ORIGINAL

Florida Cable Telecommunications Association

Steve Wilkerson, President

VIA HAND DELIVERY

November 2, 1998

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

RE: Docket No. 980696-TP

Dear Ms. Bayo:

Enclosed for filing in the above docket are the original and 15 copies of the Posthearing Brief of the Florida Cable Telecommunications Association.

Copies of the Posthearing Brief have been served on the parties of record pursuant to the attached certificates of service. Please acknowledge receipt of filing of the above by stamping the duplicate copy of this letter and returning the same to me.

Thank you for your assistance in process this filing. Please contact me with any questions.

Yours very truly,

Laura L. Gallagher
Vice President, Regulatory Affairs &
Regulatory Counsel

LLG/mj

Enclosure

cc: All Parties of Record
Steven E. Wilkerson

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FPSC-BUREAU OF RECORDS

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Posthearing Brief of the Florida Cable Telecommunications Association has been furnished by U.S. Mail delivery this 2nd day of November, 1998, to the following:

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ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Determination of the Cost of Providing Basic Local Telecommunications Service, Pursuant to Section 364.025, Florida Statutes	Docket No. 980696-TP Filed: November 2, 1998

POSTHEARING BRIEF OF THE FLORIDA CABLE TELECOMMUNICATIONS ASSOCIATION, INCORPORATED

Pursuant to Rule 25-22.56, Florida Administrative Code, and Order No. PSC-98-0813-PCO-TP, issued June 19, 1998, the Florida Cable Telecommunications Association, Inc. (FCTA) submits its Posthearing Brief to the Florida Public Service Commission (Commission) in the above-referenced proceeding.

BASIC POSITION

The Florida Legislature requested this study of the total forward-looking cost of basic local telecommunications service so that it can evaluate the need for a permanent universal service mechanism in Florida. At this time, the Legislature has only asked for a determination of the forward-looking cost of service. It has not asked the Commission to establish a universal service mechanism or to quantify the need for a fund. Tr 20. Accordingly, the Commission should distinguish between the estimated cost of service versus the need for and size of any fund. Id. The Commission's February 15, 1999 Report should be limited to a determination of the cost of service and identify additional issues that should be addressed in future proceedings before any permanent universal service mechanism is established in Florida.

FCTA has not advocated the adoption of a particular cost model in this proceeding. Instead, FCTA's testimony, which was stipulated into the record without objection, addresses

the inputs that are most likely to influence the cost estimates submitted under the Benchmark Cost Proxy Model, Version 3.1 ("BCPM 3.1") and the Hatfield Model, Version 5.0a ("HM 5.0a" or "Hatfield Model"). FCTA has taken this approach because the BCPM 3.1 and HM 5.0a models have evolved and will continue to evolve. FCTA recommends that the Commission focus on input modifications to develop more reliable cost estimates. In particular, the following inputs appear to have the most significant effect on the model outputs: copper/fiber crossover point, fill factors, percentage of structure sharing, purchase price for outside plant and switching facilities, fill factors/percentage of structure sharing, purchase price for outside plant and switching facilities, labor rates and installation times, capital costs and operating expenses. Tr. 25-32. These inputs should be carefully scrutinized.

The inputs proposed by the BCPM 3.1 model suffer from lack of documentation and their accuracy is not readily verifiable. Tr. 32-39. The LECs appear to rely heavily on historic cost data and cost relationships to project the forward-looking expenses that an efficient carrier would incur. Tr. 38. Over-reliance on historic costs and cost relationships - without careful analysis of whether such costs and relationships are forward looking and efficient - results in compensating the LECs for sunk, embedded or inefficiently incurred costs and needlessly inflates the size of any universal service fund. Tr. 20. This result is contrary to the Legislature's request for a determination and report on the "total forward-looking cost" of providing basic local telecommunications service pursuant to s. 364.025(4)(b), Florida Statutes.

