State of Florida

Public Service Commission

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RECORDS AND REPORTING

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DATE: NOVEMBER 4, 1999

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

FROM: DIVISION OF APPEALS (BROWN) MCB DES
DIVISION OF COMMUNICATIONS (MARSH) CSO fr. AEH DM PS
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (HEWITT) CBH

RE: DOCKET NO. 980253-TX - PETITION TO INITIATE RULEMAKING, PURSUANT TO SECTION 120.54(7), F.S., TO INCORPORATE "FRESH LOOK" REQUIREMENTS IN ALL INCUMBENT LOCAL EXCHANGE COMPANY CONTRACTS, BY TIME WARNER AXS OF FLORIDA, L.P. D/B/A TIME WARNER COMMUNICATIONS

AGENDA: November 16, 1999 - REGULAR AGENDA - POST HEARING RULE ADOPTION - PARTIES MAY PARTICIPATE FOR THE LIMITED PURPOSE OF ADDRESSING THE STATEMENT OF REGULATORY COSTS ISSUED SEPTEMBER 13, 1999.

RULE STATUS: ADOPTION MAY NOT BE DEFERRED

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\APP\WP\980253#3.RCM

CASE BACKGROUND

On February 17, 1998, Time Warner AxS of Florida, L.P. (Time Warner), filed a Petition to Initiate Rulemaking. Time Warner petitioned the Commission to include "fresh look" requirements in its rules. Fresh look provides customers of incumbent local exchange companies (LECs or ILECs) a one-time opportunity to opt out of existing contracts with LECs so as to avail themselves of competitive alternatives now offered or to be offered in the future by alternative local exchange companies (ALECs). The Commission currently does not have any rules or established policy related to fresh look.

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FPSC-RECORDS/REPORTING

The Commission granted the petition to initiate rulemaking. A Notice of Rule Development was published in the April 10, 1998, Florida Administrative Weekly (FAW) and a workshop was held April 22, 1998. Interested persons filed comments after the workshop, and a draft rule and request for rulemaking was prepared by staff. The Statement of Estimated Regulatory Cost (SERC) was requested and due to the Division of Appeals on September 30, 1998. Staff filed a recommendation on November 19, 1998. However, that recommendation was deferred from the December 1, 1998 Agenda Conference. A new recommendation was considered at the March 3, 1999 Agenda Conference. The Commission voted to set the matter for hearing.

A Notice of Rulemaking was published in the FAW on April 2, and April 23, 1999. Supra, GTEFL, BellSouth, and Time Warner filed direct and rebuttal testimony. FCCA, BellSouth, e.spire, Sprint and KMC filed comments. FCCA, KMC, AT&T, Time Warner, BellSouth filed responsive comments. The Commission conducted a rulemaking hearing on May 12, 1999. On June 16, 1999, GTEFL, KMC, Supra, Sprint, and e.spire filed posthearing comments. FCCA and AT&T, Time Warner, and BellSouth filed posthearing briefs.

As noticed orally at the hearing, a revised SERC was issued September 13, 1999, based upon the evidence of the hearing. A Notice of Rule Hearing at the November 16, 1999, Agenda Conference was published in the September 24, 1999, Florida Administrative Weekly.

As previously noted, fresh look provides customers of LECs a one-time opportunity to opt out of existing contracts. Prior to ALEC competition, LECs entered into customer contracts covering local telecommunications services offered over the public switched network (typically in response to PBX-based competition). In addition, the LECs entered into customer contracts covering dedicated services and long distance services due to competition from AAVs and IXCs, respectively. However, the regulatory environment has changed due to the 1995 rewrite of Chapter 364, Florida Statutes, and the Telecommunications Act of 1996. ALECs are now offering switched-based substitutes for local service, either through use of their own facilities, unbundled network elements, or resale, where PBXs had previously been the only alternative. For multi-line users not interested in purchasing a PBX (due to financing, maintenance needs, constraints on upgrades, air conditioning, space limitations, or whatever reason), the LEC was heretofore the only option.

The purpose of the proposed fresh look rule is to allow customers to take advantage of competitive offers for service. It will also enable ALECs to compete for existing LEC customer contracts covering local telecommunications services offered over the public switched network. The rules describe those limited circumstances under which a customer may terminate a LEC contract service arrangement or tariffed term plan (collectively, contracts) subject to a termination liability less than that specified in the contract. Those limited circumstances are for customer contracts covering local telecommunications services offered over the public switched network, which were entered into prior to the effective date of this rule, and that are still in effect and will remain in effect for at least one year after the effective date of the rule. A customer may terminate the contract during the fresh look window by paying a certain amount to terminate the contract as outlined in the rule. The fresh look window will begin 60 days following the effective date of this rule and end one year later. The 60 days will allow the LECs time to set up procedures to implement this rule.

The following is a rule-by-rule summary and analysis of the proposed rules:

25-4.300, Scope and Definitions: The Scope explains what contracts are eligible for a fresh look and to which LECs the rules apply. The following terms are defined: "Fresh Look Window;" "Notice of Intent to Terminate;" "Notice of Termination;" and "Statement of Termination Liability."

25-4.301, Applicability of Fresh Look: This rule provides that the fresh look applies to all eligible contracts and specifies that the window of opportunity to exit an eligible contract will begin 60 days after the effective date of the rule and remain open for one year. It contemplates an end user and LEC going through this process only once during the fresh look window for each eligible contract.

25-4.302, Termination of LEC Contracts: This rule provides for the process under which eligible contracts may be terminated. The LEC must designate a contact to whom inquiries must be addressed. The rule provides for notice and procedure. The end user sends the LEC contact a Notice of Intent to Terminate. The LEC has ten business days to provide the end user with a written Statement of Termination Liability. The rule specifies that for contract service arrangements the Termination Liability is limited to any unrecovered, contract-specific nonrecurring costs and may not exceed the termination liability specified by the terms of the contract. The contract itself or the working papers used to support the contract may be used for the calculation. Tariffed Term Plans will be repriced to the applicable shorter period.

