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November 13, 1992

Mr. Steve Tribble  
Director, Records and Reports  
Florida Public Service Commission  
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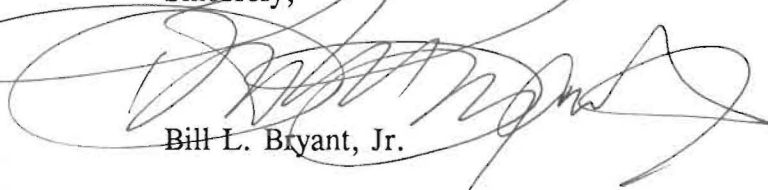
**RE: Comprehensive Review of the Revenue Requirement and Rate Stabilization Plan of Southern Bell Telephone & Telegraph Company, Docket No. 920260-TL**

Dear Mr. Tribble:

Enclosed for filing in the above-referenced case are the original and 15 copies of the Direct Testimony of David Chessler, with Exhibits, which are being filed on behalf of the American Association of Retired Persons ("AARP").

Thank you for your assistance in the processing of this filing, and please call if there are any questions or further requirements.

Sincerely,



Bill L. Bryant, Jr.

- ADM ✓
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- BOB
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- CTR
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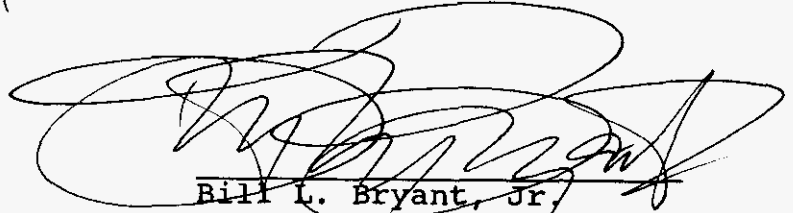
Enclosure

cc: Parties of Record

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail ~~or Hand Delivery~~ this 13th day of November, 1992.



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SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY

DOCKET NO. 920260-TL

DIRECT TESTIMONY OF

DAVID CHESSLER

ON BEHALF OF

THE AMERICAN ASSOCIATION OF RETIRED PERSONS

FILED: NOVEMBER 13, 1992

DOCUMENT NUMBER-DATE

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1 DIRECT TESTIMONY OF DAVID CHESSLER, PH.D.

2 Q. Please state your name and address for the record.

3 A. My name is David Chessler. My business address is Post  
4 Office Box 1195, Bethesda, Maryland 20827.

5 Q. What is your present occupation?

6 A. I am President of David Chessler and Associates, a  
7 consulting firm that provides advice and consultation in  
8 matters of telecommunications regulation, principally to  
9 state regulatory commissions in the United States and to  
10 provincial and national regulatory bodies in Canada.

11 Q. Please summarize the pertinent facts of your education and  
12 work experience,

13 A. I have a doctorate in economics and wrote my dissertation  
14 in the field of public utility regulation. I have twenty  
15 years of experience in telecommunications regulation at the  
16 federal and state levels. A summary of my relevant  
17 education and work experience is attached hereto as exhibit  
18 DC-1.

19 Q. What is the purpose of your testimony?

20 A. The primary purpose of my testimony is to provide advice  
21 and assistance to the Florida Public Service Commission in  
22 making a critical examination of certain testimony which  
23 was provided by Southern Bell Telephone and Telegraph  
24 company in Docket No. 920260-TL.

25 I am concerned with three principal issues:

- 1           1. The degree of competition faced by Southern Bell in  
2           various markets, and the appropriateness of price cap  
3           regulation as a regulatory approach in those markets.  
4           2. The appropriateness of Southern Bell's Extended Area  
5           Service (EAS) proposal in view of the demographics and  
6           calling patterns known to exist in Florida. My primary  
7           concern is with the implications that this service  
8           offering will have for lower-income residential  
9           customers  
10          3. The appropriateness of the list of basic services given  
11          by Southern Bell in its filing, and the possibility  
12          that certain "rate elements" should be considered  
13          "basic" or "non-basic," depending on the primary  
14          services to which the customer subscribes.

15          These tasks, of necessity, require the examination of  
16          Southern Bell's prefiled testimony and exhibits, other  
17          related documents and evidence and an assessment of their  
18          relevance to and impact upon the Southern Bell proposal.  
19          I will discuss the competitive issues first, and then the  
20          matter of the proposed EAS. After that, I will conclude  
21          with a discussion of the question of what is a basic  
22          service, and whether certain rate elements may be basic or  
23          non-basic depending on the status of the underlying  
24          service.

25          Q. Can you summarize briefly your views with respect to the



1 nature and degree of competition faced by Southern Bell?

2 A. I discuss Southern Bell's experience with toll competition,  
3 coin competition, and bypass, since these are the only  
4 forms of competition for which Southern Bell presents any  
5 evidence at all. I conclude that with respect to toll  
6 competition, Southern Bell has competed effectively, and  
7 since the flexibility plan came into effect in late 1988,  
8 Southern Bell's intra-LATA competitors have failed to grow,  
9 while Southern Bell has been able to maintain its profits  
10 in a recession.

11 With respect to service bypass, I conclude that the  
12 evidence is clear that bulk discounted services can be as  
13 profitable as MTS, even when subject to competition. With  
14 respect to facilities bypass, there is little evidence that  
15 it is occurring to any substantial degree, based upon  
16 review of statistical and financial operating results.

17 With respect to coin competition, Southern Bell has been  
18 doing very well, and the slowing in the rate of revenue  
19 growth is related to the rate of growth in the number of  
20 access lines. Furthermore, coin is a costly service, and  
21 it appears that it is more profitable to let others have  
22 the problems of actually collecting the coins and  
23 maintaining the instruments.

24 Q. Can you summarize briefly your views on the Rate Cap plan  
25 proposed by Southern Bell?

1       A. The plan is badly flawed, anticompetitive, and can result  
2       in rate increases for basic customers, even if the  
3       company's costs are declining. The rate cap for basic  
4       rates permits rate increases, even if other rates are  
5       falling, and the company is lowering the overall index of  
6       the rates.  
7       Because of this, the company can arbitrarily lower  
8       competitive rates, whether rates as a whole are rising or  
9       falling. I show by example how the company could so target  
10      some competitive services as to drive its competitors from  
11      the market.  
12      Since no cost support is required for rate changes, and  
13      since the Commission would not have time or information to  
14      react to rate changes, competition in toll or other markets  
15      the company might target would end.  
16      With respect to the company's proposed "productivity  
17      offset," I show that it is much below historic values in  
18      the telephone industry, and that 5.5 per cent is the offset  
19      that would be justified by a review of the evidence.  
20      Furthermore, because of the lack of filing requirements and  
21      cost support, the Commission will be in a poor position to  
22      review anti-competitive rates the company might file. The  
23      lack of a requirement for cost support is particularly  
24      hurtful here, since the company might file rates below its  
25      incremental cost, or might structure the rates to "target"

1 competitive portions of a service. The Commission would  
2 not have the information needed to prevent such  
3 anticompetitive behavior.

4 Q. Can you summarize your views on the extended calling area  
5 plan?

6 A. The extended calling area plan is designed as a migration  
7 strategy to force some flat rate customers to subscribe to  
8 measured rates, in such a manner as to raise company  
9 revenues without changing prices or the price index.  
10 The other effect of the overly-large proposed local calling  
11 areas is anti-competitive. The proposal extends calling  
12 areas to distances that interexchange carriers probably  
13 find it profitable to serve. Charging local rates would  
14 prevent these companies from serving the market in the  
15 future, even though they do not now provide much service,  
16 and the amount of service they do provide does not appear  
17 to be increasing substantially (intra-LATA access revenues  
18 have declined, 1988-1991).  
19 The plan is not supported by appropriate studies.  
20 Experience in other states suggests that the local calling  
21 areas are too wide, and that customers have relatively  
22 little interest in calling some of the new areas. If  
23 appropriate studies were done, the calling areas could be  
24 expanded on the basis of customers actual calling patterns  
25 and needs.

1 Q. Can you summarize you views on what constitutes a basic  
2 service and the rate protection that should be offered such  
3 services?

4 A. A basic service is a service that is essential to some  
5 customers or to some class of customers, and that is  
6 offered under conditions of monopoly. The newness of the  
7 service or feature does not affect whether it is essential  
8 for some customers, or whether it is or can be offered only  
9 by a local exchange carrier. Some basic "services" are  
10 actually rate elements, that must be ordered in conjunction  
11 with another underlying service. In such case, a "feature"  
12 or option that is essential to some customers and that is  
13 ordered in conjunction with a basic service should also be  
14 considered a basic service.

15 A basic service merits protection from excessive or  
16 unreasonable price increases. The five per cent per year  
17 cap on increases proposed by Southern Bell is grossly  
18 inadequate protection. All basic services, whether they  
19 are services in their own right or are elements or options  
20 of a basic service that are essential and monopolized,  
21 should get the protection of the five per cent rate cap or  
22 whatever stricter rate cap replaces it.

23 Q. Can you describe briefly the competitive pressures Southern  
24 Bell faces in various markets, as you see them, and as the  
25 company describes them?

1       A. Southern Bell witnesses have averred that Southern Bell  
2       faces a great deal of competition. Company witness  
3       Lombardo (p. 6ff) claims that the amount of competition has  
4       increased in several markets since the Florida Public  
5       Service Commission dealt with the question in 1988, in re:  
6       Petitions of Southern Bell Telephone and Telegraph Company  
7       for Rate Stabilization and Implementation Orders and Other  
8       Relief, Florida Public Service Commission, Docket No.  
9       880069-TL, Order No. 20162, October 13, 1988. However, he  
10      presents no evidence as to the amount of the alleged  
11      increase in competition. Indeed, his primary claim is that  
12      competition will increase in the future, although, again,  
13      he presents no studies to show that competition has  
14      increased.

15      Q. On page 6 of his testimony Mr. Lombardo lists three kinds  
16      of facilities bypass, service bypass, pay telephone  
17      service, intra-LATA toll, operator services, and business  
18      telephone systems as services in which Southern Bell is  
19      experiencing competition. Please analyze his support for  
20      this contention.

21      A. The specific example he most attempts to support  
22      statistically is of toll competition (p. 7), where Southern  
23      Bell's intra-LATA toll service has been growing at the rate  
24      of 5 per cent, compared with the market for switched  
25      access, which has been growing at the rate of 9 to 11 per

1 cent. (He also presents some statistical information about  
2 coin competition, which I will get to shortly.)  
3 With respect to toll competition, Mr. Lombardo does not  
4 specify whether he is talking of revenues or physical  
5 quantities (calls or minutes of use). Clearly, if he is  
6 talking of revenues, the discounts Southern Bell has been  
7 giving to large telephone users naturally have depressed  
8 its revenues, but any further discounts Southern Bell might  
9 give if the Florida PSC were to grant Southern Bell further  
10 flexibility in setting rates would depress its revenues  
11 still further.

12 On the other hand, carrier access charges are never  
13 discounted, so revenues here reflect the full growth in the  
14 traffic. Thus, it is not legitimate to compare toll  
15 revenues with access revenues, unless one adjusts first for  
16 changes in prices.

17 Moreover, on page 21, Mr. Lombardo states that the company  
18 charges less than its competitors for MTS. Various MTS and  
19 WATS discount toll plans were introduced in 1989 and 1990.  
20 Thus, some of the loss in revenues is to be explained by  
21 Southern Bell's response to competition. Permitting  
22 Southern Bell even more rate flexibility will not prevent  
23 further losses from this source. Indeed, unless Southern  
24 Bell targets its competitive response better (a point I  
25 discuss in more detail below), additional flexibility may

1 simply exacerbate the loss in revenue.

2 Q. If Southern Bell is charges less than its competitors, and  
3 has instituted all the marketing programs and discount  
4 rates permitted by the flexibility plan, and which Mr.  
5 Lombardo lists on page 21, what can be the explanation for  
6 Southern Bell's failure to grow as fast as its competitors?

7 A. There are several possible explanations. The first is that  
8 despite being the cheapest supplier of telecommunications,  
9 Southern Bell's marketing is somehow ineffective, and it is  
10 losing market share to higher priced competitors. If this  
11 were the case, further ratemaking flexibility would not  
12 give Southern Bell any advantage. The solution to the  
13 problem would lie in improving Southern Bell's sales and  
14 marketing functions, or its quality of service.

15 Q. That answer assumes that Southern Bell is the low cost  
16 supplier, as Company Witness Lombardo claims, has a lot of  
17 special discounts and custom contracts, as he explains, and  
18 is still losing market share for some reason other than  
19 price and the ability to customize service contracts to the  
20 needs of its customers. Do you have any other possible  
21 explanations of how Southern Bell could lose market share  
22 in MTS as claimed by Mr. Lombardo, while being the low cost  
23 provider.

24 A. As I explained above, some of the purported loss in MTS  
25 market share may simply be a result of reduced rates, while

1 the number of calls or minutes of use is growing. There  
2 are some other likely reasons.

3 The first is the growth of WATS. Note that Mr. Lombardo  
4 compares MTS with switched access. Switched Access is used  
5 by the interexchange carriers to provide both MTS and WATS  
6 service. One result of the discounting is to cause some  
7 customers to change their traffic from the MTS tariff to  
8 the WATS tariff. Indeed, many of the recent changes in  
9 WATS tariffs have encouraged this, such as elimination of  
10 the requirement that WATS be provided on separate access  
11 lines. But, the result is that Southern Bell could have  
12 been gaining market share relative to its competitors, and  
13 still be experiencing slow growth in MTS.

14 Q. Let us explore this further. Do you mean that Southern  
15 Bell's slow growth in MTS at a time when Switched Access  
16 was rising rapidly may be due to changes in the way  
17 telecommunications services are marketed?

18 A. Precisely. Some of the difference may be caused by  
19 customers changing from MTS to WATS because WATS, which was  
20 always just discounted MTS, has been changed to be even  
21 more like MTS.

22 Similarly, some of the slow growth may also be caused by  
23 customers changing from switched services to private line  
24 services. Private line services have become one of the  
25 most rapidly growing segments of the telecommunications



1 industry, after years of slow growth in the 1960's and  
2 early 1970's. While not thought of as substitutes for MTS,  
3 there are many customers and many services for which  
4 private line service--or services offered under the private  
5 line tariffs--have become substitutes for switched services  
6 like MTS and WATS. A lot of data-related services, such as  
7 point-of-sale terminals, credit card verification, and the  
8 like can use private lines or dial-up lines depending on  
9 the volume of traffic.

10 Q. Isn't what you just described an example of "Service  
11 Bypass," which Mr. Lombardo cites as a problem on page 6?

12 A. "Service Bypass" means that the customer has substituted  
13 one service for another but has remained with the same  
14 carrier. The people who use the term often fail to define  
15 it carefully. Indeed, Mr. Lombardo never explains exactly  
16 what he means by it.

17 I believe that Mr. Lombardo uses Service Bypass to refer to  
18 situations where Southern Bell customers chose a bulk-  
19 discounted or private line service from Southern Bell  
20 rather than MTS or a more basic private line service. I am  
21 reasonably sure he would say that when a customer switches  
22 from MTS or WATS to private line service, this change  
23 constitutes Service Bypass. You will have to ask him  
24 whether he thinks that a customer switching from MTS to  
25 WATS, or to WATSaver or SuperSaver (two of the discount

1 plans mentioned on p. 21 of his testimony) would be an  
2 example of Service Bypass. Maybe he considers Southern  
3 Bell's "aggressive use of the Contract Service Arrangement  
4 (CSA) process" (p. 21) to constitute service bypass as  
5 well.

