Approved: April 29, 2005 Carl Dean Holmes
Date

MINUTES OF THE HOUSE COMMITTEE ON UTILITIES.

The meeting was called to order by Vice-Chairman Carl Krehbiel at 9:05 a.m. on February 7, 2005 in Room 231-N of the Capitol.

All members were present except: Representative Carl Holmes - Excused
Representative Judy Morrison - Excused
Representative Jason Watkins - Excused

Committee staff present: Mary Galligan, Legislative Research
Dennis Hodgins, Legislative Research
Mary Torrence, Revisor of Statutes
Jo Cook, Administrative Assistant

Conferees appearing before the committee:
Representative Tom Sloan, Lawrence, KS
Mike Murray, Sprint, Topeka, KS
Janet Buchanan, Kansas Corporation Commission, Topeka, KS
Anne Spiess, Kansas Telecommunications Industry Assn, Topeka, KS

Others attending: See Attached List

HB 2043 - KDFA authorized to issue bonds to finance broadband facilities where no broadband service is currently available

Vice-Chairman Krehbiel opened the hearing on **HB 2043**.

Representative Tom Sloan appeared in support of **HB 2043** (Attachment 1). Representative Sloan told the committee that the bill authorized the Kansas Development Finance Authority (KDFA) to issue bonds for the financing of regional broadband facilities where public agencies and private sector providers partner. He explained that it was an attempt to expand the areas of the state in which providers could recover their investments while offering many benefits to the citizens.

Mike Murray, Director of Governmental Affairs for Sprint, addressed the committee in opposition to **HB 2043** (Attachment 2). Mr. Murray expressed concern that the bill would create an incentive for local governments to enter the telecommunications business, thereby competing with the private sector.

Representative Sloan and Mr. Murray responded to questions from the committee. Additionally, Shirley Allen, representing the Kansas Rural Independent Telephone Companies, responded to questions.

Vice-Chairman Krehbiel closed the hearing on **HB 2043**,

HB 2046 - Regulation of local exchange carriers; broadband deployment

Vice-Chairman Krehbiel opened the hearing on **HB 2046**.

Representative Tom Sloan testified in support of **HB 2046** (see Attachment 1). Representative Sloan explained that this bill provided means for rural residents to receive access to high speed Internet services. It provides for the Kansas Corporation Commission to return those companies currently at price cap regulation to the traditional rate-of-return regulation on an exchange-by-exchange basis to achieve ubiquitous broadband service.

Janet Buchanan, Chief of Telecommunications for the Kansas Corporation Commission, appeared as an opponent to **HB 2046** (Attachment 3). Ms. Buchanan stated that the Commission opposed the bill for two reasons: 1) it would be extremely difficult to implement rate of return regulation on an exchange by exchange basis and 2) they do not have the jurisdictional authority to require deployment of broadband. She also stated that the legislation would impose a significant change in the policies under which price cap local exchange carriers have been operating since 1997 as well as setting out another criterion for rate of return regulation.

Anne Spiess, President of the Kansas telecommunications Industry Association, testified in opposition to **HB 2046** (Attachment 4). Ms. Spiess stated the Association believed the bill to be unnecessary because Kansans have access to broadband and subscribership will continue to grow, without government intervention.

Ms. Buchanan and Ms. Spiess responded to questions from the committee.

Vice-Chairman Krehbiel closed the hearing on **HB 2046**.

The meeting adjourned at 10:48 a.m.

The next meeting will be on Tuesday, February 8, 2005 at 9:00 a.m.

HOUSE UTILITIES COMMITTEE GUEST LIST

DATE: February 7, 2005

NAME	REPRESENTING
Anne Spiess	K.T.A Topeka
Janet Buchanan	KCC
Tom Day	KCC
Andy Shaw	Alltel
Mike Murray	Sprint Topeka
David Springe	Curb
Colleen Mullen	COX
Shirley Allen	Ks Rural Ind Tel Assoc
Paul Snider	SBC
Tim Pickering	SBC
Ken Secker	Henlan Firm
Jim Gartner	SBC
Debbie Vignatelli	SBC
Brent Larson	RTG

