Approved: February 19, 1999
Date

MINUTES OF THE SENATE COMMERCE COMMITTEE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on February 18, 1999 in Room 123-S of the Capitol.

All members were present except:

Committee staff present:
Lynne Holt, Legislative Research Department
Bob Nugent, Revisor of Statutes
Betty Bomar, Committee Secretary

Conferees appearing before the committee:
Representative Jim Morrison
Shawn McKenzie, President, Southwestern Bell Telephone Company - - Kansas
Edward H. Hammond, President, Fort Hays State University

Others attending: See attached list

SB 54 - Access to television services

The Chair appointed a subcommittee of Senators Umbarger, Donovan, Barone and Gooch to consider and report back to the Committee their recommendations on **SB 54**.

SB 290 - Telecommunication universal service fund access

A copy of testimony from Michael Ensrud, Comp Tel-Kansas, was distributed to the Committee. (Attachment 1)

Representative Morrison testified on **SB 290** stating he strongly supports the section of the bill that amends the definition of "enhanced universal service", and the section of the bill that creates "parity" in access and cost between urban and rural areas of the state. Representative Morrison stated he is not in favor of the balance of the bill which returns the telecommunication system to a "rate of return" regulatory system. (Attachment 2)

Shawn McKenzie, President, Southwestern Bell Telephone Company(SWBT) - Kansas, testified in opposition to **SB 290**, stating the legislation is a return to rate of return regulation. SWBT shares the concern about the size of the KUSF, which is presently about $100 million; however, this is a result of the 1996 Act requirement that access rates be reduced. SWBT's draw from the Fund is about $65 million because the Kansas Corporation Commission (KCC) has completed its initial three-year access rate reduction study early, and the KUSF is sufficient to compensate SWBT for its universal service subsidy support of revenues lost through access and toll rate changes. Prior to the 1996 Act, access and toll charges were the principal source of the implicit subsidy necessary to provide universal local service throughout the state. (Attachment 3)

After the 1996 Act, SWBT, Sprint/United and the KCC staff recommended the KCC remove the implicit subsidies by rebalancing the access rate reduction to local rates over a period of three years. The proposal submitted would have increased local rates by a total of $4.50/mo incrementally added over three years, with a resultant KUSF balance of about $25 million. This is a lower amount than the projected KUSF under **SB 290** of $33 million. The KCC Commissioners decided, however, that the KUSF alone would be used to handle the subsidy issue. Consequently, as a result of that decision, the KUSF has become larger in comparison

CONTINUATION SHEET

with universal service funds of other states.

In order to reduce the size of the KUSF, **SB 290** removes the revenue neutrality from the Act. The proposal eliminates the historic subsidy revenue SWBT lost as a result of legislatively mandated reductions in access and toll charges, and requires SWBT to prove that it is entitled to recover the subsidy. The KCC, based on data, concluded that SWBT's statewide cost of service was $34.50 pr line per month, and the KUSF subsidy received was approved as reasonable.

SB 290, now proposes a different standard for support - $36.88 per line/per year, a figure developed from independent phone company data. The KCC determined that the $36.88 was the remaining amount of support needed after all the federal support was obtained for the independent companies. SWBT receives no FCC support, and, as the KCC found in the same order, SWBT's costs are $34.50 per line per month. The $36.88 is neither company nor state specific, but the $34.50 per line per month number is a perfect number as it is Kansas specific and SWBT specific. Mr. McKenzie also stated the $36.88 is not "need" based, but is a "cost" based number.

Mr. McKenzie believes **SB 290** is unrealistic and unfair and undermines the intricate design of compromises and concessions that allowed the legislature and the industry to move forward toward regulatory reform. The concepts of revenue neutrality, price-cap regulation, and freedom from earnings audits were established because SWBT and other were willing to agree to significant new investments and reductions in access fees. SWBT has kept the commitments it made in formulating policy and finds it unfair to now have this attempt at reversing the commitments by only one side of the parties. The premise upon which **SB 290** is based is even more complexing as it would return SWBT to regulation when deregulation is being embraced across the country. The bill takes approximately $57.2 million from SWBT and $10.5 million from another company, and tells them that in order to get the money back it is necessary to submit their companies to an unlimited inquiry into their books and business practices. The legislation provides no limits on the power of the KCC to investigate and no limits on a time by which they must rule on a petition to return revenue. **SB 290** requires yearly access reductions to bring intrastate rates into parity with interstate rates, and requires SWBT to provide rate based, rate of return and earnings documentation to recover lost revenue. The legislation removes any incentive to invest in the residential and rural markets by putting regulatory barriers in the way of those willing to risk their capital in competing in such markets.

SWBT presently shoulders a pervasive regulatory burden not shared by most of its competitors; it is the carrier of last resort, its prices are regulated under price caps, it cannot provide interLATA long distance, the investigations undertaken by the KCC have cost them significantly in both time and money, necessitating over 17,000 pages of evidence in the cost of local service docket. Yet SWBT must provide broad-based access to internet at $15 per month, provide schools and libraries broad band service at cost, justify that all of its rates are above cost, must resell services at a 21% discount and open their local markets to competition.

SB 290 does not only adjust the size of the KUSF which is designed to lower the assessment, it fundamentally changes the state's telecommunications policy. Kansas is proving that less regulation leads to competition which gives people a choice and serves as an incentive for better service, more products and more innovation, at lower prices. Now is not the time to renege on the promise made by the Telecommunications Act of 1996.

