

A Report on

**The Pricing of Basic
Telecommunications Service
under the
Wyoming Telecommunications Act of 1995**

prepared by:

The Wyoming Public Service Commission

Public Service Commission

(023)

<http://psc.state.wy.us>

Cheyenne, Wyoming 82002

December 2, 2002

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Definitions

We hope that the following definitions will be useful to you in reading this Report. If you have further questions, please contact the Public Service Commission at soxley@state.wy.us.

“access” Access, as used in “access charge” and “switched access” means the ability of a customer to have access to the local telephone company’s switch to make or to receive long distance calls. Long distance companies depend on access to complete calls made by their customers; and these companies pay on a per minute-of-use basis for this access.

“Act” The Wyoming Telecommunications Act of 1995, Chapter 15 of Title 37 of the Wyoming Statutes, is the basic telecommunications regulatory law in Wyoming.

“central office” A central office is the installation containing the local telephone switch serving a community and the surrounding area (the “local exchange”). The central office switch connects customers to the local and long distance networks.

“competitive” Under W.S. § 37-15-202, the Legislature has deemed some telecommunications services “competitive” and the PSC may find other services competitive. Competitive services are not subject to price regulation by the PSC. Local basic telephone services, switched access and long distance services, if provided by an established local exchange company, are not automatically considered “competitive.” Most other services are “competitive,” including local service provided by resellers, long distance services of long distance companies, and added features like call waiting and caller ID. As a general rule, if a customer has the choice of similar services at similar prices from different providers, the service can be found competitive by the PSC under the Act.

“de-averaging” When a telecommunications company de-averages its rates, it breaks down its subscribers into rate categories recognizing the different costs of serving different customer groups. Subscribers all pay the same price if the company has averaged rates.

“embedded” An embedded cost of providing telephone service is an actual investment that has already been made. Embedded costs show up on the books of the company.

“equal access” This is the ability of a customer to choose any in-state and any interstate long distance carrier and to use that carrier to complete calls without having to dial any extra numbers. This is also called “1+” equal access.

“explicit” An explicit subsidy is one that a consumer can see on the telephone bill. An example is the credit against high cost basic service from the Wyoming Universal Service Fund.

“implicit” An implicit subsidy is one that cannot be identified on the customer’s bill. An example would be a rate for a service which is lower because of revenue generated by the sale of other services above their costs.

“Total Service Long Run Incremental Cost” or “TSLRIC” According to the Act at W.S. § 37-15-103(a)(xiii), this means “. . . the total forward-looking cost, using least cost technology, for a telecommunications service or basic network function that the telecommunications provider would incur if it were to initially offer such telecommunications service or basic network function;” Telecommunications companies which offer non-competitive services must price each of its services at least at a level that allows the service to recover its own TSLRIC cost. This is intended to eliminate implicit subsidies and to encourage competitors to enter the market on a level playing field.

1. Executive Summary

The Wyoming Public Service Commission (Commission) prepared this report on the pricing of basic telecommunications service under the Wyoming Telecommunications Act of 1995 (the Act) as part of its ongoing review of Wyoming telecommunications issues. It is intended [a] to provide policy makers with information to help them respond to constituent inquiries and address public interest questions on the future direction of telecommunications policy in Wyoming, and [b] to give the Commission an up to date comparative overview of this important subject.

For example, questions have arisen about why prices for local exchange service vary from place to place in Wyoming. How do these pricing differentials arise in practice under the Act? Should basic service prices be the same throughout Wyoming? These are some of the concerns this Report will discuss.

One of the goals of the Act was to eliminate implicit subsidies built into rates over many years by the pricing policy, prevalent throughout the United States, of keeping residential rates low by giving preferential treatment in the form of subsidies paid for by other services. The Act removes implicit subsidies by requiring the use of a cost methodology referred to as Total Service Long Run Incremental Cost or TSLRIC. Simply put, if a company offers noncompetitive services, each of its services must be priced so that the revenue stream derived from that service covers its own TSLRIC costs. Each service must pay its own way. Under the Act, subsidies for high-cost customers are made explicit through the use of the Wyoming Universal Service Fund.

This use of TSLRIC-cost based pricing is intended to encourage competition in the local service market. When an incumbent company does not subsidize its local service rates with money from other services, that, in theory, allows competitors to enter a local service market and compete on level ground.

Questions have arisen about whether the transition from prices based on historic embedded costs (or other methodologies) to TSLRIC-based prices has caused the differences in local telephone service pricing that exist in Wyoming today. After gathering seven years of experience in implementing and administering the Act, we have found that TSLRIC-based pricing is only one of a number of issues involved in the broad range of basic local exchange service and switched access prices charged by Wyoming telecommunications companies.

We have found that the effects of pricing methodologies in general -- TSLRIC-based pricing, embedded historical cost pricing or some other method -- must be considered in context with other factors influencing cost. Four of the most influential factors driving pricing differences among Wyoming telecommunications service providers are: [a] the density and composition of the customer base and the extent to which price averaging (or de-averaging) is incorporated in pricing decisions; [b] the amount of federal support received by a telecommunications service provider and whether that support is targeted directly to high cost customers or retained by the service provider to off-set the cost of service; [c] differences in network architecture (whether driven by customer demand or the physical nature of the service

area in question); and [d] the business strategies and plans of the telecommunications service providers themselves. As is the case in other utility industries, variations in these factors would produce variations in results even if the same pricing methodology were to be used. Those factors above which drive the costs themselves also are related to a TSLRIC examination of a company's pricing.

The cost of providing telephone service in Wyoming has always been relatively high because of factors that do not vary with the pricing methodology used; and Wyoming's small and widely separated markets in a large and mainly rural state are major factors driving these costs. Among companies serving in Wyoming, the diversity in the effect of these factors is also substantial.

With the Act's statutory emphasis on toll competition and "1+" equal access to toll carriers in Wyoming's telecommunications markets, we have observed lower switched access rates and lower intrastate toll rates. The Act also creates a Wyoming Universal Service Fund (WUSF) which places a ceiling of 130% of the statewide average price on the amount that anyone in Wyoming would pay for basic local service. The level of cash flow and explicit support through WUSF is approximately \$9.5 million per year.

