

NATIONAL ECONOMIC
RESEARCH ASSOCIATES

ONE MAIN STREET
CAMBRIDGE, MASSACHUSETTS 02142
TEL: 617.621.0444 FAX: 617.621.0336
INTERNET: <http://www.nera.com>



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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

1 **DIRECT TESTIMONY OF DR. KENNETH GORDON**

2

3 **I. PURPOSE & SUMMARY OF CONCLUSIONS**

4 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

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

7

8 **Q. WHAT IS YOUR CURRENT POSITION?**

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

11

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

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

21

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

1 Massachusetts at Amherst, and Smith College.

2

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

7

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

14

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

19

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

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

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

4

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

8

9 **Q. WHAT ARE YOUR MAJOR CONCLUSIONS?**

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

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

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

¹ See Section II below.

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

6
7 In addition, I conclude that the plans will enhance economic welfare in Florida by
8 increasing economic activity. As described in the respective testimonies of the
9 companies' cost witnesses, the cost evidence submitted in this proceeding demonstrates
10 that rates for residential basic local service diverge significantly from their underlying
11 costs. A movement toward costs—and, therefore toward more rational economic
12 pricing—will bring with it several economic benefits. These benefits include providing
13 market participants—i.e., customers, the companies and potential and actual
14 competitors—with more cost-based price signals, which will improve economic decision
15 making and lead to more economically rational utilization of telecommunications services.
16 Economic activity in Florida will increase as a result of the companies' plans because
17 rebalancing generates substantial consumer benefits. Telephone consumers are better off
18 as a result of moving prices more in line with costs, and will likely increase their
19 purchases of those services whose price has come down. Perhaps of even greater
20 significance, competitive telephone service providers will be seeing better price signals
21 for local service, and will be able to invest without having to face the level of subsidized
22 competition they have faced in the past. New investment by these providers should, at the
23 margin, increase.

24
25 The cost evidence presented by the companies demonstrates that basic local prices are

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

8
9 I also conclude that the companies' plans will not jeopardize universal service in the state
10 of Florida. The companies' residential basic local prices are substantially below the
11 national average and Florida is not a poor state. The Florida Public Service Commission
12 ("Commission") has the flexibility to approve the companies' plans and still have
13 residential basic local prices remain affordable. The Florida Legislation requires that any
14 price increase in basic local service not apply to Lifeline consumers and also increased the
15 income eligibility for Lifeline consumers to 125 percent, thus protecting those customers
16 most likely to be sensitive to potential price increases from a rebalancing plan.
17 Importantly, the companies' rebalancing plans will lead to lower intrastate toll prices for
18 all consumers. At the end of the day, the mix of services that consumers purchase as a
19 result of the companies' plans will make consumers better off overall.

20
21 Finally, the fact that some customers may experience unwanted rate changes should not be
22 an argument for the status quo. Good policy requires weighing and balancing the costs
23 and benefits of particular actions. While it may seem that maintaining current prices is the
24 least objectionable thing to do from a policy perspective, there is an implicit but very real
25 cost to continuing the status quo. The deployment of next generation, advanced networks

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

5

6 **II. BACKGROUND**

7 **Q. PLEASE DESCRIBE THE BASIS FOR THE COMPANIES' REQUEST TO** 8 **INCREASE BASIC EXCHANGE PRICES.**

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

17

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

² See Section IV below.

³ See Section III.

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

3

4 **Q. WHAT ARE THE IMPORTANT PROVISIONS OF § 364.164?**

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

- 9 a. Remove current support for basic local telecommunications services that
10 prevents the creation of a more attractive competitive local exchange
11 market for the benefit of residential consumers;
- 12 b. Induce enhanced market entry;
- 13 c. Require intrastate switched network access rate reductions to parity over a
14 period of not less than 2 years or more than 4 years; and
- 15 d. Be revenue neutral as defined in subsection (7) within the revenue
16 category defined in subsection (2).

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

20

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

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

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

9
10 The current rate design for telephone services—where basic local services are priced
11 below cost and other services, including intrastate access service, are priced in such a way
12 so as to provide the support—while in the process of being reduced or eliminated in a
13 number of states, continues to be encountered in state regulation of telephone services.
14 However, as the Florida Legislature wisely recognized, whatever benefits such a rate
15 design policy has arguably achieved in the past, such as helping the United States achieve
16 universal telephone service—the continuation of such policies frustrates another important
17 policy goal of Federal and state regulators, namely, the establishment of efficient
18 competition to as broad a base of business and residential consumers as is economically
19 feasible—not to mention the economic costs that arise from price-cost distortions, *per se*,
20 as I discuss further below.

