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August 1, 2003

Mrs. Blanca S. Bayó
Director, Division of the Commission Clerk and
Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 000121A-TP (OSS)

Dear Ms. Bayó:

Enclosed is an original and 15 copies of a detailed analysis regarding the ALECs' revised payment function and the ALECs' definition of the disparity index. While the attachment is a detailed analysis regarding these two issues, BellSouth believes it is important to recall the other weaknesses of the ALECs' plan:

1. The ALEC plan, at its core, is really not transaction-based. The first proposal of the ALEC Coalition specified payments based on an arbitrary function of the ALEC sample size. Secondly, the payments were not based on the number of failed transactions.

In their subsequent proposal, the "Simplified ALEC Severity Component Proposal," the ALEC Coalition merely made the sample size a determinant of the maximum payment, rather than a determinant of both the minimum and the maximum payment as in the original formulation. However, the revised payment function still does not base payments on the number of failed transactions.

2. The calculation of the disparity measure in the simplified proposal has been revised from the ALEC Coalitions' initial proposal but it still produces results that defy logic. As an example, even with near-perfect performance, penalty payments could be in excess of the maximum payment proposed by the ALEC Coalition.

The revised ALEC Coalition proposal contains some minor 'tweaks' of its earlier proposal, but the revision still does not resolve these issues. Nor does the ALEC proposal address the critically important issues of fee schedule and disaggregation.

DOCUMENT NUMBER-DATE
07020 AUG-1 03
FPSC-COMMISSION CLERK

The attached analysis provides an in-depth assessment of the disparity measure and the revised payment function. We ask that you file this document in the referenced docket.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served to the parties shown on the attached Certificate of Service.

Sincerely,

J. Phillip Carver (KA)

Enclosures

cc: All parties of record
Marshall M. Criser, III
Nancy B. White
R. Douglas Lackey

CERTIFICATE OF SERVICE
Docket No. 000121A-TP

I HEREBY CERTIFY that a true and correct copy of the foregoing was served via First Class U. S. Mail this 1st day of August, 2003 to the following:

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(+) Signed Protective Agreement

#237366

Assessment of the Remedy Payment Function
in

"Update to Simplified ALEC Severity Component Proposal
and
ALEC Coalition Comments on Revised BellSouth Proposal"

INTRODUCTION

In this note, we examine the reasonableness and logical consistency of the Remedy Payment Function ("RPF") proposed by the ALEC Coalition to be used for determining what BellSouth would need to pay a ALEC for a performance disparity, i.e., inferior quality service provided to a ALEC relative to what BellSouth provides itself.[1]

The ALEC Coalition originally proposed the following RPF:

$$P = p_{\min} + (p_{\max} - p_{\min})\left(\frac{d-1}{m-1}\right)^{\lambda} \tag{1}$$

where P is the amount of remedy payment due, $p_{\min}$ and $p_{\max}$ are the minimum and maximum payments, respectively, d is a measure of disparity (defined by the ALEC Coalition as the percent difference in ILEC and ALEC means), m is the disparity level at which the maximum payment $p_{\max}$ is made, and λ is a shape parameter (that determines the shape of the payment function). The ALEC Coalition attempted to make this formulation of the RPF "transaction-based" by assuming—arbitrarily and without any support—that the minimum and maximum payments, $p_{\min}$ and $p_{\max}$, are functions of the number of ALEC transactions. Thus, they specified the following functions for $p_{\min}$ and $p_{\max}$:

$$p_{\min} = f \cdot n_A^{\alpha} \quad \text{and} \quad p_{\max} = \phi \cdot p_{\min} \tag{2}$$

[1] Although Florida has now adopted the almost universally used acronym "CLEC" in place of "ALEC," we continue to refer to the ALEC Coalition and ALECs for ease of reference and consistency with the existing written record in this proceeding.

where the parameter f is chosen to set $p_{\min}$ at some desired level for sample size n_A (the number of ALEC transactions), α is a proportionality or scaling factor, and ϕ is an arbitrarily chosen multiplier representing the ratio of $p_{\max}$ to $p_{\min}$.

Following a critique by BellSouth of various aspects of this RPF (mainly that there were too many "free parameters" in these formulas and choices of values for those parameters were inherently arbitrary), the ALEC Coalition proposed that the RPF be simplified in the following form:

$$P = p_{\min} + (p_{\max} - p_{\min})d \tag{3}$$

where each variable is defined as before. This revised formulation of the RPF has only three parameters—as opposed to eight in the original formulation—and is claimed by the ALEC Coalition to be simpler to implement because d, as before, is simply the percent difference in mean performance, $p_{\min}$ is based on the existing fixed payments in BellSouth's SEEM plan, and $p_{\max}$ is determined by

$$p_{\max} = \sqrt{n_A} \cdot p_{\min}$$

that is, the maximum payment is related to the minimum payment through the square root of the number of ALEC transactions. Thus, $p_{\max}$ itself is linked to, and determined by, $p_{\min}$.

