

SIDNEY J. WHITE, JR.
General Attorney

Southern Bell Telephone
and Telegraph Company
Suite 400
150 South Monroe Street
Tallahassee, Florida 32301
(404) 529-5094

ORIGINAL
FILE COPY

- 14684-92 - Lombardo
- 14685-92 - Reid
- 14686-92 - Sims
- 14687-92 - Keck
- 14688-92 - Wilson
- 14689-92 - Billingsley
- 14690-92 - McClellan
- 14691-92 - Thompson
- 14692-92 - Gray
- 14693-92 - Taylor
- 14694-92 - Lacher

December 18, 1992

Mr. Steve C. Tribble
Director, Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301

RE: Docket No. 920260-TL

Dear Mr. Tribble:

Enclosed for filing in the above-referenced docket are an original and fifteen copies of the Rebuttal Testimony of Anthony M. Lombardo, Walter S. Reid, Nancy H. Sims, William B. Keck, Jerry L. Wilson, Randall S. Billingsley, John D. McClellan, Margaret K. Thompson, H.E. Gray, Jr., and William E. Taylor for Southern Bell Telephone and Telegraph Company.

Also enclosed is an original and fifteen copies of the Revised Direct Testimony of Joseph P. Lacher which is being resubmitted in order to bring the testimony in conformity with Order No. PSC-92-1320-PCO-TL.

Finally, Southern Bell is not presenting any testimony rebutting the intervenor witnesses' testimony which the Company has moved to strike since such testimony is in contravention of Order No. PSC-92-1320-PCO-TL. Southern Bell reserves the right to file rebuttal to this testimony in the event Order No. 92-1320-PCO-TL is altered to allow such testimony in this proceeding.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served on the parties shown on the attached Certificate of Service.

Sincerely,
Sidney J. White, Jr.
Sidney J. White, Jr.

Enclosures

cc: All Parties of Record
A. M. Lombardo
H. R. Anthony
R. D. Lackey

SEARCHED
SERIALIZED
[Signature]

CERTIFICATE OF SERVICE
Docket No. 920260-TL

I HEREBY CERTIFY that a copy of the foregoing has been furnished
by United States Mail this 18th day of December, 1992 to:

Robin Norton
Division of Communications
Florida Public Svc Commission
101 East Gaines Street
Tallahassee, FL 32399-0866

Angela Green
Division of Legal Services
Florida Public Svc Commission
101 East Gaines Street
Tallahassee, FL 32399-0863

Joseph A. McGlothlin
Vicki Gordon Kaufman
McWhirter, Grandoff & Reeves
716 - 315 S. Calhoun Street
Tallahassee, Florida 32301
atty for FIXCA

Patrick K. Wiggins
Wiggins & Villacorta, P.A.
Post Office Drawer 1657
Tallahassee, Florida 32302
atty for Intermedia

Joseph Gillan
J. P. Gillan and Associates
Post Office Box 541038
Orlando, Florida 32854-1038

Floyd Self, Esq.
Messer, Vickers, Caparello,
Madsen, Lewis & Metz, PA
Post Office Box 1876
Tallahassee, FL 32302
atty for US Sprint

Charles J. Beck
Deputy Public Counsel
Office of the Public Counsel
Room 812, 111 W. Madison Street
Tallahassee, FL 32399-1400

Michael J. Henry
MCI Telecommunications Corp.
MCI Center
Three Ravinia Drive
Atlanta, Georgia 30346-2102

Richard D. Melson
Hopping Boyd Green & Sams
Post Office Box 6526
Tallahassee, Florida 32314
atty for MCI

Rick Wright
Regulatory Analyst
Division of Audit and Finance
Florida Public Svc Commission
101 East Gaines Street
Tallahassee, FL 32399-0865

Peter M. Dunbar
Haben, Culpepper, Dunbar
& French, P.A.
Post Office Box 10095
Tallahassee, FL 32301
atty for FCTA

Chanthina R. Bryant
Sprint
3065 Cumberland Circle
Atlanta, GA 30339

Michael W. Tye
AT&T Communications of the
Southern States, Inc.
Suite 1410
106 East College Avenue
Tallahassee, Florida 32301

Dan B. Hendrickson
Post Office Box 1201
Tallahassee, FL 32302
atty for FCAN

Benjamin H. Dickens, Jr.
Blooston, Mordkofsky, Jackson,
& Dickens
2120 L Street, N.W.
Washington, DC 20037

Monte Belote
Florida Consumer Action Network
4100 W. Kennedy Blvd. #128
Tampa, FL 33609

Mr. Cecil O. Simpson
General Attorney
Mr. Peter Q. Nyce, Jr.
General Attorney
Regulatory Law Office
Advocate General
Department of the Army
901 North Stuart Street
Arlington VA 22203-1837

Michael B. Twomey
Assistant Attorney General
Department of Legal Affairs
Room 1603, The Capitol
Tallahassee, FL 32399-1050

Florida Pay Telephone
Association, Inc.
c/o Mr. Lance C. Norris
President
202 - 8130 Baymeadows Cir. West
Jacksonville, FL 32256

Bill L. Bryant, Jr., Esq.
Foley & Lardner
Suite 450
215 South Monroe Street
Tallahassee, FL 32302-0508

Douglas S. Metcalf (Ad Hoc)
Communications Consultants, Inc.
1600 E. Amelia Street
Orlando, FL 32803

Thomas F. Woods, Esq.
Gatlin, Woods, Carlson, and
Cowdery
1709-D Mahan Drive
Tallahassee, FL 32308
atty for the Florida Hotel and
Motel Association

C. Everett Boyd, Jr.
Ervin, Varn, Jacobs, Odom &
Ervin
305 South Gadsen Street
Tallahassee, FL 32302

Laura L. Wilson, Esq.
Messer, Vickers, Caparello,
Madsen, Lewis & Metz, PA
Post Office Box 1876
Tallahassee, FL 32302
atty for FPTA

Sidney J. White, Jr.

1 BELL SOUTH TELECOMMUNICATIONS, INC.
2 REBUTTAL TESTIMONY OF ANTHONY M. LOMBARDO
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 920260-TL
5 DECEMBER 18, 1992

6 ORIGINAL
7 FILE COPY

7 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

8

9 A. MY NAME IS TONY LOMBARDO. I AM EMPLOYED BY
10 BELL SOUTH TELECOMMUNICATIONS INC. D/B/A/SOUTHERN
11 BELL TELEPHONE AND TELEGRAPH COMPANY ("SOUTHERN
12 BELL" OR THE "COMPANY") AS ASSISTANT VICE PRESIDENT
13 OF REGULATORY RELATIONS IN FLORIDA. MY BUSINESS
14 ADDRESS IS 150 SOUTH MONROE STREET, TALLAHASSEE,
15 FLORIDA.

16

17 Q. ARE YOU THE SAME TONY LOMBARDO THAT PREFILED DIRECT
18 TESTIMONY IN THIS DOCKET?

19

20 A. YES, I AM.

21

22 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

23

24 A. THE PURPOSE OF MY TESTIMONY IS TWO-FOLD. FIRST,
25 SINCE THE ISSUES IN THIS DOCKET WERE DETERMINED

1 AFTER SOUTHERN BELL'S DIRECT TESTIMONY WAS FILED,
2 THERE IS ONE ISSUE IN THIS PROCEEDING WHICH HAS NOT
3 BEEN ADDRESSED BY ANY PARTY AND WHICH FALLS WITHIN
4 MY AREA OF RESPONSIBILITY. THE SECOND PORTION OF
5 MY REBUTTAL TESTIMONY WILL ADDRESS THE TESTIMONY OF
6 INTERVENOR WITNESSES WHO DEAL WITH FOUR MAJOR
7 ISSUES ADDRESSED IN MY DIRECT TESTIMONY: (1)
8 COMPETITION; (2) THE 1988 INCENTIVE REGULATION
9 PLAN; (3) THE PROPOSED PRICE REGULATION PLAN; AND
10 (4) SEVERAL MATTERS RELATED TO THE OPTIONAL
11 EXPANDED LOCAL SERVICE PLAN (ELS).

12

13 Q. WHAT CRITERIA SHOULD THE COMMISSION USE TO EVALUATE
14 SOUTHERN BELL'S PERFORMANCE UNDER, AND ITS PROPOSAL
15 FOR, AN INCENTIVE REGULATION, PRICE CAP, OR PRICE
16 REGULATION PLAN (ISSUE 26A)?

17

18 A. SOUTHERN BELL BELIEVES THE PRICE REGULATION PLAN
19 SHOULD PRODUCE RESULTS WHICH BENEFIT BOTH OUR
20 CUSTOMERS AND OUR OWNERS. WHEN THE FPSC REVIEWS
21 OUR RESULTS, IT SHOULD ASSURE ITSELF THAT THIS PLAN
22 HAS PRODUCED JUST AND REASONABLE RATES, HAS
23 FULFILLED THE FPSC SERVICE STANDARDS, HAS CREATED
24 INCENTIVES TO INVEST IN THE NETWORK, HAS IMPROVED
25 OPERATIONAL EFFICIENCIES, AND HAS ENCOURAGED THE

1 INTRODUCTION OF NEW AND INNOVATIVE SERVICES. THE
2 COMMISSION SHOULD ACKNOWLEDGE, HOWEVER, SINCE IT IS
3 NOT POSSIBLE TO REPLICATE THE PAST ASSUMING A
4 DIFFERENT FORM OF REGULATION, THAT THE
5 DETERMINATION OF WHETHER THE CRITERIA ARE MET WILL
6 NECESSARILY BE LESS THAN PRECISELY MEASURABLE.

7

8 Q. HOW HAVE YOU ORGANIZED THE REBUTTAL PORTION OF YOUR
9 TESTIMONY?

10

11 A. I HAVE ORGANIZED THE REMAINDER OF MY TESTIMONY BY
12 SEGREGATING EACH MAJOR ISSUE AND THEN ADDRESSING
13 THE TESTIMONY OF WITNESSES WHO HAVE DISCUSSED THAT
14 ISSUE.

15

16

TABLE OF CONTENTS

17

18

PAGE

TOPIC

19

20

4

COMPETITION

21

13

1988 INCENTIVE REGULATION PLAN

22

19

PRICE REGULATION PLAN

23

50

OPTIONAL EXPANDED LOCAL SERVICE PLAN

24

54

SUMMARY

25

1 GROWTH, THEN THE LEC WILL CONTINUE TO SEE ITS
2 REVENUES AND TRAFFIC VOLUMES INCREASE -- EVEN
3 WITHOUT ATTEMPTING TO REDUCE ITS COSTS IN RESPONSE
4 TO COMPETITION." WOULD YOU COMMENT ON THIS?

5

6 A. YES. MR. GILLAN FAILS TO CONSIDER THE OTHER PART
7 TO THIS ISSUE. THERE IS NO GUARANTEE THAT MARKET
8 GROWTH WILL OUTPACE COMPETITIVE EROSION AND INDEED
9 THE REVERSE MAY BE TRUE.

10

11 Q. IN HIS DIRECT TESTIMONY ON PAGE 11 (LINES 10-16),
12 DR. CHESSLER STATES THAT YOU CITE SERVICE BYPASS AS
13 A PROBLEM BUT NEVER EXPLAIN EXACTLY WHAT YOU MEAN
14 BY SERVICE BYPASS. ARE HIS STATEMENTS TRUE?

15

16 A. NO. FIRST, I DO NOT CITE SERVICE BYPASS AS A
17 "PROBLEM"; RATHER I IDENTIFY IT AS AN AREA IN WHICH
18 SOUTHERN BELL HAS SEEN COMPETITION GROW.

19

20 SECOND, I DO EXPLAIN EXACTLY WHAT I MEAN BY SERVICE
21 BYPASS ON PAGE 9 OF MY DIRECT TESTIMONY: "...THE
22 MIGRATION OF INDIVIDUAL SWITCHED CIRCUITS TO HIGH
23 CAPACITY (HICAP) SPECIAL ACCESS SERVICES USED BY
24 COMPETITORS TO PROVIDE ALL OF A BUSINESS CUSTOMER'S
25 LONG DISTANCE SERVICES." FURTHER, I STATE THAT

1 "...THE MIGRATION PREVIOUSLY DISCUSSED FROM
2 SWITCHED ACCESS, I.E. WATS AND 800 SERVICE, TO
3 SPECIAL ACCESS, I.E. HICAP (SERVICE BYPASS), NOT
4 ONLY IMPACTS SOUTHERN BELL'S INTRALATA TOLL MARKET
5 BUT ALSO REDUCES THE ACCESS CHARGES THE COMPANY
6 RECEIVES FROM IXCS." (PAGE 9) THE ACCEPTED
7 INDUSTRY/FCC DEFINITION OF SERVICE BYPASS WHICH IS:
8 SPECIAL ACCESS (EITHER END USER LOCATION TO END
9 USER LOCATION, OR END USER TO POINT-OF-PRESENCE)
10 BYPASSES SWITCHED ACCESS. THIS IS WHAT WE AND THE
11 OTHER RBOCS HAVE BEEN REPORTING TO THE FCC ANNUALLY
12 FOR AT LEAST FIVE YEARS NOW.

13

14 Q. DR. KAHN, ON PAGE 24 (LINES 2-9) OF HIS DIRECT
15 TESTIMONY, CLAIMS THAT THE USE OF 10XXX CODES TO
16 ACCESS IXCS FOR INTRALATA TOLL IS AN EQUIVALENT
17 OFFSET TO SOUTHERN BELL'S COMPLETE EXCLUSION FROM
18 THE INTERLATA, INTERSTATE MARKETS. DO YOU AGREE?

19

20 A. NO. THE USE OF 10XXX BY IXCS IS HARDLY AN
21 EQUIVALENT OFFSET TO TOTAL EXCLUSION FROM THE
22 INTERLATA AND INTERSTATE MARKETS. UNLIKE THE IXCS
23 IN THE INTRALATA TOLL MARKET, SOUTHERN BELL HAS NO
24 OPPORTUNITY TO COMPETE IN THE INTERLATA AND
25 INTERSTATE MARKETS OR RELATED REVENUE STREAMS.