21
22 The current rate design policy as it pertains to residential basic local services, frustrates
23 that policy goal and by enacting § 364.164, the Florida Legislature has provided the
24 Commission with the direction it needs to make competition work better for all Florida
25 consumers.

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

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

5

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

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

20

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

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

6

7 **Table I – Comparison of Verizon, BellSouth and Sprint’s flat-rate residential basic**
8 **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 |

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

12

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

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

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

12

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

16 A. Yes, there is some support for my assertion. The FCC compiles data on local telephone
17 competition. Its most recent report, released June 12, 2003 included a table that lists, for
18 each state available, the percentage of lines provided to residential and small business
19 customers by ILECs and CLECs.⁴ The FCC provided data on 40 states and of those 40
20 states Florida ranked 30th in the percent of CLEC lines that were sold to residential and
21 small business customers. This means that in 29 out of 40 states, CLECs' served
22 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.

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

5
6 **Q. YOU MENTIONED THAT THERE WAS A SECOND REASON WHY YOU**
7 **BELIEVE THAT FLORIDA'S LOW RESIDENTIAL BASIC LOCAL PRICES, IN**
8 **COMPARISON WITH OTHER STATES, ARE RELEVANT IN THIS**
9 **PROCEEDING. WHAT IS THAT SECOND REASON?**

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

21

22 At the same time, Florida consumers will pay less for intrastate toll calls. The companies'
23 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.

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

6
7 In addition, the Tele-Competition Act also requires that any increase in basic local service
8 rates not apply to Lifeline customers and that the ILECs increase Lifeline participation to
9 125 percent of federal poverty income level.⁶ These requirements further protect low-
10 income consumers—and it is low-income consumers who would be most prone to
11 disconnections in the face of price increases—thus providing the Commission with even
12 more flexibility to approve the companies' rate rebalancing request with minimal concern
13 that such a rate restructuring would negatively affect subscribership. I discuss this point,
14 and other reasons why I believe the companies' plans will not negatively affect
15 subscribership in Florida, in more detail in Section VI below.

16
17 **Q. VERIZON, BELLSOUTH AND SPRINT ARE FILING THEIR PLANS AT THE**
18 **SAME TIME. IS THERE ANY PUBLIC POLICY BENEFIT TO HAVING THE**
19 **COMMISSION REVIEW THE COMPANIES' PLANS AT THE SAME TIME?**

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

⁶ § 364.10(3)(a).

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

15
16 Second, it is also important to avoid unnecessary marketplace distortions that could affect
17 the purchase decisions of end-users. End-users normally make their purchase decisions
18 based in large part on relative price differences among providers. If the rate-rebalancing is
19 not implemented across all companies simultaneously, end-users will make these
20 decisions based on incomplete and imperfect information as they see some providers'
21 rates increasing while other providers' rates remain the same (at least temporarily). The
22 risk will be that regulatory scheduling rather than the relative costs and benefits of various
23 service offerings becomes the driving force behind consumers' decisions. For example, it
24 is easy to imagine a situation involving two or more of the ILECs —where a CLEC might
25 be able to offer service at a legitimate cost savings to all customers, but if re-balancing is

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

7

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

12

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

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

1 economic efficiency gains sooner as well.

2

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

9

10 **Q. PLEASE EXPLAIN WHY YOU BELIEVE THAT THE COMPANIES’ PLANS**
11 **WILL NOT RESULT IN RATE SHOCK.**

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

16

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

22

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

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

4

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

9

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

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

22

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

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

5

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

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

13

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

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

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

10

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

19

20 Prior to divestiture of AT&T in 1984, toll prices provided the bulk of support for basic
21 local telecommunications services. As technological advances lowered the cost of
22 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.

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

5
6 Notably, even after the substitution of price cap regulation for traditional regulation, the
7 cross subsidies that were present under traditional regulation have been maintained.

