

Approved: 1-16-96
Date

MINUTES OF THE HOUSE SELECT COMMITTEE ON TELECOMMUNICATIONS

The meeting was called to order by Chairperson Doug Lawrence at 1:30 p.m. on January 10, 1996 in Room 313-S of the Capitol.

All members were present except:

Committee staff present: Raney Gilliland, Legislative Research Department
Bob Nugent, Revisor of Statutes
Mary Ann Graham, Committee Secretary

Conferees appearing before the committee: David J. Heinemann - General Counsel, Kansas Corporation Commission
Glenda L. Cafer - Director of Utilities, Kansas Corporation Commission
Karen Flaming - Chief of Telecommunications, Kansas Corporation Commission
Jerry Lammers - Managing Telecommunication Auditor/Analyst
Kansas Corporation Commission

Others attending: See attached list

Chairman Lawrence opened the meeting at 1:30 p.m..

The Chairman recognized David Heinemann, General Counsel for the Kansas Corporation Commission, Mr. Heinemann appeared on their behalf to review the actions being taken by the Commission to encourage the development of effective competition for telecommunication services in Kansas. (See Attachment 1) He also presented an 89 page order in the Competition Docket. (see Attachment 2) He introduced Glenda Cafer, Director of Utilities for the Kansas Corporation Commission.

Chairman Lawrence welcomed Ms. Cafer. Ms. Cafer discussed SCR 1627 which was passed in April of 1994 by the Kansas Legislature. (See Attachment 3) This includes a tentative schedule for Phase II of the Competition Docket. She introduced the staff and gave members of the committee a directory of the Kansas Corporation Commission Telecommunication staff (See Attachment 4) Ms. Cafer introduced Karen Matson-Flaming, Chief of Telecommunications.

The Chairman announced that since the Kansas Corporation Commission had been given two days to make its presentation, all questions by the committee would be held until that had been completed.

The Chair welcomed Karen Flaming. Ms. Flaming presented testimony and discussed the "hows" and "whys" of the work done at the Commission by the staff that make up the research arm of the Commission (See Attachment 5) She introduced Jerry Lammers, Managing Telecommunications Auditor/Analyst of the Kansas Corporation Commission.

The Chair welcomed Mr. Lammers, he had a presentation along with exhibits on Universal Service within the Telecommunications Industry (See Attachment 6)

Chairman Lawrence asked David Heinemann if he had additional comments. He said he did not, and was looking forward to coming back tomorrow.

The meeting adjourned at 3:05

The next meeting is scheduled for January 11, 1996.

SELECT COMM. ON TELECOMMUNICATIONS
COMMITTEE GUEST LIST

DATE: 1-10-96

NAME	REPRESENTING
Randy Debenham	K9. Corp. Comm.
David Burtz	KCC
Ronald Miller	"
Parshah Das	KCC
Ann McDonald	KCC-Staff
Tom Palmer	KCC
Dave Heinemann	"
Jerry Lammers	KCC Staff
Karen Fleming	KCC Staff
Glenda Cater	KCC
Ron Hein	
M ^C HARRISSIMEAUX	CLASSIC COMMUNICATIONS
Rob Hodges	KTA
George Barber	R T M C
JEFF RUSSELL	SPRINT
Patrick Skurley	CI+T
Wilson Krueger	Kansas City FiberNet
Tom Bruno	Allen + Assoc.
Mike REECHT	AT+T

SELECT COMM. ON TELECOMMUNICATIONS COMMITTEE GUEST LIST

DATE: 1-10-96

NAME	REPRESENTING
Eva Powers	MCI
STEVE KEARNEY	KINI L.C.
Jay Scott Emler	KINI L.C.
Walter Henry	Hair, Emt & Hair
Walter Henry	CURB
Kathy Peterson	AT&T
JASON PITZENBURGER	BRAD SMOOT
Mike Meacham	Ks. Cable Telecommunications Assn.
Doug Smith	SITA
DENNY S. KOCH	SW Bell Tel.
Bill Drexel	SWBT
BILL BLASE	SWBT
JAMES M CAPLINGER	SITA
MARK CAPLINGER	Kansas Independent Telecommunications Co's.
Tom Day	KCC
John Peterson	Comp Tel of Kansas
Don Brown	ADIC & ABOO
Robert Kreyer	RRDeGeo & ABOO

SELECT COMMITTEE ON TELECOMMUNICATIONS

Testimony Presented By David J. Heinemann, General Counsel
Kansas Corporation Commission
January 10, 1996

Mr. Chairman, Members of the Committee:

I am David J. Heinemann, General Counsel for the Kansas Corporation Commission, appearing on their behalf today to review for the committee the actions being taken by the Commission to encourage the development of effective competition for telecommunication services in Kansas.

First, since coming to the Commission almost four months ago, I have found the area of telecommunications regulation to be a extremely complex and contentious arena. Not only do you feel like you have to learn a new language (ILEC, RBOC, MTSO, PSTN, etc.), but you also have to develop an understanding of the many developing communication technologies in order to converse intelligently with the many parties who have become active players as we head toward competition.

Second, having had the rare opportunity to have worn a hat as a legislator and now as general counsel, I have seen that our process is similar, but different. While legislative bodies hear testimony, sometimes limited by time, the Commission through its quasi judicial process is often able to involve all of the interested parties in a due process proceeding where testimony, both written and oral, can be taken on the record with the right of other participating parties to cross examine if they choose. This has been particularly true of the Competition Docket where literally volumes of testimony were presented to the Commission because of the complexity of the many issues involved.

I also have now had the opportunity to attend seminars dealing with telecommunication issues and have learned first hand that the Kansas Commission is not lagging in dealing with the telecommunications competition issues. Of the many state commissions nationwide, the Kansas Commission is with those states taking the lead. In my discussions with other states, it appears that the Kansas Legislature had the foresight decades ago to provide the Commission with the tools necessary to promote effective competition. Many of the states have been active adopting legislation which removed the barriers contained in their statutes

*House Sel/comm Telecomm.
1-10-96
Attachment 1*

which would bar their respective commissions from providing effective competition.

I will now introduce our new Director of Utilities, Glenda Cafer, who will proceed to brief you on many of the technical issues the Commission is dealing with as it continues to follow the direction given by the legislature in SCR 1627.

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Susan M. Seltsam, Chair
F.S. Jack Alexander
Rachel Lipman

In the Matter of a General Investigation into) Docket No. 190,492-U
Competition within Telecommunications Industry) 94-GIMT-478-GIT
in the State of Kansas.)

ORDER

NOW, the above-captioned matter comes before the State Corporation Commission of the State of Kansas ("Commission"). Having examined its files and records, and being duly advised in the premises, the Commission finds and concludes as follows:

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I. BACKGROUND

1. On April 22, 1994, the Commission issued an Order establishing this generic docket "to investigate the level of competition for each regulated or flexibly regulated telecommunications service within the telecommunications industry and other issues related to competition within the telecommunications industry." (Commission Order of April 22, 1994; at 14). In that Order, the Commission requested preliminary statements of position on various issues, comments on what other issues should be addressed, and procedural comments in light of Senate

Concurrent Resolution 1627 (SCR 1627) and pending federal legislation. The Commission's Order found all local exchange companies (LECs), interexchange companies (IXCs), and resellers certificated in Kansas to be parties to the proceeding. However, to continue to receive orders regarding the proceeding or to otherwise participate, the Commission found parties other than all LECs, AT&T, MCI, and Sprint, were required to file a notice of intent to participate with the Commission on or before May 5, 1994.

2. On April 28, 1994, Landmark Communications (Landmark) filed a Notice of Intent to Participate, and on August 30, 1994, Value-Line of Kansas Inc. (Value-Line) filed a Notice of Intent to Participate.

3. - On April 25, 1994, May 2, 1994, and May 27, 1994, The Citizens' Utility Ratepayer Board (CURB), CompTel of Kansas Association (CompTel), and Teleport Communications Group, Inc. (TCG), respectively, filed Petitions for Leave to Intervene. On September 19, 1994, the Commission issued an Order granting these Petitions.

4. On May 2, 1994, Kansas City Fiber Network, L.P. (KC Fiber) and Multimedia Hyperion Telecommunications (MHT) filed Notices of Intent to Participate. On May 4, 1994, Kansas Consolidated Professional Resources (KCPR) filed a Notice of Intent to Participate. On May 5, 1994, Kansas CATV Association, Inc. (Kansas CATV), The Telecommunications Resellers Association (TRA), and Mid-America Cable TV Association, Inc. (Mid-America CATV) each filed a Notice of Intent to Participate. On May 17, 1994, the United States Department of Defense and

All Other Federal Executive Agencies (DoD/FEA) filed a Petition for Leave to Intervene. On May 27, 1994, MFS Communications Company, Inc. (MFS) filed a Notice of Intent to Participate.

5. On May 23, 1994, The Council Grove Telephone Co. (Council Grove) filed Preliminary Comments, and on May 26, 1994, Kansas CATV filed a Preliminary Statement of Position and Comments. On May 27, 1994, preliminary statements of position and comments were filed by: CURB, AT&T Communications of the Southwest, Inc. (AT&T), Kansas Telecommunications Association (KTA), Sprint Communications Company L.P., United Telephone Company of Eastern Kansas, United Telephone Company of Kansas, United Telephone Company of South Central Kansas, and United Telephone Company of Southeastern Kansas (Sprint/United), The United States Department of Defense and All Other Federal Executive Agencies (DoD/FEA), Kansas City Fiber Network, L.P. (KC Fiber), The Telecommunications Resellers Association (TRA), Southwestern Bell Telephone Company (SWBT), MCI Telecommunications Corporation (MCI), Blue Valley, Et Al. (Blue Valley), Independent Telecommunications Group, Columbus, Et Al. (Columbus), and KIN Network, Inc. (KIN).

6. On July 12, 1994, after review of the parties preliminary statements of position and comments, Commission Staff ("Staff") filed a Motion Proposing Adoption of Issues List and Procedural Schedule recommending how the Commission might organize issues and set schedules to determine the impact of various changes in the industry on current Commission policies regarding

ratemaking, the public interest, universal service, and how such policies should be modified or adapted. Staff also suggested, given comments by many of the parties, the Commission should form an Industry Task Force to "investigate the most effective way to transition and implement 1+ and 0+ equal access presubscription", pursuant to the Commission's April 30, 1993 Order in Docket 181,097-U. (Staff Motion of July 12, 1994; at 19).

7. On August 17, 1994, subsequent to consideration of Staff's Motion and Responses of the parties, the Commission issued an Order indicating that deliberation of issues in this docket would be accomplished in two Phases and adopting a list of issues to be addressed in Phase I. The Commission also set a procedural schedule for Phase I which directed all parties to submit written comments regarding certain Phase I issues and to submit prefiled testimony regarding the remaining Phase I issues. The Commission set the hearing on Phase I issues for November 21-23, 1994, and November 28-December 2, 1994. The Commission ordered Proposed Findings of Facts and Conclusions of Law to be filed on or before December 23, 1994. The Commission also ordered "the industry to form immediately the IntraLATA Presubscription Task Force within 30 days of the date of this Order." (Commission Order of August 17, 1994; at 23).

8. On August 31, 1994, SWBT filed a Petition for Reconsideration of the portion of the Commission's August 17, 1994 Order establishing a Task Force to investigate the most effective way to transition and to implement 1+ and 0+ equal access presubscription. On Sept. 20, 1994, the Commission issued an Order

Clarifying Previous Order and Denying Petition of Reconsideration. On October 3, 1994, SWBT filed a Petition for Reconsideration of the Commission's September 20, 1994 Order. MCI and AT&T filed responses to SWBT's Petition on October 12, 1994 and October 17, 1994, respectively. On October 23, 1994, the Commission issued an Order Denying SWBT's Petition for Reconsideration of its September 20, 1994 Order Clarifying Previous Order and Denying Petition of Reconsideration.

9. On October 3, 1994, TRA filed comments on those issues designated for comment in Phase I. On October 7, 1994, comments were filed by Comptel, MHT, Blue Valley, AT&T, KC Fiber, Sprint/United, SWBT, MCI, and Columbus. On November 4, 1994, Staff and DoD/FEA filed comments. On November 14, 1994, reply comments were filed by Columbus and rebuttal comments were filed by SWBT.

10. On October 7, 1994, prefiled testimony on those issues designated for testimony in Phase I was filed by Blue Valley, Columbus, MHT, AT&T, KC Fiber, Kansas CATV, SWBT, Sprint/United, and MCI. On November 4, 1994, prefiled testimony was filed by Staff, DoD/FEA, and CURB. On November 14, 1994, rebuttal testimony was filed by Comptel, SWBT, MCI, Sprint/United, MCI, AT&T, and Kansas CATV. On November 16, 1994, reply testimony was filed by Staff, and on November 18, 1994, rebuttal testimony and supplemental testimony were filed by CURB.

11. Prehearing conferences were held on November 10, 1994 and November 16, 1994. At the November 16, 1994 prehearing conference, all active

parties agreed to an order of cross examination, an order of witnesses, and to waive cross-examination on Phase I issues which were set for written comment. The Commission Staff circulated a proposed stipulation and agreement.

12. On November 18, 1994, the Commission issued an Order, revising its Order of August 17, 1994 to conclude that post-hearing briefs should be filed no later than December 22, 1994. The Commission Order also postponed commencement of the hearing in the above-captioned docket to November 28, 1994. The November 18, 1994, Order also granted the Petition for Leave to Intervene filed by DoD/FEA; and granted the Notices of Intent to Participate as Petitions for Leave to Intervene filed by: KC Fiber, MHT, KCPR, Kansas CATV, Mid-America CATV, TRA, and MFS.

13. Hearings were held November 28 through December 2, and on December 5, 1994, which resulted in 6 volumes and over 2000 pages of transcript. The following appearances of counsel were made at hearing:

On behalf of Columbus, et al:

Mr. Thomas E. Gleason
Thomas E. Gleason, Chartered
Attorneys at Law
P.O. Box 490
Ottawa, Kansas 66067-0490

On Behalf of Southwestern Bell Telephone Company:

Mr. William R. Drexel
Mr. Michael C. Cavell
Mr. Michael G. G. Smith
Southwestern Bell Telephone Company
220 East Sixth Street
Room 515
Topeka, Kansas 66603

On behalf of Blue Valley, Et. Al.:
Mr. James M. Caplinger
James M. Caplinger, Chartered
Attorneys at Law
823 West 10th Street
Topeka, Kansas 66612

On Behalf of Sprint Communications, L.P.:
Ms. Mary Hull
Sprint Communications
8140 Ward Parkway - SE
Kansas City, Missouri 64114-8417

On Behalf of United Telephone Company of Kansas:
Mr. Stephen D. Minnis
Mr. Denton Roberts
United Telephone Company of Kansas
5454 West 110th Street
Overland Park, Kansas 66211

On behalf of AT&T Communications of the Southwest:
Mr. Mark Witcher
AT&T Communications of the Southwest
8911 Capital of Texas Highway
Suite 1100
Austin, Texas 78759

Ms. Glenda L. Cafer
Bennett & Dillon
Attorneys at Law
1605 S.W. 37th Street
Topeka, Kansas 66611

On behalf of MCI Telecommunications Corp.:
Mr. Edward Cadieux
MCI Telecommunications Corporation
100 South Fourth Street
Suite 200
St. Louis, Missouri 63102

Ms. Eva Powers
Morris, Laing & Evans
Attorneys at Law
800 S.W. Jackson Street
Suite 914
Topeka, Kansas 66612-2214

On behalf of Comptel of Kansas:

Mr. James Roth
Woodward, Blaylock, Hernandez, Roth & Day
Attorneys at Law
833 North Waco
Wichita, Kansas 67203-0127

On behalf of Kansas CATV Association:

Mr. Victor Davis, Jr.
Weary, Davis, Henry, Struebing & Troup
Attorneys at Law
819 North Washington Street
P.O. Box 187
- Junction City, Kansas 66441

On behalf of Multimedia Hyperion Telecommunications, and on behalf of
Kansas City Fiber Network, L.P.:

Mr. Mark P. Johnson
Sonnenschein, Nath & Rosenthal
Attorneys at Law
One Kansas City Place
1200 Main Street
Suite 3850
Kansas City, Missouri 64105

On behalf of Department of Defense:

Mr. Robert A. Ganton
Trial Attorney
Office of the Judge Advocate General
Department of the Army
901 North Stuart Street
Arlington, Virginia 22203-1837

On behalf of Citizens' Utility Ratepayer Board:

Mr. K. Bill Craven
Ms. Nicole Bryant
Consumer Counsel
Citizens' Utility Ratepayer Board
1500 Southwest Arrowhead Road
Topeka, Kansas 66604-4027

On behalf of Commission Staff:

Ms. Dana Bradbury
Ms. Martha Cooper
Ms. Shirley Sicilian
Legal Division
Kansas Corporation Commission
1500 Southwest Arrowhead Road
Topeka, Kansas 66604-4027

14. On December 22, 1994, briefs were filed by the following parties: Staff, AT&T, SWBT, Kansas CATV, Sprint/United, Blue Valley, MHT, KC Fiber, CURB, MCI, CompTel, Columbus, and DoD/FEA.

II. SUMMARY OF PARTIES' POSITIONS

15. Staff, CompTel, DoD/FEA, MHT, Sprint/United, MCI, Kansas CATV, and AT&T assert that effective competition in the local exchange market does not exist today, but that it is in the public interest to allow competitive entry in all segments of the telecommunications industry provided that appropriate mechanisms and procedures are instituted which not only encourage and allow the development of effective competition but also ensure and promote reasonable rates, efficient and sufficient services and universal service. Required mechanisms and procedures would include new, competitively neutral universal service mechanism(s), and alternative regulatory mechanisms, which allow prices for

telecommunications services to better reflect the cost of services whenever reasonable. According to these parties, an appropriate alternative regulatory mechanism would allow individual services or groups of services to be classified into "non-competitive" and "competitive" categories. Specific price floors and ceilings for services in the "non-competitive" category, and price floors for services in the "competitive" category, would be calculated using the results of suggested cost studies and appropriate "imputation" requirements and safeguards. Additionally, these parties assert that there are several barriers to increased competition which should be addressed. Further, various cost studies would need to be performed for use in considering: (a) "rate rebalancing" and implementation of alternative regulatory plans for SWBT and other requesting LEC's; (b) pricing of interconnection services, unbundled services, and, possibly, reciprocal compensation; and, (c) universal service matters. The "Texas rules" would be used as a starting point for Total Service Long Run Incremental Cost ("TSLRIC") studies for local exchange service and Basic Network Functions. Other cost studies, including distributed cost studies, should be performed as necessary and appropriate.

16. These parties maintained that in addition to its current procedures regarding certification of interexchange carriers, the Commission should adopt a process for expedited approval of applications for certificates of convenience and necessity for the provision of telecommunications services, where such authorization has been granted for similar services and in similar circumstances. Certificates would be granted on a non-discriminatory basis as long as the applicants

show the technical, financial and managerial ability to provide the service requested.

17. In addition, Staff suggested that until such time as effective competition has developed, the Commission should have a rule against abandoning a customer or territory, thereby leaving no other providers to offer service to the end users. The Commission should not allow revenue replacement for incumbent LECs if they lose business to competitors, or equivalently, the Commission should not guarantee recovery of investment stranded by competition. Staff asserted that where there is the potential for markets to be disciplined by competition, the Commission should take steps to ensure that competition is as full, fair, and effective as possible, and the Commission should continue to monitor these markets to ensure that competition is sustainable. Staff noted that the Commission should not assume now that competition will ensure reasonable rates, or that effective competition exists.

18. Additionally, AT&T stated that given the capital intensive nature of local exchange service, fostering resale is critical. AT&T noted that two or three or more competitors alone is not determinative of effective competition. AT&T indicated that the Commission should not guarantee recovery of investment stranded by competition. AT&T noted that until effective competition has developed, the Commission should have a rule against abandoning a customer or territory.

19. Further, Sprint/United stated that the obligation to provide local service to all should diminish as the transition to full and fair competition. MCI agreed that potential competition is not effective competition.

20. MHT and KC Fiber also argued SWBT should not be allowed pricing on an individual customer basis until there is effective competition and the Commission should impose continued stringent regulation of incumbent carriers. MHT stated that the number of certificates or competitors is not an indicator of the level or effectiveness of competition.

21. CURB stated that the Commission should consider increased competition for SWBT first, and consider others with strong preference for preservation of universal service. CURB further offered its own public interest criteria. CURB asserted that the Commission should adopt a plan of Outcomes and Performance Based Alternative Regulation Plan (OPBAR) which would establish goals so that outcomes and performance of alternative regulatory plans may be evaluated. CURB opposes any pricing scheme which would promote virtual automatic annual increases in basic local rates by tying increases in rates to changes in general price indexes and flowing through cost increases but not cost decreases. CURB noted that if the Commission favors continuation of alternative regulation there is a natural progression to an outcomes and performance based philosophy focused on correcting any deficiencies resulting from TeleKansas and emphasizing accountability and specificity for measurable criteria. CURB maintained that the Commission should require SWBT and other LECs requesting alternative

regulation plans to perform certain cost studies for major services, and the Commission should recognize SWBT's market power and consider this when establishing regulatory flexibility for services. CURB stated that the Commission should endorse a cost causer/cost payer philosophy for allocating costs associated with trying to promote competition.

