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BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

PETITION BY VERIZON FLORIDA INC. TO REFORM INTRASTATE NETWORK ACCESS AND BASIC LOCAL TELECOMMUNICATIONS RATES IN ACCORDANCE WITH SECTION 364.164, FLORIDA STATUTES. DOCKET NO. 030867-TL

PETITION BY SPRINT-FLORIDA, INCORPORATED TO REDUCE INTRASTATE SWITCHED NETWORK ACCESS RATES TO INTERSTATE PARITY IN REVENUE-NEUTRAL MANNER PURSUANT TO SECTION 364.164(1), FLORIDA STATUTES. DOCKET NO. 030868-TL

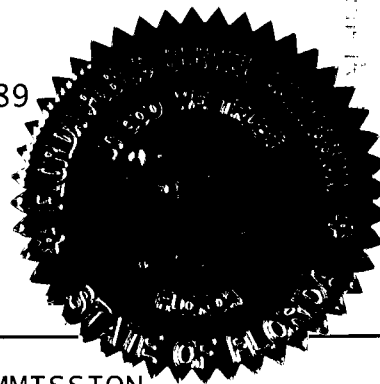
PETITION FOR IMPLEMENTATION OF SECTION 364.164, FLORIDA STATUTES, BY REBALANCING RATES IN A REVENUE-NEUTRAL MANNER THROUGH DECREASES IN INTRASTATE SWITCHED ACCESS CHARGES WITH OFFSETTING RATE ADJUSTMENTS FOR BASIC SERVICES, BY BELLSOUTH TELECOMMUNICATIONS, INC. DOCKET NO. 030869-TL

FLOW-THROUGH OF LEC SWITCHED ACCESS REDUCTIONS BY IXCs, PURSUANT TO SECTION 364.163(2), FLORIDA STATUTES. DOCKET NO. 030961-TI

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VOLUME 5
PAGES 419 THROUGH 589

PROCEEDINGS: HEARING



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BEFORE: CHAIRMAN LILA A. JABER
COMMISSIONER J. TERRY DEASON
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER RUDOLPH "RUDY" BRADLEY
COMMISSIONER CHARLES M. DAVIDSON

DATE: Thursday, December 11, 2003

TIME: Commenced at 8:40 a.m.

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

REPORTED BY: MARY ALLEN NEEL, RPR

APPEARANCES: (As heretofore noted.)

I N D E X

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56	SB-1, SB-2, SB-3, and SB-4	428	447
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P R O C E E D I N G S

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CHAIRMAN JABER: Good morning. Let's get
on the record and start the hearing this morning.

MS. MAYS: Good morning, Madam Chair.

CHAIRMAN JABER: Good morning. You know, I
neglected to come back to Ms. White yesterday about a
request for official recognition. Ms. Mays, do you
have that information or -- let's go ahead and --

MS. WHITE: I do. Nancy White for
BellSouth. I spoke with Mr. Twomey and Mr. Beck, and
neither one of them had an objection to those orders
having official notice taken of those two court
orders.

CHAIRMAN JABER: Okay. Do you have the
orders handy? You can read them into record, and
we'll grant your request for official recognition.

MS. WHITE: Yes, ma'am. Just one second.

The first one is the United State District
Court, Southern District of Miami, Miami Division.
The case is called Padron, P-a-d-r-o-n, vs.
BellSouth. It's Case No. 00-3489-CIV-KING, and it's
an order granting a motion for summary judgment.

The second one is the United States Court

1 of Appeals for the Eleventh Circuit. Again the title
2 is Padron vs. BellSouth Telecommunications. The
3 number is 02-12441. And it's just called "Order," I
4 believe.

5 CHAIRMAN JABER: Okay. Thank you. Your
6 request for official recognition is granted --

7 MS. WHITE: Thank you.

8 CHAIRMAN JABER: -- for those two orders.
9 And, parties, I asked Ms. Keating if we
10 could all agree to putting into the record via
11 official recognition what the federal poverty income
12 level was, and I'm hoping, Ms. Keating, you've had an
13 opportunity to talk to the parties about that.

14 MS. KEATING: Yes, Madam Chairman, and it
15 appears that no one objects to that.

16 CHAIRMAN JABER: Okay. And it looks like
17 you've handed the Commissioners a copy of what we
18 believe the federal poverty income level is as of
19 2002; is that right?

20 MS. KEATING: Yes, Madam Chairman. That is
21 excerpts. I believe most of the parties would prefer
22 that the entire document be taken official recognition
23 of, but it is a rather voluminous document, so we've
24 provided only pertinent excerpts.

25 CHAIRMAN JABER: Okay. And what's the

1 appropriate title for the entire document so I can go
2 ahead and do that?

3 MS. KEATING: U.S. Census Bureau
4 information regarding federal poverty level as of
5 2002.

6 CHAIRMAN JABER: we'll officially recognize
7 that document.

8 Anything else as a preliminary matter this
9 morning before we take up the first witness?

10 MS. KEATING: None that I'm aware of, Madam
11 Chairman.

12 CHAIRMAN JABER: No stipulated witnesses?
13 well, maybe after lunch.

14 BellSouth, call your next witness.

15 MS. MAYS: Thank you, Madam Chairman. Our
16 next witness is E. Steven Bigelow, and he was sworn in
17 yesterday.

18 Thereupon,

19 E. STEVEN BIGELOW
20 was called as a witness on behalf of BellSouth
21 Telecommunications, Inc. and, having been duly sworn,
22 testified as follows:

23 DIRECT EXAMINATION

24 BY MS. MAYS:

25 Q Mr. Bigelow, could you please provide your

1 name and business address for the record?

2 A My name is Steve Bigelow. My business
3 address is 3535 Colonnade Parkway, Birmingham, Alabama
4 35243.

5 CHAIRMAN JABER: I don't know if Mr. Self
6 helped you or hurt you. We saw you touch it.

7 Tap on your microphone for me, please.

8 Now turn the button on again.

9 Thank you.

10 BY MS. MAYS:

11 Q Mr. Bigelow, did you cause to be prefiled
12 in this case seven pages of revised direct testimony?

13 A I did.

14 Q Do you have any changes or corrections to
15 that testimony?

16 A No.

17 MS. MAYS: Madam Chair, if we could cause
18 the prefiled revised direct testimony of Mr. Bigelow
19 to be inserted in the records as if read.

20 CHAIRMAN JABER: The prefiled revised
21 direct testimony of E. Steven Bigelow will be inserted
22 into the record as though read.

23 BY MS. MAYS:

24 Q Mr. Bigelow, did you also cause to be
25 prefiled four exhibits with your direct testimony?

1 A I did.

2 Q And those exhibits are SB-1 through 4?

3 A That's correct.

4 Q Mr. Bigelow, did you cause to be prefiled
5 revised Exhibits SB-1 and 2?

6 A Yes, I did.

7 MS. MAYS: Those exhibits have been
8 provided to the Commissioners, Madam Chair, and to all
9 parties.

10 BY MS. MAYS:

11 Q Mr. Bigelow, are there any changes to your
12 prefiled Exhibits SB-3 and 4?

13 A No, there are not.

14 Q Mr. Bigelow, please describe briefly what
15 the changes are to the Exhibits SB-1 and 2.

16 A We discovered that there was a rounding
17 error in some of the rates that caused them to be
18 raised to the next penny, so we corrected that
19 rounding to round it to the nearest penny instead.

20 Q And could you please provide the overall
21 impact of the correction to revised SB-1 and 2?

22 A It was \$2,800 to SB-1, and approximately
23 \$1,300 to SB-2.

24 MS. MAYS: Madam Chair, if we could have
25 marked as the next exhibit the revised SB-1 and 2 and

1 SB-3 and 4.

2 CHAIRMAN JABER: Exhibit 56 will be used
3 for revised Exhibits SB-1 and 2 and Exhibits SB-3 and
4 4.

5 (Exhibit 56 marked for identification.)

6 BY MS. MAYS:

7 Q And all of those exhibits are confidential;
8 is that correct, Mr. Bigelow?

9 A That's correct.

10 Q Mr. Bigelow, did you also cause to be
11 prefiled in this case three pages of rebuttal
12 testimony?

13 A I did.

14 Q Do you have --

15 CHAIRMAN JABER: Can I interrupt you for a
16 minute? All of the SB-1 through 4 exhibits are
17 confidential?

18 MS. MAYS: Yes, Madam Chair. They have all
19 been previously filed with the appropriate request for
20 confidential treatment.

21 CHAIRMAN JABER: The numbers?

22 MS. MAYS: The --

23 CHAIRMAN JABER: Ms. Mays, walk up here,
24 please, and look at my exhibit. My question to you,
25 is, is that confidential information?

1 (Chairman Jaber and Ms. Mays confer at the
2 bench.)

3 CHAIRMAN JABER: Thank you.

4 Commissioners, if you have actually in your
5 material tables that are labeled SB-1 through SB-4,
6 please make a note that those are confidential. And
7 again, SB-1 through SB-4 are confidential exhibits,
8 and they're identified as Exhibit 56 for the hearing.

9 MS. MAYS: Thank you, Madam Chair.

10 COMMISSIONER DEASON: Madam Chair, I do not
11 have SB-4, so if I could have that provided to me.

12 MS. MAYS: Yes, Commissioner Deason. That
13 was prefiled with Mr. Bigelow's testimony. That --

14 COMMISSIONER DEASON: I have SB-1, 2, and
15 3.

16 MS. MAYS: Okay. We'll make sure we get
17 you another copy.

18

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25

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**
2 **REVISED DIRECT TESTIMONY OF E. STEVEN BIGELOW**
3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
4 **SEPTEMBER 30, 2003**

5
6 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

7
8 A. My name is E. Steven Bigelow. My business address is 3535 Colonnade Parkway,
9 Birmingham, Alabama. I am a Director in the Pricing Strategy Department of
10 BellSouth Telecommunications, Inc. ("BellSouth"). My area of responsibility is
11 the provision of demand and revenue analysis in support of regulatory filings.

12
13 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR EDUCATIONAL**
14 **BACKGROUND AND WORK EXPERIENCE.**

15
16 A. I attended the University of Alabama, graduating with a Bachelor of Science
17 Degree in 1975. I received a Masters of Business Administration from the
18 University of Alabama in 1976.

19
20 My career with BellSouth spans twenty-seven years. My initial employment was
21 with South Central Bell in 1976, where I held positions in Market Research,
22 Economic Analysis and Rates and Tariffs. In 1981 I accepted a transfer to AT&T
23 where I served as the coordinator for a tariff standardization project. After
24 divestiture, I transferred to BellCore where I worked on local exchange planning
25 and new service concepts. In 1984 I returned to BellSouth to work in the pricing

1 organization. I have been in my current assignment since 1989.

2

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

4

5 A. The purpose of my testimony is to demonstrate that the revenue impacts of the
6 price changes proposed by BellSouth in this petition are calculated in compliance
7 with Section 364 of the Florida statutes. Section 364.164 contains specific rules
8 concerning which services are to be included in the new revenue category and how
9 the units of demand and revenues for the category are to be calculated. I will show
10 that the priceouts presented in Exhibits SB-1, SB-2, SB-3 and SB-4 (attached) are
11 in compliance with these rules.

12

13 **Q. WHAT REQUIREMENTS DOES THE STATUTE IMPOSE FOR**
14 **SERVICES TO BE INCLUDED IN THE NEW REVENUE CATEGORY?**

15

16 A. Section 364.164(2) states that:

17 If the commission grants the local exchange telecommunications company's
18 petition, the local exchange telecommunications company is authorized, the
19 requirements of s. 364.051(3) notwithstanding, to immediately implement a
20 revenue category mechanism consisting of basic local telecommunications
21 service revenues and intrastate switched network access revenues to achieve
22 revenue neutrality.

23 Section 364.02(1) further defines this authorization by stating that:

24 Basic local telecommunications service means voice-grade, flat-rate
25 residential, and flat-rate single-line business local exchange services which

1 provide dial tone, local usage necessary to place unlimited calls within a local
2 exchange area, dual tone multifrequency dialing, and access to the following:
3 emergency services such as "911," all locally available interexchange
4 companies, directory assistance, operator services, relay services, and an
5 alphabetical directory listing. For a local exchange telecommunications
6 company, such term shall include any extended area service routes, and
7 extended calling service in existence or ordered by the commission on or
8 before July 1, 1995.

9 While the statute does not provide a complete definition of "intrastate switched
10 network access service", Section 364.164(6) identifies the services to be used to
11 determine rate parity. These services are:

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

17

18 **Q. DOES BELLSOUTH'S FILING COMPLY WITH THESE**
19 **REQUIREMENTS?**

20

21 A. Yes it does. Exhibits SB-1 and SB-2 contain all of the exchange services specified
22 by the legislation. Exhibit SB-3 contains all of the switched access services
23 identified for calculating parity. These are the services BellSouth proposes to
24 include in the new revenue category.

25

1 **Q. WHAT REQUIREMENTS DOES THE STATUTE IMPOSE FOR**
2 **CALCULATING THE REVENUES RECEIVED FROM SERVICES IN**
3 **THE NEW CATEGORY?**

4

5 **A.** Section 364.164(7) states that the:

6 Calculation of revenue received from each service before the implementation
7 of any rate adjustment must be made by multiplying the then-current rate for
8 each service by the most recent 12 months' actual pricing units for each service
9 within the category, without any adjustments to the number of pricing units.

10 Section 364.164(7) also states that:

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

13

14 **Q. DOES BELLSOUTH'S FILING COMPLY WITH THIS REQUIREMENT?**

15

16 **A.** Yes it does. The demand data used to develop Exhibits SB-1, SB-2, SB-3 and
17 SB-4 are based on 12 months of historical data ending June 2003. All of this data
18 comes from BellSouth's billing records and are an accurate representation of the
19 actual demand for these services. These are the same sources of data that
20 BellSouth has been using to support tariff filings before the Commission since well
21 before the adoption of price regulation. The end user recurring monthly demand in
22 Exhibits SB-1 and SB-2 comes from a summarization of the monthly end user
23 billing records known as the STAT Master File. The source for the end user non-
24 recurring demand is a direct feed from the service order portion of the customer
25 billing records. The end user usage data is a summarization of a direct feed from

1 CRIS Usage Processing, which is the portion of the billing system responsible for
2 local usage billing.

3 The demand in Exhibits SB-1 and SB-2 is summarized at the tariff rate element
4 level, and where possible into retail units, concession units and resale units to
5 show actual billing units without any adjustments. Where BellSouth was unable to
6 separately identify demand units sold at a discount, the units are shown without
7 any adjustments and are presented as if they are billed at the full retail level.

8 In accordance with the statute's directive, access lines associated with pay
9 telephone service and Lifeline service are not included in any of the calculations.

10 The switched access demand in Exhibits SB-3 and SB-4 is a summarization of a
11 direct copy of the CABS carrier level billing data.

12

13 **Q. IN HIS TESTIMONY, BELLSOUTH WITNESS JOHN RUSCILLI STATES**
14 **THAT THE EXCHANGE PRICE INCREASES PROPOSED BY**
15 **BELLSOUTH TO OFFSET THE ACCESS REDUCTIONS FOR THE**
16 **"TYPICAL NETWORK" COMPOSITE ARE WORTH \$125.2 MILLION.**
17 **CAN YOU SUPPORT THIS STATEMENT?**

18

19 A. Yes. As shown in Exhibit SB-1, implementing the prices proposed in Exhibit
20 JAR- 1 to Mr. Ruscilli's testimony will produce an impact of \$125.2 million using
21 the demand and rate methodology specified by the legislation.

22

23 **Q. IN HIS TESTIMONY, BELLSOUTH WITNESS JOHN RUSCILLI STATES**
24 **THAT THE EXCHANGE PRICE INCREASES PROPOSED BY**
25 **BELLSOUTH TO OFFSET THE ACCESS REDUCTIONS FOR THE RATE**

1 **ELEMENT MIRROR ARE WORTH \$136.3 MILLION. CAN YOU**
2 **SUPPORT THIS STATEMENT?**

3

4 A. Yes. As shown in Exhibit SB-2, implementing the prices proposed in Exhibit
5 JAR- 1 to Mr. Ruscilli's testimony will produce an impact of \$136.3 million using
6 the demand and rate methodology specified by the legislation.

7

8 **Q. IN HIS TESTIMONY, BELLSOUTH WITNESS JERRY HENDRIX**
9 **STATES THAT THE REVENUE IMPACT FROM USING THE**
10 **MIRRORING METHODOLOGY IS \$136.4 MILLION. CAN YOU**
11 **SUPPORT THIS NUMBER?**

12

13 A. Yes. As shown in Exhibit SB-3, converting the current intrastate access rates to the
14 interstate rate in effect on January 1, 2003, produces an impact of \$136.4 million using
15 the demand and rate methodology specified by the legislation.

16

17 **Q. IN HIS TESTIMONY, BELLSOUTH WITNESS JERRY HENDRIX ALSO**
18 **STATES THAT THE REVENUE IMPACT FROM USING THE TYPICAL**
19 **NETWORK COMPOSITE METHODOLOGY IS \$125.2 MILLION. CAN**
20 **YOU SUPPORT THIS NUMBER?**

21

22 A. Yes. As shown in Exhibit SB-4, reducing the rate elements contained in the typical
23 network composite produces an impact of \$125.2 million using the demand and rate
24 methodology specified by the legislation.

25

1

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

3

4 A. Yes it does.

5

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1 MS. MAYS: Madam Chair, can we proceed?

2 CHAIRMAN JABER: Yes.

3 BY MS. MAYS:

4 Q Mr. Bigelow, we were discussing your
5 rebuttal testimony. Did you have any changes or
6 corrections to your rebuttal testimony?

7 A No, I do not.

8 Q And if I were to ask you the questions here
9 today, your answers would be the same?

10 A Yes, they would.

11 MS. MAYS: For the record, Madam Chair,
12 pages 2 and 3 of Mr. Bigelow's rebuttal testimony were
13 filed as confidential. There are certain numbers on
14 that testimony that are confidential. If we could
15 have that prefiled rebuttal testimony inserted in the
16 record as though read.

17 CHAIRMAN JABER: The prefiled testimony of
18 E. Steven Bigelow is inserted into the record as
19 though read.

20

21

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25

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**
2 **REBUTTAL TESTIMONY OF E. STEVEN BIGELOW**
3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
4 **DOCKET NOS. 030867-TL, 030868-TL, 030869-TL & 030961-TI**
5 **NOVEMBER 19, 2003**

6
7 Q. **PLEASE STATE YOUR NAME, ADDRESS AND POSITION WITH**
8 **BELLSOUTH TELECOMMUNICATIONS, INC.**

9
10 A. My name is E. Steven Bigelow. My business address is 3535 Colonnade
11 Parkway, Birmingham, Alabama. I am a Director in the Pricing Strategy
12 Department of BellSouth Telecommunications, Inc. ("BellSouth"). My area of
13 responsibility is the provision of demand and revenue analysis in support of
14 regulatory filings.

15
16 Q. **ARE YOU THE SAME STEVE BIGELOW WHO FILED DIRECT**
17 **TESTIMONY?**

18
19 A. Yes.

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

22
23 A. The purpose of my testimony is to rebut witness Dr. David J. Gabel's
24 calculation of BellSouth's average business rate in Florida and witness Bion C.

25

1 Ostrander's estimate of the average toll minutes of use for a BellSouth
2 customer in Florida.

3

4 **Q. ON PAGE 29, LINE 1 OF HIS TESTIMONY, DR. GABEL PROVIDES A**
5 **CALCULATION OF THE AVERAGE REVENUE FOR A BUSINESS**
6 **LINE IN FLORIDA USING DATA FROM EXHIBIT SB-1. IS THERE A**
7 **PROBLEM WITH THIS AVERAGE?**

8

9 A. Yes. Dr Gabel's calculation is based on the data contained in the original
10 exhibit SB-1. Prior to re-filing the petition, BellSouth discovered that single
11 line business demand in Exhibit SB-1 was overstated due to a database error.
12 This error was corrected in the re-filed Exhibit SB-1. Had Dr. Gabel used the
13 correct data when he developed his testimony, he would have shown an
14 average of **begin proprietary** [REDACTED] **end proprietary**. This is composed of
15 \$6.50 for the SLC and **begin proprietary** [REDACTED] **end proprietary** for the
16 line.

17

18 **Q. BEGINNING ON PAGE 24, LINE 18 OF HIS TESTIMONY, BION**
19 **OSTRANDER EXPLAINS HOW HE DETERMINED THE AVERAGE**
20 **MINUTES OF INTRASTATE TOLL USE PER MONTH FOR A**
21 **FLORIDA RESIDENTIAL CUSTOMER. IS HIS ESTIMATE OF 44**
22 **MINUTES REASONABLE TO USE IN CALCULATING THE**
23 **BENEFITS OF BELL SOUTH'S REBALANCING PROPOSAL?**

24

25

1 A. No. The data provided to the Office of Public Counsel in response to its
2 Request for Production number 3, included a detailed study on customer
3 calling patterns in Florida. The April 2003 data BellSouth collected shows that
4 an average of **begin proprietary** [REDACTED] **end proprietary** minutes of use per
5 residence account would be a more reasonable estimate. This is composed of
6 approximately **begin proprietary** [REDACTED] **end proprietary** minutes of BellSouth
7 intraLATA toll minutes of use and approximately **begin proprietary** [REDACTED] **end**
8 **proprietary** minutes of intrastate access minutes of use.

9

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

11

12 A. Yes.

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1 BY MS. MAYS:

2 Q Mr. Bigelow, have you prepared a summary of
3 your testimony?

4 A I have.

5 Q would you please give it now?

6 A Good morning. The purpose of my testimony
7 is to demonstrate that the revenue impacts of the
8 price changes proposed by BellSouth in this case have
9 been calculated in compliance with the Florida
10 Statutes.

11 Now, the Florida Statutes imposes several
12 requirements on BellSouth in this case. First, it
13 specifies the services to be included in the
14 analysis. More specifically, it states that the new
15 revenue category shall include basic local exchange
16 service, including the extended calling routes
17 approved by the Commission prior to July 1995, and the
18 intrastate switched access services. BellSouth's
19 analysis includes these services.

20 Second, the statute specifies the units of
21 demand and the rates to be considered. It states that
22 the filing is to be made with the most recent 12
23 months worth of historical building units without
24 adjustments, and that it should exclude Lifeline and
25 pay telephone access lines. It states that the rates

1 to be used should be the most current rates in effect,
2 and that the target rate for parity should be the
3 January 2003 interstate switched access rates.
4 BellSouth has used these rates and these units of
5 demand.

6 Finally, the statute specifies that the
7 impact to BellSouth should be revenue neutral in the
8 new category. As shown in the summaries of the
9 attachments to my testimony, BellSouth has complied
10 with this requirement as well.

11 Based on my testimony, BellSouth's revenue
12 impacts have been calculated in compliance with the
13 requirements of the statute and should be accepted.

14 Thank you. That concludes my summary.

15 MS. MAYS: The witness is available for
16 cross.

17 CHAIRMAN JABER: Mr. Chapkis, Mr. Fons,
18 Mr. Meros, Mr. Hatch.

19 MR. HATCH: No questions.

20 CHAIRMAN JABER: Mr. Beck.

21 MR. BECK: Thank you, Madam Chairman.

22 CROSS EXAMINATION

23 BY MR. BECK:

24 Q Good morning, Mr. Bigelow.

25 A Good morning.

1 Q would you please turn to your rebuttal
2 testimony at page 3?

3 A Okay.

4 Q And in your confidential rebuttal
5 testimony, you break down the average calling per
6 residential account between interLATA and intra -- and
7 interLATA intrastate minutes, do you not?

8 A I show the total number of minutes of use
9 on a residence account, and the number of minutes that
10 would represent BellSouth's intraLATA toll, and the
11 number of minutes that would represent intrastate
12 access minutes.

13 Q What was your database for using this? Was
14 it all BellSouth residential customers?

15 A Yes.

16 Q And did it matter whether a customer was
17 presubscribed to another carrier for intraLATA long
18 distance?

19 A No.

20 Q BellSouth does not have any proposed
21 reductions for intraLATA toll in this proceeding;
22 isn't that correct?

23 A Well, my testimony doesn't address the
24 rates, but I'm not aware of any.

25 Q Do you know what the median use would be

1 for these figures that you provide in your testimony?

2 A No, I do not.

3 Q wouldn't the median amounts typically be
4 less than the average amounts?

5 A Yes.

6 MR. BECK: Thank you. That's all I have.

7 CHAIRMAN JABER: Thank you, Mr. Beck.

8 Ms. Bradley?

9 CROSS EXAMINATION

10 BY MS. BRADLEY:

11 Q Sir, is it my understanding that when you
12 say that your testimony and the rate proposals are in
13 compliance with the Florida Statute, you're just
14 addressing the four provisions of that one statute;
15 correct?

16 A What four provisions?

17 Q well, clarify for me then. When you say
18 it's in compliance with the Florida Statute, which
19 Florida Statute are you saying it's in compliance
20 with?

21 A As I state in my testimony, I'm in
22 compliance with section 364.164(2) that states that
23 we're going to be able to create a new revenue
24 category that would be comprised of local basic
25 exchange services and intrastate toll services. I'm

1 in compliance with the section that says that that
2 should be based on historical units of demand and
3 current rates for the current revenue and the target
4 rate for interstate, and that --

5 Q So you're not -- I'm sorry. Are you
6 through?

7 A And that we're in compliance with the
8 requirement that that overall impact be revenue
9 neutral in the new revenue category.

10 Q And your opinion is limited to that;
11 correct?

12 A That is correct.

13 Q And so you're not giving an opinion on
14 compliance with any other provisions of Florida
15 Statute?

16 A No, I am not.

17 MS. BRADLEY: Okay. Thank you.

18 CROSS EXAMINATION

19 MR. TWOMEY:

20 Q Good morning, Mr. Bigelow.

21 A Good morning.

22 Q Just briefly to follow up on what
23 Ms. Bradley asked you, on page 2 of your prefiled
24 direct testimony, when you talk about the revenue
25 category and the company's compliance with 364.164(2),

1 do I understand you to be saying that that statute
2 limits the revenue that has to be considered just to
3 the definition of basic local service?

4 A Yes.

5 Q And so do I understand that to mean that
6 necessarily the revenues that the company earns from
7 other services, access, vertical services, and so
8 forth, is specifically excluded in this calculation?
9 Is that correct?

