BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into the regulatory safeguards required to prevent cross-subsidization by telephone companies	) DOCKET NO. 910757-TP) ORDER NO. PSC-93-1015-FOF-TP) ISSUED: July 12, 1993

The following Commissioners participated in the disposition of this matter:

J. TERRY DEASON, Chairman
THOMAS M. BEARD
SUSAN F. CLARK
JULIA L. JOHNSON
LUIS J. LAUREDO

Pursuant to Notice, a public hearing was held on March 10-11, 1993, in Tallahassee, Florida.

APPEARANCES:

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FINAL ORDER

BY THE COMMISSION:

I. CASE BACKGROUND

By Order No. 24510, issued August 13, 1991, this Commission determined that issues regarding cross-subsidization resulting from the revisions to Chapter 364, Florida Statutes, should not be dealt with in Docket No. 900633-TL, the local exchange company cost of service docket, but instead should be addressed in a separate proceeding. Consequently, this docket was opened to examine matters concerning regulatory safeguards required to prevent cross-subsidization by local exchange companies (LECs). On September 20, 1991, intervening parties submitted briefs addressing the legal requirements of revised Chapter 364. Based on the reaction of the parties at the February 4, 1992 Agenda Conference, the Commission determined that any proposed agency action issued would be protested by the parties. Accordingly, by Order No. 25816, issued February 4, 1992, this docket was set for hearing.

By Order No. 24853, issued July 25, 1991, the Commission acknowledged the intervention of the Office of Public Counsel (OPC) in this docket. In addition, intervention was sought by and granted to the following parties: AT&T of the Southern States, Inc. (ATT-C), BellSouth Telecommunications, Inc. d/b/a Southern Bell Telephone and Telegraph Company (Southern Bell), Central Telephone Company of Florida (Centel), the Florida Ad Hoc Telecommunications User's Committee (Ad Hoc), the Florida Cable Television Association (FCTA), the Florida Interexchange Carriers Association (FIXCA), the Florida Pay Telephone Association (FPTA), GTE Florida Incorporated (GTEFL), MCI Telecommunications Corporation (MCI), United Telephone Company of Florida (United), and US Sprint Communications Telecommunications Company Limited Partnership (Sprint).

Pursuant to Notice, a Prehearing Conference was held on February 26, 1993, establishing the issues to be addressed and the procedure to govern the hearing. The hearing was held on March 10-11, 1993, in Tallahassee.

II. DEFINITION OF CROSS-SUBSIDIZATION

In order to prevent cross-subsidization, it is initially necessary to define the term. Cross-subsidization is not specifically defined in Chapter 364, but is addressed in Section 364.3381, which is titled "Cross-subsidization." This section provides that:

> (1) The price of a competitive telecommunications service provided by a local exchange telecommunication company shall not be below its cost by use of subsidization from rates paid by customers of monopoly services subject to the jurisdiction of the commission.
>
> (2) A local exchange telecommunications company which offers both monopoly and competitive telecommunications services shall segregate its intrastate investments and expenses in accordance with allocation methodologies as prescribed by the commission to ensure that competitive telecommunications services are not subsidized by monopoly telecommunications services.

Paragraph (1) explicitly prohibits the cross-subsidization of a LEC's competitive services by its monopoly services, while Paragraph (2) requires that a LEC segregate its investments and expenses associated with competitive services from those related to its monopoly services, to guard against cross-subsidization of the former by the latter.

The characterizations of cross-subsidization presented generally fall into two categories. The LECs, including Centel, GTEFL, Southern Bell, and United, assert that the "economic definition" of cross-subsidy is well understood, widely accepted and is the notion that most appropriately conforms with Section 364.3381. However, the FCTA, FPTA, FIXCA, and ATT-C advocate a more expansive definition which they assert is derivative from, and supported by reading Chapter 364 as a whole.

Although the LECs differ somewhat as to the wording of their respective definitions, they all agree that cross-subsidization is an economic concept that fundamentally deals with the relationship between a service's price and its cost. Southern Bell and United maintain that a cross-subsidization occurs when the revenue caused by the provision of a particular segment of the firm's output is exceeded by the incremental cost of producing that segment. Centel

contends that cross-subsidization is the support of a LEC's effectively competitive services whose prices do not cover total incremental costs with revenues from the LEC's monopoly services. GTEFL asserts that cross-subsidization is the pricing of some services above their incremental cost in order to allow other products sold by the firm to be priced below their incremental costs of production. Thus, GTEFL believes that the comparison of price with incremental cost is the appropriate determinant.

FCTA supports a much broader concept maintaining that cross-subsidization occurs when the monopoly provides the following: benefit to its competitive business for which it is not fully compensated by the competitive business; benefit to its competitive business that is not provided to competitors; or, benefit to its competitive business under more favorable terms than provided to competitors. FPTA also proposes the broad definition that cross-subsidization includes any activity on the part of the LEC monopoly involving a competitive service that works to the detriment of the LEC's monopoly ratepayers and impedes competition for end users. FIXCA believes that cross-subsidization occurs when a service fails to recover an appropriate allocation of the LEC's accounting costs. ATT-C also supported the more expansive position that cross-subsidization is a situation in which investments and/or expenses associated with the provision of a competitive service are inappropriately borne by monopoly ratepayers. MCI did not take a position on this issue.

Finally, OPC proposes that cross-subsidization includes the transfer of costs from unregulated operations to regulated operations or the lack of appropriate compensation from competitive operations to the regulated operations.

FCTA's witness Cicchetti stated that the FCTA's primary concern was that if the Commission adopted a cross-subsidy standard based on incremental cost, the LECs could install fiber optic facilities in excess of what would be economically efficient for the provision of local exchange service. Given the acceptance of incremental cost as the benchmark for compensatory pricing, FCTA presumably is concerned that in the future the LECs may offer video services in competition with cable companies, with the bulk of the cost of the necessary facilities being recovered through rates for monopoly services.

