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August 27, 2003

030868-TL

BY HAND DELIVERY

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: *In re: Sprint-Florida, Incorporated's Petition to Reduce Intrastate Switched Network Access Rates to Interstate Parity in a Revenue Neutral Manner Pursuant to Section 364.164(1), Florida Statutes*

Dear Ms. Bayo:

Enclosed for filing in the above matter are the original and fifteen (15) copies of the following:

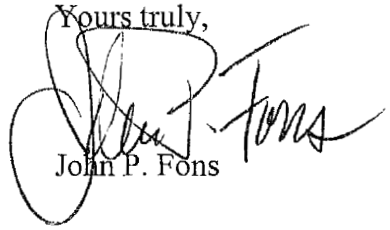
1. Sprint-Florida, Incorporated's ("Sprint's") Petition to Reduce Intrastate Switched Network Access Rates to Interstate Parity in a Revenue Neutral Manner;
2. John M. Felz Direct Testimony (redacted) and Exhibits JMF-1 through JMF-18 (redacted);
3. Kent W. Dickerson Direct Testimony and Exhibits KWD-1 and KWD-2 (redacted);
4. Dr. Brian K. Staihr Direct Testimony and Exhibits BKS-1 and BKS-2;
5. Dr. Kenneth Gordon Direct Testimony and Attachments A and B; and
6. Sprint's Request for Confidential Classification and Protective Order pursuant to Section 364.183(1), Florida Statutes.

The confidential portions of the Direct Testimony and Exhibits of John M. Felz and the Exhibits of Kent W. Dickerson are being filed under seal by separate letter.

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this letter and returning the same to this writer.

Thank you for your assistance in this matter.

Yours truly,



John P. Fons

Enclosures

cc: Certificate of Service List

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: SPRINT-FLORIDA, INCORPORATED'S PETITION TO REDUCE INTRASTATE SWITCHED NETWORK ACCESS RATES TO INTERSTATE PARITY IN A REVENUE NEUTRAL MANNER PURSUANT TO SECTION 364.164(1), FLORIDA STATUTES

DOCKET NO.
FILED: August 27, 2003

SPRINT-FLORIDA, INCORPORATED'S PETITION TO REDUCE INTRASTATE SWITCHED NETWORK ACCESS RATES TO INTERSTATE PARITY IN A REVENUE NEUTRAL MANNER

Sprint-Florida, Incorporated ("Sprint"), pursuant to Rule 28-106.104, Florida Administrative Code, and Section 364.164(1), Florida Statutes, petitions the Florida Public Service Commission ("Commission") to reduce its intrastate switched network access rates to interstate parity in a revenue neutral manner, stating as follows:

1. Petitioner is a local exchange telecommunications company ("ILEC") as that term is defined in Section 364.02, Florida Statutes. Petitioner's name, address and telephone number are:

Sprint-Florida, Incorporated
c/o Ben Poag
P. O. Box 2214
Tallahassee, FL 32316-2214
(850) 599-1029

2. All pleadings, filings and orders shall be directed on behalf of Sprint-Florida, Incorporated to:

John P. Fons, Esq.
Ausley & McMullen
P. O. Box 391
Tallahassee, FL 32302

Susan Masterton, Esq.
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Tallahassee, FL 32316

3. The Florida Tele-Competition Innovation and Infrastructure Enhancement Act ('2003 Act'), which became effective on May 23, 2003, authorizes the Commission to grant the reduction of intrastate switched network access rates charged by a local exchange telecommunications company in a revenue neutral manner upon the filing of a petition by a local exchange telecommunications company and upon consideration of whether granting the petition will:

(a) Remove current support for basic local telecommunications services that prevents the creation of a more attractive, competitive local exchange market for the benefit of residential consumers;

(b) Induce enhanced market entry;

(c) Require intrastate switched network access rate reductions to parity over a period of not less than 2 years or more than 4 years; and

(d) Be revenue neutral as defined in subsection (7) within the revenue category defined in subsection (2).

See Section 364.164(1), Florida Statutes 2003.

4. Sprint's Petition, and associated testimony and exhibits accompanying this Petition,[1] incorporated herein by this reference, address and fully satisfy each of the provisions of the 2003 Act to be considered by the Commission. The evidence presented by Sprint demonstrates that reducing intrastate switched access rates to interstate parity in a revenue neutral manner over a two-year period will achieve the goals of the 2003 Act by removing current support for basic local telecommunications services that prevents the creation of a more

[1] This Petition is supported by the testimony and exhibits sponsored by John M. Felz, Kent W. Dickerson, Dr. Brian K. Staihr and Dr. Kenneth Gordon. Dr. Gordon has prepared direct testimony and exhibits on behalf of Sprint and BellSouth Telecommunications, Inc. ("BellSouth") and Verizon Florida, Inc. ("Verizon"). The citations will be to the witness' direct testimony at a given page or to the exhibits referenced in that direct testimony; such as Felz Direct Testimony at ___, or Dickerson Direct Testimony at Exhibit KWD-___.

attractive, competitive local exchange market for the benefit of residential consumers, and by inducing enhanced market entry.

I. Introduction

5. The areas served by Sprint are predominantly non-urban, with lower customer density levels and higher costs per end user access line than its larger Florida ILEC neighbors, BellSouth Telecommunications, Inc. ("BellSouth") and Verizon Florida, Inc. ("Verizon"). Sprint offers subscribers within its service areas – many of which areas are non-contiguous areas – a variety of basic and non-basic telecommunications services, the prices or rates of which have been established by or approved by the Commission.

6. Until 1996, when Sprint elected price regulation, the prices for Sprint's residential basic local telecommunications service were set by the Commission using residual ratemaking principals which ignore the cost of provisioning as a factor in setting prices. Since 1996, any residential basic price increases have been made pursuant to a statutory index formula of inflation minus 1 percent. *See* Section 364.051(3), Florida Statutes. As reflected in cost studies approved by the Commission in 1998, the prices established by the Commission for Sprint's residential basic local telecommunications services do not, on average, cover the cost of providing residential basic local telecommunications service. *Report of the Florida Public Service Commission on the Relationships Among the Costs and Charges Associated with Providing Basic Local Service, Intrastate Access, and Other Services Provided by Local Exchange Companies, in Compliance with Chapter 98-277, Section 2(1), Laws of Florida*, Vol. 1, pp. 9-10, February 15, 1999 (Docket No. 980000A-SP). Similarly, using more current forward-looking economic cost analysis, the cost of providing residential basic local telecommunications service still, on average, exceeds its price. Felz Direct Testimony at Exhibit JMF-3.

7. Sprint's intrastate switched network access rates in effect today are rates which were initially established by the Commission prior to the 1995 Florida Telecommunications Act ("1995 Act"), except for the reductions required by the 1995 Act and Chapter 98 -277, Section 4, Laws of Florida. Sprint's intrastate switched network access rates were initially established by the Commission in 1983, without regard to cost, to replicate the significant contribution flowing to the local exchange companies from intrastate toll revenues through the division of revenues/toll settlements process. *See* Order No. 12765, Docket No. 820537-TP, issued December 9, 1983, at page 6. Intrastate switched network access charges were then, and have continued to be, the major source of interservices cross-subsidy. Even though intrastate switched network access rates were reduced through a series of devices on a LEC-by-LEC basis subsequent to 1983, but prior to the 1995 Act, rarely were the access rate reductions offset by increases in residential basic local service rates. In one situation in which the Commission was presented with an opportunity to reduce intrastate switched network rates, the Commission declined the opportunity and reduced residential basic local telecommunications service rates instead. *See In re:. Investigation into Earnings of Central Telephone Company of Florida,* Docket No. 861361-TL, Order No. 17783, issued June 30, 1987.

8. The level of intrastate switched network access charges was designed by the Commission 'to maintain the financial viability of the LECs while maintaining universal service." *Id.* page 7. 'Maintaining Universal Service" means that residential basic local telecommunications service prices have been set as low as possible without regard to whether the prices cover cost. In other words, it has been standard regulatory policy that the contributions provided by intrastate switched network access rates and other non-basic services are to be used to subsidize residential basic local telecommunications service prices. Gordon Direct Testimony at 18-21. This policy of interservices cross-subsidies, while controversial, was marginally

maintainable as long as the LECs maintained a local monopoly. Staihr Direct Testimony at 4. But, when the 1995 Act opened the LEC's local markets to competition, this policy of interservices cross-subsidies became a serious roadblock to the development of a competitive residential local market.

9. Consequently, Florida, today, finds itself in the difficult situation of trying to encourage residential local competition, but where the competitors have to compete against residential local service prices that are well below cost, are heavily subsidized by over-priced intrastate switched network access rates; and which provide insufficient margins to attract competition. The Florida Legislature, in recognition of this dilemma, enacted the 2003 Act to provide a mechanism for moving past these historical regulatory policies, thereby making the residential local service market more attractive to competitors. It is within the context of the 2003 Act that Sprint files this Petition. The balance of this Petition summarizes how the testimony and exhibits being proffered in support of the Petition demonstrate that granting the Petition meets the letter and spirit of the 2003 Act.

II. Granting Sprint's Petition Will Remove Current Support for Basic Local Telecommunications Services that Prevents the Creation of a More Attractive, Competitive Local Exchange Market for the Benefit of Residential Consumers

A. Intrastate Switched Network Access Rates are Providing Support for Sprint' s Residential Basic Local Telecommunications Services

10. It is without question that Sprint' s intrastate switched network access rates have been set by the Commission and the Legislature at levels to support Sprint' s belowcost residential basic local telecommunications services. Currently, Sprint' s intrastate composite switched network access rate provides *over* $142 million per year in contribution to support below-cost residential basic local telecommunications service rates. In passing the 1995 Act, the Florida Legislature went so far as to protect the ILECs' intrastate switched network access

revenue stream by setting the switched network access rates in the statute and prohibiting CLECs from knowingly terminating toll calls over local interconnection facilities without paying the appropriate access charges. See Section 364.16(3), Florida Statutes. The Legislature' s goal of preventing such arbitrage was to preserve the ILECs' ability to maintain universal service support. In 1995, the Commission ultimately determined that for the foreseeable future each ILEC should bear its own universal service support burden through its existing services and rate structure. *In re: Determination of Funding for Universal Service and Carrier of Last Resort Responsibilities*, Docket No. 950696, Order No. PSC-95-1592-FOF-TP, issued December 27, 1995, at page 20.

11. Sprint's *intrastate* switched network access rates (combined - originating and terminating) have been reduced from a high of approximately $0.24 per minute in 1984 to approximately $0.104 per minute today. Sprint's *interstate* switched network access rates, which are set by the Federal Communications Commission ("FCC"), have been reduced to approximately $0.013 per minute as of January 1, 2003. As defined in the 2003 Act, "parity" is the company's *intrastate* switched network access rate equal to its *interstate* switched network access rate in effect on January 1, 2003. See Section 364.164(5). In other words, by granting this Petition, Sprint's combined *intrastate* switched network access rate will decline from approximately $0.104 per minute to about $0.013 per minute. Even at this new price, Sprint' s intrastate switched network rate will still exceed Sprint' s forwardooking economic cost of $0.004475 per minute of use (Dickerson Direct Testimony at Exhibit KWD-2, page 4), and will continue to support below-cost residential basic local service.

12. Reducing Sprint' s intrastate switched network access rates to interstate parity (from approximately $0.104 per minute to approximately $0.013 per minute) will result in the elimination of approximately $142 million per year in universal service support. Felz Direct

Testimony at Exhibit JMF-9. Based upon Sprint' s forwardooking economic costs, Sprint' s residential access lines are provided at a cost of $30.46 per month. Dickerson Direct Testimony at Exhibit KWD-2, page 2. Sprint' s current residential basic service rate (weighted average) is $9.98 per month, per access line. Adding the Subscriber Line Charge (SLC) of $6.50 per line, per month, Sprint' s residential basic access line revenue is $16.48 per month, versus the cost of $30.46. Felz Direct Testimony at Exhibit JMF-3. This means that Sprint is experiencing a negative contribution amount of $13.98 per residential access line, per month, or a total annual shortfall from providing residential access lines at current rates well in access of $142 million per year.

B. Current Support for Residential Basic Local Telecommunications Services Prevents the Creation of a More Attractive, Competitive Residential Local Exchange Market

13. The Act makes it clear that it is level of support from intrastate switched network access rates which is to be addressed in any petition filed pursuant to the Act. This is because it is switched network access rates that are to be reduced in a revenue neutral manner. Section 364.164(1), Florida Statutes. The current level of support for residential basic local telecommunications services provided by Sprint' s intrastate switched network access rates prevents the creation of a more attractive, competitive residential local market. That this is so is evident from a.) the level of competition in Florida for business customers compared to the level of competition for residential customers and b.) the level of residential competition in other states in which residential basic local telecommunications service rates are not so heavily supported. For example, in Florida, where business local services are priced well above cost, the level of CLEC penetration is remarkable - approaching 30 percent of the business access lines. In comparison, the level of CLEC penetration in the residential local market is markedly lower - somewhere around 7 percent of the residential access lines. The difference in CLEC penetration

levels can be attributed to the fact that Sprint' s price for a business local access line is well above Sprint' s cost to provide it- thereby creating attractive margins for CLECs - while Sprint' s residential basic local access lines are saddled with historical regulatory prices that produce a negative contribution and a negative attractiveness to the CLECs. Staihr Direct Testimony at 4.

14. The CLECs' current lack of incentives for providing local service to Sprint' s residential customers is further confirmed by comparing the residential basic local service rates in other states with the level of residential competition in those other states. In many of the other states in which residential basic local service competition is greater than what Sprint is experiencing in Florida, residential basic local services are priced closer to cost and, therefore, are not receiving the same high level of support from intrastate switched network access services as is occurring in Florida. Felz Direct Testimony at 10; Gordon Direct Testimony at 11-12. Competition is more likely where basic local service rates are more aligned with the cost of provisioning and less dependent upon interservice cross-subsidies. Staihr Direct Testimony at 5 and 7. It is worth noting that, upon the implementation of the reduction in intrastate switched network access rates to interstate parity in a revenue neutral manner, Sprint' s residential basic local service prices will still be lower than the residential basic service prices in many other states. But, the movement in Sprint' s Florida residential basic local service prices will send a clear signal to the CLECs that there are significant financial benefits available in serving the residential basic local service market. Staihr Direct Testimony at 6.

C. Removal of the Current Level of Support for Residential Basic Local Telecommunications Services Will Create a More Attractive, Competitive Local Exchange Market for the Benefit of Residential Customers

15. Those telecommunications consumers - both business and residential - who are experiencing robust local competition are the beneficiaries of that competition in the form of consumer choice of services, bundles of services, pricing packages and technologies. Staihr

Direct Testimony at 15-16. The full benefits of residential local service competition will occur only when the residential local service market is not distorted by the presence of supported residential basic local service prices. Staihr Direct Testimony at 6; Gordon Direct Testimony at 23-25.

16. More closely aligning residential basic local service prices with the forward-looking economic costs will serve to jump-start residential local competition in Florida. It can be expected that Sprint' s residential local telecommunications service customers will thereby benefit from the availability of competitive local service providers offering a variety of services, packages of services, innovative pricing options and new technology. Gordon Direct Testimony at 37. Although residential local competition will not happen overnight or come to all markets at the same time or in the same form, residential local competition will happen and will grow when the economics of competing are made more attractive to more competitors. As the process goes forward, more and more residential local service users will receive the benefits of competition. Staihr Direct Testimony at 8-10.

17. Because much of the territory served by Sprint is not a densely populated urban service territory, it is not certain that under current basic local service prices, the benefits of residential local service competition will immediately come to each of Sprint' s customers. Yet, the evidence unquestionably demonstrates that residential competition will come as the result of granting Sprint' s Petition. Likewise, the evidence also demonstrates that competition in the less urban residential markets is not likely to ever materialize if Sprint' s Petition is not granted. Granting Sprint' s Petition will provide the impetus for CLECs and other entrants to serve all Sprint' s residential markets wherever located - with new, different technologies, such as voice over internet protocol ("VOIP"), broadband over power lines ("BPL"), and fixed wireless services.

- The cable TV industry is currently conducting voice telephony trials using the VOIP transmission technology over cable TV lines and cable modems. Because of the extensive availability of cable TV networks, especially in residential areas, including rural areas, the cable TV infrastructure is readily available to provide voice telephony using VOIP transmission technologies. Staihr Direct Testimony at 9.
- The electrical power industry, including Florida electric utilities, are currently in trials using BPL technology to provide broadband services to consumers using the existing electrical grid. BPL technology is adaptable to also providing voice telephony. Again, because of the ubiquitous presence of the existing electric grid, BPL is a readily available alternative on a widespread basis to Sprint' s local exchange telecommunications network and could be a significant competitive threat to its residential voice telephony, as well as data services. Staihr Direct Testimony at 9.
- There are a number of firms throughout the nation that are providing wireless services in less urban areas in competition with the ILECs. Given the proper financial incentives - including the ability to serve the less urban areas' profitability, these wireless firms can and will serve residential local customers in Sprint' s rural areas as an alternative to wireline-based technologies. Staihr Direct Testimony at 9-10.

18. Infrastructure investment is contemplated by the federal 1996 Act and is an integral aspect of Florida' s 2003 Act. With competition entering the residential local telecommunications service markets - urban, suburban and rural - on a large scale basis, there will be a substantial increase in infrastructure investment by the CLECs and by Sprint as well. In

order to be able to compete successfully and efficiently in the residential market, Sprint will need to upgrade its network, including facilities and switches. Staihr Direct Testimony at 14. As just discussed, the competitors' infrastructure investment willcome in several forms, including wireline, wireless, cable TV and electric power lines. As an additional benefit from stimulating local competition, the CLECs and Sprint' s infrastructure investment activity will tend to create new, high-tech jobs and will tend to provide an infusion of capital-spending dollars into Florida' s economy. Gordon Direct Testimony at 31-33.

19. Making the residential local market more attractive to competitors is not the only benefit that Sprint' s residential local service users wilexperience from granting Sprint' s Petition. Sprint' s residential local service customers who subscribe to a major interexchange carrier (IXC) for their toll services will see a significant benefit from granting Sprint' s Petition. Felz Direct Testimony at 24-25; Staihr Direct Testimony at 14. As required by the 2003 Act, each IXC that experiences expense savings from the reduction of intrastate switched network access rates must pass all of those savings on to their customers in the form of: a.) eliminating any "instate connection fee" by January 1, 2006; and b.) reducing intrastate toll rates. Section 364.163(2), Florida Statutes.

20. The "instate connection fee," which amounts to about $1.90 per month, is collected by several, major IXCs from many of their toll customers, regardless of the customers' level of toll usage. Thus, every residential toll customer paying the "instate connection fee" will see a reduction and eventual elimination of that $1.90 fee, regardless of how many or how few toll calls the residential consumer makes each month. Felz Direct Testimony at 24-25; Staihr Direct Testimony at 14. Thereafter, the IXCs' perminute toll rates must be reduced to flow-through any residual intrastate switched network access rate reduction amounts.

21. Sprint will also provide its customers in outlying areas with additional benefits by reducing some extended calling service (ECS) charges, thereby effectively increasing those residential customers' flatrate calling scope. These customers have long wanted the ability to have flat-rate calling opportunities with other Sprint customers with whom they have a community of interest. By bringing the residential basic local service prices more in line with costs, the past cost-disincentives will be greatly reduced, thereby making it more financially justifiable to provide these customers' with reduced charges in the form of a five (5) free-call allowance. Felz Direct Testimony at 24.

22. Also of importance in assessing the impact of granting Sprint' s Petition is the protection the 2003 Act provides for Florida' s economically disadvantaged residential local service subscribers. Under the 2003 Act, any increases in residential basic local telecommunications service rates authorized by granting Sprint' s Petition will not apply to Sprint' s Lifeline subscribers during the period that Sprint' s intrastate switched network access rates are being reduced to interstate parity in a revenue neutral manner. Section 364.10(3)(c). Sprint is also committing, as part of its plan, to exempting its Lifeline subscribers from the effects of granting Sprint' s Petition for a three (3) year time period. Felz Direct Testimony at 25.

III. Granting Sprint's Petition Will Induce Enhanced Market Entry

23. Granting Sprint' s Petition will induce enhanced market entry. Realigning access and basic local service prices closer to their costs will send a powerful signal to the CLECs who have otherwise been reluctant to serve the residential local service market. Once the competitors are convinced that serving Sprint' s residential local service markets is more in line with their economic interest, and once the entrants make the necessary infrastructure investment to serve the residential local service markets, residential local service consumers will see an array of enhanced services, bundles of services and technologies from which they can pick and choose at

prices dictated by the marketplace. Gordon Direct Testimony at 37-38; Staihr Direct Testimony at 8-10.

IV. Granting Sprint's Petition Will Result in Intrastate Switched Network Access Rate Reductions to Parity Over a Period of Two Years

24. The 2003 Act provides that Sprint has the flexibility to determine the time period over which it may implement its intrastate switched network access rate reductions, so long as the reductions are revenue neutral to Sprint and are achieved between two (2) years and four (4) years. Sprint is designating a two-year time period to accomplish the revenue neutral intrastate switched network access reductions. Felz Direct Testimony at 17. By implementing the reductions over a two-year timeframe, Sprint will signal its competition that the residential local service market will be an attractive market sooner rather than later, and that the competitors can commence their infrastructure investment now rather than years from now. Gordon Direct Testimony at 15-16; Felz Direct Testimony at 23-24. In this way, residential local service users will receive the benefits of a competitive market in a relatively short timeframe, furthering the overarching purpose of the 2003 Act to promote competition.

25. Sprint recognizes that by implementing the intrastate switched network access reductions over a two-year period, as opposed to a longer period, the size of each annual basic local telecommunications service rate adjustment will therefore be larger each year. Consequently, as noted previously, in order to provide additional benefits to its residential customers (especially those customers most likely to feel the impact of the basic local service price increases), Sprint will commit to the following steps:

a) eliminate/reduce the charge paid by basic local telecommunications service customers for certain extended calling service (ECS) and extended area service (EAS) routes by providing a five-free-call allowance; and

b) exempt Lifeline service subscribers from basic local telecommunication service price increases associated with the rate rebalancing for three (3) years from the grant of the Petition. See Felz Direct Testimony at 24-25.

V. Granting Sprint's Petition Will Be Revenue Neutral

26. The 2003 Act mandates that Sprint must reduce its intrastate switched network access rates in a revenue neutral manner. The mechanism for achieving revenue neutrality is set forth in the statute. See Sections 364.164(4) and (7), Florida Statutes. Simply stated, the revenue neutrality requirement means that the intrastate switched network access rate reductions made by Sprint must be offset by increases in Sprint' s basic local service rates[2]. In this regard, as stated previously, Sprint' s reduction of its intrastate switched network access rate from a combined $0.104 per minute to parity with its interstate switched network access rate in effect on January 1, 2003, of $0.013 per minute, will, based upon current annual units, result in a reduction in Sprint' s intrastate revenues by approximately $142 million.

27. Sprint will offset the annual $142 million shortfall by increasing its residential and single-line business basic local telecommunications service rates over two years. Based upon current annual basic local service units, Sprint will increase residential basic local service rates by $3.23 per month in year one and by $3.63 per month in year two. Even with these increases, the monthly price of residential basic local service will, on average, still be below the average monthly cost of $30.46 per access line. Dickerson Direct Testimony at Exhibit KWD-2, page 2. In addition, as required by the 2003 Act, Sprint will recover a portion of the revenue offset requirement from basic local service connection fees. Felz Direct Testimony at 21.

28. Sprint will also increase its single-line business basic local service rates by $2.87 per month in year one and by $3.13 in year two. Felz Direct Testimony at 21. Sprint' s current

[2] Basic local service rates include the monthly recurring rates for residential and single-line business basic local telecommunications service and non-recurring charges associated with the installation and connection of these services.

average single-line business access line revenue of $27.68 per month, including the $6.50 per month SLC, exceeds Sprint' s average cost of providing singldine business basic local service. Felz Direct Testimony at Exhibit JMF-4. By recovering a portion of Sprint' s intrastate switched network access reduction amount from single-line business basic local telecommunications customers, even though those service rates already, on average, cover costs, Sprint is actually shifting away a portion of the access revenue reduction impact which otherwise would need to be recovered from Sprint' s residential basic local telecommunications service customers.

29. Although the annual intrastate switched network access rate adjustments will be fixed, the actual amount of the basic local telecommunication service revenue annual offset will be dependent upon the size of the intrastate switched network access revenue reduction. This amount will be calculated by multiplying each annual intrastate switched network access per minute rate reduction by the number of intrastate switched network access minutes of use for the most recent, available 12-month period at the time the rate adjustments are made. Felz Direct Testimony at Exhibit JMF-11. Also, the amount of any annual rate increase to be applied to a given basic local telecommunications rate element will be dependent upon several factors, including the 2003 Act' s provision that not all of the offset is to be recovered from the basic monthly recurring rate. Felz Direct Testimony at Exhibit JMF-12. Other factors impacting the amount of the adjustment might include the cost/revenue relationship of the basic service rate element and the most recent 12-month number of units of the basic service rate element. Felz Direct Testimony at 22-23.

VI. Conclusion

30. The 2003 Act creates the mechanism by which residential local competition can become a reality in Florida. The key to that reality is the reduction of the considerable local residential service price support being provided by over-priced intrastate switched network

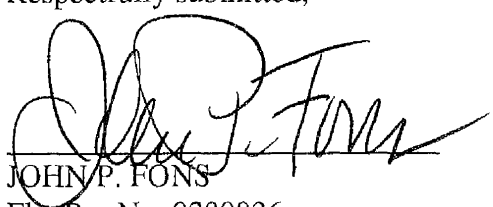
access in a revenue neutral manner. By shifting the cost recovery to the cost-causers, namely, to basic local service customers, it follows that competitors will enter Sprint' s local market to serve a broader number of residential customers with a variety of innovative technologies, services and pricing choices. Competition will allow the market, rather than regulation, to determine these technologies, services and pricing choices. As noted by Governor Bush in his May 23, 2003, transmittal letter approving the 2003 Act:

> I am certain that this legislation will allow all Floridians to experience greater options, so that, ultimately, local phone customers will have the opportunity to access new technology and be offered the level of choice and quality that is now commonplace in long distance services and cellular phone plans.

As demonstrated by the accompanying testimony and exhibits, granting Sprint' s Petition will bring the full benefits of competition to Florida' s residential consumers as contemplated by the 2003 Act.

WHEREFORE, having demonstrated, through this Petition and the accompanying testimony and exhibits, that the criteria to be considered by the Commission, pursuant to Section 364.164(1)(a)-(d), Florida Statutes, have been fully addressed and satisfied, Sprint requests that the Commission grant this Petition and authorize Sprint to reduce its intrastate switched network rates to interstate parity in a revenue neutral manner.

Respectfully submitted,



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ATTORNEYS FOR SPRINT-FLORIDA, INCORPORATED

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by e-mail and U.S. Mail this 27th day of August, 2003, to the following:

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Attorney

BEFORE THE PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

JOHN M. FELZ

I. INTRODUCTION

Q. Please state your name, occupation and business address.

A. My name is John M. Felz. I am employed as Director - State Regulatory for Sprint Corporation. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.

Q. Please describe your educational background and business experience.

A. I received my Bachelor's degree in Accounting from Rockhurst University in Kansas City, Missouri in 1979. In 1989, I earned a Master's Degree in Business Administration with an emphasis in Finance from Rockhurst University. I began my career with Sprint as an internal auditor in 1979 and assumed increasing levels of responsibility in that department, including positions as Senior Auditor, Audit Manager and Assistant Director. From 1986 to 1988, I was Revenue Accounting Manager for Sprint's Midwest Group of local telephone companies with responsibility for billing approximately 500,000 customers in six states. In 1988, I was named to the position of Financial Budget Manager and had responsibility for preparing and managing the budget for Sprint's Midwest Group of local telephone companies. From 1991 to 1996, in the position of Revenue Planning Manager, I was responsible for regulatory and tariff issues for Sprint's local telephone operations in Kansas. From 1996 to 1998, I held the position of Senior Manager - Wholesale Markets with

responsibility for negotiating and implementing interconnection agreements with competitive local exchange carriers and wireless providers. I was named to my current position as Director - State Regulatory in January 1998 and have responsibility for development and implementation of regulatory policies for Sprint' s operations in a number of states, including Florida.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain Sprint-Florida, Incorporated' s (Sprint's) plan for reducing its intrastate switched network access rates in a revenue neutral manner as authorized in Section 364.164(1), Florida Statutes 2003. As a matter of introduction, I describe Sprint's service territory in Florida and its differences from BellSouth's and Verizon's territories in the state. I also provide a brief history of intrastate switched network access rates in Florida and how they were developed and modified over the years. In my testimony, I also explain and provide support for Sprint's plan for reducing intrastate access rates to parity with its January 1, 2003 interstate access rates on a revenue neutral basis. Finally, I describe the consumer benefits associated with Sprint's plan.

Q. Are there other witnesses who support Sprint's plan for reducing intrastate switched access rates to interstate levels in a revenue neutral manner?

A. Yes. Sprint is co-sponsoring (with BellSouth and Verizon) the testimony of Dr. Kenneth Gordon who addresses how the removal of implicit subsidies is consistent with the development of a healthy competitive market for basic local telecommunications services throughout the state of Florida. Sprint witness Dr. Brian Staihr demonstrates how Sprint's plan will remove current support for basic local

telecommunications services and create a more competitive local exchange market in Sprint's service area for the benefit of residential customers. Dr. Staihr will also describe how Sprint's plan for revenue neutral access rate reductions will induce enhanced market entry and create a more attractive residential competitive market. Sprint witness Kent Dickerson provides cost study results which demonstrate that Sprint's current intrastate switched network access rates are priced well above their costs and that Sprint's current residential basic local service rates are priced well below their costs. Through the testimony and supporting information of Sprint's witnesses, the evidence demonstrates that Sprint's plan for revenue neutral access rate reductions meets the criteria of section 364.164(1) and should therefore be approved by the Commission.

II. BACKGROUND

Q. Please describe Sprint's certificated local service market areas?

A. Sprint serves approximately 40 percent of the State's geographical area with 104 exchanges, but only 19.6 percent of the State' s access lines, serving approximately 2.2 million total access lines out of a total of 11.2 million access lines.

Just over 70 percent of Sprint' s access lines are residential. The exchanges vary in number of access lines from Tallahassee, the largest exchange, with 218,638 access lines, to Kingsley Lake, the smallest exchange, with only 332 access lines. Seventy-nine percent of Kingsley Lake's access lines are residential as compared to fifty percent for Tallahassee. Sprint has only five exchanges with more than 100,000 access lines, which are: Ocala with 108,052 access lines; Naples with 138,878 access

lines; Fort Myers with 167,238 access lines; Winter Park with 208,268 access lines; and Tallahassee with 218,638 access lines. Eighty-two (82) of Sprint's 104 exchanges have less than 25,000 access lines and 60 exchanges have less than 12,000 access lines.

