

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Alltel Florida, Inc.'s Petition)
To Reduce Intrastate Switched Network)
Access Rates In A Revenue Neutral)
Manner Pursuant to Section 364.164,)
Florida Statutes)
_____)

DOCKET No.: 050693-JL
FILED: Sept. 29, 2005

ALLTEL FLORIDA, INC.

Prepared Direct Testimony

of

David C. Blessing

DOCUMENT NUMBER-DATE

09292 SEP 29 05

FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Alltel Florida, Inc.'s Petition)
To Reduce Intrastate Switched Network)
Access Rates In A Revenue Neutral)
Manner Pursuant to Section 364.164,)
Florida Statutes)
_____)

DOCKET No.:
FILED: Sept. 29, 2005

ALLTEL FLORIDA, INC.

Prepared Direct Testimony

of

David C. Blessing

DOCUMENT NUMBER DATE

09292 SEP 29 05

FPSC-COMMISSION CLERK

1 **BEFORE THE PUBLIC SERVICE COMMISSION**
2 **DIRECT TESTIMONY**
3 **OF**
4 **DAVID C. BLESSING**

5
6 **I. INTRODUCTION AND WITNESS BACKGROUND**

7
8 **Q. Please state your full name, position, and business address.**

9 **A.** My name is David C. Blessing. I am a principal partner of Parrish, Blessing, &
10 Associates, Inc. (PBA). PBA provides consulting services to telecommunications
11 companies regarding economic, policy, and financial issues. My business address is
12 10905 Fort Washington Road, No. 307, Fort Washington, MD 20744.

13
14 **Q. Please describe your educational background, work experience and present**
15 **responsibilities.**

16 **A.** I am a principal in the consulting firm of Parrish, Blessing & Associates, Inc. I have
17 over sixteen years of experience in the area of telecommunications regulation and
18 economic analysis beginning with various managerial positions at Rochester
19 Telephone Company in Rochester, New York. For the last twelve years I have been a
20 principal in my current firm. During this period I have represented telephone
21 companies in a number of regulatory proceedings before the Federal Communications
22 Commission ("FCC") and state regulatory commissions in Alaska, Arkansas, Georgia,
23 Kansas, Kentucky, Missouri, Nebraska, New York, Ohio, Pennsylvania, Texas and
24 Puerto Rico. I have presented and defended analyses and testimony before regulatory
25 commissions and government officials in the United States and abroad. My

1 professional background also includes an appointment to the faculty of Nazareth
2 College of Rochester, where I taught courses in economics and finance. I hold a
3 Baccalaureate of Arts from Kalamazoo College and a Master of Arts in Economics
4 from Fordham University. In addition, I have successfully completed all required
5 course work and comprehensive exams for my doctorate in economics. A detailed
6 summary of my background is included as Exhibit No. ___ (DCB-39)

7
8 **Q. What is the purpose of this docket?**

9 **A.** In this docket, Alltel requests that the Florida Public Service Commission (“FPSC” or
10 “Commission”) grant its petition to decrease its intrastate switched access rates and
11 offset the revenue loss by increasing its local rates in the same manner as was
12 approved by the FPSC for BellSouth, Verizon, and Sprint in Dockets 030867-TL,
13 030868-TL, 030869-TL (“Rebalancing Dockets”), respectively. Specifically, Alltel
14 seeks to reduce its intrastate switched access rates by approximately \$6 million and
15 increase basic local residential, single-line business and associated non-recurring rates
16 in three increments over two years for a total of \$6 million to offset the revenue loss.
17 The purpose of this rate rebalancing is to remove implicit support that is provided by
18 intrastate switched access rates by moving those rates down toward cost while at the
19 same time, offsetting the revenue loss by increasing local rates to more cost-based
20 levels. Alltel’s plan follows the procedure set forth under Section 364.164, Florida
21 Statutes (“Act”), and the similar plans that have been previously approved by this
22 Commission for BellSouth, Verizon, and Sprint in the Rebalancing Dockets.¹

23

¹ See Order No. PSC-03-1469-FOF, issued December 23, 2003 in the Rebalancing Dockets (hereinafter
“Rebalancing Order”), a copy of which is attached hereto as Exhibit No. ___ (DCB-10).

1 Q. Please provide a brief summary of your testimony.

2 A. I will address the portions of the Act that allow incumbent local exchange carriers
3 (ILECs) to rebalance their intrastate switched access rates with their local rates and
4 will demonstrate that Alltel's proposed plan satisfies the requirements of the Act.
5 Specifically, I will discuss the following:

6
7 The need to rebalance rates and the requirements of the Act (Section II).

8
9 Intrastate switched access rates currently provide support for basic local
10 telecommunications service that would be reduced by lowering these rates (Section
11 III).

12
13 The existence of local service support prevents the development of a more competitive
14 local exchange market (Section IV).

15
16 The reduction of support will induce market entry into the local exchange market
17 (Section V).

18
19 Enhanced market entry will result in the creation of a more competitive local exchange
20 market that will benefit residential consumers (Section VI).

21
22 After the proposed rate increases, basic local service rates will remain affordable for
23 consumers (Section VII).

24
25 Q. What are your major conclusions?

1 A. Based upon my review of the Act, Alltel's proposal to rebalance rates and Alltel's
2 costs, I have concluded that Alltel's plan meets the criteria outlined in the Act.
3 Specifically, upon implementation, the plan will:

- 4
- 5 1. Reduce current support for basic local telecommunications
6 services that prevents the creation of a more attractive
7 competitive local exchange market for the benefit of
8 residential consumers; and
 - 9 2. Induce enhanced market entry.
- 10

11 Alltel's plan, if approved, will also decrease support for basic local service by
12 reducing prices for intrastate switched access service which are priced above average
13 cost² to support artificially low basic local service rates. To achieve revenue neutrality
14 as required by the Act, Alltel will increase basic local residential prices toward cost-
15 based levels. Moving residential rates toward average cost will create a more
16 attractive market for potential competitive local exchange company ("CLEC") entrants
17 that will create additional choices that will benefit residential consumers.

18

19 I also conclude that Alltel's rate rebalancing plan will provide economic benefits to
20 the public in Alltel's service territory because moving rates toward average cost will
21 provide consumers and competitors cost-based pricing signals which will lead to more
22 economically rational utilization of telecommunications services. This, in turn will
23 foster competition which will increase consumer benefits by providing consumer

² As it is used here, average cost is defined as covering all direct costs and a proportional share of joint and common costs.

1 choice in telecommunications services and providers, place downward cost pressure
2 on telecommunications firms, drive telecommunication service prices downward
3 reduce costs for businesses which will lead to lower prices for their products, and
4 stimulate innovation and investment in telecommunications.

5
6 The cost evidence presented below demonstrates that Alltel's basic local residential
7 service rates are priced significantly below the average cost of providing the service.
8 Moving these rates toward cost will provide consumers and competitors the
9 appropriate cost-based pricing signals that will lead to more economically rational
10 utilization of telecommunications services. It may seem counter-intuitive that
11 telephone consumers will be better off with an increase in local service rates; however,
12 as the Commission acknowledged when it issued the Rebalancing Order addressing
13 BellSouth, Verizon, and Sprint ("Large ILECs"), the benefits of additional choice in
14 local telephone service will be available when local service is priced closer to average
15 cost.

16
17 Alltel's plan will not jeopardize universal service in its Florida service territory. Like
18 the rates proposed by the Large ILECs and approved by the Commission, Alltel's
19 proposed rates for basic local residential telephone service will remain affordable and
20 will not harm universal service. Additionally, although its proposed basic rates will
21 remain at or below the state-wide average for such services, consistent with the Act,
22 any price increase in basic local service will not apply to Lifeline consumers and
23 consistent with the 2005 amendments to Section 364.10, Florida Statutes, the income
24 eligibility for Lifeline consumers will be increased to 135 percent. This proposal

1 would extend Lifeline benefits to those additional customers that are the most likely to
2 be sensitive to price increases.

3
4 **Q. Have you prepared exhibits to your prepared direct testimony?**

5 **A.** Yes. Accompanying my prepared direct testimony are four volumes of exhibits,
6 numbered DCB-0 through DCB-40. These exhibits were prepared by me or under my
7 direction and supervision and were compiled from Alltel's business records or from
8 authoritative and/or reliable sources. My exhibits contain reports by governmental
9 entities, authoritative papers written by persons considered to be experts in their fields
10 and other materials upon which reasonably prudent persons rely in the conduct of their
11 affairs. Exhibit DCB-4 contains confidential information that has been filed under
12 separate cover with the Commission.

13
14 **II. THE NEED TO REBALANCE RATES AND THE REQUIREMENTS OF THE**
15 **ACT.**

16
17 **Q. Please describe why local basic residential service rates are supported by**
18 **intrastate switched access and other services.**

19 **A.** Historically, public policy to assure universally available and affordable basic
20 telephone service dictated that rates for basic local residential telephone service should
21 be priced at artificially low levels and supported by rates for other services whose
22 prices were set above average cost, such as intrastate switched access services. The
23 belief was that lower rates for basic local residential telephone service would be more
24 affordable and would increase the penetration of local residential telephone service.
25 While this may have been true during the introduction and growth phase of

1 telecommunications service nearly a century ago, today, low prices for basic
2 residential telephone service may not be an effective or necessary means to further
3 increase penetration. Since 1983 (the earliest date in the FCC's recent 2004
4 Monitoring Report that includes statistics on penetration), over 90% of U.S.
5 households have subscribed to basic local residential telephone service. Today, over
6 95% of households have at least one phone line and many have several lines including
7 a second wired phone line and one or more wireless phone lines.³ Even among the
8 highest income groups where affordability is presumably not an issue, wireline
9 telephone penetration does not reach 100%. Furthermore, telephone service has
10 become so widely accepted in the United States that the demand for basic local
11 residential telephone service has become very inelastic, so that the price appears to
12 have little impact on a consumer's decision to purchase voice telecommunications
13 service. While it appears that the historic policy goal of increasing local telephone
14 subscribership by holding down local basic residential rates below average cost by
15 supporting them with above average cost rates for intrastate switched access may have
16 been a factor in increasing local telephone subscribership to present levels, a policy of
17 holding down local basic residential rates below average cost is no longer effective or
18 necessary to further increase penetration.

