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November 19, 2003

Ms. Blanca S. Bayo, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 030867-TL
Amended Petition of Verizon Florida Inc. to Reform Its Intrastate Network Access and Basic Local Telecommunications Rates in Accordance with Florida Statutes, Section 364.164

Dear Ms. Bayo:

Please find enclosed for filing an original and 15 copies of the Rebuttal Testimonies of Carl R. Danner, Orville D. Fulp, Dr. Kenneth Gordon and Evan T. Leo on behalf of Verizon Florida Inc. in the above matters. Service has been made as indicated on the Certificate of Service. If there are any questions regarding this matter, please contact me at 813-483-1256.

Sincerely,

Richard A. Chapkis

Richard A. Chapkis

C. Danner	11656-03
O. Fulp	11657-03
K. Gordon	11658-03
E. Leo	11659-03

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of the foregoing were sent via electronic mail and overnight delivery on November 19, 2003 to:

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Verizon Florida Inc. to Reform Its Intrastate Network Access and Basic Local Telecommunications Rates in Accordance with Florida Statutes, Section 364.164	)	Docket No. 030867-TL

REBUTTAL TESTIMONY OF
CARL R. DANNER
ON BEHALF OF
VERIZON FLORIDA INC.

November 19, 2003

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SUBJECT INDEX

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I.

INTRODUCTION AND OVERVIEW OF REBUTTAL TESTIMONY

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Carl R. Danner. I am a Director with Wilk & Associates/LECG LLC. My business address is 201 Mission Street, Suite 700, San Francisco, California 94105.

Q. ARE YOU THE SAME CARL R. DANNER WHO SUBMITTED DIRECT TESTIMONY ON BEHALF OF VERIZON IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my testimony is to respond to certain issues raised by Citizens' witnesses Drs. David Gabel and Bion Ostrander, AARP witness Dr. Mark Cooper, AT&T witness Mr. Wayne Fonteix, AT&T and MCI witness Dr. John Mayo, and Commission Staff witness Mr. Gregory Shafer.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. Opposition witnesses have made a variety of claims regarding Verizon Florida's pricing reform plan. I review these claims, and find them to be unwarranted for a variety of reasons.

First, the criteria under Section 364.164(1) are factors for the Commission to consider, not standards that must individually be satisfied. Moreover, these criteria are clear and unambiguous on their face and therefore require no elaborate exercise in interpretation. In particular, Section 364.164(1)(a) provides that the Commission must consider whether Verizon's rate rebalancing plan removes pricing support that stands in the way of increased competition that would benefit residential customers. It does not require that Verizon must show that residential customers will immediately receive lower monthly bills, as opposing witnesses contend.

Second, Verizon has submitted evidence demonstrating that granting its rate rebalancing plan will remove current support for basic local services that prevents the creation of a more attractive competitive local exchange market for the benefit of residential customers. The claims of opposing witnesses to the contrary rely on strained analysis, suggest unrealistic scenarios, and are contrary to observed fact.

Third, Verizon has demonstrated that its basic local residential services are supported. The claims of opposing witnesses to the contrary either misapply or contradict fundamental principles of costing and economics.

Fourth, Verizon has shown that granting its rate rebalancing plan will provide a variety of benefits to residential customers. The evidence does not support claims that pricing reform will harm universal service or cause undue customer hardship.

Finally, although this testimony is necessarily devoted to the rebuttal of mistaken opposition positions, the Commission should keep in mind the positive opportunity Verizon's petition provides for the people of Florida. Moving telephone service prices towards their true costs is an important step that will benefit customers and the economy, will promote competition, and will not cause disruption or hardship. The Commission should take this opportunity to approve Verizon's balanced and reasonable reform plan.

II.

THE STATUTE'S MEANING IS CLEAR AND FOLLOWS DIRECTLY FROM THE COMMISSION'S OWN ANALYSIS AND CONCLUSIONS

Q. DR. COOPER CONTENDS THAT PORTIONS OF THE ACT ARE UNCLEAR AND REQUIRE CLARIFICATION FROM THE LEGISLATIVE RECORD (COOPER PAGE 4, LINES 3–6). DO YOU AGREE?

A. No. The statute is clear and unambiguous on its face.

Q. WHAT IS THE MEANING OF SECTION 364.164(1)(A), THE PROVISION THAT PURPORTEDLY CONFUSED DR. COOPER?

A. Section 364.164(1)(a) directs the Commission to consider whether granting these petitions will:

> Remove current support for basic local telecommunications services that prevents the creation of a more attractive competitive local

exchange market for the benefit of residential customers.

This provision is clear in both of its essential regards.

First, it is clear that Section 364.164(1)(a) is only one of four criteria the Commission must consider in evaluating Verizon's petition. The statute does not create a "pass fail" test regarding this or the other specified criteria. Under the Act, the Commission retains discretion to evaluate and balance these criteria as it sees fit.

Second, Section 364.164(1)(a) is equally clear in the substance of what the Commission is to consider. This provision encourages the <u>removal of pricing support</u> that stands in the way of <u>increased competition</u> that would benefit residential customers. It is a fundamental principle of economics that subsidized prices impair competition. In this provision, the Legislature has recognized this basic principle and asked the Commission to pursue the related remedy of pricing reform to address a well-recognized fact – that basic service competitors are largely ignoring residential customers in Florida.

Q. HAS THE COMMISSION PREVIOUSLY RECOGNIZED THAT BASIC RATE INCREASES MAY REDUCE HISTORICAL SUBSIDIES AND MAKE RESIDENTIAL CUSTOMERS MORE ATTRACTIVE TO LOCAL SERVICE COMPETITORS?

A. Yes. In 1998, the Legislature requested that the Commission conduct a comprehensive study of competition in Florida. In response to the Legislature's request, the Commission complied and issued its Fair and Reasonable Report. See "Report of the Florida Public Service Commission on the Relationships Among the Costs and Charges Associated with Providing Basic Local Service, Intrastate Access, and Other Services Provided by Local Exchange Companies, in Compliance with Chapter 98-277, Section 2(1), Laws of Florida," and "The Conclusions of the Florida Public Service Commission as to the Fair and Reasonable Florida Basic Local Telecommunications Service Rate, in Compliance with Chapter 98-277, Section 2(2)(A), Laws of Florida" (February 15, 1999).

In that Report, the Commission addressed the exact questions that are at issue here – i.e., where subsidies exist, what effect they have on competition, what a fair and reasonable remedy would be, and various related technical issues of costing and economics. Significantly, the Commission reached a number of conclusions in the Report that directly influenced the Legislature. Indeed, it is striking how closely the statute mirrors this Commission's conclusions:

FPSC Fair & Reasonable Rate Report	**The Act**
1. A three to five year phase-in of basic rate increases of up to $5 would be acceptable to	1. Two to four year phase-in of basic rate increases acceptable to remove subsidy support.

reduce subsidies.	
2. Access charges should be reduced to interstate parity over three to five years.	2. Two to four year phase-in of access charge reductions to interstate parity.
3. A basic rate increase and rebalancing would help stimulate local competition for residential customers.	3. Purpose of removing support from rates is to promote competition for benefit of residential customers.
4. Protection for vulnerable customers is important.	4. Lifeline eligibility to be expanded along with pricing reform.
(Source: Report Executive Summary, and Conclusions)	(Sections 364.164, 364.10(3))

As shown above, the Legislature followed the road map for pricing reform laid out by the Commission in response to the Legislature's prior request for a study and report. The Commission and the Legislature have been engaged in this process for over five years, and it has produced a reasonable result that is ready to implement. The Commission should now follow through and approve Verizon's plan to put this road map into action.

