

Approved: Don Myers
Date
Apr 9, 98

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Chairperson Don Myers at 9:00 a.m. on March 17, 1998 in Room 514-S of the Capitol.

All members were present except:

Committee staff present: Lynne Holt, Legislative Research Department
Mary Ann Torrence, Revisor of Statutes
Mary Shaw, Committee Secretary

Conferees appearing before the committee:

Others attending: See attached list

Vice Chairman Clay Aurand introduced Lynne Holt, Staff, Legislative Research Department, who gave a presentation on Background Information/Policy Issues Regarding the Universal Service Fund. She outlined the actions taken at the state and federal government levels toward the realization of regulatory reform, universal service and advanced technology (Attachment #1). She presented information regarding TeleKansas 1 and TeleKansas II, 1994 SCR 1627 which established the 17-member Telecommunications Strategic Planning Committee charged with developing a state telecommunications strategic plan, initial concepts on Universal Service - Kansas Corporation Commission, Telecommunications Strategic Planning Committee Activities, Federal Telecommunications Act, the Kansas Telecommunications Act of 1996, and the Kansas Corporation Commission Order on Competition/Implementation of the Kansas Universal Service Fund.

Questions and discussion followed.

Chairman Myers thanked Lynne Holt for presenting the information on the subject of the Universal Service Fund. The presentation will be continued tomorrow beginning with the section on Litigation.

The meeting was adjourned at 9:58 a.m.

The next meeting is scheduled for March 18, 1998.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: March 17, 1998

NAME	REPRESENTING
WALKER HENDRIX	CURB
Rob Hodges	KTA
Mike Scott	SWBT
Nelson Krueger	KY5F
Doug Lawrence	SWBT
John Pinegar	State Independent Telephone Assn.
Blake Murray	Sprint
Tom Laches	McCill's Asso.
George Barber	RTMC
Lester Murphy	KEC
Roger Bales	KOPR
Jerry Lammers	KCC
Sandy Reams	KCC
MARK CAMINER	SITA
Walter Randall	Whitney Larson, PA
Mike Recht	AFT
Jim Youally	Cellular One
Bill Bryant	SWBT

March 16, 1998

To: House Utilities Committee

From: Lynne Holt, Principal Analyst

Re: Background Information/Policy Issues Re: Universal Service Fund

Beginning in 1990, with the implementation of TeleKansas, the Kansas Corporation Commission (KCC) recognized that certain services were becoming competitive and there was a need to establish a regulatory framework to promote further competitiveness among services. Furthermore, the KCC recognized that advanced technologies would have to be deployed to make available certain applications, such as Internet access and two-way interactive video. In 1994, the Legislature and KCC realized that the movement toward competitive services might result in disparities in telecommunications service availability in certain parts of the state. This resulted in the KCC initiating an investigation of issues concerning universal service, infrastructure, and quality of service. The balancing act of:

- providing regulatory flexibility to promote competition,
- ensuring affordable telecommunications services (universal service) throughout the transition to competition, and
- establishing appropriate conditions for investments in advanced technologies has been a recurring theme of state and federal regulatory action on telecommunications for the past several years.

This memorandum outlines the actions taken at the state and federal government levels toward the realization of regulatory reform, universal service, and advanced technology deployment.

TeleKansas I—A modified version of TeleKansas was approved by the KCC in February 1990. The KCC's order applied only to Southwestern Bell. This alternative regulatory scheme essentially capped local rates for residential and single-line businesses for five years, until March 1995. Moreover, it provided flexible pricing procedures for other services. In exchange for not reducing its local rates, the company committed to invest \$160 million for infrastructure upgrades, such as digital switches in central offices and single-party lines. For its part, the KCC agreed not to impose on the company rate-of-return regulation for the duration of five years. There was a disagreement between the KCC staff and Southwestern Bell about the possible review of earnings after TeleKansas terminated.

TeleKansas II—In accordance with the provisions of 1994 H.B. 3039, the Legislature extended TeleKansas for another two years (until March 1, 1997), and

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Attachment 1

the Commission issued an order to implement the plan. Once again, the arrangement centered around a commitment to infrastructure investment by Southwestern Bell, in exchange for capped local rates and no investigation of the company's earnings. The Legislature required the company to construct, when necessary, a fiber optic network to provide broadband educational video services to educational institutions requesting them in the company's service area. The required company investment was not less than \$64 million above normal construction expenditures; however, the company's deployment expenditures actually exceeded that amount. An executive agreement also provided for Southwestern Bell to increase the number of employees in Kansas.

