

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.<sup>1</sup> 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 upgrading of facilities and services for which the support is intended.<sup>2</sup> 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.<sup>3</sup>

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<sup>1</sup> *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*).

<sup>2</sup> *Id.*, at 8889-90, ¶ 225.

<sup>3</sup> *Id.*, at 8934-37, ¶¶ 291-95

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.<sup>4</sup> 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.<sup>5</sup>

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.**"<sup>6</sup> 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 levels for both rural and non-rural carriers."<sup>7</sup> 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

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<sup>4</sup> *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*).

<sup>5</sup> *Id.*, at 11258-59, ¶ 29.

<sup>6</sup> *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).

<sup>7</sup> *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, fn. 267 (citing *Rural Task Force Order*, 16 FCC Rcd at 11310, ¶ 170).

problems inherent in indefinitely maintaining separate mechanisms based on different economic principles.”<sup>8</sup>

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 to competitors. 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 is that Kansas ratepayers now pay, through KUSF assessments, the cost of support for each line won by competition (encouraged by the Kansas Telecommunications Act), while still paying support for the line lost by the incumbent carrier. This double payment results from what CURB believes is the unintended consequence of the language used to codify the 2001 agreement between Commission Staff, CURB, and the rural carriers in the 086 Docket.

The cost of that double payment 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,<sup>9</sup> but more importantly, an additional \$1.7 million will be required each year. The \$1.7 million is likely to grow, as

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<sup>8</sup> *Id.*

<sup>9</sup> Direct Testimony of Ms. Sandra Reams, KCC, December 22, 2005, Docket No. 06-GIMT-332-GIT, page 6.

any additional lines lost to competitors will result in further double payment of support by Kansas ratepayers.<sup>10</sup>

The KUSF fund will increase from about \$63.2 million in 2005 to about \$73.2 million in 2006,<sup>11</sup> 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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<sup>10</sup> *Id.*, at p. 14.

<sup>11</sup> 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.