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November 17, 2004

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 040604-TL
Adoption of the National School Lunch Program and an income-based criterion at or below 135% of the Federal Poverty Guidelines as eligibility criteria for the Lifeline and Link-up programs

Dear Ms. Bayó:

Please find enclosed for filing an original and 15 copies of the Direct Testimonies of Carl R. Danner and Harold E. West, III on behalf of Verizon Florida Inc. in the above matter. Service has been made as indicated on the Certificate of Service. If there are any questions regarding this filing, please contact me at 813-483-1256.

Sincerely,

Richard A. Chapkis DW

Richard A. Chapkis

RAC:tas
Enclosures

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of the Direct Testimonies of Carl R. Danner and Harold E. West, III on behalf of Verizon Florida Inc. in Docket No. 040604-TL were sent via U. S. mail on November 17, 2004 to the parties on the attached list.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Adoption of the National School Lunch Program and an income-based criterion at or below 135% of the Federal Poverty Guidelines as eligibility criteria for the Lifeline and Link-up programs	))))))	Docket No. 040604-TL

DIRECT TESTIMONY OF CARL R. DANNER

ON BEHALF OF

VERIZON FLORIDA INC.

NOVEMBER 17, 2004

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. I am Carl R. Danner. I am a Director with Wilk & Associates/LECG, 201 Mission Street, Suite 700, San Francisco, CA 94105.

Q. PLEASE SUMMARIZE YOUR BACKGROUND AND QUALIFICATIONS.

A. I was Advisor and Chief of Staff to Commissioner (and Commission President) G. Mitchell Wilk during his tenure at the California Public Utilities Commission (CPUC), where I played a leadership role in the initiation of a successful price cap incentive regulation program for California local telephone companies. Since leaving the CPUC, I have provided consulting services to various clients on regulation and policy, with emphases on the telecommunications and energy industries. I hold a Masters and Ph.D. in Public Policy from Harvard University, where my dissertation addressed the strategic management of telecommunications regulatory reform. At Harvard, I served as Head Teaching Assistant for graduate courses in microeconomics, econometrics and managerial economics. I hold an AB degree from Stanford University, where I graduated with distinction in both economics and political science. In the summer of 2003, I co-taught classes on UNEs and impairment to new state commissioners and staff at Michigan State University's annual "Camp NARUC" educational program. My experience includes researching and teaching regulation, advising regulators, testifying in regulatory proceedings, and advising clients on regulatory issues. My complete resume is attached as Exhibit CRD-1.

I have previously testified before the Florida Public Service Commission (Commission) on several occasions, most recently in Docket No. 030867-TL last year.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my direct testimony is to address three issues raised in the Order Establishing Procedure (issued November 1, 2004) on behalf of Verizon Florida Inc. (Verizon):

<u>Issue 4</u>: What are the economic and regulatory impacts of implementing the actions taken by the Commission in Order No. PSC-04-0781-PAA-TL?

<u>Issue 5A</u>: Should consumers be allowed to self certify for program-based Lifeline and Link-Up eligibility?

<u>Issue 6A</u>: What is the appropriate state Lifeline funding mechanism and how should it be implemented and administered?

Q. WHAT ARE YOUR PRINCIPAL OBSERVATIONS, CONCLUSIONS AND RECOMMENDATIONS?

A. I offer the following observations, conclusions and recommendations for the Commission's consideration:

1. The Commission has appropriately recognized that the purpose of the Lifeline program should be to increase telephone penetration, not to increase the number of people who receive state and federal support. The proposals to expand the Lifeline eligibility criteria will not substantially increase telephone penetration, because most of the people who would receive support under the expanded criteria already have telephone service.

2. The prevalence of wireless service helps to ensure that customers are connected to essential services, while reducing the importance of wired service penetration as a measure of access to communications.

3. The Commission should not adopt self-certification for Lifeline eligibility because self-certification is likely to result in waste, fraud and abuse, as well as customer confusion and irritation.

4. Companies should be permitted to petition to recover Lifeline-related costs if Lifeline enrollment increases dramatically, or if a company believes its particular circumstances so warrant. This will help to ensure the long-term viability of the Lifeline program, and to level the competitive playing field.

5. To the extent necessary, Lifeline-related costs should be recovered through general tax revenues. If general tax revenues cannot be

used for this purpose, Lifeline-related costs should be recovered through a per-line surcharge.

6. The Commission should not seek to expand the Lifeline eligibility criteria due merely to a concern about an outflow of funds from Florida to other states. Florida is an overall net beneficiary of federal programs, spending, and taxes. Moreover, Florida should benefit from the FCC's recent initiative to address California's Lifeline program (the principal source of the concern). If every state were to try to increase the size of their Lifeline programs to capture additional funding from other states, the federal program would grow and ultimately burden customers in all states with greater support obligations unrelated to increasing universal service.

I. ISSUE NO. 4

A. BACKGROUND

Q. HAS THE COMMISSION RECOGNIZED THAT ADDING MORE CUSTOMERS TO THE NETWORK IS THE APPROPRIATE PURPOSE FOR LIFELINE PROGRAMS?

