

FLORIDA PUBLIC SERVICE COMMISSION  
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MEMORANDUM

September 11, 1997

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF COMMUNICATIONS (AUDU, CORDIANO, KING, SHELFER) *TD*  
DIVISION OF LEGAL SERVICES (COX, BROWN) *m3jw/pc*  
DIVISION OF AUDITING AND FINANCE (BOYER, WRIGHT) *AB DM*

RE: DOCKET NO. 970281-TL - ESTABLISHMENT OF INTRASTATE IMPLEMENTATION REQUIREMENTS GOVERNING FEDERALLY MANDATED DEREGULATION OF LOCAL EXCHANGE COMPANY PAYPHONES.

DOCKET NO. 970173-TP - PETITION BY MCI TELECOMMUNICATIONS CORPORATION FOR AN ORDER REQUIRING BELLSOUTH TELECOMMUNICATIONS, INC. TO REMOVE ITS DEREGULATED PAYPHONE INVESTMENTS AND ASSOCIATED EXPENSES FROM ITS INTRASTATE OPERATIONS AND REDUCE THE CARRIER COMMON LINE RATE ELEMENT OF ITS INTRASTATE SWITCHED ACCESS CHARGES BY APPROXIMATELY \$36.5 MILLION AS REQUIRED BY THE FEDERAL TELECOMMUNICATIONS ACT OF 1996.

DOCKET NO. 970173-TP - PETITION BY MCI TELECOMMUNICATIONS CORPORATION FOR AN ORDER REQUIRING GTE FLORIDA INCORPORATED TO REMOVE ITS DEREGULATED PAYPHONE INVESTMENTS AND ASSOCIATED EXPENSES FROM ITS INTRASTATE OPERATIONS AND REDUCE CARRIER COMMON LINE RATE ELEMENT OF ITS INTRASTATE SWITCHED ACCESS CHARGES BY APPROXIMATELY \$9.6 MILLION AS REQUIRED BY THE FEDERAL TELECOMMUNICATIONS ACT OF 1996.

AGENDA: SEPTEMBER 23, 1997 AGENDA - POST HEARING DECISION - PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\CMU\WP\970281TL.RCM

CASE BACKGROUND

On September 20, 1996, the Federal Communications Commission (FCC) issued its First Report and Order, Order No. 96-388, CC Docket No. 96-128, implementing the Telecommunications Act of 1996,

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47 U.S.C. § 276(b)(1)(B) (the Act). On November 8, 1996, the FCC issued its Order on Reconsideration, Order No. 96-439, on the same issues presented in Order No. 96-388. As the FCC indicated in Order No. 96-388, Section 276(b)(1)(B) of the Act requires that incumbent local exchange carriers (LECs) remove from their intrastate rates charges that recover the costs of their pay telephones. Further, FCC Order No. 96-388 requires that the revised intrastate rates must be effective no later than April 15, 1997. Also by this date, FCC Order No. 96-388 directs the states to determine the intrastate rate elements that must be reduced to accomplish this elimination of any intrastate subsidies. FCC Order No. 96-388, ¶ 186.

Paragraph 145 of FCC Order No. 96-388 requires that all LECs deregulate their pay telephone operations by separating the pay telephone operation from the local exchange carrier. The LEC can accomplish this separation with either of two options: structural safeguards (separate subsidiary) or non-structural safeguards (accounting separations).

On February 7, 1997, MCI Telecommunications Corporation (MCI) filed a petition requesting that we order BellSouth Telecommunications Inc. (BellSouth) to remove its deregulated payphone investment and associated expenses from its intrastate operations and reduce its intrastate Common Carrier Line (CCL) charge by 36.5 million dollars (Docket No. 970172-TP). On the same date, MCI filed a similar petition for GTE Florida Incorporated (GTEFL) to reduce its intrastate CCL charge by 9.6 million dollars (Docket No. 970173-TP). On February 26, 1997, BellSouth filed a revised tariff (T-97-156). On February 27, 1997, BellSouth and GTEFL responded to MCI's petitions. MCI subsequently filed a response to GTEFL's answer to the MCI petition and particularly GTEFL's motion to dismiss.

On March 31, 1997, the Commission issued Proposed Agency Action (PAA) Order No. PSC-97-0358-FOF-TP denying both of MCI's petitions. This Order also established several generic implementation requirements that apply to all LECs (Docket No. 970281-TL). The implementation requirements dealt with the LEC pay telephone operation separation and the removal of the intrastate pay telephone subsidy. The Order required that LEC tariff changes regarding the removal of the intrastate subsidy should be filed and become effective by April 15, 1997.