1

2 DR. KAHN MUST THINK THAT THE MANY
3 TELECOMMUNICATIONS MANAGERS HIRED BY OUR MAJOR
4 CUSTOMERS ARE IGNORANT. LET ME ASSURE HIM THAT
5 THOSE PEOPLE, EMPLOYEES OF OUR LARGEST AND MOST
6 PROFIT-PRODUCING CUSTOMERS AS A GROUP, ARE MORE
7 THAN COMPETENT TO SELECT ALTERNATE MEANS OF
8 TRANSPORTING THEIR VOICE AND DATA TRAFFIC.
9 ALTERNATIVES ABOUND IN TECHNOLOGY TO ALLOW BUSINESS
10 AND RESIDENCE CUSTOMERS TO DIAL 1+ AND SELECT THEIR
11 10XXX IXC CODE OF CHOICE IN THE INTRALATA TOLL
12 MARKET. THIS CONVENIENCE IS EASILY ATTAINABLE IN
13 BUSINESS SYSTEMS THROUGH THE USE OF PBX SOFTWARE,
14 ESSX AUTOMATIC ROUTE SELECTION OR SPECIAL ACCESS
15 BASED SERVICES. IN ADDITION, SMALLER CUSTOMERS CAN
16 SIMPLY BUY AUTODIALERS OR A K-MART \$19.95 TELEPHONE
17 SET WHICH ALLOWS FOR PROGRAMMABLE DIALING.

18

19 FINALLY, DR. KAHN SEEMS TO FORGET THE SIGNIFICANT
20 PENETRATION THE IXCS AND RESELLERS MADE ON AT&T'S
21 MARKET IN THE PRE-EQUAL ACCESS ENVIRONMENT WHEN
22 COMPETITORS' END USERS WERE REQUIRED TO DIAL MANY
23 EXTRA DIGITS.

24

25 Q. IN HIS DIRECT TESTIMONY, DR. KAHN TALKS ABOUT

1 MARKET LEVERAGING (PAGE 40, LINES 20-22), THAT IS,
2 EXTENDING MARKET POWER IN ONE MARKET INTO A SECOND
3 RELATED MARKET THAT WOULD OTHERWISE BE COMPETITIVE.
4 DO OUR COMPETITORS DO THIS?

5
6 A. YES. OUR COMPETITORS HAVE FREQUENTLY LINKED
7 DIFFERENT SERVICES WHICH WE CANNOT PROVIDE, I.E.
8 INTERSTATE AND INTERLATA TOLL OFFERINGS WITH THEIR
9 INTRASTATE TOLL OFFERINGS, THUS COMPETING WITH OUR
10 INTRALATA TOLL AND LEVERAGING THEIR CAPABILITY TO
11 INCLUDE SERVICES WHICH WE CANNOT PROVIDE. EXAMPLES
12 OF THIS INCLUDE, BUT ARE NOT LIMITED TO, AT&T'S
13 MEGACOM AND TARIFF 12, SPRINT'S VPN AND MCI'S
14 PRISM.

15
16 Q. MR. METCALF STATES ON PAGE 11 (LINES 7-10) OF HIS
17 DIRECT TESTIMONY, "...IT WAS SBT'S CONSTANT THREATS
18 AND REQUESTS FOR UNJUSTIFIED INCREASES IN EXCESS OF
19 100% IN PRIVATE LINE RATES DURING THE MID-1980'S
20 THAT CAUSED USERS TO LOOK AT ALTERNATE VENDORS AND
21 EQUIPMENT." CAN YOU COMMENT ON THIS STATEMENT?

22
23 A. MR. METCALF TAKES MANY LIBERTIES IN DESCRIBING WHAT
24 HAPPENED TO THE REPRICING OF PRIVATE LINE SERVICES
25 IN THE MID 1980'S. AS MR. METCALF SHOULD KNOW,

1 MANY OF OUR PRIVATE LINE SERVICES WERE PRICED BELOW
2 COST. IT WAS OUR INTENTION IN REPRICING THESE
3 SERVICES TO PROVIDE THESE SERVICES AT A RATE THAT
4 WOULD COVER THE COST OF THE SERVICE. IN THIS
5 REGARD, BEFORE CHANGES WERE MADE, A VERY EXTENSIVE
6 COST METHODOLOGY PROCEDURE FOR PRIVATE LINE WAS
7 UNDERTAKEN WITH INPUT FROM THE INDUSTRY AND WAS
8 ULTIMATELY APPROVED BY THIS COMMISSION. USING
9 THESE COSTS, SOUTHERN BELL THEN RECOMMENDED
10 REPRICING, WHICH WAS PHASED IN OVER THREE YEARS SO
11 THAT OUR CUSTOMERS COULD PLAN AND BUDGET FOR THESE
12 CHANGES. THIS PHASE-IN WILL BE COMPLETE AS OF
13 JANUARY 16, 1993, AND REPRICING WILL HAVE BEEN
14 ACCOMPLISHED SO THAT RATES FOR THESE SERVICES NOW
15 COVER THEIR COSTS. IF WE HAD DONE ANYTHING LESS
16 THAN THIS PROCESS, IT WOULD HAVE REQUIRED OTHER
17 CUSTOMERS THAT DO NOT UTILIZE PRIVATE LINE SERVICES
18 TO CONTINUE TO SUBSIDIZE THOSE THAT DO. THIS IS
19 THE VERY KIND OF INEQUITY WHICH WE ARE TRYING TO
20 REMEDY WITH OUR PROPOSED PLAN.

21

22 Q. MR. METCALF GOES ON TO STATE IN HIS DIRECT
23 TESTIMONY (PAGE 11, LINES 22-25), "DESPITE AD HOC'S
24 OPPOSITION AND WARNINGS OF BYPASS, SBT HAS
25 MAINTAINED UNREASONABLY HIGH RATES FOR SERVICES

1 USED BY THE BUSINESS COMMUNITY. THAT SBT'S
2 UNECONOMIC PRICING OF THESE SERVICES HAS PRODUCED
3 SOME LIMITED MIGRATION TO ALTERNATIVES IS NOT
4 SURPRISING." DO YOU AGREE WITH THIS STATEMENT?

5
6 A. NO. OUR CURRENT BUSINESS PRICES ARE A MIXED BAG;
7 SOME ARE TOO HIGH WHILE OTHERS ARE TOO LOW. MR.
8 METCALF, LIKE AT&T, WANTS US IMMEDIATELY TO REDUCE
9 PRICES FOR SERVICES THAT HIS CLIENTS USE TO LEVELS
10 THAT HE DETERMINES ARE APPROPRIATE. MY RESPONSE IS
11 THAT THIS IS WHY WE HAVE PROPOSED THE PRICE
12 REGULATION PLAN: SO THAT MARKET INTELLIGENCE CAN BE
13 USED TO DETERMINE THE APPROPRIATE PRICE AS IT
14 RELATES TO VALUE, AND THEN WE CAN GRADUALLY ATTAIN
15 THAT PRICE. WITH THE PLAN'S PRICE INDEX MECHANISM
16 WE CAN ACCOMPLISH THAT OBJECTIVE.

17
18 Q. MR. METCALF CONTINUES ON PAGE 11 (LINE 25) AND PAGE
19 12 (LINES 1-2) OF HIS DIRECT TESTIMONY TO SAY THAT
20 "...THE TRULY LIMITED USE OF THESE ALTERNATIVES
21 DEMONSTRATES THE BASIC SERVICE NATURE OF THE
22 COMPANY'S PRIVATE LINE AND PRIVATE LINE-LIKE
23 SERVICES, FOR WHICH FEW PRACTICAL ALTERNATIVES ARE
24 AVAILABLE ON A LOCAL BASIS." DO YOU AGREE THAT
25 THERE ARE FEW ALTERNATIVES?

1

2 A. NO. SINCE I AM DISCUSSING MR. METCALF'S TESTIMONY,
3 I WOULD POINT OUT THAT THE CLIENTS ON THE LIST HE
4 PROVIDED IN HIS TESTIMONY USE A NUMBER OF
5 ALTERNATIVES AVAILABLE TO THEM INCLUDING MICROWAVE,
6 FIBER, VSAT AND HICAP ALTERNATIVES.

7

8 Q. IN HIS DIRECT TESTIMONY, MR. METCALF, WHEN
9 DISCUSSING CUSTOMERS WHO USE SINGLE CHANNEL PRIVATE
10 LINES TO TRANSFER DATA OR TO ESTABLISH A DEDICATED
11 VOICE PATH, ASSERTS "THERE IS NO REALISTIC
12 ALTERNATIVE TO THIS COMMON USE OF LOW CAPACITY,
13 RELATIVELY LOW SPEED PRIVATE LINE SERVICE." (PAGE
14 15, LINES 9-10) DO YOU AGREE?

15

16 A. NO. OTHER SERVICE PROVIDERS SUCH AS IXCS AND AAVS
17 OFFER PRIVATE LINE AND DATA SERVICES ON AN
18 INTRALATA BASIS IN FLORIDA. CARRIERS OFFER DATA
19 SERVICES AT SPEEDS RANGING FROM 2.4 KBPS ALL THE
20 WAY TO 56 KBPS IN ADDITION TO VOICE GRADE PRIVATE
21 LINE SERVICES THAT CAN REPLACE SOUTHERN BELL
22 PRIVATE LINE AND DATA SERVICES. AAVS OFFER 64 KBPS
23 VOICE GRADE EQUIVALENT AS WELL AS FRACTIONAL T-1
24 SERVICES THAT ARE COMPARABLE TO OUR SERVICES.

25

1 ADDITIONALLY, VSAT PRESENTS A VIABLE ALTERNATIVE
2 FOR LOW SPEED DATA TRANSMISSION APPLICATIONS SUCH
3 AS POINT-OF-SALE TRANSACTIONS INCLUDING CREDIT CARD
4 VERIFICATION. IF AN END USER DOES NOT HAVE
5 SUFFICIENT VOLUME TO COST JUSTIFY HIS OWN BYPASS
6 ALTERNATIVE, VENDORS WHO RESELL VSAT SERVICES
7 PRESENT ALTERNATIVES TO SOUTHERN BELL PRIVATE LINE
8 SERVICES. EXAMPLES INCLUDE MASTERCARD, WHICH
9 OFFERS POINT-OF-SALE SERVICES AND AVDATA, A VSAT
10 SERVICES RESELLER.

11

12 Q. MR. METCALF ON PAGE 17 (LINES 3-8) OF HIS DIRECT
13 TESTIMONY STATES, "AS A MATTER OF PRACTICALITY, THE
14 LOOP PORTION OF THE NETWORK IS EXTREMELY DIFFICULT,
15 IF NOT IMPOSSIBLE, FOR A COMPETITOR TO REPLACE.
16 SBT COMPETES IN THE TOLL MARKET WHICH DEPENDS ON
17 SPECIAL ACCESS SERVICES, INCLUDING THE LOOP
18 FACILITIES OF THE SERVICE. SBT SHOULD NOT BE
19 ALLOWED TO HAVE SUCH DISCRETIONARY POWER TO RAISE
20 THE PRICES OF AN ESSENTIAL FACILITY (THE LOCAL
21 LOOP) IN A MARKET IN WHICH IT ALSO ACTS AS A
22 COMPETITOR." IS HE RIGHT?

23

24 A. NO. WHILE IT IS TRUE THAT SOUTHERN BELL COMPETES
25 IN THE TOLL MARKET, SPECIAL ACCESS SERVICES ARE

1 USED PRIMARILY FOR LARGE BUSINESS CUSTOMERS SUCH AS
2 MR. METCALF'S CLIENTS. IT IS RELATIVELY EASY FOR A
3 COMPETITOR SELECTIVELY TO LOCATE FACILITIES TO
4 SERVE THOSE LARGE BUSINESS CUSTOMERS, AS AAVS HAVE
5 DONE IN SOME OF OUR METROPOLITAN AREAS. THEN IT
6 BECOMES RELATIVELY EASY FOR A COMPETITOR TO REPLACE
7 THE LOOP PORTION OF SPECIAL ACCESS FROM AN END USER
8 TO OUR CENTRAL OFFICE TO AN IXC POP WITH FACILITIES
9 FROM THE END USER DIRECTLY TO THE IXC POP. IF
10 INTERSTATE SPECIAL ACCESS COLLOCATION AND
11 INTERCONNECTION BECOME EFFECTIVE, MORE ALTERNATIVES
12 TO OUR SPECIAL ACCESS SERVICES WILL EXIST.

13

14 PART II: 1988 INCENTIVE REGULATION

15

16 Q. DO YOU AGREE WITH DR. KAHN'S ASSERTIONS ON PAGE 22
17 (LINES 10-19) AND PAGE 26 (LINES 21-23) OF HIS
18 DIRECT TESTIMONY THAT THE CURRENT REGULATORY
19 STRUCTURE PROVIDES YOU WITH ADEQUATE FLEXIBILITY TO
20 MEET COMPETITION IN THE MARKETPLACE?

21

22 A. NO. WHILE THERE IS NO QUESTION THAT OUR EXISTING
23 INCENTIVE REGULATION STRUCTURE IS MORE EFFECTIVE
24 THAN TRADITIONAL RATE BASE REGULATION, IT FALLS
25 SHORT OF WHAT IS NEEDED IN OUR CURRENT AND EVOLVING

1 MARKET ENVIRONMENT.
2
3 TODAY, SOUTHERN BELL'S MIX OF PRODUCT AND SERVICE
4 PRICES IS BASED TO A GREAT DEGREE ON A REGULATORY
5 PROCESS THAT PRODUCED SUBSIDIES AND PRICES
6 DETERMINED THROUGH ARBITRARY FALLOUTS FROM RATE
7 CASES OR EARNINGS ADJUSTMENTS. THIS HAS CREATED AN
8 OPPORTUNITY FOR COMPETITORS TO ENTER MARKETS AND
9 TARGET SERVICES WITH HIGH MARGINS AND HIGH DEMAND,
10 LITERALLY SKIMMING THE CREAM FROM SOUTHERN BELL'S
11 REVENUE STREAMS.
12
13 CERTAINLY, THIS ENVIRONMENT HAS ENCOURAGED NEW
14 ENTRY INTO EXISTING MARKETS. BUT, COMPETITION
15 SHOULD PROMOTE EFFICIENCY AMONG THE COMPETITORS.
16 THIS EFFICIENCY IS DISTORTED WHEN VENDORS CAN ENTER
17 THE MARKETPLACE, PRICE UNDER A LEC'S ARTIFICIALLY-
18 INFLATED PRICES, CREATED THROUGH REGULATORY
19 PROCEEDINGS RATHER THAN THE DYNAMICS OF THE MARKET,
20 AND GAIN MARKET SHARE. THIS IS NOT COMPETITION; IT
21 IS SIMPLY THE PLACEMENT OF REGULATORY BURDENS ON
22 ONE FIRM SO THAT COMPETITORS CAN COME IN AND TAKE
23 AWAY ITS CUSTOMERS. THIS KIND OF SO-CALLED
24 COMPETITION IS NOT IN THE PUBLIC INTEREST.
25

1 SOUTHERN BELL'S PLAN PROVIDES THE FRAMEWORK TO
2 BEGIN TO RECTIFY THIS MARKET IMPAIRMENT. THE PRICE
3 REGULATION PLAN PUTS IN PLACE A STRUCTURE WHICH
4 EMPOWERS THE COMPANY TO USE KNOWLEDGE OF THE MARKET
5 AS THE BASIS FOR DETERMINING PRICES. PRICES WOULD
6 BE BASED ON THE VALUE PLACED ON THE PRODUCTS AND
7 SERVICES. THIS FLEXIBILITY, ALTHOUGH LIMITED,
8 WOULD ENABLE THE COMPANY TO BECOME MORE EFFICIENT
9 IN THE MARKETPLACE, WHICH IN TURN BENEFITS THE
10 COMPANY AND CUSTOMER ALIKE.