A. Yes. The Commission made clear that Lifeline is intended to increase telephone subscribership in its comments to the FCC:

> As we discussed in our December 26, 2001, comments to the Joint Board, the FPSC continues to

support the original intent of Lifeline and Link-Up, which is to help low-income customers obtain basic telephone service.[1]

Q. ARE FLORIDA'S TELEPHONE PENETRATION RATES LOW RELATIVE TO OTHER STATES?

A. No. FCC data[2] show that Florida's penetration levels are at approximately the national average, having increased somewhat over the past ten years for all customers, and at a slightly higher pace for low-income customers:

	All Customers		Low Income	
	Florida	National	Florida	National
1994	92.4%	93.9%	84.2%	85.7%
1995	93.9	93.9	86.7	85.1
1996	93.4	93.9	86.6	85.4
1997	92.1	94.0	84.4	86.0
1998	93.3	94.1	85.4	85.7
1999	92.6	94.0	87.8	85.5
2000	92.4	94.5	85.6	87.5
2001	92.3	94.4	84.2	87.6

[1] "Comments of the Florida Public Service Commission Regarding the Federal-State Joint Board on Universal Service Lifeline and Link-Up Recommended Decision," FCC WC Docket No. 03-109, August 18, 2003, page 2.

[2] Data are percentages of households with telephone service in March of applicable year. Low income customers are those under $17,954/year in current dollars. FCC, Universal Service Monitoring Report, CC Docket No. 98-202 (2004), Table 6.11.

2002	94.7	95.5	89.7	89.1
2003	95.1	95.5	89.8	89.2
Change	+2.7%	+1.6%	+5.6%	+3.5%

Notably, the Commission's Proposed Agency Action Order does not identify subscribership levels as a concern in Florida.

Q. IS THE WIDESPREAD USE OF WIRELESS SERVICE RELEVANT TO LIFELINE GOALS?

A. Yes. Many people contend that Lifeline programs are necessary to ensure that low-income customers have a minimal, "life line" connection to the outside world so they can reach essential services. The fact that over 60 percent of Florida's population (of all ages) has wireless phones helps mitigate concerns about whether some people may be unconnected to essential services, because wireless phones can be used to reach these services.[3] Additionally, the fact that an increasing percentage of customers have given up wired service (and rely on

[3] As of this writing, there are approximately 11.7 million wireless subscribers in Florida, as determined by assuming that Florida subscribership has increased at the same rate (plus 7.65 percent) as the country as a whole since December 2003 recorded Florida subscriber data. See <u>FCC Ninth Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,</u> released September 28, 2004 (<u>http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-216A1.pdf</u>), Appendix A, Tables 1-2; report of current number of U.S. wireless subscribers on CTIA web site (<u>www.wow-com.com</u>, viewed October 29, 2004). As of mid-2003, the US Census Bureau estimated Florida's population as 17,019,068, suggesting a current total of between 18.5 and 19 million based on its recent growth rate. U.S. Census Bureau, Florida Quick Facts (<u>http://quickfacts.census.gov/qfd/states/12000.html</u>, accessed October 29, 2004).

wireless exclusively)[4] also renders traditional measures of wireline penetration, such as the FCC data reported above, less relevant for gauging the success of efforts to promote connectivity for customers.

B. LIFELINE WILL DO LITTLE, IF ANYTHING, TO PROMOTE UNIVERSAL SERVICE; LIFELINE IS PRIMARILY A CASH-TRANSFER PROGRAM

Q. DO LIFELINE MONTHLY BASIC RATE DISCOUNTS INCREASE TELEPHONE PENETRATION?

A. Monthly rate discounts do relatively little, if anything, to increase penetration. Most, if not all, customers on Lifeline would have a phone even without the Lifeline discount on monthly service charges.

Q. HOW WOULD YOU CHARACTERIZE THE LIFELINE PROGRAM'S MONTHLY BILL DISCOUNTS?

A. For the most part, Lifeline monthly discounts are a way by which some customers are given small cash grants. To be given a discount on a service one would buy anyway is the same as being given that amount of money in cash.

Q. IS VERIZON'S FLORIDA LIFELINE PROGRAM PRINCIPALLY A MONEY-TRANSFER PROGRAM, RATHER THAN A WAY TO INCREASE SUBSCRIBERSHIP?

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[4] e.g., the 2004 Census Bureau Current Population Survey found a 6 percent complete replacement rate (Federal Communications Commission, Telephone Subscribership in the United States (August, 2004), page 2 note 2.

A. Yes, Lifeline benefits generally go to customers who would already have service. Between March and September of 2004, 4,190 customers signed up for Verizon's Lifeline service. A review of billing records[5] confirmed that 3,184 of these customers already had Verizon non-Lifeline service in March. Therefore – at most – Verizon's Lifeline program could have added 1,006 subscribers to the network in Florida. In other words, at least 76% of new Lifeline recipients already had telephone service, and received no more than the equivalent of a cash grant through their Lifeline discount.

Q. YOU JUST STATED THAT AT LEAST 76% OF THE NEW LIFELINE RECIPIENTS ALREADY HAD TELEPHONE SERVICE. IS IT CLEAR THAT THE REMAINING 24% OF NEW LIFELINE CUSTOMERS LACKED TELEPHONE SERVICE BEFORE SUBSCRIBING TO LIFELINE?

A. No. We know that at least 76% of the Lifeline recipients already had telephone service before subscribing to Lifeline, but it is not possible to determine directly from the data exactly how many of the remaining 24% of new Lifeline customers lacked telephone service before subscribing to Lifeline. That is because there is a natural churn of all customers, including Lifeline customers, and we cannot tell, for example, how many of the remaining 24% moved into Verizon's service territory from another location, or moved out of a home or household that already had service.

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[5] This process involved an electronic review of billing records. At no time did I view or make use of any individual customer identifying information.