10 A I'm not sure that I follow your question.
11 Access is included in the new revenue category, so we
12 would be explicitly considering the reductions in
13 access.

14 As far as the portion of your question
15 concerning vertical service features, no, we would not
16 be considering those.

17 MR. TWOMEY: Okay. Thank you. That's
18 all.

19 CHAIRMAN JABER: Staff?

20 MS. BANKS: Staff has no questions.

21 Commissioners?

22 Redirect.

23 Thank you, Mr. Bigelow, for your testimony.

24 THE WITNESS: Thank you.

25 CHAIRMAN JABER: Ms. Mays, Exhibit 56?

1 MS. MAYS: Yes, Madam Chair, if it could
2 be moved into the record.

3 CHAIRMAN JABER: Without objection, Exhibit
4 56 is admitted into the record.

5 (Exhibit 56 admitted into the record.)

6 CHAIRMAN JABER: Commissioner Bradley, do
7 me a favor. If you have SB-1 through SB-4 attached to
8 Mr. Bigelow's testimony, would you mark those
9 confidential, if you have it? You may not.

10 MS. MAYS: Madam Chair, may the witness be
11 excused?

12 CHAIRMAN JABER: Yes, absolutely.

13 MS. WHITE: BellSouth calls Jerry Hendrix
14 to the stand.
15 Thereupon,

16 JERRY HENDRIX
17 was called as a witness on behalf of BellSouth
18 Telecommunications, Inc. and, having been duly sworn,
19 testified as follows:

20 DIRECT EXAMINATION

21 BY MS. WHITE:

22 Q Mr. Hendrix, could you please state your
23 name and address for the record?

24 A Yes. My name is Jerry Hendrix. My address
25 is 675 West Peachtree Street, Atlanta, Georgia.

1 Q By whom are you employed, and in what
2 capacity?

3 A By BellSouth, as Assistant Vice President,
4 ICS Marketing.

5 Q Have you caused to be prefiled in this case
6 direct testimony consisting of seven pages?

7 A Yes, I did.

8 Q Do you have any changes to that testimony
9 at this time?

10 A No, I do not.

11 Q If I were to ask you the questions
12 contained in your prefiled direct testimony today,
13 would your answers be the same?

14 A Yes, they would be.

15 MS. WHITE: I would ask that Mr. Hendrix's
16 direct prefiled testimony be entered into the record.

17 CHAIRMAN JABER: The prefiled revised
18 direct testimony of Jerry Hendrix shall be inserted
19 into the record as though read.

20 BY MS. WHITE:

21 Q And, Mr. Hendrix, did you have three
22 exhibits attached to your direct testimony, JH-1,
23 JH-2, and JH-3?

24 A Yes, I did.

25 Q Do you have any changes to those exhibits?

1 A No, I do not.

2 MS. WHITE: I would ask that the exhibits
3 attached to Mr. Hendrix's direct testimony be labeled
4 with the next exhibit number.

5 CHAIRMAN JABER: JH-1 through JH-3 will be
6 identified as Exhibit 57.

7 (Exhibit 57 marked for identification.)

8 BY MS. WHITE:

9 Q And, Mr. Hendrix, none of those exhibits
10 are confidential, are they?

11 A No, they are not.

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1 BELLSOUTH TELECOMMUNICATIONS, INC.
2 REVISED DIRECT TESTIMONY OF JERRY HENDRIX
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 030869-TL
5 SEPTEMBER 30, 2003
6

7 Q. PLEASE STATE YOUR NAME, YOUR POSITION WITH BELLSOUTH
8 TELECOMMUNICATIONS, INC. ("BELLSOUTH") AND YOUR BUSINESS
9 ADDRESS.
10

11 A. My name is Jerry Hendrix. I am employed by BellSouth as Assistant Vice President,
12 Interconnection Services Marketing. My business address is 675 West Peachtree Street,
13 Atlanta, Georgia 30375.
14

15 Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR EDUCATIONAL
16 BACKGROUND AND EXPERIENCE WITH BELLSOUTH.
17

18 A. I graduated from Morehouse College in Atlanta, Georgia, in 1975 with a Bachelor of Arts
19 Degree. I began employment with Southern Bell in 1979 and have held various positions in
20 the Network Distribution Department before joining the BellSouth Headquarters Regulatory
21 organization in 1985. On January 1, 1996, my responsibilities moved to Interconnection
22 Services Pricing in the Interconnection Customer Business Unit. As part of this transition I
23 became BellSouth's representative in the negotiation of BellSouth's interconnection
24 agreements including the BellSouth/AT&T Interconnection Agreement, among others.
25

1 In my current position as Assistant Vice President, Interconnection Services Marketing, I
2 oversee the negotiation of interconnection agreements between BellSouth and Competitive
3 Local Exchange Carriers (“CLECs”) in BellSouth’s nine-state region, relationships with
4 Independent Telephone Companies and certain product management functions including
5 Switched Access Services.

6
7 Q. PLEASE EXPLAIN THE PURPOSE OF YOUR TESTIMONY.

8
9 A. My revised testimony deals with the switched network access issues associated with this
10 filing. This revised testimony serves a four-fold purpose: (1) to describe the categorization
11 of switched access services under revised Section 364.164, (2) to present two methodologies
12 for the calculation of the reduction of intrastate switched network access revenues in which
13 to achieve revenue neutrality, the “mirroring” methodology and the “typical network”
14 methodology, (3) to demonstrate the achievement of rate parity between the composite
15 intrastate switched network access rate with the composite interstate switched network
16 access rate for each methodology , and (4) to present the plan to implement the revenue
17 reduction.

18
19 Q. HOW ARE SWITCHED NETWORK ACCESS SERVICES CATEGORIZED UNDER
20 THE REVISED SECTION 364.164?

21
22 A. The new Florida legislation provides for a new revenue category consisting of basic local
23 telecommunications service revenues and intrastate switched network access revenues. This
24 new revenue category will include approximately 1,700 rate elements associated with
25 intrastate switched network access. These rate elements in this new revenue category

1 include the rate elements from these sections of the Access Services tariff – Carrier
2 Common Line, BellSouth SWA Services, BellSouth Directory Assistance Services, and
3 Access Service for Local Exchange Companies completion of IntraLATA-Intercompany
4 Long Distance MTS and WATS Calls. The switched network access rate elements are listed
5 in Exhibit SB-3, which is attached to the testimony of BellSouth witness Steve Bigelow.

6
7
8 Q. WHAT IS THE APPROPRIATE METHODOLOGY FOR THE REDUCTION OF
9 INTRASTATE SWITCHED NETWORK ACCESS REVENUES TO ACHIEVE
10 REVENUE NEUTRALITY?

11
12 A. There are two methodologies from which the Commission can choose in order to lower
13 intrastate switched network access revenues for the achievement of revenue neutrality within
14 the new revenue category. The first methodology is developed from a “mirroring” of the
15 recurring rate elements in the new revenue category specified by the legislation: carrier
16 common line, local channel/entrance facility, switched common transport, access tandem
17 switching, interconnection charge, signaling, information surcharge, and local switching.
18 The reduction of these elements to interstate parity is \$136.4M. Revised Exhibit JH-1
19 provides the detail of the revenue reduction calculated under this methodology.

20
21 The second methodology achieves parity by comparison of the “typical network” composite
22 for interstate with the composite with intrastate switched network access rates utilizing the
23 rate elements in BellSouth’s annual filing with the Commission, the Florida Access and Toll
24 Report, Tables 1 and 2. The revenue reduction resulting from the achievement of parity
25 using the typical network methodology is \$125.2M. Exhibit JH-2 contains a replication of
26 Tables 1 and 2 as well as the revenue reduction calculations with this methodology.

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Q. WHY IS THERE A DIFFERENCE IN THE REVENUE IMPACT BETWEEN THE TWO METHODOLOGIES?

A. The difference in the revenue impact stems from the number of rate elements utilized in each methodology. Both methodologies use the most recent 12 months demand to determine the intrastate switched network access revenue reduction.

The mirroring methodology utilizes all of the recurring switched network access rate elements as specified in Section 364.164(6) and included in the new revenue category (summary shown on revised Exhibit JH-1). The difference in the sum of the revenues calculated from the intrastate rates and the sum of the revenues calculated from the interstate rates is the intrastate switched network access revenue reduction.

On the other hand, the typical network methodology is based on the limited, specific rate elements as reported annually by BellSouth in the Florida Access and Toll Report, Tables 1 and 2 (see Exhibit JH-2). These rate elements are considered to be representative of averages for BellSouth's network. The use of composites from a typical network is consistent with the Commission's past practice for determination of switched access revenue reductions. The typical network methodology relies on network averages regarding minutes of use per line and distances for interoffice mileage. The difference in the composite rates per minute of use for intrastate and interstate switched network access rates are then multiplied by the most recent 12-month demand for local switching. The resulting

1 difference is the intrastate switched network access revenue reduction (see Exhibit JH-2,
2 page 3).

3
4 Q. DOES BELLSOUTH'S MIRRORING METHODOLOGY ACHIEVE COMPOSITE RATE
5 PARITY BETWEEN INTRASTATE AND BELLSOUTH'S INTERSTATE SWITCHED
6 NETWORK ACCESS RATES?

7
8 A. Yes. Revenues for the recurring rate elements are totaled and divided by the most recent 12
9 months local switching demand to provide composite rates. The composite intrastate
10 switched network access rate proposed upon implementation of the third reduction of this
11 plan is equal to the composite interstate switched network access rate in effect on January 1,
12 2003. The demonstration of composite rate parity is shown on revised Exhibit JH-1.

13
14 Q. DOES BELLSOUTH'S TYPICAL NETWORK METHODOLOGY ACHIEVE
15 COMPOSITE RATE PARITY BETWEEN INTRASTATE AND BELLSOUTH'S
16 INTERSTATE SWITCHED NETWORK ACCESS RATES?

17
18 A. Yes. The composite intrastate switched network access rate proposed after implementation
19 of the third reduction is equal to the composite interstate switched network access rate in
20 effect on January 1, 2003. These composite rates are shown on Exhibit JH-2.

21
22 Q. HOW DOES BELLSOUTH PLAN TO IMPLEMENT THE PROPOSED ACCESS
23 REVENUE REDUCTIONS ASSOCIATED WITH EACH METHODOLOGY?

24

1 A. In both methodologies, BellSouth proposes to implement the access revenue reduction
2 during the twenty-four (24) month period. The first reduction will be taken during the first
3 quarter, 2004 (1Q04), the second reduction during the first quarter, 2005 (1Q05), and the
4 third reduction during the first quarter, 2006 (1Q06). The proposed reductions will be taken
5 in the following manner:

6 1Q04 – 40 percent

7 1Q05 – 35 percent

8 1Q06 – 25 percent

9 For both methodologies proposed by BellSouth, implementation of the 1Q04 reduction will
10 eliminate originating Carrier Common Line (CCL) revenues and reduce terminating CCL
11 revenues. For both methodologies again, the 1Q05 reduction will eliminate terminating
12 CCL revenues and reduce local switching revenues. For both methodologies again, the
13 1Q06 reduction will be taken in local switching revenues. Revised Exhibit JH-3 provides
14 the details of the implementation of the access revenue reductions.

15
16
17 Q. HOW WILL THE MOST RECENT 12 MONTHS PRICING UNITS BE UTILIZED TO
18 IMPLEMENT THE ACCESS REDUCTION?

19
20 A. To determine the access revenue reduction for this filing, BellSouth used most recent 12
21 months pricing units (July 2002 through June 2003) as required by the legislation and as
22 described above. Therefore, for presentation of both methodologies, the same demand is
23 utilized for each year.

24

1 Upon the Commission's selection and approval of BellSouth's petition, BellSouth intends to
2 update its filing with the most recent 12 months pricing units. It is anticipated that pricing
3 units at least through September 2003 will be available. This procedure allows calculation
4 of the impacts to switched network access and to the corresponding basic local
5 telecommunications service revenues utilizing the most current pricing units available.

6
7 Likewise, BellSouth intends to make similar filings prior to the beginning of the last two
8 reductions. Accordingly, the most recent 12 months demand will be utilized to set rates to
9 be implemented on 1Q05 and 1Q06. This procedure will allow for a more accurate
10 demonstration of the achievement of revenue neutrality for the second and third reductions.

11
12 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

13
14 A. Yes.

1 BY MS. WHITE:

2 Q Mr. Hendrix, would you please give a
3 summary of your testimony?

4 A Yes. Thank you. Good morning.

5 CHAIRMAN JABER: Good morning.

6 A My testimony deals with the switched
7 network access issues and serves four purposes. Those
8 purposes are, I lay out the categories of switched
9 access under the revised Section 364.164, provide the
10 methods for calculating reduction in the intrastate
11 switched network access charges. I demonstrate how to
12 achieve parity between inter- and intrastate switched
13 access charges and provide a plan for implementing
14 these reductions.

15 BellSouth offers two methods for reducing
16 intrastate switched access charges to interstate
17 levels. First is the mirroring method. This is a
18 rate-by-rate mirroring of certain elements, as
19 contained in Section 364.164, and a typical network
20 method, which is a comparison of composite rates for
21 intra- and interstate switched access rates.

22 That concludes my summary.

23 Q And Mr. Hendrix, just to clarify, you did
24 not have any rebuttal testimony in this case; is that
25 right?

1 A That is correct.

2 MS. WHITE: Thank you. Mr. Hendrix is
3 available for cross examination.

4 CHAIRMAN JABER: Mr. Mann.

5 MR. MANN: Yes, Commissioner. Thank you.

6 CROSS EXAMINATION

7 BY MR. MANN:

8 Q Good morning, Mr. Hendrix. My name is Rick
9 Mann.

10 A Good morning.

11 Q Have you testified about switched network
12 access issues prior to today?

13 A Yes, only about 200 times.

14 Q Okay. And in your summary, you mention
15 that you present two methods of calculating for the
16 Commission's benefit. The second of those I would
17 like to ask you some questions about.

18 Are you familiar with a stipulation
19 agreement with the Office of Public Counsel and
20 Southern Bell telephone in '92, Docket 920260-TL?

21 A I think I am. Is that the docket in which
22 the legislation was passed and we reduced rates over
23 three phases in the mid-'90s?

24 Q Yes, sir.

25 A Yes, I am.

1 Q Okay. And in that docket, you used the
2 typical network composite method to calculate the
3 access charges, did you not, the reduction in access
4 charges?

5 A Subject to check, I believe that is right.
6 There may have been a mixture of how that was done. I
7 think in certain cases you had an element-by-element
8 basis, and then had you a composite rate basis where
9 you compared the composite rate. So it was a mixture,
10 but it would be more in line with the typical network
11 arrangement.

12 Q You use the typical network composite in
13 utilizing rate elements in your annual filing with the
14 Commission, do you not?

15 A Yes, we do. That's part of the access toll
16 report. Is that what you're referencing?

17 Q Yes, sir.

18 A Yes, sir.

19 Q And -- pardon me. This second methodology,
20 the result of that in the achievement of parity is
21 \$125.2 million; is that correct?

22 A That is correct. That is the typical
23 method that is used.

24 Q And the use of these composites, this
25 typical network composite method is consistent with

1 the Commission's past practice for the determination
2 of the switched access revenue reductions?

3 A Yes, sir, as I mentioned earlier, as part
4 of the previous legislation.

5 MR. MANN: I have no further questions.
6 Thank you, Mr. Hendrix.

7 CHAIRMAN JABER: Ms. Bradley?

8 MS. BRADLEY: No questions.

9 CHAIRMAN JABER: Mr. Twomey.

10 MR. MANN: Yes, ma'am, just briefly.

11 CROSS EXAMINATION

12 BY MR. TWOMEY:

13 Q Good morning.

14 A Good morning.

15 Q You just told Mr. Mann, as I heard it, that
16 the \$125.2 million methodology is consistent with
17 prior Commission practice?

18 A Yes, sir, I did.

19 Q And is the \$136.4 million methodology
20 consistent also with prior Commission practice?

21 A Well, what I mentioned in the very earlier
22 question he asked is that the mid-'90s, the dockets,
23 we used a mixture of elemental as well as the typical,
24 and the purpose for doing so was to target certain
25 reductions at certain elements when we went through

1 that mid-'90 process. And I also stated it was more
2 in line with the typical network arrangement.

3 Q Yes, sir. I think the difference between
4 the two numbers is about \$11.2 million; correct?

5 A That is correct.

6 Q I don't see that it's the purpose of your
7 testimony to suggest to the Commission which of those
8 two methodologies should be adopted; is that correct?

9 A No. I did not lay that out. What I laid
10 out was just the two methods by which it could be
11 done. And the mirroring is an elemental basis where
12 you look at intrastate rates and interstate rates and
13 apply those rates and then use the minutes of use and
14 back into the impact, whereas the typical is an
15 average, where you make certain assumptions about
16 transport haul of the interoffice piece, certain fill
17 factors on the dedicated transport that may be used.
18 And so it is just looking at averages, wherein some
19 customers may not use a DS1. They may use a DS3.
20 Some may use tandem switching. And so it's just
21 taking a typical DS1 network and using that. So I
22 didn't offer any. It's just two different ways of
23 coming up with the various impacts.

24 Q Yes, sir. But it's true, is it not, that
25 the bottom line is that if the Commission were to pick

1 the mirroring method that you offer, your customers'
2 basic local rates would necessarily have to increase
3 by \$11.2 million more than the other methodology?

4 A Well, I'm not exactly sure how the \$11.2
5 million would be spread, but it is a difference
6 between the 136 and the 125 of \$11 million.

7 Q So the answer is yes? Is it not yes?

8 A No, the answer is not yes. The answer is
9 no, I do not know how the 11.2 would be spread over
10 the customer, as to what part would be on the
11 recurring charges and what part would be on the
12 one-time charges. I do not know. That's beyond the
13 scope --

14 Q I see your distinction. You're saying the
15 distinction in my question is basic local rates as
16 opposed to nonrecurring?

17 A That's correct.

18 Q So if I rephrased my question to say isn't
19 it true that if the mirroring methodology were
20 selected by the Commission, your residential and
21 single-line business customers' rates, annual rates
22 would necessarily have to go up by \$11.2 million
23 either through basic local monthly rates or
24 nonrecurring charges?

25 A That's my understanding. But again, that's

1 beyond the scope of what I offer here today.

2 MR. TWOMEY: Okay. Thank you. That's all
3 I have.

4 CHAIRMAN JABER: Staff?

5 MS. BANKS: Thank you, Chairman.

6 CROSS EXAMINATION

7 BY MS. BANKS:

8 Q Good morning, Mr. Hendrix.

9 A Good morning.

10 Q I'm Felicia Banks, and I'm appearing in
11 this matter on behalf of the Commission. I have a few
12 questions to ask you.

13 Before we begin, I just want to be sure
14 that you have your exhibits in front of you that's
15 attached to your testimony.

16 A I do.

17 Q And do you have a copy of Section 364.164
18 of the Florida Statutes?

19 A Yes, I do.

20 Q Okay. I want to begin with the issue of
21 parity. Beginning with the statute, Section 364.164,
22 and I'm actually looking at subsection (6).

23 A I have it. Thank you.

24 Q Does Section 364.164(6) of the Florida
25 Statutes specifically mention that the intrastate

1 switched access rate includes the following: local
2 channel/entrance facility charges?

3 A Yes, it does.

4 Q Switched common transport charges?

5 A Yes.

6 Q Access tandem switching charges?

7 A Yes.

8 Q Access interconnection charges?

9 A Yes.

10 Q Signaling charges?

11 A Yes.

12 Q And information charge?

13 A Yes.

14 Q Okay. If the aforementioned items are
15 specifically mentioned in Section 364.164 of the
16 Florida Statutes, why are they not included in
17 BellSouth's proposed access charge reductions used in
18 the typical network methodology?

19 A They are. They are included. If you were
20 to look at JH-2, the first item that is mentioned is
21 the carrier common line. That is mentioned as carrier
22 common line at (6), under 364.164(6).

23 The second item that is mentioned is local
24 channel/entrance. That too is mentioned as local
25 channel/entrance. It's under the bold heading of

1 switched transport.

2 Switched common transport is also under
3 that bold heading of switched transport.

4 Access tandem switching is listed under
5 that bold heading.

6 Interconnection charges is a separate bold
7 heading. There aren't any rates associated with that
8 element, at least not for BellSouth.

9 And then you would have your local
10 switching, which is under your bold heading of end
11 office switching.

12 Q Okay. Does the network access rate
13 reduction utilized in the typical network methodology
14 meet the definition of switched network access rate as
15 defined in 364.164?

16 A My reading of that section, yes, the
17 typical network will satisfy what is in that section
18 of 364.164.

19 Q Okay. In BellSouth's calculations of the
20 intrastate switched access rates, does BellSouth
21 include the interstate PIC charge?

22 A No, we do not have a PICC. When you say
23 PIC, are you talking PICC?

24 Q Yes, PICC charge. Yes, that's correct.

25 A Okay. No, we do not have a PICC charge.

1 It was eliminated, so we have not included it.

2 Q So isn't it true that BellSouth does not
3 consider the interstate PIC charge to be a switched
4 access charge?

5 A No, that is not true. We simply do not
6 have a rate. We've gone through a process over the
7 years in our interstate filings to target certain rate
8 elements, and that is one we do not have.

9 Q I want to change gears a little bit,
10 Mr. Hendrix, to looking at the issue of revenue
11 neutrality. And this is kind of a follow-up to your
12 deposition, in which we discussed several hypothetical
13 scenarios involving originating and terminating access
14 charges in the context of wireless customers.

15 BellSouth receives both originating and
16 terminating access revenues in situations where an
17 interLATA call from a wireless customer is received by
18 a BellSouth wireline customer; correct?

19 A That is correct.

20 Q So then isn't it true that BellSouth
21 receives both originating and terminating access
22 revenues in situations where an interLATA call from a
23 BellSouth wireline customer is received by a wireless
24 customer?

25 A On the originating end -- this is a little

1 confusing. First, let me preface what I'm going to
2 say with how wireless is a little different from
3 regular switched access toll type calls.

4 In the State of Florida, you have what are
5 called MTAs. Those are major trading areas for our
6 wireless customers. There are four. There is a
7 Panhandle, Orlando, Jacksonville, and Miami. So for a
8 wireless customer, anything that is interMTA are
9 assessed -- those calls are assessed access charges.
10 If it's intraMTA, those wireless calls are assessed
11 local.

12 So if a call is originated by a landline
13 customer terminating to a wireless customer, if that
14 is a toll call, then, yes, we would receive access
15 charges on the originating end of that call.
16 Likewise, if it's originated by a wireless customer to
17 a landline customer and it's an interMTA call, yes, we
18 would assess access charges on that call. So it has
19 to travel between MTAs to have access charges apply.

20 Q Assuming that BellSouth is the ILEC and
21 the call is between two different locations, does
22 BellSouth receive both originating and terminating
23 access revenues in situations when an interLATA call
24 is made between two wireless customers?

25 A You say this is an inter?

1 Q That is correct, interLATA call.

2 A Okay. But is it interMTA?

3 Q Yes, it is.

4 A Then if it touches BellSouth's public
5 switched network -- and that is the key, if it touches
6 our public switched network, yes, we would receive
7 access charges on an interMTA call. But I don't know
8 that all of those calls would touch our network if
9 it's a wireless to wireless customer call.

10 Q Okay. Is the revenue received from either
11 the originating or the terminating access charges
12 involving the wireless providers included in the
13 amount of access revenue that you reference early in
14 your exhibit?

15 A Okay. I reference access rates in my
16 exhibit. If these rates are applied on a call that
17 would involve a wireless customer, then the revenues
18 are included as part of either the 125 or the 136
19 million.

20 I hope that answers your question. I'm
21 not --

22 Q Yes, sir, I believe you did answer my
23 question.

24 Assuming BellSouth's petition is granted,
25 will wireless providers receive the benefit of paying

1 lower access charges to BellSouth due to BellSouth's
2 reduced intrastate access charges?

3 A Yes, they would.

4 Q And assuming that BellSouth's petition is
5 granted, will some of those benefits of the BellSouth
6 proposed access rate reductions, will the wireless
7 customers receive a portion of that benefit?

8 A I don't know that I can answer that
9 question. Certainly if they are passed through to
10 those end-user wireless customers, then, yes, they
11 would receive benefits.

12 Q And what benefits might those be?

13 A Hopefully -- well, I could only assume that
14 if they are passed through, there would be reductions
15 in various plan rates, minute of use rate charges.
16 I'm assuming that would likely be the benefit.

17 Q So you think they would receive a reduction
18 in access charges?

19 A If the plan is approved and they pay access
20 charges, then the rates would be lower, so they should
21 receive a benefit in those access charges. Those that
22 are wireless carriers should receive a benefit.

23 MS. BANKS: Thank you, Mr. Hendrix. That's
24 all that staff has.

25 CHAIRMAN JABER: Mr. Hendrix, let me be

1 clear in my mind what the interstate access rate is as
2 of January 1, 2003. If you look at the statute, it
3 says parity is defined -- is achieved when the LEC
4 intrastate switched network access rate is equal to
5 the interstate switched network access rate in effect
6 on January 1, 2003. Pursuant to that definition, what
7 exactly is the interstate switched access rate as of
8 January 1st?

9 THE WITNESS: That is a hard question to
10 answer, because there are many variables. For
11 instance, if you were to look at JH-2 --

12 CHAIRMAN JABER: I'm there. I'm looking
13 at it.

14 THE WITNESS: Okay. We list the elements,
15 and we make certain assumptions. Looking at those
16 assumptions, you come back with a composite rate,
17 originating plus terminating, of .0098.

18 Now, the assumptions are listed below,
19 wherein you assume this is a Zone 1 type arrangement,
20 meaning that it's the most dense zone in the access
21 world. You also assume that you're using a DS1. And
22 there are other capacities available to the carrier.
23 It could be a DS3. It could be an OC type level. It
24 could be tandem switch, and tandem switch is simply on
25 a minute-of-use basis. But we made assumptions that

1 it would be a DS1 local channel and a DS1 entrance.
2 We made certain assumptions as to the minutes of use
3 that would travel over that circuit that would give
4 rise -- give some indication as to what the fill
5 factor is on that circuit and how the circuit is
6 engineered.

7 And so using those assumptions on a typical
8 network basis and consistent with the access toll
9 report, we would have a rate of .0098.

