COMPETITION IN TELECOMMUNICATIONS MARKETS IN FLORIDA

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LIST OF EXHIBITS

LIST OF ACRONYMS

AAV	Alternative Access Vendor (see also CAP)
ALEC	Alternative Local Exchange Company (see also CLEC)
AOS	Alternative Operator Services
AT&T	American Telephone & Telegraph Company
B1	Business Access Line
BOC	Bell Operating Company
CAGR	Compound Annual Growth Rate
CAP	Competitive Access Provider (see also AAV)
CATV	Cable Television Service
CLEC	Competitive Local Exchange Company (see also ALEC)
CO	Central Office
COLR	Carrier of Last Resort
CPE	Customer Premises Equipment
DBS	Digital Broadcast System
DOJ	Department of Justice
DTMF	Dual Tone Multifrequency (Touch Dialing)
EAS	Extended Area Service
ETC	Eligible Telecommunications Carrier
FCC	Federal Communications Commission
FPSC	Florida Public Service Commission
GTEFL	GTE Florida, Inc.
GTELD	GTE Long Distance
ICI	Intermedia Communications of Florida, Inc.
ISP	Internet Service Provider
IXC	Interexchange Carrier
LATA	Local Access And Transport Area
LEC	Incumbent Local Exchange Company
MABC	Modified Access Based Compensation
MAs	Mergers and Acquisitions

MFJ . . . . . Modification of Final Judgment
MFS . . . . . Metropolitan Fiber Systems
MOU . . . . . Minute of Use
MSA . . . . . Metropolitan Statistical Area
MTS . . . . . Message Toll Service
MTSO . . . . . Mobile Telephone Switching Office
NARUC . . . . . National Association of Regulatory Utility Commissioners
NECA . . . . . National Exchange Carrier Association, Inc.
NOI . . . . . Notice of Inquiry
NPAT . . . . . Non-LEC Pay Telephone Service Provider
NPRM . . . . . Notice of Proposed Rulemaking
NXX . . . . . End Office Code
OSP . . . . . Operator Service Provider
OSS . . . . . Operational Support System
PATS . . . . . Pay Telephone Service Provider
PBX . . . . . Private Branch Exchange
PCS . . . . . Personal Communications Systems
PSC . . . . . Florida Public Service Commission
PSP . . . . . Payphone Service Provider
R1 . . . . . Residential Access Line
RBOC . . . . . Regional Bell Operating Company
ROR . . . . . Rate of Return
SMNI . . . . . Sprint Metropolitan Networks, Inc.
STS . . . . . Shared Tenant Services
TA 96 . . . . . Telecommunications Act of 1996
TELRIC . . . . . Total Element Long Run Incremental Cost
TSLRIC . . . . . Total Service Long Run Incremental Cost
UNE . . . . . Unbundled Network Element
US . . . . . Universal Service
xDSL . . . . . Digital Subscriber Line

EXECUTIVE SUMMARY

- This report on the status of competition in Florida's telecommunications markets is being submitted in compliance with Section 364.386(1), Florida Statutes. In addition, Section 364.051(3)(a), Florida Statutes, requires the Commission to report this year on the status of local competition and recommend on an exchange by exchange basis whether or not there is a need to extend price caps for basic local telecommunications service, or whether there is some other means, excluding rate of return regulation, to ensure reasonable and affordable rates for basic local telecommunications service. Both statutory requirements are addressed in this report.
- The two events which significantly impacted the role of the Florida Public Service Commission (FPSC) in overseeing the telecommunications industry were passage of: 1) 1995 amendments to Chapter 364, Florida Statutes, and 2) the federal Telecommunications Act of 1996 (TA 96).
- The ongoing implementation of TA 96 continues to have significant effects on Florida. While some issues have been initially addressed by the courts, such as the state commissions' appeal of the FCC Interconnection Order, others have not. In its opinion filed on July 18, 1997, the United States Court of Appeals for the Eight Circuit found that the FCC has no express authority under TA 96 to issue local pricing rules. Universal service, access charge reform, and price cap reform have several facets which remain to be implemented or resolved, and are subject to court challenges.
- The FPSC has been involved in several proceedings during the past year to implement the changes in the telecommunications laws. As of September 15, 1997, a total of nineteen petitions for arbitration of the rates, terms and conditions for interconnection, unbundling and resale had been filed with the FPSC. Nine have resulted in a Commission decision, eight were withdrawn, one was dismissed, and one is pending. During the past year BellSouth Telecommunications, Inc. filed its petition for entry into the interLATA market. After two weeks of hearings the FPSC found that BellSouth should not be allowed to enter the interLATA market in Florida. The FPSC also adopted the FCC's universal service discount matrix for schools and libraries. Florida's universal service provisions, Section

364.025, Florida Statutes, specifically exclude funding for schools and libraries. No state funding for these intrastate discounts, however, is required, because the FPSC adopted the FCC discount levels. In addition, the FPSC implemented certain provisions of Section 276 of TA 96 which deregulates the pay telephone market. Specifically, the Commission has addressed the removal of intrastate payphone subsidies from basic exchange and exchange access revenues. The FPSC determined that LECs with an intrastate payphone subsidy, could remove intrastate subsidies by reducing rates for one of four services (business rotary, access charges, intrastate toll or operator services).

- As of September 1, 1997, there were 108 ALECs certificated in Florida. Twenty-two ALECs are providing local switched service, to approximately 56,000 business and residential access lines. Only six ALECs were providing local switched service at this time last year.
- In compliance with Section 364.025(2), Florida Statutes, the FPSC instituted an interim universal service mechanism in December 1995. Our research indicates that competitive entry has been negligible, and has not caused universal service to deteriorate. If the Legislature wishes to implement a universal service mechanism, the FPSC reaffirms the basic recommendations contained in our December 1996 universal service report. State action should consist of funding for (a) local service providers serving high-cost areas, and (b) low-income customers. The Legislature should authorize the FPSC to implement a permanent universal service mechanism, subject to moderately broad guidelines and principles, but recognizing that refinements will likely be needed as the FCC proceeds to implement the federal mechanisms.
- For those customers having a choice of a local exchange provider, it appears that they are able to obtain service at comparable rates. For the most part, the ALECs providing service appear to be charging rates that are similar to the rates charged by LECs with two exceptions. It seems that Easy Cellular, Inc. and Hart Communications may be service alternatives for customers that have been denied local service from the LEC because of non-payment, late payment, lack of personal identification, or a bad credit history. Easy Cellular's rate is $39.95 per-month, pre-paid, and Hart Communication's rate is $47.95 for service with similar restrictions.

- The tables below summarize the number of exchanges where ALECs are providing basic local service, and in what areas there are the most ALECs providing service.

SUMMARY OF FLORIDA EXCHANGES WITH AND WITHOUT AN ALEC PROVIDER	
Exchanges With One ALEC Provider	74
Exchanges With Two ALEC Providers	23
Exchanges With Three or More ALEC Providers	28
Exchanges Without an ALEC Provider	158
Total Exchanges in Florida	283

EXCHANGES WITH THE MOST ALEC PROVIDERS			
EXCHANGE	SERVING		TOTAL ALEC PROVIDERS*
	Business	Residential	
Ft. Lauderdale	8	5	11
Gainesville	4	6	8
Jacksonville	7	7	10
Miami	9	8	14
Orlando	6	3	7
Pompano Beach	6	3	7
West Palm Beach	7	6	9

*Total does not add across columns because an ALEC provider may offer service to both business and residential customers in the exchange.

- The total number of business access lines served by all entrants combined is 42,303 and the total number of residential access lines is 13,857. By way of comparison, the three large LECs (BellSouth, GTE Florida, and Sprint-Florida) have approximately 2.9 million business access lines and 7.8 million residential access lines, which account for approximately 98.5% of the total access lines in the state (the remaining 1.5% of the total access lines belong to the remaining seven incumbent LECs). Based on information received as of September 1997, the competitors account for 0.5% overall of the total access lines served, 1.4% of the business access lines, and 0.2% of the residential access lines. The Jacksonville exchange has the largest percent of business (5% to 6.99%)[1] and residential (1% to 4.99%)[1] access

[1] To avoid revealing data that may be considered confidential, a percentage range of ALEC lines served was used.

lines served by an ALEC.

- Section 364.051(3)(a), Florida Statutes, requires the Commission to report and recommend on whether there is a need to extend the price caps for basic local service beyond their current expiration dates. Basic local service rates are capped until January 1, 2001 for BellSouth, and until January 1, 1999 for all other price cap LECs. We are to make our recommendation on an exchange by exchange basis, based on an evaluation of the extent of competition present in each exchange. Section 364.051, Florida Statutes, states that the level of competition will be used to justify any decision to eliminate or extend price caps. The results of our survey indicate that entrants appear to be focusing to the greatest degree on BellSouth's territory. In contrast, competitive entry in other LEC territories has been extremely limited. While ALECs have managed to attract approximately .2% and 2% of the residential and business access lines, respectively, in BellSouth's service area, analogous percentages in the territories for the other price cap LECs are even more modest. For example, in GTE Florida's territory, ALECs have obtained less than .05% of the residential lines and approximately .5% of the business lines, while in Sprint-Florida's territory, ALECs have roughly .05% of the residential lines and .2% of the business lines. Based on the lack of local exchange competition present, we recommend that the price caps on basic local telecommunications prices be extended for an additional two years, until 2001, for price cap LECs with fewer than 3 million access lines: (currently) GTE Florida, Sprint-Florida, Indiantown, GTC (Gulf, Florala, St. Joseph), and Vista-United. Under the terms of Section 364.051, Florida Statutes, basic local price caps for these companies could expire on January 1, 1999. Since it is highly unlikely that significant local exchange competitive local entry will flower in the next 13 months, we believe it is appropriate for the Legislature to act during the 1998 session to extend these price caps. However, at this time we decline to recommend that basic local price caps should be extended for BellSouth. Although the extent of competitive entry in BellSouth's service area admittedly has been modest, we believe that it is not necessary to recommend now on whether BellSouth's caps should be extended past 2001, their current expiration date.

- As we explore and look at the barriers to competition and evaluate implicit subsidies, the Commission may need flexibility and authority in addressing those issues. Solutions may include a permanent universal service mechanism, rate rebalancing and deaveraging. The Commission may need authority to address these issues, within the guidelines set forth by the Legislature.

CHAPTER I: INTRODUCTION

Chapter 364, Florida Statutes, contains the framework the Commission uses for regulation of the telecommunications industry. As a result of certain amendments to this chapter made during the 1995 legislative session, the Commission has a statutory requirement to prepare and deliver two reports to the Governor and the Legislature by December 1, 1997.

First, Chapter 364.386, Florida Statutes, requires the Commission to submit a report annually on "the status of competition in the telecommunications industry." This annual report must discuss:

- The overall impact of local exchange telecommunications competition on the continued availability of universal service.
- The ability of competitive providers to make functionally equivalent local exchange services available to both residential and business customers at competitive rates, terms, and conditions.
- The ability of customers to obtain functionally equivalent services at comparable rates, terms, and conditions.
- The overall impact of price regulation on the maintenance of reasonably affordable and reliable high-quality telecommunication services.
- What additional services, if any, should be included in the definition of basic local telecommunications services, taking into account advances in technology and market demand.
- Any other information and recommendations which may be in the public interest.

Second, Chapter 364.051(3)(a), Florida Statutes, requires the Commission to ". . . report and recommend on an exchange by exchange basis . . . whether there is a need to extend price caps . . . for basic local telecommunications service prices, or whether there is some other means, excluding rate of return regulation, to ensure reasonable and affordable rates for basic local telecommunications service."

In order to meet these statutory requirements the Florida Public Service Commission surveyed the incumbent and alternative local exchange companies. In addition, extensive research was conducted using numerous sources, such as ALEC certification records, companies' annual reports, company-provided public information (such as 10-K forms filed with the Securities and Exchange Commission), industry publications, and articles from an assortment of sources.

Following this introduction there are five other chapters in this report. Chapter II discusses key federal and state decisions regarding the implementation of competition. Decisions discussed in Chapter II address interconnection, universal service, and access charge reform. Chapter III highlights some of the FPSC proceedings that occurred this past year to implement the state and federal telecommunications laws. Chapter IV addresses the five issues specifically identified in Section 364.386, Florida Statutes, and provides information on telecommunications competition on an exchange by exchange basis as required in Chapter 364.051, Florida Statutes. Chapter V is devoted to predicting some potential directions local exchange competition might take. Chapter VI is the concluding chapter.

After Chapter VI there are four appendices. Appendix A provides a list of the alternative local exchange providers certificated as of September 1, 1997, and identifies those that were providing basic local service as of June, 1997. Appendix B is a brief discussion of the structure of the local network. Also included is a description of the various service providers and how they interconnect with the network. Appendix C presents a review of the current level of competition in the local market by examining the types and numbers of players actually in a position to provide local service. Appendix D reviews the predictions we made in last year's report, and examines their accuracy given a year of experience.

CHAPTER II: KEY FEDERAL AND STATE POLICY DECISIONS

INTRODUCTION

The sweeping revisions to Chapter 364, Florida Statutes, made during the 1995 legislative session permanently changed telecommunications in Florida. The most significant change occurred in the finding that ". . . the competitive provision of telecommunications services, including local exchange service, is in the public interest . . ." (Section 364.01(3), Florida Statutes)

Similarly, the Telecommunications Act of 1996 (TA 96, or the Act), signed by President Clinton on February 8, 1996, transformed the provision of telecommunications in the United States. TA 96 directed the FCC to pursue a competitive course by seeking ". . . to promote the policies and purposes of this Act favoring diversity of media voices, vigorous economic competition, technological advancement, and promotion of public interest, convenience, and necessity." (Section 257(b))

The ongoing implementation of TA 96 continues to have significant effects on Florida. The Act added a layer of complexity to Florida's move to competition in the telecommunications markets. With the FCC determined to seek a national approach to telecommunications policy, the line between federal jurisdiction and state jurisdiction has seemed, at times, to blur. The FCC's approach already has caused Florida, and more than a majority of other states, to cry foul at the FCC's encroachment on states' rights to set intrastate prices. Careful oversight of each stage of TA 96's implementation is required to ensure that the proper balance between federal and state regulatory authority is maintained.

This chapter will discuss interconnection, universal service, access charge reform (along with price cap reform), and the effects of the Internet.

THE ROAD TO COMPETITION

There are three key components in the provision of local competition: interconnection, resale, and unbundled network elements (UNEs). Interconnection is the exchange of traffic between companies. Resale is what the name implies: Company A buys services from Company B at a discount and then resells them under Company A's name. Unbundled network elements are, in effect, piece parts of a LEC's network that the LEC must make available for sale to an ALEC. The ALEC purchases the unbundled network elements, packages them into various services, and then sells the services to its customers.

INTERCONNECTION, RESALE AND UNBUNDLED NETWORK ELEMENTS

In order for there to be facility-based competition, all carriers, both LECs and ALECs, must be able to exchange traffic with each other. In order for this exchange of traffic to occur, interconnection between the two competing carriers must be in place. Interconnection already occurs between LECs and IXCs (access charges), LECs and wireless carriers, and between individual LECs. Interconnection must be transparent to the end user -- that is, the traffic must be exchanged in such a way that the end user is unaware of the exchange.

TA 96 requires all incumbent LECs to provide interconnection to any requesting telecommunications carrier. To facilitate interconnection, the LECs are required to allow competitors to collocate their equipment with the LECs' equipment. The LECs are also required to provide nondiscriminatory access to their network elements on an unbundled basis at any technically feasible point, and are required to offer for resale any telecommunications service they provide at retail to subscribers who are not telecommunications carriers.

On August 8, 1996 in CC Docket No. 96-98, the FCC issued its First Report and Order

(Interconnection Order) concerning the rules for interconnection, unbundling, and resale. The FCC defined interconnection as the "physical linking of two networks for the mutual exchange of traffic." The Order specified a minimum of five points in the LEC's network where interconnection is practical. These points include: 1) the line side of a local switch, 2) the trunk side of a local switch, 3) the trunk interconnection points for a tandem switch, 4) central office cross-connect points, and 5) out-of-band signaling transfer points. The FCC defined unbundled elements as the physical facilities of the network, together with the features, functions, and capabilities associated with those facilities. The FCC required LECs to provide the following items on an unbundled basis: local loops, local switching, interoffice transmission facilities, network interface devices, signaling and call-related database facilities, operations support systems functions, and operator and directory assistance facilities. These unbundled network elements (UNEs) are to be made available at the same quality level as the LEC provides to itself.

TA 96 specifies that the rates for interconnection and unbundled network elements are to be cost-based. The FCC required that the states set rates for interconnection and unbundled network elements based on Total Element Long Run Incremental Cost (TELRIC) including a reasonable share of forward-looking joint and common costs. For certain unbundled elements, the FCC also established proxy rates for use by states if TELRIC studies had not been completed.

For resale prices, the Act states that state commissions are to determine wholesale rates based on a LEC's retail rates, excluding any marketing, billing, collection, and other costs that will then be avoided by the LEC. The FCC said that in order to ensure a consistent interpretation of the Act when setting rates for resold services, it was adopting minimum requirements for the states to use. States are to consider the avoidable costs from providing a service at wholesale instead of retail, including the shared and indirect costs, expenses and general overheads such as marketing,

billing, collection, and other costs. Non cost-based factors are to be excluded from the states' evaluations.

After the FCC issued its Interconnection Order, numerous parties, including the Florida Public Service Commission (FPSC) and 30 other state commissions, filed appeals, and requested that provisions of the order be stayed pending judicial review. The FPSC's concerns stemmed from the FCC's assumption of more authority than Congress intended, thus improperly shifting power from the states to the federal government. In the Order, the FCC set a mandatory intrastate pricing methodology for interconnection and UNEs. Florida believed, along with other states and some telecommunications carriers, that dictating this pricing methodology violated Section 2(b) of the Communications Act of 1934, as amended. This section specifically reserves to the states authority to set rates for intrastate services.

The United States Court of Appeals for the Eighth Circuit agreed. In its opinion filed on July 18, 1997, the Eighth Circuit found that the FCC has no express authority under TA 96 to issue local pricing rules. This decision removed an almost year-long uncertainty, especially about the pricing of unbundled network elements and interconnection. If the FCC does not appeal this decision to the U.S. Supreme Court, then a great deal of the uncertainty faced by new local exchange entrants will dissipate, thus hopefully encouraging the pace of competition. This decision means that potential competitors will face appropriate pricing signals, now that prices for UNEs and interconnection can accurately reflect Florida-specific costs.

The Eighth Circuit also vacated the FCC's "pick and choose" rule. This provision would have allowed a telecommunications carrier to "shop" agreements, e.g., a carrier would have been able to purchase one UNE from one agreement, a second UNE from another agreement, etc. The Eighth Circuit vacated this rule because: 1) the structure of the Act reveals Congress' preference for

voluntarily negotiated agreements, 2) the rule thwarts the negotiation process by discouraging a LEC from making a concession in one area in exchange for more favorable terms in another area, and 3) the rule conflicts with TA 96's requirement that agreements be "binding," by allowing the entrant to supplant an existing agreement by piecing together provisions contained in subsequent agreements negotiated by other carriers. As of this writing, the FCC has indicated that it intends to appeal this decision to the United State Supreme Court.

On September 16, 1997, the National Association of Regulatory Utility Commissioners (NARUC) and 26 state regulatory commissions filed a petition with the U.S. Court of Appeals for the Eighth Circuit. The petition urged the Eighth Circuit to enforce its pricing decision that upheld states' rights to set intrastate prices. The petition was filed because the FCC, in its decision denying Ameritech interLATA entry, did so, in part, using the pricing rules vacated by the Eighth Circuit (in its July 18, 1997 order). On October 14, 1997, the Eighth Circuit issued an interim mandate order against the FCC. This interim order bars the FCC from enforcing the use of its pricing rules during RBOC in-region interLATA entry proceedings while the Court considers motions to enforce its mandate.

UNIVERSAL SERVICE

In its simplest definition, Universal Service (US) is the longstanding public policy that mandates that a specified set of telecommunications services be available to all customers at affordable rates. Typically, universal service has been supported by higher rates for other services. TA 96 codified a universal service policy. Section 254 of TA 96 lists the FCC's responsibilities in implementing universal service on a national basis. Chapter 364.025, Florida Statutes, provides guidelines for the maintenance of US objectives with the introduction of competition in the local exchange market.

The FCC was required by TA 96 to define, by May 8, 1997, which services should receive universal service support, and to set a timetable for implementation. On May 7, 1997, the FCC issued its Universal Service Order.[1] The FCC defined universal service to include: 1) voice grade access to the public switched network, with the ability to place and receive calls; 2) dual tone multifrequency (DTMF) signaling or its functional equivalent, also known as touch dialing; 3) single-party service; 4) access to emergency services, including 911 and Enhanced 911; 5) access to operator services; 6) access to interexchange services; 7) access to directory assistance; and 8) Lifeline and Link Up services for qualified low-income consumers. This definition will be revisited by a to-be-convened Federal-State Joint Board (Joint Board) on or before January 1, 2001.

The authority to designate which carriers are eligible to receive support rests with the states. (By Order No. PSC-97-1262-FOF-TP, the FPSC designated the incumbent local exchange companies as eligible telecommunications carriers (ETCs) for purposes of the federal universal service program.) Only a state-certified ETC will be able to receive federal US support. An eligible

[1]Numerous parties, including the FPSC, filed petitions for reconsideration and/or clarification of the US Order, which are still pending at this writing.

carrier must be a common carrier, but the technology used is immaterial (e.g., a wireless carrier could be eligible if it met all the requirements). An eligible carrier must also offer and advertise, throughout a commission-approved service area, all of the services listed in the preceding paragraph.

US support is available for rural, insular, and high cost areas. The FCC found that support for high-cost areas should be based on forward-looking economic costs. While forward-looking costs ultimately will be the basis for determining US support for all carriers, the non-rural LECs[2] will be the first ones to have support computed and provided on this basis, beginning January 1, 1999.

There will be no material change in how US support is determined for rural carriers, until at least 2001. The FCC plans to work with the Joint Board to develop an appropriate forward-looking mechanism for the rural carriers. The Joint Board has established a task force to consider the development of forward-looking mechanisms for rural carriers.

A forward-looking cost model is currently under development for non-rural LECs. The FCC found the cost analyses presented prior to May 7, 1997 to be insufficiently developed and not reliable. Consequently, the FCC issued a Further Notice of Proposed Rulemaking on July 18, 1997 in order to gather more information. States may choose to submit their own forward-looking cost studies which, if approved by the FCC, will be used as the basis for funding. (States were required to notify the FCC of their decisions by August 15, 1997. The FPSC informed the FCC that it may submit a forward-looking economic cost study.) States also have the option of using the FCC's forward-looking cost study.

By the end of 1997, the FCC plans to select the national forward-looking cost study platform

[2]In Florida, the non-rural LECs are BellSouth, GTE Florida, and Sprint-Florida.

that will then be refined and used to determine support for non-rural LECs. Any state that has opted to submit its own universal service cost study must file it with the FCC by February 6, 1998. By August 1998, the FCC will adopt a forward-looking mechanism for non-rural LECs, to take effect January 1, 1999. Until this forward-looking mechanism takes effect, non-rural carriers will continue to receive support based on existing US mechanisms.

The Lifeline and Link Up programs are designed to assist low-income consumers to obtain monthly telephone service and the initial connection to the public switched network, respectively. The FCC expanded Lifeline to make it available in every state, territory and commonwealth; increased the federal Lifeline support amount; and modified the state matching requirement.

Subscribers may receive the initial $3.50 waiver of the subscriber line charge, whether or not a state participates. An additional rate reduction of $1.75 is available with state approval, although no state matching is required. If a state provides funding of $3.50, then subscribers can receive an additional $1.75 in federal support. So, absent a state match, $5.25 is the maximum federal support available. If a state provides support of $3.50, then the total Lifeline support available is $10.50 ($7.00 federal support plus $3.50 state support).

All providers of interstate telecommunications will contribute to the fund, and all eligible telecommunications carriers will be able to receive support from the Fund. This provision is designed to make the contribution and distribution of low-income support competitively and technologically neutral, according to the FCC.

Eligible schools and libraries can receive discounts on the purchase of all commercially available telecommunications services, Internet access, and internal connections. The discounts range from 20% to 90% depending upon whether, and by how much, a school or library is disadvantaged. In Order No. PSC-97-0557-FOF-TP, issued May 19, 1997, the FPSC adopted the

FCC's discount matrix for Florida schools and libraries so that schools and libraries will receive discounts on both interstate and intrastate rates.

The new federal US mechanism also will provide support for rural health care providers. A rural health care provider may obtain telecommunications service at a transmission capacity of up to and including 1.544 megabits per second, which is equivalent to a T-1(or DS1) line. Rates assessed will be comparable to those paid for similar services in the nearest urban area, in the provider's state, that has more than 50,000 residents. In addition, rural health care providers can receive support for both distance-based charges and a toll-free connection to an Internet service provider. If a rural health care provider lacks toll-free access to an Internet service provider, that rural health provider may also receive the lesser of 30 hours per month of Internet access at local calling rates, or $180 per month in toll charge credits for toll charges imposed for an Internet connection.