Having participated in a portion of this process and had some understanding of its overall scope and extent, I can affirm that reform is overdue and should occur now. Indeed, reform was already overdue in 1998 – the first time I helped address these issues before the

Commission.

Q. WHAT IS STAFF'S UNDERSTANDING OF THE LEGISLATURE'S INTENT?

A. Staff correctly observes that the Legislature recognized that subsidized basic local rates inhibit competition:

> ... the Legislature subscribed to the notion that access charges subsidize basic local rates, or that access charge rates far exceed cost and basic local service rates are on average below cost. To the degree that basic local service rates are below cost, that is a significant deterrent to market entry for that particular service. (Shafer, Page 6, Lines 13–17).

Q. DO DRS. COOPER AND GABEL ACKNOWLEDGE THE FAIR AND REASONABLE REPORT?

A. No. They do not acknowledge the extensive study and debate that led to the Report, nor do they acknowledge the Report itself. I suspect the reason for this omission is that the Report's conclusions contradict the arguments that they wish to present here.

Q. DR. COOPER OFFERS SNIPPETS FROM SELECTED LEGISLATORS IN AN ATTEMPT TO REWRITE THE STATUTE. IS THERE ANY RELEVANCE TO THIS EXERCISE?

A. No. The Florida Legislature expressed itself clearly in the statutory provisions that it enacted. Dr. Cooper's attempts to misconstrue the plain meaning of an unambiguous statute should be given no weight.

Q. DR. COOPER CLAIMS THAT THE STATUTE REQUIRES VERIZON TO SHOW THAT RESIDENTIAL CUSTOMERS WILL RECEIVE OVERALL LOWER MONTHLY BILLS. IS HE CORRECT?

A. No. The statute says nothing of the kind. By mandating the pass-through of access charge reductions, the elimination of fixed monthly fees, and an expanded Lifeline program, the Legislature has separately addressed the question of total bill benefits for customers.

Q. IF THE STATUTE IS GIVEN ITS COMMON SENSE MEANING, WHAT OTHER CONSUMER BENEFITS SHOULD BE CONSIDERED BY THE COMMISSION?

A. Competition provides the potential for many customer benefits, including innovative new services and capabilities, reduced prices, and new price/quality tradeoffs that may better fit consumers' preferences. Competition also spurs greater operating efficiency that will improve the general economy of Florida. Benefits such as these underlie the public policy choice that has been made nationally and in Florida – in favor of competition rather than regulated monopolies in telecommunications. If the Commission attempts to rewrite the statute, as Dr. Cooper urges, it will forego these clear benefits.

III.

THE OPPOSITION WITNESSES' ASSERTIONS ABOUT COMPETITION ARE STRAINED, UNREALISTIC, AND CONTRARY TO FACT

Q. WHAT DO OPPOSITION WITNESSES ASSERT ABOUT THE NEED TO CREATE A MORE ATTRACTIVE COMPETITIVE LOCAL EXCHANGE MARKET FOR THE BENEFIT OF RESIDENTIAL CUSTOMERS?

A. Drs. Gabel and Cooper present a variety of assertions that fail to recognize the significance of competition, and criticize Verizon's rate rebalancing plan for mistaken and/or insufficient reasons. These assertions will be discussed and rebutted below.

Q. HOW DOES DR. COOPER RESPOND TO CONCERNS ABOUT THE EXTENT OF COMPETITION FOR RESIDENTIAL CUSTOMERS IN FLORIDA?

A. Dr. Cooper does not see a problem. He suggests that while local competition in Florida is only "mixed," it is good enough and the Commission should not be particularly concerned (Cooper, Page 26, Line 22).

Q. DO DR. COOPER'S OWN STATISTICS SHOW THAT COMPETITORS IGNORE RESIDENTIAL CUSTOMERS IN FLORIDA?

A. Yes. Dr. Cooper calculates a measure he refers to as "balance," which compares the proportion of CLEC residential customers to those of ILECs (Cooper, Page 27, Lines 7–11). On this measure, Dr. Cooper finds that Florida ranks 33rd out of 39 states reviewed. In other words, there were only six states in this group that ranked worse than Florida in skewing competition away from residential customers. Accordingly, Dr. Cooper's own statistics highlight that the existing pricing structure inhibits competition for residential customers.

Q. DO THE TERMS OF THE ACT CONTRADICT DR. COOPER'S PERSPECTIVE ON RESIDENTIAL LOCAL COMPETITION?

A. Yes. The Legislature was concerned enough about the level of residential competition in Florida to enact a specific provision to spur residential competition. That is hardly in keeping with Dr. Cooper's assessment of the situation.

Q. DOES THE DRAFT 2003 FPSC COMPETITION REPORT SHOW THAT COMPETITORS ARE DISPROPORTIONATELY TARGETING BUSINESS CUSTOMERS, AND IGNORING RESIDENTIAL CUSTOMERS?

A. Yes. The Report highlights the ongoing disparity between competitive interest in business and residential customers:

> CLEC business market share increased to 29% from 26% in the previous year. CLEC residential market share increased to 9% from 7% in the previous year. (Draft FPSC 2003 Competition

> Report, Page 8).

The Report makes clear that the disparity is especially apparent in Verizon's territory:

> Figure 4 shows CLEC share of the residence and business markets by ILEC. The figure highlights that the only substantial residential competition is taking place in BellSouth's territory. Figure 4 show that CLECs serve only 1% of the residential market in Verizon's service territory. (Draft FPSC 2003 Competition Report, Page 10).

Moreover, the Report shows that facilities-based competitors have been especially unwilling to serve residential customers:

> As of June 30, 2003, thirty CLECs were serving 992,990 lines in Florida from their own switches; however, 90% of these lines served business customers. (Figure 11). Figure 12 shows that these switch-based CLECs served an additional 364,391 lines through ILEC switches (UNE-P and resale lines) for a total of 1,356,381 lines served. (Draft FPSC 2003 Competition Report, Page 20).

Thus, there is ample evidence from a variety of sources to rebut Dr. Cooper's claim that the lack of residential local competition is of no particular concern.

Q. DRS. GABEL AND COOPER CLAIM THAT LOWER UNE PRICES,

AND NOT VERIZON'S PLAN, WOULD STIMULATE FURTHER LOCAL COMPETITION (GABEL, PAGE 38, LINE 7 – PAGE 42, LINE 2; COOPER, PAGE 30, LINES 13–15). PLEASE ADDRESS THIS CLAIM.

A. Reducing UNE prices even further might stimulate an increase in resale competition. Whether any resulting increase in competition would be economically sustainable or even beneficial to Florida is a debate for another day. Verizon's plan will create more economically rational retail prices, which in turn will create positive incentives for facilities-based (and other) competitors to target consumers.

Indeed, AT&T and Knology each made clear that their entry into the Florida local market was linked to the passage of the legislation authorizing pricing reform (Fonteix, Page 7, Lines 4–9). Such statements by actual competitors demonstrate that pricing reform will stimulate local competition for the benefit of residential customers.

The Draft 2003 Competition Report also contradicts Dr. Gabel's claim that UNE-P rates are the critical factor in stimulating residential competition:

> Table 7 also reveals that low margins may be more a result of low local rates than high UNE-P rates. UNE-P rates are based on the ILEC's forward-looking costs to provide local service, while local rates historically have been subsidized in order to

> make them more affordable. Residential rates in Florida are lower than most other states. Thus, even though Florida's UNE rates may be comparable to other states, CLECs may find the residential market less attractive. (Draft FPSC 2003 Competition Report, Page 18).