FCTA's testimony also addresses LEC arguments about the immediate need for a large permanent universal service fund. Tr. 40. These arguments must be rejected at this time. The Legislature is not convinced that a permanent mechanism is necessary and, since local competition is virtually non-existent, the LEC ability to maintain universal service has not been

eroded. Tr. 40-43; 605.

When Chapter 364 was amended in 1995, the Commission was directed to establish an interim "mechanism" for a "transitional period" while competition emerged. s. 364.025(2), Florida Statutes. The Commission was also directed to track and annually report "the overall impact of local exchange competition on the continued availability of universal service." s. 364.386 (1)(a), Florida Statutes. Exhibit 14, FPSC Order No. PSC-95-1592-FOF-TP, Issued December 27, 1995 (Interim Universal Service Order). These protections were put into place in an abundance of caution because it was unclear to the Legislature in 1995 what impact, if any, emerging competition would have on the continued maintenance of universal service and, therefore, the need for funding.

When the Commission established the interim universal service "mechanism," no costly fund was established or demonstrated to be necessary. Interim Universal Service Order, 95 FPSC 12:397; Tr. 604. Instead, any LEC experiencing an erosion of its ability to maintain universal service as a result of competition is able to petition the Commission and demonstrate the need for funding. The petitioner is able to receive any necessary funding in an expedited manner. In the almost three years since the interim mechanism was established, no LEC has filed a petition for universal service support. Tr. 604-605.

Despite broad LEC assertions about the need for a fund in this proceeding, the impact of competition on the maintenance of universal service has yet to be demonstrated. Tr. 42. The record reveals that little to no local exchange competition has emerged since competition was authorized January 1, 1996. As FCTA witness Barta points out:

> The total number of business access lines served by all entrants combined is 42,303 and the total number of residential access lines is 13,857. By way of comparison, the three large LECs (BellSouth, GTE Florida, and Sprint-Florida) have approximately 2.9 million business access lines and 7.8 million residential access lines, which account for approximately 98.5% of the total access lines in the State (the remaining 1.5% of the total access lines belong to the remaining seven incumbent LECs). Based on information received as of

> September 1997, the competitors account for 0.5% overall of the total access lines served, 1.4% of the business access lines, and 0.2% of the residential access lines.

Tr. 42-43, quoting Competition in Telecommunications Markets in Florida, FPSC Division of Communications at page 8. Florida Competitive Carriers Association (FCCA) witness Gillan adds:

> History has shown that ILEC claims concerning the "threat of competition" have been... unfounded. Despite numerous cries during the 1995 proceeding that widespread local competition was "imminent", the competitive landscape is a little different now than then. There is still no widespread local competition in Florida and ILEC earnings continue to grow.

Tr. 604-605. BellSouth witness Martin concedes that BellSouth's basic residential service marketshare is over 99%. Tr. 1156. The LECs have failed demonstrate that a universal service fund is needed due to competitive pressures.

Amendments to Chapter 364 during the 1998 session only highlight the Legislative uncertainty over the need for a permanent fund. This proceeding is being conducted according to s. 364.025(b), Florida Statutes, to assist the Legislature in ultimately establishing a permanent "mechanism." The word "mechanism" used in s. 364.025(b) is the same term used in referring to the interim universal service "mechanism" in s. 364.025(1)(-2), Florida Statutes. As the with the interim universal service mechanism, the term "permanent mechanism" makes no assumptions concerning the need for an immediate costly fund. For example, it may be appropriate for the Legislature to simply adopt the interim mechanism as the permanent universal service mechanism rather than establish a costly fund.

Given this context, the Commission should focus on issuing a narrow report to the Legislature that: 1) determines the cost of providing basic local telecommunications service and 2) identifies what additional issues should be evaluated in future proceedings before a permanent mechanism is established. These additional issues should include, at minimum:

1. any rate rebalancing permitted and the impact on the need for a universal service fund;

2. the appropriate revenue benchmark and other policy considerations;

3. the overall profitability of serving residential subscribers; and

4. the degree of local competition in Florida.

