

## BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of AT&T Communications	)	DOCKET NO. 870347-TI
of the Southern States for Commission	)	ORDER NO. 23997
forbearance from Rule 25-24.495(1) and	)	ISSUED: 1-16-91
25-24.480(1)(b), F.A.C. for a trial	)	
period.	)	

The following Commissioners participated in the disposition of this matter:

MICHAEL McK. WILSON, Chairman  
 THOMAS M. BEARD  
 BETTY EASLEY  
 GERALD L. GUNTER  
 FRANK S. MESSERSMITH

NOTICE OF PROPOSED AGENCY ACTION

ORDER EXTENDING FORBEARANCE EXPERIMENT  
FOR AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.  
WITH CERTAIN CONDITIONS

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are adversely affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

I. The Forbearance Experiment

By Order No. 19758, issued August 3, 1988, this Commission granted AT&T Communications of the Southern States, Inc., (ATT-C) forbearance from rate base regulation for a trial period of two years. This two year period ended on July 10, 1990. However, by Order No. 23186 we extended the experiment through December 31, 1990, to enable us to gather a full two years data on which to evaluate the success of the forbearance experiment. Also, on June 8, 1990, ATT-C filed a Petition for Further Relaxation of Regulation. ATT-C requested in its Petition that we permanently forbear from rate of return regulation in its regard and that we relieve ATT-C from all rules, regulations, orders or other regulatory requirements which do not apply to all other interexchange carriers (IXCs). We have now gathered the necessary two full years of data and we may now evaluate the experiment.

DOCUMENT NUMBER-DATE

00524 JAN 16 1991

ISS. RECORDS/REPORTING

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 2

It is first important to set out the basis for our decision in July 1988 to grant ATT-C's original petition for forbearance from rate base regulation with certain modifications. That decision represented a major shift in our regulatory policy toward ATT-C. Prior to that decision, our regulatory policy permitted the application of principles of traditional rate base regulation to ATT-C, although we have never fully rate base regulated ATT-C.

Ever since divestiture, the Florida intrastate interexchange market structure has been in a process of transition from one historically characterized as a monopoly to one for which there is evidence that some competition exists. Although traditional rate base regulation is generally considered appropriate under a monopoly market structure, it is not widely viewed as the most appropriate type of regulation when effective competition is present. This is primarily because it does not provide incentives for the regulated company to be efficient, innovative, or to introduce new services.

In Order No. 19758 we set out specific goals we hoped the forbearance experiment would achieve, including ensuring that all customers in the State of Florida have adequate long distance service, that long distance service is provided at statewide average rates that are just, reasonable, and fair, that all customers in the State of Florida have access to new services, and that competition in the long distance market is encouraged.

In order to evaluate the success of the forbearance experiment in achieving those goals, we identified criteria focusing on the long distance market in general, as well as criteria specific to ATT-C. To evaluate the general long distance market and ATT-C's relationship to this market, we must examine ATT-C's market share, earnings, and quality of service, as well as the carrier and service alternatives to ATT-C, and the extent of competition in the interexchange market in general. In addition, we must examine ATT-C's marketplace activities, including ATT-C's provision of new services to the Florida market, ATT-C's activities in improving its operating efficiency, and ATT-C's pricing of services.

Our intent in approving forbearance in July 1988 was to test the interexchange market over a trial period to determine if it was sufficiently competitive to regulate ATT-C's earnings and provide incentives for ATT-C to introduce new services and exercise management efficiency. Over the past two years we have received

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 3

four semi-annual reports from ATT-C providing data to track the progress of the forbearance experiment. We have analyzed data submitted by ATT-C and from the local exchange carriers (LECs) in Florida, as well as data from outside sources such as the Federal Communications Commission, and numerous articles and reports. A great deal of information was also derived from Effective Competition written by a member of our staff, Barry Huddleston, and published in August 1990.

