Approved: January 18, 2005
Date

MINUTES OF THE SENATE UTILITIES COMMITTEE

The meeting was called to order by Chairman Jay Emler at 9:30 A.M. on January 17, 2006 in Room 526-S of the Capitol.

Committee members absent: Senator Roger Reitz- excused

Committee staff present: Athena Andaya, Kansas Legislative Research Department
Raney Gilliland, Kansas Legislative Research Department
Bruce Kinzie, Revisor of Statutes' Office
Ann McMorris, Committee Secretary
Leann Hirschfeld, Intern

Conferees appearing before the committee:
Michael J. Foster, president, Twin Valley Telephone Inc., Miltonvale
Steve Rarrick, staff attorney, CURB
Janet Buchanan, Chief of Telecommunications, KCC

Others in attendance: See attached list

Chairman Emler opened the hearing on:

SB 349 - Telecommunications, Kansas Universal Service Fund

Proponent -
Michael J. Foster, president, Twin Valley Telephone, Inc., Miltonvale appeared on behalf of thirty-six Kansas rural independent telephone companies in support of **SB 349**. He testified that this bill will maintain existing regulatory standards that have allowed rural companies to invest in improved telecommunications services. (Attachment 1)

Opponent -
Steve Rarrick, staff attorney, Citizens' Utility Ratepayer Board (CURB), opposed the proposed amendment to K.S.A. 66-2008(e) because it would eliminate the ability of the KCC to use a forward-looking cost model if the FCC implements a forward-looking cost model. He reviewed the history behind the provisions in K,S,A, 66-2008(e). He urged the committee to vote against **SB 349** as drafted but instead approve CURB's proposal to repeal in its entirety the provisions of K.S.A. 66-2008(e) to reverse the effects of the *Bluestem* decision as it did not, in his opinion, accurately reflect legislative intent. Senator Lee strongly disagreed, stating it did accurately reflect the intent of the Kansas Legislature. (Attachment 2)

Neutral -
Janet Buchanan, Chief of Telecommunications, Kansas Corporation Commission, testified the Commission is taking a neutral position on **SB 349** but would like to provide the Committee with background information and point out two implications of the bill. First, removal of the June 30, 2006, date from subsection (e) will require use of embedded costs for determining KUSF support for rural ILECs indefinitely and without regard for any changes made by the FCC or Congress concerning federal USF support. Second, leaving (e) otherwise unmodified means legislative acceptance of the Court's statutory interpretation which may require the Commission to make new findings regarding competitive neutrality and require increases in the size of the KUSF and the assessments to fund those increases. (Attachment 3)

After considerable discussion and questions from the committee, it was moved by Senator Lee, seconded by Senator Apple, **SB 349** be passed out favorably. Motion carried.

Adjournment.
Respectfully submitted,
Ann McMorris, Secretary
Attachments - 3

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: JANUARY 17, 2006

Name	Representing
Steve Harrick	CURB
John Federico	KCTA
Andy Shaw	Alltel
John D. Pinegar	SITA/RTMC
Janet Buchanan	KCC
Don Low	KCC
Melissa Hunsicker Walburn	KCC
Dave Holthaus	KEC
Joe Dick	KCBPU
Larry Berg	Midwest Energy
David Springe	Curb
Tom Day	KCC
Anne Spiess	KTIA
Mandy Phillips	Senator Schmidt
Jim Gardner	AT&T
Kimberly Lehman	Aquila
Steve Johnson	KGS
Dena Fink	VZW

SENATE UTILITIES COMMITTEE GUEST LIST

DATE: JANUARY 17, 2006

Name	Representing
Ben Cleeves	DOB
Shirley [illegible]	KS Ind [illegible]
Mark Schreiber	Westar Energy
Jennifer [illegible]	PS+A

KANSAS
RURAL INDEPENDENT
Telephone Companies

Investment that works for all Kansans

Before the Senate Utilities Committee
Testimony of Michael J. Foster, president
Twin Valley Telephone, Inc.
Miltonvale, Kansas
on behalf of
The Kansas Rural Independent Telephone Companies
January 17, 2006

Mr. Chairman and Senators:

My name is Mike Foster. Thank you for the opportunity to appear on behalf of thirty-six Kansas rural independent telephone companies serving about 120,000 Kansas families, businesses, and individuals. I appear in strong support of Senate Bill 349; this bill will maintain existing regulatory standards that have allowed rural companies to invest in improved telecommunications services.

