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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

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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

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FLOW-THROUGH OF LEC SWITCHED  
ACCESS REDUCTIONS BY IXCs,  
PURSUANT TO SECTION  
364.163(2), FLORIDA STATUTES.

DOCKET NO. 030961-TI

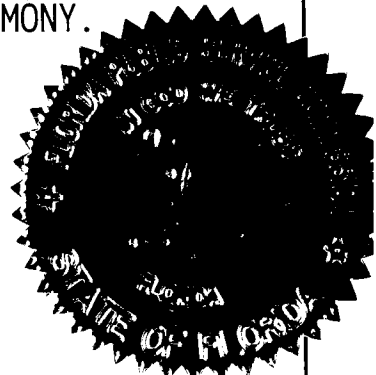
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VOLUME 10

PAGES 1151 THROUGH 1286

PROCEEDINGS: HEARING



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

6 DATE: Friday, December 12, 2003

7 TIME: Commenced at 9:00 a.m.

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

10 REPORTED BY: JANE FAUROT, RPR  
11 Official FPSC Reporter  
12 (850) 413-6732

13 APPEARANCES: (As heretofore noted.)  
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## I N D E X

## WITNESSES

3	NAME:	PAGE NO.
4	JOHN W. MAYO	
5	Direct Examination by Mr. Hatch	1155
6	Prefiled Direct Testimony Inserted	1159
6	Prefiled Rebuttal Testimony Inserted	1178
7	Prefiled Rebuttal Testimony Inserted	1197
7	Cross Examination by Mr. Fordham	1209
8		
9	WAYNE FONTEIX	
9	Direct Examination by Mr. Hatch	1247
10	Prefiled Direct Testimony Inserted	1250
11	Cross Examination by Mr. Twomey	1265
12		
13		
14		
15		
16		
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EXHIBITS

1  
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10  
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12  
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14  
15  
16  
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22  
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24  
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NUMBER:

ID. ADMTD.

71 JWM-1 through JWM-2

1158 1247

72 WF-1 through WF-3

1249

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

(Transcript continues in sequence from Volume 9.)

CHAIRMAN JABER: Good morning, Commissioners. Good morning parties, staff. We are ready to get back on the record. And we left off with John Mayo's testimony, AT&T, MCI. I assume that is Mr. Mayo sitting there?

MR. HATCH: Yes, ma'am.

CHAIRMAN JABER: And was Mr. Mayo sworn?

MR. FORDHAM: Dr. Mayo, have you been sworn?

THE WITNESS: Yes, I have been.

MR. HATCH: AT&T calls Doctor Mayo to the stand.

JOHN W. MAYO

was called as a witness on behalf of AT&T Communications and MCI WorldCom Communications, Inc., and having been duly sworn, testified as follows:

## D I R E C T E X A M I N A T I O N

BY MR. HATCH:

Q Dr. Mayo, could you please state your name and address for the record.

A My name is John W. Mayo. My address is 6653 Hillandale Road, Chevy Chase, Maryland 20815.

Q By whom are you employed and in what capacity?

A Georgetown University. I am a professor of economics, business, and public policy, and I am the Dean of the McDonough School of Business.

1 Q And on whose behalf are you testifying in this  
2 proceeding?

3 A AT&T and MCI.

4 Q Have you prepared and caused to be filed in this  
5 docket direct testimony consisting of 20 pages, I believe filed  
6 October 31st?

7 A Yes, I did.

8 Q Do you have any changes or corrections to that  
9 testimony?

10 A For the testimony on October 31st, no.

11 Q Have you also caused to be prepared and filed in this  
12 series of dockets rebuttal testimony on November 19th  
13 consisting of 18 pages?

14 A Yes.

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

17 A No, I do not.

18 Q And did you also prepare and caused to be filed  
19 additional rebuttal testimony filed on November 26th consisting  
20 of 18 pages?

21 A Yes, I did.

22 Q And do you have any changes or corrections to that  
23 testimony?

24 A Yes, I do. If everyone will turn to Page 3, please,  
25 of my second rebuttal testimony. On the 23rd line, the

1 sentence begins on the 22nd line, it says, "Importantly, these  
2 benefits are available with the need for any overt governmental  
3 regulation of prices." The word "with" should be without. I'm  
4 not suggesting that there should be government regulation, in  
5 that case it is available without government regulation.

6 Q Subject to that one change, if I asked you the same  
7 questions as are in your direct, your rebuttal, and your  
8 additional rebuttal testimonies, would your answers be the  
9 same?

10 A Yes, they would.

11 MR. HATCH: Madam Chairman, I would ask that Dr.  
12 Mayo's direct, rebuttal, and additional rebuttal be inserted  
13 into the record as though read.

14 CHAIRMAN JABER: The prefiled testimony of Dr. John  
15 W. Mayo, direct and rebuttal, shall be inserted into the record  
16 as though read.

17 BY MR. HATCH:

18 Q Now, Dr. Mayo, did you also have three exhibits  
19 attached to your direct testimony?

20 A Yes, I did.

21 Q And those are labeled JWM-1 through 3?

22 A Yes.

23 Q Were those exhibits prepared by you and under your  
24 supervision and control?

25 A Yes.

1           CHAIRMAN JABER: Mr. Hatch, get right into the  
2 microphone, okay?

3           MR. HATCH: Madam Chairman, could I ask that Dr.  
4 Mayo's three exhibits attached to his direct testimony be  
5 marked for identification.

6           CHAIRMAN JABER: JWM-1 through JWM-3 will be marked  
7 as Composite Exhibit 71.

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I. **INTRODUCTION, QUALIFICATIONS AND PURPOSE OF  
TESTIMONY**

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

A. My name is John W. Mayo. My business address is Georgetown University, McDonough School of Business, Old North Building, 37<sup>th</sup> and O Streets, N.W., Washington, D.C. 20057.

**Q. WHAT IS YOUR OCCUPATION?**

A. I am Dean of the McDonough School of Business at Georgetown University and Professor of Economics, Business and Public Policy at Georgetown University in the McDonough School of Business. I am also the Executive Director of the Center for Business and Public Policy in the McDonough School at Georgetown University.

**Q. WOULD YOU PLEASE SUMMARIZE YOUR QUALIFICATIONS?**

A. Yes. I hold a Ph.D. in economics from Washington University, St. Louis (1982), with a principal field of concentration in industrial organization, which includes the analysis of antitrust and regulation. I also hold both an M.A. (Washington University, 1979) and a B.A. (Hendrix College, Conway, Arkansas, 1977) in economics.

1 I have taught economics, business and public policy courses at  
2 Georgetown University, Washington University, Webster University, the  
3 University of Tennessee and at Virginia Tech (VPI). Beginning in the fall of  
4 1999 and continuing until July 2001, I served as Senior Associate Dean of the  
5 McDonough School of Business. Also, I have served as the Chief Economist,  
6 Democratic Staff of the U.S. Senate Small Business Committee. Both my  
7 research and teaching have centered on the relationship of government and  
8 business, with particular emphasis on regulated industries.

9 I have authored numerous articles and research monographs, and have  
10 written a comprehensive text entitled Government and Business: The Economics  
11 of Antitrust and Regulation (with David L. Kaserman, The Dryden Press, 1995).  
12 I have also written a number of specialized articles on economic issues in the  
13 telecommunications industry. These articles include discussions of competition  
14 and pricing in the telecommunications industry and have appeared in academic  
15 journals such as the RAND Journal of Economics, the Journal of Law and  
16 Economics, the Journal of Regulatory Economics, and the Yale Journal on  
17 Regulation. A more detailed accounting of my education, publications and  
18 employment history is contained in Exhibit JWM-1.

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

22  
23 A. I have been asked by AT&T Communications of the Southern States, LLC and  
24 MCI WorldCom Communications, Inc. to provide an economic evaluation of the

1 merits of the petitions of Verizon, BellSouth and Sprint to reduce intrastate  
2 switched access charges and to rebalance local exchange rates in Florida.

3  
4 **II. LEGISLATIVE AND POLICY GUIDEPOSTS**

5  
6 **Q. CAN YOU PLEASE EXPLAIN WHAT VERIZON, SPRINT AND  
7 BELLSOUTH ARE PROPOSING IN THIS CASE?**

8 A. Yes. These principal incumbent local exchange carriers are proposing to  
9 rebalance rates in a revenue-neutral manner under the Florida Tele-Competition  
10 Innovation and Infrastructure Enhancement Act (“2003 Act”). This rebalancing  
11 involves the reductions in intrastate switched access charges along with a  
12 commensurate (revenue-neutral) increase in local exchange rates.

13  
14 **Q. IS THERE LEGISLATIVE GUIDANCE REGARDING THE CRITERIA  
15 TO BE USED WHEN EVALUATING THE MERITS OF THE  
16 PETITIONERS’ PROPOSALS?**

17 A. Yes. The 2003 Act requires that the Commission consider whether the  
18 petitioners’ request for rebalancing will: (a) remove current support for basic  
19 local telecommunications services that prevents the creation of a more attractive,  
20 competitive local market for the benefit of residential customers; (b) induce  
21 enhanced market entry; (c) require intrastate switched network access rate  
22 reductions to parity over a period of not less than 2 years or more than 4 years;  
23 and (d) be revenue neutral.

24

1 **Q. ARE THERE ADDITIONAL INSTRUCTIVE GUIDEPOSTS FOR THE**  
2 **COMMISSION?**

3 **A.** Yes. While federal telecommunications policy had trended toward an  
4 increasingly pro-competitive posture over the past thirty years, the passage of the  
5 federal Telecommunications Act in 1996 (“the 1996 Act”) represented a true  
6 watershed event in terms of the public policy that is to be directed toward the  
7 telecommunications industry. Specifically, the purpose of the 1996 Act was to  
8 bring the benefits of competition to all telecommunications markets by creating a  
9 “pro-competitive, de-regulatory national policy framework.”<sup>1</sup> To do so, the 1996  
10 Act endowed state and federal regulatory authorities with a host of responsibilities  
11 for advancing the goals of the 1996 Act.

12

13 **Q. SPECIFICALLY, HOW HAS THE 1996 ACT CHANGED THE MISSION**  
14 **OF THE PUBLIC UTILITY COMMISSIONS?**

15 **A.** The 1996 Act fundamentally altered the forward-going role of regulatory  
16 commissions. Much of the language of the 1996 Act focuses on the specific  
17 mechanisms to open local telecommunications markets; the obligations for  
18 network interconnection; the requirements for interLATA entry for RBOCs; and  
19 the objective of universal accessibility to the internet. Yet in the effort to  
20 implement the specifics of the 1996 Act, policymakers must not lose sight of the  
21 fundamental way in which it transformed the traditional role and function of  
22 regulation.

---

<sup>1</sup> Senate Rpt.104-023, entitled “Telecommunications Competition.” March 30, 1995

1           In particular, the traditional function of regulatory commissions had been  
2 one of *disabling the potential ill-effects of monopoly power*. The 1996 Act  
3 changed this primary role in telecommunications to one of *enabling competition*.  
4 That is, a new and fundamental role of regulatory commissions in the wake of the  
5 1996 Act is to develop a set of competition-enabling policies that will allow for  
6 the introduction and development of competition. Under this new mandate, as  
7 competition grows and becomes effective, markets can replace regulation as the  
8 primary source of protection of consumers.

9  
10 **Q. HAS THERE BEEN RECENT CLARITY PROVIDED ON THE ISSUE OF**  
11 **THE NATIONAL GOAL OF ENABLING COMPETITION IN**  
12 **TELECOMMUNICATIONS MARKETS?**

13 A. Yes. The United States Supreme Court opinion in 2002 clearly and persuasively  
14 underscores the fact that the Congressional intent of the 1996 Act was to alter  
15 prevailing regulatory structures as necessary to as fully as possible enable  
16 competition.<sup>2</sup> For instance, the Opinion points out that “For the first time,  
17 Congress passed a rate-setting statute with the aim not just to balance the interests  
18 between sellers and buyers, but *to reorganize markets by rendering regulated*  
19 *utilities’ monopolies vulnerable to interlopers...*” (emphasis added, Opinion,  
20 p.16) Thus, rate setting in the Post-1996 Act world must seek to promote the  
21 advent of competition. Exhibit JWM-2 provides a published review of the  
22 Supreme Court Opinion for the Commission’s consideration.

---

<sup>2</sup> VERIZON COMMUNICATIONS INC. V. FCC 535 U.S. 467 (2002).

1

2

**III. BACKGROUND**

3

4 **Q.****WHY HAS IT BEEN NECESSARY TO REGULATE LOCAL  
TELECOMMUNICATIONS PROVIDERS IN FLORIDA?**

5

6 **A.**

Local exchange carriers, including BellSouth, Verizon (formerly GTE) and Sprint historically enjoyed a monopoly in the provision of telecommunications services. Given their monopoly positions within their service territories, both the federal and state governments found it necessary to regulate the rates of the company in order to ensure that the local carrier did not exercise its monopoly power to the detriment of the state's residents and businesses. Indeed, most state-level public utilities laws, including the law established in Florida, give public utility commissions the obligation to ensure that rates are "just and reasonable." In this regard, it is important to note that price regulation is a substitute for rates set by competitive market forces. That is, economists commonly recommend that the rate setting exercise should, insofar as possible, try to establish rates that mimic the rates that would be set by competitive market forces.

18

19 **Q.****WITHIN THIS MONOPOLY ENVIRONMENT HOW HAS  
REGULATION TYPICALLY ESTABLISHED PRICES?**

20

21 **A.**

Traditionally, rates for local exchange telephone companies were set within the context of rate-of-return (ROR) regulation. Under ROR regulation, the magnitude of the firm's capital stock or rate base was determined and then rates for the

23

1 various services offered by the telephone company were established to achieve  
2 the “fair” rate of return on those assets. Because the local exchange company  
3 offered multiple services, regulators were free to establish rates for individual  
4 services that would achieve a fair overall ROR but which would also be seen to  
5 further social goals such as the achievement of universal service.

6 The classic regulatory paradigm set rates for basic residential local  
7 exchange telephone service “residually.” That is, rates for other services, for  
8 example long distance and switched access services were set well above cost in  
9 order to maximize the “contribution” to be made toward achieving the overall  
10 target ROR for the company. Then, once the contributions from these services  
11 were maximized, the rates for residential local exchange service were set at a  
12 level as low as possible to achieve the desired return.<sup>3</sup> In this form of regulation,  
13 considerable uncertainty existed regarding the appropriate or desired mark-up of  
14 access charges that was necessary to “promote” universal service and still allow  
15 the firm to earn a fair rate of return.<sup>4</sup> This residual pricing methodology led very  
16 naturally to a set of largely inefficient prices for the portfolio of telephone  
17 services offered by the local exchange company (LEC). In particular, access

---

<sup>3</sup> In practice, it was often the case that rate cases chronologically reversed the order of the residual price-setting process. That is, local rates were selected, often by slightly raising or lowering the then-current rates, and long distance and access charges were set residually to achieve the desired ROR. Analytically there is little difference between the two approaches, both of which are referred to herein as the residual pricing approach.

<sup>4</sup> I use the term “promote” in quotations because this regulatory pricing policy was a failure both in concept and practice as a means of promoting universal service in an economically efficient fashion. See, e.g., “Cross-Subsidization in Telecommunications: Beyond the Universal Service Fairy Tale,” Journal of Regulatory Economics, Volume 2, September 1990, pp. 231-250.

1 charges have been set at rates that have been widely acknowledged to be  
2 economically inefficient.<sup>5</sup>

3  
4 **Q. HAS THE ESTABLISHMENT OF PRICE-CAP REGULATION ENDED**  
5 **THE INEFFICIENT PRICING OF LOCAL EXCHANGE AND ACCESS**  
6 **SERVICES?**

7 A. No. In the vast majority of cases where price cap regulation was adopted,  
8 including Florida, the initial prices established for the firm's regulated services  
9 were those that prevailed under ROR regulation. Over time, the natural forces of  
10 price-cap regulation with positive escalators for inflation and negative forces for  
11 productivity modified the set of prices but failed to address the fundamental  
12 pricing distortions brought about by residual pricing. In particular, the access  
13 charges assessed on long distance carriers for the use of local exchange facilities  
14 to originate and terminate calling continued to be significantly marked-up above  
15 its economic cost, and residential local exchange rates continued to be priced at  
16 levels below those warranted by economic efficiency.

17  
18 **Q. WHAT SPECIFIC IMPLICATIONS FOR RESIDENTIAL TELEPHONE**  
19 **SERVICE POLICIES FLOW FROM THE NEW GOAL AND EMPHASIS**  
20 **ON ENABLING COMPETITION?**

21 A. Residual pricing of residential local exchange telephone services must end. This  
22 pricing methodology simply fails to efficiently or effectively accomplish the goal

---

<sup>5</sup> See David L. Kaserman and John W. Mayo « Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing, » Yale Journal on Regulation, Vol. 11, Winter 1994, pp. 119-148.



1 of encouraging the efficient and widespread provision of residential local  
2 exchange services throughout Florida.

3  
4 **Q. PREVIOUSLY YOU MENTIONED THE SUPREME COURT OPINION.**  
5 **IS THE COURT’S OPINION RELEVANT TO YOUR ADVOCACY OF**  
6 **THE END TO RESIDUAL RATEMAKING IN FLORIDA?**

7 A. Yes. The Supreme Court was quite clear in its read of the Congressional intent  
8 of the 1996 Act. Specifically, the Court noted that: “*Congress called for*  
9 *ratemaking different from any historical practice, to achieve the entirely new*  
10 *objective of uprooting the monopolies that traditional rate-base methods had*  
11 *perpetuated.*” (Opinion, pp. 15-16, emphasis added) Thus, to be consistent with  
12 the Act, it is now clear that the Commission must embrace the new “competition-  
13 enabling” objective of the 1996 Act and, perforce, eliminate residual ratemaking.

14  
15 **IV. SPECIFIC ISSUES RAISED BY THE PETITIONS**  
16

17 **Q. TURNING TO THE SPECIFIC CRITERIA OF THE 2003 ACT, DOES**  
18 **THE PROPOSED REBALANCING OF SWITCHED ACCESS CHARGES**  
19 **SATISFACTORILY FULFILL THE FLORIDA LEGISLATIVELY-**  
20 **MANDATED CONSIDERATIONS?**

21 A. Yes. As I noted earlier there are four legislatively-mandated considerations. Two  
22 are relatively mechanistic – the achievement of parity within a two to four year  
23 window and the requirement that the adjustments be revenue neutral. For

1 purposes of my testimony, I assume that these considerations are satisfied. The  
2 remaining two criteria require further consideration, but are also fulfilled.

3

4 **Q. TURNING TO THE LATTER TWO REQUIREMENTS, HOW DOES THE**  
5 **PROPOSED REBALANCING OF RATES “REMOVE CURRENT**  
6 **SUPPORT FOR BASIC LOCAL TELECOMMUNICATIONS**  
7 **SERVICES”?**

8 A. It does so by simultaneously reducing intrastate switched access rates that have  
9 been established at economically inefficient levels through the residual rate  
10 setting process and adjusting local exchange rates upward on a revenue neutral  
11 basis. This movement unequivocally “removes support for basic local  
12 telecommunications services” in Florida. Indeed, as I described in Section II  
13 above, through the process of residual ratemaking intrastate switched access  
14 charges have been historically elevated well above their relevant economic cost  
15 and the surplus has served as residual support for basic local telecommunications  
16 services. Thus, it is quite clear that the statutory requirement of removing support  
17 for basic local services will be met by the plan described in the ILECs’ petitions.

18

19 **Q. REGARDING THE NEXT CRITERION, WILL THE PROPOSED**  
20 **REBALANCING OF RATES “INDUCE ENHANCED MARKET ENTRY?”**

21 A. Yes. While the entry decisions of new competitive local exchange carriers  
22 (CLECs) are multifaceted, economic theory clearly indicates that the decrease in  
23 overpriced access charges together with the corresponding elevation in the retail

1 price of residential service in Florida will positively affect the likelihood of  
2 market entry. Specifically, prices serve the very important role of signaling  
3 prospective entrants regarding the desirability of entry. Higher prices relative to  
4 cost provide greater inducements for entry. In this regard, the historical practice  
5 of residual pricing of local exchange services in Florida has contributed to an  
6 environment that is relatively unattractive for market entry. By moving toward a  
7 set of prices that better reflect the cost of providing local exchange service,  
8 market entry will be enhanced. Moreover, recent developments in the  
9 telecommunications industry further enhance the pro-competitive, pro-entry  
10 consequences of the carrier access charge reductions and local rate rebalancing.

