

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

PETITION BY VERIZON FLORIDA, INC.
TO REFORM INTRASTATE NETWORK ACCESS
AND BASIC LOCAL TELECOMMUNICATIONS
RATES IN ACCORDANCE WITH SECTION
364.164, FLORIDA STATUTES.

DOCKET NO. 030867-TL

PETITION BY SPRINT-FLORIDA,
INCORPORATED TO REDUCE INTRASTATE
SWITCHED NETWORK ACCESS RATES TO
INTERSTATE PARITY IN REVENUE-NEUTRAL
MANNER PURSUANT TO SECTION
364.164(1), FLORIDA STATUTES.

DOCKET NO. 030868-TL

PETITION FOR IMPLEMENTATION OF
SECTION 364.164, FLORIDA STATUTES,
BY REBALANCING RATES IN A
REVENUE-NEUTRAL MANNER THROUGH
DECREASES IN INTRASTATE SWITCHED
ACCESS CHARGES WITH OFFSETTING
RATE ADJUSTMENTS FOR BASIC SERVICES,
BY BELL SOUTH TELECOMMUNICATIONS, INC.

DOCKET NO. 030869-TL

FLOW-THROUGH OF LEC SWITCHED
ACCESS REDUCTIONS BY IXCs,
PURSUANT TO SECTION
364.163(2), FLORIDA STATUTES.

DOCKET NO. 030961-TL

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PROCEEDINGS:

HEARING

FLORIDA PUBLIC SERVICE COMMISSION

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1 BEFORE: CHAIRMAN LILA A. JABER
2 COMMISSIONER J. TERRY DEASON
3 COMMISSIONER BRAULIO L. BAEZ
4 COMMISSIONER RUDOLPH "RUDY" BRADLEY
5 COMMISSIONER CHARLES M. DAVIDSON

6 DATE: Thursday, December 11, 2003

7 TIME: Commenced at 8:40 a.m.

8 PLACE: Betty Easley Conference Center
9 Room 148
4075 Esplanade Way
Tallahassee, Florida

10 REPORTED BY: LINDA BOLES, RPR
11 Official FPSC Reporter
12 (850) 413-6734

13 APPEARANCES: (As heretofore noted.)
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I N D E X

WITNESSES

NAME:

PAGE NO.

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932

EXHIBITS

NUMBER:

ID. ADMTD.

61 SMO-1

801 801

62 CRD-1

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63 (Confidential) Documents sponsored
by Verizon Florida, Report 3A

904

P R O C E E D I N G S

(Transcript follows in sequence from Volume 7.)

CHAIRMAN JABER: Knology requested, Commissioners, that we take up their witness before this evening. I think, since we're at a natural breaking point, if there's no objection, I'd like to go ahead and bring up the Knology witness.

Mr. Mann, is there --

MR. MANN: We, we have no questions.

CHAIRMAN JABER: Thank you. Well, let me ask that. Ms. Bradley, are you going to have questions of the Knology witness?

MS. BRADLEY: No.

CHAIRMAN JABER: Mr. Twomey?

MR. TWOMEY: I don't.

CHAIRMAN JABER: Companies? I shouldn't have neglected to ask the companies.

MR. CHAPKIS: I have a couple of questions for the witness.

CHAIRMAN JABER: Staff?

MS. KEATING: We have just a few quick ones.

CHAIRMAN JABER: Okay. We move forward.

Were you here yesterday when I swore in witnesses?

THE WITNESS: I was not.

CHAIRMAN JABER: You were not?

1 THE WITNESS: No, ma'am.

2 CHAIRMAN JABER: Okay. Would you please raise your
3 right hand.

4 FELIX L. BOCCUCCI

5 was called as a witness on behalf of Knology, Inc., and, having
6 been duly sworn, testified as follows:

7 DIRECT EXAMINATION

8 BY MR. MEROS:

9 Q Mr. Boccucci, tell me -- tell us your full name and
10 business address, please, sir.

11 A Yes. My name is Felix L. Boccucci, Jr. I'm the vice
12 president of business development for Knology, Inc. My address
13 is P.O. Box 501, West Point, Georgia, zip code 31833.

14 Q Did you cause to be prepared in this proceeding
15 prefiled sworn testimony dated, I believe, October 31 of 2003?

16 A Yes. That is correct.

17 Q Do you have any changes or corrections to that
18 testimony?

19 A No, I do not.

20 Q If I were to ask you today the same questions found
21 in that testimony, would you give the same answers that are
22 reflected in that prefiled testimony?

23 A Yes, I would.

24 MR. MEROS: Madam Chair, I would request that the
25 prefiled testimony of Mr. Felix Boccucci be admitted into

1 evidence as though read.

2 CHAIRMAN JABER: The prefiled testimony of
3 Felix Boccucci, Jr., shall be inserted into the record as
4 though read.

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1 **Q: Please state your full name, business addresses, and titles.**

2 A: My name is Felix L. Boccucci, Jr., I am Vice President of Business
3 Development for Knology, Inc., which is the parent to Knology of Florida, Inc. My
4 business address is 1241 O.G. Skinner Drive, West Point, Georgia 31833.

5

6 **Q: What is the purpose of your testimony?**

7 A: The purpose of my testimony is to present the position of Knology of Florida,
8 ("Knology"), a competitive local exchange carrier, in support of the petitions subject
9 to this proceeding. The testimony will include a description of the company's
10 operations including other markets it currently serves and will explain the impact that
11 granting these petitions will have on competitive telecommunication services
12 providers in Florida. Section 364.164 of the Florida Statutes sets forth four criteria the
13 Commission must consider in its decision to grant or deny a petition filed pursuant to
14 this statute. Knology will focus on the following specific criteria; (a) Remove current
15 support for basic local telecommunications services that prevents the creation of a
16 more attractive competitive local exchange market for the benefit of residential
17 consumers; and (b) Induce enhanced market entry.

18

19 **Q: Please describe your educational backgrounds and business experiences.**

20 A: I have served as Vice President of Business Development since August 1997,
21 and as the Chief Financial Officer, Treasurer and Secretary from November 1995
22 through August 1997. In addition, I currently serve as the Chief Financial Officer for
23 Interstate and Valley Telephone Companies. From October 1994 until December

1 1995, I served as Vice President Finance Broadband of ITC Holding. Prior to such
2 time, I worked for GTE Corporation, a telecommunications company, which merged
3 with Contel Corporation in March 1991. From May 1993 to October 1994, I served as
4 a Senior Financial Analyst for GTE. From 1991 to 1993, I served as Financial Director
5 for GTE's Central Area Telephone Operations. From 1987 to 1991, I was the Assistant
6 Vice President controller in charge of Contel's Eastern Region Telephone Operations
7 comprising 13 companies in twelve states.

8

9 **Q: Please describe the current corporate structure of Knology of Florida.**

10 A: Knology of Florida is a competitive local and long distance telephone company
11 certified by the Florida Public Service Commission. Knology of Florida is
12 incorporated under the laws of Delaware and is a subsidiary of Knology, Inc.

13

14 **Q: What is Knology's position on FL Statute 364.164 and the related petitions**
15 **filed in this proceeding?**

16 A: Knology believes that Florida Statue 364.164 creates the framework to
17 promote facility-based local exchange competition. Knology has made a substantial
18 investment in the Panama City market to provide competitive services and has been
19 operating its facility-based broadband network there since 1997. In addition to this
20 market, Knology operates in the following states: Georgia, Alabama, South Carolina
21 and Tennessee. In those states, Knology has made the strategic decision to continue to
22 deploy capital to expand its footprint due to the favorable regulatory framework for
23 competition. Previous legislation in these states restricted the Company's ability to

1 attract and deploy capital because investors were unwilling to invest in a market where
2 the rates for service were legislatively mandated. The new Florida legislation recently
3 signed by the Governor creates the regulatory environment necessary to attract capital
4 investment to expand telephone competition in Florida by allowing the Florida Public
5 Service Commission (FPSC) to begin the process of deregulating rates. Knology
6 believes that the petitions filed in these dockets should be granted, because that
7 decision will help to implement the policy underlying 364.14, and it will enhance the
8 competitive choices available to Florida citizens. Knology made the strategic decision
9 to expand its service offerings to other cities in Florida. Shortly after the passage of
10 this legislation, Knology entered into an agreement with Verizon Media Ventures, Inc.
11 to purchase its Cable and Data Asset (Verizon Media) in Pinellas County. This
12 acquisition will provide an additional opportunity for Knology to market voice, video
13 and data services to approximately 275,000 homes and businesses. Knology seeks a
14 market-driven competitive price structure when it makes a strategic decision to deploy
15 capital resources to bring the most updated technology to the marketplace. It is
16 Knology's opinion that granting these petitions will bring new capital investment and
17 additional jobs, in addition to new products and price competition to the State of
18 Florida.

19

20 **Q: Please provide a brief history of Knology, Inc.**

21 A: Interstate and Valley Telephone Company (IVT) has been providing telephone
22 service in rural Alabama and Georgia for over 100 years. Knology was formed in
23 1994 in anticipation of the emerging demand for bandwidth. The Company began in

1 the spring of 1995 with a small operation in Montgomery Alabama. In 1999, IVT and
2 Knology merged to combine their resources bringing the highest quality services and
3 the most advanced technology to its customers. Today Knology operates in five states
4 in the Southeastern United States and serves 8 metropolitan markets including Panama
5 City, Florida. Upon close of the aforementioned transaction with Verizon Media,
6 Pinellas County Florida will be our ninth market.

7

8 **Q: In what metropolitan markets does Knology, Inc. have operating**
9 **subsidiaries?**

10 A: Knology currently has broadband networks in Augusta, Columbus, and West
11 Point, Georgia; Huntsville and Montgomery, Alabama; Charleston, South Carolina;
12 Knoxville, Tennessee; and in Panama City, Florida and its surrounding cities.
13 Knology plans to commence operations in Pinellas County, Florida when all the
14 regulatory approvals are granted and the transaction with Verizon Media is complete.

15

16 **Q: Are any of Knology's current operations competing in the franchised**
17 **jurisdictions of the parties in this docket?**

18 A: Yes. Knology's Panama City Operations is located within the boundaries of
19 BellSouth's franchised service territory. The recently announced transaction with
20 Verizon Media is in Verizon of Florida's service territory in Pinellas County.

21

22

23

1 **Q: What types of services does Knology provide to the markets it serves?**

2 A: Knology constructs broadband networks to provide voice, video and data
3 services. Knology has invested a minimum of \$100 million to construct networks in
4 each of the communities it serves. These two-way, high-capacity, hybrid fiber-coaxial
5 (HFC) and Fiber-to-the-Curb (FTTC) networks allow it to provide a product offering
6 that includes local and long-distance telephone service, video service that offers over
7 150 Channels of quality programming along with another 50 channels of CD quality
8 music, and data service that offers variable speed, high-bandwidth access to the
9 internet. Furthermore, from its network operations center (NOC) Knology monitors
10 virtually all elements of its network including the customer's set-top box and cable
11 modem as well as provides 24x7 customer service.

12

13 **Q: Does Knology offer a “bundled” service in its markets?**

14 A: Yes. Knology offers the “triple-play” bundle of voice, video and data services
15 over an HFC or FTTC network; all billed on a single bill to the customer. Knology
16 also offers these services on an ala-carte basis; however, the customer enjoys greater
17 discounts as they increase the number of services purchased from Knology.

18

19 **Q: Is there any advanced or new services that Knology offers in its markets?**

20 A: Yes. Knology utilizes its advanced networks to provide the latest in
21 technology to all its customers. Knology's Passive Optical Network (PON)
22 deployment allows Knology to deliver in excess of 100mps of scalable bandwidth to
23 business and schools at substantial cost savings to traditional circuit based services

1 such as frame relay service. The seamless fiber optic path from Knology's central
2 office to the customer premises significantly increases network reliability and allows
3 for the delivery of voice and video over the same network connection. The advanced
4 IP/Ethernet bandwidth services provide enhanced upstream and downstream speeds,
5 and it enables scalable access to additional bandwidth for more capacity when
6 business needs dictate (and not according to installation lead times). The Virtual
7 Private Network (VPN) service provides businesses with multiple site locations to
8 create an intranet network, enabling them to exchange information privately within
9 their organization by accessing remote locations or company networks over the public
10 Internet network.

11

12 **Q: Is Knology considered a competitive service provider or an incumbent**
13 **service provider in its markets?**

14 A: Knology is a competitive service provider that has built its network across the
15 territories of both the incumbent telephone companies and incumbent cable television
16 companies ("CATV") in the markets it serves. This network allows Knology to
17 compete with not only the local telephone company, but the CATV provider and the
18 internet service providers in that market; a virtual three-for-one for the consumers with
19 regards to competitive service offerings. Knology also operates two incumbent
20 independent telephone companies in rural Alabama and Georgia.

21

22

23

1 **Q: What is the reaction of the incumbent CATV and Telephone providers to**
2 **the entrance of Knology's into its markets?**

3 A: Knology's experience has been that the incumbent providers upgrade their
4 networks to enhance their own service offerings, implement new products and price
5 reductions and increase the level of customer service and marketing to compete with
6 Knology. Given the flexibility offered by this legislation, and should the related
7 petitions be granted, it is Knology's opinion that consumers will experience
8 competitive offerings and the newest technology not only from Knology, but also from
9 the incumbents who will improve their service and products to compete with Knology
10 as a new facilities-based competitor.

11

12 **Q: What is the residential versus business mix of Knology's customer base?**

13 A: Knology is currently a consumer-oriented company. Approximately 90% of
14 Knology's overall customer base is residential with the balance of 10% business
15 customers. This compares with traditional Competitive Local Exchange Companies
16 ("CLEC") mixes of 58%/42% Residential/Business as reported in United States
17 Telephone Association's Phone Facts Plus 2004.

18

19 **Q: How does Knology rank overall given the markets it serves?**

20 A: The first quarter 2003 Kagan report ranks Knology as the 26th largest cable
21 company. This report also ranks Knology number one as having the highest
22 percentage of telephone customers (66%) and internet customers (41%) as a factor of

1 cable customers. Knology's bundle of services and its one company, one bill, one call
2 approach contributes to this success.

3

4 **Q: Does Knology serve all customers in its franchised areas?**

5 A: Yes, Knology offers service to all customers in its service territories.

6

7 **Q: Does Knology only focus on customers in the "urban" setting?**

8 A: No. Knology's serves multiple tiers of cities including cities as small as Lynn
9 Haven, Calloway, Parker and Cedar Grove, Florida.

10

11 **Q: How does Knology's pricing for services compare with that of the**
12 **respective incumbent for that service?**

13 A: Knology offers a bundled package of services that is competitively priced and
14 includes telephone, internet, and cable services. While not its focus, Knology does
15 offer competitively priced a-la-carte services. However, Knology's bundled offering
16 provides incremental discounts as the customer purchases more services. Thus
17 Knology's customer has an opportunity to lower his or her overall bill for all
18 telecommunications services, while reaping the benefits of dealing with one company
19 and receiving a converged bill detailing all services purchased. In order for the bundle
20 to be successfully marketed and sold, it is necessary for the marketplace to determine
21 prices. Granting these petitions will provide the framework necessary to have market-
22 based prices without subsidies. In addition to price, it is my opinion that as result of

1 the grant of these petitions, competitive providers will deploy more capital
2 investments and hence create more jobs.

3

4 **Q: If Knology is pricing its individual services at or near the incumbent, how**
5 **is the consumer benefited by competition?**

6 A: Knology's bundled discount structure gives consumers a discount in direct
7 proportion to the number of services to which he or she subscribes. Basically, the
8 more the customer buys the greater the discount. It is Knology's experience that
9 consumers evaluate prices based on the value of the bundle, not on an a-la-carte basis.
10 Furthermore, additional benefits result from competitive offerings of voice, video *and*
11 data services and the customer's ability to choose from multiple service providers.
12 With the introduction of competitors, all consumers will experience higher levels of
13 customer service and will be offered the newest in technology more quickly.

14

15 **Q: How do the petitions filed in this proceeding affect Knology and its**
16 **business strategy?**

17 A: If these petitions are granted, Knology will be able to attract and deploy new
18 capital investment in Florida, thereby offering consumers a choice in facilities-based
19 providers for new and advanced high-tech services.

20

21 **Q: How is Knology perceived by its customers?**

22 A: Knology is perceived as a quality provider of bundled services (telephone,
23 internet, cable). A third-party firm hired to gather customer satisfaction statistics and

1 report the results to our senior management confirms this. These reports indicate that
2 approximately 92% of existing customers would recommend Knology to a friend,
3 which is certainly a statistic that the Company is proud to report.
4

5 **Q: Has Knology had any impact on local economic development in any of its**
6 **markets?**

7 A: Competitive providers of voice, video and data services bring investment and
8 jobs to the communities they serve. Typically Knology deploys capital in excess of
9 \$100 million and hires over 100 employees in a mid size market similar to Panama
10 City. Additional benefits include better customer service and new advanced products
11 coming to market more quickly.
12

13 **Q: Does Knology provide support to Schools, Libraries and other**
14 **governmental institutions in the markets it serves?**

15 A: Knology provides cable and data services to schools and libraries across its
16 markets. Knology provides connectivity between governmental facilities within the
17 markets it serves. Examples of these services include data services to the Autuga
18 County schools in Montgomery, Alabama, fiber connectivity between satellite offices
19 of the Augusta Medical College and Passive Optical Network service to the
20 Charleston Coliseum.
21
22
23

1 **Q: Please summarize your testimony.**

2 A: Knology seeks and supports a competitive marketplace with a price structure
3 that reflects market value and imbedded costs. This environment will give the
4 incentive to Knology and other competitive providers to launch services, deploy
5 capital, create new jobs and provide consumers and businesses a choice of
6 telecommunication products with exceptional customer service at competitive prices.
7 For the aforementioned reasons, Knology believes that the grant of these petitions will
8 remove current support for basic local telecommunications services that prevents the
9 creation of a more attractive competitive local exchange market for the benefit of
10 residential consumers, will induce enhanced market entry and will create more capital
11 investment and provide more employment in the State of Florida.

12

13 **Q: Does this conclude your testimony?**

14 A: Yes.

1 BY MR. MEROS:

2 Q Mr. Boccucci, would you please summarize your
3 testimony.

4 A Yes. My name is Felix Boccucci, Jr. I'm currently
5 the vice president for business development of Knology. I am
6 the, one of the original employees of Knology, and built the
7 competitive model for Knology back in 1994. Knology's
8 real-life experience demonstrates, in my view, that granting
9 these positions -- petitions will create a more attractive
10 competitive local exchange market for the benefit of
11 residential consumers. It will also induce enhanced market
12 entry -- it will also induce enhanced market entry by Knology,
13 and would encourage other competitors to enter the market as
14 well.

15 The current structure for local exchange rates in
16 Florida, in my view, is inefficient and too low to justify
17 further expansion in Knology's present operations in the state.
18 For example, in the Panama City market, the ILEC offers local
19 telephone service for \$9.12 per month. In the four other
20 states where Knology competes the average price for residential
21 service offered by the incumbent telephone company is
22 \$15.02 per month. This disparity plays a critical role in our
23 market analysis in determining future market entry and
24 deployment of capital in the, in the marketplace.

25 The passage of the 2003 Telephone Competition Act

1 prompted Knology to purchase Verizon's media ventures fiber
2 network in Pinellas County. The prospect of rate rebalancing
3 was a significant factor in Knology's consideration of this
4 purchase. As we speak, Knology is raising millions of dollars
5 to purchase and upgrade Verizon facilities and launch
6 facility-based telephone services in Pinellas County for
7 residential consumers.

8 Knology would like to continue to expand and compete
9 aggressively throughout the State of Florida. When we first
10 came to Panama City, our entry generated increased competition,
11 new service, new services, better service and price discounts
12 for consumers. Real-life on-the-ground experience in that area
13 showed tangible benefits to residential customers arising from,
14 from that competition.

15 But under the current rates for local services in
16 Florida, Knology has not been able to generate rates of return
17 sufficient to attract the capital necessary to expand in
18 adjacent areas to Panama City or elsewhere in Florida. If rate
19 rebalancing is implemented, Knology has every intention to
20 expand and compete further in Florida. That competition would
21 improve services and prices to residential customers, and would
22 incentivize Knology and other competitors to innovate expanded
23 service options for the consumers in the state.

24 Our, our, our experience proves the wisdom of the
25 legislative policy in Section 364.164. Rebalancing will induce

1 Knology and others to enter and compete in many Florida
2 markets, and that competition will provide tangible benefits to
3 residential customers. Without rebalancing Knology's future
4 lies outside of the State of Florida where we can provide
5 benefits to residential consumers in a more competitive market
6 environment.

7 MR. MEROS: Madam Chair, I tender the witness for
8 cross-examination.

9 CHAIRMAN JABER: Thank you.

10 Mr. Chapkis, you said you had questions?

11 MR. CHAPKIS: Yeah. I just have a couple of quick
12 question.

13 CROSS EXAMINATION

14 BY MR. CHAPKIS:

15 Q Good afternoon. Sir, how would Knology's business
16 plan change if the ILECs' rate rebalancing plans were not
17 granted?

18 A Knology has better opportunities to deploy capital in
19 other, in other states where the local exchange rates are
20 higher. As I, as I discussed in my summary, the average rate
21 in their other markets is \$15.12. So from a rate of return in
22 order to attract capital to, to build networks, the, the
23 benefit would far exceed the existing benefit in Florida
24 without rate rebalancing.

25 Q We've heard testimony and concerns about whether the

1 rate rebalancing plans will benefit seniors and people with low
2 bills, people in those classes. Does Knology have any
3 experience that would speak to those concerns?

4 A We do. We've been providing competitive
5 telecommunications services for over, for over nine years, and
6 we find the competitive environment opens up benefits to all
7 demographics in the marketplace, from seniors to high
8 demographics to medium demographics, et cetera. But in order
9 to provide those benefits to the, to the consuming public there
10 has to be a value proposition what the service is worth. And
11 in my view a \$9 local exchange rate in Panama City, if the
12 value proposition is that the service is only worth \$9, it
13 makes it very difficult for Knology to bring the enhanced
14 services and other significant discounts of our, our bundled
15 services, which include cable, Internet and telephone.

16 Q And when you decide to enter a market, what is it
17 that you decide to look at? Do you look at the residential
18 rate, the total bill? What is it exactly that your company
19 focuses on when entering a market?

20 A We look at multiple factors in terms of determining
21 our capital. As you well know, capital is a scarce resource
22 and investors want to achieve the maximum returns that they can
23 get by deploying their capital. So one of the big criterias we
24 look at is the underlying residential exchange rates in a
25 particular market, it's one of the major factors, along with

1 other regulatory, the other -- the regulatory climate, the
2 market, demographics and other such, and other such issues.

3 MR. CHAPKIS: Thank you. That's all the questions I
4 have.

5 CHAIRMAN JABER: Okay. Anyone else here at the
6 bench?

7 Mr. Beck, do you all have questions?

8 MR. BECK: Yes. Thank you, Madam Chairman.

9 CROSS EXAMINATION

10 BY MR. BECK:

11 Q Could I ask you what -- you offer bundled packages as
12 well as stand-alone residential services; is that right?

13 A Knology's business case is centered around a, a
14 bundled product which includes local and long distance
15 telephone service, Internet service as well as digital and
16 analog cable services.

17 Today, if you look at our existing market, more than
18 83 percent of our customers take at least more than, more than
19 one service from us, either two or three services; i.e.,
20 telephone, Internet and cable or telephone and cable, vice
21 versa.

22 Q Which is your most popular product?

23 A If you look at systemwide in Florida, our cable
24 product competes strongly in the marketplace in conjunction
25 with telephone. Almost every customer that has a telephone

1 line from us also has our, our cable service.

2 The interesting fact is the -- our cable service, in
3 conjunction with our telephone service, provides an overall
4 significant benefit to the, to our customers. One is they get
5 a converged bill with all the services on the same bill. Two,
6 we continue to discount services further and further, the more
7 the customer, the customer buys from us.

8 And to give you, and to give you an example, if you
9 look at the typical prices for cable, for example, are
10 somewhere in excess of \$45. And if you look in the markets
11 that Knology operates in, the cable rates typically are
12 somewhere around \$30. So when you bundle telephone, cable and
13 Internet together, the, the population gets a far better value
14 proposition and competes very well with both the ILECs and the
15 cable providers and the Internet providers.

16 Q Are there three, three products you offer all
17 together, or how many, how many products do you offer all
18 together?

