Approved: January 24, 2000
Date

MINUTES OF THE SENATE COMMERCE COMMITTEE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on January 20, 2000 in Room 123-S of the Capitol.

All members were present except:

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

Conferees appearing before the committee:
Joe Lawhon, Legislative Division of Post Audit
Janet Luehring, Kansas Corporation Commission

Others attending: See attached list

Joe Lawhon, Legislative Division of Post Audit, distributed copies of the *"Performance Audit Report 'Reviewing Payments from the Kansas Universal Service Fund'"*. (A copy is on file in the Legislative Research Department) Mr. Lawhon testified the audit explains what happened during the Kansas Universal Service Fund's (Fund) first two years of operation; why the Kansas Telecommunications Act and Universal Service Fund became so controversial; and evaluates certain actions taken by Kansas Corporation Commission (KCC) staff to implement and control the Fund.

Mr. Lawhon stated the goal of universal service is to have affordable quality telephone services available to all people. In 1996, the Legislature adopted the Telecommunications Act which created the Fund. The conferee noted three provisions of the Act that affected the KUSF: 1) required local telephone companies to reduce the access fees they charged on in-state long distance phone calls; 2) specified that all the revenues these companies lost as result of that action should be replaced through "revenue neutrality"; and 3) allowed the KCC to decide how companies could make up the access fee revenue they lost. Access fee rates are access rates per minute fees a local telephone company charges a long distance telephone company to use its network. The Fund became operational on March 1, 1997 and the Report finds the revenues exceeded $80 million each year, expenditures were about $67 million in year 1 and increased to about $91 million in year 2; more than $150 million, about 96% of the Fund's expenditures, were used to replace access rate revenues. The KCC hired a third party to administer the Fund. The organization chosen is the National Exchange Carrier Association (NECA).

Mr. Lawhon testified the approved scope statement for the Audit had four questions, and for reporting purposes the first two questions have been combined into one.

Question 1: On what basis are moneys in the KUSF collected and distributed, and are reasonable methods used to ensure that those amounts are appropriate?

The Report finds that after the Act was adopted, the KCC staff first had to determine how much access charge revenue would be lost on an annual basis by the 41 local telephone companies operating in Kansas at that time. The KCC staff evaluated the revenues earned by the 41 local telephone companies during the 12 months ending September 30, 1996, and determined that these companies would lose about $106 million. The KCC decided that most of the lost revenue would be replaced through the Fund for the following reasons: 1) public opposition to a rate increase; 2) the KCC wanted the ability to retain flexibility over local telephone company rates; and 3) the KCC didn't want Southwestern Bell's customers to have to pay twice - once for a local rate increase and once for the Fund's assessment. The KCC decision to replace lost access fee revenues through the Fund explains why the Fund is so large - about $100 million. To ensure the Fund is adequately funded, the KCC staff annually calculates the amount telecommunications companies must pay into the Fund. Each year the KCC approves the rate that the staff has calculated.

The Report finds that the KCC and the NECA have established and are carrying out reasonable procedures for ensuring that the moneys in the Fund are collected and distributed appropriately. The actions taken are as follows: 1) verified the amount of access charge revenues that the local telephone companies reported they would lose (approximately $106 million); 2) adjusted the amounts companies should receive from the Fund if new information suggested those payment amounts should be raised or lowered; 3) contracted for special audits to look at a financial statement audit of the Fund, an examination of NECA's internal controls, the accuracy of the assessment rate charged for the second year of the Fund; and to ensure that those companies paid the correct amount. The latter 16 audits identified an additional $21,000 owed to the fund, and another special audit found that the assessment rate in the second year was reasonable.

The Report identifies the following problems with the Fund's collection and payment processes as follows: 1) need to develop a better definition of intrastate revenues because that is the amount to which the assessment rate is applied; 2) clarify whether the assessment rate should be applied to net or gross intrastate revenue, (The KCC issued an order in August 1999 clarifying this issue. Companies now report net revenues); 3) need to require telephone companies to submit a reconciliation about revenues collected because different revenue amounts were being reported to NECA and the Commission. (This has been done); 4) need to determine if the KCC should initiate better controls over payments made for high-cost lines.