22. SWBT stated that competition in telecommunications in Kansas is here and will grow in virtually every area of the business. SWBT indicated that its local service rates are repressed through support mechanisms which comport with the Commissions' historic policy of making local service rates affordable and obtaining universal service within Kansas. SWBT argued removing such support to local residential rates would require another mechanism be put in place, prior to authorized switched competition in local markets, in order to assure the continuation of universal service and carrier of last resort obligations. SWBT asserted competitive services of SWBT should not be singly responsible for maintaining universal service support and that a realignment of rates is appropriate as a part of the alternate plan for universal service support recovery. SWBT proposed that individual services or groups of services be classified into "non-competitive", "subject to competition" and "discretionary services" categories, and that the services listed by SWBT as "subject to competition" be presumed as such and subject to market pricing and incremental cost floors. SWBT stated that "discretionary services" should be regulated by market forces to the maximum extent possible. Local switched residential and business service is not currently

competitive; for any other service, the service will be deemed "competitive" upon a showing that there is at least one alternate supplier offering an effective substitute, considering its features and prices, in the same geographic areas. Furthermore, SWBT argued that competition should be measured by service, not by individual basic network functions (BNFs), which have no stand alone value and would never be purchased individually. SWBT indicated that even the potential for competitive entry can and has disciplined incumbent behavior and will act as a check to abusive actions by SWBT or other LECs. SWBT maintained that price regulation is appropriate for non-competitive services in the Kansas telecommunications markets, and the rate should be capped and subject to an adjustment/index factor change. The price plan should also include pricing flexibility to enable SWBT (or LECs) to meet specific targeted sub-markets selected by competitors who do not have statewide service obligations. SWBT noted that price regulation should not include any sharing functions or a periodic re-evaluation of rates or the price regulation formula based on earnings. SWBT stated that pricing for competitive services should be above incremental costs for all firms. SWBT concluded that historic rate base/rate of return regulatory policy is no longer appropriate because telecommunications markets are no longer a stable environment, and therefore the Commission should implement a permanent change to price regulation for SWBT. SWBT stated that there is no significant barrier to entry other than the SWBT/MFJ interLATA barrier, and that other alleged barriers seem less intrusive and are not absolute, if barriers at all. SWBT stated that support flowing from intrastate services

to local services should be transferred to different services or a rate recovery mechanism of the carrier of last resort for support of that carrier's actual historic costs to provide and maintain its universal service network in Kansas. SWBT stated that for pricing purposes, incremental costs are appropriate in non-basic services. However, they are not appropriate or needed to measure the support flows to local service. SWBT maintained that it has not been proven that TSLRIC for BNFs are at all necessary to advance competition in any market, they would be costly and not yield any obvious benefits to service pricing. SWBT noted that stand alone studies are difficult to perform and offer nothing in the way of useful information for pricing service in competitive markets or universal service support identifications.

23. Columbus stated that competition will prove harmful to the public interest in smaller communities and rural areas of Kansas and local exchange competition should be authorized only to the extent that it may be implemented consistent with universal service objectives throughout the state. Columbus indicated that alternative regulatory plans may hold benefit for customers of ILECs who seek to become subject to such plans, and therefore phase II of this docket should include consideration of one or more alternative regulatory plans under which ILECs might choose to operate. However, absent a clear showing of public benefit no alternative regulatory plan shall be imposed upon an ILEC which has not sought to depart from operation under traditional rate of return regulation.

Columbus stated that there should be no action regarding actual or alleged barriers to entry as relates to the operation of ILECs until such time as there is evidence of actual sustainable and effective competitive opportunity in the territories presently served by such companies. Columbus indicated that authorization of competition for rural local exchange service, if and when granted, must be subject to a mechanism providing for continued opportunity for recovery and return on investments made in reliance on present policy. Columbus noted that because the feasibility of effective competition for local exchange services in territories of ILECs has not been demonstrated, it would not be in the public interest at this time to impose additional regulatory burdens or expenses on ILECs either through the outright authorization of competition or through requiring the preparation of extensive cost studies by such companies.

24. Blue Valley stated that competition will irreparably damage the ubiquitous network now placed in the rural areas of Kansas and if the Commission should conclude that competition in local exchanges could benefit the public, it should consider a provision for a rural exemption. Blue Valley maintained that competition will jeopardize the mechanisms which provide support for universal service. Blue Valley indicated that the Commission should not allow competitors free entry into any market without regulations and then continue to regulate the incumbent LEC. Furthermore, Blue Valley suggested deregulation has not been examined with care for rural markets. Blue Valley noted that, under a competitive

framework, no one can be forced to serve everywhere and eventually no one will be legally obligated to serve every potential user of the network.

III. FINDINGS AND CONCLUSIONS

A. The Commission Will Take Steps To Promote Competition In Local Exchange Telecommunications Markets Which Is Compatible With The Public Interest

1) The Current Regulatory Structure Must Be Modified To Ensure That Competition In General Is As Compatible With The Public Interest As Possible

25. The general benefits of competition have been recognized by this Commission in several past dockets, including those relaxing regulation and approving competition in interLATA toll (Docket No. 127,140-U), intraLATA toll (Docket No. 181,097-U), special access (Docket Nos. 189,681-U and 190,368-U), customer premises wiring (Docket No. 127,140-U) and customer premises equipment (Docket No. 127,140-U). These benefits include:

- a. Greater customer choice among services offerings and providers;
- b. Lower prices;
- c. Increased incentives for efficiency and technological innovation, and thus more rapid introduction of advanced technologies.

26. While some benefits of effective competition may already be enjoyed by Kansans in markets for customer premise equipment, network equipment, interLATA long distance, and intraLATA long distance; one market, local exchange, remains largely regulated, and thus largely monopolistic. (See Flappan/AT&T, Tr. p.

1132-19; See Ivanuska/Sprint/United, Tr. p. 1328-9, "Currently, competition in the local exchange market place is very limited."; Price/MCI, Tr. p. 421-9, "Currently, the local exchange telecommunications market is dominated by the traditional LECs who possess significant market power." James/CompTel, Tr. p. 965-5). Nonetheless, it is clear from the record in this case that some degree of competition does exist today in certain segments of the local exchange market, and in general, the potential for effective competition in this market is increasing due to technological developments and likely federal action. (Smith/SWBT, Tr. p. 490-2; Vanston/SWBT Tr. p. 335-2 to 3; Brevitz/Staff Tr. pp. 1531-1 to 2; 1531-5,11,17; 1677-78; And see Staff Comments, p. 8; Ivanuska/Sprint-United, Tr. p. 1328-12 and 36 regarding some competition in the local transport market and regarding changes in technology; Fannin/SWBT, Tr. p. 65-2). Furthermore, there is substantial consensus among the parties that expanding this local exchange competition will promote the public interest and should be authorized in Kansas.

The Commission agrees with testimony that:

Competition can benefit the public by encouraging efficient provisioning of the telecommunications products and services consumers want.

(Fannin/SWBT, Tr. p. 65-2; see also, Larson/SWBT, Tr. p. 563-8).

Full and fair [local exchange]competition will drive prices down toward costs and will force competitors - incumbents and new entrants alike - to reduce those costs through more efficient operations and investments in cost-saving technologies. Competition will also expand the range and quality of choices available to customer, whether due to market-responsive service offerings making use of existing network functionalities or to innovative services made possible by investment in new technologies. All customers, whether they remain with their

incumbent LEC or switch to a new provider, will benefit from lower-cost, higher-quality telecommunications services.
(Murray/MCI, Tr. p. 868-4).

The well established benefits of competition are lower prices, better quality and increased innovation. These benefits are brought about because customers have a choice of who they want to supply their needs. Suppliers in a competitive market strive to obtain and retain customers through offering more customer tailored services and products at lower prices. Under competition, suppliers drive waste and inefficiency out of their businesses in order to be able to offer a more competitive price to end users. Through competition, scarce resources are allocated efficiently and consumer welfare is maximized... Most, if not all, parties will agree that an effectively competitive local exchange would bring many benefits to Kansas... Hopefully, [local exchange] competition will be robust and will take all of these forms, bringing free choice and immense benefit to Kansas consumers and businesses.
(Flappan/AT&T, Tr. p. 1132-2, and 12).

Local exchange competition will result in reduced costs, new services, lower overall telephone bills, and more choices for customers.
(Ivanuska/Sprint/United, Tr. p. 1328-4).

The Commission's goal should be to adopt new telecommunications policies that promote diversity of choice for consumers.
(James/CompTel, Tr. p. 965-3).

[C]ompetition is the appropriate condition for Kansas telecommunications, as long as the new providers are given appropriate protection from potentially anti-competitive conduct by incumbent providers.
(Scott/KC Fiber, Tr. p. 1232-4).

[Curb advocates] support of concepts which will encourage competition and remove barriers to entry without negative impacts on customers.
(Ostrander/CURB, Tr. p. 1448-3).

[The Commission should] strive to create an environment to make competition by new entrants, where they in fact enter, as efficient as possible in as short a time frame as possible.
(Brevitz/Staff, Tr. p. 1531-3).

(Also See Kravtin, Tr. p. 971-4).

27. Therefore, the Commission's goal in Phase I of this docket, is to determine, and implement to the greatest extent possible, those changes in state regulatory structure necessary to provide a timely, yet orderly, transition to a competitive local exchange telecommunications market. A timely and orderly transition requires encouraging competitive entry in Kansas in a way which maximizes its benefit to the public interest, while maintaining ratepayer protections where competition has not yet developed. In order to simultaneously provide for such competitive entry and maintain appropriate ratepayer protections, the Commission determines that three major features of the current regulatory structure must be modified as follows:

- a. Universal service mechanisms must be revised to be competitively neutral and sustainable in a more competitive environment.
- b. An alternative to traditional ratebase/rate of return regulation must be established.
- c. Existing barriers to competition must be reduced or eliminated wherever a cost effective means of doing so is available.

Modifications to these features of the current regulatory structure are essential in order to transition local exchange telecommunications markets and bring the full benefits of competition to Kansas consumers and businesses. For each such regulatory feature, a description of all modification which the Commission will require to be implemented or studied further, and the rationale and evidence supporting such requirement, are set out in detail below.

2. Whether A Particular Application By An Individual Competitor Is Compatible With The Public Interest Will Be Determined On A Case By Case Basis In Light of Certain Factors.

28. In addition to identifying the structural changes necessary to ensure competition generally is as compatible with the public interest as possible, the Commission must also identify the factors it will consider in determining whether a particular application by an individual competitor is in the public interest. In order to make this determination, applications must include geographic territory description and a statement as to whether the applicant intends to operate as a common carrier in that territory.

29. The Commission finds that a number of factors should be considered in determining whether a particular application is consistent with the public interest. These factors may include, but are not limited to the following:

- a. The technical, managerial and financial capabilities of the applicant, (Ivanuska/Sprint/United, Tr. p. 1328-27);
- b. The effect on the public convenience and necessity, e.g.:
 - i. the potential to bring about increased service options;
 - ii. the potential to bring about lower service prices; and
 - iii. the potential to bring about higher quality of services offered, taking into account existing barriers to competition and the likelihood of their eventual reduction or elimination;
- c. The effect on universal service, including applicants proposal for complying with its own universal service obligations;
- d. The effect on economic and infrastructure development; and

- e. The effect on the incumbents revenues and ability to serve, to the extent relevant, and taking into account whether the incumbent is operating under traditional ratebase/rate of return regulation or an alternative regulatory mechanism.

30. The Commission will not require the changes to universal service mechanisms, alternatives to traditional ratebase/rate of return regulation, or reductions in barriers to competition to have been implemented prior to considering individual applications from alternative suppliers. The factors listed above, which the Commission will review in considering these applications, encompass the effect of allowing competition at whatever stage the change in regulatory structure happens to be in when the application is made.

31. Once the Commission has considered these factors and allowed competitive entry into a particular service category, subsequent applications by additional providers may be given expedited treatment. Having found that approval of an initial competitor's application is consistent with the public interest when taking into account the public convenience and necessity (b.), universal service (c.), economic and infrastructure development (d.), and the incumbents revenues and ability to serve (e.), it may be assumed that additional applications will be consistent as well. Therefore, the focus of proceedings regarding additional providers may be limited to those providers' technical, managerial and financial capabilities (a.). "Competition will be fostered if applications for certificates are granted where the applicant demonstrates that it is technically and financially able to comply with the obligations imposed by the certificate and applicable law." (Flappan/AT&T, Tr. p. 1132-4; See also, Ivanuska/Sprint/United, Tr. p. 1328-27).

B. Universal Service Mechanisms Must Be Revised To Be Competitively Neutral And Sustainable In A More Competitive Environment.

32. In order to ensure competition in general is as compatible with the public interest as possible, universal service mechanisms must be revised to be competitively neutral and sustainable in a more competitive environment. Provision of universal service has long been one of the Commission's most fundamental policy goals in regulating the telecommunications industry. This broad goal is also reflected in the Federal Communications Act of 1934, which assures the availability "so far as possible, to all the people of the United States, of a rapid, efficient, nation-wide and world-wide wire and radio communications service with adequate facilities at reasonable rates..." The universal service policy has been justified largely on the bases of equity and social policy concerns for health and safety.

33. In Kansas, universal service has mainly been accomplished through two techniques:

a. A rate setting policy, whereby a company's rates tended to be averaged over high cost and low cost geographic areas and services to produce an affordable rate for the entire range of services and certificated territory. (Cooper/SWBT, Tr. p. 791-5). The result is that rates do not vary widely between a company's rural and urban areas, even though most parties agreed that generally the cost per access line is highest in rural areas where there is a lower population density and lower total volumes of telecommunications traffic; while, conversely,

the cost per access line is usually lowest in areas where there is a high population density and higher total volume of traffic. (Cooper/SWBT, Tr. p. 791-6 to 7; See Wildman/Blue Valley, Tr. p. 726-7 to 10). According to testimony of Mr. Cooper of SWBT, the monthly cost of local exchange service in urban areas is approximately \$29 while the cost of such service in rural areas is approximately \$77. (Cooper/SWBT, Tr. p. 791-20 to 21; Ex. p. 3). Many argued that the resulting averaged local rates do not even cover the total cost of providing local service. (Fannin/SWBT, Tr. p. 68). State regulators have supported lower local rates with intrastate intraLATA toll, and Yellow Pages revenues. Rate differentials between local residential and local business services have also been maintained. (Cooper/SWBT, Tr. pp. 791-8 to 11; Brevitz/Staff, Tr. pp. 1531-70 to 73).

b. Separations rules and operation of a Universal Service Fund, whereby the incumbent LECs are the sole recipients of the various revenue flows. To make the network available to as many customers as possible, federal and state commissions have created separations rules and rate structures by which local exchange rate levels in general, both urban and rural, have been supported by revenues from other services such as interstate and intrastate toll/access.

34. Historically, the cost of these techniques for promoting universal service, in terms of reduced economic efficiency, may not have been very great. When companies operated in an environment of government granted monopoly, pricing would not have as much effect on the consumers decision to purchase a certain quantity of the sole providers product, especially where that product is a basic

and necessary commodity, like telecommunications service. However, as competition develops, both the rate support method and the current Universal Service Fund method of providing for universal service may inhibit effective competition in some service markets, and be unsustainable in others.

35. As competition develops, customers will have increasing choices regarding what to purchase and from which company. Under these conditions, Commission rate setting decisions aimed at creating low local service rates may not be sustainable. (SWBT br. p. 33, "These supports simply are not sustainable..."; Ivanuska/Sprint/United, Tr. p. 1328-6, regarding contribution through access charge). Raising the contribution over incremental cost in one sector to support a lower contribution over incremental cost in another, may simply create an incentive for new entrants in the first, higher margined sector. Customers could avoid the higher price by switching to the new entrant, thereby eliminating that source of support revenues. In fact, according to testimony of SWBT witness, Mr. Cooper, Yellow pages, toll and access services were among the first services to experience competitive entry.(SWBT br. p. 33). Such entry may not be economic if the incumbent's incremental cost of providing the service is actually lower than the new entrants'. The new entrants may be producing less efficiently, but nonetheless able to stay in business, if the price the incumbent charges is set high to effectuate the support. (Ivanuska/Sprint/United, Tr. p. 1328-68 to 70). Thus, without appropriate changes in universal service support mechanisms, even efficient incumbents may be destined to lose profitable high-margin business only to find

remaining average costs rising, creating a situation in which the incumbent may enter what Staff economist, Dr. Rearden, calls a death spiral leading to bankruptcy. (Rearden/Staff Tr. p. 1476A-13, 1484; SWBT br. p. 33).

36. As competition develops, problems also arise with the explicit Universal Service Fund mechanism. To the extent that rates for local exchange service may be set below cost, allowing only one provider of service, the incumbent LEC, access to subsidy flows serves to inhibit competitive entry. The effect of continuing this aspect of the current Universal Service funding mechanism would be to reduce the profitability of entry by potential providers of service, even where those providers are more efficient than the incumbent. (Price/MCI, Tr. p. 421-24 to 28). If the Universal Service Fund mechanism were available to all providers, it could reduce the prices paid by customers and remove a barrier to competition which served to insulate incumbents from the need to achieve greater efficiencies in their operations.

37. Thus, the Commission finds current universal service support mechanisms must be reviewed and adjusted. This does not mean that universal service will no longer be promoted as a policy goal; universal service maintains its importance as one of the most fundamental goals of telecommunications regulation. Rather, the Commission will commence development of a Universal Service Fund mechanism and rate structures that are more competitively neutral and compatible with local exchange competition. Furthermore, the Commission recognizes the importance of concerns expressed by SWBT witnesses that these rate

structures and Fund mechanisms be addressed as quickly as possible in light of the increasingly competitive environment.

38. Therefore, in order to perform a proper and timely review of the current policy of achieving universal service objectives through rate setting practices, the Commission requires all local exchange companies to file by April of 1996 a long run incremental cost study, and a fully allocated cost study, each in sufficient detail to identify the costs in different geographic regions of providing each service the local exchange company will offer.¹ Small, predominantly rural exchanges may elect to file "representative" cost studies. The Commission's goal is to have data available which will enable it to set prices and price caps in Phase II in accordance with universal service rate restructuring determinations, as well as with the other determinations the Commission must make on unbundling, resale and traditional versus alternative regulatory mechanisms. Parties may also file any additional studies they believe will be useful in making these universal service determinations. For example, the Commission took testimony in Phase I from Blue Valley, et al. witness, Dr. Wildman, which suggested there are beneficial externalities accruing to urban customers by virtue of services being provided to rural customers, and that these externalities should be taken into account in determining contributions over cost from urban customers. (Wildman/Blue Valley, Tr. p. 726-16 to 21). Also noteworthy is Phase I testimony by SWBT witness, Mr.

¹ A Commission Cost Study Working Group, described in detail below, will work towards consensus on additional specification of the cost studies to be performed.

Cooper, suggesting the impacts of rate restructuring on low income subscribers could be mitigated by a targeted lifeline support fund. Of course, this testimony, and all other universal service related testimony, and exhibits filed in Phase I, and cross examination, re-direct examination or re-cross examination on such testimony, remain in the record. However, if a party wishes the Commission to consider relevant Phase I Universal Service Fund related testimony and exhibits, they must be resubmitted in Phase II, and any relevant examination on such resubmitted testimony may be cited in Phase II briefs.

39. In order to formulate a competitively neutral Universal Service Fund mechanism, the Commission establishes a Universal Service Fund ("USF") Working Group. The purpose of this Working Group is to consider alternative Universal Service Fund mechanisms, and submit a proposal to the Commission by October of 1995. Each local exchange company, or consortium of smaller, predominantly rural local exchange companies, shall appoint at least one representative to the USF Working Group. Any interexchange carrier, reseller, special access provider, or potential competitor may also appoint one or more representatives. Staff, CURB, and the Department of Defense may also each appoint one or more representatives. Staff shall be responsible for coordinating the efforts of the USF Working Group. Staff shall also be responsible for determining what data will be required to make an appropriate Universal Service Fund recommendation to the Commission. Parties shall supply Staff the requested information on a timely basis. If the Working Group cannot reach unanimous agreement on a proposal,

then in addition to any results of the Working Group, individual parties may file proposals for alternative Universal Service Fund mechanisms with their testimony in Phase II.

C. An Alternative To Traditional Ratebase/Rate Of Return Regulation Must Be Established.

40. In order to ensure competition is as compatible with the public interest as possible, the Commission must establish an alternative to traditional ratebase/rate of return regulation. Where effective competitive entry occurs or has the potential of occurring, traditional ratebase/rate of return regulation is no longer viable. (Rearden/Staff, Tr. p. 1476A-9; Harris/SWBT, Tr. p. 211-2 and 14; Flappan/AT&T, Tr. p. 1132-36; Ivanuska/Sprint/United, Tr. p. 1328-5). This is because as competition emerges in segments of the local exchange market, the potential increases for traditional regulation, with its heavy reliance on government oversight and inflexibility, to create uneconomic market distortions. A new regulatory mechanism is necessary which not only minimizes these distortions, but also allows the industry and consumers to reap the efficiencies competition is capable of producing. At the same time, some segments of the local exchange market may not be effectively competitive, or may even remain monopolistic. In these segments a greater degree of regulatory oversight is still required. Because this is a time of transition from regulated monopolies to competitive markets, an appropriately designed alternative regulatory mechanism must be flexible enough to recognize the differing levels of competition among the different service and geographic markets, and provide regulatory oversight accordingly. (See

Harris/SWBT, Tr. p. 211-56 to 58; Ivanuska/Sprint/United, Tr. p. 1328-16 and 37; Brevitz/Staff, Tr. p. 1531-40 and 43). For these reasons, the Commission will allow an alternative to ratebase/rate of return regulation, set out below, the purpose of which is to provide local exchange companies with the incentive to increase productivity and the ability to meet competition where it emerges, while maintaining ratepayer protections where competition has not yet developed.

41. The Commission's alternative mechanism accomplishes these purposes through certain major features which are summarized as follows. First, all services, and the costs associated with their provision, are classified at the outset into one of two main categories: Competitive or Non-Competitive. Non-Competitive services are then further classified into Essential and Non-Essential. This feature helps to protect against cross-subsidization of Competitive services with revenues from Non-Competitive services, and thus helps to protect emerging markets in the Competitive category, as well as protect ratepayers from payments in excess of costs in the Non-Competitive category. This feature also enables the Commission to apply differing regulatory treatment to these two very different types of services. Competitive services are allowed maximum pricing flexibility and light-handed regulation, subject only to price floors and tariff filing requirements. Both flexibility and light-handed regulation are crucial to the provider's ability to compete:

An appropriate regulatory plan should...be flexible, by encouraging enterprises to respond quickly to different customer needs and competitive conditions by offering different prices and trying product offerings...First, a regulatory framework should be flexible because

conditions in some market segments will differ from conditions in other segments...Second, flexibility is necessary because there is so much uncertainty and unpredictability about the demand for new services, price sensitivity of customers, response of competitors, rate of technological change and other market conditions...For these reasons, an alternative regulation plan should allow regulated companies considerable freedom in bringing new services to market and in pricing new and existing services...the company can gain the valuable information it needs to serve its customers well and compete with unregulated firms who have almost complete flexibility in responding to different market conditions.

(Harris/SWBT, Tr. p. 211-56 to 58).