S.B. 349 applies only to rural telephone companies and does only one thing: it deletes an expiration date for use of one particular regulatory standard. By statute we operate under an embedded cost standard, which means our opportunity for cost and investment recovery is based on what we actually spend to serve Kansans. If you allow this current law to expire this June, we face the sort of regulatory uncertainty that would stifle vitally needed investment and economic growth in rural Kansas.

Our company, Twin Valley Telephone, is a good example. We've agreed to triple our size by buying thirteen rural exchanges from their present carrier. We plan to invest millions to deliver advanced services demanded by customers and required for rural economic development. Rural companies can't make that kind of commitment if we face unknown rules limiting our recovery opportunities. Even going through a KCC process of considering a different rule would require us to wait and see, and to pull resources out of serving consumers in the meantime and spend them on increased expense of state regulation.

The current embedded cost standard is fair and reasonable. It allows us the chance to recover what we actually spend, without undeserved windfalls or unreasonable shortfalls. The alternative, a hypothetical cost model, would be uncertain, contentious, and expensive to develop, without any assurance of a net public benefit. Only one thing would be sure: all the costs of the process would wind up being paid by consumers.

Hypothetical models may work for large companies, with large customer bases to even out the variations up and down from an average, but smaller companies and their customers are best served by using real instead of imaginary cost figures. Under hypothetical models some rural companies could receive increased support without any increased investment; others could lose the opportunity to recover investments made in good faith to serve Kansas consumers. Neither result would be in the public interest.

We urge you to act promptly and favorably on S.B. 349; that action is necessary to maintain a regulatory principle that serves our state well.

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Citizens' Utility Ratepayer Board

Board Members:
Gene Merry, Chair
A.W. Dirks, Vice-Chair
Carol I. Faucher, Member
Laura L. McClure, Member
Douglas R. Brown, Member
David Springe, Consumer Counsel

State of Kansas
Kathleen Sebelius, Governor

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Phone:(785) 271-3200
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Testimony on Behalf of the Citizens' Utility Ratepayer Board
By Steve Rarrick, Staff Attorney
Before the Senate Utility Committee
Re: Senate Bill 349
January 17, 2006

Chairman Emler and Members of the Committee:

Thank you for the opportunity to appear before you this morning on behalf of the Citizens' Utility Ratepayer Board (CURB) to testify in opposition to Senate Bill 349. My name is Steve Rarrick and I am an attorney with CURB.

Senate Bill 349 proposes to eliminate the June 30, 2006, sunset on the provisions of K.S.A. 66-2008(e). These provisions require Kansas Universal Service Fund (KUSF) support for rate of return local exchange carriers to be based on the carrier's embedded costs, revenue requirements, investments and expenses until June 30, 2006.

CURB opposes the proposed amendment to K.S.A. 66-2008(e) in SB 349 because it would eliminate the ability of the Kansas Corporation Commission (KCC) to use a forward-looking cost model if the Federal Communications Commission (FCC) implements a forward-looking cost model. K.S.A. 66-2008(c) requires the KCC to periodically review the KUSF to determine whether the costs to provide local service justify modification of the KUSF.

In order to explain CURB's position, the history behind the provisions contained in K.S.A. 66-2008(e) must be considered.

- In 1997, the FCC issued its *First Report and Order,* which determined that high-cost support for all eligible carriers eventually should be based on the forward-looking economic cost of constructing and operating the network facilities and functions used to provide the supported services.[1] The FCC agreed with the Federal-State Joint Board on Universal Service (Joint Board) that because forward-looking economic cost is sufficient for the provision of the supported services, setting support levels in excess of forward-looking economic cost would enable the carriers providing the supported services to use the excess to offset inefficient operations or for purposes other than the provision, maintenance, and

[1] *In the Matter of Federal-State Joint Board on Universal Service,* Report and Order, 12 FCC Rcd 8776, 8899, ¶ 224 (1997) (*First Report and Order*).