Given the above exchange, one of two fundamental concerns of FCTA's, which is shared, in varying degrees, by FPTA, FIXCA, and

ATT-C, can be described as follows. The LECs are multiproduct firms which enjoy economies of scale and scope in the provision of their services. Where economies of scale are present, both the average cost per unit and the incremental cost per unit produced are declining, and the incremental cost per unit--the cost of the next unit or increment produced-- is less than average cost. Simply stated, economies of scope exist where it is less costly for a single firm to produce two goods, than it would be for two single-product firms to produce these two goods separately.

Fiber optics is a transmission technology that affords significant economies of scale because of its nonlinear cost characteristics. Once a fiber route is in place, on a per unit basis the cost of expanding the route's capacity in terms of additional derived channels declines; the major limiting factors are technological limitations and the offered demand. For most transport applications fiber optics is currently the technology of choice. For example, when upgrades are needed, many if not most Florida LECs are installing fiber optics for interoffice transport.

The issue raised here by FCTA is a matter of equity in pricing. Assume that fiber facilities originally were installed to provide local exchange service, but a LEC now proposes to offer a new service, such as video transport, using these same embedded facilities. If this is a service for which competitive alternatives exist, the LEC presumably would set its price, subject to a floor cost, in recognition of the market characteristics. FCTA is concerned that if the price floor for this new service were set relative to its associated incremental cost, the result should be viewed as cross-subsidization.

When dealing with a technology such as fiber optics that can yield economies of scale, the incremental cost of any one service can be quite sensitive to the sequence in which services are offered. As noted in the above example, where fiber optic facilities are installed and local exchange services are offered first, the incremental cost of services subsequently provided using this technology will tend to be lower than the cost of the local exchange service first service provided. Further, by the time that additional services are eventually offered, the bulk of the fixed costs of the fiber optic facilities usually either have been or are being recovered through the rates for existing services, in this case primarily local exchange services.

It appears FCTA believes that the cost of fiber optics is not justified solely for the provisioning of local exchange service, but the LECs nevertheless are installing it and recovering the costs from local exchange ratepayers. No evidence was presented at the hearing as to whether or not this in fact is true. We would note that issues involving whether or not a LEC was installing the most cost-effective technology to provide service are routinely dealt with in rate cases and in depreciation cases. Regardless, we believe that whether such actions are occurring relates to questions of prudence, not cross-subsidization.

Witness Cicchetti also contended that cross-subsidy pertains to various forms of behavior which could be considered instances of anticompetitive behavior. Such behavior would include price discrimination, refusal to deal, above-cost affiliate transactions, among others. The specific forms of anticompetitive behavior enumerated by witness Cicchetti are addressed in Section V, herein. However, witness Cicchetti did acknowledge that anticompetitive behavior can be distinct from cross-subsidization in the economic sense. Moreover, witness Cicchetti agreed that the Commission could fulfill its statutory duties under Chapter 364 by treating anticompetitive matters separately from cross-subsidy concerns.

Upon review, we find that the record in this proceeding does not support the broad characterization of cross-subsidy advocated by FCTA's witness Cicchetti. Witness Cicchetti admitted during cross-examination that his broad definition of cross-subsidization was distinct from the test used by federal antitrust courts, while the economic definition is the standard for antitrust cases. He was unable to cite any works, treatises or court opinions that supported his characterization of cross-subsidy. Witness Cicchetti agreed that the economic definition, based on the relationship between price and cost, has a well-known and widely accepted meaning. Moreover, he was unaware of any articles in journals or in the professional literature which indicate that the economic definition, based on the relationship between price and incremental cost, is inappropriate. We find that the record in this proceeding does support the more narrow view propounded by the LECs. Accordingly, we find it appropriate to adopt the following economic definition of cross-subsidy: Cross-subsidization exists when competitive services are priced below their incremental costs, and the resulting revenue shortfall is recovered through the rates for monopoly services.

III. DETECTION OF CROSS-SUBSIDIZATION

All parties in this proceeding generally agree that it is necessary to examine the revenues and costs associated with competitive services in order to detect cross-subsidization; they differ according to their views on how the costs should be determined or measured. FCTA also maintains that cross-subsidization can be detected by comparing the prices that the monopoly service provider charges when making services available to its own competitive business to what it charges other competitive providers for such service. Again, FCTA appears to be advocating a broader approach to the concept of cross-subsidization.

There is no significant disagreement among the parties regarding the need to examine a service's revenues and costs to detect cross-subsidization. Accordingly, we find that the presence of cross-subsidization can be determined by comparing the revenues generated from a service with the relevant costs of providing the service, or, equivalently, a service's price with its relevant unit cost.

IV. COST STANDARD

Centel, GTEFL, Southern Bell and United all agree that incremental cost is the proper standard against which to determine the presence or absence of cross-subsidization. Southern Bell witness Emmerson noted that the total incremental cost test, which involves comparing a service's total incremental costs to its total revenues generated, is the accepted standard among economists.

FCTA's witness Cicchetti contended that the cost standard for detection of the presence or absence of cross-subsidization must be based on fully distributed cost (FDC). He asserted that Section 364.3381 requires a full allocation of a LEC's costs between competitive and monopoly services that ties back to the books and records of the company. Moreover, witness Cicchetti objected to the use of incremental cost because it fails to share equitably the benefits arising from the firm's economies of scope. FPTA and FIXCA also endorse FDC as the cost standard.

The LEC witnesses argued against the propriety of using FDC as the standard for cross-subsidy because of its inherent flaws. A fundamental problem noted by the LECs is that FDC approaches attempt to do the impossible: to directly attribute joint and

common costs among services. Since by definition joint and common costs are unattributable, the LECs assert that any FDC methodology is inherently arbitrary.

