

Approved: 2/11/94  
Date

## MINUTES OF THE SENATE COMMITTEE ON COMMERCE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on February 10, 1994 in Room 123-S of the Capitol.

Members present: Senators Downey, Feleciano, Gooch, Harris, Hensley, Kerr, Petty, Ranson, Reynolds, Salisbury, Steffes and Vidricksen

Committee staff present: Lynne Holt, Legislative Research Department  
Bob Nugent, Revisor of Statutes  
Mary Jane Holt, Committee Secretary

Conferees appearing before the committee: James Chadwick, Superintendent, Comanche County USD #300  
Brian Moline, General Counsel, Kansas Corporation Commission  
Don Low, Director of Utilities, Kansas Corporation Commission  
Mike Ensrud, Commuigroup of Kansas City, CGI  
Pres Sheppard, Vice President, Government Affairs, AT&T  
Bion Ostrander

Others attending: See attached list

### Hearing on SB 591--Limited deregulation of the telecommunication industry

James Chadwick, Superintendent, Comanche County USD #300, informed the Committee the A-Plus interactive television network, made possible, in part, by the encouragement, assistance in the area of design and engineering, and construction on the state's premier interactive television network by Southwestern Bell Telephone, is a fiber-optic network that links together various high schools. He stated SB 591 will help Kansas communities gain access to services that typically are only available in the metropolitan areas, see attachment 1.

Brian Moline, General Counsel, Kansas Corporation Commission, testified SB 591 is premature, unnecessary and unwise legislation that would complicate tremendously the evolving public interest role in the telecommunications industry. He stated TeleKansas II should stay regulatory instead of legislative. TeleKansas I does not expire until February 25, 1995 and the Commission can and will craft a successor plan unless preempted by legislative action. The Kansas Corporation Commission has never hesitated to give serious consideration to incentive regulation where applicable. Nor has the Commission been hostile to the utility enjoying the financial benefits of such regulation. The Commission has, however, never accepted the idea that the utility should keep all the benefits, forever, as mandated by SB 591. Rate payers should not be shut out, by law, from any benefits from the tremendous earning potential of the telecommunications revolution. Kansas can participate fully and timely in the development of the "information superhighway" without sacrificing all consumer protection safeguards, see attachment 2.

Don Low, Director of Utilities, Kansas Corporation Commission, testified the Commission staff has evaluated the experiment of TeleKansas I to determine what the next step should be in the changing telecommunications environment. The conclusion is that, although TeleKansas I has been a good experiment, it should be not be continued exactly as is because of the unreasonable earnings and rates that would result without modifications. Pricing flexibility mechanisms in TeleKansas I should be continued but total earnings flexibility is unwarranted. TeleKansas II should include an excess earnings sharing mechanism. Such a mechanism provides rewards to the company for improved efficiencies but also ensures that rate payers share in the benefits of relaxed regulation. Mr. Low set forth his objections in attachment 3.

Mike Ensrud, Commuigroup of Kansas City, informed the Committee CGI is a Kansas based long distance company that opposes SB 591. Southwestern Bell provides monopoly facilities for over 99% of the connections between a long distance company and its customers. CGI pays Southwestern Bell 40% to 70%

## CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON COMMERCE, Room 123-S Statehouse, at 8:00 a.m. on February 10, 1994.

of their gross revenue in order to utilize Southwestern Bell's monopoly facilities. Implementation of SB 591 will result in Southwestern Bell being in a unique position to take advantage of both captive customers and competitors. He stated CGI's main objection to SB 591 is that it allows Southwestern Bell to extend the freeze and pocket all excessive earnings, see attachment 4.

Pres Sheppard, Vice President, State Government Affairs, AT&T, testified the balloon amendment to SB 591, as offered by Southwestern Bell on February 9, 1994, addressed some of their concerns but still left three major flaws. Section 3, upon finding of competitive status for a service, completely deregulates that service without providing any safeguards for consumers or competitors or any oversight by the Kansas Corporation Commission. Section 1 (b) would authorize Southwestern Bell to raise any of its rates to offset lost revenue under some circumstances. Section 1 (c) provides greater flexibility for Southwestern Bell than is currently afforded to AT&T and the other long distance carriers. He submitted an amendment to Southwestern Bell's amended SB 591, see attachment 5.

Bion Ostrander, Topeka, testified he is a Certified Public Accountant and specializes in telecommunications matters regarding regulatory issues. He stated he has eight years of experience with the Kansas Corporation Commission, and was the only KCC staff signatory to TeleKansas in November 1989 while serving as the Chief of Communications. He said he opposes SB 591 and proposed that the legislature defer to the KCC regarding a successor plan to TeleKansas at the present time. If the Commission is unable to implement a plan by the approximate expiration date of TeleKansas in early 1995, then perhaps other avenues should be explored.

Mr. Ostrander explained if the modernization and related services which Southwestern Bell proposed are in the best interests of Kansans, then these services should be provided regardless of the type of regulation. In fact, if these services are needed and desired by Kansans (such as schools and hospitals) then there is an inference that these are in fact efficient and sufficient services which Southwestern Bell is obligated to provide, see attachment 6.

The Chairman announced the Committee meeting would convene at 7:30 a.m., Friday, February 11, 1994.

Senator Steffes moved and Senator Ranson seconded to adopt the minutes of February 9, 1994. The motion carried by voice vote.

The Chairman adjourned the meeting at 9:00 a.m.

The next meeting is scheduled for February 11, 1994.

# GUEST LIST

COMMITTEE: SENATE COMMERCE COMMITTEE

DATE: 2/10/94

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
DENNY KOCH	TOPEKA	SWBT
Glan Steppat	Topeka	PETE McGill + Assoc.
HAROLD P. FRS	Topeka	AARP-CATF
BRIAN LIPPOLO	WICHITA	MULTIMEDIA HYPERION TELECOMMUNICATIONS
BEN SCIORTINO	WICHITA	MULTIMEDIA CABLE
BRIAN MOLINE	TOPEKA	KCC
Don Low	"	"
Tom Gleason, Jr.	Lawrence	Independent Telecom Grp.
STEVE KEARNEY	TOPEKA	KINI
Nelson Krueger	Lawrence	KINNET
Jay Scott Emmer	Salina	KINI
Martha Jenkins	Ks City	Sprint
JEFF RUSSELL	TOPEKA	UNITED TELE.
Mike Reeb	TOPEKA	AT&T
Paul Sheppard	Aurora, IL	AT&T
Michael J. Cusumano	5960 W. 56th St Mission, KS 66202	C&I
Dan Moore	Topeka	KSBE
Russ Phelps	Topeka	SWBT
Glenda Capin	Topeka	wave
RICHARD SCHARFENBERG	St. Louis	SWBT
Larry Diarmitt	Topeka	SWBT
Alice Amstutz	Topeka	SWBT
SUSAN FOX	Topeka	SWBT
Kope Trautve	"	Ks Gov. Consulting
THOMAS C. Schuer	Topeka	KCC

## GUEST LIST

COMMITTEE: SENATE COMMERCE COMMITTEE

DATE: \_\_\_\_\_

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## SENATE COMMERCE COMMITTEE

February 9, 1994

### TELECOMMUNICATIONS: A CHANGE IN REGULATION

James C. Chadwick, Superintendent  
Comanche County USD 300

Chairman Salisbury, Members of the Committee. I appreciate the opportunity to appear before you today and speak on behalf of passage of Senate Bill No. 591.

I believe this legislation to be a change in the way in which telephone companies, in particular, are regulated. I understand this is not deregulation but a change in the manner in which they are regulated. Primarily I want to share the successes and future plans for the A-Plus interactive television network, made possible, in part, by the encouragement, assistance in the area of design and engineering, and construction on the state's premier interactive television network by Southwestern Bell Telephone. The A-Plus Network is a fiber-optic network that links the high schools in the communities of Ashland, Protection, Coldwater, Haviland, Greensburg, Mullinville, Fowler, Meade, and Plains.

I believe it is important for you to know how the A-Plus Network has made a difference in my community and the communities with which we are connected. The reason I attach such importance to this is that my understanding Southwestern Bell plans to make this same type of network available to all communities they serve. Without question this will be good for the citizens of Kansas as we have seen in our area.

The A-Plus Network started as a vision. A vision created and nurtured by sales people and engineers from Southwestern Bell Telephone. A group of what eventually turned out to be nine school districts accepted the challenge and as the vision grew an organization developed called Interlocal 625. This organization of schools proceeded to plan the system with the assistance of Southwestern Bell Telephone. Construction, by Southwestern Bell Telephone followed and in late August of 1990 classes began over the system.

Since the fall of 1990 Southwestern Bell Telephone has maintained the system, sometimes responding within minutes. This quick response and the very low incidence of maintenance problems has allowed us virtually trouble free operation with a negligible amount of down time.

During the first year of operation, in addition to the classes taught for high school students, a number of staff development opportunities were presented. The Special Education Cooperative held staff development sessions for professional and paraprofessional staff on a regular basis via the system, eliminating a good deal of expense for travel

2/10/94  
Commerce  
Attachment 1-1

time and per diem costs for those teachers who participated. In addition, these sessions were more effective in our opinion because they occurred on a regular basis. Since they were on a regular basis the need for covering a multitude of topics and material was not present. Timely topics, more relevant to the current problems existing in our special education cooperative were presented.

Administrative meeting of the Interlocal and other administrative organizations within the network have taken place over the system, eliminating lost time from assigned duties as well as travel costs.

The community has used the system in many and varied ways. The Extension service has regular sessions within our region, via our system. Extension courses are presented on a regular basis within the network, and 4-H clubs and other youth organizations are conducting meetings between communities over the system. In addition to the extension service, EMT's, volunteer firemen, and law enforcement people, are using our system for training. Schools with needs for CAL license training, defensive driving courses and other training courses for school bus drivers have used the system, saving a great deal of staff time and travel cost.

The Kansas Agricultural Rural Leadership organization has used the system for training session, attempting to re-train young leaders in the area of economic development, specifically in the agricultural world.

The community colleges beginning with the second semester of the 90-91 school year, offered thirteen community college courses throughout the network, both to high school students wishing to begin their college career and to adults wishing to re-train. Many of those re-training courses were aimed at the health care field to update health care providers in our nursing homes and hospitals, as well as developing new personnel for a very tight work force. The number of offerings now exceeds twenty community college courses.

The second year of operation started with an increase in enrollment as has the current year. The number of class offerings has increased each year of operation. We currently offer a full seven period schedule including two foreign languages, advanced math, economics, art and advanced science courses. There are 318 students enrolled in these courses. Some are for college credit through one of the area community colleges. We are looking to regents institutions for additional classes at this time. Ft. Hays State University offered, during the previous summer, a teacher training course for college credit via the system. The limiting factor at this time is access to the outside world. To offer the course, Ft. Hays State University had to actually send the person to one of the sites in our network. With some additional equipment and planning, our hopes are to access the regents universities state wide for further training of staff and additional adult education training courses. This

capability would open the system for more effective use by commercial interests within our network.

### **VISIONS FOR THE FUTURE**

We have an ever developing vision for this technology and new technology that will be added using our interactive television system as the vehicle for integrating the various technologies. We plan to use the fiber system for networking computers, both for instruction and curriculum management, and possible administrative functions. We have a vision that involves networking library media centers throughout the A-Plus Network, along with access to public libraries and university libraries throughout the state. With the advancing technology and necessary funding we plan to open a gateway to the outside world. An outside world in which we will be able to access information and interact with the very people that we are studying. What better way to make education relevant for students than accessing the real world in which we are training them to function. We want to involve business and industry. With this gateway to business places throughout the state and nation, our business people will be able to take advantage of information, training and other opportunities for development. Let students, business people and ordinary citizens participate in the legislative process as we are here today. Let health service workers receive instruction from professionals at Kansas University Medical Center. Let students participate in dialog with commodities brokers in a brokerage house somewhere within our state or Nation. A Spanish class studying the Spanish language and culture could certainly benefit from interaction with a class of Spanish students in Mexico. The list could go on to include the Space Center in Hutchinson, a space shuttle, etc., etc. Again, as I understand it, passage of Senate Bill No. 591 would allow Southwestern Bell to implement it's plan which would provide this gateway.

### **LEGISLATIVE ASSISTANCE NEEDED**

You can help with this vision. You can recommend passage of Senate Bill No. 591 and allow this phone company to operate from the same page in the regulations as all other such companies. They are the primary source of assistance in many areas of the state and in most cases are the only one with the availability of proper expertise to accomplish the design and engineering necessary to develop a premier state wide system.

If to continue price regulation as they have now and have had for the last four years, is all that is necessary to allow the \$138,000,000 expenditure to further develop the telecommunications system in this state, let's do it. How can we, as a state, turn down such a capital expenditure, an expenditure that may be made elsewhere.

This legislation will help mine as well as other communities in Kansas gain access to services that typically

are only available in the metropolitan areas. I fully realize that a community the size of Coldwater or Comanche County, Kansas, can not stand alone in justifying the cost for new technology. But when you combine all of Southwestern Bell served communities, as they have done in their plan, we are assured of affordable access to current and future services like our friends in Wichita, Topeka , or Kansas City. I believe this legislation insures that we will have an on-ramp to the information highway of tomorrow.

Words on paper, such as the testimony provided for you can not convey the excitement our people feel about the A-Plus Interactive Television Network. If you have never seen such a system please let our students share the experience with you. You are invited to come to Comanche County and let our students show you what a difference it has made.

Thank you for the opportunity to submit this information and my opinions. Please feel free to contact me for more information or questions.

THE ONLY LIMITING FACTOR IN THE ADVANCEMENT AND SUCCESS OF OUR SYSTEM AND THE STATE SYSTEM IS THE COLLECTIVE IMAGINATION OF ALL IT'S PARTICIPANTS!

**STATEMENT OF BRIAN J. MOLINE  
GENERAL COUNSEL - KANSAS CORPORATION COMMISSION**

**SENATE BILL 591**

Senate Bill 591 is premature, unnecessary and unwise legislation that would complicate tremendously the evolving public interest role in the telecommunications industry. Regulation acts as a surrogate for competition in a monopoly industry. All would agree, as competition increases, less government regulation is required to protect ratepayer interests. The key is whether competition is real or illusory and whether emerging competition can realistically compete; whether the playing field is level. The telecommunications industry is currently in a transition period, transitioning from monopoly markets to more competitive. Some services face real competition, some services remain monopolies.

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Attachment 2-1

As TeleKansas I demonstrated the Commission successfully allowed more pricing flexibility and less regulation of these more competitive services while maintaining oversight of the monopoly services - to the benefit of both SWBT and ratepayers. But TeleKansas I was done in an administrative proceeding with evidence, and full opportunity to participate to interested parties. This legislation frames a particular moment in time in a rapidly changing industry and freezes it in statutory form with serious but largely unknown consequences on emerging competition and captive ratepayers.

Let me begin by stating some important points that this discussion revolves around.

(1) There is no disagreement between staff and the company that there should be a successor plan to TeleKansas I. Nor is there any dispute that non-traditional regulation is necessary in this industry while the industry is transitioning from monopoly to competitive markets. The main dispute

between staff and the company is whether ratepayers should share in some fashion the undoubted financial benefits of TeleKansas I, while SWB remains a monopoly service provider, and whether successor alternative plans should be permanently frozen into a statute or subject to periodic review and adjustment to new economic and technical realities?

(2) Unless the legislature intervenes, a TeleKansas II will emerge from the regulatory process just as TeleKansas I did.

(3) The telecommunications industry is changing rapidly, however, it is also true that Kansas telephone companies continue to enjoy a state sanctioned monopoly in the provision of basic service; a monopoly that SWB vigorously protects from any encroachment at every opportunity.

SB 591 is premature because legislation is currently pending in Congress that will almost certainly pre-empt much traditional state authority in this arena. As Dr. Hammond stated yesterday, to the extent that state legislation is inconsistent with

the federal effort, it will needlessly complicate policy implementation.

SB 591 is unnecessary because TeleKansas II is proceeding before the Commission. Unless the legislature chooses to intervene, and decide the issues, the Commission will fashion a successor plan during this final year of TeleKansas I. I submit to you that the regulatory process works and as Exhibit A to prove that contention I simply point to TeleKansas I. That plan emerged from the regulatory process. There are a number of reasons why this matter should continue to be determined, at least initially, by that same process.

(1) An administrative proceeding is particularly suited to the complex fact-finding necessary to formulate a coherent policy in this arena. While administrative hearings can be slow and expensive, they are also deliberate, considered, incremental, subject to both judicial and legislative review and decisions are

made on an evidentiary record with extensive procedural safeguards and opportunity to participate.

(2) The Administrative process does not have the same time constraints that the legislative process operates under and has the luxury of gathering and analyzing more information.

(3) A Commission Order is subject to re-hearing and correction if there are factual or legal errors and flexible enough to be amended or even nullified as emerging conditions require. As committee staff so ably pointed out, it is difficult to craft a statute with the degree of precision necessary to cover all contingencies.

(4) TeleKansas I doesn't expire until February 25, 1995. The Commission can and will craft a successor plan unless preempted by legislative action. And that plan is subject to both legislative and judicial review.

SB 591 is unwise because it sets a precedent that will complicate the entire regulatory process. A statute lacks the

flexibility to adapt to or adjust to any future event that might impact SWBT, the industry as a whole or ratepayers. The point is that the degree to which regulation should be lessened or changed to deal with emerging competition should be made in the administrative hearing and on a case by case basis - with an opportunity to present expert evidence pro and con on the record and with full due process considerations. Because this bill removes a pending matter from the Commission, it could be interpreted as a signal to other regulated entities to seek similar legislative relief if regulatory prospects look dim in their proceedings. Also to the extent that SB 591 removes regulatory oversight over earnings of SW Bell presumably because they face potential (but not actual) competition in some areas for some services, it should be pointed out that the gas industry has been extremely competitive in virtually all areas for some years. The electric industry also faces possible competition. SB 591 has the

potential to become a precedent for wholesale de-regulation of monopoly industries in the name of potential competition.

In conclusion, should you disagree and believe that the legislature should adopt SB 591 and pre-empt the KCC decisionmaking process there are several important policy trade-offs the Commission faces that you must address and resolve:

(1) Should ratepayers have an opportunity to share in the financial benefits of so-called incentive regulation or be forever precluded from such relief as provided in SB 591?

(2) Should TeleKansas II and other successor plans be subject to periodic review and possible adjustment or should the Commission be precluded from any rate re-adjustment based upon Bell's overall profits indefinitely?

(3) Should local rates remain static when the costs of providing that service may and probably will continue to decrease.

(4) Should the Commission continue to have some limited oversight over the pricing of such services as multiple business, 911, touchtone, operator assisted calls, such as person-to-person, station-to-station, and credit card calls, and such services as call waiting, directory assistance.

(5) Should the Commission continue to have some oversight over universal service concerns?

(6) Should the Corporation Commission continue, as long as federal law permits, to evaluate competition through the hearing process on a case-by-case basis, or should SW Bell be sheltered from the consequences of any Commission action which might result from increasing competition. SB 591 furnishes a guarantee that service rates will be increased - dollar for dollar - to compensate in advance for any anticipated lost revenues and without any opportunity for the Commission to compare such lost revenues against overall company

earnings. The events that could trigger such revenue insurance is maddeningly vague

This issue is not whether telecommunications should be subject to incentive, non-traditional regulation. That decision was made four years ago. The issue is how? What is the best method of coping and adjusting to the shifting and sometimes conflicting changes in technological, legal and economic policy considerations that rapidly occur in this industry? I respectfully submit that a statute is not as desirable as the administrative hearing method.

The Kansas Corporation Commission has never hesitated to give serious consideration to incentive regulation where applicable. Witness the KGE-KPL merger. Nor has the Commission been hostile to the utility enjoying the financial benefits of such regulation. The Commission has, however, never accepted the idea that the utility should keep all the benefits - forever- as mandated by SB 591. Ratepayers should

not be shut out, by law, from any benefits from the tremendous earning potential. of the telecommunications revolution.

Kansas can participate fully and timely in the development of the "information superhighway" without sacrificing all consumer protection safeguards. The baby does not have to be thrown out with the bathwater, and that's what SB 591 does.

BEFORE THE SENATE COMMERCE COMMITTEE

PRESENTATION OF THE  
KANSAS CORPORATION COMMISSION STAFF

On  
SB 591

This bill has been introduced because Southwestern Bell does not agree with the Commission Staff's position concerning a successor plan to TeleKansas (TK I). That alternative regulatory plan is a five year experiment which basically allows SWB, in exchange for significant rate reductions and modernization commitments, to have increased overall earnings flexibility and pricing flexibility for certain services. The KCC appropriately only approved of TK as an experiment rather than on a permanent basis, as requested by SWB, because of the radical change it represented.

As required by the provisions of TK I, the staff has evaluated the experiment to determine what the next step should be in the changing telecommunications environment. Staff has concluded that, although TK has been a good experiment, it should not be continued exactly as is because of the unreasonable earnings and rates that would result without modifications. Staff has suggested that the pricing flexibility mechanisms in TK I should be continued but total earnings flexibility is unwarranted. Staff has suggested that, like an overwhelming majority of states with alternative regulatory plans for telephone companies, the successor plan, TK II, should include a excess earnings sharing mechanism. Such a mechanism provides rewards to the company for improved efficiencies but also ensures that ratepayers share in the benefits of relaxed regulation. As long as significant telephone services are provided on a monopoly basis, staff believes this kind of mechanism is desirable. Such a excess earnings sharing mechanism is still a significant departure from traditional rate base regulation in which rates can always be adjusted to account for any and all earnings above reasonable levels.