³ Penetration in Florida peaked in 2003 when 95.0% of all households in Florida subscribed to basic local residential telephone service on the wireline network. See Belinfante, Alexander; *Telephone Subscribership in the United States (Data Through March 2003)*; Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission; Table 2; Released November 2003, which is included as Exhibit ___ (DCB-1). Based on the most recent FCC data (May 2005) 91.6% of all households in Florida subscribe to basic local residential telephone service on the wireline network. See Belinfante, Alexander; *Telephone Subscribership in the United States (Data Through March 2005)*; Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission; Table 2; Released May 2005, which is included as Exhibit ___ (DCB-2). It should be noted that that the FCC's household penetration statistics do not count households that only use a wireless phone for all of their voice communications and have discontinued their wireline service.

1 **Q. How has competition for local telephone service impacted the support flows to**
2 **residential local service?**

3 **A.** Rates for basic residential local telephone service provided by Alltel over the local
4 wireline network continue to be priced based on past public policy principles. These
5 principles, and the resulting low prices, may have been useful in a monopoly
6 environment when telephony was a new service and policy-makers sought to increase
7 subscribership. However, as discussed above, that policy is no longer an effective or
8 necessary means to increase penetration for local residential telephone service beyond
9 95%. Additionally, in light of today's competitive market for toll and local telephone
10 service via wireline, wireless, VoIP and cable TV, it has become increasingly difficult
11 to sustain the contributions from the now competitive services that support Alltel's
12 basic local residential telephone service. Competition for toll, business lines, and
13 other services has put pressure on Alltel and other ILECs to reduce the prices for these
14 services and, as a result, reduce the support that they provide to local residential
15 service. As competition forces these rates down closer to average cost, support for
16 basic local residential telecommunications service is eroding and can no longer be
17 sustained. Thus, as the market for all telecommunications services becomes
18 increasingly competitive and the current support flows erode, the rates for Alltel's
19 basic local telephone service must be increased to more accurately reflect the actual
20 underlying cost for the service. The Florida Legislature recognized the impact of
21 competitive pressure and the resulting necessity to rebalance rates when it adopted the
22 Act.

23
24 **Q. Please describe the Florida statutory requirements with regard to the reduction**
25 **of intrastate switched access rates to parity in a revenue-neutral manner.**

1 A. The Act allows an ILEC to reduce its intrastate switched access rates to parity over a
2 period of two to four years in a revenue-neutral manner. For Alltel, an ILEC with less
3 than one million lines, "parity" is defined in the Act as: "the company's intrastate
4 switched network access rate⁴ is 8 cents per minute." See § 364.164(5), Fla. Stat.
5 Under the Act, local exchange carriers that reduce their intrastate switched access rates
6 to parity may increase the price of other services in a revenue-neutral manner.⁵
7 Subsection (1) of the Act states that the Commission shall consider whether granting
8 the petitions will:

- 9
- 10 a. Remove current support for basic local telecommunications services
 - 11 that prevents the creation of a more attractive competitive local
 - 12 exchange market for the benefit of residential consumers;
 - 13 b. Induce enhanced market entry;
 - 14 c. Reduce intrastate switched network access rates to parity over a period
 - 15 of not less than 2 years or more than 4 years; and
 - 16 d. Be revenue neutral as defined in subsection (7) within the revenue
 - 17 category defined in subsection (2).
- 18

19 **Q. Is the Alltel plan similar to those the Commission approved for BellSouth, Sprint**
20 **and Verizon?**

⁴ Section 364.164(6), Florida Statutes, defines the term intrastate switched network access rate for purposes of this section as "the composite of the originating and terminating network access rate for carrier common line, local channel/entrance facility, switched common transport, access tandem switching, interconnection charge, signaling, information surcharge, and local switching." A copy of Section 364.164, Florida Statutes, ("Act") is included in Exhibit No. ____ (DCB-3).

⁵ Section 364.164(7), Florida Statutes, states that the term "revenue neutral" means: "the total revenue within the revenue category established pursuant to this section remains the same before and after the local exchange telecommunications company implements any rate adjustments under this section."

1 A. Yes. In Dockets 030867-TL, 030868-TL, 030869-TL (“Rebalancing Dockets”), this
2 Commission approved petitions by BellSouth, Verizon, and Sprint to reduce their
3 intrastate switched access rates to parity and offset the revenue reduction by increasing
4 their rates for basic local residential service. As I will describe in more detail later,
5 Alltel is seeking approval of a very similar plan to reduce its intrastate switched access
6 rates to parity and offset the revenue reduction by increasing its basic local service
7 rates.

8

9 **III. INTRASTATE SWITCHED ACCESS RATES CURRENTLY PROVIDE**
10 **SUPPORT FOR BASIC LOCAL TELECOMMUNICATIONS SERVICE THAT**
11 **WOULD BE REDUCED BY LOWERING THESE RATES.**

12

13 **Q. Do Alltel’s intrastate switched access rates provide support to basic local**
14 **telecommunications service?**

15 A. Yes. Alltel’s basic local residential telephone services are priced below average cost
16 and are supported by contributions from a number of other telecommunications
17 services. Chief among these are intrastate switched access rates which were set
18 significantly above average cost in order to provide support to basic local residential
19 telephone services. Prior to the divestiture of AT&T in 1984, interstate and intrastate
20 toll was priced above average cost and the excess revenues were used to support basic
21 local telecommunications services. After the divestiture of AT&T, interstate and
22 intrastate switched network access services were created and used as the means to
23 continue the support flow from toll users to subscribers of basic local residential
24 telecommunications service.

25

1 The fact that intrastate switched access supports basic local telecommunications was
2 acknowledged in the Florida *Senate Staff Analysis and Economic Impact Statement on*
3 *the Tele-Competition Act*, which stated:

4
5 According to the commission, intrastate network access service
6 rates were set well above the incremental cost of providing the
7 service in order to keep rates for basic local telecommunications
8 service as low as possible and to encourage subscribership.⁶

9
10 **Q. What demonstrates that Alltel's residential local rates are currently receiving**
11 **implicit support contributed by intrastate access rates?**

12 **A.** Below, I present and discuss the results of three cost studies, each of which
13 demonstrate that Alltel's residential rates are below average cost. This means that
14 Alltel's basic residential local telephone service is being supported by other services
15 because it is not covering its share of common and overhead costs. Conversely, the
16 Hatfield Version 5.0a cost study cost study also demonstrates that Alltel's intrastate
17 switched access rates are currently priced significantly above average cost, meaning
18 that access is not only covering its own cost including overheads but is also providing
19 support for residential local service.

20
21 In Table 1, shown in Exhibit No. ____ (DCB-O), the current and proposed rates for
22 Alltel Florida's basic local residential telephone service and intrastate switched
23 network access service are compared to two cost studies from Florida Commission

⁶ See *Senate Staff Analysis and Economic Impact Statement of CS/SB 654 - the Tele-Competition Innovation and Infrastructure Enhancement Act.*, dated April 8, 2003, p. 9, a copy of which is included as Exhibit No. ____ (DCB-34).

1 Docket No. 980696-TP - a forward-looking TELRIC-based cost study calculated using
2 the Benchmark Cost Proxy Model Version 3.1 ("BCPM 3.1") with the model default
3 settings and a fully distributed embedded cost study also presented in that docket by
4 the small ILECs with adjustments made by the FPSC Staff. The third study reflected
5 in Table 1 is also a forward-looking TELRIC-based cost study and was conducted by
6 Alltel for this proceeding. It was developed from the Hatfield Cost Model Version
7 5.0a ("HAI 5.0a") using default inputs modified with company specific inputs for
8 Alltel.⁷

9
10 As can be seen in Table 1 of Exhibit ____ (DCB-O), the current price of \$10.49 for
11 Alltel Florida's basic local residential telephone service is far below the forward-
12 looking cost study estimates produced by the BCPM 3.1 and the HAI 5.0a proxy cost
13 models and is below the cost study estimate produced by the Commission-approved
14 fully distributed embedded cost study conducted in Docket No. 980696-TP.
15 Additionally, the table illustrates that the proposed price for intrastate switched access
16 is still higher than the HAI 5.0a forward-looking cost of providing that service despite
17 the fact that Alltel proposes to price its switched access below the statutorily defined
18 "parity" rate of \$0.08 per minute.

19
20 **Q. What type of cost study does Chapter 364, Florida Statutes, require for**
21 **determining the cost of providing basic local telecommunications service for**
22 **small local exchange telecommunications companies?**

⁷ The HAI 5.0a model is used to provide an estimate of forward-looking TELRIC rates for Alltel because the Company has not yet estimated a forward-looking model for the Florida study area. Later versions of HAI and the FCC's BCPM model that are publicly available do not contain data for Alltel. The HAI value found in Table 1 was developed using the total per line cost of service multiplied by the portion of total cost allocated to local service (non-private line) in the Company's 2004 cost study. Exhibit No. ____ (DCB-4) reflects related HAI 5.0a files and Exhibit No. ____ (DCB-5) reflects the Alltel 2004 embedded cost study.

