BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

SPECIAL PROJECT
NO. 980000A-SP

In Re: Fair and reasonable residential basic local telecommunications rates.

DAY 1
MORNING SESSION

IN RE: Staff Workshop

CONDUCTED BY: Anne Marsh

DATE: Thursday, October 1, 1998

TIME: Commenced at 8:30 a.m.
Adjourned at 4:15 p.m.

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

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P R O C E E D I N G S

MS. MARSH: Good morning. We are ready to start. I've got a few preliminary matters before we begin with the speakers. One of the matters we needed to determine today is whether we'll start tomorrow at 8:30 or nine. We had originally noticed it for 8:30. We have actually for the speaker to start at nine. We can move that up, and I wanted to get an idea of what people's preference is. Is there anybody that prefers to start at 8:30? Could you all just -- How about nine? You all need to raise your hands a little higher here. How about the commissioners, do you have a preference?

COMMISSIONER CLARK: 8:30 is fine.

MS. MARSH: 8:30 is fine? I think we'll just go with 8:30. There are some each way. We normally, you know, have a set time, but we had to notice this before we knew who was going to be speaking, and we wound up without very many speakers for tomorrow.

The commissioners will be coming in and out. They do have other obligations, but I know most of them do wish to be here for as much as they can. We will break at noon today because Commissioner Garcia has an oral argument, so we will break for lunch at twelve. So if somebody is not finished, we may need to split up their presentation. I've timed it in such a way that I hope it won't happen that way, but we do need to break today at twelve.

If anybody needs any kind of equipment for their presentations, once we get started, please get up with me so I can get a list to Carol Purvis so she can get everything together. The screen up here operates off of a laptop, but we do not have software that everybody needs. If you all have your own laptops and wish to use this same setup that Ben Poag is using, you can do that. Get with me for the list of what anybody might need.

There are some extra materials up here. They are the same comments that have been served to everybody. There are some extras in case you need them or in case there are interested persons here who don't have copies of the comments, and we'll be putting some extras out each day.

I want to remind everybody, this isn't a hearing. It is a workshop, and we are not doing cross examination. I expect everybody to ask questions and for there to be discussion. And I'd like the speakers, if you would, to indicate your preference as you get up here whether you want questions asked as you go, or if you want them held until the end of your presentation. I know some people get rolling and it breaks up their train of thought, so if the speakers will just announce that at the beginning of each presentation, what your preference is.

Also want to announce, I know some of you heard this yesterday. We will be having a workshop on October 20th dealing with Lifeline. It is not docketed, and it is not part of this project. We will be investigating certain issues, such as automatic enrollment in Lifeline or the possibility of a standardized form. We'll also be discussing ancillary services and whether or not Lifeline subscribers should be allowed to take ancillary services. There will be a call-in number for that workshop, and it is in the notice. It has been noticed. I think it has just gone out in the last few days, so you may not have the notice yet. There are copies up front of the notice.

I think that's everything I really needed to bring up before we get started. We are a few minutes early, but I think Mr. Poag is ready to start.

Does anybody else have any preliminary matters?

(NO RESPONSE)

MS. MARSH: If you do, we have microphones set up. That is something else I need to mention. We have a microphone set up up here but whenever somebody is using the lapel mike, that one has to be off, and Mr. Poag will be using the lapel mike. So when he is using that or any of the other speakers, either come up to this mike here or the one over here on the side so that the court reporter will be able to hear you. So if anybody has anything or if you have any questions, come up to one of those mikes.

(NO RESPONSE)

MS. MARSH: If not, then I guess we are ready to start. Ben you, you ready to go?

MR. POAG: Good morning. I'm Ben Poag. I'm with Sprint. I've got some handouts that I can give you all that will follow along with the slides. You're getting ahead of me, Commissioner.

COMMISSIONER DEASON: I'm always ahead of you.

MR. POAG: Yes, sir, you are.

With that in mind, let's go ahead and get started. I will take questions as we go through the presentation, so if you have anything, just stop me and I'll try to respond to the question on it.

Why are we here? Just a quick review of the legislation and why we got here, or how we got here. We are talking about Section 2 of chapter 98-277. Basically the Commission has been mandated with making some reports. The ones I'm going to talk about today are under Subsection 1 and Subsection 2, but under Subsection 1 we are talking about relationships among costs and charges and the legislation said for basic local service, intrastate access and other services.

We filed cost studies, total service long run incremental cost studies in response to the Division of Communications data request on June the 19th. Now those are the same types of incremental cost studies that we have filed historically in tariff filings and other proceedings before the Commission, the same basic type studies that we have always filed. We broke the residence -- broke it down into residence and different categories of business services, and I'll review those in just a few minutes.

The second thing that we were charged with is that -- under subsection 2 to report on the conclusions, the Commission's conclusions as to the fair and reasonable residential basic rate considering affordability, value of service, comparable rates and cost. And I will touch on each of these, but there are other witnesses that will be talking about value of service, affordability, comparable rates and cost that Sprint is sponsoring as well.

The question is, you know, what was on the legislature's mind when they gave you this charge; and again, citing that chapter, subsection 1, it's in the first sentence, the legislature determined that the charges for intrastate switched access and other services may be set above cost and may be providing an implicit subsidy of residential basic local telecommunications service rates in this state, emphasis added.

So lets look at what some of those charges. Excuse me, look at what some of the problems are if that predicate is correct. First of all, is we've got cross subsidies between customers and services and that's without regard to subsidy needs. The second thing is that subsidies are not targeted to low-income subscribers in high-cost areas. Thirdly, we are subsidizing those that do not need to be subsidized, and we are substantially increasing the size of the subsidy by doing that. The fourth problem is that the subsidies are implicit and are not competitively neutral. Five, is that under the current pricing structure we are sending the wrong pricing signals. This is effectively the result of some prices being too high and inviting inefficient entry into the market, and on the other hand, some prices are too low and they are serving as barriers to entry in certain markets.

Low-cost, high-profit margin customers will see the benefits of competition under the structure that we have today, but as profits are lost from those customers, either through price reductions or loss of the customers themselves to competitors, the contributions that they are making, the implicit subsidies that they are making to other customers, will be lost and will put upward pressure on the prices to the high-cost customers. And we are looking at this thing from a long-term.

COMMISSIONER GARCIA: Ben, what do you mean by inefficient entry on five? Some prices are too high, what do you mean by -- what is inefficient entry?

MR. POAG: Let's say I'm sitting out there and I've got a particular customer segment where the profit margin is 50%, and with that profit margin a lot of that is an implicit subsidy that is going to high-cost areas today. Okay, somebody can come in and they can compete with me, let's say at 75% of my price, but their actual cost is higher than my cost. And if my prices were based more on my cost than on the current structure where --

COMMISSIONER GARCIA: Your term of "inefficient entry" is not as a market concept but simply as a concept to Sprint?

MR. POAG: No, I think it's a basic economic concept.

COMMISSIONER CLARK: What he is suggesting is that if they were allowed, in fact, to charge the prices that are more reflective of their cost this competitor wouldn't come in because they couldn't provide it efficiently enough?

MR. POAG: Yes, that's correct.

COMMISSIONER CLARK: But because they are higher, they can do it inefficiently and still get their share of the market?

MR. POAG: Correct. Yeah, in the long-term, I don't think that is a competitor that you necessarily want in the marketplace because they are not going to be able to sustain competing if they are less efficient in the long-term. Basically what you're saying is --

COMMISSIONER GARCIA: I understand what --

MR. POAG: You are basically getting resources committed to something that for the long-term --

COMMISSIONER CLARK: Yeah, I agree.

MR. POAG: -- won't really benefit consumers, yeah.

COMMISSIONER GARCIA: It has been benefitting consumers in that particular case. Do me a favor, go back to three before you get too far off the mark.

MR. POAG: Okay.

COMMISSIONER GARCIA: What does that mean?

MR. POAG: To the -- Number 3?

COMMISSIONER GARCIA: Yeah.

MR. POAG: Yeah. To the extent that you are subsidizing high-income or medium-income customers' services that don't need to be subsidized, it's a subsidy going to customers that don't need to be subsidized, and yet it -- As a result of that, the size of the entire subsidy is larger than it needs to be. And what we are saying is that to the extent that customers can afford to pay more, you can reduce the subsidy to them, then that's the appropriate action to take.

COMMISSIONER GARCIA: Okay. Thank you.

MR. POAG: Yeah. So we've talked about the low-cost, high-profit margin customers. Let's look at this in terms of services. We are talking about cross subsidies being between customers. One of the benefits, I think, that if we fix this is, is that we can really take care of a lot of low-income customers that are spending money on what I'll call non-basic and toll services. According to the FCC's 1997 reference book, approximately half of the telephone expenditures by low-income households are for toll and other discretionary services. So to the extent that these people are paying premium prices for those services we're not helping them.

Proper cost price cost relationships will provide more efficient allocation of resources, and that's what we just kind of talked about. The benefits of competition will be expanded to more residential customers instead of focusing competition on the low-cost, high-profit margin customers. Basically, we are going to reprice services such that the customers in other markets are attractive for competition as well.

And basically, both state and federal legislation are designed to foster competition, and in the long run --

and I think this is where we've got to keep our focus on, the long run of where we're going, and that's to bring the benefits of competition to as many customers as possible, not only those in the low-cost areas, but those in the more rural and higher cost areas as well.

Look at some of the information that we filed in the proceeding, basic residence service, our average charges for that, and this includes the basic service rate, the 3.50 subscriber line charge, one dollar -- excuse me, the touchtone charges, and we included in that the 25-cent message revenues as well because some of those were classified as basic services under the statute. When you add all those up, you come to $14.23 in charges, you have a cost of $26.91, and a negative contribution. The other services that we filed -- and this is not all of them, but I picked a sample of the ones that I thought were the bigger buckets in terms of the revenues -- the single line business, the charges, again, with the subscriber line charge and touchtone and the extended local calling, 31.71; cost 18.64; the contribution 70%. PBX trunk, 54.14; cost 19.70; contribution, 174%. Switched access, about five cents a minute on each end, as far as the access charge, about four tenths of a cent in cost, about 1200% contribution. IntraLATA toll 18 cents per minute in revenue, about a half a cent in cost. The non-basic features, and my terms for it today, by the way, in most cases when I talk about non-basic features, I'm talking about custom calling features. I'm talking about class features, caller ID, call waiting, those types of features. When I talk about toll, I'm talking about intraLATA long distance toll and I'm talking about access charges.

COMMISSIONER CLARK: Can I ask a question? Going back to your benefits on the cross subsidies and nearly half the telephone expenditures by low-income household are for toll, is it all toll, or is it also intraLATA toll?

MR. POAG: That's all toll. That is FCC data, and that was -- I believe I put that right in as a quote..

COMMISSIONER CLARK: Yeah.

MR. POAG: Yeah, and that is a quote right out of the FCC's 1997 reference book.

COMMISSIONER DEASON: Ben, I have a question. The 14.23 for basic residence --

MR. POAG: Yes, sir.

COMMISSIONER DEASON: -- that includes an amount for ECS, and that is an average over all of your residential customers?

MR. POAG: Yes, sir.

COMMISSIONER DEASON: Even those that don't even have access to ECS plans because their calling scope is already large enough they don't need it?

MR. POAG: Yes, sir.

COMMISSIONER DEASON: Okay. So then in your incremental cost for intraLATA toll is .005. So then for those customers who use ECS a lot in those areas that don't have a large calling area, they are giving you more contribution than those that do not use ECS; is that correct?

MR. POAG: If you are only looking at those two pieces of the pie, yes, sir.

COMMISSIONER DEASON: For example, if there is a customer who is in an area that doesn't have a large local calling area, uses ECS a great deal, and say their basic residence rate, including ECS is $30 a month, you are actually getting a positive contribution because your incremental cost of intraLATA toll is only .005?

MR. POAG: Yes, sir, absolutely.

COMMISSIONER DEASON: Okay.

COMMISSIONER GARCIA: I want to make sure I understand that number then because Commissioner Deason clarified it for me. The 14.23 is then an average of those customers included, or is that charge basically what your basic service is, you add to it touchtone, you add to it the 3.50 subscriber line charge from the FCC that what you get, or is that -- you begin from an average of contributions to ECS and things of that nature?

MR. POAG: Yeah, I'm trying to remember how we did this now going back. Let me verify what I just told you. It was spread over all of the routes where -- It may have been spread over all of the routes where there was ECS and where there were exchanges that did not have ECS it wasn't spread, but the net result of it is, is that when I come to this overall revenue, I guess it has to -- yeah, it ends up being spread over all of them in this scenario. If you went into the details of it you may be able to see by individual exchange that the revenues varied, and I just don't recall exactly how we filed that at this point in time.

But going back to your question, Commissioner Garcia, it's the basic rate, plus the 3.50, plus the average touchtone charge, not all customers get touchtone, and then it's the -- in this case, the average of the ECS spread against all of the residential customers. That's the total 25-cent revenues divided by the total residence access lines.