Once the end user receives the Statement of Termination Liability, he has 30 days to provide a Notice of Termination to the LEC. If no notice is sent, the contract remains in effect. If notice is sent, the end user will pay the termination liability by a one-time, lump-sum payment.

Finally, the LEC has 30 days to terminate the service from the date it receives the Notice of Termination.

Issue 1 of this recommendation deals with legal issues that arose in the course of the proceeding, including whether the Commission has authority to promulgate fresh look rules. Issue 2 discusses the provisions of the rules. Issue 3 recommends closure of the docket.

The rules as originally proposed by the Commission are shown in Attachment 1, with the changes recommended by the staff shaded. For purposes of this recommendation, recommended additions to the rules are shown as shaded and underlined. Recommended deletions are shown as shaded and stricken through.

DISCUSSION OF ISSUES

ISSUE 1: Does the Commission have the authority to promulgate fresh look rules?

RECOMMENDATION: Yes, the Commission has the authority to promulgate fresh look rules. (BROWN)

STAFF ANALYSIS: BellSouth and GTEFL contend that the Commission lacks the statutory authority to adopt the fresh look rules proposed in this docket. They argue that the rules would infringe upon constitutional sanctity of contract guarantees, and effect an unconstitutional taking of their property. They contend that the Commission's proposed rules would "abrogate" or "drastically disrupt" existing contracts between them and their customers, and therefore, the Commission should not adopt the rules in any form. The Joint Administrative Procedures Committee also questions the constitutionality of the proposed rules and asks whether the proposed rules would retroactively interfere with existing contracts, contrary to Section 120.54(f), Florida Statutes. Time Warner, the Florida Competitive Carriers Association (FCCA), AT&T, SUPRA, e.spire, KMC, and Sprint all assert that BellSouth's and GTEFL's legal objections to the proposed rules are unfounded. They argue that the Commission clearly has the statutory authority to adopt these rules, which, they also argue, do not unconstitutionally interfere with existing contracts or take the incumbent carriers' property without just compensation.

As described above, fresh look provides customers of incumbent local exchange companies a one-time opportunity of limited duration to opt out of their existing contracts without incurring high termination liability charges in order to avail themselves of competitive alternatives that did not exist at the time the existing contracts were entered into. The proposed rule operates on a going-forward basis, and does not retroactively affect the contracts. It only modifies the termination liability provisions of the contracts from the date of adoption of the rules to further the development of competition, and it provides that the ILECs will receive the compensation they would have received if the contracts had been made for a shorter term.

The concept of fresh Look is not a new one in regulatory policy. Other states have adopted it to encourage competition in local telecommunications markets.[1] Both the FCC and the Florida Commission employed the policy in expanded interconnection dockets in the early 90's.[2] In Order No. PSC-94-0285-FOF-TP, issued March

[1] Ohio, In the Matter of the Commission Investigation relative to the establishment of Local Exchange and Other Competitive Issues, Case No. 95-845-TP-COI (P.U.C.O, June 12, 1996); Wisconsin, Supplemental Findings of Fact, Conclusions of Law and Interim Order re Investigation of the Appropriate Standards to Promote Effective Competition in the local Exchange Telecommunications Market in Wisconsin, Docket No. 05-TI-138 (Wic.P.S.C., September 19, 1996); New Hampshire, In the Matter of the Petition of Freedom Ring Communications, L.L.C. Requesting that the Commission Require that Incumbent LECs Provide Customers with a Fresh Look Opportunity, Docket No. DR96-420, Order No. 22, 798 (N.H.P.U.C., December 8, 1977). It should be noted as well that some states have refused to adopt fresh look rules, and many states have not considered the matter at all.

[2] See, In re: Competition in the Interstate Interexchange Marketplace, 7 FCC Rcd 2677 (1992).

3, 1994, in Docket No. 921074-TP, the Commission adopted a fresh look provision for customers of LEC private line and special access services with terms equal to or greater than three years. Customers were permitted a limited time to terminate their existing contracts with LECs to take advantage of emerging competitive alternatives. The Commission limited the customers' termination liability to the amount the customer would have paid for the services actually used.[3] The Commission reasoned:

> [W]e find that introducing competition, or extending the scope of competition, provides end users of particular services with opportunities that were not available in the past. However, these opportunities are temporarily foreclosed to end users if they are not able to choose competitive alternatives because of substantial financial penalties for termination of existing contract arrangements. A fresh look proposal will enhance an end user's ability to exercise choice to best meet its telecommunications needs. Order No. PSC-94-0285, p. 28.

Staff believes that the Commission clearly has the statutory authority to adopt these rules. That authority is found expressly and specifically in section 364.19, Florida Statutes, which provides:

> The Commission may regulate, by reasonable rules, the terms of telecommunications service contracts between telecommunications companies and their patrons.

Chapter 364, Florida Statutes, directs the Commission to encourage the development of competition in local telecommunications markets. See, for instance, section 364.01(4), Florida Statutes, which specifically states that:

> The commission shall exercise its exclusive jurisdiction in order to . . .
>
> > (b) Encourage competition through flexible regulatory treatment among providers of telecommunications services in order to ensure the availability of the widest range of

[3] "For example, if an end user has a five-year contract but terminates the contract after three years, the termination liability equals the difference between what the end user would have paid if the contract were three years and the amount it actually paid..." Order no. PSC-94-0285, p. 28.

> consumer choice in the provision of all telecommunications services. . .

See also, section 364.01(4)(d), which gives the Commission the power to "[p]romote competition by encouraging new entrants into telecommunications markets. . . ." The fresh look rules proposed here are reasonable, limited in scope and duration, and designed to further the development of competition in local telecommunications markets. As such they are consistent with the Commission's regulatory mandate and within the scope of its authority.