Mr. McKenzie stated that as a result of deregulation of the telephone industry, there has been a 50% reduction in intraLATA toll rates, a decrease in toll and access charges of over $73 million in the last two years, an investment by SWBT to its infrastructure of more than $817 million in the last four years (fiber optic connections between central office and replaced analog switches with digital switches, eliminated party lines and made option services available, enabled two-way interactive video for schools and universities, and offered broadband services to all customers with discounts for schools, libraries, hospitals and state and local governments.) SWBT has lost over 70,000 customers to competitors. The KCC has approved 77 companies to offer local service in competition and SWBT has signed interconnection agreements with 68.

The policies SWBT has established were based on the belief that the marketplace is the best place for allocating services, setting prices and protecting consumers. Kansas is proving that less regulation leads to competition and competition gives people a choice and serves as an incentive for better service, more products, more innovation and, eventually, lower prices. Now is not the time to return to a type of rate of return regulation we have been emerging from.

Dr. Edward H. Hammond, President, Fort Hays State University, testified in opposition to the definition of "enhanced universal service" as defined in **SB 290**, stating there needs to be time specific provisions to ensure that all areas of the state receive the latest technology available. Without the time specific requirements and standards established in the 1996 Act, there will not be the level of service to provide health care and educational services. Dr. Hammond specifically requested the definition not be changed this year in order that the deployment be completed. (Attachment 4)

Upon motion by Senator Ranson, seconded by Senator Brownlee, the Minutes of the February 17, 1999 Meeting were unanimously approved.

The meeting adjourned at 9:00 a.m.

The next meeting is scheduled for February 19, 1999.

SENATE COMMERCE COMMITTEE GUEST LIST

DATE: February 18, 1999

NAME	REPRESENTING
Brady Cantrell	CURB
Anne Wickliffe	KCC
Mike Reecht	AT&T
Charlie Cleek	SWBT
Bill Roche	Sprint
RICHARD LAWSON	Sprint
STEPHEN MINNIS	Sprint
JAMES M CAPLINGER	SIA
Virginia Stau	Federico Consulting
Bob Cowdrey	Sprint
Mark Harper	Sprint
Debbie Snow	CWA
Beth Canuteson	Sprint PCS
Dave Dittemore	KCC
Cindi Ferguson	CWA/SWBT
Mary Peters	Sprint
PATRICE SCOTT	SPRINT
Roger Franzke	KGC
John Federico	Ks Cable Telecom Assoc

Sharon Harris CWA-6327-SBC

SENATE COMMERCE COMMITTEE GUEST LIST

DATE: 2/18/99

NAME	REPRESENTING
Ann Durning-R. Hinson	KASB
Michael J. Emerson	CompTel Kansas/CGI
Mike Murray	Sprint
JIM TACKETT	SWBELL
Paul Snider	SWBT
SHAWN McKENZIE	"
Mike Moffet	SWBT
Jerry Lammers	KCC
MIKE LURA	CURB
BOB FCHAPPAN	AT+T
Ross Miller	KCC
Bob Zender	Intern.
GREG MANN	Gorham, Gold, Greenwich & Associates
DENNY KOCH	SWB
James M. Caplinger Jr	CAPLINGER CHARTERED
MARK CAPLINGER	SITA
George Barbee	RTMC
John D. Pinegar	SITA
Roger Baker	KCPR

CompTel-Kansas

Competitive Telecommunications
Kansas Association

Before the Senate Commerce Committee
Comments by Michael Ensrud
On Behalf CompTel Kansas
February 18, 1999
Senate Bill No. 290

CompTel Kansas supports SB # 290 for many of the same reasons expressed by AT&T. It is our understanding that no other state has an assessment rate of the magnitude that exists in Kansas. Our customers complain vociferously about the magnitude of the KUSF rate.

No CompTel member has yet to draw from the fund. We offer service, today, without benefit of any subsidy.

There are a few points that I would like to offer about the nature of regulation, in general, and how SB #290 fits into the scheme of regulation.

- There are basically two types of regulation prevalent today – "cost-based" versus "price-cap".

- In "cost-based" regulation, the major premise is that the underlying financial condition of the entity being regulated, should be the determining factor as to whether that entity is entitled to price increases or price reductions.

- In "price-cap" regulation, the major premise is that the underlying financial conditions of any particular entity do not matter. It presumes that there is some surrogate that can be used to determine the "appropriate" price for services rendered. Results derived by the use of indexes, formulas, models or national averages are "close enough" to supplant actual, company-specific financial information. It is only a slight exaggeration to assert that when an entity picks "price-cap" regulation, that entity is saying, "my specific costs don't matter".

- SB # 290 is totally consistent with the theory of "price-cap" regulation. As described in the testimony of Ms. Wickliffe, the $36.88 monthly "draw" was derived from federal universal service calculations. SB #290 merely uses a national figure to supplant a company-specific figure. Such a substitution is totally in character with the general precepts of "price-cap" regulation.

- Further, SB #290 also offers an "escape hatch" in that it allows an entity that voluntarily chooses "price-cap" regulation, to justify a figure higher than the compensation produced by the national average. In oth[illegible] benefits by the use of a company-specific, cost-based m[illegible] entity is free to pursue additional compensation via this

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Attachment # 1-1 thru 1-2

methodology. Therefore, I would characterize SB # 290 as actually allowing a company to draw the higher of either the figure produced by "price-cap" regulation, or by "cost-based" regulation. In this aspect, SB #290 could be characterized as more lenient than traditional "price-cap" regulation.

- SB #290 merely changes the surrogate from an "old" revenue neutral figure, to the current national average. It is not a return to "cost-based" regulation, although it does give the regulated entity that option. At its heart, SB #290 remains a form of "price cap" regulation.