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On April 21, 1997, MCI filed a Petition on Proposed Agency Action, protesting the Commission's PAA Order with regard to all three dockets: Docket Nos. 970172-TP, 970173-TP, and 970281-TL. MCI's protest requested a hearing to determine the amount of rate reductions required to eliminate the intrastate pay telephone subsidies for BellSouth and GTEFL, and to determine the specific rate elements to which such reductions should be applied.

On May 15, 1997, BellSouth filed a Response to MCI's Petition and Motion for Expedited Resolution. On May 16, 1997, Sprint-Florida Incorporated (Sprint-Florida) filed its Response to MCI's Petition.

MCI's protest also requested that the Commission suspend the tariff filed by BellSouth to implement its estimate of the required rate reduction pending resolution of the protest. MCI requested that the Commission also require BellSouth to hold the amount of such reductions subject to disposition by further order of the Commission. On June 10, 1997, the Commission voted to deny these requests.

On June 19, 1997, the Prehearing Officer issued Order No. PSC-97-0721-PCO-TP establishing the procedural schedule and issues to be addressed at the hearing. The Commission held the hearing on August 7, 1997. At the commencement of the hearing the Commission approved several stipulations of the parties as follows.

STIPULATION 1: With respect to the amount of intrastate payphone subsidy to be eliminated by each local exchange company, the Commission approved the following stipulated amounts:

Vista-United	\$234,900
ALLTEL	\$ 66,600
St. Joseph	\$ 25,740
Quincy	\$ 10,980
Gulf	\$ 9,900
Northeast	\$ 7,020
Indiantown	\$ 5,760
Frontier	\$ 1,980
Floral	\$ 1,080
GTE	\$ 0

With the exception of Quincy and Indiantown, these subsidy amounts will be eliminated by the small LECs via intrastate switched access rate reductions effective April 15, 1997.

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Indiantown and Quincy's subsidy will be eliminated in accordance with the Commission's decision on Issue 3 in this proceeding.

To the extent that a small LEC is required to reduce its switched access rates by 5% on or before October 1, 1997, the rate reductions made to eliminate the subsidy in this docket will be considered to be a part of, rather than in addition to, the 5% rate reductions required by the statute.

If the small LEC is required to reduce intrastate switched access rates by 5% on or before October 1, 1997, the tariff changes necessary to make the required rate reductions to eliminate the subsidy in this docket shall be made in accordance with the time schedule in Order No. PSC-97-0604-FOF-TP. Otherwise, the tariff filings shall be made no later than 30 days after the issuance of the final order in this case.

STIPULATION 2: To the extent that a small LEC is required to reduce its switched access rates by 5% on or before October 1, 1997, the rate reductions made to eliminate the subsidy in this docket will be considered to be a part of, rather than in addition to, the 5% rate reductions required by the statute.

If the small LEC is required to reduce intrastate switched access rates by 5% on or before October 1, 1997, the tariff changes necessary to make the required rate reductions to eliminate the subsidy in this docket shall be made in accordance with the time schedule in Order No. PSC-97-0604-FOF-TP. Otherwise, the tariff filings shall be made no later than 30 days after the issuance of the final order in this case.

STIPULATION 3: The amount of the intrastate payphone subsidy for Sprint-Florida is zero. Sprint-Florida will not revise its previous tariff filing reducing MABC intraLATA access charges, based on a preliminary calculation showing a subsidy of approximately \$1.5 million. Since there is no subsidy, the Commission will not require Sprint-Florida to make any rate reductions through this proceeding.

STIPULATION 4: If the Commission makes the same decision that it did in Proposed Agency Action Order No. PSC-97-0358-FOF-TP in Docket Nos. 970172-TP, 970173-TP, and 970281-TL, the revised tariff filings made by BellSouth shall remain effective as filed. If the Commission makes a different decision in this docket and a different rate reduction is required by the Commission, the revised tariff filings for the removal of the subsidy should be made within 30 days of the issuance of the final order in this docket. This

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stipulation does not apply to the nine small LECs who reached their own separate stipulation. (See Stipulation 1)

STIPULATION 5: If the Commission makes the same decision that it did in Proposed Agency Action Order No. PSC-97-0358-FOF-TP in Docket Nos. 970172-TP, 970173-TP, and 970281-TL, the effective date of BellSouth's tariff filed in compliance with this Order shall remain as filed. If the Commission makes a different decision and a rate reduction is required, the effective date of the revised tariff with the appropriate rate reduction would be April 15, 1997, per FCC Order No. 96-388. This stipulation does not apply to the nine small LECs who reached their own separate stipulation. (See Stipulation 1)

Staff's recommendations on the issues remaining for consideration are presented below.

