of the regulated operating company is such that development of the state system will, beyond question, impact rates to other users by raising rates to compensate for loss of state revenues. The impact in dollars that this might have on the residential customer is unknown. The Office of Telecommunications noted in one of its earlier reports that the phone company could lose approximately 1 percent of gross revenues.

6. The multiple evaluations and revisions of cost projections undertaken by the Department of Administration and Southwestern Bell leave recent recipients of such information wondering which comments relate to which version of the respective reports. Caution is advised in reaching conclusions without further clarification.

7. Concern expressed by independent operating companies appears unwarranted insofar as it relates to previous practices regarding division of revenues. Some impact might be felt by such companies as a result of the construction of transmission facilities by the state, but that impact has not been defined in any concise way and should not be significant.

8. Most of the criticisms raised in the Ernst and Whitney evaluation (commissioned by Southwestern Bell) of the state plan are not particularly relevant in this stage of consideration. However, the Department of Administration should be asked to respond to certain questions raised about cost projections.

   a. The study claims that state costs are escalated at a 10 percent annual rate, while telco costs are escalated at 15 percent. Is this true in the most recent state cost projections?

   b. Do state projections add $2.4 million to telco costs for video transmission service?

   c. Are different assumptions made in the state plan regarding discontinuing Telpak, i.e., do current Telpak rates apply to the cost of residual intercity service if the state purchases its own system?

9. It might be questioned whether the time value of money is as relevant to governmental decisions as it is to private investment decisions (Ernst and Whitney criticism).

83-67/SB