Barta, rebuttal at 23. This approach is consistent with that of other states where cost of service issues were handled separately. See, i.e. Commonwealth of Kentucky Administrative Case No. 360, North Carolina Utilities Commission - Docket No. P-100, SUB 133b, Louisiana Public Service Commission - Order Nos. -0-22022/22093-A, U20883-A, Stipulated Exhibit 14, and Tennessee Docket No. 97-00888 Phase II.

ISSUE ONE:

What is the definition of the basic local telecommunications service referred to in Section 364.025(4)(b), Florida Statutes?

The definition contained in section 364.02(3), Florida Statutes, should be utilized for this proceeding. However, the support for universal service should not include support for any business line service and should be limited to the first residential line.

DISCUSSION: Section 364.025(4)(b), Florida Statutes, provides that the Commission shall determine and report to the Legislature the total forward-looking cost of providing "basic local telecommunications service." Issue one is directed at determining the meaning of the phrase "basic local telecommunications service." The phrase is defined in Section 364.02(2) which states:

> Basic local telecommunications service" means voice-grade, flat-rate residential, and flat-rate single-line business local exchange services which provide dial tone, local usage necessary to place unlimited calls within a local exchange area, dual tone multifrequency dialing, and access to the following: emergency

> services such as "911," all locally available interexchange companies, directory assistance, operator services, relay services, and an alphabetical directory listing. For a local exchange telecommunications company, such term shall include any extended area service routes, and extended calling service in existence or ordered by the commission on or before July 1, 1995.

Consistent with principles of statutory construction, the definition contained in section 364.02(3), Florida Statues, should be utilized in this proceeding. The appropriate definition of "universal service" is a separate issue not specifically addressed in this proceeding. The support for universal service should not include support for any business line service and should be limited only to the first residential line.

ISSUE TWO:

For purposes of determining the cost of basic local telecommunications service appropriate for establishing a permanent universal service mechanism, what is the appropriate cost proxy model to determine the total forward-looking cost of providing basic local telecommunications service pursuant to Section 364.025(4)(b), Florida Statutes?

The appropriate cost proxy model is one that is consistent with forward looking economic costing principles and not a reflection of a blend of costing (i.e. embedded and TSLRIC) approaches.

DISCUSSION: As a general matter, the appropriate cost proxy model is one that is consistent with forward-looking economic costing principles and not a reflection of a blend of costing (i.e. embedded and TSLRIC) approaches. Tr. 17. The model should not incorporate less efficient technology than is currently available, work processes that are more labor intensive than existing automated procedures, or any types of past inefficiencies. Capital costs and operating expenses utilized by such a model must be reasonable on a forward- looking basis. Id.

FCTA has not recommended the adoption a specific model in this proceeding. Because

BCPM 3.1 and HM 5.0a the cost models are continuing to evolve, FCTA recommends that the Commission should focus on selecting the appropriate model inputs. The major input drivers that the Commission should address are: copper/fiber crossover point, fill factors, structure sharing, cable and outside plant costs, labor rates and installation times, cost of capital, and operating expenses. These inputs are discussed in more detail under Issue Four.

The Commission should also carefully scrutinize LEC-proposed company-specific inputs. To at least some extent, the model adopted by the Commission should accommodate the individual circumstances of individual LECs. However, as more and more company-specific inputs are selected, the model ceases to be a model which produces the forward-looking cost of providing basic service in a certain geographical area and instead becomes a model designed to recover the costs for a specific LEC. This result is inconsistent with s. 364.025(4)(b), Florida Statutes, and FCC requirements that cost models utilize the least-cost, most-efficient, and reasonable technology for providing the supported service "that is currently being deployed." Federal-State Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157, 7CR (P&F) 109 at Par. 250 ("Federal Universal Service Order"), (Released: May 8, 1997), Exhibit 14.