1994 S.C.R. 1627—In addition to extending TeleKansas, the 1994 Legislature adopted S.C.R. 1627, which established the 17-member Telecommunications Strategic Planning Committee and charged it with developing a state telecommunications strategic plan. This charge was made in 1994 within the context of several assumptions outlined in the resolution:

- the telecommunications industry has undergone tremendous change in recent years;
- new levels of competition exist or may soon exist in the industry which will fundamentally alter the economic conditions in which telecommunications public utilities operate;
- greater competition in telecommunications services demands consideration of relaxed regulation of such services; and
- movement toward relaxed regulation of telecommunications services is desirable if it is accomplished in a systematic and logical manner based on accurate information, public analysis, and debate.

The resolution assigned several tasks to the Committee, including, among others, defining the term "telecommunications infrastructure" and a procedure for possibly modifying that definition; undertaking a statewide inventory of existing telecommunications infrastructure and an assessment of telecommunications needs of end users; and identifying the applications for telecommunications of importance to the state and a method of setting priorities for their development. The resolution also required the KCC to open one or more generic dockets to investigate the level of competition for each regulated or flexibly regulated telecommunications service under its jurisdiction. Part of the direction given the KCC in this resolution was to define universal service, determine the extent to which it has been achieved in every region of the state and establish appropriate policies to ensure universal service in high-cost areas of the state.

Initial Concepts on Universal Service—KCC

On April 11, 1994, the KCC opened a docket on Universal Service, Infrastructure, and Quality of Service. In its order on competition, the KCC established a Universal Service Working

Group. A report released by the Working Group on October 31, 1995 outlined six areas of conceptual agreement:

- the need for a Kansas Basic Service Fund to which funding will be credited and redistributed to companies with high-cost customers;
- the need to provide support payments in rural areas for high-cost service, as determined by standardized criteria;
- the preferability of paying subsidies to the provider directly rather than a voucher system;
- the need to provide a support mechanism to protect consumers from a rapid increase in local rates once rates are rebalanced;
- the importance of conducting careful analysis of lifeline service and a need to take some action to assist economically disadvantaged residential customers; and
- the need to maintain universal service (here defined as the availability to every Kansan of, at a minimum, a basic level of telephone service which is offered at affordable rates for all who seek connection to the telecommunications network).

The concepts of an explicit fund, as defined by the Working Group, would: provide direct payments to providers; offset reduced intrastate access while keeping local rates from escalating rapidly; maintain affordable basic services for all Kansans; and provide lifeline services. These concepts were subsequently adopted in the 1996 Kansas Act.

Telecommunications Strategic Planning Committee Activities

The 1994 resolution required the KCC to apply for a federal grant to support the strategic planning effort. The KCC succeeded in obtaining funds matched by state funding which enabled the Telecommunications Strategic Planning Committee (TSPC) to engage a consultant to assist in developing a strategic plan. The consultant, Weber Temin & Company, issued several reports addressing various aspects of the TSPC's charge. In addition, the consultant developed recommendations for a regulatory framework and submitted them to the TSPC in May 1995. While the consultant developed its recommendations (focused on competition, infrastructure, and universal service), the KCC proceeded with its deliberations on the competition docket. The first phase of the KCC's investigation was issued on May 5, 1995, and identified certain policy determinations pertaining to competition in the telecommunications industry. Both the KCC's order on competition (Phase I) and the consultant's proposal addressed certain issues which reflected agreement and other issues which reflected divergent views. In contrast to the KCC's order of May 5, the consultant did not recommend that cost studies be filed at the outset of regulatory reform because of the belief that fully allocated cost studies were unreliable, in addition to being time consuming and contentious. The consultant also did not support earnings audits in light of the movement toward price cap regulation. Moreover, the consultant also recommended that infrastructure plans and regulatory plans be filed. These concepts (no

earnings audit and the requirement for companies to file infrastructure plans and regulatory plans) became part of the 1996 Kansas Telecommunications Act, addressed below.