It has long been established that public utility companies are considered "businesses imbued with a public interest," which operate always subject to the legitimate police power of the state. Contracts for telecommunications service are not purely private contracts. "Contracts by public service corporations for their services or products, because of the interest of the public therein, are not to be classed with personal and private contracts, the impairment of which is forbidden by constitutional provisions." Miami Bridge Co. v. Railroad Commn. Of Florida, 20 So.2d 356, 377 (Fla. 1944). One who conducts business in this arena does so with the " full knowledge of the existence of the police power which authorizes regulations in behalf of the public." Id. In H. Miller & Sons v. Hawkins, 373 So. 2d. 913 (Fla. 1979), where a developer with an existing contract with a water utility appealed the Commission's decision to increase the utility's service availability charges and modify the developer's existing contract accordingly, the Court stated:

> The Commission's decision was based upon the well-settled principle that contracts with public utilities are made subject to the reserved authority of the state, under the police power of express statutory or constitutional authority, to modify the contract in the interest of the public welfare without constitutional impairment of contracts. . . . [T]the effect of ruling in favor of Miller would have been to allow a private party to circumvent by contract the police power of the state, which is impermissible.

If the Commission may alter the rights of private parties who contract with public utilities for a reasonable and valid public purpose without violating constitutional principles, certainly the Commission may alter the contract rights of the public utilities themselves. See also, Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983). Similarly, if the exercise of regulatory authority here is reasonably designed to further a valid public interest, staff does not believe that it can be said to unconstitutionally take the ILEC's property without just compensation. See, U.S. Trust Co. Of New York v. New Jersey, 431 U.S. 1 (1977) While GTEFL argues that the Fresh Look rules will confer only a private benefit on a small group of customers, the clear purpose of the rules is to encourage the development of competition for the long-run benefit of all consumers.

> There is no absolute freedom to do as one wills or to contract as one chooses. The guaranty of liberty does not withdraw from legislative supervision that wide department of activity which consists of the making of contracts, or deny to government the power to provide restrictive safeguards. Liberty implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community. Chicago, Burlington & Quincy R.R. Co. V. McGuire, 219 U.S. 549, 567 (1911).

For these reasons, staff recommends that the proposed fresh look rules are constitutionally sound, and the Commission has the statutory authority to adopt them.

ISSUE 2: Should the Commission adopt Rules 25-4.300, F.A.C., Scope and Definitions; 25-4.301, F.A.C., Applicability of Fresh Look; and 25-4.302, F.A.C., Termination of LEC Contracts, with changes?

RECOMMENDATION: Yes, the Commission should adopt the new rules with changes as recommended in the body of this recommendation. (MARSH)

STAFF ANALYSIS: The fresh look rules "give the consumer the opportunity to consider competitive alternatives not previously available to them and allows the consumer to realize the benefits of competition now instead of waiting for these less competitive contracts to expire." (Marek TR 13) The table below and the ensuing discussion will give a flavor for the numbers of customers that are likely to benefit from a fresh look. It is impossible to know with certainty exactly how many customers will have an opportunity to utilize a fresh look.

Eligible contracts include CSAs and tariffed term plans. A CSA is a contract service agreement. It is a private arrangement not subject to a tariff. A tariffed term plan is a long-term plan that is contained in the company's tariff. A customer who subscribes to the tariffed term plan will receive a discount from the monthly tariffed rate. The longer the contract, the greater the discount.

Although there has been a dramatic increase in CSAs and tariffed term plans since 1997 (TR 77), the evidence shows that most of these contracts are for periods of two or three years. As shown in Table 1, many of them will expire in 2000, thus negating the need for a fresh look. However, other customers could benefit from the rule. For example, BellSouth has 166 7-year tariffed term plans that will expire after 2000, some in 2004 and beyond. These customers truly are locked into long-term contracts without hope of taking advantage of competitive opportunities. There are many more customers who could benefit besides the 166 mentioned here. It appears reasonable to give ALECs the opportunity to compete for this business without having to overcome the significant termination liability inherent in many LEC contracts. Nevertheless, it should be noted that the picture painted by the ALECs of increasing numbers of customers locked in for long periods of time is not as dire as it would seem.

Table 1
Contracts Expiring by Year*

Year	2000	2001	2002	2003	2004	Post 2004
GTEFL Tariffed Term Plans	3834	1868	280	21	7	4
GTEFL CSAs	28	12	4	0	0	0
BellSouth Tariffed Term Plans	1636	715	527	289	85	53
BellSouth CSAs	64	26	20	32	2	0
Total	5562	2621	831	342	94	57
Percent	58.5%	27.6%	8.7%	3.6%	1.0%	0.6%

*Contracts executed through second quarter, 1999
Source: Staff Composite Exhibit

BellSouth alleged that competitive alternatives have existed for the services covered by these contracts for many years. (BellSouth Response Comments, pp. 1-2) Referring to CSAs, BellSouth noted that "[t]he Commission has permitted BellSouth to enter into such contracts since the 1980's in order to meet competition." (BellSouth Response Comments, p. 2) However, CSAs make up only a small portion of the contracts in question.

While competition may have existed in very limited situations, the local market for basic, switched telephony has not been open to competition since the 1980s. In the short period of time that competitive entry has been permitted, only modest inroads have been made by ALECs. As noted by KMC, "the Florida legislature's decision to open the local exchange market to competition on July 1, 1995 did not mean that the market became instantaneously competitive on that date." (KMC, post-hearing comments, p. 6)

Supra noted in its discussion of the Commission's December 1998 Report to the Legislature, *Competition in Telecommunications Markets in Florida*, "that as of July 10, 1998, only 51 Alternative Local Exchange (ALECs) were actually providing service in Florida.

The report also states that the competitors' share of the total access lines served in 1998 was approximately 1.8 percent." (Supra, post-hearing comments, p. 2) KMC explained that ". . . as of September 30, 1998. . . ALECs were serving only 1.6% of the customers in BellSouth's Florida service territory through unbundled loops or resold lines. Likewise, in GTEFL's service territory, ALECs had a 2.0% market share through resale, and no customers were being served through unbundled loops as of September 30, 1998." (KMC, post-hearing comments, p. 7)

GTEFL also discussed the extent of competition in Florida.

