

Approved: January 29, 1998
date

MINUTES OF THE SENATE COMMITTEE ON COMMERCE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on January 28, 1998 in Room 123-S of the Capitol.

Members present: Senators Salisbury, Barone, Brownlee, Donovan, Feleciano, Gooch, Jordan, Ranson, Steffes and Umbarger.

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

Conferees appearing before the committee:
Richard Veach, Pioneer Communications, Ulysses, Kansas
E. Clarke Garnett, President and CEO, Liberty Cellular, Inc., a/k/a Kansas Cellular
Marc Elkins, Attorney on behalf of CMT Partners,

Others attending: See attached list

Upon motion of Senator Donovan, seconded by Senator Steffes, the Minutes of the January 27, 1998 Meeting were unanimously approved.

Richard Veach, General Manager of Pioneer Communications, appeared with his colleagues Carl Krehbiel, Kendall Mikesell and legal representatives Mark Caplinger, Jim Caplinger and Tom Gleason, who together represent nearly every rural telephone company in Kansas, and stated their support for maintaining the Kansas Universal Service Fund (KUSF). Mr. Veach related the purpose of the KUSF was to ensure "Every Kansan will have access to a first class telecommunications infrastructure that provides excellent services at an affordable price". The Kansas Telecommunications Act defines the level of telecommunications service to which every Kansan would have access and mandates the deployment of enhanced universal service by July 1, 2001. (Attachment 1)

Mr. Veach stated KUSF is not "new money". KUSF took "hidden" intrastate access rates paid by all toll users and replaced them with an explicit support mechanism. The revenues of rural companies come from three jurisdictions: a) local - portion of investment and costs allocated to originating and completing local telephone calls. b) intrastate - portion of investment and costs allocated to originating and completing long distance calls between callers, both of whom are within the State of Kansas; and, c) interstate - portion of investment and costs allocated to originating and completing calls either to or from locations outside of Kansas. All rural telephone companies operate in Kansas under a rate-of-return regulation. The costs and investment that are allocated to each jurisdiction are determined by cost studies performed annually and reviewed by the KCC.

Mr. Veach stated long distance revenues for rural carriers comes from access charges paid by long distance carriers. The access charges compensate the rural carriers for the costs and investment in the infrastructure to complete long distance calls. Mr. Veach stated that in the case of Pioneer Communications, Inc., as an example, 31% of their revenue comes from the intrastate jurisdiction, 47% from the interstate jurisdiction and 22% from the local jurisdiction. The Kansas Telecommunications Act of 1996 required the rural carriers to move their intrastate access charges to the same level as their interstate access charges. The interstate access costs are based on the average interstate costs of the more than 1,000 rural telephone companies nationwide. Intrastate access rates are cost based, therefore, rural companies would be selling access at rates below their costs had access charges been lowered without a mechanism to make up the shortfall, i.e. KUSF. The rural carriers would have been happy to leave their cost based intrastate access rates where they had been and not have the KUSF, but the policy of the State is to lower access rates in order to lower intrastate long distance rates.

Mr. Veach reiterated that only 31% of the overall cost comes from the intrastate jurisdiction and of that part 17% comes from KUSF; the rest comes from intrastate access charges. All rural carriers would have a

similar situation. Mr. Veach in responding to a question stated that the percentage Pioneer Communications receives from the KUSF is less than 4-5% of total revenue.

E. Clark Garnett, President and CEO of Liberty Cellular, Inc., a/k/a Kansas Cellular, reported the impact of KUSF on its customers and company. Mr. Garnett stated the fund was established with the concept that telecommunications providers would find themselves revenue neutral after the establishment of the KUSF. Kansas Cellular has experienced an increase in expenses from approximately \$500,00 in annual access charges by local telephone companies to over \$6 million in KUSF surcharges. (Attachment 2)

Mr. Garnett stated cellular is not a replacement for landline telephone service. The Organization for the Protection and Advancement of Small Telephone Companies indicates that total landline access lines in Kansas have increased from 1,278,9908 in 1990 to 1,712,189 in 1996. Cellular, since its inception in 1990, has added 130,000 access lines, not even 10% of the total access lines in Kansas. Mr. Garnett noted from these figures that the wireless industry has a long way to go before it can be remotely considered a replacement for landline telephone service.

