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REPORT ON

Universal Service and Lifeline Funding Issues

as Required by
Section 364.025, Florida Statutes

February 1999

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VOLUME ONE

FPSC-REGGDS/REPORTING

**REPORT OF
THE FLORIDA PUBLIC SERVICE COMMISSION
ON THE TOTAL FORWARD-LOOKING COST OF PROVIDING
BASIC LOCAL TELECOMMUNICATIONS SERVICE AND THE AMOUNT
OF SUPPORT NECESSARY TO PROVIDE BASIC LOCAL
TELECOMMUNICATIONS SERVICE TO LOW-INCOME CUSTOMERS IN
COMPLIANCE WITH THE REQUIREMENTS OF SECTIONS
364.025(4)(b),(c), and (d) FLORIDA STATUTES**

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FPSC-RECORDS/REPORTING

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LIST OF ACRONYMS

ALEC	Alternative Local Exchange Company
AHCA	Agency for Health Care Administration
B1	Business Access Line
BCPM	Benchmark Cost Proxy Model
CB	Census Block
CBG	Census Block Group
CLEC	Competitive Local Exchange Company
COLR	Carrier of Last Resort
DCA	Department of Community Affairs
DCF	Department of Children and Families
EDR	Division of Economic and Demographic Research
ETC	Eligible Telecommunications Carrier
FCC	Federal Communications Commission
FLEC	Forward-Looking Economic Cost
FPSC	Florida Public Service Commission
HAI	Hatfield Model 5.0a
HUD	Housing and Urban Development
ILEC	Incumbent Local Exchange Company
LEC	Local Exchange Company
LIHEAP	Low-Income Home Energy Assistance Program
MST	Minimum Spanning Tree
R1	Residential Access Line
SSI	Supplemental Security Income
TA 96	Telecommunications Act of 1996
TANF	Temporary Assistance to Needy Families

TELRIC	Total Element Long Run Incremental Cost
TSLRIC	Total Service Long Run Incremental Cost
UNE	Unbundled Network Element
US	Universal Service

OVERVIEW

This report is being submitted in compliance with Sections 364.025(4)(b), (c), and (d), Florida Statutes. Sections 364.025(4) (b) and (c), Florida Statutes, require that the Commission, by February 15, 1999, determine and report to the President of the Senate and the Speaker of the House of Representatives the total forward-looking cost of providing basic local telecommunications service in Florida. Specifically, Section 364.025(4)(b), Florida Statutes, requires that the Commission, after notice and opportunity for hearing, select a cost proxy model and determine the total forward-looking cost of providing basic local telecommunications service. For the small local exchange companies (those with fewer than 100,000 access lines), the Commission was not required to but could use the same proxy model determined in response to 364.025(4)(b), or had the option of using a different cost proxy model or a fully distributed embedded cost approach. In addition, Section 364.025(4)(d), required that the Commission report, by February 15, 1999, the amount of support necessary to provide residential basic local telecommunications service to low-income customers. This report is being submitted to meet these statutory requirements. The report consists of three distinct chapters; the contents of each chapter are described below.

The Commission established Docket No. 980696-TP: Determination of the Cost of Basic Local Telecommunications Service, pursuant to Section 364.025, Florida Statutes, to conduct the required administrative hearing. From October 12 through October 16, 1998, the Commission conducted a formal administrative hearing according to the provisions of Chapter 120, Florida Statutes, and the rules of the Commission. Chapter I of this report provides a summary of the Commission's findings in Docket No. 980696-TP. Order No. PSC-99-0068-FOF-TP, issued January 7, 1999, is included in Volume II of this report. However, since two parties filed motions for reconsideration on January 22, 1999, this order is not final.

Chapter II provides the Commission's findings regarding the amount of support necessary to provide residential basic local telecommunications service to low-income customers. Included within this chapter is information regarding the methodology used to determine the support needed, as well as some of the legal, technical, and administrative issues to be considered.

Chapter III provides additional information regarding a permanent universal service (US) fund. This chapter addresses such issues as why US funding may be needed, intrastate support for low-income consumers, and intrastate support for providers serving high-cost areas. Furthermore, this chapter examines the impact US funding may have on competitive entry into Florida's telecommunications markets. Finally, Chapter III includes the Commission's recommendations regarding a permanent mechanism.

CHAPTER I: THE COST OF BASIC LOCAL TELECOMMUNICATIONS SERVICE

Docket No. 980696-TP, Determination of the Cost of Basic Local Telecommunications Service, was opened in order to comply with Sections 364.025 (4)(b) and (c), Florida Statutes. Consistent with the provisions of this section, the Commission must select a proxy cost model for BellSouth, GTE Florida, and Sprint-Florida, and determine the cost of providing basic local service. The Commission must also determine the cost of providing basic local service for the seven small local exchange companies (LECs).

This chapter presents a summary of the conclusions reached in the Commission order. (The complete order is contained in Volume Two, Appendix A.) However, since two parties filed motions for reconsideration on January 22, 1999, this order is not final.

DEFINITION OF BASIC LOCAL TELECOMMUNICATIONS SERVICE

The Commission found that the definition of "basic local telecommunications service" referred to in Section 364.025 (4) (b), Florida Statutes, is defined in Section 364.02(2), Florida Statutes. Section 364.02(2), Florida Statutes, defines basic local telecommunications service as 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. Accordingly, a cost model must derive cost results that account for all of these components.

THE APPROPRIATE COST PROXY MODEL

There were two models submitted in this proceeding: the HAI 5.0a, sponsored by AT&T and MCI, and the BCPM 3.1, sponsored by BellSouth and Sprint-Florida.¹ Both models are "scorched node" models; that is, the only constraint is that the wire center (switch) locations remain where they currently are. A hypothetical network is then created instantaneously from the ground up to serve all existing customers.

The Commission found that both models suffer from various deficiencies. However, deficiencies are not unexpected, because by definition, a model does not replicate reality with complete accuracy. The Commission's choice hinged upon which model generates a more reasonable estimate of the cost of basic local telecommunications service.

¹On October 22, 1998, after the PSC discovery process and hearing had been concluded, the FCC adopted a model platform for nonrural LECs. The FCC's model platform includes elements from three models: BCPM 3.0, HAI 5.0a, and the Hybrid Cost Proxy Model 2.5 (HCPM). The HCPM was developed by FCC staff.

The Commission chose the BCPM 3.1 Model with several modifications. The first two modifications are designed to ensure that the model does not underestimate the amount of cable required, particularly in low density, more rural areas. The remaining modifications deal with the development of BCPM 3.1's switching costs.

- The global constraint that restricts the amount of distribution cable built in a quadrant to be less than or equal to the road mileage in the quadrant needs to be relaxed in low-density areas, in order for BCPM's modeled route miles to approximate those of the Minimum Spanning Tree (MST) analysis. The MST analysis is an internal consistency check which allows a modeler to estimate the minimum amount of cable needed to connect customers in their assumed serving areas and compare that minimum connecting distance, as the crow flies, with the amount of cable actually built by the model.
- The model sponsors are to extend the backbone and branch cable to the perimeter of lots, rather than just between lots.
- The formula that computes the required number of trunks must be changed to use working lines, rather than engineered lines.
- BCPM 3.1's formula associated with how engineering and installation costs for switching are developed must be corrected.
- The discrepancy between the cost per line and the amount of usage assigned on a per line basis to universal service, and the total amount of universal service-related switching investment must be resolved.

BASIS ON WHICH THE COST SHOULD BE DETERMINED

The Commission found that the total forward-looking cost of basic local telecommunications service, pursuant to Section 364.025(4)(b), Florida Statutes, should be determined by the modified BCPM 3.1 model at the wire center level. BCPM 3.1 actually calculates costs at a smaller geographic level than the wire center; however, this information is then used to aggregate costs into larger areas, including wire centers. Currently, however, the LECs gather data at the wire center level. For the LECs to collect data below the wire center level would be, at present, burdensome due to operational and administrative constraints. However, as data is gathered at smaller geographic levels, the Commission may need to re-examine the geographic level at which costs are calculated in order to target high cost areas with more precision.

APPROPRIATE INPUT VALUES FOR THE MODIFIED BCPM 3.1

BCPM 3.1 comes populated with national, default inputs that can be changed by users. The user-adjustable inputs can be grouped into four main categories: financial, unit investment, expense, and

engineering design. Financial inputs include depreciation, cost of money, and taxes. The unit investment inputs include, for example, prices for poles, copper and fiber cable, etc. Expense inputs include the cost of maintenance for cables and switches, for example. Engineering design inputs include such data as how much telephone plant is aerial versus underground, how many local calls are made, how much extra cable is installed to ensure that new service can be provided promptly, and the type of terrain (e.g., sandy or rocky soil) present in a given area.

As a cost proxy model is a time-sensitive, snapshot model, so are the inputs. This means that the input values in the Commission's order may need to be examined again, in the event of a significant time lapse between the order issuance and any use of the model results.