Q. DR. GABEL CONTENDS THAT RATE REBLANCING WILL NOT ENCOURAGE COMPETITION BECAUSE POTENTIAL ENTRANTS EVALUATE "EXPECTED TOTAL REVENUES," NOT THE PRICES OF INDIVIDUAL SERVICES SUCH AS BASIC LOCAL SERVICE (GABEL, PAGE 46, LINES 15–16). PLEASE COMMENT.

A. Dr. Gabel's contention is incorrect. In reality, competitors also consider the prices of individual services when making entry decisions. This is demonstrated by the fact that IXCs spent years fighting regulatory entry barriers to target long distance customers – a single part of the bundle – whose prices more than adequately covered their costs. And today, IXCs still make considerable efforts to sell stand-alone long distance service. That competitors consider the prices of individual services is also demonstrated by the fact that competitors compete in the market for a host of stand-alone services (e.g., unbundled handsets, customer premises equipment, operator services, directory assistance, calling cards, inside wire, and voice mail) because the prices of these stand-alone services produce a sufficient margin. That competitive focus on the source of the subsidy highlights Dr. Mayo's point that a policy of low residential basic service prices "actually acts to prevent the introduction and growth of competition." (Mayo, Page 14, Lines 21–22).

In my direct testimony, I recognize that individual prices and total customer bills both influence entry decisions. Moreover, by reference to a range of specific competitors and technologies, I demonstrate that Verizon's proposed rebalancing plan encourages market entry from both perspectives. Dr. Gabel's testimony fails to rebut the specific evidence that I present except to offer an irrelevant comment on the FCC's Triennial Review order. Accordingly, the evidence makes clear that rebalancing rates will provide an incentive for competitors to target residential customers.

Q. DOES MR. SHAFER TESTIFY THAT THE PRICES OF INDIVIDUAL SERVICES AFFECT MARKET ENTRY?

A. Yes, Mr. Shafer presents an analysis similar to mine, and concludes that the price of basic local services directly affect market entry:

> [T]he price of local exchange is a critical element for competitors to consider when choosing whether to enter a particular market.... One can reasonably expect that there will be additional market entry, particularly in markets that have previously been only marginally profitable or slightly unprofitable... [if the ILECs' petitions are approved] (Shafer, Page 8, Line 18 – Page 9, Line 7).

Q. DR. GABEL ARGUES THAT YOUR TESTIMONY ON INCENTIVES FOR COMPETITIVE ENTRY CONFLICTS WITH VERIZON'S FCC TRIENNIAL REVIEW COMMENTS (GABEL, PAGE 52, LINE 17–PAGE 55, LINE 8). PLEASE RESPOND.

A. I see no such conflict. In the excerpts Dr. Gabel cites, Verizon asserts that CLECs will look beyond basic rates in making their competitive entry decisions. I agree that entrants will not ignore possible revenues. At the same time, the prices of individual services have had an undeniable influence on patterns of entry in this industry, and will continue to influence entry into the future. Just because an entrant is going to consider the entire picture of possible opportunities does not mean it will overlook significant cross-subsidies within that picture.

Q. DR. GABEL OFFERS SEVERAL EXAMPLES (E.G., RAZORS AND BLADES, COMPUTER PRINTERS AND INK CARTRIDGES, AND WIRELESS PHONES AND SERVICE) IN AN ATTEMPT TO ARGUE THAT SUBSIDIZED BASIC RATES DO NOT IMPEDE COMPETITION AND THAT SUBSIDIZED PRICES MAY ACTUALLY BE PREFERABLE TO COMPETITORS (GABEL, PAGE 61, LINE 10–PAGE 66, LINE 6). PLEASE COMMENT.

A. The examples offered by Dr. Gabel are irrelevant because they relate to products that have different characteristics than telephone service. Dr. Gabel's examples relate to the phenomenon of "lock-in" – where a customer's initial purchase commits him to further purchases (e.g., of supplies, parts, software upgrades, and so forth) from the same supplier. The ability to "lock in" a customer is why it can make sense to give away the razor to sell the blades, or to sell a low-priced printer to encourage the purchase of high-priced replacement ink cartridges.

However, there is little or no lock-in for initial purchases that do not commit customers to ongoing use of the supplier's proprietary parts, upgrades, or supplies. For the most part, that description fits local telephone service in an equal access environment. To minimize lock-in, regulators have spent decades assuring that customers can access any competitor's services from an ILEC telephone. In particular, ILECs cannot rely on any ability to overcharge customers for toll and long distance service (the services at issue here) to make up losses on basic residential service. Verizon's "razor" also accepts AT&T's blades.

The dissertation excerpt Dr. Gabel cites about razors makes this point, by referring to discounted sales of sophisticated, innovative (perhaps patented) "shaving systems" to encourage customers to buy high-priced Gillette replacement blades. (Gabel, Page 64, Lines 8–11). By contrast, one would hardly expect Gillette to subsidize the sale of old-fashioned razors that use commodity double-edged blades. Likewise, computer companies intend only their own ink cartridges to be used in their low-priced printers. And while wireless providers do not offer equal access (and so create some lock-in), I have never seen a "free" wireless handset offered without a mandatory term contract (including a substantial early termination fee) that appears to offset the handset subsidy. Rather than getting something for nothing on the prospect of future usage, wireless customers pay for their handsets on the installment plan.

In sum, the examples cited by Dr. Gabel are not relevant here because telecommunications carriers cannot "lock in" their customers.

Q. DOES MARKET BEHAVIOR CONTRADICT DR. GABEL'S CLAIM ABOUT THE MARKET SUITABILITY OF SUBSIDIZED BASIC SERVICE PRICING?

A. Yes. A good test of Dr. Gabel's speculative claim is whether those companies that would purportedly benefit from basic service pricing actually embrace it. To believe that Dr. Gabel's suggested pricing strategy made sense, one would have to conclude that the ILECs would be doing themselves more harm than good through the present petitions, and that Knology and AT&T are mistaken as to their own best interests. Dr. Gabel does not cite any examples of competitive local telephone service providers that voluntarily practice such pricing absent either a regulatory requirement to do so, or lock-in contracts to assure cost recovery (as with wireless). Thus, the facts contradict Dr. Gabel's claim.

Q. DOES MR. OSTRANDER DIRECTLY ADDRESS THE ISSUES IN THIS PROCEEDING?

A. No. On most subjects, he provides no evidence of his own, but merely complains that the LECs have not satisfied him. For example, he complains that "the LEC proposals cannot prove that residential customers will gain a net benefit," in areas that include "enhanced competition," "rate changes," "new or unique service introductions," "uniquely associated benefits of capital investment," and "uniquely improved service quality." (Ostrander, Page 5, Lines 8–Page 6, Line 12). These unsupported complaints do not address the evidence submitted by the ILECs.

Q. DOES MR. OSTRANDER PROVIDE ANY EVIDENCE REGARDING COMPETITION AND VERIZON, SUCH AS THE COMPETITORS WITHIN VERIZON'S SERVICE TERRITORY, THE TECHNOLOGIES THEY USE, OR THEIR POSSIBLE COST STRUCTURES?

A. No. Moreover, he makes no reference to the extensive evidence on competition presented by Verizon.

Q. DOES MR. OSTRANDER'S TESTIMONY REFLECT A MISUNDERSTANDING OF A SIGNIFICANT ECONOMIC PRINCIPLE REGARDING COMPETITION?

A. Yes. Mr. Ostrander repeatedly refers to "LEC inelastic basic service revenues," as some kind of safe entitlement for Verizon and the other petitioners (e.g., Ostrander, Page 4, Line 20 – Page 5, Line 14). This demonstrates a misunderstanding of a basic economic principle. Customer demand for basic monthly service is highly inelastic (i.e., the demand by customers for basic service is not very sensitive to its price). However, that is not the same thing as an inelastic demand for a particular ILEC's services. When customers have choices, their determination to have some kind of basic service does not extend to a similar determination to buy it only from a particular provider.

