State of Florida

Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: September 23, 2004

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Office of the General Counsel (Moore)
Office of the Executive Director (Bane, Hill)
Division of the Commission Clerk & Administrative Services (Sharma)
Division of Competitive Markets & Enforcement (Mailhot)
Division of Economic Regulation (Hewitt)

RE: Docket No. 040436-TP – Proposed amendment of Rule 25-4.0161, F.A.C., Regulatory Assessment Fees; Telecommunications Companies.

AGENDA: 10/05/04 – Regular Agenda – Interested Persons May Participate

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\GCL\WP\040436.RCM.DOC

Case Background

Sections 350.113 and 364.336, Florida Statutes, require regulated companies under the Commission's jurisdiction to pay fees to the Commission based upon their gross operating revenues. Section 350.113(3) further requires that such regulatory assessment fees (RAF) shall, to the extent practicable, be related to the cost of regulation. The maximum rate authorized by statute for telecommunications companies is .25 percent of the companies' gross operating revenues derived from intrastate business. § 364.336, Fla. Stat. (2003). Rule 25-4.0161, F.A.C., currently sets the RAF rate at .15 percent of the companies' gross operating revenues derived from intrastate business.

A notice of rule development to increase the telecommunications company RAF rate to .23 percent of gross operating revenues was issued in May 2004. A workshop was conducted by staff on June 8, 2004, to discuss the need for additional revenues to cover the cost of regulating the industry. Representatives of BellSouth, Verizon, Sprint, AT&T, GT Com, Alltel

Communications, and TDS Telecom participated in the workshop. On June 14, 2004, the Florida Telecommunications Industry Association (FTIA) submitted a request for information about the RAF increase, including information regarding the Commission's budget, staffing, and time and cost allocations. Staff provided the information on June 21, 2004. Staff also held a meeting with company representatives on July 1, 2004, to answer any further questions the companies had about the proposed increase. A workshop was conducted by Commissioners on August 18, 2004, to assess methods for reducing and/or recovering costs of regulating telecommunications companies.

As directed by the Commission at the workshop, staff has met with industry representatives, considered and analyzed suggestions from the workshop, revisited its own plan for internal cost cutting methods, and explored alternative revenue sources in an attempt to minimize the need for increasing RAFs. This recommendation reflects the results of those efforts.

Discussion of Issues

Issue 1: Should the Commission amend Rule 25-4.0161, F.A.C., to increase the regulatory assessment fee rate paid by telecommunications companies?

Recommendation: Yes. The Commission should amend Rule 25-4.0161, F.A.C., to increase the regulatory assessment fee rate to .20 percent of gross operating revenues derived from intrastate business. (Moore, Mailhot, Sharma)

Staff Analysis: Rule 25-4.0161, F.A.C., currently sets the RAF rate at .15 percent of the companies' gross operating revenues derived from intrastate business. Based upon the most recent projection of costs for Fiscal Year 2005-2006, RAFs collected from the telecommunications industry at the current rate are expected to be at least $3.1 million less than the cost of regulating the industry. A number of diverse factors have converged to create the current deficit and the need for the Commission to consider increasing the RAF rate. Those factors are both external and internal. External factors include changes in state and federal law, resulting structural changes to the industry, a Florida Supreme Court decision excluding directory advertising revenues from RAFs, a decline in telephone company intrastate revenues subject to the fee and changes in the overall state budget process. Internally the Commission has changed the way it allocates employees' work time to more accurately reflect work time spent on the different industries. The following discussion details these factors, describes efforts to control costs, and provides the calculation of costs and the required RAF rate.

The recommended rule and revised RAF returns are **Attachment 1**. The Statement of Estimated Regulatory Cost is **Attachment 2**.

I. Industry and Workload Changes Due to Statutory Revisions

Due to the changes in Florida Statutes in 1995 and the federal law in 1996 that were made in order to open the local telecommunications market to competition, the structure of the telecommunications industry has changed. The workload at the Commission has also changed dramatically. Prior to 1995, the 14 local exchange companies were rate base regulated and were subject to earnings reviews and occasional rate cases. Based on the statutory changes, the Commission eliminated all of its rules and regulations dealing with earnings regulation for the price-capped companies and no longer required earnings surveillance, depreciation studies, or other rate of return reports. However, with the new statutory requirements came new responsibilities related to facilitating the development of competition in the local exchange market.

As of the end of May 2004, there were 10 incumbent local exchange companies (ILECs) and 401 competitive local exchange companies (CLECs) certificated in Florida. In addition, there were 470 pay telephone service (PATs) providers, 42 alternative access vendors (AAVs) and 31 shared tenant service (STS) providers certificated as well as 686 interexchange companies (IXCs) registered in Florida.