The ultimate size of the federal fund is undetermined until the FCC completes its efforts to revamp the high cost portion of the fund. The schools and libraries program is capped at $2.25 billion per year, with a rollover into following years allowed for funds not disbursed in a given year. The program for rural health care providers is capped at $400 million per year.

All telecommunications carriers that provide interstate services, pay phone aggregators, and non-common carrier "interstate" providers must contribute to the mechanisms. Contributions will be assessed based on providers' end user telecommunication revenues, including subscriber line charge revenues. Both interstate and intrastate revenues will be assessed for the schools and libraries program and the rural health care program. A potentially contentious issue, for high cost areas, is the FCC's proposal that only 25% of the difference between the forward-looking methodology's cost of service and the national benchmark may be funded by the federal Universal

Service Fund. This might put pressure on predominantly rural states (e.g., Alaska, North Dakota, and Wyoming) with numerous high cost areas to implement their own support mechanisms.

On the state side, the FPSC submitted its recommendation on universal service (US) to the Governor and the Legislature in December 1996, in compliance with Section 364.025, Florida Statutes. The FPSC made the following recommendations:

* Major state legislation on US should be postponed until at least the 1998 session. This was because the FCC had not yet issued its US order, there were uncertainties about the impact of local exchange competition on US, and an interim mechanism was already in place. This interim mechanism permits the LECs to apply for US funding if needed. (It should be noted that many of the uncertainties still exist.)

* If US legislation is desired, it should be limited to one or both of a) proposed refinements to mechanisms targeted to low-income consumers; and b) development of moderately broad guidelines and principles and provision of authority to the FPSC to implement a permanent US mechanism if and when needed.

* All providers of residential local service should be required to offer Lifeline services, thus requiring that the statute be expanded to include ALECs. The lack of participation in the lifeline program indicates that additional effort is needed to enroll eligible customers.

* Funding should also be provided to those high cost areas that truly need assistance, to ensure that rural consumers enjoy the benefits of US. Broad guidelines should be adopted to allow the FPSC to implement a permanent mechanism for high cost support.

* Basic local service, as defined by statute, should constitute the definition of services covered under a US mechanism, although this definition must be permitted to evolve over time. However, funding should only be for a primary residential line.

* All carriers who meet eligibility requirements should be allowed to receive funding for serving high-cost and low-income customers.

* All telecommunications companies and commercial mobile radio service providers are subject to fees, etc., assessed pursuant to Section 364.025, Florida Statutes, and therefore are potentially liable to provide universal service support, whether on an interim or permanent basis.

* A revenue-based assessment scheme would be the easiest procedure to implement.

* A neutral third-party administrator is preferable, although the FPSC could be selected to administer the US fund.

* Although at least some portion of the state US fund will most likely be obtained from assessments on telecommunications carriers, other approaches could include end user assessments and rate rebalancing.

* Caution must be used in any contemplation of rate deaveraging in order to ensure that undue rate disparities between urban and rural customers do not occur.

* For the present, any rate increases should be capped.

ACCESS CHARGE REFORM AND PRICE CAP REFORM

Switched access charges are the charges an IXC pays to a LEC/ALEC for the use of the LEC/ALEC's network when the LEC/ALEC's customer makes or receives a long distance call. When a GTE Florida customer in Tampa, for example, calls a BellSouth customer in Miami, the IXC pays access charges to GTE Florida on the originating end of the call (Tampa) and to BellSouth on the terminating end of the call (Miami).

The federal Access Charge Reform Order adopted May 7, 1997, included reforms whose stated goal is to move interstate access charges, over time, to a more economically efficient structure. Access charges are being restructured so that implicit subsidies are removed (and converted to explicit subsidies), and rates are more closely aligned with costs, as they would be in a competitive market. Part of this effort involves removing from minute-of-use (MOU) access

charges those costs that are not incurred on a MOU basis; these costs will be recovered on a flat-rate basis. In addition, interstate transport charges will move toward cost-based levels. This is intended, according to the FCC, to promote competition for transport services.

Although the FCC hopes that market forces will drive prices lower, it did provide for prescriptive safeguards to serve as a "backstop" to bring access rates to competitive levels even in the absence of competition. This backstop includes a requirement that price cap LECs file a cost study, no later than February 8, 2001, for those interstate services that are still price cap-regulated due to a lack of "substantial competition." The effect of changes to the price cap scheme discussed below can also be viewed as a prescriptive safeguard.

The FCC also revised its price cap plan for interstate access on May 7, 1997. The original price cap plan was instituted in 1990 as a mandatory plan for the regional Bell telephone companies and GTE. Since that time, independent LECs can elect to be subject to price cap regulation. The federal price cap plan broke the linkage between earnings and prices, creating an incentive for LECs to reduce costs. If a LEC did reduce its costs, it could then keep a portion of any increased earnings that resulted from the cost savings. The original plan set maximum or ceiling prices that a LEC could charge for access service. Thus, prices were more constrained, while earnings were less constrained.

The price ceilings on LECs' interstate access services are adjusted annually by a measure of inflation minus a productivity factor, known as the "X-Factor." The new X-Factor, which was increased to 6.5%, is the same for all LECs regulated under price caps, a change from the former price cap plan. The increase in the X-Factor resulted in reductions to interstate switched access rates, effective July 1, 1997. In addition to establishing a new X-Factor, the revised price cap plan eliminated sharing (previously when a LEC earned a return over a certain level, it was required to

"share" the excess amount with its customers).

In Florida, access charge reform has been concerned more with removing the disparity between the levels of interstate and intrastate switched access rates. Intrastate switched access rates are typically higher than interstate rates, although the technology and equipment is identical. The Florida legislature addressed this disparity as part of its 1995 revisions to Chapter 364. Section 364.163(6), Florida Statutes, requires that a LEC whose intrastate switched access rates are higher than its December 31, 1994 interstate switched access rates, reduce its intrastate rates by 5% on October 1 of every year until parity is reached.

During the 1997 legislative section, both branches of the Florida legislature considered access reform bills. The bills were similar, in that they addressed ways to lower intrastate access charges where they are higher than the interstate access charges. Both bills would have increased the rate of access charge reductions mandated by Section 364.163(6) Florida Statutes

This is a highly contentious issue. The IXCs, who pay the access charges, lobbied strenuously for reduced charges, both in the media and at the legislature. The large LECs with intrastate rates higher than their interstate rates contended that any reduction in access charges would mean an increase in local telephone rates.[3] Neither bill passed in the 1997 session.

[3]On July 1, 1997, the *Tallahassee Democrat* reported price increases (on some custom calling features) for Sprint-Florida: "The rate increases were made necessary by a $10-million revenue loss Sprint projects because of the 1995 Florida telecommunications act, Sprint officials say. That law put a cap on local call rates until 1999, while reducing the per-minute connection charges that long-distance carriers such as AT&T pay to local companies such as Sprint for in-state toll calls." (Page 1C).

THE INTERNET

Internet issues have generated a lot of controversy. LECs claim that the average Internet connection is far longer than a typical voice telephone call, thus creating congestion on the network. In order to relieve the congestion, the LEC is then required to make large investments to increase network capacity. However, LECs have argued that they do not see a commensurate increase in revenue because LECs are not permitted to assess access charges to Internet Service Providers (ISPs). LECs, though, have seen increased revenue from second residential lines typically used for Internet access. The underlying cause of the congestion problem is engineering in nature: the public switched telephone network was designed for short duration voice traffic, not long duration data traffic, such as that produced by connections to the Internet. In a Notice of Inquiry (NOI) issued in CC Docket 96-263, the FCC stated that its existing rules were designed for traditional circuit-switched voice networks, and because of this, the rules may hinder the development of emerging packet-switched data networks, such as the Internet. The FCC noted a need to identify what federal policies would facilitate the development of future high bandwidth data networks, while promoting continued investment in, and development of, the voice network. The FCC asked in the NOI whether it should consider any additional actions relating to interstate information services and the Internet after the FCC completed its access charge reform. In the Access Charge Reform Order adopted on May 7, 1997, the FCC reaffirmed that the LECs may not assess interstate access charges on information service providers, and stated that another NOI will be issued to address questions about ISP usage.

During the 1997 Florida legislative session, a bill passed that exempted ISPs from being treated as telephone-type providers for purposes of applying the gross receipts tax (Chapter 97-283, Laws of Florida).

CONCLUSION

The move to local competition continues to proceed, although at a slower pace than perhaps desired, in Florida and nationwide. According to information provided by respondents to our data request, attempts by the FCC to expand its authority into local state issues and subsequent court challenges have caused delays in competitive entry. These attempts, and their challenges, must be resolved in order for competition to evolve more quickly. However, even with these issues resolved, local competition will still have to overcome technical, capital funding, and customer reluctance-to-change issues.

Thanks to the 1995 revisions to Chapter 364, Florida had a jump start in moving the local exchange market toward competition. Not unexpectedly, of course, there were some inconsistencies between the revisions to Chapter 364 and TA 96. These inconsistencies, while not profound, have required time and effort to resolve.

CHAPTER III: FLORIDA PUBLIC SERVICE COMMISSION ACTIONS

Since the passage of the amendments to Chapter 364, Florida Statutes, and the Telecommunications Act of 1996, the FPSC has been involved in several proceedings implementing these laws. While both laws strive to open the local telecommunications markets, each does so in a somewhat different manner. In this chapter some of the actions the Commission has undertaken during the past year to implement portions of both laws are discussed. Topics discussed include: 1) arbitration proceedings, 2) BellSouth's application for entry into the interLATA market, 3) adoption of discounts for telecommunications services for schools and libraries, 4) switched access flow-through, and 5) pay telephone deregulation.

ARBITRATION PROCEEDINGS

One of the initial undertakings to implement the laws and open the local telecommunications markets was setting the rates, terms, and conditions for interconnection, unbundling, and resale. Both the state and federal laws contain provisions that allow parties to negotiate the prices, terms, and conditions for interconnection, resale, and unbundling with the LEC. However, if negotiations are not successful, both state and federal law have a provision that allows either party to have the state Commission arbitrate those terms and conditions.

Under state law, if the parties cannot reach agreement, either party may petition the Commission to establish non-discriminatory rates, terms, and conditions. The Commission has 120 days following the filing of a petition to resolve the matter.

Under TA 96, when negotiations are unsuccessful, either party may request the state commission to resolve the differences between the parties. Between the 135th day and the 160th

day following the date the LEC receives a request for negotiation, either party may request the state commission to arbitrate any open issues. The state commission must complete the arbitration process no later than nine months following the date the LEC received the initial request. If the state commission does not act, the FCC assumes responsibility for the proceeding 90 days following notification of the state's failure to act.

The majority of the parties have filed their petitions pursuant to TA 96. As of September 15, 1997, nineteen arbitration requests have been filed with the Commission, one under the state law, and eighteen under the federal law. Of the nineteen, nine have resulted in a Commission decision, eight were withdrawn, one was dismissed and one is pending. Table 3-1 shows the parties in those arbitrations in which a Commission decision resulted.

TABLE 3-1

ARBITRATION PROCEEDINGS IN WHICH A DECISION RESULTED

PARTIES	DOCKET NO.
BellSouth/MFS	960757-TP
BellSouth/AT&T	960833-TP
Sprint/MFS	960838-TP
BellSouth/MCI	960846-TP
GTEFL/AT&T	960847-TP
GTEFL/MCI	960980-TP
BellSouth/Sprint	961150-TP
GTEFL/Sprint	961173-TP
Sprint/MCI	961230-TP

BELLSOUTH'S 271 APPLICATION FOR ENTRY INTO THE INTERLATA MARKET

One of the most significant and difficult proceedings the Commission undertook as part of its duties in implementing provisions of the Telecommunications Act of 1996, stemmed from its consultative role to the FCC in determining if BellSouth (Florida's BOC) has met the conditions to enter the in-region interLATA market (in-region service refers to a LEC offering interLATA toll service within a state and within its present service territory). TA 96 prohibits a Bell Operating Company (BOC) from entering the in-region interLATA market until it meets several provisions of the Act. Under TA 96, a BOC can request the FCC to approve its entry into the in-region interLATA long distance market once it has met a series of conditions contained in a "competitive checklist." (Section 271(c)(2)(B)) The checklist requires that the BOCs provide interconnection and access to unbundled network elements including unbundled local loops, unbundled transport, and unbundled switching. They also must make available dialing parity, reciprocal compensation, resale, access to rights-of-ways, conduit and poles, access to 911 and E911, directory assistance, operator call completion services, white pages directory listings, access to data bases and signaling, and interim number portability.

Pursuant to Section 271(d)(3) of the Telecommunications Act, the FCC has 90 days from the date the BOC files its application for interLATA authority with the FCC to issue a written determination approving or denying the application. Further, the FCC is directed to consult with the state commission and the Department of Justice before making its determination.

In its consultative role to the FCC, a state commission must determine within a very short time frame of a BOC filing with the FCC if all fourteen points within the competitive checklist have been met. Because of the rigid schedule and the fact that an evidentiary hearing would be necessary, Docket No. 960786-TL was opened on June 28, 1996, well in advance of any BellSouth filing with

the FCC. There were approximately 45 parties to the proceeding. Issues were identified and extensive discovery was conducted.

On July 7, 1997, the Commission received BellSouth's application and supporting documents (the supporting documents were submitted in 84 separate binders). The evidentiary hearing was held during the first two weeks in September 1997, and the Commission made its decision on November 3, 1997.

By Order PSC-97-1459-FOF-TL, issued November 19, 1997, the Commission determined that BellSouth only met eight of the fourteen requirements of the competitive checklist and should not be allowed to compete in the in-region interLATA market. For those requirements that were not met, the FPSC provided BellSouth with specific guidance for a future filing. If BellSouth files its application with the FCC, then the FPSC's Order will be filed; however, if BellSouth chooses not to file its application with the FCC, then the entire process must be repeated.

UNIVERSAL SERVICE PLAN FOR SCHOOLS AND LIBRARIES

On May 8, 1997, the FCC issued its Report and Order, FCC Order No. 97-157, implementing key portions of Section 254 of TA 96, which addresses universal service. It does not appear that any other provision of TA 96 impacts as many individuals either directly or indirectly as the provisions for universal service. The specific implications of US are discussed in greater detail in Chapter II and Chapter IV of this report. However, it is important to mention here what the FPSC has done to implement part of the FCC's US plan for schools and libraries.

The FCC's Order provides for federal funding of discounts on both interstate and intrastate services for schools and libraries. Eligibility for the discounts for intrastate services is predicated upon adoption by the states of an intrastate discount level equal to or greater than the federal

discount levels. The FCC adopted rules that will permit schools and libraries to begin receiving the discounted services on January 1, 1998.

Section 254(h)(1)(B) of the Act states:

> All telecommunications carriers serving a geographic area shall, upon a bona fide request for any of its services that are within the definition of universal service under subsection (c)(3), provide such services to elementary schools, secondary schools, and libraries for educational purposes at rates less than the amounts charged for similar services to other parties. The discount shall be an amount that the [FCC], with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities.

While Section 254(h)(1)(B) of the Act permits the states to determine the level of discount available to eligible schools and libraries with respect to intrastate services, the Act is silent on federal funding of such intrastate discounts. However, the Order does condition federal funding on state adoption of the federal discount levels. In its May 1997 order, the FCC decided to exercise its authority to provide federal universal service support for intrastate discounts.

Florida's universal service provisions, Section 364.025, Florida Statutes, specifically exclude funding for schools and libraries. No state funding for these intrastate discounts, however, is required, because the FPSC adopted the FCC discount levels. The participating providers will be compensated for the discounts provided to schools and libraries completely through the federal universal fund. States may adopt their own additional intrastate funds, thus reducing concerns about potential conflicts between the FCC's order regarding discounts for schools and libraries.

The discounts range from 20% to 90% for all telecommunications services, Internet access, and internal connections, subject to a $2.25 billion annual funding cap. The range of discounts is

correlated with students' eligibility for the national free and reduced school lunch program, and urban or rural location based on metropolitan statistical areas (rural and urban categories are based on definitions adopted by the U.S. Department of Health and Human Services Office of Rural Health Policy). The following discount matrix has been adopted by the FCC and FPSC:

Table 3-2

SCHOOLS AND LIBRARIES DISCOUNT MATRIX

Students Eligible for National School Lunch Program (%)	Estimated US Schools in Category (%)	Urban Discount (%)	Rural Discount (%)
<1	3	20	25
1-19	31	40	50
20-34	19	50	60
35-49	15	60	70
50-74	16	80	80
75-100	16	90	90

By Order No. PSC-97-0557-FOF-TP issued May 19, 1997, the FPSC adopted the discount matrix, thus ensuring Florida's schools and libraries the opportunity to obtain discounted telecommunications services. Table 3-3 provides the potential discounts for schools and libraries in Florida.

Table 3-3

POTENTIAL DISCOUNTS FOR SCHOOLS AND LIBRARIES IN FLORIDA

County	% of Public School Students Eligible for Free/Reduced Lunch[1]	% Discount[2]	
		Urban	Rural
ALACHUA	45.46%	60%	70%
BAKER	41.88	60	70
BAY	45.47	60	70
BRADFORD	53.46	80	80
BREVARD	29.60	50	60
BROWARD	36.74	60	70
CALHOUN	47.55	60	70
CHARLOTTE	41.96	60	70
CITRUS	42.21	60	70
CLAY	22.23	50	60
COLLIER	42.58	60	70
COLUMBIA	47.74	60	70
DADE	59.24	80	80
DESOTO	62.50	80	80
DIXIE	60.31	80	80
DUVAL	46.39	60	70
ESCAMBIA	54.94	80	80
FLAGLER	38.01	60	70
FRANKLIN	54.44	80	80
GADSDEN	83.34	90	90
GILCHRIST	50.25	80	80
GLADES	57.62	80	80
GULF	47.59	60	70
HAMILTON	62.02	80	80
HARDEE	56.87	80	80
HENDRY	54.90	80	80
HERNANDO	45.92	60	70
HIGHLANDS	52.03	80	80
HILLSBOROUGH	48.63	60	70
HOLMES	59.31	80	80
INDIAN RIVER	40.39	60	70
JACKSON	52.64	80	80
JEFFERSON	67.07	80	80
LAFAYETTE	52.66	80	80
LAKE	40.63	60	70
LEE	43.89	60	70
LEON	23.36	50	60
LEVY	55.56	80	80
LIBERTY	44.35	60	70
MADISON	63.04	80	80
MANATEE	42.95	60	70
MARION	50.30	80	80
MARTIN	30.63	50	60
MONROE	34.97	50	60

Table 3-3

POTENTIAL DISCOUNTS FOR SCHOOLS AND LIBRARIES IN FLORIDA

County	% of Public School Students Eligible for Free/Reduced Lunch[1]	% Discount[2]	
		Urban	Rural
NASSAU	31.33	50	60
OKALOOSA	29.84	50	60
OKEECHOBEE	53.95	80	80
ORANGE	38.20	60	70
OSCEOLA	.00	NO FIGURES AVAILABLE	
PALM BEACH	29.37	50	60
PASCO	44.10	60	70
PINELLAS	37.81	60	70
POLK	52.99	80	80
PUTNAM	61.86	80	80
ST. JOHNS	26.44	50	60
ST. LUCIE	53.17	80	80
SANTA ROSA	30.98	50	60
SARASOTA	33.49	50	60
SEMINOLE	25.32	50	60
SUMTER	62.86	80	80
SUWANNEE	44.92	60	70
TAYLOR	46.74	60	70
UNION	42.21	60	70
VOLUSIA	39.70	60	70
WAKULLA	36.14	60	70
WALTON	50.83	80	80
WASHINGTON	51.99	80	80

[1] The number of students that qualify for the free/reduced lunch program is collected from each school district by the Department of Education. The figures represent the average for all schools in each district.

[2] Depending upon whether Florida schools file individually or on a county wide basis, individual schools may receive greater or lesser discounts than for the county as a whole.

SOURCE: Free/Reduced Lunch Program information provided by Florida Department of Education.

SWITCHED ACCESS

Section 364.163(6), Florida Statutes, requires any LEC whose current intrastate switched access rates are higher than its December 31, 1994, interstate switched access rates to reduce its intrastate switched access rates by 5% annually, beginning October 1, 1996. Once parity between the intrastate and 1994 interstate rates is reached, no further reductions are required.

On October 8, 1996, Order No. PSC-96-1265-FOF-TP, was issued. This was the first Order issued to implement the mandatory access reductions. It accomplished two things: 1) it ensured that

the LECs reduced their intrastate switched access rates by 5%, and 2) ensured that the facilities-based IXCs passed the reductions through to their customers.

The LECs who were required to reduce their rates by 5% effective October 1, 1996, were ALLTEL Florida, Inc., Frontier Communications of the South, Inc., GTE Florida, Inc., Sprint-Florida, Inc., and Vista-United Telecommunications. BellSouth was not required to reduce its intrastate rates by 5%. Instead, a different percentage (16.2%) was applied to BellSouth based on the stipulation in Docket No. 920260-TL resolving BellSouth's last earnings review. The stipulation called for a series of annual switched access rate reductions. BellSouth's March 1, 1997, intrastate switched access rate reductions filed pursuant to Order No. PSC-97-0128-FOF-TL, in Docket No. 920260-TL, brought BellSouth's intrastate composite switched access rate below its December 31, 1994, interstate composite switched access rate, thus achieving parity.

Per Order No. PSC-97-0604-FOF-TP, issued May 27, 1997, tariffs were filed on August 1, 1997, for the 1997 reductions. The LECs who were required to reduce their rates by 5%, effective October 1, 1997, were ALLTEL Florida, Inc., Frontier Communications of the South, Inc., GTE Florida, Inc., Sprint-Florida, Inc., and Vista-United Telecommunications. With this filing Frontier's intrastate switched access rates reached parity with its December 31, 1994, interstate switched access rates.

PAY TELEPHONE PROCEEDING

There have been several significant regulatory changes recently in the pay telephone industry. The most significant changes have come about as a result of Section 276 of the Telecommunication Act of 1996 (TA 96). The goals of Section 276 of TA 96 are to encourage widespread deployment of payphone services and promote competition among all payphone service

providers (PSPs). Section 276 required, among other things:

- the establishment of a per-call compensation plan to ensure all payphone service providers are fairly compensated for each and every completed intrastate and interstate call;
- discontinuing all intrastate and interstate payphone subsidies from basic exchange and exchange access revenues.

The FCC issued several orders to implement the payphone provisions of TA 96. These orders required that:

- all facilities-based interexchange companies pay compensation for access code calls and subscriber 800 calls;
- all payphones must provide free access to dial tone, emergency calls, and the telecommunications relay system;
- effective no later than October 7, 1997, the rate for a local call was deregulated (FPSC staff has already identified PSPs that have increased their rates to $.35);
- LECs were to treat payphones as deregulated and detariffed customer premises equipment (the LECs had the option to deregulate using structural (separate subsidiary) or non-structural safeguards (accounting separations));
- LECs were required to eliminate retail payphone offerings from their General Subscriber Services Tariffs and to offer wholesale services at cost-based rates;
- LECs were to remove subsidies from their intrastate and interstate payphone operation; and
- local exchange companies were to continue to provide basic payphone services (e.g., access lines and blocking features) to pay telephone providers and to provide any services they provide to their own payphones.

The FCC did not explicitly address the size of any LEC intrastate payphone subsidy and the appropriate method for disposition; rather, it was left up to the state commission to make that determination. At the March 18, 1997, Agenda Conference, the FPSC decided what actions were necessary to determine and to eliminate any intrastate subsidies associated with the LECs' payphone operations. The Commission ordered (PSC-97-0358-FOF-TP) that LECs were to provide:

- As of December 31, 1995, the amount of payphone investment and any other assets used in the provision of payphone service along with the accumulated depreciation and deferred income tax liabilities.
- 1995 payphone services revenues by account or source, with supporting documentation.
- 1995 payphone services expenses by account or source, with supporting documentation.
- Amount of any subsidy for its payphone services.
- A copy of the common carrier line (CCL) rate revision filings and accompanying subsidy calculation data submitted to the FCC in CC Docket Number 96-128.

In addition, the Commission ordered that a LEC must make rate reductions to the extent necessary to eliminate any intrastate subsidy; however, the FPSC did not specify a particular service or element where LECs were to make reductions.

All ten LECs provided the requested information, but only BellSouth and Sprint-Florida believed they had a subsidy. BellSouth calculated a $6.5 million subsidy and chose to eliminate it by reducing business rotary rates. Sprint-Florida determined it had a $1.5 million subsidy, and chose to reduce modified access based compensation (MABC) rates.

