BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

980000C

In re: Draft Report on Universal Service and Lifeline Funding as Required by Section 364.025(4), Florida Statutes

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PROCEEDINGS:	SPECIAL INTERNAL AFFAIRS
BEFORE:	CHAIRMAN JOE GARCIA COMMISSIONER J. TERRY DEASON COMMISSIONER SUSAN F. CLARK COMMISSIONER JULIA L. JOHNSON COMMISSIONER E. LEON JACOBS, JR.
DATE:	Tuesday, January 26, 1999
TIME:	Commenced at 3:40 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	Debra R. Krick Court Reporter and Notary

APPEARANCES:

RICK MOSES, FPSC staff
WILL COX, FPSC staff
BILL McNULTY, FPSC staff
WALTER D'HAESSLER, FPSC staff

JOHN FONS, BellSouth, GTE FL and Sprint FL
JEFF WAHLEN, Alltell, Vista and Northeast
TOM McCABE, TDS, Telecom.
TRACY HATCH, AT&T Communications & Southern States, Inc.

P R O C E E D I N G S

CHAIRMAN GARCIA: All right. We are going to start the Universal Service report.

Let me tell you what we are going to do. I am going to -- unless it's unbearable, I am going to try to limit -- how many are going to speak on this? We have a pretty long list.

Are consumer groups going to be speaking on this one at length or -- Ms. Marsh, I look at you. Are you going to be speaking on this, or Mr. Belote, are you going to be speaking?

MR. BELOTE: No.

CHAIRMAN GARCIA: Good. So what we have is --

MR. BELOTE: I was short.

CHAIRMAN GARCIA: You were. You were great. I am encouraging you.

We are going to have Mr. Fons, Mr. Hatch, Mr. Melson.

Anybody else?

Okay. Good. So then we will -- if it's all right with you, gentlemen, is 15 minutes a piece all right? Is 15 minutes enough? Yes?

MR. MELSON: Way too much.

CHAIRMAN GARCIA: Good. We'll limit it to 10, then.

Then we will hear from staff. Staff has a presentation to make on fair and reasonable.

You have a presentation on fair and reasonable that you want to make before we go on.

Why haven't we made that before? I guess -- we were running -- we were out of time, okay.

Well, then let me do that. That way, we have got that out of the way.

You don't have a presentation on Universal Service?

Well, then it makes more sense that we wait a minute and we take staff's presentation now on fair, just and reasonable, if that's all right with you, Walter?

MR. D'HAESELEER: It is still being worked on.

CHAIRMAN GARCIA: Okay. We will hear from the parties on Universal Service.

MR. DOWDS: Chairman Garcia, would you like and introduction on the Universal Service?

CHAIRMAN GARCIA: Yes, I would. I just wanted to make a concept of where we were on this, and how we have added Mr. Wahlen and Mr. McCabe.

All right. At 10 minutes a piece, we have more than enough time to deal with it.

Let me just state what we are going to do. When we finish that, we are going to go back to staff, and the staff may take as long as it needs to to make its presentation on its report. When that is concluded, if the Commissioners so desire, we can entertain questions. And that can go as long as they wish.

Then we will reconvene to vote on these issues on Wednesday -- I mean, on Thursday at noon after we voted out the multitenant one. Then we will take up fair and reasonable. And then we will take up Universal Service as report.

But my hope is, Commissioners, if you have any concerns, any questions or things that you don't want fleshed out, this might be a good opportunity to say something to staff.

With that said, Mr. Fons, you're always talkative, why don't you ante this one up. We are starting on Universal Service. So why don't you tell us.

MR. DOWDS: I thought we were --

CHAIRMAN GARCIA: I thought Walter said they weren't ready. Go ahead.

MR. DOWDS: Commissioners, this report consists of two volumes. The first volume has three chapters.

The first chapter consists of a summary of the Commission's order from 980696, the cross proxy model docket.

The second chapter is an estimate of the potential funding amount for Lifeline, which was conducted by the Division of Research. And it's solely their product.

The third chapter has discussions with some recommendations on permanent Universal Service mechanisms. Particularly, we are recommending that the Commission recommend to the Legislature that they establish now an explicit funding mechanism to pick up the state match portion of Lifeline. And there is also some recommendations as to -- under what conditions a intrastate high cost mechanism might be warranted.

The second volume of this report has two components. Appendix A consists of the Commission's order and the cost proxy model proceeding. And due to its voluminous nature, it wasn't provided here.

Appendix B consists of cost proxy model results from 10 Florida LECs by wire center, incorporating all of the revisions and recommendations of the Commission's order in Docket No. 980696.

CHAIRMAN GARCIA: Okay. Mr. Fons.

MR. FONS: Thank you. Good afternoon.

My name is John Fons, and I am representing BellSouth, GTE Florida and Sprint Florida.

As I mentioned this morning, the Commission was directed by the Legislature by Chapter 98.277, which was passed last spring, to determine and report the cost of providing basic local telecommunication service for universal support purposes. That is what the statute says. That is what you are to report to the Legislature on February 15th of this year.

The Commission, in order to address the cost of providing local service for Universal Service purposes, instituted Docket 980696-TP. And the Commission established a hearing process. There were hearings. There were issues. There was testimony taken.

And on January 7th of this year, the Commission issued its order number PSC 990068-FOFTP. And that order was in response to the Legislature's direction to provide the Legislature with the cost of providing basic local telecommunication services for Universal Service purposes.

That was your mandate. That was your only mandate.

The report which the staff has prepared for you to -- and proposed that you send to the Legislature, not only addresses what came out of the Commission's order, it goes far beyond that. Indeed, it goes so far beyond what was required by the Legislature that it's extraneous, it's gratuitous, and, quite frankly, the proposals are wrong, especially in the area of need.

There was nothing in the act that was passed directing you to study Universal Service to address the issue of need. The fact that you have -- the staff proposes that you report on need takes the report far beyond that.

But that's not our main concern. Our main concern is that, in proposing to address whether a Universal Service funding mechanism is needed, staff has given you wrong data. Indeed, not only is it wrong, it's internally inconsistent.

For example, the issue of need was never addressed in the -- in the proceedings. In fact, at page 17 of the Commission's order in 980696, the Commission stated, we recognize that the parties have presented positions and arguments on various issues involving Universal Service under the umbrella of this issue. And the issue in question was, what is the definition of basic local telecommunication service.

Those issues include whether there should be a state Universal Service fund and to what revenue benchmark should we compare the cost to determine the funding amount.

These other issues are not a part of this hearing process and are, moreover, not relevant to our decision on determining a definition for basic local telecommunication services.

So the Commission determined that, whether or not Universal Service funding was necessary, was not an issue to be determined in this proceeding. And not having determined that, there is nothing really for you all to report on, except what the staff may have decided on its own is the proper, whether or not the funding mechanism is needed.

But what's interesting is is that with regard -- there is two pieces to Universal Service funding. The first one is high cost, and the other one is low income. In its proposed report, the staff says that there should be -- there should be Universal Service funding for low income. And the rationale for doing so is that, since the burden of providing the intrastate matching monies fall solely on the incumbent local exchange companies, Florida's

Lifeline program clearly is not competitively neutral.

Therefore, staff concludes that, since the incumbent LECs are bearing the entire burden of funding low income, there should be a fund in order to spread that burden.

Strangely enough, when staff starts talking about high cost funding, they say, no, there is no need for a Universal Service mechanism, even though today the same ILECs that are funding solely Lifeline are also funding Universal Service. So what's good for the goose should be good for the gander, but staff says, no, there should be no Universal Service funding mechanism at this time.

Not only is it internally inconsistent, what staff is proposing appears to violate the '96 Telecommunications Act.

Where at Section 254(f). It stated, under state authority, for under Universal Service, the State may adopt regulations not inconsistent with the Commission's rules to preserve and advance Universal Service. Every telecommunications carrier that provides intrastate telecommunications service shall contribute on an equitable and nondiscriminatory basis in a manner determined by the State to the preservation and advancement of Universal Service in that state.

And that particular language mirrors the overall requirement of the act with regard to Universal Service. And that is, all providers -- and this is at 254(b)(4), where it says, all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of Universal Service.

Well, today, as I indicated earlier, only the incumbent local exchange companies are supporting Universal Service. And all of the other carriers are not.

And the only way that all of the other carriers will make an equitable contribution to the support of the Universal Service is if there is a Universal Service mechanism. But the staff's proposal tells the Legislature that that's not needed. And that is just wrong.

It does not provide the opportunity for all carriers to support Universal Services. And it's not an issue of competition. It's an issue of fairness. If it's not fair for the local exchange companies to bear the sole burden of funding low income, then it should also be unfair for the incumbent local companies to share -- or bear the sole burden of supporting high costs.

Interestingly enough, the staff proposes a couple of alternatives as to what -- how should we determine whether there is need for a Universal Service funding mechanism. And these two alternatives are complex, confusing and inconsistent.

The first alternative --

COMMISSIONER JOHNSON: Mr. Fons, let me just ask you a quick question to the argument that you are making, that none of the other carriers are contributing to Universal Service at least as it relates -- or particularly as it relates to the high cost fund.

Do you not consider the access rates that everyone agrees are priced above cost and the vertical services that, I think, everything demonstrates are priced above cost to provide some level of contribution?

MR. FONS: No more than any of our other customers who pay higher rates for touch tone -- I am sorry, for voice mail, for call waiting and other ancillary services, and our toll customers who pay prices higher than their costs are contributing to the support of Universal Service.

But it doesn't say customers. It says all telecommunications carriers shall equitably support it. To the extent that the access charges are providing contribution, that's fine. But there is erosion in those access charge contributions through bypass and other means by which the IXCs are avoiding paying access charges to support Universal Service.

So it's the local exchange company's customers who are supporting the provision of Universal Service, both the low income and the high cost.

COMMISSIONER JOHNSON: Okay.

MR. FONS: Alternative one says that there may be the need for a fund when the LEC demonstrates that local competitive entry has eroded it's ability to sustain Universal Service.

Now, this particular alternative has some other steps to it. But they all presuppose some kind of an earnings test. Otherwise, it is very unclear how you would show that your ability to sustain Universal Service has eroded.

Quite frankly, this particular mechanism triggers -- ignores the need for high cost support to stimulate local competition, which we talked about this morning. But it also -- it also requires that this be done on a LEC-by-LEC basis.

Now, think about that for a moment. A Universal Service mechanism which would be on a LEC-by-LEC basis. That means that there would be Universal Service funds for each one of the LECs. And if that's the case, then, if -- let's say Sprint qualified for a Universal Service. If it met this test, who then would contribute to this particular fund? Would that mean that BellSouth and GTE would have to contribute to this fund, or Quincy Telephone Company would have to contribute to this particular fund for Sprint? And yet, they would get no money out of it. They would be contributors, but they would get nothing out of it. And on what mechanism would they contribute? So it is very hard to figure out what this particular alternative says.

Alternative two, which says approximately the same thing, you have to show that there is full rampant competition in your service area also suffers from the same problems that I just described.

But the bottom line is, there is another alternative that's not even mentioned in the staff's proposed report. And that alternative is, institute a Universal Service support mechanism today. And that would be the only way in which this state could meet the requirements of the federal act and would be a consistent approach together with what the staff has recommended with regard to instituting Universal Service support mechanism for low income.

So the report, as I indicated earlier, goes far beyond what the Legislature asked you to do. But in going beyond what the Legislature asked you to do, has come out with the wrong proposal.

Thank you.

CHAIRMAN GARCIA: Thank you very much.

COMMISSIONER JOHNSON: I still have to ask you one more question just to better understand your argument, Mr. Fons.

The aspect of the federal law that you believe that we are in violation of would be the competitively neutral funding source for Universal Service, or --

MR. FONS: No, not at all. It has nothing to do with competitively neutral. As I indicated, it's 254(f) of the '96 act, which states that every telecommunications carrier that provides intrastate telecommunications service shall contribute on an equitable and nondiscriminatory basis in a manner determined by the State for the preservation and advancement of Universal Service in that state, which that means that, not only does the local exchange company, the incumbent, contribute, but the ALECs would contribute, the IXCs would contribute, the wireless carriers would contribute, anybody who provides telecommunication service in that state.