#### DISCUSSION OF ISSUES

ISSUE 1: What is the amount of intrastate payphone subsidy, if any, that needs to be eliminated by each local exchange company pursuant to Section 276(B)(1)(b) of the Telecommunications Act of 1996?

RECOMMENDATION: The subsidy amount for BellSouth is \$7.543 million. (BOYER)

#### POSITION OF PARTIES:

AT&T: The subsidy amount for BellSouth is no less than \$6,501,000.

BELLSOUTH: The amount of intrastate payphone subsidy of BellSouth's rates is \$6.501 million.

FPTA: The commission has approved stipulations resolving this issue for all companies except BellSouth. For BellSouth, the amount of the subsidy is \$7,502,000.

MCI: According to BellSouth's study, the amount of the intrastate payphone subsidy in BellSouth's rates is \$6,501,000. The amount of the subsidy would be \$7,502,000 if BellSouth had calculated set expenses and line expense on a consistent basis.



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**STAFF ANALYSIS:** In FCC Order No. 96-388, the FCC required "incumbent LECs to remove from their intrastate rates any charges that recover the costs of payphones." (Order 96-388, ¶186) These payphones are those which are owned by the LEC. The Order also required that price cap LECs develop their interstate subsidy calculations based upon their embedded 1995 Automated Report Management Information System (ARMIS) data. (Order 96-388, ¶185) In Order No. PSC-97-0358-FOF-TP, the FPSC also required LECs to use 1995 data when calculating their subsidies, to be consistent with the data used by the FCC, and because it was the most current data available when this docket was established. On February 26, 1997, attached to its tariff filing number T-97-156 (EXH 2), BellSouth submitted a copy of its \$6.501 million subsidy calculation.

BellSouth's subsidy calculation includes retail payphone revenues and subtracts the expenses associated with the payphone sets, or the payphone set component, and the expenses associated with the payphone access lines, or the payphone line component. The payphone set component was estimated from BellSouth's 1995 ARMIS Report, filed with the FCC. (TR 69) The payphone line component, per BellSouth witness Lohman, was estimated from a special SmartLine service cost study. (TR 66) SmartLine service provides the features and functions of the payphone. The return BellSouth actually earned on its payphone operations of -9.72% was compared to the 11.25% rate of return, which is the rate used to calculate the return component included in the ARMIS data. The \$6.501 million difference between the two rates of return was the amount BellSouth estimated as its subsidy. (EXH 2)

Staff believes that, for the most part, the subsidy calculation is appropriate. However, for two reasons, staff disagrees with BellSouth's estimation of its line expense component. First, witness Lohman testified that the special cost study was a SmartLine service incremental cost study, based on 1993, which was brought forward to a 1995 basis by applying various factors. (TR 66-67) BellSouth had to perform two steps to get from the 1993 study amount to the amount it used in its subsidy calculation: (1) transition the study from an incremental cost study to an embedded cost study; and (2) transition the 1993 actual amounts to 1995 estimated amounts. Witness Lohman stated that he believes the special cost study is more accurate because it is a Florida-specific study of the cost of a SmartLine. (TR 69) Staff believes that this estimated line cost is not as accurate as the actual line cost obtained from BellSouth's 1995 ARMIS report.

Second, using different methodologies for estimating the payphone set expense and the line expense could result in an incorrect payphone set expense amount. To determine the set

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expense, BellSouth split the total payphone operations expense and investment shown in the ARMIS report between payphone sets and lines. (TR 73) BellSouth used the direct investment for sets and lines from the ARMIS report to develop "direct percentage" allocators. Indirect expenses, such as corporate, marketing, and general support, were then divided between set and line based on those direct percentage allocators. (EXH 2) In this calculation, the amount of the line investment from the ARMIS report, used to develop the indirect expense allocations, directly affects the amount of set expense that results. Therefore, substituting a different line investment amount, such as that from BellSouth's SmartLine cost study, would result in a different amount of indirect expense being allocated to the set component compared to what is included in BellSouth's subsidy calculation. (EXH 2)