8
9 The notion that intrastate switched network access services have been used as a source of
10 support for basic local telecommunications is confirmed in the Florida *Senate Staff*
11 *Analysis and Economic Impact Statement on the Tele-Competition Act*, where it states:

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

16
17 The second reason why I believe that intrastate access services currently support basic
18 local service is cost considerations. As described in the testimonies of their witnesses, the
19 companies have established that the price of residential basic local telecommunications
20 services is below forward-looking direct cost estimates. From an economic perspective,
21 whenever the revenues from a service are insufficient to recover its forward-looking direct
22 costs, that service is said to be in receipt of an economic subsidy. The source of the
23 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.

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

5

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

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

16

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

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

3

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

8

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

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

21

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

1 **CONSUMERS. WILL THE COMPANIES' PLANS MEET THIS CRITERION?**

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

5

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

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

18

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

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

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

6

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

18

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

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

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

5

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

13

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

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

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

22

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

1 In the same report, the Florida Commission cites nation-wide data indicating that about
2 5% of U.S. wireless subscribers have disconnected wireline service and conclude that
3 substituting wireless for wireline services appears to be a national trend.¹¹ Moreover, as
4 the same report concludes, Florida may be especially susceptible to this phenomenon
5 because of the large population in Florida that also has residences in other states. For
6 many of these consumers, “it makes little sense to continue paying for telephone service
7 that sits idle much of the year when wireless enables them to stay connected wherever
8 they are.”¹²

9
10 The Florida Commission has also concluded that cable providers are competing directly
11 with fixed-wireline providers. The Commission cites to national data that shows that by
12 second quarter of 2002, there were 2.5 million cable telephony subscribers and that cable
13 companies expect to see one-third of their digital cable households take cable telephony
14 service by 2005.¹³

15
16 There is evidence that the Tele-Competition Act is already having a positive impact on
17 competitors’ incentive to enter and expand in the Florida market. On July 18, 2003,
18 Knology, a provider of broadband and voice telephony services, announced it has entered
19 into a definitive agreement to purchase certain assets from Verizon Media Ventures, Inc.¹⁴
20 Knology offers local and long distance telephone service and its purchase of Verizon’s
21 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*.

1 release announcing its decision, Knology stated:

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

8

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

12 A. Yes, there is empirical evidence. Two of my colleagues at NERA investigated empirically
13 whether low residential basic local rates were having any impact on competition in the
14 states and, specifically, whether low rates were hindering the development of residential
15 competition.¹⁵ In that paper, the authors hypothesized that inefficient local exchange
16 prices are having an impact on competition and that, specifically, low residential prices
17 are inhibiting competition for residential customers. To test their hypotheses, the authors
18 compared how local competition varied across the different states depending on how
19 “unbalanced” were local exchange prices. Specifically, the authors estimated several
20 cross-section econometric models of facilities-based competition, controlling for things
21 such as cost and demand considerations in the different states. The authors also included
22 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.

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

3 Using OLS and GLS estimates we found a significant and positive association
4 between states that have more “balanced” tariffs and residential competition.
5 For two measures of residential competition used in our data, we found that
6 “rebalancing” tariffs by 10% leads to approximately a 9% and 13% increase,
7 respectively, in residential competition.¹⁶

8
9 In addition, James Eisner (an FCC staff member) and Professor Dale E. Lehman
10 performed a somewhat similar study.¹⁷ Eisner and Lehman state in their conclusion:

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

14
15 Finally, another empirical study examined rate rebalancing in Latin America and found
16 that rate rebalancing in some Latin American countries has led to increases in the supply
17 of main telephone lines by providing better incentives to market participants.¹⁹

18

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.

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

4

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

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

14

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

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

22

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

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

11

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

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

23

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

1 services and achieving the economically efficient outcomes described above.

2

3 **IV. OTHER ECONOMIC BENEFITS FROM THE COMPANIES'**
4 **PLANS**

5

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

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

12

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

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

21

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

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

7

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

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

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

3

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

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

15

16 **V. COST ISSUES**

17

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

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.

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

14

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

18

19 **Q. THE COMPANIES' PLANS ARE BASED UPON THE FACT THAT THE LOCAL**
20 **LOOP IS NOT A SHARED OR COMMON COST AND THAT ITS COST IS**
21 **CAUSED SIMPLY BY PROVIDING CUSTOMERS ACCESS TO THE**
22 **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.