COMMISSIONER JOHNSON: Okay.

MR. FONS: Today, that's not happening. Only one entity is providing universal support mechanism.

COMMISSIONER JOHNSON: Okay. That's what I meant by competitively neutral, and that all competitors would pay into --

MR. FONS: Right. But it's not driven by competition. It's driven by a need that -- not -- so there would be an equitable distribution of this burden.

COMMISSIONER JOHNSON: Okay.

CHAIRMAN GARCIA: Just to keep staff alert, I would like staff to respond to the comments that are made by the parties when all the parties conclude.

COMMISSIONER DEASON: All right. Let me ask a question, Mr. Fons.

Is Universal Service mechanism needed because of the threat of competition, or as the result of competition, or is it to stimulate competition?

MR. FONS: It is more to recognize both the existence and threat of competition. As my exchange with Commissioner Johnson indicated, one of the big current contributors that allows the ILECs to support Universal Service is access. And access is under pressure in two different ways.

Number one, by the IXCs attempting to avoid paying access charges through bypass by going out and acquiring what we would call -- what used to be called access vendors, TCI -- or Teleport, et cetera. So they are going out and getting their own companies that they are buying that already have infrastructure, and they are going to the big customers. And so all of that access revenue is disappearing. So to that extent, it is recognizing competition.

Another big contributor to supporting Universal Service is toll. And as you all know, BellSouth, alone, in the last year or so, has lost over one million intralata toll customers in the state of Florida, which is a significant loss of revenue; and, therefore, a significant loss of contribution to support a Universal Service.

There are also competitors out there for all of those services that are high margin services, that provide a large contribution of high difference between their cost and their rate, which, again, is going to support Universal Service.

So, yes, it recognizes current competition and the threat of additional competition when the local markets become more competitive. And when that happens, the local exchange companies will no longer be able to carry the burden alone. The recognition that's already happening. It only makes sense to start the process now of providing the mechanism whereby all of the parties contribute to that.

COMMISSIONER DEASON: Does a Universal Service mechanism have any effect on stimulating competition?

MR. FONS: Oh, absolutely, because, without a Universal Service mechanism, there will not be the monies available to incent new entrants to go into quite the high cost areas. Under a Universal Service mechanism that's envisioned at the interstate level and would be envisioned here, I am sure, that that's a portable support; so that in a high cost area where the difference between the rate or a threshold or a benchmark is $20 or $30 in the cost of providing in a high cost area, then that money, when the customer goes to a new entrant, that money goes to the new entrant, and no longer is available to the ILEC. So the new entrant has an incentive of going into the high cost areas to provide service, because they will be subsidized in doing so. But everybody will be partaking in that subsidization, not just the ILEC.

COMMISSIONER JACOBS: Do you think that incentive would be enough?

MR. FONS: Pardon me?

COMMISSIONER JACOBS: Do you think that will be enough of an incentive?

MR. FONS: I think it will be -- I don't know if it will be enough of an incentive, but if that incentive isn't there, you will never see residential competition in the high cost areas.

CHAIRMAN GARCIA: Thank you.

MR. WAHLEN: Thank you. Good afternoon, Commissioners.

I am Jeff Wahlen. And I am going to speak this afternoon on behalf of Alltell, Vista and Northeast, all three of those companies are small local exchange companies. Tom McCabe is here from Quincy Telephone. He may add some things after I finish my comments.

I would like to start first with a general comment on a general suggestion. And it relates to the report on pages 22 and 23. My client would agree with Mr. Fons's comments that you were not asked specifically to report on need. But if you are going to report on need, we think there is a presumption in this discussion that is not necessarily complete.

The report seems to presume that the only reason you would ever provide Universal Service funding is because a local exchange company has already experienced erosion of its revenues due to competition. And we think that is not a correct presumption.

We think that, if progress towards competition is going to continue and telephone companies are going to be able to eliminate a lot of the implicit subsidies that exist in their rate structure, you need to have a state Universal Service fund there to facilitate that transition. So whether or not anyone can prove specifically that they have lost revenue to local exchange competition, we think there needs to be a state Universal Service fund. Whether or not you decide to put that in your report, is, of course, up to you.

COMMISSIONER DEASON: Let me interrupt you.

You just used the term erosion, I think, from local service competition. Is that the terminology you used?

MR. WAHLEN: Local exchange competition.

COMMISSIONER DEASON: Local exchange competition.

Mr. Fons just indicated that if there is an erosion from reduction in access charges due to bypass or toll revenue reductions due to competitors competing on toll, do you agree that those are considerations, too, that it's not just local exchange competition?

MR. WAHLEN: Absolutely. And I guess --

COMMISSIONER DEASON: You can give a definition of local exchange.

MR. WAHLEN: I'm agreeing with what he's saying.

COMMISSIONER DEASON: Okay.

MR. WAHLEN: But the way the report's written, if you can't show that you've got local exchange competition in a pure sense, it suggests that you shouldn't be entitled to Universal Service money. And we think that is much too narrow. We think that the small LECs have already suffered revenue erosion, due to all kinds of competition, intraLATA pre-subscription, other kinds of bypass, and that those erosions are creating pressures on local rates that make it very difficult to have a flexible way to resolve these implicit subsidies. So we are agreeing with Mr. Fons.

The second point I would like to make is more specific. And if I could draw your attention to the discussion in the report that begins on page 29 and goes over to page 32, and in particular, the very first full paragraph on page 31 of the report. This is the part of the report that talks about the options for determining when it's appropriate to provide explicit support.

And at the outset, I want to say that we agree with what Mr. Fons says, but I have a little twist on this that I want to bring to your attention from the small LEC's perspective.

This section says there is two options. One is a case-by-case company showing that they need to use Universal Service funding. The second one is some sort of triggering test where you would come in and show there is a certain amount of competition in your territory. And, therefore, you would get local exchange, or you would get Universal Service support.

But then if you look on page 31, the first full paragraph that begins forth, the staff's concluding that small companies should never get Universal Service support, because they haven't suffered the effects of competition and aren't going to suffer the effects of competition.

We disagree with that as a factual premise for the reasons I have discussed before. Small companies have suffered the erosion of local exchange revenues due to different types of competition. But moreover, it is very bold to suggest that the small companies will never get local exchange competition. And, therefore, should not get Universal Service funding.

That's particularly strange in light of the two options that are presented, both of which are essentially some sort of case-by-case showing. So on one hand, we seem to be suggesting a case-by-case showing that you're entitled to Universal Service funding. But in this paragraph on page 31, they are saying, but small companies will never be able to come in and make that showing.

I may have misread that, and maybe misunderstanding it. But our suggestion would be that this paragraph that begins forth that the Legislature opts ought to be just stricken from the report. We don't think it's correct, and we don't think it necessarily makes sense in light of the two options that have been presented in the report itself.

Having said that, I would go on to say that we do agree with the suggestion that Mr. Fons made about the third option that is not in the report; and that is, to set up a mechanism now and work through that on a going-forward basis.

That concludes my comments.

COMMISSIONER DEASON: Let me ask you a question. How -- I understand your basic point that you feel like that the small LECs would never qualify for Universal Service funding. And in reading the report, I had that same difficulty. And one of the things that struck me was that it's almost like the chicken and the egg thing, if we are saying small LECs would never have local exchange competition, therefore, they don't need it. They are never going to get local exchange competition if, by definition, their high costs, who is going to come in without some type of a subsidy and try to compete. I guess that's a concern that I have. Do you share that concern?

MR. WAHLEN: Sure, absolutely. And I think it goes to the heart of the need for a Universal Service fund to start getting the rate structure squared away, so that the economics work better, and competition can be encouraged, and things can make more sense from an economic perspective.

COMMISSIONER JOHNSON: Let me follow up on that question. This is for you and Mr. Fons also, because I do understand your argument. But one of my concerns -- and perhaps you can help alleviate that concern -- is that we are talking about the need for Universal Service to promote competition.

But from the customer's perspective, someone's got to pay for it. And to the extent that we set up some mechanism, where there is a surcharge on the bill, or whatever the mechanism might be, it may mean that rates for the customers will go up.

So we brought about competition, but a lot of customers are expecting that competition will mean lower rates. How are we going to ensure that that will happen, or is it going to happen? Are we going to say, look, we made good on a promise, there is competition, but then we don't have lower rates that go along with it. And most customers just believe that those two things should go together.

And maybe they do. Maybe you can explain to me how the Universal Service fund would actually bring about more competition and lower rates.

MR. WAHLEN: Well, I am going to try this. And if I mess it up, John Fons is going to jump in and correct me; but I would begin by saying that we have

Universal Service. If you look in your report that staff has concluded that penetration levels are very high, and lots and lots of people have telephones. So there is Universal Service.

And Universal Service is being paid for now. It's just a change in the way it is going to be paid for. And in order to accomplish the elimination of the implicit subsidies that we think needs to occur to make the economics work better, so that competition will form, you may have to change around the way it's being paid for, because, right now, it's being paid for, as Mr. Fons indicated in your discussion with Mr. Fons, through access charges and those other things.

So, yes, there will be some that have a rate increase, but there will be some that have a rate decrease. But overall, the economics are going to work better, if you have this fund that allows you to do some of the other things that are necessary for competition.

And I will stop there and let John chime in if he wants to.

MR. FONS: I think that Jeff has adequately described it. I will just add one other point to it. And that is, that today the subsidization or the provision of Universal Services, when I talked about, is implicit in the rates that customers are charged.

One of the things that Universal Service mechanism is supposed to do is make explicit those things that are implicit. And to the extent --

COMMISSIONER JOHNSON: Is that in our law, our state law?

MR. FONS: No. It's in the '96 act.

COMMISSIONER JOHNSON: We don't have to do that here in Florida?

MR. FONS: Well, if the federal comes up with a -- if the FCC comes up with a Universal Service mechanism, then whatever the State comes up with cannot be inconsistent with that.

COMMISSIONER JOHNSON: Yes. But they have made declarations that -- with respect to making the State contributions explicit, that they aren't req -- thus far -- the declaration, they aren't required.

MR. FONS: All I am saying is that that's one of the things that will happen in Universal Service, because what it means is that, instead of continuing to get the money out of access and toll and others, that monies will be gotten -- will be received from the fund. And then the local exchange company that gets those funds will have to reduce its rates for those services that are currently providing the implicit amount by the net amount that they get out of the fund.

So there will be reductions from the Universal Service mechanism. It's not a case of rates going up in order to fund the mechanism. Whatever the net amount is that comes will cause a reduction in prices. It will remain -- or it will be -- as we talked about this morning on fair and reasonable, it will be revenue-neutral.

So that the customers will see reductions in the rates for those services that are providing implicit subsidy. Access charges will come down; therefore, the toll rates will come down from the IXCs. The toll rates from the local exchange company will come down to the extent that there is offsetting Universal Service support, and also the ancillary services, like call waiting, caller ID and et cetera.

So if -- there will be reductions. What you are doing is, you're moving from an implicit subsidy situation to an explicit subsidy.

Now, what you've talked about is the possibility of there being some kind of a surcharge on the bill. And that is something totally up to the State of Florida. It's totally up to what the State decides with regard to that kind of recapturing of whatever you put into the Universal Service mechanism.

COMMISSIONER JOHNSON: Okay. You just clarified a point that -- I wasn't clear that you were talking about the Universal Service mechanism in total that would be revenue-neutral.

MR. FONS: Yes.

COMMISSIONER JOHNSON: But you are?

MR. FONS: Yes.

COMMISSIONER JOHNSON: And you will have different contributors. And maybe this goes to the mechanics, and I can talk to staff about it later. Like you will have the cellular providers, you will have a lot of different providers paying into a fund. So for every dollar that you receive, you are going to reduce some other service, would be the scenario. And you are not --

MR. FONS: Well, it's not just the other providers paying into the fund. The local exchange company will also pay into that fund, and will probably pay the lion's share, because they have the lion's share of the intrastate service in the state of Florida. If you follow the staff's plan, there is also another mechanism where you count both interstate and intrastate.