Mr. Garnett stated the wireless industry supports the concept of the universal service fund, but cellular customers are paying a disproportionate amount of the total fund. The KUSF surcharge constitutes in excess of 22% of total bills. Liberty Cellular has received thousands of call complaining about the unfairness of the surcharge and has experienced a drop in its revenue of approximately \$2 million. In polling its customers a consensus emerged that they are not against the universal service fund but feel the charge should be a flat monthly amount rather than a percentage assessment.

Mr. Garnett responded to questioning that the company is holding the KUSF in escrow pending a court decision.

Marc Elkins, attorney on behalf of CMT Partners which provides cellular telephone service in the Wichita, Topeka, Lawrence and metropolitan Kansas City areas under the name of Cellular One, informed the Committee that there is presently litigation before the Kansas Supreme Court and the United States District Court for the District of Kansas on certain aspects of the KUSF based on its belief they are inherently discriminatory, inequitable and anti-competitive. (Attachment 3)

Mr. Elkins stated Kansans currently pay a 9.89% tax on their cellular telephone charges in contrast with 14 other states which have universal service funds. Seven states have exempted wireless service providers from the fund; and the surcharge imposed by other states varies between 1% and 6%. The burden of KUSF to wireless telephone service providers is further exacerbated due to the failure of the KCC's Order to recognize that the wireless industry has constructed its own infrastructure without the guaranteed returns afforded landline companies. As a result, one half of every wireless call is carried on infrastructure constructed by the wireless industry and is not supported by the KUSF. In contrast, both ends of a landline call are carried on infrastructure that is supported by the KUSF. Mr. Elkins stated the revenue neutral provisions of the state are anti-competitive and impact the current funding mechanism for the KUSF because of new telecommunications providers and new technologies which hope to provide competitive services and which are required to subsidize and protect revenues of the incumbent local exchange carries. The effect of imposing these cross subsidization burdens erects steep barriers to competition in Kansas.

Mr. Elkins proposed the Telecommunications Act be amended to eliminate the current revenue protection afforded local exchange carriers by revenue neutrality requirements; establish a requirement that the size of the KUSF be defined by the cost of providing universal service within the State; and exempt wireless carriers from the KUSF until it is demonstrated they have become a substantial substitute for landline telephone service for the state.

The meeting adjourned at 9:00 a.m.

The next meeting is scheduled for January 29, 1998.

SENATE COMMITTEE ON COMMERCE

JANUARY 28, 1998

Testimony of Richard Veach, General Manager
Pioneer Communications

RE: Kansas Universal Service Fund

Good morning Madame Chair and Senators. I appreciate the opportunity to talk with you this morning. My name is Richard Veach and I am the General Manager of Pioneer Communications with headquarters in Ulysses. I am here to visit with you about the Kansas Universal Service Fund (KUSF). I have a short statement and at its conclusion my colleagues and I will stand for questions. My colleagues are Carl Krehbiel of the Moundridge Telephone Company and Kendall Mikesell of the Southern Kansas Telephone Company in Clearwater. In addition, Mark Caplinger, Jim Caplinger and Tom Gleason, attorneys who together represent nearly every rural telephone company in Kansas, are here to address any legal questions.

Pioneer Communications provides local exchange telephone service to nearly 16,000 access lines in a 5,000 square mile service area in southwest Kansas. Some of the fifteen communities in which we provide telephone service are Hugoton, Ulysses, Lakin, Syracuse and Johnson.

The purpose of my appearance here is to discuss the Kansas Universal Service Fund portion of the 1996 Kansas Telecommunications Act. In 1994 I was appointed to the Kansas Telecommunications Strategic Planning Committee, a committee created by the 1994 Kansas Legislature to make recommendations to the Legislature about the direction that telecommunications in Kansas should take. The TSPC committee, as it was commonly known, was made up of seventeen Kansans including three of your fellow legislators from the House and three from the

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Senate including Senators Salisbury and Feleciano as well as representatives from business, a state agency, various segments of the telecommunications sector, the Kansas Corporation Commission and the public. The TSPC conducted numerous meetings, received input from a consultant that was engaged specifically to work with the committee and received presentations from various segments of the telecommunications users community.

