

KANSAS TELECOMMUNICATIONS REGULATORY REFORM –  
A MODEL FOR BROADBAND SUCCESS

The ongoing consideration of the National Broadband Plan (NBP) is an opportunity to review the history and implementation of telecommunications regulatory reform at the state level. The Kansas experience with comprehensive reform is a significant and instructive area for study, as Kansas has experienced both success and difficulty advancing the public interest in advanced communications capabilities. This experience provides clear evidence to evaluate policy choices that can similarly advance or hinder the laudable objectives of the NBP.

Kansas undertook comprehensive reform of telecommunications policy in the mid-1990's, both to address state concerns and in light of the coincident development of the federal Telecommunications Act of 1996. Extensive study and effort by a statewide Task Force representing government, consumer and provider interests led to development of the Kansas Telecommunications Act, enacted by the 1996 Kansas Legislature. Subsequent fine-tuning by legislative amendment, and implementation under Kansas Corporation Commission (KCC) regulatory oversight have allowed Kansas to enjoy the benefits of substantial investment in communications facilities, while consumer service rates have been restrained or often reduced. Possibly the most illuminating features of the Kansas experience are the clear contrasts between specific policies that have advanced policy objectives and others that have had less salutary effects.

The Kansas Telecommunications Act, found at Kansas Statutes Annotated § 66-2001 *et seq.*, recites a list of public policy objectives:

- (a) Ensure that every Kansan will have access to a first class telecommunications infrastructure that provides excellent services at an affordable price;
  - (b) ensure that consumers throughout the state realize the benefits of competition through increased services and improved telecommunications facilities and infrastructure at reduced rates;
  - (c) promote consumer access to a full range of telecommunications services, including advanced telecommunications services that are comparable in urban and rural areas throughout the state;
  - (d) advance the development of a statewide telecommunications infrastructure that is capable of supporting applications, such as public safety, telemedicine, services for persons with special needs, distance learning, public library services, access to internet providers and others;
- and

(e) protect consumers of telecommunications services from fraudulent business practices and practices that are inconsistent with the public interest, convenience and necessity.

A particular policy objective not specified but agreed as appropriate by all stakeholders was the reduction of intrastate toll rates through significant reductions in access charges. As was true in most states, Kansas intrastate access rates had been maintained at a level sufficient to maintain cost recovery in high-cost rural service areas. In order to reduce toll rates without eroding service in these areas, the Kansas legislation required a shift of cost recovery from access revenue to local rates and to a new Kansas Universal Service Fund (KUSF). The Act mandated intrastate access rates at parity with interstate rates, to be achieved over a three-year period for larger local carriers and immediately for rural independent carriers. Rather than attempt to legislate rebalancing, the legislature assigned responsibility to the KCC (the state's utilities regulator) to determine appropriate levels of local service rates and to transition from historic access support to cost-based KUSF support. Assurance of continuing consumer benefit came from a statutory requirement that interstate-intrastate access rate parity continue indefinitely, through biennial intrastate rate adjustment. While regulated local service rates have trended upward, they have been undoubtedly restrained as compared to pure market-based alternative approaches.

Implementation of mandated rate rebalancing was accomplished over a transition period, both to permit prudent regulatory oversight and to avoid consumer "rate shock." The extensive local services of Southwestern Bell (now AT&T) and Sprint (subsequently Embarq, and thereafter CenturyLink) were addressed through cost model analysis (using the FCC's Hybrid Cost Proxy Model) of their respective statewide operations and subsequent rebalancing of recovery through local rate adjustments and continuing (but reduced) KUSF support. The KCC then instituted a program of audits of each independent rural local exchange carrier (LEC), recognizing that the Hybrid Cost Proxy Model was not suitable for application to smaller carriers' service areas. Rural LECs had not undergone state audits for at least a decade prior, and as a result some distortions in their cost recovery had developed - some companies were over-recovering, while others were under-recovering in relation to their KCC-approved intrastate revenue requirements met through local rates, intrastate access and state fund support.