11  
12 **Q. YOU JUST REFERRED TO RECENT DEVELOPMENTS IN THE**  
13 **INDUSTRY HAVING A “PRO-ENTRY” EFFECT. CAN YOU EXPLAIN**  
14 **HOW SUCH RECENT DEVELOPMENTS IN THE EVOLUTION OF**  
15 **TELECOMMUNICATIONS SERVICES OFFERINGS ENHANCE THE**  
16 **PROSPECTS FOR MARKET ENTRY IN THE EVENT OF SWITCHED**  
17 **ACCESS CHARGE REDUCTIONS?**

18 A. Yes. The recent re-integration of RBOCs such as BellSouth and Verizon create  
19 opportunities for these firms to bundle local and long-distance services into what  
20 might be referred to as “all-distance” telephony. While bundles hold the promise  
21 of providing a variety of consumer benefits, the presence of excessive access  
22 charges undermines these benefits in at least two important ways. First,  
23 competitors that compete against a bundled offering cannot drive the flat-rate

1 prices down to squeeze out excess profits that may be earned by ILECs because  
2 these competitors face asymmetrically higher costs as a consequence of the  
3 excessive switched access charges that are assessed on a per minute basis. That  
4 is, because access charges are presently set well above the incremental cost of  
5 providing access, the lower bound to which the competitors can drive prices is  
6 defined by the artificially high level of access charges. Thus, in the presence of  
7 such elevated charges, the normal salutary effect of competitive markets -  
8 eliminating excess profit - is eviscerated. Specifically, the entrant can only drive  
9 prices down to its artificially high cost basis and not to a level sufficiently low to  
10 squeeze out excessive profits that might be earned in the market.

11 Second, if high access charges are continued and widespread bundling of  
12 telecommunications services continues to grow, it is likely that competitors may  
13 not even be able to make a competitive offering, thereby assuring monopoly  
14 control over some customers. For example, with the elimination of the  
15 interLATA distinction, a set of flat-rate plans for bundled "all-distance" telephony  
16 has developed in Florida. Specifically, as seen in Exhibit JWM-3, suppose a flat  
17 fee of  $R_0$  for a bundled local and long distance offering is established to be  
18 compensatory for the ILEC for all customers with less than  $M_1$  of usage. At the  
19 same time, competitors of the ILEC which face switched access charges that  
20 exceed the incremental cost of providing access will only find such flat-fee  
21 bundled service offerings profitable for customers with usage levels less than  $M_2$ .  
22 Thus, the presence of excessive access charges will act to limit the ability of  
23 competitors to enter the market as segments of the market are profitable only to

1 the ILEC. Alternatively stated for purposes here, to the extent that the  
2 competitive standard for telecommunications service is evolving more toward an  
3 all-distance format, reductions in the carrier access charge will afford new  
4 entrants an improved opportunity to enter the market and compete.

5  
6 **Q. BUT DON'T LOW RESIDENTIAL RATES PROMOTE THE GOAL OF**  
7 **UNIVERSAL SERVICE BY MAKING TELEPHONE SERVICE MORE**  
8 **AFFORDABLE?**

9 A. No. While consumers of residential telephone service (or any product for that  
10 matter) would prefer low rates to high rates, the imposition of residually  
11 determined, artificially low rates actually are quite harmful to the goal of efficient,  
12 widespread provision of residential telephone services in Florida.

13  
14 **Q. CAN YOU EXPLAIN?**

15 A. Yes. While nominally popular with consumers, perpetuation of artificially low  
16 residential rates through residual pricing serves as a significant impediment to the  
17 achievement of the goals established in the Act. Prices that do not – at a  
18 minimum -- recover the incremental cost of providing a service will simply fail to  
19 encourage any other parties to consider entry into the market. In this case, while  
20 consumers are nominally “protected” from monopoly through a policy of low  
21 prices, such a policy actually acts to prevent the introduction and growth of  
22 competition.

1           Indeed, prices that are held below cost in the subsidized sector will tend to  
2 discourage all entry, even efficient entry. This latter effect tends to have a self-  
3 perpetuating influence on regulation in the affected industry. Specifically,  
4 because entry is artificially restricted through the below-cost price realized in the  
5 subsidized segment of the market, the incumbent firm will tend to maintain a  
6 monopoly in that market, thereby justifying continuing regulation. That  
7 regulation, in turn, tends to maintain the cross-subsidy, which prevents the entry,  
8 which justifies the continuing regulation. Consequently, not only is competition  
9 incompatible with cross-subsidies, but cross-subsidies tend to distort the  
10 competitive process and delay the time when competition arrives. Thus, a  
11 necessary (but not sufficient) condition for the emergence and growth of  
12 competitors is the removal of regulatory barriers to entry, and there can be no  
13 more effective barrier to entry than prices that are lower than the incremental cost  
14 of providing a service.

15  
16 **Q. SHOULD THE COMMISSION BE CONCERNED THAT HOUSEHOLDS**  
17 **WILL BE HARMED BY LOCAL EXCHANGE PRICE INCREASES AND**  
18 **WILL QUIT SUBSCRIBING TO THE PUBLIC SWITCHED NETWORK?**

19 **A.** No. Household subscription to telephone service in Florida is quite high and is in  
20 no danger of eroding in the face of price increases, should they occur. The vast  
21 majority of Florida households are fully able and willing to pay the full costs that  
22 they impose on local exchange companies for their subscription to the public  
23 switched network. Some households are at risk, but it is possible to identify these

1 and to target assistance (subsidies) toward these households. By targeting such  
2 assistance rather than maintaining a grossly inefficient system of perpetuating  
3 artificially low prices to all households, the subsidy mechanism can be made to  
4 deliver more punch, precisely where it is needed.<sup>6</sup>

5  
6 **Q. SPECIFICALLY, WHAT PUBLIC POLICY MEASURES IN FLORIDA**  
7 **PROVIDE COMFORT THAT THE STATE'S UNIVERSAL SERVICE**  
8 **GOALS ARE NOT AT RISK BY THE ADOPTION OF THE PETITIONS?**

9 A. There are several considerations that provide such comfort. First, the household  
10 subscription decision is based on the value realized by the household by all of the  
11 services that such subscription permits. Thus, while the elevation of local  
12 exchange prices associated with the revenue-neutral rebalancing of switched  
13 access charges will act to reduce the net value realized by consumers, the very  
14 same rebalancing increases that net value as the household realizes lower  
15 intrastate long distance rates. Second, while the demand curve for local exchange  
16 service is normal in the sense that price and the quantity demanded are inversely  
17 related, the price elasticity of the demand for access is exceedingly small. Most  
18 empirical estimates place the price elasticity of demand for access in the practical  
19 neighborhood of zero.<sup>7</sup> Thus, the elevation of local exchange prices is unlikely to

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<sup>6</sup> For a study of the effectiveness of targeted versus untargeted subsidy mechanisms in telecommunications, see Ross Eriksson, David L. Kaserman and John W. Mayo "Targeted and Untargeted Subsidy Schemes: Evidence from Post-Divestiture Efforts to Promote Universal Telephone Service," Journal of Law and Economics, Vol. 41, October 1998, pp. 477-502.

<sup>7</sup> Kaserman, Mayo and Flynn (Journal of Regulatory Economics, September, 1990, pp. 231-250.) find a price elasticity of the demand for access of -.068; Cain and MacDonald (Journal of Regulatory Economics, December 1991., pp. 293-308) find that "when measured service options are available, price changes for flat rate service have essentially no effect on access demand... These estimates suggest that universal

1 cause any serious erosion to the quite high levels of household subscription in  
2 Florida.<sup>8</sup> Third, the 2003 Act generally requires that the increases to local  
3 exchange rates that will accompany the approval of the rebalancing petitions  
4 would not apply to Lifeline customers. See Chapter 364.10(3)c, Florida Statutes.  
5 It is these Lifeline customers that are the most susceptible to dropping off the  
6 network when faced with a price increase. Thus, the 2003 Act effectively  
7 insulates these vulnerable customers from any economic harm that may result  
8 from the general escalation of rates. At the same time, it is important to note that  
9 these same customers will benefit from the reduced intrastate toll charges that  
10 accompany the intrastate carrier access charge reductions embedded in the  
11 petitions. Finally, the 2003 Act goes even farther in its desire to protect the  
12 universal service mission of the state by expanding the eligibility criterion for  
13 Lifeline service to 125 percent of the federal poverty income level. Again, this  
14 targeted approach has been shown to be the most economically efficient means of  
15 protecting the widely held goal of universal service.<sup>9</sup>

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service can be maintained and expanded, even while more of the NTS financial burden is shifted to local charges.” (p. 303); Garbacz and Thompson (*Journal of Regulatory Economics*, January 1997, pp. 67-78) provide a series of estimates, including state-specific estimates of the price elasticity of demand. For Florida, they find that the price elasticity is either -.006 or -.0058. (See their Tables 6 and 7) For six aggregate models they find that elasticities vary from -.001 to -.026. (See their Table 5). And Garbacz and Thompson (*Journal of Regulatory Economics* 2001) in a review of a telecommunications study by Crandall and Waverman (CW) note that CW “end up with a price elasticity for local telephones no different than zero (quite similar to our results).” They conclude, “The fact that studies using significantly different data sources ... rarely find economically meaningful price elasticities strongly indicates that such an effect is very unlikely.” (p.95)

<sup>8</sup> The latest FCC data reveals that household subscription rates in Florida is nearly 95 percent (94.8) as of November 2002. See Industry Analysis and Technology Division, Wireline Competition Bureau, “Telephone Subscribership in the United States” (April 2003).

<sup>9</sup> See Eriksson, et al, op cit., note 5.



1 **Q. ARE THERE OTHER ECONOMIC BENEFITS THAT ARE LIKELY TO**  
2 **EMERGE FROM ADOPTION OF THE PETITIONS?**

3 A. Yes. To the extent that the price rebalancing brought about by approval of the  
4 petitions gives rise to new competitors, the result will be a greater scramble  
5 among competitors for the patronage of telecommunications customers in Florida.  
6 The resulting heightened level of competition will promote the advent of  
7 innovative telecommunications services that better fulfill the desires of Florida's  
8 consuming public.

9  
10 **Q. SHOULD THE COMMISSION BE MINDFUL OF OTHER**  
11 **CONSIDERATIONS AS IT MOVES TO REDUCE INTRASTATE**  
12 **CARRIER ACCESS CHARGES AND REBALANCE LOCAL EXCHANGE**  
13 **RATES IN FLORIDA?**

14 A. Yes. Even as the Commission moves to rebalance rates, it should be mindful of  
15 additional obstacles to the emergence of local exchange competition in Florida.  
16 Specifically, several characteristics of the evolution of telecommunications policy  
17 in Florida in general and residential markets in particular make this sector  
18 especially vulnerable to efforts by the incumbent local exchange carrier (ILEC) to  
19 protect its dominant position through anticompetitive means. For instance, as  
20 input prices are transitioned to economically efficient levels the incentive by the  
21 ILEC to engage in non-price discriminatory conduct – sabotage – of its new retail  
22 stage rivals grows.<sup>10</sup> Thus, the Commission must be especially mindful as it

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<sup>10</sup> See T. Randolph Beard, David L. Kaserman and John W. Mayo "Regulation, Vertical Integration and Sabotage", *Journal of Industrial Economics*, Volume 49, September 2001, pp. 319-334.

1 transitions to economically rational pricing policies that its efforts to promote  
2 competition are not undermined by non-price exclusionary tactics by the  
3 incumbent.<sup>11</sup>

4 This is particularly important in residential markets because residential  
5 customers' appetite for competitive alternatives and the ability of new entrants to  
6 secure and retain these customers is especially tenuous. Residential customers  
7 spend considerable less than business customers on local telephone services.  
8 Thus, while having some affinity for the prospect of competitive alternatives, the  
9 resistance to switch carriers is especially sensitive for residential customers. Bad  
10 experiences with competitors – whether due to the shortcomings of the new  
11 entrant or the incumbent underlying carrier of the wholesale input – will quickly  
12 quash the residential consumers' appetite for competitive alternatives. That is,  
13 for the amount of money that residential consumers spend on local exchange  
14 telephone services, it is simply not worth the hassles to repeatedly test the  
15 competitive waters, especially if the customer does not have a positive initial  
16 experience with competitors. Moreover, any sabotage that does occur in  
17 residential exchange services is likely to be long-lasting and widespread as the  
18 “reputation” of the new entrants' larger portfolio of telecommunications services

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<sup>11</sup> In addition to the heightened incentive for non-price exclusionary tactics (viz., sabotage), incumbent firms may be expected to use price as a vehicle for excluding new entrants. For example, it is my understanding that BellSouth has introduced a marginal retail long distance rate of 1 cent per minute as a recent promotional offering in Florida. This marginal rate has a *prima facie* anticompetitive quality about it as it is well below the cost imposed on BellSouth's rivals who must purchase access at rates of up to 4.6 cents per minute. That is, as a practical matter, there is a significant disadvantage facing new entrants that must pay 4.6 cents per minute for one of their inputs – access – when the marginal price established in the market by the incumbent is 1 cent per minute. While there is a fixed monthly charge associated with this offering, it is unclear whether BellSouth's offering passes a properly designed imputation test. More fundamentally, the higher are switched access charges, the greater the temptation for the incumbent to enact a vertical price squeeze and, hence, the greater the need for reducing intrastate switched access charges immediately.

1 (e.g., long distance) may be damaged by sabotage of the new entrants' local  
2 exchange service offerings.

3

4 **Q. IS A REDUCTION IN INTRASTATE SWITCHED ACCESS RATES TO**  
5 **INTERSTATE LEVELS SUFFICIENT TO ACHIEVE ECONOMIC**  
6 **EFFICIENCY?**

7 A. No. My understanding is that interstate access charge rates continue be set at  
8 rates that exceed the economic cost of providing access. The relevant target,  
9 however, for the establishment of competition-enabling intrastate switched access  
10 charges in Florida is the economically efficient rate as approximated by  
11 incremental cost. Moreover, not only will establishment of this rate be  
12 economically efficient but it also will eliminate the unsupportable differences that  
13 currently exist in pricing between access provided to long-distance providers and  
14 the essentially identical access provided to competitive local exchange carriers  
15 when, in fact, the service and costs are the same regardless of the party receiving  
16 the service. This efficient target is, in fact, embodied in the 2003 Act when it  
17 notes that ILECs seeking regulatory parity must reduce their intrastate switched  
18 network access rates to local reciprocal interconnection rates.<sup>12</sup>

19

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

21 A. Yes.

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<sup>12</sup> Section 364.051 (7)(b)

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

2 A. My name is John W. Mayo. My business address is Georgetown University,  
3 McDonough School of Business, 37<sup>th</sup> and O Streets, N.W., Washington, D.C.  
4 20057.

5

6 **Q. ARE YOU THE SAME JOHN MAYO THAT PROVIDED TESTIMONY**  
7 **EARLIER IN THIS PROCEEDING?**

8 A. Yes.

9

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

11 A. The purpose of my testimony is to offer comments and clarification on the  
12 testimony offered by Dr. David Gabel (testifying on behalf of the Office of  
13 Public Counsel) and Dr. Mark Cooper (testifying on behalf of AARP).

14

15 **Q. AVOIDING FOR THE MOMENT THE NUANCES OF THEIR**  
16 **TESTIMONIES, ARE THERE GENERAL DIFFERENCES IN THE**  
17 **APPROACHES ADOPTED BY DR. GABEL, DR. COOPER AND**  
18 **YOURSELF?**

19 A. Yes. I believe that we all are interested in the goal of furthering competition  
20 in the residential telecommunications markets in Florida. The big question is  
21 what is the best way to proceed to accomplish that goal while either  
22 enhancing – or at least not sacrificing – other goals. My approach toward

1 this issue is that the matter of residential rates for long distance and local  
2 exchange services must be considered as part of a larger effort, necessitated  
3 by both the federal Telecommunications Act of 1996 ("1996 Act") and the  
4 Florida Tele-Competition Innovation and Infrastructure Enhancement Act  
5 ("2003 Act"), to enable competition through policies that will ensure full,  
6 open, efficiently priced and nondiscriminatory access to inputs and  
7 compensatory retail prices. Although a bit of a caricature, the spirit behind  
8 the testimony of Drs. Gabel and Cooper seems to be "business as usual"  
9 which, as I explained in my initial testimony is contrary to the competition-  
10 enabling mandate of the 1996 Telecommunications Act.

11

12 **Q. TURNING SPECIFICALLY TO DR. GABEL'S TESTIMONY, WHAT**  
13 **ARE HIS PRINCIPAL POINTS?**

14 A. He argues that: (1) the ILECs use the wrong cost standard for satisfying the  
15 statutory test laid out in the Tele-Competition Act and that by application of  
16 the correct cost standard the ILECs' demonstration of the statutory test  
17 fails; and (2) that there is little or no evidence that rebalancing will stimulate  
18 entry.

19

20 **Q. TURNING TO THE FIRST OF DR. GABEL'S ARGUMENTS, HOW DOES**  
21 **HE PURPORT TO SHOW THAT THE ILECS HAVE FAILED TO**  
22 **SATISFY THE STATUTORY REQUIREMENT FOR REBALANCING?**

1 A. Dr. Gabel provides an extended discussion of the ILECs' cost methodologies,  
2 which are based upon estimates of the Total Element Long Run Incremental  
3 Costs (TELRIC) in Florida, and why, he believes, reliance on this cost  
4 methodology is inappropriate. Specifically, he argues that the Commission  
5 should, instead, rely upon an alternative methodology, Total Service Long  
6 Run Incremental Costs (TSLRIC), in determining whether the statutory test  
7 is satisfied.

8

9 **Q. ARE YOU PERSUADED BY DR. GABEL'S DISCUSSION ON THIS**  
10 **POINT?**

11 A. No. It suffers on several grounds. Most fundamentally, the debate about  
12 "this" versus "that" cost methodology almost certainly misses a more  
13 significant point. Specifically, Dr. Gabel wishes to show that today's retail  
14 prices in Florida, while less than TELRIC, lie above a measure of TSLRIC.  
15 The conclusion that Dr. Gabel draws from this is that there is no subsidy  
16 going to local exchange service and, consequently, the petitions necessarily  
17 fail to demonstrate that the rebalancing will remove "current support."

18

19 **Q. WHY IS THERE A PROBLEM WITH DR. GABEL'S APPROACH?**

20 A. Dr. Gabel's detailed analysis of the costing methodology is incongruous with  
21 the way in which prices in this industry have been set. Specifically, as  
22 described in my initial testimony, local exchange telephone rates have not,

1           except in the most surreal sense, been predicated on the cost of providing  
2           such service. Rather, mark-ups on non-basic services, on switched access  
3           and long-distance services have traditionally been set at rates to generate  
4           high contributions and then local residential rates have been set residually.  
5           Thus, regardless of the relationship of current rates to a cost benchmark, the  
6           fact remains that the method of residential pricing has historically been  
7           residually determined and not based on costs. Thus, reductions in switched  
8           access charges, with a commensurate rebalancing of local exchange rates do  
9           – unequivocally – “remove current support for basic local  
10          telecommunications services” as required by the 2003 statute.

11

12   **Q.    ACCEPTING FOR THE MOMENT THE VALIDITY OF HIS**  
13   **ALTERNATIVE COST APPROACH, WHAT SHOULD WE THEN MAKE**  
14   **OF THE CONCLUSION BY DR. GABEL THAT BASIC LOCAL**  
15   **TELECOMMUNICATIONS SERVICE RATES ARE NOT SUBSIDIZED?**

16   A.    Unfortunately, Dr. Gabel’s conclusion, even if it were based on the correct  
17   costing methodology, does not effectively rebut the reality that access charge  
18   reductions and commensurate rebalancing of local exchange rates will act “to  
19   remove current support for basic local telephone services.” Specifically,  
20   regardless of a finding of “subsidy” or “no subsidy” – the apparent linchpin  
21   in Dr. Gabel’s testimony – the reality is that access charge reductions and  
22   local exchange rates are intrinsically linked. Reducing access charges  
23   removes the source of current support for those low local exchange rates.

1 This removal of support exists independent of whether current local  
2 exchange rates are the beneficiary of a classic economic subsidy.

3

4 **Q. HOW THEN DO YOU RESPOND TO DR. GABEL'S ASSESSMENT**  
5 **THAT ILECS ARE EITHER BREAKING EVEN OR EARNING A**  
6 **SURPLUS FROM RESIDENTIAL RATES?**

7 A. I think Dr. Gabel's conclusion overreaches the analysis. It is predicated on a  
8 cost discussion that creates more confusion than insights in this particular  
9 case and is at odds with marketplace evidence.