The result of the TSPC's activities was a report to the legislature titled *Connections to the Future: A Telecommunications Strategic Plan for Kansas*. In the report was a chapter titled "A Vision of Kansas Telecommunications for the 21st century". The vision statement that was adopted by the TSPC for the report is as follows:

Every Kansan will have access to a first class telecommunications infrastructure that provides excellent services at an affordable price.

It was not by chance that the Kansas Telecommunications Act codifies the same language as being public policy of the State of Kansas.

That was a bold statement by a legislature that knew what was needed for Kansas to not just survive but to prosper in the 21st century. In the Act the Legislature, for the first time in Kansas, defined the level of telecommunications service to which every Kansan would have access. Known as universal service it includes all the telecommunications services to which all Kansans are entitled.

The Act further mandates the deployment of enhanced universal service by July 1 of 2001. Enhanced universal service will provide, according to the Act, "consumer access to a full range of telecommunications services, including advanced telecommunications services that are comparable in urban and rural areas throughout the state". This is the public policy of the State of Kansas and I think it is a good one that shows foresight and an understanding of one of the essentials necessary for Kansas to move forward.

Lately, the Kansas Universal Service Fund has come under attack. It has been characterized as a "pot of gold" or a "telephone tax" or a "pig in a poke". Speaking on behalf of the rural telephone companies of Kansas, I can tell you that it is nothing of the kind.

This attack is 180 degrees off. KUSF support is not "new money". The KUSF took "hidden" intrastate access rates paid by all toll users and replaced them with an explicit (i.e., not hidden) support mechanism. If it were hidden, Senators would not be hearing about it from ratepayers.

Please indulge me for moment as I explain from where the revenues of the rural companies come. They come from three different areas that we call jurisdictions. The three jurisdictions are:

Local - This is the portion of our investment and costs that are allocated to originating and completing local telephone calls.

Intrastate - This is the portion of our investment and costs that are allocated to originating and completing long distance telephone calls between callers, both of whom are within the State of Kansas.

Interstate - This is the portion of our investment and costs that are allocated to originating and completing telephone calls either to or from locations outside the State of Kansas.

I believe that there is a misconception concerning rural telephone companies when it comes to raising rates. All rural telephone companies in Kansas operate under rate-of-return regulation. The costs and investment that are allocated to each jurisdiction are determined by detailed cost studies that are performed annually. The KCC has always had the authority to audit or review our earnings and determine whether they are correct. They had this authority before the Kansas Act was passed and they have it now after the Act has become law.

Our long distance revenue does not come from our subscriber's long distance telephone bills. That money goes to the long distance carrier such as AT&T, MCI or Sprint. Our long distance revenue comes from access charges paid to us by long distance carriers. These access charges compensate us for the costs and investment in the infrastructure to complete long distance calls. In the case of my company, approximately thirty-one percent of our revenues come from the intrastate jurisdiction, forty-seven percent from the interstate jurisdiction and twenty-two percent from local.

One of the provisions of the Kansas Telecommunications Act of 1996 required us to move our intrastate access charges to the same level as our interstate access charges. You are probably wondering why they were different to start with. That's because in most cases, the more than 1,000 rural telephone companies nationwide pool their interstate access costs. That is, everyone from companies with very low access rates to those with very high access rates, put everything into a pool and then our access rates become an average of all these rates. Pooling gives small companies stability in rates. For instance, if it were necessary for a small company to make large infrastructure investments for some reason, an exponential rise in access rates would result. Pooling shares the risk and in a pooling environment this wouldn't even cause a blip on the screen overall.

Companies in the densely populated areas of the eastern United States have lower access charges simply because it costs less to provide telephone service in these kinds of areas. The farther west you go, the more expensive it is to provide telephone service. The cost to provide telephone service in Alaska, for instance, is tremendous. Kansas is a kind of microcosm of the nation in this regard in that it costs more to provide service in sparsely populated areas of Kansas than in urban areas.

Intrastate access rates, on the other hand were essentially cost based. The reasoning behind moving intrastate access charges to interstate levels was to give the long distance carriers rates that were the same for both intrastate and interstate long distance calls. When the access rate reductions for all local exchange carriers, including

Southwestern Bell and Sprint, are fully implemented, it should no longer cost more to call Pittsburgh, Kansas or Manhattan, Kansas than it does to call Pittsburg, Pennsylvania or the borough of Manhattan in New York.