Q. How does Sprint's service area compare with the areas served by BellSouth and Verizon in Florida?

A. As just noted, Sprint, with the exception of a few urban-type exchanges, has a less urban market area. In contrast, BellSouth and Verizon, which serve approximately 78 percent of the state' s access lines, serve more urban and suburban areas and have a combined total of approximately 9 million access lines. When measured on the basis of access lines per square mile, Sprint's service territory exhibits significantly less customer density than that of either BellSouth or Verizon. Sprint's service territory encompasses over 22,000 square miles and exhibits a customer density of 94 lines per square mile. This is in stark contrast to BellSouth's density of 341 lines per square mile and Verizon's density of 465 lines per square mile. I have included Exhibit JMF-1 as an attachment to my testimony which provides a visual representation of the differences in customer density between Sprint and BellSouth and Verizon. In Docket Nos. 990649A & B – TP this Commission recognized the more diverse geographic Sprint service area and established four (4) UNE loop rate bands for Sprint as compared to three (3) rate bands each for the more urban BellSouth and Verizon service areas. Additionally, Sprint's basic local telecommunications service rates are lower on average than both BellSouth's and Verizon's.

Q. Why are the differences between the serving areas of Sprint, Verizon and

BellSouth important in the context of this proceeding?

A. The differences in the geographic density and customer mix are important factors that influence the magnitude of the revenue-neutral price changes that Sprint is requesting in its Petition. The unique characteristics of Sprint's service territory and customer mix, when compared to those of Verizon and BellSouth, means that Sprint's rate structure reflects a greater subsidy from intrastate switched network access charges than being experienced by the other companies. Hence, a greater increase in basic local service rates will be necessary for Sprint to achieve the interstate parity and revenue-neutral provisions of the legislation.

Q. Please explain how rates were established historically in a monopoly environment?

A. Under historical rate base, rate-of-return regulation, a total company revenue requirement was determined based on the company's total expenses, plus a return on its investments. After the overall revenue requirement was established, prices were set to optimize revenues from discretionary and non-basic services. To the extent the firm' s revenue requirement could not be recovered from raising non-basic service rates, the residual amount would be recovered from access charges and residential and business local access line services. Because residential basic local service rates were set based on universal service and other objectives (well below cost), access charges and business services became the "plug" to provide the revenue to meet the revenue requirement. The principle underlying this "residual" pricing concept was the idea of maintaining the universal service objective of making residential basic local service widely available at "affordable" rates, regardless of cost/revenue relationships. The net effect was to set prices for non-basic and discretionary services above their costs to

support lower-priced, below-cost residential basic local service rates.

Historically, the largest contribution to the support for residential basic local service was long distance calling, which was viewed in a monopoly environment as a highly desirable, premium, discretionary service with a predictable, stable revenue stream. The significant contributions from both interstate and intrastate long distance toll were used to support below-cost residential basic local service rates through end user rate-setting proceedings including a division of revenue/settlements process overseen by the federal and state regulators. In the now intensely competitive long distance market, the regulator' s maintenance of the historic contribution levels from long distance toll to subsidize below-cost residential basic local service is provided from access charges paid to the local exchange companies by the long distance carriers.

Q. What are Sprint's current intrastate switched access rates and what regulatory proceedings influenced the current rate levels?

A. Sprint's current intrastate switched network access rates are the product of several decisions and now average approximately $.104 per minute (originating and terminating). The current rates reflect a significant change from the structure and rates originally established by the Commission in 1983.

Rates were originally established in Docket 820537-TP which was initiated by Order No. 11551, issued January 26, 1983, on the eve of the impending AT&T divestiture. The purpose of the proceeding was to implement an intrastate access charge structure in Florida that would compensate local exchange companies for the use of their local facilities to originate and terminate long distance traffic by interexchange carriers. As

stated in Commission Order No. 12765, issued December 9, 1983, the primary goal ". . . was to set access charges that would adequately compensate the LECs for use of their local facilities for originating and terminating toll traffic and to provide incentives for competition, while maintaining universal telephone service." This policy goal resulted in the Commission setting intrastate switched network access charges for Sprint (then United Telephone) in the neighborhood of $0.25 per minute.

Thereafter, Docket No. 8609874-TL was initiated in mid-1986 to re-address the level of, and the mechanism for, recovering non-traffic sensitive costs associated with the local loop. The outcome of that docket was essentially a continuation of the historical regulatory policies of maintaining low basic local service rates through the support of revenues from other services, principally intrastate switched network access charges.

In 1989, in Docket No. 891239-TL, and again in 1991, in Docket No. 910980-TL, Sprint (United Telephone at the time) filed petitions that proposed increases in residential basic local service rates and reductions in switched network access charges. The $16 million access charge reduction and local service rate increase requested in the 1989 case was approved, however, the $8 million access reduction requested in the 1991 case was rejected since it would have increased residential basic local service rates. Specifically, the Commission stated:

> "We increased local rates by $15.9 million in United's last rate case and lowered the BHMOC [an intrastate access charge component]. But, we do not believe that local rates should again be raised in this proceeding in order to have a greater BHMOC reduction. Accordingly, we shall deny United's request." (Order No. PSC-92-0708-FOF-TL, Docket Nos.

910980-TL, 910529-TL.)

In 1995, the Florida Legislature passed the Florida Telecommunications Act ("1995 Act") which opened the local exchange carriers' local markets to competition and mandated reductions in access charges for any LEC who chose to become regulated under a price regulation plan and whose intrastate switched network access charges were not then at parity with its interstate switched network access charges. The 1995 Act established a target for intrastate switched access rates as the December 31, 1994 interstate switched network access rate levels and provided for a 5 percent annual reduction in access charges as the mechanism for achieving parity with a LEC' s interstate switched network access rates. Sprint fulfilled the annual reductions mandated under this legislation in 1996 and 1997. In 1998, the Florida Legislature modified the provisions related to access charge reductions and required a 15 percent reduction to be made in 1998, while at the same time removing the 1994 interstate rate as the target. Since Sprint' s 1998 access rate reductions of 5 percent ($9.3 million) in July and 10 percent ($17.6 million) in October, there have been no further changes to Sprint' s intrastate switched network access rates.

Q. You have discussed generally how access charges have historically been set above cost and identified Sprint's current access rates and how they arrived at their current level. Does the cost study information supplied by Sprint witness Dickerson confirm that Sprint's current intrastate switched access rates reflect a substantial contribution?

A. Yes. Sprint's current intrastate access rates provide a substantial contribution when compared with the forward-looking cost of switched access services. I have prepared

exhibit JMF-2 to illustrate the current relationship between intrastate access rates and cost. The analysis demonstrates that Sprint's current average intrastate switched access rate of $.050392 per minute of use (per end) exceeds the cost for the service of $.004475, thereby providing a significant contribution of $.045917 per minute of use. It should be noted that this analysis of current intrastate access rates and costs is presented solely to demonstrate the existing subsidy to residential local service provided by intrastate access charges.

Q. Is cost the target for the intrastate access reductions?

A. No. The 2003 Act established parity with the January 2003 interstate access rates as the appropriate target for reducing intrastate access rates.

Q. What evidence do you have that the contributions from intrastate switched network access charges are subsidizing residential basic local service?

A. Exhibit JMF-3 to my testimony demonstrates the significant subsidy being provided to residential basic local service rates. The cost studies presented by Sprint witness Dickerson identify the forward-looking cost of residential basic local service as $30.46 and business basic local service as $XX.XX. A comparison of these costs to the current associated rates (including the subscriber line charge) for basic local service reveals that residential basic local service is currently priced well below its associated costs. The exhibit clearly demonstrates that the rates for residential basic local service are not recovering the associated costs of providing the service. Coupled with the previous analysis of intrastate access rates and its associated costs, it is clear that intrastate access charges are providing a subsidy to residential basic local service rates. Exhibit JMF-4 provides a comparison of the rates and costs for single-line business

service.

Q. How do intrastate switched access rate levels in Florida compare to those in other states?

A. Exhibit JMF-5 demonstrates the disproportionate contribution made by Sprint' s intrastate switched network access charges to support residential basic local service rates in Florida, relative to seven other southeastern states. I have shown the access rates of BellSouth, the largest ILEC in each of these other states. Sprint's intrastate access charge rate is more than twice the intrastate access charge rate of the next highest rate and more than ten (10) times higher than four (4) of the other states' rates.

Q. How do Sprint's basic local service rates in Florida compare to the rates in other states?

A. Sprint's average monthly rate for residential basi c local service, including TouchTone, is $9.98 in Florida, compared to a national average rate of $14.55, a difference of $4.57. The national average rate is from the FCC's 2003 Reference Book of Rates, Price Indices and Household Expenditures for Telephone Service, Table 1.1. Exhibit JMF-6 is a comparison of Sprint's rates with those of BellSouth's rates in other states in the southeast. BellSouth's rates were used for comparison as they are the largest ILEC in the subject states.

As can be seen from Exhibit JMF-6, Sprint's residential basic local rates are significantly lower than the comparable rates in its seven neighboring southeastern states. Sprint's rates in its lowest rate group are on average $4.47 per month lower than the comparable rates in the other states. In the highest rate group, Sprint's

Florida residential rates are on average $3.86 per month lower than the comparable rates in the other states.

Exhibit JMF-7 shows that Sprint's single-line business rates are also significantly below the rates for business lines in these neighboring states. Sprint's single-line business average rate of $21.18 is also well below the national average of $33.34 (FCC's 2003 Reference Book of Rates, Price Indices and Household Expenditures for Telephone Service, Table 1.8).

Q. Has Sprint' s Local Telephone Division had experience in other states in transitioning subsidies from access charges to end user rates?

A. Yes. Sprint's experiences in Ohio and Pennsylvania with rate rebalancing between access charges and end user rates provides information which is insightful in evaluating a similar initiative here in Florida.

Q. Could you describe Sprint's access rebalancing experience in Ohio?

A. In June 2001, the Public Utilities Commission of Ohio approved Sprint's proposed plan to reduce intrastate switched access charges to interstate levels and increase certain end user rates to offset the access revenue reduction (Commission Opinion and Order in Case No. 00-127-TP-COI and Case No. 01-1266-TP-UNC, Issued June 28, 2001). The plan provided for a reduction of intrastate switched access rates to parity with the interstate switched access rates that resulted from the FCC's Coalition for Affordable Local and Long Distance Service ("CALLS") proceeding. To offset the access reduction, Sprint established an end user charge (called an 'intrastate access fee') of $4.10 for residential customers, $6 for single-line business customers and

\$8.90 for multi-line customers. These local rate increases were implemented on a flash-cut basis.

Q. What has been Sprint's experience with switched network access rate rebalancing in Pennsylvania?

A. The Public Utility Commission of Pennsylvania has allowed residential basic local service rates to periodically increase up to a weighted average cap of \$16 per month to offset decreases in intrastate switched access rates. Rates for business local service were also allowed to increase, but by a smaller amount than residential rates. Intrastate traffic sensitive access charges were to be reduced to the July 1998 interstate rate levels. The carrier common line charge was restructured from a minute-based charge to a flat-rate carrier charge. Under this plan, Sprint has increased its residential basic local service rates by approximately \$4.41 to an average of \$15.88 and has offset these local rate increases with corresponding reductions to its traffic sensitive intrastate switched network access rates and the carrier charge.

Q. Have there been recent developments in Pennsylvania which will further reform the intrastate access rate structure for Sprint in Pennsylvania?

A. Yes. On July 10, 2003, the Pennsylvania Commission approved a joint proposal of Sprint, the Rural Telephone Company Coalition, the Office of Consumer Advocate, Office of Trial Staff and Office of Small Business Advocate that provides for further access charge reductions on a revenue-neutral basis. The approved plan allows Sprint to increase its residential basic local service rates to achieve a maximum weighted average of \$18 and to offset these increases with corresponding reductions to its traffic sensitive access rates and the carrier charge. Rates for business local service are

allowed to increase by the same amount as the residential rates.

Q. What was the Pennsylvania Commission's rationale in approving the local rate increases and corresponding access charge reductions?

A. The Pennsylvania Commission recognized the need to rationalize the pricing structure for both basic local service and access charges to foster a more competitive environment. The Pennsylvania Commission specifically found in its July 10, 2003, order that:

> "At this juncture, the Commission is persuaded that the proposed access charge reductions are in the public's interest and in accordance with the Commission's objective to reduce implicit subsidy charges such as access charges that impede competition in the telecommunications market. As implicit charges become explicit charges, competitors are better able to compete for local and long distance customers in an ILEC's service territory because IXCs are not hindered by paying ILECs excessive access charges in providing competitive toll services and CLECs are better able to compete with ILEC local service rates that have been kept artificially low as a result of the access charge subsidies." (Order at page 10).
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> "We further look to the Federal Communications Commission's (FCC) recent decisions in the CALLS and MAG orders for precedence in ordering implicit charges to become explicit, either through an increase in basic local telephone service rates, or through service line charges on customer bills. This enables other carriers to compete due to reduced

subsidies. While the Joint Proposal does not require a rural ILEC or Sprint/United to mirror interstate access charges, the fact that this is a step towards making the charges closer to cost and closer to the interstate access charges will help to avoid arbitrage and will help competition enter the ILEC territories." (Order at page 11).

III. ACCESS RATE REDUCTIONS

Q. What provisions of the Tele-Competition Innovation and Infrastructure Enhancement Act ("2003 Act") govern Sprint's filing of its petition to reduce its intrastate switched access rates?

A. The applicable provisions of the legislation associated with the access reductions include the following:

364.164 (1)

"Each local exchange telecommunications company may, after July 1, 2003 petition the Commission to reduce its intrastate switched network access rate in a revenue neutral manner."

364.164 (5)

"As used in this section, the term ' parity' means that the local exchange telecommunications company's intrastate switched network access rate is equal to its interstate switched network access rate in effect on January 1, 2003, if the company has more than 1 million access lines in service."

364.164 (6)

"As used in this section, the term ' intrastate switched network access rate' means the composite of the originating and terminating network access rate for carrier common line, local channel/entrance facility, switched common transport, access tandem switching, interconnection charge, signaling, information surcharge, and local switching."

Q. Please describe Sprint's interstate switched network access rate structure that will be used as the target for Sprint's intrastate access reductions.

A. Sprint's January 1, 2003 interstate switched network access rates are the result of the CALLS plan adopted by the Federal Communications Commission in June 2000 (Sixth Report and Order in CC Docket No. 96-262 and 94-1, Report and Order in CC Docket 99-249, Eleventh Report and Order in CC Docket 96-45, released May 31, 2000). The CALLS plan established a five-year timeframe for addressing issues with both the rate structure and rate levels for interstate switched network access service. Exhibit JMF-8 to my testimony identifies the rate elements reflected in Sprint's January 2003 interstate switched access rates.

Q. Are there any differences between Sprint's interstate and intrastate switched access rate structures?

A. Yes. Sprint's intrastate switched network access rates include rates for carrier common line and interconnection charge, however the interstate rates for these elements are set at zero. Also, the interstate switched transport rate category has sub-element rates for common and dedicated trunk ports, which are not disaggregated from the switched common transport rate element in the intrastate tariff.

Q. How will Sprint reduce intrastate switched access rates to be in parity with interstate switched access rates?

A. Because the 2003 Act specifically identifies the interstate switched access rate as the target for parity, Sprint will implement a very simple and straight-forward approach to achieve parity. Sprint will establish a rate structure for its intrastate switched network access rates that mirrors both the rate structure and rate levels for interstate switched network access service in effect on January 1, 2003. This approach ensures that the intrastate switched network access rates are in parity with their interstate counterpart since both the structure and rates will be exactly the same once the transition to parity is completed.

Q. Using this method of mirroring both the rate structure and rate levels for interstate switched network access rates, how did Sprint calculate the impact of the intrastate switched network access rate reduction?

A. As specified by the 2003 Act, Sprint will utilize the most recent 12 months' actual pricing units in developing the impact of the intrastate switched access reduction. For purposes of this filing, the most recent available 12 months information covers the period from June 2002 to May 2003. Sprint applied the current intrastate switched access rates to the actual pricing units to develop the current intrastate switched access revenues. Sprint then applied the January 1, 2003 interstate access rates to those same pricing units to develop the estimate of revenues to be received after implementation of the rate changes. Assuming – for illustration purposes only - a flash-cut, one-time reduction, the difference between the two revenue amounts represents the total value of the intrastate switched access rate reductions. For purposes of its Petition, Sprint has calculated this amount as $142,073,492. The detailed calculations of this amount

are included on Exhibit JMF-9 to my testimony.

Q. Does Sprint's approach result in parity between the intrastate composite switched network access rate and the interstate composite switched network access rate?

A. Yes. As noted earlier, Section 364.164 (6) provides a comprehensive description of what is included in the term 'intrastate switched network access rate."

> "As used in this section, the term ' intrastate switched network access rate means the composite of the originating and terminating network access rate for carrier common line, local channel/entrance facility, switched common transport, access tandem switching, interconnection charge, signaling, information surcharge, and local switching."

I have prepared Exhibit JMF-10 which demonstrates that Sprint's access rate reduction plan will produce a composite switched intrastate access rate that is equal to the composite January 1, 2003 interstate switched access rate. Sprint's calculation produces an intrastate switched access composite rate of $.012852 after the access rate reduction is completed. This composite rate is equivalent to the January 1, 2003 interstate switched access composite rate of $.012852.

Q. What is Sprint's plan for adjusting intrastate switched network access rates ?

A. Sprint will reduce its intrastate switched network access rates to the target levels over a two-year period. This means approximately 50 percent of the access reduction will occur in year 1 and the remainder in year 2. The access reductions in year 1 are

targeted to reducing the current intrastate switched network access charge elements which have no associated costs and are therefore providing a pure subsidy. Specifically, Sprint will target the reduction of $71,035,981 to the interconnection charge and the carrier common line rates. The reduction amount in year 1 results in an elimination of the interconnection charge and a substantial reduction in the carrier common line rates. Exhibit JMF-11 to my testimony provides the detailed calculations supporting the year 1 access reductions.

Q. What intrastate switched network access rate changes are planned for year 2?

A. The year 2 intrastate switched network access rate reductions will be directed first towards elimination of the remaining carrier common line rates. The remainder of the access rate reduction is directed at establishing the rate elements and rates that fully mirror the January 1, 2003 interstate rates. Sprint has estimated the impact of the second year reduction as $71,037,512 based on current pricing units (see Exhibit JMF-11). However, it is recognized that the actual reduction amount for year 2 will be based on the latest 12 months pricing units at that time. As a result, the impact of the access reduction for year 2 will likely vary from the $71,037.512 amount.

Q. With these changes, does Sprint's plan comply with the provisions of the 2003 Act regarding intrastate switched access rate levels?

A. Yes. Based on this plan, at the end of the second year, Sprint's intrastate switched access rates will exactly match (in both structure and rate level) the January 2003 interstate switched network access rates.

IV. REVENUE NEUTRALITY

Q. You have described Sprint's plan for reducing its intrastate switched access rates to parity with interstate rates. What does the 2003 Act provide for in terms of revenue neutrality?

A. The 2003 Act specifies that, if intrastate access rates are to be reduced, they must be reduced in a revenue-neutral manner. Section 364.164 (2) describes the specific methodology to be used for calculating revenue neutrality:

> "If the Commission grants the local exchange company's petition, the local exchange company is authorized, the requirements of section 364.051 (3) notwithstanding, to immediately implement a revenue category mechanism consisting of basic local telecommunications service revenues and intrastate switched network access revenues to achieve revenue neutrality. The local exchange company shall thereafter, on 45 days' notice, adjust the various prices and rates of the services within its revenue category authorized by this section once in any 12-month period in a revenue-neutral manner."

Q. What information did Sprint use to create the revenue category mechanism provided for in the provision quoted above?

A. The provisions of the 2003 Act related to calculation of the revenue category mechanism are contained in section 364.164 (7):

> "Calculation of revenue received from each service before the implementation of any rate adjustment must be made by multiplying the then-current rate from each service by the most recent 12 months' actual pricing units for each service within the category, without any

adjustments to the number of pricing units. Calculation of revenue for each service to be received after implementation of rate adjustments must be made by multiplying the rate to be applicable for each service by the most recent 12 month's actual pricing units for each service within the category, without any adjustments to the number of pricing units."

Based on these guidelines, Sprint extracted billing information for the most recent 12 months (June 2002 through May 2003) for intrastate switched network access services and basic local telecommunications services and created a model which documents the calculations necessary to achieve the revenue neutrality provisions of the 2003 Act. This information is summarized in Exhibit JMF-12 to my testimony.

Q. What is Sprint's plan for achieving revenue neutrality?

A. As noted previously, Sprint will reduce its intrastate switched access rates to the target interstate levels over a two-year period. To achieve the revenue neutrality provided by the 2003 Act, Sprint will increase rates for basic local telecommunications services over that same two-year period. I previously described how Sprint's calculation of the amount to achieve access rate parity produces a reduction of $142,073,492 in access revenues, assuming a one-time, flash-cut reduction. This $142,073,492 represents an estimate of the amount to be recovered through adjustments in the rates for basic telecommunications service, assuming the same one-time, flash-cut adjustment.

As noted previously, Sprint will implement 50 percent of the total switched network access rate reduction and corresponding revenue-neutral increases to basic

telecommunications services in year 1. The remaining access rate reduction and revenue-neutral increases to basic local telecommunications service rates will be accomplished in year 2.

Q. What rate changes to basic local telecommunications services will be implemented to achieve revenue neutrality?

A. Exhibit JMF-12 to my testimony summarizes Sprint's rate change plan for its basic residential and single-line business local service rates for both year 1 and year 2. Sprint will increase residential basic local service recurring rates by $3.23 in year 1 and $3.63 in year 2. Rates for single-line business basic local service will increase by an average of $2.87 in year 1 and $3.13 in year 2. Sprint will also increase certain residential and business non-recurring service charges. These rate changes will increase basic local service revenues by $142,085,602, an amount which is slightly different from the total access reduction amount due to rounding differences.

Q. How does Sprint's plan comply with the provision in 364.164 (2) regarding limiting the increases to the basic local service monthly recurring rate?

A. The 2003 Act provides that:

> "An adjustment in rates may not be offset entirely by the company's basic monthly recurring rate."

In compliance with this provision, Sprint's plan includes an estimated $7,638,900 of increases to certain non-recurring, service charges. As a result, Sprint's access charge reductions are not offset entirely by increases in the basic local service monthly recurring rate.

Q. How will Sprint comply with the provisions of the 2003 Act relating to Lifeline and pay telephone access lines?

A. The 2003 Act provides that:

> "Billing units associated with pay telephone access lines and Lifeline service may not be included in any calculation under this subsection."

Sprint has specifically identified the number of Lifeline and pay telephone lines in service during the 12-month period used in calculating the revenue neutrality provisions of its plan. The pay telephone lines were removed from the calculation of revenue neutrality and the current rates will not be affected by rate changes associated with implementing the 2003 Act. For Lifeline customers, billing system limitations will preclude Sprint from continuing to display the current basic local service rate for Lifeline customers on the bill as the rate changes resulting from the revenue neutrality provisions are implemented. Sprint will, instead, reflect on these customers' bills, a Lifeline credit that is increased by the amount of the increases to recurring residential rates. This will insure that there is no net impact to the customer from the increases associated with implementing the 2003 Act. Sprint believes this approach is expressly consistent with the legislative provisions regarding Lifeline customers – namely, to ensure their bills are unaffected by the rate changes resulting from implementation of the revenue neutrality provisions of the 2003 Act.

Q. What are the factors that could change the actual basic local service rates in the Sprint plan?

A. The 2003 Act provides that the actual pricing changes to accomplish revenue

neutrality must be based on the company's most recent 12 months' pricing units. As a result, changes to the pricing units for both switched access services and basic local telecommunications services are expected and will affect both the year 1 and year 2 price changes. Upon the granting of the Petition, Sprint will adjust the price changes to ensure revenue neutrality is achieved and the calculations remain in compliance with the provisions of the 2003 Act.

Q. Could you identify the specific rate changes planned for residential and single-line business basic local service rates?

A. Yes. I have prepared exhibit JMF-13 which identifies the current rates and the specific rate changes for both year 1 and year 2 for residential and single-line business basic local service. The exhibit also identifies the current and planned rates for the service connection charge elements.

Q. Does Sprint's plan apply the basic local service increase equally across all rate groups?

A. For residential basic local service rates, Sprint will implement increases that are consistent across all rate groups. For single-line business basic local service rates, Sprint has taken into account competitive and calling scope considerations in its rate design. As a result, Sprint's plan for single-line business basic local service rates does reflect some variability in the increases across the rate groups.

V. CONSUMER IMPACTS

Q. Sprint includes a two-year timeframe for implementation of its revenue-neutral

plan. Why is a two-year plan most appropriate?

A. As described in more detail in the testimony of Dr. Kenneth Gordon, the elimination of implicit subsidies in access rates and the establishment of pricing for local services which are more closely aligned with their costs, will make the residential local market more attractive to competitors and will bring about enhanced market entry. Additionally, as indicated by the access charge and local service rate differentials shown in my exhibits JMF-5 and JMF-6, Florida is already well behind other states in making these changes.

Q. Will Sprint introduce other consumer benefits in addition to those that accrue from a more competitive market?

A. Yes. In an effort to mitigate the impacts to customers from the increases in rates for basic local service, Sprint will reduce the amount residential customers pay for extended local calling services by providing a free allowance of five calls per month for routes which are charged on a per message basis. Currently, customers incur a charge of $.20 or $.25 per message for all calls made on these local calling plans. Under Sprint's plan, customers will receive the first five calls free, and will incur the tariff charges for calls over the allowance. Based on current rates, customers could experience savings of up to $1.00 or $1.25 per month in their charges for extended local calling. This plan has the potential for providing benefit to a large number of Sprint's residential customers as over 82 percent have extended local calling service available to them over 283 routes included in Sprint's proposal.

Q. Are there other consumer benefits provided by the legislation?

A. Yes. The interexchange carriers ("IXCs") are required to return to their residential and

business customers the benefits of access reductions they realize from the ILEC rate reductions. The reductions that customers experience in the rates for long distance calling will serve to offset the increases they will experience for basic local services. This offset will consist of eliminating, by January 1, 2006, any "instate connection fee" which for the "big three" IXCs is currently approximately $1.90 per month, and flowing-through any residual switched network access charge reduction amount in the form of lower toll rates. Thus, IXC' s residential customers currently being chaged an instate connection fee will see a direct reduction in their monthly toll bill of about $1.90, regardless of the amount of their toll calling volume. Thereafter, long distance users will receive the benefits of additional IXC flow-through toll price reductions.

Q. What additional protections are there for those customers that are economically disadvantaged who might otherwise be impacted more significantly by the increases in basic local service?

A. As I stated previously, Section 364.10(3)(a) exempts Lifeline customers from the rate changes allowed by Section 364.164. Additionally, Section 364.10 (3) (a) enhances the Lifeline program effective September 1, 2003, to allow any customer who meets a stand-alone income eligibility test at 125% or less than the federal poverty level to subscribe to Lifeline service without having to apply to a low-income assistance program. Eligibility for these customers will be administered by the Office of Public Counsel. Sprint implemented this new criterion as of August 1, 2003. As further protection for Lifeline customers, Sprint will extend the Lifeline credit amount for an additional year beyond the two-year rebalancing period.

Q. What about universal service objectives? Aren't you concerned that increasing

residential local service rates will result in some subscribers dropping off the network?

A. No, for several reasons. First, the 2003 Act has increased Lifeline service availability to a greater number of Florida' s economically disadvantaged. In fact Lifeline is being expanded such that the requirement of participation in one of the six public assistance programs is not required. Customers that have household incomes up to 125% of the Federal Poverty Level can apply to the Office of Public Counsel for approval for subscription to Lifeline service. Additionally, as I stated previously, the rates for Lifeline service will not increase for a period of three years as a result of the rebalancing.

Second, the empirical data from the other states that have increased their local service rates demonstrates that subscribership has not been adversely affected. Exhibit JMF-14, shows that of the seven other southeastern states, all of which have higher local service rates than Florida, each has increased its residence subscribership more than Florida's subscribership, except for Georgia, where subscribership has remained unchanged. Exhibit JMF-15 shows the subscribership for 1988 and November of 2002 for each of the seven other southeastern states.

Finally, from an ability to pay perspective, Florida customers have higher average incomes than any of the other seven states. Exhibit JMF-16 shows the per capita personal income for Florida as compared to the other states. Exhibit JMF-17 shows Florida's higher level of disposable personal income versus the seven other states. Nationally, Florida ranks 25th in per capita personal income, again higher than the other states as shown in Exhibit JMF-18, another indication of Florida's higher income

relative to the other states.

Q. You previously described Sprint's access rebalancing experience in Ohio and Pennsylvania. How do the rates for basic residential local service in those states compare to the rates in the Sprint plan for Florida?

A. Sprint's rate for basic residential local service in Ohio averages $16.55. The $4.10 "intrastate access fee" authorized by the Ohio Commission brings the total charge for residential local service to $20.65. In Pennsylvania, Sprint's current average residential local service rate is $15.88 and based on the Pennsylvania Commission's recent order, it will move towards the cap of $18 in 2004. Sprint's revenue-neutral plan for Florida will result in a weighted-average residential local service rate of $16.84 (current average of $9.98 plus increase of $6.86 over Sprint's two-year plan). The resulting residential local service rate in Florida will be significantly below Sprint's rates in Pennsylvania and Ohio.

Q. Has Sprint experienced any significant changes in subscribership for residential basic local service as a result of the local rate increases in Pennsylvania or Ohio?

A. No, there was virtually no negative customer reaction to the increases in local rates in these two states, either in the form of complaints to the Commission or decreases in subscribership. In Ohio, primary residential access lines declined approximately 1% during the six months following the local rate increase. In Pennsylvania, primary residential access lines declined less than ½ of 1 percent in the six months following the most recent local rate increase. Although minor declines in residential access lines were experienced in these states, there are many factors other than the local rate increases that influenced this trend, including the general state of the economy,

wireless replacement and competition from other wireline carriers. As an illustration, Sprint's primary access lines for its entire 18 state local telephone division declined approximately .3 percent during 2001 and .5 percent in 2002, even though the other states were not experiencing the type of local rate increases that were ordered in Ohio and Pennsylvania.

Q. Do the changes in interstate access rates provide any evidence that the correct assignment for recovery of these costs to end users does not negatively impact universal service objectives?