The Commission found that whether inputs should be specific to a geographic area or statewide values, depends not only on the particular input, but also what an efficient provider would use or encounter in Florida.

Structure sharing is an example of an input which the Commission found to be specific to a particular geographic area. Structure sharing represents the amount of outside plant structure (e.g., poles and conduit) that telephone companies share with other utilities; structure sharing percentage values yield the amount of investment for which the LECs are responsible. The Commission found that although a cost proxy model is forward-looking, one cannot assume that other utilities' (e.g., power and cable television) facilities will also be "scorched." In addition, the other utilities' structure requirements may differ from one geographic area to the next. Therefore, the Commission found that the ILECs' proposed structure sharing values should be accepted because they function as reasonable surrogates for an efficient provider in specific geographic areas.

An example of an input where the Commission found a single statewide value to be appropriate is the switch discount factor. Switches have list prices; however, each LEC negotiates its own discount from the list price. The Commission found that the discount is not specific to a particular geographic or serving area in Florida; rather, it is a function of a company's purchasing decisions and power. Since this proceeding is to develop the cost faced by an efficient provider, the Commission ordered a single discount amount to be used.

Signaling systems costs, the cost of communication among switches, is one input where the Commission found that the BCPM 3.1 default values are appropriate for BellSouth, GTE Florida, and Sprint-Florida. There was virtually no testimony from any party on this input, and all three LECs proposed the default values.

Expenses is another category of the inputs into BCPM 3.1. The Commission ordered statewide numbers for all expense categories, developed primarily through the averaging of inputs proposed by the ILECs, with some modifications. The statutory-mandated time frame for this proceeding did not permit exhaustive review of certain expense categories. The Commission recommends that in any further proceeding these expense categories undergo substantial scrutiny. Topics for future review and analysis include nonrecurring charges (and concomitant revenue streams), billing and collections for toll and access, and advertising.

Nonrecurring charges can be either installation or service change charges. Typically, they are one-time charges which are recovered on the first bill or, by special arrangement, over several billing periods. BellSouth and Sprint-Florida subsumed these costs in their expense calculations, while GTE Florida specifically excluded them. Given that these are one-time costs, the Commission is concerned that their inclusion in the expense calculations, even with averaging, may overstate the cost of basic local telecommunications services.

GTE Florida specifically excluded expenses for billing and collections for toll and access from its expense calculations. It is unclear whether BellSouth and Sprint-Florida subsumed billing and collections for toll and access charges in their expense calculations, although apparently they did. As with nonrecurring charges, the Commission is concerned that their inclusion in the expense calculations, even with averaging, may overstate the cost of basic local telecommunications services.

Advertising expense is included in marketing expense. All the parties agreed that advertising is a cost of business, and as such, some level should be included in the cost of basic local service. The difficulty is in determining exactly how much of advertising expense is reasonably attributable to basic local service, since much of the advertising appears to be related to vertical services. Detailed knowledge of advertising campaigns is necessary in order to determine with reasonable accuracy the amount of expenses related to advertising for basic local service. Determining a reasonable advertising level is complicated because the new, competitive paradigm is not yet firmly in place. The Commission reduced the amount of marketing, and thus advertising expense, included in the cost of basic local service from what the ILECs proposed. However, even with the reduction, and averaging, the Commission is concerned that the ordered expense still may overstate the cost of basic local telecommunications service.

FLORIDA LECS WHICH MUST USE THE MODIFIED BCPM 3.1 MODEL TO DETERMINE THE COST OF BASIC LOCAL TELECOMMUNICATIONS SERVICE

The Commission found that BellSouth Telecommunications, Inc., GTE Florida Incorporated, and Sprint-Florida, Inc. must use the modified BCPM 3.1 model to determine their respective costs of basic local telecommunications service appropriate for establishing a permanent universal service mechanism. The cost results for BellSouth Telecommunications, Inc., GTE Florida Incorporated, and Sprint-Florida using the ordered model and input values are contained in Appendix B.

THE COST OF BASIC LOCAL TELECOMMUNICATIONS SERVICE FOR EACH OF THE LECS THAT SERVE FEWER THAN 100,000 ACCESS LINES

Given the choice between the modified BCPM 3.1, a different cost proxy model, and a fully embedded cost study, the Commission chose the fully embedded study. The embedded cost study results for the seven small Florida LECS are shown in Table I-1. The embedded study includes such non-basic services as call waiting and nonrecurring costs. Generally, it also produces a lower cost than the output of the modified BCPM 3.1. However, if an incumbent LEC's embedded costs are lower than

the costs of a new entrant, the incumbent LEC can use its cost advantage to underprice an efficient provider, and thus prevent competition.

For information purposes, the Commission also performed studies for the small LECs, using the modified BCPM 3.1 model. Since there was no record evidence for inputs for these LECs, the Commission used the inputs ordered for GTE Florida; GTE Florida's values were chosen as surrogates to use for the small LECs because they tended to be higher than those of BellSouth or Sprint. These cost proxy model results for the small LECs are also included in Volume Two, Appendix B.

Table I-1 - Embedded Cost Results

Local Exchange Company	Monthly Embedded Cost Per Access Line
ALLTEL	\$41.32
Frontier	\$44.30
GTC - Florida	\$42.18
GTC - Gulf	\$33.43
GTC - St. Joe	\$38.99
ITS	\$65.50
Northeast	\$55.43
TDS Quincy	\$42.81
Vista-United	\$63.34

CHAPTER II: SUPPORT NECESSARY TO FUND LIFELINE FOR QUALIFYING SUBSCRIBERS

INTRODUCTION

In May 1998, the Florida Legislature passed HB 4785 relating to telecommunications services in Florida. One of the requirements of the bill is for the Florida Public Service Commission (Commission) to "determine and report to the President of the Senate and the Speaker of the House of Representatives the amount of support necessary to provide residential basic local telecommunications service to low-income customers" by February 15, 1999.¹ For the purpose of this legislation, low-income customers are those who qualify for Florida's Lifeline Assistance Program. The program is designed to defray a portion of the cost of telephone service to low-income residential customers.

The estimate of the amount of support necessary to provide residential basic local telecommunications service to low-income customers is a function of the number of eligible households and the funding level required. The eligibility standards for Lifeline Assistance in Florida include participation in any of the following programs: Medicaid, Temporary Assistance to Needy Families (TANF), Supplemental Security Income (SSI), food stamps, Federal Public Housing Assistance and Section 8, or the Low-Income Home Energy Assistance Program (LIHEAP). Thus, the major task of this study was to estimate the total number of households which currently participate in at least one of the six qualifying programs. Each Lifeline Assistance subscriber currently receives a total of \$10.50 per month in Lifeline assistance, including \$7.00 in federal Lifeline support and \$3.50 in matching state support. Therefore, the estimate of the annual amount of state support necessary to fund Florida's Lifeline Assistance program was based on \$3.50 per household, per month. In addition, a projection was made of the number of eligible households and the related support amount for 1999 and 2000. Data used in this study was obtained from each of the state and federal agencies responsible for administering the Lifeline-qualifying programs.

BACKGROUND

Lifeline assistance is part of the federal Universal Service program that is designed to enable low-income residential customers to afford basic monthly local telephone service. According to the Federal Lifeline program, states that provide matching funds may set their own eligibility standards. Eligibility standards for states which do not provide matching funds are determined by the Federal Communications Commission (FCC). The FCC's default eligibility standards include participation in any of the following programs: Medicaid, Temporary Assistance to Needy Families (TANF), Supplemental Security Income (SSI), food stamps, Federal Public Housing Assistance (including Section 8), or the Low Income Home Energy Assistance Program (LIHEAP).

¹Chapter 98-277, Section 1, (4)(d), Laws of Florida.

Since the passage of the Telecommunications Act of 1996, the FCC has increased the amount of available federal Lifeline support. Based on the new FCC Lifeline plan, a Lifeline Assistance subscriber receives a monthly credit of \$3.50 for the subscriber line charge, whether or not the state in which the subscriber resides participates in the FCC Lifeline plan. An additional \$1.75 of federal Lifeline assistance is provided to Lifeline subscribers in those states which adopt the FCC Lifeline plan, with no state matching required. However, in those states which agree to match the federal funding, the FCC authorizes an additional 50 percent of the state matching fund, up to \$1.75 in federal support. In other words, absent a state match, \$5.25 ($\$3.50 + \1.75) is the maximum federal support available. If a state provides matching support of \$3.50, then the maximum federal Lifeline support will be \$7.00 ($\$5.25 + \1.75). Including the \$3.50 of state matching support, a Lifeline subscriber would receive a monthly credit of \$10.50 (Table 1).