Both the company's proposals for TK II and staff's recommendations are before the Commission for consideration and decision before the expiration of TK I a year from now. SB 591, however, short circuits the administrative process and goes far beyond both TK I and SWB's TK II proposal.

The KCC Staff believes this bill is bad legislation because it flies in the face of accepted public policy: Regulation of utility monopolies is a substitute for competition. Therefore the amount of regulation should correspond to the degree of competition; and competition does not exist in major segments of the telecommunications industry in Kansas. If full competition existed, excess earnings and unreasonable rates would not be a public concern but until real competition develops there needs to be appropriate regulation.

2/10/94  
Commerce

Attachment 3-1

This bill does not allow for the appropriate degree of regulation during the transition to greater telecommunications competition. Specifically, the bill is inappropriate for the following reasons:

- 1) It is a premature and inflexible mandate for how local telephone companies should be regulated.
- 2) There is no reason for the bill to apply to all local phone companies and it would hinder the KCC in addressing telephone service and rate problems.
- 3) It allows Southwestern Bell to retain unreasonable profits at the expense of monopoly ratepayers.
- 4) It does not reflect the current status of competition in Kansas.
- 5) It allows Bell to unfairly position itself for competition and would allow for service and rate discrimination and geographic deaveraging of services, to the detriment of rural customers.
- 6) It allows for hindrances to the development of competition, at the expense of ratepayers.

- Attachments:
- 1) Ambiguities in SB 591 - bill contains numerous ambiguities which could lead to even more disputes than TK I.
  - 2) Differences between TK II proposal and bill - the bill provides for greater regulatory changes and fewer assurances of benefits than SWB's TK II proposal.
  - 3) Background on TK I & II and issues involved:
    - A) Details on TK I.
    - B) Traditional regulation and alternatives.
    - C) Telecommunications Competition.

Application to All Local Companies.

- No apparent reason to apply to other telephone companies since they face little competition in foreseeable future.
- Removal of earnings oversight and requirement of Section 1(b) might hinder KCC ability to address quality of service, calling scope, and other problems.

- Ordering of facility improvements would not affect revenues so Section 1(b) requirement to allow offsetting increase in rates shouldn't be triggered, but companies might argue that "revenues" really means operating income so that cost impacts must also be offset regardless of overall earnings.

- Although KCC could apparently order expanded calling scope or other service/rate changes, it would have to allow offsetting increases in other rates (Sect. 1(b)) for lost revenues, regardless of overall earnings. For many independent telcos, would have to increase either basic local service or access charge rates, which results in corresponding increases in long distance rates.

#### Excess SWB Earnings.

- Basic reason for regulation of utility monopolies to ensure just, reasonable, and nondiscriminatory rates. Customers have no choices and shouldn't be forced to contribute to excess earnings of monopoly provider.

- Staff Bell audit shows excess earnings, based on 1992 data. More importantly, clear trend is toward greater earnings in future.

- Audit shows need for rate adjustments now and sharing mechanism for successor plan to help ensure reasonable rates.

- Bill guarantees continuation of excess profits.

- Section 1(a) does not allow for any KCC action to adjust rates to reflect reasonable earnings levels.

- Sect. 1(b) requires KCC to allow increase in rates for "noncompetitive" services to offset any KCC actions, other than rate actions, that has effect of reducing revenues. (Unclear whether this includes increases in costs.) Since section requires consideration of price elasticity effects, increases most likely on price inelastic services - noncompetitive services.

- Sect. 1(c) allows company flexibility to change rates for all services except basic local service, regardless of competitive nature of service or effects on company earnings. Although proposed changes are subject to review and suspension in light of other considerations,

presumption of reasonableness for any rates above incremental cost appears to effectively preclude KCC review.

- Freeze on basic local rates is no bargain.
  - No increase in local rates necessary in light of Bell's earnings.
  - Technological improvements, growth, and development of new services decrease costs of basic service.
  - On national annual basis, states have ordered net reductions in telephone rates by hundreds of millions every year since 1987.
  - "Basic" local service does not include multiline business rates.
  - "Basic" local service is not only essential service for "Universal Service" in Information Age.
- "Modernization" commitment for interactive video services no bargain if KCC doesn't have ability to determine rates.

#### Status of Competition.

- Bill assumes full competition but Bell is presently subject to competition only in certain markets.
  - As a result of recent decision, Bell now faces authorized competition in intraLATA long distance market for WATS, 800 and other services. For "regular" long distance, competition only in form of 10XXX dialing, which is expected to be limited.
  - Bell also subject to competition for certain services from features in customer provided equipment - answering machines, speed dialing, PBXs - or customer owned coin phones.
- No authorized "Competitive Access Providers" but application pending.
- No competition for local service likely for several years, although SWB was the first to take steps toward potential BOC/cable vs. BOC competition.
- KCC staff perfectly willing to allow Bell pricing flexibility corresponding to real competition since competition should restrain prices. (See Attachment)

- Flexibly priced services under TK I includes all competitive services.
- Includes "discretionary" services which are not "competitive."
- Bill (Section 1(c)) would give telco ability to change any rates other than basic local on 15 days notice.
  - Although now appears to require KCC approval of proposed changes, creates presumption of reasonableness for proposed rates at or above incremental cost.
  - Establishment of incremental cost as floor may address competitor concerns about "predatory" pricing for more competitive services but presumption of reasonableness for rates above that level provides no protection for noncompetitive services: multiline business, carrier access, DA, Touchtone, 1+ long distance, interactive video, etc.
    - Should note that multiline business was frozen service under TK I. TK II proposal is to restructure but not cap.
    - Touchtone service rate substantially reduced or eliminated in many states in light of importance to "Information Age" and low costs.
  - Unclear whether carrier access charges subject to presumptions and other considerations of rest of Sect. 1(c). "Changes carrier access charges . . . shall be determined by the commission . . ."
  - If incremental cost is presumed reasonable, could result in huge increases in other rates, including basic local rates, since some definitions of "incremental costs" would not include large portion of costs now recovered through carrier access charges.
  - Reasonableness presumption could also allow telco to charge excessive rates for access, with resulting higher long distance rates.
  - Criteria for suspension problematic since appears to require KCC conclusions that would normally follow full investigation and hearing.
  - Also, 15 days inadequate for staff investigation and KCC action in many cases, especially for noncompetitive services.

### Competitive Positioning.

- SWB can and should use reasonable monopoly earnings to prepare for competition and has already taken steps to do so.
- SWB should also be given some incentives to reduce costs, improve efficiencies, and further modernize, which sharing mechanism does.
- Bill would allow Bell to use excess monopoly earnings to position the company for future competition.
  - Excess earnings can be used for competitive ventures like Cox Cable.
  - \$138 million modernization proposal also represents competitive positioning.
    - Details not known but fiber capacity will likely not be dedicated only to education, health care, and "economic development" applications of immediate benefit to customers; but also for future competitive uses.
    - Since annual costs of program less than overearnings, Bell would be using overearnings to fund infrastructure it will use in competitive environment.
  - Although infrastructure also potentially beneficial for education and health applications, not clear how much actual benefit.
    - Unlike TK II proposal, Bill does not reflect any discounted rates for the interactive video and other applications. Under Section 1 (c) of Bill, unclear how much discretion KCC has over rates.
    - Even with discounts, not known whether schools and other entities can actually afford services.
  - Should note that similar SWB bill in Missouri provides for continuing annual commitment of investment dollars rather than investment over five years as in Bill.
  - Bell had also proposed to the Missouri Public Service Commission interactive video connections to junior highs rather than just high schools as in TK II proposal.
- Bill would also allow Bell to obtain competitive advantages in service offerings.
  - Restrictions on KCC's ability to investigate price changes

could lead to cross subsidization and strategic pricing designed to forestall competition.

- Section 3 very ambiguous since any similar offering may be "competition" and Bill could require deregulation of Bell services regardless of size, technical and financial viability, etc. of purported competitor. Section deregulates Bell service but not competitor's.
- Not only is Bell service deregulated but, under Section 1(b), KCC action which allows competition requires increase in noncompetitive service rates. Obviously deters KCC from authorizing more competition but also further allows Bell to fund competitive services with noncompetitive services.
- In any event, "deregulation" of even competitive services may lead to geographic deaveraging, service discrimination, and other problems regulation originally intended to address.
  - For example, long distance services likely to be first "competitive" service deregulated which would mean that rates for long distance could be higher in rural areas than urban areas.

#### Development of Competition.

- As noted above, SWB is facing some competition in some of its markets, but no real competition in its core markets. As competition emerges, telecommunications customers will benefit only if competition is meaningful and strong enough to provide real options to all customers.
- Customers will be worse off if incumbent is given too much flexibility in noncompetitive markets which delays development of competition.
- In addition to above specific problems of bill, general problem is that it may restrict KCC's ability to take steps promoting competition but protecting universal service.
- Congress likely to pass legislation this session which intended to promote further competition as means of developing National Information Infrastructure but also to ensure a newly defined "Universal Service." The legislation involves trade offs for telephone companies by allowing entry into markets now foreclosed, such as video services, but requiring open access to the telephone company networks.
- The proposed federal legislation includes components which will: require open access, interconnection, and interoperability for

networks; require filing of unbundled, cost-based tariffs for such access and interconnection; require the FCC to develop criteria for determining if services are subject to competition; remove the MFJ "line of business" restrictions on Bell companies; remove other restrictions on entry into communications markets that now apply to telephone companies and other entities, such as cable companies; and require re-examination of the definition of, and mechanisms for promoting, "universal service."

- Much of the proposed Congressional legislation will pre-empt state regulation or make aspects of it subject to federal guidelines. Any state legislation enacted now could be pre-empted by, or be inconsistent with, federal legislation. At the very least, SB 591 would likely hinder the KCC's ability to effectuate the purposes of federal legislation.

- For example, if federal legislation requires open access to exchange networks to be implemented by states, SB 591 would require the KCC to increase noncompetitive service rates to compensate for lost revenues while ignoring increased earnings or revenues due to other parts of the legislation, like allowing the RBOC's into the interLATA long distance market.

- Further, the federal proposals contemplate structured efforts to determine what types of services, like Touchtone, might be considered essential as part of the Universal service goals. SB 591 could hinder those efforts since the KCC would have less ability to determine rates for all services.

**Ambiguities Contained in SB 591**

Section 1(a)

§1(a) If public utility agrees not to file rate increase for basic local telecommunications service - the public utility shall not be subject to investigation, complaint or hearing regarding basic local rates or overall earnings.

This section contains no requirement of reasonableness of rates, obligation to serve or sufficiency of service.

Capital expenditures will be above normal construction investment. This section provides no direction regarding what is normal. How is normal determined? What time frame is considered in determining what is normal? It is unclear who makes the determination regarding what is normal construction investment?

Targeted to infrastructure having applications in areas of education, health care, or economic development but not necessarily required to result in those applications.

Targeted - but no requirement for results.

Applications - how directly or indirectly related to these areas. Who decides what is needed and/or where investment should be placed.

Economic Development - not defined, can be solely for competitive infrastructure advantage, doesn't specify rural areas.

When public utility proposes rate change for other services §1(c) refers to Commission review, but §1(a) provides proposals consistent with subsection (c) shall not authorize investigation, complaint or hearing as to reasonableness of rates.

Section 1(b)

§1(b) Before Commission takes any action subjecting SWBT to any reduction in revenues, Commission must by order, specify a plan to ensure revenue recoverable by SWBT through increase in rates for any service - recognizing rate increase on certain services may further reduce revenues.

"Any action" - Does this only include any action directly involving SWBT, or does it include action concerning other companies/ Further, does it apply only to new actions or to continuing effects of prior Commission actions?

"Any reduction in revenues" - It is unclear whether this means "margins or profits", booked revenues or the impact of increased costs? (e.g. service improvements) Does reduction in revenues mean the reduction in existing revenues or does it include lost opportunity revenues? (e.g. what might be revenues under continued monopoly status?)

The plan to ensure revenues will be recoverable through rates will be based on projected losses because it must occur prior to Commission action. It is unclear how far in the future the projection should go and whether this section allows for a true up mechanism if the projected losses differ from actual losses.

#### Section 1(c)

§1(c) Public utility (under commitment) can propose rate change for "other services" on not less than 15 days before the effective date, subject to limited Commission review for reasonableness but rates are presumed reasonable if above incremental cost.

This section assumes the requirement of reasonable rates is still applicable but no other section provides a requirement that rates be reasonable. It is also unclear how the presumption of reasonableness affects the Commission's ability to review existing rates under §1(a). Presumption that rates are reasonable if above incremental cost vitiates any other Commission review as specified in bill.

Suspension criteria specifies rates must be clearly inconsistent with laws or Commission rules or clearly unjust and unreasonable. This section shifts the burden of proof to staff to prove rates clearly unlawful or unreasonable, in advance of suspension, in order to suspend rates. The 15 day deadline does not allow adequate time for that type of review because the criteria are grounds for denial of the tariff. This section shifts the burden of proof to staff rather than the company having the burden to prove the proposed rates are lawful and reasonable. In essence, this section requires the Commission to determine the tariff should be denied before it can be suspended. Further, the repeated use of the term "clearly" in this section may also raise the current burden of proof.

Carrier access charges shall be determined by the Commission without reference to the public utility's earnings. It is not

clear whether the incremental cost test applies to access charges. This section allows SWBT to continue to recover access revenues without a determination of whether the amount of revenue recovery is appropriate or cost based. Further, the Commission would be unable to apply any separations evaluation without information involving earnings.

### Section 3

§3 If Commission determines same or similar service by that provider is offered by another provider at equivalent or lower price and Commission determines such offering constitutes competition, Commission shall exempt that (SWBT) service from regulation.

This section does not define what is meant by "same or similar service". (e.g. Does a phone book provide the same or similar service as Directory Assistance?)

The bill sets forth no criteria for determining what constitutes competition. The bill makes no reference to market share. Thus, SWBT service may be deregulated when there is an entrant into the market without significant market share.

If entrant does not survive in the marketplace, there is no provision for that SWBT service to return to regulation.

The bill only exempts from regulation the SWBT service facing competition. It does not exempt from regulation the same or similar service if the other provider is not operating pursuant to §1(a) of the bill.

Commission action exempting a service from regulation does not fall under §1(b) but authorizing the same or similar service would potentially trigger §1(b). Therefore, its possible that SWBT's service would be unregulated and SWBT would receive an automatic rate increase for the displaced revenues while the similar service remains regulated.

**Differences Between SB 591  
and  
SWBT TK II Proposal Before the KCC**

1. Capital expenditures (\$138 million) are targeted to applications related to education, health care or economic development in S.B. 591; TK II included, in the same \$138 million, network reliability (redundancy in network).

2. SB 591 does not include any provisions regarding 911 emergency service; TK II provides for free provision of 911 transport facilities.

3. SB 591 does not provide for discounted rates for interactive video usage for schools; TK II provides for discounted rates.

4. SB 591 does not specify what is referenced in "applications related to education...." TK II specified interactive video connections between rural high schools, community colleges, and universities.

5. SB 591 establishes rate changes in all services other than basic local upon 15 days notice to the Commission; TK II would continue with the existing 20 day filing requirements for specified competitive or discretionary services with an advance 6-months notice of expected filings.

6. SB 591 calls for an increase in service rates equal to any revenue reductions resulting from regulatory action. The regulatory action must be preceded by an order outlining a plan for revenue recovery. The regulatory plan must also consider that SWBT may lose further revenues from the rate changes, which in effect, requires the KCC place increases in the most inelastic service, basic local service. TK II does not contain such provisions.

7. Rate changes proposed in other services, other than the frozen rates, shall be effective fifteen days after filing and rates shall be presumed reasonable as long as the rate equals or exceeds incremental cost in SB 591. TK II does not establish a "reasonable" rate test. The Commission would be able to review proposed rate changes utilizing normal methods of analysis and its reasoned judgement under TK II.

8. "Carrier access charges" will be established by the Commission without "reference" to SWBT's level of earnings. TK II does not address access charges.

9. SB 591 does not call for a continuation of the "TALK" (Telephone Assistance for Low-income Kansans) program; TK II does.

10. SB 591 requires deregulation of any service for which competition is found to exist. TK II calls for "same treatment" of SWBT and its competitors, i.e. if the competitor is regulated, SWBT would also remain regulated.

Comparisons of TeleKansas I and SB 591

	<u>Tele Kansas I</u>	<u>SB 591</u>
Lenth of Time	5 years.	No time limit.
Reduction in Regulation	SWBT could price some services with minimal oversight.	SWBT could price all but local service with almost no oversight.
Investment	\$160 million over 5 years.	\$138 million over 5 years.
Areas of Investment	Local and long distance facilities affecting quality of service.	Not specific. Could be facilities which could be provided by competitors.
Applicability	Southwestern Bell only.	All local exchange companies, including United Telephone and others.
Direct Ratepayer Benefits	Over \$28 million in upfront rate. reductions.	No rate reductions.

## TELEKANSAS II BACKGROUND AND ISSUES

**Background:**

TeleKansas (TK) is a five year experimental alternative regulatory plan which expires on February 25, 1995. The experiment was authorized through Commission approval of a settlement (Stipulation) between KCC staff and SWB on February 2, 1990. The Stipulation resulted from SWB's June 7, 1989, filing of a Petition for approval of a TeleKansas plan and Staff's subsequent investigation, including a review of SWB's rates and earnings. The KCC authorized experiment differed from Bell's original proposal in several important respects, including the facts that the plan was authorized only as a five year experiment rather than on a permanent basis, much greater rate reductions were actually implemented than Bell had proposed, and SWB's proposal to change basic local rates according to an indexing mechanism, after the first three years of the plan, was rejected. (See Attachment A for details of the authorized TeleKansas experiment.)

The experiment essentially gives SWB greater earnings and pricing flexibility in exchange for rate reductions of approximately \$25 million, capital expenditures for modernization of about \$160 million, and capping of local service and other rates at current or reduced levels. The greater earnings and pricing flexibility gives SWB the opportunity to increase earnings by repricing many of its services, introducing new services, improving its operating efficiency or simply retaining revenues from growth in usage of its services. Under traditional regulation (See Attachment B), the increase in earnings above a reasonable level would be flowed back to customers through rate cases but under TK there is no limit on the earnings that SWB can achieve during the experiment. Unlike alternative regulation plans in many other states (Attachment B), there is no mechanism by which achieved earnings above certain levels are shared between the company and its customers.

Under the experiment, SWB has taken advantage of its opportunities by filing for changes in rates or introducing new services, which have contributed to SWB's \$53 million increase in intrastate revenues in the last three years. Part of those increased revenues, over \$7.5 million, are also associated with increases in local rates due to growth in its Topeka and Wichita exchanges and increases of another \$500,000 are expected in the coming year due to growth of other exchanges. (Local rates are

based on the size of the local calling area and TK allows for rates increases as exchanges grow from one rate group to another.) Furthermore, the modernization program itself has produced additional annual revenues of more than \$2.5 million associated with the services SWB could not previously offer in the upgraded areas. Bell has also fully retained the benefits of normal customer and usage growth and substantial cost-saving measures it has untaken, such as employee reductions.

The Stipulation required SWB and Staff to evaluate the results of TK and file recommendations on a successor plan to TK at the end of 1993. While Staff and CURB were conducting audits and reviews, SWB filed a motion arguing that the evaluation should not include a determination of the reasonableness of current earnings under traditional ratemaking methods because of the Stipulation's provision that the parties did not intend to return to rate base regulation. Staff responded that since TK was an experiment and the KCC had an obligation to ensure just and reasonable rates, the evaluation needed to determine whether unreasonable earnings resulted from the experiment. The KCC denied SWB's Motion and allowed Staff and CURB to proceed with their audits.

The parties, as a result of their evaluations, could not agree on a single recommendation and therefore filed separate ones. It will consequently be up to the Commission to determine what happens at the expiration of the experiment.

#### **Successor Plan Recommendations:**

SWB's Proposal. SWB wishes to modify and extend the TeleKansas experiment on a semi-permanent basis. TK II would involve the following major components:

1. The plan would not be experimental and would automatically renew on an annual basis after five years as long as Bell committed to no increase in basic local residential and single-line business rates. Bell proposes to restructure multi-line business rates but does not propose to cap the new rates.

2. Earnings would never be subject to review as long as SWB did not propose an increase in basic local rates but there would be special provisions to allow for relief from governmentally imposed changes in SWB's costs.

3. SWB would expend about \$138 million to build facilities which, among other things, would allow for interactive video connections between high schools, community colleges and universities, telemedicine applications between hospitals and

increased network reliability for SWB exchanges. The video access services would be provided at special rates.

4. SWB would provide certain 911 interoffice facilities without charge and eliminate charges for existing Group or Conference Alert systems.

5. The existing pricing flexibility opportunities would be expanded to allow for "Target Pricing" for "competitive" services and long distance MTS and Directory Assistance would be subject to special flexibility.

Staff Recommendations. The Commission Staff recommendations primarily addressed the larger issues surrounding a successor plan:

1. Staff suggested that before commencement of an alternative regulatory plan, Bell's rates should be adjusted to just and reasonable levels. Staff stated that its audit of 1992 data suggested that SWB's current rates produce excess revenues of some \$22.6 million and this overearnings will likely increase through the remainder of the TK experiment. (CURB's recommendations also found similar overearnings.) Staff recommended that updated 1993 data should be used to determine the appropriate level of rates.