10

11 **Q. HOW DOES DR. GABEL'S COST ANALYSIS CREATE MORE**  
12 **CONFUSION THAN INSIGHTS FOR THIS CASE?**

13 A. Dr. Gabel argues that TSLRIC should form the basis for assessing the cost of  
14 providing basic local exchange service and that the relevant incremental cost  
15 is very low. This approach, however, is wrought with the potential for  
16 creating poor public policy. To see this, consider the foundation of Dr.  
17 Gabel's argument. Specifically, akin to the multiproduct nature of the  
18 telecommunications industry, imagine a situation where it is possible to  
19 supply three services called X, Y and Z. The incremental cost of X might be  
20 represented as  $C(X,Y,Z) - C(0,Y,Z)$ . Similarly, the cost of Y and Z can be  
21 represented as  $C(X,Y,Z) - C(X,0,Z)$  and  $C(X,Y,Z) - C(X,Y,0)$ , respectively.  
22 If one assumes absolutely no knowledge that this is a network industry with



1 customer access as the *sine qua non* service, then the incremental cost of  
2 supplying only the last service may be seen as quite low. This appears to be  
3 where Dr. Gabel's analysis stops.

4 This is, however, not any industry; it is telecommunications, and one  
5 service – customer access – is primary. We know that this is a network  
6 industry with a bona fide demand for access to the network and that there  
7 are identifiable and incremental costs – including the cost of loops – that are  
8 caused by the provision of that service. That is, the incremental cost of  
9 access in a network industry should be calculated first.<sup>1</sup> In this case, and  
10 unlike the conclusion of Dr. Gabel, the incremental cost of access is properly  
11 identified on a cost-causative basis and is not shared among the other  
12 services.

13  
14 **Q. WHAT THEN SHOULD THE COMMISSION MAKE OF DR. GABEL'S**  
15 **CLAIM THAT THE COST OF THE LOOP SHOULD BE SHARED**  
16 **ACROSS MULTIPLE SERVICES RATHER THAN IMPOSED IN BASIC**  
17 **RESIDENTIAL RATES?**

18 A. The Commission should give it little or no weight in the policy determination  
19 in this case for it is based on a mistaken economic perspective. In particular,  
20 it violates fundamental tenets of efficient costing and pricing. For instance, it  
21 is well established in both economic theory and regulatory parlance that  
22 costs should be determined consistent with principles of cost causation to the

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<sup>1</sup> Thus, the incremental cost of putting access in place is  $C(\text{Access},0,0) - C(0,0,0)$ .

1 maximum – not minimal – extent possible. In the case of  
2 telecommunications, this requires examining the bona fide demand and bona  
3 fide supply characteristics of services provided. In the specific situation  
4 under consideration, consumers demand, and suppliers supply, access to the  
5 network, local usage, and long-distance usage. The fact that loops are used  
6 in the provision of a variety of telecommunications services does not alter the  
7 fact that these loops provide access – the *sine qua non* of wireline  
8 telecommunication.

9 In this regard, Dr. Gabel has previously acknowledged that, “The  
10 defining characteristic of a service is that it is or would be demanded in its  
11 own right.”<sup>2</sup> Residential dial tone access is certainly “demanded in its own  
12 right” and the costs of providing that access, including the costs of the local  
13 loop, can readily be identified with the provision of such access.<sup>3</sup> Thus, the  
14 incremental cost associated with the provision of access, including the costs of  
15 loops that enable that access should be recovered in the residential monthly  
16 fixed charge.

17

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<sup>2</sup> See Rebuttal Testimony of David Gabel, footnote 17, p. 9 filed before the Massachusetts Department of Telecommunications and Energy, In the Matter of Phase II Alternative Regulation, Docket No. 01-31, September 18, 2002.

<sup>3</sup> This conclusion is widely recognized. For example, in a symposium issue on “Telecommunications in Transition” in the Yale Journal on Regulation it was noted that “subscriber access is a service in its own right. ...A customer who demands subscriber access with no intention of ever placing a call...causes the same loop costs as other customers that use the network infrequently.” See Steve G. Parsons, “Seven Years After Kahn and Shew: Lingering Myths on Costs and Pricing Telephone Service,” Yale Journal on Regulation, Winter 1994, p. 153. See also, Alfred E. Kahn and William B. Shew “Current Issues in Telecommunications Regulation: Pricing,” Yale Journal on Regulation, Vol. 4, 1987.

1 Q. **TURNING TO DR. GABEL'S SECOND PRINCIPAL ARGUMENT, IS**  
2 **THERE EVIDENCE REGARDING MARKET ENTRY BY NEW**  
3 **ENTRANTS INTO RESIDENTIAL MARKETS IN FLORIDA?**

4 A. Yes. Quite apart from the mixed picture painted by the ILECs and Dr.  
5 Gabel on the issue of the price-cost relationship in local exchange service in  
6 Florida, the marketplace itself seems to offer some (albeit imperfect)  
7 information that residential service is under-priced in Florida. Specifically,  
8 in competitive markets firms are attracted to "surpluses" and repelled by  
9 "deficits". In this regard, it is certainly incontrovertible that the level of  
10 competitive interest (entry, marketing, and growth of competitors) in  
11 residential markets has been anemic to this point. This would seem to  
12 provide some amount of *prima facie* evidence that residential prices are too  
13 low.

14  
15 Q. **BUT WHAT ABOUT DR. GABELS'S ARGUMENT THAT IT IS THE**  
16 **HIGHER GROSS MARGINS IN OTHER STATES – NOT LOW LOCAL**  
17 **RATES – THAT ARE DRIVING THE DEARTH OF COMPETITIVE**  
18 **ENTRY INTO RESIDENTIAL MARKETS IN FLORIDA?**

19 A. Dr. Gabel creates a false dichotomy in his challenge to the ILECs'  
20 presentation of data on low local exchange prices in Florida. (Gabel Direct,  
21 p. 42) Specifically, he argues that "the ILECs focus on the price of BLTS as  
22 the primary determinant of entry when elsewhere they contend that entry is  
23 based on the relationship between total revenue and total cost." The fact is

1 that price levels *are part of the total revenue-total cost relationship* so that the  
2 focus by the ILECs in this case on the level of local rates is not inconsistent  
3 with the perspective that entry decisions are determined by anticipated  
4 revenues from market entry relative to the anticipated costs. While  
5 attempting to create the dichotomy, and suggest to the Commission its  
6 importance for this proceeding, Dr. Gabel actually, albeit perhaps  
7 inadvertently, seems to acknowledge the point that pricing and costs are both  
8 important when he states that “these factors work together to explain why  
9 the pattern of entry is different” (Gabel Direct, p. 41).

10

11 **Q. BUT DOESN'T DR. GABEL'S ANALYSIS DEMONSTRATING HIGHER**  
12 **“GROSS MARGINS” ON LOCAL EXCHANGE SERVICES IN OTHER**  
13 **STATES ALTER THE VALUE OF THE ILECS' CLAIMS THAT LOW**  
14 **LOCAL RATES ACT TO INHIBIT ENTRY IN THE CURRENT**  
15 **ENVIRONMENT? (GABEL DIRECT, PP. 39-40)**

16 A. No. I agree with Dr. Gabel's basic point, that prospective entrants are likely  
17 to consider the relationship between expected revenues and expected costs in  
18 making a determination of the merits of entry. Moreover, marketplace  
19 evidence of higher gross margins between retail rates and the price of UNES  
20 in Illinois and Michigan compared to Florida is suggestive of a greater  
21 incentive in these states for entry than in Florida. This higher gross margin  
22 is determined by *both* retail rates and the price of UNES. The fact that both  
23 retail rates and the costs made to be paid by the CLECs for UNES affect the

1 entry decision in no way invalidates the argument, necessarily made on a  
 2 *ceteris paribus* (i.e. “holding all other factors constant”) basis, that lower  
 3 retail rates have a depressing effect on entry. Thus, while Dr. Gabel wishes  
 4 to argue that it is gross margins *rather* than retail rates that affect the entry  
 5 decision, the correct perspective is that gross margins, *which are in part*  
 6 *determined by retail rates*, affect entry. Thus, the ILECs’ point regarding the  
 7 impact of low local rates remains valid.

8 Interestingly, while Dr. Gabel’s analysis is in one respect misleading,  
 9 it is also useful in making a different, but powerful point. Specifically, Dr.  
 10 Gabel’s analysis quite effectively points out that beyond rebalancing, there  
 11 are other policy levers that are available to help enable competition and that  
 12 UNE rates are likely to be relevant also. That is, over and above the entry-  
 13 enhancing impact that the rebalancing will have, the Commission can,  
 14 through aggressively pursuing efficient UNE pricing further enhance the  
 15 prospects for competitive entry.

16

17 **Q. DR. GABEL ARGUES THAT RATE REBALANCING – BECAUSE IT IS**  
 18 **REVENUE NEUTRAL – WILL NOT LEAD TO INCREASED**  
 19 **ATTRACTIVENESS OF ENTERING THE LOCAL EXCHANGE**  
 20 **MARKET. DO YOU AGREE? (GABEL DIRECT, P. 48)**

21 A. No. It is incontrovertible that higher rates – which make more favorable the  
 22 existing margins in BLTS (regardless of whether they are positive or  
 23 negative) will positively dispose firms to consider entry into the service whose

1 margin is positively affected. The question raised by Dr. Gabel is whether  
2 the offsetting reduction in long distance rates that will occur in Florida will  
3 act as an equal, offsetting drag on the entry process. Based on the  
4 fundamental economics of long distance and local markets, the answer is  
5 likely to be “no.” Specifically, while local rate increases are likely to lead to  
6 higher margins, the lower access charges will not affect margins (long  
7 distance is already competitive) but will affect the volumes. Thus, the impact  
8 on entry is quite likely to be positive from both the long distance and local  
9 sides. Indeed, switched access reductions will help enable traditional long-  
10 distance firms and new entrants to compete on more equal footing with  
11 extraordinarily aggressive long distance offerings such as the 1-cent per  
12 minute promotion currently being featured by BellSouth. As discussed in my  
13 Direct Testimony, pp. 12-14, by creating opportunities for firms to enter the  
14 near-monopoly portion of the industry, the prospect for new entrants to  
15 meaningfully offer a bundled service packages is enhanced.

16  
17 **Q. DR. GABEL ARGUES THAT EVEN IF ENTRY BECOMES MORE**  
18 **PROFITABLE ENTRY WILL NOT NECESSARILY FOLLOW. (GABEL**  
19 **DIRECT, P. 58) CAN YOU COMMENT?**

20 **A.** Yes. As I noted in my initial testimony, the entry decision is, indeed,  
21 manifold and some other conditions in this marketplace impose formidable  
22 challenges for new entrants. In this regard, I agree with Dr. Gabel when he  
23 states that “a rise in total revenues ... may not be sufficient to allow new

1 entrants to overcome existing entry barriers.” The fact is, however, that the  
2 rebalancing unequivocally enhances the likelihood that whatever existing  
3 barriers are in place will be overcome. Thus, it seems a poor justification  
4 for not moving forward with a policy that enhances the prospects for entry  
5 based on the fear that it might not create as much new entry as might be  
6 ideally desired.

7  
8 **Q. DR. GABEL ARGUES THAT NEW TECHNOLOGIES FACE**  
9 **CHALLENGES IN CREATING COMPETITION FOR LOCAL**  
10 **TELEPHONE CUSTOMERS, AND THAT CONSEQUENTLY THE**  
11 **COMMISSION SHOULD NOT ORDER RATE REBALANCING ON THE**  
12 **“UNSUPPORTED PROPOSITION” THAT THE DEPLOYMENT OF NEW**  
13 **TECHNOLOGIES WILL BE ENHANCED IF RATES ARE**  
14 **REBALANCED. (GABEL DIRECT, PP. 59-61) DO YOU AGREE?**

15 A. No. Once again, I agree with Dr. Gabel’s premise: it seems that alternative  
16 technologies ranging from cellular to provision of telephony over power lines  
17 currently face a number of technological challenges to make them effective  
18 substitutes for traditional wireline telephony. The agreement on this  
19 premise, however, in no way invalidates the economic reality that rate  
20 rebalancing creates, *ceteris paribus*, an economic attraction to entry.

21

1 **Q. DR. GABEL ARGUES THAT THE WELFARE GAINS FROM LONG**  
2 **DISTANCE RATE REDUCTIONS THAT ACCOMPANY ACCESS**  
3 **CHARGE REDUCTIONS ARE LIKELY TO BE SMALL BECAUSE THE**  
4 **ELASTICITIES OF DEMAND FOR INTRASTATE LONG DISTANCE**  
5 **CALLING ARE LOW. (GABEL DIRECT, PP. 69-72) DO YOU AGREE?**

6 A. No. Dr. Gabel's reference to studies of low price elasticities for toll services  
7 misses a fundamental lesson from the empirical literature on  
8 telecommunications price elasticities. Specifically, the empirical literature on  
9 price elasticities of demand unequivocally reveals that the price elasticities  
10 for long distance services are many times higher than those for local  
11 exchange service. Specifically, there is a large and robust econometric  
12 literature that indicates that the price elasticity of demand for residential  
13 customer access is very low, indeed, very near zero, while estimates of the  
14 price elasticity of demand for toll services range from those cited by Dr.  
15 Cooper on the low end to -1.5 on the high end.<sup>4</sup> Thus, price increases in  
16 local exchange service will lead to relatively smaller consumer welfare losses  
17 (even before any public policy measures such as Lifeline to insulate low  
18 income consumers) than the welfare gain that results from reductions in the  
19 prices of long distance services.

20

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<sup>4</sup> See footnote 7 from my direct testimony for the econometric literature related to local telephone price elasticities. Toll elasticities as high as -1.5 are reported in C. Martins-Filho and J.W. Mayo "Demand and Pricing of Telephone Services: Evidence and Welfare Implications," RAND Journal of Economics, Vol. 24, Autumn 1993, pp. 439-454. For a general review of the toll price elasticity literature, see L.D. Taylor Telecommunications Demand in Theory and Practice (Kluwer Academic Publishers, 1994).



1 **Q. TURNING TO THE DIRECT TESTIMONY OF DR. COOPER, WHAT**  
2 **ARE HIS PRINCIPAL ARGUMENTS?**

3 A. While making a variety of claims, the essence of Dr. Cooper's testimony is  
4 that the petitions fail the statutory test because: (1) there is no "subsidy"  
5 from local exchange telephone service to other services; (2) that rate  
6 rebalancing will not stimulate competition; and (3) that consumers will not  
7 benefit from the proposed rebalancing.

8

9 **Q. DO YOU FIND DR. COOPER'S ARGUMENTS COMPELLING?**

10 A. No.

11

12 **Q. CAN YOU PLEASE COMMENT ON DR. COOPER'S FIRST POINT?**

13 A. Yes. Much like Dr. Gabel, Dr. Cooper sets about the task of rejecting the  
14 petitions for rebalancing on the grounds that unless the ILECs demonstrate  
15 that a "subsidy" exists the statutory test fails. The language of the statutory  
16 test, however, indicates that the rebalancing proposal is keyed to whether the  
17 rebalancing acts to "remove current support" -- not that it be done to  
18 "eliminate a subsidy".<sup>5</sup> And, as I explained in my initial testimony the  
19 method of rate setting in the local telephone monopoly era has been to  
20 establish local rates residually. It is clear that, but for the presence of higher

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<sup>5</sup> From an economic perspective, if the rebalancing were shown to "eliminate a subsidy" then the public policy merits of the rebalancing petitions are strengthened as such cross-subsidies are incompatible with the competitive market standard that should guide policy. See my Direct Testimony, pp. 14-15.

1 rates imposed on business customers, interstate and intrastate long distance  
2 switched and special access, and vertical features the local telephone rates  
3 necessary for the ILECs to earn their “fair rate of return” would have had to  
4 have been higher. In this sense, then, there can be no doubt that the proposal  
5 to reduce switched carrier access charges in Florida certainly “removes  
6 current support for basic local telephone service” as required by the  
7 statutory test. Thus, while considerable debate certainly exists about  
8 whether a classically defined economic subsidy is presently going to local  
9 exchange services in Florida, there is no question that the switched access  
10 charge reductions being proposed will remove current support for basic local  
11 telecommunications services.

12

13 **Q. WHAT SHOULD WE MAKE OF DR. COOPER'S SECOND MAJOR**  
14 **POINT?**

15 A. Dr. Cooper's second principal argument is that a requirement of the  
16 statutory test is that “actual local competition will result in specific  
17 geographic areas (meaning individual urban rate zones) before ... [the  
18 Commission]... can consider raising basic local residential rates”. (Cooper  
19 Direct, p. 12). As I have pointed out in my initial testimony, however, it is  
20 clear that the rate rebalancing will, ceteris paribus, make entry into local  
21 exchange markets more attractive. Economic theory unequivocally indicates  
22 that reductions in switched access rates (which will expand output of long  
23 distance calling) will “make room” for more long distance competitors.

1           Additionally, the rebalancing of local exchange rates will unequivocally  
2           increase the attractiveness of entering the local exchange arena in Florida.  
3           Finally, in a world of the emerging “all-distance” bundle, the reduction in  
4           access charges that will occur with approval of the petitions will enhance the  
5           ability of the ILECs’ most potent potential competitors, such as AT&T and  
6           MCI, to compete more effectively in the residential arena.

7                       It is also worth noting that Dr. Cooper’s requirement that the  
8           Commission know, presumably with certainty, the exact nature of the  
9           “actual” competition that will result “in specific geographic areas (meaning  
10          individual urban rate zones)” before approving a rebalancing petition asks  
11          considerably more than is possible using modern economic analysis. While  
12          this Commission can (and should) aggressively pursue competition-enabling  
13          policies, it cannot be expected to perfectly know or engineer the precise  
14          nature of how and where competition will arise.<sup>6</sup>

15

16   **Q.    BUT WHAT ABOUT THE CLAIM BY DR. COOPER THAT**  
17   **COMPETITION IN FLORIDA IS NOT LAGGING THE COUNTRY, BUT**  
18   **RATHER IS “MIXED”? (COOPER DIRECT, P. 26)**

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<sup>6</sup> In a similar vein, while the Commission may wish to satisfy itself that switched access charge reductions are passed along to customers, it can be comforted that this will happen without heavy-handed micromanagement of such flow-throughs. The reason is that long distance markets are effectively competitive so traditional long distance firms will see switched access rate reductions as a means to compete for increased consumer patronage, to the maximum benefit of consumers. See, e.g., David L. Kaserman and John W. Mayo “Competition in the Long Distance Market,” in Handbook of Telecommunications Economics, Volume 1, Martin E. Cave, Sumit Majumdar and Ingo Vogelsang, Eds. North Holland, 2002.

1 A. While Dr. Cooper finds the empirical evidence on competition “mixed,” I am  
2 unconvinced that the status of local exchange competition in Florida is at  
3 anywhere near acceptable levels relative to the goals of the Federal  
4 Telecommunications Act or the state Tele-Competition Act. Indeed, Dr.  
5 Cooper’s own evidence (Exhibit MNC-3 at p. 40) indicates that ILECs in  
6 Florida retain a market share of roughly 92 percent of the residential  
7 customer base in the state. I cannot envision any serious economist who  
8 would conclude that the local exchange market for residential local telephony  
9 is effectively competitive. Clearly, the state needs to pursue policies to more  
10 affirmatively open residential markets to competition and the rebalancing of  
11 rates is a positive step in this regard.

12

13 **Q. FINALLY, HOW DO YOU RESPOND TO DR. COOPER’S LATENT, IF**  
14 **NOT EXPLICIT, PROPOSITION THAT RAISING RATES IS NOT AN**  
15 **APPROPRIATE METHOD FOR INCREASING COMPETITION AND**  
16 **CREATING CONSUMER BENEFITS?**

17 A. I agree that raising rates is not in all circumstances a way for “increasing  
18 competition.” For example, the deregulation of local cable rates in 1984 and  
19 the subsequent increases in rates did not lead to any meaningful increase in  
20 competition. The reason, at least in part, however, for this failure of rate  
21 increases to lead to increased competitiveness was the result of the failure by  
22 policymakers at the time to establish a broader set of competition-enabling  
23 policies. In that case, while rates were deregulated monopoly franchise

1 authority continued. As such, it should certainly not be a surprise that rates  
2 rose and competition did not. Similarly, I must emphasize that absent the  
3 full development and implementation of a set of competition-enabling  
4 policies in Florida, rate increases alone will not achieve Florida's goal of  
5 promoting competition. If, however, the Commission does seek to enable  
6 competition in all of its dimensions, then it must be recognized that retaining  
7 retail residential rates that have been set based on residual pricing principles  
8 has the prospect itself of restraining the emergence of competition. Thus, as  
9 part of a larger strategy of enabling competition, allowing for the prospect of  
10 switched access rate reductions (and the retail rate reductions that ensue)  
11 balanced with local rate rebalancing will promote the goal of increasing  
12 competition in residential telecommunications in Florida.