- To may knowledge, there is no evidence that the use of a "current" national cost figure is in any way, inferior to the use of an "old" revenue neutral figure. Kansas may be a "high cost" state compared to the national average. On the other hand, there have been massive technical advancements in our industry. Since divestiture (breakup of AT&T and the RBOCs) the volume of traffic being generated overall has skyrocketed. If the "revenue neutrality" figures were developed in the mid-1980s, use of "old" figures would result in a per-minute network "cost" that is far greater than would be case today. In other words, "old" revenue neutral rates, when applied to today's volume of traffic and use of "today's" underlying costs are likely to be far more profitable than they were in the mid-1980s.

- There is probably some variation between both surrogates and "true" underlying cost. The problem of variance between company-specific "costs" and a surrogate figure is inherent in "price-cap" regulation. If such a variance is unacceptable, then "cost-based" regulation is the solution. I assume this body wants to stay with "price cap" regulation.

- Based upon this assumption, I would support SB #290 in that it substitutes a "current" national "cost" figure as the most appropriate surrogate. The use of such a figure is more likely to be reflective of current "underlying" costs. I believe it to be more representative than is the use of "revenue neutral" figures derived from underlying costs out of the mid-1980s.

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HOUSE OF REPRESENTATIVES

STATE CAPITOL
TOPEKA, KANSAS 66612-1504
COMMITTEE ASSIGNMENTS
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JOINT COMMITTEE ON INFORMATION TECHNOLOGY
Chairman:
SELECT COMMITTEE ON INFORMATION MANAGEMENT
Member:
HEALTH & HUMAN SERVICES
Member:
EDUCATION

February 17, 1999

Testimony for Senate Commerce Committee

Good morning. Thank you for the opportunity to let you know my views on SB 290. Please understand that I appear on my own and not representing the views of the JCIT or the House SCIM. I am a listed **proponent** of the bill and I strongly support that section of the bill that defines "enhanced universal Service"

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Enhanced universal service" means ~~telecommunications services, in addition to those included in universal service, which shall include: Signaling system seven capability, with CLASS service 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 accredited pursuant to K.S.A. 72-1101 *et seq.*, and amendments thereto; hospitals as defined in K.S.A. 65-425, and amendments thereto; public libraries; and state and local government facilities which request broadband services,~~ *without regard to any transmission, media or technology, high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics and video telecommunications using any technology.*

AND that section of the bill that creates "parity" in access and cost between urban and rural areas of the state for telecommunications.

Further: (Page 7)

The commission shall establish rules and regulations by June 30, 2000, to address access to enhanced telecommunications and information services that are rea- ***sonably comparable between urban and rural areas throughout the state.*** *Such rules shall establish a method by which telecommunications services providers may request supplemental funding for enhanced universal services. Those local exchange carriers that have deployed enhanced universal*

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service will be eligible for reimbursement from the KUSF pending verification of the expenditure, the timing of the expenditure and the associated costs.

Page 8 really moves telecommunications back and may not be in compliance with the Federal Act of 1996 (Then again maybe it is). It still looks to me like rate regulation and that is not good.

Subsequent reductions in intrastate access rates may be ordered by the commission in order to maintain parity with interstate access rates. The commission is authorized to rebalance local residential and business service rates to offset the *initial three-year phase in of the* intrastate access and toll charge reductions *and to offset any subsequent intrastate access and toll charge reductions, to the extent justified, based on a cost of service investigation*

Unfortunately the rest of the bill and the bills you heard last week (SB 84, 85 and 86) need to be eliminated. The above two parts are the only portion of the four bills that I can support. The rest simply returns us to rate regulation and overregulation by the KCC.

Actually it is my opinion that we really should leave alone the Federal Act of 1996 and the changes we made at that time. I recognize that the USF is getting a great deal of money in it but then I do not see the competition, deployment of technologies or any of the things which were promised to us in the past. Citizens are unhappy and need to understand that the bells do not, in my opinion, seem to be playing fairly with the fund or their customers. I do NOT support removing SW Bell from the fund or anyone else for that matter. Please, just leave things alone even though representatives of CURB may want us to change the law it is too soon to do so.

If you have any questions I will do my best to answer them.

Sincerely,

Jim Morrison

Jim Morrison

Testimony of Shawn McKenzie, President
Southwestern Bell Telephone Company--Kansas
Regarding SB290
Commerce Committee
Kansas State Senate
Thursday, February 18, 1999

Over the last ten years, the telecommunications industry, the Legislature, the governor's office, the KCC and others have labored mightily to usher in a new approach to telecommunications policy. And, for the most part, that hard work has paid off. In particular, I would point to the actions the legislature took over the last five years to advance regulatory reform, culminating in the enactment and implementation of HB 2728--the keystone of the progress we've made.

The main goals of TeleKansas I, II and the '96 Act were to promote the statewide availability of basic and enhanced telecom services, and establish the conditions for a speedy transition to competition and to lower long distance rates. And I think it's fair to say that these main goals have been met: long-distance rates are lower, companies have invested (and continue to invest) in infrastructure upgrades and competition is growing. All this has been accomplished with no increase in Southwestern Bell's basic local rates since 1984. (See Attachment A for more detail on these accomplishments.)

It is fair to say that SB290 would alter that progress and, at least for Southwestern Bell, return it to more regulatory oversight than has existed for a decade. Southwestern Bell opposes this radical change in course and SB290.