On April 21, 1997, MCI Telecommunications Corporation protested Order No. PSC-97-0358-FOF-TP. The basis for MCI's protest was that it believed the FPSC was required to specify which intrastate rate elements or services were to be reduced, and to confirm the amount of the subsidy calculations.

A hearing was held on August 8, 1997. At hearing, the amount of intrastate subsidy as well as which service or element should be reduced was stipulated for all LECs except for BellSouth. Table 3-4 shows the stipulated amounts and areas of reduction.

TABLE 3-4

STIPULATED PAY TELEPHONE ISSUES

Company	Amount of Subsidy	Service/Element Reduced
ALLTEL	$66,600	Intrastate Switched Access
Frontier	$1,980	Intrastate Switched Access
GTC, Inc. (Florala)	$1,080	Intrastate Switched Access
GTC, Inc. (Gulf)	$9,900	Intrastate Switched Access
GTC, Inc. (St. Joseph)	$25,740	Intrastate Switched Access
GTEFL	$0	n/a
Indiantown	$5,760	Whatever Commission Orders
Northeast	$7,020	Intrastate Switched Access
Quincy	$10,980	Whatever Commission Orders
Sprint-Florida	$0[1]	n/a
Vista-United	$234,900	Intrastate Switched Access

[1]Sprint-Florida's original subsidy calculation (which showed a $1.5 million subsidy) was not based on the FCC's methodology or data source; once calculations were performed using a methodology similar to that used by the FCC for interstate subsidy calculations, Sprint-Florida's subsidy was found to be $0. However, Sprint-Florida's $1.5 million reduction to MABC remains in place.

Per Order No. PSC-97-1312-FOF-TL, issued on October 22, 1997, the Commission determined that BellSouth's payphone subsidy was $7.5 million and that business rotary was one of the appropriate services or elements to be reduced. The Commission also determined that in addition to business rotary, reductions could be made to access charges, intrastate toll, or operator services.

The FCC's Orders also required that the LECs file intrastate tariffs for payphone services and for any unbundled features they provide to their own payphone services. The tariffs had to be cost-based (meeting the FCC's "new services" test), consistent with Section 276 of TA 96, and nondiscriminatory. While the LECs offer all of the services called for in the FCC's order, it has not yet been determined if these rates are cost-based as defined by the FCC. FPSC staff is in the process of investigating this matter.

CHAPTER IV: STATUS OF LOCAL COMPETITION

Section 364.386, Florida Statutes, requires the Commission to report annually to the Governor and the legislature on the **status of competition in the telecommunications industry in Florida**, with emphasis on competitive entry into the local services market. The first section of this chapter addresses the requirements of Section 364.386.

Section 364.051(3)(a), Florida Statutes, requires the Commission to submit an additional report by December 1, 1997, on an **exchange by exchange basis**, on the need to extend price caps for basic local service or whether there is some means other than rate-of-return regulation that will ". . . ensure reasonable and affordable rates for basic local telecommunications service." The second section examines the extent of competitive entry at this more detailed level. The last section summarizes our findings and concludes with our recommendation.

In order to prepare these reports, Commission staff requested data this summer from the ALECs and LECs concerning the extent of competitive entry. As has been the case throughout the country, competitive entry by the ALECs has been slow to develop in Florida. As of June 5, 1997, 86 entities were certificated as ALECs, but only 22 were actually providing service to a relatively small group of customers. (The number of ALECs continues to increase, with over 100 certificated as of September 1, 1997. The data in this report is from responses to data requests sent to ALECs that were certificated as of June 1997.)

STATUS OF LOCAL SERVICE COMPETITION THROUGHOUT FLORIDA

In analyzing the status of competition in Florida, Chapter 364.386(1), Florida Statutes, requires that the Commission examine the following points:

(1) The overall impact of local exchange telecommunications competition on the continued availability of universal service.

(2) The ability of competitive providers to make functionally equivalent local exchange services available to both residential and business customers at competitive rates, terms, and conditions.

(3) The ability of customers to obtain functionally equivalent services at comparable rates, terms, and conditions.

(4) The overall impact of price regulation on the maintenance of reasonably affordable and reliable high-quality telecommunications services.

(5) What additional services, if any, should be included in the definition of basic local telecommunications services, taking into account advances in technology and market demand.

(6) Any other information and recommendations which may be in the public interest.

Each point will be addressed in the following discussion.

(1) The overall impact of local exchange telecommunications competition on the continued availability of universal service.

Universal service can be thought of in the following way: more consumers are able to obtain and maintain local service if it is priced low. According to the FCC, as of July 1997, 93.1% of Florida households had local telephone service. (Telephone Subscribership in the United States, Federal Communications Commission, October 1997, p. 7) Residential basic local service rates have been kept low because the LECs have been able to price other services at higher levels. The greater margin provided from the higher priced services helps offset the lower revenues the LECs obtain from residential basic local service. For example, business basic local service, which has been priced well above residential service, is generally a higher margin service. Vertical services such as call waiting, caller ID, and call forwarding are also priced above cost, as is intrastate access.

The revenues from business customers are a major source of support for universal service.

A primary concern of a LEC is that a competitor will target high-volume business customers and, if successful, reduce the LEC's revenue and impair the LEC's ability to continue to offer basic local service at low rates.

The FPSC conducted hearings from October 16 through 18, 1995, to address issues associated with the implementation of an interim universal service/carrier of last resort (US/COLR) mechanism, as required by Section 364.025(2), Florida Statutes We evaluated proposals submitted by various parties for an interim US/COLR mechanism that would have required the creation of an intrastate fund. However, we declined to adopt any of them due to specific flaws. In particular, the FPSC concluded that these proposed mechanisms' funding levels were excessive and likely would have constituted a barrier to entry for competitive local providers. Further, we believed that it was clear that any negative impact on universal service due to competitive local entry would be minimal in the short run, because of the significant task facing the competitors of just becoming sufficiently established to offer service.

Another key factor we considered was that Chapter 364 now allowed LECs to opt for price regulation instead of rate-of-return regulation. Under price regulation local rates are capped for at least three years (five years for BellSouth). Moreover, Section 364.025(1), Florida Statutes, requires incumbent LECs to continue as carriers of last resort within their existing service areas until 2000. Accordingly, the important issue was whether or not the incumbent LECs that elected price regulation would suffer financial harm sufficient to erode their ability to maintain their US/COLR requirements.

To achieve the balance required by statute between assuring that each telecommunications company contributes its fair share to support US/COLR objectives, while not creating a barrier to entry, the FPSC found that the best option was to pursue a conservative course and select the

simplest mechanism possible. Although we concluded that it was unnecessary to establish an intrastate fund at that time, we provided a procedure whereby a LEC could petition the Commission for universal service funding if it could demonstrate that its ability to sustain its US/COLR obligations had been eroded as a result of competitive entry into the local exchange market. To date, no LEC has filed a petition with the Commission seeking intrastate universal service funding.

In December 1996 the Commission submitted its report Universal Service in Florida to the Governor and the Legislature, as required by Section 364.025(4). In that report the FPSC's primary recommendation was that legislation on universal service matters should not be pursued until at least the 1998 legislative session. In that report we also stated:

> In the short run, any impact on universal service in Florida due to local exchange competition will likely be negligible, largely due to the monumental task confronting the competitors of becoming established sufficiently to offer service. In addition, an interim mechanism is already in place whereby LECs can apply for funding if needed until such time as a permanent universal service mechanism is developed. (p.8)

Again, our research indicates that competitive entry has been limited, and we have no basis to conclude that universal service has deteriorated.

As discussed in detail later in this chapter, local exchange competitive entry in Florida has been very limited. As of June 5, 1997, 86 ALECs were certificated but only 22 were actually providing service to consumers; these 22 ALECs served a total of 56,000 access lines, or only about 0.5% of the state's total access lines. Given the modest market penetration made by ALECs during the two plus years since passage of the revisions to Chapter 364 which authorized and encouraged entry, and the absence of a petition for universal service funding, we are led to conclude that local competition has had little if any adverse impact on universal service in Florida.

The Commission's reluctance to recommend pursuing legislation concerning a permanent

universal service mechanism in the 1996 report was due to actions pending by the Federal Communications Commission (FCC) in their universal service proceeding (CC Docket No. 96-45). The FCC was conducting a complete overhaul of the federal universal service mechanisms but had not issued an order on universal service issues. As discussed in Chapter II, the FCC released an order on May 8, 1997. (The order is on appeal in the Fifth Circuit Court of Appeals.) While some uncertainty now has been eliminated, decisions by the FCC on some very substantial matters were postponed to a future date. Moreover, the FCC needs to clarify its intended interpretation of certain key policy decisions in its May order. Even once all policy interpretations have been concluded, there will still remain numerous extremely complex implementation details to be resolved.

Of particular importance, it is still unknown what the dollar amount of federal universal service funding available for serving high cost areas will be. It is essential to know the amount of federal high-cost support before we can assess whether there is a need for supplemental support at the state level. Under the FCC's plan, beginning in 1999 high cost funding for non-rural LECs will be computed based on the difference between the costs of serving a geographic area, as derived from a cost proxy model, and a revenue benchmark. The problem is that the FCC has not yet defined the geographic areas, finalized the cost model, nor specified the revenue benchmark. (Florida's non-rural LECs are BellSouth, GTE Florida, and Sprint-Florida.) Under its current schedule, these issues may not be resolved until at least August 1998, and the financial impacts of the FCC's universal service programs may not be known until some time in 1999.

Another major unknown is whether federal universal service funding will continue to be made available to fund intrastate universal service costs. Under the current federal high cost funding mechanism, the interstate program effectively provides monies to the states which go to offset intrastate costs and thus help to keep local rates affordable. There have been indications that the

FCC may cease providing high-cost funds to cover intrastate universal service costs. For example, in its companion access charge reform order in CC Docket No. 96-262, also adopted on May 7, 1997, the following language appears:

> Consistent with our decision in the Universal Service Order to fund only interstate costs through the federal universal service fund, we direct incumbent LECs to use any universal service support received from the new universal service mechanisms to reduce or satisfy the interstate revenue requirement otherwise collected through interstate access charges. (¶ 381)

Under a literal interpretation, the new federal universal service fund may no longer provide monies that are currently used to recover, at least in part, the costs of local service. However, this issue is currently the subject of various petitions for reconsideration at the national level, and the ultimate outcome is unknown.

The FPSC believes that any intrastate universal service mechanism should meet two standards. First, it is our belief that, although a state mechanism does not have to mirror the federal mechanism, it must be complementary. Section 254(f) of the Telecommunications Act of 1996 provides that a state ". . . may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service." For example, while a state mechanism can provide funding for services beyond those funded by the federal mechanism, a state mechanism must be competitively neutral as to contributions to, and disbursements from, the fund. Second, the FPSC believes, there ought to be an objective demonstration that intrastate funding is appropriate and needed. Such a finding should be independent of the identity of a given provider, and should consider all relevant revenue sources. As stated above, we do not know how much, if any, federal funding will be provided; we are concerned that the addition of monies from a state fund could either over-or undershoot the mark as to the overall level of universal service funding actually

required. The FPSC believes that any legislation regarding a permanent universal service mechanism should afford the Commission sufficient latitude to ensure these standards are met.

Moreover, we believe that it is important not to lose sight of why a permanent universal service fund might be needed. Fundamentally, universal service has two components: availability and affordability. Historically, state and federal regulators have attempted to maximize the availability of reliable, high quality basic telephone service to consumers, at affordable rates. With the advent of local competition, there are legitimate concerns that this social goal may not be sustained. Driven by a desire for supranormal profits, competitors will likely focus (at least initially) on providing service in the lowest cost areas, to those customers that have the highest demand for telecommunications services and the greatest ability to pay for them. Similarly, universal service policy has focused on two potentially at-risk groups of consumers: those low-income individuals with the least ability to pay, and those residing in high-cost areas.

While revisions to the federal low-income programs, Lifeline and Linkup, are virtually complete, much work still remains on overhauling the high-cost support mechanisms. Identifying the truly high-cost areas to serve is essential, especially since funding will go to whomever provides service in these high-cost areas. Once established, federal high-cost support will be indifferent to the provider's identity and the level of revenues it may generate from other services. In particular, any revenue gains or losses experienced by a provider associated with offerings such as access charges will be irrelevant; the provider will receive federal funding only for providing the supported services.

The substantial uncertainty at the federal level will have a direct bearing on any state level decision to establish a permanent intrastate universal service mechanism. As discussed above, federal funding will be a function of yet to be determined costs of serving a geographic area, as

estimated through a cost proxy model that is still under development. This cost estimate will in turn be compared to a revenue benchmark which the FCC has not yet specified, and some unspecified percentage of this difference will be funded through the federal universal service mechanism. Finally, it is not clear whether the federal support monies will have the effect of lowering the intrastate revenue requirement. Traditionally, federal support monies have lowered intrastate revenue requirements, thereby enabling residential basic local service rates to be lower than otherwise. If these federal support monies continue to lower the intrastate revenue requirement as has been the traditional practice, then it will be a matter of comparing the old and new support levels and determining if a permanent intrastate Universal Service mechanism is needed. If these federal support monies do not lower the intrastate revenue requirement, but instead help satisfy the intrastate revenue requirement, residential basic local service rates will no longer have the benefit of any federal support, increasing the likelihood that a permanent intrastate Universal Service mechanism will be needed.

If the Legislature wishes to implement a permanent universal service mechanism, the FPSC reaffirms the basic recommendations contained in our December 1996 universal service report. State action should consist of providing funding for (a) local service providers serving high-cost areas, and (b) low-income customers. The Legislature should authorize the FPSC to implement a permanent universal service mechanism, subject to the moderately broad guidelines and principles described in the December 1996 report but recognizing that refinements will likely be needed as the FCC proceeds to implement the federal mechanisms. The key guidelines from our December 1996 report include:

1. Universal service should be understood for the present as the provision of basic local telecommunications service, as defined by statute, to customers at reasonable and affordable rates. However, the services which comprise universal service should be allowed to evolve

over time.

2. Availability of funding must be indifferent to provider of service, as well as to the technology used to provide service. All carriers who meet certain eligibility requirements should be allowed to receive funding for serving high cost areas and low-income customers. Funding should not go to a reseller of local service unless the rates it pays to the facilities-based provider are fully compensatory; funding should go to the provider that actually incurs the cost.

3. All telecommunications companies, as defined under Section 364.02(12), Florida Statutes, and commercial mobile radio service (CMRS) providers, as defined by Section 364.02(3), Florida Statutes, are subject to fees or other obligations assessed pursuant to Section 364.025, Florida Statutes, and thus are liable to provide universal service support.

4. Universal service assessments should be based on subject providers's revenues; the specific assessment basis should be complementary to the basis adopted by the FCC.

5. While the FPSC could be selected to administer an intrastate universal service fund, a neutral third party administrator is preferable. If administered by a third party, the duties should be ministerial in nature. All policy functions, as well as selection of the fund administrator, should be performed by the FPSC.

Although at least some portion of the monies for a permanent state universal service fund most likely would be derived from assessments on telecommunications carriers, it may be appropriate also to consider other actions which would reduce the size of the fund needed. One option would be to implement an explicit end user surcharge to fund all or a portion of universal service requirements. An additional option would be to allow for the rebalancing and possible deaveraging of local rates to levels closer to their costs, while reducing rates for other services which contain implicit subsidies.

Depending on which options are selected, statutory changes would be required. To implement a universal service end user surcharge for universal service, the Legislature would need to grant specific statutory authority. To effect rate rebalancing for price cap LECs may necessitate modifying Section 364.051, Florida's price cap statute. Currently, basic local telecommunications rates are capped at their current levels until 1999 (2001 for BellSouth); even when these caps are

lifted, increases are constrained to inflation less one percent, thus severely limiting any possible rebalancing. The price caps could be retained but allowed to increase to some predetermined level over time. In the case of deaveraging, care must also be taken not to run afoul of the provision in Section 254 of TA 96 that requires that basic local rates for rural consumers be ". . . reasonably comparable to rates charged for similar services in urban areas." (Sec. 254(b)(3)) Moreover, any rate rebalancing and deaveraging allowed should be subject to FPSC oversight and approval.

As discussed in Chapter II, the FCC has made several changes in the existing Lifeline program. Currently, the federal jurisdiction funds a waiver of the $3.50 Subscriber Line Charge (SLC), if the state provides a matching $3.50. The matching amount can come from any source; in Florida the matching amount has not come from an explicit fund, but implicitly through the rates charged by LECs to non-Lifeline subscribers. Beginning January 1, 1998, a baseline federal support amount of $3.50 will be available in all states, the District of Columbia, and all territories and possessions, regardless of whether any intrastate support is provided. The baseline amount of federal support will increase from the current $3.50 waiver of the Subscriber Line charge (SLC) to $5.25, provided the state approves the additional support to be passed through in intrastate rates. The federal jurisdiction will also provide additional Lifeline support equal to one-half of any intrastate support, up to an additional $1.75. A total of $7.00 in federal universal support can be received for each Lifeline subscriber.

While intrastate matching may still be provided from any source, the FCC has expressed a preference that states explicitly fund the Lifeline program, rather than generate matching amounts through the state rate-regulation process. In Florida, Lifeline has been implemented under Section 364.10(2), Florida Statutes. The statute states that ". . . a telecommunications company serving as carrier of last resort shall provide a Lifeline Assistance Plan to qualified residential subscribers, as

defined in a commission-approved tariff. . . ." It should be noted, that states must meet the requirements of Section 254(e) of TA 96 in providing equitable and non-discriminatory support for state universal service support mechanisms. It could be argued that because current funding comes from the LECs and its rate payers, Florida's Lifeline program is not equitable and non-discriminatory. The FPSC believes that it would be appropriate for the state matching portion of Lifeline to be recovered as part of any permanent state universal service mechanism. Alternatively, Lifeline could be funded separately, such as through the use of an end user surcharge like that used to fund the Telecommunications Relay System.

According to Section 214(e) of the Act, only an entity that has been designated as an "eligible telecommunications carrier" (ETC) can receive federal universal service support. An ETC must offer those services supported by the federal mechanisms and advertise the availability of these services. In its Universal Service order, the FCC concluded that the provision of Lifeline service should be considered part of the federal "supported services;" the effect of this decision is to require that an ETC must provide Lifeline in order to receive high cost universal service support. The FPSC believes that any necessary statutory revisions (e.g., to Section 364.10(2), Florida Statutes) should be made to allow for the imposition of a similar requirement with respect to any intrastate universal service support mechanism that is established.

(2) The ability of competitive providers to make functionally equivalent local exchange services available to both residential and business customers at competitive rates, terms, and conditions.

The FPSC staff surveyed the 86 ALECs that were certificated as of June 5, 1997. Of the 86, approximately 25% (22 ALECs) were actually providing service in Florida. The parties identified several obstacles they had encountered in entering the local market. Their statements concerning those obstacles fall into four broad categories: regulatory uncertainty, contract issues, pricing issues,

and technical problems.

Some ALECs indicated that regulatory uncertainty is the primary factor delaying their entry into the local service market. The FCC released its order on interconnection, unbundling and resale (CC Docket 96-98, FCC 96-325) on August 8, 1996. It was appealed to the United States Court of Appeals, Eighth Circuit, by numerous parties, including this Commission. The Court released its decision reversing portions of the FCC's original order on July 18, 1997, almost a full year following the FCC's action. During that time, many ALECs were reluctant to begin preparing their operational systems for fear that any actions they took might be undermined by the Court's decision. Similarly, the LECs likely were reluctant to incur the expense and undertake the effort to make changes to their operational systems and networks to accommodate entry by the ALECs. The uncertainty may continue, causing further delay. FCC Chairman Reed Hundt has indicated the FCC intends to appeal the 8th Circuit Court's decision to the Supreme Court. In addition, Senator McCain (Arizona) has stated that he is planning to hold hearings and offer more telecommunications-related legislation early next year. (NECA Washington Watch, August 15, 1997)

The large LECs have entered into agreements with several ALECs. At the time of this writing, BellSouth has entered into 38 contracts for resale, interconnection, or the purchase of UNEs. GTEFL has 10 agreements covering resale or interconnection. Sprint has a total of 11 contracts for resale and some combinations of interconnection, UNEs, and resale. These LECs have several agreements pending as well. Despite the number of agreements entered into or pending, several ALECs have stated they have had, or are having, trouble reaching agreement with the LECs. Some ALECs claim that the LECs use delaying tactics in reaching agreements and do not agree to make needed elements or services available for purchase.

Nevertheless, the number of agreements finalized indicates that entry can be accomplished

despite difficulties. A contract negotiation is a two-way street. A party that is unhappy with the process is usually unhappy because it cannot get something it wants. The fact is that several of the ALECs that expressed having difficulties with the LECs are actually providing or offering service.

Three ALECs contend that they have had little trouble entering the local market, although only one gave a reason for the ease of entry, and its explanation is very terse. Hart Communications stated that it has found the LECs it has been working with, specifically BellSouth and Sprint-Florida, to be very helpful.

Dissatisfaction with the resale discounts is a third area of complaint. ALECs contend that there is not enough margin between what they pay for the element or service, and what price they have to charge to attract customers. BellSouth's wholesale rates for residential local service have been set at a 21.83% discount from the retail rate. BellSouth charges $10.65 for flat rate residential local service in those portions of its territory that have the largest concentration of end users. A reseller can purchase the service for resale for $8.33, a discount of $2.32. At least one ALEC indicates that once marketing, billing, and administrative expenses are factored in, there is insufficient margin remaining to make resale profitable. For an ALEC wanting to resell service in territories where the retail rate for residential flat rate service is considerably less than $10.65, the dollar margin between what the ALEC pays for the service and what he can sell it for would be even less profitable.

Some ALECs are experiencing technical difficulties that are causing them delays in providing services. For example, some ALECs complained of not having customers switched to them expeditiously, and being unable to access or obtain customer records needed to switch customers. Operational support systems (OSS) are generally used to perform these and similar functions. Some ALECs have blamed this problem on the LECs' inadequate operational support

systems. One ALEC stated that the BellSouth's OSS are so poorly engineered that the OSS suffer chronic failures.

From a technical aspect, some ALECs have found that entering the local market is a very complex undertaking. Other ALECs cite difficulties in the daily operational processes, the processes of ordering and provisioning service, and in some cases, obtaining access to buildings to install equipment and wiring.

The data show that the ALECs are able to obtain the items they need to offer service, although not always under the terms they would like. Our research indicates that reaching agreement on the terms for resale, interconnection, and the purchase of UNEs has been difficult for both parties. Sometimes the parties are unable to reach agreement. In this case, they can come to the Commission for arbitration. The Commission has arbitrated 10 agreements to date. Nine have been approved and one is pending. However, numerous parties have been able to enter into agreements without Commission intervention; consequently, it can be done.

(3) The ability of customers to obtain functionally equivalent services at comparable rates, terms, and conditions.

At the time of this writing, 22 ALECs reported they are providing service in Florida. Table 4-1 lists each ALEC, the type of customers it serves, how its service is provided, and the general area it serves.

TABLE 4-1

ALECS PROVIDING SERVICE

ALEC	SERVICE PROVIDED TO:	METHOD	MARKET AREAS SERVED[1]
ACSI	Business	Resale	Jacksonville, Miami, Tampa
BellSouth	Business	Combination of methods	Orlando
Cable & Wireless	Business	Resale	Miami, Tampa, Orlando

Communications Service Centers	Business	Facilities-Based	Miami
COMUSA	Residential	Resale	Daytona Beach, Gainesville, Miami
Easy Cellular	Residential	Resale	Throughout Florida
Florida Comm South	Residential	Resale	Jacksonville, Miami
Hart Communications	Residential	Resale	Jacksonville, Daytona Beach, Gainesville, Panama City
Intermedia Communications	Residential & Business	Resale	Miami, Ft. Lauderdale, West Palm Beach, Orlando, Jacksonville, Tampa

TABLE 4-1

ALECS PROVIDING SERVICE

ALEC	SERVICE PROVIDED TO:	METHOD	MARKET AREAS SERVED[1]
Intetech	Residential & Business	Resale	Jacksonville, Gainesville, Tallahassee
Jetcom	Residential	Resale	Miami, West Palm Beach, Gainesville
LCI	Business	Resale	Miami, West Palm Beach
MCImetro	Business	Facilities-Based	Miami, Tampa, Orlando
MediaOne	Business	Facilities-based	Jacksonville and Ft. Lauderdale
NationalTel	Residential & Business	Resale	Orlando
PCS	Residential & Business	Resale	Miami
Reconex	Residential	Resale	Jacksonville, Orlando, Miami, Tampa, West Palm Beach
SMNI	Business	Combination of Methods	Orlando
TCCF	Residential & Business	Resale	Miami, Tampa, Orlando, West Palm Beach, Jacksonville
TCG	Business	Facilities-Based	Miami
The Other Phone Company	Residential & Business	Resale	Miami, West Palm Beach, Jacksonville
Unicom Communications	Residential & Business	Resale	Miami, West Palm Beach

1. In this case, a market area refers to a territory surrounding a major city. It does not designate an exchange. It can contain several exchanges. See Table 4-4 for exchange specific data. The list of market areas for each ALEC may not be all-inclusive.