6 Q. If Southern Bell has retained the customer by offering the  
7 discount or other service, how is Southern Bell harmed by  
8 Service Bypass?

9 A. There is an unspoken and unproven assumption that MTS is  
10 more profitable than the other services, and that simple  
11 private line services are more profitable than complex or  
12 bulk private line services.

13 Q. Isn't it obvious that a discounted service is less  
14 profitable than an undiscounted service?

15 A. No. The discounted services generally involve the  
16 provision a large amount of service to a single customer,  
17 which may be cheaper than providing the same amount of  
18 service to a great many different customers. Furthermore,  
19 to be eligible for the bulk or discount service, a customer  
20 often has to accept some limitations or do some of the  
21 bundling, which reduces costs to the telephone company.  
22 Table 1, Exhibit DC-2 shows rates of return for the major  
23 interstate service classes between 1964 and 1974. It is  
24 instructive to look at the rates of return of the  
25 discounted "bulk" services over this ten-year period.

1 For example, WATS service seems to be discounted MTS.  
2 During the 1960's and 1970's, repeated studies found  
3 interstate WATS to be more profitable than interstate MTS.  
4 These cost revenue relationships clearly show that it is  
5 possible for a discounted bulk service to be consistently  
6 more profitable than its undiscounted non-bulk equivalent.  
7 While these cost/revenue relationships may no longer apply  
8 at the present, and may not apply to the Florida  
9 jurisdiction, they clearly show that one must not make  
10 presumptions about cost/revenue relationships based upon  
11 preconceptions, but should review appropriate and recent  
12 cost studies.

13 Q. What about Private Line service. Is not Private Line a  
14 major form of Service Bypass?

15 A. Look at TELPAK. TELPAK was discounted private line  
16 service. Prior to 1968, TELPAK A and B applied to  
17 customers with 12 and 24 voice grade lines, respectively,  
18 and the service did poorly. In 1969, when TELPAK A and B  
19 were ordered canceled, the remaining discounts, TELPAK C  
20 and D (60 and 120 lines respectively), show a greater rate  
21 of profit than does private line voice service.

22 To anticipate your next question, TELPAK was simply a bulk  
23 discount. If a customer had 60 private lines from Miami to  
24 Atlanta, the customer could receive the discount. The  
25 lines did not necessarily move on the same physical

1 facility, or even on the same route. There were no obvious  
2 cost savings, apart from the savings of dealing with a  
3 large customer, yet the service was consistently more  
4 profitable than voice grade private line service.

5 Q. What matters in the case of Service Bypass as discussed by  
6 Company Witness Lombardo is a comparison with MTS service.  
7 Can you compare private line service in Table 1 with MTS?

8 A. In Table 1, the relevant line is the one for TELPAK. From  
9 1973 and 1974, TELPAK, the bulk-discounted private line  
10 service, earned almost as much as MTS, 8.2 per cent  
11 compared with 8.8 to 8.9 per cent. This earnings level,  
12 which occurred after some rate adjustments shows that  
13 Private Line Service, which AT&T and the Bell Companies  
14 claimed to be competitive at the time, could earn as much  
15 as MTS service, which all parties at the time considered to  
16 be a monopoly.

17 Q. Wasn't MTS subject to "service bypass" in 1974?

18 A. The term hadn't been invented, but I recall some Bell  
19 Witnesses did make similar arguments.

20 Q. Shouldn't you be comparing the "Private Line Telephone"  
21 line on Table 1 with the "MTS" line?

22 A. We are not trying to replicate the rate levels and  
23 competition conditions of two decades ago. Rather, we are  
24 trying to learn from history, to avoid the mistakes of the  
25 past. What is important is that the most competitive of

1 the private line services could be priced to earn as much  
2 as MTS, so that "Service Bypass" need not constitute a  
3 threat to earnings.

4 Q. How is it possible that bulk-discounted services like WATS  
5 and TELPAK could earn as much as undiscounted MTS service?

6 A. While private line service is much cheaper than many hours  
7 of use of MTS or WATS, there are significant cost savings  
8 compared to services that use the telephone company's  
9 switch. For example, some Embedded Direct Cost Studies  
10 show Local Private Line Service returning a higher  
11 "contribution" as a percentage of direct costs than  
12 business lines or PBX trunks.

13 During the 1980's there has been a major re-alignment of  
14 private line costs in many states, raising them relative to  
15 rates for the switched services. Thus, cost/revenue  
16 relationships should be analyzed using current cost studies  
17 for the Florida jurisdiction, and it can certainly not be  
18 inferred that Private Line services are now less profitable  
19 than switched services.

20 If WATS and Private Line services are as profitable as some  
21 companies claim, then a gradual "migration" of customers to  
22 such services (gradual, so that normal growth of the  
23 switched services will maintain the "fill" level of the  
24 company's plant) would appear to increase the profitability  
25 of the telephone company.

1 Q. But you are talking about rates of return in Table 1.  
2 Surely it is the loss in revenue that is significant.

3 A. To the contrary, it is elementary economics that what  
4 matters is the return on investment. The more you have  
5 invested, the more you must earn, and the ratio of earnings  
6 to investment, expressed as a percentage, is the return on  
7 investment. It is this that the investor must compare with  
8 Government Bonds, Common Stocks, and other investment  
9 media.

10 Put another way, it is the same concept as the "Cost of  
11 Capital" by which we traditionally regulate the fixed  
12 utilities. We say they are "under-earning" or "over-  
13 earning" based on earnings as a percentage of investment:  
14 the "used and useful" investment we call the "rate base."

15 Q. How did you select the data for Table 1?

16 A. The data in Table 1 are the longest series of revenue and  
17 cost data for specific services, and it covers the early  
18 competitive period. Similar series after 1977 use a  
19 different methodology, which is not directly comparable to  
20 this series. Furthermore, after 1980 the number of  
21 "services" reported declines to four, and then to two.  
22 After 1983 the series applies to AT&T only. Regardless of  
23 ones views of the relevance of fully distributed costs for  
24 rate making, the relatively consistent methodology of this  
25 study, and the high percentage of costs that were directly

1 allocated (as much as eighty per cent of cost), suggest  
2 these data are indicative of the broad trends in cost-price  
3 relationships, whatever the methodology preferred. This  
4 was a period of substantial interstate rate stability--  
5 there were only two major rate cases--so most of the  
6 changes in the operating results are due to changes in  
7 traffic volume or in costs.

8 Q. Do you have any evidence about Mr. Lombardo's implication  
9 (p. 7, ll. 6-14) that Southern Bell's competitors have  
10 been growing faster than Southern Bell?

11 A. Mr. Lombardo's implied claim that Southern Bell's  
12 interexchange competitors have been growing much faster  
13 than Southern Bell is inaccurate. According to the Florida  
14 Public Service Commission, Biennium Report of the Status of  
15 Competition in the Telecommunications Industry, December,  
16 1991, the Local Exchange companies have precisely the same  
17 98.8 per cent of intrastate intra-LATA revenues in January-  
18 June, 1991 as they did in January-June, 1989. "Other"  
19 companies (primarily the interexchange carriers) still have  
20 the same 1.2 per cent of revenues. They have not gained in  
21 market share (p. 20).

22 Moreover, the interexchange companies' Florida revenues  
23 have been essentially flat, since the Flexibility plan took  
24 effect. From January-June, 1989, to January-June, 1991,  
25 their revenues rose from \$429 million to \$435 million (p.

1           23). This is an increase of 1.5 per cent in two years; the  
2           interexchange carriers grew less than one per cent per  
3           year!

4           Q. Please describe Tables 2, 3, 4 and 5 which are contained in  
5           Exhibits DC-3, DC-4, DC-5 and DC-6?

6           A. All these exhibits use the same basic spreadsheet. Tables  
7           2 and 3 use "total company" data, for Southern Bell's  
8           multistate operating region, as reported to the FCC. My  
9           source for these data was Statistics of Communications  
10          Common Carriers, an annual publication of the FCC based  
11          upon data submitted by the carriers. At one time the data  
12          came on Hollerith punch cards; now I believe they are  
13          submitted on diskette ("floppy disk").

14          The data were taken from the years 1988, 1989, 1990, and  
15          1991 on Table 2. These are the years the flexible rate  
16          plan was in effect in Florida, and I was able to calculate  
17          three-year rates of growth for the important measures of  
18          revenues of various services and of access lines and  
19          traffic on various services.

20          Page 2 of Table 2 contains the information on the number of  
21          telephone calls and some calculated data, such as the  
22          number of dollars in revenue per access line in each  
23          service. Thus, rather than calculate an overall figure of  
24          "dollars in total company revenue per access line", which  
25          is not a meaningful figure if one wants to know how the



1 company was affected by competition, I calculated:

- 2 1. Private Line and Special Access Revenue per
- 3 Special Access Line.
- 4 2. Local Revenue plus Customer Access Line Charge
- 5 Revenue per Switched Access Line (that is, per
- 6 residential plus business access line).
- 7 3. Toll plus Switched Access Revenue per Customer
- 8 Access Line (Residential plus Business plus Coin
- 9 Access Lines).
- 10 4. Coin Revenue per Coin Access line.

11 Table 3 contains the same information, but for the period

12 prior to the Flexibility order. I calculate rates of

13 growth from 1984 (the first year of the present industry

14 structure and access charge tariffs, although customer

15 access charges did not take effect until mid-year 1984,

16 which does affect some comparisons). I calculated these

17 rates of growth to 1987, which shows the competitive

18 situation the Commission was considering in 1988. I also

19 show growth through 1988, so you can compare the entire

20 pre-competitive period with the entire post-competitive

21 period. Tables 2 and 3 have a few blanks, which reflect

22 data which were not reported in certain years.

23 Table 4 and 5 substantially duplicate Tables 2 and 3,

24 except they use data for Southern Bell's Florida operations

25 as reported on surveillance reports which were included as

1 Exhibits in Company Witness Reid's testimony. Physical or  
2 traffic quantities, such as the number of access lines in  
3 each service, or the number of calls, are not reported on  
4 these reports, so some cells had to be left blank.  
5 The letters and numbers on the tables represent the column  
6 letters and row numbers of the Quattro Pro computer  
7 "spreadsheet" which I used to calculate and present these  
8 four tables.

9 Q. Returning to the question of the growth or rather, the lack  
10 thereof, of Southern Bell's intra-LATA toll competitors  
11 from 1989 through 1991, what growth has Southern Bell  
12 experienced in the same period.

13 A. Table 2 clearly shows that in the region as a whole, the  
14 decline in revenues is due to a decline in rates, rather  
15 than a decline in traffic.

16 If you look at the number of calls, revenues declined  
17 despite sharp increase in the number of intra-LATA and  
18 inter-LATA intrastate toll calls. State access revenues  
19 actually grew rapidly in 1989-90, but declined during 1988-  
20 1989 and 1990-1991. Long distance message revenues grew,  
21 though less rapidly than access charges in 1989-90, but  
22 declined in 1988-1989, 1990-91 and for the period as a  
23 whole. This corroborates my argument that the decline in  
24 Southern Bell revenues is due to rate declines.

25 Table 4 shows that contrary to Mr. Lombardo's allegations,

1 Southern Bell has had very substantial growth in Local  
2 private line revenues through the period. Moreover, its  
3 intra-territory access revenues declined over the period,  
4 showing an increase only in 1990. This shows more decline  
5 over the period than do intrastate switched access revenues  
6 as a whole, indicating that the competitors were making no  
7 inroads into Southern Bell's local toll service; indeed,  
8 Southern Bell was doing very well in this market.

9 Q. Please compare the experience under the flexibility order,  
10 that is, after 1988, with the period from 1984 through 1987  
11 or 1988.

12 A. I prepared tables, Tables 4 and 5, for the period since  
13 divestiture, using 1984, 1987, and 1991, giving two periods  
14 of approximately equal length (3 years and 4 years), the  
15 first of which precedes the flexibility order and the  
16 second of which follows it. I also provided data for 1988,  
17 and calculated growth rates for the four-year period, 1984  
18 through 1988. Combined with the growth rates for 1988-1991  
19 reported on Tables 2 and 3, I have presented figures for  
20 every period of interest.

21 Table 5 shows that the rate of revenue growth did decline  
22 after 1987, although this appears to be an artifact of the  
23 rate reductions. As I said, these Special Access and Local  
24 Private Lines are not necessarily less profitable to  
25 Southern Bell than the MTS and WATS traffic that might be

1 diverted upon them. Moreover, just looking at the number  
2 of Special Access Lines is not conclusive as to Service  
3 Bypass, since a lot of these lines serve new applications,  
4 such as point-of-sale terminals and automatic teller  
5 machines, and thereby reflect completely new traffic, not  
6 traffic diverted from another service.  
7 Accordingly, I conclude that the evidence Southern Bell has  
8 presented does not substantiate its claims that competition  
9 has caused it any financial damage or injury in the intra-  
10 LATA market, local and toll.

11 Q. Can you say anything about Mr. Lombardo's claim (p. 9) that  
12 Facilities Bypass has been a problem?

13 A. If it has been a problem, the evidence does not appear in  
14 the statistics. The number of special access lines grew  
15 much more rapidly than any other class of access lines, and  
16 this is the service most susceptible to Facilities Bypass,  
17 which means obtaining a connection to an interexchange  
18 carrier's location using telecommunications plant owned by  
19 the customer or by a carrier other than the Local Exchange  
20 Telephone Company (Southern Bell). Presumably, a direct  
21 connection to the local exchange carrier's central office  
22 using facilities owned by the customer or another carrier  
23 would also be Facilities Bypass. This arrangement must be  
24 very rare, if there are any at all. The number of business  
25 lines has been increasing, although there has been a net

1 change from single analog lines to multi-line digital  
2 service.

3 I am sure that Mr. Lombardo can cite a few examples of  
4 facilities bypass. He mentions 38 small aperture satellite  
5 locations in his testimony, but has presented no evidence  
6 that even for these customers Southern Bell had a net loss  
7 of access lines. These are the only specific examples of  
8 facilities bypass that he mentions.

9 Note, too, that the revenues from local private lines were  
10 the most rapidly growing segment of the business in 1990-  
11 1991, and the second most rapidly growing segment in 1989-  
12 1990 (second to Optional EAS which had a major expansion  
13 that year). Since these statistics also show rapid growth  
14 in revenues from special access and very rapid growth in  
15 the number of special access lines, particularly in 1990-  
16 91, we must conclude that Facilities Bypass is not a  
17 problem that Southern Bell has been unable to solve under  
18 the flexibility plan in effect since 1988.

19 Q. Why do you think special access lines and private lines are  
20 particularly important indicators of Facilities Bypass?

21 A. With a few exceptions, private line services do not require  
22 connection to a telephone company's switch. The private  
23 line is from one customer location to another. That's why  
24 they are called point-to-point private lines. Thus, if the  
25 customer can install a microwave, or a satellite link, or a

1 cable (or lease one of these from a supplier other than the  
2 local telephone company), it is a natural replacement for a  
3 private line.

4 Q. But isn't it possible to use a private line as a means of  
5 connecting with the network at another location?

6 A. You are referring to a few special situations.

7 PBX "tie lines" connect two customer PBXs, which may be in  
8 different cities. Traffic can originate on one PBX, and  
9 then "leak" out to the telephone network from the other.  
10 The telephone company sees this as a private line, and sees  
11 the traffic as originating in the second location. If  
12 there were already a tie line, the telephone company  
13 already had a private line or "special access" line (this  
14 is the local exchange company's segment of an inter-LATA  
15 private line), my comments on the ease of replacing a  
16 private line with a facilities bypass line apply. If the  
17 customer did not have a tie line previously, then the  
18 customer has to make some changes in the way the PBXs  
19 handle traffic to install a bypass line, which is at least  
20 as complex as installing a tie line.