Let's just assume for the moment the hypothetical that it's just intrastate revenues that you are looking at. The bulk of the revenues are coming from the local exchange companies, because they have the bulk of the revenues in the state. So they will being making the lion's share of the contribution to the Universal Service mechanism. So the local exchange companies aren't moving out of the picture and letting all of these other people pour money in. The local exchange company will be participating together with these other carriers in providing the monies for the Universal Service support mechanism.

COMMISSIONER DEASON: How do we guarantee revenue-neutrality?

MR. FONS: Because each local exchange company will -- whoever administers the fund will know how much money they have sent to the local exchange company. And whatever amounts that they have sent to the local exchange company, then that money will -- you will subtract from that amount that the local exchanges company gets, what the local exchange company has paid in. And the difference would be the amount that by which other rates have to be reduced.

COMMISSIONER DEASON: Right. And I guess my concern is that, is that an ongoing monitoring situation?

MR. FONS: Oh, yes. I would assume that the mechanism would be such that every month people pay in and every month monies come out.

COMMISSIONER DEASON: For example, if a particular local exchange company is -- pays into the fund and receives more back out of the fund, which is probably going to be the typical case --

MR. FONS: May not be.

COMMISSIONER DEASON: Not for all companies, but --

MR. FONS: No.

COMMISSIONER DEASON: But for the typical company.

First of all, let me ask you this, do you agree with Mr. Wahlen that small companies should be included in the fund?

MR. FONS: Absolutely. They should be able to get monies out of the fund. If anybody needs the monies, it's the small company.

COMMISSIONER DEASON: Okay. Let's take a small company then, for example. Most likely a small company can make the assumption they're serving a high cost area, which is probably a logical assumption. They are going to be paying into the fund, but they are probably going to be receiving more out of the funds than they pay in.

MR. FONS: That's correct.

COMMISSIONER DEASON: All right. Given that scenario, and they have to reduce, for example, access charges and perhaps some ancillary services which provide a high contribution. And would it be with -- or should it be within our authority to look at the stimulation that results from that rate reduction, so that there is revenue-neutrality and not revenue-enhancement as a result of that restructure?

MR. FONS: I would assume that you could look at it. You have to be very cautious, however, that because of the erosive effect of competition that you may not be getting the kind of stimulation that you might have gotten in another environment. So you can't just say that there will be stimulation and it needs to be taken into account. You have to recognize, also, that with all of the new competition coming in that there will be losses of revenue from those services, because you will be losing customers;

especially to the extent you start stimulating entry into the high cost areas, because of the existence of the subsidy and the portability of the amounts that there will be competition occurring throughout the service area.

COMMISSIONER DEASON: It seems like a very difficult proposition, because, basically, you're comparing actual results with what would have happened had you not made the contribution.

MR. FONS: And that's why I said you might want to look at it, but I am not sure how you would implement it.

COMMISSIONER JOHNSON: And do you envision, from this process, this Universal Service process, for local rates to go up?

MR. FONS: I would expect that the -- any -- again, as Mr. McCabe talked about this morning, the rebalancing and the Universal Service are inextricably linked in this regard, but to the extent that you -- you have got to attack this problem in two different ways. One is by rebalancing, because local rates are already below cost, and they are the ones that are being subsidized, particularly in the high cost areas, and the other is Universal Service.

Putting aside any rebalancing in that

regard, I would not anticipate that local rates would go up as a result of Universal Service.

COMMISSIONER JACOBS: How do you respond to the statements that it is not so much the access revenue that is subsidizing, but more and more the number of lines that are being added and the vertical services?

MR. FONS: I would say vertical services produce a fair amount of revenue over cost. But the number of ancillary or vertical service is not big enough to have that kind of an impact. I would agree that it's -- and it's not adding lines, because in high cost areas, every line that you add is costing you more than you get the money for.

So whether you're adding lines, the second lines or new lines to new areas, there is a cost associated with that. It's not a free amount. Indeed, at the current rates of less than $10 in some areas, with costs, even in those areas of $17, $18, $20, it's highly unlikely that adding a new line guarantees that you are going to get more revenue.

Now, to the extent that that second line uses a lot of toll, or it uses a lot of vertical services, then you would get more money. But what our experience is is that most of those second lines are used for one of two things, or three things.

Number one, it's a children's line; and that's basically for local calling, so you don't get any access revenue off of that. And there is -- it's highly unlikely there are a lot of vertical features on that. More likely, the second lines are being used for computers, Internet and facsimile. And Internet usage is a local usage. And most assuredly, you don't have a lot of vertical services on that, because the vertical services may well cause problems with your computer in trying to get access to the Internet.

So just adding lines is not the main driver.

COMMISSIONER JACOBS: Now, touching briefly on a point that Commissioner Deason brought up. If you do incorporate a fund, and in this high cost area, it turns out that it does not spur new interest, would you agree that more than likely what will happen is that an entrant, not only will they have whatever is provided from the fund, they will now have -- they will likely retain, because there has been no real competition, they will retain the toll revenues. And perhaps even if there is any rebalancing, they will retain those revenues, if competition --

MR. FONS: Surely, surely. But the amount of revenue will -- whether or not that will cover the costs in some of the high cost areas is debatable, because some of the cost in the high cost areas is around $100; and that would mean that the consumer, the subscriber would have to have a lot of vertical features, do an awful lot of toll calling in order to generate the $100.

CHAIRMAN GARCIA: Okay.

MR. McCABE: Tom McCabe on behalf of TDS, Telecom. Just briefly, we support the comments that have been mentioned. What we would like to point out is we think that the report lost sight of what the purpose of the Universal Service is.

The impression that I walked away with reading the report is that it is a fund to replace revenue from competition, local exchange competition. The intent of Universal Service is to ensure that all customers, whether low cost or in high cost areas have access to affordable telecommunications service, including access to advanced services. And we believe that the principles of the federal LEC, as well as the Florida Statute are centered on that.

Earlier today, there was some discussion in terms of possibly, you know, this no-frills local rate. That may put you in a position of having to fund that rate in that high cost area. And I think if you were to put -- leave the report as it is, it potentially puts you into a box in saying, unless there is a trigger, unless there is local exchange competition in a smaller inventory, nothing -- some of the public policies that you may want to put in place today will be impacted.

For example, as a rate-of-return company, if we end up losing revenues to provide this no-frills rate, and we were to file a rate case, we were then in a situation of having a small base in which we can look to recover those dollars. And it would be from whatever local rates are still sitting out there, 12.70 or whether we have some rate rebalancing.

It may put you in a situation of saying, hey, the rate over in Gadsden County is now going to be too high if we want to put this other policy into place. But we can still put this policy into place with the -- and have an affordable rate level and fund that through Universal Service.

And to come back maybe three years and say, well, we got it wrong, and maybe for small LECs we are not going to have this trigger. I am pretty sure that we are not going to go over to the Legislature and open up 364 to fix a problem for small LECs, because, all of a sudden, tons of things will try to be added to it, and the bill never goes forward.

So we think it needs to be taken care of in this, and we think a fund needs to be established with this legislation today.

Thank you.

CHAIRMAN GARCIA: Mr. Hatch.

MR. HATCH: Just briefly. I am Tracy Hatch, and I am representing AT&T Communications and Southern States, Inc.

To address a couple of the comments of Mr. Fons, with respect to 254, I think his analysis is correct. I think the telecom act requires that all carriers bear their fair share.

However, I would depart from Mr. Fons in saying that that requires the establishment of a fund now. As Commissioner Johnson pointed out, what Mr. Fons is really talking about is explicit versus implicit.

It is very arguable that the IXCs are paying more than their fair share now based on the volume of access and the markup of access over costs. That seems to be -- I don't think anybody would dispute that access is a major, if not the major, source of the subsidies flowing. To the extent that that still happens, and there isn't a problem, if it's not broken, don't fix it.

With respect to the creation of a fund will create incentives for competition, we would depart, again; because if you create a fund, that fund isn't paid for by companies, it's paid for by customers. But more importantly, it is the revenues and the competitive effect of those revenues that the ILECs will receive from that fund. And where will they target those revenues? They will target them to their best competitive advantage.

You will not incent competition. You will serve to delay it if you don't get it right.

COMMISSIONER JOHNSON: Excuse me, let me just -- on that point, because I understood Mr. Fons to -- because that was -- you know, I had similar thoughts. But Mr. Fons is suggesting that these aren't new revenues. They are getting them anyway. They are just going to be getting them from different sources now.

MR. HATCH: That is correct. They will be getting them from a fund, instead of getting them from access or getting them from vertical ancillary services. Some of the revenues that they implicitly get now will be freed up.

Remember, it's going to be revenue-neutral. They will get more money from the fund than they contribute into it. They will have a net increase in revenues.

Now, in order to achieve the next step and get to revenue-neutrality, they have to reduce some rates. What will those rates be? Is it all going to access? Certainly, we would like to think so, in which case it may not affect or create a competitive problem, but we believe that it will.

COMMISSIONER JOHNSON: Why?

MR. HATCH: If it all goes to access, then it is something that they can't use to target at us in a competitive manner. For example --

COMMISSIONER JOHNSON: So that's good, right?

MR. HATCH: As the staff points out, competitive entry is principally focused initially in any competitive market about the high volume, big customers, where you get the most bang for the buck by serving that customer.

It was true in 1984 that the advent of the long distance competition. Long distance competition started principally with the big customers and worked its way down through the system. If you try and create a big fund now, those revenues targeted at big businesses to reduce the ability of market entrants to target those companies, then you will short-circuit competition and competition's development. And whether there is a fund or not in rural areas, you'll never see it, because it will never happen in the big areas, either.

With respect to -- getting back to the point of -- the staff is quite right, you should be very, very careful here. They urge caution, and rightfully so.

COMMISSIONER DEASON: Let me -- I didn't really follow your last point.

COMMISSIONER JOHNSON: I didn't, either.

MR. HATCH: Which one?

COMMISSIONER DEASON: That we are never going to get competition, because they are going to get more funds, and they are going to use those funds in a competitive way. But just because they act in a competitive way, how does that preclude you acting in a competitive way and still competing?

MR. HATCH: If --

COMMISSIONER DEASON: Obviously, if they get more funds, they are going to reduce those services which are providing the high contribution, access charges and vertical services. But if they don't use those funds for that purpose, that's the very thing that you are going to compete for. But that's what competition is all about. Competition is going to have the ultimate result of driving services towards their cost.

MR. HATCH: The premise to that, Commissioner, Commissioner Deason, is that there will be competitors in the market to do that. Long-term -- and I am speaking very long-term, that will happen as you have facilities, networks built up.

The notion that you will have a duplicate facilities network for telecommunications everywhere in the state that it exists now is probably not realistic. And even if that were going to happen, it would be a very long time out.

COMMISSIONER DEASON: Well, I didn't think the goal of the Universal Service was to have a duplicate system.

MR. HATCH: The goal of Universal Service, as I understand the very premise, is to protect their revenues from competitive erosion. If there is no competitive erosion --

COMMISSIONER DEASON: You just said that the question is implicit or explicit subsidies, not protecting their revenue stream.

MR. HATCH: I agree with that.

COMMISSIONER DEASON: Okay.

MR. HATCH: We are mixing different concepts here. We are pulling from back and forth.

COMMISSIONER DEASON: All right.

MR. HATCH: If you are talking about whether you need a fund now or not, my answer to that is no. There is no demonstration of a need for a fund.

The whole premise for the creation of a Universal Service mechanism is to ensure Universal Service. What is the underlying premise to that is the competition will come in, erode their revenue streams, such that they can no longer serve these customers profitably in an aggregate.

If that's not happening, you don't need a fund, period. I think that's the point of the staff with respect, particularly with the small companies. But getting --

COMMISSIONER DEASON: But they are arguing that that's happening already; that they are losing access revenue; they are losing toll revenue; they are losing some vertical services that perhaps can be provided by some other means more cheaply; that that's happening already.

MR. HATCH: We don't see that. He says that it is happening. Is it really? We don't know frankly.