The Act seeks to rid the market of hidden subsidies, and instead allows the WUSF to work as an explicit subsidy which can be easily seen and understood. It replaces numerous non-uniform implicit subsidy mechanisms such as the traditional subsidy for residential service. As technology develops and more services become available to and accepted by the public, there will be some pressure to view more services as "essential telecommunications services" eligible for support from the fund. If that happens, it would necessitate a policy review and perhaps statutory modification in the future to ensure that the fund can be implemented in a fair and uniform manner throughout Wyoming.

Local service pricing differentials in Wyoming affect the statewide average rate and therefore the WUSF itself. Qwest and the other ("independent") local service providers currently give differing treatment to incremental amounts of federal support payments they receive. The Commission has addressed the influence of this difference on the WUSF and whether all service providers should be required to treat federal support payments in the same way in its amended Rule 500j.

2. General Comments

The Wyoming Telecommunications Act of 1995 is intended to do away with historical implicit subsidies for basic telecommunications services and to promote competition to encourage the deployment of more infrastructure and the earlier introduction of advanced technologies in Wyoming. Its TSLRIC pricing model and simplified market entry and regulatory procedures, seek to make a rural state with relatively small markets more attractive to new service providers who have traditionally been more inclined to invest in densely populated areas before considering our Wyoming markets. Criticisms lodged against the Act include the idea that it has ended the era of low, subsidized local service rates which Wyoming citizens had

become accustomed to in the past. The Act's new explicit subsidy in the form of the Wyoming Universal Service Fund is visible and increases awareness of the true cost of service in a rural state.

Industry and regulators have gained much experience in the seven years since the Wyoming Act was passed. Added to this is the further experience throughout the United States developed in the process of implementing the federal Telecommunications Act of 1996 -- a law in many ways quite similar in approach to the Wyoming Act.

The Act clearly sets out its objectives. It seeks to promote competition in Wyoming, to encourage improved telecommunications service through an upgrade of facilities, equipment and infrastructure, and to make certain that basic service remains affordable during the transition to competitive local service markets. The Legislature expressed the intent this way:

"37-15-102. Legislative intent.

"It is the intent of this act to ensure essential telecommunications services are universally available to the citizens of this state while encouraging the development of new infrastructure, facilities, products and services. The provision of telecommunications services has been developed and regulated under a monopolistic environment. This act recognizes the increasingly competitive nature of the telecommunications industry and the benefits of competition. It is the intent of this act to provide a transition from rate of return regulation of a monopolistic telecommunications industry to competitive markets and to maintain affordable essential telecommunications services through the transition period, and the provisions of this act shall be construed to achieve those goals."

The traditional rate-of-return regulatory rate setting paradigm which gave a telecommunications utility the opportunity (but without a guarantee) to recover its prudently incurred costs and to earn a reasonable and limited return on its investment was not seen as being appropriate to the task of promoting competition in Wyoming. The Act took this into consideration and established a new standard for judging telecommunications service prices in Wyoming. Rather than basing prices on historic, embedded costs with hidden or implicit subsidies in local service rates, the Act, at W.S. § 37-15-402(a) sought to give competitors equal footing as they sought to enter the market by requiring, at a minimum, that:

"Services provided by a telecommunications company that provides noncompetitive services shall be priced such that the service's revenues from sale of the service recover the total service long-run incremental cost of providing that service, . . ."

By pricing in this manner and using the Total Service Long Run Incremental Cost (TSLRIC) concept, each service would pay its own way, thereby eliminating subsidies in rates.

In its simplified form, TSLRIC cost modeling seeks to determine a utility's required investment in new plant, switches, fiber and wires using least-cost, state-of-the-art facilities needed to deliver the essential local services required to serve residential and business customers. TSLRIC tries to approximate the costs that a new entrant would incur in entering the market and competing. By requiring the incumbent service provider's price to at least cover the TSLRIC floor, that removes the ability of the incumbent, who often enjoys an infrastructure monopoly, to "squeeze" out potential customers by using its monopoly pricing advantages. TSLRIC theory

also assumes that all sources of revenue used to cover the cost of serving, such as federal high cost support, Wyoming universal service support and customer revenues, are “portable” -- that any market entrant could avail itself of all the revenues associated with a particular customer if the customer opted to take service from that entrant.

Pricing policy common to Wyoming and throughout the United States in the past allowed companies to draw subsidies for local service rates from the rates for long distance, switched access and other services which were intentionally priced well over their true costs to fund the subsidy. To offset the anticipated increases in basic local service prices when the TSLRIC was applied to eliminate subsidies, the Act established the Wyoming Universal Service Fund to support high cost customers so that they would not, after consideration of any federal support, pay more than 130% of the statewide average rate for basic local exchange service.

1995 Local Basic Service Rates

Table 1, at page 10 below, includes information on 1995 local basic service prices for Wyoming incumbent telecommunications companies (companies which have not made the transition to TSLRIC pricing under the Act are shown in *italics*), and shows that relatively low prices existed in 1995 across Wyoming. This was primarily a result of the application of an accepted industry pricing policy for local exchange telecommunication service referred to as “residual pricing” in which toll, switched access, directory services, private lines, inside wire maintenance, enhanced services and in many instances even business local exchange services were priced higher, and then the relatively small “residual” revenue requirement was made up by residential local exchange service after being subsidized by these other services. The Act makes the judgment that, given the cost of new technology and advanced telecommunications plant and facilities, companies hoping to make inroads into the competitive market would not be able to compete if the incumbent service provider were able to offer local service at prices that were subsidized by other forms and types of service.

Note that two incumbent local exchange service providers in Wyoming, Golden West Telephone Cooperative and Project Telephone, are not included in the tables in this report because they serve very few customers in Wyoming. Golden West serves only 32 Wyoming customers and Project serves approximately 200 Wyoming customers. The vast majority of the operations and customers of these companies are in South Dakota and Montana, and their few Wyoming customers are served under tariffs reflecting the rates applicable to these other customers.

1995 Switched Access and Toll Rates

Higher switched access charges and intrastate toll charges were the two most common sources of the implicit subsidies that kept basic local exchange service prices low prior to the Act; and these two services were given explicit consideration in the Act. Although the Act does not mandate price reductions for toll and access, it promotes competition through its “1+” equal access mandate and simple entry and regulatory requirements for interexchange carriers. The Act does not give the Commission explicit power to order access charges to be lowered; but it gives access charges special consideration by instructing the Commission to initiate an

investigation immediately (in 1995) and evaluate the feasibility of eliminating access subsidies no later than January 1, 2002. The Commission made the investigation and reviewed possible methods for determining access charges. Based on the facts found in this investigation, the Commission did not recommend legislative changes regarding the determination of access charges. Table 2, at page 11 below, includes 1995 switched access and intrastate toll service prices. Data for those companies that have thus far completed TSLRIC proceedings to transition local service rates to meet the forward looking cost-based requirements of W.S. § 37-15-402 are shown in *italics*.