21 The customer can also install special access facilities to  
22 the premises of a toll carrier to get the benefit of some  
23 bulk discounts, and to avoid switched access charges on the  
24 traffic. Such arrangements exist, and if the local  
25 telephone company supplies the special access facilities

1 (that is, the point-to-point private line from the customer  
2 to the toll carrier), it is an example of service bypass,  
3 not facilities bypass. The studies of this are a few years  
4 old, and some antedate some new bulk discounted or digital  
5 private line services which might have changed the customer  
6 perceptions, but the studies did not show this to be a  
7 serious problem. I think if it were a serious problem,  
8 Southern Bell would not have so much growth in its private  
9 line and special access lines and revenues, and Mr.  
10 Lombardo would have more specific examples in his  
11 testimony. We did ask about this, and if Southern Bell has  
12 additional information, I will discuss it in rebuttal  
13 testimony.

14 Q. What can you say about the provision of access lines to  
15 small customers? Does Southern Bell face a competitive  
16 threat in this service situation?

17 A. With respect to the provision of access lines to small,  
18 medium, and most large customers, there are no claims that  
19 Southern Bell faces any competition at all. Only in the  
20 provision of access lines to the very largest of customers,  
21 is there such a claim, and it is not quantified. Thus, we  
22 know that 38 of Southern Bell's customers are using small  
23 satellite dishes (VSATs) for some of their traffic, but we  
24 are not told how large a portion of the traffic of these  
25 customer has been moved to the VSATs, nor are we told what

1           proportion of the traffic of similar customers have been  
2           moved to VSATs. In other words, we do not know whether the  
3           VSATs are a common and important phenomenon, or an  
4           aberration.

5           Similarly, Southern Bell's witnesses tell us that even now,  
6           Southern Bell has the lowest basic rates for intra-LATA  
7           toll service. Given the mechanical difficulties most  
8           customers would experience if they tried to access an  
9           interexchange carrier (such as AT&T or MCI) for such  
10          traffic, it is surprising that Southern Bell does not  
11          choose to charge a premium for basic toll service. Large  
12          customers are served by PBXs that do permit complex  
13          routings to save money, as Mr. Lombardo says, p. 8. Such  
14          PBXs give the customers easy access to the toll offerings  
15          of the interexchange carriers. Accordingly, there would  
16          appear to be more competition for the intra-LATA toll  
17          traffic of the large customers with the sophisticated PBXs  
18          --customers with a lot of toll traffic, who benefit from  
19          savings in their toll expense. Since interexchange  
20          carriers seem to have very small shares of the intra-LATA  
21          toll traffic in other states (a recent estimate by AT&T in  
22          Maryland was in the range of 5 to 6 per cent), it appears  
23          that Southern Bell, by targeting small users of toll  
24          service (rather than by limiting its targeting to those who  
25          are eligible for deep discounts) is responding to an



1 exaggerated perception of the amount of competition it  
2 faces.

3 Q. What about potential private line competition? Doesn't the  
4 FCC's decision in its Expanded Interconnection for  
5 Interstate Special Access docket mean that there is or soon  
6 will be a lot of competition for intrastate private lines?

7 A. Because Mr. Lombardo cannot demonstrate any significant  
8 effect of present levels of competition, he spends a lot of  
9 his testimony trying to show that there will be competition  
10 in the future. We have had competition in the telephone  
11 industry at least since 1980, and significant amounts of  
12 competition since 1984. Southern Bell has grown and  
13 prospered. Since 1988, Southern Bell has maintained its  
14 rate of return even in a recession, which shows its  
15 strength as a competitor: A strong competitor does better  
16 than the economy, a weak competitor does worse.  
17 Competition is coming. Competition is here. There is no  
18 evidence that future competition will be any more effective  
19 than present competition.

20 Turning to the question of competition on intra-LATA and  
21 local private lines, perhaps eventually there will be such  
22 competition, but again, only for very large customers. The  
23 FCC decision permits interexchange carriers and other  
24 competitors of the local exchange carriers, and customers  
25 of the local exchange carriers, to terminate their own

1 access lines at the telephone company central offices.  
2 While this change will permit access companies to compete  
3 with telephone companies in providing access facilities, it  
4 will do so only for interstate traffic, which is only a  
5 part of the whole. The conditions that are propitious for  
6 such companies to develop exist primarily in large cities,  
7 or where there are extremely large customers. These are  
8 the same customers who might now be attracted to VSATs, or  
9 who might be using direct access methods to connect with  
10 their interexchange carriers. Interstate traffic is  
11 carried by interexchange carriers, such as AT&T, MCI or  
12 Sprint. These carriers can minimize their "transport  
13 costs" by locating their "points of presence" where there  
14 are concentrations of customers. Thus, if construction of  
15 access facilities is feasible, using cables, microwaves, or  
16 satellites, there is a good chance that such construction  
17 has already occurred.

18 Q. Have you viewed the statistics of Southern Bell? Do they  
19 tell you anything about the growth of private line  
20 competition?

21 A. I have looked at some statistics as reported by the FCC's  
22 Statistics of Communications Common Carriers. See Tables 2  
23 and 3. The Florida monitoring reports I looked at in  
24 Tables 4 and 5 had no information on quantities.  
25 It is difficult to compare operating results, because the

1 time periods are short, and 1991 was a recession year,  
2 which depressed growth rates for the recent period. Also,  
3 FCC data is for the company as a whole, while we are  
4 interested in data for Florida alone in this Docket.  
5 Moreover, the FCC drastically changed its reporting  
6 requirements and publication formats in 1989, when the new  
7 system of accounts came into effect. Thus, a lot of  
8 detailed information that is available for the later period  
9 does not appear in the earlier period.

10 To the extent possible, then, I compared 1987 and 1988 with  
11 1991 and with 1984, the first year for the new industry  
12 structure. Over a time period this long, some of the  
13 revenue increase is accounted for by rate changes, of  
14 course, and with service aggregations this broad, it is  
15 difficult to compensate for such rate changes unless one  
16 has access to a lot of information that is only available  
17 from the telephone company--if it exists at all--and which  
18 the telephone company considers very "proprietary"  
19 marketing data.

20 Still, some things do stand out. Southern Bell has  
21 experienced a remarkable growth in Special Access lines  
22 since 1984. However, after 1987, while the number of lines  
23 grew at an annual rate of 45 per cent (even faster than  
24 between 1984 and 1987), special access revenues declined at  
25 a rate of 11 per cent per year (they had risen at the rate

1 of 87 per cent per year between 1984 and 1987. Thus, we  
2 can say that the present rate flexibility plan has given  
3 Southern Bell a great deal of leeway to adjust its rates.  
4 We can say something about intra-LATA special access  
5 revenues in Florida: they declined since 1984, but since  
6 the Flexibility Plan went into effect in 1988, the rate of  
7 decline has been cut in half. Southern Bell has improved  
8 its standing in the private line market; it has cut the  
9 rate of revenue decline in half (despite rate cuts). In  
10 other words, there is no evidence that Facilities Bypass  
11 has been a problem.

12 Table 5 shows that Intrastate Special Access revenues  
13 declined between 1984 to 1988 (1987 was not reported).

14 Table 4 shows that they also declined 1988 to 1991.

15 Compare the rates of decline: between 1984 and 1988 access  
16 revenues declined at an average rate of 5.98 per cent per  
17 year; between 1988 and 1991, the average annual rate of  
18 revenue decline was only 3.10 per cent per year.

19 Q. Exhibit 1 of Company Witness Lombardo lists revenue losses  
20 due to competition of \$201 million. What probative value  
21 should we assign to this amount?

22 A. After a decade of competition, the claimed effect is \$201  
23 million on revenues (not profits). There is no support for  
24 this number so it is quite possible that Southern Bell is  
25 claiming as "losses" revenues or traffic which its

1 competitors "stimulated," and which Southern Bell never  
2 carried. It is also possible that some of the revenues or  
3 traffic were originally carried by AT&T or by one of the  
4 other Local Exchange Carriers in Florida. Furthermore,  
5 some of the revenues are footnoted by the Company Witness  
6 as being from a report to the FCC. Reports to the FCC are  
7 on a total company basis, so some of the claimed losses may  
8 refer to competition outside of Florida, in one of the  
9 other states served by Southern Bell.

10 This value, \$201 million, appears to be an overstatement of  
11 Southern Bell's revenue losses to competition.

12 Furthermore, revenue losses do not equate to profit losses.  
13 Gradual losses of revenues mean that the company can adjust  
14 its operations and realize a cost-saving. Thus, the lost  
15 traffic, whether \$201 million or some lesser amount,  
16 equates to much less of a loss of profits. And, since  
17 Southern Bell needs less plant if it handles less traffic,  
18 the effect may be that Southern Bell has had no reduction  
19 in its rate of return, which is, of course, the important  
20 statistic.

21 And I remind you that Southern Bell has maintained its  
22 profitability in terms of a relatively constant rate of  
23 return, even in a recessionary period.

24 Q. But isn't \$201 million a lot of revenue to lose? Will this  
25 not have a deleterious effect upon Southern Bell?

1       A. Southern Bell reported \$7,176,365,000 in company operating  
2       revenues to the FCC in 1991. The claimed loss is 2.9 per  
3       cent of operating revenues after a decade of competition.  
4       This is truly negligible.  
5       Even if we compare the claimed loss to the Florida  
6       operations only (despite having some reason to suspect that  
7       some of the "losses" may be from other companies or other  
8       states), Southern Bell had \$3,008,452,000 in Florida  
9       revenue in 1991. \$201 million is only 6.7 per cent of  
10      Florida revenues. (It would be illegitimate to compare the  
11      claimed loss to intrastate revenues, because some of the  
12      elements of the claimed loss are stated by the company to  
13      have interstate components.)  
14      Q. Why do you keep mentioning that the claimed losses have  
15      occurred after competition has been in effect for a decade?  
16      A. I have two reasons. The first is that the losses reflect  
17      the accumulated effect of a decade of competition, so new  
18      competition each year represents only a small increment to  
19      the loss. Indeed, the Florida Commission determined that  
20      in the past two years, the intra-LATA competitors gained  
21      essentially no market share. Thus, Southern Bell's losses  
22      primarily reflect past experience, rather than recent  
23      experience.  
24      The second reason is that the present level of competition  
25      reflects the growth of competitors over a decade. To have

1           gone from nearly zero to \$201 million in 10 years may be  
2           commendable, but it reflects growth of only about \$20  
3           million a year on average--and most of the growth actually  
4           seems to have occurred earlier in the period.

5           Q. Can you summarize your testimony with respect to the effect  
6           of toll competition?

7           A. Toll competition appears to be having a negligible effect  
8           on Southern Bell. Southern Bell's claims of losses, amount  
9           to a few per cent of its revenues, and even these may be  
10          exaggerated. Furthermore, the effect of competition upon  
11          Bell South's profits does not appear to be substantial,  
12          since the company has been able to maintain profits in a  
13          recession, and because there is no evidence that bulk-  
14          discounted services are necessarily less profitable than  
15          MTS and WATS.

16          Q. Let us turn to the question of potential competition. In  
17          1987, faced with evidence that Southern Bell was  
18          encountering significant amounts of competition in its  
19          markets for some services the Florida PSC held hearings.  
20          In 1988 it issued a decision. Has the Flexibility Plan  
21          introduced in October, 1988, been a failure? Is there any  
22          other reason to replace it?

23          A. There is no evidence that Southern Bell has been unable to  
24          compete in intra-LATA markets since 1988. Company Witness  
25          Lombardo states that the company has had a lot of rate

1 flexibility, and has been able to introduce a variety of  
2 discount plans and customized contracts (CSAs), p. 21.

3 Q. What, then, is the cause of the revenue erosion that the  
4 Company Witnesses complain of?

5 A. There are two issues here, slowing of the growth in gross  
6 revenues and loss of profitability. The company admits  
7 that by strenuous cost cutting it has generally kept up its  
8 profitability. (Company Witnesses Lacher, p. 12; Lombardo,  
9 p. 25.) I will not deal directly with the question of the  
10 appropriate rate of return in the present environment. I  
11 will deal with the company's efforts at cost-cutting,  
12 below.

13 The slowing of the growth in gross revenues, to the extent  
14 it has occurred, is largely because of reductions in the  
15 rate of growth of revenues from a variety of services.  
16 Statistically, these appear to be the toll services and  
17 special access (private lines other than local private  
18 lines). I showed in the previous section that most  
19 measures of traffic or lines have actually grown, so the  
20 problem is caused by the company's reducing rates in what  
21 appears to be an overreaction to anticipated competition.

22 Q. The company does say it is experiencing competitive  
23 pressures. Why do you say it is overreacting?

24 A. To a great extent the reduction in revenue growth in some  
25 services appears to be an overreaction to competition



1           because the company does not appear to be targeting the  
2           rate reductions to the largest customers, which are the  
3           ones for which there is the most competition.  
4           Company Witness Lombardo says, p. 8, "Typically, our  
5           largest business customers are targeted, particularly in  
6           the intra-LATA toll market."  
7           For example, Southern Bell has the cheapest intra-LATA toll  
8           rates, cheaper than any of its competitors, at all mileage  
9           bands (Lombardo, p. 21). But switched access charges are  
10          independent of mileage of the call. Therefore, Southern  
11          Bell might well find it more profitable to lose the very  
12          shortest intra-LATA mileage bands to its competitors, and  
13          collect originating and terminating access charges instead.  
14          Current rates for originating and terminating access total  
15          \$0.11640 per minute (Sims, Exhibit, Attachment 3, p. 1).  
16          For comparison, look at toll rates. In 1992, according to  
17          its Consultants Liaison Program binder (p. 19), MCI charged  
18          8.91 cents per minute (day rate, less evening and weekend)  
19          for a 0-10 mile intrastate call in Florida. It charged  
20          15.84 cents or less for an 11-22 mile call. Clearly,  
21          Southern Bell's competitors are unlikely to wish to engage  
22          it in a price war for services for which they have to pay  
23          Southern Bell so large a portion of their revenues. The  
24          better they would do in a price war, with resulting  
25          increase in market share, the greater the revenues to

1 Southern Bell. Paying a royalty to one's competitor is not  
2 the way to engage in rate competition.

3 Q. At what distance do Southern Bell's competitors start to  
4 make money, competing against the Southern Bell?

5 A. I don't know their costs, so I can't estimate the exact  
6 point of profitability. However, in the next mileage bands  
7 MCI charges as follows:

8	<u>Miles</u>	<u>Price</u>
9	23-55	\$0.2178
10	56-124	\$0.2203
11	125-292	\$0.2322
12	293-430	\$0.2357
13	431 +	\$0.2442

14 I don't know why rates rise so steeply at the shortest  
15 distance (\$0.0891 and \$0.1584), and then are so flat.  
16 Competition has a lot to do with it, of course. However,  
17 with access charges at 11.648 cents a minute, it is clear  
18 that the competitors are losing money on calls under 10  
19 miles, and are making little or no money on calls of 11 to  
20 22 miles.

