> exchange telecommunications companies be used to satisfy these objectives. For a period of 4 years after the effective date of this section, each local exchange telecommunications company shall be required to furnish basic local exchange telecommunications service within a reasonable time period to any person requesting such service within the company's service territory.

In addition, under Section 364.025(2), Florida Statutes:

> The Legislature finds that each telecommunications company should contribute its fair share to the support of the universal service objectives and carrier-of-last-resort obligations. For a transitional period not to exceed January 1, 2000, an interim mechanism for maintaining universal service objectives and funding carrier-of-last-resort obligations shall [sic] established by the commission, pending the implementation of a permanent mechanism. The interim mechanism shall be implemented by no later than January 1, 1996, and shall be applied in a manner that ensures that each alternative local exchange telecommunications company contributes its fair share to the support of universal service and carrier-of-last-resort obligations. The interim mechanism applied to each alternative local exchange telecommunications company shall reflect a fair share of the local exchange telecommunications company's recovery of investments made in fulfilling its carrier-of-last-resort obligations, and the maintenance of universal service objectives. The commission shall ensure that the interim mechanism does not impede the development of residential consumer choice or create an unreasonable barrier to competition.

Moreover, under Section 364.025(4), Florida Statutes, the Legislature directed the Commission to:

> [R]esearch the issue of a universal service and carrier-of-last-resort mechanism and recommend to the Legislature what the commission determines to be a reasonable and fair mechanism for providing to the greatest number of customers basic local exchange telecommunications service at an affordable price. The recommendation shall be provided to the Governor, the President of the Senate, the Speaker of the House of Representatives and the minority leaders of the Senate and the House of Representatives no later than January 1, 1997.

We opened this docket to address the legislative requirements noted above. Thus far, we have focused on an interim universal service/carrier of last resort (US/COLR) mechanism. After that is implemented, we shall turn our attention to our recommendation to the Legislature on a permanent US/COLR mechanism.

We held hearings on the interim mechanism on October 16 - 18, 1995. The following parties participated: ALLTEL Mobile Communications of Florida, Inc. (AMC); GTE Mobilnet Incorporated, GTE Mobilnet of Tampa Incorporated, and Contel Cellular of the South, Inc. (GTEM); AT&T Communications of the Southern States, Inc. (AT&T); BellSouth Mobility Inc. (BMI); Florida Cable Telecommunications Association, Inc. (FCTA); Florida Interexchange Carriers Association (FIXCA); Florida Public Telecommunications Association, Inc. (FPTA); GTE Florida Incorporated (GTEFL); Intermedia Communications of Florida, Inc. (ICI); McCaw Communications of Florida, Inc. and its Florida regional affiliates (McCaw); MCI Telecommunications Corporation Inc. and MCI Metro Access Transmission Services, Inc. (MCI); Metropolitan Fiber Systems of Florida, Inc. (MFS); the Office of Public Counsel (OPC); BellSouth Telecommunications, Inc. d/b/a Southern Bell Telephone and Telegraph Company (SBT); the Small Company Committee of the Florida Telephone Association (SCC); Sprint Communications Company, L.P., Central Telephone Company of Florida and United Telephone Company of Florida (S/C/U); Teleport Communications Group, Inc. (TCG); and Time Warner AxS of Florida, L.P. and Digital Media Partners (TW/DMP).

At an issue identification conference, held July 14, 1995, issues were structured in an attempt to achieve two goals. First, given the tight schedule mandated by statute, it was essential that the record reflect sufficiently detailed information to allow us to actually implement an interim mechanism. Second, the statute appears to allow for a distinction between an interim mechanism for US versus for COLR; Section 364.025(2), Florida Statutes, states that "[t]he interim mechanism . . . shall reflect a fair share of the local exchange company's recovery of investments made in fulfilling its carrier-of-last-resort obligations, <u>and</u> the maintenance of universal service objectives." (Emphasis added)

In their post-hearing filings, most of the parties did not distinguish between a US versus a COLR mechanism. We agree that, at this time at least, it would be virtually impossible to separate US objectives from COLR obligations. Consequently, our discussion will center on a combined interim US/COLR mechanism.

II. WHAT ARE "UNIVERSAL SERVICE" OBJECTIVES?

The majority of the parties agreed that US "means an evolving level of access to telecommunications services that, taking into account advances in technologies, services, and market demand for essential services, the commission determines should be provided at just, reasonable, and affordable rates to customers, including those in rural, economically disadvantaged, and high-cost areas." § 364.025(1), Fla. Stat. In addition, most of the parties contended that, at a minimum, US includes basic local telecommunications service. Under Section 364.02(2), Florida Statutes:

> 'Basic local telecommunications service' means voice-grade, flat rate residential and flat-rate single line business local exchange services which provide dial tone, local usage necessary to place unlimited calls within a local exchange area, dual tone multi-frequency dialing, and access to the following: emergency services such as '911', all locally available interexchange companies, directory assistance, operator services, relay services, and an alphabetical directory listing. For a local exchange telecommunications company, such term shall include any extended area services routes, and extended calling service in existence or ordered by the commission on or before July 1, 1995.

SBT witness Varner argued that US objectives are ensured for the present since, under Section 364.025(1), Florida Statutes, during the four-year period following the effective date of that section, each LEC is required "to furnish basic local exchange telecommunications service within a reasonable time period to any person requesting such service within the company's service territory."

GTEFL excluded single line business (B1) service. GTEFL based its argument on the definition of US as "an evolving level of access to telecommunications services that, taking into account advances in technologies, services, and market demand for 'essential services', the commission determines should be provided at just, reasonable, and affordable rates. . . ." § 364.025(1) Fla. Stat. According to GTEFL witness Williams, although B1 service is a basic service for purposes of price caps, B1 service should not be considered an "essential service" for purposes of a US funding mechanism. GTEFL argued that B1 rates cover their cost and help support residential US objectives.