ISSUE THREE:

For purposes of determining the cost of basic local telecommunications service appropriate for establishing a permanent universal service mechanism, should the total forward-looking cost of basic local telecommunications service pursuant to Section 364.025(4)(b), Florida Statutes, be determined by a cost proxy model on a basis smaller than a wire center? If so, on what basis should it be determined?

***Costs may be modeled at the wire center or lower levels for purposes of developing an estimate of cost; but costs should be aggregated no lower than**

the wire center level for universal service support purposes.*

DISCUSSION: For purposes of developing an estimate of the costs to provide basic local telecommunications service, it is appropriate to examine costs modeled at the wire center as well as lower levels of geographic disaggregation. However, for universal service support purposes, costs should be aggregated no lower than the wire center level. Exhibit 6, FCTA's Response to Staff's First Set of Interrogatories.

The Commission's decision concerning the aggregation of costs will be an important determinant in the ultimate size of the Florida universal service fund. Each cost proxy model can disaggregate the costs to provide universal service at a very discrete level. In developing cost estimates, data is disaggregated at the wire center level, Census Block Groups ("CBGs"), Census Blocks ("Cbs"), and even at the grid and microgrid level. Tr. 24.

Although each successive level of disaggregation can be helpful in locating customers and configuring a network to serve those customers, the geographic area that is ultimately defined for universal service support consideration is especially important in determining the magnitude of the support. As the geographic serving areas being modeled become increasingly granular, it should be recognized that the alleged precision of the cost estimates does not fully take into account the economies of scale and scope engineered into the incumbent LEC's network. Taking the level of granularity to its extreme, the costs necessary to provision universal service for one customer may result in high cost support, but the facilities to serve an adjacent subscriber may be below the cost threshold.

The wire center appears to be the most suitable level at which to aggregate the costs to calculate universal service support requirements. Indeed, BellSouth witness Peter Martin agrees by recommending in his prefiled direct testimony that:

> Initially, the forward-looking cost of basic telecommunications should be calculated at the wire center level. Current telecommunications providers capture data at this level of

> aggregation on a standardized basis. Therefore, a wire center basis for cost calculation would be less burdensome initially than going to a more targeted area of measure like a census block group (CBG).

Tr. 1144-1145.

ISSUE FOUR:

For purposes of determining the cost of basic local telecommunications service appropriate for establishing a permanent universal service mechanism, for each of the following categories what input values to the cost proxy model identified in Issue 2 are appropriate for each Florida LEC?

(a) Depreciation rates

FCC prescribed economic lines and net salvage values should be adopted for BellSouth and GTE. The default rate of HAI 5.0a provides a suitable proxy for Sprint.

DISCUSSION (a): The Federal Communications Commission (FCC) requires that the model adopted by state Commissions utilize economic lives and future net salvage percentages used in calculating depreciation expense within the FCC-authorized range and currently authorized depreciation lives. See Federal Universal Service Order at ¶250, no. (5). The Commission should reject any proposals to apply economic lives outside the prescribed range and should substitute, in their place, economic lives and net salvage percentages within the FCC-authorized range.

The Hatfield Model adopts the average projection lives adjusted for net salvage value as determined in the three-way meetings held between the FCC, state regulatory authority and the utility for 76 LEC study areas. As explained in the Hatfield Model 5.0a documentation on page 67:

> [T]he model assumes straight-line depreciation and calculates

return on investment, tax gross-up and depreciation expenses annually on the mid-year value of the investment. Because capital carrying costs are levelized, substitution of nonlinear or accelerated depreciation schedules for straight-line depreciation would have almost no net effect on calculated annual capital carrying costs (aside from favorable tax effects).

The LECs adopt a different approach. BellSouth presents rates developed by its Depreciation Organization. GTE asserts that its 1996 financial reporting rates are representative of forward-looking conditions. Sprint relies on an outside study conducted by Technology Futures, Inc.

