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September 24, 1998

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RECORDS AND REPORTING

VIA HAND DELIVERY

Ms. Blanca Bayó
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Undocketed Special Project No. 980000A-SP - Fair and Reasonable Residential Basic Local Telecommunications Rates -- Comments of the Florida Competitive Carriers Association

Dear Ms. Bayó:

Enclosed are 15 copies of Joe Gillan's comments that he will present at the October 9, 1998 workshop in the above matter. We are delivering the original to Anne Marsh in the Division of Communications.

I have enclosed an extra copy of the above document for you to stamp and return to me. Please contact me if you have any questions. Thank you for your assistance.

Sincerely,

Joe McGlothlin
Joseph A. McGlothlin

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ORIGINAL

September 24, 1998

Anne Marsh
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Undocketed Special Project No. 980000A-SP - Fair and Reasonable Residential Basic Local Telecommunications Rates -- Comments of the Florida Competitive Carriers Association

Dear Anne:

In accordance with your letter of July 10, 1998, and in anticipation of the workshop scheduled for October 9, 1998, I am forwarding these comments on behalf of the Florida Competitive Carriers Association.

The legislative direction to the Commission requires is two-fold. First, the Commission is directed to:

[S]tudy and report ... the relationships among the costs and charges associated with providing basic local service, intrastate access and other services provided by local exchange telecommunications companies.

And, secondly, to:

[R]eport ... its conclusions as to the fair and reasonable Florida residential basic local telecommunications service rate considering... (1) affordability, (2) value of service, (3) comparable residential basic local telecommunications services in Florida, including the proportionate share of joint and common costs.

Individual members of the Florida Competitive Carriers Association (AT&T and MCI/Worldcom in particular) have sponsored HAI 5.0 to address the cost of network facilities used to provide exchange services. As a result, the Association's comments (and presentation at the October 9th workshop) will focus on the "relationship among the costs and charges associated with providing basic local service, intrastate access and other services."

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The Association's primary recommendation is that the Commission report to the legislature the information needed to understand the practical and business reality of an industry where most of the costs to serve a customer (i.e., all the cost of the loop and much of the cost of the switch) is fixed. Specifically, we recommend that the Commission report the total cost and revenue associated with the purchasing pattern of the average Florida residential consumer for the family of local exchange services (i.e., including ECS, EAS, optional local services and access).

First, it is impossible to determine the cost of "universal service" -- a cost which would include the cost of the loop and fixed cost of the switch -- without also including in that cost the functionality which underlies the entire "family" of local exchange services (i.e., those other services which are offered in conjunction with local exchange service for an additional charge). Second, the inseparable nature of this "family" of local services also means that they are practically available only from the customer's local telephone company. Because there can be no separate market for individual services within this group, it is important to evaluate any question of subsidy from the perspective of the total cost and revenue from the entire family of services.

The Association recommends that the Commission report to the legislature on the inseparable relationship between the cost of local network facilities and the family of services offered over these facilities so that the legislature can make an informed judgement concerning the need for external subsidy. Although the "traditional" pricing strategy used by the local telephone companies has been to keep the subscription rate low (i.e., the basic local rate), this strategy does not necessarily mean that most (or even many) residential customers warrant a subsidy. Whether a customer is profitable to serve is determined by its total purchasing pattern, and not simply by the single price associated with the basic service.

It is also useful to appreciate that this "traditional" local exchange pricing strategy is not an unusual marketing tactic. For instance, it is generally recognized that razor-handles are underpriced (indeed, frequently distributed in promotions) with the expectation consumers will later purchase more profitable razor blades. Similarly, cellular phones are deliberately priced to attract subscribers, with profits earned as cellular users purchase more expensive air-time.

Significantly, an entrant to the residential local exchange market will similarly view customers by the total potential revenue the customer represents. As a result, the Commission (and the legislature) should not automatically assume that competition will challenge the traditional pricing of exchange services. The goal of a competitive entrant is to win customers. To the extent that the prevailing pricing strategy is popular with consumers, the Commission should expect that it will be *mimicked* by entrants (although with lower overall

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prices). There is little reason to expect that entrants will offer services with higher "basic" local rates, tied to lower "optional" prices, and force the consumer to undertake the calculus to determine which package is preferable.

Having recognized the interrelationship among the "family" of local exchange service, the Association does not believe that it would be sound policy to use a universal service fund to try to maintain *any* particular balance in the *retail* prices that are used to attract (or retain) profitable residential customers. Our point is that today most residential customers are profitable, competition should only be expected to offer these customers lower overall prices, and a universal service mechanism should not be interposed into this process in an effort to keep just *one* of these prices -- the basic subscription price -- at any particular level.

Equally fundamental to the Association's position, however, is that the incumbent local exchange companies should not be permitted the flexibility to restructure their rates until competitive alternatives exist. No *market-based* rebalancing of rates can occur unless a *market* develops first. Consequently, while the Association believes that a competitive market is the best mechanism to ultimately determine whether prices within the family of local service should be rebalanced, we also believe that process should only begin *after* consumers have a meaningful opportunity to choose alternatives.

Finally, we also recognize that *within* the residential market there are customers which are not profitable to serve. If these are "deserving" customers (by whatever standard), however, then targeted assistance programs (such as lifeline service) should be used to directly address their needs. We support a universal service fund to address these customers. But there is no reason for the Commission, or the legislature, to use this need as a justification to more broadly attempt to use a subsidy to maintain a rate relationship.

Sincerely,

Joseph Gillan / JAM

Joseph Gillan
Consultant

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