M E M O R A N D U M

DECEMBER 17, 2003

TO: DIVISION OF THE COMMISSION CLERK AND ADMINISTRATIVE SERVICES

FROM: OFFICE OF THE GENERAL COUNSEL (B. KEATING) *BK*

RE: DOCKET NOS. 030867-TL, 030868-TL, 030869-TL, and 030961-TI

Please place the attached PowerPoint presentations in the Docket files for consolidated Dockets Nos. 030867-TL, 030868-TL, 030869-TL, and 030961-TI.

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Attachment
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FPSC-COMMISSION CLERK

Statutory Interpretation

- Is the language of the statute subject to interpretation?
  - If not, then there is no need to consider evidence regarding legislative intent; if so, you may consider evidence of the Legislature's intent
  - Staff recommends that it is unclear because:
    - Lack of clarifying language and punctuation
    - Strong arguments supporting differing interpretations

- If Commission decides it's unclear, then the following questions must be addressed regarding the statute's interpretation:

  - *Does subsection (1)(a) of the statute presume that the removal of current support for basic local service will, in fact, result in enhanced competition in the local market?*

  - *Does subsection (1)(a) presume that enhanced competition in the local market will, in fact, benefit residential customers?*

  - *Does subsection (1)(a) contemplate that the only benefit to residential customers to be considered is whether or not enhanced competition will occur?*

  and finally

  - *If the answer to Question 3 is "no," then does subsection (1)(a) of the statute allow the Commission to consider impacts on the toll market in determining whether and to what extent residential customers will receive a benefit?*

III. Decision Matrix

Question	If answer is "YES"	If answer is "NO"	Staff's recommendation
1. Does subsection (1)(a) of the statute presume that the removal of current support for basic local service will, in fact, result in enhanced competition in the local market?	If so, no need to make separate determination on whether removing the support will create a more attractive local exchange market.	If not, separate determination needed to demonstrate removal of support will create more attractive market.	Stronger argument appears to be that the statute presumes removal of the support will lead to the creation of a more attractive market; little legislative history directly on this point.

Question	**If answer is "YES"**	**If answer is "NO"**	**Staff's recommendation**
2. *Does subsection (1)(a) presume that enhanced competition in the local market will, in fact, benefit residential customers?*	If so, no need to make determination on whether customers will benefit from enhanced competition.	If not, separate determination needed to show that to the extent the local market is made more attractive for competitors, residential customers will see the benefit of that competition.	More difficult question. Arguably, sentence structure can be read either way, but lack of clarifying language and legislative history lend more support to the argument that the benefit to residential customers must be demonstrated.

Question	If answer is "YES"	If answer is "NO"	Staff's recommendation
3. Does subsection (1)(a) contemplate that the only benefit to residential customers to be considered is whether or not enhanced competition will occur?	If so, then Commission needs only address benefit of more competitively attractive local market.	If not, Commission may also consider other benefits, such as the toll market.	Again, a much closer question, with very strong arguments on both sides. Clearly, the Legislature focused its concern on the local market by only including language regarding the local market in the statute, but it did not expressly exclude consideration of the toll market. While staff believes the stronger argument is that the impacts on the toll market are not mandated to be considered, there is some limited legislative history supporting some consideration of the impacts on the toll market.

Question	If answer is "YES"	If answer is "NO"	Staff's recommendation
4. If the answer to Question 3 is "no," then does subsection (1)(a) of the statute allow the Commission to consider impacts on the toll market in determining whether and to what extent residential customers will receive a benefit?	If so, then Commission needs only address benefit of more competitively attractive local market.	If not, Commission may also consider other benefits, such as the toll market.	Again, a much closer question, with very strong arguments on both sides. Clearly, the Legislature focused its concern on the local market by only including language regarding the local market in the statute, but it did not expressly exclude consideration of the toll market. While staff believes the stronger argument is that the impacts on the toll market are not mandated to be considered, there is some limited legislative history supporting some consideration of the impacts on the toll market.

