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 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.

---

[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.