COMMISSIONER GARCIA: Off the top of your head, do you remember how many -- what percentage of your customers get touchtone?

MR. POAG: I think it's 74%.

COMMISSIONER GARCIA: Okay.

MR. POAG: Now let me qualify that, it's 74% that are charged for it; and the reason I say that is some customers basically don't get it. For example if you are an Internet service provider and you've got a 20-line incoming rotary, you don't have any outgoing calls, you don't need touchtone service, so they don't order it, as an example. And some residence customers just don't order it either.

COMMISSIONER GARCIA: The charge is the same for everyone, which is --

MR. POAG: The charge is one buck for everyone, yes, sir.

COMMISSIONER DEASON: Ben, what is the reason for the difference in incremental cost between residence and business, single line business?

MR. POAG: Mr. Dickerson can probably get into more detail with you on that.

COMMISSIONER DEASON: That's fine.

MR. POAG: Essentially it's the fact that business loops are closer to the central office and they are shorter, and they are also in more dense facilities, more dense locations; so the big driver, density and distance. If you look at the difference between the single line business and the PBX trunk, there is probably not -- there may be some difference in loop length, but most likely that is probably more a difference in switching cost than it is anything else for the difference in those two. But Mr. Dickerson is the expert on the cost, and he is the one that actually did the actual development of those costs.

Now talking about cost, I think the one thing that is going to be the big issue is the basic residence cost. And a lot of people would suggest to you that that's a joint cost, or that's a common cost, or that it ought to be allocated, or that you ought to take the revenues from other services and attribute it to basic residential service; and I'd like to look at an example of what happens when we do that.

I've got two customers, grandma local and grandma toll. And grandma local lives in the same town as her grandchildren, but grandma toll, her grandchildren live in Miami. They're neighbors of Commissioner Garcia down there. So she makes a lot of long distance calls to talk to her grandchildren. Now on the basic service side, I'm saying that we've got an average cost of $25 for these two customers. Grandma local pays $15 in charges. That's my 14.23 rounded. On the other hand, grandma toll, she has the same cost, $25, pays the same charges for basic service, $15, she generates another five dollars in ccsts for toll, placing those calls down to Miami to talk to her grandchildren, but she gets charged $25 in toll charges by the long distance carrier. Now what some folks are suggesting is that this service over here should be credited with some of these revenues, or some of the costs of this service ought to be put over here with this person because of the fact that the basic service is used for toll and local usage, and it's also used for non-basic features. But effectively, what happens is that when somebody just orders the basic service or they just order the basic service and they use very little toll or very little non-basic services, we end up putting the burden of paying for that, this shortfall, on these other customers; and there is no economic rationale or social welfare reason why we are doing it. What I'm saying is that these are two equally situated customers, but when we attempt to allocate some of this cost to toll or when we allocate it to non-basic service or say that those revenues should go over there, we are just causing some other customer to pay for the service for another customer. I don't follow the logic. It's an illogical approach to it to me when you look at it in this way, but I think that's the big problem that you run into.

Now there is another problem with it too, and that is, that if you look at the situation where you've got high-cost customers and low-cost customers, you run into the same thing. In this scenario I'm saying that the cost ot service is a rural area, low density area, so your cost of service is $50. Also, since this is a rural area, instead of a $14 -- or excuse me, $15 charge for local service, because of the grouping plan and this being in a small exchange with very few access lines, it's got a small local calling area, it's in rate group one, the charges for that are as low as about $7 a month and you put the subscriber line charge on it as 3.50, but I'm saying about $10.

Now they've also got the $3 is what I'm saying is some cost associated with non-basic services, or it can be toll services -- it doesn't make any difference -- and then you've got some revenues, about $15. I've got exactly the same thing on the other side. The big difference here is that my cost is less because it's a high-density, low-cost area and my revenues for the non-basic services are larger and my costs are larger. And what I'm trying to reflect here is that not only do I have in some of the high-cost, less-dense areas the higher cost, but also, when you look at our subscription rate levels to the non-basic services, we have about a 66% take of the custom calling features and class features in what I refer to as in our rate group 6. Our largest rate groups, our largest exchanges have about a 66% take, but in the -- all the rate groups five down, the take rate is about 40%, so there is about a 25% difference in the take rate.

So here again, you get into the situation of, okay, yes, these customers are generating some non-basic feature charges, but if you start looking at averages, you can say, well, yeah, if we get enough of these other customers, we'll make up the difference in cost. Now this is a hypothetical example. I've got a real world example, and this kind of goes to that question, so what? On average you're okay.

And then what we are driving at here is that in Maitland -- this is a wire center in our Winter Park exchange down in central Florida, and I've got Kenansville, is a wire center which is full exchange, which is south of Saint Cloud, kind of in between the Melbourne, Eau Gallie area in south Osceola County -- or excuse me, west of the Eau Gallie, Melbourne area in south Osceola County. It's a very rural area, very large geographic land area. I think we've got about 750 access lines in the Kenansville exchange.

Now I couldn't separate my revenues between residence and business, but when I look at my revenues for all services in Maitland and my revenues for all services in Kenansville, we see that up here I've got about $70 per access lines, got a higher ratio of business lines bringing in more revenue per line. Down here I've got a higher ratio of residence lines relative to Maitland, not as much money.

Look at the basic service rates. Here again, this is in rate group 3, so their charges are a little lower. This is rate group 6, so the charges -- the base rate there is 10.23, plus the 3.50 subscriber line charge. I didn't put -- yeah, and the touchtone, and then look at the cost per line. The cost in Maitland is 15.75. The cost in Kenansville is 2.46.

Now the costs are out of the benchmark cost model, and the 2.46, is what is referred to as an uncapped cost. The capped cost, and that's where they basically say that when you get into an exchange and the investment per access line goes over 10 thousand, 10 thousand dollars, they cap it at 10 thousand dollars. What I'm showing you is the uncapped cost. If you cap it at the 10-thousand-dollar investment per line, then that number would drop to about 1.20.

But in any case, what we are showing here is that in this market I'm going to get lots of competition, particularly for the business. In fact, in the Maitland central office, we've had more requests, I think, for collocation than in any other wire center; and I can't remember the exact numbers now, but I think we had like four or five collocated with additional requests coming in, and we didn't have the space to accommodate them. Now I've got room down in Kenansville, but for some reason nobody wants to go down there and compete.

COMMISSIONER JACOBS: Ben.

MR. POAG: Yes, sir.

COMMISSIONER JACOBS: Is that the reason that your cost in the Maitland center is not going to come up to your -- I mean, I'm sorry, your charge doesn't come up to your cost in the Maitland center because of competition there?

MR. POAG: What I'm reflecting here is just the residence basic rate. This does not have any toll or any of the non-basic features included in it. But overall, I will -- in Maitland, I will far exceed my cost in Maitland.

COMMISSIONER JACOBS: Okay. So the average basic service charge here, the 15.75, that's your cost, right?

MR. POAG: Yes, sir.

COMMISSIONER JACOBS: And your 14.73 is what you are charging for that with the touchtone in it, right?

MR. POAG: Yes, sir.

COMMISSIONER JACOBS: I'm wondering what factors drive that below cost there because it appeared to me that you recovered the cost on that, the basic charge, the 14.73 could approach the 15.75.

MR. POAG: Well, right now I'm capped in these charges --

COMMISSIONER JACOBS: Oh, that's your cap.

MR. POAG: -- what I can charge here by the current statute.

COMMISSIONER JACOBS: That's your cap?

MR. POAG: Yes, sir.

COMMISSIONER JACOBS: Okay. I'm sorry.

MR. POAG: Is that --

COMMISSIONER JACOBS: That was my question.

MR. POAG: Okay. Right, I'm capped there.

Okay. So basically, the current structure is not conducive to bringing competition to all areas; and then again, it's inviting the efficient entry where you've got a situation like Maitland.

COMMISSIONER DEASON: Your first column there, it says "All services." That includes toll?

MR. POAG: I'm sorry?

COMMISSIONER DEASON: Your first column --

MR. POAG: All services.

COMMISSIONER DEASON: -- all services, Does that include toll?

MR. POAG: Yes, sir. Now when I say "toll," in my talking about "toll" I'm talking about intraLATA toll and the access charges associated with the toll provided by interexchange carriers. I guess another way to say it, those are local exchange company revenues.

So what I think we need to do to fix it is price services more in line with costs. Now we're talking about repricing services on a revenue-neutral basis, and I would just like to clarify something here. When we are talking about repricing go on a revenue neutral basis, we are saying, yes, we think that residential local exchange service rates need to be increased. We say we are going to decrease the prices of access charges and decrease the prices of vertical services.

Now I will tell you that our access charges historically have been growing in the vicinity of about 10% a year. Vertical services probably growing somewhere close to that. And what I'm driving at here is that when we -- if we make this change and we say, okay, increase residence and decrease these others, remember we had a 10% growth rate out here. We are looking at a 5 or 6% over here, so there is no revenue benefit to the local exchange company over time to make that change.

We think that as part of the repricing that we are basically saying that those that can afford to pay a larger portion of the cost should, and to the extent that we determine that there are subsidies that are needed and that we've got an affordable level beyond which we do not want to raise rates, then we need to establish subsidies for the low-income customers in the high cost areas.

Talking about low-income customers, what is the impact of the current price structure on low-income customers? Again, I'm going back to the FCC. 50% of low-income expenditures are for toll and non-basic services. In Florida, what I'm hearing from some of the data that is going to be presented, that that number is higher. It's something more in the range of maybe two thirds of the expenses are for toll and non-basic services, and that kind of follows because, if you think about it, Florida with the local service rates --

COMMISSIONER GARCIA: Does that include intrastate in that too?

MR. POAG: That includes both inter and intrastate I believe. Again, that is an FCC number, and I don't -- I didn't have the details of it. It's right out of their report.

COMMISSIONER GARCIA: I was asking for your Florida.

MR. POAG: I've got some --

COMMISSIONER GARCIA: Because it could also be a result of poor regulation on our part, making territories too small, therefore, we force more of that expense on the customer in Florida to pay intrastate tolls.

MR. POAG: Say that again.

COMMISSIONER GARCIA: Don't worry about it. Don't worry about.

MR. OCHSHORN: Is your definition of low income under 25 thousand dollars per year?

MR. POAG: I did not have an explicit definition of low income. The 25-thousand-dollar number is the number that was in the survey that was done by PENR and Associates. They did not have any information below 25 thousand. Had they had that, I probably would have looked at it.

MR. OCHSHORN: Did they ask people on the telephone what their annual income was? Is that how they got the income?

MS. MARSH: Excuse me, I don't want to interrupt, but you do need to come to the microphone. The court reporter can't hear you. Either on the side over there and remember to turn it on, or for those of you on this side, if you'll come up to this one right here and turn it on.

MR. OCHSHORN: I want to apologize to the court reporter. My name is Benjamin Ochshorn. I'm with Florida Legal Services. And the question I had was whether the definition of a low-income household was less than 25 thousand dollars income per year.

MR. POAG: I do not have a definition. I do have some information that I will bring up later, that it regards Lifeline, and it shows that people can qualify for Lifeline when they make up to as much as 48 thousand dollars a year. So if you would, it would probably be better to respond to that a little bit later in the presentation.

MR. OCHSHORN: Yeah, that information is correct because some of the qualifying programs for Lifeline aren't necessarily based on income. For the most part they are, but some families can qualify with incomes well above the poverty level.

The other question that I had was how Sprint came up with the customer income data.

MR. POAG: The customer?

MR. OCHSHORN: Income information.

MR. POAG: Okay, I didn't -- You're talking about this?

MR. OCHSHORN: Right.

MR. POAG: Yeah, Sprint didn't come up with that. That is from a survey that was done by PENR and Associates.

MR. OCHSHORN: Okay. And --

MR. POAG: And I'm not -- I'm looking at the results of the survey. It's a nationally acknowledged survey. I don't know the details of exactly how it was done.

MR. OCHSHORN: It was done in 1998?

MR. POAG: I do not know.

MR. OCHSHORN: And did they get the income data from asking people on the telephone what their income was?

MR. POAG: I presume. It was a survey. It was a written survey.

MR. OCHSHORN: A written survey?

MR. POAG: Yeah. I believe it was, yes.

MR. OCHSHORN: How was it administered if it was a written survey?

MR. POAG: I don't know.

MR. OCHSHORN: Thank you.

COMMISSIONER JACOBS: A lot of the testimony we got, and I guess we have to look at the FCC numbers, but I just toss this out, seem to indicate as income levels went down, that was a much greater scrutiny in the household on subscription to these services, and I'm wondering how sound that average of 50% is. You know, it seemed to indicate that as income became more scarce in the household they monitored the long distance calls to a much greater level, and a lot of the elderly customers said they simply didn't subscribe to a lot of these services. I don't doubt that there is a large volume of customers in that income level who subscribe to those services, but I'm just wondering how the 50% across all households is.

MR. POAG: Yeah, I've got some Sprint-specific information, and there is a witness from General Telephone, I believe, that has some General Telephone-specific information, and staff also did a data request. And, Anne Marsh, I think you indicated in the data request that you got that 60% of customers generally subscribe to non-basic services.