By Order No. PSC-97-1262-FOF-TP, issued October 14, 1997, the Florida Public Service Commission (Commission) adopted the FCC Lifeline program, thereby extending the additional baseline of \$1.75 to Lifeline subscribers. In Order No. PSC-98-0328-FOF-TP, issued on February 24, 1998, the Commission adopted the remaining \$1.75 of FCC Lifeline support with state matching support of \$3.50.² With this action, the maximum amount of support (\$7.00 federal support and \$3.50 state support) was made available to Florida Lifeline Assistance subscribers.

The Eligible Telecommunications Carriers (ETCs) in Florida receive reimbursement for the \$7.00 federal portion from the federal universal service program administered by a subsidiary of NECA. The full \$10.50 of Lifeline Assistance appears on customers' bills as a credit to intrastate rates for Lifeline subscribers.

Historically, the participation level in Florida's Lifeline Assistance Program has been low. In 1994, the first year of the Florida Lifeline program, there were 61,442 BellSouth low-income customers participating in Florida's Lifeline program. (The other Florida LECs did not offer Lifeline until late 1995.) By 1997, participation had increased to 133,664 households. A recent data request revealed that as of December 1997, the participation level was 130,664 households. By July 31, 1998, the number had dropped to 129,396.

Low Lifeline subscribership levels may be due to a number of factors, including a low number of eligible households, a low participation rate for eligible households, or a combination of both reasons. The low participation rate for eligible households may result from a lack of knowledge of the Lifeline program on the part of either the low-income customers or the state agencies that administer the qualifying programs, or possibly the reluctance on the part of some low-income customers to participate in what they may perceive to be another welfare program.

²A state can choose whether or not to provide matching funds and how much to match, but the 50 percent federal matching policy is capped at \$1.75. In other words, if a state Lifeline contribution is greater than \$3.50, the portion above \$3.50 will not get any federal matching. The \$3.50 state contribution was established by the Florida Public Service Commission in Order No. PSC-98-0328-FOF-TP, issued February 24, 1998.

As a result of the low subscribership levels in Florida's Lifeline program, the Florida Public Service Commission adopted expanded eligibility criteria in its Order No. PSC-98-0328-FOF-TP to replace AFDC with Temporary Assistance to Needy Families (TANF), and to include Federal Public Housing Assistance and Section 8, and LIHEAP.³ In addition, the Commission entered into an Interagency Agreement in March 1998 with the Florida Department of Elder Affairs, the Florida Department of Children and Families, and the Florida Department of Labor and Employment Security to educate consumers about the availability of the Lifeline program.

**TABLE 1
LIFELINE ASSISTANCE FUNDING**

\$ 3.50	Baseline federal Lifeline support
<u>+\$ 1.75</u>	Additional baseline federal Lifeline support if state adopts FCC Lifeline Plan
\$ 5.25	Total support available without any state contributions
<u>+\$ 1.75</u>	Maximum additional federal support available (up to 50% of state support)
\$ 7.00	Maximum federal support available
<u>+\$ 3.50</u>	State support needed to maximize federal support
\$10.50	Total Lifeline support available in Florida as of April, 1998

Source: Division of Communications

METHODOLOGY

The current amount of state matching support for Lifeline Assistance is \$3.50 per month, pursuant to Order No. PSC-98-0328-FOF-TP. The substantive portion of this study deals with estimating the number of low-income households which qualify for the Lifeline Assistance program in Florida. The straightforward multiplication of the state matching amount of \$3.50, times the number of eligible households, will yield the estimated amount of monthly support needed to fund Lifeline in Florida.

Commission staff solicited program participation data from those state and federal agencies that administer the six Lifeline-qualifying programs. State liaison agencies exist for each of the federal programs except for the Public Housing Program, which is administered by the U.S. Department of Housing and Urban Development (HUD). In Florida, the Department of Children and Families (DCF)

³This program was previously referred to as "Aid to Families with Dependent Children" (AFDC). Federal welfare reforms replaced AFDC with TANF.

administers the food stamps, TANF,⁴ and non-SSI Medicaid programs and the Agency for Health Care Administration (AHCA) administers the SSI Medicaid program. The Florida Department of Community Affairs (DCA) administers LIHEAP.

Initially, the number of current Lifeline-eligible households was going to be estimated by attempting to collect the most updated program recipient data from each of the six programs. Data regarding recipient addresses was requested in an electronic format so that the data could be matched electronically to identify and eliminate duplicate households, using identifiers such as addresses and Social Security numbers. The address-matching process was expected to result in an accurate estimate of the number of eligible Lifeline households, without duplication across the six qualifying programs. In addition, the agencies were requested to provide household data, rather than individual or caseload data, since Lifeline assistance is provided to households.

In order to facilitate this task, several preliminary steps were taken. Phone calls were made to each of the state and federal agencies to obtain fundamental information about the qualifying programs and the availability of the required data. Meetings were held between Commission staff and each of the agencies, with the exception of HUD, to gain a better understanding of the way their program data are maintained and manipulated. Data requests were then sent to each agency as the official means of collecting the requested data. Phone calls were made, where necessary, to clarify the data request or to make follow-up inquiries regarding late or missing responses.

Although analyzing all of the agencies' participant address data sets collectively for multiple occurrences of participant identifiers could not be performed, each agency was able to perform such analysis within its own programs and account for each participant household only once. The DCF eliminated duplicate participant identifiers both with and between the Medicaid, food stamps, and TANF programs. In addition, the DCF eliminated from the resulting household data set any household which participated in SSI. The AHCA identified the total, unduplicated number of households participating in SSI. The number of participants reported by both the DCF and the AHCA provided the participation level for four of the six Lifeline-qualifying programs, without duplication of households.

HUD performed an address-matching routine of Public Housing and Section 8 recipient households with TANF and SSI recipient households and eliminated duplicate household counts. While that number still contains some level of duplication between Public Housing/Section 8 households and the households reported in the other three programs (Medicaid, food stamps, and LIHEAP households not receiving TANF or SSI), the number of duplicate households is believed to be negligible. Finally, no address matching was possible for LIHEAP recipient households against any of the other five programs, nor was it possible to make a precise statistical inference of the proportion of LIHEAP recipients participating in any of the other five programs. However, a best-guess assumption was made in order to approximate the appropriate number of LIHEAP households to be included.

⁴In Florida, TANF is referred to as the Work And Gain Economic Self-sufficiency (WAGES) program.

An effort was made to obtain projected program participation data for 1999 and 2000 from the agencies. Although the agencies did provide some projections of program participant growth rates, they did not provide sufficient participant forecast data necessary to develop a precise forecast of Lifeline-eligible customers in Florida for 1999 and 2000. Some of the programs, such as LIHEAP, are based on the availability of federal funding, which may change in the future depending upon legislative budgeting. Historical program participation data, assumptions regarding conversions of caseload data to household data, projected program participation, growth rate data, projected unit caseload, and household data provided by the agencies were used to develop projected household participation levels for 1999 and 2000.

LEGAL, TECHNICAL, AND ADMINISTRATIVE ISSUES

Several issues emerged during the data collection process which added a source of potential error to the qualifying household estimation process. First of all, the legislation is silent regarding the time frame for estimating or projecting the Lifeline program support requirements. This is important because the participation levels in each qualifying program do not remain constant over time. Therefore, we requested both current and projected data from the agencies.

The second issue involves the ways in which the various agencies maintain and format their participant data. Merging the databases of the different programs in order to identify and eliminate duplicate households is difficult, and in some cases even impossible. Each agency administering the qualifying programs maintains its recipient database for its own management or budget purposes. For example, AHCA maintains Medicaid program participation data by individual case or caseload, rather than by household participation. Other agencies maintain program participation data based on household units. Converting all program participation data into recipient household data is time-consuming and burdensome, since address information may not be available or may exist only in written, non-electronic format. In addition, even if the data are maintained in electronic format, any one qualifying program's data format may be incompatible with another's. The FPSC relied on the agencies to provide the number of households, as opposed to individuals or caseloads, participating in the program(s) they administer. In addition, we relied on certain agencies, such as DCF, to identify, to the extent possible, those households participating in more than one qualifying program.

Third, even if each of the agencies had program recipient data which could be technically merged for address-matching purposes, there are often confidentiality requirements which prevent release of the data. Agencies usually have little difficulty in providing a total number of recipients. However, to run computerized recipient address matches in order to avoid double-counting of qualifying households requires agencies to release confidential recipient data, such as names, social security numbers, or addresses. Agencies are understandably reluctant or unwilling to share data in circumstances where the legality of such actions is questionable. The confidentiality issue stands as a legal hurdle to the task of eliminating recipient duplication across the six qualifying programs.