The KCC's combination of large-carrier rate rebalancing and rural carrier audits eventually resulted in reductions in the initial level of KUSF support (approximately \$200 million per year total initial support for large and small LECs) to a current level of around \$70 million per year. This reduction was due primarily to the rebalancing of larger carriers' rates. The level of state universal service support for rural LECs has remained relatively constant as a whole, even as a number of these carriers have increased significantly their investment in facilities capable of providing ubiquitous broadband service. Any such investment has been supported only to the extent an

investment was deemed reasonable and appropriate on review by the KCC. The current size of the KUSF, roughly one-third the original Fund size, now encompasses not only high-cost support but also communications services for Kansans with disabilities (TRS/TDD) and an annual expenditure of \$10 million for the state's developing Kan-Ed distance learning, telemedicine and public institution communications system.

Separate from the treatment of company-specific Southwestern Bell and Sprint local rates, the KCC initiated a proceeding in 2001 to determine, *inter alia*, reasonable and affordable local rates for rural LEC customers. Consumers served by rural LECs are able to reach far fewer other subscribers through local calling than is true for consumers in more densely populated areas. Therefore, rural LECs' basic local service rates historically have been significantly lower than those charged by larger carriers. The objective of the KCC's inquiry was to assure KUSF contributors were not required to subsidize artificially low local rates. After interested parties had submitted testimony the rural LECs, KCC Staff and the Citizens Utility Ratepayer Board (CURB, a state-created consumer advocacy office) held negotiations on the issue of an affordable or "benchmark" rural local rate. The result of these negotiations was an agreement on a formula for an evolving benchmark rate, gradually bringing rural local exchange rates into parity statewide. The KCC approved this agreement, and the Kansas Legislature enacted the formula as an amendment to the Kansas Telecommunications Act. See K.S.A. 66-2005(e). The KCC recalculates the target rate every other year, with all resulting rural LEC rate revenue increases being offset by reductions in the carriers' KUSF support to preclude windfall support payments.

The KUSF has experienced a general reduction in amounts committed to rural high cost support. There are countervailing factors placing continuing upward pressure on the overall size of the state fund, but these are primarily in three areas: a significant increase in support to wireless eligible carriers under the equal support rule, some increased levels of support to incumbents resulting from uncompensated use of rural facilities by other carriers (*i.e.*, "phantom traffic") and generally declining access revenue. Wireless carriers have never been subjected to the level of regulatory scrutiny imposed on incumbent LECs, nor have they been required to demonstrate the necessity for their receipt of external ratepayer-originated support revenues. Meanwhile, new internet-based voice technologies utilize local facilities for call completion without paying technology-neutral compensation to the carriers that have made the commitment to deploy and maintain those local facilities.

In 1996 there was little recognition of the extensive and vital role broadband technologies would assume in consumers' daily lives. While the Kansas Telecommunications Act included some recognition of advanced services – and the importance of universal access to these services – there was little specificity to assure broad availability of data capacity at levels now commonly enjoyed. This did not, however, prevent substantial deployment of broadband capabilities by Kansas rural LECs. Since adoption of the federal and state Telecommunications Acts in 1996,

consumers in the half of the state's area served by rural independent LECs have come to enjoy near-universal access to broadband services as "broadband" has been defined by state and federal authority at the time of rural LECs' respective service deployments.

The comparative costs of fiber and copper facilities have converged to the extent that prudent network maintenance alone has dictated and will continue to dictate wider fiber deployment. Fortunately, given the cost-effective scalability of service levels over fiber facilities, capacity increases can be achieved at prudent cost levels as more fiber is deployed. While a number of RLEC customers enjoy access to broadband service at or above data speeds proposed in the National Broadband Plan (*i.e.*, 4 Mbps download and 1 Mbps upload), provision of that service level to many other consumers will require further investment subject to regulatory oversight. This local investment will support rural economies both directly and indirectly, as it facilitates local business retention and expansion.