MS. MARSH: It was 60% of Lifeline, but we don't know to what extent, what dollar amounts or what particular ones. It was just a question: What percentage of customers subscribe to ancillary services? We will be getting that information to the commissioners and to everyone shortly. We have just gotten the information, and there were some numbers we were going to be qualifying -- or clarifying, so that is why you haven't seen them yet, but that is what the number was.

COMMISSIONER JACOBS: Okay.

MR. POAG: Yeah, now I do have -- Now what I'm giving you here is basically Florida-specific data from the PNR and Associates, and this basically just shows subscription to the different features. Now to the extent that some of these customers have more than one feature, it won't tell you exactly what the overall take is or that -- you know, 38% could have call waiting and 23% could have call forwarding, and there be no duplication, which would suggest that you had a 61% take rate, which is about what she is saying overall they had, just for Lifeline, for Lifeline customers.

Let me go -- point out though that on the long distance side, 94% make long distance calls, I don't know whether that is 94% in a month or whether that is 94% in a year; but they do, you know, use long distance services. Again, that's inter and intrastate I feel certain.

Sprint-specific Lifeline customer data, 49.2% of our Lifeline customers subscribe to non-basic services. Now for those that -- the subscribers, that 49%, their average charges are $9.69. Now the predominant two features that they subscribe to were call waiting and caller ID. And the reason I bring that out is I think it's important to understand how a Lifeline household might use some of these services and that these services can have significant value.

Okay. If you -- I read all these papers and comments and everything, and I hear things about, well, you've got to have a phone to get a job and, you know, all these other things. By the same token, if you've got a phone and you've been on the phone and you've been trying to get a job and somebody calls you back and you are still on the phone and they can't get through to you, then you may not -- they may go down the list and call somebody else to offer that job to. These services can be very valuable to these folks. In the case of the low-income --

COMMISSIONER GARCIA: Would you like to lump in then caller ID or call waiting into basic service; is that what you're saying?

MR. POAG: No, sir, I won't do it for free.

COMMISSIONER GARCIA: I was surprised. I was going to snap up that offer.

MR. POAG: Yeah, I'm sure you were. But I guess what I'm saying though is that --

COMMISSIONER GARCIA: Let me ask you before you get off that. That 49.2%, is that call waiting and caller ID, or do you include, because you've used that non-basic services with several definitions. Does that non-basic services include long distance?

MR. POAG: No, sir.

COMMISSIONER GARCIA: No. In this case it's only these two features, the 49%?

MR. POAG: No, it's all features.

COMMISSIONER GARCIA: For these two features and other vertical services.

MR. POAG: It's all features.

COMMISSIONER GARCIA: All vertical services?

MR. POAG: Yeah, it's all features, excepting call blocking, which we don't charge for, and excepting touchtone.

MR. OCHSHORN: Does it include inside wiring?

MR. POAG: No.

MR. OCHSHORN: Okay.

MR. POAG: This is strictly the --

MR. OCHSHORN: The vertical services.

MR. POAG: -- regulated class and -- We refer to them -- internally we refer to them sometimes as network features as well.

Again, let me go back to my definition again. My definition of toll is intraLATA toll and access charges, and my non-basic is effectively the network services and other, what we've referred to historically as vertical or discretionary services, or network services, yeah.

But again, these can be very valuable services to low-income customers, and I think, again, call waiting can be in lieu of that extra line, and if you -- if you've ever been in a situation where you are intimidated by phone calls or have some concerns about who is calling you, then caller ID might be the answer to a lot of your concerns. By the same token, if you're not in the house, people sometimes won't necessarily leave a message on a voice mail system, but if you've been out job hunting and you come back in and you scan your caller ID calls and you find out that the company that you called about a job earlier called you back and you've got a notification on that caller ID unit that they called you, then you are going to get back to them and see if you can get that job.

COMMISSIONER DEASON: Mr. Poag, do you conclude that if these services are that valuable and those Lifeline customers subscribing spend on average of almost $10 a month for these services, that they value telephone service generally and would probably still subscribe to telephone service, even if they were not getting the Lifelire subsidy?

MR. POAG: Absolutely.

COMMISSIONER DEASON: So you are saying that the subsidy is really not -- for these customers, at least, it's not being used to increase the penetration in universal service because these customers probably would subscribe to telephone service anyway, even without the Lifeline subsidy; is that your conclusion, or should we -- What do you read into this?

MR. POAG: Well, when I build that into the other information that I have in the presentation that I haven't gotten to yet, my conclusion is that these folks will continue to subscribe to telephone service. I think that where we have lost people off the network has not been because of the charges for basic local service, but as we all know, it's been in the case of where they have not been able to manage the long distance charges and it's the long distance charges. Now we work with those folks today to keep them on the network if they will agree, for example, you know, to go with the call blocking.

COMMISSIONER GARCIA: And then unless you've had significant penetration in that area, customers you don't want to stay on the network or you don't give them options to stay on the network, you have competitors who provide services for them, phone services, certainly not at your rates, but at more expensive rates?

MR. POAG: That's true, yeah. That's a good point too. There are competitors out there who will come in and provide basically -- resell our service at a much higher rate to these same folks; so, yes, they will get back on the network somehow. Yeah, and I've got some actual subscribership levels for the low-income folks, which I'll get to a little bit later.

Okay. Basically what I'm saying here is that low-income customers are paying premium rates for toll and non-basic services, and the problem is that the current structure doesn't target the subsidies where needed. The scope of the subsidy is too large, we talked about that. And my question is, is the current structure fair and reasonable? And when I look at the data, I just -- it doesn't -- When we see the low-income customers that are paying premium prices for these services, I don't see that that is necessarily fair and reasonable; but we are talking about fair and reasonable, talk about -- go to the subsection 2, what we were asked to look at was cost, value of service, affordability and comparable rates.

Now I've already talked about cost. The next thing I want to talk about is value of service. With value of service -- The whole key to value of service in my mind is usage. And historically, if you go back to when we came up with these rate grouping plans, we essentially said that people that are in an area that have a limited number of access lines that they can call within their flat rate toll free area, will pay a lower rate than people who are in the larger areas and have a lot more access lines. Well, if you do traffic studies on these customers, you go out here and you study the small exchange and you study the large exchange, you will find that the usage in the small exchanges is significantly lower than it is in the larger exchanges. So the same thing, when you go to the business/residence relationships. And let me say when I'm talking about usage in the context that I'm talking about it now, I'm talking about total usage. I'm talking about usage for long distance. I'm talking about incoming usage. I'm talking about outgoing usage and a local usage, so I'm talking about total usages.

Go to the business/residence relationships. Business rates historically have been somewhere between two to 2.5 times as much as residence service rates. If you go back over history -- and when I say history, you go back before Internet -- and you'll find that when these rates were actually put in place for those types of structures, if you did the usage studies on them, you'd see down here in rate group 1 that business would have X-amount of usage. Up here in rate group 6, it would have more usage. And you'd find that the rate structure just kind of followed that level of usage. By the same token, you look at residence and the residence rate structure, the rates are about as half as much. The usage, similarly, was about half as much.

So when you are talking about the value of service, you buy it so you can use it, and so the demand for it is related to the usage. To the extent that the local calling area is part of that usage, and as I talked about, as you get into the higher rate groups, the more access lines you've got in your flat rate local calling area, the more you use the service. So the more we have extended the local calling area, the more we have increased the value of that service. By the same token, as far as the availability of complimentary or non-basic services, to the extent that we give people these other services, which will help them utilize the service, whether it be voice mail, whether it be call waiting, whether it be caller ID, whether it be call forwarding, it increases the value of the service. By the same token, the prices of those will affect the value of service. An analogy I used in my comments is that the price of gas, the price of parking, the availability of parking and these things become lower or more accessible, then the greater the value of owning an automobile to me. I think it's the same analogy with the telephone service.

Prices of -- Talking about the prices. Access to Internet. This one is a situation where not only is there such value to having access to the Internet, that that value is driving a lot of subscription to additional lines.

The other one is the prices of toll services, in some cases the prices of extended area calling. People have demonstrated that they are willing to pay more for, on a monthly recurring basis for extended local -- additional or extended local calling. Today long distance companies will, in fact, charge a recurring monthly rate; and if you pay that recurring monthly rate, then you get a discounted toll -- a discount on your toll usage. So basically what we're saying is that they are willing to pay more for the service as the price of the usage and the complimentary services go down.

COMMISSIONER JACOBS: What is your experience -- I guess it kind of goes back to Internet access as well -- in terms of line, access line growth? Are you finding that the demand comes from more dense areas versus less dense? I would expect more dense areas. And do you find business versus -- what do you find in business versus residential in terms of that line growth?

MR. POAG: Our line growth has changed rather, over the last several years significantly towards second lines. We have a substantial number of residence lines -- substantial number of lines going in today, and I don't remember. I think it's somewhere even around 50% are second lines.

COMMISSIONER JACOBS: Residential?

MR. POAG: Yes, sir. Also, we, generally speaking, are seeing fairly strong business growth.

COMMISSIONER JACOBS: On par, one pace of growth out exceeds the other?

MR. POAG: I'm not sure.

COMMISSIONER JACOBS: Okay.

COMMISSIONER GARCIA: Ben, is that second line growth simple line growth, or is it a complex service -- vertical and network services.

MR. POAG: I'm not sure. I have heard that, generally speaking, second lines have less features on them and less toll. What we are looking at there, generally speaking, is the teen line or the Internet access line.

COMMISSIONER GARCIA: Right.

MR. POAG: And there is not a lot of need for features or long distance on Internet lines. The same thing by the folks -- the same thing with people buying lines for the teenagers aren't necessarily inclined to put a lot of features on them, in some cases.

Just real briefly a look at the FCC data on what has happened to toll prices in 1984 to 1998. Just indicates that in real dollar terms they are down about 50 to 60%. Looking at Sprint long distance, data from our long distance company, they've indicated to me that they have reduced rates intrastate in Florida on a per minute basis in '94 to '95, 6.6%; '95 to '96 4.9%; and '96 to '97 of 9.5%. So we are seeing competition working in that long distance market in bringing prices down.

COMMISSIONER DEASON: Ben, these prices, are they -- is it a cents per minute of usage, is that the way it's calculated?

MR. POAG: Yes, sir.

COMMISSIONER DEASON: How do you determine these prices?

MR. POAG: Yeah, basically, you have

difficulty -- Because you have so many plans out there, what you have to look at is the average revenue per minute, look at all the revenues and all of the usage and then just divide it by total minutes.

COMMISSIONER DEASON: Do you factor in the 3.50 SLC charge as being toll revenue.

MR. POAG: No, sir that is not included in this.

COMMISSIONER DEASON: But that's what that -- people are told that is what that is for, right? I mean that is access to be able to make an interstate call, correct?

MR. POAG: Well --

COMMISSIONER DEASON: So, and there have been costs that have been, that are being recovered now through a 3.50 charge on customers as opposed to costs being recovered on a per minute of usage, and my question is: What would happen to this, the shape of this curve? If you factored in the 3.50 in with the per-minute cost, would you have it as a dramatic reduction in toll cost? Do you understand the question?

MR. POAG: Yes, sir, I understand the question. I would phrase the application of the 3.50 differently, and I think that's where we got into a lot of unnecessary criticism with our customers because of what we -- the way it has been explained. My understanding of it is that the interstate jurisdiction basically takes responsibility for an allocation or recovery --

COMMISSIONER DEASON: Hold on. I understand that, and it's basically where costs are and how you recover those costs and how costs have been recovered historically; but what you were doing, is you were doing a historical comparison. And we know that in 1984 that there were costs that were being recovered at that time that were basically costs being recovered through minutes of use. Now whether that was a good thing or a bad thing, I'm not arguing that. But that was in that price, and that's why that price started out at the index level of a hundred in 1984. And one of the reasons that price has been able to go down though is there has been a change in the method of recovery of costs allocated between jurisdictions, et cetera. And that to have a proper comparison of costs or prices now back to 1984, it seems to me you need to factor in the impact of that method of switching cost recovery. Do you understand?

MR. POAG: Yes, sir, I understand, and I do not disagree with you. I pull this right out of the FCC reference book, and I do not believe that the 3.50 has been factored into it; and I do understand what you're saying. I will say this, that if you put the 3.50 in there, I would agree that the declines would be less; but I would say that with the increasing volumes of traffic that we've seen that you would still see a significant decrease in revenue per minute, yeah.

Okay. Talk about -- when we talk about affordability, I think there are basically three primary inputs. There may be more, but the three that I'm going to deal with are value of service, income and price. Now I've already talked about value of service.

I do want to talk for a minute though about how do you measure affordability, and I think the only thing that is out there that I'm aware of that would really measure it on an empirical basis would be the demand or households with service. And we take a look at penetration levels or subscribership in the southeast, and I will point out that what I'm using here is the BellSouth states in the southeast excluding Kentucky. The reason I excluded Kentucky is that I'm also using some income data, and I didn't have income data available for Kentucky on a state basis. So anyway, I left them out of my analysis, but that is the only reason.