COMMISSIONER DEASON: Is it because their earnings are healthy? How do you know that's not happening?

MR. HATCH: Their earnings clearly are healthy. The question is, why is the revenue effects of competition not showing up creating the allusion that there isn't much competition. I think that's one of the points that staff is making.

I think that staff suggests to you that the reason for that is, even though their market share is declining, albeit not very fast, the revenues are going up, because they are getting a consistent or a consistent piece of a larger market.

I mean, if you look back at competition for the long distance market, if you go back to -- I believe it was in the intraLATA prescription docket -- there was a demonstration by AT&T at the time that, even though AT&T's market share from 1984 up through I guess '91, maybe '92 -- and I would have to go back and look -- AT&T's revenues grew every year but one in that time period, even though their market share declined from virtually 100 percent down into I guess the 70s or something like that, 60 percent.

So the point is, is competitive erosion precluding their ability to serve all of their customers in an aggregate sense? And what I am suggesting to you is, if you create a fund, what you will do is short-circuit the natural competitive mechanisms that allowed AT&T's market share to erode, even though the revenues grew, is that if you go in and allow them to target revenues, not necessarily those services that produced the most contribution, but those that will serve them best long-term in a competitive environment, essentially retarding or taking out nascent competition before it ever really starts.

COMMISSIONER JOHNSON: What if we decided which services would be reduced? That would help mitigate?

MR. HATCH: Certainly, it could. But I think you need to have some sort of a proceeding to examine all of that that's out there, when you have some indication of that through the contribution analyses that were provided in some of these cases. But I don't think that's just the end of the question. I think you need a lot of work before you start doing that.

COMMISSIONER DEASON: Well, couldn't it be argued it's just as anti-competitive, the fact that the company, the incumbent LECs, since they are having to rely upon these services which are so high above costs or below costs to provide them the revenue stream that they need, and if they can't make the competitive moves that a truly competitive market would have, isn't that just as anti-competitive?

MR. HATCH: I would suggest to you, Commissioner Deason, there is no showing by any means that they can't compete in the marketplace today, based on their currents revenue flows. To separate out --

COMMISSIONER DEASON: We are back to an earnings test then?

MR. HATCH: It could very well be at some point.

COMMISSIONER DEASON: So is it your basic position there is no need for a Universal Service fund until the companies are earning below what is considered a reasonable rate-of-return? At that point, then we should look at a Universal Service?

MR. HATCH: I wouldn't characterize it strictly in terms of a revenue or an earnings test. I would suggest that that may be part of it.

COMMISSIONER DEASON: I'm really -- I'm trying to understand then when -- if you make the assumption that at some point we are going to have to have a Universal Service fund -- maybe we never will, I don't know. But if we are, what triggers us getting there in your viewpoint?

MR. HATCH: I think the trigger has to be a demonstration that you need it, more than just a claim, I have to have this.

COMMISSIONER DEASON: And you think that that's essential to earnings test, that could include an earnings test or should include an earnings test?

MR. HATCH: It may very well, but the only point that I would make there is that you need to leave your options open and consider all the factors and the relevant circumstances at the time.

I don't think you can put on blinders today and say, we have to have a fund, it has to work like this, it has to look like this today.

COMMISSIONER DEASON: What should the legislation be? I know it's not our position to legislate, but we are in a position of trying to make a recommendation. Should it be that the Commission should have the authority to set up a Universal Service fund when the Commission deems it appropriate?

MR. HATCH: I think that's appropriate, based on some standard, some showing that a fund is required. And that's what option one is, essentially.

COMMISSIONER JACOBS: Could one such standard be that it is now -- the market demonstrates that a price signal, indeed, will attract new entrants?

Because what I am hearing them say is that new entrants will come in, because they recognize now that the availability of these very pots of revenues. But if they don't show up, that argument doesn't hold, so would that be --

MR. HATCH: Yeah. I think there is a lot of validity, I would agree with that.

The premises that you need this for carriers to come in is premised on they are going to be an ETB, an eligible telecommunications -- or ETC, eligible telecommunications carrier. There is a whole lot of baggage incumbent on that that the carrier would have to be of significant size and ability in any given exchange to even begin to apply with that. That would be very problematic. I don't think being an ETC, in and of itself, is an incentive for them to flood into the market in any way.

I mean, as we have talked about all day today, carriers will come into the market for the total revenue streams will exceed whatever their relevant costs are. That's the determining factor.

That's when they will enter, or that's when they will seek -- or not enter. That's the threshold.

CHAIRMAN GARCIA: Okay. Are you through, Mr. Hatch?

MR. HATCH: Yes.

CHAIRMAN GARCIA: Mr. Melson.

MR. MELSON: It's late in the day, and I will try to keep it short.

I think everything I have to say can probably be summed up in a partial answer to Commissioner Deason's last question about if we are going to make recommendation about a Universal Service mechanism, what should it be? And MCI WorldCom supports the staff's option one, which essentially is a continuation of the policy that you adopted on an interim basis when you looked at interim Universal Service several years ago.

You said, at that time, there is no demonstration that competition has impaired the company's revenues to the point that Universal Service is impaired. They are in the best position to judge if and when they feel a need for explicit Universal Service funding. Let them come to the Commission. We will consider that on an expedited basis.

You didn't set out real specific standards at that point. I think Mr. Hatch is right. That's something you would best develop on a case-by-case basis. Yes, the small LECs say they have faced erosion of access revenues, erosion of toll revenues. None of them has yet got to the point, though, where they have come to you and tried to make a showing that Universal Service is impaired, and that they need funding.

COMMISSIONER DEASON: Should it be done on a company-by-company basis?

MR. MELSON: Yes, sir.

COMMISSIONER DEASON: So what if Quincy, TDS says our 8.6 return on equities is deficient, and the reason we are not earning that is because we are high cost, and we have lost these revenues to -- we have had access reductions, we have lost toll revenue. We want to increase our return on equity, and we want a Universal Service fund to pay for it.

MR. MELSON: I think, Commissioner, you have got to look at a host of issues. You have got to look at what is the reason for the erosion in revenues? Is it, in fact, due to competition? I think you have to look at the whole range.

COMMISSIONER DEASON: And that begs the question, what is the purpose of Universal Service? Is it to replace revenues from competition, or is it to make sure everybody that wants a telephone can get it at a reasonable rate? Or is it both, or is it neither, what is it?

MR. MELSON: I think the basic purpose of Universal Service is to make sure that everybody who wants a telephone can get it at a reasonable rate. And we know that going into this new environment, that happened, and that happened because of subsidy flows within the local companies.

The question is -- and the reason that Universal Service funding was looked at as something we may need to do was the fear that competition would come in, would erode those historical subsidy flows and would put the company in a position where it could not offer affordable service.

COMMISSIONER DEASON: So a TDS would come in and say that we were getting X-dollars in toll revenue before intraLATA pre-subscription, and now it's something less, and we want Universal Service to make up the difference?

MR. MELSON: They could say that. The question is -- and I think the question you are going to have -- I think in that situation you are going to have to look at more than just, you know, a particular impact on toll revenues. I think you are going to have to look -- take a broader look at the company's overall situation, particularly where you have got a company that is still -- has not opted yet for price regulation. It's under rate base rate-of-return regulation, whereby statute -- there is no local competition.

I mean, for a company that has not elected price regulation, you are really operating under the old set of rules to a large extent.

COMMISSIONER DEASON: I mean, I don't know what TDS's situation is, but it could be that their options -- maybe they're earning an 8.6 return on equity, because they don't want to burden their customers. And they know the only way to earn that, because it is going to mean a tremendous increase on those small customer base. I don't know.

Maybe the only alternative is Universal Service. But you are saying they would have the burden to demonstrate, that is the purpose --

MR. HATCH: I am saying they have got -- you have got the mechanism in place today that if they feel there is a need for explicit Universal Service funding, there is a mechanism to come in and try to make that case.

I don't think I can sit here today and tell you what it takes to make that case. I think the first two are going to be like any policy-making case you go through. You are going to have a lot of tough decisions to make. But I don't think we have seen an impact at this point that goes out and justifies creating huge universal -- explicit Universal Service funding infrastructure to deal with something that, as we sit here today, doesn't appear to be a real problem.

COMMISSIONER JACOBS: How do you respond to the equity argument; i.e., that, even for the existing fund, there ought to be more equitable contribution to it?

MR. MELSON: Well, I think at first I would reiterate what Mr. Hatch said, which is, at least the long distance side of the business is probably making more than an equitable contribution.

Question, do you -- if you make a fund explicit at this point and collect it from everyone, you are going to place an additional dollar burden on the new competitive local exchange companies, the new ALECs, that they don't explicitly have today. I think if anything you're creating -- whether that is more or less fair, I think that is something we can sit and debate. But I think as a practical matter you're creating another hurdle, another barrier to entry. I am concerned that creating an explicit Universal

Service funding mechanism at this time is going to slow down competition rather than speed it up.

CHAIRMAN GARCIA: Commissioners, any more questions?

All right. We are -- we are then going to take up staff's concerns right now, or staff wants -- might want to respond to some of the things that were said.

MR. DOWDS: Would you like me to describe the report I wrote as opposed to what they apparently read?

CHAIRMAN GARCIA: Whichever one you would rather -- you do what you think best.

MR. DOWDS: I am a tad perplexed that Mr. Fons finds the report gratuitous, complex, confusing and inconsistent. I don't know where he has been for the last three-and-a-half years, but let me try to explain what I wrote, and then we will go from there.

1995, we endured a long arduous hearing to establish, as required by 364.025, an interim Universal Service mechanism. The purpose of that mechanism, as discussed in that docket, was whether or not a mechanism was required to sustain carrier of last resort and Universal Service responsibilities of the incumbent LECs. And the issue as characterized in that docket, and the order came out in December of 1995 -- it's been around a long time -- was as Mr. Melson characterized it. The concern was, in the 1995 revisions to Chapter 364, competitive entry was allowed. And there was legitimate concerns that rivalrous competitive entry would have an adverse effect on the incumbent's ability to sustain their Universal Service and COLR responsibilities.

So the key issue was, what should we do in the way of implementing interim mechanism. The decision by the Commission at that time was the degree of competitive entry was essentially inconsequential. And thus, it was decided not to establish a permanent funding mechanism at that time.

Instead, what was established was an expedited petition process, whereby until such time as the Legislature acted, because 364.025 does not convey to the Commission currently the authority to establish a permanent mechanism, the LECs would be able to petition for relief, if necessary, if they could establish that their abilities to sustain their COLR and Universal Service responsibilities had deteriorated.

In 1996, December, I believe, we -- staff brought a report to the Commission at internal affairs on Universal Service, and described in broad strokes the structure of a possible Universal Service mechanism. We also indicated, I believe, in that report, that if the Legislature opted -- wanted to take action in the following sessions, they could, if they wished, explicitly fund Lifeline.

In the 1997 report to the Legislature on local competition, we, again, reiterated broad stroke recommendations on the creation, possible creations of Universal Service funds.

In 1998, in December of '98, we filed at internal affairs, and was subsequently passed on to the Legislature. The annual report on the status of local competition. One of the requirements in that report is we are supposed to report on the extent to which Universal Services is being sustained. We have been doing this diligently for the last several years.

The conclusion was that competitive entry had not caused any meaningful detrimental effect on Universal Service.

We filed this report as required by House Bill 4785. And with a few exceptions, there is no surprises in here. It's the same thing we have been telling you for three-and-a-half years. The one big difference that's in here is there is what I call characterized as the good news and the bad news.

The good news is, on pages 22 and 23, it describes under what circumstances a Universal Service funding might be needed. And that's basically where there is meaningful competitive entry, and it's having an adverse effect on the COLR, whoever that might be. It might be multiple COLRs eventually.

As such, the at risk groups, assuming this scenario, are low income customers and those who have the misfortune of residing in high cost areas, because if they -- if the -- if entry is successful, then it may put the incumbent LEC in a position where he might want to deaverage local rates, especially in high cost areas.

Overall, and I believe around page 20, 28, is what I would refer to as the other hand.