MCI agreed with GTEFL. According to MCI, for purposes of an interim mechanism, US should include "basic local telecommunications service" as defined in Section 364.02(2), Florida Statutes, excluding single line business service. MCI argued that this will ensure that any US funding would only subsidize basic residential service, the only service the LECs allege is provided below cost.

FCTA introduced several legislative transcripts relevant to the legislative intent of the following amendments to Section 364.01(4)(a), Florida Statutes:

> (4) The Commission shall exercise its exclusive jurisdiction in order to:
> (a) Protect the public health, safety, and welfare by ensuring that basic local telecommunications services are available to all consumers in ~~residents of~~ the state at reasonable and affordable prices.

FCTA argued that these amendments link US to "basic local telecommunications services," as defined under Section 364.02(2), Florida Statutes, and require that such services be made available to all "consumers" rather than "residents." FCTA argued that the above language reflects the Legislature's intent that B1 service be included as part of the US package. According to FCTA, if US was only intended to include residential service, the amendments to Section 364.01(4), Florida Statutes, would not have been necessary.

FCTA contended that the inclusion of B1 service in the initial US package is further supported by the following excerpt from a transcript of the April 5, 1995 Meeting of the House of Representatives Committee on Utilities and Telecommunications:

> MR. CHAIRMAN: Representative Warner on Amendment No. 5.
>
> REPRESENTATIVE WARNER: Mr. Chairman, on Page 6, Line 9, we tell the Public Service Commission to protect the public health, safety, welfare [sic] of ensuring basic local telecommunications services are available to all residents of the state. And our concern here was that we were emphasizing residents, and perhaps that meant residential customers of the LECs. And we wanted to change that word to 'consumers,' so that it would cover small businesses, also. Unfortunately, the amendment that you have before you says 'customers,' instead of 'consumers,' and I would like to do an amendment to the amendment that changes 'customers' to 'consumers,' and then urge the adoption of the amendment.

> MR. CHAIRMAN: Okay. Members, Representative Warner proposes Amendment 5-A to the amendment. It changes the word to 'consumers.' Any questions? Any objection to the amendment? The amendment to the amendment is adopted. Now on the amendment, any questions? Any objections to the amendment? The amendment is adopted without objection.

Finally, FCTA pointed to the portion of Section 364.025(1), Florida Statutes, which requires that "[f]or a period of 4 years after the effective date of this section, each local exchange telecommunications company shall be required to furnish basic local exchange telecommunications service within a reasonable time period to any person requesting such service within the company's service territory." According to FCTA, the term "basic local exchange telecommunications service" relates back to the definition in Section 364.02(2), Florida Statutes, and includes B1 service.

SBT agrees that B1 service should be included as part of US. SBT argued that the statute clearly includes this category of business service within the definition of basic local telecommunications service.

The SCC panel of witnesses argued that, since under Section 364.10(2), Florida Statutes, each LEC serving as a COLR is required to establish a Lifeline rate, small LECs should be allowed to recover the difference between the Lifeline rate and the normal residential rate through a US mechanism.

Fundamentally, US concerns the provision of a specified set of services to customers at affordable rates. Based on our review of the record, we find that US should be construed as the provision of "basic local telecommunications service," including B1 service, at just, reasonable, and affordable rates. We note that this interpretation is consistent with the requirement in Section 364.025(1), Florida Statutes, that incumbent LECs furnish "basic local exchange telecommunications service" within their service territories for four years. We note that the set of essential services that comprise US may be expanded in the future.

GTEFL's suggestion to exclude B1 service from US funding is a separate matter from whether B1 service is a part of US. If B1 rates are both reasonable and compensatory, which appears likely, then the US requirement for this service is being met and the issue of funding is moot. If the rate/cost relationships of this service change, US funding for B1 service may become appropriate. However, the statute is clear that B1 service is included in US.

III. CARRIER OF LAST RESORT

The witnesses largely focused their testimony on COLR as the availability of service or the obligation to serve, and as being inextricably linked with US. "COLR" is not defined by statute. Generally, the parties agreed that the COLR is the provider that must provide basic service at affordable rates to any customer in its service territory. Essentially, the parties argued that the COLR must fulfill US requirements and that the incumbent LEC will have that responsibility for at least four years.

Most of the parties argued that "COLR" refers to the historic obligation of a LEC to serve on reasonable terms all customers in its service area. In support of this view, S/C/U cited Section 364.03, Florida Statutes (1993), which requires LECs to maintain suitable and adequate facilities for the "convenience of its patrons" and to "furnish to all persons who may apply therefor and be reasonably entitled thereto suitable and proper telecommunication facilities and connections for telecommunication services and furnish telecommunications service as demanded upon terms to be approved by the Commission."

FCTA argued that the COLR obligation was created by Section 364.025(1), Florida Statutes, that it only arises with the advent of local exchange competition, and that it is a "future" obligation that will not begin until January 1, 1996. FCTA contended that this is significant when considering the facilities and investments allegedly used by LECs to fulfill their COLR obligations.

Other than whether COLR is an existing or a future obligation, the parties agreed that the COLR obligation assures that US be available ubiquitously. Section 364.01(4)(a), Florida Statutes, which states the legislative intent that basic local telecommunications services be available to all consumers at reasonable and affordable prices, comports with this view of the COLR obligation.

We disagree with FCTA's claim that COLR is a new obligation that arises due to the introduction of local exchange competition. While it is true that the COLR obligation has been made explicit in revised Chapter 364, Florida Statutes, the underlying concept is not new. Under traditional monopoly rate of return regulation, the obligation to make service available within a reasonable period of time at affordable rates was part of the regulatory bargain.