Docket Nos. 030867-TL, 030868-TL, 030869-TL, 030961-TL

Staff Recommendation

December 16, 2003

Issue 1: Will the ILECs' rebalancing proposals remove the current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential consumers?

(A) What is a reasonable estimate of the level of support provided for basic local telecommunications services?

- Staff recommends that the ILECs have provided a reasonable estimate of the level of support for basic local telecommunications services.
  - No blanket approval of the costs, inputs, or methodologies should be stated or implied.
- A number of areas created concern for staff. Examples of those areas include:
  - BellSouth's use of model inputs that disregard previous decisions of this Commission reached in evaluating BellSouth's UNE study.
  - Verizon's use of interstate minutes of use in calculating switching and transport.

- Sprint's use of average cost estimates contained in its filing. However, these were subsequently revised in response to staff discovery.

- Sprint and BellSouth's use of what appear to be excessive retailing costs that do not differentiate between costs that apply to basic local service and costs that apply to all other services.

- For the most part, AARP and OPC witnesses reiterated positions that have been decided previously by this Commission.

  - A notable new position is OPC's shared cost treatment, which excludes costs from TSLRIC that are shared by more than one service.

    - For example, shared poles may be included, but installation, engineering may not be included in TSLRIC.

- Although staff has concerns with the Incumbents' cost estimates, staff believes those estimates provide a more reasonable estimate of cost, and therefore of support, than the AARP and OPC estimates provide.

Issue 1: Will the ILECs' rebalancing proposals remove the current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential consumers?

(B): Does the current level of support prevent the creation of a more attractive competitive local exchange market for the benefit of residential consumers?

- Residential basic rates lower than would be expected in undistorted competitive markets
  - Lock-in strategy for some complementary products (e.g., razors and blades) not applicable
  - Economics of pricing complementary products does not justify underpricing of basic service which is demand inelastic relative to usage

Issue 1(B) cont'd:

- Residential basic rates are lower compared to many states
- Bundle-based competition is possible today, but risky and limited
    - CLEC does consider revenues and costs for all services, a point all parties acknowledge
    - Only limited range of customers can be served profitably; thus, CLECs must rely on segmenting the market effectively and marketing selectively
- Current support does impede competition in residential local exchange markets

Issue 1: Will the ILECs' rebalancing proposals remove the current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential consumers?

(C): Will the ILECs' rebalancing proposals benefit residential consumers as contemplated by Section 364.164, Florida Statutes? If so, how?

- Economics of serving residential customers improves for CLECs, leading to greater choice of providers
  - Local Only Provider
    - Higher rate for residential monthly service
    - Lower originating access rate charged
    - No change in terminating access rate charged
    - Improved profitability (on per end user basis)
  - Local/LD Bundled Provider
    - Higher rate for residential monthly service
    - No change in terminating access rate charged
    - Lower terminating access rate paid
    - Improved profitability (on per end user basis)

- Argument that certain categories of residential customers will not benefit is not indicative of effect on overall consumer welfare.

- Argument that bundled-based competition is not dependent on rebalancing is suspect based on economics and risk

- Entry in residential market premised on expected approval of ILEC Petitions
  - AT&T, BellSouth UNE Zones 1&2
  - Knology agreement with Verizon Media Ventures

- Price increases for basic service would generate relatively smaller aggregate consumer welfare losses than the aggregate welfare gain resulting from lower LD prices

  - Based on demand inelastic nature of basic service compared to usage, greater propensity to pay for the former as compared to the latter

  - Pro-rata IXC flow-through based on minutes of access; market forces ensure continued flow-through

  - Elimination of in-state connection fees

  - Corroborating testimony by OPC (Ostrander) that access minutes are at risk, while basic service is demand inelastic

Issue 1(C) cont'd:

- Targeted Assistance
  - Lifeline protection for customers with incomes at or below 125% of federal poverty level
  - More efficient than continuing, untargeted subsidy
- 5 free ECS calls (Sprint)
- Approval of the ILECs' petitions will benefit residential customers by encouraging competition in residential local exchange markets

Issue 2: Will the effects of the ILECs' rebalancing proposals induce enhanced market entry? If so, how?