Even witness Cicchetti conceded numerous points relating to the arbitrariness of FDC methods. He admitted that FDC ignores market forces and customer demand, sets an arbitrary price floor, and yields an allocation of overhead costs that does not reflect any causal relationship. Further, witness Cicchetti acknowledged that requiring a competitive service to be priced to cover fully distributed cost may result in the service not being offered, resulting in a lost contribution towards monopoly services.

ATT-C witness Guedel espoused a position somewhat in between that of the LECs and FCTA. He contended that the Commission should establish a price floor for LEC competitive services based on their direct costs; where monopoly services are used to provide the competitive service, the tariffed rates for the monopoly services should be imputed as direct costs of the competitive service. Witness Guedel further testified that as more and more services are subject to competition, it will become necessary to develop a mechanism to allocate overhead costs between monopoly and competitive services, to protect the monopoly ratepayer. However, overhead costs need not be assigned to individual competitive services, or to affect the level of the price floors for individual services.

Southern Bell witness Emmerson took exception to witness Guedel's proposal to allocate overhead costs between competitive and monopoly services. He argued that there is no rational economic basis to perform such an allocation, that it would result in economic inefficiencies, and thus would be plagued with the same problems associated with fully distributed costs.

GTEFL witness Beauvais indicated that witness Guedel's proposal for imputing monopoly inputs into price floors is not generally correct, but rather represents a special case of the economically proper imputation treatment. Witness Beauvais stated that imputing tariffed rates is only appropriate where there are no differences in the cost of the LEC providing the monopoly service to itself as opposed to a competitor, and there are no qualitative or quantitative services in the service being provided. Instead, the appropriate method would impute the LEC's incremental cost of

providing the monopoly service to itself, plus any foregone contribution it would have received from selling it to another party.

Additionally, we note that the incremental cost standard is embodied in the economic definition of cross-subsidy which has been adopted by the federal antitrust courts. In Northeastern Telephone v. AT&T, 651 F.2d 76 (2d Cir. 1981), the court endorsed the economic cost standard. The court also adopted the incremental cost standard, while repudiating the use of fully distributed costs, in MCI v. AT&T, 708 F.2d 1081 (1983):

> MCI argues at considerable length that an FDC methodology is required to prevent AT&T from subsidizing its competitive services with revenues from services in which it retains a monopoly.
>
> . . . .
>
> MCI's argument presumes that customers of monopoly services will have to pay higher prices if AT&T prices below FDC in markets where competition is present. (citation omitted) Such arguments ignore the nature of costs and revenues in a multi-service enterprise. AT&T's unattributable overhead costs do not increase when AT&T offers a new service, nor do they decrease when such a service is discontinued. When a multiproduct firm prices a competitive service above its long-run incremental cost, no cross-subsidy can occur because the additional revenues produced exceed all additional costs associated with the competitive service and provide a contribution to the unallocable common costs otherwise borne by the firm's existing customers.

Id. at p. 1123-24.

Upon consideration, we find that fully distributed cost is not an appropriate cost standard for use in the telecommunications industry, for detecting cross-subsidy or for any other purpose. First, an FDC methodology assigns all of the firm's costs to individual goods and services. Multiproduct firms such as LECs have at least two types of costs, common and family costs, for which it is impossible to arrive at a causal basis for allocating them to individual services. Common costs are general overhead costs, such as the president's salary and the cost to prepare the firm's annual report to stockholders. Family costs are those costs that are occurred to offer a group of services, but for which there

is no rational basis to assign them to individual services. By definition there is no correct way to allocate these costs; any allocation scheme is inherently arbitrary and thereby subject to manipulation by the analyst. Cross-subsidy is a function of a service's price and cost; a service either is being cross-subsidized or it isn't. Since FDC cannot yield a single unique cost standard, it is impossible for it to detect cross-subsidy.

Second, the results of an FDC study are inappropriate for pricing purposes, especially where competitive entry is allowed into a LEC market. Where an FDC methodology is used to establish floor prices for LEC services that are also available from other providers, the result is an artificial price level. The LECs' competitors are not required to recover their common costs from their services based on an FDC allocation scheme; as such, they have greater flexibility than the LEC to set prices for individual services, especially those for which the greatest competition exists. Consequently, the LEC's FDC price floor affords its competitors an arbitrary price ceiling.

Third, based on the evidence presented, it appears that advocates of FDC confuse pricing and costing. They contend that it is necessary to allocate all costs to individual services in order to ensure that the firm's total costs are recovered. We believe this represents a fundamental conceptual confusion. Costing is properly limited to determining and quantifying the identifiable costs associated with producing a given good; whereas, pricing uses cost results in conjunction with demand characteristics and other information to arrive at an optimal means of recovering costs. An FDC study effectively yields prices for individual services, but it disregards all market considerations. By collapsing the two activities, costing and pricing, FDC approaches are intrinsically unable to yield efficient prices.

Based on the record in this proceeding, we conclude that the appropriate cost standard for detecting cross-subsidization is incremental cost. Although we believe that how and when to require imputation is a legitimate fairness issue, we do not believe it is relevant for purposes of detecting cross-subsidy. The incremental cost standard is universally endorsed in the economics literature and is accepted in the federal antitrust courts in the context of predatory pricing and cross-subsidization cases.

Moreover, this Commission has previously endorsed the incremental cost standard. In Order No. 22282, issued in Docket

No. 891181-TL on December 12, 1989, concerning Southern Bell's tariff filing to introduce ESSX Station Message Detail Recording, the Commission stated that new competitive offerings such as ESSX SMDR must feature rates that at least meet the incremental cost associated with the service. This is a means of ensuring that cross-subsidization of competitive offerings does not occur. Similarly, by Order No. 23431, issued September 5, 1990, in Docket No. 900514-TL regarding Southern Bell's proposed CO LAN offering, the Commission concluded that incremental costs are the relevant costs for this decision since they apply to the pricing decision and do not affect costs that are not affected as a result of the decision. Furthermore, since all services with prices set above their incremental cost will not affect other service rates, but will make a contribution to the common and joint costs. Accordingly, we find that incremental cost is the proper cost benchmark against which to determine the presence or absence of cross-subsidization.