TOM SLOAN
REPRESENTATIVE, 45TH DISTRICT
DOUGLAS COUNTY

STATE CAPITOL BUILDING
ROOM 446-N
TOPEKA, KANSAS 66612-1504
(785) 296-7677
1-800-432-3924

772 HWY 40
LAWRENCE, KANSAS 66049-4174
(785) 841-1526
sloan@house.state.ks.us

STATE OF KANSAS

TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENT
CHAIRMAN: HIGHER EDUCATION
MEMBER: UTILITIES
ENVIRONMENT
AGRICULTURAL & NATURAL RESOURCES BUDGET

KANSAS WATER AUTHORITY

Testimony on HB 2043 and HB 2046
House Utilities Committee
February 7, 2005

Mr. Chairman, Members of the Committee: For the past few years I have been concerned with the digital divide that exists between our larger urban population centers and the more rural areas of our state. Economics dictates that large numbers of potential customers should receive new inventions, technologies, and opportunities first. However, as a public policy-maker, I believe that it is imperative that the life altering technologies be available to all Kansans within reasonable time frames.

Veterans of this Committee have heard me talk about the need to provide access to high speed Internet service, broadband, ubiquitously. We have received a presentation on KAN-ED, the program to provide broadband to all school districts, libraries, hospitals, and higher education institutions. High speed service opens the door to educational opportunities. However, many students have access to it in the classroom, but if they live outside the city limits they are able to access the world only through dial-up. Those of you with dial-up service may want to explain to our urban colleagues the difference in speed, ability to down-load large files and pictures, and the other factors that impede your ability to access a universe of information.

Last year at this time the Chairman of the Federal Communications Commission came to Kansas at my invitation for a Summit on Rural Broadband and Telemedicine issues. Representatives of telecommunications, education, health care, government, and other interests participated. One of the "stories" that attracted Chairman Michael Powell's attention was the woman from the Dodge City area that sells tumbleweeds to New York City interior decorators. She is able to have a web page with photographs of the tumbleweeds because she lives in town. If she lived at the ranch where she collects them, she would have dial up service and be unable to maintain a viable web page or business. You may also recall the reports by the independent telephone company representatives about the woman who owns a business in St. Louis and telecommutes from Allen, Kansas; as well as the Boeing engineer who telecommutes to St. Louis from northwest Kansas.

The Independent Telephone Association presentation included a focus on the value of broadband to a rural hospital. In addition, Lawrence Memorial Hospital is linking all of

HOUSE UTILITIES
DATE: 2-7-05
ATTACHMENT 1

the physicians' offices and homes to the hospital via the Internet so that if a patient is brought to the emergency room at 2:00 a.m. the primary heath care provider can access his/her office records and communicate with the emergency room doctor from his/her home. This opportunity is not available to physicians who live outside the city limit because they do not have access to high speed Internet service providers.

HB 2043:

HB 2043 is a simple bill. It authorizes the Kansas Development Finance Authority (KDFA) to issue bonds to finance regional broadband facilities in which public (city, county) agencies and private sector (telephone, cable) broadband providers partner. This bill recognizes that the ability to recover investment costs is partially dependent on population density served and costs associated with reaching those people in rural areas. The more people available as potential customers, the better the return on investment. By authorizing the KDFA participation with broadband providers, the state is explicitly trying to reduce the cost of infrastructure development; and hence increasing the potential to profitably deploy broadband.

The Kansas Development Finance Authority is the state agency that sells bonds to finance highway projects, the Capitol renovation project, university dorms, and other capitol projects. Through HB 2043, the KDFA offers lower borrowing costs to finance the broadband infrastructure, is technology neutral, and requires that broadband providers work with local governments.

HB 2043 is one attempt to expand the areas of Kansas in which broadband providers can recover their investments, while offering educational, employment, and public safety/health benefits to the citizens.

HB 2046:

HB 2046 is another means by which rural residents of Kansas may receive the opportunity to access high speed Internet service. Currently, the independent telephone companies are rate regulated. In simple terms, that means that the Kansas Corporation Commission reviews their operating costs, investments in plant, and other expenditures for appropriateness, and grants them a rate-of-return opportunity. If the company "over earns" on its operations and investment, the KCC at its next review will make adjustments.