19 A On the residential side we offer local and long
20 distance telephone service, we offer analog and digital cable
21 services, including interactive television, video on demand,
22 high, high-definition television, and we also offer high-speed
23 Internet service through a cable modem platform.

24 Q And is the -- is there a most typical service? In
25 other words, do most people take the whole package or, or just

1 one extra? What's your typical customer?

2 A The, the typical customer typically takes local
3 telephone service and cable services from us with a significant
4 portion of other customers taking all three services, which
5 includes the Internet service.

6 When you look at the, the, our long distance service,
7 we're not an interexchange carrier. We, we provide Knology
8 long distance service provided through, through other carriers,
9 and less than 50 percent of our customers take our own, own
10 long distance. So it's very important for us to have the
11 R1 rate; the value proposition for the R1 rate to be at a
12 market-based competitive, in a market-based competitive type
13 arena.

14 Q How long have you been offering services in Panama
15 City?

16 A We, we acquired a, a small cable overbuilt company in
17 Panama City Beach in 1997. We expanded to the Panama City
18 metropolitan market through 1998 and began, began offering the
19 bundled services sometime in the 1998 time frame.

20 Q And you've recently purchased some assets that were
21 owned by Verizon in Pinellas County; is that right?

22 A We currently have an asset purchase agreement with
23 Verizon New Media in Pinellas County, Florida. That
24 transaction has not yet closed.

25 MR. BECK: Thank you. That's all I have.

1 CHAIRMAN JABER: Mr. -- Ms. -- hang on a second,
2 Ms. Bradley.

3 Commissioner Bradley, did you want to wait until
4 later?

5 COMMISSIONER: I'll wait.

6 CHAIRMAN JABER: Okay. Ms. Bradley, Mr. Twomey,
7 anyone else?

8 MS. BRADLEY: Okay. Thank you.

9 CROSS EXAMINATION

10 BY MS. BRADLEY:

11 Q Sir, you mentioned the fact that you offer these
12 various services. Is it necessary to buy telephone before
13 using the other services?

14 A It's not necessary, but most of the, the consumers
15 see the, the advantage of buying telephone service from us with
16 the convenience of one bill. They can talk to one provider and
17 they can also discount their telephone service as well as their
18 other services by buying multiple products from us. So the big
19 draw in terms of the consumer in our markets is telephone
20 bundled with other products is the, is the catalyst for us to
21 be successful in the marketplace.

22 Q Would you agree that in order for a senior or anyone
23 else to enjoy these extra benefits, they would have to be able
24 to essentially afford this increase?

25 A No. I think competition changes the whole, whole

1 arena. If you look at the history and you look at where we're
2 currently serving, serving customers, is the, the benefits of
3 competition changes.

4 I heard in, in Mr. Fulp's testimony that nonrecurring
5 charges were an issue. In a competitive world, nonrecurring
6 charges in a lot of cases go away.

7 The other thing that we see from the competition side
8 and in the telephone arena where we've been doing this since
9 1998 is that promotional opportunities, win-back opportunities,
10 that the consumer fairs far better.

11 In addition, when you have a value proposition of
12 the, of a local residential service, one, the service quality
13 gets better. You know, I would throw this out to you from a
14 common sense perspective. If you have a, a low generating
15 revenue unit, is the quality of service to the residential
16 customer that's not producing significant revenues is going to
17 be as good to a, to business customers for example? Is the --
18 without competition is the incumbent operator going to answer
19 the phone in 30 seconds? Is the incumbent operator going to
20 make a service call within 24 hours like we do?

21 So it happens when you bring competition to the
22 marketplace, everybody gets better, and everybody gets better,
23 and competition will -- provides a catalyst for, for pricing.

24 And I think -- and if you look at cable as, as a
25 service, for example, in markets where there's competitive

1 cable products in the marketplace across the country, the rates
2 are somewhere in the, in the neighborhood of \$30. Where
3 there's no cable competition, the rates are \$45. And, and I
4 would offer to you that most of our senior population probably
5 enjoys the benefit of cable television significantly.

6 In the local exchange rates, if priced right, it
7 gives us the incentive to move into the market, gives a
8 significant benefit to the seniors in this state to enjoy
9 enhanced and better services in the marketplace.

10 Q You provide basic residential services?

11 A We do.

12 Q Do you provide them at a lower cost than customers
13 are currently paying?

14 A The, the concept of -- in our view,
15 telecommunications services are converging. You see that with
16 the recent rulings from the FCC in terms of landline to
17 wireless portability. You see the value proposition that the
18 wireless carriers have put out there. The consumer in the
19 wireless world doesn't even think that it's long-distance when
20 they're making a phone call from Pinellas County, Florida, to,
21 to California.

22 So it's my view that it's the -- the value
23 proposition to the customer is a converged bill with multiple
24 telecommunications services and the convenience of, and the
25 convenience of dealing with one customer in a competitive

1 environment that, that, that literally creates a great quality
2 of service: Companies answer the phone, networks are upgraded
3 and price, and there's price competition, there's competition
4 entering the market, nonrecurring charges. Because if, if you
5 don't do those things in a competitive world, you're not going
6 to be, you're not going to be around.

7 Q If we can go back to my question though. Are you
8 offering basic residential services at rates lower than are
9 currently being offered by the companies here?

10 A In some markets our rates are, are comparable a la
11 carte to the incumbent operators. However, as soon as the
12 customer buys a second service from us, the, the rate gets
13 discounted, as well as the other enhanced features that we
14 talked about earlier in terms of, you know, the popular
15 features in terms of Caller ID and Call Forwarding.

16 What the, what the local rate does is it enables us
17 to provide bundled packages and to provide really economical
18 prices to seniors to get actually more and better services than
19 they currently have today.

20 Q Are these bundled services dependent upon basic,
21 having basic residential service?

22 A It's -- in order to -- capital is a scarce resource.
23 In order to attract the investment necessary, for example --

24 CHAIRMAN JABER: Do you remember yesterday when I
25 said the witnesses will start their answer with a yes or no,

1 and then are allowed to elaborate? I need you to do that.
2 Here's the question, and then you're free to elaborate.

3 THE WITNESS: Thank you.

4 CHAIRMAN JABER: What Ms. Bradley wants to know is is
5 your basic local rate the same or lower, I guess, if I recall
6 the question, to the incumbent basic local rate?

7 THE WITNESS: Yes, on an a la carte basis.

8 CHAIRMAN JABER: Okay. Ms. Bradley, what was your
9 next question?

10 BY MS. BRADLEY:

11 Q I believe my next question was --

12 CHAIRMAN JABER: See, that's what happens when you
13 elaborate before the yes or no. I stop listening and I forget
14 what the question is.

15 THE WITNESS: My apologies.

16 BY MS. BRADLEY:

17 Q I think my question was in order to enjoy these
18 vertical services, do you have to first purchase basic
19 residential service?

20 A Yes. You can't provide vertical services if the
21 customer doesn't have a residential, residential line.

22 Q So if a person can't afford a rate increase, they're
23 not going to be able to afford the vertical services either,
24 are they?

25 A I really don't understand the question. If you could

1 restate it for me.

2 Q If a person can't afford a rate increase, if they
3 can't afford to pay more than they're paying now, then they're
4 not going to be able to afford vertical services either, are
5 they?

6 A I don't view this as a -- I don't view the increase
7 in the local, local rates as a rate increase because I look at
8 telecommunications products as a, as the market is converging
9 into products -- local and long distance services converging
10 into one product, Internet and cable. So when I view the
11 marketplace, I see an overall value proposition for the
12 customer where ultimately they're going to save more money than
13 they're currently, currently saving in today's marketplace, and
14 our history in the business across our markets proves that.

15 Q So all these rates and figures are confidential.
16 Just take a figure. If somebody is paying \$10 and they've said
17 they can't afford to pay \$12, then they're not going to be able
18 to afford to pay \$10 plus \$20 to maybe get a \$2 discount, are
19 they?

20 A Well, I make the, the assumption that most seniors
21 watch television. And so the fact that they get television or
22 cable television bundled into their service and the cable
23 television rates in themselves are \$15 lower than in the
24 noncompetitive market, I think that's more than incentive to,
25 to provide to the consumer to, to buy the services.

1 Q So I would take it that your answer is inapplicable
2 to the seniors on fixed incomes that can hardly afford
3 telephone service.

4 A I mean, there's Lifeline services. The great thing
5 about competition, if the underlying incumbent telephone
6 company is providing Lifeline services to the, the
7 underprivileged in the marketplace, they have a choice. If
8 they want to, to get more than a basic telephone line and they
9 can see the value proposition and can afford the bundle of our
10 services, I think they benefit, benefit greatly. But I still
11 think there's a, that there's a safety net for the, the
12 ultimate consumer with, with the, with the incumbent operator
13 that's what they call an ETC carrier and has universal service
14 responsibility.

15 Q I understand your convergence theory, but I'm
16 concerned as to whether you understand what I'm saying, that
17 there has been testimony from consumers coming in before this
18 Commission all over the state that have said they can't afford
19 an increase. And for those consumers I have to assume that
20 your convergence theory is not going to have a lot of meaning;
21 would you agree?

22 A No, I would not agree.

23 Q So you think they're going to be able to come up with
24 even more money than they can't afford now?

25 A The, the public hearings that the Public Service

1 Commission held throughout the state was, was focused in the
2 environment of, in my view, in a vacuum of one
3 telecommunications service, which is the, the local rate.

4 My phone as the vice president of business
5 development at Knology is continually off the hook. I receive
6 calls weekly including folks in Florida asking us to bring our
7 competitive services to the, to the marketplace. And I think
8 the Commission here in Florida has done a great job with the
9 safety net for, for a consumer that absolutely needs Lifeline
10 services out there.

11 Q Are you familiar with some of the surveys that the
12 Commission did a few years ago when they were looking at rate
13 prices and as to how much people would be willing to pay an
14 increase before they would disconnect?

15 A I'm not familiar with those, no.

16 Q Did you hear the testimony yesterday about the fact
17 that BellSouth is disconnecting approximately 2,000 Lifeline
18 customers a month?

19 A I did not hear that testimony.

20 MS. BRADLEY: No further questions.

21 CHAIRMAN JABER: Mr. Twomey.

22 MR. TWOMEY: Yes, ma'am. Thank you. Just a few.

23 CROSS EXAMINATION

24 BY MR. TWOMEY:

25 Q Good afternoon. Over here.

1 CHAIRMAN JABER: He's over there.

2 THE WITNESS: Oh. Thank you.

3 MR. TWOMEY: Good afternoon.

4 THE WITNESS: I apologize.

5 CHAIRMAN JABER: No. It's our microphone system. We
6 apologize.

7 BY MR. TWOMEY:

8 Q Y'all came to Florida in 1997; is that correct?

9 A That is correct.

10 Q And you bought -- did you say you bought an overbuilt
11 cable system?

12 A That is correct.

13 Q Okay. When you came here, isn't it true that there
14 was no immediate prospect for access local rate rebalancing?

15 A In 1997 -- can you repeat the question?

16 I think Commissioner Jaber wanted me to answer yes or
17 no. So before I elaborate, can you ask the question again?

18 Q Was your, was your, was your move to Florida -- let
19 me ask it differently.

20 Was your move to Florida premised on the expectation
21 that the local telephone company in Panama City would have
22 increased rates to make your rates appear more viable or
23 whatever?

24 A Yes.

25 Q It was premised, it was premised -- in 1997 you

1 expected, you expected the local telephone companies' rates to
2 go up?

3 A I did. And the reason -- we took a calculated risk
4 in entering the Panama City market. If you recall, in 1996 the
5 Telecommunications Act was passed. Part of my responsibilities
6 with, with Knology is two ILECs that we currently own in rural
7 Georgia, in Alabama. And when I looked at what was going on in
8 those states at that particular time, they were moving forward
9 with rate rebalancing issues back in the, in the 1997 to 1998
10 time frame. As a matter of fact, the Georgia Legislature
11 actually passed legislation prior to the, to the '96 Act
12 positioning the State of Georgia for, for competition. And so
13 the premise we were seeing across the, across the states was
14 that there was a movement afoot to reduce, reduce the access
15 rates and rebalance the rates in conjunction with, with at that
16 time, time costs. So we took the calculated risk coming to
17 Florida that Florida was going to move on the, the same, same
18 path that the other states that we were looking at were
19 currently moving.

20 Q Let me see if I understand that. You just testified,
21 if I understood you correctly, that, that the State of Georgia
22 was making moves to, to balance, rebalance rates, and that
23 based upon the experience then in Georgia, you decided to
24 invest your money in the panhandle of Florida.

25 A No, that's not correct. We had already invested in,

1 in a property in Montgomery, Alabama, which was the first
2 competitive market that we invested in, which was in 1995. We
3 saw the, the Alabama Commission moving in that, that arena. We
4 had also invested in markets in Georgia as well and were
5 expanding our business to other states in the region. And
6 Florida being in our own background, we thought, was a, would
7 be a great place for us to, to do business.

8 Q If the, if the Florida Public Service Commission
9 denies these petitions and access rates are not reduced and, as
10 a consequence, local service rates are not increased, will you
11 leave Panama City?

12 A We will not. We have deployed the capital in Panama
13 City. The impact that it would have in the State of Florida
14 is -- for example, we have just raised significant amounts
15 of -- we're currently raising significant amounts of money to
16 rebuild the properties or the networks that Verizon constructed
17 in Pinellas County. We will meet our commitments in the State
18 of Florida, but further expansion in Florida would be competing
19 with expansion in other states where we would deploy the
20 capital in a more favorable environment and create jobs and
21 capital investment in those particular markets.

22 Q I mean, you're saying, if I hear you, you'll go to
23 wherever locations, whatever states you expect to get the
24 greatest return on your capital; correct?

25 A We will go to the states. In order to -- was that a

1 yes or no? The answer is no.

2 We go -- capital -- in order for investors to invest
3 in network, they have to be assured that they can earn the
4 required rate of return for them to, to invest. The
5 opportunity for the assurance (phonetic) for them to earn the
6 necessary return on their capital would be far greater in a
7 market that had more competitive value R1 rates than if the
8 rebalancing petitions weren't granted by, by this Commission.

9 Q Yes, sir. The -- if the Commission -- same premise,
10 in the Commission denies the petitions here, would it be your
11 intention to try and get out of your asset purchase agreement
12 with Verizon?

13 A No. We -- no. We have a value system as a company.
14 Part of the consideration for us acquiring the Pinellas County
15 property was the, the passage of the legislation this summer.

16 In business you have to take calculated risks, and
17 this is a calculated risk that we took that the petitions here
18 are going to be granted and that we will fulfill our
19 commitments that we have made to the communities in Pinellas
20 County.

21 Q In -- on Page 8 of your testimony, the question at
22 Line 4 asks, "Does Knology serve all customers in its franchise
23 areas?" And your answer is, "Yes. Knology offers service to
24 all customers in its service territories."

25 Would I be correct in assuming that your franchise

1 service territory is smaller than the, than the incumbent LECs
2 in that area?

3 A Let me find the testimony so that we can be accurate.

4 Q Yes, sir.

5 A Thank you.

6 Q Page 8, Line 4.

7 A Okay. The answer to that question is yes. Knology
8 constructs -- in terms of the franchise agreements that we
9 negotiate with the local municipalities, the local
10 municipalities, in granting the franchises, typically require
11 an ubiquitous bill throughout their entire municipality. So as
12 a result, our networks almost mirror the exact same path as the
13 incumbent cable company and the incumbent telephone company as
14 well. So, so we pass almost every, every residential house
15 within the franchise area as required by the grant of the
16 franchises by the municipalities.

17 Q And just out of curiosity, in Panama City is your
18 franchise area the City of Panama City or is it the county or
19 what is it?

20 A We have multiple franchises in Panama City. We have
21 a franchise for Bay County, Florida, we have one for Panama
22 City, we have one for Panama City Beach, we have one for the
23 City of Lynn Haven and we have one for the City of Springfield.

24 Q Okay. As I understand it, your -- essentially the
25 thrust of your testimony is, is that -- let me ask you, is your

1 company profitable now in Panama City?

2 A The company is not profitable from a net income basis
3 in Panama City.

4 Q The, the -- am I correct in understanding the thrust
5 of your testimony is, is that the local exchange company having
6 their rates increased will either make your current rates look
7 more favorable to your potential customers or allow you, and/or
8 allow you to raise your rates as well?

9 A No, I don't agree with that. In the marketplace
10 there's a value perception for services. So if the perception
11 of, of a consumer, of a residential consumer in Panama City is
12 that their telephone service is worth \$8, it makes it very
13 difficult for us to have the total value proposition of
14 bundling services which provides, in my view, significant
15 benefits to all consumers: The senior citizens, the high
16 demographics, low demographics, medium demographics in the
17 marketplace.

18 MR. TWOMEY: Okay. That's all. Thank you.

19 CHAIRMAN JABER: Staff.

20 CROSS EXAMINATION

21 BY MS. KEATING:

22 Q Good afternoon, Mr. Boccucci. I've really just got
23 one clarification question and then a couple of follow-ups from
24 our discussion in the deposition.

25 First, I just want to clarify, is Knology going to

1 generally be, have a little more incentive to enter low density
2 or rural markets if the petitions are granted?

3 A If -- you know, we currently -- the answer is yes.
4 Thank you. We currently --

5 CHAIRMAN JABER: You're doing great.

6 THE WITNESS: Pardon me?

7 CHAIRMAN JABER: You're doing great.

8 THE WITNESS: Thank you. We currently -- we built
9 the -- we acquired and built the market in Panama City. We've
10 looked at historically about expanding our markets in the past.
11 You know, we looked at expanding to Tallahassee, for example,
12 when Tallahassee was competing against Knoxville, Tennessee.
13 And as a result of the fact that the local rates in, the
14 R1 rates in Knoxville, Tennessee, the Knoxville, Tennessee, won
15 out over Tallahassee.

16 But what rate rebalancing would enable us to do is to
17 continue to extend our networks in the -- we would look at the
18 possibility of extending our networks through the, through the
19 panhandle of Florida. Specifically some of the territory that
20 Sprint currently serves, with rate rebalancing, it makes the
21 competition for the capital in that particular market arena
22 compete with other markets that we have or other opportunities
23 we have for, for capital since we already have the
24 infrastructure in Panama City that we could leverage off of.

25 BY MS. KEATING:

1 Q All right. And just to follow up from a discussion
2 that we had in your deposition. If I understood correctly,
3 Knology keeps its switched access rates in Panama City in line
4 with those of BellSouth's; isn't that correct?

5 A Yes. Our, our switched access rates are in parity
6 with the local incumbent telephone operator, which in this case
7 is BellSouth in Panama City.

8 Q And if the Commission approves BellSouth's petition,
9 will Knology adjust its own access rates?

10 A We would. I would state that access revenue for our
11 competitive properties is a smaller part, and it's not very
12 significant to our operations.

13 MS. KEATING: Thank you, Mr. Boccucci.

14 THE WITNESS: You're welcome.

15 CHAIRMAN JABER: Commissioner Bradley.

16 COMMISSIONER BRADLEY: Yes. I want to ask you the
17 same question that I asked earlier, and if you can't answer it,
18 then I'll respect that.

19 THE WITNESS: I will do my best.

20 COMMISSIONER: And I don't think it's a yes or no
21 question.

22 THE WITNESS: I just didn't want to offend the
23 Chairman.

24 COMMISSIONER BRADLEY: What percentage as it relates
25 to your customer base, and I'm speaking of residential and, and

1 business customers, if you had to apportion the percentage of
2 long distance calls, and if you, if you are able to put a
3 percentage to my question, what percentage of the calls that,
4 that you all handle, long distance calls that you all handle
5 would you attribute to your business customers as compared to
6 your residential customers?

7 THE WITNESS: Okay. First, let me -- we're a little
8 bit different than a, than an ILEC. Our primary business is
9 the consumer market. Approximately 90 percent of our customers
10 are consumers, with some business customers. So the long
11 distance that we provide, which we like to do it in a bundled
12 package with all-you-can-eat packages, is primarily related to
13 the 90 percent of the consumers that we currently provide
14 services to.

15 COMMISSIONER BRADLEY: So you can't break it out by
16 residential versus business?

17 THE WITNESS: I would tell you that almost all of it
18 is, approximately almost all of it is residential, to our
19 residential customers, because our primary, our primary
20 business plan is to serve the, the residential market with some
21 small businesses.

22 For example, in Pinellas County, Florida, it's -- as
23 we look and do the due diligence in Pinellas County, Florida, I
24 think there's more small businesses and mom and pop stores that
25 I think I've seen in any market that we operate in. And we

1 think there's a great opportunity in the business arena in that
2 particular market because the larger telephone companies tend
3 to, tend to ignore the, the smaller businesses than, than we do
4 because that's our bread and butter. So as a result, more and
5 more long distance, if we're successful or when we're
6 successful in Pinellas County, will be generated by these small
7 business customers.

8 COMMISSIONER BRADLEY: Okay. Thank you.

9 THE WITNESS: Did that help. I don't --

10 COMMISSIONER BRADLEY: Yes.

11 THE WITNESS: Thank you.

12 CHAIRMAN JABER: Commissioner Davidson.

13 COMMISSIONER DAVIDSON: Thank you, Chairman. Just a
14 couple of questions.

15 One of our upcoming witnesses, Carl Danner, testified
16 at Page 13 of his direct that for those who might commit new
17 capital to Florida, this pricing reform signal will be
18 important not just for what it says about current business
19 opportunities, but also for what it says about the Commission's
20 likely future approach to issues that may affect these
21 investments in the future. Do you agree with that statement?

22 THE WITNESS: Yes, I do.

23 COMMISSIONER DAVIDSON: If the petitions were granted
24 in this proceeding, can Knology commit on the record to
25 continue its expansion in Florida?

1 THE WITNESS: I cannot commit. I can make the
2 commitment that Florida will compete extremely well for
3 capital. The process for capital, where we deploy capital,
4 without rate rebalancing, I feel very comfortable in saying
5 that Florida would not compete in terms of attracting more
6 capital into, into the, the state.

7 Now I will add I won't make a commitment that I'm
8 absolutely, can't 100 percent commit, commit to, but we are
9 currently exploring several other opportunities in the State of
10 Florida. We think these opportunities will be great
11 opportunities for, for Knology as well as the state. And when
12 the rate rebalancing petitions are approved, I think there's a
13 significant likelihood that we'll pursue those opportunities.

14 COMMISSIONER DAVIDSON: If Knology ultimately
15 competes with companies like Florida Digital Network and with
16 Brighthouse and with BellSouth Telecommunications and other
17 LECs and cable companies, how will this process, in your view,
18 impact consumers in Florida, if at all?

19 THE WITNESS: Oh, I mean, historically we've been
20 doing this since 1995. The benefits are -- we talked -- I'll
21 give you an example. I know the Chairman talked about
22 nonrecurring costs. It's very difficult to charge a \$30
23 installation charge when you have a competitor sitting behind
24 your neck trying to get the same, the same business.

25 What we find, too, is in the marketplace from a, from

1 a service call perspective that we gain significant market
2 share when our competitors didn't answer their phone in 30
3 seconds and we answered our phone in 30 seconds. So ultimately
4 the competitors aren't going to let that business get away from
5 them, so they're going to answer the phone and they're going to
6 be able, the consumers are going to be able to talk to the
7 company representative.

8 Service calls, if you take a residential R1 rate
9 today, and the value proposition is, let's say, \$8 for that R1,
10 and the incumbent operator, and this is just my view, you know,
11 I'm not speaking for the incumbents, has a business customer
12 that's creating tremendous more margin or opportunity for them
13 and, you know, they have to compete in terms of work force to
14 serve that customer, who are they going to serve first? It
15 would be the business customer.

16 What competition does is that you can't afford to do
17 that because if you don't serve the residential, the senior
18 citizen or the low demographic customer, it goes away because
19 they're going to switch their service to, to another provider.

20 And the other thing that we, we see in the
21 marketplace -- we compete primarily in the telephone arena with
22 BellSouth across the southeast. BellSouth is a very formidable
23 competitor. And BellSouth is -- they have win-back procedures,
24 they have promotions to compete against us, and the customer
25 gets great value out of the competition between providers.

1 COMMISSIONER DAVIDSON: You had mentioned earlier,
2 you had mentioned earlier in your testimony that in your
3 experience seniors subscribe to cable. Do you have any feel or
4 evidence as to the extent of take rates among seniors?