## II. The Forbearance Experiment Achieving Its Goals

Based on our review of all of the criteria set forth in Order No. 19758, we have concluded that the forbearance experiment has, up to this point, moved toward the regulatory goals it was intended to achieve. ATT-C's market share is an indicator of the level of competition it is experiencing in the interexchange market. Based on LEC-reported originating switched access minutes of use, ATT-C experienced an accelerating decline in its intrastate switched access market share between June 1988 and June 1990. The Company lost 15 percentage points, reducing its market share from a high of 77% down to 62% at the end of the two year period. The Company's daytime share fell 21 percentage points for the two year period, while its evening and night/weekend usage for the same period declined 11% each.

Reviewing the earnings criterion, the most recent surveillance report filed by ATT-C for the 12 month period ending June 1990 indicates an achieved return on equity (ROE) of 25.48%. This ROE is slightly less than the 26.86% achieved ROE reflected in ATT-C's December 1989 surveillance report, but much higher than the 11.43% reported in the Company's December 1988 report. Several factors may have contributed to the Company's increased earnings. The Company has introduced several new services. The Company's expenses, excluding access and depreciation, have continued to decline, possibly indicating that the Company may be experiencing efficiency gains. Also, it is clear that ATT-C continues to reap the benefit of a growing market. Firms competing in a non-regulated market tend to experience higher earnings during times of economic expansion and lower earnings during times of economic contraction. Because Florida has been in a period of expansion during the forbearance time frame, it is difficult to determine if the Company's earnings will continue to improve.

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 4

Regarding carrier and service alternatives to ATT-C, there are ten facilities-based carriers operating in Florida, as well as 54 certificated IXCs that reported revenues for 1989. Therefore, it is clear that there are carrier and service alternatives to ATT-C in Florida.

According to our Service Evaluation Bureau, ATT-C's service quality exceeds our Commission quality of service standards. These service standards include a 95% completion rate of attempted calls, transmission standards, and billing accuracy standards. Based on our Consumer Affairs Division, ATT-C has a considerably smaller percentage of complaints per customer than US Sprint, Telus and MCI. Also, ATT-C reacts more promptly to complaints than most other carriers, usually by the day following notification. Therefore, it appears that ATT-C is working to ensure that its customers are provided with a satisfactory level of service quality.

Regarding the extent of competition, the most widely used statistic for determining the extent of market power as opposed to monopoly power in a given market is the market concentration ratio. The most prevalent variant of this statistic is the four-firm concentration ratio--the percentage of total industry sales, or other unit of measure, realized by the leading four firms in the industry. For this analysis, the Florida ratios are based on IXC intrastate revenues reported by certificated Florida IXCs for purposes of calculating Florida regulatory assessment fees. Little change has occurred in this ratio for the period 1985 to 1989. The top four firms have maintained approximately 85% of the intrastate toll market for the four year period.

The Department of Justice (DOJ) utilizes the Herfindahl-Hirschman Index (HHI), another commonly used measure of concentration, to specify treatment of proposed mergers. When the industry contains but one firm, indicative of a monopoly, the index attains its maximum value of 10,000. The index' value declines with increases in the number of firms, and increases with rising market share inequality among any given number of firms. The DOJ guidelines state that HHIs below 1000 points are considered to be indicative of unconcentrated industries with implicit or explicit collusion likely to be difficult.

As is the case in estimating the four-firm ratio, the HHI is based on intrastate revenue data gathered from the

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 5

telecommunications company regulatory assessment fee filings. Unfortunately, these filings are not detailed enough to allow useful breakdown of the revenues into specific individual service offerings. Rather, they merely permit the revenue categories to be separated into intrastate and intrastate plus interstate revenues. With HHIs above 1800, markets are considered highly concentrated, with any additional concentration resulting from merger activity a matter of significant competitive concern. High HHIs have been calculated for the years 1985 through 1989--6633 in 1985, 5852 in 1986, 5115 in 1987, 4674 in 1988, and 3969 in 1989. Although still well above the 1800 level, the HHI figure for ATT-C is steadily falling although at a declining rate. In addition, the industry is characterized by a dominant firm--a firm above the 35% market share per DOJ guidelines. ATT-C's 1989 market share remains above 60% of all intrastate toll revenues. ATT-C's market share has been declining from approximately 81% in 1985 to slightly above 63% in 1989, while, at the same time, other large IXCs have shown significant percentage increases in market shares.