The other hand, as Mr. Hatch and Mr. Melson basically alluded to is, there is a downside of creating a massive Universal Service fund now when you do not have competitive entry. Because essentially what -- it's kind of a good news, bad news situation. It makes sense, but it can have perverse consequences.

And the perverse consequences are, if you create a huge multi-million dollar fund, and even if it is revenue-neutral, whereby you require the incumbents to reduce rates for services, which in all likelihood, they are going to be those that are most elastic, then what you have done is you have substituted revenue streams that potentially are competeable away for revenue streams which may not be.

Another observation that would I like to make, it is my personal opinion, and I have been consistent, if nothing else, is the Universal Service is not intended to incent competitive entry. That's not its purpose whatsoever. Its to offset the deleterious effects that might occur, visa vis end user rates. The purpose is not to create a war chest to incent entry. But any Universal Service mechanism should be competitively neutral and portable.

Now, Mr. Fons referred to his alternative three. And he had referred to my option one and option two as somehow on a par with his alternative three. And I don't think that's quite on mark. And let me explain where I am coming from.

I explained to you what I call the good news and the bad news. And the puzzle I face, and the Commission obviously faces is, at what point in time should you start explicit funding?

Mr. Fons, obviously, would like to have it started probably July 1st. Our concern, as we have indicated here is based upon the local competitive entries data that was in the December '98 report, we got, what, 4.3 percent of the access lines, business access lines are in the hands of alternative LECs.

But apparently, there is not significant market entry in a residential sector. Based upon what we looked at, we had no information that would indicate that the ability to sustain Universal Service obligations had deteriorated.

So the puzzle is, when do we do it? Do we do it on July 1st, as Mr. Fons would opine that we should, and create a massive fund, and then thereby require offsetting reductions in rates? That's the puzzle.

I don't have the answer. What I propose, instead, was option one and option two. His option three is, forget staff's option one and option two, turn on the tap. My option one is, I don't know at this point in time the best criteria that should result in funding. So one option is basically to continue what you decided in November, I believe of

-- November, December of 1995, that an expedited process is in effect. If there is a problem, funding will be made available, and we will put the whole architecture of an intrastate fund in place.

Now, elsewhere in this recommendation, as was in the prior recommendations, general implementation issues are already -- there are explicit recommendations as to how certain things would be done, when the fund needs to be created.

Option two is -- again, the term that's used here is what I call trigger, for want of a better term.

And the question is, what event or occurrence or whatever should trigger Universal Service funding? Mr. Fons says July 1st. My option one says, I don't know, but I know darn well that a LEC will probably tell me if they need it, if that's the mechanism.

And option two is -- again, it's struggling trying to come up with a scheme. And option two basically says, perhaps have a proceeding before the Commission to determine what market share loss or whatever variable should trigger the event.

There was discussion earlier about the requirement to eliminate the subsidies, and Commissioner Johnson addressed herself to that. That's not in the Act as a requirement for the states.

Mr. McCabe indicated that apparently Staff had lost sight of the purposes of the fund, unquote. Perhaps. But I can define my Universal Service mechanism.

Now, TDS is in a very unique situation. And I'm -- on the one hand I'm troubled by providing explicit funding for Universal Service to a rate-of-return company. The reason being there presumably is a regulatory mechanism in place such that if their earnings are less than optimal, and thereby having a deleterious effect on their maintaining their universal obligations, then -- our rules presumably have procedures whereby he can file for relief.

The conundrum I have with respect to including rate-of-return companies in a Universal Service fund is the primary reason, as decided back in December '95, was competitive erosion. If there is no competition, then there can't be competitive erosion. There may be earnings erosion but that's a different issue. So what I would opine there is one of two things: Either a rate-of-return company, such as TDS, could file for a rate case, or if the Commission -- even that -- that earnings investigation or whatever, however it was conducted, determined that the resulting rates that Quincy would have to charge would be too onerous, then on a case-by-case basis it might be warranted to develop what's called a special TDS cost mechanism or something. But it's --

COMMISSIONER DEASON: It could be erosion of earnings from competition when there is not the possibility of being local exchange competition.

MR. DOWDS: I'm sorry, I didn't hear you. Forgive me.

COMMISSIONER DEASON: Isn't there the possiblity that it can be erosion of earnings due to competition even for a rate base regulated company who by definition cannot have local exchange competition?

MR. DOWDS: Absolutely. And that's what I was saying, what I'm troubled -- and I don't have a good answer to be quite honest, but I can give you two options and then my misgiving.

My Option 1 is they have the normal rate relief process. Option 2, if the results of their filing a rate case would yield rates that were deemed unaffordable, then it makes perfect good sense, in my opinion, to perhaps create a special mechanism, something conceptually like the old subsidy mechanism for toll and things like that.

What I am troubled about, though, is for those LECs who -- especially who are not rate of return, who opt to invoke 251(f)(1) or (f)(2) and bar entry. And, you know, I have misgivings about whether it makes sense to fund what is essentially a rate rebalancing through a Universal Service fund. If they are a price cap company, they voluntarily undertook the risk and rewards of being a price cap company, but that's basically --

COMMISSIONER DEASON: Then why are we recommending a $5 increase in local rates in the other study then?

MR. DOWDS: The recommendation in the other report is that the -- let me back up. The Commission said -- strike that.

The legislature said we are to report -- determine a report, the fair and reasonable Florida residential basic local telecommunications rate considering four characteristics. The conclusion of the report is that allowing the price cap LECs to increase their residential basic local telecommunications rate by up to $5 over a five-year period would result in a rate which is still fair, reasonable and affordable.

Now, the subsequent points, which Ms. Marsh will get into when she reappears, are more in the terms of what further recommendations the Commission does or does not want to make. Was that responsive?

COMMISSIONER DEASON: I don't think so, but I will think about it. Go ahead. I just see an inconsistency between the two recommendations.

COMMISSIONER JOHNSON: Let me pick up on that point, too, and we'll get into it further when Ms. Marsh comes back.

But with respect to that $5 increase, that doesn't necessarily address -- well, it doesn't address Universal Service. It wasn't stated as an Universal Service mechanism.

MR. DOWDS: No, it was not.

COMMISSIONER JOHNSON: And it's not really stated to address competition because you state that it alone probably wouldn't be enough. So is it just answering the four corners of the question affordability.

MR. DOWDS: That's all it is intended to do. Whether or not good public policy would go further is a decision that you Commissioners need to make.

COMMISSIONER DEASON: But that recommendation says to the Legislature the Legislature should do it. It didn't say you can do this and it still would be affordable. It says you should do this.

MR. DOWDS: Obviously, we have to apologize because the wording was less than artful perhaps. The intent was that they should be allowed to do it but it's part of a package deal. So that, yes, the price cap LECs would be allowed to increase up to $5 or five years given that they are offsetting consumer benefits. That was the general intent.

COMMISSIONER JOHNSON: And the offsetting consumer benefits would occur because of the flow-through of the $2?

MR. DOWDS: I'd have to defer to Ms. Marsh with all of the details.

COMMISSIONER JOHNSON: Okay. I'll wait.

MR. DOWDS: The other point that Mr. McCabe mentioned I wrote down is possibly funding the no frills rate. And we haven't given any thought one way or the other, but in principle it's not, you know, out of the question. Conceptually one could argue it's like the third pot. I mean, you have a Lifeline fund, you have high cost and perhaps you have a no frills fund to fund perhaps the difference between whatever the no frills rate is and whatever the going rate is. It's not inconceivable at all. It might be a viable option. We haven't proposed any recommendations one way or the other. We haven't really discussed it at length.

CHAIRMAN GARCIA: What do we have left in terms of presentations? Do you want to make the fair, just and reasonable? All right. Let's do this. I think we have been here a while and we've only had one five-minute break in that time. Let's take 15 minutes, if that's all right -- is that enough for you, Walter, to get --

MR. D'HAESELEER: We can do it in five.

CHAIRMAN GARCIA: We'll do it in 15. And we'll be back at quarter after and we'll start up again.

(Brief recess taken.)

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CHAIRMAN GARCIA: Okay. We're back on.

We're going to listen to Staff's presentation on the fair and reasonable. Is this your response to some of the comments or is this your response to the comments of the company?

MS. MARSH: It's a response and then some proposals that we would make.

CHAIRMAN GARCIA: Very good.

MS. MARSH: Okay. In addressing the concerns --

CHAIRMAN GARCIA: By the way, Commissioner Jacobs is right outside and he'll be right back. And just for the record, Commissioner Clark will be picking up the tape of these proceedings. She had a doctor's appointment, so she left right after the vote on the third-party tenant.

MS. MARSH: In addressing the concerns of the interested persons, we will address the comments in general rather than specific concerns.

The comments were numerous and it would take considerable time to address them all, unless the Commissioners have specific items they would like addressed and we'll certainly be glad to address those. The comments fell into certain themes and can be addressed as such.

We considered our report to be less than favorable to the LECs. It was unfortunate that the consumers didn't recognize that fact but rather chose to view the recommendation as a windfall to the companies. As to consumer advocates, the Staff left earlier wondering what report it was they read. They seemed to focus on just one piece of the recommendation. Almost to the last one they soundly thrashed the Staff for saying that a rate increase was possible while still keeping the rate affordable, but ignored the facts about what we really recommended.

The consumer protections contained in our conclusion were specifically designed to address the very concerns they raised. For example, the purpose of the no frills rate is to serve as a safety net for those consumers who would otherwise feel compelled to drop service as a result of a rate increase. We listened to what consumers had to say in the hearings and in their many letters, over 600 letters, and recognize that there is a need for such a safety net for low income and elderly who do not qualify for Lifeline but nevertheless must stay within a budget. They should have access to affordable service without the embarrassment of proving need.

In doing this we recognize that affordability is not the same for everyone. Rather, we targeted the fair and reasonable rate to most consumers and tried to build in protection for the rest. We addressed potential declines in customer service as well in the index on the nonbasic rates. That index could be adjusted downward for poor quality of service. Thus, if quality standards were not met, the companies could lose potential revenues. In that index we also addressed the need to ensure that companies could not simply increase rates at will. When the bargain was struck for price regulation the idea was that competition would be coming and that competition would provide checks and balances for rates. Where is that competition? Obviously it will be much slower in developing than we were told in 1995. We believe the customers must be protected in the meantime. For the same reason we believe caps should be extended on the local rates once they are rebalanced for another five years or until there is a determination that sufficient competition exists to impact rates in the place of regulation.

Thus, this is an eight- to ten-year plan but that time frame could be shortened through the development of competition. Will there be any competition? According to some of the participants in this project, there are barriers to entry that will remain even if rates are rebalanced. If the LECs want price caps lifted, it would behoove them to see that competitors have access to the items they need at prices that aid competition in developing. That is the surest way for the LECs to eliminate price caps.

As far as the consumer protection, the companies are the other side of the coin. They did recognize consumer protections built into our recommendation but would have you remove them. They want to eliminate the extended price caps, the index, the no frills rate. I guess they didn't listen to what consumers had to say like we did, where the no frills rate would not have been the surprise that they claim it is. While a point was made also that there are other ways to approach these things, Staff would point out that the Legislature mandated this Commission report its conclusions as to the fair and reasonable rates, and that's exactly the language in the statute.

In developing the report the Commission heard from everyone who had a wish to participate. The conclusion to be drawn now falls to you. What is a fair and reasonable rate for Floridians? Based on what the speakers had to say, we would suggest a few things to make the intent of our recommendation more clear and to allow a further option. We would propose a few modifications and if you want to follow along with the bullets at the very end of the report, it might be useful.

The first bullet --

COMMISSIONER JOHNSON: What page is that on?

MS. MARSH: The very end. I think it maybe starts at the second to the last page. I think the page numbers varies whether you downloaded it from the Internet or whatever, but it's the very end.

