

FLORIDA PUBLIC SERVICE COMMISSION

Switched Access Charges in Florida

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September 2001

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I. Introduction

During the 2001 Florida Legislative Session, bills concerning access charges were introduced in both the House (House Bill 611) and Senate (Senate Bill 1136) committees, but they did not pass.

Access charge rates are a highly contentious issue, pitting the interexchange or long distance carriers (IXCs) against the incumbent local exchange carriers (LECs or ILECs) as well as the alternative local exchange carriers (ALECs).¹ Simply put, access charges are paid by IXCs to LECs or ALECs whenever a LEC or an ALEC customer makes or receives a long distance call. Access rates were originally set in a revenue requirement environment; they were designed to replace toll revenues previously shared or provided prior to long distance competition and AT&T's 1984 divestiture of its operating companies. The IXCs argue that access rates are above cost and should be reduced. While the LECs do not dispute that access rates are above cost, they reply that access charge revenue contributes to keeping the cost of basic local telephone service as low as it is. For example, in a May 4, 2001 letter to the Orlando Business Journal, Dean Kurtz, Director of Corporate Communications and Public Affairs for Sprint-Florida, in discussing the proposed legislation reducing access charges, stated:

Sprint stood to lose \$91 million a year in operating revenue had this bill passed. The key word here is revenue, not profit. To offset that loss, Sprint would have to raise local phone rates by almost \$3.50 a month.²

One way the IXCs have responded to intrastate access rates that are higher than interstate access rates has been through a higher per minute rate for intrastate long distance calls. Sprint and AT&T have developed another solution to high access rates: beginning earlier this year, Sprint began charging its end user customers in Arkansas, Colorado, Georgia, Kentucky, Massachusetts, Michigan, and New York an "In-state Access Recovery" charge ranging from \$.57 per month to \$1.99 per month. AT&T introduced a similar charge in Arkansas, Colorado, Florida, Kentucky, Massachusetts, Missouri, New Jersey, Oregon, and Texas, which it calls an "In-State Connection Fee." AT&T's charge ranges from \$.50 (Massachusetts) to its \$1.95 charge in Florida, Missouri, and Texas. AT&T's Florida charge became effective July 15, 2001.

Should intrastate access rates be reduced? If so, should LECs be permitted to offset any or all of the resulting revenue loss with new add-ons to the telephone bill such as a universal service surcharge or with increases in other rates, including basic local service rates? These issues are not

¹Section 364.02(6), Florida Statutes, defines local exchange company (LEC) as any company certificated by the Florida Public Service Commission to provide local exchange telecommunications service on or before June 30, 1995. Incumbent local exchange company (ILEC) is another term commonly used to describe these LECs. Section 364.02(1), Florida Statutes, defines alternative local exchange carrier (ALEC) as any company certificated by the Florida Public Service Commission to provide local exchange telecommunications services on or after July 1, 1995. Competitive local exchange carrier (CLEC) is another term commonly used to describe these ALECs.

²Mr. Kurtz does not mention that as a price cap LEC, Sprint is constrained in any increase in basic local telephone rates unless a "compelling showing of changed circumstances" is made. (Section 364.051(4), Florida Statutes).

unique to Florida; other states have (or have had) similar issues with access charge rates. How other states have dealt with these issues is useful information in exploring Florida's options.

This paper is designed to provide a starting point for discussion of the problems and possibilities with regard to intrastate switched access charges. It begins by providing some general background information on access charges, followed by a description of how other states have dealt with this issue. The information on what other states have done with access charges comes in large part from a survey conducted by the National Regulatory Research Institute (NRRI) on the Florida Public Service Commission's (Commission or FPSC) behalf; staff also gathered information directly from other states. Information from other states is followed by a discussion of the marketplace response (Sprint's and AT&T's charging their end users to recoup the cost of access), points to consider, and lastly, by the conclusion.

II. Definition of switched access charges

Switched access charges are the per minute rates billed by LECs or ALECs to IXC's for the use of the LEC's network when the LEC's customer makes or receives a long distance call. Switched access refers to the use of the public switched telephone network (calls travel through a telephone company switch). These charges help a LEC recover the cost associated with originating or terminating a call. An example of how access charges work within Florida is when a Verizon customer in Tampa calls a BellSouth customer in Miami; the IXC pays intrastate access charges to Verizon on the originating end of the call (Tampa) and to BellSouth on the terminating end of the call (Miami). An interstate example (regulated by the FCC) is when a BellSouth customer in Jacksonville calls a BellSouth customer in Atlanta. In that case the IXC pays interstate access charges to BellSouth on the originating end of the call (Jacksonville) and to BellSouth on the terminating end of the call (Atlanta).