Yes. Granting petitions will induce market entry.

- Theoretical evidence is in balance with empirical.

Theoretical

- Reducing access charge subsidies will induce enhanced market entry by:
  - leveling the playing field
  - mitigating the price distortions created by subsidy support that deter market entry

Empirical

- Deterrent to entry evidenced by low residential market penetration in Florida.
- Entry barriers especially high in Verizon and Sprint territories.
- Higher residential entry in BellSouth region due in part to better margins.
- Rebalancing improves CLEC margins.
- Petitions supported by both UNE-P based CLECs (AT&T and MCI) and facilities-based CLECs (Knology).
- AT&T entered BellSouth territory based in part on expected approval of ILEC petitions.

Issue 2 cont'd:

- Knology's entering Pinellas County based in part on expected approval of ILEC petitions.
- Knology first entered Florida market in 1997 taking calculated risk that Florida would move on the same path as Alabama and Georgia in rebalancing rates.
- Knology: level of residential rates is preventing entry into other market areas in Florida.
- Knology is seeking to expand further into panhandle and other regions of Florida, but will be forced to deploy capital in more favorable states if rates not rebalanced. A $9 local rate in Florida cannot compete with $15 rate in other states.

- Approval blends hard-headed with soft-hearted approach by bringing equities and efficiencies to the marketplace and targeting assistance to those least able to afford.

  The vast majority of Florida households are fully able and willing to pay the full costs that they impose on local exchange companies for their subscription to the public switched network. Some households are at risk, but it is possible to identify these and to target assistance (subsidies) toward these households. By targeting such assistance rather than maintaining a grossly inefficient system of perpetuating artificially low prices to all households, the subsidy mechanism can be made to deliver more punch, precisely where it is needed. (AT&T/MCI witness Mayo)

- Denial of petitions maintains status-quo - anemic to non-existent residential competition in much of Florida. The results will be continued inequities and inefficiencies in the market, and potential competitors (e.g., Knology) will shift attention to other states with better conditions for market entry.

Issue 3: Will the ILECs' rebalancing proposals reduce intrastate switched network access rates to interstate parity over a period of not less than two years or more than four years?

- Statutory Requirements on Timing:

- Section 364.164 (1)(c), Florida Statutes, requires "intrastate switched network access rate reductions to parity over a period of not less than 2 years or more than 4 years."

- Definition of Parity:

    - Section 364.164 (5), Florida Statutes, defines "parity" to mean "that the local exchange telecommunications company's intrastate switched network access rate is equal to its interstate switched network access rate in effect on January 1, 2003, if the company has more that 1 million access lines in service. . ."

Issue 3 cont'd:

Reduction in Access Charges as filed by the Companies (CONFIDENTIAL CHART)

Issue 3 cont'd:

- Do the petitions meet section 364.164 (c), Florida Statutes', requirements on timing?
  - BellSouth - Yes
  - Sprint – Yes
  - Verizon - Yes

- Do petitions meet section 364.164 (5), Florida Statutes, requirements on parity?
  - BellSouth-Yes
  - Sprint-Yes
  - Verizon-No. Staff does not believe that the statute contemplated the PICC charge being included in the calculation of the interstate switched network access rate. Staff believes that it is inappropriate to include the PICC charge in the calculation of interstate switched network access rate, but acknowledges that the elimination of the PICC from the calculation leads to an additional 86 cents per month increase in basic local residential rates.
  - If the Commission believes that it is appropriate to include the PICC charge in the calculation of interstate switched network access charges, staff believes that Verizon improperly calculated the conversion of the PICC charge to minutes of use. Staff questions Verizon's calculation of the PICC as it determines the PICC by taking the interstate PICC charge and dividing it by intrastate minutes of use. Staff believes that it would be more appropriate to develop the ARPM equivalent of the PICC charge by taking the PICC revenue and dividing it by the interstate minutes of use. Staff has calculated a rough estimate of the impact of recalculating the PICC charge. As calculated, the impact on basic local residential rates would be less than the 86 cent increase that would result from removing the PICC entirely. (see staff confidential handout)

Issue 4: Are the ILECs' rebalancing proposals revenue neutral, as defined in Section 364.164(2), Florida Statutes?