While maintaining evolving retail responsibilities such as tariffs, consumer complaints, and quality of service, the Commission has been charged with wholesale responsibilities as well. On the wholesale side, the Commission is responsible for interconnection agreements: petitions requesting arbitrations; adoption of agreements; and complaints about rates, terms, and conditions in current agreements. As market players become more sophisticated and proficient, issues are becoming more complex, technical and specific, and thus more time consuming. The Commission also deals with the complex issues involved with setting unbundled network rates, collocation terms and conditions, and barriers to competition. Numbering issues also arise as area code relief and number portability are needed due to increased demand and to enhance competition.

As the Commission's work has evolved to reflect an emerging competitive telecommunications environment, the workload has not diminished. Consumer complaints for this industry have increased from an annual total of 12,592 on June 30, 2000, to 20,233 as of June 30, 2004. While parties are always encouraged to negotiate issues and resolve them without Commission intervention, complex issues are still litigated before the Commission, and many are appealed to the courts. During the foreseeable future, workload appears to be heavy for the telecommunications industry due in part to issues surrounding the Triennial Review Order (TRO), the Federal Communications Commission's (FCC) unbundling rules, and pending court challenges. Moreover, workload associated with arbitrations and complaints is greater now than in the past several years and staff believes this workload may increase as agreements expire and TRO issues arise. In addition, staff does not know what role the states will play in the final rules that will be promulgated by the FCC. Traditionally, there has been a significant role for the states during implementation of FCC rules.

While current workload remains relatively heavy it should be noted that several events already in motion at the state and federal level provide a reasonable basis for anticipating some abatement of workload in many areas of telecommunication oversight over the next several years. Commission staff will closely monitor the level of RAF revenue necessary to conduct the required regulatory oversight to ensure that any appropriate RAF rate adjustments are brought to the Commissioners' attention.

II. Factors Affecting RAF Collections and Regulatory Costs Assigned to Telecommunications

During the 5-year period from Fiscal Year 2000-2001 through 2005-2006, telecommunications RAF revenue is expected to decline by over $2.5 million. This decline has two primary causes. First, in February 2002, the Florida Supreme Court ruled that directory advertising revenue billed and collected by the local exchange companies (LECs), but booked by the companies' directory affiliates, could not be imputed to the LECs for RAF purposes. Verizon Florida, Inc. v. Jacobs, 810 So. 2d 906 (Fla. 2002). This decision resulted in a loss of $1.5 million in annual RAF revenues--revenues that prior to that decision allowed the Commission to cover the cost of continuing regulatory functions and workload associated with the transition to a competitive market. Second, the revenues of the companies have declined due to changes in the telecommunications industry, including a loss of business to other providers such as cellular companies that do not currently pay RAFs. Annual RAF revenues have declined by over $1.0 million due to this decline in the companies' revenues.

In addition, in recent years, liquidation of the Commission's trust fund reserves and loss of interest earned on the trust fund balance have made it more difficult, if not impossible, for the Commission to absorb fluctuations in RAF collections. In the past, the Commission was able to delay increases in the RAF because of the trust fund reserve.

Finally, the Commission changed its cost allocations beginning July 1, 2003, to more accurately reflect the amount of time being spent by Commission employees in the regulation of each industry. The change in recording of employee work time was partially in response to a finding by the Auditor General:

> Finding No. 3: Improvements in accounting for employee work time would promote a more equitable distribution of regulatory costs to the industries or sub-industries.

(Auditor General Report No. 2004-031: Public Service Commission Regulatory Assessment Fee and Other Matters - Operational Audit August 2003.) The report noted that the Division of Consumer Affairs was significantly under-allocating its time to telecommunications. Since then, changes have been made to time reporting by Consumer Affairs to more accurately capture time worked. As a result of more accurate allocation of time worked, the total amount of time and Commission costs being allocated to telecommunications increased from 39.9 percent in Fiscal Year 2002-2003 to a projected 43.11 percent for Fiscal Year 2005-2006. This resulted in an additional $.8 million in costs being allocated to the telecommunications industry.