Sixteen have entered via resale, four through use of their own facilities, one combining resale with its own facilities, and one combining UNEs with its own facilities. For an ALEC using resale, either in its entirety or in combination with its own facilities, the service it offers would be functionally equivalent to that available from the incumbent. The service is the same, only the name of the

provider is different.

Assuming an ALEC is offering quality service, price is the one factor the ALEC can use to attract customers. BellSouth, GTEFL, and Sprint-Florida have traditionally set rates for basic local service by rate groups. The size of the rate group is determined by the number of parties (as measured by access lines) in the local calling area.

The ALECs can choose whatever pricing scheme they believe will work the best for them. Some ALECs have elected to set up their price structures using rate groups. For example, Intermedia Communications of Florida, Inc. (ICI), The Other Phone Company, and Unicom Communications have prices arranged by rate groups. ICI has rate groups and prices set in relation to the LEC territory in which it is operating. ICI has one set of prices for its local service offerings in GTEFL's territory and another set of prices for BellSouth's territory. Similarly, some ALECs are setting rates by city. Intetech has separate rates for Jacksonville and Gainesville. This pricing practice may be directly tied to the LEC's pricing. A reseller such as ICI and Intetech resells local service which it purchases at a wholesale rate based on the service's retail rate. Retail rates differ by rate group and by company. As a result, the reseller is paying differing wholesale rates and would likely price its service offering to reflect the differing cost. The above reasoning assumes the ALEC wants to price its service at comparable levels to the LEC, which is not always the case. Some ALECs have found a potentially profitable niche by charging for local service well in excess of LEC rates. These ALECs purchase local service at wholesale rates and resell it with toll blocking on a prepaid basis (service is paid for in advance). Their typical customer has been denied local service from the LEC because of non-payment or late payment, a lack of personal identification to obtain service, or a bad credit history. ("Phone Sharks: Instigators of Local Competition," Exchange, August 1997, pp. 28-29) Based on their rates and blocking requirements,

there are at least two providers in Florida that may fit this description. The charge for basic service provided by Easy Cellular is $39.95, per month, prepaid, with toll blocking and other number blocking applicable at the carrier's discretion. Hart Communications charges $47.95 for its service with the similar restrictions.

A few ALECs such as Easy Cellular and Hart Communications are charging a flat rate without regard to location or customer type. At least one ALEC, MCImetro, offers along with a flat rate option, an option where the customer is subject to usage-based rates in a fashion similar to traditional long distance. The Company charges a monthly recurring charge along with a per-minute charge.

ALECs are not currently required to offer service to all who request service. Therefore, whether or not service is available to business customers, residential customers, or both depends on the particular ALEC. Nine ALECs are providing service exclusively to business customers, six to residential only, and seven to both business and residential customers. In areas where the ALEC is offering service only to a selected group, the other group has no choice but the LEC. For example, residential customers residing in the service territory of an ALEC that serves only business users may not be able to get alternative local service.

For those customers having a choice of local exchange provider, it appears that they are able to obtain service at comparable rates. Table 4-2 shows the business and residential rates by various exchanges for some of the ALECs. For comparison purposes, the corresponding LEC rates for those exchanges are also shown.

TABLE 4-2

LOCAL RATES FOR SELECTED ALECS IN VARIOUS EXCHANGES

ALEC	EXCHANGE/LEC	ALEC RATE		LEC RATE	
		BUSINESS	RESIDENTIAL	BUSINESS	RESIDENTIAL
BELLSOUTH	Winter Park/Sprint-Florida	$24.00	N/A	$24.03	$10.23
INTERMEDIA	Tampa/GTEFL	$26.91	$10.63	$29.90	$11.81
	Miami/BellSouth	$26.19	$9.59	$29.10	$10.65
INTETECH	Jacksonville/BellSouth	$28.00	$10.30	$28.00	$10.30
	Gainesville/BellSouth	$28.00	$9.15	$24.60	$9.15
	Tallahassee/Sprint-Florida	$21.79	N/A	$21.75	$9.65
TCCF	Orlando/BellSouth	$25.75	$9.50	$28.60	$10.45
SMNI	Orlando/BellSouth	$24.00	N/A	$28.60	$10.45
EASY CELLULAR	Ft. Lauderdale/ BellSouth	$39.95	$39.95	$29.10	$10.65
THE OTHER PHONE COMPANY	Hollywood/BellSouth	$27.64	$10.12	$29.10	$10.65
HART COMMUNICATIONS	Panama City/BellSouth	$47.95	$47.95	$23.85	$8.80
UNICOM COMMUNICATIONS	Perrine/BellSouth	$29.10	$10.65	$29.10	$10.65

N/A = Not available

For the most part, the ALECs providing service appear to be charging rates that are similar to the rates charged by the LECs with two exceptions. Easy Cellular's rate is $39.95 and Hart Communication's rate is $47.95, both regardless of customer type.

Along with determining if customers can obtain services at comparable rates, the FPSC is also required to examine if customers can obtain services on comparable terms and conditions. Comparing the terms and conditions from ALEC to ALEC and from ALEC to LEC is difficult due to the variety of ways the ALECs structure their price lists. However, the primary LEC terms and

conditions can be roughly reduced to five categories: 1) limitations on the use of service, 2) establishing and furnishing service, 3) payment arrangements, 4) liability of the company, and 5) obligation of the company. "Limitations on the use of service" refers to who can use a service and for what. An example of limitations on the use of service is restricting a customer from using a service for illegal purposes. This section may also include cancellation of service provisions. "Establishing and furnishing service" lists what the customer can get -- for example, flat rate service or message rate service. It also includes how the customer goes about ordering service and the methods for maintaining the service. "Payment arrangements" include when and how payment for service is to be made. This section may include provisions for advance payments, payment of taxes, and payment programs and plans. The "liability of the company" section addresses the various provisions and events the company may or may not be held liable for. The "obligation of the company" section is the portion where the company states that it will provide service where it is able to do so.

Most ALECs include similar terms and conditions in their price lists in one form or another. Although ALECs certificated in Florida must adhere to certain Commission rules, they are not required to meet the same requirements and operate under the same conditions as the LECs. However, information included in the ALEC price lists indicates that there is general comparability in the terms and conditions under which service is offered by the ALECs and the LECs. Hence, it is reasonable to assume ALEC customers are being offered service under at least similar terms and conditions as the LECs.

The data regarding the ability of the customer to obtain functionally equivalent services at comparable rates, terms, and conditions is mixed. For the most part, ALEC rates are comparable to the LEC rates. Many ALECs do not wish to offer service to all customers. Some ALECs target only residential customers, while other ALECs offer service only to business customers. Additionally, ALECs are not required to make their service universally available. They can target selected territories, such as areas where high-volume customers reside, and ignore territories where calling volumes are lower. Subject to these caveats, customers appear to be able to obtain service from ALECs under terms and conditions comparable to the LECs.'

(4) The overall impact of price regulation on the maintenance of reasonably affordable and reliable high-quality telecommunications services.

The LEC remains the dominant primary local service provider, whether price-regulated or rate-of-return regulated, because there has been so little competitive entry. Since there have been virtually no rate increases, services continue to be reasonably affordable (assuming they were reasonably affordable prior to price cap legislation). Especially notable is that rates for the essential service, basic local service, have remained static for the last several years. Further, basic service rate caps are to remain in place until January 1, 1999 for price-regulated LECs with fewer than 3 million access lines, and until January 1, 2001 for BellSouth. The three largest price regulated LECs, BellSouth, GTEFL, and Sprint-Florida, serve over 98% of the access lines in the state.

When under rate of return regulation, the LECs offered high quality services. In the current price cap regulatory environment, it appears that service continues to be high quality.

A particularly relevant measure of quality of service is the degree to which customers are satisfied with service. In terms of customer complaints, the number of justified complaints filed

with the Commission against these three companies is steady or falling (see Table 4-3 below).

Table 4-3

Customer Complaints - Justified[1]

COMPANY	1996	1997 - YTD[2]
BELLSOUTH	234	160
GTEFL	300	126
SPRINT -FLORIDA	81	29

1. Justified = action of the utility was an infraction of a Commission rule
2. Year to Date ending August 1997

In addition to the total number of complaints holding steady or falling, in comparison to the number of access lines the LECs serve, the ratio of complaints to the number of access lines is very small. To illustrate, for the period January 1, 1997 to August 31, 1997, For the three largest LECs, the number of infractions per 1,000 access lines was 0.0272 for BellSouth, 0.0593 for GTEFL, and 0.0160 for Sprint-Florida.

Some parties were concerned that when a LEC became price-regulated, its service quality would decline. Judging by customer complaints, despite the LECs being allowed the greater freedom afforded by price regulation, they continue to provide high quality service.

During 1996, the Commission conducted service evaluations of three price-regulated LECs: BellSouth, GTEFL, and Sprint-Florida. In determining if a company is providing quality service, the Commission measures each company's overall performance based on 70 service variables.

It is important to note two caveats regarding the service evaluation process. First, the process involves examining several service categories ranging from the delivery of dial tone to the provision of pay phones and there can be a number of variables within each category. Each variable is assigned a weight based upon its importance in the provision of service. For example, a delay in delivering dial tone is heavily weighted as is the ability of a customer to quickly be connected to

911. On the other hand, whether or not a telephone directory is in evidence at a pay phone station is not as heavily weighted.

Second, due to manpower constraints, a service evaluation is performed on a sample of a LEC's central offices. For example, for GTEFL's 1996 evaluation, six of the Company's over 60 central offices were examined. BellSouth's evaluation involved seven of the Company's over 200 central offices. Service problems found at one location may not be inherent in all of a company's remaining central offices.

Although the overall performance of a company may be adequate, it means little to a person who has lost service and is unable to reach the company service office to get service restored. The customer is unhappy with service. It is this very situation that creates opportunities for competitors. In a competitive environment, the LEC would be wise to eliminate any deficiencies in its provision of service or it must face losing customers. However, there has been no conclusive evidence to date indicating that the quality of service has deteriorated.

(5) What additional services, if any, should be included in the definition of basic local telecommunications services, taking into account advances in technology and market demand.

There should be no additions or deletions at this time. However, it should be noted that the definition of basic local service differs between LECs and ALECs. The LEC-provided basic local service includes ". . . voice grade, flat-rate residential and flat-rate single-line business local exchange services which provide dial tone, local usage necessary to place unlimited calls within a local exchange area, dual tone multi-frequency dialing (touch dialing), and access to the following: emergency services such as '911,' all locally available interexchange companies, directory assistance, operator services, relay services, and an alphabetical directory listing." (Section 364.02(2), Florida Statutes)

In contrast, the list of services included in ALEC-provided basic local service is not nearly as extensive. The ALEC provided basic local service includes ". . . access to operator services, '911' services, and relay services for the hearing impaired." The ALEC is also required to offer a flat-rate pricing option. (Chapter 364.337(2), Florida Statutes) Thus, the ALEC does not have to provide, touch dialing, access to IXCs, directory assistance, or directory listings.

(6) Any other information and recommendations which may be in the public interest.

No additional information is provided at this time.

SUMMARY OF STATUS OF LOCAL COMPETITION THROUGHOUT FLORIDA

To summarize the status of local competition throughout Florida, competitive entry is occurring in Florida. Eighty-six ALECs were certificated in Florida as of June 5, 1997. Some competitors have had difficulty obtaining needed elements or facilities from the LECs, but the issues arising from the difficulties are gradually being resolved. With 22 ALECs providing service, it is evident that these ALECs have been able to work with the LECs to get what they need. The ability of customers to obtain service from an ALEC is very limited. ALECs have not entered every market in Florida, and the smaller markets will likely continue to have limited competitive entry as most ALECs are focusing on the larger markets. In several markets where ALECs are providing service, service availability is limited to either residential customers only or business customers only. Most ALECs' rates for basic local service are fairly close to the rates charged by the LECs for equivalent service. However, one or two ALECs charge substantially higher rates than the LEC. These ALECs are probably targeting customers the LEC has denied service to because of lack of payment or credit problems. Six of Florida's 10 LECs have elected to be price-regulated. Prior to these six LECs being price-regulated, quality telecommunications services were offered at reasonable rates. We

have no reason to believe that price regulation has had an impact, either positive or negative, on the quality and affordability of telecommunications services to date.

STATUS OF LOCAL SERVICE COMPETITION IN FLORIDA BY EXCHANGE

The Commission is required to report on price caps. Chapter 364.051(3)(a), Florida Statutes, requires the Commission to " . . . report and recommend on an exchange by exchange basis . . . whether there is a need to extend price caps . . . for basic local telecommunications service prices, or whether there is some other means, excluding rate of return regulation, to ensure reasonable and affordable rates for basic local telecommunications service."

The law indicates that consideration on whether to extend or lift price caps for price regulated LECs must be applied on an exchange by exchange basis. If a company is facing competition in a single exchange, price caps on basic local service could be lifted for that exchange only. The LEC's remaining territory is unaffected. For example, Sprint-Florida has over 100 exchanges, including the East Orange and Orlando exchanges. If competition is sufficient in the East Orange exchange, which abuts the Orlando exchange and is in the same county, price caps could be lifted for the East Orange exchange, while remaining in effect for the Orlando exchange.

The Commission examined, by exchange, the level of local competition the LECs face from ALECs. The FPSC evaluated several factors to determine if the ALEC market share has been increasing. These factors include the number of competitors providing service in the exchange, the number of access lines each competitor has by exchange, and the type of customer -- residential, business, or both -- to whom the provider is offering service.

LECs claim that they are facing competition in the local services markets. For a LEC's claim to be considered, there must be a competitor actually providing local service in an exchange in the

LEC's territory. According to responses to staff's data requests, there are competitors providing local service in several exchanges. Table 4-4 lists those exchanges where an ALEC is providing service, the number of ALECs serving business and residential customers in the exchange, and the percentage of the total lines in the exchange served by the ALEC (if not proprietary). To avoid revealing data that may be considered confidential, a percentage range of ALEC lines served is included.

TABLE 4-4

EXCHANGES WITH AN ALEC PROVIDER [1]

Exchange	Total ALEC Bus. Providers	% of Bus. Access Lines ALEC Providers	Total ALEC Res. Providers	% of Res. Access Lines ALEC Providers
Apopka	1	> 0 to .99%	2	> 0 to .99%
Archer	1	1% to 4.99%		
Baldwin	1	> 0 to .99%		
Belle Glade	1	> 0 to .99%		
Belleview	1	> 0 to .99%		
Big Pine Key	1	> 0 to .99%	1	.02%
Boca Raton	4	1% to 4.99%	4	> 0 to .99%
Boynton Beach	3	1% to 4.99%	3	> 0 to .99%
Bradenton	1	> 0 to .99%		
Branford	1	> 0 to .99%		
Brooksville	1	> 0 to .99%		
Bunnell			1	.07%
Bushnell	1	1% to 4.99%		
Cape Coral	1	> 0 to .99%	1	> 0 to .99%
Chiefland	2	1% to 4.99%		
Citra	1	> 0 to .99%		
Clearwater	1	> 0 to .99%		
Clermont	1	> 0 to .99%		
Cocoa	2	> 0 to .99%	3	> 0 to .99%
Cocoa Beach	1	> 0 to .99%		
Coral Springs	2	1% to 4.99%	2	> 0 to .99%
Cross City	1	> 0 to .99%		
Crystal River	1	> 0 to .99%		
Dade City	1	1% to 4.99%	1	> 0 to .99%
Daytona Beach	2	> 0 to .99%	4	> 0 to .99%
DeBary	1	> 0 to .99%		
Deerfield Beach	4	> 0 to .99%	2	> 0 to .99%
Deland	1	> 0 to .99%	2	.01%
DeLeon Springs	1	1% to 4.99%		
Delray Beach	4	> 0 to .99%	3	> 0 to .99%
Dunnellon	1	> 0 to .99%		
Eau Gallie	1	> 0 to .99%	1	> 0 to .99%
Englewood	1	> 0 to .99%		
Eustis	1	> 0 to .99%		
Fernandina Beach	1	1% to 4.99%	1	> 0 to .99%
Ft. Lauderdale	8	1% to 4.99%	5	> 0 to .99%
Ft .Pierce	1	> 0 to .99%	1	> 0 to .99%
Ft. White	1	> 0 to .99%		
Gainesville	4	1% to 4.99%	6	> 0 to .99%
Geneva			2	> 0 to .99%
Green Cove Springs	1	> 0 to .99%		
Greensboro	1	> 0 to .99%		
Haines City	1	> 0 to .99%		

TABLE 4-4

EXCHANGES WITH AN ALEC PROVIDER [1]

Exchange	Total ALEC Bus. Providers	% of Bus. Access Lines ALEC Providers	Total ALEC Res. Providers	% of Res. Access Lines ALEC Providers
Homestead	2	1% to 4.99%	2	> 0 to .99%
Homosassa	1	> 0 to .99%	1	> 0 to .99%
Howey-in-the-Hills	1	> 0 to .99%		
Hudson	1	> 0 to .99%		
Inverness	1	> 0 to .99%		
Islamorada	1	> 0 to .99%	1	> 0 to .99%
Jacksonville	7	5% to 6.99%	7	1% to 4.99%
Jacksonville Beach	1	1% to 4.99%	1	> 0 to .99%
Jensen Beach	1	> 0 to .99%		
Jupiter	3	> 0 to .99%	3	> 0 to .99%
Key Largo	1	> 0 to .99%	1	.007%
Key West	4	1% to 4.99%	4	> 0 to .99%
Kissimmee	2	1% to 4.99%	1	> 0 to .99%
Lake City	2	1% to 4.99%	2	> 0 to .99%
Lakeland	1	> 0 to .99%		
Lake Wales	2	> 0 to .99%		
Leesburg	1	> 0 to .99%	1	> 0 to .99%
Live Oak	1	> 0 to .99%		
Madison			1	.6%
Marathon	1	> 0 to .99%	1	.03%
Marco Island	1	> 0 to .99%		
Maxville	1	1% to 4.99%		
Melbourne	2	> 0 to .99%	3	> 0 to .99%
Miami	9	1% to 4.99%	8	> 0 to .99%
Middleburg	1	> 0 to .99%		
Monticello			1	.2%
Mount Dora	1	> 0 to .99%	1	> 0 to .99%
Newberry	1	> 0 to .99%		
New Port Richey	1	> 0 to .99%		
New Smyrna Beach	1	> 0 to .99%	1	.007%
North Dade	1	1% to 4.99%	2	> 0 to .99%
North Port	1	> 0 to .99%		
Oak Hill			1	.05%
Ocala	1	> 0 to .99%	1	> 0 to .99%
Old Town	1	1% to 4.99%		
Orange City	1	> 0 to .99%	1	.005%
Orange Park	1	> 0 to .99%	1	> 0 to .99%
Orlando	6	1% to 4.99%	3	> 0 to .99%
Oviedo	2	1% to 4.99%	1	> 0 to .99%
Pahokee	1	> 0 to .99%		
Palatka	1	> 0 to .99%	1	.04%
Palm Coast	1	> 0 to .99%	1	.02%
Palmetto	1	> 0 to .99%		
Panama City	2	> 0 to .99%	1	.03%

TABLE 4-4

EXCHANGES WITH AN ALEC PROVIDER [1]

Exchange	Total ALEC Bus. Providers	% of Bus. Access Lines ALEC Providers	Total ALEC Res. Providers	% of Res. Access Lines ALEC Providers
Panama City Beach	1	> 0 to .99%	1	> 0 to .99%
Pensacola	2	> 0 to .99%		
Perrine	1	> 0 to .99%	2	> 0 to .99%
Plant City	1	> 0 to .99%		
Pompano Beach	6	1% to 4.99%	3	> 0 to .99%
Ponte Vedra Beach	1	1% to 4.99%	1	> 0 to .99%
Port St. Lucie	1	> 0 to .99%		
Reynolds Hill	1	1% to 4.99%		
Sanford	3	> 0 to .99%	2	> 0 to .99%
Sarasota	2	> 0 to .99%		
Sebastian	1	> 0 to .99%	1	> 0 to .99%
Silver Springs Shores	1	> 0 to .99%		
St. Augustine	2	> 0 to .99%	1	.003%
St. Petersburg	1	> 0 to .99%		
Stuart	1	> 0 to .99%		
Sugarloaf Key	1	> 0 to .99%	1	> 0 to .99%
Tallahassee	3	> 0 to .99%	3	> 0 to .99%
Tampa	3	> 0 to .99%	1	.0002%
Tarpon Springs	1	> 0 to .99%		
Titusville	2	> 0 to .99%	2	> 0 to .99%
Trenton	1	> 0 to .99%	1	.03%
Venice	1	> 0 to .99%		
Vero Beach	2	> 0 to .99%	2	> 0 to .99%
Weekiwachee Springs	1	> 0 to .99%		
Welaka	1	> 0 to .99%	1	> 0 to .99%
West Palm Beach	7	1% to 4.99%	6	> 0 to .99%
Wewahitchka	1	> 0 to .99%		
Wildwood	1	1% to 4.99%		
Windermere			1	> 0 to .99%
Winter Garden	1	> 0 to .99%	1	> 0 to .99%
Winter Haven	1	> 0 to .99%		
Winter Park	3	> 0 to .99%	1	> 0 to .99%
Yankeetown	1	1% to 4.99%	1	> 0 to .99%
Youngstown-Fountain	1	> 0 to .99%		
Zephyrhills	1	1% to 4.99%		

1. The data for one ALEC is excluded due to insufficient detail.

The tables below summarize the number of exchanges where ALECs are providing basic local service, and in what areas there are the most ALECs providing service.

Table 4-5

SUMMARY OF FLORIDA EXCHANGES WITH AND WITHOUT AN ALEC PROVIDER

Exchanges With One ALEC Provider	74
Exchanges With Two ALEC Providers	23
Exchanges With Three or More ALEC Providers	28
Exchanges Without an ALEC Provider	158
Total Exchanges in Florida	283

Table 4-6

EXCHANGES WITH THE MOST ALEC PROVIDERS

EXCHANGE	SERVING		TOTAL ALEC PROVIDERS [1]
	Business	Residential	
Ft. Lauderdale	8	5	11
Gainesville	4	6	8
Jacksonville	7	7	10
Miami	9	8	14
Orlando	6	3	7
Pompano Beach	6	3	7
West Palm Beach	7	6	9

[1]Total does not add across columns because an ALEC provider may offer service to both business and residential customers in the exchange.

Most of the exchanges with one or two ALECs are located in smaller market areas. A notable exception is the Tampa exchange. The Tampa exchange has numerous high volume users, particularly business customers, concentrated in a fairly small area. Such a market would likely be attractive to competitors, but the exchange has just three providers of business service and one provider of residential service. Two of Tampa's neighboring exchanges, St. Petersburg and

Clearwater, each have only a single ALEC providing only business service.

The number of competitors in an exchange may be of little value as an indicator of the degree of competition if competitors have been unsuccessful in obtaining customers. A more significant number for determining the level of competitive entry is the number of access lines the competitors are actually serving, compared to the total number of access lines in service. The total number of business and residential access lines served by the 22 ALECs is 56,160. In comparison, the total number of access lines served by the three largest LECs is approximately 10.7 million. The total number of business access lines served by all entrants combined is 42,303, and the total number of residential access lines is 13,857. The three largest LECs serve approximately 2.9 million business lines and 7.8 million residential access lines. In percentages, the competitors account for 0.5% of the total access lines served, 1.4% of the business access lines, and 0.2% of the residential access lines.

The majority of the ALECs are focusing on markets that have large populations with large concentrations of customers. Despite this targeting, the number of access lines these providers serve is extremely small in comparison to the number of access lines the LEC serves. Based on access lines served, there is only one exchange in the state, Jacksonville, where ALECs have garnered even 5% of the market, and this is only for business lines. For no exchange is the percentage of residential lines served by an ALEC anywhere near 5%. In fact, in only one exchange, Jacksonville, do ALECs account for more than 1% of the residential access lines. Twenty-nine exchanges have ALECs that serve in excess of 1% of the total business lines. Eighty-seven exchanges have ALECs serving less than 1% of the business lines.

There is no requirement that a competitor's services be available to all customers. In some exchanges, the competitor is limiting the availability of its service to one of the two customer classifications, residential or business. For example, MCImetro offers service only to business customers, while Reconex limits its service to residential customers. In exchanges where there is a single competitor that offers service only to a selected group of customers, the other classification of customers is without an alternative to the LEC. Therefore, a competitor can be operating in an exchange and have customers, but still not be competing for **all** customers.