III. The switched access charge issue

Access charges originated in the early 1980s when AT&T divested itself of its regional Bell operating companies (RBOCs). The rate levels were established through a revenue requirement process and did not reflect the actual cost of originating or terminating calls. In the FPSC's 1999 *Report on the Relationship of the Costs and Charges of Various Services Provided by Local Exchange Companies and Conclusions as to the Fair and Reasonable Florida Residential Basic Local Telecommunications Service Rate*, BellSouth and Sprint-Florida provided public data on the positive contribution (difference between total revenues and total costs) they receive from intrastate switched access: 215% for BellSouth and 1,259% for Sprint-Florida.

Florida intrastate access rates are generally significantly higher than interstate access rates, although the two are not directly comparable. On the interstate side, for example, part of the cost of the local telephone line is recovered through the Subscriber Line Charge (SLC), a flat-rate, end user charge found on the local telephone bill (typically \$5.00 for a single, residential line). The interstate

SLC serves to keep interstate switched access rates lower than they would be otherwise; however, there is no analogous intrastate charge.

IXCs believe that the access charges which they pay to the LECs should be reduced to reflect more closely the rate levels that would prevail in a competitive market, i.e., rates closer to cost. If one believes that switched access rates should be reduced, then the issue centers around whether the affected LECs should be made whole, that is, should they receive revenue increases from other sources to offset the revenue loss from any switched access rate reductions? If the LECs should be made whole, then how should that occur, and perhaps most important, who pays? Should a LEC's current profits be taken into consideration in determining whether they should be made whole?

IV. The Commission's authority over switched access rates

The Commission does not have rate-making authority over intrastate switched access rates for the LECs that have elected price regulation. Under current law, the Legislature has authority over those access rates. In the 1995 revisions to Chapter 364, Florida Statutes, LECs were permitted to elect price regulation in lieu of traditional rate base regulation. Section 364.051(1)(c), Florida Statutes, exempts price regulated carriers from Section 364.05, Florida Statutes, which gives the Commission rate-setting authority over the LECs.³

Section 364.163, Florida Statutes, caps the access rates until January 1, 2001 (or five years after filing an election for price regulation). It also provides that a LEC may annually adjust any specific intrastate access rate by an inflation index (but not more than 3 percent per year) after the termination of the caps, and if the LEC's intrastate access rates are at parity with its interstate access rates. As can be seen in Table 1, none of LECs' intrastate rates are at parity with their interstate rates; all are higher.

V. Legislative switched access rate reductions

Section 364.163(6), Florida Statutes, was amended in 1995 and again in 1998 ordering certain LECs to reduce their switched access rates. The statutory revisions did not provide a mechanism for LECs to offset the revenue loss from their switched access rate reductions. The IXCs which benefitted from the access rate reductions were ordered to reduce their long distance rates to flow through the benefit of the rate reductions to their customers.

The 1995 revision required all LECs whose intrastate switched access rates were higher than their December 31, 1994, interstate switched access rates to reduce intrastate rates by 5% on October

³Frontier is the only Florida LEC that has not elected price regulation as of this writing.

1 of each year until parity was reached.⁴ The revision also required all IXC's paying the reduced rates to decrease their long distance rates so that their customers would receive the benefit of the switched access rate reductions. The required 5% switched access and long distance rate reductions were made in October of 1996 and 1997.

The 1998 revision required Sprint-Florida and Verizon (then known as GTE Florida) to implement two switched access rate reductions: 5% on July 1, 1998, and 10% on October 1, 1998. The requirement for any other LEC to make the 5% annual reduction was eliminated. IXC's were again required to flow through to their customers the benefits of the reductions, but two constraints were added. The IXC's were permitted to pick which rate elements they wanted to reduce provided that both business and residential customers benefitted from the rate decreases. The 1998 revision also placed a restriction on how much the IXC's could reduce their intraLATA (or "local toll") rates: the percentage reduction to intraLATA rates was not to be greater than the required per minute rate reductions.

The 1998 access rate reductions were the last ones required by statute, and there have been no intrastate access rate reductions since then (though there have been interstate access rate reductions for some LEC's).