- Text of Section 364.164 (2), Florida Statutes;
  - "If the commission grants the local exchange telecommunication's company's petition, the local exchange telecommunications company is authorized, the requirements of s. 364.051 (3) notwithstanding, to immediately implement a revenue category mechanism consisting of basic local telecommunications service revenues and intrastate switched access revenues to achieve revenue neutrality. . ."
- Definition of revenue neutral per the statute.
  - Section 364.164 (7) defines revenue neutral as "the total revenue within the revenue category established pursuant to this section remains the same before and after the local exchange telecommunications company implements any rate adjustments under this section. Calculation of revenue received from each service before implementation of any rate adjustment must be made by multiplying the then-current rate for each service by the most recent 12 months' actual pricing units for each service within the category without any adjustments to the number of pricing units. . ."

Amounts Included in the ILEC's Petitions (CONFIDENTIAL CHART)

Proposed Basic Local Residential Increases

Company	Increment 1	Increment 2	Increment 3	Increment 4	Total
BellSouth (Mirroring)	$1.39 36%	$1.38 36%	$1.09 28%		$3.86
BellSouth (Typical Network)	$1.25 36%	$1.25 36%	$1.00 28%		$3.50
Sprint*	$2.25 33%	$2.25 33%	$1.36 20%	$1.00 15%	$6.86
Verizon	$1.58 33%	$1.58 33%	$1.57 33%		$4.73

** At the hearing, Sprint agreed to spread it basic local increase to residential consumers to four increments over three years.*

Issue 4 cont'd:

Single-Line Business Plans

- BellSouth
  - Rate Groups 1 through 3 increase to $25.00 over two equal increments.
  - Rate Groups 4 through 6 and X1 to $28.00 over two equal increments.
  - Rate Groups 7 through 11 and X2 through X4 adjusted to $30.20 (Current Rate Group 12 Rate) in two equal increments.
  - Increments will be in the 1st quarters of 2004 and 2005.
  - Total Increase to Single Line Business Recurring Rates of $1.16 million.
- Sprint
  - 1st Increment-$2.70
  - 2nd Increment-$2.40
  - 3rd Increment-$0.90
- Verizon
  - Raise the basic monthly recurring rate to $32.00 for all rate groups. Will take place in the second and third increments for Rate Groups 1 through 4 and in the third increment for Rate Group 5.

Issue 4 cont'd:

- Non-Recurring Charges

  - BellSouth-Proposes various increases in both residential and single-line business line connection and line change non-recurring charges.

  - Sprint-Proposes various increases in both residential and single line business service connection charges. At the end, the service connection charges in the Centel and United territories will be equal, with the exception of the residential record change charge.

  - Verizon-Increases business network establishment charge to $34.00. Increases Residential Network Establishment Charge to $25.00 and Central Office Connection Charge to $40.00.

- Do the petitions meet the statutory requirements on revenue neutrality?
  - BellSouth-Yes. BellSouth proposed two different methodologies. The difference between the two results from the calculation of the access charge reduction.
  - While the mirroring methodology more closely meets the requirements of the statute, both the mirroring and typical network methodology meet the statutory requirements for revenue neutrality. The typical network methodology provides for less of an increase in basic local residential rates. Staff recommends that the typical network methodology be approved.
  - Sprint-Yes. Sprint's proposal meets the statutory requirements for revenue neutrality.
  - Verizon-Yes. As filed, Verizon's proposal meets the statutory requirements for revenue neutrality. But, if the Commission determines that it is inappropriate for the PICC charge to be included in the calculation of access charges, Verizon's petition does not meet the requirements of revenue neutrality.

Issue 5: Should the ILECs' rebalancing proposals be granted or denied?