13 Finally, it is important to bear in mind that, to the extent that  
14 competition for local exchange telephony is enhanced in Florida as a  
15 consequence of the intrastate switched access charge reductions and the  
16 BLTS rebalancing, a dynamic is put in place that will enhance consumers'  
17 choice, put downward pressure on costs and rates, provide incentives for new  
18 competitors to create innovative service offerings and for incumbents to  
19 match this innovative stimuli with new services of their own. These are  
20 known and historically demonstrated benefits of competition. Thus, while  
21 Dr. Cooper prefers to narrowly focus on the aspect of the petition that  
22 involves BLTS increases, there are, in fact, likely to be a variety of

1 competitively-generated beneficial consequences from the approval of the  
2 petitions.

3

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

5 **A. Yes.**

1 **REBUTTAL TESTIMONY OF**

2 **JOHN W. MAYO**

3 **ON BEHALF OF**

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

5 **AND**

6 **MCI WORLDCOM COMMUNICATIONS, INC.**

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

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

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

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

18 A. Yes.

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

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

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

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

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

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

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

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

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



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

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

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

15 Second, a regulatory imposition of a multi-year price cap on the flow-  
16 through is fundamentally at odds with the reality of the competitive provision of  
17 long distance services in Florida. Specifically, it is widely agreed in the economic  
18 policy community that where competition is effective (i.e., there is an absence of  
19 significant monopoly power) the market is capable of ensuring that consumers  
20 will receive a variety benefits as individual firms strive against each other for the  
21 patronage of consumers. These benefits include competitive pricing, new service  
22 innovations, attention to quality, and so on. Importantly, these benefits are  
23 available <sup>without</sup> ~~with~~ the need for any overt governmental regulation of prices. Thus, the  
24 imposition of a multi-year cap as suggested by Mr. Ostrander simply amounts to

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

3

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

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

7

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

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

14

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

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

23 Ostrander's proposal is unnecessarily regulatory because each long

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

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

21

22

23

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

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

6

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

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

11

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

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

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

9

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

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

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

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

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

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

19 A. Yes.

---

<sup>1</sup> [http://www.psc.state.fl.us/general/publications/consumer\\_bulletin/jan03jaber.pdf](http://www.psc.state.fl.us/general/publications/consumer_bulletin/jan03jaber.pdf)

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

1 BY MR. HATCH:

2 Q Dr. Mayo, do you have a summary of your testimony?

3 A Yes, I do.

4 Q Could you please give your summary?

5 A Certainly. Good morning, Madam Chairman, and members  
6 of the Commission.

7 CHAIRMAN JABER: Good morning.

8 A I have been asked in this proceeding by AT&T and MCI  
9 to evaluate the economic merits of the petitions filed by  
10 BellSouth, Verizon, and Sprint under the Tele-Competition  
11 Innovation and Infrastructure Act.

12 Two criteria which are part of the act in particular  
13 are the focus of my testimony. First, whether approval of the  
14 petitions will act to remove support for basic local exchange  
15 telephone service and, second, whether removal of that support  
16 makes entry and the development of local exchange competition  
17 more likely.

18 To frame these issues, it is absolutely essential for  
19 the Commission to recognize not only the immediate statutory  
20 requirements of the Florida Tele-Competition Act, but also the  
21 Federal Telecommunications Act of 1996. That federal act  
22 fundamentally shifts the historical role of state and federal  
23 commissions away from the historical practices of protecting  
24 monopolists from entry and protecting consumers from that  
25 monopolist to one of enabling competition. This shift in the

1 fundamental desire of Congress for commissions to take all  
2 reasonable steps to enable local exchange competition have now  
3 been endorsed by the Supreme Court of the United States.

4           It is also necessary when framing the specific issues  
5 before you to understand the historical context within which  
6 local exchange telephone rates have been set. Specifically,  
7 the traditional rate of return regulation approach to setting  
8 rates established a fair rate of return for local exchange  
9 companies then turned to the issue of rate design. Because  
10 these companies offer multiple services, various combinations  
11 of prices were capable of achieving the same rate of return.  
12 In that context, the common practice of public utility  
13 commissions was to set rates for nonbasic services, such as  
14 long distance, carrier switched access, and vertical features  
15 well in excess of cost and by doing so were able to hold down  
16 the rate for basic exchange service. This practice of  
17 residually pricing local exchange service was thought to be  
18 meritorious because it allowed commissions to pursue the social  
19 policy of promoting universal service.

20           In effect, the practice of residual pricing was very  
21 much like the process of filling a balloon with air and then  
22 squeezing the balloon. How much air went into the balloon was  
23 akin to deciding what the fair rate of return should be. And  
24 then the rates for basic local telephone service were squeezed  
25 down and the pricing of other services expanded. As



1 commissions moved to price cap regulation, nothing really  
2 fundamentally about that pricing structure changed. Prices for  
3 nonbasic services have been kept well above their economically  
4 efficient levels while local residential rates have maintained  
5 at very low levels.

6           So, turning specifically to the issues in the act it  
7 is absolutely unequivocal that a reduction in network switched  
8 access rates and a corresponding revenue neutral adjustment to  
9 local exchange rates will remove support for basic local  
10 telephone service. It is also equally clear that the removal  
11 of this support makes entry more attractive to prospective  
12 entrants and enhances the prospect for the development of a  
13 truly competitive local exchange telephone market.

14           In my rebuttal testimonies I address what are some  
15 confusions that would, I think, but for my testimony possibly  
16 arise in the testimonies of Drs. Gabel and Cooper and Mr.  
17 Ostrander. Drs. Cooper and Gabel both argue that the ILECs  
18 have not shown, nor they suggest have I that a subsidy exists  
19 for basic local service in Florida, and that consequently  
20 without a subsidy no support exists and, therefore, the  
21 petitions should fail. I disagree. And in my rebuttal  
22 testimony, I describe why their arguments should not be relied  
23 upon by the Commission.

24           Specifically, Drs. Gabel and Cooper focus on  
25 demonstrating an absence of subsidy. Their focus on

1 demonstrating an absence of subsidy is misplaced. The  
2 statutory test does not require elimination of a subsidy.  
3 Instead, the statutory requirement speaks of removing current  
4 support for basic local telephone service. In this regard, the  
5 historical practice of residually pricing basic local telephone  
6 service makes it absolutely clear that switched access rates  
7 have been maintained at inefficiently high levels in Florida  
8 for supporting residential basic local telephone service rates  
9 at rates that are lower than would otherwise exist. Thus, Drs.  
10 Gabel and Cooper, I think, misdirect their energies by  
11 focussing on the issue of a pure economic subsidy.

12           Drs. Gabel and Cooper are also incorrect in their  
13 belief that the effects of rebalancing will not be to enhance  
14 entry. In my rebuttal testimony I point out a variety of  
15 misplaced arguments that they make in that regard. The simple  
16 and I believe incontrovertible fact from the prospective of  
17 both economic theory as well as empirical evidence is that  
18 higher retail rates and lower prices for inputs will make this  
19 market more attractive for new entrants.

20           Finally, in my second rebuttal testimony I point out  
21 that Mr. Ostrander's approach to ensuring flow-through of  
22 switched access reductions is extraordinarily heavy-handed in  
23 its regulatory approach, and wildly inconsistent with the  
24 realities of a competitive long distance marketplace. His  
25 approach effectively wishes to reimpose price regulation on a

1 competitive industry for the next six years. This  
2 recommendation, I think, both misreads the statute and is in  
3 contradiction to sound public policymaking in effectively  
4 competitive markets.

5 Mr. Ostrander also seeks to link by regulation the  
6 incidence of long distance price reductions, that is the amount  
7 of long distance reductions flowing to residential and business  
8 customers to the distribution of local rate increases imposed  
9 by the ILECs. This approach, I believe, both misreads the  
10 statute, which explicitly gives the IXC's the right to determine  
11 the specific rates to be decreased, and is a serious violation  
12 of economic efficiency by attempting to divorce through  
13 regulation the way cost changes occur in the long distance  
14 market from the pricing of long distance services. For these  
15 reasons I believe the Commission should not rely in any manner  
16 on the testimony of Mr. Ostrander. Thank you.

17 MR. HATCH: We tender the witness for cross.

18 CHAIRMAN JABER: Companies. Public Counsel. Mr.  
19 Shreve. Mr. Twomey. Staff.

20 MR. FORDHAM: We have a few questions, Madam  
21 Chairman.

22 CROSS EXAMINATION

23 BY MR. FORDHAM:

24 Q Good morning, Dr. Mayo. My name is Lee Fordham.

25 A Good morning, Mr. Fordham.

1 Q We have just a few questions here, sir. First of  
2 all, you have testified that BellSouth, Sprint, and Verizon's  
3 access rates are set above incremental cost, is that correct,  
4 sir?

5 A Yes, sir.

6 Q Now, when access rates are set above incremental  
7 cost, you have testified that this has a negative effect when  
8 competitors bundle local and long distance services, is that  
9 correct, sir?

10 A Yes, I did.

11 Q And would you explain why that is, sir?

12 A I will be happy to. And it may help in that regard  
13 if you will turn with me to my testimony, my direct testimony.  
14 And, I apologize, there is an exhibit which is I am thinking  
15 the second exhibit. One moment. I apologize, it is JWM-3, and  
16 the actual language in this regard is contained on Page 13 of  
17 my direct testimony. But if you will look at JWM-3, it  
18 provides a bit of a visual for you.

19 In JWM-3 what you see on the vertical axis is a fixed  
20 rate, a flat rate for a bundled offering that let's say is  
21 local and long distance. And in that particular case the --  
22 and on the horizontal axis are minutes of use. That are long  
23 distance, let's say, minutes of use. As minutes of use  
24 increase, the RBOC's cost, or the ILEC's cost -- I list it as  
25 an RBOC here, but it applies to any ILEC -- costs go up. The

1 more minutes of use you have the higher are your costs, and  
2 that is reflected in the line that says RBOC costs, associated  
3 with access, with the provision of access. That is their  
4 incremental cost.

5           The charges, however, the price that we just talked  
6 about being above incremental cost to the IXCs is reflected in  
7 the more steeply sloped line called competitors cost with  
8 excessive access charges. The consequence of that is that the  
9 costs rise much more quickly on a minutes of use basis for an  
10 IXC than for the ILEC. Thus, for an RBOC or an ILEC that might  
11 find a bundled offering attractive for any level of output up  
12 to M1 minutes of use, you see that the IXC can only find the  
13 bundled offering competitive to be made for output levels up to  
14 M2. Thereby either restricting the nature of the bundled  
15 offering that they could make, or raising the entire price of  
16 the bundle. So, in that sense I think it provides a nice  
17 visual impression of why the excessive access charges restrict  
18 the ability of the IXCs to competitively drive down prices of  
19 bundles.

20           Q     Thank you. Following through a little bit, you  
21 stated in your direct testimony on Page 14, I think Lines 1  
22 through 4, and I quote, "To the extent that the competitive  
23 standards for telecommunications service is evolving more  
24 toward and all distance format, reductions in the carrier  
25 access charge will afford new entrants an improved opportunity

1 to enter the market and compete."

2 Now, you are referring there, Dr. Mayo, to new  
3 entrants in the market for bundled services, local and long  
4 distance bundled services, is that correct, sir?

5 A Yes, sir.

6 Q Now, would the opportunity to provide bundled  
7 services at lower access charge rates indirectly at least lead  
8 to new market entry into local services, or would the benefits  
9 be strictly in switched access competition?

10 A It would actually be in both. I am speaking here  
11 addressing the bundled issue, but it actually applies to both,  
12 both a stand-alone offering on a local exchange service or a  
13 bundled offering.

14 Q Okay. Thank you. On Page 11 of your rebuttal  
15 testimony, beginning at Line 22, you said you agree with Dr.  
16 Gabel's statement that, "A rise in total revenues may not be  
17 sufficient to allow new entrants to overcome existing  
18 barriers." Is that correct, sir?

19 A That is correct.

20 Q But then you go on to qualify that by saying, "The  
21 fact is, however, that the rebalancing unequivocally enhances  
22 the likelihood that whatever existing barriers are in place  
23 will be overcome, thus it seems poor justification for not  
24 moving forward with a policy that enhances the prospects for  
25 entry based on the fear that it might not create as much new

1 entry as might be ideally desired."

2 Now, if the rise in revenues after rebalancing are  
3 not sufficient to allow new entrants to overcome existing  
4 barriers, then how can rebalancing enhance the likelihood that  
5 these barriers will be overcome?

6 A Well, I think the premise of your sentence in your  
7 question was that the rise in revenues is not sufficient to  
8 overcome the barriers, so in that assumption, then how will it  
9 enhance market entry. And I think you have answered it in its  
10 own question. The question answers itself. But let me try and  
11 explain.

12 There is a discussion in Dr. Gabel's testimony about  
13 what I think is a very real issue, and that is that the entry  
14 decision is not simply based on the issues at hand in this  
15 particular proceeding. Entry is a multi-faceted phenomenon.  
16 It is going to be driven by a lot of things. Obviously, the  
17 likelihood of profit is the driving force, and the actions  
18 taken by approval of this particular petition or set of  
19 petitions will enhance that profitability making entry more  
20 likely.

21 There are other factors that new entrants will be  
22 considering. The ability to come into the market and have  
23 access to the same level of quality of service of the  
24 underlying wholesale services on a nondiscriminatory basis, to  
25 be able to have access to economically efficient pricing of

1 UNEs, of the UNE-P and so on. So those are real issues, but  
2 what I am suggesting is the fact that there are those real  
3 issues, and they too need to be addressed by the Commission, is  
4 not a sufficient ground for saying, oh, no, let's deny this  
5 petition because there are other areas that do represent  
6 challenges for new entrants. This approval unequivocally moves  
7 us toward making entry more likely, not less likely.

8 Q Okay. We have had discussions with other witnesses,  
9 sir, on elasticity of demand, but let me ask you just one  
10 question and then we will leave that. On Page 16 of your  
11 direct testimony, Lines 15 through 19, you indicate --

12 A If you will bear with me just one second. You are  
13 faster than I am.

14 Q I'm sorry, go ahead, sir.

15 A The direct testimony at Page 16?

16 Q Correct.

17 A Okay.

18 Q Starting at Line 15. You are discussing elasticity  
19 of demand, and you indicate that recent empirical estimates for  
20 the price elasticity of demand for access is exceedingly small  
21 and actually approaching zero in value. Now, in your opinion,  
22 does that simply mean that rebalancing will cause only a very  
23 small number of customers to drop telephone service?

24 A That is absolutely true, and it is especially true in  
25 the context -- in a broader context of not simply that the



1 price elasticity of demand is low, but that there are also a  
2 variety of protections built in for the people that are most  
3 likely to demonstrate any elasticity whatsoever, that is to  
4 drop off in the form of the expansion of Lifeline services that  
5 are envisioned in the statute, and I would envision it being  
6 part of the approval of this petition or these petitions.

7 Q Okay. Just one more subject area, sir. In  
8 Section 364.164, that is the subject of these hearings, it  
9 requires that an ILEC's petition be revenue neutral for the  
10 ILEC. Now, the next questions concern that, the granting these  
11 petitions might have on a UNE-P based CLEC. So let's have just  
12 a couple of questions on those, and I think that will be all.  
13 If the ILECs' petitions are approved, would you agree that a  
14 UNE-P based CLEC would be able to increase its residential  
15 monthly rate in like fashion?

16 A It would initially, yes. In the longer run, and I  
17 don't know how long the longer run is, the idea of doing so  
18 would be to create a dynamic pressure in the marketplace on the  
19 incumbent firms, the ILECs that would then at some point create  
20 downward pressures on those local rates. But in the shortest  
21 of runs, the answer is yes, it would create an opportunity to  
22 have a higher price for the CLEC.

23 Q And would you agree, sir, that market forces would be  
24 inadequate to force the UNE-P based CLEC to lower the  
25 terminating access rates that it charges?

1 A Yes.

2 Q Now, to the extent that the UNE-P based CLEC does not  
3 provide bundled local and long distance service, do you agree  
4 that the CLEC would charge IXCs originating access fees?

5 A Yes.

6 Q And would you also agree, sir, that the market forces  
7 would necessitate that the UNE-P based CLEC lower its  
8 originating access rates to roughly the same levels as the  
9 ILEC?

10 A Yes.

11 Q Now, based on these factors, these past few  
12 questions, do you agree that the UNE-P based CLEC's total  
13 revenue when placed on a per end user basis would be higher if  
14 the ILECs' petitions are approved?

15 A Yes.

16 Q Would you also agree, sir, that for the CLEC that  
17 provides bundled local and long distance service, the cost of  
18 terminating long distance calls placed by those end users would  
19 be lower?

20 A Yes, I do.

21 Q And is it also correct, sir, that the CLEC's risk  
22 would decrease if the ILECs' petitions are approved?

23 A It actually depends on the specific meaning of the  
24 term risk, but I will generally agree with you in the sense  
25 that your costs are going down, your likely revenues are going

1 up, the likely profit from entering the market at least  
2 initially is higher, it makes it more attractive to enter the  
3 market as suggested by Knology and a variety of other folks.  
4 So in that sense, I think the risk of market entry is reduced.

5 MR. FORDHAM: Thank you, Dr. Mayo. No further  
6 questions.

7 CHAIRMAN JABER: Dr. Mayo, I just have a  
8 implementation question, and it is really not from your  
9 testimony, but something I found in the MCI witness' testimony,  
10 Mr. Guepe. How do you pronounce it?

11 MS. McNULTY: AT&T's testimony, Mr. Guepe.

12 THE WITNESS: Okay.

13 CHAIRMAN JABER: No, I'm sorry, I'm looking at Mr.  
14 Dunbar's testimony.

15 MS. McNULTY: Okay.

16 CHAIRMAN JABER: And in his testimony he concedes  
17 that MCI would support the IXCs' filing concurrently with the  
18 LEC access reduction if MCI is given 60 days to implement the  
19 rate changes. And my question is simply does AT&T have the  
20 same position, and if you are not the right witness to address  
21 that, I can hold onto that question.

22 THE WITNESS: I can't speak for AT&T. You will have  
23 to ask an AT&T witness that. I'm sorry.

24 CHAIRMAN JABER: Mr. Hatch, I looked all over for a  
25 similar statement. I didn't really know who to ask that of.

1 MR. HATCH: That would be Mr. Guepe.

2 CHAIRMAN JABER: Commissioners, do you have any other  
3 questions?

4 COMMISSIONER BRADLEY: I have several.

5 CHAIRMAN JABER: Commissioner Bradley, Davidson, and  
6 then Deason.

7 COMMISSIONER BRADLEY: Thank you, Madam Chair. First  
8 of all, an observation in that no one either from the industry,  
9 from the telecommunications industry that is, or any of the  
10 consumer advocates had any questions of you. That is  
11 interesting.

12 THE WITNESS: I can only assume that it is their  
13 version of a Christmas present to me. But the reality is they  
14 may just be tired from last night. A long day yesterday.

15 COMMISSIONER BRADLEY: Well, that is still a very  
16 interesting observation on my part, because we have been here  
17 for a couple of days now. This is the third day, and most  
18 witnesses have been grilled, and I am just -- it is interesting  
19 that only staff had questions. And I don't know if that means  
20 that there is agreement with your positions or what, but let me  
21 ask this question. Is your basic position that you support  
22 rate rebalancing based upon the theories, your hypotheses, and  
23 your supporting argument?

24 THE WITNESS: Yes, I do. I think the petitions are  
25 in the public interest. I think they are consistent with the

1 statute, and they are consistent with good economics. I think  
2 it will enhance the likelihood of moving us toward something  
3 that at a national level and at a state level we all, I think,  
4 desire. And that is to see the emergence of competition in  
5 telephony. It will enhance that and that is a good thing for  
6 everybody.

7           COMMISSIONER BRADLEY: You used the statement moving  
8 us forward. Can you expound a little bit. I'm really  
9 interested, because I have been reading your background. You  
10 are the Dean of the School of Business at Georgetown University  
11 in Washington D.C., is that true?

12           THE WITNESS: Yes, sir.

13           COMMISSIONER BRADLEY: And you also have taught  
14 economics, business, and public policy courses at Georgetown  
15 University, Washington University, Webster University, the  
16 University of Tennessee, and at Virginia Tech. And you also  
17 have served as the chief economist democratic staff of the U.S.  
18 Senate Small Business Committee?