The TSPC made its final recommendations in the form of a proposed policy framework, despite extensive disagreement among TSPC members on several key issues. The TSPC's report, which included the policy framework, was relayed to the Governor and Legislature in January 1996. In its proposed policy framework, the TSPC recommended the KCC be required to develop a process of supporting universal service, including a definition thereof and a method of updating the definition periodically. The KCC would have to determine: if a new fund is necessary; the size of the fund that is needed; if such fund can be transitional; who contributes to the fund and on what basis; who receives payments from the fund and on what basis; and to what extent the fund shall support infrastructure improvements. The TSPC's proposed policy framework also called for each telephone company to file network infrastructure plans with SS7 capability; basic and primary rate ISDN capability; full fiber interconnectivity (or technological equivalent); among central offices; and broadband capable facilities to all schools, hospitals, libraries, and state and local government facilities requesting such services. The infrastructure in those plans would be part of the universal service definition (in the Kansas Act, "enhanced universal service"). The schedules for deployment of those services and facilities would be subject to agreement by the KCC and the companies. (The Kansas Act subsequently established a date of July 1, 2001 for deployment of enhanced universal service capabilities.) Each telephone company also was required to file a regulatory plan. As part of that plan, the company could elect price cap regulation or continuation of rate of return regulation. The proposed policy framework also recommended intrastate access charges to be reduced with the objective of equalizing intrastate and interstate rates over a three-year period.

Federal Telecommunications Act. The Federal Telecommunications Act became law on February 8, 1996. The Federal Act requires the Federal Communications Commission (FCC) to establish a federal universal service fund mechanism. Although states do not appear to be mandated in the law to establish state universal service funds, state involvement in ensuring the availability of universal service is clearly expected, as is evident in various sections of the law. For example, Section 254(a) provides that a Federal-State Joint Board on Universal Service recommend to the FCC the definition of services to be supported by federal universal support mechanisms. One section of 254(b) states: "There should be specific, predictable and sufficient federal and state mechanisms to preserve and advance universal service." Therefore, if a state elects to establish a funding mechanism to promote universal service, that fund should be explicit and not implicit.

The definition of universal service in the federal Act (Section 254 (c)) states that universal service is an evolving level of telecommunications services that the Commission (FCC) shall establish periodically . . . taking into account advances in telecommunications and information technologies and services. In their deliberations on the definition, the FCC and the Federal-State Joint Board were required to consider the extent to which such telecommunication services:

- are essential to education, public health, or public safety;
- have through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;
- are being deployed in public telecommunications networks by telecommunications carriers; and

- are consistent with the public interest convenience and necessity.

To date, the FCC's definition of "universal service" addresses only basic services.

One of the universal service principles identified in the federal Act (Section 254 (b)) pertains to rural and high cost areas:

Consumers in all regions of the nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

Section 254(f) states:

A state may adopt regulations not inconsistent with the Commission's (FCC's) rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal support mechanisms.

In other words, if states decide to augment the federal definition of "universal service," the funding should be explicit and sufficient without recourse to federal universal service funds.

Another provision in the law (Section 254 (i)) requires the FCC and the states to ensure that universal service is available at rates that are just, reasonable, and affordable to all Americans. Yet another section in the law (Section 254 (k)), which prohibits telecommunications carriers from using noncompetitive services to subsidize competitive services, requires states to establish "any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."

Throughout the federal Act, there appears to be recognition that:

- competition must not be impeded;
- the definition of universal service is evolving but must be available at rates that are just, reasonable, and affordable; and
- access by all consumers (urban and rural) to advanced telecommunications and information services is a federal objective for universal service although

the federal Act does not include specific provisions of how those services are to be financed and what is meant by "advanced telecommunications and information services."