5 THE WITNESS: I do not have that, that information.
6 But I could look at our statistics and forward it to the, to
7 the Commission, if I can find it.

8 COMMISSIONER DAVIDSON: I'll tell you one, one piece
9 of information for the parties and staff that would be useful
10 for me would be any facts or data regarding the extent to which
11 senior citizens subscribe to any communication service, whether
12 it be cable modem, Internet service, dial-up, DSL, the extent
13 to which they subscribe to any communication service beyond
14 basic telephone service. So I don't know if it would be
15 possible to gather that information from the cable associations
16 or if we have that data here at the Commission in the
17 demographic breakdown amongst age categories. And that's just
18 something I would like to see before the end of the proceeding.
19 We don't need to pull that out now. Thanks.

20 No further questions, Chairman.

21 CHAIRMAN JABER: Commissioner Bradley, you had
22 another question; right?

23 COMMISSIONER BRADLEY: Commissioner Davidson's last
24 question was, was going to be my question. I was going to ask
25 if you could give a breakout as it relates to a percentage of

1 your customers, the elderly -- well, all categories of
2 customers. And I was -- my question was going to be how many
3 of your customers subscribe just to basic phone service and how
4 many -- and what percentage of them subscribe either to a
5 package or bundled services? So his question was my question.

6 COMMISSIONER DAVIDSON: And I've got one follow-up to
7 that. I would also like to see, and I think we do have this
8 information, the extent to which Lifeline subscribers subscribe
9 just to basic service or have opted to pay additional sums to
10 subscribe to enhanced services. Thanks.

11 CHAIRMAN JABER: Okay. On Page 7 of your testimony
12 you made me think of two of the service hearings that we went
13 to in the panhandle: One was Pensacola, the second one was
14 Fort Walton Beach, and then throughout those two, and then
15 yesterday we heard from customers from Lynn Haven. And one of
16 the things that struck me in the panhandle in particular, it's
17 not that it didn't come up everywhere else, but in the
18 panhandle in particular, was the assertion from customers that
19 they are not getting solicitation calls or, or advertisements
20 from competitors, that they don't believe they have a choice,
21 regardless of how they felt about the rate proposals. And it's
22 made me think a little bit about how competitors are marketing
23 their services.

24 So my first question to you is how is it you marketed
25 your services to the residential consumer, and does that

1 service extend outside Panama City to Pensacola, Fort Walton
2 Beach and Lynn Haven? I'm not real clear with your answer
3 there.

4 THE WITNESS: Okay. Can I take it one step at a
5 time?

6 CHAIRMAN JABER: Absolutely.

7 THE WITNESS: First, our, our marketing sales is a
8 combination of direct mail pieces as well as feet on the street
9 in terms of direct, direct sales reps.

10 We talked about the, the, the value proposition of
11 the rates. So if we look at Panama City, for example, we have
12 embedded plant there. But in terms of marketing dollars, our
13 marketing dollars probably create more value in markets where
14 the local exchange or the local rate is higher. So there's
15 probably in my view more focus in the markets that have a more
16 competitive structure than they have in Panama City. Not to
17 say that we don't do direct mailing and, and direct sales in,
18 in Panama City.

19 We also focus a little stronger in the business
20 market in Panama City because we have to have the opportunity
21 to increase our margins. So we have a, not a large base, but
22 we focus a little bit more on the business customers in Panama
23 City to offset the low local exchange rate in Panama City.

24 CHAIRMAN JABER: So what would you say -- how many
25 residential customers then do you serve in Panama City?

1 THE WITNESS: I would say -- I don't have the numbers
2 exactly in front of me, but approximately probably, in that
3 market probably 15 to 20,000.

4 CHAIRMAN JABER: And, and that is landline
5 residential service? Are you serving anyone through cable
6 telephony or anything like that?

7 THE WITNESS: We currently use our roots as a local
8 exchange telephone company in Georgia and Alabama. So we
9 currently provide to our residential customers a full
10 facility-based circuit-based TDN switched platform for the
11 customers in Panama City across all of our networks.

12 From an IP telephony perspective, we do have a
13 product that we use in the business arena which is a, is an IP
14 Centrex product. And the technology there is we use basically
15 the loop as packets or data stream which moves through to a
16 media gateway in the marketplace, and then we use the switched
17 network to switch those calls. So the, the Internet protocol
18 we use today is primarily related to a, a business customer
19 that wants to buy an IP Centrex type product.

20 CHAIRMAN JABER: Okay. Then as I look on Page 7 of
21 your testimony, it is not correct then based on what you just
22 said, in Panama City it is not correct that 90 percent of your
23 customer base is residential and 10 percent is business, that's
24 not Panama City. You're talking companywide --

25 THE WITNESS: Yeah.

1 CHAIRMAN JABER: -- that may be the percentage.

2 THE WITNESS: No, but I would -- no. No. I would
3 still -- I still believe that the percentage in Panama City is,
4 approximates the 90 percent, the 90 percent range. But what
5 I'm saying is that we aggressively pursue more small businesses
6 in Panama City because of the low local exchange rate.

7 CHAIRMAN JABER: Okay. So that 12 -- I think you
8 told me 12,000 is what you guessed?

9 MR. MEROS: Madam Chair --

10 CHAIRMAN JABER: Mr. Meros.

11 MR. MEROS: -- I apologize. With respect to specific
12 numbers, we may be getting into areas of confidential
13 information. We would be happy to provide that in writing
14 under some protection, but that kind of jumped out and I
15 probably should have said something first. But I would --

16 CHAIRMAN JABER: Okay. No. And I appreciate you
17 saying something now.

18 COMMISSIONER DEASON: I was about to say it was
19 refreshing to hear a company give numbers and not claim
20 confidentiality.

21 CHAIRMAN JABER: I know it. I know.

22 MR. MEROS: Well, and then I messed it up. I
23 apologize.

24 CHAIRMAN JABER: No. And I appreciate your saying
25 something. Here's what I'm trying -- this is why I'm asking

1 these questions. Again, going back to Pensacola, Fort Walton
2 Beach, Lynn Haven, one of the things that struck me as
3 attractive in your strategy is that you are, it does appear
4 that you're targeting the residential consumer whether you're
5 using your IP telephony or your landline technology or even
6 cable. And I heard from Pensacola, Fort Walton Beach and
7 Lynn Haven customers that they have local service, some had
8 long distance, some were talking about using more e-mail
9 instead of phone service, and some did say that they have cable
10 and, when they considered all of their bill, there was that
11 affordability issue. And company -- companies like yours are
12 not marketing to those areas, and I'm trying to understand why
13 Panama City? Why not other parts of the panhandle?

14 THE WITNESS: That's a great question. I don't think
15 it's yes or no. But, again, we made the -- we took the
16 calculated risk in 1997. Panama City from our home office in
17 West Point, Georgia, is a, is a short drive. We had an
18 opportunity to have a base of cable customers there which we,
19 we acquired. We have looked at extending our services to
20 Pensacola and other markets on the panhandle: As I testified
21 earlier, Tallahassee versus the Knoxville issue.

22 But from our investors' perspective, in the
23 competition for the valuable CAPX or the capital expenditures,
24 it was tough to make a business case to expand into the
25 panhandle when we could expand into Georgia, Tennessee, Alabama

1 and North Carolina and be more assured that we could meet the
2 returns that our investors expected in the marketplace.

3 CHAIRMAN JABER: Okay. And my final question, we did
4 hear, again in all of those territories I just described, from
5 Lifeline customers who do subscribe to ancillary services,
6 Caller ID, Caller Waiting, the three-way calling, that package.
7 And my question to you is do you have a bundled offering that
8 actually meets or beats what the BellSouth or Sprint local rate
9 would be in the panhandle plus those three ancillary services?

10 THE WITNESS: Can I repeat the question to make sure
11 I answer it correctly?

12 CHAIRMAN JABER: Sure. Absolutely.

13 THE WITNESS: You're, you're asking me if our bundle
14 in Panama City, for example, competes with BellSouth, Comcast
15 Cable and all the Internet providers.

16 CHAIRMAN JABER: No. I'm asking if your bundled
17 package in Panama City can compete with the BellSouth or Sprint
18 Lifeline customer who also takes Caller ID, Caller Waiting and
19 three-way calling?

20 THE WITNESS: Yes, if the, if the consumer buys
21 multiple services from us.

22 CHAIRMAN JABER: Okay. So the missing piece is if
23 that customer also has Internet service and cable, perhaps your
24 services are comparable or better.

25 THE WITNESS: I'm going to throw -- for example, a

1 bundle, we'll eliminate the Internet and the cable in Panama
2 City. You know, we would have a bundled package for local and
3 long distance telephone company in features that probably
4 approximates somewhere between \$30 and \$35. And so we think
5 that probably competes.

6 CHAIRMAN JABER: Take that \$30, \$35 package and tell
7 me what all is in it.

8 THE WITNESS: Okay. It's, it's my understanding it
9 could change. You could go to our Web site at Knology.net and
10 get the specifics, but it would include a package of features,
11 which I believe would include features such as Caller ID, Call
12 Waiting, Call Forwarding, as well as a package of minutes. So
13 it would be an all-you-can-eat type package. So if the, the
14 customer in Panama City wanted to call Pensacola, it would all
15 be included in that bundled rate.

16 CHAIRMAN JABER: And cable and Internet?

17 THE WITNESS: Cable and Internet is also available.
18 And if the customer would like to provide those services, they
19 would get, the prices would continue to get discounted and then
20 the customer gets a converged bill with all services on one
21 bill which shows the discounts.

22 CHAIRMAN JABER: Thank you. Commissioners, do you
23 have any -- Commissioner Deason.

24 COMMISSIONER DEASON: Earlier in answer to a question
25 you mentioned ETC status for incumbent companies.

1 THE WITNESS: Yes.

2 COMMISSIONER DEASON: Is Knology an ETC in any of its
3 territories?

4 THE WITNESS: We are an ETC carrier so that we can
5 compete for the E-Rate money for schools and libraries. For
6 example, in Prattville, Alabama, we just provided 100 megabits
7 of bandwidth to the schools through an E-rate program. But,
8 again, I'm fully aware that an ETC status requires universal
9 service.

10 CHAIRMAN JABER: So what does that mean in Florida?
11 They're not?

12 So in Florida you are not an ETC?

13 THE WITNESS: Let me correct that. I know we have a
14 spin number in Florida, but I don't think we have ETC status.

15 CHAIRMAN JABER: Well, are you required to provide
16 Lifeline, for example?

17 THE WITNESS: No.

18 CHAIRMAN JABER: Commissioner Deason.

19 COMMISSIONER DEASON: So you have no Lifeline
20 customers in Florida; is that correct?

21 THE WITNESS: None that I'm aware of.

22 COMMISSIONER DEASON: I believe Commissioner Davidson
23 asked some for some information concerning senior citizen
24 subscriptions to various services. I don't know where we're
25 going to get all that information from, but I think it would be

1 interesting to know, if we have it available, how many senior
2 citizens subscribe also to cable television services.

3 CHAIRMAN JABER: I think that was part of the
4 request.

5 COMMISSIONER DEASON: Is that part of your request?

6 CHAIRMAN JABER: Yeah. That was part of the request.

7 And, you know, for whatever it's worth, staff and
8 parties, would you take a look at the Advanced Services Report
9 that the FCC puts out? I don't -- I know obviously there's a
10 breakdown. Is it specific to seniors? I just can't recall.

11 MR. MEROS: Commissioners --

12 MS. WHITE: Madam Chair.

13 CHAIRMAN JABER: Yes.

14 MS. WHITE: I'm sorry to interrupt you, but it goes
15 directly to what Commissioner Davidson and you and Commissioner
16 Deason asked. I thought I remembered something in the Fair and
17 Reasonable Report. Now, granted this is as of February 1999.
18 It does have in the Affordability Survey that the staff hired
19 to have done, it has breakdowns of services, including cable,
20 satellite, security alarm, cellular, and based on age levels
21 and income levels.

22 CHAIRMAN JABER: What was the source for that, Ms.
23 White? I can't imagine we've updated it, but maybe if there's
24 a source.

25 MS. WHITE: It was called an affordability survey --

1 it was called the Affordability Survey. I believe the staff
2 had it performed by the -- now I'm going to get in trouble.

3 CHAIRMAN JABER: University of Florida.

4 MS. WHITE: It was either someone at FSU or --

5 COMMISSIONER DEASON: University of Florida.

6 CHAIRMAN JABER: No, the Gators. I remember that.

7 MS. WHITE: University of Florida. See, I knew I was
8 going to get in trouble.

9 CHAIRMAN JABER: I remember that. So clearly we
10 can't rely on that.

11 MS. WHITE: And it was a survey performed by them.
12 It was called the -- and they did -- you do have tables in here
13 that look at like, for example, in February of '99 the
14 households over age 65, with two or more members over the age
15 of 65, 64.8 percent had cable television service. So there are
16 tables that go to that. Now granted it is 1999 information,
17 but it is in this report.

18 COMMISSIONER DAVIDSON: Well, my preference would be
19 to put that together with whatever the best information is you
20 can find. You've got a good staff. Go on Google, do some
21 research. I know there's a lot of information out there on the
22 digital divide and efforts to bridge the divide and how many
23 take rates among seniors of different services. So there's
24 bound to be some current information. If that ultimately is
25 the most current, great. But if y'all can put together some

1 good information with perhaps a summary table that just lays
2 out whatever might be the most relevant, that would be helpful.

3 MS. WHITE: And I would like to point out that
4 BellSouth did ask the AARP if they had information on their
5 members as to whether they subscribe to cable TV, as to income
6 levels, as to questions like that, and they responded that they
7 did not have information like that.

8 CHAIRMAN JABER: Commissioner Davidson though makes a
9 good point that we need to get this in, in the record if that's
10 the desire. And staff has been trying to say something as
11 well, so we'll let Ms. Keating address your question,
12 Commissioner.

13 MS. KEATING: I was just going to point out that the
14 stuff that Ms. White referred to is in the record. You have
15 taken official recognition of the Fair and Reasonable Rate
16 Report. We can get you copies right now of the charts that
17 Ms. White referred to, and we're also still checking to see if
18 we can't find some more current information.

19 CHAIRMAN JABER: But at the very least that study is
20 in, is in the record?

21 MS. KEATING: This is already in the record, yes,
22 ma'am.

23 CHAIRMAN JABER: Okay. Great.

24 All right, Commissioners. Do you have any other
25 questions of this witness? Commissioner Bradley.

1 COMMISSIONER BRADLEY: Packaging and bundling, who,
2 who can give me, tell me the difference, specific differences
3 between the two? And I'm just wondering if --

4 CHAIRMAN JABER: Do you want to ask the witness so we
5 can get it in the record?

6 COMMISSIONER BRADLEY: Can you -- is there a
7 difference between packaging and bundling? And if so, would
8 you be so kind as to explain the difference or the differences?

9 THE WITNESS: Yes. I can explain it from my
10 company's marketing strategy and point of view, if that would
11 help.

12 COMMISSIONER BRADLEY: Thank you.

13 THE WITNESS: We look at -- there's, there's really
14 subsets of our bundle. We'll take cable television first since
15 that's on the top of everybody's mind.

16 The customer can purchase typical analog cable
17 service from us, which is typically around 75 or 80 channels.
18 They can also upgrade that service to digital service,
19 high-definition television, interactive television, video on
20 demand, et cetera. So as part of the bundle there's multiple
21 levels within cable.

22 From a telephone perspective our customers could take
23 R1. And if you look at the statistics, less than 50 percent of
24 our customers today take long distance from us. Or they can
25 buy local and long distance from us on an a la carte basis and

1 bundle it into the, the mix, or they can buy a bundled
2 telephone package that's bundled in with Internet and cable.
3 Does that help?

4 COMMISSIONER BRADLEY: Well, yes. But --

5 THE WITNESS: So there's --

6 COMMISSIONER BRADLEY: Are you saying that there's no
7 difference between packaging and bundling, the two are
8 interchangeable, they mean the same?

9 THE WITNESS: If I understand -- if you could help me
10 understand packaging from -- because I might, I might be
11 explaining it from my understanding of packaging versus what
12 the question you want answered.

13 COMMISSIONER BRADLEY: Okay. Basically what you're
14 saying is that the terms may have a different meaning as we go
15 from company to company and how they market their services.

16 THE WITNESS: Yes. Knology markets its service as a
17 bundle provider.

18 COMMISSIONER BRADLEY: Okay.

19 THE WITNESS: However, we do offer a la carte to the
20 consumers that would like that.

21 COMMISSIONER BRADLEY: Okay. You just answered my
22 question.

23 THE WITNESS: Thank you.

24 CHAIRMAN JABER: Okay. Mr. Meros, do you have
25 redirect?

1 MR. MEROS: Just a couple, Madam Chair.

2 REDIRECT EXAMINATION

3 BY MR. MEROS:

4 Q Mr. Boccucci, do you -- does Knology advertise in the
5 mass media, TV and radio, in the Panama City/Lynn Haven area?

6 A I believe that we run advertising through our cable
7 network through the, through the, through the media in Panama
8 City.

9 Q TV and radio?

10 A Ad insertions into the, into our cable system.

11 Q Okay. Now make sure it's clear, is Knology presently
12 in the Fort Walton/Pensacola area?

13 A We are not.

14 Q Okay. If rate rebalancing were to occur, would
15 Knology like to consider and to possibly invest in those areas
16 as further expansion in the Florida market?

17 A Yes. We have considered those markets in the past
18 and have eliminated the possibility because of the local rate
19 structure in those particular markets. So with rate
20 rebalancing, we would again go back to the chalkboard and
21 reevaluate our strategy in the panhandle of Florida.

22 MR. MEROS: No further questions, and I appreciate
23 the Commissioners' and the parties' indulgence in letting
24 Mr. Boccucci testify. Thank you.

25 CHAIRMAN JABER: You're welcome.

1 THE WITNESS: Thank you for your accommodation of my
2 schedule.

3 CHAIRMAN JABER: Thank you for your testimony. And
4 you had no exhibits, so that takes us to the next witness.

5 How about, Verizon, you bring up the next witness.
6 And, Commissioners, if you need a short --

7 MR. MEROS: And I apologize. If Mr. Boccucci can be
8 excused.

9 CHAIRMAN JABER: Sure. Uh-huh.

10 MR. MEROS: Thank you.

11 (Witness excused.)

12 CHAIRMAN JABER: Commissioners, do you need a short
13 break while we're putting the witness on the stand, just five
14 minutes? Yeah. We'll take a five-minute break and take up the
15 next Verizon witness.

16 (Recess taken.)

17 CHAIRMAN JABER: Okay. Let's get back on the record.

18 Commissioners, I've looked at how many witnesses
19 we've gotten through, and obviously all of this is information
20 we need and we're, we're doing what we need to do in delving
21 into the information before us and asking all the questions we
22 need to ask, but it gives me -- having done that, it gives me
23 an opportunity to reiterate to folks that we will be working
24 late tonight and late tomorrow and we still have a long way to
25 go.

1 It is my understanding though, Commissioners, if we
2 could go ahead and take this up, that staff witness Ollila, her
3 testimony can be stipulated into the record; is that correct?

4 MS. CHRISTENSEN: That is correct.

5 CHAIRMAN JABER: Sue Ollila, Suzanne Ollila, second
6 page. Right. And, Ms. Keating, if you want to go ahead and
7 introduce her testimony, I'll insert it into the record and
8 I'll give you an exhibit number and we'll get that out of the
9 way.

10 MS. CHRISTENSEN: Commissioners, staff would ask to
11 have Ms. Ollila's testimony admitted into the record as though
12 read. And I believe she has one exhibit that is attached to
13 her direct testimony. I believe that's SMO-1.

14 CHAIRMAN JABER: The prefiled direct testimony of
15 Suzanne M. Ollila shall be inserted into the record as though
16 read. And the exhibit number again?

17 MS. CHRISTENSEN: I believe the exhibit number is
18 SMO-1, and that's the 2002 competition report.

19 CHAIRMAN JABER: Exhibit SMO-1, 2002 competition
20 report, will be identified as Exhibit 61, and Exhibit 61 is
21 admitted into the record.

22 (Exhibit 61 was marked for identification and admitted
23 into the record.)

DIRECT TESTIMONY OF SUZANNE M. OLLILA

1
2 Q. Please state your name and business address.

3 A. My name is Suzanne M. Ollila and my business address is 2540 Shumard Oak
4 Boulevard, Tallahassee, Florida 32399.

5 Q. By whom are you presently employed and in what capacity?

6 A. I am employed by the Florida Public Service Commission (Commission) as
7 an Economic Analyst in the Office of Market Monitoring and Strategic Analysis.

8 Q. How long have you been employed by the Florida Public Service
9 Commission?

10 A. I have been employed by the Commission since January 1997.

11 Q. Please briefly review your educational and professional background.

12 A. I received a Bachelor of Arts degree from Columbia University (Barnard
13 College) in 1975. I received a Master of Arts degree in Applied Economics from
14 the University of Michigan in 1978.

15 I have almost 18 years professional experience in telecommunications,
16 including approximately 7 with the Commission and 11 in the industry.

17 My telecommunications industry experience began in 1985 when I was
18 employed by Bell of Pennsylvania (a part of Bell Atlantic, now Verizon, which
19 included the states of Pennsylvania and Delaware) in Product Line Management
20 as an Assistant Manager in the Analytic Support Group. In that capacity, I
21 developed econometric models and forecasts for the Centrex and Operator
22 Services product lines for use in the product plan. In 1987, I moved to the
23 Carrier Access group and was responsible for switched access demand and
24 revenue analysis for Pennsylvania and Delaware. When Bell Atlantic
25 regionalized its Carrier Access groups in 1988-1989, my responsibilities were

1 expanded to include, in addition to Pennsylvania and Delaware, the states of
2 New Jersey, Maryland, Virginia, and West Virginia, and the District of
3 Columbia. In that position, I was responsible for the measurement and
4 analysis of switched access billed revenue (\$1.3 billion annually) and demand.

5 From 1992 to 1996, I was employed by Cincinnati Bell Telephone as a
6 Specialist in Capital Recovery and Asset Management. I managed depreciation
7 and performed asset management for approximately \$615 million of outside plant
8 facilities, primarily fiber and copper cable.

9 In January 1997, I began employment with the Commission in the Division
10 of Communications, now the Division of Competitive Markets and Enforcement.

11 While employed in the Division of Communications, I worked on
12 arbitration dockets between incumbent local exchange companies (ILECs) and
13 competitive local exchange companies (CLECs), and an arbitration and unbundled
14 network element (UNE) pricing proceeding between BellSouth and CLECs. I also
15 worked on other dockets, including the determination of the cost of basic
16 local telecommunications service (universal service cost proxy model) and
17 switched access rate reductions and interexchange company flow-throughs. I
18 was the docket coordinator for BellSouth's UNE pricing proceeding through the
19 end of 2000. Additionally, I was a part of the team that wrote the 1997 Local
20 Competition Report.

21 In December 2000 I moved to the former Division of Policy Analysis and
22 Intergovernmental Liaison. In January 2002, I began work in the Office of
23 Market Monitoring and Strategic Analysis.

24 Q. Please describe your current responsibilities.

25 A. I am an Economic Analyst with responsibilities including the research,

1 analysis and evaluation of regulatory issues affecting competition in the
2 telecommunications market. I am also involved in monitoring, analyzing and
3 evaluating the impact of Commission decisions on market development in the area
4 of telecommunications.

5 Q. What is the purpose of your testimony today?

6 A. The purpose of my testimony is to sponsor the Annual Report on
7 Competition as of June 30, 2002 (Competition Report) issued in December 2002.
8 The Competition Report is filed with my testimony and is identified as SMO-1.

9 Q. Did you prepare the Competition Report?

10 A. The Competition Report was a collaborative effort by staff in the Office
11 of Market Monitoring and Strategic Analysis; I coordinated the project as well
12 as contributed to the content. Staff from the Divisions of External Affairs
13 and Competitive Markets and Enforcement also contributed to the report.

14 As coordinator, I supervised production of the data requests and
15 accompanying letters to over 400 companies, responded to questions from
16 companies, tracked and received the responses, performed the initial review of
17 the responses and distributed the responses to the appropriate staff members.
18 I was responsible for the compilation of the report, reviewing and editing it
19 both for format and content, incorporating review comments and preparing it for
20 publication. As a contributor to the report, I developed the initial outline
21 and worked with other team members developing the data requests and writing the
22 report.