10 CHAIRMAN JABER: Okay. Recognizing those
11 assumptions, accept for a moment that I believe the
12 total interstate switched access rate can be
13 considered .0098 as of January 1, 2003. Now switch to
14 your JH-3. I'm assuming those same assumptions were
15 used in trying to achieve parity with .0098 and
16 calculating what the intrastate access charges are.

17 THE WITNESS: Yes, ma'am.

18 CHAIRMAN JABER: And my question to you is,
19 have you done -- using the typical network methodology
20 just to make it easier for you for purposes of this
21 question, using the typical network methodology, have
22 you calculated out what the numbers would be in terms
23 of reductions only to achieve .0098?

24 THE WITNESS: Yes. In fact, that is
25 contained at JH-2, page 3 of 3.

1 CHAIRMAN JABER: JH-2, page 2 of 3. And
2 where would I find the reductions? What I'm looking
3 for, just in layman's terms, Mr. Hendrix, do you see
4 how you come up with year 1 reduction of 50 million
5 plus, year 2, 43 plus, year 3, 31 plus?

6 THE WITNESS: Yes, ma'am.

7 CHAIRMAN JABER: I'm asking what the
8 reductions for that three-year period would be if you
9 were only trying to achieve a .0098 parity level.

10 THE WITNESS: And I believe that is what is
11 contained at JH-2, page 3 of 3. Just walking through
12 page 3 of 3, the .0098 is the second number.

13 CHAIRMAN JABER: I see. So is it your
14 testimony then that -- is it your testimony then that
15 the typical network methodology is the answer to my
16 question?

17 THE WITNESS: Yes, ma'am, I believe it is.

18 CHAIRMAN JABER: Okay. Thank you.

19 THE WITNESS: Thank you.

20 CHAIRMAN JABER: Commissioners, do you have
21 any questions?

22 Redirect?

23 MS. WHITE: I have no redirect. And may
24 Mr. Hendrix be excused?

25 CHAIRMAN JABER: Yes.

1 MS. WHITE: And I would move in Exhibit 57
2 into the record.

3 CHAIRMAN JABER: Without objection, Exhibit
4 57 is admitted into the record.

5 (Exhibit 57 admitted into the record.)

6 CHAIRMAN JABER: BellSouth, call your next
7 witness.

8 MS. WHITE: Yes. BellSouth calls Dr. Andy
9 Banerjee.
10 Thereupon,

11 ANDY BANERJEE, Ph.D.
12 was called as a witness on behalf of BellSouth
13 Telecommunications, Inc. and, having been duly sworn,
14 testified as follows:

15 DIRECT EXAMINATION

16 BY MS. WHITE:

17 Q Dr. Banerjee, could you please state your
18 name and address for the record.

19 A Yes. My name is Aniruddha "Andy"
20 Banerjee, and my address is 10 Main Street -- excuse
21 me. One Main Street, Cambridge, Massachusetts, 02142.

22 Q By whom are you employed and in what
23 capacity?

24 A I'm employed by NERA Economic Consulting.
25 I'm a vice president and an economic consultant for

1 the company.

2 Q And have you caused to be prefiled in this
3 case, or have you caused to adopt the prefiled direct
4 testimony of Dr. william Taylor in this docket?

5 A Yes, I have.

6 Q And that testimony consists of 16 pages?

7 A Correct.

8 Q If I were to ask you the questions
9 contained in that direct testimony today, with the
10 exception of the biographical material, would your
11 answers be the same?

12 A That's correct.

13 MS. WHITE: I would ask that the direct
14 testimony of Dr. william Taylor adopted by
15 Dr. Banerjee be accepted into the record.

16 CHAIRMAN JABER: The prefiled direct
17 testimony of william E. Taylor as adopted by
18 Dr. Banerjee shall be inserted into the record as
19 though read.

20 MS. WHITE: There is one exhibit to
21 Dr. Taylor's direct testimony, but it's his curriculum
22 vitae, so I don't think we need to enter that into the
23 record today.

24

25

ON BEHALF OF BELL SOUTH TELECOMMUNICATIONS, INC.
DIRECT TESTIMONY OF WILLIAM E. TAYLOR, Ph.D.
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
AUGUST 27, 2003

1 **I. INTRODUCTION AND SUMMARY**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT**
3 **POSITION.**

4 A. My name is William E. Taylor. I am Senior Vice President of NERA Economic
5 Consulting, ("NERA"), head of its Communications Practice, and head of its
6 Cambridge office located at One Main Street, Cambridge, Massachusetts 02142.

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL, PROFESSIONAL, AND**
8 **BUSINESS EXPERIENCE.**

9 A. I have been an economist for over thirty years. I earned a Bachelor of Arts degree
10 from Harvard College in 1968, a Master of Arts degree in Statistics from the
11 University of California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974,
12 specializing in Industrial Organization and Econometrics. For the past twenty-five
13 years, I have taught and published research in the areas of microeconomics,
14 theoretical and applied econometrics, and telecommunications policy at academic
15 and research institutions. Specifically, I have taught at the Economics Departments
16 of Cornell University, the Catholic University of Louvain in Belgium, and the
17 Massachusetts Institute of Technology. I have also conducted research at Bell
18 Laboratories and Bell Communications Research, Inc.

19 I have participated in telecommunications regulatory proceedings before
20 many state public service commissions, including the Florida Public Service
21 Commission ("Commission"). Before the Commission, I have testified in Docket
22 Nos. 900633-TL, 920260-TL, 920385-TL, 960786-TP, 980000-SP, 980696-TP,
23 990750-TP, 000075-TP, 000121-TP, 020119-TP, 020578-TP, and 020507-TP.

1 In addition, I have filed affidavits before the Federal Communications
2 Commission (“FCC”) and the Canadian Radio-television Telecommunications
3 Commission on matters concerning incentive regulation, price cap regulation,
4 productivity, access charges, local competition, interLATA competition,
5 interconnection and pricing for economic efficiency. Recently, I was chosen by the
6 Mexican Federal Telecommunications Commission and Telefonos de Mexico
7 (“Telmex”) to arbitrate the renewal of the Telmex price cap plan in Mexico.

8 I have also testified on market power and antitrust issues in federal court. In
9 recent years, I have studied—and testified on—the competitive effects of mergers
10 among major telecommunications firms and of vertical integration and
11 interconnection of telecommunications networks.

12 My curriculum vita is attached as Exhibit WET-1.

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

14 A. I have been asked by BellSouth Telecommunications, Inc. (“BellSouth”)—an
15 incumbent local exchange carrier (“ILEC”)—to comment on economic issues
16 arising from the recent legislative amendments to Chapter 364 (pertaining to
17 telecommunications regulation) of the Florida Statutes. Specifically, I comment on
18 the provisions of the newly created Section 364.164 on “Competitive Market
19 Enhancement,” and reduction of intrastate switched access rates to parity with
20 interstate switched access rates (Section 364.163, as amended).

21 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

22 A. The newly created Section 364.164 aims to encourage greater competitive entry
23 into Florida’s local exchange markets by simultaneously removing the current
24 support for residential basic local telecommunications service (“RBLTS”) and
25 reducing intrastate switched access rates to parity with interstate switched access
26 rates within 2-4 years.

27 There is no doubt that competitive local exchange carriers (“CLECs”) have
28 made considerable strides in Florida in the past few years. The problem lies,

1 however, with the persistent *unevenness* of CLEC entry in Florida. As of
2 December 2002, 83 percent of ILEC-served access lines went to residential and
3 single-line business customers, while only 48 percent of CLEC-served access lines
4 did. Given the specific market and regulatory circumstances of Florida, this
5 unevenness of competitive entry in the state is attributable in large part to the
6 relationship between end-user rates for basic local telephone service (in particular,
7 for RBLTS) and unbundled network element/unbundled network element-platform
8 (“UNE/UNE-P”) rates. Generally, the margins available between the two rates are
9 far more substantial for *business* basic local telephone service than for RBLTS.
10 Unconstrained by public policy or regulation regarding which customers they may
11 or may not serve, CLECs have gravitated naturally toward higher-margin medium
12 and large businesses or customers using four or more lines. It is this unevenness in
13 competitive entry incentives that Section 364.164 is designed to correct.

14 Finally, Section 364.164 seeks to make the withdrawal of support for
15 RBLTS revenue-neutral from the perspective for the ILEC. For this purpose,
16 Section 364.163 (as amended) requires the ILEC’s current intrastate switched
17 access rates in Florida to be dropped to parity with current interstate switched
18 access rates. Historically, intrastate switched access rates have been a source of
19 support for RBLTS. This reduction of intrastate switched access rates will remove
20 an equivalent amount (in dollar terms) of support for RBLTS end-user rates, but
21 whether that would suffice to remove *all* of the support currently available is hard
22 to ascertain. However, any rate rebalancing of the form envisioned by Sections
23 364.164 and 364.163 (as amended) would improve incentives for competitive entry
24 into Florida’s local exchange markets and lead to more efficient prices for RBLTS
25 and switched access services. This would greatly benefit consumers and local
26 exchange competition alike.

27 **II. COMPETITIVE MARKET ENHANCEMENT: SECTION 364.164**

28 **Q. WHAT PROVISIONS OF SECTION 364.164 DOES YOUR TESTIMONY**

ADDRESS?

A. Section 364.164(1) states as follows:

(1) Each local exchange telecommunications company may, after July 1, 2003, petition the commission to reduce its intrastate switched network access rate in a revenue-neutral manner. The commission shall issue its final order granting or denying any petition filed pursuant to this section within 90 days. In reaching its decision, the commission shall consider whether granting the petition will:

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

Q. IN ECONOMIC TERMS, HOW DO THESE PROVISIONS AMOUNT TO AN ATTEMPT TO "INDUCE ENHANCED MARKET ENTRY"?

A. This section recognizes a fundamental precept of market competition, namely, that competitive market entry by new service providers depends on, among other things, the rates that incumbent service providers can (or are required to) charge for the service or services for which competition is supposed to occur. Given this recognition, this section seeks to promote a form of rate rebalancing which would likely provide the correct price signals to potential competitive entrants. The rate rebalancing consists of, on the one hand, moving ILEC rates for RBLTS up to levels that reflect true ILEC costs by removing currently available subsidy support

1 and, on the other hand, reducing ILEC rates for intrastate switched access.¹

2 Because this rate rebalancing is required to be revenue-neutral, the amount of
3 support removed from RBLTS rates would be the contribution to that subsidy
4 provided historically by intrastate switched access rates to RBLTS rates.²

5 A rate rebalancing of this form could prove salutary in two respects. First,
6 by lowering *intrastate* switched access rates to parity with *interstate* switched
7 access rates, this section would eliminate an artificial discrepancy in rates between
8 two nearly identical services. Lower intrastate switched access rates—which are
9 required by Section 364.163(2) to be flowed through in their entirety into intrastate
10 long distance rates—would make intrastate long distance calling more attractive for
11 both residential and business customers, and for competitive entrants who wish to
12 offer long distance service alongside basic local services.

13 More importantly, the removal of subsidy support for RBLTS service
14 offered by ILECs would likely move RBLTS rates up to levels that more closely
15 reflect the ILECs' cost to offer RBLTS. Potential competitive entrants base their
16 entry decision on whether or not they can at least match the rates being charged by
17 incumbents. In theory, competitive entrants that are at least equally efficient (i.e.,
18 able to offer a competing service at comparable incremental cost) are best
19 positioned to match incumbents' rates. If, however, incumbents' rates are lowered
20 artificially with the help of subsidy support, but their incremental costs do not
21 change, potential competitive entrants that are not entitled to comparable subsidy
22 support are likely to be deterred from entering the market. This, in turn, is likely to
23 limit the amount of competition that develops in the market over time. The

¹ At least, this is what is expected to happen in theory. Whether, in fact, the rate rebalancing envisioned here would make end-user rates for RBLTS truly and completely subsidy-free is another matter entirely and hard to predict *a priori*. I return to this issue later in the testimony.

² Again, it is difficult to say whether the amount of subsidy contribution from intrastate switched access rates removed in this manner would constitute *all* of the subsidy contribution that those rates have made historically. That is because intrastate switched access rates are only being required to be reduced to parity with interstate switched access rates. If there is some remaining subsidy contribution built into current interstate rates, then so would some remain in the intrastate rates even after the reduction.

1 amendments to Chapter 364, and section 364.164 in particular, reflect a recognition
2 of this limitation and provide specific steps for boosting competitive entry.

3 **Q. ISN'T THERE EVIDENCE ALREADY OF SIGNIFICANT COMPETITIVE**
4 **ENTRY IN LOCAL EXCHANGE MARKETS? IF THERE IS SUCH**
5 **EVIDENCE, WHY ARE THE PROVISIONS OF SECTION 364.164**
6 **NECESSARY?**

7 A. There is no doubt that CLECs have made considerable strides in the past few years,
8 both in Florida and elsewhere in the country. For instance, data recently published
9 by the FCC show that, as of the end of 2002, CLECs served about 13 percent of
10 end-user switched access lines in Florida, which was just about the national average
11 market share of CLECs as well.³ Based on the FCC data, only 15 states are ahead
12 of Florida in terms of access line market shares achieved by CLECs. It is
13 significant that CLEC market share in Florida was only 6 percent—less than half of
14 that presently—in 1999, just three years ago.⁴

15 The problem lies, however, with the persistent *unevenness* of CLEC entry in
16 Florida and elsewhere. For instance, according to the FCC, while nearly four out of
17 every five end-user switched access lines served by ILECs nationwide go to
18 residential and small business customers, the share of CLEC-served access lines
19 going to such customers has only recently crossed the 50 percent mark.⁵ In Florida,
20 the discrepancy is even more acute. As of December 2002, 83 percent of ILEC-
21 served access lines went to residential and small business customers, while only 48

³ FCC, *Local Telephone Competition: Status as of December 31, 2002* (“FCC Local Competition Report”), Industry Analysis and Technology Division, Wireline Competition Bureau, June 2003, especially Table 6.

⁴ *Id.*, Table 7.

⁵ *Id.*, Table 2. The share of ILEC-served access lines accounted for by residential and small business customers has remained stable over the past three years, at 77.1 percent in December 1999 and 78.0 percent in December 2002. In contrast, the share of CLEC-served access lines accounted for by residential and small business customers was as low as 39.6 percent in June 2000 before rising to 58.0 percent in December 2002.

1 percent of CLEC-served access lines did.⁶ This is the case despite the fact that, as
2 of the same date, 8 ILECs and 24 CLECs were operating in Florida.⁷ Only Texas
3 (at 29) had more operational CLECs than Florida, and only Minnesota (at 34) and
4 Texas (at 43) had more operational ILECs and CLECs combined than Florida (at
5 32).

6 Slightly older data reported by this Commission corroborate the FCC's
7 statistics on the degree to which competitive entry has occurred in all of Florida's
8 local exchanges (not merely those served by BellSouth). For instance, in mid-2002,
9 83 percent of Florida's local exchanges had three or more CLECs, while 95 percent
10 of local exchanges had at least one CLEC.⁸ At the same time, there is clear
11 evidence of the unevenness of competitive entry. For instance, as of June 30, 2002,
12 CLECs served only 7 percent of residential customers in Florida (up from 4 percent
13 a year earlier).⁹ In contrast, they served 26 percent of business customers in Florida
14 (up from 16 percent a year earlier).¹⁰

15 Thus, even though Florida is among the national leaders in accomplishing
16 entry *per se* by CLECs, it lags behind most states on the one statistic that the
17 framers of the Telecommunications Act of 1996 ("1996 Act") must have most
18 desired: the availability of basic service choice and variety to *residential*
19 customers.

20 **Q. TO WHAT DO YOU ATTRIBUTE THIS UNEVENNESS IN CLEC ENTRY?**

⁶ *Id.*, Table 11. The FCC shows only nine states with a lower percentage for CLEC-served access lines.

⁷ *Id.*, Table 12. Note that the CLEC count only includes those serving 10,000 access lines or more.
Therefore, the actual count of CLECs in any state may actually be higher, perhaps considerably so.

⁸ Florida Public Service Commission, *Telecommunications Markets in Florida: Annual Report on Competition as of June 30, 2002* ("Florida Competition Report"), December 2002, Table 4.

⁹ *Florida Competition Report*, at 3.

¹⁰ *Id.* The *Florida Competition Report* appears to agree with the FCC's estimate that 13 percent of access lines in Florida were served by CLECs in 2002. However, note that the FCC's estimate of this share as of June 2002 (i.e., the date to which the *Florida Competition Report* pertains) was only 9 percent. See *FCC Local Competition Report*, Table 7.

1 A. In theory, equally-efficient CLECs would expect to be able to charge at least
2 matching (if not lower) rates for RBLTS than the ILEC. Stated another way, CLEC
3 entry would be predicated on CLECs being able to enjoy profit margins that are at
4 least comparable to those of the ILECs against whom they compete.

5 It is well known that of the various modes of entry available to them,
6 CLECs have resorted primarily to the use of unbundled loop-switch combinations
7 (called UNE-platforms or “UNE-P”) leased from ILECs.¹¹ For instance, in Florida,
8 57 percent of CLEC-served access lines at the end of 2002 were provided through
9 UNE or UNE-P arrangements, while nationally that share was 55 percent.¹² More
10 significantly, the share of UNE and UNE-P based lines among those served by
11 CLECs rose nationally from only 24 percent in December 1999 to over 55 percent
12 three years later.¹³ Based on these data, it may be surmised that the greatest
13 competitive entry would occur wherever the margin between the entrant’s revenue
14 (i.e., the revenue earned from basic local telephone service) and its cost (i.e., what it
15 pays, for example, to lease UNE or UNE-P facilities) is the greatest. This is exactly
16 the conclusion reached by this Commission as well.¹⁴

17 Given the specific market and regulatory circumstances of Florida,
18 therefore, the unevenness of competitive entry in the state must be attributed in
19 large part to the relationship between end-user rates for basic local telephone
20 service (in particular, for RBLTS) and UNE/UNE-P rates.¹⁵ It is safe to generalize
21 that the margins available between the two rates are far more substantial for
22 business basic local telephone service (nationwide generally, but in Florida as well)

¹¹ The other modes of entry include resale of ILEC’s basic local telephone service and provision of such service through entirely CLEC-owned facilities.

¹² *FCC Local Competition Report*, Table 10. In the two states most widely regarded as having the greatest local exchange competition, namely, New York and Texas, that share was even higher at 67 percent for both.

¹³ *Id.*, Table 3.

¹⁴ *Florida Competition Report*, at 25-37.

¹⁵ The observed unevenness is more acute in suburban or rural areas where the margins may be even
(continued...)

1 than for RBLTS. Unconstrained by public policy or regulation regarding which
2 customers they may or may not serve, it is not hard to imagine why CLECs have
3 gravitated naturally toward medium and large businesses or customers using four or
4 more lines.

5 **Q. WHAT ACCOUNTS FOR THE COMPARATIVELY SLIM OR**
6 **UNATTRACTIVE MARGINS FOR RBLTS IN FLORIDA, AND WHAT**
7 **SHOULD BE PUBLIC POLICY'S RESPONSE TO THAT PROBLEM?**

8 A. Subsidized end-user rates are a large factor behind narrow or uneconomic margins
9 for RBLTS in Florida. Higher (cost-based) end-user rates for RBLTS or lower
10 UNE/UNE-P rates, or both, can obviously create more attractive margins for
11 potential entrants (particularly those seeking the UNE mode of entry). It is
12 important, however, not to make rate adjustments in a purely reflexive or seat-of-
13 the-pants fashion. Unwilling to tinker with end-user RBLTS rates, many regulators
14 around the country have looked to lowering UNE/UNE-P rates as a way to
15 encourage competitive entry, particularly for RBLTS.

16 Once UNE/UNE-P rates have been set properly relative to the underlying
17 cost standard (which is total element long run incremental cost or "TELRIC"), there
18 is no *automatic* economic justification for lowering those rates without any
19 definitive evidence that the level of TELRIC itself has fallen. However, given that
20 competitive entry for RBLTS has not been boosted despite setting UNE/UNE-P
21 rates at TELRIC-based levels, it is imperative that the more politically-sensitive
22 RBLTS end-user rates themselves be examined more carefully. It is no secret that,
23 by long-standing tradition, those end-user rates (in Florida and other states) have
24 received subsidy support in order to keep them lower than they would be otherwise.
25 That tradition originated from the idea that telecommunications networks generate

(...continued)

slimmer, a fact noted by the *Florida Competition Report*.

1 positive network externalities that are benefits to telephone subscribers.¹⁶ Because
2 such externalities, which are not captured through prices or other market processes
3 are considered beneficial, public policy has for a long time used subsidies to
4 RBLTS rates as a means of encouraging greater network participation by customers
5 (in particular, residential customers).

6 The traditional justification for subsidizing (or artificially lowering) RBLTS
7 end-user rates is now being subjected to considerable rethinking for two reasons.
8 First, thanks to the success of universal service policies, network subscribership by
9 residential customers is now close to the saturation point. FCC statistics show that
10 93.2 percent of Florida households (and 95.1 percent of households nationwide)
11 received basic local telephone service in July 2001, up from 85.5 percent in Florida
12 (and 91.4 percent nationwide) in November 1983.¹⁷ While this shows some gain,
13 other FCC statistics show the significant slow-down in the *rate* of gain: the percent
14 of households with basic local telephone service went from 78.3 to 90.5 in one
15 decade between 1960 and 1970, but it has grown only to 95.1 in the next 31 years.¹⁸
16 This slow-down is to be expected as the 100 percent mark is approached, but it also
17 implies that little further gain in network externalities can be expected. The
18 continuing need for subsidies at the current level is, therefore, reduced (if not
19 mitigated).

20 Second, economic efficiency considerations have risen to the fore in the
21 post-1996 Act telecommunications environment. Now that market competition (in
22 particular, entry and participation by new service providers) is relying increasingly
23 on market signals, continuing subsidies to end-user rates for RBLTS are distorting

¹⁶ The network externality arises as expansion of the network by even one additional subscriber increases the economic value of the network to all existing subscribers (because of the increased number and variety of calls that can be made).

¹⁷ FCC, *Trends in Telephone Service*, Industry Analysis and Technology Division, Wireline Competition Bureau, May 2002, Table 17.2.

¹⁸ *Id.*, Table 17.3. While there can be several reasons for this slow-down, the advent of mobile telecommunications (and, in particular, the increasing substitution of mobile for wireline telephone service) may be an important one.

1 those signals.¹⁹ It is now imperative that public policy re-examine the wisdom in
2 subsidizing RBLTS end-user rates with the decline in the importance of network
3 externalities and a rising need to ensure efficient competition. The provisions of
4 Section 364.164 take a major step in precisely this direction. Rather than look
5 reflexively to lowering UNE/UNE-P rates further, the new policy direction favors
6 encouraging greater competitive entry for RBLTS by allowing end-user rates to rise
7 to unsubsidized levels.

8 **Q. PLEASE COMMENT ON SECTION 364.164'S PROVISION FOR THE**
9 **REDUCTION OF INTRASTATE SWITCHED ACCESS RATES.**

10 A. The reduction of intrastate switched access rates charged by ILECs is the second
11 part of a coherent strategy to realign service rates to make them more cost-based
12 and, more importantly, encourage greater CLEC activity in Florida's local
13 exchanges. As referred to earlier, the complete flowthrough of the intrastate access
14 rate reductions into intrastate long distance rates (as required by Section
15 364.163(2)) is expected to stimulate intrastate long distance calling and make it
16 more attractive for CLECs to offer bundles of local and long distance services.
17 Also, the requirement of revenue-neutral rate reductions would ensure that
18 intrastate access charges are lowered by only as much as is necessary to reduce—if
19 not completely eliminate—intrastate switched access service's share of support for
20 (or "contribution" to) the subsidy presently available to RBLTS end-user rates.
21 Such revenue-neutral rate reductions would, in principle, enhance economic
22 efficiency by eliminating the distorted price signals that occur from artificially
23 maintaining rates either below cost (as for RBLTS end-user rates) or above cost (as
24 for intrastate switched access rates).

¹⁹ From an economic efficiency perspective, it would be far better to employ *targeted* subsidies (to either attract the small percent of households currently not subscribing to basic local telephone service or maintain *marginal* households as subscribers) than to continue with the long-standing system of *generalized* subsidies to RBLTS rates.

1 **Q. HOW WOULD REDUCING INTRASTATE SWITCHED ACCESS RATES**
2 **TO PARITY WITH INTERSTATE SWITCHED ACCESS RATES HELP TO**
3 **ACCOMPLISH SUBSIDY ELIMINATION AND ENHANCE ECONOMIC**
4 **EFFICIENCY?**

5 A. It is true that Section 364.164 only seeks to reduce intrastate switched access rates
6 to parity with their interstate counterparts. However, that reduction may be
7 expected legitimately to move *all* service rates closer to true underlying costs and,
8 in the process, enhance economic efficiency. Even if the gain in economic
9 efficiency were not maximized in the process, some gain would be better than no
10 gain at all.

11 First, for a number of years now, interstate switched access rates have been
12 moving toward incremental cost-based levels, i.e., freed of the sizable contribution
13 support elements that were hallmarks of those access rates in the past. Significant
14 action in this regard was initiated by the FCC and a consortium of ILECs and other
15 carriers.²⁰ Intrastate/interstate distinctions for switched access rates are based
16 primarily on jurisdictional differences; the incremental costs to provide the two
17 forms of switched access tend to be quite close. Thus, equalizing switched access
18 rates in Florida, regardless of jurisdictional distinctions, would base those rates
19 more closely on cost than ever before and, in the process improve economic
20 efficiency.

21 Second, end-user rates for RBLTS have historically received subsidy
22 support from several ILEC-supplied services, among which intrastate switched
23 access was only one. Moreover, as noted earlier, there can be no guarantee that
24 simply moving intrastate switched access rates to parity with their interstate
25 counterparts would end all subsidy support from the intrastate rates. It is, therefore,

²⁰ FCC, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, and Federal-State Joint Board On Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, and Eleventh Report and Order in CC Docket No. 96-45 (“*CALLS Order*”), May 31, 2000.

1 debatable how completely reducing intrastate switched access rates in the manner
2 proposed by Section 364.164 would purge *all* subsidy support from end-user rates
3 for RBLTS. However, *any* move to rationalize rates in the direction provided for in
4 that section would enhance economic efficiency. More importantly, such a move
5 would provide greater incentives for equally-efficient competitors to serve
6 residential customers.