I too am concerned about the current size of the KUSF. Unfortunately, the KUSF has come to be a target for everyone to attack. Some try to make it into an urban vs. rural issue. Others suggest that it is providing an unwarranted source of revenue to rich incumbent phone companies. But both suggestions are wrong and ignore history. For SWBT both rural and urban residential service is provided below statewide average cost. (See docket 190.492-U referred to in SB 290)

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There's about $100 million in the fund now. This is the direct result of the telecom act requirement to reduce access rates. Of that amount, SWBT now draws about $65 million, because the KCC has now completed early the initial three-year access rate reductions under the Telecom Act. The KUSF balance is now sufficient to compensate SWBT for the Universal service subsidy support revenue lost through these access and toll rate changes. Before 1996, access and toll charges were a principal source of the implicit subsidy necessary to provide universal local service throughout the state. Now the subsidy is explicit and comes from the KUSF. (The KUSF also supports KRSI [service for hearing impaired], TAP [equipment for the disabled] and Lifeline [phone service for the poor]). The amount carriers contribute to the KUSF is determined and assessed at an equal percentage of their intrastate retail revenues.

After the 1996 Kansas Act was passed, SW Bell, Sprint/United and the KCC staff recommended to the KCC that the best way to remove the implicit subsidies was by rebalancing the access rate reductions to local rates over three years. In order to bring rates into line with the cost of actually providing the service, rates for local service would have increased as decreases in toll and access charges mandated by the Legislature were implemented. The proposal we submitted (which followed the TSPC approach recommended to the Legislature) would have increased local rates by a total of $4.50/mo. incrementally added over three years. If this approach had been followed, the KUSF balance would have been about $25 million. (This is even lower than the projected KUSF under SB290 of $33 million.) But the KCC—the Commissioners themselves—decided that the KUSF alone would be used to handle the subsidy issue. As a result of this KCC decision, the size of the KUSF has become larger in comparison with universal service funds of other states.

Now some seem to be suggesting that the proper way to solve "the problem" of the size of the fund is to simply remove "revenue neutrality" from the act. Indeed, this was the tack taken by the KCC staff in their testimony Tuesday. The SB290 proposal would simply eliminate the historic subsidy revenue Southwestern Bell lost as a result of legislatively mandated reductions in access and toll charges, and require the company to "prove" that it was entitled to recover it.

SB290 appears to be based on a false premise. From the presentations Tuesday, it appears that some seem to believe that the reason the KUSF is at a $100 million balance today is only because the KCC was forced to blindly apply the "revenue neutral" provision of the 1996 Telecom Act. But in fact the commission made findings of fact and reviewed financial data and cost data as part of the initial KUSF undertakings in Docket 190.492-U. Indeed this suggestion that there was "no cost support" for the KCC decisions has been raised before. CURB and others argued in the Phase II proceedings that there was no cost basis for the "revenue neutral" access reductions mandated by the 1996 Act. The KCC, KCC staff and SWBT countered those arguments with facts: with cost studies and financial data. Based upon this data, the KCC concluded that SWBT local service rates were at least $7 below the cost of service and that the statewide cost of service for SWBT was $34.50 per line per month. And the KUSF subsidy was therefore approved as reasonable. On appeal to the Supreme Court, and in the face of challenges from CURB, the KCC argued that there was ample, substantial and competent cost support that justified the current KUSF payments to SWBT and that it met all federal requirements. And the Kansas Supreme Court unanimously upheld all aspects of the KCC proceedings last March. So there is a "cost justification" for the current KUSF support for SWBT.

Given this history, I am at a loss to understand why SB290 now proposes a completely different standard for support --$36.88 per line/per year. The $36.88 figure was specifically developed from independent phone company data, based upon their costs and the corresponding FCC support they receive in Kansas. And it may well be correct for those companies, but it is not based on SWBT data. The KCC confirmed that the $36.88 was the remaining--not the total--amount of support needed after all the federal support was obtained for these independent companies. SWBT receives no such FCC support and, as the KCC found in the very same order that SWBT's costs are $34.50 per line, per month. I am not at all sure why SB290 imputes to SWBT an independent phone company cost basis particularly when, at the same time, it does not impute the corresponding FCC cost recovery source. Indeed, KCC staff admitted in their testimony on Tuesday that $36.88 is "not a perfect number" because it is neither company nor state specific. But the $34.50 per line per month number is a perfect number, by that definition, because it is Kansas specific and SWBT specific.

I also bring to your attention that witnesses argued that it was appropriate that SB 290 would require SWBT to prove a "need" for a KUSF distribution. I emphasize their use of the word "need" because it is a euphemism for an earnings review. But you need to understand that $36.88 is not "need" based--it is a straight forward cost based number, exactly like SWBT's $34.50 per line per month cost basis.

I believe that SB290 is unrealistic and unfair. The changes contemplated by SB 290 would undermine the intricate design of compromises and concessions that allowed the Legislature and the industry to move forward toward regulatory reform. The telecommunications policies that now govern our business were, like all public policy, built on an intricate foundation of compromises, negotiations, and give-and-take.

The concepts of revenue neutrality, price-cap regulation, and freedom from earnings audits were established in the law because our company and others were willing to agree to such things as significant new investments and reductions in access fees. We have kept the commitments that we made in the process of formulating that policy and it would be manifestly unfair now to set about reversing only one side of those agreements.

SB290 is not a simple "tweaking" of the legislative framework that this committee labored so hard to construct three years ago. It is, as I noted earlier, a radical change in direction --180-degrees--in the course we've been taking. This is bad for my company, yes, but more importantly it is bad for Kansas.