42. Another major feature of the Commission's alternative is that regulation of Non-Competitive services is also relaxed while still affording ratepayer protections, by employing a "price cap" mechanism. Under "price cap" regulation, providers have pricing flexibility necessary to meet emerging competitors, yet prices remain "capped" to limit potential for monopolistic pricing which is present until the service is fully competitive. Price cap regulation also has the major advantage of providing incentives for efficiency through cost reductions, much like those which exist in a competitive environment, but which are not present under traditional regulation. One caveat is that price cap regulation's incentives for cost reduction could lead to reductions in the quality of the service provided. Thus, the Commission will take steps to ensure that service quality in Kansas remains at its current high level. Each of these major features is discussed in detail below.

43. The choice between traditional ratebase/rate of return regulation and the Commission's approved alternative will be optional with the LEC, unless after review the Commission determines the alternative mechanism is in the public interest for a particular service territory. The alternative mechanism shall be

implemented on a substantially uniform basis wherever elected or required. The Commission's goal is to implement the alternative mechanism, for companies desiring to do so, on or before March of 1997. By creating this window for implementation, the Commission is allowing time for company compilation of data and testimony required for filing an alternative mechanism, further specification of the alternative mechanism in Phase II, company evaluation of the Commission's final full specifications and decision on whether to withdraw or amend the filing in compliance, Commission consideration of compliance filings, and finally, implementation. In order to accomplish this within the March, 1997 time frame, companies opting for the alternative mechanism as opposed to traditional regulation should file a proposed alternative mechanism complying with the framework set out in this order below, by April of 1996. This filing date is intended to be concurrent with the filing date for all cost study data which the Commission has determined to be required, including any further determinations which may result from recommendations of the Cost Study Working Group, as set out below.

1) Classification of Service Offerings Into Competitive, Non-Competitive/Non-Essential and Non-Competitive/Essential Categories.

44. **Services shall first be categorized as either Competitive or Non-Competitive.** The Commission finds that services, and the costs associated with their provision, should be grouped into two main categories: Competitive and Non-Competitive. (Flappan/AT&T, Tr. p. 1132-14; Ivanuska/Sprint/United, Tr. p. 1328-65 to 67). As mentioned above, such classification and cost allocation allows the

Commission to better protect consumers of Non-Competitive services from cross-subsidization of Competitive revenues in the short term, and thus better protect consumers of Competitive service categories from anti-competitive below cost pricing, i.e. price-cutting, which, especially in the presence of barriers to competition, could lead to remonopolization of Competitive services in the longer term. This categorization also enables the Commission to regulate the different categories differently, according to their degree of competitiveness.

45. Upon implementation of the alternative mechanism, and classification of services, those costs associated with Competitive services must be allocated to the Competitive class, and costs associated with Non-Competitive services must be allocated to the Non-Competitive class. All costs allocated to the Non-Competitive class, and none of those allocated to the Competitive class, will be taken into account in setting price caps on Non-Competitive services, as set out in more detail below. This cost allocation process will prevent cost shifting from Competitive to Non-Competitive markets due to loss of market share in Competitive markets. Ratepayers of Non-Competitive services will thus be more insulated from the potential for cross-subsidization of any competitive losses that may come about as segments of the LEC business become subject to competition. If price caps on Non-Competitive services are frozen (or only vary according to automatic adjustment mechanisms), and demand erodes due to competitive losses in the Competitive category, the provider will be less able to recover the revenues associated with the lost demand from the Non-Competitive service ratepayers, than is the case under

traditional rate of return regulation. (See Ivanuska/Sprint/United, Tr. p. 1328-65 to 67; Rearden/Staff, Tr. p. 1476A-12). Furthermore, competition will be better protected in that any ability of the incumbent provider to subsidize price-cutting in Competitive markets through cost recovery in the Non-Competitive markets will be limited:

[T]he price ceilings often imposed on less competitive services protect users of those services against price increases beyond the regulatory ceiling and against the risk of cross-subsidization of competitive services The removal of the incentive to cross-subsidize competitive services with less competitive service revenues inherent in the design of price regulation is one of the most important pro-competitive features of price regulation.
(Harris/SWBT, Tr. p. 211-89).

[One] reason that competitive risks are shifted to customers in non-competitive markets is that rate of return regulation facilitates cross-subsidization. Costs incurred to compete in competitive markets are hard to track. This makes it possible for these costs to show up in revenue requirements for noncompetitive markets. When companies operate only in competitive markets, competitive losses in one market cannot be made up by increasing prices in other markets.
(Ivanuska/Sprint/United, Tr. p. 1328-65 to 66).

46. Parties choosing to operate under the alternative regulatory mechanism, as opposed to traditional regulation, must therefore file, by April of 1996, a long run incremental and a fully allocated cost study in order for the Commission to, among other things, segregate costs between competitive and non-competitive service categories, as set out above. In addition, parties may file any other cost studies they believe relevant. Furthermore, small, predominantly rural, local exchange companies which choose the alternative mechanism may opt to file "representational" cost studies. A Commission Cost Study Working Group,

described in detail below, will work towards consensus on additional specification of the cost studies to be performed for all services.

47. The Commission finds that such a filing by SWBT would not amount to a violation of SWBT's TeleKansas agreement. The purpose of the filing is simply to gather information which will allow a new, alternative regulatory mechanism to be in place by March of 1997. Because SWBT's TeleKansas agreement expires in March of 1997 it may be desirable to have such an alternative mechanism immediately available, as opposed to falling back on traditional regulation. The filing in no way requires any current SWBT prices to change prior to that March 1997 expiration date.

48. The Commission acknowledges that there is an issue of recovery for some investment which may have been undertaken in the past not because it was cost effective to do so, as in the case of a competitive environment, but because regulation imposed a duty to serve. Further, "past depreciation practices" may have created "substantial unrecovered sunk cost in current plant". (Harris/SWBT, Tr. p. 211-113).

49. However, allowing for recovery of any such costs originally allocated to, but ultimately unrecoverable in, the Competitive service category from Non-Competitive ratepayers would amount to a regression into traditional ratebase/rate of return regulation. The Commission will not decide at this time whether such a regression may be justified. To the extent it is requested to do so in the future, the Commission will decide issues of appropriate cost recovery for past investments

taking into account the facts specific to each case in light of the requesting companies overall cost recovery shortfall, as would be appropriate under such a return to traditional regulation.

50. The explicit mechanism by which services will be classified as either Competitive or Non-Competitive must be established. Accordingly, the Commission finds services must meet a two pronged test in order to be categorized as Competitive: First, there must be at least one actual competitor certificated to serve in that service's specific geographic and product market. And second, that market must be effectively competitive.

51. The first condition prohibits services from being termed Competitive where the only restraint on market power is the threat of potential entry. Although potential entry can sometimes adequately discipline a market, the Commission does not wish to rely on this theory during a time of transition from monopolistic markets. Rather, evidence of at least one actual competitor will be required, at least for the time being. (Harris/SWBT, Tr. p. 265 to 266). The first prong of the test also imposes the requirement that the competitor's service characteristics and supply area be sufficiently similar to the incumbents so that, on its face, it appears to be able to provide some actual market discipline. Specifically, there should be at least one alternate supplier certificated to provide functionally equivalent service at comparable rates in the same geographic region. (Harris/SWBT, Tr. p. 263).

52. The second prong of the test, that the market be effectively competitive, requires a more in depth analysis as to whether market discipline is in fact likely to

exist. (Ivanuska/Sprint/United, Tr. p. 1328-77 to 78; Scott/KC Fiber, Tr. p. 1232-8). The Commission agrees with testimony of SWBT witnesses that imposing a single "threshold" test, such as a required number of competitors, percentage market share, etc., would, by itself, be an unnecessarily rigid and crude measure and provide only an incomplete picture of overall market competitiveness. Instead, in order to determine whether the second condition is met, the Commission will consider all relevant market factors on balance. These factors may include, but are not limited to:

- a. The incumbent's current market share; (Ivanuska/Sprint-United, Tr. p. 1328-39; Flappan/AT&T, Tr. p. 1132-37).
- b. The capacity of competitors systems to absorb the first provider's market share in a reasonable amount of time.(Flappan/AT&T, Tr. p. 1132-37).
- c. The number of competitors in the market; (Rearden/Staff, Tr. p. 1476A-11; Kravtin/KCATV, Tr. p. ; Harris/SWBT, Tr. p. 263).
- d. The degree of substitutability of services offered by alternative suppliers, including service characteristics and geographic availability; (Ivanuska/Sprint/United, Tr. p. 1328-78; Harris/SWBT, Tr. p. 267).
- e. The existence and level of barriers to entry, exit or competition generally;(Ivanuska/Sprint/United, Tr. p. 1328-38; Flappan/AT&T, Tr. p. 1132-37).
- f. The existence of sustained economic profits for the service over a long run period.(Ivanuska/Sprint/United, Tr. p. 1328-38, regarding the ability of incumbent service providers to raise prices; Rearden/Staff, Tr. p. 1476A-12).

53. **Non-Competitive services shall be further categorized as either Essential or Non-Essential.** The Commission finds that Non-Competitive services

should be further categorized as either Essential or Non-Essential. The Commission agrees with testimony by SWBT witness, Mr. Larson, that in most cases, the buyer's ability to abandon Non-Essential service will constrain prices, and that the selling of Non-Essential services at market prices can contribute to recovery of the joint and common costs incurred in providing other services. (Larson/SWBT, Tr. p. 563-13 to 14; And see Fannin/SWBT, Tr. p. 65-14). For this reason, the Commission agrees with SWBT that it may not always be necessary to cap prices for Non-Essential services, even if they are not competitive.² However, the Commission finds that, while services which are optional in nature may warrant some greater degree of pricing flexibility, they must be subject to rules that prohibit the recovery of competitive losses. (Ivanuska/Sprint-United, Tr. p. 1328-37 to 38). Thus, in order to limit the potential for cross-subsidy between Competitive and non-competitive Non-Essential services, non-competitive Non-Essential services must be designated to the Non-Competitive category.

54. Non-Competitive services will be presumed Essential unless the Commission determines otherwise. As a first cut, only those services which do not meet the definition of "basic local service", as that term may eventually be defined in Docket No. 191,206-U, will be considered as candidates for the Non-Essential category. (See Ivanuska/Sprint-United, Tr. p. 1328-37). The Commission may also consider any other factors it deems relevant on a case-by-case basis.

² Commission will determine in Phase II whether non-competitive Non-Essential services will be subject to a price cap.

55. **Service Re-classification.** A service may be re-classified among the Competitive, Non-Competitive/Non-Essential, and Non-Competitive/Essential categories if its defining characteristics, set out above, change. The Commission expects that over time services on the whole will gravitate from the Non-Competitive to the Competitive category, although we recognize it is possible for the opposite to occur for any specific service. (Flappan/AT&T, Tr. p. 1132-15). Services may also shift between the Non-Competitive/Essential and the Non-Competitive/Non-Essential categories. For example, services once thought of as Non-Essential may come to be considered Essential as consumer expectations, and standards of service, rise. (Flappan/AT&T, Tr. p. 1132-15).

56. **Services need not be classified for all carriers.** Individual services should not be classified in isolation. Rather, if the provider, whether it be a LEC or a new entrant, has no market power and does not have bottleneck facilities, there is no rationale for the protections provided under the Non-Competitive classifications of the alternative regulatory mechanism, and all of that provider's services will be considered competitive. (Flappan/AT&T, Tr. p. 1132-18; Brevitz/Staff, Tr. p. 1531-45 to 49; James/CompTel, Tr. p. 965-19; Scott/KC Fiber, Tr. p. 1232-19). Further, the Commission will not require the setting of a price floor for these Competitive Services of a provider with no market power or bottleneck facilities. Where there is no market power or bottleneck facilities, there is little to be gained from pricing below cost because any later attempt to raise prices and recoup losses would presumably be met with renewed competition, which that provider would have no

ability to forestall. Furthermore, where there are only Competitive, and no Non-Competitive services provided, the ability to support price cutting of Competitive services through cross-subsidization from Non-Competitive services doesn't exist. Thus, the Commission's price regulation of such a provider will be limited to the filing of tariffs and specific prices.

57. Some argued regulation should focus on the character of services only, and that regulation which varies in application depending on the service provider amounts to "asymmetric" regulation and should not be implemented. Rather, these witnesses argued, all carriers should be subject to the same regulatory requirements for the same service offerings. (Fannin/SWBT, p. 65-2; Larson/SWBT, Tr. p. 563-7 to 8; Harris/SWBT, Tr. p. 211-28 to 33). The Commission disagrees. The test for relaxed regulation is either the existence of effective competition for the service, or the lack of market power by the provider. Any provider which meets the test for lack of market power, may be exempted from a service by service review of competitiveness. Thus, new entrants will be required upon application to present evidence of lack of local exchange market power in order to be exempted from a service by service review. Likewise, if new entrants are found to have local exchange market power, they will be required to categorize each of their local exchange services as Competitive or Non-Competitive (or opt for traditional rate of return regulation).

As for incumbents, the evidence presented in this docket makes clear that, at this time, their status as incumbent provides ample market power which is not irrelevant to the type of regulation to which they must be subject:

The record to this point in the proceeding is nearly unanimous in the fact that LECs dominate the local exchange marketplace....To begin with, the playing field is greatly tipped in favor of the incumbent LECs, with LECs currently having the only viable pathway to the end user for basic local dial tone service, a virtual monopoly on local switching capabilities within Kansas, and virtually 100% of the local dial tone subscriber base (with no number portability that will inhibit competitors ability to erode this subscriber base).
(Ivanuska/Sprint/United, Tr.p. 1328-76).

In sum, market power may be defined as the ability to control prices or exclude competition. Incumbent LECs have substantial leverage to dictate terms and price of telecommunications services, and also to exclude competition via selective price cutting and other actions such as delaying or otherwise impeding interconnection.
(Brevitz/Staff, Tr. p. 1531-46).

(Also See James/CompTel, Tr. p. 965-19).

SWBT argued that it exerts no sustainable market power. (Fannin/SWBT,Tr. p. 65-2 and 65-6 to 7; Larson/SWBT, Tr. p. 563-5). Sprint countered that:

I cannot accept the practical implications that, absent empirical evidence of actual competition, LECs nonetheless possess no sustainable market power. I also do not accept Mr. Larson's position that the mere existence of competitors (with no indication of the strength of competition) or the act of authorizing competition should trigger the elimination of regulation of prices. (Larson/SWBT, p. 5). In sum, I cannot agree with Mr. Larson's testimony when he claims that the extremely complex actions of merely opening the doors to local exchange competition serves as an effective check on anticompetitive behavior in and of itself. He is asking the KCC to place too much reliance on speculative market forces (that may or may not be present) without a rigorous test of the competitiveness of that market.
(Ivanuska/Sprint/United, Tr. p. 1328-77 to 78).

The many barriers to competition that currently exist (each described in detail below) contribute to the existence of the incumbents' market power. (Ivanuska/Sprint-United, Tr. p. 1328-75 to 76). Thus, incumbents wishing to adopt the alternative regulatory mechanism will be required to show competitiveness on a service by service basis.

2) Regulatory Treatment of the Different Service Categories.

58. The Commission finds that once services have been categorized as either Competitive or Non-Competitive, they shall be subject to different regulatory requirements as follows.

59. **Treatment of Competitive services.** One of the most significant failings of traditional ratebase/rate of return regulation in a competitive environment is that it hinders a provider's ability to compete by limiting price flexibility. (See e.g. Harris/SWBT, Tr. p. 211-56 to 58; Ivanuska/Sprint/United, Tr. p. 1328-13). Thus one major advantage of the Commission's alternative regulatory mechanism is that it allows maximum price flexibility for Competitive services. Indeed, many parties argued that Competitive services need little or no price regulation. For example:

It is universally accepted that regulation is merely a substitute for the market discipline that is brought about by competition. Regulation is needed when competition is lacking. Competition causes providers to seek the least cost, highest quality, most innovative way of providing service to the customer. If effective competition is present, there is no need for regulation.... Services that face rigorous competition need little or no Commission oversight. (Flappan/AT&T, Tr. p. 1132-14).

Rates for competitive [network functions] should be set by the marketplace. It is inefficient to spend resources to try to regulate

markets where competitive forces already eliminate the possibility of monopolistic abuses.

(Flappan/AT&T, Tr. p. 1132-18).

If a service is fully competitive, where the market can, in fact, function as an effective regulator of the price, a high degree of pricing flexibility would be appropriate, and rules to prohibit the recovery of LEC competitive losses from these services/markets are unnecessary.

(Ivanuska/Sprint/United, Tr. p. 1328-38).

Thus, the Commission will not set prices for Competitive services. Rather, the Commission will allow price flexibility, unconstrained by price caps. A different issue is whether price floors are necessary for these services. The two, floors and caps, serve entirely different purposes. Price caps are intended to protect consumers from uneconomic price hikes where competition is not sufficiently vigorous to do so. Thus, caps are not required for effectively Competitive services. Price floors on the other hand, are intended to protect consumers from the possibility of longer-term monopolization of otherwise competitive service markets through temporary below cost pricing, or price cutting, by a dominant firm which is intended to drive competitors from the market. If there are barriers to re-entry by competitors, the dominant firm could eventually be free to set prices at monopolistic levels. The ability of the dominant firm to withstand temporary revenue losses from price cutting is enhanced where that firm can cross-subsidize, i.e, draw on profits from other, non-competitive service categories in the meantime. As was pointed out by AT&T witness, Mr. Flappan:

It may sometimes even be appropriate to prevent competing firms from driving one another into suicide by adoption of uncompensatory prices through price wars or other related forms of behavior. Much

more likely, however, is the possibility that excessively low prices, perhaps financed by cross-subsidy, can be used for predatory purposes. (Flappan/AT&T, Tr. p. 1132-59, citing William J. Baumol and J. Gregory Sidak, Toward Competition in Local Telephony, The MIT Press, 1994, at p. 61).

The Commission agrees with testimony of SWBT witness, Dr. Harris, that one of the most important pro-competitive features inherent in the design of price regulation is the reduction of incentives to cross-subsidize Competitive services with Non-Competitive service revenues. (Harris/SWBT, Tr. p. 211-89). By capping prices in the Non-Competitive services categories, a dominant firm's ability to raise Non-Competitive service prices in order to cross-subsidize, and thus better withstand revenue losses from price cutting in the Competitive service categories, is reduced. However, the Commission disagrees that price caps on Non-Competitive services, by themselves, completely eliminate a firm's ability to cross-subsidize. Specific caps may be set too high initially. In addition, technological change is likely to drive costs down over time. In a competitive market, this would tend to drive prices down over time as well. But, if Non-Competitive service's price caps are fixed, or if a "productivity index" is set too low, the profit margin between the price caps and costs may widen enough to allow sufficient profits in the Non-Competitive categories to sustain price-cutting in the Competitive category. The Commission therefore finds, in order to provide a backstop against both cut throat competition and anti-competitive price cutting, pricing for Competitive services should be constrained by a price floor.

60. Price floors for Competitive services must be set out in tariffs filed with the Commission. Floors must be established based on long run incremental cost.

The specific prices being charged must also be on file with the Commission. The specific price charged for a particular Competitive services may vary on a total service basis or a zone basis. Customer by customer price variances, or Individual Case Basis ("ICB") prices, for services deemed Competitive by the Commission are also acceptable. The Commission agrees that:

Ultimately, the degree of competition for services should dictate the amount of pricing flexibility. ICB pricing for services deemed competitive by the Commission is entirely appropriate. To the extent that full and fair competition has developed, the role of the regulator as guarantor of non-discriminatory pricing diminishes. (Ivanuska/Sprint/United, Tr. p. 1328-40).

[I]f the firm is in a competitive market, ICB is efficient. As long as prices are above costs, any profitable sales create net value without arbitrarily discriminating against some customers. (Rearden/Staff, Tr. p. 1476A-17).

61. **Treatment of Non-Competitive Services.** Where competition is not yet effective, some level of regulatory oversight is still needed. (See Flappan/AT&T, Tr. p. 1132-14). However, the Commission agrees with testimony of SWBT and others that even for Non-Competitive services, this regulatory oversight need not, and should not, take the form of traditional ratebase/rate of return regulation. Instead, the Commission will apply "price cap" regulation to Non-Competitive/Essential services. Under price cap regulation prices are allowed to vary subject to a price floor and a price cap. Because Non-Competitive/Non-Essential services are optional in nature, and because this may warrant a greater degree of pricing flexibility, (Ivanuska/Sprint/United, Tr. p. 1328-38), the Commission will consider

the limited issue of whether these services should also be subject to a price cap in Phase II of this docket.

62. Like traditional regulation, price cap regulation protects consumers from monopolistic pricing:

There are two areas where the KCC should be involved during any transition. One is price ceilings (like price caps) to restrain possible market power of incumbents and entrants. Second, the KCC should set price floors to prevent cross-subsidization by multi-product providers. (Rearden/Staff, Tr. p. 13).

[T]he price ceilings often imposed on less competitive services protect users of those services against price increases beyond the regulatory ceiling and against the risk of cross-subsidization of competitive services....
(Harris/SWBT, Tr. p. 211-89).

An appropriate price cap system could be placed on all LEC services or service components which are not subject to effective competition. (Flappan/AT&T, Tr. p. 1132-36).

While both traditional and price cap regulation protect consumers of Non-Competitive services, price cap regulation provides at least two important benefits over traditional regulation: flexible pricing and incentives for cost minimization. Traditional regulation has long been criticized for its inflexibility. Traditional regulation is also uniformly criticized for distorting a providers incentive to minimize costs by making the regulated firm comparatively indifferent about its efficiency and possibly even giving it positive incentives to incur higher costs than necessary.³ By contrast, price cap regulation allows service price flexibility between

³ Alfred Kahn, and William B. Shew, Testimony on Behalf of Bellsouth in Price-Cap Proceeding Before the Federal Communications Commission, in the Matter of Policy and Rules Concerning Rates for Dominant Carriers (CC Docket 87

the floor and the cap, thus allowing providers to respond to competitors entering the service market. Price cap regulation also provides incentives for cost minimization by committing to frozen caps, subject only to automatic adjustment for expected industry wide changes such as productivity and inflation. These benefits are discussed in more detail below.