7 **Q. IS THERE ANY WAY TO ASCERTAIN WHETHER, IN FACT, THE**
8 **SUBSIDY SUPPORT HAS BEEN REMOVED FROM END-USER RATES**
9 **FOR RBLTS?**

10 A. Yes. Economic theory prescribes a price floor and a price ceiling for ensuring that
11 no service provided by a multi-service firm (such as an ILEC) either *receives* a
12 subsidy or *provides* a subsidy. The price floor in question is the total service long
13 run incremental cost (“TSLRIC”) and the price ceiling in question is the stand-
14 alone cost (“SAC”). Ensuring that each ILEC service is priced somewhere in
15 between its TSLRIC and its SAC prevents either the provision or receipt of a
16 subsidy.²¹ Accordingly, if the end-user rate for RBLTS is no lower than its TSLRIC
17 (per unit of volume), then it cannot be receiving any subsidy support.

18 **Q. IS THERE ANY OTHER ACCOMPANYING CONDITION THAT MUST**
19 **BE MET FOR SERVICE PRICES TO BE CONSIDERED SUBSIDY-FREE?**

20 A. Yes. The ILEC in question must at least “break even,” i.e., its total revenue from
21 all services must at least equal its total cost to provide those services in the long
22 run.

23 **Q. HOW RELIABLY CAN THE PRICE FLOOR AND CEILING BE**

²¹ G.R. Faulhaber, “Cross-Subsidization: Pricing in Public Enterprises,” *American Economic Review*, 65(5), 1975, at 966-977. Note that this principle defines the price of a *total service*. Individual *units* of service can be sold efficiently at a price below the TSLRIC of the service—but no lower than the long run incremental cost (“LRIC”) of those units—provided the incremental revenue from the service as a *whole* covers its incremental cost, here the TSLRIC.

1 **DETERMINED IN ORDER TO OPERATIONALIZE THE SUBSIDY-FREE**
2 **PRICING CONDITION?**

3 A. TSLRIC is simply the sum of (1) the direct incremental cost of providing the entire
4 volume of a service and (2) all fixed costs specific to that service. Other things
5 being equal, these are costs that would be avoided in their entirety if the service
6 were dropped from the ILEC's lineup of services (or, alternately, the costs that
7 would be added if the service were added to the lineup of existing services).
8 TSLRIC is now routinely estimated for various telephone services, including
9 RBLTS.

10 SAC is the cost to provide the entire volume of a new service on a stand-
11 alone basis, i.e., by use of dedicated network/production facilities and
12 independently of any of the ILEC's other services. It is the same as the TSLRIC
13 when the ILEC provides only one service. In reality, however, unless an ILEC
14 provides only RBLTS, determining its SAC can be problematic and even
15 impossible. That is because when the ILEC experiences shared (or common) costs,
16 those costs *cannot* be attributed directly to individual services (as they would be in
17 any SAC study).

18 Fortunately, this limitation of the SAC (as the price ceiling) for a multi-
19 service ILEC need not be critical for determining whether or not RBLTS rates are
20 subsidized. First, the function of the SAC is to determine whether a service is
21 *providing* a subsidy—it would do so if the revenue earned by the service exceeds
22 the SAC. If, however, it could be determined separately that none of the ILEC's
23 services is *receiving* a subsidy, then no service could be providing any. Second, if
24 for an ILEC that at least breaks even, every service price is set at or above its
25 respective TSLRIC (per unit volume), then there can be no question of subsidy
26 support to any individual service. Thus, for RBLTS, an end-user rate that is no
27 lower than TSLRIC (per unit volume) must, by definition, be free of subsidy. In a
28 revenue-neutral realignment of the RBLTS end-user rate and the intrastate switched
29 access rate, a reduction of that access rate that suffices to raise the end-user rate for
30 RBLTS to at least its TSLRIC per unit level would ensure that the subsidy support

1 has been removed properly. Whether that would happen simply by reducing
2 intrastate switched access rates to parity with interstate such rates is another matter;
3 at least, it would be a move in the right direction.

4 **Q. AT THE END OF THE TRANSITION PERIOD OF TWO TO FOUR**
5 **YEARS, SHOULD END-USER RATES FOR RBLTS AND INTRASTATE**
6 **SWITCHED ACCESS RATES BE SET *EQUAL* TO THEIR RESPECTIVE**
7 **TSLRICs?**

8 A. No, that should not be the goal of any policy that implements Section 364.164.
9 Aside from the fact that there is no explicit requirement in that section for the two
10 rates to be so set, it should also not be inferred that the purposes of Section 364 can
11 be best served (or only be served) by setting the service rates exactly at their
12 respective TSLRICs per unit.

13 **Q. PLEASE EXPLAIN WHY NOT.**

14 A. Modern multi-service ILECs (that provide RBLTS, switched access service, and
15 other services out of shared network facilities) experience economies of scale
16 and/or scope.²² Any ILEC in that position cannot recover all of its costs (i.e.,
17 inclusive of fixed and incremental costs) by pricing all of its services *exactly* at
18 their respective TSLRICs per unit. This feature of multi-service provision would
19 remain true no matter how efficiently the ILEC in question functions or how
20 intensely the ILEC and its rival CLECs compete in the market. The efficient
21 pricing principle that enables complete recovery of the multi-service ILEC's
22 legitimate total costs would then be to allow the ILEC to mark up its service prices

²² A firm with high fixed costs and relatively low variable or operational costs (such as a modern ILEC) can often benefit from both *increasing* and *diversifying* production. Provided that the relatively low variable costs do not increase steeply as the volume of service grows, the ILEC's *average* cost of service may actually decline with volume expansion. This is the effect known as *economies of scale*, i.e., the ability to provide service less expensively as service volume is expanded. Similarly, when that ILEC can use shared fixed resources (such as network facilities and various administrative functions) to generate multiple and distinct services, it can be more economical to provide those services together than to provide them on a stand-alone (or separate) basis. This is the effect known as *economies of*
(continued...)

1 above their respective TSLRICs per unit. If the markups are done right, the
2 contribution so generated from each service price would enable the ILEC to fully
3 recover its shared and common costs.

4 In economic theory, while any deviation of price from the underlying
5 incremental cost triggers a loss of *allocative* economic efficiency, it is possible to
6 set the ILEC's service prices in a manner that minimizes the cumulative loss of
7 economic efficiency. Economic theory prescribes relying on the strength of market
8 demand for each service to determine what markup its price should bear. This
9 market-determined method can be shown to be superior (in terms of economic
10 efficiency outcomes) to an arbitrary and across-the-board percent markup in service
11 prices. It is important to note, however, that whether or not end-user rates for
12 RBLTS and intrastate switched access rates contain any markup (or contribution)
13 *toward the ILEC's shared and common costs* should at least be subjected to the
14 market demand test. What is clear from Section 364.164 is that an earnest effort
15 needs to be made to minimize, if not eliminate, the contribution *toward subsidy*
16 *support* for RBLTS end-user rates.

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

18 A. Yes.

(...continued)

scope.

1 BY MS. WHITE:

2 Q Dr. Banerjee, did you also cause to be
3 prefiled in this case rebuttal testimony consisting of
4 28 pages?

5 A Yes, I did.

6 Q Do you have any changes to that testimony?

7 A No.

8 Q If I were to ask you the questions
9 contained in your prefiled rebuttal testimony today,
10 would your answers be the same?

11 A They would.

12 MS. WHITE: And you did have -- I'm sorry.
13 I would ask that the prefiled rebuttal testimony of
14 Dr. Banerjee be inserted into the record.

15 CHAIRMAN JABER: The prefiled rebuttal
16 testimony of Dr. Banerjee shall inserted into the
17 record as though read.

18 BY MS. WHITE:

19 Q And, Dr. Banerjee, you also had one exhibit
20 attached to your rebuttal testimony labeled AXB-1?

21 A Yes, I do.

22 Q Do you have any changes to that exhibit?

23 A No.

24 MS. WHITE: I would ask that the exhibit
25 attached to Dr. Banerjee's rebuttal testimony be

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labeled with the next exhibit number.

CHAIRMAN JABER: AXB-1 will be identified
as Exhibit 58.

(Exhibit 58 marked for identification.)

ON BEHALF OF BELLSOUTH TELECOMMUNICATIONS, INC.
REBUTTAL TESTIMONY OF ANIRUDDHA (ANDY) BANERJEE, Ph.D.
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NOS. 030867-TL, 030868-TL, 030869-TL & 030961-TI
NOVEMBER 19, 2003

1 **I. INTRODUCTION AND SUMMARY**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT**
3 **POSITION.**

4 A. My name is Aniruddha (Andy) Banerjee. I am a Vice President at NERA
5 Economic Consulting located at One Main Street, Cambridge, Massachusetts
6 02142.

7 **Q. HAVE YOU TESTIFIED PREVIOUSLY IN THIS PROCEEDING?**

8 A. No. However, I am adopting the Direct Testimony of William E. Taylor (also of
9 NERA Economic Consulting), which was filed on behalf of BellSouth
10 Telecommunications, Inc. ("BellSouth") on August 27, 2003.

11 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL, PROFESSIONAL, AND**
12 **BUSINESS EXPERIENCE.**

13 A. I earned a Bachelor of Arts (with Honors) and a Master of Arts degree in
14 Economics from the University of Delhi, India, in 1975 and 1977 respectively. I
15 received a Ph.D. in Agricultural Economics from the Pennsylvania State University
16 in 1985, and subsequently served there as an Assistant Professor of Economics. I
17 have over eight years of experience teaching undergraduate and graduate courses in
18 various fields of Economics, and have conducted academic research that has led to
19 several publications and conference presentations.

20 Since 1988, I have held various positions in the telecommunications
21 industry. Prior to my present position, I have been an economist in the Market
22 Analysis & Forecasting Division at AT&T Communications in Bedminster, NJ, a

1 Member of Technical Staff at Bell Communications Research in Livingston, NJ,
2 and a Research Economist at BellSouth Telecommunications in Birmingham, AL.
3 In these positions, I was responsible for conducting economic and market analysis,
4 building quantitative demand models for telecommunications services, developing
5 economic positions and strategies, and providing expert testimony support on
6 regulatory economic matters.

7 In my present capacity, I provide quantitative and regulatory economic
8 analysis for telecommunications industry clients principally on matters of concern
9 to local exchange carriers. I have testified before state and federal regulators on
10 interconnection and unbundling, universal service, local and long distance
11 competition, and inter-carrier compensation. I have participated in several
12 proceedings on antitrust damage issues, price and alternative regulation, and
13 telephone company mergers. I have published and presented at international
14 forums several papers, including those on telephone service quality performance,
15 mobile telephony growth, telecommunications privatization, and Internet
16 economics. My curriculum vitae is attached to this testimony as Exhibit AXB-1.

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

18 A. In this rebuttal testimony, I respond to allegations that BellSouth's petition to
19 rebalance rates does not satisfy the requirements of the Competitive Market
20 Enhancement provisions of Chapter 364. Specifically, I have been asked to address
21 the economic issues associated with Section 364.163 (1), including claims that
22 granting the petition would not remove support from basic local telephone service
23 ("BLTS") or stimulate greater competition for local services to the benefit of
24 residential consumers.

25 **Q. WHAT ARE YOUR PRINCIPAL CONCLUSIONS?**

26 A. My principal conclusions are:

- 27 1. The BellSouth rebalancing plan will promote greater competition to the benefit
28 of residential consumers. Claims to the contrary are flawed as a matter of
29 economic principle and are inconsistent with experience in the industry.

-
- 1 • Entry to serve low-revenue customers will be stimulated by the rebalancing
 2 plan. Many entrants have chosen to use unbundled network element
 3 platforms (“UNE-Ps”) to serve residential customers; thus, it is useful to
 4 compare UNE-P rates with basic local service prices. Both Dr. Gabel’s and
 5 BellSouth’s wire center-level data show little or no profit can be had from
 6 low-revenue customers at current BLTS rates. Raising these rates would
 7 allow entrants to serve profitably a greater share of residential customers.
- 8 • Dr. Gabel claims that rebalancing will not stimulate competitive entry
 9 because entrants compare total potential revenues with total costs. This claim
 10 is false. Although the overall entry decision rests on this comparison, the
 11 decision to serve *low-revenue* customers (that purchase BLTS and little, if
 12 any, of the other services) is based on whether serving *those* customers will
 13 contribute to the firm’s profits. Thus, rebalancing that reduces rates for
 14 higher usage customers (by reducing their toll rates) alongside offsetting rate
 15 increases for basic service will allow entrants to serve more low-revenue
 16 customers without impeding competition for more lucrative customers.
- 17 • Dr. Gabel’s argument that unregulated competitive firms set prices to
 18 maximize total profits, and “may” thus sell some products below costs to
 19 stimulate overall demand, does not justify a regulatory policy to *impose* such
 20 pricing on incumbent local exchange carriers (“ILECs”). Unregulated
 21 competitive firms may offer promotional prices for some components of
 22 their services, but they are also free to set the prices, terms, and conditions
 23 for the rest of their services so as to maximize *overall* profits. For example,
 24 wireless mobile companies are able to set package prices and require
 25 subscribers to keep their service long enough to more than compensate for
 26 the cost of “free” handsets. In contrast, ILECs are not allowed to require
 27 BLTS customers to purchase the other services at prices that generate
 28 offsetting contributions to costs.
- 29 • The margin between unbundled network element (“UNE”) rates and retail
 30 rates should not be adjusted to stimulate competition. UNE rates should be
 31 based purely on cost considerations. Lowering UNE rates to artificially
 32 stimulate entry would be particularly poor regulatory policy because doing so
 33 would (1) harm competition by reducing the competitive parity between the
 34 ILEC and the CLEC, and (2) undermine the incentives for network
 35 investment and modernization.
- 36 2. Allegations that BellSouth’s BLTS is not supported are inconsistent with
 37 economic principles and with evidence presented in the rebuttal testimony of
 38 Bernard Shell.
- 39 • Dr. Gabel’s claim that *residential* BLTS (“RBLTS”) is not supported is

- 1 based on an incorrect definition of the relevant service. Accordingly, his
 2 analysis that allegedly “shows” that RBLTS is not supported is irrelevant and
 3 should be ignored by the Commission. Dr. Gabel argues that the ILECs have
 4 overstated the TSLRIC of RBLTS by including certain shared costs in their
 5 TSLRIC estimates. However, his claim and the analysis based on it rest on a
 6 false distinction between RBLTS and business BLTS. BLTS is a *single*
 7 service, with at least two classes of customers—residential and business
 8 customers. Thus, the allegedly shared costs of structure and installation are
 9 truly part of the TSLRIC of BLTS.
- 10 • As Mr. Shell explains in his rebuttal testimony, if customers did not demand
 11 BLTS, the network would be fundamentally different and the structure costs
 12 associated with BLTS would not be incurred.
- 13 • Dr. Cooper’s claim that the cost of the loop is a common cost is not
 14 consistent with economic principles or with the Commission’s prior rulings.
 15 The fact that several different services may use the loop does not mean that
 16 the loop should be considered, in Dr. Cooper’s words, “a common cost of
 17 those services.” The loop is one component of “network access” service,
 18 which is demanded by the customer in its own right. The customer may
 19 demand the loop simply to be able to *receive* calls, even if he or she never
 20 *made* calls.
- 21 • Dr. Cooper’s claim that local rate increases should be apportioned to
 22 residential and business customers in proportion to their share of the
 23 access/toll rate reductions ignores the fact that the ultimate benefits of
 24 competition come from setting prices as close as possible to economically
 25 efficient levels, as well as from long-term benefits that accrue when entrants
 26 find it profitable to serve a wider spectrum of consumers. Following Dr.
 27 Cooper’s recommendation would harm economic efficiency and fail to
 28 promote competition for residential customers.
- 29 3. The competitive forces operating in the telecommunications markets should be
 30 allowed to ensure that access charge reductions continue to be passed through to
 31 consumers.
- 32 • Competition has been vigorous for toll services, especially since BellSouth
 33 was authorized to provide in-region interLATA toll services.
- 34 • Competition for toll and bundled services, i.e., packages of local and toll
 35 services, should be allowed to set rates for toll services. Thus, market forces
 36 should be relied upon to ensure that competitive rates are charged.

1 **II. PROPOSED RATES WILL STIMULATE GREATER COMPETITION AND**
2 **BENEFIT CONSUMERS**

3 **Q. DO YOU AGREE WITH THE OPC WITNESSES (DAVID J. GABEL AND**
4 **BION C. OSTRANDER) THAT REBALANCING WILL NOT STIMULATE**
5 **COMPETITIVE ENTRY?**

6 A. No. Dr. Gabel's arguments [at 10] that the proposed reforms will not "create a
7 more attractive competitive local exchange market for the benefit of residential
8 customers or enhance market entry... because they fail to demonstrate support of
9 residential BLTS" and similar claims by Mr. Ostrander are incorrect. Raising basic
10 rates will clearly expand the scope of entry to serve residential customers—
11 especially "low-revenue customers"—who subscribe to BLTS but purchase little, if
12 any, of the other services. Competitors estimate likely total revenues and total
13 costs to make *overall entry* decisions; however, they determine which *types of*
14 *customers* to compete for by comparing likely revenues with costs for every
15 customer category. Thus, allowing ILECs to raise RBLTS rates should stimulate
16 competition for a wider spectrum of residential customers and, in particular, the
17 low-revenue customers.

18 **Q. ASSUMING—CONTRARY TO THE EVIDENCE THAT YOU DISCUSS IN**
19 **THE NEXT SECTION—THAT RBLTS IS PRESENTLY NOT SUPPORTED**
20 **(AS ARGUED BY DR. GABEL), WOULD REBALANCING STILL LEAD**
21 **TO GREATER COMPETITION?**

22 A. Yes. Even if, contrary to the evidence presented below, RBLTS were not
23 subsidized in the strict economic sense, i.e., even if residential service as a whole
24 were priced above the relevant TSLRIC, approving the rebalancing proposal would
25 still enhance CLECs' incentives to serve low-revenue residential customers.

26 **Q. PLEASE EXPLAIN WHY RAISING RBLTS RATES WILL STIMULATE**
27 **COMPETITION FOR LOW-REVENUE CUSTOMERS.**

28 A. Most of the entry to serve residential customers thus far has been in the form of

1 UNE-P competition.¹ Thus, Dr. Gabel's comparison of Florida residential retail
2 rates with UNE-P rates provides a useful starting point to illustrate the economic
3 principles involved. According to Dr. Gabel's testimony, there is a "gross margin"
4 of only \$0.11 between the average UNE-P price and RBLTS rates in Florida.
5 BellSouth's wire center-level data also show that those margins are negligible or
6 even negative.² This negligible gross margin implies that low-revenue consumers
7 who use RBLTS but little, if any, of the other services will simply not be profitable
8 to serve. In fact, as described by Dr. Gabel, the average residential rate in his
9 example includes taxes and surcharges, so the actual gross margin would be lower
10 since taxes would have to be remitted to the relevant governmental entities.
11 Moreover, once we take account of the entrants' retailing costs, the loss is even
12 larger. In this context, even if the *incumbent's* RBLTS rates were above TSLRIC,
13 competitors seeking to enter or to expand to serving a wider range of residential
14 customers would find it profitable to serve the low-revenue customers *only if* rates
15 were rebalanced.

16 **Q. PLEASE ILLUSTRATE THIS ISSUE WITH A HYPOTHETICAL**
17 **EXAMPLE.**

18 A. Consistent with experience, assume that different customers spend differing
19 amounts on LEC-provided telephone service. For the purposes of the hypothetical
20 example, assume that these spending amounts range from \$20.70 (from Table 1 in
21 Dr. Gabel's direct testimony) for those who purchase only RBLTS to various
22 greater amounts per month for higher-usage customers who purchase many vertical
23 services and make greater use of the network. In this context, it can be shown that

¹ As noted in Dr. Taylor's direct testimony [at 8], 57 percent of CLEC-served access lines at the end of 2002 in Florida were provided through UNE or UNE-P arrangements, while nationally that share was 55 percent. More significantly, the share of UNE and UNE-P based lines among those served by CLECs rose nationally from only 24 percent in December 1999 to over 55 percent three years later.

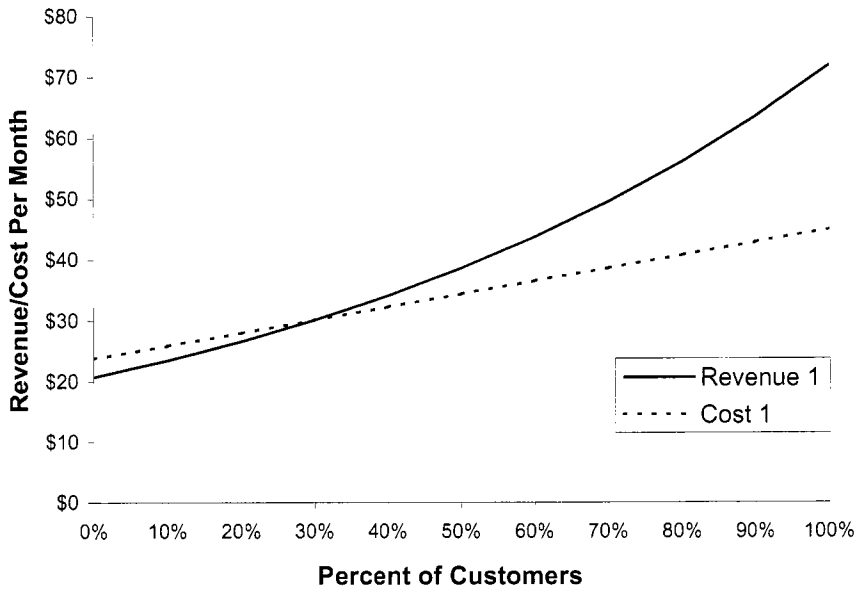
² BellSouth Telecommunications, Inc.'s Responses to the Staff of the Florida Public Service Commission's Second Set of Interrogatories, Response to Item No. 47.

1 increasing the RBLTS rate from its present supported, below-competitive level
2 would expand the range of customers for which entrants would be willing to
3 compete. This is illustrated in the hypothetical scenarios depicted by Figures 1 and
4 2 below.

5 Figure 1 shows that, at the current RBLTS rate (\$20.70), only about 70
6 percent of customers would generate enough revenues to yield a positive margin
7 above the average UNE-P rate plus other costs for retailing, vertical services, and
8 usage. But, if the RBLTS rate were to rise by \$4.00 per month, and toll rates and
9 access charges were lower, then *all* customers would generate enough revenue to
10 yield a positive margin. This would be the case even if we assumed that the access
11 charge reduction would cause the higher-usage customers to generate lower access
12 revenues and costs. As Figure 2 shows, with falling revenues and costs at the
13 margin, e.g., on every minute of toll service, both the revenue curve and the cost
14 curve would get flatter than in Figure 1, although the revenue curve would now
15 start at \$24.70, rather than at \$20.70. As a result, in this hypothetical example,
16 profits would become possible for a wider range of customers with the RBLTS rate
17 higher than it is currently.

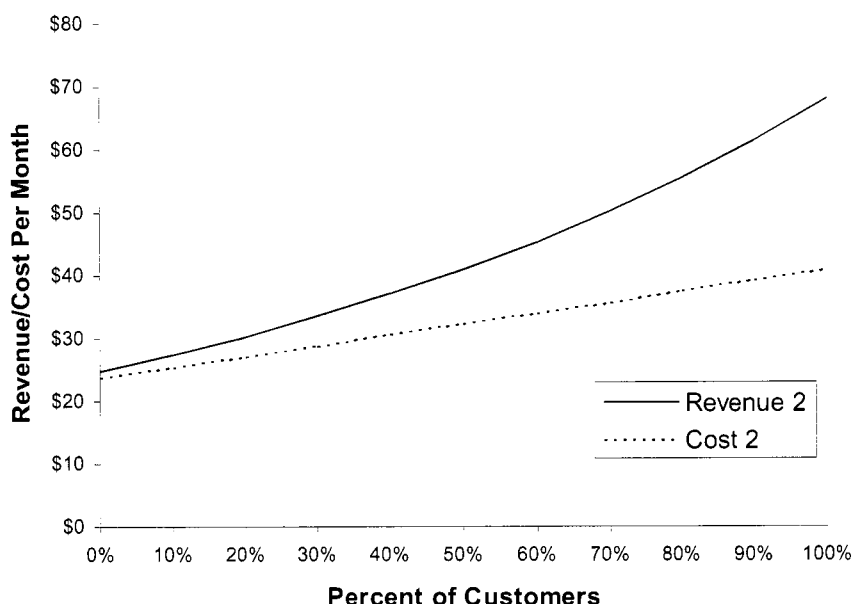
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Figure 1. Illustration of CLEC's Potential Profit Margin Without Rate Rebalancing



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1 **Figure 2. Illustration of CLEC's Potential Profit Margin With Rate**
 2 **Rebalancing**



3

4 **Q. WHAT IS YOUR ASSESSMENT OF DR. GABEL'S CLAIM [AT 46-49]**
 5 **THAT REBALANCING WILL NOT STIMULATE COMPETITIVE ENTRY**
 6 **BECAUSE ENTRANTS COMPARE TOTAL POTENTIAL REVENUES**
 7 **WITH TOTAL COSTS?**

8 A. Dr. Gabel's argument is fundamentally flawed. He claims [at 47] that:

9 It is completely irrelevant to a firm's decision, say, to supply local access
 10 lines, that it might make an expected loss on BLTS ... if total expected
 11 revenues, including those earned from retailing vertical and ADSL
 12 services, and wholesaling or retailing long distance services, cover the
 13 total expected cost of entry and the BLTS losses must be incurred to gain
 14 this overall position of profit.

15 The flaw in this argument is that it ignores the fact that the decision to serve
 16 specific types of customers—notably low-revenue customers—rest on whether the
 17 different customer types are likely to contribute to the firm's profits. Thus, raising

1 RBLTS rates will stimulate competition for low-revenue customers as illustrated
2 above. Dr. Gabel's contention ignores the fact that entrants can—and do—focus
3 most on capturing the customers who purchase vertical services, ADSL, and long
4 distance services. Thus, they have little incentive to serve customers who do not
5 contribute to their profit margin.