A. The FCC, in recognition of the problems of continuing service cross-subsidies in a competitive telecommunications markets, has been transitioning the support for local services provided through interstate access charges from toll users to local service via the End User Common Line or Subscriber Line Charge. Local subscribership, measured by the FCC' s Telephone Penetration Data as the percentage of households with telephone service, has steadily increased even though the subscriber line charge has increased to $6.50 for primary residential service as of July 2003. The subscriber line charge for residential and single-line business was initially implemented at a rate of $1.00 on June 1, 1985. At that time, the FCC reported subscribership nationally at 91.8%; as of November 2002, the latest available data, subscribership was at 95.3%. This is not surprising given that the increase in the recurring subscriber line charge rate has been offset by significant decreases in long distance rates and increases in consumer income.

Q What is your conclusion regarding the significance of this data?

A. The data conclusively demonstrates that basic local service rates in Florida can be

increased without negatively impacting universal service or subscribership levels. In fact, when basic local service rates are increased on a revenue neutral basis, with access charge rate reductions flowed through to end user customers, along with Sprint's plan to provide the first five extended local calls free, universal service will be positively impacted. This is particularly true given that under Section 364,164, those most economically disadvantaged consumers, Florida's Lifeline subscribers, will not be subject to rate increases in their recurring local service rates from the rate rebalancing for three years and will have the benefit of reduced toll charges.

It is also worth noting that even with the basic local service price increases being implemented by Sprint, the residential basic local service prices will still be below the cost of providing the basic local service. As noted by Dr. Staihr and Dr. Gordon, there are significant benefits to the residential marketplace that will result from moving prices towards cost in terms of making the residential market more attractive to competitors and inducing enhanced market entry.

VI. CONCLUSION

Q. Could you summarize Sprint's position in this proceeding?

A. Through its petition and the testimony and exhibits of its witnesses in this proceeding, Sprint demonstrates that its plan for reducing intrastate network access rates in a revenue neutral manner meets all of the criteria established by the 2003 Act and should therefore be approved by the Commission. Specifically, granting Sprint's petition will:

- ***Remove current support for basic local telecommunications services that prevents the creation of a more attractive, competitive local exchange market for the benefit of residential customers.***

  My testimony, along with the cost study information supported by Sprint witness Dickerson, provides evidence that intrastate switched network access rates are providing support for Sprint's residential basic local telecommunications services. Sprint's witnesses Gordon and Staihr provide evidence that the removal of the current level of support for residential local services will create a more attractive, competitive local exchange market for the benefit of residential customers.

- ***Induce enhanced market entry.***

  Sprint witnesses Gordon and Staihr provide evidence demonstrating that approval of Sprint's petition will result in enhanced market entry by competitors.

- ***Result in intrastate switched access rate reductions to parity over a period of two years.***

  My testimony describes Sprint's plan for implementing its revenue neutral intrastate switched access reductions over a two-year period, which complies with the 2003 Act provisions of a period of not less than two years or more than four years.

- ***Will be revenue neutral.***

  My testimony describes Sprint's plan for decreasing intrastate network switched access rates to the January 2003 interstate levels and increasing basic local service rates to offset the access reductions. Sprint's plan fully complies with the

provisions of the 2003 Act regarding revenue neutrality.

Q. Does this conclude your testimony?

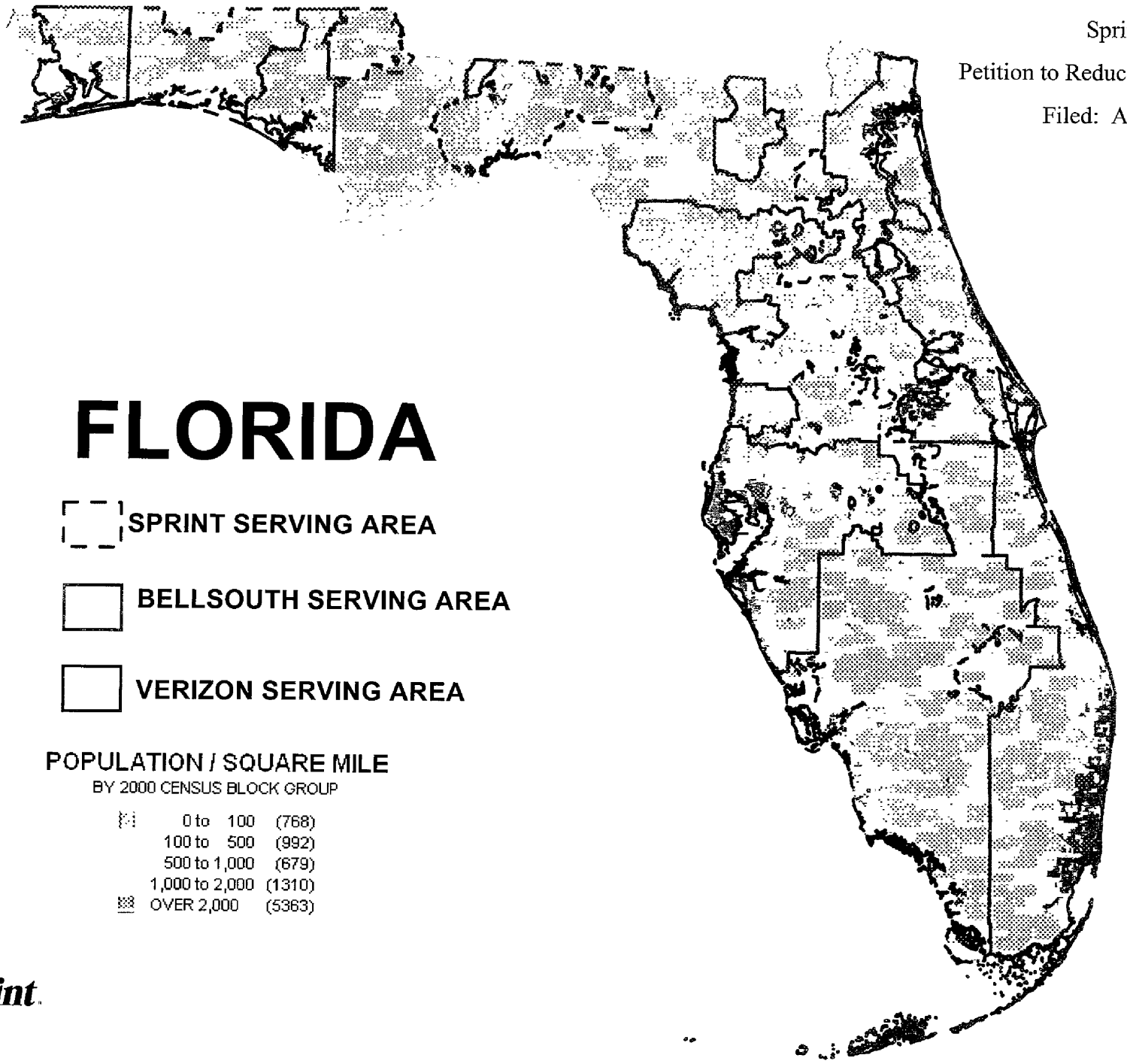
A. Yes, it does.

Sprint-Florida, Inc.

Petition to Reduce Access Rates

Filed: August 27, 2003

Exhibit JMF-1



Sprint

Sprint-Florida, Inc.
Switched Access Rate vs. Cost Analysis

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-2

	Current Intrastate Originating Rate	Current Intrastate Terminating Rate	Average Current Intrastate Rate	TSLRIC Cost	Contribution
Carrier Common Line	0.025800	0.033600	0.029700	0.000000	
Interconnection Charge	0.001512	0.001512	0.001512	0.000000	
Tandem Switching (Zone 2)	0.000880	0.000880	0.000880	0.001806	
Common Transport** (Zone 2)	0.000600	0.000600	0.000600	0.000716	
End Office Switching	0.017700	0.017700	0.017700	0.001953	
Total	**0.046492**	**0.054292**	**0.050392**	**0.004475**	**0.045917**

**Common transport calculation

Facility (MOU/airline mile)	0.000400
Termination (MOU/termination)	0.000200
Total switched common transport	0.000600

Common transport = (common transport termination rate + (10 miles * common transport facility)).

Sprint-Florida, Inc.
Basic Local Service Rates vs. Cost Comparison

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-3

Line		Residential
1	Current Basic Local Service Rate (weighted average)	$ 9.98
2	Subscriber Line Charge	$ 6.50
3	Total (weighted average) line 1 + line 2	$ 16.48
4	Forward-Looking Cost (weighted average)	$ 30.46
5	Difference line 3 - line 4	$ (13.98)

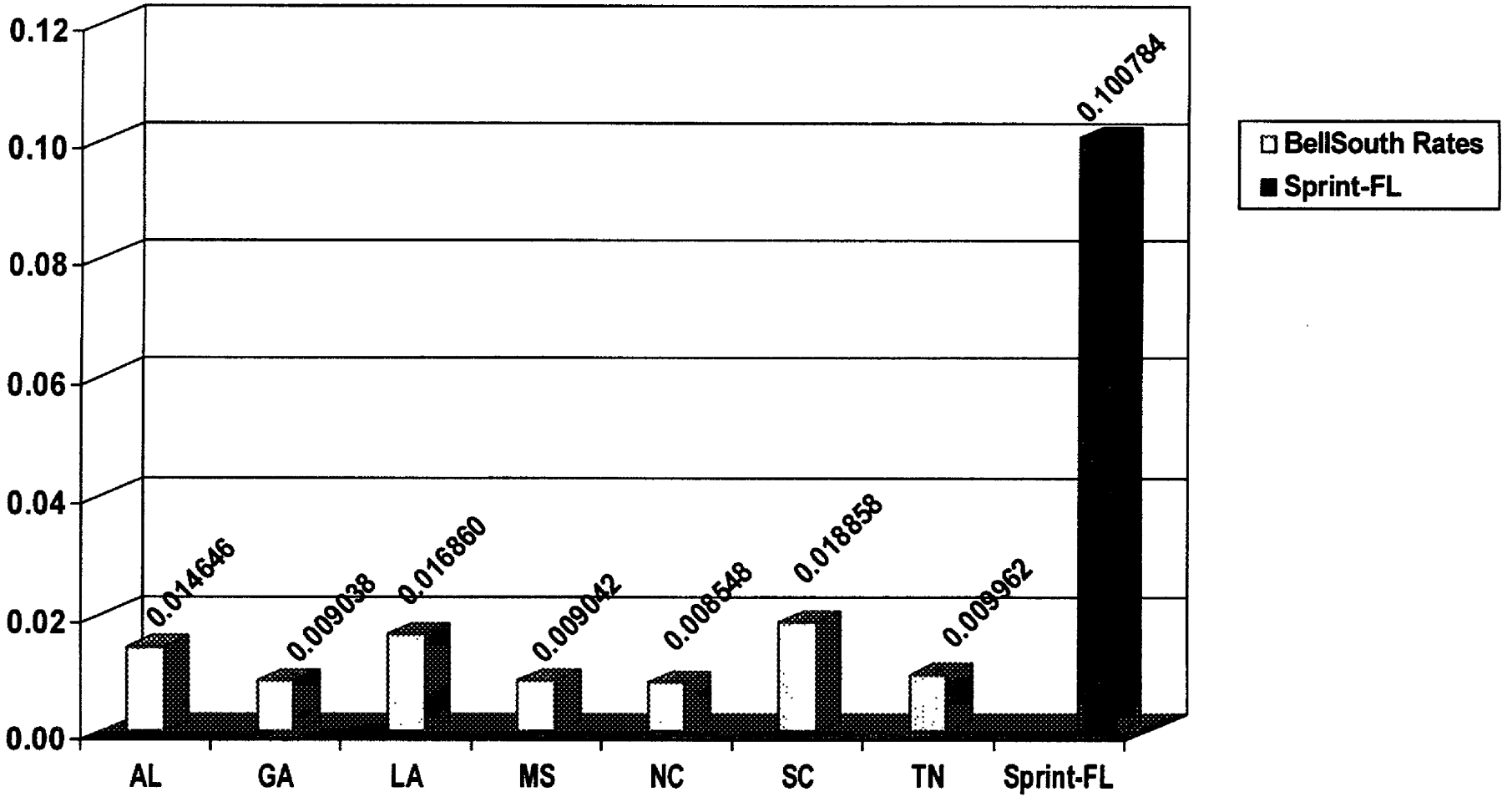
Sprint-Florida, Inc.
Basic Local Service Rates vs. Cost Comparison

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-4

Line	A	B
		Single-Line Business
1	Current Basic Local Service Rate (weighted average)	$ 21.18
2	Subscriber Line Charge	$ 6.50
3	Total (weighted average) line 1 + line 2	$ 27.68
4	Forward-Looking Cost (weighted average)	
5	Difference line 3 - line 4	

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-5

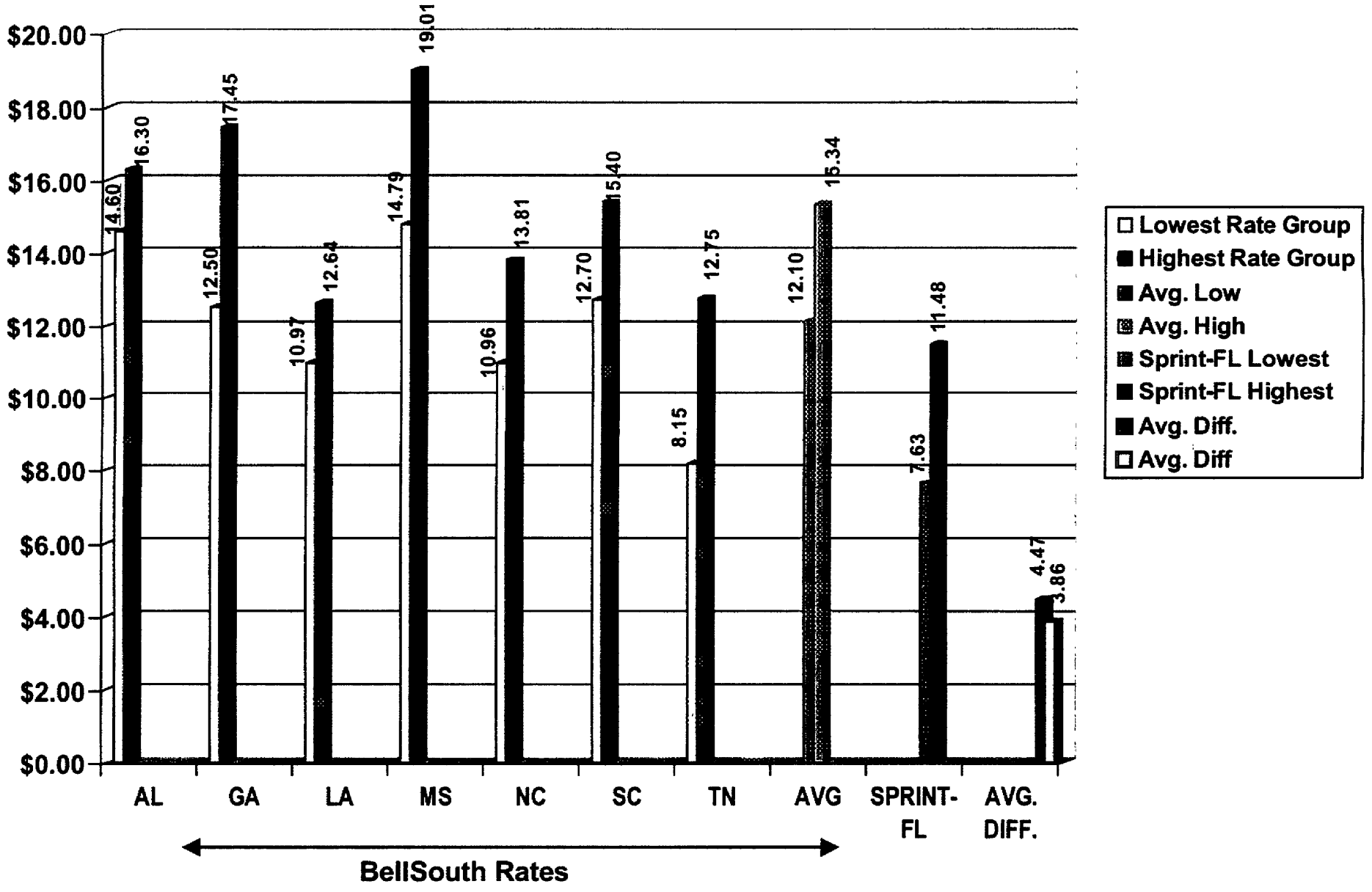
BellSouth/Sprint
INTRASTATE ACCESS RATES
One Minute Originating and Terminating with 10 Miles Common Transport (Excluding Entrance Facility)
Source: BellSouth Telecommunications, Inc., Access Services Tariffs, and Sprint-Florida, Incorporated Access Service Tariff



Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-6

Residence One-Party Flat-Rate Service with TouchTone

Source: BellSouth Telecommunications, Inc., General Subscriber Service Tariffs, and Sprint-Florida, Incorporated General Exchange Tariff



Sprint-Florida, Inc.

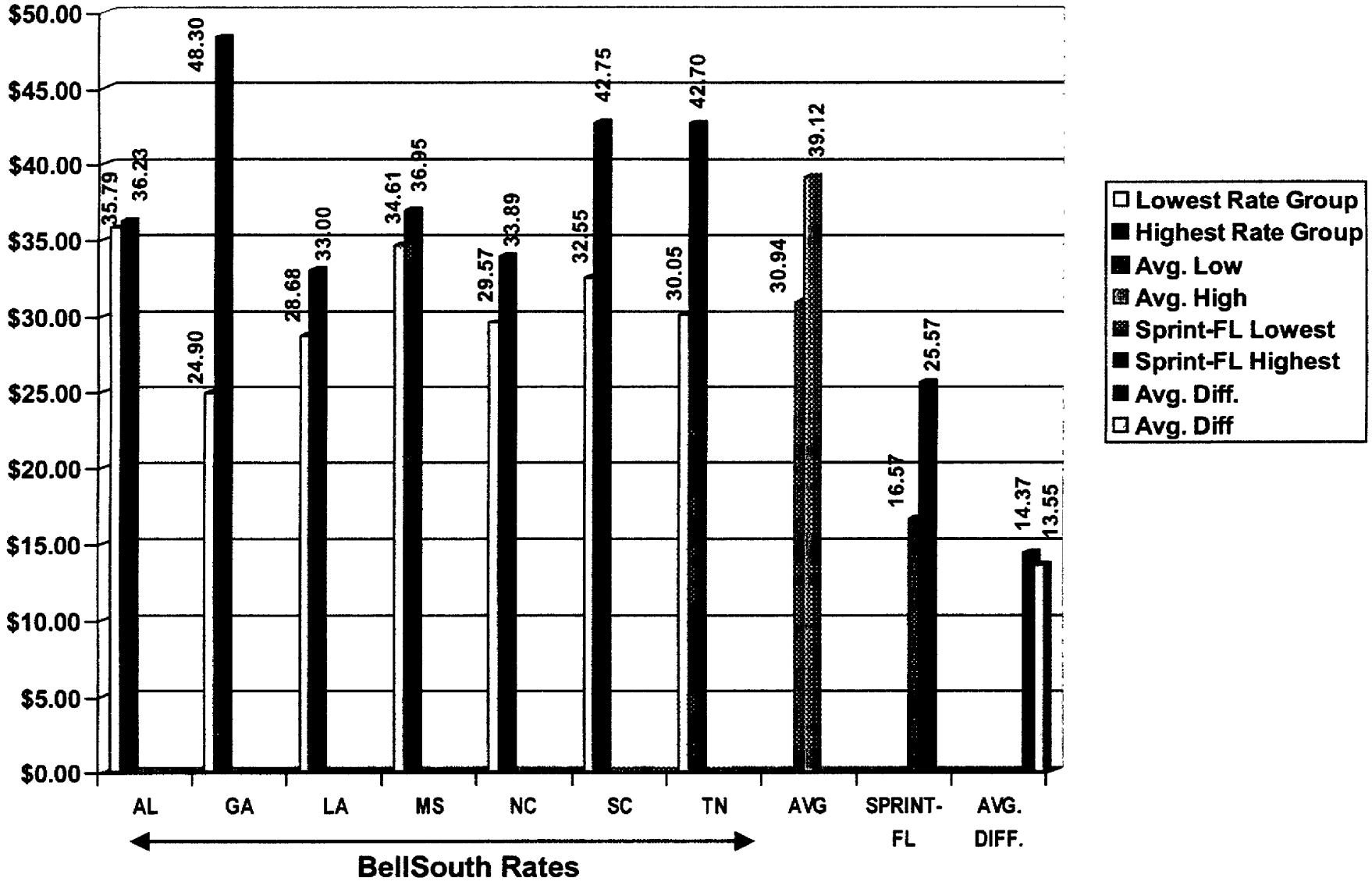
Petition to Reduce Access Rates

Filed: August 27, 2003

Exhibit JMF-7

Business Flat-Rate Service with TouchTone

Source: BellSouth Telecommunications, Inc., General Subscriber Service Tariffs, and Sprint-Florida, Incorporated General Exchange Tariff



Interstate Switched Access Rate Elements

- Switched Transport – Entrance Facility
- Switched Transport – Direct Trunked Transport
- Switched Transport – Tandem Switched Transport
  - Tandem Switching
  - Tandem Switched Transport – Termination
  - Tandem Switched Transport – Facility
  - Common Transport Multiplexing
  - Common Trunk Port
  - Dedicated Trunk Port
- Switched Transport – Chargeable Optional Features
- Switched Transport – CCS/SS7 Interconnection
  - Local Channel
  - Interoffice Channel
  - Multiplexing
- End Office Local Switching

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-9

SPRINT-FLORIDA, INC.
Intrastate Access Reductions Summary

	Twelve Months Billing Units *	Current Intrastate Access Rate		Current Intrastate Revenue	New Intrastate Access Rate	New Intrastate Access Revenue	Annual Access Revenue Change
Carrier Common Line Access							
Originating Access Minute	1,137,803,229	$0.025800		$ 29,355,323	$ -	$ -	$ (29,355,323)
Terminating Access Minute	1,950,818,429	$0.033633	**	$ 65,612,727	$ -	$ -	$ (65,612,727)
Interconnection Charge							
Total Interconnection Charge-Per Access Minute	3,289,996,573.00	$0.001758	**	$ 5,783,559	$ -	$ -	$ (5,783,559)
Switched Transport-Local Channel/Entrance Facility							
Local Channel/Entrance Facility - Voice Grade	804.74	$ 80.00		$ 64,379	$ 102.60	$ 82,566	$ 18,187
Local Channel/Entrance Facility - DDS - 56.0 kbps	168.00	$ 69.10		$ 11,609	$ 160.00	$ 26,880	$ 15,271
Local Channel/Entrance Facility - DS1 - 1.544 kbps	985.44	$ 205.65		$ 202,657	$ 110.81	$ 109,195	$ (93,462)
Local Channel/Entrance Facility - DS3 - 44.736 mbps	319.99	$ 1,250.50		$ 400,149	$ 670.42	$ 214,526	$ (185,622)
Switched Transport-Direct Trunked Transport							
Voice Grade-Termination (Fixed)	575.46	$ 33.80		$ 19,451	$ 60.00	$ 34,528	$ 15,077
Voice Grade-Facility (Per Mile)	13,113.08	$ 1.80		$ 23,604	$ 2.23	$ 29,242	$ 5,639
DDS-Termination (Fixed)	48.00	$ 37.55		$ 1,802	$ 85.00	$ 4,080	$ 2,278
DDS-Facility (Per Mile)	223.56	$ 3.80		$ 850	$ 4.30	$ 961	$ 112
DS1-Termination (Fixed)	6,988.29	$ 72.57		$ 507,171	$ 41.16	$ 287,655	$ (219,516)
DS1-Facility (Per Mile)	135,414.48	$ 12.37		$ 1,675,122	$ 4.96	$ 671,232	$ (1,003,890)
DS3-Termination (Fixed)	176.69	$ 476.75		$ 84,237	$ 482.70	$ 85,288	$ 1,052
DS3-Facility (Per Mile)	3,221.23	$ 244.96		$ 789,081	$ 81.64	$ 262,967	$ (526,114)
Switched Transport-Tandem Switched Transport							
Tandem Switched Transmission Termination	1,106,569,637.50	$0.000207		$ 229,263	$ 0.000562	$ 622,268	$ 393,005
Tandem Switched Facility	24,977,040,255.96	$0.000042		$ 1,036,611	$ 0.000075	$ 1,868,218	$ 831,607
Tandem Switching	970,994,904.00	$0.000899		$ 873,165	$ 0.001525	$ 1,481,069	$ 607,904
Common Transport Multiplexing	1,319,493,579.64	$ -		$ -	$ 0.000367	$ 483,805	$ 483,805
Common Trunk Port	1,490,689,259.47	$ -		$ -	$ 0.000557	$ 830,314	$ 830,314
Dedicated Trunk Port-DS0	2,148.69	$ -		$ -	$ 4.07	$ 8,745	$ 8,745
Dedicated Trunk Port-DS1	15,875.31	$ -		$ -	$ 93.58	$ 1,485,612	$ 1,485,612
Switched Transport-Chargeable Optional Features							
Multiplexing-DS1 to Voice	4.09	$ 301.32		$ 1,232	$ 248.92	$ 1,018	$ (214)
Multiplexing-DS3 to DS1	498.30	$ 585.94		$ 291,972	$ 225.58	$ 112,406	$ (179,565)
STP Port Charge	120.00	$ 485.00		$ 58,200	$ 430.85	$ 51,702	$ (6,498)
End Office-Local Switching							
Local Switching-Per Access Minute	3,099,745,853.00	$0.017700		$ 54,865,502	$ 0.003568	$ 11,059,893	$ (43,805,608)
TOTAL SWITCHED ACCESS SERVICES				$ 161,887,665		$ 19,814,173	$ (142,073,493)

*** Unit information based on June 2002 thru May 2003**
**** Current rate is a composite of rates from sections E3, E6 and E16.**

Sprint-Florida, Inc.
Composite Switched Access Rate Analysis

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-10

Switched Access Rate Element	Interstate			Intrastate		
	Originating	Terminating	Composite	Originating	Terminating	Composite
Carrier Common Line	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Switched Transport**						
Local Channel/Entrance Facility	0.000532	0.000532	0.001064	0.000532	0.000532	0.001064
Switched Common Transport	0.000988	0.000988	0.001976	0.000988	0.000988	0.001976
Access Tandem Switching	0.001338	0.001338	0.002676	0.001338	0.001338	0.002676
Interconnection Charge	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Signaling	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
Information Surcharge	0.000000	0.000000	0.000000	0.000000	0.000000	0.000000
End Office						
Local Switching	0.003568	0.003568	0.007136	0.003568	0.003568	0.007136
Total	**0.006426**	**0.006426**	**0.012852**	**0.006426**	**0.006426**	**0.012852**

**Switched common transport calculation	Interstate	Intrastate
Local Channel/Entrance Facility		
DS1: Per System (monthly)	$ 115.00	$ 115.00
Estimated MOU Equivalent	0.000532	0.000532
Switched Common Transport		
Facility (MOU/airline mile)	0.000438	0.000438
Termination (MOU/termination)	0.000550	0.000550
Total switched common transport	0.000988	0.000988

Local Channel/Entrance Facility rates are for zone 2.
Local Channel/Entrance Facility = (DS1 monthly charge)/(24 voice grade equivalents * 9,000 MOU).
Switched Common transport = (Switched common transport termination rate + (10 miles * switched common transport facility)).