IV. WHO IS LIABLE FOR US/COLR SUPPORT?

Section 364.025(2), Florida Statutes, states, in pertinent part:

> The Legislature finds that each telecommunications company should contribute its fair share to the support of the universal service objectives and carrier-of-last-resort obligations. For a transitional period not to exceed January 1, 2000, an interim mechanism for maintaining universal service objectives and funding carrier-of-last-resort obligations shall [sic] established by the commission, pending the implementation of a permanent mechanism. The interim mechanism shall be implemented by no later than January 1, 1996, and shall be applied in a manner that ensures that each alternative local exchange telecommunications company contributes its fair share to the support of universal service and carrier-of-last-resort obligations. The interim mechanism applied to each alternative local exchange telecommunications company shall reflect a fair share of the local exchange telecommunications company's recovery of investments made in fulfilling its carrier-of-last-resort obligations, and the maintenance of universal service objectives.

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

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

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

With the exception of AMC, virtually all of the parties agreed that all telecommunication services providers, including CMRS providers, should participate in any permanent mechanism determined to be necessary to support US objectives and COLR obligations.

AMC argued that CMRS providers are not subject to any US/COLR mechanism because state regulation of CMRS providers is expressly preempted by federal legislation. Specifically, AMC points to 47 U.S.C. § 332(c)(3)(A) which states, in pertinent part, that:

> Notwithstanding sections 152(b) and 221(b) of this title, no State or local government shall have any authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service, except that this paragraph shall not prohibit a State from regulating the other terms and conditions of commercial mobile services. Nothing in this subparagraph shall exempt providers of commercial mobile services **(where such services are a substitute for land line telephone exchange service for a substantial portion of the communications within such State)** from requirements imposed by a State commission on all providers of telecommunications services necessary to ensure the universal availability of telecommunications service at affordable rates. (Emphasis added)

According to AMC, there is no evidence, in this or any other Commission proceeding, that CMRS services are a substitute for landline telephone exchange service for a substantial portion of the communications within the state of Florida. AMC, therefore, argued that "[u]ntil such time as CMRS services become a substitute for landline telephone exchange service for a substantial portion of the communications within Florida, the Legislature and this Commission are preempted from imposing US/COLR fees upon CMRS providers including Alltel."

We believe that the Legislature has already acted, in Section 364.02(12), Florida Statutes, to make CMRS providers liable for "any fees assessed pursuant to s. 364.025." Presumably, the Legislature is aware of 47 U.S.C. § 332(c)(3)(A)[1], and believes that CMRS services are a substitute for landline telephone exchange

[1] 47 U.S.C. is referenced twice within Section 364.02, Florida Statutes.

service for a substantial portion of the communications within Florida. We, therefore, reject AMC's assertion that CMRS providers are not subject to US/COLR funding pursuant to 47 U.S.C. § 332(c)(3)(A).

AMC also argued that it is not subject to a US/COLR mechanism because there is a conflict between Sections 364.02(12), Florida Statutes, which exempts CMRS providers from the definition of "telecommunications company" yet subjects them to any fees assessed pursuant to Section 364.025, Florida Statutes[2], and 364.025, Florida Statutes, which states only that each "telecommunications company" should contribute US/COLR funding. According to AMC, Section 364.025, Florida Statutes, should prevail because it is a specific statute, while Section 364.02(12), Florida Statutes, is a "general" (i.e. definitional) statute.

In support thereof, AMC cited McKendry v. State, 641 So. 2d 45 (Fla. 1994). In McKendry, the defendant was convicted of possession of a short-barreled shotgun, in violation of Section 790.221, Florida Statutes (1989). The mandatory minimum sentence under that section was five years. The trial court, relying on Section 948.01, Florida Statutes, suspended the five year sentence and sentenced McKendry to one year of community control, followed by three years of probation. The State appealed and the District Court reversed. The Supreme Court agreed with the District Court, and held that "a specific statute covering a particular subject area always controls over a statute covering the same and other subjects in more general terms. (Citations omitted.) The more specific statute is considered to be an exception to the general terms of the more comprehensive statute." Id., at 46.

We do not agree that any incompatibility exists. Yet, even assuming such a conflict, Section 364.02(12), Florida Statutes, is the specific statute, not Section 364.025, Florida Statutes. While Section 364.02(12), Florida Statutes, exempts CMRS providers from the definition of "telecommunications company," it specifically subjects them to any fees imposed under Section 364.025, Florida Statutes. AMC's argument is, therefore, not persuasive.

AMC also argued that US/COLR fees "carry some similarities to an excise tax." Citing Green v. Panama City Housing Authority, 110 So. 2d 490 (Fla. 1st DCA 1959), AMC argued that "when there is any

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[2] Section 364.02(12), Florida Statutes, also subjects CMRS providers to any taxes imposed pursuant to Chapters 203 and 212, Florida Statutes.

ambiguity as to the application of a tax to an entity, the tax cannot be assessed upon that entity."

A mechanism to support US objectives and COLR obligations is not a tax. A tax is levied and collected by a governmental authority. US/COLR funds, if any, will be collected primarily by privately owned companies. We, therefore, reject AMC's argument in this regard, as well.

Finally, AMC argued that, even if CMRS providers are subject to a US/COLR funding mechanism, CMRS providers already make substantial contributions to US objectives and COLR obligations through interconnection fees, and that any fees assessed pursuant to a US/COLR mechanism should be offset by corresponding reductions in interconnection fees.

GTEM and McCaw also argued that CMRS providers already support US objectives and COLR obligations through interconnection charges. While McCaw argued that it should not be required to provide additional support, GTEM argued that, if we determine that CMRS providers should provide support for US/COLR obligations, we should reduce interconnection charges proportionately.

AT&T and FIXCA argued that, if a LEC demonstrates that it requires US/COLR funding, all telecommunications services providers, including CMRS providers, should contribute toward maintaining US objectives and COLR obligations in a competitively neutral manner. However, they argued that, until we reform the existing system of subsidizing US through access charges, we should not impose another subsidy upon interexchange carriers (IXCs).

FPTA argued that independent pay telephone providers (IPPs) already provide US/COLR support through charges for business lines, screening and blocking services, operator services revenues, intraLATA toll revenues, and originating access charges.

MFS argued that ALECs will contribute their fair share by investing in the development and construction of local networks. Only after research had been done to determine that there is a requirement for a subsidy would MFS take part in any funding.