III. Internal Efforts to Control Costs

Past Efforts

During the 7-year period from Fiscal Year 1998-1999 through 2005-2006, the Commission's expenses will have actually *decreased* by 1.3 percent. In comparison, inflation has been 14.6 percent over this same time frame. In Fiscal Year 1994-1995, the number of Commission employees per million Florida residents was 28.5. For projected Fiscal Year 2005-2006, this figure declines to 18.8. **Attachment 3** shows how this ratio has declined annually since Fiscal Year 1999-2000. The number of Commission employees also compares favorably to other states. We are the eleventh lowest in terms of employees per access line and twelfth lowest in terms of employees per million residents. (See **Attachments 4 and 5.**)

Eighty percent of the Commission's operating budget consists of salaries and benefits. Another 13 percent is directly related to employees and represents costs such as rent, telephone, and computer expenses. Additional amounts over which the Commission has little or no control include insurance and human resources management outsourcing costs.

Over the past several years the Commission has streamlined its processes, eliminated inefficiencies, and, as a result, reduced the number of staff. From Fiscal Year 2000-2001 through Fiscal Year 2004-2005, the Commission has reduced staffing by 37.5 Full-Time Equivalent positions (FTEs) which is more than a nine percent reduction in staff. For Fiscal Year 2004-2005, the Commission reduced its staff by 18 FTEs with the aim of reducing costs, improving efficiency and achieving fiscal balance. To further reduce costs this fiscal year, the

Commission is holding positions vacant in areas where workload has been or will be reduced. For Fiscal Year 2005-2006, a further reduction of 20.5 FTEs was approved at the September 13 Internal Affairs meeting for a total decrease of 58 positions or 14.5 percent since Fiscal Year 2000-2001.

Current Budget Submission

Of the approved staffing reductions for Fiscal Year 2005-2006, 4.5 FTEs come from streamlining the regulation of water and wastewater companies and 4 FTEs from reducing regulatory oversight of telecommunications companies and by implementing a variety of efficiency measures. Also included are corresponding reductions in administrative support staff (2 FTEs) and technical support staff (2 FTEs). In addition, with the loss of jurisdiction over several Class A water and wastewater utilities and our continued efforts to streamline the regulatory process, we are closing the Orlando district office, whose staff primarily does water and wastewater work, and reassigning the remaining work. Closing that office results in the reduction of an additional 8 FTEs. In addition to these issues that involve staff reductions, next fiscal year's proposed budget also includes a reduction of $80,000 in the Other Personal Services (OPS) category, which is used for items such as temporary employees, contractual services, and court reporters, and a reduction of $135,295 resulting from giving up certain leased office space in the Betty Easley Conference Center.

Future Efforts

In future years, staff will continue to identify and propose revisions to regulatory functions and staffing consistent with the Commission's statutory responsibilities in all industries. For example, when the first rate adjustment from the access charge reductions becomes effective, we can determine when an ILEC will reach parity and can elect to have nonbasic treatment for its rates, at which time quality of service oversight may be reduced. At that point, all things held constant, workload and, in turn, the number of staff may be reduced. Further, we can estimate when the major ILECs may petition to be regulated only to the degree that CLECs are regulated as provided for in Section 364.051, Florida Statutes. These elections will potentially further reduce our workload and staffing needs.

Cross-training of staff will continue to be an important tool for the Commission to be able to meet its peak workload demands and will be key in transitioning staff away from functions being eliminated. Commission staff will be trained to perform a number of tasks so that they can be moved to areas where they are most needed to meet the Commission's statutory responsibilities and deadlines.

Beyond staffing, management plans continued cost control efforts in all expense categories and continued evaluation and elimination of any nonessential items. For example, we are pursuing every avenue to continue to reduce office space expense. Currently, we plan to vacate as much additional space as possible in the Betty Easley Conference Center.

Finally, at the August 2004 workshop, the issue of charges for copies of documents was discussed as another method of cost recovery. The Commission currently charges $.05 per page

for one and two-sided copies of documents (including transcripts which are public records subject to the same copying charges once they are filed with an agency). Florida law, however, allows charging up to $.15 per page for one-sided copies and up to $.20 cents for a two-sided copy if the copy is not more than 14 inches by 8.5 inches. The actual cost of duplication may be charged for all other copies. The actual cost of duplication does not include the labor cost or overhead cost associated with providing copies unless extensive use of information technology resources or extensive clerical or supervisory assistance is required. §119.07(1)(a), Fla. Stat. In Fiscal Year 2002-2003, the Commission collected just over $12,000 in copy charges at $.05 per page. Increasing the per page copy charge could result in increased revenue of at least $24,000. However, because most Commission documents are available online and an increased price for hardcopy documents may well lead to a reduction of requests, we recognize revenues may be significantly less than the estimated $24,000. We intend to review this possibility further.