6 **Q. DR. GABEL ALSO MAINTAINS [AT 48-54] THAT ENTRY STIMULATED**
7 **BY RAISING THE PRICE OF RBLTS WILL BE OFFSET BY**
8 **OFFSETTING PRICE REDUCTIONS FOR OTHER SERVICES AND,**
9 **THUS, "NET PROFITABILITY WOULD NOT CHANGE AT ALL." DOES**
10 **THIS MEAN THAT THE PATTERN OF COMPETITION WILL NOT BE**
11 **AFFECTED BY REBALANCING?**

12 A. No. Dr. Gabel's argument ignores the fundamental fact that different customers
13 purchase different combinations and amounts of telecommunications services. As
14 explained above, rebalancing rates will provide competitors with a greater chance
15 of realizing positive margins from low-revenue customers, even if they earn
16 somewhat less from serving customers who use the network more for toll calls.
17 Thus, the pattern of competition and entry will be affected, whether or not net
18 profitability from entering the overall market changes. Moreover, rebalancing rates
19 will bring efficiency gains as well. See Dr. Taylor's direct testimony [at 12-13].

20 **Q. DR. GABEL ARGUES [AT 41] THAT "THE LACK OF CLEC ENTRY [IN**
21 **FLORIDA, COMPARED TO ILLINOIS] COULD BE ADDRESSED JUST**
22 **AS EFFECTIVELY BY LOWERING UNE PRICES." DOES THE LOW**
23 **MARGIN BETWEEN RBLTS AND UNE-P RATES IMPLY THAT IT**
24 **WOULD BE APPROPRIATE TO LOWER UNE-P RATES?**

25 A. No. According to applicable FCC regulations, UNE-P rates must be set based on
26 costs. Setting UNE-P rates with an eye towards stimulating entry rather than on the
27 basis of costs would be entirely inappropriate because doing so (1) would lead to
28 inefficient and excessive use of the UNE-P option, (2) discourage facilities-based

1 competition, and (3) artificially disadvantage the ILECs and reduce their incentives
 2 to invest in and upgrade their networks. In the end, lowering UNE-P rates purely
 3 for the reason provided by Dr. Gabel would discourage network investment by *both*
 4 entrants and incumbents.

5 **Q. PLEASE RESPOND TO DR. GABEL’S CLAIM [AT 40] THAT THE**
 6 **OBSERVED DIFFERENCES IN COMPETITION BETWEEN FLORIDA**
 7 **(WITH A UNE-P COST OF \$20.59) AND ILLINOIS (WITH A UNE-P COST**
 8 **OF \$12.22) “IS MORE EASILY EXPLAINED BY THE DIFFERENCES IN**
 9 **UNE-P RATES FOUND IN THE TWO STATES, NOT THE PRICE OF**
 10 **BLTS.”**

11 A. I disagree with this claim inasmuch as it suggests the “don’t raise the bridge, lower
 12 the river” argument for why relatively greater competitive entry has occurred in
 13 Illinois to serve residential and small business customers than in Florida.³
 14 Following the logic of Dr. Gabel’s argument, it would appear that the margins
 15 available to CLECs in Florida are much thinner than in Illinois not because the
 16 RBLTS rate in Florida is too low relative to the UNE-P rate, but because the
 17 UNE-P rate is too high relative to the RBLTS rate.

18 As explained above, my understanding is that UNE costs must be the sole
 19 basis for setting UNE rates. If the cost is known (and determined properly), the
 20 UNE rate should become immutably linked to that cost. Dr. Gabel’s argument, on
 21 the other hand, strongly suggests that this Commission should consider tinkering
 22 with the UNE-P rate in order to get competitive entry rates up. Once they have
 23 been set properly, UNE-P rates are not—and should not be—a discretionary tool for
 24 managing competitive entry. Instead, as Section 364.164 (and the thinking behind
 25 it) recognizes, removing the support for the RBLTS rate and allowing it to rise to

³ Illinois is a leader in setting cost-based rates for local exchange services that undertook efforts to “rebalance” rates long before most other states. Also, measured rate local exchange service is available in Illinois. Arguably, whatever the level of UNE-P rates, some of these factors may have had a salutary effect on competitive entry in Illinois to serve residential and small business customers.

1 the competitive and economically efficient level would prove conducive to
2 competitive entry.

3 Assuming that BellSouth's UNE rates have been properly set at economic
4 costs as required by the FCC, any lowering of UNE rates at this stage would
5 necessarily imply that they be set *below cost* simply to stimulate entry. Doing so
6 would be particularly poor regulatory policy because it would lead to the
7 competitive distortions and economic inefficiencies described above.

8 **Q. WHAT IS YOUR RESPONSE TO DR. GABEL'S ARGUMENT [AT 61-66]**
9 **THAT UNREGULATED COMPETITIVE FIRMS SET PRICES TO**
10 **MAXIMIZE TOTAL PROFITS, AND "MAY" THUS SELL SOME**
11 **PRODUCTS BELOW COSTS TO STIMULATE OVERALL DEMAND?**

12 A. Although this practice may occur in certain situations, it does not justify a
13 regulatory policy to *impose* such pricing on ILECs. In unregulated competitive
14 markets, firms are free to offer promotional prices for selected products or services
15 provided they do not violate antitrust laws; however, they are also free to set the
16 prices, terms, and conditions for their other products or services so as to maximize
17 *overall* profits. Thus, the example of free cellular phones (handsets) is not
18 analogous to the situation in the wireline market; customers of wireless mobile
19 companies frequently accept service contracts that require them to spend certain
20 minimum amounts on service for long enough to recover the *combined* cost of the
21 service and the "free" phones. In contrast, ILECs cannot *require* RBLTS customers
22 to purchase other services that generate offsetting contributions to costs. Even
23 circumstances that do not involve contracts, e.g., selling razors at or below cost that
24 are compatible only with the razor manufacturer's own blades, or buy one get one
25 free offers, are markedly different than those that require a single competitor to sell
26 service at levels that are not determined by market forces. The difference is that
27 when firms undertake such practices in unregulated markets, they do so in the
28 expectation that they will be able to enhance their overall profits; they are not
29 forced to charge prices that do not generate competitive returns.

1 Consider the example of razors and blades, which are “complementary
2 products,” i.e., any price-related stimulation of the demand for one also increases
3 the demand for the other. Although Gillette may sell the razor for a “low price,” it
4 can do so, as Dr. Gabel recognizes, because razors and blades “must be used
5 together....[and] replacement blades ... fit only the systems for which they have
6 been designed.” In the case of telephone service, RBLTS is demanded in its own
7 right and customers may *or may not* decide to use other services heavily enough to
8 offset any losses incurred on RBLTS. There are likely to be many customers that
9 purchase little, if any, of the other telephone services offered by their local
10 exchange carrier. For example, those customers may use their cable modem for
11 Internet access, and their wireless or toll provider for calling, or reserve the use of
12 the access line in RBLTS for incoming calls only. That is, the services in question,
13 unlike razors and blades, are not truly complementary. Thus, these customers may
14 not purchase the other telecommunications services in sufficient quantities to make
15 it worthwhile for either the incumbent or the entrants to serve them at current rates.
16 Current rates are not set at competitive levels, and competitors will continue to
17 forsake the low-revenue customers and compete only for the more lucrative
18 customers who purchase more, especially network usage, services.

19 **Q. WHAT TYPE OF PRICING WOULD YOU EXPECT TO SEE FROM**
20 **CLECS IF DR. GABEL WERE CORRECT ABOUT THE IMPLICATIONS**
21 **OF THE EXAMPLES OF PRICING FOR COMPLEMENTARY**
22 **PRODUCTS?**

23 A. Dr. Gabel refers to the economics of pricing complementary services to support the
24 notion that competitive standards are consistent with selling certain products below
25 even marginal cost provided demand is raised for related products. If Dr. Gabel
26 were correct about competitive pricing for complementary products, it is clear that
27 CLECs would be offering such prices for telephone service because the *overall*
28 local exchange market had been opened to competition and numerous firms had
29 entered to serve the higher-revenue segment.

1 The observed behavior of CLECs does not suggest, however, that they view
 2 the network access part of RBLTS and the usage services as complementary in the
 3 same sense as razors and blades in Dr. Gabel's example. CLECs, by and large,
 4 prefer to sell bundles of services, in which they include network access, local usage,
 5 long distance, vertical, and other optional services. That doesn't suggest a strategy
 6 in which CLECs first try to lure residential customers with "low" (even below-cost)
 7 rates for RBLTS and, once they have signed up, ply them with higher-margin usage
 8 services. The discounts that CLECs offer tend to apply to the service bundle as a
 9 whole, rather than to a component service in the bundle.

10 **Q. ARE THE UNDERLYING ECONOMICS OF PRICING FOR THE**
 11 **COMPLEMENTARY PRODUCTS THAT DR. GABEL DESCRIBES**
 12 **CONSISTENT WITH THE ECONOMICS OF WIRELINE LOCAL**
 13 **TELEPHONE SERVICES?**

14 A. No. Dr. Gabel's analysis and examples fail to recognize the differences in market
 15 and regulatory conditions between the examples he provides and competition for
 16 BLTS. For reasons explained by Professor Alfred Kahn, the economics of BLTS
 17 are very different from the economics of the wireless, shaving, and other
 18 unregulated industries like those described by Dr. Gabel:

19 Competition in unregulated markets often involves—indeed
 20 introduces—a great deal of price discrimination in favor of demand-
 21 elastic or low "value of service" customers: witness the positive
 22 association of such discrimination with airline competition. The
 23 elasticity of demand for *subscription* to cellular telephone service is
 24 probably higher than for usage of the service, once subscribed to, and
 25 undoubtedly far higher than for basic telephone service. Similarly,
 26 potential users of credit cards are more sensitive to the fixed fee than the
 27 careless or more profligate among them to the interest charge on unpaid
 28 balances. So here competition has produced a combination of give-away
 29 cellular equipment with high-markup cellular usage; give-away credit
 30 card service with high interest charges: that is where the big money is.
 31 In these cases, selling underpriced cellular phones, credit cards (and
 32 razors) and overpriced cellular usage, credit (and razor blades) is an
 33 effective means of price discrimination, with the latter serving as a
 34 counting device to identify users for whom the value of the combined

1 service is high and charging them correspondingly more, in the
 2 aggregate, than customers for whom the consumer surplus is relatively
 3 low, as reflected in their purchasing relatively few razor blades, cellular
 4 usage or credit.

5 In situations in which prices uniformly set at marginal costs would not
 6 recover total costs, such price discrimination can clearly be welfare-
 7 enhancing—I suspect this is the case with cellular phone service, airlines
 8 and probably also goods sold in shopping malls. It would certainly not
 9 make economic sense to prohibit it in unregulated industries generally.

10 Nor should it be forsworn in regulated industries, either, for exactly the
 11 same reason. But that fact does not exempt its specific applications from
 12 the necessity of complying with the relevant principles I have just
 13 summarized. *The justifications that I have inferred in the several*
 14 *examples just described clearly do not apply to or justify the*
 15 *underpricing of residential dial tone, the incremental costs of which are*
 16 *very high and the demand highly inelastic relative to those of usage.*⁴

17 Professor Kahn also notes that:

18 As I have already suggested, where, as in most of these examples, first
 19 best, marginal cost pricing is not feasible and some of the products or
 20 services are complementary, it is necessary, in designing second-best
 21 efficient prices, to take into account the cross-elasticities of their
 22 demands. The demand for the goods sold in shopping malls, credit card
 23 loans and for cellular telephone service might well be more responsive to
 24 the price of admission—parking in the first case, the fixed fee in the
 25 second, the cost of the equipment in the third—than to the “usage”
 26 charges themselves. In that event, the price discrimination (or
 27 “counting”) effected by pricing the former services at zero and below
 28 marginal costs, respectively, and the complementary products or services
 29 correspondingly above marginal costs is probably welfare-enhancing.
 30 But it is almost certainly not true that telephone usage is more sensitive
 31 to the admission fee—the charge for dialtone alone—than to its own
 32 direct charges—so the logic of the practice in unregulated industries
 33 frequently cited by defenders of the regulated telephone rate structures
 34 simply does not apply.⁵

⁴ Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation*, MSU Public Utilities Papers, 1998, at 80-81 (emphasis added).

⁵ *Id.*, fn. 111. Also see A.E. Kahn and W.B. Shew, “Current Issues in Telecommunications Regulation:
 (continued...)”)

1 **Q. ARE THE PASSAGES FROM ILEC COMMENTS CITED BY DR. GABEL**
 2 **TO SUPPORT HIS ARGUMENTS CONSISTENT WITH THE POSITION**
 3 **THAT RATES SHOULD BE REBALANCED?**

4 A. Yes. Dr. Gabel fails to recognize that the market includes many different types of
 5 customers; thus, while competitors can and will enter the market based on
 6 comparisons of total revenue and total costs, they probably do so selectively. That
 7 is, while ILECs are *required* to serve the low-revenue customers, CLECs may avoid
 8 those customers if they wish and compete instead for the more lucrative parts of the
 9 market. Indeed, the concluding sentence from Verizon comments quoted by Dr.
 10 Gabel [at 54] actually contradicts his use of those comments to refute the need to
 11 rebalance rates: “No CLEC competes solely for the local telephone service
 12 revenues of potential customers, and no ILEC would either *if it had a choice*.”⁶ The
 13 point is that CLECs can and do consider all revenue streams associated with entry,
 14 but they focus on the high-revenue customers who generate positive contribution
 15 above direct costs, whereas the ILECs *do not have that choice*. The ILECs must
 16 serve customers who take only RBLTS with few other services and CLECs who
 17 have a choice are not likely to compete to serve such customers unless rates are
 18 rebalanced.

19 Similarly, Dr. Gabel’s use [at 55-56] of an excerpt from Dr. Taylor’s
 20 testimony in a Massachusetts proceeding is actually perfectly consistent with the
 21 need to rebalance rates.

22 [S]ometimes we ask the question, can a LEC make money in residential
 23 service, for example? And for that, what matters is the full panoply of
 24 services that a CLEC or ILEC can expect to provide *when it attracts a*
 25 *customer*. So *for that* it makes...sense to include the revenues and the

(...continued)

Pricing,” *Yale Journal on Regulation*, Vol. 4, No. 1, Spring, 1987, at 251-252.

⁶ Emphasis added.

1 costs from vertical services in the calculation.⁷

2 Again, the point is that CLECs can make money when they can sell the full
 3 panoply of services. However, they will take steps, e.g., use rate structures and
 4 marketing efforts, to attract only the customers likely to take numerous (mostly
 5 higher-margin) services, rather than compete for low-revenue customers.

6 **Q. MR. OSTRANDER [AT 38-40] CONTENDS THAT THE ILECS HAVE**
 7 **PROVIDED NO INFORMATION OR SUPPORT THAT REBALANCING**
 8 **WILL LEAD TO NEW SERVICE INTRODUCTIONS OR**
 9 **MODERNIZATION EFFORTS. DO ECONOMIC CONSIDERATIONS**
 10 **IMPLY THAT REBALANCING WILL BRING SUCH BENEFITS?**

11 A. Yes. Basic economic considerations indicate that improvements will occur in both
 12 areas because the profit opportunities are clearly increased by the plan. Whether or
 13 not RBLTS rates are currently subsidized, we would expect to see greater
 14 investment in, and competition for, basic services as a result of rebalancing because
 15 the potential returns will increase.

16 **Q. ACCORDING TO DR. COOPER [AT 32], THE “COMMISSION SHOULD**
 17 **REQUIRE THAT THE INCREASE IN BASIC MONTHLY CHARGES BE**
 18 **ALLOCATED IN PROPORTION TO ACCESS MINUTES OF USE**
 19 **BETWEEN THE CLASSES.” WOULD FOLLOWING THIS**
 20 **RECOMMENDATION PROMOTE EFFICIENT COMPETITION?**

21 A. No. Dr. Cooper’s recommendation ignores the fact that the ultimate benefits of
 22 competition have to do with allocative efficiency, namely, setting prices closer to
 23 efficient competitive levels (as explained in Dr. Taylor’s direct testimony), as well
 24 as longer-term benefits that accrue when entrants find it profitable to serve a wider
 25 spectrum of consumers. Adopting Dr. Cooper’s proportional allocation approach

⁷ Massachusetts Department of Telecommunications and Energy, Price Cap Regulation for Verizon, DTE 01-31, Phase II Order, April 11, 2003, at 82.

1 may seem fair on the surface but it would not promote competition for residential
2 customers who already benefit from disproportionately low rates (compared to
3 business local rates) in Florida. Thus, apportioning the rate increase based on toll
4 rate reductions would simply perpetuate an inefficient rate structure and weaken
5 incentives of competitors to compete for low-revenue customers.

6 **III. THE OPPOSING PARTIES' ANALYSES OF SUPPORT FOR RBLTS ARE**
7 **NOT CONSISTENT WITH ECONOMIC PRINCIPLES**

8 **A. Dr. Gabel's Analysis is Based on an Incorrect Service Definition**

9 **Q. PLEASE SUMMARIZE DR. GABEL'S ARGUMENT THAT RBLTS IS**
10 **CURRENTLY NOT SUPPORTED.**

11 A. Dr. Gabel's argument in this regard runs as follows.

- 12 1. To show that RBLTS is supported, one must compare the revenues from RBLTS
13 with the associated TSLRIC.
- 14 2. The ILECs' TSLRIC estimates are too high because the ILECs incorrectly
15 include costs shared among RBLTS, business BLTS, other business services and
16 data services.
- 17 3. The ILECs do so because they have presented estimates of the costs of TSLRIC
18 for the combined set of business, residential, and data services.
- 19 4. When the alleged shared costs are excluded from the study, it turns out the
20 RBLTS is actually priced above TSLRIC.

21 **Q. IS DR. GABEL'S ANALYSIS OF BELLSOUTH'S TSLRIC STUDY**
22 **CORRECT?**

23 A. No. Dr. Gabel distinguishes incorrectly between the costs of residential and
24 business BLTS. Dr. Taylor's direct testimony considers whether RBLTS presently
25 receives subsidy support, i.e., whether (or not) the revenues from RBLTS are
26 sufficient to cover the associated TSLRIC. However, that does not mean that the
27 cost of RBLTS should be computed separately from that of business BLTS.
28 Residential customers are just one class of customers for BLTS. The costs of BLTS
29 may differ according to qualities such as loop length and population density. But

1 neither the service nor the underlying costs of providing the physical service differ
 2 simply because a customer is a given classification. Thus, Dr. Gabel's attempts to
 3 distinguish between the costs of RBLTS and business BLTS are misguided.

4 We can further see the fallacy of Dr. Gabel's approach by carrying it to its
 5 logical extreme. Thus, if we examine the costs for serving a single residence
 6 customer using Dr. Gabel's method, we would find that there are almost no direct
 7 costs. For example, the only costs added when I am served by BellSouth would be
 8 simply the costs of the port at the central office and the drop wire from the pole to
 9 my house. All of the costs of the installation, poles, etc. would (according to Dr.
 10 Gabel's logic) be deemed shared by the other customers, so serving me would add
 11 almost nothing to the company's costs. The problem is that Dr. Gabel suggests the
 12 wrong increment.

13 **Q. IF BLTS IS A SINGLE SERVICE THAT INCLUDES BOTH RESIDENTIAL**
 14 **AND BUSINESS CUSTOMERS, SHOULDN'T YOU DETERMINE**
 15 **WHETHER BLTS IS SUPPORTED BY COMPARING THE**
 16 **INCREMENTAL COSTS OF BLTS WITH THE TOTAL REVENUES OF**
 17 **RESIDENTIAL AND BUSINESS BLTS?**

18 A. No. Doing so would hide the fact that residential and business customers pay
 19 different prices for the same service. Assume that the monthly TSLRIC of BLTS is
 20 \$20 per line and there are as many residential subscriber lines as business
 21 subscriber lines. Also assume that residential customers pay \$10 per line per
 22 month, while businesses pay \$30 per line per month. In this circumstance, total
 23 revenues would equal the TSLRIC and it would appear that BLTS was not
 24 supported. Of course, the fact is that residential customers are being supported
 25 because they pay less than the TSLRIC per line. Thus, we should assess support
 26 separately for these two customer classes because they each pay different amounts
 27 for the same service.

28 **Q. BUT, WOULD YOU NOT AGREE THAT PRIVATE LINE SERVICES**

1 **SHARE THE SAME FACILITIES AS THOSE USED BY BLTS?**

2 A. I have not studied BellSouth's network design in detail; however, I believe the key
 3 point is that the network demand that drives the preponderance of the current local
 4 access plant is the demand for BLTS. Thus, without BLTS, costs would decline by
 5 a considerable amount. The amount of the decline is extremely difficult to
 6 estimate; thus, the Commission has historically accepted the approach used by
 7 BellSouth (see Mr. Shell's testimony). Moreover, if BLTS were not offered then it
 8 is entirely possible that the rest of the network would never be built, or that it would
 9 be built in a very different way, e.g., using point-to-point wireless technology.
 10 Thus, in principle, it may be appropriate to assign all of the shared structure costs to
 11 BLTS.

12 **Q. WHAT IS YOUR OPINION OF DR. GABEL'S POSITION ON RETAILING**
 13 **COSTS?**

14 A. With regard to retailing costs, it is clear that if customers did not take BLTS from
 15 BellSouth they would not be purchasing any of the other services, e.g., vertical
 16 services. Therefore, it is reasonable to assign the billing and collection costs to
 17 BLTS.

18 **B. Dr. Cooper's Claim that the Loop Cost is a Common Cost is Not**
 19 **Consistent with Economic Principles**

20 **Q. DO YOU AGREE WITH DR. COOPER [AT 16-26] THAT THE LOOP**
 21 **COST SHOULD BE CONSIDERED "A COMMON COST" OF THE**
 22 **SERVICES THAT ARE CARRIED OVER THE LOOP?**

23 A. No. The local loop enables end users to gain access to the public switched
 24 telephone network. It may alternatively be characterized as a network access
 25 service that enables customers to utilize various forms of usage services, e.g., local
 26 calling, long distance (toll) calling, Internet calling, Call Waiting and other custom
 27 features, voice messaging, etc. On the basis of this attribute, Dr. Cooper argues that

1 the local loop is a shared or common facility and, hence, a source of common cost.
 2 Because he views the loop as an intermediate product used to support toll, local,
 3 and other services rather than as a service that would be demanded in its own right
 4 by the end-user, Dr. Cooper would exclude loop costs from the direct incremental
 5 cost of RBLTS. However, from an economic perspective, the local loop's cost is
 6 *not* a common cost of all telecommunications services. Rather, it is a service that is
 7 demanded in its own right. As Alfred E. Kahn and William B. Shew explain:⁸

8 First, does subscriber access have a separate identifiable incremental cost
 9 associated causally with providing it? The answer is, unquestionably,
 10 yes. Connecting a customer to the network uses scarce resources, even if
 11 he or she never uses the connection. The customer who subscribes to
 12 two access lines imposes a greater cost on the system than the customer
 13 who subscribes to one, even if they make the same number of calls, at the
 14 same times and places.

15 Second, does charging for access separately serve a purpose? The
 16 answer is that it serves the very important purpose of economic
 17 efficiency if buyers are confronted, in each of their purchase decisions,
 18 with prices that reflect the respective incremental costs to society of their
 19 taking more or less of each available good and service or, to put it
 20 another way, what costs society would save if they took less of each.

21 Thus, other economists generally disagree with the view that the cost of the
 22 local loop is a common or shared cost because it conflicts with the fundamental
 23 principle of cost causation.⁹ That principle tells us to ask why the resources used in
 24 providing the loop have been expended. Applied to loops, the answer is simple: a
 25 customer gaining access to the network *causes* the costs associated with the loop.
 26 That is true whether that access is gained as part of a standard bundled offering like

⁸ Kahn and Shew, *op cit.*, at 201.

⁹ See, e.g., John T. Wenders, *The Economics of Telecommunications: Theory and Policy*, Cambridge, MA: Ballinger, 1987; Alfred E. Kahn, "Pricing of Telecommunications Services: A Comment," *Review of Industrial Organization*, 8, 1993, at 39-41; William E. Taylor, "Efficient Pricing of Telecommunications Services: The State of the Debate," *Review of Industrial Organization*, 8, 1993, at 21-37; and Lester D. Taylor, "Pricing of Telecommunications Services: Comment on Gabel and Kennet," *Review of Industrial Organization*, 8, 1993, at 15-19.

1 RBLTS or, in the new environment, by purchasing an unbundled loop. Once the
2 loop is provisioned, the cost is incurred. The way in which it is *used* (if at all) does
3 not change that cost.

4 Loop subscribers essentially acquire the right to access the network and
5 receive services of his or her choosing. Actual usage of the loop does not matter for
6 cost causation. The loop has been provisioned—and a cost incurred—regardless of
7 whether the customer uses the loop at all, accesses only one service, or accesses
8 multiple services. The cost of that loop should be recoverable regardless of actual
9 use. Moreover, the costs of toll and local usage service are distinct from those of
10 the local loop. As Professor Kahn explains:

11 [W]hen we say the “cost” of a subscriber loop is some amount, it can
12 mean nothing except that some act of purchase by a consumer causes a
13 telephone company and society to incur that cost....Consumers impose
14 the cost of the loop on a telephone company and society by the act of
15 subscribing to telephone service. The causation principle therefore
16 requires that the cost of providing the loop be fully incorporated in the
17 cost of basic service. Conversely, if as I understand to be essentially the
18 case, actual use of the loop for local or long distance calling or for other
19 services imposes no loop costs on the supplier and if subscribers were to
20 refrain from placing those calls or using any of those other services it
21 would not save any of those costs, there is no sense in which usage or
22 other services can be held causally responsible for them.¹⁰

23 The contrary position—that the loop’s cost should depend on how it is
24 used—is based on a fallacy. To see why that is so, ask whether the cost of the loop
25 should be recovered differently from different customers, depending on how many
26 services (including none at all) they access with it. If the answer is “yes,” then we
27 find absurd results. For example,

- 28 • by this reasoning, shouldn’t the cost of constructing a highway be
29 considered a shared or joint cost to butchered meats, milk, stereo
30 equipment, and dry cleaning if distributors of these products use that
31 highway to receive them?

¹⁰ Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation*, at 71-72.