For two reasons, staff believes that BellSouth's subsidy calculation should include the line component calculated from its ARMIS report. First, the line and set expense amounts are more consistent when they are based upon the same source, the ARMIS report. As stated above, using one source for the actual 1995 data is more reliable and accurate than combining a portion of the ARMIS report total with an estimated 1995 cost study total. (EXH 2)

Second, the FCC used BellSouth's 1995 embedded cost ARMIS data to calculate the company's interstate payphone set expense. (EXH 2) Staff believes that it is appropriate to use the same kind of ARMIS data for the line expense component of the subsidy calculation. We agree with Mr. Lohman that the appropriate way to calculate the subsidy is on an embedded cost basis. (TR 79)

As expected, using a special cost study to estimate BellSouth's line expense, instead of the amounts taken from the ARMIS report, creates a difference in the resulting line expense amounts and, subsequently, the subsidy calculation. Witness Lohman agreed that the subsidy would be approximately \$1 million higher had the line amounts from BellSouth's ARMIS report been used. (TR 76-77) The following is Staff's calculation of the additional subsidy amount using the line expense and plant developed in BellSouth's allocation of its ARMIS report. (EXH 2)

Additional BellSouth Payphone Subsidy Calculation			
		Amount (Thousands)	Source (Exhibit #2)
A	Access Line Plant in Service - Intrastate	\$39,843	Page 22 of 27
B	Access Line Inventories - Intrastate	362	Page 22 of 27
C	Access Line Accumulated Depreciation - Intrastate	(17,930)	Page 22 of 27
D	Access Line Deferred Taxes - Intrastate	(3,359)	Page 22 of 27
E	Access Line Average Net Investment - Intrastate (Lines A, B, C & D)	\$18,916	
F	Rate of Return	11.25%	
G	Return on Access Line Investment (Line E x Line F)	\$2,128	
H	Access Line Interest Expense - Intrastate	588	Page 17 of 27
I	(Line G - Line H)	\$1,540	
J	Gross Up Factor	+ 61.43%	Page 12 of 27
K	Access Line Revenue Requirement - Intrastate (Line I + Line J)	\$2,507	
L	Composite Tax Rate	x 38.575%	Page 12 of 27
M	Income Tax (Line K x Line L)	\$942	
N	Access Line Return Component - Intrastate (Line G + Line M)	\$3,070	
O	Access Line Expense - Intrastate	12,775	Page 17 of 27
P	Total Access Line Expense - Intrastate (Line N + Line O)	\$15,845	
Q	Company Reported Access Line Expense	14,803	Page 16 of 27
R	Additional Access Line Expense and Subsidy (Line P - Line Q)	\$1,042	

Therefore, it is Staff's recommendation that BellSouth's subsidy is \$7.543 million, the \$6.501 from BellSouth's original filing plus the additional \$1.042 million.



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**ISSUE 2:** If an intrastate payphone subsidy is identified in Issue 1, do the FCC's Payphone Reclassification Orders require the Florida Public Service Commission to specify which rate element(s) should be reduced to eliminate such subsidy?

**RECOMMENDATION:** Yes, the FCC's Orders require the Commission to specify which rate element(s) should be reduced to eliminate any subsidy identified in Issue 1.

**POSITION OF PARTIES:**

**AT&T:** Yes, The FCC has delegated to the state commissions the responsibility to determine that payphone costs and subsidies have been removed from intrastate rates. The Commission's determination must logically specify the rate being reduced to remove the subsidy.

**BELLSOUTH:** The FCC's Orders state that the subsidy must be removed from intrastate rates. This Commission has authority under the Orders to determine what elements should be reduced in order to eliminate the subsidy. The Commission has exercised that authority by reducing BellSouth's hunting charges.

**FTPA:** Yes, the Commission is required to specify which rate element(s) must be reduced to eliminate any subsidies identified in Issue 1.

**MCI:** Yes.

**STAFF ANALYSIS:** All of the parties, with the exception of BellSouth and those parties who reached separate stipulations, agree that the FCC's Payphone Reclassification Orders require the Commission to specify which rate element(s) must be reduced to eliminate any intrastate subsidy that may exist. Those parties believe that the Commission failed to comply with the FCC's Orders in its earlier decision, Order No. PSC-97-0358-FOF-TP.