3. TSLRIC Pricing Cases

After the Act went into effect in March 1995, several Wyoming telecommunications companies filed pricing applications to begin compliance with the Act and to position themselves to react to potential competitive challenges in the rapidly changing telecommunications industry. Qwest filed four separate pricing applications with the Commission between 1997 and 1999 to re-price services based upon TSLRIC principles and to eliminate cross-service subsidies. The Commission considered several costing models in the Qwest applications to judge their suitability for determining TSLRIC; and the model finally adopted for use, referred to as RLCAP, was developed by Qwest. The four Qwest pricing cases eventually resulted in substantially reduced access rates and recognized zone pricing, acknowledging that, in local service pricing, the cost to serve customers located farther away from the local central office in less densely populated areas is actually higher. Qwest used three rural zones or bands beyond the base rate area, a pricing technique known as de-averaging.

In 1995, Dubois Telephone Exchange applied to the Commission to begin the transition to TSLRIC compliance for its local service rates. Residential rates moved from \$11 to \$19.25 per month. In July 2002 and on rehearing of a 2001 order in another Dubois Telephone case, the Commission found that the company's local service rates were TSLRIC-compliant based on the use of the rates of CenturyTel as a surrogate (allowed for small companies under W.S. § 37-15-402(a)) and on a Dubois Telephone-specific run of the Benchmark Cost Proxy Model (BCPM).

In 1998 CenturyTel, formerly PTI, filed a revenue neutral TSLRIC application using a model specifically developed for its unique circumstances. Like Qwest, CenturyTel advocated a significant access charge reduction and local exchange pricing similar to Qwest in which a local exchange base rate area is defined with de-averaged, and higher, pricing for rural zone increments.

In 1999, Sprint/United Telephone Company of the West filed a TSLRIC application with the Commission using the BCPM which Sprint/United and U S WEST developed jointly for use in determining federal universal service support benchmarks. Sprint/United's approach to pricing was to recognize customer density differences among exchanges, but not to recognize them within individual exchanges as Qwest had done. As a result, Sprint/United has different local exchange service prices at each of its Wyoming exchanges which are applicable to the entire exchange and include no zone increments outside of the base rate area. Sprint/United

received a waiver from the Commission, as provided for in the Act, of TSLRIC compliance for the West Lyman exchange which Sprint serves from western Nebraska; but it has recently filed an application with the Commission for TSLRIC-compliant pricing at West Lyman.

In a mid 2001 application, Range Telephone Cooperative and RT Communications proposed, under W.S. § 37-15-202(a), that their services should be found competitive by the Commission and not subject to price regulation. The evidence did not adequately support this argument and the Commission did not accept the prices proposed by them. In July 2002, Range and RT filed revenue neutral TSLRIC-compliant pricing plans proposing to increase basic local exchange service prices for residential customers. The Commission approved their requested \$16.00 per month rate for residential local service.

In June 2002, All West Communications filed a proposed TSLRIC-compliant pricing plan with the Commission. The application was based on a company-specific run of the HAI cost model and sought to implement a local exchange service rate of \$59.52 per month. Its current residential and business local exchange service rates are \$14.25 and \$20.25, respectively. This case is currently set for hearing in late October 2002.

In July 2002, Chugwater Telephone Company filed an application seeking an annual revenue increase of \$45,000 per year, including a proposal to increase the monthly basic service price paid by residential customers from \$10.50 to \$39.22. The application also proposes to decrease access rates and implement Extended Area Service (EAS, which would make calls to certain other exchanges in Wyoming toll free local calls). This case is currently pending.

Union Telephone Company filed a general rate case application in 1998. Testing the rates which would result from this case, using the BCPM model with company-specific inputs pertaining to Union's Wyoming operations, showed that those rates would bring Union into compliance with the cost-based TSLRIC pricing mandates of W.S. §37-15-402(a). The rates developed in the proceeding produced equalized access line rates within base rate areas for all of the original Union exchanges and the exchanges Union purchased from Qwest. The resulting rate was \$40.95 per month after recognition of all local service revenue sources as provided for in W.S. § 37-15-402(a). Union's application also provided for more de-averaged distance-sensitive (mileage based) local service rates for customers located outside of the base rate areas. The movement to cost-based pricing also resulted in a reduction by Union of its switched access rates to 3.25¢ per minute as shown in Table 2 below. Union Telephone's local service rate reflects its actual revenue requirement. Because the TSLRIC cost associated with a service is, under the Act, only a pricing floor, rates could have been lower if only TSLRIC had been considered.

Tri County and TCT West filed a consolidated compliance application seeking to meet the cost-based pricing mandates of W.S. §37-15-402(a). These companies performed their own TSLRIC studies based on standards and assumptions very specific to their Wyoming operations. Both Tri County and TCT West maintain that they essentially rebuilt the distribution and transmission networks in their service territories. Since they employed what they argued was the most efficient, least-cost technology available, they determined that this situation

provided the ideal conditions under which to conduct TSLRIC studies. The network they installed included a single central office location and the placement of Digital Loop Carriers (DLCs) within 12,000 feet of almost all of their customers. There was discussion of de-averaging prices down to the individual DLC level, but this could have produced some rates of more than \$500 per month for a single local basic service line. Their local service prices were de-averaged down to the individual exchange level. The movement to cost-based pricing also allowed for a reduction by the companies of their switched access rates to 1.5445¢ per minute as shown in Table 2.

The monthly residential and business local service rates of Silver Star Communications are \$16.80 and \$25.20, respectively. There are also current monthly charges for extended area service (EAS) of \$3.65 for residential service and \$5.50 for business service. Under Silver Star's pending rate application, which is intended to bring the company into compliance with the TSLRIC provisions of the Act, both local service rates would move to \$24.50 per month; and the monthly EAS rate would move to \$3.65 per line for any local access line. If approved, that would bring the total proposed rate for local exchange service, both residential and business service, to \$28.15 per month.