In addition to these problems with the premise upon which this bill appears to be based, there is an even more fundamental problem. In an era when deregulation is being embraced across the country, a trend that the 1996 Legislature helped to lead, SB290 would return us to a highly regulated environment.. It takes at least $57.2 million from my company, $10.5 from another, and tells us that to get the money back we must submit ourselves to an unlimited inquiry into our books and business practices. There are no limits on the power of the commission to investigate, including no time limit by which they would have to rule on our petition to return our revenue. And that is only the first bite of the apple. The bill also requires further yearly access reductions to bring intrastate rates into parity with interstate rates, and puts us in the same regulatory morass each time to recover the lost revenue. It essentially singles out two companies and returns them to rate-of return regulation. For example:

- SB290 gives the KCC the power to conduct rate base, rate of return and earnings regulation on carriers that have elected to be price cap companies. (Page 7, lines 17, 18, and 19).
- It gives the KCC the power to annually investigate and adjust rates (page 9, lines 37-41) using the broadest possible grant of investigative authority (Page 11, lines 41-43).

A return to such pervasive and burdensome regulation would surely stifle competition. Investors will not put their capital in a state where the regulatory climate is so uncertain. Furthermore, by requiring a highly regulatory approach to recovering revenues for high-cost service, SB290 removes any incentive whatsoever to invest in the residential and rural markets by putting regulatory barriers in the way of those willing to risk their capital in competing in such markets.

For my company, the new regulatory burdens proposed in this legislation would be imposed at a time when Southwestern Bell is facing increased competition from unregulated competitors. Southwestern Bell has lost over 70,000 customers in Kansas to its competition. That's better than a 100 percent increase in one year's time. Over 70 companies have been approved by the KCC to compete against us in Kansas. The papers are full of ads and stories about new competitors--both facilities based, such as KMC Telecom in Topeka and resellers like Feist. And, I would note, both of these companies, like AT&T or wireless carriers, are not similarly regulated by the KCC. And competition is not just an urban phenomenon, established competitors are moving in to smaller communities. These examples are to say nothing about the competition from cable providers, the Internet and wireless providers that is on the horizon and being written about every day.

And please remember, even absent new regulation as proposed in SB 290, Southwestern Bell continues to shoulder a pervasive regulatory burden not shared by many of our competitors:

- We are the carrier of last resort--we must provide service to all who request it.

- Prices continue to be regulated, under price caps.
- We cannot provide interLATA long distance.
- The investigations the KCC has undertaken pursuant to current law impose significant costs in both time and money. For example, in the cost of local service docket we have produced over 17,000 pages of evidence and are continuing to provide more information as it is requested.
- We must provide broad-based access to internet at $15 per month.
- We must provide schools and libraries broad band service at cost.
- We must justify that all of our rates are above cost.
- We must resell our services at a 21 percent discount.
- We must open our local markets to competition.

Finally, I believe the bill has consequences that may have been unintended by its sponsors. Certainly there are provisions that have received little critical examination. For example:

- Changes in the universal service definition would remove the current requirement that carriers eligible for KUSF support provide equal access to long distance services (Page 2 line 39). This would make wireless carriers eligible to draw on the fund, thereby creating upward pressure on the fund. (Ironically, with this change no carrier is being forced to provide equal access except SWBT. Those who compete with us need not provide it. Why would this inequity be appropriate?)
- In the changes to KSA 66-2002, the bill would remove quality of service standards that the '96 Legislature put in HB2728 to emphasize to the KCC it should consider the quality of telephone service in establishing rates.
- The bill removes the "one-plus" presubscription timing provision.
- It changes the mechanics of the price cap formula.
- The bill changes the method of handling exogenous costs.

In summary, I think the concerns with SB290 that I have pointed out demonstrate that this bill is not just a simple adjustment to the size of the KUSF designed to lower the assessment. It would do that, but it would do much, much more. It works a fundamental change in the state's telecommunications policy.

At the outset of this testimony, I alluded to the many benefits Kansans have experienced as a result of the changes in telecommunications policy that this committee, the Legislature and the industry have forged. Those successes were not built over night. The road we've been travelling down began 10 years ago with TeleKansas I, which evolved into TeleKansas II. That progress was enhanced by the work of the Telecommunications Strategic Planning Committee that led to HB2728. And that bill was heard, debated and evaluated for months, passed with overwhelming support in the Legislature and then was tested and upheld in the Courts. This proposal would overturn all of that work and, if this committee reports this bill in the next few days, do so after only cursory deliberation.

The policies we have put into place together are based on a fundamental belief--that the marketplace is the best place for allocating services, setting prices and protecting consumers. And I believe that we in Kansas are proving that less regulation leads to competition, and that competition gives people a choice and serves as an incentive for better service, more products, more innovation and, in the long run, lower prices. Surely, now is not the time to turn back the clock on that promise.

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Attachment A

As a result of our move together to reduce regulation of the telephone industry, Kansans have received:

- **Quick reductions in long distance charges.** Since going to alternative regulation, Intra-LATA toll rates have been reduced by nearly 50 percent. In just the last two years ('97 and '98) Southwestern Bell has decreased toll and access charges by over $73 million

- **Wider availability of enhanced service due to infrastructure investment**. Southwestern Bell has, over the last several years, invested more than $200 million over and above our normal capital expenditures. (Normal capital expenditures amounted to $617 million in the last four years). We've completed fiber optic connections between our central offices and replaced analog switches with digital switches. These and other enhancements have eliminated party lines and made optional services like caller ID widely available. We've also invested to enable two-way interactive video for schools and universities and to offer broadband services to virtually all of our customers with discounts for schools, libraries, hospitals and state and local governments

- **More choice through entry of competitors into the market.** Southwestern Bell has lost over 70,000 customers to competitors (a number that has increased 100 percent in the last year). And competition has not been limited to the largest markets. We're losing customers in small towns and big cities. The KCC has approved 77 companies to offer local service in competition with us and we've signed interconnection agreements with 68. Customers in most cities need only to look in the front of their phone books to realize phone competition is alive and growing every day in Kansas. In terms of competition, Kansas is further along than most states in the nation, certainly ahead of our neighbors

Attachment B

Parts of SB 290 we do not oppose.