Bullet 1. The $5 can be considered as a range from zero to $5. This could be considered as a decision tree. The Legislature could decide that zero is the appropriate increase in local rates for policy reasons without regard to the four factors they charged us with considering. They may choose to question why there should be an increase or whether competition will come. However, should the Legislature decide that rates should be rebalanced, the remainder of what we recommended worked apply with certain modifications. I would also note, in response to one thing that was brought up earlier, when we said price regulated companies, that was intentional because other companies can apply for rate increases the same as they have always done. So we did specify price regulation for that reason. We would also add in that bullet to make it clear that it would be revenue neutral with an exception that is discussed in the second bullet. And that was also brought up earlier.

For Bullet 2, I should indicate that where we refer to parity, the interstate rates, that should be as of January 1st, 1999, and in considering what that rate is, it should include the portion recovered by the PICC as part of the rate. However, this does not mean that Florida should have a PICC-type charge. It simply should be considered as part of what is recovered in the interstate rates. It also must be made clear our intent that reductions must be passed through to consumers.

And at the last sentence in that bullet, in the part that makes an exception for the revenue neutrality, where the amount of the decreases exceed the increases, we would except the small LECs from that requirement.

CHAIRMAN GARCIA: You would what?

MS. MARSH: Except the small LECs from that. So in other words, for the small companies only, if they rebalance rates -- and some of them are price regulated so this would apply to them -- if they rebalance rates, once they hit the $5, they would not reduce anything any further, so they would not have an amount to eat on that. That is for the small companies.

For Bullet 3, we would add after the words meaningful competition, "as determined by this Commission as part of its annual report on competition."

Bullet 4 would have no change.

And Bullet 5, we would suggest that the no frills rate be capped at the current local rate for each company, and also add that --

COMMISSIONER JOHNSON: I'm sorry, could you say that again?

MS. MARSH: To cap the no frills rate at the current local rate.

CHAIRMAN GARCIA: You mean if -- I'm sorry, you mean in terms of measured service, that if you got to the local rate that that would be a cap?

MS. MARSH: No. No. No, that's not what I meant. The current rate would remain as the no frills rate.

CHAIRMAN GARCIA: So you're saying that the -- if I remember through reading this and through our discussions the no frills rate didn't have a price.

MS. MARSH: It did not.

CHAIRMAN GARCIA: And now you're saying that the price should be whatever local service is.

MS. MARSH: Right. You threw out this morning $10, I think the statewide average is 10.16 but that $10 does not --

CHAIRMAN GARCIA: But your no frills is substantively different than my no frills, and so I -- yours sounds expensive.

MS. MARSH: No, it's not intended to be expensive.

CHAIRMAN GARCIA: No, but I'm just saying the limits -- yours is measured and that's what worries me. Is that what you're saying? That your measured no frills rate should be capped at what the local rate is now.

MS. MARSH: That's a different thing from what I'm recommending here. You didn't have a rate before. We're putting in a rate. Should you all decide you want it to be not a measured and a flat rate, that could certainly be a part of that. But all I'm saying in that sense is that the rate would be whatever the rate is now. As other rates go up for the no frills, we would suggest --

CHAIRMAN GARCIA: All right. And I'm just responding that it strikes me is that it's more expensive than we had talked about.

When I asked you -- forgive me, because there was a long discussion and I got up and walked out several times when we had a discussion through the report -- you said that no frills should average -- that measured service is about $6 when you average it out, and this one would be somewhere around $8 because it basically doubles the amount of measured service. Measured service is 30 calls a month, more or less, the ones that aren't tariffed, correct?

MS. MARSH: We kicked some ideas around and that was one of them.

CHAIRMAN GARCIA: And that was speculation. I know it wasn't in the report. But now it strikes me that you have gone up from that number, and 10.16 as an average seems expensive for a measured service.

MS. MARSH: We're not saying it should be 10.16. We're saying that it should be --

CHAIRMAN GARCIA: Capped.

MS. MARSH: Capped.

CHAIRMAN GARCIA: Should never go higher.

MS. MARSH: No. That the rate would be whatever the local rate is now, that's going to be the no frills rate, as other rates go up. As to whether it is measured or not, that is certainly on the table. And if you wish it to be a flat rate, that can be a part of the proposal. But that's wasn't what I meant in that sentence.

What we had discussed before was that -- it's discussed not in the conclusion but in the language in the discussion in the report -- was that at no time should the additional calls exceed the amount that other customers are paying for flat-rated service.

CHAIRMAN GARCIA: Which also made, I thought, very good sense. And I agreed with that.

MS. MARSH: Because the way local measured -- or the call count-type service works now that's not the case. You make more than the 9.65 in Sprint's area, you pay more. You can get up to a considerable amount. But that was something we would have proposed as part of the measured --

CHAIRMAN GARCIA: That is in.

MS. MARSH: Pardon?

CHAIRMAN GARCIA: That is in.

MS. MARSH: It's in the body of it. It wasn't actually included in the conclusion. Should you wish to go with a measured rate, that would certainly be part of it. That we would want to be in there.

CHAIRMAN GARCIA: Okay.

MS. MARSH: And one final remaining thing -- and this ties somewhat to the other study -- if the

Universal Service fund is established, this rate could be considered for funding through that Universal Service fund.

CHAIRMAN GARCIA: The no frills.

MS. MARSH: No frills.

CHAIRMAN GARCIA: Okay. Good. Very well. We've got through this. Hang on a second. (Pause)

MS. MARSH: Walter had some --

CHAIRMAN GARCIA: We're kind of slow up here so make sure that we --

MS. MARSH: Walter had some concerns. It's been a long day for everybody. And they wanted to make sure that you understood what we intended in the first bullet. I think he's referring to the decision tree, that one of the options to be considered is zero rate increase.

CHAIRMAN GARCIA: I understood the conclusion.

MS. MARSH: And only if an increase was desired then the rest of the bullets would kick in.

CHAIRMAN GARCIA: Let me just state this, because obviously it's tough for you guys to sit here -- it was good to see the fire in your eyes as well as Mr. Dowd's defending your report. I know you've put in a lot of time and effort in this. This is a substantive work. There's a lot of gray matter that may have been lost here forever from all of you. I appreciate that tremendously. I think you've done a very tough job with a very tough task from the Legislature, and with such broad guidance that I think the LECs could have been surprised at all the other options that they could have encountered today when we went through this. I think you did a conservative job and I think you did something that is a very commendable. And that I say with -- understanding that we may fiddle with it a little bit from this point forward. But I think that this was a mammoth task. And I appreciate all of the work you all have put into it.

And I know how sensitive Staff was to the consumer hearings. I know that when we began that process, certain of us thought that this is just such a drudgery. But I think we learned so much from those 22 hearings-plus, and, again, I appreciate the work that you all have put into it.

COMMISSIONER JACOBS: I would concur in those comments. I think an absolutely excellent job has been done on this. There's a point, however, that I would like to raise and it's not so much a shortcoming of the report, I think, but it's a glaring absence.

Throughout our customer testimony the sentiment was echoed at almost every stop the level of consumer confusion and dissatisfaction with their ability to interpret what it is they are being charged for.

If these recommendations are adopted in any way, form or fashion, that confusion will become exponential. Not only would they not understand why they are getting $2 more extra for local, they will probably get some extra charges that may be interstate in nature or intrastate in nature, and the potential for consumer confusion is exorbitant. You weren't asked to look at that and I understand that's why it's not covered here. But I think we have to look at that.

I have some principles that I'd like for you to take a look at. And we may need to figure out how we go about getting that out of this body before the Legislature. But I'm of the opinion, and just my own humble opinion, that to send forth a recommendation of this nature, expecting that there would be serious consideration, without caveat as to how to help consumers address and deal with this menu is -- in my mind would be irresponsible and unthinkable.

CHAIRMAN GARCIA: If I can allay some fears, I know that the Chairman on the House side has, in discussions with myself, talked about insuring that anything we do, if there is any substantive change in telecommunications policy, he already -- he wants to include with it some type of assistance through this agency to inform people of precisely what is happening. I know that that was part of the package that was crafted last session to try to educate the people. And, in fact, it was part of the funding source, if I remember correctly, that was involved in that. And I think it wouldn't be a bad idea that you mentioned what Leon is addressing somewhere in the report saying if the Legislature is going to move forward on this, clearly we need to -- we've already addressed the billing problem, the complexities of that and we have an open docket, and we're working on that, but there's certainly an educational component to this. If this moves forward, we should suggest to the Legislature that they should give us some kind kind of duty on the consumer education side so that we can explain this to -- and the point made, I think Staff did an admirable job of trying to explain this. I think some consumers understood what you did and some did not. And these are probably among the more sophisticated consumers in the state of Florida.

So we would have a job to explain to the public regardless, whether the Legislature took our suggestion or not, what was implemented. And I think the PSC would probably be as good an instrument as any other to educate the public on the role of whatever they decide to pass.

Commissioners, it is quarter to six, more or less. I envision us coming back on Thursday at noon and hashing this out with Staff. We have questions for the companies. It's a good opportunity.

I was simply going to discuss what I conceptually had as a theme for the Lifeline -- sorry, the no frills rate after I had an explanation of Staff's.

If you have anything you want Staff to be thinking about in the next day -- and I guess we can always meet with them and discuss that -- but this, I guess, would be as good a time as any. I know it's been a long day and it's tough to sort of organize our thoughts.

As you can imagine, I think the multitenant was a big document and we're now on three days on multitenant. This is a bigger document, I think, and much more philosophical in nature, so it's sort of tough to nit pick at the way you can a legislative proposal.

Let me just discuss my issue that I wanted to discuss and it's been out there, but just so that you understand, and I guess we can have a discussion tomorrow in my office about it.

My belief is that measured service is something that in Florida does not fly. I don't know if it flies anywhere else, but in Florida it does not fly.

When you compare some of the people who could have measured service and don't take measured service because -- they just don't think it's a valuable commodity, I worry about how this would be affected by the Legislature. And what my biggest problem and concern is, this is a subpar service. We're saying to people we're going to give you a subpar service. And I worry about that. I do not believe that we should be offering a subpar service for the basic customer. I think that they should have as much right to the basic service as everyone else, and I think everything else is plus, you know, it's basic plus.

So it strikes me that we should -- on no frills I would be much more comfortable if our report suggested that no frills simply be basic service, unlimited basic service at its present price or lower. And I picked the dollar -- the amount of the $10 because that would be almost -- that would be a reduction of people who get that service. It would be a reduction of the rate at that basic point. Now, of course, everything else would be plus.

And so I believe that that is a -- I believe it's a much more acceptable alternative. And I think it addresses a lot of the concerns that AARP presented to us. I believe it addressed some of the concerns that the consumers addressed. Even FKAN, as difficult as it sometimes is for me to know exactly what they want, they make a good job of articulating a lot of the issues. I think it addresses a lot of their concerns. We keep a series of people in Florida at a certain level and that level being the best we can do with basic service present.

I go further than that. I also think about the retirees in Florida. My concept, I can't do without call waiting. It's been around long enough that it's part of my necessary phone options. So I would not be able to be a subscriber to this phone service. That said, I think most people -- and our numbers bear that out -- that have, are all right with not having that; almost the majority are all right with not having it. I know that 60% of people get caller waiting but that's not broken out in terms of individually; it's a much broader thing.

So my thinking is we would probably go for a number, a $10 figure, and we would offer a no frills not measured service. If people got other things then they clearly would fall into the basic plus. But I think it would meet the needs of those who are in a difficult position or who simply don't want everything else.

Likewise, I think the fact is that as we go forward we tend to forget the technological advances that occur and the necessities that we all have. But the truth is that as these companies roll out more things, people are going to want not to be in basic service. They are going to want those other things. And hopefully that will stimulate people. And then they can be in whatever basic plus the Legislature or we decide in this report.

I just want you to give that some thought and maybe we'll talk about it tomorrow at some point when I have a few moments and I certainly will want to discuss it at length with my fellow Commissioners on Thursday. If you can make it more tenable for that discussion with the facts and your knowledge of it, I would greatly appreciate that.

COMMISSIONER JOHNSON: I have some general questions based upon some of the testimony that we've heard today. And I'll tee them up. You don't necessarily have to -- if there's a quick brief answer, fine. If it's going to take a little research, then we can answer those when we come back.