1 A. Section 364.025(c), Florida Statutes, which applies to ILECs with fewer than 100,000
2 access lines, gives the Commission two options for determining the forward-looking
3 cost of providing basic local telecommunications service for small local exchange
4 telecommunications companies. The Commission may elect to use a proxy cost
5 model, but one that is different than the model the Commission would develop for the
6 larger ILECs in a public docket or the Commission may use a fully distributed
7 embedded cost model that is consistent with 47 C.F.R. parts 32, 36, and 64.⁸

8
9 The Commission has used an embedded cost study before. Docket No. 980696-TP
10 was initiated by this Commission to satisfy the legislative requirement to determine
11 and report to the Legislature the total forward-looking cost of providing basic local
12 telecommunications service. The purpose of the docket was to advise the Legislature
13 of the cost of providing local service for the purpose of establishing a permanent
14 universal service mechanism. In Docket 980696-TP, the small ILECs sponsored an
15 embedded cost study that was based on Part 36 jurisdictional separations procedures.
16 The Commission determined that the fully distributed embedded cost study sponsored
17 by the small ILECs best represented the cost of providing basic local
18 telecommunications for the small ILECs, such as Alltel. Thus, rather than use the
19 results generated by the BCPM 3.1 cost proxy model as the cost basis, the
20 Commission elected to use the results from the small ILECs' embedded cost study as
21 the appropriate cost basis for the purposes of establishing a universal service fund. In
22 its order, the Commission ruled that under Section 364.025(4)(c), Florida Statutes, the
23 embedded cost methodology, with adjustments as specified in the body of the Order,
24 was "adopted for Alltel Florida ... to determine those carriers' respective costs of

⁸ See § 364.025(c), Fla. Stat., a copy of which is included as Exhibit No. ____ (DCB-6).

1 providing basic local telecommunications service.” Relevant excerpts from the Final
2 Order in Docket No. 980696-TP are included as Exhibit No. ____ (DCB-7).

3

4 **Q. What adjustments did the Commission make to the embedded cost model**
5 **proposed by the small ILECs?**

6 **A.** The Commission used the embedded cost methodology proposed by the small ILECs
7 and made a few adjustments to the ILECs’ cost study. The Commission adjusted
8 AFUDC (Allowance for Funds Used During Construction), Account 7370 lobbying
9 and contribution expenses, gross receipts tax, working capital account, property taxes,
10 interest expense, corporate operations expense per line, and cost of equity for various
11 ILECs. After the Commission’s adjustments, the embedded cost model produced a
12 final cost number for Alltel’s basic local service of \$41.32, which was only slightly
13 lower than the \$41.97 cost estimate developed by Alltel. By comparison, the results of
14 the embedded cost study were 38% lower than the cost estimate of \$66.37 generated
15 by the BCPM 3.1 cost proxy model in that docket, but only 12% lower than the cost
16 estimate of \$48.44 generated by the HAI Version 5.0a cost proxy model that I present
17 in Exhibit No. ____ (DCB-4) and discuss in this testimony.

18

19 **Q. What adjustments did Alltel make to the HAI 5.0a cost proxy model?**

20 **A.** Alltel changed a few of the default inputs in the HAI 5.0a cost proxy model in order to
21 better reflect Alltel’s actual investment and expenses in Florida. Accordingly, Alltel
22 modified the following inputs: cost of capital; depreciation lives and salvage value for
23 some of the equipment; and the investment dollars for NID (Network Interface
24 Device) and DLC (Digital Loop Carrier); cable investment (distribution, feeder and
25 drop); and the factors for corporate overhead and taxes. A list of the input factors that

1 Alltel changed in the HAI 5.0a cost proxy model to better reflect the costs of Alltel
2 providing service in its Florida service area is provided in Exhibit No. ____ (DCB-4).

3
4 With respect to the cost of capital, Alltel changed the HAI model inputs to reflect a
5 lower debt ratio and a higher equity ratio, which better represents Alltel's debt-equity
6 ratio. Additionally, Alltel's current cost of debt is lower than the HAI 5.0a model's
7 default rate. Alltel also changed the cost of equity slightly to reflect Alltel's cost of
8 equity. These changes produce an overall rate of return of 10.79% for Alltel as shown
9 in Exhibit No. ____ (DCB-4). The depreciation lives and salvage values for twelve of
10 the twenty-two equipment investment categories were modified to reflect the
11 depreciation lives and salvages values that were approved by this Commission in 1996
12 during Alltel's last depreciation study.⁹

13
14 Alltel also increased the default setting for the per line monthly LNP revenue collected
15 to 37 cents per month to reflect the amount that Alltel actually collects. The
16 investment dollars for NIDs were changed from the HAI 5.0a model default inputs to
17 reflect the current material prices and installation labor amounts used by Alltel Florida
18 for capital cost estimates. The model input for DLC Investment dollars was changed
19 to reflect the fact that Alltel uses Calix equipment which comes in different size
20 increments than the 120/240 low-density and 672/1344/2016 high-density sizes used
21 in the HAI model. This change led to slight increase in DLC investment when Calix
22 equipment requirements were developed using the HAI cluster data and current
23 material prices.

⁹ See Order No. PSC-96-0680-FOF-TL; In Re: Request for Approval of 1995 Depreciation Study by Alltel Florida, Inc.; Dkt. No. 950887-TL (May 23, 1996), a copy of which is included as Exhibit No. ____ (DCB-8).

1 Alltel changed the investment dollars per foot and labor installation costs for
2 distribution, feeder, and drop cable as well as for poles using current material costs
3 and average installation hours found in Alltel's work order management system. The
4 fill rates in the HAI model were not changed because the HAI model reflects what
5 Alltel believes would be a reasonable forward-looking fill rate. Finally, Alltel reduced
6 the corporate overhead cost factor and reduced the "Other Taxes" factor as shown in
7 Exhibit No. ___ (DCB-4). The net change resulting from Alltel's input changes was
8 to increase the HAI 5.0a model output for the default cost of local service in Alltel's
9 service territory from \$41.76 to \$48.44. Both cost estimates are significantly greater
10 than Alltel's current average rate for residential basic local service of \$10.49.

11

12 **Q. What do you conclude about Alltel's cost of providing basic local service and**
13 **whether its local service is being supported by contributions from Alltel's**
14 **intrastate switched access revenues?**

15 **A.** The fully distributed embedded cost study as modified by the Commission Staff and
16 as approved by the Commission in Docket 980696-TP and the HAI 5.0a forward-
17 looking cost study developed by Alltel for this proceeding both show conclusively that
18 the average cost of Alltel's residential basic local telecommunications services is
19 much greater than its current price of \$10.49. This means that basic residential local
20 telephone service is being supported by other services because it is not covering its
21 share of common and overhead costs. Alltel's basic local service is receiving implicit
22 support because the revenues from Alltel's basic local service are insufficient to
23 recover its own long run forward-looking and/or direct costs. The support for basic
24 residential local service comes from all those services that are priced above average
25 cost; most notably intrastate switched access. Alltel's intrastate switched access rate is

1 priced significantly above average cost and is not only covering its own cost including
2 overheads, but is also providing support for residential local service.

3 **Q. Is it clear that residential local service is being supported by intrastate switched**
4 **access?**

5 **A.** Yes. However, even though the price of one service may be supported by the price of
6 another, it does not mean that a subsidy exists. There is a fundamental distinction
7 between a subsidy flow and a support flow. Although these terms are sometimes used
8 interchangeably, they are not the same. Subsidy has a very precise definition in
9 economic literature that a service is said to be internally subsidized if the price of the
10 service is below its long run marginal cost while the price of another service exceeds
11 its stand alone cost.¹⁰ On the other hand, implicit support can occur even if the
12 favored service is priced at or just above long run marginal cost but below the average
13 cost of providing the service and other services are priced above average cost. In each
14 case, one set of services is priced at artificially high levels (above average cost) to
15 support other service(s) priced at below average cost. Thus, internal subsidization is
16 an extreme example of implicit support. In either case, as competition forces the price

¹⁰ See *Handbook of Telecommunications Economics*, Amsterdam: Elsevier Science, 2001 and *Chapter 10, UNIVERSAL RESIDENTIAL TELEPHONE SERVICE*, Michael H. Riordan, *Columbia University*, August 29, 2001, a copy of which is included as Exhibit No. ____ (DCB-9). A possible tension between the popular meaning and Faulhaber's definition of a cross-subsidy is revealed in the following quotation from Kaserman and Mayo (1994 pp. 135-6):

'To some extent, the argument over whether a subsidy exists is semantic. The answer hinges upon one's definition of a subsidy and how one would measure the costs of the services involved. Regardless of the position one adopts, however, there is no economic justification for a system that places the burden of fixed network costs on usage-sensitive prices. Such a system is inefficient whether or not a subsidy results. Consequently, one need not become mired in the subsidy debate to make definite statements about efficient pricing policies. We will continue to use the cross-subsidization terminology throughout the remainder of this article because it is convenient to characterize the overpricing of one service along with the under-pricing of another as a cross-subsidy, whether or not these prices fall outside the range that the Faulhaber criteria define. What is more, we are convinced that such cross-subsidization exists, is substantial, and is an accurate description of the existing price structure in this industry.'" See Exhibit No. ____ (DCB-9).

1 of contributing services down to average cost, it becomes more difficult to fund the
2 support flows. I am not claiming that residential service is internally subsidized nor
3 does the statute require such a demonstration.¹¹ It is clear, however that residential
4 local service prices are supported by intrastate access rates and that as competition
5 continues to develop, these support flows are not sustainable.

6
7 The Commission concluded in the Rebalancing Dockets that intrastate switched access
8 rates do, in fact, provide support to basic local residential telecommunications
9 services. Specifically, in paragraph 1 of section V, Summary of Decision, in the
10 Rebalancing Order, the Commission stated:

11
12 Intrastate access rates currently provide support for basic local
13 telecommunications services that would be reduced by bringing
14 such rates to parity with interstate access rates.¹²

15
16 The Commission should make the same finding in this proceeding, that intrastate
17 access rates currently provide support for basic local telecommunications services that
18 would be reduced by bringing such rates to parity as defined by the Act. The cost
19 studies clearly show that basic local residential telecommunication service is priced far
20 below its embedded and forward-looking average cost while intrastate switched access
21 is priced above its embedded and forward-looking average cost conclusively showing

¹¹ Section § 364.164(1) (a), Florida Statutes, speaks of removing support not eliminating internal subsidies.