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

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

7 Is the cost of local loop facilities properly attributable to the provision of basic
8 local telecommunications service? By definition, yes. Section 364.02(2),
9 Florida Statutes, defines “basic local telecommunications service as”

10 Voice grade, flat-rate residential and flat-rate single-line business local
11 exchange services which provide dial tone, local usage necessary to
12 place unlimited calls within a local exchange area, dual tone multi-
13 frequency dialing, and access to the following emergency services such
14 as “911,” all locally available interexchange companies, directory
15 assistance, operator services, relay services, and an alphabetical
16 directory listing.

17

18 Given such an identification of the cost object to be studied, the principle of
19 cost causation leads one to the unavoidable conclusion that the decision to
20 have local service leads to the incurrence of loop costs.²⁵

21

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.

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

3
4 Q. SHOULD THE COMMISSION BE CONCERNED ABOUT UNIVERSAL
5 SERVICE?

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

11

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

19

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

1 phone service when prices for basic local service increase.²⁶

2

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

13

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

20

21 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.

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

7

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

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

17

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

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

24

25 **Q. WOULD YOU PLEASE DESCRIBE THE RATE REBALANCING PROCESS IN**

1 **MASSACHUSETTS?**

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

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

14

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

23

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

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

7
8 When the Massachusetts price-rebalancing process ended in January of 1994 (with the
9 adoption of a price cap plan), the price for basic residential dial-tone service (1MR) had
10 risen from about \$3.00 per month in 1990 to \$9.91 per month in 1994 (net of the SLC).²⁸
11 Comparable increases also occurred for residential flat-rate service (1FR), which was the
12 most popular service in Massachusetts, at that time. Flat rate residential prices had ranged
13 from \$9.95 in rural areas to \$12.38 in urban areas. The rebalancing process moved flat
14 rate residential prices to \$16.85 state wide. During this period, the average increase for
15 residential consumers was \$2.18 per year over four years and, according to the DTE,
16 record evidence shows virtually no impact on residential telephone subscriber
17 penetration.²⁹ Because the price-rebalancings were revenue-neutral, these increases were
18 completely offset by decreases in prices for other services, notably residential and
19 business intraLATA toll and carrier switched access.

20
21 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.

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

3

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

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

11

12 The DTE concluded that a \$2.44 increase will not harm the Department's universal
13 service goals, based on similarity to the several, annual \$2.18 increase in the early 1990s
14 rebalancing plans and comparable increases in several other states and in the Federal
15 subscriber line charge since 2000. For example, the Maine PUC approved a \$1.78
16 increase in Verizon's basic monthly per line rate in May 2001 and the New York Public
17 Service Commission authorized a two-year Incentive Plan which permitted an increase of
18 \$1.85 on March 1, 2002 and another \$0.65 on March 1, 2003 for a total increase of \$2.50
19 in the space of a year. The FCC's Federal subscriber line charge has increase from \$4.35
20 in July 2000 to \$6.50 in July 2003.

21

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

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

³⁰ *Ibid*, p. 361.

1 noticeable impact on telephone subscribership levels. In 1997, the Maine legislature
2 (M.R.S.A. 35-A, §7101-B) directed the Maine Public Utility Commission to establish,
3 notwithstanding any other provision of state law, intrastate access rates that are less than
4 or equal to interstate access rates established by the FCC (*i.e.*, parity with interstate access
5 rates) by May 30, 1999. At the time, Bell Atlantic's intrastate access rates were \$0.26 per
6 minute, significantly higher than its then-current Federal interstate access rate of about
7 \$0.07 per minute.

8

9 Subsequently, on March 17, 1998, the Commission approved an Order (Docket No. 94-
10 123 reopened) that approved a stipulation between Bell Atlantic-Maine (now known as
11 Verizon-Maine) and a group of intervenors, including the Commission's Advocacy Staff
12 and the Public Advocate. This stipulation allowed Bell Atlantic-Maine to increase its
13 basic local exchange rates by a total of \$3.50 by May 30, 1999, with steps of \$1.50 in
14 1998 and \$2.00 in 1999. This was followed by another increase of \$1.78 in 2000.

15

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

20

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

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

³¹ MPUC Annual Report 2002, pp. 43.