19           THE WITNESS: Yes, sir.

20           COMMISSIONER BRADLEY: You do have an extensive  
21 background. Moving forward, and I know that in America, in  
22 this great country that we all reside within, there are a  
23 couple of schools of thought which makes this country great.  
24 Some folks want to maintain the status quo, keep things the way  
25 they are because of obvious reasons. They are comfortable and

1 they understand that system. Some folks want to move things  
2 forward and do it in a very radical way, in a very radical  
3 fashion, but I don't see what you have presented to us as being  
4 radical. I probably as an observation would state that my  
5 opinion is that you are somewhere in the middle. You are  
6 forward moving, but in the spirit of what America is all about,  
7 making progress. In order for -- my question is this, in order  
8 for America to remain in the forefront of the  
9 telecommunications -- I wouldn't say industry, but the  
10 telecommunication field, is it your opinion that we need not  
11 stay on the same page that we are on today, but that we need to  
12 move forward and be progressive in order to maintain our  
13 position in the order, world order as it relates to the  
14 development of new technology and the expansion of new and  
15 expanded concepts as it relates to telecommunications, and this  
16 rate rebalancing moves us in that direction? I am just  
17 interested in hearing your comments.

18 THE WITNESS: Yes, sir. I think the answer is yes.  
19 And what I have seen, and I have tried to pay a lot of  
20 attention over the last couple of days to the tensions that  
21 have arisen, the natural intellectual tensions in this case,  
22 and they seem to be a very honest tension. The tension is, I  
23 believe, and I may be misreading, but I believe every single  
24 Commissioner would like to move us forward in promoting  
25 competition in Florida. At the same time, there is a very

1 legitimate and real concern that says how are we going to do  
2 this in a way that does not in any substantive way harm real  
3 people. And that is a very legitimate tension.

4           What I am suggesting, I think, I would like to  
5 believe is a way to both move us forward in the form of  
6 advancing competition, but to do so in a way that is  
7 sympathetic and responsive to society's desires to not harm  
8 individual members of society. There was a -- if you will  
9 allow me, there was a book written several years ago now, the  
10 title of which was called "Hard Heads, Soft Hearts." And it  
11 was written by a professor named Allen Blinder (phonetic) at  
12 Princeton University, who argued that all too often one  
13 particular political party -- I won't say which, you can figure  
14 it out -- advocated policies that were hardheaded, but  
15 hardhearted. And another political party offered policies that  
16 were all too often soft hearted, but also soft headed. And  
17 that what we needed in this country were a set of policies that  
18 were hardheaded, but softhearted. I like that. I think this  
19 can be accomplished.

20           The ability of this Commission to target assistance  
21 to those people who are most at risk of being harmed by and  
22 would drop off the network if faced with the full brunt of the  
23 local price increase is a good thing. Targeted assistance to  
24 those people who are in need of that assistance is something I  
25 wholeheartedly endorse. I have been endorsing that for a long

1 time now in both my writing as a matter of theory, and it turns  
2 out as a matter of empirical reality it turns out to be far  
3 more effective in terms of promoting the goal of universal  
4 service. So I think we can do both and move us forward.

5 COMMISSIONER BRADLEY: One other question. As a  
6 person who is an expert in public policy, can you define or  
7 give me an example of -- give me a definition of what you  
8 consider good public policy to be. And I have heard some  
9 things, but I want to ask that question specifically.

10 THE WITNESS: Well, you are going to hear my position  
11 as an economist, and that is that what you would like to do in  
12 considering any particular public policy is to promote a  
13 particular set of objectives as efficiently as possible. In  
14 this particular case what I would say the objective would be to  
15 promote the goal of enhancing competition, but to do so with  
16 the constraint of not leaving members of society behind. And  
17 to accomplish those two objectives as efficiently as possible.  
18 To not waste society's resources in doing that. That I think  
19 is the goal here. That is the goal that underlies my testimony  
20 at any rate.

21 COMMISSIONER BRADLEY: Thank you.

22 CHAIRMAN JABER: Commissioner Davidson.

23 COMMISSIONER DAVIDSON: Thank you, Chairman. Some  
24 economists have traced the origin of the economic subsidy being  
25 discussed here to the nascency of wireline telephony. The



1 build-out of the network occurred at the local level, circuit  
2 switches were deployed in cities, those cities had to be then  
3 connected. States had to be connected, et cetera. That whole  
4 process according to this argument required a market leader,  
5 which was American Telephone and Telegraph. In this context,  
6 the discussion continues that social policies sought to ensure  
7 that every Aunt Bee in every Mayberry across America had local  
8 phone service that was affordable. And to keep that phone  
9 service affordable, James Bond paid what would be considered  
10 supracompetitive prices for long distance service. Does that  
11 argument or discussion in your mind have merit or no merit?

12 THE WITNESS: Well, I think it is a relatively  
13 accurate description of history of the evolution of the policy.  
14 The sense has always been that when I was growing up and we  
15 were all growing up, we remember that there was a long distance  
16 call from someone, some aunt or some relative, and they would  
17 say, oh, it is Aunt MC. And I would watch my parents almost  
18 run across the room to have to get that phone because you  
19 didn't want to waste that precious time because you knew you  
20 were being charged a lot for it. That was considered, if you  
21 will, a luxury item.

22 Today I think it is just absolutely as plain as the  
23 nose on our faces that long distance and local, what were  
24 called long distance and local are not luxury items anymore.  
25 Long distance is certainly not a luxury item anymore. The

1 notion of being able to at this point in time in our history to  
2 be able to begin to price those services to reflect their  
3 actual cost, I think, is something that society is ready for.  
4 And we have seen that happen in variety of state jurisdictions  
5 and the federal jurisdiction without deleterious effects. So I  
6 think we can -- your description is not inaccurate, I just  
7 don't know that I think we need to continue that practice.

8           COMMISSIONER DAVIDSON: If you know, how did the  
9 economic subsidy remain in place with first the breakup of AT&T  
10 and then the breakup of the RBOCs?

11           THE WITNESS: Of course, initially it was an internal  
12 intra-company transfer within the AT&T system between the Bell  
13 Operating Companies and what was referred to as AT&T long lines  
14 through what was called separations and settlements. There  
15 were a variety of transfer payments made to support local basic  
16 telephone service. At the time of the divestiture there was a  
17 great deal of angst about whether those two entities, the RBOCs  
18 on one hand and AT&T on the other could stand on their own  
19 bottoms, so to speak.

20           And the judgment was made that without a perpetuation  
21 or a continuation of an equivalent amount of revenue flows that  
22 had been going through separations and settlements, that the  
23 local exchange companies would be forced to raise prices  
24 dramatically. So a system of access charges was created that  
25 effectively made intercompany payments at the same levels that

1 were the old intracompany payment levels.

2 Now those have been, those intercompany payments,  
3 access charges, have at the federal level been reduced pretty  
4 dramatically over the last 17 years or so. 19 years, I'm  
5 sorry. And in many states have been, as well. But those  
6 charges continue to exist at rates well in excess of their  
7 economic or incremental cost.

8 COMMISSIONER DAVIDSON: What is a supercompetitive  
9 price as compared to a supracompetitive price?

10 THE WITNESS: Let me take the issue of  
11 supracompetitive price. The notion of a supracompetitive  
12 price, I think, would be -- both from an economic and, I think,  
13 a lay perspective be a price that could not be achieved in an  
14 effectively competitive market. That is a price level that  
15 would be sustainable by providers in a marketplace, a provider  
16 or providers in a marketplace that was above those sustainable  
17 and in an effectively competitive market. Turning to the  
18 latter, a supercompetitive price, I am afraid I don't know that  
19 term. I can only imagine it is a really good price, but I just  
20 don't know what that is.

21 COMMISSIONER DAVIDSON: Well, it is a term used in a  
22 predatory pricing context. That it is a very, very low price,  
23 but one designed -- it is very low and one designed to obtain  
24 market share tending toward a monopoly, and once the firm  
25 engaging in supercompetitive pricing attains market power it

1 then locks in its ability to charge --

2 THE WITNESS: If by supercompetitive you mean beyond  
3 the bounds of, as in super or beyond extracompetitive in the  
4 sense of going beyond competitive pricing, then I will agree  
5 with your description.

6 COMMISSIONER DAVIDSON: In the long run, in your  
7 opinion, what will best maximize consumer welfare, the current  
8 pricing of the local loop and the local market, which is  
9 alleged to be below cost, or competitive pricing, whatever that  
10 pricing may be? And if you could explain the basis for your  
11 answer.

12 THE WITNESS: I think the answer is unequivocally the  
13 prices that would be achieved in a competitive marketplace as  
14 opposed to a set of prices that would be perpetuated which have  
15 been distorted over time, and which at this point in time are  
16 creating distortions not simply in the form of simple -- I will  
17 call it welfare losses of consumer loss. There was some  
18 discussion of gains. There is a simple gain from reducing long  
19 distance prices which have a large elasticity to them that  
20 outweigh the losses that would be inflicted by raising prices  
21 to local service. So there is an immediate gain, but I think  
22 that misses a larger dynamic. The larger dynamic is that if by  
23 doing this, by adjusting these prices and through a whole host,  
24 I think, of complimentary activities that this Commission could  
25 engage in to truly enable local exchange competition, this

1 market gets open to effective competition, then it is  
2 unequivocal that consumers of Florida are going to win by  
3 having more choices, higher quality, greater innovation,  
4 downward pressure on cost, lower price bundles, the ability of  
5 all competitors to begin to compete on effectively equal  
6 grounds instead of setting the IXC cost at ten times the real  
7 price, or the real cost imposed on the ILECs for providing that  
8 interexchange access. So there are a host of benefits, I  
9 think, in the long run.

10           COMMISSIONER DAVIDSON: Assume that the Commission  
11 agrees with the theory underlying elimination of economic  
12 subsidies in a competitive market in a general sense. Assume  
13 that we agree with that theory, as I for one do. What is the  
14 most economically rational way and effective way to protect  
15 those consumers in the state who are economically  
16 disadvantaged?

17           THE WITNESS: That is a good question. I think it  
18 goes back to the discussion I was having with Commissioner  
19 Bradley a moment ago. As a general economic proposition, if we  
20 need to have a subsidy, the economics are very simple and  
21 clear. Instead of a system that collects the subsidy from a  
22 narrow source, in this case the interexchange industry, and  
23 distributes it very broadly to all consumers in the State of  
24 Florida, including the multimillionaires that live in West Palm  
25 Beach, we should instead collect the subsidy very broadly and

1 target it very narrowly. That is to target it to those people  
2 who are most in need. And actually if we do that we can be  
3 very generous toward those people, much more generous than we  
4 are today.

5 COMMISSIONER DAVIDSON: I have no further questions.  
6 Thank you, Chairman.

7 COMMISSIONER DEASON: Madam Chairman, I had two  
8 questions. First, I was going to ask the witness if he was  
9 either hardheaded or hardhearted, and that one has already been  
10 answered. The real question that I have is in your exchange  
11 with Mr. Fordham there was a question concerning the  
12 possibility that the CLECs, if we do rebalance, the CLECs may  
13 have the ability to have greater total revenue than the  
14 incumbents. Total revenue, I guess, would be also the effect  
15 of access charges as part of that calculation. I may have  
16 misinterpreted the question and the answer, I just need some  
17 clarification on that if you could help me, please.

18 THE WITNESS: Thank you. I did not understand our  
19 discussion to suggest, nor did I intend to suggest that the  
20 CLECs would have greater revenues than the incumbent.

21 COMMISSIONER DEASON: Okay. Well, I misunderstood.

22 THE WITNESS: What was the case is that they will  
23 have greater revenues than would exist if the petitions were  
24 denied. And I apologize if I misspoke earlier.

25 COMMISSIONER DEASON: No, I probably just

1 misunderstood. My apology. So it is just a -- it's not a  
2 comparison of revenue between CLECs and ILECs, it is a question  
3 of revenues before or after rebalancing?

4 THE WITNESS: Correct.

5 COMMISSIONER DEASON: Okay. Thank you.

6 CHAIRMAN JABER: Commissioner Baez, you said you had  
7 a question?

8 COMMISSIONER BAEZ: Thank you, Madam Chair. Dr.  
9 Mayo, first a simple question. You implied in your summary  
10 that there is a difference, you characterized what exists --  
11 the condition that exists now as support rather than subsidy,  
12 and I'm trying to understand what you mean by that, what the  
13 difference is.

14 THE WITNESS: Sure. The distinction I was drawing is  
15 this, that as I watch the debate unfold in this case between  
16 the testimonies of the ILEC witnesses, and those of OPC and  
17 AARP, there was a debate about the existence of a subsidy. And  
18 we could take that on its own merits, but as I looked at the  
19 statute, the statute does not speak of a subsidy, removing a  
20 subsidy. It speaks of removing support. And everything about  
21 my understanding of this industry, both in general and with  
22 respect to specifically the evolution a prices in Florida, it  
23 is my understanding that the practice of residually pricing  
24 local exchange service has led to a situation where high access  
25 charges, in fact, do lead to -- have been used to support lower

1 basic exchange rates. And that removing that support, reducing  
2 carrier access charges to their competitive level, or to an  
3 economically efficient level, removes that support.

4           So that is why I chose to focus on the term support.  
5 I would suggest that if over in the realm of subsidy that if  
6 you accept the proposition that there are subsidies, then I  
7 think it holds a fortiori that subsidy, that a support exists.  
8 But I thought the debate was in some ways just simply  
9 misplaced. You may care to take it on the grounds of subsidy,  
10 I think it is more simple than has been portrayed.

11           COMMISSIONER BAEZ: As a practical matter, though,  
12 the movement is the same.

13           THE WITNESS: Correct.

14           COMMISSIONER BAEZ: Okay. I want to talk a little  
15 bit about this hardheaded, softhearted part. And I would ask  
16 you with what -- from what you know and what you have been able  
17 to gather from the petitions that we have before us, the  
18 proposals, in your opinion is there enough softheartedness, if  
19 you will, and what all that entails. Is there enough  
20 softheartedness in your opinion as part of these proposals?

21           THE WITNESS: Let me tell you what is there and I am  
22 encouraged by, and then let me suggest where I think, again,  
23 the boundaries are that if I were in your chair I would be  
24 thinking about. I am encouraged by the notion in the statute  
25 that the current Lifeline consumers are insulated from any



1 local price increase. I am encouraged by the expansion of that  
2 set of Lifeline consumers in terms of the eligibility up to 125  
3 percent of the poverty rate relative to today's eligibility  
4 criteria. So the eligibility criteria are expanded. Those  
5 encourage me. And I feel as if that is likely to be plenty  
6 softhearted. But if I were on the margin, what I would be  
7 debating is actually something -- and I was encouraged by your  
8 discussion that surfaced yesterday about the notion of saying,  
9 well, if we aren't satisfied enough that there is not enough  
10 softheartedness in this, that we want to go beyond the  
11 statutory requirements and look at expanding the eligibility  
12 criteria further. That still remains a targeted system, but  
13 goes beyond the 125 percent level to 135 percent, or 133, or  
14 some of the numbers that were floating around. I think that  
15 helps. That helps create a greater softheartedness without  
16 giving up the hardheadedness of moving forward on competition.

17 I also will tell you that one of the things I have  
18 struggled with is that -- and I wish I had time to do the  
19 research paper, I'm sorry I haven't. I wish I could be more  
20 educated about this. But historically, the take rates, if you  
21 will, of people that are eligible for Lifeline service and  
22 Link-up service has been quite low. And it is low not only in  
23 Florida, but across the country.

24 There is some cross-sectional variation. California  
25 has the highest, but even there it is relatively low, 20

1 percent or so, I think, were the last numbers I looked at. So  
2 even with an expansion of the eligibility criteria, you have  
3 still got let's call it somewhere between 80 and 90, 95 percent  
4 of the people that are eligible for that relief from the public  
5 policy perspective not taking it. And I don't honestly know  
6 why. There is some language in the legislation that encourages  
7 the Commission to engage in activities to accelerate those take  
8 rates. And I guess I would be thinking about doubling up on my  
9 efforts in that regard. I can't tell you precisely what the  
10 empirical determinants are of those take rates. I haven't done  
11 the study, I would love to. But that is where I would be  
12 looking.

13 COMMISSIONER BAEZ: And I would agree with you on  
14 that. The proposals and those aspects of softheartedness, I  
15 guess, now that is the concept we are going to deal with, what  
16 we are calling it, those aspects that are in the proposals have  
17 a definite termination. Would you agree with that?

18 THE WITNESS: That is my understanding.

19 COMMISSIONER BAEZ: How can you reconcile your  
20 encouragement with rational economic behavior beyond those  
21 points? I mean, I guess what I'm trying to get at is it long  
22 enough, is there a point in which these policies or these  
23 efforts have to say, well, caution to the winds. You know, I  
24 mean, now everybody gets thrown into the same pot.

25 THE WITNESS: You've got, I think, and I don't want

1 to mischaracterize the ILECs' testimony, but I think they were  
2 talking about a four-year window roughly.

3 COMMISSIONER BAEZ: Yes.

4 THE WITNESS: Okay. It was a four-year window, and  
5 at some point it terminates and there is the ability at that  
6 point, or the possibility that Lifeline customers may face  
7 increases at that point.

8 COMMISSIONER BAEZ: And understand the source, the  
9 impetus for my question is not any knowledge I have, or any  
10 intention certainly that the companies -- they have always been  
11 very candid about revisiting it at some point and so on. But I  
12 guess since the softheartedness of all of this, that that  
13 responsibility sort of falls on us because rational economic  
14 entities aren't responsibility for that, in essence.

15 THE WITNESS: In that sense, I think I would add a  
16 third item to my list of things that you might be thinking  
17 about, though I'm not sure I would impose it at this moment. I  
18 might say that you would be committed to revisit as necessary  
19 that issue of extending that. You know, I would keep an eye on  
20 the marketplace. If this becomes a robustly competitive market  
21 where all providers, including Lifeline consumers, have  
22 options, then it may, may not be necessary to impose that. But  
23 certainly I would, if I were you, keep my eye on that one.

24 COMMISSIONER BAEZ: And one last question. Going  
25 back to something you said before, and I think something that

1 we have at least accepted as true. Somehow you have -- even I  
2 have implied that the responsibility for this type of policy  
3 aspect, or this type of goal falls mainly on the Commission,  
4 yet whether it is limited by the legislation itself, or perhaps  
5 by what our authority may be pursuant to that, which I don't  
6 think we have defined truly, but if it is our responsibility,  
7 what are the tools that you would know of, or that may be  
8 familiar to you in order that we discharge our responsibility?  
9 Or is there a -- is there a way of shifting or holding the  
10 petitioners accountable for implementing what our  
11 responsibility is? Is it appropriate and how would you go  
12 about that? I know there is like five questions in there, but  
13 --

14 THE WITNESS: It's sort of a broad question, but let  
15 me give you the example of -- and maybe this gets at it. Take  
16 the issue of the take rates. Well, you could say, okay, to the  
17 ILEC industry, okay, guys, go do that. Go improve your take  
18 rates. And just go on about the rest of your business and hope  
19 they do it. You could alternatively adopt a somewhat more  
20 activist role in partnering with the ILEC industry and saying  
21 let's sit down and think about this together. And I don't know  
22 that I would disagree with the latter approach. So far I am  
23 disappointed by the take rates. We may be letting folks fall  
24 through the crack because they simply don't know of the  
25 existence of Lifeline program or Link-up program. And that

1 seems to me to be unacceptable. And I'm not meaning to suggest  
2 that the ILECs, Sprint, Verizon, and BellSouth, have  
3 purposefully in some sense sought to minimize those take rates.  
4 That is not what I am suggesting at all.

5 COMMISSIONER BAEZ: No, and I am not suggesting that  
6 either.

7 THE WITNESS: But I am simply suggesting that an  
8 activist partnership that does involve you, and I won't  
9 prejudge what tools you have at your disposal, but I think that  
10 partnership might be very promising.

11 COMMISSIONER BAEZ: Thank you.

12 CHAIRMAN JABER: Dr. Mayo, I knew if you talked long  
13 enough I may have a follow-up question for you. Based on your  
14 expertise, is it completely unheard of from an economic  
15 standpoint to think you could reach a level of competition such  
16 that universal service isn't needed at all?

17 THE WITNESS: Yes.

18 CHAIRMAN JABER: It is unheard of?

19 THE WITNESS: I'm sorry. I apologize. It is  
20 certainly conceivable that we might get to a point where  
21 competition satisfies our society's need for universal service.  
22 I think that it certainly may happen.

23 CHAIRMAN JABER: And in that regard, could it be,  
24 based on economic theory, that the Lifeline rates are what they  
25 are because for whatever reason the people that haven't

1 subscribed to Lifeline have found phone service thus far  
2 affordable?