¹² See Rebalancing Order at 14, Exhibit No. ____ (DCB-10).

1 that basic local residential telecommunications service is being supported by intrastate
2 switched access services.

3 **Q. How should the loop be allocated?**

4 **A.** The Commission determined in the Rebalancing Dockets, that the cost of the local
5 loop is a cost of basic local service. A contrary finding would be inconsistent with
6 past Commission decisions, especially the Commission's 1998 Report on Fair and
7 Reasonable Rates to the Legislature wherein it specifically stated that the costs
8 associated with the local loop should not be allocated. This Commission has a
9 consistent policy on this issue.¹³

10

11 **Q. If Alltel's intrastate switched access rates are moved to parity as defined by the**
12 **Statute and Alltel's rates for residential local service are increased, will all**
13 **support for Alltel's residential local service rates have been eliminated?**

14 **A.** No. In addition to some remaining support continuing to flow from access, Alltel's
15 residential local service receives additional support from other services. To the extent
16 that any service that Alltel provides is priced above average cost, it may be considered
17 to be providing support to Alltel's residential local service and any other service that
18 may be priced below its average cost. For example, intraLATA toll and custom
19 calling features generally are considered to provide support to local residential service.
20 However, for the purposes of this proceeding, the Legislature has specified that
21 intrastate switched access rates are the target and are to be reduced and rebalanced
22 against basic local rates. However, because residential rates will still be below their
23 average costs, this proceeding will not lead to a complete rebalancing of rates.

24

¹³ See Rebalancing Order at 18.

1 **IV. THE EXISTENCE OF LOCAL SERVICE SUPPORT PREVENTS THE**
2 **DEVELOPMENT OF A MORE COMPETITIVE LOCAL EXCHANGE**
3 **MARKET.**

4
5 **Q. How does support from intrastate switched access prevent the development of a**
6 **more competitive local exchange market?**

7 **A.** Artificially low local residential service prices discourage potential competitors from
8 entering the residential market. Potential competitors look at the prevailing market
9 price, their own costs of providing the service and the resulting profit margins as key
10 factors in making a determination as to whether they will enter a particular market. If
11 the market price of residential local service is less than the potential competitor's
12 anticipated costs, the potential competitor will not view residential service as a
13 potentially profitable venture and therefore will not enter that market.

14
15 Even if a potential competitor has a lower underlying cost of provisioning local
16 residential service than the ILEC, the potential competitor will not enter the market if
17 the ILEC's artificially low price for local residential service is below the potential
18 entrant's cost. As discussed previously, this is exactly the situation in the Alltel
19 markets.¹⁴

20
21 **Q. What happens if the market price of residential local service is greater than the**
22 **potential competitor's anticipated costs?**

¹⁴ Uneconomic competitive advantage refers to differences not resulting from underlying cost or quality differences.

1 A. If the market price of residential local service is equal to or greater than the potential
2 competitor's anticipated costs (including a reasonable profit), the potential competitor
3 is incented to enter that market. Of course, the greater the profit margin, the greater
4 the number of potential competitors that will enter the market. For example, if the
5 market price of residential local service in Alltel's territory were \$100 and the new
6 entrants' cost to provide service was only \$30, Alltel's territory would be flooded with
7 new entrants seeking to participate in a very lucrative market to capture those profits.
8 While I am not advocating a market price of \$100, I simply use this example to
9 illustrate the principle that the higher the price, the greater the number of competitors
10 that will seek to enter the market. Ultimately, the increased competition will force
11 prices down to cost and drive out the inefficient providers. To the extent that the price
12 for Alltel's local residential service is moved closer to average cost, the market will
13 become that much more attractive to potential competitors.

14
15 **Q. Does that fact that the price of Alltel's residential local service is so far below its**
16 **cost have any impact on whether a competitor will enter Alltel's local market?**

17 A. Absolutely not. Although cost and market share measures are meaningful to
18 competitors, competitors will look principally at Alltel's price of local 1R service, not
19 just Alltel's cost. Competitors are primarily concerned about their own cost of
20 providing service and whether they can charge a price that is high enough to cover
21 their own costs. If the market price (i.e., Alltel's price) of residential local service is
22 greater than the potential competitor's anticipated costs (including a reasonable profit),
23 the potential competitor is incented to enter that market. Thus, a competitor doesn't
24 care if Alltel's costs are \$1 or \$100 greater than Alltel's price. A competitor only
25 cares whether its own costs are less than Alltel's price.

1 Q. Will moving the price of Alltel's residential local service closer to average-cost
2 attract other providers of local telecommunications besides CLECs?

3 A. Yes. As the price of Alltel's local residential service moves closer to average cost, all
4 types of providers of local telecommunications services will factor the new market
5 price into their market entry analyses and re-evaluate whether entry will be profitable.
6 Today, there are a number of different technologies and carriers that compete in the
7 local telecommunications market in Florida and/or the United States, including
8 wireline CLECs, wireless carriers, cable telephony providers, voice over internet
9 protocol ("VoIP") providers, electric utilities, and even satellite carriers. One
10 important reason for moving the price of Alltel's residential local service toward
11 average cost is that technological change is proceeding rapidly and that competitive
12 markets can do a much better job of discovering which technologies can best provide
13 service to customers in any given region. However, in order for the lowest-cost mix of
14 technologies to enter or remain in the market, prices and the signals they send must
15 not be distorted and must reflect the underlying cost of providing service. Alltel's
16 plan to move the price of its residential local service closer to average cost will
17 encourage new entrants, regardless of their chosen technology, to enter or expand in
18 the marketplace. At current rate levels even competitors using lower-cost (or more
19 attractive) technologies may not be able to compete against a supported ILEC price
20 that does not reflect its own average costs.

21
22 This Commission's decision in the Rebalancing Dockets also supports my conclusion.
23 The Commission found that the existence of local service support from intrastate
24 switched access prevents the creation of a more attractive competitive local exchange

1 market. Specifically, in paragraph 2 of the Summary of Decision portion of the
2 Rebalancing Order, the Commission concluded:

3

4 The existence of such support (i.e., subsidies from intrastate
5 switched access) prevents the creation of a more attractive
6 competitive local exchange market by keeping local rates at
7 artificially low levels, thereby raising an artificial barrier to entry
8 into the market by efficient competitors.¹⁵

9

10 The same finding is appropriate in this proceeding for Alltel that the existence of
11 support from intrastate switched network access prevents the creation of a more
12 attractive competitive local exchange market by keeping rates for basic local
13 residential telephone service at artificially low levels, thereby raising an artificial
14 barrier to entry into the market by efficient competitors.

15

16 **V. THE REDUCTION OF SUPPORT WILL INDUCE MARKET ENTRY INTO**
17 **THE LOCAL EXCHANGE MARKET.**

18

19 **Q. Why will the reduction of support enhance market entry into the local exchange**
20 **market?**

21 **A.** As discussed in the preceding section, market entry will be enhanced if implicit
22 support is removed from Alltel's local residential service rates and the service is
23 priced at or above long run incremental cost plus a reasonable share of common and
24 overhead costs. Reducing implicit support and raising residential service rates will

¹⁵ See Rebalancing Order at 14.

1 better enable potential competitors with cost structures lower than and or equal to that
2 of Alltel to compete effectively. Conversely, continuing to support 1R basic local
3 services will continue to hamper the development of competition for those services.
4 In effect, the elimination of implicit support will result in a price that will give more
5 correct economic signals about the potential profitability of providing local residential
6 telecommunications service and lead to a more efficient allocation of resources.

7
8 **Q. What empirical evidence supports the idea that rate rebalancing will enhance**
9 **entry into the residential local telecommunications market?**

10 **A.** The National Economic Research Associates published a research paper describing the
11 results of an empirical investigation of whether low basic local residential rates were
12 stifling the development of residential competition. The authors, McDermott and Ros,
13 compared how local competition varied across different states depending on how
14 “unbalanced” the prices were for local telephone service; that is, the extent to which
15 rates for local residential telephone service were priced below average cost and rates for
16 local business telephone service were priced above average cost. The authors even
17 measured the degree to which local residential exchange prices were “distorted” in each
18 state. The authors found that residential rates priced below average cost inhibited the
19 development of competition for local residential telephone service.

20
21 More specifically, Ros and McDermott set out to test the hypothesis of whether
22 residential rates set below average cost and business rates set above average cost were
23 having an impact on the development of local exchange competition and inhibiting the
24 development of residential competition. Ros and McDermott noted that competitors
25 are targeting business services because they tend to be priced above their average

1 costs. Conversely, the authors noted that CLECs are largely ignoring residential
2 customers because residential services tend to be priced below average cost. CLECs
3 may be ignoring residential customers not because underlying demand and supply
4 conditions justify it but rather because of regulatory distortions. If true, the policy
5 implication is that states should move more aggressively than they have to date in
6 rebalancing prices – i.e., setting residential and business prices in accordance with
7 economic efficiency.¹⁶

8
9 Ross and McDermott measured residential competition separate from business
10 competition and further divided competition into both facilities-based and resale.
11 Using both ordinary least squares (OLS) and generalized least squares (GLS), the
12 authors found that unbalanced local exchange prices had a negative impact on the
13 development of residential local exchange competition. Specifically, they found that
14 as prices were more unbalanced, the percent of ILEC residential lines served by
15 switching centers where new entrants have collocation arrangements decreased.
16 Based on the model's results, the authors concluded that a 10% increase in residential
17 rates (which were below average cost) could lead to a 9% to 13% increase in local
18 competition. Their paper notes:

19
20 we found a significant and positive association between states that
21 have more “balanced” tariffs and residential competition. For two
22 measures of residential competition used in our data, we found that

¹⁶Agustin J. Ros and Karl McDermott, “Are Residential Local Exchange Prices Too Low? Drivers to Competition in the Local Exchange Market and the Impact of Inefficient Prices,” in Michael Crew, *Expanding Competition in Regulated Industries*, Kluwer Academic Publishers, 2000. p. 54, a copy of which is included as Exhibit No. ___ (DCB-11).