The fourth issue encountered during the Lifeline study is the limited availability of agencies' resources and personnel to respond to Commission staff's data requests. The administrative agencies

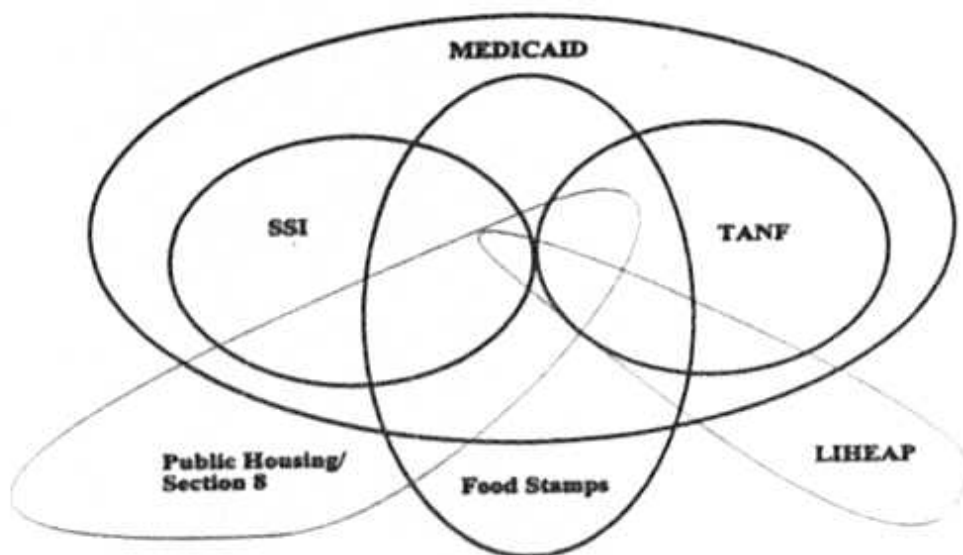
were dealing with internal demands which, in some instances, prevented them from responding in a timely fashion to our data requests. In addition, because of the time constraint placed on the agencies to provide the requested data, their responses were not as complete as they might have been, given more time to respond.

THE FINDINGS

ESTIMATED NUMBER OF CURRENT ELIGIBLE LIFELINE CUSTOMERS AND LIFELINE SUPPORT

A generalized model of the household participation interrelationships between the Lifeline-qualifying programs is depicted in the Venn Diagram below. Obviously, elimination of multiple occurrences of participating household identifiers, such as addresses and Social Security numbers, is a major issue when trying to sum the number of participating households in these programs.

**Potential Overlapping Household Participation
Among the Lifeline Qualifying Programs**



The result of eliminating duplicate household participation identifiers is represented in Table 2. The first column identifies the agency that administers the program. The second column identifies the program(s). The third column indicates the estimated total number of households currently participating in programs administered by each agency, without duplication, for the program in question. Elimination of duplicate identifiers within a program is necessary, since sometimes a single program may have many sub-programs, and households may participate in more than one sub-program. The fourth column of Table 2 contains the estimated, unduplicated number of households participating in a Lifeline-qualifying program. This estimate represents the most current program participation data available from the agencies.

TABLE 2
1998 ESTIMATED HOUSEHOLDS ELIGIBLE TO RECEIVE
LIFELINE ASSISTANCE IN FLORIDA

Administering Agency	Lifeline-Qualifying Programs	Total Households	Unduplicated Households
DCF and AHCA	Total Medicaid, TANF, and SSI	627,437	627,437
DCF	Food Stamps	417,360	50,500
HUD	Public Housing and Section 8	151,178	103,341
DCA	LIHEAP	69,999	25,000*
	Total Eligible Households	---	816,278
	Annual Lifeline Support		\$34,283,676

*LIHEAP households participating in other programs is estimated to be 50%.

As shown in Table 2, we estimated that the total number of unduplicated households currently participating in Lifeline-qualifying programs is 816,278. (We acknowledge the potential for an unknown, but relatively small, percentage of error in this estimate.) The estimated annual amount of state support required to fund Lifeline Assistance, at the current funding level of \$3.50, is \$34,283,676. This estimate includes all households which qualify for Lifeline Assistance.

As of December 31, 1997, only 130,664 households out of 816,278 qualified households subscribed to Lifeline Assistance. Thus, Florida households that subscribe to Lifeline Assistance represent 16 percent of the Florida households estimated to be qualified to receive assistance.

Medicaid. DCF reported 320,976 households participating in either TANF or Medicaid, but not SSI, during August 1998. DCF did not include nursing home recipients, since Lifeline Assistance is normally not provided in nursing home facilities. AHCA reported that 306,461 households received SSI benefits in August 1998. The sum of these two amounts (627,437) represents the total number of unduplicated households participating in Medicaid, TANF, and SSI.

Non-SSI Medicaid, including TANF	320,976
SSI Medicaid	<u>306,461</u>
Total Medicaid ⁵	627,437

Food Stamps. DCF maintains the database for food stamp recipients, which totals 417,360 households. However, DCF determined that only 50,500 of these households do not receive some other type of Medicaid assistance. Therefore, the unduplicated number of food stamp households is 50,500.

Public Housing and Section 8. The HUD reported 151,178 households participating in Public Housing or Section 8 programs during July 1998. In order to address the problem of duplication between these and other Lifeline-qualifying programs, HUD provided percentage estimates of Public Housing and Section 8 household participation in other public assistance programs, which primarily include TANF and SSI. However, some small amount of duplication may remain between Public Housing and Section 8 households and Medicaid general assistance programs. HUD was not able to determine this amount of duplication.

Table 3 contains the HUD data used to estimate the number of Public Housing and Section 8 households that do not receive other public assistance. The estimated number of unduplicated households participating in Public Housing and Section 8 programs is 103,341.

TABLE 3
1998 ESTIMATED HOUSEHOLDS PARTICIPATING
IN PUBLIC HOUSING AND SECTION 8 PROGRAMS

Public Housing and Section 8 Programs	Total Households	Households Receiving Other Public Assistance	% Households Receiving Other Public Assistance	Unduplicated Households
Public Housing	43,852	18,418	42%	25,434
Certificates and Vouchers	66,596	23,309	35%	43,287
Project-Based Section 8	40,730	6,110	15%	34,620
Total Households	151,178	47,837	32%	103,341
*Some small amount of duplication may remain between Public Housing and Section 8 households and Medicaid general assistance programs. HUD was not able to determine this amount of duplication				

⁵Some Medicaid recipient households do not have telephone service as a result of disconnection for non-payment. These households are included in staff's estimate of Lifeline-eligible households, since they continue to meet the criteria established for Lifeline qualification.

LIHEAP. LIHEAP reported 69,999 households receiving assistance in Florida in 1997. Actual monthly data for 1998 was unavailable.⁶ Our efforts to eliminate duplicate identifiers of those LIHEAP households which participate in other programs were unsuccessful for two primary reasons. First, Florida LIHEAP Administrator Robert Lakin indicated that recipient address information is confidential. Second, LIHEAP has no central database for LIHEAP participants in Florida. Instead, 32 field offices, involving non-affiliated, cooperating agencies or governments, maintain data pertaining to the LIHEAP program. The field offices often do not maintain their LIHEAP recipient data in electronic format, so that centralized deposit of recipient information is not performed. The field offices report their total number of participants to DCA.⁷ For these reasons, households participating in both LIHEAP and one or more of the other qualifying programs cannot be identified.

Because of the low-income criteria for all Lifeline-qualifying programs, including LIHEAP, there may be a significant portion of the total number of LIHEAP participants who also receive funding from one or more of the other programs. Lacking any precise method of determining the amount of duplication, we made a simplifying assumption that half of all LIHEAP participants are active in at least one of the other programs. Thus, the FPSC estimates that currently 35,000 Florida households receive only LIHEAP Assistance and no other program funding or assistance from the other five programs. With the understanding that this simplifying assumption may result in substantial error in the estimate of the number of unduplicated LIHEAP households, this error is mitigated by the fact that LIHEAP in total represents less than 10 percent of all households which qualify for Lifeline Assistance in Florida.

ESTIMATED NUMBER OF FUTURE LIFELINE-ELIGIBLE HOUSEHOLDS AND LIFELINE SUPPORT

Input from DCF, DCA, and HUD, as well as information provided by the Division of Economic and Demographic Research (EDR) of the Joint Legislative Management Committee, was used to project the number of households that may be eligible to receive Lifeline Assistance in 1999 and 2000.

Florida's Medicaid enrollment is expected to increase about 5.6% in 1999 and about 2.5% in 2000. Therefore, we projected Medicaid enrollment of 622,574 in 1999 and 679,138 in 2000.

According to DCF, the number of Florida households participating in food stamps will decrease by approximately 1.7% in 1999 and will further decrease by approximately 1.1 % in 2000. Therefore, we projected households participating in the food stamp program to be 49,641 in 1999 and 49,095 in 2000.

⁶DCA maintains annual, but not monthly, LIHEAP participation data.