SBC and Sprint/United are price cap companies. Again in simple terms, that means that the Corporation Commission has agreed to a price cap under which the companies may price their services, and recover and earn on their investments without review by the KCC. If the company is able to reduce its expenditures while continuing its earnings level, it makes a greater profit. The KCC does not review those earnings, rather it ensures that the price cap is not violated.

HB 2046 provides the KCC authority to return SBC and/or Sprint/United to traditional rate-of-return regulation on an exchange-by-exchange basis in order to achieve ubiquitous (universal) broadband service availability.

An exchange is the first three digits of your telephone number (e.g., 841) with the final four numbers being your individual location (e.g., 1526). The FCC reports broadband availability by exchange. Thus, if one customer in the 841 exchange has access to broadband, the FCC considers that all customers do. The reality is that too often only a few persons in an exchange have access to broadband. That is why most of my questions during the background briefings provided our committee have focused on customer service lines with broadband capability.

HB 2046 provides the KCC authority to return SBC and Sprint/United to rate-of-return regulation on an exchange-by-exchange basis so that the companies can recover their investment in broadband. Price cap "regulation" does not automatically ensure recovery of investment; rate-of-return provides more assurance that investments will be recovered through rates.

There is nothing wrong with a company making a business decision that, within their revenue stream, sufficient money is not available to expand services. However, as a policy-maker trying to balance the needs of our citizens and our corporative partners, I believe it is our responsibility to create conditions suitable for both parties to benefit.

Independent telephone companies are rate regulated and have access to lower cost capitol. SBC and Sprint/United are price cap companies and are generally not eligible for federal low-interest loans.

HB 2043 and HB 2046 are efforts, on a technologically neutral basis, to provide the financial conditions necessary for broadband providers to deploy.

There is nothing in HB 2046 that says SBC or Sprint/United must deploy the most expensive broadband technology (DSL service). It permits partnerships with other technology providers (e.g., wireless), partnerships with local governments, or the utilization of company-owned alternative technologies. HB 2046 simply requires that all Kansas residents be provided the opportunity to avail themselves of high speed Internet services. The independent telephone companies almost universally are providing these services to their customers because they can recover their investments. HB 2046 provides a mechanism by which SBC and Sprint/United can make comparable investments, recover their expenses, and earn a reasonable return on that investment.

If you agree with the premise that a digital divide is not good for our state and citizens, but do not support the two approaches to incenting investment and deployment proposed in HB 2043 and HB 2046, I encourage you to offer an alternative proposal.

Mr. Chairman, I will be pleased to respond to questions regarding my vision for our state or how HB 2043 and/or HB 2046 provide the mechanism by which our residents in rural areas can participate in 20^{th} century opportunities.

1-4

Sprint

Michael R. Murray
Director
Governmental and Public Affairs

Midwest Operations
800 Southwest Jackson, Suite 1108
Topeka, KS 66612-1242
Voice 785 232 3826
Fax 785 234 6420

Outline of Testimony Before the House Utilities Committee
February 7, 2005
HB 2043
Michael R. Murray, Sprint, Director of Governmental Affairs
Topeka, Kansas

1. One consequence of HB 2043 may be to allow the use of public funds to develop broadband networks and services that will compete with the private investments that telecommunications companies and other providers have already made.

2. HB 2043 will also create an incentive for local governments to enter the telecommunications business and unfairly compete with the private sector

3. We have always said in this ongoing debate about broadband deployment that if the Legislature deems it good public policy for broadband to be deployed more rapidly, you can mandate its deployment, and we will deploy it. But we will also require the means to recover our costs of doing so where the costs are high and the demand is minimal.

4. If the issuance of bonds is the answer, then HB 2043 could be amended to **require** that local governments deploy the proposed broadband networks in partnership with private business, rather than making such partnerships an option.

5. And there are other ways to make broadband funding available to private companies. The State of Tennessee, for example, is considering tax incentives to encourage broadband deployment in high cost/low demand areas

HOUSE UTILITIES

DATE: 2-7-05

ATTACHMENT 2

Before the House Utilities Committee
February 7, 2005
HB 2043
Michael R. Murray, Sprint, Director of Governmental Affairs
Topeka, Kansas

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to comment on the provisions of HB 2043.