23 Q. Why was the Competition Report prepared?

24 A. This report is prepared annually to satisfy the statutory requirements
25 set forth in Section 364.386 and Section 364.161(4), Florida Statutes.

1 Q. How was information included in the Competition Report obtained?

2 A. The information contained in the Competition Report was obtained from
3 several sources. These sources include responses to data requests from ILECs
4 and CLECs, the FCC, surveys and market research conducted by staff. These
5 sources are more fully described on pages 15 - 16 of the report.

6 Q. What conclusions were identified in the Competition Report?

7 A. The conclusions identified in the Competition Report are included in
8 Chapter III. Responses from ILECs and CLECs indicated the following:

- 9 ● Competitors obtained a 13% market share in 2002, up from 8% in
10 2001.
- 11 ● CLECs made impressive gains in the business market in 2002,
12 increasing their share to 26% of business access lines, up from
13 2001's share of 16%.
- 14 ● The CLEC residential market share increased to 7% in 2002 from 4%
15 in 2001.
- 16 ● Two percent (260,000) fewer access lines were reported in service
17 in 2002 compared to 2001. Much of this decline is believed to be
18 from customers discontinuing traditional lines in favor of wireless
19 or broadband service.

20 Q. Please describe other information contained in the report.

21 A. Chapter II of the report contains a brief overview of the local
22 telecommunications exchange market-opening provisions of the Telecommunications
23 Act of 1996 and the ongoing changes occurring in the marketplace. Chapter IV
24 of the reports highlights current issues in local telecommunications
25 competition such as what factors influence CLEC market entry decisions and the

1 economic impacts resulting from the surge of bankruptcies. Chapter V of the
2 Competition Report covers the six issues required to be addressed by Chapter
3 364, Florida Statutes. The attached appendices provide tables listing the CLECs
4 providing service in Florida, the exchanges with providers, the percentage of
5 CLEC access lines by exchange, state activities, federal activities, the
6 summary of CLEC complaints, and a list of certificated CLECs as of June 30,
7 2002.

8 Q. Does this conclude your testimony?

9 A. Yes, it does.

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1 CHAIRMAN JABER: Okay. Verizon, was Mr. Danner
2 sworn?

3 MR. CHAPKIS: Yes. Dr. Danner has been sworn
4 yesterday.

5 CHAIRMAN JABER: Okay.

6 CARL R. DANNER

7 was called as a witness on behalf of Verizon Florida Inc. and,
8 having been duly sworn, testified as follows:

9 DIRECT EXAMINATION

10 BY MR. CHAPKIS:

11 Q Dr. Danner, could you please state your name and
12 address for the record.

13 A Yes. My name is Carl R. Danner. I'm a director with
14 Wilk & Associates/LECG. My business address is 201 Mission
15 Street, Suite 700, San Francisco, California 94105.

16 Q By whom are you employed and in what capacity?

17 A I'm a director with Wilk & Associates/LECG LLC.

18 Q And have you caused to be filed amended direct
19 testimony consisting of 28 pages in this docket?

20 A Yes, I have.

21 Q And do you have any changes to that testimony?

22 A Yes. There's one missing word on Page 13, Line 12.
23 The last word on the line should be options. So it would say,
24 "more options." I apologize. That was left out somehow.

25 Q And if I were to ask you the questions contained in

1 that testimony today, would your answers be the same with the
2 exception of that one change?

3 A Yes, they would.

4 MR. CHAPKIS: I would ask that the testimony be
5 entered into the record as though read from the stand.

6 CHAIRMAN JABER: The prefiled direct testimony of
7 Carl R. Danner shall be inserted into the record as though
8 read.

9 BY MR. CHAPKIS:

10 Q Dr. Danner, did you cause to be filed one exhibit
11 numbered CRD-1 to be filed as an attachment to your amended
12 direct testimony?

13 A Yes, I did.

14 Q Was this exhibit created under your supervision and
15 control?

16 A Yes.

17 Q Do you have any changes to that exhibit?

18 A No.

19 Q I would ask that that exhibit be numbered for the
20 record, please.

21 CHAIRMAN JABER: CRD-1 will be identified as Exhibit
22 62.

23 (Exhibit Number 62 marked for identification.)
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I.

INTRODUCTION AND WITNESS BACKGROUND

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. PLEASE SUMMARIZE YOUR BACKGROUND AND QUALIFICATIONS.

A. I was Advisor and Chief of Staff to Commissioner (and Commission President) G. Mitchell Wilk during his tenure at the California Public Utilities Commission (CPUC), where I played an important role in the initiation of a successful pricing reform effort with many parallels to that which Verizon's petition will accomplish in Florida. Since leaving the CPUC, I have provided consulting services to various clients on regulation and policy, with emphases on the telecommunications and energy industries. I hold a Masters and Ph.D. in Public Policy from Harvard University, where my dissertation addressed the strategic management of telecommunications regulatory reform. At Harvard, I served as Head Teaching Assistant for graduate courses in microeconomics, econometrics and managerial economics. I hold an AB degree from Stanford University, where I graduated with distinction in both economics and political science. Recently, I co-taught classes on UNEs and impairment to new state commissioners and staff at Michigan State University's annual "Camp NARUC" educational program. My experience includes researching and teaching regulation, advising regulators, testifying in regulatory

1 proceedings, and advising clients on regulatory issues. My complete
2 resume is attached as Exhibit CRD-1.

3

4 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE STATE REGULATORY**
5 **COMMISSIONS?**

6 A. Yes. I have testified regarding various telecommunications and energy
7 issues before state commissions in Florida, Hawaii, California, Oregon,
8 Washington, Illinois, and Indiana, and filed written comments at the FCC. I
9 have also testified in Federal District Court on economic valuation and
10 regulatory issues regarding a water company.

11

12 **Q. HAVE YOU PREVIOUSLY ADDRESSED PRICING REFORM ISSUES**
13 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
14 **(COMMISSION)?**

15 A. Yes. I was instrumental in preparing comments filed by GTE Florida
16 Incorporated (currently, Verizon Florida Inc.) in an undocketed special
17 project regarding fair and reasonable residential basic local
18 telecommunications rates (Special Project 980000A-TP). In addition to
19 preparing comments, I participated in workshops in that special project.

20

21 Based on my experience with pricing reform in Florida, I am aware that this
22 issue has been debated in Florida for a number of years. I am also aware
23 that this debate has now culminated in the decision by the Florida
24 Legislature and the Governor, as a matter of public policy, to create a
25 process by which reform can go forward.

II.

OVERVIEW OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is twofold. First, I demonstrate that Verizon's rate rebalancing plan meets the first two criteria established in Florida Statutes, Section 364.164. More specifically, I show that Verizon's plan will:

1. 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 consumers (Section 364.16(1)(a)); and
2. induce enhanced market entry (Section 364.16(1)(b)).¹

Second, I apply economic principles to show that Verizon's plan will have beneficial effects on customers and the Florida economy.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. My review of Verizon's plan confirms that it meets the foregoing statutory criteria, and will create substantial benefits for (1) competition in local telephone service, (2) telephone service customers, and (3) the Florida economy. I draw from a range of sources to document the sources of competition the plan will encourage. In my opinion, the Commission

¹ Verizon witnesses Fulp demonstrates that Verizon's rate rebalancing plan meets the remaining criteria established in Florida Statutes, Section 364.164.

1 should embrace Verizon's plan for the benefit of the people of Florida.

2

3 **Q. VERIZON HAS AMENDED ITS RATE REBALANCING PLAN, FILED**
4 **ON AUGUST 27, 2003, TO EXTEND THE TIME OVER WHICH**
5 **INTRASTATE NETWORK ACCESS AND BASIC LOCAL**
6 **TELECOMMUNICATIONS RATES WILL BE REFORMED. DOES**
7 **THIS AMENDMENT AFFECT YOUR ANALYSIS OF VERIZON'S**
8 **PLAN?**

9 **A.** After reviewing Verizon's amended plan, I find that it does not affect my
10 analysis.

11

12

III.

13 **VERIZON'S RATE REBALANCING PLAN REMOVES SUPPORT**
14 **FOR BASIC LOCAL TELECOMMUNICATIONS SERVICES (SECTION**
15 **364.164(1)(A))**

16

17 **Q. IS VERIZON'S BASIC LOCAL RESIDENTIAL SERVICE A SUPPORTED**
18 **SERVICE?**

19 **A.** Yes. A supported service is one that is priced below cost. Even if a
20 service covers its incremental cost, it is still supported if it does not make
21 an appropriate contribution towards joint and common costs.²

22

23 A contribution is any amount that a firm receives from the sale of a service

24

² Verizon cannot profitably sustain its services merely by covering only their incremental cost.

1 that exceeds the incremental cost of that service. The incremental cost is
 2 the total cost (including a return on investment and depreciation) that a firm
 3 will directly incur (or avoid) by deciding to offer (or withdraw) a service.

4

5 Verizon's basic local residential service is a supported service because, as
 6 Verizon witness Fulp describes, it is priced below its incremental cost, and
 7 — thus makes no contribution to the recovery of Verizon's joint and common
 8 costs.³

9

10

11 **Q. WILL VERIZON'S RATE REBALANCING PLAN REMOVE SUPPORT**
 12 **FROM THE COMPANY'S BASIC LOCAL SERVICES?**

13 A. Yes. Increasing the price of a supported service decreases support for
 14 that service. Verizon's rate rebalancing plan will increase the price of basic
 15 local services, thereby removing support from those services.

16

17

IV.

18

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VERIZON'S RATE REBALANCING PLAN (1) FACILITATES
THE CREATION OF A MORE ATTRACTIVE LOCAL EXCHANGE
MARKET FOR THE BENEFIT OF RESIDENTIAL CONSUMERS AND
(2) INDUCES ENHANCED MARKET ENTRY (SECTION 364.164(1)(A)– (B))

Q. WILL VERIZON'S RATE REBALANCING PLAN FACILITATE THE
CREATION OF A MORE ATTRACTIVE LOCAL EXCHANGE MARKET

³ Fulp Direct Testimony at 26:10-16.

1 **FOR THE BENEFIT OF RESIDENTIAL CONSUMERS?**

2 A. Yes. Verizon's rate rebalancing plan will remove support for its basic local
3 residential services by reducing the contribution made by its intrastate
4 access rates. Because the reformed rates will more closely reflect the
5 actual cost of providing these services than do the existing rates, the
6 reformed rates will send more accurate price signals to the market. The
7 existence of more accurate price signals will increase consumer welfare by
8 (1) making the local exchange market more attractive to competitors,
9 thereby inducing enhanced market entry and (2) giving consumers
10 improved economic incentives to demand services based on comparing
11 their value (to a consumer) against their actual economic cost.⁴ As I
12 discuss further below, an important benefit of these improved economic
13 incentives will be the ability for consumers to use their telephones more by
14 making more intrastate long distance calls at lower prices.

15
16 **Q. DOES YOUR ANALYSIS OF ENHANCED MARKET ENTRY EXAMINE**
17 **ALTERNATIVE MARKET DEFINITIONS AND A VARIETY OF TYPES OF**
18 **ENTRY?**

19 A. Yes, it does. I examine the market from the standpoint of basic service
20 only, and also from the standpoint of a basic/non-basic service bundle. In
21 addition, I examine a variety of types of entry with respect to a range of

⁴ Verizon's proposed basic business rates will in certain zones make a substantial contribution to common costs (based on the cost standard used in Mr. Fulp's testimony). The increased basic business service and non-recurring installation charges will create a risk for Verizon, because these prices may be more difficult for Verizon to sustain than its reformed residential service prices. Verizon's willingness to assume this risk is evidence that these prices are reasonable in light of the market conditions in Verizon's Florida service areas.

1 technologies, and how competitive providers using such technologies may
2 approach a basic service-only market, or a more expansive market
3 definition focused on bundles.

4

5 **Q. HOW WILL MORE ACCURATE PRICE SIGNALS INDUCE ENHANCED**
6 **MARKET ENTRY AND WHY IS THIS GOOD FOR CONSUMERS?**

7 A. — Verizon's current residential basic monthly rates are well below
8 incremental cost, and therefore impair competition for residential
9 customers. The availability of local service at these below-cost or
10 supported prices limits the prices that competitive local providers can
11 charge. To the extent other providers' costs are similar to Verizon's, the
12 existing supported prices make it economically infeasible for those
13 providers to compete.

14

15 If a provider had a cost structure similar to Verizon's, the existing
16 supported prices would be below that provider's costs to provide the same
17 or a similar service. Therefore, to win customers from Verizon, that
18 provider would be forced to price its services at below-cost levels. Absent
19 a support flow similar to Verizon's, it is not rational or profitable for the
20 provider to price its services below cost. For this reason, competitors that
21 have cost structures similar to Verizon's simply cannot compete against
22 Verizon's existing supported rates.

23

24 Prices that more closely reflect underlying costs, such as those in
25 Verizon's rate rebalancing plan, will increase the likelihood that other

1 providers can offer services at a price equal to or lower than that offered by
 2 Verizon, and still remain profitable. As a result, reformed prices will make
 3 the local exchange market more attractive to competitors and induce
 4 enhanced market entry.⁵

5
 6 **Q. UNDER VERIZON'S RATE REBALANCING PLAN, THE INCREASE IN**
 7 **BASIC LOCAL RATES WILL BE OFFSET BY A DECREASE IN**
 8 **INTRASTATE ACCESS RATES, AND CORRESPONDING REDUCTIONS**
 9 **IN INTRASTATE LONG DISTANCE PRICES. IN LIGHT OF THIS FACT,**
 10 **IS IT REASONABLE TO CONCLUDE THAT REFORMING PRICES WILL**
 11 **INDUCE ENHANCED MARKET ENTRY?**

12 **A.** Yes. Reforming Verizon's rates will induce market entry even though the
 13 basic local rate increases will be offset by decreases in intrastate long
 14 distance prices.

15
 16 First, the prices of individual services can stimulate market entry.

17

⁵ For example, FCC Chairman Michael Powell has observed the following: "...there's been talk for years about rate rebalancing. I happen to believe strongly that if a state doesn't take on seriously the question about how to examine the issue of rate rebalancing, it's all for naught. You don't know how many competitors are going to find a way to compete if they can't get their retail rate at some level of economic reasonableness..." (Phone+ Magazine, Interview With FCC Chairman Michael Powell, April, 2002, <http://www.phoneplusmag.com/articles/241INTERVIEW.html>). Moreover, Economists Robert Crandall and Leonard Waverman described the impact of pricing in this way: "An obvious explanation exists for the lack of competition in residential lines: regulated flat rates are so low that no new entrant is interested in pursuing such customers. Only when rates are rebalanced toward cost will these entrants attempt to compete for residential customers." (Crandall, Robert W. and Leonard Waverman. Who Pays for Universal Service? When Telephone Subsidies Become Transparent (Brookings Institution Press, 2000), page 137).

1 Basic service and other offerings are priced separately, and customers
 2 routinely mix and match basic service from one provider with other
 3 offerings from different providers. Moreover, regulators treat basic service
 4 and long distance services as distinct offerings, and for many years have
 5 required that carriers have equal access to local exchange customers. As
 6 a result, competitors may choose to compete in the basic local market, the
 7 long distance market, markets for specialized offerings, or all of the above.

8
 9 Historical patterns of entry and competition show that the prices of
 10 individual services influence competition. There is a reason, for example,
 11 that long distance providers often bombard customers with competitive
 12 service solicitations, but express little or no corresponding interest in
 13 supplying the same customers' basic service: the long distance offering is
 14 profitable, while the basic local service is not.⁶

15
 16 Second, the distribution of customer bills affects competition.

17
 18 The inaccurate pricing inherent in Verizon's existing rate structure tends to
 19 skew the distribution of customer bills. By overpricing intrastate long
 20 distance calling, current rates increase bills for high volume toll and long
 21 distance users by an amount greater than the added costs such users
 22 impose on carriers. As a result, high volume toll and long distance users
 23 are made artificially attractive to competitors, while others (whose bills are

⁶ The price of an individual service may also affect competitors that want to assemble retail bundles for customers from a variety of wholesale providers (including providers of basic service).

1 thereby reduced) are made artificially unattractive.

2

3 This skewed distribution of customer bills has implications for the entry
 4 decisions made by competitive providers. For example, a carrier deciding
 5 whether to build facilities to a neighborhood must consider factors such as
 6 the number of customers it can attract, and their likely spending on its
 7 — services. The skewed bills that result from the current rate structure
 8 reduce the number of potentially compensatory customers available to the
 9 new provider, and therefore force that provider to try to attract the relatively
 10 small pool of potentially compensatory customers to help cover its costs.
 11 By decreasing the size of the pool of potentially compensatory customers,
 12 the current rate structure increases the risk of such investment. Verizon's
 13 plan will level out the distribution of customer bills to better resemble the
 14 actual costs of service, thus making a greater proportion of customers
 15 potentially compensatory for a new provider.

16

17 **Q. WILL VERIZON'S PRICING REFORM PLAN ENCOURAGE INCREASES**
 18 **IN TOLL AND LONG DISTANCE USAGE, AND THEREFORE MAKE**
 19 **RESIDENTIAL CUSTOMERS MORE ATTRACTIVE TO COMPETITION?**

20 **A.** Yes. Because the newly enacted legislation requires long distance
 21 providers to flow through access reductions,⁷ toll and long distance prices
 22 will fall, which in turn would stimulate toll and long distance usage. This
 23 reaction will increase the size of the market opportunity for competitors,
 24 and therefore also promote competition for residential customers.

⁷ Section 364.163(2).

1

2 **Q. ARE THERE ANY OTHER BENEFITS ASSOCIATED WITH VERIZON'S**
3 **PRICING REFORM PLAN?**

4 A. Yes. Competitive pressures will likely force Verizon to reduce its toll
5 prices. Such reductions will not be offset with increases under §364.164
6 and will therefore serve as an additional customer benefit.

7

8 **Q. IS THERE A PARTICULAR CLASS OF RESIDENTIAL CUSTOMER**
9 **THAT BENEFITS THE MOST FROM VERIZON'S PLAN?**

10 A. Yes. Verizon's plan will benefit existing Lifeline customers and additional
11 customers who will qualify for Lifeline under the expanded provisions of
12 §364.164.⁸ Lifeline subscribers will see the price they pay for basic service
13 preserved at its current level, while at the same time enjoying the benefits
14 of reduced prices for long distance calling created by the pass through of
15 access charge reductions.⁹

16

17 **Q. WHAT ADDITIONAL ECONOMIC BENEFITS WILL FLOW TO**
18 **CUSTOMERS, INCLUDING RESIDENTIAL CUSTOMERS, WHEN**
19 **VERIZON'S PLAN IS APPROVED?**

20 A. There are two important additional economic benefits that customers will

⁸ At present, Verizon serves just over 21,000 Lifeline customers in Florida, and Verizon expects that its Lifeline subscribership will nearly double under the new criteria that make more low income customers eligible for the program's benefits.

⁹ Some of these customers may also benefit from the elimination of fixed monthly in-state access charge recovery fees imposed by long distance carriers.

1 receive under Verizon's plan.¹⁰

2

3 First, as I suggested above, customers will respond to lower toll and long
4 distance prices by increasing their use of those services. It is well
5 established in economics that such volume increases benefit customers; in
6 the instant case, customers will benefit from being able to use the phone
7 more than they did before at lower prices.¹¹ This point can be
8 demonstrated by a consumer surplus analysis, or by the common-sense
9 observation that a customer who freely elects to make more calls would do
10 so only if he or she is made better off as a result.¹²

11

12 Second, customers will benefit from increased availability of competitive
13 options. Increased competition is likely to provide at least some customers
14 with options they find preferable to their existing Verizon wireline service,
15 including innovations that Verizon may then be encouraged to adopt for its

16

¹⁰ For an outstanding quantitative analysis of some of the benefits of pricing reform, see 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. Professor Hausman and his co-authors documented a small, but meaningful increase in universal service due to a Federal pricing reform that was similar to Verizon's plan. The reason was that undercharging for basic phone service through overcharging for long distance calls (the same situation Verizon's plan will remedy in Florida) was a bad bargain; on average, it degraded the value of telephone service to consumers by more than the basic service price discount they thereby obtained.

¹¹ By increasing the value of phone service to customers, such benefits can even cause an increase in universal service (an effect that has previously been documented, e.g., by Hausman et.al).

¹² This additional calling may increase customer phone bills somewhat, but any such increased bill amounts will be more than offset by the consumer benefits of the added calls.

1 remaining customers. Increased competition will also place increased
 2 pressure on Verizon to operate efficiently, thereby promoting the efficient
 3 use of resources in Florida's economy.

4

5 **Q. FROM A BROAD PUBLIC POLICY PERSPECTIVE, WILL PRICING**
 6 **REFORM CREATE BENEFITS FOR THE PEOPLE OF FLORIDA?**

7 A. _ Yes. Floridians will see net economic benefits and an increase in
 8 competitive alternatives. As stated above, more economically rational
 9 prices will stimulate local competition based on a sound economic footing,
 10 rather than stimulating competition based on the arbitrage of inaccurate
 11 prices. As a result, customers (including those who may have been
 12 deterred in the past by high prices) will be able to take advantage of more *options*
 13 at affordable prices.

14

15 Pricing reform will also signal investors that the Governor, Legislature and
 16 this Commission are serious about promoting competition and removing
 17 impediments to its success.¹³ For those who might commit new capital to
 18 Florida, this signal will be important not just for what it says about current
 19 business opportunities, but also for what it says about the Commission's
 20 likely future approach to issues that may affect these investments in the
 21 future. Reform will thus build confidence in the investment climate for local
 22 competition in Florida.

23

¹³ An even stronger positive signal will be sent if the Commission approves pricing reforms at the same time for Verizon, BellSouth and Sprint, which collectively serve 98 percent of ILEC lines in Florida.

V.

POTENTIAL COMPETITORS ARE POISED TO ENTER
THE MARKET IN RESPONSE TO PRICING REFORM
(SECTION 364.164(1)(B))

Q. HAS THE ENACTMENT OF PRICING REFORM LEGISLATION
ALREADY LED TO A SPECIFIC, PRO-COMPETITIVE MARKET
DEVELOPMENT THAT BENEFITS RESIDENTIAL CUSTOMERS IN
VERIZON'S SERVICE AREA?

A. Yes. On July 18, 2003, Knology, Inc. announced that it had agreed to purchase Verizon's broadband cable assets in Pinellas County. Knology already offers bundled video, Internet and phone service in eight other markets in the southeast, and is now positioned to offer these bundles in Pinellas.¹⁴ In its press release regarding the transaction, Knology made clear the potential for future pricing reform influenced its decision to expand. Specifically, the press release states:

the Tele-Competition Act recently enacted in Florida positively influenced [Knology's] decision to expand operations in the state. This Act, as written by the Florida Legislature and supported by Governor Bush, laid the foundation for companies like Knology to enter the Florida market, and offer competitive services and products to consumers.

The Tampa Tribune reported that Knology's senior director of marketing

¹⁴ "Verizon Finds Cable Buyer," St. Petersburg Times, July 19, 2003.

1 "said the deal was facilitated by the state law approved by the Legislature
2 this year that raised local phone rates as a way to stimulate telephone
3 competition."¹⁵

4

5 **Q. DOES VERIZON'S CURRENT RATE STRUCTURE DISCOURAGE**
6 **COMPETITORS THAT ARE WELL POSITIONED TO SERVE**
7 **— RESIDENTIAL CUSTOMERS FROM ACTUALLY DOING SO?**

8 A. Yes. The evidence demonstrates that Verizon's distorted rates discourage
9 such competitors from serving residential customers.

10

11 Facilities-based competition has developed for business customers but not
12 for residential customers. In Verizon's Florida service area, competitors
13 now serve approximately 10 business lines for every one residential line,
14 and facilities-based competitors now serve more than one hundred
15 business lines for every residential line.¹⁶

16

17 The scarcity of residential competition cannot be attributed to an absence
18 of viable competitors. Verizon's competitors have deployed extensive
19 facilities (including numerous circuit and packet switches, and more than
20 15 competitive local fiber networks) in geographic locations that include
21 virtually all of Verizon's residential customers.¹⁷ This is significant
22 because, as a technical matter, it is just as feasible to serve residential

¹⁵ "Verizon Sells Cable television Units to Ga. Company," Tampa Tribune, July 19, 2003, Business section page 5.

¹⁶ Leo Direct Testimony, Exhibit ETL-1at 2.

¹⁷ In many of these locations, four or more CLECs are providing service today.