⁷According to the DCA LIHEAP program office, the LIHEAP funds are provided directly to energy utility companies, which in turn credit LIHEAP recipient accounts. Hence, DCA referred staff to the energy utility companies as potential data sources for LIHEAP accounts. However, upon inquiry, the utility companies responded that they either did not have such information available in a form that could be readily extracted electronically from their customer databases or they could only do so through incurring significant programming expense.

HUD stated that it expects approximately 1,000 additional Florida households to participate in the Section 8 certificate and voucher programs in each of the next two years. HUD further stated that it expects no change in participation levels for any other Public Housing and Section 8 programs. The projected participation in Public Housing and Section 8 programs is 104,341 in 1999 and 105,341 in 2000.

DCA did not provide explicit projection data for LIHEAP participation. However, Florida LIHEAP Coordinator Robert Lakin indicated that LIHEAP funding has maintained a level of \$13 million to \$14 million in recent years. Assuming this funding level does not change significantly during the next two years, LIHEAP household participation should not change significantly. Therefore, an estimate of 35,000 households was used for 1999 and 2000.

TABLE 4
PROJECTED HOUSEHOLD PARTICIPATION
IN LIFELINE-QUALIFYING PROGRAMS IN FLORIDA,
1999-2000

Lifeline-Qualifying Programs	Unduplicated Households	
	1999	2000
Total Medicaid, TANF, and SSI	662,574	679,138
Food Stamps	49,641	49,095
Public Housing	104,341	105,341
LIHEAP	35,000	35,000
Total Lifeline-Eligible	851,556	868,574
Annual Lifeline Support	\$35,765,352	\$36,480,108

As shown in Table 4, the projected number of Lifeline-eligible households in Florida for 1999 is 851,556. Using the current state funding level of \$3.50 per household, per month, the projected annual amount of support required to fund Lifeline Assistance in Florida in 1999 is \$35,765,352, assuming all households that qualify for such assistance receive it.

The projected number of Lifeline-eligible households in Florida for 2000 is 868,574. Using the current state funding level of \$3.50 per household, per month, the projected amount of annual support required to fund Lifeline Assistance in Florida in 2000 is \$36,480,108, assuming all households that qualify for such assistance receive it.

FLORIDA DEMOGRAPHIC ANALYSIS

According to the most updated EDR demographic information, Florida's total population was 14,712,922, as of April 1, 1997.⁸ According to the U. S. Bureau of Census, 14.3% of Floridians, or 2,103,948 people, were living under the federal poverty line in 1997.⁹ EDR also estimated that the average household size for participants in the TANF regular programs is 2.596 persons per household. Based on this data, we estimated that the number of Florida households living under the federal poverty line in 1997 was 810,458.

Our estimate of 1998 Florida Lifeline-eligible households (816,278) is 101% of the estimated number of households living under the federal poverty line during 1997 (810,458). These data indicate that the majority of impoverished households in Florida qualify for Lifeline assistance.

⁸www.state.fl.us/edr/ (visited November 18, 1998).

⁹The U.S. Bureau of Census provides the average percentage of people in poverty in 1995, 1996, and 1997 for each state. [Http://www.census.gov/hhes/poverty/poverty97/pv97state.html](http://www.census.gov/hhes/poverty/poverty97/pv97state.html) (visited October 26, 1998).

CHAPTER III: PERMANENT UNIVERSAL SERVICE MECHANISMS

On several previous occasions (in particular, in the December 1996 report, Universal Service in Florida, and in the Commission's 1997 annual report on the status of local competition) the Florida Public Service Commission has addressed itself to whether an explicitly funded universal service mechanism is needed and, if deemed necessary, how such a mechanism should be implemented. Much of the narrative in this chapter reiterates and builds on the major themes and conclusions from these prior documents.

WHY UNIVERSAL SERVICE FUNDING MAY BE NEEDED

Universal service policy traditionally has focused on two general principles: availability and affordability. Prior to the 1995 revisions to Chapter 364, the availability of high-quality basic local service was ensured by requiring LECs to provide service throughout the geographic area over which they were given exclusive grants of authority. Although most LECs have now opted for price cap regulation and local competitive entry is allowed in their territory, Section 364.025(1) requires them to retain this "carrier of last resort" responsibility until January 1, 2000.

Affordability was realized primarily by the pricing of customer access to the network and local usage on a bundled, flat-rate basis at a price level that is often argued to be below the cost of providing the service. Under rate of return regulation, rates in the aggregate were set to generate a revenue requirement to cover a company's overall costs and return on investment. In the case of residential local service, which was residually priced, there was little concern whether the rates that were established covered their associated costs. Historically, additional support has been received through the pricing of other services, notably long distance, access and vertical services, at rates substantially above cost, thereby generating support for basic local service. Although many Florida LECs have chosen price cap regulation, their basic local service rates are capped at levels that were set under a rate of return regime.

Under a monopoly, rate of return environment, pricing local service in this manner was sustainable, and often considered desirable public policy. A consequence has been that residential subscribership has achieved an extremely high level. As of March 1998, telephone penetration in Florida (the percentage of households with telephone service) had reached 93.3%. Thus, there would be an understandable reluctance to tinker with something that has worked.

However, while they still retain extremely large market shares, those Florida LECs that have opted for price cap regulation also gave up their status as the monopoly provider of local exchange service within their respective service territories. As such, the problem to be faced is that competitive entry by CLECs may erode the revenue streams that currently provide substantial contribution to universal service. Where the LECs' rates exceed costs, there is an incentive for competitors to target such lucrative high-margin services and customers. While the loss of a few customers is not critical, sufficient erosion could occur over time to undermine the viability of the existing subsidy arrangement. Pressure to increase local rates could mount, and if rate increases

occur, there could be a potential negative impact on subscribership, especially among low-income groups and in rural and high-cost areas.

Moreover, one would expect that local exchange competitors would initially target their entry in the lowest cost areas, to customers that have the largest overall demand for telecommunications services and the greatest ability to pay. For example, in 1995 during the interim universal service proceeding, GTE Florida noted that less than two percent of its customers provided 46 percent of its toll revenues. The LECs have previously cited their belief that it is in highly concentrated areas and to such lucrative customers that the CLECs will target -- especially facilities-based competitors.

Although the impacts to date do not appear to have been detrimental on universal service, a comparison of evidence from the FPSC's 1997 and 1998 annual reports on local exchange competition supports the above hypothesized entry patterns by CLECs. In 1997 CLECs served a total of 56,160 access lines, or approximately .5% of all access lines in Florida. Of this total, 13,857 were residential, representing .2% of all residential lines, and 42,303 were business, representing 1.4% of all business lines. In 1998 total CLEC lines served had grown to 194,142 or 1.8% of all lines. However, their share of business lines had increased to 143,959 or 4.3% of business lines, while their residential share grew to 50,183 or .7% of residential lines. In 1998 CLECs had at least 5% of the total access lines in several of Florida's major metropolitan areas: Ft. Lauderdale, Jacksonville, Miami, and Orlando.

From this data it is evident that many CLECs are focusing on the state's high-density, low-cost urban areas, with particular emphasis on business customers, who tend to generate total revenues disproportionately higher than their number of access lines (e.g., because they have higher consumption of toll and certain vertical services). In contrast, it appears that there is less interest in serving the residential market, because of this market's probably lower average revenue per line. In addition, around 20% of the exchanges in Florida (primarily rural) still have no CLECs offering service.

Accordingly, there are potentially two at-risk consumer sectors that entrants may ignore but who may be adversely affected by competitive entry: low-income customers, and those customers who reside in areas where the cost to serve is high. To preserve the longstanding goals of availability and affordability in a competitive environment, intervention may be warranted. To ensure ubiquitous availability of universal service, restrictions on market exit by local providers are warranted. While Section 214(e)(4) of the federal Telecommunications Act of 1996 provides that an eligible telecommunications carrier (ETC) may relinquish its ETC status in a given area served by more than one ETC, it requires the carrier to provide advance notice to a state commission and for the commission to ensure other ETCs will continue to serve the customers of the exiting ETC. Further, Section 214(e)(3) affords a state commission the authority to require a carrier to serve an unserved area. Since the combination of these two federal provisions imposes reasonable exit conditions on eligible telecommunications carriers, it does not appear that state action is needed at this time. However, to sustain affordability for low-income and high-cost customers, under certain conditions it may be appropriate to allow for explicit funding to providers, in exchange for an explicit assurance of service to such customer groups at a rate deemed affordable by society.

The next two sections contain our recommendations regarding possible intrastate support for low-income customers, and for providers serving high-cost areas, while the last section pertains to general implementation issues associated with implementation of any universal service mechanism.