21 Q. Company Witness Lombardo says, at pp. 7-8:

22 Southern Bell must impute in its intraLATA toll  
23 rates intrastate access charges, which are  
24 substantially higher than interstate access  
25 charges. Competitors, on the other hand, are

1           able to price their services using a meld of  
2           intrastate and interstate access charges.  
3           Depending on a specific customer's mix of  
4           services, interstate margins could permit lower  
5           intrastate (including intraLATA) prices.

6           Is this an accurate statement of the pricing strategies of  
7           Southern Bell and its competitors?

8           A. By no means. If a competitor wins some intra-LATA traffic  
9           from Southern Bell by charging 9 cents a minute, for  
10          example, that competitor loses 2 cents a minute on the  
11          traffic. That is a loss by any measure. Revenue is below  
12          short run marginal cost, and certainly below long run  
13          marginal cost, direct cost, or full cost. That the  
14          competitor may be paying somewhat less than 11 cents a  
15          minute for interstate access charges has no bearing on the  
16          problem.

17          Southern Bell could reduce its intrastate access charges,  
18          and the only effect would be to make it more profitable for  
19          the competitor carrying the traffic, and less profitable  
20          for Southern Bell.

21          Q. Do you mean, then, that a competitor will not charge toll  
22          rates that are less than access charges?

23          A. An unregulated competitor will charge whatever it wishes,  
24          regardless of costs. If, however, it charges less than its  
25          costs it will be unprofitable, and may eventually have to

1 go out of business.

2 Q. Do you agree that Southern Bell is constrained in its  
3 ability to compete by having to impute to itself high  
4 intrastate access charges?

5 A. Company Witness Lombardo says Southern Bell has the lowest  
6 intra-LATA toll rates, lower than any major competitor.  
7 And Southern Bell can compete for the high-volume users,  
8 regardless of the access charges it imputes to itself,  
9 since the Florida PSC merely requires Southern Bell to show  
10 toll rates as a whole are profitable (including access  
11 charges as a cost); the Florida PSC does not require  
12 Southern Bell to show that every rate element and  
13 promotional discount in the tariff is profitable.

14 Q. Are there any other business reasons for Southern Bell not  
15 to want to be the low cost toll carrier?

16 A. Yes. With small and medium toll customers, there is still  
17 a certain inconvenience in dialing an interexchange  
18 carrier, so Southern Bell can maintain a small premium on  
19 convenience grounds.

20 There is no reason to offer a discount to those customers  
21 who do not qualify for discount plans from the major  
22 competitors. If the major competitors do not feel the need  
23 to compete for these customers, why should Southern Bell,  
24 which will certainly retain them.

25 Q. What reasons might induce Southern Bell to reduce rates to

1 small customers for whom it does not have significant  
2 competition?

3 A. I could speculate on advantages stemming from the prestige  
4 of having a large market share. There may be reasons for  
5 seeking to minimize the steepness of the discount schedule,  
6 although that is generally accomplished by defining the  
7 heavily discounted rates as a different "service."

8 Q. Can you summarize your views on the ability of other  
9 companies to compete with Southern Bell in the future?

10 A. Southern Bell claims to have been very effective at using  
11 the flexibility granted to it by the 1988 decision to  
12 devise services, tariffs and special contract to retain  
13 customers and traffic. The statistics support these  
14 statements.

15 With respect to the ability of competitors to provide  
16 increased competition for intra-LATA message toll, with  
17 access charges at present levels, it is unprofitable for  
18 competitors to compete with Southern Bell for most of the  
19 traffic volume in the Intra-LATA Toll Market. Accordingly,  
20 I do not expect them to stress competition in these  
21 markets.

22 Q. Southern Bell states it is facing competition for coin  
23 telephones (Lombardo, pp. 10-11). How significant is this  
24 competition?

25 A. For some years now all telephone companies have faced

1 competition from other suppliers for the provision of coin  
2 telephone sets. Customers are allowed to own their own  
3 telephones, and that includes coin telephones. The  
4 competition can be significant. Customers who own their  
5 own coin telephones merely rent an access line from the  
6 telephone company, which may lose the local usage charges  
7 on the phone.

8 Still, when the local exchange telephone company does not  
9 have to handle the coins from a telephone, it saves a lot  
10 of costs: the costs of collecting the coins and handling  
11 them; the costs of maintaining the telephone equipment that  
12 is probably subject to the most physical abuse. And most  
13 studies show the marginal cost of a local (non-coin)  
14 telephone call to be negligible--hundredths of a cent--  
15 while the revenue for a local call is several cents (12  
16 cents a call; or 2 cents per minute for band A; 8 cents for  
17 band B. (Tariff A3; Sims Exhibit, Attachment 1; pp. 9-11,  
18 89-91). The ratio of revenues to costs approaches 1000 to  
19 1. On the other hand, for years most telephone companies  
20 have presented evidence suggesting the cost of handling a  
21 local coin call is over 20 cents. It may be more  
22 profitable to collect the coins, although it is certainly  
23 not obvious from the cost studies. Since I have not  
24 reviewed a recent Southern Bell cost study for coin  
25 telephone service, I cannot be certain where the advantage

1 lies, and it may be nearly a "wash," although it certainly  
2 appears as if the advantage lies with letting the customers  
3 own and maintain the instruments. (There are important  
4 social reasons for insisting that local telephone  
5 companies, including Southern Bell, continue to provide  
6 public coin service; I am dealing here with the financial  
7 effect upon the company of competition in the provision of  
8 coin telephone instruments. Furthermore, there are high-  
9 profit locations, such as airports and bus terminals. To  
10 the extent that Southern Bell retains any such locations,  
11 it has done so in the face of strong competition. To know  
12 whether there is net benefit to the company for having  
13 retained such locations, presumably by paying very high  
14 royalties, would require more evidence than has been  
15 provided.)

16 On toll calls, Southern Bell retains access charge revenue,  
17 of course. On Intra-LATA toll traffic, it is possible that  
18 the owner of the telephone might negotiate a deal with an  
19 interexchange carrier, paying less for handling the call.  
20 However, as I have already discussed, switched access  
21 charges are so large in relation to short distance toll  
22 charges, that the interexchange carriers are unlikely to  
23 chase the revenues, nor is Southern Bell going to lose much  
24 if it does lose the traffic. Indeed, it appears that  
25 Southern Bell will benefit financially from any intra-LATA

1 toll traffic it loses to its interexchange competitors.

2 Q. Have you looked at Southern Bell's actual recent experience  
3 with coin service?

4 A. Yes. On Tables 2 and 3, public telephone revenues are  
5 shown rising over the period 1988-1991, and rising more  
6 strongly in 1990-91 than in the earlier year. Public  
7 telephone revenues did grow more strongly in the period  
8 1984-1987, but there was a great deal of competition in  
9 that period--as much as after 1988. Moreover the slowing  
10 of the rate of increase in revenue growth compared with the  
11 earlier period (1984-1987), but that is partly an effect of  
12 a loss in the number of access lines. Coin revenue per  
13 coin access line has been increasing as strongly as any  
14 other access service, and more strongly than any other  
15 local service except private line or optional EAS for the  
16 period 1989-1991, or for 1990-1991.

17 It would appear that Southern Bell has done better with  
18 coin service than with most other services, and the data do  
19 not support any claim that Southern Bell has been injured  
20 with respect to coin service.

21 Q. Does the testimony of Company Witness Lombardo (p. 11, 11.  
22 1-5) contradict this evidence?

23 A. No. He states that the company has lost 27 per cent of  
24 coin locations and "approximately one-third" of the  
25 revenues. Thus, the locations Southern Bell has lost do



1 not appear to have been only the very high traffic, "busy"  
2 locations, although they may be a bit busier than average.  
3 (pp. 10, 11). Since the loss of coin telephone locations  
4 also involves the reduction of cost, too, and since toll  
5 and access revenues at public telephone locations are  
6 largely retained even when the location is "lost," it does  
7 not appear that the company has been injured. The fact  
8 that coin telephone revenues are rising more rapidly than  
9 most other local revenues--or almost any other service--  
10 suggests that Mr. Lombardo is speaking of a particular  
11 situation that appears to have occurred in 1990, and which  
12 Southern Bell has since remedied.

13 Q. Does Southern Bell need additional flexibility with respect  
14 to Coin Service rates?

15 A. It is obvious that Southern Bell is preserving and  
16 enhancing its position in the coin telephone market by  
17 using its present degree of flexibility. It is further  
18 obvious that existing tariff arrangements protect Southern  
19 Bell from serious revenue erosion, even if it were to lose  
20 further coin locations. Many of the high-profit locations,  
21 such as airports and bus terminals, have long since been  
22 lost to competitors; to the extent that Southern Bell  
23 retains any, it has done so in the face of strong  
24 competition for many years, and there is no evidence that  
25 such competition is getting any stronger.

1 Q. What can you say about the cost savings and productivity  
2 gains that Southern Bell has experienced under the  
3 Incentive Regulation plan the commission adopted in 1988?  
4 A. About the time competition began in the late 1970's, with  
5 the FCC's rulings on terminal equipment, and the  
6 interconnection of "specialized" telecommunications common  
7 carriers to the telephone network, productivity began to  
8 drop in the telephone industry. Productivity fell well  
9 below long term trends. In addition, starting in 1980,  
10 with the FCC's revision of depreciation rates, the industry  
11 began to experience substantial cost increases.  
12 After about 1986, this trend was reversed. Tax changes  
13 began to lower the revenue requirement. The rate of  
14 inflation in the economy slacked off. The high costs of  
15 rapid modernization to permit "equal access" and network  
16 reconfiguration and to prepare for competition diminished.  
17 And productivity began to increase again. After about 1987  
18 or 1988 it appears that the rate of productivity gain may  
19 have again reached its long-term level.  
20 Southern Bell's witnesses Lacher and Lombardo state, as  
21 already noted, that the company has preserved its rate of  
22 return in a very harsh economic environment in Florida.  
23 Despite a recession, the Company preserved a high rate of  
24 return, and, according to company witnesses, returned  
25 substantial amounts to customers in rate reductions.

- 1 Q. What is the historic experience of the telephone industry  
2 with respect to the rate of productivity increase each  
3 year?
- 4 A. Historically, the telephone industry had a much larger rate  
5 of increase in labor productivity than the rest of the  
6 economy. Much of the productivity increase came from the  
7 conversion to "self-service," with direct dialing: the  
8 customer's labor is not measured. From 1960 to 1977, the  
9 average rate of increase in labor productivity was 5.5 per  
10 cent annually, and was about the same from 1960 to 1967 and  
11 1967 to 1977. This was higher than in most other  
12 industries and "well above the average for the total  
13 private economy." The Bureau of Labor Statistics reported  
14 "[c]urrent growth trends of output and employee hours  
15 indicate continued high productivity in coming years,  
16 associated with expanding use of the newest technological  
17 developments." (U.S. Department of Labor, Bureau of Labor  
18 Statistics (BLS), Technology and Labor in Five Industries,  
19 Bulletin 2033, September, 1979, page 28.)
- 20 Q. What about the decline in employment in the telephone  
21 companies in the 1980's? Didn't this raise labor  
22 productivity?
- 23 A. One would think so. However, the statistics do not show  
24 this for the early part of the period. Still, the U.S.  
25 Bureau of Labor Statistics does show labor productivity

1 increasing at an average annual rate of 5.58 per cent from  
2 1975 to 1988, Robert W. Crandall, After the Breakup: U.S.  
3 Telecommunications in a More Competitive Era, 1991, page  
4 67. This is in line with the historical trend. Robert  
5 Crandall thinks productivity growth was actually better,  
6 since he thinks the Bureau of Labor Statistics may be  
7 including employees of non-telephone subsidiaries of the  
8 common carriers, thereby overstating employment and  
9 understating output.

10 In any event, it does appear that low productivity in the  
11 early 1980's, and the telephone companies have now resumed  
12 their historic trend.

13 Q. Why do you look at industry productivity? In other aspects  
14 of regulation we regulate the individual company, rather  
15 than the industry average, do we not?

16 A. In rate cap plans, the productivity offset is a goal. It  
17 should be set high enough to force the company to be at  
18 least as good as the industry average, or be penalized in  
19 some way. Thus, the appropriate offset is the industry  
20 average gain over a substantial period of time, and  
21 omitting periods of turmoil (such as 1980-1985), just as we  
22 omit catastrophic events from the test year.

23 Q. Can you compare this with Company Witness Reid's testimony  
24 that 4 per cent is an appropriate rate of productivity  
25 increase to impute during the period this rate cap plan is

1 in effect?

2 A. The appropriate productivity offset is much higher. I will  
3 discuss some of the reasons that the industry's rate of  
4 productivity increase was depressed in the first years of  
5 this decade, and the estimates of some analysts that  
6 productivity growth is returning to former levels. A rate  
7 of productivity increase that the industry sustained for 17  
8 years, from 1960 to 1977, without any special incentive  
9 plans (and, indeed, with the disincentives inherent in  
10 rate-base-rate-of-return regulation) is reasonable to  
11 impute in the future.

12 Q. What is the significance of the company's success with cost  
13 cutting and productivity?

14 A. The Incentive plan adopted in 1988 gave the company a great  
15 deal of flexibility. Furthermore, it gave the company  
16 specific financial incentives to cut costs and improve  
17 productivity. It was a success, in that respect. As shown  
18 above, the company has been competing very effectively, and  
19 appears to have been maintaining its market share in all  
20 significant markets. (When the company responds to our  
21 information request for specific information on various  
22 markets, I will analyze it in rebuttal testimony.)  
23 The company's cost cutting has been so successful that each  
24 manager is now supervising 1.2 more workers, on average.  
25 (Lombardo, p. 20). Since the Bell companies had been

1           reducing management previously, effectively combining the  
2           third and fourth levels of management after 1983, this is  
3           excellent performance.  Indeed, it is, in percentage terms,  
4           9 times as good an increase as the company achieved between  
5           1985 and 1988.)  Since the company has achieved its recent  
6           managerial reductions with early retirements in 1990 and  
7           1991, we can expect even greater cost savings in the  
8           future, since the costs of an early retirement are high in  
9           the first year that the employee retires.

10          The company has also reduced the number of employees per  
11          10,000 access lines from 48 in 1988 to 36.1 in 1991.  This  
12          is excellent performance, suggesting a reduction of nearly  
13          1/4 of the work force (the number of access lines did  
14          increase a bit over that period) and it makes even more  
15          striking the more than proportional reduction in the number  
16          of managers.

17          The productivity gains from this kind of improvement are  
18          really striking.  The number of employees for any unit of  
19          real output must have improved (that is, been reduced) in  
20          approximately the same proportion.  And Southern Bell  
21          achieved this productivity while competing effectively.

22          Q.  Who benefitted from the productivity gains the company  
23          achieved?

24          A.  Everyone.  The shareholders clearly benefitted from the  
25          cost savings that permitted the company to maintain its

1 rate of return during a recessionary period. And the  
2 ratepayers benefitted from the rate reductions they  
3 experienced as a result of the plan. The company estimates  
4 these rebates and reductions as \$1.18 billion, through  
5 1992. (Lombardo, p. 24)

6 Q. The company has proposed a new plan. What do you see as  
7 the most important differences from the old plan?

8 A. The new plan appears to be a rate cap plan, rather than an  
9 incentive plan. Some rates, for what are claimed to be  
10 basic services, are said to be capped, although substantial  
11 rate increases are possible. The rates for "Basic"  
12 services can rise as much as 5 per cent per year, for each  
13 service. (Lombardo, p. 37) (The example is of "business  
14 monthly service"; it is not clear whether this 5 per cent  
15 limit is for each rate element or for an "index" of the  
16 "service.") Only "lifeline" and "link up" rates are  
17 actually frozen.