11
12 WHAT SOUTHERN BELL'S PROPOSAL PROVIDES THAT IS NOT
13 CURRENTLY PROVIDED BY OUR PRESENT FORM OF INCENTIVE
14 REGULATION IS BEST SUMMED UP IN A JULY 15, 1992
15 ARTICLE, "THE CHALLENGE FOR INCENTIVE REGULATION,"
16 BY TERRENCE L. BARNICH, PRESENTLY A COMMISSIONER ON
17 THE ILLINOIS COMMERCE COMMISSION, (SEE EXHIBIT
18 AML-3). THAT ARTICLE CORRECTLY NOTES ON PAGE 16,
19 PARAGRAPH HEADED "REGULATORY SCHEMES: PRICE CAPS":

20
21 "THERE ARE FOUR PRIMARY WAYS PRICE CAPS SERVE
22 TO ENHANCE INCENTIVE REGULATORY MODELS.
23 FIRST, PRICE CAP INCENTIVE REGULATION PUTS
24 LONGER TERM INVESTMENTS IN COST-CUTTING
25 TECHNOLOGIES ON THE SAME LEVEL AS SHORTER TERM

1 SAVINGS. SECOND, PRICE CAPS WILL HELP MAKE
2 THE INCENTIVE REGULATION MORE CLOSELY RESEMBLE
3 THE DYNAMICS OF THE COMPETITIVE MARKET.
4 THIRD, A PRICE CAP MODEL WILL GIVE THE
5 REGULATED COMPANY SELLING A REGULATED SERVICE
6 THE FREEDOM TO MEET THE PRICES OF COMPETITORS
7 IN THE MARKETPLACE WHOSE ACTIVITIES ARE NOT
8 REGULATED. FINALLY, RATEPAYERS WILL
9 EXPERIENCE EITHER STABLE OR DECLINING PRICES
10 AS NEW TECHNOLOGIES ARE PUT INTO PLACE."

11

12 Q. ON PAGE 3 (LINES 15-17) AND PAGE 7 (LINES 1-3) OF
13 HIS TESTIMONY, DR. KAHN ARGUES THAT SOUTHERN BELL
14 HAS NOT PROVED A CAUSAL LINK BETWEEN INCENTIVE
15 REGULATION, ITS COST REDUCTIONS AND THE
16 INTRODUCTION OF NEW SERVICES AND SERVICE
17 ARRANGEMENTS. HE FURTHER CLAIMS IN HIS DIRECT
18 TESTIMONY ON PAGE 7 (LINES 17-19) THAT, IN FACT,
19 "THESE COST CUTTING ACTIONS WERE MORE LIKELY IN
20 RESPONSE TO COMPETITIVE MARKET PRESSURES THAN TO
21 NOMINAL CHANGES IN THE REGULATORY STRUCTURE." DO
22 YOU CONCUR WITH THIS OPINION?

23

24 A. NO. DR. KAHN WOULD LIKE US TO SEPARATE THE IMPACT
25 OF INCENTIVE REGULATION FROM THE PRESSURES OF THE

1 MARKETPLACE. IN FACT, THE TWO ARE INTERRELATED AND
2 SOUTHERN BELL DOES NOT ATTEMPT TO SEPARATE THEM.
3 THEY ARE PART OF THE SAME FABRIC. REGULATION IS
4 INTENDED TO BE A SURROGATE FOR COMPETITION AND BOTH
5 SHOULD PRODUCE SIMILAR OUTCOMES. AN EFFECTIVE
6 REGULATORY STRUCTURE SHOULD PROVIDE INCENTIVES
7 SIMILAR TO THE COMPETITIVE MARKET.

8
9 DR. KAHN WOULD ALSO LIKE THE COMMISSION TO IGNORE
10 SOME SIMPLE FACTS. IN 1988, WE SAID THAT, GIVEN
11 INCENTIVE REGULATION, SOUTHERN BELL WOULD BE
12 ENCOURAGED TO OPERATE MORE EFFICIENTLY AND WOULD
13 BRING TO THE MARKETPLACE NEW PRODUCTS AND SERVICES
14 MORE EXPEDITIOUSLY. WE HAVE MORE THAN ACCOMPLISHED
15 WHAT WE SAID WE WOULD DO.

16
17 THE FACT THAT WE HAVE WITHSTOOD THE NEGATIVE
18 CONSEQUENCES OF A MAJOR ECONOMIC RECESSION AND THE
19 ONSLAUGHT OF HURRICANE ANDREW WITHOUT REQUESTING
20 RATE RELIEF CONFIRMS SOUTHERN BELL'S SUCCESSFUL
21 PERFORMANCE DURING THE FIRST FIVE YEARS OF
22 INCENTIVE REGULATION. THIS PERFORMANCE IS FURTHER
23 SUPPORTED WITH QUANTITATIVE RESULTS WHICH BOTH
24 WALTER REID AND I HAVE PRESENTED IN OUR DIRECT
25 TESTIMONY FILED WITH THE FPSC ON JULY 15, 1992.

1

2 Q. DR. KAHN ASKS ON PAGE 15 (LINES 9-16) OF HIS DIRECT
3 TESTIMONY IF THE SAME RESULTS WOULD HAVE OCCURRED
4 UNDER TRADITIONAL RATE BASE REGULATION. WHAT IS
5 YOUR OPINION?

6

7 A. FOR THE REASONS I SET OUT ABOVE, IT IS DIFFICULT TO
8 IDENTIFY SPECIFIC PROGRAMS OR ACTIONS TAKEN BY THE
9 COMPANY, INCLUDING THE DEPLOYMENT OF TECHNOLOGY, AS
10 A DIRECT RESULT OF INCENTIVE REGULATION. IT IS
11 EQUALLY DIFFICULT TO SAY THAT IF THIS COMMISSION
12 HAD NOT ALLOWED SOUTHERN BELL TO OPERATE UNDER
13 INCENTIVE REGULATION, NONE OF OUR ACCOMPLISHMENTS
14 WOULD HAVE OCCURRED. WE CANNOT ANSWER THESE
15 QUESTIONS BECAUSE THE INCENTIVE REGULATION PLAN WAS
16 IN PLACE.

17

18 HOWEVER, IT IS CERTAIN THAT INCENTIVE REGULATION
19 HAS PROVIDED A REGULATORY STRUCTURE THAT ENCOURAGES
20 THE COMPANY TO EVOLVE A 100-YEAR OLD WAY OF
21 THINKING FROM MONOPOLY TO COMPETITION. THE
22 INCENTIVE REGULATION PLAN HAS CREATED AN
23 ENVIRONMENT IN WHICH PROCESS IMPROVEMENT, COST
24 REDUCTION, AND INNOVATION ARE PART OF OUR DAILY
25 ACTIVITIES AND TANGIBLE EVIDENCE DOES EXIST THAT

1 THIS REGULATORY ENVIRONMENT ENGENDERED SUCCESS.

2

3

4

PART III: PRICE REGULATION PLAN

5

6 Q. DR. KAHN ASSERTS ON PAGE 21 (LINES 18-20) OF HIS
7 DIRECT TESTIMONY THAT THE PROPOSED PRICE REGULATION
8 PLAN, WHILE BENEFICIAL TO SOUTHERN BELL, WILL NOT
9 BENEFIT THE RATEPAYER. HE FURTHER STATES THAT THE
10 RATEPAYER WOULD BE BETTER OFF WITH TRADITIONAL RATE
11 BASE REGULATION. IS HE CORRECT?

12

13 A. NO. THIS PLAN, LIKE THE 1988 PLAN, PROVIDES A
14 BALANCE OF BENEFITS FOR BOTH THE CUSTOMER AND THE
15 COMPANY, AGAIN WEIGHTED IN FAVOR OF THE CUSTOMER.
16 FOLLOWING IS A LIST OF SOME OF THOSE BENEFITS THAT
17 WOULD NOT BE PRESENT UNDER TRADITIONAL ROR
18 REGULATION:

19

20 1. GUARANTEES A 4% ANNUAL REDUCTION, RELATIVE TO
21 INFLATION, IN AVERAGE AGGREGATE REAL PRICES THROUGH
22 THE COMPANY'S UPFRONT PRODUCTIVITY COMMITMENT.

23

24 2. IMPLEMENTS A SERIES OF RATE REDUCTIONS, THE FIRST
25 IN 1993 PROMPTED BY THE COMMISSION'S ACTION IN OUR

1 PRIOR CASE OF \$47.5M, AND THEN FURTHER ANNUAL RATE
2 REDUCTIONS IN 1993 AND 1995 OF \$36M AND \$22M
3 RESPECTIVELY.
4
5 3. ENABLES SOUTHERN BELL TO INTRODUCE NEW PRODUCTS AND
6 SERVICES MORE QUICKLY TO MEET CUSTOMERS' NEEDS.
7
8 4. ENCOURAGES THE COMPANY, ITS OWNERS AND OTHERS TO
9 INVEST IN A FEATURE-RICH, TECHNOLOGICALLY-ADVANCED
10 TELECOMMUNICATIONS NETWORK, PROVIDING THE BASE FOR
11 SERVICES THAT MORE EFFECTIVELY MEET CUSTOMER NEEDS
12 AND IMPROVE THE QUALITY OF LIFE.
13
14 5. PROVIDES PRICING FLEXIBILITY WHICH ENABLES THE
15 COMPANY TO PRICE SERVICES MORE APPROPRIATELY AND TO
16 RESPOND MORE RAPIDLY TO SHIFTS IN THE COMPETITIVE
17 MARKETPLACE.
18
19 6. PLACES LESS RISK ON OUR CUSTOMERS BY MOTIVATING
20 SOUTHERN BELL TO OPERATE MORE EFFICIENTLY IN ORDER
21 TO MEET THE UPFRONT PRODUCTIVITY COMMITMENT.
22
23 7. ALLOWS FOR SHARING OF BENEFITS BETWEEN OUR
24 CUSTOMERS AND THE COMPANY IF THE COMPANY IS
25 SUCCESSFUL IN IMPROVING ITS EFFICIENCIES TO REACH

1 THE EARNINGS SHARING THRESHOLD.

2

3 8. CONTINUES TO EVOLVE OUR CORPORATE CULTURE TO A MORE
4 COMPETITIVE MINDSET THAT FOCUSES ON CUSTOMER
5 SATISFACTION.

6

7 EACH OF THESE BENEFITS IS PROVIDED BY SOUTHERN
8 BELL'S PROPOSED PLAN.

9

10 Q. DR. CHESSLER CLAIMS IN HIS DIRECT TESTIMONY THAT
11 BASIC SERVICES CONSIST OF ANY "SERVICES INVOLVING
12 ACCESS LINES" (PAGE 74, LINES 14-15). DO YOU AGREE
13 WITH THIS DEFINITION?

14

15 A. DR. CHESSLER'S DISCUSSION OF WHAT CONSTITUTES BASIC
16 SERVICE IS UNCLEAR AND DEMONSTRATES A LACK OF
17 KNOWLEDGE OF MY DIRECT TESTIMONY. HE APPEARS TO
18 DRAW SOME ANALOGY FROM THE FCC REGARDING INTERSTATE
19 BASIC SERVICES: "THE FCC LIMITS THE ACCESS CHARGE
20 APPLICABLE TO SINGLE LINE AND TWO LINE BUSINESSES,
21 SO PRESUMABLY THE FCC HAS HIGHER ACCESS CHARGES FOR
22 MULTI-LINE BUSINESS CUSTOMERS (KEY SYSTEMS AS WELL
23 AS PBXS). THUS, THE FCC PRESUMABLY CONSIDERS THEM
24 NON-BASIC." (PAGE 74, LINES 19-23)

25

1 WE ARE LEFT TO DETERMINE: 1) WHAT THIS HAS TO DO
2 WITH THE PROPOSED PRICE REGULATION PLAN, OR WITH
3 FLORIDA AT ALL; 2) HOW SPECIAL ACCESS IS RELATED TO
4 THE FCC ACCESS CHARGES (BY WHICH PRESUMABLY DR.
5 CHESSLER MEANS THE FCC SUBSCRIBER LINE CHARGE); AND
6 3) HOW HIGHER FEDERAL ACCESS CHARGES NECESSARILY
7 RENDER A SERVICE NON-BASIC.

8
9 DR. CHESSLER'S DISCUSSION OF BASIC SERVICES REVEALS
10 HIS CONFUSION ON THE ISSUE. DR. CHESSLER SAYS IN
11 HIS DIRECT TESTIMONY THAT "THERE IS NO PRECISE
12 DEFINITION OF A BASIC SERVICE", BUT THEN ASSERTS
13 THAT SERVICES INVOLVING ACCESS LINES ARE CONSIDERED
14 BASIC, PBX LINES ARE CONSIDERED "BASIC", AND "ANY
15 BASIC SERVICE CAN HAVE RATE ELEMENTS WHICH APPEAR
16 NOT TO BE BASIC" (PAGE 75, LINES 2-3). IN ONE
17 CONTEXT HE DEFINES BASIC SERVICES AS "ESSENTIAL"
18 (PAGE 77, LINES 8-25 AND PAGE 78, LINES 1-20), IN
19 ANOTHER EXAMPLE BASIC IS DEFINED AS SUBJECT TO THE
20 CUSTOMER'S ABILITY TO USE THE SERVICE (PAGE 78,
21 LINES 9-14) AND IN YET ANOTHER EXAMPLE BASIC IS
22 CHARACTERIZED AS SERVICES HAVING LIMITED
23 COMPETITION (PAGE 76, LINES 15-20). DR. CHESSLER
24 SEEMS TO HAVE NO DEFINITION OF BASIC SERVICE.