The Commission should reject the LEC approaches by adopting the FCC economic lives and net salvage values prescribed for the Florida Operations of BellSouth and GTE. The FCC estimates are grounded in a comprehensive examination and offer an objective assessment of capital recovery rates. The FCC has not prescribed rates for the Sprint operating companies. In lieu of FCC specific rates, the default rates of the HM 5.0a serve as a suitable proxy. Tr. 31.

(b) Cost of money

"The rate of return estimated by the HAI 5.0a sponsors appears more representative of the LECs' forward looking cost of capital."

DISCUSSION (b): The FCC requires that the cost model adopted by the Commission utilize a rate of return at "either the authorized federal rate of return on interstate services, currently 11.25 percent, or the state's prescribed rate of return for intrastate services." See Federal Universal Service Order at ¶250, no. (4). Capital costs appear to be a major driver in the model results. Sprint and BellSouth believe that the FCC authorized rate of return of 11.25% should be used in the cost proxy model. A 12.63% overall cost of capital is projected by GTE. Tr. 26.

The Commission should adopt a capital structure and cost of capital for use in the

universal service cost proxy model that recognizes the LECs' network economies of scale and scope and the fact that there is no meaningful competition for basic local exchange service from facilities-based providers at this time. On a forward-looking basis, the weighted average cost of capital is likely to be closer to that endorsed in the Hatfield Model rather than the assumptions made in the BCPM 3.1. The HM 5.0 cost of capital more appropriately recognizes the lower business risk attributed to the inherent efficiencies derived from the LECs' network economics of scale and scope as well as the fact that no meaningful local competition exists for basic local service at this time. Tr. 27.

(c) Tax rates

No position.

(d) Supporting structures

No position.

(e) Structure sharing factors

Model inputs for structure sharing should reflect a realistic sharing arrangement.

DISCUSSION: Structure sharing refers to the practice of sharing investments in poles, trenches, and conduits with other utilities and/or carriers. Tr. 29. The model inputs for structure sharing should reflect a realistic sharing arrangement. The structure sharing percentage should recognize that, over time, there will be more carriers seeking the economic benefits of structure sharing, but the opportunities for such sharing may be constrained for a number of reasons, including engineering limitations. Tr. 30.

The level of sharing of support structures projected in the Hatfield Model is significantly greater than in the BCPM 3.1. In both models, the amount of structure sharing depends upon the type of structure and the density zone.

The Hatfield Model sponsors believe that the increased level of sharing of support structures on a forward-looking basis is attributed to the strong economic and financial

incentives that will prevail on a forward-looking basis:

> First, because utilities are now more likely to either face competition or to be regulated on the basis of their prices (e.g. price caps) rather than their costs (e.g. ratebase), a LEC's own economic incentive is to share use of its investment in outside plant structure. Such arrangements permit the LEC to save substantially on its outside plant costs by spreading these costs across other utilities or users. Second, many localities now strongly encourage joint pole usage or trenching operations for conduit and buried facilities as a means of minimizing the unsightliness and/or right-of-way congestion occasioned by multiple poles, or disruptions associated with multiple trenching activities.
>
> Because of these economic and legal incentives, not only has structure sharing recently become more common, but its incidence is likely to accelerate in the future-especially given the Telecommunications Act's requirements for nondiscriminatory access to structure at economic prices.

Hatfield Model Version 5.0a, Inputs Portfolio, Appendix B, page 151.

The sponsors of the BCPM 3.1 rely upon past and current experience with the sharing of structures within the state. The BCPM model documentation contemplates sharing of poles based on "BellSouth Florida-specific structure sharing percentages to reflect values representative of BellSouth's costs in Florida" BCPM 3.1 documentation, Section 4, Proposed BCPM 3.1 Inputs. The proponents of BCPM 3.1 in other jurisdictions have concluded that, currently, the sharing of trenches and conduit among utilities and other users is negligible and is not practicable at any significant level. Tr. 29-30.