Teton Telecom's current tariffed rate for residential local exchange service is \$18.75 per month; and its rate for business local exchange service is \$30.56. Under Teton's pending rate application, which is intended to bring the Company into compliance with the TSLRIC provisions of the Act, both local exchange rates will move to \$31.25 per month. Currently Teton has zone charges for local service which are currently \$10.90 per month and \$9.90 per month for residential and business service, respectively. The zone rate would be eliminated under the pending rate proposal.

The great majority of the customers of Project Telephone and Golden West Telephone are located in other states, and their relatively small numbers of Wyoming customers are, for efficiency, served under rates developed for the other jurisdictions. Both companies have been granted TSLRIC waivers through January 1, 2005, as allowed for in the Act at W.S. § 37-15-402(c).

4. Current Prices

As a result of pricing cases over the past seven years, TSLRIC-based local exchange service and switched access prices are in place for many companies and the great majority of Wyoming access lines. TSLRIC applications are pending before the Commission for other companies. In addition to the historical data discussed above, Table 1 shows the current status of basic local exchange service prices and the percentage change from the prices which were in effect when the Act was passed in 1995. Companies which have not made the transition to TSLRIC pricing under the Act are shown in *italics*).

Table 1

Company	Residential Rates			Business Rates		
	1995	2002	change	1995	2002	change
Qwest						
base rate area:	\$14.64	\$23.10	58%	\$30.56	\$23.10	(24%)
farthest from base area:	\$24.54	\$69.35*	183%	\$41.46	\$69.35*	67%
Union Telephone						
base rate area:	\$8.49	\$40.95*	382%	\$13.69	\$40.95*	199%
farthest from base area:	\$26.49	\$88.47*	234%	\$31.69	\$88.47*	179%
CenturyTel of Wyoming						
base rate area:	\$10.00	\$15.00	50%	\$15.00	\$15.00	0%
farthest from base area:	\$17.50	\$28.00	60%	\$26.25	\$28.00	7%
Dubois Telephone	\$11.00	\$19.25	75%	\$19.55	\$24.25	24%
Range Telephone	\$11.65	\$16.00	37%	\$18.40	\$19.00	3%
RT Communications						
Shoshoni & central WY exch:	\$10.04	\$16.00	59%	\$19.66	\$22.50	14%
farthest from base area:	\$19.94	\$25.90	30%	\$29.56	\$32.40*	10%
Thermopolis & Newcastle:	\$10.78	\$16.00	48%	\$22.03	\$22.50	2%
farthest from base area:	\$20.68	\$25.90	25%	\$31.93	\$32.40*	1%
Worland exchange:	\$11.51	\$16.00	39%	\$24.42	\$22.50	(8%)
farthest from base area:	\$21.41	\$25.90	21%	\$34.32	\$32.40*	(6%)
Pine Bluffs, Burns, Carpenter:	\$12.98	\$16.00	23%	\$29.19	\$22.50	(23%)
farthest from base area:	\$22.88	\$25.90	13%	\$39.09	\$32.40*	(17%)
Sprint/United						
Guernsey exchange:	\$7.94	\$36.22*	356%	\$13.39	\$36.22*	171%
LaGrange exchange:	\$11.13	\$91.36*	721%	\$17.35	\$91.36*	427%
Lingle exchange:	\$11.13	\$82.23*	639%	\$24.63	\$82.23*	234%
Torrington exchange:	\$11.13	\$27.48	147%	\$24.63	\$27.48	12%
TCT West						
Greybull exchange:	\$10.14	\$27.31	172%	\$19.66	\$27.31	39%
Lovell exchange:	\$10.78	\$30.63	184%	\$22.03	\$30.63	39%
Basin exchange:	\$10.78	\$31.42	191%	\$22.03	\$31.42	43%
Frannie & Meeteetse:	\$10.78	\$45.08*	318%	\$22.03	\$45.08*	105%
Tri County Telephone						
Burlington exchange:	\$6.75	\$44.86*	565%	\$10.25	\$44.86*	338%
all other exchanges:	\$8.25	\$45.08*	446%	\$14.00	\$45.08*	222%
<i>Teton Telecom † **</i>	<i>n/a</i>	<i>\$29.65</i>	<i>n/a</i>	<i>n/a</i>	<i>\$40.46*</i>	<i>n/a</i>
<i>Silver Star Communications †</i>	<i>\$16.80</i>	<i>\$16.80</i>	<i>0%</i>	<i>\$25.20</i>	<i>\$25.20</i>	<i>0%</i>
<i>Chugwater Telephone †</i>	<i>\$10.50</i>	<i>\$10.50</i>	<i>0%</i>	<i>\$15.25</i>	<i>\$15.25</i>	<i>0%</i>
<i>All West Communications †</i>	<i>\$14.25</i>	<i>\$14.25</i>	<i>0%</i>	<i>\$20.25</i>	<i>\$20.25</i>	<i>0%</i>

* before applying credit for federal universal service support

† TSLRIC cases pending

** Did not exist in 1995

In addition to historical 1995 data, Table 2 shows the current status of switched access and intrastate toll prices and the percentage changes from 1995 levels just prior to the Act.

Table 2

Company	Switched Access Rates (¢ per minute)			Intrastate Toll Rates (¢ per minute)		
	1995	2002	change	1995	2002	change
Qwest (U S WEST)	9.71¢	1.4698¢	(85%)	20.86¢	**	‡
Tri County Telephone	16.53¢	1.5445¢	(91%)	20.86¢*	**	‡
TCT West	9.71¢	1.5445¢	(84%)	20.86¢*	**	‡
Dubois Telephone	11.52¢	11.470¢	(0.4%)	20.86¢*	**	‡
Union Telephone	10.60¢	3.2500¢	(69%)	20.86¢*	**	‡
Sprint/United	10.33¢	0.4571¢	(96%)	20.86¢*	**	‡
RT Communications	9.71¢	7.5000¢	(23%)	20.86¢*	**	‡
Range Telephone	9.08¢	7.2610¢	(20%)	20.86¢*	**	‡
CenturyTel	6.60¢	3.1369¢	(52%)	20.86¢*	**	‡
All West Communications	14.78¢	14.78¢	0%	20.86¢*	**	‡
Chugwater Telephone†	8.99¢	3.1369¢	(52%)	20.86¢*	**	‡
Silver Star Communications	9.7067¢	9.7067¢	0%	20.86¢*	**	‡
Teton Telecom***	n/a	6.56¢	n/a	n/a	**	n/a

* In 1995, Qwest (then U S WEST) was the designated toll carrier in Wyoming.