The Kansas Telecommunications Act of 1996. The Kansas Act was drafted with knowledge of provisions included in the 1996 federal Act and the input of the Kansas TSPC. For example, one policy articulated in the Kansas Act is: "to promote consumer access to a full range of telecommunications services, including advanced telecommunications services, that are comparable in urban and rural areas throughout the state." That public policy statement uses language similar to universal service principles outlined in Section 254 (b) of the federal Act and draws from the TSPC's proposed vision statement contained in its report. The Kansas Act retained from the TSPC's proposed policy framework the provisions that each local exchange carrier file regulatory reform plans and infrastructure plans containing basic and enhanced services to be subject to universal service protection. The Kansas Act links those infrastructure plans to deployment of basic universal service capabilities by July 1, 1998 and enhanced universal service capabilities by July 1, 2001. As previously noted, "enhanced universal service" is essentially the same set of technologies and services recommended in the TSPC's proposed policy framework: SS7 capability; basic and primary rate ISDN capability (or the technological equivalent); full-fiber interconnectivity (or the technological equivalent) between central offices; and broadband-capable facilities to all schools, hospitals, public libraries, and state and local government facilities requesting such services.

The Kansas Act also provided for reduced long distance rates for access to internet providers in certain areas of the state where local access was not available. Beginning October 1, 1996, this access had to support at least 14.4 kilobit per second service throughout the service area. Telephone companies must have the capacity to support 28.8 kilobits to any customers requesting such Internet access on or after July 1, 1999. Moreover, lifeline service and services for speech, hearing, and visual impediments had to be provided although the Kansas Act did not specify the funding source.

The Kansas Act was more specific in setting guidelines for establishment of the state universal service fund than was the TSPC's proposed policy framework, which essentially left all discretion to the KCC to develop and implement the state universal service fund. The Kansas Act named the fund the Kansas Universal Service Fund (KUSF) and included the following provisions:

Initial Funding. The initial amount must consist of revenues lost by local exchange carriers due to rate rebalancing (resulting from a reduction in intrastate access charges to interstate levels over a three-year period); all lost revenues must be recovered on a revenue neutral basis with additional statutorily authorized revenues to come to the fund from equitable assessments against providers.

Contributors. All providers of intrastate telecommunications service, including wireless providers, must contribute to the KUSF in an equitable and nondiscriminatory manner.

Administrator. The KCC must use a competitive bidding process to select a neutral, competitive, and bonded third party to administer the KUSF, which involves, among other responsibilities, collecting money due to the KUSF and disbursing it on a monthly basis to eligible companies.

Purposes. Disbursements from the KUSF may be made for:

- recovery by local exchange carriers of shortfalls due to rebalanced rates (see above) and ongoing maintenance of parity between intrastate and interstate access;
- shortfalls resulting from changes in federal rules related to access revenue requirements;
- a percentage increase in access lines over the 12-month period prior to request;
- infrastructure expenditures necessary to serve additional customers within a company's service area;
- additional investment required to provide universal service and enhanced universal services: SS7 capability; basic and primary rate ISDN capability (or the technological equivalent); full-fiber interconnectivity (or the technological equivalent) between central offices; and broadband-capable facilities to all schools, hospitals, public libraries, and state and local government facilities requesting such services;
- infrastructure investments responding to facility or service requirements of the Legislature (such as Internet access requirements addressed above), regulatory (FCC or KCC), or judicial authority.

With the exception of the initial revenues replaced from the KUSF to offset intrastate access reductions, companies must request recovery from the KCC, subject to an expedited hearing and review process.

KCC Order on Competition/Implementation of the KUSF. On December 27, 1996, the KCC issued an order which implemented the 1996 Kansas Act. To that end, the KCC made the following determinations:

Assessments to Providers. After determining the initial size of the fund necessary to replace intrastate access reductions, the KCC determined an assessment rate of 9 percent for each provider of intrastate telecommunications services, including local exchange carriers, long distance companies, and wireless companies. Southwestern Bell's contributions to fund the KUSF (its portion of the assessment) over a three-year period was to assess: \$2.00 per access line the first year, an estimated \$1.00 the second year, and at least \$.21 the third year. Moreover, pay phone calls were increased from \$.25 to \$.35 and free directory assistance service was eliminated. Sprint/United's KUSF assessments to customers total approximately \$3.00 phased in over the three-year period. Rural telephone companies' KUSF assessments to customers totaled \$1.43 per access line the first year. In addition, the Kansas Act authorized each rural telephone company to increase annually its monthly rates by up to \$1.00 until such rates equaled the average rate for all rural telephone companies in Kansas.