Clearly, the model sponsors have differing views on the level of structure sharing that is likely to occur on a forward-looking basis. The issues raised by the Hatfield Model sponsors have merit. The percentage of structure sharing among utilities and other users should increase in the future as more parties require space on a limited number of rights-of-way. But it is unclear whether the degree of structure sharing will materialize. On the other hand, the BCPM 3.1 sponsors' absolute reliance on current practice is not reflective of a forward-looking

and efficient cost analysis. As a result, the Commission should revise model inputs for structure sharing, by density zone, to reflect a more realistic sharing arrangement. The sharing percentage should recognize that there will be more carriers seeking the economic benefits of structure sharing but such opportunities may be constrained for a number of reasons, including engineering limitations. Tr. 30.

(f) Fill factors

The appropriate fill factor should balance current and expected demand levels for basic local telecommunications services as well as accommodate the requirements for administrative and modular related spare capacity over the economic life of the feeder and distribution facilities.

DISCUSSION: A fill factor represents the percentage of the network facility that is being used. Tr. 27. Neither regulated or nonregulated firms anticipate or desire to be at full or 100 percent utilization of capacity. Thus, network facilities are engineered with an appropriate amount of spare capacity. The spare capacity can take the form of administrative spare (necessary for network testing and management functions), spare capacity attributed to modularity (resulting from the indivisibility of certain types of equipment), and demand related spare (necessary to serve future customers). Id.

The fill factors used in the models affect the level of investment required to provide services to customers. Lower than necessary utilization rates increase total loop investment because the increase in capacity associated with lower fill factors increases the amount of loop plant used to deliver telecommunications services. Optimistically robust fill factors may jeopardize the quality of service.

The appropriate fill factor used by the Commission in the cost proxy model should balance current and expected demand levels for the supported services as well as accommodate the requirements for administrative and modular related spare capacity over the

economic life of the feeder and distribution facilities. Tr. 28.

(g) Manholes

No position.

(h) Fiber cable costs

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

(i) Copper cable costs

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

DISCUSSION for (h) and (i): The FPSC should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information. The FPSC should also determine whether the BCPM 3.1 inputs inappropriately reflect historical experience (i.e. embedded costs) or are more appropriately indicative of the forward-looking operations that an efficient carrier would be likely to incur in a competitive market.

The Hatfield Model sponsors admit that the propriety claims of switching manufacturers and vendors of outside plant facilities increase the difficulty of estimating the acquisition costs for such network facilities as central office switches, and copper and fiber optic cable. HM 5.0a documentation, Inputs Portfolio, page 10. The BCPM 3.1 sponsors draw upon the opinions of engineers to compliment the use of state-specific data regarding the costs to engineer, furnish, and install network facilities. The vendor prices for the facilities are deemed proprietary by the BCPM 3.1 sponsors. The BCPM sponsors are critical of the network facilities prices utilized in HM 5.0a.

In this context, the Commission cannot be assured that the prices for switching and outside plant network facilities used in the models reflect forward-looking conditions unless additional support for the BCPM 3.1 input values is required. More reliable data should be

obtained from the BCPM 3.1 sponsors - under proprietary protection - in order to determine whether the values input into the model are supported by actual vendor information. Tr. 35. The supporting documentation may include vendor invoices that can be verified with individual construction work order summaries that capture vendor material costs, contractor labor costs, and company labor costs. Id.

(j) Drops

No position.

(k) Network interface devices

No position.

(l) Outside plant mix

No position.

(m) Digital loop carrier costs

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

(n) Terminal costs

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

DISCUSSION of (m) and (n): The FPSC should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information. The FPSC should also determine whether the BCPM 3.1 inputs inappropriately reflect historical experience (i.e. embedded costs) or are more appropriately indicative of the forward-looking operations that an efficient carrier would be likely to incur in a competitive market.

(o) Switching costs and associated variables

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

DISCUSSION: The FPSC should require additional documentation for the BCPM 3.1 input values to ensure the values are supported by actual vendor information. The FPSC should also determine whether BCPM 3.1 inputs inappropriately reflect historical experience (i.e. embedded costs) or are more appropriately indicative of the forward-looking operations that an efficient carrier would be likely to incur in a competitive market.