18 Rates for other regulated services can increase as much as  
19 20 per cent annually. These include some apparent near  
20 monopoly services, such as "special access." (p. 38) Two  
21 services which now have "banded rates" retain the present  
22 bands.

23 There does not appear to be any limit on the company's  
24 liberty to reduce rates, whether or not they are for  
25 competitive services.

1 Q. What then prevents the company from just raising rates as  
2 much as it likes?

3 A. Not much. For the company as a whole, rates are subject to  
4 a price index, so a rate increase in one service must be  
5 compensated for by a rate decrease in other services. (p.  
6 31)

7 Overall, the index of regulated rates can be raised if the  
8 rate of inflation exceeds a productivity "guarantee" of 4  
9 per cent (historically, the rate of productivity increase  
10 in this industry has been 5.5 per cent). If the rate of  
11 inflation is less than 4 per cent, rates will be reduced.  
12 This is modified by certain "exogenous" changes, which are  
13 those brought about by regulatory or governmental action.

14 Q. Does this mean that the company can raise rates for basic  
15 services by the full 5 per cent, even if there is little  
16 inflation, so that it must reduce rates elsewhere, to keep  
17 the index from rising?

18 A. Yes. There is no protection for basic services under this  
19 plan, beyond the guarantee that the rates won't increase  
20 more than 5 per cent per year. The company can decide  
21 which rates to reduce, and by how much.

22 Q. It is possible that inflation in 1993 will be two per cent.  
23 Inflation in 1992 may be about two per cent, and two per  
24 cent inflation was achieved for some years in the late  
25 1950's and early 1960's. What will happen to rates in



1 1994, when Southern Bell comes in for an increase?

2 A. We don't know what will happen, because Southern Bell can  
3 change any rates it wants. The only thing that must happen  
4 is that the overall index be reduced two per cent.

5 Q. So does this mean that Basic rates will go down two per  
6 cent?

7 A. Absolutely not. Southern Bell can raise and lower any  
8 rates, so long as the index changes by the appropriate  
9 amount.

10 What can happen is that basic service rates rise by 5 per  
11 cent, and the company reduces some "competitive" rate by an  
12 even greater percentage to reduce the index by 2 per cent.

13 Q. What do you mean, "an even greater percentage"?

14 A. Consider this example. In 1991, Basic Area Revenues plus  
15 optional EAS revenues, plus state access revenues were:

16	Basic area Revenues	\$2,083,937,000
17	Optional Extended Area Revenues	\$ 20,956,000
18	State Access Revenues	<u>\$ 556,530,000</u>
19	Approximate Total "Basic" Revenues	\$2,661,423,000

20 This is from the 1991 Statistics of common carriers, so  
21 it's for Bell South as a whole. It's only "approximate"  
22 basic revenues, because state special access is not "basic"  
23 under the company's plans, but is lumped in with state  
24 switched access and state customer access in the FCC's  
25 publication.

1 Total company operating revenues were \$7,176,385,000. Of  
2 these, \$916,438,000 in Miscellaneous Revenues are not  
3 regulated or not covered by the plan, leaving  
4 \$6,259,947,000 in company revenues.

5 Thus, increasing basic revenues by 5 per cent would raise  
6 the revenues to \$2,821,108,380, an increase of  
7 \$159,685,300. But company revenues, now \$6,259,947,000,  
8 have to be reduced by 2 per cent, or \$125,198,940.

9 Southern Bell can chose which rates to reduce. Any rates  
10 it wants to. Let us assume that it wants to reduce "Total  
11 Long Distance Network Service Revenues," which are  
12 \$789,146,000. It can reduce them by the \$125 million it  
13 has to reduce overall revenues, and it also can reduce them  
14 by the \$160 million it is raising basic local services.  
15 This is a reduction of \$284,884,240, which is a 36.1 per  
16 cent reduction in Total Long Distance Network Service  
17 Revenues.

18 Q. These are revenues. The plan refers to prices. Please  
19 explain why you are varying revenues in your calculations.

20 A. Revenues are prices times quantities. If the quantities  
21 are held constant, as when you are repricing a service or  
22 calculating a price index, then price times quantity will  
23 vary by the same percentage as price is varying. Thus a  
24 two per cent increase in prices with quantities constant is  
25 equivalent to a two per cent increase in revenues.

- 1 Q. In your example, above, what if there is 6 per cent  
2 inflation? Can the company still reduce toll revenues by  
3 such an amount?
- 4 A. With 6 per cent inflation, and a 4 per cent offset, company  
5 revenues could be raised by 2 per cent, or \$125 million.  
6 The company gets \$160 million from raising basic services  
7 by 5 per cent. Thus, the increase in revenues is  
8 \$34,486,360 more than allowed. So the company can lower  
9 Toll rates by \$34 million, or 4.4 per cent.
- 10 Q. Does the company have to take the full 2 per cent rate  
11 increase it is entitled to in this scenario?
- 12 A. No. And, of course, if the company chooses to forego some  
13 of the 2 per cent overall increase in rates it can lower  
14 Toll rates by more than 4.4 per cent. Or if its own costs  
15 do not increase as fast as inflation, less the offset it  
16 can lower Toll rates more than 4.4 per cent.
- 17 Q. What effect would a 36 per cent rate decrease have upon  
18 competition?
- 19 A. There would be a devastating effect. I doubt whether  
20 intra-LATA toll competition, or any of the forms of bypass  
21 (which is also just competition) would remain in Florida.  
22 And such a scenario is conceivable in 1994. Certainly, the  
23 possible reduction in toll rates could be between 4.4 and  
24 36 per cent.
- 25 Q. Would all Toll rates go down by the same percentage?

1       A. That is up to the company. It controls the index. Each  
2       item in the index is a rate element. It could reduce only  
3       those rate elements that it thinks are subject to serious  
4       competition. Naturally, the fewer rate elements it  
5       reduces, the greater the reduction that is possible for  
6       those elements that are reduced. For example, if the  
7       company applied the entire \$234 million rate reduction to  
8       long distance message revenues (\$622,134,000) it would  
9       effectively cut them about in half. Applied to local  
10      private line revenues of \$92,953,000, the company could  
11      give the lines away--indeed, it could pay customers to take  
12      private lines. Applied to the 124,103 Public Access lines,  
13      the company could pay each customer almost \$2,000 per year  
14      in royalties to accept one of Southern Bell's coin phones,  
15      rather than a competitor's.

16     Q. What would be the cost support for the rate reductions?

17     A. Under the plan, no cost support is required for rate  
18      reductions or for rate increases. Lombardo, p. 28.

19     Q. But does not Mr. Lombardo state that the company does not  
20      price services below Long Run Incremental Cost?

21     A. Since no cost support is required to be filed, Mr.  
22      Lombardo's statement has no operational effect.

23     Q. What other strategies can the company follow which would be  
24      anticompetitive in your view?

25     A. The company can lower rates for only the competitive parts

1 of the service, and raise rates for parts of the service  
2 where it faces no competition.

3 Q. What about the Commission's review? Won't that prevent  
4 such abuses?

5 A. The rates go into effect on short notice, generally 30 to  
6 60 days. There is no requirement for the filing of cost  
7 support or other support. The Commission will have no  
8 information on which to act, and it is not clear from the  
9 proposal how the Commission could act to suspend the  
10 tariffs for hearing, since they would be presumptively  
11 lawful, or at least presumptively not unlawful.

12 Before agreeing to any such extreme flexibility plan, the  
13 Commission should require that rate filings, even for  
14 competitive services provide cost support and market  
15 studies, allow enough time for staff review, provide for  
16 suspension, and provide for expedited discovery and  
17 hearings if need be. (Clearly the Staff cannot act in 30  
18 to 60 days, when discovery is on a 30-day cycle.)

19 Q. What happens if interest rates change, and the cost of  
20 capital changes?

21 A. If the cost of capital rises, Southern Bell can file for a  
22 rate increase. If the cost of capital falls, presumably  
23 the commission can file a rate case.

24 Q. What happens if the company's costs don't rise as fast as  
25 inflation for reasons other than productivity?

1       A. Since major inputs to the company are electronic components  
2       which rise in price less rapidly than the overall rate of  
3       inflation, this is a likely event. Moreover, it can happen  
4       for other reasons, which I discuss below.  
5       If the company's costs do not rise as fast as inflation for  
6       reasons other than productivity (as productivity is  
7       measured in the plan), then the company will earn a rate of  
8       return greater than the allowed cost of capital.  
9       Presumably, the company could use this to make further  
10      reductions in competitive rates, but the company could  
11      simply retain it for its shareholders.

12     Q. The company says there are protections for basic service  
13      customers in the plan, because the rates, overall, can't  
14      increase faster than inflation, less the productivity  
15      offset.

16     A. Basic customers have no such protection. Their rates can  
17      go up as much as 5 per cent per year, whether inflation is  
18      rapid or slow. The plan provides some protection for basic  
19      customers if the rate of inflation rises above 9 per cent  
20      per year, but this is an unlikely scenario, and the company  
21      is then free to come to the commission for a modification  
22      of the plan. And the commission, since it cannot  
23      "confiscate" the company's assets, would have to give due  
24      consideration to the demands for a rate increase, and grant  
25      it, if the company's revenues will have fallen below the

1 cost of capital.

2 Specifically, the company does not offer to increase basic

3 rates by no more than the increase in the price index less

4 a productivity offset; to make such an offer would

5 eliminate much of the company's flexibility for targeted

6 price increases and decreases discussed above.

7 Q. Does the revised plan provide the same incentives for

8 productivity as the present plan?

9 A. No. Since the company can raise rates if inflation exceeds

10 its productivity gains, it does not have to concern itself

11 with cost savings that are not reflected in productivity

12 gains. It no longer has an incentive to seek out such cost

13 savings.

14 Q. What would be an example of cost savings that are not due

15 to gains in productivity, or to the "exogenous" government

16 actions that are not included in the plan?

17 A. The productivity gains mentioned in the plan are gains in

18 labor productivity, it appears, rather than total factor

19 productivity, which includes improvements in the way the

20 company uses its other inputs, such as capital and

21 materials.

22 If the company renegotiates its leases to save money, this

23 is not a productivity gain as measured.

24 If the company achieves savings in investment from ISDN or

25 some other technology reducing its need for local loops,

1 (that is, by substituting subscriber carrier for local  
2 loops), this is a gain in capital productivity or total  
3 factor productivity, but not in labor productivity.

4 Q. Assuming the company achieves productivity gains. Do basic  
5 service customers benefit from them?

6 A. No. There is no longer any sharing of productivity gains.  
7 The company is permitted to raise the rates for the "basic"  
8 services within the 5 per cent limits, regardless of  
9 whether it has had productivity gains. As in the example  
10 above, other, non-basic, services can get all the benefits.

11 Q. Can you summarize your views with respect to the rate plan?

12 A. The rate plan is badly flawed. It is anticompetitive,  
13 because it permits the company too much flexibility for  
14 targeted rate decreases. It provides customers for the  
15 basic services with little protection from targeted rate  
16 increases, even if rates are falling, overall.

17 Because of the lack of filing requirements, such as cost  
18 support, the Commission will be unable to review the  
19 company's rate filings, particularly in the unreasonably  
20 short review periods.

21 The productivity offset is much too low. It should be  
22 based upon realized industry experience, other than in  
23 times of major re-organization (such as World War II, or  
24 the breakup of the Bell System, 1980-1985). The  
25 historically justified level for the offset is 5.5 per cent



1 or even a bit higher.

2 Q. Let us turn to extended local service areas. Can you  
3 describe the company's proposal?

4 A. The company proposes to abolish present flat rate extended  
5 local service areas, although existing customers will be  
6 allowed to retain this service. Instead, new customers  
7 will be offered larger local service areas with measured  
8 rates instead of flat rates. Sims, p. 4.

9 Q. Is there any consumer demand for enlarging local service  
10 areas?

11 A. The company has not mentioned or presented evidence of a  
12 large number of complaints that local calling areas are too  
13 small, and customer requests are not mentioned in the  
14 company testimony. Unless the company presents evidence of  
15 a large number of such complaints, the Commission must  
16 assume there are none.

17 Q. Has the company presented any studies showing market demand  
18 for extended local calling areas?

19 A. No. Tables 2 does show that extended local calling areas  
20 were the by far most rapidly growing form of service for  
21 Southern Bell between 1988 and 1991, and for two of the  
22 three sub-periods (they were second to local private line  
23 in 1991). Thus, there may be some demand for the service.  
24 (It is possible, of course, that some of this increase in  
25 revenue reflects events outside Florida.)

1 Q. Taken in conjunction with the rate cap plan, what will be  
2 the effect of the extended service area?

3 A. The rate cap plan will base its index on 1992 rates and  
4 quantities. The extended area service will not be  
5 reflected in 1992 rates, of course. Thus, it would appear  
6 as a rate increase or reduction in 1993, whenever the  
7 changes went into effect.

8 It appears that this will be considered a basic service.  
9 The rate elements for measured lines, unmeasured lines, and  
10 message units will all remain, even though the measured  
11 lines will be "grandfathered." Except to the extent that  
12 rate elements have different prices from the present rate  
13 elements, this will not appear as a rate change.

14 Q. What will be the effect upon toll competition?

15 A. Since measured rates are generally lower than short-  
16 distance toll rates, we can expect that intra-LATA toll  
17 competition, particularly at the shorter distances, will be  
18 effectively eliminated.

19 Because access charges are so large, relative to the rates  
20 for these short-distance toll calls (switched access  
21 charges are over 11 cents per minute as explained above),  
22 it is not certain that the interexchange carriers will be  
23 greatly upset by this. Southern Bell, however, does claim  
24 that intra-LATA toll is a competitive service.

25 Q. If extended local service rates are lower than toll rates,

1 will not Southern Bell experience a reduction in revenues?  
2 A. Possibly. Even though it appears that a peculiarity in the  
3 way Southern Bell calculates its index will not show this  
4 as a rate reduction, Southern Bell will probably experience  
5 a decrease in revenues.

6 There are some offsets, however. Because flat rate service  
7 is eliminated for new customers, those customers will pay  
8 measured rates. Presumably, this will be an effective rate  
9 increase (which will not appear in Southern Bell's Index),  
10 and will offset some of the revenue loss from toll revenue.  
11 Company Witness Sims does not explain how Southern Bell  
12 will make up the loss of revenues. Presumably it is  
13 reflected in the overall rate adjustments in the tariff  
14 filing.

15 Some of the revenue will be made up by reclassification of  
16 exchanges to higher rate groups. Rate groups are generally  
17 determined by the number of customers in exchanges that a  
18 customer can reach with a local call (rather than a toll  
19 call). The more customers, the higher the rate group, and,  
20 the greater the alleged "value of service," so the higher  
21 the basic service rate. This rate increase would occur  
22 even if no customers in the exchanges given extended local  
23 calling in its proposal called each other (I will explain  
24 this more fully below).

25 Moreover, the fact that the present rate plan permits flat

1 rate EAS, and the new plan is measured rate only will cause  
2 the forced migration of some customers to measured rates  
3 for all their lines. This will raise their expenditures  
4 and Southern Bell's revenues, but will not appear as an  
5 increase in the price levels in the index. (I discuss the  
6 tariff provisions that cause this migration below.)

7 Q. What is the company's estimate of the loss in revenues from  
8 this plan?

9 A. According to Company Witness Sims (p. 8), the revenue loss  
10 will be \$7.7 million in 1993 (assuming the rates will be in  
11 effect for six months), and \$23.9 million in 1994.  
12 For 1995, Ms Sims says the revenue loss will be \$22 million  
13 "additional" because of service enhancements. Presumably,  
14 this means that revenue losses will total \$45.9 million in  
15 1995.