1 customers using these facilities as it is to serve business customers.

2

3 The disparity in the level of competition for business and residential
4 customers is attributable, at least in part, to distorted residential prices.
5 Fortunately, as explained above, Verizon's rate rebalancing plan will
6 reduce this disparity by making residential customers more attractive to
7 competitors.

8

9 **Q. SHOULD THE COMMISSION CONSIDER A VARIETY OF**
10 **TECHNOLOGIES AND BUSINESS MODELS WHEN EVALUATING THE**
11 **COMPETITIVE LANDSCAPE IN VERIZON'S SERVICE TERRITORY?**

12 A. Yes. Given the diversity of customers, providers, technologies, and
13 possible competitive strategies that exist in the market, a wide range of
14 competitive approaches will be used to reach residential customers. Most
15 of these competitors will not closely copy Verizon's existing network or
16 specific service options because offering something new or slightly
17 different is (1) consistent with many of the available competitive
18 technologies and (2) a good way to attract customers' attention.

19

20 Customers themselves will be likely to differ in the features and services
21 they prefer and how much they will be willing to pay for them. Some
22 customers will opt for less costly, lower-quality alternatives, while others
23 will choose to pay a premium for higher quality service.

24

25 Accordingly, when evaluating the potential impact of Verizon's rate

1 rebalancing plan, the Commission should consider all potential substitutes
2 for Verizon's basic local service.

3

4 **Q. ARE LOCAL CABLE TELEVISION SERVICE PROVIDERS WELL**
5 **POSITIONED TO COMPETE FOR BASIC RESIDENTIAL CUSTOMERS**
6 **IN VERIZON'S FLORIDA TERRITORY?**

7 A. _ Yes. Cable television providers in many parts of the nation have already
8 upgraded their networks to provide a variety of two-way services (including
9 local telephone service) to residential customers.

10

11 Bright House Networks, the principal cable television provider in Verizon's
12 service area, is well on its way to being able to offer cable telephony
13 services. It already provides cable modem service over its network in
14 Tampa, which makes clear that it has completed many of the upgrades
15 needed to provide telephony service and has already gained experience in
16 provisioning and billing non-cable television offerings to its customers.¹⁸

17

18 Moreover, the corporate owners of Bright House Networks have
19 experience with cable telephony services. Before Time Warner sold its
20 Tampa cable system to its venture partner Advance/Newhouse, Time
21 Warner (which is still one of Bright House's owners) completed a trial in
22 Tampa of cable telephony that relies on Internet Protocol (IP)-based

¹⁸ A natural competitive evolution for cable television providers has been to first offer digital cable and cable modem service, and then to begin offering local telephony.

1 packet switching, rather than conventional circuit switching.¹⁹

2

3 Time Warner's reliance on IP Protocol is particularly significant because:

4 (1) IP-technology can permit a cable provider to add a telephone line for a

5 one-time cost of about \$300-600,²⁰ which is less expensive than the circuit-

6 switched technology that has been used to provide most of the cable

7 — telephony offered to date;²¹ and (2) concerns with the quality of voice-over-

8 IP service have recently diminished, as evidenced by IBM's recent decision

9 (in March, 2003) to transition its workforce to voice-over-IP telephone

10 service.²²

11

12 **Q. IS IT IMPORTANT TO TAKE ACTION TO ENSURE THAT CABLE**
 13 **TELEVISION PROVIDERS INVEST IN FLORIDA?**

14 **A.** Yes. Cable television providers, especially those like Time Warner (a

15 subsidiary of a diversified media, entertainment and information technology

16 company with worldwide operations), have a plethora of investment

¹⁹ Time Warner's experience is not limited to that single trial. It has begun offering commercial versions of IP cable telephony in other parts of Verizon's service territory. Of course, Time Warner is not alone in this endeavor, as Cablevision, Comcast and Cox are also conducting trials of this service in various markets. *Id.* at 12.

²⁰ Merrill Lynch Global Securities Research & Economics Group. "Voice Over Broadband," (June 24, 2003), page 2.

²¹ Using circuit-switched technology, Cox estimates a per-customer investment of \$610 to provide the average 1.3 lines a residential customer demands (\$498 per line); for voice over IP, the corresponding figures are \$564 per customer and \$462 per line. "Cox Communications VoIP Whitepaper," February, 2003, pages 6-8 (<http://www.cox.com/PressRoom/supportdocuments/VOIDwhitepaper.pdf>, viewed July 31, 2003). If the VOIP service is powered from home electricity (i.e., no network backup power), the cost falls to \$404 per customer and \$310 per line.

²² Goldman Sachs Global Equity Research. "VoIP – the enabler of real telecom competition," (July 7, 2003), pages 6, 15-19.

1 opportunities available to them. Even cable television providers that have
2 decided to offer telephone service on a broad basis have the opportunity to
3 invest in a number of different markets outside of Florida. Given that there
4 is competition for the cable companies' investment dollars, it is important
5 for the Commission to improve the attractiveness of investing in telephony
6 in Florida by approving Verizon's pricing reform petition. Pricing reform
7 — can move Florida markets ahead in the queue, bringing more telephone
8 service options to consumers sooner.

9
10 **Q. WILL THE INCREASE IN VERIZON'S BASIC LOCAL RESIDENTIAL**
11 **RATES BE PARTICULARLY SIGNIFICANT TO CABLE TELEVISION**
12 **PROVIDERS?**

13 A. Yes. Cable television providers typically have a market share for cable
14 television service of about two-thirds of all homes passed. The cable
15 provider starts with an access line already in the home, onto which
16 telephone service can be added on a purely incremental basis. The start-
17 up cost (of \$600 or less per service) is thus an important benchmark
18 against which a cable provider will evaluate the attractiveness of its
19 residential service offering. Given their high market penetration and this
20 relatively low start-up cost, an increase of four to five dollars on the basic
21 monthly rate is a significant inducement for cable television providers to
22 enter the basic local service market.

23

24 Cable telephony is one alternative for which the stand-alone increase in
25 the basic rate may be particularly significant. Cable television providers

1 use a different technology than a customer may be accustomed to, and
 2 therefore may have difficulty capturing all of a customer's local telephone
 3 business at first. For example, one option for a cable provider could be to
 4 use non-powered equipment, which does not have a battery to permit
 5 service during power outages.²³ Cable telephony also uses a different
 6 technology from that which a customer may be used to. Reasons like
 7 — these may cause customers to hesitate to commit to cable telephony as
 8 their primary line before gaining experience with the offering. To the extent
 9 a customer initially may wish to try cable telephony as a second or third
 10 line rather than a full replacement for existing service, the customer may
 11 generate few additional usage charges (e.g., for second lines used for fax
 12 or Internet connections). Because the cable provider will need to rely
 13 almost entirely on the basic rate to try to recover its investment in these
 14 cases, a more cost-based Verizon basic service price will make it easier for
 15 cable providers to charge a basic service rate that offers an acceptable
 16 investment return.²⁴

17
 18 Accordingly, the adoption of Verizon's rate rebalancing plan is particularly
 19 important to stimulate market entry among cable television providers.

20

²³ This approach may become more acceptable given the enormous customer penetration of wireless phones that will function in a blackout (as long as their batteries are charged).

²⁴ As a simple illustrative example, the payback period needed to recover a \$600 investment is reduced by nearly a year if one compares a \$20 basic rate ($600 / 20 = 30$ months), versus a \$15 basic rate ($600 / 15 = 40$ months). Other things equal, a shorter payback period generally indicates a more attractive investment opportunity.

1

2 **Q. ARE OTHER PROVIDERS THAT MAKE USE OF ALTERNATIVE**
3 **TECHNOLOGIES WELL POSITIONED TO ENTER THE MARKET IN**
4 **RESPONSE TO PRICING REFORM?**

5 A. Yes. Vonage (www.vonage.com) employs voice over IP technology to
6 offer flat-rate local service for \$25.99 per month, including a large local
7 — calling area, 500 minutes of long distance, vertical services and voice mail,
8 and deeply discounted long distance and international calling rates.
9 Vonage will add unlimited long distance calling for \$39.99 per month.
10 Vonage already has gained over 20,000 subscribers nationwide, and plans
11 to acquire 100,000 customers before the end of 2003. Pricing reform will
12 make residential customers more attractive to Vonage (and to other
13 providers that might use similar technology), because Verizon's basic local
14 rate will more closely approach the competitive price that Vonage charges
15 for its local service alternative.

16

17 **Q. WILL PRICING REFORM PROMOTE CUSTOMER INTEREST IN**
18 **BROADBAND INTERNET CONNECTIONS IN FLORIDA?**

19 A. Yes. Today, broadband connections to the Internet are increasingly
20 available to customers. Florida's current prices for local telephone service
21 systematically under-price the old, less capable network connections, and
22 thus discourage consumers from upgrading to something better. When
23 presented with prices that more closely reflect the genuine costs of their
24 choices, some consumers will doubtless elect to stay with what they have,
25 but others will recognize a better value in upgrading to a broadband

1 connection that may allow them, among other things, to obtain basic
 2 telephone service through the same connection over which they access
 3 the Internet at high speed. Thus, pricing reform will promote the goal of
 4 making broadband use more ubiquitous.

5

6 **Q. WILL VERIZON'S PLAN PROMOTE INCREASED COMPETITION BY**
 7 **WIRELESS PROVIDERS?**

8 A. Yes. Wireless services already compete extensively with wireline services,
 9 and pricing reform will increase the attractiveness of wireless as a
 10 substitute for wireline services. Increased competition from wireless
 11 providers will benefit a large number of Floridians because: (1) wireless
 12 phones are close substitutes for wireline phones;²⁵ (2) wireless phones are
 13 prevalent in this state;²⁶ and (3) a growing number of customers are
 14 abandoning their wireline phone service for a wireless phone, and an even
 15 larger share of traffic minutes are migrating to wireless networks.²⁷

16

17 **Q. WILL PRICING REFORM MAKE RESIDENTIAL CUSTOMERS IN**
 18 **VERIZON'S SERVICE AREA MORE ATTRACTIVE TO REGIONAL**

²⁵ A majority of Florida residents already considered wireless to be a "close substitute" to wireline service in 1998. Florida Public Service Commission. "Telecommunications Markets in Florida," Annual Report on Competition (as of June 30, 2002), pages 7-9.

²⁶ Nationally, there is a wireless phone in service for every one out of two people (including children), and, in Florida, wireless phones are even more prevalent than in the nation as a whole. FPSC Annual Report on Competition, *supra* note 25. As of year-end 2002, the FCC estimated a penetration of 55.73 percent for Tampa – St. Petersburg – Clearwater, FL. FCC, Eighth Report on CMRS Competition (July 14, 2003), Appendix D, page D-4 (Table 3).

²⁷ For its part, the Commission has already recognized that "Florida ILECs are perhaps more vulnerable to wireless competition than most other states," due to seasonal residents discontinuing landline connections in favor of wireless.

1 **WIRELESS PROVIDERS?**

2 A. Yes. Verizon's plan will encourage competition from smaller, regional
3 wireless providers that can compete directly with wireline basic service
4 through local calling plans with unlimited wireless minutes.²⁸

5
6 In other jurisdictions, regional wireless providers offer packages that are
7 — designed to replace wireline service. For example, in Sacramento,
8 California, SureWest Wireless offers a wireless plan with unlimited local
9 minutes and five vertical services for \$33 per month, which can be
10 upgraded to include unlimited long distance calling within northern
11 California for another \$4 per month.²⁹ Similarly, Cricket Wireless in
12 Columbus, Georgia offers unlimited local usage for \$32.99 per month,
13 which can be upgraded to include three vertical features and 500 minutes
14 of long distance for an additional \$7 per month.³⁰ In their marketing, such
15 carriers make clear that their service is intended as a replacement for a
16 wireline phone, not just an adjunct to it.³¹

²⁸ See a discussion of this strategy at pages 51-52 of the FCC's Eighth Report, supra note 21.

²⁹ SureWest "Unlimited" plan from <http://www.surewestwireless.com/products/plans/unlimited.htm>; SureWest "Unlimitedplus" plan from <http://www.surewestwireless.com/products/plans/unlimitedplus.htm> (pages viewed July 2, 2003). Both plans require two-year contracts, and include discounts on wireless phones (including some "free" handset options).

³⁰ <http://www.cricketcommunications.com/service.asp#cricket> (viewed July 2, 2003). A one-year service commitment is required; customers purchase handsets for prices starting at \$99.

³¹ For example, a recent survey revealed that 37 percent of Cricket customers have no wired phone. Other research indicates that wireless usage (on all wireless carriers) has displaced 25 percent of U.S. landline phone minutes. "Leap Continues to Lead National Trend of 'Cord Cutters'", May 12, 2003 Leap Wireless International press release found at <http://www.leapwireless.com/d/index.html> (viewed July 30, 2003).

1

2 At present, such wireless alternatives do not appear to be available to
 3 Verizon's Florida customers, even though Alltel (which does offer wireless
 4 service in the area) offers similar plans in several other states.³² A below-
 5 cost wireline basic rate obviously impairs competition for residential
 6 consumers from this source.

7

8 By reducing the gap between the basic wireline monthly rate and the price
 9 of this alternative, pricing reform will encourage current (or potential)
 10 wireless providers to offer these services in Florida, either by repricing
 11 existing service or by building out facilities that may be needed to use
 12 existing wireless licenses to provide service.

13

14 **Q. WILL PRICING REFORM ALSO ENCOURAGE CUSTOMERS WITH**
 15 **EXISTING WIRELESS PLANS TO CONSIDER EXPANDING THEIR**
 16 **WIRELESS USE TO SUCH AN EXTENT THAT THEIR WIRELESS**
 17 **SERVICE BECOMES A COMPLETE SUBSTITUTE FOR THEIR**
 18 **WIRELINE SERVICE?**

19 **A.** Yes. Pricing reform will encourage such expansion by making it more
 20 economically attractive for these customers to shift all of their telephone
 21 usage to a wireless service. The average wireless bill is about \$50 per
 22 month.³³ In Verizon's Florida service area, a wireless rate plan of about

23

³² Supra note 26; the FCC reported such Alltel plans in Arizona, New Mexico, North Carolina, Nebraska and Arkansas.

³³ The average was \$48.40 per month for 2002. FCC, Eighth Report (supra note 26), Appendix D, table 9.

1 \$75 per month can substitute for a residential wireline telephone. Thus, for
 2 the average customer who already uses a wireless phone, the incremental
 3 expense to disconnect the wired phone is approximately \$25 per month. A
 4 customer with less than average line usage (or whose wireline usage
 5 already tends towards off-peak times as rated for wireless plans) will have
 6 an even greater inducement to shift entirely to wireless.³⁴ By bringing
 7 Verizon's wireline basic rate to a more cost-based level, pricing reform will
 8 make the replacement of wired service with wireless service (for those who
 9 already have the latter) potentially attractive to an even greater cross-
 10 section of residential customers, and therefore encourage wireless
 11 providers to refine and market such plans.

12
 13 **Q. WILL PRICING REFORM CREATE INCREASED COMPETITIVE RISK**
 14 **FOR VERIZON?**

15 A. Yes, Verizon will face increased risk, just as the statute intends through its
 16 stimulus of local competition for residential customers. For this reason, it is
 17 not possible to predict with any precision what revenues Verizon will
 18 ultimately receive following pricing reform, or how those revenues will
 19 change in the following months or years. The great uncertainty (and
 20 controversy) that would be inherent in any such forecasting effort helps
 21 highlight why the Florida Legislature made a wise choice to base pricing
 22 reform on recorded revenues and units for a defined period, absent
 23 demand stimulation.

³⁴ For example, T-Mobile offers a plan with 1000 peak minutes, unlimited off-peak minutes and the full set of features (including long distance) for \$59.99/month. <http://www.t-mobile.com/plans/national/plus.asp> (viewed August 7, 2003, for Tampa, Florida).

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VI.

**PRIOR EXPERIENCE WITH PRICING REFORM
INDICATES THAT IT CAN PROCEED WITHOOUT
NOTABLE DIFFICULTIES FOR CUSTOMERS**

**Q. DOES PRIOR EXPERIENCE WITH PRICING REFORM SUGGEST THAT
IT CAN PROCEED WITHOUT CAUSING NOTABLE DIFFICULTIES FOR
CUSTOMERS?**

A. Yes. In California, for example, the Public Utilities Commission pricing reform order in 1994³⁵ raised basic rates for Pacific Bell and GTE California customers in exchange for reductions in access charges and toll prices. The basic rate increase for Pacific Bell customers was slightly smaller than the increase Verizon proposes for Florida, while the GTE California basic rate increase was larger (from \$9.75 per month to \$17.25 per month). As is proposed here, prices for in-state toll and access charges were also cut sharply to promote competition and to encourage economic efficiency. Lifeline customers were among the biggest beneficiaries of pricing reform in California (as they will be in Florida), and pricing reform was understood to be an essential component of a pro-competition regulatory policy (at that time for toll service in California, and now for basic residential service in Florida).³⁶

³⁵ CPUC decision 94-09-065, September 15, 1994.

³⁶ It is noteworthy that the ratepayer advocacy arm of the CPUC staff (then the Division of Ratepayer Advocates) supported pricing reform as beneficial to consumers.

1

2 Following the implementation of these rate changes in California, there
3 was no apparent impact on universal service, and no widespread
4 expressions of concern from customers that were evident either to me as a
5 close observer of the situation, or to the companies themselves.

6

7 — There are other examples that suggest pricing reform does not undermine
8 universal service. For example, Professor Hausman and his co-authors³⁷
9 noted that the Consumer Federation of America and the U.S. Public
10 Interest Research Group predicted that 6 million subscribers would give up
11 their phone service during 1984-86 due to Federal telephone pricing
12 reform (that again paralleled the reform Verizon proposes for Florida).
13 Contrary to this claim, subscribers actually increased by 4.1 million during
14 this period, in part due to the reform's beneficial impacts on universal
15 service.

16

17

VII.

18

CONCLUSION

19 **Q. PLEASE SUMMARIZE YOUR PRINCIPAL CONCLUSIONS.**

20 A. Verizon's pricing reform plan conforms with the requirements of §364.164,
21 and will result in telephone service prices that are more fair, accurate,
22 economically efficient, and consistent with local telephone service
23 competition for residential customers. Through its compliance with
24 §364.164 and in my independent judgment, Verizon's plan will advance the

³⁷ Hausman et. al, (op. cit.), page 182 note 7.

1 public interest and should be approved.

2

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

4 **A.** Yes, it does.

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1 BY MR. CHAPKIS:

2 Q Dr. Danner, did you cause to be filed in this docket
3 rebuttal testimony consisting of 50 pages?

4 A Yes, I did.

5 Q And did you cause to be filed an errata revising
6 Pages 42 and 43 of your rebuttal testimony on December 2nd,
7 2003?

8 A Yes, I did.

9 Q And other than the errata changes, do you have any
10 other changes to that testimony?

11 A I do not.

12 Q And if I were to ask you the questions contained in
13 that testimony today, would the answers be the same with the
14 exception of the errata portion?

15 A Yes, they would.

16 MR. CHAPKIS: I would ask that the testimony be
17 entered into the record as though read from the stand,
18 including the errata sheets.

19 CHAIRMAN JABER: Prefiled rebuttal testimony of Carl
20 R. Danner, including the errata sheets to said testimony, will
21 be inserted into the record as though read.

22 MR. CHAPKIS: Thank you. And I will just note for
23 the record that Pages 42 and Pages 43 of that rebuttal
24 testimony contain confidential information.

25 CHAIRMAN JABER: Thank you.

1 I.

2 INTRODUCTION AND OVERVIEW OF REBUTTAL TESTIMONY

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

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

7

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

10 A. Yes.

11

12 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

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

18

19 Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

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

23

24 First, the criteria under Section 364.164(1) are factors for the
25 Commission to consider, not standards that must individually be

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

9
10 Second, Verizon has submitted evidence demonstrating that granting its
11 rate rebalancing plan will remove current support for basic local services
12 that prevents the creation of a more attractive competitive local
13 exchange market for the benefit of residential customers. The claims of
14 opposing witnesses to the contrary rely on strained analysis, suggest
15 unrealistic scenarios, and are contrary to observed fact.

16
17 Third, Verizon has demonstrated that its basic local residential services
18 are supported. The claims of opposing witnesses to the contrary either
19 misapply or contradict fundamental principles of costing and economics.

20
21 Fourth, Verizon has shown that granting its rate rebalancing plan will
22 provide a variety of benefits to residential customers. The evidence
23 does not support claims that pricing reform will harm universal service or
24 cause undue customer hardship.

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

10 II.

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

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

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

18
 19 Q. WHAT IS THE MEANING OF SECTION 364.164(1)(A), THE
 20 PROVISION THAT PURPORTEDLY CONFUSED DR. COOPER?

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

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

1 exchange market for the benefit of residential
2 customers.

3

4 This provision is clear in both of its essential regards.

5

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

11

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

21

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

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

13

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

21 **FPSC Fair & Reasonable**

22 **Rate Report**

23 1. A three to five year phase-in
 24 of basic rate increases of up to
 25 \$5 would be acceptable to

The Act

1. Two to four year phase-in of
 basic rate increases acceptable
 to remove subsidy support.

1 reduce subsidies.

2 2. Access charges should be
3 reduced to interstate parity over
4 three to five years.

5 3. A basic rate increase and
6 rebalancing would help stimulate
7 local competition for residential
8 customers.

9 4. Protection for vulnerable
10 customers is important.

11

12 (Source: Report Executive
13 Summary, and Conclusions)

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

21

22 Having participated in a portion of this process and had some
23 understanding of its overall scope and extent, I can affirm that reform is
24 overdue and should occur now. Indeed, reform was already overdue in
25 1998 – the first time I helped address these issues before the

2. Two to four year phase-in of
access charge reductions to
interstate parity.

3. Purpose of removing support
from rates is to promote
competition for benefit of
residential customers.

4. Lifeline eligibility to be
expanded along with pricing
reform.

(Sections 364.164, 364.10(3))

1 Commission.

2

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

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

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

14

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

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

21

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

25 A. No. The Florida Legislature expressed itself clearly in the statutory

1 provisions that it enacted. Dr. Cooper's attempts to misconstrue the
2 plain meaning of an unambiguous statute should be given no weight.

3

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

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

11

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

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

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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

1 compares the proportion of CLEC residential customers to those of
2 ILECs (Cooper, Page 27, Lines 7–11). On this measure, Dr. Cooper
3 finds that Florida ranks 33rd out of 39 states reviewed. In other words,
4 there were only six states in this group that ranked worse than Florida in
5 skewing competition away from residential customers. Accordingly, Dr.
6 Cooper's own statistics highlight that the existing pricing structure
7 inhibits competition for residential customers.

8

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

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

15

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

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

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

1 Report, Page 8).

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

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

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

13 As of June 30, 2003, thirty CLECs were serving
14 992,990 lines in Florida from their own switches;
15 however, 90% of these lines served business
16 customers. (Figure 11). Figure 12 shows that these
17 switch-based CLECs served an additional 364,391
18 lines through ILEC switches (UNE-P and resale
19 lines) for a total of 1,356,381 lines served. (Draft
20 FPSC 2003 Competition Report, Page 20).

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

24

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

1 **AND NOT VERIZON'S PLAN, WOULD STIMULATE FURTHER**
2 **LOCAL COMPETITION (GABEL, PAGE 38, LINE 7 – PAGE 42, LINE**
3 **2; COOPER, PAGE 30, LINES 13–15). PLEASE ADDRESS THIS**
4 **CLAIM.**

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

11

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

17

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

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

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

7
 8 **Q. DR. GABEL CONTENDS THAT RATE REBLANCING WILL NOT**
 9 **ENCOURAGE COMPETITION BECAUSE POTENTIAL ENTRANTS**
 10 **EVALUATE "EXPECTED TOTAL REVENUES," NOT THE PRICES OF**
 11 **INDIVIDUAL SERVICES SUCH AS BASIC LOCAL SERVICE (GABEL,**
 12 **PAGE 46, LINES 15–16). PLEASE COMMENT.**

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

1 residential basic service prices “actually acts to prevent the introduction
2 and growth of competition.” (Mayo, Page 14, Lines 21–22).

3

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

13

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

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

18 [T]he price of local exchange is a critical element for
19 competitors to consider when choosing whether to
20 enter a particular market.... One can reasonably
21 expect that there will be additional market entry,
22 particularly in markets that have previously been
23 only marginally profitable or slightly unprofitable...
24 [if the ILECs’ petitions are approved] (Shafer, Page
25 8, Line 18 – Page 9, Line 7).