For example, the demand for some level of food and nutrition is presumably also highly inelastic (general price increases will not deter customers from buying a basic amount of food). That is not the same, however, as saying that a particular restaurant or supermarket can raise its prices sharply and not lose customers.

LECs have been losing access lines, and their basic service revenues are not guaranteed in the manner that Mr. Ostrander asserts. In economic terms, we can correct Mr. Ostrander's error by noting that the demand for a given LEC's basic service is more elastic than is the overall market demand.

Q. MR. SHAFER EXPRESSES CONCERN THAT IT MAY NOT BE GOOD FOR SOME CUSTOMERS TO MIGRATE FROM NARROWBAND TO BROADBAND NETWORK CONNECTIONS (SHAFER, PAGE 13, LINES 3–19). PLEASE COMMENT.

A. There is both a customer-specific and societal dimension to my observation about how reform will bring the prices of basic access lines and broadband connections more in line with their relative costs. More economically sensible prices will allow individual customers to recognize that the step up to a more capable service is not as costly as they might have thought. This will encourage them to obtain broadband, and benefit from its use.

Florida will gain two benefits from accurate price signals that will accelerate broadband subscription. First, more customers will have broadband sooner, advancing the various social goals that are usually discussed for such deployment. Second, the scarce resources required to provide and maintain such connections will be used more efficiently if customers choose between them based on prices that more accurately reflect costs.

Q. MR. FONTEIX (PAGE 2, LINES 18–22) EXPRESSES CONCERN ABOUT AN "ANTI-COMPETITIVE PRICE SQUEEZE" HE BELIEVES IS CREATED BY CURRENT ACCESS CHARGES. IS HIS CONCERN VALID?

A. No. Mr. Fonteix argues that an ILEC charging an above-cost access charge might price its own toll service below that access charge – thereby freezing out competitors – and still make a profit on the service. His claim ignores a basic principle of economics – that of opportunity cost. If an ILEC were to divert traffic from IXCs in the manner suggested, the ILEC would forego the access charges paid by the IXCs. As a result, the ILEC would make a smaller profit (i.e., it would receive less money than it did from the IXC, and it would have to provide the long distance service in place of the IXC). Accordingly, an ILEC would not engage in the behavior that purportedly concerns Mr. Fonteix because it would be economically irrational to do so.

The only possible incentive an ILEC could have to engage in the suggested behavior would be to drive the IXC out of business, re-monopolize the market, and then raise prices to sufficient levels to recoup at least as much money as it had lost in the process. However, predatory pricing is illegal, virtually impossible to perpetrate for a wide variety of reasons (including the oversight of this Commission), and rarely seen in reality. It is thus widely recognized as an irrational tactic by many authorities, including the U.S. Supreme Court. (*Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.* (92-466), 509 U.S. 209 (1993)). Accordingly, Mr. Fonteix's purported concern about a "price squeeze" is unfounded.

In any event, since the pro-competitive benefits of pricing reform do not hinge on this claim, there is no need to consider this issue further.

IV.
BASIC LOCAL SERVICE RATE SUBSIDIES ARE GENUINE AND UNDENIABLE

Q. ARE DRS. COOPER AND GABEL CORRECT IN ASSERTING THAT BASIC RESIDENTIAL RATES ARE NOT SUBSIDIZED?

A. No. The loop is a cost of basic service (as the Commission has found), and the Commission's own approved UNE cost calculations reveal the subsidy (as Mr. Fulp has described). It remains true that basic residential rates are subsidized, and therefore supported.

Q. THE STATUTE SPEAKS OF REMOVING "SUPPORT" FROM RESIDENTIAL RATES. HOW IS SUPPORT RELATED TO SUBSIDY?

A. "Support" is the difference between current rates and those that would fully recover costs (including common costs) – which are, in a competitive context, competitive market rates. The Telecommunication Act of 1996 ("TA96") distinguishes the term "support" used in Section 254 (when discussing universal service support for prices) from the prohibition of "subsidy" of competitive services as discussed in Section 254(k). When I use the term "subsidy," I refer to prices below marginal or incremental cost. Therefore, even rates that are not subsidized can be supported, if they are required to be set below market levels. Additionally, since competitive market prices must recover common costs, the calculated size of a subsidy is a lower bound for the actual extent of support, a point Dr. Gabel does not appear to recognize in his testimony.

Q. IS THERE A GENERALLY ACCEPTED UNDERSTANDING THAT RESIDENTIAL BASIC SERVICE RATES ARE SUPPORTED?

A. Yes. The D.C. Circuit Court of Appeals recently observed that implicit support flows have tended to result in rates that are lower than they otherwise would be for residential and rural customers. *Report and*

Order on Remand and Further Notice of Proposed Rulemaking, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 01-338; 96-98; 98-147, August 21, 2003, Para. 156. The Commission's Fair and Reasonable Rate Report also reported subsidy levels in LEC basic rates, showing that those rates are supported in Florida. FPSC Report, Pages 23-24.

Q. DR. GABEL'S DISCUSSION OF COST STUDIES AND STANDARDS GOES ON FOR MANY PAGES. IS THIS DISCUSSION BASED UPON A FALSE PREMISE?

A. Yes. Dr. Gabel takes an incorrect assumption, or perspective, and follows it through to its logical conclusion. Little more than that occurs in his entire discussion of TSLRIC, TELRIC and cost studies (i.e., Sections 3.1–3.2). As discussed below, the Commission should disregard this erroneous reasoning, and the unreliable results it produces.

Q. WHAT IS DR. GABEL'S INCORRECT ASSUMPTION?

A. Dr. Gabel confuses the costs of a service with either the identity of the customer who happens to be using it (as with business and residential basic service), or the manner it is used (as with data services). He assumes erroneously that, from a costing standpoint, the components used to provide basic residential and basic business service are different. Based on that incorrect assumption, he severely underestimates the cost of basic residential and basic business service by excluding from his cost calculation any facilities that these services have in common.

Q. WHAT IS THE CORRECT APPROACH TO DETERMINING THESE COSTS?

A. Rather than starting with a use or a user, as does Dr. Gabel, one should start with the costs of the facilities or activities that comprise each service. The principal cost item, as Dr. Gabel reluctantly acknowledges, is the loop. Loops are the general means of providing access to an ILEC network; and whether a loop is used to serve a residential or a business customer, its engineering and physical characteristics are the same. Moreover, whether a loop is used to serve a business or a residential customer depends on which customer happens to be at a location, not something inherent in the design of the loop itself.

It is therefore correct from a costing standpoint to calculate the incremental cost of a loop as a single kind of facility that is used to provide network access to a variety of customers, or uses. That is what this Commission (like its peer agencies across the country) has done for UNE pricing purposes. All the equipment and expenses that are incremental to creating loops should be included in the cost of the loop. Then, to calculate the cost of a particular service that includes the loop (such as residential or business basic service), one should add up the cost of the loop, plus the cost of other components of the service (such as local usage) – just as Verizon has done in this proceeding.