2. Staff was not opposed to giving Bell credit against its overearnings for the proposed modernization plan, provided that the level of other investment which is reflected in rates is taken into account. Staff also noted potential concerns that the modernization plan not solely benefit certain customers.

3. Staff suggested the basic framework of TK was acceptable and should be continued with some modifications. The major modification recommended was adoption of an "earnings sharing" mechanism which would allow Bell earnings flexibility and incentives but also ensure customer benefits. Staff recommended a two to four year plan, depending on whether a sharing mechanism was adopted.

4. Staff noted that a goal during any successor plan should be development of procedures for determining what services need continued full rate regulation and ensuring that rates for such services are reasonable.

#### **Major Questions Raised By TK II Proposal:**

1. Should SWB earnings no longer be subject to oversight?

- The KCC staff believes that SWB is currently earning in excess of a reasonable return. This is due to precipitous drops in the cost of capital since TK was first authorized, as well as other factors. Furthermore, the data for the first three years of TeleKansas indicates a trend that earnings are increasing as the effects of technology improvements and other cost-saving measures, such as employee reductions, are further realized.

- Utility regulation has historically been felt necessary to keep utilities from exploiting their monopoly status to make unreasonable profits. Changes in regulation are necessary as competition increases in not only the telecommunications but also electric and gas industries. However, total removal of earnings oversight is not justified by the actual degree of competition in telecommunications. Such removal of oversight would therefore establish a bad precedent for the gas and electric utilities.

- SWB's customers, who pay the rates which produce overearnings, for the most part currently are captive monopoly customers and don't have choices for services. Only a limited number of services, such as some "custom calling" type functions and certain long distance services like WATS and 800, are currently competitive. Certainly, customers don't have choices for local telephone services or basic (1+) long distance services within the (LATA) areas served by SWB. (See Attachment C)

2. Is the telecommunications industry becoming more competitive and does SWB need more flexibility to meet competition? (See Attachment C)

- Competition for certain services (primarily long distance) has been increasing gradually since the 1984 breakup of the Bell system and will probably increase at a faster rate in the future, but it's difficult to foresee when SWB will face meaningful competition in each of its markets. This will largely be determined by pending Congressional legislation and KCC decisions.

- SWB should have every reasonable opportunity to prepare for competition but it shouldn't be allowed to use excess earnings from largely monopoly customers to do so. This gives SWB an unfair advantage over potential competitors so that the benefits of competition will be stifled. It would allow SWB to use captive ratepayers' money in funding competitive

ventures so that SWB is not undertaking all the competitive risks.

- There is no indication that SWB's earnings are not allowing it to prepare for competition. It was the first Bell company to announce purchase of cable TV systems (in the Washington D.C. area) to potentially compete against another Bell company. It has recently announced a \$4.9 billion joint venture with Cox Cable Communications. Most recently, it announced the largest earnings in the company's history.

- The KCC staff is not opposed to continued pricing flexibility for SWB's services which are subject to competition. However, the degree of flexibility needs to match the amount of competition, just as regulation of AT&T changed gradually over the last ten years as long distance competition grew. Allowing too much flexibility too soon might prevent competition from developing because SWB could use revenues from noncompetitive services to place potential competitors at a disadvantage.

3. Does the proposal to freeze basic local rates provide benefits to customers?

- Only if such rates would otherwise need to be increased. This hasn't been necessary since 1984 because of overall growth in Bell's revenues and reductions in costs. Technology improvements continue to reduce costs and the full effects other cost-savings measures, such as employee reductions, are still to be realized.

- Although it is sometimes suggested that local rates are subsidized by long distance or other services, this is true only if all or most of the costs of facilities which are jointly used to provide all the other services, such as long distance, are allocated only to basic local service. As new services, like "video dial tone," are developed they will produce new revenues but should also pay a fair share of the costs of facilities which they will use.

- Furthermore, what is now called "basic" local telephone service is not the only essential element of "universal telephone service" anymore. Many consider "Touchtone" and other services to be necessary components of "core" telecommunications services in the Information Age. Such services are probably currently overpriced and SWB's proposal would hinder the KCC's

ability to address concerns about pricing of essential services. Pending Congressional legislation would require a redefinition of Universal Service to determine what services are essential.

4. Do SWB's plans for more "infrastructure" investment provide substantial benefits for the state's economic development?

- Distance learning, telemedicine and other telecommunications applications that are part of the emerging "information superhighway" are desirable and beneficial. However, such economic development need not occur at the expense of protecting consumers.

- The \$138 million investment over five years proposed by SWB amounts to around \$5 - \$7 million in annual revenue requirements. This should be compared to the \$22 million overearnings which Staff has initially calculated and the likely increase in earnings in the future.

- SWB's current rates allow it to recover both return of (through depreciation expense) and return on (through return on net "rate base") a certain level of investment. If SWB's capital expenditures are not otherwise at levels which replace the natural decline in rate base (due to depreciation), the proposed "infrastructure" investment would actually be funded by ratepayers and not SWB. (See Attachment B)

- Much of the infrastructure development is likely to enhance SWB's advantages over competitors in the future. Ratepayers should not pay excessive rates to promote SWB's future competitive interests.

- It is unknown whether all the schools and other institutions will actually want, or can afford, to use the facilities and services proposed, even with the proposed discounts. Furthermore, it not clear whether and how SWB's proposal will allow such institutions to take full advantage of other opportunities such TCI's recent announcement that it will provide free fiber optic links to schools in its service areas.

**ATTACHMENT A**

**DETAILS OF TELEKANSAS EXPERIMENT**

**Major Components of TeleKansas:**

1. Immediate reduction of SWB's rates for various services: MTS and WATS long distance (\$17 million), access services provided to interLATA long distance companies (\$2 million), residential Touchtone (\$1.6 million), basic 911, residential service connections charges (\$1.5 million) and local mileage charges (\$1.5 million). The rates for these services were capped for the duration of the plan at the reduced levels. (Access service rates were capped in a separate proceeding.) SWB was also to introduce a optional toll plan by the beginning of the third year of TK, which would allow for an estimated reduction in rates of \$1.5 million.

2. Immediate increases in rates for Directory Assistance (\$1.3 million) and Rotary Hunt (\$1.3 million).

3. Modernization program involving \$160 million capital expenditures over five years to convert 131 central offices to digital equipment and eliminate multi-party service and N-carrier facilities.

4. Recognition of the anticipated costs of three SWB programs: Dual Party Relay Service (\$2 million), Optional Community Calling Plans (\$1.5 million) and Assistance Fund for Local Service Rates (\$100,000).

5. Cap on basic local rates for duration of experiment, except for increases due to party line elimination and exchange reclassifications (due to growth in size of exchanges).

6. Immediate placement of twenty existing service groups into a "flexible priced" category. This categorization allowed the company to revise rates for these services on an accelerated timeframe of 20 days rather than the 30-day time frame specified by the statutes. The company was also authorized to utilize incremental cost studies as its pricing tool rather than the previously required fully allocated cost study methodology. This change benefits SWBT in several ways: first, it grants SWBT a greater range of rate flexibility and, second, it simplifies filing requirements since SWBT already prepared incremental pricing studies as its standard analysis for all SWBT-served states and had previously prepared fully allocated studies only for use in Kansas. Moreover, the pricing requests made by SWBT

for services in this category could be based upon "market-based pricing" (what the market will bear) rather than traditional pricing policy of setting rates above cost with some amount of mark-up for profit.

7. Services which were neither "capped" nor flexibly priced were subject to "traditional" regulation. This meant that in addition to examining the cost and value of the service, and operating, marketing, pricing and other justifications for a proposed change in rates, the Commission would consider customer impacts, and effect on earnings.

#### Activities during TeleKansas:

The provisions of TeleKansas have been subject to a few disputes but otherwise have been implemented without problems.

DA. SWB filed in 1991 to reduce the number of Directory Assistance "allowances" - 3 monthly calls before a charge is imposed, even though the Stipulation provided that after the charge was allowed to increase from \$.25 to \$.35, all other aspects of DA would remain unchanged. SWB interpreted the Stipulation to mean that DA would only remain unchanged initially. It also disagreed with Staff's interpretation of the KCC Order that proposed changes in rates for services that were neither capped nor flexibly priced should be examined in light of the company's overall earnings. The Commission denied the proposed DA change on the basis that the Stipulation did not allow for it.

FASB 106. SWB filed in 1992 for a special accounting order which would allow it to create a regulatory asset on its books to capture the impacts of a new accounting requirement that results in the recognition of increased health care costs. The purpose of the request was to shield SWB from negative financial impacts while it was operating under the terms of TeleKansas, its incentive regulatory plan. Without KCC authorization of the special accounting treatment, SWB would be required to charge these increased costs as an expense during the period of TeleKansas. The request by SWB to create a regulatory asset for these increased costs requires a commitment by the KCC that SWB would be allowed to pass on these retiree health care cost increases to ratepayers in any future rate proceeding.

The KCC Staff and CURB opposed this request in pre-filed testimony by arguing that SWB bore the risk from cost increases such as this one under the incentive regulatory compact. Both parties pointed out that viewing this cost increase in isolation was one-sided without a full earnings review of SWB's total operations. After much negotiation, the KCC Staff and SWB entered into a stipulation, subsequently approved by the KCC, which

allowed SWB to record 50% of the incremental retiree health care costs as an asset, while the other 50% would be charged to an expense, never to be recovered from ratepayers.

Pricing Flexibility. Since the initial placement of twenty service groups into Flexible Pricing, an additional twenty one service groups have been added to the category. Furthermore, at least forty-nine other filings have been processed which restructured and repriced the service options after they were placed within the category. With the exception of a few services, such as basic local rates, service connection, touch tone, and basic long distance, virtually all of SWBT's service options are flexibly priced today.

#### SWBT Flexibly Priced Services

##### Original Flexibly Priced Services from TeleKansas I:

- Billing and Collection Services
- Conference Calling - Local and Toll
- Directory Services - Directory Listings
- MICROLINK I
- MICROLINK II
- Special Billing Service Numbers
- Remote and Local Remote Call Forwarding
- Toll Restrictions
- Plexar I
- Plexar II
- Custom Calling Services
- Local Operator Assistance Service Charges
- Line Status Verification/Interrupt
- MTS Two-point Service - Service Charges
- Selective Class of Call Screening
- CALL FREE Kansas Inward (KITS)
- Kansas Experimental Outward OLDPCP (KOTS)
- Kansas Connection

##### Flexibly Priced Services Designated by Commission Since TeleKansas I:

- Maximizer 800
- Family Space
- Hot Line & Warm Line
- Customer Alerting Enablement Exchange Interconnection Service
- Plexar Custom Service
- Digital Loop Service
- Integrated Services Digital Circuit Switched Voice/Circuit
- Switched Data Transport
- 1+ Saver Plan for Residential Customers
- SmartTrunk Service

Business Video Service  
Frame Relay Digital Service  
Bill Plus  
Caller ID  
Service Loop Facility Modification  
DOVLINK  
Improved Data Transmission Service  
BizSaver  
Discount Rates & Annuity Factors  
IntraLATA 800 Service  
Special Access Service  
1+ Saver for Business Customers  
Remote Access to Call Forwarding

## ASPECTS OF RATE BASE REGULATION AND ALTERNATIVES

Traditional rate base regulation allows the utility an opportunity to recover through rates its reasonable costs of operations, including depreciation and taxes, plus a reasonable rate of return on its net "rate base" (original cost of investment in facilities minus accumulated depreciation.) Determination of a utility's "revenue requirements through rate base regulation has been considered appropriate because utilities are capital intensive - they require extensive plant and facilities to provide services.

The capital intensive nature of utilities substantially affects the utilities' rates and earnings. Generally, when utilities are making significant additions to rate base by building new facilities, rate increases are necessary to provide for the return on the increased rate base. However, the need for increased rates depends on the net impact on rate base and depreciation expense. Since a substantial portion of the rate base is depreciated every year, there may be a decline in net rate base not offset by new investment so that the overall revenue requirements actually decrease. Thus, in times of declining rate base, utilities may attempt to avoid review of their earnings since rates may need to be reduced.

Similarly, utilities may have an incentive to avoid rate review when other operating characteristics cause declines in costs. For example, prior to the 1970's, the electric industry benefitted from decreasing rates due to improved economies of scale in generating facilities so that once the new facilities were included in rate base, there was some incentive to not reflect the decreased operating costs in subsequent rates. In the telecommunications industry the same incentive would encourage companies to build new facilities at ratepayers expense but not recognize new revenues from new services to be provided over those facilities.

One criticism of rate base regulation is that it does not provide adequate incentives for improved efficiencies. Because rates are readjusted in rate cases to reflect any changes in costs, the main reward given to improved utility operations is that associated with "regulatory lag," the utility's retention of benefits during the period before regulatory adjustments in rates.

In an attempt to address this concern, alternative regulatory plans include components which "institutionalize" this regulatory lag incentive by providing for rate moratoriums or for a sharing of excess earnings during the periods between rate readjustments.

## **SUMMARY OF STATES' ALTERNATIVE TELECOMMUNICATIONS REGULATORY PLANS**

- 34 STATES HAVE ALTERNATIVE REGULATION PLANS
- 25 PLANS, OR 74%, INCLUDE A SHARING MECHANISM
- 21 PLANS INCLUDE A FREEZE ON BASIC LOCAL RATES
- 19 PLANS INCLUDE SPECIFIC NETWORK UPGRADES
- 16 PLANS SET OUT SERVICE STANDARD REQUIREMENTS
- 30 PLANS WERE IMPLEMENTED FOR A TRIAL PERIOD

# ALTERNATIVE TELECOMMUNICATIONS REGULATION

## SELECTED FEATURES

STATE	DATE STARTED	TRIALS /LENGTH	SHARING	RATE OF RETURN RANGE	FREEZE ON BASIC	AGREED TO UPGRADES	SERVICE STANDARDS	ANY DETARIFFING, DEREGULATION RATE FLEXIBILITY
AL		Until Jan-94	Yes	11.65 - 12.30% ROC	Yes	N/A	Yes	N/A
AK	N/A	N/A	N/A	N/A	N/A	N/A	N/A	
AZ	N/A	N/A	N/A	13.75% No range	N/A	N/A	N/A	Law allows dereg of non-essential services. Mobil, rural radio
AR	Jan-94	Dec-96	No	10.5% ROE 6.41% ROR	Yes	Yes	N/A	No
CA	10-89. Modified Sep-93		Yes	7.75% Floor to 15.5% ROR Ceiling	No	Yes	Yes Monitoring	Categ. II services allowed downward pricing flexibility. Categ III allowed max pricing flexibility.
CO	Jan-93	Yes. Through 1997	Yes	N/A	N/A	N/A	Yes Monitoring	Fully competitive-dereg. Emerging competitive - rate flexibility.
CT		No	Yes	11.26-13.05%	No	No	Yes	N/A
DE		N/A	N/A	12% ROE	N/A	N/A	N/A	Flex pricing for compet or discretionary services.
DC	Jan-93	Yes 3 years.	Yes	11.5-13.5%	Yes	N/A	N/A	Criteria adopted for pricing flexibility.
FL	Jan-94	Extended to 1997	Yes	12-14%	Rate reductions	No	No	
GA	Jan-92	3 years	Yes	12-16%	Not determinable	No	Yes	No
HI		N/A	N/A	N/A	N/A	N/A	N/A	N/A
ID	1989	1 year, extended	Yes	N/A	Effectively	Yes	N/A	Yes. All Services except basic local services.
IL	Order expected in '94					N/A	N/A	N/A
IN	Sep-91	3 years	N/A	N/A	N/A	N/A	N/A	Detariffing flexibility for small co's. Rate flexibility for large LECs only for customer-specific service offerings.
IA		N/A	N/A	N/A	N/A	N/A	N/A	Deregulated many services subject to competition.
KS	Feb-90	5 Years	No	13.25% ROE	Yes	Yes	No	Flexible pricing on certain non-basic services
KY	Apr-91	Extended to May-94	Yes	10.99-11.61%ROC 12.5- 13.5% ROE	Till 1994	No	No	No
LA	Feb-92	Yes. 3 years	Yes	11.75-12.75% ROE	No	Yes	Yes	No
ME	1990	To Jun-92	N/A	N/A	Yes	Yes	No	Yes. Allow service trials with expedited approval.
MD	1990	2 years	Yes	13.6-15.6%ROE	Yes 2 years	N/A	No	Yes. For competitive services.
MA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	AT&T
MI	Jan-92	2 years	N/A	N/A	Yes	N/A	N/A	Yes. Most services except basic exchange and access.
MN	1990	2 years extended to 1994	Yes	13.25% ROE	Limited	Yes	Yes	For competitive and emerging competitive services.
MS	Jun-90	3 years	Yes	10.74-11.74% ROC	No	No	No	No
MO	1989	To 12-31-93 On 12-28-93, SWBT rejected the alternative regulation plan offered by the Mo. PSC.	Yes	12.62-14.1%ROE	Yes	Yes	Yes	Not determinable

N/A = Not Applicable

3-26

STA.	DATE	TRIALS /LENGTH	SHARING	RATE OF RETURN RANGE	FREEZE ON BASIC	AGREED TO UPGRADES	SERVICE STANDARDS	DEREGULATION RATE FLEXIBILITY
MT		N/A	N/A	N/A	N/A	N/A	N/A	Competitive services on service-by-service basis
NE		N/A	N/A	N/A	N/A	N/A	N/A	All services except basic are detariffed
NV	Jul-91	No	Yes	Up to 13% ROE	5 Years	Yes	Yes	Rate flexibility and detariffing
NH		N/A	N/A	N/A	N/A	N/A	N/A	N/A
NJ	Dec-92	6 Years	Yes	11.7-13.7%	Yes	Yes	Yes	Earnings flexibility for competitive services
NM	1990	3 years with extension	Yes	13.75% ROE	Yes	Yes	No	Price flexibility for non-basic services
NY	Jan-94	1 year NYT	Yes	10.8% ROE 9.15% ROR	No	No	Yes	AT&T
NC		N/A	N/A	N/A	N/A	N/A	N/A	N/A
ND	Jul-89	No	No	N/A	No	Yes	No	Non-essential services detariffed
OH		N/A	N/A	N/A	N/A	N/A	N/A	Streamlined regulation for competitive serv, incl flex pricing & automatic tariff approval
OK		N/A	N/A	N/A	N/A	Yes	N/A	N/A
OR	Nov-91	5 Years	Yes	13.53% ROE	No	No	Yes	Price flexibility allowed for fully competitive services
PA		N/A	N/A	N/A	N/A	N/A	N/A	Price flexibility for competitively bid contracts & some competitive services
RI	Jun-92	2 yrs, extended and modified	Yes	12.25-15.75% ROE	Yes	Yes	No	Not determinable
SC	1991	3 Years	Yes	12-16.5% ROE	No	No	Yes	Not determinable
SD		N/A	N/A	N/A	N/A	N/A	N/A	Fully competitive dereg. Emerging competitive subject to price reg.
TN	Jan-93	Thru 10-92, extended	Yes	+/- 60 basis points from targeted return	No	Yes	Yes	For competitive services.
TX	Nov-90	4 Years	Yes	10.49-12.06% ROR	Yes	Yes	No	Law allows SWBT to petition for price flexibility/ competitive services
UT		N/A	N/A	N/A	N/A	N/A	N/A	Competitive services flexibly priced
VT	Feb-89	2 yrs extended to Dec-93	N/A	No	Yes	Yes	Yes	Detariffing for new services
VA	Jan-89	4 Years extended to Jun-93	Yes	12-14%ROE	Short-term	No	Monitoring	Competitive services, market priced. Potentially competitive, price flex. Other serv, ROR reg.
WA	Jan-90	5 Years	Yes	9.25-11% ROP	Rate cap on basic access/ 5 years	Yes	No	No
WV	Apr-88	3 years, extended	No	N/A	Yes	Yes	No	For non-basic service
WI	Sep-90	3 years, revised	No	No	Yes	No	No	No
WY		N/A	N/A	N/A	N/A	N/A	N/A	Flexible pricing above cost where effective competition exists.

Source: National Regulatory Research Institute Update to the Maine and Missouri Reports on Alternative Regulation Plans in Telecommunications, June, 1993 (Updated for AR,CA,FL,MO & NY)

**TELECOMMUNICATIONS COMPETITION**

Introduction. Competition has been increasing in the telecommunications industry since the mid-1980's. Although some competition started before then, the breakup of the Bell system in 1984 and the prior deregulation of telephone equipment used by customers (Customer Premises Equipment-"CPE") were major steps. The breakup of the Bell system in a Justice Department antitrust lawsuit was premised on the idea that the such an integrated system unfairly prevented the development of competition.

Consequently, the settlement embodied in the Modified Final Judgment ("MFJ"), was intended to open up competition in the long distance market by restricting the seven Regional Bell Operating Companies ("RBOC's") to providing service only within areas called Local Access and Transport Areas ("LATA's"). In Kansas, there are three LATA's corresponding to the 913 and 316 area codes with a separate LATA around the Kansas City metropolitan area. This restriction was intended to prevent the RBOC's from using their control of the "bottleneck" local exchange facilities in anticompetitive ways. Other "line of business" restrictions were also intended keep the RBOC's from exploiting their monopoly of the local exchanges to prevent competition in design and manufacture of telecommunications equipment and in the provision of "information services." These restrictions have subsequently been reviewed by the Court administering the MFJ and the "information services" restriction has been lifted. However, despite requests to the Court and Congressional activity, the manufacturing and interLATA restrictions are still in place.