1

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

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

14

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

22 A. The examples offered by Dr. Gabel are irrelevant because they relate to
23 products that have different characteristics than telephone service.
24 Dr. Gabel's examples relate to the phenomenon of "lock-in" – where a
25 customer's initial purchase commits him to further purchases (e.g., of

1 supplies, parts, software upgrades, and so forth) from the same
2 supplier. The ability to “lock in” a customer is why it can make sense to
3 give away the razor to sell the blades, or to sell a low-priced printer to
4 encourage the purchase of high-priced replacement ink cartridges.

5
6 However, there is little or no lock-in for initial purchases that do not
7 commit customers to ongoing use of the supplier’s proprietary parts,
8 upgrades, or supplies. For the most part, that description fits local
9 telephone service in an equal access environment. To minimize lock-in,
10 regulators have spent decades assuring that customers can access any
11 competitor’s services from an ILEC telephone. In particular, ILECs
12 cannot rely on any ability to overcharge customers for toll and long
13 distance service (the services at issue here) to make up losses on basic
14 residential service. Verizon’s “razor” also accepts AT&T’s blades.

15
16 The dissertation excerpt Dr. Gabel cites about razors makes this point,
17 by referring to discounted sales of sophisticated, innovative (perhaps
18 patented) “shaving systems” to encourage customers to buy high-priced
19 Gillette replacement blades. (Gabel, Page 64, Lines 8–11). By
20 contrast, one would hardly expect Gillette to subsidize the sale of old-
21 fashioned razors that use commodity double-edged blades. Likewise,
22 computer companies intend only their own ink cartridges to be used in
23 their low-priced printers. And while wireless providers do not offer equal
24 access (and so create some lock-in), I have never seen a “free” wireless
25 handset offered without a mandatory term contract (including a

1 substantial early termination fee) that appears to offset the handset
2 subsidy. Rather than getting something for nothing on the prospect of
3 future usage, wireless customers pay for their handsets on the
4 installment plan.

5

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

8

9 **Q. DOES MARKET BEHAVIOR CONTRADICT DR. GABEL’S CLAIM**
10 **ABOUT THE MARKET SUITABILITY OF SUBSIDIZED BASIC**
11 **SERVICE PRICING?**

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

23

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

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

10

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

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

17

18 **Q. DOES MR. OSTRANDER’S TESTIMONY REFLECT A**
19 **MISUNDERSTANDING OF A SIGNIFICANT ECONOMIC PRINCIPLE**
20 **REGARDING COMPETITION?**

21 A. Yes. Mr. Ostrander repeatedly refers to “LEC inelastic basic service
22 revenues,” as some kind of safe entitlement for Verizon and the other
23 petitioners (e.g., Ostrander, Page 4, Line 20 – Page 5, Line 14). This
24 demonstrates a misunderstanding of a basic economic principle.
25 Customer demand for basic monthly service is highly inelastic (i.e., the

1 demand by customers for basic service is not very sensitive to its price).
2 However, that is not the same thing as an inelastic demand for a
3 particular ILEC's services. When customers have choices, their
4 determination to have some kind of basic service does not extend to a
5 similar determination to buy it only from a particular provider.

6

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

12

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

18

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

23 A. There is both a customer-specific and societal dimension to my
24 observation about how reform will bring the prices of basic access lines
25 and broadband connections more in line with their relative costs. More

1 economically sensible prices will allow individual customers to recognize
2 that the step up to a more capable service is not as costly as they might
3 have thought. This will encourage them to obtain broadband, and
4 benefit from its use.

5

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

13

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

18 **A.** No. Mr. Fonteix argues that an ILEC charging an above-cost access
19 charge might price its own toll service below that access charge –
20 thereby freezing out competitors – and still make a profit on the service.
21 His claim ignores a basic principle of economics – that of opportunity
22 cost. If an ILEC were to divert traffic from IXCs in the manner
23 suggested, the ILEC would forego the access charges paid by the IXCs.
24 As a result, the ILEC would make a smaller profit (i.e., it would receive
25 less money than it did from the IXC, and it would have to provide the

1 long distance service in place of the IXC). Accordingly, an ILEC would
 2 not engage in the behavior that purportedly concerns Mr. Fonteix
 3 because it would be economically irrational to do so.

4
 5 The only possible incentive an ILEC could have to engage in the
 6 suggested behavior would be to drive the IXC out of business, re-
 7 monopolize the market, and then raise prices to sufficient levels to
 8 recoup at least as much money as it had lost in the process. However,
 9 predatory pricing is illegal, virtually impossible to perpetrate for a wide
 10 variety of reasons (including the oversight of this Commission), and
 11 rarely seen in reality. It is thus widely recognized as an irrational tactic
 12 by many authorities, including the U.S. Supreme Court. (*Brooke Group*
 13 *Ltd. v. Brown & Williamson Tobacco Corp.* (92-466), 509 U.S. 209
 14 (1993)). Accordingly, Mr. Fonteix's purported concern about a "price
 15 squeeze" is unfounded.

16
 17 In any event, since the pro-competitive benefits of pricing reform do not
 18 hinge on this claim, there is no need to consider this issue further.

19
 20 **IV.**

21 **BASIC LOCAL SERVICE RATE SUBSIDIES**

22 **ARE GENUINE AND UNDENIABLE**

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

25 **A.** No. The loop is a cost of basic service (as the Commission has found),

1 and the Commission's own approved UNE cost calculations reveal the
2 subsidy (as Mr. Fulp has described). It remains true that basic
3 residential rates are subsidized, and therefore supported.
4

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

7 A. "Support" is the difference between current rates and those that would
8 fully recover costs (including common costs) – which are, in a
9 competitive context, competitive market rates. The Telecommunication
10 Act of 1996 ("TA96") distinguishes the term "support" used in Section
11 254 (when discussing universal service support for prices) from the
12 prohibition of "subsidy" of competitive services as discussed in Section
13 254(k). When I use the term "subsidy," I refer to prices below marginal
14 or incremental cost. Therefore, even rates that are not subsidized can
15 be supported, if they are required to be set below market levels.
16 Additionally, since competitive market prices must recover common
17 costs, the calculated size of a subsidy is a lower bound for the actual
18 extent of support, a point Dr. Gabel does not appear to recognize in his
19 testimony.
20

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

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

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

10

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

14 A. Yes. Dr. Gabel takes an incorrect assumption, or perspective, and
15 follows it through to its logical conclusion. Little more than that occurs in
16 his entire discussion of TSLRIC, TELRIC and cost studies (i.e., Sections
17 3.1–3.2). As discussed below, the Commission should disregard this
18 erroneous reasoning, and the unreliable results it produces.

19

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

21 A. Dr. Gabel confuses the costs of a service with either the identity of the
22 customer who happens to be using it (as with business and residential
23 basic service), or the manner it is used (as with data services). He
24 assumes erroneously that, from a costing standpoint, the components
25 used to provide basic residential and basic business service are

1 different. Based on that incorrect assumption, he severely
2 underestimates the cost of basic residential and basic business service
3 by excluding from his cost calculation any facilities that these services
4 have in common.

5

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

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

17

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

1 cost of the loop, plus the cost of other components of the service (such
2 as local usage) – just as Verizon has done in this proceeding.

3

4 **Q. HAS DR. GABEL’S ERRONEOUS ASSUMPTION ALSO BEEN**
5 **REBUTTED BY AN EMINENT AUTHORITY?**

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

20

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

24 A. No. Dr. Gabel asserts that he is providing a TSLRIC analysis (i.e., one
25 based on Total Service *Long Run* Incremental Cost), as opposed to a

1 short-run analysis during which some costs might reasonably be
2 assumed not to vary.

3

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

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

10

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

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

21

22 Dr. Gabel's analysis is erroneous because the choice of how network
23 access is priced to different customers does not affect the underlying
24 network costs of providing it. For example, if the pricing categories were
25 combined (so that there was just one basic service applicable to all

1 customers), then according to Dr. Gabel's method the subsidy would
2 once again exist – because those costs would no longer be allocated
3 between pricing categories. If, subsequently, a category of business
4 customer persuaded the Commission to create a separate tariff for its
5 purchases, the subsidy would again vanish. In this way, calculations of
6 basic service costs would fluctuate widely, even though nothing had
7 changed about how the phone network was actually built or maintained,
8 or how these services were provided.

9
10 The ability to make subsidies seem to appear and disappear in this
11 arbitrary fashion is another indication of the fundamental problems with
12 Dr. Gabel's approach. The Commission should disregard the costing
13 approach advocated by Dr. Gabel, and the unreliable numerical
14 calculations it produces.

15
16 **Q. DR. GABEL CRITICIZES THE LECS' USE OF TELRIC UNE COST**
17 **ESTIMATES TO DETERMINE THE LEVEL OF SUBSIDY IN**
18 **RESIDENTIAL BASIC SERVICE RATES. DID THE FCC**
19 **ENCOURAGE STATES TO COORDINATE THE DEVELOPMENT OF**
20 **UNE COST STUDIES WITH THOSE USED TO CALCULATE**
21 **UNIVERSAL SERVICE SUPPORT?**

22 **A.** Yes. The FCC encouraged states to relate these studies:
23 [T]o prevent differences between the pricing of
24 unbundled network elements and the determination
25 of universal service support, we urge states to

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

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

8

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

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

21

22 Dr. Gabel's only specific criticism is to remove the common costs from
23 the UNE rates. However, while neither TELRIC nor TSLRIC by
24 themselves includes common costs, the proper cost standard for
25 measuring support is competitive market prices, which must recover

1 common costs; therefore, common costs are a reasonable factor to
2 include in measuring support. Additionally, the level of common costs
3 that is included in these UNE rates is less than the retailing costs that
4 are left out, but which belong in a TSLRIC study. Adjusting for both of
5 these factors would thus increase, not reduce calculated incremental
6 costs.

7

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

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

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

21 (Fair and Reasonable Rates Report, Page 51).

22

23 In responding to Dr. Cooper's arguments, it is difficult to know to what
24 extent one should rebut such claims given that the Commission has
25 already ruled on this dispute in a study process in which Dr. Cooper and

1 his client both participated. Briefly, the cost of the loop is incurred – in
 2 its entirety – by providing basic service to a customer. The decision to
 3 have basic service is what causes the cost to be incurred. The essence
 4 of the economic definition of “cost” is causation; and a customer’s
 5 decision to use a loop to buy other services, or to call other people, no
 6 more “causes” the cost of that loop than does a mail carrier “cause” the
 7 cost of one’s driveway by walking down it to deliver a package. This is
 8 the correct analysis with which the Commission agreed in the fair and
 9 reasonable rate study process, and nothing Dr. Cooper states here
 10 changes it. (An extensive discussion and refutation of the loop
 11 allocation fallacy can be found in Kahn, Pages 70-89).

12

13 **Q. REFERRING TO THE EARLY 1900S, DR. COOPER STATES THAT**
 14 **TELEPHONE NETWORKS, “INCLUDING THE LOOP,” ARE NOW**
 15 **ENGINEERED TO HANDLE MULTIPLE SERVICES THAT SHOULD**
 16 **BE ALLOCATED SOME OF THE LOOP’S COST (COOPER, PAGE**
 17 **18, LINE 22 – PAGE 19, LINE 1). IS THIS RELEVANT?**

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

23

24 **Q. DR. COOPER CLAIMS THAT A VARIETY OF AUTHORITIES**
 25 **(INCLUDING “THE FCC, THE STATES, AND THE COURTS”) HAVE**

1 **“CONSISTENTLY AND REPEATEDLY” FOUND THAT THE LOOP IS**
2 **A COMMON COST (COOPER, PAGE 21, LINES 5–6). PLEASE**
3 **COMMENT.**

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

15
16 Dr. Cooper’s employer (the Consumer Federation of America) was one
17 of the organizations that opposed the subscriber line charge based on a
18 claim that it would drive millions of subscribers off the network. As
19 reported by Professor Hausman and his colleagues, not only was that
20 claim proved wrong, millions more subscribers would have been kept off
21 the network if the FCC had abandoned that reform at the CFA’s behest.
22 Hausman, Jerry, Tardiff, Timothy, and Alexander Belinfante. “The
23 Effects of the Breakup of AT&T on Telephone Penetration in the United
24 States,” American Economic Review 83, Volume 2 (May, 1993), 178-
25 184. The Commission should disregard this tired argument from an

1 advocate whose employer's prior advice on the same subject would
2 have demonstrably harmed consumers and universal service.

3
4 As for the views of the courts, in its 1984 opinion reviewing the FCC's
5 decision to impose per-line subscriber line charges (NARUC v. FCC,
6 737 F.2nd 1095 [1984]), the District of Columbia Circuit Court of
7 Appeals made the following statement about the cost characteristics of
8 local loops, and how those relate to appropriate recovery of those costs:

9 Plant costs are nontraffic sensitive when they do not
10 vary with the extent to which the facilities are used.

11 The basic cost of installing and maintaining a local
12 loop, for example, remains the same whether the
13 subscriber, or 'end user,' uses the loop to make one
14 call or a hundred, and whether those calls are local
15 or long-distance. (Opinion, Page 1104).

16
17 The end user charge reflects costs caused not by a
18 subscriber's actually making interstate calls, but by
19 the subscriber's connection into the interstate
20 network, which enables the subscriber to make
21 interstate calls. The same loop that connects a
22 telephone subscriber to the local exchange
23 necessarily connects the subscriber into the
24 interstate network as well. Under Smith, a portion
25 of the costs of that loop are assigned to the

1 interstate jurisdiction, for recovery under the
2 regulatory authority of the FCC, on the basis of a
3 complex division taking into account statistical
4 calling patterns. That separations decision,
5 however, does not affect the cost of the loop. Local
6 telephone plant costs are real; they are necessarily
7 incurred for each subscriber by virtue of that
8 subscriber's interconnection into the local network,
9 and they must be recovered regardless of how
10 many or how few interstate calls (or local calls for
11 that matter) a subscriber makes. (Opinion, Pages
12 1113-14).

13
14 Every telephone subscriber is automatically
15 connected through the same subscriber plant into
16 both the local exchange and the interstate network.
17 No subscriber can avoid 'causing' those costs of its
18 telephone line allocated to the interstate jurisdiction.
19 (Opinion, Page 1115).

20 In defending the FCC's CALLS order on appeal, the Department of
21 Justice made these same points in March, 2002. See Brief for the
22 Federal Respondents in Opposition (to a petition for writ of certiorari),
23 National Association of State Utility Consumer Advocates v. Federal
24 Communications Commission and United States of America, (U.S.
25 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.

1

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

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

16

17 Dr. Gabel minimizes the economic benefits to customers of the
18 additional calls they will make if prices are reformed. He cites Dr.
19 Tardiff's one-year elasticity estimate for California of $-.24$, suggesting
20 that price responsiveness will be modest -- in part because the value of
21 a customer's time will become the limiting factor on call volumes when
22 prices get low enough. I disagree with the claim that customer response
23 to price changes will be minimal. Call volume increases will be more
24 than trivial considering that (1) the access charge reductions proposed
25 here are substantial and (2) call volumes will increase over time (multi-

1 year responses will exceed the first year's worth). In any event,
2 reaching the point at which the value of one's time is the limiting factor
3 on toll calling (rather than the resulting phone bill) would be a welcome
4 development for customers in Florida.

5
6 Dr. Gabel also fails to recognize the benefits to residential customers of
7 abolishing IXC in-state long distance monthly fees (e.g., \$1.88/month for
8 AT&T residential customers), or the expanded eligibility for Lifeline.
9 Moreover, he fails to recognize the benefits to customers of additional
10 local competition. Of course, these are very real benefits that should be
11 considered in the Commission's analysis.

12

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

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

24

25 **Q. DR. COOPER WOULD PREFER THAT BUSINESS RATES RECEIVE**

1 **SUBSTANTIALLY HIGHER INCREASES SO THAT RESIDENTIAL**
2 **CUSTOMER TOTAL BILLS COULD DECREASE (COOPER, PAGE**
3 **30, LINE 18 – PAGE 34, LINE 5). MR. OSTRANDER ATTEMPTS TO**
4 **ESTIMATE WHETHER AVERAGE RESIDENTIAL BILLS WILL**
5 **DECLINE ON AN INITIAL BASIS (OSTRANDER, PAGE 18, LINE 4 –**
6 **PAGE 32, LINE 7). PLEASE COMMENT.**

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

10
11 First, the statute says nothing about total customer bills, or a monetary
12 accounting of benefits. There is no pass-fail test that has to be satisfied
13 with respect to any particular set of customer bills.

14
15 Second, the statute refers specifically to removing “...current support for
16 basic local telecommunications services that prevents the creation of a
17 more attractive competitive market for the benefit of residential
18 customers.” (Section 364.164(1)(a)). This can only mean raising below-
19 cost basic residential rates. Raising basic business rates will do nothing
20 to help residential customers become a more attractive market to
21 competitors; and, basic residential rates are the services that are
22 supported in Florida.

23
24 Third, there is no doubt that customer bills will change, both as a direct
25 result of the plan, and increased competition and changes in customer

1 behavior once the new rates are put in place. Whatever customer bills
2 may be a month after pricing reform is concluded, they will be different a
3 year later, and different again a year after that. Customers will use their
4 phones more, and will respond to new competitive options and offers in
5 ways that are difficult to predict precisely, but will certainly occur.

6

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

13

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

21

22 Finally, reforming prices will make residential customers more attractive
23 targets to competitive providers. Already, AT&T and Knology have
24 entered the Florida local market in anticipation of this reform and other
25 competitors will follow. The benefits that will flow from increased

1 competition will more than outweigh a few percent of an average
2 residential bill.

3

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

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

9

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

12

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

23

24 Third, as customers adjust to the new prices and opportunities they
25 face, they will become progressively better off as their purchasing and

1 consumption decisions (and phone bills) change. For example, a
2 customer who chooses to make more long distance calls (in response to
3 a lower price) or switches to a new competitive entrant will receive an
4 economic benefit that helps to offset any initial bill increase that the
5 customer may experience. And, of course, a customer whose bill goes
6 down initially will only gain further benefits of this kind over time.
7 Although these effects can be difficult to quantify, they more than offset
8 any small initial bill increases that residential consumers may
9 experience.

10
11 Finally, as Mr. Fulp has explained, the actual price changes that occur in
12 the second and third phases of reform will be determined based on the
13 most recent 12 months' billing units (as the statute requires). This
14 means the actual rate changes will vary somewhat from those used for
15 this analysis. For example, if Verizon's access minutes of use continue
16 to decline, the amount of revenue to be rebalanced will be less. Other
17 variables may also change. This is another reason why the bill impacts
18 noted below are only initial projections.

19
20 **Q. HAVE CUSTOMERS ALREADY RECEIVED BENEFITS OF THE KIND**
21 **THAT VERIZON'S PLAN WILL CREATE?**

22 **A.** Yes, they have, by diverting long distance calls from wired to wireless
23 networks to take advantage of a low (or free) price for such calls.
24 Estimates are that customers have already shifted about 30 percent of
25 wired long distance traffic in this fashion, thereby saving the access

1 charges on those calls (since wireless carriers do not pay the same kind
2 of access charges the Commission has required for Verizon in Florida).
3 In this fashion, Florida customers have already received a down
4 payment on the benefits of Verizon's plan that is not captured in the
5 average bill figures I report below. Moreover, the fact that customers
6 have already begun diverting long distance calls from wired to wireless
7 demonstrates that consumers will avail themselves of the benefits of
8 competition that will flow from Verizon's rate rebalancing plan.

9
10 **Q. DOES THE STAFF RECOGNIZE SOME OF THE DYNAMIC**
11 **BENEFITS OF REFORM THAT RESIDENTIAL CUSTOMERS WILL**
12 **RECEIVE?**

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

24
25 **Q. WHAT RESULTS DID YOU OBTAIN FROM YOUR AVERAGE BILL**

Revised 12-02-2003

1 **ANALYSIS?**

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

11

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

16

17 A similar calculation was performed that focused on the age distribution
 18 of Verizon's Florida customers, and produces the results below. These
 19 results are only approximate, because age data was not available for a
 20 significant proportion of customers (as the table shows).

21

22 Age Strata	Florida Lines (confidential)	Net Change (confidential)
23 18-25 years		
24 26-35 years		REDACTED
25 36-45 years		

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1 46-55 years

2 56-65 years

3 66-75 years

REDACTED

4 76 + years

5 unknown

6

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

19

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

24 **A.** Based on my experience helping reach a wide variety of rate decisions
 25 at the largest state commission in the country, a phased-in rebalancing

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1 of this modest amount will not be disruptive to customers and will fall
2 well within the realm of ratemaking decisions and adjustments that
3 regulatory commissions regularly undertake.

4
5 Indeed, the modest size of this effect highlights several important facts
6 about customer bills and rates:

- 7
- 8 • Residential customers do cross-subsidize themselves on the
9 same bill, and will benefit substantially from lower calling prices
10 that result from reform;
 - 11 • The elimination of long distance carrier monthly access fees
12 directs substantial benefits towards residential customers;
 - 13 • The notion that residential customers are affected only by basic
14 monthly rates is a myth.
- 15

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

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

24
25 **Q. MR. OSTRANDER CONTENDS THAT OFFSETTING RATE**

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

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

13

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

23 A. While I will leave it to Sprint to discuss its own rate adjustments, it is
24 common for long distance competitors to adjust the prices of various
25 plans in response to competitive conditions, and the underlying costs of

1 serving customers. This is a healthy and normal part of competition that
2 involves discounts and attractive packages in addition to increases such
3 as the one Mr. Ostrander chose to highlight. The elimination of monthly
4 long distance carrier fees will provide a baseline benefit for many
5 residential customers, including (presumably) many low-volume callers.
6 Customers can also move between the many different calling plans that
7 long distance carriers offer. In light of these factors, the Commission
8 should hesitate before accepting any invitation to specifically target price
9 reductions towards particular customers, or those Mr. Ostrander might
10 consider “average.”

11

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

18 **A.** No. It would be more accurate for Mr. Ostrander to characterize
19 possible complaints of business customers who have been asked to
20 subsidize below-cost residential service for many years. Remedying a
21 subsidy requires, to at least some degree, an increase in the price of the
22 service that has been subsidized. Additionally, given that over half the
23 population of Florida now has a wireless phone, it is becoming less clear
24 to what extent the stereotypical “POTS customer” still exists. Finally, as
25 the average bill analysis shows, Verizon’s plan is balanced and will have

1 only a modest short-term effect on the average bills of residential
2 customers.

3

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

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

17

18

VI.

19

CONCLUSION: THE COMMISSION SHOULD

20

APPROVE VERIZON’S BALANCED PLAN

21

FOR LONG-OVERDUE PRICING REFORM

22

23

24

25

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,

1 **LINES 20–21). IS THIS ACCURATE?**

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

15

16 **Q. TAKEN TOGETHER, DOES THE TESTIMONY OF DR. COOPER AND**
17 **DR. GABEL LEAD TO A CONFUSED AND CONTRADICTIONARY**
18 **RESULT?**

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

1 from residential customers.

2

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

11

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

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

17

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

23

24 Second, experience elsewhere combines with analysis of Verizon's plan
25 to reveal that the transitional impacts of pricing reform will not be

1 problematic. Shifts in phone bills will be modest, gradual, and soon
2 modified by the responses of customers to beneficial new opportunities.

3

4 **Q. WHAT ACTION SHOULD THE COMMISSION TAKE?**

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

9

10 **Q. DOES THAT CONCLUDE YOUR TESTIMONY AT THIS TIME?**

11 A. Yes.

12

13

14

15

16

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25

1 BY MR. CHAPKIS:

2 Q Dr. Danner, would you please summarize your
3 testimony?

4 A Thank you very much. Good afternoon, Madam Chairman
5 and Commissioners.

6 When Verizon asked me to participate in this docket,
7 I looked back at the earlier comments I provided to this
8 Commission in its Affordable Rates Workshop process. That was
9 in 1998. I spoke then about the same issues that confront us
10 here today: The harm caused to customers and competition by
11 cross-subsidies, the benefits of pricing reform and the false
12 suggestions that something terrible would happen if progress
13 was made toward basing rates on what telephone service actually
14 costs to provide. That study process led to a carefully
15 considered report by this Commission to the Legislature in
16 which the Commission concluded that the problem was real, that
17 a phased-in solution would make sense and, indeed, that such a
18 result would be affordable and reasonable.