All companies could pass, but were not required to pass, the assessments through to their customers, as authorized by the Kansas Act. A second year of assessments was supposed to have become effective March 1, 1998. However, the Supreme Court, upon the KCC's request, allowed the KCC to stay increases in assessments and other changes to the KUSF pending its decision on the litigation addressed below. The Supreme Court's decision, also summarized below, subsequently dissolved the stay. The KCC may now proceed with implementation of increases in assessments and changes to the KUSF.

Size of Fund. The fully implemented amount for the KUSF originally was determined in the KCC order to be \$111.6 million. For the first year, the size of the KUSF is \$77 million. The KCC staff projected moneys from the Fund, after the phase-in, to be disbursed for a Fund of approximately \$111 million, as follows (assuming 1996 conditions): \$106 million for support to high cost customers; \$2.4 million for relay service; \$0.5 million for the Telecommunications Access Program; \$2 million for the Lifeline Program; and \$200,000 for administration costs.

Lifeline, Kansas Relay Services, Telecommunications Access. In its order, the KCC determined that the Kansas Lifeline Program, the Kansas Relay Services Program (hearing impaired relay service center), and Telecommunications Access Program (terminal equipment for individuals with disabilities) would be funded through the KUSF assessment.

Reduction in Long Distance Rates. The KCC order required basic intrastate long distance rates to be reduced to reflect the access charge reductions, as required by the Kansas Act. The order required the amount of the reduction to be in proportion to the local exchange carriers' phased-in access reductions.

Fund Administrator. The KUSF is administered by the National Exchange Carrier Association, Inc. (NECA), which was selected by a competitive bid, as required by the Kansas Act.

Litigation. There were two lawsuits that took issue with the Kansas Act—the first is pending and the second has just been resolved. First, wireless service providers initiated litigation in the U.S. District Court for the District of Kansas challenging the Kansas Act and the KCC's order establishing and funding the KUSF. This litigation alleged Kansas law was in violation of federal law—47 U.S.C. Section 332(c). That section prohibits a state from regulating the entry of, or the rates charged by any commercial mobile service or any private mobile service, under certain conditions. The District Court ruled that the Kansas statutes did not violate Section 332(c). The wireless providers subsequently appealed the decision to the U.S. Court of Appeals for the 10th Circuit in Denver where the case is pending. If the decision is ultimately made in favor of the wireless providers, they would not be required to contribute to the KUSF and moneys paid in would have to be refunded.

Second, the Citizens Utility Ratepayer Board (CURB), Multimedia Hyperion Telecommunications, Kansas City Fiber Network, CMT Partners, Topeka Cellular Telephone, and Airtouch Cellular of Kansas appealed the KCC's order implementing the Kansas Act to the Kansas Court of Appeals. The Kansas Court of Appeals issued its decision in August 1997. That decision required the KCC to set aside its order on the KUSF and remanded it to the KCC for further

hearing and consideration. The decision took issue with the concept of revenue neutrality which the Court claimed was foreign to the federal Act. The decision also took issue with the prohibition against audits and earnings reviews in the Kansas Act. The decision noted the impossibility for the KCC to determine an affordable rate for universal service without being able to perform an audit or earnings review of the incumbent local exchange carrier. The KCC appealed the decision to the Kansas Supreme Court which issued its decision on March 13, 1998.

The Kansas Supreme Court unanimously upheld the validity of the Kansas Act and the KCC orders on competition. The Supreme Court's decision reversed the Court of Appeals' opinion that the concept of revenue neutrality and the prohibition against audits and earnings reviews in the Kansas Act are inconsistent with the federal Act and the KCC's statutory obligation to ensure just and reasonable rates and charges for Kansas consumers. The Supreme Court affirmed the validity of the methodology prescribed in the Kansas Act for setting the initial funding level for the KUSF. To that end, the Supreme Court acknowledged that the KCC was not required, only authorized, to rebalance rates (increase local rates to recover lost revenues from access rate reductions). As previously noted, the KCC elected to partially rebalance rates by reducing intrastate access charges to interstate levels. However, the KCC did not elect to totally rebalance rates because lost revenues are being recovered through the KUSF and not through local rate increases.