V. BEHAVIORS THAT CONSTITUTE CROSS-SUBSIDIZATION

The parties are clearly divided on this issue. Southern Bell, GTEFL, United, and Centel believe that the only type of behavior which constitutes cross subsidization, as contemplated by Section 364.3381, is pricing some services above incremental costs in order to allow other services sold by the same firm to be priced below incremental costs. They believe that cross-subsidization is distinctly different from other forms of anticompetitive behavior, and as such, advocate a narrow and specific type of behavior. ATT-C supports the concept of a specific type of behavior; however, it also believes that the provisions of Section 364.3381 should be read in conjunction with the other provisions of Chapter 364.

FCTA, FPTA, and OPC assert that behaviors considered to be cross subsidization should be considered in the broad sense. They believe that this Commission should be concerned not only with the relationship between price and cost, but also with any actions which might be considered to be discriminatory or anticompetitive. FCTA witness Cicchetti listed six types of behavior that he contended amount to cross subsidization:

1. Losses incurred from competitive services are financially subsidized through revenues from monopoly services (cross-subsidy).

2. The LEC monopoly pays in excess of current fair market price for products or services received from its subsidiaries or affiliated companies (cross-subsidy).
3. The LEC monopoly receives less than fair market price for products or services provided to its subsidiaries or affiliated companies (cross-subsidy).
4. A LEC competitive service does not bear its share of the costs of providing the service, including a pro rate share of overhead, and those costs are instead covered by revenues received from monopoly services (cross-subsidy).
5. The LEC monopoly provides service to its own competitive activity under rates, terms, or conditions more favorable than those services are provided to other companies offering similar competitive service (anticompetitive behavior).
6. The LEC monopoly provides services to its own competitive services that the monopoly will not provide to other companies (anticompetitive behavior).

We agree that the first case cited by FCTA does amount to cross-subsidy and thus is proscribed by Section 364.3381; however, although the other five cases noted may, in certain instances, be prohibited by the Commission in accord with the statutes, they are not prohibited by Section 364.3381.

The second case cited by witness Cicchetti is where a LEC purchases goods and services from an affiliate at prices in excess of fair market value. We agree that this behavior would be improper if the excess costs were passed on to LEC's ratepayers. If such actions result in ratepayers absorbing excess costs, then Section 364.03(1) affords the Commission the necessary authority to prohibit these actions.

Neither FCTA's third case, concerning a LEC charging less than fair market value for services rendered to an affiliate or subsidiary, or the fifth case, regarding a LEC providing monopoly service to its competitive operation under terms more favorable than those afforded a competitor, pertain to cross-subsidy. Moreover, in certain instances they are not necessarily improper. A differential in a price charged two parties in and of itself does not constitute undue price discrimination. However, where instances of undue discrimination by the LECs are identified, Section 364.10 expressly gives the Commission the authority and responsibility to evaluate these matters. Since the LECs are not

immune from the antitrust laws, adversely affected parties may also have recourse in the courts.

Witness Cicchetti's fourth case, where a LEC-provided competitive service does not bear its appropriate share of the firm's overhead costs, is associated with FCTA's concerns that, absent the Commission mandating a fully distributed cost methodology, LEC competitive services will get a free ride, to the detriment of monopoly ratepayers. We believe that the overheads to which witness Cicchetti referred are the LEC's joint and common costs, which are not reflected in incremental cost studies. The real issue thus is: How should rates for a mixture of competitive and monopoly services be set so as to recover in an equitable manner the LEC's total costs? This is clearly unrelated to cross-subsidization, although it is an extremely important issue to which the Commission devotes considerable efforts. One of this Commission's prime statutory directives is to establish just and reasonable rates.

Finally, witness Cicchetti's sixth example concerns a LEC providing certain services to its competitive operations that it will not provide to alternative providers. Again, we believe that these matters do not relate to cross-subsidization; rather, they tend to be associated with general policy questions regarding what actions the Commission should take to foster competition. Consequently, the appropriate action would depend upon the particular circumstances. In such matters, it is the function of the Commission to balance and resolve matters relating to the availability of monopoly services and inputs. In reaching decisions on such issues, the Commission has been directed by the Legislature to consider various factors, including encouraging competition in the telecommunications industry where it is deemed to be in the public interest.

This Commission is aware of FCTA's concerns regarding the potential for anticompetitive behavior to occur in the Florida telecommunications market, and the Commission will continue to identify such actions and provide appropriate remedies. With the expansion of competition into more sectors of the telephone market, the need for Commission oversight has increased as well.

However, we believe it is improper to interpret the cross-subsidization statute in so broad a sense that, conceivably, almost <u>any</u> business practice that adversely affects a party could be construed as "cross-subsidy." In addition to being improper, such

a broad interpretation is unnecessary. Various provisions of the statutes, including Sections 364.01(3)(d), 364.03, and 364.10, are sufficient to deal with any allegations of anticompetitive behavior.

We believe that cross-subsidization should be understood in terms of the economic definition, as a function of a service's price and cost. This Commission has determined herein that the incremental cost standard is the appropriate benchmark for detecting the presence or absence of cross-subsidy. Consequently, it follows that we believe that Section 364.3381 prohibits only a narrow range of actions: specifically, those instances where a LEC-provided competitive service is priced below its total incremental cost.