The Hatfield Model sponsors admit that the proprietary claims of switching manufacturers and vendors of outside plant facilities increases the difficulty of estimating the acquisition costs for such network facilities as central office switches and copper and fiber optic cable. The BCPM sponsors draw upon the opinions of engineers to compliment the use of state specific data regarding the costs to engineer, furnish, and install network facilities. The vendor prices for the facilities are deemed proprietary by the BCPM sponsors.

Since the BCPM sponsors are critical of the prices for network facilities used in the Hatfield Model, it seems reasonable for the Commission to require additional support for the BCPM input values. The Commission should seek more reliable data from the BCPM sponsors-under proprietary protection-in order to determine whether the values input into the model are supported by actual vendor information. Tr. 35. The supporting documentation may include vendor invoices that can be verified with individual construction work order summaries that capture vendor material costs, contractor labor costs, and company labor costs. In the end, however, this data must be analyzed for consistency with forward-looking and efficient cost requirements. Tr. 35.

(p) Traffic data

No position.

(q) Signaling system costs

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

(r) Transport system costs and associated variables

The Commission should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information.

DISCUSSION of (q) and (r): The FPSC should require additional support for the BCPM 3.1 input values to ensure the values are supported by actual vendor information. The FPSC should also determine whether the BCPM 3.1 inputs inappropriately reflect historical experience (i.e. embedded costs) or are more appropriately indicative of the forward-looking operations that an efficient carrier would be likely to incur in a competitive market.

(s) Expenses

The estimates developed by the BCPM 3.1 and HAI 5.0a models lack adequate support and do not provide reasonable assurance that the levels are representative of an efficient carrier operating in a competitive environment.

DISCUSSION: The estimate of operating expenses developed by the BCPM 3.1 model lacks adequate support and does not provide reasonable assurance that the levels are representative of an efficient carrier operating in a competitive market. The FPSC should require BellSouth, Sprint and GTE to provide detailed documentation supporting either the adjustments they have made to recast embedded cost activity as forward-looking expenses or, in the case of BellSouth, provide the detail that is relied upon from other cost studies prepared by the company. Tr. 39.

The level of operating expenses greatly affect the cost estimates developed by the models to provide universal service. In past versions of the BCPM, it was estimated that an average of up to 40% to 50% of the cost of universal service was attributable to the operating expenses of the company. Tr. 36.

In the BCPM 3.1, operating expenses are input as expenses per line or as a percentage of investment. BellSouth used the same plant-specific expense factors developed for its

TSLRIC cost studies submitted July 31, 1998 in Docket No. 980000A-SP. Tr. 36. The operating expenses for Sprint were derived from the actual operating expenses incurred in Florida for 1997. Id. GTE also uses 1997 actual operating expenses as the basis for its BCPM 3.1 input values. GTE, however, makes a series of adjustments (i.e out-of-period normalizations, going forward adjustments, and yellow page revenues adjustments) in order to recast the actual 1997 expenses as forward-looking. Id.

The Hatfield Model sponsors acknowledge the difficulty in developing forward-looking cost estimates for the operations of the incumbent local exchange providers:

> Estimating LEC operating costs is more difficult than estimating capital costs. Few publicly available forward-looking cost studies are available from the ILECs. Consequently, many of the operating cost estimates developed here must rely on relationships to and within historical ILEC cost information as a point of departure for estimating forward-looking operating costs. While certain of these costs are closely linked to the number of lines provided by the ILEC, other categories of operating expenses are related more closely to the levels of their related investments. For this reason, the Expense Module develops factors for numerous expense categories and applies these factors both against investment levels and demand quantities (as appropriate) generated by previously modules.

Hatfield Model Version 5.0a documentation, page 68.