Current Status of Competition

Inter-LATA long distance. Competition for long distance services between LATA's has developed substantially since 1984 due to the "equal access" requirements imposed by the FCC, as part of the implementation of the MFJ. In order to ensure that the spun-off AT&T did not receive unduly favorable treatment from not just the RBOC's but all local telephone companies (Local Exchange Companies - "LEC's"), they are required to allow all long distance companies (interexchange carriers - "IXC's") access (use of) to the local distribution networks for origination and termination of long distance calls. The IXC's pay the LEC's for use of the local facilities according to access charges approved by the FCC and state commissions. In areas served by appropriate switches,

customers are allowed to choose (presubscribe) which IXC will provide their interLATA service on a "1+" dialing basis. In addition to the larger IXC's, such as AT&T, MCI and Sprint, customers may choose from dozens of other national carriers, as well as local and regional resellers. However, because of the switch costs, "presubscription" equal access has not been available in most of the rural areas served by independent telephone companies. This is changing due to the KCC's recent authorization of KIN Net to provide centralized equal access.

Intra-LATA long distance. Except for some long distance services used by large customers, such as 800 and WATS, there is limited competition with SWB in the intraLATA long distance market. Until last year's KCC order, SWB (and to a very minor extent, United Telephone Company) was the only authorized provider of intraLATA calls. This meant that SWB either blocked such calls or was compensated extra amounts by the IXC's when such calls could not be blocked, due to the technical nature of the calls. Last year, Kansas became one of the last states to authorize intraLATA competition for all long distance services, except "1+" MTS. Because of the technical and cost questions involving customer presubscription on an intraLATA basis, few states have required the LEC's to offer such customer choice. The lack of 1+ equal access has historically meant that few customers went to the effort of dialing extra numbers to use another carrier for intraLATA service. The KCC found, based on the evidence in the record, such as SWB's loss of only 10% of MTS volumes after ten years of competition in Texas, that SWB and its customers would not be adversely affected by such limited competition.

Access services. The IXC's are largely dependent on the LEC's local distribution facilities to originate and terminate the calls from the customer's premises to the IXC's networks. The use of the LEC facilities by the IXC's is known as "access service" and is provided pursuant to federal and state tariffs. Such services are either "switched" so that the calls are routed by the LEC's central offices or are "special" so that the calls are carried over a LEC dedicated line between the IXC and a large customer. The LEC access services can be bypassed if the customer is large enough to economically build private facilities to the IXC facilities or if there is a "Competitive Access Provider (CAP)" as an alternative to the LEC. Such CAP's have been authorized by the FCC and several states in the larger metropolitan areas, where they have built "fiber rings" aimed at providing access to the larger customers. On a national basis, CAP's have less than 1% of the access market. No CAPs are authorized to provide intrastate access in Kansas, although one application is pending.

### Congressional Legislation

Although the FCC and Courts have taken various actions affecting telecommunications competition, it appears likely that Congress will pass comprehensive legislation which will establish future rules concerning the "convergence" of the telecommunications, cable, computer and other industries in the emerging Information Superhighway or National Information Infrastructure. Attached are summaries of the major pieces of legislation and a copy of Vice-President Gore's speech discussing the major policy considerations. The administration recently announced that it will not introduce separate legislation but will work with the already introduced bills.

## **Summary of H.R. 3626**

H.R. 3626 was introduced by Reps. Brooks (D-TX) and Dingell (D-MI) shortly before the first session of the 103rd Congress adjourned. The bill was jointly referred to the Judiciary and Energy and Commerce Committees. The bill's title is "Antitrust Reform Act of 1993".

### **Title I - Supersession of the Modification of Final Judgment**

Section 101 - permits BOCs to apply for authorization, from the Attorney General and the FCC, to provide alarm monitoring or interexchange telecommunication services. Approval of the application must be made by both the FCC and the Attorney General. Applications for interstate interexchange service within a BOC region may be submitted immediately; applications for the resale of interexchange services will be accepted 18 months after date of enactment; applications for nationwide interexchange service will be accepted 60 months after date of enactment; and alarm monitoring service applications will be accepted 66 months after date of enactment. The legislation outlines the procedure for consideration of the BOCs applications by the Attorney General and the FCC and directs both to jointly prescribe regulations to establish procedures and criteria for the expedited determination and approval of applications for proposed interexchange service. The legislation outlines the Judicial Review process for BOC applications

Section 102 - allows BOCs to immediately provide alarm monitoring or interexchange services if: 1) if the activity was authorized by the U.S. District Court before date of enactment of this bill or request for authorization was pending before the District Court on the date of enactment; 2) if a State has authorized the provision of interexchange telecommunication on an intrastate basis; 3) if it (interexchange service) is provided through the purchase and resale of telecommunications services obtained from a person who is not an affiliate of such a company in a state which has equal access.

Section 103 - places a one year-from-date-of-enactment limitation on BOC manufacturing or providing telecommunications equipment or CPE.

Section 104 - prohibits the tying of any product or service to the provision of any telecommunications service, if the effect of such an arrangement will harm competition or tend to create a monopoly.

Section 105 - discusses enforcement procedures. U.S. attorneys, under the direction of the Attorney General, shall institute proceedings in their respective districts to prevent and restrain violations of this Act. Violations of this act shall be a felony and punishable upon conviction of a violation of section 1 of the Sherman Act. This section also discusses private right of action and private injunctive relief.

Section 106 - includes definitions for terms in this section.

Section 107 - discusses this Act's relationship to sections of the MFJ, to anti-trust laws, and to Federal, state and local law. With respect to state law, this Act shall not supersede any state law

unless expressly so provided in this Act. However, the Act does supersede any State and local law to the extent that such law would impair or prevent the operation of this Act.

Section 108 - offers a technical amendment to the definition of antitrust laws appearing in the Clayton Act.

## **Title II - Regulation of Manufacturing, Alarm Services and Electronic Publishing by Bell Operating Companies.**

### **Section 201 - Regulation of manufacturing by BOCs.**

Gives BOCs authority to, through an affiliate, manufacture and provide telecommunications equipment and manufacture customer premises equipment subject to the requirements and regulations established as a result of this Act. The manufacturing affiliate must be separate from any Bell operating company, keeping separate books, records, and accounts which identify all financial transactions between manufacturing affiliate and BOC. There are also strict limits on the types of in-kind of activities which are allowed. There is also a domestic manufacturing provision included.

There are provisions on protecting ratepayers from debt incurred by a manufacturing affiliate, the availability of equipment to other carriers, prohibitions on sales practices of manufacturing affiliates, joint planning obligations, access by competitors to information with respect to the protocols and technical requirements for connection, and additional "competition" requirements.

Such "competition" requirements include: opportunities for non-affiliated companies to sell such equipment to the Bell companies; and a prohibition from subsidizing manufacturing affiliates with revenues from exchange or toll telephone services. This section also contains accessibility requirements for individuals with disabilities.

A BOC having a manufacturing affiliate is required to establish a permanent program for R&D on enhancement of the public switched network.

The FCC has the authority to administer and enforce this act. Common carriers providing telephone exchange service that are injured by a BOC or its manufacturing affiliate which may have violated the rules may initiate legal action.

### **Section 202 - Regulation of Entry into Alarm Monitoring Services**

Not later than six years after date of enactment of this section, the FCC shall prescribe regulations for the offering of alarm services. This section prohibits the BOCs from recording the occurrence or the content of calls received by providers of alarm monitoring services for the purposes of marketing such services on behalf of the BOC or its affiliates. The FCC must establish procedures for the receipt and review of complaints concerning violations of this provision.

### **Section 203 - Regulation of Electronic Publishing.**

A BOC and any affiliate shall not provide electronic publishing that is disseminated by means of such BOC's or affiliates' basic telephone service. A separate affiliate or electronic publishing joint venture may provide electronic publishing. A separated affiliate or joint venture must:

- maintain separate books, records and accounts from those of the Bell operating company and from any affiliate according to generally accepted accounting principals
- not incur debt which would allow one access to assets of the Bell operating company
- prepare financial statements that are not consolidated with those of the BOC or an affiliate and file annual reports with the FCC
- 1 year after effective date of this section, not hire as corporate officers sales and marketing management personnel whose responsibilities include the geographic area where the BOC provides basic telephone service
- Annually conduct a compliance review and file corrective actions with the FCC.

The BOC under common ownership or control with a separated affiliate or electronic publishing joint venture shall:

- not provide a separated affiliate any facilities, services, or basic telephone service information unless available to others on the same terms and conditions
- carry out transactions for affiliated and unaffiliated in the same manner
- have transactions with a separated affiliate in an auditable form and file annual compliance reports with the FCC
- value any assets which are transferred to the affiliate at the greater of net book cost or fair market value, unless the Commission or State permit in-arrears payments
- must comply with all FCC and state cost allocation and accounting rules
- must, if it provides facilities or services for telecommunications, transmission, billing and collection including a separated affiliate, for use with or in connection with electronic publishing, offer such service to all other electronic publishers on request on the same terms and conditions as required by the Commission or State
- provide network access and interconnection for basic telephone service to electronic publishers at prices that are regulated so long as the prices for these services are subject to regulation or under same terms and conditions as separated affiliates receive such services
- provide advance notification relating to changes in basic telephone service network design and technical standards which would affect provision of electronic publishing
- not discriminate in the presentation or provision of any gateway for electronic publishing
- have no directors, officers or employees in common with a separated affiliate or own any property in common with a separated affiliate or hire or train personnel, purchase, install or maintain equipment on behalf of a separated affiliate except for telephone service under tariff or conduct R&D on behalf of a separated affiliate.

BOCs are prohibited from providing to any electronic publisher customer proprietary network information for use with or in connection with the provision of electronic publishing that is not available to all electronic publishers on the same terms and conditions.

Except as provided a BOC may not engage in any promotion, marketing, sales or advertising for or in conjunction with a separated affiliate or with an affiliate that is related to the provision of electronic publishing.

The provisions of this section shall sunset on June 30, 2000.

Persons claiming that an act or practice by an BOC has violated part of this act may file a complaint with the FCC or bring a suit against the BOC.

### **Summary of H.R. 3636**

H.R. 3636 was introduced by Representative Ed Markey (D-MA) on November 22, 1993. It was referred to the Energy and Commerce Committee. The bill has several original co-sponsors including: Jack Fields (R-TX) the ranking member of the Subcommittee; Rick Boucher (D-VA); and Michael Oxley (R-OH). The bill's official title is "National Communications Competition and Information Infrastructure Act of 1993".

#### **Title I - Telecommunications Infrastructure and Competition.**

##### **EQUAL ACCESS, INTERCONNECTION.**

1. Mandates the FCC, to within one year after date of enactment of the subsection, establish regulations for equal access and interconnection. The FCC shall establish regulations after consultation with the Joint Board on Equal Access and Interconnection Standards also established in this section. The FCC is also to establish rules on just and reasonable compensation for interconnection and equal access for exchange carriers.

2. Rural Areas. Rural LECs are exempt from interconnection and equal access mandates if fewer than 500,000 subscriber lines. The FCC may modify this exemption after reviewing the affects of compliance.

3. States are preempted after one year from date of enactment from:

- effectively prohibiting any provider of telecommunications services from providing such service, or imposing restrictions on entry into the business of providing such service that is inconsistent with this subsection or any other provision of this Act.
- Prohibiting any carrier from exercising the access and interconnection rights provided under this subsection.

- Imposing any limitation on the exercise of such rights that is inconsistent with the regulations prescribed under this subsection.

4. Tariffs. LECs have 18 months after the date of enactment to file tariffs in accordance with this Act with respect to equal access and interconnection. The Commission shall review the tariffs to ensure that service charges are cost-based and that tariffs do not bundle together any separable elements, features or functions.

5. Pricing Flexibility. The FCC will establish criteria for determining if a service or provider is subject to competition either within a geographic area or within a class or category of service, whether the competition will effectively prevent rates for such service that are unjust or unreasonable and whether flexible pricing procedures can be used in lieu of tariff schedules.

6. Joint Board to Preserve Universal Service. Establishes such a Joint Board. The Joint Board shall survey providers of telephone exchange service and consult with state commissions in order to determine the pecuniary difference between the cost of providing universal service and the prices determined to be appropriate for such service. Lists four principals by which the Joint Board policies shall be based. Recommendations shall be reported within 270 days after the date of enactment of this subsection.

7. Resale. Resale or sharing of telephone exchange service is not prohibited nor subject to unreasonable conditions by the carrier, FCC or any State.

8. Requires the FCC to at least once every three years review standards and requirements, definition of universal service and submit a report on findings to Congress.

9. Requires a study of rural telephone service to examine effects of competition.

## NETWORK FUNCTIONALITY AND QUALITY

1. Coordinated planning. The FCC will establish procedures for coordinated network planning by common carriers and other providers for effective and efficient interconnection and interoperability of public and private networks. Subject to FCC supervision are standards for interconnection and interoperability and standards for design of networks.

2. Open Platform Service. The FCC will initiate inquiry on policies needed for open platform within 90 days of enactment of this subsection. FCC will also prescribe regulations for results of study. The Commission must also submit annually to Congress a report on the progress of establishing an open platform.

3. Accessibility Regulations. Within one year of date of enactment, the FCC will prescribe regulation as may be necessary to ensure accessibility to individuals with disabilities.

4. Quality Rules. The FCC will designate network reliability and benchmarks to measure quality performances by common carriers not 180 days later than date of enactment.

5. Rural Areas. The FCC may grant waivers to rural LECs for the requirements of this subsection.

Section 103 - provides for expedited review of alleged violations of rules pursuant to section 201(c) (equal access and interconnection).

Section 104 - Provides expedited licensing of new technologies and services.

## **Title II - Communications Competitiveness**

Section 201 Cable Service provided by Telephone Companies.

Allows common carriers and their affiliates to provide video programming directly to subscribers in its telephone service area subject to Part V of this Act.

Part V - requires that common carriers to provide video programming through a separate video programming affiliate. The video programming affiliate must maintain separate books, records and accounts from the carrier. The video programming affiliate must do its own advertising and promoting and it cannot own real or personal property in common with its carrier. The common carrier may provide inbound telemarketing or referral services related to video programming. If such service is provided to the affiliate, it must also be available on nondiscriminatory terms to any other video programmer or cable operator on request.

Separate Video Programming Affiliate. Transactions relating to property, furnishing of goods and services between affiliate and carrier and transfer of assets must be conducted on a fully compensatory and auditable basis in compliance with FCC rules. Criteria for a waiver of these rules will be established by the FCC.

Video Platform. Common carriers providing video programming shall establish a video platform which the FCC, together with the States, shall establish regulations to prohibit discriminatory behaviors.

Provision of Affiliated Video Programming. Common carriers providing a video programming shall make available such capacity, not more than 75%, as is requested by unaffiliated video program providers upon reasonable notice.

Cross-Subsidization. The FCC prescribe regulations prohibiting common carriers from cross subsidizing its video programming affiliate.

Prohibition on Buy-outs. No common carrier that provides telephone exchange service may purchase or otherwise obtain control over any cable system that is located within its telephone service area and is owned by an unaffiliated person. Rural exceptions are permitted and waivers may be granted from the FCC

Consumer Protection. FCC establishes a Joint Board for the purpose of establishing the practices, classifications, and regulations as may be necessary to ensure proper jurisdictional separation and allocation of the cost of establishing and providing a video platform and

allocations of costs between regulated and unregulated services. Recommendations to the Commission shall be made 270 days after the date of enactment.

**Franchise Fees.** A video programming affiliate of a common carrier that establishes a video platform shall be subject to the payment of fees imposed by a local franchising authority in lieu of the fees required under section 622.

**Rural Areas.** Many of the provisions shall not apply to video programming provided in a rural area by a common carrier that provides telephone exchange service in the same area.

\*\*\*\*\*Prepared by Michelle Harris, NARUC

## **BILL SUMMARY**

### **Summary of H.R. 2586**

H.R. 2586 was introduced by Representative Dan Glickman (D-KS) and referred to the Judiciary Committee. The bill's title is "Reorganization of the Federal Administrative Judiciary Act." To promote efficiency and productivity the Federal administrative law judges are to be organized into a unified corps. The legislation establishes a chief judge, division chief judge, council and complaints resolution board. All administrative law judges are members of the Administrative Law Judge Corps, which is to be administered in Washington, DC. The chief administrative law judge is appointed by the President. Divisions of the corps include: Communications, Public Utility, and Transportation regulation; safety and environmental regulation; labor; labor relations; health and benefits programs; securities, commodities and trade regulation; general programs and financial services institutions. Each division will have its own division chief judge.

### **Summary of S. 486**

S. 486 was introduced by Senator Heflin (D-AL) and referred to the Committee on the Judiciary. Its title is "Administrative Law Judge Corp Act." The legislation is almost identical to H.R. 2586. It reorganizes the administrative law judges into a corps, with a chief administrative law judge, division chief judges, and a council of corps.

### **Summary of H.R. 2592**

H.R. 2592 was introduced by Representative Kreidler (D-WA) and referred to the Committee on Energy and Commerce. This bill is also known as the "Distance Learning Information Act of 1993." This legislation would establish a clearinghouse of information concerning telecommunications technologies that are useful in distance learning programs within the National Telecommunications and Information Administration. The clearinghouse would: maintain a database of distance learning providers; receive and review reports on distance learning projects; analyze the activities which appear to be successful; publish periodically a compilation of the reports submitted and analysis; and coordinate with the public telecommunications facilities program and other grant programs of the Department of Commerce for review of distance learning grant applications.

### **Summary of H.R. 2639**

H.R. 2639 was introduced by Representative Markey (D-MA) and referred to the Committee on Energy and Commerce. It is also known as the "Telecommunications and Information Infrastructure and Public Broadcasting Facilities Assistance Act of 1993." The legislation was introduced at the request of the National Telecommunications and Information Administration (NTIA). It sets forth a plan to authorized the NTIA to fund pilot projects that promote a national communications and Information Infrastructure, focusing on the areas of education, health care, and social services. Title I sets out Congressional findings, purposes and definitions. Title II establishes the Telecommunication

sand Information Infrastructure Program. Title III amends the Public Telecommunications Facilities Program so that it focuses exclusively on the needs of public broadcasting. Title IV reauthorizes appropriations for the NTIA. Title V reauthorizes funds for the National Endowment for Children's Educational Television.

### Summary of S. 1086

S. 1086 was introduced by Senators Danforth (R-MO) and Inouye (D-HI) and referred to the Senate Commerce Committee. The bill is now called the Telecommunications Infrastructure Act of 1993. The Senate language is based on the premise that it is in the public interest to encourage the further development of the Nation's telecommunications infrastructure as a means of enhancing the quality of life and promoting economic development and international competitiveness and further, that competition in telecommunications services will have beneficial effects on the price, universal availability, variety, and quality of telecommunications services.

Section 5 of the bill relates to telecommunications competition. One year after enactment of the provision, States and local governments are preempted from prohibiting or limiting the ability of any entity to provide telecommunications services. The proposal leaves it to the States to prescribe the regulations requiring each telecommunication carrier to provide, to any entity seeking to provide telecommunications services, reasonable terms and conditions on: interconnection; nondiscriminatory access to carriers' telecommunications facilities and information necessary to the transmission and routing of telecommunications services; access where possible to poles, ducts, and rights of way; unbundled access to network functions; and telecommunications services and network functions without any restrictions on the resale or sharing of those services and functions. Section 5 mandates that all telecommunications carriers shall contribute to the preservation and advancement of universal service. States, in coordination with the FCC, shall ensure the preservation of universal service. This section also mandates number portability which will be administered by an impartial entity. Concerning reciprocal compensation agreements, telecommunications carriers shall compensate each other on a reciprocal and equivalent basis for termination of service on each other's network. Compensation shall be determined by negotiation between carriers or by the FCC if negotiations fail. Finally, in Section 5 is a provision regarding regulatory flexibility for competitive services. The FCC and the States may permit telecommunications carriers to have pricing flexibility for services that the FCC finds are competitive. In implementation of this section, the FCC and States shall ensure that rates for basic telephone service and for services that are not competitive remain just and reasonable and that universal service is preserved.

Section 6 relates to infrastructure investment. It requires States to ensure that consumers in rural and noncompetitive markets have access to high quality telecommunications network facilities and capabilities. The FCC retains the authority to preempt any State or local statute which prevents the full effectuation of the preceding statement. States shall implement regulatory incentives to encourage the development of high quality telecommunications network facilities and capabilities. If incentives fail, the States shall adopt other methods to ensure the mandate of this section.

Section 7 says that the States shall issue regulations to implement this Act within 12

months after the date of enactment of this Act. Regulations shall be in effect 6 months after their issuance.

Section 8 pertains to the ownership and control of cable television systems by telephone companies. Common carriers are prohibited from owning more than five percent financial interest in any cable system that is providing service within the carrier's service area and is owned by an unaffiliated person and prohibited from entering into any joint venture or partnership with such a cable system. Common carriers cannot provide video programming service directly to subscribers in its telephone exchange service area unless it is provided through a separate subsidiary and a tariff filed in compliance with the regulations has been approved by the State in which the common carrier provides service unless the State failed to act upon the tariff within 12 months.

Section 11 allows a Bell Telephone Company or its affiliate to provide electronic publishing services only through a subsidiary that is separated from the telephone exchange service operations of the Company, maintaining separate books, records, accounts and commercial activities. To prevent cross subsidies, the Bell Telephone Company shall establish and administer a cost allocation system that is intended to prohibit any cost of providing such service from being subsidized by revenue from telephone exchange service.