IV. Calculation of Telecommunication Regulatory Costs which must be Funded

The RAF rate for telecommunications companies was last changed effective January 1, 1991, when it was increased from .125 percent to .15 percent of gross intrastate operating revenues. The .15 percent rate was calculated based on projected telecommunications RAF revenues and Commission expenses. Using a similar method to calculate the rate here results in a RAF rate of .21 percent. Staff has projected that the amount of telecommunications revenue that is subject to RAF will decrease during the next fiscal year. The cost of regulating the telecommunications industry is based on the Commission's proposed Fiscal Year 2005-2006 budget. The projected amount of total Commission expenses to attribute to telecommunications companies is calculated by multiplying the projected total expenses by the percentage of Commission time spent on telecommunications issues. The 43.11 percent of Commission time spent on telecommunications is based on the actual results from the Time Direct system for the period April 2004 through June 2004.

Projected total Commission expenses		$26,198,784
Telecommunications percentage	x	43.11 percent
Telecommunications cost		$11,294,295

V. Proposed Change to RAF Rate

Rule 25-4.0161, F.A.C., currently sets the RAF rate at .15 percent of the companies' gross operating revenues derived from intrastate business. Based upon the most recent projection of costs for Fiscal Year 2005-2006, RAFs collected from the telecommunications industry are expected to be at least $3.1 million less than the cost of regulating the industry. This deficit developed in recent years due to (1) a decline in telecommunication RAFs and (2) more accurate time reporting by staff during the past year which increased the relative share of costs assigned to the telecommunications industry. Telecommunications revenues subject to RAFs are projected to continue to decrease. The projected deficit will continue unless steps are taken to remedy the situation.

As previously discussed, management began an aggressive program of cost reduction that continues today and will continue in the future. Nevertheless, while staff hoped the deficit could be eliminated without raising regulatory fees, it appears some adjustment cannot be avoided in the near term. Based on projections of revenues and expenses for Fiscal Year 2005-2006, staff has calculated that a RAF rate of .21 percent is necessary for telecommunications companies to cover the cost of regulating the industry. Staff recommends, however, that the RAF rate only be increased to .20 percent. Staff believes that through continued cost cutting efforts and the pursuit of alternative revenue sources discussed in Issue 2 of this recommendation, the remaining deficit for telecommunications that exists at the .20 percent RAF rate can be eliminated.

Changing the rate to .20 percent is projected to increase the amount collected from telecommunications companies from $8.8 million to $11.7 million. Of the $11.7 million, 7.3 percent ($854,000) must be paid by the Commission to the General Revenue Fund as a statutorily required service charge. §§ 215.20 and 350.113(2), Fla. Stat. (2003).

In the foreseeable future, staff envisions the continued evolution of the telecommunications market and the exertion of continued pressures on wireline carriers from other technologies such as wireless, voice-over-internet (VOIP), and cable. The Commission will still have responsibility for areas such as arbitrations, area code/numbering relief, consumer education, resolving customer complaints, setting wholesale rates and terms, and preventing anticompetitive pricing. However, staff anticipates that in the future (3-5 years) the Commission could experience a reduction in telecommunications workload. State law establishing a timetable for intrastate access charge reductions also includes triggers for certain reductions in regulatory requirements relating to tariffs and service quality. Consistent with the foregoing discussion, staff will conduct an annual assessment of the relationship between RAF revenues and regulatory costs associated with the telecommunication industries.

In conclusion, a number of factors both external and internal have converged, resulting in a budget deficit that is expected to continue unless some action is taken. Despite significant efforts--past, present and future--to streamline, to become more efficient and to cut costs, the deficit remains. Therefore, staff recommends the Commission increase the RAF rate from .15 percent to .20 percent. The effective date of the rule change should be January 1, 2005.

Statement of Estimated Regulatory Cost Associated with the Proposed Rule Change

Amendment of the rule to increase the RAF rate from .15 to .20 will increase the amount of regulatory assessment fees that telecommunications utilities will be required to pay. More specific discussion is included in the SERC. **(Attachment 2.)**

Issue 2: Should the Commission investigate alternative mechanisms for recovering the costs of regulating the telecommunications industry and pursue statutory authority to increase minimum regulatory assessment and certificate application fees?

Recommendation: Yes. (Moore, Mailhot)

Staff Analysis: At the August 18, 2004 workshop, industry representatives observed that the current funding mechanism may no longer be appropriate for recovering the regulatory costs associated with the telecommunications industry. Collection of RAFs based on company revenues dates back to a time when regulatory efforts focused on monopoly providers and most proceedings involved only one company. In a telecommunications industry that has been opened up to competition, Commission workload is no longer driven by a single company seeking rate relief, but rather by multi-company dockets addressing competitive issues. Staff will work with industry representatives to study the cost causing factors in regulating the telecommunications industry and determine whether alternative funding mechanisms that are more related to cost causation can be developed. Based on this study, the Commission can determine whether it is appropriate to restructure the method of cost recovery to reflect the competitive dynamics of the industry. Staff will also explore with the companies the creation of incentives for companies to resolve their disputes by mediation.