Pg. 1/In 42 etc.

Pg. 2/In 41 etc.

Pg. 3/In 32 etc.

Pg. 3/In 36 etc.

Pg. 4/In 4 etc.

Pg. 4/In 28 etc. (although we would prefer that it be left with KCC)

Pg. 5/In 7 etc.

Pg. 6/In 5 etc.

Pg. 7/In 14 etc.

Pg. 7/In 25 etc.

Pg. 7/In 31 etc.

Pg. 13/In 6 & 11

Pg. 14/In 5

Pg. 15/In 4 etc.

SWBT RESPONSE TO SENATE COMMERCE FOLLOW UP QUESTIONS TO STAFF.

Re: SB 290 2/17/99

Q1. Whose role is it to define what type of "cost study?" The Legislature or KCC?
A1. It should be the KCC based on guidance from the Legislature since the Legislature is the principal source for utility policy. The Legislature has identified cost study methods in the Legislative references for TeleKansas I (K.S.A. 66-1,197) and in HB 2728 when it required long run incremental cost floors for price cap companies. K.S.A. 66-2005(b)(1). In SB 290 the Legislature has given additional guidance by its reference to the study methods that supported the KCC decision ($36.88) in the Phase II Order of Dkt. 190,492-U. For continued universal service preservation, the study should be at least sufficient to confirm continued ability to recover the costs already expended in providing universal service, as was determined in Dkt. 190,492-U. This type of study would be different than studies for pricing decisions which are affected by long run principals.

Q2. Has the KCC ever required certain technology or service improvement by certain time frames in the past?
A2. SWBT believes this answer is yes. The KCC has required certain physical upgrades in the past for things such as 4 party/1 party service, switch upgrades to digital. TeleKansas I and II have also involved certain deadlines for technology changes.

Q3. Can SB 290 include instead certain deadlines for completion of KUSF local cost review studies?
A3. Yes. K.S.A. 66-117 has a time limit for the KCC to complete its review of rate cases at 240 days after submission. Other time limits are found in K.S.A. 66-1,197(a) and also in the current act, such as the "21" day rule for KCC review of price cap changes (e.g. K.S.A. 66-2005(n)). It is not unusual for the Legislature to direct that the KCC act within certain time limits.

Q4. Are cost studies different from "audits?"
A4. Yes. Cost studies are a different discipline than audits – the latter generally an accounting type undertaking pursuant to certain the CPA accounting standard board's audit guidelines. Audits – for public utility regulation -- are typically associated with rate base earnings examinations which validate the books and records of historical operations of the firm. Cost studies are more narrowly focused and, due to accounting limitations, the identification of cost for the particular undertaking is often subject to some estimation or reasonable allocation techniques. Audits, on the other hand, will normally include full revenue, investment and expense reviews, from which an overall achieved return on investment can be calculated. Cost studies will normally have to impute a return component and assign a uniform expense and investment component. Both type of undertakings are difficult and require certain skills, but the objectives of each are different. An audit of SWBT's earnings is not an essential component of the

examination of the SWBT cost of local service in different exchanges or wire centers for KUSF purposes.

Q5. What part of the KUSF is for high cost areas? What part "revenue neutral?"
A5. First, "high cost" is a subset of universal cost. The initial universal service KUSF allocations were directly the result of the reduction in access rates which implicitly funded universal service historically. As K.S.A. 66-2008(a) states, the "initial amount" of the KUSF is the "revenues lost" as a result of access rate reductions. Only an estimate of what part of the universal service requirements in the KUSF is related to "high cost" needs can be given at this point since the KCC has not yet finally resolved and defined the high cost areas or finished its review of the FCC's universal service funding criteria for potential application in Kansas. In the past, the federal fund was limited to certain high cost "study areas" which in Kansas essentially was limited to all but SWBT. Since SWBT had metropolitan exchanges and long distance toll services, it was allowed (or directed by the KCC) to internally manage its universal service requirements by internal subsidies rather than explicit federal subsidies. For SWBT, universal service is indeed "universal" throughout all its exchanges and data in Dkt. 190,492-U indicates that all exchanges are priced below cost of service requiring universal service support. With the elimination of implicit subsidy from access, that support source is now in the KUSF. The KCC has used 10,000 lines and below in Dkt. 190,492-U as a estimate for "high cost" support – which, under FCC parlance, is the additional support beyond what is already provided from other FCC sources. From Phase II, this amounts to currently about $45 million for these exchanges (perhaps slightly less, perhaps slightly more.)

TESTIMONY TO THE SENATE COMMERCE COMMITTEE

Presented by Edward H. Hammond, President, Fort Hays State University

February 17, 1999

Madame Chairperson and Members of the Committee:

I am not here to testify about the debate over which telecommunications company will make millions of dollars of profit. I am here to testify about what, I believe, is in the best interest of the citizens of Kansas and in the state's future economic development. In 1996, Kansas passed one of the most forward looking state telecommunications acts in the United States. The act established three general levels of universal service: 1) lifeline services, 2) "universal service" access for individual users, and 3) "enhanced universal service" which assured a base level of services would be available in every community in Kansas. The Act defined "enhanced universal service" as:

> telecommunications services, in addition to those included in universal service, which shall include: Signal system seven capability, with CLASS service 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 accredited pursuant to K.S.A. 72-1101 *et seq.*, and amendments thereto; hospitals defined in K.S.A. 65-425, and amendments thereto; public libraries; and state and local government facilities which request broadband services.