Section 12 provides for the privacy of customer proprietary network information (CPNI). Telecommunications carriers are prohibited from disclosing any CPNI to any person except as required by law or requested by the customer to which it relates. Carriers shall notify the FCC of the availability of aggregate or compiled information and make it available on the same terms and conditions to other service providers upon reasonable request and shall not discriminate between affiliated or unaffiliated service providers. Local exchange carries shall provide subscriber list information under nondiscriminatory rates, terms and conditions. Subscribers must be given the opportunity to prohibit or limit the disclosure of his or her subscriber list information. This language is similar to the proposed legislation offered by Rep. Markey and summarized above.

Section 13 preempts the States from regulating the rates, terms or conditions for the offering of information services, except as provided in title IV.

\*\*\* Prepared by Michelle Harris, NARUC

Remarks  
Prepared for Delivery  
by Vice President Al Gore  
Royce Hall, UCLA  
Los Angeles, California  
January 11, 1994



**NARUC**

It's great to be here at the Television Academy today. I feel I have a lot in common with those of you who are members of the Academy. I was on Letterman. I wrote my own lines.

I'm still waiting for residuals.

At first, I thought this could lead to a whole new image. And maybe a new career. No more Leno jokes about being stiffer than the Secret Service. Maybe an opportunity to do other shows. I was elated when "Star Trek: The Next Generation" wanted me to do a guest shot -- until I learned they wanted me to replace Lieutenant Commander Data.

The historian Daniel Boorstin once wrote that for Americans "nothing has happened unless it is on television." This of course leaves out a few major events in our history. But this meeting today is on television -- so apparently this event is actually occurring.

I join you to outline not only this Administration's vision of the National Information Infrastructure but our proposals for creating it.

Last month in Washington, I set forth some of the principles behind our vision. Today I'll talk about the legislative package necessary to ensure the creation of that national infrastructure in a manner which will connect and empower the citizens of this country through broadband, interactive communication.

We've all become used to stumbling over cliches in our efforts to describe the enormity of change now underway and the incredible speed with which it is taking place. Often we call it a revolution -- the digital revolution.

Speaking of cliches, I often use the analogy to autos, saying that if cars had advanced as rapidly as computer chips in recent years, a Rolls Royce would go a million miles an hour and cost twenty-five cents.

The last time I used it was at a meeting of computer experts and one of them said, "Yeah -- but that Rolls Royce would be one millimeter long."

What we've seen in the last decade is amazing. But it's nothing compared to what will happen in the decade ahead. The word revolution by no means overstates the case.

But this revolution is based on traditions that go far back in our history.

Since the transcontinental telegraph that transmitted Abraham Lincoln's election victory to California in real time, our ability to communicate electronically has informed and shaped America.

It was only a year before that election that the Pony Express was the talk of the nation, able to send a message cross country in seven days. The next year, it was out of business.

Today's technology has made possible a global community united by instantaneous information and analysis. Protesters at the Berlin Wall communicated with their followers through CNN news broadcasts. The fax machine connected us with demonstrators at Tiananmen Square.

So it's worth remembering that while we talk about this digital revolution as if it's about to happen, in many places it's already underway. Even in the White House.

The day after Inauguration, I was astonished to see how relatively primitive the White House communications system was. President Clinton and I took a tour and found operators actually having to pull cords for each call and plug them into jacks. It reminded me of the switchboard used by Ernestine, the Lily Tomlin character.

And there were actually phones like these all over the White House. They're still there. But we made progress. They're only in the press room now.

Those phones didn't meet our needs. So now, especially on trips, I use a cellular phone.

Our new ways of communicating will entertain as well as inform. More importantly, they will educate, promote democracy, and save lives. And in the process they will also create a lot of new jobs. In fact, they're already doing it.

The impact on America's businesses will not be limited just to those who are in the information business, either. Virtually every business will find it possible to use these new tools to become more competitive. And by taking the lead in quickly employing these new information technologies, America's businesses will gain enormous advantages in the worldwide marketplace. And that is important because if America is to prosper, we must be able to manufacture goods within our borders and sell them not just in Tennessee but Tokyo -- not just in Los Angeles but Latin America.

Last month, when I was in Central Asia, the President of Kyrgyzstan told me his eight-year-old son came to him and said, "Father, I have to learn English."

"But why?" President Akayev asked.

"Because, father, the computer speaks English."

By now, we are becoming familiar with the ability of the new communications technologies to transcend international boundaries and bring our world closer together. But many of you are now in the process of transcending other old boundaries -- the boundary lines which have long defined different sectors of the information industry. The speed with which these boundaries are eroding is quite dramatic.

I'm reminded of an idea of Stephen Hawking, the British physicist. Hawking has Lou Gehrig's disease. But thanks to information technology he can still communicate not only to his students and colleagues but to millions around the world. Incidentally, I read the other day that his voice box has an American accent -- because it was developed here in California.

Anyway, in that American accent, Hawking has speculated about a distant future when the universe stops expanding and begins to contract. Eventually, all matter comes colliding together in a "Big Crunch," which scientists say could then be followed by another "Big Bang" -- a universe expanding outward once again.

Our current information industries -- cable, local telephone, long distance telephone, television, film, computers, and others -- seem headed for a Big Crunch/Big Bang of their own. The space between these diverse functions is rapidly shrinking -- between computers and televisions, for example, or inter-active communication and video.

But after the next Big Bang, in the ensuing expansion of the information business, the new marketplace will no longer be divided along current sectoral lines. There may not be cable companies or phone companies or computer companies, as such. Everyone will be in the bit business. The functions provided will define the marketplace. There will be information conduits, information providers, information appliances and information consumers.

That's the future. It's easy to see where we need to go. It's hard to see how to get there. When faced with the enormity and complexity of the transition some retreat to the view best enunciated by Yogi Berra when he said: "What we have here is an insurmountable opportunity."

Not long ago this transition did indeed seem too formidable to contemplate, but no longer. Because a remarkable consensus has emerged throughout our country -- in business, in public interest groups and in government. This consensus begins with agreement on the right, specific questions we must answer together.

How can government ensure that the information marketplace emerging on the other side of the Big Crunch will permit everyone to be able to compete with everyone else for the opportunity to provide any service to all willing customers? How can we ensure that this new marketplace reaches the entire nation? How can we ensure that it fulfills the enormous promise of education, economic growth and job creation?

Today I will provide the Administration's answers to those questions. But before I do let me state my firm belief that legislative and regulatory action alone will not get us where we need to be. This Administration argued in our National Performance Review last year, that government often acts best when it sets clear goals, acts as a catalyst for the national teamwork required to achieve them, then lets the private and non-profit sector, move the ball downfield.

It was in this spirit that then-Governor Clinton and I, campaigning for the White House in 1992, set as a vital national goal linking every classroom in every school in the United States to the National Information Infrastructure.

It was in this same spirit that less than a month ago, I pointed out that when it comes to telecommunications services, schools are the most impoverished institutions in society.

And so I was pleased to hear that some companies participating in the communications revolution are now talking about voluntarily linking every classroom in their service areas to the NII.

Let me be clear. I challenge you, the people in this room, to connect all of our classrooms, all of our libraries, and all of our hospitals and clinics by the year 2000. We must do this to realize the full potential of information to educate, to save lives, provide access to health care and lower medical costs.

Our nation can and must meet this challenge. The best way to do so is by working together. Just as communications industries are moving to the unified information marketplace of the future, so must we move from the traditional adversarial relationship between business and government to a more productive relationship based on consensus. We must build a new model of public-private cooperation that, if properly pursued, can obviate many governmental mandates.

But make no mistake about it -- one way or another, we will meet this goal.

As I announced last month, we will soon introduce a legislative package that aggressively confronts the most pressing telecommunications issues, and is based on five principles.

This Administration will:

- Encourage Private Investment
- Provide and Protect Competition
- Provide Open Access to the Network
- Take Action To Avoid Creating a Society of Information "Haves" and "Have Nots"
- Encourage Flexible and Responsive Governmental Action

Many of you have our White Paper today, outlining the bill in detail. If you didn't get your copy, it's available on the Internet, right now.

Let me run through the highlights with you -- and talk about how they grow out of our five principles.

We begin with two of our basic principles -- the need for private investment and fair competition. The nation needs private investment to complete the construction of the National Information Infrastructure. And competition is the single most critical means of encouraging that private investment.

I referred earlier to the use of the telegraph in 1860, linking the nation together. Congress funded Samuel Morse's first demonstration of the telegraph in 1844. Morse then suggested that a national system be built with federal funding. But Congress said no, that private investment should build the information infrastructure. And that's what happened -- to the great and continuing competitive advantage of this country.

Today, we must choose competition again and protect it against both suffocating regulation on the one hand and unfettered monopolies on the other.

To understand why competition is so important, let's recall what has happened since the breakup of AT&T ten years ago this month.

As recently as 1987, AT&T was still projecting that it would take until the year 2010 to convert 95% of its long distance network to digital technology.

Then it became pressed by the competition. The result? AT&T made its network virtually 100% digital by the end of 1991. Meanwhile, over the last decade the price of interstate long distance service for the average residential customer declined over 50%.

Now it is time to take the next step. We must open the local telephone exchanges, those wires and switches that link homes and offices to the local telephone companies.

The pressure of competition will be great -- and it will drive continuing advancements in technology, quality and cost. One businessman told me recently that he was accelerating his investment in new technology to avoid ending up as "roadkill" on the information superhighway.

To take one example of what competition means, cable companies, long distance companies, and electric utilities must be free to offer two-way communications and local telephone service. To accomplish this goal, our legislative package will establish a federal standard that permits entry to the local telephone markets. Moreover, the FCC will be authorized to reduce regulation for telecommunications carriers that lack market power.

We expect open competition to bring lower prices and better services. But let me be clear: We insist upon safeguards to ensure that new corporate freedoms will not be translated into sudden and unjustified rate increases for telephone consumers.

The advancement of competition will necessarily require more opportunity, as well, for the Regional Bell Operating Companies. Current restrictions on their operations are themselves the legacy of the break-up of AT&T and must be re-examined.

This Administration endorses the basic principles of the Brooks-Dingell bill, which proposes a framework for allowing long-distance and local telephone companies to compete against each other.

Regulation and review of this framework should be transferred from the courts to the Department of Justice and the Federal Communications Commission.

This process of change must be carefully calibrated. We must make sure that the Regional Bells will not be able to use their present monopoly positions as unfair leverage into new lines of business. That is why the Administration supports the approach of the Brooks-Dingell provision that requires the approval of the Department of Justice and the Federal Communications Commission before the Regional Bells may provide

interexchange services -- most notably long distance.

In working with Congress, the Administration will explore the creation of incentives for the Regional Bells. We want to increase the transparency of those facility-based local services that raise concerns associated with cross-subsidization and abuses of monopoly power.

Our view of the entry of local telephone companies into cable television also balances the advantages of competition against the possibility of competitive abuse. We will continue to bar the acquisition of existing cable companies by telephone companies within their local service areas. We need this limitation to ensure that no single giant entity controls access to homes and offices. But to increase diversity and benefit consumers, we will permit telephone companies to provide video programming over new, open access systems.

Even these measures, however, may not eliminate all scarcity in the local loop -- those information byways that provide the last electronic connection with homes and offices. For some time, in many places, there are likely to be only one or two broadband, interactive wires, probably owned by cable or telephone companies. In the long run, the local loop may contain a wider set of competitors offering a broad range of interactive services, including wireless, microwave and direct broadcast satellite.

But, for now, we cannot assume that competition in the local loop will end all of the accrued market power of past regulatory advantage and market domination.

We cannot permit the creation of information bottlenecks that adversely affect information providers who use the highways as a means of supplying their customers.

Nor can we can permit bottlenecks for information consumers who desire programming that may not be available through the wires that enter their homes or offices.

Preserving the free flow of information requires open access, our third basic principle.

How can you sell your ideas, your information, your programs, if an intermediary who is also your competitor has the means to unfairly block your access to customers? We can't subject the free flow of content to artificial constraints at the hands of either government regulators or would-be monopolists.

We must also guard against unreasonable technical obstacles. We know how to do this; we've seen this problem in our past. For example, when railroad tracks were different sizes, a passenger could not travel easily from a town served by one railroad to a town served by another. But the use of standardized tracks permitted the creation of a national system of rail transport.

Accordingly, our legislative package will contain provisions designed to ensure that each telephone carrier's networks will be readily accessible to other users. We will create an affirmative obligation to interconnect and to afford nondiscriminatory access to network facilities, services, functions and information. We must also explore the future of non-commercial broadcasting;

there must be public access to the information superhighway.

These measures will preserve the future within the context of our present regulatory structures. But that is not enough. We must move towards a regulatory approach that encourages investment, promotes competition and secures open access. And one that is not just a patch-work quilt of old approaches, but an approach necessary to promote fair competition in the future.

We begin with a simple idea: Similar entities must be treated similarly. But let's be clear: our quest for equal treatment of competing entities will not blind us to the economic realities of the new information marketplace, where apparent similarities may mask important differences.

This idea is best expressed in the story about the man who went into a restaurant and ordered the rabbit stew.

It came, he took a few bites, then called the manager over. "This doesn't taste like rabbit stew!" he said. "It tastes ... well, it tastes like horsemeat!"

The manager was embarrassed. "I actually ran out of rabbit this morning and I -- well, I put some horsemeat in."

"How much horsemeat?"

"Well -- it's equally divided."

"What's that mean?"

"One horse, one rabbit."

The lesson is obvious. A start-up local telephone company isn't the same as a Baby Bell.

What we favor is genuine regulatory symmetry. That means regulation must be based on the services that are offered and the ability to compete -- and not on corporate identity, regulatory history or technological process.

For example, our legislative package will grant the Federal Communications Commission the future authority, under appropriate conditions, to impose non-discriminatory access requirements on cable companies. As cable and telephone service become harder and harder to distinguish, this provision will help to ensure that labels derived from past regulatory structures are not translated into inadvertent, unfair competitive advantages.

As different services are grouped within a single corporate structure, we must ensure that these new, combined entities are not caught in a cross-fire of conflicting and duplicative regulatory burdens and standards. This Administration will not let existing regulatory structures impede or distort the evolution of the communications industry.

In the information marketplace of the future, we will obtain our goals of investment, competition and open access only if regulation matches the marketplace. That requires a flexible, adaptable regulatory regime that encourages the widespread provision of broadband, interactive digital services.

That is why the Administration proposes the creation of an alternative regulatory regime that is unified, as well as symmetrical. Our new regime would not be mandatory, but it would be available to providers of broadband, interactive services. Such companies could elect to be regulated under the current

provisions of the Communications Act or under a new title, Title VII, that would harmonize those provisions in order to provide a single system of regulation. These "Title VII" companies would be able to avoid the danger of conflicting or duplicative regulatory burdens. But in return, they would provide their services and access to their facilities to others on a nondiscriminatory basis. The nation would thus be assured that these companies would provide open access to information providers and consumers and the benefits of competition, including lower prices and higher-quality services, to their customers.

This new method itself illustrates one of our five principles -- that government itself must be flexible. Our proposals for symmetrical, and ultimately unified, regulation demonstrate how we will initiate governmental action that furthers our substantive principles but that adapts, and disappears, as the need for governmental intervention changes -- or ends. They demonstrate, as well, the new relationship of which I spoke earlier -- the private and public sectors working together to fulfill our common goals.

The principles that I have described thus far will build an open and free information marketplace. They will lower prices, stimulate demand and expand access to the National Information Infrastructure.

They will, in other words, help to attain our final basic principle -- avoiding a society of information "haves" separate from a society of information "have nots".

There was a Washington Post headline last month: "Will the 'Information Superhighway' Detour the Poor?"

Not if I have anything to do about it. After all, governmental action to ensure universal service has been part of American history since the days of Ben Franklin's Post Office. We will have in our legislative package a strong mandate to ensure universal service in the future -- and I want to explain why.

We have become an information-rich society. Almost 100% of households have radio and television, and about 94% have telephone service. Three-quarters of households contain a VCR, about 60% have cable, and roughly 30% of households have personal computers.

As the information infrastructure expands in breadth and depth, so too will our understanding of the services that are deemed essential. This is not a matter of guaranteeing the right to play video-games. It is a matter of guaranteeing access to essential services.

We cannot tolerate -- nor in the long run can this nation afford -- a society in which some children become fully educated and others do not; in which some adults have access to training and lifetime education, and others do not.

Nor can we permit geographic location to determine whether the information highway passes by your door. I've often spoken about my vision of a schoolchild in my home town of Carthage,

Tennessee being able to come home, turn on her computer and plug into the Library of Congress. Carthage is a small town. Its population is only about 2,000. So let me emphasize the point: We must work to ensure that no geographic region of the United States, rural or urban, is left without access to broadband, interactive service. Yes, we support opening the local telephone exchange to competition. But we will not permit the dismantling of our present national networks.

All this won't be easy. It is critically important, therefore, that all carriers must be obliged to contribute, on an equitable and competitively neutral basis, to the preservation and advancement of universal service.

The responsibility to design specific measures to achieve these aims will be delegated to the Federal Communications Commission. But they will be required to do so. Our basic goal is simple: There will be universal service; that definition will evolve as technology and the infrastructure advance; and the FCC will get the job done.

Reforming our communications laws is only one element of the Administration's NII agenda. We'll be working hard to invest in critical NII technologies. We'll promote applications of the NII in areas such as scientific research, energy efficiency and advanced manufacturing. We'll work to deliver government services more efficiently. We'll also update our policies to make sure that privacy and copyright are protected in the networked world.

We'll help law enforcement agencies thwart criminals and terrorists who might use advanced telecommunications to commit crimes.

The Administration is working with industry to develop the new technologies needed for the National Information Infrastructure Initiative.

I have been working with the First Lady's Health Care Task Force, former Surgeon General C. Everett Koop, and others to develop ways we can use networks to improve the quality of health care.

Beginning this month, we are concentrating first on the legislative package I outlined earlier. We haven't invented all of the ideas it contains ourselves. Representatives Dingell and Brooks, Markey and Fields--and Senators Hollings, Inouye, and Danforth have all focused on these issues.

In many ways our legislative goals reflect or complement that work. We expect to introduce our legislative package shortly, and to work with Congress to ensure speedy passage this year of a bill that will stand the test of time.

Our efforts are not, of course, confined only to government. The people in this room, and the private sector in general, symbolize private enterprise.

Our economic future will depend, in a real sense, on your ability to grasp opportunity and turn it into concrete achievement.

As we move into the new era, we must never lose sight of our heritage of innovation and entrepreneurship.

In some ways, we appreciate that heritage more when we see countries without it. Last month, in Russia, I had a chance to see close up a country that tried to hold back the information age -- a country that used to put armed guards in front of copiers. In a way we should be grateful it did; that helped strengthen the desire of the Russian people to end Communism.

My hope is that now Central and Eastern Europe can use technology and the free market to build democracy -- not thwart it.

And my hope is that America, born in revolution, can lead the way in this new, peaceful world revolution.

Let's work on it together.

A few months ago, Toni Morrison won the Nobel Prize for Literature. It was a proud -- and signal -- moment for this country: recognition of an African-American woman who has communicated her insight and narrative power to readers all over the world.

In her acceptance speech, Tony Morrison used one version of an old story -- a parable, really -- to make an interesting point. It's of a blind, old woman renowned for her wisdom, and a boy who decides to play a trick on her. He captures a bird, brings it to her cupped in his hands, and says "Old woman, is this bird alive or dead?"

If she says "Dead," he can set it free. If she says "Alive," the boy will crush the bird.

She thinks, and says, "The answer is in your hands."

Toni Morrison's point is that the future of language is in our hands.

As we enter this new millennium, we are learning a new language. It will be the lingua franca of the new age. It is made up of ones and zeros and bits and bytes. But as we master it ... as we bring the digital revolution into our homes and schools ... we will be able to communicate ideas, and information -- in fact, entire Toni Morrison novels -- with an ease never before thought possible.

We meet today on common ground, not to predict the future but to make firm the arrangements for its arrival. Let us master and develop this new language together.

The future really is in our hands.

Thank you.



**NARUC**

## BACKGROUND ON THE ADMINISTRATION'S TELECOMMUNICATIONS POLICY REFORM INITIATIVE

On September 15, 1993, the Administration issued "The National Information Infrastructure: Agenda for Action," which unveiled our National Information Infrastructure (NII) initiative. There is a national consensus that construction of an advanced NII will "help unleash an information revolution that will change forever the way people live, work, and interact with each other." The "Agenda for Action" recognized that realizing the full potential of the NII will require aggressive, far-sighted government action on a number of fronts. The legislative proposals that Vice President Al Gore has outlined today are the culmination of extensive Administration efforts in one critical area — telecommunications regulatory reform. Similar work is being done in other important areas, including support for innovative applications that will use the NII, improving access to government information, and protecting individual privacy and intellectual property rights.

In a December 21 speech at the National Press Club in Washington, DC, the Vice President announced the Administration's plans to present a package of legislative and administrative proposals concerning telecommunications and information policy. He stated that the Administration's policy would be based on the following fundamental principles:

- ✓ Encouraging private investment in the NII;
- ✓ Promoting and protecting competition;
- ✓ Providing open access to the NII by consumers and service providers;
- ✓ Preserving and advancing universal service to avoid creating a society of information "haves" and "have nots";
- ✓ Ensuring flexibility so that the newly-adopted regulatory framework can keep pace with the rapid technological and market changes that pervade the telecommunications and information industries.