But when I start looking at penetration levels or affordability of telephone service, and this is 1997 data. This is reported by the FCC, we see that Florida is 94%. And you come across the scale, or across the chart, and they are all within one percent, except for Tennessee.

Tennessee is about 96.4%. And so when we look at Florida and we look at the other states, we don't see any big difference in the demand for service. But let's look at one other thing, and that's your income in Florida. If you look at income in Florida, you see that we are at 24 thousand per capita, higher than all of the other states. Looking at Social Security payments. See, again, that Florida in terms of Social Security recipients, it's on average as higher Social Security receipts.

COMMISSIONER GARCIA: Is that based on population, per head?

MR. POAG: That's per head.

COMMISSIONER GARCIA: Divided by the population or just by the Social Security recipients?

MR. POAG: Social Security recipients. This information is out of the Florida Statistical Abstract.

Looking at ranked nationally with one being the highest and I'm not sure who that was, New York or California, but we see that Florida ranks 20th in terms of per capita income. Again, going across the other states in the Southeastern Sunbelt area 26, 32. Mississippi at the tail end with number 50 in terms of per capita income rank.

Look at disposable personal income. Again, it's the same story, Florida is far and away ahead of the other companies in terms of financial economic ability to pay.

Now look at residence one-party, flat-rate service with touchtone throughout these same states. Alabama, their highest rate is $16.30, and some of this stuff I know that you all have seen and you've got it in your own chart, and I won't spend too much time on it, but I do want to make a couple of points. Talk about the average though, the average is 16.01, and the difference being is that the 16.30 would be in the highest rate group and then having some slower rate groups; but when you take all of the revenues and add them together and divide by the residential access line, you get an average. And I think it's important to show what that is.

Coming across the states, Georgia, 17.45 their highest. Louisiana is 12.33 and 12.64. Mississippi is $19.01. Now these do not include the subscriber line charge. You would have to add the 3.50 on to this to get the total charges for these services.

Tennessee has a separate touchtone charge. I've added that in at a buck 50. The other states the touchtone is included. Come across and you get an average of $14.64 for these states 15.62 on the highest.

Sprint's rates, our average rate is $9.65. Our highest rate is $11.23 with touchtone. We are about $5 per residential access line less than the average of the other states. Now what has this done for Florida?

MR. BECK: Ben, could I ask you a question? Do you see the comments filed by Ben Ochshorn that showed that business rates in Florida are less than the other southeast states as well? I just wondered how you would explain that.

MR. POAG: That they're -- I'm sorry, that what?

MR. BECK: That the Florida business rates are less on average than the southeast as well, so we have both lower residential and business rates. Why is that?

MR. POAG: Charlie, I just got his mater.al. In fact, I didn't get that until last night, and I haven't been all the way through it, but I was looking at some of the rates in there, and I noticed that the rates were referenced to the FCC report; but I couldn't track those back to the FCC report.

Okay, what I did find is that he had quoted a California rate in there of $11.25, but that $11.25 California rate is the rate that is offered by Pac Bell, and that is a flat measured service offering. It's not a flat rate service offering.

MR. OCHSHORN: Where the rates came from was the report, but it is in some of the appendices. They are available in Sprint's spread sheet form. The report itself simply reports the averages, as you know, and then the different appendices.

MR. POAG: Well, you need to be careful with that data because like you were showing an 11.25 rate there in California, that is 11.25 rate has a 12-mile limit on the calling radius, okay? So that is not a comparable rate with what we have got in Florida for local calling areas.

MR. OCHSHORN: Well, according to the FCC report, it was for unlimited basic service.

MR. POAG: Within a 12-mile area.

MR. OCHSHORN: That is not what the FCC report --

MR. POAG: I will provide you the information.

MR. OCHSHORN: That would be a good idea.

MR. POAG: Yeah. What has this done for us in Florida? And if you look at Florida back in 1988, and the reason that I stumbled onto this slide was that back in 1989 I made a presentation somewhat similar to the one that I'm doing today in terms of the rates in the other states, but those rates in those other states, back in 1989 averaged $14.85; and I've still got the chart from that prior rate case. But if you look at Florida, from 1988 to 1997, you don't see a heck of a lot of change in the subscribership. Now actually it's down a half a percent. This is sampling, and it could be basically statistical error, so it's not something that, you know, I jump up and get too concerned about. We need to look at it overtime.

This is a 1997 annual average number.

Look at Alabama, again, with rates that were much higher throughout this time period than in Florida, and their subscribership level has gone from 89.6% to 93.6%.

COMMISSIONER GARCIA: What conclusion are you drawing from this, that if we charge more, more people would get the phone?

MR. POAG: I'm saying that if you charge more you certainly will not lose subscribership, particularly if you offset the charges in one service with decreases in another service; and that service, for example, long distance, adds value.

MR. OCHSHORN: Mr. Poag, did you do research on changes in state median income over that ten-year period?

MR. POAG: Did I do median income changes?

MR. OCHSHORN: Right, I mean the main determinant of subscribership generally is income, and so I was curious whether you'd done research on changes in income in those states over that time period.

MR. POAG: I have not. I think Mr. Harris has some information on that in his comments, Doctor Harris.

MR. OCHSHORN: Okay. I think that would be pretty relevant to subscribership.

MR. POAG: I don't disagree with you that it might be relevant, but I would also suggest to you that it's pretty relevant that their rates have been 20 to 30% higher than in Florida and they've got about the same subscribership level. I don't care about their income. And their income is not higher than Florida.

COMMISSIONER JACOBS: Do we have any information on Lifeline subscribership in these states?

MR. POAG: Yes, sir. I don't have it with me. I don't have it with me, but I do have it. I can't tell you specifically what each state -- I can basically tell you what the ranges were, and I can talk about that.

I will tell you that Louisiana did not have Lifeline until 1998. Both Louisiana and Mississippi do have measured service offerings that have fairly high levels of subscription. Louisiana has about a 22% take rate on their measured service option. Mississippi has about a 51% take rate. But I will tell you that the take rate in Mississippi -- excuse me, with the 51% take rate on measured service in Mississippi, the charge for their measured service in Mississippi is about the same as Sprint's flat rate charges in Florida.

MR. DUNKEL: I have a simple question. The FCC reports -- My name William Dunkel. The FCC reports two different percent penetration figures. One is the unit penetration, which means you have a telephone in your home; and the other is availability, which means you can go to a neighbor's house and use a telephone. You are using the term available. Which of those two measures are you using?

MR. POAG: I'm using the available.

MR. DUNKEL: So this is not the percent of people with telephone service, but this includes those who can go to a neighbor and use their phone?

MR. POAG: Well, they can go to a neighbor, or they may have one in the hallway. If it's a dorm, maybe somebody else in the dorm has one. I presume, and correctly or incorrectly, that a large proportion of those that had it available would not subscribe because it was available. There is not a significant difference in the two. I think there is 1 or 2%, and there may be more than that by some states; but the difference between actually in the home and available is actually 1 or 2%, I believe.

MR. DUNKEL: Well, there is a difference, and most people usually track -- when they are talking about subscribership, they track how many people or what percent have telephone service in the unit.

MR. POAG: Well, the FCC prints both of them.

MR. DUNKEL: That's correct.

MR. POAG: Yeah. They are about that far (indicates) apart on the page, if I remember.

COMMISSIONER JACOBS: Has anybody looked at, compared those two slides of, i.e., change in rates versus change in subscribership? I guess that is what you are telling us, is that while there have been moderate changes in rates in those states there have been significant increases in subscribership levels; is that in essence what we are coming away with?

MR. POAG: Well, actually, I don't think the rates have increased in those states since 1989, or there haven't significant changes in the rates up or down.

COMMISSIONER JACOBS: Right.

MR. POAG: Because they had those higher rates back in 1989. Their rates were at these approximate same levels at that time frame. And basically what we are seeing is that even though they had those higher rates, their subscription levels or take -- or percent of households with service available is about the same as in Florida. The exception being that in North Carolina you've got a little bit higher and in Tennessee, 2.4% higher.

Now I will tell you this: Tennessee, according to the Sprint Long Distance Company, is where I could get the data, has lower long distance rates than these other states.

COMMISSIONER DEASON: You're talking about intrastate long distance rates are lower in Tennessee than in Florida?

MR. POAG: Yes, sir. Yes, sir, intrastate long distance, right.

COMMISSIONER DEASON: How does their local calling scopes compare to Florida?

MR. POAG: Generally speaking, the local calling scopes are not going -- I haven't looked specifically, but generally speaking, when I was collecting data, one of the things that I asked for was that they provide me with a number of access lines in the local calling area. What I found was is that it got to be kind of difficult because of independent companies and things like that, so I didn't get real reliable data, so I didn't try to use it. But generally speaking, their local calling areas are smaller than the local calling areas in Florida.

Trying to put all of these things together and bringing the United States into it or the national average, the national average rate for residential local service is $13.94; per capita income on the national basis, 22 thousand; subscribership of service -- I tried to keep with Mr. Dunkel's point; I tried to remember to put "available" up on most of my charts to make that clarification, I guess I didn't on this one -- but 95%. Look at the southeast Sunbelt states, the average 14.64; 20k per capita income; 94% subscribership. Florida, Sprint's local service rates, BellSouth, General Telephone, all of them lower than the southeast, the national average, higher per capita income, about the same subscribership level. The basic premise is that the rates in Florida can be increased, be affordable and not impact subscribership.

COMMISSIONER GARCIA: Couldn't you also draw the same corollary that the rate -- that this is an inflexible service that is necessary for people; therefore, you are going to have that penetration rate regardless of a fluctuation in the price.

MR. POAG: Well, it's basically, yes, it's an inelastic service; but what I'm really saying is that if you change the price of the local service but you reduce the price of other services, reducing the price of other services, may add more value such that you could actually increase penetration even though, if you did just a price increase alone, you would have some people that would discontinue service.

COMMISSIONER JACOBS: Does the other data argue at least neutral to that, perhaps even against that proposition? Because in those other states they had those rates, those high rates over time.

MR. POAG: Yeah, it -- Well, I don't know that it argues against it. It sort of suggests that they are just not going to drop off.

COMMISSIONER JACOBS: Right. It's neutral.

MR. POAG: Or that there is not going to be any significant impact. I can't stand here and say that there won't be any impact. I mean, obviously, I believe in the price elasticity theory even though I probably couldn't explain it very well.

COMMISSIONER DEASON: What about, your availability or your subscribership, what is that? Is it availability?

MR. POAG: Yes, sir, it's availability. I can give you the households with service too, and I don't remember the numbers off the top of my head, but it would be 1 or 2% difference from what the numbers I'm showing you are. And I'm kind of -- Somebody asked --

COMMISSIONER DEASON: That's okay. I guess my, the real question I have concerns, is there any data concerning the fact that there are probably now households with multiple lines such that one measure of penetration would actually be over a hundred percent? If you take in the number of lines that are actually in service and divide that by the number of households you probably would have an index over a hun -- conceivably over a hundred because there are so many people that have two access lines per household.

MR. POAG: Yes, sir, that is exactly correct; and that, in fact, is what happened. Before the FCC started using this reporting method, they were using the method that you are talking about; and what happened is they actually got to where they were showing, yeah, we had a hundred percent penetration or we had 105% penetration because you had more access lines than households as a result of the second line. That's when they went to the method of including the penetration -- the determination of penetration through the census bureau.

COMMISSIONER DEASON: Well, for those customers -- would you agree though that for those customers that have more than one access line, that that second line, that there is more flexibility there and that if rates get too high, then those lines would probably drop off? Now I know that wouldn't affect your measure of subscribership or whatever, but that would have an effect upon revenues to the company for those second lines, would it not?

MR. POAG: Yes, sir. Yeah, I would very definitely agree with that.

COMMISSIONER DEASON: You're not proposing a different rate between the first and second line, are you? I know that -- Ignoring access and what the FCC is doing. I'm talking about for Florida you're saying there needs to be an increase and that it needs to be the same increase regardless of whether it's a first or second line.

MR. POAG: Yeah, if there are -- if we can show that there may be some other marketing or cost-based reasons of why there ought to be a difference, then it might be different. It might be just a marketing tool. I know that some of the cable folks are marketing a second line with not a lot more additional charge for that.

COMMISSIONER DEASON: Does the second line, incremental cost of a second line vary from incremental cost of providing a first line to a new residence?

MR. POAG: It depends on how you -- the assumptions that you put into your cost study, quite frankly. Generally speaking, there is not a significant difference in the two. If there is a difference in the two, it would probably have more to do with the drop in the network access -- or the network interface device on the side of the house.

COMMISSIONER DEASON: So it's conceivable that a second line to an existing residence that already has telephone service, that that incremental cost could be less than providing a new line to a newly constructed home.

MR. POAG: Yes, sir, and I'm going to say that as a qualified yes. And, again, I'm going to say that it depends on what assumptions you put into the study of the first line and what kind of a fill factor analysis you made when you were determining what that drop and what that NID would be used for.