SPRINT-FLORIDA, INC.
Intrastate Access Reductions

	Year 1									
	Twelve Months Billing Units *	Current Intrastate Access Rate		Current Intrastate Access Revenue		Year 1 Intrastate Access Rate		Year 1 Intrastate Access Revenue		Year 1 Annual Revenue Change
Carrier Common Line Access										
Originating Access Minute	1,137,803,229	$0.025800		$ 29,355,323		$ 0.009621		$ 10,946,805		$ (18,408,518)
Terminating Access Minute	1,950,818,429	$0.033633	**	$ 65,612,727		$ 0.009621		$ 18,768,824		$ (46,843,903)
Interconnection Charge										
Total Interconnection Charge-Per Access Minute	3,289,996,573.00	$0.001758	**	$ 5,783,559		$ -		$ -		$ (5,783,559)
Switched Transport-Local Channel/Entrance Facility										
Local Channel/Entrance Facility - Voice Grade	804.74	$ 80.00		$ 64,379		$ 80.00		$ 64,379		$ -
Local Channel/Entrance Facility - DDS - 56.0 kbps	168.00	$ 69.10		$ 11,609		$ 69.10		$ 11,609		$ -
Local Channel/Entrance Facility - DS1 - 1.544 kbps	985.44	$ 205.65		$ 202,657		$ 205.65		$ 202,657		$ -
Local Channel/Entrance Facility - DS3 - 44.736 mbps	319.99	$ 1,250.50		$ 400,149		$ 1,250.50		$ 400,149		$ -
Switched Transport-Direct Trunked Transport										
Voice Grade-Termination (Fixed)	575.46	$ 33.80		$ 19,451		$ 33.80		$ 19,451		$ -
Voice Grade-Facility (Per Mile)	13,113.08	$ 1.80		$ 23,604		$ 1.80		$ 23,604		$ -
DDS-Termination (Fixed)	48.00	$ 37.55		$ 1,802		$ 37.55		$ 1,802		$ -
DDS-Facility (Per Mile)	223.56	$ 3.80		$ 850		$ 3.80		$ 850		$ -
DS1-Termination (Fixed)	6,988.29	$ 72.57		$ 507,171		$ 72.57		$ 507,171		$ -
DS1-Facility (Per Mile)	135,414.48	$ 12.37		$ 1,675,122		$ 12.37		$ 1,675,122		$ -
DS3-Termination (Fixed)	176.69	$ 476.75		$ 84,237		$ 476.75		$ 84,237		$ -
DS3-Facility (Per Mile)	3,221.23	$ 244.96		$ 789,081		$ 244.96		$ 789,081		$ -
Switched Transport-Tandem Switched Transport										
Tandem Switched Transmission Termination	1,106,569,637.50	$0.000207		$ 229,263		$ 0.000207		$ 229,263		$ -
Tandem Switched Facility	24,977,040,255.96	$0.000042		$ 1,036,611		$ 0.000042		$ 1,036,611		$ -
Tandem Switching	970,994,904.00	$0.000899		$ 873,165		$ 0.000899		$ 873,165		$ -
Common Transport Multiplexing	1,319,493,579.64	$ -		$ -		$ -		$ -		$ -
Common Trunk Port	1,490,689,259.47	$ -		$ -		$ -		$ -		$ -
Dedicated Trunk Port-DS0	2,148.69	$ -		$ -		$ -		$ -		$ -
Dedicated Trunk Port-DS1	15,875.31	$ -		$ -		$ -		$ -		$ -
Switched Transport-Chargeable Optional Features										
Multiplexing-DS1 to Voice	4.09	$ 301.32		$ 1,232		$ 301.32		$ 1,232		$ -
Multiplexing-DS3 to DS1	498.30	$ 585.94		$ 291,972		$ 585.94		$ 291,972		$ -
STP Port Charge	120.00	$ 485.00		$ 58,200		$ 485.00		$ 58,200		$ -
End Office-Local Switching										
Local Switching-Per Access Minute	3,099,745,853.00	$0.017700		$ 54,865,502		$ 0.017700		$ 54,865,502		$ -
TOTAL SWITCHED ACCESS SERVICES				$ 161,887,665				$ 90,851,685		$ (71,035,981)

*** Unit information based on June 2002 thru May 2003**
**** Current rate is a composite of rates from sections E3, E6 and E16.**

SPRINT-FLORIDA, INC.
Intrastate Access Reductions

		Year 1	Year 1	Year 2	Year 2	Year 2
	Twelve Months Billing Units	Intrastate Access Rate	Intrastate Access Revenue	Intrastate Access Rate	Intrastate Access Revenue	Annual Revenue Change
Carrier Common Line Access						
Originating Access Minute	1,137,803,229	$ 0.009621	$ 10,946,805	$ -	$ -	$ (10,946,805)
Terminating Access Minute	1,950,818,429	$ 0.009621	$ 18,768,824	$ -	$ -	$ (18,768,824)
Interconnection Charge						
Total Interconnection Charge-Per Access Minute	3,289,996,573.00	$ -	$ -	$ -	$ -	$ -
Switched Transport-Local Channel/Entrance Facility						
Local Channel/Entrance Facility - Voice Grade	804.74	$ 80.00	$ 64,379	$ 102.60	$ 82,566	$ 18,187
Local Channel/Entrance Facility - DDS - 56.0 kbps	168.00	$ 69.10	$ 11,609	$ 160.00	$ 26,880	$ 15,271
Local Channel/Entrance Facility - DS1 - 1.544 kbps	985.44	$ 205.65	$ 202,657	$ 110.81	$ 109,195	$ (93,462)
Local Channel/Entrance Facility - DS3 - 44.736 mbps	319.99	$ 1,250.50	$ 400,149	$ 670.42	$ 214,526	$ (185,622)
Switched Transport-Direct Trunked Transport						
Voice Grade-Termination (Fixed)	575.46	$ 33.80	$ 19,451	$ 60.00	$ 34,528	$ 15,077
Voice Grade-Facility (Per Mile)	13,113.08	$ 1.80	$ 23,604	$ 2.23	$ 29,242	$ 5,639
DDS-Termination (Fixed)	48.00	$ 37.55	$ 1,802	$ 85.00	$ 4,080	$ 2,278
DDS-Facility (Per Mile)	223.56	$ 3.80	$ 850	$ 4.30	$ 961	$ 112
DS1-Termination (Fixed)	6,988.29	$ 72.57	$ 507,171	$ 41.16	$ 287,655	$ (219,516)
DS1-Facility (Per Mile)	135,414.48	$ 12.37	$ 1,675,122	$ 4.96	$ 671,232	$ (1,003,890)
DS3-Termination (Fixed)	176.69	$ 476.75	$ 84,237	$ 482.70	$ 85,288	$ 1,052
DS3-Facility (Per Mile)	3,221.23	$ 244.96	$ 789,081	$ 81.64	$ 262,967	$ (526,114)
Switched Transport-Tandem Switched Transport						
Tandem Switched Transmission Termination	1,106,569,637.50	$ 0.000207	$ 229,263	$ 0.000562	$ 622,268	$ 393,005
Tandem Switched Facility	24,977,040,255.96	$ 0.000042	$ 1,036,611	$ 0.000075	$ 1,868,218	$ 831,607
Tandem Switching	970,994,904.00	$ 0.000899	$ 873,165	$ 0.001525	$ 1,481,069	$ 607,904
Common Transport Multiplexing	1,319,493,579.64	$ -	$ -	$ 0.00	$ 483,805	$ 483,805
Common Trunk Port	1,490,689,259.47	$ -	$ -	$ 0.00	$ 830,314	$ 830,314
Dedicated Trunk Port-DS0	2,148.69	$ -	$ -	$ 4.07	$ 8,745	$ 8,745
Dedicated Trunk Port-DS1	15,875.31	$ -	$ -	$ 93.58	$ 1,485,612	$ 1,485,612
Switched Transport-Chargeable Optional Features						
Multiplexing-DS1 to Voice	4.09	$ 301.32	$ 1,232	$ 248.92	$ 1,018	$ (214)
Multiplexing-DS3 to DS1	498.30	$ 585.94	$ 291,972	$ 225.58	$ 112,406	$ (179,565)
STP Port Charge	120.00	$ 485.00	$ 58,200	$ 430.85	$ 51,702	$ (6,498)
End Office-Local Switching						
Local Switching-Per Access Minute	3,099,745,853.00	$ 0.017700	$ 54,865,502	$ 0.003568	$ 11,059,893	$ (43,805,608)
TOTAL SWITCHED ACCESS SERVICES			$ 90,851,685		$ 19,814,173	$ (71,037,512)

*** Unit information based on June 2002 thru May 2003**
**** Current rate is a composite of rates from sections E3, E6 and E16.**

Sprint-Florida, Inc.
Summary of Revenue-Neutral Rate Changes

	Year 1 Annual Revenue Change	Year 2 Annual Revenue Change	Total Annual Revenue Change
INTRASTATE SWITCHED ACCESS	$ (71,035,981)	$ (71,037,512)	$ (142,073,493)

BASIC LOCAL SERVICE	Year 1 Rate Increase	Year 1 Annual Revenue Change	Year 2 Rate Increase	Year 2 Annual Revenue Change	Total Annual Revenue Change
Residential Basic Local Service	$ 3.23	$ 55,295,408	$ 3.63	$ 62,143,086	$ 117,438,494
Business Basic Local Service	$ 2.87	$ 8,132,959	$ 3.13	$ 8,875,169	$ 17,008,128
Residential Service Connection Charges		$ 5,509,680		$ -	$ 5,509,680
Business Service Connection Charges		$ 2,129,300		$ -	$ 2,129,300
Total Basic Local Service Increases		$ 71,067,347		$ 71,018,255	$ 142,085,602

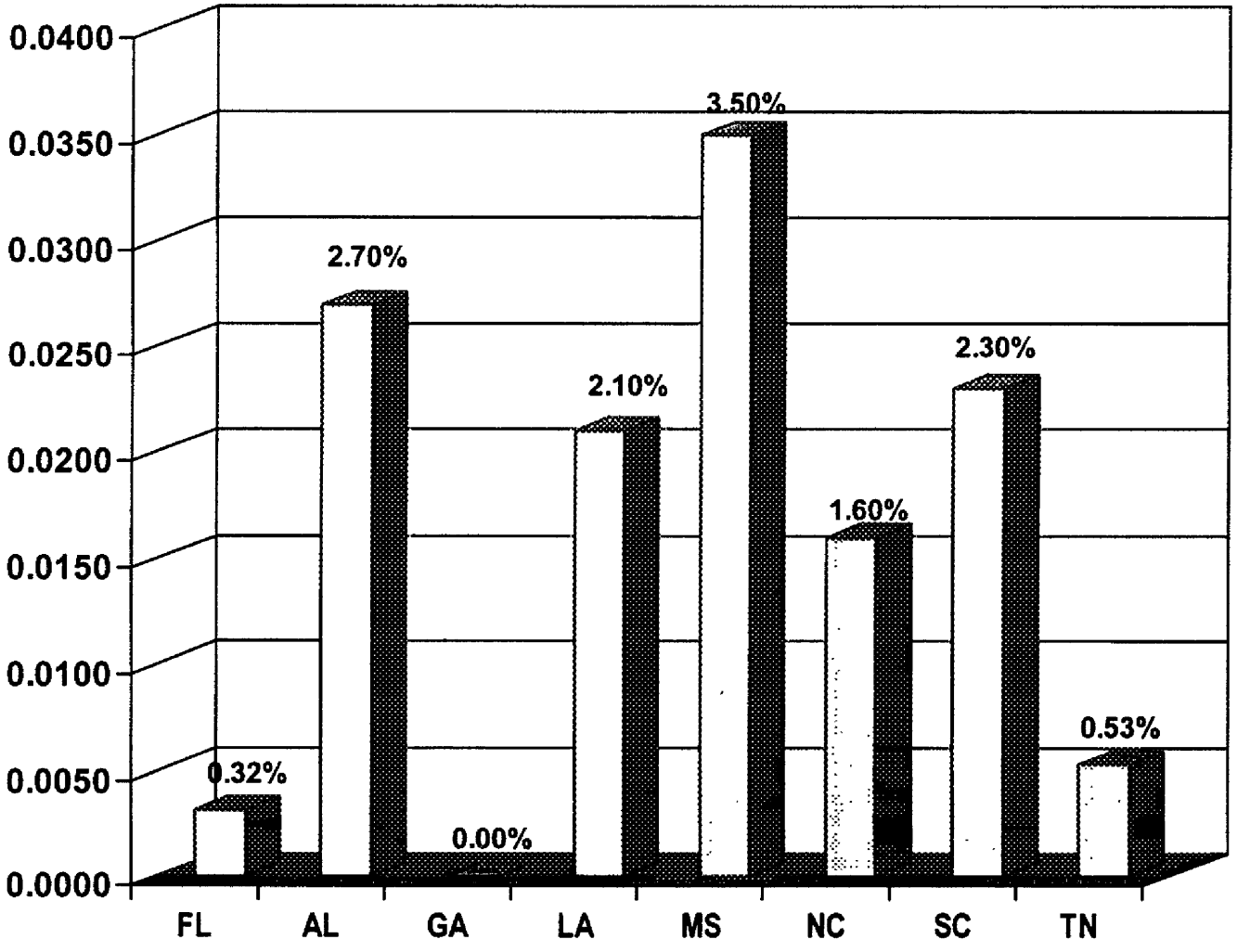
Sprint-Florida, Inc.
Florida Access Reform
Current and New Basic Rates

	Residential Current Rate	Residential Year 1 Rate	Residential Year 2 Rate	Business Current Rate	Business Year 1 Rate	Business Year 2 Rate
Individual Access Line						
United Rate Group 1	$ 7.63	$ 10.86	$ 14.49	$ 16.57	$ 21.73	$ 27.12
United Rate Group 2	$ 8.39	$ 11.62	$ 15.25	$ 18.37	$ 22.78	$ 27.39
United Rate Group 3	$ 9.18	$ 12.41	$ 16.04	$ 20.15	$ 23.71	$ 27.62
United Rate Group 4	$ 9.94	$ 13.17	$ 16.80	$ 21.94	$ 24.63	$ 27.89
United Rate Group 5	$ 10.72	$ 13.95	$ 17.58	$ 23.79	$ 25.80	$ 28.32
United Rate Group 6	$ 11.48	$ 14.71	$ 18.34	$ 25.57	$ 27.39	$ 29.61
Centel Rate Group 1	$ 8.58	$ 11.81	$ 15.44	$ 18.04	$ 22.48	$ 27.12
Centel Rate Group 2	$ 9.05	$ 12.28	$ 15.91	$ 19.07	$ 23.13	$ 27.12
Centel Rate Group 3	$ 9.45	$ 12.68	$ 16.31	$ 19.99	$ 23.63	$ 27.39
Centel Rate Group 4	$ 9.91	$ 13.14	$ 16.77	$ 21.06	$ 24.24	$ 27.62
Centel Rate Group 5	$ 10.37	$ 13.60	$ 17.23	$ 22.08	$ 24.95	$ 27.89
Centel Rate Group 6	$ 10.89	$ 14.12	$ 17.75	$ 23.25	$ 26.33	$ 28.32
Service Charges						
Primary - United	$ 20.45	$ 25.00	$ 25.00	$ 25.60	$ 35.00	$ 35.00
Primary - Centel	$ 20.45	$ 25.00	$ 25.00	$ 30.65	$ 35.00	$ 35.00
Secondary - United	$ 9.70	$ 15.00	$ 15.00	$ 16.35	$ 25.00	$ 25.00
Secondary - Centel	$ 12.25	$ 15.00	$ 15.00	$ 14.30	$ 25.00	$ 25.00
Access Line Charge - United	$ 30.70	$ 31.00	$ 31.00	$ 35.75	$ 40.00	$ 40.00
Access Line Charge - Centel	$ 30.70	$ 31.00	$ 31.00	$ 35.75	$ 40.00	$ 40.00
Premise Visit - United	$ 10.20	$ 50.00	$ 50.00	$ 10.24	$ 50.00	$ 50.00
Premise Visit - Centel	$ 21.50	$ 50.00	$ 50.00	$ 30.65	$ 50.00	$ 50.00
Record Change - United	$ 5.10	$ 15.00	$ 15.00	$ 5.10	$ 15.00	$ 15.00
Record Change - Centel	N/A	N/A	N/A	$ 5.10	$ 15.00	$ 15.00
Number Change - United	$ 9.70	$ 15.00	$ 15.00	$ 11.75	$ 20.00	$ 20.00
Number Change - Centel	$ 9.70	$ 15.00	$ 15.00	$ 11.75	$ 20.00	$ 20.00
Restore Service - United	$ 15.35	$ 25.00	$ 25.00	$ 20.45	$ 35.00	$ 35.00
Restore Service - Centel	$ 15.35	$ 25.00	$ 25.00	$ 15.35	$ 35.00	$ 35.00

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-14

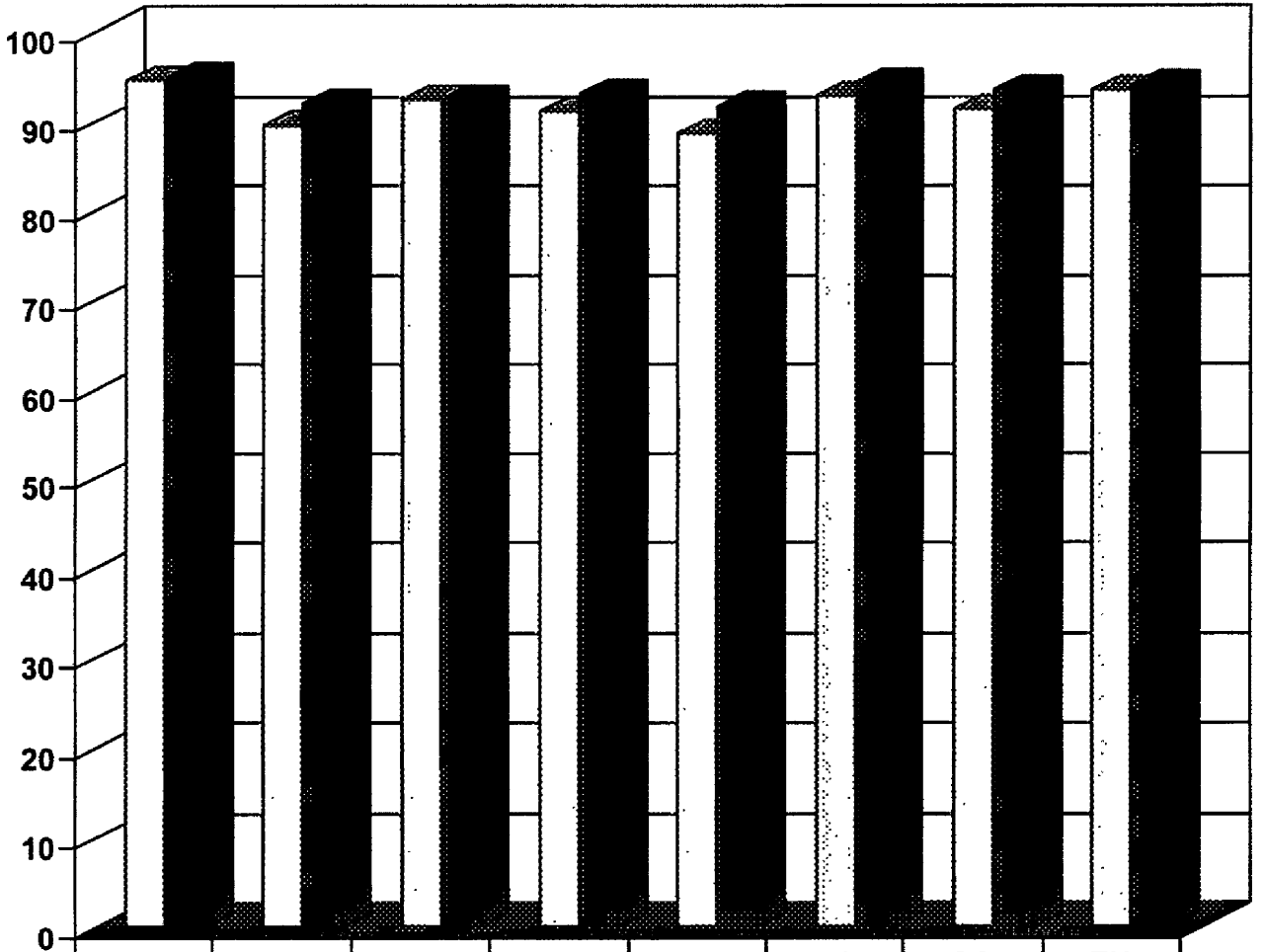
% INCREASE RESIDENTIAL SUBSCRIBERSHIP 1988 – 2002

Source: Telephone Subscribership in the United States
FCC – Wireline Competition Bureau



Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-15

% Households with Telephone Service
Data through November 2002
Source: Telephone Subscribership in the United States
FCC-Wireline Competition Bureau

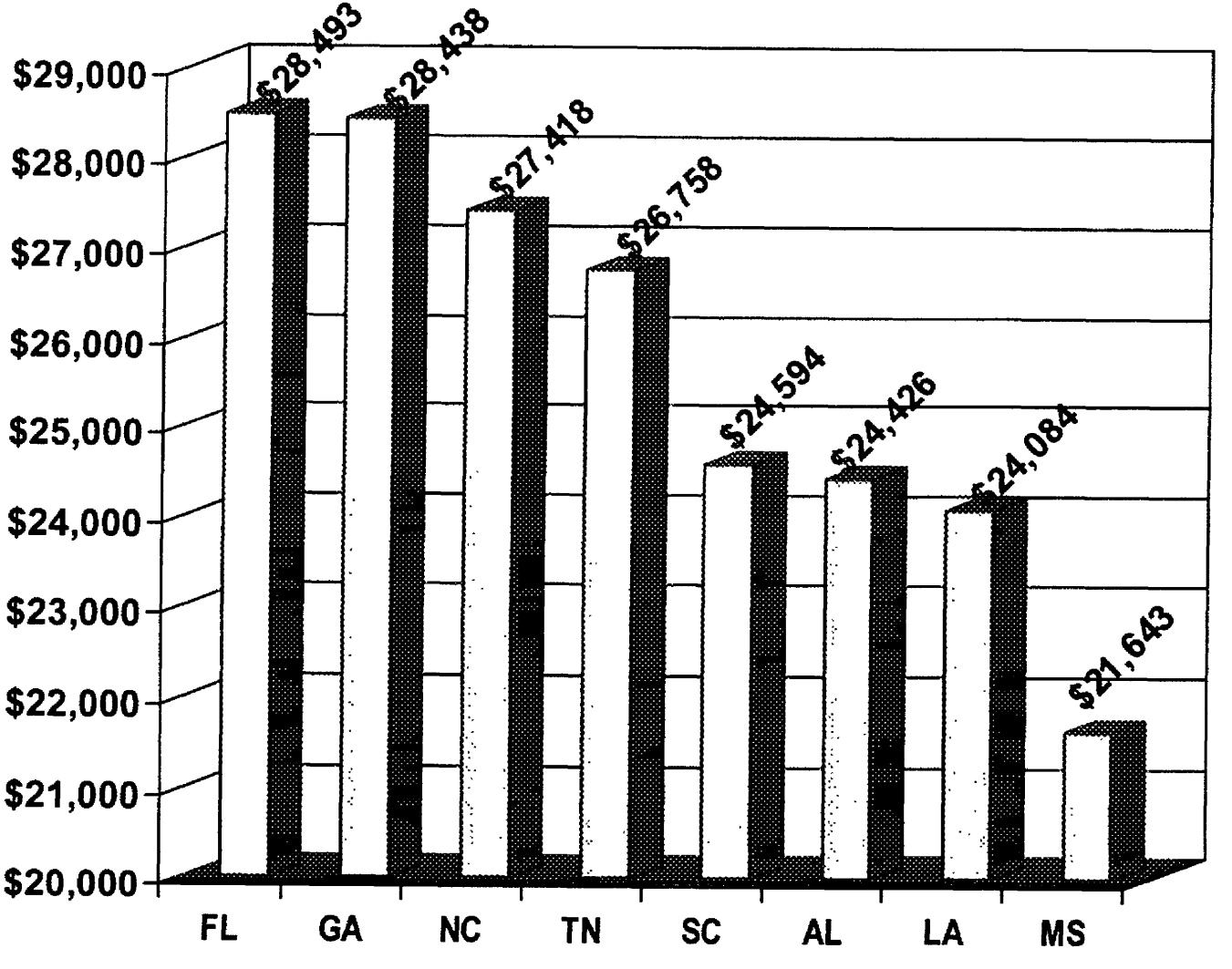


	FL	AL	GA	LA	MS	NC	SC	TN
□ 1988	94.50	89.60	92.40	91.10	88.60	92.80	91.40	93.50
■ 2002	94.80	92.00	92.40	93.00	91.70	94.30	93.50	94.00

Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-16

PERSONAL INCOME PER CAPITA

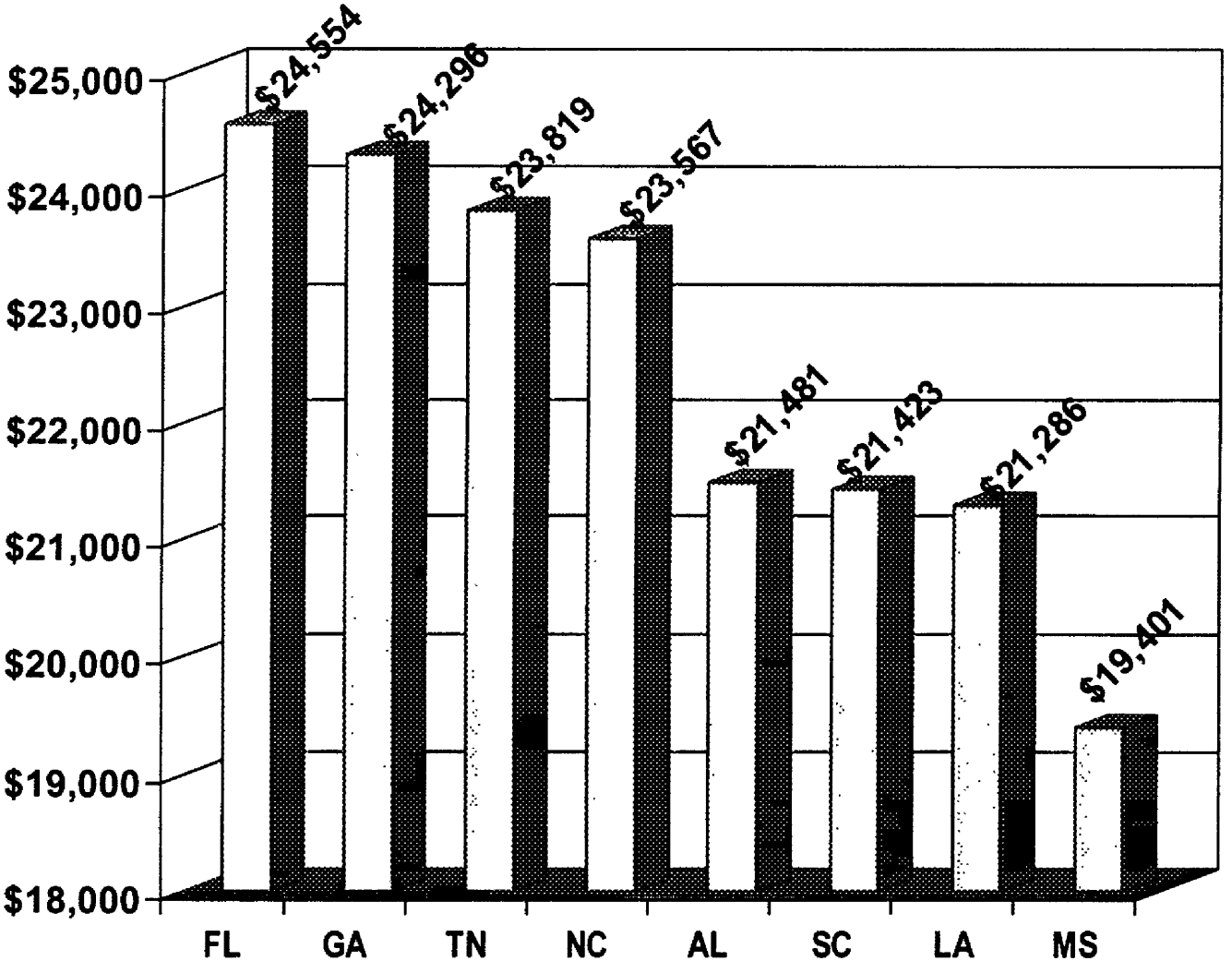
Source: 2002 Florida Statistical Abstract



Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-17

DISPOSABLE PERSONAL INCOME

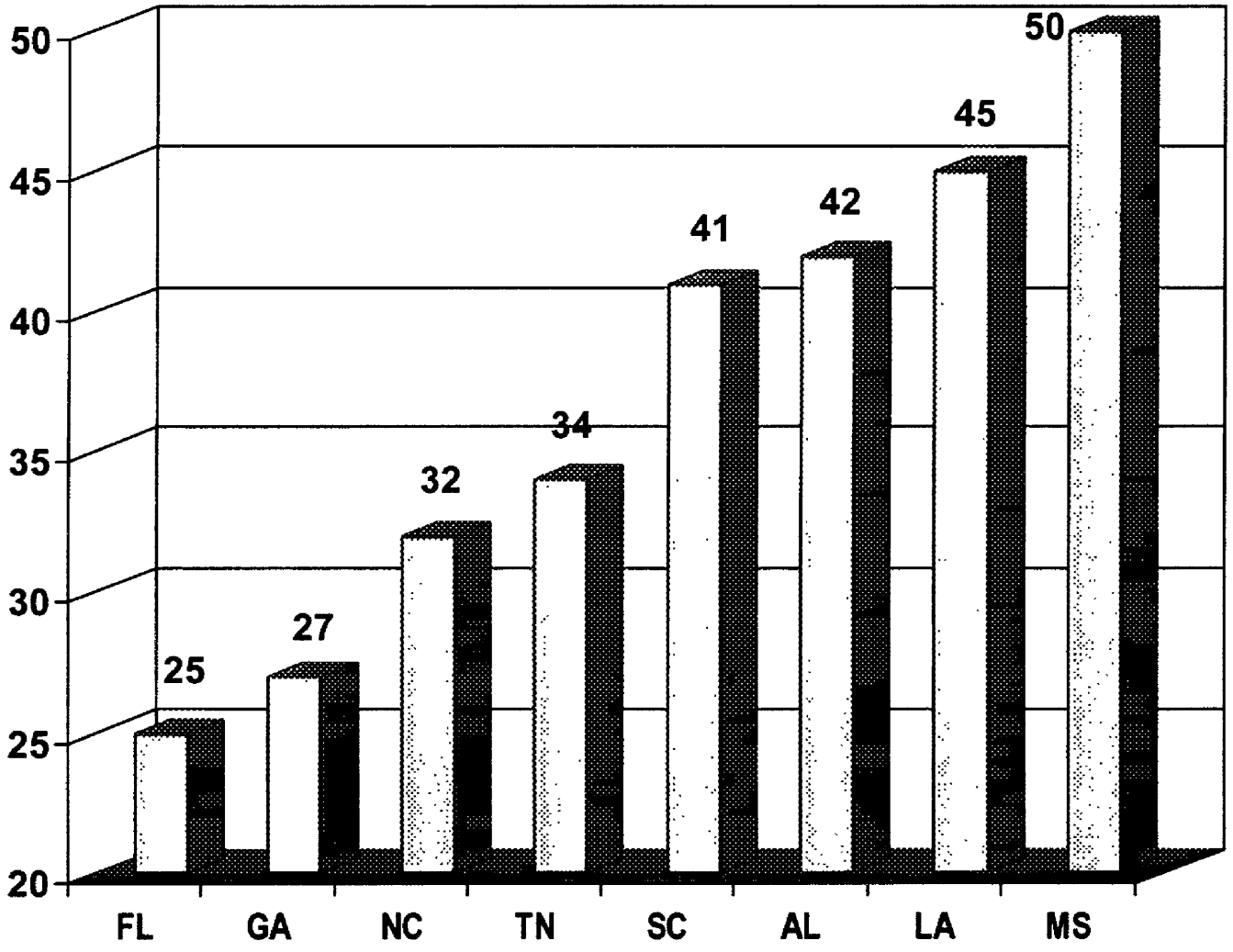
Source: 2002 Florida Statistical Abstract



Sprint-Florida, Inc.
Petition to Reduce Access Rates
Filed: August 27, 2003
Exhibit JMF-18

PER CAPITA PERSONAL INCOME
RANK BY STATE
1 EQUALS HIGHEST INCOME

Source: 2002 Florida Statistical Abstract



BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

KENT W. DICKERSON

Q. Please state your name, business address, employer and current position.

A. My name is Kent W. Dickerson. My business address is 6450 Sprint Parkway, Overland Park, KS 66251. I am employed as Director - Cost Support for Sprint/United Management Company.

Q. Please summarize your qualifications and work experience.

A. I received a Bachelor of Science degree from the University of Missouri - Kansas City in 1981 with a major in Accounting. In 1984, I passed the national exam and am a Certified Public Accountant in the State of Missouri.

From 1981 to 1983, I was employed as a Corporate Income Tax Auditor II for the Missouri Department of Revenue. From 1983 to 1985, I worked for Kansas Power and Light (now Western Resources) in the Tax and Internal Audit areas. I joined United Telephone Midwest Group in September, 1985 as a Staff Accountant in the Carrier Access Billing area. Thereafter, I moved through a progression of positions within the Toll Administration and General Accounting areas of the Finance Department.

In 1987, I was promoted into the Carrier and Regulatory Services group as a Separations/ Settlement Administrator performing Federal and Intrastate access/toll

pool settlement, reporting and revenue budgeting functions. I was promoted to Manager - Pricing in June, 1989 where I performed FCC regulatory reporting and filing functions related to the United Telephone - Midwest Group Interstate Access revenue streams.

In 1991, I was promoted to Senior Manager - Revenue Planning for United Telephone - Midwest Group. While serving in this position, my responsibilities consisted of numerous FCC regulatory reporting and costing functions. In 1994, I accepted a position within the Intrastate Regulatory operations of Sprint/United Telephone Company of Missouri where my responsibilities included regulatory compliance, tariff filings, and earnings analysis for the Missouri company's intrastate operations.