63. As with Competitive services, price floors for each Non-Competitive service shall be set based on long run incremental cost. Price caps shall be set based on the fully allocated cost for that service, or basket of services as set out below. Caps or floors may also be based on a total service long run incremental cost methodology, if a company so chooses to file. Each LEC electing the alternative regulatory mechanism shall perform long run incremental cost and fully allocated cost studies for each service and shall submit such studies to the Commission by April of 1996. Small, predominantly rural local exchange companies, should they opt for alternative regulation, may elect to file "representative" cost studies. A Commission Cost Study Working Group, described in detail below, will work towards consensus on additional specification of the cost studies to be performed. The Commission will thus have the data required to set the price floors and caps for all services, including functions and facilities the Commission determines should be unbundled, and unbundled wholesale services allowed to be resold. In setting price caps, the Commission will also take into account the recommendations of the USF Working Group, and all parties' testimony in Phase II, regarding the extent to

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which universal service support flows exist across the various service categories and the extent to which these should or should not be maintained. The Commission will also consider unbundled pricing for those services identified by the recommendations of the Unbundling task force and the Resale and Sharing task force, as well as all parties testimony in Phase II on the need for unbundled pricing of particular services.

64. Price caps may be set for each service individually. Alternatively, the applicant may propose a group or "basket" of services, the average price of which would be subject to the cap. The "basket" option allows a provider to exercise greater control over its own prices than if the price cap were required to be placed on each individual service. The provider could propose, for example, that its services be grouped into baskets of network access channel services, switching services, transport services, and signalling services. (See Flappan/AT&T, Tr. p. 1132-17).

65. For Non-Competitive special access services, where the Commission has already permitted competitive entry, floors and caps may be tailored for different geographic zones. The proven potential for competition in this service category creates a possible need for limited de-averaging of pricing of this service across those geographic zones where costs are likely to vary. Thus, predominantly urban LECs may file with the Commission for this limited de-averaged, or zone, pricing for special access services. The Commission will review such "zone" pricing proposals on a case-by-case basis. Where the Commission approves such a filing, it may take effect prior to having the entire alternative regulatory mechanism in place.

66. Unlike prices for Competitive services, prices for Non-Competitive services may not vary on a customer by customer basis. Where competition is still developing and not yet effective, Individual Case Basis (ICB) filings (defined as off-tariff rate filings for tariffed services) have the potential to harm competitors:

In an emerging competitive marketplace, [ICB] filings...have the potential to significantly harm competitors. Off-tariff pricing allows for price discrimination well beyond what could be cost and/or economically justified. Pricing to individual customers could vary to the point of significantly altering the unit cost structures of efficient competing firms, thus forcing them out of the market. Ultimately, the degree of competition for services should dictate the amount of pricing flexibility.

(Ivanuska/Sprint/United, Tr. p. 1328-40).

The answer to [the question of ICB appropriateness] depends on [the] position of the firm in the market. If it is a dominant firm, such price discrimination is harmful, because it leads to arbitrary price differences not based on costs, and it can forestall possibly efficient entry....

(Rearden/Staff, Tr. p. 1476A-17).

Allowing [ICB] pricing would defeat the goals of effective competition...Setting such equality in regulation would allow the dominant company to flex [its] market muscle by reducing its rates to the point that no customer would move to [a] new carrier.

(Scott/KC Fiber, Tr. p. 1232-22).

(See Price/MCI, Tr. p. 421-22 to 24).

The Commission agrees that the degree of competition for services should be one factor influencing the amount of pricing flexibility within a service category.⁴ Therefore, provider's services treated as Competitive may be ICB priced, but services treated as Non-Competitive may not.

⁴ The market power of a particular provider may also be a factor, as discussed above.

67. As mentioned in summary above, the Commission finds that once price caps are set, they should be subject to periodic automatic adjustment factors which reflect trends affecting the telecommunications industry in general, and are exogenous to the company's specific performance. The Commission agrees with testimony of SWBT witness, Dr. Harris, that "[w]here regulation may still be required, it should rely on external variables (such as a price index) and performance incentives, rather than administrative controls." (Harris/SWBT, Tr. p. 211-54). Thus, these periodic automatic adjustment factors shall include a general industry productivity index and an inflation index.

68. A productivity index will ensure that ratepayers benefit from decreasing unit costs due to efficiency gains from general technological advances in the industry which the provider should be expected to implement. (Flappan/AT&T, Tr. p. 1132-37). This result is analogous to a competitive market, where prices will decline when technological progress results in lower unit cost. An inflation index, on the other hand, will reflect the generally increasing cost of whatever factors of production are required to provide services. Even in a competitive market, if the costs of production inputs rise, the price of services will eventually reflect the increase, or the company cannot continue to offer the service. Even though productivity should be increasing over time and driving prices downward, while inflation will drive prices upward, it cannot be assumed these effects will be similar enough to more or less just offset each other. Indeed, in an industry such as telecommunications, the effect of productivity changes may be quite large compared

to periods of low rates of inflation. Several witnesses testified that rapid technological change is a defining characteristic of the telecommunications industry. For example, SWBT witness, Dr. Harris, testified that “[t]echnological change has become a pervasive force in telecommunications equipment, telecommunications services and telecommunications-usage-intensive industries because innovation and adoption are occurring at a breath-taking rate....Along with computers, telecommunications is on center stage of the microelectronics revolution: the application of transistors, semiconductors, integrated circuits and other microelectronics in telecommunications equipment has dramatically reduced switching and transmission equipment costs....” (Harris/SWBT, Tr. p. 211-35 to 36). While the Commission will require alternative regulatory mechanisms to contain both a productivity and an inflation index, we recognize the precise specifications of appropriate indexes are crucial and complex. Thus, the Commission will take additional testimony in Phase II on exactly how these mechanisms should be specified.

69. Under this mechanism, any cost savings from technological changes which the provider can develop and implement above those expected in the telecommunications industry generally would remain with the provider as an incentive for better than industry performance. As mentioned in summary above, this incentive feature, is one of the primary advantages of price cap regulation over traditional regulation. To the extent these caps will be periodically realigned to reflect the individual providers overall profit level, the incentive may be reduced,

although it will not be eliminated. (Harris/SWBT, Tr. p. 283 to 285). This reduction in the incentive to create benefits in the first place must be balanced with the need to periodically flow part of the benefits of cost reduction to consumers of these Non-Competitive services, just as will naturally occur without regulation in the Competitive service categories. Thus, the Commission will determine in Phase II whether price caps should be subject to a set time table for realignment in light of profits, and if so, what that period should be.

70. In addition to automatic adjustment mechanisms for expected general industry changes, a method of treating significant, unexpected changes in either general industry or company specific costs of production due to major changes such as policy or legislative mandates outside the company's control may be appropriate. This is because prices will be frozen, subject to only automatic adjustment for expected industry wide changes, upon entry into the alternative rate mechanism. Thus, they "assume a current state of the network." (Ivanuska/Sprint/United, Tr. p. 1328-68). For example, if subsequent to election of price caps the Commission were to mandate fiber to the home, cost recovery would need to be considered, as this would not have been contemplated in the existing LEC price structure. (Ivanuska/Sprint/United, Tr. p. 1328-68). Significant cost decreases which are beyond that considered upon entry into the alternative regulatory mechanism should be afforded similar treatment. (See Ivanuska/Sprint/United, Tr. p. 1328-68).

71. In Phase II of this proceeding, the Commission will consider evidence identifying other factors upon which it may be appropriate to base an adjustment,

automatic or otherwise, as well as evidence regarding the specific operation of the productivity and inflation indices. For example, a quality of service adjustment factor may be appropriate. (See Ivanuska/Sprint-United, Tr. p. 1328-33). Because there is often a trade-off between cost and quality, it is possible that by encouraging providers to lower costs, price cap regulation also encourages firms to lower quality. It was argued during hearing that one of the benefits of price cap regulation was the creation of extra profits which could be reinvested as infrastructure development, thus raising the quality of service. (See Harris/SWBT, Tr. p. 278). The Commission agrees, but also recognizes that without some form of continued quality monitoring, there is no guarantee these excess profits would actually be reinvested in local exchange infrastructure, as opposed to paid out in dividends or reinvested in some other venture, such as an unregulated affiliate. (Harris/SWBT, Tr. p. 279 to 281). Thus, the Commission will insure quality of service under price cap regulation by continuing to monitor and set quality standards. Specific quality standards will be considered by the Commission in Docket No. 191,206-U. In Phase II of this docket (Docket No. 190,492-U), the Commission will address the interrelationship of such standards with the alternative regulatory regime.

72. In addition, the Commission will consider in Phase II potential alternatives to automatic adjustment. One alternative would be frozen rates with no automatic adjustment. Rather, rates would be periodically reviewed and reset. For example, the SWBT TeleKansas Plan required at least a five year rate freeze. A seven to ten year rate freeze, with no automatic adjustment, but with review and

realignment of rates at the end of the period, together with quality of service monitoring and allowance for significant unexpected costs outside the company's control, may produce the same incentives, safeguards and efficiencies as would a rate freeze with annual automatic adjustment for industry wide factors and quality of service. Such a long term rate freeze may be particularly appropriate if some expected productivity gains are built in to the initial setting of rates.

3) Periodic Review of Alternative Mechanism

73. The performance of the alternative regulatory mechanism will periodically be reviewed by the Commission. The goal of such review is not to change rates, but to test the performance of the program. Nor is the goal of this review to perform an "audit" for purposes of traditional ratebase/rate of return regulation, or even for purposes of a periodic price cap realignment. Rather, the goal of this review is to determine whether the alternative regulatory mechanism is meeting its purpose of providing utilities with adequate incentive and ability to compete in the emerging markets, while maintaining ratepayer protections where competition has not yet developed.

74. The quantifiable measures which the Commission may consider in determining whether the goals are being achieved include, but are not limited to, such matters of public interest as:

- a. The effect on rates;
- b. The effect on quality of service;
- c. Any changes in indicators of market power;

- d. The level of real profits over the long run;
- e. Other Kansas or company wide, or service specific quantitative measures may also be reviewed.

75. The Commission distinguishes (d) above, from traditional ratebase/rate of return regulation and periodic price cap review. Under traditional regulation, commissions focus on determining the appropriate profit level for a particular market and enforcing that level at any, if not every, point in time. Similarly, under periodic review of the price caps themselves, appropriate profit levels would be determined and price caps would be reset accordingly, after specific intervals of many years. By contrast, under this review of the performance of the alternative mechanism in general, the Commission will not be realigning rates to enforce a particular profit level. Rather, the Commission will recognize that in a competitive market, innovations or extraordinary efficiencies could very well yield extraordinary profits for a time. However, even in a competitive market, competitors are likely to eventually catch up with a market leader and bring its return back to a normal level. (Flappan/AT&T, Tr. p. 1132-38). For Non-Competitive services, this phenomena should be captured overtime through the automatic price cap adjustment method. Providers are expected to be able to reap the rewards of innovation and extraordinary efficiency over some period, but not indefinitely, just as in a competitive market. (See Flappan/AT&T, Tr. p. 1132-38). Review of profits over the long run will enable the Commission to determine whether its automatic adjustment mechanism is indeed providing adequate incentives, without producing sustained monopoly profits over several years.

76. If after review the Commission finds these goals are not met, the Commission will take whatever action is deemed appropriate. Nothing in this decision establishing an alternative regulatory mechanism is intended to proscribe the Commission's statutory responsibility to protect ratepayers.

D. Existing Barriers To Competition Must Be Reduced Or Eliminated Wherever A Cost Effective Means Of Doing So Is Available.

77. In adopting the alternative regulatory mechanism set out above, the Commission is moving away from traditional regulation with its relatively heavy reliance on government oversight. The alternative regulatory mechanism substitutes lighthanded government regulation, with more selective oversight. This reduction in the scope of formal regulatory oversight reflects a greater reliance on competitive forces, rather than government, to bring about efficient production and consumption of telecommunications services. Competition must be as full, fair and effective as possible, so that it can indeed be relied on to provide that market discipline, in place of direct government regulation. Where any industry barriers to full, fair and effective competition exist, modifications to the regulatory structure may be necessary

78. Based on the record evidence in this case, the Commission has identified several existing barriers inherent in the current structure. Each is set out in detail below. The Commission is not at this time determining the extent of the barriers, nor is it deciding whether or how they should be addressed. Rather, the Commission directs further study of most, although not all, of the identified barriers, through the establishment of industry task forces.

79. Where a task force is established, its charge is to investigate and make technical recommendations to the Commission. Specifically, recommendations should include an identification of the best method(s) for eliminating or reducing the barriers, including an explicit discussion of the cost of, and the benefits to be gained under, each alternative method. All societal costs and benefits may be considered. If the task force finds there is no cost effective method for reducing a particular barrier, it should so inform the Commission, and present those method(s) with the highest benefit to cost ratio. Recommendations should also include a proposed schedule for implementation of any suggested changes.

80. Each local exchange company, or consortium of smaller, predominantly rural local exchange companies, shall appoint at least one representative to each task force. Any interexchange carrier, reseller, special access provider, or potential competitor may also appoint one or more representatives to each task force. Staff, CURB, and the Department of Defense may also each appoint one or more representatives. Task forces shall hold at least one working session within two weeks of issuance of this Order. Members of the task force shall appoint one person to coordinate the efforts of the task force and submission of required reports to the Commission. No task force shall appoint a coordinator who represents a Company which already has a representative appointed to coordinate another task force. Each task force shall submit a status report to the Commission within 30 days of the issuance of this Order. This initial status report shall include an identification of the person appointed to coordinate the efforts of the task force.

A second status report shall be submitted within 90 days of the date of this Order. Each task force shall submit a final report containing the findings of its investigation and its recommendations on or before October 1995.

81. The Commission finds four task forces should be established. One task force shall be responsible for considering issues of network unbundling and providing non-discriminatory access to certain LEC facilities, including conduits, poles and ducts; LEC databases, signaling and interoffice networks, and LEC operational support systems; and co-location. A second task force shall investigate and/or monitor issues of number assignment and portability. A third task force shall be charged with issues of resale and sharing in Kansas. And, a fourth task force shall deal with customer information issues. The Commission also supports a fifth task force, investigating 1+/0+ equal access presubscription issues, which is already underway pursuant to Commission Order of August 17, 1994. Each of the issues set for task force investigation and recommendation is discussed in detail below.

- 1) **Task Force One: Network Unbundling and Providing Access To Conduits, Poles And Ducts; Network Data Bases, Signaling, Interoffice Networks, And Operational Support Systems; And Co-location.**

82. Perhaps the most significant obstacle to maximizing the effectiveness of local exchange competition in Kansas is the control of incumbent LECs over functions and facilities to which other providers must have access in order to compete effectively. (Murray/MCI, Tr. p. 868-5). All LEC services are comprised of individual network functions, such as local loop functions, switch functions, interswitch transport functions and signaling functions, which are bundled together

in different forms to provide all of the LEC's different services. Unbundling certain of these functions and providing access to competitors is critical because it creates the basis for the appropriate implementation of several of the other conditions necessary for competition. (Flappan/AT&T, Tr. p. 1132-5 to 6). Failure to unbundle certain functions could amount to prohibitively high pricing of functions essential to development of competition in downstream telecommunications markets:

For effective competition to develop wherever it is feasible, both end users and competitive providers must be able to obtain the incumbent LEC's monopoly [functional components of the system] on an unbundled, tariffed basis, so that they can purchase from the LEC only the ones that they want. Otherwise, end users would never choose the services of competitive providers because they would have to pay twice for some of the functions - once from the competitive provider and once as part of a bundle from the LEC. Similarly, competitive providers would be unable to compete with the LEC if they had to purchase as a bundle both the [functions] they need and the [functions] they want to provide competitively. Thus, each of the LECs monopoly network [functions] must be offered on an unbundled, tariffed basis. (Murray/MCI, Tr. p. 868).

In order to do an adequate job of testing competition, each [network function] must be offered separately for sale in a non-discriminatory manner, at non-discriminatory, cost based prices. Only then can one determine which of these can be subject to competition and which would remain monopoly components. In Kansas currently, LECs can package their bottleneck network in such a way as to force potential competitive suppliers to purchase unwanted and unneeded components if the competitors want to offer an alternative service. This is obviously a barrier to entry of alternative suppliers. (Flappan/AT&T, Tr. p. 1132-6).

Furthermore, requiring some level of unbundling should eliminate some incentive for inefficient investment in duplicative facilities, where such facilities could most efficiently be provided by a single supplier, the incumbent. (Murray/MCI, Tr. p. 868-10). Rate structures that allow competing carriers and

major users to obtain only the telecommunications functions and facilities that they actually need are important to the development of competition. (See Kravtin/KCATV, Tr. p. 976-17). Unbundling network functions is important to a properly operating resale market as well:

Cost-based pricing and resale obligations require that 'wholesale' prices not reflect 'retail costs' that are not actually incurred by the LEC in their wholesale offerings. Inclusion of 'retail'-related administrative costs (e.g., billing individual end users, uncollectibles, marketing) in 'wholesale' cost floors would inappropriately hinder resale, and its pro-consumer, pro-competitive effects. (Flappan/AT&T, Tr. p. 1132-9).

(Also See Ivanuska/Sprint/United, Tr. p. 1328-83).

83. Thus, the Commission finds non-discriminatory access to certain LEC functions and facilities should be available, and priced at cost based rates, in order to ensure full, fair and effective competition. Pricing at cost based rates implies rates based on the costs of only those functions and facilities supplied plus some contribution to fixed common costs where appropriate. (Murray/MCI, Tr. p. 868-12; Kravtin/KCATV Tr. p. 967-16 to 17). "All prices for unbundled exchange services should be based on principles of efficiency and reflect underlying costs." (Flappan/AT&T, Tr. p. 1132-7).

84. The Commission recognizes that the depth of network unbundling required will have significant impact on the competitiveness of local exchange markets. Disaggregation of network services could, at a minimum include dividing the local exchange into its most major functions, loop and switching (link and port). On the other hand, disaggregation could run as deeply as separate pricing and

availability of all "basic network functions" or BNFs. The Commission will not require unbundling of all BNFs. However, the Commission finds that, in addition to the major functions of loop and switching, some specific functions and facilities likely to have significant bottleneck characteristics are also appropriate candidates for unbundling in Phase II. The functions and facilities which may be reviewed in Phase II are: conduits, poles and ducts; network data bases, signaling, and interoffice networks; operational support systems; and facilities required for co-location. Each of these more specific functions is discussed in detail below. This identification of functions and facilities for unbundling consideration should not be considered static. New types of functions and facilities will surely evolve with advances in the technology by which local exchange service is provisioned. (Flappan/AT&T, Tr. p. 1132-6). And, as the Commission further discusses below, other functional components of the system may need to be unbundled on a negotiated, or case by case, basis in order to effectuate efficient interconnection. The Commission is not, by this Order in Phase I of this docket, prohibiting LECs from offering rebundled, or "repackaged", functions and facilities as separate LEC service offerings in addition to the unbundled offerings.

85. Thus, the Commission finds that LECs should be required, to the extent demand exists and supply can be cost effective, to unbundle certain functions and facilities and offer them as separate services to reduce barriers to competition and to entry of alternative suppliers. The Commission finds that a task force shall be established, in accordance with the findings set out above, to investigate such

demand and supply characteristics of the functions and facilities identified above (and discussed in more detail below), and any others which the task force may deem appropriate. Based on its investigation, the task force shall make recommendations regarding the appropriateness of unbundling these functions and facilities into separate service offerings. The appropriate time frame for implementing these recommendations should also be investigated. Because competition is most likely to develop initially in the metropolitan areas of the state served by the larger, more urban, local exchange companies, the task force may consider a longer timetable for implementing unbundling of the smaller, predominantly rural, local exchange companies' services.

86. Costing and pricing methodologies specifically for unbundled services need not be investigated by this task force. Costing and pricing for a provider's newly unbundled services should conform to the same costing and pricing principles applied to all other services of that provider, whether that provider has chosen traditional rate base rate of return regulation or the alternative regulatory mechanism which the Commission establishes in this docket, and in accordance with universal service objectives. So that unbundled service offerings may be properly considered in accordance with these universal service objectives and the alternative regulatory mechanism, each LEC shall perform long run incremental cost and fully allocated cost studies for each service, facility and function considered for unbundling and submit such studies to the Commission by April 1996. Small, predominantly rural LECs, to the extent the task force recommends that they

unbundle services, may elect to file "representative" cost studies for services considered for unbundling. A Commission Cost Study Working Group, described in detail below, will work towards consensus on additional specification of the cost studies to be performed for unbundled, as well as all other services. To the extent the Commission orders unbundling of specific functions and facilities in Phase II, it will thus have the data required to also set the prices (or price floors and caps) for these unbundled functions and facilities in Phase II, along with setting all other service prices, in accordance with universal service determinations, and either traditional or alternative regulatory mechanisms.

87. **Access to conduits, poles and ducts.** Currently, LECs are not required to offer non-discriminatory access to their poles, ducts, and conduits. Several parties argued that to allow the local exchange carriers continued discretion in exercising control over the use of these facilities would perpetuate a significant barrier to competition:

There is limited room for conduits under the street and pole lines above the ground. The public is only willing to accept a certain degree of disruption for the installation of such facilities. Attempting to obtain separate pathways comparable to those of the incumbent LEC is likely to prove impossible. This leaves the incumbent LEC pathways as a bottleneck on which all providers must rely. Potential competitors must have access to these essential facilities on the same terms and conditions as the incumbent provider.
(Flappan/AT&T, Tr. p. 1132-4).

[W]here the LEC has existing conduit in a building or poles on rights-of-way which have available space for additional lines...the Commission should ensure that alternative providers are provided access to the available space under the same terms that the LEC provides such access to itself. This will preserve valuable right-of-way space, avoid unnecessary or wasteful conduit placement, eliminate

access advantages derived by the incumbent LECs from their historical, regulatorily enforced status as the sole providers of local services, and provide those LECs with valuable revenue sources.
(Flappan/AT&T, Tr. p. 1132-5).

[Access to conduit is] essential to the evolution of full and fair local exchange competition. Absent the presence of [this] essential element, competition will be stifled and the consumer benefits of full competition will be delayed. Competitors must offer reciprocal and nondiscriminatory access to conduit...to the extent capacity exists, and should be compensated appropriately for such access.
(Ivanuska/Sprint/United, Tr. p. 1328-26 and 29).

There are several critical barriers to competitive entry for entities who would provide competitive alternatives. Those barriers include...[p]referential access to conduits, rights of way, and entrance facilities which advantage the incumbent LECs.
(Price/MCI, Tr. p. 421-24).