- 1 • shouldn't a car be considered a shared cost of motels since access to
2 motels is facilitated by the car?¹¹

3 **Q. DOES DR. COOPER'S ARGUMENT [AT 23] THAT THE TREND IS**
4 **TOWARD SALES OF BUNDLED SERVICES IMPLY THAT LOOP COSTS**
5 **ARE COMMON COSTS?**

6 A. No. The fact that telecommunications firms today compete by selling bundles of
7 services does not alter the manner in which cost is incurred or caused. Regardless
8 of how many usage services are bundled together with network access service, the
9 fact remains that the cost of the loop arises entirely to provide network access and
10 that cost is distinct from the cost of any usage service. Moreover, customers may
11 take varying amounts of usage, i.e., not in fixed proportion to network access, so
12 that it is important to assess the cost of each service separately.

13 Simply because a network access line (or loop) may be used for (and is
14 necessary for) access to other telecommunications services, it does *not* mean that it
15 is not a separate service with a separate cost. The same arguments made by Dr.
16 Cooper could be made for the telephone set, which once was bundled into the price
17 of basic service and is necessary for local and toll calls and other telephone
18 services. According to Dr. Cooper's flawed logic, the cost of the telephone set
19 should be allocated to all of the services that require its use, yet it is clear that
20 telephone sets are separate facilities with separate and definable costs. The same is
21 true of the network access line or local loop.

22 **Q. SUPPOSE, AS DR. COOPER DESCRIBES [AT 17], A LEC WERE TO**
23 **WITHDRAW ITS RBLTS, BUT NOT THE LOOP OR ITS OTHER**
24 **SERVICES. WOULDN'T THE LOOP STILL BE NEEDED AND DOESN'T**
25 **THAT MAKE THE LOOP A SHARED FACILITY?**

¹¹ Steve G. Parsons, "Seven Years After Kahn and Shew: Lingering Myths on Costs and Pricing Telephone Service," *Yale Journal on Regulation*, 11, 1994, at 159, note 35.

1 A. There is no denying the fact that the local loop is required within a wireline network
2 to deliver *any* wireline service. However, the essential fact remains that the only
3 way I could avoid the cost of the loop is by discontinuing RBLTS from that LEC
4 altogether. I could not selectively drop the loop but continue to consume the other
5 services.

6 I agree that in the *purely hypothetical case*, if an LEC were to discontinue
7 the *usage* part of RBLTS but were to continue to provide the loop along with toll,
8 switched access, and other services, then the cost of the loop would not be avoided.
9 But this thought experiment just tells us something we knew already: that no loop
10 costs are associated with the provision of local usage. The same is true of any other
11 services that use the loop. Moreover, if the loop remained entirely unused, the
12 costs would still be the same.

13 **Q. DR. COOPER CLAIMS [AT 22-24] THAT VARIOUS FCC DECISIONS**
14 **SUPPORT THE IDEA THAT THE LOOP IS A COMMON COST. PLEASE**
15 **INDICATE THE SALIENT FCC FINDINGS ON HOW LOOP COSTS**
16 **SHOULD BE RECOVERED.**

17 A. First, the FCC's various actions in setting up recovery of the *full* interstate portion
18 of the cost of the local loop through fixed subscriber line charges—and reducing
19 recovery of loop costs from carrier access usage charges—speak loudly about what
20 the FCC truly believes.

21 Second, consider the FCC's language in its recent access reform docket.¹²
22 In that decision, the FCC accepted many of the salient features of an integrated
23 proposal by the Coalition for Affordable Local and Long Distance Service
24 (“CALLS”)—a group of prominent local exchange and long distance carriers

¹² FCC, *In the Matter of Access Charge Reform* (CC Docket No. 96-262), *Price Cap Performance Review for Local Exchange Carriers* (CC Docket No. 94-1), *Low Volume Long Distance Users* (CC Docket No. 99-249), and *Federal-State Joint Board on Universal Service* CC Docket No. 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, and Eleventh Report and Order in CC Docket No. 96-45 (“*CALLS Order*”), May 31, 2000.

1 including AT&T and Sprint—for universal service and access charge reform.
2 Significantly, the FCC increased the subscriber line charge on residential and
3 business customers with the aim eventually of recovering the entire interstate
4 portion of the non-traffic-sensitive local loop in fixed flat-rated charges. The
5 following excerpts from the *CALLS Order* amply demonstrate the FCC’s firm
6 commitment to the view that the cost of the local loop is not—and should not—be
7 shared with usage services.

8 In promulgating its access charge rules, the Commission has recognized
9 that, to the extent possible, costs of interstate access should be recovered
10 in the same way that they are incurred. This approach is consistent with
11 principles of cost-causation and promotes economic efficiency. Thus,
12 non-traffic sensitive costs should be recovered through fixed, flat-rated
13 fees. Similarly, traffic sensitive costs should be recovered through
14 corresponding per-minute access rates. The Commission’s rules,
15 however, are not fully consistent with this goal. In particular, because
16 the Commission has taken a cautious approach in addressing
17 affordability concerns, it has taken measured steps toward this goal by
18 limiting the amount of the allocated interstate cost of a local loop that is
19 assessed directly on residential and business customers as a flat monthly
20 charge.¹³

21 With the passage of the 1996 Act, the Commission determined that it
22 was necessary to make substantial revisions to access charges. In the
23 *Access Charge Reform Order*, the Commission instituted reforms that
24 changed the manner in which price cap LECs recover access costs by
25 aligning the rate structure more closely with the manner in which costs
26 are incurred. Prior to such reform, some costs that did not vary with
27 usage, in particular the local loop, were not wholly recovered through flat
28 charges. The SLC, which is a flat charge that recovers the interstate
29 portion of local loop costs from an end user, is subject to a cap that,
30 particularly for residential customers, is often below the level that would
31 enable the LEC to recover the entire interstate cost of the local loop.
32 [footnote omitted].¹⁴

33 The Eighth Circuit upheld the Commission’s increases to various LEC

¹³ *Id.*, at ¶12.

¹⁴ *Id.*, at ¶18.

1 SLC caps, however, and found that “Texas Counsel’s contention that
 2 increasing the SLC price ceiling violates the prohibition against using
 3 non-competitive services to subsidize competitive services [wa]s
 4 unpersuasive.” In doing so, the court reaffirmed the *Commission’s long*
 5 *standing view that the subscriber “causes” local loop costs, whether the*
 6 *subscriber uses the service for intrastate or interstate calls.* These costs
 7 are, in any event, recovered from the end user, either through direct end-
 8 user charges or indirectly through higher rates or additional charges paid
 9 to IXCs. The court further affirmed the Commission’s conclusion *that it*
 10 *was appropriate and rational for the Commission to impose these costs*
 11 *on the end user.* The court concluded as a result that increasing SLC
 12 caps on certain lines did not result in a windfall for IXCs.¹⁵

13 **IV. ADDITIONAL REGULATORY INTERVENTION IS NOT NEEDED TO**
 14 **ENSURE THAT CUSTOMERS BENEFIT FROM RATE REBALANCING**

15 **Q. MR. OSTRANDER CLAIMS [AT 32-33] THAT INCREASES IN BASIC**
 16 **RATES ARE PERMANENT WHILE TOLL REDUCTIONS MAY BE**
 17 **SHORT LIVED. IS THERE ANY NEED FOR THE COMMISSION TO**
 18 **IMPOSE ADDITIONAL REGULATORY MEASURES TO ENSURE THAT**
 19 **TOLL REDUCTIONS ARE NOT ERODED?**

20 A. No. Competitive trends will insure that rate reductions in toll will not be short
 21 lived. As explained by Staff witness Gregory L. Shafer [at 14-15], wireless
 22 carriers have put substantial competitive pressure on long distance carriers and the
 23 proposed access rate reductions will give the long distance carriers the opportunity
 24 to lower their rates and/or offer new calling plans to win back traffic. Moreover,
 25 competition for intrastate and interstate toll traffic has become quite vigorous as
 26 ILECs such as BellSouth have been allowed to provide in-region long distance
 27 service; thus, there is every reason to assume that regulatory intervention is not
 28 needed to insure that rate reductions associated with access charge reductions will

¹⁵ *Id.*, at ¶95 (footnotes omitted, emphasis added).

1 continue to be passed through.¹⁶

2 **Q. MR. OSTRANDER CONTENDS [AT 4] THAT THE PROPOSALS LET**
 3 **THE LECS GET THE BEST OF ALL WORLDS BECAUSE “THE LECS**
 4 **TRADE-OFF AT-RISK ACCESS REVENUES FOR INCREASES IN**
 5 **INELASTIC REVENUES OF RESIDENTIAL BASIC LOCAL SERVICE**
 6 **CUSTOMERS.” PLEASE RESPOND TO THIS CONTENTION.**

7 A. Mr. Ostrander’s contention unwittingly actually supports the proposal. The
 8 recognition that carrier access revenues are at risk is implicit acknowledgement that
 9 carrier access service is relatively more price-elastic than RBLTS and that fact
 10 alone supports the need to rebalance rates. From an economic standpoint, the
 11 economic efficiency (and consumer surplus) gained from lowering the price of a
 12 more price-elastic service outweighs the economic efficiency (and consumer
 13 surplus) lost from raising the price of a less price-elastic service in a corresponding
 14 manner. As a result, economic efficiency and consumer welfare rises upon such
 15 rate rebalancing.

16 Mr. Ostrander’s statement is also somewhat misleading because he cannot
 17 possibly know how much ILEC revenues would be affected by the proposed rate
 18 rebalancing. Therefore, it is far from certain that the trade-off that Mr. Ostrander
 19 mentions will necessarily enable ILECs to “get the best of both worlds.” It is true
 20 that wireline network access service has traditionally been regarded as highly price-
 21 inelastic, although that has been changing as wireless and broadband have
 22 increasingly served as replacements for wireline services. However, as long as
 23 these alternatives are not pressing enough to force RBLTS to actually become
 24 price-elastic, any increase in the RBLTS rate would raise the ILEC’s revenues, just
 25 as a lowering of access charges and, ultimately, long distance rates would lower the

¹⁶ BellSouth’s data show that between 44 and 52 percent of *new* presubscribed long distance customers in Florida have chosen carriers other than BellSouth Telecommunications or BellSouth Long Distance in every month over the past two years.

1 ILEC's revenues (provided long distance services too remain price-inelastic).¹⁷
2 What is impossible to predict precisely is how much of the increased RBLTS
3 revenue is likely to be lost as competitive entry occurs. Within the family of
4 wireline services, increasing competition likely makes the firm-specific price
5 elasticity of demand is higher than the overall market price elasticity for network
6 access. Thus, BellSouth is likely to gain less additional revenue from an increase in
7 RBLTS rates than if it were the only provider of RBLTS in its service territory, and
8 progressively less so as other sources of RBLTS emerge.

9 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

10 A. Yes.

¹⁷ Price elasticity measures the consumer's sensitivity to price. When a service is price-elastic, any change in price is likely to induce significant consumer response; when the service is price-inelastic, that change in price is likely to induce a more muted response. At the extreme, when the price elasticity tends to zero, there is almost no response at all to a price change. Thus, as long the price elasticity of a service is in the "inelastic" range (between zero and -1), a price increase (decrease) will increase (reduce) revenue. And, once the price elasticity reaches the "elastic" range, a price increase (decrease) will reduce (increase) revenue. Both RBLTS and long distance service have traditionally fallen in the inelastic range, the former even more so. However, as competition builds for both, the price elasticity of both services (especially at the individual carrier level) is likely to go up. Whether they are anywhere near the elastic range, or will be following the proposed rebalancing, is unknown at this time. Thus, Mr. Ostrander's prediction is, at best, premature and, at worst, unduly alarmist and false.

1 BY MS. WHITE:

2 Q Dr. Banerjee, could you please give your
3 summary?

4 A Yes. Good morning, Madam Chairman and
5 Commissioners.

6 CHAIRMAN JABER: Good morning.

7 A As was said yesterday, and it bears
8 repeating again, the newly created Section 364.164
9 aims to encourage greater competitive entry into
10 Florida's local exchange markets by simultaneously
11 removing the current support for residential basic
12 local telecommunications service and reducing
13 intrastate switched access rates to parity with
14 interstate switched access rates. Section 364.164
15 seeks to make the withdrawal of support for
16 residential basic service revenue neutral from the
17 perspective of the ILEC. For this purpose, Section
18 364.163, as amended, requires the ILECs' current
19 intrastate switched access rates in Florida to be
20 dropped to parity with current interstate switched
21 access rates.

22 Historically, intrastate switched access
23 rates have been the source of support for residential
24 basic service. This reduction of intrastate switched
25 access rates will remove an equivalent amount, in

1 dollar terms, of support for residential basic service
2 end-user rates, and any rate rebalancing of the form
3 envisioned by 364.164 and 364.163, as amended, would
4 improve incentives for competitive entry in Florida,
5 Florida's local exchange markets, and lead to more
6 efficient prices for residential basic service and
7 switched access services. This would greatly benefit
8 consumers and local exchange competition alike.

9 The BellSouth rebalancing plan will promote
10 greater competition, to the benefit of residential
11 consumers, and claims to the contrary are flawed as a
12 matter of economic principle and are inconsistent with
13 experience in the industry. I wish to address four
14 points in this connection.

15 Entry to serve low revenue customers will
16 be stimulated by the rebalancing plan. Many entrants
17 have chosen to use UNE-PS to serve residential
18 customers. Thus, it is useful to compare UNE-P rates
19 with basic local service rates. Various data show
20 that little or no profit can be had from low revenue
21 customers, I repeat, low revenue customers at current
22 basic rates. Raising these rates would allow entrants
23 to serve profitably a greater share of residential
24 customers.

25 Number two, there may be some question

1 regarding rebalancing, will it or will it not
2 stimulate competitive entry, given that entrants
3 compare total potential revenues with total costs.
4 The premise of this question, however, is false.
5 Although the overall entry decision may rest on this
6 comparison, the decision to serve low revenue
7 customers that purchase basic service and little, if
8 any, of the other services, is based on whether
9 serving those customers will contribute to the firm's
10 profits. Thus, rebalancing that reduces rates for
11 high usage customers by reducing their toll rates,
12 alongside offsetting rate increases for basic service,
13 will allow entrants to serve more low revenue
14 customers without impeding competition for more
15 lucrative customers.

16 Number three, the argument that unregulated
17 competitive firms set prices to maximize total
18 profits, and may thus sell some products below cost to
19 stimulate overall demand, does not justify a
20 regulatory policy to impose such pricing on ILECs.

21 And number four, the competitive forces
22 operating in the telecommunications markets should be
23 allowed to ensure that access charge reductions
24 continue to be passed through to consumers.
25 Competition has been vigorous for toll services,

1 especially since BellSouth and the other RBOCs were
2 authorized to provide in-region interLATA toll
3 services. And competition for toll and bundled
4 services, that is, packages of local and toll
5 services, should be allowed to set rates for toll
6 services. Those market forces should be relied upon
7 to ensure that competitive rates are charged.

8 To summarize, the actions and choices of
9 CLECs in Florida speak louder than words. At the end
10 of 2002, only 48% of CLEC-served lines went to
11 residential customers -- this is from FCC data --
12 while that number was 83% for ILEC-served lines.

13 Given these circumstances, implementing
14 Section 364.164 in the manner proposed by BellSouth
15 and the other petitioners offers the best chance to
16 get greater and, more importantly, efficient basic
17 residential local exchange competition in Florida.

18 Thank you.

19 MS. WHITE: Dr. Banerjee is available for
20 cross.

21 CHAIRMAN JABER: Public Counsel.

22 MR. BECK: Thank you, Madam Chairman.

23 CROSS EXAMINATION

24 BY MR. BECK:

25 Q Good morning, Dr. Banerjee.

1 A Good morning.

2 Q would you please turn to your rebuttal
3 testimony at page 17?

4 A Yes.

5 Q And would you review to yourself the
6 question that begins on line 16 and the answer that
7 goes through the next page at line 5?

8 A I'm with you.

9 Q You take exception to the recommendation of
10 Dr. Cooper that the Commission should require that the
11 increase in basic monthly charges be allocated in
12 proportion to access minutes of use between the
13 classes, do you not?

14 A I do.

15 Q And is your concern that if that procedure
16 were followed, that residential customers would
17 receive toll reductions that offset the local
18 increases for those customers?

19 A My concern is that there is no economic
20 basis for proportional allocations. The amount by
21 which rates should be reduced for one set of customers
22 may not necessarily be the same for the allocation
23 that is given to some other set of customers.

24 Q Let me try to ask the question again. If
25 the Commission followed Dr. Cooper's recommendation,

1 wouldn't a consequence be that residential customers,
2 the increase that they experience in their local rates
3 would be offset by reductions to their long distance
4 charges, would it not?

5 A Yes.

6 Q And that's the concern you have. You don't
7 think that that should be required?

8 A My concern is that it should not be
9 required in the manner proposed, which is proportional
10 allocation between business and residential.

11 Q And is it your testimony that you believe
12 that the proposals by the companies will make lower
13 revenue customers higher revenue customers for the
14 competitors?

15 A If Section 364.164 is implemented as
16 everyone wants it to be, then the lower revenue
17 customers would be more attractive to serve, yes.

18 Q And the reason they'll be more attractive
19 is that their total bills will increase; is that
20 correct?

21 A That's correct.

22 Q And the reason they will be more attractive
23 to competitors is because they're paying more money in
24 total?

25 A For the residential basic service part of

1 it, yes.

2 Q well, it's residential basic service plus
3 their long distance charges, would it not?

4 A It all depends on what the long distance
5 usage is.

6 Q Could you go to the charts that you have on
7 pages 8 and 9 of your rebuttal testimony?

8 A Yes.

9 Q These two charts illustrate a portion of
10 what you've just been discussing, do they not?

11 A Yes, they touch upon that point.

12 Q On the vertical access, the revenue divided
13 by -- or revenue to cost per month, could you tell us
14 what that stands for?

15 A That's not revenue divided by cost. That
16 is revenue/cost, so that access could represent either
17 revenues or costs.

18 Q So is that the total bill to be paid by
19 residential customers?

20 A That's correct.

21 Q Okay. And then on the horizontal axis, you
22 have the percent of the customers who pay that much
23 for their total bill; is that correct?

24 A That's correct.

25 Q And then Figure 1 illustrates before

1 rebalancing; is that correct?

2 A That's right.

3 Q And then Figure 2 on the next page shows
4 after rebalancing?

5 A Yes.

6 Q These are just hypothetical examples, are
7 they not?

8 A These are hypotheticals.

9 Q Okay. And your illustration shows that
10 what the rebalancing does is, it takes the total bill
11 paid by low revenue customers and makes them higher
12 revenue customers; is that right?

13 A Within the context of these hypotheticals,
14 yes.

15 Q Is it your experience that competitive
16 local carriers offer stand-alone basic local telephone
17 service to customers, or do they tend to offer
18 packages that include vertical services?

19 A Well, I can't speak for all CLECs, but I
20 know that some offer packages. They prefer to compete
21 for all services if they compete at all. But that's
22 probably because of the market conditions the way they
23 are, that it's only profitable for them to compete for
24 those customers who are likely to take packages of
25 services rather than those customers who are on the

1 lower end in terms of the revenues they produce,
2 perhaps because they only take the basic service and
3 not much else.

4 Q Is that a phenomenon that's specific to
5 Florida, or would that be typically true of
6 competitive carriers throughout the country?

7 A I couldn't give you a definitive answer on
8 that, but my suspicion is that it's probably true of
9 Florida as well as of other states.

10 Q Okay. And that would be true in other
11 states where the local rate paid by residential
12 customers is higher than it is in Florida?

13 A Perhaps. I don't know the answer to that
14 question.

15 Q Could you turn to your direct testimony at
16 page 11?

17 A Yes.

18 Q And specifically, lines 13 through 16?

19 A I've read them.

20 Q Okay. And here you mention that the rate
21 reductions in long distance rates would be expected to
22 stimulate long distance calling; is that correct?

23 A I assume so.

24 Q Okay. Have you reviewed any of the filings
25 by AT&T, MCI, or Sprint on how they intend to flow

1 through the access reductions to their customers?

2 A Not in detail, no.

3 Q You've assumed your statement in the direct
4 testimony that there's going to be reductions in the
5 per minute rates that they charge; is that correct?

6 A That's correct.

7 Q Let me go back to your rebuttal testimony,
8 if we could, at page 4.

9 A Yes.

10 Q You state that Dr. Cooper's claim that the
11 cost of the loop is a common cost is not consistent
12 with economic principles or with the Commission's
13 prior rulings; is that right?

14 A Correct.

15 Q I would like to hand you an exhibit that's
16 a prior order of the Commission.

17 COMMISSIONER DEASON: Madam Chairman, this
18 is an old order.

19 CHAIRMAN JABER: Even you weren't on this.

20 COMMISSIONER DEASON: Even I wasn't on this
21 one.

22 COMMISSIONER DAVIDSON: Did you write the
23 order, though?

24 CHAIRMAN JABER: No. He participated when
25 he was at Public Counsel. No?

1 COMMISSIONER DEASON: '87. I don't know.

2 MR. HATCH: Mr. Fons was there for AT&T.

3 MR. BECK: Mr. Hatch was there for the
4 Commission.

5 CHAIRMAN JABER: Oh, yeah.

6 COMMISSIONER BAEZ: Mr. Self was there as
7 well.

8 COMMISSIONER DAVIDSON: Our general counsel
9 was there.

10 CHAIRMAN JABER: All this shows is you
11 people have been hanging around here too long, that's
12 all.

13 COMMISSIONER DEASON: Mr. Fons was
14 representing AT&T.

15 MR. FONTS: And your General Counsel was
16 representing MCI.

17 CHAIRMAN JABER: Well, he saw the light.

18 BY MR. BECK:

19 Q Dr. Banerjee, I was wondering if you could
20 review briefly the bottom of page 447 and the top of
21 page 448.

22 CHAIRMAN JABER: Where, Mr. Beck?

23 MR. BECK: The bottom of page 447 and the
24 top of 448.

25 A Is that starting with the paragraph that

1 goes over onto 448?

2 Q Yes.

3 A I've read it.

4 Q Okay. Would you agree in this case that
5 the Commission found that there was no subsidy between
6 access charges and local service?

7 A In this paragraph, that appears to be the
8 case.

9 Q And on page 446, where it says no NTS costs
10 recovered from access service?

11 A That's what it says.

12 Q And would you agree that the Commission
13 rejected the notion that no nontraffic-sensitive costs
14 should be recovered from access services in this
15 order?

16 A In 1987 it did.

17 Q Yes.

18 A But not subsequently.

19 MR. BECK: Thank you. That's all I have.

20 CHAIRMAN JABER: Ms. Bradley.

21 CROSS EXAMINATION

22 BY MS. BRADLEY:

23 Q Sir, you made a statement that if this is
24 implemented, that your lower revenue customers would
25 be paying more, so it would be more attractive to

1 competition; correct?

2 A That's correct.

3 Q Isn't that making an assumption, though,
4 that these customers will be able to pay this
5 increase?

6 A Let me answer the question this way, if I
7 may. I'm going to give you a direct answer to your
8 question.

9 Q Okay.

10 A The category of low revenue customers is
11 itself fairly broad. There may be people who take
12 very few services besides basic services out of
13 choice, not because they cannot afford it, and there
14 may be others who might find it unaffordable to take
15 ancillary services. In either case, they return very
16 little revenue to the CLEC. If the rates were to
17 rise, it's very likely that the first subcategory that
18 I mentioned is going to find it not at all difficult
19 to adjust to the higher rates. If there is a problem,
20 it would be with the second subcategory, who might
21 feel it difficult to pay a little bit more per month.
22 In that situation, targeted subsidies or assistance
23 programs are perfectly justified.

24 Did that answer your question?

25 Q In some ways.

1 But there has to be -- in order for them to
2 be more competitive, either through subsidies or some
3 other means, there has to be an ability for them to
4 pay that increase; correct?

5 A Are you asking me whether there should
6 remain some kind of assistance program for the
7 disadvantaged?

8 Q No, sir. I'm just asking you if your
9 statement makes the assumption that they're going to
10 be able to pay that increase.

11 A Generally, yes.

12 Q So if this category of persons either was
13 unable or unwilling to pay the increase, maybe they
14 are electing to go to some -- disconnecting and going
15 to a wireless company. But the more of those people
16 that elected or were just physically unable to pay
17 that increase, then that would have some effect on the
18 amount of competition, would it not?

19 A It could. It's hard to predict. Certainly
20 if they get direct assistance, they might well decide
21 to stay with a wireline network and take service from
22 whichever local exchange carrier best serves them.

23 It's -- one thing to keep in mind in this
24 connection is that historical studies have shown that
25 it's not the basic exchange rate that necessarily

1 holds up the decision of the most disadvantaged
2 consumers to subscribe or not subscribe. There are
3 other factors, including whether or not they can
4 afford to pay long distance charges, whether or not
5 the hook-up charge itself is affordable to them. So
6 there is a whole range of factors that come into play
7 to decide whether or not a so-called low revenue
8 customer can afford to take wireline service from --
9 basic service from a local exchange carrier. This is
10 not the only reason.

11 Q Were you here the first day and heard the
12 testimony of consumers that were saying that they or
13 many of their friends are unable to pay the current
14 rate, and certainly would be unable to pay an
15 increased rate?

16 A Yes, I heard the testimony. And with all
17 due respect, I don't know if that was a representative
18 sample of consumers, or even the consumers that
19 perhaps are on the margin between subscribing and not
20 subscribing. So I heard their testimony, but I'm
21 pretty sure that a larger perspective ought to be
22 adopted here, not just the testimony of a selected
23 group of customers.

24 Q Have you reviewed the report and surveys
25 that this Commission has done previously regarding the

1 amount of increase that would cause customers to
2 disconnect?

3 A No, I'm not familiar with those surveys.

4 MS. BRADLEY: No further questions.

5 CHAIRMAN JABER: Go ahead, Mr. Twomey.

6 MR. TWOMEY: Madam Chair, thank you.

7 Mr. Poucher is going to pass out my art work exhibit.

8 CHAIRMAN JABER: There you go, Commissioner
9 Davidson, another crude drawing lacking an eyeball.

10 COMMISSIONER DAVIDSON: I hope -- I was
11 going to say, I hope this one at least has the eye on
12 it.

13 MR. TWOMEY: If we could have that -- a
14 number, identified.

15 CHAIRMAN JABER: Short title?

16 MS. WHITE: Madam Chair, this has already
17 been identified as an exhibit once. Do we need to --

18 CHAIRMAN JABER: Oh, is it the same one?

19 MR. TWOMEY: I was going to put the -- we
20 can probably use it. I was just going to -- we can
21 use the same one then.