Also affirmed was the authority of the KCC to adjust the KUSF or perform cost studies or audits to establish future funding levels for the KUSF. The Supreme Court held that the prohibition against audits and earnings reviews in the Kansas Act only applies to initial prices filed for price caps by companies that make such an election. At the time the appeal was filed with the Supreme Court, no company had made such an election. (Since the appeal was filed, Southwestern Bell and Sprint have filed a petition with the KCC for price cap regulation which is currently pending.) The Supreme Court affirmed the KCC's argument in its petition for review that even if the federal Act requires states to implement cost-based universal service mechanisms, it does not require state universal service mechanisms to be cost-based as of a specific date. The KCC's argument, affirmed by the Supreme Court's decision, noted that: "The Federal Act and the FCC's implementation of that Act recognize that a transition to cost-based funding may be necessary to avoid the disruption that may result from an abrupt transition both for local exchange companies and their customers."

In other provisions of its decision, the Supreme Court concluded that:

- The KUSF assessment on wireless providers is not in conflict with the state statute exempting them from KCC jurisdiction, regulation, supervision, or control.
- If the KCC had made any changes to the KUSF, the KCC would have to restore telephone companies to the same financial position they would have enjoyed had the KCC orders regarding the KUSF never been remanded by the Court of Appeals. However, the KCC made no changes.
- In accordance with the Court of Appeals' finding, the KUSF is a surcharge and not a tax because it does not raise any revenues but only shifts money to the same parties; this surcharge makes explicit the subsidy (previously embedded in higher access rates) to local exchange carriers for deployment and maintenance of land lines.

- In accordance with the Court of Appeals' finding, the Legislature's delegation to the KCC to create, fund, and administer the KUSF is proper and did not violate the separation of powers doctrine.
- The KCC orders on competition do not violate the Kansas Act requiring KUSF contributions to be "equitable and nondiscriminatory" with respect to the local exchange carriers' authorized practice of using a set off procedure (paying the differential between the required assessment and the amount the carrier is expected to receive) to contribute to the KUSF. The Supreme Court contended that all providers are required to pay the same percentage of intrastate revenues to the KUSF and are not exempted from that requirement due to this accounting procedure.

Federal Universal Service Fund. According to information furnished by KCC staff, the existing Federal Universal Service Programs will be reconfigured. Under consideration are plans to phase down federal universal service funding support for the independent telephone companies starting in 2001 and totally discontinue support for United in 1999. The federal support for central office switching for small companies (DSM weighting) would likewise be phased down. The KCC estimates that there may be a decrease in support from over \$45 million in 1998 to potentially no support in 2003. The FCC has appointed a task force to develop the formula for another support mechanism to address 25 percent of the high cost areas of the state. The unknown issue at this juncture is the extent to which companies will receive support from a new federal universal service funding mechanism. However, the new federal USF will not replace any of the \$45 million of existing support, but will only be used to reduce interstate access rates. The KCC has joined other states to appeal this heavily contested portion of the FCC's order on universal service issued May 1997.

Separations. Since the same loop facilities and telephone company switches are used to provide services like local, intrastate, and interstate long distance services, a process known as Separations is used to allocate the investments and the expenses to the different jurisdictions (interstate long distance, state long distance, and state local). The FCC has opened a docket to look at the rules used in the Separations' process. Changes in the rules could have an impact on the recovery mechanisms of the local exchange carriers. For example, if the amount of cost allocated to the interstate long distance jurisdiction is reduced, the local exchange carrier would collect less from its interstate access rates. Any shift in costs because of changes in the Separations rules could place greater reliance on recovery from the state jurisdiction. This could cause local exchange carriers to petition the KCC to raise intrastate access rates or to increase KUSF funding. As previously noted, the Kansas Act allows additional funding from the KUSF to be requested for shortfalls due to changes in access revenue requirements resulting from changes in federal rules.

Policy Questions and Implications. The following policy questions and associated implications might be considered in any amendments to legislation contemplated for the KUSF.