VI. 2001 Florida Legislative Session

Bills to reduce access charges have been introduced in the legislative sessions since 1998, although no bill has passed since the 1998 Legislative Session. Bills were introduced in both the House and Senate committees during the 2001 Legislative Session; a brief description of each bill follows.

A. House Bill 0611

As initially filed, House Bill 0611 (HB 611) would have required Sprint and Verizon to reduce their intrastate switched access rates to the level of BellSouth's intrastate switched access rates effective October 1, 2001.⁵ As shown in Table 1, this meant that Sprint's switched access rate reduction would have been 5.6 cents for one minute of originating access and one minute of terminating access while Verizon's reduction would have been 5.15 cents. In addition, effective

⁴BellSouth was required to reduce its intrastate access rates pursuant to the FPSC-approved stipulation in Docket No. 920260-TL, resolving BellSouth's last earnings review. The stipulation called for a series of annual switched access rate reductions, the last of which went into effect on October 1, 1996, reducing BellSouth's intrastate switched access rates to its January 11, 1994, interstate level, as required by the stipulation. On March 1, 1997, BellSouth filed intrastate switched access rate reductions, pursuant to Order No. PSC-97-0128-FOF-TL, in Docket No. 920260-TL, which brought BellSouth's intrastate composite switched access rate below its December 31, 1994 interstate switched access composite rate.

⁵The bill language required that any LEC with more than 100,000 but fewer than 3 million, basic local telecommunications service access lines in service on July 1, 1995 (only Sprint and Verizon meet this requirement) reduce its intrastate switched access rates to the level of the rates of the largest LEC in Florida (BellSouth).

November 1, 2001, an IXC would have been permitted to petition the Commission to reduce the intrastate switched access rates of any LEC with a decision to be rendered in 180 days. IXCs would also have been required to flow-through to their residential and business customers all of the benefits of the switched access rate reductions.

HB 611 also provided that the access rates of a LEC electing price regulation would have been capped for a period of 5 years at the rates that were in effect upon the election.⁶ Effective November 1, 2001, any non-price regulated LEC (only Frontier) would have been permitted to petition the Commission to increase its switched access rates with a decision to be rendered in 180 days.

HB 611 did not pass out of the House Utilities and Communications Committee.

B. Senate Bill 1136

Initially Senate Bill 1136 (SB 1136) was very similar to HB 611. However, the amendment adopted in the March 20, 2001 Senate Commerce Committee meeting took a different approach. SB 1136, as amended, would have returned jurisdiction to the Commission for intrastate switched access and customer long distance rates

for purposes of determining the correctness of any rate decrease by a telecommunications company resulting from the application of this section and making any necessary adjustments to those rates, establishing reasonable service-quality standards, and assuring resolution of service complaints. (SB 1136, Section 364.163(3))

SB 1136 also would have required the Commission to initiate a proceeding, by July 1, 2001, to determine the appropriate level of access rates, considering several factors including

. . . the effect on competition, the costs of access, the costs of basic local service, the costs of vertical services, the impact on continued provision of universal service, the affordability of basic local service and long-distance service to customers, the network access rates in other states and factors affecting such rates, the effect of alternative technologies on telecommunications services, and any other factors the commission considers appropriate. (SB 1136, Section 364.163(4)(a))

A Commission decision would have been required by January 1, 2002 and would have included a timetable for any necessary actions, as well as a separate report to the Governor, the President of the Senate, and the Speaker of the House of Representatives describing the proceeding.

⁶The largest ILECs elected price regulation in 1996; Frontier is the only remaining LEC not under price regulation.

The bill also would have required the Commission to provide organizational and staff support for a convening of industry representatives by July 1, 2001, in order to have the representatives negotiate among themselves the appropriate levels for access rates and to identify other solutions that promote local competition. The representatives would have had 90 days to reach an agreement, which they would have then submitted to the Commission. If the representatives had entered into negotiations or the Commission had disapproved a negotiated agreement, the proceeding described above would have been delayed until October 1, 2001, with the decision delayed until March 1, 2002. The bill gave the representatives until July 15, 2001 to enter in the negotiations in good faith. If not, then the Commission was to commence with the proceeding as outlined above.

SB 1136 also would have required the IXC's to flow through to their residential and business customers the effects of the rate reduction, however, the decrease would have been offset by the amount of revenues lost from the gross receipts tax in order to hold harmless the impact on the Public Education Capital Outlay and Debt Services Trust Fund.