Had access charges been lowered without a mechanism to make up the shortfall, the rural companies would then be selling access at rates that were below their costs. In other words, most of the rural companies would be losing money on every intrastate long distance call. Enter the Kansas Universal Service Fund. The purpose of the fund was to make up the money that the rural companies would be losing. This is revenue neutrality.

The idea was that after the intrastate access rates were moved to interstate levels and all the dust had settled, the rural telephone companies wouldn't end up with any more money than we had before all this started. We would be "revenue neutral". We would have been happy to leave our cost based intrastate access rates where they were and not have a Kansas Universal Service Fund but the public policy of the State of Kansas, and I think it's a good policy, is that lower access rates will naturally lead to lower intrastate long distance rates which is good for Kansas.

Remember that the intrastate access rates used to be cost based. If a company had to make a significant investment to provide telephone service to a new housing development or business or upgraded its telephone switch to provide better service, these costs would be reflected in an increase in its access rates.

You may be wondering who was paying the higher cost based intrastate access charges in the past, before passage of the Act. It was being paid by the long distance carriers and was recovered by them through their statewide long distance rates. In other words, all long distance users in Kansas were.

Under the Act, if a company needed to make infrastructure improvements in the future in order to comply with the law, that company would be allowed to go to the KUSF for supplemental funding. That is the mechanism that the Act provides to insure that *every Kansan will have access to a first class telecommunications infrastructure that provides excellent services at an affordable price.* But also bear in mind, that in my company's case for instance, only thirty-one percent of the overall cost would come from the intrastate jurisdiction and of that, only a part of it comes from the Kansas Universal Service Fund. The rest would come from intrastate access charges. All rural telephone companies would have a somewhat similar situation. The interstate and local jurisdictions would make up the rest.

So far, only one rural company has sought supplemental funding from the KUSF. A representative of CURB addressed the House Utility Committee last week and stated that this rural telephone company was "gaming the system" because it had bought a broken down telephone system in Dighton, Kansas with a history of deplorable service and was rebuilding it so that its residents could "have access to a first class telecommunications infrastructure that provides excellent services at an affordable price." This company, a small western Kansas telephone cooperative wasn't "gaming the system", it was attempting to carry out the public policy of

the State of Kansas. As a matter of fact, one of the stipulations that was required of this company by the KCC when they purchased the Dighton exchange was that the system be rebuilt so that the residents could obtain modern dependable state-of-the-art telephone service.

While the Act mandates universal service by July 1, 1998 and enhanced universal service by July 1, 2001, many of the components of both are already in place at many of the rural companies. For instance, the only element of both types of service that our company can't provide is the high speed digital integrated services digital network (ISDN) service to all customers. At present, twenty percent of our customers do not have access to this service but they will by 2001 and it will not require a fortune from the KUSF to do it. In fact, it is possible that it won't require any additional KUSF funds at all.

Kansas telecommunications public policy is well thought out and sound. It is good public policy. We should ignore the naysayers and get on with building the telecommunications infrastructure of the 21st century.

Thank you for the opportunity to speak with you. That concludes my remarks and my colleagues and I will now stand for questions.

Testimony of
E. Clarke Garnett
Before the Senate Commerce Committee
January 28, 1998

Chairman Salisbury and committee members, thank you for the opportunity to speak before you today. My name is Clarke Garnett and I am the president and CEO of Liberty Cellular, Inc. also known as Kansas Cellular.

I am here to speak today on the topic of the Kansas Universal Service Fund and its impact on our customers as well as our company. I wish to address three issues: First is the issue of the fund and its purported revenue neutrality; second is the issue of whether or not cellular is a replacement for landline telephone service and third is our support of the concept of the universal service fund and the feedback we have received from our customers, the preponderance of whom are citizens of the State of Kansas.