Conduits, poles and ducts are somewhat analogous to gas pipelines or electric transmission lines in that when excavating the streets along the right of way to lay conduit, it is most efficient to attempt to put in place a large enough conduit to hold all the cable necessary to serve the entire market, taking into account present value considerations. (See Flappan/AT&T, Tr. p. 1227-1229). This cost characteristic suggests the provision and supply of conduit, poles and ducts is naturally monopolistic:

If the total costs of supplying the entire industry demand for a product or service are lower when a single firm produces it than when any collection of two or more firms produce it, then authorizing an additional provider of the service may disservice the public interest because it is not efficient or desirable to have multiple providers. In that instance, industry supply by a large number of firms can only be more costly, and hence less efficient, than if just one firm supplies the entire industry demand for a service.
(Larson/SWBT, Tr. p. 563-9).

88. Thus, much like the emerging gas pipeline and electric transmission regulation,⁵ open access and unbundled pricing is required in order to prevent natural monopolies over conduits, poles and ducts from being leveraged into monopolies over the various potentially competitive downstream local exchange service markets. Unless LECs are required to provide open access at cost based rates to conduit and pole space, and a duty to serve is imposed, competitors in downstream markets would be required to anticipate conduit needs for their own market shares individually and put just that amount in place. This would create multiple demands for excavating streets along rights of way and negate the potential economies of scale of having a single supplier of conduit. (Flappan/AT&T, Tr. p. 1227-1229). The external cost to the public convenience from constant excavation of roads and rights of way is also an important consideration and contributes to the natural monopoly status of conduits and poles.

89. Therefore, the Commission finds lack of access to conduits, poles, and ducts at cost based rates is a barrier to maximizing the effectiveness of competition in downstream telecommunications markets. Accordingly, the task force set out above shall have the responsibility to review access to conduits, poles and ducts to determine the benefits and costs (including any legal considerations) of

⁵ The Commission has taken a strong position regarding open access to gas pipelines and electric transmission in several federal energy regulatory commission dockets. (See e.g., Kansas City Power and Light Company, FERC Docket No. ER94-1045)

implementing procedures allowing access to these facilities or specific components of these facilities, and making recommendations to the Commission.

90. Many parties also argued a task force should review access to easements and rights of way as well as poles, ducts, and conduits. (See e.g. Ivanuska/Sprint-United, Tr. p. 1328-29). The Commission finds this is neither necessary nor appropriate. It is not necessary for a new entrant to obtain its own easement or right of way in order to make use of the incumbent LEC's poles, ducts, and conduits. Even if the new entrant desires only the use of the right of way, Kansas statutes place its control in the hands of municipalities which grant use on a non-exclusive basis. (K.S.A. 12-2001, 17-1901, 17-1902; see also, Fannin/SWBT, Tr. p. 65-27 to 28).

91. **Access to network data bases; signaling and interoffice networks; and operational support system databases.** Much like access to conduits, poles and ducts, access to certain network data bases, signaling and interoffice networks is required for competition to fully develop:

[Competitor's access to LEC directories, 911 systems, and operator services, pursuant to contract and for reasonable compensation] is essential to the evolution of full and fair local exchange competition...Absent the presence of [this] essential element, competition will be stifled and the consumer benefits of full competition will be delayed.

(Ivanuska/Sprint/United, Tr. p. 1328-26 and 29).

Today's local exchange providers have already cooperated to provide some access to network databases and signalling functions. (Brevitz/Staff, Tr. p. 1531-28 to 29). In Kansas and other states the directory listings of non-Bell local exchange carriers reside in the Directory Assistance database maintained and operated by

SWBT. It should be manageable to include the listings of competitors' customers in this database as well. (Brevitz/Staff, Tr. p. 1531-28 to 29). The Commission agrees that ideally:

all competitors should have the right to list their customers in directory assistance and in both White and Yellow Page directories under non-discriminatory and cost-based terms and conditions. Competitors should also be given access to the LECs' signaling network and their signaling databases.
(Kravtin/KCATV, Tr. p. 971-17).

92. The issue regarding seamless integration into the LECs signalling and interoffice networks appears to be substantially analogous to the database access issues discussed above. Signaling points, links to the signal transfer points, signal control points, and interoffice networks are the physical network components required for database access. Signaling System Seven (SS7) connectivity, like database access, has already been implemented for some carriers by the local exchange network provider, via contractual agreements and BellCore published standard interfaces. (Brevitz/Staff, Tr. p. 1531-28). However, the current relationship for network access generally is one where the local exchange carrier controls the terms of its "customers'" connection to the LEC network. Changes must be made in recognition of the fact that those requesting access to signalling and interoffice networks, like those requesting access to databases, are competitors as well as customers, and the local exchange carrier may have little incentive to provide such access:

There are several critical barriers to competitive entry for entities who would provide competitive alternatives. Those barriers include...[a]n

absence of a clear policy statement granting co-carrier status to alternate providers.

(Price/MCI, Tr. p. 421-24 to 25).

A request for access to signaling and interoffice networks is analogous to a request for database and network access, and the issues should be investigated under an overall philosophy that competing network providers should be allowed to connect as network peers. (Brevitz/Staff, Tr. p. 1531-29).

93. The Commission finds that lack of access by all market participants to network databases, signaling, and interoffice networks, or certain components of these facilities, at cost based rates is a barrier to maximizing the the effectiveness of competition in telecommunications markets. Therefore, the Commission finds access to local exchange carrier network databases, signaling, and interoffice networks should be investigated by the task force as set out above. The task force should consider which databases, signalling and interoffice networks are essential to competition and the technical methods by which a local exchange company can cost effectively provide open access.

94. Some parties suggested that LECs be required to provide access to their operational support system (OSS) databases, as well as their network databases. While access to OSS is considerably different than access to the other network databases discussed above, access to at least some OSS may be necessary to achieve desired full interconnection and seamless operation of competing networks. (Brevitz/Staff, Tr. p. 1531-28 to 29). Thus, the Commission finds lack of access to operational support systems databases is no less a barrier to competition than lack of

access to the other databases. However, the Commission recognizes that providing OSS access may entail significant difficulties not present for other databases. In recognition of these differences, the need for access to OSS should be discussed and analyzed separately from other database issues. Thus, this issue should be reviewed by the task force set out above, with recognition made of any special considerations necessary for, or benefits of, OSS database access. Competitors seeking such access should specify to the task force which OSS databases must be accessible and why. The task force shall be charged with ultimate responsibility to recommend which, if any, can be cost effectively opened and the steps which should be taken to provide access. If access to requested OSS cannot or should not be provided, the task force must explicitly state the supporting rationale.

95. **Co-location.** The ability of competitors to co-locate facilities for local exchange network access at LEC premises would have a significant positive impact in facilitating competition. (Brevitz/Staff, Tr. p. 1531-26; Flappan/AT&T, Tr. p. 1132-12). The FCC, in recognition of this fact, originally established a policy mandating physical co-location for federally jurisdictional facilities, but was overturned on appeal. Thus, the FCC's current policy requires only virtual co-location of these federal facilities, while expressing a policy preference for physical co-location. The Commission finds similarly that inability to co-locate state jurisdictional facilities constitutes a barrier to maximizing the effectiveness of competition and should be investigated. Thus, a task force shall be established, as set forth above, to recommend whether and when Kansas jurisdictional intrastate co-location should

be required. The task force should consider whether the FCC's virtual co-location mandate and rate structure, and physical co-location preference, should be mirrored in Kansas. The task force may also consider whether physical co-location requirements are appropriate in Kansas. If physical co-location requirements are considered, the task force shall also perform a legal, policy, and technical review of whether the Commission could mandate physical co-location under existing law, including Kansas statutes. (Brevitz/Staff, Tr. p. 531-26).

2) Task Force Two: Number Portability and Assignment.

96. Number portability would allow end-use customers to change local service providers while retaining their telephone number. Without such portability, customers must change phone numbers each time they change providers. (Brevitz/Staff, Tr. p. 1531-30). Many parties suggested the current lack of portability adds to customer inertia and lessens the effectiveness of any existing competition:

Customers have an interest in maintaining their current telephone numbers. The interest may be personal (e.g., young children having to "relearn" their home numbers for emergencies) or economic (e.g., businesses with investments in advertising or programmed buttons on their customer's speed dialers). The difficulties and costs associated with a telephone number change may deter some customers from changing service providers, even if other competitive factors such as price or service quality would make such a change desirable. Entry into the market, and the success of competitors that do enter, are artificially repressed when customers must forfeit their current numbers. Thus, local telephone number portability is needed to foster the maximum feasible development of competition in the local exchange. (Flappan/AT&T, Tr. p. 1132-10).

[T]he lack of number portability...inhibit[s] the emergence of effective local competition...[which] makes it more difficult for new entrants to

pose a viable competitive threat to incumbent providers and therefore limits the effectiveness of competition in constraining prices and stimulating innovation and improved service quality.
(Murray/MCI, Tr. p. 868-6).

[Number portability is] essential to the evolution of full and fair local exchange competition. Absent the presence of [this] essential element, competition will be stifled and the consumer benefits of full competition will be delayed. Number portability should occur when it becomes technically and economically feasible, subsequent to an industry developed architecture and design.
(Ivanuska/Sprint/United, Tr. p. 1328-26 and 28).

There are several critical barriers to competitive entry for entities who would provide competitive alternatives. Those barriers include...[p]referential policies serving to deny "freedom of choice" for customers, including a lack of local number portability....
(Price/MCI, Tr. p. 421-24).

A recent nationwide Gallup survey commissioned by MCI shows that 40% - 50% of residential customers, and 70% - 80% of business customers who otherwise were willing to consider a change of carriers, became unlikely to consider a change without provider number portability.
(Price/MCI, Tr. p. 421-48 and 50).

Incumbent LECs have also recognized that customers may place a large value on number portability, and that lack of number portability is a barrier which the industry ought to move towards eliminating by creating a good, efficient data base system for portability. (See Harris/SWBT, Tr. p. 299).

97. Thus, the Commission finds lack of number portability is a barrier to maximizing the effectiveness of competition in Kansas. While portability is being addressed on a national level (Brevitz/Staff, Tr. p. 1531-30 and 32), there are also possible state level solutions such as the deployment of regional number screening databases (Price/MCI, Tr. p. 421-28). Therefore, a task force should be established, as

set out above, to monitor the development of national level solutions and to investigate and make recommendations regarding possible cost effective state level development of comprehensive portability and its administration, including cost allocation across the industry. If costs of such portability prove to be substantial, the task force should recommend a mechanism to recover the cost of implementation from as broad a base of direct and indirect benefactors as possible. (Ivanuska/Sprint/United, Tr. p. 1328-28). The task force could investigate and recommend measures, such as remote call forwarding and flexible DID offering, which are less desirable than full portability, but can be used to mimic portability over the near term. (Ivanuska/Sprint/United, Tr. p. 1328-28).

98. Lack of neutral administration of numbering resources was also identified as a barrier. (Brevitz/Staff, Tr. p. 1531-31 to 32; Ivanuska/Sprint/United, Tr. p. 1328-28). The Commission agrees with this assessment. However, as stated by SWBT witness, Mr. Sharfenberg, the issues of administration of numbering resources encompasses assignment of telephone numbers to carriers and the administration of the North American Numbering Plan (NANP). (Sharfenberg, Tr. p. 752-8). These matters may very well require a national solution. Thus, with respect to numbering resources, the Commission directs the task force to monitor the national efforts and report to the Commission any state action which might be taken to further the implementation of national solutions.

3) **Task Force Three: Resale and Sharing.**

99. Currently in Kansas, the purchase and resale of local services, is limited to Commission approval of certain Shared Tenant Service arrangements. (See Flappan/AT&T, Tr. p. 1132-9). Many parties recommended the Commission actively promote development of non-facilities-based local competition by permitting resale of all local exchange telephone services:

The Commission must...actively promote the development of non-facilities-based local competition by requiring local exchange carriers and new facilities-based local carriers to permit resale of all local exchange telephone services. I...support the removal of restrictions on resale of all LEC services.

(James/Comptel, Tr. p. 965-6).

Removal of resale restrictions would reduce barriers to local market entry by making it possible for competitors to enter a market where some [network components] may be subject to provision by the new entrant while other [network components] remain as monopolies of the LEC. Specifically, resale enables new entrants to self-provide those components that are subject to competitive provisioning, and to combine those components with monopoly inputs of the LEC, in order to create alternative services for Kansas consumers. In addition, resale and sharing may also make it possible for competitors to enter a market without large capital requirements. The resulting competition may also increase overall demand and result in more efficient utilization of the LEC's network.

(Flappan/AT&T, Tr. p. 1132-8).

[Resale and sharing] are essential to the evolution of full and fair local exchange competition. Absent the presence of [this] essential element, competition will be stifled and the consumer benefits of full competition will be delayed. Telecommunications services and functions should be provided without restrictions on resale and sharing.

(Ivanuska/Sprint/United, Tr. p. 1328-31).

Resale/sharing restrictions currently in the tariffs also constitute a barrier to further competition. Resale is an important competitive mechanism. Unrestricted resale also serves the important economic

function of arbitrage--eliminating non-cost based price differences for services that are functionally similar. (Brevitz/Staff, Tr. p. 1531-36).

100. According to testimony, resale enables new entrants to self-provide those components that are subject to competitive provisioning, and to combine those components with monopoly inputs of the LEC in order to create alternative service packages for Kansas consumers. (Flappan/AT&T, Tr. p. 1132-8; James/CompTel, Tr. p. 965-8). Resale and sharing also make it possible for competitors to enter a market without large capital requirements, perhaps facilitating competition before other companies could enter in a full facilities-based manner. (Flappan/AT&T, Tr. p. 1132-8; Kravtin/KCATV, Tr. p. 988; Fowler/MHT, Tr. pp. 1070 to 1071; James/CompTel, Tr. p. 965-7). Furthermore, resale can be a useful pro-competitive tool to drive the price of local service lower. (Harris/SWBT, Tr. p. 211-102, and p. 249).

101. The New York Public Service Commission's recently approved resale approach for Rochester Telephone was given as an example. Rochester will provide a stand-alone local service product for resale with the retail functions unbundled. Under the Rochester plan, all local services are available for resale at a wholesale discount of five (5) percent off the retail price. Residential local exchange service, which is priced below business service, is available at the residential rate minus 5 percent. (James/CompTel, Tr. pp. 965-8 to 9).

102. Based on the testimony set out above, the Commission finds that current restrictions on resale and sharing, are barriers to maximizing the

effectiveness of competition. In order to encourage introduction and growth of competition in the local exchange market, LECs should be required to lift tariff restrictions on resale and sharing of certain services and functions where appropriate. Thus, the Commission finds a task force shall be charged with responsibility for evaluating resale and sharing restrictions of local exchange services, and recommending Commission actions and timetable for modification or removal of such restrictions where appropriate.

103. Generally, the Commission agrees as noted above, care must also be taken not to set the price floor to resellers too far above cost:

Cost-based pricing and resale obligations require that 'wholesale' prices not reflect 'retail costs' that are not actually incurred by the LEC in their wholesale offerings. Inclusion of 'retail'-related administrative costs (e.g., billing individual end users, uncollectibles, marketing) in 'wholesale' cost floors would inappropriately hinder resale, and its pro-consumer, pro-competitive effects. (Flappan/AT&T, Tr. p. 1132-9).

In addition, the Commission also agrees with SWBT and others that it should also avoid setting wholesale price to resellers below cost. (Harris/SWBT, Tr. pp. 249-250).

This issue of appropriate pricing is related to identifying the appropriate level of unbundling of services, functions and facilities. Thus, while the task force on resale and sharing will make recommendations regarding which services should be allowed to be resold, the task force on unbundling should then consider the appropriate level of unbundling of retail functions from these services when they are offered at wholesale.

104. Likewise, specific costing and pricing of these unbundled wholesale services, functions and facilities, need not be investigated by this task force, or the task force on unbundling. Costing and pricing for a provider's newly unbundled wholesale services should conform to the same costing and pricing principles applied to all other services of that provider, whether that provider has chosen traditional rate base rate of return regulation or the alternative regulatory mechanism which the Commission establishes in this docket, and should be in accordance with universal service objectives, all as set out below. So that unbundled wholesale service offerings may be properly considered in accordance with these universal service objectives, and the alternative regulatory mechanism or traditional regulation as the provider chooses, each LEC shall perform long run incremental cost and fully allocated cost studies for each service, facility and function considered for resale, and submit such studies to the Commission by April 1996. Small, predominantly rural local exchange companies, to the extent the task force recommends that they are required to allow resale of services, may elect to file "representative" cost studies for wholesale services considered for unbundling. A Commission Cost Study Working Group, described in detail below, will work towards consensus on additional specification of the cost studies to be performed for unbundled wholesale services, as well as all other services. To the extent the Commission orders unbundling of specific wholesale functions and facilities in Phase II, it will thus have the data required to set the prices (or price floors and caps) for these unbundled wholesale services, functions and facilities in Phase II, along

with setting all other service prices, in accordance with universal service determinations, and either traditional or alternative regulatory mechanisms depending on which form of regulation the provider has chosen.

4) Task Force Four: Customer Information.

105. In the past, the Commission has recognized that lack of adequate customer knowledge regarding telecommunications providers' services and prices can be a barrier to maximizing effective competition. (Commission Order of May 5, 1984 in Docket No. 127,140-U, requiring filing of marketing materials by resellers) The Kansas legislature has also recognized the importance of customer knowledge by charging the Telecommunications Strategic Planning Committee created under SCR 1627 to consider the development of a "process for informing prospective end users about the use and availability of new technologies associated with" telecommunications applications of importance to the State. (Brevitz/Staff, Tr. p. 1531-37). Here as well, the Commission finds that adequate customer knowledge of telecommunications providers' services and prices is important if local exchange markets are to function effectively under competition.

106. Research to determine the level of customer knowledge in markets where competition is emerging has not been undertaken. (See Larson/SWBT, Tr. pp. 601-602). In the absence of research, adequate knowledge cannot be assumed to exist, especially during this period of transition in the industry. Therefore, the Commission finds that a task force should be established, in accordance with the specifications set out above, to make recommendations as to how to facilitate

dissemination of information regarding providers, services, and prices in potentially competitive telecommunications markets.

5) Task Force Five: 1+/0+ Presubscription.

107. The Commission finds persuasive evidence in the record suggesting SWBT's and United's 1+/0+ advantage for intraLATA competition is a barrier to maximizing the effectiveness of competition. Without 1+ presubscription, often called "equal access competition," customers wishing to use any provider other than the local exchange carrier for an intraLATA call are required to dial a five-digit access code (10XXX). The requirement to enter extra digits in order to use the services of competitors creates an unfair advantage for the local exchange carrier. (Kravtin/KCATV, Tr. p. 976-17 to 18). No matter the devices, mechanisms and technology with which other IXC's and customers may use to get around the presence of this customer inconvenience, it is still a significant hinderance to competition in that it increases the cost to customers of utilizing an alternative provider. (Brevitz/Staff, Tr. p. 1531-36). Witnesses testified that:

Within the intraLATA toll markets, the lack of "1+/0+" presubscription gives incumbent LECs a major advantage over other carriers in the provision of intraLATA toll service...[This makes] it more difficult for new entrants to pose a viable competitive threat to incumbent providers and therefore limits the effectiveness of competition in constraining prices and stimulating innovation and improved service quality.
(Murray/MCI, Tr. p. 868-6).

To the extent a disparity [in dialing] exists between potential competitors, it deters customers from changing providers even when other competitive factors would make such a change desirable. In the context of interLATA services, much time, energy, and money was

devoted to the equal access process at the judicial, FCC, and state commission level precisely because of the conclusion that "1+" dialing should be available to all carriers. The LEC is in the position of the incumbent for both exchange and intraLATA interexchange calling. Its competitors must persuade customers that something else, such as lower prices, higher quality, or other inducements, is offered by them to compensate for the additional dialing requirement. Because this advantage is not due to the efficiency, skill, or service quality of the LEC, it stands as a major barrier to the potential development of competition in local exchange markets. (Flappan/AT&T, Tr. p. 1132-11).

108. SWBT testimony provides indirect evidence that lack of 1+/0+ equal access may be a barrier to effective competition. SWBT states that if it were to "lose the 1+/0+ presubscription dialing advantage, it would cause SWBT to lose a huge market share...." (Fannin/SWBT, Tr. p. 127). Apparently, many customers recognize 1+/0+ dialing as an important convenience which only SWBT and United can offer. Allowing SWBT and United to retain this advantage is clearly a constraint on maximizing effective competition.

109. The Commission finds that SWBT's and United's 1+/0+ advantage is a barrier to maximizing the effectiveness of competition. Thus, the Commission shall continue the course it has established in prior orders, and expect the 1+/0+ task force to investigate the most cost effective way to transition and implement 1+ and 0+ intraLATA equal access presubscription. (Commission Orders of August 17, 1994, September 20, 1994, and October 24, 1994, in Docket No. 190,492-U). The task force report, due June 1, 1995, shall then be subject to further Commission consideration and order.

6) **Other Barriers: Interconnection, Reciprocal Intercarrier Compensation, and Imputation**

110. In addition to the barriers listed above for which the Commission establishes task forces, the Commission finds three other aspects of the current structure to pose barriers to maximizing the effectiveness of competition. However, as explained below, the Commission will attempt to minimize these barriers through means other than the establishment of a task force to make technical recommendations for further Commission action. These three aspects are lack of standards for interconnection, reciprocal intercarrier compensation, and imputation.

111. **Interconnection.** Under the current regulatory structure, certain aspects of interconnection pose barriers to maximizing competition. As Staff pointed out, interconnection was a primary issue in the previous era of increasing competition, around the turn of the century, and is equally important now. (Brevitz/Staff, Tr. pp. 1531-22 to 25). Many other parties as well provided substantial evidence that interconnection is critical to competition. (Price/MCI, Tr. p. 480; Murray/MCI, Tr. p. 876; Vanston/SWBT, Tr. p. 390; Harris/SWBT, Tr. pp. 295-297 and 321; Flappan/AT&T, Tr. p. 1132-6 to 7; Ivanuska/Sprint/United, Tr. p. 1328-28 to 29). The Commission is persuaded by this testimony to require interconnection between incumbent LECs and new entrants. The Commission agrees with SWBT that, ideally, 1) interconnection of authorized competing local networks should be on terms and conditions mutually acceptable to LECs and interconnectors; and 2) interconnection should not be mandated at any specific location or point in the

network (we add that, at this time, interconnection should not be prohibited at any specific location or point, either). (Fannin/SWBT, Tr. pp. 65-25 to 26). However, the Commission will not require interconnection issues to be dealt with in a task force. Nor will the Commission at this time require LECs to file interconnection tariffs which would be identically applicable to all new entrants. Rather, the Commission finds that local interconnection is best handled through negotiations between the LECs and individual new entrants. (Fannin/SWBT, Tr. pp. 65-25 to 26). A negotiation process, as opposed to tariffs, can provide flexibility which may be necessary to meet new entrants' diverse needs.