BellSouth contends that the real dispute on this issue is not whether the Commission had an obligation under the FCC's Orders, but whether the Commission fulfilled that obligation. (BST BR p.4) BellSouth believes that the Commission did comply with the FCC's Orders by issuing an order that allowed BellSouth's tariff reducing hunting charges to go into effect, while at the same time rejecting specific tariff elements recommended by its staff. (BST BR p.5, Lohman TR p.25-27) Further, BellSouth argues that Paragraph 183 of

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FCC Order 96-388, deals only with the interstate jurisdiction. Finally, BellSouth contends that the Commission itself concluded that it had complied with the FCC's Orders by allowing BellSouth (and all ILECs) to choose the element that should be reduced to eliminate the subsidy. (BST BR p.5)

AT&T disagrees with BellSouth's argument. AT&T contends that the intent of Paragraph 186 of FCC Order 96-388 is "abundantly clear". AT&T argues that the Commission's FCC-mandated review must include more than simply determining that the subsidy has been eliminated. AT&T believes that this section of the FCC Order requires the Commission to affirmatively determine which rate elements should be reduced. (AT&T BR p.3)

MCI also believes that the Commission still needs to make a determination of the specific rate element(s) for reduction. (MCI BR p.3, Reid TR p.151-152) MCI adds that specifying a limited menu of rate elements to be reduced would also be non-compliant with the FCC's Orders. MCI argues that the only way a menu approach could be compliant is if the Commission removed all discretion from BellSouth by specifying the portion of the payphone subsidy to be removed from each rate element identified for reduction. (MCI BR p.4)

The FPTA agrees with AT&T and MCI. Further, the FPTA asserts that no party really disagrees with the position that the Commission must specify the rate elements for reduction, including BellSouth. (FPTA BR p.3-4)

Section 271(b)(1)(A) and (B) of the Telecommunications Act of 1996 states:

(1) CONTENTS OF REGULATIONS.- In order to promote competition among payphone serviceproviders and promote the widespread deployment of payphone services to the benefit of the general public, within 9 months after the date of enactment of the Telecommunications Act of 1996, the Commission (FCC) shall take all actions necessary (including any reconsideration) to prescribe regulations that

(A) establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed

intrastate and interstate call using their payphone, except that emergency calls and telecommunications service relay calls for hearing disabled individuals shall not be subject to such compensation;

(B) *discontinue* the intrastate and interstate carrier access charge payphone service elements and payments in effect on such date of enactment, and all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues in favor of a compensation plan as specified in subparagraph (A); (emphasis added)

The FCC established the requirements for removal of the intrastate payphone subsidy as required by this provision of the Act in FCC Order 96-388 in CC Docket Nos. 96-128 and 91-35, issued September 20, 1996. Specifically, Paragraph 186 states as follows:

We require, pursuant to the mandate of Section 276(b)(1)(b), incumbent LECs to remove from their intrastate rates any charges that recover the costs of payphones. Revised tariffs must be effective no later than April 15, 1997. Parties did not submit state-specific information regarding the intrastate rate elements that recover payphone costs. States must determine the intrastate rate elements that must be removed to eliminate any intrastate subsidies within this time frame. (Emphasis added)

The FCC's Order requires the states to "determine" which intrastate elements must be removed to eliminate any intrastate subsidies. Taken literally, "determine" means to set boundaries or to limit. "Determine" also means to fix authoritatively or conclusively. Staff believes that by any definition of "determine", it is reasonable to conclude that the Commission must take some affirmative, conclusive action to decide what intrastate rate elements should be reduced to remove the subsidy.

The question then becomes whether the Commission's earlier decision in Order No. PSC-97-0358-FOF-TP, was a sufficient "determination" as required by Paragraph 186 of FCC Order 96-388. Does the FCC's requirement to "determine" the rate elements to be

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reduced mean that the Commission must "specify" particular rate elements? In Order No. PSC-97-0358-FOF-TP, the Commission stated:

Upon consideration, we find that a LEC must make rate reductions to the extent necessary to eliminate any intrastate payphone subsidy. We will not specify particular services or elements where LECs may make reductions. The LEC should have discretion regarding which rate elements are reduced and need only demonstrate via a price-out that the rate reduction eliminates the subsidy.

By placing the determination of what intrastate elements to reduce in the hands of the LECs, the Commission has allowed the LECs complete discretion. Thus, in effect, the LECs have made the FCC-required determination, and the Commission has not. Staff recommends that the Commission should specify which rate element(s) should be reduced to eliminate any subsidy identified in Issue 1. Staff believes that at a minimum the Commission should identify one or more intrastate rate elements that, based on the record in this proceeding, reasonably warrant reduction to remove the intrastate subsidy. While we do not believe that the Commission must remove all discretion from the LECs as MCI suggests, we do believe that the Commission's determination should provide some reasonable constraint on the LECs' discretion to choose the rate elements to be reduced.