Forbearance was intended to encourage ATT-C to introduce new services, to manage its operations more efficiently, and to price its services competitively, while still covering costs, as well as to lower prices on those services that have a high margin of profit. ATT-C did, in fact, introduce several new services in Florida during the two year forbearance trial. ATT-C also states that, during the forbearance period, it offered several services or changed existing services to respond to customer needs.

Utilizing an incremental cost methodology, ATT-C estimated costs for several of its services. Once these costs were established, the Company increased the rates for many of its services to ensure that they were covering costs and providing at least a small contribution. These services had been priced before or during divestiture and were not priced to cover costs, but were priced instead for reasons related to the public interest. In examining its service costs, the Company found three areas to be especially deficient in terms of revenues recovering costs. These were evening and night/weekend Message Toll Services (MTS) rates, Directory Assistance charges, and charges for operator assisted conference calls. The Company proposed and we approved increases for each of these services.

While ATT-C has flowed through rate reductions in response to BHMOC reductions by both Southern Bell Telephone and Telegraph

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 6

Company (SBT) and GTE Florida, Inc. (GTEFL), competition is forcing other pricing behavior changes. ATT-C has stated that it is confronted with increasing competition and is responding to this competitive pressure in both the residential and business markets. The Company is becoming more aggressive in the residential market by offering residential WATS type services, such as ReachOut. In addition, the Company introduced its first voluntary MTS rate reduction in December 1989, to become effective in January 1990. In the business market, ATT-C has also responded to competition by reducing rates for Megacom WATS/800, SDN, 800 Readyline, and ASDS.

With the exception of price reductions in response to declines in BHMOC charges levied by the LECs, ATT-C has lowered the rates on Megacom Wats/800, SDN, 800 Readyline, Accunet T1.5, Channel Services, at least once during the forbearance period. In the majority of these cases, ATT-C states that rates were lowered in response to competitive pressures. ATT-C also introduced several enhancements to these services or add-ons to the interstate tariffs which, ATT-C states, were in response to competition or customer demand.

An examination of supply capabilities of the competitors, including a review of the services provided, supply elasticity, and technological capabilities of the system, allows one to make an assessment of the level of competition in the interexchange market. Immediately following divestiture ATT-C offered considerably more services than its competitors. The offerings in 1990 by these companies are virtually the same. Supply elasticity, the ability of competitors to meet additional demand, also provides some insight into the competitiveness of a market. A number of IXCs, including MCI and Sprint, have engaged in intensive capital investment programs that should allow them to operate on a cost effective basis well into the future, but which also vastly expand their supply capacity. At the national level, ATT-C now owns about 38% of all IXC fiber optic route miles. It appears that ATT-C's competitors now have so much transmission capacity that they could handle additional traffic with ease and with relatively little additional investment.

In addition, technological advances are increasing the capacity of fiber enabling the companies to increase their transport capacity without adding additional fiber. Optical systems of the late 1970's were capable of transmitting at the rate of 45 megabits per second or 672 voice channels per fiber. Present

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 7

systems routinely operate at 565 megabits per second, accommodating 8064 voice channels with greater expansions projected for the future.

Having been the primary carrier prior to divestiture, ATT-C had little inclination to make large scale improvements to its system. Since divestiture and the influx of competitors, ATT-C has acted to improve its system. However, ATT-C's competitors, and in particular MCI and Sprint, as new entrants to the market, have been installing the latest technology, not out of choice but because outdated equipment has not been available. On the other hand, ATT-C was slow to replace existing equipment for economic reasons: immediately following divestiture, putting the Company at somewhat of a disadvantage to its competitors in this area.

Florida's LECs have been upgrading their systems to accommodate other carriers with the same quality access facilities as that enjoyed by ATT-C. In August 31, 1990, for the total state, 96.4% of the offices were capable of being converted. On this same date, 95.3% of those central offices capable of being converted, had been converted. It is projected that by December 31, 1990, 97.4% of the central offices will be made capable of conversion and 95.3% will be converted. With the exception of United, the largest LECs are already 100% converted.