The discussion in this section has addressed competitive entry in Florida on an exchange-by-exchange basis. The data show that a majority of the 280 plus exchanges in Florida do not have an ALEC serving any customers, and in the majority of those exchanges where a competitor is serving, there is only one ALEC. The exchanges in the largest markets in Florida have the most ALECs, with the exception of the Tampa area. Judging by the number of ALEC customers, competitors have not obtained a significant portion of the market in any exchange. Collectively, the ALECs providing service serve less than 0.5% of the total lines in Florida. In only one exchange have competitors (combined) been able to gain up to 5% of the market. In some exchanges where ALEC service is offered, not all customers have a choice. In many exchanges, service is limited either to business customers at the exclusion of residential customers, or to residential customers at the exclusion of business customers.

SUMMARY & RECOMMENDATION

SUMMARY

Robust competition has not yet developed. As of June 1, 1997, the Commission had issued ALEC certificates to 86 carriers; only 22 of these ALECs were actually providing service. There are numerous complex issues that have arisen, and many competitors will have to resolve these issues before entry will occur. To quote AT&T with respect to the Act: "Let's keep in mind, though, that this was an act of Congress, not an act of God. No one can pry the local markets open overnight or even over one year." (1996 AT&T Annual Report, p. 3)

As we explore and look at the barriers to competition and evaluate implicit subsidies, the Commission may need flexibility and authority in addressing those issues. Solutions may include a permanent universal service mechanism, rate rebalancing and deaveraging. The Commission may need authority to address these issues, within the guidelines set forth by the Legislature.

RECOMMENDATION ON THE NEED TO EXTEND PRICE CAPS

Section 364.051(3)(a), Florida Statutes, requires the Commission to report and recommend on whether there is a need to extend price caps for basic local service beyond their current expiration dates. Basic local service rates are capped until January 1, 2001 for BellSouth and January 1, 1999 for all other price cap LECs. The Commission is also to make its recommendation on an exchange by exchange basis, based on an evaluation of the extent of competition present in each exchange. Section 364.051, F.S, states that the level of competition will be used to justify any decision to eliminate or extend price caps. Based upon our findings the Commission recommends price caps for basic local service should be extended an additional two years for everyone but BellSouth

beyond the current schedule.

Parties have argued that the mere presence of a competitor operating in an exchange fulfills the requirement that competition is occurring. However, we contend that having a competitor in evidence is a necessary condition for competition, but not a sufficient condition. Competitors should be engaged in active, vigorous rivalry, each trying to sign up new customers and trying to take customers away from each other.

There is no hard and fast figure at which point a market can be proclaimed to be "competitive." Defining a specific point can be highly subjective. Based on data on the number of access lines the ALECs are serving, where they are serving, and to which customer classes, it is difficult, if not impossible, to conclude that the local services market in Florida is anywhere near competitive. In our view, a market share of 1% to 7% is not indicative of robust competition.

The only truly viable alternative to price caps is open, unfettered market competition. Price caps are a step along the way for a market that is moving toward being a competitive one, but has not yet reached that stage. Price caps are effective at limiting the amount prices can be raised by a competitor having significant market power, in this case the LEC. At the same time, price caps acknowledge that the market is becoming more competitive and allow the LEC some latitude in its pricing decisions. Once competition is sufficient, competition itself will limit prices. What price caps fail to do, however, is to force the LEC to pass on any cost reductions to ratepayers in the absence of competition. Under rate base regulation, excess profits were flowed back to the ratepayers. Under price-regulation, excess profits are retained by the company if there are not enough competitors to bring market pressures to bear.

The results of our survey indicate that entrants appear to be focusing to the greatest degree on BellSouth's territory. In contrast, competitive entry in other LEC territories has been extremely

limited. While ALECs have managed to attract approximately .2% and 2% of the residential and business access lines, respectively, in BellSouth's service area, analogous percentages in the territories for the other price cap LECs are even more modest. For example, in GTE Florida's territory, ALECs have obtained less than .05% of the residential lines and approximately .5% of the business lines, while in Sprint-Florida's territory, ALECs have roughly .05% of the residential lines and .2% of the business lines.

Based on the lack of local exchange competition present, we recommend that the price caps on basic local telecommunications prices be extended for an additional two years, until 2001, for price cap LECs with fewer than 3 million access lines: (currently) GTE Florida, Sprint-Florida, Indiantown, GTC (Gulf, Florala, St. Joseph), and Vista-United. Under the terms of Section 364.051 basic local price caps for these companies could expire on January 1, 1999. Since it is highly unlikely that significant local exchange competitive local entry will flower in the next 13 months, we believe it is appropriate for the Legislature to act during the 1998 session to extend these price caps.

However, at this time we decline to recommend that basic local price caps should be extended for BellSouth. Although the extent of competitive entry in BellSouth's service area admittedly has been modest, we believe that it is not necessary to recommend now on whether BellSouth's caps should be extended past 2001, their current expiration date. Although future trends for entry are unclear, a reasonable step is to wait and see how much local competitive entry occurs in the next few years. If meaningful local competition does not flourish in BellSouth's territory, we can apprise the Legislature as late as the 2000 session of any need to extend price caps.

Although we thus believe, given the facts currently before us, that basic local price caps for all price cap LECs should remain in place until January 1, 2001, the Legislature has provided the

Commission with an avenue to acknowledge future competitive changes in an exchange. Section 364.051(3)(c) provides that during this two-year period, if the Commission subsequently determines that the level of competition in an exchange justifies the elimination of price caps, the Commission can eliminate caps in that exchange. The Commission will continue to encourage local competitive entry and conduct research for its annual reports on the status of competition. As part of these efforts, the Commission will continue to monitor the level of competition by exchange and will keep you apprised of our research. If appropriate, we will provide recommendations on proposed legislative changes for future sessions.

CHAPTER V: POSSIBILITIES - THE FUTURE DIRECTION OF COMPETITION?

Last year's Competition Report included a chapter identifying some future directions that competition might take. Appendix D of this report reviews the accuracy of those forecasts. The conclusion to be drawn from Appendix D is that the direction in which competition is evolving in Florida remains unclear because it is still in such a nascent stage of development. Again, this year there is limited actual experience to draw from to formulate an estimate of the future of competition within the state. However, several information sources provide some idea of the areas in which competition may soon evolve. These include reported financing and construction activities and activities by various companies. Also, in terms of both geography and economics, there are areas where competition would meet less resistance than it would in other areas. The following discussion is devoted to predicting some potential directions competition might take.

A great deal of the data gathered for this report is not Florida-specific, but is national or regional. Consequently, any prediction made concerning Florida will be made based at least in part on this national data.

Prediction: In Florida, LECs will continue to dominate the local services market.

Despite all the talk of impending competition, there has been little actual entry by competitors into the local market. In Florida, telephone service (i.e., wireline local service) is ubiquitously available. As of July 1997, the percentage of households with telephone service in Florida was 93.1% (Telephone Subscribership in the United States, Federal Communications Commission, October 1997, p. 7). The figure is not 100% because there are persons unable to afford service and there are persons who, for whatever reasons, simply do not want service.

In all likelihood, the LECs will continue to dominate the local market for the foreseeable future. When the long distance market was opened to competition, AT&T had well over 90% of the market. It took almost 10 years for AT&T's market share to drop below 60%. If the same holds true for the local market, the LEC will be the dominant carrier for a long time.

There is some risk in forecasting the evolution of competition in the local market on the basis of the evolution in the IXC market. First entry into the IXC market was less complicated and less costly for the entrant. When long distance competition developed, competing long distance networks needed only one connection to each LEC in each LATA -- at the access tandem. The single connection gave each long distance company access to every customer within that LATA, and precluded the necessity for each long distance company to build facilities into each end office. The effect of this was two-fold: it saved the IXCs money by reducing the size of the network needed and it reduced the need for the financing to create such a network; and it decreased the amount of time it would otherwise take for competitors to enter. Second, the margin between the retail price of basic local service and the wholesale price may be too small to make resale viable. When long distance competition emerged, AT&T was required to offer its long distance services for resale, similar to what has been mandated in the local market. However, in 1984, retail toll prices (MTS) were significantly above their wholesale cost (WATs), creating a large margin. This was crucial in encouraging entry. These margins simply do not exist for local resale.

Using the federal "avoided cost" method, where the margin is based upon the costs the LEC avoids by selling the service at wholesale rather than retail, has been little help. The average discount from the local retail rate has ranged between 17% and 22% nationally, leaving little room for profit. Even if the ALEC prices service at a 10% discount off the LEC's rates, it is faced with covering its internal marketing, operational, and other costs with the remaining 7% to 12%. This

margin may not be enough to encourage large numbers of ALECs to enter the market using resale.

There are several additional reasons why the LECs will likely maintain substantial market share well into the future. Starting and operating a telephone company, particularly a facilities-based company, is a technically complex task. Potential competitors already having substantial facilities, such as the cable TV providers, are finding that reengineering their systems to allow the provision of local phone service is more difficult and expensive than first thought. This has inhibited their ability to enter and compete with the LECs.

For some potential competitors, the investment needed to install the facilities is prohibitive. In some cases, investing in areas other than telephony has made far more economic sense when the return on investment is more predictable. The LECs are not in the same position. For the most part, the LECs are well financed and, with very high bond ratings in comparison to other players, have access to additional financing, when needed.

Most ALECs are not yet recognized as telephone companies. Many ALECs are well known, but for reasons other than being telephone companies. For example, Time Warner is a recognized leader in the entertainment field; Comcast is well known as a provider of cable TV service. For some ALECs, such as the City of Lakeland, making the connection between their primary line of business as a provider of municipal services and being a provider of telephone service may take time.

The ALECs have yet to establish a presence that is highly recognized. Currently, there are over 100 ALECs certificated to provide local service in Florida. Only a handful of these are actually offering service, and then only on a limited basis. Their services are available either to selected buyers such as businesses, or confined to locations where high volumes of traffic are in evidence.

On the other hand, the LECs are acknowledged for their provision of telephone services, and

in particular local service. For most end users, the LECs have been the only choice for obtaining local service. End users, having little or no experience with an alternative carrier may be reluctant to switch.

Prediction: ALEC entry will be primarily in locations with high concentrations of businesses and locations of least entry resistance.

ALECs will select locations for entry where the potential for profits is the greatest and entry is easiest. The LECs have a statutory requirement to be the carrier of last resort (COLR). The LECs must provide ". . . basic local exchange telecommunications within a reasonable time period to any person requesting such service within the company's service territory." (Chapter 364.025(1)) The LEC cannot deny service because it is uneconomical to provide it or it is too costly to install the facilities to provide service. Unlike the LECs, the ALECs do not have a statutory requirement to be the COLR. Within certain limitations defined by statute, they can pick and choose to whom they want to provide service.

The ALECs' likely early targets will be those customers who offer the greatest profit potential, i.e., high volume users that can be easily served with a minimum of expense. These targets would probably be in locations where businesses are concentrated, such as office parks and downtown areas of large cities. Several entrants have already demonstrated their desire to focus on business customers, and there is no reason to expect that to change.

AT&T, MCI, and WorldCom are new entrants into the local market. AT&T has two local service offerings directed at business customers. Business local service is a full featured service available on a limited basis at this time (in California). Digital Link ". . . is an outbound facilities based local service available in 45 states that's targeted at businesses with dedicated links to

AT&T's network." (1996 Annual Report, p. 13) MCI is entering the local market in a fashion similar to the way it entered the long distance market. "Our entry into local services via the business market parallels our entry in the long distance market - a strategy that changed the long distance landscape forever." (1996 MCI Annual Report, p. 1) However, MCI fully intends eventually to enter the residential markets as well. (1996 MCI Annual Report, p. 1) WorldCom appears to have focused almost entirely on the business customer. Its 1996 WorldCom Annual Report cover is demonstrative of WorldCom's desire to be the one source for "Local, Long Distance, International and Internet Services For **Business** Communications." (emphasis added)

Winstar Wireless, an ALEC, has adopted a strategy of targeting small and medium size businesses where competitive opposition is expected to be limited. The idea behind this strategy is for the Company to avoid competitors by establishing itself as "the" ALEC before other competitors arrive. The Company's belief is that many of its potential customers will not be served by competitors. Consequently, Winstar will have the advantage of being "first-to-market" for these customers. (Form 10K, year ending December 31, 1996, pp.5-6) Winstar indicates it will provide service in Tampa and Miami. (Form 10K, year ending December 31, 1996, p. 9) If Winstar's strategy works, it like the wireless market in general, should grow substantially.

Prediction: The market share for wireless services will continue to grow, but wireless will remain a complement rather than a substitute for landline local service.

Wireless services include cellular service, PCS, paging, and other specialized mobile radio services. For the following discussion, wireless services refers primarily to cellular and PCS services. The importance of paging or other specialized mobile radio services cannot be understated. However, paging service is not a two-way voice service like telephone service and as such, it is not

included in this report.

The wireless services market should continue to grow. A growing portion of the public needs, and enjoys having, portable telecommunications service. Wireless service is becoming more reasonably priced, and the quality is improving. Wireless service will continue to experience growth, but it will not become a replacement for landline local services in the near term.

Carriers have recognized the large increase in demand for wireless services. For example, BellSouth refers to the wireless market as "booming." (1996 Annual Report, p. 4, p. 26) Sprint reports that ". . . the number of wireless subscribers is expected to triple by 2005 . . . ." (1996 Annual Report, p. 15) Cox Communications believes PCS ". . . will revolutionize the wireless telecommunications business . . . ." (1996 Annual Report, p. 8) Cox indicates that PCS offered in Washington D.C. has been very successful, and PCS provided over its cable television infrastructure in San Diego has ". . . been very promising." (1996 Annual Report, p. 8)

As noted above, wireless communications services such as cellular and PCS are, in effect, local services. In fact, Winstar Wireless refers to itself as a wireless CLEC (competitive local exchange company). (Form 10K, year ending December 31, 1996, p. 1) Today, wireless providers are a complement to LEC-provided local service rather than a substitute. But, as wireless service rates decrease, the subscriptions for wireless services are likely to increase.

The prices for cellular services have decreased substantially over the last decade but still remain fairly high. A recent issue of the Tallahassee Democrat contained an ad for 360^0 Communications, a cellular service provider. The ad stated rate plans started at $15.95 per month for the Tallahassee calling area. (Tallahassee Democrat, p. 6B, May 18, 1997) This rate is higher than the monthly $9.65 flat rate landline fee charged by Sprint, the LEC serving the Tallahassee area. However, when the $3.50 subscriber line charge is included, and the $1.00 touch calling

charge is also included, the local calling rate rises to $14.15. In this scenario, the rate for cellular service compares well with the rate for local landline service. But, like other cellular service providers, 360^0 Communications assesses a per-minute charge for both received calls as well as outgoing calls. This rate is $.49, regardless of time-of-day or distance. At this rate, one hour of calling costs $29.40, in addition to the $15.95 monthly charge. However, wireless providers, including cellular providers, usually offer promotions that can offset much of the per-minute expenses. In the ad noted above, 360^0 Communications also includes limited free bonus air time if the end user commits to take 12 months of service. Also, cellular providers generally offer plans that provide reduced rates for calls placed during off-peak times.

Because it is a new service, PCS has not yet developed a record of price changes suitable for reaching any substantive conclusions about the direction of rates. PCS spectrum licensing allows several providers to enter the same market (cellular licensing allows only two cellular providers per market). A successful bidder for a PCS license will not procrastinate on entering a market because PCS spectrum licenses are expensive. Early entrants probably will have an incentive to offer lower rates in the face of virtually certain market entry by several competitors.

If an ad run in a recent issue of the Tallahassee Democrat is indicative of PCS pricing in general, PCS rates might be considered fairly reasonable if one is willing to limit his calling. The ad, for Powertel, offers the purchaser willing to prepay for 12 months of service, 60 minutes of local air time service per month at a rate of $10.00. (Tallahassee Democrat, p. 10B, May 18, 1997) Usage over 60 minutes is rated at $.50 per minute.

There is some evidence that, on a per-minute basis, PCS rates are approaching cellular rates. Three ads run in a recent edition of the Orlando Sentinel for PrimeCo PCS service, show PCS rates of $14.00 a month and $.29 per minute regardless of time-of-day. (Orlando Sentinel, June 20, 1997,

pps. A-2, A-9, and D-6) The advertisement excludes the initial cost of the handset, which can be substantial; these ads show the cost of handset to be $199.99. (Orlando Sentinel, June 20, 1997, pps. A-2, A-9, and D-6) However, if the history of cellular pricing is any indication, PCS handset prices will drop substantially, possibly to zero. Cellular handsets are now routinely being given to subscribers at no charge when the customer agrees to certain service conditions (usually, agreeing to take service for a specified time period).

The actions of several large corporations support the notion that the market shares of wireless services, and specifically PCS, will continue to grow. AT&T successfully bid on enough PCS licenses to reach potentially over 90% of the US population. (1996 Annual Report, pp. 2-3) Sprint's PCS offering is an equally ambitious undertaking. Sprint expects to have a 100% digital, 100% nationwide PCS system at the completion of the project. (1996 Annual Report, p. 15) Sprint is joined by Tele-Communications, Inc. (TCI), Cox Communications, Inc., and Comcast Corporation in funding the venture.

There will likely be further rate decreases by wireless providers. As more and more providers enter the wireless market, competitive pressures should force rates lower. This should entice more and more customers to subscribe to wireless services. Therefore, as wireless becomes more affordable, we believe the service (cellular or PCS) will move closer to being a substitute, rather than a complement, for landline service. However, in the short term, it will remain a complement to LEC landline service.

Prediction: Demand for greater bandwidth will increase.

The demand for greater bandwidth should increase in the future. When telecommunications consisted of voice and limited data, the bandwidth provided by copper twisted pair wires was

adequate. Today, end users still want voice service. As their use of high powered high capacity computing capabilities such as FAX machines and high speed modems increases, end users also want to transport and receive large amounts of data with little delay. Tomorrow, even higher powered-higher capacity devices will become commonplace, forcing the need for even more bandwidth.

In Florida and throughout the country, home and small business connections to the telephone networks continue to be made via twisted copper pair wire. While landline voice communication and data can be carried over twisted pair, the use of twisted pair limits the quantity and quality of data that can be transmitted in a reasonably short period of time. The need for bandwidth is not based on the amount of data that can be transmitted, but how much can be transmitted in a limited time frame. In general, data applications require greater bandwidth to minimize transmission errors and provide higher speed service.

Today, the network's capability (its speed and capacity) is described using digital terminology. The telecommunications network is designed to carry traffic volumes up to a 56 kilobytes (56k) per voice grade channel (a voice grade channel could be roughly compared to a residential access line). For voice transport, this amount of capacity is more than adequate. But, data transmissions now are the rule rather than the exception, and data transmissions need greater bandwidth to be effectively executed. Future demands such as real-time video communications will require even more bandwidth.

Providers are responding to the demand for greater bandwidth. For example, LDDS WorldCom is deploying new facilities specifically in response to the demand for greater bandwidth. (1996 Annual Report, p. 4) Sprint will expand the bandwidth capacity of its all-fiber network by adding newly developed multiplexing that will ". . . increase the capacity on its long distance

network by 16%." (1996 Annual Report, p. 24)

The demand for greater bandwidth is increasing, primarily due to increases in individuals' needs to efficiently and quickly transport data. Data transmission has been commonplace throughout the business community for a number of years. Prior to the availability of the personal computer (PC), the transmission of data had been limited to communications between large computer configurations. With the advent of affordable high powered PCS and high speed modems, individuals and businesses with modestly priced computing systems are now capable of transmitting and receiving large amounts of data.

In the business world, the PC's traditional role has been as a tool used for word processing, spreadsheets, and other business related applications. With the advent of greater computing power being packed into less and less space, and high speed modems and facsimile (FAX) modems, the PC is now capable of storing and transmitting large amounts of data. The PC, and in particular PC portables such as laptops, have become very popular in businesses where communication with employees in the field is critical. For example, using a high capacity high powered laptop, a salesman making road calls during the day can, at the end of the day, transmit his orders to the home office, fax copies of the orders, and retrieve voice mail in a single session. This data is being carried over telephone networks designed primarily for voice traffic.

In the lodging industry, customers' uses of personal computers are generating calls of longer than expected duration, which is causing congestion problems for hotel PBX systems. Hotels order a specific number of trunks from the LEC based on the estimated average length of time of a typical voice call placed by a guest. Past analyses show the average voice call is approximately 3.8 minutes in length. Research indicates that some guests using computers to communicate with a site are staying online over 20 minutes. In some cases, guests will log onto a site in the morning, conduct

the business at hand, then leave the room for the day with the computer still connected to the site and the line tied up for that day. This is overloading hotel systems. (Newsletter, the Official Publication of the Hotel Association of Canada, Winter 1997)

Offering video services and high-speed data services to business and residential customers is a potential market for telecommunications providers. The twisted pairs typically used for voice service are inadequate for transporting television quality video (barring any significant advances in compression technology, advances that may, in fact, already be happening). If telephone companies are going to enter the cable TV business, they are going to need to increase their bandwidth capacity in the local loop. The companies can do this by installing coaxial cable to the location. But this essentially means rewiring the loop; a very expensive proposition.

One way of overcoming the need to install coax is to offer wireless cable TV service. Wired cable TV service is delivered from a central location to the end user on a cable TV network. When using a wireless cable TV system, there is no cable network. The end user runs a short cable from an antenna, which is usually a small dish placed on his roof or the side of his home, to his TV. The antenna receives the transmitted TV signal and the signal is then carried to the television via the short cable. There is no need for more coaxial cable other than that which attaches the antenna to the TV.

Some companies are exploring wireless cable TV services. BellSouth is offering wireless cable service, but in only a few markets at this time. If these markets prove profitable, Bell will likely expand to other locations, including Miami. MCI has obtained a digital broadcast system (DBS) license from the FCC that will enable the company to offer satellite-provided multimedia services. (1996 Annual Report, p. 9) AT&T has invested in DIRECTV, a wireless cable TV system. (1996 Annual Report, p. 9)

It should be noted that technological advances may eliminate the bandwidth limitations of twisted copper pair wire. Telecommunications companies may begin to offer digital subscriber line technology (xDSL). xDSL is significant because it makes possible high-bandwidth data transport over standard twisted-pair copper wire. In other words, it is possible to dramatically boost the usable bandwidth of wires that are already in place. According to X-CHANGE (October 1996, p. 38), xDSL is the most progressive transmission technology to surface in the past five years. Several large telecommunications companies have said they will launch xDSL sometime in 1997. However, before volume deployment can occur, terminal costs must come down. The xDSL terminal is the most expensive piece of the system, costing in excess of $1000 per terminal. (X-CHANGE, January, 1997, pp 32-33)

As the affordability of high speed computing power (and related devices) increases, the demand for expanded bandwidth is also expected to increase. Should telecommunications players begin offering video, the need for bandwidth will grow.

Prediction: The distinction between providers and what markets they serve will blur.

The distinction between who provides what will become less clear. Traditional telecommunications service markets will dissipate as companies begin offering non-core services along with their core services. Several companies also have taken this position.

For example, AT&T is best known as a long distance carrier, but it also provides wireless service (both cellular and PCS), and it is entering the local services market. When AT&T's former president John Walter was asked how AT&T would compete in the local market he stated that the Company planned to ". . . provide customers with 'all distance' service that makes no distinction among local and long distance, wired, wireless or fixed wireless." (1996 Annual Report, p. 5) Sprint sees the future for telecommunications as an ". . . emerging market for integrated services . . . ." (1996 Annual Report, p. 10) Bill Esrey, CEO of Sprint, has expressed that Sprint will ". . . no longer be simply a local company, or a long distance company. Instead we will be your complete telecommunications company, providing a **total package** of communications services and products whether they be wireless or wired, data or video, local, long distance or international. We are prepared to service all of the communications needs of our customers." (emphasis added) (1996 Annual Report, p. 4) Cox Communications sees mergers and splits as having a profound impact on the distinction between services. In reference to this activity Cox states ". . . the lines formerly separating various communications service providers have blurred; perhaps it would be more accurate to say those lines have been obliterated." (1996 Annual Report, p. 5) The very title of

WorldCom's 1996 Annual Report: "WorldCom . . . One Company, One Source" expresses their position on packaging of services. Similarly, BellSouth states it is working to be ". . . the single source to provide [their] customers' many telecommunications needs. . . ." (1996 Annual Report, p. 2)

Commission actions, coupled with provisions in the Act, have also had an impact on the distinction between services, in particular between interLATA and intraLATA markets. In Docket No. 930330-TL, the Commission required that the intraLATA 1+/0+ market be opened to presubscription. Prior to the Commission's decision, the LEC was the designated carrier of 1+/0+ intraLATA toll traffic. The IXCs were not allowed to carry this traffic. With the Commission's decision, a subscriber can now select any carrier, IXC or LEC, for transport of his intraLATA calls. Consequently, a subscriber can select an IXC for both intraLATA and interLATA calls. For LECs other than an RBOC, this decision effectively eliminated the intraLATA/interLATA distinction because they could now provide both interLATA and intraLATA toll services.