INTRASTATE SUPPORT FOR LOW-INCOME CUSTOMERS

BACKGROUND ON LIFELINE

In its Report and Order on Universal Service in CC Docket No. 96-45 (FCC Order No. 97-157), released May 8, 1997, the FCC indicated that it was expanding the scope of its Lifeline program, with the changes to be effective on January 1, 1998. A baseline federal support amount of \$3.50 per month for Lifeline subscribers is now available in all states, the District of Columbia, and all territories and possessions, regardless of whether any intrastate support is provided. This baseline amount of federal support is increased from \$3.50 to \$5.25, provided only that the state approves the additional support being passed through in intrastate rates. Finally, the federal jurisdiction will also provide additional Lifeline support equal to one-half of any intrastate support, up to an additional \$1.75 of federal funding. Consequently, a total of \$7.00 in federal universal service support can be received for each Lifeline subscriber, if a state provides \$3.50 in intrastate support. By way of illustration, a single-line residential customer in Miami would pay \$10.65 for the access line plus \$3.50 for the subscriber line charge, for a total of \$14.15 (disregarding miscellaneous taxes and fees). A Lifeline subscriber would receive a total credit of \$10.50 against these charges, thus paying \$3.65 (again excluding miscellaneous taxes and fees).

In an order dated October 14, 1997 the Commission adopted the initial \$1.75 (for a total Lifeline amount of \$5.25) but declined to adopt the remaining \$1.75, because it was unclear from the FCC's May 1997 Universal Service Order whether Florida's Lifeline program, which requires LECs to absorb the \$3.50 state match, qualified as providing matching state support. Instead, on October 19, 1997, the FPSC filed a petition with the FCC, seeking clarification as to whether Florida's Lifeline regulatory treatment qualified as providing state matching for purposes of receiving federal funds. In December 30, 1997, the FCC released its Fourth Order on Reconsideration in the Universal Service docket in which it resolved the subject matter contained in Florida's petition. The FCC responded:

Consistent with the [FCC's] earlier finding that we should not prescribe the methods that states use to generate intrastate Lifeline support in order to qualify for federal support, we conclude that, although all carriers are not required to contribute to Florida's Lifeline support mechanisms, Florida's Lifeline program nevertheless qualifies as providing intrastate matching funds. (FCC 97-420, Fourth Order on Reconsideration in CC Docket No. 96-45, Report and Order in CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, ¶132)

By Order No. PSC-98-0328-FOF-TP, issued on February 24, 1998, the Commission modified its Lifeline policy so that eligible Florida consumers can now receive the \$10.50 maximum funding amount.

Although the FCC concluded that Florida's regulatory treatment equates to providing matching funds, they also noted that this policy requires only LECs to contribute. In its Universal Service Order the FCC adopted competitive neutrality as an additional principle to be considered when determining universal service support. They defined this principle as:

COMPETITIVE NEUTRALITY -- Universal service support mechanisms and rules should be competitively neutral. In this context, competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another. (FCC 97-157, ¶47)

Since the burden of providing the intrastate matching monies falls solely on the incumbent local exchange companies, Florida's Lifeline program clearly is not competitively neutral.

Currently, Section 364.10(2), Florida Statutes, requires that ". . . a telecommunications company serving as carrier of last resort shall provide a Lifeline Assistance Plan to qualified subscribers. . . ." While the incumbent LECs presently are the carriers of last resort (COLRs) in their service areas, Section 364.025(5), Florida Statutes, allows for an alternative local exchange company (ALEC) to ". . . petition the commission to become the universal service provider and carrier of last resort in areas requested to be served by that alternative local exchange telecommunications company. . ." after January 1, 2000.

An "eligible telecommunications carrier" (ETC) is the notion analogous to a COLR in the Telecommunications Act of 1996 (TA 96, or the Act). In order to receive federal universal service funding, a carrier must be designated by a state commission as an ETC. Section 214(e)(1) of the Act states that in order to be designated an ETC and thus

eligible to receive universal service support in accordance with section 254 . . . shall, throughout the service area for which the designation is received --

- (A) offer the services that are supported by Federal universal service support mechanisms under section 254(c), either using its own facilities or a combination of its own facilities and resale of another carrier's services (including the services offered by another eligible telecommunications carrier); and
- (B) advertise the availability of such services and the charges therefore using media of general distribution.

The LECs were designated ETCs in their existing territory by the Commission; to date, no ALEC has requested designation as an ETC.

It appears there is a minor conflict between the federal statute and Florida law. Florida law requires a COLR to offer Lifeline; after 1/1/2000, an ALEC can become the carrier of last resort within a given area. However, Section 214(e)(2) of the Act requires that a state commission designate multiple ETCs in non-rural areas, as long as each carrier meets the standards in 214(e)(1) and doing so is in the public interest. Assuming the intent was not to preclude there being multiple COLRs within a given geographic area, perhaps the simplest legislative remedy is to substitute "a" for "the" in Section 364.025(5).

LIFELINE RECOMMENDATION

As the FPSC has stated in previous reports, we believe there is merit in eliminating the existing competitive inequity whereby the LECs and their customers absorb the \$3.50 per line state match, by expanding who must fund Florida's Lifeline program. Although the absence of explicit state level funding of Lifeline may have been appropriate under rate of return regulation, where a LEC could apply for rate increases if needed, we believe that in the long term this policy is likely not sustainable in a competitive environment. Local exchange companies with qualifying customers could provide a disproportionate share of the state matching funds for those customers, while providers with no Lifeline customers would contribute nothing. The provider serving the most low-income customers thus would be disadvantaged.

Although we recognize the merit of eliminating the competitive inequity associated with funding Lifeline, the FPSC believes that, on balance, the LECs do not currently bear an undue burden by absorbing the \$3.50 state match. We reach this conclusion based on the relatively low program subscribership and thus the relatively small effective funding requirement. Consequently, we do not believe it is necessary to establish a funded Lifeline universal service mechanism at this time.

Because of the FPSC's ongoing role as the agency directed to monitor competitive conditions in the evolving telecommunications industry in Florida, we further believe that the Commission is well suited to determine if and when a funded universal service mechanism should be established. Accordingly, the FPSC requests that the Legislature grant the Commission the authority to establish a funded mechanism when the Commission makes a determination that such a fund is necessary.

INTRASTATE SUPPORT FOR PROVIDERS SERVING HIGH-COST AREAS

POTENTIAL NEED FOR HIGH-COST FUNDING

As discussed earlier, successful and pervasive competitive entry by CLECs (other than pure resellers) may result in the erosion of contribution from high margin services provided in low-cost areas, that is currently the source of funds for the provision of subsidized services in high-cost areas. The cost of providing basic local service varies significantly throughout Florida but is driven primarily by two variables: density (typically measured by the number of lines provisioned per square mile) and distance (the length of the local loop, measured from a customer's premises to the serving

central office). Not surprisingly, major urban areas generally reflect high line densities and relatively short loops, while the characteristics in rural areas are reversed.

As reflected in the wire center cost results in Appendix B, urban versus rural cost differences can be quite dramatic, with urban average monthly costs per access line typically in the \$15 - \$20 range, while rural average monthly costs per access line can be in the hundreds of dollars. (In fact, cost can vary significantly within a wire center.) However, incumbent LECs' existing prices for residential and business exchange access services were set based on value of service principles, not based on the cost to serve. Under value of service pricing, the greater the number of lines that could be called, the higher the access line rates. As a result, the highest rates are charged in those areas where, on balance, the costs are the least. For example, BellSouth currently charges a single-line business customer \$29.10 in Rate Group 12, which has a calling scope in excess of 700,000 lines and likely represents its highest line densities; in all likelihood, this rate exceeds the cost to serve. In contrast, BellSouth's comparable rate in Rate Group 1, which has a calling scope of a maximum of 2,000 lines, is only \$19.80; it is doubtful that this rate covers its cost.

In addition to large businesses locating primarily in urban areas, they tend to generate a disproportionate share of a LEC's revenues -- especially for such high margin services as toll, access, and features. Although data are not readily available at present, historically toll revenues roughly reflected a 80/20 rule: 80% of the revenues were generated by only 20% or so of the customers. (This is consistent with GTE Florida's experience, cited earlier, that less than two percent of its customers provided 46 percent of its toll revenues.) Thus, if a CLEC successfully lures away low-cost, high-volume business customers, the net contribution foregone by a LEC could be significant.

Although the potential for a LEC to experience competitive erosion of its high-margin customers while retaining its high-cost (and perhaps priced below-cost) customer base is a real concern, the Commission has not discerned any such major impact to date. In the FPSC's 1996 report to the Legislature on universal service, and again in the Commission's 1997 and 1998 annual reports on the status of local competition, we have stated that our research has indicated that universal service in Florida has not been adversely affected. As anticipated, local exchange competitive entry has been gradual but it is occurring, especially for business customers. While we have not conducted an exhaustive analysis of the causes, it is probable that the absence to date of any impact on universal service may be due to strong underlying growth in access lines and minutes of use; while the LECs may be losing some market share, they still have the dominant share of an increasing market.