Staff has already considered several possible areas to implement fees and charges for Commission services as well as increasing existing minimum RAF payments and certification fees as a way to collect regulatory revenues without increasing the RAF rate itself. With statutory changes, the Commission could increase the minimum RAF paid by small telecommunications companies to more closely reflect the cost of regulatory activity required by those companies. The current statutory minimum is $50 for all telecommunications providers. If the minimum is increased to $100 for pay telephone providers, alternative access vendors (AAVs), and shared tenant service providers (STS), and to $1,000 for interexchange companies (IXCs) and competitive local exchange companies (CLECs), staff estimates that the change could result in an increase in revenues of $850,000, excluding any adjustments for repression. If as a result of the increase in the minimum payment, companies cancel their certificates or do not obtain certificates, the increase in RAF revenue could be much less than $850,000. Some companies seek a certificate but never actually do business in Florida and an increased minimum may discourage them from doing so in the future, thus reducing the work associated with issuing certificates and in turn, our costs. The proposed statutory language to increase the minimum fee is contained in **Attachment 6.**

Staff is also proposing a statutory change to increase the certification fee maximum from the current $250 to $500, based on the cost of processing a request for certification. This could result in an additional $5,000 to $10,000 in annual revenue. A preliminary draft of suggested legislation is attached. **(Attachment 7.)** Again, the increased fee could deter some companies from applying for a certificate in Florida.

Any additional revenues that may result from the proposed statutory changes will take time to implement. If the proposed statutory changes are enacted, implementing rule changes will be required. Further, a monitoring period of approximately one year will be necessary to determine the level of repression and the resulting impact on Commission revenues.

Staff has also considered proposing legislation authorizing the Commission to adopt a rule imposing filing fees. Such legislation requires further study, however, to determine whether and on what basis to set different fees, and to evaluate the potential impact on development of a competitive market. As in the case of increasing certificate application fees, imposing fees for filing such matters as disputed interconnection agreements, could influence the filing parties' decision making process. While charging a filing fee may well reduce the number of petitions that are of questionable merit, input from all parties and careful consideration by the Commission will be needed prior to pursuing fees of this nature.

As stated earlier, staff will work with the industry to investigate alternative mechanisms to recover the costs of regulating the telecommunications industry, with particular attention on ways to align recovery with specific regulatory functions.

Staff recommends that the Commission pursue statutory authority to increase existing minimum RAF amounts and to increase application fees to more accurately reflect the cost incurred by the agency in processing applications.

Issue 3: Should the Commission amend Rule 25-4.0161, F.A.C., governing extensions of time to file a regulatory assessment fee return in order to codify the standards that are actually used by staff to determine whether an extension should be granted?

Recommendation: Yes. (Moore, Sharma)

Staff Analysis: The Commission should also amend the provisions of Rule 25-4.0161 governing extensions of time to file a RAF return and pay the fees in order to codify the standards that are actually used by staff to determine whether an extension should be granted. Subsection (7)(a) of the rule currently requires companies to submit a statement of good cause for the extension to the Commission. "Good cause" is not defined in the rule, and there is nothing in the rule explicitly stating what reasons justify an extension of time. Similar omissions have caused a Joint Administrative Procedures Committee's (JAPC) staff attorney to submit comments in other Commission rule dockets. Staff recommends eliminating the requirement for companies to include a statement of good cause and simply provide that an extension of 30 days will be granted if the company has applied for the extension within the time required (two weeks before the date the return is due) and the company does not have any unpaid regulatory assessment fees, penalties or interest due from a prior year. Companies that obtain an extension are assessed interest for the additional time unless they submit an estimated return by the due date and pay at least 90 percent of the full amount of RAFs that are owed. The form to be used to request an extension of time is attached to this recommendation. **(Attachment 8.)**

Because the rule change codifies current practice, and the forms will be reprinted to reflect the rate change, there should be no additional cost to the Commission as a result of revising the extension language.

Issue 4: Should this docket be closed?

Recommendation: Yes, if no requests for hearing or comments are filed, the rules as proposed should be filed for adoption with the Secretary of State and the docket closed. (Moore)

Staff Analysis: Unless comments or requests for hearing are filed, the rules as proposed may be filed with the Secretary of State without further Commission action. The docket may then be closed.