16 Q. What "improvement" to the plan could possibly cost an  
17 additional \$22 million in 1995?

18 A. This is not stated in Sims' testimony. One possibility is  
19 LATA-wide local calling. By eliminating toll rates  
20 entirely, except for low-volume customers, Southern Bell  
21 would effectively eliminate toll competition. Revenue  
22 losses would be substantial, of course, since toll revenues  
23 and intra-LATA access charges would be lost.

24 Q. How will the company recover these revenues that it says it  
25 will lose in 1993, 1994 and 1995?

1       A. As I noted in response to another question, Sims does not  
2       state that some rates are being raised to offset this  
3       revenue loss. Still, it is inevitable that some rates are  
4       being raised, or that some rate reductions could be even  
5       greater, were these revenue losses not being incurred.

6       Q. Can you explain further?

7       A. Southern Bell has a revenue requirement. It sets rates to  
8       recover that revenue requirement. If some rates are lower,  
9       others, pari passu, must be higher to reach the required  
10      total. The more some rates are lowered, the more some  
11      other rates must be raised.

12     Q. Perhaps it would help if you provided an example.

13     A. Company Witness Sims Exhibit, Attachment No. 8, p. 35 of  
14      38, states that it has 3,245,374 Basic Residence Flat 1  
15      party customers. The stated revenue loss in 1993 is \$7.7  
16      million. Without this revenue loss, which is \$2.40 per  
17      residential customer, their rates could be reduced \$2.40  
18      per year in 1993 or 50 cents per month.

19      In 1994, the stated revenue loss is \$23.9 million, or \$7.47  
20      for each residential customer. Thus, if this loss were not  
21      incurred, their rates could be that much lower each year,  
22      or 62 cents per month.

23      In 1995, revenue losses of \$45.9 million mean flat rate  
24      residential service could be about \$14.34 per year cheaper  
25      (\$1.20 a month) cheaper, if this plan were not being

1           introduced.

2           Q. Can you compare this to the lifeline proposal?

3           A. According to Sims Exhibit, Attachment 9, revenue losses in  
4           1993 will be \$14.7 million. Thus, the revenue losses from  
5           the extended area service plan are equivalent to, and would  
6           pay for, about half the cost of the lifeline rate  
7           reductions.

8           Q. Will customers who now have flat rate extended area service  
9           have any reason to contemplate changing to the new measured  
10          service?

11          A. Yes. They will get a much larger local calling area. Some  
12          customers will find this advantageous and will accept it,  
13          even though it means they will pay measured rates in what  
14          is now their extended calling area.

15          Q. Do you expect that many customers will be in this  
16          situation?

17          A. We have been given absolutely no evidence as to how many  
18          people in Florida will prefer the new rates. Our own  
19          experience in Maryland, where we analyzed point to point  
20          studies for a plan that extended local calling areas to a  
21          thirty mile radius (rather than a forty mile radius as  
22          proposed in Florida) was that relatively few customers  
23          would benefit from so great an extension of the local  
24          calling area.

25          When we tried to apply traditional criteria for expanding

1 service areas to the Maryland "point to point toll study"  
2 (a study of how many customers in each exchange called each  
3 other exchange in the LATA that was a toll call) was that  
4 few customers made at least four calls per month to or from  
5 the distant exchanges; indeed, few customers even made one  
6 call per month. We found very few exchanges that merited  
7 inclusion in an extended calling area by traditional  
8 criteria.

9 Southern Bell has presented no study in the present case to  
10 suggest that many people will voluntarily accept the new  
11 rates.

12 Q. Then why will anyone accept the new rates?

13 A. People will not have a choice. Southern Bell will not  
14 allow new customers to subscribe to the old flat rates  
15 applicable to the old, smaller, extended calling areas.  
16 These areas seem to be popular (but see my qualification,  
17 above), so there may be many people who take the new  
18 service, even though it provides more than they really  
19 want.

20 Q. What happens to existing customers for flat rate extended  
21 area service?

22 A. They are permitted to retain the service indefinitely.

23 Q. What happens if they move, or if they drop the service and  
24 then want to resume it?

25 A. This is not discussed in the filing. It appears that,

1           since there is no provision for portability, or resuming  
2           the service, these customers (including any customers who  
3           are wrongfully switched by the company's high pressure  
4           tactics discussed by other witnesses), they lose their  
5           right to the service.

6           Q. Even if they move nearby and retain the same telephone  
7           number.

8           A. It's not discussed in the filing. Since this is new  
9           service with respect to service connection charges and  
10          other rate elements, it would appear that they lose their  
11          right to the flat rate extended area service.

12          Q. What happens if a customer requires an additional line at  
13          the same location?

14          A. If a customer requires an additional line, present tariffs  
15          prevent flat rate and measured rate service at the same  
16          location, so it would appear that a businessman (usually,  
17          but it could be a parent of teenagers, for example) who  
18          requires an additional line might be forced to convert all  
19          existing flat rate lines to measured rate.

20          Effectively, this is a forced migration strategy, that will  
21          cause many businesses to switch from flat rate to measured  
22          rate service.

23          Q. What is the overall effect of this filing?

24          A. It is a migration strategy, which will have the effect of  
25          eliminating flat rate extended area service in a few years.



1 Q. If, as you say, there is no evidence that there is a great  
2 deal of consumer demand for measured extended area service  
3 to a forty mile radius, why is the plan so expensive?

4 A. If a lot of people make a few calls each, they may not be  
5 willing to pay the premium to receive service to exchanges  
6 forty miles away at local measured rates, but they do make  
7 some calls. Southern Bell loses the revenue. A few people  
8 may make a lot of calls, and they are a lot better off.  
9 An analysis of Southern Bell's calling studies will show  
10 (based upon my experience with similar studies in Maryland)  
11 that most customers make no long distance calls to the  
12 affected areas at present (in Maryland, the extended  
13 calling area was 30 miles; the proposed extended calling  
14 area is 40 miles in Florida, so even fewer customers call  
15 the exchanges they would "gain"). Those customers who do  
16 make long distance calls do not necessarily make them  
17 within the boundaries that the Southern Bell would give  
18 them; they may call across LATA boundaries, or make calls  
19 to exchanges more than 40 miles away. Therefore, while  
20 receiving a larger calling area and a larger telephone bill  
21 under the proposal, the average customer would not  
22 necessarily receive an extended calling area he or she  
23 needed or wanted.

24 Q. What has been the experience with customer acceptance of  
25 arbitrary extensions of calling areas to "circles" of large

1 radius?

2 A. In a similar plan in West Virginia, involving calling areas  
3 of 22 miles from the subscriber's "home exchange," (that  
4 is, 44 miles in diameter) C&P's admitted that only 6.4 per  
5 cent of the customers subscribed to the extended calling  
6 area which is evidence that the new calling areas do not  
7 represent substantial communities of interest. Report,  
8 February, 1989, page 9.

9 This calling area plan in West Virginia, which replaced  
10 "circle calling" and other pre-subscribed discounted toll  
11 arrangements, has effectively eliminated complaints about  
12 local calling areas, and has been sufficiently successful  
13 as to be adopted throughout the state. Residential  
14 customers have options of home-exchange flat rates, and  
15 measured rates to the rest of the 22-mile zone or of flat  
16 rates for the 22 mile zone. All customers have an option  
17 of measured rates throughout the zone or of flat rates for  
18 existing areas and measured rates for the rest of the zone.  
19 These are not "grandfathered"--all options are open to all  
20 customers in the appropriate class.

21 There is no consideration in West Virginia for expanding  
22 the size of the zone, for a variety of reasons, including  
23 the competitive effects.

24 Q. Are the revenue effects the only effects to be considered?

25 A. No. When toll rates are replaced by local rates there is

1 often a stimulation of traffic, which causes the telephone  
2 company to have to construct additional plant. This  
3 increase in cost is, of course, most significant where  
4 existing local calling areas are very small. However, the  
5 high expenses that have been incurred in some states make  
6 it imperative that the Company and the Commission review  
7 the Point-to-point studies to assess the need and potential  
8 demand for the service.

9 Q. What are the "point-to-point" studies you just mentioned,  
10 and how should they be analyzed? More generally, what  
11 evidence should the Commission require before extending the  
12 service areas?

13 A. The Company performs an annual "point to point" study,  
14 which measures the toll traffic from each exchange to each  
15 other toll exchange in the LATA. This study shows the  
16 number of customers in each exchange, and the number making  
17 zero, one, two, three, and four or more calls in the test  
18 month from each exchange to each other exchange. It also  
19 shows the average revenue per call for calls from each  
20 exchange to each other exchange.

21 Clearly, if the point-to-point study shows that most of the  
22 customers in exchange A call exchange B in the test month,  
23 and most of the customers in B call A in the test month,  
24 and many customers make four or more calls, then there is a  
25 lot of "community of interest" between the two exchanges.

1 Under these circumstances, it is often considered  
2 appropriate to extend local calling areas to include the  
3 two exchanges, but it is also considered possible that  
4 there will be much stimulation of traffic from the lower  
5 rates, and more plant may have to be constructed.  
6 If few customers in exchanges A and B call the other  
7 exchange in the test month, and very few make four or more  
8 calls, the exchange are usually said not to exhibit  
9 "community of interest." In such circumstances they  
10 generally remain toll calls.

11 Q. Are there any quantifiable measures of "community of  
12 interest"?

13 A. In Maryland the Chesapeake and Potomac Telephone Company of  
14 Maryland, a Bell Company, now a subsidiary of Bell  
15 Atlantic, stated it has extended local calling areas when  
16 more than fifty per cent of the subscribers in each of a  
17 pair of exchanges call the other exchange more than four  
18 times per month. C&P Telephone Company of Maryland, Report  
19 to the Commission, Docket 8026, February, 1989, page 3.  
20 This is a very rigorous standard, and the requirement that  
21 it be met in both directions makes it impossible when the  
22 exchanges are of different sizes. Nanjemoy, Maryland, has  
23 691 subscribers (access lines). If 346 of them called  
24 Washington, D.C. (this is an intra-LATA call under an  
25 exception in the 1982 Consent Decree) 4 times in a month,

1 the 1,384 calls would amount to 0.0018 calls per month to  
2 each of the 785,063 subscribers (access lines) in  
3 Washington - roughly one call every 50 years. If 392,532  
4 of the subscribers in Washington were to make 4 calls per  
5 month the Nanjemoy, the 1,570,128 calls would amount to  
6 about 57,338 calls per day to each subscriber in Nanjemoy -  
7 roughly 36 per minute, or a call every two seconds. Some  
8 actual examples of the disparities in two-way calling  
9 between exchanges of different sizes were shown in the  
10 "Proprietary" version of Appendix A of David Chessler,  
11 William Fenton, Richard Gabel, and Dr. Boyd L. Nelson,  
12 Extended Area Service in Maryland: Analysis of C&P's Report  
13 and Supplemental Report to the Commission Dated February,  
14 1989, and April 21, 1989, with Recommendations, Maryland  
15 Public Service Commission Case Number 8026, Staff Comments  
16 (May 5, 1989).

17 In fact, the Maryland staff found that for exchanges in the  
18 23 mile bands, and 30 mile bands, there were very few where  
19 half or more of the customers made calls to the new calling  
20 areas. Fewer than 10 per cent of the customers made calls  
21 into the proposed extended calling areas. Put another way,  
22 the staff found that, in most of the exchanges 85 to 90 per  
23 cent of the customers made zero calls to each of the  
24 exchanges in the proposed extended calling area.

25 On the other hand, there were many existing exchanges where

1 the local calling area extended 22 miles in some direction,  
2 and several where it extended 30 miles. Accordingly, it is  
3 quite possible that some portion of Southern Bell's plan  
4 may meet customer demand. We just don't know which  
5 portion.

6 Q. You cite evidence from Maryland and West Virginia. Do you  
7 consider these states to resemble Florida?

8 A. What is important is that these states' experience  
9 demonstrates that expanding local calling areas requires  
10 careful study, and a plan that is supported by the  
11 evidence, and is related to the needs and calling pattern  
12 of customers.

13 In many respects, LATAs, which break up states into local  
14 calling areas, have made states more alike. LATAs tend to  
15 be predominantly urban or rural, and of more compact size,  
16 so they are more easily compared than states. Maryland and  
17 West Virginia are small states, while Florida is a large  
18 one. Florida has large urban areas. Maryland also has  
19 large urban areas, while West Virginia does not. Florida  
20 is a rapidly growing state, and Maryland is also growing.  
21 West Virginia is not.

22 But people and commuting and calling patterns have  
23 similarities everywhere. People make most calls to people  
24 they know or to nearby businesses. The further away a  
25 community is, the fewer calls people make to that

1 community. If the distant community is a large urban  
2 center (a market and business center), people will call it  
3 even if it is very distant, while they may make few calls  
4 to the small communities between their location and the  
5 large center.

6 Thus, it is impossible to infer that because communities  
7 are within twenty or thirty or forty miles from each other  
8 people want to call from one to the other. It may be true,  
9 but more often it is false. However, people do want to  
10 call the nearest large urban centers, even if these are  
11 relatively distant.

12 Q. Can you summarize the problem you perceive with arbitrarily  
13 extending local calling areas to geographic boundaries  
14 based on distance, rather than on the basis of studies of  
15 calling patterns?

16 A. One of the large interexchange carriers advertises "reach  
17 out and touch someone." It does not advertize "reach out  
18 and touch someplace." People call people. In this, people  
19 are not affected by arbitrary dividers such as exchange or  
20 LATA boundaries, or even by state lines.

21 People are affected by whether they know the people they  
22 are calling or have business with them. Distance is one  
23 consideration in this, and the greater the distance, the  
24 less likely it is that one person will know another, or  
25 have business with another. But, the larger the urban

1 place, the more likely it is that people will know someone,  
2 or deal with a business there. Distance and size interact  
3 to determine the traffic volumes which we consider  
4 reflections of "community of interest."

5 Q. What is a basic service?

6 A. There is no precise definition of a basic service. The  
7 concept of a Basic service was developed in the early  
8 1980's to reflect services which are essential, not  
9 complex, and not subject to competition. There is an  
10 implication that regulators are to protect customers of  
11 basic services from high rates to a greater extent than  
12 customers of some other services.

13 Q. Can you present a list of basic services?

14 A. Generally, services involving access lines are considered  
15 basic. Thus, residential and business exchange services  
16 are usually considered basic. In some instances PBX lines  
17 are considered "basic." In the proposal at hand, special  
18 access lines are specifically not considered basic.

19 The FCC limits the access charge applicable to single and  
20 two line businesses, so presumably the FCC considers them  
21 "basic." However, the FCC has higher access charges for  
22 multi-line business customers (key systems as well as  
23 PBXs). Thus, the FCC presumably considers them non-basic.

24 Q. What determines whether a particular service charge is  
25 Basic or non-Basic?



1       A. We have to look at the nature of the underlying service.  
2       Any basic service can have rate elements which appear not  
3       to be basic. For example, lifeline service ordered by a  
4       blind, movement-impaired person might require that the  
5       customer be allowed tone dialing if the service is to be  
6       used. And the customer might need to use directory  
7       assistance, because Braille telephone directories do not  
8       exist.

9       Extended area service is arguably a luxury, a substitute  
10      for toll service. But it is usually considered a local  
11      service, and appears to be basic in Southern Bell's plan,  
12      although this is not actually stated anywhere.