Q. HAS DR. GABEL'S ERRONEOUS ASSUMPTION ALSO BEEN REBUTTED BY AN EMINENT AUTHORITY?

A. Yes. Dr. Alfred Kahn addressed this argument directly in an extended analysis of the fallacies of loop allocation in telephone service costing. See Kahn, Alfred E. Letting Go: Deregulating the Process of Deregulation (Institute of Public Utilities and Network Industries, Michigan State University, 1998), Pages 73-76. Dr. Kahn made two observations consistent with my analysis above: (1) that the loop is the heart of basic telephone service, to which its cost obviously belongs ("...to define basic service as not essentially equivalent to the loop is to define Hamlet without the Prince of Denmark"); and, (2) that the proper estimate of the cost of a service is the higher of the TSLRIC result, or the LRIC (long run incremental cost) of the various elements (such as the costs of the loop and the costs of associated local usage) that comprise the service. Verizon's approach, unlike Dr. Gabel's, is consistent with the methodology advocated by Dr. Kahn.

Q. DO DR. GABEL'S RESULTS FOLLOW FROM A DIFFERENCE IN TIMING (E.G., THE POSSIBILITY THAT SOME COSTS MIGHT BE FIXED IN THE SHORT-RUN)?

A. No. Dr. Gabel asserts that he is providing a TSLRIC analysis (i.e., one based on Total Service *Long Run* Incremental Cost), as opposed to a short-run analysis during which some costs might reasonably be assumed not to vary.

Q. HOW DOES DR. GABEL MISUSE HIS INCORRECT ASSUMPTION?

A. To determine the incremental costs of serving residential customers, Dr. Gabel starts by assuming (in effect) that a whole network infrastructure has already been built to provide loops to business customers. He then relies on this erroneous assumption to exclude costs that are common to both services from his calculations.

Q. IS THERE A SELF-FULFILLING ASPECT TO DR. GABEL'S ANALYSIS REGARDING SUBSIDIES AND THEIR IMPACT?

A. Yes. The existence of separate tariffs for residential and business customers is one factor that has facilitated the creation of subsidies, by allowing residential and business customers to be charged different prices for essentially the same service. Rather than acknowledging this situation for what it is, Dr. Gabel claims (in effect) that creating the different pricing categories eliminates the subsidy – because everything that exists in common between the two services is no longer relevant for determining incremental costs.

Dr. Gabel's analysis is erroneous because the choice of how network access is priced to different customers does not affect the underlying network costs of providing it. For example, if the pricing categories were combined (so that there was just one basic service applicable to all customers), then according to Dr. Gabel's method the subsidy would once again exist – because those costs would no longer be allocated between pricing categories. If, subsequently, a category of business customer persuaded the Commission to create a separate tariff for its purchases, the subsidy would again vanish. In this way, calculations of basic service costs would fluctuate widely, even though nothing had changed about how the phone network was actually built or maintained, or how these services were provided.

The ability to make subsidies seem to appear and disappear in this arbitrary fashion is another indication of the fundamental problems with Dr. Gabel's approach. The Commission should disregard the costing approach advocated by Dr. Gabel, and the unreliable numerical calculations it produces.

Q. DR. GABEL CRITICIZES THE LECS' USE OF TELRIC UNE COST ESTIMATES TO DETERMINE THE LEVEL OF SUBSIDY IN RESIDENTIAL BASIC SERVICE RATES. DID THE FCC ENCOURAGE STATES TO COORDINATE THE DEVELOPMENT OF UNE COST STUDIES WITH THOSE USED TO CALCULATE UNIVERSAL SERVICE SUPPORT?

A. Yes. The FCC encouraged states to relate these studies:

> [T]o prevent differences between the pricing of unbundled network elements and the determination of universal service support, we urge states to

> coordinate the development of cost studies for the pricing of unbundled network elements and the determination of universal service support."

Report and Order. In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, May 8, 1997, Para. 251. Verizon's use of approved FPSC UNE costs for determining the extent of subsidy is consistent with that encouragement from the FCC.

Q. DR. GABEL OBJECTS TO VERIZON'S USE OF UNE RATES TO CALCULATE THE SUBSIDY IN BASIC RESIDENTIAL SERVICE PRICES (GABEL, PAGE 21, LINE 8 – PAGE 23, LINE 7). DOES HIS OBJECTION HAVE MERIT?

A. No. The UNE prices employed by Verizon represent approved FPSC calculations of forward-looking economic costs; they are appropriate for use in calculating the subsidy in basic residential services prices and should be presumed to be correct here. Further, since residential services are generally provided in less dense areas than business service and therefore tend to have longer and more costly loops, the statewide average UNE loop rate is a conservative estimate of the cost of loops used to provide residential basic service.

Dr. Gabel's only specific criticism is to remove the common costs from the UNE rates. However, while neither TELRIC nor TSLRIC by themselves includes common costs, the proper cost standard for measuring <u>support</u> is competitive market prices, which must recover common costs; therefore, common costs are a reasonable factor to include in measuring support. Additionally, the level of common costs that is included in these UNE rates is less than the retailing costs that are left out, but which belong in a TSLRIC study. Adjusting for both of these factors would thus increase, not reduce calculated incremental costs.

Q. DOES DR. COOPER ALSO ADVANCE AN ARGUMENT TO DENY THE EXISTENCE OF SUBSIDIES?

A. Yes. He reargues a claim that was exhaustively debated (and rejected) in the Commission's fair and reasonable rate study process – that the loop should be considered a common cost, rather than a cost of basic service (Cooper, Page 17, Line 3 – Page 26, Line 5). As one who participated in that process, it is apparent to me that that Dr. Cooper is merely repeating arguments that were already addressed at length in a debate that led to the Commission's conclusion that the loop is appropriately considered a cost of basic service:

> the principle of cost causation leads one to the unavoidable conclusion that the decision to have local service leads to the incurrence of loop costs.

(Fair and Reasonable Rates Report, Page 51).

In responding to Dr. Cooper's arguments, it is difficult to know to what extent one should rebut such claims given that the Commission has already ruled on this dispute in a study process in which Dr. Cooper and his client both participated. Briefly, the cost of the loop is incurred – in its entirety – by providing basic service to a customer. The decision to have basic service is what causes the cost to be incurred. The essence of the economic definition of "cost" is causation; and a customer's decision to use a loop to buy other services, or to call other people, no more "causes" the cost of that loop than does a mail carrier "cause" the cost of one's driveway by walking down it to deliver a package. This is the correct analysis with which the Commission agreed in the fair and reasonable rate study process, and nothing Dr. Cooper states here changes it. (An extensive discussion and refutation of the loop allocation fallacy can be found in Kahn, Pages 70-89).

Q. REFERRING TO THE EARLY 1900S, DR. COOPER STATES THAT TELEPHONE NETWORKS, "INCLUDING THE LOOP," ARE NOW ENGINEERED TO HANDLE MULTIPLE SERVICES THAT SHOULD BE ALLOCATED SOME OF THE LOOP'S COST (COOPER, PAGE 18, LINE 22 – PAGE 19, LINE 1). IS THIS RELEVANT?

A. No. The incremental costs of network access, in the manner service is provided today, are caused by the subscriber's decision to have network access. Therefore, the fact that today's loop can handle multiple services is irrelevant, and musings about 1900-vintage systems are beside the point.

Q. DR. COOPER CLAIMS THAT A VARIETY OF AUTHORITIES (INCLUDING "THE FCC, THE STATES, AND THE COURTS") HAVE

"CONSISTENTLY AND REPEATEDLY" FOUND THAT THE LOOP IS A COMMON COST (COOPER, PAGE 21, LINES 5–6). PLEASE COMMENT.