112. While the Commission will require negotiation, we recognize that bargaining power may not always be equal between the incumbent LEC and the new entrant. (Harris/SWBT, Tr. pp. 295-297). This could create a pattern of prolonged negotiations and interconnection rates which are too high. (Brevitz/Staff, Tr. p. 1531-30). Excessive interconnection rates to new entrants could tip the balance as to whether getting into a particular local exchange market is cost justified. (Harris/SWBT, Tr. p. 321). Thus, while the incumbent LEC and the new entrant will be responsible for negotiating interconnection, the Commission may monitor the negotiation processes and will maintain complaint jurisdiction over interconnection issues. If, after reasonable efforts, the negotiating parties are unable to reach agreement, either party may file a complaint with the Commission.

113. **Reciprocal intercarrier compensation.** Currently, reciprocal intercarrier compensation arrangements, i.e. practices and financial arrangements to allow

competitors and LECs to terminate traffic on each others' networks, do not exist in Kansas. (Ivanuska/Sprint/United, Tr. p. 1328-14). Reciprocal intercarrier compensation is an essential element to the evolution of full and fair local exchange competition. Absent the presence of this essential element, competition will be stifled and the consumer benefits of full competition will be delayed. (Ivanuska/Sprint/United, Tr. p. 1328-26; Scott/KC Fiber, Tr. p. 1232-26). If compensation arrangements cannot be achieved among the providers of network facilities in relation to the traffic interchanged and costs of the network, competition is unlikely to be effective. (Brevitz/Staff, Tr. p. 1531-34). Thus the Commission finds that entities offering competing telecommunications services must arrange some method of reciprocal and nondiscriminatory compensation, whether monetary or in-kind, for functional use of each other's network.

114. Like interconnection agreements, LECs and new entrants should have the flexibility to negotiate compensation on mutually acceptable terms and conditions. Thus, like interconnection issues, the Commission will not require reciprocal intercarrier compensation issues to be dealt with in a task force. Nor will the Commission require LECs to file intercarrier compensation tariffs which would apply identically to all new entrants. Rather, the Commission finds that reciprocal intercarrier compensation issues are best handled through negotiations between the LECs and individual new entrants. Again, the Commission recognizes that bargaining power may not always be equal between the incumbent LEC and the new entrant. This could create a pattern of prolonged negotiations and unfair intercarrier

compensation rates. Unfair interconnection rates between incumbent LECs and new entrants could influence their relative costs of supplying the market, and thus could influence the effectiveness of competition. Thus, while the incumbent LEC and the new entrant will be responsible for negotiating intercarrier compensation, the Commission may monitor the negotiation processes and will maintain complaint jurisdiction over these compensation issues. If, after reasonable efforts, the negotiating parties are unable to reach agreement, either party may file a complaint with the Commission.

115. **Imputation of Price.** Several parties argued that an imputation standard is necessary in order to ensure that an LEC, which is simultaneously competing with a new entrant and providing inputs to that new entrants competing services, cannot use that dual role to forestall competition:

The local exchange companies must charge themselves the same prices for all uses of [network functions] as they charge others. That is, LECs must impute the prices of [network functions] they actually use into the price floors of their services. This will provide incentives to set fair prices and avoid anti-competitive conduct.
(Flappan/AT&T, Tr. p. 1132-8).

Some imputation standard is necessary to establish LEC price floors to ensure that the LEC does not utilize any monopoly network advantage over a competitor. In determining the price floor for LEC services that compete with services of the LEC's competitors, LECs must impute, at the aggregate level, the same charges and costs for essential network services and functionality as are paid by their competitors to them for the same services and functionality plus the incremental cost of any competitive component of service. For example, in the intraLATA toll context, Sprint advocates a[n] LEC price floor equal to the price of access charged to the competing carrier plus the LEC's Long Run Service Incremental Cost of toll-only functions, minus any economies of vertical integration that can be identified.
(Ivanuska/Sprint/United, Tr. p. 1328-30 to 31).

[T]he Commission should direct that imputation methodologies be determined in Phase II to impute appropriate costs into the retail service offerings of SWBT, particularly for those services in which competition is present. The Commission made a similar finding in its intraLATA competition decision, and it is very appropriate. Without imputation, there is no assurance that the incumbent is not garnering unfair competitive advantage via differential between what it is "charging itself" internally, and what it charges its competitors via access charges or other mechanism[s].

(Brevitz/Staff, Tr. p. 1531-33).

[T]he Commission could take several actions whose purpose would be to break down barriers to entry. These actions include: 1. impute access service costs to all LEC retail service offerings....

(Scott/KC Fiber, Tr. p. 1232-27).

SWBT cautioned that:

An incorrect and overly high price floor imposed on SWBT gives a potential advantage to SWBT's competitors, for it would preclude economically efficient competitive responses by SWBT in the cases where SWBT is the most efficient supplier...Continuing with the intraLATA toll example, the economically correct imputation rule is that the LEC should impute to itself the contribution foregone due to selling intraLATA toll in lieu of access services. It is not necessary to impute the full access *charge*, only the *contribution* from access charges that is foregone due to selling intraLATA toll instead. This imputation rule yields a price floor for intraLATA toll of : the contribution foregone due to selling intraLATA toll (in lieu of access services) plus the incremental cost of toll.

(Larson/SWBT, Tr. p. 563-54).

Indeed, in its Order on intraLATA toll competition, the Commission found imputation to be a necessary competitive safeguard (Commission Order of April 30, 1993 in Docket No. 181,097-U; at 48 to 49). The Commission is now interpreting this requirement as it pertains to Docket No. 95-SWBT-234-TAR (regarding 1 + Saver issues), Docket No. 95-SWBT-142-TAR, (regarding OCCS), and Docket No. 191,994-U

(regarding Local +), now before it. The importance of imputation expressed in the Commission's Order on intraLATA competition applies equally to local exchange competition. Inadequate imputation requirements would present a barrier to maximizing the effectiveness of competition.

116. Thus, the importance of proper imputation standards for effective competition has been and will continue to be recognized by this Commission. In the context of local exchange competition, the Commission will take imputation concerns into consideration in setting price floors for the various network services, functions and facilities under the alternative regulatory mechanism, set out above. If it is not resolved in currently pending dockets, the Commission will decide in Phase II exactly what the appropriate imputation methodology should be, including whether imputation should be limited to the cost (including forgone revenues) of providing the input service, as argued by SWBT, or should reflect the price at which SWBT sells those input services to competitors.

E. A Cost Study Working Group Must Be Established to Assist in Developing Cost Study Standards Necessary for the Study and Implementation of Regulatory Structure Modifications Set Out Above

117. As discussed in the Order above, the study and implementation of modifications to each of the three features of current regulatory structure requires the filing by incumbent local exchange companies of long run incremental and fully allocated cost data. Such cost data is required to fully evaluate barriers to competition for purposes of setting proper prices for unbundled and resale services, functions and facilities. Universal service determinations are dependant on cost

data for purposes of re-evaluating service contribution levels. Implementation of the alternative regulatory mechanism will require similar cost data for purposes of separating costs between competitive and non-competitive services and for setting price caps and floors on all services to be offered (including those newly unbundled and resale services). In order for the Commission to manage the review and application of such a large amount of cost data from each party to the case, it is desirable to have as high a degree of consistency as possible across companies in the specification of the data filed. Furthermore, given the ultimate purpose of filing the data is to address the need for regulatory changes on a timely and orderly basis, it is desirable to avoid undue argument and the use of hearing time by reaching as high a level of consensus as possible across parties as to what specification of the data is appropriate.

118. Therefore, the Commission establishes a Cost Study Working Group. The purpose of this Working Group is to consider alternative specifications of long run incremental, fully allocated, or any other appropriate cost studies, and submit a proposal to the Commission which reflects as high a degree of consensus among the parties as possible. Each local exchange company, or consortium of smaller, predominantly rural local exchange companies, shall appoint at least one representative to the Cost Study Working Group. Any interexchange carrier, reseller, special access provider, or potential competitor may also appoint one or more representatives. Staff, CURB, and the Department of Defense may also each appoint one or more representatives. Staff shall be responsible for coordinating the

efforts of the Cost Study Working Group. Staff shall also be responsible for determining what analysis, data, or research will be required to make an appropriate recommendation to the Commission. Parties shall supply Staff the requested information on a timely basis. The Working Group is directed to have a proposal for cost study specifications to the Commission by October, 1995. The Commission will accept, reject or modify the consensus specifications. By April, 1996, parties shall file all cost studies required by this Order, and upon which the company will base its case in Phase II, in a manner which reflects those specifications approved by the Commission.

F. Summary of Commission Working Groups, Industry Task Forces, and Data Filing Requirements Established By This Order.

119. The Industry Task Forces and Commission Working Groups which the Commission has established by this Order are as follows:

COMMISSION WORKING GROUPS

- 1) Universal Service Fund Working Group
- 2) Cost Study Working Group

INDUSTRY TASK FORCES

- 3) Task Force One: Unbundling And Providing Access To Conduits, Poles And Ducts; Network Data Bases, Signaling, Interoffice Networks, And Operational Support Systems; And Co-Location
- 4) Task Force Two: Number Portability And Assignment
- 5) Task Force Three: Resale And Sharing
- 6) Task Force Four: Customer Information
- 7) Task Force Five: 1+/0+ Presubscription

All Industry Task Force and Commission Working Group Proposals and Recommendations are due to be filed with the Commission by October 1995. In addition to Task Force and Working Group recommendations and proposals, parties

SELECT COMMITTEE ON TELECOMMUNICATIONS

Testimony Presented By Glenda L. Cafer, Director of Utilities
Kansas Corporation Commission
January 10, 1996

Mr. Chairman, Members of the Committee:

SCR 1627 was a beneficial resolution received from the Kansas legislature at a time when the push for competition in the telecommunications market in Kansas seemed to have slowed. SCR 1627 was what was needed to push the issue into the forefront once again. The resolution gave broad, general direction to the Commission, and then let the Commission carry out the details of the policy identified by the resolution.

Well, the devil is in the details. There are many issues to address and problems to solve before we can get from wanting competition to having competition so that deregulation can occur. We can not simply remove our regulatory structure and "hope" competition flourishes. It will not. First, the regulatory structure must change, to assist the initial birth and growth of competition. Then, as competition increases, regulation must decrease. The decrease in regulation must be in response to increased competition, not the other way around. Once a market becomes effectively competitive, then regulation can cease. That is our goal.

SCR 1627 was passed in April of 1994 and the Commission has been very busy since that time carrying out the legislature's directive. Attached to my testimony as Exhibit "A" is a summary of the Commission's actions taken to date to implement competition in Kansas. The Commission began investigations into Access Charges, Competitive Access Providers, Universal Service, and Local Competition. The local competition docket was the primary arena of activity. The Commission issued its order in this docket on May 5, 1995, which affirmed that, as a general rule, competition is in the public interest. The order acknowledged that there are differences between rural and urban markets, and that these markets would need to be evaluated on a case by case basis. The order confirmed the need for an alternative regulatory plan for Southwestern Bell Telephone Company and acknowledged the differences between Independent Local Exchange Companies serving rural areas and SWBT serving the highly populated areas of our state.

The order identified the barriers that competitors face when they attempt to

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break into the incumbent telephone companies monopoly market. For example: number portability, interconnection, 1+/0+ presubscription, unbundling, and resale. It set up a number of industry task forces to work on resolving these barriers. Those task forces worked throughout last summer and filed their reports with the Commission a few months ago. These reports will be used by the Commission in the Phase II hearing on this docket scheduled for the summer of 1996.

The Commission's order identified the need for cost based rates, since subsidies built into some rates (i.e. access and toll rates), and other rates priced below costs (i.e. local rates), send the wrong signals to a competitive marketplace. To properly rebalance these rates, the Commission established a cost study working group which filed a report with its findings and recommendations. Comments were received by all interested parties, and last December, the Commission issued an order adopting a methodology to be used for costs studies and identifying the services for which cost studies would be required. Those services are access, toll and local.

The Commission's order also stressed the importance of Universal Service, which is the term used to describe the goal of making telephone service affordable for everyone in Kansas. The Commission took comments from all parties and received a task force report on Universal Service as well. The issue is pending before the Commission right now, and we expect to have everything submitted to the Commission so that a decision can be rendered in March.

Finally, the order set up three categories for telecommunications services. They are competitive, non-competitive/non-essential, and non-competitive/essential. This designation will allow the Commission to ensure that revenue lost by a telephone company on its competitive services will not be recovered from that company's monopoly services. It will also assist the Commission in determining when consumers need regulatory protection or when the market is sufficiently competitive to provide the necessary protection for consumers.

The foregoing are highlights of what we have accomplished to date. It has been and will continue to be an abundance of work, and illustrates the complexity of the issue of telecommunications competition. We are half way through the procedure of implementing competition in Kansas, and Exhibit "B" to my testimony is the calendar establishing the time frame for Phase II of this procedure. When the statutory extension of TeleKansas II expires in March of 1997, the telecommunications industry in Kansas will be poised for competition.

I wish to stress my personal commitment to the schedule you see in Exhibit "B". There will not be postponement by my staff, nor will we accept any attempts at

delay made by other involved parties. Absent events which are outside of my power, this schedule will be honored.

We are dealing with complex and often times confusing issues. I will be followed today by the head of my telecommunications staff, Karen Flaming. She will give you a more detailed explanation of the issues the Commission has addressed and those pending. After she speaks, our telecommunications staff accountant, Jerry Lammers is going to explain to you one of the plans which our staff has developed to solve the Universal Service problem. There is no way we could explain everything adequately to you in two days, or even two weeks. So please remember that our staff is available to each of you and your staff and we hope you will contact us with any questions you might have.

KCC IMPLEMENTATION OF S.C.R. 1627

Date	Other	Competition Docket	Access Charges Docket	Competitive Access Providers Docket	Universal Service Docket
April 1, 1994	Local Exchange Resiliency 1627 Hearing				
April 22, 1994		Competition Docket Opened Pursuant to SCR 1627			
April 28, 1994			Access Charge Docket Opened		
May 6, 1994				Competitive Access Provider Docket Opened	
May 11, 1994	Rate of Return Adjustment Schedule by KCC for ISPC				
Late May, 1994			Access Charge Comments Received		
May 27, 1994		Comments Filed in Competition Docket			
July 12, 1994		KCC Staff files Procedural Motion in Competition Docket			
July 19 - 20, 1994				Certificate Hearings for KC FiberNet & Multimedia Hyperion	
August 11, 1994					Universal Service, Infrastructure & Quality of Service (QOS) Docket Opened
August 17, 1994		KCC Staff proposes Schedule by Order in Competition Docket			
September 29, 1994				Certificates Approved for KC FiberNet & Multimedia Hyperion	
October 14, 1994					Universal Service/Infrastructure/QOS Comments Filed
Oct. - Nov., 1994		Comments and testimony filed in Competition Docket			
November 18, 1994			Access Charge Order allows Access Charge Stipulation to Expire		
Nov. 28 - Dec. 2, 1994		Competition Hearings			
April 1, 1995			Access Charge Status Report filed by the industry		
April 17, 1995	Order Implementing Interactive Video Tariffs, & Extension of SWBT's TeleKansas Plan				
May 5, 1995		Comments and testimony filed in Competition Docket			
May 11, 1995				KC FiberNet - switched	
June 1, 1995		Competition Hearing Filed			
September 28, 1995		Cost Study Work Group Report Filed			
October, 1995					
October, 1995		Unbundling, Resale, Number Portability and Customer Information Reports Filed			
Nov. - Dec., 1995					

TENTATIVE SCHEDULE PHASE II

EXHIBIT B

Assessment of Congressional Legislation and Adjustment (if necessary) of KCC Phase II objectives - Review of Task Force Reports	Nov. '95 - Mar. '96
Access Hearing/Interim Plan	November, 1995
Commission Decision to finalize Cost Study methodology	January, 1996
Commission Decision to establish Universal Service parameters	March, 1996
<ul style="list-style-type: none">· Establish KBSF· Definition of "Basic" Service· Establish Charter - Issue RFP	
Commission Decision on Interim Access Plan	January, 1996
Cost Studies filed by Industry	April 1, 1996
Filed Direct Testimony/Phase II Competition	May 24, 1996
Rebuttal Testimony/Phase II Competition	June 3, 1996
Prehearing Conference/Deadline for Discovery/Motions	June 10, 1996
Hearing	July 15 - 19, 1996
<ul style="list-style-type: none">· Establish Price Cap Components· Rate rebalancing· Resale· Unbundling· Number Portability· Access Charges· Finalization of Kansas Basic Service Fund· Additional Regulatory Changes	
Briefs filed	August 16, 1996
Decision	September 13, 1996
Close dockets Universal Service, Competitive Access Providers & Access Charges	Sept. - Oct. 1996
Results of September 13th Decision:	
<ul style="list-style-type: none">· Framework to Promote Competition in place	March 1, 1997
<ul style="list-style-type: none">· Alternative Regulatory Framework for SWBT in place	March 1, 1997
<ul style="list-style-type: none">· Universal Service Fund· Rate Rebalancing· Resale· Unbundling· Number Portability· Quality of Service Measures as function of Rate Caps· Interconnection (if requested by parties, after negotiations)· Access Charges	
<ul style="list-style-type: none">· Regulatory Framework for other Local Exchange Companies	March 1, 1997
<ul style="list-style-type: none">· "Traditional" regulation option· "Competitive" option - similar to SWBT above	
<ul style="list-style-type: none">· KBSF Functional for all providers regardless of Competitive Status	March 1, 1997

Kansas Corporation Commission



David Heinemann
General Counsel

Chief Legal Advisor to the Commission. David was the youngest elected member to the House of Representatives where he served the longest consecutive public service in that body. David has practiced law in Garden City since 1973. David joined the Commission in September, 1995.



Glenda Cafer
Director of the Utilities Division

Responsible for oversight and direction of all utility matters. Glenda was an attorney for the KCC from 1987 to 1990 and then went into private law practice from 1990 to 1995. Glenda was re-appointed to the Commission to head the Utilities Division in September, 1995.

Telecommunications Staff



Jerry Lammers
Managing Telecommunications Auditor

Primary responsibilities: Audits filings for telecommunications rate changes, oversees access charges, and works on Universal Service and Cost Study issues in connection with the Competition Docket. He joined the KCC in 1994, and previously worked for twenty four years in accounting for Southwestern Bell. Responsibilities included billing for access service, long distance, local, and new service offerings. Provided staff support for property and cost operations.



Guy McDonald
Telecommunications Analyst

Primary responsibilities: Review, research and recommendation development for applications. Staff person on General Investigation dockets for Quality of Service and Local Competition. Guy has more than 30 years of industry experience in Network Engineering, Design, and Operations. He also has recent experience in the marketing and sales of Cellular and dedicated telecommunications services.



Karen Matson-Flaming
Chief of Telecommunications

Primary responsibilities: Oversight of all telecommunications matters that come before the Commission. Karen has experience in radio and TV broadcasting and TV production in addition to her telephony background. She was hired by the Commission from the telecommunications private sector and has twelve years of telephone experience including her ten years at the Commission.



Ross I. Miller
Telecommunications Analyst

Primary responsibilities: Responds to application inquiries; conducts annual toll survey and compiles results; handles requests for certification; processes tariff filings; investigates and resolves complaints; and coordinates various other assigned tasks. Hired by the Commission in 1994, his experience includes twenty three years with Southwestern Bell in operator services and personnel.



Randy Debenham
Senior Telecommunications Analyst

Primary responsibilities: Review and analysis of interexchange carrier issues, complaints regarding long distance companies, and competitive applications. Randy has been with the Commission for over eight years, most of which have been in the telecommunications section. Randy received his undergraduate from K.S.U. and graduate degree from the University of Texas. Randy has an electrical background, has taught at the college level, and was a Legislative Assistant for Congressman Pat Roberts before coming to the Commission.



Panchali Das
Telecommunications Engineer/Depreciation Analyst

Primary responsibilities: Conducts depreciation studies, assists on technical issues such as service quality and service complaints, and reviews tariff and Interexchange Carrier filings. She has worked five years in the telecommunications industry, including three years at the KCC. In addition, she has one year experience in Investments. She has a background in Finance and Electrical Engineering.



Tom Behner
Senior Telecommunications Analyst

Primary responsibilities: Reviews, analyzes and makes recommendations regarding general investigation issues, applications submitted by local exchange and interexchange carriers and complaints registered by their customers. Maintains tariffs, boundary certificates and provides research and assistance to the Commission and other staff. Tom has over thirty one years experience with a major telecommunications corporation in the areas of Network, Marketing, and Customer Services. He has been with the Commission staff for two years.



Kansas Corporation Commission

1500 SW Arrowhead Road, Topeka, KS 66604-4027
(913) 271-3220 Fax (913) 271-3357

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ATTACHMENT 4

SELECT COMMITTEE ON TELECOMMUNICATIONS

Testimony Presented By Karen Flaming, Chief of Telecommunications
Kansas Corporation Commission
January 10, 1996

Mr. Chairman, Members of the Committee:

Thank you for this opportunity to address your committee. My name is Karen Matson Flaming, and I'm Chief of Telecommunications at the Commission. The staff members you just met make up the research arm of the Commission. We don't often get a chance like this to talk about the "hows" and "whys" of the work we do at the Commission. So, we greatly appreciate the time you have offered us.

What we're going to talk about first is a little history of how we've gotten where we are at today so that you'll know where it all fits in. Then I'll go on to the basic elements of the Commission's primary work underway right now....local competition.

To understand where we're at today, we must look at the history of telecommunications. While it seems we are in the midst of a great change that seemed to jump up at us in just the last few years, when we plot these events on a timeline, we see that we are actually dealing in the final stages of a competitive surge that began 15 to 20 years ago with the introduction of competition in the provision of telephone equipment. It's hard to imagine life without our decorator phones. But we all remember the time when our telephone could be any color we wanted as long as it was black.

Telecommunications has become increasingly competitive and each new market has opened faster than the one before. First equipment; then long distance, inside wiring, payphones, billing and collection, shared tenant service, operator service, enhanced services, and special access. Finally, the last and possibly the most difficult market to address is left...Local Service.