3 THE WITNESS: Yes. That is one of the issues -- I'm  
4 sorry, what I understand you to be asking is is it possible  
5 that those people who are eligible for Lifeline service  
6 nonetheless do not subscribe to that Lifeline service, do not  
7 do so because it is still a pretty good deal, the answer I  
8 think is yes. And a way to think about this is to compare the  
9 amount of money that people spend on telephone service relative  
10 to their income. In Florida, the per capita income for the  
11 medium -- I'm sorry, the medium income for a family of four is  
12 about \$57,000 a year. That means that if you take typical  
13 rates in Florida, that consumers spend less than 4/10ths of one  
14 percent of their income on telephone service today. After this  
15 petition they will still spend less than 4/10ths of one percent  
16 of their income on telephone service. Now, if you knock that  
17 down and you say, okay, what about the folks making \$30,000 a  
18 year? Well, you are still talking about people spending  
19 7/10ths of one percent of their income a year, or something  
20 like that. So it is still a very small fraction. And  
21 competitive alternatives we hope are going to be happening that  
22 create choices for consumers that make them better off.

23 CHAIRMAN JABER: The reason I bring that up is,  
24 again, focusing on hard heads and soft hearts as the title of  
25 book, candidly what I struggle with is looking at increasing

1 take rates for Lifeline as a good thing. I have been  
2 struggling with that, and that has been a problem of mine for  
3 years now having been on the joint board for universal service,  
4 and just as the federal -- as the FCC looks at redoing all of  
5 the federal programs. I don't know that the goal from a  
6 policymaking standpoint should be get more people on the  
7 universal service program and looking at taking care of  
8 expanding eligibility for Lifeline as a social goal as opposed  
9 to looking for alternatives that eventually remove people from  
10 those programs. I think that is a better place to be as a  
11 policymaker. And I struggle with that as it relates to this  
12 case knowing what the appropriate price level and moving us  
13 forward should be without encouraging more participation in the  
14 universal service programs. Can you help me understand what I  
15 should look at in trying to figure out what that price level is  
16 and how to allocate increases and reductions knowing that my  
17 goal is to provide an environment that facilitates a  
18 competitive framework without making Florida ratepayers  
19 contribute more to a universal service program. That is a lot,  
20 but that is where I am.

21 THE WITNESS: Let me take the first part of your  
22 question, because I think you raise a very good point. I would  
23 not suggest that the goal necessarily should be to increase  
24 take rates. The goal, I think, is to allow for people not to  
25 be harmed if they so choose. And in that regard, the two key

1 things that I think I might focus on is making sure that  
2 information is available to consumers regarding  
3 Lifeline/Link-up and other outreach programs. If you were to  
4 go beyond the tools available to this Commission, you would  
5 like to say for people who are impoverished you would like to  
6 let them know generally about the outreach efforts that are  
7 available by all elements of society. It turns out that the  
8 take rates in food stamps and other social services are  
9 similarly low, by the way. So, I think making information  
10 available to people is a goal, because without information you  
11 can't get good public policy. People will make bad decisions  
12 if they don't get information. They may still make bad  
13 choices, but getting information is a necessary condition.

14           And the second thing I think I would do is focus on  
15 reducing the administrative burden to those individuals and not  
16 put up institutional barriers to take services that are  
17 available. Once you have done that, if people choose for their  
18 own particular reasons to not avail themselves of those social  
19 services, then I think I would feel comfortable knowing that  
20 take rates aren't so high. So that really dealt with the first  
21 part of your question. If there was more in the latter part,  
22 you might want to help me.

23           CHAIRMAN JABER: I don't think you can.

24           THE WITNESS: Okay. A longer discussion.

25           CHAIRMAN JABER: Commissioners, any other questions?



1 Commissioner Davidson and then Commission Bradley.

2           COMMISSIONER DAVIDSON: Thank you, Chairman. I view  
3 my goal as a regulator in this process to try and make sure  
4 that if an economically disadvantaged person cannot afford the  
5 competitive price, that we somehow get whatever group of  
6 persons are encompassed in a position to afford that  
7 competitive price. I agree with the Chairman wholeheartedly  
8 that we don't necessarily want to extend subscribership in a  
9 social program, however, we do want to make sure folks can  
10 afford what is a competitive price. My own philosophy is that  
11 some type of direct economic subsidy as would be provided  
12 through Lifeline/Link-up is more of an economically rational  
13 way to deal with the issue than with tweaking of price levels.  
14 That is something I just don't want to engage in. I don't know  
15 that contributes to market development. Can you comment on  
16 what is the best approach in your opinion to get to the support  
17 needed for economically disadvantaged persons? Should we work  
18 on sort of price issues or should we work on the economic  
19 subsidy support issue?

20           THE WITNESS: Two things. One, I agree with you  
21 regarding the merits of targeted assistance versus untargeted  
22 assistance, both as a matter of economic theory that I  
23 described earlier. It is economically more efficient as a  
24 theoretical proposition to target the assistance where it is  
25 needed and to collect it from as broad a base as is possible,

1 because that creates -- whatever tax is necessary, whatever  
2 funds are necessary, then don't impose distortions on society.  
3 They minimize the distortions to society and you maximize the  
4 benefit to those people you really want to help. As opposed to  
5 the way we have done it, which is the opposite, which is target  
6 the tax on the interexchange or long distance user and create a  
7 benefit for everybody. To distribute that benefit to  
8 everybody, a lot of people who do not need that subsidy to  
9 subscribe to telephone service. So, as a matter of economic  
10 theory, that is the smart way to go. Also, and I will point to  
11 a study that I did in the Journal of Law and Economics in 1998,  
12 and it is in my testimony, it was cited in my testimony that  
13 looks empirically at the effectiveness of targeted mechanisms  
14 like Lifeline and Link-up relative to untargeted mechanisms  
15 like the universal fund, or the high cost fund. And it finds  
16 empirically that the targeted mechanisms are as a very  
17 practical matter much for effective, not inconsistent with  
18 economic theory.

19           The second thing I would say is, and it sort of  
20 transitions back to -- it hits both your issue and something  
21 that Commissioner Jaber noted. I would keep in mind the  
22 following, that to the extent that you are thinking about a  
23 targeted assistance, this is not -- there is an extra reason to  
24 do that. It is not simply helping that one individual or  
25 household that is economically disadvantaged. It goes to your

1 question, Commissioner Jaber, of saying how do you help all of  
2 society. Well, in telecommunications there something called a  
3 network externality. It helps society to have us all hooked up  
4 on the network. It helps that poor family to be able to  
5 receive a call from a perspective employer that might get him  
6 or her out of poverty. It helps in a variety of ways. It  
7 helps society, so there is an external benefit that is derived  
8 beyond the strict monetary benefit to that particular  
9 individual associated with that targeted assistance program.  
10 So it starts to begin to do what you can do at this Commission  
11 to elevate this broader social goal of society.

12 COMMISSIONER DAVIDSON: Are you aware, Dr. Mayo, that  
13 the local exchange companies' petitions ask for a certain level  
14 of local rate increase associated with flow-through reductions  
15 for 2004, 2005, 2006, each of three years?

16 THE WITNESS: Yes.

17 COMMISSIONER DAVIDSON: Following up on Commissioner  
18 Baez's focus on how can we make this more softhearted while  
19 maintaining the hardheadedness economic rationale of the  
20 petitions, what do you think of the idea of tying, say, the  
21 2004 local rate increase and the 2005 local rate increase to a  
22 company's demonstrating to the satisfaction of the Commission  
23 that it has engaged in meaningful action to increase Lifeline  
24 subscribership? While we certainly can't place all the burden  
25 on the company to ensure take rates because there are a variety

1 of reasons that folks don't subscribe to Lifeline, or to food  
2 stamps, or to other social programs, is it reasonable in your  
3 view to ask the companies to at least engage in meaningful  
4 efforts to try and increase take rates?

5 THE WITNESS: I am a little torn on that one. I am  
6 torn because I suggested earlier, and I will continue to say  
7 that I would like to see those efforts continue. And  
8 Commissioner Baez asked about the various tools that are  
9 available and that sort of tying policy is certainly one that  
10 is available to you. The reason I am torn is that my first  
11 inclination is that the policy of rebalancing rates is a policy  
12 that is meritorious in its own right. The policy of pursuing  
13 meaningful efforts to ensure that economically disadvantaged  
14 portions of Florida households are not harmed is a policy that  
15 is meritorious on its own. And I'm not sure that  
16 preconditioning the former on the existence of the latter is  
17 necessarily something you want to do, but it is certainly  
18 available to you.

19 COMMISSIONER DAVIDSON: Why? I mean, why wouldn't we  
20 want to do it? I understand there are stand-alone policies,  
21 and I think -- I am speculating here -- companies to some  
22 extent may have a bit of a simple or split personality on this.  
23 On the one hand their true sort of a one hardheaded interest  
24 ought to say we need to get as many people on our service as we  
25 can, including via Lifeline. We need to get those economically

1 disadvantaged people for a couple of reasons. One -- a few  
2 reasons -- externalities. Two, they may at some point not be  
3 economically disadvantaged. We want to have them, we want to  
4 keep them. Three, we see a benefit to our company of having  
5 these folks on our network. We perhaps can sell ancillary  
6 services. Who knows what we can do if we reach out and provide  
7 service. That is one train of thought.

8           The other train of thought may be we don't have an  
9 interest in getting Lifeline subscribers on our network because  
10 it is going to cost us money, and those customers aren't quite  
11 as profitable as other customers. And you may very well be  
12 right, it may not be economically rational or make sense to do  
13 that, but if you could help me understand why the tying aspect  
14 isn't perhaps a good idea.

15           THE WITNESS: I think the only reason that I suggest  
16 that it might not be the best idea is that it would, I think,  
17 it sounds like it would run the prospect of perhaps dooming  
18 both. But if you want to create particular benchmarks for the  
19 industry and hold their feet to the fire, in general, I think  
20 that would be a healthy thing because of your second of your  
21 two trains of thought.

22           COMMISSIONER DAVIDSON: And on this issue, I mean, it  
23 may be that additional criteria could help limit it. For  
24 example, maybe the tying makes sense, where a company in its  
25 service area retains 90 percent of the local residential market

1 because there they truly have close to a monopoly and  
2 competition probably hasn't come into play there. A company in  
3 another area where they maybe have an 80 percent share, if they  
4 don't take aggressive steps to offer Lifeline, a competitor  
5 might through some form or another. So competition may come in  
6 to answer some of these issues as competitive share increases.  
7 It's just a thought, and I thank you for your comments.

8 THE WITNESS: Thank you.

9 CHAIRMAN JABER: Commissioner Bradley.

10 COMMISSIONER BRADLEY: Yes. Dr. Mayo, I know we have  
11 had you here for quite awhile, and this has been a very  
12 interesting exchange, but I'm really interested in your public  
13 policy theories. And my question centers around market forces  
14 and institutional behavior. Just an observation before I ask  
15 my question. I have always -- not always, but in a lot of  
16 instances I have observed that market forces are institutional  
17 opinions that are espoused by various components of our  
18 society. Institutions usually will espouse their position  
19 based upon either how it advantages big business, and profit is  
20 not a bad word in my opinion, or how it hurts the elderly and  
21 the disabled or the poor. And when you give consideration to  
22 how it hurts the elderly, I'm sure that you can have many  
23 opinions on that for different reasons. The disabled, you can  
24 have many opinions on that particular category for many  
25 different reasons. And the poor, and the same thing applies to

1 that category. And all of them are similar but different.

2 But these institutional market forces who take these  
3 positions to either enhance progress or fight progress, can you  
4 somewhat discuss these institutional forces and why sometimes  
5 they take these various positions, and discuss that from an  
6 economic perspective.

7 THE WITNESS: Sure. And I hope I will be responsive  
8 to your question. If you go back a long, long way in the field  
9 of economics, all the way to Adam Smith, we realize that -- we  
10 begin to realize that individual consumers, individual  
11 producers acting in their own self-interest could through the  
12 marvels of the capitalist system turn something which was, and  
13 still is sometimes thought to be a vice, selfishness, acting in  
14 your own self-interest, into a virtue. And it has built what  
15 is, I think, incontrovertibly the strongest economic society  
16 that has ever existed. And that is a very, very good thing.

17 In the public policy process, that same selfishness  
18 carries over. And I don't think we should expect that  
19 individual proponents of positions would act in any way other  
20 than in their own self-interest. Whether that is Sprint,  
21 Verizon, AARP, MCI, AT&T, they are all going to offer their own  
22 particular individual perspectives. Honestly, and it is just  
23 one person's opinion, I think I marvel at our public policy  
24 process in filtering through those individual selfish,  
25 self-serving advocacy positions to be able to manage what are

1 despite all of the grumblings about government, what winds up  
2 being a pretty good system.

3           You have had in this course of this proceeding a  
4 whole lot of public hearings, that have had individual members  
5 of society, Florida, come in and talk, and you have heard those  
6 people. And you have heard all these self-serving folks, and  
7 it is not going to be as good, I will suggest that the economic  
8 analysis of the public policy process cannot say with the same  
9 degree of robustness, boy, look at how good public policy turns  
10 out in promoting the welfare of society as the pure private  
11 system where competition exists. But it works pretty well.

12           And I am actually in this particular instance, well,  
13 let's see how you guys decide, but I am pretty encouraged by  
14 where I think we have the prospect to go as a result of this  
15 case.

16           COMMISSIONER BRADLEY: Thank you.

17           CHAIRMAN JABER: Redirect.

18           MR. HATCH: No redirect.

19           CHAIRMAN JABER: Okay. Dr. Mayo, thank you for your  
20 testimony. And, Mr. Hatch, your witness may be excused and we  
21 have Exhibit 71.

22           THE WITNESS: Thank you very much.

23           MR. HATCH: We would request that Exhibit 71 be  
24 admitted into the record.

25           CHAIRMAN JABER: Without objection, Exhibit 71 is



1 admitted into the record.

2 (Exhibit 71 admitted into the record.)

3 CHAIRMAN JABER: Wayne Fonteix is your next witness.

4 MR. HATCH: AT&T calls Wayne Fonteix to the stand.

5 WAYNE FONTEIX

6 was called as a witness on behalf of AT&T Communications of the  
7 Southern States, LLC, and having been duly sworn, was examined  
8 and testified as follows:

9 DIRECT EXAMINATION

10 BY MR. HATCH:

11 Q Mr. Fonteix, could you please state your name and  
12 address for the record?

13 A My name is Wayne F. Fonteix, my address is One AT&T  
14 Way, Bedminster, New Jersey.

15 Q By whom are you employed and in what capacity?

16 A I am employed by AT&T in the capacity as a director  
17 of regulatory affairs with responsibility for public policy  
18 implementation.

19 Q Did you prepare and cause to be filed in this  
20 proceeding direct testimony?

21 A I did.

22 Q Do you have any changes or corrections to that  
23 testimony?

24 A I do have one minor correction.

25 Q Could you tell us what that is, please?

1           A     That would be on Page 12 of my direct testimony,  
2 Line 4, wherein it currently states, "First, the statute is  
3 unequivocal, long distance rates must be reduced." That should  
4 be, "Long distance revenues must be reduced to be consistent  
5 with the actual language of the act."

6           Q     Subject to that change, if I asked you the same  
7 questions as in your direct testimony, would your answers be  
8 the same?

9           A     Yes, they would.

10           MR. HATCH: Madam Chairman, could I request that Mr.  
11 Fonteix's testimony be inserted into the record as though read?

12           CHAIRMAN JABER: The prefiled direct testimony of  
13 Wayne Fonteix shall be inserted into the record as though read.

14 BY MR. HATCH:

15           Q     And do you have three exhibits attached to your  
16 direct testimony labeled as WF-1 through WF-3?

17           A     I do.

18           Q     Do you have changes or corrections to those exhibits?

19           A     I do not.

20           Q     Were those exhibits prepared by you or under your  
21 supervision?

22           A     Yes, they were.

23           MR. HATCH: Madam Chairman, could I get those  
24 exhibits marked for identification?

25           CHAIRMAN JABER: Sure. WF-1 through WF-3 will be

1 identified as Composite Exhibit 72.

2 (Composite Exhibit 72 marked for identification.)

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1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION**  
2 **TITLE.**

3 **A.** My name is Wayne Fonteix. My business address is One AT&T Way, Bedminster,  
4 NJ 07921. I am employed by AT&T Corp. as Director – State Regulatory Affairs.

5  
6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**  
7 **EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY.**

8 **A.** I received a BA degree from Drew University in Madison, NJ. I have 21 years  
9 experience in the telecommunications industry, and am currently responsible for  
10 managing the planning and implementation of public policy initiatives before state  
11 regulatory bodies. I also have primary responsibility for AT&T's relationship with  
12 the National Association of Regulatory Utility Commissioners (NARUC).

13  
14 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE REGULATORY**  
15 **COMMISSIONS?**

16 **A.** Yes, I have testified before state regulatory commissions in Illinois and Alabama, as  
17 well as in U.S. Senate staff hearings and proceedings at the FCC.

18  
19 **Q. WHAT ISSUES DOES YOUR TESTIMONY ADDRESS?**

20 **A.** My testimony addresses Issues 1(c), 2, 3, 4 & 5.

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

23 **A.** The purpose of my testimony is to describe the competitive market enhancement and

1 resulting benefits to Florida consumers that will accrue from proper implementation  
2 of the Tele-Competition Act of 2003 (“the 2003 Act”). As evidenced by the 1995  
3 amendments to Chapter 364, Florida Statutes, the State of Florida was a leader in  
4 *permitting* competition in the telecommunications local exchange market. However,  
5 the past eight years have demonstrated that mere permission to compete is insufficient  
6 to create a competitive local exchange market. Proper implementation of the 2003  
7 Act could allow Florida to become a leader in *implementing* competition.

8  
9 **Q. PLEASE EXPLAIN.**

10 **A.** Local competition in Florida has developed at a slow pace. Seven years after passage  
11 of the federal Telecommunications Act of 1996, most Floridians have yet to reap the  
12 benefits of a truly competitive market for local telecommunications services. The  
13 disappointing pace of local exchange competition in Florida is due, in part, to high  
14 access charges. Excessive access charges retard competition in two ways. First, they  
15 subsidize ILEC local exchange service. In fact, the access charge regime, which  
16 stems from the AT&T divestiture, was specifically implemented to keep local  
17 exchange rates artificially low by drawing a subsidy from high long distance rates.  
18 Dr. John Mayo addresses the economic implications of subsidizing  
19 telecommunications services, but as a practical matter, it is difficult for a  
20 telecommunications company to enter the local exchange market and compete against  
21 incumbent providers whose rates are subsidized; the subsidy allows incumbent  
22 providers to subject their competitors to an anti-competitive price squeeze.

23 Excessive access charges further depress competition by limiting competitors’

1 ability to compete across the full range of service categories. The ILECs' per-minute  
2 cost to terminate a telephone call is the same whether that call originated across the  
3 street, across the state or across the continent; a minute-long telephone call uses a  
4 minute of the terminating ILEC's network resources regardless of the distance it  
5 traveled before reaching the ILEC network. However, competitors are charged  
6 higher rates to terminate long distance calls, so they must charge their customers  
7 higher rates for such calls, even though distance-based distinctions are increasingly  
8 irrelevant to consumers. The 2003 Act allows the Commission to rebalance retail  
9 service rates to reduce the outdated access subsidy, thereby reducing intrastate access  
10 charges to parity with interstate access charges and limiting ILECs' ability to leverage  
11 an anti-competitive price squeeze.

12  
13 **Q. DOES THE 2003 ACT ALLOW ACCESS REDUCTIONS BELOW**  
14 **INTERSTATE PARITY?**

15 **A.** Yes. Section 364.164 (5) states "...Nothing in this section shall prevent the company  
16 from making further reductions in its intrastate switched network access rate, within  
17 the revenue category established in this section, below parity on a revenue-neutral  
18 basis, or from making other revenue neutral rate adjustments within this category."  
19 Therefore, if an ILEC chooses to reduce access below parity, it is permitted to do so  
20 on a revenue neutral basis.

21  
22 **Q. WHAT MUST THE COMMISSION DO TO PROPERLY IMPLEMENT THE**  
23 **2003 ACT?**

1 A. The keystone of the 2003 Act is reducing the access subsidy to ILEC local exchange  
2 rates. The full benefits of the 2003 Act can only be realized to the extent that the  
3 subsidy currently provided by in-state access charges is removed from ILEC local  
4 exchange rates. Naturally, reducing access charges will tend to reduce ILEC  
5 revenues. The Legislature elected to allow ILECs to recover these lost revenues by  
6 implementing revenue-neutral price increases. Therefore the Commission must  
7 rigorously ensure that ILEC rate rebalancing plans (a) result in a reduction of  
8 intrastate access charges to parity with interstate access charges and (b) do not result  
9 in a net increase in revenue for the ILECs. Proper implementation of the 2003 Act  
10 requires careful attention to both of these goals so that any rate increases are  
11 accurately balanced by access charge reductions.