VI. EFFECTIVELY COMPETITIVE SERVICES

By Order No. PSC-93-0289-FOF-TL, issued February 23, 1993, in Docket Nos. 910590-TL and 920255-TL, this Commission determined that the legislature did not differentiate the meaning of "competitive," "effectively competitive," and "subject to effective competition." That Order is, at this time, subject to a Motion for Reconsideration. However, witness Cicchetti filed testimony on behalf of FCTA asserting exactly the same arguments put forth by FPTA in the above referenced dockets.

Centel, GTEFL, Southern Bell, United, and ATT-C assert that the terms "competitive," "subject to effective competition," and "effectively competitive" are used interchangeably in Chapter 364. These terms are not specifically defined in the statute, but a monopoly service is defined as one "for which there is no effective competition, either by fact or by operation of law."

FIXCA, FPTA, and FCTA all argue that the three terms are not synonymous. FPTA and FCTA both argue that the terms had distinct meanings and should be construed as separate terms when reading the statute. FCTA witness Cicchetti testified that the term "competitive" means a service experiencing some form of competition, "subject to effective competition" means having the potential to become effectively competitive, and "effective competition" means a service experiencing true and fair competition between two or more providers.

FCTA and FPTA argue that the LECs' claims are also contrary to the rules of statutory interpretation. FPTA and FCTA cited numerous examples of case law that supported two specific rules: 1) that every provision in a statute is there for a purpose; and 2) that each word in a statute must be given its plain and ordinary meaning. FPTA argues:

> If the Legislature had intended the terms to have the same meaning, it would have left the words "subject to" and "effectively" out of the statute altogether. See, Sumner v. Board of Psychological Examiners, 555 So. 2d 919, 921 (Fla. 1st DCA 1990). (FPTA brief at 15)

This argument is not persuasive. The argument is more compelling, by reversing it: if the Legislature had intended "effective competition" and "subject to effective competition" to have different meanings, it simply would have defined them separately in Section 364.02.

Witness Cicchetti also argued that the plain and ordinary meaning of the term "competitive" according to Webster's dictionary is one relating to a service offered by the LEC and at least one other provider.

We do not dispute the rules of statutory interpretation cited by FPTA and FCTA, but would note that other more compelling rules of statutory interpretation exist as well. For example, it is a well-accepted rule of interpretation that a statute is passed as a whole and not in sections; therefore, each part of the statute must be construed in connection with every other part to produce a harmonious whole. In addition, even apparently plain words may not convey the meaning the drafters intended to impart; it is only within the full context of the statute that a word can convey an idea. When interpreting a statute, it is generally unnecessary to look beyond the language of the statute itself to arrive at its meaning. However, when different readings are urged, the tribunal must look to the reasons for enactment and the purposes to be served by the statute so that it can be construed consistent with such purposes. A statute should not be read literally where such a reading would be contrary to its purposes. These rules of interpretation negate the rules invoked by FPTA.

Also, a statute must be construed so as to make sense as a whole. This rule was cited by Southern Bell in its brief. If the

plain and ordinary meaning of a word or phrase causes the sentence or statute to become illogical or nonsensical, an interpretation that allows the statute to make sense must be used.

Applying the rules of construction stated above, a simple analysis of Sections 364.02 and 364.338 makes it clear that the Legislature did not differentiate the meaning of "competitive," "effectively competitive," and "subject to effective competition." Section 364.02 provides definitions for the terms used in Chapter 364. None of the three terms is defined in this section. However, the term "monopoly service" is defined as "a telecommunications service for which there is no effective competition, either in fact or by operation of law." This, under a plain and ordinary interpretation, provides for only two types of services: monopoly services and effectively competitive services. No provision is made for a service that is potentially competitive.

The term "effectively competitive" is only used once in Section 364.338, and is sandwiched between two uses of the term "competitive" in the same provision. One could extrapolate that the interchangeable use of these two terms in one provision means that they are synonymous.

The term "subject to effective competition" is used three times in Sections 364.338(2) and (3). It is also interlaced with several uses of the term "competitive." For example, "the competitive service" is used several times in Section 364.338(3) to refer back to "a service provided by a local exchange telecommunications company is subject to effective competition ..." It is evident that the meanings of "competitive" and "subject to effective competition" in these provisions are identical.

In addition, we note that if witness Cicchetti's claim of separate meanings for the terms were true, the statute would make no sense. For example, Section 364.338(3)(a)2 reads, in part, that "[i]f the commission determines ... that a service ... is subject to effective competition, the commission may: ... require that the competitive service be provided pursuant to a fully separate subsidiary or affiliate." (emphasis added) If separate meanings are to be given in this sentence, the sentence simply no longer makes logical sense. What competitive service is being discussed? If it cannot be the one referred to as "subject to effective competition," which one is it?

Therefore, even though "effectively competitive" and "subject to effective competition" are used in separate provisions of the statute, they are inextricably interwoven through the repeated use of the term "competitive." This fact, coupled with the clear lack of definitions for any of the three terms in Section 364.02, leads us to conclude that all three terms have identical meanings when used in Sections 364.338 and 364.3381. FCTA has not offered any evidence that would persuade us to change in any way the determination this Commission made in Docket Nos. 910590-TL and 910255-TL.

VII. DETERMINATION THAT SERVICE IS EFFECTIVELY COMPETITIVE REQUIRED BEFORE PROVISIONS OF SECTION 364.3381 APPLY

ATT-C, Centel, GTEFL, Southern Bell, United and OPC all agreed that a determination must first be made that a service is effectively competitive before Section 364.3381 is applicable. FCTA, FPTA, FIXCA, and MCI all believe that no such determination is necessary. The parties arguments are a direct result of the positions taken on the distinction of the terms "effectively competitive," "subject to effective competition," and "competitive." The LECs and ATT-C maintained that since the three terms are synonymous, the only services mentioned in Section 364.3381 would be effectively competitive ones. Thus, they conclude that a determination that a service is effectively competitive must precede the actions proffered in Section 364.3381. OPC maintains that a determination about the existence of effective competition must precede the actions in Section 364.3381.