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E. Clarke Garnett

The first topic is the issue of revenue neutrality. The fund was established with the concept that telecommunications providers would find themselves in a neutral revenue/expense position with the implementation of the surcharge due to the fact that the providers would see a commensurate reduction in other charges they had been paying. In the case of Kansas Cellular, we saw an increase in expenses from roughly \$500,000 in annual access charges by local telephone companies to over \$6,000,000 in KUSF surcharges. This is clearly not revenue neutral. The KCC argues that we could simply choose not to pass this cost on to our customers. This is true, unfortunately, this amount is in excess of 35% of our annual cash flow and it would virtually eliminate our ability to invest in capital improvements to continue the buildout of our cellular system. This would result in the citizens of Kansas having a wireless system, which would lag woefully behind the industry in technology and features.

Next, I want to address the issue of whether or not cellular is a replacement for landline telephone service. Information from the Organization for the Protection and Advancement of Small Telephone Companies indicates that the total landline access lines in Kansas have increased from 1,278,908 in 1990 to 1,712,189 in 1996. Since our company's inception in 1990, we have added 130,000 access lines. Needless to say, we are not even 10% of the total access lines in Kansas and, nationwide, the average penetration of cellular is currently 15% of the population, which would translate to about 372,000 cellular access lines. Doing the math, it is clear that we have seen an increase of landline access lines of nearly 450,000 while we have added only 372,000 cellular customers industry wide during the same timeframe. This is pretty compelling evidence that the wireless industry has a long, long way to go before we can be remotely considered as a replacement for landline telephone service.

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E. Clarke Garnett

Finally I want to touch on our company's position on the need for the fund. It is our belief that a universal service fund is clearly necessary. Our company was founded by rural telephone companies and we have aggressively built our system to cover all of rural Kansas. Our biggest concern is in the fact that the current method of contributing to the fund is patently unfair to the wireless customer. It places a disproportionate amount of the total fund burden on cellular customers and it is a charge which is perceived as a luxury tax by our customers. With this surcharge, we have many customers who are seeing taxes and surcharges in excess 22% of their total bill!

Our customers have placed tens of thousands of calls to us complaining about the unfairness of the surcharge. We have lost well over 100 customers who have explicitly told us that they were leaving due to the KUSF and we estimate we have experienced a drop in our revenues in the neighborhood of \$2,000,000 as our customers adjust their usage to compensate for their increasing bills. At the same time, these same customers have indicated that they, too, agree that the fund is needed and they consider it fair that they are asked to contribute to this fund. All they ask for is a measure of fairness in the application of the assessment.

This is the same position we at Liberty advocate: Apply a method of assessment which does not unfairly burden the cellular/wireless customer. Most of our customers commenting on the charge say that either a flat monthly charge or a much lower percentage assessment would be fair.

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E. Clarke Garnett

To recap, (1) this surcharge is not revenue neutral to the cellular companies nor is it a feasible alternative for the cellular companies to "eat" the charges due to the size of the assessment, (2) cellular service is not currently a replacement for landline service and it appears that this will not be the case for many years to come and (3) we believe that there is a definite need for a Kansas Universal Service Fund but we feel it needs to be more fairly applied so as to prevent the onerous, disproportionate burden it currently places on the cellular customer.

Again, thank you for the opportunity to speak to the committee today. I will be glad to stand for any questions you may have.

**KANSAS SENATE
COMMERCE COMMITTEE
KANSAS UNIVERSAL SERVICE FUND**

**TESTIMONY OF MARC ELKINS ON BEHALF OF
CMT PARTNERS
JANUARY 28, 1998**

Good morning Madam Chairman. My name is Marc Elkins and I am an attorney with the Morrison & Hecker law firm of Kansas City Missouri and Overland Park, Kansas. I appear today on behalf of CMT Partners which provides cellular telephone service to the public in the Wichita, Topeka, Lawrence and metropolitan Kansas City areas under the name of Cellular One. I have represented Cellular One before the Kansas Corporation Commission, the United States District Court, the United States Court of Appeals for the Tenth Circuit, the Kansas Court of Appeals and the Kansas Supreme Court in litigation challenging both K.S.A. §66-2001, *et seq.* and the Corporation Commission's Order establishing and funding a Kansas Universal Service Fund.

I come before the Committee today for the purpose of advising the Committee on the status of that litigation and commenting on certain aspects of the KUSF that Cellular One believes are inherently discriminatory, inequitable and anti-competitive.