22 CHAIRMAN JABER: I have it, Commissioners.
23 Feel free use this one, but if it's the same exhibit I
24 identified and moved into the record --

25 MR. TWOMEY: Yes, ma'am, it's exactly the

1 same.

2 CHAIRMAN JABER: Okay. For purposes of the
3 record, Mr. Twomey, that was Exhibit 54.

4 MR. TWOMEY: Thank you, ma'am.

5 CHAIRMAN JABER: And the short title was
6 Diagram of Local Loop.

7 MR. TWOMEY: Okay.

8 CROSS EXAMINATION

9 BY MR. TWOMEY:

10 Q Good morning, sir.

11 A Good morning.

12 Q You in your rebuttal testimony take issue,
13 as pointed out by Mr. Beck, with Dr. Cooper's
14 suggestion that the local loop should be a shared
15 cost; correct?

16 A I do.

17 Q Okay. You used a hypothetical earlier in
18 your testimony, rebuttal testimony, to argue against
19 one of the Public Counsel's witness's theories; right?
20 You used a hypothetical earlier in your rebuttal?

21 A To which hypothetical would you be
22 referring?

23 Q Well, don't you recall whether you used a
24 hypothetical?

25 A I do recall using a hypothetical in those

1 two figures, Figures 1 and 2 on pages 8 and 9 of my
2 rebuttal testimony.

3 Q Yes, sir. I was just asking you whether or
4 not you used a hypothetical.

5 A In that context I did.

6 Q Okay. I want to ask you a hypothetical in
7 the common cost arena, and I want you to assume this.
8 Commissioner Terry Deason is returning to Tallahassee
9 from a business trip at the airport, and he gets in a
10 cab to return to the Public Service Commission
11 building here. The cost of the cab is \$20 for that
12 journey. As he's ready to depart, the vice president
13 each from Verizon, Sprint, and BellSouth hail the cab
14 and ask if they can share the cab with Commissioner
15 Deason. The four of them proceed --

16 COMMISSIONER DEASON: That's a bad example.
17 I wouldn't let that happen, Mr. Twomey.

18 BY MR. MR. TWOMEY:

19 Q The four of them proceed to be driven to
20 the Commission, at which point the cabbie says, "That
21 that will be 20 bucks."

22 So my question to you is -- it's multiple
23 choice. Under your theory of cost causation, which
24 would be the proper answer? A, BellSouth's vice
25 president says, "The cab fare is \$20 divided by four

1 equals \$5 each. I owe you \$5," or B, "Commissioner
2 Deason, you were initially riding alone and would have
3 paid \$20 in any event. We didn't impose any
4 additional cost on you; therefore, we owe you nothing
5 in contribution"?

6 A With great regret, I have to say it's B.

7 Q Okay. Now --

8 COMMISSIONER DEASON: Mr. Twomey, just let
9 me -- the reason I wouldn't let that happen is that
10 under our rules, I couldn't -- they couldn't pay for
11 their share, so I would have to pay the \$20, and they
12 would have to ride free. So they would have to take
13 their own cab, and I would have to take mine.

14 MR. TWOMEY: Okay.

15 BY MR. TWOMEY:

16 Q Now, the -- so you would pick B in my
17 hypothetical?

18 A I did.

19 Q Okay. And under that scenario, the three
20 telephone executives would get a free ride; right?

21 A I don't know what your definition of free
22 ride is. This is certainly collegiality or anything
23 else you want to call it. It's not a free ride in
24 that sense. Free ride in economics means something
25 quite different from the way you're defining it.

1 Q Well, they would be transported, and they
2 wouldn't pay anything; correct?

3 A That's true. But every time I take my
4 daughter or my son to some school or some other
5 function, should I expect to make them pay for the
6 cost of the ride?

7 CHAIRMAN JABER: It depends on how old they
8 are.

9 THE WITNESS: Well, I'm afraid these days
10 they take me.

11 BY MR. TWOMEY:

12 Q Okay. On page 24, top of the page, in
13 response to a question asked on the previous page, you
14 --

15 MS. WHITE: I'm sorry, Mr. Twomey. Is this
16 rebuttal or direct?

17 MR. TWOMEY: I'm sorry. Rebuttal. All my
18 questions are rebuttal.

19 A Page 24?

20 Q Yes, sir. At the top of the page, line 1,
21 in response to the question on the previous page, you
22 say, "There is no denying the fact that the local loop
23 is required within a wireline network to deliver any
24 wireline service." That's what you say in part. And
25 I want to ask you to refer to my handout exhibit, No.

1 64, I believe it was. And we'll just run through
2 these, okay, to see if --

3 CHAIRMAN JABER: Fifty-four.

4 MR. TWOMEY: Ma'am?

5 CHAIRMAN JABER: Fifty-four.

6 MR. TWOMEY: I'm sorry, 54.

7 BY MR. TWOMEY:

8 Q Take that as the representation of the
9 local loop. Okay?

10 A Right.

11 Q And I want to ask you each of those
12 services listed in the middle. Can intraLATA long
13 distance service be provided without use of the local
14 loop?

15 A This is provided by the LEC or by --

16 Q By anybody.

17 A -- any carrier?

18 Q By anybody.

19 A Yes. It's called private line. You could
20 have -- that's why I asked you the clarifying
21 question. If it's the LEC that provides the
22 connection between the customer premises and the
23 network, then it comes over that local loop. But if
24 a customer desires to bypass the local network and
25 send its traffic directly to a destination, it could

1 deal directly with the interexchange carrier through a
2 private line arrangement.

3 Q Good point. Yes. Constrain -- all my
4 questions are constrained to the provision of services
5 by the LEC.

6 A Yes. If the only way that the customer is
7 connected to the network is through that connection to
8 the local exchange carrier's switch, then, yes, the
9 answer is yes. But I'm just trying to point out that
10 there are other ways to get service.

11 Q Yes, sir. Let me be clear then. My
12 question again is, if it's the LEC, can intraLATA long
13 distance service be provided without the use of the
14 local loop?

15 A Within the context of this hypothetical,
16 no.

17 Q No, it can't?

18 A No.

19 Q Okay. Thank you. How about interLATA long
20 distance service? Can it be provided without use of
21 the loop?

22 A Well, I will make it easy for you. The
23 answer is no in all of these cases, but it doesn't
24 prove the point about cost causation.

25 Q Well, it's true, is it not, that those

1 additional services, and perhaps others, that are
2 listed in the middle column there, BellSouth charges
3 revenues to its customers for those services; right?

4 A That's certainly true.

5 Q Okay. And is it your testimony that you
6 believe that -- in fact, those revenues at times are
7 quite substantial; correct?

8 A They may or may not be. I don't know. It
9 depends on usage, and it depends on the rates that are
10 charged.

11 Q Are you familiar with what BellSouth's
12 current vertical service rates are?

13 A Current what services?

14 Q Vertical service rates, for example, what
15 they charge monthly for voice mail?

16 A I couldn't give you an exact figure, no.

17 Q Do you have a ballpark figure?

18 A I don't know. Four, five, eight dollars.
19 I don't know what it is.

20 Q Four, five, or eight dollars?

21 A I have no idea.

22 Q How about for caller ID?

23 A I couldn't tell you.

24 Q Not even a ballpark?

25 A No. It changes so much over time that I

1 couldn't tell you.

2 Q They've usually gone up, haven't they?

3 A I couldn't tell you that either.

4 Q Okay. In any event, they don't provide
5 those services for free?

6 A Does anybody? I don't believe so, no.

7 Q Yes, right. And consequently, a portion of
8 their total annual revenues are derived from those
9 vertical services; correct?

10 A True.

11 Q Okay. And I understand you to say -- or do
12 I understand you to say that you don't think it is
13 fair or necessarily appropriate to attribute any costs
14 of the loop to those services?

15 A Mr. Twomey, speaking as an economist, I
16 concentrate on the term "efficient" rather than fair.
17 But I would tell you that the cost arises in a
18 particular manner, and that is what cost causation
19 decides. What happens subsequently in terms of how
20 something is used, which is what you have in this
21 hypothetical, has no relevance to how the cost is
22 caused. That distinction is very important to make.

23 And so while I agree with you that these
24 services are delivered over the very same local loop
25 that the customer gains network access, it doesn't

1 mean that the cost is caused by these things. The
2 cost is caused by the customer gaining network access,
3 period, whether or not they use the loop for anything
4 else.

5 Q Let me ask you this. The ability of this
6 Commission to apportion costs to any service that
7 utilizes any portion of the local loop or utilizes the
8 local loop is not necessarily constrained, is it, by a
9 theory of cost causation?

10 A If what you're saying is shall the cost of
11 the loop be allocated, then the answer is that no such
12 allocation is permissible under the theory of cost
13 causation.

14 Q Yes, sir. But my -- I'll ask the question
15 again. Is this Commission, to your knowledge,
16 constrained from allocating the cost of the loop to
17 all the services that utilize it absent a theory of
18 cost causation?

19 A Absent?

20 Q Absent a theory of cost causation.

21 A In other words, outside of the scope of
22 economics?

23 Q wherever cost causation comes from, yes,
24 sir, absent that.

25 A Well, I can only speak as an economist,

1 which is why I'm saying that if you utilize the theory
2 of cost causation, the Commission shall be so
3 constrained. But if you take away that premise, then
4 the Commission is free to do exactly what it wishes.

5 Q Right. Thank you. And if that were the
6 case, couldn't this Commission, if it wanted, take and
7 look either on a rate group basis or on a total
8 company basis for BellSouth and say, okay, the total
9 costs of the local loop are X, the total revenues the
10 company receives by all the services utilizing the
11 local loop for their provision is another number, and
12 apportion the dollars against each other and take a
13 percentage for each? Couldn't they do that if they
14 wanted to?

15 A Certainly the Commission --

16 MS. WHITE: I'm going to object on the
17 basis that he's asking the witness to speculate on
18 what the Commission may or may not do.

19 CHAIRMAN JABER: Mr. Twomey, the objection
20 is speculation, the question calls --

21 MR. TWOMEY: I don't know that that's
22 speculation. I'm asking him --

23 CHAIRMAN JABER: Ask the question again.
24 Let me hear it.

25 MR. TWOMEY: Yes, sir.

1 BY MR. TWOMEY:

2 Q If the Commission wanted to, if the
3 Commission wanted to apportion a portion of the costs
4 of the local loop to each service that had to use it
5 to be provided, couldn't they take a ratio of the
6 revenue achieved from each one of those services?

7 CHAIRMAN JABER: I'll allow the question.
8 Go ahead.

9 BY MR. TWOMEY:

10 Q To the total of revenues and apportion them
11 a -- the same portion on costs. Isn't that
12 mathematically possible?

13 A It is mathematically possible. It would be
14 extremely unwise. It would be arbitrary, capricious,
15 and economically meaningless.

16 Q But it would also eliminate the rest of
17 these services aside from basic local service getting
18 a free ride on the loop, wouldn't it?

19 A There is no question of a free ride on the
20 loop, Mr. Twomey. I disagree with you on that
21 premise.

22 Q Okay. Now, Mr. Beck handed out an order
23 of the Commission, which I might suggest even though
24 it's old, I'm not -- let me ask you this way. Are you
25 aware of any subsequent written order of the Florida

1 Public Service Commission that has reversed or
2 modified the order that Mr. Beck gave you?

3 A Yes. I am generally aware of something
4 that came out of the fair and reasonable -- I think
5 that's how the docket is referred to, in 1999.

6 Q And what is that?

7 A What is the docket?

8 Q Well, not the docket. What is --

9 A Oh, what did the Commission --

10 Q What is the document that you have
11 reference to?

12 A I understand that the Commission has agreed
13 with the general cost causation principle that the
14 loop's costs should not be allocated.

15 Q Are you aware of whether or not the
16 document that that conclusion is contained in is an
17 order of the Commission, or is it merely a report?

18 A I would have to look at the Commission's
19 order to ascertain that.

20 MR. TWOMEY: Okay. That's all I have,
21 Madam Chair. Thank you.

22 CHAIRMAN JABER: Staff?

23 CROSS EXAMINATION

24 BY MS. BANKS:

25 Q Good morning, Dr. Banerjee.

1 A Good morning.

2 Q I'm assuming that you still have your
3 rebuttal testimony nearby.

4 A The deposition?

5 Q Your rebuttal testimony.

6 A Oh, yes. I'm sorry. Yes, I do.

7 Q Okay. Going again on page 12 of your
8 rebuttal --

9 A Yes, ma'am.

10 Q Are you there?

11 A Yes, I am.

12 Q Okay. You address Dr. Gabel's argument
13 that some unregulated competitive firms may employ a
14 profit maximizing approach in which some products may
15 be sold below cost to stimulate overall demand.

16 Are the examples cited by Mr. Gable based
17 on a lock-in strategy?

18 A You mean the razor and razor blade example?

19 Q Yes, that's correct.

20 A How do you define a lock-in strategy?
21 would you explain that, please, because it means
22 different things to different people.

23 CHAIRMAN JABER: What's your question
24 again, Ms. Banks?

25 BY MS. BANKS:

1 Q My former question was: Are the examples
2 cited by Dr. Gable based on a lock-in strategy that
3 you referenced in your testimony?

4 A Well, I don't wish to put words into your
5 mouth, but if lock-in strategy means that if you buy
6 one, you have to buy the other --

7 Q Yes, that's correct.

8 A Okay. As far as that example goes, I agree
9 with him.

10 Q So a customer's decision to subscribe to
11 basic service does not lock in or commit the customer
12 to subscribing to other telecommunications services;
13 correct?

14 A That's correct.

15 Q Then is it accurate to conclude the profit
16 maximizing approach described by Dr. Gable, in which
17 he believes basic service may be sold at a low price
18 in order to stimulate overall demand, would be very
19 unlikely in an unregulated competitive
20 telecommunications market?

21 A I would say that that is not something that
22 should be imposed on the local exchange carrier. If
23 it wishes to do that, that's its prerogative, but it's
24 not good regulatory policy to impose it on them,
25 because the circumstances different from the razor and

1 razor blade example.

2 Q would it be likely if it's in a regulated
3 market?

4 A I'm sorry. Would you repeat the question,
5 please?

6 Q If the basic service is sold at a low price
7 in order to stimulate overall demand, would it be
8 likely in a regulated competitive telecommunications
9 market, the profit maximizing approach that he
10 discussed in that context?

11 If it will help, I'll repeat the question.

12 A I'm trying to understand the question, if
13 you wouldn't mind repeating it again.

14 Q Okay. Is it accurate to conclude that the
15 profit maximizing approach described by Dr. Gable, in
16 which he believes basic service may be sold at a low
17 price in order to stimulate overall demand, would it
18 be very unlikely in a regulated --

19 A Unlikely in a regulated market?

20 Q Yes.

21 A In other words, would be it be unlikely for
22 regulators to impose such a policy? I guess what I'm
23 trying to understand is whether you're asking me
24 whether in a regulated market things happen
25 differently because regulators make certain choices as

1 opposed to in a competitive market.

2 Q I want to, I guess, just go to a different
3 question. I want to kind of look now at page 14 of
4 your rebuttal testimony, where you make reference to
5 complementary products.

6 A Yes.

7 Q Can you just indicate to me what you
8 consider to be complementary products?

9 A In economics, two products are said to be
10 complementary if they have what's called negative
11 cross-price elasticity. All that means is that if the
12 price of one, say, drops, then the demand for that
13 would go up, which is what the law of demand predicts,
14 but the demand for the other goes up as well, so they
15 tend to move together. So if the price of one rises,
16 then the demand for both will fall. If the price of
17 one falls, then the demand for both will rise. Those
18 are complementary products in economics.

19 Q So wouldn't the economics of, I think as
20 you just described, pricing complementary products
21 apply in a regulated competitive market?

22 A A regulated competitive market?

23 Q I'm sorry. An unregulated competitive
24 market.

25 A If those are truly complementary products,

1 yes, that would apply.

2 Q Okay. On page 14 through 15 of your
3 direct testimony, you make reference to a paper by
4 Albert Kahn.

5 A Yes, ma'am.

6 Q Would it be correct to conclude that the
7 complement which is demand-elastic might be
8 underpriced compared to incremental costs, and the
9 complement which is demand-inelastic be overpriced
10 compared to incremental costs?

11 A Just give me a minute to look through this
12 passage that you referenced.

13 Q Take a moment if you need it.

14 A In general, what this passage is leading up
15 to is that in general, when you have two complementary
16 products, and let's say one of them has a relatively
17 higher price-elasticity than the other, then it is
18 possible to maximize the overall profits from the two,
19 if you were to do the following. Let's say you've got
20 two products, A and B. Or let's make it more
21 concrete. Let's say you've got a credit card, and
22 you've got use of the credit card. Those are the two
23 products. One could say that if you're willing to pay
24 the annual fee for the credit card, then more than
25 likely you're likely to have some usage of the credit

1 card. But it's that annual fee that might stop you
2 cold if it's too high. In other words, that's where
3 your price-elasticity is likely to be higher. You're
4 very sensitive to what the annual fee is.

5 Now, there, if you were to lower the annual
6 fee or to eliminate it altogether, you might get the
7 customer to buy in, might take the credit card. And
8 there you can mark up the usage part, let's say have
9 an 18% interest rate or 28% interest rate. So you
10 have utilized the differing price-elasticities of
11 those two complementary products. In one case, you've
12 made entry possible or easier by lowering the more
13 price-elastic service's price or product's price, and
14 you have recouped some of the money that you lost on
15 that by raising the price on the less price-elastic
16 component.

17 Q So would you say that basic service is
18 generally considered to be inelastic?

19 A In the case of basic service, ironically,
20 it works in the opposite direction. The entry part is
21 less price-elastic. The usage part is more
22 price-elastic. So it's the opposite of the credit
23 card example I gave you.

24 Q Then according to the economics of pricing
25 complementary products, is it correct to conclude that

1 there would be no reason for basic service to be
2 underpriced compared to incremental costs?

3 A Basic service is underpriced relative to
4 incremental costs as it currently exists, and that's
5 why -- because the theory of complementary products
6 that we just talked about does not apply fully to the
7 basic service issue, I would recommend that the
8 practice of underpricing access to basic service be
9 discontinued.

10 Q If you can give me one moment,
11 Dr. Banerjee.

12 A Certainly.

13 Q Would you agree, Dr. Banerjee, that the
14 economics of pricing complementary products yields a
15 different pricing result than that obtained through
16 residual pricing of basic service?

17 A Yes, it could. In some circumstances, you
18 could end up with similar prices, but they don't
19 necessarily have to.

20 Q I'm going to go to page 27 of your rebuttal
21 testimony.

22 A Yes.

23 Q Could you please read aloud for me lines 2
24 through 15?

25 A Starting with the question?

1 Q Yes, sir.

2 A "Mr. Ostrander contends, at 4, that the
3 proposals let the LECs get the best of all worlds
4 because the LECs trade off at-risk access revenues for
5 increases in inelastic revenues of residential basic
6 local service customers. Please respond to this
7 contention."

8 Answer: "Mr. Ostrander's contention
9 unwittingly actually supports the proposal. The
10 recognition that carrier access revenues are at risk
11 is implicit acknowledgment that carrier access service
12 is relatively more price-elastic than RBLTS," which is
13 residential basic local telephone service, "and that
14 fact alone supports the need to rebalance rates. From
15 an economic standpoint, the economic efficiency and
16 consumer surplus gained from lowering the price of a
17 more price-elastic service outweighs the economic
18 efficiency and consumer surplus lost from raising the
19 price of a less price-elastic service in a
20 corresponding manner. As a result, economic
21 efficiency and consumer welfare rises upon such rate
22 rebalancing."

23 Q would you agree that there would be gains
24 in economic efficiency and consumer welfare from
25 lowering the price of a more price-elastic service

1 such as switched access?

2 A Correct.

3 Q And would you agree that there would be
4 losses in economic efficiency and consumer welfare
5 increasing the price of a less price-elastic service
6 such as basic service?

7 A Yes.

8 Q And is it your testimony that based on the
9 differences in price-elasticities, rates should be
10 rebalanced, since the gains in economic efficiency and
11 consumer welfare will be greater than the losses in
12 economic efficiency and consumer welfare?

13 A That's correct.

14 Q What is the basis of your position that
15 switched access is more price-elastic compared to
16 basic service?

17 A Well, these premises are based on almost
18 two decades of empirical studies that have looked at
19 price-elasticities of various telephone services,
20 including basic, toll, switched access, et cetera.
21 There is widespread evidence -- and that evidence
22 changes over time, but nevertheless, there seems to be
23 repetitive confirmation of it -- that the least
24 price-elastic service is residential basic access. In
25 some studies that I've seen, it goes almost close to

1 zero.

2 And that just shows people's dependency on
3 having access to the network. They just want to keep
4 that. Even the option of keeping that kind of service
5 is very high, even if they don't make use of any
6 subsequent services.

7 But when it comes to more discretionary
8 services, like toll or anything else that requires
9 access, carrier access, switched access, there the
10 price-elasticities are typically higher.

11 There have been several studies of toll
12 price-elasticities, and I've seen numbers anywhere
13 from minus .2 to minus .7, depending on whether it's
14 intrastate or interstate. And some portion of that
15 would be the price-elasticity of switched access,
16 which is a component of toll service. So the
17 component services's price-elasticity is derived from
18 the final service's price-elasticity, and it's usually
19 dependent on what share of the cost of the final
20 service is accounted for by that component service.
21 So you can back out an implicit price-elasticity for
22 switched access from that, and whatever number you get
23 would be relatively higher than the price-elasticity
24 for residential basic service.

25 Q I want to change gears a little bit,

1 Dr. Banerjee, and wanted to give some consideration to
2 what evidence this Commission should look at in making
3 its decision on these petitions.

4 You believe that BellSouth's filing, should
5 it be approved, creates the appropriate conditions for
6 market entry; correct?

7 A Yes, I believe so.

8 Q And your position is based more on theory
9 than empirical evidence; correct?

10 A That is true as far as it goes, but I will
11 tell you that that theory has several decades of
12 empirical experience behind it.

13 Q Okay. Do you believe that there must be
14 empirical evidence in order to satisfy the criterion
15 that rebalancing will induce enhanced market entry?

16 A In the ultimate analysis, the answer is
17 yes. Of course, it's hard to predict exactly what the
18 outcomes will be long before anything is done. But we
19 have empirical evidence in other contexts which tell
20 us that rebalancing generally results in the kind of
21 effects that are being predicted here.

22 Q And in your mind, could the Commission rely
23 solely upon economic theory without any empirical
24 evidence to determine whether granting the ILECs'
25 petition will induce enhanced market entry?

1 A Yes. I'm quite confident in relying on
2 economic theory, because as I said a minute earlier,
3 it's informed by decades of actual observation and
4 empirical experience.

5 Q And you believe that the economic theory
6 provides adequate assurance that granting the petition
7 will induce market entry?

8 A Yes, I do.

9 Q So wouldn't it be fair to say that we will
10 not know for sure the criterion of inducing enhanced
11 market entry is met until some time has lapsed after
12 the petitions are approved?

13 A I'm sorry to trouble you, but could you
14 repeat the question?

15 Q Would it be fair to say that there are
16 certain things that are identified in economic
17 theories that we have not made observations for,
18 meaning that there are tests and experiments done, in
19 contrast to information that has actually been proved
20 versus theory?

21 A That's probably true, because there are
22 always unique circumstances. This is going to create
23 changes in the marketplace that are not 100%
24 predictable at this point. But generally, the weight
25 of evidence from past experience would suggest that we

1 are able to predict at least most of what the effects
2 are likely to be.

3 MS. BANKS: Thank you, Dr. Banerjee.
4 That's all the staff has.

5 CHAIRMAN JABER: Commissioners.
6 Commissioner Davidson.

7 COMMISSIONER DAVIDSON: Thank you,
8 Chairman.

9 Dr. Banerjee, I would like you to turn to
10 Mr. Twomey's exhibit with the local loop diagram
11 between the central office and the residential
12 customer.

13 THE WITNESS: Yes, sir.

14 COMMISSIONER DAVIDSON: Is it accurate to
15 state that the local loop must exist to provide basic
16 local telephone service, but that one cannot have the
17 additional services identified below without the local
18 loop?

19 THE WITNESS: That is accurate so far as
20 this example goes, yes.

21 COMMISSIONER DAVIDSON: Thank you. If an
22 existing asset is used to generate new revenue, is
23 there any economic principle or accounting principle,
24 if you know, that would permit or instruct some
25 allocation of the cost of the asset across the various

1 services that depend on the asset to generate revenue?

2 THE WITNESS: As a cost recovery issue,
3 there is some discretion, but I would suggest that the
4 most efficient way to recover cost is to recover it
5 from its source, which is, in this case, the loop
6 which is purchased by the customer in order to gain
7 access to the network. Any other additional revenues
8 that the company gains from that particular customer
9 from selling services over the same loop ought to be
10 recovered separately from the price of the loop.

11 COMMISSIONER DAVIDSON: I understand that.
12 Thank you, Doctor. So the discretion would rest --
13 the industrial organization or the company, the firm,
14 would have the discretion to allocate.

15 My question was, is there any economic
16 principle or accounting principle, if you know, that
17 instructs that's what should be done.

18 THE WITNESS: No, I'm not.

19 COMMISSIONER DAVIDSON: One of the exhibits
20 identified earlier in the case, and I don't believe
21 you would have a copy there, is an executive summary
22 of the Telecompetition Innovation and Infrastructure
23 Act of 2003. That summary provides that the PSC must
24 find that granting these types of petitions will do
25 six things. And I'm going to take these out of order,

1 but the PSC must find that granting the petition will
2 be revenue neutral, occur over a period of two to four
3 years, move access charges to parity, induce market
4 entry, make local residential competition more
5 attractive, and benefit residential consumers. Those
6 are the six factors. I would like to focus on the
7 last three, induce market entry, make local
8 residential competition more attractive, and benefit
9 residential consumers.

10 what would we need to find benefit to
11 residential consumers over and above inducing market
12 entry and making local competition more attractive?
13 The benefit to residential consumers is a stand-alone
14 factor. It's not encompassed in this listing with
15 inducing market entry or making competition more
16 attractive. what type of benefit would you have in
17 mind from an economic perspective?