The bill also provided that the Commission, upon petition by a provider or purchaser of switched access, or on its own motion, could review the level of access rates and make any necessary adjustment with a decision required within 180 days after notice of the hearing.

SB 1136, as amended, was not heard in any other committees or calendared for a floor vote after the March 20, 2001 Senate Commerce Committee meeting.

VII. Current switched access rates

Interstate and intrastate switched access charges as of August 13, 2001, are contained in Table 1. These charges represent one minute of originating switched access plus one minute of terminating switched access. The charges represent a commonly used combination of services, so actual charges may vary depending upon the services actually provided.

Table 1: Switched Access Charges - Intrastate vs. Interstate Rate Comparison*
One Minute of Originating Access + One Minute of Terminating Access

LEC	8/13/01 Intrastate Rate	8/13/01 Interstate Rate
ALLTEL	\$0.1132	\$0.0524
BellSouth	\$0.0467	\$0.0098
Frontier	\$0.1040	\$0.0245
GT Com (Floral)	\$0.1522	\$0.0568
GT Com (Gulf)	\$0.1214	\$0.0568
GT Com (St. Joseph)	\$0.1306	\$0.0568
ITS	\$0.1130	\$0.0829
Northeast Florida	\$0.1126	\$0.0607

LEC	8/13/01 Intrastate Rate	8/13/01 Interstate Rate
Smart City Telecom	\$0.1426	\$0.0403
Sprint-Florida	\$0.1027	\$0.0140
TDS Telecom/Quincy	\$0.1287	\$0.0575
Verizon	\$0.0982	\$0.0203

*Assumes common transport. Rates shown are those actually billed and, thus, for interstate rates exclude long term support.

VIII. Other states' actions on switched access charges

Staff gathered information on several states, primarily in the Southeast, and then in March and April, 2001, NRRI conducted a survey on access charges on behalf of the Commission. Twenty-five states, including Florida, responded to the survey.

A. NRRI Survey results

Five states that responded to NRRI's survey, including Florida, indicated that they had not had any switched access rate changes from 1999 to the present. The other four states were Hawaii, New Hampshire, New York (staff was able to gather some information on an earlier access rate reduction), and Wisconsin.

The responding states with switched access rate changes since 1999 were Alabama, Indiana, Iowa, Kansas, Kentucky, Maine, Michigan, Missouri, Montana, Nebraska, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, Texas, Utah, Vermont, Virginia, and Wyoming. For these states, the primary goal of the rate change varied by state and included:

- bring rates closer to costs
- eliminate subsidies⁷
- make explicit an implicit subsidy⁸
- satisfy legislative mandate(s)
- bring interstate and intrastate rates into parity⁹
- partially reduce disparity between interstate and intrastate rates

⁷ Access rates generally have been set above cost in order to help keep basic rates lower than might otherwise be possible.

⁸ Where certain rates contain subsidies, those subsidies are removed from the rates and charged for separately, thus making explicit an implicit subsidy.

⁹ Typically, this means to reduce intrastate rates so they equal the corresponding interstate rates, or "mirror" each other.

- de-mirror interstate and intrastate rates¹⁰
- rate rebalancing¹¹
- rate case
- price cap requirement
- stipulation as a result of a complaint
- bring rates closer to rates in nearby states
- TELRIC (pricing) case before the commission

Some of these states had only one reason for the rate change (e.g., satisfy legislative mandate) while others had more than one reason (e.g., bring rates closer to cost, satisfy legislative mandate, and make explicit an implicit subsidy). Only Michigan reported an increase in a switched access rate in order to achieve the goal of bringing intrastate and interstate rates into parity.

Of the 20 states reporting switched access rate changes, 8 (Alabama, Indiana, Iowa, Michigan, Oklahoma, Rhode Island, Vermont, and Virginia) reported that there were no offsetting changes made to other intrastate rates. Alabama, however, reported that it used \$2.8 million of interstate Universal Service Fund money to offset its 2000 intrastate access rate reduction. In Ohio, Verizon has proposed a full offset of its access reductions, while Sprint has proposed a partial offset. The Ohio Commission has not yet ruled on Sprint’s and Verizon’s requests. Also in Ohio, Ameritech and Cincinnati Bell have not requested to offset any reductions because of their state alternative regulation plans.

Of the remaining states, Montana did not provide information on any offsets. Intrastate access rate reductions were partially or fully offset by the LEC(s) for Kansas, Kentucky, Maine, Missouri, Nebraska, North Carolina, Oregon, Texas, Utah, and Wyoming as shown in Table 2.