12  
13 **Q. HOW DO ACCESS RATES IN FLORIDA COMPARE WITH ACCESS**  
14 **RATES IN OTHER SOUTHERN STATES?**

15 A. ILECs charge higher access rates in Florida than in virtually every other Southern  
16 state. For example, BellSouth charges significantly higher switched access rates to  
17 long distance carriers in Florida than in any other BellSouth state. In fact, as shown  
18 in my Exhibit WF-1, BellSouth's access rates in Florida are nearly five times the rates  
19 it charges in states like neighboring Georgia.

20  
21 **Q. DO VERIZON AND SPRINT ALSO CHARGE HIGHER ACCESS**  
22 **CHARGES?**

23 A. Yes. Sprint charges higher access rates in Florida than in any other Southern state in

1 which it conducts business. As shown in Exhibit WF-2, Sprint's access rates in  
2 Florida are as up to three times the rates it charges in other Southern states. Verizon  
3 charges equally high rates in several Southern states, but charges over three times  
4 more in Florida than in South Carolina as demonstrated in Exhibit WF-3.

5  
6 **Q. HOW WILL PROPER IMPLEMENTATION OF THE 2003 ACT ENHANCE**  
7 **COMPETITION IN THE LOCAL EXCHANGE MARKET?**

8 **A.** Reducing intrastate access charges to parity with interstate rates in a truly revenue-  
9 neutral fashion will significantly reduce the ILECs' advantage of receiving huge  
10 access charge subsidies,<sup>1</sup> thereby moving ILECs and competitors closer to an equal  
11 footing and enhancing competition. This step is vitally important. Only when the  
12 competitive playing field is level on all parts of the end-to-end telecommunications  
13 market can competition flourish.

14  
15 **Q. WHAT DO YOU MEAN BY "END TO END TELECOMMUNICATIONS**  
16 **MARKET"?**

17 **A.** By "end to end telecommunications market," I mean the entire gamut of a  
18 telecommunications customer's calling needs, whether across the street, across the  
19 state or across the country. Increasingly, customers are rejecting the historical  
20 landline distinction between local and long distance service in favor of non-distance  
21 sensitive service commonly offered by wireless providers but increasingly available

---

<sup>1</sup> BellSouth, Sprint and Verizon function in two capacities: as both wholesalers of access service and retailers of toll service. Within their respective serving areas, each company is virtually the sole supplier of switched access service. Switched access is an essential component used by all interexchange carriers, including these



1 from ILECs such as BellSouth. A much smaller percentage of wireless carriers'  
2 intrastate traffic is subject to inflated access charges and thus they are able to offer  
3 customers the ability to place calls without a distance premium.<sup>2</sup> As I indicated  
4 previously, the 2003 Act also envisions the ultimate reduction of intrastate switched  
5 access rates to reciprocal compensation levels, as specified in Section 364.051(7)  
6 Florida Statutes. This will further assist in making intrastate calls more competitive  
7 with wireless options.

8  
9 **Q. HOW WILL PROPER IMPLEMENTATION OF THE ACT BENEFIT**  
10 **LOCAL SERVICE CUSTOMERS?**

11 **A.** The Legislature recognized that the subsidization of local exchange service “prevents  
12 the creation of a more attractive competitive local exchange market for the benefit of  
13 residential consumers” and that the removal of this subsidy will induce competitors to  
14 enter the local exchange market. Section 364.164(1), Florida Statutes. This increase  
15 in competition will benefit consumers of local exchange service in the same way that  
16 increased competition has benefited consumers of long distance service – they will  
17 have a wider choice of providers who will offer innovative services, a variety of  
18 service plans, and ultimately, lower prices, in order to win and retain customers.  
19 However, this will not be possible until the competitive playing field is leveled by  
20 reducing the access subsidy.

---

ILECs' long distance affiliates, to provision toll service. Competing carriers must be able to purchase access on the same basis as ILEC affiliates in order to maintain a competitive long distance marketplace.

<sup>2</sup> Unlike IXC, wireless carriers typically pay cost-based reciprocal compensation rates to terminate most intrastate calls within Metropolitan Statistical Areas. Reducing intrastate switched access rates paid by IXCs will bring in-state long distance wireline charges more in line with wireless prices and help remove the artificial distinction between in-state and state-to-state calls for wireline carriers.

1

2 **Q. HOW WILL PROPER IMPLEMENTATION OF THE 2003 ACT RESULT IN**  
3 **“INDUCED MARKET ENTRY” AS ANTICIPATED BY THE ACT?**

4 **A.** Reduction of the existing access subsidy will make the market more attractive for  
5 traditional long distance companies to enter the telecommunications local market, as  
6 discussed by Dr. Mayo. For example, since the passage of the 2003 Act, AT&T has  
7 entered the local residential market in Florida. On October 6, AT&T filed its first  
8 residential local service offering with the Commission, and expanded that offering  
9 with another tariff filing on October 23.

10

11 **Q. DO YOU VIEW THE PROPER IMPLEMENTATION OF THE 2003 ACT AS**  
12 **A CRITICAL FIRST STEP IN BRINGING ROBUST LOCAL SERVICE**  
13 **COMPETITION TO FLORIDA?**

14 **A.** Absolutely. Reduction and eventual elimination of the access subsidy is critical. It  
15 will allow CLECs to compete on a more equal footing with the ILECs who already  
16 provide both local and long distance services to their customers.

17

18 **Q. WILL PROPER IMPLEMENTATION OF THE ACT BENEFIT LONG**  
19 **DISTANCE CUSTOMERS?**

20 **A.** Yes. The 2003 Act requires long distance providers to reduce their revenues in order  
21 to flow access charge reductions through to their residential and business customers.  
22 Thus, long distance customers will benefit from access charge reductions. Further,  
23 the 2003 Act requires all interexchange carriers charging in-state connection fees to

1 eliminate any such charges, so AT&T will eliminate its current in-state connection  
2 fee of \$1.88 per month in compliance with the statute. Thus, even customers who  
3 place few long distance calls will benefit from the Commission's implementation of  
4 the Act.

5  
6 **Q. WILL PROPER IMPLEMENTATION OF THE ACT BENEFIT FLORIDA'S**  
7 **SENIOR CITIZENS?**

8 **A.** Yes. Florida's senior citizens will also benefit from the 2003 Act. Demographic  
9 studies indicate that older Floridians who use wireline long distance service spend, on  
10 average, approximately \$14 per month on such service.<sup>3</sup> Furthermore, Florida's  
11 seniors are less likely than younger consumers to be "zero users" of wireline long  
12 distance services.<sup>4</sup> Clearly these older consumers will benefit from increased  
13 competition for bundled services and lower prices in intrastate long distance.

14  
15 **Q. DO THE ILEC-PROPOSED ACCESS REDUCTIONS PROPERLY**  
16 **IMPLEMENT THE ACT?**

17 **A.** Sprint's proposal appears to satisfy the statute, as does BellSouth's "mirroring"  
18 proposal. However, BellSouth's "typical network" proposal and Verizon's proposal  
19 do not fully comply with the Act's requirements.

20  
21 **Q. PLEASE COMMENT ON BELL SOUTH'S PROPOSALS.**

---

<sup>3</sup> TNS Telecoms Market Monitor and Bill Harvesting, 3Q02 – 2Q03.

<sup>4</sup> *Id.*

1 A. BellSouth offered two proposals: a “mirroring” proposal and a “typical network”  
2 proposal. Under its “mirroring” proposal, BellSouth simply quantified the revenue  
3 impact of the intrastate rate reductions necessary to achieve parity by multiplying  
4 demand times the delta between its intrastate and interstate tariffed rates. This  
5 methodology results in a proper calculation of revenue impact. However, BellSouth’s  
6 “typical network” methodology is inappropriate because it targets only a select set of  
7 rate elements to equal interstate rate levels, and thus fails to address all of the rate  
8 elements in the statutory definition of intrastate switched network access rate.

9

10 **Q. PLEASE EXPLAIN YOUR CONCERNS AND RECOMMENDATIONS**  
11 **REGARDING VERIZON’S PROPOSAL.**

12 A. First, Verizon proposes to include a Terminating Carrier Common Line  
13 (“Terminating CCL”) charge in its intrastate switched network access rate under its  
14 proposal to achieve interstate parity. The Terminating CCL charge is an explicit  
15 subsidy charge not found in Verizon’s interstate switched access charge. Verizon’s  
16 proposed intrastate access rates thus do not equal and are not at parity with its  
17 interstate access rates as required by the Act. Verizon admits that it is appropriate to  
18 eliminate Originating CCL from its intrastate calculations because it eliminated the  
19 charge at the interstate level;<sup>5</sup> that same policy should apply to the Terminating CCL  
20 rate as well. The Commission should require Verizon to remove this pure subsidy  
21 from its calculations in order to properly implement the Act.

---

<sup>5</sup> Direct Testimony of Orville Fulp, pages 15 – 16.

1 Further, Verizon improperly includes a rate element in its proposed access  
2 charges that is not permitted by the 2003 Act. Section 364.164(6) of the Act defines  
3 “intrastate switched network access rate” as follows:

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

10  
11 Arguing that it is a “federal common line charge”, Verizon includes a primary  
12 interexchange carrier charge (“PICC”) rate element in its proposed access rate in  
13 addition to the originating and terminating carrier common line charges permitted by  
14 statute.<sup>6</sup> Mr. Fulp confuses the straightforward requirements of the statute.

15 “Common line charges” are related to recovery of costs allocated to loops. The CCL,  
16 PICC and subscriber line charge are all types of “common line charges”. However,  
17 the legislature contemplated only originating and terminating carrier common line  
18 charges in intrastate access rate calculations, thereby excluding other types of  
19 common line charges such as the PICC and SLC, which are assessed on a per line  
20 basis. The PICC simply is not an “originating or terminating carrier common line  
21 charge” and therefore cannot be included in Verizon’s intrastate access rate  
22 calculations.

23 Additionally, Verizon improperly developed its proposed PICC, effectively  
24 *doubling* Verizon’s proposed intrastate access rates. Mr. Fulp states at page 12 of his  
25 testimony that Verizon developed its interstate access rate (for which its intrastate rate  
26 must provide parity) by dividing its total *interstate* PICC revenues by *intrastate*

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<sup>6</sup> *Id.* at 13.

1 traffic sensitive demand. This is inappropriate; this calculation does not produce an  
2 interstate per-MOU equivalent. Even if the Act allowed Verizon to include the PICC  
3 in its rate calculations – which it does not – Verizon’s proposal would be  
4 unacceptable because an interstate switched access rate should be based on interstate  
5 traffic sensitive demand, while Verizon’s calculation incorrectly assumes that  
6 *intrastate* demand must produce the same revenue currently received from *interstate*  
7 charges to business customers.

8 Verizon’s proposal to include the PICC in its calculations (by recovering its  
9 revenue through a Terminating CCL rate) also is objectionable on another ground.

10 Verizon’s interstate PICC applies only to multi-line business customer lines.

11 Including this revenue rate element in access calculations allows Verizon to recover  
12 business line revenue from all Florida IXC customers, both business and residential.

13 In effect, Verizon’s calculation forces residential customers to subsidize business  
14 customers.

15  
16 **Q. UPON IMPLEMENTATION OF THE ACT, WILL AT&T ONLY REDUCE**  
17 **RATES FOR LARGE BUSINESS CUSTOMERS?**

18 **A.** No. The statute is very clear. AT&T and all IXCs must reduce both business and  
19 residential customers’ long distance rates. The competitive market for long distance  
20 service will dictate reductions for both residential and business customers. Further,  
21 the in-state connection fee is charged only to residential customers, so they alone will  
22 receive the exclusive benefit from elimination of the fee.

23

1 **Q. ARE THERE ANY SAFEGUARDS THAT ENSURE THAT LONG DISTANCE**  
2 **RATES WILL REFLECT ANY ACCESS CHARGE REDUCTIONS**  
3 **ORDERED BY THE COMMISSION?**

4 **A.** Yes. First, the statute is unequivocal; long distance rates must be reduced and in-state  
5 connection fees eliminated. Furthermore, the legislature authorized the Commission  
6 to ensure that access charges are flowed through to Florida long distance consumers.  
7 In fact, the Commission has already opened Docket No. 303961-TI to ensure the  
8 proper flow through of access charge reductions.

9  
10 **Q. YOU HAVE STATED THAT REMOVAL OF THE ACCESS SUBSIDY IS**  
11 **INTENDED TO INDUCE COMPETITORS TO ENTER THE LOCAL**  
12 **EXCHANGE MARKET. DO YOU HAVE ANY REAL-LIFE PROOF THAT**  
13 **THIS WILL HAPPEN?**

14 **A.** One need only look to Michigan and Georgia to see that vibrant end-to-end  
15 competition follows low access charges and true TELRIC UNE rates. In Michigan,  
16 for example, the Michigan PSC has enforced the state statutory requirement for SBC  
17 to cap its intrastate access rates at its corresponding interstate access rate levels, and  
18 has established TELRIC-based UNE-P charges. MCI, AT&T and a host of other  
19 CLECs began entering the local market in Michigan with bundled offers as early as  
20 2001. In response, SBC has reduced rates for residential local calling plans several  
21 times over the last two years, and has introduced new service offerings to respond to  
22 this new competition. SBC has recently gained approval from the FCC to offer long  
23 distance service in Michigan, and has introduced residential packages which provide

1 for unlimited local and long distance usage, in direct competition with even wireless  
2 providers.

3 In Georgia, BellSouth's intrastate access rates are much lower than the rates  
4 BellSouth charges here in Florida. In fact, Georgia law already requires that  
5 intrastate switched access rates be set at parity with interstate switch access rates.<sup>7</sup>  
6 Coupled with TELRIC-based UNE rates, these closer-to-cost access rates provided  
7 adequate incentive for numerous CLECs, including AT&T, to enter the end-to-end  
8 market in all three geographic zones.

9

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

11 **A.** Yes.

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<sup>7</sup> Section 46-5-166, Georgia Code.



1 BY MR. HATCH:

2 Q Mr. Fonteix, do you have a summary of your testimony?

3 A I do. Good morning, Madam Chair and --

4 CHAIRMAN JABER: Isn't it like three pages of  
5 testimony?

6 THE WITNESS: I think it is 13, but I will be very  
7 brief in my summary. Good morning, Madam Chair and  
8 Commissioners. My testimony addresses the competitive market  
9 enhancement that will result from the proper implementation of  
10 the Tele-Competition Act of 2003.

11 Competition in Florida has been thus far impeded in  
12 large part by the static nature of the intrastate access charge  
13 regime here in the state. This Public Service Commission, the  
14 agency with the necessary expertise in this area, has lacked  
15 statutory authority to address the residual support for local  
16 services that has remained embedded in the major ILECs'  
17 intrastate access charges. Meanwhile, since 1998, significant  
18 access charge reform has been accomplished by both the FCC and  
19 public utility commissions across the country. As a result,  
20 the legacy intrastate access charges in Florida are now many  
21 times higher than the access rates in other states and at the  
22 interstate level.

23 Fortunately for Florida's consumers, through the  
24 Tele-Competition Act of 2003, this agency now has the authority  
25 to move this market forward consistent with a competitive

1 model. While access charges that remained inflated to provide  
2 support to local services had historically constrained the  
3 ability of IXCs to compete for price for long distance  
4 services, today with the entry of the ILECs into that long  
5 distance market and the emergence of the all distance or  
6 end-to-end market these distortions have become a barrier to  
7 local market entry and threaten to severely damage the  
8 competitive market for long distance. Such is the situation  
9 today in Florida where one competitor, an IXC, is forced to pay  
10 support to another competitor, the ILEC.

11           Clearly the market is distorted in favor of the ILEC  
12 and competition is harmed. However, with some noted  
13 exceptions, and in particular the Verizon PICC proposal that  
14 has been discussed, the ILEC petitions in this case represent a  
15 significant and essential step forward toward remediating this  
16 distortion and removing the resulting barriers to competition  
17 in Florida. Thus, approval of these petitions with the noted  
18 exceptions would clearly enhance the competitive market in  
19 Florida.

20           MR. HATCH: Madam Chairman, we tender the witness for  
21 cross.

22           CHAIRMAN JABER: Companies. Mr. Beck. Mr. Shreve.  
23 Mr. Twomey.

24           MR. TWOMEY: Yes, ma'am, I do.

25                           CROSS EXAMINATION

1 BY MR. TWOMEY:

2 Q Good morning, sir.

3 A Good morning.

4 Q Would you turn to Page 6 of your testimony, please?  
5 Beginning at Line 9 there is a question about how the proper  
6 implementation of the act will benefit local service customers.  
7 And starting at 14, you say this increase in competition will  
8 benefit consumers of local exchange service in the same way  
9 that increased competition has benefitted consumers of long  
10 distance service. They will have a wider choice of providers  
11 who will offer innovative services, a variety of service plans,  
12 and ultimately lower prices in order to win and retain  
13 customers, is that correct?

14 A That is correct.

15 Q Okay. I want to ask you a couple of questions about  
16 that. First, you say they will have a wider choice of  
17 providers. Isn't it true that competitors will most likely  
18 seek to enter markets where the prices after these increases  
19 are approved, if, in fact, they are, will most closely approach  
20 the cost of providing service within those markets or  
21 exchanges?

22 A That is true.

23 Q Were you here yesterday when Witness Fulp testified?

24 A Yes, I was.

25 Q Did you follow my discussion with him about his

1 exhibit that showed the differences in the proposed rates, if  
2 approved, versus the UNE-P costs for the various rate groups?

3 A I did my best without the exhibit in front of me,  
4 yes.

5 Q Would you concede, sir, that it is most likely  
6 that -- let me start over. Isn't it correct, if you know, that  
7 currently even without these rates being approved, that  
8 competitors, to the extent that they wish to enter markets in  
9 Florida, would tend to go to those markets where the existing  
10 rates are closest to UNE-P cost?

11 A Yes.

12 Q Now, AT&T has announced, and I think you mention it  
13 in your testimony, that it will begin providing local service  
14 throughout the State of Florida, correct?

15 A We will beginning providing local service in Zones 1  
16 and 2 of BellSouth territory for residential customers.

17 Q Rate Groups 1 and 2?

18 A UNE Rate Zones 1 and 2, yes.

19 Q Okay. And where are those zones located  
20 geographically?

21 A I do not have that information on a map.

22 Q Are they rate zones or groups in which the existing  
23 BellSouth rates are closest to the UNE-P rates?

24 A They are the UNE rate zones of the higher density  
25 which typically translates into lower loop prices, lower loop

1 costs.

2 Q Would it be reasonable to assume then that after you  
3 reached a certain level of penetration in that zone that you  
4 would next go to a zone where the density is next highest?

5 A Well, not necessarily. The decision on where market  
6 entry occurs and where marketing is pursued is a somewhat more  
7 complicated task than simply looking at the UNE rate relative  
8 to the retail rate. You have to factor in the access rate, as  
9 well. You need to also consider the operational support  
10 systems required to interface with that incumbent LEC to  
11 provide that service.

12 Q Well, let me ask you this. What kind of marketing  
13 theory would advance the notion of going to Sprint's smallest  
14 rate group, for example, Kingsley Lake, I think it was, with  
15 322 access lines, before you would attempt to invest your  
16 capital in a company's rate groups that are substantially more  
17 dense, or is there any such marketing notion?

18 A The marketing approach certainly with AT&T  
19 residential on a mass market basis is to look at a large  
20 market, a contiguous large market in which you can pursue  
21 marketing. To the extent that there are patchworks of  
22 opportunities, it does not lend itself easily to mass  
23 marketing.

24 Q Okay. So my point, I guess, and my question to you  
25 is that your statement that consumers of local exchange service

1 will have a wider choice of providers isn't true in all cases,  
2 that is to say it will become true in areas where there is, in  
3 fact, local competition achieved, correct?

4 A It is generally true for consumers. The rate at  
5 which that competition develops in individual markets is  
6 something we can't prejudge at this point.

7 Q Yes, sir. But, again, isn't it true that, for  
8 example, in the most rural areas served by these three  
9 companies, they may not have a wider choice of providers within  
10 the next five or ten years, right?

11 A Oh, I would certainly not say that. Five years is a  
12 very far out horizon to predict that there will not be  
13 competition throughout the state. At the rate competition is  
14 developing in other states where, at least in AT&T's  
15 experience, we are entering the more rural geographic zones, it  
16 has not taken five years to make that move.

17 Q How long has it taken?

18 A In a couple of cases we are entering in rural  
19 territories, and I qualify rural by Zone 3 UNE rate zones,  
20 within two years of initial market entry.