** There are multiple calling plans available from approximately 100 active interexchange telecommunications carriers registered at the Commission to provide long distance service through the implementation of equal access with all of the incumbent local exchange service providers in Wyoming. Prices vary from approximately 5.0 cents to 7.5 cents per minute.

*** Did not exist in 1995.

‡ Intrastate toll prices have been reduced up to 70% from 1995 levels.

† Proposed price, application pending.

The obvious conclusion that can be drawn from the information in Table 1 is that residential local exchange service prices of incumbent telecommunications service providers in Wyoming have increased significantly since 1995 and that the same holds true for business local exchange service, with the exceptions of Qwest and RT Communications which have lowered basic business service prices as noted above. Reviewing these facts in conjunction with Table 2 shows that, in most cases, higher prices for local exchange service have been off-set to an extent by lower switched access and toll prices (i.e., the price changes may result in higher overall telecommunications bills for subscribers who make few long distance calls and use the telephone primarily for local calling). Subscribers who make a relatively high percentage of calls between exchanges or between states can realize lower overall bills.

While there are common trends across Wyoming for the re-pricing of telecommunication services offered by incumbent service providers, this does not in itself explain why significant pricing differences exist between service providers. Those reasons are explained in Sections 5 through 8 of this report.

5. The Customer Density and De-Averaging Factor

One of the most important factors in utility ratemaking, regardless whether the industry is natural gas, electric, water or telecommunications service, is the customer density influence. This important factor is illustrated in the following simplified example: Assume that a utility's cost of providing service is \$1,000 per month and there are 100 customers served by the utility. For the utility to recover its cost of service, the uniform monthly rate would need to be \$10.00 per month for each customer. If, however, there were only 25 customers and the utility had the same monthly cost, the rate would be \$40.00 per month or 400% more as a result of serving 75% fewer customers.

Some people mistakenly assume that public utility investment is directly proportional to the number of customers served by it. This is not true. A considerable amount of plant and other physical facilities are necessary to provide utility backbone and infrastructure that is not directly related to the number of customers being served. As a result, if utility customers are spread out over a large geographic area, the costs will be higher per customer than in areas where customer density is higher.

Distance and density factors show themselves in the higher cost of serving persons in less densely populated areas or in remote locations which require higher investments per customer for necessary infrastructure. These effects are then reflected in rates. For example, Union Telephone's local service prices consist of a base rate charge of \$40.95. Outside of this area, there is an extra charge of 25¢ per quarter mile per month to cover the higher costs. Qwest has a uniform price of \$23.10 per month for local service in the base rate areas it serves. For persons in less dense and more remote locations, there are additional charges per month for three concentric zones surrounding each base rate area, with additional basic service charges of \$15.50 for Zone 1, \$25.50 for Zone 2 and \$46.25 for Zone 3 -- the least dense and farthest zone. However, density plays an additional role in Qwest's pricing. For, example, where a dense group of customers is located in zone 3, their service cost increment is priced the same as the increment for zone 2, clearly recognizing the density factor.

De-averaging is a rate design technique used to express the fact that every utility customer, regardless whether the service is for natural gas, electricity, telecommunications, water, etc., has a somewhat different cost associated with being served. Every customer requires at least a slightly different amount of wire, pipe, meters and other facilities to serve them; and their usage patterns and other related factors also help to make them unique. It would, however, be impractical and administratively expensive and burdensome for a utility to charge a different price to each customer, which reflected the customer's unique cost imposed on the utility. Utilities have usually addressed this by aggregating customers into rate classes such as, for example, residential, business, or industrial, which have similar service characteristics. This has the effect of averaging rates to save expense and for ease of administration. If a utility averaged all of its costs and used a single rate applicable to all customers and all services, it would be simple to administer; but it would not recognize legitimate cost differences among customer classes or the cost differences associated with different types of services. Some

telecommunications service providers in Wyoming have de-averaged prices based on the differences in the cost of providing service to different customers. These include Qwest, Union Telephone, Sprint/United, TCT West, and Tri County.

Other telecommunications service providers in Wyoming, such as Dubois and Range Telephone, use an average price within the entire service territory because of the geographic configuration of the areas involved or due to lending requirements (the Rural Utility Service (RUS) generally requires average exchange-wide prices in order to qualify for a RUS loan). Chugwater Telephone has a similar rate application pending before the Commission.

Many factors have an influence on the prices offered by each telecommunications service provider in Wyoming. These factors include considerations of whether to average or de-average prices, how to reflect distance-related costs, and how to account fairly for customer density, loan requirements, billing administration and other costs. The usefulness of direct comparison of the prices among the various service providers is therefore diminished because each service provider confronts a unique combination of geographic service areas, customer bases, and other factors that all play a role in the price differentials seen in Wyoming.

6. The Federal Universal Service Support Factor

How support from the federal Universal Service Fund is treated by the companies receiving that support has a significant effect on local service prices in Wyoming. There are several rate design approaches that could be legitimately proposed and supported by utilities (and approved by the Commission) to account for federal Universal Service Funds. Two differing examples help to illustrate the application of Federal Universal Service Funds:

a. Federal Universal Service Fund support may be used by the service provider as another local revenue source which then results in a lower local service price but no direct credit to the customer's bill for Federal Universal Service Fund support. This is referred to as a "rolled-in" or embedded treatment of federal Universal Service Fund support.

b. Federal Universal Service support may be accounted for outside of the process of determining local service prices if the utility gives an explicit and identifiable federal Universal Service Fund credit on the customer's bill against a higher local service price.

Regardless of which approach is used, if all other things are equal, the customer would pay the same net amount for local services, but the observed local service price may appear to be higher under example B in comparison to prices under example A. In reality, however, all other things are not equal among Wyoming companies because of, for example, variations over time in the amount of federal support; and other factors make direct comparisons of the prices and rate design methodologies among telecommunications companies very difficult. Under the Act, changes in the levels of explicit subsidies are recognized yearly. Where subsidies are implicit, this recognition does not occur.