We can show, however, that a large percentage of the remaining 24% of new Lifeline customers likely had telephone service before subscribing to Lifeline. This can be done by comparing Lifeline customer churn to that of residential customers generally. If many Lifeline customers were taking service for the first time, then their churn rate might be greater than for other residential customers. A measure of this effect is to divide the number of new customers by the existing customer base at the start of the period. For residential customers as a whole, the proportion of new customers was 6.8%. In other words, for every 1,000 residential customers in March of 2004, another 68 new customers subscribed to Verizon R1 service by September of 2004. For Lifeline customers, the proportion of new customers was 5.2%. For every 1,000 Lifeline customers in March, another 52 new customers subscribed to Verizon's Lifeline R1 service by September of 2004. Because of the high telephone penetration rates for residential customers in general across the U.S., we can presume that almost all new residential non-Lifeline customers had service before. The fact that Lifeline and non-Lifeline customers took new Verizon service at comparable rates shows that there was no great influx of new Lifeline customers who previously lacked telephone service.

Q. WHAT OTHER EVIDENCE SHOWS THAT THE LIFELINE MONTHLY SERVICE DISCOUNT IS AN INEFFECTIVE APPROACH FOR INCREASING SUBSCRIBERSHIP?

A. There are several sources of evidence that reinforce one another to make clear that basic rate discounts do little, if anything to promote universal service.

First, it has been well-documented through econometric studies (i.e., studies that use data on actual customer responses to price changes) that residential customers are highly insensitive to the price of basic service, within the normal ranges the price occurs in the U.S.[6] Almost regardless of the price, they subscribe anyway, and variations in subscribership across the country are explained instead by other factors. The same result has also been documented for low-income customers, in particular.[7] The results of two noted economists, Crandall and Waverman, (using data from 1990 and 1995) fail to find any price sensitivity of customers – including low income customers – with respect to the basic monthly rate. These results indicate that monthly Lifeline subsidies produce no increase in penetration at all. By contrast, there is consistent econometric evidence that customers are somewhat sensitive to the one-time service connection fee; indeed, Crandall and Waverman find that low–income customers have a price elasticity of -.10 to -.15 with respect to that charge (i.e., a 10 percent change in the service connection charge leads to a 1 to 1.5 percent change in penetration

[6] Crandall and Waverman provide a summary of econometric study results that have consistently produced this finding based on actual customer behavior. Crandall, Robert W. and Leonard Waverman. Who Pays for Universal Service? (Brookings Institution Press, 2000), Table 5-1, page 91.

[7] Crandall and Waverman, pages 98-104 (e.g. "The sensitivity of telephone penetration to the recurring monthly price is so small that it is increasingly difficult to detect in modern studies.").

among low-income subscribers).[8] Therefore, whatever effect these programs have in increasing penetration is almost certainly due to Link-Up, and not Lifeline.

Second, there are a number of in-depth customer surveys that show that basic rate discounts do little, if anything, to improve telephone subscribership. For example, findings from a Texas survey affirm that local access charges do not keep low-income customers off of the network:

> 1. The price of basic telephone service does not seem to be the main barrier to phone subscribership among the survey sample. Across several different questions, people consistently demonstrated awareness of the prices of phone installation and monthly local service, and indicated they could afford these charges.
>
> 2. It is the variable costs of having a phone, as opposed to the fixed cost of installation and monthly service charges, that create affordability problems. The survey results indicated that long-distance charges were the primary reason for disconnection; respondents also indicated that inability to control who uses the phone and control over 900 services come

[8] Crandall and Waverman, page 98.

into play in disconnection situations. This inference is consistent with the finding that phoneless people are interested in fixed-cost services, limited only to local phone service or inexpensive voice mail services.

3. Affordability problems arise from high installation charges that result from disconnection due to outstanding bills…[9]

Likewise, findings from a New Jersey survey make clear that providing low-income customers with discounts on the price of local service will not bring large numbers of customers onto the network:

MYTH #1: The affordability of telephone service hinges on the price of local access. Thus, the price of basic monthly service should be the focus of universal service policy.

FACT: Most marginal users are driven off the network by usage-related costs, such as long distance calls, collect calls, credit card calls, and optional features, rather than access-related costs. In addition, for new users with low incomes, the chief

[9] "The Evolution of Universal Service Policy in Texas," Policy Research Project on the Evolution of Universal Telecommunications Service in Texas, Lyndon B. Johnson School of Public Affairs, University of Texas at Austin (1995), pages 17-18 (discussing "primary inferences" that can be drawn from a survey of Texas residents who lacked telephone service).

> economic barrier is the initial deposit (a minimum of $100 in New Jersey) required by telephone companies to protect themselves against the buildup of large, usage-related bills which may prove to be uncollectible.[10]

A survey of Californians lacking phone service also showed that Lifeline benefits are not the key to accomplishing universal service goals. Sixty-five percent of the survey respondents had previously been on the network. Reasons cited for a lack of service included:

"cost-related reasons"	(56%)
"trouble controlling calls"	(35%)
"no need for it"	(27%)
fear/worry/discomfort calling phone company"	(11%).

Notably, the "basic monthly cost" was only sixth in ranking on a list of seven issues cited.[11]

The foregoing surveys, which show that non-basic rates (*e.g.*, installation charges, related deposits and difficulty controlling overall

[10] "Universal Service from the Bottom Up: A Profile of Telecommunications Access in Camden, New Jersey," Rutgers University Project on Information Policy (1995), executive summary (reflecting results of interviews with low-income residents in Camden).