25

1 IT SHOULD BE NOTED THAT DR. CHESSLER'S DISCUSSION
2 OF "BASIC" SERVICE AS ESSENTIAL IS SO BROAD IT
3 COULD INCLUDE EVERYTHING -- A BUSINESS CUSTOMER
4 MIGHT THINK DATA SERVICE, HUNTING, AND WATS ARE ALL
5 ESSENTIAL; ONE RESIDENTIAL CUSTOMER MAY THINK
6 CUSTOM CALLING IS ESSENTIAL WHEREAS ANOTHER MAY
7 THINK TOUCHSTAR OR A DATA LINE TO WORK AT HOME IS
8 ESSENTIAL. THIS EXPANSIVE DEFINITION WOULD BE
9 IMPRACTICAL.

10

11 IT IS IRONIC THAT SOME NOW WANT BASIC SERVICE TO
12 INCLUDE FEATURES AND OPTIONS THAT NEW TECHNOLOGY
13 HAS MADE POSSIBLE, AND AT THE SAME TIME THEY
14 DISCOURAGE INVESTMENT IN NEW TECHNOLOGY CLAIMING
15 CUSTOMERS ONLY WANT PLAIN OLD TELEPHONE SERVICE.

16

17 NONETHELESS, THE DEFINITION OF THE BASIC CATEGORY
18 IN SOUTHERN BELL'S PROPOSED PLAN IS CLEAR. IT IS
19 ESSENTIALLY THE CUSTOMER LOOP, DIAL TONE AND
20 ACCESS. THIS IS EXPLAINED IN MY DIRECT TESTIMONY
21 AND IS ENUMERATED IN LOMBARDO (DIRECT) EXHIBIT
22 NUMBER 2.

23

24 MORE IMPORTANTLY, THE PURPOSE OF THE CATEGORIES IN
25 THIS PLAN IS TO CONSTRAIN SOUTHERN BELL'S PRICING

1 FLEXIBILITY BEYOND THAT WHICH IS ALREADY PROVIDED
2 BY THE PRICE REGULATION INDEX, AND TO TARGET THIS
3 CONSTRAINT TO THOSE SERVICES THAT MAY NEED PRICE
4 PROTECTION. THE FLORIDA STATUTE GUIDED US IN THIS
5 DEFINITION BY SPECIFICALLY DEFINING BASIC SERVICE
6 AND TARGETING IT FOR PROTECTION. THUS, WE PLACE A
7 TIGHTER PRICING CONSTRAINT, 5%, ON BASIC SERVICES.
8 ANY SERVICE THAT WAS NOT BASIC WAS CATEGORIZED AS
9 NON-BASIC. NON-BASIC SERVICES ARE OPTIONAL
10 SERVICES OR SERVICES WHICH CAN BE PROVIDED BY
11 ANOTHER VENDOR. THUS, THEY DO NOT NEED AS MUCH
12 PRICE CONSTRAINT.

13

14 Q. IN THEIR DIRECT TESTIMONIES, SEVERAL OF THE
15 INTERVENORS HAVE CHALLENGED SOUTHERN BELL'S REQUEST
16 FOR ADDITIONAL FLEXIBILITY. MR. KING STATES (PAGE
17 8, LINES 8-9) THAT SOUTHERN BELL'S 5% AND 20%
18 FLEXIBILITY "...REPRESENTS VIRTUAL DEREGULATION OF
19 SOUTHERN BELL'S RATES." MR. CRESSE (PAGE 13, LINES
20 9-11) REMARKS THAT THE PLAN, "...DELEGATES TOO MUCH
21 FLEXIBILITY TO SOUTHERN BELL IN RATE DESIGN." WHAT
22 IS YOUR RESPONSE?

23

24 A. SOUTHERN BELL'S PROPOSED PLAN INCLUDES PRICING
25 FLEXIBILITY THAT WOULD ALLOW IT TO BEGIN TO ALIGN

1 PRICES TO THE CURRENT MARKET. WE HAVE CONSISTENTLY
2 SAID THAT THE PRICES OF SOME SERVICES, SUCH AS
3 SWITCHED ACCESS AND SELECTED BUSINESS SERVICES,
4 NEED TO BE LOWERED TO MORE CLOSELY REFLECT MARKET
5 OR COST, AS WOULD OCCUR IN A COMPETITIVE MARKET.
6 WE HAVE PROPOSED REDUCTIONS FOR THESE SERVICES IN
7 OUR PLAN. THE PRICE REGULATION PLAN ITSELF
8 PROVIDES A MECHANISM TO ACHIEVE THIS REASONABLE
9 RESULT GRADUALLY, WITH A FLOOR OF LONG RANGE
10 INCREMENTAL COST AND A CEILING OF 5% PER YEAR FOR
11 BASIC SERVICES, 20% PER YEAR FOR NON-BASIC
12 SERVICES.

13
14 WHAT WE HAVE REQUESTED IS FAR FROM VIRTUAL
15 DEREGULATION. WE STILL MUST PROVIDE COST SUPPORT
16 FOR NEW SERVICES; WE STILL MUST COVER LONG RANGE
17 INCREMENTAL COSTS WITH OUR PRICES; WE STILL MUST
18 FILE TARIFFS TO IMPLEMENT NEW SERVICES; OPPONENTS
19 TO OUR PRICES OR SERVICES STILL HAVE THE RIGHT TO
20 PETITION THE COMMISSION TO CHALLENGE OUR ACTIONS.
21 IN OTHER WORDS, REGULATION STILL IS A MAJOR PART OF
22 SOUTHERN BELL'S PRICING PROCESS, UNLIKE THAT OF OUR
23 COMPETITORS.

24

25 Q. IN HIS DIRECT TESTIMONY, MR. GUEDEL STATES THAT

1 "CURRENT BELLSOUTH PRICING DOES NOT SUPPORT PRICE
2 CAP INCENTIVES. FOR EXAMPLE, SWITCHED ACCESS
3 CHARGES ARE CURRENTLY PRICED WELL IN EXCESS OF
4 COSTS." (PAGE 4, LINES 2-4) PLEASE COMMENT.

5

6 A. SOCIAL PRICING HAS RESULTED IN SOME SERVICES BEING
7 PRICED SUBSTANTIALLY ABOVE COST TO SUPPORT LOCAL
8 EXCHANGE SERVICE. HOWEVER, IT IS SOUTHERN BELL'S
9 INTENT THROUGH THE PRICE REGULATION PLAN TO MORE
10 CLOSELY ALIGN ITS PRICES WITH COSTS.

11

12 SWITCHED ACCESS IS A GOOD EXAMPLE OF AN AREA IN
13 WHICH THE COMPANY CONTINUES TO MOVE PRICING MORE
14 TOWARD COST. AT&T SEEMS TO HAVE FORGOTTEN THAT
15 SOUTHERN BELL-FLORIDA HAS AGGRESSIVELY TAKEN THE
16 INITIATIVE TO REDUCE ACCESS RATES, RESULTING IN A
17 REDUCTION OF GREATER THAN 42% SINCE 1987. OUR
18 RATES ARE CURRENTLY THE LOWEST IN FLORIDA. THE
19 PRICE REGULATION PLAN PROVIDES A MECHANISM WHICH
20 WILL ALLOW FOR A GRADUAL CONTINUANCE OF THIS
21 EFFORT.

22

23 Q. ARE YOU SURPRISED THAT AT&T TAKES THE POSITION THAT
24 PRICE CAP REGULATION IS INAPPROPRIATE FOR SOUTHERN
25 BELL?

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

A. YES. MR. GUEDEL'S POSITION ON THE APPROPRIATENESS OF PRICE REGULATION IS ASTOUNDING, GIVEN AT&T'S PUBLICLY-STATED VIEWS ON THIS FORM OF REGULATION:

"...PRICE CAP REGULATION WOULD BE FAR PREFERABLE TO RATE OF RETURN REGULATION, PROVIDING CONSUMERS SUBSTANTIAL BENEFITS THAT RATE OF RETURN REGULATION DENIES TO THEM. CUSTOMERS WOULD NOT ONLY BE AFFORDED SIGNIFICANT NEW PROTECTION AGAINST PRICE INCREASES, BUT PRICES WOULD IN ALL PROBABILITY DECLINE MORE (OR RISE LESS) THAN UNDER RATE OF RETURN REGULATION. A PROPERLY DESIGNED PRICE CAP SYSTEM WILL RELEASE THE INCENTIVES TO INNOVATION AND EFFICIENCY THAT ARE SUPPRESSED BY RATE OF RETURN REGULATION, INCREASING THE AVAILABILITY OF NEW SERVICES AND LOWERING PRICES. PRICE CAPS ALLOWING RATES TO BE SET BY COMPETITIVE FORCES, RATHER THAN ARBITRARY COST ALLOCATIONS, WILL ALSO INCREASE EFFICIENCY AND AVOID THE WASTE OF MISALLOCATED RESOURCES, WHILE BETTER PROTECTING CONSUMERS AGAINST ANY PERCEIVED RISK OF COST-SHIFTING AND CROSS-SUBSIDY. (COMMENTS OF AT&T, IN THE

1 MATTER OF POLICY AND RULES CONCERNING RATES
2 FOR DOMINANT CARRIERS, FEDERAL COMMUNICATIONS
3 COMMISSION, CC DOCKET 87-313, OCTOBER 19,
4 1987, PAGE iii)

5
6 "AT&T CONTINUES TO BELIEVE THAT INCENTIVE
7 REGULATION OF THE LECS' INTERSTATE ACCESS
8 CHARGES IS APPROPRIATE, AND THAT A PROPERLY
9 STRUCTURED SYSTEM OF PRICE CAP REGULATION
10 WOULD PROVIDE SUBSTANTIAL ADVANTAGES OVER RATE
11 OF RETURN REGULATION." (RESPONSE OF AT&T, IN
12 THE MATTER OF POLICY AND RULES CONCERNING
13 RATES FOR DOMINANT CARRIERS, FEDERAL
14 COMMUNICATIONS COMMISSION, CC DOCKET 87-313,
15 JUNE 8, 1990, PAGE i)

16
17 Q. MR. GUEDEL ASSERTS ON PAGE 5 (LINES 20-25) OF HIS
18 DIRECT TESTIMONY THAT PRICES SHOULD NOT BE CAPPED.
19 INSTEAD WE SHOULD "...RECAST THE SERVICES (OR THE
20 BASIC NETWORK FUNCTIONS WHICH MAKE UP EXISTING
21 SERVICES) UNDER A RATE DESIGN THEORY THAT FEATURES
22 UNBUNDLED, UNIVERSALLY AVAILABLE RATE STRUCTURES
23 AND PRICES WHICH ARE BASED UPON THEIR UNDERLYING
24 COSTS." PLEASE RESPOND.

25

1 A. MR. GUEDEL'S RECOMMENDATION IS A RED HERRING. THE
2 RECASTING OF SERVICES, BASIC NETWORK FUNCTIONS, AND
3 RATE DESIGN THEORIES IN GENERAL ARE NOT
4 INCONSISTENT WITH PRICE REGULATION OR INCENTIVE
5 REGULATION. WHAT HE FAILS TO UNDERSTAND IS THAT
6 RATE DESIGN CAN BE ACHIEVED UNDER VARIOUS FORMS OF
7 REGULATION. THE FORM OF REGULATION DOES NOT DRIVE
8 UNBUNDLING, RATE STRUCTURES OR RATE DESIGN.

9
10 MOREOVER, PRICE REGULATION ACHIEVES PRECISELY THE
11 PRICES BASED ON UNDERLYING COSTS THAT MR. GUEDEL
12 SEEKS BECAUSE IT ALLOWS THE COMPANY TO MOVE AWAY
13 FROM ARTIFICIAL PRICE RELATIONSHIPS THAT CONTAIN
14 EMBEDDED SUBSIDIES. THE FUNDAMENTAL CONCEPT OF
15 PRICE REGULATION, WHICH AT&T HAS RECOGNIZED IN
16 PUBLIC STATEMENTS, ALLOWS THE COMPANY TO MOVE
17 TOWARD A RATIONAL SET OF PRICES THAT DO NOT CONTAIN
18 THOSE EMBEDDED INEFFICIENCIES. IN AT&T'S WORDS:

19
20 "THE FOCUS ON 'HOW CARRIERS RUN THEIR
21 BUSINESS' IS ITSELF THE FUNDAMENTAL FLAW IN
22 RATE OF RETURN REGULATION. IT IS THAT FOCUS
23 THAT DISCOURAGES EFFICIENCY AND INNOVATION BY
24 REDUCING MARKET INCENTIVES TO IMPROVED
25 PERFORMANCE. IT IS THAT FOCUS THAT DISTORTS

1 PRICES AND MISALLOCATES RESOURCES BY FORCING
2 CARRIERS TO SET PRICES ON THE BASIS OF
3 ARBITRARY COST ALLOCATIONS RATHER THAN TRUE
4 ECONOMIC COSTS. IT IS THAT FOCUS, IN SHORT,
5 THAT DENIES CONSUMERS THE BENEFITS REGULATION
6 IS INTENDED TO ACHIEVE.

7
8 ...A FEW COMMENTERS, OSTENSIBLY CONCERNED
9 ABOUT CROSS-SUBSIDY IN THE PRICING OF
10 INDIVIDUAL SERVICES, RECOMMEND THAT SEPARATE
11 PRICE CAPS BE PLACED ON EACH AND EVERY ONE OF
12 THE THOUSANDS OF RATE ELEMENTS COMPRISING
13 AT&T'S SERVICES. SUCH AN EXTREME APPROACH
14 WOULD BE A REGULATORY STEP BACKWARDS, FREEZING
15 INTO THE CAPS ALL OF THE PRICING
16 INEFFICIENCIES CAUSED BY EXISTING REGULATION
17 AND ALLOWING AT&T EVEN LESS FLEXIBILITY TO
18 RESPOND TO MARKET FORCES THAN IT HAS TODAY."
19 (COMMENTS OF AT&T, IN THE MATTER OF POLICY AND
20 RULES CONCERNING RATES FOR DOMINANT CARRIERS,
21 FEDERAL COMMUNICATIONS COMMISSION, CC DOCKET
22 87-313, DECEMBER 4, 1987, PP. 2-3)

23

24 Q. MR. KING PROPOSES ON PAGE 9 (LINES 12-15) OF HIS
25 DIRECT TESTIMONY THAT THE TWO SOURCES OF TOTAL

1 REVENUE ADJUSTMENTS (PRICE REGULATION INDEX ANNUAL
2 ADJUSTMENT AND EARNINGS SHARING) BOTH BE TREATED AS
3 PERMANENT RATE REDUCTIONS. HE SUGGESTS
4 CALIFORNIA'S METHOD OF SURCREDIT OR SURCHARGES.
5 PLEASE COMMENT.