Three years after the passage of this act, we see attempts by some portions of the telecommunications industry to substantially water down Kansas's enhanced universal service. There are three reasons articulated for lowering Kansas's standard: first, ISDN (Integrated Services

Senate Commerce Committee

Date: 2-18-99

Attachment # 4-1 thru 4-8

Digital Network) is an old technology and it should not be required when it will likely be outdated by better technologies; secondly, the current standard requiring fiber between central offices and broadband offerings to schools is too costly; and thirdly, many small communities will never have anyone who will require broadband services, therefore installing such services is wasteful and needlessly places costs on other telephone users. I would like to address each of these arguments.

At the time of the 1996 Act, ISDN was one of the better digital techniques for transmitting video and data over copper lines. Today, it is the standard that is being used in two-way desktop video conferencing throughout the Kansas Regents System's Telenet 2 system and for a number of other uses. It is also the method that many Internet subscribers who need speeds faster than local dial-up access are using. ISDN is not a terribly fast or cost effective way of accessing the Internet, but in many areas of Kansas, this is the only means of obtaining speeds faster than 58.8 kbps and in some areas, this is the only option for obtaining speeds of more than 14.4 kbps. In effect, if ISDN or "technological equivalent," is not available, there are whole classes of businesses that cannot operate in rural areas. Currently, the cost of ISDN in some areas of Rural Kansas is more than three times the competitive rate offered in the Johnson County area.

The 1996 Kansas Act does not require the deployment of ISDN. If a telephone company believes that this is an outdated or soon to be obsolete technology, it can install a "technological equivalent." Some independent companies in Kansas are currently offering xDSL options that give customers substantially greater speeds and better technological service than that offered by ISDN (I have attached a summary of xDSL options for your information).

If we look back historically at Kansas telecommunications regulation, we remember that Southwestern Bell initiated TeleKansas and sought to have the Kansas Corporation Commission freeze the company's rates in return for the company's investment in the state's infrastructure. Southwestern Bell sought to extend the freeze on rates under its TeleKansas II proposal and committed to making an investment of $64 million in the state's infrastructure above its normal investments of $74 million. This investment was to be over a five year period running from 1994-1999. In 1994-95 era, Southwestern Bell sought first the KCC's and then the Legislature's authorization to move to a permanent price based regulatory status and to permanently leave rate of return regulation behind. The Legislature established the Kansas Telecommunications Strategic Planning Committee (TSPC) which met in 1994-95. During the TSPC process, Southwestern Bell made it clear that if it were "freed" from rate of return regulation, it would be able to invest substantial funding in Kansas, provide a high level of telecommunications service and provide services for a lesser cost. During the 1996 Legislative Session, this was the message delivered by Southwestern Bell. The level of Enhanced Universal Service was a negotiated level reached through compromise and with the support of the local service provider coalition and grassroots players. Many organizations such as educational institutions, cities, and counties supported the 1996 Act because it would give local service providers such as Southwestern Bell the regulatory structure that the company sought and in return, the local service providers would create the telecommunications infrastructure that Kansas needs.

The 1996 compromise was a very good one for all parties involved. Southwestern Bell through application of technology and redeployment of staff has been able to invest in the state while keeping costs stable. Independent companies serving rural areas benefitted substantially from the state universal service fund. Finally and perhaps most importantly, Kansas consumers across the state benefitted: Kansas for the first time had a standard for service. Urban and suburban local service rates were generally frozen and rate rebalancing reduced long-distance access fees. Rural areas were guaranteed that they would not be excluded from the information economy and that modern health care, education, and governmental services could be provided using telecommunications.

Today, many of the Kansas independent telephone companies have already invested and installed the Enhanced Universal Service level required in the Act. To retreat from this level will be a breach of faith with these companies. The Enhanced Universal Service requirements in Southwestern Bell's service area should not be financed from the Kansas Universal Service Fund (KUSF) because Southwestern Bell assured Kansas that it could fund these infrastructure investments if released from rate of return regulation. To retreat from the 1996 promises will be a breach of faith with the Kansas people.

If Southwestern Bell is not drawing from the KUSF to fund Enhanced Universal Service, the fund's amount is not forced to grow to politically untenable levels. The argument that Enhanced Universal Service is not politically feasible in Kansas is based upon the premise that the fund would pay for Southwestern Bell's investment. To fund Southwestern Bell in this manner would in effect charge customer's twice – once for the telecommunications prices that currently exist because prices are currently NOT required to drop as they would under rate of return regulation; and secondly through the USF charge levied on customers.

I testified in 1996 that the Act should require fiber to every county seat because of the possibility of more than one lightly populated county (e.g. Scott and Logan Counties) eventually being serviced by a single central office. The Kansas Senate Commerce Committee was assured by Southwestern Bell and other local service provider representatives that this was not necessary. The companies stated that they would certainly want to have fiber to at least the county seat of every county and that this was not a controversial issue. Now, some representatives of both local service providers and Interlata providers are commenting that "there are a lot of little communities out there who will never need fiber or this capacity." It is important to note that Southwestern Bell spokespersons have stated that their company already has fiber interconnectivity between nearly all central switches. Most independent companies also state that they have this in place. The gaps are in some of Southwestern Bell's smallest communities and in Sprint's service area. If we stop now, we write-off these areas for a number of types of businesses, health care, and educational services. Fiber prices continue to drop and we should not have to turn to the Universal Service fund. This investment should be a basic cost of operation for all companies.