What is the effect of capping or freezing the surcharge assessed customers at existing rates? This is the policy question central to H.B. 2802. Proponents argued that a freeze or cap will limit the anticipated increase in customers' surcharges for a specified number of years (in H.B. 2802, the freeze would have lasted two years). This freeze could give policymakers time to assess the KUSF and recommend modifications, if needed. Concerns raised about such a

freeze include upward pressures to fund certain investments required by the Kansas Act, such as enhanced universal services by July 1, 2001 and Internet access at 28.8 kilobits by July 1, 1999. In addition, changes in federal access requirements and universal service support, addressed above, could warrant additional distributions from the KUSF. These and other funding requirements might cause a significant increase in assessments after the freeze has expired. Conceivably, infrastructure reimbursements to rate of return companies could be partially supported by increases in intrastate access charges if KUSF surcharges are capped. However, long distance companies are likely to oppose such an increase. Furthermore, increases in intrastate access rates would be counter to the objective of the Kansas Act to bring intrastate access charges to parity with interstate access charges. Moreover, such increases could conflict with directives in the federal Act to make universal service support explicit and eliminate implicit support.

Should certain mandates governing disbursements from the Fund be eliminated as a means of curbing the size of the KUSF? One mandate that has received considerable attention is the use of the KUSF to reimburse eligible telephone companies for investments in enhanced services and Internet access capabilities. Proponents of eliminating those services from the definition of universal service contend that some of these services are costly, particularly deployment of ISDN and high-speed Internet access. Another contention is that outdated technology may be the basis for KUSF reimbursements to companies. One conferee who testified in support of H.B. 2082 cited as an example the possible deployment of Asymmetrical Digital Subscriber Line (ADSL), which could be considered superior to ISDN. That conferee raised the policy question as to whether technologies of limited duration should be made available through a subsidy mechanism.

Arguments against elimination of enhanced services from universal service protection contend that competition is not likely to occur outside of the metropolitan areas of the state. Without some type of universal support mechanism for the deployment of advanced technologies in rural Kansas, either local rates would have to increase to support such investments or the investments will not be made. If such investments are made in urban areas but not rural areas, the previously referenced policy objective articulated in the federal Act may not be realized:

Consumers in all regions of the nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

The magnitude of other funding requirements, such as changes in the funding requirements for access charges or local number portability, are presently subject to speculation but may affect demands on the KUSF.

Should financing of the KUSF be predicated upon the cost of providing universal service to Kansans? As previously discussed, this question is at the heart of litigation recently resolved by the Kansas Supreme Court. The Kansas Act provides that the KUSF finance revenue neutrality for local exchange carriers during rebalancing. The intent is to replace the revenue loss from reductions in intrastate access with revenues from the KUSF. Proponents of the revenue neutral funding concept currently in effect argue that this concept represents a shift

in funding and not additional funding. Proponents argue that investments that were formerly funded through an implicit mechanism, such as a component of access charges, are now funded through an explicit mechanism. Previously, companies used intrastate access revenues to a greater extent to finance their technological deployment. Without such funding, however, companies would either have to increase local rates, resort to an explicit funding mechanism, such as the KUSF, or not fund the deployment. Opponents argue that the revenue neutrality concept is flawed because that concept assumes, without any substantiation through cost studies,* that every dollar lost from the reduction in access charges equates to the loss of a dollar spent on high cost service. Consequently, the size of the KUSF has been determined by keeping local exchange carriers revenue neutral and not by the cost of providing universal service. Opponents argue that because of the prohibition against the KCC to perform audit reviews or earnings audits of incumbent local exchange carriers, revenue requirements to provide universal service cannot be determined.

Should the Legislature take any action? The KCC staff reported a balance of \$13 million at the end of the first year of assessments. Despite imposition of the KUSF surcharge, the assessment base has been expanding due to increased usage of the network. The KCC staff indicated the agency's intention to apply that balance to the second year of company assessments. Whether increasing intrastate revenues will offset other pressures on the KUSF is difficult to predict. To date, funding from the KUSF has been used primarily to offset reductions in intrastate access charges. No reimbursements have been made to date for enhanced services, high speed Internet access capabilities, or revenue losses resulting from changes in federal law. Arguably, there will not be extensive disbursements from the KUSF for those purposes for at least another year but there would undoubtedly be greater company investments in, and deployment of, enhanced services in another year.

* Incumbent local exchange carriers filed cost studies with the KCC but the revenue neutrality requirement in the Kansas Act precluded their use for establishing the size of the fund.