COMMISSIONER DEASON: But you don't think there would be a significant difference?

MR. POAG: No, sir. Mr. Dickerson would probably be the better person to address that question to.

MR. BECK: Ben, I thought I heard you suggest that the higher local rates in other southeastern states is offset by the value for other services. Was I right on that? Because I was looking for a comparison of --

MR. POAG: When I was talking to Mr. Garcia, I wasn't referring to the other states. I was referring to Florida.

MR. BECK: Have you done a comparison of vertical service prices in other southeastern states to Florida.

MR. POAG: Not a detailed analysis, no. I have looked at some of the tariffs, but I haven't done a detailed analysis.

MR. BECK: Sprint says that the custom calling service and so forth are very high margin services; is that right?

MR. POAG: Yes, sir.

MR. BECK: And you've had certain flexibility in pricing those services since 1995?

MR. POAG: Yes, sir.

MR. BECK: You've generally increased the prices for those services since '95, haven't you?

MR. POAG: Yes, sir.

MR. BECK: Why is that?

MR. POAG: To generate revenues.

MR. BECK: Thank you.

MR. FRANK: Mr. Poag, my name is David Frank. I represent AARP.

MR. POAG: Yes, sir.

MR. FRANK: Just a real quick question. Your presentation on affordability seems to focus on penetration, but isn't it true that the legislature is looking at more than that? In other words, they are not just worried will people -- if you raise the rate, will people drop their phones? Aren't they also looking at fairness? Isn't fair one of the components of the study? Which data would you point to, or how is Sprint looking at the fairness analysis?

MR. POAG: Well, I tell you what, I've got some slides coming up on that. Do you mind if I just kind of go into that, okay? I think the --

MR. FRANK: Yeah, thank you.

MR. POAG: Okay. Yeah, in fact, I kind of lost my place. Not yet. I've got to go one more thing first, okay? But you could think about this as being fair, okay, because, if we look at the affordability issue, in 1978 in the Apopka exchange, that was the old Florida Telephone

Company at that time. But the individual line rate was $14.85. We had two-party service that was available for $11.65, and at that time the CPI, all goods and services, I believe, was 67.1 in October of '78. Now I -- This 14.85 included inside wire. It included your telephone set, and there was no additional charge for directory assistance. So what I did was I backed out the value of those from that 14.85 based on prices I had back at that time for the set and the inside wire maintenance when it first came on line; and then for the DA, I took average DA charges today per customer and backed that out. But when I make those adjust for inside wire, CPE, and directory assistance, the phone we come up with a CPI adjusted rate for the Apopka change of $32.13. And you say, well, wait a minute. Well, they had the option to go two party. Well, even if you look at the two-party line, in real dollar terms, at that time that was equivalent to $24.34.

So if that was a fair rate at that time, or an affordable rate, or a reasonable rate at that time in terms of the income, okay, you know, what is a fair and reasonable rate today? And the current rate, again, my 13.73, and that doesn't have the touchtone in it because that didn't have touchtone in it; but we're basically saying that in real dollar terms that that service is somewhere between 10 and $18 less today than it was in

1978. So we've basically seen the price of telephone service in real dollar terms substantially decrease.

For all practical purposes, we have not had any price increases in local telephone rates in Florida for 15 or 20 years. There are some minor exceptions.

COMMISSIONER DEASON: Mr. Poag, well, what about the -- I know you are using CPI -- what about the -- Ignore that measure. What about the cost of providing telephone service between 1978 and 1998? What index would that show?

MR. POAG: I don't know what that would be, and are you going to the point that the cost is less today?

COMMISSIONER DEASON: Well, I don't know. I mean you are using CPI. My question is, what would it show if you had cost data in '78 and compared that to today's 1998 cost, what would be the difference, or would it actually be a negative number as opposed to a positive?

MR. POAG: Yeah, I really do not know. I haven't looked at that that recently, and maybe I can research it and find out. But historically, over the years, the investment per access line has been, I believe, around about a couple of thousand dollars; and I don't know that -- The incremental investment each year, you take your capital investments each year and divide by the gain and access lines. I don't think that number has changed significantly. Now it doesn't get to expenses, but the point is there is still significant investments today per access line.

COMMISSIONER DEASON: But it's still about two thousand dollars?

MR. POAG: Subject to --

COMMISSIONER DEASON: On average?

MR. POAG: Let me check that. I mean I haven't looked at those numbers in probably a year or more.

COMMISSIONER DEASON: But everything else, according to CPI, has increased substantially, but the cost of providing telephone service, at least as opposed to initial investment per additional access line, has held steady?

MR. POAG: Steady or maybe declining some, yeah.

The affordability conclusions, if you look at Florida income versus the other states, look at the rates in the other states, the southeast and the nation, look at subscribership levels, look at historical rates, look at increases in the value of service, my personal opinion is that the affordable rate is something greater than 20 bucks; and I'll qualify that. I'll say for medium- and high-income customers.

COMMISSIONER GARCIA: That would obviously be with corresponding reductions to other services as you stipulated throughout your presentation?

MR. POAG: Yes, sir.

Now if 20 dollars is affordable for the medium high income, you know, what is a fair and reasonable recommendation, or what is a fair and reasonable recommendation for the non-Lifeline customers? And I would say -- and this is just a straw man. Nobody has, you know, suggested what that number ought to be, but I think going to the -- what is fair and what is reasonable, historically in Florida, we have phased in rate changes, and I'm suggesting that we phase in some rate changes over three years at a maximum of two dollars per year, okay? I would say that a fair, a fair rate would be the average, the average, not the highest rate, of what is in these other states, or about 15 or $16; and if we do it at two dollars a year, we'll get there in the year 2003. Now that is assuming that we have something that happens in the next legislature, and that towards the end of 1999 or the first of the year 2000 some action is taken.

After 2003, allow pricing flexibility of up to 6% a year up to an affordable level. Monitor your subscription levels. What is deemed to be above an affordable level, establish universal service for high cost and low income. Reduce rates for toll and non-basic services on a revenue-neutral basis, your point.

COMMISSIONER JACOBS: Earlier you had indicated perhaps that subsidies were misplaced or structured incorrectly. Is that -- that last statement there, is that the remedy you would propose to rectify that, or are you anticipating that subsidies will continue to exist?

MR. POAG: Yeah, I think under this plan you begin to phase out some of the subsidies. What I'm suggesting is that there are a lot of customers that are out there today that are paying on average the $14.23 that can well afford -- you know, they are paying, you know, 30 bucks a month for cable TV, they are paying $50 or $60 or $70 for a wireless telephone, then why should they be subsidized for their basic service?

COMMISSIONER JACOBS: So, basically, your recommendation would be to basically phase them out?

MR. POAG: Yes, sir.

MR. OCHSHORN: Mr. Poag, I have a few questions about this. These recommendations that you're making, are you making them on behalf of Sprint?

MR. POAG: Yes, these are not recommendations by any other company. I'm not representing any other company in this.

MR. OCHSHORN: Okay. But what I'm getting at is, they are the position of your company as opposed to your own views?

MR. POAG: Yes. Yes.

MR. OCHSHORN: And these --

MR. POAG: I mean this is a straw-man position, yeah. Actually we probably have another position that would be a little stronger than this.

MR. OCHSHORN: Right. I --

MR. POAG: But this is a very fair and a very reasonable position.

MR. OCHSHORN: Right. I understand this is this week's position.

Another question I had was, are these recommendations based on the factors that you've discussed this morning, that is, affordability, value of service, or do they also take into account cost?

MR. POAG: Well, these are primarily not just based on -- it does take into consideration cost, but it's primarily driven by what is affordable and what the value of the service is.

MR. OCHSHORN: Okay.

MR. POAG: Yeah. I mean now if the cost were a lower number, then we wouldn't -- if the cost were a lot lower number, we wouldn't be here probably making these kind of recommendations.

MR. OCHSHORN: Okay. And your cost is based on allocating the local loop cost primarily to basic service, correct?

MR. POAG: Well, the costs are the cost. The cost of the local basic service, is the cost of basic service. It's not allocated.

MR. OCHSHORN: Well, yeah, but the way that your company is figuring cost is allocating most of the cost of the local network to basic services as opposed to vertical services or intraLATA or whatever.

MR. POAG: Just those components that are necessary to provide the residential basic service.

MR. OCHSHORN: Okay. And a last question that I have is, is Sprint arguing that phone rates for basic service should be based on subscribers' income?

MR. POAG: No. Generally, no. We are suggesting that for -- and I haven't talked about the Lifeline portion of the presentation yet, okay?

MR. OCHSHORN: Right.

MR. POAG. I've got a section on Lifeline that I want to talk, and so we haven't gotten to that. So, yes, there is a recommendation regarding a Lifeline customer, that there be different rates.

MR. OCHSHORN: Right. The reason I asked that is you made a number of arguments that people's income has gone up over the last 20 years.

MR. POAG: Those were facts. Those weren't arguments.

MR. OCHSHORN: Well, I meant that in a lawyer sense.

MR. POAG: I know you did.

MR. OCHSHORN: That is what you are basing your case on. And then you also mention in terms of justifying both your allocation of cost in the local loop and Sprint's overall position that there is an unfairness because some people with more money are paying less while other people who earn less are paying more. Is that the basic equitable justification that Sprint puts forward for raising basic rates?

MR. POAG: Yeah. Well, you know, when I first started out, I put six problems up there. Now you've identified one of them. Okay, there are five more, and they are in the handout.

COMMISSIONER GARCIA: Let me go through your straw man real quick. Three-year maximum, $2 per year, who determines that? Is it just $2 per year and then the last year when you get to -- the last figure would get to the 15, or would you have the Commission do that, monitor that $2 or in-between figure for a three-year period? Would you have the Commission implement that, or how would you do that? I understand what you're saying.

MR. POAG: I guess my position on it is that the question--

COMMISSIONER GARCIA: It's two dollars, $2 and then the last year, whatever --

MR. POAG: Right, whatever it gets to take you to 15.

COMMISSIONER GARCIA: You wouldn't require the Commission to do that. Then where it says, "Up to an affordable level," obviously you've determined an affordable level is $20. That would mean that on year 2003 you would then take a 6% increase until you reach $20, or by 2003 your affordable level would have climbed so it would be your determination of affordable, or would this Commission do a study on what is affordable in 2003 and then determine that 6%, or that 6% would be left to your discretion to do as a --

MR. POAG: No, this Commission would determine the affordable level, and they would do that as part of the universal service, as part of a universal proceeding.

COMMISSIONER GARCIA: 6% on the yearly increase?

MR. POAG: No, they would, they would -- Forget the 6%. Keep in mind --

COMMISSIONER GARCIA: No, I understand the universal service, let's leave that out of it. We are talking about an increase of, at your rate, of almost $68 after -- on a yearly level when you get to 2003 at $2 a year for three years on a yearly basis; but what I'm talking about -- and that's going to, obviously, differ because the last year won't be the full amount. But you're saying that after 2003 allow pricing flexibility up to 6%. When you say allow pricing flexibility, is that allow pricing flexibility to the company to determine what is affordable, or this Commission would make a study on what is affordable and you would try to approach that at 6% increments until you reached affordable?

MR. POAG: Yes, sir.

COMMISSIONER GARCIA: Okay.

MR. POAG: Let me give you an example in here. Okay, today we are a combination of the former Centel and the former United Companies. We've got one rate schedule for the United customers. We've got another rate schedule for the Centel customers. I would like to have some flexibility to move those rate schedules more in line with each other, okay, just for administrative purposes.

Now what you are going to find too is that --

COMMISSIONER GARCIA: For administrative purposes. Would you think about that we should fold in, for example, your touchtone into your basic service now that we are looking at this as an issue and just increase it at basic rate on that touchtone issue?

MR. POAG: Yeah, I have no problem with rolling that in. Yeah, the only reason it's still a separate charge for us is because we didn't have a proceeding before this Commission at the time the trend was to start rolling it in, okay?

COMMISSIONER JACOBS: Do you have any information which reveals to what extent your service territory is changing with regard to density?

MR. POAG: No, sir. It's clearly getting more dense, and I think that's where you are seeing some of the -- some of the cost declining, is the fact that the more dense it is, the more efficient it is to provide the services.

COMMISSIONER JACOBS: Okay. How will we factor that into this, into this rate schedule?

MR. POAG: I don't think that you should factor that into the rate schedule. I think that what you really -- what you really want to do is let the market begin to determine what the rates will be. Now what I'm saying is that, yes, we haven't developed that competition yet, and we are not going to develop it in the a lot of areas if we don't do something on the prices. But if you put in motion the fact that over time you are going to allow prices for residential services in these other areas to increase, then the competitors, if they know that is going to happen, can then begin to think about serving those markets. And to the extent that they begin to think about serving those markets, you will begin to see more competition in those markets, and the competition then needs to be able to determine what the prices will be; and yes, competition will drive prices down, but competition won't drive prices down when they are already below cost.