[11] Findings were summarized from "Affordability of Telephone Service: A Survey of Customers and Non-Customers," Field Research Corporation (1993), pages 14, 17 (survey results from California customers).

phone bills) are key drivers of telephone penetration, dovetail with the econometric evidence.[12]

Third, an average bill analysis provides further evidence that the basic rate is not the key driver of telephone penetration. Lifeline customers tend to buy services and use their phones in a very similar way to other residential customers. If the basic rate were the issue, one would expect Lifeline customers to have substantially lower average bills reflecting an inability or unwillingness to pay more than a modest amount for service. However, the monthly bill (pre-discount) of the average Verizon Lifeline customer is slightly higher ($27.58 in September, 2004) than the average residential bill for non-Lifeline customers ($26.54 in September, 2004).[13]

Q. HAS THE FCC STAFF ESTIMATED WHAT PROPORTION OF LIFELINE/LINK-UP BENEFITS ARE PAID TO HOUSEHOLDS THAT WOULD HAVE HAD TELEPHONE SERVICE ANYWAY?

A. Yes. FCC Staff examined this issue in conjunction with the decision to standardize the income-based eligibility criterion. Nationwide, FCC Staff estimated that about 80 percent of new beneficiaries of the expanded

[12] This is also consistent with the econometric evidence that higher prices for toll and long distance calls decrease customer demand for basic telephone service, and therefore can adversely affect universal service. Hausman, Jerry, Tardiff, Timothy, and Alexander Belinfante. "The Effects of the Breakup of AT&T on Telephone Penetration in the United States," American Economic Review vol. 83, no. 2 (May, 1993), 178-184.

[13] Data is for customers taking basic residential service (R1), does not include packages.

Lifeline/Link-Up program would already have telephone service, and that about 20 percent would be new to the network.[14]

Q. WOULD THE FCC'S ESTIMATE OVERSTATE THE PROPORTION OF NEW FLORIDA LIFELINE CUSTOMERS WHO PREVIOUSLY LACKED TELEPHONE SERVICE?

A. Yes. FCC Staff's analysis assumed that there was not an income-based eligibility criterion in existence, but that assumption is not accurate for Florida. In Florida, people who earn less than 125% of the Federal Poverty Guidelines (FPG) are already eligible for Lifeline. The proposal at issue would merely expand the income-based eligibility criterion from 125% to 135% of the FPG. Since customer demand for telephone service increases with income, customers earning between 125% and 135% of the FPG will on average have the highest existing penetration of those falling under the 135 percent threshold. Therefore, FCC Staff's estimate would overstate the number of customers that would be added to the network in Florida if the Commission were to expand the income-based eligibility criterion.

This conclusion is bolstered by another conclusion from the same study in which FCC Staff considered, hypothetically, what would happen if the income-based eligibility criterion were expanded from 135% to 150% of the FPG. FCC Staff found that this would have no effect on telephone service penetration – a fact that supports the common sense notion that

[14] FCC, "Report and Order and Further Notice of Proposed Rulemaking," WC Docket No. 03-109, released April 29, 2004, paragraph 10.

increasing the income-based eligibility criterion from 0% - 135% of the FPG will have a greater effect on penetration than increasing this criterion from 125% to 135% of the FPG.

Q. SHOULD LIFELINE BE USED AS A CASH-TRANSFER PROGRAM RATHER THAN A MEANS TO INCREASE TELEPHONE SUBSCRIBERSHIP?

A. No. Lifeline should not be used to transfer money between existing subscribers, rather than adding new ones, for at least two reasons. First, welfare payments are typically delivered to low-income individuals through the general tax system. Simply using the tax and benefit system alone would avoid the extra administrative costs of Lifeline, which Verizon has shown would be significant for a self-certification program. Second, the Lifeline program can interfere with the efficient functioning of the competitive communications market in Florida – a substantial sector whose health is important for Florida's economy. The larger the program is, the more cross-subsidies and potential competitive distortions will be created by even the best-designed means of obtaining needed revenues. I address this concern further below, which is an important reason for limiting the program to benefits that actually increase telephone service penetration.

Q. DO FLORIDA CUSTOMERS ALREADY PAY A SUBSTANTIAL NUMBER OF SURCHARGES, TAXES AND FEES ON THEIR TELEPHONE BILLS?

A. Yes. This fact is additional evidence that militates in favor of limiting the Lifeline program to benefits that actually increase subscribership so that a need for carrier cost recovery can be avoided or minimized.

The following list contains the larger monthly totals of such charges that tend to appear on most, if not all, Verizon customer bills for R1 and B1 services:

- Residential Customers

Charge	Average bill amount, per month
Federal Excise Tax	$1.19
Local Communications Service Tax	$2.01
State Gross Receipts Tax	$0.96
TRS Surcharge	$0.15
County 911 Service Fee	$0.47
Number Portability Fee	$0.21
Federal Universal Service Fees	$1.02
Communications Services Tax	$0.02

Total	$6.03

- Business (Single Line Switched) Customers

Charge	Average bill amount, per month
Federal Excise Tax	$1.25
Local Communications Service Tax	$2.55
State Gross Receipts Tax	$1.20

TRS Surcharge	$0.11
County 911 Service Fee	$0.39
Number Portability Fee	$0.24
Federal Universal Service Fees	$0.91
Communications Services Tax	$3.28

Total	$9.93

II. ISSUE NO. 5A

Q. SHOULD CONSUMERS BE ALLOWED TO SELF CERTIFY FOR PROGRAM-BASED LIFELINE AND LINK-UP ELIGIBILITY?

A. No. As discussed below, the California experience demonstrates that self-certification is likely to result in waste, fraud and abuse, and, as discussed in Mr. West's testimony, self-certification, is likely to result in customer confusion and irritation, which is likely to harm the reputation of Lifeline providers and the Commission.