Can we just leave competition alone? No. We cannot. Technology is driving the competitive move of the last 15-20 years. We have been on the forefront of the competitive movement at various times throughout the history of our state and the Commission desires to strengthen this progressive movement. The technological change driving competition is the merging of video, voice, dialtone, and data. It is happening and cannot be stopped. Ask any user of the Internet or any school relying on Interactive Television for educational courses if they want

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to freeze their service options or stop using the service altogether, and you'll get your answer. The choice for us is not whether to allow or disallow competition, it's a matter of how to manage the transition.

The technological convergence of voice, video, and data causes difficulty because one of the components...voice... is a highly regulated, monopolistic service. It cannot be haphazardly blended with the other competitive technologies because it has been artificially developed. The telephone companies that provide local service are like hybrid greenhouse flowers that have been artificially encouraged and suppressed over many many years to accomplish various objectives that were felt to be in the public interest.

At the time, in the 1930's, 40's and 50's, our legislative and regulatory predecessors didn't have an inkling that we would ever have the technological advancements that we have today. They were struggling just to get a phone available to every household. And if it meant that you artificially raised the rates in one area to help keep the local rates low, that was okay. In fact, it was encouraged.

As a result, "supports" for local service were built all throughout the rate structure of the telephone companies. Today, we cannot point to one service and say "Here, it is. This is the support for local service". It's everywhere...some is built into what we call Access charges; some may be in the Business rates; and some may be in the Urban local service rates. We might be counting the extra pennies in Call Waiting service rates, or in Caller Id rates or in Private Line services. Can these "supported" services survive in a competitive environment? We are concerned that they cannot. But we'll come back to these supported rates in just a few moments.

Lets go back to our dilemma caused by our convergence of technology. We realize that in some areas of the state, where there is competition, we are going to have to take this hybrid greenhouse flower and move it to the open field. We've got two major concerns. Because we have artificially manipulated this flower, we may need to rebalance the flower's strengths and weaknesses so that it does not overrun the others in the field. In the same sense, we also want to ensure the flower is vigorous enough to survive so that these long sought-after public benefits, such as everyone having access to a phone, is also preserved.

How are we going to do this? This is the question looked at by the Commission in hearings in 1994 that were set up in response to SCR 1627. After hearing days of the presentation of testimony and cross-examination by industry and consumer experts, the Commission made several initial decisions and set numerous additional matters for study in what you might call an "interim session".

Following the results of the study in the interim session, the Commission is proceeding with the second phase of the process.

What has been decided? It's been decided that there must be changes made to accommodate and allow for competition to grow in the areas of the state where it has the potential to flourish. The primary regulatory change will be that an alternative regulatory plan for competitive local telephone companies must be developed to bridge the transition from regulation and monopoly providers to deregulation and full competition.

What will the plan look like? The Commission has determined that a Price Cap-type plan would be most desirable. The components of the price cap plan will be competitive and non-competitive "baskets" or groupings of services. There will also need to be some kind of adjustment factor for the prices of services in these baskets, since we will not be using regulators to set the prices. The specifics of those factors, which will be designed to account for productivity and general price increases and decreases, will be addressed in hearings this summer.

In addition to the basic outline of a price cap plan, there were some other issues that we needed to develop more fully for the Commission so that it would have additional information on which to base its decisions in Phase II this summer. One of those issues, is that of cost studies. In May, the Commission referred this matter to one of the committees to work on in the "interim session". Using the work of this committee, comments from the industry and the record from the previous hearings, the Commission, last week, requested the two largest members of the industry prepare cost studies on several components of local service, in addition to "toll" or long distance service, and local service.

These components, which are unbundled piece-parts of the network, are those which are expected to be used by the new entrants to the market. It is critical for all the new companies to interconnect their network with that of the existing telephone company so that customers can exchange calls back and forth. It is also possible that there is the potential for viable competition in some of these unbundled areas of the network. This issue is critical to developing a seamless and strong network made up of numerous providers. The costing information will be one of several tools for the Commissioners to use this summer in determining the proper components of unbundling and their respective prices.

Other matters which went to the interim session for more factual development were Number Portability and Resale. Number portability is the ability to take your telephone number with you if you want to change telephone companies. It's something that we may take for granted, but it's a pretty big deal if you have to change your phone number everytime you want to make use of your ability to

chose a telecommunications provider.

There is a lot of work being done on this issue nationwide. Again, our goal is a smooth seamless network that will recognize numbers and phone service providers across the nation. Already in Kansas, we have two areas of the state that we have competing providers for local service. The first area of the state to have local competition is Hill City. The other area is Kansas City. Both these applications were approved by the Commission in December, 1995.

Because these new providers are building their own networks from scratch, there is an engineering cycle of a year to a year and a half that gives a window of time to work on some solutions to these technical difficulties. While we often talk of the fast pace of telecommunications; the reality of competition, if you're building a network, is more like a starter's pistol going off and a bunch of turtles beginning their crawl to the finish line. Yet, other pieces of the competitive puzzle will fall into place overnight. Because of these timing disparities, some changes must be made well in advance of others to ensure a simultaneous entry by all parties.

A prime example of a timing issue that is outside of state control is the entry of Southwestern Bell into the interLATA long distance market. The pending Congressional bill, if passed, will alleviate a good portion of the timing difficulty for it sets a pretty specific plan for what has to happen prior to and at the same time as, the Bell companies fully enter into the long distance market. Understandably, all the players are at the starting line, jockeying for position. The turtles are claiming the rabbits will get the head start. The rabbits are claiming they are really turtles and can't possibly run as fast as the other runners think they can. And then there is a frog or two mixed in. It gets pretty noisy.

Resale is also under consideration by the Commission and will be dealt with more fully this summer. There is some fairly strong evidence to indicate that allowing competitors to resell some portions of local service is an efficient and effective way to promote competition in its early stages. It's somewhat the equivalent of allowing a trucking firm to use the existing local streets and driveways to deliver their product rather than forcing the new firm to build it's own roads and driveways to each customer.

But resale is not without its difficulties, as was pointed out by the members of the industry committee working in the interim session.. Remember that hybrid greenhouse flower we were talking about? The one that we artificially manipulated to constrain certain rates and we raised others to compensate? If a service has been "supported" and the rates are artificially low, how do you resell it to someone else? If the retail rate is already less than cost, how do you set a

wholesale rate? Obviously we may need to rebalance.

This is starting to get us to what I call the Rubik's Cube part of telecommunications. Did you ever play with one of these? They're maddening aren't they? I think in a thousand years in the future, archaeologists will be unearthing the remains of our civilization and they'll be conjecturing as to the religious significance of these artifacts found in the basement of virtually every home. The colors all jumbled up. Never all the colors the same.

In evaluating how we are going to rebalance this complex hybrid flower that we created, we start to realize each part is interconnected to another. Everytime we move one part of the cube, we are changing the colors on the other five sides.

For example, we know that we have access rates that are greater than cost; this is impeding competition, so we reduce access charges. But the extra dollars from access charges were supporting local rates, so now we've created a significant revenue shortfall to the local telephone company. Now it's going to have to increase local rates or else it's going to go underwater and we'll lose telephone service to everyone in the community. So, we increase the local rates, but that forces low and fixed-income subscribers off the network; so we need a lifeline program to keep them on. The schools are needing interactive television service for long distance learning, can we discount their rate? Oops, we just increased access charges again.

That is why we have so many dockets open simultaneously at the Commission. It's becoming pretty apparent that the industry will have to make a number of these changes simultaneously, so that the positive effects can be maximized and hopefully mitigate any negative effects. There will be a lot of work to be done, even after competition is introduced.

A little earlier, I had described to you the public goal of making sure everyone had a phone available to them and how we have supported these rates to some degree in the past. We call having a phone available to everyone who wants one, "Universal Service". Universal Service was dealt with very extensively in one of the Commission's working groups. Universal Service is an important benefit of the telecommunications network today, and we don't want to lose this benefit tomorrow in a competitive environment. In the rural areas of the state, this hybrid flower has served us well, and we don't need to disturb it. But we do have to have a plan ready in case competition does arrive (like in Hill City) so that our flower will survive. The most advanced telecommunications network in the world is of no use to us if we cannot afford to connect to and use the network.

Even the pending Congressional legislation has portions dealing with Universal

Service. In fact, the latest draft specifically calls for special funding for the facilities to provide advanced services to schools and libraries. But, it's a very fine balancing act. We must weigh out very carefully the effects of our actions. Is it appropriate to jump in now and support or subsidize a rate today if there's a chance competitors would have provided the service in a month or in a year? Everytime we set an artificially low rate, we distort the market, prevent competition, and perpetuate the legacy of our hybrid greenhouse flower.

We'd like to give you a short 15-20 minute look at some of the research we are doing on Universal Service. Jerry Lammers and Ross Miller have been working very extensively on this issue. They and members of the telecommunications industry, potential competitors, and consumer groups met many many times this summer. We're not asking you to make any judgements at this time on Universal Service, this is simply a demonstration of research work in progress that we'd like to share with you so that you can get a flavor of the complexities of this issue.

(Turn podium over to Jerry Lammers - Managing Communications Auditor)

CLOSING:

I know the details become mind-boggling; it's a little easier for us because we deal in it everyday, but there are even times when we wish we had some sort of a Cliff Notes summary of telecommunications. Just remember where we are; we are in the last wave of a competitive surge that began 15-20 years ago. There has been a lot of good research work done by the industry members, the competitors, the Telecommunications Strategic Planning Committee, and the Commission. The going will be uncertain. It is a Rubik's Cube. We are in the midst of transition and we will need to have plans that are flexible and forward-looking, but the convergence of voice, video, cellular, and computers will ultimately bring great benefits to Kansans.

We thank you again for this opportunity to appear before this Committee, and if you have any questions, we would be more than happy to address them.

SELECT COMMITTEE ON TELECOMMUNICATIONS

Testimony Presented By Jerry Lammers,
Managing Telecommunications Auditor/Analyst
Kansas Corporation Commission
January 10, 1996

UNIVERSAL SERVICE WITHIN THE TELECOMMUNICATIONS INDUSTRY

Mr. Chairman, Members of the Committee:

(The following presentation is given using an overhead projector. The attached exhibits are numbered and referenced with the text.)

Exhibit 1 Universal Service

This presentation is about Universal Service within the telecommunications industry. Universal Service is the policy pursued by regulators to insure widespread availability of telephone service at reasonable rates. As part of the Competition Docket the Kansas Corporation Commission (KCC) created an industry work group to look at the issues associated with universal service. The group was composed of major parties interested in the competition docket. The Committee met 9 times from May to October of last year and filed its report with the Commission in October, 1995. What I will present today is background information on Universal Service, some of the issues dealt with by the Committee, and the KCC Staff Perspective which was an attachment to the Committee's report. The Commission is currently seeking additional comments from the parties on Universal Service.

Exhibit 2 Struggle

A struggle is going on between competition and universal service. When competition is authorized and the arrangements are made for interconnection and number portability, competitors will enter the market. For a while competition will be sporadic. It will spring up in selected locations and for select types of service. As competition becomes more widespread, it will have its desired effect. Customers will receive a greater variety of services and pricing arrangements. Under the

influence of Competition Person prices will be pushed toward their cost. This will unravel the current pricing structure for telephone service.

Exhibit 3 Regulated Monopoly

Currently the telephone industry operates as a regulated monopoly. Regulators and service providers have placed universal service on a pedestal. This has been more than a mere philosophy. Using the "Value of Service Pricing" concept, the industry has been able to make service available at affordable rates, even in high cost rural areas. Examples of value of service pricing are:

- Business is higher than residence \$ 1.50 to \$ 13.75 difference in rates (EOY 1994)
- Metro customers pay more than rural Res. \$12 vs. \$9 Bus. \$26 vs. \$14
- Statewide average long distance even though costs are higher to reach some rural locations.

The Universal Service concept has served us well. We have realized benefits:

- 94.7% of the households have a telephone
- No areas exist where service is not available, but desired
- 99.9% of Kansas customers will have service from a digital or electronic switch by the end of 1997
- 99.9% of Kansas customers will have one-party service by the end of 1997.

We can take pride in the progress that has been made and the effectiveness of the current arrangement. But times are changing. To understand where we need to make changes, let's take a look at exactly what we are supporting with our universal service concept.

Exhibit 4 Costs Are Higher in Rural Areas

Costs are higher in rural areas. How do we know that? First of all, it is intuitive. To service customers in the rural area the company installs a two mile trunk that connects four customers in the southwesterly part of the exchange. In contrast, in the metro area, a company installs a bigger trunk, but still two miles in length and connects a hundred customers. The costs for telephone poles or to bury the cable are similar for the two mile trunk, but the cost per customer are much higher in the rural area.

The KCC Staff has also looked at the cost per loop that the companies file with the FCC. Many of the ILECs (Independent Local Exchange Companies) serve rural areas. The highest cost company is four times as much as the lowest company who does not have any rural customers. Even the average is almost twice as high. United is a predominantly rural service provider and their cost/loop of \$404 is much higher than SW Bell whose cost is \$247. The average for Kansas is higher than the national average, reflecting the rural nature of the state.

Another way in which this higher cost is reflected is in the rates for access service. Each time a long distance call is made, the long distance company pays an access charge to the Local Exchange Company(LEC). In Kansas this rate is higher for companies with higher costs. So in our example the highest company's access charges for 1,000 Minutes of Use (MOU) is over three times as high as the lowest, and double the average. United's charges are twice those of SW Bell.

Conclusion: In general, costs are higher in the rural area. Presently support is provided to help recover these higher costs.

Exhibit 5 Who Pays Universal Service Support

One of the major ways in which this support is provided is through the rate level of the access charge. Today the long distance companies pay the access charge and thereby provide the needed support. "IXCs" stands for InterExchange Carriers, like AT&T, MCI, and Sprint. They pay 100% of the support that is derived through intrastate access service.

The KCC Staff has looked at several ways in which this support could be rearranged. In the next few slides I will show a specific example of how the rebalancing of rates could be done to prepare the industry for competition and still provide the support needed to preserve affordable service in the rural areas. Tomorrow, this kind of support could be rearranged. Long distance providers would still pay 45% of the support. Approximately 47% of the support would be paid by customers as a recurring monthly charge on their bill. In the Universal Service Work Group, there was support to have all telecommunications providers help in the payment of the support. One of the fastest growing providers is cellular service. In the future this will be expanded to include Personal Communications Service(PCS). When calls are made from a cellular phone, they most frequently terminate to a wire line phone. Thus the wire line phones are of value to the wireless customer, and it is appropriate that

Cellular and PCS help in the provision of support. Presently wireless service is outside the regulatory scope of the KCC. Absent a legislated change, the way that this support can be assessed is to have a portion of the interconnection charge revenue paid by cellular companies to the LECs be designated as support for universal service.

Exhibit 6 Impact on Individual Companies

One way that the costs could be recovered is to have each company be responsible for its own support. The KCC Staff analyzed the impact on 35 ILECs trying to recover the full amount of the support from their own customers in the form of a monthly recurring charge. This example takes the present intrastate access rates to the interstate rate level and shifts a 100% of the cost to the monthly rate. The local rate on average increases by \$ 9.00. However the story gets even worse, the effect on some companies and their customers is much larger. In the worse case, the monthly rate increases \$51.00. For the companies that we looked at, 7 had increases more than \$ 20, and 9 more were in the \$10- \$20 range. These kind of increases would have a severely adverse effect on universal service. However, what is unmanageable for a few, can be managed if shared.

Exhibit 7 Effect of Support For Universal Service

Let's take a look at the effect that pursuing value of service pricing has had on prices and their related costs in the industry. What is shown here is the revenues for each service category and the relationship to cost. I have drawn a cost level on this slide. These are broad gauge estimates. Especially for residence service, we are not exactly sure whether the revenues are greater than or less than their costs. This is why the Commission has placed an importance on getting some key cost study information to help in making rate rebalancing and creating an environment suited for competition.

Generally speaking, the price for long distance is significantly higher than its cost. A major part of the cost for long distance is access charges. The reason these rates are high is that they are designed to recover support to help support rural service where the revenues are much less than the costs. Business service rates exceed their cost levels much more than residence revenues do.

Exhibit 8 Long Distance Charges

There are consequences to "value of service pricing." Long distance charges for intrastate calls within Kansas are higher than similar calls that cross the state boundary. For example a 5 minute call from Topeka to Stateline Drive in Kansas City can vary from \$1.49 to the west side of the street to \$1.30 to talk to the east side of the street. Similarly a call from Topeka to 130 miles away are higher to Wichita than to Lincoln Nebraska. In these examples the average rate difference is 26%. One of the major reasons for this disparity is that the federal jurisdiction introduced the end user common line charge in the 1980's . This is a \$3.50 charge for each residence or single line business line, and up to \$6.00 for multiline business lines. Since this is a flat rate charge per month, it reduces the per minute access rate that IXCs pay to originate or complete long distance calls. In looking at this rate rebalancing one of the problems we would like to eliminate is to reduce the disparity between intrastate and interstate long distance rates.

Exhibit 9 Impacts on Constituents

In a rate rebalancing scenario, customers would receive a toll reduction of 20% which would put their rates at or below interstate rate levels. A monthly charge of \$2.60 is added to the bill. This does not fully recover the reduced access reduction, so the remaining \$.40 would be recovered through miscellaneous rate adjustments. Under this arrangement residence customers who make more than \$13 of intrastate long distance calls per month will benefit. In the rural areas 50% of the customers would experience at least a \$2.60 reduction in their long distance charges to make up for the monthly recurring charge. On a statewide basis 33% of the residence customers would also experience a rate reduction.

Exhibit 10 How Much Is Universal Service Support

So how large is this support. In one estimate, by reducing the Kansas access charges to interstate access rate level, the support was determined to be around \$ 88M. In this rebalancing example, \$49M will shift away from the long distance providers and be recovered by:

- Monthly Charge of \$2.60 \$42M
- Miscellaneous service rate adjustments \$ 4M
- Cellular/PCS \$ 3M

The remaining support would still be paid by the IXCs and SW Bell for redistribution to high cost service providers.

Exhibit 11 Operation of the Kansas Basic Service Fund(KBSF)

The long distance providers would pay support based upon how much long distance traffic they handle. End user customers would pay additional monthly recurring charge to their service provider who would flow the revenue to the KBSF. The administration of the fund would be performed by a neutral third party responsible to the KCC and would be funded by a small portion of the revenues that it collects. The KBSF would then redistribute the support funds to the providers of rural service. This would include most of the ILECs, United, SW Bell, and the Alternative Local Exchange Companies(ALEC). SW Bell is included because it does provide service to as many rural customers as United and all the ILECs together. Presently SW Bell internally provides this support from its metro locations and long distance services to support its rural customers. In the face of competition, this type of support may erode. If it does it should not be to the detriment of service to SW Bell's rural customers. For ALECs, if they provide service to customers in the high cost rural areas then they would also be eligible to receive support, thus making this plan competitively neutral.

Exhibit 12 Shields

Basically this rebalancing scenario adds \$2.60 additional to every customers' bill. While this is not a huge amount, it may be significant for some customers. Two shields need to be used to provide additional protection for universal service. First, a shield for residence service to protect them from other rate increases associated with shifts in pricing in other more competitive areas, such as business services. Second, in this transition we do not want to force customers off the network who do not make many long distance calls but would experience a higher recurring rate. This shield is designed to protect low income customers.

Exhibit 13 Lines Disconnecting over Monthly Increase

OPASTCO, Organization for the Protection and Advancement of Small Telephone Companies, did a customer survey to evaluate the effect of the loss of support for rural service. They asked customers how many would disconnect if rates went up \$5, \$10, \$15. At \$5 43,000 Kansas customers

might disconnect, At \$10 129,000 might disconnect. We are discussing an increase of \$2.60, which equates to 22,000 customers. Even at this level, that would be a significant blow to universal service. We believe that this 22,000 would include a large number of low income customers.

Exhibit 14 Lifeline Service

The Federal Communications Commission (FCC) has a program called Lifeline Service. It allows the waiving the \$3.50 Interstate EUCL charge for qualifying customers. Presently, 39 states are participating, Kansas is not. The introduction of rate rebalancing is an ideal time to introduce Lifeline service. This shows how the state EUCL of \$2.60 would be waived as well as an additional \$.90 in local service charges.

Exhibit 15 Support Choice

Residence service is priced below business. Should we continue to support residence service? While the direct support for residence service may not be continued, we can take a different look at the difference in the rate levels and say that the higher business rate is really providing support for rural service. Under competition that higher rate will be driven to cost and that support will be gone. This is an example of where it may be appropriate to make an implicit support item explicit by capturing \$5.00 of the existing business rate in metro areas, and \$2.50 in rural areas as support and including that in the Kansas Basic Service Fund. The advantages are:

- It captures support that already exists
- It is competitively neutral in that all providers of business service would remit the \$5.
- It avoids pressure to raise residence rates to compensate for the lost support

Exhibit 16 Summary

In summary, this example of rate rebalancing includes the following steps:

- Creates the KBSF to support basic service in high cost rural areas
- Changes the support mechanism from Access Service
- Reduces Long Distance and Access Services to or below the interstate rate level
- Establishes an end user charge
- Shields low-income and residence customers

The KCC is currently soliciting comments in a proceeding to address universal service issues.