6
7 A. MR. KING IMPLIES THAT CALIFORNIA APPLIES BOTH PRICE
8 REGULATION INDEX ADJUSTMENTS AND SHARED EARNINGS AS
9 PERMANENT RATE ADJUSTMENTS. WE AGREE THAT THE
10 CALIFORNIA PLAN PROPOSES THAT PRICE REGULATION
11 INDEX ADJUSTMENTS BE APPLIED AS RATE CHANGES.

12
13 HOWEVER, THE CALIFORNIA COMMISSION DID SPECIFICALLY
14 STATE ITS INTENT THAT SHARED EARNINGS NOT RESULT IN
15 PERMANENT RATE REDUCTIONS IN ITS DECISION
16 89-10-031, PAGE 191:

17
18 "WE CONCLUDE THAT DRA'S PROPOSAL TO RETURN
19 SHARED EARNINGS TO RATEPAYERS THROUGH
20 PERMANENT RATE REDUCTIONS IS BASED ON A FALSE
21 ASSUMPTION REGARDING THE STABILITY OF
22 PRODUCTIVITY GROWTH RATES AND SHOULD NOT BE
23 ADOPTED. ON THE OTHER HAND, THE PROPOSAL MADE
24 BY PACIFIC AND GTEC THAT A REFUND BASED ON
25 OVEREARNINGS IN THE SINGLE YEAR BE MADE IS

1 REASONABLE AND IS ADOPTED BECAUSE IT WOULD
2 MAINTAIN AN INCENTIVE TO TAKE FULL ADVANTAGE
3 OF TEMPORARY PRODUCTIVITY IMPROVEMENTS AND
4 FURTHER TO IMPLEMENT PRODUCTIVITY IMPROVEMENTS
5 AS QUICKLY AS FEASIBLE."

6

7 Q. HOW DOES SOUTHERN BELL PROPOSE THESE TWO SOURCES OF
8 REVENUE CHANGES (PRICE REGULATION INDEX ANNUAL
9 ADJUSTMENT AND EARNINGS SHARING) BE TREATED?

10

11 A. IN THE CASE OF REDUCTIONS OR INCREASES DUE TO THE
12 ANNUAL PRICE REGULATION INDEX ADJUSTMENT, SOUTHERN
13 BELL PROPOSES THAT SUCH CHANGES BE PASSED ON TO
14 CUSTOMERS THROUGH PERMANENT RATE CHANGES. THESE
15 CHANGES SHOULD REFLECT PRICES THAT ARE BASED ON THE
16 MARKET CIRCUMSTANCES WHICH EXIST AT THAT TIME.

17

18 IN THE CASE OF EARNINGS SHARING, SOUTHERN BELL
19 PROPOSES ONE TIME BENEFITS, E.G. REFUNDS. IN
20 ADDITION TO THE RATIONALE GIVEN BY THE CALIFORNIA
21 COMMISSION, IT SHOULD BE POINTED OUT THAT SOUTHERN
22 BELL'S RATES WILL ALREADY REFLECT (THROUGH THE
23 PRODUCTIVITY OFFSET) HISTORICAL EFFICIENCIES.
24 SOUTHERN BELL MUST THEN EXCEED THE 4% PRODUCTIVITY
25 HURDLE TO GENERATE ADDITIONAL EARNINGS. THUS, ANY

1 "EXCESS EARNINGS" ARE THE RESULT OF ADDITIONAL
2 EFFICIENCIES, NOT RATES AS MR. KING SUGGESTED.

3

4 Q. IN EACH OF THEIR DIRECT TESTIMONIES, DR. KAHN (PAGE
5 28, LINES 1-5) AND MR. KING (PAGE 4, LINES 1-5)
6 STATE THAT THEY BELIEVE OUR RATES AND EARNINGS
7 RANGE SHOULD BE RESET. DR. KAHN SUMMARIZES THIS BY
8 SAYING, "WITH THE SOUTHERN BELL PROPOSAL, EVEN IF
9 THE COMPANY IS NOT SUCCESSFUL IN IMPROVING ITS RATE
10 OF PRODUCTIVITY ADVANCE, IT WILL CONTINUE TO EARN
11 AT ITS CURRENT LEVEL WHICH IS IN EXCESS OF ITS COST
12 OF CAPITAL. THIS GUARANTEE FOR HIGHER EARNINGS HAS
13 NO BUILT IN INCENTIVE EFFECTS." DO YOU AGREE?

14

15 A. NO. LET ME EXPLAIN BY DISSECTING DR. KAHN'S
16 ASSERTION.

17

18 1.) "EVEN IF THE COMPANY IS NOT SUCCESSFUL IN IMPROVING
19 ITS RATE OF PRODUCTIVITY ADVANCE, IT WILL CONTINUE
20 TO EARN AT ITS CURRENT LEVEL,"

21

22 DR. KAHN MUST NOT HAVE READ ALL OF SOUTHERN BELL'S
23 PROPOSAL. SOUTHERN BELL HAS PROPOSED A FIRST YEAR
24 ANNUAL REVENUE REDUCTION OF \$36M, WITH AN
25 ADDITIONAL REVENUE REDUCTION OF \$22M PROPOSED IN

1 1995. THE COMBINATION OF THESE TWO REVENUE
2 REDUCTIONS IS EQUIVALENT TO APPROXIMATELY 175 BASIS
3 POINTS OR 1.75% ROE. IN ORDER FOR SOUTHERN BELL TO
4 OFFSET THIS 175 BASIS POINT EARNINGS REDUCTION IT
5 MUST SIGNIFICANTLY IMPROVE ITS PRODUCTIVITY.

6

7 2.) "WHICH IS IN EXCESS OF ITS COST OF CAPITAL."

8

9 SOUTHERN BELL'S COST OF CAPITAL CONTINUES TO REMAIN
10 IN THE RANGE RECOGNIZED BY THIS COMMISSION IN 1988,
11 WHEN RATES WERE SET AT 13.2%. (SEE BILLINGSLEY
12 TESTIMONY.) HOWEVER, EVEN WITH THE HYPOTHESIS THAT
13 OUR COST OF CAPITAL HAS DROPPED, THE COMMISSION
14 SHOULD NOT REDUCE SOUTHERN BELL'S EARNINGS, RATE
15 SETTING POINT, EARNINGS SHARING POINT OR EARNINGS
16 RANGE.

17

18 TO REDUCE OUR EARNINGS OR RATES WOULD DESTROY THE
19 INCENTIVES INCLUDED IN OUR CURRENT INCENTIVE
20 REGULATION PLAN. AS SOUTHERN BELL WITNESS LACHER
21 CITES IN HIS DIRECT TESTIMONY:

22

23 "AS STATED BY DOD/FEA'S WITNESS KING IN THE
24 FEBRUARY 1992 HEARING BEFORE THIS COMMISSION:
25 'WHAT I'M SUGGESTING IS THAT INCENTIVE

1 REGULATION HAS DONE ITS JOB. IT HAS
2 ENCOURAGED THE COMPANY TO MAINTAIN A HIGH RATE
3 OF RETURN IN THE FACE OF A RECESSION. AND
4 THAT IS (A) DEMONSTRATION OF THE BENEFIT OF
5 INCENTIVE REGULATION.' WHILE I WOULD NOT
6 CHARACTERIZE OUR EARNINGS AS HIGH,
7 IMPROVEMENTS IN OUR ABILITY TO MANAGE
8 EXPENSES HAVE CONTRIBUTED SIGNIFICANTLY TO
9 OUR EARNINGS RESULTS." (PAGE 13, LINES 11-22)

10

11 DURING THE PAST FOUR YEARS WE HAVE IMPLEMENTED MANY
12 ACTIONS WHICH HAVE HAD BOTH SHORT AND LONG TERM
13 POSITIVE EFFECTS ON OUR BUSINESS. SOME OF THESE
14 EFFORTS HAVE ALREADY PRODUCED RESULTS WHILE OTHERS
15 HAVE NOT YET BEGUN THEIR PAY BACK. THESE ACTIONS
16 HAVE ENABLED US TO OVERCOME MAJOR NEGATIVE ECONOMIC
17 SETBACKS: THE RECESSION AND HURRICANE ANDREW. IF
18 THE REVENUE LOSSES ATTRIBUTABLE TO THESE NEGATIVE
19 EVENTS WERE TAKEN INTO CONSIDERATION THEY WOULD
20 MORE THAN OFFSET ANY REDUCTION IN OUR COST OF
21 CAPITAL. WE OVERCAME THESE SETBACKS NOT THROUGH
22 ANY REGULATORY RELIEF, BUT INSTEAD THROUGH THE
23 EFFORTS OF THE 17,000 SOUTHERN BELL EMPLOYEES IN
24 THIS STATE. TO REDUCE OUR EARNINGS AT THIS POINT,
25 IN ADDITION TO WHAT WE HAVE ALREADY RECOMMENDED,

1 WOULD BE PUNITIVE AND WOULD COMPLETELY UNDERMINE
2 THE NEW REGULATORY ENVIRONMENT WHICH THIS
3 COMMISSION PUT IN PLACE IN 1988.

4
5 THIS CONCEPT IS RECOGNIZED ON PAGE 12 OF ORDER
6 NUMBER 92-0524-FOF-TL, DATED JUNE 18, 1992:

7
8 "THE PURPOSE OF AN INCENTIVE PLAN IS TO
9 ENCOURAGE A COMPANY TO INSTITUTE EFFICIENCIES
10 BY ALLOWING SHAREHOLDERS TO SHARE IN THE
11 PROFITS THAT RESULT FROM GREATER OPERATING
12 EFFICIENCIES. A DECISION TO PLACE MONEY
13 SUBJECT TO REFUND WOULD CAUSE COMPANIES TO BE
14 CONCERNED THAT THE COMMISSION AND OTHER
15 INTERESTED PARTIES WILL USE SHIFTS IN THE
16 CAPITAL MARKET TO CLAIM ALL OF THE SAVINGS FOR
17 THE RATEPAYERS, THUS NEGATING ANY INCENTIVE TO
18 INSTITUTE EFFICIENCIES."

19
20 THE DYNAMICS OF THE CAPITAL MARKET SHOULD BE
21 REVIEWED, BUT IT SHOULD NOT CREATE CHANGES TO THE
22 PARAMETERS OF THE PLAN UNLESS EITHER THE CUSTOMER
23 OR COMPANY IS BEING TREATED UNFAIRLY. THIS HAS NOT
24 BEEN THE CASE. THE NEW PLAN INTRODUCES YET ANOTHER
25 SENSITIVITY PARAMETER, THE PRICE REGULATION INDEX

1 AND ITS 4% COMMITMENT TO REAL RATE REDUCTIONS.
2 THIS CHANGE ALONE, NOT TO MENTION THE EXPECTED
3 GROWTH OF COMPETITION, SIGNIFICANTLY INCREASES
4 SOUTHERN BELL'S RISK. CONSIDERING THESE NEW
5 FACTORS, FURTHER CHANGES IN THE SHARING AND
6 EARNINGS STRUCTURE ARE NOT WARRANTED.

7

8 3.) "THIS GUARANTEE FOR HIGHER EARNINGS HAS NO BUILT IN
9 INCENTIVE EFFECTS."

10

11 FIRST, THERE IS NO "GUARANTEE FOR HIGHER EARNINGS."
12 THIS IS AN ABSURD STATEMENT TO MAKE IN THE FACE OF
13 OUR PROPOSED 175 BASIS POINT ANNUAL RATE REDUCTION
14 AND A COMMITMENT TO ANNUAL 4% REAL RATE REDUCTIONS.
15 IN ADDITION, DR. KAHN HAS NOT TAKEN INTO ACCOUNT
16 THE INCREASE OF COMPETITION OR THE PROSPECT OF MANY
17 OTHER UNKNOWNNS THE LIKE OF WHICH OCCURRED THROUGH
18 THE FIRST FIVE YEARS OF OUR CURRENT PLAN. THE
19 MULTIPLE DEMANDS OF THESE FINANCIAL PRESSURES
20 PROVIDE ADEQUATE "INCENTIVE" FOR FURTHER
21 PRODUCTIVITY AND OPERATIONS IMPROVEMENT.

22

23 Q. ON PAGES 10 (LINES 26-27) AND 11 (LINES 1-3) OF HIS
24 DIRECT TESTIMONY, MR. KING AGREES THAT THE PRICE
25 REGULATION PLAN PROPOSAL BE ADOPTED "IN PERPETUITY"

1 WITH A REVIEW EVERY FOUR YEARS. HOWEVER HE
2 PROPOSES A TRIGGER MECHANISM TO INITIATE A
3 RECONSIDERATION OF THE RATE OF RETURN BANDS. IT
4 WOULD BE TIED TO AN INDEX OF INTEREST RATES. DO
5 YOU AGREE WITH SUCH A TRIGGER MECHANISM?

6

7 A. NO. WE DID NOT FEEL IT NECESSARY TO INCLUDE
8 ANOTHER MECHANISM IN THE PLAN. HOWEVER, IF A
9 TRIGGER MECHANISM IS USED, IT SHOULD BE STRUCTURED
10 MORE IN LINE WITH WHAT MR. BILLINGSLEY DISCUSSES IN
11 HIS REBUTTAL TESTIMONY.

12

13 FIRST, A LONG TERM Aaa PUBLIC UTILITY BOND YIELD,
14 SHOULD BE USED. ALSO, A CHANGE OF AT LEAST 200
15 BASIS POINTS WHICH IS SUSTAINED FOR SIX MONTHS
16 WOULD BE ROUGHLY COMPARABLE TO THE 100 BASIS POINT
17 CHANGE IN THE COST OF EQUITY THAT THIS COMMISSION
18 HAS TYPICALLY USED AS A CRITERION TO ADJUST RATE OF
19 RETURN PARAMETERS.