COMMISSIONER JACOBS: Is there an artificial price point here? Because you started off at a figure that may be shifting. You started off with a $20 figure which we assumed to be --

MR. POAG: Yeah. Yes, sir, I'm sorry. I'm just basically saying that as far as the affordability, what you can do without impacting subscribership, is it's a $20 plus number. It's a $20 plus number, if you do these other things.

COMMISSIONER JACOBS: I buy that.

MR. POAG: And the evidence from the other states proves that.

COMMISSIONER JACOBS: Let's say I buy wholeheartedly that --

MR. POAG: Thank you. Where is my bag? I'm out of here.

COMMISSIONER JACOBS: Let's say I buy wholeheartedly that $20 is an affordable figure, that 90% of the people in Florida can pay that figure, okay? But the point is, we are trying to drive this market towards competition.

MR. POAG: Yes, sir.

COMMISSIONER JACOBS: And if we continue to look at affordability and not try and factor in where costs are headed, or do we have an accurate price?

MR. POAG: Okay. All right, I see where you are going now. All right. Okay. And this is only -- Okay, this, this -- And this is only part of it. The other piece of it is down here, okay? You are going to do the cost for the universal service, and if you really want to see the competition come to these low-dense, high-cost areas, then you are going to have to put an explicit fund out there and make it available to all potential competitors in that marketplace, and that's what's going -- You can't -- This by itself isn't going to get you where you want to be with fostering competition. And I heard somebody -- I think Ed Paschall at one of the hearings said, well, you haven't got competition in these other states. Well, you don't a universal service fund in those other states either. And the cost in those other states are still higher than the rates they've got in place out there.

COMMISSIONER GARCIA: I want to go to your last points, reduce rates for access, toll and non-basic services. You're talking about on a revenue-neutral basis, so for every $2 we see an increase, we are going to see a corollary corresponding decrease to other customer -- to other customers for those $2?

MR. POAG: Yes, sir. Now, obviously, that's my position. We've got to go through the legislation and all that kind of stuff; but, yes.

COMMISSIONER GARCIA: But you would probably want us to advocate this. If it's in there, and if you were talking about this kind of increase, you are saying that this should be revenue neutral. So what you're saying is that that subsidy that is being collected on one side, we are going to redistribute it and will simply go somewhere else, but it will still be -- it will be a pass-through, it won't be a revenue. And would you think that that should be a pass-through on an equal basis, or should you be able to as a pass-through to business to meet competition, or should it be revenue neutral to all classes?

MR. POAG: No, I think it needs to be a commitment to do a pass-through. When we start talking about doing non-basic services, non-basic services are the predominant supplier -- or subscriber to non-basic services, the caller IDs and the call waiting are the residential customers, okay?

COMMISSIONER GARCIA: And I would assume that when you -- And intraLATA rates?

MR. POAG: Yes, sir.

COMMISSIONER GARCIA: Reduction.

MR. POAG: Yeah, and talk about access and toll, your business customers, especially your big business customers, are the ones that are putting in the dedicated facilities, and they are bypassing a lot of the access charges already, okay?

COMMISSIONER DEASON: Should there be verification of the revenue neutrality?

MR. POAG: Yes, sir.

COMMISSIONER GARCIA: And I assume this Commission would handle those proceedings.

MR. POAG: Yes, sir, unless you just want me to do it.

COMMISSIONER DEASON: What about -- how do you calculate in your revenue neutrality analysis, how do you calculate in the fact that there is probably going to be stimulation as a result of reducing non-basic services? For example, if you reduce -- by increasing basic service $2 a month, it's your position that is going to have none or very little impact on your penetration rates, but when you --

MR. POAG: I would agree with you on that.

COMMISSIONER DEASON: Okay. Now but when you reduce -- when you reduce a non-basic service, for example, call waiting, do you factor in the fact that by having a reduced rate there is going to be more people subscribing to that and your revenue -- While you reduce the rate for those customers who already have it, sure that's a hit, but then probably there is going to be customers to subscribe to that who formerly did not subscribe because of the rate. Do you factor in that revenue enhancement in your neutrality analysis?

MR. POAG: There could be some adjustment for that. I will say this too though, okay, that already to the extent that you are going to reduce the prices of two services that are growing faster than your access line service, you are going to take care of some of that in that. Okay, the other thing is that you are still looking at the customer's total bill, and if you are increasing this, then they may decide that they are going to get rid of the call waiting; so you've got to look at it from basically a total bill perspective. But I don't disagree -- I don't know what that would be. If it's a reasonable number, you know, clearly something that we can deal with; but I think if you are going to take that into consideration, then you ought to look at, you know, what you are going to lose on the growth as well.

MR. BECK: Ben, could I ask you, on your straw man proposal, the 15.62 average that you are looking at --

MR. POAG: Yes, sir.

MR. BECK: -- we looked at the other states in the southeast that are higher than that average, like Mississippi at 17.95 and Alabama at 16.30. Are they having increased residential competition because of those higher rates?

MR. POAG: I don't know. I had heard someone indicate that they hadn't, and I addressed that a few minutes ago.

MR. BECK: About Ed Paschall's comment?

MR. POAG: Basically -- Yes. Basically, those other states have higher costs than Florida, okay? Now to the extent that there is not a universal service fund out there yet, okay, that's a factor that may be impeding competition, okay, because you don't have that implicit universal service out there, which is going to draw these folks to the high-cost area. Do they have competition? Yes. Do they have more than Florida? I don't know.

MR. BECK: Is there some witness from local companies that is going to address that, whether those higher rates have spurred competition?

MR. POAG: I don't know if anybody addresses that or not.

MR. BECK: Let me ask you one other question about your straw-man proposal. You do not include a proposal to reduce business rates in your proposal. Why is that?

MR. POAG: I hadn't thought about it, to tell you the truth; but beyond that, I would say that, yes, there are some business rates that need to be reduced, and that's primarily probably in the PBX rates. And let me -- Just let me finish, Charlie, before you go away, okay? In our situation, in our situation, not only are our residential local service rates very low, some of our business rates, single line business rates are also very low and I don't see, given the cost data that we have on them, that there would be any significant cost reductions in them. Where I might see some cost reductions is in the PBX trunks and in the business rotary. I don't think I would see anything in any of the CENTREX rates. Those rates are fairly competitive and fairly low. So, yes, for those two categories of services which make up a relatively small percentage of the total access lines, I'd see some reductions.

I forgot where I am. Okay, what are the reasonable rates for low-income customers, i.e., those that qualify for Lifeline service? I would just like to review Lifeline services for just a few minutes. I knew you wouldn't be able to read this, so in the handouts, there are copies of this that are at the back of the handouts, but basically just want to mention that there are six programs in Florida: The Medicaid, Temporary Aid to Needy Families, Supplemental Social Security income, Food Stamps, low-income home energy, and federal public housing.

Now I believe -- going back, I believe a Supplemental Social Security income or one of the other ones is available at up to 130% of the poverty level. Where is it up there? Okay, excuse me, Food Stamps, but you go up to 130% of the poverty level, so let's take a look at what that means in terms of income, and these are the federal poverty guidelines for 1998 looking at a family unit size of one through eight. We see that the federal poverty level is 8 to 27 thousand, and I have just added 30% to get to that, and that shows that to be eligible for Food Stamps which makes you eligible for Lifeline, you can have income as an individual of $10,465; or if you a household of eight up to $35,000.

Looking at the housing assistance program, the federal housing assistance program. You have two basic plans here. One is what they call the very low income, and these are folks that, as I understand it, make less than 50% of the median income in the household, and they are eligible then for free rent and assistance on their utilities. Now on the other side is what they call just the low income, and these are folks -- and these guidelines, by the way, they do make adjustments for special circumstances, so I'm giving you just the order of magnitude. But in this category, they make up to 80 percent of the median income in the area, and these things are kind of like area specific. But, basically, in that situation, a one-person household of 25,700 or up to 48,450 can qualify for Lifeline service.

Now the next slide. We look at what low-income household subscribership is throughout the United States, and this is not just Lifeline customers, this is just what is classified as low income -- or what I'm classifying as low income, my definition here is from the FCC driven numbers of less than five thousand dollars. You see that we've got an 80.8% take rate. Five thousand to 75 hundred dollars, 85.9% penetration level, and 75 hundred to 10 thousand, gives you almost a 90% subscription level.

Now we just saw that in our prior data that anybody that qualifies, 10 thousand up to 48 thousand dollars can get Lifeline service. Now look at Lifeline rates, and I picked the individual cities throughout the southeast. The average of the southeast is $9.21. The national average is $9.48. Our rate in Winter Park, which is the highest rate is $3.23 for Lifeline. These are the rates in the other states.

Now Commissioner Deason, or somebody asked me earlier about what was the take rate in the other states. I don't remember what it was individually by state, and I will tell you Louisiana did not have Lifeline in 1997. But the highest take rate of any of those states, I believe was about 7% and that was in one state. I believe BellSouth in Florida is somewhere around 6%. And by the way, when I give you these percentages, I am giving you BellSouth, not for the entire state data because those are the folks that I use for my data. The rest of the states had Lifeline take rates that were probably, you know, half to two or 3%, and I have that information, and I can make it available to you.

MR. DUNKEL: I have one question. A few minutes ago you showed the take rate for Lifeline customers. Again, is that the unit take rate or the availability rate?

MR. POAG: I'm going to assume that is the availability because I think I stayed consistent, but I'm not positive.

MR. DUNKEL: So, again, that's not -- those customers do not necessarily have telephone service, but they might have a neighbor that would let them use telephone service or something like that?

MR. POAG: Well, they could have a neighbor, or if it was an apartment complex, you know, one in the hallway or something of that nature, yeah.

MR. DUNKEL: Thank you.

MR. POAG: My conclusion is that when you look at the items that the legislature asked us to look at, a fair and reasonable rate is much greater than the current rates in Florida. I based most of my conclusion on the subscribership levels in the other states and what their rates are and the value of service in Florida. And in closing I'm just going to put that other slide back up because basically I think this is the empirical evidence that demonstrates more than anything else that we can do a much better job in Florida of maintaining subscribership, and by the same token, pricing our service more in line with the economic cost, foster the competition, better allocation of resources, and keep people on the network. Thank you.

MR. OCHSHORN: Mr. Poag, I have a question. Are you prepared to discuss the results of the Florida Public Service Commission survey that was done in the past few months?

MR. POAG: No.

MR. OCHSHORN: No. Is there somebody in your company who can?

MR. POAG: I think Mr. Perry with General Telephone is going to do that.

MR. OCHSHORN: Okay. The reason I asked is that in the 696 docket one of the phone company representatives in the prefiled testimony goes on for pages and pages about how the findings in the survey can't be relied upon, and those findings showed that a substantial number of people would discontinue their basic service if it was raised as little as $2 --

MR. POAG: Yeah, I think it's --

MR. OCHSHORN: -- a month.

MR. POAG: I think it's pretty clear from this slide.

MR. OCHSHORN: As long as you don't consider changes in income over that time or whether that's an accurate reflection of number of phones in people's houses.

MR. POAG: Income in Florida is higher than these other states, rates are lower than these other states, and there is not a significant difference in penetration levels. When those rates -- when those rates in Mississippi went to $19, they didn't lose 2% or 5% of their customer base, their base increased.

MR. OCHSHORN: Okay. Well, we've each said our interpretation, so that's fine.

MR. POAG: There is not a whole lot of interpretation to this.

MR. FRANK: Mr. Poag, first I would like to commend you on actually putting up a straw man and having the courage, you and Sprint to have the courage to just put forth your proposal and your thoughts on the specifics. I've heard at least one executive from another company dance around the issue and assert that they really aren't looking for a rate increase in this procedure, but my -- And I think you can understand the problem some of us have with just the general premise. If you look at it on the surface, your proposal basically is that you would like to raise the basic residential rate in order to foster competition on a revenue-neutral basis to get no gain out of it just so you can eventually lose some of your business to the competitors or give up some of your business. Superficially it doesn't have a good -- it doesn't make business sense, and I think some folks are having trouble with the general premise.

But let me ask you this specifically: We talked about -- Commissioner Deason talked about the elastic measures, charges, like the verticals that if you reduce the price of those, the volume would increase. I think we all agree that's something -- an economic principle that it's going to happen.

MR. POAG: Let's stick with those economic principles, I like those.

MR. FRANK: Okay. All right. If that's true, going to have competition in the market, let's get the prices right. Let's have competition where people are competing for the right reasons.

MR. OCHSHORN: Mr. Poag, there was a written comment filed in this special project by the Florida Competitive Carriers Association.

MR. POAG: Mr. Gillan, is that who it is?

MR. OCHSHORN: I think he was the individual. This is an association of carriers who, I guess, would compete with Sprint. And in their comment, they request that rates not be readjusted until there actually is competition and that they would expect that competitors would mimic existing rates in order to attract customers through getting their basic service. Do you have a response to that?

MR. POAG: Yeah, my mommy always told me to consider the source.

MR. OCHSHORN: Well, the source is the Florida Competitive Carriers Association.