The argument that the 1996 Kansas Act requires telecommunications companies to provide broadband services "where they will never be needed" does not hold water. The Act does require that such services will be provided to schools – and a great many schools are using interactive video television and the Internet as teaching tools. The Federal funding of the E-Rate will allow many more schools to afford such services. Over time, very few schools will operate without broadband services if such services are available and affordable.

The 1996 Kansas Act also requires broadband services to all hospitals. Telemedicine is continuing to gain acceptance. Small hospitals will almost certainly be linked to larger regional facilities for a variety of diagnostic, therapeutic, and administrative services. Arguably, some larger hospitals may not need or want broadband services because they are "stand-alone" operations. However, hospitals are increasingly linking computer systems for billing, linking with medical suppliers, and a variety of other operations.

Libraries and governmental entities only have to be provided broadband services when requested. It is very clear that if an organization requests services, it has a need for such service at a reasonable price. Providers are not required to build dead-end infrastructure and to leave it sitting without a use.

The final topic that I would like to address is that of Internet access. I believe that Kansas earned a reputation as a national leader when the 1996 Act established a cost-effective way for people who do not have a local Internet service provider to access the Internet for a flat fee. Last legislative session, some telecommunications providers tried to amend the 1996 Act's requirement that flat-rate dialing speeds would increase beyond 14.4 Kbps on or after July 1999. Efforts were made to keep this rate from increasing. The final 1998 Legislation specifies that the July 1999 rate will be decided by the Universal Service Working Group. In today's world, using 14.4 Kbps access to the Internet is akin to traveling a dirt road. It can be used for access, but the access is slow, clumsy, and most businesses cannot locate there. Until we have local Internet access in every telephone exchange in Kansas, we must make certain that we have a mechanism to provide flat-rate dialing at a speed that is at least competitive with contemporary standards.

I appreciate this opportunity to testify. The Kansas economy has grown faster than the national average over the last several years partially due to the growth of information technology businesses. This growth has allowed us the policy options of cutting taxes, funding vital programs (such as higher education), and improving our highway infrastructure. To sustain this growth, we need an information technology infrastructure that will place all of Kansas urban and rural in an economically viable position. I would be pleased to answer any questions.

ATTACHMENT

Government Technology, October 1998 p. 54 provides an excellent overview of the emerging xDSL services and the bandwidth these services allow over traditional copper lines.

xDSL accomplishes its magic using frequencies far above regular phone traffic. Standard phone lines use no more than about 4KHz of bandwidth. This is not a limitation of the copper wire, but of filtering devices within the phone network itself. Copper is perfectly able to carry higher-frequency signals--which can carry more data--so xDSL sends signals in these upper frequency bands. For those types of DSL that use frequencies well above those used by analog phone, the xDSL and phone traffic do not clash. The two signals are separated at the user's end with a splitter that routes the phone traffic to the phone and the xDSL transmissions to the xDSL-enabled device. The phone company also needs to install specialized xDSL equipment, but this is far less expensive than having to install new cable to each home.

Although copper does carry higher frequencies, it imposes some distance limitations on how far it will carry them. The higher the frequency, the shorter the distance. It is this limitation that has given rise to the varieties of xDSL technology.

The original DSL technology is now used to transmit ISDN (Integrated Services Digital Network) signals, but because this flavor uses frequencies that overlap traditional telephones, the same line cannot be used for regular analog phone and digital traffic. Nonetheless, DSL does have greater data-carrying capacity--160Kbps for up to 18,000 feet from the telephone distribution center--and, if the user switches to digital phone, voice and data can be transmitted and received over the same line.

HDSL (High Data Rate Digital Subscriber Line) transmits in higher frequencies than DSL and achieves transmission rates from 1.5Mbps to a bit over 2Mbps. However, it requires two lines for 1.5Mbps speeds and three lines for 2Mpbs. It will, therefore, not likely be widely adopted in home or small business connections.

SDSL (Single Line Digital Subscriber Line) achieves transmission in the 1.5Mbps range using a single line. However, it has a reach of only 10,000 feet from the phone office, and ADSL (see below) provides downstream rates of more than 6Mpbs over that distance.

ADSL (Asymmetric Digital Subscriber Line) is the variant of DSL consistently in the news in the last few months. The "asymmetric" in the

name refers to the difference between its downstream and upstream rates. At the low end of ADSL service, the downstream rate is 1.5Mbps, with an upstrean rate of 16-64Kbps. It can deliver these rates up to 18,000 feet from the phone distribution center. Within 12,000 feet, it delivers up to 6Mbps downstream.
The difference between downstream and upstream speed is what "buys" the extra distance--signals sent asymmetrically interfere with each other far less than symmetric signals, thereby minimizing signal deterioration. Fortunately, this lopsided speed fits most home applications in which users primarily download data--whether text, graphics or software--or are accessing city or state services. In all of these cases, the bandwidth of the upstream data flow is far less important than the downstream flow.

ADSL operates in frequencies well above regular phone service, so it does not interfere with the phones, which means no new lines need to be strung into the home. Perhaps more importantly, ADSL lines are not shared. Each household has a unique connection between it and the phone company, making ADSL lines inherently more secure than cable's shared-bandwidth scheme.

VADSL (Very High Data Rate Digital Subscriber Line) started out as ADSL with a shorter distance limitation. In fact, within 1,000 feet of the phone distribution center, it offers speeds faster than 51Mbps. Today, it is more commonly called VDSL because it is expected to eventually deliver symmetrical service. Although VDSL may provide a way for agencies to make very high-speed connections to the Internet, it is unlikely to reach into the average home any time soon. However, in the immediate future, its speed will not be needed in the home where 1.5Mbps to 6Mbps is adequate for most applications.