1 “rebalancing” tariffs by 10% leads to approximately a 9% and 13%
2 increase, respectively, in residential competition.¹⁷

3
4 **Q. What other empirical evidence can you provide that supports this concept?**

5 **A.** Two other studies, referenced in the Rebalancing Dockets, also support the conclusion
6 that rate rebalancing will enhance entry into the local residential telecommunications
7 market.¹⁸ Specifically, an empirical study conducted by James Eisner and Dale E.
8 Lehman concluded: “there appears to be less competitive entry (principally facilities-
9 based) where residential rates are lower. These findings are generally statistically
10 significant at the 90% level.”¹⁹ Also an empirical study conducted by Ros and
11 Banejee that examined rate rebalancing in Latin America concluded that in some Latin
12 American countries where the supply of residential local service had been constrained
13 by below cost pricing, rate rebalancing led to increases in the supply of main
14 telephone lines by providing better incentives to market participants.²⁰ Specifically,
15 the authors concluded that:

16
17 instead of relying on artificially low prices to trigger greater use of
18 the telecommunications network—on the theory that low prices

¹⁷ Id. at 67

¹⁸ These studies were discussed in the Amended Direct Testimony of Dr. Kenneth Gordon On behalf of Verizon Florida Inc., BellSouth Telecommunications, Inc., and Sprint-Florida Inc, a copy of which was entered into the record in the Rebalancing Dockets and which is included as Exhibit No. ____ (DCB-12).

¹⁹ James Eisner and Dale E. Lehman, *Regulatory Behavior and Competitive Entry*, presented at the 14th Annual Western Conference Center for Research in Regulated Industries, June 28, 2001; p. B24 [Hereinafter “Eisner and Lehman”], a copy of which is included as Exhibit No. ____ (DCB-13).

²⁰ Agustin J. Ros and Aniruddha Banejee, “Telecommunications Privatization and Tariff Rebalancing: Evidence from Latin America,” *Telecommunications Policy*, 24 (2000) 233-252, a copy of which is included as Exhibit No. ____ (DCB-14).

1 enable consumers to harness network externalities and increase
2 penetration rates—it is more pragmatic to allow
3 telecommunications operators, especially in countries that have
4 privatized, to recover their costs by charging compensatory prices.
5 A country may be able to generate “high” levels of demand by a
6 deliberate policy of maintaining prices below cost or at low levels,
7 but—as long as it does not provide subsidy support for such
8 prices—it is only by increasing actual supply that the country can
9 actually expect to see service delivered to consumers.²¹

10 **Q. Please provide more detail about the Eisner and Lehman study.**

11 **A.** Using data compiled by the FCC, Eisner and Lehman, developed and ran more than 40
12 regression models to determine the ways in which regulatory behavior may have
13 affected the rate and type of competitive entry into the local telecommunications
14 market. In particular, the authors were interested in the efficacy that the pricing of
15 unbundled network elements (UNEs) and the setting of resale discounts had on CLEC
16 entry. The authors reviewed several variables including rates for basic local
17 residential telephone service and confirmed earlier research conducted by Ros and
18 McDermott, which found that higher retail residential rates tend to promote facilities-
19 based entry.²² Eisner and Lehman also found that “In most of the models, CLEC lines
20 increase with residential rates and the effect is significant at the 90 percent
21 significance level.”²³ Thus, there is empirical evidence that higher retail rates for

²¹ Id. at 27, Exhibit No. ____ (DCB-14).

²² See Eisner and Lehman at B10 [Exhibit No. ____ (DCB-13)].

²³ Id. at B20.

1 basic local residential telephone service provide stronger incentives for CLECs to
2 enter those local markets and tend to promote facilities-based entry.

3

4 **Q. Who are the competitors that could enter Alltel's markets if rates are**
5 **rebalanced?**

6 **A.** Since DSL is available in all of Alltel's exchanges except Hastings, it is physically
7 possible for Vonage, AT&T, BellSouth and others to offer VoIP telephony service
8 throughout Alltel's Florida territory. Therefore, if the price of Alltel's 1R service
9 increases to \$16.49, then Vonage's \$14.99 plan becomes a viable competitive choice
10 in Alltel's Florida territory that customers might choose over Alltel for a second phone
11 line.²⁴ It is likely that other VoIP-based providers such as AT&T and BellSouth
12 would also find it profitable to enter Alltel's territory if the average price of Alltel's
13 1R service was increased to \$16.49.

14

15 Skype is another potential VoIP-like competitor in Alltel's territory and may, in fact,
16 be competing within Alltel's Florida territory today. Ebay recently spent \$2.6 billion
17 to purchase Skype - a software-based peer-to-peer ("P2P") file sharing program
18 similar to Napster and Kazaa (the music file-sharing programs that caused much
19 controversy), that allows callers to use the P2P file-sharing software to place voice
20 phone calls over the internet in real-time with call quality that is comparable to the
21 quality provided by the traditional public switched telephone network. Skype's
22 software is available as a free download on the internet at www.skype.com and only

²⁴ Since Alltel provides DSL service over its own loops, Alltel's DSL customers are required to purchase 1R voice service from Alltel. Thus, existing Alltel customers would only be buying their 2nd and 3rd lines from Vonage or another VoIP provider. However, if the local cable TV provider offered broadband internet services to any of Alltel's customers, then those customer could purchase Vonage's VoIP local phone service without having to also purchase voice service from Alltel.

1 requires a 33.6 kbps dial-up internet connection for phone service although faster
2 speeds are better. Calls between Skype customers are free and calls from a Skype user
3 to a landline or wireless customer are approximately 2.3 cents per minute. Skype
4 already has 54 million members in 225 countries and territories and adds
5 approximately 150,000 users a day. In North America alone, Skype has more users
6 and serves more voice minutes than any other Internet voice communications
7 provider.²⁵

8
9 **Q. In addition to VoIP providers, could cable TV companies also provide competing**
10 **voice telephone services in Alltel's Florida territory?**

11 **A.** Yes, many cable TV companies such as Cox, Time Warner, Comcast, and others are
12 providing voice telephony services over their cable networks throughout the U.S. and
13 have plans to some day offer voice telephony service in Alltel's territory if they
14 currently provide cable TV service there. Cox Communications has over one million
15 telephone customers and plans to offer its \$39.95 local calling/unlimited long distance
16 calling plan in Alachua, which is currently served by Alltel.²⁶ Time Warner's Digital
17 Phone service has been launched in all of its divisions and is available to over 70% of
18 TWC Inc.'s homes passed.²⁷ Time Warner provides cable TV and broadband internet
19 services in Live Oak, Mayo, Jennings, and Interlachen which are in Alltel's service
20 territory. I anticipate that Time Warner will offer voice telecommunications in these
21 Alltel communities in the future. In addition to offering voice telephony, Cox and
22 Time Warner offer high speed internet service in direct competition with Alltel's DSL

²⁵ See "eBay to Acquire Skype" eBay press release dated September 12, 2005; available at http://investor.ebay.com/downloads/eBay_PressRelease.pdf included as Exhibit No. ____ (DCB-36).

²⁶ See Cox Communications website at <http://www.cox.com/GainesvilleOcala/>, included as Exhibit No. ____ (DCB-37).

²⁷ See Time Warner Inc, Form 10-Q Quarterly Report, Filed 8/3/2005 For Period Ending 6/30/2005; p.3. Included as Exhibit No. ____ (DCB-38).

1 offering. Both Cox and Time Warner bundle cable TV, broadband internet, unlimited
2 long distance calling and, in some instances, wireless calling, with their local phone
3 service in an effort to entice customers away from the ILEC.

4
5 **Q. What should the Commission conclude with regard to whether the elimination of**
6 **support will enhance market entry into the residential local exchange market?**

7 **A.** The Commission should find, as it did in the Rebalancing Dockets, that the
8 elimination of support will induce competitive entry into the residential local exchange
9 market. In paragraph 3 in the Summary of Decision section of the Rebalancing Order,
10 the Commission found that: "The elimination of such support (i.e., subsidies from
11 intrastate switched access supporting local residential service) will induce enhanced
12 market entry into the local exchange market."

13
14 Accordingly, based on the record in this case, the Commission should make the same
15 finding in this proceeding for Alltel that the elimination of support will enhance
16 market entry into the local exchange market. As discussed above, empirical evidence
17 supports the contention that raising retail rates for basic local residential telephone
18 service closer to cost provides stronger incentives for CLECs to enter those local
19 markets and promotes facilities-based entry.

20
21 **VI. ENHANCED MARKET ENTRY WILL RESULT IN THE CREATION OF A**
22 **MORE COMPETITIVE LOCAL EXCHANGE MARKET THAT WILL**
23 **BENEFIT RESIDENTIAL CONSUMERS**

24

1 Q. How will enhanced market entry result in the creation of a more competitive
2 local exchange market that will benefit residential consumers?

3 A. As discussed above, to the extent that Alltel's rates for local residential telephone
4 service are moved closer to average cost, competitors will have a greater incentive to
5 enter Alltel's territory and provide competitive local residential telephone service.
6 Today, competitors are making in-roads into the local residential telecommunications
7 market. Alltel's rate rebalancing is necessary to increase such competition.

8

9 Q. Is there evidence that other types of local telecommunications providers are
10 competing with ILEC fixed-wireline local service?

11 A. Yes. CLECs, wireless carriers, cable telephony providers, VoIP providers, electric
12 utilities, and even satellite carriers are competing in the local telecommunications
13 market in Florida. In its most recent report to the state legislature regarding the status
14 of competition in the telecommunications market in Florida, the FPSC discussed
15 existing and potential competitors providing local telecommunications services, and
16 stated:

17

18 In an environment of emerging intermodal competition for voice
19 service, analysis of this statutory factor (i.e., the ability of customers to
20 obtain functionally equivalent services at comparable rates, terms, and
21 conditions) is not simple. Customers may obtain what they consider
22 functionally equivalent services – via wireline telephony, wireless,
23 VoIP, or cable telephony.²⁸

²⁸ See Florida Public Service Commission, *Annual Report To The Florida Legislature On The Status Of Competition In The Telecommunications Industry In Florida as of May 31, 2004*, p. 75, a copy of which is included as Exhibit No. ____ (DCB-15).