The SCC panel argued that all telecommunications providers should contribute to a funded US/COLR mechanism based on their percentage of total intrastate revenues.

SBT agreed that most telecommunications services providers already contribute to the maintenance of US objectives and COLR obligations through various implicit and explicit mechanisms. SBT, therefore, argued that an interim US/COLR mechanism should apply to ALECs. GTEFL, generally, agreed.

TW/DMP argued that ALECs should not only contribute to, but receive funds from any US/COLR funding mechanism. They argue that the mechanism should be targeted toward low income consumers.

The statutory provisions clearly state the Legislature's intent that all telecommunications companies, as defined under Section 364.02(12), Florida Statutes, and CMRS providers, as defined by Section 364.02(3), Florida Statutes, should contribute toward the support of US objectives and COLR obligations. However, virtually all of the parties agreed that existing providers, including LECs, IXCs, IPPs, and CMRS providers, presently contribute US/COLR support through various implicit or explicit mechanisms. ALECs are the only providers for whom a mechanism does not exist. Accordingly, for purposes of the interim mechanism, we find that, to the extent any additional US/COLR funding is needed, such support should, at a minimum, be collected from ALECs.

The US/COLR support mechanisms raised by AMC, GTEM, AT&T, FIXCA, FPTA, and McCaw will be considered during the development of our recommendation to the Legislature regarding any permanent US/COLR mechanism.

V. INTERIM US/COLR MECHANISM

The interim US/COLR mechanisms proposed by the parties can be basically divided into two categories: those proposed by SBT and GTEFL and those proposed by the non-LECs and SCU. We will address the non-LEC and SCU proposals first, followed by the SBT and GTEFL proposals. Finally, we will address what we believe to be the appropriate interim US/COLR mechanism.

A. Non-LEC and S/C/U Comments/Proposals

AT&T witness Sather argued that we should not implement a funded US mechanism unless and until a LEC can establish a need for funds. He suggested that an investigation of existing cost/revenue relationships, together with the amount of existing subsidies, would reveal that no US subsidies are required. Mr. Sather argued that consumer benefits are maximized by pricing all services at economically efficient, or unsubsidized, levels. According to Mr. Sather, the US goal of optimizing connection to the network is an overlay to the efficient pricing principle and not a substitution for or a modification of that objective. He argued that the goal of US should be to establish targeted subsidies for individual consumers that were unable to afford telephone service at the economically efficient price level.

FCTA witness Pacey contended that it is unlikely that the local market will transform dramatically on January 1, 1996, and that the incumbent LEC will continue to control all or virtually all of the local exchange market. She cautioned that immediate US/COLR funding could create an unintended and impenetrable barrier to competition and the development of full consumer choice.

Ms. Pacey also argued that an interim mechanism should be viewed as a means of protecting the public from any adverse impact on US as a result of local competition, rather than as a means of keeping LECs whole. She argued that, at this point, it is not clear whether revenues lost to competition will be greater than LEC gains under the new law as a whole. She stated that revenue gains could come from a number of sources such as local interconnection, unbundling arrangements, expanded services and products, expanded service territory and/or increases in demand. Ms. Pacey proposed an interim mechanism based on a tracking system; LECs would identify low revenue-producing customers in high cost exchange areas, on an exchange by exchange basis, and report the costs associated with providing basic local telecommunications services to such customers. Ms. Pacey recommended using total service long run incremental cost (LRIC) cost information to determine those exchanges in need of funding.

FIXCA witness Gillan cautions that we not confuse the LECs' profit-maximizing behavior with a claimed COLR obligation. He asserts that the LECs face strong profit incentives to build their subscriber base that exceeds any perceived social obligation. Mr. Gillan argued that, while the price of residential basic local exchange service may be below its cost, this does not mean that it is uneconomic to provide local service to any customer class or geographic area. He testified that if the total revenues generated by a customer, including charges for basic local exchange service, vertical services, intraLATA toll services, and access charges, exceed the cost to serve the customer, it is economically practical to serve that customer.

Mr. Gillan argued that an interim mechanism does not necessarily equate to a fund. Mr. Gillan recommends that we articulate a set of procedures that we intend to apply to respond to any definitive request for funding in the future. He recommends that we not conclude that additional funding is necessary simply because the restriction on local competition has been lifted.

FPTA witness Norris argued that an interim US/COLR mechanism should monitor competitive developments and gather data so that we have sufficient information to prepare our recommendation to the Governor and Legislature before the interim period expires.

McCaw witness Cresse argued that the burden to demonstrate the need for a subsidy rests on the LECs, and that they have not met their burden. He also argued that losses due to competition do not justify financial support. Mr. Cresse testified that, in the competitive world, no company sends money to another company to "make up" for competitive losses. Mr. Cresse believes that the only subsidy LECs should be entitled to is one shown to be necessary for them to continue to serve specific exchanges.

MCI witness Price argued that the Commission will ultimately have to face the issue of restructuring US funding if a competitive local telecommunications market is to develop. He argued that we should establish a mechanism that, under certain circumstances, would be triggered to allow a qualifying LEC to receive US support. Mr. Price testified that, before a LEC receives any US/COLR funding, it should be required to demonstrate that the economic cost of providing basic local telecommunications services exceeds the revenues generated by such services, including the associated Subscriber Line Charges, and that the contribution from service rates is insufficient to cover the difference between costs and revenues. He also urged that cost studies be based on total service LRIC.

MFS witness Devine argued that no state that has authorized competitive local exchange service has found it necessary to impose an interim US obligation on new entrants. He argued that in Florida, local exchange rates are very low while interexchange access rates are very high and, as a result, LECs receive limited contribution from basic service. Accordingly, he argued that, to the extent that ALECs are able to obtain local exchange business, the LEC will suffer little, if any, loss of contribution.

Mr. Devine also argued that applying switched access rates for US/COLR support would impose costs on the ALEC in excess of the retail rate charged by the LEC. According to Mr. Devine, since ALECs' rates will likely have to be no higher than the LEC's rates, this plus all of the charges the ALECs will have to pay would create a price squeeze.

