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November 26, 2003

BY HAND DELIVERY

Ms. Blanca Bayó, Director
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Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Docket Nos. 030867-TL, 030868-TL, 030869-TL, and 030961-TI

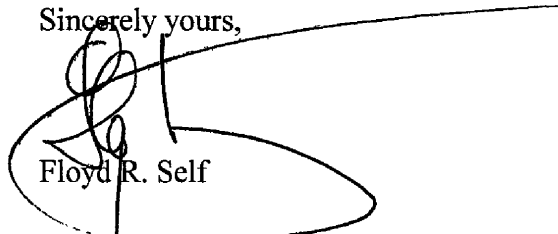
Dear Ms. Bayó:

Enclosed for filing on behalf of AT&T Communications of the Southern States, LLC are an original and fifteen copies of the Rebuttal Testimony of Dr. John W. Mayo on behalf of AT&T Communications of the Southern States, LLC and MCI WorldCom Communications, Inc. in the above referenced dockets.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

Thank you for your assistance with this filing.

Sincerely yours,



Floyd R. Self

FRS/amb
Enclosures
cc: Parties of Record

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been served on the following parties by U. S. Mail this 26th day of November, 2003.

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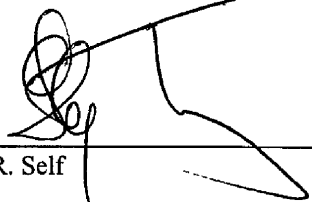
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Floyd R. Self

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by Verizon Florida Inc. to reform)
intrastate network access and basic local)
telecommunications rates in accordance with) Docket No. 030867-TL
Section 364.164, Florida Statutes.)
_____)

In re: Petition by Sprint-Florida, Incorporated to)
reduce intrastate switched network access rates to)
interstate parity in revenue-neutral manner) Docket No. 030868-TL
pursuant to Section 364.164(1), Florida Statutes.)
_____)

In re: Petition for implementation of Section)
364.164, Florida Statutes, by rebalancing rates in a)
revenue-neutral manner through decreases in) Docket No. 030869-TL
intrastate switched access charges with offsetting)
rate adjustments for basic services, by BellSouth)
Telecommunications, Inc.)
_____)

In re: Flow-through of LEC Switched Access)
Reductions by IXCs, Pursuant to Section) Docket No. 030961-TI
364.163(2), Florida Statutes)
_____)

**REBUTTAL TESTIMONY OF
JOHN W. MAYO**

**ON BEHALF OF
AT&T COMMUNICATIONS OF THE SOUTHERN STATES, LLC
AND
MCI WORLDCOM COMMUNICATIONS, INC.**

November 26, 2003

1 **REBUTTAL TESTIMONY OF**

2 **JOHN W. MAYO**

3 **ON BEHALF OF**

4 **AT&T COMMUNICATIONS OF THE SOUTHERN STATES, LLC**

5 **AND**

6 **MCI WORLDKOM COMMUNICATIONS, INC.**

7
8 **Dockets Nos. 030867-TP, 030868-TP, 030869-TP and 030961-TI**

9
10 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE**
11 **RECORD.**

12 A. My name is John W. Mayo. My business address is McDonough School of
13 Business, Georgetown University, 37th and O Streets, N.W., Washington D.C.
14 20057.

15
16 **Q. ARE YOU THE SAME JOHN MAYO THAT PROVIDED TESTIMONY**
17 **EARLIER IN THIS PROCEEDING?**

18 A. Yes.

19
20 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

21 A. The purpose of my testimony is to respond to the direct testimony of Bion
22 Ostrander filed on behalf of the Office of Public Counsel. In particular, I find that
23 Mr. Ostrander's advocacy and recommendations are contrary to sound economic

1 policy in Florida. Specifically, Mr. Ostrander's testimony is extraordinarily
2 heavy-handed in its regulatory approach toward the issue of the flow-through of
3 access charge reductions. This regulatory approach is predicated on a false, albeit
4 latent, proposition. Specifically, Mr. Ostrander's recommendations are consistent
5 with a view of a long-distance market that is not subject to effective competition.
6 Because the long-distance market, however, is subject to vigorous and effective
7 competition, the regulatory micro-management of the flow-through of access
8 charges proposed by Mr. Ostrander imposes unnecessary regulation and is likely,
9 perversely, to harm consumers. Unfortunately, this failure underpins virtually all
10 of Mr. Ostrander's testimony, rendering it effectively useless.