ISSUE 3: If an intrastate payphone subsidy is identified in Issue 1, what is the appropriate rate element(s) to be reduced to eliminate such subsidy.

RECOMMENDATION: If Issue 2 is approved, the Commission should specify that access charges, intrastate toll, and operator services provide revenue streams that can flow into a payphone operation, and rates for one or more of these services should be reduced to remove the intrastate subsidy. If the Commission denies staff's recommendation in Issue 2, the Commission should allow the ILECs the discretion to reduce any rate element(s) to eliminate the intrastate payphone subsidy. In any event, the ILECs should

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demonstrate in their tariff filings, via a price-out, that this revenue reduction eliminates the subsidy. (AUDU)

**POSITION OF PARTIES:**

**BELLSOUTH:** The business hunting charge is the appropriate element to be reduced to eliminate BellSouth's payphone subsidy.

**PT&T:** All identifiable revenues should be used to reduce switched access charges - specifically to reduce the Carrier Common Line charge. Access charges remain significantly over cost and are not likely to be influenced favorably by competition in the near term.

**MCI:** The carrier common line (CCL) charge is the appropriate rate element to be reduced to eliminate any payphone subsidy.

**FPTA:** The Commission should reduce the rates that LECs charge PSPs to cost-based levels.

**STAFF ANALYSIS:** Section 276(a)(1) states that any Bell operating company (BOC) that provides payphone services shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations. In addition, Section 276(b)(1)(B) states that a BOC shall discontinue all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues. Further, the FCC Order requires LECs to remove from their intrastate rates any charges that recover the costs of payphones, and it also requires that the states must determine the intrastate rate elements that must be reduced to eliminate any intrastate subsidies. (FCC Order No. 96-388, paragraph 186)

In enacting the Telecommunications Act of 1996, Congress explicitly intended to open up the telecommunications industry for effective local competition. The reclassification of payphones is one step toward the realization of this goal.

BellSouth's witness Lohman testifies that with Section 276(b)(1)(B) Congress intended to promote competition among payphone providers and encourage widespread deployment of payphone service to the benefit of the general public. (TR 54) He also states that the FCC Order gave the states the authority to determine which rate elements should be removed or reduced in order to remove the intrastate subsidy. (TR 36) Witness Lohman further argues that the Commission met this requirement as memorialized in Order No. PSC-97-0358-FOF-TP, which reads:



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Upon consideration, we find that a LEC must make rate reductions to the extent necessary to eliminate any intrastate payphone subsidy. We will not specify particular services or elements where LECs may make rate reductions. The LEC should have discretion regarding which tariff elements are reduced and need only demonstrate via a price-out that the revenue reduction eliminates the subsidy. (Order at 6).

Accordingly, BellSouth reduced its hunting charges by \$6.5 million. (TR 37)

MCI's witness Reid agrees that the FCC Order requires the Commission to determine which rate element should be reduced to eliminate any intrastate payphone subsidy. (TR 149) However, witness Reid disagrees with BellSouth that the Commission met this requirement, since the Commission did not specify the rate element(s) that the LECs should reduce in order to eliminate this subsidy. Witness Reid asserts that the Commission's decision to allow the LECs the discretion to select the rate element(s) is in direct contradiction of the FCC Order's "must" requirement. Hence, witness Reid asserts that the Commission has not met this FCC requirement. (TR 150)

BellSouth's witness Lohman argues that the selection of hunting charges was a choice that directly benefits end user customers, as well as responding to repeated customer requests for rate relief. (TR 25) Witness Lohman further argues that it's time for another group of customers to benefit from a reduction, and states: "... we believe the hunting charge is the most appropriate place to put it". Witness Lohman contends that access rates have been reduced substantially in the last three years, and asserts that of the \$224 million reduction required by the BellSouth Settlement, \$183 million has gone to access. (TR 37) Witness Lohman did concede that the Commission had determined that it was appropriate to use those dollars to reduce access charges. (TR 40)

BellSouth's witness Lohman argues that the Commission's decision to approve BellSouth's reduction in hunting rates in order to eliminate the intrastate payphone subsidy recognized that the subsidies cannot be traced to any particular service. The witness further argues that the Commission had the right to reduce any intrastate rate element it deemed appropriate. (TR 35)