The SCC panel argued that all telecommunications providers should contribute to a funded US/COLR mechanism based on their percentage of total intrastate revenues.

TW/DMP witness Selwyn argued that development of competition for local service will be sufficiently gradual that the LECs should have no difficulty adjusting their capital spending and other costs to accommodate the impact of any market share erosion. He argued that competition in the interexchange market did not happen overnight; it has been evolving for more than two decades.

Mr. Selwyn proposed a two-step process to identify segments of the local market that are so costly to serve that, absent funding, basic rates would exceed an affordability threshold. The first step is to conduct an objective analysis of the costs of the particular area based upon its physical characteristics and on that basis develop cost proxies that would establish normal or expected cost levels for areas with the specified geographic and density attributes. The second step would be to implement bidding to determine the fair market value of serving the area.

Under Mr. Selwyn's proposal, the provider (bidder) requiring the least subsidy to offer basic residence local exchange services to the area at a pre-specified rate and a pre-specified quality of service would obtain the exclusive right to receive support for a specified number of years. He argued that, absent the bidding process, calculations of the required US/COLR funding would be based upon the incumbent's reported costs, with no incentive for LECs to minimize their costs of serving such areas. Mr. Selwyn admitted, however, that it would not be possible to implement this procedure by January 1, 1996. He also did not know whether it would be permissible under current law.

A number of parties presented testimony and argument that pricing residential local exchange service below incremental cost is a chief contributor to the US situation. Subsidizing residential service has required that other services, such as toll and access, be priced above cost.

AT&T witness Sather argued that, in order to foster true competition, all current subsidies should be eliminated, including those generated by access charges. He contended that, absent rate rebalancing, there is no justification for US funding for any company that is meeting its overall revenue requirement. However, he admitted that, under price cap regulation, our latitude to modify the pricing of access charges and local services is restricted for at least four years.

Instead of an interim mechanism that requires immediate funding, S/C/U witness Poag advocated a mechanism whereby LECs could petition for US/COLR funding on an expedited, case-by-case basis. The LEC would have the burden of demonstrating that competition has adversely affected its ability to sustain US/COLR obligations. Mr. Poag asserts that this procedure would ensure due process to both LECs and ALECs, based upon the circumstances in each instance.

B. SBT Proposals

SBT argued that virtually all of its facilities are required to meet its US objectives and COLR obligations. According to SBT, its net investment in plant used to maintain US objectives and COLR obligations is $2,088,275,000. SBT did not, however, identify any specific facilities used exclusively to provide US as a COLR.

SBT witness Martin argued that, given the terms of the legislation and the January 1, 1996 deadline, any interim mechanism should be simple. He proposed three alternative solutions.

Under SBT Alternative 1, each LEC would tariff a flat-rated US preservation charge (USPC), derived as follows:

> [The] element would be determined separately for each ALEC and each interexchange carrier based on revenue data provided by those companies. To determine each company's assessed amount, the LEC would first determine the amount of implicit support that is currently built into the LEC's rate structure. This amount of support would then be reduced to reflect the fact that the LEC would continue to support US/COLR obligations. The remaining amount of support would then be divided and bulk billed to interexchange carriers and ALECs based on their individual share of assessable revenues within the state. When this mechanism is first implemented, the LECs' access prices would be reduced in the aggregate by the net amount received from the US preservation charges.

The "assessable revenues" used in SBT's proposed allocation would be revenues derived from services sold to end users. Since the allocation is based on revenues, an ALEC would only receive an assessment once it generates eligible revenues.

Under SBT Alternative 2, each LEC would tariff a per minute USPC that would apply to an ALEC each time it accesses the LEC's network. This charge would be calculated by determining the amount of implicit support embedded in the LEC's rate structure, reduced to reflect the fact that the LEC would continue to support its US/COLR obligations. The resulting amount is then divided by the LEC's total access minutes to yield an estimate of the amount of implicit support on a per minute basis. As calculated by Mr. Martin, SBT's USPC under Alternative 2 is $0.1856 per minute.

The methodology underlying SBT Alternatives 1 and 2 requires a calculation of the implicit support embedded in the LECs' rate structures. According to SBT, the implicit support is the total company revenue requirement associated with its common line investment; Mr. Martin argues that, for SBT, this amount is $1.834 billion.

SBT argues that there are two components to its implicit support: its past US/COLR investment and US/COLR investment made on an ongoing basis. According to SBT, in the past, recovery of investment was deferred and, through residual pricing, basic local rates were the beneficiaries of this deferral. With the advent of local competition, its recovery of that investment in rates for service is no longer assured. SBT argues that ALECs, as well as other providers, will benefit from this investment and should contribute to its recovery. SBT witness Emmerson testified that the past COLR component is necessary in order to "catch us up to the present." As for the ongoing COLR component, SBT argues that, since incumbent LECs will remain the COLR for at least four years, ALECs and others will benefit from their investment in plant to fulfill US/COLR obligations and should contribute thereto.

SBT equated its past COLR component with the past investment it associates with the COLR obligation and the annual amount of associated depreciation expense. According to Mr. Martin, SBT's past COLR component is $78 million per year which, subtracted from the total common line revenue requirement, yields $1.786 billion.

Mr. Martin computed the ongoing COLR investment component by multiplying the percentage of flat rate residential and single line B1 access lines (70 percent) by $1,786 million, yielding $1,250 million. From this, Mr. Martin subtracted the amount of revenues currently received from local loop services ($668 million), and any explicit support already associated with US/COLR obligations ($13 million). According to Mr. Martin, the result, $569 million, is the implicit support associated with traditional social pricing policies.

According to SBT, the sum of its past and ongoing COLR components is $647 million per year. This includes not only a return on investment, but operating expenses, depreciation and taxes. Mr. Martin stated that this figure is SBT's best estimate of its required support, and that additional data would need to be gathered in order to arrive at a statewide amount. Mr. Martin argued that, under SBT Alternatives 1 and 2, the amount of support to which SBT is entitled is the total implicit support of $647 million less its own contribution of $253 million, or an estimated net total of $394 million.