upgrading of facilities and services for which the support is intended.[2] However, the FCC also agreed with the Joint Board that support for rural carriers should be transitioned to forward-looking costs at a later date to allow sufficient time for rural carriers to adjust to any changes in support calculations.[3]

- On May 23, 2001, the FCC released its *Rural Task Force Order*, wherein it modified the embedded cost support mechanism for rural carriers for a five-year period based on the recommendations of the Rural Task Force. While accepting this recommendation of the Rural Task Force, the FCC firmly disagreed with commenters representing rural carriers who had argued that a forward-looking cost mechanism should not be used to determine rural company support and that only an embedded cost mechanism would provide sufficient support for rural carriers.[4] While the FCC decided to implement the modified embedded cost mechanism on July 1, 2001, and have it remain in place until July 1, 2006, the FCC stated that it would continue to consider a forward-looking methodology during the duration of the plan.[5]

- On March 11, 2002, the KCC issued an order in KCC Docket No. 02-GIMT-068-KSF (068 Docket), adopting a stipulation and agreement involving Commission Staff, CURB, and the rural telephone companies. In that order, the KCC adopted the parties' agreement to use embedded costs to compute KUSF support for rural companies for the five-year period covered by the federal universal service plan approved in the *Rural Task Force Order*. Under the agreement and order, the embedded cost methodology was to remain in effect "until July 1, 2006, and thereafter **until modified by the Commission**."[6] CURB continues to support this agreement.

- The 2002 Legislature subsequently passed the provisions of K.S.A. 66-2008(e), codifying the agreement reached between the parties in the 068 Docket.

- On February 27, 2004, the Federal-State Joint Board on Universal Service released its Recommended Decision, again noting that in developing a long-term universal service plan the FCC said that it intended "to consider all options, including the use of forward-looking costs, to determine appropriate support

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[2] *Id.*, at 8889-90, ¶ 225.
[3] *Id.*, at 8934-37, ¶¶ 291-95
[4] *In the Matter of Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11310-13, ¶¶ 169-77 (2001) (*Rural Task Force Order*).
[5] *Id.*, at 11258-59, ¶ 29.
[6] *In the Matter of the Investigation into the Kansas Universal Service Fund (KUSF) Mechanism for the Purpose of Establishing Cost Based KUSF Support for Rural Local Telephone Companies,* Order Adopting Stipulation and Agreement, KCC Docket No. 02-GIMT-068-KSF, p. 4, ¶ 11 (emphasis added).

levels for both rural and non-rural carriers."[7] The Joint Board further noted that the FCC had also emphasized in the *Rural Task Force Order* that the Act does not require separate rural and non-rural support mechanisms, and although the FCC found that a distinct rural mechanism, based on embedded cost, was appropriate for the five-year period, it expressed its belief "that there may be significant problems inherent in indefinitely maintaining separate mechanisms based on different economic principles."[8]

The history leading to the enactment of K.S.A. 66-2008(e), the continued analysis of support methodology by the FCC, and the agreement between rural companies and the Commission Staff and CURB, are all reasons why CURB is asking this Committee to vote against SB 349 as drafted. The current statutory language will enable the Commission to continue to use embedded costs to set KUSF support for rural companies consistent with how federal universal support is calculated, but more importantly, will enable the Commission to transition to forward-looking costs in the event the FCC ultimately adopts a forward-looking cost model for federal universal support. It is crucial that the Legislature allow the KCC to remain consistent with FCC policy on universal service. Passage of this bill as drafted, however, will tie the hands of the Commission and require legislative change to enable Kansas to transition to a forward-looking cost mechanism in the event the FCC adopts such a mechanism. Given the expertise and ability to open general investigations and hold extensive hearings, CURB would recommend the legislature continue to defer to the Commission on this technical issue.

However, rather than simply denying the proposed amendment to K.S.A. 66-2008(e), CURB proposes that this Committee amend the bill to strike all of the language contained in K.S.A. 66-2008(e) to reverse the effects of the April 8, 2005, decision of the Kansas Court of Appeals in *Bluestem Telephone Co. v. Kansas Corporation Comm'n*, 33 Kan. App.2d 817, 109 P.3d 194 (2005).