Based on our foregoing evaluation of all of the criteria set out in Order No. 19758, we have determined that the forbearance experiment has moved towards achieving its goals.

### III. Forbearance Experiment Extended With Certain Conditions

As stated above, in Order No. 19758, we set forth several goals we hoped would be achieved through our modification of this Commission's regulation of ATT-C. Based upon the number of providers in the IXC market and the quality and quantity of services available, we find that the people of Florida are being provided adequate long distance service at just, reasonable, and fair rates. We also expect that the current service will be further improved due to increasing competition in the long distance market and, in particular, increasing competition in those service offerings aimed at the middle to large business customer.

Although ATT-C's ROE suggests that its rates may be high, we are concerned that lowering the Company's rates to a return

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 8

appropriate for a LEC could force the Company's smaller competitors out of business, resulting in decreased competition for ATT-C. At this time, the other carriers are managing to capture increasing amounts of market share with rates at current levels. Because there is evidence that the carriers base their MTS rates on those established by ATT-C, one can conclude that they also are finding these rate levels profitable. However, it is expected that over time, as these smaller IXCs continue to erode ATT-C's market, ATT-C will respond by lowering its rates, and the rates and ATT-C's ROE will fall.

We are faced with a choice of returning to rate base regulation and possibly decreasing competition by lowering rates or leaving rates at their present level and accepting the possibility that ATT-C may continue to earn an ROE higher than regulated monopoly LECs, at least for a while. Given this dilemma, we find the former the least reasonable option. Enforcing a decrease in rates may actually encourage an oligopoly to evolve as the larger companies swallow up the smaller companies who cannot weather a long term decreased earnings situation. While the ultimate goal of regulation is to allow the formation of a competitive market, and while an oligopoly may be an improvement over monopoly, an oligopoly cannot be construed as competition.

We believe ATT-C recognizes that it is being confronted with increasing competition and is positioning itself, by introducing new services and enhancing its existing services, to function in this progressively competitive market. It certainly appears that ATT-C's market share has eroded and that ATT-C's competitors have reasonable financial strength, are providing quality service to these customers via advanced and sizable networks, and that their service offerings parallel those offered by ATT-C. Thus, based on the limited data that can be gathered during a two year period, we find that the regulatory goals of forbearance are gradually being realized.

Therefore, we find the time is right to further relax our regulation of ATT-C. However, we are not approving ATT-C's Petition as filed. Certain modifications are appropriate because ATT-C is still a formidable power in the interexchange marketplace and is unique in its role as carrier of last resort.

In addition, the two year experimental period that we are evaluating here transcended a period of expansion in the Florida



ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 9

economy. Firms, in general, show positive results during these times. It is likely that the economy will experience a downturn in the coming two and one-half years. By extending this forbearance experiment, with the modifications further relaxing our regulation, we will be able to obtain data on market performance by competitors in this type of environment and thus, perform a more thorough analyses of the experiment. Therefore, we find it appropriate to extend the forbearance experiment for a two and one-half year period under the following conditions:

1. ATT-C shall continue to be the carrier of last resort; ATT-C shall not withdraw from providing MTS service anywhere in Florida without prior Commission approval;
2. ATT-C shall continue to charge statewide average rates on MTS services only;
3. ATT-C shall flow through switched access charge reductions based on minutes of use for all services that utilize switched access;
4. ATT-C shall continue to file Florida-specific annual reports;
5. There shall be no rate caps or floors on any ATT-C services;
6. As we currently do for the rate changes of all other IXCs, ATT-C's rate changes will be monitored through tariff filings; ATT-C is directed to work with our Staff to develop a computerized tracking system and to file a copy of all tariff changes on electronic media in the format so developed; and
7. ATT-C shall not be required to file cost support data for customer specific contracts, as is true of all other IXCs.