Under Alternative 3, SBT derived a per minute USPC by adding the weighted average interstate and intrastate Carrier Common Line (CCL) charge, and the weighted average intrastate and interstate Interconnection Charge (IC) associated with switched access transport. The resulting USPC would be approximately $0.01822 per minute. Mr. Martin cautioned, however, that the local transport interconnection charge had not been filed or approved in Florida.

Mr. Martin recommended that contributions and recovery should begin upon implementation of the new USPC tariff (SBT Alternative 1) or with the first interconnection by an ALEC to the LEC network (SBT Alternatives 2 and 3).

C. GTEFL Proposals

GTEFL argued that the primary facilities used to maintain US objectives and COLR obligations are common line facilities: the subscriber loop, customer drop, and associated non-traffic sensitive central office equipment. GTEFL contended that its net investments and reserves required to maintain US objectives and COLR obligations are $1.308 billion. According to GTEFL witness Williams, "we're forced to look at the total common line investments because we can't distinguish those common lines that are specifically there for carrier of last resort as opposed to other common lines or loops that are there not under that requirement."

GTEFL calculated that approximately $293 million per year is needed to fulfill its US/COLR obligations, based upon an embedded, fully allocated cost study using ARMIS data. This amount consists of return on net investment, operating expenses, depreciation and taxes. GTEFL proposes to recover only the portion of US/COLR support lost from an erosion of local exchange market share. The remaining amount will continue to be recovered through GTEFL's various revenue sources, such as yellow pages revenues, access charges, toll rates and vertical services.

Mr. Williams argued that ALECs will only have to pay US/COLR support after they acquire local customers, and that the amount each ALEC would contribute would be directly related to the amount of traffic carried or the number of lines provided. Further, the amount contributed by the ALECs would be based upon LEC-specific costs, rather than average statewide figures. Mr. Williams stated that, by targeting the loss of US/COLR support created by competition, the amounts the ALECs will contribute will not be so great as to impede competition or residential customer choice.

Mr. Williams argued that GTEFL's proposed mechanisms are fair to other providers, and do not affect existing subsidies from other sources or providers. Accordingly, other telecommunications providers will not pay additional US/COLR support, and ALECs' contributions will not replace any existing subsidies. He also emphasized that GTEFL's mechanisms are designed to be implemented on an interim basis only. On a long term basis, he recommends that the entire system of implicit and explicit subsidies be overhauled.

Under GTEFL Alternative 1, a flat monthly rate of $4.10 and $45.00 would be charged for each residential and business access line, respectively, served by an ALEC that is interconnected to GTEFL. The charges would be assessed to all customer access lines, not just to those making interconnecting calls. He stated that one drawback to this approach is that LECs would be unable to directly measure business and residence access lines served by the ALECs and would have to rely on ALEC reporting.

Under GTEFL Alternative 2, a per minute rate of $0.025638 would be applied to ALEC traffic, business or residential, terminated on the LEC's network. Mr. Williams argued that one disadvantage of a single rate per minute for business and residence traffic is the immediate reduction of support from business access line charges and long distance services. One advantage, however, is that LECs can measure usage.

Mr. Williams argued that GTEFL prefers Alternative 1 because it has a higher charge for business customer activity during the interim period than the charge for residential customers served by the ALECs. He also believes that it is a step in the right direction toward aligning rates with costs.

Mr. Williams recommended that contributions by ALECs and recovery by LECs begin as soon as customers transfer local service to an ALEC.

D. <u>Analysis of SBT/GTEFL Proposals</u>

Upon consideration, we believe that SBT's and GTEFL's proposals suffer from three major problems. First, SBT and GTEFL contend that emerging competition will erode their ability to carry out their US/COLR obligations and that they need US/COLR funding beginning January 1, 1996, or immediately upon competitive entry. SBT and GTEFL failed, however, to demonstrate that local competition will have such an immediate and overwhelming effect or, indeed, any effect whatsoever. Second, SBT and GTEFL based their calculations of the required funding on the amount of revenues that are currently available to support US, rather than on the amount of subsidy required to sustain US. Third, their proposals suffer from a number of specific mechanical and technical flaws.

1. Erosion of LECs' Ability to Sustain US Due to Competition

SBT and GTEFL acknowledged that existing implicit and explicit mechanisms currently fulfill their US/COLR funding needs. However, they argued that competitors will target densely populated areas with low costs to serve, thus eroding one of their historically major subsidy mechanisms. According to SBT, approximately 30 percent of its revenues in Florida are generated by approximately 6.4 percent of its geographical territory. Similarly, GTEFL witness Williams asserted that less than 2 percent of GTEFL's customers account for 46 percent of its toll revenues. However, neither SBT nor GTEFL was able to quantify the amount of support for their respective US/COLR obligations that might be lost.

FIXCA witness Gillan argued that it has not been demonstrated that competition will alter the balance of profitable/unprofitable customers served by an incumbent LEC. Although it can be assumed that entry will occur within defined geographic areas, he argued that it does not necessarily follow that ALECs will attract only profitable customers. According to Mr. Gillan, ALECs will likely construct facilities to serve customers with a wide variety of spending patterns. Mr. Gillan also noted that certain entrants, such as cable companies, will likely serve areas already defined by their current networks. While he conceded that ALECs would prefer to serve areas where all customers are profitable, he argued that it is pure speculation whether such areas exist.

MCI witness Price stated that it is unlikely that LECs will idly allow competition to erode their markets. He argued that, in the intraLATA market, LECs have effectively slowed or prevented loss of market share. He also stated that LEC responses to AAV competition have been aggressive and largely successful. He, therefore, believes that LECs will be successful in their efforts to retain local market share. He also cited MCI's experience in the interLATA toll market, where it took a full 10 years after divestiture to garner 20% of the market, when all one must do is place a phone call to change long distance carriers. He asserts that because changing local service providers will not be so easy, changes in the local service market will occur even more slowly.