1 The report goes on to state that competition for local telecommunications service from
2 wireless carriers is “fiercely competitive.” The report states:

3
4
5
6
7
8
9

 Approximately 23 wireless competitors serve the state, including all six
 nationwide providers. Some 77% of Floridians have a choice of five or
 more wireless carriers. Statewide subscribership is high at over 10
 million..... Florida’s consumers benefit from an array of services,
 offered at competitive prices, by numerous and fiercely competitive
 providers.²⁹

10
11
12
13
14
15
16
17
18
19
20
21
22
23

 The Staff’s report declares that Florida leads the nation in recognizing the benefits of
 VoIP technologies because of the Florida Legislature’s proactive steps to exempt VoIP
 from unnecessary regulation. As a result, “[T]his model has already spurred several
 companies, such as Vonage, AT&T, and Bright House Networks, to offer VoIP
 service – a technology that makes use of a broadband connection to deliver voice
 service, at least in part, over the Internet.”³⁰ In addition, the RBOCs, including
 Bellsouth, are also starting to provide voice service using VoIP technology further
 ensuring that VoIP technology will survive and prosper. The FPSC report also
 recognizes the potential of Broadband over power line communications (BPL) as
 another promising technology in the competitive telecommunications arena and notes
 that “Because power lines reach virtually every home and community, BPL provides
 potential to become an additional major communications pipe into the home.”³¹

²⁹ Id. at 11; Exhibit No. ____ (DCB-15).
³⁰ Id. at 14; Exhibit No. ____ (DCB-15).
³¹ Id. at 16; Exhibit No. ____ (DCB-15).

1 As conclusive evidence that competitors are making inroads into the market for local
2 telecommunications services in Florida, the Commission's report notes:

3
4 While not all customers have numerous alternatives to traditional
5 telephone service today, the decline of the traditional telecom sector –
6 and the emergence of alternatives to traditional telephony - are hard to
7 ignore. ILEC access lines are decreasing, due at least in part to
8 competitive technologies such as wireless, broadband, and VoIP.
9 Florida-specific data supports this trend of declining ILEC access lines.
10 Specifically, ILECs lost 12% of their lines to CLECs and intermodal
11 competitors between 2001 and 2004.³²

12
13 As Alltel moves the price of its residential local service closer to average cost, new
14 entrants, especially those that are already competing in other areas of Florida, will
15 have a stronger incentive to enter and compete in Alltel's service territory.

16
17 **Q. Are competitors entering rural markets similar to those served by Alltel?**

18 **A.** Yes. Rural communities are beginning to see smaller, regional competitors entering
19 and providing local telephone service. Companies such as Unite Communications
20 Systems are entering rural communities, deploying fiber, and offering triple-play
21 packages of local phone service, cable TV, and broadband internet.³³ In other rural

³² Id. at 17; Exhibit No. ____ (DCB-15).

³³ Unite Communications Systems provides local phone service, cable TV, and broadband internet services to rural communities in Kansas and Missouri. See <http://www.uniteone.net/index.html> to learn more about Unite Communications Systems. A copy of the home page is included as Exhibit No. ____ (DCB-16).

1 communities, cable companies are beginning to offer local telephone service in
2 addition to cable television and broadband internet services. In other states, such as
3 Washington and Utah, public utilities and municipalities have built their own fiber
4 networks capable of providing local phone service, cable TV, and broadband internet
5 targeting smaller communities.³⁴ And finally, the widespread reach of the internet into
6 even rural communities allows companies, such as Skype, to offer an alternative to
7 traditional ILECs as long as the user has access to dial-up speeds of at least 33.6 kbps.

8
9 **Q. How will increased competition benefit consumers?**

10 **A.** Increased competition will provide local residential consumers with a wider choice of
11 local service providers that will offer new bundles of services, new and innovative
12 services, and lower prices as they compete for customers. While it is impossible to
13 know exactly who the competitors are that will enter Alltel's local market service
14 territory, when they will enter, or which new bundles of services they will offer, we
15 can be certain that more competitors will come once rates are rebalanced and will
16 bring benefits to residential consumers because this has occurred in other states.

17
18 The success Wyoming has found in attracting competitors to its rural local
19 telecommunications markets by rebalancing rates is indicative of the competition that
20 consumers in Alltel's service areas can expect and illustrative of the benefits they will
21 enjoy. Since the Wyoming Telecommunications Act of 1995 was passed ten years

³⁴ In the State of Utah, 14 municipalities that have banded together to build and operate their own fiber network under the project name of Utopia (Utah Telecommunication Open Infrastructure Agency). See <http://www.utopianet.org/>, a copy of which is included as Exhibit No. ___ (DCB-17). In Washington State, the Grant County Public Utility District and the Chelan County Public Utility District have built their own fiber networks. See <http://www.gcpud.org/zipp/zippnews.htm>, a copy of which is included as Exhibit No. ___ (DCB-18), and https://fiber.chelanpud.org/euedu/about_Us/PUD_Fiber/Presentations/, a copy of which is included as Exhibit No. ___ (DCB-19).

1 ago, the Wyoming PSC has worked to rebalance rates for all of Wyoming's ILECs by
2 reducing intrastate switched access rates and 1B rates and raising 1R rates to offset the
3 reduced revenues. The result is that new competitors have entered the local telephone
4 market in Wyoming despite the fact that local service areas in Wyoming are largely
5 rural, high cost areas. These new competitors are offering better bundles of services
6 (for example, cable TV bundled with high speed internet, local calling and unlimited
7 long distance) with lower prices.

8
9 The Wyoming PSC's 2005 Annual Report on Telecommunications shows that
10 Wyoming consumers now have a wider choice of local service providers offering new
11 bundles of services as a result of increased competition caused by rate rebalancing.

12 The report states:

13
14 The Wyoming Act and the federal Act have had a profound effect
15 on the development of the telecommunications industry in
16 Wyoming. They have encouraged the development of competitive
17 alternatives for business and residential. Competition and
18 communications infrastructure development are increasing but it is
19 not all being done by traditional service providers. Examples of
20 this are the high speed data services being offered by Contact
21 Communications in a number of smaller and larger Wyoming
22 markets, the point-to-point communications services of Bresnan
23 Communications offered using cable television infrastructure, the

1 proliferation of digital cellular service throughout the state, and the
2 SWEETNET local infrastructure project.³⁵

3 The Wyoming PSC's 2005 Annual Telecom Report goes on to say that:

4
5 The successful entry of Silver Star Communications into direct
6 facilities-based local service competition with Qwest in the Afton
7 exchange shows that it is possible to be technologically advanced
8 and successful in such a competitive endeavor in Wyoming -- even
9 in a relatively small market.³⁶

10
11 Rural electric cooperatives like Carbon Power & Light now offer
12 satellite service. In March 2005, it will participate in the trial of
13 Wild Blue, a new and more technologically advanced satellite
14 service capable of providing television programming, Internet
15 service, and eventually VoIP. This service is targeted at consumers
16 in rural areas which characterize rural electric cooperative service
17 territories in Wyoming.³⁷

18
19 A closer look at Contact Communications and Bresnan Communications shows that
20 these two CLECs have carved out a niche targeting smaller towns and rural areas and
21 providing them with quality voice telephony and high-speed internet connectivity.

22

³⁵ See Wyoming Public Service Commission, *Wyoming PSC 2005 Annual Telecom Report*, prepared by the Wyoming Public Service Commission, January 10, 2005, p. 54, a copy of which is included as Exhibit No. __ (DCB-20).
³⁶ Id. at 62; Exhibit No. __ (DCB-20)
³⁷ Id. at 63; Exhibit No. __ (DCB-20).

1 Bresnan Communications is a broadband telecommunications provider founded in
2 1984 that targets small and medium-sized markets. Bresnan currently serves over
3 300,000 customers in Colorado, Montana, Wyoming, and Utah providing voice
4 telecommunications, high-speed Internet access, cable TV, video-on-demand, and
5 digital video recorder to residential and business customers across its own fiber-optic
6 coaxial network that reaches across 95% of its footprint. Bresnan Business Services
7 delivers custom data, voice, and video solutions to businesses and institutions of all
8 sizes. Bresnan Digital Phone is currently available in Grand Junction, CO, Durango,
9 CO, Cheyenne, WY, Billings, MT, Butte, MT and Helena, MT and offers local calling
10 with unlimited long distance for only \$39.95 per month which is superior to Qwest's
11 bundled offers.³⁸

12
13 Contact Communications is a CLEC headquartered in Riverton, WY (population
14 9,443) that grew out of Wyoming's largest privately held ISP and provides next-
15 generation data telecom services to ISPs. Contact received certification to serve
16 Qwest's territory in April 1997 as a wholesale data exchange carrier. The Company is
17 expanding into additional services for ISPs and a variety of traditional
18 telecommunications services (including voice telephony) using state-of-the-art
19 protocols and expandable hardware designs. Contact serves numerous small, rural
20 communities throughout Wyoming (with an average population of 13,600) and is
21 certified in eight other western states. Contact's intent is to compete with the

³⁸ See Bresnan Communications home page at <http://bresnan.com>, a copy of which is included as Exhibit No. __ (DCB-21).