19 The Legislature and the Governor eventually responded
20 with a new law that was based rather closely on this
21 Commission's recommendations, which led us to today discussing
22 a proposal from Verizon which closely resembles the reform
23 approach that the Commission endorsed.

24 Let me briefly describe some of the analysis from my
25 testimony that shows why Verizon's proposal should be approved.

1 I would just note that this evidence is not just theoretical.
2 It's also highly factual and empirical. We have a great deal
3 of information about specific competitors in Verizon's service
4 territory in general and specific alternatives.

5 To begin with, it is undeniable in my view that basic
6 residential rates are supported and, therefore, encourage local
7 service competitors to ignore residential customers in Florida.
8 Among other sources, as you've heard, these facts are
9 established by the Commission's own UNE cost decisions and
10 competitive analysis. There is a real problem with rates and
11 competition when there are 100 business customers served by
12 competitive facilities for every one residential customer
13 served by competitive facilities in Verizon's service
14 territory: 100-to-1 ratio.

15 Verizon's reform proposal will address these problems
16 and create a host of benefits. Customers will be able to call
17 all over Florida for much lower prices. They will call more
18 and they will worry less about their bills. That's a clear
19 economic benefit. Competitors will give residential customers
20 new and innovative local service options that current pricing
21 prevents. That's a clear economic benefit. Specific local
22 service alternatives from voice over Internet protocol to cable
23 telephony to wireless providers and even UNE-P will be
24 stimulated for residential customers. Indeed, as you've just
25 heard from Knology and as AT&T has also affirmed, specific

1 competitors have already entered the market based on their
2 expectation of pricing reform. That is powerful proof of a
3 clear economic benefit. Some customers are now charged more
4 for phone service based not on the actual costs they're
5 responsible for, but just because they use the phone more.
6 Overcharging customers on that basis creates an important
7 fairness issue, and I think we should not forget equity to
8 those customers as well who will gain from pricing reform.

9 More competition will also place increased pressure
10 on incumbent providers to cut costs and be efficient, creating
11 another economic benefit. And Verizon's proposal will promote
12 demand for broadband Internet connections in Florida,
13 furthering yet another important goal.

14 Against all these benefits, what arguments have been
15 raised? Essentially there are two claims. The first is that
16 economics should be stood on its head to deny that subsidies
17 really exist. That is a claim that's incorrect, as the
18 Commission has previously found and as I again point out in my
19 testimony.

20 The second concern is that residential customers will
21 be harmed, perhaps severely and irreparably, by Verizon's
22 proposal. That claim is also incorrect for several important
23 reasons worth mentioning here.

24 We already have pricing experience with pricing
25 reform in other states and at the federal level. I can affirm

1 personally that the implementation of pricing reform in
2 California caused no harm to universal service and no customer
3 outcry. Pricing reform at the federal level actually benefited
4 universal service. That's right. Brought more people onto the
5 network, in the millions.

6 The opposition to Verizon's proposal has produced no
7 evidence. Yes, I believe that's literally no evidence that
8 such reform has ever caused significant customer harm where it
9 has been implemented before. In my rebuttal testimony I point
10 out that I reviewed opposition testimony in vain for any such
11 specific evidence. I believe no such evidence was produced
12 because there's none to be found.

13 There have also been claims that residential
14 customers would suffer large increases to their bills. The
15 facts again show this to be incorrect.

16 Let's start with Lifeline customers. Commissioner
17 Davidson raised a concern earlier asking about the extent to
18 which Lifeline customers actually use service. If you look at
19 the bills of Lifeline customers, you find out they consume
20 quite a lot of service. Indeed, one of the benefits of
21 Verizon's proposal is the average bill for current Lifeline
22 customers and for the number of Lifeline customers who will
23 join the program based on the expansion that's tied to this
24 proposal. They will get \$3.15 each a month reductions in their
25 bills due to pass-through of toll and long distance and

1 benefits such as that.

2 CHAIRMAN JABER: Say that one more time.

3 THE WITNESS: Current Lifeline customers as well as
4 customers who join Lifeline, presuming they're similar
5 customers, will see their bills fall by \$3.15 a month due to
6 pass-through of benefits from Verizon's proposal.

7 CHAIRMAN JABER: \$3.15 a month because of the
8 interstate long distance reductions?

9 THE WITNESS: Yes. Yes. That's right, Commissioner.

10 CHAIRMAN JABER: How do you know that?

11 THE WITNESS: We know that through a bill analysis of
12 current Lifeline customers.

13 CHAIRMAN JABER: No. How do you know that's what the
14 reduction will be? What are, what are you looking at?

15 THE WITNESS: Pardon me, Madam Chairman. What we did
16 in the analysis was we looked specifically at current Lifeline
17 customers on an aggregate statistical basis with actual bill
18 data and assessed the level of toll and long distance calling
19 they were doing in Florida with respect to their access
20 charges, made assumptions about the pass-through of the \$1.88
21 or \$1.90 benefit that the long distance carriers will provide
22 them, and simply rerated their bills.

23 CHAIRMAN JABER: I just wanted to get that out
24 through your summary. I'm sure we'll have more questions
25 later, but --

1 COMMISSIONER DAVIDSON: Chairman, I have one
2 follow-up on that just related to my prior question. And it's
3 for the non-Lifeline customers, and I don't know if you have
4 this data or if you could identify. You were identified as the
5 person who would have it. If you don't have it, if you could
6 identify the right witness.

7 If you know, what impact would Verizon's local rate
8 increase coupled with Verizon's long distance access charge
9 reductions have on the average Verizon customer's residential
10 monthly bill?

11 THE WITNESS: Thank you very much, Commissioner. You
12 anticipated my, my next statement.

13 For the average residential customer in total, the
14 initial bill impact at the end of the process, after the two
15 years, will be an increase of about \$1 a month or 50 cents for
16 each year of the proposal.

17 It is important to remember, however, that those
18 increases will occur as against average phone bills that, at
19 least measured on a national basis, we don't have the total
20 bill information for Florida, but on a national basis average
21 phone bills for residential customers are almost \$50 a month,
22 average wireless bills for customers are almost \$50 a month,
23 and in Verizon's service territory in Florida nearly 60 percent
24 of all people have wireless phones. That's not 60 percent of
25 all households or businesses. 60 percent of all men, women and

1 children of all ages have wireless phones. And as I said,
2 those bills on a national average are nearly \$50 a month.

3 CHAIRMAN JABER: Commissioner Davidson, repeat your
4 question one more time so I can make sure I understand what the
5 witness's response was. What's the impact to the average
6 Verizon residential customer; right?

7 COMMISSIONER DAVIDSON: Yes, Chairman. It's, if you
8 know, what impact would Verizon's local rate increase coupled
9 with Verizon's access charge reductions have on the average
10 Verizon customer's residential bill?

11 CHAIRMAN JABER: Okay. So that question -- your
12 response to that question then includes the long distance
13 flow-through?

14 THE WITNESS: Yes, Madam Chairman. That was, that
15 was \$1 a month cumulative effect after the full implementation
16 of the proposal, or about 50 cents for each of the two years.

17 CHAIRMAN JABER: And this assumes the average Verizon
18 residential customer has both local and long distance.

19 THE WITNESS: This is again based on actual bill
20 data, actual statistical examination of their bills and
21 rerating them to take effect of what the proposal will
22 accomplish.

23 CHAIRMAN JABER: And what assumptions did you make as
24 it relates to the flow-through?

25 THE WITNESS: We did two things, Madam Chairman.

1 First, we needed to make an assumption for the elimination of
2 the customer charge that the legislation requires be done. We
3 didn't have access to exactly what proportion of customers are
4 charged that charge, so we did the following. We knew that
5 AT&T charges all their residential customers this charge. We
6 knew that MCI WorldCom charges most of their customers this
7 charge. So to be conservative, we assumed -- we also knew that
8 Verizon's customers, certain Verizon customers who have certain
9 packages don't pay these charges, so we excluded those
10 customers. Then we assumed that two-thirds of the remaining
11 customers would receive that benefit. Now that may be a little
12 low. And if that's a little low, then the average bill impact
13 will be even less. But that's the assumption we took. So we
14 assumed that two-thirds of those customers would receive that
15 benefit. Then we took the money that was remaining and
16 apportioned it across all access, reduced all access by the
17 amount you could, and then attributed those reductions as well.

18 CHAIRMAN JABER: Okay.

19 THE WITNESS: So that was the best we could do. It
20 is a little bit approximate, as I have described, but I don't
21 think it's very bad either.

22 CHAIRMAN JABER: To arrive at the \$1 a month
23 estimated increase, you also made the assumption that the long
24 distance reductions were happening simultaneously with the
25 increases to local rates, didn't you?

1 THE WITNESS: Well, yes and no, Madam Chairman.
2 That's a cumulative total, so it assumes that the pass-through
3 will occur by the end of the period. Personally, and I've
4 testified to this, I don't think there will be any way the long
5 distance carriers can keep those, those monies and I think
6 they'll have to pass them through rather quickly. But the
7 assumption we made in the analysis was that by the conclusion
8 of the transition, the money would have been passed through.

9 CHAIRMAN JABER: By the end of what period? The
10 two-year period proposed by Verizon or by your first 12-month
11 period?

12 THE WITNESS: Well, the analysis is cumulative. So
13 it says when we get to the end of the transition, we looked at
14 the rate increases that would occur versus the pass-throughs
15 and decreases that would occur, added them up and set them
16 against each other in that manner.

17 CHAIRMAN JABER: Okay.

18 COMMISSIONER DEASON: Can I ask a question?

19 CHAIRMAN JABER: Commissioner Deason, yeah.

20 COMMISSIONER DEASON: Since we're asking questions
21 during the summary. Your \$1 per month average increase is a
22 net amount after taking into consideration the local, impact of
23 the local rate increase netted against your two-thirds
24 assumption on the elimination of recurring customer charges and
25 an assumption concerning the pass-through of the reduced access

1 charges on a usage basis; is that correct?

2 THE WITNESS: That's correct, Commissioner.

3 COMMISSIONER DEASON: Okay. How did you -- what
4 assumptions or how did you determine the impact of the reduced
5 access charges on a per-minute-of-usage basis for the average
6 customer?

7 THE WITNESS: We have billing records in the system
8 or Verizon does, I should say, that reflects the number of
9 access minutes in the Florida jurisdiction that each customer
10 uses. And we picked a particular month, and I think, I believe
11 it was March of this year, and looked at the number of access
12 minutes that actually appeared on customer bills for that
13 month, and didn't do it obviously customer by customer, but did
14 it through an automated process, and then applied those
15 reductions in the manner I described.

16 COMMISSIONER DEASON: Did you make any assumption
17 about how the long distance carriers were going to apportion
18 the benefits between small residential and small business and
19 large business customers?

20 THE WITNESS: For this purpose, Commissioner, we
21 assumed that a minute was a minute. And so if a customer used
22 a minute, they'd get a minute's worth of benefit.

23 COMMISSIONER DEASON: Thank you.

24 CHAIRMAN JABER: Go ahead.

25 THE WITNESS: Yes. Thank you.

1 I should note that the bill impacts we've just asked
2 discussed and I suspect we'll discuss a little further are not
3 the end of the process. They're just the beginning of the
4 process because it's a static analysis to get to that point.
5 The prices change, the bills change, then things start to
6 happen with respect to competition.

7 We heard today from Knology in terms of the large
8 benefits that customers can get from their services. Those
9 benefits aren't counted in these bill numbers. And we'll
10 reduce them and turn them positive for customers who have any
11 opportunity for those services.

12 We've talked about the ability to make additional
13 calls that will occur because long distance prices will be
14 reduced. Those benefits are not included in here. Those will
15 be economic benefits to customers that will offset, work to
16 offset that dollar. We talked about a variety of competitive
17 and wireless and other alternatives that will be stimulated or
18 will become more attractive and interesting to customers.
19 We'll provide them benefits that are not counted in terms of
20 that dollar.

21 CHAIRMAN JABER: Mr. Danner, the reason I allowed the
22 expansion of the summary on the previous question is because
23 the Commissioners asked the question related to Lifeline. I
24 need you to wrap up your summary and keep it focused on what's
25 in your written testimony.

1 THE WITNESS: I apologize, Commissioner. That
2 discussion is in my rebuttal testimony. But I am virtually
3 done, except with one last observation that another way to look
4 at this is, even disregarding, disregarding those other
5 benefits that I've spoken to, this Commission and the country
6 generally have been through a very involved, very costly, very
7 lengthy process to try to stimulate local competition. Florida
8 was a leader in the nation, as we've heard discussed earlier.
9 A tremendous amount has been done at great expense and great
10 contribution of your time and effort as well, yet we haven't
11 succeeded. We don't have residential competition for Verizon's
12 customers. Economic theory and a great deal of actual evidence
13 shows that these reform proposals will get us in that, move us
14 in that direction and help get us the results that everyone has
15 been working for, and I encourage the Commission to support
16 this proposal for that reason.

17 MR. CHAPKIS: Thank you, Dr. Danner. The witness is
18 available for cross-examination.

19 CHAIRMAN JABER: Mr. Fons. Mr. Hatch.

20 MR. HATCH: No questions.

21 CHAIRMAN JABER: Okay. Public Counsel.

22 MR. BECK: Thank you, Madam Chairman.

23 CROSS EXAMINATION

24 BY MR. BECK:

25 Q Good afternoon, Dr. Danner.

1 A Good afternoon.

2 Q My name is Charlie Beck with the Office of Public
3 Counsel.

4 In response to questions by the Commissioners about
5 your summary and about how you, what assumptions you made on
6 the access charge reductions, you know --

7 A Yes.

8 Q -- regarding your conclusion about the effect on
9 customer bills, did I understand you correctly that you said
10 you first assumed that the interexchange carriers applied the
11 access reduction first to reduce the in-state connection fee?

12 A Yes, sir. That's right.

13 Q Okay. And did you do that in three increments, so
14 you --

15 A No, sir. It was a cumulative analysis, as I
16 mentioned. So the result I spoke of is the end result by the
17 end of the transition.

18 Q Okay. What portion of the access charge reduction
19 was used in your analysis to, to -- that was applied to the
20 reduction of the in-state connection fee?

21 A I don't recall the specific proportion of the money.
22 I think we have some work papers that would speak to that.
23 What we did, as I mentioned earlier, was to assume that
24 two-thirds of that group of residential customers who would be
25 eligible for it would obtain that reduction. Since the statute

1 required that reduction, we assumed that was the first call on
2 the money. And then we, in essence, gave the long distance
3 carriers credit for having done that before they started
4 reducing other per minute rates.

5 Q Okay. So you first -- I guess off the top then you
6 first assumed they applied all of that to benefit solely their
7 residential customers by reducing the in-state connection fee;
8 is that right?

9 A Yes, that's correct.

10 Q And then the balance you distributed proportionately
11 between residence and business?

12 A Based on -- yes, sir. Based on how many access
13 minutes they had.

14 Q So in effect what you've assumed then is that the,
15 the interexchange carriers would apply more than the relative
16 business and residential split to benefit their residential
17 customers?

18 A Well, that does seem to be the intent and effect of
19 the legislation, and that's the way the analysis worked out.
20 Yes.

21 Q Okay. So let me understand then. Off the top, and
22 you can't tell me what the proportion was, but off the top you
23 assumed that they would flow it all through benefit residences,
24 and then they would simply take the portion and, the remaining
25 portion and apportion that between residence and business to

1 the, in the same proportion that they use access charges?

2 A Well, yes, with a qualification. I -- when you said
3 that they would pass it all through, what we assumed was that
4 they would meet their statutory obligations to eliminate those
5 connection fees, and that that would be a principal call that
6 they'd have to meet.

7 Q Was that a significant, the amount that you put
8 toward the in-state connection fee, was that a significant
9 portion of the access charge reduction?

10 A Without being able to recall specifically the
11 proportion, I think it was.

12 Q Okay. And then it was the balance that was left over
13 that you, you decided would be go proportionately between
14 residence and businesses?

15 A Well, again, in proportion to their usage of long
16 distance services within Florida, yes.

17 Q Now does that assumptions that you used match what
18 any of the interexchange carriers have proposed to your
19 knowledge?

20 A My understanding is that it generally does in the
21 sense that the interexchange carriers are agreeing to reduce
22 the connection fees, and they would like credit for that in
23 terms of their pass-through obligation.

24 Q Okay. Do you --

25 A I can't say that it specifically matches them. It is

1 my best opinion as to what will actually happen.

2 Q Okay. Did you review the testimony by AT&T to see
3 how they were reducing their access, or flowing through their
4 access charge reduction?

5 A No. I didn't have a chance to review their specific
6 proposal.

7 Q How about MCI?

8 A You know, I think I read the testimony from each of
9 them but did not see the numbers. I can't say I reviewed their
10 proposal in detail, no.

11 Q Did you see their confidential testimony describing
12 how they were going to pass it through?

13 A I don't believe so, no.

14 MR. BECK: Okay. Madam Chair, I'd like an exhibit to
15 be marked for identification, if I could. The cover sheet for
16 this is very generally described as documents produced by
17 Verizon Florida.

18 CHAIRMAN JABER: Let me wait until all the parties
19 have it.

20 MR. BECK: What I've asked Mr. Poucher to do -- this
21 is a document claimed to be confidential by Verizon. We're
22 handing it out to the witness and to the Commissioners. We're
23 going to give the remaining copies to Verizon and let them
24 distribute it to parties that they have given permission to see
25 this to.

1 CHAIRMAN JABER: Mr. Chapkis, is there a, is there a
2 short title? Is there, you know, another way of identifying
3 this document without revealing confidential information?

4 MR. CHAPKIS: May I have one moment, Madam Chairman?

5 CHAIRMAN JABER: Sure. Uh-huh.

6 (Pause.)

7 CHAIRMAN JABER: Mr. Chapkis, just to make it easier
8 for you, all I propose would be something like document
9 number -- do you see what it says at the top left-hand side,
10 document number --

11 MR. CHAPKIS: That would be fine.

12 CHAIRMAN JABER: Report 3A?

13 MR. CHAPKIS: That would be fine.

14 CHAIRMAN JABER: Okay. Documents produced by Verizon
15 Florida, Report 3A will be identified as Exhibit 63.

16 (Exhibit Number 63 marked for identification.)

17 MR. BECK: Thank you, Madam Chairman.

18 CHAIRMAN JABER: Confidential, it's a confidential
19 exhibit.

20 BY MR. BECK:

21 Q Dr. Danner, are you familiar with Confidential
22 Exhibit for Identification 63?

23 A Yes, I am.

24 Q Did you oversee an analysis prior to Verizon filing
25 its first petitions in this case that, that attempted to

1 analyze the effect of Verizon's petition on customer bills?

2 A Yes, I did.

3 Q And does this -- this report has a print date of
4 August 8th, 2003, at the top. Does that reflect the time
5 period about when this was done?

6 A Yes, I believe that's right.

7 Q In your, in your analysis that's reflected on these
8 pages, you had some different assumptions concerning the
9 flow-through of access charges, did you not?

10 A Yes, I did.

11 Q Could you explain how your flow-through that you
12 assumed on this document differs from the flow-through you
13 described during your summary?

14 A Yes, I can. And, generally speaking, my opinion was
15 that this was not actually as accurate as we would like for
16 this purpose. But this document looked only at a subset of
17 residential customers, those whose bill would be directly
18 affected. It did not take account of Lifeline in any respect
19 in terms of overall impacts or benefits. I believe there is
20 some breakout of Lifeline customers at some point.

21 But most importantly it did not consider the in-state
22 connection fee in any fashion. So this assumed a simple
23 pass-through on a minute-for-minute basis without taking
24 account of the Legislature's mandate to eliminate the in-state
25 connection fees.

1 Q Okay. Let me make sure I understand. This document,
2 the exhibit we've identified, assumes that all interexchange
3 carriers in Verizon's territory would flow through the access
4 reductions in their permanent charges to residential customers;
5 is that right?

6 A Yes.

7 Q Okay. Now the way that different -- and they would
8 do it proportionately, you know, residential and business
9 proportionately to, to how those charges are incurred by
10 residential and businesses; is that right?

11 A Yes.

12 Q Okay. Now this differs from the method you mentioned
13 in your summary because you've assumed in that other analysis
14 that the carriers would first use it, use their access
15 reductions solely to reduce that residential in-state fee, and
16 then they would apply the balance for residence and businesses
17 according to the proportions that access charges are used by
18 those categories?

19 A That's correct as a description of the method. I
20 don't think there's any particular timing implied by it.

21 Q Okay.

22 A But that's the method, yes.

23 Q And so the assumptions that you used in your, in the
24 procedure you mentioned in your summary allocate more of the
25 reductions to residential customers than do the assumptions you

1 used in the document in front of you?

2 A That's correct. And, and my -- it's my belief that
3 that's a more accurate representation of what's required by
4 Verizon's proposal in the legislation.

5 Q Now what caused you to prepare or conduct the
6 analysis that's reflected in the Exhibit 63 for identification?

7 A It was a couple of different things. Having
8 experience in this kind of process before, I know that a lot of
9 exaggerated and sometimes false claims are made about impacts
10 on customers of bill pricing reform, and so I had an
11 intellectual curiosity to see what the impacts might be. There
12 was consideration of whether we might want to file this with
13 direct testimony or not, considering that the analysis was
14 incomplete, and also that in our view the, the statute didn't
15 require such analysis. We didn't file it. But that's
16 basically where it came from.

17 Q Okay. So you conducted this analysis prior to
18 Verizon filing its first petitions, but decided not to include
19 the results of that in the petitions?

20 A Yes. For the reasons I stated, that it wasn't as
21 realistic as it should be and because it didn't seem required
22 by the statute.

23 Q Now the first two pages -- you've broken down the
24 impact on customers in various ways in this analysis, have you
25 not?

1 A Yes.

2 Q One is by rate groups?

3 A Yes.

4 Q Okay. Now Pages 5 and 6 break down the impact on
5 rate groups in a way that appears similar to Pages 7 and 8,
6 does it not?

7 A Yes.

8 Q Okay. In the analysis on Pages 5 and 6 you included
9 both the impact of the petitions Verizon was filing, as well as
10 the impact of some price cap increases that Verizon had
11 implemented; is that right?

12 A That's correct. So Pages 1 and 2 really include more
13 than the proposal even in the limited way that it was analyzed.

14 Q Okay. But Pages Bate stamped 7 and 8, those are
15 limited to the, the impact of the petitions; is that right?

16 A Yes, in the manner I described with the limitations I
17 mentioned, yes.

18 Q On Page 8 there's an overall total that's listed, is
19 there not, as the impact on customer bills?

20 A Page 8?

21 Q Right. Let me ask you to go to Page 8 and look at
22 the row entitled "Total."

23 A Yes.

24 Q Okay. And on that row, staying on that row, there's
25 a column total, what, circuit switched units?

1 A Yes.

2 Q Okay. And that's all the, the residential nonbundled
3 customers in Verizon Florida's territory, is that right,
4 residential customers?

5 A Yes, that's correct.

6 Q Okay. Now at the time you were doing this analysis,
7 Verizon had proposed two increases one year apart, had it not,
8 to implement the Act?

9 A Yes.

10 Q And so you show two changes here that reflect what
11 Verizon was filing at that time; right?

12 A That's correct.

13 Q And, and after both changes were implemented, that
14 would have been the total implementation of Verizon's proposal;
15 is that right?

16 A Yes.

17 Q Okay. And did you conclude that the result from the
18 first installment on, on that total group would be the amount
19 shown on the net change dollars per unit year one rates?

20 A Again, given limited and not fully accurate
21 assumptions, yes.

22 Q And then there's a similar number for year two rates;
23 is that right?

24 A Yes.

25 Q And so would it be true that the total of those two

1 columns was your estimate, given the limitations you said, of
2 the impact Verizon's petition would have on residential
3 customers bills; is that right?

4 A Given the limitations, yes.

5 Q Okay. Now you excluded bundled packages from your
6 analysis in this analysis, did you not?

7 A Yes.

8 Q In the analysis you mentioned in your summary, did
9 you include bundled packages?

10 A Yes. Because that analysis is an impact on the
11 average residential bill for all residential customers.

12 Q And Verizon does not propose to increase any of the
13 prices for bundled packages; is that right?

14 A That's not part of their proposal, although I don't
15 know what will happen in the market afterwards. But, yes.

16 Q Okay. And what impact did you assume would occur on
17 the bundled packages as a result of the petitions?

18 A I didn't know. I didn't make an assumption because
19 I'm not sure whether they will gain or lose bundled packages,
20 whether they'll be able to charge more, be forced to charge
21 less for them. I -- you know, it depends on how, on the pace
22 that competition takes. Additionally, they're nonbasic
23 services and, you know, outside the gamut of the proposal. So
24 I didn't know what to assume about them, so I left them where
25 they were.