It is our understanding the bill seeks to facilitate the rapid and ubiquitous of broadband to rural Kansas by allowing use of bonds issued by the Kansas Developmental Finance Authority.

We have some concerns with the bill, however.

One consequence of HB 2043 may be to allow the use of public funds to develop broadband networks and services that will compete with the private investments that telecommunications companies and other providers have already made.

Specifically, political jurisdictions will likely use wireless technology as one method of deploying broadband services. Under this scenario, the wireless signals will undoubtedly overlap parts of the broadband networks already deployed by private companies. Where there is an overlap, the private companies' broadband customers will rightfully demand the publicly funded and lower priced service being offered by the local government. After all, it's the tax payers' money that is being used to pay for the bonds.

As private providers lose their existing customers to counties and cities, they will be faced with stranded investments.

HB 2043 will also create an incentive for local governments to enter the telecommunications business and unfairly compete with the private sector. If local governments deploy these broadband networks, they will have more capacity than can be used by today's underserved customers. To achieve efficient use of these high capacity networks, local governments will have an incentive to offer other services to a larger market.

We are concerned this is the camel's nose under the tent for municipalities to enter the telecommunications business and unfairly compete with private enterprise.

We have always said in this ongoing debate about broadband deployment that if the Legislature deems it good public policy for broadband to be deployed more rapidly, you can mandate its deployment, and we will deploy it. But we will also require the means to recover our costs of doing so where the costs are high and the demand is minimal.

If the issuance of bonds is the answer, then HB 2043 could be amended to require that local governments deploy the proposed broadband networks in partnership with private business, rather than making such partnerships an option. By doing so, you would avoid the public-private conflicts. In addition, local telephone companies and other providers already have the experience to build and operate such networks.

And there are other ways to make broadband funding available to private companies. The State of Tennessee, for example, is considering tax incentives to encourage broadband deployment in high cost/low demand areas. The amount of the annual tax credit depends on population density. For example, the state would offer a tax credit equal to five percent of the cost of broadband equipment deployed in counties with a population density of 500 people per square mile or more. A credit equal to 10 percent of a provider's cost would be offered where population density is 100 to 500 people per square mile. And a 15 percent credit would be offered population density is 100 people per square mile or less.

If you determine that a more rapid and wider deployment of broadband services is good public policy, Sprint will do its part in implementing that policy. And we'll gladly work with you to develop ways of paying for that deployment in high cost, minimal demands areas. However, we do not believe HB 2043, as it is written, goes about it the right way.

2-3

AD ASTRA PER ASPERA

KANSAS

CORPORATION COMMISSION

KATHLEEN SEBELIUS, GOVERNOR
BRIAN J. MOLINE, CHAIR
ROBERT E. KREHBIEL, COMMISSIONER
MICHAEL C. MOFFET, COMMISSIONER

Testimony of
Janet Buchanan, Chief of Telecommunications
Kansas Corporation Commission

Before the House Utilities Committee
Regarding HB 2046
February 7, 2005

Chairperson Holmes and Committee Members:

Thank you for allowing me to appear before you this morning on behalf of the Kansas Corporation Commission to express the Commission's views regarding HB 204~~2~~6. My name is Janet Buchanan. I am the Commission's Chief of Telecommunications.

While supportive of efforts to deploy broadband throughout Kansas, the Commission opposes this legislation for two basic reasons:

- In practice, it would be extremely difficult to implement rate of return regulation on an exchange by exchange basis.
- The Commission does not have the jurisdictional authority to require the deployment of broadband.

To explain the Commission's position, it is helpful to provide background regarding the methods of rate regulation employed by the Commission. Prior to the enactment of the Kansas Telecommunications Act of 1996 ("KTA"), the primary form of rate regulation employed by the Commission was rate of return regulation. Under this form of regulation, a local exchange carrier or other utility is permitted to implement rates that cover all allowable operating costs and that provide the utility with an opportunity to earn a fair rate of return on its investments. The Commission conducts an audit to determine the revenue required to operate the utility and then sets rates at a level to produce the required revenue. The formula below illustrates the determination of required revenue in simple terms.