1 Bell. GTE's residential rates immediately went from \$9.75 to \$17.25 while Pacific's
2 residential rates went from \$8.35 to \$11.25.³² Recently, as part of a rebalancing plan for
3 Sprint's local telephone company in Ohio where intrastate access fees were lowered to
4 mirror Federal charges, the Commission approved the creation of an end user charge of
5 \$4.10 for residential customers and \$6.00 for single-line business.³³

6

7 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

8 A. Yes.

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

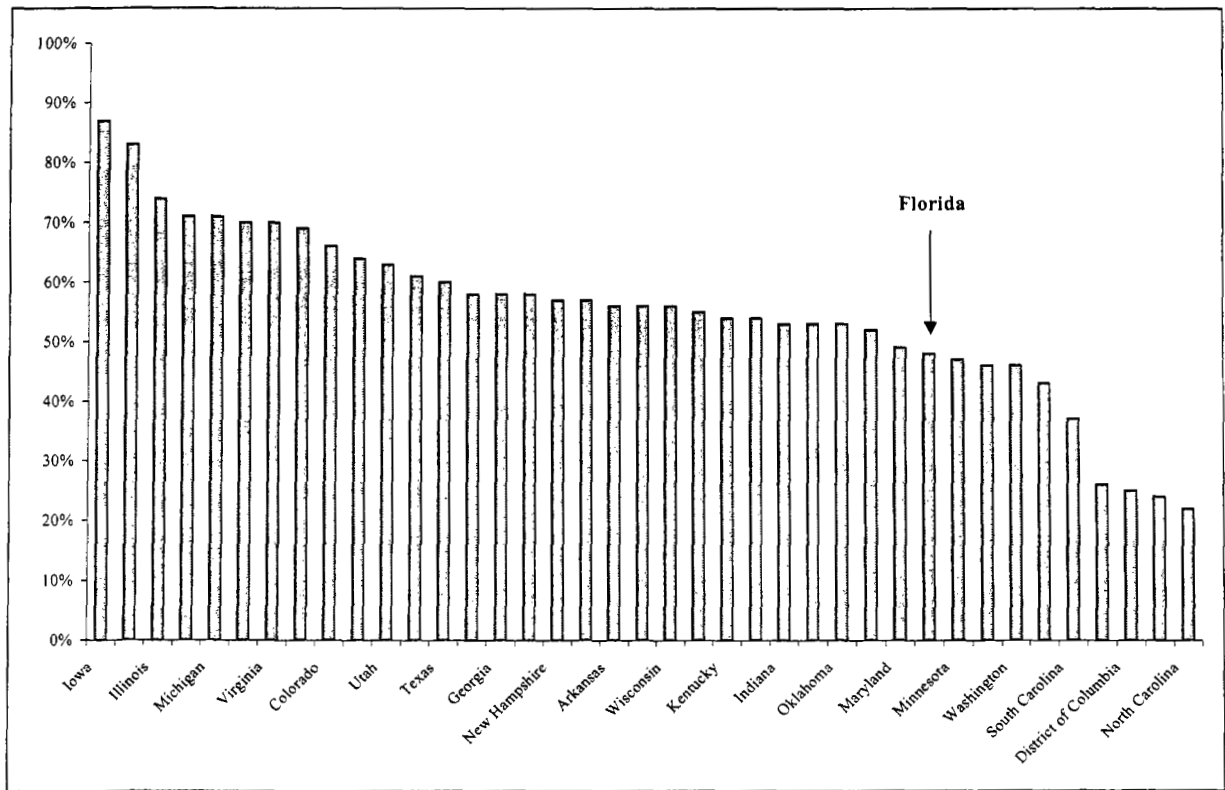
³³ See, The Public Utilities Commission of Ohio, Case No. 00-127-TP-COI and 01-1266-TP-UNC, June 28, 2001.

ATTACHMENT A

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*



NATIONAL ECONOMIC
RESEARCH ASSOCIATES

ONE MAIN STREET, CAMBRIDGE, MASSACHUSETTS 02142
TEL: 617.621.0444 FAX: 617.621.0336



DR. KENNETH GORDON

BUSINESS ADDRESS

National Economic Research Associates, Inc.
One Main Street
Cambridge, MA 02142
617-621-0444

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

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. FUA980020): 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.

Before the Virgin Islands Public Service Commission, on behalf of the Virgin Islands Telephone Company: Testimony regarding the Industrial Development Corporation tax benefit. Filed October 5, 1998.

Before the Wisconsin Public Service Commission, on behalf of The Edison Electric Institute: Rebuttal testimony addressing affiliate interest issues in a traditional regulatory environment. Filed October 2, 1998.

Before the Wisconsin Public Service Commission, on behalf of The Edison Electric Institute: Direct testimony addressing affiliate interest issues in a traditional regulatory environment. Filed September 9, 1998.