MFS witness Devine argued that, given MFS' experience in implementing competitive local exchange service in other states, it is clear to him that competitors will make no appreciable impact on LEC revenues absent the existence of true number portability.

S/C/U witness Poag stated that his companies could not accurately determine the possible impacts of competition on their ability to maintain US/COLR obligations, and concluded that they would not require any funding in the near future:

> We've got, I think, a fair understanding of what we believe to be the major areas where we're going to have competition. We believe that given our circumstances, that in the next 18 months that we're not going to need funding. And related to that is the difficulty in sitting here today and predicting the future and saying that this is how much I need and this is when I need it, when, again, I don't know the rules and I don't know the players.

Based upon the evidence in this proceeding, we do not believe that there is adequate information regarding when and where competition may emerge in the local exchange market or the magnitude of its impact on the LECs' ability to sustain their US/COLR obligations. Accordingly, we do not believe that SBT and GTEFL have adequately demonstrated their alleged need for US/COLR funding, beginning January 1, 1996, or immediately upon competitive entry.

2. Support Versus Subsidy

The amount of implicit support generated via the LECs' rate structures is not necessarily the same as the amount of support required to sustain any existing subsidies. For example, in 1993, a study was performed on behalf of the USTA which estimated that, on a nationwide basis, the amount of contribution generated from above cost pricing of certain services, such as access and toll, was approximately $20 billion. In 1994 Hatfield Associates, Inc. prepared a study for MCI which estimated that the total nationwide US subsidy was on the order of $3.7 billion. Although we do not pass on the accuracy of these figures, it is likely that there is a significant disparity between the amount that is available to support US and the amount of US subsidy required.

Moreover, as noted by MCI witness Price, SBT's and GTEFL's requests for US support appears to represent a change in position:

> What we are seeing in this proceeding is a subtle shift in terminology. Whereas historically the LECs claimed that there existed a need for US subsidy, now we are told that the issue is support for US. This shift in terminology is clearly designed to permit the LECs to claim an entitlement to revenues far in excess of their economic cost of providing basic service.

Mr. Price argued that the effect of the LEC proposals is "to position the LECs to have their cake and eat it, too." He asserted that, on the one hand, under the guise of US the LECs would guarantee recovery of all embedded costs, giving them a free network and providing risk-free recovery of significant levels of corporate overhead. On the other hand, he argued that the LECs seek to price potentially competitive services using LRIC methods, excusing them from responsibility for the cost of the network used to provide them and permitting the LECs to be "supercompetitive."

GTEFL witness Williams accepted that the annual shortfall between GTEFL's basic local residential rates and the long run incremental cost of providing such service is approximately $82 million, yet GTEFL proposes a total of $293 million in interim US support. When asked to reconcile these amounts, he stated:

> And the difference between the 82 million and the 293 million goes back to the fact we're using an imbedded [sic] cost study in our analysis to look at past costs, if you will, and calculate what we believe to be the ongoing level of support that universal service is getting. And so it includes a contribution to joint and common costs of the company, as well as there may be some profit included in that.

The common overhead costs, a portion of which is implicitly included in GTEFL's $293 million, consist of such items as costs associated with corporate aircraft, and the GTE corporate planning and marketing departments. SBT witness Martin also acknowledged that the US support amount reflected in the SBT proposals included shared and common costs.

After evaluating the evidence, we are not persuaded that it is appropriate to require ALECs to pay a share of the LECs' common overhead. We also note that LEC incremental cost studies generally include a return on the investment used to provide the service as a cost component. To the extent that SBT's and GTEFL's LRIC studies for residential service comply with this standard practice, it is likely that the amount of universal service support they are requesting includes additional profit.

Since the core problem giving rise to US concerns is the subsidization of residential rates, the appropriate solution is to identify the amount required to fund a US subsidy, not the amount of support for US purportedly being generated. Determining the presence and amount of a subsidy requires the use of an incremental cost standard. Analyses based on embedded costs, such as those employed by SBT and GTEFL, are irrelevant and inappropriate to determining the amount of US subsidy required. If a LEC wishes to recover additional costs from a US/COLR mechanism, they should request such costs explicitly, and decisions thereon should be made on a case-by-case basis.

3. Mechanical/Technical Flaws

SBT's and GTEFL's proposals are derived from a revenue requirements calculation, are based upon embedded costs, and assume that all common line investment they have made has been to meet US and COLR obligations. They also argue that revenues attributable to fulfilling their US/COLR obligations should be restricted to recurring access line revenues and subscriber line charges, plus federal US funds.

It cannot be disputed that a LEC's entire investment in common line facilities is required to maintain US objectives and COLR obligations; however, those facilities are not put in place solely for that purpose. A number of other parties testified, and we hereby find, that those facilities are also used to provide services other than basic service. Using the entire common line investment, but only revenues derived from recurring access line revenues, subscriber line charges, and federal US funds, therefore, results in a mismatch between the investment and revenue sources.

When asked whether revenues from services other than just basic service should be considered, GTEFL witness Williams stated that they should not be included in a permanent mechanism unless the definition of US was expanded to include such features. However, he stated that it would not be improper to include them in an interim mechanism, as long as the interim mechanism were only in place for two years.

Another problem with the SBT and GTEFL proposals is that they used an 11.25 percent rate of return, the interstate rate of return used by the National Exchange Carriers Association to determine US support, which is higher than the intrastate rate of return approved by this Commission. Mr. Williams stated that GTEFL used this rate because sources of US/COLR support lost to an ALEC would include those from exchange access service, as well as services that yield high contributions, such as toll and access. This assumes that the level of contribution lost from services like toll and access will be relatively uniform. While this could prove to be the case, it will depend on the specific mix of services offered by ALECs; since this information is not known, SBT's and GTEFL's use of an inflated return rests on an unsupported assumption.