In our 1997 annual report on local competition, the last time this Commission submitted comments on universal service to the Legislature, we recommended that the Legislature delay passing universal service legislation because of uncertainties as to the impacts of FCC actions regarding their overhaul of the federal universal service mechanisms. In particular, the FCC had indicated that beginning in 1999, high-cost funding for non-rural LECs (BellSouth, Sprint, and GTE Florida, in Florida) would be based on the difference between the costs determined by a cost proxy model and a revenue benchmark. The FPSC noted, however, that the FCC had not selected the cost proxy model to be used, had not specified how to arrive at the revenue benchmark, and not decided what

geographic areas would be the basis for funding. Moreover, it was uncertain whether or not federal high-cost monies would continue to be used to offset intrastate revenue requirements and thus support local rates, as had been the case traditionally.

Since then, the FCC has made some headway with respect to revamping its high-cost mechanism for non-rural LECs. It has selected the cost proxy model that will be used to compute costs. It reconvened the Federal-State Joint Board for further consideration of certain key issues -- most notably, whether federal funding would be limited up front to 25% of the difference between the model's results and a revenue benchmark, and whether federal funding would be applied against intrastate revenue requirements. The Joint Board released its Second Recommended Decision in November 1998, and the FCC is seeking comments prior to its issuance of an order on the topics addressed in the decision. Of importance to the states is the Joint Board's and the FCC's public endorsement of a "hold harmless" provision, whereby under the new funding mechanism no state would receive fewer dollars than under the prior mechanism. However, the FCC still has to complete the selection of inputs to use in the model, and determine how to establish the benchmark, among other tasks.

While we believe that any state actions that result in explicit intrastate funding for serving high-cost areas must acknowledge any interstate universal service support that is received, we no longer believe it is necessary to wait for the FCC to complete its proceeding prior to the Florida Legislature taking action. We feel reasonably confident that enough is known about the FCC's general direction that the probable effects of a revised federal program can be accommodated. Further, Section 364.025, the Florida universal service statute, presently indicates that the Legislature "shall establish a permanent universal service mechanism" prior to January 1, 2000. Accordingly, some legislative action (which may or may not result in creation of a permanent mechanism) appears required.

RISKS RELATED TO PREMATURE HIGH-COST FUNDING

Although failure to take timely action by creating an explicit high-cost fund to offset lost contribution could have an adverse effect on universal service in Florida, premature funding could undermine meaningful local exchange competitive entry. We believe that truly rivalrous competition can only occur through the use of unbundled network elements (UNEs) and through the existence of facilities-based local competition. In developing a business case to decide whether or not, and under what conditions, to enter a market, an entrant will consider all possible sources of revenue. For example, if using UNEs an entrant will compare the price it is charged for an unbundled loop by the incumbent LEC not just to the LEC's retail loop-based offering, but to the entire stream of costs and revenues involved. Assume that the CLEC faced a UNE loop rate from the LEC of \$15 and also had internal costs of \$4, for a total cost per line of \$19. If the LEC's comparable retail offering was priced at \$17, then the CLEC has a shortfall of \$2 and thus there is an insufficient margin to justify the CLEC's business case.

However, whoever provides the end user's loop is guaranteed the switched access revenues associated with that end user's toll traffic. If the CLEC's cost of providing switched access was \$.005 per minute and the prevailing LEC access rate were \$.045, the CLEC could break even in this example if his subscriber generated a combination of just 50 minutes of inbound or outbound toll calling. ($\$2.00$ divided by $(\$0.045 - \$0.005) = 50$ minutes)

A key component of any universal service plan for serving high-cost areas is that it must be revenue neutral for incumbent LECs at the onset of funding. For every dollar received from the universal service mechanism, the LEC must reduce rates so as to effect a one dollar reduction. High margin services such as switched access, toll, and vertical features are popular candidates for such an offsetting rate reduction.

Assume that a LEC is not suffering any net competitive erosion to any meaningful degree, high-cost universal service funding has begun, and switched access rates have been chosen to be reduced from \$.045 per minute to \$.005. Consider the consequences: CLEC entry that would otherwise have occurred, is stifled; the LEC's competitive posture is enhanced, since the entry hurdle for a CLEC has been raised; and since funding of universal service mechanisms is typically from virtually all telecommunications carriers, a sizeable portion of the switched access rate reduction was funded by carriers other than the LEC, including the LEC's competitors.

In addition to the possibility of impacts that undermine the presumed goal of fostering competition, it must not be overlooked that the effect of creating a universal service mechanism is to increase the costs of doing business for some telecommunications providers -- costs that will be passed on to consumers either through explicit charges or through the rates for the provider's services. Regardless of the perceived societal benefit of the program, some consumers will pay more than they do today. In its Second Recommended Decision released on November 25, 1998, the Joint-Board acknowledged the delicate balancing act in establishing a sustainable universal service policy in a competitive environment:

The transition to a competitive environment requires us to be mindful of two competing goals: (1) supporting high cost areas so that consumers there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, overburden consumers across the nation. (FCC 98J-7, ¶3)

HIGH-COST RECOMMENDATIONS

The FPSC believes that it is critically important to determine when it is appropriate to provide explicit funding, by identifying the conditions or circumstances which should "trigger" funding. As the agency directed to monitor competitive conditions in the complex and evolving telecommunications industry in Florida, we respectfully submit that the Commission is well suited for determining if and when funded universal service mechanisms should be established. As such, the FPSC requests that the legislature grant the Commission statutory authority to determine under what circumstances funded universal service mechanisms are warranted, and the express authority

to create such funded mechanisms if such circumstances occur. If given this authority, the FPSC would propose to conduct a formal evidentiary hearing to receive testimony from affected parties and subsequently render a decision on the appropriate conditions that should trigger explicit high-cost universal service support.

PRINCIPLES FOR ESTABLISHING AN EXPLICIT HIGH-COST MECHANISM

Given existing conditions, if an explicit universal service mechanism is implemented, the FPSC recommends that such a mechanism incorporate the following principles.

First, any high-cost funding should be portable, and technologically and competitively neutral. Once areas deemed to be high-cost are specified and the level of available funding in a given area established, the funding should be stated on a per line basis and go to whomever provides the actual facility that serves the customer. Resellers thus would not be eligible to receive funding.

Second, in prior reports on universal service we recommended that funding be provided for a single line to a residence, and no funding provided for business lines. On further consideration, we recommend that funding should be available for both single-line residential and single-line business customers. Our decision to fund single-line businesses is to avoid inadvertently disadvantaging providers of service to small business customers located in rural high-cost areas.

Third, consistent with Section 364.025(4)(b), we believe that the cost standard for potentially funding local exchange providers operating in the territories of the large LECs should be the forward-looking economic cost from a cost proxy model. However, as discussed in our universal service order on a proxy model contained in Appendix A, both of the proxy models scrutinized in our proceeding had deficiencies. As such, further refinements in the cost determination might still be appropriate.

Fourth, as reflected in our Order and described in the summary in Chapter I, the Commission opted to submit embedded cost data for the small LECs, as allowed by Section 364.025(4)(c). However, in Appendix B we are also providing for informative purposes cost proxy model results for the small LECs. If the Legislature directs the Commission to determine whether universal service high-cost funding should be provided to small LECs at this time, the Commission would need clarification from the Legislature as to what cost data to use to derive funding amounts: embedded cost data or cost proxy model results.

Fifth, we recommend that high-cost funding be based on the difference between the relevant cost standard and an affordability benchmark. However, there are various ways that one could arrive at such a benchmark. For example, the FCC to date has indicated that it intends to employ a revenue benchmark, where this benchmark includes not just revenues from the basic local rate but apparently also revenues from toll, access and vertical services. Alternatively, as recommended by the state staff of the Joint Board and which we endorse in principle, a cost benchmark could be established, where the monthly costs per line of basic local service in excess of a given level would be reimbursed, in

whole or in part, from the fund. Regardless of which of these two basic alternatives are selected, the FPSC would also consider the impact on consumers' rates as a function of the resulting size of the fund. Telecommunications carriers subject to a universal service assessment will pass on their assessment to their customers. Assuming for discussion purposes that it shows up on a LEC's bill as a percentage surcharge, or a per line amount, it could have the perverse consequence that it causes service to become unaffordable for certain groups of customers.

Sixth, as noted above, any net new monies received by a LEC must be offset by reductions to rates for existing services, to yield revenue neutrality and avoid a windfall for the LEC. Again, careful thought would be given to the services to be reduced, so as not to unduly advantage the LEC, or disadvantage its competitors.

Seventh, the Commission would ensure that a quid pro quo for universal service high-cost funding be made explicit in the funding plan. In exchange for receiving explicit high-cost funding, the Commission would ensure that the recipient provider agrees to charge basic local ratepayers a price no greater than that deemed affordable.

HIGH-COST FUNDING: AN ALTERNATIVE PARADIGM?