13     Q. You hesitate about whether or not particular services are  
14      basic for the purposes of the plan. Has Southern Bell  
15      developed a list of Basic Services for this case?

16     A. According to Company Witness Lombardo, (pp. 36-39) there is  
17      no definitive list, but:

18             Category one, "Basic Services," contains those  
19             services generally required to provide essential  
20             local exchange services to an end-user as well as  
21             access to providers of basic local services and  
22             toll service. This category includes such  
23             offerings as Residence and Business Exchange  
24             Services, Service Connection Charges, and Switched  
25             Service to an interexchange carrier.

1           Category two, "non-Basic Services," contains  
2           all tariffed services not included in the basic  
3           category. These services are optional or can  
4           be provided or substituted by a vendor other  
5           than Southern Bell. Examples include Special  
6           Access services, Touchstar Services, and  
7           IntraLATA Toll.

8           Obviously, there is some room for discussion as to whether  
9           some services are "basic" or "non-basic." For example, the  
10          status of PBX lines is unclear. Likewise, is it unclear  
11          whether "Touchtone dialing," unlisted and non-published  
12          numbers, and a variety of other services commonly ordered  
13          in connection with local residential service are basic or  
14          non-basic in the company's plan.

15          Moreover, not all these services can be ordered from other  
16          vendors, as the definition requires: Touchstar Services  
17          are clearly monopolies (I will discuss below whether and to  
18          what extent they may be "optional"--and to whom). Special  
19          access is still a monopoly for small customers, whatever  
20          its status with large customers.

21          Furthermore, there is, in the company's plan, a class of  
22          service we might call "superbasic." This consists of  
23          Lifeline and Link-up rates, which the company may not  
24          raise at all.

25          Q. What is significant about the services you name which are

1 commonly ordered in connection with residential service?  
2 A. Customers order these services for a variety of reasons,  
3 and we do not normally enquire into customer reasons for  
4 ordering these services. However, they are often ordered  
5 by customers who are apprehensive about crime and other  
6 disorders of urban society; by customers who are disabled  
7 or who have limited abilities. These customers need a  
8 variety of services which might appear to be "non-  
9 Essential" to a healthy, able-bodied, middle class person  
10 like Company Witness Lombardo or myself, but which would be  
11 essential for a poor, or disabled, or elderly person, or  
12 perhaps a single woman living alone.  
13 Company Witness Lombardo or I might make a directory  
14 assistance call because we are feeling too lazy to look in  
15 the phone book. Mr. Lombardo's mother--or mine--might call  
16 directory assistance because she is unable to lift the  
17 phone book, or to read it without assistance. It may be  
18 appropriate to charge for directory assistance, but, for  
19 residential customers with basic service it is appropriate  
20 to control or limit increases in those charges. And it is  
21 certainly appropriate to prohibit increases in these  
22 charges for customers of "superbasic" services such as  
23 lifeline and link-up.  
24 Similarly, most users of non-Published or unlisted numbers  
25 are reportedly young, mobile, people who value their

1           privacy and want to reduce the number of telephone  
2           solicitations they receive. But some subscribers to this  
3           service are women living alone, battered wives, elderly  
4           people, and others who live in fear of burglars who look in  
5           the telephone book for an address and then call to  
6           ascertain whether the subscriber is home. Non-published  
7           and unlisted numbers, ordered in connection with  
8           residential service, should be basic.

9           Tone service is a nice luxury which helps us dial a bit  
10          faster. Except, perhaps, for disabled people who find it a  
11          necessity because it is easier to push a button than twist  
12          a dial, and because it lets them do things like bank by  
13          phone, thereby making their life easier. Tone dialing for  
14          residential customers is a basic service.

15          And then we get to some of the "touchstar" services.  
16          Caller ID, call trace, and call blocking, for example, have  
17          obvious importance to the people who live in fear of crime.  
18          I assume the company does not call them essential because  
19          they are new. New or not, many people find them essential  
20          for living in our society. They are basic services.

21          Q. You mentioned Lifeline and Link-up rates as a class of  
22          "super-basic" services. What do you mean by that?

23          A. These are the ones mentioned by Company Witness Lombardo.  
24          There may be other services which are so carefully targeted  
25          that they merit absolute rate protection. That is, no rate

1 increases are permitted. This is greater protection that  
2 offered the "basic" services in the company's plan, so  
3 "super-basic" seems an appropriate term.

4 There is a tendency among some regulators to think that a  
5 service that is targeted to the poor and is heavily  
6 discounted should be, in some way, limited or inferior.  
7 Thus, there is a tendency to say that Lifeline service  
8 should be Plain Old Telephone Service (POTS) or worse.  
9 "Luxury features" such as unlisted numbers, touchtone  
10 service, or "touchstar" services should be prohibited in  
11 connection with lifeline, according to this theory.  
12 We have just seen that these ancillary services (sometimes  
13 called vertical services) are very important for  
14 maintaining the quality of life of some people. Just  
15 because a person is poor, and is getting lifeline service  
16 does not mean the person does not have other problems.  
17 Indeed, customers with problems such as disability, or  
18 abusive spouses, are more likely than most people to be  
19 poor. Thus, we should permit customers to order lifeline  
20 service in connection with these other services, the ones I  
21 described as basic, when ordered in connection with  
22 residential service.

23 Q. How do you recommend that we determine what is a "basic"  
24 service?

25 A. Some of the so-called services are actually "rate elements"

1           since they cannot be ordered except in connection with a  
2           specific individual service. For example, one can order  
3           call waiting only in connection with access service. One  
4           has no choice of vendor; Southern Bell is an monopoly with  
5           respect to the "touchstar" services, as are other local  
6           exchange companies. This differs from toll service, where  
7           one does have a choice of vendor.

8           Accordingly, services that must be ordered under monopoly  
9           conditions, and which can be used only in connection with  
10          basic services, should get basic service protection from  
11          rate increases.

12         Q. But these are minor services. Very few people use them.  
13           How can they be basic?

14         A. Is TDD service basic? Very few people use it, and many of  
15          them use it in connection with regular telephone service  
16          for other members of the family.

17          The definition of whether a service is essential or not, or  
18          basic or not, depends on whether it is essential. To many  
19          people in our society, all the services I mentioned are  
20          essential; to others they are not. For example, all the  
21          examples I gave of Caller Identification being essential  
22          pertain to residences. Businesses may use the service for  
23          a different reason. Thus, it is easy to say it is basic  
24          with respect to residences and not basic with respect to  
25          businesses.

1 Q. Shouldn't a service be essential to everyone to be  
2 considered "basic"?

3 A. There is no such thing as a service which is essential to  
4 everyone. There are people who chose not to have telephone  
5 service because they do not want it. There are people who  
6 manage without electrical service because they do not want  
7 it. The Amish people are the most obvious examples, but  
8 there are others. Southern Bell states that among the  
9 customers for basic access service there are some who could  
10 be as well served by cellular service at a much higher  
11 price. I do not think there are many such people in  
12 Florida, but there are surely some. However, not even the  
13 company argues that the possibility of cellular competition  
14 in the access market makes "switched access service" a  
15 competitive, non-essential service. And just as switched  
16 access service is "basic" because it is essential and a  
17 practical monopoly, so, too, are the services and rate  
18 elements I mentioned. And just as switched access service  
19 merits rate cap protection, so, too, do the services and  
20 rate elements I mentioned.

21 Accordingly, we must look at the nature of the service and  
22 whether it is essential to the people who use it. If we  
23 can identify a group or subgroup of customers for whom the  
24 service is essential, and if the service is offered under  
25 monopoly conditions, it meets the traditional criteria for

1 public utility status: it is a basic service. And if it  
2 is a basic service, it merits real protection under an  
3 effective rate cap.

4 Q. What is the significance of the question of what services  
5 and rate elements constitute the list of "basic" services?

6 A. Southern Bell has proposed a very limited and ineffective  
7 rate cap, and then further limited its application to a  
8 very short list of services and rate elements. Many  
9 services or rate which are not on the list should be  
10 classified as basic because they are both essential to at  
11 least some of the customers who use them. These services  
12 should be given rate protection. I argue, above, that the  
13 Commission should adopt much stricter criteria for the rate  
14 cap on the basic services (for example, limiting rate  
15 increases for the basic services to the rate of inflation,  
16 less an appropriate productivity offset). Whatever rate  
17 cap protection is given to basic services should be applied  
18 to all services which are essential and offered under  
19 conditions of monopoly.

20 Q. Does not the company offer a rate cap for the non-basic  
21 services?

22 A. A 20 per cent increase each year is no real protection. In  
23 2 years, a second 20 per cent increase could cause the  
24 rates to rise 44 per cent (1.2 times 1.2). (See Lombardo,  
25 p. 40, ll. 6-9.) In 3 years the increase could be 73 per



1 cent (1.2 times 1.2 times 1.2). In four years the increase  
2 could be 101 per cent (1.2 to the fourth power). Thus,  
3 rates could double each 4 years (not 5 years, as simple  
4 application of the 20 per cent to the original index might  
5 seem to imply).

6 If some of the basic services are covered by the twenty per  
7 cent cap, they are getting no effective protection.

8 Q. What do you mean by "appropriate productivity offset"?

9 A. As I explained above, a productivity offset based on  
10 studies of what the industry has been capable of sustaining  
11 over a long period of time, and which will give the company  
12 an effective incentive for further efficiencies, and  
13 customers effective protection from unreasonable and  
14 unnecessary rate increases.

15 Q. Can you summarize your views with respect to basic  
16 services?

17 A. Basic services are essential to at least some customers,  
18 are provided under conditions of monopoly by the local  
19 exchange company. Some must be ordered and used in  
20 connection with another basic service, or with a non-basic  
21 service; obviously, these are basic only when ordered in  
22 connection with basic services. Some are basic to some  
23 classes of customer and not to others: these are basic  
24 only for the class of customer that considers them basic.

25 Q. Can you summarize your testimony, as a whole?

1       A. I discussed Southern Bell's competitive experience. The  
2       company has exaggerated the degree of competition it is  
3       facing, and claimed to be losing business in ways that are  
4       not supported by review of the financial and statistical  
5       statements.

6       The company also claims that "service bypass" is adverse to  
7       its interests. However, the data clearly show that bulk  
8       rate discounted services, even when the bulk services are  
9       offered under conditions of competition, can be at least as  
10      profitable as MTS.

11      The company also claims to be suffering from competition  
12      for coin telephones. Again, the statistics do not show any  
13      injury, and a review of the financial arrangements suggests  
14      that the company will find it much more profitable if  
15      customers operate the coin telephones.

16      The company presented a rate cap plan that is very  
17      anticompetitive, and which cannot be effectively  
18      administered by the Commission. The plan provides no  
19      effective protection for customers of basic services, who  
20      can be subject to rate increases even when rates are  
21      declining overall. The plan permits targeted rate  
22      reductions, and provides no effective protections against  
23      pricing below cost.

24      The company presented a measured rate EAS plan that is  
25      effectively a migration strategy, designed, in part, to

1 force business and other customers from flat rates to  
2 measured rates.

3 While there is often interest in expanding local calling  
4 areas, the company's proposal is excessive. It is unlikely  
5 that there would be customer demand for calling areas as  
6 broad as proposed, and the effect would be anticompetitive  
7 (although competitors have not been successful in the  
8 intra-LATA toll market).

9 The company's definition of basic services does not  
10 recognize that some services are, indeed, essential even  
11 though they are new. (The telephone itself was once a new  
12 service, but rapidly became a public utility.) Customers  
13 need rate protection for essential, monopoly services, even  
14 if they are new.

15 Q. Does this conclude your direct testimony?

16 A. Yes, it does.

### BIOGRAPHICAL INFORMATION

Dr. David Chessler is president of a telecommunications consulting firm in Bethesda, Maryland. The firm, David Chessler and Associates, does economic analysis of issues in telecommunications, competition, technology and computerization, addressing the engineering and accounting aspects of these issues as well. Dr. Chessler performs economic analysis to help form government regulatory policy and for competitive and antitrust analysis. He also advises clients on regulatory accounting and cost accounting for telephone companies, to help develop pricing policies, rate schedules, and tariffs. In formal proceedings, he provides expert support in the fields of economics, statistics, and telecommunications cost accounting and pricing.

Previously, Dr. Chessler was at the National Regulatory Research Institute from 1983 to 1986. At NRRI he did research into the new structure of the telecommunications industry, and intercorporate relations in the Bell Regional Holding Companies. He wrote several monographs and articles on the issue of the relations between state commissions and the regional holding companies. He completed reports on the Yellow Pages market (including electronic Yellow Pages), and the non-traditional, unregulated activities of the Bell companies. He also supervised research on "bypass," "smart buildings," and the national and state exchange carriers associations.

Before going to NRRI, Dr. Chessler was at the Federal Communications Commission for eleven years. At the FCC, he first spent a year studying Western Electric's prices. Dr. Chessler then transferred to the Economics

Division of the Common Carrier Bureau, where he headed the group doing research in pricing and the analysis of domestic demand. He then had several assignments with the "Cost Analysis Task Force," and eventually spent three and one-half years developing the new Uniform System of Accounts for Telephone Carriers: he wrote the Notice of Proposed Rulemaking and the First Supplemental Notice. Dr. Chessler's last FCC assignment was with the Enforcement Division of the Common Carrier Bureau, where he helped develop a system of cost accounting as part of the implementation of the Commission's decision in the Second Computer Inquiry. While at the FCC he wrote several published articles on the 1982 Consent Decree and divestiture.

While at the FCC Dr. Chessler also taught courses in Public Utilities Economics and Government and Business in the College of Business and Public Administration of the University of Maryland.

David Chessler received his bachelors and doctoral degrees from Columbia University. He wrote his dissertation, Price Discrimination by Electric Utilities and the Effect of State Commission Regulation on the Rate Structure, with Professor Donald J. Dewey. While writing his dissertation, and before going to the FCC, he taught at several branches of the City University of New York.

**TABLE 1**  
**Bell System Interstate Earnings by Service, 1964 to 1974**

	<u>August</u> <u>1964</u>	<u>Late</u> <u>1965</u>	<u>Late</u> <u>1967</u>	<u>Late</u> <u>1969</u>	<u>July</u> <u>1971</u>	<u>August</u> <u>1972</u>	<u>December</u> <u>1973</u>	<u>August</u> <u>1974</u>
Message Toll	9.7%	8.8%	8.2%	8.4%	8.6%	8.2%	8.8%	8.9%
WATS	13.4%	12.9%	13.7%	10.3%	9.4%	9.3%	12.6%	12.3%
TWX	3.4%	3.7%	6.1%	4.9%	-	-	-	-
P.L. Telephone	4.7%	4.3%	4.2%	4.2%	4.0%	4.5%	5.5%	5.5%
P.L. Telegraph	1.4%	1.4%	5.6%	7.4%	5.3%	4.7%	1.4%	(0.4%)
Telpak	0.3%	(0.8%)	2.1%	5.6%	5.4%	4.9%	8.2%	8.2%
Audio/Radio	-	-	4.9%	2.5%	3.0%	0.4%	2.0%	1.9%
TV	-	-	4.1%	5.3%	4.9%	3.7%	2.9%	2.0%
Other	0.9%	0.8%	12.1%	11.4%	3.1%	11.1%	3.2%	3.3%
Total Inter.	7.5%	7.8%	7.4%	7.8%	7.8%	7.7%	8.6%	8.7%

Source: FCC, Recommended Decision of the Chief of the Common Carrier Bureau,  
 Docket 18128, 41 FR 4320 (January 29, 1976), Attachment D.