Since December 1994, I have set-up and directed a work group which performs cost of service studies for retail services, wholesale unbundled network elements cost studies, and state and federal Universal Service Fund cost studies. Over the last seven years, I have been charged with developing and implementing cost study methods which conform with Total Service Long Run Incremental Cost ("TSLRIC") and Total Element Long Run Incremental Cost ("TELRIC") methodologies. I am responsible for written and oral testimony, serving on industry work groups, and participating in technical conferences related to TSLRIC/TELRIC costing methodology, filing of studies within 18 individual states that comprise Sprint's Local Telephone Division (LTD) and providing cost expertise to Sprint' s participation in regulatory cost dockets outside of the LTD territories.

Q. Have you previously testified before state regulatory commissions?

A. Yes. I have testified before the Florida, Nevada, North Carolina, Texas, Kansas, Missouri, Georgia, and Wyoming regulatory commissions regarding TSLRIC/TELRIC cost matters.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to introduce and support TSLRIC studies for Sprint-Florida, Inc.'s ("Sprint's") Residential (R1) service, Single Line Business (B1) service, and Intrastate Switched Network Access per minute of use.

Q. Please describe how the studies were completed.

A. Exhibit KWD-1 provides a narrative description of how the TSLRIC studies were completed. Exhibit KWD-2 provides the TSLRIC studies for the previously mentioned services. Since it is extremely unlikely that the 90-day timeframe established by the Legislature contemplates rehashing of the very recently decided inputs and models related to the network elements comprising these services, Sprint is using the same cost studies that the Florida Public Service Commission approved in Docket No. 990649B-TP for Sprint's unbundled network element (UNE) prices (Final Order PSC-03-0918-FOF-TP, issued August 8, 2003, denying Motion for Reconsideration of Order PSC-03-0058-FOF-TP, issued January 8, 2003). Using the Commission-approved cost studies, Sprint deaveraged the investments to match the investments associated with R1 and B1 services. Since UNEs are sold to wholesale carrier customers, the UNE cost studies do not include any costs associated with retail functions. To appropriately account for the costs Sprint incurs to provide these services on a retail basis, the cost of retail service was added to the TSLRIC studies for R1 and B1 services.

Q. What cost of money did Sprint use in developing these TSLRIC studies?

A. For the TSLRIC studies in this docket, Sprint is using the same cost of money the Commission ordered in Docket No. 990649B-TP. Sprint believes that the Commission-ordered cost of money from Docket No. 990649B-TP understates Sprint's costs demonstrated in the testimony of Dr. Brian Staihr in that docket. Therefore, because the Commission-ordered cost of money understates Sprint's costs, the costs resulting from the TSLRIC studies presented here are also understated.

Q. Does this conclude your direct testimony?

A. Yes.

Cost of Local Service Study - Methods

Sprint-Florida, Inc.

August 2003

Table of Contents

I. STUDY SUMMARY

A. Purpose

The purpose of this Cost of Local Service Study ("Study") is to develop the Total Service Long Run Incremental Cost (TSLRIC) associated with Residential Basic Local Service (R1), Single Line Business Basic Local Service (B1), and Switched Network Access Services for Sprint-Florida, Inc. ("Sprint"). This Study supports Sprint's Petition to reduce intrastate switched network access rates in a revenue neutral manner.

In an effort to minimize issues regarding the Study results, all cost elements are derived from Sprint's Commission-approved rates for unbundled network elements ("UNEs") in Florida Public Service Commission ("FPSC") Docket No. 990649-TP.

B. Cost Study Overview

This section explains Exhibit KWD-2, pages 1 to 7.

1. Summary (Exhibit KWD-2, page 1 of 7): brings forward the results for Residential Basic Local Service, Single Line Business Basic Local Service and Intrastate Switched Network Access.
2. Residential Cost Summary (Exhibit KWD-2, page 2 of 7) & Business Cost Summary (Exhibit KWD-2, page 3 of 7): lists the components and costs associated with the TSLRIC of basic local service. The Loop Summary (Exhibit KWD-2, page 5 of 7) section

of this narrative describes the method used to best match the approved UNE-P loop investment to basic residential and basic business loop services. The Port and NID costs in Column F of Exhibit KWD-2, pages 2 and 3 of 7 are the approved TELRIC less common costs. The Usage Cost component is addressed in the Local Usage (Exhibit KWD-2, page 6 of 7) section of this narrative. The Retail Related Cost component is discussed in the Retail Expenses (Exhibit KWD-2, page 7 of 7) section of this narrative.

3. Intrastate Switched Network Access (Exhibit KWD-2, page 4 of 7): develops the End Office and Tandem Switching minute-of-use cost from the UNE Rate Docket 990649B-TP approved rates. The End Office Switching (Call Termination) MOU (minute-of-use) cost is for an interoffice trunk to line side connection for one end of the call which is originating or terminating. Common Transport cost is the Commission approved rate from UNE Docket 990649-TP less common cost. The intrastate switched network access rate elements of Carrier Common Line and the Interconnection Charge accurately reflect no corresponding costs.
4. Loop Summary (Exhibit KWD-2, page 5 of 7): The investments and counts used in the loop calculations were taken from the loop studies that support Sprint's Commission-approved rates for loop unbundled network elements in Docket No. 990649-TP.

The Sprint Loop Cost Model (SLCM or the model) that supports the approved UNE loop rates uses grids as the smallest geographic area for computing forward-looking loop investments. The model calculates the investment required to build the least-cost, most efficient plant alternative needed to serve all business and residence locations within each grid based on the services in use by the customer(s) at their respective service locations. An average loop investment is then generated within each grid for all Sprint wirecenters. This average investment per loop by grid is used to develop the current residential and business retail loop investments using the formulas listed below. Line counts are also taken from the model output.

The average R1 loop investments can be explained by the following formulas:

Total R1 loop investment per grid =
UNE-P actual loop investment per line for the grid *
Number of R1 lines in the grid

Average Company R1 Loop Investment =
Sum (Total R1 loop investment per grid) for all grids in the study area /
Total R1 access lines in the study area

The average B1 loop investments can be explained by the following formulas:

Total B1 loop investment per grid =
UNE-P actual loop investment per line for the grid *
Number of B1 lines in the grid

Average Company B1 Loop Investment =
Sum (Total B1 loop investment per grid) for all grids in the study area /
Total B1 access lines in the study area

R1 and B1 lines by grid are used to develop weighted average investment per R1 and B1 line. The average company loop investment per R1 line and per B1 line is then incorporated into the study for basic local retail services.

5. Local Usage (Exhibit KWD-2, page 6 of 7): Average Local MOU per Line in Column D are local originating MOU which include intraoffice, EAS and interoffice traffic plus terminating MOU for EAS and interoffice. These minutes are multiplied by the TELRIC without Common MOU cost in Column E to calculate the TSLRIC for Total Average MOU per Line for residential and business services in Column F. The average local MOU per line are from a 2003 Florida traffic study for basic residential and for basic business services.

   Local Switching per MOU cost is representative of local calling for both local interoffice calls and local intraoffice calls. The weighted MOU cost of $.001846 in the Local Usage worksheet (Exhibit KWD-2, page 6 of 7), Column E, is the approved Local Switching cost without common from the UNE rate Docket No. 990649B-TP.

   Common Transport costs are the approved TELRIC costs less common costs.

6. Retail Expenses (Exhibit KWD-2, page 7 of 7): Retail related expenses are expenses directly attributable to residential and business customers. These expenses are excluded from UNE rates but applicable to the basic service costs resulting from this study. These expenses are expressed as a per access line unit cost in Column E, Line 9. This unit cost is added to the basic residential service and basic business service to determine the final TSLRIC cost found on the Residential Cost Summary (Exhibit KWD-2, page 2 of 7) and the Business Cost Summary (Exhibit KWD-2, page 3 of 7).

Sprint-Florida, Inc.
Cost of Local Service Study
Summary

A	B	C	D
Row	**Cost Element**	**Source**	**TSLRIC**
1	Residential - Basic Local Service Cost (Per Line)		
2	TSLRIC	Exhibit KWD-2, Page 2 of 7, Col. F, Line 7	$ 30.46
3	Single Line Business - Basic Local Service Cost (Per Line)		
4	TSLRIC	Exhibit KWD-2, Page 3 of 7, Col. F, Line 7	
5	Intrastate Switched Network Access (Per MOU)		
6	TSLRIC	Exhibit KWD-2, Page 4 of 7, Col. D, Line 13	$ 0.004475

Sprint-Florida, Inc.
Cost of Local Service Study
Residential Cost Summary

A	B	C	D	E	F
			Docket 990649 TP	Docket 990649 TP	D * E /12
Row	**Description**	**Source**	**Investment**	**UNE ACF**	**TSLRIC**
1	Total Cost				
2	Average Residential Line	Exhibit KWD-2, Page 5 of 7, Col. I	[illegible]	22.30%	[illegible]
3	Port	Docket 990649-TP, Switch04!UNE_Port!J7	72.87	30.05%	1.82
4	NID	Docket 990649-TP, NID04!NIDLine2	41.79	20.78%	0.72
5	Residential Usage Cost	Exhibit KWD-2, Page 6 of 7, Col. F, Line 5			[illegible]
6	Retail Related Costs	Exhibit KWD-2, Page 7 of 7, Col. E, Line 9			
7	Total TSLRIC	Sum (F2+F3+F4+F5+F6)			**$ 30.46**

Sprint-Florida, Inc.
Cost of Local Service Study
Business Cost Summary

A	B	C	D	E	F
			Docket 990649 TP	Docket 990649 TP	D * E /12
Row	Description	Source	Investment	UNE ACF	TSLRIC
1	Total Cost				
2	Average Business Line	Exhibit KWD-2, Page 5 of 7, Col. J	[illegible]	22.30%	[illegible]
3	Port	Docket 990649-TP, Switch04!UNE_Port!J7	72.87	30.05%	1.82
4	NID	Docket 990649-TP, NID04!NIDLine2	41.79	20.78%	0.72
5	Business Usage Cost	Exhibit KWD-2, Page 6 of 7, Col. F, Line 6			[illegible]
6	Retail Related Costs	Exhibit KWD-2, Page 7 of 7, Col. E, Line 9			
7	Total TSLRIC	Sum (F2+F3+F4+F5+F6)			[illegible]

Sprint-Florida, Inc.
Cost of Local Service Study
Intrastate Switched Network Access Summary

A	B	C	D	
Row	**Description**	**Source: Docket 990649-TP**	**MOU Cost Without Common**	
	End Office (Call Termination)			
1	Call Termination MOU	Switch04!CT_MOU_Summary!D3	$	0.001239
2	Call Termination Call Attempt	Switch04!CT_CA_Summary!D3		0.003202
3	Avg. Hold Time	Inpflt01!Switching_1!$L$40		4.48
4	Cost	D1+(D2/D3)	$	0.001953
	Tandem Switching			
5	Tandem Switching MOU	Switch04!TS_MOU_Summary!C4	$	0.001083
6	Tandem Switching Call Attempt	Switch04!TS_CA_Summary!C4		0.003247
7	Avg. Hold Time	Inpflt01!Switching_1!$L$41		4.49
8	Cost	D5+(D6/D7)	$	0.001806
9	**Common Transport**	Trans04!Common_Rate!B4	$	0.000716
10	**Carrier Common Line**		$	-
11	**Interconnection Charge**		$	-
12	Retail ACF			0.0%
13	**Total TSLRIC**	Sum (D4+D8+D9+D10+D11)*(1+D12)	**$**	**0.004475**

Sprint-Florida, Inc.
Cost of Local Service Study
Loop Summary

A	B	C	D	E	F	G	H	I	J

Row		Total Residential Lines	Total Single Line Business	Total Business Lines	Total Switched Lines		Average UNE-P Loop Investment	Average Residential Investment	Average Single Line Business Investment
1	Total	1,557,117	313,501	634,749	2,191,866		$ 1,132.15		
	Source	Docket # 990649B TP	Docket # 990649B-TP	Docket # 990649B-TP	Docket # 990649B-TP		Docket # 990649B-TP		

Sprint-Florida, Inc.
Cost of Local Service Study
Local Usage

A	B	C	D	E	F
					D * E
Row	**Description**	**Source**	**Average Local MOU per Line**	**Approved UNE Rate Docket 990649-TP Without Common**	**TSLRIC for Total Average MOU per Line**
	Residential				
1	Local Switching	Florida Customer Usage Study-07/2003		$ 0.001846	
2	Common Transport	Florida Customer Usage Study-07/2003		0.000716	
	Business				
3	Local Switching	Florida Customer Usage Study-07/2003		$ 0.001846	
4	Common Transport	Florida Customer Usage Study-07/2003		0.000716	
5	**Total Residential Usage**	F1 + F2			
6	**Total Business Usage**	F3 + F4			

Sprint-Florida, Inc.
Cost of Local Service Study
Retail Related Expenses

A	B	C	D	E
Row	Account Number	Description	Source: Docket 990649-TP	Total Expenses
1	6121	Land & Building		
2	5301	Uncollectible Revenue		
3	6611	Product Management		
4	6612	Sales		
5	6613	Product Advertising		
6	6623	Customer Services		
7		Total Retail Related Expenses	Sum (Rows 1-6)	
8		Access Lines	Exhibit KWD-2, C1 + D1	1,870,626
9		Retail Related Expenses per access line per month	Sum (Rows 7 / 8) / 12 months	

BEFORE THE PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DR. BRIAN K. STAIHR

I. BACKGROUND/PURPOSE

Q. Please state your name, title, and business address.

A. My name is Brian K. Staihr. I am employed by Sprint Corporation as Senior Regulatory Economist in the Department of Law and External Affairs. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.

Q. Please briefly describe your educational background and work experience.

A. I hold a B.A. in Economics from the University of Missouri-Kansas City, and an M.A. and Ph.D. in Economics from Washington University in St. Louis. My field of specialization is Industrial Organization, including Regulation.

I began working with Sprint's Regulatory Policy Group in 1996. In my current position I am responsible for the development of state and federal regulatory and legislative policy for all divisions of Sprint Corporation. I am also responsible for the coordination of policy across business units. My particular responsibilities include 1) ensuring that Sprint's policies are based on sound economic reasoning, 2) undertaking or directing economic/quantitative analysis to provide support for Sprint's policies, and 3) conducting original research. The specific policy issues that I address include universal service, pricing, costing (including cost of capital), access reform, reciprocal

compensation and interconnection, local competition, and more.

In my position I have appeared before the Florida Public Service Commission, the Kansas Corporation Commission, the New Jersey Board of Public Utilities, the Pennsylvania Public Utility Commission, the North Carolina Utilities Commission, the Public Service Commission of South Carolina, the Public Service Commission of Nevada, the Texas Public Utilities Commission, the Illinois Public Service Commission, the Oregon Public Utility Commission, and the Missouri Public Service Commission. I have also worked extensively with the Federal Communication Commission's staff and presented original research to the FCC. My research has also been used in congressional oversight hearings.

In January 2000 I left Sprint temporarily to serve as Senior Economist for the Federal Reserve Bank of Kansas City. There I was an active participant in the Federal Open Market Committee process, the process by which the Federal Reserve sets interest rates. In addition, I conducted original research on telecommunication issues and the effects of deregulation. I returned to Sprint in December 2000.

For the past eight years I have also served as Adjunct Professor of Economics at Avila University in Kansas City, Missouri. There I teach both graduate and undergraduate level courses.

Prior to my work in Sprint's Regulatory Policy Group I served as Manager-Consumer Demand Forecasting in the marketing department of Sprint's Local Telecom Division. There I was responsible for forecasting the demand for services in the local market,

including basic local service, and producing elasticity studies and economic and quantitative analysis for business cases and opportunity analyses.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss how the removal of implicit subsidies is consistent with—and necessary for—the development of a healthy and sustainable competitive market for basic local telecom services throughout the state of Florida, a competitive market that will simultaneously 1) provide benefits and choices to the largest number of Florida's residents possible, and 2) operate on a level playing field for all competitors. Sprint-Florida, Inc. (Sprint) is also co-sponsoring (with BellSouth and Verizon) the testimony of Dr. Kenneth Gordon, who addresses these same issues in a general sense, and from a state-wide and nation-wide perspective. My testimony addresses why the removal of implicit subsidies will have an even greater impact, and is even more critically needed, in the portions of Florida served by Sprint.

II. IMPLICIT SUBSIDIES AND COMPETITION

Q. Why is the removal of implicit subsidies, such as those found in access charges, necessary for the development of a healthy competitive market for basic telecom services in Florida?

A. The relationship between implicit subsidies and competition is something of a double-edged sword: On one hand, competition erodes the ability to maintain artificially imposed implicit subsidies. On the other hand, the existence of implicit subsidies inhibits full and fair competition for all customers. Both of these effects are economically undesirable, and unfortunately we see evidence of both of these effects in

Florida today.

With regard to the first point—competition eroding the ability to maintain implicit subsidies—the only way that any firm can successfully maintain a pricing structure based on implicit subsidies is if the firm is able to control two things: the *source* of the subsidy and the *target* of the subsidy. In a regulated monopoly environment this is possible. In a competitive environment it is not, because the source of the subsidy is (by definition) some customer paying a price that exceeds cost. And in a competitive environment prices that exceed cost attract entry. For the entrant, the difference between price and cost is not a *subsidy* but simply a *margin* (unless the entrant is somehow required to serve both the customer providing the subsidy and the customer receiving the subsidy). If the entrant prices the service at a slightly lower margin (but still above cost), and underbids the incumbent firm, the entrant succeeds in capturing that margin and therefore eroding the incumbent' s needed subsidy.

With regard to the second point—implicit subsides inhibiting full and fair competition for all customers—a pricing structure based on implicit subsidies divides the universe of potential customers into two distinct subsets: the attractive customers who are providing the subsidy (margin) and the unattractive customers who require the subsidy and are, therefore, unprofitable to serve on an individual basis at current prices.

Q. Do the implicit subsidies contained in access charges inhibit the development of local competition?

A. Absolutely. Since the passage of the 1996 Telecom Act the FCC has indicated that access charges represent implicit subsidies and that implicit subsidies are antithetical to

effective and healthy competition. In its very first Access Reform Order (*First Report and Order* in CC Docket 96-262 released May 16, 1997) the FCC stated that "implicit subsidies also have a disruptive effect on competition, impeding the efficient development of competition in both the local and long-distance market" (*Id.* at ¶ 30). More recently, the FCC, with the adoption of its CALLS Order in May 2000, (*Sixth Report and Order* in CC Docket Nos. 96-262 and 94-01, *Report and Order* in CC Docket No. 99-249, *Eleventh Report and Order* in CC Docket 96-45, released May 31, 2000 ("CALLS Order")) undertook exactly the same type of reform that we are discussing here today: converting implicit subsidies generated on a per-minute-of-use basis to flat-rate charges directly recovered from the cost-causer (the end-user). Although that Order obviously addressed interstate access rates, rather than intrastate rates, the issue is identical. The CALLS Order states,

> "Where existing rules require an incumbent LEC to set access charges above cost for a high-volume user, a competing provider of local service can lease unbundled network elements at cost, or construct new facilities, thereby undercutting the incumbent's access charges"

which has the effect of...

> "jeopardizing the source of revenue that, in the past, has permitted the incumbent LEC to offer service to other customers, particularly those in high-cost areas, at below-cost prices." (CALLS Order at ¶ 24)

Notice that this quote from the CALLS Order addresses both of the points discussed above. It clearly illustrates how competition erodes implicit subsidies. But it also makes specific reference to a "high-volume user." Obviously any access charge that would be above cost for a high-volume user would also be above cost for a low-volume

user, and theoretically a competitor could enter a market and capture either user. But the implication is that low-volume users are not the customers that would motivate the competitive entry. They are, as I described above, the competitively-unattractive customers. This phenomenon is particularly visible when we examine various UNE-P based offerings currently available from competitive local providers. For example, MCI's "The Neighborhood" Offering, which starts at a price of $49.99 in many states, offers virtually no price benefit to a very low-volume toll user; the offer is priced so as to attract high-volume toll users. So while an offer such as "The Neighborhood" does provide certain customers with an alternative provider for basic local service, it is not really a viable alternative for many other customers. Rebalancing rates for basic local service will create a situation where competitors will find that, on average, a larger percentage of the residential market is financially attractive to serve.

Clearly the *degree* or the *magnitude* of the implicit subsidy plays a significant role in the disruption of healthy competition. All else held equal, the larger the amount of implicit subsidy that a customer is *providing*, the more attractive that customer is to a competitor. But the larger the amount of implicit subsidy that is *required* to cover the cost of serving any customer, the less likely a competitor will find that customer attractive. When customers living in high-cost areas pay the same retail rates for service as customers living in lower cost areas (or in some cases pay even *lower* retail rates than low-cost customers) the magnitude of the implicit subsidy associated with the high-cost customers effectively serves to discourage would-be competitors. The task at hand in this proceeding, which is to reduce the magnitude of the implicit subsidy and allow retail rates to approach costs, is exactly the mechanism needed to encourage, rather than discourage, competitive entry. As the FCC states in another CALLS-related order,

'Competitors are more likely to enter high-cost areas if the incumbent LECs' rates are closer to cost..." *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers,* Order, 17 FCC Rcd. 10868.

Q. Why would Sprint, as an incumbent local telephone company in Florida, want to encourage competition?

A. Competition is a fact, and it is here in Florida today. But in many cases, the type of competition that exists is not particularly healthy or sustainable, nor is it taking place on a level playing field. First, cream-skimming and arbitrage opportunities account for much of the competitive activity we see. This leaves the incumbent carrier, with its carrier-of-last-resort status, in the unenviable position of losing the customers whose revenues cover the costs of serving them, and retaining the customers whose revenues do not cover the costs of serving them. Second, incorrect signals are sent to potential competitors. Competitors that might actually be less efficient than the incumbent can enter a market in pursuit of the margin (subsidy) that the customers provide. Third, advances in technology are quickly blurring the competitive lines across different service offerings as inter-modal competition grows at a rapid pace. Competition from standard telephony providers is matched by competition from wireless companies, cable television companies, and even electric power companies. Not only do these forms of competition also erode the much-needed implicit subsides—particularly in the case of wireless calling replacing wire-line long distance, and the associated loss of access revenue—but they exacerbate the problem created by the incumbent's carrier-of-last-

resort status. For example, when a customer "cuts the cord" and replaces his or her wireline phone with a wireless phone, the revenues associated with that customer go away, but some of the costs of serving that customer do not; the company is still obligated to maintain the network to the customer's premises.

By allowing local rates to approach costs for more and more customers, a true win-win situation is created in the competitive market: A larger number of basic local service customers become attractive to competitors (which means more customers will be offered choices). And competitive entry will occur when it is efficient and sustainable, not when it is inefficient. With rate rebalancing, incumbents will still incur competitive losses. But when the incumbent loses a customer it will only lose that customer's revenues, not the revenues needed to cover the costs of serving that customer plus another (subsidized) customer. The incumbent will still be affected negatively, because it will have to continue to incur some costs for customers from whom it receives no revenues. But every loss will not be a "double-hit" to much-needed revenues.

One additional point is worth making with regard to competition. Because the telecommunications industry is witnessing such significant growth in inter-modal competition, the absence of a level playing field increases the potential for competitive distortion. As cable companies, wireless companies and even electric power companies compete with ILECs for customers, the maintaining of implicit subsidies (which the ILEC has but which these other firms are not obligated to have) combined with a lack of pricing freedom (which the other firms *do* have but ILECs do not) create an even greater hurdle that ILECs must overcome in order to remain financially viable in an increasingly competitive marketplace.

The cable television industry is quickly moving into the voice market and conducting telephony trials across the nation, including the state of Florida. Many of these trials utilize voice over Internet protocol (VOIP) technology, which raises important questions regarding the long-term sustainability of the implicit subsidies found in access charges. And because of the extensive penetration of cable television networks, it is highly likely that many residential customers in less-urban areas will, if cable companies are given the right incentives to enter, be able to choose between telephone companies and cable companies for their telephony services. Removing the implicit subsidies that currently exist in prices will help competition to develop in two ways: it will level the playing field between inter-modal competitors, and it will not force other technologies such as cable telephony to compete head-to-head against *subsidized* prices for basic local service.

Another potential competitor, with a network even more ubiquitous than that of the cable industry, is the electric power industry. The FCC is currently examining the state of broadband offerings over power lines (BPL) (FCC Docket No. ET 03-104), and BPL technology is capable of providing voice telephony service. As with the case of the cable industry, the electric power industry is in a position to provide alternatives to customers in less-urban areas if the proper pricing incentives exist in the market and therefore, as stated above, competition is better served when alternate providers are not forced to compete with artificially subsidized prices.

Last, but perhaps most importantly, in purely economic terms it is the wireless industry that is, in many ways, best suited to offer an alternative to wireline basic local service in

all areas of Florida, including the less urban regions. If wireless companies are faced with the correct economic incentives—again, such as not needing to compete against artificially subsidized prices for basic local service—they will find it financially feasible to offer Florida's residents even more alternatives for basic local service.

Q. Will rate re-balancing have a different competitive impact for customers who only purchase basic local service on (essentially) a stand-alone basis, compared to customers who purchase additional services or large amounts of toll?

A. In many cases, such as the UNE-P based offerings discussed above, it is the customers who purchase only basic local service that are currently least attractive to competitors. Rate rebalancing will make them relatively more attractive since it will be more profitable for competitors to serve them when their rates cover—or come closer to covering—the costs of providing service.

III. IMPLICIT SUBSIDIES IN THE AREAS SERVED BY SPRINT-FLORIDA

Q. How does the magnitude of implicit subsidies found in Sprint's serving territory compare with the areas served by BellSouth and Verizon?

A. As Sprint witness John Felz discusses in his testimony, Sprint's basic local service rates are lower, on average, than both BellSouth's and Verizon's basic local service rates. If Sprint's costs were also lower than BellSouth's and Verizon's then the magnitude of implicit subsidy might be roughly the same. However, evidence supports the conclusion that the costs that a competitor would incur in Sprint's territory are, on average, higher than the costs a competitor would incur in BellSouth's or Verizon's territories. This

fact, combined with Sprint's lower rates, translates to a larger degree of implicit subsidization and a greater hurdle for would-be competitors to overcome in Sprint' s service areas.

Q. What evidence supports the conclusion that the cost a competitor would incur in Sprint's territory are, on average, higher than the costs a competitor would incur in BellSouth's and Verizon's territory?

A. All else held equal, the cost of providing basic local service is dominated by the cost of the local loop. On average, throughout Sprint's local serving territory the cost of the loop accounts for over 90% of the cost of providing basic local service. And average loop costs (as well as the overall costs of service) increase as density and concentration of customers decrease. This is simply a function of the economies of networks, combined with the presence of a certain fixed costs. For example, the FCC, in its universal service cost model proceeding, indicated that 'the most significant portions of network costs" were affected by 'the location of customers relative to the wire center." *Fifth Report and Order* in CC Docket Nos. 96-45 and 97-160, released October 28, 1998, ¶ 27.

If we compare density and concentration characteristics among Sprint, BellSouth, and Verizon in Florida we find dramatic differences. As Exhibit BKS-1 shows, BellSouth and Verizon serve regions that are, respectively, three and four times more concentrated than Sprint's serving territory. For a new competitor this difference would translate to a measurable cost difference, whether the competitor was overbuilding or simply purchasing unbundled elements.

Q. If implicit subsidies really represent a hurdle to competitive entry, then shouldn't we see less competitive entry in Sprint's serving territory?

A. Yes, we should see less competitive entry and we do see less competitive entry in Sprint' s territory. According to the FCC's Local Competition Report released June 2003, in the state of Florida CLEC lines accounted for 13% of all end-user switched access lines at the end of 2002. (These figures do not reflect the competitive situation is regions served by companies with less than 10,000 lines.) Another data source, the Florida Commission's own Annual Report on Competition (released in December 2002) indicates that CLEC lines in Florida accounted for 13% of all end-user lines as of June 30, 2002. These two sources, although they reflect slightly different timeframes, are consistent enough to give us a "bound of reasonableness" regarding the overall level of competitive activity throughout the state of Florida. According to the FCC data, Florida at year-end 2002 was roughly in line with the nationwide average for competitive activity, which was also 13% of end-user switched access lines. (However, Florida's competitive activity was more heavily weighted toward business customers than the national average. This is discussed in the testimony of Dr. Ken Gordon.)

By comparison, the level of competitive activity in Sprint's serving territory at year-end 2002 was significantly below this statewide average of 13%. Using forms filed with the FCC, it is possible to estimate the percent of end-user switched access lines served by competitors in Sprint's Florida serving territory on December 31, 2002 to be approximately 3.4%. In all likelihood, this figure of 3.4% actually overstates the level of competitive activity in Sprint's territory (see Exhibit BKS-2).

Furthermore, the largest portion of this 3.4% is actually made up of resold lines, rather

than some form of facilities-based competition. This is a dramatic departure from the type of competition seen in the remainder of the state. According to the Florida Commission's Annual Report on Competition, resold lines accounted for approximately 14% of competitive activity statewide (as measured by CLEC lines) in 2002. By comparison, resold lines account for over 56% of the competitive activity in Sprint's Florida service territory. The reason that this fact is notable is that high network costs (and the need for implicit subsidies to cover them) do not inhibit competitive entry when the competitor is a reseller, because the reseller does not undertake network investments, nor does the reseller incur network costs in the form of cost-based UNEs. The fact that reselling accounts for such a significantly larger percentage of the competitive activity in Sprint's Florida service territory underscores the fact that the higher costs of serving Sprint's customers have effectively discouraged other forms of competition in many areas.

Q. How can we be sure that Sprint's dramatically lower levels of competitive activity are not attributable to some factor other than the presence of implicit subsidies?

A. The characteristics of Sprint's serving territory speak for themselves. The low density and high-dispersion of Sprint's customers affect many aspects of a potential business case, from network-related expenses (higher costs by necessity translate to higher UNE rates) to marketing expenses. Any competitor entering Sprint's territory is faced with, on average, lower rates to compete against and higher costs to incur. If Sprint's customers are unattractive to competitors for some additional reason (for example, perhaps on average they might generate lower vertical feature revenue or lower access revenue) this simply adds further support for the removal of high implicit subsidies since doing so will help to make Sprint's customers more attractive to competitors.

Because Sprint's residential local service rates are lower and its costs are higher, the current implicit subsidy system is an even greater barrier to competition in Sprint's territory than in other portions of Florida. Therefore, as Sprint witness John Felz states in his testimony, it will be necessary to allow greater movements in Sprint's residential local service rates to bring about a comparable level of competitive inducement seen in other regions of the state.

Q. But doesn't that mean that residential local service rates would possibly increase more in Sprint's territory than in other regions?