THE LITIGATION

- Wireless service providers initiated litigation in the United States District Court for the District of Kansas challenging the statute as in violation of the Federal Telecommunications Act, 47 U.S.C. §332(c). The District Court ruled that the statute did not violate §332(c). The wireless service providers appealed that decision to the United States Court of Appeals for the Tenth

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Circuit in Denver. The issues have been fully briefed and we await oral argument.

- The wireless service providers, certain alternative local exchange carriers, and CURB appealed the Corporation Commission's Order implementing the statute to the Kansas Court of Appeals. The Kansas Court of Appeals ruled that certain provisions of the statute, including revenue neutrality, violated §254 of the Federal Telecommunications Act. The Commission, Southwestern Bell Telephone Company and a number of independent telephone companies asked the Kansas Supreme Court to review the Court of Appeals decision and the Commission's Order. The issues have been briefed and argued before the Court and we are currently awaiting the Court's decision.

THE STATUE

- The fundamental flaw in the KUSF is the statutory requirement of K.S.A. §§66-2005(c) and 66-2008(a) that the financing of the KUSF be *revenue neutral* to local exchange carriers.
- The revenue neutrality requirements of the statute causes the size of the KUSF to be determined by the historic revenues of the local exchange carriers and *not by the cost of providing universal service to the citizens of Kansas.*
- Because the size of the KUSF is defined by the local exchange carriers' revenue requirements and not the cost of service, Kansans currently pay a 9% tax on their cellular telephone charges – the highest charge for universal

service in the nation. That tax is currently scheduled to increase to approximately 15% by 2000.

- The KUSF is contrasted with the funds created by 14 other states that have implemented state universal service programs. Seven of those states have exempted wireless service providers from the burden financing the universal service fund. The surcharges imposed by other states for universal service vary between 1% and 6%.
- The burden of an oversized KUSF is inequitably and discriminatorily placed on wireless and long distance telecommunications providers and their customers because the Commission's Order permits local exchange carriers to self fund their contributions through rate increases while imposing surcharges on the revenues of wireless and long distance telecommunication service providers.
- The discriminatory and inequitable burden on wireless telecommunications providers is exacerbated because wireless service providers have not enjoyed the significant cost reductions realized by long distance carriers as a result of reduced access charges mandated by K.S.A. §66-2005(c).
- The burden to wireless telecommunications service providers of the KUSF is further exacerbated because the Commission's Order fails to recognize that the wireless industry has constructed its own infrastructure without the guaranteed returns historically afforded landline companies. As a result, one half of every wireless call is carried on infrastructure that was constructed by the wireless industry and that is *not* supported by the KUSF. In contrast, both

ends of a landline call are carried on infrastructure that is supported by the KUSF. Yet wireless service providers unfairly bear the same burden as those providers whose entire call is carried on the landline infrastructure that is supported by the KUSF.

- The revenue neutrality provisions of the statute also are anti-competitive. These provisions protect the revenues of local exchange companies that have operated as state sanctioned monopolies for more than one hundred years. Thus, the impact of the statute conflicts with the public policies stated in . K.S.A. §66-200(b) which is to ensure that Kansans enjoy the benefits of competition.
- Contrary to Mr. Lammers' testimony of yesterday, wireless telecommunications is not a substantial substitute for landline telephone service in Kansas. Although landline service has penetrated virtually 100% of the market, wireless service has penetrated approximately 20% of the market.
- The anti-competitive impact of the current funding mechanism for the KUSF is exacerbated because it is the new telecommunications providers and the new technologies, such as wireless telecommunications, that hope to provide competitive services who are required to subsidize and protect the revenues of the incumbent local exchange carriers. The effect of imposing these cross subsidization burdens is to erect very steep barriers to competition in Kansas.

For these reasons, Cellular One believes that the Kansas Legislature should consider the following:

- Elimination of the current revenue protections afforded local exchange carriers by revenue neutrality requirements.
- A statutory requirement that the size of the KUSF be defined by the cost of providing universal service within the State of Kansas.
- Recognition of the public policy articulated by 47 U.S.C. §332(c) by exempting wireless carriers from state universal service support until they are demonstrated to have become a substantial substitute for landline telephone service for a substantial portion of telecommunications within the State of Kansas.

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