20

21 FURTHERMORE, IF THIS MECHANISM IS USED, THE
22 COMMISSION SHOULD DETERMINE IN THIS PROCEEDING WHAT
23 CHANGE OR ACTION IS TO OCCUR AS A RESULT OF THE
24 TRIGGER.

25

1 Q. DO YOU AGREE WITH MR. KING'S STATEMENT ON PAGE 6
2 (LINES 22-24) OF HIS DIRECT TESTIMONY THAT, "...THE
3 INSTITUTION OF A PRODUCTIVITY OFFSET CONSTRAINT ON
4 SOUTHERN BELL MAY ADD FURTHER RISKS TO THE
5 COMPANY'S OPERATIONS, AND THEREFORE I BELIEVE THE
6 50/50 SHARING ALTERNATIVE IS ACCEPTABLE."

7

8 A. YES. THERE SHOULD ALWAYS BE A BALANCE BETWEEN RISK
9 AND THE POTENTIAL FOR REWARD. SOUTHERN BELL'S
10 PROPOSED PLAN INCLUDES SIGNIFICANT RISKS NOT
11 INCLUDED IN TRADITIONAL RATE BASE REGULATION,
12 INCLUDING:

13

14 1. BOTTOM OF EARNINGS RANGE LOWERED BY 70 BASIS POINTS
15 BEFORE RATE RELIEF CAN BE REQUESTED.

16

17 2. GUARANTEED ANNUAL ABSORPTION OF 4% OF INFLATION
18 DESPITE FACTORS WHICH COULD RESULT IN A SIGNIFICANT
19 IMPACT ON EARNINGS, E.G. A RECESSION, A NATURAL
20 DISASTER, OR THE RATE OF GROWTH OF COMPETITION.

21

22 3. COMMITMENT TO UPFRONT PERMANENT RATE REDUCTIONS,
23 WHICH WILL REQUIRE THE COMPANY TO ACHIEVE EARNINGS
24 TO MEET THOSE REQUIREMENTS EVEN BEFORE THE
25 PRODUCTIVITY HURDLE.

1

2 Q. MR. CRESSE'S DIRECT TESTIMONY ON PAGE 13 (LINES
3 18-21) STATES THAT CUSTOMERS SHOULD BE GIVEN THE
4 OPPORTUNITY TO BE HEARD ON PRICE CHANGES BEFORE
5 THEY GO INTO EFFECT, AND THAT PRESUMPTIVE APPROVAL
6 SHOULD BE REJECTED. WHY DOES THE COMPANY BELIEVE
7 PRESUMPTIVE APPROVAL IS NECESSARY?

8

9 A. AS THE TELECOMMUNICATIONS ENVIRONMENT CONTINUES TO
10 BECOME INCREASINGLY COMPETITIVE, THE COMMISSION
11 MUST RECOGNIZE THE NEED FOR THE COMPANY TO
12 IMPLEMENT PRICE CHANGES IN A TIMELY MANNER TO MEET
13 THE DEMANDS OF THE MARKETPLACE. MR. CRESSE STATES
14 IN HIS TESTIMONY THAT, "...60 DAYS IS AN
15 APPROPRIATE AND REASONABLE AMOUNT OF RESPONSE
16 TIME..." (PAGE 4) YET HE DOES NOT POINT OUT THAT 60
17 DAYS AND RESULTANT DELAYS CAN CLOSE COMPETITIVE
18 WINDOWS OF OPPORTUNITY FOR THE COMPANY.

19

20 NOTHING IN THE PLAN PREVENTS CUSTOMERS FROM
21 OBJECTING TO A PRICE CHANGE; HOWEVER, THE PLAN
22 ALLOWS SUCH PRICE CHANGES TO OCCUR WITHIN THE PRE-
23 SET LIMITS. AN AGGRIEVED CUSTOMER MAY MAKE HIS
24 CASE TO THE COMMISSION REGARDING A PRICE.
25 PRESUMPTIVELY VALID PRICE CHANGES ALLOW THE

1 COMMISSION TO STREAMLINE THE REGULATORY PROCESS,
2 WHILE RETAINING THE AUTHORITY TO HEAR COMPLAINTS
3 AND ACT IN THE PUBLIC INTEREST SHOULD A PRICE
4 CHANGE BE DETERMINED TO BE INAPPROPRIATE.

5

6 Q. WHAT OTHER ASPECTS OF MR. CRESSE'S TESTIMONY DO YOU
7 WISH TO ADDRESS IN YOUR REBUTTAL TESTIMONY?

8

9 A. IN MR. CRESSE'S DIRECT TESTIMONY (PAGE 9, LINES
10 9-26 AND PAGE 10, LINES 1-22) HE EXPRESSES HIS
11 OPINION REGARDING THE MEANING AND INTENT OF
12 SPECIFIC TERMS USED IN CHAPTER 364 OF THE FLORIDA
13 STATUTES. MR. CRESSE'S OPINIONS CONCERNING THE
14 MEANING OF "COMPETITIVE," "EFFECTIVE COMPETITION,"
15 "SUBJECT TO EFFECTIVE COMPETITION," AND "MONOPOLY
16 SERVICES" ARE NOT NEW TO THIS COMMISSION AND ARE
17 ONLY ADVANCED BY MR. CRESSE TO FURTHER HIS CLIENT'S
18 AGENDA. AS WAS DISCOVERED DURING HIS TESTIMONY
19 BEFORE THIS COMMISSION IN DOCKET NO. 920255-TP, MR.
20 CRESSE CAN FIND NO LEGISLATIVE HISTORY TO SUPPORT
21 HIS CONTENTION THAT THE LEGISLATURE INTENDED TO
22 CREATE FOUR CATEGORIES OF LOCAL EXCHANGE COMPANY
23 SERVICES IN ITS REWRITE OF CHAPTER 364 IN 1990.

24

25 Q. IS IT APPROPRIATE FOR MR. CRESSE TO TESTIFY AS AN

1 EXPERT CONCERNING THE MEANING AND INTENT OF CHAPTER
2 364?

3
4 A. NO. THE MEANING AND INTENT OF STATUTORY LANGUAGE
5 IS A LEGAL QUESTION AND SHOULD BE LEFT UP TO THE
6 LAWYERS TO ARGUE IN THEIR LEGAL BRIEFS TO THE
7 COMMISSION. THE COMMISSION, AS A QUASI-JUDICIAL
8 BODY, IS CHARGED WITH INTERPRETING THE
9 LEGISLATURE'S INTENT.

10

11 Q. SINCE MR. CRESSE HAS FOUND IT APPROPRIATE TO GIVE
12 HIS OPINION AS TO THE MEANING AND INTENT OF
13 SPECIFIC TERMS USED IN CHAPTER 364, DO YOU AGREE
14 WITH HIS OPINION AS TO THE LEGISLATURE'S INTENTION
15 TO CREATE FOUR CATEGORIES OF LOCAL EXCHANGE COMPANY
16 SERVICES?

17

18 A. NO. MR. CRESSE IS WRONG. THE STATUTES ARE VERY
19 CLEAR. THE LEGISLATURE INTENDED FOR THERE TO BE
20 TWO CATEGORIES OF LOCAL EXCHANGE COMPANY SERVICES:
21 MONOPOLY SERVICES AS DEFINED IN 364.02(3) AND
22 EFFECTIVELY COMPETITIVE SERVICES AS DEFINED IN
23 364.338, FLORIDA STATUTES. INDEED, THIS COMMISSION
24 ON DECEMBER 14, 1992, DETERMINED IN ITS SPECIAL
25 AGENDA SESSION FOR DOCKET NO. 920255-TP CONCERNING

1 PAY TELEPHONE COMPETITION THAT THE TERMS
2 "COMPETITIVE," "EFFECTIVELY COMPETITIVE" AND
3 "SUBJECT TO EFFECTIVE COMPETITION" AS USED IN
4 CHAPTER 364 ARE SYNONYMOUS.

5

6 Q. MR. CRESSE STATES IN HIS DIRECT TESTIMONY ON PAGE
7 14 (LINES 31-32) AND CONTINUING ON PAGE 18 (LINES
8 11-12) THAT SOUTHERN BELL'S PROPOSED PRICE
9 REGULATION PLAN DOES NOT MEET ALL THE REQUIREMENTS
10 SET FORTH IN CHAPTER 364.036(2) (A)-(G), FLORIDA
11 STATUTES, SPECIFICALLY SUBSECTIONS (C) AND (F).
12 WHAT IS YOUR RESPONSE?

13

14 A. MR. CRESSE IS AGAIN INCORRECT. SOUTHERN BELL'S PLAN
15 WAS CAREFULLY DRAFTED TO ENSURE THAT IT MET ALL OF
16 THE NECESSARY STATUTORY REQUIREMENTS. IN MY DIRECT
17 TESTIMONY AND ELSEWHERE IN THIS REBUTTAL TESTIMONY
18 I HAVE OUTLINED THE BENEFITS TO CONSUMERS THAT ARE
19 NOT OTHERWISE AVAILABLE UNDER EXISTING REGULATORY
20 PROCEDURES. THE BENEFITS I HAVE DISCUSSED SATISFY
21 THE REQUIREMENTS OF SUBSECTION (C).

22

23 Q. WHAT ABOUT THE REQUIREMENTS OF SUBSECTION (F)?

24

25 A. SUBSECTION (F) REQUIRES ADEQUATE SAFEGUARDS TO

1 ASSURE THAT MONOPOLY SERVICES ARE NOT SUBSIDIZING
2 COMPETITIVE SERVICES. THE COMMISSION IN ITS ACTION
3 AT THE SPECIAL AGENDA CONFERENCE ON DECEMBER 14,
4 1992 CONCERNING DOCKET NO. 920255-TP PUT TO REST
5 THE ISSUE OF WHETHER THE TERMS "COMPETITIVE
6 SERVICES" MEANS SOMETHING DIFFERENT THAN
7 "EFFECTIVELY COMPETITIVE SERVICES." THE COMMISSION
8 FOUND THAT THE TERMS ARE SYNONYMOUS. NONE OF
9 SOUTHERN BELL'S SERVICES HAVE BEEN DETERMINED TO BE
10 EFFECTIVELY COMPETITIVE UNDER CHAPTER 364.338,
11 FLORIDA STATUTES, AND THEREFORE THIS ISSUE IS NOT
12 RIPE FOR CONSIDERATION. IN ANY EVENT, SOUTHERN
13 BELL'S PLAN REQUIRES THE COMPANY TO PRICE ABOVE
14 LONG RUN INCREMENTAL COST, WHICH IS A PROPER AND
15 ADEQUATE SAFEGUARD AGAINST CROSS-SUBSIDIZATION.

16

17 Q. MR. CRESSE FURTHER DISCUSSES ISSUES 30 (A)-(D)
18 CONCERNING THE STATUTORY REQUIREMENTS OF CHAPTER
19 364.3381. WHAT IS YOUR RESPONSE TO HIS DISCUSSION?

20

21 A. AGAIN MR. CRESSE, IN FURTHERANCE OF HIS OWN AGENDA,
22 ATTEMPTS TO CONFUSE THE ISSUE OF COMPETITIVE AND
23 EFFECTIVELY COMPETITIVE SERVICES. SECTION
24 364.3381, FLORIDA STATUTES SIMPLY DOES NOT COME
25 INTO PLAY UNTIL MONOPOLY SERVICES HAVE BEEN DEEMED

1 BY THE COMMISSION TO BE EFFECTIVELY COMPETITIVE.
2 THE COMMISSION WILL BE ADDRESSING THE REQUIREMENTS
3 OF SECTION 364.3381 IN DOCKET NO. 910757-TP. DR.
4 TAYLOR, SOUTHERN BELL'S REBUTTAL WITNESS, DISCUSSES
5 THE APPROPRIATE ECONOMIC STANDARDS FOR PRICING AND
6 COSTING OF SERVICES.

7

8 Q. MR. CRESSE CRITICIZES THE PRICE REGULATION PLAN IN
9 HIS DIRECT TESTIMONY ON PAGE 17 (LINES 11-14)
10 SAYING THAT COMPETITIVE SERVICES HAVE NOT BEEN
11 IDENTIFIED BY THE COMPANY. WHAT IS YOUR RESPONSE?

12

13 A. SINCE NONE OF OUR TARIFFED, REGULATED SERVICES HAS
14 BEEN DEEMED EFFECTIVELY COMPETITIVE BY THE FPSC,
15 THE SAFEGUARD REQUIREMENTS AS STATED IN SECTION
16 364.338 DO NOT APPLY. NONETHELESS, WE HAVE
17 SUBJECTED ALL TARIFFED SERVICES TO PRICE REGULATION
18 AND PRICING RULES WHICH DO PROVIDE ADEQUATE
19 SAFEGUARDS.

20

21 Q. MS. CORNELL MAKES THE FOLLOWING STATEMENT IN HER
22 DIRECT TESTIMONY ON PAGE 16 (LINES 17-26) AND PAGE
23 17 (LINES 1-5):

24

25 "SOUTHERN BELL'S PROPOSED PLAN WOULD ALLOW

1 SOUTHERN BELL TO FILE FOR INCREASED RATES ON
2 60 DAYS NOTICE WITHOUT REGARD TO THE FORMULA
3 THAT IS SUPPOSED TO CAP ITS RATES IF ANY ONE
4 OF THREE EVENTS OCCURS. THE FIRST IS IF
5 EARNINGS FALL BELOW A FLOOR OF 11.5%, A
6 PROVISION I HAVE ALREADY DISCUSSED. THE
7 SECOND IS IF THERE ARE "SIGNIFICANT STRUCTURAL
8 CHANGES TO SOUTHERN BELL'S SERVICE OFFERINGS
9 DUE TO CHANGES IN THE INDUSTRY AND/OR
10 COMMISSION ORDERS...THE THIRD IS IF THERE ARE
11 'CHANGES TO COMPETITIVE CONDITIONS AUTHORIZED
12 BY THE COMMISSION.'" "

13
14 "THESE LAST TWO PROVISIONS PROVIDE SOUTHERN
15 BELL WITH AN ABILITY TO ESCAPE FROM ITS OWN
16 FORMULA FOR PRICE INCREASES FOR VIRTUALLY ANY
17 CHANGE IN THE CURRENT STATUS OF THE INDUSTRY.
18 IF THE COMMISSION WERE TO ORDER ANY UNBUNDLING
19 OF CURRENT SERVICES, FOR EXAMPLE, OR TO ORDER
20 FURTHER IMPLEMENTATION OF ONA SERVICES,
21 PRESUMABLY SOUTHERN BELL COULD INCREASE ITS
22 RATES. IT WOULD NOT NEED TO SHOW ANY EVIDENCE
23 OF HARM TO SOUTHERN BELL'S EARNINGS OR
24 INCREASES IN ITS COSTS, JUST THAT THE EVENT
25 HAD OCCURRED."