The major elements of the Administration's legislative initiative are identified below, along with a brief discussion of how each proposal advances the principles set forth above. In doing so, the Administration has studied carefully the legislative initiatives of Senators

Hollings, Inouye, and Danforth and Representatives Brooks, Dingell, Markey, and Fields. Its proposals reflect the strengths of, and build on, those bills. The Administration is building upon the dramatic steps taken by the states, including substantial and innovative regulatory reforms. The Administration intends to work closely with the states, some of which are moving aggressively to encourage competition, infrastructure modernization, and NII applications in health care, education, and government services.

In addition to the legislative package, it is a goal of this Administration that by the year 2000 all of the classrooms, libraries, hospitals, and clinics in the United States will be connected to the NII.

## ***ENCOURAGING PRIVATE INVESTMENT AND PROMOTING COMPETITION***

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To fully realize the benefits of private investment and more competition in the information infrastructure, regulatory change is needed. For many years, government regulation assumed clear, stable boundaries between industries and markets. This assumption sometimes prompted regulators to view (and to regulate) firms in various industries differently, even when they offered similar services. It also caused regulators to address the threat of anticompetitive conduct on the part of some firms by barring them from certain industries and markets.

The time has come for another approach. Even if the lines between industries and markets were clear in the past, technological and market changes are now blurring them beyond recognition, if not erasing them entirely. Regulatory policies predicated on such perceived distinctions can harm consumers by impeding competition and discouraging private investment in networks and services. The Administration is therefore committed to removing unnecessary and artificial barriers to participation by private firms in all communications markets, while making sure that consumers remain protected and interconnected.

### **CABLE-TELCO CROSS-OWNERSHIP**

The Administration proposes to remove the current cross-ownership restriction of the 1984 Cable Act, and allow telephone companies to provide video services in their local exchange areas in order to promote investments that expand consumer choices and services. To ensure that telephone company entry does not harm consumers or competition, such entry will be subject to certain safeguards, most notably a requirement that the telephone company make channel capacity available to unaffiliated video program providers on a nondiscriminatory basis. This requirement should create market opportunities for competing providers of video services, thereby reducing prices and expanding the diversity of services available to television viewers.

Further, to deter premature and potentially anticompetitive mergers between telephone companies and their most likely competitors -- existing cable companies -- the Administration proposes to prohibit telephone companies from acquiring cable systems located in the companies' local exchange areas. There would be an exception for those telephone companies operating in rural areas, which may be unable to support more than one carrier. However, to ensure that this measure does not outlive its usefulness, the Administration proposes to authorize the Federal Communications Commission (FCC) to begin proceedings that could allow such acquisitions five years after the date of legislative enactment, if certain conditions are met (e.g., the presence of sufficient competition in the telco's service area). Any telephone company/cable system acquisition would also be subject to the antitrust laws in the same manner as an acquisition in any other industry.

### LOCAL COMPETITION

Competition has generated substantial benefits for consumers in a host of communications and information service markets, including customer premises equipment and long distance service. The varieties of customer premises equipment have expanded dramatically since deregulation. In addition, the price of interstate long distance telephone service for the average residential user has declined more than fifty percent in real dollars since 1984, due to competition and regulatory reform. Consumers will realize similar benefits by the expansion of competition in the local telephone service market. Competition in that market will reduce the ability of any telephone company to harm competition and consumers through monopoly control and will encourage investment and innovation in the "on and off ramps" of the NII.

Accordingly, the Administration proposes to ensure that competing providers have the opportunity to interconnect their networks on reasonable, nondiscriminatory terms, with the facilities of all local telephone companies. Such companies should also be required to unbundle their service offerings so that alternative providers can offer similar services using a combination of, for example, telephone company-provided switching and their own transmission facilities. Finally, the Administration's plan will preempt state entry barriers, as well as rate regulation of carriers that the FCC finds or has found to lack market power.

The Administration understands that the growth of competition for local telephone services may require repricing of some local services. Such repricing must not be allowed to cause "rate shock" for consumers. Therefore, in implementing network interconnection and unbundling, the FCC and state regulators will be directed to prevent undue rate increases for any class or group of ratepayers.

## MODIFIED FINAL JUDGEMENT (MFJ) RESTRICTIONS

The Administration is grateful for and appreciative of the excellent job done by the courts in connection with the MFJ. The break-up of AT&T has helped spur the competition and innovation that have kept America at the vanguard of the telecommunications industry. Now, the time has come to move beyond a decree remedying only specific violations of law administered by the courts and to enact a far-reaching and comprehensive plan reflecting a vision of the telecommunications world of the future. A key element of that plan must be to promote and protect competition, the engine of progress and jobs.

### *LONG DISTANCE SERVICE*

The Administration supports the Brooks-Dingell bill provision that requires Department of Justice (DOJ) and FCC approval before the Regional Bell Operating Companies (RBOCs) may provide interexchange services -- most notably long distance service. In determining whether to lift the restriction, the Department of Justice will apply the test contained in Section VIII(C) of the MFJ. The FCC will apply a public interest test like that set forth in the legislative proposal offered by Chairmen Brooks and Dingell. These entry tests are designed in part to ensure competition and to protect consumers and local telephone ratepayers against cross-subsidization and other potential abuses of monopoly power. In working with the Congress, the Administration will explore the creation of incentives for RBOCs to increase the transparency of their facility-based local services, because of concerns associated with cross-subsidization and abuses of monopoly power. The Administration's plan will also include an immediate and limited exception to the prohibition of the provision of long distance services incidental to RBOC provision of wireless, cable television, and certain other services.

### *INFORMATION SERVICES*

As current law provides, the RBOCs are permitted to offer information services. The Administration supports the approach taken in the Brooks-Dingell legislation that requires a separate affiliate for electronic publishing.

### *MANUFACTURING*

In keeping with the principle of removing barriers to participation by all firms in all markets except where necessary, the Administration proposes to remove the current ban on RBOC research, development, and manufacturing subject to safeguards to prevent cross-subsidization and discriminatory practices. The safeguards to be applied before entry would include a

notification-and-waiting-period procedure, as contained in the legislation proposed by Chairmen Brooks and Dingell, under which an RBOC would submit relevant information about its proposal to the Department of Justice, which could investigate and sue to enjoin the proposed entry. The Administration also supports substantive post-entry safeguards, as contained in legislation introduced by Chairman Hollings and passed by the Senate in the last Congress. Those safeguards include, among other things, requirements that manufacturing be kept separate from the monopoly portion of the telephone company's business, that the RBOC not discriminate in either procurement or sales, and that needed network information be timely disclosed to competing manufacturers.

### ***OPEN ACCESS/PROGRAMMING DIVERSITY***

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There is a long-standing national policy, embodied in the First Amendment, of protecting diversity and competition in the flow of ideas. This fundamental interest is critical not only with respect to the provision of entertainment, but also with respect to educational material, health information, information necessary to an informed citizenry, and other programming matter. To further this goal, the Administration plans to require the FCC, one year after enactment, to impose nondiscriminatory access obligations on cable television systems, except when technology, costs, and market conditions make it inappropriate.

### ***ENSURING REGULATORY FLEXIBILITY AND FAIRNESS***

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The new regulatory framework that the Administration seeks to create is designed to adjust to the technological and market changes that have undermined the regulatory regime created by the Communications Act. Legislation in this area must stand the test of time, by addressing tomorrow's challenges as well as today's. The Administration's lodestars in this efforts are flexibility, adaptability, and fairness. The regulatory instruments we choose must be supple enough to accommodate the continual change that will typify communications industries in the future. At the same time, those instruments must be equitable; similarly situated services should be subject to the same regulatory requirements.

Beyond tackling the problems that have arisen as a result of current technological and market changes, the Administration recognizes that a new kind of communications service provider will emerge, one that offers switched, broadband digital transmission services to home and office. Such firms face the potential of being regulated under two different parts of the Communications Act -- Titles II (common carriers) and VI (cable communications). These firms will also be regulated

at the state level for the intrastate component of their Title II services and at the local level for their Title VI services, creating a needlessly overlapping and complex regulatory environment.

The nation needs a flexible, adaptable regulatory regime that encourages the competitive provision of the broadband, switched digital transmission services that can truly knit homes and businesses together. The Administration will propose a future-oriented regulatory regime, to be enacted as a new Title VII to the Communications Act, that will encourage firms to provide these services.

**The keys to regulatory reform:**

- Flexibility
- Adaptability
- Fairness

The Administration's proposal would provide the FCC with broad forbearance authority while maintaining key public policy goals, including open access and interoperability requirements, along with obligations to support universal service. In addition, consistent with the approach taken in the 1992 Cable Act, the proposal will provide for rate regulation until competition is established in these service markets, with a presumption of forbearance for new entrants that are not dominant in related services. State and local regulation of services not subject to competition could take place subject to FCC guidelines. Under the Administration's plan, the FCC would adopt transition rules to move to this new regime. Firms would elect to be regulated under the new framework, provided that they meet threshold criteria established by the FCC.

In addition, the Administration proposes to allow the FCC to reduce regulation for telecommunications carriers that lack market power. This provision will ensure that unnecessary government regulation -- however well-intentioned -- does not harm users of the infrastructure, or impede competitive entry, investment, and the introduction of new services.

## ***UNIVERSAL SERVICE***

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The United States has long been dedicated to "universal service" -- widespread availability of basic telephone service at affordable rates. As stated in the "Agenda for Action," the Administration is committed to developing a new concept of universal service that will serve the information needs of the American people in the 21st century. Indeed, the full potential of the NII will not be realized unless all Americans who desire it have easy, affordable access to advanced communications and information services, regardless of income, disability, or location.

It is a goal of this Administration that by the year 2000, all of the classrooms, libraries, hospitals, and clinics in the United States will be connected to the NII.

The Administration recognizes, however, that crafting a new, meaningful, and practical definition of universal service will require flexibility, foresight, and the balancing of diverse interests. Given these circumstances, the proposed legislation will establish several overarching guidelines and charge the expert agencies -- the FCC and the state regulatory commissions -- with establishing the details.

The Administration therefore proposes to:

- ✓ Make the preservation and advancement of "universal service" an explicit objective of the Communications Act, in order to establish the goal that advanced services be available to rural and urban lower income users, to users in areas where the costs of service are high, and to social institutions, especially schools and health care facilities.
- ✓ Charge the FCC and the states with continuing responsibility to review the definition of universal service to meet changing technological, economic, and societal circumstances.
- ✓ Establish a Federal/State Joint Board to make recommendations concerning FCC and state action on the fundamental elements of universal service. In its deliberations, the Joint Board must gather input from non-governmental organizations.
- ✓ Oblige those who provide telecommunications services to contribute to the preservation and advancement of universal service. However, the FCC, in consultation with the states, would be authorized to permit "sliding scale" contributions (e.g., to avoid burdening small providers and new entrants), or "in-kind" contributions in lieu of cash payments (e.g., to reduce the monetary payments owed by providers that offer to connect with schools, hospitals, etc.).



## CGI's OPPOSITION TO SENATE BILL 591

CGI is a Kansas based long distance company that opposes Senate Bill 591 (SB 591) for the following reasons:

- **Southwestern Bell (SWB) provides monopoly facilities for over 99% of the connections between a long distance company and its customers.** SWB owns the lines that connect each customer's home or work place to the long distance company. This component of SWB's operation remains a virtual monopoly. To originate or terminate a call, those facilities (the wires between your house or business & the customer's long distance company of choice) must be utilized to complete a phone call.
- **CGI and most other long distance companies pay SWB 40% to 70% of their gross revenue in order to utilize SWB's monopoly facilities.** Without question, the cost associated with utilizing SWB's monopoly service constitutes long distance companies' greatest single expense.
- **Implementation of SB 591 will result in SWB being in a unique position to take advantage of both captive customers and competitors.** We strongly urge that effective regulation be restored to the Kansas Corporation Commission in order to safeguard consumers against monopoly abuses.
- **CGI's major objection to SB 591 is that it allows SWB to extend the freeze and pocket all excessive earnings.** That money rightfully belongs to Kansas consumers who are presently being overcharged. The consumers of Kansas deserve rate reductions and refunds from the excessive earnings of SWB.
- **In the past, SWB had no compunction about demanding higher rates from captive customers when they experienced higher underlying costs for providing service. Now that these costs are going down, consumers should be entitled to benefit from those cost savings caused by advanced technology.**
- **SB 591 proposes a rate "freeze". Compare the proposed Kansas freeze to what has transpired in Missouri. Since 1989, Missouri has experienced both rate reductions and refunds. Missouri ordered Bell to reduce rates by approximately \$82 million annually in 1989 and \$84.6 million in 1993.**

2/10/94

Commerce

Attachment 4-1

- Missouri also negotiated with SWB an arrangement where customers "shared" (received bill credits) due to SWB's excessive earning. During 1991 and 1992, SWB refunded to customers excessive earnings of approximately **\$22 million each year.**
- Similar cost reductions are taking place in Kansas but **the Kansas "freeze" prevent's the consumer from benefiting.** The Kansas Corporation Commission has preformed an audit which shows SWB is presently overcharging customers **by \$22.6 million per year.**

This bill will eliminate rate setting controls for SWB and other telecommunication monopolies. Such controls should be properly exercised by the Kansas Corporation Commission. Rates based upon underlying cost is a proper criteria for monopoly-provided services.

Passage of SB 591 will perpetuate SWB's practice of extracting excessive profits from consumers. **This bill should be defeated.**

# THE KANSAS CITY STAR.

Vol. 114, Wednesday, February 9, 1994, No. 145

A Capital Cities/ABC, Inc., Newspaper

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## Two bad bills from Bell

Southwestern Bell Telephone Co. now is supporting two similar, anti-consumer bills in Kansas and Missouri.

In both states, the utility is trying to get legislators to allow the company to lock in excessive rates for years to come. Southwestern Bell also is trying to wipe out important consumer-protection powers now held by the Missouri Public Service Commission and the Kansas Corporation Commission.

In Kansas, the Senate Commerce Committee is scheduled to hold hearings today and Thursday on Senate Bill 591. Bell's goal is clear. It wants state legislators to strip the Kansas Corporation Commission of power it has to make sure Bell charges fair rates to consumers.

In Missouri, the House Consumer Protection Committee has yet to hold hearings on House Bill 1477. Last year, thanks to forceful lobbying, Bell rammed another anti-consumer bill through this committee. The full General Assembly finally blocked the measure's passage on the last day of the 1993 session.

If the bill as amended passes in Kansas, it says Bell "shall not under any circumstances be subject to any investigation, complaint or hearing as to its rates for basic local telecommunications service or as to its overall earnings," unless the utility asks for a basic rate increase. The

Missouri bill contains similar wording.

Bell essentially doesn't want anyone telling it how much it should earn or charge ratepayers, even while it remains a monopoly. That's nonsense.

Both the Kansas and Missouri measures this year also are patently unfair to consumers. Essentially, the utility is trying to freeze telephone rates at current figures, then call this a victory for customers. Meanwhile, improved technology is driving down Bell's cost of doing business.

That means more excess profits for the utility, and less in returned savings to phone users.

Bell's lobbyists are scurrying in Topeka and Jefferson City, telling legislators that the firm has to be allowed to fend off competitors who provide basic telephone services. But these competitors don't exist yet in great numbers.

In Missouri, Bell also is promising to invest in improvements in its statewide network if it gets to keep excessive rates. The entire Missouri Public Service Commission has seen through this charade. It has said the improvements can be made even if Bell's current rates go lower.

It would be amazing if any lawmaker would fall for the utility's arguments, while making enemies of several million phone customers. The bills should be rejected in both states.

## Bell earns too much, KCC staff says

**Company seeks to invest millions in Kansas upgrade.**

By MARTIN ROSENBERG  
Staff Writer

The staff of the Kansas Corporation Commission said Wednesday that Southwestern Bell Telephone Co. is overearning more than \$22.6 million a year, but the company has offered to invest \$138 million to update its network.

Both the commission staff and the company earlier this week filed testimony with state regulators.

A five-year rate plan is to expire early next year, and regulators must come up with a replacement. Staff recommendations are not binding on the commis-

sion.

In Missouri, state regulators last month cut Southwestern Bell's annual revenue by \$84.6 million, and the company has decided to appeal the ruling.

Don Low, director of the KCC's utility division, said the commission staff continues to negotiate with Southwestern Bell.

If Southwestern Bell wants to invest \$138 million over five years, Low said, it would only need \$5 million to \$8 million a year in added revenue to make such improvements.

Therefore, the commission is willing to adjust future cuts in Southwestern Bell revenue to reflect any investments the company thinks is needed, Low said.

If formal hearings are needed, they

should take place before October, he said.

The commission staff would like to implement a profit-sharing program in Kansas that would give Southwestern Bell an incentive to continue to cut costs but would share some of the savings with customers, Low said.

Such a profit-sharing effort has been in effect in Missouri for several years.

Southwestern Bell said its planned improvements in Kansas, called TeleKansas II, would provide video access to schools, hospital and county governments.

"Our customers tell us in research that modern telecommunications is essential to economic growth," said Susan Fox, president of Southwestern Bell Telephone in Kansas.

# THE KANSAS CITY STAR

Vol. 114, Saturday, January 22, 1994, No. 127

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## Bell's blatant end-run

Southwestern Bell Telephone Co. is getting ready to stroke Missouri legislators and try to convince them to pass a misguided, special-interest bill. It could allow Bell to take hundreds of millions of dollars from phone customers and put the money in the utility's pockets.

Bell has prepared legislation that could be introduced soon by a sympathetic lawmaker. If it becomes law, the bill effectively could prevent the Missouri Public Service Commission from ever again challenging the phone monopoly's excess profits or its rates.

A draft of the legislation, obtained Friday, says that if Bell adheres to several easily met requirements, it "shall not under any circumstances be subject to any complaint or hearing as to the reasonableness of its rates, charges, rentals or earnings."

Why is Bell pushing this legislation? Partly, it's an end-run around the Public Service Commission. The regulators last month ordered Bell to reduce rates by \$84.6 million a year. Essentially, the company was earning too much money; its phone rates were too high.

But Bell has decided it won't give the money back to its customers, and is fighting the matter in court. The new legislation even could make

that court challenge irrelevant: The bill allows the utility to maintain all the rates it had in effect on Dec. 31, 1993.

That means the excessive annual earnings could continue in 1994, in 1995 and on and on. If Bell gets its way in Jefferson City, the utility will be able to retain all that money, rather than let phone customers get it, as the PSC wants.

Observers of the telephone industry make an interesting point. Bell has been ordered to reduce its rates three times in the last decade, generally because technology has made telephone service cheaper to provide. Thus, its profits are likely to increase in coming years, even though rates can't be reduced by the PSC.

The company argues that it wants to invest in the most modern equipment possible, and says the bill is a bid to wrest itself from burdensome regulation while the nation moves toward an "information superhighway." True, regulatory duties of the PSC likely are going to be reduced as phone competition heats up.

Problem is, that day is not here yet. State legislators should reject Bell's bid to so completely gut the power of the Public Service Commission to protect ratepayers.

# Opinion

THE KANSAS CITY STAR

WEDNESDAY, January 26, 1994

## Bell bill should set alarms ringing across state

**Phone company is intent** on eliminating regulation of excess earnings, ending role of Public Service Commission in protecting consumer rates.

By Yael T. Abouhalkah  
Of the Editorial Staff

Southwestern Bell's latest attempt to twist the arms of Missouri legislators could wind up hurting 2.3 million Bell customers in Kansas City and the rest of the state.

Under a bill Bell officials wrote for consideration in Jefferson City, the company could:

- Increase residential phone rates with impunity.
- Keep tens of millions of dollars in future excess earnings, instead of handing refunds back to phone customers — even as its costs decline further.
- End forever the ability of the Public Service Commission and the Office of the Public Counsel to defend consumers from phone rates that are too high.

"This bill does not protect the consumer and I don't know how you can reach any other conclusion," said Kenneth McClure, vice chairman of the PSC.

Public Counsel Martha Hogerty said of the bill, "It's so outrageous, it's hard to believe they're really serious."

But longtime followers of Southwestern Bell realize the company is very intent on eliminating the ability of regulators to question how much money it makes and how much it charges for phone service.

In interviews, Bell officials say they are merely trying to respond to a newly competitive world in provid-

ing local phone service. They say the PSC is impeding the utility's plans to install a modern communications system in Missouri.

Nonsense. The "draft Missouri regulation" written by Bell includes proposals that ought to alarm phone users around the state.

Bell could increase or decrease any of its rates as long as they are revenue neutral or result in decreased revenue for the company.

If competitors try to steal Bell's big businesses — which is probable because it's the easiest and cheapest market to pursue — Bell could reduce business rates, which now are higher than residential ones.

That, in turn, would mean local residential rates could go up.

Under Bell's bill the PSC would be unable to evaluate and stop changes of local rates for basic services, as it now can, said PSC Chairman Allan Mueller.

The PSC's power "is all going to be out the window, and they'll be able to manipulate rates any way they want," Mueller said.

Bell's critics correctly point out that the utility is crying wolf on how much competition it now faces to provide local service. The utility doesn't yet face any real challenge to its control of local phone service.

Hogerty put it well: "You don't want to take away restrictions in a monopoly until you know that real competition exists."

Of course, Bell would love to keep all of its excess earnings, grow financially stronger and be in a better position to fend off competitors. As PSC officials note, Bell already has tremendous advantages over companies that want to break into the business of providing local phone service.

Instead of passing Bell's bill, the Missouri General Assembly ought to wait another year and see what happens to the four federal measures that are moving through Congress on setting up the national "information superhighway."

These bills probably will remove some of the regulatory pressures Bell is complaining about. At the same time, though, the federal government may say states should keep some control over quality of service.