Q. DOES CALIFORNIA HAVE LONGSTANDING EXPERIENCE WITH A SELF-CERTIFIED LIFELINE PROGRAM?

A. Yes, it does, having used self-certification since the inception of its Lifeline program in 1984.

Q. DOES CALIFORNIA APPEAR TO HAVE A LARGE NUMBER OF SUBSCRIBERS RECEIVING LIFELINE THAT ARE NOT ELIGIBLE FOR BENEFITS?

A. While there is no way to be absolutely certain without an audit of some kind, at present (for example) just over 25 percent of the households in Verizon's California service area subscribe to Lifeline service. As the Commission itself observed, it is simply not credible to believe that all of these California households have incomes that actually qualify for the program.[15] It is also obvious that any related increase in California's penetration rate (to the extent there has been such an effect) cannot be anything like the number of Lifeline subscribers now receiving benefits.

Q. DOES CALIFORNIA VERIFY ELIGIBILITY OF LIFELINE SUBSCRIBERS?

A. No.

Q. HAS VERIZON IDENTIFIED OTHER PROBLEMS THAT WOULD OCCUR DUE TO THE COMMISSION'S PROPOSED SELF-CERTIFICATION PROGRAM?

A. Yes. As Mr. West describes in his testimony, significant problems may be created for Verizon, the Commission, and the customers themselves in cases where customers sign up for Lifeline service and are later found ineligible for it. Dealing with such situations (which can occur due to customer confusion or fraud) may prove costly and difficult for those

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[15] FCC, "Report and Order and Further Notice of Proposed Rulemaking," WC Docket No. 03-109, paragraph 28.

involved. As Mr. West discusses, many customers would be confused and aggravated by a notification that their Lifeline service has been denied and that they owe a back bill for higher charges as a result. For Verizon, the necessity of delivering such an adverse message to the customer may harm its relationships with customers or reputation for customer service, and can be costly as an administrative matter. If Verizon's competitors are not faced with a similar requirement, they will gain a competitive advantage. Related grievances or disputes could be brought to the Commission for resolution, tying up resources and possibly affecting the Commission's own reputation.

Q. CAN THE COMMISSION AVOID SUCH PROBLEMS WITH SELF-CERTIFICATION BY LIMITED VERIFICATION ACTIVITIES, SUCH AS AN ANNUAL SAMPLE AUDIT OF CUSTOMERS?

A. No. I do not believe so. In the first instance, an absence of verification could leave the door open for California-style problems of large numbers of ineligible recipients. A sample audit, by itself, will not address this problem. Additionally, it would not be fair to the customers themselves to allow a potential back-billing obligation to grow over an extended period to where its repayment became a burden – as could occur if verification was only performed at long or irregular intervals (such as the annual sampling process the Commission's Proposed Agency Action suggests). The Commission has previously expressed concerns about the need for specific verification in a self-certified program:

> The FPSC has reservations that a verification process that relies on end-users validating their eligibility can be effective at minimizing waste, fraud and abuse...[A]t a minimum, a periodic verification process should affirmatively validate a customer's eligibility.[16]

III. ISSUE NO. 6A

Q. WHAT IS VERIZON'S POSITION REGARDING COST RECOVERY OF LIFELINE BENEFIT AND PROGRAM COSTS?

A. ETCs should be allowed to recover Lifeline-related costs if there is a rapid and dramatic expansion to Lifeline enrollment, particularly one related to program changes. Carriers should be permitted to petition the Commission when and if they believe the circumstances warrant a limited and targeted cost recovery mechanism to be implemented.

Q. AT PRESENT, HOW IS VERIZON'S FLORIDA LIFELINE BENEFIT FUNDED?

A. Verizon is not provided any external funding to cover the program's benefits or related administrative costs. Neither is Verizon permitted to adjust its regulated prices to recover these expenses. The costs fall entirely on the company.

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[16] "Comments of the Florida Public Service Commission Regarding the Federal-State Joint Board on Universal Service Lifeline and Link-Up Recommended Decision," FCC WC Docket No. 03-109, August 18, 2003, page 5.

Q. **IS IT FAIR OR APPROPRIATE FOR VERIZON, OR OTHER ILECS, TO BE SOLELY RESPONSIBLE FOR FUNDING A SOCIAL PROGRAM?**

A. Social programs such as Lifeline ought to be a general responsibility, and should not be placed entirely on the companies that are required to provide the services. **Moreover, it is not reasonable, in today's** competitive environment, to place this obligation on only one category of providers in the marketplace. Of course, Verizon is aware that it previously committed to expand the income-based Lifeline eligibility criterion as soon as it is authorized to rebalance its rates in accordance with Section 364.164, Florida Statutes. At the same time, in light of the highly competitive nature of today's competitive marketplace, it would be reasonable for Commission to allow cost recovery if the Commission's actions result in a demonstrable increase – over present levels – of the ILECs' Lifeline costs.