Table 2: Intrastate LEC Offset of Switched Access Rate Reductions - States Responding to NRRI Survey

State	Other Intrastate Rate Changes to Offset Switched Access Rate Reductions
Kansas	Offset depends on LEC. Rural LECs recovered from Kansas Universal Service Fund (KUSF). Southwestern Bell’s reduction was fully offset; for example the basic residential rate increased from \$12.15 to \$13.80. Of the \$1.65 increase, \$0.31 of the rate change was due to access reductions; the remainder of the increase was due to the KUSF. The average Sprint residential rate increased from \$10.50 to \$12.00 with the bulk of the increase, \$1.01, due to the access charge reduction. Rates for vertical services were also increased.

¹⁰When intrastate access rates, terms, and conditions (either together or singly) are the same as the interstate rates, terms, and conditions, they are said to “mirror” each other. When changes are made to either the interstate or intrastate rates, terms, and conditions so that they are not the same, the tariffs are “de-mirrored.”

¹¹Under rate rebalancing, rates are either increased or decreased so that they more accurately reflect their costs. Rates typically have not been based on cost; for example, rates for vertical and access services have been higher than cost so that their greater positive contribution (revenue less cost) can be used to subsidize local rates in order to keep them affordable. Rebalancing rates generally means that local rates increase and the rates for vertical and access services decrease.

State	Other Intrastate Rate Changes to Offset Switched Access Rate Reductions
Kentucky	Partially offset; basic residential rates increased between \$0.60 to \$0.85, depending on the rate group. Other rate changes included decreasing the business touchtone rate and eliminating the volume discount on toll.
Maine	Partially offset; basic residential rates increased by about \$3.50 and basic business rates increased by about \$5.00.
Missouri	Fully offset as part of rate rebalancing.
Nebraska	Partially offset; basic residential rates were between \$5 and \$18+; rates were rebalanced to \$17.50. Business rates were between \$5 and \$38+; rates were rebalanced to \$27.50.
North Carolina	Partially offset; as of 12/31/01 basic residential rates to increase about 50 cents per line/month; DA call allowance will decrease from 5 free calls to 4.
Oregon	In process of rate design for Qwest, expect rate changes for basic, vertical and toll services. Filing for Verizon is revenue neutral.
Texas	Partially offset; intrastate universal service fund (TUSF) set up; 3.6% charge on bill for TUSF.
Utah	Partially offset; done on a case by case basis.
Wyoming	Partially offset; basic residential rate increased from \$18.75 to \$23.10. Basic business rate decreased from \$30.56 to \$23.10.

Of the responding states with switched access rate changes since 1999, only Iowa, Michigan, Utah, and Virginia did not require IXC's to flow through to their customers the benefits of switched access rate reductions. Oregon required only Qwest to flow-through the switched access reductions. Alabama, Indiana, Kansas, Kentucky, Maine, Missouri, Nebraska, North Carolina, Ohio, Oklahoma, Rhode Island, Texas, Vermont, and Wyoming all required a full or partial flow-through by the IXCs of the effects of the switched access rate reductions. Montana did not provide any information on a flow-through to toll rates.

B. Additional information from other states

Staff gathered information from states in the BellSouth region, as well as Illinois and New York. This additional information is summarized in Table 3.

Table 3: Additional Information on Switched Access Rate Actions in Other States

State	Information on Switched Access Rate Actions
Georgia	In January of 2001, BellSouth and AT&T agreed on a plan to reduce switched access rates by a total of \$19 million between January and July, 2001. The Georgia Commission approved the plan, ordering IXCs to flow through their net access reduction in its entirety within 30 days of the Commission order. No offset mechanism was established; however, BellSouth can choose to increase its local service rate under its alternative regulation plan.