11
12 **Q. SPECIFICALLY WHICH ISSUES DO YOU ADDRESS?**

13 A. I address issues 8, 9 and 10, while Mr. Guepe, also testifying on behalf of AT&T,
14 addresses issues 6 and 7.

15
16 **Q. TURNING SPECIFICALLY TO THESE ISSUES, WHAT IS ISSUE 8?**

17 A. The Commission has asked for opinions on how long revenue reductions should
18 last associated with access charge reductions.

19
20 **Q. WHAT IS MR. OSTRANDER'S RECOMMENDATION?**

21
22 A. Mr. Ostrander argues that "IXCs should be required to cap and maintain their long
23 distance rate reductions for a period of three years after parity is achieved, as
24 required by Section 364.163(1)." Mr. Ostrander interprets this as meaning that

1 long distance retail rate reductions would be locked in until 2009, that is for a
2 period of six years. (Ostrander Direct, pp. 15-16).

3
4 **Q. DO YOU AGREE WITH MR. OSTRANDER'S RECOMMENDATION?**

5 A. No. There are at least two fundamental problems with Mr. Ostrander's
6 recommendation. First, I believe that Mr. Ostrander fundamentally misreads the
7 statute. Specifically, the section of the statute cited by Mr. Ostrander [Section
8 364.163(1)] refers to the "local exchange telecommunications company's
9 intrastate switched network access rates" in imposing a rate cap. The imposition
10 of such a cap on local exchange companies (LECs) is not the same as a cap on
11 retail rates charged by interexchange carriers (IXCs) that pay, as input prices, for
12 switched network access services. Thus, Mr. Ostrander errs in saying that the
13 statute requires a cap on long distance rates for three or (as seemingly proposed)
14 six years.

15 Second, a regulatory imposition of a multi-year price cap on the flow-
16 through is fundamentally at odds with the reality of the competitive provision of
17 long distance services in Florida. Specifically, it is widely agreed in the economic
18 policy community that where competition is effective (i.e., there is an absence of
19 significant monopoly power) the market is capable of ensuring that consumers
20 will receive a variety benefits as individual firms strive against each other for the
21 patronage of consumers. These benefits include competitive pricing, new service
22 innovations, attention to quality, and so on. Importantly, these benefits are
23 available with the need for any overt governmental regulation of prices. Thus, the
24 imposition of a multi-year cap as suggested by Mr. Ostrander simply amounts to

1 regulatory micro-management that is unwarranted by any demonstrable market
2 failure.

3
4 **Q. WHAT IS ISSUE 9?**

5 A. Issue 9 asks how should the IXC flow-through of the benefits from the ILEC
6 access rate reductions be allocated between residential and business customers.

7
8 **Q. WHAT IS MR. OSTRANDER'S POSITION ON THE WAY IN WHICH**
9 **ACCESS CHARGE REDUCTIONS ARE FLOWED THROUGH TO**
10 **RESIDENTIAL AND BUSINESS CUSTOMERS?**

11 A. Mr. Ostrander argues that, "Since residential basic local customers are receiving
12 most of the proposed increases in basic local rates, they should receive a
13 proportionate amount of the long distance rate reductions."

14
15 **Q. DO YOU AGREE WITH MR. OSTRANDER ON THE DISTRIBUTION OF**
16 **ACCESS CHARGE REDUCTIONS BETWEEN RESIDENTIAL AND**
17 **BUSINESS CUSTOMERS?**

18 A. No. Mr. Ostrander simply seems to argue that because residential customers are
19 facing price increases for local exchange service regulation should *force* a
20 distribution of access charge reductions to precisely this same group of customers.
21 While such an approach may have a superficial appeal, it is both unnecessarily
22 regulatory and economically flawed.

23 Ostrander's proposal is unnecessarily regulatory because each long

1 distance firm, with its own distribution of business and residential customers will
2 have a unique distribution of cost changes as a consequence of the access charge
3 reductions. To dictate -- through the regulatory process -- that access charge
4 reductions be distributed in any particular manner by the manifold competing
5 IXCs in Florida will unnecessarily stifle the ability of these firms to creatively
6 pursue the patronage of Florida's customers. Moreover, any attempt to tailor such
7 a "proportional offsetting benefit" based upon the unique distribution of
8 residential and business customers for each long-distance carrier would constitute
9 a massive spread of regulation in a segment of the industry that is widely
10 acknowledged to be vigorously competitive.

11 Ostrander's proposal is economically flawed because it ignores the
12 market-based incentives for price changes that would naturally follow cost
13 changes in the IXC industry, and which would result naturally from the free
14 interplay between the long-distance market participants. Rather, Mr. Ostrander
15 proposes to artificially link the incidence of local retail rate increases with retail
16 rate decreases in the IXC industry. He does so, however, while ignoring the more
17 proper linkage which is through cost changes occurring in the IXC industry. It is
18 this latter change in costs (which may not mirror the incidence of residential
19 versus business local exchange rate increases) that would properly and naturally
20 be reflected in long distance rates by market forces.