Q. **CAN PLACING LIFELINE OBLIGATIONS SOLELY ON ILECS CAUSE GENERAL ECONOMIC HARM IN FLORIDA?**

A. Yes, it can, by distorting investment incentives. A unique economic burden placed on one class of carrier can reduce its expected returns on investment in Florida, leading to less-rapid deployment of new or improved technology, or delays in replacing older technology that is still serviceable but less than ideal. Such problematic incentives can diminish or delay the opportunities for customers to enjoy new or improved communications services in Florida, and possibly reduce the general economic benefits that such investment spending can bring locally to an economy.

Q. WHY ARE THESE ECONOMIC CONCERNS OF PARTICULAR IMPORTANCE NOW?

A. As a practical matter, the economic concerns I noted are related to the size of the unfunded obligation that carriers must bear. Given the Commission's explicit interest in increasing the number of Lifeline recipients, the funding obligation appears poised to grow – perhaps rapidly and substantially. However, it should be left up to each carrier to determine whether, and when to seek an appropriate support mechanism to fund these benefits.

Q. WHAT METHOD WOULD BE BEST FOR FUNDING LIFELINE BENEFITS?

A. The best approach would be to fund Lifeline with general tax revenues. This would avoid the administrative expense and inefficiency of layering another program to fund Lifeline on top of existing systems of taxation (with their existing administrative infrastructure). Funding Lifeline with general tax revenues would also permit the Legislature to consider (and prioritize) Lifeline benefits and spending along with other cash or in-kind social benefit programs.

Q. WHAT IS THE ESSENCE OF THE PROBLEM OF FUNDING LIFELINE BENEFITS AND COSTS?

A. If and when external support is needed, paying for this program will require the equivalent of taxing somebody or something. We can use economic principles and an understanding of the industry's current status to determine a reasonable approach.

Q. DO ECONOMIC PRINCIPLES OFFER INSIGHT INTO THE BEST METHOD FOR FUNDING LIFELINE?

A. Yes. Economic principles are clear on this point. Any tax creates economic distortions by changing incentives, and therefore economic behavior, away from what otherwise would have made the most sense to consumers and to producers. For example, a price increase on a service (due to a tax) encourages consumers to use less of that service than they would have if they had been able to pay a true economic (i.e., non-taxed) price. As a result, consumers lose the benefits they would have obtained from greater consumption, while producers lose analogous surplus they would have made from similarly increased sales. Therefore, a tax that changes consumer and producer behavior least (and therefore causes the least economic losses) is the best tax if one has to be levied.

Another way to think about the question is to recognize that a tax creates three kinds of costs: (1) the funds actually collected as tax revenues, (2) the administrative costs of collecting the tax, and (3) the economic losses caused to consumers and producers as a byproduct of collecting the tax in a particular manner. Surprising as it may seem, in the case of some poorly designed taxes, the economic losses induced by their method of collection can exceed the overall revenues collected – so the total cost of raising a single tax dollar can be two dollars, or more.

Q. TO MINIMIZE ECONOMIC LOSSES, WHAT ESSENTIAL PRINCIPLE SHOULD THE COMMISSION RESPECT?

A. The most efficient tax is that which changes economic behavior the least. It is more costly to raise tax revenues from goods and services for which consumer demand is highly price-sensitive – i.e., those with larger (or more negative) price elasticities – because demand for the product in question may diminish significantly as a result of the price increase caused by the tax. It is less costly to raise tax revenues where consumer demand is relatively insensitive to price, because consumers will buy almost as much of the product as they would have absent the tax, and therefore suffer fewer economic losses from being forced to give up something they would prefer to use or consume.

Q. DO THE PRINCIPLES OF EFFICIENT TAX COLLECTION HAVE SPECIFIC IMPLICATIONS FOR COLLECTING REVENUES FROM TELECOMMUNICATIONS SERVICES TO SUPPORT LIFELINE?

A. Yes. It is highly inefficient to tax wireless or long distance services, because demand for them is substantially sensitive to price. It is much less costly to tax basic local service prices because demand for them is much less sensitive to price. M.I.T. economist Dr. Jerry Hausman made this point in a quantitative analysis of the harm caused to the economy by the taxation of wireless services:

> I calculate the efficiency cost to the economy of raising the approximately $4.79 billion that is currently raised from wireless taxation to be about $2.56 billion (in addition to the $4.79 billion in tax revenue) or the efficiency loss to the economy for every $1 raised is about $0.53. Furthermore, for every additional dollar raised, the marginal efficiency loss to the economy varies between $0.72 to $1.14. This cost to the economy is high compared to other taxes used by the federal and state governments to raise revenues...
>
> [O]ther commodities can be taxed to raise the same revenue without creating nearly the same deadweight losses or losses in economic efficiency. Within telecommunications, a tax on monthly local landline access rates will create almost no deadweight loss or loss in economic efficiency since the price elasticity for local access has been estimated to be very near zero: -0.005.[17]

[17] Hausman, Jerry. "Efficiency Effects on the U.S. Economy from Wireless Taxation," National Tax Journal (vol. LIII, No. 3, part 2; 2000), pages 733-742. Excerpt is from page 735, citations omitted.

Therefore, any surcharge on telecommunications services used to fund Lifeline should be levied only on basic monthly rates if and when a company seeks recovery.

Q. WHAT OPTIONS EXIST FOR ESTABLISHING A SURCHARGE ON BASIC LOCAL RATES TO FUND LIFELINE SERVICE, AND WHICH OPTION DO YOU RECOMMEND?