Assessment of the Revised RPF

We note the following features and implications of the revised RPF proposed by the ALEC Coalition:

1. There is some confusion about the manner in which d measures disparity. The ALEC Coalition has claimed alternately that d is a disparity measure "based on a ratio of means or proportions, not on a difference." [ALEC Coalition cover letter at 2-3] Yet, the ALEC Coalition defines d as "the percentage difference in average performance levels—an uncontroversial measure of how different two numbers are" [ALEC Coalition cover letter at 5 and Attachment 1]. Given that the "percentage difference in average performance" is also the "ratio of means minus one," this would appear to be a mere semantic issue. However, defined this way, d leaves upon some important questions:

- Is d expressed in decimal form? That is, would $d = 1$ correspond to a difference in average performance of 100% or 1% (equivalent to $d = 0.01$)? For our purposes, we assume it is the former.

- What happens to the RPF function when *d exceeds* one? This question is re-visited below.

2. According to the revised RPF formula in equation (3), when $d = 1$, the implied payment is $P = p_{\max}$. Thus, BellSouth is only obliged to pay the maximum amount when the disparity level is 100%. Does this mean that this level of payment would not be exceeded even when the disparity level exceeds 100%? While such a large disparity level is unlikely, in practice, the ALEC Coalition does not clarify whether $p_{\max}$ would remain the upper bound on the payment in this circumstance.

3. Interpreted literally, when $d > 1$ (disparity level exceeds 100%), the revised RPF formula would imply that the payment P should *exceed* the maximum payment $p_{\max}$. If this can be true, then in what sense would $p_{\max}$ be the "maximum" payment? This is not a trivial issue because, as we show below, values of d exceeding one can arise easily with even fairly close performances when BellSouth provides excellent service to both the ALECs and itself.

4. The revised RPF formula also implies that in the absence of any disparity ($d = 0$), the payment P should be $p_{\min}$. The clear implication of this is that BellSouth would remain obliged to make at least the minimum payment *even when* there is no disparity in average performance.

5. Although the ALEC Coalition does not say so, we assume that the revised RPF formula does not become applicable until d is at least *marginally* greater than zero (i.e., there is *some* disparity, however small). However, even making that assumption, we find that there can be *no* circumstance in which BellSouth is responsible for at most the minimum payment $p_{\min}$. That is because even when d is marginally greater than zero, the second term in the revised RPF formula becomes non-zero, no matter how small. This term, when added to the first term, would result in some payment that exceeds $p_{\min}$, even if by a small margin. That is, the lower bound $p_{\min}$ can never be achieved at *any* disparity level. Thus, $p_{\min}$ can be characterized as a "false floor" on remedy payments.

6. There appears to be a fundamental error in the manner in which the ALEC Coalition proposes to apply its formula to calculate the disparity level when comparing not *means* but *proportions*. The ALEC Coalition proposes the following formula for proportions (ALEC Coalition Attachment 1):

$$\text{disparity proportion} = \frac{w - ALEC\ mean}{w - BellSouth\ mean} - 1$$

where, according to the ALEC Coalition, "w is 1.0 if performance closer to 100% is desirable and w is 0.0 if performance closer to 0% is desirable. The "w" adjustment is required to normalize for percent measures because such measures are inconsistently defined in that in some cases low values are desirable and in other cases high values are desirable." We assume that references to "*ALEC mean*" and "*BellSouth mean*" in the formula for calculating the disparity with proportion measures imply mean *proportions* rather than mean *levels*.

The ALEC Coalition then explains the use of this formula with an example. Assuming an ALEC mean proportion of 93% and a BellSouth mean proportion of 95% (a difference of only 2 percentage points), the ALEC Coalition applies the formula above with $w = 1$ (following its own logic that w should be so when "performance closer to 100% is desirable." Under this logic, the disparity d is a whopping 40% despite a relatively minor 2 percentage point difference in performance. Conversely, if the same assumption about ALEC and BellSouth mean proportions is cast in terms of a "failure" or "miss," then the ALEC mean proportion is 7% (i.e., 100% - 93%) and the BellSouth mean proportion is 5% (i.e., 100% - 95%). In this case, the ALEC Coalition applies its disparity formula with $w = 0$ (following its own logic), and finds the same 40% disparity (again, despite a minor 2 percentage point difference).