> In certain metropolitan areas, ALECs have captured a substantial portion of the total business access lines-for example, 10-13.99% in Orlando and 14-17.99% in nearby West Kissimmee; 10-13.99% in Melbourne; 5-6.99% in Miami and Jacksonville; and 7-9.99% in Ft. Lauderdale. Even in Reedy Creek, a population center that is much smaller but relatively near Disney World, ALECs have obtained between 5 and 6.99% of business lines (1998 Local Competition Report at 46, Table 3.4) (GTEFL post-hearing comments, p. 44)

The percentages provided by GTEFL hardly equate to widespread competition. Many customers entered into long-term contracts at a time when there were no other alternatives. The cost to terminate the contracts, absent a fresh look, may be prohibitive. Sprint agreed that contract termination penalties impose impediments "on customers who want new products and services from facilities based competitors that did not exist at the time contracts were signed." (Sprint post-hearing comments, p. 2) Although the LECs argued that the ALECs could always resell existing contracts, this avenue would not provide any benefit to the customer. KMC witness Duke argued that

> . . . the ILEC's assertions that we could always resell their long-term contracts also missed the mark. Even if we do resell a BellSouth customer's contract, for example, the customer really doesn't see the benefit of competition, because he's still locked into the same terms, conditions, and services for the duration of the contract just as if he never switched from BellSouth at all. (Duke, TR 31)

Thus, without fresh look, customers who are subject to long-term contracts will receive no benefit from competition for many years to come. The adoption of a fresh look rule would help mitigate the impediment of termination liabilities for these customers.

The changes below are recommended to help ensure that fresh look is targeted to those customers who will benefit most from it, and to implement fresh look in a way that is not unduly burdensome when weighed against the potential benefits to be received. The rules as originally proposed by the Commission are shown in Attachment 1, with the changes recommended by the staff shaded. For purposes of this recommendation, additions to the rules are shown as shaded and underlined. Recommended deletions are shown as shaded and stricken through.

Recommended Changes to the Rule

1) . . .[Contracts] that are scheduled to remain in effect for at least ~~six months~~ one year after the effective date of this rule will be contracts eligible for fresh look.

Discussion

As shown in Table 1, some 58.5% of all contracts will expire in 2000. Further, an analysis of data provided by GTEFL and BellSouth shows that a large percentage of contracts are two-year contracts. For example, of the BellSouth contracts expiring in 2000, 75% are two-year contracts. (Staff Composite Exhibit) Parties could not agree on what constitutes a long-term contract. Opinions ranged from six months to two years. (TR 18, 765, 101) Even though most of the contracts are for two years or more, and would fit even the most lengthy definition of long term, there seems little benefit to be derived from a fresh look for contracts that will expire during the one year fresh look window during which contracts are eligible for termination. As discussed below, a one-year window is recommended. Given that 5562 contracts will expire in 2000, repricing of so many contracts appears unduly burdensome.

2) Eligible contracts include, but are not limited to, Contract Service Arrangements (CSAs) and tariffed term plans in which the rate varies according to the end user's term commitment.

Discussion

Questions arose at the hearing as to whether some contracts were being excluded from fresh look because they are titled differently from CSAs and Tariffed Term Plans. KMC witness Duke remarked

> It's not clear to me in my review of what the ILECs have filed that all eligible contracts are being captured or identified by the incumbent local exchange companies. It appears that some of the participants in this docket are being very literal with their definitions, and when terms are used such as contract service arrangement, they are identifying documents that have this on the title, that say "contract service arrangement." (Duke TR 38)

Any contract that serves the same purpose as CSAs, but which has a slightly different title, should nevertheless be afforded the same treatment as other contracts that are subject to a fresh look.

> 3) The end user may exercise this provision solely for the purpose of contracting for obtaining a new contract.

The purpose of this provision is to ensure that fresh look is not used simply as a way to avoid a contract commitment. Sprint urged that "customers not have the option to artificially avoid termination liability." (Sprint posthearing comments, p. 1) Witness Poag stated that it was Sprint's intent in proposing this restriction to "avoid having current ILEC customers who do not intend to switch services, but merely intend to stop taking services, to be able to use this rule to terminate the service." (TR 119) Witness Poag further argued that there was no intent to "prohibit ILECs from competing for the business of a customer who sends a termination liability notice." (TR 119) Accordingly, a customer may use the fresh look provision to obtain service from a new provider, or to accept a better offer from the current provider.

> 4) The Fresh Look Window shall remain open for ~~two years~~ one year from the starting date of the Fresh Look Window.

Discussion

The choice of a one-year window is a compromise position suggested by Sprint. The range of choices advocated by the parties was from six months to four years. (Sprint posthearing comments, p. 3)

Parties advocating a four-year window believe it would help to ensure that competition reaches various areas, since all parts of the state will not have competitive entry at the same time. (Marek, TR 23) Sprint argued that "a four year window is unreasonable in that it would introduce unnecessary cost and uncertainty into the business operations while not providing any competitive benefits beyond a one year window." (Sprint posthearing comments, p. 1)

As previously discussed, an examination of the affected contracts as shown in Table 1 shows that 58.5% of all contracts will expire in the year 2000. An additional 27.6% will expire in 2001, leaving only 13.9% of the contracts in existence prior to the implementation of fresh look. Additionally, responses to a staff data request showed that many of the contracts were only two-year contracts. For example, 75% of BellSouth contracts that will expire in 2000 are two-year contracts. Such contracts are not of sufficient duration to warrant a four-year window. There was no evidence to show that two-year contracts will be replaced by longer contracts. Thus, all contracts expiring in 2000 and 2001, if replaced with new two-year contracts, will again expire before a four-year window closes. It appears that there will be sufficient marketing opportunities for ALECs without extending the window to four years.

One consequence of this action is that customers in areas that as yet have no competition may not have an opportunity to use fresh look. However, there is no way to predict when all areas of the state will have competitive entry. The business uncertainty spoken of by Sprint is an important factor to consider. Keeping a window open just in case competition reaches new areas will inject uncertainty into the contract process. Some customers will no doubt benefit in being allowed to opt out of contracts that were entered into when there were no other choices. However, given that most contracts will expire soon without a fresh look, the additional benefits to be derived through a longer window do not seem sufficient to warrant the uncertainty in the market that would result from a longer window.