Revenue Requirement = Operating Costs + (Net Investment * Rate of Return)

The Commission must determine the allowable operating costs by examining expenses (wages, maintenance, advertising, charitable contributions, etc), depreciation and taxes. A utility may spend any amount it chooses but it is possible that the Commission will not allow all expenditures for ratemaking purposes. Expenditures may be disallowed because they are recovered in another jurisdiction or because the utility could not demonstrate a ratepayer benefit. Disallowed expenditures are, in effect, charged to the utility's shareholders. The Commission must also determine the net value of investment (gross value of property less depreciation).

HOUSE UTILITIES
DATE: 2-7-05
ATTACHMENT 3

1500 SW Arrowhead Road, Topeka, KS 66604-4027 785.271.3100

Finally, the Commission must determine a fair rate of return to apply to the net investment. Rate of return regulation is typically applied on a territory-wide basis. For telecommunications utilities, some costs must be allocated to the federal jurisdiction based on rules developed by the FCC. Additionally for utilities that are part of a holding company, that cross state boundaries or that have unregulated affiliates, the determination of the revenue requirement requires the utility to develop additional procedures to allocate costs to the appropriate jurisdiction.

The KTA, at K.S.A 66-2005(b) permits a local exchange carrier to elect price cap regulation. Under price cap regulation, the local exchange carrier is no longer subject to audits to determine appropriate rate levels. Instead, rates are allowed to fluctuate up to a cap and down to a price floor. Price cap regulation was viewed as providing a transition to competition. It would permit pricing flexibility but restrain prices until effective competition takes hold. K.S.A. 66-2005(f) established three baskets for services: Basket 1 for residential and single line business, Basket 2 for switched access service, and Basket 3 for multi-line business and miscellaneous services. The KTA, required that the initial price cap be set at the rate levels existing when the local exchange carrier applied to elect price cap regulation and at K.S.A. 66-2005(g), required the Commission to determine a formula for adjusting the level of the cap. The Commission was directed to "balance the public policy goals of encouraging efficiency and promoting investment in a quality, advanced telecommunications network in the state." The Commission opened a proceeding to determine a price cap formula. All interested parties were invited to participate. Ultimately, the Commission determined that the price cap should be adjusted according to the following formula:

Price Cap Index = Inflation – Productivity Offset + Extraordinary Event Adjustment

Rates would be allowed to increase as costs of the local exchange carrier increase and would be decreased to reflect the effects of increases in productivity. The extraordinary event adjustment would permit adjustment to the price cap to reflect events that changed costs or cost recovery that were beyond the control of the local exchange carrier. After considering the positions of all parties, the Commission found that inflation would be determined by percent change in the Gross Domestic Product Price Index (chain-weighted). This index (or the similar Gross National Product Price Index) was utilized by most states and by the FCC at the time. The Gross Domestic Product Price Index measures the price level, incorporating all final goods produced within the boundaries of the United States. However, it was generally recognized that the costs in the telecommunications market were rising more slowly than for the economy in general and that the productivity level of the telecommunications market differed from that of the economy in general. Therefore, the productivity offset was established to account for such differences. The Commission determined that the productivity offset should initially be set at 2.3%. The KTA, at K.S.A. 66-2005(g) requires the Commission to review the price cap formula every five years. The Commission reviewed the formula in 2002 and approved a Stipulation and Agreement presented by the parties. The parties agreed to retain the Gross Domestic Product Price Index (chain weighted) as the measure for inflation. The parties agreed that the productivity offset for Basket 1 should be set at 3.15% and for Basket 3 it should be set at 1.4%. The price floor is set out in K.S.A. 66-2005(k) as the long-run incremental cost of a service. K.S.A. 66-2005(b) permits the Commission to resume rate of return regulation for a local exchange carrier upon a finding that the carrier has violated minimum quality of service standards after having been given an opportunity to correct the violation and failing to do so.