1 incumbent telephone companies so that ISPs serving rural markets are able to offer
2 advanced services with reasonable margins.³⁹

3

4 In Wyoming, some consumers are substituting wireless service for their landline
5 service. As LR prices have increased toward average cost and as cellular prices have
6 continued to fall, some consumers are discontinuing their landline service and relying
7 solely on their wireless service for their voice telecommunications. The Wyoming
8 Commission expects this trend to continue.⁴⁰

9

10 As can be seen from the experience in Wyoming, competitors have moved in to
11 provide service in Wyoming despite the fact that Wyoming is a rural, high cost state.
12 Rebalancing rates has brought competition to Wyoming. As a result, Wyoming
13 consumers have a wider choice of local service providers that are offering new
14 bundles of services, new and innovative services, and lower prices as they compete for
15 consumers' business. These same benefits will be realized in Florida after the
16 Commission rebalances Alltel's rates.

17

18 **Q. What other indication is present that enhanced entry will benefit residential**
19 **consumers?**

20 **A.** In reaching its decision in the Rebalancing Dockets, this Commission concluded that
21 enhanced market entry will result in the creation of a more competitive local exchange
22 market that will benefit residential consumers. Specifically, in paragraph 4 of the
23 Summary of Decision portion of the Rebalancing Order, the Commission found:

³⁹ See Contact Communication's home page at <http://www.contactcom.net/default.htm>, a copy of which is included as Exhibit No. ____ (DCB-22).

⁴⁰ Wyoming PSC 2005 Annual Report; p. 54. Exhibit No. ____ (DCB-20).

1 Enhanced market entry will result in the creation of a more competitive
2 local exchange market that will benefit residential consumers through:

- 3 a. increased choice of service providers;
- 4 b. new and innovative service offerings, including
- 5 bundles of local and long distance service, and
- 6 bundles that may include cable TV service and high
- 7 speed internet access service;
- 8 c. technological advances;
- 9 d. increased quality of service; and
- 10 e. in the long run, reductions in prices for local
- 11 service.

12
13 Additionally, the Florida Supreme Court agreed with the Commission that the
14 introduction of competition will benefit residential language and stated: “We further
15 conclude that the Commission’s determination that its grant of the petitions will
16 “[i]nduce enhanced market entry,” is supported by competent, substantial theoretical
17 and empirical evidence.” Crist v. Jaber, ____ So. 2d ____, 30 Fla. L. Weekly S531,
18 2005 WL 1577998 (Fla. 2005).

19
20 Based on the record in this case and consistent with its decision in the Rebalancing
21 Order, the Commission should make the same finding in this proceeding for Alltel that
22 enhanced market entry will result in the creation of a more competitive local exchange
23 market that will benefit residential consumers.

24

1 VII. AFTER THE PROPOSED RATE INCREASES, BASIC LOCAL SERVICE
2 RATES WILL REMAIN AFFORDABLE FOR CONSUMERS.

3
4 Q. Will basic local service rates remain affordable for consumers after the proposed
5 rate increases?

6 A. Yes. I reviewed Alltel's proposal and have concluded that it will not jeopardize
7 universal service in its territory and its service will remain affordable. Alltel's prices
8 for residential local service currently average around \$10.49 a month. This is
9 substantially below the national average of \$14.53 per month (which includes only
10 urban areas that are lower cost than rural areas).⁴¹ Additionally, Section 364.164,
11 Florida Statutes, requires that any price increase in basic local service not apply to
12 Lifeline consumers and increases the income eligibility for Lifeline consumers to 135
13 percent. These requirements extend protection to those customers most likely to be
14 sensitive to potential price increases from a rebalancing plan. Consumers will be
15 better off overall as a result of rate rebalancing proposals that properly align prices
16 with average costs as such prices send correct signals to both buyers and suppliers.
17 Buyers will purchase the right amount of service and suppliers will supply the right
18 amount of service. Because the price of Alltel's local voice wireline service is priced
19 too low, competing suppliers are not entering the market and thus, are denying Alltel's
20 consumers the wider choice of service providers, new bundles of service offerings,
21 and lower prices that will result when competitors enter. Additionally, when the price
22 of Alltel's 1R service is moved toward average cost and will rely less on support from

⁴¹ See Zimmerman, Paul R., *FCC Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, Industry Analysis & Technology Division, Wireline Competition Bureau, July 2005, Table 1.1, rates exclude Federal and State subscriber line charges, touch tone charge and taxes, 911 and other charges, a copy of which is included as Exhibit No. ___ (DCB-23).

1 other services, then the price of those other services (such as intrastate switched
2 access) can be decreased. Ultimately, those decreases should flow through to end user
3 customers in the form of lower intrastate toll rates.

4
5 There are a number of other reasons why I believe Alltel's rates for basic local
6 residential telephone service will remain affordable after the implementation of
7 Alltel's proposal. Empirical evidence suggests that virtually all subscribers will
8 continue to purchase voice communications whether it be over Alltel's wireline
9 network, one of the cellular company's networks, one of the cable TV company's
10 networks, or by some other means. Local rates will remain affordable and universal
11 service will not be negatively impacted under Alltel's proposal for the following
12 reasons:

- 13
14 A. Basic local service rates will remain affordable because the price increase is a
15 very small percentage of the average household's budget -- less than the cost of
16 a movie ticket for one adult.
- 17 B. The majority of consumers are currently paying more than twice as much for
18 cellular phone service, cable TV, and internet service.
- 19 C. Other states have determined that \$20.00 is an affordable rate for basic
20 residential local service.
- 21 D. Support for basic local service rates should be targeted only to low-income
22 families needing financial assistance.
- 23 E. Lifeline ensures that basic local service will remain affordable for low-income
24 families.

1 F. Increasing rates for basic local service has not had a negative impact on
2 universal service in other states.

3
4 *A. Basic local service rates will remain affordable because the price increase is a*
5 *very small percentage of the average household's budget -- less than the cost of a*
6 *movie ticket for one adult.*

7
8 **Q. Why do you believe that Alltel's proposed residential rates are affordable?**

9 **A.** Under Alltel's proposed rate restructuring, Alltel's residential customers will see a
10 maximum increase over two years of \$6.00 in their monthly expenditure for local
11 telecommunications services. Alltel's average rate for residential local service is
12 currently \$10.49 per month. Alltel's proposal increases rates to a maximum average
13 of \$16.49 per month. I use the word maximum here because it must also be
14 remembered that after the rate rebalancing proposals of the large ILECs have been
15 implemented, residential customers should see reduced expenditures for intrastate toll
16 calling resulting in a change in total expenditures for local and toll services that is less
17 than the \$6.00 increase for local residential service. Even so, a \$6.00 increase is less
18 than the cost of a movie ticket for one adult.

19
20 A monthly total of \$16.49 generates an annual expenditure for basic local residential
21 telephone service of only \$197.88 which represents only 0.7% of annual median
22 family income of \$29,972 in Florida and 0.5% of the annual median household income
23 of \$38,819 in Florida.⁴² Table 2 in my Exhibit No. ____ (DCB-0) illustrates the

⁴² See U.S. Census Bureau, Household Income and Expenditures, Census 2000 Summary File 3, Matrices P52, P53, P54, P79, P80, P81, PCT38, PCT40, and PCT41, a copy of which is included as Exhibit No. ____ (DCB-24).

1 relationship between household income and telecommunications expenditures. As can
2 be seen in Table 2, annual telephone expenditures represent less than 2% of total
3 income for any household. It should also be noted that the majority of households in
4 the lowest income bracket are eligible for lifeline assistance which would reduce their
5 expenditure by \$13.50 per month; the per line amount for Lifeline in Florida, and
6 reduce their annual expenditures for telecommunications services to only 0.7% of their
7 annual budget.

8
9 **Q. What would Alltel's rates for basic local residential telephone service be today if**
10 **they had been indexed to inflation starting in 1984?**

11 **A.** Rates for Alltel's basic local residential telephone service were set in its last rate case
12 in 1984 and as a result have not kept pace with inflation. Although the Legislature
13 through the FPSC has recently allowed Alltel and other ILECs to index basic local
14 residential rates to inflation, this change did not take effect until 2001. If the rates for
15 local residential telephone service had been indexed to the rate of inflation in the
16 Consumer Price Index ("CPI"), the average rate for all of Alltel's residential voice
17 services of \$10.49 approved in 1984 would have gradually increased to \$19.92 today.
18 Thus, increasing Alltel's rate to an average of \$16.49 only moves local rates two-
19 thirds of the distance to where they would be if they were simply indexed with
20 inflation beginning in 1984. Therefore, in terms of real dollars, the rates for Alltel's
21 basic local residential telephone service have actually been decreasing each year by
22 the rate of inflation up until 2001. When compounded over the past 21 years, Alltel's
23 rates have decreased in real terms by 47% since 1984. Thus, if rates for phone service
24 were affordable in 1984, then an average rate of only \$16.49 per month should be

1 considered even more affordable since it is 17% less than the \$19.92 rate that would
2 be in place if Alltel's rates had simply kept pace with inflation since 1984.

3

4 **Q. Can you provide a table to illustrate your point?**

5 **A.** Yes. Table 3, which is contained in Exhibit No. ____ (DCB-O), illustrates the change
6 in the average price of Alltel's rates for their various residential calling plans that
7 would have occurred if the rates had increased at the same rate of inflation as other
8 goods and services over the past 21 years.

9

10 As Table 3 illustrates, the prices of goods and services have nearly doubled since
11 1984, yet Alltel's prices for basic local residential telephone service provided over
12 wireline were frozen from 1984 to 2001. These small annual increases in CPI pass by
13 relatively unnoticed by most consumers and have little impact on their decision to
14 continue purchasing the product. If the rates for basic residential local telephone
15 service were indexed with inflation and increased annually the same as prices for
16 bread, milk, and other commodities, it is likely that these increases would also have
17 been relatively unnoticed by consumers and have had little impact on their decision to
18 continue purchasing local service. However, due to the nature of setting rates in
19 regulatory proceedings, rates for regulated telephone services such as residential local
20 service, tend to be "lumpy" or move in occasional and sporadic jumps larger than the
21 rate of inflation for one year. The fact that Alltel's rates have remained frozen for 17
22 years illustrates the efficiency gains made by the industry during this period.