Under the first approach, federal support is considered as another source of local service revenue which lowers the amount that must be collected from other local revenue sources. Many independent telecommunications companies use this method for determining the local service prices required to meet the TSLRIC provisions of state law. There are several revenue sources that may be considered in pricing decisions including Federal Universal Service Fund revenues, the federal Subscriber Line Charge revenues, interstate Carrier Common Line revenues (which are being phased out by the FCC) and local service revenues. Of these, the Federal Universal Service Fund component has the potential to influence the local service rate the most as illustrated in the following example:

Assume that a Wyoming telecommunications company (Company A) has an individual or adopted surrogate TSLRIC cost study that indicates a total cost of \$81.00 per line per month for a residential line. The Act requires, at W.S. § 37-15-402(a), that each service provided by a telecommunications company must be priced so that the revenues from the sale of that service recover the total service long run incremental cost of providing it. The local service revenues and TSLRIC unit price floor may be derived from the TSLRIC by subtracting: [i] the federal Subscriber Line Charge revenue of \$6.00 per month; [ii] any interstate Carrier Common Line revenues (which in this example we will assume are \$15.00 per month); and [iii] federal Universal Service Fund revenues (which in this example are assumed to total \$20.00 per month). The remaining revenue requirement must come from local service, which in this case would result in a local service price of \$40.00 per month as illustrated below:

Company A	
Total Service Long Run Incremental Cost (per month):	\$81.00
less federal Subscriber Line Charge revenue:	-\$6.00
less interstate Carrier Common Line revenue:	-\$15.00
less federal Universal Service Fund revenue:	-\$20.00
Required monthly local service revenue and tariff rate billed	\$40.00
Wyoming Universal Service Fund bill credit	-\$8.07
Net local service price billed to the subscriber*	\$31.93*

* This net figure equals 130% of the statewide average price, but it does *not* include the Wyoming Universal Service Fund assessment paid on the gross tariffed rate by all Wyoming subscribers, including those who receive bill credits from the fund.

In the example above, the customer will not pay \$40.00 per month even though this is the tariff rate. The Act provides, at W.S. § 37-15-501, that a Wyoming Universal Service Fund shall be established and administered by the Commission to provide assistance to high cost service providers to the extent that the local service rate exceeds 130% of the statewide average rate. At present, the statewide average rate is \$24.56 per month and 130% of the statewide average is \$31.93 per month. Therefore, in the example above, the customer would be billed a gross amount of \$40.00 per month, but would receive a billing credit from the Wyoming Universal Service Fund of \$8.07 per month and would thus pay a net amount of \$31.93 pursuant to state law.

One can see from the example above, that, as the federal Universal Service Fund revenue varies either up or down, the net local service revenue and unit price would also vary up or

down. However, the tariffed prices are not changed frequently through applications to the Commission. Incremental changes to federal support for companies receiving support from the Wyoming Universal Service Fund are required by Commission Rules to be targeted to and credited against the bills of high cost customers. The federal Universal Service Fund support that is available to each company differs based on historic embedded costs determined through the traditional ratemaking elements of return on plant investment (including the wire, optical fiber, switches, buildings, etc.), plus expenses for operations and maintenance, and administrative and general costs. There are also significant differences in the manner in which rural and non-rural costs are computed under FCC Rule.

In contrast, the second approach treats federal Universal Service Fund receipts as direct bill credits rather than simply as another source of revenue to be accounted for before the tariffed price is determined. In this case, the basic local service price at least covers its TSLRIC cost (but could be more if supported by additional revenue requirement elements) and the federal support is identified explicitly on the customer's bill as a separate line item credit. Qwest treats federal Universal Service Fund monies in this manner, and this makes it difficult to compare Qwest's local service price directly to the prices of companies that do not state their credits separately. Basic service prices appear somewhat higher when compared to the prices of some independent telephone companies, in part because Qwest's federal Universal Service Fund credit is explicit and not rolled in to the monthly basic service rate.

Assuming, for illustrative purposes, the same levels of cost as used above in the first example, we can see below how Company B would handle the explicit crediting of federal Universal Service Funds:

Company B	
Total Service Long Run Incremental Cost (per month):	\$81.00
less federal Subscriber Line Charge revenue:	-\$6.00
less interstate Carrier Common Line revenue:	-\$15.00
Required monthly local service revenue and billed tariff rate	\$60.00
federal Universal Service Fund bill credit:	-\$20.00
Wyoming Universal Service Fund bill credit	-\$8.07
Net local service price billed to the subscriber*	\$31.93*

* This net figure equals 130% of the statewide average price, but it does *not* include the Wyoming Universal Service Fund assessment paid on the gross tariffed rate by all Wyoming subscribers, including those who receive bill credits from the fund.

Company B's customer would not pay \$60.00. Because of the federal and Wyoming universal service fund credits, the customer would pay \$31.93 per month just as Company A's customer does. Note that how federal universal service monies are treated has an impact on the perceived price of local service in the examples above. Therefore, a simple comparison of local service price differentials of various Wyoming telecommunications companies would not be complete and might be misleading if the treatment of federal support is not considered.

In the past, the treatment of federal support has differed among Wyoming telecommunications companies as some treatments were established in cases coming before our

rules on the treatment of incremental federal universal service support. The Commission has reviewed the situation and issued an order to companies not currently in compliance. Qwest's current prices, which include federal support credits applied ("targeted") only to its highest cost customers in zones 1, 2 and 3, are a result of its Phase IV price plan case, which was approved by the Commission in September 1999.

7. The System Architecture Factor

System architecture may also have a significant influence on pricing differentials when one telecommunications utility is compared to another. The Commission has adopted Sections 517 through 546 of its Rules to promote a consistent TSLRIC study methodology intended to achieve the lowest cost network with the most current technology available in the telecommunications industry. Nevertheless, the timing of a TSLRIC study, the inputs to the study, and the capped or uncapped nature of the company's investments may result in different costs between utilities and thus different pricing conclusions. TSLRIC studies are often acknowledged to be partially "science" and partially "art," meaning that there can be legitimate differences of opinion among experts about the nuances of how a study should be conducted and what it should contain. Timing, technology, market size and density, and assumptions about the necessary facilities are among the numerous variables affecting the outcome of TSLRIC studies. Each TSLRIC study must make numerous technological choices and assumptions about how the technology is to be employed before it can yield a result.