AT&T's witness Guedel agrees that there is no direct mapping between subsidies or excess contribution produced by one service to a service that may receive a subsidy to the extent such services

are priced below cost today. While AT&T recognized the lack of a direct mapping, witness Guedel contends that this was not the basis for AT&T's position that the CCL is the appropriate rate element to be adjusted. (Guedel, TR 117) Witness Guedel contends that AT&T bases its position on the fact that such a reduction should not be targeted toward a service that BellSouth would reduce anyway in order to meet competition, but should be targeted toward a service that is not driven by competition, such as switched access charges. (Guedel, TR 120) MCI's witness Reid also agrees that there is apparently no way of directly tracing which rate elements provide some subsidy and which ones do not. (Reid, TR 152)

AT&T's witness Guedel testifies that AT&T does not object to BellSouth reducing its hunting rates; however, he argues that AT&T does not believe that the reduction in hunting charges represents the appropriate disposition of the available subsidy. Instead, witness Guedel argues that the Commission should utilize the subsidy dollars to reduce switched access charges, specifically, the carrier common line charge. (TR 100-101) Witness Guedel enumerated six points that the Commission should consider in implementing this reduction. These six points are:

1. Access charges are priced significantly above cost;
2. The mark-up on switched access charges is significantly higher than the mark-up BellSouth enjoys on any other major revenue producing service that BellSouth offers;
3. The incremental cost incurred in providing the CCL charge is zero;
4. Switched access has traditionally been priced high in an effort to keep other rates low; this was not the case with hunting charges or other local service offerings;
5. As a price-cap LEC, BellSouth has sufficient opportunity to reduce end user rates to meet potential competitive markets; and
6. Because of the price-cap status of BellSouth, this reduction may be one of the last opportunities that this Commission may have in moving access charges closer to cost. (TR 101-102)

BellSouth's witness Lohman agrees that it is common understanding that the CCL is priced above cost. Witness Lohman argues that hunting, vertical services, operator services, and intrastate toll are similarly priced above cost and therefore are providing contributions. (TR 48) Witness Lohman asserts that

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hunting has been identified as providing a significant contribution above cost, similar to access charges. (TR 49)

MCI's witness Reid contends that BellSouth's CCL rates provide substantial contribution to BellSouth's telephone operations in Florida. MCI's witness further asserts that payphone service is one of the services that requires this contribution. (TR 146, 152) Witness Reid argues that in deciding which rate element(s) must be reduced, one must consider the relationship of the targeted rate element(s) to payphones, whether or not the targeted rate element(s) is providing a contribution, and whether or not the targeted rate element(s) is favorably affected by competitive pressure. (TR 159)

AT&T's witness Guedel argues that the ILECs are the sole provider of switched access services; and thus, their prices have not been subject to competition at this point in time. Witness Guedel further contends that regardless of the arrangements, terminating access charges will still not be subject to competitive forces, since the LEC who has the access line sets the terminating access charges. The witness also concludes that any ALEC providing local service has a monopoly on that terminating access because nobody else could provide this to the ALEC's local customers. The witness concludes that the price of hunting will be subject to competition sooner than the price of access. (TR 103, 138)

MCI's witness Reid agrees with AT&T that switched access receives little competitive pressure. (Reid, TR 159) BellSouth's witness Lohman did not agree with or refute AT&T and MCI's assertion that switched access is less subject to competitive pressure. (Lohman, TR 39-40)

AT&T's witness Guedel argues that while switched access, intrastate toll and operator services are not really associated with payphone service or the payphone itself, these are services that can be purchased or accessed through a payphone instrument. (TR 125) Witness Guedel contends that there are five major revenue producing services that BellSouth has: single line residence service, single line business, switched access service, LEC toll service, and possibly special access/private line. While witness Guedel could not ascertain if hunting services are in this category, nonetheless, witness Guedel asserts that the mark-up in hunting services will be less than the mark-up CCL provides. (TR 132-133)

MCI's witness Reid argues that intrastate toll, operator charges and switched access all have some linkage to payphones. Witness Reid contends that hunting charges have no basis or

connection to the subsidy presently being provided to BellSouth's payphone operations in Florida. MCI's witness further argues that the action of lowering hunting charges will only serve to secure BellSouth's existing business customers and further help BellSouth to acquire business customers in the future. (Reid, TR 147) Witness Reid asserts that only rate elements that have a reasonable relationship to BellSouth's payphone operations should be used to effect the removal of the payphone subsidy. (Reid, TR 147) Also, BellSouth's witness Lohman agrees that hunting, vertical services, operator services, and intrastate toll are similarly priced above cost and therefore are providing contributions. Witness Lohman asserts that hunting has been identified as providing a significant contribution above cost, similar to access charges. (Lohman, TR 48-49)