5) The termination liability shall be calculated as follows:

(a) For tariffed term plans, the payments shall be recalculated based on the amount that would have been paid under a tariffed term plan that corresponds to the actual time the service has been subscribed to.

(b) For CSAs, the termination liability shall be limited to any unrecovered, contract specific nonrecurring costs, in an amount not to exceed the termination liability specified in the terms of the

> contract. The termination liability shall be calculated from the information contained in the contract or the workpapers supporting the contract. If a discrepancy arises between the contract and the workpapers, the contract shall be controlling. In the Statement of Termination Liability, the LEC shall specify if and how the termination liability will vary depending on the date services are disconnected pursuant to subsections (4) and (6)~~ and on the payment method selected in subsection (5)~~.

Discussion

One area of the proposed rule that could give rise to difficulties in administration is the manner in which termination charges are recalculated. FCCA proposed that there be no termination liability. FCCA witness Marek argued that such a liability "is going to be a barrier to customers who want to switch carriers, to become involved in a dispute over what is the termination liability, to have to go through a proceeding in order to figure that out." (Marek, TR 23) KMC witness Duke opined that "customers facing termination liability or disputes over how much a termination penalty they owe are going to be deterred from taking advantage of a fresh look." (TR 32)

However, allowing customers to opt out of a contract without paying anything would have an adverse impact on the ILECs. Although the ILECs have not been able to determine what the financial impact would be, nevertheless it is clear that there would be an impact, as discussed in the SERC. Certain negative aspects of calculating the termination liability could be mitigated by simplifying the mechanism through which the liability is calculated.

GTEFL pointed out that other states have adopted fresh look rules that "require repricing of the terminated contract to the shorter term (instead of payment of unrecovered nonrecurring charges.)" (GTEFL post-hearing comments, p. 4) GTEFL suggested that,

> [a]side from being relatively more reasonable and appropriate, contract repricing will be easier, less costly, and less contentious to administer than the nonrecurring cost recovery scheme in the draft rule. For instance, the question of identifying and recovering certain nonrecurring charges, which would obviously differ for each contract and customer, would not be an

> issue with term plan repricing. (GTEFL post-hearing comments, p. 28; Robinson, TR 89-90)

Contract repricing would put all parties in the same position as if the customer had originally selected a shorter term contract period. (TR 89) As shown in Table 1, the majority of contracts in question are tariffed term plans which easily lend themselves to repricing. Staff believes it is appropriate to change the rule to allow for repricing of tariffed term plans, while retaining a calculation of termination charges for CSAs which would be more difficult to reprice.

> 6) If the end user provides the Notice of Termination, the end user will ~~choose and~~ pay any termination liability in a one-time payment. ~~according to one of the following payment options:~~
>
> ~~(a) One-time payment of the unrecovered nonrecurring cost, as calculated from the contract or the work papers supporting the contract, at the time of service termination; or~~
> ~~(b) Monthly payments, over the remainder of the term specified in the now terminated contract, equal to that portion of the recurring rate which recovers the nonrecurring cost, as calculated from the contract or the work papers supporting the contract.~~

Discussion

Rule 25-4.302(5), as previously proposed, would allow the customer to pay the adjusted termination liability either in a lump sum or in monthly installments over the remainder of the term. GTEFL noted that "most rational businesses will prefer to keep their money for as long as possible, and will thus choose the monthly payment plan. Thus, the ILEC will be forced to retain in its system billing records for an entity that is no longer its customer and it will need to issue monthly bills to this former customer." (GTEFL post-hearing comments, pp. 22-29) Additionally, payment in a lump sum would be in keeping with the typical practice for such payments.

As with the calculation of termination liability, a method that puts all parties in the same position that they would have been in under a shorter contract period seems preferable to allowing payments to continue over an extended period of time which the payor is no longer a customer. For example, for a three-year contract that is being repriced to a one-year contract, the customer would have paid the amount in question already, had he opted for a one-year contract in the first place. Thus, there would be no reason to extend payment over a three-year period.

Statement of Estimated Regulatory Cost: While a new SERC was completed after the hearing, the conclusions remain the same as in the earlier SERC. With no fresh look rule in place, a LEC is entitled to collect the contract termination charges reflected in the contract or tariff when a customer chooses early termination. If the proposed fresh look rule becomes effective, a LEC will lose the revenues it would have earned from a customer who terminates early, except for the portion of those revenues associated with unrecovered nonrecurring costs. A LEC would only experience a financial loss if its unrecovered, contract-specific nonrecurring costs exceeded the termination liability specified in the controlling contract or tariff. LECs were generally unable to estimate the amount of costs, if any, they would be unable to recover since it is unknown which contracts might be terminated.

LECs would incur relatively minor administrative and labor costs to provide the Statement of Termination Liability to customers. Transactional costs for ALECs should be limited to the administrative cost of setting up new customer accounts. End-user customers should benefit from the proposed rules by having the opportunity to obtain services at lower rates with limited liability for contract termination charges.

Conclusion

There is a sufficient number of customers who could benefit from a fresh look that the adoption of a rule is warranted. However, that rule should not impose an undue burden on the ILECs to administer. The recommended changes are designed to mitigate that burden concerning contracts that will expire soon without a fresh look. Accordingly, staff recommends that the Commission adopt the new rules, with the changes recommended in the body of this recommendation.

ISSUE 3: Should the rules as adopted be filed with the Secretary of State and the docket be closed?

RECOMMENDATION: Yes. (BROWN, MARSH)

STAFF ANALYSIS: If there is no challenge to the rules within 21 days after a notice of change is published in the Florida Administrative Weekly, the rules as approved may be filed for adoption with the Secretary of State without further Commission action. The docket may then be closed.