There are two major starting points for TSLRIC studies. The Commission does not advocate the "scorched earth" approach to TSLRIC studies which starts from the basic premise that the telecommunications company's existing network architecture is completely and utterly useless and that infrastructure must be priced to produce an entirely new network to serve the company's existing customers. Instead, the Commission favors the "scorched node" approach which assumes the existing locations of the company's central offices are acceptable and that it is reasonable to redesign the network using these current locations. Under this assumption, the local telecommunications plant is priced to serve existing customers from existing central office locations. Switches and all of the various components of the local telecommunications plant needed to serve local business and residential customers are examined for price, appropriateness and usefulness in providing basic local exchange service. The TSLRIC studies should show the relative cost effectiveness and break points at which migration to a different technology would be appropriate. The end result should be a realistic expression of the cost a new carrier seeking to compete would incur in becoming a facilities-based local exchange service provider.

Some of the key variables that influence TSLRIC studies are: [i] **Network Blockage**, which is a measure of the percentage of subscribers expected on the network at the same time and who may be blocked due to insufficient capacity of the network to handle peak calling volume; [ii] **Fill Factors**, which helps to size telecommunications cable and related plant by measuring the need for spare loops and multiple loops per customer to accommodate fax machines and dedicated Internet lines or other multiple line requirements in modern society (assumptions about Fill Factors change the size, and therefore, the cost, of facilities used in TSLRIC studies); [iii] a **Productivity Factor**, which measures the increased efficiency of a

modern network; and [iv] the **Cost of Capital** which is a measure of the cost of borrowing money to construct a new network. As these important variables are applied in TSLRIC studies, the results for Qwest, serving Cheyenne, Casper and the other large Wyoming cities, may be far different from the results for Chugwater Telephone Company which serves a very small, single exchange in Chugwater, Wyoming.

8. The Business Plan Factor

The final factor that may contribute to significant pricing differences between telecommunications utilities is the company business plan and the margin or a profitability designed into the various components of its service offerings. As long as companies comply with state law, and rate subsidies are eliminated, the utility may, under an approved price plan, price its services at or above their individual TSLRIC. The Act allows for great flexibility in allowable pricing plans; and the service providers must weigh their pricing objectives in light of business competition, loss of customers and lower revenues. Additionally, technological advancements in wireless telecommunication for voice and data, coupled with increased speed, reliability and the inherent flexibility of wireless services, have led some subscribers to abandon land-line communications entirely. Faced with these prospects, an incumbent utility may decide to keep basic local exchange rates as low as allowable under the Act and look to other services to increase profitability. For example, a review of current data in Tables 1 and 2 suggests that some service providers may have considered this factor in establishing their local exchange service and switched access prices in Wyoming.

Companies must also take into account customer calling patterns, usage statistics, compliance with state and federal law, packaged competitive service offerings, customer loyalty and many other factors when pricing their service offerings. Under W.S. § 37-15-102, the Act spells out the required changes in Wyoming telecommunications:

“It is the intent of this act to provide a transition from rate of return regulation of a monopolistic telecommunications industry to competitive markets and to maintain affordable essential telecommunications services through the transition period, and the provisions of this act shall be construed to achieve those goals.”

This transition is not simple and not identical for all companies.

9. Actual Price Effects: The Wyoming Universal Service Fund

The actual impact of local exchange service pricing differentials on Wyoming citizens is relatively small because of the operation of the Wyoming Universal Service Fund, which limits basic local service prices actually paid to 130% of the statewide average price. Currently, the statewide average local exchange rate (residential and business combined) is \$24.56 per month and 130% of that average is \$31.93 per month. For example, the Sprint/United customer in LaGrange whose rate is \$91.36 per month will only pay \$31.93 per month for basic service as a result of support from the federal and Wyoming Universal Service Funds.

Under the Act, the WUSF is “rate based;” or, in other words, it is based on an average statewide local exchange rate and then support payments are made whenever a customer bill, after consideration of any federal support, exceeds 130% of the statewide average rate. Thus, regardless whether a customer’s local exchange rate is \$40.00 per month or \$400.00 per month, that customer’s basic local exchange charge is \$31.93 per month. Wyoming universal service support is not free to any customers because all customers, including those customers receiving universal service fund credits, also contribute to the Wyoming Universal Service Fund. Because contributions to the Wyoming Universal Service Fund are based on gross local exchange prices, once the USF contribution (at the current rate of 4%) is added in, these two customers described above would be responsible for paying \$33.53 (\$31.93 + 4% of \$40.00) and \$47.93 per month (\$31.93 + 4% of \$400.00), respectively. Alternatives to the current rate based universal service fund methodology include a fund based [i] on the forward-looking or actually incurred costs of the telecommunications company or [ii] on a statutorily stated support threshold expressed in dollars.

Either actual, effective competition or Commission determinations about whether local services are subject to “effective competition” and therefore not subject to price regulation, as the Act provides under W.S. § 37-15-202 are important to ensure the proper functioning of the fund. They are both intended to avoid the problem of an “unregulated monopoly” with pricing freedom and no competition.

Note that various taxes and fees will generally add about another \$5.00 to \$10.00 to the total bill actually paid by retail customers.

The following are the assessment history since the inception of the WUSF and a summary of statistics regarding the WUSF.

Wyoming Universal Service Fund Assessment History:

Assessment Level	Docket Number	Effective Date
1%	90072-XO-97-1	7/1/97
2%	90072-XO-98-2	4/1/98 or next billing cycle
2%	90072-XO-98-3	7/1/98
6%	90072-XO-98-4	10/1/98
3%	90072-XO-99-6	3/1/99
2%	90072-XO-99-10	7/1/99
3%	90072-XO-99-11	10/1/99
2%	90072-XO-00-13	7/1/00
4%	90072-XO-01-17	7/1/01
4%	90072-XO-02-20	7/1/02

Each docket number refers to an order of the Commission discussing its decision regarding Universal Service Fund assessment levels. You may view them on the Internet at <http://psc.state.wy.us/htdocs/asp/drilldetail2.asp?Target=90072>.

Number of service providers contributing to the USF: Approximately 200 companies out of 400 companies registered to conduct business in Wyoming.

Number of service providers who receive support from the USF: 6

FY02 funding level: \$9,513,000

Number of customers (access lines) who receive USF support: 52,505 out of approximately 275,000 Wyoming access lines.