While a policy decision for this body to make, this legislation would impose a significant change in the policies under which price cap local exchange carriers have been operating since 1997. This legislation would create another criterion, the lack of broadband deployment, under which the Commission should resume rate of return regulation. However it requires the Commission to make such decisions on an exchange-by-exchange basis. While not impossible, it would be extremely difficult to impose rate of return regulation on an exchange-by-exchange basis. Local exchange carriers do not track all costs at the exchange level. Thus, additional allocations procedures would need to be developed. The allocations procedures applied to account for jurisdiction over costs are already complex and this would impose another level of complexity. It also disrupts the benefit of price cap regulation serving as a transition to competitive market place. The KTA, at K.S.A. 66-2005(g), requires the Commission to "balance the public policy goals of encouraging efficiency and promoting investment in a quality, advanced telecommunications network in the state" when determining the price cap formula. Thus, it appears the existing statutory language may achieve the desired results from a financial perspective. However, under either rate of return or price cap regulation, the Commission has no jurisdiction to require that any financial incentives provided to a local exchange carrier be utilized to deploy broadband. Broadband has been determined by the FCC to be an interstate service.

Kansas Telecommunications Industry Association
4848 SW 21st Street • Suite 201 • Topeka, KS • 66604-4415
785•234•0307 • 785•234•2304 (FAX)

Testimony of Anne Spiess
on behalf of the
Kansas Telecommunications Industry Association (KTIA)
In opposition to HB 2046
Before the House Utilities Committee
February 7, 2005

Good morning, Vice-Chairman Krehbiel and members of the Committee. I am Anne Spiess, appearing on behalf of the Kansas Telecommunications Industry Association (KTIA). I'm here today to oppose House Bill 2046 on behalf of our price-capped companies, Sprint and SBC. I also want to state that our rural companies have no official position on the bill because it does not affect them at this time.

While we all would agree that in a perfect world, everyone would have access to the newest innovations and infrastructure, we actually live in a world of limited resources. Kansans have a lot to be proud of including a very good quality of life, with good highways, doctors, and communications services. But we do not have ubiquitous interstate highways across the state, or medical specialists in every town.

We also don't have telephone company DSL broadband deployed to every person in the state. But there are a number of broadband technologies available to consumers in Kansas, with at least one option available to every Kansan. These broadband options include:

- Cable Modem (Cox, Time Warner, Comcast)
- Satellite (DirecWay)
- Wireless (Verizon, Sprint)
- Fixed wireless (Pixius)
- WiFi (McDonald's, airports)
- DSL (SBC, Sprint, rural ILECs, CLECs)
- Broadband over Power Line (BPL—coming soon)

HOUSE UTILITIES

DATE: 2-7-05

ATTACHMENT 4

As this Committee is aware, broadband use in Kansas has grown tremendously in the last several years. The Federal Communications Commission (FCC) reports that in December 1999 about 26,000 Kansans subscribed to broadband services – but by June 2004 almost 325,000 Kansans were accessing the Internet via broadband. The FCC reports that 65 percent of those connections are via cable modems, while 27 percent use DSL.

SBC has provided DSL service to exchanges with more than 1,000 access lines. That leaves about 40 SBC exchanges without SBC DSL service, yet only 13 of those, representing a total of about 5,500 lines, are without non-satellite broadband service. Clearly, many, many Kansans have access to broadband and the KTIA believes subscribership will continue growing, without government intervention. Therefore, we believe HB 2046 is unnecessary.

HB 2046 also has a misplaced assumption of what "rate of return" regulation can accomplish. First, rate of return regulation is designed to operate in place of competitive forces and guarantees a monopoly provider a "fair" return on investment. But broadband services are highly competitive and no rate fixing can ever guarantee a company a return on investment in the competitive broadband market. Second, it would be contrary to rate making processes to allow intrastate (local) rates to be used to subsidize the deployment of facilities for a competitive interstate service. Third, broadband services are "interstate" in nature, and are subject to regulation by the FCC; thus the Kansas Corporation Commission (KCC) has no jurisdiction over broadband pricing.

In conclusion, the communications market in Kansas is open to competition. Regulation will only serve to increase consumer prices and decrease consumer choice. HB 2046 goes against free market principles, and will thwart innovation and independent business investment in Kansas. Thank you for your time today and I, along with our member company representatives, will be happy to answer any questions.

Anne Spiess, President
Kansas Telecommunications Industry Association (KTIA)
4848 SW 21st Street, Suite 201
Topeka, Kansas 66604-4415
785-234-0307 Voice
785-234-2304 FAX
785-234-0207 TTY
aspiess@kstelecom.com