1 Q Okay. So your assumption was is that their prices
2 would stay the same as a result of the petition; is that right?

3 A For this purpose, yes.

4 Q Okay. And so, and so when you added them in, it made
5 a broader base. That reduced the average increase then on the,
6 on that larger customer base; is that right?

7 A I suppose you could say that, yes. And going from a
8 subset of residential customers to all residential customers,
9 yes, that would have that effect.

10 Q Okay. Let me make sure I understand the differences
11 between what, the analysis you mentioned in your summary and
12 this. One difference is the flow-through in access, which
13 we've discussed already.

14 A Yes.

15 Q Okay. And another is in your, the process you
16 mentioned in your summary, you included package customers at no
17 increase in determining the average increase for customers.

18 A Yes. Because they'll get neither the increases nor
19 the benefit of the reduced flow-through either.

20 Q Okay. Are there any other differences between the
21 analysis?

22 A Yes, there's one other difference. There's a small
23 change. Given that the legislation and proposal are related to
24 an expansion of the Lifeline, I took Verizon's forecast for the
25 increase in Lifeline subscribership, took that times the

1 Lifeline benefit and prorated that benefit across all
2 residential customers since that'll be part of the impact on
3 the total residential bill.

4 Q Okay. And what was the increase in Lifeline
5 customers that you used in that assumption?

6 A 20,000.

7 Q Okay. And how many Lifeline customers does Verizon
8 have currently?

9 A Just over 21,000. The estimate is that that
10 population will double due to the expanded eligibility
11 criteria.

12 Q Okay. As part of the analysis you did that's
13 reflected in the exhibit, you also broke down the impact on
14 customers in different age groups; is that right?

15 A Yes.

16 Q Okay. And you've -- you had various strata. And
17 this is on Bate stamp Page 9 of the analysis?

18 A Yes. And a similar analysis also appears in my
19 testimony, as you know, with the full population.

20 Q Well, let's go through this, and then we'll also go
21 through your rebuttal on, on that.

22 Now the strata themselves are not confidential, is
23 it; it's just the impact that the company is claiming is
24 confidential?

25 A That's my understanding, yes. That's correct.

1 Q Okay. Okay. Which age strata has the highest
2 increase in their total bill?

3 A Let's see. It would be 76 plus years is slightly
4 higher, I think, than the next one, next highest one.

5 Q Okay. I'm sorry. The 76 plus years is slightly
6 higher than the 66 to 75 year group?

7 A Yes.

8 Q Okay.

9 A Well, actually -- I beg your pardon. Let me just
10 check.

11 No. Pardon me. I just did a little incorrect math
12 in my head. Yes. I think you're right.

13 Q So the impact in this analysis on the age group
14 76 years old and older would be the sum of the amounts shown in
15 the column for net change in year one rates and the net change
16 for year two rates; is that right?

17 A Yes. Again, under the assumptions we've discussed.

18 Q Okay. Which would be the -- which age group would
19 have the lowest impact on it?

20 A You know, I think it might be the 26 to 35 years.
21 Does that agree with your eye?

22 Q I'm just asking.

23 A I believe it's the 26 to 35 years. I should make one
24 other note just for reference, that this average bill price
25 plan rates is incomplete over here because it doesn't include

1 long distance bill, just so there's no misunderstanding. But
2 that doesn't include the retail long distance charges. But I
3 believe it's, it would be 26 to 35 years.

4 Q Okay. You did take into account the long distance
5 reductions in determining the total impact that's shown in the
6 columns, did you not?

7 A In the manner we describe.

8 Q Right.

9 A Yes.

10 Q It's just that the total bill doesn't have those
11 charges, doesn't have which charges in it?

12 A The total bill reflects only Verizon charges.

13 Q Okay.

14 A A substantial portion of what customers pay are bills
15 to long distance carriers. So these numbers are considerably
16 low in terms of average customer bill levels. But, again, it's
17 just to avoid confusion I wanted to make that clear because the
18 column is somewhat misleading the way it's titled.

19 Q Okay. Now you've testified, if I take it correctly,
20 that the largest increase would be on the age group 76 plus and
21 the lowest increase would be in the age group 26 to 35 years in
22 your analysis?

23 A Based on these assumptions, yes.

24 Q Okay. And you've added up the two-year, or the total
25 impact on both of those age groups?

1 A I can do it now.

2 Q Okay.

3 A Yes.

4 Q Okay. And you've claimed that those actual numbers
5 are confidential, or the company has claimed that, has it not?

6 A Yes.

7 Q Okay. Could you tell me what the multiple is of the
8 impact on 76-year-olds as compared to the impact on 26- and
9 35-year-olds?

10 A The multiple? Huh.

11 Q For example, what would you have to multiply that
12 impact on the age group 26/35 years to come up with the answer
13 or come up with the amount that applies to 76-year-olds?

14 A Well, you're starting with a pretty small base, but I
15 guess you'd have to multiply it by a little more than three in
16 this analysis.

17 Q Okay. So the impact on the age group 76 years old is
18 three times the impact on the age group 26 to 35; is that
19 right?

20 A In that way of calculating, yes.

21 Q Would you turn to your rebuttal testimony, please.
22 And this is --

23 COMMISSIONER DEASON: I'm sorry, Mr. Beck. Before
24 you leave this, can I ask a question?

25 MR. BECK: Sure.

1 COMMISSIONER DEASON: The, the last column, "Average
2 Bill Price Plan Rates," and I know you qualified what that
3 number represents, but is there any explanation for the amount
4 of that for 76 plus years in comparison to the amount for 26 to
5 35 years?

6 THE WITNESS: You know, Commissioner, I'd have to
7 speculate a little bit, but I suspect the younger customers buy
8 more features since this is principally, as I said, this is
9 just what's paid to Verizon. This does not include what's paid
10 to AT&T or other long distance carriers. So I would suspect
11 that the difference has something to do with features and a
12 little bit of different usage level.

13 COMMISSIONER DEASON: Okay.

14 BY MR. BECK:

15 Q Dr. Danner, in your rebuttal testimony at Pages
16 42 and 43.

17 A Yes.

18 Q If you'd turn to those, please. And Verizon has
19 claimed that this data is also confidential in the charts that
20 you have on Pages 42 and 43 of your testimony, does it not?

21 A Yes.

22 Q This shows the result on age groups that, using the
23 assumptions that differ from the ones in the exhibit that we've
24 discussed; is that correct?

25 A Yes.

1 Q Okay. In other words, this data in your rebuttal
2 testimony reflects the assumptions that you discussed in your
3 summary of testimony.

4 A Yes. It's more accurate.

5 Q Okay. But you have the same age strata, is that
6 right, that you have in your initial analysis?

7 A Yes.

8 Q Okay. And, again, in this analysis the impact on the
9 76-plus-year-old age group, how does that compare to the
10 others?

11 A Well, it's slightly smaller than the unknown group or
12 people who wouldn't respond and give their ages. It's slightly
13 more than the average. It is the highest of the numbers.

14 Q Okay. You state in your testimony, in the public
15 testimony that the average is about \$1 using those assumptions;
16 is that right?

17 A Yes.

18 Q And you state that the impact of the confidential
19 number or the impact shown in your confidential numbers for
20 76-years-old is slightly more than the average?

21 A Yes. Yes. Slightly more.

22 Q And could you give us a multiple to give us an idea
23 of what you mean by slightly? How much more -- what's the
24 multiple of the average that you, that is reflected in this
25 data for the 76-years-olds?

1 A My opinion is not based on a multiple. It's based on
2 a value of dollars and cents. If you -- you know, I believe
3 that the difference between the average and that number there
4 is only slightly more. That's my characterization of it. And
5 I don't think it's susceptible to a multiple when you're
6 dealing with small numbers like this.

7 Q Do you recall when I asked you about the exhibit, I'd
8 asked you what multiple the impact on 76-years-olds was
9 compared to the age group 26 to 35?

10 A Yes.

11 Q And you mentioned about three.

12 A Yes.

13 Q Could you give us the same multiple that, that would
14 be reflected in your rebuttal testimony?

15 A Yes. I think the multiple is slightly smaller, but
16 it would still be about a three. Again, in numbers that I
17 generally consider to be not, not very large.

18 Q Dr. Danner, the impact -- do you have the number on
19 Line 24 of your rebuttal testimony, Page 42 that shows the
20 impact on 26-to-35-year-olds?

21 A Yes.

22 Q And have you compared that to the number that's shown
23 on Line 4 of Page 43 showing the impact on 26-year-olds? I'm
24 sorry. On 76-year-olds.

25 A Yes.

1 Q And you're telling me that the number on Line 24 of
2 Page 42 is less than three of the numbers shown on Line 4 of
3 Page 43?

4 A Oh, you know, I'm sorry. I misspoke. I was looking
5 at Line 23.

6 If you looked at Line 24, no, it would be, if you
7 insist on a multiple, 5-and-a-half times maybe. But, again,
8 with relatively small actual dollar differences.

9 MR. BECK: Dr. Danner, thank you. That's all I have.

10 CHAIRMAN JABER: Go ahead, Ms. Bradley.

11 CROSS EXAMINATION

12 BY MS. BRADLEY:

13 Q Dr. Danner, I just have a few questions.

14 When you were talking about the benefits to
15 consumers, you mentioned that they would have a greater choice
16 of companies and that they would have available more services
17 that would be available to them; correct?

18 A Yes. That's correct.

19 Q Are you familiar with the report that the Public
20 Service Commission did in February of '99, the Fair and
21 Reasonable Rates Report?

22 A Yes, I have read that.

23 Q That report talks about the fact that if they raise
24 rates \$2, that approximately 7.1 percent said they would
25 discontinue service. And if they raised it by \$5,

1 approximately 13.4 percent of the consumers said they would
2 discontinue service. And then they also looked at low income
3 consumers and found that if they raised it by \$2, that
4 approximately 9.5 percent would discontinue service, and
5 approximately, if they raised it by \$5, approximately 20.5 of
6 low income seniors would have to, I mean, low income persons
7 would have to discontinue service.

8 Now for the folks that are going to have to
9 discontinue service because of this rate increase, they're not
10 going to enjoy any of these benefits, are they?

11 A I'm afraid I have to disagree with the conclusions of
12 the report. I understand it was prepared in good faith and
13 there is a good effort made to do so, but those numbers are
14 wildly incorrect. Actual experience with price changes in
15 telecommunications confirms that the effect of pricing reform
16 or price increases will be nothing like those numbers you have
17 read to me.

18 In fact, when the FCC pursued pricing reform very
19 much like this pricing reform through creating the subscriber
20 line charge in, in the federal jurisdiction, millions of
21 customers were actually added to the network as a direct result
22 of that reform.

23 I have some experience in my graduate work with
24 studies and surveys of the kind that were used to develop that
25 information. And it's unfortunate that when you ask people

1 questions like that, you know, would you give up the service
2 for a certain amount or how much would you pay for this, you
3 just don't get accurate information. The accurate information
4 that we can rely upon is that which has been determined by
5 observing actual customer behavior in response to actual price
6 changes, and, for example, resides in books such as Lester
7 Taylor's book on demand studies that was referred to by some of
8 the other, other witnesses earlier.

9 So I'm afraid I can't accept the premise of your
10 question because those data are not correct.

11 Q Did you hear the testimony yesterday?

12 A Yes.

13 Q Did you hear the testimony that BellSouth
14 discontinues approximately 2,000 citizens on Lifeline per
15 month?

16 A Yes. And I am familiar with detailed empirical
17 research as to why customers actually give up service.

18 Q Those that are going to have to or have testified or
19 feel that --

20 MR. CHAPKIS: Objection. Could you please let the
21 witness finish his answer to your question?

22 MS. BRADLEY: I'm sorry. I thought he was through
23 with it.

24 CHAIRMAN JABER: Excuse me, Mr. Danner. Ms. Bradley,
25 I noticed that, too. So let's wait until the witness finishes

1 the answer, and you're welcome to ask the next question.

2 MS. BRADLEY: Certainly.

3 CHAIRMAN JABER: Go ahead.

4 THE WITNESS: Thank you, Madam Chair. In, in a
5 number of places, in particular in California and in Texas,
6 there has been detailed research performed as to why customers
7 actually give up phone service. This has gone through
8 investigation of those very customers through researching the
9 actual reasons why they give up phone service.

10 Overwhelmingly the reason why customers give up phone
11 service when they fall off the network is uncontrollable toll
12 and long distance bills. It dwarfs any other concern.

13 The second most prevalent reason is high connection
14 charges and credit requirements. When customers fall off the
15 network, they tend to have very high bills, they have high
16 unpaid bills, they may have bad credit due to other problems
17 they have in their lives and their jobs and their finances, and
18 they're unable to meet the credit requirements and the
19 connection charges to get back in the network.

20 Almost never in those studies and that empirical
21 research is the basic rate ever mentioned as an actual factor
22 in customers losing phone service.

23 BY MS. BRADLEY:

24 Q I guess it's a good thing we're not in Texas.

25 Sir, let me ask you a question. For those people

1 that are going to have to give up service because they can't
2 afford the increase, they're not going to enjoy the benefits
3 that you're talking about, are they?

4 A To the extent there are any such people, I would
5 agree with your premise. But another -- again, as I've said, I
6 don't believe that's going to be a, a genuine concern in the
7 end.

8 MS. BRADLEY: I don't think I have anything else.

9 CHAIRMAN JABER: Okay.

10 CROSS EXAMINATION

11 BY MR. TWOMEY:

12 Q Good afternoon, Dr. Danner. I'm Mike Twomey.

13 A Good afternoon, sir.

14 Q The first thing I'd like to do is refer you back to
15 the confidential exhibit Mr. Beck was asking you about.

16 A Yes, sir.

17 Q And he -- I believe you acknowledged that the 76 and
18 above age strata was the group that had the most adverse
19 consequence as a result of this analysis; is that correct?

20 A Yes. And presumably I guess they're one of the most
21 heavily subsidized and that's why that occurs, yes.

22 Q Okay. Now would you agree with me that the
23 66-to-75-degree strata is the second most adversely impacted?

24 A Yes. In this analysis, that's correct.

25 Q And then after that would you agree with me that the

1 56-to-65-year-old strata is the next most adversely affected?

2 A Yes. In this analysis, that's correct.

3 Q And then finally -- not finally, but finally for my
4 purposes, the 46-to-55-year strata would be the next.

5 A Yes.

6 Q Okay. The -- were you in the room this morning when
7 I asked the, the BellSouth witness a hypothetical of
8 Commissioner Deason coming back from the airport?

9 A Yes. I understand it is truly a hypothetical because
10 Commissioner Deason would never come back from the airport in
11 the manner that was described.

12 Q That's true. And I've learned from that, Dr. Danner,
13 so --

14 COMMISSIONER DEASON: He catches on fast.

15 MR. TWOMEY: Well, I have, I have, too, Commissioner
16 Deason. So --

17 CHAIRMAN JABER: He's changed the hypothetical.

18 BY MR. TWOMEY:

19 Q The -- what I propose to do to make it more real life
20 is to substitute Commissioner Deason for AARP's volunteer
21 worker in Tallahassee, Mr. Ed Paschall, who testified yesterday
22 in the public part of the hearing who said that he was --

23 COMMISSIONER DEASON: You know, I have traveled
24 extensively with Mr. Paschall in years past when he was a
25 pilot.

1 MR. TWOMEY: Yes, Commissioner, so I have.

2 BY MR. TWOMEY:

3 Q So let's substitute, let's substitute Mr. Paschall
4 for Commissioner Deason and just say -- do you recall the, the
5 premise of my hypothetical?

6 A Yes.

7 Q That, that Mr. Paschall would be coming back from the
8 airport coming here for this hearing, jumps into the cab, three
9 telephone executives, vice presidents jump in, hitch a ride,
10 they get here, the cabby says the fair is \$20. And I asked the
11 BellSouth witness, which would BellSouth use, which option: The
12 divide \$20 by four, each person pay five bucks as their share
13 or, B, say, Mr. Paschall, you were coming here anyways, 20
14 bucks is yours you were going to spend, we don't owe you
15 anything?

16 A Well, there are two ways to look at your
17 hypothetical, which, if I can beg your indulgence, I'd like to
18 amend slightly as well in a moment.

19 Q Sure.

20 A The -- we need to distinguish the actual decision to
21 purchase the ride versus how it's used by whoever we've decided
22 has purchased it once they're done. So if it's clear that the
23 first individual bought the cab ride and then decided to use it
24 by sharing it with others, then I suppose it would all be his
25 responsibility.

1 If the four gentlemen purchased it collectively, said
2 let's, you know, go get a ride together, then, you know, they
3 could bargain among themselves as to who would pay what but the
4 ride would be their joint responsibility.

5 I think to bring it back to the telephone analogy
6 though, if the -- your suggestion, I think, would be that if
7 the, if the cab stopped at Burger King on the way home to pick
8 up some hamburgers, that the Burger King ought to pay for part
9 of the ride too because the cab was also being used to buy
10 takeout food. I apologize. I couldn't resist.

11 BY MR. TWOMEY:

12 CHAIRMAN JABER: I wish you would have. It's dinner
13 time.

14 BY MR. TWOMEY:

15 Q You have a degree in economics amongst your other
16 degrees; right?

17 A Yes, sir.

18 COMMISSIONER DAVIDSON: Mr. Twomey, could you just
19 identify what you handed to the witness, please?

20 MR. TWOMEY: I'm sorry. It's the, it's the Twomey
21 artwork also known as Exhibit 54, I believe.

22 BY MR. TWOMEY:

23 Q The, the same questions on that. The, the --
24 without, without regard, for purposes of my question, issues of
25 cost causation, can any of the services indicated on that

1 exhibit be provided by a LEC to its customers without
2 utilization of the local loop?

3 A Pardon me for asking for one clarification. When you
4 say without use, use by whom?

5 Q By utilization of the loop. Let me ask you this way.

6 The -- can the LEC in this example sell, provide
7 through it intraLATA long distance service to its customers
8 without utilization of the local loop?

9 A Well, yes, it could if it had some other way to
10 access the network. The usual manner though I think you have
11 in mind would be that the customer would have a loop and the
12 customer would use the loop to access the service and/or call
13 its accountant or order a pizza or whatever, yes.

14 Q But your -- I take it you mean another method would
15 be wireless or something; right?

16 A Yes. Or there are companies like AT&T that, you
17 know, offer long distance service to customers who have loops
18 they got elsewhere.

19 Q Okay. I said the LEC. But now can the LEC provide
20 interLATA long distance service without utilizing the loop?

21 A I would assume that in the usual case a customer
22 would have to have a loop to access the LEC to get long
23 distance service, yes.

24 Q Okay. And the vertical services, same thing?

25 A Yes.

1 Q Okay. Directory assistance?

2 A Well, again, there are a lot of ways to access
3 directory assistance. But in the scenario you're imagining, I
4 assume you could use a loop to do that.

5 Q Do these companies or does Verizon provide DSL
6 service as utilizing the local loop?

7 A I believe Verizon's DSL service is carried over
8 customer loops, yes.

9 Q Okay. And do they to your knowledge receive revenues
10 for those services, DSL?

11 A They sell it, yes.

12 Q Okay. Now I had asked Mr. Fulp, I think it was, if,
13 if you had revenues of \$10 for access and -- I'm sorry, \$10 for
14 local service, \$5 for access and a total of \$10 for vertical
15 services combined for a total of \$25, could the Commission, if
16 it wanted to, allocate cost of the services, those services
17 utilizing the local loop based upon the proportion of revenues
18 earned through it?

19 A You know, if you abandon economic principles, I guess
20 you can -- it's hard for me to tell you what to do based on
21 economics for setting those prices.

22 Q Yes, sir. But let me repeat the question.

23 Could you -- absent cost causation and all the rest
24 of that, can the, could the Commission mathematically apportion
25 cost to these various services based upon the revenue they earn

1 through the utilization of the local loop?

2 A If that's within their legal authority, I assume they
3 could.

4 Q So that would be a yes, correct, Dr. Danner?

5 A Again, I, I don't mean to quibble. Yes, assuming
6 they have the legal authority to do that.

7 Q Okay.

8 A I'm not an attorney.

9 Q Well, you're not. But you say in your rebuttal
10 testimony that you think the statute is real clear; is that
11 correct?

12 A Yes, I do.

13 Q Excuse me. When you say that the statute is not a --
14 I'm trying to find the words you used. On Page, Page 4 of your
15 rebuttal testimony at Line 6 you say, "First, it is clear that
16 Section 364.164(1)(a) is only one of four criteria the
17 Commission must consider in evaluating Verizon's petition. The
18 statute does not create a 'pass fail' test regarding this or
19 the other specified criteria. Under the Act, the Commission
20 retains discretion to evaluate and balance these criteria as it
21 sees fit." And that's your testimony; correct?

22 A Yes.

23 Q Now what I want to know is do you mean by that that
24 it's your opinion, whether legal or not, that, that this
25 Commission could find that Verizon met two or three of the four

1 criteria and still authorized the rate increases sought?

2 A The statute says, "The Commission shall consider the
3 following criteria." In my experience when legislatures intend
4 for an agency to meet each individual criterion or make that a
5 requirement, they say it shall meet this and this and this or
6 some such language. I'm not saying the Commission, you know --
7 obviously in considering those criteria the Commission can
8 evaluate the petition, and if they feel that it doesn't meet
9 one of them, they can say no for that reason. This is not --
10 but it's not mandatory based on the statute.

11 Q Well, let's look at that again. Let's go back to
12 your Page 3 of your rebuttal, please. Because isn't it true,
13 Dr. Danner, that the statute doesn't exactly say the way you
14 paraphrased it -- isn't it true, as you have it quoted in your
15 testimony, that it says, directs the Commission to consider
16 whether granting these petitions will; is that correct?

17 A Yes.

18 Q Okay. And, again, is it your testimony that it's
19 your belief that the Commission mandatorily doesn't have to
20 find that each one of those conditions is met?

21 A In my view, if each of these was to be absolutely
22 mandatory, which, again, is not to suggest that the Commission
23 shouldn't interpret it the way, you know, it sees fit, it would
24 say, and/or some such language between each or would say, you
25 know, will -- whether the petition will satisfy all of the

1 following criteria or pass all of the tests individually and
2 collectively or something like that.

3 Q Is -- are you finished? Is, is that the, is that
4 Verizon's legal position in this case, or do you know?

5 MR. CHAPKIS: Objection. Calls for speculation.

6 CHAIRMAN JABER: Mr. Chapkis --

7 MR. CHAPKIS: Calls for a legal conclusion.

8 CHAIRMAN JABER: Mr. Chapkis, the question concluded
9 with "do you know," so I'll allow it.

10 THE WITNESS: I don't know.

11 BY MR. TWOMEY:

12 Q So it would be your testimony, would it, Dr. Danner,
13 that, that if the Commission found for some reason that there
14 were no subsidy or support to be removed by rate increases,
15 that it could still go ahead and increase local rates
16 notwithstanding that?

17 A I think it's -- that's -- they're not precluded from
18 doing that based on the statute as far as I can see. Whether
19 they would or not, I don't, I wouldn't say. But in this case
20 we don't have to reach that question.

21 (Transcript continues in sequence with Volume .)
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1 STATE OF FLORIDA)
2 COUNTY OF LEON)

CERTIFICATE OF REPORTER

3
4 I, LINDA BOLES, RPR, Official Commission
5 Reporter, do hereby certify that the foregoing proceeding was
6 heard at the time and place herein stated.

7 IT IS FURTHER CERTIFIED that I stenographically
8 reported the said proceedings; that the same has been
9 transcribed under my direct supervision; and that this
10 transcript constitutes a true transcription of my notes of said
11 proceedings.

12 I FURTHER CERTIFY that I am not a relative, employee,
13 attorney or counsel of any of the parties, nor am I a relative
14 or employee of any of the parties' attorneys or counsel
15 connected with the action, nor am I financially interested in
16 the action.

17 DATED THIS 12th DAY OF DECEMBER, 2003.

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LINDA BOLES, RPR
FPSC Official Commission Reporter
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