MCB
Attachments

PART XII - FRESH LOOK

25-4.300 Scope and Definitions

25-4.301 Applicability of Fresh Look

25-4.302 Termination of LEC Contracts

25-4.300 Scope and Definitions.

(1) Scope. For the purposes of this Part, all contracts that include local telecommunications services offered over the public switched network, between LECs and end users, which were entered into prior to the effective date of this rule, that are in effect as of the effective date of this rule, and are scheduled to remain in effect for at least ~~six months~~ one year after the effective date of this rule will be contracts eligible for Fresh Look. Local telecommunications services offered over the public switched network are defined as those services which include provision of dial tone and flat-rated or message-rated usage. If an end user exercises an option to renew or a provision for automatic renewal, this constitutes a new contract for purposes of this Part, unless penalties apply if the end user elects not to exercise such option or provision. This Part does not apply to LECs which had fewer than 100,000 access lines as of July 1, 1995, and have not elected price-cap regulation. Eligible contracts include~~, but are not limited to,~~ Contract Service Arrangements (CSAs) and tariffed term plans in which the rate varies according to the end user's term

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commitment. The end user may exercise this provision solely for the purpose of obtaining a new contract.

(2) For the purposes of this Part, the definitions to the following terms apply:

(a) "Fresh Look Window"- The period of time during which LEC end users may terminate eligible contracts under the limited liability provision specified in Rule 25-4.302(3).

(b) "Notice of Intent to Terminate"- The written notice by an end user of the end user's intent to terminate an eligible contract pursuant to this rule.

(c) "Notice of Termination"- The written notice by an end user to terminate an eligible contract pursuant to this rule.

(d) "Statement of Termination Liability"- The written statement by a LEC detailing the liability pursuant to 25-4.302(3), if any, for an end user to terminate an eligible contract.

Specific Authority: 350.127(2), FS; 364.19,FS.

Law Implemented: 364.19, FS, 364.01,FS.

History: New XX-XX-XX.

25-4.301 Applicability of Fresh Look.

(1) The Fresh Look Window shall apply to all eligible contracts.

(2) The Fresh Look Window shall begin 60 days after the effective date of this rule.

(3) The Fresh Look Window shall remain open for ~~two years~~ one year from the starting date of the Fresh Look Window.

(4) An end user may only issue one Notice of Intent to Terminate during the Fresh Look Window for each eligible contract.

Specific Authority: 350.127(2), FS; 364.19,FS.

Law Implemented: 364.19, FS; 364.01,FS.

History: New XX-XX-XX.

25-4.302 Termination of LEC Contracts.

(1) Each LEC shall respond to all Fresh Look inquiries and shall designate a contact within its company to which all Fresh Look inquiries and requests should be directed.

(2) An end user may provide a written Notice of Intent to Terminate an eligible contract to the LEC during the Fresh Look Window.

(3) Within ten business days of receiving the Notice of Intent to Terminate, the LEC shall provide a written Statement of Termination Liability. The termination liability shall be limited to any unrecovered, contract specific nonrecurring costs, in an amount not to exceed the termination liability specified in the terms of the contract. The termination liability shall be calculated as follows:

(a) For tariffed term plans, the payments shall be recalculated based on the amount that would have been paid under a tariffed term plan that corresponds to the actual time the service has been subscribed to.

(b) For CSAs, the termination liability shall be limited to any unrecovered, contract specific nonrecurring costs, in an amount not to exceed the termination liability specified in the terms of the contract. The termination liability shall be calculated from the information contained in the contract or the workpapers supporting the contract. If a discrepancy arises between the contract and the workpapers, the contract shall be controlling. In the Statement of Termination Liability, the LEC shall specify if and how the termination liability will vary depending on the date services are disconnected pursuant to subsections (4) and (6) ~~and on the payment method selected in subsection (5)~~.

(4) From the date the end user receives the Statement of Termination Liability from the LEC, the end user shall have 30 days to provide a Notice of Termination. If the end user does not provide a Notice of Termination within 30 days, the eligible contract shall remain in effect.

(5) If the end user provides the Notice of Termination, the end user will ~~choose and~~ pay any termination liability in a one-time payment. ~~according to one of the following payment options:~~

~~(a) One-time payment of the unrecovered nonrecurring cost, as calculated from the contract or the work papers supporting the contract, at the time of service termination; or~~

~~(b) Monthly payments, over the remainder of the term specified in the now terminated contract, equal to that portion of the recurring rate which recovers the nonrecurring cost, as calculated from the contract or the work papers supporting the contract.~~

(6) The LEC shall have 30 days to terminate the subject services from the date the LEC receives the Notice of Termination.

Specific Authority: 350.127(2), FS; 364.19, FS.

Law Implemented: 364.19, FS; 364.01,FS.

History: New XX-XX-XX.

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MEMORANDUM

September 13, 1999

99 SEP 13 PM 4:24

TO: DIVISION OF APPEALS (BROWN)

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (HEWITT) (CBH DM JS

SUBJECT: REVISED STATEMENT OF ESTIMATED REGULATORY COST FOR PROPOSED RULES: 25-4.300, F.A.C., SCOPE AND DEFINITIONS; 25-4.301, F.A.C., APPLICABILITY OF FRESH LOOK; 25-4.302, F.A.C., TERMINATION OF LEC CONTRACTS. DOCKET NO. 980253-TX.

SUMMARY OF THE RULES

There are no existing Commission rules governing contract service arrangements (CSAs), tariffed term plans, or "Fresh Look." Presently, Commission Orders permit incumbent local exchange companies (ILECs) to offer special contract service arrangements for those services which are susceptible to uneconomic bypass by competitors. That is, when a competitor is able to offer the service at a price lower than the ILEC's tariffed rates, but above the ILEC's incremental costs, the ILEC may provide the customer with a CSA. A customer who enters into a CSA may be required to pay a termination charge if he terminates the contract prior to the date the contract is scheduled to expire. Termination charges vary according to each contract. Tariffed term plans, in which the rate varies according to the term of commitment, also typically include termination charges. The initial proposed rules went to a hearing by the Commission and the latest version of the proposed rules reflect consideration of that input and of post-hearing filings.