A. Yes, but there are counter-balancing factors that must be considered. First, it is important to keep in mind that inter-exchange carriers (IXCs) are required to flow through the access charge reductions that accompany the rate rebalancing. This includes elimination of the 'in state connection fee." As a result, toll customers currently pay ing such a fee to an IXC—regardless of their level of usage—will benefit as this charge is eliminated. Also, because per-minute access charges will be reduced, many customers' total bills (for all telecom services) will, on average, decline as well. So although basic rates will rise, toll rates will fall and in many cases the effects will offset each other

Second, if the status quo were to continue, the persistent erosion of subsidy by competitors (who naturally target higher-margin customers) would force incumbent carriers to either scale back investment in their networks or seek increases in residential rates or both. Residential customers are not well served when carriers cannot afford to invest in improving their networks. But they benefit greatly when technological advances and the new services that accompany them, are made available to as many

residents as possible. Sprint is currently investigating several different technological advances in its local serving areas in all of its states, including Florida, as part of its overall network-upgrading plans. These include the migration of circuit-to-packet switching, fiber-to-the-home solutions, voice over DSL offerings, and more. The ability to undertake capital investment to upgrade the network, which will allow Sprint (and all carriers) to offer new and enhanced services to customers, depends on the company being able to cover the costs of serving its customers. In a competitive market, all telecom carriers must perform something of a balancing act; they must undertake the capital investment needed to stay competitive and offer innovative products, but they must do so while managing their profitability and maintaining sufficient revenue flow from their current products in a world of decreasing revenues and increasingly tight investor capital. Currently, the ability of carriers to pull off this balancing act is hindered by an implicit-subsidy-based pricing regime that creates an entire subset of the population that must be served but is unprofitable to serve at current prices.

Q. But how can raising residential rates benefit Sprint's residential customers?

A. The benefit to Sprint's residential customers will come through increased choices brought about by competition, and enhanced service offerings and innovation that are stimulated by competition. When alternative technologies are forced to compete with subsidized prices—as they are currently—technologies that have genuine efficiency advantages can be kept out of the market. If prices move closer toward actually reflecting costs, all customers will be better served because firms will be able to compete for their business with prices that reflect legitimate differences in costs, not simply differences in cross-subsidization.

It is true that many residential consumers currently enjoy paying below-cost rates for their telecom services. Most consumers would enjoy paying below-cost based rates for *any* good or service. But these artificially low prices are unsustainable in the face of competition, and they come at a cost: fewer options among services, less innovation, and—in large portions of Sprint's serving territory—no competitive choices.

IV. EFFECTS ON SUBSCRIBERSHIP AND UNIVERSAL SERVICE

Q. In his testimony Sprint witness John Felz concludes that the rebalancing will not adversely affect universal service in Florida. As an economist do you agree with that conclusion?

A. Yes. Economic evidence supports Mr. Felz' conclusion: The proposed rate re-balancing will not have a negative effect on universal service. Economists who have studied the demand for basic telephone service know that econometric studies have demonstrated that it is income, rather than price, that plays the largest role in a customer's choice of whether or not to subscribe to basic telephone service. As economist Lester Taylor cited in his seminal 1994 text, "Actually, when all is said and done, the primary factor [affecting access to the public switched network] is really income, or rather its absence." (Lester Taylor, *Telecommunications Demand in Theory and Practice*, Kluwer Academic Publishers, 1994.) Given this fact, the most efficient and effective way to address any potential non-subscription to basic service is through explicit subsidization in cases of low income, such as the state and Federal Lifeline and Link-Up programs, not by artificially suppressing prices for everyone. As Mr. Felz notes, the rates for low-income/Lifeline customers will not increase as a result of the proposed rate rebalancing. Therefore, the select set of customers for

whom a rate increase *might* have an effect on their decision of whether or not to subscribe to the network will be the very customers who will not see an increase.

One additional point is worth mentioning with regard to universal service. With the amazing growth of wireless service and other technological alternatives, customers now have choices as to *how* they access the public switched network. The Associated Press recently reported that, nationwide, 7.5 million residents have "cut the cord" and now access the public switched network only through their mobile phone. (See.www.cnn.com/2003/TECH/08/04). In any market that contains services that act as substitutes for one another, a change in the price of one service will affect the demand for the other. This will be the situation in Florida as well. As the prices of basic wire-line service move closer to their true economic costs, it is possible that some customers will evaluate their need for both a wire-line and wireless phone. In some cases these customers may opt to forgo wire-line access to the public switched network, as millions have already done. It is important that the Commission recognize two facts: First, customers making this choice do not represent any type of universal service concern; these customers remain connected to public switched network, the have simply chosen to utilize a different mechanism. Second, this phenomenon is actually beneficial because markets operate efficiently when consumers make choices based on prices that reflect the underlying costs of services. Markets do not operate efficiently when customers make choices based on prices that misrepresent the underlying costs.

Q. Is there any concern that, even if the rebalancing has no universal service impacts, that customers might experience some level of "rate shock" when they are faced with rates that come closer to costs?

A. Not really. First, as Sprint witness John Felz discusses, Sprint has had experience with rate rebalancing in other states and "rate shock" has not been a problem. Nor is there any evidence that "rate shock" was a concern when the federal subscriber line charge (SLC) increased as a result of the FCC's CALLS Order. But more importantly, Sprint is like every other company that seeks to earn a reasonable profit in that it is a company that wants to hold on to its customers, and would not engage in pricing plans that had the opposite effect.

Q. Does this conclude your testimony?

A. Yes it does.

SPRINT-FLORIDA, INC.
PETITION TO REDUCE ACCESS RATES
FILED: AUGUST 27, 2003
EXHIBIT BKS-1

Density and Customer Concentration Data for Sprint, BellSouth and Verizon in Florida
(Source: USAC and BLR)

Access Lines Per Square Mile	
BellSouth	341
Verizon	465
Sprint	**94**
Average Land Area Per Wire Center (square miles)	
BellSouth	92
Verizon	49
Sprint	**211**
Access Lines Per Wire Center	
BellSouth	31,424
Verizon	22,664
Sprint	**14,307**

SPRINT-FLORIDA, INC.
PETITION TO REDUCE ACCESS RATES
FILED: AUGUST 27, 2003
EXHIBIT BKS-2

Explanation of Competitive Activity Level

All companies having more than 10,000 access lines file form 477 with the FCC to report the level of competitive activity taking place within their serving territories. According to Sprint's filings, as of December 31, 2002 there were slightly over 55,800 competitive lines (either resold or UNE-based) in its Florida serving area. Because companies do not report pure facilities-based competitive activity it is necessary to estimate the number of facilities-based (or 'CLEC-owned") lines in an area. Using nationwide numbers from the FCC's Local Competition Report we find that, on average, resold and UNE-based lines account for approximately 74% of competitive lines. If we divide Sprint's UNE-based and re-sold lines by this 74%, we can arrive at an estimate of Sprint's total competitive lines. Applying this figure to Sprint's Florida-specific lines, we would estimate that total competitive lines would equal [55,800 / .74] or 75,405.

This figure, 75,405, as a percentage of Sprint's total Florida lines—approximately 2,200,000—equates to [75,405 / 2,200,000] or 3.4%. The reason this figure, 3.4%, is most likely overstated is because, based on the geographic characteristics of Sprint's serving territory it is highly likely that Sprint actually has less pure-facilities-based competitive activity than the national average. This would mean that the 74% used above should actually be a higher percentage, which would (when used as the denominator in line 14 above) produce a smaller number of total competitive lines, and a percentage somewhat less than 3.4%.

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DIRECT TESTIMONY OF DR. KENNETH GORDON

On behalf of Verizon Florida Inc., BellSouth Telecommunications, Inc., and Sprint-Florida Inc.

August 27, 2003

DIRECT TESTIMONY OF DR. KENNETH GORDON

I. PURPOSE & SUMMARY OF CONCLUSIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Dr. Kenneth Gordon. My business address is One Main Street, Cambridge, Massachusetts 02142. My C.V. is provided as Attachment A.

Q. WHAT IS YOUR CURRENT POSITION?

A. I am a Special Consultant of National Economic Research Associates, Inc. ("NERA"). Previously, I was Senior Vice President at NERA.

Q. WILL YOU PLEASE SUMMARIZE YOUR EDUCATION AND PROFESSIONAL QUALIFICATIONS?

A. I am an economist and former Chairman of the Maine Public Utilities Commission ("Maine Commission") and the Massachusetts Department of Public Utilities ("Mass. DPU"). The Mass. DPU is now known as the Massachusetts Department of Telecommunications and Energy. I have been an economist since 1965, and I have been directly involved with developing and establishing regulatory policy at the federal and state levels since 1980, when I became an industry economist at the Federal Communications Commission ("FCC").

I received my A.B. degree from Dartmouth College in 1960. I received my M.A. degree in 1963 and my Ph.D. degree in 1973, both in economics, from the University of Chicago. I have taught applied microeconomics, industrial organization, and regulation (as well as other subjects) at Georgetown University, Northwestern University, University of

Massachusetts at Amherst, and Smith College.

From 1980 to 1988, I was an industry economist at the FCC's Office of Plans and Policy, where I worked on a full range of regulatory issues, including telecommunications, cable, broadcast, and intellectual property rights. At the FCC, one of the major focuses of my work was activity aimed at introducing competition into communications markets.

Prior to joining NERA in November 1995, I chaired the Maine Commission (1988 to December 1992) and the Mass. DPU (January 1993 to October 1995). During my term as Chairman of the Mass. DPU, the DPU investigated and approved a price cap incentive regulation plan for NYNEX and also undertook a proceeding to examine interconnection and other issues related to the development of competition at all levels of telecommunications, including basic local service.

While a regulator, I was active in the National Association of Regulatory Utility Commissioners ("NARUC"), serving on its Communications and Executive Committees. In 1992, I served as President of NARUC. I was also Chairman of the BellCore Advisory Committee and the New England Governor's Conference Power Planning Committee.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Verizon Florida Inc., BellSouth Telecommunications, Inc., and Sprint-Florida Inc., ("the companies") are seeking to restructure their rates for intrastate network access services ("intrastate access") and basic local telecommunications services ("basic local") in

accordance with recently passed legislation by the Florida Legislature.[1] The companies' plans—which must address the criteria established in the legislation—call for them to restructure their intrastate access and basic local rates in a revenue-neutral manner.

The companies have asked me to provide an economic and policy analysis of their rate plans and to testify on whether I believe those plans meet the criteria laid out in the legislation.

Q. WHAT ARE YOUR MAJOR CONCLUSIONS?

A. After reviewing the newly-enacted legislation, the evidence in this case—specifically the companies' plans and the cost evidence submitted by the companies' witnesses—and based on my general knowledge and expertise on telecommunications economic and regulatory matters, I conclude that the plans submitted by the companies meet the criteria contained in the legislation. Specifically, upon implementation, the plans will, *inter alia*:

- Reduce current support for basic local telecommunications services that prevents the creation of a more attractive competitive local exchange market for the benefit of residential consumers; and
- Induce enhanced market entry.

The companies' plans significantly decrease support for basic local service by reducing prices for a service that has historically and purposely been an important source—but by no means the only source—of support for basic local services, namely intrastate access. In order to achieve revenue neutrality, the companies' plans increase residential basic local prices towards cost-based levels, thus creating a more attractive market for potential

[1] *See* Section II below.

entrants, ultimately for the benefit of residential consumers. Both theory and empirical evidence show that low residential basic local prices have hindered the development of residential competition. By better aligning residential basic local prices with cost, competitors will have increased incentives to target a broader mix of residential consumers, which is the intent of the Florida legislature.

In addition, I conclude that the plans will enhance economic welfare in Florida by increasing economic activity. As described in the respective testimonies of the companies' cost witnesses, the cost evidence submitted in this proceeding demonstrates that rates for residential basic local service diverge significantly from their underlying costs. A movement toward costs—and, therefore toward more rational economic pricing—will bring with it several economic benefits. These benefits include providing market participants—i.e., customers, the companies and potential and actual competitors—with more cost-based price signals, which will improve economic decision making and lead to more economically rational utilization of telecommunications services. Economic activity in Florida will increase as a result of the companies' plans because rebalancing generates substantial consumer benefits. Telephone consumers are better off as a result of moving prices more in line with costs, and will likely increase their purchases of those services whose price has come down. Perhaps of even greater significance, competitive telephone service providers will be seeing better price signals for local service, and will be able to invest without having to face the level of subsidized competition they have faced in the past. New investment by these providers should, at the margin, increase.

The cost evidence presented by the companies demonstrates that basic local prices are

receiving an economic subsidy from other services. The companies submitted forward-looking direct cost evidence to demonstrate that their residential basic local services are priced below the costs the companies incur to provide the services. Forward-looking direct cost is the basis for determining whether a service is receiving an economic subsidy. Moreover, consistent with this Commission's ruling, the companies' cost witnesses, when measuring the economic subsidy flowing to basic local services, correctly assign the entire cost of the loop to basic local.

I also conclude that the companies' plans will not jeopardize universal service in the state of Florida. The companies' residential basic local prices are substantially below the national average and Florida is not a poor state. The Florida Public Service Commission ("Commission") has the flexibility to approve the companies' plans and still have residential basic local prices remain affordable. The Florida Legislation requires that any price increase in basic local service not apply to Lifeline consumers and also increased the income eligibility for Lifeline consumers to 125 percent, thus protecting those customers most likely to be sensitive to potential price increases from a rebalancing plan. Importantly, the companies' rebalancing plans will lead to lower intrastate toll prices for all consumers. At the end of the day, the mix of services that consumers purchase as a result of the companies' plans will make consumers better off overall.

Finally, the fact that some customers may experience unwanted rate changes should not be an argument for the status quo. Good policy requires weighing and balancing the costs and benefits of particular actions. While it may seem that maintaining current prices is the least objectionable thing to do from a policy perspective, there is an implicit but very real cost to continuing the status quo. The deployment of next generation, advanced networks

depends crucially on providing all market participants the sound economic signals that will encourage efficient investment and innovation. Cost-based prices provide the incentives needed to bring to market the new services that customers demand. This cannot be accomplished by distorted prices.

II. BACKGROUND

Q. PLEASE DESCRIBE THE BASIS FOR THE COMPANIES' REQUEST TO INCREASE BASIC EXCHANGE PRICES.

A. From an economic perspective, the fact that the companies' current residential basic local prices are not fully recovering their forward-looking economic cost is, by itself, a good enough reason to begin the process of moving them to more economically rational levels. Both theoretical and empirical research have shown that rebalancing rates and moving them toward levels more commensurate with their underlying costs results in significant benefits to telecommunications consumers and, by so doing, benefits the economy as well.[2] Rebalancing rates has also been demonstrated to have a positive effect on competitive entry into the local exchange market.[3]

The immediate catalyst for the companies' plans is the recent changes in Florida laws. I have been informed by counsel that the legal authority for the companies' request arises from recent changes in the statutory framework in Florida. During the 2003 regular legislative session, the Legislature passed Senate Bill 654, the Tele-Competition Innovation and Infrastructure Enhancement Act ("Tele-Competition Act"). The Tele-

[2] See Section IV below.

[3] See Section III.

Competition Act implements several important policies, but for our purposes the relevant Section of the Tele-Competition Act is § 364.164 "Competitive market enhancement."

Q. WHAT ARE THE IMPORTANT PROVISIONS OF § 364.164?

A. § 364.164 permits local exchange telecommunications companies to petition the Commission to reduce their intrastate access rates in a revenue-neutral manner. In reaching its decision, § 364.164 (1) states that the Commission shall consider whether granting the petitions will:

a. Remove current support for basic local telecommunications services that prevents the creation of a more attractive competitive local exchange market for the benefit of residential consumers;

b. Induce enhanced market entry;

c. Require intrastate switched network access rate reductions to parity over a period of not less than 2 years or more than 4 years; and

d. Be revenue neutral as defined in subsection (7) within the revenue category defined in subsection (2).

Throughout my testimony, I will focus on whether the companies' plans are consistent with and meet the criteria provided in § 364.164 (1) (a) and (b). Other company witnesses discuss how the companies' plans would meet criteria (c) and (d).

Q. IN ORDER TO REDUCE INTRASTATE ACCESS RATES IN A REVENUE NEUTRAL MANNER, RATES FOR OTHER SERVICES NEED TO BE INCREASED. WHAT SERVICES DO YOU BELIEVE SHOULD BE INCREASED?

A. The first category of services that should be considered are those services whose current

prices do not recover fully their underlying costs, such as residential basic local telecommunications services. Rates for these subsidized services should be increased in order to better reflect their real economic cost. This is confirmed in §364.164 (2), where the legislation calls for the creation of a revenue category mechanism consisting of basic local telecommunications service revenues and intrastate switched network access revenues in order to achieve revenue neutrality. That is, the legislation states that in order to achieve revenue neutrality, if intrastate access prices are reduced, then basic local service prices need to be increased.

The current rate design for telephone services—where basic local services are priced below cost and other services, including intrastate access service, are priced in such a way so as to provide the support—while in the process of being reduced or eliminated in a number of states, continues to be encountered in state regulation of telephone services. However, as the Florida Legislature wisely recognized, whatever benefits such a rate design policy has arguably achieved in the past, such as helping the United States achieve universal telephone service—the continuation of such policies frustrates another important policy goal of Federal and state regulators, namely, the establishment of efficient competition to as broad a base of business and residential consumers as is economically feasible—not to mention the economic costs that arise from price-cost distortions, *per se,* as I discuss further below.

The current rate design policy as it pertains to residential basic local services, frustrates that policy goal and by enacting § 364.164, the Florida Legislature has provided the Commission with the direction it needs to make competition work better for all Florida consumers.

Q. ARE THE COMPANIES' PLANS CONSISTENT WITH § 364.164 (1) (a) and (b)?

A. Yes. The companies' plans are consistent with and meet the criterion of § 364.164(1)(a) and (b). Below in Section III, I fully describe why I believe that the companies' plans are consistent with and meet those criteria.

Q. DR. GORDON, FROM A POLICY PERSPECTIVE DO YOU BELIEVE THAT IT IS APPROPRIATE TO ENGAGE IN THE TYPE OF REBALANCING THAT IS BEING CONTEMPLATED BY THE COMPANIES' PLANS?

A. Yes, I do. In this testimony, I describe fully why I believe that the companies' plans are consistent with the criteria of the Tele-Competition Act that the Commission shall consider and why the plans would likely result in increasing competitive activity in the state of Florida. Specifically, the plans will create a more attractive local exchange market for residential consumers and lead to enhanced market entry—two criteria that need to be considered by the Commission in addressing the companies' plans. By making the residential local exchange market more attractive, residential consumers will likely see more companies competing for their business, which will, in turn, result in more options for residential consumers, improved services and lower prices for their telecommunications services. From a policy perspective, it is appropriate to accomplish these tasks.

In addition, I describe below the history of rate design for basic local services in the United States and how the end result of these policies has been uneconomically low residential basic local prices; lower than what one would expect to find in undistorted competitive markets. Of course, states have differed in their implementation of these policies and, as a result, residential basic local service prices vary quite a bit from state to

state. In Florida, residential basic local prices are quite low when compared to prices in other states. In Table I below, I list the flat-rate charges for each of the three companies' lowest and highest rate groups compared to the national average flat-rate charges. As can be seen in the table, each of the companies' highest rate group is well below the national average of $14.55 per month.

Table I – Comparison of Verizon, BellSouth and Sprint's flat-rate residential basic local charges and National Average flat-rate charges

Company	Lowest Rate Group	Highest Rate Group	Unweighted Average	National Average (2002)
Verizon	$9.72	$12.06	$10.89	
BellSouth	$7. 57	$11.04	$9.31	
Sprint	$7.63	$11.48	$9.56	
National Average (2002)				$14.55

Source: Florida Senate Staff Analysis And Economic Impact Statement, p. 4, April 8, 2003; FCC *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, Table 1.1 July 2003, rates exclude Federal and State subscriber line charges, touch tone charge and taxes, 911 and other charges.

Q. HOW DOES THE FACT THAT FLORIDA HAS LOW RESIDENTIAL BASIC LOCAL TELECOMMUNICATIONS PRICES RELATE TO THIS PROCEEDING?

A. It relates to this proceeding in two important ways. First, the Legislature has correctly perceived that low residential basic local prices have led the residential local exchange

market to be less attractive to competitors than would be the case with more economically rational residential basic local prices. In Section III below, I describe fully why, from an economic perspective, I believe the Legislature is absolutely correct on this point. Put simply, holding all other factors constant, the lower the residential basic local price (when set governmentally without regard to whether the prices cover cost), the more unattractive those customers are to actual and potential competitors. Since Florida residential basic local prices are lower than those in many other states, and in fact lower than the national average, the problem facing potential new entrants as a result of these low rates is likely to be even more severe and pronounced in Florida than in other states. For this reason, it is even more important that Florida policymakers tackle this problem sooner rather than later.

Q. IS THERE ANY SUPPORT FOR YOUR ASSERTION THAT THE PROBLEM OF AN UNATTRACTIVE RESIDENTIAL MARKET MAY BE WORSE IN FLORIDA THAN IN OTHER STATES?

A. Yes, there is some support for my assertion. The FCC compiles data on local telephone competition. Its most recent report, released June 12, 2003 included a table that lists, for each state available, the percentage of lines provided to residential and small business customers by ILECs and CLECs.[4] The FCC provided data on 40 states and of those 40 states Florida ranked 30th in the percent of CLEC lines that were sold to residential and small business customers. This means that in 29 out of 40 states, CLECs' served proportionately greater residential customers than in Florida (see Figure 1 at the end of

[4] *See, Local Telephone Competition: Status as of December 31, 2002*, Table 11, Industry Analysis and Technology Division Wireline Competition Bureau, Federal Communications Commission.

this testimony). Florida ranks below states such as Georgia (58%), Alabama (52%), Louisiana (61%) and Virginia (70%) to name a few, all of which have higher residential prices. This provides some evidence that low residential basic local prices are having a negative impact on residential competition in Florida.

Q. YOU MENTIONED THAT THERE WAS A SECOND REASON WHY YOU BELIEVE THAT FLORIDA'S LOW RESIDENTIAL BASIC LOCAL PRICES, IN COMPARISON WITH OTHER STATES, ARE RELEVANT IN THIS PROCEEDING. WHAT IS THAT SECOND REASON?

A. The second reason has to do with affordability considerations and the flexibility this Commission has in rebalancing rates while still maintaining basic residential local rates that are quite affordable for most Floridia consumers. As mentioned above, the companies' prices for residential basic local services are generally well below the national average. However, Florida is not a poor state. According to data from the U.S. Bureau of Economic Analysis, Florida is on par with the national average in personal income per capita.[5] Specifically, as of 2001, the data show that personal income per capita in Florida was $29,047 compared to the national average of $30,413. Thus, the Commission has the flexibility to increase residential basic local prices, which are currently well below the national average, to more economically reasonable levels without making the services unaffordable to Florida consumers.

At the same time, Florida consumers will pay less for intrastate toll calls. The companies' rebalancing plan will lower the access charge component of the cost of producing

[5] Bureau of Economic Analysis, Regional Economic Information System, Table SA1-3.

intrastate toll calls. IXCs are required to pass these cost savings through to consumers in the form of lower prices. Thus, even with the increase in basic residential local rates, telecommunications will be just as affordable to Florida consumers as before, yet consumers will be better off because they will be consuming a different mix of telecommunications services that provides more value than they are currently receiving.

In addition, the Tele-Competition Act also requires that any increase in basic local service rates not apply to Lifeline customers and that the ILECs increase Lifeline participation to 125 percent of federal poverty income level.[6] These requirements further protect low-income consumers—and it is low-income consumers who would be most prone to disconnections in the face of price increases—thus providing the Commission with even more flexibility to approve the companies' rate rebalancing request with minimal concern that such a rate restructuring would negatively affect subscribership. I discuss this point, and other reasons why I believe the companies' plans will not negatively affect subscribership in Florida, in more detail in Section VI below.

Q. VERIZON, BELLSOUTH AND SPRINT ARE FILING THEIR PLANS AT THE SAME TIME. IS THERE ANY PUBLIC POLICY BENEFIT TO HAVING THE COMMISSION REVIEW THE COMPANIES' PLANS AT THE SAME TIME?

A. Yes. The benefits are at least threefold. First, to the extent that basic local rates are simultaneously adjusted closer to their costs throughout the territory of the three companies serving 98 percent of the ILEC customers, the better competition will be benefited and market entry enhanced. Certain providers who might be positioned to

[6] § 364.10(3)(a).

provide facilities–based basic local service (e.g. cable telephony, electric and wireless providers) will not necessarily configure their coverage areas based on the ILECs service territories. For them the potential staggered implementation of the rebalancing could be an obstacle to competitive entry. There are several areas within Florida where at least two of the three major ILECs provide service where it may be economical for a new entrant to provide service regardless of the ILEC boundary. For example, the Orlando/Central Florida (BellSouth/Sprint) area, Southwest Florida (between Sarasota and Ft. Myers (Verizon/Sprint)) area and the Pensacola – Ft. Walton – Destin -- Panama City (BellSouth/Sprint/BellSouth) area are three relatively compact geographic areas served in part by at least two of the three companies. Each of these areas might appropriately comprise the service territory of a single facilities–based entrant. When the price increases contained in the company plans are implemented and signal to these entrants that pricing distortions are being reduced on a broad basis, the competitors may be able to more efficiently execute their business plans.

Second, it is also important to avoid unnecessary marketplace distortions that could affect the purchase decisions of end-users. End-users normally make their purchase decisions based in large part on relative price differences among providers. If the rate-rebalancing is not implemented across all companies simultaneously, end-users will make these decisions based on incomplete and imperfect information as they see some providers' rates increasing while other providers' rates remain the same (at least temporarily). The risk will be that regulatory scheduling rather than the relative costs and benefits of various service offerings becomes the driving force behind consumers' decisions. For example, it is easy to imagine a situation involving two or more of the ILECs —where a CLEC might be able to offer service at a legitimate cost savings to all customers, but if re-balancing is

not done simultaneously perhaps only one firm's customers would respond to the competitive offer, because the other firm's rate increase had yet to be implemented. Coordinated rate rebalancing across all companies will ensure that potential competitors are not artificially disadvantaged when introducing new service offers by artificial boundaries, and that customers are not disadvantaged by incorrect and incomplete information driving their purchase decisions.

Third, the magnitude and timing of the access charge price reductions for the three companies would also benefit end users statewide. IXCs will be able to implement more meaningful price reductions if they can aggregate their access cost reductions into a single round of pricing changes.

Q. THE LEGISLATION PERMITS A COMPANY TO RESTRUCTURE ITS RATES OVER A MINIMUM OF TWO YEARS AND A MAXIMUM OF FOUR. EACH OF THE COMPANIES PLANS TO HAVE INTRASTATE ACCESS RATES REACH PARITY WITH INTERSTATE RATES OVER A TWO-YEAR PERIOD. DO YOU BELIEVE THIS IS A GOOD IDEA?

A. Yes I do, for several reasons. First, it is clearly permitted by the Tele-Competition Act. Second, it is a matter of economic principle that economic welfare is at its highest when prices are based on their underlying forward-looking costs and are not distorted. As I discuss in greater detail in Section III, prices that are distorted provide inferior signals for market participants and result in losses in consumer welfare because investment and purchase decisions by firms and consumers do not reflect the true costs that society incurs to provide the services. The companies' plans reduce these pricing distortions in the Florida telecommunications markets sooner rather than later and, by so doing, achieve

economic efficiency gains sooner as well.

Third, a possible reason why one would prefer a more gradual rate restructuring time frame has to do with avoiding consumer "rate shock". As the words imply, rate shock implies that the increase in price proposed by the company is so high, that consumers would be obviously and adversely affected. However, based upon my personal experience as a former commissioner, as well as what I have observed in other states, I do not believe that the yearly increase in basic local prices will result in rate shock.

Q. PLEASE EXPLAIN WHY YOU BELIEVE THAT THE COMPANIES' PLANS WILL NOT RESULT IN RATE SHOCK.

A. The companies' plans will result in relatively minor increases in a customer's basic local price. In addition, as I stated earlier, these price increases will not even apply to current Lifeline consumers and new Lifeline consumers who have become eligible as a result of the Tele-Competition Act raising the income threshold to 125% of the poverty level.

In addition, with the reduction and elimination of the in-state connection fees, many customers might not even experience a significant change in their total bill. If there is an increase in the customers' bill, it will likely result in large part from increased stimulation from lower long distance charges that represent real gains to consumers because they are now able to make more calls at the new lower prices.

Finally, the companies' plans compare favorably with other states that have approved rate-rebalancing plans that approved much larger increases than the companies' request Importantly, these states' price adjustments did not jeopardize universal service. In

Section VI, I also discuss the experience of some of the states that have already implemented serious rate rebalancing plans, including Massachusetts where I presided as Chairman through one such adjustment.

III. THE COMPANIES' PLANS WILL RESULT IN A "MORE ATTRACTIVE COMPETITIVE LOCAL EXCHANGE MARKET FOR THE BENEFIT OF RESIDENTIAL CONSUMERS" AND WILL INDUCE "ENHANCED MARKET ENTRY"

Q. HOW DO YOU JUDGE WHETHER THE COMPANIES' PLANS MEET THE CRITERIA OF § 364.164 (1) (a) AND (b)?

A. § 364.164 (1) (a) states that the companies' plans should remove the current support for basic local telecommunications services that is impeding the creation of a more attractive competitive local exchange market for the benefit of residential consumers. In order for the companies' plans to meet the first criterion, they must show that the plans remove—or at a minimum reduce—support for basic local telecommunications. By so doing, they create a more "attractive" competitive local exchange market, because the price to be competed against by new entrants is raised to more closely reflect the real economic costs of doing business. The second criterion for the Commission's consideration is § 364.164 (1) (b) which simply states that the plans should induce enhanced market entry and no distinction is made between residential or business consumers.[7]

[7] There are other criteria in § 364.164 (1) that I do not discuss but that are the subject of the companies' respective witnesses.

Therefore, in evaluating whether the companies' plans meet the criteria in these sections, I must ascertain whether the plans: (1) remove current support for basic local telecommunications services, and (2) will likely result in a more attractive competitive environment that would benefit residential consumers and induce enhanced market entry.

Q. DO THE COMPANIES' PLANS REMOVE CURRENT SUPPORT FOR BASIC LOCAL TELECOMMUNICATIONS SERVICES?

A. Yes, the companies' plans significantly decrease current support for basic local telecommunications services. The plans do this by reducing the prices of a service that has historically been set by regulators to provide an important source—but by no means the only source—of support for basic local services, namely, intrastate switched network access.

Q. WHY DO YOU BELIEVE THAT INTRASTATE SWITCHED NETWORK ACCESS CURRENTLY SUPPORTS BASIC LOCAL TELECOMMUNICATIONS SERVICES?