**TABLE 2**  
**Southern Bell Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
30											88-91	88-89	89-90	90-91			
31											Annual	Percent	Percent	Percent			
32											Rate of	Growth	Growth	Growth			
33			Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	Growth	Growth	Growth	Growth			
34	Service		1988	1989	1990	1991	1991	1991	1991	1991							
35																	
36	Basic Area Revenues		\$1,944,129	\$2,071,187	\$2,077,226	\$2,083,937					2.34%	6.54%	0.29%	0.32%			
37	Optional EAS		\$1,701	\$6,002	\$19,213	\$20,956					130.96%	252.85%	220.11%	9.07%			
38	Public Telephone		\$157,921	\$165,160	\$167,770	\$175,498					3.58%	4.58%	1.58%	4.61%			
39	Local Private Line		\$68,572	\$68,673	\$79,546	\$92,953					10.67%	0.15%	15.83%	16.85%			
40	Basic Local Service		\$2,888,025	\$3,105,805	\$3,219,455	\$3,285,270					4.39%	7.54%	3.66%	2.04%			
41																	
42	End User Access		\$352,375	\$443,453	\$470,016	\$492,608					11.81%	25.85%	5.99%	4.81%			
43	Switched Access		\$1,143,609	\$1,070,007	\$990,916	\$972,515					-5.26%	-6.44%	-7.39%	-1.86%			
44	Special Access		\$287,554	\$235,886	\$237,589	\$250,573					-4.48%	-17.97%	0.72%	5.46%			
45	State Access		\$540,494	\$523,901	\$572,080	\$556,530					0.98%	-3.07%	9.20%	-2.72%			
46																	
47	Long Distance Message		\$665,142	\$646,390	\$674,151	\$622,134					-2.20%	-2.82%	4.29%	-7.72%			
48																	
49											88-91	88-89	89-90	90-91			
50											Annual	Percent	Percent	Percent			
51			Lines	Lines	Lines	Lines	Lines	Lines	Lines	Lines	Rate of	Growth	Growth	Growth			
52			1988	1989	1990	1991	1991	1991	1991	1991	Growth	Growth	Growth	Growth			
53																	
54	Business Analog Single		331,080	336,846	346,730	326,574					-0.46%	1.74%	2.93%	-5.81%			
55	Business Analog Multi		3,138,044	2,308,702	2,594,133	2,522,011					-7.03%	-26.43%	12.36%	-2.78%			
56	Business Digital					355,084											
57	Total Business		3,469,124	2,645,548	2,940,863	3,203,669					-2.62%	-23.74%	11.16%	8.94%			
58	Public Access		119,782	126,328	128,952	124,103					1.19%	5.46%	2.08%	-3.76%			
59	Residential (An.+Dig.)		6,708,886	6,965,206	7,161,931	7,297,690					2.84%	3.82%	2.82%	1.90%			
60																	
61	Special Access Analog					115,627											
62	Special Access Digital					251,352											
63	Total Special Acc.		197,296	189,008	157,343	366,979					22.98%	-4.20%	-16.75%	133.24%			
64																	

TABLE 2  
 Southern Bell Revenue Growth by Service, 1988-1991  
 (Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

**TABLE 2 (Continued)**  
**Southern Bell Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
			Calls		Calls		Calls		Calls		88-91		88-89		89-90		90-91
			1988		1989		1990		1991		Annual		Percent		Percent		Percent
											Rate of		Growth		Growth		Growth
65																	
66																	
67																	
68																	
69																	
70	Local Calls		34,953,141,123		38,379,341,901		39,375,955,222		40,662,407,000		5.17%		9.80%		2.60%		3.27%
71	IntraLATA Toll Calls		417,270,975		923,330,421		933,530,128		989,205,000		33.34%		121.28%		1.10%		5.96%
72	InterLATA Interstate		1,998,875,318		2,378,686,640		2,460,035,771		2,617,274,000		9.40%		19.00%		3.42%		6.39%
73	InterLATA Intrastate		516,779,840		700,982,959		825,881,953		857,660,000		18.40%		35.64%		17.82%		3.85%
74																	
75	P.L.&Access/Access Line		\$1,805.03		\$1,611.36		\$2,015.56		\$936.09		-19.66%		-10.73%		25.09%		-53.56%
76	Local+CALC/Res.+Bus.		\$225.80		\$262.27		\$254.03		\$247.35		3.08%		16.15%		-3.14%		-2.63%
77	Toll+SwAcc/Res+Bus+Coin		\$228.13		\$230.08		\$218.65		\$202.46		-3.90%		0.85%		-4.97%		-7.41%
78	Coin/Line		\$1,318.40		\$1,307.39		\$1,301.03		\$1,414.13		2.36%		-0.84%		-0.49%		8.69%

**TABLE 2 (Continued)**  
**Southern Bell Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)



**TABLE 3**  
**Southern Bell Revenue Growth by Service, 1987-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T
83			Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	Revenues	84-91	84-87	87-88	87-91	84-88					
84			1984	1987	1988	1988	1988	1988	1991	Annual	Annual	Percentage	Annual	Annual					
85										Rate of	Rate of	Change	Rate of	Rate of					
86	Service									Growth	Growth		Growth	Growth					
87																			
88	Basic Area Revenues				\$1,944,129				\$2,083,937										
89	Optional EAS				\$1,701				\$20,956										
90	Subscriber Service		\$2,078,240	\$2,549,027	\$1,945,830				\$2,104,893										
91	Public Telephone		\$116,541	\$131,241	\$157,921				\$175,498	6.02%	4.04%	20.33%	7.54%	7.89%					
92	Local Private Line		\$45,972	\$62,062	\$68,572				\$92,953	10.58%	10.52%	10.49%	10.63%	10.51%					
93	Total Local Service		\$2,264,098	\$2,795,774	\$2,888,025				\$3,285,270	5.46%	7.28%	3.30%	4.12%	6.27%					
94																			
95	End User Access		\$50,183	\$294,505	\$352,375				\$492,608	38.58%	80.38%	19.65%	13.72%	62.78%					
96	Interstate Sw. Acc.		\$1,256,742	\$1,227,331	\$1,143,609				\$972,515	-3.60%	-0.79%	-6.82%	-5.65%	-2.33%					
97	Special Access		\$34,081	\$279,143	\$287,554				\$250,573	32.98%	101.58%	3.01%	-2.66%	70.43%					
98	State Access		\$475,949	\$510,652	\$540,494				\$556,530	2.26%	2.37%	5.84%	2.17%	3.23%					
99																			
100	MTS		\$432,828	\$599,585															
101	WATS		\$86,502	\$131,648															
102	Long Distance Message		\$519,330	\$731,233	\$665,142				\$622,134	2.61%	12.08%	-9.04%	-3.96%	6.38%					
103																			
104										84-91	84-87	87-88	87-91	84-88					
105										Annual	Annual	Percentage	Annual	Annual					
106			Lines	Lines	Lines	Lines	Lines	Lines	Lines	Rate of	Rate of	Change	Rate of	Rate of					
107			1984	1987	1988	1988	1988	1991	1991	Growth	Growth		Growth	Growth					
108																			
109	Business Analog Single				331,080				326,574										
110	Business Analog Multi				3,138,044				2,522,011										
111	Business Digital								355,084										
112	Total Business		1,927,165	2,394,960	3,469,124				3,203,669	7.53%	7.51%	44.85%	7.54%	15.83%					
113	Public Access		138,744	140,792	119,782				124,103	-1.58%	0.49%	-14.92%	-3.11%	-3.61%					
114	Residential (An.+Dig.)		5,696,999	6,440,614	6,708,886				7,297,690	3.60%	4.17%	4.17%	3.17%	4.17%					
115	Resid. + Bus. Acc.		7,624,164	8,835,574	10,178,010				10,501,359	4.68%	5.04%	15.19%	4.41%	7.49%					
116																			
117	Special Access Analog								115,627										
118	Special Access Digital								251,352										
119	Total Special Acc.		6,694	32,851	197,296				366,979	77.18%	69.94%	500.58%	82.82%	133.00%					
120																			

(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)  
**TABLE 3**  
**Southern Bell Revenue Growth by Service, 1987-1991**

**TABLE 3 (Continued)**  
**Southern Bell Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T
			Calls 1984	Calls 1987	Calls 1988	Calls 1991	84-91 Annual Rate of Growth	84-87 Annual Rate of Growth	87-88 Percentage Change	87-91 Annual Rate of Growth	84-88 Annual Rate of Growth								
121																			
122																			
123																			
124																			
125																			
126	Local Calls		29,913,700,000	34,183,268,000	34,953,141,123	40,662,407,000	4.48%	4.55%	2.25%	4.43%	3.97%								
127	IntraLATA Toll Calls				417,270,975	989,205,000													
128	InterLATA Interstate				1,998,875,318	2,617,274,000													
129	InterLATA Intrastate				516,779,840	857,660,000													
130	Total Toll		3,441,546,042	4,624,613,307	2,932,926,133	4,464,139,000	3.79%	10.35%	-36.58%	-0.88%	-3.92%								
131																			
132																			
133	P.L.&Access/Access Line		\$11,958.92	\$10,386.44	\$1,805.03	\$936.09	-30.51%	-4.59%	-82.62%	-45.21%	-37.67%								
134	Local+CALC/Res.+Bus.		\$279.17	\$321.83	\$225.80	\$247.35	-1.71%	4.85%	-29.84%	-6.37%	-5.17%								
135	Toll+SwAcc/Rest+Bus+Coin		\$290.10	\$275.08	\$228.13	\$202.46	-5.01%	-1.76%	-17.07%	-7.38%	-5.83%								
136	Coin/Line		\$839.97	\$932.16	\$1,318.40	\$1,414.13	7.73%	3.53%	41.43%	10.98%	11.93%								

(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)  
**TABLE 3 (Continued)**  
**Southern Bell Revenue Growth by Service, 1988-1991**

**TABLE 4**  
**Southern Bell Florida Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
30											88-91	88-89	89-90	90-91			
31											Annual	Percent	Percent	Percent			
32											Rate of	Growth	Growth	Growth			
33			Revenues		Revenues		Revenues		Revenues		Growth	Growth	Growth	Growth			
34	Service		1988		1989		1990		1991								
35																	
36	Basic Area Revenues																
37	Optional EAS																
38	Public Telephone																
39	Local Private Line		\$66,821		\$65,801		\$68,046		\$92,953		11.63%	-1.53%	213.75%			36.60%	
40	Basic Local Service		\$1,188,398		\$1,267,222		\$1,344,182		\$1,347,991		4.29%	6.63%	6.07%			0.28%	
41																	
42	Total Access		\$1,128,288		\$1,048,589		\$1,070,492		\$1,023,387		-3.20%	-7.06%	2.09%			-4.40%	
43	Intrastate Switch Access		\$262,750		\$234,541		\$257,090		\$248,930		-1.78%	-10.74%	9.61%			-3.17%	
44	Intrastate Spec. Access		\$24,412		\$21,688		\$19,893		\$19,276		-7.57%	-11.16%	-8.28%			-3.10%	
45	Intraterritory Access		\$13,946		\$11,963		\$12,621		\$12,500		-3.58%	-14.22%	5.50%			-0.96%	
46																	
47	MTS		\$277,896		\$251,042		\$267,840		\$255,265		-2.79%	-9.66%	6.69%			-4.69%	
48	WATS		\$44,269		\$36,097		\$25,728		\$25,260		-17.06%	-18.46%	-28.73%			-1.82%	
49	Long Distance Message		\$322,165		\$287,139		\$293,568		\$280,525		-4.51%	-10.87%	2.24%			-4.44%	
50																	
51											88-91	88-89	89-90	90-91			
52											Annual	Percent	Percent	Percent			
53			Lines		Lines		Lines		Lines		Rate of	Growth	Growth	Growth			
54			1988		1989		1990		1991		Growth	Growth	Growth	Growth			
55																	
56	Business Analog Single																
57	Business Analog Multi																
58	Business Digital																
59	Total Business																
60	Public Access																
61	Residential (An.+Dig.)																
62																	
63	Special Access Analog																
64	Special Access Digital																
65	Total Special Acc.																
66																	

**TABLE 4**  
**Southern Bell Florida Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

**TABLE 4 (Continued)**  
**Southern Bell Florida Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
67											88-91		88-89		89-90		90-91
68											Annual		Percent		Percent		Percent
69			Calls		Calls		Calls		Calls		Rate of		Growth		Growth		Growth
70			1988		1989		1990		1991		Growth						
71			-----		-----		-----		-----								
72	Local Calls																
73	IntraLATA Toll Calls																
74	InterLATA Interstate																
75	InterLATA Intrastate																
76																	
77	P.L.&Access/Access Line																
78	Local+CALC/Res.+Bus.																
79	Toll+SwAcc/Res+Bus+CoIn																
80	CoIn/Line																
81																	
82																	
83																	

**TABLR 4 (Continued)**  
**Southern Bell Florida Revenue Growth by Service, 1988-1991**  
(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)

**TABLE 5**  
**Southern Bell Florida Revenue Growth by Service, 1984-1991**  
(Dollars In thousands. Lines, Calls, and Dollars per Line, In units.)

A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T
											84-91	84-87	87-88	87-91	84-88				
			Revenues		Revenues		Revenues		Revenues		Annual	Annual	Percentage	Annual	Annual				
			1984		1987		1988		1991		Rate of	Rate of	Increase	Rate of	Rate of				
											Growth	Growth		Growth	Growth				
84																			
85																			
86																			
87																			
88	Service																		
89																			
90	Basic Area Revenues																		
91	Optional EAS																		
92	Public Telephone																		
93	Territory Toll P.L.		\$69,269				\$66,821		\$92,953		4.29%								-0.90%
94	Total Local Service		\$958,834		\$1,139,322		\$1,188,398		\$1,347,991		4.99%	5.92%	4.31%	4.29%					5.51%
95																			
96	Total Access		\$690,087		\$1,108,445		\$1,128,288		\$1,023,387		5.79%	17.11%	1.79%	-1.98%					13.08%
97	Intrastate Switch Access		\$162,247				\$262,750		\$248,930		6.31%								12.81%
98	Intrastate Spec. Access		\$31,244				\$24,412		\$19,276		-6.67%								-5.98%
99	Intraterritory Access		\$0				\$13,946		\$12,500										
100																			
101	MTS		\$196,015				\$277,896		\$255,265										9.12%
102	WATS		\$50,016				\$44,269		\$25,260										-3.01%
103	Long Distance Message		\$246,031		\$339,393		\$322,165		\$280,525		1.89%	11.32%	-5.08%	-4.65%					6.97%
104																			
105											84-91	84-87	87-88	87-91	84-88				
106											Annual	Annual	Percentage	Annual	Annual				
107			Lines		Lines				Lines		Rate of	Rate of	Increase	Rate of	Rate of				
108			1984		1987				1991		Growth	Growth		Growth	Growth				
109																			
110	Business Analog Single																		
111	Business Analog Multi																		
112	Business Digital																		
113	Total Business																		
114	Public Access																		
115	Residential (An.+Dig.)																		
116	Resid. + Bus. Acc.																		
117																			
118	Special Access Analog																		
119	Special Access Digital																		
120	Total Special Acc.																		
121																			

(Dollars in thousands. Lines, Calls, and Dollars per Line, in units.)  
**Southern Bell Florida Revenue Growth by Service, 1984-1991**

**TABLE 5**

Exhibit DC-6

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Docket No. 920260-TL  
Florida Public Service Commission  
Dr. David Chessler