9a. Facts about the Wyoming Universal Service Fund

The size of the WUSF varies depending upon circumstances in the telecommunications industry, average statewide rates, support eligibility and other factors. During the first year of operation, fiscal year 1997-98, cash flow in and out of the WUSF was approximately \$1 million. Since that time, the fund has undergone significant evolutionary change and today approximately 200 companies are making monthly contributions into the WUSF. Although about 400 companies are subject to assessment, half of them do not generate intrastate Wyoming revenue and thus do not contribute. The total annual support payments to qualified companies and the operational expenses of the WUSF now require a cash flow into and out of the fund of approximately \$10 million per year.

The Commission is the administrator of the WUSF and the Commission contracts with a professional manager to handle the daily activities of receiving payments, determining support payment amounts and gathering all of the data necessary to design and support the assessment rate. The Commission requested and received budget authority for the 2003/2004 biennium for the WUSF program of \$24 million per biennium, which should provide sufficient flexibility for the Commission to adjust the WUSF if necessary to comply with state law. At existing assessment and support levels, the cash flow into and out of the WUSF is approximately \$10 million per year. The Commission does not use the WUSF for any other regulatory or administrative purposes other than to support high-cost local exchange telecommunications services pursuant to state law.

In 2001, the Wyoming Legislature amended W.S. § 37-15-501 and created W.S. § 37-15-502 concerning the eligibility of wireless carriers to receive support from the WUSF. For eligibility, a carrier must qualify for Eligible Telecommunications Carrier (ETC) status under the federal Telecommunications Act of 1996 and must meet specific service requirements. The qualifying wireless service must be single party with unlimited local calling for a flat fee, a broadly advertised service offering, and in other ways the general equivalent of basic land line local service. One of the current rulemaking issues before the Commission is whether or not the 130% threshold for support eligibility is applicable to wireless carriers. The Commission is expected to rule on this issue in the latter part of 2002. Wireless carrier support through the WUSF may further increase the size of the fund and the explicit subsidy of high cost service in Wyoming.

The transformation of Wyoming telecommunications pricing to phase-out implicit subsidies for local exchange, toll and switched access prices in favor of an explicit subsidy in the form of the Wyoming Universal Service Fund is a public policy decision that the Wyoming

Legislature made in 1995. The Legislature, in W.S. § 37-15-501(e), would permit the Commission to suspend the WUSF after notice if, for public interest reasons, the WUSF is no longer serving its intended purpose. Phasing out the Wyoming Universal Service Fund could have serious consequences for individual high-cost customers. Although all of Wyoming's local exchange service customers contribute to the fund, 19% of those customers receive support.

Technological and business model innovations pose challenges for the future. For example, the use of prepaid "phone cards" in Wyoming has increased fourfold over the past eight to twelve months because of their convenience and relatively low cost. There is no practical way to apply the WUSF assessment to phone card providers or business vendors; and revenues from these cards are lost to the WUSF. As this method of acquiring long distance calling credit continues to expand, and the use of other innovative services increase, revenues available to the fund may diminish. This could drive WUSF assessment levels up and result in larger explicit subsidies being paid by Wyoming subscribers.

10. Summation and Conclusions

As illustrated in this report, there are significant differences among the prices of telecommunication service providers in Wyoming and the reasons are identifiable. There is no individual model or set of physical or regulatory conditions that would guarantee uniform prices among the fifteen incumbent local exchange service providers in Wyoming. Significant diversity exists among Wyoming service providers in a number of important ratemaking areas which support variations in local exchange and switched access prices.

Pricing methodologies -- TSLRIC, historic embedded cost, and others -- used by the Commission, allowed by law, and employed by the service provider, do not drive the existence or magnitude of pricing differentials between one utility and another. If an historic embedded cost and a traditional rate-of-return/rate base regulatory approach were used to set prices for local exchange telecommunications service providers, the result would be that pricing differentials would continue to exist just as they do when TSLRIC is employed to establish price floors. Four important factors, all of which are independent of the pricing methodology employed (but which can affect the outcome), actually drive the differences. They describe the physical and business realities of providing service to customers in Wyoming; and they include: [a] the density and composition of the customer base and the extent to which price averaging (or de-averaging) is incorporated in pricing decisions; [b] the amount of federal support received by a telecommunications service provider and whether that support is targeted directly to high cost customers or retained by the service provider to off-set the cost of service; [c] differences in network architecture (whether driven by customer demand or the physical nature of the service area in question); and [d] the business strategies and plans of the telecommunications service providers themselves.

The elimination of implicit subsidies under the Act has resulted in price increases for local exchange service. In order to protect high cost customers, the Act also provides for the Wyoming Universal Service Fund to assure that no one pays more than 130% of the statewide average rate after consideration of other support like the federal Universal Service Fund. Some issues remain, such as the possible examination of the feasibility of requiring consistent treatment of federal high cost support, and how that would influence the WUSF.

**Appendix A:
Some Specific Requirements of the Wyoming Telecommunications Act of 1995**

Subject	Task	Important Dates	Statute
Pricing	Services provided by a telecommunications companies that provide noncompetitive services shall be priced such that the revenues recover TSLRIC. Cost studies shall be filed annually except companies having 30,000 access lines or fewer are exempt from annual cost filing requirement.	36 month time period to transition to TSLRIC.	W.S. §§ 37-15-402(a) and (b)
Pricing	Companies with fewer than 30,000 access lines may apply to the PSC for noncompetitive service prices to remain below TSLRIC up to January 1, 2005, based upon a showing that a waiver is necessary in order to provide essential services.	The Act automatically repeals this exemption as of 1/1/2005	W.S. § 37-15-402(c)
Cross-Subsidies	Companies shall not use revenues from noncompetitive services to subsidize competitive services and vice versa. Nothing in this section shall affect the assignment of revenues received from the WUSF for the exclusive support of high cost local exchange services.		W.S. § 37-15-403(a)
Access Investigation	The PSC shall commence an investigation into the appropriate methodology for calculating intrastate switched access charges and the feasibility of phasing out subsidies by January 1, 2002.	Begin investigation in 1995 to assess phase-out by 1/1/02	W.S. § 37-15-411
"1+" equal access	Each local exchange company shall provide 1 + equal access where technically and economically feasible by January 1, 1998	1/1/1998	W.S. § 37-15-410
Universal Service Fund	A Universal Service Fund is established and it shall be administered by the PSC.	none, the fund may be abolished if necessary	W.S. § 37-15-501