Before the Maine Public Utilities Commission, on behalf of Bell Atlantic-Maine: Declaration describing state regulation and special tariffs filed by Bell Atlantic. Filed August 31, 1998.

Before the Vermont Public Service Board, on behalf of Bell Atlantic-Vermont: Rebuttal testimony regarding economic consequences of granting CTC's request to allow assignment of BA-VT retail contracts without customer penalty or termination charges. Filed August 28, 1998.

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.

Before the Maine Federal District Court, on behalf of Bell Atlantic: Expert report responding to CTCs anti-competitive claims against Bell Atlantic-North. Filed July 20, 1998.

Before the New Hampshire Public Utilities Commission, on behalf of Bell Atlantic: Direct testimony on petition by CTC to assume contracts that CTC had won for Bell Atlantic when it was an agent. Filed July 10, 1998.

Before the Virgin Islands Public Service Commission, on behalf of VITELCO: Testimony on use of consultants by regulatory commissions; benefits of incentive regulation and treatment of tax benefits. Filed July 10, 1998.

Before the Public Utility Commission of California, on behalf of The Edison Electric Institute: Comments on the enforcement of affiliate transactions rules proposed by the California Public Utility Commission. Filed May 28, 1998.

Before the Public Service Commission of New Mexico, on behalf of Public Service Company of New Mexico: Rebuttal testimony regarding the Commission's investigation of the rates for electric service of PNM. Filed May 6, 1998.

Before the Oklahoma Corporation Commission, on behalf of Southwestern Bell Communications: Reply affidavit regarding SBC's application for provision of in-region interLATA service in Oklahoma. Filed April 21, 1998.

Before the Public Utility Commission of Texas, on behalf of Southwestern Bell Communications: Rebuttal testimony regarding SBC's application for provision of in-region interLATA service in Texas. Filed April 17, 1998.

Before the Public Service Commission of New Mexico, on behalf of the Public Service Company of New Mexico: Direct testimony to address the economic efficiency, equity, and public policy concerning PNM's company-wide stranded costs. Filed April 16, 1998.

Before the Illinois Commerce Commission (Docket nos. 98-00013 and 98-0035), on behalf of The Edison Electric Institute: Rebuttal testimony addressing the adoption of rules and standards governing relationships between energy utilities and their affiliates as retail competition in the generation and marketing of electricity is introduced, filed March 25, 1998. Surrebuttal filed March 11, 1998.

Before the Public Utility Commission of Texas, on behalf of Southwestern Bell Communications: Testimony regarding SBC's application for provision of in-region interLATA service in Texas. Filed February 24, 1998.

Before the Kansas Corporation Commission on behalf of Southwestern Bell Telephone Company: Direct testimony regarding SBC's application for provision of in-region interLATA service in Kansas. Filed February 15, 1998. Rebuttal filed May 27, 1998.

Before the Maine Public Utilities Commission, on behalf of Bell Atlantic - Maine: Testimony regarding the reasonableness of restructuring rates. Filed February 9, 1998.

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.

Before the Oklahoma Corporation Commission, on behalf of Southwestern Bell Communications: Affidavit regarding SBC's application for provision of in-region interLATA service in Oklahoma. Filed January 15, 1998.

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.

Before the Public Utility Commission of Texas, on behalf of Entergy-Gulf States Utilities: Rebuttal testimony regarding Entergy's "Transition to Competition" proposal. Filed October 24, 1997.

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.

Before the Indiana Utility Regulatory Commission, on behalf of Ameritech Indiana: Testimony regarding Ameritech Indiana's proposal for a new alternative regulatory framework. Filed July 30, 1997.

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.

Before the New Jersey Assembly Policy and Regulatory Oversight Committee, on behalf of Public Service Electric and Gas Company: Testimony regarding transition cost recovery from self generators. June 16, 1997.

Before the New Jersey Board of Public Utilities, on behalf of Public Service Electric and Gas Company: Testimony regarding transition cost recovery from self generators. Filed June 6, 1997.

Before the Federal Communications Commission: Reply Affidavit in support of SBC Communications Inc.'s application to offer interLATA service in Oklahoma. Filed May 27, 1997.

Before the Corporation Commission, on behalf of Kansas Pipeline Partnership: Testimony regarding Purchase Gas Adjustment proceeding for Western Resources, Inc. Filed May 7, 1997.