1

2 Q. DO YOU AGREE WITH MS. CORNELL'S STATEMENT?

3

4 A. NO. MS. CORNELL HAS MISINTERPRETED THESE
5 PROVISIONS IN SOUTHERN BELL'S PLAN. IN ORDER TO
6 CLARIFY OUR INTENT I WILL CITE DIRECTLY FROM AND
7 COMMENT ON MY DIRECT TESTIMONY. SPECIFICALLY I SAY
8 AT PAGE 43:

9

10 "SOUTHERN BELL WOULD BE ALLOWED TO REQUEST
11 PRICE CHANGES THAT WOULD OTHERWISE EXCEED THE
12 PRI LIMIT AND/OR THE SERVICE CATEGORY PRICE
13 LIMITS UNDER THE FOLLOWING CIRCUMSTANCES:

14

15 IF EARNINGS FALL BELOW THE ESTABLISHED FLOOR,
16 PRICE INCREASES WILL BE PERMITTED TO BRING
17 EARNINGS BACK TO THE LEVEL OF THE FLOOR."

18

19 SHOULD SUCH A CIRCUMSTANCE OCCUR, THE COMPANY WOULD
20 FILE A NOTICE WITH THE COMMISSION THAT OUR EARNINGS
21 HAD FALLEN BELOW 11.5%. ASSOCIATED WITH THAT
22 FILING WOULD BE RECOMMENDED PRICE CHANGES TO
23 RECTIFY THE EARNINGS DEFICIT. IF THE COMMISSION OR
24 OTHER PARTIES DID NOT CONCUR IN THE PROPOSED
25 CHANGES THEY WOULD HAVE THE RIGHT TO CHALLENGE THE

1 INCREASES BEFORE ANY PRICE CHANGES WOULD BE
2 IMPLEMENTED. IF NO CHALLENGE WERE MADE, THE PRICE
3 CHANGES WOULD BE EFFECTIVE AT THE END OF THE 60
4 DAYS NOTICE.

5
6 CONTINUING WITH MY DIRECT TESTIMONY, I SAY AT PAGE
7 43 THAT WE COULD CHANGE RATES IF THERE WERE
8 "...SIGNIFICANT STRUCTURAL CHANGES TO SOUTHERN
9 BELL'S SERVICE OFFERINGS DUE TO CHANGES IN THE
10 INDUSTRY AND/OR COMMISSION ORDERS."

11
12 AN EXCELLENT EXAMPLE OF A POTENTIAL NEED TO REQUEST
13 A CHANGE IN PRICES WOULD BE THE RECENT NOTICE BY
14 THE FCC THAT THEY MAY GIVE AAVS THE AUTHORITY TO
15 PROVIDE SWITCHED ACCESS INTERCONNECTION FOR
16 INTERSTATE SERVICES. IF THE FPSC FOLLOWS SUIT FOR
17 INTRASTATE SERVICES, THIS COULD CREATE INTENSE
18 COMPETITION IF AN AAV WERE TO SET UP IN A SPECIFIC
19 GEOGRAPHIC AREA. IF THIS WERE TO OCCUR, SOUTHERN
20 BELL IN ALL PROBABILITY WOULD COME TO THIS
21 COMMISSION AND REQUEST ADDITIONAL PRICING
22 FLEXIBILITY OF OUR COMPARABLE SERVICES WHICH THE
23 AAV IS OFFERING. ALL PARTIES WOULD BE GRANTED DUE
24 PROCESS BEFORE ANY CHANGE WERE GRANTED.

25

1 IN ADDITION TO THE PRECEDING CONDITIONS, I ALSO
2 NOTE THAT WE COULD CHANGE RATES IN RESPONSE TO
3 "...CHANGES TO COMPETITIVE CONDITIONS AUTHORIZED BY
4 THE COMMISSION." (PAGE 43-44)
5
6 AN EXAMPLE OF THIS CIRCUMSTANCE WOULD BE IF THE
7 COMMISSION WERE TO DECIDE THAT A SERVICE IS
8 EFFECTIVELY COMPETITIVE AND PROCEED TO MAKE CHANGES
9 IN THE REQUIREMENTS FOR BOTH SOUTHERN BELL AND THE
10 ALTERNATIVE PROVIDER OF THE SERVICE OFFERING.
11 THESE CHANGES MAY REQUIRE THAT THE PARTICULAR
12 SERVICE BE MOVED OUT OF ITS EXISTING SERVICE AND
13 EXCLUDED FROM PRICE REGULATION ALTOGETHER.
14
15 FINALLY I CLEARLY STATE AT PAGE 44, THAT "THESE
16 PRICE CHANGES WOULD BE FILED ON 60 DAYS NOTICE,
17 ACCOMPANIED BY THE APPROPRIATE DOCUMENTATION AND
18 JUSTIFICATION."
19
20 IT IS CLEAR THAT OUR INTENT IN THESE CIRCUMSTANCES
21 WAS TO LIMIT OUR ABILITY TO CHANGE RATES OUTSIDE OF
22 THE PLAN AND MS. CORNELL HAS CREATED AN ISSUE WHERE
23 NONE EXISTS.
24
25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

PART IV:

OPTIONAL EXPANDED LOCAL SERVICE PLAN

Q. PLEASE COMMENT ON MR. CRESSE'S CONCERNS REGARDING THE COMPANY'S EXPANDED LOCAL SERVICE ("ELS") PLAN.

A. MR. CRESSE'S CONCERNS ARE MISPLACED. I EXPECT THAT WHAT HE IS REFERRING TO AS LMS AT PAGE 13 OF HIS TESTIMONY IS OUR ELS PLAN. I DID NOT REALIZE THAT OFFERING OUR CUSTOMERS A CHOICE OF A SERVICE FROM WHICH MANY MIGHT BENEFIT AND NONE WOULD BE HARMED WOULD BE DEEMED NOT IN THE PUBLIC INTEREST.

THE OPTIONAL ELS PLAN IS A NEW SERVICE DESIGNED TO FIT A NICHE IN THE MARKET. THE PLAN INCLUDES USAGE BASED PRICING ELEMENTS AND WILL BENEFIT MANY OF OUR SUBSCRIBERS.

OUR GOAL IS TO HAVE THE FLEXIBILITY TO PRICE AND PACKAGE OUR SERVICES BASED ON MARKET INTELLIGENCE WHICH CORRELATES VALUE WITH PRICE. THE OPTIONAL ELS PLAN IS JUST ONE STEP IN THAT DIRECTION, BUT IT IS A VERY IMPORTANT ONE. THIS COMMISSION MUST ACCEPT THE PREMISE THAT OUR BUSINESS IS GOING TO CONTINUE TO BECOME MORE COMPETITIVE, THAT

1 TRADITIONAL REVENUE STREAMS CANNOT CONTINUE TO BE
2 SOURCES OF SUBSIDY, AND AS A RESULT, WE NEED TO PUT
3 IN PLACE AN ORDERLY PROCESS TO ALIGN PRICE WITH
4 COST THUS REMOVING THE HEAVY DEPENDENCE ON SOME
5 SERVICES TO SUPPORT LOCAL EXCHANGE SERVICE AND ALSO
6 TO CREATE NEW REVENUE BY HAVING THE FLEXIBILITY TO
7 PACKAGE OUR SERVICES TO MEET MARKET NEEDS.

8

9 WITH ELS, WE HAVE INTRODUCED AN OPTIONAL SERVICE
10 WHICH MEETS SEVERAL OBJECTIVES:

11

12 FIRST, IT REDUCES THE PRESSURE ON EXTENDED AREA
13 SERVICE (EAS) AS THE ELS PLAN PROVIDES
14 SIGNIFICANTLY REDUCED RATES IN THE EXPANDED LOCAL
15 CALLING AREA;

16

17 SECOND, OPTIONAL ELS HAS NO DETRIMENTAL IMPACT ON
18 UNIVERSAL SERVICE. IN FACT, IT MAY HAVE A POSITIVE
19 IMPACT AS IT IS OPTIONAL AND MANY CUSTOMERS WHO DO
20 NOT HAVE HIGH LEVELS OF LOCAL USAGE CAN GET THE
21 SERVICE AT A LOWER RATE;

22

23 THIRD, THE USAGE ELEMENT IS PRICED TO COVER COST
24 AND VARIES WITH THE LEVEL OF USAGE. THIS IS
25 CONSISTENT WITH TWO OBJECTIVES WHICH ARE PRINCIPAL

1 TO OUR TOTAL PLAN: 1. MOVEMENT TOWARD MORE COST-
2 BASED RATES; 2. PRICES PAID BY CUSTOMERS BASED ON
3 VALUE RECEIVED.

4
5 FINALLY, OPTIONAL ELS PROVIDES AN INCENTIVE FOR THE
6 COMPANY TO INCREASE THE APPLICATIONS AND USE OF
7 FEATURES ON THE NETWORK. BY ADDING VALUE TO THE
8 ELS PLAN, WE MAY BE ABLE TO INCREASE REVENUES.
9 AGAIN THIS BENEFITS BOTH COMPANY AND CUSTOMER.

10

11 Q. MR. METCALF HAS PROPOSED AN UNBUNDLED ACCESS LINE
12 FOR PRICING PURPOSES WITH A NETWORK USAGE ELEMENT
13 THAT SHOULD BE FLAT RATED. HE HAS BASED HIS FLAT
14 RATE RECOMMENDATION ON THE PREMISE THAT IN AN
15 INCREASINGLY DIGITAL NETWORK, WHERE TRAFFIC
16 SENSITIVE COSTS ARE ALREADY LOW AND WILL CONTINUE
17 TO DECREASE, FLAT RATE PRICING IS THE MOST
18 APPROPRIATE. DO YOU AGREE?

19

20 A. NO. TODAY APPROXIMATELY ONE-THIRD OF FLORIDA'S
21 NETWORK INVESTMENT CONSISTS OF THE SWITCH AND
22 INTEROFFICE FACILITIES, WHICH ARE BOTH TRAFFIC
23 SENSITIVE. OF THE SWITCH INVESTMENT, 27% OF THE
24 SWITCHES ARE ANALOG AND 73% ARE DIGITAL WITH AN
25 EXPECTED INCREASE IN THE PERCENT OF DIGITAL

1 SWITCHES OVER THE NEXT SEVERAL YEARS. STUDIES
2 INDICATE THAT THE TREND OF TRAFFIC SENSITIVE COSTS
3 IN DIGITAL SWITCHES IS INCREASING. IN ADDITION,
4 TRAFFIC USAGE (CENTUM CALL SECOND/NETWORK ACCESS
5 LINE) HAS BEEN INCREASING SINCE 1983 AND THE TREND
6 IS EXPECTED TO CONTINUE. THIS INCREASED USAGE HAS
7 BEEN DIRECTLY RESPONSIBLE FOR UNEXPECTED COSTS DUE
8 TO PROCESSOR EXHAUSTS AND LINE CONCENTRATION RATIO
9 CHANGES. THE INCREASE IN CUSTOMER USAGE HAS ALSO
10 RESULTED IN AN INCREASE IN THE TRUNK USAGE
11 (TRUNKS/NETWORK ACCESS LINE).

12
13 THE REMAINING PORTION OF THE NETWORK INVESTMENT
14 CONSISTS OF THE LOCAL LOOP. THE LOCAL LOOP IS
15 USUALLY THOUGHT TO BE NON-TRAFFIC SENSITIVE. WITH
16 DIGITAL LOOP CARRIER, A CALL CAN BE BLOCKED IN THE
17 LOCAL LOOP IF THE ATTEMPTS ARE HIGH. AS WE MIGRATE
18 TO BROADBAND TECHNOLOGY, THE LOOP WILL BECOME
19 INCREASINGLY TRAFFIC SENSITIVE. THIS WILL BE
20 DRIVEN BY SUBSCRIBER DEMANDS TO COMMUNICATE TEXT,
21 DATA, AND IMAGES FOR APPLICATIONS SUCH AS MEDICAL
22 IMAGING AND LOCAL AREA NETWORK INTERCONNECTION.

23
24 THEREFORE, THE STATEMENT THAT THE TRAFFIC SENSITIVE
25 PORTION OF THE TOTAL COSTS IS EXPECTED TO DECREASE

1 IS NOT TRUE BECAUSE THE NETWORK IS BECOMING
2 INCREASINGLY TRAFFIC SENSITIVE AND CUSTOMER USAGE
3 IS INCREASING. THUS, FLAT RATE PRICING BECOMES
4 INAPPROPRIATE BECAUSE CUSTOMERS WITH THE LOWEST
5 USAGE WILL UNFAIRLY SUBSIDIZE HIGHER USAGE
6 CUSTOMERS.

7

8 Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY.

9

10 A. YES. MY TESTIMONY FOCUSES ON RESPONDING TO FOUR
11 MAJOR ISSUES OUTLINED IN INTERVENOR TESTIMONY:
12 COMPETITION; THE 1988 INCENTIVE REGULATION PLAN;
13 THE PROPOSED PRICE REGULATION PLAN; AND THE
14 OPTIONAL EXPANDED LOCAL SERVICE PLAN.

15

16 I WILL BRIEFLY DESCRIBE MY REBUTTAL IN THESE FOUR
17 AREAS.

18

19 COMPETITION: THE INTERVENORS ADDRESSING THIS AREA
20 HAVE ATTEMPTED TO DEPICT A MARKET WHERE
21 ALTERNATIVES TO SOUTHERN BELL SERVICES ARE SPARSE,
22 WHERE COMPETITIVE INROADS HAVE BEEN MINIMAL AND
23 WHERE COMPETITION POSES NO REAL THREAT TO SOUTHERN
24 BELL'S TRADITIONAL REVENUE STREAMS. IN MY
25 TESTIMONY I HAVE OUTLINED A CURRENT REALITY WHICH

1 IS VERY DIFFERENT. ALTERNATIVE SERVICES AND
2 PROVIDERS ARE NUMEROUS. CUSTOMER CHOICES,
3 PARTICULARLY FOR LARGE CUSTOMERS, ARE MANY. THIS
4 HAS BUILT AN UNSTOPPABLE MOMENTUM THAT WILL
5 SIGNIFICANTLY INCREASE COMPETITION IN THE COMING
6 YEARS. WHAT WE ARE ASKING FOR IS A CHANGE IN THE
7 REGULATORY PROCESS TO PROVIDE US WITH ADEQUATE
8 TOOLS TO COPE WITH THIS COMPETITION IN A MANNER
9 THAT IS EQUITABLE AND IN THE BEST INTEREST OF OUR
10 CUSTOMERS.