State	Information on Switched Access Rate Actions
Illinois	In March, 2000, the Illinois Commission ordered Ameritech and GTE to reduce access charges and directed IXCs to flow through the cost reductions to their customers. The Commission ruled that Ameritech's 1997 and 1998 access rate increases violated earlier Commission orders. The Commission has ordered Ameritech and GTE to base access prices solely on cost, rather than have the intrastate rates mirror the interstate rates.
Louisiana	The state uses overearnings or cost reductions to fund access charge reductions, among other items. In 2000, legislation was passed which equated the corporate and public service property tax rate, reducing the tax liability for many carriers. In order for the legislation to become effective, the Commission was required to implement rate reductions equal to the tax credits received. BellSouth's switched access rates were among those required to be reduced. IXCs were also ordered to flow through the rate reductions to their carriers.
Mississippi	Several years ago, the Commission required BellSouth's intrastate access rates to mirror its interstate access rates. In 2000, the state lowered BellSouth's property taxes by \$28 million, requiring access reductions. At the present time no local rates have been increased to offset access rate reductions.
New York	In 1998, the Commission reduced New York Telephone's (n/k/a Verizon) switched access charges by approximately 44% without any offsetting change to basic local telephone rates. The reductions were ordered as necessary for competition and efficiency. AT&T, Sprint, and MCI were required to flow-through their savings to their customers. Under its Performance Regulatory Plan, Verizon is permitted to recover impacts of certain exogenous cost changes, including those changes due to Commission mandates. In June, 2000 Verizon filed to recover certain exogenous costs, including costs of access charge reductions. In its January, 2001, white paper, Commission staff took a position that merger savings offset the access charge reductions. The Commission has not yet rendered a decision.
South Carolina	The Commission ordered an intrastate universal service fund to be set up to pay for an intrastate access rate reduction. Rates will be reduced approximately 50%, while end users will be assessed a 1.4% surcharge on their interstate and intrastate telecommunications services charges to fund the program.
Tennessee	Although the Tennessee Regulatory Authority (TRA) has no jurisdiction over the level of access charges because of price regulation, BellSouth and Sprint-United agreed to reduce access charges in agreements with MCI and Sprint. These agreements would have brought intrastate access charges to parity with interstate access charges. However, before these agreements were implemented, legislation was introduced that would require BellSouth to price intrastate access at cost. BellSouth reached an agreement with the legislature and implemented a three-year phased reduction of access charges, ending January, 2001. Although basic residential and business service rates are frozen until 2002, rates for other services may be increased.

C. Summary of activity in other states

A great deal of information is contained in this section on how other states have dealt with the issue of access charges; however, certain themes emerge. In general, IXCs are required to flow

through some or all of the benefits of the rate reductions.¹² Eight states, 40 percent of the respondents reporting switched access rate changes, have reduced intrastate access charges without increases in other rates. When states look to offset the access rate reductions, they appear to look in two primary areas for revenue: basic local rates and an intrastate universal service fund. Since a universal service fund is commonly funded by increases in the retail bill, in both cases, end user customers explicitly pay for the access charge reductions. Certainly, LECs may be able to increase rates for vertical services (e.g., Call Waiting, Caller ID) in order to increase revenue, although other factors such as demand elasticity and competitive alternatives come into play.

There is not much consistency among the states in the BellSouth region. For example, in Kentucky and North Carolina, the basic rate was increased to at least partially offset the reduction in access revenue. In South Carolina, an intrastate universal service fund (funded by end users) was ordered to pay for the reduction. Georgia's experience is relatively uncommon: in January, 2001 BellSouth and AT&T agreed on a plan to reduce switched access rates. No offset mechanism was established for BellSouth; however, under BellSouth's alternative regulation plan it can choose to increase its local service rate. The Georgia Commission approved the plan, ordering IXCs to flow through their savings.

State experience is divided upon whether the LECs' decreased revenue resulting from reduced switched access rates must be passed through to their consumers. In some states, when switched access rates were reduced, consumers typically paid for the reductions through increased rates in other services or through a surcharge on their bill. However, in other states, including Florida, there was no explicit mechanism for the affected LECs to increase rates to offset the loss of revenue from switched access rate reductions.

IX. Marketplace response

One way the IXCs have responded to higher intrastate access charges has been through a higher per minute rate for intrastate long distance calls. For example, a July 6, 2001 search on AT&T's website shows a 7 cents per minute interstate long distance rate with a 14 cents per minute intrastate long distance Florida rate. A search on Sprint's website, on the same date, shows a 7 cents per minute interstate long distance rate with a 10 cents per minute intrastate long distance rate.

Sprint and AT&T have developed a new way to compensate for higher in-state access rates. Effective July 15, 2001, AT&T began to charge its Florida customers an "In State Connection Fee" of \$1.95 per month. According to a June 28, 2001 letter sent from Claudia E. Davant, AT&T State President, Legislative and Regulatory Affairs, to Representative Tom Feeney, Speaker of the Florida House of Representatives (Attachment A),¹³

¹²Even though IXCs may be required to flow-through the benefits of the access reductions, there are issues about a commission's ability to ensure that the entire amount of the flow-through actually occurs and how long the flow-through must occur.

