

1       **8.     *Rate Rebalancing***

2

3       **Q.     Let's turn to the eighth section of your testimony, concerning rate rebalancing.**  
4       **Should we expect similar support amounts when comparing the current KUSF**  
5       **mechanism to a properly crafted cost-based mechanism?**

6       A.     No. As I mentioned earlier in my testimony, the current KUSF mechanism was  
7       designed to recoup the revenues lost as carriers lowered their intrastate access rates to  
8       the level of their interstate rates. The amounts they receive are not directly related to  
9       the carriers' cost of service, nor is there necessarily any link between the amounts they  
10      draw from the KUSF and the amount of support needed due to high cost conditions in  
11      their service territory. If the Commission moves to a cost-based mechanism, we will  
12      likely see significant differences between the amounts currently received by some  
13      carriers, and the amount of support that is cost-justified, and thus received under the  
14      new system. Some carriers may receive more support; some may receive less.

15             Stated differently, the current KUSF isn't directly based on cost (embedded or  
16      forward looking). Hence, if KUSF payments are based upon cost, the payment  
17      amounts may be substantially higher or lower than the amounts currently being received  
18      by each carrier. Whether this is a problem justifying some offsetting action by the  
19      Commission will depend upon the specific circumstances of each carrier. One cannot  
20      assume that in every case the resulting increase or decrease in revenues is appropriate;  
21      in some cases it might be appropriate to require or permit rate changes which have the  
22      effect of decreasing or increasing some other category of revenues.

23             In some cases an increase in KUSF payments might appropriately lead to a  
24      reduction in rates; otherwise, the incumbent LEC's revenues and profits may be  
25      boosted above a reasonable level. Conversely, in some cases a decrease in KUSF

1           payments might appropriately lead to an increase in rates; otherwise, the incumbent  
2           LEC's revenues and profits may be pushed below a reasonable level. The extent to  
3           which an offsetting adjustment to another source of revenues might be appropriate, will  
4           vary depending upon the circumstances.

5  
6           **Q. Will moving to a cost-based support system necessarily require widespread**  
7           **rate changes?**

8           A. No. There may be instances in which no price adjustments are called for. For example,  
9           the carrier might currently be earning less than a fair return, and an increase in its draw  
10          from the KUSF may simply increase its return toward a more reasonable level. In other  
11          cases a carrier might be earning more than a fair return, and experience a decrease in its  
12          KUSF draw which decreases its return toward (but not below) a reasonable level. Of  
13          course, the reverse situations could also arise: a reduction in KUSF payments might  
14          potentially exacerbate an under-earnings situation, and an increase in KUSF payments  
15          might exacerbate an over-earnings situation.

16                 In my opinion, there are too many possible factual situations to deal with this  
17                 issue on an automatic basis. The best solution is for the Commission to deal with any  
18                 offsetting rate changes on a case-by-case basis, taking into account all of the relevant  
19                 circumstances. The Commission should require offsetting rate decreases where those  
20                 are justified, and it should permit rate increases where those are justified.

21                 I realize that some companies may argue they are automatically entitled to  
22                 offsetting rate increases on a "revenue-neutral" basis. However, such a policy certainly  
23                 would not be in the public interest, nor would it be fair to ratepayers. If rate increases  
24                 were required on a "revenue neutral" basis, regardless of circumstances, customers

1           might be forced to pay unreasonably high rates. That is, a “revenue neutral” rate  
2           increase might not be justified, and it might push rates above a reasonable level.

3                       When the KUSF is changed to a cost-based mechanism, there should be an  
4           opportunity to re-evaluate a carrier’s rates (or its price caps), taking into account  
5           changes in the KUSF payments and other relevant factors. The Commission should  
6           review and approve any proposed changes, to ensure that the changes are appropriate  
7           and justified.

8                       The “revenue neutral” concept is not necessarily justified in the context of  
9           changes to convert the KUSF into a cost-based mechanism. There is no logical  
10          necessity for changes in a carrier’s revenues from the KUSF to be precisely offset by  
11          changes in its other revenues. Moreover, there is no simple and uncontroversial way to  
12          ensure that rates that are changed in order to maintain revenue neutrality will necessarily  
13          be fair, just and reasonable after being changed. In other words, a rate increase that is  
14          mandated by nothing more than “revenue neutrality” might be unreasonably large.  
15          Accordingly, the best solution is for the Commission to deal with this issue on a case by  
16          case basis, taking the necessary steps to ensure that rates are reasonable after  
17          implementation of a cost-based fund, and ensuring that both the carrier and its  
18          customers are treated fairly.

19  
20       **Q.    How should rebalancing be approached with respect to rate-base regulated**  
21       **carriers?**

22       A.    If a rate base regulated carrier experiences a reduction in revenues it receives from the  
23       KUSF, it should be given the opportunity to request a rate increase, to ensure that it  
24       continues to have an opportunity to earn a fair return on its intrastate rate base. The  
25       specific rates to be increased, and the amount of the increase, would be determined by

1 the Commission in a rate proceeding in which the parties would be given an opportunity  
2 to submit evidence concerning the potential impact of the change in KUSF revenues  
3 and other relevant matters.

4 The reverse would also be true: if a rate base regulated carrier experiences an  
5 increase in the revenues it receives from the KUSF, the Staff and other parties should  
6 be given the opportunity to request a rate decrease, to ensure that customers are  
7 treated fairly, and aren't required to pay unreasonably high rates.