In our discussions to this point certain themes emerge. First, we have assumed that the service for which universal service funding may be needed closely approximates the flat-rate voice grade service described in Chapter 364. Second, we have explicitly assumed that in a competitive environment, it is necessary that any and all universal service funding be portable and competitively and technologically neutral, so as not to unduly advantage or disadvantage any provider.

WHAT IF WE HAVE IT WRONG?

Historically, this Commission has fundamentally assumed that local exchange competitive entry would be by alternative wireline providers; for example, we initially expected to see entry early on by cable television companies or by the large interexchange carriers, entities that owned some facilities. In the annual reports on the status of local exchange competition we focused our efforts on monitoring the extent of entry that is occurring by certificated alternative local exchange companies. However, we have not scrutinized to the same degree the growth in the number of wireless providers, and the expansion of their serving areas.

What if we have underestimated the extent to which local competition exists and largely will be able to constrain upward price behavior with respect to flat-rate voice grade service, by downplaying the importance of wireless providers? In addition to an increase in the number of wireless carriers in many markets and a decrease in their prices, wireless providers often offer as part of their bundled service packages advanced features for which the incumbent LECs assess separate charges. It may be quite likely that the price spread between wireline and wireless for a typical package of services has narrowed to where they may be perceived as substitutes for many consumers.

If government and regulators do not need to intervene in the telecommunications market to ensure reasonable prices for basic local service, when slow proliferation of both wireline and wireless carriers is considered, then maybe we should narrow our focus to the extremes. On the one hand, we believe that Lifeline funding for low-income customers is appropriate under any scenario. On the other hand, perhaps we should merely mandate that the eligible telecommunications carrier must offer a "no frills" local service package at a lower rate. In exchange, the ETC could be reimbursed for the difference between his cost of providing the "no frills" service and the lower rate, for those consumers who opt to subscribe to the service.

Needless to say, countless details would need to be worked out to implement such a plan, such as: defining the nature of the "no frills" service; ensuring that "no frills" service is not unduly discriminatory relative to other customer classes; ensuring that there are no state or federal statutory obstacles to such a plan.

GENERAL IMPLEMENTATION GUIDELINES

ELIGIBILITY FOR REIMBURSEMENT

For simplicity and to ensure compatibility with the federal guidelines, we recommend that a local provider would need to be designated an eligible telecommunications carrier (ETC) in order to receive reimbursement from the fund. Adopting the federal criterion avoids any possible under- or overcompensation to a provider, and is eminently reasonable since the state plan complements the federal plan. We would note that designation of a carrier as an ETC does not presuppose the use of a particular technology. Rather, all that is required for designation is for a carrier to offer the supported services throughout a given area, and advertise their availability.

WHO SHOULD CONTRIBUTE?

All telecommunications companies, as defined under Section 364.02(12), Florida Statutes, and commercial mobile radio service (CMRS) providers, as defined by Section 364.02(3), Florida Statutes, are subject to fees or other obligations assessed pursuant to Section 364.025, Florida Statutes, and thus are potentially liable to provide universal service support, whether on an interim or a permanent basis. Section 364.025(2), Florida Statutes, states, in pertinent part:

The Legislature finds that each telecommunications company should contribute its fair share to the support of the universal service objectives and carrier-of-last-resort obligations....

Further, Section 364.02(12), Florida Statutes, specifies that:

"Telecommunications company" includes every corporation, partnership, and person and their lessees, trustees, or receivers appointed by any court whatsoever, and every political subdivision in the state, offering two-way telecommunications service to the public for hire within this state by the use of a telecommunications facility. The term "telecommunications company" does not include an entity which provides a telecommunications facility exclusively to a certificated telecommunications company, a commercial mobile radio service provider, a facsimile transmission service, a private computer data network company not offering service to the public for hire, or a cable television company providing cable service as defined in 47 U.S.C. 522. However, each commercial mobile radio service provider shall continue to be liable for any taxes imposed pursuant to chapters 203 and 212 and any fees assessed pursuant to s. 364.025.

"Commercial mobile radio service providers" (CMRSs) are defined in Section 364.02(3), Florida Statutes, and include, but are not limited to, cellular providers, personal communications systems, and paging services.

We believe that all providers of telecommunications services should be assessed in a like manner for universal service. Assessing the broadest base of providers as possible would reduce the impact on any single telecommunications sector, and would minimize the magnitude of the resulting surcharge. Accordingly, we recommend that all ALECs, LECs, IXC's, PATS, and any other telecommunications company meeting the definition of Section 364.02(12), Florida Statutes, and CMRS providers, should be required to contribute to the funding of universal service.

METHOD OF ASSESSMENT

We believe that a revenue-based assessment scheme would be the easiest procedure to implement. Currently, the FCC assessments to fund Lifeline and the high-cost fund are based on providers' interstate and international end-user telecommunications revenues. "End-user" refers primarily to revenues from retail services, but also includes monies from subscriber line charges and revenues from other carriers (where the carrier is the consumer of the service and thus an end user). The FCC considered adopting the Joint Board's recommendation, which was to base universal service assessments on subject providers' gross revenues from telecommunications services less intermediary payments made to other providers subject to the universal service assessment. However, they concluded that their proposal would achieve the same goals as the Joint Board's but would be more administratively efficient.

All other things equal, the FCC's approach would tend to result in lower assessments from LECs and higher from interexchange carriers, while the Joint Board recommendation would have the opposite effect. Although we do not believe we are bound to assess fees in the same manner as the

federal mechanism, we tentatively recommend that assessments be based on subject providers' intrastate retail revenues.

ADMINISTRATION OF THE FUND

The National Exchange Carrier Association (NECA) is one potential organization that could serve as administrator. NECA was established in 1983 at the direction of the FCC to administer certain functions associated with the division of toll revenues. Today, NECA also serves as the administrator of several state universal service funds. For example, in 1994, the Vermont Public Service Board chose NECA for that purpose. In this role, NECA acts as fiscal agent for the fund, and works with the state in establishing the fund, identifying and notifying carriers of their obligations, collecting revenues, investing monies, and making payments to state benefactor programs.

Other potential candidates could include private entities such as consulting firms, accounting firms, or financial management firms, as well as not-for-profit organizations. The administrator could be selected through a competitive bid process among applicants that have demonstrated the administrative and financial management capabilities necessary to perform as administrator.

An example of a not-for-profit administrator for a telecommunications fund is the Administrator (Florida Telecommunications Relay, Inc. - FTRI) of the Telecommunications Access System Act (TASA). This organization, in a sense, administers a "universal service" fund for the hearing impaired. The cost associated with administration of this program is 4 percent of total expenses. Chapter 427, Florida Statutes, which established the Telecommunications Access System, authorized the FPSC to

designate as the administrator of the telecommunications access system a corporation not for profit organized for such purposes and incorporated pursuant to chapter 617. For the purposes of this part, the Commission may order telecommunications companies to form such a corporation not for profit.(Sec. 427.704(2))

The Commission could serve as the fund administrator. However, the FPSC would require explicit statutory authority to perform such a function.

The administrator's functions would include such duties as collecting universal service assessments, compiling data on revenues subject to an assessment, and distributing funds to eligible telecommunications carriers. The administrator could also maintain a database on high cost areas which would contain information on the households eligible for support, the support available per household, the eligible carriers, and the households served by eligible carriers. Such information would provide the basis for determining the amount of support needed on an ongoing basis. The fund administrator also should be granted sufficient audit authority to ensure that funding requirements reported by the carriers are in compliance with universal service rules.

On balance, the FPSC recommends that a neutral third-party administrator should be selected. Although we have no particular preference, we would note that NECA has considerable experience in this area; on the other hand, a subsidiary of Lockheed Martin was chosen to manage numbering resources. Regardless, if administered by a third party, the duties should be ministerial in nature; all policy functions, as well as the selection of the administrator, should be performed by the FPSC.

PROVIDERS' RECOVERY OF THEIR ASSESSMENTS

While providers who are subject to universal service assessments should essentially be free to recover their intrastate assessments from their customers as they see fit, the FPSC believes that they should be forbidden from mislabeling or otherwise misrepresenting the nature of any explicit charge they choose to put on a customer's bill. During 1998 the Commission received numerous consumer inquiries pertaining to new charges that were appearing on customers' bills. Many of these new entries were charges created by interexchange carriers to recover federal universal service assessments and presubscribed interexchange carrier charges (PICCs -- an interstate switched access rate element assessed to IXCs by certain LECs). However, it was brought to our attention that some consumers were being misled about these new charges by some IXCs. For example, certain long distance carriers were incorrectly asserting that their new charges were mandated by the FCC.

To avoid any similar misrepresentations occurring with respect to carrier recovery of intrastate universal service charges, we recommend that the FPSC should have oversight authority with respect to the nature and format of intrastate charges assessed by telecommunications providers to recover such assessments. Further, we recommend that if explicit charges appear on customer bills, any such charge should not exceed the amount attributable to a given customer, and should be clearly labeled as to what gave rise to the charge.