It is our intent generally to exercise the same degree of regulatory oversight over ATT-C that we exercise over the other interexchange carriers in Florida, with the specific exceptions noted above. ATT-C's tariff filings will be considered presumptively valid, as is true of those of the other interexchange carriers. We will not vote to approve or deny ATT-C's tariff

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 10

filings as we have in the past, but will monitor those filings in the same fashion in which we review such filings of the other interexchange carriers.

We find it appropriate, in addition to the rule waivers already granted when the forbearance experiment was first established, to also grant ATT-C's request that we waive Rule 25-24.475(1)(b), Florida Administrative Code, which requires the filing of maintenance and service reports. ATT-C also requests that we waive Rule 25-24.485(4)(d) and (e), Florida Administrative Code, which requires tariff backup data. We find it appropriate to waive Rule 25-24.485(4)(d) and (e), Florida Administrative Code, since all tariff filings will be considered presumptively valid and no other IXC must file this backup data. We also find it appropriate to grant ATT-C's request for waiver of Rule 25-4.0245, Florida Administrative Code, which requires the filing of surveillance reports. However, we will not grant ATT-C's request for waiver of Rule 25-24.480(1)(b), specifically referring to Rules 25-4.0166, 25-4.017, and 25-4.0174, Florida Administrative Code, which require ATT-C to follow the Uniform System of Accounts, and Rule 25-4.018 which requires ATT-C to file annual reports.

The effect of our foregoing decisions is to approve, with modifications, ATT-C's Petition for Further Relaxation of Regulation. At the end of the two and one-half years period, we will revisit our method of regulation of ATT-C. During the period January 1, 1993, to June 30, 1993, our Staff shall evaluate and analyze data for the two year period from January 1, 1991, through December 31, 1992. Prior to June 30, 1993, our Staff shall present a recommendation to us based upon their analysis of this data. At that time, we will take the appropriate action.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that this Commission's forbearance from rate base regulation of AT&T Communications of the Southern States, Inc., is hereby extended for the next two and one-half year period, beginning January 1, 1991, and ending June 30, 1993, with the conditions set forth herein. It is further

ORDERED that ATT-C's Petition for Further Relaxation of Regulation is hereby approved with modifications. It is further

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 11

ORDERED that this docket shall remain open to evaluate this extension of the forbearance experiment at the end of the two and one-half year period. It is further

ORDERED that ATT-C shall work with our staff to develop a computerized tracking system for tariff changes and ATT-C shall file all tariff changes on electronic media in such format. It is further

ORDERED that ATT-C shall continue to be the carrier of last resort. ATT-C shall not withdraw from providing MTS service anywhere in Florida without prior Commission approval. It is further

ORDERED that ATT-C shall continue to utilize statewide average rates. It is further

ORDERED that ATT-C shall flow through switched access charge reductions based on minutes of use for all services utilizing switched access. It is further

ORDERED that ATT-C shall continue to file Florida-specific annual reports. It is further

ORDERED that there shall be no rates caps or floors on any ATT-C services. It is further

ORDERED that ATT-C will not be required to file cost support data for customer specific tariffs. It is further

ORDERED that all rule waivers granted by Order No. 19758, which initially established the forbearance experiment, are hereby extended for the duration of this two and one-half year period. It is further

ORDERED that ATT-C's additional request for waiver of Rules 25-24.475(1)(b), 25-24.485(4)(d) and (e), and 25-4.0245 is hereby granted to the extent set forth herein. It is further

ORDERED that the provisions of this Order are issued as proposed agency action and shall become final unless a petition in the form required by Rule 25-22.036, Florida Administrative Code, is received by the Director of the Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee,

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 12

Florida 32399-0870, by the close of business on the date set out in the Notice of Further Proceedings below. It is further

ORDERED that this docket shall remain open to review the results of the two and one-half year extension of the forbearance period ordered herein.

By ORDER of the Florida Public Service Commission, this  
16th day of JANUARY, 1991.

  
\_\_\_\_\_  
STEVE TRIBBLE, Director  
Division of Records and Reporting

( S E A L )

SFS

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-

ORDER NO. 23997  
DOCKET NO. 870347-TI  
PAGE 13

22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on

February 6, 1991.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party adversely affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.