A. There are two reasons. The first is the historical rate design policy prevalent in telecommunications regulation in Florida and throughout the United States. As I mentioned earlier, historically, telecommunications rate design was premised on the policy goal—at times stated and sometimes left implicit—of keeping the price of basic local telecommunications low or as low as possible. This policy began early on in telecommunications regulation and was accomplished through the rate design mechanisms that were part and parcel of traditional regulation. Traditional regulation required two broad steps. The first was to determine a revenue requirement that was sufficient to meet the prudently incurred operating expenses and a reasonable return on prudently invested

capital. The second broad step was the rate design process, which determined the price of each regulated service to ensure that the regulated company had the opportunity to recover its revenue requirement from its regulated service.[8] Normally, a proper rate design process would require that the price of any service recover at least its underlying cost and, in addition, contribute to the firm's shared and common cost in some manner. At times that manner was consistent with economic efficiency goals—as when demand considerations were taken into account—and at other times it was more reflective of other policy considerations—as when an equal percentage markup was applied across the board to the different services.

For basic local services, however, in most instances the price was set on a residual basis without taking into consideration the underlying cost of providing basic local telecommunications. That is, the goal of residual pricing was to keep basic local prices low, or as low as possible, and to recover more revenue from other telecommunications services, constrained by what consumers were willing to pay for the non-basic telecommunications services and by—as competition began to become more prevalent in telecommunications markets—the threat of customers bypassing the public switched telecommunications network.

Prior to divestiture of AT&T in 1984, toll prices provided the bulk of support for basic local telecommunications services. As technological advances lowered the cost of providing toll services, toll prices did not decrease commensurately and were used as a

[8] I say opportunity to recover its revenue requirement because the regulatory process does not generally guarantee a regulated company a certain return, it only provides the regulated company the opportunity to earn a certain return.

means to support basic local telecommunications services—i.e., to keep the prices of basic local lower than would otherwise be the case. After divestiture of AT&T, interstate and intrastate switched network access services were substituted as a means of supporting basic local telecommunications services.

Notably, even after the substitution of price cap regulation for traditional regulation, the cross subsidies that were present under traditional regulation have been maintained.

The notion that intrastate switched network access services have been used as a source of support for basic local telecommunications is confirmed in the Florida *Senate Staff Analysis and Economic Impact Statement on the Tele-Competition Act*, where it states:

> According to the commission, intrastate network access service rates were set well above the incremental cost of providing the service in order to keep rates for basic local telecommunications service as low as possible and to encourage subscribership.[9]

The second reason why I believe that intrastate access services currently support basic local service is cost considerations. As described in the testimonies of their witnesses, the companies have established that the price of residential basic local telecommunications services is below forward-looking direct cost estimates. From an economic perspective, whenever the revenues from a service are insufficient to recover its forward-looking direct costs, that service is said to be in receipt of an economic subsidy. The source of the subsidy—including that for residential basic local services—comes from all those services

[9] *See* Senate Staff Analysis and Economic Impact Statement on CS/SB 654, April 8, 2003.

that are priced above their respective forward-looking direct costs. As a whole, these services contribute to the support of residential basic local. Because intrastate access services are priced significantly above their forward-looking direct costs, this means that intrastate switched network access services are supporting basic local service.

Q. DOES THIS IMPLY THAT THERE MAY BE OTHER SERVICES, BESIDE INTRASTATE ACCESS SERVICES, THAT MAY ALSO BE SUPPORTING BASIC LOCAL TELECOMMUNICATIONS SERVICES?

A. Yes, that is correct. In general, for multi-product firms, where there are significant amounts of shared and common costs, firms must, in the aggregate, price their services above forward-looking direct costs in order to earn sufficient revenues to remain viable. When one service is priced below its forward-looking direct costs, as is the case for residential basic local telecommunications services, other services that are priced above forward-looking direct costs are supporting the service that is priced below its own forward-looking direct costs.

The Florida Legislature, however, has specifically determined that it is the support provided by intrastate switched network access that is to be reduced. The Tele-Competition Act calls for rebalancing to take the form of lowering intrastate access rates to parity—over a 2 to 4 year period—with interstate switched network access rates and to simultaneously increase basic local telecommunications services by an amount sufficient to make up the revenue over the same time period. Under this approach, there is still no guarantee that residential basic local services recover <u>at least</u> their forward-looking direct costs once intrastate access rates are set to parity with interstate switched access rates. In fact, according to the companies' evidence, residential rates will still be below forward-

looking direct costs even when intrastate switched network access rates reach parity with the interstate rates.

Therefore, while the companies' plans are consistent with the criteria to be considered by the Commission, the plans do not result in the complete rebalancing of rates. Thus, there will still likely be some (lesser) distortions in prices even after the implementation of the plans.

Q. AS AN ECONOMIST, DO YOU BELIEVE THAT REBALANCING IS COMPLETED ONCE BASIC RESIDENTIAL PRICES ARE SET AT FORWARD-LOOKING DIRECT COSTS?

A. While having basic local services recover at least their underlying forward-looking direct costs is a good first step, it would not necessarily result in economically efficient prices. As I discuss in greater detail below in Section IV, economically efficient prices require that a multi-product firm's shared and common costs be recovered through markups on each service or product above forward-looking direct costs in a manner that least distorts economic efficiency. Therefore, to have economically efficient basic local prices would likely require that basic local services be priced above forward-looking direct costs. However, as markets become more competitive, markups will be limited by the need to be competitive with other firms in the market.

Q. HAVING ESTABLISHED THAT THE PLANS REMOVE CURRENT SUPPORT FOR BASIC LOCAL, § 364.164 (1) (a) PROVIDES THAT, AS A RESULT OF THE REMOVAL, THEY WILL RESULT IN A MORE ATTRACTIVE COMPETITIVE LOCAL EXCHANGE MARKET FOR THE BENEFIT OF RESIDENTIAL

CONSUMERS. WILL THE COMPANIES' PLANS MEET THIS CRITERION?

A. Yes, the companies' plans will create a more attractive competitive local exchange market for the benefit of residential consumers. Economic theory and empirical research both indicate that this will likely be the case. I discuss these two factors below.

Q. PLEASE DISCUSS WHY YOU BELIEVE THAT ECONOMIC THEORY SUGGESTS THAT THE COMPANIES' PLANS WILL LIKELY RESULT IN A MORE ATTRACTIVE COMPETITIVE LOCAL EXCHANGE MARKET FOR THE BENEFIT OF RESIDENTIAL CONSUMERS?

A. One of the key components of the companies' plans is that intrastate access revenues will be decreased in a revenue-neutral manner by increasing the price of (and revenue from) basic local telecommunications services for residential consumers. The cost information provided by the companies in this proceeding indicates that residential basic local telecommunications prices are currently below forward-looking direct costs. Increasing the price of a service, especially a service that is below forward-looking direct costs, will make for a more attractive market for actual and potential competitors. Competitors will not rationally try to compete against heavily subsidized prices.

Q. WOULD YOU PLEASE EXPLAIN WHY YOU BELIEVE THIS TO BE THE CASE?

A. In a market economy, prices are the essential tool that send signals to market participants that, in turn, determine market behavior and outcomes. For example, as prices increase or decrease, consumers alter their consumption decision because the value consumers place on goods and services changes in relation to price. Producers alter their production, investment and research and development decisions as well, because as prices increase or

decrease, profits change along with them. It is the search for profits that drives firms to enter or expand into new markets. As prices change, potential entrants into the market will be affected as well. Lower prices may act to keep new firms from entering the market and higher prices more reflective of cost will tend to attract new firms into the market.

Like any other firm, the investment decision of a telecommunications competitor is based on the present value of the cash flows that the investment project is likely to generate over the useful economic life of the project. Holding all other factors constant, when the price of a service increases, a cash flow analysis would show that the investment project becomes more profitable (or less of a loss) and thus more attractive. In the case before us, an increase in the price of basic local telecommunications service would increase the revenues from residential basic local services in a cash flow analysis, thus increasing the attractiveness of providing those residential services. As a result of rate rebalancing, where the companies plan to raise residential basic local prices, the residential local exchange market will look more attractive to all actual and potential telecommunications providers of residential services.

Q. WILL THE COMPANIES' PLANS ALSO PROVIDE INCREASED INCENTIVES FOR OTHER COMPETING TELEPHONY TECHNOLOGIES?

A. Yes. An important reason for opening local telecommunications markets to competition is the belief that technological change is proceeding so rapidly that competitive markets will do a much better job than monopoly of discovering which technologies can or cannot succeed in the long run. For example, access to customers for their telecommunications needs comes in the form of fixed-wireline access, wireless access, cable telephony,

Internet, and potentially satellite and even access via electric utilities. Of course, not all of these technologies will necessarily survive in the long run and competition will likely lead to a mix of technologies surviving and providing the lowest possible cost for each consumer's telecommunications needs.

However, in order for the lowest-cost mix of technologies to remain in the market, prices and the signals they send must not be distorted and must reflect the underlying cost of providing service. The companies' plans move positively in this direction and encourage new entrants—regardless of the chosen technology—to enter or expand in the marketplace because even competitors using lower-cost (or more attractive) technologies may not be able to compete against a subsidized ILEC price that does not fully reflect its own costs. This would be a loss for consumers and the Florida economy.

Q. IS THERE EVIDENCE THAT OTHER FORMS OF ACCESS ARE COMPETING WITH FIXED-WIRELINE ACCESS?

A. Yes. The Florida Commission has recognized the actual and potential substitution occurring between fixed-wireline and other forms of access, including wireless and emerging IP-telephony providers. As the Commission states:

> Regarding the substitution of technology and services, as they are being found to be close substitutes to traditional wireline services, both wireless and emerging broadband IP-telephony providers must be included in the analysis.[10]

[10] *See*, Florida Public Service Commission, *Telecommunications Market in Florida Annual Report on Competition As of June 30, 2002*, December 2002, p. 6.

In the same report, the Florida Commission cites nation-wide data indicating that about 5% of U.S. wireless subscribers have disconnected wireline service and conclude that substituting wireless for wireline services appears to be a national trend.[11] Moreover, as the same report concludes, Florida may be especially susceptible to this phenomenon because of the large population in Florida that also has residences in other states. For many of these consumers, "it makes little sense to continue paying for telephone service that sits idle much of the year when wireless enables them to stay connected wherever they are."[12]

The Florida Commission has also concluded that cable providers are competing directly with fixed-wireline providers. The Commission cites to national data that shows that by second quarter of 2002, there were 2.5 million cable telephony subscribers and that cable companies expect to see one-third of their digital cable households take cable telephony service by 2005.[13]

There is evidence that the Tele-Competition Act is already having a positive impact on competitors' incentive to enter and expand in the Florida market. On July 18, 2003, Knology, a provider of broadband and voice telephony services, announced it has entered into a definitive agreement to purchase certain assets from Verizon Media Ventures, Inc.[14] Knology offers local and long distance telephone service and its purchase of Verizon's Americast cable system will permit it to compete directly with Verizon. In its press

[11] *Ibid,* at 7.

[12] *Ibid,* at 9.

[13] *Ibid,* at 10.

[14] *See,* Knology Press Release July 18, 2003, *Knology Announces Agreement to Purchase Broadband Asset*.

release announcing its decision, Knology stated:

> In commenting on this transaction, Knology noted that the Tele-Competition Act recently enacted in Florida positively influenced its decision to expand operations in the state. This Act, as written by the Florida Legislature and supported by Governor Bush, laid the foundation for companies like Knology to enter the Florida market, and offer competitive services and products to consumers.

Q. IS THERE EMPIRICAL EVIDENCE THAT SUPPORTS YOUR VIEW THAT RATE REBALANCING WILL LIKELY MAKE THE RESIDENTIAL LOCAL EXCHANGE MARKET MORE ATTRACTIVE?

A. Yes, there is empirical evidence. Two of my colleagues at NERA investigated empirically whether low residential basic local rates were having any impact on competition in the states and, specifically, whether low rates were hindering the development of residential competition.[15] In that paper, the authors hypothesized that inefficient local exchange prices are having an impact on competition and that, specifically, low residential prices are inhibiting competition for residential customers. To test their hypotheses, the authors compared how local competition varied across the different states depending on how "unbalanced" were local exchange prices. Specifically, the authors estimated several cross-section econometric models of facilities-based competition, controlling for things such as cost and demand considerations in the different states. The authors also included several policy variables, including one that measured the degree to which residential local

[15] *See*, Agustin J. Ros and Karl McDermott, "Are Residential Local Exchange Prices Too Low? Drivers to Competition in the Local Exchange Market and the Impact of Inefficient Prices," in Michael Crew, *Expanding Competition in Regulated Industries*, Kluwer Academic Publishers, 2000.

exchange prices were "distorted" in each state. The authors summarized their results, as they pertained to residential competition, as follows:

> Using OLS and GLS estimates we found a significant and positive association between states that have more "balanced" tariffs and residential competition. For two measures of residential competition used in our data, we found that "rebalancing" tariffs by 10% leads to approximately a 9% and 13% increase, respectively, in residential competition.[16]

In addition, James Eisner (an FCC staff member) and Professor Dale E. Lehman performed a somewhat similar study.[17] Eisner and Lehman state in their conclusion:

> ...in some specifications, there appears to be less competitive entry (principally facilities-based) where residential rates are lower. These findings are generally statistically significant at the 90% level.[18]

Finally, another empirical study examined rate rebalancing in Latin America and found that rate rebalancing in some Latin American countries has led to increases in the supply of main telephone lines by providing better incentives to market participants.[19]

In summary, both economic theory and the empirical literature suggest that the

[16] *Ibid.*, at 167.

[17] *See*, James Eisner and Dale E. Lehman, *Regulatory Behavior and Competitive Entry*, presented at the 14th Annual Western Conference Center for Research in Regulated Industries, June 28, 2001. The authors' main motivation appears to have been ascertaining how regulatory behavior—as it pertains to unbundled loop prices and 271 entry—affects competitive entry. Nevertheless, they control for local exchange prices as well.

[18] *Ibid.*, p. 25.

[19] *See*, Agustin J. Ros and Aniruddha Banerjee, "Telecommunications Privatization and Tariff Rebalancing: Evidence from Latin America," *Telecommunications Policy*, 24 (2000) 233-252.

companies' plans—by setting residential rates at more economically efficient levels—would likely make the residential local exchange marketplace more attractive to actual and potential competitors.

Q. BUT ISN'T IT THE CASE THAT CLECS ALREADY HAVE ENOUGH INCENTIVES TO SERVE LUCRATIVE RESIDENTIAL CUSTOMERS?

A. Yes, it is probably the case that CLECs have enough incentive to serve a subset of residential customers, namely those customers that are very profitable either because the cost of serving them is especially low or because their volumes are unusually high. But the promise of the Tele-Competition Act is to ensure that competition for residential customers is as broad and diffuse as is economically feasible, and by better aligning the prices of residential basic local services with their underlying costs, a broader base of residential customers will obtain the benefits of competition.

Q. § 364.164 (1) (b) PROVIDES THAT THE COMPANIES' PLANS CONSIDER THE EFFECT ON ENHANCED MARKET ENTRY. WILL THE COMPANIES' PLANS MEET THIS PROVISION?

A. Yes, the companies' plans will induce enhanced market entry. Above, I have discussed how the plans would likely create a more attractive competitive local exchange market for the benefit of residential consumers. This is an example of how the plans will induce enhanced market entry.

In general, the companies' plans will provide for improved entry signals into the local exchange market by diminishing distorted price signals that may encourage uneconomic entry into the overpriced markets. Prices that are free of distortions will lead to several

economically-efficient outcomes known as allocative, technical and dynamic efficiencies. First, efficient pricing assumes that the marginal cost that society incurs to produce goods and services reflects the value that consumers place on the good or service consumed, (allocative efficiency). Second, optimal signals are provided to firms in the industry (e.g., whether to increase production or exit the industry) and to potential entrants contemplating entering the market. This ensures that it is the lowest cost firms that stay in the market and provide goods and services. In this way the use of society's scarce resources is minimized (technical efficiency). Third, prices that adequately cover costs ensure that appropriate incentives exist for improvement in technology, increased research and development and higher quality goods and services (dynamic efficiency).

Q. UNDER WHAT CONDITIONS CAN IT BE SAID THAT PRICES ARE FREE OF DISTORTION, AND ARE THE COMPANIES' CURRENT PRICES FOR BASIC LOCAL SERVICES FREE OF DISTORTIONS?

A. Prices are free of distortion when: (1) they recover at least the forward-looking incremental cost of production and (2) for multi-product firms, markups above incremental costs take into account demand characteristics in the market, subject, of course, to the need for the firm to meet competition. As described in the companies' cost testimonies, the companies' prices for basic local residential services are not recovering the forward-looking direct cost of production. As such, prices for these services do not meet the economic criterion that prices should at a minimum recover the forward-looking direct cost of production.

By adopting the companies' plans, however, the Commission will be reducing significantly the distortions in the price of intrastate access and residential basic local

services and achieving the economically efficient outcomes described above.

IV. OTHER ECONOMIC BENEFITS FROM THE COMPANIES' PLANS

Q. ARE THERE OTHER ECONOMIC BENEFITS THAT WILL LIKELY ARISE FROM THE COMPANIES' REBALANCING PROPOSAL?

A. Yes, there are other economic benefits that will likely arise from the companies' rebalancing proposals. Both economic theory and empirical research suggest that rate rebalancing will likely increase economic activity in Florida as increased competition brings benefits to Florida consumers of telecommunications services.

Q. WOULD YOU PLEASE DESCRIBE WHY ECONOMIC THEORY SUGGESTS THAT RATE REBALANCING WILL INCREASE ECONOMIC ACTIVITY IN FLORIDA?

A. Rate rebalancing consists of increasing the prices of services that are priced below forward-looking direct costs and reducing the prices of services that are priced significantly above forward-looking direct costs. As mentioned earlier in my testimony, the history of telecommunications rate design is such that residential basic local prices were set low and usage services (such as toll and intrastate access services) were set high.

However, economic theory teaches that economic efficiency (and overall consumer welfare) is at its highest level when prices of goods and services in an economy are set at forward-looking direct cost. Of course, in industries where there are significant fixed costs—that give rise to economies of scale—and in multi-product firms where there are

significant amounts of shared and common costs, pricing services at forward-looking direct cost does not permit the firm to earn sufficient revenues to recover all its costs. Under such conditions, markups above forward-looking direct costs are required. Specifically, as competition develops, those services that are more price elastic will likely receive a proportionately lower markup above cost than those services that are more price inelastic.

Q. PLEASE DESCRIBE HOW REBALANCING RESULTS IN INCREASED ECONOMIC ACTIVITY IN FLORIDA?

A. The companies' plans will lower intrastate access prices, which will in turn result in lower intrastate toll prices, as required by the Tele-Competition Act. As a result of the reduction in intrastate toll prices, Floridia consumers will use more toll services. This will create value for them that they are not now receiving. This, in turn, will reflect an increase in economic activity in Florida. In addition, and of more direct importance to this proceeding, more cost reflective prices for local service will send signals to competitors that will more efficiently guide their investment decisions, and in all likelihood, increase their investment beyond what it is in the face of today's artificially low prices. Thus, rebalancing will generate significant gains in economic activity in Florida. It is important to stress the point that demand for access to the network by consumers depends not only on the price of network access but it also depends on the value that consumers obtain (consumers' surplus) from using the network. While higher network access prices may, in theory, decrease the quantity of access consumed, the concomitant decrease in long distance price will increase the quantity of access consumed. Empirical evidence suggests

that, in net, we may well find that rebalancing leads to more consumers subscribing to the network.[20]

Q. IS THERE EMPIRICAL EVIDENCE THAT QUANTIFIES THE AMOUNT OF ECONOMIC BENEFIT THAT A REBALANCING PLAN CAN GENERATE?

A. Yes, there is empirical support. There have been several studies that have examined the welfare gains arising from rate rebalancing. One of the first studies found that, for the U.S. as a whole, the loss from overpricing long distance service to business and residential consumers in 1983 was around $10 billion, a finding that was confirmed in subsequent research.[21] More recent research confirms the significant gains in economic welfare that can be achieved from more economically rational prices. For example, a 2000 study by Robert Crandall and Leonard Waverman (a NERA colleague) found the total cost of the current rate design—i.e., lower basic local prices and higher long distance prices—to be anywhere between $2.5 to $7.0 billion per year, depending on the assumptions made.[22]

V. COST ISSUES

Q. WHAT IS THE CORRECT COST CONCEPT TO USE FOR DETERMINING WHETHER A SERVICE IS RECEIVING AN ECONOMIC SUBSIDY?

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[20] *See,* Hausman, J., T. Tardiff, and A. Belinfante, "The Effects of the Breakup of AT&T on Telephone Penetration in the United States," *The American Economic Review*, Vol. 83, May 1993, pp. 178-184.

[21] *See,* John T. Wenders and Bruce L. Egan, "The Implications of Economic Efficiency for U.S. Telecommunications Policy." *Telecommunications Policy* 10 (1986): 33-40 and Lewis Perl, "Social Welfare and Distributional Consequences of Cost-Based Telephone Pricing." Paper presented at the Thirteenth Annual Telecommunications Policy Research Conference, Airlie, Va. April 23, 1985.

[22] *See*, Robert Crandall and Leonard Waverman, *Who Pays for Universal Service?: When Telephone Subsidies Become Transparent*, Brookings Institute, (2000), p. 119.

A. From an economic perspective, use of forward-looking direct costs (economic costs as opposed to embedded or historical costs) is the proper basis for determining whether a specific service is in receipt of an economic subsidy. The embedded cost or historical cost of an activity is a record of the costs a firm attributes to the pursuit of its activity in a given (past) accounting period. That cost reflects what the firm actually paid for capital equipment,[23] its actual costs of operating and maintaining that equipment, and other costs incurred in operating the enterprise. By contrast, the economic cost of an activity is the actual forward-looking cost of accomplishing that activity in an efficient manner. In contrast to embedded costs, forward-looking costs are those associated with present and future uses of the firm's (or society's) resources. Only these forward-looking costs are relevant for making present and future production and investment decisions, for placing resources in alternative uses, and for setting efficient prices for the services to be provided presently or in the future.

According to the evidence presented by the companies, their residential basic local rates are below forward-looking direct costs and I conclude, therefore, that those rates are in receipt of an economic subsidy.

Q. THE COMPANIES' PLANS ARE BASED UPON THE FACT THAT THE LOCAL LOOP IS NOT A SHARED OR COMMON COST AND THAT ITS COST IS CAUSED SIMPLY BY PROVIDING CUSTOMERS ACCESS TO THE TELEPHONE SYSTEM AND CANNOT APPROPRIATELY BE SPREAD

[23] Embedded costs also include the annual depreciation expenses associated with the stock of equipment that (1) was purchased in the current and previous years and (2) is still in use.

AMONG THE REMAINING TELEPHONE SERVICES. DOES THE FLORIDA COMMISSION AGREE WITH THIS APPROACH REGARDING THE LOCAL LOOP?

A. Yes, it does. In a report to the Florida Legislature in 1999, the Commission explicitly rejected the notion that the cost of the loop should be recovered from non basic local telecommunications service.[24] In that report, the Commission stated:

> Is the cost of local loop facilities properly attributable to the provision of basic local telecommunications service? By definition, yes. Section 364.02(2), Florida Statutes, defines "basic local telecommunications service as"
>
> > Voice grade, flat-rate residential and flat-rate single-line business local exchange services which provide dial tone, local usage necessary to place unlimited calls within a local exchange area, dual tone multi-frequency dialing, and access to the following emergency services such as "911," all locally available interexchange companies, directory assistance, operator services, relay services, and an alphabetical directory listing.
>
> Given such an identification of the cost object to be studied, the principle of cost causation leads one to the unavoidable conclusion that the decision to have local service leads to the incurrence of loop costs.[25]

[24] *See*, "Report of the Florida Public Service Commission on the Relationship Among the Costs and Charges Associated with Providing Basic Local Service, Intrastate Access, and Other Services Provided by Local Exchange Companies, in Compliance with Chapter 98-277, Section 2(1), Laws of Florida," Florida Public Service Commission Tallahassee, Florida February 15, 1999.

[25] *Ibid*, at 51.

VI. UNIVERSAL SERVICE WOULD NOT BE PUT AT RISK AS A RESULT OF THE COMPANIES' PLANS

Q. SHOULD THE COMMISSION BE CONCERNED ABOUT UNIVERSAL SERVICE?

A. While it is true that, in theory, as the price of basic local service increases, some consumers may decide the new price is above the value he or she places on the service—and may, as a result, decide to do without telephone service—I do not believe that, in practice, this would occur, or occur to such an extent as to jeopardize universal service in Florida. There are several reasons why I believe this is the case.

First, although low-income subscribers may be more sensitive to price increases than are middle and higher income users, the Tele-Competition Act does two things to help low income consumers. It provides that, in the event of an increase in residential basic local service prices, low-income consumers who are Lifeline customers will be exempted from the price increase; and, it expands the number of Lifeline-eligible customers to 125 percent of the federal poverty level. These steps should go far to address any problems of affordability.

Second, the price elasticity of demand for access to the network is quite low, meaning that the vast majority of consumers will continue to subscribe. Specifically, the price elasticity of demand measures the percentage impact on demand given a percentage change in price. Previous research has demonstrated that customers generally do not disconnect their

phone service when prices for basic local service increase.[26]

Third, and very importantly, in addition to its own price, the demand for residential basic local service is determined by the amount of value consumers obtain from using the services produced by the network, i.e., local calling, intraLATA toll, interLATA toll, vertical services and newer services such as broadband Internet access. As prices for these services decrease over time due to competitive pressure and technological innovation, the value that consumers place on having access to the network increases and so, therefore, does their demand to stay on the network.[27] The companies' plans call for rate increases phased in over a two year period and to the extent that prices for complementary goods decrease so will consumers' desire to remain on the network increase. This helps reduce, or may even offset, the negative effect of the price increase.

Finally, as discussed above, less distorted prices should provide better incentives for competitors to compete for residential consumers. Competition brings with it improved quality, different selection of goods and services bundled together in a way that customers find attractive, and lower prices. These factors provide additional reasons why during the phase-in period, customers will likely place increased value on subscribing to the network, thus mitigating the effects of any local rate increase.

To the extent the Florida Commission is concerned with the few remaining users who may

[26] *See,* Lester D. Taylor, (1994), *op. cit.*

[27] Hausman, J., T. Tardiff, and A. Belinfante, "The Effects of the Breakup of AT&T on Telephone Penetration in the United States," *The American Economic Review*, Vol. 83, May 1993, pp. 178-184.

decide to drop off the network it is also important to be aware that alternatives to the fixed network are growing and at least some customers may be turning to alternative means of meeting their communications needs. For example, the extraordinary growth of wireless service, driven by lower wireless prices and pricing plans that include a "bucket" of minutes provides customers with more meaningful opportunities to use wireless service as a substitute to wireline service.

Q. SHOULD THE COMMISSION BE CONCERNED IF CUSTOMERS DROP OFF THE FIXED NETWORK BUT INSTEAD RELY PRIMARILY ON OTHER FORMS OF ACCESS?

A. No. An important goal for policymakers has been to ensure that as many consumers as possible have access to the public switched telecommunications network, irrespective of how that access is obtained. When a customer drops off the fixed-line network and accesses the public network via wireless access, this is simply a substitution effect caused by the customer choosing between fixed and wireless access. This is not a universal service concern for policymakers.

Q. DR. GORDON, HAVE OTHER STATES IMPLEMENTED RATE REBALANCING?

A. Yes, there are other states that have implemented rate rebalancing including California, Illinois, Ohio, and in Massachusetts where I served as Chairman. Even in Maine, where by statute basic residential services are to be set as low as possible and where I also served as Chairman, they have recently approved a rebalancing plan.

Q. WOULD YOU PLEASE DESCRIBE THE RATE REBALANCING PROCESS IN

MASSACHUSETTS?

A. The process for changing prices in Massachusetts began before I became Chairman of the Massachusetts Commission and continued during my tenure. In Massachusetts, residential fixed monthly charges were increased significantly, with offsetting decreases in business, toll, and carrier access prices. The Massachusetts Commission early on after divestiture recognized the problems that historic pricing policies were creating, as other (especially institutional) barriers to market entry were being eliminated, and thus ordered a change in price structure:

> "properly defined incremental costs should be used as the primary basis for pricing all services, including local exchange service ...to the extent that current rates do not reflect an appropriate allocation of costs, the [MDPU] will, consistent with the need to avoid major discontinuities in rate levels, move toward that goal." IntraLATA Competition, D.P.U. 1731 (1985), p. 36-38.

> "Traditionally, the pricing of telephone service was based on a method whereby residential monthly exchange rates were priced below cost in order to promote universal service; and long-distance, toll, and business rates were priced above cost in order to subsidize residential exchange rates. While this system succeeded in serving a social purpose, it was a pricing scheme not conducive to the development of a fully-competitive market, in which the benefits associated with competition would be realized by all customers." NET, D.P.U. 93-125 (1994), pp. 10-11.

In Massachusetts, moving prices more in line with incremental costs required a significant shift in revenue recovery from usage-based prices, such as intraLATA toll and intrastate

carrier access, to fixed monthly prices for all classes of customers. In addition, because the MDPU found that there were no significant cost differences in serving different classes of customers, the price-rebalancing process also entailed a further shift in revenue recovery from business customers to residential customers. Of course, the necessary changes were not made overnight. The MDPU established a series of annual, revenue-neutral, price-rebalancing investigations in order to achieve its goal over time.

When the Massachusetts price-rebalancing process ended in January of 1994 (with the adoption of a price cap plan), the price for basic residential dial-tone service (1MR) had risen from about $3.00 per month in 1990 to $9.91 per month in 1994 (net of the SLC).[28] Comparable increases also occurred for residential flat-rate service (1FR), which was the most popular service in Massachusetts, at that time. Flat rate residential prices had ranged from $9.95 in rural areas to $12.38 in urban areas. The rebalancing process moved flat rate residential prices to $16.85 state wide. During this period, the average increase for residential consumers was $2.18 per year over four years and, according to the DTE, record evidence shows virtually no impact on residential telephone subscriber penetration.[29] Because the price-rebalancings were revenue-neutral, these increases were completely offset by decreases in prices for other services, notably residential and business intraLATA toll and carrier switched access.

Massachusetts was one of the first states to open toll and local markets to competitive

[28] I was Chairman of the MDPU for the last of these annual investigations.

[29] *See*, "Re Verizon New England, Inc. dba Verizon Massachusetts D.T.E. 01-31-Phase II," *Public Utilities Reports – 223 PUR4th,* p. 397.

entry, and the price rebalancing helped to lessen opportunities for uneconomic bypass and thus promoted the development of an efficient competitive process.