MR. POAG: Mr. Gillan is an economist, I believe, and I --

COMMISSIONER GARCIA: You guys do me a favor and not speak over each other. I'm sure it's bad for our transcriber because it's bad for myself, so --

MR. POAG: Yeah, I just think it -- Mr. Gillan

MR. TUDOR: Mr. Poag, Richard Tudor.

MR. POAG: Yes, sir.

MR. TUDOR: In one of your earlier charts you showed a cost for residential service of 26 plus dollars and a revenue of $14. Could you tell me or send to us later what that basic residential revenue stream would be if you included the non-basic services, not toll, but, you know, the call waiting and the custom calling features, what that number would be?

MR. POAG: Yes, sir, we can. Yeah, I think it's -- Yeah we can do that. Yeah, I was trying to think, most of it is probably is in what we already filed, but it may not have included all of the features, but we can do that.

MR. TUDOR: And the cost number, how much would it increase if you were looking at the cost of those features?

MR. POAG: Yes, sir.

MR. TUDOR: Okay. Thanks.

MR. POAG: Thank you.

MS. MARSH: We are going to take a 15-minute break, and we do need to keep it to 15 minutes because we do need to break at 12 o'clock sharp today.

Let me remind everybody that is going to need equipment for your presentations to please get with me, during the break if you can or as soon as possible, so we can get that stuff arranged. Thanks.

(BRIEF RECESS TAKEN)

MS. MARSH: We need to get started again. If everybody would take their places please.

We are going to go ahead and start. Tom McCabe is the next speaker, and he is up there and ready, so, Tom, go ahead.

MR. McCABE: My name is Tom McCabe, and I'm employed by TDS Telecom, and the comments that I'm offering today are on behalf of all the small LECs operating in Florida. Those would include AllTell, Frontier, GTC, Vista United, Northeast, TDS Telecom-Quincy and ITS Telecommunications Systems.

Basically the issues that we are talking about today have a great importance to small LECs, and that really all focuses on universal service. The Telecommunications Act of 1996 outlines in Section 254, requirements essential to the preservation of universal service. Under this law congress intended that the federal/state joint board and the Federal Communications Commission base universal service policies on specific policies outlined in the Act. Small LECs believe that the first three principles are intertwined in the issues before the Public Service Commission today. These principles are: Quality service should be available at just, reasonable and affordable rates; access to advanced telecommunications and information services should be provided in all regions of the nation; and consumers in all regions of the nation, including low-income consumers, those in rural, insular and high-cost areas should have access to telecommunications and information services, including interexchange service, advanced telecommunications, and information services that are reasonably comparable. And that's very important to the small LECs, is that those rates be reasonably comparable to the services provided in urban areas and that are available at rates that are reasonably comparable to the rates charged for similar services in urban areas.

Basically, the majority of our comments follow in line with what Mr. Poag just discussed today. I mean all those issues that are faced by the large LECs are faced by us, and rather than going in through, you know, all of the things that were provided in our report, I just want to kind of touch on some differences from the small LEC perspective.

In some of the comments that I have seen, there has been references to the idea that the historical residual pricing framework that existed in the past will exist today. I think that I remember seeing reference to a docket back in 1986 which, from my conclusion in those comments, was that the Commission has already determined that local, toll, access, all those rates were reasonable. Well, a lot has changed since 1986, and a lot of those impacts have come to small LECs.

Under the Telecommunications Act we have not seen the level of competition that one would hope to expect, and quite frankly, I'm not sure that we ever will. I can't imagine that somebody is going to want to go ahead and plow cable and facilities into an area in which they can get $7.45 for local service.

The issue of price is a factor in terms of investment decisions and what companies can expect in terms of a reasonable return. We have looked at expanding outside of our local territory. We have had opportunities in which we have been approached by some developers in which they came and said would you be interested in looking at providing service, and we have evaluated those, but we cannot evaluate those based on $9. We cannot look at it from the standpoint of investing two or three million dollars to go in and serve maybe three or four hundred customers and say we can do that with the idea that we hope to get all that back in interLATA -- through toll and through ancillary services. I mean that is not a business decision that we are willing to make, and we certainly don't have the financial resources with the size of our company that we would be willing to risk that.

COMMISSIONER DEASON: Tom, is it because those revenue sources would not be sufficient, or those revenue sources would be at risk of being lost even though you have the investment committed?

MR. McCABE: When we looked at it it was kind of both. I mean, granted, that the services such as your class features can, someone can come back in and reprice them lower in order to compete, but we kind of look at it more from the standpoint of toll. I mean we have -- you know, obviously there are several large interexchange carriers. We are not at the level that we believe that we can compete head to head with those carriers. So just from name recognition alone, we can do that on price; but, you know, from name recognition alone, it creates a lot of uncertainty in terms of what we may -- what we believe we may be able to get. So our focus tends to go towards what are we going to get back on that investment in terms of the plant that we put in the ground to those customers purchasing dial tone and not somebody that then has access to purchase those other services from other carriers.

COMMISSIONER JACOBS: Do you know if you're able to achieve the same kind of contributions to your profit margin from the ancillary services as was projected by

Sprint?

MR. McCABE: I'll touch quickly on that. The small LECs were not able to produce TSLRIC studies for this proceeding. Quincy had looked into doing that, and we had an estimate of about $30,000, and at that time it would have only been for basic service. It would not have been for the other ancillary services in terms of what this TSLRIC study would have shown. But I think if you go ahead and you look at some of the differences in the cost -- in the components of small LECs, probably the biggest thing that impacts small LECs is density.

As you can see on page 7 of our comments, I believe -- actually, I believe TDS -- I'm sorry, yes, TDS has the largest customers, access lines per square mile of all of the small LECs and that's 31. In comparison to the three large LECs, we are looking at 314 for BellSouth, 472 for GTE, and 135 for Sprint. So from the standpoint of the cost of the basic loop, while the TSLRIC studies that have been produced by the companies, we would probably think that those would be a starting point in terms of where our TSLRIC rates would be, and then you'd probably factor up from there.

Now as for --

COMMISSIONER JACOBS: I'm sorry, what would that rate -- Is that on this table?

MR. McCABE: No, like I said, we did not produce those.

COMMISSIONER JACOBS: Oh, I see.

MR. McCABE: But if you were to go ahead and you look at the highest rate that has been provided, like $31 --

COMMISSIONER JACOBS: I got you.

MR. McCABE: -- we would probably say that is a starting point, and then you could probably consider that it would be somewhat higher than that.

COMMISSIONER JACOBS: Okay.

MR. McCABE: As far as the ancillary services, such as your vertical services, we would probably -- I think it would be reasonable to conclude that those rates do provide sizable contribution to us.

The other thing I wanted to mention, you know, although we haven't seen, you know, the level of local competition, we have seen a lot of competition in other areas; and a lot of those revenues that we received went to supporting basic as well as the company's overall rate of return. We've seen bypass, intraLATA presubscription, wireless competition, and competition from pay telephone service providers. And now all those things -- We are not opposing any of them. I mean from the standpoint that we could sit here and argue we don't think that is a good thing from our company's standpoint, we believe it is a good thing for consumers. I mean from Quincy's standpoint, we introduced -- we implemented intraLATA presubscription December of 1996. Since that time, we have lost, looking at our August revenue from toll, annualizing that over the year, we will have lost an average of 120 thousand dollars a year from toll. Now it's benefitted the customer, but it's harmed the company, and those toll revenues were part of the residual pricing that was done in the past in terms of achieving the company's overall rate of return.

So we think that there is a need to go ahead and do some rate rebalancing. We also think that that rate rebalancing will enable us to look into other things. We look at the Telecommunications Act from the standpoint of comparable rates, and we look at that as the whole range of telecommunications services. Our business rates in Quincy are $15 higher than the business rates in Tallahassee.

We would probably -- we would argue that that basically is in conflict with the Communications Act that rates in urban areas are -- that rates in rural areas are comparable to rates in urban areas. So one of our goals through a rate rebalancing situation would be try to and bring some of those business rates down.

From a legislative standpoint, we kind of -- our main goal is to kind of stay out of the way and not get in anybody's harm, at the same time make sure we don't get trampled in the process; and we have been successful at that. I mean the large, you know, access reforms have been before the legislature for the past two years and, you know, we have received concessions on the part of the interexchange carriers that I believe back in '96 we were looking at going to BellSouth's intrastate rate, which our calculation showed that that would be about a $5 impact on our residential subscribers.

Now because of the size of the access revenues that we have, the large interexchange carriers didn't feel that that was something that they really cared a whole lot about. While they believed that access rates should be reduced for everybody, they are willing to make that compromise and say, hey, you know, we can exclude out the small LECs from this process.

Well, that works fine from the standpoint, but I think it doesn't move in a direction that we need to go. So that's why, you know, we are involved in this process. We don't want to go back to the legislature and say, everything that you are doing today, please don't do that to the rural LECs. We want to be involved in that process.

Access reform, we can look at it two ways: One, if you reduce access rates, that will possibly encourage more people, more interexchange carriers to come in and take away our intraLATA customers. So from that standpoint, it impacts our toll revenues; but at the same time, our customers are demanding to have those types of opportunities.

In Quincy's standpoint we have very limited interexchange competition. Now I'm not here asking for anyone to come in and take my toll customers, but we've had customers saying -- we've had carriers, in our opinion, and throughout the country in terms of rural areas because of the way access rates are, they don't want to go into high cost rural areas where access rates are extremely high -- Florida is a bit lower than a lot of other rural areas -- and go in and compete for those toll customers. It doesn't do them any good to be offering ten cents a minutes and paying access rates at 15 cents a minute. That's not the case in Florida for the rural companies. I think we are around six, eight, cents for the most part, but it does create disincentives for people to come in. In fact, we had one interexchange carrier that came in, issued us an ASR for intraLATA presubscription but limited it to government accounts. Yet we have got customers who have asked, How come we can't get access from that individual? So we think in terms of, you know, a rate rebalancing process we can adjust our access rates, at the same time encourage intraLATA competition, and at the same time protect our revenue sources and our revenue streams.

Another issue is if you look at -- even if we don't have people coming into our market, the rates that we are currently charging for toll are much higher than the rates that people can get elsewhere. Last night I got a call, and I was offered ten cents a minute all day and five cents on Sundays. A lot of customers in rural areas cannot get that type of an offer because people do not want to come and serve those areas with access rates being high. So that's just, you know one part of, you know, a whole picture of things that are --

COMMISSIONER DEASON: Are you saying that if you had lived in Quincy you would not have gotten that call and provided you with that rate, offering you that rate?

MR. McCABE: From that interexchange carrier I would have, but I would not necessarily have gotten that call from others offering that same rate. In order to --

COMMISSIONER DEASON: You're saying the opportunities for rural customers in terms of competition, toll competition is limited?

MR. McCABE: Yes.

COMMISSIONER DEASON: And that's because of high access charges?

MR. McCABE: That's part of it. And customer -- And business decisions. I mean it may be that it may cost more to try and get those customers than they believe that the revenues are going to be there to generate regardless of what those access rates are. I mean they may perceive that calling patterns would be low and, therefore, even if you had an access rate of a penny, it may not make that business decision.

We would also look at the ability to do rate rebalancing to take a look at our toll rates. Like I said, I think our initial minute is 14 cents in the first rate band, the second rate band is the same, and then I think it goes to 22 cents. Rate rebalancing would allow us to reduce some of those toll rates in order -- and then we would be able to offer those services and those rates to our customers. They may be comparable to what they can get in an urban area.

When we look at affordability, it's our view that you need to look at the entire picture. I mean affordability shouldn't be looked at as just the lowest common denominator. We believe that you need to look at just and reasonable rates in that context. The rate needs to be just and reasonable in order to encourage companies to invest in that infrastructure in those rural areas. It's quite possible -- I mean from a small LEC's standpoint, we have limited resources and limited capital, and we are going to take those revenues, those capital dollars that we have available to us and invest in those areas in which we know we are going to receive our greatest return. And that may mean that some areas will not get the investment because it's going to be put somewhere else. So when we look at it from Quincy's standpoint, we want to ensure that the prices that we are charging in the long run are going to provide the incentives for us to invest, whether that's from taking into account the potential losses that we have in toll, and so I don't think that the residual price making that occurred in the past exists any more today.

You know, the idea that competition for the sake of competition is bad, well, you can't limit it to one source of telecommunication product. You can't sit there and say, We think it's wonderful in rural areas to have competition in everything, but we don't want to see competition come in the local market because it's not sustainable. At the same time, though, you are going to drive away the competition. You would have to eliminate the competition in the other markets in order to maintain those revenue flows in terms of keeping the local rates where they are today.

I think the lowest local rate in Florida is probably one of the St. Joe companies which is in the $7 range. Quincy has the highest local exchange rate,

$12.70. And again, you know, we look at the issue, again, about comparability. We agree -- we believe that rates from other services are subsidizing local. When you look at a neighboring community such as Tallahassee, well, Sprint has an enormous array of customers in which they are deriving subsidies from, and those subsidies are spread out and can keep the local rate at a lower level. We have a lot fewer customers that are purchasing those ancillary services and providing a level of contribution in which our rate, in terms of getting our overall rate of return, those local rates have to be higher than what you would see possibly over in Tallahassee because we don't have as many discretionary services and revenues coming from that. So in that respect, our local rates are now higher than Tallahassee, but the rates in Tallahassee are being -- have greater subsidies attached to those; so, again, you know, we are missing the comparability issue.

From the standpoint of low income, I'll be the first to admit that we have a lot of low-income consumers that reside in rural areas; and we believe that, you know, this Commission has a responsibility from the legislature to ensure that those people stay on the network.

A big concern for us is the Commission has been working diligently to encourage companies to put more people onto Lifeline, and we are not opposed to that. The problem that we see though is today that 3.50 is not funded. If you have a large percentage of your rural customers that qualify as poor and there is no funding for that, that puts an enormous strain on companies, and if you look at the -- if you look at the Florida Statistical Abstract, I believe Gadsden County, 30% of the population qualifies as poor. Do we have 30% of our customers on Lifeline? No. Can I from a business standpoint go out and say, yeah, I want to go ahead and get these 30% of my customers onto Lifeline and not have funding? We'll be out of business. I mean we just will not be able to be a profitable company, and if we are not a profitable company, I would imagine we would try to find somebody else that would want to take it. And so I think that it's really important that the issue of low-income customers is addressed and that a funding mechanism is put into place, and I think that will help a lot of the issues in terms of affordability and protect a lot of those people that cannot afford it today.

COMMISSIONER JACOBS: What parameters would you suggest for that, just income?

MR. McCABE: At this point in time I think that the requirements of a Lifeline that are laid out by the FCC and this Commission are sufficient at this time, and I don't think that the Commission should be expanding that until there is, you know, clear evidence that it needs to because that will only increase the level of funding that is needed. The more you expand Lifeline the more funding that's going to be required.

I guess the other thing I wanted to touch on in terms of, you know, the reasonableness of rates, you know, it has to do with, you know, encouraging infrastructure investment. And if you look at the Act, the Act is, you know, goes ahead and points out the need for advanced telecommunications service -- access to advanced telecommunications services to be available in rural areas. And with the rates set at levels that we believe are sustainable and provide some certainty in the future in terms of revenue streams, that will only encourage investment. And if you want to go back and look at, you know, competition investment in infrastructure from competitors, I do not believe that there is one person in here today that would say they would go in and provide dial tone service at $7.45 in rural areas.

The big difference between rural and urban, we are in the business of providing residential dial tone. The ancillary services are just features that people demand or want from us. We are not in -- you know, our network isn't designed in looking at, you know, attracting business customers. Our B1 customers -- our B1 customers are more like residential customers. They are really mom-and-pop stores that have a local community presence, and the rates that they are being charged in some areas are significantly higher. So I mean when we talk about cost allocation, I'm not even going to get into that. There are a lot more people much more qualified than I am, but we do support the comments that have been offered by GTE and BellSouth and Sprint on that issue, but we are in the business of providing residential dial tone really.

COMMISSIONER JACOBS: I know you probably can't speak to the price level where competition would evolve, but wouldn't it have to be that there would have to be some contribution from vertical services in order for there to be meaningful attraction of competitors in rural areas? If they come in, not only are they going to have get their basic rate, but they are going to want to see some contribution from those other services?

MR. McCABE: Certainly.

COMMISSIONER JACOBS: So the basic POTS customer is probably not going to be the focus of those competitive efforts is what you're saying?

MR. McCABE: From competition in a residential market in rural areas, I don't believe that the basket of goods between local rates at $7.75 and some ancillary services that may amount to $5 is going to attract people to come into that market. Now I think when you go a step further, when you start looking at universal funding service in high cost areas, that will aid in individuals coming into rural markets.

COMMISSIONER JACOBS: Okay.

COMMISSIONER DEASON: Are you finished? Because my question can wait until you're finished.

MR. McCABE: Yeah, I think I'm finished because I think, you know, most of the questions -- you know, Ben addressed so many of the issues that we support. I mean I think when you look at affordability, you look at other services that, comparable services that people are purchasing. One thing that we found very interesting is that expenditure levels, based on the FCC's 1997 trend report, showed that telephone expenditures per household is roughly around $62, which equates to about a 2.2% expenditure of the household income. Less than 1% of that is attributed to basic service. And when we look at basic service, I mean we tend to look at that as what is the necessity, the ability for people to contact, for use of emergency services, contact, you know, their communities of interest and things of that nature. Granted, toll is a necessity from the standpoint of how we have envisioned the tele -- how the world has changed and how it's become much more mobile, but we don't really think of that as what

Universal Service Act is all about in terms of trying to ensure that people are connected to the network. The Act only requires access to toll services. It does not require that toll services be made affordable. Competition has made toll services affordable.

I guess that's -- And so then when I think, you know, you look at Internet service, cable television, I mean people were paying a considerable amount of their household expenditures on services that we would consider as non-essential; and so I don't think that we need to be in a situation of saying, well, we need to subsidize essential services in order to free up disposable income to non-essential services. I mean dad always said if you can't afford steak, eat hamburger. Well, if you find that telephone service is a necessity, well, maybe then you have to do without Internet if you can't afford both.

As far as, you know, comparable rates in other areas, we've seen -- there is really nothing further that I have to add on that, although, you know, this process that we are talking about today isn't new in Florida, and it's occurring all over the place. I mean in Georgia right now we are in the process -- we have three companies up there, and we are in the process of rate rebalancing there; and that has to do with reductions in access rates. That's all the comments I have.

COMMISSIONER DEASON: My question, I guess, is a simple one; and that is, where, if anywhere, do you differ from Sprint, BellSouth and GTE in the sense that you oppose a position that they are advocating in this proceeding?

MR. McCABE: We do not oppose any of the positions that they are advocating in terms of rate rebalancing. There have been some references in terms of rates for local service should be more reflective of the cost incurred, and we agree with that to an extent; but the cost for rural companies is much greater than that of urban areas. So we do not -- So then we focus back on the issue of comparability.

We certainly wouldn't want to see the Commission going ahead and saying, okay, we have determined the level of affordability is much higher than what we are probably thinking in our minds, and in rural areas, because the cost is much higher, we are going to set local rates in rural areas at a higher level than the rates are in urban areas. What we would like to see is whatever the Commission does, that we move in that same direction.

COMMISSIONER DEASON: Then you advocate a universal service fund?

MR. McCABE: Definitely.

MR. PASCHALL: Ed Paschall with AARP. I have a question here that I would -- I have been sort of searching for an answer to, and I wonder if you have any ideas along that line. Over in Gadsden County you have an average income of about $13,712 over there, and you have about 28% of the people below the poverty level. You've got about 44 thousand people there in the county at all, and now how can you come up with the single affordable rate that would be usable statewide whenever you must also consider that you have Palm Beach County with about 32 thousand people in it considering 980 thousand people and only about 9.3% of those are below the poverty level; so do you have any suggestions along that line?

MR. McCABE: We agree that, you know, income levels should be a consideration for the Commission, but I think -- you know, we are looking at it from the standpoint of the entire basket of goods that consumers will be able to purchase in Gadsden County. We are looking at it from the standpoint that, yes, they may pay more in basic rates. Access rates will come down, that hopefully we'll encourage more entrant into the toll business. Customers will then have an opportunity to purchase their toll at 10 cents a minute, compared to having to pay the rate that was residually set for Quincy, I don't know how long back, of about 24 cents a minute. So we think that those -- In conjunction, I mean when you look at the entire basket, is where you need to look at in terms of affordability and not just simply the fact that customers would be paying more for local service.

COMMISSIONER GARCIA: But just how essential is lowering access to those rural areas? I mean what do that level of income -- Why do they need those type of toll services?

MR. McCABE: We look at it from a company standpoint. Today, like I said, our toll rates are exceptionally high. At the same time we have to impute our access costs in terms of setting our toll rates. Well, if our access rates are high, we can't bring our toll rates down a whole lot. If we can't bring our toll rates down, we can't compete with the few interexchange carriers that have chosen to come into our territory. If we can't compete with those, those that go out and solicit those customers, you know, a lot of them have gone after -- targeted our business customers. We can't match that the way the pricing structure is today, and we are losing those, and in a sense -- in effect we end up losing the revenue associated with it.

COMMISSIONER JACOBS: We heard a lot from people in rural areas about the scope of their calling areas, and it kind of led me to believe that that is an important enough issue that it could factor into the whole competitive arena, i.e., that companies could wade into this business simply -- not only on price but on calling scope.

MR. McCABE: That's true, but I don't -- I can't speak on behalf of all the small companies because I don't know the extent of their calling area; but from my experience, I mean this Commission has done a real good job of addressing community of interest. You know, Quincy does have local calling into the Tallahassee area. Granted, there would be some people that would want to have calling somewhere else; but as far as the ability to call their doctors, schools, things of that nature, you have within Gadsden County itself. But at the same time, and from our perspective, there was a lot of calling that went over to Tallahassee. There is a lot of business done over. Opportunities are somewhat limited. It creates an issue that required customers' bills to be higher from toll. So the Commission took those steps and expanded that local calling area, and from our standpoint we think that that calling area is sufficient to meet the needs of our customers today.

COMMISSIONER JACOBS: But let's say another company other than Quincy, because I agree that it probably is an example where something is very effective has been done, but let's say there is a company that has a high toll rate, getting a lot of revenue from that, and their competition is going to occur not only from the local rate price but somebody coming in and competing on their calling scope area. What would be the impact to the consumers there? Ultimately you would think that they would get, that would be a -- that the price, the overall price would go down.

MR. McCABE: Yes.

COMMISSIONER JACOBS: Okay.

MR. McCABE: Yes.

COMMISSIONER JACOBS: And one of the things I noticed in examples of other states where they have been doing rebalancing, most of those prices are rates -- I guess let me ask this question, those rates are not approaching the rates that we discussed earlier the rates in the states that you cited have done rebalancing. They don't approach the $31 or above that we had talked about earlier.

If one of the small LECs were to go to a level that doesn't reach some of those levels we talked about, i.e., they are still not coming up to where their costs are justified, aren't they going to begin to look at some of those other areas such as, you know, how to keep toll revenue, your calling scope plans and that sort of thing?

MR. McCABE: Yes.

COMMISSIONER JACOBS: Okay.

MR. McCABE: Yes, but I also think there in terms of -- I gather from your question what you're referring to is competitors coming into that area?

COMMISSIONER JACOBS: Yeah. Yeah.

MR. McCABE: What will it be that is going to attract them?

COMMISSIONER JACOBS: Yeah.

MR. McCABE: I really think it's going to boil down to universal service funding is what is going to attract people into rural market.

COMMISSIONER JACOBS: And how that is set.

MR. McCABE: And how that is set. I think if you were to -- I mean everybody -- Capital resources are limited for everybody, so you are going to go ahead and you are going to spend those dollars in areas in which you have the greatest return, and it will be out in the conceivable future probably before you are going to see it out in rural areas. Now we may have some niche players coming in here and there. We did get -- I think every small LEC has received a request to do resale. The rules and requirements for resale, residential resale is somewhat different for rural companies under the Act, so we haven't heard back from that company.

COMMISSIONER JACOBS: Okay.

COMMISSIONER DEASON: What's your position on

Mr. Poag's straw man proposal?

MR. McCABE: We support that straw man's proposal. I mean we believe that you can go ahead and have some modest rate increases. We think that it should be, you know, transitioned over time. We certainly wouldn't expect a flash cut. At the same time, those corresponding offsets would occur over time. You know, we look at it as a revenue-neutral issue. There are some differences though in terms of some of the rural companies, or at least from my company's perspective, that looking at, you know, rate case issues. You know, as I mentioned, I mean we have had a lot of revenue erosion. Surveillance reports that we filed with the Commission, they are not great. You know, we would really like to see everyone's rates going to some type of a benchmark rate so that when our local rates, if we were to come in here tomorrow for a rate case and you determined that we have a revenue requirement of say five hundred thousand dollars, the majority of that, where are we going to get it from? For the most part it's going to come from residential. We already have a $35 business rate, so at the same time our -- because of our revenue losses, we are going to be back here looking to increase local rates which, you know, we don't want to do that to our consumers either. You know, we end up being the bad guys of the world, but it's a matter of replacing revenues.

COMMISSIONER DEASON: But you do agree that what we are doing here in terms of rate rebalancing is a revenue-neutral proposition, you are not in here seeking a revenue enhancement as a result of this?

MR. McCABE: No, we are not. Thank you.

MS. MARSH: We are going to break for lunch, and we'll start back at one o'clock. The speakers this afternoon, please get with me as to what your equipment needs are. A couple of you did say something, but it's gone completely out of my head, so please let me know before you leave today for lunch what it is you need as far as an easel or anything like that; and we'll start back at one o'clock.

(WHEREUPON, THE AFTERNOON SESSION IS CONTAINED IN VOLUME II WITHOUT OMISSION)

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