The RBOCs also will be allowed to provide interLATA toll services, but only after certain requirements have been met. The Modified Final Judgement prohibited the RBOCs from entering the interLATA toll market, confining them to intraLATA toll calls. The 1996 Act removed this requirement, but with the condition that each RBOC must meet the specific requirements listed in Section 271 of the Act before the RBOC begins offering interLATA service.

Some providers have begun to package various services together and sell them through retail outlets. BellSouth states: "We're already selling wireless through distribution channels that traditionally sold only wireline telephone service. We literally packaged together our Internet access product, BellSouth.net™ service, with our 'phone line in a box concept' in retail stores." (1996 Annual Report, p. 8) Sprint and Radio Shack plan to make Sprint products such as long distance,

PCS, and Internet Access, available in many Radio Shack locations. (1996 Annual Report, p. 7) A recent ad indicates that Radio Shack is also an authorized distributor for BellSouth Mobility. (Orlando Sentinel, June 20, 1997, p. D-5)

Several companies indicate that they believe customers want simplicity. Sprint found that as customers subscribe to greater numbers of services, they desire the simplicity of having a single bill for several services. (1996 Annual Report, p. 7) BellSouth also includes simplicity in its definition of value. BellSouth defines value as ". . . getting the variety of practical services customers need in today's busy world, without the hassle of dealing with a bunch of different suppliers." (1996 Annual Report, p. 21) In fact, BellSouth's 1996 annual report is titled "Keeping it Simple {for our Customers}."

Consolidation of services under a single bill should continue to grow, for two reasons. First, from the customer's standpoint, communications services are confusing in and of themselves. Receiving multiple bills can add to the confusion. Making payments to multiple vendors is also costly and time consuming. A single bill for multiple services simplifies the payment process and provides the customer with convenience.

Second, billing multiple services under a single bill also gives a company an opportunity to market several services under a single brand name. Over time, a company benefits from customers relating the company's name to products with which it has not previously been identified.

Prediction: Mergers and acquisitions (M&As) will continue.

Following deregulation, the telecommunications industry has become a busy area for M&As. It is difficult, if not impossible, to pick up an issue of an industry trade magazine that does not contain an article discussing aspects of a recently announced merger, acquisition, or some type of

joint venture. Some have used the M&A route as a tool to enter a specific market. Others appear to be based on expanding territory and/or market share. Still others appear to be based on building a financial power base. In general, as competition intensifies, the telecommunications industry should experience increased numbers of M&As as providers position themselves to compete in various industry markets.

M&As have been a tool used by industry players for entry into a particular market segment. The strategy is attractive because it can provide a potential entrant with expertise that it may lack, or it may provide financial support for an entrant to enter a market more aggressively than it could on its own.

WorldCom wanted to enter the internet market. The Company could create its own research, design, and implementation team, or it could enter into an agreement with an existing provider. WorldCom's approach was to acquire an existing provider, a provider whose profile fit WorldCom's. WorldCom places great emphasis on serving the business market; therefore, it wanted a partner that focused on services to business customers as well. (1996 Annual Report) The Company elected to acquire UUNET, the world's largest provider of internet service and a firm with experience in serving the business market. This same approach is being undertaken by GTE. GTE has announced an agreement to acquire BBN Corporation, a large provider of internet services. GTE's actions are being taken to enable the Company to be a supplier of integrated telecommunications services. (NECA Washington Watch, April 25, 1997)

Some M&As have involved especially large providers. Two mergers are between RBOCs -- one between Bell Atlantic and NYNEX, and one between Pacific Telesis and Southwestern Bell (SBC). The merger between Bell Atlantic and NYNEX was not objected to by the Department of Justice. Approved by the FCC, Bell Atlantic/NYNEX is the second largest telecommunications

company (AT&T is the largest) serving approximately 37 million access lines in the U.S. (NECA Washington Watch, April 25, 1997) Geographically, the merger between Pacific Telesis and SBC would create the largest telephone company in the nation. Its territory would extend from the Mississippi River to the Pacific Ocean. (NECA Washington Watch, April 2, 1997)

Early this year, British Telecom (BT) announced its intention to acquire MCI. (NECA Washington Watch, April 3, 1997) During the summer months, MCI's earnings fell, causing BT to review its initial offering. Following the review, BT confirmed that it was going forward with the acquisition. Then, October 1, 1997, WorldCom announced that it had made an offer to buy MCI for approximately $30 billion in stock, about $9 billion more than BT's offer. GTE then entered the fray and offered to buy MCI for $28 billion. Although GTE's offer was $2 billion less than WorldCom's, GTE's was a cash offer. WorldCom countered with an offer of $37 billion. November 10, 1997, WorldCom announced both WorldCom's and MCI's board of directors approved the merger between the two companies. The merger is subject to final approval by the stockholders of both companies, as well as the FCC and the DOJ.

Mergers and acquisitions will likely continue. As traditional barriers to entry are successfully challenged following TA 96, competition in telecommunications markets is sure to increase. Many companies desiring to enter various markets - both geographic and service-related markets - will find combining forces to be the best strategy for accomplishing that task.

This chapter contains numerous predictions on what may be some near term directions in the competitive evolution. The predictions include LEC dominance of the local market, ALECs' targeted customer types, the growth of cellular and PCS services, the demand for bandwidth, the distinction between services, and mergers and acquisitions in the industry. It should be noted that unanticipated events could influence the accuracy of the predictions.

Legislative activity at the federal level could impact the development of competition in Florida. As stated above, companies have used M&As as a tool to enter certain markets. In June 1997, a bill was introduced in the US Senate by Senator Kerrey to block mergers between telecommunications companies. The bill would prevent the DOJ from approving mergers unless it found that the merger would "significantly enhance competition." (NECA Washington Watch, June 26, 1997) The Senator was reportedly unhappy with the DOJ's approval of the NYNEX/Bell Atlantic merger. Should it pass and be signed into law, the bill would likely affect the speed of entry by companies into various communications markets, including the local market. Because the bill is in its early stages, its odds of passage are unknown, and if it does pass, its ultimate form.

A new technology could alter the way competition evolves in telecommunications markets. As a general rule, technological changes are not instantaneously absorbed into the system. From the time fiber optics technology was invented, it took many years for it to be deployed to any significant degree in the network. The glass was one step. Following that step, affordable electronics to make transmission possible had to be developed. While gradual deployment historically has been the rule, faster computing power is making technological advances occur more quickly. For example, modem speeds have been increasing dramatically over just the last few years. Faster modems need greater bandwidth to transfer data as quickly as they are capable.

Demographic changes within Florida may affect the accuracy of our prognostications. This state is experiencing dramatic growth. Counties that are rural may become highly populated very quickly. Disney's presence quickly changed Orange county and Orlando from a place travelers passed through on their way to Ft. Lauderdale and Miami to one of the most popular tourist destinations in the world.

An acceleration of the current economic boom or an economic slowdown could influence

a firm's decision to enter a telecommunications market in Florida. On the one hand, a further economic upturn could create added earnings to a company's investment account, enabling the company to expand. On the other hand, a fairly deep or lengthy recession could reduce a company's earnings, and could reduce the portion of those earnings earmarked for use in telecommunications.

These factors and others could arise during the next year. Should that happen, our predictions could be negatively affected; on the other hand, they could be enhanced as well. Another year of experience will tell.

CHAPTER VI: CONCLUSION

The two events that significantly impacted the role of the Florida Public Service Commission (FPSC) in overseeing the telecommunications industry were: 1) the passage of the 1995 amendments to Chapter 364, Florida Statutes, and 2) the federal Telecommunications Act of 1996 (TA 96). The FPSC continues to implement the provisions of both laws.

Florida's telecommunications markets generated estimated revenues of approximately $7.7 billion in 1996. Increasing revenues coupled with continued access line growth makes Florida extremely attractive for competitive entry. Not surprisingly, however, the LECs continue to dominate the local services market, with three LECs accounting for 98.2% of all LEC revenues.

As of September 1, 1997, there were 108 ALECs certificated in Florida. Twenty-two ALECs are providing basic local service, to approximately 56,000 business and residential access lines. Of the over 280 exchanges in the state, ALECs are providing basic local service in 125 of them. In the majority of exchanges (74) there is only a single ALEC providing service. There are 28 exchanges with three or more ALECs. Only six ALECs were providing basic local service at this time last year, to approximately 600 business and residential customers. Progress is being made, although somewhat slower than expected.

For those customers having a choice of local exchange provider, it appears that they are able to obtain service at comparable rates. For the most part, the ALECs appear to be charging rates that are similar to the rates charged by LECs.

Despite the passage of legislation that essentially allows unfettered entry into the local services market, and the potential dollars to be made in the local market, competitive entry has been limited at best. The ALECs have argued that delays have occurred due to regulatory uncertainty and

LECs' stalling tactics. In some cases, ALECs have found operating a telephone company is more complex and costly than anticipated. Based on the lack of local exchange competition present, we recommend that the price caps on basic local telecommunications prices be extended for an additional two years, until 2001, for price cap LECs with fewer than 3 million access lines: (currently) GTE Florida, Sprint-Florida, Indiantown, GTC (Gulf, Florala, St. Joseph), and Vista-United. However, at this time we decline to recommend that basic local price caps should be extended for BellSouth.

Local exchange competition is in its infancy, not only statewide but also nationwide. While some issues have been initially addressed by the Courts, others have not. Competition will continue to evolve, but how quickly is uncertain. As we explore and look at the barriers to competition and evaluate implicit subsidies, the Commission may need flexibility and authority in addressing those issues. Solutions may include a permanent universal service mechanism, rate rebalancing and deaveraging. The Commission may need authority to address these issues, within the guidelines set forth by the Legislature.

APPENDIX A: ALECs CERTIFICATED AS OF SEPTEMBER 1, 1997

!nterprise America, Inc.

A.R.C. Networks, Inc.

Access Network Services, Inc.

AD-TEL Communications

Alternative Phone, Inc.

America's Tele-Network Corp.

*American Communication Services of Jacksonville, Inc.

Ameritech Communications International, Inc.

Annox, Inc.

Arrow Communications, Inc.

AT&T

ATI Telecom, Inc.

Atlantic Telecommunication Systems, Inc.

*BellSouth Telecommunications, Inc.

Biz-Tel Corporation

BTI

*Cable & Wireless, Inc.

Cellular One of Southwest Florida

CFT INC.

City of Lakeland

City of Ocala

*Communication Service Centers

*COMUSA, Inc.

Connect USA, Inc.

Cypress Telecommunications Corporation

Data and Electronic Services, Inc.

Datacomm International Company, Ltd.

DeltaCom, Inc.

Dial & Save of Florida, Inc.

*Providing basic local service as of June, 1997.

Digital Cable, Inc.

Digital Media Partners

Digital Services Corporation

East Florida Communications, Inc.

Eastland of Orlando Telephone Corporation

Easton Telecom Services Inc.

*Easy Cellular, Inc.

Excel Telecommunications, Inc.

Fascon, Inc.

FiberSouth, Inc.

*Florida Comm South

Florida Public Telecommunications Association, Inc.

Florida Telecommunications Services, Inc.

GE Capital Commercial Direct

Global Tel*Link Corporation

GRU Communication Service/GRUCom/GRU

GTE Long Distance Incorporated

*Hart Communications

ICG Telecom Group, Inc.

Indiantown Telephone System, Inc.

Interlink Telecommunications of Florida, Inc.

*Intermedia Communications, Inc.

Interprise-Continental Fiber Technologies Alternet Data Co

*Intetech, L.C.

Jacksonville Teleport, L.C.

*Jetcom, Inc.

KMC Telecom Inc.

*LCI International Telecom Corp.

Local Line America, Inc.

Mat-Tell Communications, Inc.

*Providing basic local service as of June, 1997.

*MCI Metro Access Transmission Services, Inc.

MCI Telecommunications Corporation

MediaOne Fiber Technologies, Inc.

*MediaOne Florida Telecommunications, Inc.

MET Communications, Inc.

Metropolitan Fiber Systems of Florida, Inc.

MH Lightnet of Florida, Inc.

Microwave Services, Inc.

*NationalTel

OpTel

Orlando Business Telephone Systems, Inc.

Orlando Digital Telephone Corporation

Pacific Gateway Exchange, Inc.

*Preferred Carrier Services, Inc.

Priority Link

Quentel Communications, Inc.

Quintelco, Inc.

*Reconex

Shands Teaching Hospital and Clinics, Inc.

Siemens Business Communications Systems, Inc.

Sprint Communications Company Limited Partnership

*Sprint Metropolitan Networks, Inc.

Strategic Technologies, Inc.

Supra Telecommunications & Information Systems

T-Netix, Inc.

Tallahassee Memorial Telephone Company

*TCG South Florida

Tel-Link of Florida, LLC.

Telaleasing Enterprises, Inc.

Teleco Communications, Ltd.

*Providing basic local service as of June, 1997.

Telecommunications Service Center, Inc.

Telenet of South Florida, Inc.

*Telephone Company of Central Florida, Inc.

TelQuest Communications, Corp.

*The Other Phone Company, Inc.

The Phone Company

Time Warner Communications

Time Warner Connect

TotalTel USA Communications, Inc.

TransAmerican Telephone

Travelers Telecom Corp.

U.S. Long Distance, Inc.

U.S. One Communications Services Corp.

U.S. Telco, Inc.

*Unicom Communications, LLC (formerly Unique Communications)

US Xchange of Florida, L.L.C.

WinStar Wireless of Florida, Inc.

World Access Communications Corp.

World Telecommunications Services, Inc.

*Providing basic local service as of June, 1997.

APPENDIX B: THE LOCAL NETWORK

Contained within the appendix is a brief discussion of the structure of the local network as it exists today. The typical network in place at the time of this writing is reviewed, as well as a description of the various service providers and how they interconnect with this network.

TODAY'S LOCAL NETWORK

When telephones first came into use, each pair of phones was a single dedicated system. For example, one telephone might be located at a bank and be connected with another instrument located in the bank president's home. At the same time, another telephone might be located at the post office and directly connected to another phone at the train station. Each system operated independently of one another. The bank president could not call the post office and the train station could not call the bank. Eventually, people recognized the value of interconnecting these private systems. This interconnectivity was made possible by development of a system to "switch" calls between parties.

Initially, the switching was done manually by a local operator utilizing a switchboard. As the number of telephone calls increased, the number of operators also increased. However, the volume of calls soon exceeded the capabilities of the operators. This growing demand led to the development of non-manual switching equipment. Mechanical switches, such as the step-by-step and the cross-bar, were created to meet the expanding need. These switching systems evolved from mechanical switches to the electronic digital systems used today.

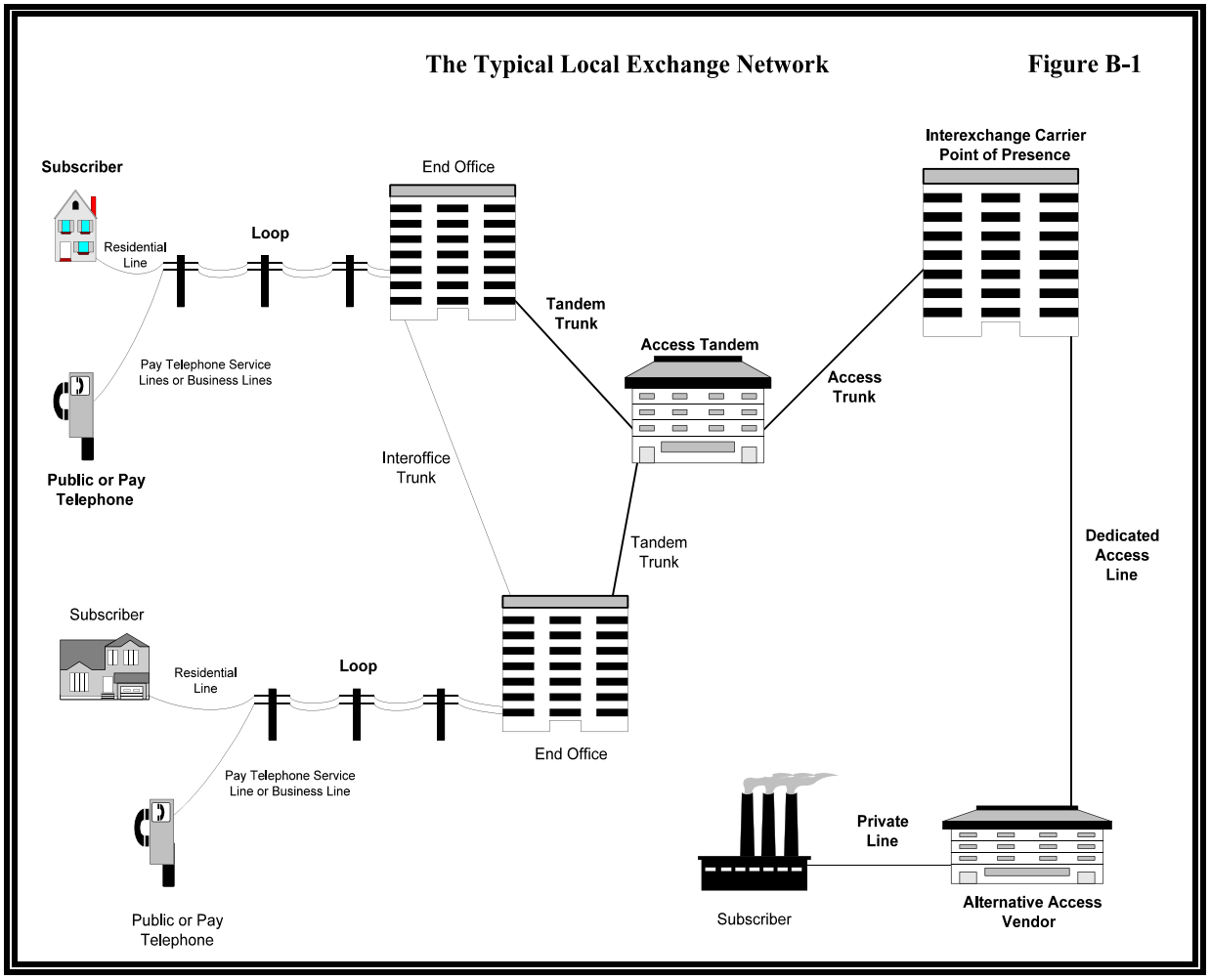
With advances in technology, the number and quality of telecommunications services has increased. As stated above, local service began as a private line service. Each instrument was hard-wired to another instrument. The advent of the switch allowed several instruments to communicate with one another through mutual connection at a central point. End users soon desired to talk with inhabitants in areas outside their local area. This required more sophisticated equipment and larger capacity switches to enable "long distance" calling.

Typically, the term "network" refers to the local network. Obviously, each type of provider has his own network. For example, AT&T has its own long distance network, as do MCI and Sprint. However, the local exchange company is the final link to the end user. Stated differently, the LEC furnishes its customers and other service providers with access to the end users served by the LEC's network.

Figure B-1 illustrates typical local network facilities. Subscribers are connected to end offices by a loop. The most common form of loop, a pair of wires, is also called a line. Loops serve as a channel between a customers' terminal and an end office. In a small community, there may be only a single end office. However, in larger communities, there will be several end offices. These end offices must be connected for a subscriber to be able to complete a local call that transcends one or more central offices. This is accomplished via interoffice trunking.

Access tandems are LEC switching systems that provide a traffic connection and distribution function for interLATA traffic that originates or terminates within a LATA. They provide a point of connection with IXCs through an access trunk. The access tandems are, in turn, connected to the end office by a tandem trunk. Trunks function to connect two switching systems used in the establishment of an end-to-end connection. The type of trunk describes the type of switches it is

connecting.



Subscribers can also gain access to their interexchange carrier through the use of an alternative access vendor (AAV). AAVs typically connect to the IXC by a dedicated access line. These networks permit a company to offer carriers and end users (both business and government) an alternative to the local exchange company in connecting to their long distance interexchange carrier. The subscriber is connected to the AAV by a private line (a facility dedicated to his use). Subscribers use AAVs for access to such services as dedicated WATS, voice grade private lines,

analog data, digital data, video, and other services requiring high bandwidth capacity.

DESCRIPTION OF PROVIDERS

INCUMBENT LOCAL EXCHANGE COMPANY (LEC)

At the time of this writing, the LEC is the primary provider of local services. The term "incumbent" is used in reference to the traditional LEC, certificated to provide local exchange telecommunications service before June 30, 1995, such as BellSouth and GTE Florida.

The LEC offers a variety of services, including limited long distance calling. Prior to the passage of the Telecommunications Act of 1996 (TA 96) the Bell Operating Companies (BOCs) and GTE Florida were prohibited from carrying traffic that crossed a LATA boundary. TA 96 removed prior restrictions on GTE, thus allowing it to enter the interLATA market immediately. TA 96 also sets forth certain criteria that, once met, allow the BOCs to provide interLATA service.

INTEREXCHANGE CARRIERS (IXCS)

As the value of the telephone increased, the desire for service that connected communities evolved. For communities lying in close proximity to one another, connection was fairly easy. However, demand created the need for interconnection between communities many miles apart. Because of the expense involved in establishing such links, calls carried over these distances could not be treated as local calls but were designated as long distance calls. Connection began between centers of commerce and industry. Eventually, a long distance network was created which interconnected local community telephone systems throughout the country. Today there are over 500 IXCs certificated in Florida.

Historically, IXCs were not permitted to operate in the local market. Consequently, they could not connect directly to the end user because they did not own local facilities and thus needed to use the LEC's facilities to originate and terminate calls. Figure B-1 also shows how an IXC connects with the end user. This can be accomplished in two ways: the IXC can reach a subscriber through the LEC's switched network, or the IXC can connect to the end user by means of a dedicated access arrangement.

Under the switched network scenario, the IXC hands off a long distance call to the LEC for termination at the LEC's end user's location. (For simplicity, this discussion will concentrate on terminating calls. For originating toll calls, the interconnection process between the LEC and the IXC is essentially the same.) For providing this service, the LEC levies a per-minute charge on the IXC.

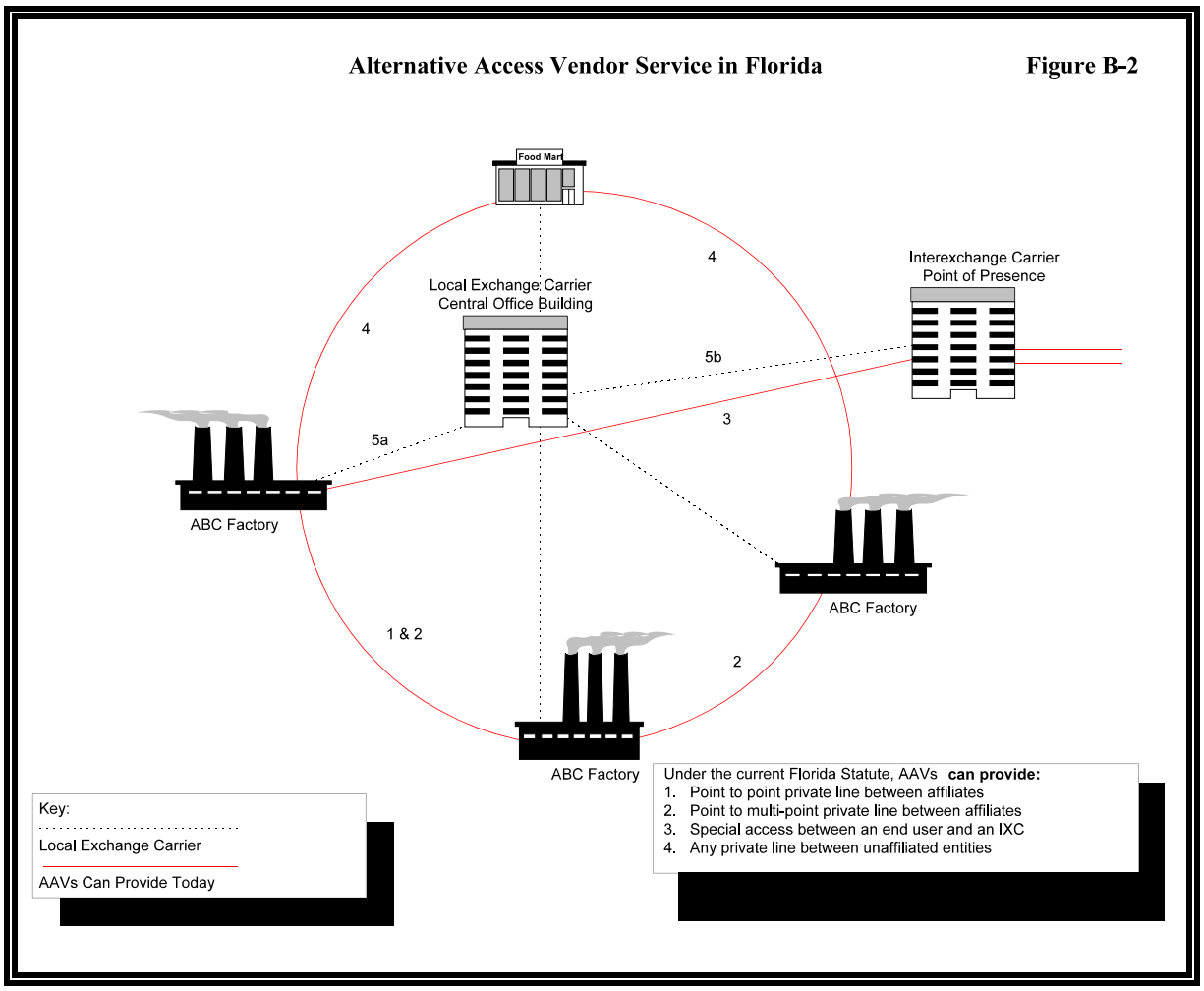
Under the dedicated access scenario, the end user is directly connected to the IXC using a dedicated facility, and LEC-provided switching is not involved. Dedicated access is priced on a flat-rated basis and, for most customers, would be considerably higher than rates charged for switched access. The exception occurs when calling volumes are large enough that the switched access charges that would accrue would exceed the charges for dedicated access. Consequently, dedicated access is used by large volume users.