8  
9 **Q. If rates were reasonable prior to the KUSF change, why might they be**  
10 **unreasonable after the change?**

11 A. Whether or not a specific set of rates is reasonable depends upon the relevant  
12 circumstances. The exact same set of rates might be reasonable under one set of  
13 circumstances, and unreasonable under a different set of circumstances. The entire  
14 system of rate base regulation is designed to deal with the fact that circumstances don't  
15 necessarily remain constant. Rates which were reasonable at one point in time may  
16 become unreasonable as relevant circumstances change. Regulatory commissions are  
17 given the responsibility of dealing with these complications, and the concept of  
18 calculating a revenue requirement and return on rate base was developed in order to  
19 fairly treat regulated companies and their customers as revenues, expenses,  
20 investments, and other factors change over time.

21 More specifically, with regard to changes in the KUSF consider first the  
22 situation where the carrier's revenues from the KUSF increase. This means that Kansas  
23 customers are now paying more to that carrier, via the KUSF, in support of its high  
24 costs. This suggests the possibility of double counting since the carrier would be  
25 compensated for its costs once through the rates it charges, and again through the

1 KUSF. To the extent a carrier is now recouping a larger portion of its costs from  
2 customers statewide (via the KUSF), perhaps a lesser portion should be paid by the  
3 customers within its specific service territory (through its intrastate rates).

4 Much the same reasoning applies in reverse, where the carrier's revenues from  
5 the KUSF decrease. This means that Kansas customers statewide are paying less to  
6 that carrier. This suggests the possibility that the carrier may no longer have an  
7 adequate opportunity to recover all of its costs and earn a fair return on its investment.  
8 To the extent a carrier is now recouping a smaller portion of its costs from the KUSF,  
9 perhaps it should be allowed to raise some of its rates, in order to continue to have an  
10 opportunity to earn a fair return. The magnitude of any such increase, however, would  
11 need to be determined on a case-by-case basis. Revenue growth from other sources  
12 may be sufficient to partially or entirely offset the adverse impact of the KUSF change.  
13 Furthermore, this is a declining cost industry, and costs per unit are likely declining; thus  
14 the existing rates may be adequate to cover the current level of costs, notwithstanding a  
15 reduction in revenues from the KUSF.

16  
17 **Q. How should rebalancing be approached with respect to price-cap regulated**  
18 **carriers?**

19 A. To the extent adjustments are appropriate in reaction to changes in the KUSF, the  
20 ceiling prices, or price-caps, should be adjusted, rather than specific rates. To the  
21 extent the price-cap would be increased (e.g. in response to a decrease in KUSF  
22 revenue), the carrier might or might not choose to increase rates by the full amount  
23 allowed. Similarly, to the extent the price-cap is decreased, it might or might not result  
24 in a reduction in rates. For example, if some of its rates are currently below the  
25 maximum level allowed, and the ceiling is decreased by the Commission in response to

1 changes in the KUSF, the new price-cap level might remain above the rates actually  
2 being charged by the carrier.

3 If a price-cap regulated carrier experiences a reduction in revenues it receives  
4 from the KUSF, it should be given the opportunity to request an increase in its price  
5 cap level. Whether or not an increase is actually warranted, and the magnitude of any  
6 such change should be determined by the Commission in an appropriate regulatory  
7 proceeding in which the parties would be given an opportunity to submit evidence  
8 concerning the potential impact of the change in KUSF revenues and other relevant  
9 matters. The reverse would also be true: if a price-cap regulated carrier experiences an  
10 increase in the revenues it receives from the KUSF, the Staff and other parties should  
11 be given the opportunity to request a reduction in the price caps, to ensure that  
12 customers are treated fairly, and they aren't required to pay unreasonably high rates.

13  
14 **Q. If the Commission determines that some rate rebalancing is justified, what**  
15 **category of rates should be adjusted?**

16 A. The specific rates to rebalance will depend upon the specific situation. For example, as  
17 should be apparent from a review of Schedule 1 of my exhibit, some carriers currently  
18 have relatively high rates for business local exchange service. For a carrier in this  
19 situation, a decrease in those rates might be a reasonable and appropriate response to  
20 an increase in KUSF revenues. On the other hand, if the carrier were seeking an  
21 offsetting increase (rather than decrease) in its rates, the Commission might determine  
22 that any rate increase would most appropriately be dealt with in some other category,  
23 such as switched access. Moderate deviation from interstate parity might be preferable  
24 to adjustments which would move a particular carrier's local rates farther out of  
25 alignment with the statewide average local rate.

1                   Another factor to consider is the degree of impact involved in the potential rate  
2                   adjustment. A longstanding principle of rate making is that even where revenue  
3                   shortfalls exist, customers should not be exposed to sudden and extreme increases in  
4                   rates, particularly if the increases are unrelated to improvements in service quality or  
5                   expansions in service offerings, and even more particularly if no reasonable substitute  
6                   for the service is readily available. For equitable and other reasons, regulatory  
7                   commissions have often found that “rate shock” should be avoided, or minimized.  
8                   Where customers do not have other viable options (e.g., where effective competition  
9                   does not exist), extreme or abrupt rate increases are not appropriate or desirable. Such  
10                  increases should be particularly avoided in the context of residential basic local  
11                  exchange rates, because abrupt increases in this category could cause substantial  
12                  numbers of subscribers to drop off the system, to the detriment of universal service and  
13                  society in general.

14  
15                  **Q.     Doesn't the Commission need to ensure that local rates are “just, reasonable,**  
16                  **and affordable”?**

17                  A.     Yes. The Consumer Protection clause of the 1996 Federal Act provides that both the  
18                  FCC and the states “should ensure that universal service is available at rates that are  
19                  just, reasonable, and affordable.” [§ 254(i)]. This is the first time that Congress has  
20                  used the term “affordable” in the context of universal service. The extent to which  
21                  people can afford telephone service is typically measured through telephone penetration  
22                  rates, and percentages of income spent on telephones.