18 THE WITNESS: I have two kinds of benefits
19 in mind. The direct benefits are obviously those
20 which most people seem to be concerned with, namely,
21 what happens to prices and so forth.

22 The indirect benefits, or the more
23 intangible benefits, let's put it that way, in
24 economics, we talk about consumer utility or consumer
25 welfare, which is the satisfaction that someone

1 derives from being able to consume a service on terms
2 that are more favorable to the customer than would be
3 the case if the price were too high or if the quality
4 of the service were not good enough.

5 So what we concentrate on from an economic
6 standpoint is what are the benefits that maximize
7 consumer utility. And there are several ways that
8 consumer utility could rise. The least understood
9 way, perhaps, although it's significant nonetheless,
10 is additional choice.

11 Choice can benefit customers in a number of
12 ways, choice of services, choice of service providers,
13 choice of pricing plans, the freedom to switch if you
14 are not satisfied with the status quo. These are the
15 kinds of flexibilities that would come in with
16 enhanced market entry and more attractive competition.
17 In that sense, the three things are connected. But
18 they're not directly measurable, because it's hard to
19 observe how individual customers react on these
20 different factors.

21 But it's reasonable to predict that more
22 choice leads to more flexibility and more ability to
23 switch, and the best empirical standard by which we
24 can judge that is by seeing what's happening in the
25 wireless industry. We have a proliferation of pricing

1 plans. Customers are being told essentially that you
2 are able to participate in the process of what's
3 going on in the market. Here are six different
4 plans. You tell us which one you like best. Show us
5 by your actions what is the most preferred course of
6 action. Those are the kinds of choices that we hope
7 would be made possible by 364.164.

8 COMMISSIONER DAVIDSON: Is it fair to state
9 that competition law from an economics perspective is
10 focused on protecting the dynamics of competition
11 rather than on protecting particular competitors or
12 groups of competitors?

13 THE WITNESS: Oh, I certainly hope that's
14 the case.

15 COMMISSIONER DAVIDSON: Is it also accurate
16 that competition policy is focused on maximizing
17 consumer welfare?

18 THE WITNESS: Yes, it is. But that's --
19 if I may qualify the answer just a bit, generally the
20 idea is to maximize overall social welfare, of which
21 consumer welfare is a very important part.

22 COMMISSIONER DAVIDSON: Fair enough. Thank
23 you.

24 Please turn to page 3 of your direct
25 testimony. And I understand that you've adopted the

1 direct testimony of Dr. Taylor. At lines 11 and 12,
2 the statement is made that CLECs have gravitated
3 naturally toward higher margin medium and large
4 businesses or customers using four or more lines. Do
5 you agree with that statement?

6 THE WITNESS: I do, sir.

7 COMMISSIONER DAVIDSON: Is it fair to state
8 that at least in the short to medium run, one desired
9 outcome of this rate rebalancing is a higher margin
10 residential market so that CLECs will gravitate there
11 as well?

12 THE WITNESS: That is indeed fair to say.

13 COMMISSIONER DAVIDSON: Please on page 3
14 move down to lines 25 and 26. The last statement is
15 that this would greatly benefit consumers and local
16 exchange competition alike.

17 My question is, if medium and large -- if
18 the medium and large business market is a higher
19 margin market, and if one outcome of these rate
20 rebalancing petitions is a higher margin residential
21 market, what do you see as the benefits to consumers
22 of that higher margin residential market?

23 THE WITNESS: Well, as I said a minute
24 earlier, it is those intangible benefits that are
25 currently being denied, because these low revenue

1 customers are not part of that big tent. They are not
2 receiving the attention of competitors who can do a
3 lot of good for them. So the idea here is to expand
4 the pie. Right now the pie has excluded the low end
5 residential customers.

6 COMMISSIONER DAVIDSON: In your opinion,
7 could alternatives such as voice-over-Internet
8 protocol and wireless act as a check on any supra
9 competitive pricing by providers?

10 THE WITNESS: Yes, very much so.

11 COMMISSIONER DAVIDSON: If in any market,
12 as a matter of general theory, the margin between an
13 entrant's revenue and its costs -- strike that. If in
14 any market the margin between a potential entrant's
15 revenue and its costs is not sufficiently wide to
16 encourage market entry, what would you predict as the
17 long-run consequences of that characteristic?

18 THE WITNESS: well, there would be very
19 little market entry as a result of that. Efficient
20 competition has one foremost property, and that is to
21 force existing competitors, whether incumbents or new
22 entrants, to reduce their costs over time, to generate
23 more services and make investments in greater service
24 quality and so forth. Those are the kinds of things
25 that will not happen if greater market entry is not

1 made possible because of unattractive margins.

2 COMMISSIONER DAVIDSON: Concern has been
3 expressed that if the margin between a potential
4 entrant's revenue and its costs are raised such that a
5 potential entrant finds it profitable to enter the
6 market, consumer welfare is not enhanced because
7 consumers pay higher prices, and no consumer ever
8 wants to pay higher prices, and that's an
9 understandable desire.

10 Do you agree that some residential
11 customers, namely, those who do not have sufficient
12 in-state long distance calls to benefit from access
13 rate reductions, will pay higher prices, at least in
14 the short run?

15 THE WITNESS: Yes, I do.

16 COMMISSIONER DAVIDSON: In a competitive
17 market, would you expect higher prices to be a
18 long-term economic outcome?

19 THE WITNESS: Higher relative to today's
20 prices?

21 COMMISSIONER DAVIDSON: Yes.

22 THE WITNESS: They should be. Today's
23 prices are below cost in many instances.

24 COMMISSIONER DAVIDSON: In other markets,
25 less regulated markets such as wireless and long

1 distance, has the trend been sustainable higher
2 prices, lower prices, or steady prices?

3 THE WITNESS: In the wireless market, as
4 best as I understand it, prices started out quite high
5 on a per minute basis relative to what consumers paid
6 on the wireline side, and have over the past five
7 years or so, thanks to competition and improvements in
8 technology, coverage, et cetera, come down
9 substantially. They may not be all the way down,
10 let's say, to comparable levels of wireline service,
11 but they have certain appealing other factors which
12 makes them a reasonable alternative to wireline
13 service, such as lifestyle, convenience, mobility, and
14 various other things that go for them.

15 COMMISSIONER DAVIDSON: Related to some
16 things that have been discussed previously, there have
17 been concerns expressed by many folks that the burden
18 of any granting of these petitions will be
19 disproportionately borne by residential customers,
20 while the benefit of access charge reductions will be
21 primarily or disproportionately business customers.

22 Assume for the moment that is true. Also
23 assume that this Commission understands the need to
24 send accurate and correct pricing signals in all the
25 markets it regulates. If the Commission sought some

1 type of greater parity of the benefit and the burden
2 amongst similarly situated customers, even though you
3 may have cringe at that notion, but assuming the
4 Commission sought that, can you suggest anything that
5 the Commission could do to get to that concept in the
6 least intrusive way possible?

7 THE WITNESS: Certainly. Economics is not
8 entirely sterile on that point. It does invoke this
9 notion of the tradeoff between efficiency and
10 distributive justice or equity, and I think that's
11 what your --

12 COMMISSIONER DAVIDSON: Yes.

13 THE WITNESS: -- question is getting at.

14 Efficiency is obviously the hallmark of
15 this proposal. You're trying to get as efficient
16 competition as possible. But in the process, as you
17 correctly surmise, Commissioner, there are going to be
18 people who will experience a price increase. There's
19 no question about that, especially if they don't make
20 long distance calls to offset some of the price
21 increase.

22 But in those instances where the burden is
23 truly going to be harmful to them, I would recommend
24 that they be given assistance on a direct basis.
25 Instead of using the pricing system, distorted prices,

1 to assist a segment of consumers, it is always
2 economically better from an efficiency standpoint to
3 provide assistance on a direct basis, identify who
4 they are, what their needs are, and use general
5 targeted subsidies out of general funds to support
6 them so that they're not disadvantaged.

7 Those who are not disadvantaged to begin
8 with are going to be able to sustain this rebalancing.

9 That is from an economic standpoint a much
10 better outcome, because it looks at both efficiency
11 and distributive justice, rather than one which relies
12 solely on distorted prices to accomplish these social
13 goals.

14 COMMISSIONER DAVIDSON: Thank you, Doctor.
15 I have no further questions.

16 CHAIRMAN JABER: Commissioners, do you have
17 any questions?

18 Commissioner Deason.

19 COMMISSIONER DEASON: Thank you.

20 Doctor, I have a few questions, and what I
21 want to explore with you is the concept of efficient
22 pricing and maximization of consumer benefit.

23 THE WITNESS: Sure.

24 COMMISSIONER DEASON: I think you would
25 agree generally with the concept that efficient

1 pricing is correlated, maybe directly related to, or
2 results in the maximization of consumer benefit. Do
3 you agree with that concept generally?

4 THE WITNESS: I do indeed. And if I could
5 just qualify that slightly, I would say, like I said a
6 little bit earlier, it's social welfare maximization
7 rather than just consumer welfare maximization.

8 COMMISSIONER DEASON: Okay. So it's the
9 overall perspective.

10 THE WITNESS: That's right. It takes into
11 account both producer surplus, which is profits, as
12 well as consumer service.

13 COMMISSIONER DEASON: Okay. I've got a few
14 simplistic hypothetical examples, and they probably go
15 more to the concept of an individual customer than the
16 overall maximization of the social good, but if you'll
17 just bear with me with those limitations there.

18 THE WITNESS: Sure.

19 COMMISSIONER DEASON: I want you to assume
20 for purposes of these questions that there's a
21 telephone company that provides two services. One is
22 basic local, and the other is caller ID. That's it.
23 That's the customer's choice.

24 THE WITNESS: Okay.

25 COMMISSIONER DEASON: And I apologize for

1 this, but if you have a pencil and a piece of paper,
2 it may be helpful for you to write this down.

3 If you could assume that the price for
4 basic local service is \$10 a month.

5 THE WITNESS: Okay.

6 COMMISSIONER DEASON: And that the price
7 for caller ID is \$5 a month.

8 THE WITNESS: Okay.

9 COMMISSIONER DEASON: Also assume with me
10 that the cost of providing basic local service is \$20
11 a month, and that --

12 THE WITNESS: Cost.

13 COMMISSIONER DEASON: The cost. And that
14 the cost to provide caller ID is \$1 a month.

15 THE WITNESS: All right.

16 COMMISSIONER DEASON: Okay. And we have a
17 hypothetical customer out there, and he or she, they
18 place a value on basic local service of \$20 a month.
19 That's what it's worth to them. So if it goes over
20 \$20, they would not subscribe. If anything is -- if
21 it's \$20 or under, they're willing to subscribe to the
22 service.

23 THE WITNESS: I see.

24 COMMISSIONER DEASON: And also assume with
25 me that this customer values caller ID at \$4 a month.

1 They would be willing to pay 4, but not any more than
2 4.

3 THE WITNESS: All right.

4 COMMISSIONER DEASON: So under this
5 scenario, this hypothetical, this customer would only
6 subscribe to the basic local services and would forgo
7 the caller ID.

8 THE WITNESS: That's possible.

9 COMMISSIONER DEASON: Because the value is
10 \$4 to this customer, and the price is 5, even though
11 it only costs a dollar to provide.

12 THE WITNESS: I agree.

13 COMMISSIONER DEASON: Would that be
14 inefficient pricing?

15 THE WITNESS: That would be, which is why
16 bundles exist. Bundling is a strategy which is used
17 to overcome precisely this problem.

18 COMMISSIONER DEASON: Okay. I want to take
19 this one more step. Let's assume that there is a
20 restructuring of the prices for these services and
21 that the price for basic local service is increased
22 from \$10 a month to \$11 a month. And by doing this,
23 the entity, the provider of the service is able to
24 reduce the price for caller ID from \$5 a month down to
25 \$2 per month.

1 THE WITNESS: Okay.

2 COMMISSIONER DEASON: Now, the cost would
3 stay the same, because the only thing we're changing
4 is the pricing. The cost again is \$20 for basic local
5 and \$1 for caller ID, and the value that the customer
6 places on these services is the same.

7 This hypothetical customer would now
8 subscribe to caller ID because he places a value of
9 \$4, but the price is down to 2.

10 THE WITNESS: That's correct.

11 COMMISSIONER DEASON: Okay. So now the
12 bill increases to a total of \$13 a month, but he's
13 getting \$24 worth of utility, in his viewpoint,
14 because he is willing to pay up to 20 for local and up
15 to \$4.

16 THE WITNESS: Right.

17 COMMISSIONER DEASON: So this maximizes his
18 utility under this scenario, would you --

19 THE WITNESS: That consumer service you
20 were talking about.

21 COMMISSIONER DEASON: And so this is more
22 -- while it's not 100% efficient pricing, it's a
23 better pricing methodology, and this customer gets
24 greater benefit out of that.

25 THE WITNESS: That's true.

1 COMMISSIONER DEASON: Okay. So that would
2 be a step in the right direction.

3 THE WITNESS: That's true.

4 COMMISSIONER DEASON: And I understand
5 that, and what I want to do now is to change the
6 hypothetical to an entity that provides -- here again,
7 provides two services. But we're going to forget
8 about caller ID. It's just going to be basic local
9 and long distance. Those are the two services that
10 this company provides. And I want you to assume that
11 the price for basic local service is \$10 a month, and
12 that there is a \$2 per month access to have the
13 privilege of making a long distance call, and this is
14 a recurring monthly charge, and that the per minute
15 price for using the long distance is 10 cents per
16 minute. This is the current pricing structure. Okay?

17 THE WITNESS: Okay.

18 COMMISSIONER DEASON: I want you to assume
19 that -- here again that the cost of providing basic
20 local service is \$20 a month. The cost of providing
21 access for a customer to have the privilege of making
22 a long distance call is \$2.

23 MR. BECK: So it's the same as price.

24 COMMISSIONER DEASON: Yes, same as the
25 price. This is just for simplistic purposes. I don't

1 know what the relationship is in reality.

2 And here again, assume that the cost --
3 that the per minute cost of providing long distance
4 service is 5 cents.

5 THE WITNESS: Okay.

6 COMMISSIONER DEASON: I apologize for all
7 the assumptions in this, but I think it will help
8 clear it up in my mind.

9 The value that the customer places -- here
10 again, the value the customer places on basic local is
11 still the \$20 a month.

12 THE WITNESS: Okay.

13 COMMISSIONER DEASON: They are willing to
14 pay \$2 a month to have the privilege of making a call.
15 But when it actually comes to making a call, they're
16 not going to utilize that service unless they are
17 paying on average about 7 cents a minute.

18 THE WITNESS: Okay.

19 COMMISSIONER DEASON: So under this pricing
20 arrangement, this customer would subscribe to basic
21 local service, they would subscribe to the ability to
22 make a long distance call, but they would probably
23 make very few calls because the price is 10 cents, and
24 their marginal utility is 7 cents a minute, even
25 though the cost is 5 cents.

1 THE WITNESS: That's right.

2 COMMISSIONER DEASON: Would this generally
3 be an inefficient -- or it has some inefficient
4 pricing --

5 THE WITNESS: For that particular customer,
6 it would not produce as much consumer surplus as the
7 alternative that you were talking about.

8 COMMISSIONER DEASON: Okay.

9 THE WITNESS: Of course, we make decisions
10 about inefficiency not on an individual customer
11 basis, but in this example, you're right.

12 COMMISSIONER DEASON: Okay. All right.
13 Now I want to take it a further step and say we're
14 going to change the pricing structure for this company
15 that just provides basic local and long distance.
16 This company increases the basic local rate from \$10
17 to \$15 a month.

18 THE WITNESS: Okay.

19 COMMISSIONER DEASON: And by doing this,
20 they put long distance access at zero.

21 THE WITNESS: Okay.

22 COMMISSIONER DEASON: But since they
23 reduced the long distance access to zero, they are not
24 able to reduce the per minute cost of 10 cents per
25 minute, so it's still 10 cents per minute to the

1 customer.

2 THE WITNESS: Okay.

3 COMMISSIONER DEASON: Okay. The costs
4 don't -- the only thing we're doing is changing
5 prices. We aren't changing costs in this hypothetical
6 assumption here. The marginal benefit or the utility
7 the customer gets is still the same. They value basic
8 local at 20, and they value the fact that they can
9 have access to make a long distance call at \$2. But
10 still, when they make that decision to make that call,
11 they don't want to pay more than 7 cents per minute.
12 So under this hypothetical, this customer doesn't
13 receive any increased marginal benefit, have they?

14 THE WITNESS: Well --

15 COMMISSIONER DEASON: Or have they? Can
16 you explain?

17 THE WITNESS: It could happen. If you look
18 at the total cost of the long distance experience,
19 under your assumptions, in the initial case, it's a \$2
20 sign-up or monthly recurring charge and 7 cents per
21 minute called.

22 COMMISSIONER DEASON: No, no, no. The
23 price is 10 cents they have to pay.

24 THE WITNESS: Excuse me. My fault. Yes, 2
25 and 10.

1 COMMISSIONER DEASON: Yes.

2 THE WITNESS: And now they don't have to
3 pay the \$2.

4 COMMISSIONER DEASON: That's correct.

5 THE WITNESS: So if you --

6 COMMISSIONER DEASON: But their local rate
7 is increased to 15, from 10 to 15.

8 THE WITNESS: That's true. And it's the
9 tradeoff that will determine -- the more they make
10 long distance calls, the greater the tradeoff will be
11 between the two. So usage will decide -- long
12 distance usage will decide whether the customer is
13 actually better off in the aggregate or worse off.

14 COMMISSIONER DEASON: Okay. And I think
15 that's a very good point. Long distance usage would
16 determine the benefit for this hypothetical customer,
17 and the more he or she were inclined to use the long
18 distance service and get that benefit, the more likely
19 they would receive benefit from this pricing change.

20 THE WITNESS: On the face of it, looking at
21 the numbers, it would seem like you're absolutely
22 right. They pay \$5 more for basic and \$2 less for
23 long distance. And other things being equal --

24 COMMISSIONER DEASON: But the per minute
25 rate is still 10 cents per minute.

1 THE WITNESS: Yes, it's still the same.

2 COMMISSIONER DEASON: And the customer only
3 values it at 7 cents a minute.

4 THE WITNESS: That's correct. If you were
5 to confine yourself to just that example, they would
6 be worse off, because they are paying more in the
7 aggregate.

8 COMMISSIONER DEASON: Okay.

9 THE WITNESS: But if you have a slight
10 modification in that per minute rate, then the usage
11 factor starts to kick in.

12 COMMISSIONER DEASON: Okay. Thank you.

13 THE WITNESS: My pleasure.

14 CHAIRMAN JABER: Dr. Banerjee, let me start
15 by telling you I fully appreciated your testimony,
16 both written and live, today. It was very, very
17 helpful.

18 My questions go directly to your written
19 testimony and perhaps just in theory some of the
20 things you've said this morning. But I want to start
21 with page 3 of your direct.

22 THE WITNESS: Yes, ma'am.

23 CHAIRMAN JABER: On lines 11 through 13,
24 CLECs have gravitated naturally toward higher margin
25 medium and large business customers. And I think

1 there's consensus across the board with all the
2 witnesses, frankly, with all the companies, that's the
3 case, that the pricing signals are closely matched
4 with costs when you start looking at the larger
5 business environment. You would agree with that as a
6 foundation?

7 THE WITNESS: I do.

8 CHAIRMAN JABER: And you recognized
9 earlier, and you just did it again with Commissioner
10 Deason, that to determine affordability, if you're a
11 residential customer, you're going to look at your
12 overall bill.

13 THE WITNESS: That's right.

14 CHAIRMAN JABER: And to determine whether
15 you want to maintain your residential phone service,
16 you're going to look at your overall bill.

17 THE WITNESS: It could come down to that,
18 yes.

19 CHAIRMAN JABER: Now, I think that's pure
20 economics. If it's not economics, it's common sense.

21 THE WITNESS: Yes, it is. Economics,
22 surprisingly, is a lot of common sense.

23 CHAIRMAN JABER: Common sense, yes. I
24 would like to think so.

25 If that's the case and we've all agreed to

1 it, then wouldn't it make more sense that at least in
2 the beginning, at least in the beginning, to trigger
3 further investment in the residential market, taking
4 into consideration with the overall bill, taking into
5 consideration what you just said to Commissioner
6 Deason about long distance usage, the sensitivity
7 associated with that, shouldn't the long distance
8 flow-through reductions be greater on the residential
9 and single-line businesses?

10 THE WITNESS: As far as your example goes,
11 I would agree with that.

12 CHAIRMAN JABER: In that same vein, if you
13 look at page 11 of your testimony, lines 13 and 16, I
14 circled, highlighted, triple highlighted your word
15 "complete," the usage of the word "complete," the
16 complete flow-through of the intrastate access rate
17 reductions into intrastate long distance rates is
18 expected to stimulate intrastate long distance calling
19 and make it more attractive for CLECs to offer bundles
20 of local and long distance rates. I think that's
21 consistent with what you just said.

22 THE WITNESS: Yes. It would maximize the
23 effect.

24 CHAIRMAN JABER: Okay. Taking that a step
25 further, that common-sense theory, economic theory, is

1 only true if those reductions and adjustments and
2 increases happen simultaneously. Would you agree with
3 me?

4 THE WITNESS: I do.

5 CHAIRMAN JABER: Okay. Dr. Banerjee, I
6 really appreciate your testimony.

7 THE WITNESS: My pleasure.

8 CHAIRMAN JABER: And my last question is
9 really more to the parties. Let me tell you what I'm
10 struggling with. And while I can get this information
11 from our staff, I'm hoping that the parties can just
12 compile this cheat sheet I'm about to ask you for and
13 do so in the form of a stipulated cheat sheet.

14 I'm flipping back and forth between
15 witnesses and looking at charts as it relates to what
16 your proposals are. I'm not suggesting that anything
17 be manipulated in this cheat sheet I want, but if you
18 look at BellSouth's witness Ruscilli, and if you look
19 at Verizon's witness -- I think it's Fulp, there's a
20 chart in each of those testimonies that shows what the
21 increase, what the proposed increases are per rate
22 group, and then for residential, and then there's a
23 part of the chart that shows what the increases will
24 be for recurring and nonrecurring.

25 Even if you do it in a side by side, what I

1 would love to have is a legal sheet of paper that
2 shows Verizon, BellSouth, Sprint. And the reason I'm
3 hoping that could be a stipulated exhibit, or at least
4 agree that the handout represents what's in the
5 testimony, when we're at the post-hearing stage, if
6 staff gives us something, I won't be able to ask the
7 parties questions about it. So I would much rather
8 make sure it's an accurate exhibit before we conclude
9 the hearing.

10 I'm not suggesting it's an apples-to-apples
11 comparison. I understand that. I understand the
12 costs are different. I understand the proposals are
13 different. I understand the incremental
14 implementation is different. I just want it all on
15 one page. Is that doable?

16 MS. WHITE: I think that's possible. It
17 may be tomorrow before --

18 CHAIRMAN JABER: That's fine.

19 MS. WHITE: -- it could get done.

20 CHAIRMAN JABER: I would ask that you show
21 it to the parties. I'm not looking for controversy.
22 I'm looking for a cheat sheet.

23 MR. CHAPKIS: Verizon concurs. We'll try
24 to do it as quickly as possible.

25 CHAIRMAN JABER: Public Counsel, do you

1 understand what I'm asking for? Do you think that's
2 something you can work with the parties on?

3 MR. BECK: Yes, I think it's doable too.

4 COMMISSIONER DEASON: Ms. Bradley?

5 MS. BRADLEY: (Nodding head
6 affirmatively.)

7 CHAIRMAN JABER: Mr. Twomey?

8 MR. TWOMEY: Yes, ma'am.

9 CHAIRMAN JABER: Okay. Commissioners, do
10 you have any other questions of this witness?

11 Okay. BellSouth, Exhibit 58.

12 MS. WHITE: Yes, ma'am. BellSouth would
13 move Exhibit 58.

14 CHAIRMAN JABER: Without objection, Exhibit
15 58 is admitted into the record.

16 (Exhibit 58 admitted into the record.)

17 MS. WHITE: And we would ask that
18 Dr. Banerjee be excused.

19 CHAIRMAN JABER: Thank you for your
20 testimony. You may be excused.

21 THE WITNESS: Thank you.

22 CHAIRMAN JABER: Okay. Commissioners, do
23 you need a short break at least? Okay. We'll --

24 MR. MEROS: Madam Chair, this is George
25 Meros. I'm sorry.

1 CHAIRMAN JABER: That's okay.

2 MR. MEROS: You thought it was from on
3 high, huh?

4 I have to ask a procedural question. I
5 know the Chair did not want to consider too much in
6 the way of changed schedules. I do have one request.
7 Mr. Boccucci, Felix Boccucci is here on behalf of
8 Knology. He has to get home tonight if at all
9 possible. His wife underwent major shoulder surgery
10 and cannot drive. He literally has to drive his kids
11 to school tomorrow.

12 So if he could be taken sometime before
13 seven o'clock tonight, I would ask the Commission to
14 permit that. I've spoken to AARP and OPC about that,
15 and they have no objection. I assume the parties do
16 not, but I will certainly ask them on the break. But
17 I would ask the Chair to consider taking him out of
18 order if necessary. And hopefully we will be there,
19 but --

20 CHAIRMAN JABER: If the parties have no
21 objection, I certainly don't mind, Commissioners.
22 When there's a natural breaking point between the
23 company witnesses and we can take your witness up,
24 we'll do that. Maybe it's after lunch.

25 MR. MEROS: Oh, that's fine, and I much

1 appreciate it. Thanks.

2 CHAIRMAN JABER: Okay. Fine. No problem.

3 Commissioners, let's break until 11:00.

4 we'll come back with Verizon witness Fulp.

5 (TRANSCRIPT CONTINUES IN SEQUENCE WITH
6 VOLUME 6.)

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CERTIFICATE OF REPORTER


STATE OF FLORIDA)

COUNTY OF LEON)

I, MARY ALLEN NEEL, do hereby certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter transcribed under my supervision; and that the foregoing pages numbered 419 through 588 are a true and correct transcription of my stenographic notes.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, or relative or employee of such attorney or counsel, or financially interested in the action.

DATED THIS 12th day of December, 2003.


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