Dedicated access may also be used where security is a concern, or higher quality service is needed to ensure against corruption of information such as in the case of data transmission. Although the IXC can provide dedicated access arrangements for this connection to the end user, the service is usually provided to the end user by the LEC (or an alternative access vendor as discussed below).

ALTERNATIVE ACCESS VENDOR (AAV)

Beginning in 1992, AAVs (or Competitive Access Providers -- CAPs) were allowed to compete on a limited basis in the local private line arena. AAVs typically install fiber rings around, or within, major cities, and provide either an alternative to, or a back-up for, dedicated services offered by the LECs. Prior to July 1, 1995, AAVs were restricted to offering three types of service: point-to-point private line service between affiliated entities, point-to-multi-point private line service between affiliated entities, and dedicated access between an end user and an IXC. Thus, they were not allowed to offer any private line services between unaffiliated entities, any part of switched local service, or any packet switching. The 1995 Amendments to Chapter 364, Florida Statutes, removed the "affiliated" restriction, effective January 1, 1996. Thus, AAVs can now offer private line service between unaffiliated entities.

Figure B-2 illustrates the various components of an AAV network, and how service has been provided. Most AAVs provide their services by way of fiber optic facilities in ring or loop configured systems around major metropolitan areas. The major selling point for AAVs is that their dedicated high speed, high capacity fiber rings offer great security from loss of service. This is accomplished by means of reverse routing on its ring. Should a cable cut occur, the direction of the traffic is immediately reversed, enabling calls to continue to be completed. As of October 15, 1997, there were 37 certificated AAVs in Florida.



PAY TELEPHONE PROVIDERS (PATS)

In 1985, pay telephone providers (PATs) other than the LECs were allowed to enter the local and toll markets. NPATs providers "resell" local telephone service by purchasing PATs lines or business lines from the LEC to connect their pay phones with the local network. Each time an end user makes a call from a pay phone, the NPATs provider is reselling the line to the end user for the duration of the call. Today, there are over 1,000 certificated PATs.

ALTERNATIVE OPERATOR SERVICE (AOS):

AOS companies provide operator services to hotels, motels, hospitals, airports, PATS, universities, and other entities with high volumes of operator-assisted calls. The AOS company pays a commission to the institution for the right to handle its operator-assisted calls, and arranges for the local exchange carriers to provide billing and collection services. The AOS company may also bill the end-user via a bank card to attract customers who do not have a telephone credit card account. As of October 15, 1997, there were 88 certificated AOS providers.

SHARED TENANT SERVICE (STS):

STS provider typically uses a private branch exchange (PBX, a small switch) to provide telephone service to tenants in a structure such as an office building or apartment house. To connect with the local network, the STS provider leases PBX trunks from the LEC. An STS system is attractive to customers such as large businesses who prefer to have some control over their internal communications. STS service is somewhat similar to pay telephone service in the sense that it also "resells" local service. Because the tenant does not purchase phone service directly from the LEC, an STS provider is acting as the local exchange company to its tenants -- essentially reselling basic local service. As of October 15, 1997, there were 35 certificated STS providers.

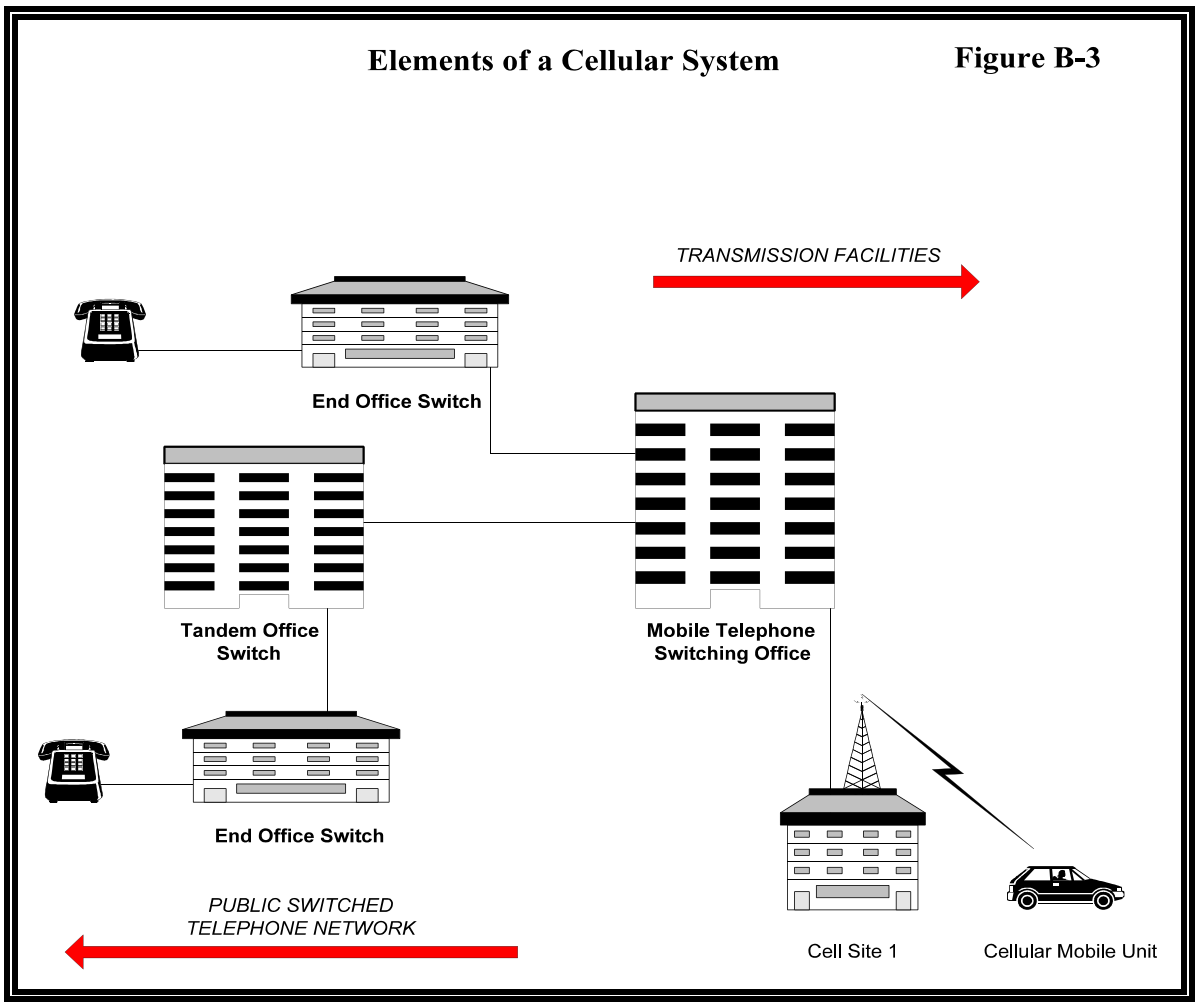
CELLULAR/MOBILE CARRIERS:

The types of mobile carriers operating in Florida include cellular carriers, radio common carriers (both two-way mobile and paging), and private land mobile radio systems, including specialized mobile radio systems which operate in the 800 MHZ range. In order to provide their customers with access to LEC customers, mobile carriers must purchase interconnection from the

LEC. The Cellular Telecommunications Industry Association reports that the number of cellular customers in the United States at the end of 1996 was approximately 44 million, a 30% increase over 1995.

A cellular system operates by dividing a large geographical area into "cells" and assigning the same channel to multiple, nonadjacent cells. This allows channels to be reused, increasing spectrum efficiency. As a subscriber travels across the service area the call is handed off from one cell to another. Figure B-3 illustrates the various elements of a cellular system. Each cell is served by its own radio telephone and control equipment. All the cells in a cellular system are connected to a mobile telephone switching office (MTSO) by landline or microwave links. In order to assure nationwide compatible service, all cellular systems must operate in accordance with the technical specifications outlined by the FCC.

Cellular service differs from previous mobile communications technology in that the radio system operates at low power, thus confining the range of a given transmitter to a smaller geographic area. By operating at low power, the same frequency can be reused at several transmitter locations within a given area, thus using that frequency for multiple simultaneous conversations.



Paging services began about 1960, and were originally provided via a dispatch operator. Today, paging is a one-way service whereby a land-line caller can dial a number and the pager assigned that number will signal the paged customer that he has a call or message.

APPENDIX C: LOCAL COMPETITION TODAY: THE PLAYERS

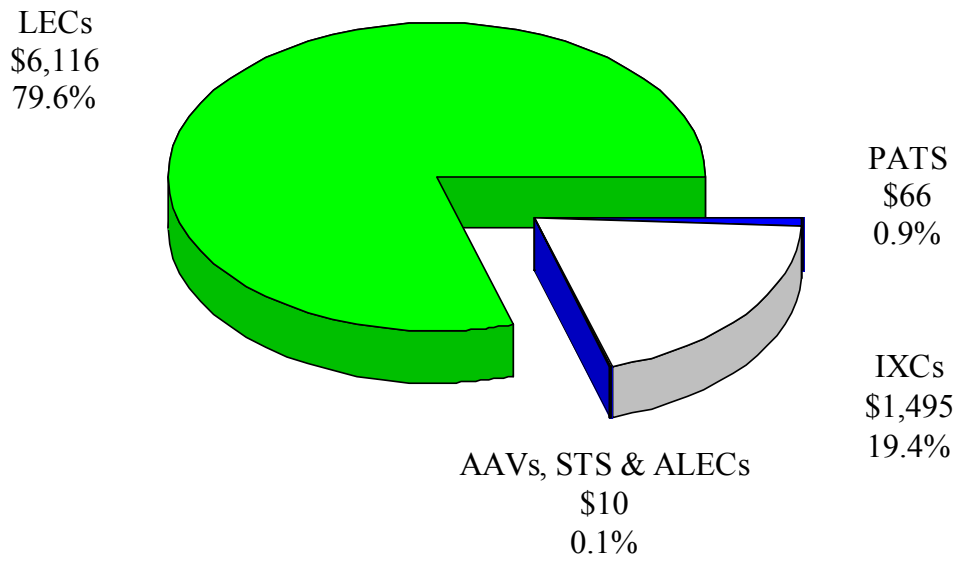
The various categories of providers which make up Florida's telecommunications market (excluding wireless providers) generated estimated revenues of approximately $7.7 billion in 1996. This is a 5.5% increase over the $7.3 billion in revenues estimated for 1995. The two largest shares of revenue are, not surprisingly, local exchange companies (79.5%) and interexchange carriers (19.5%). The remainder is nonLEC pay telephone (NPATS) revenue (0.9%), and combined revenues for alternative access vendors (AAVs), shared tenant services (STS), and alternative local exchange companies (ALECs) of 0.1%. Total revenues, shown by provider category, are summarized in Figure C-1. This appendix will focus on the current level of competition in the local market by examining the types and numbers of players actually in a position to provide local exchange service. Although there are significant dollars to be had, entry into the local market has been limited to date.

INCUMBENT LOCAL EXCHANGE CARRIERS

As illustrated in Figure C-1, the companies which make up Florida's telecommunications market (excluding wireless providers) generated revenues estimated at $7.7 billion in 1996. With the consolidation of Central Telephone Company of Florida (Centel) and United Telephone Company of Florida (United), to form Sprint-Florida, Inc., and the recent consolidation of The Florala Telephone Company, Inc. (Florala), Gulf Telephone Company (Gulf) and St. Joseph Telephone & Telegraph Company (St. Joseph), to form GTC, Inc., there are now only ten incumbent local exchange companies (LECs) in Florida. (While this report contains historic data, the tables and figures in this report will reflect twelve LECs. Historic data for Centel and United have been

Figure C-1

Total Estimated Florida Communications Revenues (millions)
For the Year Ending December 31, 1996



Source: 1996 Regulatory Assessment Fee Reports, 1996 Annual Reports of Local Exchange Companies, and data requests.

combined. However, since the consolidation of the three companies forming GTC is very recent the three GTC companies will be listed separately.) Total LEC revenues for 1996 were reported at $6.1 billion, a 6.5% increase over total LEC revenues reported in 1995. Table C-2 shows total revenues by LEC for 1992-1996.

TABLE C-2
TOTAL LEC REVENUES (Thousands of Dollars)

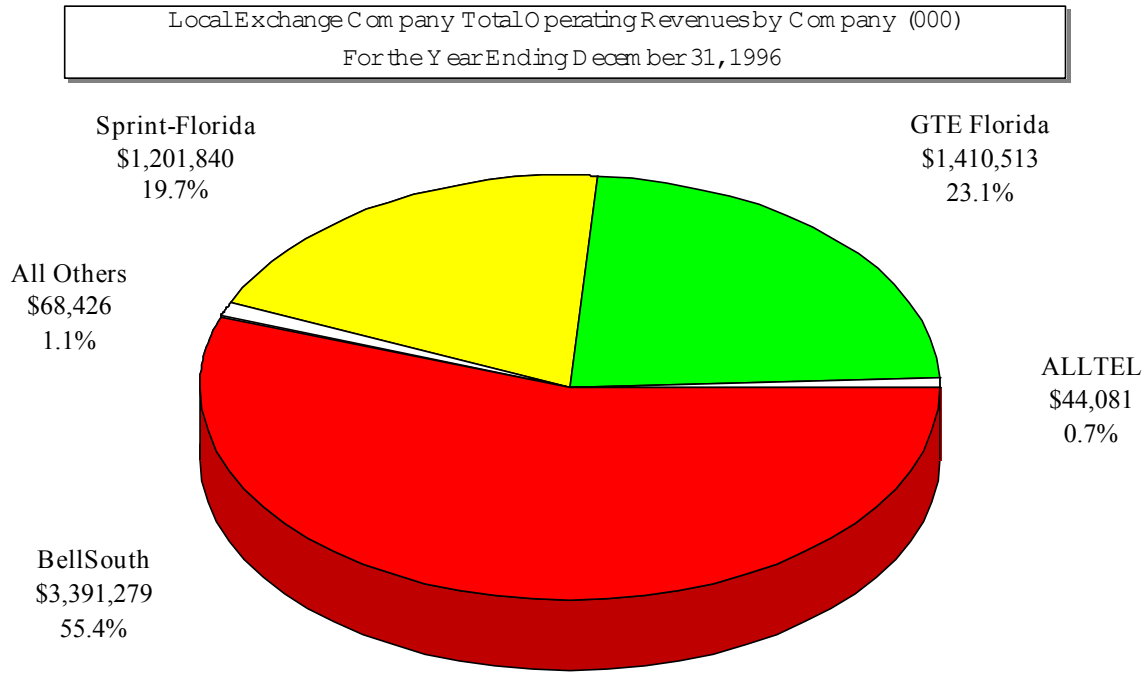
LEC	1992	1993	1994	1995	1996	CAGR 1992-1996
ALLTEL	$45,170	$45,990	$44,299	$44,951	$44,081	-0.6%
BELLSOUTH	3,086,849	3,212,187	3,259,546	3,323,426	3,391,279	2.4%
FRONTIER	1,863	1,895	1,801	1,816	1,608	3.6%
GTC, INC. (FLORALA)	781	1,240	1,302	1,464	1,415	16%
GTC, INC. (GULF)	4,536	5,189	5,240	5,667	5,461	4.8%
GTC, INC. (ST. JOSEPH)	18,356	19,846	20,707	22,178	20,950	3.4%
GTEFL	1,153,542	1,119,180	1,210,068	1,312,433	1,410,513	5.2%
INDIANTOWN	3,561	4,459	4,168	4,175	4,163	4.0%
NORTHEAST	5,810	5,659	6,451	6,273	6,705	3.6%
TDS/QUINCY	7,072	7,430	8,073	7,096	7,745	2.3%
SPRINT-FL	863,847	900,306	949,556	993,153	1,201,840	8.6%
VISTA-UNITED	12,900	13,668	15,694	17,977	20,379	12.1%
TOTAL:	**$5,204,288**	**$5,337,049**	**$5,526,903**	**$5,740,611**	**$6,116,138**	**4.1%**

Note: Does not add to total due to rounding. Source: 1992-1996 Annual Reports of Local Exchange Telephone Companies to FPSC and responses to staff data requests.

The three largest LECs (both in terms of revenues and access lines) - - BellSouth, GTE Florida, and Sprint-Florida, Inc. - - continue to dominate this market. As shown in Figure C-3 these three LECs' 1996 revenues account for approximately 98.2% of all LEC revenues. Total LEC revenues have risen at a compound annual growth rate (CAGR) of 4.1% since 1992, with the largest annual increase of 6.5% occurring in 1996.

LEC revenues continue to be reported in four major categories: local network services, network access, long distance network, and miscellaneous. Local network services primarily includes basic and extended area service, custom calling features, and local private line. Until recently, this category also included public telephone revenues; however, as of April 15, 1997, public phone revenues are no longer included in this category because payphones were deregulated. (Since this report examines historic revenues pay telephone revenue are included in the data.) Pay

Figure C-3



"All Others" Includes: Frontier Communications, GTC, Inc. (Gulf, Florala, and St. Joseph), Indiantown Telephone, Northeast Florida Telephone, TDS Telecom/Quincy Telephone, and Vista-United Telecommunications

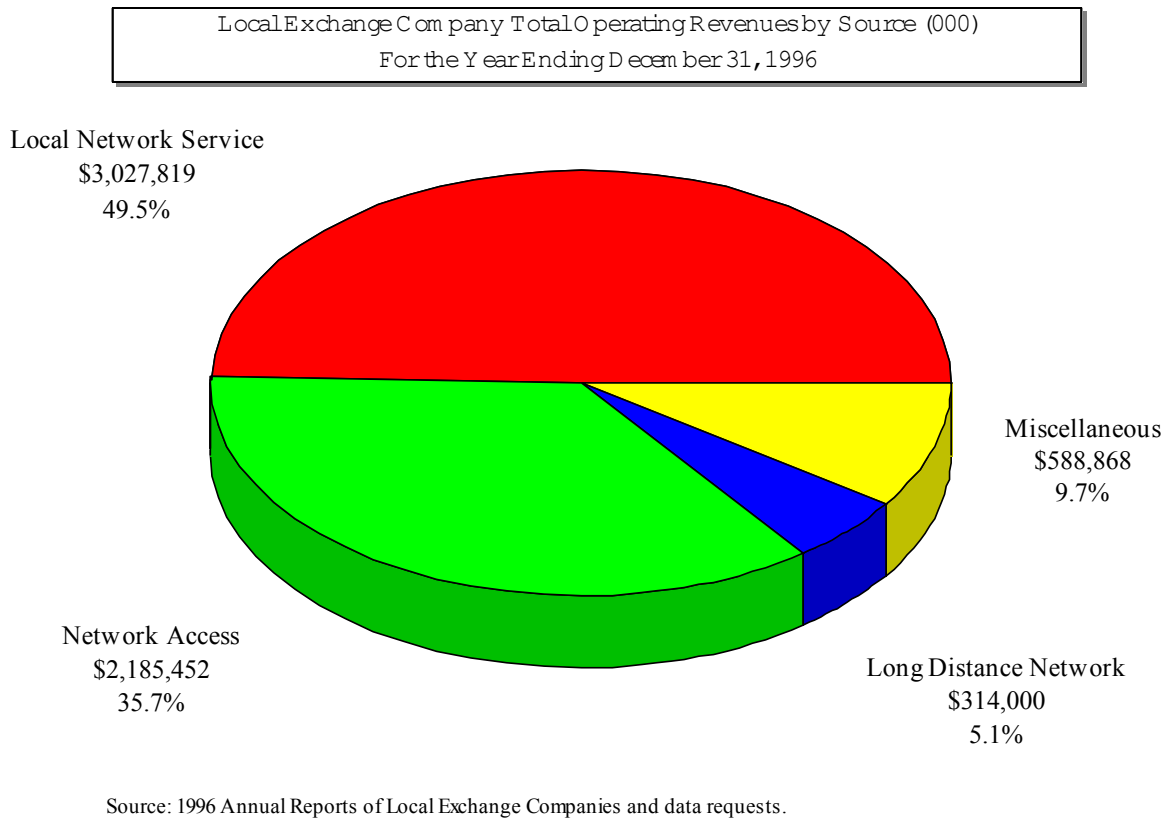
Source: 1996 Annual Reports of Local Exchange Companies and data requests.

telephone deregulation is discussed in Chapter III.

As illustrated in Figure C-4, local network service revenues accounted for 49.5% of LEC revenues reported in 1996. These revenues continue to be a dominant source of income for the LECs, accounting for approximately 46.2% of total revenues in the years reviewed (1992-1996).

The second largest revenue category for the LECs is network access. These revenues are

Figure C-4



Source: 1996 Annual Reports of Local Exchange Companies and data requests.

derived from switched and special access charges, and subscriber line charges, and account for approximately 35.7% or $2.2 billion of all LEC revenues in 1996.

The final two categories, long distance network and miscellaneous, together account for 14.8% of LEC revenues, or $.9 billion for 1996. Long distance network (5.1%) includes a variety of items, but primarily intraLATA toll; it generated $314 million in revenues for the LECs in 1996.

Total miscellaneous (9.7%) generated $589 million and includes such items as directories and rents.

It should be noted that the percentages for the four categories vary among the three largest LECs. Table C-5 provides the percentages for each of the four categories for the three largest LECs.

Table C-5

Percent of 1996 Total Operating Revenue by Source for the Three Largest LECs

LEC	Local Network Service	Network Access	Long Distance Network	Miscellaneous
BellSouth	55.5%	33.8%	4.9%	5.9%
GTEFL	47.0%	35.8%	5.2%	12.0%
Sprint-Florida	37.4%	39.5%	5.3%	17.8%

While the total LEC revenues CAGR is 4.1% since 1992, access lines have experienced a CAGR of 6.4% over this same period. Table C-6 shows the number of access lines per LEC for 1992-1996 and the compound annual growth rates over this five-year period.

Each LEC has experienced an increase in the number of access lines, with Vista-United experiencing the greatest increase (based on its CAGR). According to the FCC, total national access lines have grown at a CAGR of 6.1% since 1992. By way of comparison, Florida has experienced a CAGR of 6.4% for the same period. Florida's large market size and a somewhat higher than average growth rate, continue to make Florida extremely attractive for competitive entry.

TABLE C-6

TOTAL NUMBER OF ACCESS LINES PER LEC

LEC	1992	1993	1994	1995	1996	CAGR 1992-1996
ALLTEL	61,554	64,936	70,217	72,228	76,612	5.6%
BELLSOUTH	5,017,055	5,098,495	5,535,986	5,874,804	6,520,381	6.8%

FRONTIER	3,329	3,451	3,626	3,721	3,930	4.2%
GTC, INC. (FLORALA)	1,864	1,920	2,027	2,079	2,285	5.2%
GTC, INC. (GULF)	7,916	8,048	8,492	8,654	9,036	3.4%
GTC, INC. (ST. JOSEPH)	24,813	24,812	26,031	27,024	30,160	5.0%
GTEFL	1,821,641	1,810,591	1,896,201	2,161,945	2,339,415	6.5%
INDIANTOWN	2,838	3,027	3,139	3,265	3,419	4.8%
NORTHEAST	6,248	6,502	6,787	7,144	7,539	4.8%
QUINCY	10,211	10,736	11,457	12,464	13,051	6.3%
SPRINT-FL	1,516,575	1,554,398	1,629,832	1,711,409	1,845,093	5.0%
VISTA-UNITED	6,490	8,347	10,137	11,846	14,324	21.9%
TOTAL:	**8,480,534**	**8,595,263**	**9,203,932**	**9,896,583**	**10,865,245**	**6.4%**

Source: 1992-1996 Annual Reports of Local Exchange Telephone Companies to FPSC and responses to staff data requests.