¹³The letter was also sent to Senator John M. McKay, President, The Florida Senate.

. . . the legislation [HB 611 and SB 1136] was not passed. Because long-distance, unlike local telephone service, is a highly competitive industry with very slim margins, AT&T must institute a fee in states like Florida which have grossly inflated access fees, to help cover the cost of doing business.

The letter continues:

AT&T will continue to pursue legislative remedies to correct this inequity of high access charges and would like to meet with you [Representative Feeney] before Session to discuss options in accomplishing this goal. Reduced access charges could mean a savings in long distance charges to Florida consumers of \$465 million annually. Your action could also mean the elimination of the In State Connection Fee.

Florida was not the first state where AT&T instituted this charge. Effective May 15, 2001, AT&T began charging its Colorado customers this fee, at \$1.25 per month. Effective June 15, 2001, Kentucky's AT&T customers were charged this fee, at \$.90 per month.¹⁴ Since then, AT&T has begun charging its customers \$1.40 in Arkansas, \$.50 in Massachusetts, \$1.95 in Missouri, \$1.35 in New Jersey, \$1.65 in Oregon, and \$1.95 in Texas.

AT&T is not the first IXC to institute this charge. According to a May 10, 2001 *USA Today* article, Sprint's long distance company has also added a similar fee to its customers' bills. According to the article, earlier this year Sprint began adding monthly fees ranging from \$.57 to \$1.99, in Arkansas (\$1.99), Colorado (\$1.30), Georgia (\$.87), Kentucky (\$1.98), Massachusetts (\$1.01), Michigan (\$0.57), and New York (\$1.76) to "keep in-state per-minute rates low." A Sprint spokeswoman stated, "We have been absorbing this cost, but we can no longer afford to do so." Sprint describes this charge as "[I]n-state Access Recovery" on its website. These statements suggest that this in-state access recovery charge was implemented rather than an increase in intrastate long distance rates, due to market pressure. However, other IXCs appear to have found it unnecessary to implement such a fee or increase per minute rates to cover costs. According to the *USA Today* article, WorldCom is not seeking to add a connection fee, but has not ruled out charging such a fee. No other IXCs were addressed in the article.

In Florida, the Public Service Commission does not have ratesetting authority over IXCs' intrastate rates pursuant to Section 364.337(4), Florida Statutes. IXC tariffs are presumptively valid; they may be filed on one day's notice (Chapter 25-24.485(2)(b), Commission Rules).

¹⁴Ms. Davant refers to Kentucky in her letter as one of the states where the local telephone companies have agreed to reduce access charges to actual cost.

X. Some points to consider

Common sense as well as economic theory suggest that rates should be based on cost, thus sending proper pricing signals to the market. However, earlier public policy concerns resulted in a regulatory plan where switched access rates were not based on cost, rather certain services subsidized other services to satisfy public policy concerns. This intertwining of services through implicit subsidies makes it extremely difficult to untangle one service and move it to cost-based rates without an adverse impact on at least one of the interested parties.

IXCs also pay switched access charges to ALECs, although neither the 1995 and 1998 revisions to Section 364.163(6), Florida Statutes nor 2001's proposed legislation addressed ALEC access rates. On the interstate side, the FCC recently released an order (FCC 01-146 in CC Docket No. 96-262) that addressed ALEC interstate access charges. The IXCs argued that high ALEC interstate access rates are unjust and unreasonable and, in effect, allow ALECs to unfairly shift their operation and network build-out expenses to IXCs, and through them, to long distance ratepayers. In the FCC's view, ALECs have two distinct customer groups: IXCs and end users; with the IXCs subject to the monopoly power that ALECs wield over access to their end users.¹⁵ The FCC's solution is to establish a four year plan with a declining benchmark level at which ALEC access rates will be conclusively presumed to be just and reasonable. The FCC stated that ALECs are free to recover from their end users any greater costs that they incur in providing either originating or terminating access.¹⁶ Of course, the ALECs operate as competitors and, depending on the market and their services, may not be able to increase prices to their end users to offset declining access revenue.

Would a benchmarking scheme tied to interstate rates work here? Certainly, a declining benchmark would bring access prices closer to costs. However, part of interstate cost recovery includes a flat-rate charge paid by consumers (i.e., subscriber line charge or SLC); there is no analogous intrastate charge. If a benchmarking scheme were to be tied to interstate rates, should the new intrastate rates include or exclude the effect of the interstate SLC? Should ALEC rates be included in any intrastate access rate reduction scheme?