While the ALEC Coalition is, at least, consistent in its finding of the same disparity when mean proportions are looked at both ways (i.e., for both successes and failures), its plainly incorrect use of its own formula causes it to produce disparity measures for proportions that are patently unacceptable.

Another example further demonstrates the error in the ALEC Coalition's formula. Suppose the measure in question is the percentage of missed appointments. Obviously, performance in this respect would be better the closer the measure got to 0%. Next, suppose that the mean proportion of missed appointments for ALECs is 2%, but it is only 1% for BellSouth Retail (i.e., an absolute difference of only one percentage point). Stated differently, ALECs are able to keep their retail appointments 98% of the time, only slightly different from the 99% of the time that BellSouth Retail can keep its appointments. Yet, upon applying the ALEC Coalition's formula with its logic of setting $w = 0$ when performance closer to 0% is desirable, the disparity measure in this example turns out to be $\frac{(0-0.02)}{(0-0.01)} - 1 = 1$ or 100%. Given the manner in which the disparity measure d is intended to be used in the revised RPF formula, this would automatically result in the *maximum* payment $p_{\max}$ being paid by BellSouth. In other words, BellSouth would have to pay the ALECs the maximum penalty for an almost inconsequential *one* percentage point difference in performance.[2] This problem gets

[2] Instead, by setting $w = 1$ when performance closer to 0% is desirable, the disparity measure d would only be 0.01 (in absolute value), i.e., about 1%. In turn, for such a small disparity (in both absolute and relative terms), the penalty would be very close to the *minimum* payment $p_{\min}$. By how much it would exceed $p_{\min}$ would depend on the value of $p_{\max}$ which, in turn, would depend on the number of ALEC transactions. See below for a critique of these relationships.

even worse when the absolute disparity in mean proportions is only slightly worse. For example, if ALEC appointments are missed 3% of the time (instead of 2%) but BellSouth Retail remains at 1% missed appointments, the value of *d* calculated by the ALEC Coalition would be 2 or 200%. As noted above, this could cause the penalty payment to exceed p_{max}, by the ALEC Coalition's own formula (although that would be clearly counter-intuitive).

Using a more dramatic example, assume that ALEC appointments are missed only 0.9% of the time and Bellsouth Retail does so only 0.3% of the time (a minuscule absolute difference of 0.6 percentage points). Stated differently, both ALEC and BellSouth Retail appointments are met at least 99% of the time. Yet the ALEC Coalition's formula would produce a disparity level of $\frac{(0-0.009)}{(0-0.003)}-1=2$ or 200%. In other words, despite highly similar performance for both the ALECs and BellSouth Retail and, more importantly, despite performance that is close to perfection, the calculated disparity level remains very high and implies a substantial penalty. In this example, even though the ALEC appointments are met over 99% of the time, the RPF would have BellSouth paying *greatly in excess of the maximum penalty*, if the ALEC Coalition's formula is to be believed. While these examples are intended to illustrate some of the many frailties of the ALEC proposal, it is not uncommon for BellSouth to have a low value for missed appointments for some installations such as those not requiring a dispatch.

Finally, while the ALEC Coalition's Simplified ALEC Severity Component Proposal provides a revised calculation for interval and proportion measurements, it provides nothing for the rate measurements.

7. In the revised RPF formula, the maximum payment p_{max} is related to the minimum payment p_{min} through the square root of the number of ALEC transactions. Thus with fewer ALEC transactions, p_{max} would come closer to p_{min}; alternately, with more ALEC transactions, the two bounds on payments would diverge. This means that, as long as p_{max} depends parametrically on the number of ALEC transactions, it can never be a fixed amount. This is not a desirable property for a maximum or upper bound.

8. The two payment bounds—indeed the actual payment *P*—bears no relationship to the number of *failed* ALEC transactions. This is a critical deficiency in the revised RPF formula. Payments should be based on, and linked to, the number or proportion of failed transactions, not on *all* transactions. In circumstances in which the number of ALEC transactions is large, p_{max} could be considerably higher than p_{min}, regardless of what proportion of those transactions end in failure, i.e., fail to deliver at least the same level of quality to the ALEC as the ILEC receives itself.

CONCLUSION

Even with the reduced number of free parameters, the simplified RPF function proposed by the ALEC Coalition still has several troubling properties. Furthermore, the counter-intuitive results of the simplified RPF clearly show that, at best, the proposal is not well thought out and, at worst, the simplified RPF amounts to nothing more than a mechanism for transferring substantial amounts of money to the ALECs, without regard to any reasonable definition of actual disparity. Without resolution of these deficiencies or counter-intuitive properties, the revised RPF function cannot be considered acceptable for the purpose of determining remedy payments.