A. Dr. Cooper offers a selective, dated list of filings, comments and a few decisions to support his incorrect claim. It is true that some authorities have yielded to confusion (or an apparent desire to justify a preference for subsidized basic rates) and come to such a conclusion. But by way of state counter examples, Dr. Cooper's list does not include California, or (most importantly for present purposes) Florida. Dr. Cooper's claim about the FCC is particularly odd, since the FCC has been the most consistent and effective regulatory proponent of shifting loop costs from access charges to fixed monthly fees paid by the subscriber – as the FCC did when it created the subscriber line charge, which involved the same kind of reform that is proposed here by Verizon.

Dr. Cooper's employer (the Consumer Federation of America) was one of the organizations that opposed the subscriber line charge based on a claim that it would drive millions of subscribers off the network. As reported by Professor Hausman and his colleagues, not only was that claim proved wrong, millions more subscribers would have been kept off the network if the FCC had abandoned that reform at the CFA's behest. Hausman, Jerry, Tardiff, Timothy, and Alexander Belinfante. "The Effects of the Breakup of AT&T on Telephone Penetration in the United States," American Economic Review 83, Volume 2 (May, 1993), 178-184. The Commission should disregard this tired argument from an advocate whose employer's prior advice on the same subject would have demonstrably harmed consumers and universal service.

As for the views of the courts, in its 1984 opinion reviewing the FCC's decision to impose per-line subscriber line charges (NARUC v. FCC, 737 F.2nd 1095 [1984]), the District of Columbia Circuit Court of Appeals made the following statement about the cost characteristics of local loops, and how those relate to appropriate recovery of those costs:

> Plant costs are nontraffic sensitive when they do not vary with the extent to which the facilities are used. The basic cost of installing and maintaining a local loop, for example, remains the same whether the subscriber, or 'end user,' uses the loop to make one call or a hundred, and whether those calls are local or long-distance. (Opinion, Page 1104).
>
> The end user charge reflects costs caused not by a subscriber's actually making interstate calls, but by the subscriber's connection into the interstate network, which enables the subscriber to make interstate calls. The same loop that connects a telephone subscriber to the local exchange necessarily connects the subscriber into the interstate network as well. Under Smith, a portion of the costs of that loop are assigned to the

> interstate jurisdiction, for recovery under the regulatory authority of the FCC, on the basis of a complex division taking into account statistical calling patterns. That separations decision, however, does not affect the cost of the loop. Local telephone plant costs are real; they are necessarily incurred for each subscriber by virtue of that subscriber's interconnection into the local network, and they must be recovered regardless of how many or how few interstate calls (or local calls for that matter) a subscriber makes. (Opinion, Pages 1113-14).

> Every telephone subscriber is automatically connected through the same subscriber plant into both the local exchange and the interstate network. No subscriber can avoid 'causing' those costs of its telephone line allocated to the interstate jurisdiction. (Opinion, Page 1115).

In defending the FCC's CALLS order on appeal, the Department of Justice made these same points in March, 2002. See Brief for the Federal Respondents in Opposition (to a petition for writ of certiorari), National Association of State Utility Consumer Advocates v. Federal Communications Commission and United States of America, (U.S. Supreme Court No. 01-968), March, 2002, Pages 14-15 ("...It has long been accepted that the customer 'causes' the costs of the loop...[b]ecause the costs of the loop are not traffic-sensitive, the costs caused by a particular customer do not vary depending on how many calls he or she makes...[T]he SLC requires consumers to pay only for the loop costs that they cause...[I]t is end-users of the telecommunications network, not their long-distance carriers, that ultimately cause the costs associated with interstate access.").

These facts and citations flatly contradict Dr. Cooper's claim that state and federal authorities have uniformly found that the loop is a common cost.

V.

RESIDENTIAL CUSTOMERS WILL BENEFIT FROM VERIZON'S PLAN

Q. DID ANY WITNESS PRESENT EVIDENCE SHOWING THAT CUSTOMERS HAVE BEEN FORCED OFF THE NETWORK BY PRICING REFORM, OR THAT ANY PARTICULAR CUSTOMERS HAVE EVER SUFFERED ANY RELATED HARDSHIP?

A. No, they did not, even though pricing reform in places such as California, Massachusetts, Maine, and across the nation (through the Federal subscriber line charge, and related access charge cuts) should have produced such results if there was any credence to such claims. In actuality, the evidence shows that pricing reform has improved universal service, and not caused any notable difficulties for customers.

Q. DR. GABEL SUGGESTS THAT THE BENEFITS TO RESIDENTIAL CUSTOMERS OF REDUCED TOLL AND IN-STATE LONG DISTANCE PRICES WILL BE "MINIMAL" (GABEL, PAGE 66, LINE 8 – PAGE 72, LINE 8). PLEASE COMMENT.

A. During my time at the California Public Utilities Commission, I observed a very consistent response in personal discussions with residential customers about telephone service pricing. Most had little to say about their rates and bills, except to complain about the high prices they paid to make toll calls within the state. Based upon these discussions, I firmly believe that, contrary to Dr. Gabel's contentions, customers care about the price of calling, and can distinguish between various kinds of toll calls and their prices. It was this belief, along with an understanding of the economics of telecommunications pricing, that motivated me and the Commissioner I advised to pursue pricing reform.

Dr. Gabel minimizes the economic benefits to customers of the additional calls they will make if prices are reformed. He cites Dr. Tardiff's one-year elasticity estimate for California of -.24, suggesting that price responsiveness will be modest -- in part because the value of a customer's time will become the limiting factor on call volumes when prices get low enough. I disagree with the claim that customer response to price changes will be minimal. Call volume increases will be more than trivial considering that (1) the access charge reductions proposed here are substantial and (2) call volumes will increase over time (multiyear responses will exceed the first year's worth). In any event, reaching the point at which the value of one's time is the limiting factor on toll calling (rather than the resulting phone bill) would be a welcome development for customers in Florida.

Dr. Gabel also fails to recognize the benefits to residential customers of abolishing IXC in-state long distance monthly fees (e.g., $1.88/month for AT&T residential customers), or the expanded eligibility for Lifeline. Moreover, he fails to recognize the benefits to customers of additional local competition. Of course, these are very real benefits that should be considered in the Commission's analysis.

Q. WOULD DR. GABEL'S ALTERNATIVE REBALANCING APPROACH BE BETTER FOR CONSUMERS AND COMPETITION THAN VERIZON'S PLAN (GABEL, PAGE 74, LINES 2–10)?

A. No Dr. Gabel's alternative approach embodies the unrealistic view of the market I addressed above. Such an approach would fail to reduce network access subsidies to the same degree as Verizon's plan, while merely shifting around (to different services) other substantial support that now exists in access charges. From the standpoint of economic efficiency and promoting competition for the benefit of residential customers, more progress towards economically rational pricing is better.

Q. DR. COOPER WOULD PREFER THAT BUSINESS RATES RECEIVE

SUBSTANTIALLY HIGHER INCREASES SO THAT RESIDENTIAL CUSTOMER TOTAL BILLS COULD DECREASE (COOPER, PAGE 30, LINE 18 – PAGE 34, LINE 5). MR. OSTRANDER ATTEMPTS TO ESTIMATE WHETHER AVERAGE RESIDENTIAL BILLS WILL DECLINE ON AN INITIAL BASIS (OSTRANDER, PAGE 18, LINE 4 – PAGE 32, LINE 7). PLEASE COMMENT.

A. No particular short-term bill impact is required by the statute, nor by fairness. Moreover, focusing solely on such short-term goals and ignoring the very real benefits of competition would be wrong.

First, the statute says nothing about total customer bills, or a monetary accounting of benefits. There is no pass-fail test that has to be satisfied with respect to any particular set of customer bills.