Before deciding Florida's next step, it is important to come to an agreement about what intrastate switched access rates should be designed to do. Should they be designed to cover costs, or to provide a positive contribution that can be used to maintain basic local rate levels? The answer to this question is key, because if "provide a positive contribution" is the answer, then nothing further needs to be done. However, a cautionary note is in order based on the new fee AT&T is adding to its Florida customers' bills. With this fee, Florida consumers who are AT&T customers have just begun to pay a new explicit charge because of higher access rates. Will other IXCs follow AT&T's lead? What effect would an access rate reduction have on AT&T's new fee? If a determination is

¹⁵FCC 01-146 in CC Docket No. 96-262, ¶s 31, 38.

¹⁶Ibid., ¶ 39.

made that switched access rates must be based on cost, then considerable work lies ahead. Leaving aside the jurisdictional issues for the moment, there are some questions that need to be answered:

- For which LECs, if any, should rates be reduced? All the LECs? Only certain LECs? What criteria should be used to determine whether access rates should be reduced for all, or some, LECs?
- Assuming LEC switched access rates should be reduced, should the affected LECs be permitted to fully or partially offset their revenue reduction by increasing other rates? Should the LECs' rates of return be a consideration? If they should, what should be the criteria used to determine this? Should switched access rate reductions be ordered, with the proviso that if a LEC believes it needs to, it can petition the Commission for permission to offset the rate reductions?
- Assuming LEC switched access rates should be reduced, to what level should they be reduced? To parity with interstate rates; if so, how should the end user SLC be taken into consideration? To BellSouth's intrastate rates? Should they be pegged to interstate rates, e.g., if interstate rates change, intrastate rates follow suit?
- What potential impact could access rate reductions have on local competition? On long distance competition?
- Should ALEC access rates be addressed?
- Assuming IXC flow-throughs are required, then an important issue becomes the flow-through itself. How long should a flow-through last? A year? Forever? Should any statutory language requiring flow-through specify the length of time the flow-through should be in place? Should the Commission verify that the flow-throughs have taken place, and if so, how?
- If reductions in LEC access revenues are offset by increases in other LEC retail rates, then the result for the Florida consumer who is an AT&T customer may be to pay more to two different carriers. If access charges are reduced, then how is AT&T's new charge addressed – or is it addressed at all? If other IXCs introduce a similar charge, how are their charges addressed?

Turning back to the jurisdictional issues, what is the best way to accomplish switched access rate reductions? Should this be done by the Legislature or should the Legislature give authority with statutory standards to the Commission for the purpose of switched access rate reductions? Should any legislative grant of authority be on a one-time or on an on-going basis?

It should be noted that competition in both the local and long distance telecommunications markets is still evolving. This makes it difficult to assess the impact of certain policy options.

XI. Conclusion

Telecommunications regulation over the last two decades has moved to open up markets to competition, beginning with long distance and the AT&T divestiture in 1984, continuing with Florida's 1995 statutory revisions that opened up Florida's local markets to competition, and the 1996 federal Act that opened local markets across the United States to competition.

Access rates are a consequence of AT&T's divestiture and were set, in part, with the objective of having little or no impact on local rates. This left in place the implicit subsidies, formerly embedded in long distance rates, that kept local rates low. However, along with the transition to competition, the long distance and local markets came under pressure (and on the federal side, the law) to make implicit subsidies explicit and to set prices based on cost. Consequently, interstate access rates have been reduced substantially. Although intrastate access rates have been reduced as well, they still greatly exceed their costs (and interstate access rates) in many states, including Florida. Florida's LECs have resisted efforts to lower intrastate access rates, maintaining that they still provide significant subsidies that keep local rates as low as they are. The IXCs claim that the rates greatly exceed cost, and that reducing them will save consumers millions of dollars.

It is clear that the IXCs will continue their campaign for reductions in intrastate access rates. This paper has set forth a variety of approaches and posed a number of questions that should be carefully considered before access rate reductions are required and before the mechanism and parameters for implementing the reductions are chosen. These issues are complex, involving the vested and conflicting interests of several stakeholders.

The authority to reduce intrastate access rates currently resides with the Legislature. If the Legislature determines that the rates should be reduced, it must decide on the appropriate venue for addressing the issues raised, either the Legislature or the FPSC.