The estimates of operating expenses developed by both models lack adequate support and do not provide the Commission reasonable assurance that the levels are representative of an efficient carrier operating in a competitive market. For instance, the Forward-Looking Network Operations Factor input of the Hatfield Model assumes that the incumbent LEC will reduce this type of expense by 50% from the current level reported in ARMIS. The assumption is supported by the statement that **"ARMIS-based network operations expenses are - by definition a function of telephone company embedded costs. As reported, these costs are artificially high because they reflect antiquated systems and practices that are more costly than the modern equipment and practices that the HA Model assumes will be installed on a**

forward-looking basis" HM 5.0A documentation, Inputs Portolio, page 120. The relevancy and accuracy of the documentation used to support operating expense inputs to the model is also questionable. Tr. 38.

The documentation supporting the BCPM sponsors' view of forward-looking operating expenses is flawed in a different sense. The BCPM sponsors assert that the operating expenses generated by the model are forward-looking as a result of adjustments made to the expenses. Although the adjustments may appropriately exclude specific expenses on a forward-looking basis, the Commission simply does not have sufficient information to judge the appropriateness of the adjustments without more detailed filings. It is not at all clear whether the BCPM estimate of operating expenses allegedly required to support basic local service include categories of expenses that are incurred mainly to provide competitive and/or discretionary services. Tr. 39.

In this context, the Commission should require the LECs to provide more detailed documentation supporting either the adjustments they have made to recast embedded cost activity as forward-looking expenses or, in the case of BellSouth, provide the detail that is relied upon from other cost studies prepared by the company. Id.

(t) Other inputs

The Commission must determine, based upon sound engineering practices, the appropriate economic cross-over point (i.e. a threshold where fiber facilities are used in lieu of copper) to be utilized in the cost proxy models.

DISCUSSION: The copper/fiber crossover point refers to the threshold where fiber facilities are used in lieu of copper facilities. Tr. 32. The BCPM is designed to limit copper loop lengths 12,000 fees. BCPM 3.1 Model Methodology documentation, Appendix C, page 125. The Hatfield Model specifies a default that no total copper loop length, including feeder and distribution, exceeds a user adjustable parameter of 18,000 feet. HM 5.0a

documentation, Model Description, page 20.

The Commission should determine, based upon sound engineering practices, the appropriate economic crossover point to be used in the cost proxy models. Tr. 33.

ISSUE FIVE:

(a) For purposes of determining the cost of basic local telecommunications service appropriate for establishing a permanent universal service mechanism, for which Florida local exchange companies must the cost of basic local telecommunications service be determined using the cost proxy model identified in Issue 2?

The cost of basic local telecommunications service should be determined for BellSouth, GTE and Sprint.

(b) For each of the LECs identified in (a), what cost results from using the input values identified in Issue 5 in the cost proxy model identified in Issue 2?

No position.

ISSUE SIX:

(a) For purposes of determining the cost of basic local telecommunications service appropriate for establishing a permanent universal service mechanism, should the cost of basic local telecommunications service for each of the LECs that serve fewer than 100,000 access lines be computed using the cost proxy model identified in Issue 2 with the input values identified in Issue 4?

No position.

(b) If yes, for each of the LECs that serve fewer than 100,000 access lines, what cost results from using the input values identified in Issue 4 in the cost proxy model identified in Issue 2?

No position.

(c) if not, for each of the Florida LECs that serve fewer than 100,000 access lines, what approach should be employed to determine the cost of basic local telecommunications service and what is the resulting cost?

No position.

CONCLUSION

The Commission should issue a narrow report to the Legislature that: 1) determines the total forward-looking cost of basic local telecommunications service; and 2) recommends additional issues to be resolved by the Commission, similar to the way other state Commissions have done, before any permanent mechanism is established. These issues include, at minimum:

1. any rate rebalancing permitted and the impact on the need for a universal service fund;
2. the appropriate revenue benchmark and other policy considerations;
3. the overall profitability of serving residential subscribers; and
4. the degree of local competition in Florida.

Respectfully submitted this 2nd day of November, 1998.

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