More recently, Massachusetts has continued to better align prices with their underlying costs by reducing switched access and increasing residential dial-tone rates. Specifically, the DTE authorized the ILEC to implement a one-time increase of $2.44 to its residential dial-tone line charge. In commenting on its decision, the DTE stated:

> Moreover, the department finds that with the $2.44 increase in the dial-tone line charge, competitive local exchange carriers (CLECs) can profitably enter and serve the residential telephone market in Massachusetts.[30]

The DTE concluded that a $2.44 increase will not harm the Department's universal service goals, based on similarity to the several, annual $2.18 increase in the early 1990s rebalancing plans and comparable increases in several other states and in the Federal subscriber line charge since 2000. For example, the Maine PUC approved a $1.78 increase in Verizon's basic monthly per line rate in May 2001 and the New York Public Service Commission authorized a two-year Incentive Plan which permitted an increase of $1.85 on March 1, 2002 and another $0.65 on March 1, 2003 for a total increase of $2.50 in the space of a year. The FCC's Federal subscriber line charge has increase from $4.35 in July 2000 to $6.50 in July 2003.

Q. PLEASE DISCUSS MAINE'S EXPERIENCE WITH RATE REBALANCING?

A. Significant rate rebalancing has been achieved in Maine in recent years, with no

[30] *Ibid*, p. 361.

noticeable impact on telephone subscribership levels. In 1997, the Maine legislature (M.R.S.A. 35-A, §7101-B) directed the Maine Public Utility Commission to establish, notwithstanding any other provision of state law, intrastate access rates that are less than or equal to interstate access rates established by the FCC (*i.e.*, parity with interstate access rates) by May 30, 1999. At the time, Bell Atlantic's intrastate access rates were $0.26 per minute, significantly higher than its then-current Federal interstate access rate of about $0.07 per minute.

Subsequently, on March 17, 1998, the Commission approved an Order (Docket No. 94-123 reopened) that approved a stipulation between Bell Atlantic-Maine (now known as Verizon-Maine) and a group of intervenors, including the Commission's Advocacy Staff and the Public Advocate. This stipulation allowed Bell Atlantic-Maine to increase its basic local exchange rates by a total of $3.50 by May 30, 1999, with steps of $1.50 in 1998 and $2.00 in 1999. This was followed by another increase of $1.78 in 2000.

Maine continues to have the highest telephone penetration rate in the country—about 98 percent of Maine's households have telephone service.[31] In addition, lower intrastate toll rates have benefited some customer classes, especially those customers in rural areas with relatively small toll-free calling areas.

Q. WHAT OTHER STATE EXPERIENCES DO YOU BELIEVE ARE RELEVANT?

A. In California in 1994, the Commission approved a rebalancing plan for GTE and Pacific

[31] MPUC Annual Report 2002, pp. 43.

Bell. GTE's residential rates immediately went from $9.75 to $17.25 while Pacific's residential rates went from $8.35 to $11.25.[32] Recently, as part of a rebalancing plan for Sprint's local telephone company in Ohio where intrastate access fees were lowered to mirror Federal charges, the Commission approved the creation of an end user charge of $4.10 for residential customers and $6.00 for single-line business.[33]

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

[32] *See*, Decision 94-09-065, *et. al.*, September 15, 1994.

[33] *See*, The Public Utilities Commission of Ohio, Case No. 00-127-TP-COI and 01-1266-TP-UNC, June 28, 2001.

ATTACHMENT A

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Dr. Kenneth Gordon, as of April 2001, is a Special Consultant with National Economic Research Associates, Inc. specializing in utility regulation and related issues. Prior to that date, Dr. Gordon was a Senior Vice President with National Economic Research Associates. He was Chairman of the Massachusetts Department of Public Utilities from January 1993 to October of 1995. He came to the Massachusetts Commission from the Maine Public Utilities Commission, where he held the office of Chairman from 1988 through the end of 1992. Prior to that, he was an Industry Economist at the Federal Communications Commission's Office of Plans and Policies. Prior to that, he taught at several colleges since 1965, the most recent position having been at Smith College.

Dr. Gordon was an active member of the National Association of Regulatory Utility Commissioners (NARUC) and served as president of that organization in 1992. He was also a member of the Executive Committee, and the Committee on Communications of NARUC. He has served as Chairman of the New England Conference of Public Utilities Commissioners Telecommunications Committee, and is a former Chairman of the Power Planning Committee of the New England Governors' Conference. He currently also serves on several boards and committees. Dr. Gordon has authored a number of publications and lectures widely on topics related to utility regulation.

Dr. Gordon is a graduate of Dartmouth College and holds a doctorate in economics from the University of Chicago.

EDUCATION

University of Chicago	Ph.D	1973
University of Chicago	M.A.	1963
Dartmouth College	A.B.	1960

EMPLOYMENT

April 2001 -	**National Economic Research Associates, Inc.,** Cambridge, MA Special Consultant
August 1996 – March 2001	**National Economic Research Associates, Inc.,** Cambridge, MA Senior Vice President
November 1995 – July 1996	**National Economic Research Associates, Inc.,** Washington, D.C. Senior Vice President
October 1995	**Consulting Economist**
January 1993 - October 1995	**Massachusetts Department of Public Utilities** Chairman
October 1988- December 1992	**Maine Public Utilities Commission** Chairman
1980 - 1988	**Federal Communications Commission, Office of Plans and Policy** Industry Economist
1965 - 1980	**University and College Teaching** (most recently at Smith College)
1963 - 1964	**University of Chicago** Research Associate

CURRENT APPOINTMENTS AND MEMBERSHIPS

Telecommunications Policy Research Conference
Chair, 1995-1996
Board Member, 1994

Energy Modeling Forum (EMF 15, A Competitive Electricity Industry),
Stanford University
Member

American Economic Association

Transportation and Public Utilities Group, AEA

PAST APPOINTMENTS AND MEMBERSHIPS

National Association of Regulatory Utility Commissioners
Communications Committee, 1990 - 1995
Executive Committee, 1991-1995
President, 1992

New England Conference of Public Utility Commissioners
Power Planning Committee
Chairman

Governor's Electric Utility Market Reform Task Force
Co-Chairman

Boston University Telecommunications Forum
Advisor

Center for Public Resources, Legal Program to Develop Alternatives to Litigation
Chairman, Utilities Committee

Office of Technology Assessment, Advisory Panel on International Telecommunications Networks

Bellcore Advisory Committee,
Member and Chairman, 1993 to 1996.

ACTIVITIES

Participant in numerous regional and state committees, organizations, and task forces.

Participant in various NARUC/DOE conferences on gas and electricity issues.

Frequent speaker on electric, telephone and environmental issues nationally.

TESTIMONIES

Before the New York State Public Service Commission, on behalf of Rochester Gas & Electric Company, direct testimony regarding the determination of merger-enabled savings. May 16, 2003.

Before the Connecticut Department of Public Utility Control, on behalf of Connecticut Natural Gas Corporation and the Southern Connecticut Gas Company, Docket Nos. 99-09-03PH02, 99-04-18PH03 and 01-04-04, direct testimony regarding the determination of merger-enabled gas cost savings. April 28, 2003.

Before the Iowa Utilities Board, on behalf of Iowa Telecommunications Services, Inc., rebuttal testimony regarding economic support of the company's rate adjustment proposal. August 6, 2002.

Before the Public Utilities Commission of Ohio, on behalf of the Cincinnati Gas & Electric (Company), Case No. 00-813-EL-EDI and 01-2053-EL-ATA, direct testimony on the imposition of a moratorium on minimum stay requirements with respect to switching between default (POLR) service and competitive service. Filed June 4, 2002.

Before the Iowa Utilities Board, on behalf of Iowa Telecommunications Services, Inc., direct testimony regarding economic support of the company's rate adjustment proposal. May 24, 2002.

Before the Florida legislature, on behalf of Bell South (Florida), oral testimony on rate rebalancing issues in telecommunications. Presented on January 30, 2002.

Before the Public Utilities Subcommittee of the Maryland House Environmental Matters Committee, on behalf of Southern Maryland Electric Cooperative and Choptank Electric Cooperative, testimony on affiliate issues relating to cooperatives' participation in non-core markets. Filed January 22, 2002.

Before the Indiana Utilities Regulatory Commission on behalf of Citizens Gas & Coke Utility and Indiana Gas Co., Inc., Case Nos. 37394GC50S1 and 37399GC50S1. Affidavit on why the use of RFP bids as a transfer price is appropriate. Filed December 10, 2001.

Before the Alberta Energy & Utilities Board, on behalf of EPCOR Transmission Inc., rebuttal testimony addressing code of conduct issues. November 2, 2001.

Before the Illinois Commerce Commission on behalf of Commonwealth Edison Company, Docket No. 01-0423, surrebuttal testimony on designing delivery service tariffs in a way that support economic efficiency. October 24, 2001.

Before the Illinois Commerce Commission on behalf of Commonwealth Edison Company, Docket No. 01-0423, rebuttal testimony on designing delivery services in a way that supports economic efficiency. September 18, 2001.

Before the Alberta Energy & Utilities Board, on behalf of Atco Group of Companies, Affiliate Proceeding Before the Alberta Energy and Utilities Board, Testimony of Rebuttal Evidence, submitted August 3, 2001

Before the Massachusetts Department of Telecommunications and Energy, on behalf of Berkshire Gas Company, direct testimony on benefits of incentive ratemaking and policy rational supporting company's plan. July 17, 2001.

Before the New Jersey Board of Public Utilities on behalf of Verizon New Jersey, Surrebuttal Testimony on structural separation and code of conduct issues (Docket No. TO01020095). Filed June 15, 2001 (panel testimony co-sponsored by C. Lincoln Hoewing).

Rebuttal Testimony on behalf of Qwest Corporation, Application of Authority to provide in-region interLATA service (Docket No. INU-00-2). Filed May 23, 2001.

Before the State of New York State Public Service Commission on behalf of Verizon New York (Case No. 00-C-1945): Initial panel testimony on the New York State competitive marketplace. May 15, 2001 (co-sponsored with William E. Taylor).

Before the Commonwealth of Kentucky Public Service Commission on behalf of E.ON AG, Powergen plc, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company, (Case No. 2001-104). Direct testimony on the benefits to consumer's resulting from the acquisition of Powergen by E.ON AG. May 14, 2001.

Before the New York State Public Service Commission on behalf of New York State and Gas Corporation, Affidavit on the proper treatment of proprietary competitive information by regulators. Affidavit filed April 23, 2001.

Before the Virgin Islands Public Services Commission, Government of the Virgin Island of the United States (PSC Docket No. 526) on behalf of Innovative Telephone, Rebuttal testimony regarding rural exemption, request for interconnection for Innovative Telephone. Filed April 10, 2001.

Before the State of New York Public Service Commission on behalf of Energy East Corporation, RGS Energy Group, Inc., New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation, and Eagle Merger Corp. Affidavit filed March 23, 2001.

Before the Indiana Utility Regulatory Commission on behalf of PSI Energy, Inc. (IURC Docket No. 41445-S1): Rebuttal testimony on the continued use of a purchased power tracker. Filed February 8, 2001.

Before the Pennsylvania Public Utility Commission on behalf of Verizon PA: Rebuttal testimony on why the structural separation model used in electricity does not apply to telecommunications. October 30, 2000.

Before the State of New York Public Service Commission on behalf of New York State Electric & Gas Corporation (Case 96-E-0891): Rebuttal testimony on market power analyses used in setting the backout credit. October 30, 2000. (Cosponsored with David Kathan.)

Before the Connecticut Department of Public Utility Control, on behalf of Connecticut Natural Gas Corporation (Docket No. 99-09-03, Phase II): Rebuttal testimony on role of incentive ratemaking. October 11, 2000.

Before the New York Public Utilities Commission on behalf of New York State Electric & Gas Corporation (Case 96-E-0891): Direct testimony on whether the backout credit set in a stipulation continues to be proper. October 4, 2000. (Cosponsored with David Kathan.)

Before the Virginia State Corporation Commission on behalf of Appalachian Power d/b/a/ American Electric Power Company (Docket Case No. PUA980020): Direct testimony regarding use of "asymmetric" transfer price rules. Filed September 20, 2000.

Before the Alberta Energy and Utilities Board, on behalf of ATCO Gas, ATCO Pipelines, and ATCO Electric: Direct testimony addressing affiliate issues. August 31, 2000.

Before the Iowa Utilities Board on behalf of Qwest Corporation (Docket No. INV-00-3): Direct testimony on deregulation of local directory assistance services. August 11, 2000.

Before the Connecticut Department of Public Utility Control on behalf of the Southern Connecticut Gas Company (Docket No. 99-04-18, Phase III): Late-filed Exhibit No. 159 (direct testimony) on the proper design of an incentive ratemaking plan. August 11, 2000.

Before the Connecticut Department of Public Utility Control on behalf of Connecticut Natural Gas Corporation (Docket No. 99-09-03 Phase II): Prefiled supplemental testimony addressing incentive rate-making issues. Filed August 11, 2000.

Before the Maine Public Utilities Commission on behalf of Central Maine Power Company. Surrebuttal testimony regarding the proper role of incentive ratemaking. August 10, 2000.

Before the Pennsylvania Public Utility Commission on behalf of Bell Atlantic PA (now Verizon PA): Direct testimony on the costs and problems with structural separation in telecommunications. June 26, 2000.

Before the Maine Public Utilities Commission on behalf of Central Maine Power Company (Docket No. 99-666): Rebuttal testimony on incentive rate-making issues. Filed June 22, 2000.

Before the Connecticut Department of Public Utility Control, The Southern Connecticut Gas Company Bench Request/Late file Exhibit (direct testimony) on proper implementation of incentive ratemaking. May 24, 2000.

Before the Public Utilities Commission of Ohio, on behalf of the Cincinnati Gas & Electric Company (Case No. 99-1658-EL-ETP): Supplemental testimony addressing shopping incentive and market power issues. Filed May 1, 2000.

Before the New York Public Service Commission on behalf of New York State Electric & Gas Corporation (NYSEG). Affidavit on the proper calculation of the billing credit customers would receive that switch. Filed April 20, 2000.

Before the Public Utilities Commission of Ohio, on behalf of the Cincinnati Gas & Electric Company: Direct testimony addressing shopping incentive and market power issues. Filed December 28, 1999.

Before the Federal Communications Commission, on behalf of Virgin Islands Telephone: Comments addressing Federal universal service support in the U.S. Virgin Islands. Filed December 19, 1999.

Before the Connecticut Department of Public Utility Control, on behalf of Connecticut Natural Gas Corp.: Direct testimony on performance based ratemaking. Filed November 8, 1999.

Before the Public Service Commission of Maryland, on behalf of Baltimore Gas and Electric Co., etc.: Reply testimony on "code of conduct" issues. Filed October 26, 1999.

Before the Illinois Commerce Commission, on behalf of Illinois Power Company: Rebuttal testimony addressing the pricing of metering and billing services. Filed October 21, 1999.

Before the Maine Public Utility Commission, on behalf of CMP Group, Inc.: Rebuttal testimony on issues related to acquisition of CMP by Energy East. Filed October 13, 1999.

Before the Illinois Commerce Commission, on behalf of Illinois Power Company: Direct testimony addressing the proper pricing of metering and billing services. Filed October 8, 1999.

Before the Public Service Commission of Maryland, on behalf of Baltimore Gas and Electric Co., etc.: Direct testimony on "code of conduct" issues. Filed October 1, 1999.

Before the Maine Public Utilities Commission, on behalf of Central Maine Power Co.: Direct testimony addressing the proposed alternative ratemaking plan. Filed September 30, 1999.

Before the Michigan Public Service Commission, on behalf of Ameritech Michigan: Direct testimony regarding economic consequences resulting from full avoided cost discount as applied to resale of existing contracts. Filed September 27, 1999.

Before the Public Service Commission of West Virginia, on behalf of Allegheny Power and American Electric Power: Rebuttal testimony on "code of conduct" issues. Filed July 14, 1999.

Before the Maine Public Utilities Commission, on behalf of Central Maine Power Co.: Direct testimony on the acquisition of CMP by Energy East. Filed July 1, 1999.

Before the Public Service Commission of West Virginia, on behalf of Allegheny Power and American Electric Power: Direct testimony on "code of conduct" issues. Filed June 14, 1999.

Before the Illinois Commerce Commission, on behalf of Commonwealth Edison: Rebuttal testimony addressing the design of delivery services tariffs. Filed May 10, 1999.

Before the Subcommittee on Energy and Power, on behalf of National Economic Research Associates: Statement addressing electric restructuring market power issues. Filed May 6, 1999.

Before the New Jersey Public Utilities Board, on behalf of the Edison Electric Institute: Direct testimony on the PUC's draft affiliate relations standards. Filed May 3, 1999.

Before the US District Court, Western District of Pennsylvania, on behalf of Allegheny Energy, Inc.: Expert report on regulatory issues regarding the recovery of stranded costs, filed May 1989

Expert report, on behalf of ICG/Teleport addressing the way in which Denver's ordinance allocates costs among users of public rights-of-way. Filed April 21, 1999.

Before the Ohio Senate Ways and Means Committee, on behalf of the Ohio Electric Utility Institute: Direct testimony regarding restructuring of Ohio electricity industry. Filed April 20, 1999.

Before the Federal Energy Regulatory Commission, on behalf of the Central Vermont Public Service Corporation: Rebuttal testimony regarding CVPSC's reasonable expectation to serve its Connecticut Valley affiliate. Filed April 8, 1999.

Before the Joint Committee on Utilities and Energy, on behalf of the Central Maine Power Company: Direct testimony on rate design for recovery of stranded costs. Filed March 23, 1999.

Before the Illinois Commerce Commission, on behalf of the Commonwealth Edison Company: Direct testimony on Commonwealth Edison's delivery service tariffs. Filed March 1, 1999.

Before the Indiana Utility Regulatory Commission, on behalf of Ameritech Indiana: Direct testimony on interconnection issues between RBOC and independent LECs. Filed February 19, 1999.

Before the Indiana Utility Regulatory Commission, on behalf of Ameritech Indiana: Direct testimony on competitive flexibility and alternative rate plan issues. Filed January 29, 1999.

Before the Rhode Island Public Utilities Commission, on behalf of Bell Atlantic-Rhode Island: Rebuttal testimony regarding economic consequences of granting a request by CTC to assume BA-RI retail contract without customer penalty or termination charges. Filed December 4, 1998.

Before the Michigan Public Service Commission, on behalf of Ameritech Michigan: Surrebuttal testimony regarding interconnection agreement. Filed November 9, 1998.

Before the Michigan Public Service Commission, on behalf of Ameritech Michigan: Direct testimony regarding interconnection dispute with a CLEC. Filed October 20, 1998.

Before the Wisconsin Public Service Commission, on behalf of the Edison Electric Industry: Surrebuttal testimony on utility diversification issues. Filed October 16, 1998.

Before the Wisconsin Public Service Commission, on behalf of The Edison Electric Institute: Supplemental direct testimony addressing DSM issues and electric restructuring. Filed October 13, 1998.

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Before the Massachusetts Department of Telecommunications and Energy, on behalf of Bell Atlantic-Massachusetts: Direct testimony commenting on economic consequences of CTC's policy of allowing customers to assign service agreements, without customer penalty, on resold basis to CTC. Filed August 17, 1998.

Before the Vermont Public Service Board, on behalf of Bell Atlantic-Vermont: Testimony regarding the economic consequences of granting a request by CTC to assume BA-VT retail contract without customer penalty or termination charges. Filed August 14, 1998.

Before the Illinois Commerce Commission, on behalf of Ameritech Illinois: Direct testimony on rate rebalancing plan. Filed August 11, 1998.

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Before the Arizona Corporation Commission, on behalf of Tucson Electric Power Company: Rebuttal testimony regarding the Commission's rules for introducing competition into the electric industry. Filed February 4, 1998.

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Before the Arizona Corporation Commission, on behalf of Tucson Electric Power Company: Testimony regarding the Commission's rules for introducing competition into the electric industry. Filed January 9, 1998.

Before the Maine Public Utilities Commission, on behalf of Central Maine Power Company: Testimony regarding the Commission's proposed affiliate rules. Filed January 2, 1998.

Before the Indiana Utility Regulatory Commission, on behalf of Ameritech Indiana: Testimony regarding Ameritech Indiana's proposal for an interim alternative regulation plan. Filed October 29, 1997.

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Before the Illinois State Senate, "Report on SB 55," on behalf of Illinois Power Company: Report and Testimony on proposed electric industry restructuring legislation in Illinois. Filed October 9, 1997.

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Before the Public Utilities Commission of Ohio, on behalf of Ameritech Ohio: Testimony responding to AT&T's "Complaint against Ameritech Ohio, Relative to Alleged Unjust, Unreasonable, Discriminatory and Preferential Charges and Practices." Filed July 7, 1997.

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Panelist, "Regulatory Panel: Who Has Jurisdiction?" Public Power in a Restructured Industry, Washington, D.C., December 8, 1995.

Participant, "Public Policy for Mergers in a Time of Restructuring," Harvard Electric Policy Group, Crystal City, Virginia, December 7, 1995.

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Panelist on "The Range of Uncertainty" at the Illinois Electricity Summit, Northwestern University, Evanston, IL., November 28, 1995.

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"Demand Side Management in Today's Electricity Market," Electricity Deregulation Commentary, Maine Policy Review, Winter 2001, pp. 19-21.

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"Economics and Telecommunications Privacy: A Framework for Analysis," Federal Communications Commission, Office of Plans and Policy, Working Paper No. 5, December, 1980. (With James A. Brown).

"The Effects of Minimum Wage on Private Household Workers" in Simon Rottenberg, (ed.), *The Economies of Legal Minimum Wages*, American Enterprise Institute, Washington, 1981.

"Deregulation, Rights and the Compensation of Losers, "in William G. Shepherd and Kenneth Boyer, eds., *Economic Regulation: A Volume in Honor of James R. Nelson*, University of Michigan Press, 1981. Also circulated as American Enterprise Institute Working Paper in Regulation, 1980.

"Social Security and Welfare: Dynamic Stagnation", *Public Administration Review*, March 1967.

INCIDENTAL TEACHING AND LECTURING

University and College
Yale School of Management and Organization
Harvard Law School, Telecommunications Seminar
Suffolk University Law School
University of Maine
Boston University

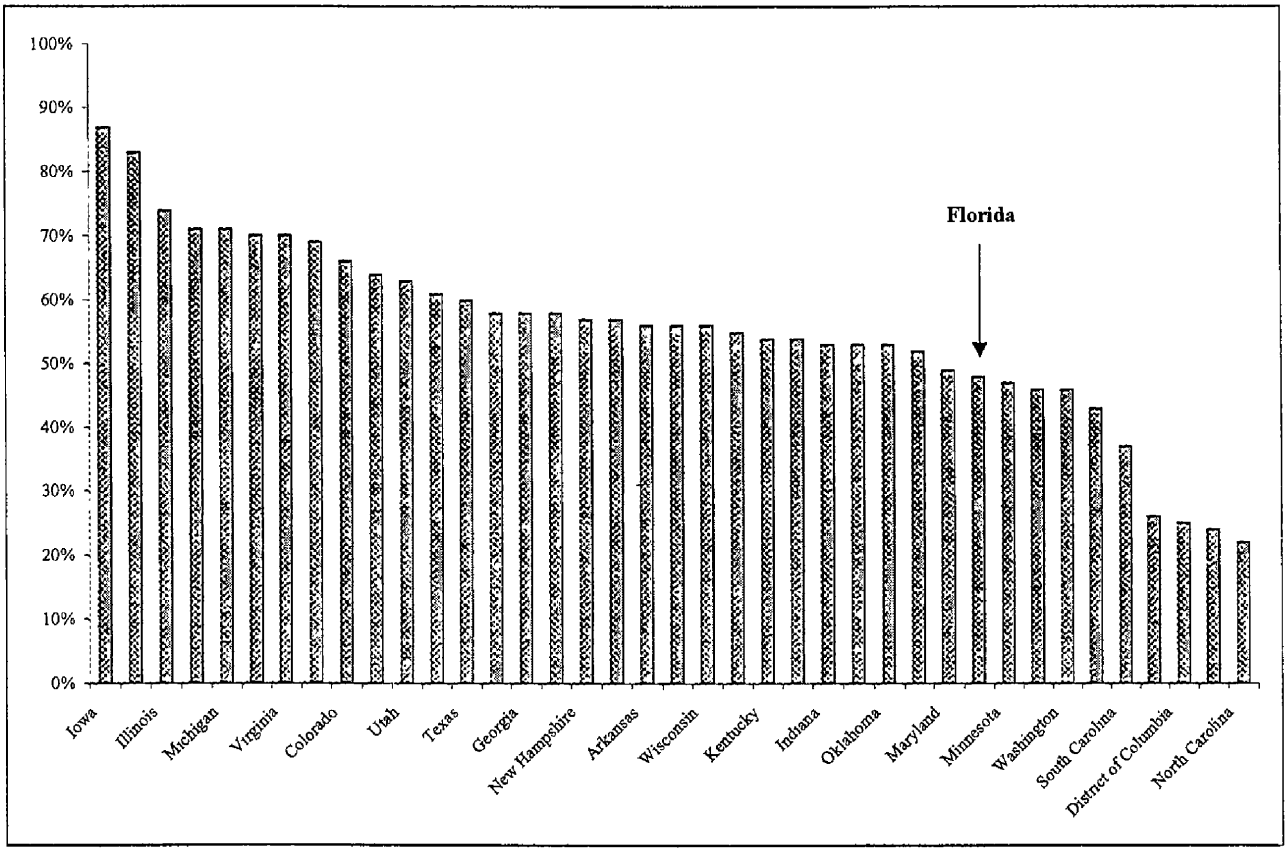
Other
Edison Electric Institute
(Electricity Consumers Resource Council)

June 18, 2003

ATTACHMENT B

FIGURE 1 – PERCENT OF CLEC LINES SOLD TO RESIDENTIAL AND SMALL BUSINESS CUSTOMERS BY STATE, AS OF DECEMBER 31, 2002

SOURCE: FCC, *Local Telephone Competition: Status as of December 31, 2002*



BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: SPRINT-FLORIDA, INCORPORATED'S PETITION TO REDUCE INTRASTATE SWITCHED NETWORK ACCESS RATES TO INTERSTATE PARITY IN A REVENUE NEUTRAL MANNER PURSUANT TO SECTION 364.164(1), FLORIDA STATUTES

DOCKET NO.
FILED: August 27, 2003

/

SPRINT'S REQUEST FOR CONFIDENTIAL CLASSIFICATION AND PROTECTIVE ORDER PURSUANT TO SECTION 364.183(1), FLORIDA STATUTES

Sprint-Florida, Incorporated ("Sprint") hereby requests that the Florida Public Service Commission ("Commission") classify certain documents and/or records identified herein as confidential, exempt from public disclosure under Chapter 119, Florida Statutes and issue a protective order reflecting such decision and protecting the information in the possession of the Commission and the Office of the Public Counsel. The information that is the subject of this request is contained in certain documents contained in Sprint's pre-filed testimony and exhibits accompanying its Petition to Reduce Intrastate Switched Network Access Rates to Interstate Parity in a Revenue Neutral Manner filed today in this docket.

1. The following documents or excerpts from documents are the subject of this request:

   a. **Highlighted portions of page 9, line 18, of the Direct Testimony of John M. Felz**
   b. **Highlighted portions of Exhibit JMF-4**
   c. **Highlighted portions of Exhibit KWD-2, pages 1 ,2, 3, 5, 6 & 7**

2. Unredacted copies of the documents have been submitted to the Division of Records and Reporting under seal this same day. The confidential information is identified by gray highlighting. Two redacted copies of the information are attached to this request.

3. The information for which the Request is submitted is trade secret or other highly proprietary competitive or valuable information and thus meets the definition of confidential proprietary business information pursuant to Section 364.183(3), Florida Statutes. Specific justification for confidential treatment is set forth in Attachment A.

4. Section 364.183(3), provides:

> (3) The term "proprietary confidential business information" means information, regardless of form or characteristics, which is owned or controlled by the person or company, is intended to be and is treated by the person or company as private in that the disclosure of the information would cause harm to the ratepayers or the person's or company's business operations, and has not been disclosed unless disclosed pursuant to a statutory provision, an order of a court or administrative body, or private agreement that provides that the information will not be released to the public. The term includes, but is not limited to:
>
> (a) Trade secrets.
>
> (b) Internal auditing controls and reports of internal auditors.
>
> (c) Security measures, systems, or procedures.
>
> (d) Information concerning bids or other contractual data, the disclosure of which would impair the efforts of the company or its affiliates to contract for goods or services on favorable terms.
>
> (e) Information relating to competitive interests, the disclosure of which would impair the competitive business of the provider of information.
>
> (f) Employee personnel information unrelated to compensation, duties, qualifications, or responsibilities.

5. Furthermore, Section 688.002(4), Florida Statutes is instructive on what constitutes a trade secret and provides that:

(4) "Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process that:

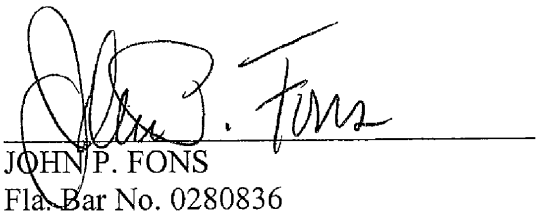
(a) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use; and

(b) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

6. The subject information has not been publicly released. Furthermore, release of the information could impair the company's ability to compete for, or negotiate with, certain business customers.

WHEREFORE, based on the foregoing, Sprint respectfully requests that the Commission grant Sprint's Request for Confidential Classification, exempt the information from disclosure under Chapter 119, Florida Statutes and issue a protective order, protecting the information from disclosure while it is maintained at the Commission and in the possession of the Office of the Public Counsel.

RESPECTFULLY SUBMITTED this 27th day of August 2003.



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ATTORNEYS FOR SPRINT-FLORIDA, INCORPORATED

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by e-mail and U.S. Mail this 27th day of August, 2003, to the following:

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Attorney

ATTACHMENT A

Document and Page and Line Numbers	**Justification for Confidential Treatment**
Highlighted portions of page 9, line 18 of the Direct Testimony of John M. Felz	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit JMF-4, column B, lines 4 & 5	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit KWD-2, page 1, column D, line 4	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit KWD-2, page 2, column D, line 2 & column F, lines 2, 5 & 6	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit KWD-2 page 3, column D, line 2 & column F, lines 2, 5, 6 & 7	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit KWD-2 page 5, columns I & J, line 1	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit KWD-2 page 6, column D, lines 1-4 & column F, lines 1-6	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)
Exhibit KWD-2 page 7, column D, lines 1-6 & column E, lines 1-6, 7 & 9	Contains information concerning Sprint's cost to provide competitive services, disclosure of which will harm Sprint's competitive business interests (s. 364.183(3) (e), F.S.)