FIXCA, FPTA, and FCTA argue that since the terms have different meanings, no such determination need be made. Witness Cicchetti testified that since "competitive" is used in Section 364.3381, F.S. and "competitive" means any service provided by two or more providers, all such services would invoke the requirements of Section 364.3381. MCI agreed with FPTA's position; however it used its "building block" approach as its basis in its brief. MCI maintained that if the Commission properly implemented MCI's building block methodology, cross-subsidization would not occur. However, it presented no witnesses or testimony to substantiate this claim.

We agree that this issue is a direct result of the decision reached regarding the terms above. Sections 364.338 and 364.3381 are concerned primarily with services that are "competitive" and

"subject to effective competition." If these terms are synonymous with the term "effective competition," as we have determined herein, a plain and ordinary reading of Section 364.3381 tells us that this section deals solely with the determination and treatment of effectively competitive services. Accordingly, we find that the provisions of Section 364.3381 apply only after a determination is made, pursuant to Section 364.338, that a service is effectively competitive.

VIII. OTHER FORMS OF ANTICOMPETITIVE BEHAVIOR

The LECs maintained that existing antitrust laws and Commission policies and complaint processes are adequate provisions for controlling any anticompetitive behavior.

ATT-C, FCTA, FPTA, FIXCA, and OPC all argued that certain forms of anticompetitive behavior should be prohibited. FCTA witness Cicchetti's list was the most exhaustive, and included the issues and items raised by all of the other parties:

1) predatory pricing by LECs;
2) excessive costs transferred to monopoly ratepayers by the LEC paying excessive rates for some services;
3) discriminatory provision of service to competitors by LECs;
4) discriminatory charges for services to competitors by LECs;
5) inferior services provided to competitors by LECs; and
6) undue preference by LECs for LEC-provided services such as marketing CPE with equipment.

Witness Cicchetti's first example, predatory pricing, is cited in Section 364.338(1) as a practice this Commission should not tolerate. The other examples given by witness Cicchetti are certainly areas that this Commission should investigate in detail, but are not necessarily anticompetitive behaviors.

For example, situation 2 may be an anticompetitive act if the regulated LEC pays an excessive cost for an unregulated service from an affiliate. However, it would only be an anticompetitive act if the service were identical to one offered from another entity, yet priced higher.

Situation 3 could be anticompetitive if the LEC used a discriminatory policy in its provision of services to competitors. For example, if a LEC provided certain features and functions to its pay telephone instruments but did not make them available to non-LEC pay telephones, it could be an anticompetitive act. However, there also could be technical limitations, a substitutable product, or public policy considerations that make such a policy desirable.

Situation 4 could also be anticompetitive if a LEC used price discrimination to artificially inflate its competitors' costs by marking up features the competitors needed such as access lines. On the other hand, there could also be justifiable reasons of fairness to other similarly-situated industries, cost differentials, or other public policy goals that make price discrimination a desirable outcome (for example, residence versus business access lines).

The same alternatives could be argued, depending on circumstances, for each of witness Cicchetti's examples with the exception of predatory pricing, which should be avoided whenever encountered. Witness Cicchetti described these practices as forms of cross-subsidization. However, we have determined herein that these practices are not cross-subsidization, but may be anticompetitive acts, depending on individual circumstances. Without the facts of each case before us, the Commission should not be put in the position of making blanket judgments regarding anticompetitive behavior. Additionally, there was no evidence presented by any witness that any of these possible anticompetitive behaviors are occurring in this state by any LEC.

ATT-C's witness Guedel attempted to address this issue by recommending several pricing guidelines for use by LECs. He advocated the imputation of tariffed rates for services when determining price floors, and the unbundling of LEC services consistent with Open Network Architecture guidelines. We agree that witness Guedel's ideas have some merit. However, they are not the focus of this case. Witness Guedel's arguments are aimed at how the Commission should set prices for certain LEC services. But, cross-subsidization concerns whether, given a set of prices, they are compensatory.

We do recognize the potential for anticompetitive behavior given the LECs' position as a monopoly provider of access for many of its competitors. We also acknowledge that the activities

identified by witness Cicchetti could be determined as poor public policy by this Commission. However, there was no evidence presented in this docket that would indicate that any such behavior exists. Additionally, each case should be examined separately to determine if the practice is detrimental to ratepayers, or possibly serves a public policy goal.

Southern Bell's witness Denton argued that the Commission's complaint process is sufficient for controlling these instances. We agree. This Commission has conducted in the past and is currently conducting several investigations, regarding anticompetitive behavior in the pay telephone market, voice mail market, and others. Many of these investigations were a result of complaints filed by customers or competitors of the LECs.

IX. LEC REQUIREMENTS FOR COMPETITIVE SERVICES

We have defined cross-subsidy and have determined that once a service is found to be effectively competitive it is subject to the provisions of Section 364.3381. In addition, we must decide how to ensure that the requirements of Section 364.3381 are met.

A. When Services Should Be Tested to Meet Requirements of Section 364.3381

The positions of the various parties regarding this issue derive from their views as to which services are subject to the cross-subsidy restrictions, the proper cost standard to detect cross-subsidization, and whether cross-subsidy should be understood in a narrow or a broad sense.

Southern Bell and Centel contend that once the Commission has determined, pursuant to Section 364.338, that a service is effectively competitive, it should be tested for compliance with Section 364.3381. United and GTEFL assert that the appropriate times to test for compliance are when new services are first offered, and when a significant change in price is made for a service.