- Testimony from public hearings
  - Correspondence side of the dockets
- Decisions on other issues

Issue 6: Which IXCs should be required to file tariffs to flow through BellSouth's, Verizon's, and Sprint-Florida's switched access reductions, if approved, and what should be included in these tariff filings?

Staff recommends the following:

- All IXCs that paid $1 million or more in intrastate switched access charges in 2003 should include in their tariff filings:
  - A calculation of the dollar benefit associated with the LEC's intrastate switched access rate reductions.
  - Separate demonstrations that residential and business long distance rates have been reduced and the estimated annualized revenue effect, residential and business, including how those estimates were made.
  - A demonstration that all reductions have been flowed through.
  - IXCs that paid less than $1 million in intrastate switched access charges in the most recent 12-month period, should include with their tariff filing, a letter certifying that they paid less than $1 million in intrastate switched access charges in that period, and that they have complied with each of the flow-through requirements as specified in Section 364.163(2), Florida Statutes.
  - Any IXC whose intrastate switched access expense reduction is $100 or less per month is not obligated to flow through its reduction, but should attest to such, through a letter filed with the Commission.

Issue 7: If the ILEC access rate reductions are approved, should the IXCs be required to flow through the benefits of such reductions, via the tariffs, simultaneously with the approved ILEC access rate reductions?

- The staff recommends:
  - The IXCs file within 44 days of the LECs' filings. LECs are required to give a 45 day notice before tariffs go into effect, while the IXCs only need to give one day's notice.
  - LEC and IXC tariffs should be effective simultaneously.

Issue 8: For each access rate reduction that an IXC receives, how long should the associated revenue reduction last?

- Staff recommends that the IXC reductions should remain in place, at a minimum, for one year after parity is reached.
- OPC, AARP, and the Attorney General believe the IXCs should the required to cap and maintain reductions for 3 years after parity.
- Sprint Communications was willing to keep reductions in place for 3 years plus 1 and Sprint now agrees to spread their increases over an additional year so that the reductions should be in effect for 4 years plus 1. The last reduction would be in effect for 2 years.
- Verizon Long Distance is willing to keep reductions in place for 3 years.
- ATT, MCI, and BSLD state that the competitive market should take care of any time requirements.
- There is no requirement in the statute on how long the revenue reduction should last.

Issue 9: How should the IXC flow-through of the benefits from the ILEC access rate reductions be allocated between residential and business customers?

- There is no requirement in the statute on how the benefits from the ILEC access rate reductions should be allocated between residential and business customers other than both must receive a benefit. Section 364.163(2), F.S.

- Staff recommends that the IXCs' proposed allocations between residential and business customers based on access minutes of use is reasonable.

Issue 10: Will all residential and business customers experience a reduction in their long distance bills? If not, which residential and business customers will and will not experience a reduction in their long distance bills?

- Staff believes, as identified by the parties, not all customers will receive a reduction including customers that do not pay an in-state connection fee and customers that do not make long distance calls.

- OPC believes all residential and business customers should experience a reduction in their long distance bills unless they subscribe to one of the small IXCs with $100 or less in access expense or the customer makes no long distance calls.

- AT&T states that all residential customers paying the $1.88 in-state connection fee will experience a reduction in their long distance bills immediately upon the effective date of the IXC tariff revisions through in of the in-state connection fee.

- Sprint has committed to eliminate its $1.99 in-state connection fee in the first year.

- MCI states that, at a minimum, it will reduce its in-state connection fee of $1.88 evenly over three years.

- Verizon would not reduce prices on any of its unlimited long distance plans.

Issue 11: Should these Dockets be closed?

- Administrative authority recommended for 45 day LEC filings
- 135% Lifeline tariffs should be effective concurrently with 45 day LEC filings
- If the Commission denies one or more petitions, the corresponding docket(s) should remain open, the record should be preserved, and the LEC(s) should be granted leave to refile.
- Each docket, if approved, should be closed upon expiration of the time for taking an appeal