The Report concludes that the KCC and NECA have taken adequate steps to carry out their responsibilities and not that corrective action was underway for the problems cited.

Question 2: What portion of the payments from the Kansas Universal Service Fund represents "high-cost recover" and what portion represents "revenue neutrality"?

Mr. Lawhon testified that more than $150 million, or about 96% of the Fund's expenditures during its first two years of operation, were paid for revenue neutrality. Inasmuch as the Fund's payments are based on costs incurred by local telephone companies, none of the Fund's payments are considered to be high-cost recovery. In March 1998 the Kansas Supreme Court ruled and affirmed the KCC's order implementing the Fund, and ruled that "revenue neutrality" was transitional, and that the KCC was aware of its responsibilities to examine costs and to modify the Fund based on that cost information. Kansas law is being challenged before the FCC. Commission staff argued that "the revenue neutrality mechanism is not permanent. The KCC must reduce KUSF funding to levels which do not make up for all that the incumbent local exchange carriers lost through the rate cut, if the cost studies show the full amount is not needed to keep revenues from falling below costs".

One conclusion in the Report is that given the number of parties, competing interests, and complexities involed in the telecommunications arena, the process will take some time. Things seem to be headed in the right direction, and the Legislature may want to give the process time to evolve before considering any action in this area.

Question 3: How does the Kansas Universal Service Fund compare with other Universal Service Funds?

The Federal Universal Service Fund and the KUSF have little in common. Both contribute money to a program designed to provide discounted telecommunications services to people with low incomes; all providers of telecommunications services contribute and the funds are administered by a third party. A comparison of Kansas and other states' universal service funds collections and expenditures showed Post Audit that there are some similarities and some differences.

Janette Luehring, Chief of Telecommunications, Kansas Corporation Commission, testified that since the Legislative Post Audit Report the KCC has clarified what constitutes in-state revenues and that all companies should report revenues net of the uncollectible revenues; it continues to monitor the companies that submit annual reports and compare that list to the companies that file KUSF reports with NECA . Companies are now required to reconcile the revenues reported in their annual reports with the revenue amounts submitted to NECA for universal service purposes.

Ms. Luehring stated the KCC has made significant progress in making the Fund cost-based, consistent with state and federal statutes, primarily through the 99-326-Docket which determined that forward-looking economic costs should be used for Southwestern Bell and Sprint and chose the FCC's Synthesis proxy cost model; established the assessment rate for year 4 effective March 1, 2000 at 4.66% for wireless and 4.92% for wireline telecommunications carriers.

In response to a question regarding a concern outlined in the Report relating to the definition of "in-state", Ms. Luehring stated the KCC believes it has addressed the definition of "in-state" as it has identified by account number those revenues that are intra-state. As to the wireless companies, the KCC has adopted a policy similar to the Federal program, "that an assumption is made on a default basis that 85% of the revenues are intra-state and 15% are inter-state".

Ms. Luehring, in response to a question as to what the KCC has done to verify the new high-cost lines, responded that it used the FCC model and the cost benchmarks which is about 125% of the cost average.

In response to a question about rural telephone companies and their entitlement to KUSF funds based on revenue neutrality and the funds they receive from the FUSF, Ms. Luehring stated those funds are separate and apart. Ms. Luehring stated the federal money is not taken into consideration for state moneys. Senator Ranson voiced the opinion that consequently the rural companies are not reimbursed on a revenue neutral basis; they are getting a windfall.

The Committee discussed the method for determining revenue neutrality based on a one time analysis of revenues for the 12 months ending September 30, 1996., and requested the KCC to conduct a more recent analysis of current minutes of use and access rates.

Upon motion by Senator Ranson, seconded by Senator Umbarger, the Minutes of January 18, and January 19, 2000 were unanimously approved.

The meeting was adjourned at 9:00 a.m.

The next meeting is scheduled for January 21, 2000.