A. Generally, I would identify two options: (1) an industry-wide pool or fund, or (2) a surcharge levied by each local service provider to fund its own Lifeline discounts. Of these, the former carries potential disadvantages in terms of necessary administration costs, and a need to collect and distribute funds between carriers. The latter carries potential disadvantages from a competitive standpoint, because one carrier might have to charge a higher surcharge than another, which could skew customer choices between providers. On the other hand, for major carriers (that are now providing all the Lifeline service available in Florida), there may be little practical difference between the two approaches since each carrier will both be collecting (through surcharges) and disbursing (through Lifeline benefits to its customers) substantial amounts of support. Therefore, I recommend that the Commission authorize each carrier that offers Lifeline service to surcharge the basic rates of its own customers for the costs of providing that service (including relevant administrative costs).

Q. WHAT DISADVANTAGES EXIST FOR YOUR RECOMMENDED APPROACH, AND HOW CAN THEY BE ADDRESSED?

A. One important concern is competitive neutrality, because competing wireline carriers would not pay support to other wireline carriers that are providing Lifeline. A solution to this concern may be to require all certificated wireline carriers to offer Lifeline service if they provide any basic service – with the same ability to collect the costs through a surcharge on their own customers. Rather than requiring all carriers to contribute, this approach would attempt to equalize burdens by requiring all carriers to offer Lifeline service.

Some other concerns are more difficult to deal with in the context of any Lifeline program that is funded through surcharges or assessments on telecommunications services of some kind. Other competing technologies might be difficult to tax (such as VoIP providers), or unreasonably costly to tax (such as wireless service). Given the shifting boundaries of technology and service in the industry, some providers may brand or structure their service offerings to try to escape a definition that would require them to offer a Lifeline option – in the same way some providers will likely try to escape any definition of what services might be taxed through an alternative surcharge approach. Ultimately, given the increasingly competitive nature of this industry, any industry-based cross-subsidy (which Lifeline is) will become more difficult and perhaps impossible to sustain as competitive alternatives undercut whatever support sources for that subsidy (i.e., levies on particular services) are attempted. This is an important reason to try to limit the program's scope, as much as possible, to benefits that actually increase telephone penetration rather than those that simply transfer money among telephone service customers who would have had phones anyway.

Q. SHOULD FLORIDA BE CONCERNED ABOUT A FUNDING OUTFLOW TO OTHER STATES DUE TO THE FEDERAL UNIVERSAL SERVICE PROGRAM?

A. No, for three reasons.

First, residents of all states pay Federal taxes, and participate in a wide variety of programs that provide corresponding benefits to one degree or another. Residents of Florida will come out ahead with respect to some programs, while coming out behind on others. This is fair, because it is almost certainly impossible to design a tax and benefit system to be net neutral to every state with respect to every program.

Florida tends to be a net beneficiary of Federal programs. In 1977, the late Senator Daniel Patrick Moynihan initiated an ongoing, annual nationwide study of these "balances of payments" across the country. As of 1998, Florida residents each received an average of $125 more from the Federal government than they paid to it.[18] By contrast, a

[18] Leonard, Herman B., Walker, Jay H. and Jose A. Acevedo. The Federal Budget and the States: Fiscal Year 1998. Taubman Center for State and Local Government, John F. Kennedy School of Government and Office of Senator Daniel Patrick Moynihan (December 9, 1999), page 51.

negative universal service outflow of $20 million/year would amount to about $1 per Florida resident. While this analysis is somewhat dated because the study program was discontinued for a number of years, it is notable that Floridians received a net Federal benefit in 15 of the 16 years the report references (1983-1998).[19] The principal drivers of that positive balance of payments, Social Security and Medicare, presumably continue to provide substantial cash flows into Florida.

Second, the FCC has now required California to address the problem caused by its enormous, unverified Lifeline program that is the principal cause for the funding outflow that most states experience.[20] While it is not yet known what specific form that remedy will take, the FCC's action offers a reason to expect that the size of the outflow will decrease over time.

Third, if the origin of the concern is an out-of-control California Lifeline program, it does not necessarily follow that other states should attempt to catch up to California so as to improve their balance of payments for this particular program. Such a possible motivation is not unique to telecommunications; a similar temptation would exist for any Federal program that provides support based on the number of enrolled beneficiaries, where any state could theoretically increase its financial

[19] The last year for which the study was performed was 1999; however, the latest report I could obtain was 1998. As of this writing, the study has been revived and I understand that data analysis is underway for an updated report that may include all years subsequent to 1999. I will furnish an updated report to the Commission if it becomes available prior to the hearing in this matter.

[20] FCC, "Report and Order and Further Notice of Proposed Rulemaking," WC Docket No. 03-109, paragraphs 28-32.

benefits at the expense of the rest of the country. With respect to Lifeline, the end result of such efforts would be a much bigger, national problem in terms of increasing cross-subsidies between customers, for reasons in fact unrelated to universal service, at a time when intensifying competition should signal the need to reduce subsidies instead. The Commission has pointed to related concerns:

> It has become increasingly clear that greater emphasis must be placed on accountability. The FPSC believes that the long-term sustainability of the fund is critical, and that appropriate accountability standards are necessary to insure the long-term success of the program.[21]

Therefore, I believe the Commission should consider changes to its Lifeline program with regard to whether they will increase telephone penetration, not with regard to the net flow of funds for just one of the many Federal programs that collectively benefit Florida.

Q. DOES THAT COMPLETE YOUR DIRECT TESTIMONY AT THIS TIME?

A. Yes.

[21] "Comments of the Florida Public Service Commission Regarding the Federal-State Joint Board on Universal Service Lifeline and Link-Up Recommended Decision," FCC WC Docket No. 03-109, August 18, 2003, page 2.