Before the Public Utility Commission of Texas, on behalf of Entergy-Gulf States Utilities: Supplemental direct testimony regarding Entergy's "Transition to Competition" Proposal. Filed April 4, 1997.

Before the Illinois Commerce Commission, on behalf of Ameritech Illinois: Testimony regarding price cap regulation. filed April 4, 1997

Affidavit: in support of SBC Communications Inc.'s application to offer interLATA service in Oklahoma. Before the Oklahoma Corporation Commission and the Federal Communications Commission. Filed February 20, 1997 (OCC) and April 7, 1997 (FCC).

Before the Federal Communications Commission, on behalf of Ameritech: Reply comments on access reform. Filed February 14, 1997.

Before the Federal Communications Commission, on behalf of Ameritech: Paper on access reform, "Access, Regulatory Policy, and Competition", filed January 29, 1997.

Before the Wisconsin Public Service Commission, on behalf of Ameritech - Wisconsin: Testimony regarding interconnection arbitrations. Filed December 5, 1996.

Before the Public Utility Commission of Texas, on behalf of Entergy-Gulf States Utilities: Testimony regarding Entergy's "Transition to Competition" proposal. Filed November 27, 1996.

Before the California Public Utilities Commission: Rebuttal testimony in support of the joint application of Pacific Telesis Group and SBC Communications Inc. for approval of their merger, (Application No. 96-04-038). November 8-9, 1996.

Affidavit: in support of Florida Public Service Commission's appeal of Federal Communications Commission's interconnection order (CC Docket No. 96-98). September 12, 1996.

Before the New Jersey Board of Public Utilities on behalf of Bell Atlantic - New Jersey: "Economic Competition in Local Exchange Markets," position paper on the economics of local exchange competition filed in connection with arbitration proceedings, August 9, 1996 (with William E. Taylor and Alfred E. Kahn).

Federal Communications Commission (CC Docket No. 96-45) on behalf of BellSouth Corporation, "Comments on Universal Service," (with William Taylor), analysis of proposed rules to implement the universal service requirements of the Telecommunications Act of 1996, filed April 12, 1996.

Before the Senate Committee on Commerce, Science and Transportation on FCC Structure and Function: Suggested Revisions, March 19, 1996.

Before the Federal Communications Commission in the Matter of Pricing for CMRS Interconnection on behalf of Ameritech, March 4, 1996.

Before the Senate Committee on Commerce, Science and Transportation on Telecommunications Reform on behalf of NARUC, March 2, 1995.

Before the House Committee on Energy and Commerce Committee, Subcommittee on Telecommunications and Finance on H.R. 4789, the Telephone Network Reliability Improvement Act of 1992, on behalf of NARUC, May 13, 1992.

Before the Senate Committee on Commerce, Science and Transportation on H.R. 2546, a bill proposing the Infrastructure Modernization Act of 1991, on behalf of NARUC., June 26, 1991.

SPEECHES (partial list)

Remarks before the 1996 Telecommunications Policy Research Conference, "Interconnection Principles and Efficient Competition", Solomon's Island, MD, October 7, 1996.

Remarks before the American Bar Association Section of Antitrust Law, "Charging Competitors and Customers for Stranded Costs: Competition Compatible?" Four Seasons Hotel, Chicago, IL, September 19, 1996.

Remarks before the 1996 EPRI Conference on Innovative Approaches to Electricity Pricing, "Prices and Profits: Perceptions of a Former Regulator," La Jolla, California, March 28, 1996.

Remarks before the Innovative Fuel Management Strategies for Electric Companies Conference sponsored by The Center for Business Intelligence, "Anticipating the Impact of Fuel Clause Reversal on Fuel Management," Vista Hotel, Washington, D.C., March 15, 1996.

Remarks before Electricity Futures Trading Conference, "Electricity Futures Trading: What the States Are Doing," Houston, Texas, March 14, 1996.

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.

Panelist, Roundtable on "Competitive Markets in Electricity and the Problem of Stranded Assets," Progress and Freedom Foundation, Washington, D.C., December 1, 1995.

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

PUBLICATIONS

“Demand Side Management in Today’s Electricity Market,” *Electricity Deregulation Commentary*, Maine Policy Review, Winter 2001, pp. 19-21.

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INCIDENTAL TEACHING AND LECTURING

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Yale School of Management and Organization
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Suffolk University Law School
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Boston University

Other

Edison Electric Institute
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