"Legislation of any kind is premature because of what is happening at the federal level," McClure said.

Bell's powerful lobbyists can be counted on to push the company's arguments in the next few weeks.

"It's very persuasive to run into legislators and say this is a great deal for economic development," said Hogerty.

The problem is, Bell's legislation is not needed. The PSC determined in December that Southwestern Bell has plenty of time and money right now to make great improvements in its fiber optic system in the state.

The PSC should not be driven out of business at this point by short-sighted legislation pushed by one company that stands to gain economically.

Gov. Mel Carnahan and Missouri legislators should have the courage to reject Bell's special-interest measure.

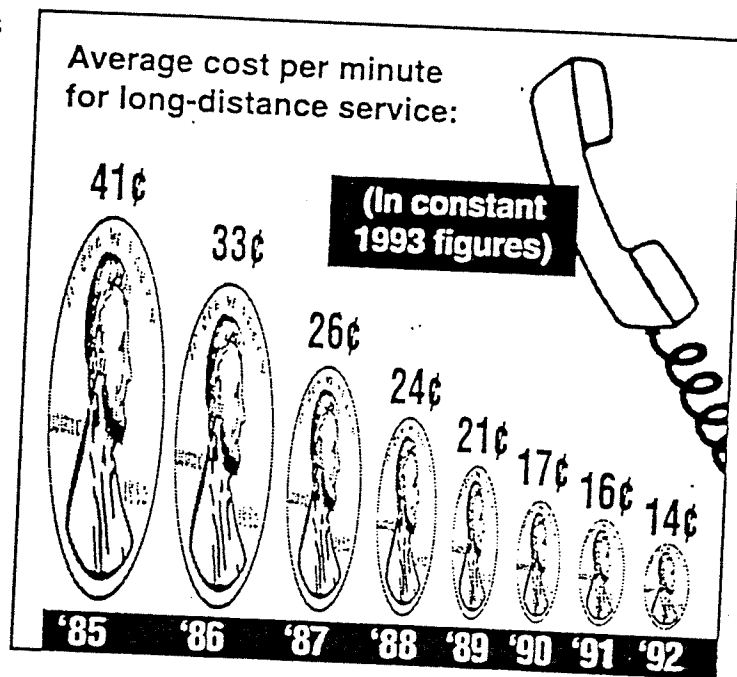
# Competition Works for America

Thanks to competition, consumers pay 63% less (adjusted for inflation) today for long distance calling than before the Bell System break-up. The break-up, agreed to by the Bell Companies, was designed to end anticompetitive harm to the long distance industry.

Competition drove long distance companies to build our national "information superhighways" which, in turn, have produced:

- Dramatic quality improvements
- Explosive technological development
- Unprecedented, innovative services

At the same time, local Bell telephone rates have climbed 13%. Yet the Bells have failed to use their monopoly profits to build the local "on and off ramps" for the access to the information superhighways.



Tell the Bells  
to mind their  
own business!

KEEP THE BELL  
MONOPOLIES OUT  
OF LONG DISTANCE

COMPTEL



LDDS METROMEDIA  
COMMUNICATIONS

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# Competition Works for America

Long distance companies depend on local Bell telephone monopolies for access to our customers.

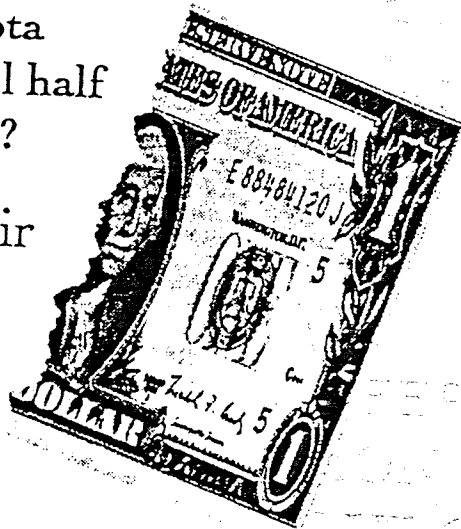
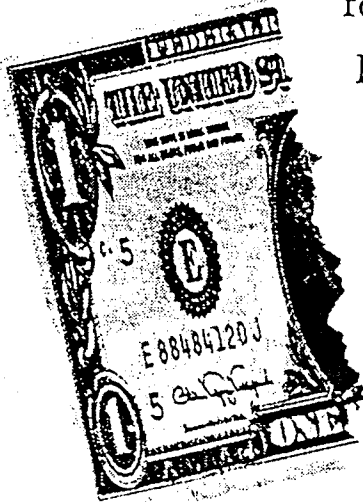
Nearly half of every dollar earned by long distance companies is paid to local telephone companies for the use of their local networks. In 1992, those payments totalled more than \$20 billion!

Now the Bell monopolies want the whole dollar. They want to "compete" against the very companies that pay them dearly for using the local network.

Wouldn't Toyota love to control half of GM's costs?

Tell the Bells to mind their own business!

KEEP THE BELL  
MONOPOLIES  
OUT OF LONG DISTANCE



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LDDS METROMEDIA  
COMMUNICATIONS

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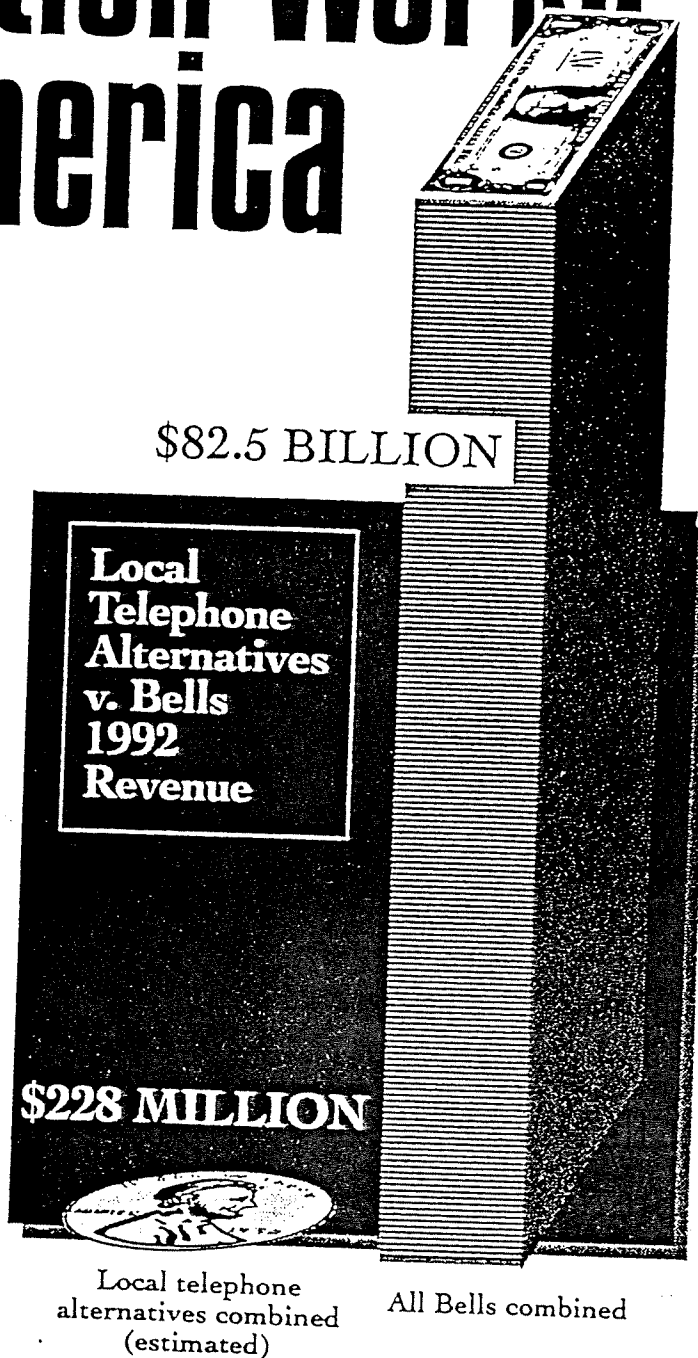
# Competition Works for America

Competition in long distance has been a huge success. But there is virtually no competition in the local telephone business—99% of all long distance calls go through the local monopolies' networks.

And the Bell monopolies say that they need to get into long distance because they face so much competition.

Get real!

Tell the Bells to  
mind their own  
business!



KEEP THE BELL MONOPOLIES  
OUT OF LONG DISTANCE

COMPTEL



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COMMUNICATIONS









MCI

 Sprint

WILTEL 

# Competition Works for America

Competition in long distance has been a huge success. Does America need the Bell monopolies in long distance? The scorecard says "No!"

LONG DISTANCE MARKET	BELL TELEPHONE MARKETS
 Intense competition with numerous customer choices for all services	 Monopoly—no customer choice for basic services
 Real prices down 63% since 1984	 Real local rates up 13% since 1984
 State-of-the-art digital, fiber optic networks	 Mostly copper, analog network
 Job growth of 18% since 1988	 Job losses of 11% since 1988

The long distance market is competitive, using the latest technology, and producing job growth and lower prices. The long distance information superhighways are in place.

The Bell Companies are monopolies, making a slow transition from old to new technologies, producing job losses and higher local telephone bills. We need the Bell Companies to modernize their local networks into a state-of-the-art information infrastructure. And we need competition in local telephone service to get the job done.

Tell the Bells to mind their own business!

DON'T LET THE BELLS MONOPOLIZE  
LONG DISTANCE TOO

COMPTEL



LDDS METROMEDIA  
COMMUNICATIONS

MCI

 Sprint

WILTEL

**AT&T**

Communications — Kansas

TESTIMONY ON BEHALF OF AT&T  
BEFORE THE SENATE COMMERCE COMMITTEE  
PRES SHEPPARD  
SENATE BILL 591  
FEBRUARY 10, 1994

Madam Chairperson and members of the Committee:

My name is Pres Sheppard. I am Vice-president, State Government Affairs for AT&T in our Southwest Region.

As such, my primary responsibility is to manage AT&T's interface with the state regulatory commissions in Kansas, Missouri, Oklahoma, Arkansas and Texas. In this capacity, I have been dealing with the Kansas Corporation Commission since mid 1983.

It is with this historical perspective that I would like to address the impact of the legislation proposed in SB591.

The bill, as originally proposed, was characterized as an extension of the 5 year regulatory plan known as TeleKansas I, which is currently in effect for Southwestern Bell through March of 1995. AT&T was a party to TeleKansas I and supported its adoption. AT&T would still support the application of similar principles in TeleKansas II or in legislation.

Unfortunately, SB591 as originally proposed goes significantly beyond the flexibility granted in TeleKansas I, which causes AT&T serious concerns. It provides for deregulation of competitive services with no appropriate safeguards for consumers or competitors. As such, we believe it would tend to stunt or thwart the development of competition in Kansas thereby reducing choices for Kansans. This legislation grants regulatory freedoms far beyond those afforded Southwestern Bell in TeleKansas I and beyond the flexibility applicable to AT&T and the other long distance companies in Kansas that operate in a much more competitive market. AT&T opposes the bill as originally filed.

2/10/94  
*Commerce*

*Attachment 5-1*

AT&T has negotiated with Southwestern Bell to incorporate changes to the legislation which would address our concerns during the previous week since we first saw the legislation. The balloon amendment, as offered by Southwestern Bell on February 9, 1994, addressed some of our concerns but still left three major flaws from our perspective. These concerns are outlined in my next comments;

1. Section 3, upon finding of competitive status for a service, completely deregulates that service without providing any safeguards for consumers or competitors or any oversight by the Kansas Corporation Commission.

2. Section 1(b) would authorize Southwestern Bell to raise any of its rates to offset lost revenue under some circumstances.

3. Section 1(c) provides greater flexibility for Southwestern Bell than is currently afforded to AT&T and the other long distance carriers.

AT&T offers the substitute language attached to my testimony which addresses these major concerns. I have attached a copy of a balloon amendment to SB591 as originally filed(attachment 1). I have also attached the same amendatory language to the balloon amendment offered by Southwestern Bell on February 9, 1994 (attachment 2). I believe these changes grant Southwestern Bell the ability to compete in the changing marketplace and provides balancing features for Kansas consumers and Southwestern Bell's competitors alike.

These amendments were discussed with Southwestern Bell after the committee took testimony on February 9. In that short timeframe, we made significant progress in addressing our concerns and reached a general agreement on principles to revise the legislation. Our amendments represent the principles which we negotiated in this meeting. We do not represent that these changes reflect the concerns of any other party.

All of these changes are important to AT&T as Southwestern Bell's largest customer, important to the development of competition in Kansas and important for the introduction of new technologies and infrastructure in the state. At the same time, it allows Southwestern Bell to respond to competition for the benefit of the customers that they will continue to serve.

In the interest of time, I will not describe the proposed changes in detail. Generally, they allow for the adoption of safeguards in the emerging competitive marketplace such as protection from predatory pricing and cross-subsidization. The amendments also level the playing field in those areas where Southwestern Bell competes with other long distance companies.

In summary, AT&T will not oppose SB591 if the essential amendments that we have proposed are included in order to encourage competition and competitive responses, while providing a mechanism to institute competitive safeguards and to enable the Kansas Corporation Commission to guide the process to a positive and balanced outcome.

Proposed Amendment to SB 591

SENATE BILL NO. 591

By Committee on Commerce

AN ACT concerning public utilities; regarding regulation of telecommunications.

*Be it enacted by the Legislature of the State of Kansas:*

Section 1. (a) Subsequent to the effective date of this act and for so long as a telecommunications public utility agrees not to file for any increase in the rates, ~~charges or rentals~~ for residential or business basic local telecommunications service, such public utility shall not under any circumstances be subject to any investigation, complaint or hearing as to its rates for basic local telecommunications service, charges, rentals or as to its overall earnings unless and until such public utility proposes an increase in basic local telecommunications service. For purposes of this subsection, a company's rates shall be those in effect on December 31, 1993. Any telecommunications public utility with more than 500,000 access lines in this state must also agree by notification to the Kansas corporation commission that it will make capital expenditures of approximately \$138,000,000, spread over a period of ~~not less than~~ five years, commencing with its agreement not to file for any increase in basic local telecommunications service. Such capital expenditures will be above normal construction investment and targeted to network infrastructure projects that will have application in the areas of education, health care or economic development. Actions or proposals pursuant to and consistent with subsection (b) or (c) of this section shall not authorize an investigation, complaint or hearing as to the reasonableness of the ~~rates, charges, rentals or~~ earnings of a telecommunications public utility which has made and is otherwise in compliance with a commitment made pursuant to this subsection.

(b) If the commission takes any action other than an action affecting rates which subjects such a public utility, while it is in compliance with a commitment made pursuant to subsection (a), to any reduction in its revenues, the commission shall be required to first provide, by order, a plan which ensures the revenue will be recoverable through an increase in rates for any services, other than carrier

access charges, provided by such public utility, recognizing that a rate increase on certain services may further reduce revenues of the public utility. authorize such public utility to increase its rates, charges or rentals for basic local telecommunications service by an amount that allows the public utility to recover the reduction in revenues caused by such commission action.

(c) Notwithstanding any other provision of chapter 66 of the Kansas Statutes Annotated, a public utility which is still in compliance with a commitment made pursuant to subsection (a) of this section shall be authorized to propose initiate an increase or decrease in the rates, charges or rentals for any of its services other than basic local telecommunications services if it files such proposal notice of its intention to do so with the commission not less than 15 days prior to the effective date of such increase or decrease subject to suspension by the commission for a period no longer than that provided in subsection (b) of K.S.A. 66-117 and amendments thereto. The commission's review of any such proposed change in rates shall include consideration of the costs for the services involved, the charges for similar services, the demand therefor, and market conditions. The proposed rate change may be suspended within 15 days after filing if further investigation is necessary. Suspensions of any such proposed rate shall be made only when good cause exists to believe that such changes are inconsistent with established commission rules, or policies or applicable law, are inconsistent with prevailing competitive conditions or are unjust or unreasonable. The earnings of such public utility may not be considered or constitute grounds for rejecting such a proposed rate change. Changes in carrier access charges charged by a public utility shall be determined by the commission, without reference to the public utility's overall earnings..

Section 2. For purposes of section 1 only; (a) "basic local telecommunications exchange service" shall mean single line service to either residential or business customers within a specified geographical area for local calling, excluding optional services; and (b) "Carrier access charges" shall mean the services included in the access service tariff of the telecommunications public utility.

Section 3. If the commission, on its own motion or on a petition by a public utility which is still in compliance with subsection (a) of this section, determines that the same or a similar service as that provided by such public utility is being offered by another provider in the same

geographic market at an equivalent or lower price or on more favorable terms and conditions, and determines that such offering constitutes effective competition, the commission shall develop necessary competitive safeguards and allow competition in the provision of that service. ~~exempt. from regulation with regard to its price and the terms and conditions on which it is offered.~~ Upon such a determination by the commission, that service would then be exempt from regulation, except for being subject to complaint procedures concerning alleged violations of competitive safeguards as determined by the commission. The competitive safeguards to be considered include, but are not necessarily limited to: 1) measures necessary to prevent cross-subsidization, predatory pricing and discrimination; 2) interconnection; 3) resale of appropriate services; and 4) annual financial reporting. Complaints shall be limited to an alleged violation of the competitive safeguards. Such safeguards shall not include a review of earnings. They also shall not include a review of price except when necessary to address the specific complaint. Any petition filed under this subsection by a public utility must be acted upon by the commission in no greater than 120 days after it is filed. Any action by the Commission to exempt services under this section would not constitute an action by the commission under subsection (b) of section 1.

Section 4. This act shall take effect and be in force from and after its publication in the statute book.

Proposed Amendment to Southwestern Bell's Amended SB 591

SENATE BILL NO. 591

By Committee on Commerce

AN ACT concerning public utilities; regarding regulation of telecommunications.

*Be it enacted by the Legislature of the State of Kansas:*

Section 1. (a) Subsequent to the effective date of this act and for so long as a telecommunications public utility agrees not to file for any increase in the rates for residential or business basic local telecommunications service, such public utility shall not under any circumstances be subject to any investigation, complaint or hearing as to its rates for basic local telecommunications service or as to its overall earnings unless and until such public utility proposes an increase in basic local telecommunications service. For purposes of this subsection, a company's rates shall be those in effect on December 31, 1993. Any telecommunications public utility with more than 500,000 access lines in this state must also agree by notification to the Kansas corporation commission that it will make capital expenditures of approximately \$138,000,000, spread over a period of five years, commencing with its agreement not to file for an increase in basic local telecommunications service. Such capital expenditures will be above normal construction investment and targeted to network infrastructure projects that will have application in the areas of education, health care or economic development. Actions or proposals pursuant to and consistent with subsection (b) or (c) of this section shall not authorize an investigation, complaint or hearing as to the reasonableness of the ~~rates, charges, rentals or~~ earnings of a telecommunications public utility which has made and is otherwise in compliance with a commitment made pursuant to this subsection.

(b) If the commission takes any action other than an action affecting rates which subjects such a public utility, while it is in compliance with a commitment made pursuant to subsection (a), to any reduction in its revenues, the commission shall be required to first provide, by order, a plan which ensures the revenue will be recoverable through an increase in rates for any services, other than carrier

access charges, provided by such public utility, recognizing that a rate increase on certain services may further reduce revenues of the public utility.

(c) Notwithstanding any other provision of chapter 66 of the Kansas Statutes Annotated, a public utility which is still in compliance with a commitment made pursuant to subsection (a) of this section shall be authorized to propose an increase or decrease in the rates for any of its services other than basic local telecommunications services if it files such proposal with the commission not less than 15 days prior to the effective date of such increase or decrease, subject to suspension by the commission for a period no longer than that provided in subsection (b) of K.S.A. 66-117 and amendments thereto. The commission's review of any such proposed change in rates shall include consideration of the costs for the services involved, the charges for similar services, the demand therefor, and market conditions. The proposed rate change may be suspended within 15 days after filing shall be if further investigation is necessary. ~~presumed just and reasonable if the proposed rates for the services equal or exceed the incremental cost in providing such services.~~ Suspensions of any such proposed rate shall be made only when good cause exists to believe that such changes are clearly inconsistent with established commission rules, or policies or applicable law, are clearly inconsistent with prevailing competitive conditions or are clearly unjust or unreasonable. The earnings of such public utility may not be considered or constitute grounds for rejecting such a proposed rate change. Changes in carrier access charges charged by a public utility ~~which is in compliance with a commitment made pursuant to subsection (a)~~ shall be determined by the commission, without reference to the public utility's overall level of earnings.

Section 2. For purposes of section 1 only, "basic local telecommunications service" shall mean single line service to either residential or business customers within a specified geographical area for local calling, excluding optional services. "Carrier access charges" shall mean the services included in the access service tariff of the telecommunications public utility.

Section 3. If the commission, on its own motion or on a petition by a public utility which is still in compliance with subsection (a) of this section, determines that the same or a similar service as that provided by such public utility is being offered by another provider in the same

geographic market at an equivalent or lower price or on more favorable terms and conditions, and determines that such offering constitutes effective competition, the commission shall develop necessary competitive safeguards and allow competition in the provision of exempt that service. from regulation with regard to its price and the terms and conditions on which it is offered. Upon such a determination by the commission, that service would then be exempt from regulation, except for being subject to complaint procedures concerning alleged violations of competitive safeguards as determined by the commission. The competitive safeguards to be considered include, but are not necessarily limited to: 1) measures necessary to prevent cross-subsidization, predatory pricing and discrimination; 2) interconnection; 3) resale of appropriate services; and 4) annual financial reporting. Complaints shall be limited to an alleged violation of the competitive safeguards. Such safeguards shall not include a review of earnings. They also shall not include a review of price except when necessary to address the specific complaint. Any petition filed under this subsection by a public utility must be acted upon by the commission in no greater than 120 days after it is filed. Any action by the commission to exempt services under this section would not constitute an action by the commission under subsection (b) above.