1 **Q. WHAT IS ISSUE 10?**

2 A. Issue 10 addresses the question, whether all residential and business customers
3 will experience a reduction in their long distance bills? If not, which residential
4 and business customers will and will not experience a reduction in their long
5 distance bills?

6
7 **Q. WHAT IS MR. ORSTRANDER'S POSITION ON THIS ISSUE?**

8 A. Mr. Ostrander argues that "the 'average residential user' of long distance service
9 should be the primary beneficiary of these long distance rate reductions which
10 should not be unduly restricted to large residential and business toll users."

11
12 **Q. DO YOU AGREE WITH MR. OSTRANDER'S RECOMMENDATION?**

13 A. No. In addressing this issue he appears once again to dictate the precise
14 beneficiary of the access charge reductions by requiring that a particular type of
15 user, the "average residential user," should – through regulation -- be favored over
16 other types of users. While his choice of beneficiary has a certain populist
17 appeal, the notion of imposing such an outcome through regulation is an
18 anathema to sound public policy toward competitive industries. Moreover, the
19 statute does not prescribe such an approach. Indeed Section 364.163(2) of the
20 statute explicitly states, "that IXCs may determine the specific intrastate rates to
21 be decreased provided that residential and business customers benefit from the
22 rate decreases."

1 Finally from an economic policy perspective, Mr. Ostrander's proposal
2 makes no more sense than to dictate, through regulation, that when wholesale
3 computer prices come down "the average user" of computers is mandated to be
4 the "primary beneficiary." I must emphasize that while it is a poor idea for
5 heavy-handed regulation to attempt to dictate the specific nature of price
6 reductions in the long-distance industry, the Commission can, nonetheless, be
7 confident that the competitive market for long-distance services will create
8 benefits for both residential and long distance consumers.

9
10 **Q. YOU HAVE SPOKEN SEVERAL TIMES IN THE COURSE OF YOUR**
11 **TESTIMONY ABOUT THE COMPETITIVE NATURE OF THE LONG**
12 **DISTANCE MARKETPLACE. ON WHAT GROUNDS DO YOU MAKE**
13 **SUCH A CLAIM?**

14 A. A dispassionate assessment of the nature of competition in the long-distance
15 industry unequivocally reveals the very competitive and rivalrous nature of this
16 market. The industry is composed of low barriers to entry, hundreds of firms, and
17 competitors that are eager to capture business. In Florida, there are hundreds of
18 long distance competitors from which consumers may choose. Moreover, under
19 Section 271 of the Telecommunications Act of 1996, Regional Bell operating
20 companies (RBOCs) such as BellSouth have recently entered the long-distance
21 market and are competing vigorously for consumers. As Chairman Lila Jaber of
22 this Commission has observed, "(t)he long distance market is competitive and

1 companies want your business.”¹ This rivalry incontrovertibly creates the ability
2 for competition to ensure that the benefits of input cost changes such as for
3 switched access are passed along to Florida’s consumers without the dictates of
4 regulatory fiat.

5
6 **Q. FINALLY, YOU EXPRESS CONFIDENCE THAT, ABSENT HEAVY-**
7 **HANDED REGULATORY APPROACHES TO ENSURE FLOW-**
8 **THOUGH, FLORIDA’S CONSUMERS WILL STILL SEE THE**
9 **BENEFITS OF ACCESS CHARGE REDUCTIONS ORDERED IN THIS**
10 **CASE. WHAT ASSURANCES CAN YOU OFFER IN THAT REGARD?**

11 A. First, as specified by the statute, in-state connection fees must be eliminated as a
12 condition of receiving the access charge reductions. Second, the competitive
13 nature of the long-distance market assures that cost reductions will flow to the
14 benefit of Florida’s consumers. Finally, the empirical evidence on access charge
15 reductions and long-distance rates indicates that IXCs have historically more than
16 passed through access charge reductions that they have received.²

17
18 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

19 A. Yes.

¹ http://www.psc.state.fl.us/general/publications/consumer_bulletin/jan03jaber.pdf

² See, e.g., S.A. Edelman “The FCC and the Decline in AT&T’s long distance rates, 1980-1992: Did Price Caps do it?” Review of Industrial Organization, Vol. 12, 1997, pp. 537-553; and F.K. Kahai, D.L. Kaserman, and J.W. Mayo “Is the ‘Dominant Firm’ Dominant? An Empirical Analysis of AT&T’s Market Power,” Journal of Law and Economics, Vol 39, October, 1996, pp. 499-517.