21 Q And you are doing that in all states that have  
22 rebalanced?

23 A We are doing that in two states that have rebalanced.

24 Q Just two states?

25 A Currently, yes.

1 Q Okay.

2 A But I would point out that our local market entry is  
3 in the residential market but two years old.

4 Q And a wider choice of providers, do you offer any  
5 evidence on how many providers will become available?

6 A How many providers will become available?

7 Q Yes, sir.

8 A I have no way of predicting that.

9 Q Okay. And how about will offer innovative services,  
10 what do you mean by innovative services?

11 A Using the long distance market experience as an  
12 indication of the potential for innovation, innovative pricing  
13 plans, combinations of packages of services, innovative  
14 consumer support services. The options, you know, are limited  
15 only by the imagination of the companies competing for that  
16 customer's attention and dollar.

17 Q So as I understand it you are talking about marketing  
18 combinations, not technological advances in service, correct?

19 A No, there are certainly technological advances that  
20 we have witnessed in the long distance market. The classic  
21 example was the AT&T prior monopoly with divestiture maintained  
22 its old networks. Sprint came along and said, well, guess  
23 what, we are going to fiber. We are dropping a pin, and AT&T  
24 was immediately forced to basically change out its long  
25 distance network to keep up with the competitive pressures of

1 fiber build-out.

2 Q Okay. Can you name one technological innovation that  
3 may be around the corner that will come only if this Commission  
4 increases local rates and thereby presumably incents  
5 competition?

6 A I can suggest one, certainly. The core backbone of  
7 the telecommunications world is increasingly becoming dominated  
8 by packet switched IP technology. That technology has not  
9 permeated the local loop world to this point. This competition  
10 in that longhaul backbone world, transmission world where there  
11 is not currently significant competition in the last mile  
12 access. The move to a packetized network in the core is taking  
13 place now. The transition is well underway. That transition  
14 of packetization of the local loop has not really begun to  
15 occur. Competition spurred in the longhaul market, I see no  
16 reason why the advent of competition in the local market won't  
17 eventually spur that packetization, as well.

18 Q I see. You say and ultimately lower prices. And I  
19 want to ask you what do you mean by lower prices?

20 A By lower prices I would suggest that you are looking  
21 at the total package of telecommunication services and end user  
22 buys. Looking at the end-to-end market, the end-to-end price  
23 of the combination of services they purchase rather than a  
24 piece part, one lower, one higher.

25 Q So you are not suggesting that basic local service



1 rates will at any point come down to current rates or lower?

2 A Potentially. I would, however, suggest that looking  
3 at local service rates in isolation is no longer really  
4 appropriate. A few years from now, I think, we will as we have  
5 seen in the wireless world be looking at truly an all distance  
6 offer, and the distinction between local and long distance will  
7 have kind of receded into history.

8 Q But if there were customers who testified that they  
9 take only local service and could only afford local service,  
10 their needs, if there are such customers, won't be addressed by  
11 this solution, will they?

12 A I can't predict that. It is possible that  
13 stand-alone local to the extent it exists will realize some  
14 downward pressures, as well.

15 Q Okay. On Page 7 you have identified the areas you  
16 are going to offer service in initially. At Page 7, Line 18,  
17 you were asked the question, will proper implementation of that  
18 benefit long distance customers, and you say yes. And you say  
19 at Line 22, "Thus, long distance customers will benefit from  
20 access charge reductions." Are you familiar with the  
21 confidential exhibit that your company submitted in this case?

22 A Confidential exhibits, which ones in particular?

23 Q The one that shows the likely percent of access fee  
24 reductions that will flow to residential customer plans?

25 A I have not reviewed that exhibit.

1 Q Well, aside from that, do you know how much of the  
2 access fee reductions your company proposes to return to  
3 residential customer plans?

4 A I do know that AT&T's current \$1.88 in-state  
5 connection fee will be returned directly to the consumer, the  
6 residential market. Beyond that I have no knowledge of  
7 specific plans.

8 Q Okay. Let me ask you about the \$1.88 fee. It is  
9 true, isn't it, that that fee isn't required by the statute to  
10 be eliminated until July 2006, correct?

11 A I believe it is upon completion of the rate  
12 rebalancing.

13 Q You do?

14 A I can check the statute. I have it here in front of  
15 me.

16 Q Do you have it. Please do.

17 A Yes, you are correct, by July 1, 2006.

18 Q And if you are aware of this, isn't it also true that  
19 even in July of 2006 you only have to eliminate that in-state  
20 connection fee if you have access fees left to net against it,  
21 correct?

22 A Yes.

23 MR. TWOMEY: Mr. Hatch, I don't recall if the current  
24 amount of access -- I mean, in-state connection fee revenue is  
25 confidential or not. Is it?

1 MR. HATCH: I think that it is, but I would have to  
2 check on that one. I don't believe that actual number is in  
3 the testimony.

4 MR. TWOMEY: Okay.

5 CHAIRMAN JABER: Mr. Twomey, your last question,  
6 repeat that for me. I want to make sure I understand the  
7 answer. You said something like isn't it true that even the  
8 elimination of the July 2006 in-state fee --

9 MR. TWOMEY: Yes, ma'am. I attempted to ask him --

10 CHAIRMAN JABER: Go ahead.

11 MR. TWOMEY: I attempted to ask him isn't it true  
12 that even in July of 2006 you only have to eliminate the  
13 in-state connection fee if you still have access fee revenues  
14 and reductions against which to net it out. And I think he  
15 said yes.

16 THE WITNESS: And the specific language in the act is  
17 provided that the timetable determined pursuant to  
18 Section 3664.164(1) reduces intrastate switched network access  
19 rates in an amount that results in the elimination of such fee  
20 in a revenue neutral manner.

21 BY MR. TWOMEY:

22 Q So isn't it possible that by July 2006, if you know,  
23 that you will no longer have any access fee revenues with which  
24 you are required to net those in-state connection fees against?

25 A Are you suggesting that the access reduction would be

1 in an insufficient amount to warrant full reduction of the  
2 in-state connection fee?

3 Q Yes, sir. Isn't that a possibility?

4 A It certainly is possible, but I don't have specific  
5 knowledge of the amount of access reduction we are talking  
6 about in net.

7 Q Okay. Now, in your discussion at Page 8 about the  
8 elimination of the in-state connection fee, which is \$1.88 per  
9 month, you say, "Thus, even customers who place few long  
10 distance calls will benefit from the Commission's  
11 implementation of that." Now, we need to qualify that  
12 statement, don't we, because isn't it true that only customers  
13 that have selected AT&T and, in fact, pay the in-state  
14 connection fee to you will receive that benefit if and when it  
15 occurs?

16 A AT&T customers who pay the in-state connection fee,  
17 yes, will receive that benefit.

18 Q Now, I don't know if it is confidential, or you can  
19 tell me, do you know, sir, how many people in the State of  
20 Florida, residential customers continue to pay in-state  
21 connection fees to yourself and/or the three ILECs in these  
22 cases?

23 A I do not.

24 Q Do you know, sir, and I don't know if you are the  
25 right witness for this or not, but let me ask you, and if not

1 you can refer me to the correct person. Do you know how long  
2 AT&T plans to continue to flow-through the access fee  
3 reductions to its long distance customers in-state?

4 MR. HATCH: Objection, it is beyond the scope of this  
5 witness' testimony. That is a subject for Mr. Guepe's  
6 testimony. All the flow-through issues that Mr. Guepe is  
7 testifying to.

8 MR. TWOMEY: Okay.

9 BY MR. TWOMEY:

10 Q Sir, there was extensive public testimony -- let me  
11 go with the question first. At Line 8 on Page 8, you state,  
12 "Demographic studies indicate that older Floridians who use  
13 wireline long distance service spend on average approximately  
14 \$14 per month on such service. And I want to ask you, there  
15 was extensive public testimony in the 14 public hearings the  
16 Commission held that many seniors were increasingly using  
17 calling cards that they purchased at Sam's Club or other long  
18 distance methodologies, such as wireless or dial-around  
19 numbers. Has AT&T observed that that is occurring or that it  
20 is a trend?

21 A Nationwide it certainly is a trend. The 1+ long  
22 distance revenues have been declining dramatically nationwide  
23 certainly.

24 Q Okay. Now, individuals that are using one of those  
25 alternative in-state long distance methodologies, wouldn't it

1 necessarily be true that they wouldn't pay in-state connection  
2 fees?

3 A Not necessarily. Just because a consumer chooses to  
4 use on a transactional basis either a prepaid card or their  
5 wireless phone for a long distance call, they likely still have  
6 wireline service with a presubscribed IXC. In the case that  
7 AT&T is that IXC, the in-state connection fee applies.

8 Q That's right. I should have prefaced it by saying  
9 isn't it true that smart people that use those methodologies  
10 wouldn't pay an in-state connection fee to anybody?

11 A To the extent that the end user is either not  
12 subscribed to an IXC or does not have wireline service, I  
13 suppose that could be the case.

14 Q Now, the people that use those alternative  
15 methodologies, isn't it generally true that they won't receive  
16 the benefits of the in-state access reductions your company  
17 proposes to pass through?

18 A I would, first of all, preface this by saying the  
19 billing data and demographic study that we reviewed indicates  
20 that the zero long distance user in the older group, that would  
21 be age 50 and above, is a 10 percent figure of that total age  
22 group. So we are looking at a fairly, you know, smaller  
23 population of that overall age group.

24 Secondly, I would suggest that if in that 10 percent  
25 you are looking at consumers who choose to use prepaid card

1 services, for example, in that case that is a decision they are  
2 making to take further steps to dial into a prepaid platform  
3 typically here and add from Wal-Mart on the latest greatest  
4 deal at Wal-Mart in order to place a call ultimately that is  
5 cheaper than a 1+ call. Much of that is predicated on the fact  
6 that those prepaid card calls are subject to interstate access  
7 charges as opposed to intrastate access charges with a  
8 difference of as much as 7 or 8 cents per minute in the access  
9 charge regime.

10           So there is kind of a cost to the consumer of going  
11 to the extra effort of going to Sam's Club, buying the card,  
12 making the 800 call into the platform, hearing the  
13 announcements and going forward. If access charges are  
14 rationalized to parity with interstate levels, that cost  
15 discrepancy will disappear, and it may be liking that that end  
16 user can enjoy the same benefits on a 1+ basis. Likewise, in  
17 the wireless world, I think there is a cost, at least from my  
18 own experience, in making a long distance call from my wireless  
19 phone in that I may lose signal halfway through the call.

20           You know, there is the reliability factor quality of  
21 service in that transmission. However, if the fact of the  
22 matter is on a wireless basis I have an all distance flat-rated  
23 plan, the actual monetary cost of making that call is  
24 negligible. Much of that is predicated on the fact that the  
25 wireless carriers do not pay intrastate access charges for the

1 most part, and rather are terminating their calls on a much  
2 lower local interconnection charge.

3           If that is rationalized, and the cost discrepancy,  
4 the artificial cost discrepancy between terminating a wireless  
5 call and a 1+ landline call is removed, that end user may  
6 benefit by now being able to place calls on a comparable cost  
7 basis over their wireline phone as they had on their wireless  
8 phone and enjoy the benefit of having better quality of  
9 service.

10           Q    Are you prepared to testify to this Commission that  
11 AT&T as a result of these access rates being reduced as  
12 requested here will institute residential plans, in-state rates  
13 that are competitive with those now attainable at Sam's Club,  
14 for example?

15           A    I'm not prepared to commit AT&T's pricing plans in  
16 any market. It is certainly a matter that is under continual  
17 review and is competitive information.

18           Q    Yes, sir. In fact, isn't it true that you testified  
19 that you don't know what percentage AT&T plans to give back to  
20 its residential in-state customers, and that, therefore -- that  
21 that is true, you did testify to that?

22           A    I did.

23           Q    And, therefore, isn't it true that you can't know  
24 what level AT&T's in-state residential rates will go to and,  
25 therefore, what they will be competitive with?



1           A     I cannot predict what level they will go to. I can  
2 point to just industry experience that shows that prices do go  
3 to cost in a competitive environment. And when the costs are  
4 normalized, it is reasonable to expect that the industry will  
5 move those retail prices to similar priced ones.

6           CHAIRMAN JABER: I have a similar question and it  
7 seems to me the appropriate place to ask it. Will AT&T commit  
8 to entry into the Verizon service territory if these petitions  
9 are approved?

10          THE WITNESS: AT&T will commit to reviewing and  
11 continually reviewing under new assumptions as these plans are  
12 approved, as other pricing developments occur reviewing the  
13 competitive viability of making market entry. But I cannot  
14 stand here today and commit to any individual market entries.

15          CHAIRMAN JABER: And how does your answer change if  
16 by some miracle Verizon wins its appeal of UNE rates?

17          THE WITNESS: Well, certainly if UNE rates increase,  
18 the likelihood of market entry decreases proportionately.

19          CHAIRMAN JABER: So even if we approve these  
20 petitions, heavy into your consideration is what the UNE rates  
21 will be?

22          THE WITNESS: The market entry decision is what I  
23 would refer to as kind of a cocktail. You know, one part  
24 wholesale rates which includes UNE rates and access rates that  
25 we would pay to the wholesale provider, in this case the ILEC,

1 one part retail rates, certainly something to be entered into  
2 the equation for market viability, and one part operational  
3 capabilities, to be able to seamlessly move those customers  
4 between carriers.

5 CHAIRMAN JABER: Those are topics to be discussed in  
6 the triennial review?

7 THE WITNESS: And in other forums, certainly. I  
8 mean, my strong belief is that this is one essential ingredient  
9 in that cocktail. Essential, but not on its face sufficient.

10 CHAIRMAN JABER: And as it relates to the operational  
11 issues and the UNE issues, those are factors in your  
12 consideration because AT&T is still not a facilities-based  
13 provider, certainly in the Verizon territory you are not.

14 THE WITNESS: Not in the mass market.

15 CHAIRMAN JABER: And even for business customers you  
16 are not a facilities-based provider.

17 THE WITNESS: AT&T has facilities serving the  
18 enterprise market throughout Florida, but the mass market, that  
19 applies to the business single or, you know, multiple line  
20 business customer is still predominately a UNE-P capability.

21 CHAIRMAN JABER: In particular in the Verizon  
22 territory.

23 THE WITNESS: I do not know of the specific facility  
24 configuration in Verizon territory, per se. I'm sorry, I can't  
25 address that.

1 CHAIRMAN JABER: Mr. Twomey.

2 MR. TWOMEY: Thank you, Madam Chair.

3 BY MR. TWOMEY:

4 Q You may not be in a position to answer this, but let  
5 me take a stab at it. I believe I have read someplace that  
6 some of the IXCs, if not perhaps all of them, aren't  
7 necessarily bound contractually to pass along the access fee  
8 reductions they would obtain here if these petitions are  
9 granted to their resellers, or all of their resellers. Is that  
10 true in your case?

11 MR. HATCH: Objection, it is still going beyond th  
12 scope of Mr. Fonteix's testimony.

13 MR. TWOMEY: Well, Madam Chair, I think it is fair in  
14 the sense that he has testified that consumers generally will  
15 receive the benefits of these access fee reductions. And I  
16 think it is fair questioning to try to limit, if I can, the  
17 number that attain those benefits, that can possibly attain it.

18 CHAIRMAN JABER: I will allow it. Mr. Hatch, you are  
19 welcome to redirect.

20 THE WITNESS: Could you please ask the question  
21 again.

22 MR. TWOMEY: Yes, sir.

23 BY MR. TWOMEY:

24 Q And here is the context. There has been in the  
25 public hearings in my recollection some suggestion that the

1 access fee reductions to the IXC's would flow to Sam's Club  
2 cardholders, wireless providers, and so forth, and that  
3 everybody would get their piece of the reductions. And my  
4 question is that I believe I have read or heard someplace that  
5 the IXC's, or some of them are not contractually obliged to pass  
6 on to their resellers any access fee reductions they would see  
7 from these petitions being granted. And I wanted to know if  
8 you knew if that was true with AT&T.

9 A I am not familiar with a waiver of the flow-through  
10 obligation to resellers. Ultimately it is the price for the  
11 end user market that will be determinant of the benefit to the  
12 consumers, and if the direct IXC prices to consumers drops as a  
13 result of the flow-through, I don't see how the downstream  
14 competitors, those who purchase the resold services from IXC's  
15 can do anything but respond in the market to those price  
16 changes.

17 Q Yes, sir. But did you understand my question? I am  
18 asking if you are aware of not whether the resellers have to  
19 respond to the price changes, but whether they would  
20 necessarily contractually have to receive a flow-through from  
21 AT&T of the access fee reductions you obtain from the three  
22 ILECs?

23 A I am not familiar with contractual obligations, no.

24 Q Fair enough. If you would turn to Page 11, please.  
25 At Line 18, you say AT&T and all IXC's must reduce both business

1 and residential customers' long distance rates. Are you  
2 sufficiently knowledgeable of the statute to know whether or not  
3 there are percentages stated in that direction?

4 A There are not.

5 Q So isn't it theoretically possible that you could  
6 give 90 percent of the access fee reductions to either your  
7 business customers or to your residential customer plans and  
8 the remaining 10 percent to the others and be in compliance  
9 with the law?

10 MR. HATCH: Objection. Again, it is beyond Mr.  
11 Fonteix's scope. Mr. Guepe is our flow-through person. He can  
12 ask those questions to Mr. Guepe.

13 MR. TWOMEY: Well, Madam Chair, the witness'  
14 testimony that I just pointed out says must reduce both  
15 business and residential long distance rates. And inherent in  
16 that, I think, is the notion that this is a fair result. And  
17 what I'm trying to establish is where and how much has to go to  
18 residential.

19 CHAIRMAN JABER: Mr. Hatch, I will allow the question  
20 because Lines 19 and 20 follow up with an opinion from this  
21 witness on what should happen as opposed to specific dictated  
22 reductions. I will allow the question. Go ahead.

23 MR. TWOMEY: Thank you, Madam Chair.

24 THE WITNESS: If you could please repeat the  
25 question.

1 MR. TWOMEY: Yes.

2 BY MR. TWOMEY:

3 Q Isn't it possible, if you know, that since there are  
4 no percentages stated in the statute, that you could give 90  
5 percent of the access fee reductions you would receive here to  
6 either your residential or business plans and the remaining 10  
7 percent to the other and be in compliance with the law?

8 A In AT&T's case is theoretically possible that we  
9 could give 90 percent of the reduction to the residential  
10 market given the prescription that we reduce the in-state  
11 connection fee, which is strictly a residential charge, and is  
12 clearly more than 10 percent of any reduction being discussed  
13 here today in these petitions. It is not theoretically  
14 possible based on that that we could give 90 percent of the  
15 reduction only to business customers because of the obligation  
16 to eliminate the in-state connection fee.

17 Q Well, let's explore that. You have to start flowing  
18 through the access fee reductions you obtain from the ILECs  
19 immediately, correct?

20 A Upon implementation of the petitions, yes.

21 Q Okay. And you don't have to eliminate your in-state  
22 connection fee, if ever, until July of 2006, correct?

23 A To the extent that the access reductions result in a  
24 revenue neutral requirement to match the in-state connection  
25 fee by no later than July 1st, 2006.

1 Q And these rates if they are approved will become  
2 effective in January of 2004, correct?

3 A I'm not sure that that is the date, but first quarter  
4 of 2004.

5 Q So isn't it possible in the implementation of your  
6 rate reductions initially that you could give 90 percent of the  
7 rate reductions to your business plan customers and 10 to  
8 residential?

9 A I think at the end of the period over which the  
10 petitions cover for the rate rebalancing, if the requirement is  
11 that AT&T eliminate \$1.88 in the in-state connection fee, the  
12 only way that could represent in total 10 percent of the access  
13 reduction would be that the access reduction would be, and the  
14 equivalent rate rebalancing would be \$18.80 to the end user. I  
15 have seen no access reductions approximating that level.

16 Q You state at Line 19, Page 11, the competitive market  
17 for long distance service would dictate reductions for both  
18 residential and business customers. Isn't it true that in some  
19 quarters AT&T is still considered a market leader in  
20 establishing price?

21 A I'm sorry, I'm not sure I understand your definition  
22 of market leader and who would consider that.

23 (Transcript continues in sequence with Volume 11.)

24

25

1 STATE OF FLORIDA )  
2 :  
3 COUNTY OF LEON )

CERTIFICATE OF REPORTER

4  
5 I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter  
6 Services, FPSC Division of Commission Clerk and Administrative  
7 Services, do hereby certify that the foregoing proceeding was  
8 heard at the time and place herein stated.

9 IT IS FURTHER CERTIFIED that I stenographically  
10 reported the said proceedings; that the same has been  
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18 the action.

19 DATED THIS 13th day of December, 2003.

20  
21 

22 \_\_\_\_\_  
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