Second, the statute refers specifically to removing "...current support for basic local telecommunications services that prevents the creation of a more attractive competitive market for the benefit of residential customers." (Section 364.164(1)(a)). This can only mean raising below-cost basic residential rates. Raising basic business rates will do nothing to help residential customers become a more attractive market to competitors; and, basic residential rates are the services that are supported in Florida.

Third, there is no doubt that customer bills will change, both as a direct result of the plan, and increased competition and changes in customer behavior once the new rates are put in place. Whatever customer bills may be a month after pricing reform is concluded, they will be different a year later, and different again a year after that. Customers will use their phones more, and will respond to new competitive options and offers in ways that are difficult to predict precisely, but will certainly occur.

Fourth, it is not surprising that a proportion of residential customers, and perhaps residential customers as a whole, might come out with small average bill increases. Basic residential rate subsidies are substantial for Verizon's customers in Florida. The benefits of competition will more than offset the small initial bill increases experienced by residential customers.

Fifth, it is fair for consumers to cover the costs of the services they use. While no one wants to pay a higher bill for service, customers whose bills increase will only be paying their fair share of what it costs to provide service. Other customers who have been overpaying will see their bills reduced. Although there is more to the benefits of this plan than a short-term dollars and cents calculation, the bill shifts that occur between customers will be inherently fair.

Finally, reforming prices will make residential customers more attractive targets to competitive providers. Already, AT&T and Knology have entered the Florida local market in anticipation of this reform and other competitors will follow. The benefits that will flow from increased competition will more than outweigh a few percent of an average residential bill.

Q. HAVE YOU CALCULATED THE CHANGE IN AVERAGE RESIDENTIAL TELEPHONE BILLS THAT WOULD OCCUR UNDER VERIZON'S PLAN?

A. Yes. I should, however, highlight some important caveats before reviewing these results.

First, under the statute there is no obligation to review average customer bills, or consider any related changes in bills.

Second, the objective of the statute is to accelerate the transformation of the residential local telephone market from a monopoly to a competitive environment. As a transformative measure, Verizon's plan will create new opportunities for customers both through reduced toll and long distance calling prices, as well as new competitive options and technologies over time. By contrast, a bill impact analysis is static – it takes customers' current purchases and calling habits and projects them into a future in which we know their habits will change. Therefore, the validity of any such bill analysis is only short-term at best, and its results will overlook many of the benefits of pricing reform.

Third, as customers adjust to the new prices and opportunities they face, they will become progressively better off as their purchasing and consumption decisions (and phone bills) change. For example, a customer who chooses to make more long distance calls (in response to a lower price) or switches to a new competitive entrant will receive an economic benefit that helps to offset any initial bill increase that the customer may experience. And, of course, a customer whose bill goes down initially will only gain further benefits of this kind over time. Although these effects can be difficult to quantify, they more than offset any small initial bill increases that residential consumers may experience.

Finally, as Mr. Fulp has explained, the actual price changes that occur in the second and third phases of reform will be determined based on the most recent 12 months' billing units (as the statute requires). This means the actual rate changes will vary somewhat from those used for this analysis. For example, if Verizon's access minutes of use continue to decline, the amount of revenue to be rebalanced will be less. Other variables may also change. This is another reason why the bill impacts noted below are only initial projections.

Q. HAVE CUSTOMERS ALREADY RECEIVED BENEFITS OF THE KIND THAT VERIZON'S PLAN WILL CREATE?

A. Yes, they have, by diverting long distance calls from wired to wireless networks to take advantage of a low (or free) price for such calls. Estimates are that customers have already shifted about 30 percent of wired long distance traffic in this fashion, thereby saving the access charges on those calls (since wireless carriers do not pay the same kind of access charges the Commission has required for Verizon in Florida). In this fashion, Florida customers have already received a down payment on the benefits of Verizon's plan that is not captured in the average bill figures I report below. Moreover, the fact that customers have already begun diverting long distance calls from wired to wireless demonstrates that consumers will avail themselves of the benefits of competition that will flow from Verizon's rate rebalancing plan.

Q. DOES THE STAFF RECOGNIZE SOME OF THE DYNAMIC BENEFITS OF REFORM THAT RESIDENTIAL CUSTOMERS WILL RECEIVE?

A. Yes. Mr. Shafer recognizes that intermodal competition has benefited customers and that approving the LECs' petitions should lead to more competitive activity of this kind. (Shafer, Page 10, Line 13 – Page 11, Line 7). The competitive interplay between wireless and wireline carriers is one example of benefits for residential customers that will be ignored if the Commission focuses solely on an initial average bill analysis. This benefit will be enhanced by the recent affirmation by the FCC that local number portability will permit customers to take landline phone numbers to wireless phones (FCC News Release, "FCC Clears Way for Local Number Portability Between Wireline and Wireless Carriers," November 10, 2003).

Q. WHAT RESULTS DID YOU OBTAIN FROM YOUR AVERAGE BILL

ANALYSIS?

A. With respect to the population of residential customers Verizon now serves, the initial, static effect of Verizon's plan will be to increase the average telephone bill by about $1.00/month. This result includes the initial customer benefits (i.e., flow-through of access charge reductions and elimination of long distance carrier monthly access fees), but not any of the dynamic benefits over time that I described above – which are an important focus of the legislation, and of Verizon's plan. These results are also more accurate than the preliminary results I discussed at a deposition in this proceeding.

Existing Lifeline customers will see their bills reduced by $3.15 per month, and about 20,000 additional, new Lifeline subscribers will receive not only that benefit, but an additional $13.50/month for qualifying under the expanded eligibility standards.

A similar calculation was performed that focused on the age distribution of Verizon's Florida customers. That calculation is set forth below:

Age Strata	Florida Lines (confidential)	Net Change: (confidential)
18-25 years	**REDACTED**	**REDACTED**
26-35 years	**REDACTED**	**REDACTED**
36-45 years	**REDACTED**	**REDACTED**

46-55 years	**REDACTED**	**REDACTED**
56-65 years	**REDACTED**	**REDACTED**
66-75 years	**REDACTED**	**REDACTED**
76 + years	**REDACTED**	**REDACTED**
unknown	**REDACTED**	**REDACTED**

Finally, although we did not calculate this data, from experience I know that every demographic group of customers will contain high, low, and average bills that reflect the varying ways people use their telephones. So, for example, there are certainly some low-income customers with high bills who effectively subsidize some high-income customers with low bills. Likewise, among individual customers the subsidies will flow in every direction with respect to age groups, ethnicity, or any other demographic characteristic. Additionally, given the large volume of long distance calling that has moved to wireless phones, some low-bill customers will merely be those who no longer use a wired phone for these calls – and who have already received related benefits, as I noted above.

Q. SHOULD THE COMMISSION BE CONCERNED BY AN INITIAL CHANGE IN AVERAGE RESIDENTIAL BILLS OF ABOUT $1 PER MONTH OCCURRING OVER A PERIOD OF MORE THAN TWO YEARS?

A. Based on my experience helping reach a wide variety of rate decisions at the largest state commission in the country, a phased-in rebalancing of this modest amount will not be disruptive to customers and will fall well within the realm of ratemaking decisions and adjustments that regulatory commissions regularly undertake.

Indeed, the modest size of this effect highlights several important facts about customer bills and rates:

- Residential customers do cross-subsidize themselves on the same bill, and will benefit substantially from lower calling prices that result from reform;
- The elimination of long distance carrier monthly access fees directs substantial benefits towards residential customers;
- The notion that residential customers are affected only by basic monthly rates is a myth.