Section 4. This act shall take effect and be in force from and after its publication in the statute book.

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ted by *2/10/94*  
*Annex*  
591  
*Attachment 6-1*

- 1 3) codification of a successor plan to TeleKansas is not  
2 necessary because this can be accomplished through the  
3 KCC and related fair and impartial hearings,
- 4 4) competition and economic development are potentially  
5 impaired because excessive monopoly profits are  
6 retained to subsidize competitive services which acts  
7 to drive competitors and related economic development  
8 from Kansas,
- 9 5) the bill neither promotes nor establishes a balancing  
10 of interests among all affected parties including  
11 Kansas ratepayers and competitors of SWBT,
- 12 6) SWBT should modernize its network (to provide  
13 efficient and sufficient service) when it is in the  
14 best interests of Kansans (like many other telephone  
15 companies in Kansas have already done), without having  
16 to be promised unjustified regulatory freedoms in a  
17 continued local monopoly environment,
- 18 7) based on SWBT's compromise of the original TeleKansas  
19 stipulation, there should be serious concerns about SB  
20 591 which includes language which is much more vague  
21 and obscure and invites continued problems,
- 22 8) prior to this deregulatory-type bill being implemented  
23 there are various other important industry issues  
24 which need to be addressed and implemented (consistent  
25 with other states) such as formal quality of service  
26 standards,
- 27 9) there is no guarantee the \$138 million of capital  
28 expenditures will be priced in a manner by SWBT that  
29 services will or can afford to be subscribed to, as  
30 evidenced by SWBT's history of problems in the  
31 interactive video arena in Kansas (and the KCC's hands  
32 will be tied regarding evaluation of customer pricing  
33 concerns).

34 I would propose that the legislature defer to the KCC  
35 regarding a successor plan to TeleKansas at the present  
36 time. If the Commission is unable to implement a plan by  
37 the approximate expiration date of TeleKansas in early  
38 1995, then perhaps other avenues should be explored.  
39 However, at this point in time there still has not been  
40 full accountability and evaluation of TeleKansas  
41 (especially since one year still remains under the present  
42 plan). I would hope that SWBT would support a full and  
43 public accountability of TeleKansas, rather than be  
44 perceived as railroading a successor plan that doesn't  
45 improve upon or correct the problems which occurred under  
46 the original TeleKansas plan.

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1 technical staff. As I mentioned earlier, I was the only  
2 KCC representative to sign the TeleKansas stipulation.

3 Intent of TeleKansas -

4 I viewed TeleKansas as a good faith effort between KCC  
5 staff and SWBT -- from the standpoint that SWBT wouldn't  
6 take actions to increase local rates, directory assistance  
7 and long distance rates and staff would not initiate any  
8 earnings investigations against SWBT as long as earnings  
9 levels were reasonable. It is my impression that neither  
10 party was obligated by this language, but it was intended  
11 to be a good faith effort. In light of the TeleKansas  
12 stipulation, Mr. Callaway (President of SWBT in Kansas at  
13 the time) testified early in the TeleKansas hearings that  
14 SWBT may need to file a rate case under certain  
15 circumstances. In response to Mr. Callaway's  
16 interpretation, I indicated that KCC staff may have to  
17 initiate an earnings investigation (show-cause) of SWBT  
18 under certain overearnings conditions. I addressed the  
19 good faith scenario and the earnings concerns during cross-  
20 examination of the TeleKansas hearings at Volume III of  
21 the transcript, page 895, lines 1 to 20.

22 TeleKansas Rate Reductions -

23 During the period of TeleKansas review in 1989 SWBT  
24 provided information which showed that SWBT was  
25 underearning by \$8 million (or SWBT needed additional  
26 revenues of \$8 to earn a reasonable return). In contrast,  
27 KCC staff presented evidence which showed that SWBT's  
28 excessive earnings were about \$24 million. Eventually the  
29 Commission approved a reduction in rates and provision of  
30 benefits of \$24 million, consistent with Staff's findings.  
31 In addition, original elements of SWBT's proposal were  
32 significantly changed because these acted to automatically  
33 increase local rates depending upon changes in the  
34 Consumer Price Index. The exaggerations of SWBT's  
35 original TeleKansas proposal is more evident today, four  
36 years into TeleKansas. A review by KCC staff shows that  
37 SWBT today is currently overearning by about \$23 million.  
38 In addition, under the original TeleKansas proposal KCC  
39 staff recommended that an allowance of funds be  
40 established for the provision of Dual Party Relay Service  
41 in Kansas for persons which are hearing or speech impaired  
42 and that a fund be established to assist low-income  
43 Kansans in paying their telephone bills. The provisions  
44 of SB 591 do not have the flexibility to address these  
45 types of important issues, as no similar type issues are  
46 proposed by SWBT in SB 591.

1 Interpretation of TeleKansas Language -

2 In the hearings yesterday a number of proponents of SB 591  
3 provided their interpretation of some language included in  
4 the TeleKansas stipulation. I would like to provide my  
5 interpretation of that language and clarify this matter.  
6 The TeleKansas stipulation includes one sentence which  
7 states that, "It is the intent of the parties not to  
8 merely return to rate base regulation at the end of five  
9 years". If you read the entire stipulation, particularly  
10 other passages at this same page, you will understand that  
11 it was the intent of both SWBT and KCC staff to explore  
12 other forms of regulation which may be better than  
13 TeleKansas during the five year TeleKansas period. One  
14 form of regulation is rate of return regulation.  
15 Likewise, there are many other types of regulatory plans.  
16 KCC staff's intent was to indicate that it would not  
17 propose to return to rate of return regulation if there  
18 was a better form of regulation -- or at least without  
19 exploring and evaluating many other options. Given that  
20 KCC staff entered into the TeleKansas experiment, with  
21 numerous revisions it made to SWBT's originally proposed  
22 TeleKansas plan, it is obvious that staff was interested  
23 in objectively exploring other forms of regulation that  
24 might better serve the needs of SWBT, competitors of SWBT,  
25 the Kansas ratepayer and KCC staff. In other words, staff  
26 was interested in a form of regulation that might better  
27 balance the playing field for all parties affected. It is  
28 worth noting here that upon entering TeleKansas I noted  
29 that alternative regulation had a difficult act to follow.  
30 Rate of return regulation had served Kansas well through  
31 difficult times and an evolving telecommunications arena  
32 which included issues such as divestiture of AT&T,  
33 various telecommunication technologies, competition and  
34 inflationary periods -- while preserving reasonable rates  
35 and quality service for Kansans under all of those  
36 conditions.

37 In summary, neither SWBT nor KCC staff got everything they  
38 wanted in the original TeleKansas stipulation. Whenever  
39 agreement could not be reached on certain language in the  
40 stipulation then language which provided enough  
41 flexibility for both parties to argue these issues in the  
42 future was included in the stipulation. Unfortunately,  
43 that is one of the by-products of a stipulation as opposed  
44 to a more definitive and detailed Commission order  
45 supported by hearings.

1 SWBT Violations of TeleKansas -

2 I oppose SB 591 because it includes much vague and obscure  
3 language which is conducive to misinterpretation and  
4 manipulation. Leaving these kinds of loopholes and  
5 subjective language in SB 591 will inevitably (and  
6 unfairly) leave SWBT in the driver's seat in future years  
7 regarding interpretation of that language. This type of  
8 language is less exact than the TeleKansas stipulation,  
9 and therefore potentially leads to more problems than what  
10 were incurred under the TeleKansas stipulation.

11 SWBT violated the good faith agreement of TeleKansas on  
12 various occasions. I will explain several of the most  
13 prominent examples.

14 1) Directory Assistance:

15 This is perhaps the most blatant example of a violation,  
16 from the standpoint that the language in TeleKansas is  
17 persuasive and cannot possibly be interpreted in any  
18 manner which supports SWBT's position.

19 Page 4, item 15 of the stipulation indicates changes in  
20 rates for Directory Assistance which were agreed to under  
21 TeleKansas. This is not in dispute. However, the next  
22 sentence regarding Directory Assistance service indicates,  
23 "All other aspects of Directory Assistance will remain  
24 unchanged." Despite this language in the stipulation --  
25 on March 8, 1991, SWBT filed tariffs with the KCC  
26 proposing to change other aspects of Directory Assistance  
27 service. Ultimately the Commission denied SWBT's tariff  
28 filing as indicated at page 9 of the order in Docket No.91-  
29 SWBT-245-RR, order dated December 4, 1991. The Commission  
30 stated in its order that SWBT's proposed changes are, "...  
31 prohibited by the clear intention expressed by parties in  
32 the TeleKansas Stipulation..."

33 2) FAS 106:

34 The next example of a violation of TeleKansas relates to  
35 issues regarding FAS 106. In my opinion SWBT violated the  
36 good faith agreement of TeleKansas, although the company  
37 perhaps stays within the technical confines of obscure  
38 language included in TeleKansas. In this docket SWBT  
39 argued it would incur unusually large expenses related to  
40 health care costs in the period 1993 and 1994. SWBT was  
41 not required to address significant savings it incurred  
42 for this same time period such as due to force reductions.  
43 SWBT requested to defer recovery of these costs in rates  
44 subsequent to TeleKansas expiration in early 1995.  
45 Technically this does mean that rates will not change

1 during the TeleKansas period. However, ratepayers in  
2 future years will be detrimented by this deferral of costs  
3 to the extent this offsets potential rate reductions or  
4 refunds in a post-TeleKansas environment. I did not  
5 envision that TeleKansas would allow SWBT to defer certain  
6 costs to future periods. The good faith agreement of  
7 TeleKansas anticipated that both parties entered the  
8 agreement willing to accept certain risks in return for  
9 certain rewards. In this instance SWBT bears no risk.

10 Ultimately KCC staff and SWBT reached an agreement whereas  
11 about one-half of a certain portion of these costs were  
12 deferred to the post-TeleKansas time period.

### 13 Application of Past SWBT Violations to SB 591 -

14 Given the maneuvering of SWBT under the TeleKansas  
15 stipulation, this has significant implications under a  
16 scenario such as SB 591. For example, if the KCC is  
17 allowed to establish a successor alternative regulation  
18 plan then the specific loopholes which existed under  
19 TeleKansas can be addressed in specificity and corrected.  
20 However, the vague and obscure language which currently  
21 exists under SB 591 will allow SWBT more interpretative  
22 license than it used under TeleKansas. As an extreme  
23 situation, SWBT could defer all costs and expenses it  
24 incurs for the five years under SB 591 (TeleKansas II) for  
25 to a period subsequent to the expiration of TeleKansas II.  
26 This perpetuity of deferred expenses will insure that SWBT  
27 is never in a position where it could have excessive  
28 earnings.  
29

### 30 PROBLEMS WITH SB 591

#### 31 1) SWBT is a Monopolist Provider of Local Service -

32  
33 SWBT should not be deregulated along the lines of SB 591  
34 as long as SWBT is the only local exchange alternative for  
35 its customers, as currently exists. The degree of  
36 competition varies in each state and among different  
37 cities. Kansas has yet to see the degree of local  
38 competition that is beginning to make inroads in large  
39 urban cities such as Chicago. Until customers have an  
40 alternative local exchange service provider, or are on the  
41 verge of having on, this type of deregulation actually  
42 acts to help insure SWBT's retention of its monopoly  
43 status. An environment which acts to discourage  
44 competition represents a step backward and is out of touch  
45 in today's regulatory environment. A movement towards  
46 deregulation in Kansas at this time is premature and an  
47 environment friendly to effective competition should

1 continue to be fostered.

2 Local service continues to be the single largest revenue  
3 contributor for SWBT in Kansas by providing about 40% of  
4 SWBT's total Kansas revenues. These revenues range from  
5 about \$280 million for total local exchange service to  
6 \$205 million for just basic local exchange service. These  
7 numbers are based on 1992 results from SWBT's annual  
8 report.

9 2) Local Rates Are Not in an Increasing Mode -

10 A person outside of the regulatory arena may feel that a  
11 guarantee by SWBT to not increase rates for the next five  
12 years is a good deal. However, due to declining costs in  
13 the telecommunications arena, the positive economy and  
14 reductions in the cost of capital it is normal for local  
15 rates to be declining in today's environment. Under SB  
16 591 SWBT will keep these profits gained from monopoly  
17 service which could otherwise be used to reduce basic  
18 local rate, reduce touch-tone rates or reduce the rates  
19 perhaps for other services such as 911 and other basic and  
20 emergency services. These profits may be used to  
21 subsidize those services which are potentially competitive  
22 or have already been deregulated by the KCC by virtue of  
23 existing competition.

24 Nationwide the recurring trend is a reduction in local  
25 rates or refunds returned to customers under alternative  
26 regulatory plans which share the excessive monopoly  
27 profits between telephone companies and customers. A  
28 person has to look no further than the SWBT region to see  
29 this trend. For example, these rate reductions/refunds  
30 are noted in SWBT's 1992 Annual Report to Stockholders:

31 Missouri - In the third year of its alternative  
32 regulatory plan proposed rate cuts of \$22  
33 million were planned.

34 Oklahoma - The Public Service Commission has yet to  
35 implement an alternative regulatory plan but  
36 under rate of return regulation in 1992 the  
37 Commission ordered a permanent reduction in  
38 rates of \$101 million along with an  
39 additional refund to customers of \$148  
40 million. This matter is under appeal and  
41 potential refunds and rate reductions are  
42 accruing interest at a substantive rate from  
43 day to day.

1 Texas - The Texas alternative regulatory plan calls  
2 for rate reductions and customer benefits of  
3 \$246 million in 1991 and additional rate  
4 reductions of \$34 million in 1992, \$23  
5 million in 1993 and \$102 million in 1994.

6  
7 3) KCC Leadership Stalled on Important Industry Issues -

8 The KCC has historically supported modernization and has  
9 initiated policy which promotes modernization or the  
10 provision of services which are emergency in nature or  
11 necessary in providing equivalent telephone service for  
12 persons which are hearing or speech impaired. For  
13 example, while I was the Chief of Communications my staff  
14 and I initiated the provision of Dual Party Relay Service  
15 for persons which are speech and hearing impaired. As  
16 another example, we initiated and implemented the concept  
17 of "Economic Development Rates" which was done to allow  
18 services such as interactive video to be widely offered to  
19 customers (schools, etc.) at rates which may be below a  
20 standard cost level. This is somewhat of a departure from  
21 Commission policy which normally endorses a concept that  
22 rates be cost-supported to eliminate potential cross-  
23 subsidization concerns. This type of effective industry  
24 leadership on these issues will likely be stalled under SB  
25 591, given the potential rates issues which the Commission  
26 cannot address.

27 4) SWBT Should be Obligated to Modernize -

28 Under SB 591 SWBT indicates it will spend another \$138  
29 million in modernization if it is given additional  
30 significant regulatory freedoms. This particular part of  
31 the plan is especially disturbing in view of the ultimatum  
32 which is presented. In regards to this issue I believe an  
33 important message should be sent to SWBT that citizens of  
34 Kansas will not be held hostage for this type of  
35 presumptuous demand. If the modernization and related  
36 services which SWBT proposes are in the best interests of  
37 Kansans, then these services should be provided regardless  
38 of type of regulation. In fact, if these services are  
39 needed and desired by Kansans (such as schools and  
40 hospitals) then there is an inference that these are in  
41 fact efficient and sufficient services which SWBT is  
42 obligated to provide. When I was present yesterday  
43 listening to various industry proponents which favored  
44 this modernization, I got the impression that these  
45 potential customers considered these services to be  
46 efficient, sufficient, in demand and in the best interests  
47 of Kansans. Given these services are efficient and  
48 sufficient they should be provided under any type of  
49 regulation, and can certainly be provided under existing

1 Kansas statutes.

2 At least one proponent of SB 591 tried to give the  
3 impression yesterday that the \$138 million investment was  
4 above and beyond what could be considered efficient and  
5 sufficient service under existing statutes, and thus SWBT  
6 was not legally obligated to provide these related  
7 services or make this investment. (Prior to addressing  
8 this matter I will note that historically the Commission  
9 has refrained from making management decisions for  
10 regulated companies, such as when to invest, how much to  
11 invest and what type of capital investment should be made.  
12 Obviously, this type of Commission intervention would meet  
13 with much opposition from the industry. Therefore, the  
14 utility companies have always retained discretion in this  
15 area.) I find the arguments of the SB 591 proponent  
16 ironic in several accounts:

17 a) Obviously at some point in time efficient and  
18 sufficient service under this Kansas statute likely  
19 inferred 8-party service, a hand-cranked telephone and  
20 other technologies and standards which are largely  
21 archaic at this time. It did not take a change in  
22 Kansas statute, nor a change in any other KCC policy,  
23 for telephone networks to evolve to analog and digital  
24 (which is now considered state of the art). Likewise,  
25 the provision of interactive video and other services  
26 does not anticipate nor require a change in the  
27 efficient and sufficient language of Kansas statute.  
28 I believe the Commission has the discretion to  
29 interpret the types of services potentially provided  
30 by the \$138 million as efficient and sufficient  
31 services.

32 b) SWBT prides itself on surveying its customers and  
33 trying to remain appraised of its customers needs and  
34 desires. I find it unusual that SWBT would not  
35 provision a service on a timely basis that is in  
36 demand, especially since SWBT is asking that response  
37 time on tariffs filed with the KCC be cut from 20 days  
38 to 15 days. Asking for expedited service  
39 implementation time on one hand, yet not providing  
40 requested service to customers on the other hand is an  
41 interesting combination of circumstances.

1 5) Other Kansas Companies Modernize Without the Demands  
2 SWBT Has Made -

3 Calling upon my experience when I was with the KCC, SWBT  
4 lagged the small independent telephone companies in terms  
5 of placement of interactive video from the standpoint of  
6 cooperation with customers and pricing which is agreeable  
7 to the customer. The modernization and placement of  
8 interactive video by independent telephone companies can  
9 be a greater proportion of the budget of an independent  
10 versus an interactive application for SWBT's budget.  
11 Technically, this is a proportionately greater risk for  
12 the smaller telephone companies. However, the independent  
13 telephone companies have not requested preferential  
14 treatment and have not held modernization decisions  
15 hostage for additional regulatory freedoms.

16 In 1990 when I was with the KCC I sat on several  
17 committees including Kansas Technology Enterprise  
18 Corporation, the Kansas Telecommunications Consortium and  
19 other committees dealing with issues such as interactive  
20 video placement for educational purposes. Generally,  
21 based on what I heard in these committees SWBT's pricing  
22 and placement of interactive video was inferior to that of  
23 the independent telephone companies. It is interesting to  
24 note that SWBT did not avail itself to the "Economic  
25 Development Rates" which could be used to price  
26 interactive video applications at a below-cost standard to  
27 schools and hospitals. The independent telephone  
28 companies served as the impetus for the KCC initiating and  
29 implementing these rates, per interactive video  
30 applications installed by both Pioneer Telephone and Craw-  
31 Kan Telephone (and perhaps other independent companies).

32 Basically the KCC did what was within its powers to do  
33 regarding promotion of interactive video. However, we did  
34 not force a telephone company to come in and establish a  
35 certain price for its services nor dictate to a company  
36 how to price its services to potential customers regarding  
37 disputes on interactive video rates. These types of  
38 issues create questions of the commitment to interactive  
39 video and other modernization by SWBT. Basically, SWBT  
40 has a tremendous amount of freedom available to it  
41 regarding pricing of interactive video, so it is  
42 interesting that this construction is not being pursued on  
43 its own merits.

44  
45 6) Extent of SWBT Modernization -

46 While I support the concept of modernization of \$138  
47 million, I believe this is an obligation of SWBT and not  
48 something to be bargained for through regulatory freedoms.

1 However, I do believe the \$138 million does need to be put  
2 into perspective. While \$138 million, if spent prudently,  
3 can likely go a long ways in the provision of education  
4 and health care this is not a significant capital  
5 investment by SWBT capital budgeting standards.  
6 Therefore, the \$138 million needs to be viewed in the  
7 proper perspective that it is not the substantive  
8 sacrifice it may be made out to be.

9 The amount of \$138 million translates to about \$28 million  
10 a year to be invested for five years. The amount of \$28  
11 million is about 1/10 of 1% of SWBT's total gross plant  
12 investment in Kansas of \$25.2 billion as of 1992.  
13 Likewise, the average annual plant investment in Kansas  
14 for the last five years has fluctuated from about \$1.2  
15 billion to \$1.8 billion, or an average of \$1.4 billion.  
16 The \$28 million represents about 2% of SWBT's annual  
17 investment in Kansas for the last five years. It is also  
18 worth noting that this capital is largely internally  
19 financed with the company's cash on hand, versus resulting  
20 from new debt or equity issuances.

#### 21 THE STATE OF REGULATION NATIONWIDE

22 In testimony yesterday at least one proponent of SB 591  
23 indicated that alternative regulatory plans with a sharing  
24 provision for earnings between ratepayers and the company,  
25 was in fact rate of return regulation. This is not rate  
26 of return regulation. In fact, this type of regulatory  
27 plan is most commonplace nationwide.

#### 28 CONCLUSION

29 Thank you for your time. I would be pleased to address  
30 questions you may have.