Mr. Paschall stated something in his testimony, his presentation, that Staff had an affirmative finding, I believe, that business rates subsidize local rates. And I didn't recall seeing that in here written as such. Did we say that? Did we make findings as to what subsidized what?

MS. MARSH: I don't recall having said that. Certainly it shows the business rates provides --

COMMISSIONER JOHNSON: Contributions.

MS. MARSH: But I don't remember us ever saying this service or that service.

COMMISSIONER JOHNSON: I started to ask him but we weren't asking questions at that time, and I just wanted to be clear that we weren't making those kind of declarations.

I'm going to go through each of them. The AG's office stated that they thought the mechanism that we set up for the pass-through, understanding what you just said, Ms. Marsh, is that we're trying to -- or at least Staff's proposal was designed to provide benefits to customers. And that although we were saying the increase may be affordable, it wasn't a windfall for the companies because they'd have to flow that through.

And then with respect to those nonbasic service, the ones you were concerned about, how could we enforce that flow through, you had suggested a mechanism. His response is that those type flow-through provisions are not enforceable. That, in fact, they won't be of benefit to the customers. David looks like he's ready to jump on that one now. If you want to think about it, you can. But I do think we need some discussion -- Ms. Marsh, did you want -- whoever would like to answer. You don't have to answer it today. Because I think that would be important to the extent we're putting something out there and we're explaining it to the Legislature that we think this is a public good. Whether or not it's forceful is an important point, or if there are other things we can do to make it more enforceable. Any comment on that?

MS. MARSH: I just think it's nonsense, basically. It's our job to enforce those -- see that those rates stay the same. Now one point they did bring up is that the Legislature could certainly change it. Well, of course, they can. If they want to put it in an index now and change it later they can do so. But as far as enforcement of any kind of index, that would be up to us and that would be our job.

COMMISSIONER JOHNSON: Okay. What about to that same provision, where you had the nondiscretionary with the index, Mr. Fons suggested maybe we should not have an index, but that if the Legislature wanted to they could impose a cap. How do you feel about us suggesting a cap and not having an index at all?

MS. MARSH: He suggested a cap only for those services that were reduced, if I recall correctly, which is a very different thing from what we suggested. Right now the companies can pretty much raise rates at will. 6% when you consider the current inflation rate is pretty hefty and when you consider the flexibility they have within those categories, it's a considerable amount. He, of course, wants the LECs to have all of the flexibility they have now and that's why he's trying to dissuade you from that particular thing.

COMMISSIONER JOHNSON: How would a cap mechanism help them?

MS. MARSH: He suggested only capping the things they reduced. There would be a lot of things they didn't reduce.

COMMISSIONER JOHNSON: Oh, I see.

MS. MARSH: In fact, in the case of some of the LECs, there might be anything left over after the $5 to reduce ancillary services. So, for example, if they reduce call waiting, maybe that will be capped but caller ID won't be, if I understood what he proposed correctly. So in his case --

CHAIRMAN GARCIA: Walk me through that. Is that the concept that we will reduce access and then we're not going to reduce it anymore so they reduce called ID to rebalance it. But once you reduce that, then clearly that one has to be capped.

MS. MARSH: Under his proposal. But he's proposing that in lieu of this index that I propose. The index would apply to all of those services in that particular category.

CHAIRMAN GARCIA: Tell me the problem you have with his proposal there.

MS. MARSH: He's only proposing if they reduce something to cap them.

CHAIRMAN GARCIA: Right.

MS. MARSH: The index we're suggesting would apply to all of the services in that category. So he could reduce one thing, cap it at that and then increase everything else at will, up to the 6%. And there's considerable leeway in there because the 6% is for the whole category.

CHAIRMAN GARCIA: Let me ask you, 6% works -- when we did the rate, what time does the 6% work? In other words, basic is not up at 6%.

MS. MARSH: No, it's all of the nonbasic.

CHAIRMAN GARCIA: All of the nonbasic services.

MS. MARSH: Until there's competition and then that number jumps to 20%.

CHAIRMAN GARCIA: And basic right now, the only increase that you can have on basic for the companies that are in price regulation is just a --

MS. MARSH: They are capped.

MR. DOWDS: They are capped.

CHAIRMAN GARCIA: There's no inflationary provision or anything like that.

MS. SIMMONS: No. They would have to petition under changed circumstances to the Commission for relief.

The other thing I was going to mention, Commissioners, the nonbasic service categories, just for your information, there are like ten of those and there are, as Ms. Marsh indicated, a large number of services in any particular category. So there's quite a bit of flexibility and still -- to rearrange prices and still stay within the 6% overall limit.

COMMISSIONER JOHNSON: I'll sit down with you all sometime tomorrow to go over that, how it's done now and how that the index would work, and how if we did delineate a specific cap, how that works. But I'll get with Anne tomorrow.

The gentlemen representing the AG's office also stated that -- this goes to the cost allocation issue -- allocating all of the cost of the local loop to residential service was illegal. I think he said it violates -- it might have been Public Counsel -- it violated 254(K) of the Federal Act, and that that was binding on the states. Any response to that? David? The gentlemen from the AG's office raised the 254(K) argument, in that we couldn't allocate all of the costs of the loop to local service.

MR. DOWDS: We don't need to allocate loop cost period in my opinion. We need to recover them but we don't need to allocate them.

COMMISSIONER JOHNSON: Let's pick up on that point. What we're doing -- what do you call it, the cost object. You're just saying what causes the costs to occur, but you don't speak at all to recovery mechanisms.

MR. DOWDS: No.

COMMISSIONER JOHNSON: Should we speak to that?

MR. DOWDS: I think it's beyond -- my personal opinion, it's beyond the scope of this project. But I would note, I believe, on Page 51 of the recommendation in the section on Conclusions and Observations, I note that it appears, at least to me, that various parties tend to confuse cost determination versus cost recovery. And as indicated there, it's our opinion that it's, by definition, given the way basic local service is defined, you need a full loop. One-third of a loop won't cut it. But that doesn't concern me. But the fact that the cost might be $29, and for whatever reasons we're not charging at that rate, that's a pricing issue. The cost is what the cost is, in my opinion.

COMMISSIONER JOHNSON: And to that pricing issue or recovery issue, the $2 you all are saying --

or the zero to $5 -- the amount of money that the Legislature could increase local rates by and the rates would remain affordable, what is that $2 doing? Is that then part of the cost recovery for local? In that way are we talking cost recovery? There's got to be something.

MR. DOWDS: You'd be recovering an increasing share of the local loop through local rates. We also indicated, I believe on Page 52, that that cost tracking in and of itself is not a particularly interesting rate design goal. It's not necessary, in our opinion, to always track costs in setting rates. There may be public policy externalities where you wouldn't want to do that. And local rates historical have been in that camp.

COMMISSIONER JOHNSON: How do you know -- or maybe you're saying it's not important to determine if there is overrecovery. How would you ever know?

MR. DOWDS: I'm sorry, overrecovery?

COMMISSIONER JOHNSON: How do you know what's recovering the cost of what? If we're saying we know what it costs but we don't know, nor have we assigned values to the mechanisms for recovering that cost.

MR. DOWDS: Well, given --

COMMISSIONER JOHNSON: Or is it not relevant since we earn a rate of return?

MR. DOWDS: I'll give you two quick answers. One is that if you've done a cost study and you know how the cost study is done, and how it defines its terms, then by definition you know the cost of X. If you know what you're charging for X, then you know what percentage of the, quote, "cost", unquote, you're recovering with that rate element. Maybe I'm missing the point here, I'm sorry.

COMMISSIONER JOHNSON: So with respect to $5, we know how much -- that tells us something about the cost recovery, that we're allowing -- we will receive $5 more from our local customers to recover the cost of the loop?

MR. DOWDS: Yeah, theoretically. I'll give you an example, a hypothetical.

Rate group 12, BellSouth is 10.65 currently. Under the plan over presumably a five-year period -- or three years, I guess, is the shortest -- they could out to 15.65. I don't recall offhand what BellSouth claims the cost is for rate group 12, but let's assume for sake of argument it's $20. Well, they are currently recovering a little over 50% of the quote, "loop cost" in the local rate. When it was 15, they are going to recover whatever that math is. Just by definition, if you know what the cost is and know what the rate you're charging is, you know how much you're recovering.

Now, things get real messy where you don't have costs equal to the rates. For example, I know that BellSouth is presumably recovering a little over 50% in my hypothetical, from the rate group 12 rate. And I know that they are making money. Therefore, I know they are recovering the other 48-9% from something, but I don't necessarily know exactly from where. And perhaps in the aggregate they don't care. But that's beyond my purview. I don't know. I don't have any special knowledge on that.

COMMISSIONER JOHNSON: I think one of the things we'll need to do, particularly if we follow the revised recommendation of Staff, and I know it's something all of the Commissioners have to think about, is provide, in my mind more specific -- I don't want to say direction, but more specific explanation as to our findings for the Legislature. And I say that -- and let me give you an example. With respect to the zero to $5 increase, we need to be clear that we are not saying -- and I think Public Counsel cited to three places where Staff said even if you do this,

this does not mean competition is going to occur. Because I wouldn't want to give someone the false impression or lead the consumers to believe another false expectation that doing this will lead to competition.

And secondly, that we are not doing this necessarily -- we're not doing it at all to promote Universal Service. Because Staff has also stated that that's not the purpose of those dollars. So that when those elected officials are making a determination, and when they are faced with a question, "Well, why did you do this?" Because in my mind the reason why Staff is suggesting that we do this is because using the criteria that the Legislature delineated, it's affordable; that people can afford this. And I guess also on the cost recovery issue, because we determined that the loop was priced below its cost, these dollars could be used as a means of recovering some of the cost of the local loop. But I would like for us to be clear because when Mr. Beck started making his points as to -- I think his first point was that this wasn't being done to promote competition, so his next question was why are we doing this? That was my first reaction too. And that's one of the things I have to think through too. I feel better about the revision that Ms. Marsh put forward where we're saying zero to a certain number, telling the Legislature -- you know, it's kind of up to them. They don't have to do this but if they want to know what is affordable, this is in the affordable level. Because looking at the evidence, looking at the value of service, looking at other states, this appears to be affordable. I feel better about that having a range.

And another thing I think would be helpful if we focussed on is that I think in one of our reports we talk about the penetration level in the state of Florida, 92, 93, whatever that might be. But I don't know if we addressed the penetration rates for special classes of customers that I think is somewhat edifying, like Hispanics, African Americans, single-family households and how those penetration rates are a lot less.

Also someone raised a very, I thought, important issue with respect to, and if we do get to $5, how does that generically impact people? How many people might we lose off the system? Just so that they have that information. Some of that might be mitigated by a no frills rate. Some of that may be mitigated by other things. But I do think I want to be very clear with our report to the Legislature. I don't see it as a recommendation to increase rates at all. I see it as answering their questions and making sure that they understand what we believe impacts will or will not be. That we're not saying this will provide competition. That we're not saying this is Universal Service. I think we need to be really clear.

One of the mistakes that I think we all made with respect to the 1995 legislation and 1996 legislation in Washington is our expectations were so high. If we do this we're going to have competition in two or three years. And it didn't happen that way. And I think in fairness to our elected officials, I think we should lay this all out as clearly as we can. Because, Anne, I think it's all here, but I think we ought to lay it out as clearly as we can, and I think we can do more, a little more in that regard.

I think that's most of my big issues. I may have some other questions and they are mostly directed to Staff and I can take care of those probably tomorrow.

MS. SIMMONS: Commissioners, let me make one comment, clarify here. I wanted to point out that in the report that we provided, Staff did talk in terms of a basic rate increase in an amount not to exceed $5 per month. And I think our concern is -- and the reason for Ms. Marsh clarifying is I think that kind of got lost, that notion of up to $5, and we want to make sure that's a lot clearer.

COMMISSIONER JOHNSON: That's a good point. One other issue, I don't know if it was in the Universal Service Report. Should we -- I know we didn't, David, but should we say anything about the hybrid cost model that the FCC put forward? And is that something -- at least a footnote letting them know there's another model out there; there's a hybrid model that the FCC may be adopting that we -- particularly since we're saying Universal Service, we don't necessarily need the fund at this time, letting them know that there are other models to look at to determine costs?