Chapter 364, Florida Statutes, provides that a LEC may file with the Commission a notice to be subject to price regulation. Under rate of return regulation, the focus is on constraining earnings (by constraining overall revenues and thus rates), while with price cap regulation the focus is on prices. The law limits the upward movement of rates by means of price caps, which set the maximum allowable prices that may be charged for services. Prices may be adjusted to any point below the ceiling without prior Commission approval. Tariff filings by price-regulated LECs have shortened notice periods, of 7, 15, and 30 days depending on the nature of the filing. Changes are presumptively valid, and not subject to lengthy review for Commission approval. Price regulation thus provides companies with greater pricing flexibility.

Currently six of the ten LECs have elected price regulation. They are: BellSouth Telecommunications, Inc., GTC, Inc. (The Florala Telephone Company, Inc., Gulf Telephone Company, St. Joseph Telephone & Telegraph Company), GTE Florida Inc., Sprint-Florida, Vista-United Telecommunications, and Indiantown Telephone System, Inc.

The price caps for basic and non-basic services differ. While prices for non-basic services may increase up to 6 or 20% within a 12-month period (the applicable percentage depends on the absence or presence of a competitor in an exchange area), prices for basic local telecommunications services are capped and cannot be increased prior to January 1, 1999 (January 1, 2001 for BellSouth).

Section 364.051(3)(a), Florida Statutes, requires that the Commission report to the Legislature and recommend on an exchange by exchange basis whether there is a need to extend the caps on basic local telecommunications service prices or whether there is some other means, excluding rate of return regulation, to ensure reasonable and affordable rates for basic services. Further, this Commission is to determine if the level of competition in an area justifies the elimination of price caps. The analysis and conclusions are contained in Chapter IV.

ALLTEL Florida, Inc., Frontier Communications of the South, Inc., Northeast Florida Telephone Company, Inc., and TDS Telecom/Quincy Telephone remain under rate of return regulation. Under rate of return regulation, the Commission determines the amount of revenue the firm needs in order to provide services. Once the company's revenue requirements have been established, rates are set to produce that level of revenue. While this process constrains the rate of return regulated LEC from acting or reacting quickly to competitive changes, it provides a level of revenue without the risk associated with competition. In order for the company to change rates either up or down or introduce new services, it must obtain Commission approval. This process typically takes 30 days.

These LECs can remain under traditional rate base, rate of return regulation until they elect to become price regulated or January 1, 2001, whichever comes first. While TA 96's main function is to bring competition to all telecommunications markets, it recognizes that customers of LECs operating exclusively in rural territories may be adversely impacted by competition. Rural

companies do not have to unbundle, resell, or interconnect with another carrier until they receive a bona fide request for interconnection services or network elements, provided that such a request is not unduly economically burdensome, and is consistent with TA 96's provision for universal service. However, it is up to a state commission to determine if a request meets the requirements. Additionally, a rural carrier having fewer than 2% of the nation's total installed subscriber lines can also petition its state commission for suspension of the requirements to interconnect or resell. The state commission can grant the petition if it finds that the rural LEC or its customers would be adversely affected by having to meet the interconnection or resale requirements. Specifically, a petition can be granted if it is not technically feasible for the rural LEC to meet the requirements, or if meeting the requirements is not in the public interest. It should be noted that the FCC recently preempted a Wyoming law that provided for a blanket exemption for small LECs until 2005.

In order for a LEC to compete outside its service territory, it must be certificated as an alternative local exchange company. As of September 15, 1997, there were five LEC affiliates that were certificated as ALECs. They are ALLTEL Long Distance, Inc. BellSouth Telecommunications, Inc., GTE Long Distance Incorporated, Indiantown Telephone Systems, Inc., and Sprint Metropolitan Networks, Inc. In addition, BellSouth BSE, Inc. is in the process of becoming certificated. The familiar name associated with these alternative local exchange companies is an excellent marketing tool. For example, in its 1996 Annual Report, Sprint states "We have invested more than $1 billion to create one of the most valuable assets a company can possess - a brand that will help deliver explosive growth."

ALTERNATIVE LOCAL EXCHANGE CARRIERS

Many of the amendments to Chapter 364 passed into law in 1995 were aimed at reducing the

amount of regulatory oversight of local service providers and enabling competition in the local market to evolve more freely. The legislation affords the ALECs more freedom from regulation than the incumbents receive. For example, the ALECs do not need to distinguish between basic and optional services and can change prices without regard to any limit, while the price cap LECs are constrained by an overall annual percentage.

As of September 1, 1997, there were 108 certificated ALECs in Florida (see Appendix A). This represents an increase of approximately 180% over the number certificated as of September 1, 1996, when there were 38 certificated. For some, their main line of business is providing (or planning to provide) local service. However, the vast majority of the entrants' main businesses are not the provision of local service. These core businesses include entertainment, cable TV, pay telephone, interexchange, private line/special access, wireless, and even municipal "services." In Florida, ALEC certificates held by local government affiliates are: City of Lakeland, City of Ocala, GRU Communication Service/GRUCom/GRU. The City of Tallahassee has its application pending at this time.

An incumbent price cap LEC is required to negotiate interconnection and resale agreements with providers wanting to provide local switched service in the LEC's territory. As of October 13, 1997, 181 negotiated agreements had been filed with the Commission (80 for interconnection, 100 for resale, and 1 was withdrawn). Of the 181 agreements filed, 155 have been approved. Five LECs have entered into agreements with a variety of ALECs. They are: ALLTEL, BellSouth, GTEFL, Sprint-Florida, and Vista-United. If the parties are able to reach agreement on the entire package, they bring the agreement to the Commission for approval. If they are unable to reach agreement in total, or if they disagree on selected portions of the package, they may bring the disagreement before the Commission for arbitration. It is then the Commission's job to decide what should or should not

be included in the agreement.

The arbitration process has been arduous. This was due in part to the number of issues that needed to be agreed to by the parties, and in part to the complicated nature of many of the issues. However, as parties gain experience with the process, some of the complexity should abate. Whether an agreement is for interconnection or resale, the services and the elements comprising services can be large in number and technically complex. In many cases, entrants require different arrangements of services/elements; therefore, an agreement reached between one pair of providers (ALEC and an LEC) was not suitable for another pair of providers, and an entirely new negotiation process was undertaken.

Failed negotiations have involved both entire agreements and just portions of agreements. As a result the Commission has arbitrated several disputes. As of September 15, 1997, 19 arbitration requests have been filed with the FPSC. Of the 19, nine have resulted in a Commission decision, eight were withdrawn, one was dismissed, and one is pending. Table 3-1 on page 30 shows the parties involved in those arbitrations in which a Commission decision resulted.

Despite the number of agreements that have been approved by the Commission, there are a relatively small number of ALECs actually offering service in Florida. Table 4-1, page 56, lists these providers, the type of customer they are currently serving, the method they use to offer service, and the general areas in which they provide service.

A data request was sent to the ALECs asking a variety of questions regarding their ability to enter, or their plans to enter, the local services market. For the ALECs having little trouble entering the market all but one gave no specific reason. The one that provided a specific response stated that the LEC and FPSC had been "very helpful and cooperative."

The reason most often mentioned by ALECs experiencing difficulty in entering the local market

was refusal by the LEC to accommodate the needs of the ALEC (e.g., billing delays, inadequate OSS systems). Other reasons listed by the ALECs were lack of sufficient financial resources, inexperience in operating a telephone company, and the complex nature of actually operating a telephone company.

Several ALECs indicated that they have changed their plans to enter the local markets, delayed entry, or abandoned the idea altogether. The most prevalent reason cited was uncertainty of market conditions and regulation. Many of the same reasons posed for having difficulty in entering were offered.

While some ALECs have changed their plans, some have been able to move ahead as aggressively than they had originally projected. For these ALECs, accommodation of their needs by the LECs or successful, swift negotiations between the parties was listed as the primary reason.

OTHER PROVIDERS OF LOCAL SERVICES

WIRELESS PROVIDERS

The wireless providers, cellular and PCS, in effect already provide local service (although generally at higher rates than charged for local service by the LECs). Consequently, of all potential entrants, wireless providers may pose the greatest competitive threat to local carriers.

Cellular and PCS services' appeal lies in the fact that they are a portable service.

Cellular technology was initially developed in the late 1940s, but did not become readily available until the 1980s. At the time of its commercial introduction in the 1980s, rates for cellular service were substantially higher than landline local service or long distance service. Despite this, its popularity has continued to increase.

PCS is comparatively new, created in part due to advancements in digital transmission technology.

The PCS market came about as a result of a government decision to allow the FCC to auction additional radio spectra for commercial purposes. It is estimated that the broadband PCS auctions have generated about $20 billion.

Traditional analog cellular and PCS are similar in that they are both wireless; however, PCS has some distinct advantages over traditional cellular. Through its use of digital technology, PCS provides better voice quality, and PCS can carry voice, data and video traffic more rapidly than analog cellular. Further, since voices are digitized (converted into ones or zeros) before they are transmitted, the calls made over PCS are more secure. Analog calls are transmitted in the open without being changed; therefore, anyone with a scanner can eavesdrop on random calls.

Despite cellular's historical use of analog equipment, cellular service is not a dying service. As systems are upgraded, cellular providers are replacing analog equipment with newer digital equipment. PCS systems do not yet have extensive roaming capabilities which allow for the completion of calls placed between providers' territories. Roaming refers to the customer using his cellular phone to place or receive calls in another territory other than his own. In order for this to occur, the companies must have made arrangements with each other to allow the completion of these calls. Roaming calls are generally "long distance." Roaming is a commonplace feature of cellular where most companies have agreed to complete calls. Finally, PCS systems' needs for greater numbers of switching sites tend to limit the size of their "local" calling area compared to some cellulars' local calling zones. At the time of this writing cellular service remains the dominant means of portable telephone service.

Wireless providers often have much larger local calling areas than do LECs. Thus, their "local" service can extend well beyond the LECs'. For example, the service territory for a cellular provider can extend over one hundred miles and cross state lines.

While cellular rates have generally exceeded local telephone rates, the gap is narrowing. Rates are going down due to competitive pressures and technological advances, such as the advent of PCS service. As rates continue downward, it is expected that wireless subscribership will increase. This may pose an additional threat to the LEC. As more and more subscribers use wireless phones, and the subscribers choose to "dial up" the wireless number from a wireless phone instead of dialing the landline number, the wireless provider will be able to complete calls within its own network and not have to pay the LEC for access. For the immediate future, however, wireless likely will continue to be primarily a complement to landline service rather than a substitute for it.

With the combination of advanced technology, greater security, and an anticipated lower service cost to the user, it is believed that PCS will provide significant competition to traditional cellular and, perhaps, wireline telephones. This may explain why some companies have spent hundreds of millions, even billions, bidding on PCS licenses. For example, according to Sprint's 1996 Annual Report, the company has invested more than $3.2 billion for PCS licenses and network construction. AT&T stated in its 1996 Annual Report that it had aggressively bid on wireless spectrum licenses that have increased its wireless footprint to reach more than 90% of the U.S. population.

SHARED TENANT SERVICE PROVIDERS

Shared tenant service (STS) providers resell local service and in this way compete with the local exchange provider. STS providers typically provide their services through a private branch exchange (PBX) (a small programmable switch). Service is provided to business or residential tenants that rent space in a building or complex through leases or rental agreements.

Because an STS provider provides local service, it resembles an ALEC. However, there are several restrictions placed on an STS provider that distinguish it from an ALEC. All STS providers are

limited to providing service within the confines of specifically identified continuous property under the control of a single owner or management firm. Without this restriction, there would be little to differentiate an STS provider from an ALEC.

An STS provider operating in a small rate of return regulated LEC's territory is subject to additional limitations. It is limited to having no more than 250 PBX trunks; it cannot bypass the LEC by connecting its PBX directly to an IXC point of presence (POP); it cannot construct facilities to interconnect with other STS locations; and it cannot interconnect with an unafilliated STS provider.

PAY TELEPHONE AND LOCAL SERVICE

In 1985, Florida law was amended to allow the provision of pay telephone service by companies other than LECs. Private pay telephone providers (PATS) gained entry into both the local and interexchange markets.

While PATS providers offer many services, including local, the Commission has not found NPATs service to be competitive to the end user. The end user does not always have a choice of pay telephones to use. The true customer the NPATs competes for is the location provider, not the end user. NPATs providers vie for locations with significant probable end-user traffic, locations such as a mall or an airport.

There have been many significant regulatory changes in the pay telephone industry since 1985. Perhaps the most significant changes have come about as a result of Section 276 of the Telecommunication Act of 1996 (TA 96). The goals of Section 276 of TA 96 are to encourage widespread deployment of payphone services, and promote competition among all payphone service providers. These regulatory changes are discussed in Chapter III.

APPENDIX D: COMPETITIVE ACTIVITY-EVENTS OF THE PAST YEAR

A chapter devoted to making some predictions on the development of competition in Florida was included in the 1996 Competition Report. So little competition had actually taken place in the local services market, there was not much information that could be used in making the prognostications. Consequently, the predictions were made based upon the providers that were certificated as ALECs at that time: who they were, their strengths and weaknesses, and, when known, their strategies for competing. This chapter examines the accuracy of those predictions made last year, given a year of experience.

Overall, entry into the local market has not been nearly as robust as originally hoped. Some providers argued that they were in an ideal position to compete in the local market. These providers were generally in possession of their own networks: cable TV companies, IXCs, and competitive access providers (CAPs). All that was needed was for legislators to recognize the benefits of a competitive local market, and open it up to competition. Despite state and federal legislation enacted to do just that, entry has not flourished. The reasons are varied. Some entrants found that running a telephone company was much more complex and expensive than initially thought. Some have found that reaching agreement with a LEC for resale, interconnection, or to purchase UNEs has been difficult. Many have delayed or curtailed entry plans due to uncertainty in interpreting and implementing the legislation, particularly TA 96.

1996 Prediction: Resale will be the primary means of entry by competitors.

Of the three methods of entry (resale, interconnection, and purchase of unbundled network elements), resale offers the path of least resistance. Interconnection and use of UNEs require the entrant to have either all or a portion of its own facilities. Resale enables the entrant to avoid the expense and delay of putting in its own facilities.

Responses to staff's data request suggest that resale has been, and for the near future will be, the primary means of competitive entry. Twenty two ALECs reported that they are currently offering basic local service in Florida. Sixteen listed resale as the means of offering service, two providers are using a combination of facilities and resale and UNEs, and four companies are offering service by means of solely their own facilities.

Although only 22 ALECs indicated that they were providing service at this time, many have positioned themselves to enter the local market. The obvious first step the ALEC takes is to become certificated. The next step is for agreement between the ALEC and the LEC to enable the exchange of calls. Specifically, agreement must be reached that will allow termination of a call on one provider's network that originated on the other's network. Once the two parties are in agreement, the contract is brought to the Commission for approval. As of October 13, 1997, the Commission had approved 155 negotiated agreements. The Commission has approved nine arbitrated agreements and one more is pending at this time.

BellSouth reported that it has resale agreements with 27 ALECs, while eight ALECs are interconnecting with BellSouth's facilities. Three ALECs have purchased UNEs from BellSouth. GTEFL reported that it has resale agreements with eight ALECs, and interconnection agreements with two ALECs. No ALEC has purchased any UNEs from GTEFL.

1996 Prediction: The IXCs will be the first to enter.

IXCs were considered to be likely early entrants into the local market. The large IXCs are financially strong, having substantial cash flows. They are also able to secure substantial lines of credit. All IXCs have extensive experience with competition, having been vigorously competing for long distance services since divestiture. Many IXCs have their own networks. By combining its long distance network with a local network, an ALEC/IXC can extend its local calling scope well beyond that of the LEC. Many IXCs have name recognition. They are recognized as telephone providers, unlike entrants such as cable TV providers whose names are not associated with telephone service. Finally, IXCs have experience with billing telecommunications customers, a process that may be problematic for newcomers.

In terms of any specific type of entrant, judging from the names of ALECs certified in Florida, entry has been fairly random, although the IXCs are represented. Among those ALECs certificated are AT&T, Cable and Wireless, GTE Long Distance, Dial and Save, LCI International, and LDDS WorldCom. However, the IXCs are far from being in the majority of those providing local service in Florida. Among the 22 companies who responded that they were providing local service, only four are affiliated with long distance companies. These are Cable and Wireless, LCI International, MCImetro, and Sprint Metropolitan Network Inc. There has been one entrant from the cellular business, Easy Cellular, and one from the cable TV business, MediaOne. It is unclear if any of the remaining 16 are affiliated with an IXC, cellular provider, cable TV provider, or other communications related businesses.

1996 Prediction: The LEC will remain the dominant competitor in its territory.

The LEC dominates its local market, and will continue to do so for the foreseeable future. There has been little entry, either in terms of numbers of providers offering service in Florida, or the number of customers that those entrants have. What is unknown is the revenues of those customers served by ALECs. However, LEC revenue has continued to grow even with competition.

At the time of this writing there are 22 ALECs providing service. Of the 22, ten stated they had between 1,000 and 10,000 customer accounts. Four listed the number of their accounts to be somewhere between 500 and 1000. The remaining eight stated they had between 1 and 500 customers. None responded that they had more than 10,000 customer accounts.

In some cases, the LEC has an advantage over the ALEC by offering a full array of local services. In comparison, the ALEC's offerings are usually limited. If a provider has several services to offer, it can create combinations of services to target both specific customers and many other markets besides the local services market. For example, if a customer is interested in private line service, centrex, basic local service with several enhancements such as caller ID and call forwarding, and voice mail, the LEC could package these together and offer the package at a price. But if the provider does not have anything else besides basic local service, or has very few services beyond basic local service, it has little to use to create a package of services. (Admittedly, an ALEC could obtain and offer more services by entering into agreement with the LEC to purchase many services at wholesale. However, the ALEC may decline to do this because it finds the margin between retail and wholesale provides an inadequate return. This is the situation for many ALECs. Several ALECs offer nothing in addition to local service, some are offering vertical services as well as basic local service, and some are offering specialized services such as private line/special access, frame relay services and data services. This enables entrants to compete with the LEC only in selected

markets and for a more limited universe of customers.

1996 Prediction: LECs become ALECs in another LEC's territory.

In last year's report, it was noted that a LEC affiliate could become a competitor in another LEC's territory; this is occurring. Included on the list of ALECs offering or providing service today is BellSouth (the ALEC), which is providing basic local service in the Winter Park exchange, which is in Sprint-Florida's territory. Similarly, Sprint Metropolitan Networks Inc. (SMNI) is offering service in BellSouth's Orlando area.

Affiliates of other LECs are also providing or planning to provide service in Florida. GTE Long Distance (GTELD) and US West's affiliate Alternet are both certificated ALECs. GTELD has not begun offering local service yet, but Alternet is providing private line services in the Jacksonville area, part of BellSouth's territory.

1996 Prediction: Technology may give new entrants an advantage.

As reported in 1996, the need for greater bandwidth was growing. This need was being fueled by the increasing demand for data and video services. At that time it appeared that entrants may have been in a better position to offer more advanced services than the LECs. The hypothesis was that an entrant interested in being a facilities-based carrier would be installing facilities reflecting a technology more advanced than that used in the then-existing networks. The typical incumbent's network has been in place for several years, and much of the network consists of facilities designed for carriage of traditional voice services.

So far it does not appear that entrants have a technology advantage. First, many are not constructing their own networks. In response to staff's data request, only three providers indicated

that they were providing service entirely over their own networks, and two stated that they were providing service in combination with LEC-provided services or network elements. The remaining ALECs are relying on resale rather than installing facilities. For these ALECs, their "network" can only be as advanced as the LECs, the entity whose services the ALEC is reselling. Second, Florida's LECs' networks are already equipped with advanced facilities. As reported in 1996, all LECs, with the exception of BellSouth, have fully converted to digital switches. Already substantially digital, BellSouth will complete its conversion when economically feasible.

1996 Prediction: The ALECs will target high volume customers first.

A 1996 prediction was that the ALECs would likely focus their attention on the most lucrative portion of the market: the high volume users. Lending support to this prediction were the results of a Boston based consulting firm's survey of entrants that showed the emphasis would be on business customers. Also included for support were the locations -- Jacksonville, Tampa, Miami and Orlando -- that ALECs had indicated they were considering entering or had entered. Responses to this year's staff data request do not confirm that most entrants are concentrating solely on businesses. However, the responses do confirm that many providers are operating in areas where high volume customers are located.

Of the 22 ALECs providing local service, nine are offering services exclusively to business customers. Of the remaining 13, six are offering service to both business customers and residential customers, and seven are offering service to only residential customers.

The geographic locations listed by these 22 ALECs are varied. Some report that they are offering service throughout Florida or "all" of Florida. Some of the specific locations listed include Miami, Orlando, Tampa, Ft. Lauderdale, West Palm Beach, and Jacksonville. These cities are home to

numerous large businesses having high volumes of calls.

1996 Prediction: Entrants will combine services that were previously sold separately and offer them as a single package.

This prediction was based on three observations. First, the core businesses of some ALEC entrants differ substantially from traditional landline telecommunications (for example, cable TV). It was thought that these players would offer basic telephone service as a platform to make their core businesses more attractive. Second, there was substantial interest between non-telecom providers and telecom providers in entering each other's business. For example, cable TV providers Comcast Cablevision, Cox Communication, and Tele-Communications Inc. entered into a partnership with Sprint to provide Sprint PCS service. (1996 Sprint Annual Report, p. 31) At the same time, companies such as BellSouth are experimenting with entry into the cable TV business. (1996 Annual Report, p. 23) Third, many providers have affiliates offering services in other business markets -- for example, the cellular and PCS markets. These providers are beginning to offer single bills for multitudes of services. This one stop shopping, in effect, bundles services which were previously sold separately.

Prior to passage of TA 96 and the state amendments to Chapter 364, many providers of services in industries such as cable TV had expressed their desire to enter the local telecom market. Legislation to open up the local market was needed to eliminate barriers to competition. Among the proponents of legislative reform were the cable TV providers. However, at this time few cable TV providers have actually entered the local services market.

At the time of this writing many cable TV providers have not yet become certificated ALECs in Florida. Time Warner was an early entrant to be certificated in Florida. However, if its 1996 annual

report is any indication, the Company has changed its plans. In its 1995 Annual Report, Time Warner's interest in the telecommunications market is expressed numerous times. Also, a fairly involved discussion of the Company's efforts to enter the telephony business is included under the heading "Strategic Initiatives. " (pp. 50-51) In contrast, there was only one reference to telephony in the Company's 1996 Annual Report (p. 32), and the topic is excluded from the Strategic Initiatives section.

A natural step for landline telephone companies to take is to enter the wireless market. In its second annual report on Competition in the Commercial Mobile Radio Services (released March 25, 1997, Table 2) the FCC listed the major cellular carriers and their percentage increases/decreases in subscribership from December 1995 to December 1996. Some of the carriers listed are AT&T Wireless, Bell Atlantic Mobility/NYNEX, Southwestern Bell, GTE, BellSouth, Ameritech, and US Cellular.

At the national level, wireless services have shown substantial growth. No carrier listed had a decline in subscribership. The Cellular Telecommunications Industry Association reports that the number of cellular customers in the United States at the end of 1996 was approximately 44 million, a 30% increase over 1995.

The three largest LECs operating in Florida, BellSouth, GTE, and Sprint-Florida, have affiliates in either the cellular or PCS markets. Each Company's 1996 Annual Report repeatedly references bundling of services and/or one-stop shopping. (BellSouth, 1996 Annual Report, pp. 2, 4, 5, 8, 15; GTE, 1996 Annual Report, pp. 1, 2, 4, 12; Sprint, 1996 Annual Report, pp. 4, 10, 16, 17) GTE indicates that it is already bundling wireline and wireless services. BellSouth and Sprint express their plans to combine wireline and wireless services.

The extent to which entrants are bundling services as a marketing strategy is unclear. On the one

hand cross-market entry has been extremely limited. Cross-market entry in the basic services market and the cable TV market do not appear to be happening as projected. On the other hand, efforts to combine wireless services with wireline services seem robust and suggest cross-market entry is actively happening, albeit in a different fashion than expected. It is important to note, however, that this cross-marketing is taking place one-way. Many of the entities currently providing basic local services, such as the LECs, are poised to bundle their services with their wireless affiliates. But wireless providers are not moving into the wireline basic local service market in any significant numbers. Only one cellular provider has moved to offer basic service. Easy Cellular of Las Vegas, Nevada, reports that it has begun providing basic local service throughout Florida. Given the conflicting nature of the information, there is ambiguous support for the prediction that firms will combine services as a marketing strategy.

Conclusion

The results of 1996's predictions are mixed. Some proved very accurate while others were confused or completely missed the mark. 1996's forecasts, however, were made without real experience, resulting in inevitable errors. Such will likely be the case with 1997's projections. Despite greater amounts of data available, predicting the directions that competition will take remains difficult. However, in Chapter V, we formulate some new estimates for the coming year.