The proposed rules would provide a "Fresh Look Window" or period of time during which ILEC customers may terminate a tariffed term plan or CSA with limited liability. The customer's termination liability would be limited to any unrecovered, contract-specific, nonrecurring costs, in an amount not to exceed the termination liability specified in the terms of the contract. The Fresh Look Window would begin 60 days after the effective date of the proposed rule and remain open for one year from the effective date of the rule. All contracts between ILECs and end users that include local telecommunications services offered over the public switched network would be eligible for early termination (provided such contracts were entered into prior to the effective date, are in effect as of the effective date of the proposed rule, and are scheduled to remain in effect for at least one year after the effective date of the proposed rule).

ESTIMATED NUMBER OF ENTITIES REQUIRED TO COMPLY AND GENERAL DESCRIPTION OF INDIVIDUALS AFFECTED

ILECs with 100,000 or more access lines or under price-cap regulation would be required to comply with the proposed rules. All but two of the ten ILECs operating in Florida meet this definition, The proposed rules do not apply to ILECs which had fewer than 100,000 access lines as of July 1, 1995 and have not elected price-cap regulation.

Over 200 ALECs are certified to operate in Florida. About 40 of those ALECs are known to provide the type of service (dial tone and flat-rated or message-rated usage) that could be competitive with ILEC contract service arrangements or tariffed term plans. However, if the proposed rules become effective, it would make a new pool of potential customers available to competitive providers, possibly resulting in an increase in the number of ALECs providing such services.

Customers with accounts which are priced under a CSA or tariffed term plan would be directly affected by the proposed rule, provided they entered into the contract prior to the effective date of the rule, and the contract does not expire for at least one year after the rule becomes effective. There were approximately 7,199 accounts eligible under the original proposed rules (published in FAW, April 2, 1999), according to information staff received from the three large ILECs. BellSouth reported 1,640 accounts, GTE reported 2,759, and Sprint reported 2,800 (approximately 40% of Sprint's accounts are with governmental agencies).

RULE IMPLEMENTATION AND ENFORCEMENT COST AND IMPACT ON REVENUES FOR THE AGENCY AND OTHER STATE AND LOCAL GOVERNMENT ENTITIES

The Public Service Commission and other local government entities are not expected to experience implementation costs other than the costs associated with promulgating a proposed rule. The Commission should experience little direct cost for publicizing the proposed rule, because it is expected that customers will learn about the "Fresh Look" opportunity through the marketing efforts of ALECs. Commission staff may be called upon to resolve disputes over contract eligibility, the amount of the termination liability, and other related matters, but these should be able to be handled with existing staff.

Enforcement costs for the Commission could vary, depending upon whether a complaint is handled formally or informally (undocketed). Undocketed complaints generally consume fewer Commission resources than formal docketed complaints. The Division of Communications has resolved similar complaints informally in the past. However, it is not currently known how many, if any, Fresh Look complaints the Commission may receive, nor how many would require resolution through formal proceedings.

The proposed rule may benefit the Commission and other state and local government entities if it results in their being able to renegotiate existing telecommunications contracts at lower rates. Local governments holding ALEC certificates are expected to face compliance costs that are similar to those reported by other ALECs (negligible). They could also be expected to gain the same type of benefits (competitive opportunities) as other ALECs.

ESTIMATED TRANSACTIONAL COSTS
TO INDIVIDUALS AND ENTITIES

Contract Termination

Staff asked the three large ILECs to estimate the amount of contract termination charges that would not be recoverable under the proposed rule if all eligible contracts were terminated on December 31, 1998. The purpose of this question was to determine transactional costs under a "worst-case" scenario. Certainly, there is no expectation that all eligible contracts would be terminated, much less, that they would all be terminated on a given day. Also, it is likely that another year will have passed before the effective date of the rule.

BellSouth currently serves approximately 1,640 eligible contracts (primarily ESSX) whose average contract termination charges are $10,000 per system. This would result in a maximum of $16,400,000 being potentially unrecoverable, according to BellSouth, assuming that no unrecovered, nonrecurring costs exist. It is staff's understanding that BellSouth is unsure at this time what part of the $16.4 million (if any) it could recover under the proposed rule.

GTEFL serves approximately 2,759 eligible contracts (primarily Centranet). Using staff's worst-case scenario, GTEFL estimates that approximately $3,674,000 in termination charges would potentially not be recoverable under the proposed rule. The $3,674,000 figure provided by GTEFL assumes that GTEFL would not be able to recover any of the termination charges on any of the accounts.

Sprint-Florida serves approximately 2,800 eligible contracts (primarily Centrex). About 40% of those contracts are government accounts. Sprint-Florida estimates that in excess of $4,000,000 would not be recoverable if all contract holders terminated their contracts on a given day.

If a customer chooses to terminate a contract under the proposed rule, an ILEC would certainly lose the revenues it would have earned from that customer had he not terminated his contract. However, the ILEC's unrecovered, nonrecurring costs would be covered, assuming that the ILEC has designed its contracts to recover any nonrecurring costs it incurred to serve the customer. The nonrecurring costs may be recovered through installation charges that were required to be paid in advance, a portion of the monthly charges already collected, termination charges, or a combination of the three methods. The proposed rule requires the customer to pay the ILEC an amount equal to any unrecovered, contract-specific, nonrecurring costs that do not exceed the termination liability specified in the contract being terminated. Therefore, if the proposed rule becomes effective and a customer chooses to terminate an eligible contract, the ILEC will be able to recover any outstanding nonrecurring costs of providing service.

Implementation

ILECs would incur administrative costs to provide the Statement of Termination Liability to customers. Sprint-Florida does not believe such costs would be significant. GTEFL also stated compliance costs would be relatively minor. However, GTEFL pointed out that additional labor costs could be incurred to determine the unrecovered, nonrecurring costs. BellSouth estimates labor and equipment cost totaling $239,247 to implement the proposed rule.