Moreover, SBT and GTEFL computed total company common line revenue requirements, and reduced this amount by revenues associated with US (flat rate residential and single-line B1 services, subscriber line charges, and federal high cost monies received). At the federal level, common line costs are generally recovered through residential and business subscriber line charges (SLCs), flat charges of $3.50 per access line for residential, and a maximum of $6.00 for business, that were established by the Federal Communications Commission independent of the level of common line costs. Since "slippage" can occur between total common line costs and the total revenues generated from SLCs, such slippage is recovered in the CCL charge. Neither SBT's nor GTEFL's analysis accounts for this or any associated interstate revenues.

Under SBT Alternative 1, ALECs, IXCs and SBT would contribute support based upon their relative retail revenues. Thus, access charges would be included, while the LECs' access charge revenues would be excluded, resulting in even more US/COLR support from IXCs. We note that an alternative proposed by some parties based retail revenues upon total revenues net of intermediate charges, such as access charges, shifting the burden more toward the LECs.

Also under SBT Alternative 1, monies received via the USPC would be used to reduce switched access charges (apparently the CCL charge and the IC element included in switched transport). Since SBT has computed common line costs on a total company basis, both interstate and intrastate CCL and IC charges may need to be reduced or eliminated. SBT stated that, if we adopt Alternative 1, and the USPC generates sufficient funds, it will apply to the FCC to reduce or eliminate the interstate CCL and IC. Since there is no assurance that the FCC will approve SBT's proposal, not to mention uncertainty over pending Congressional action, Alternative 1 may not be fully implemented as designed. And, if the FCC approves the required waivers but delays doing so, that might create timing problems that could result in overrecovery by SBT.

It also appears that SBT's attempt to recover its "past COLR investment" may be anticompetitive. By including this "past COLR" component in its proposed mechanisms, SBT has essentially requested that it be made whole in the face of impending competition. If SBT wishes to be assured of the opportunity to recover its "past COLR investment," it could have remained under rate of return regulation[3].

Under GTEFL Alternative 1, the proposed business rate is significantly greater than GTEFL's own business access line rates. In order for an ALEC to be price competitive, it would presumably be unable to charge access line rates higher than GTEFL's. Consequently, it would either have to forego entry into GTEFL's territory, or accept offering the business line as a "loss leader" and devise pricing packages that would, in the aggregate, generate a positive revenue level. Either way, GTEFL's proposed rate would constitute a competitive obstacle for potential entrants.

GTEFL's per line US/COLR charges will also likely be assessed on all ALEC reported access lines. Thus, the ALEC could pay both for access lines that it takes away from GTEFL and for access lines associated with growth. Such an outcome appears anti-competitive, since it would penalize the entrant for its marketing expertise.

In addition, TW/DMP witness Selwyn stated that traditional sources of support for US have included revenues from yellow pages advertising, interstate and intrastate CCL charges, interstate and intrastate switched access/transport, local and intraLATA toll, vertical services, and the federal US fund. Mr. Selwyn argued that before new burdens are imposed upon ALECs, LECs should include revenues from services such as yellow pages advertising in any US/COLR funding mechanism.

MCI also argued that the LECs ignored yellow pages revenues in calculating the basic local exchange revenues available to offset the common line costs, even though the claimed need for a subsidy for basic local service was the basis for allowing the Bell operating companies, rather than AT&T, to retain the yellow pages business on divestiture. See U.S. v. AT&T, 552 F. Supp. 131, 193-94 (D.D.C. 1982). We agree with MCI and TW/DMP that yellow pages revenue should be considered as a source of US support.

Although SBT Alternatives 2 and 3 and GTEFL Alternative 2 are not inherently improper, their proposed rates per terminating minute appear excessive. Using SBT witness Martin's assumption that an average residential customer generates approximately 460 minutes of terminating local usage per month, of which 85 percent would terminate on the LEC's network, an ALEC would pay SBT approximately \$8.00 per month, or approximately \$10.00 for GTEFL, in US/COLR charges for each residential subscriber, in addition to

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[3] SBT elected price cap regulation on November 1, 1995.

charges for other services it obtains from the LEC such as number portability and local interconnection. Since residential access line rates average approximately $10.00 per month for SBT and $11.00 per month for GTEFL, ALECs would find it difficult to compete on price.

4. <u>Conclusions Regarding SBT and GTEFL Proposals</u>

Based upon our analysis of the evidence, we find that SBT and GTEFL have not demonstrated the impact or magnitude of local competition or that competition will erode their ability to sustain their US/COLR obligations. We also find that SBT and GTEFL inappropriately based their calculations of US/COLR funding needed on the amount of support available for US, as opposed to the amount of US subsidy required to sustain their US/COLR obligations. Moreover, we find that there are numerous other mechanical and technical flaws inherent in the SBT and GTEFL proposals. We, therefore, conclude that SBT and GTEFL have not demonstrated any need for US/COLR funding at this time.

E. <u>Decision on Appropriate Interim US/COLR Mechanism</u>

As found above, SBT and GTEFL have not demonstrated that competition will erode their ability to sustain US as a COLR on January 1, 1996. In addition, their US/COLR proposals are based upon inappropriate and flawed mechanisms. As such, the record does not support the establishment of a funded interim US/COLR mechanism at this time. Accordingly, we find that the appropriate interim US/COLR mechanism should consist of two parts.

First, we believe that the LECs should continue to fund their US/COLR obligations as they currently do; that is, through markups on the services they offer. Although not the subject of this proceeding, for ALECs, such markups could presumably extend to services such as local interconnection and number portability.

However, if a LEC finds that its ability to sustain US as a COLR has, in fact, been eroded due to competitive pressures, it may file a petition for company-specific US relief. Its petition would be handled on an expedited basis. The petition must specifically demonstrate that competitive entry has eroded its ability to sustain US as a COLR, and specifically quantify the alleged shortfall that is due to competitive entry. The LEC will need to submit incremental cost data to identify the amount of its US subsidy, as well as calculations of the amount of net contribution lost that had been supporting the US subsidy. In no case will a