MR. DOWDS: We could if you like. I presume what we want to do is somewhere in Chapter 1 where we're doing a summary of the order is put a footnote saying, "Although this is what we chose, there's a third contender out there." Something like that.

COMMISSIONER JOHNSON: I think that would work. Just to tee it up so they are aware of that.

COMMISSIONER JACOBS: I have a couple of brief comments, but first I would segue from

Commissioner Johnson's comments.

I think there has been substantial, perhaps anecdotal much of it, but I think we have enough documentary evidence from surveys for low income individuals any upward pressure on local rates will have significant impacts. And, of course, the response is always, well, they'll be saved by Lifeline. I'm not persuaded at the moment that that's an adequate response. As I look at Lifeline, it is not to date serving that role. The take rate is extremely low. Information is scarce, if nonexistent, for the community of individuals who need this service. And if it is the sole facility by which we would expect low income individuals to absorb any effects of this legislation, I suspect we would do them an injustice. Even if there is a reasonable participation in Lifeline, they only get a dollar for dollar up to whatever the limit is.

And I assume -- actually for those who are already enrolled, there's probably -- argument whether or not they get any relief here because if they are already enrolled at the existing local rate, every dollar that's added on they have to pay. So really we're only talking about new, but as of today that's a whole lot of people. So the new enrollees will get that benefit and that seems to be the vast majority of those who are eligible

I would also echo the comments that that community seems to be the place where there's the greatest resistance. And we heard time and time again in our customer input that the resistance to any upward pressure on the local rate is most critical in this community, and I would add most especially for the elderly who have very little recourse on how they are to deal with this.

There was a lot of discussion -- moving to another point -- a large discussion about revenue neutrality. And I think I've heard some -- you addressed some issues on that.

I think I would like to look at a more fuller discussion about just exactly how that indexing is going to work, what kind of criteria -- I agree, you can't cast that in stone for the moment. But I think we need to have some sense, put it in context, if you will, how such a thing would work in a market that's transitioning to competition, not a market that is competitive. That's a very critical distinction in my mind. A market that is transitioning to competition -- and I'm still kind of getting a feel for this, so if I go off base correct me -- but as a hypothetical, let's say you have a company, they have a lot of EAS. So that intraLATA toll revenue is fairly minor as a factor, okay. And they are presently -- let's say this: Out of the total bundle of local service, they are making money, which is what you said, David. They are covering it. Perhaps not from the local rate but from someplace.

To the extent we increase the local rate for them, they lose -- they have no negative impact on the intrastate toll side; probably marginal, if any, from the access side. The argument is then that we're going to expect them to reduce their access charges. That may be true. But what have we done in terms of the benefits of competition to their ratepayers? Benefits of competition to their ratepayers in my mind are transparent, perhaps even onerous. Because what they are going to see is a profitable company increasing their rates. And will it lead to competition? I guess that's the 64,000 dollar question.

And I think that is -- the thing that I keep losing -- I think we run the risk of losing sight of is that ultimately it is the ratepayers' benefits that are the end sum game here. Yes, that has to come by way of fuller participation in the market. It has to come by way of more interest. But if all of that happens, you never see end sum results to the people who are paying for this service. This all has been for naught. Probably it has harmed the citizens of Florida more than helped them.

And I would -- I mean, most people point to the long distance market as an example of the benefits of competition. I don't have any evidence to refute that that would not be duplicated in the local competition market. I think there are a whole bunch of issues and arguments here that have to be addressed.

I would want to understand -- David, you have a comment on that -- more about how the revenue neutrality issue would go there and how it would work to ultimately work that benefit to the consumer? I'm fearful -- we can get to that tomorrow.

CHAIRMAN GARCIA: Address it now.

MR. DOWDS: Okay, Point No. 1, as Commissioner Johnson observed, we have not made any indication that any local rate increase would have any effect one way or the other on local competition. It doesn't have anything to do with competition. Premise number one.

Premise number two is whenever you have a rate restructuring you will have winners and losers. If you raise local rates and reduce switched access and/or toll rates, low volume customers, who don't have, as it were, "Friends or Family" -- they make virtually no toll calls, they will not benefit from the access reduction and they will be, as it were, disadvantaged by the $1 or whatever increase in local rates.

Those who make a moderate amount of toll calling, assuming that's where their decreases are targeted, will benefit. Proposal that is espoused by Ms. Marsh is an attempt to target -- to do two things. One, to ensure there is a flow-through of the benefits where access is the targeted service to be reduced. And two, to target the -- as it were, the outliers. To minimize the impact on the marginal subscribers who don't use much toll. Does that help?

COMMISSIONER JACOBS: I think I understand.

MS. SIMMONS: Let me add, too, I would say policy considerations would determine --

CHAIRMAN GARCIA: Explain how the proposal does that just -- because there are people listening in. So explain to me how your proposal does that.

MS. MARSH: I'm sorry, the question is how the proposal flows the benefits through to the customers?

One thing I want to point out right at the beginning is that it's a harsh reality that if you increase residential rates and reduce access charges everyone benefits, not just the residential consumers. So to some extent everyone is going to benefit at their expense. Within the category of residential consumers there are those who would benefit a great deal. Some make a considerable amount of toll calls and they are going to receive the benefits. Also, to the extent that they use vertical services, some of those may be decreased as well other services; they may benefit there. But you can't guarantee that all customers are going to benefit. They are not. Some are going to pay more. Some will pay less. And it's hard to determine exactly where the balance falls.

We looked at a lot of numbers and tried to figure out where the balance falls. And it just isn't very clear. We don't have all of the pieces of information that we would need to determine that. And we tried to get them but we just -- it's just not something that's easy to get your hands around.

COMMISSIONER JOHNSON: What would you need? Anne, you and I have had this conversation and I have also had this conversation with the legislators. How could you determine or how could you -- is there any numerical way of expressing the benefits to be gained by access reductions? You know, if you make $100 worth of toll calls, can a legislator say, "You're going to benefit. Your bill will now be $80 instead of a $100." Is there any numerical way to express that? And what would it take to get that information?

MS. MARSH: You can do something like that, but that's basically a hypothetical. What's more difficult to do is say how many of the consumers, what percentage of the consumers are going to benefit versus those who won't. And you need a lot of piece-parts of information from more than just the LECs. You don't know what everybody's toll usage is, for example. They only have part of it. And you can try to estimate from access charges what they are going to be, but you don't always know what customers those access charges pertain to; whether they were residential customers that you're trying to target or not. It's just really difficult to come up with a hard and fast number.

And we know some general things as far as benefits. We know, for example, that 47% of customers don't use ancillary services, so certainly they are not going to benefit if ancillary services are reduced. In any given month the amounts varied. We asked the LECs in any given month who is not using intraLATA toll, and the amounts varied all the way up to 82%. But, again, here they are not necessarily including those who were in some package plan with an IXC and who are making all of their calls through the IXC. So it's difficult there to get your hand around what the real number is. But certainly some will benefit but not all.

COMMISSIONER JACOBS: That segues into my next point, and I'm really not -- moving into shakey water for myself, but it sounds to me like to the extent we begin to make the network less expensive for certain users, they're going to get the greatest use out of it, okay? So that we may be giving incentives to -- for those heavy users of the network to really make heavy use of the network and ultimately driving those light users of the network further and further away. I don't know if that's a rational conclusion or not. But the concern I have is to the extent we pursue this idea -- and I know this goes into all of the issues of subsidy and all of that -- but to the extent we pursue this idea, should we raise that concept that more and more you're going to have people who use vertical services and people who get the benefits of access who are going to look at this as a good deal and want to make greater use of that. And more and more you're going to have people who want only the no frills that see this as a bad deal. And is that a public policy concern? If it's not, it's not. But I see it as an issue we may want to address ultimately long term.

And then it's important to me because I heard so much from the elderly. And this state is greatly populated by the elderly. So to not address that in my mind does not address a real concern for a lot of state residents. And many of them, by the way, were amongst that group that said, you know, if you increase this local rate by $2, then perhaps -- I guess it was 13, 16% of them, perhaps, said they would consider the option of dropping service.

Now, interesting enough, many of them indicated that they could get cellular. But they did not consider cellular -- well, let me not make a broad statement. I remember specifically several of them them saying that they did not wish wireless to be their substitute. They felt like wireline is what they preferred and what they'd like to keep. And so the choice here for them was to give that up. And even if they go to cellular it was a lesser alternative. I think -- and I think the report kind of says that that's a reasonable alternative. It may be in realistic terms, but in premises of the public they do not see it that way.

And then finally, I guess you guys dealt with this in -- it's a lesser point on comparing the rates of some other states and somebody addressed that so I'll pass on that.

MS. SIMMONS: Commissioner Jacobs, I just wondered if I could mention something. You were talking about public policy considerations and distribution of benefits. I really think that plays into where within this zero to $5 range you want to go. That wasn't something we were, you know, really asked to look at by the Legislature so that is probably why -- Staff would be cautious in that area. We tried to look at the four elements. But I really think bottom line it's a public policy consideration where you go in that zero to five range that we suggested.

COMMISSIONER JACOBS: Right. I think it's a real -- that's a real calibrator, if you will. In my mind that's a real factor that you would use to calibrate you along that continuum.

MS. SIMMONS: I would just reiterate what

Ms. Marsh mentioned. It's very difficult to get the appropriate data to do those distributional type analyses because you would have to have for a sample of customers their local bill, their toll bill. So it's just difficult to get the necessary information.

COMMISSIONER JOHNSON: I have one other thing that -- in fact, one of the consumer advocates reminded me, that during the course of our workshops several times it was stated that maybe the Legislature should look at Lifeline and Linkup programs in terms of customers being presubscribed. And I know, Ms. Marsh, you've done some work on that particular issue; whether they should be automatically subscribed if they meet certain criteria. Perhaps that should be mentioned and addressed here.

My opinion, candidly, is that would be something hard to implement right away even if the Legislature wanted to do it. And given the impact with respect to how many customers you all said would be eligible and the dollars involved, to the extent that we don't have a fund right now that is competitively neutral, by that I mean just the LECs are contributing, I don't know if it's something that I would readily suggest to the Legislature that they implement right away. But I think it is something we need to have a discussion on, that the issue was raised. I guess California and some other states may even be doing that and maybe an analysis of that particular issue.

MS. MARSH: I think New York is doing it. I do not believe California is. I think Montana recently has been looking at it, but I don't believe they have implemented anything yet.

It's something that can obviously be done. It isn't something we, as a Commission, can do. It requires work between the LECs and the other agencies. And I believe it would require a statutory mandate on the other agencies to do it because they are going to have to exchange records with the LECs.

There are also a few problems with it. For one thing, it doesn't pick up those who don't have phone service or phone service is in some other name, somebody else in the household has got the phone. It will miss a lot of people. That's not to say it can't benefit the customers, but it's not a whole answer to the whole issue of Lifeline enrollment. But it is something we could insert some language into there about to make the legislators aware that that's an option.

COMMISSIONER JOHNSON: Okay.

CHAIRMAN GARCIA: All right. Well, we're going to then recess this hearing, and we will convene again at noon on Thursday. And I am certain you will be receiving -- Staff will be receiving calls from Commissioners in the next day.

Thank you very much for your time. Appreciate it.

(Whereupon, special internal affairs concluded at 6:24 p.m.)

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STATE OF FLORIDA)
: CERTIFICATE OF REPORTERS
COUNTY OF LEON)

We, JOY KELLY, CSR, RPR, FPSC Chief,Bureau of Reporting and DEBRA R. KRICK;

DO HEREBY CERTIFY that the Special Internal Affairs was heard by the Florida Public Service Commission at the time and place herein stated; it is further

CERTIFIED that we stenographically reported the said proceedings; that the same has been transcribed by us; and that this transcript, consisting of 111 pages, constitutes a true transcription of our notes of said proceedings

DATED this 28th day of January, 1999.

Joy Kelly

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S/ Debra Krick

DEBRA R. KRICK