Transactional costs for ALECs should be limited to the administrative cost of setting up new customer accounts, which should be offset by new revenues. End-user customers should benefit from the proposed rules by having the opportunity to obtain services at lower rates with limited liability for contract termination charges.

IMPACT ON SMALL BUSINESSES, SMALL CITIES, OR SMALL COUNTIES

ALECS that are small businesses could benefit from the proposed rules by having the opportunity to increase their customer base. Small businesses, small cities, and small counties could benefit from the proposed rules by having the opportunity to obtain service which is more attractive in terms of functionality, features, or price than would otherwise be available under their current ILEC contract or tariffed term plan.

REASONABLE ALTERNATIVE METHODS

No Rule

The alternative of no rule is advocated by BellSouth and GTEFL. Both companies believe no rule is necessary, as the marketplace is effectively competitive. However, no evidence was provided to substantiate this. Collectively, ALECs serve only 1.8% of the total access lines in Florida, according to the most recent survey conducted by the Division of Communications staff in its 1998 report on competition.

When to Open and Close Window

According to the proposed rule, the Fresh Look Window (window) would begin 60 days after the effective date of the rule and remain open for one year. Several respondents stated opinions about how long the window should remain open. BellSouth believes the window should only remain open for three to six months. However, three to six months may not provide a sufficient opportunity for competitors to educate customers. Customers need a sufficient amount of time to evaluate their options, make choices, and have the changes implemented. In addition, three to six months may not be long enough for the market to experience lasting competitive benefits.

MCI, Intermedia, Florida Competitive Carriers Association (FCCA), and Time Warner, all believe the window should be open longer. Several respondents suggested the fresh look window should not open until there is some proof that customers will actually have choices. Sprint Communications Company Limited Partnership (Sprint) suggested the window be opened on the date the Federal Communications Commission (FCC) or the courts authorize BellSouth to provide interLATA services, and that the window remain open for six months. MCI suggested opening the window concurrent with the date long-term local number portability is implemented, and leaving the window open for three years. There are some benefits to opening the window later or tying the opening of the window to a date that marks a change in the competitive environment. More providers would be available to compete for customers in a wider area. On the other hand, opening the window later would mean customers committed to long term contracts would be delayed in receiving benefits they could otherwise gain by terminating their contracts earlier.

Setting a fixed, one-year period as the length of time the window should remain open may mean lower administrative and implementation costs to both the Commission and ILECs, as these costs would be confined to a finite time period. If the window were permitted to open at different times for different customers, depending upon factors in a particular service area, the period of time during which the Commission must monitor these events and resolve any disputes is lengthened and costs for both the Commission and ILECs may increase as a result. Those who believe the opening of the window should be tied to demonstrated competition in a specific area would argue that there is no point in having a Fresh Look window if no competitive alternatives exist. On the other hand, the opening of the Fresh Look window itself may bring competition to the area.

Eligible Contracts

The proposed rule would limit eligible contracts to those which were entered into prior to the effective date of the rule, and are scheduled to remain in effect one year after the rule's effective date.

Alternatives to the effective date were suggested by several parties. Sprint suggested that contracts entered into from August 8, 1996, through the date of effective competition (date BellSouth is authorized to provide interLATA services) be termed eligible. FCCA, Intermedia, and MCI believe contracts entered into prior to January 1, 1999, should be eligible. The difficulty is establishing when, and to what degree, competition exists.

Tariffed services are often substantially discounted when individually priced under a CSA. Due, in part, to concerns about anti-competitive behavior, ILECs are required to file quarterly reports with the Commission reflecting the number of new contract service arrangements provided.[1] A brief review of these reports shows the number of new CSAs provided annually more than quadrupled for BellSouth from 1994 to 1997. For Sprint, the number of new CSAs provided

[1] Not all the CSAs contained in these reports would be eligible contracts under the proposed rule.

annually also increased, doubling from 1994 to 1997 (combined quarterly reports of Centel and United). For GTE, the number of new CSAs provided annually increased from 1994 to 1995, but by 1997 showed a 77% decrease from 1994 levels. The following table lists the number of new CSAs provided by each of the large LECs each year from 1984 through the second quarter of 1998.

New Contract Service Arrangements Provided

	84	*85*	*86*	*87*	*88*	*89*	*90*	*91*	*92*	*93*	*94*	*95*	*96*	*97*	*2/98*
GTE	0	0	0	1	3	2	1	4	3	8	13	16	14	3	*
SBT	0	7	6	18	43	15	27	15	17	47	41	12	79	238	135
SPRINT	0	0	0	0	0	0	0	0	40	17	5	1	1	10	*

****unavailable***

Source: Numbers for 1984-1994 from Order No. PSC-95-0926-FOF-TL, remaining numbers from CSA Quarterly Reports. Numbers for United Telephone Company and Centel Telephone Company have been combined under Sprint.

One reason for the increase in the number of new CSAs could be that more customers are receiving offers from competitors. Therefore, rather than lose these customers, the ILEC responds by offering to meet the customer's needs through a contract service arrangement. Another reason more new CSAs are offered each year may be that the number of tariffed services for which the Commission has granted CSA authority has increased over the past fourteen years.

Termination Liability

The proposed rule limits the customer's termination liability to unrecovered, nonrecurring costs which do not exceed the termination liability specified in the terms of the contract. The FCCA suggests ILECs should only be allowed to recover the costs of any special construction arrangements that were additional or unplanned construction specifically to serve a user. However, limiting cost recovery to additional or unplanned construction would not permit ILECs to recover the legitimate, nonrecurring costs reflected in the work papers supporting the contract.

Time Warner expressed concern that some customers would be discouraged from taking advantage of the Fresh Look Window if they were required to make a large lump-sum payment in order to terminate a contract. Time Warner suggested permitting customers to pay the unrecovered, nonrecurring costs over time, as ILECs presently recover such costs over the term of the contract. This alternative was considered, but since the contractual time would be shortened, the ILECs should be able to recover their already incurred, unrecovered, unrecurring costs with termination of the contract.

cc: Sally Simmons, CMU
Frlok3.cbh