11

12 1988 INCENTIVE REGULATION PLAN: THE STORY
13 PRESENTED BY OUR OPPONENTS CONCERNING THE PAST FIVE
14 YEARS IS OBVIOUSLY A FRUSTRATING ONE FOR THEM.
15 THEY HAVEN'T BEEN ABLE TO CHALLENGE OUR SUCCESS.
16 INSTEAD, THEY WOULD LIKE TO ATTRIBUTE THAT SUCCESS
17 TO FACTORS OTHER THAN INCENTIVE REGULATION.
18 HOWEVER, WE CAN, IN SPITE OF RECESSIONS AND
19 HURRICANCE ANDREW, ILLUSTRATE THAT WE HAVE
20 ACCOMPLISHED WHAT WE PROMISED IN 1988, THAT IS,
21 INCREASED OPERATIONAL EFFICIENCY AND A WEALTH OF
22 NEW SERVICES, ALL OF WHICH BENEFIT OUR CUSTOMERS.
23 WE DID THIS THROUGH INCENTIVE REGULATION WHICH
24 ALLOWED US TO STIMULATE THE ENVIRONMENT THAT IS
25 EVOLVING IN THE EXTERNAL TELECOMMUNICATIONS MARKET.

1
2 PRICE REGULATION PLAN: THE INTERVENORS IN THIS
3 PROCEEDING HAVE ARGUED THAT SOUTHERN BELL SHOULDN'T
4 BE GIVEN MORE FLEXIBILITY. THEY ASSERT THAT THE
5 RATEPAYER WOULD BE BETTER OFF WITH TRADITIONAL RATE
6 BASE REGULATION. IN SHORT, THEY ARE ASKING THIS
7 COMMISSION TO REFUSE TO GIVE US ANY ADDITIONAL
8 TOOLS WITH WHICH TO COMPETE. WHAT I HAVE DESCRIBED
9 IN MY TESTIMONY IS A REQUEST FOR EQUITY. WE HAVEN'T
10 ASKED THIS COMMISSION TO RELINQUISH ITS ROLE AS
11 REGULATOR. INSTEAD, WE HAVE SHOWN THAT COMPETITION
12 IS REAL. WE HAVE PROPOSED A PLAN WHICH GIVES US
13 THE FLEXIBILITY TO BE SENSITIVE TO THE MARKET, TO
14 ALIGN OUR PRICES WITH THOSE THAT EITHER EXIST OR
15 WOULD EXIST IN A COMPETITIVE MARKET AND TO PUT IN
16 PLACE A CHALLENGING PRODUCTIVITY HURDLE WHICH
17 GUARANTEES OUR CUSTOMERS A DECREASE IN RATES
18 RELATIVE TO INFLATION EVERY YEAR THE PLAN IS IN
19 PLACE. WE HAVE PROPOSED THIS PLAN WITH SAFEGUARDS
20 TO THE CUSTOMER, WHILE AT THE SAME TIME ACCEPTING
21 FOR OURSELVES THE RISK THAT COMPETITION ENGENDERS.

22
23 OPTIONAL EXPANDED LOCAL SERVICE PLAN: FINALLY, I
24 HAVE BRIEFLY ADDRESSED THE OPTIONAL EXPANDED LOCAL
25 SERVICE PLAN. MOST OF THE CRITICISMS OF THE PLAN

1 ARE THE SAME OLD TIRED ARGUMENTS HEARD EVERY TIME
2 SUCH A PLAN IS PROPOSED. IN RESPONSE, I WOULD
3 CONTINUE TO NOTE THAT ELS IS OPTIONAL, IT WILL SAVE
4 MONEY FOR OVER 50% OF OUR CUSTOMERS AND THAT IT IS
5 A REFLECTION OF WHAT OUR PLAN IS ALL ABOUT. THAT
6 IS, WE ARE PROPOSING A SERVICE THAT FULFILLS THE
7 NEEDS OF OUR CUSTOMERS.

8

9 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

10

11 A. YES.

12

13

14

15

16

17

18

19

20

21

22

23

24

25

The Challenge for Incentive Regulation

By Terrence L. Barnich

Incentive ratemaking must be viewed only as a transitional step along the road to open competition.

Symposiums, conferences, and seminars dedicated to discussing the application of incentive regulation to those sections of the energy and communications markets that still come within the jurisdiction of economic regulation are approaching ubiquity. The near unanimity of these conventions is that incentive regulation is, by far and away, a preferable regulatory regime to the traditional rate-of-return regulatory paradigm, due to the recognized distortions and inefficiencies caused by conventional, cost-plus regulation.

I approach the topic of incentive regulation with some sense of trepidation. Not because I don't "believe" in it, but rather because from what I can tell, too few of its acolytes advocate incentive regulation, properly understood. For me, as a regulator, incentive regulation should, for the most part, serve as a transitional step in a larger movement to a truly competitive model for each of its targeted regulated industries. Too often, incentive regulation is considered as an end in-and-of itself and the desired goal of promoting and developing effective competition is forgotten. Incentive regulation models should serve as the final regulatory alternative to ratebase/rate-of-return regulation only in those cases where free markets will likely fail. Surely major portions of currently regulated industries can be truly competitive if we, the regulators, would take steps to knock down the regulatory and legal impediments

standing in the way of its emergence.

Conventional Aspects of Incentive Regulation

Utility regulators have conventionally applied incentive regulation in order to repair the distortions arising out of the cost-plus nature of utility regulation. Traditionally, these distortions have included such things as the Averch-Johnson (A-J) effect, in which utilities supposedly have the incentive to overbuild and "gold-plate." I say "supposedly" simply because the A-J effect has not been quantified, and it has also become a less attractive theory in light of the recent history of such things as prudence and used-and-useful disallowances in the electric industry. Nonetheless, I believe that it does exist, to one extent or another, and it does play a role in the way utilities are managed and the way in which their managers look at their world.

Traditional incentive regulation plans have attempted to correct this type of distortion by attenuating or even severing the tie between revenue requirement, ratebase, and earnings. However, the real focus ends up "incentivizing" aggregate, shorter term cost reductions. While this is a sound first step, and one that should not be discouraged, it is only part of the picture.

Unfortunately our focus has not been on developing incentive mechanisms that promote investments in new technologies, which in turn cut costs longer term. This is a

the development of competition.

Second, the other side of the coin is that regulators — even if they act in a protectionist manner — may design the incentive in a way that is not conducive to the offering of the competitive service in a way attractive to customers or the utility. This inadvertently makes the utility uncompetitive.

Potential Solutions to the Shortcomings

Of course, there are ways of dealing with these problems. The key, as I see it, is for regulators to look at the world from the proper end of the telescope. This means that we must begin to understand that many of the services being offered by utilities are becoming competitively available and that competition is becoming increasingly prevalent across-the-board.

This being the case, and because things can change rapidly and without any action by regulators, utility regulators should take two steps. First, we must apply incentive regulation only to those services that retain some serious dimension of natural monopoly. To do otherwise only compounds the shortcomings presented by the old ratebase/rate-of-return regulatory model.

Second, for those services that are otherwise available or even may be incipiently available, there should be free entry and exit, and prices should be subject to market forces. The identification process should be easy for these services. We would rely primarily on declarations by the regulated utility or its competitive supplier that the service is available from more than one provider, and we would then put the onus on others to show that such is not the case. With respect to services to which incentive measures would be applied, there should be greater reliance on open-ended sharing of profits and/or leveraged pricing. These types of mechanisms would link the prices for the regulated services to those movements of prices in the comparable competitive services, thus assuring monopoly customers of the benefits of competition while providing

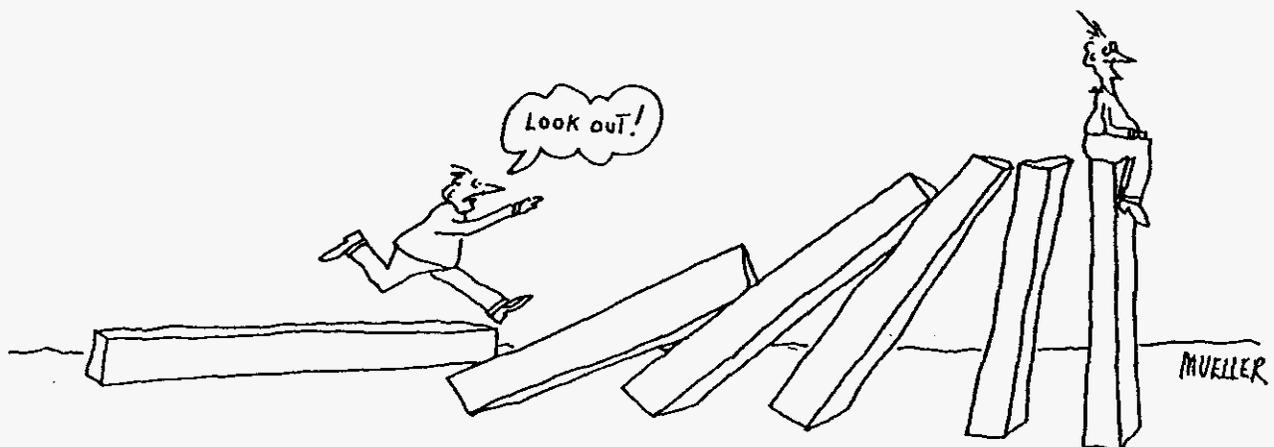
the company with the incentive to operate efficiently.

Since I believe that incentive regulatory models must serve as transitional steps toward competitive models, a key step that regulators and utilities can take right now is to begin getting the prices "right" for services before competitors get too far ahead. The unbundling of services must also move ahead as much as possible. This will set the stage for competition to develop by providing the proverbial "level playing field." Local measured service and the deaveraging of prices in the local telephone exchange is a prime example of the direction that must be taken to prepare for the market and the incumbent for competition.

The Ultimate Incentive: Crafting an Effective Competitive Paradigm

A more effective role for all incentive regulatory models is to serve as transitional steps as we move toward effective competition in the regulated industries. Just as rate-of-return regulation is supposed to serve as a surrogate for competitive markets, we have touted incentive regulation as a better surrogate. This might well be the case, but I would quickly point out that incentive regulatory schemes are still just surrogates to competition and as Ray Charles sings about Diet Pepsi, "You've got the right one, baby, uh huh." Effective competition remains the best incentive model we have, and therefore we should always foster its development whenever possible. We need to begin reexamining the traditional bases of regulation — primarily the natural monopoly arguments — and see if technological developments have rendered these arguments irrelevant. Once that has been accomplished, we then need finally to demolish the Berlin Wall of regulation that remains in place.

Terrence L. Barnich is currently a commissioner on the Illinois Commerce Commission, and previously served as chair of that body. Prior to his appointment, he served as council to the governor and was also an associate attorney in the litigation department of Rudnick and Wolfe. Commissioner Barnich received his law degree from Fordham University and a bachelor's degree from Georgetown University.



the development of competition.

Second, the other side of the coin is that regulators — even if they act in a protectionist manner — may design the incentive in a way that is not conducive to the offering of the competitive service in a way attractive to customers or the utility. This inadvertently makes the utility uncompetitive.

Potential Solutions to the Shortcomings

Of course, there are ways of dealing with these problems. The key, as I see it, is for regulators to look at the world from the proper end of the telescope. This means that we must begin to understand that many of the services being offered by utilities are becoming competitively available and that competition is becoming increasingly prevalent across-the-board.

This being the case, and because things can change rapidly and without any action by regulators, utility regulators should take two steps. First, we must apply incentive regulation only to those services that retain some serious dimension of natural monopoly. To do otherwise only compounds the shortcomings presented by the old ratebase/rate-of-return regulatory model.

Second, for those services that are otherwise available or even may be incipiently available, there should be free entry and exit, and prices should be subject to market forces. The identification process should be easy for these services. We would rely primarily on declarations by the regulated utility or its competitive supplier that the service is available from more than one provider, and we would then put the onus on others to show that such is not the case. With respect to services to which incentive measures would be applied, there should be greater reliance on open-ended sharing of profits and/or leveraged pricing. These types of mechanisms would link the prices for the regulated services to those movements of prices in the comparable competitive services, thus assuring monopoly customers of the *benefits* of competition while providing

the company with the incentive to operate efficiently.

Since I believe that incentive regulatory models must serve as transitional steps toward competitive models, a key step that regulators and utilities can take right now is to begin getting the prices "right" for services before competitors get too far ahead. The unbundling of services must also move ahead as much as possible. This will set the stage for competition to develop by providing the proverbial "level playing field." Local measured service and the deaveraging of prices in the local telephone exchange is a prime example of the direction that must be taken to prepare for the market and the incumbent for competition.

The Ultimate Incentive: Crafting an Effective Competitive Paradigm

A more effective role for all incentive regulatory models is to serve as transitional steps as we move toward effective competition in the regulated industries. Just as rate-of-return regulation is supposed to serve as a surrogate for competitive markets, we have touted incentive regulation as a better surrogate. This might well be the case, but I would quickly point out that incentive regulatory schemes are still just surrogates to competition and as Ray Charles sings about Diet Pepsi, "You've got the right one, baby, uh huh." Effective competition remains the best incentive model we have, and therefore we should always foster its development whenever possible. We need to begin reexamining the traditional bases of regulation — primarily the natural monopoly arguments — and see if technological developments have rendered these arguments irrelevant. Once that has been accomplished, we then need finally to demolish the Berlin Wall of regulation that remains in place.

Terrence L. Barnich is currently a commissioner on the Illinois Commerce Commission, and previously served as chair of that body. Prior to his appointment, he served as council to the governor and was also an associate attorney in the litigation department of Rudnick and Wolfe. Commissioner Barnich received his law degree from Fordham University and a bachelor's degree from Georgetown University.