Q. IS THE SLIGHTLY HIGHER INITIAL CHANGE IN THE BILLS OF OLDER CUSTOMERS A PARTICULAR CONCERN?

A. No, it is not. These amounts are also not large in light of the extent of reform that Verizon's rate rebalancing plan will produce, and, they reflect only averages that do not address the distribution of high, low, and average bill customers that will exist among these age groups. The targeted benefits of the expanded Lifeline program will also provide added protection for the low-income elderly.

Q. MR. OSTRANDER CONTENDS THAT OFFSETTING RATE

REDUCTIONS TO TOLL AND LONG DISTANCE PRICES MAY ONLY BE TEMPORARY, AND THAT LECS OR IXCS MAY RAISE RATES IN THE FUTURE TO OBVIATE THE BENEFITS OF VERIZON'S PLAN. (OSTRANDER, PAGE 32, LINE 9 – PAGE 35, LINE 14). IS THIS A VALID CONCERN?

A. No. The competitive toll and long distance market will not permit carriers to raise prices back to levels that would obviate the sharp access charge reductions that are proposed by Verizon and the other LECs. Whether or not a carrier may have the legal authority to attempt such increases under the Commission's authority to supervise the pass-through, there is too much competition – both from wired and wireless alternatives – to permit that to occur.

Q. MR. OSTRANDER POINTS TO A SPRINT PRICE CAP FILING THAT INCREASED SOME MTS RATES AS EVIDENCE FOR HIS CONCERNS. HE ALSO STATES THAT "THE TOLL RATE REDUCTIONS SHOULD DEFINITELY NOT BE SKEWED TOWARDS CALLING PLANS USED BY LARGE VOLUME RESIDENTIAL TOLL CUSTOMERS, THE TOLL RATE REDUCTIONS SHOULD IMPACT THOSE PLANS USED BY THE AVERAGE RESIDENTIAL TOLL CONSUMER." (OSTRANDER, PAGE 36, LINES 6–9). PLEASE COMMENT.

A. While I will leave it to Sprint to discuss its own rate adjustments, it is common for long distance competitors to adjust the prices of various plans in response to competitive conditions, and the underlying costs of serving customers. This is a healthy and normal part of competition that involves discounts and attractive packages in addition to increases such as the one Mr. Ostrander chose to highlight. The elimination of monthly long distance carrier fees will provide a baseline benefit for many residential customers, including (presumably) many low-volume callers. Customers can also move between the many different calling plans that long distance carriers offer. In light of these factors, the Commission should hesitate before accepting any invitation to specifically target price reductions towards particular customers, or those Mr. Ostrander might consider "average."

Q. MR. OSTRANDER COMPLAINS THAT "THE POTS CUSTOMERS ARE BEING ASKED TO PAY FOR SOME OF THE ACCESS RATE REDUCTIONS ASSOCIATED WITH BUSINESS CUSTOMERS AND THE ESTIMATED RATE REDUCTION ASSOCIATED WITH SUBSCRIBERS TO BUNDLED GOODS." (OSTRANDER, PAGE 37, LINES 18–20). IS THIS AN APPROPRIATE CONCERN?

A. No. It would be more accurate for Mr. Ostrander to characterize possible complaints of business customers who have been asked to subsidize below-cost residential service for many years. Remedying a subsidy requires, to at least some degree, an increase in the price of the service that has been subsidized. Additionally, given that over half the population of Florida now has a wireless phone, it is becoming less clear to what extent the stereotypical "POTS customer" still exists. Finally, as the average bill analysis shows, Verizon's plan is balanced and will have only a modest short-term effect on the average bills of residential customers.

Q. MR. OSTRANDER CLAIMS THAT LECS DID NOT "PROVIDE SPECIFIC AND TANGIBLE DOCUMENTATION" TO DEMONSTRATE THAT THEIR PLANS WILL RESULT IN "INCREASED MODERNIZATION," OR NEW SERVICE INTRODUCTIONS IN FLORIDA. (OSTRANDER, PAGE 39, LINE 11 – PAGE 41, LINE 8). PLEASE COMMENT.

A. Mr. Ostrander's claim is incorrect. Verizon's showing provided extensive, specific information on competitors and technologies that will be encouraged to focus on Verizon's residential customers. Mr. Ostrander provided nothing except his personal skepticism about some data responses. Verizon's showing is more than enough to demonstrate the competitive potential for innovative services and investment that will be encouraged by its plan.

VI.
CONCLUSION: THE COMMISSION SHOULD APPROVE VERIZON'S BALANCED PLAN FOR LONG-OVERDUE PRICING REFORM

Q. DR. COOPER CLAIMS THAT THE ILECS ARE PROPOSING A "RADICAL AND RAPID RATE REBALANCING BASED ON A NARROW, THEORETICAL VIEW OF THE ANCIENT HISTORY OF THE TELECOMMUNICATIONS INDUSTRY." (COOPER, PAGE 2,

LINES 20–21). IS THIS ACCURATE?

A. No. Verizon's plan would reduce the current subsidy of residential basic service rates by less than five dollars per month over three adjustments during a period of just over two years. It would do so through revenue-neutral offsets to access charges that will ultimately cost Verizon somewhat more in rate reductions than the increases will raise, and will benefit residential customers in the variety of ways I and others have described. The national average wired residential telephone bill is on the order of $50/month, in addition to nearly comparable amounts that half the population (and more in Florida) spends on wireless phones. Against this, pricing reform creating an initial impact of about a dollar cannot be disparaged as "radical." With respect to Dr. Cooper's other characterizations, Verizon's plan is historical in only one sense – pricing reform is overdue in Florida, and Verizon's plan will advance it.

Q. TAKEN TOGETHER, DOES THE TESTIMONY OF DR. COOPER AND DR. GABEL LEAD TO A CONFUSED AND CONTRADICTORY RESULT?

A. Yes. Dr. Cooper claims that residential bills must actually decline as part of a process to stimulate additional competition for residential customers whose subsidized basic service is now largely overlooked by competitors. Dr. Gabel claims that only total customer bills matter to competitors in deciding which customers are attractive. Left unanswered is how the lower customer bills on which Dr. Cooper insists will do anything but drive the competitors Dr. Gabel sees further away from residential customers.

In other words, by their own assertions and proposals, Drs. Cooper and Gabel essentially ask the Commission to make a nullity of the statute's goal of stimulating more competition for the benefit of residential customers. But as I have described, a common sense reading of the statute combines with a reasonable analysis of the economic issues to show that Verizon's plan will deliver the improved competitive incentives the Legislature seeks, on a basis that is reasonable and fair to customers.

Q. NOTWITHSTANDING OPPOSITION CLAIMS, DOES VERIZON'S PETITION OFFER THE COMMISSION A POSITIVE AND BENEFICIAL OPPORTUNITY ON BEHALF OF THE PEOPLE OF FLORIDA?

A. Yes. Most of what I have described in testimony reduces to two key points.

First, it is undeniable that telephone service prices are skewed in Florida, as they once were across the country. What is also undeniable is that reforming those prices to make more economic sense will create genuine benefits and stimulate competition. This is the right thing for the Commission to do.

Second, experience elsewhere combines with analysis of Verizon's plan to reveal that the transitional impacts of pricing reform will not be problematic. Shifts in phone bills will be modest, gradual, and soon modified by the responses of customers to beneficial new opportunities.

Q. WHAT ACTION SHOULD THE COMMISSION TAKE?

A. The Commission should approve Verizon's petition, along with those of BellSouth and Sprint. Verizon's petition conforms with the statute, with the Commission's own conclusions on pricing reform, and with the interests of Florida's consumers and its economy.

Q. DOES THAT CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes.