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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

SPECIAL PROJECT
NO. 980000A-SP

In re: Undocketed Special)
Project No. 980000A-SP, Fair)
and Reasonable Residential Basic)
Local Telecommunications Rates.)

DAY 2
AFTERNOON SESSION

IN RE: Staff Workshop
CONDUCTED BY: Anne Marsh
DATE: Thursday, October 9, 1998
TIME: Commenced at 1:00 p.m.
Adjourned at 3:40 p.m.
PLACE: Betty Easley Conference Center
4075 Esplanade Way
Room 148
Tallahassee, Florida
REPORTED BY: RAY D. CONVERY, Court Reporter

RECEIVED 10-26-98

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P R E S E N T

COMMISSIONERS PARTICIPATING:

J. TERRY DEASON, Commissioner
SUSAN F. CLARK, Commissioner
JOE GARCIA, Commissioner
E. LEON JACOBS, JR., Commissioner

STAFF PARTICIPATING:

MELINDA BUTLER, Aide to Commissioner Jacobs
BETH KEATING, PSC Staff, Legal
WILLIAM B. McNULTY, PSC Staff, AFAD
DAVID DOWDS, PSC Staff, CMU
SALLY SIMMONS, PSC Staff, CMU

OTHERS PARTICIPATING:

GREG FOLLENSBEE, AT&T
WILLIAM DUNKEL, Office of the Attorney General
TOM REGAN, Office of the Attorney General
CHARLES BECK, Office of Public Counsel
JOSEPH GILLAN, FCCA
BEN OCHSHORN, Florida Legal Services
NANCY WHITE, BellSouth
WILLIAM TAYLOR, BellSouth/Sprint
CARL DANNER, GTE
KIM CASWELL, GTE
TOM McCABE, TDS Telecom
JOHN P. FONS, *

1 P R O C E E D I N G S

2 MS. MARSH: We are ready to begin again. The next
3 speaker is Carl Danner.

4 MR. DANNER: Is that okay? Thanks very much.

5 I'm very pleased to be here. My name's Carl
6 Danner. I'm appearing on behalf of GTE Florida, and as
7 it indicates there, I also spent some time at the
8 California Commission, around about ten years in total,
9 the last several of which as an adviser to Commissioner
10 G. Mitchell Wilk, who was a Commissioner and then
11 president of the California Commission.

12 And one of the things I'm going to spend a little
13 time talking about today, in addition to everything
14 else we've heard about, is the experience the
15 California Commission had with rate rebalancing led by
16 the Commission, not led by the industry, and the
17 reasons why the Commission pursued it, the benefits
18 that the Commission believed it would create for
19 California, and why some of those reasons remain valid
20 for you today, if not even more so in Florida.

21 MS. CASWELL: Carl, I'm sorry. If you could move
22 your microphone, I think we're having a little trouble
23 hearing you. If you could maybe move it up closer on
24 your collar?

25 MR. DANNER: Is that a little better? Okay. I'm

1 sorry about that.

2 I have one equation in my presentation, and I'm
3 going to show you that first. It's a very simple
4 equation, I didn't even number it, but here it is.

5 Impeccable -- it's the problem with economics --
6 impeccable logic plus trustworthy data yields
7 uncomfortable answer. I've experienced this ever since
8 I first started studying economics in learning about
9 unintended consequences of well-intentioned acts and
10 other things, and I guess I would submit that this is a
11 -- in large measure what we're dealing with in looking
12 at some of the issues that the Commission is
13 considering right now.

14 We've had a number of economists here and I'll
15 talk about economists, other economists, telling you
16 what the costs of service are. I will be talking about
17 that as well. At the same time, what their answers
18 seem to imply is considerably different than the status
19 quo, and there are some good reasons and some political
20 reasons in particular why the status quo exists, why
21 the rate structure is what it is today, and that stems
22 from a number of concerns, but -- and why don't we go
23 to those answers?

24 The first answer, as I said, was that basic
25 service costs more than its current price, and that

1 pricing has to be reformed with respect to competition,
2 to adapt to it or even to permit it, but I think
3 there's a happy ending. And the happy ending is that
4 when you look at the facts, you'll find that these
5 answers can actually benefit customers and can make
6 political sense as well, at least if you pursue them in
7 a thoughtful way. And so I've got a number of slides
8 and a fair amount of presentation to make, but this is
9 the essence of it right here. So let's go to the next
10 slide.

11 I prepared a rather lengthy filing some of you may
12 have read for the Commission. I've tried to distill
13 six points or six areas of discussion from that filing,
14 and I'll say a word about each of them right now.

15 Why the loop is a cost of basic local service,
16 we'll be replowing some of the ground that's been
17 plowed. I think I have a couple of things to say that
18 you haven't heard yet on that subject. I call it
19 debunking the loop allocation fallacies. I guess
20 that's strong language, but that's what I think they
21 are. Economists think so, too. Anyway, we'll talk
22 about -- a little bit about that. Again, I'm not going
23 to try to go over all the ground that's been covered,
24 but certainly hit some of the points.

25 The California experience, which I think you will

1 find instructive, and certainly we'll talk about it.
2 It's not quite the experience Mr. Dunkel described, but
3 in any case, we have got a number of facts and kind of
4 a little personal history to go with that, since I was
5 right in the middle of it and actually had a fair
6 amount to do with it.

7 What I call economics and facts. You'll notice
8 I've given you two handouts. The second one is called
9 Customer Impact Data. We'll be delving into that a
10 little bit. I -- in combination with Bob Tanamora, who
11 is an economist at GTE, we put these facts and
12 background materials together. We'll be talking about
13 them a little bit, but they're also meant to give you a
14 little additional source of information, kind of
15 elaborating on what's already in my filed report. A
16 word about -- and in there, of course, pricing reform
17 is an issue that can help customers, promote
18 competition and advance universal service.

19 I also brought one prop for my presentation for
20 the benefit of Mr. Gillan's concerns. You don't just
21 have to use UNEs, there are other ways to get
22 alternatives to basic local service. As Dr. Harris
23 described, there are now 60 million of these around,
24 and we'll talk a little bit about some other ways that
25 pricing matters, not just for unbundled network

1 elements or resale, which was really his concern.

2 A word about how to use markups to recover common
3 costs. I guess in part that's a response to the
4 discussion of a subsidy-free zone that you've been
5 presented with in a discussion of economics. And while
6 it's important to work subsidies out of the system and
7 it's a beneficial thing to accomplish, you need to know
8 that that's not where it stops. Most of the economy
9 operates every day in what you would call a subsidy-
10 free zone, and yet there are still interesting things
11 that economics and economists can tell you, or economic
12 principles, about how you would like to set better or
13 worse prices for customers, competition and the
14 economy, even if there aren't any subsidies. And so
15 we'll talk a little bit about that.

16 And the conclusion -- I guess there's one other
17 broad new theme that I would like to bring forth, and
18 this does relate to the conclusion.

19 I understand there are really two things kind of
20 on the table or being discussed here, and I've really
21 heard mostly discussion about just one. The one we've
22 heard the most about is pricing reform, rate
23 rebalancing, something like that. There's also
24 universal service, and I guess this is a universal
25 service docket or is related to a universal service

1 docket, and the conclusion I will offer is that
2 universal service and rate rebalancing or pricing
3 changes really are complementary and can work together,
4 can bring you a lot of benefits for customers and the
5 economy in Florida, and also don't necessarily require
6 any new money. The money's already there today in the
7 rates, it's already being paid by customers today.

8 Really, in terms of these equity questions we've
9 heard discussed, we're talking about payments from
10 customers to customers. So you don't need to find new
11 money to make this occur. You may need to restructure
12 how some of the existing money flows, but you don't
13 need to go out and, you know, find a lump of new funds
14 from somewhere, so let's turn to local loop costs.

15 I guess the thing about this slide that to me is
16 really important is understanding how central this
17 notion of causation is to economics. In my prepared
18 comments I gave a couple of quotes from some
19 introductory economics textbooks and so on, but when
20 you think about what prices are supposed to do in an
21 economy, they're supposed to help us understand when we
22 should or shouldn't buy something, when we should or
23 shouldn't produce something, appreciate the
24 consequences of our actions, appreciate the benefits we
25 can get from certain opportunities, and it's really

1 critical, for that to work, that prices be tied to real
2 life consequences, because if they're not, it's kind of
3 a shell game, you know, we set prices and tell people
4 that -- or we don't tell them, the prices tell them
5 that they should respond and take action with respect
6 to those prices, and yet if the prices are sending them
7 signals that don't reflect reality, that don't reflect
8 how things will change or be used up or be made
9 available or anything like that, as a result of their
10 actions, then the pricing mechanism isn't working. It
11 isn't performing its function.

12 And so that's why what I want to show here on this
13 slide is that this notion of causality is not just a
14 quibble or a difference in view or, you know, a
15 different way to look at things or, you know, there are
16 two alternative viewpoints. If you don't accept this,
17 there's really nothing modern economics can help you
18 with. And this is what cost means.

19 Now, as we'll discuss, and as has also been said,
20 pricing is a little something different. You can find
21 that basic service, for example, costs a certain
22 amount. Because we have tools like universal service
23 support, that does not mean that the retail price to
24 the customer necessarily has to reflect that. But if
25 you get the costs wrong and don't recognize the

1 importance of cost causation, well, then, the pricing
2 isn't going to accomplish anything, really.

3 Now, I contrast that with cost allocation down at
4 the bottom of the slide, and I call it -- I call it
5 cost allocation fudge factors. That's really what it
6 is. I mean, there is no economic meaning to cost
7 allocation. There is no best, better way to allocate
8 costs.

9 There's a long history in regulated industries of
10 various ways people tried to do that. In fact, in
11 markets, competitive markets, firms don't really
12 allocate costs, either, in the sense of pricing. What
13 they do is they charge what they can for their various
14 products and hope that the resulting contribution they
15 make is enough to keep them in business. But, you
16 know, if you're an oil refinery, you don't say, well,
17 I'm going to allocate so much of my refinery to No. 2
18 fuel oil and set that as the market price. The market
19 tells you what the price is and you hope your markups
20 are big enough.

21 So just to be clear, I wanted to come back to this
22 notion that what costs are caused by someone's decision
23 is just a bedrock principle of economics, and if you
24 want to talk about costs in any economic sense, this is
25 what it means.

1 Let's go to the next slide.

2 I've listened to two days of this, I think you've
3 probably listened to more, and this is the easiest way
4 I can explain it. Getting access to the network
5 requires a connection. That connection is a loop. If
6 you want to plug in and get to any kind of phone
7 service, that's what you need. And so the decision
8 that causes the cost of the loop is the decision that
9 makes that network connection.

10 Now, you know, it's interesting, what you do in
11 Florida is what's done in most states. You bundle that
12 in with basic phone service, for the most part.
13 Actually there are some examples that don't quite fit
14 that description. There are a few other states, I can
15 think of Illinois, where they actually sell a network
16 access line to residential customers as a separate
17 product. Most people end up with, you know, what you
18 call basic service.

19 COMMISSIONER GARCIA: What is that product,
20 network access line, just receives incoming?

21 MR. DANNER: I believe it gives you a little 911,
22 access to operator services. I believe they buy their
23 local service as separate packages.

24 COMMISSIONER GARCIA: I've got you.

25 MR. DANNER: But, of course, I mean, customers,

1 you know, I mean, they -- they end up with basic
2 service, although it's interesting, there are -- there
3 is a demand for network access lines that just receive
4 calls. Does anyone know what it might be? 800
5 numbers. People who have -- these 800 service bureaus
6 get huge volumes of calls. And did you mention
7 Internet service providers? That's a tremendous new
8 market for access to the network that just receives
9 calls. You can also get access to the network just for
10 long distance.

11 You know, this hypothetical example that's been
12 bandied around is actually real. How is that done?
13 Interexchange carriers reach customers through special
14 access. Special access is a long distance only loop.
15 Of course, when the customer gets that long distance
16 only loop, that customer pays for it. It's not paid
17 for by somebody else, which of course is the result --
18 large result of what's suggested by the loop allocation
19 discussion.

20 The notion of dedication is also important. I
21 think that helps you sort out some of the examples that
22 were discussed this morning. I know Dr. Harris
23 mentioned this yesterday, about the supermarket versus
24 my special section in the supermarket. I think it
25 might have been Commissioner Garcia was talking about

1 road networks and trying to distinguish different kinds
2 of road networks and looking at that analogy. Really,
3 the interstate highway system is analogous to AT&T's
4 network because the facilities are shared and available
5 to the public and used by many people. I think the
6 right analogy to the loop there would probably be your
7 driveway. Your driveway really has all the
8 characteristics of a loop because it's dedicated to
9 you. You can receive calls as well as make them, I
10 mean, people can drop in on you unexpectedly. Any time
11 you go out on the network to make a trip, you have to
12 use it. But then, here again, everybody pays for their
13 own driveway, and we don't allocate that among some
14 uses of cars.

15 Anyway, I think this is the --

16 MR. DUNKEL: I have three simple questions here.
17 My name is William Dunkel.

18 On your top line you say the customer needs a loop
19 to get any access to the network. Is it correct that
20 the IXCs are the customers of what is called switched
21 access service?

22 MR. DANNER: Yeah, the IXCs pay a tariff for
23 switched access service.

24 MR. DUNKEL: And would the IXCs need all of the
25 loop in order for that switched access service to

1 exist?

2 MR. DANNER: The IXCs need access to the loop to
3 -- you know, for the customer to reach them, and the
4 customer reaches an IXC over a loop. The customer also
5 reaches a pizza parlor over a loop, or any other
6 business that provides separate services. L.L. Bean
7 was another example. Nothing special about the IXCs in
8 that regard.

9 MR. DUNKEL: So for customer access -- for carrier
10 access service, the loop has to exist, is that a
11 correct statement?

12 MR. DANNER: As it's defined, I think that's
13 right, although carrier access service is also an
14 artifact of loop allocation, in a way.

15 MR. DUNKEL: Thank you.

16 Now, let's go to the driveway example. In your
17 example, both the customer -- the customer owns the
18 driveway. If the driveway was owned by a profit-
19 making, independent company, is it possible they might
20 charge people to use that facility, although you don't
21 charge yourself and your children, would a private,
22 independent, profit-making company charge people to use
23 that driveway?

24 MR. DANNER: I don't know.

25 MR. DUNKEL: Thank you.

1 MR. OCHSHORN: Mr. Danner, over here. Ben
2 Ochshorn from Florida Legal Services. I had a brief
3 question, too. It's about the same question that
4 Commissioner Deason had this morning.

5 What do you mean by cause? It's your second point
6 that -- if you could move the graphic down so you could
7 see it, where you say the cost of the loop is caused by
8 a customer's decision, what do you mean by cause?

9 MR. DANNER: Well, that's when a loop is put into
10 service is when a -- you know, either a customer says,
11 "I want service," so we provide them a loop. And
12 that's the -- you know, and it's been discussed at
13 great length earlier in the day and I suppose yesterday
14 that other actions and other services don't cause any
15 additional cost to that loop or any part of that loop.
16 There's -- you know, the entire cost is there even for
17 someone who never makes a call.

18 MR. DUNKEL: Okay. Can I track that a little bit
19 closer? Would it be more proper to say that the
20 company actually installed a loop somewhere in the past
21 and the customer activates the loop, but they actually
22 installed it maybe six months or a year or years
23 before? Is that a more accurate statement?

24 MR. DANNER: Well, it's -- as I said in my
25 comments, the company can install it in anticipation of

1 customer demand. The company can also install it at
2 the time the customer has the demand if they don't have
3 any loops. That happens, too, sometimes. Hopefully
4 they would like to install it in anticipation.

5 MR. DUNKEL: All right. Is it your statement,
6 then, that when a company installs a loop in
7 anticipation of demand, that they consider only the
8 possible revenues they might get from local service, or
9 would they consider all of the possible revenues they
10 might get when they decide to install that loop?

11 MR. DANNER: I think the companies install loops
12 at the moment because they're required to and they
13 provide -- they're in the telephone service business.
14 I don't -- I am not inside the mind of a hypothetical
15 company.

16 MR. DUNKEL: Let's assume a scenario where it was
17 up to the company whether they wanted to install loops
18 in a subdivision or not. Would a rational company who
19 had their freedom to make this decision look at only
20 the revenues they expected from basic exchange, or
21 would they look at all the revenues they reasonably
22 would expect to receive when --

23 MR. DANNER: We'll get to that shortly in my
24 presentation, if you want to hold that question.

25 MR. DUNKEL: Well, I would like an answer.

1 MS. MARSH: Excuse me, can I interrupt for a
2 second? We are way behind schedule and so we do need
3 to keep the questions to what the speaker is presenting
4 this afternoon.

5 MR. DUNKEL: That's fine.

6 MR. DANNER: I'll come back to that.

7 MS. MARSH: Thank you.

8 MR. DANNER: In any event, this is the simplest
9 way I can see to get at it. I'll repeat again that I
10 don't think this necessarily binds you to a particular
11 pricing decision as a result, and there are ways that
12 you can deal with prices and costs that don't have to
13 be disruptive to anybody. But that's the bottom line.

14 The next slide. Actually, I don't need to show
15 this slide, really, I think you've seen it here.

16 Economists are virtually unanimous that the loop
17 is a cost of basic service. I referred to some
18 literature about that. Virtually the entire telephone
19 industry, I also referred to an experience I had in
20 Indiana that was quite remarkable of having AT&T and
21 MCI enthusiastically endorse an Ameritech witness on
22 this point. Sometimes courts and regulatory agencies,
23 not always. Certainly we've heard examples of cases
24 where courts and regulatory agencies have said the
25 opposite. The California Commission, for what it's

1 worth, agrees that the loop is a cost of basic
2 service. Who might disagree? I think we get back to
3 the uncomfortable notion of not wanting to change
4 rates, and we've heard a lot of discussion about the
5 status quo and why the status quo is preferable to any
6 change. I don't think that's a very pro customer
7 position, but -- yes?

8 MS. BUTLER: I'm sorry to interrupt. I just would
9 like a clarification. When you say who agrees that the
10 cost of the loop is a cost of basic service, are you
11 saying it is solely a cost of basic service?

12 MR. DANNER: Yes, that it's not to be allocated,
13 that it is caused by the basic service, yes.

14 MS. BUTLER: Thank you.

15 MR. DANNER: I've seen a couple of instances where
16 some small companies that were involved in pooling
17 mechanisms that shift costs around a little bit and
18 allow others to pay for some of their costs prefer to
19 have loop costs pooled, too. This is consistent with
20 that.

21 Let's go to the next slide.

22 Then we have a list of things that people have
23 said and we've discussed and the Commissioners have
24 discussed, and I'm not going to spend too much time on
25 these. They're also in my prepared comments. But I

1 thought I could add a few things to what's already been
2 said. We've got the used by, we've got the making
3 money from non-basic services argument, the razor and
4 the blades. Shortly after I filed my testimony in
5 Indiana, by the way, somebody sent me a free razor,
6 which I thought was kind of funny, although it used
7 very special, expensive blades.

8 The allocation of the loop between the state and
9 federal jurisdictions, that's come up, and stand-alone
10 cost arguments. So let's just touch briefly on each of
11 these.

12 The -- let's go to the next one.

13 The used by argument, you're back to really a
14 basic question of economics again. Use does not
15 determine cost. Just because something is used by
16 someone or for some purpose, if there's no additional
17 cost caused by that, it's not a cost. We can call it
18 something else, we can call it a use, a beneficial use,
19 we can talk about creating value, we can talk about a
20 lot of things like that, but it's just not cost. And
21 here again, the analogies can go on quite some time,
22 but I really don't see any difference between using the
23 loop to make a long distance call versus what I did
24 yesterday, using the loop to recharge a long distance
25 calling card, to using the loop to call the dentist, to

1 using the loop to call for take-out food and so on and
2 so forth. Those are all uses of the loop that lead to
3 someone else making money or being in business; and
4 they don't --

5 COMMISSIONER GARCIA: Wouldn't that apply to
6 vertical services also?

7 MR. DANNER: Yes.

8 MR. DUNKEL: Would that apply to local service
9 also?

10 MR. DANNER: You know, in terms of local usage, I
11 think it would --

12 MR. DUNKEL: Thank you.

13 MR. DANNER: -- because you can reach -- the loop
14 gives you access to the network. Once you get there,
15 there are a lot of things you can do. One of them is
16 local service, vertical services and so on. There's no
17 additional cost caused or no part of the cost caused by
18 that usage.

19 And the last point here, the car driven on Sundays
20 -- and I apologize for all the analogies, though I know
21 I'm not the only one making them -- this I think gets
22 to part of the heart of the issue, because what seems
23 to be the real concern in many people's hearts is that
24 there are customers out there who may make low usage of
25 the phone, may buy few services, the hypothetical

1 customer who buys nothing at all. I don't think there
2 are very many of those, but can we somehow charge those
3 customers or somehow -- I shouldn't say charge, can we
4 somehow assert that those customers are not causing the
5 entire cost of the loop? The answer is no. You need
6 -- just like the car that needs all the tires even if
7 you're just going to drive it on Sundays, you can't
8 reach the network without all the loop. And some way
9 or another, that is a cost of what is being provided.

10 Let's go to the next slide.

11 The making money from non-basic services, I think
12 Mr. Gillan, among others, was talking about this. The
13 interesting thing here is that it really is a pretty
14 explicit argument for the status quo, because it's
15 saying that, isn't it sustainable if we overprice some
16 things, underprice other things, it all comes out in
17 the wash on average? Can't you make a viable business
18 out of that? And the answer is, you could, as long as
19 you didn't face competition that forced the margins
20 down on the overpriced services, as long as you didn't
21 have customers who could buy some of what you offer and
22 not bother with the rest.

23 I'm struck by something. You know, the extent of
24 facilities-based competition in Florida for residential
25 customers I believe is not very much. The extent of

1 facilities-based interexchange competition for
2 customers is tremendous. All residential customers
3 have choices of long distance carriers, and long
4 distance carriers that want their business. Virtually
5 no residential customers have choices of local carriers
6 that want their business. Many business customers have
7 choices of facilities-based carriers who want their
8 business. That's got to tell you something, but I
9 describe this as circular reasoning to say, well,
10 what's paid in offsets what's paid out, so there are
11 not any subsidies. Well, if you have a cross-subsidy
12 scheme, what's paid in will offset what's paid out. It
13 ought to. That really doesn't tell you about, anything
14 about whether or not there are subsidies in the
15 individual services, and that's the focus of the
16 attention.

17 And really, as I'm suggesting here, that's just a
18 -- it's almost an addition exercise to see whether the
19 subsidies add up, not to determine what they are.

20 MR. DUNKEL: A question on your cost causation
21 statement. We've handed out a card earlier, a little
22 wallet card that has a test for cost causation. Do you
23 -- do you want me to read it to you, or are you
24 familiar with it? The question is, do you agree or
25 disagree with that test for cost causation?

1 MR. DANNER: Actually, I haven't had the benefit
2 of seeing your card.

3 MR. DUNKEL: All right. It says, "If the company
4 does not avoid certain costs in the long run when a
5 service in question is eliminated or not offered, while
6 holding constant the production of all other services
7 produced by the company, those costs are not caused by
8 the provision of the service in question."

9 MR. DANNER: Yeah, I think that makes sense.

10 MR. DUNKEL: Okay. If you were providing toll,
11 switched access, vertical service and local, and you
12 eliminate local service while continuing to provide all
13 of the other services, do you eliminate the need for
14 the looped facility?

15 MR. DANNER: You know, if you look at slide -- my
16 sixth slide here on loop allocation policies, you'll
17 find it fits right in there. We'll get to that in a
18 minute.

19 MR. DUNKEL: Well, I'd like an answer, if you
20 don't mind.

21 MR. DANNER: The answer is that as soon as you
22 give the customer the loop for any purpose, you have
23 once again given them access to the network.

24 MR. DUNKEL: So if you still provided all the
25 services except basic exchange, you would not eliminate

1 the cost of the loop facility, is that a correct
2 statement?

3 MR. DANNER: Well, I mean, it's a funny thing.
4 There's a definitional issue in what you're saying,
5 because the loop provides customers access to the
6 network. They buy that access through basic exchange.
7 They don't have to buy it through basic exchange, they
8 can also buy it through special access, they can also
9 buy it through other kinds of services I mentioned
10 earlier. Your hypothetical argument says, ah-hah,
11 you're not providing something called basic exchange.
12 So the loop is not part of basic exchange service.
13 Well, you're just getting your access another way.

14 In your example it would have to be a special
15 access line, and in that case, the customer would once
16 again have -- his or her access to the network would be
17 causing the cost, and I don't think you'd find a
18 competitive provider in his right mind who would be
19 willing to provide, on a general basis, that access and
20 not insist that the customer cover the cost.

21 MR. DUNKEL: Is it a correct answer the loop
22 facility would still be needed even without basic
23 exchange?

24 MR. DANNER: I've given you the answer.

25 MR. DUNKEL: Thank you.

1 MR. DANNER: Let's move along. I don't want to
2 spend too much time on these --

3 MS. BUTLER: I'm sorry. I'm puzzling over
4 something because you said something very interesting
5 to me and likewise very important to me, which is that
6 in a competitive environment the prices are not set by
7 looking at the costs. The prices are set by looking at
8 the market. And then I was thinking about, okay, well,
9 then, if that's the case, what's the next step? And
10 the next step then, as I understand it, is that the
11 company then matches up what they're getting for
12 revenues with what it is they're costing for that
13 particular service. And if the costs exceed the
14 revenues, then they don't provide that service any
15 more.

16 MR. DANNER: Exactly, they'd exit, yeah.

17 MS. BUTLER: Right. Now, this is where I got hung
18 up, okay? You get to the point where, okay, assume
19 away for the moment the obligation to serve, okay? And
20 you have a situation in which -- and let's assume for
21 the moment that -- let's just say that the cost of
22 local service includes the entirety of the loop, okay?
23 So when -- now you're saying, uh-oh, maybe my costs are
24 exceeding my revenues, but if you were to disconnect
25 that customer, the revenues that would go away for you

1 as the local exchange company might be -- you know, you
2 might be providing intraLATA toll or, you know, you
3 would be losing access.

4 So here's my question, okay. If, in fact, when
5 you make that decision as to whether or not you serve
6 local service or not, you're looking at revenues from
7 other services other than local service, then are you
8 in fact only looking at providing local service when
9 you're considering, you know, whether or not to provide
10 local service?

11 MR. DANNER: Okay. That's a very good question,
12 and there are several dimensions to talk about.

13 One is that there's a difference between going
14 forward costs and sunk costs, and the existing local
15 exchange carriers in a large part are in sort of a
16 funny situation, because they have plant and facilities
17 already out to customers. And so going back to our
18 economics again, they are really facing what you'd call
19 a short-run marginal cost problem with respect -- you
20 know, I've got a loop to your house. All of a sudden
21 you're not proving very profitable. What do I do about
22 that? Well, I've already stuck the stuff in the
23 ground. If I turn you off, I get nothing. If I leave
24 you on, I get something. Probably I'll leave you on.
25 But here comes a new competitor who says, aha, do I

1 want to think about extending some kind of service to
2 you, whether it's on a loop or, you know, attracting
3 you in some other way, perhaps some cable service.
4 That competitor is in a position to make the decision
5 all over again, to start -- and before they can make
6 the commitment and sink the cost, they have the ability
7 to say, now, wait a minute, do we want to go into this
8 neighborhood and commit a lot of plant? Because once
9 we commit a lot of plant, we're stuck in this game that
10 we're there, at least for the ones who make that kind
11 of commitment. I mean, a wireless carrier might not
12 have to. We're there, we're stuck, and once we cross
13 that threshold, we're committed. New competitors can
14 make that kind of choice.

15 Now, as with respect to the packaging issue, and
16 I'll get to that briefly in a moment, I think what
17 you'll see is what we already see in the market in a
18 lot of instances. You'll see competitors offering the
19 equivalent of kind of a minimum bill that says, the
20 example of the free basic service if you're willing to
21 buy whatever it was, 40 or 50 dollars worth of, you
22 know, long distance service. That assures the carrier
23 -- and we see this with PCS and wireless service now.
24 That assures the carrier that they're going to make
25 back that sort of fixed cost equivalent no matter what,

1 and it also gives the customer usually a lot of low
2 priced usage, which is what customers want, and we'll
3 get back to that. That's what motivated us primarily
4 in California, was to create that benefit. So, yeah.
5 Let's see, where are we?

6 The non-basic service, the circular reasoning.
7 Let's move on from here. Well, the last point, though,
8 and we'll talk about that.

9 Customers do tend to subsidize themselves on the
10 same bill. I've got a lot of bill information we'll
11 talk about later. That's one reason why pricing reform
12 shouldn't be so scary. And in fact, the total bill is
13 what really matters to customers. My wife and I tease
14 each other about this sometimes. We get the Visa bill,
15 you know, it will be a little too high, and one of us
16 will say, "But that's okay, I know what that \$100 is
17 for, that was for that." And so the response is, "Oh,
18 so that's the one I can pay with Monopoly money because
19 that's the part of the bill that isn't real?" These
20 debates, it often sounds as if customers only have to
21 use real money to pay for the basic service and the
22 other prices don't matter somehow. That's not really
23 the case and we'll talk some more about that.

24 The razors and blades, the key here is kind of my
25 third point. You need a tight linkage between the two

1 products to make this work. I mentioned to you that
2 customers -- that I got sent this free razor in the
3 mail, right, after I filed some testimony that talked
4 about razors and blades. It was a new Gillette Ultra
5 something or other razor that used some funny blades
6 and I don't know what they cost, but it had to be a
7 lot. It was not your standard razor that opens up and
8 takes the standard blade you can buy from anyone.

9 Similarly and interestingly, cellular service has
10 a little bit of a razors and blade quality because
11 there's no equal access for airtime. When I got a
12 cellular phone and activate cellular service, if I want
13 to make a call, in this case it's a GTE Mobile Net
14 phone, I've got to use GTE Mobile Net. I can't take
15 this phone and dial a few digits and get to Sprint like
16 I can on an ordinary phone system for long distance or
17 other services. So, you know --

18 COMMISSIONER GARCIA: Isn't the razor and blade
19 there also, free weekends, they're giving you part of
20 services sort of free because you're taking care of the
21 basics? If we said to a cellular company, you know,
22 you've got to bill people for X, and then everything
23 else -- doesn't that end up in the same place that --
24 in other words, they're giving you free service not
25 because it doesn't cost them, but because they're

1 getting you somewhere else?

2 MR. DANNER: And they're very assured of getting
3 it, too, in the cellular case, because, as I say, if
4 I'm going to use the phone at all, I'm going to have to
5 use it on their network. Once I've got that phone, I
6 can't shop -- I mean, I can switch service providers, I
7 suppose, but even there, well, you know, if they give
8 you a free phone, it's usually got a contract tied to
9 it that says, you will use us for a year or else you
10 will pay for the phone. So -- but the real point here,
11 as far as policy, is that this approach talks about
12 overpricing usage to underprice access. That's what
13 we're talking about. Overpricing the blades, you
14 underprice the razor, try to promote -- you know,
15 promote a market, what have you. And when government
16 overprices the use of phones, it hurts customers, and
17 I'm going to tell you why and how and more about that,
18 because people want to call more. There's a genuine
19 economic benefit to that, and that's what you give up.

20 And so the last point on the page is that, yeah,
21 bundled services can be good options, but if you
22 mandate the bundles, and particularly if you mandate
23 them kind of backwards to what customers want, you're
24 going to cause problems -- many of the problems in the
25 market that we've heard discussed. What you want to do

1 is let providers offer these bundles on an optional
2 basis. They will attract customers, but they'll tend
3 to do it with some assurance that they can recover
4 those costs. And of course, with basic service, that
5 cost includes the loop.

6 Let's go to the next slide.

7 We heard a little bit about Smith versus Illinois
8 Bell again. I guess I shudder to think about using the
9 1930s to set our going forward telephone policy, but be
10 that as it may, there is an allocation between the FCC
11 and the state commissions, and it's about
12 three-quarters to one-quarter, as everybody knows. And
13 you can read FCC decisions until you're blue in the
14 face. They certainly write enough of them and they're
15 long enough. I think the key determinant of the FCC's
16 view is what they've done on pricing, and they have
17 consistently moved loop costs to fixed charges.

18 In creating the 350 SLC, in creating the PICC,
19 which is kind of the junior version of the SLC, the FCC
20 has said, well, we've got these fixed costs, but we're
21 going to make them basically part of the basic rate in
22 some fashion.

23 And if you want to go into the history of
24 separations, I mean, instead of prices based on costs,
25 it was largely costs based on prices. Look at the

1 history of the allocation plans to try to produce
2 desired results. But in a competitive environment, we
3 need to get back to prices based on genuine costs.

4 Stand-alone costs, we talked about that just a
5 little bit before. I certainly endorse Dr. Taylor's
6 view. I don't know what would happen if you tried to
7 do the real stand-alone cost study that is required by
8 the theories, which is not just every service but every
9 combination of every service, if you want to look at
10 subsidies from that standpoint. I think that the
11 easiest way out of this is the notion I suggested
12 before, that however it happens, sooner or later that
13 customer gets the loop in these examples. Once the
14 customer gets the loop, they're plugged into the
15 network again, and that cost has been caused for the
16 cost of access.

17 Now, you can call it what you want, but as a
18 practical matter, most customers in Florida today buy
19 that through basic service.

20 So -- but let's turn to California on the next
21 slide. I said this is a little bit of a personal
22 story. Let me just give you a sense of the setting,
23 and it was a little while ago. We had a Pacific Bell
24 rate case that I think by the time it was settled
25 someone said, if it were a child, it would have been in

1 third grade. It was proving very difficult in those
2 days to practice cost of service regulation in what was
3 then even a slightly growing competitive environment.
4 Pacific Bell wanted to have a rate freeze. The
5 Commission decided to take matters into its own hands.
6 It opened an investigation into alternative regulatory
7 frameworks. We had three phases to it, and it's
8 interesting because there was a certain symmetry
9 between then and the issues the Commission was dealing
10 with, and the issues you're dealing with today.

11 We were concerned about pricing flexibility for
12 services subject to competition, concerned about
13 incentive regulation to improve the regulatory process
14 and improve the incentives it provided to companies and
15 to allow the process to adapt a little better to
16 competition, and rate realignment and new competition.
17 At that time, California's LATAs were not open.
18 California was one of the last states in the country to
19 open its LATAs to competition, and in keeping with
20 that, there were some very high toll rates at the time
21 in particular.

22 I mentioned the anecdote. My wife was a
23 consultant dietician who would go to nursing homes, and
24 I remember she went to -- used to go up to one in
25 Eureka, which is in the far north coast of California,

1 still in the San Francisco LATA. It would cost me 50
2 cents a minute to call her. Now, that was a little bit
3 extreme, but the general toll rates in California
4 weren't that much higher than they are in Florida
5 today. So we had some results, the pricing
6 flexibility phase was settled, there was a new
7 regulatory framework adopted, which was the first state
8 level price cap in the country and is still in effect
9 today, and a revenue neutral rate realignment that went
10 along with opening up the LATAs, and that's what I
11 really want to focus on is that third part of what
12 occurred in California.

13 The personal side of this, in 1987 -- and I talk
14 about this in my comments. A particular part of this
15 rate case decision was decided that involved the rates,
16 and at that time, Pacific Bell had an \$8.25 basic rate,
17 and of course, we had the usual argument about
18 realigning rates and what costs really were. But one
19 of the Commissioners was just adamant. He was really
20 upset about any potential for rate realignment for
21 increasing basic rates. He was very concerned about
22 the little guy, he came out of the labor movement. He
23 was absolutely convinced that raising basic rates and
24 lowering toll and access charges would hurt the little
25 guy, and we had this big argument, and eventually

1 Pacific Bell came out of there with, instead of an 8.25
2 rate, they had an 8.35 rate. So nothing happened in
3 1987. But I kind of realized as a commissioners'
4 adviser that, at the end of the debate, I realized that
5 nobody had any actual information to support this
6 argument, neither side, actually. The people who were
7 very concerned about hurting the little guy and the
8 people who were really concerned about making rates go
9 to costs, the arguments about impacts on customers were
10 done entirely without the benefit of data, which struck
11 me as a little strange since it seemed to be such an
12 important issue the Commission was dealing with.

13 So I kind of get the ball rolling by making little
14 data requests of the companies to produce some billing
15 information, and if we can go to the next slide, we can
16 talk about what was done with that and kind of what
17 happened, and this will feed into some of the specific
18 customer impact and customer bill data we're going to
19 talk about in a little while. Sorry, the one
20 -- looking for Pricing Reform 2, the one before that,
21 Irene. Thanks.

22 Let's see. Research demonstrated broad consumer
23 benefits from realignment. There was a comment made
24 earlier about Lifeline in California, which really is
25 apropos to this. One of the biggest winners from rate

1 realignment in California were low income African-
2 American customers. Now, why was that? Well, GTE's
3 Lifeline customers in Los Angeles who identified
4 themselves as African-American were making \$12 a month
5 on average of toll calls. Cut the price of toll calls
6 by about a half, which is about what the Commission
7 did, you give them, you know, that much of a benefit,
8 and there's an additional benefit that we'll talk about
9 as well. And of course, the Lifeline program kept
10 their basic rate from changing very much. They were
11 big winners.

12 These were people who were sort of the natural
13 constituency of the commissioner who was so concerned
14 about hurting the little guy. In fact, the way the
15 rate rebalancing proceeded, the residential customers
16 as a whole gained considerable benefits. In fact, the
17 commission in California has a rate pair advocacy arm.
18 Its name has changed, it's now called the Office of
19 Rate Pair Advocates. They supported the rebalancing,
20 they even wanted to go further than the companies in
21 terms of increasing basic rates, reducing toll and
22 access, because they saw the benefits for customers.

23 I share with you some of the rate changes that
24 occurred. It's a 400-page decision. It has about a
25 60-page rate appendix. Anybody who wants it is welcome

1 to it, although I don't have it here today. GTE's
2 rates went, as you see, from about \$10 to about \$17.
3 That's not including the subscriber line charge.
4 Measured rate went up. Look at the toll price cuts.
5 We now have very low access charges in California.
6 Pacific Bell's rates didn't go up by as much, in part
7 because there was a kind of a holdover settlements type
8 issue between GTE and Pacific Bell which required that
9 GTE's rates go up somewhat more than Pacific Bell's.

10 Now, we heard some discussion about a claim that
11 that hurt penetration. I don't have a slide on this,
12 but I've got the numbers. It helps to know a little
13 bit about California to understand them. The FCC --
14 these are the FCC numbers. Now, I have them actually
15 annually, I think we saw them in three-year chunks, but
16 that really doesn't tell the story.

17 In 1991, we had 95.0 percent penetration; 1992,
18 that went up to 95.6; 1993, went up slightly more to
19 95.8. But then something happened, and many of you who
20 remember the 1992 election know what it was. We had a
21 deep, hard recession in California that came to our
22 state latest of any of the states in the country. It
23 kind of worked its way across. Anyone working in
24 Governor Pete Wilson's staff can tell you about what a
25 joy it was to be governor during that recession. And

1 from '93 to '94, we lost one percent of the customers.

2 MR. OCHSHORN: "We" is California?

3 MR. DANNER: Yes.

4 MR. OCHSHORN: Okay.

5 MR. DANNER: I'm sorry. I hope I'm not making
6 that an imperial "we," it's the state of California,
7 not me.

8 So from '93 to '94 we lost one percent of the
9 customers. It went to 94.8 percent, that's the 1994
10 number. The rates went into effect the start of 1995,
11 and 1995 the number was 94.5; 1996, the number was
12 95.0; 1997, it fell again to 94.3. The March number
13 for 1998, which is just -- I guess is a first quarter,
14 somewhat preliminary, is not quite comparable to the
15 other ones, but it's back up a little bit.

16 As I represented in my comments, I thought the
17 most representative way to look at this was to take the
18 number the year before the rates changed, which was
19 1994, the year after they changed, which was 1996, but
20 any way you want to look at that, once you recognize
21 there was a sustained recession -- this severe
22 recession in California, you realize that we've had
23 about 95 percent penetration.

24 MR. DUNKEL: Excuse me, didn't the rate change
25 1/1/95?

1 MR. DANNER: Yes.

2 MR. DUNKEL: So isn't the year after the rate
3 change 1995, not 1996?

4 MR. DANNER: Well, I guess that depends on how you
5 count January 1st. I thought the year the rate change
6 went into effect was '95, and '96 was the year after.

7 MR. DUNKEL: Isn't the first twelve months after
8 rate change 1995?

9 MR. DANNER: Why, I think it is.

10 MR. DUNKEL: Thank you.

11 MR. DANNER: But in any case, there was also, by
12 the way, remarkably little reaction from customers. I
13 spoke to the PUC's Public Adviser with respect to after
14 the rates went into effect, what kind of response did
15 they get from customers? He said they did get some
16 angry letters and calls, numbering probably in the
17 dozens in a state with, you know, 30 million people. I
18 spoke with each of the regulatory directors for the
19 major telephone companies; they didn't report anything,
20 either. It was pretty much a non-event in terms of
21 actual effects on customers in California.

22 Now, of course, there was a lot of publicity about
23 the process. Maybe that had something to do with it.
24 I would not want to say there was no controversy about
25 it, certainly, but after the rates went into effect

1 there was very, very muted customer reaction that you
2 could barely determine.

3 COMMISSIONER GARCIA: What guarantees did the
4 California Commission make for citizens? Besides the
5 rate rebalancing on basic rate, what other guarantees
6 were made to protect customer classes? Were the toll
7 reductions guaranteed to citizens as well as business,
8 in other words, the access reductions and things of
9 that nature?

10 MR. DANNER: They reduced the toll rates directly,
11 you saw that on the slide. And at that time, I think
12 except for the business market, Pacific Bell and GTE
13 still had virtually all of the residential toll
14 markets, so those went through directly. As far as
15 access charge flow-through, I know -- I think it's been
16 established to my satisfaction that the interexchange
17 carriers kept some of that, at least initially.
18 There's an analysis Professor McAvoy's done that I
19 think shows that pretty well, although I will tell you
20 today, anytime you call in California for a calling
21 plan, you get quoted two different prices. You get
22 quoted a price for your interstate calls, and you get
23 quoted a price for intrastate calls. And the
24 intrastate price is usually about two cents a minute
25 less, which is about what the difference in access

1 charges is between California and the federal
2 jurisdiction. I know, I did it just the other day for
3 our business.

4 As far as Lifeline goes, it was mentioned
5 California has a very generous Lifeline program. That
6 was revamped somewhat about the same time I think to
7 make it even more attractive. So there is that for
8 customers.

9 Besides that, I mean, that's -- I hope that
10 answers your question. That's pretty much the way it
11 was put together.

12 Now for this next set of discussions I'm going to
13 turn to this little package, and I'm not going to go
14 through everything in it, but I'm going to try to hit
15 some highlights and make a few points, and of course,
16 you can examine it at your leisure, and I think
17 information here that doesn't come from telephone
18 companies is cited. You can look for it and so on.

19 I'm going to spend a few minutes on what I think
20 is a famous study, although I don't know if it's always
21 recognized as such, that provides the answer to
22 question 1: How does telephone pricing affect whether
23 people decide to have telephone service? The answer is
24 not nearly as much as you might think, and higher long
25 distance prices can actually hurt universal service

1 more than they help. And there's a somewhat counter-
2 intuitive conclusion that comes from that, because the
3 paper I'm going to talk about studied the imposition of
4 the \$3.50 end user charge which effectively raised
5 basic rates by 3.50, reduced other rates by the
6 equivalent, and in the process, made telephone service
7 more affordable. I know that sounds a little counter-
8 intuitive, but once again, 3.50 access charge, the end
9 user charge of the FCC made telephone service more
10 affordable.

11 How do we know they made it more affordable?
12 Because as a result of that action, more people took
13 telephone service, and you could actually see how much,
14 or how many more people took telephone service. And
15 that seems a little counter-intuitive, I know, and let
16 me explain why from the customer's standpoint it makes
17 sense, and why it's related to a primary motivation for
18 the California Commission's effort to rebalance prices.

19 MR. OCHSHORN: In your presentation somewhere do
20 you have the information on which you're basing this
21 conclusion that the restructuring increased --

22 MR. DANNER: Page 2 of the handout, under question
23 1, if you follow along there.

24 In fact, as I report in my comments, the \$3.50 end
25 user charge more or less bridged seven percent of the

1 gap of phoneless people in the United States. And how
2 did it do that? What's the intuition of that? When
3 you buy telephone service, or basic telephone service,
4 you get two things. The first thing you get is access
5 to the network, and some other things bundled in. You
6 get 911, you can maybe call directory assistance if you
7 get any free calls, call an operator and so on. So
8 there are a number of things you can do with your basic
9 telephone service once you get it that don't require
10 you to spend anymore money. And so basic telephone
11 service creates a certain value in and of itself. You
12 can receive calls, you can call in an emergency, and so
13 on.

14 The second thing you get when you buy basic
15 telephone service is the option to buy some other
16 services that are sold the same way, sold kind of over
17 the network. You can make a long distance call, you
18 can subscribe to voice mail, so on and so forth. What
19 people overlook is that how valuable that service is to
20 a customer is a function not just of what you get right
21 when you buy the service, but all the other things you
22 can do with it.

23 I'll use a very simple analogy that's in my
24 comments, and again, I apologize if it's too simple,
25 but imagine two cars. One -- you know, they're the

1 same cars, except this car uses very expensive gasoline
2 and this car uses ordinary gasoline. This car is \$10 a
3 gallon for gasoline and this car is, you know, a dollar
4 a gallon or whatever it costs. The same cars, they've
5 got the same mileage, they're appointed the same way.
6 Which of those cars would you pay more money for if you
7 were a consumer? Well, obviously the car that uses the
8 dollar gasoline, you'd be willing to pay a lot more for
9 that than the one that costs \$10.

10 Well, the same thing is true with phone service.
11 If I give you two telephones and say, here's a
12 telephone where every toll call costs you 20 cents a
13 minute, and here's a telephone where every toll call
14 costs you five cents a minute, which one of those is a
15 better telephone? Obviously the one with the five
16 cents a minute.

17 COMMISSIONER GARCIA: Unless you don't make toll
18 calls.

19 MR. DANNER: Not necessarily. Probably, but not
20 necessarily, because you may not make toll calls
21 because 20 cents is too high. Some customers who don't
22 make toll calls will start calling when you get to five
23 cents, right? So -- but you're right, I mean, that
24 could be true.

25 And that's what was going on with the \$3.50 FCC

1 rebalancing, because in fact, when you cut the price of
2 toll, long distance calls, people make more calls.
3 When they make more calls, they gain the economic
4 benefits of making those calls. It makes them better
5 off. When it makes them better off, it makes the
6 telephone service, itself, more valuable to them. And
7 so you've kind of got this little paradox because, on
8 the one hand, the price of basic telephone service is
9 going up, but so is the value. And as it turned out,
10 in the 3.50 rebalancing with the federal access charge,
11 the value went up more than the price. And so you
12 actually had more people take telephone service as a
13 result of that.

14 And in fact, Jerry Houseman, who is the lead
15 author on the study, takes pleasure in noting that
16 there are a couple of advocacy groups, I think one of
17 them was the Consumer Federation of America, who claim
18 that millions of people would be thrown off the network
19 by the \$3.50 increase. In fact, although not entirely
20 due to the increase, millions more people joined the
21 network during the period it was put into place. The
22 error in the consumer group estimate was ten million
23 customers. They said, I think it was either four
24 million would leave or six million would leave, and in
25 fact, you know, the complement of that came.

1 Those benefits of additional calling are large,
2 they are significant. Turn to the last page of this
3 little handout, page 14. And again, it's a Jerry
4 Houseman estimate here, but I've seen other ones. In
5 fact, the first time I saw this estimate made was in
6 1984 when I was in graduate school and Jerry Brock, who
7 was at the Federal Communications Commission, came and
8 presented a paper.

9 What are we talking about in terms of benefits?
10 Mispricing of long distance service is costing the
11 economy something like \$7 billion a year nationwide.
12 And I'm sorry, that doesn't correspond with the slide.
13 I went out of order, Irene. That's okay.

14 It's costing consumers something like \$1 billion a
15 year directly. The fascinating thing about this kind
16 of rebalancing or pricing reform is there is a free
17 lunch. It's one of those strange places in economics
18 where you actually get something for nothing, because
19 the price of basic service is almost entirely
20 inelastic. Within any reasonable range of prices,
21 hardly anyone will leave, and we know that. The price
22 of calling long distance services is somewhat elastic.
23 It's not, you know, tremendously so, but somewhat
24 elastic, enough so that if you reduce the markup or the
25 cross-subsidy that's involved from long distance to

1 local, people make substantially more calls. It
2 creates a stimulus to the economy, it creates benefits
3 for customers.

4 Nationwide this estimate was \$7 billion. We've
5 made a little progress. The first time I heard the
6 number from Jerry Brock in 1984, it was \$15 billion.
7 So a dollar today is not quite what it was then, and
8 we've made some progress.

9 This is something the California Commission
10 explicitly wanted for customers in California, the
11 ability to make more calls and to gain the economic
12 benefits of doing so, and this is something I would
13 suggest that should be important to Florida as well.

14 Let's go back on track and go to question 2, which
15 is on the economics and facts 1. Why do people lack
16 service who want it? We've talked about bringing more
17 people on the network. I know there was a little
18 discussion of this earlier. There are some studies and
19 they start on page 3 of this handout, and I'm not going
20 to go through all of them at this point, but I've noted
21 five different studies that actually go and interview
22 people without phones and ask them why they don't have
23 phones.

24 Now, let me just start with -- mention the first
25 one briefly. There's one the Consumer Federation of

1 America, AARP and AT&T presented in 1987, which is
2 referred to right here, and they interviewed 600 people
3 without phones in Florida, California and Texas, and
4 about three-quarters of those without phones said that
5 the front end cost of getting service, the installation
6 charges and deposit were the main barrier. Only about
7 one-quarter said that the local monthly service was the
8 issue for them. And -- and this is something that's
9 been found in some of the studies in California -- some
10 proportion of those customers, in this case it was a
11 quarter, said they owed the telephone company large
12 sums they couldn't pay, which comes into the toll
13 blocking kind of issue, because the inability to
14 control the use of the phone in addition to the
15 installation and hookup charges are really what keep
16 people off the network. It's not the basic rate.

17 COMMISSIONER GARCIA: Obviously under your
18 scenario that would no longer be the case?

19 MR. DANNER: Well --

20 COMMISSIONER GARCIA: If we were to take, say --
21 let's say we accept your concept that the cost of
22 providing service should be borne by the cost causer,
23 and in your case you believe that that is each
24 individual -- the loop costs should be paid for by the
25 customer and everything else is extra, right?

1 MR. DANNER: Well, I would say that that's how you
2 should do the cost. We'll talk a little bit about
3 pricing. You don't necessarily need to go that far.

4 COMMISSIONER GARCIA: Let's go that far.

5 That being the case, then, we should then be able
6 to say to a customer, you don't have to pay your long
7 distance bill. That's an issue you have to deal with
8 with your credit report, that's something else, but
9 basic service you get, you pay for it, you're fine.
10 Any debt you incur outside of that, since you're not --
11 that should have -- in other words, your local company
12 shouldn't be able to shut down your phone if you make
13 too many long distance calls because that's really not
14 a product of the loop.

15 MR. DANNER: Well, if you -- I mean, you could --
16 that's one thing you could do and that would have an
17 impact, certainly. Another approach would --

18 COMMISSIONER GARCIA: It would increase probably
19 the number of people that get back onto the system, I
20 would assume.

21 MR. DANNER: I think it would. It would probably
22 also, you know, increase your uncollectibles to some
23 extent. I don't know.

24 COMMISSIONER GARCIA: Right, but it wouldn't
25 increase his uncollectibles. It certainly might

1 increase the company's.

2 MR. DANNER: Sure.

3 COMMISSIONER GARCIA: Or they may put a block on
4 it. In other words, blocking then should cost nothing
5 because you're not allocating any of the costs of that
6 loop to the long distance company. They pay their own
7 way because the loop is already paid for.

8 MR. DANNER: Well, certainly, I wouldn't want to
9 see any loop costs in the blocking. You know, I don't
10 know what else it might cost. But, yeah, I would agree
11 with that.

12 Another option that I think the FCC has talked
13 about is toll limitation service for customers, and one
14 of the funny things about a telephone that you don't
15 see in almost anything else you buy, when you get a
16 telephone, you don't just get phone service, you get
17 unlimited credit, too.

18 COMMISSIONER GARCIA: Right. Well, you get
19 unlimited credit because there is -- the value of the
20 service is so great, it's like oxygen, you know, you
21 need it, you can't live without it, therefore, the
22 company can give you credit because they know they can
23 get it back from you to some degree.

24 MR. DANNER: Well, to some degree, but you could
25 also -- you know, this is why I think prepaid cards

1 have become such a success now.

2 COMMISSIONER GARCIA: Right.

3 MR. DANNER: Because prepaid calling cards
4 unbundle credit and service.

5 COMMISSIONER GARCIA: Right.

6 MR. DANNER: You pay just for what you're going to
7 use and, you know -- but we could pay for phone service
8 in advance. We don't necessarily have to pay for it in
9 arrears.

10 COMMISSIONER GARCIA: And some do, and that's why
11 there's been great penetration even in this market for
12 bad credit customers. They pay \$50 or \$60 a month to
13 some reseller of local service.

14 MR. DANNER: Yeah.

15 COMMISSIONER GARCIA: But they get no credit for
16 long distance. They're cut off basically.

17 MR. DANNER: And those are useful options, I
18 think, or also giving the customer the ability just to
19 control it and say, all right, I'll let \$20 go, but
20 that's it, you know, in any given month when I've
21 reached \$20, I want to know, you know, stop it. That's
22 another thing that can help.

23 But here again, I guess the pattern I'm trying to
24 suggest, aside from some specifics that I think you're
25 quite right to point to, is that this debate about the

1 basic residential rate is overwrought in terms of
2 impacts on customers. Because the customers pay the
3 total bill, customers want to use a phone, not just
4 have it. Universal service concerns are actually
5 better addressed through better pricing and other
6 direct means that, you know, go at the heart of the
7 problem.

8 And one other conclusion I just want to reinforce,
9 that price rebalancing can make service more affordable
10 because people -- more people will buy it, again
11 because they pay the total bill, they don't just pay
12 one piece.

13 MR. DUNKEL: Just briefly, you talked about the
14 AARP study. Is a correct statement that the customers
15 who do not have phone service indicated basic exchange
16 service as being more of a reason than long distance
17 service in that AARP study?

18 MR. DANNER: I don't remember that comparison.
19 What I saw was that installation charges and deposits
20 were the issue for about three-quarters of them, and
21 basic rates were the issue for about one-quarter of
22 them. That's what the study says. I don't remember it
23 comparing long distance. It also did say that a
24 quarter of those without phones say they owed the phone
25 company large sums. Now, I'm not quite sure how those

1 were, you know, came about, but since the study
2 suggested it would be several hundred dollars as a
3 large sum, I think it's a reasonable inference that
4 that was contributed to by long distance, so I don't
5 know how to compare those two, but that's what the
6 study said.

7 MR. DUNKEL: Moving along, you referred to a
8 California study. Is that the study that found that
9 long distance, international long distance was a large
10 problem?

11 MR. DANNER: Among other long distance, yes.

12 MR. DUNKEL: Wasn't international the largest
13 problem in the long distance category that was a
14 problem?

15 MR. DANNER: I don't recall the difference between
16 international and other long distance. The point again
17 is that it wasn't the basic rate that's keeping people
18 off the phone network.

19 MR. DUNKEL: Do you think in Florida that
20 international long distance is the major problem?

21 MR. DANNER: I don't know. Florida in many ways
22 resembles California. We have a -- you have a very
23 diverse population, you have a lot of people from other
24 countries who have moved here. I don't know. It seems
25 to me that you could well have similar circumstances to

1 those we know, but I think the Commission is more in
2 tune with that. My point is that --

3 MR. DUNKEL: Do you think that this Commission
4 regulates international long distance rates, if that is
5 a problem?

6 MR. DANNER: No, I don't think this Commission
7 regulates international long distance rates. I don't
8 think you think that either.

9 But the point being that basic service is not the
10 issue. I don't want to take the time to go through all
11 the other studies here, but I will call your attention
12 that there are five of them that are referenced.

13 Let's move on to the next slide.

14 Total bills and telephone service. Here we find a
15 very consistent pattern and we'll point to it in
16 several different ways. Average residential customer
17 bills tend to be about oh, all -- not quite three-
18 quarters, other charges, and a bit more than one-
19 quarter, the basic rate. It depends on the state, it
20 depends a little bit on how you count, but that's a
21 very consistent pattern.

22 Let's turn to the next slide.

23 Florida data, you've seen this if you've already
24 looked at my comments. Almost \$50 for the average
25 residential bill, and here you'll notice I included the

1 subscriber line charge as part of the basic rate. The
2 long distance is estimated by doubling the access
3 charges. That's a little bit conservative. It's
4 probably somewhat higher than that. We've also got it
5 by income levels here.

6 MR. OCHSHORN: I have a few questions about this
7 information. How were these totals calculated?

8 MR. DANNER: These totals are calculated -- I
9 investigated some more, actually, in response to your
10 earlier comment and question. These totals were
11 estimated kind of at the little micro-census block
12 approach by the company, took the average income for
13 the smallest census group they could find, attributed
14 that income to all the customers in that area, I think
15 they said it was about 50 to a hundred customers per
16 group, and then reported these numbers on that basis.

17 MR. OCHSHORN: So this is block data here --

18 MR. DANNER: Yes, this is block data.

19 MR. OCHSHORN: -- rather than individual.

20 MR. DANNER: We do have individual data later on,
21 but this is block data.

22 MR. OCHSHORN: Okay. For the -- just generally,
23 how did you calculate people's total phone bills? What
24 was included in that?

25 MR. DANNER: Well, you see it up here. It was

1 basically what they paid GTE plus an allowance for long
2 distance calling, and the long distance calling was
3 calculated by taking the access charges that are
4 associated with that customer and doubling them.

5 MR. OCHSHORN: Okay.

6 MR. DANNER: So it's I think a little
7 conservative, not too much, in terms of the long
8 distance portion.

9 MR. OCHSHORN: Was a particular month chosen and
10 it was whatever the person owed for that month or how
11 was that --

12 MR. DANNER: This data is for March of '98, this
13 particular data.

14 MR. OCHSHORN: And so was this -- and so the
15 49.15, and then there's different numbers on the
16 bottom, but that's how much customers owed on their
17 March '98 bills?

18 MR. DANNER: I think that's right. You're getting
19 a little beyond exactly -- you know, I asked the data
20 to be provided. They provided it and explained it as
21 far as I've explained it to you. I think we can find
22 out more.

23 MR. OCHSHORN: Okay, well, that was -- that would
24 be -- other than your basic column, which you do
25 explain, I really don't know what's included in the

1 total or what's even meant by the total there.

2 MR. DANNER: Well, it's -- the total would include
3 the basic service charge, the SLC, the toll, vertical
4 services, you know, the GTE bill.

5 MR. OCHSHORN: Would it include back amounts that
6 are owed? Would it include connection charges? Would
7 it include interest and penalties on unpaid bills? I
8 mean, there's a lot of questions, and you've already
9 explained that this was provided to you and I don't
10 mean to put you on the spot, but I'm just raising that
11 as far as what --

12 MR. DANNER: I would have to guess on some of
13 those. I know more with some of the other data. My
14 guess is that probably not on most of the item you've
15 mentioned, but I'm not certain.

16 MR. OCHSHORN: Okay. Thank you.

17 COMMISSIONER DEASON: Excuse me, a question. Why
18 do the basic rates change based upon income?

19 MR. DANNER: I think it's because you have
20 somewhat different basic rates for -- I don't think GTE
21 has a unified basic rate.

22 COMMISSIONER DEASON: Well, I guess it changes
23 based upon rate groups, but I would assume in any given
24 rate group, you've got low income people and high, I
25 don't understand why the basic rate changed according

1 to -- it looked like it went -- it consistently goes --
2 well, it goes up. I know that GTE doesn't have a
3 policy of charging more for people who make more money.

4 MR. DANNER: No, Commissioner, I don't believe
5 they do. I'm afraid I can't answer your question. I
6 don't know the answer to that question.

7 COMMISSIONER DEASON: Perhaps there were some
8 second lines that were averaged in or something or --
9 I'm just curious as to why that would be the result.

10 MR. DANNER: Well, again, I apologize --

11 COMMISSIONER GARCIA: If they have figured out how
12 to do that, we'd like to know.

13 MR. DANNER: Oh, sure.

14 COMMISSIONER GARCIA: If they know how to do that
15 through a phone line, it would be --

16 MR. DANNER: Again, Commissioner, I apologize. I
17 can't answer that question specifically, although I'm
18 sure --

19 MS. CASWELL: Yeah. I think the explanation is
20 that includes measured services and also it depends on
21 the rate group.

22 MR. DANNER: Okay. So you have the measured
23 versus flat rate difference as well as the rate group.
24 So it may be that some customers are buying more
25 measured and some are buying more flat rate.

1 MR. OCHSHORN: Do you know how many customers were
2 included in this survey?

3 MR. DANNER: No.

4 MR. OCHSHORN: Thank you.

5 UNIDENTIFIED SPEAKER: It was not a survey. It's
6 the entire customer billing.

7 MR. OCHSHORN: Okay. Thank you.

8 MR. DANNER: The point I guess I'm getting at, and
9 you'll see this as we go through other data, the
10 percent of basic here is hovering around 30 percent.
11 That's a pretty consistent pattern from state to state.
12 Once again, it just points out that at least in terms
13 of average -- the average for residential customers,
14 the basic rate is not the primary determinant of what
15 their bill is.

16 Let's go on just in here in the handout, and I
17 don't want to go through all of these, but I'll just
18 tell you what's in here and you can look at it as
19 well. We have information from California, and the
20 information from California was individual surveys of
21 customers, including their demographic characteristics
22 -- it's not on the overheads -- and in this package, by
23 the way, just because of the way they were calculated,
24 the subscriber line charge is not part of the basic
25 local rate, so you have to recognize that difference in

1 the calculations.

2 We also have some analysis from GTE and IRD, which
3 is the same rate rebalancing proceeding.

4 Look at page 7, though. There's one thing here
5 that's very intriguing, page 7 of this handout. Look
6 at the race/ethnicity group. In California, customers
7 who identified themselves as African-American or black
8 had rather high phone bills by comparison to the
9 average in the GTE analysis. In the Pacific Bell
10 analysis, which you'll see in pages to come, you see
11 the same thing, although the average is just slightly
12 above average. The New Jersey analysis that's
13 referenced here isn't very representative because it's
14 only a very small sample and it was just in Camden, but
15 here again, we had low income residents using features
16 more than average and also having minorities spending
17 significantly more on communications services.

18 If you look at the Indiana study, and this is good
19 data -- Ameritech has got a wonderful data source.
20 That's on page 12 of this handout. Look at the
21 difference on the African-American bills there. And I
22 can tell you that other minorities in Ameritech's
23 region also have above average bills. It's a very
24 interesting thing that keeps popping up in these
25 studies, but minority customers use the phone more and

1 buy more features.

2 MR. OCHSHORN: I guess two questions I have about
3 that is why are you examining customers by their
4 ethnicity, and given that, what conclusions could
5 possibly be drawn from that?

6 MR. DANNER: Well, the information is available.
7 In California, the commission ordered the studies to be
8 done by ethnicity because they wanted to avoid any
9 disproportionate impact on particular ethnic groups,
10 which is the same reason why I'm bringing up the point
11 here, that this is something that's kind of an
12 unintended consequence or finding, but insofar as
13 current pricing disadvantages people who make a lot of
14 use of the phone, it seems to have a disproportionate
15 impact on minority customers. And this is something
16 that I think deserves further investigation. I can't
17 say whether it holds for Florida or not, I have no
18 idea. I can tell you that in these other states it's
19 clearly the case.

20 MR. OCHSHORN: Well, to my knowledge, in Florida
21 we don't break up data by ethnicity when it comes to
22 phone service.

23 MR. DANNER: Okay. In any case, I'm just saying,
24 it's an unintended, kind of surprising result from
25 these studies, and it gets back to, in a way, the

1 original concerns of the commissioner who was so
2 concerned about impacts on the little guy, which I
3 think in his case included, you know, disadvantaged
4 customers or also customers of different types, you
5 know. Minority customers, at least in these states,
6 and it seems to show up in each state we look at, do
7 make more use of the phone.

8 Question 4, can pricing reform make customers as a
9 whole better off? We've talked about the free lunch,
10 the benefits of using the phone more. And again,
11 there's, as I say, there's a history of these studies,
12 and I've referenced just one of the more recent ones
13 here from Jerry Houseman.

14 Let's go to the next slide, and this is kind of a
15 key one. Don't some people lose if you do this? And
16 the answer is sure. There's no way to change rates
17 without changing bills. It can't be done. And if you
18 do pricing reform or even universal service, some bills
19 will go up and some bills will go down and a lot of
20 bills won't change very much, but there will be those
21 impacts, and I would never want to deny that. That's
22 -- you just can't deny that. It's true. So what do we
23 think about that?

24 Well, first of all, I've said here, it's beyond
25 serious dispute that customers as a whole benefit from

1 revenue neutral pricing reform. That's because of the
2 calling benefits of the extra minutes of use, the extra
3 long distance calls and so on. The billions of dollars
4 nationwide I've spoken of, which, of course, you know,
5 is a smaller amount, a proportional amount in Florida,
6 but it's still serious money. So that -- so it's a pro
7 customer thing to reform prices, but then we get into
8 distributional arguments about who wins and who loses.

9 I mentioned the minority customers here. On
10 average, and this is interesting, when I've seen
11 distributions of this information in the past, there is
12 a distribution that has a little bit of a peak on the
13 high end, so the average bill is a little higher than
14 the median bill and so on. But, you know, that
15 distribution occurs in just about every customer
16 group. If you look at elderly customers, there are low
17 users and high users. If you look at low income
18 customers, there are low users and high users. If you
19 look at rural customers, you have low users and high
20 users. So there isn't really a very consistent way of
21 saying that these people clearly win and these people
22 clearly lose. You know, you're going to have some --
23 at the moment, there are almost certainly some low
24 income elderly customers who are paying a lot so that
25 some high income young customers can pay a little. I

1 mean, you can find all kinds of cross-subsidy arguments
2 like that in the data.

3 Yes?

4 MS. BUTLER: I just wanted to ask you, I'm on page
5 7, and I just want to know if I'm interpreting this
6 correctly that, for instance, under your way of looking
7 at how this would benefit customers, that if -- under
8 the column total bill, the higher the total bill, the
9 more benefit, and the lower the total bill, the -- they
10 would be the most likely to be the ones that would be
11 the most harmed, is that correct?

12 MR. DANNER: Yes. Generally speaking, the higher
13 the bill, the more you get out of rebalancing, or out
14 of pricing reform, yes.

15 MS. BUTLER: Okay. So, for instance, because
16 we've had a lot of discussion about the elderly too, so
17 if I wanted to figure out how they would fare, I would
18 look at the 48.98?

19 MR. DANNER: In that example, yes, and that's, of
20 course, a California number from some time ago, but
21 that's right.

22 MS. BUTLER: Okay. And then the extremely low
23 income, I would look there as well, but then that would
24 be offset to some degree by those who have Lifeline, is
25 that correct?

1 MR. DANNER: Yes.

2 MS. BUTLER: Okay. Okay, thanks.

3 MR. DANNER: That would be correct.

4 MR. DUNKEL: If you raised residential rates to
5 lower business rates, is it correct that, as a result,
6 residential rates in total would be a net loser, or
7 does this restructure assume all residential increase
8 goes to reduce other residential rates?

9 MR. DANNER: You can shift to -- from residence to
10 business to an extent and still make all -- make
11 residential customers better off because of the
12 benefits of increased calling. But at some point, if
13 you shift -- I don't know what that point is exactly,
14 because again, remember, there's a free lunch in terms
15 of the benefit -- the economic benefits of additional
16 calling which accrue to all customers. But at some
17 point, if you restructure rates from resident -- you
18 know, making residential customers pay more to reduce
19 business rates, you will offset that net benefit for
20 those customers, yes.

21 MR. DUNKEL: Thank you.

22 MS. BUTLER: I have one more question. Again, I
23 want to just make sure I'm interpreting this correctly.

24 If you were to look at the low end of the total
25 bill, it wouldn't necessarily mean that they were worse

1 off, it would mean that they were not as better off and
2 possibly worse off, is that correct?

3 MR. DANNER: Yes. For example, the GTE -- when
4 GTE analyzed its proposal in California, which was
5 basically a toll to basic rate restructure, they found
6 virtually every customer group was better off. There
7 were two that lost, I can't remember which they were.
8 The one that lost the most was 84 cents a month or
9 something on their bill. So you're right. I mean, it
10 depends again on, you know, all this stuff depends on
11 how you structure your reform, which is a key point.
12 And, in fact, if you have good billing data, you can
13 play with it a little bit and you can say, okay, what
14 if we knock a little off this vertical service? What
15 if we reduce access charges some more? What if we --
16 you know, you get a sense of the winners and losers in
17 the process.

18 MR. OCHSHORN: Mr. Danner, for your California
19 data from GTE, is it also true that the income break-
20 out is by blocks?

21 MR. DANNER: No, that was an individual survey of
22 customers. That's very good data.

23 MR. OCHSHORN: Okay. And do you similarly, like
24 with the Florida data, not know for sure what charges
25 are in the total bill here?

1 MR. DANNER: No, it's -- well, I thought -- I have
2 a pretty good idea. Again, it's the local -- it's
3 everything that was provided by the local company, I
4 believe, not including disconnects, you know, some of
5 the things that you mentioned, plus the imputed toll
6 amount, which is a slightly larger --

7 MR. OCHSHORN: Okay. Do you have a greater
8 knowledge of what's in this total bill information than
9 what was in the Florida total bill information?

10 MR. DANNER: Yes.

11 MR. OCHSHORN: And that's based on what?

12 MR. DANNER: Well, these -- this information was
13 developed in response to a commission order to the
14 companies to go out and do a careful demographic study
15 of customers. And so what they did was they had a
16 survey firm contact the customers and solicit their
17 demographic -- detailed demographic information, match
18 that up with individual customer phone bills to create
19 the information you see here.

20 MR. OCHSHORN: And could you provide what is and
21 what isn't included in a total bill?

22 MR. DANNER: Yes, I will call the fellow who did
23 it, which is Bob Tanamora, listed on the front, and ask
24 him to specify exactly for you.

25 MR. OCHSHORN: Thank you.

1 MR. DANNER: Okay.

2 MR. DUNKEL: If you're going to believe that
3 raising basic rates and lowering toll rates benefits
4 almost all customers, don't you have to assume that
5 almost all customers are making significant toll
6 calling?

7 MR. DANNER: Well, that's not quite what I said.
8 I said it would benefit almost all customer groups. I
9 also said that individual customers, you'll have
10 winners and losers.

11 MR. DUNKEL: Would that include the groups that
12 make fairly little toll calling?

13 MR. DANNER: Possibly. It depends on what the
14 demographics and usage actually are. As I say, in
15 California, at least the way GTE -- you know, GTE's
16 proposal was -- came across, it benefited virtually all
17 groups on average.

18 MR. DUNKEL: So if you raised residential basic
19 rates let's say \$10 and reduced toll rates
20 significantly, you would benefit those customers, even
21 those that make very few toll calls, is that your
22 statement?

23 MR. DANNER: You're confusing individual customers
24 versus the impact on the average bill of a customer
25 group.

1 MR. DUNKEL: Yeah. Well, let's define a group as
2 those who make fairly few -- let's say there's a group
3 that makes no toll calls, and let's assume it's 20
4 percent make no toll calls. Would that group be harmed
5 by raising basic rates and lowering toll rates, or
6 would they come out neutral?

7 MR. DANNER: A group like that would pay higher
8 bills. They would have some potential benefits that I
9 think probably for that group might not offset the
10 higher bills, but they would have some potential
11 benefits of being able to make toll calls now, some of
12 them will not have been making them because of the
13 price. They also have some potential benefits of
14 seeing local competition that they can't see now. But
15 yes, those customers would probably end up with higher
16 bills, the ones you described.

17 MR. DUNKEL: Thank you.

18 MR. DANNER: But let's talk about that because,
19 once again, the last bullet point here, customers pay
20 phone bills, nobody else pays phone bills. And what
21 we're really talking about are subsidy flows between
22 customers. And sure, there may be some customers whose
23 bills go up. In fact, I'd almost guarantee it, that
24 you'd have some customers whose bills would go up. Are
25 those particularly vulnerable customers? Are those

1 particularly low income customers? Then I think you
2 may have a concern or something you want to address.
3 Are those wealthy people with second homes who aren't
4 there half the time? You'll have some of those, too.
5 Are those average customers who may just happen to be
6 low usage of the phone who are now being cross-
7 subsidized by other average customers who just happen
8 to like to use the phone? I don't think there's a good
9 fairness argument for telling, you know, two middle
10 class people that one ought to pay money to the other
11 just because the one likes to use the phone.

12 You know, there's -- it's not just what the raw
13 impacts will be, you also need to think, in considering
14 fairness, who those people are and what your concerns
15 are about their state. And again, a Lifeline program
16 or something targeted to people you're really concerned
17 about is a terrific way to take care of genuine
18 concerns without having to tell middle class customers
19 that they need to keep pushing cross-subsidies with
20 each other indefinitely.

21 Let's go on to the last few of these economics and
22 facts. Local competition, we've talked about this, or
23 other people have talked about this at considerable
24 length. I just don't think you can look at the current
25 state of the market and say anything but basic rates

1 are deterring local facilities-based competition. I
2 mean, I've been able to go to my office in San
3 Francisco and look out the window for three or four
4 years and on the street read the fluorescent letters
5 that say TCG. We have people come to our office and
6 offer us new facilities based competition. Teleport
7 has a 5-ESS in the basement across the street. I've
8 seen it in the financial district in San Francisco.
9 Where I live is a reasonably affluent area in the
10 suburbs that's kind of spread out. Nobody's there.
11 The basic rate is way below the cost of the service.

12 One other thing that I would just mention here
13 just to follow up on a question that was asked to, I
14 think it was Dr. Harris the other day about the price
15 cap and the notion of looking forward to --

16 COMMISSIONER GARCIA: Didn't you say that in
17 California they rebalanced?

18 MR. DANNER: Yes, but not all the way. In other
19 words, the Pacific Bell rate only went to 11.25. I'm a
20 Pacific Bell customer. Probably --

21 COMMISSIONER GARCIA: So they failed in
22 California. Basically what they succeeded in is
23 lowering the rates of business or they just kept
24 subsidy and --

25 MR. DANNER: I think the business rates didn't

1 change very much. They went part of the way. They
2 went further with GTE's territory than they did with
3 Pacific Bell's. There are some commissioners today who
4 will tell you that they feel badly that they didn't go
5 further at that time. But you're right, they didn't go
6 far enough to bring all the costs of the loop into
7 basic service or to otherwise support it.

8 MR. DUNKEL: Is it your testimony that if a
9 competitor was looking at an affluent subdivision such
10 as yours, that the only thing they would look at is the
11 basic exchange revenue, not the total revenue they
12 could collect?

13 MR. DANNER: No, I think they'll look at all sorts
14 of opportunities and options.

15 MR. DUNKEL: Thank you.

16 MR. DANNER: But I already have lots of
17 competition for everything else but my basic
18 residential service. I've got lots of wireless
19 providers. I've got lots of Internet choices. I've
20 got lots of long distance choices. All those services
21 are priced at market or contain significant markups.

22 MR. DUNKEL: Do you have a Caller ID choice?

23 MR. DANNER: I don't have Caller ID at all.

24 MR. DUNKEL: Do you have a -- do your carriers
25 have a switched access choice for reaching your premise

1 other than your local phone company?

2 MR. DANNER: I don't think so.

3 MR. DUNKEL: Thank you.

4 MR. DANNER: And the last question is, how
5 important is the basic rate versus the total bill? I'm
6 repeating myself if I go on here. I've tried to
7 persuade you that the total bill is what counts. Let's
8 go to the --

9 MS. BUTLER: Could you hold for just a second?
10 I'm trying to -- there are lots of different questions,
11 I'm trying to piece them together, and the one part
12 that I am getting from you is that you think that it's
13 a good idea to raise the basic exchange rate for
14 residential customers because the total bill will go
15 down for a large number of them? Is that one thing
16 you're saying?

17 MR. DANNER: That is one thing, depending on how
18 you design it, yes, because you need to reduce toll and
19 access at the same time.

20 MS. BUTLER: Okay. Is there something else that
21 I'm missing that you're also saying about what should
22 be done and why it should be done?

23 MR. DANNER: Well, perhaps so. Let me try to
24 complete the thought here. And it does really lead
25 where you're going --

1 MS. BUTLER: Okay. Thanks.

2 MR. DANNER: -- because -- so what do we do --
3 let's go to the next slide -- as a result of these
4 facts and this way of looking at it? You know, what
5 should the Commission recommend? I think the right
6 answer is not all universal service or not all rate
7 rebalancing. I think the right answer is something in
8 between, some kind of package where you can accomplish
9 several important things.

10 One thing you can accomplish is you can reduce the
11 price of toll and access in Florida to let customers
12 get this benefit of something for nothing, the free
13 lunch of all the extra calling and the economic
14 benefits.

15 I think another thing you need to do is to set up
16 a universal service fund that is fully funded with
17 respect to a realistic cost of basic service. That
18 will be a pro-competitive move because then a
19 competitor can come along and, you know, serving
20 someone like me, say, you know, get their \$30 or \$40 or
21 what have you for basic service and perhaps provide
22 some real alternatives for a range of residential
23 customers. At the same time, you don't need to take
24 the basic rate all the way to cover the full cost of
25 that service if you're concerned about affordability or

1 in high cost areas. That's what universal service
2 support is made for.

3 So a combination of recognizing the real costs of
4 service, but realizing that universal service gives you
5 the flexibility not to have to price all the way to
6 that cost for all customers for their basic service if
7 you believe it's not affordable or you're worried about
8 disruptive impacts, I think that's a policy that would
9 be very progressive, would get out of the way in terms
10 of low prices impeding local competition, and would
11 provide considerable benefits to customers in the
12 state. I think it's -- you've really got the tools for
13 it now with the universal service approach to help
14 mitigate impacts.

15 Let's go to a final topic that I have and then
16 I'll be done. Markups and common costs. I said I'd
17 say a word about the subsidy-free zone, and this is the
18 word. It still matters what prices are if there aren't
19 subsidies. I think by now I've suggested that reducing
20 the price of services that customers are sensitive to
21 is a good thing. If -- where you need to take markups
22 and common costs, markets tend to take those on the
23 components of service to which customers are not price
24 sensitive. There's an easy way to see why that's true
25 because customers like it more. In my comments, and I

1 don't want to take the time to go through it now, I've
2 got a couple of specific examples that show you how
3 customers become better off when choosing among options
4 and they have the choice of a lower price for the price
5 sensitive service as compared to the access or the less
6 price sensitive service.

7 But everybody agrees there has to be some kind of
8 markups, and really what the lesson here is, on the
9 second page, is that, you know, it's a little -- it's
10 called Ramsay pricing, and you can't follow it as a
11 strict formula, but that which is price insensitive
12 needs to take a significant markup. I can't tell you
13 exactly how much. I can tell you that the market may
14 play some games with that. If you try to mark
15 something up too much, the market may come along and
16 you'll find out, oh, gee, that wasn't so price
17 insensitive after all. But for purposes of basic
18 monthly service in particular we know it's very
19 inelastic, and I don't want to say you need to put most
20 of the markup there, but certainly no markup is the
21 wrong answer, and some significant markup, particularly
22 as the basis for universal service payments, is
23 completely consistent with economic principles and,
24 again, benefits customers.

25 MR. DUNKEL: Okay. Let me follow this up briefly.

1 Your suggestion is that if it's less price elastic
2 you should put a higher markup or higher price than if
3 it's more price elastic, is that the answer?

4 MR. DANNER: Yes.

5 MR. DUNKEL: Okay. Would you agree with the
6 statement that, everything else equal, if there is
7 monopoly service, that is less price elastic than if
8 there is competition?

9 MR. DANNER: Well, where you're going with that is
10 to suggest that basic local service is a monopoly and
11 then that's why it's priced inelastic.

12 MR. DUNKEL: I think I'd just like an answer to
13 the question. Would you agree that if customers have
14 choices, they might switch away from your service more
15 rapidly than if they have no choice other than to do
16 without?

17 MR. DANNER: Yes, that's right.

18 MR. DUNKEL: So is another way to say this that
19 you should charge higher prices where you have monopoly
20 power than where you have competition, in your opinion?

21 MR. DANNER: That's a tricky question. If a
22 company really has monopoly power and is in a position
23 to exploit it by charging prices very far above
24 incremental costs, that's a public policy concern. In
25 this case, basic residential service is priced below

1 cost. It is the antithesis of a monopoly situation.
2 It's actually a predatory price in the market, and so
3 your concern isn't really relevant because if you had
4 -- if they had a monopoly power for the service and
5 were exercising it, the price would be a lot higher
6 than incremental cost. It wouldn't be lower than
7 incremental cost.

8 MR. DUNKEL: But when you're saying less price
9 sensitive, that it can be -- indicate a monopoly
10 service, and you're simply saying if it's less price
11 sensitive you should put a bigger markup on that than
12 if it's more price sensitive?

13 MR. DANNER: Well, you know, the Ramsay rules also
14 work for competitive services as well, but you have to
15 look at a market elasticity, not just an individual
16 firm elasticity.

17 MR. DUNKEL: And would you apply it even if you do
18 have monopoly power, or would you then say that's not a
19 market price and therefore this can't apply, if you
20 have monopoly power, on any service?

21 MR. DANNER: I would say that if a company had
22 monopoly power on a service, which would be the ability
23 to raise the price significantly above incremental cost
24 and sustain it, that I would be concerned that those
25 markups not get too high.

1 MR. DUNKEL: Fine. Thank you.

2 MR. DANNER: That's not the case with basic
3 residential service, since it's below incremental
4 cost.

5 MR. DUNKEL: That's a matter of opinion.

6 MR. DANNER: Let's come to the last slide. I've
7 tried to restore some comfort to the uncomfortable
8 economic equation by suggesting that you can recognize
9 the actual cost of basic service and it's not a
10 calamity, that there are ways to cope with the pricing
11 problem that results constructively and in a way that I
12 think makes sense for customers. Certainly, a single-
13 minded focus on low monthly basic rates sends you in
14 the wrong direction. It gives you the wrong answers.
15 It tells you to price the wrong things too high. It
16 stands in the way of local competition.

17 I think you can use these facts to support a
18 moderate program, to bring more competition to Florida
19 and promote equity among customers, and I think you can
20 explain that in a way that you can defend and that the
21 Legislature can understand. I think that universal
22 service and pricing reform really go hand in hand here,
23 as I said before. I think trying to solve the problem
24 with just one or just the other isn't going to give you
25 the results you want. If you try to solve it with just

1 universal service, you'll end up with a very large
2 fund, and that creates some problems and concerns of
3 its own. It's also not necessary since the customers
4 who are of genuine concern and have very low bills are
5 probably a fairly small set.

6 If you try to use just pricing reform and send
7 everything to cost, well, I don't think that's a
8 realistic option either. I think you need to combine
9 the two. And that concludes my presentation.

10 MS. MARSH: Thank you, Dr. Danner. We'll take a
11 15-minute break.

12 (Whereupon, a recess was had in the proceedings.)

13 MR. FOLLENSBEE: Hi, I'm Greg Follensbee with
14 AT&T, and of course it's not the best thing in the
15 world to conclude the two-day or the four-day workshop,
16 but I'm going to be as brief as I can. I know the
17 schedule says I'm here for two hours, but I will not
18 take two hours, the main reason being that at the time
19 we set up the schedule, we thought we would be wanting
20 to present the HAI model, but since the Commission's
21 going to hear all they need to know about it next week,
22 I figure I'll just defer that discussion and talk a
23 little bit about what the model does in terms of how we
24 did our studies, and then talk a little bit more about
25 a couple of the other issues that we have on it.

1 AT&T used the HAI version 5.0 to produce the cost
2 studies both in this proceeding and in the USF
3 proceeding. Just a couple of the differences I wanted
4 to point out between the studies that we did and the
5 studies that the independent local exchange companies
6 did is, number one, we look at TSLRIC plus shared and
7 common costs for both instances. We just didn't look
8 at TSLRIC here and then go into the USF and do TSLRIC
9 and shared and common. So we put it all together for
10 both of our studies. In other words, we've used the
11 same studies in both cases.

12 Secondly, the studies that we've done are
13 inclusive of all the services that residential
14 customers receive today, so we didn't limit it just to
15 local service, but we've also included extended area
16 calling, vertical features, intraLATA toll and
17 intraLATA access, be it either intrastate or
18 interstate. So that again is a difference in how we've
19 approached our studies as opposed to the independent
20 LECs.

21 And again, the point I'm making is we did file the
22 same study, so there were no differences, no
23 adjustments that we made in any of the studies.

24 What I thought I'd do is just summarize the
25 results of the studies on a statewide average basis by

1 independent local exchange company. We did in fact
2 file wire center-specific costs for the four companies
3 listed there, but the summarization of what we're
4 looking at is we were looking at a cost for BellSouth
5 of \$15.43 per residential line. BellSouth in this
6 docket proposed an average cost of \$25.25 plus. The
7 reason I'm acknowledging the plus is because I'm
8 acknowledging the fact that their studies don't
9 include all the costs that ours do. So in fact if you
10 were truly making a comparison of cost studies, theirs
11 would be higher than the \$25 because they would add in
12 costs for vertical features, for toll and for access.

13 And then the last column is what they filed, which
14 will be discussed next week in the universal service
15 docket, and that is, coming out of the model, it's
16 \$31.53 on average to provide basic local exchange
17 service to residential customers in their serving
18 territory. The same analysis is done for the other
19 three entities, and we have split United and Centel
20 separately at this stage. We haven't yet been able to
21 combine the data that's needed to run HAl as a combined
22 entity, although we can do averages by using a weighted
23 average to look at them, but basically what we've
24 looked at is them separately. There's no doubt at some
25 point in time they do need to be put together. And in

1 fact, I think one of the studies I've seen for next
2 week, that Bell -- that Sprint did put their systems
3 together to present what the costs would be.

4 MR. REGAN: Mr. Follensbee, my name is Tom Regan.
5 I had a question about your -- the AT&T proposed cost
6 column.

7 MR. FOLLENSBEE: Yes.

8 MR. REGAN: I was just wondering if you have a
9 breakout of those costs by, say, loop and port usage,
10 how that 15.43, for example, breaks down?

11 MR. FOLLENSBEE: I think I've got some of that.
12 I'm not sure it would be totally representative, but --
13 let me tell you what it basically would be, but it may
14 not have all the loadings, it should have it directly,
15 because since we did all the studies together, I'm not
16 sure I have the shared and common exactly put on each
17 of the elements, I'd have to go back and look. But for
18 BellSouth, the loop price was \$12.13, I believe. No,
19 that's wrong. That's \$10.04.

20 MR. REGAN: \$10.04?

21 MR. FOLLENSBEE: \$10.04. The port charge came out
22 to be \$1.67, and then the various other elements you
23 use of switching elements would have gone into making
24 up the rest of the cost. We don't -- ourselves, when
25 we do our studies, we don't believe there are separate

1 costs for vertical features, for instance, so when we
2 have \$1.67 for the port, that also includes the ability
3 to get access to all vertical features. So there's a
4 difference also there in how we do our cost studies and
5 how the ILECs have done theirs.

6 MR. DUNKEL: Excuse me. So does that mean the
7 15.43 includes the cost of vertical services?

8 MR. FOLLENSBEE: In our studies it does.

9 MR. DUNKEL: Thank you.

10 MR. FOLLENSBEE: For GTE, the loop price is \$9.81,
11 the port price was 89 cents. For Sprint United, the
12 loop price was \$13.67, the port price is 82 cents. And
13 then for Centel, the loop price is \$17.19, the port
14 charge is 95 cents, switch port.

15 MR. DUNKEL: Thank you very much.

16 MR. FOLLENSBEE: You're welcome.

17 MR. DUNKEL: One fast question: I assume that the
18 loop cost is 100 percent of the loop, not less 25
19 percent or anything like that?

20 MR. FOLLENSBEE: That is correct.

21 MR. DUNKEL: Thank you.

22 MR. FOLLENSBEE: And the reason we've done that is
23 we've included, again, all the costs, including
24 interstate access in this, so we have not gone to the
25 -- by doing it this way, you don't need to get into the

1 discussion of how do you allocate the cost. This is
2 the total cost to provide the services that residential
3 customers are buying today, and again, it's a statewide
4 average. It definitely would vary by wire center.

5 MR. DOWDS: Dave Dowds, Commission staff. I just
6 had a clarification.

7 The HAI 508, does it still compute the port as a
8 percentage of the total switching investment or total
9 switching cost?

10 MR. FOLLENSBEE: Let me make sure I understand
11 your question. When the HAI model does its study, it
12 does take local switching and it takes the cost and
13 separates it into a line port and a usage base charge,
14 or a nonline port is what I think it's labeled. So
15 there is a switching usage-based element to it and then
16 a per line basis.

17 MR. DOWDS: Right. In prior versions of the HAI
18 model, up through at least I believe 4.0, what it did,
19 and correct me if I'm wrong, is it took total switching
20 cost and it allocated 70 percent I believe to usage,
21 considered 70 percent of that number as usage, divided
22 that through by the total number of minutes to get a
23 cost per minute, and took the remaining 30 percent and
24 divided it through by lines and called it cost per
25 port. Is that what's still being done, or is it

1 literally identifying the cost of a line card and
2 considering that a port?

3 MR. FOLLENSBEE: It's not going into a line card
4 basis, but it is identifying all of the investment that
5 would go into a local switch to be able to provide dial
6 tone and switching out of the switch to seize a trunk
7 to complete a call. And I don't know if the 70/30 was
8 still used or not, because the other thing we also look
9 at is the weighting of how much digital loop carrier
10 you have coming in as opposed to analog. So it also
11 would vary by that.

12 MR. DOWDS: Thank you.

13 MR. FOLLENSBEE: The issues that, you know, Joe
14 Gillan raised today is the way that we're looking at
15 this, is we're looking at the whole service as the
16 customers are buying today. When AT&T, when it does go
17 into the local market to compete, it's going to be
18 competing for what customers are buying for
19 telecommunications. We don't believe the market is
20 going to end up being there's local service, there's
21 toll service, there's access service. It's going to
22 evolve into narrow band telecommunications and broad
23 band telecommunications. That is the way the market is
24 evolving. Unfortunately, it's not there today. But
25 when we look to serve customers in the future, we're

1 not going to be looking at, well, this customer's
2 buying local service, because we don't know what we're
3 going to define local service as.

4 Let me give you an example. When cellular started
5 out, you were buying cellular for \$20 a month and
6 usage. Today, ATT has an offer on the market, it's
7 89.95 for a set number of minutes wherever you are,
8 wherever you want to call. There's no local, there's
9 no within a calling area, it's just the calling area
10 is the United States. I'm not too sure that's what
11 we'll end up in the future trying to market the
12 customers. We'll try to market to their
13 telecommunications needs, and we're wanting to sell
14 them minutes, and we want to sell them value through
15 feature functionality. And I'm not too sure that the
16 local calling areas will be sustained in the long run
17 as they are today with a competitive marketplace.

18 MR. DUNKEL: Does that mean in your decision-
19 making you would not look at only the basic revenues,
20 basic service revenues, but you would look at the total
21 package in making your decisions?

22 MR. FOLLENSBEE: Absolutely, but we would be
23 looking at what customers are buying. In other words,
24 we may be able to design a service for a customer that
25 is only making local calls, or calls within a short

1 area, depending on the cost. We may look at a service
2 based on the fact the customer's calling all over the
3 United States and may not be making very many local
4 calls. It's -- we're going to be, I think,
5 Commissioner Deason, you asked, are we going to have to
6 get into the minds of the consumers? Yes. I think to
7 be able to be successful in the marketplace, we're
8 going to have to know what the consumers are using
9 their telecommunications service for to know what we're
10 going to be able to sell to them.

11 And I think the whole problem that I have with the
12 arguments that I've heard for the last four days is
13 everybody's assuming that the market's going to stay
14 exactly how it is today, so you get into the discussion
15 of, will I want to allocate costs to local. I'm not
16 sure we're going to know what local is in the future.
17 I think the customers will dictate what they want, and
18 hopefully there will be providers out there that will
19 try to meet those needs. So that's why we've looked at
20 it today from the revenue stream the customers are
21 generating.

22 The second point I wanted to make on this is that
23 looking at a competitive local exchange company, what
24 I'm more interested in is taking down or tearing down
25 the barriers that are preventing me to enter the market

1 today. That's what I'm more interested in, that if we
2 could in essence make it easier for competitors to come
3 in and serve, then a lot of this discussion is going to
4 go away. The whole reason we're in this discussion is
5 because there isn't a competitive marketplace today and
6 therefore you're getting into discussions that I've
7 heard for the last 25 years that I've been in this
8 business, and that is, we're assuming it's a monopoly
9 environment, will stay a monopoly environment, and
10 therefore you can dictate how costs are allocated by a
11 regulator. I don't think that's true.

12 Once you start to get a competitive environment in
13 place, the Commission's going to lose a lot of control
14 over how that's going to occur. What does that mean?
15 I think it means exactly what they're interested in, to
16 ensure that as many subscribers as possible stay on the
17 service, to make sure there are ways to keep customers
18 on the network, and if that means there is a need to
19 have a subsidy for customers, then that's what needs to
20 be put in place for the public service.

21 But it shouldn't be, in my mind, the way it's
22 being approached today, which is you're trying to look
23 at services that need to be subsidized, not customers.
24 AT&T would argue that the better approach is to go try
25 to subsidize customers, not services, or look at the

1 relationship between necessarily some of the costs that
2 you have and the prices being charged. The emphasis
3 again should be on customers, not on necessarily
4 services. Now, that's my CLEC hat. Let me turn to the
5 next slide and put on my IXC hat, however.

6 As an IXC, though, given today's marketplace,
7 given today the way that prices and costs are there,
8 I'm very interested in seeing access lowered. So, if
9 one was to ask me, is AT&T in favor of seeing a rate
10 rebalancing occurring today, as an IXC, I would say
11 absolutely, I would like to see local rates raised to
12 get access prices down, the reason being I can't get
13 into the market today to fully go after the revenue
14 stream of the customer. The only market I'm in today
15 is the long distance marketplace in this state. So
16 therefore I'm very interested in seeing the prices I'm
17 paying to complete long distance calls come down.

18 Now, what this reflects is, again, based on the
19 model that we filed, what our access price -- what we
20 believe -- AT&T believes the access prices would be.
21 Now, let me point out also, this is not switched only.
22 What I have done is I've looked at both switched and
23 dedicated, because basically those are what we use to
24 originate and complete long distance calls. We don't
25 use totally the switched access network. We

1 extensively use special access or dedicated access.

2 So this is a reflection of the prices that we
3 believe we should be charged, because these are what we
4 believe the costs are for the three companies to
5 originate and complete a call within the state.

6 I have done the same thing for the ILECs to the
7 extent I could. For instance, in the case of GTE, they
8 did provide cost studies on dedicated. In the case of
9 BellSouth, I've used cost studies they've filed within
10 the last 12 months for dedicated. In the case of
11 Sprint, I'd honestly tell you I think Sprint's numbers
12 are understated, because I don't -- I could not find a
13 cost study from Sprint for dedicated. I used what they
14 did file and tried to extrapolate that into a dedicated
15 and a switched environment, but I clearly don't think
16 that's what they think the costs are. However, that is
17 the number they put in their cost study for originating
18 and terminating a call using switched access.

19 MR. DUNKEL: Can I presume that for the switched
20 access portion of this, at least, you did not include
21 any portion of the switched loop or the port?

22 MR. FOLLENSBEE: No, sir.

23 MR. DUNKEL: You did not include those?

24 MR. FOLLENSBEE: Did not include those costs for
25 purposes of this study, or this review. And again, I'm

1 looking at what the marketplace is today that AT&T's
2 position has been -- is publicly known that we believe
3 that these are the right prices to have if you're not
4 going to have a competitive marketplace for everything.

5 MS. BUTLER: Excuse me.

6 MR. FOLLENSBEE: Yes, ma'am?

7 MS. BUTLER: You said something that confused me a
8 little bit. I'd like to see if I can get unconfused.

9 You were talking about the idea of raising the
10 basic local exchange rate and you were talking about
11 how things were changing in -- as we move into the
12 future, and that essentially the idea shouldn't be that
13 regulators should be doing something to dictate the
14 price and changing the price. Is that basically what
15 you said?

16 MR. FOLLENSBEE: Almost. It was -- it bordered on
17 that. What I'm saying is at some point in time in the
18 future, just as you did in the interexchange industry,
19 you're going to have less ability to control prices.

20 MS. BUTLER: Okay, let me --

21 MR. FOLLENSBEE: Because you're going to have so
22 many competitors out there that if you try to do
23 something here, a competitor that doesn't do it that
24 way is going to do something different over here and
25 there's no control over that.

1 MS. BUTLER: Right. It's my understanding,
2 though, and I want to know whether or not you agree
3 with this, that the argument is that at the moment,
4 because the cost is being concluded by different
5 entities as being below the cost, that essentially even
6 though it might be the regulator or the Legislature
7 that would change the authorized price, that in some
8 ways it would be a movement towards the deregulation of
9 that price, as opposed to the other way around.

10 MR. FOLLENSBEE: In essence it would be from the
11 standpoint that if you can create an environment where
12 other providers can compete, you're going to see the
13 deregulation to some degree of the price. Unless
14 you're going to try to set the price for every
15 provider, it's going to be very difficult -- AT&T saw
16 that experience and so did the other interexchange
17 carriers, that if you try to dictate the price for the
18 largest provider for now, anomalies are still going to
19 occur in the marketplace where you're just not going to
20 necessarily like the results overall.

21 MS. BUTLER: Let me ask you more directly, if I
22 can, I'm trying to figure out whether, if one assumes
23 that the price is below the cost and that -- and the
24 Commission were to authorize -- not like authorize, but
25 recommend that the price should go higher and that

1 should be ultimately implemented, would that be a
2 movement towards more regulation or less regulation?

3 MR. FOLLENSBEE: Given where you are today, it
4 would probably be a move towards less regulation, not
5 more.

6 MS. BUTLER: I just wanted to understand what
7 you're saying. Thank you.

8 MR. OCHSHORN: Mr. Follensbee?

9 MR. FOLLENSBEE: Yes, sir.

10 MR. OCHSHORN: Ben Ochshorn, Florida Legal
11 Services.

12 I remember, and I could be wrong in my memory,
13 earlier this year it was reported in the business
14 section that AT&T was no longer interested in entering
15 local markets through renting lines?

16 MR. FOLLENSBEE: Through reselling --

17 MR. OCHSHORN: Right.

18 MR. FOLLENSBEE: -- lines. We definitely have
19 determined you can make -- you can't make any money.
20 In fact, you lose money trying to resell local service
21 on a broad-based basis for a long period of time. And
22 let me speak to that.

23 Our original entry strategy back in '95 and as we
24 proffered up trying to help pass the Telecommunications
25 Act of '96 was we really thought resale would be a

1 temporary way for us to enter the market, start to
2 build a customer base, but very quickly move to either
3 putting in our own facilities for some class of
4 customers or using the unbundled network elements of
5 the incumbent LECs and start to approach it that way so
6 we could start to design our own services and hopefully
7 put more discipline and more competition into the local
8 market by that means.

9 Well, a year later we clearly knew that we were
10 not going to be able to broad-brush put in facilities.
11 We knew that going up front because it would have taken
12 billions and billions and billions of dollars. So we
13 thought, well, then, we still hope we can get through
14 the use of the unbundled elements. Well, that has not
15 turned out to be the case. Two years later, New York
16 is probably the closest state in the nation, with
17 Kentucky maybe being the second, where that has a
18 reality of happening, but it still isn't going to
19 happen as quickly as we'd like. We're still maybe
20 several months, if not a half a year to three-quarters
21 of a year away.

22 So what did AT&T do in the meantime? They went
23 out and bought TCG, and they've now offered to buy TCI,
24 that we've basically decided we can't wait for the
25 right environment to exist, so we're going to have to

1 make the environment happen for ourselves. So the TCG
2 merger has taken place this summer, and we're now
3 starting to put together offers in the market targeted
4 to business customers that are combining local and long
5 distance. Those are the easiest customers to serve.

6 One of the comments I think from the GTE person
7 earlier was like, you know, TC -- or Teleport put a
8 switch downtown, I don't know why they didn't put a
9 switch in my community. I mean, it's pretty obvious
10 why. It's like the Willie Sutton theory, you go where
11 the money is and the cheapest way to serve them. You
12 put a switch downtown in Tampa, you put a switch
13 downtown in Orlando or Miami, you're going to pick up a
14 lot more customers and make a lot more money hopefully
15 than if you put a switch in a residential area, the
16 same one switch.

17 MR. OCHSHORN: So that's AT&T's strategy now?

18 MR. FOLLENSBEE: Well, our strategy is still
19 hopefully to offer through our own facilities where we
20 have facilities, and still we are hoping to flesh out
21 our offerings by using the unbundled network elements
22 of the incumbent local exchange companies and put some
23 of our own in there, too, to serve where we don't have
24 facilities. That are still -- that is still our
25 strategy and our hope, but it looks like it's going to

1 be a while to happen.

2 MR. OCHSHORN: Okay, thank you.

3 MR. FOLLENSBEE: You're welcome.

4 That pretty much summarized the comments I had.
5 Like I said, I cut it quite a bit short so I did not
6 present any of the HAI, so I did not know if anybody
7 else had any questions or not on this.

8 The last comment I'd make is, part of the dilemma
9 we're in as an industry is we've got all this
10 converging at once. And, you know, hopefully next
11 summer a lot of this will shake out. We're still
12 hopeful by next summer that we can start to get into
13 the market to serve the residential customer base.
14 Right now, it doesn't look real promising for next
15 summer, but we still have some hopes. The
16 Legislature's going to take up universal service next
17 spring and implement it sometime next year, and they're
18 going to look at the need to whether or not to allow
19 rate rebalancing to occur, which again would imply it
20 would happen sometime next summer or next fall. It all
21 is converging at the same time.

22 Our hopes would have been competition would have
23 happened sooner and some of the rest of this I think
24 would have taken care of itself. I know universal
25 service would not have. I know that you would have had

1 a need to have some form of universal service in place,
2 but it's questionable whether you would have needed to
3 rate rebalance across the whole span of the residential
4 base if in fact you had the ability for other providers
5 to serve the residential market.

6 This Commission has a hard decision to make in
7 terms of what they're going to recommend, and there's
8 no doubt about it.

9 MR. DUNKEL: How do you think mechanically you try
10 and serve the residential base?

11 MR. FOLLENSBEE: The only way we can do it is
12 either through the TCI purchase here in Florida, which
13 last I checked probably will not occur because I think
14 that we're selling all their properties to Media One.
15 So for our case in Florida, we may not be able to use
16 the TCI approach, so our only fallback would be to be
17 able to use as many of the unbundled elements as we
18 ourselves do not put in place to serve the residential
19 base, using loops, using switches and ports, looking at
20 where we can put our own transport into some of the end
21 offices, and then, of course, paying for mutual
22 compensation to complete calls on the other end.

23 MR. DUNKEL: Okay. In those areas where you --
24 AT&T would own the cable company, you would try and use
25 the coaxial cable to carry telephone service, is that

1 the basic concept?

2 MR. FOLLENSBEE: Absolutely.

3 MR. DUNKEL: Once you started providing telephone
4 service, basic telephone service, along with cable
5 services, would you expect you'd allocate all of the
6 co-ax cable to residential basic telephone service?

7 MR. FOLLENSBEE: To be honest with you, I don't
8 know if we'd look at allocation. We would look at what
9 are we selling the customer and are we covering our
10 costs. I'm not sure that we would get into doing
11 allocations. We would be looking at what we could
12 charge the customer for a family of services. In that
13 case, we'd be looking more at a broad band base. So
14 we'd be looking at selling them telephony or voice,
15 data and content through cable.

16 MR. DUNKEL: Would you think if you're using a
17 co-ax cable to provide cable TV and HBO and basic
18 telephone and toll, that you would have to price your
19 telephone basic service high enough to by itself cover
20 the full cost of the co-ax cable, or else you'd
21 consider it a loser?

22 MR. FOLLENSBEE: To be honest with you, I am not a
23 pricing expert, so I don't know.

24 MR. DUNKEL: I see. Thank you.

25 MR. FOLLENSBEE: I don't know. I try and argue

1 whether we -- what you're asking is, would we try to
2 price it as if each of them were stand-alone? I don't
3 think so.

4 MR. DUNKEL: Thank you very much.

5 MR. BECK: Greg, could you -- on the HAI model,
6 your costs are about roughly half of the BPCM --

7 MR. FOLLENSBEE: Yes.

8 MR. BECK: -- compared to that?

9 MR. FOLLENSBEE: Well, no, Charlie. Let me make
10 sure, that's why I put the plus there. They're going
11 to be more than half.

12 MR. BECK: Could you very briefly describe the
13 major factors that account for that difference, if you
14 can? If not, forget it, but --

15 MR. FOLLENSBEE: No, no. I mean, part of it, and
16 I can't tell you what percent, is because of the way
17 the models themselves try to put forth a network to
18 serve customers. So part of it's the actual underlying
19 algorithms and underlying design of the network and
20 whether you use square lots or rectangular lots and how
21 you're basically trying to serve customers.

22 The other part of it is inputs. You know, we've
23 got different cost of capital, we've got different
24 depreciation rates, we've got different labor rates,
25 we've got different assumptions on whether you can

1 share trenches, different costs for poles and pole
2 attachments. So part of it's the actual workings of
3 the models, I believe. Probably more of the majority
4 of it is because we have different inputs on what we
5 think it costs to provide the service.

6 MR. BECK: Is the fill factor a significant
7 portion of the difference?

8 MR. FOLLENSBEE: It is, it is.

9 MR. DUNKEL: What's the cost of capital you used?

10 MR. FOLLENSBEE: I don't know for sure. I'm going
11 to say, I think for BellSouth it was eight and a half
12 overall. I do not remember what it was for GTE and
13 Sprint, but John Hirshlifer's testimony would have what
14 that is for each of the three companies.

15 MR. DUNKEL: Thank you.

16 MR. FONS: Mr. Follensbee, I've been waiting for
17 this time for a long, long time.

18 MR. FOLLENSBEE: No, you've been waiting for me to
19 be sworn in. Well, I got to you first.

20 MR. FONS: Neither one of us are sworn in, so we
21 can have --

22 MR. FOLLENSBEE: Attorneys are never sworn in, so
23 -- sworn at, but not sworn in.

24 MR. FONS: The numbers that you've used for your
25 HAI as well as what you're indicating as the BCPM and

1 the GTE studies, that's an average cost, is it not?

2 MR. FOLLENSBEE: Yes, I stated that, that is an
3 average across all the residential lines. In the case
4 of our numbers for the ILECs, it may be across all
5 residential and small business.

6 MR. FONS: And isn't it true that in the high cost
7 areas, that the numbers may be closer together between
8 AT&T and the ILECs?

9 MR. FOLLENSBEE: Mr. Fons, I'd have to look at the
10 numbers and see. I would tend to think they would be a
11 little closer, but again, because of the difference in
12 inputs, I don't think they're going to be a lot closer.
13 In other words, unless you assume that all the costs
14 are equally incurred, which they aren't because of the
15 length of the loop or the density of a particular wire
16 center is going to dictate wire center-specific costs
17 being different, they should tend to be closer, but
18 they're not going to be, you know, within dollars, if I
19 remember right. They still may be within 15 or 20
20 dollars, but you're then talking maybe a cost of 90,
21 100, 140 dollars per line per wire center.

22 So, in other words, we're here, you've got a
23 difference of \$16, I don't know if it would be the same
24 \$16 on the highest cost center.

25 MR. FONS: Certainly in the Sprint United and

1 Sprint Centel, the difference even on the average is
2 not half of the cost.

3 MR. FOLLENSBEE: No, I would say for at least
4 Centel, I would say the cost should be a lot closer.
5 For Sprint, they're going to be closer than the other
6 two companies, that is true.

7 All right. Well, thank you very much for the
8 time.

9 MS. MARSH: Thank you. That concludes our
10 workshop.

11 (Whereupon, the proceedings were concluded at
12 3:40 p.m.)

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C E R T I F I C A T E

STATE OF FLORIDA)
COUNTY OF LEON)

I, RAY D. CONVERY, Court Reporter at Tallahassee, Florida, do hereby certify as follows:

THAT I correctly reported in shorthand the foregoing proceedings at the time and place stated in the caption hereof;

THAT I later reduced the shorthand notes to typewriting, or under my supervision, and that the foregoing pages 414 through 514 represent a true, correct, and complete transcript of said proceedings;

And I further certify that I am not of kin or counsel to the parties in the case; am not in the regular employ of counsel for any of said parties; nor am I in anywise interested in the result of said case.

Dated this 23rd day of October, 1998.



RAY D. CONVERY
Court Reporter