The *Bluestem* decision resulted from an appeal by rural carriers of a KCC determination that KUSF support is to be distributed on a portable per-line basis. The rural carriers argued that the provisions of K.S.A. 66-2008(e) precluded any reduction in KUSF support as the result of line losses. The KCC argued that this was not the intent of the legislature when enacting the provisions of K.S.A. 66-2008(e), but the Court of Appeals refused to examine legislative intent, finding the language of K.S.A. 66-2008(e) unambiguous.

The result of the *Bluestem* decision will be that Kansas ratepayers will pay, through KUSF assessments, the cost of support for each line won by a competitive eligible telecommunications carrier (encouraged by the Kansas Telecommunications Act), while still paying support for the line lost by the incumbent carrier. This double payment will result from what CURB believes is the unintended consequence of the

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[7] *In the Matter of Federal-State Joint Board on Universal Service,* Recommended Decision, CC Docket No. 96-45, FCC 04J-1 (Rel. February 27, 2004), ¶ 95, ftn. 267 (citing *Rural Task Force Order*, 16 FCC Rcd at 11310, ¶ 170).

[8] *Id.*

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language used to codify the 2001 agreement between Commission Staff, CURB, and the rural carriers in the 086 Docket.

The cost of the *Bluestem* decision is significant and will likely continue to grow with time. Testimony by Commission Staff indicates that $3.1 million will be required to pay the past due amounts resulting from the *Bluestem* decision,[9] but more importantly, an additional $1.7 million will be required each year. The $1.7 million is likely to grow, as any additional lines lost to competitors will result in double payment of support by Kansas ratepayers.[10]

The KUSF fund will increase from about $63.2 million in 2005 to about $73.2 million in 2006,[11] and the single largest portion of this increase is due to the Nemaha court decision. The KUSF fund has increased for the second straight year in a row (the first time two straight years of fund increases has occurred in the 10 year history of the KUSF, and CURB believes this may be a future trend) and the Nemaha court decision had a significant impact on this increase. CURB is concerned about these increases in the KUSF and the corresponding increase in customer rates resulting from these increases in the fund.

Repealing the entire provisions contained in K.S.A. 66-2008(e) will reverse the effect of the *Bluestem* decision going forward, saving Kansas ratepayers nearly $2 million annually. It will also allow the KCC to continue to use embedded costs to compute KUSF support for rural companies consistent with the calculation of federal universal support, but enable the Commission to transition to a forward-looking cost model in the event the FCC ultimately adopts a forward-looking model for federal universal support.

On behalf of CURB, I urge you to vote against Senate Bill 349 as drafted, but instead approve CURB's proposal to repeal in its entirety the provisions of K.S.A. 66-2008(e) to reverse the effects of the *Bluestem* decision.

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[9] Direct Testimony of Ms. Sandra Reams, KCC, December 22, 2005, Docket No. 06-GIMT-332-GIT, page 6.

[10] *Id.,* at p. 14.

[11] Supplemental Redacted Testimony of Ms. Sandra Reams, KCC, January 5, 2006, Docket No. 06-GIMT-332-GIT, Exhibit SKR-1, page 1, line 19 showing the 2006 year 10 fund balance of $73.2 million, and the December 22, 2005, Direct Testimony of Ms. Sandra Reams, page 9, showing the year 9 balance of $63.2 million in the related table.

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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 Senate Utilities Committee
Regarding SB 349
January 17, 2006

Chairperson Emler 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 SB 349. My name is Janet Buchanan. I am the Commission's Chief of Telecommunications.

The Commission is taking a neutral position on this bill but would like to provide the Committee with background information and point out two implications of the bill.

The existing language at K.S.A. 66-2008(e) was proposed to codify an order of the Commission in Docket Number 02-GIMT-068-KSF. In that order, the Commission approved a Stipulation and Agreement submitted by the parties, which established that the transition to a cost-based Kansas Universal Service Fund ("KUSF") support level for rural incumbent local exchange carriers ("ILECs") would be accomplished through use of an audit of embedded costs rather than through use of a hypothetical efficient firm cost model. The parties agreed that this issue would not be revisited until 2006.