Exhibit 17 Benefits

Universal Service is sustained

- Rural service is supported
- Low income customers avoid increases and more get connected
- Residence avoids shift from more competitive business service

Ready for Competition

- Long distance rates are reduced. Calling is stimulated and people are more readily able to stay connected with friends and family
- High access rates in some ILECs are eliminated (thus discouraging bypass and reducing pressure to deaverage long distance rates)
- Access rates are reduced throughout the state
- More of the local loop cost is recovered by a flat rate charge

Competitively Neutral

- EUCL and business line assessment paid by all
- Providers of lines in rural areas get support
- Incentive to bypass access charges is substantially reduced

**UNIVERSAL
SERVICE**

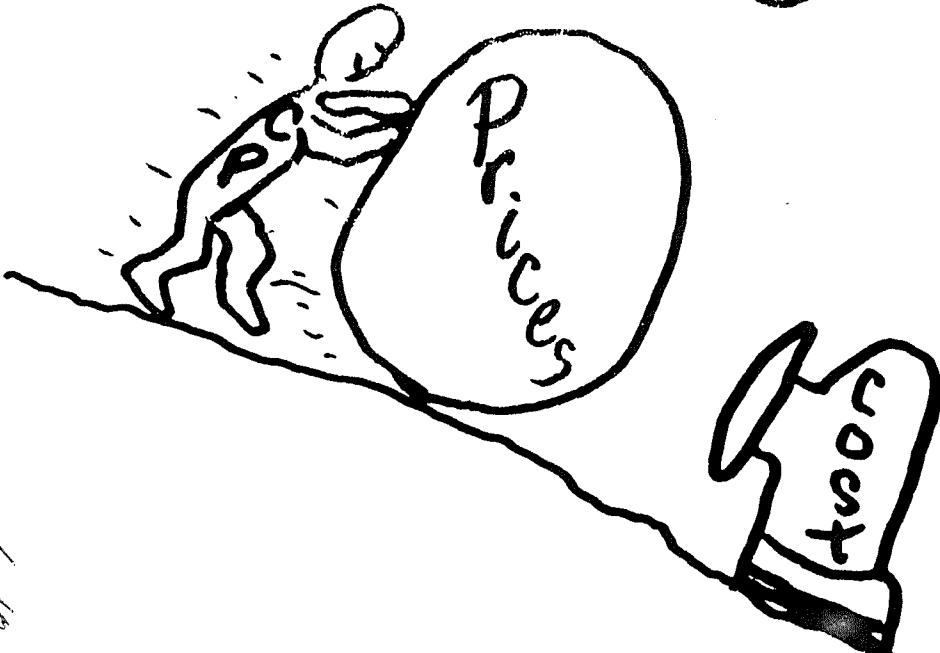
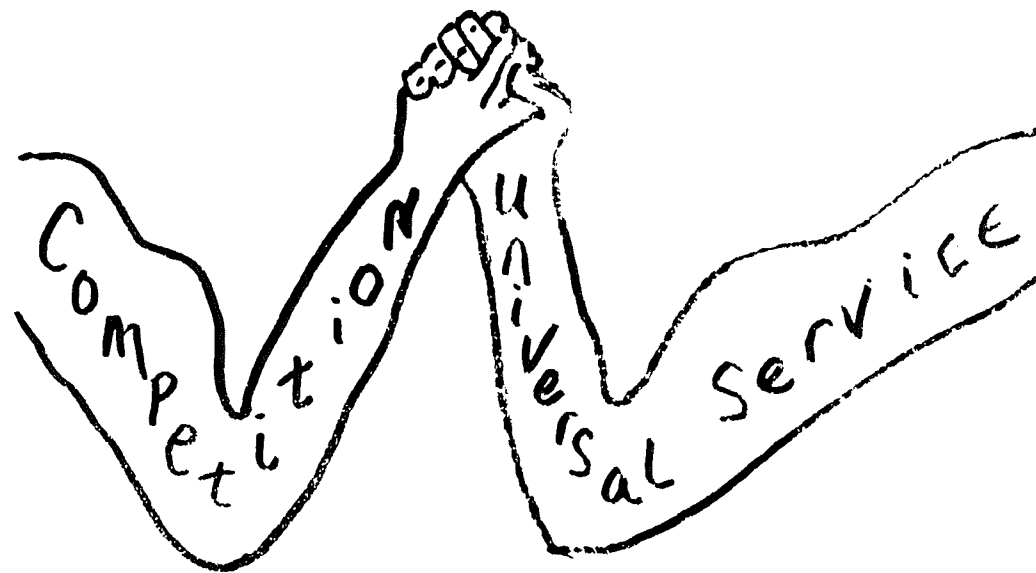
January 10, 1996

Presentation by KCC Staff

EXHIBIT 1

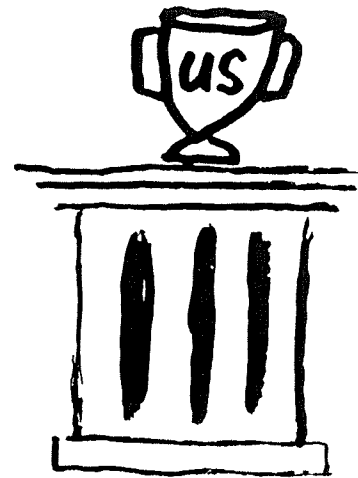
6-9

STRUGGLE



REGULATED MONOPOLY

Universal Service is on a pedestal



Value of Service Pricing

-Business is higher than Residence* \$1.50 to \$13.75 difference

-Metro is higher than Rural#
Res. \$12 vs. \$9
Bus. \$26 vs. \$14

-Statewide average Long Distance rates

Benefit: 94.7% Subscribership
No areas where service not available
99.9% Digital/Electronic switches EOY 1997
99.9% One-Party service by EOY 1997

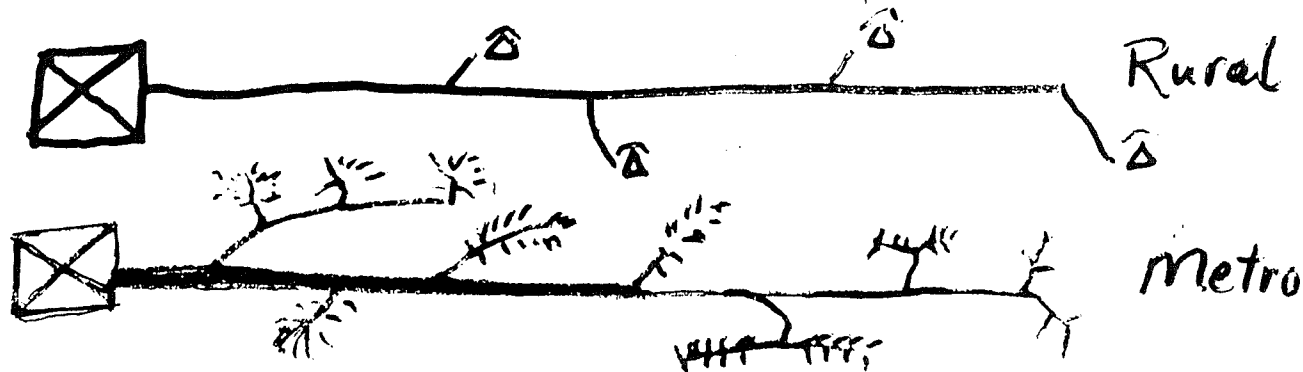
* As of Dec. 1994

Example uses SW Bell rates

11-9

COSTS ARE HIGHER IN RURAL AREAS

Fewer
Customers
per Trunk



Annual Local Loop Cost/Loop*

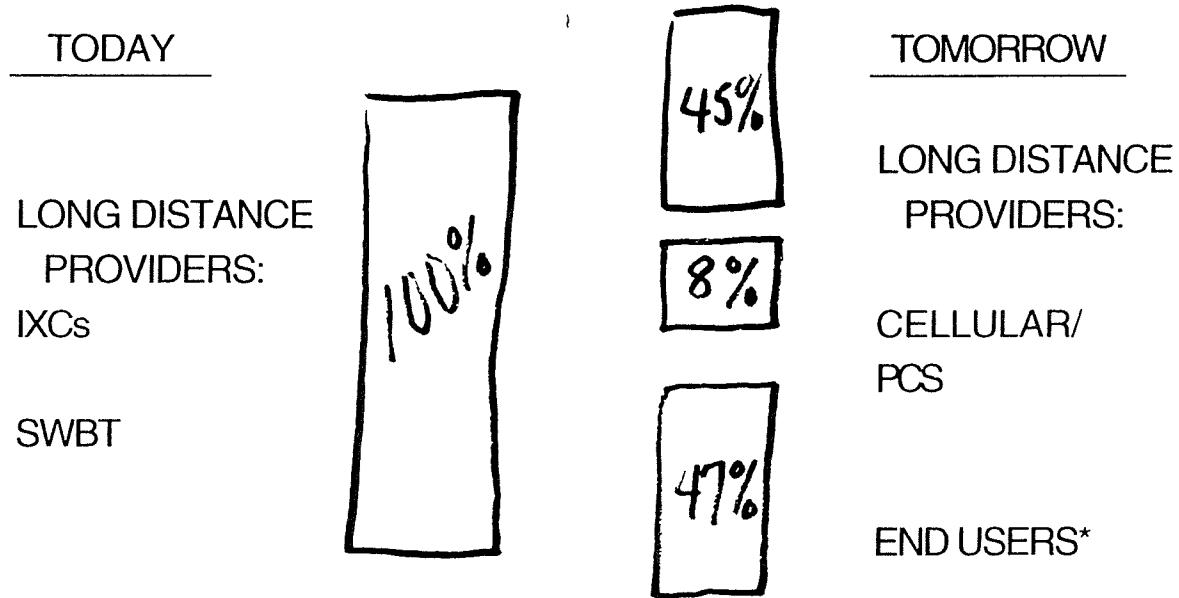
	ILECs		United	SWBT	State	National
	High	Avg			Avg	Avg
Low	\$237	\$426	\$404	\$247	\$275	\$243
State Access Rates per 1,000 MOU#	\$60	\$100	\$120	\$60		

* - Based on 1993 Monitoring Report

- Higher access rates reflect higher costs of service

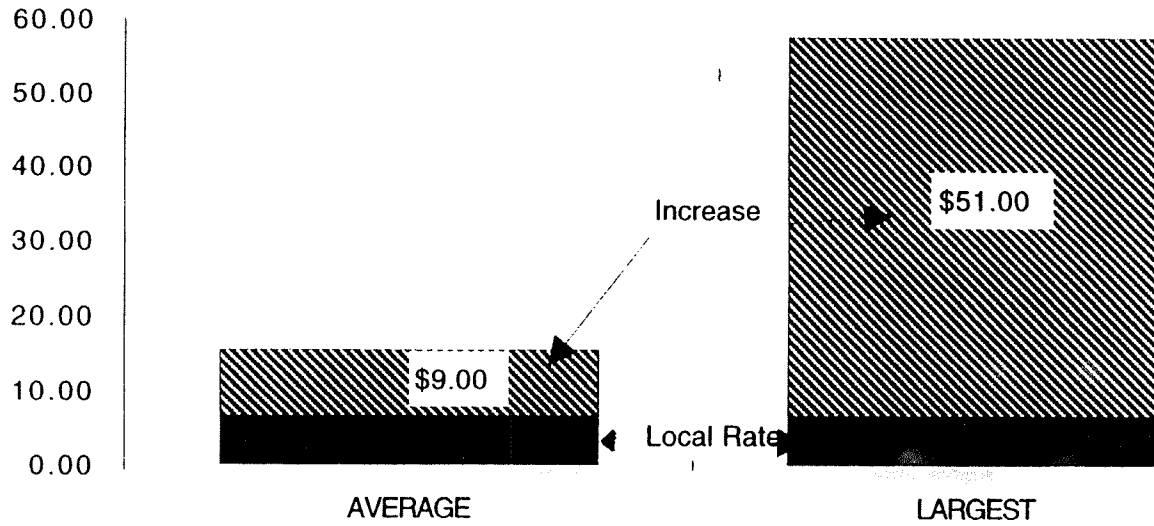
6-12

WHO PAYS UNIVERSAL SERVICE SUPPORT



* - Collected by their service provider, the LEC or Alternative Local Exchange Company (ALEC).

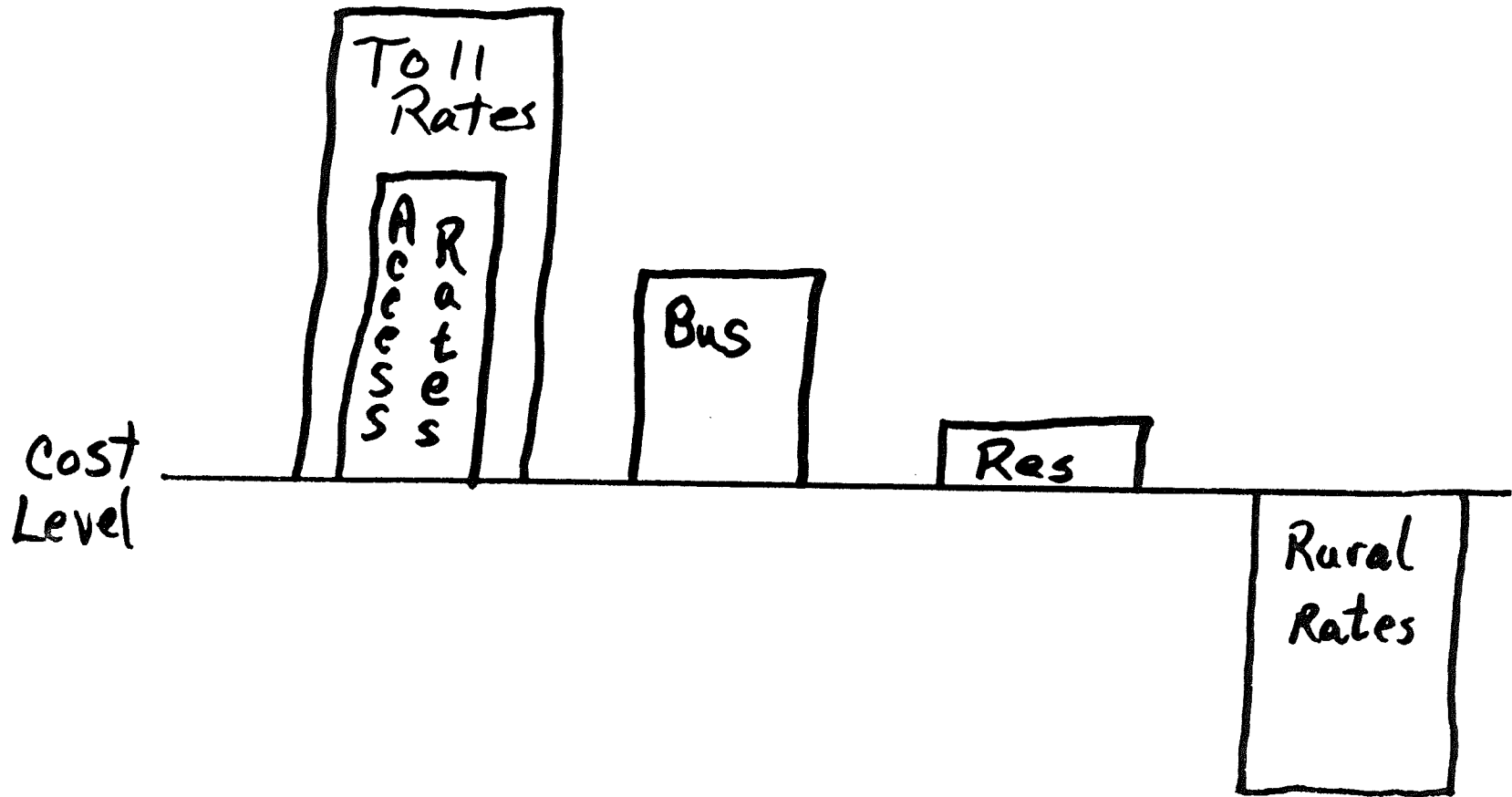
IMPACT ON INDIVIDUAL COMPANIES



No. of ILECs	Amount of Monthly Increase
7	>\$20
9	\$10-\$20
14	\$ 0-\$10

What is unmanageable for a few, can be managed if shared.

Effect of Support for Universal Service ⊗



⊗ - Illustrative only.

LONG DISTANCE CHARGES

5 Min Call

Call Topeka to Stateline Dr, Kansas City

West side

East side

\$1.49

\$1.30

Call Topeka to 130 miles away

Wichita

Lincoln

\$1.73

\$1.35

Rate Difference Is 26%

Direction: Reduce the Disparity Between
Intrastate and Interstate Long Distance Rates

Reason for Lower Interstate Rates: EUCL
(\$3.50 & \$6.00 End User Common Line Charge)

6-16

IMPACTS ON CONSTITUENTS

Customers Receive Reduction
in Long Distance Charges **20%**

Monthly Charge **\$2.60**

Miscellaneous Rate Adjustments **\$0.40**

% of Residence Customers Who Would Benefit
Rural Areas **50%** Statewide **33%**

6-17

HOW MUCH IS UNIVERSAL SERVICE SUPPORT

ESTIMATE* **\$ 88M**

Access Revenue **(\$49)M**

Makes Long Distance <= Interstate Rates

Monthly Charge of \$ 2.60 \$42M

Misc. Service Adjustments \$ 4M

Cellular \$ 3M

\$49M

Still paid by IXC's and SWBT **\$39M**

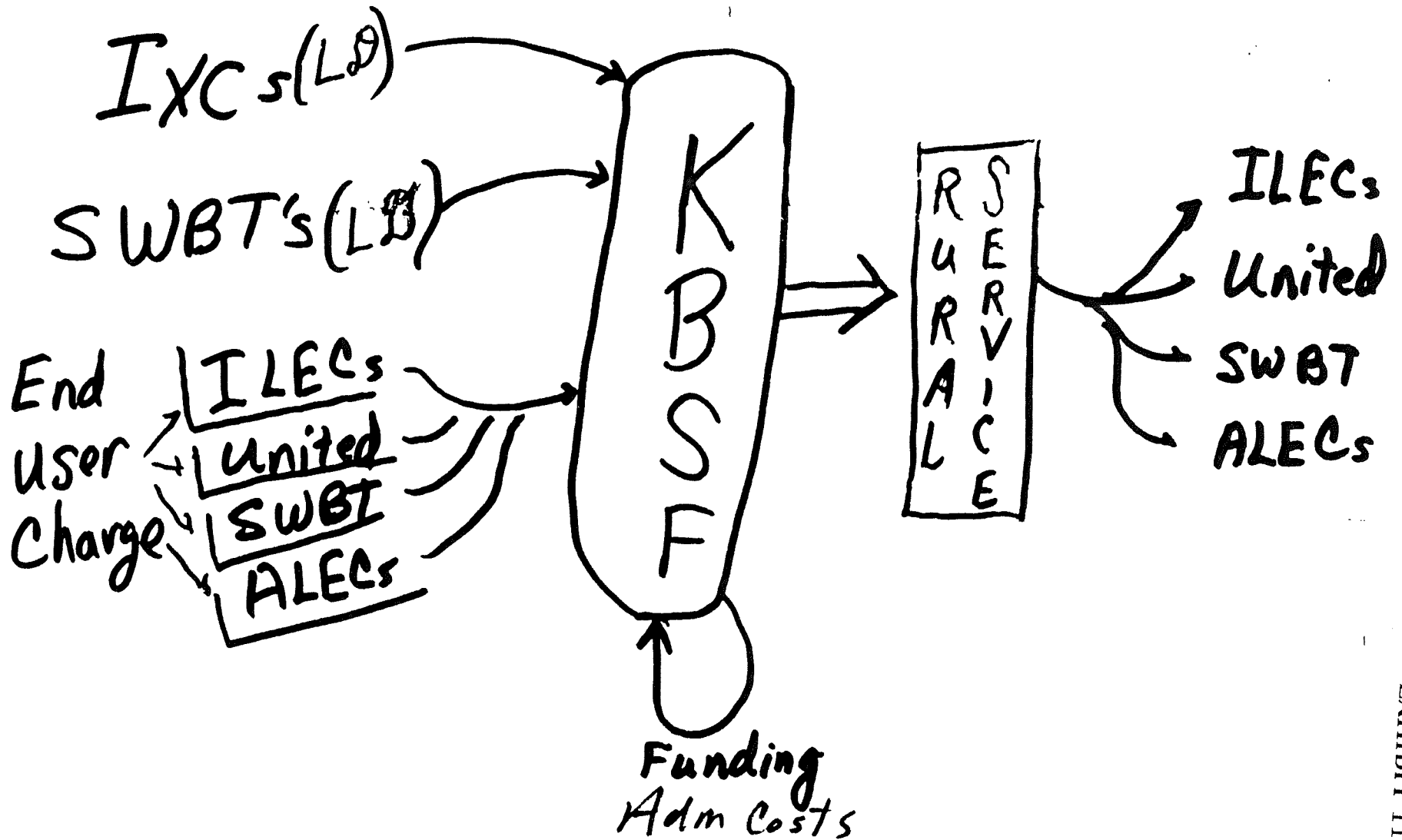
* - Estimate of reduction to interstate access rates and reduction of ILEC Billing and Collection rates.

EXHIBIT 10

6-18

Operation of KBSF

(Kansas Basic Service Fund)



SHIELDS



Protect from
more competitive
areas.



Keep them connected

LINES DISCONNECTING OVER MONTHLY INCREASE

No. of Lines

300,000

250,000

200,000

150,000

100,000

50,000

0

\$0

\$1

\$2

\$3

\$4

\$5

\$6

\$7

\$8

\$9

\$10

\$11

\$12

\$13

\$14

\$15

Amount of Increase

22,000

43,000
7.3%

129,000
12.9%

272,000
27.1%

EXHIBIT 13

6-21

LIFELINE SERVICE

Reductions

- for Low Income	
- Waive State EUCL Charge	\$2.60
- Additional Local Reduction	\$0.90 *
- Waive Interstate EUCL	<u>\$3.50 *</u>
Total Savings	\$7.00
* Amount less than Today	\$4.40

6-22

SUPPORT CHOICE

DO WE CONTINUE TO SUPPORT RESIDENCE?

OTHER OPTIONS:

MAKE PART OF IMPLICIT SUPPORT EXPLICIT

METRO \$5.00

RURAL \$2.50

ADVANTAGES:

CAPTURE SUPPORT THAT ALREADY EXISTS

COMPETITIVELY NEUTRAL

AVOIDS PRESSURE TO RAISE RESIDENCE RATES

SUMMARY

Create KBSF to support basic service in high cost rural areas

Change the support mechanism from access

Reduce Long Distance and Access to or below interstate rate level

Establish an end user charge

Shield low-income and residence customers

KCC currently addressing Universal Service issues

BENEFITS

Universal Service is Sustained

- Rural service is supported.
- Low income customers avoid increases and get connected.
- Residence avoids shift from more competitive business service.

Ready for Competition

- Long Distance rates are reduced. Connection/Stimulation
- High access rates in some ILEC's are eliminated (thus discouraging bypass and reducing pressure to deaverage long distance rates.)
- Access rates are reduced and can be used as local interconnection charge.
- More of local loop cost is recovered by a flat rate charge.

Competitively Neutral

- EUCL and business line assessment paid by all.
- Providers of lines in rural areas get support.
- Incentive to bypass access charge is reduced