ATT-C believes that the Commission should ensure that the prices charged for LEC competitive services exceed an established price floor. Witness Guedel advocated the imputation of tariffed rates for services when determining those price floors, and that the price floors should be adjusted whenever the underlying tariff

rate changes. We do not believe that the issue of whether imputation should be required is relevant to the detection of cross-subsidy. Accordingly, ATT-C's proposed imputation requirement is neither required nor appropriate to implement Section 364.3381.

FCTA witness Cicchetti asserted that cost studies should be filed every four years by the LECS as part of their minimum filing requirements. FPTA believes that the LECs should provide cost support for all LEC competitive services now and whenever a rate change is requested.

A review of the record in this proceeding reveals three instances where cross-subsidy tests may be appropriate: when a service has been found to be effectively competitive; when a new service is being offered; and, when a major change in rates is proposed. Southern Bell witness Emmerson also noted that the Commission's normal complaint process is always available to the Commission or an affected party as a means to require a LEC to establish that a competitive service is not being priced below its incremental cost.

Thus, we hereby approve the following guidelines to ensure that cross-subsidization is not present:

1) Once a service has been found to be effectively competitive pursuant to Section 364.338, it is subject to the cross-subsidization requirements of Section 364.3381 and the LEC must file the required revenue and incremental cost support information.

2) The LECs shall file cost data with new tariff filings sufficient to confirm that the service is covering its incremental costs and thus that the service is not being cross-subsidized.

3) We will not require the LECs to submit information showing the absence of cross-subsidy for all rate changes, as proposed by FPTA, when they file their Modified Minimum Filing Requirements, or for major rate changes. This requirement would prove excessive and could place the LECs at a competitive disadvantage with respect to certain service offerings. Depending upon the form of regulatory oversight afforded the effectively competitive service, requiring the LEC to submit

> incremental cost support in these instances may impede the LEC's ability to react in a timely fashion to the pricing actions of its competitors. As noted by Southern Bell witness Emmerson, the complaint process affords a party the opportunity to ascertain if a service is compensatory, if concerns exist. Moreover, for a major rate change, no party is precluded from requesting the LEC to confirm that its proposed rates are subsidy-free. Consequently, the complaint process provides a sufficient safeguard to require additional cross-subsidy tests as circumstances warrant.

Finally, we note that this Commission will initiate rulemaking proceedings, if necessary, to facilitate implementation of the requirements of Sections 364.338 and 364.3381.

B. Accounting Requirements

FCTA, FIXCA and FPTA believe that accounting requirements are needed. It appears that this view derives from their position that the Commission should mandate a fully distributed allocation methodology that ties back to the books and records of the company, to segregate a LEC's costs between competitive and monopoly services. Such an embedded cost approach presumably would be analogous to the FCC's Cost Allocation Manual (CAM). In that case, accounting guidelines would be required to ensure that allocation procedures were implemented correctly. FCTA witness Cicchetti asserted that, absent the use of fully separate subsidiaries, a fully distributed cost methodology is necessary in order to prevent cross-subsidization of competitive services by monopoly services. Although FCTA contends that use of separate subsidiaries would be the optimal way to prevent cross-subsidization, they did not indicate under what conditions this option would be preferable. However, witness Cicchetti acknowledged that the LECs currently enjoy economies of scope and scale, and admitted that these economies would be lost if the Commission imposed a separate subsidiary requirement. We have determined herein that the fully distributed cost standard is not appropriate for the detection of cross-subsidization; consequently, we conclude that there is no need for accounting requirements to track embedded cost allocations.

The LECs are all opposed to the Commission imposing additional accounting requirements. They contend that cross-subsidization is an economic notion, involving the relationship between a service's

price and its incremental cost; detection and thus prevention of cross-subsidy merely requires performing a Total Incremental Cost (TIC) test for the service. Given the nature of cross-subsidy it is inappropriate to impose ongoing accounting requirements to prevent its occurrence. Further, witness Beauvais asserted that even if the Commission were to impose accounting requirements, the existing accounting systems are inadequate, because they do not and are unable to track the financial performance of individual services. To develop such a service or product oriented system would be a massive undertaking, and unless it was maintained as a dual accounting system, would require coordination with the FCC.

Given that prevention of cross-subsidization is the primary basis for imposing accounting requirements for services subject to Section 364.3381, we do not believe such an action is needed at this time. We have identified certain specific instances where the LECs would be required to demonstrate that their effectively competitive services are not being cross-subsidized by revenues from monopoly services. We find that these requirements will constitute adequate safeguards.

C. Ensuring that Requirements of 364.3381 Are Met Before Offering Services

With the exception of MCI, who took no position, and FIXCA, all non-LEC intervenors contend that the Commission should prohibit LECs from offering services subject to the provisions of Section 364.3381 if the LECs have not provided assurance that the requirements of Section 364.3381 have been met. FCTA witness Cicchetti states that the language in the statute is mandatory and requires that the Commission prohibit the LECs from offering competitive services before the requirements of Section 364.3381 have been met.

FIXCA asserts that the LECs are currently providing services that are subject to the provisions of Section 364.3381, but that instead of having these services withdrawn, the Commission should rapidly initiate investigations for the major LECs to establish allocation methodologies for the major service categories. We would note that FIXCA did not sponsor a witness in this proceeding, and no evidence was introduced at hearing that substantiates the claim that LECs are presently offering effectively competitive services.

The LECs state that the introduction of new services which might be subject to effective competition should not be hindered due to a Section 364.338 proceeding. United witness Poag asserted that the telecommunications marketplace is too dynamic to have any procedures in place which would delay a service offering until an effectively competitive determination was made. He testified that the Commission already has the appropriate means to require cost support for prices and that tariffs can be denied if they do not meet the test. Centel agrees that the marketplace is fast moving, and suggests that services be allowed to go into effect immediately, with a requirement that the LEC demonstrate the absence of cross-subsidies within one year of their introduction. GTEFL witness Beauvais testified that the LEC will only offer those services whose prices are greater than or equal to incremental costs and whose total incremental revenues are greater than or equal to total incremental costs plus causally related fixed or common costs. If a proposed service does not pass these tests, then it will not be offered to the public. Southern Bell witness Denton stated that the provisions of Section 364.3381 do not apply until after a Section 364.338 hearing and a finding of effective competition. After such a finding the Commission must give the LECs sufficient time to be in compliance with the requirements of Section 364.3381.