Many merchants and service providers have departed from rural markets. As a consequence, access to comparable services – including medical, educational and commercial opportunities – through broadband has become the lifeline for smaller communities. The LECs based in these communities have every incentive to satisfy this growing need. Additionally, traditional rate of return regulation makes increased investment the principal vehicle for increased earnings and the best assurance of stable, sustainable networks that meet consumer needs, while providing the best return on supported investment. Under rate of return the necessary level of support for investment is measured rather than modeled or estimated, avoiding the waste that occurs when either too much or too little support is made available.

A review of results under the Kansas Telecommunications Act leads to an undeniable conclusion: the smaller carriers that elected continuing rate of return regulation have already deployed broadband facilities in their high cost markets – without an overall increase in total KUSF high cost support – while the larger carriers that operate subject to cost models and incentive regulatory methodologies have not made comparable rural commitments. The greatest correlation to rural broadband availability, at least in Kansas, is to the form of regulation elected by the local carrier. Broadband availability in smaller markets served by larger carriers has resulted, if at all, from negotiations in which the carriers received other regulatory concessions from the KCC. When cost reduction and restraint on investment are a principal means of profit enhancement, rural broadband deployment has suffered. Conversely, where carrier revenue is restrained by rate of return regulation, sufficient investment in broadband infrastructure requires little or no additional incentive. Regulatory policy has not been frustrated by the "Goldilocks Problem," under which a fixed amount of support results either in a windfall to providers at ratepayer expense or an incentive that proves inadequate to assure adequate levels of service availability and reliability; instead, thorough and transparent rate of return regulation has established and maintained a "right-sized" state support mechanism

A principal component of rural broadband deployment in Kansas has been the availability of financing through the traditional Rural Utilities Service loan program. An outgrowth of the New Deal REA programs that enabled both rural electrification and universal telephone service, this resource has provided experienced independent regulatory analysis of responsible investment, subject to LEC commitments to meet continuing long-term repayment obligations. As a general rule, RUS requires fiber rather than copper deployment in all new projects, to assure cost-effective capability to meet evolving levels of capacity. Most recent Kansas broadband deployment has been made possible in this manner, with RUS feasibility analyses based on that agency's assumption of availability of continuing reliable and sufficient state and federal support over the full repayment period often extending some 23 years. If the assurance of reliable support to rural LECs is ended there will be a high rate of default rather than the present virtual nonexistence of borrower failure. Absent an ability to rely on continuing reasonable levels of high cost support and intercarrier compensation, maintenance of investment and enhancement of service levels already achieved by rural LECs cannot be expected. Since the use of incumbent carriers' existing high capacity facilities is broadly relied upon by wireless service providers, it is problematic whether there could be an effective substitute for basic or advanced communications services if incumbent rural LECs had no way to assure their own continued operations.

In summary, the history of regulatory reform in Kansas has produced a record of remarkable overall success contrasted with a few elements of policy insufficiency. All Kansans have benefited from significantly reduced toll rates since the 1990's, while local rate increases have been substantially restrained. Both traditional and advanced high cost services have been enhanced through transparent cost-based regulation and reliable availability of cost recovery. The correlation between rural broadband deployment and specific regulatory methodologies, however, is clear. The proven beneficial results of traditional rate of return regulation, including near-universal availability of broadband access, stand in stark contrast to the clear failures of more theoretical modeling or "incentive" approaches that have resulted in rural broadband "have-nots". Market-based approaches to provision of public services are generally effective where a functional market exists, but such approaches are a prescription for either excessive or insufficient ratepayer-funded external support where high cost and low population factors prevail. Rather than experiment with the public interest, a responsible and successful National Broadband Plan must acknowledge both those approaches proven to work and those shown to be inadequate in practice.