The Stipulation and Agreement contained the provision to base support on embedded costs because the FCC had decided to use embedded costs to determine federal support for rural carriers while using a model to establish hypothetical costs for other ILECS and the Commission had, pursuant to Section 254(f) of the Federal Act, attempted to adopt rules regarding the KUSF that are "not inconsistent" with the FCC's rules to advance and preserve universal service. The June 30, 2006, date was contained in the Stipulation and Agreement because it was believed the FCC would re-examine whether a hypothetical model should be used to determine federal USF support for rural carriers in 2006; however, it does not appear to be on the FCC's agenda in the near future.

In distributing KUSF support for both carriers whose support is determined through a cost model and those whose support is determined through an audit of embedded cost, the Commission has calculated those costs and then distributed the necessary support using a "per line" method of

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distribution. The total KUSF support received by a carrier was then adjusted on an annual basis as a carrier either served more or fewer access lines (support increased as access lines increased and support decreased if access lines decreased). That same level of support per access line was also made available to qualifying competitive carriers. Again, this is consistent with the manner in which the FCC determined distribution of federal USF should occur. Additionally, the Commission believed that this distribution, on a "per line" basis was competitively neutral as required by subsection b.

The rural ILECs appealed orders of the Commission which implemented the per access line method of distributing support. The carriers cited the language in K.S.A. 66-2008(e) which states that <u>any adjustment</u> to KUSF support would be based on a carrier's embedded costs. The Court of Appeals agreed that the statute now requires KUSF support for rate of return carriers only be adjusted if there is a showing that a carrier's embedded costs have changed, regardless of changes in the number of access lines or customers the carrier actually serves. While K.S.A 66-2008(d) permits carriers to receive increases in KUSF support based on an increase in access lines, the Court's interpretation of K.S.A. 66-2008(e) will no longer allow these "per line" adjustments to KUSF support for rate of return regulated carriers.

In short, an audit must be performed before any adjustment in KUSF support -- up or down -- can be made. Absent such an audit, the rural ILEC will receive the same total amount of KUSF support even if losing a significant number of customers to competitors, competitors who may also be receiving per line support for serving those customers, which has the effect of providing duplicative support. Because the Court found that subsection (e) did not allow support adjustments without an audit, the Court also required the Commission to determine whether the resulting disparate treatment of ILECs and competitive carriers is competitively neutral, as required by subsection b.

As a result of the decision by the Court, the Commission's staff has estimated that KUSF support will increase, as of March 2006, by at least $1.7 million.[1] Additionally, one time payments will be made from the KUSF to carriers whose past support amount was reduced as they experienced reductions in access lines. That amount is estimated to be approximately $3 million.[2] In the past, if a customer disconnected service with the ILEC in favor of service provided by a competitor, only the competitor received support. Now, the total amount of KUSF support will increase as both the competitor and the ILEC will receive support for that customer. These increases in support come at time when the assessable revenues are declining. Some consumers are dropping second lines in favor of broadband services which are not a source of assessable revenues. Some consumers have subscribed to VoIP services and it is unclear whether those revenues may be assessed for KUSF purposes. Additionally, some consumers make use of email and instant messaging rather than making voice calls that would be assessed.

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[1] This is the net increase to the KUSF annually. However, if the Commission determines that carriers that received increases in support in conjunction with access line increases should be allowed to keep that support, then the KUSF support would need to be increased further by approximately $210,000.

[2] This is the net amount of the onetime payment from the KUSF. However, if the Commission determines that carriers that received increases in support in conjunction with access line increases should be allowed to keep that support, then the one time payment from the KUSF would need to be increased to approximately $3,530,000.

In conclusion, there are two implications of this bill. First, removal of the June 30, 2006, date from subsection (e) will require use of embedded costs for determining KUSF support for rural ILECs indefinitely and without regard for any changes made by the FCC or Congress concerning federal USF support. This could create an inconsistency with Federal policy and violate Section 254(f) of the Federal Act. Second, leaving (e) otherwise unmodified means legislative acceptance of the Court's statutory interpretation which may require the Commission to make new findings regarding competitive neutrality and require increases in the size of the KUSF and the assessments to fund those increases.