We believe that all new services should follow the normal course for tariff filings, whether the service has been determined to be effectively competitive or not. The LECs routinely submit incremental cost support with the bulk of their tariff filings, and they should continue this practice. If properly conducted, the LECs' cost support should be sufficient to determine if the proposed service is being cross-subsidized. We believe that prohibiting a LEC from introducing an effectively competitive service until the conclusion of a Section 364.338 proceeding could give an undue advantage to the LEC's competitors. If this restriction were imposed, the LEC's competitors could delay implementation merely by filing a complaint alleging that the new LEC service was subject to effective competition. Further, imposing such a procedural obstacle could subvert the Commission's desire to allow fair and equitable competition where it is in the public interest.

However, we shall not allow the LEC an overabundance of time to bring a service into compliance with Section 364.3381. Absent a specific date certain for compliance, the LEC could do harm to the competitive market by underpricing the service, while using the

Commission's procedures as a means to delay remedying the problem. We thus believe it is appropriate to establish a requirement as to when the LEC must demonstrate that its effectively competitive service is in compliance with Section 364.3381. For a new service offering, this also should give the LEC an added incentive to submit all relevant information when initially filing a tariff, to ensure that the requirements of Section 364.3381 have been met.

Therefore, this Commission will not prohibit LECs from offering services subject to the provisions of Section 364.3381, before ensuring that the requirements of Section 364.3381 have been met. However, once a LEC service is found by this Commission to be effectively competitive and a final order is issued, within 90 days of the order the LEC shall file incremental cost data demonstrating that the service meets the requirements of Section 364.3381. We believe that this is an appropriate requirement, in that it does not restrict the LEC from introducing new services and it provides for a reasonable period for the LEC to bring its effectively competitive service into compliance with the statute.

D. Application of Cross-Subsidization Restrictions

The issue has been raised as to whether or not the language of the statute implies that cross subsidy is acceptable or appropriate in some cases. MCI, Southern Bell and OPC did not take positions on this issue.

The parties who took positions on this issue are in general agreement that the cross-subsidization restrictions only apply to subsidization of competitive services by LEC monopoly services. ATT-C witness Guedel did not believe that it would ever be acceptable for monopoly services to subsidize competitive services. However, he stated that the statute does not specifically address other cases, such as competitive services subsidizing other competitive services. GTEFL's witness Beauvais also asserted that the statute only applies to services that have been determined to be effectively competitive.

United witness Poag maintained that the intent of the statute is not to judge whether a cross-subsidy is appropriate or acceptable, but only to ensure that services determined by the Commission to be effectively competitive are not being subsidized by monopoly services. FCTA's witness Cicchetti stated that the language in Chapter 364 implies that cross-subsidy may be acceptable in instances to allow the Commission's universal service

goals to be met, but that the determination must be done on a case-by-case basis.

We agree with the parties and acknowledge that the statute only prohibits cross-subsidization of LEC effectively competitive services by LEC monopoly services, but is silent as to whether or not cross-subsidization is appropriate or acceptable in any other cases.

E. Further Requirements

Finally, those parties who took a position, stated that no further action by the Commission on this matter is necessary at this time. However, FCTA states that Section 364.338 allows the Commission to exempt a service subject to effective competition from certain statutory requirements and to impose other constraints. In particular, FCTA notes that Section 364.338(3)(a) allows the Commission to require a LEC to offer an effectively competitive in a fully separate subsidiary. Witness Cicchetti asserted that use of a fully separate subsidiary would be a more effective means to guard against economic cross-subsidy and anticompetitive behavior than imposition of accounting safeguards.

We could impose a separate subsidiary requirement for a LEC competitive service, which may prevent cross-subsidization. However, as acknowledged by FCTA witness Cicchetti, requiring a LEC to provide an effectively competitive service in a separate subsidiary could result in the loss of any economies of scale and scope that may exist. We believe that the record in this proceeding is insufficient to conclude under what conditions a fully separate subsidiary may be the most appropriate solution. Accordingly, we find that whether or not it is appropriate to impose a separate subsidiary requirement should be considered on a case-by-case basis in the Section 364.338 proceeding wherein a service is determined to be subject to effective competition. Thus, no further restrictions shall be imposed at this time.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that each and every finding set forth herein is approved in every respect. It is further

ORDERED that the term cross-subsidization, as contained in Section 364.3381, Florida Statutes, shall be defined as the pricing

of competitive services below their incremental costs, with the resulting revenue shortfall recovered through the rates for monopoly services. It is further

ORDERED that the appropriate standard for detecting cross-subsidization is whether a service is priced below its total incremental cost. It is further

ORDERED that there is no distinction between the terms "effectively competitive," "subject to effective competition," and "competitive," as used in Sections 364.338 and 364.3381. It is further

ORDERED that the application of the provisions of Section 364.3381, first requires a determination that a service is effectively competitive, pursuant to the provisions of Section 364.338. It is further

ORDERED that the appropriate measures to ensure compliance with Section 364.3381 are set forth in the body of this Order. It is further

ORDERED that this docket shall be closed.

By ORDER of the Florida Public Service Commission this 12th day of July, 1993.

STEVE TRIBBLE, Director
Division of Records and Reporting

(S E A L)

PAK

by: Kay Flynn
Chief, Bureau of Records

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Civil Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.