Staff believes that the FCC Order could be interpreted to mean that the Commission is required to identify a definite rate element(s) or to give concrete direction as to the rate element(s) that will be reduced in order to remove the intrastate payphone subsidy. Staff believes that whichever interpretation the Commission selects, there is ample evidence in the record of this proceeding to enable the Commission to satisfy the requirement of the FCC Order. (FCC Order No. 96-388, paragraph 186)

The parties in this proceeding agree on three points which are germane to this issue:

1. There is no direct mapping between subsidies or excess contributions generated by one service to a service that may receive a subsidy;
2. Access charges, intrastate toll, operator charges, hunting, and vertical services are priced above cost, and therefore are providing contributions; and
3. The carrier common line is priced above cost.

Staff agrees with the parties that the intrastate payphone subsidies cannot be traced to any particular service. Staff also believes that access charges, intrastate toll, operator services, hunting and vertical services are priced above cost; and that the CCL is priced above cost as evidenced in the record. (TR 35, 48)

Staff also agrees with MCI and AT&T that access charges, intrastate toll, and operator services provide revenue streams that can flow into a payphone operation, thus creating a relationship to payphones. (Guedel, TR 125; Reid, TR 147) Staff does not dispute AT&T and MCI's position that switched access is a monopoly service, especially terminating access, and that only a customer's designated local exchange provider can provide terminating access



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to that customer's access line. Staff contends that switched access is therefore far less likely to be driven down by competitive pressures compared to hunting service which could be provisioned by another ALEC. (Guedel, TR 103, 138; Reid, TR 159) Staff, however, cannot support BellSouth's argument that hunting is the most appropriate rate element for the reduction. BellSouth has not demonstrated why another rate element(s) cannot likewise be appropriate for reduction. (Lohman, TR 37)

While staff recognizes that BellSouth has substantially reduced switched access in the last three years due to the Settlement Agreement, staff fails to see the relationship of the Settlement Agreement to this proceeding. (Lohman, TR 37) Staff further supports AT&T's argument that switched access is not subject to competitive pressures as hunting is. Staff would note that MCI's argument that hunting has no relationship to a payphone is without merit, since we cannot determine which rate element(s) provide the payphone subsidy. (Guedel, TR 103; Reid, TR 147) FPTA asserted that the subsidy should go to benefit the payphone providers; however, no witness was proffered to support this position. (Lohman, TR 54)

If the Commission determines that the FCC Order requires it to identify a definite rate element(s), staff believes the Commission should determine a specific rate element(s) that has some relationship to the provisioning of payphone services. Such action will go to promote effective competition among payphone providers and assist in the widespread deployment of payphone service in Florida. Thus, staff recommends that if the Commission approves Issue 2, the Commission should determine that access charges, intrastate toll, and operator services are services that provide revenue streams that can flow into a payphone operation and therefore, rates for one or more of these services should be reduced in order to remove the intrastate subsidy.

However, the Commission may interpret its responsibility as stated by the FCC Order to require the Commission to give concrete direction regarding which rate element(s) need to be reduced in order to eliminate the intrastate payphone subsidy. By so doing, the Commission has met the requirement of the Order since it has heeded the FCC's position by considering the parties' positions as posed by the evidence in this proceeding. With this position, staff believes that the Commission had the discretion of making a determination that meets its policy goals. Thus, staff recommends that if the Commission denies staff's recommendation in Issue 2, the Commission should reaffirm its earlier decision, whereby a LEC has the discretion to reduce any rate element(s) it deems necessary in order to eliminate any intrastate payphone subsidy.



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Staff further recommends that the ILECs should demonstrate in their tariff filings, via a price-out, that this revenue reduction eliminates the subsidy.

ISSUE 6: Should these dockets be closed?

RECOMMENDATION: Docket Nos. 970172-TP and 970173-TP should be closed when the Final Order in this proceeding is issued. Docket No. 970281-TL should remain open pending resolution of the remaining issues in the implementation of Section 276 of the Act.

STAFF ANALYSIS: Docket Nos. 970172-TP and 970173-TP should be closed when the Final Order in this proceeding is issued. Docket No. 970281-TL should remain open pending resolution of the remaining issues in the implementation of Section 276 of the Act.