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Consultant, Wilk & Associates, Incorporated, San Francisco, CA (1992-1999)

Expert consultant to clients in the telecommunications, natural gas, electricity and postal industries regarding regulation and public policy. Analyzed industry trends; provided case-specific advice regarding legislative and regulatory efforts; delivered expert testimony; served in "sounding board" role to evaluate client initiatives from the perspective of a senior government decision maker; helped develop corporate strategies vis a vis public policy; reviewed and analyzed technical issues of economics, finance and statistics; assisted with public relations and corporate communications efforts; prepared and edited client draft expert testimony, legal briefs, lobbying documents and reports. Typical client interactions at officer level up to CEO; frequent interactions also with attorneys and external affairs staff. Client relationships and assignments fulfilled in many states and nationwide.

Commissioner's Advisor, California Public Utilities Commission, San Francisco, CA (1987-92)

Senior Advisor and Chief of Staff for former CPUC President and Commissioner G. Mitchell Wilk. Lead Commission Advisor on telecommunications issues; also responsible for transportation, water, and selected energy matters. Helped develop Commission regulatory policy, manage proceedings and cases, direct efforts of CPUC staff, draft and revise Commission decisions. Central involvement in successful CPUC regulatory reform initiatives in local exchange, cellular, long distance and pay phone sectors of telecommunications. Analyzed proposed legislation and assisted in formulating Commission legislative strategy and positions. Made numerous public appearances representing the Commission, including testimony before state legislative oversight committees. Served as media contact on many issues, gave print and radio interviews, and prepared and reviewed press releases.

Staff Analyst, Policy and Planning Division, CPUC (1982-87)

Analyzed regulatory policies and assisted in CPUC organizational strategic planning. Co-author of several Commission Reports to the Legislature regarding telecommunications issues. Advised Executive Director on strategic planning opportunities for the agency and on strategies for effective use of computers and office automation. Helped design agency reorganization that clarified staff advocacy, advice and implementation roles.

Consultant, Citizens Utility Board, Chicago, Illinois (1985-87)

Consultant to consumer advocacy board on several matters before the Illinois Commerce Commission involving energy utility diversification, nuclear power "construction work in progress," and realignment of local telephone usage rates. Testified before ICC.

University Instructor (various dates)

Co-taught graduate courses in Government Regulation of Business (Harvard University, Kennedy School of Government), and Telecommunications Regulation (Golden Gate University, San Francisco). Head teaching assistant for graduate courses in microeconomics, econometrics, and managerial economics (Kennedy School). Guest lecturer in graduate and executive programs at U.C. Berkeley Hass Graduate School of Business, U.S.C. Graduate School of Management, U.C. Berkeley Sloan Summer Institute, University of San Francisco, the Naval Postgraduate School (Monterey), and the Michigan State University Institute of Public Utilities ("Camp NARUC").

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Ph.D. in Public Policy, 1986. Dissertation: <u>Strategic Management of Public Utility Regulation in An Era of Reform: The Case of Telecommunications.</u> Thesis committee: John R. Meyer, Robert Leone, Joseph P. Kalt. General examinations: Economics, analytic methods (operations research), statistics and econometrics, political analysis and public management.

Master in Public Policy, 1982. Thesis: "The Economics of Visibility and the Policy of Visibility Protection."

Stanford University, Stanford, CA
B.A. in Economics and Political Science, 1980. Degree awarded with Distinction in both fields.

Articles:

"Open Letter to California's Governor" (with David J. Teece, and other energy experts), in Montgomery Research, Inc. (ed.) The Utilities Project Volume 4 (San Francisco, CA, 2004).

"California: Policy and Reform" (with David J. Teece), in Montgomery Research, Inc. (ed.) Leadership in a Shifting Market, The Utilities Project Volume 3 (San Francisco, CA, 2003).

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Testimony/ Comments:

Federal Communications Commission
Federal District Court, Northern District of California
California Legislature
California Public Utilities Commission
Florida Public Service Commission
Hawaii Public Utilities Commission
Illinois Commerce Commission
Indiana Utility Regulatory Commission

Oregon Public Utility Commission
Texas Legislature
Washington Utilities and Commerce Commission

Invited Speeches/ Presentations:

Bellcore and Bell Canada Telecommunications Costing Conference
CPUC Telecommunications Training Seminar
California Telephone Association Annual Conference
Capitol Publications Seminar on Computer III and ONA
Cellular Telecommunications Industry Association
ComNet West
ElectroniCast Network Futures Conference
Golden Gate University
Hawaii Public Utilities Commission
Infocast Competitive Power for California Conference
Information Industry Association
The Junior Statesmen Foundation
Los Angeles County Bar, Antitrust & Trade Regulation Section
National Association of Regulatory Utility Commissioners
National Association of Telecommunications Officers and Advisors
National Engineering Consortium: Eastern Communications Forum
Personal Communications Industry Association: Supercomm
Probe Research
RBOC and GTE Affiliated Interests Group Conference
Rutgers University Postal and Regulated Industries Conferences
San Diego Communications Council
Telocator Spring International Convention
United States Telephone Association Capital Recovery Seminar
UC Berkeley Haas Graduate School of Business
UC Berkeley Graduate School of Public Policy: Sloan Summer Institute
Washington Independent Telephone Association
Washington Utilities and Commerce Commission
Western Conference of Public Service Commissioners

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