23

1 *B. The majority of consumers are currently paying more than twice as much as*
2 *Alltel's proposed local residential service rate of \$16.49 for cellular phone service,*
3 *cable TV, and internet service.*

4
5 **Q. How does the price of Alltel's proposed rate for residential local service compare**
6 **to what consumers are paying for cellular service?**

7 **A.** Alltel's proposed average rate of \$16.49 for basic residential local service is less than
8 half of what consumers are paying today for cellular phone service in Florida yet,
9 there are more mobile wireless telephone subscribers in Florida now than there are
10 landline telephone subscribers. As of June 2004, there were 11,916,615 mobile
11 wireless telephone subscribers in Florida⁴³ representing 68.5% of the 17,397,161
12 people in the state as compared to 11,418,566 landline telephone subscribers.⁴⁴
13 Florida's wireless penetration of 68.5% is higher than the US national average
14 penetration of 57% and ranks Florida as the 4th highest state in penetration.

15
16 The average revenue per user (ARPU) for cellular phone service is \$50.64 per
17 month,⁴⁵ which is nearly five times greater than the current average monthly
18 expenditure for local wireline phone service in Florida of \$10.49. Verizon Wireless
19 currently advertises a 450-minute wireless calling plan for \$39.99 per month and a

⁴³ See *Local Telephone Competition: Status as of June 30, 2004*; Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission; Table 13; Released December 2004, which is included as Exhibit ____ (DCB-40).

⁴⁴ Id. at Table 6, which is included as Exhibit ____ (DCB-25).

⁴⁵ See *CTIA - the Wireless Association's Annualized Wireless Industry Survey Results, December 1985 - December 2004 Reflecting Domestic U.S. Commercially-Operational Cellular, ESMR and PCS Providers*, p.2 @ http://www.ctia.org/research_statistics/statistics/index.cfm/AID/10030. \$50.64 represents Average Revenue Per User (ARPU) or the average monthly bill for one cellular telephone user, a copy of which is included as Exhibit No. ____ (DCB-26).

1 900-minute wireless calling plan for \$59.99 per month.⁴⁶ The fact that more
2 Floridians purchase cellular phone service at prices that are five times the current price
3 of Alltel's local wireline phone service indicates that Alltel's approximately 95,000
4 customers in Florida should be able to afford local wireline phone service even when
5 the price is raised to only \$16.49 for residential consumers which is still just one third
6 the rate of their wireless phone service bill. If consumers can afford a mobile wireless
7 telephone for \$50.64 per month, they can afford to pay \$16.49 for local residential
8 telephone service.

9
10 **Q. How does the price of Alltel's proposed rate for basic residential local service**
11 **compare to what consumers are paying for cable TV or internet service?**

12 **A.** Not only have wireless telephones become widely used, but cable television
13 subscription has reached high levels. In Florida today, 5,069,700 households⁴⁷ (out of
14 6,839,580 TV Households) or 74% of Florida TV households subscribe to cable TV
15 and pay an average bill of \$38.23 per month.⁴⁸ In addition, approximately 1,653,537
16 households (representing a penetration rate of one-fourth of all households) subscribe
17 to broadband internet service in Florida paying an average of \$39.95 for broadband
18 access.⁴⁹ If 5,069,700 Florida households can afford to subscribe to cable TV for

⁴⁶ See Verizon Wireless website advertisement for its America's Choice wireless calling plan which is included as Exhibit No. ___ (DCB-35).

⁴⁷ See the National Cable Television Association at <http://www.ncta.com>; Start date from Nielsen Media Research representing January 2005 TV households and September 2004 cable TV households, a copy of which is included as Exhibit No. ___ (DCB-27).

⁴⁸ See the National Cable Television Association at <http://www.ncta.com>; Industry Overview, Statistics & Resources, revenue data provided by Kagan Research LLC, a copy of which is included as Exhibit No. ___ (DCB-28).

⁴⁹ See "Trends in Telephone Service" - May 2004; FCC Industry Analysis and Technology Division Wireline Competition Bureau, Table 2.5 (June 30, 2003 data), a copy of which is included as Exhibit No. ___ (DCB-29). The estimate of \$39.95 is based on Time Warner Cable's monthly charge for digital telephone service which includes local calling, unlimited long distance toll calling, and custom calling features.

1 \$38.23 per month, there should be no question that they can afford to pay \$16.49 for
2 basic local residential telephone service.

3

4 **Q. How do wireline subscribership and rates compare to subscribership and rates**
5 **for similar services?**

6 **A.** Table 4, which is contained in Exhibit No. ____ (DCB-O), illustrates that Alltel's
7 proposed rate of \$16.49 for residential local service is very reasonable when compared
8 to the subscribership levels and the rates consumers pay for other communications
9 services.

10 **Q. How do annual expenditures for these various services compare in terms of a**
11 **percentage of annual income?**

12 **A.** As can be seen in Table 5, which is contained in Exhibit No. ____ (DCB-O), annual
13 expenditures for telecommunications and video services remain a relatively small
14 percentage of any household's annual income. Therefore, even after Alltel's rate for
15 basic local residential telephone service is increased to \$16.49 it will still remain small
16 in comparison to the price of other services that Floridians are purchasing today and
17 small in relation to a household's expenditures for all goods and services.

18

19 ***C. Other states have determined that \$20.00 is an affordable rate for basic***
20 ***residential local service.***⁵⁰

21

22 **Q. What have other states determined is an affordable rate for basic residential local**
23 **service?**

⁵⁰ \$20.00 represents the base rate for residential telephone service that does not include the SLC, federal USF, E911, taxes, or other charges.

1 A. The majority of states in the United States have increased rates for basic local service.
2 A sizeable number of these states have concluded that \$20 is an affordable rate for
3 basic local residential telephone service.⁵¹ For example, in 2000, when the Illinois
4 Commerce Commission established its state Universal Service Fund in Docket No.
5 00-0233, the ICC found that \$22.23 was an affordable monthly rate for basic local
6 residential telephone service for Verizon's customers.⁵² In 1997, Wyoming
7 established a universal service fund and simultaneously began moving basic
8 residential rates toward cost. The weighted statewide average price for residential
9 service rose from \$19.61 to \$26.78.⁵³

10
11 **Q. In terms of real dollars, what have other states determined is an affordable rate**
12 **for basic residential local service?**

13 A. When rates for basic residential local telephone service are analyzed from the
14 perspective of the year when they were set, it is possible to get a feel for different state
15 commissions' perception of affordability in terms of today's dollars. Table 6, which is
16 contained in Exhibit No. ____ (DCB-O), lists states that have increased rates for basic
17 local residential telephone service and adjusts those rates for inflation to show the real

⁵¹For the sake of comparison, please note that the base rate of \$20 does not include the SLC, USF charges, EAS surcharges, intrastate toll, or custom calling features and is comparable to Alltel's proposed base rate of \$16.49 for residential service.

⁵²The ICC later revised the rate to \$20.39 due to a mathematical calculation error in computing the rate the first time. See Second Interim Order On Rehearing Before the Illinois Commerce Commission; In re: Illinois Independent Telephone Association Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act; Docket 00-0233; Consolidated with Illinois Commerce Commission On Its Own Motion Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act; Docket 00-0335; dated: March 13, 2002, a copy of which is included as Exhibit No. ____ (DCB-30).

⁵³See Wyoming Public Service Commission "2000 ANNUAL TELECOMMUNICATIONS REPORT" prepared by the Commissioners and Staff of the Wyoming Public Service Commission; January 10, 2000, a copy of which is included as Exhibit No. ____ (DCB-31).

1 dollar value of those rates in today's (2004) dollars.⁵⁴ Expressed in 2004 dollars, the
2 average "affordable" rate for basic local residential telephone service among the
3 various states is \$19.56.

4

5 **Q. What did the Commission determine was an affordable rate in the Rebalancing**
6 **Dockets with respect to Verizon, BellSouth, and Sprint areas?**

7 **A.** When the FPSC authorized rate changes for Verizon, BellSouth, and Sprint last year in
8 the Rebalancing Dockets, the Commission approved rates for basic local residential
9 service as high as \$18.34 for Sprint's highest rate group. Given that the Commission
10 found that the proposed rate increases in the Rebalancing Dockets proceeding were
11 affordable, the Commission should similarly find Alltel's proposed rate of \$16.49
12 (which is less than Sprint's highest rate of \$18.34) is likewise, affordable. Table 7,
13 which is included in Exhibit No. ____ (DCB-O), illustrates the 1R rates for Verizon,
14 BellSouth, and Sprint before and after the rebalancing proposals, as well as Alltel's
15 proposed rates.

16

17 Under Alltel's proposed rate rebalancing plan, the new proposed rates will average
18 \$16.49⁵⁵ with only 20% of Alltel's customers paying an average of \$1.60 more than
19 that on a monthly basis. Therefore, I believe that Alltel's proposed 1R is clearly
20 affordable and supported by Commission determinations in the previous case.

21

⁵⁴ 2004 represents the most current year for which annual CPI data is available.

⁵⁵ Weighted average of Alltel's proposed 1R rate.

1 *D. Support for basic local service rates should be targeted only to low-income*
2 *families needing financial assistance.*

3
4 **Q. Should the price of residential local service be kept low for all subscribers to**
5 **ensure that rates are affordable for the lowest income levels?**

6 A. No. The price of basic local residential telephone service should not be held
7 artificially low for all consumers in order to make it affordable for the few consumers
8 that would need financial assistance to buy telephone service if the price were to be
9 increased to \$16.49. Rather, financial assistance should be targeted towards those
10 households that truly cannot afford the cost of basic local residential telephone service
11 while allowing the price of local residential telephone service to migrate toward its
12 average cost in order to foster a competitive market.

13
14 **Q. What is the harm in pricing residential local service low for all subscribers rather**
15 **than targeting Lifeline support?**

16 A. By pricing basic local telephone service artificially low for all consumers rather than
17 just for the few that need financial assistance, the size of the support mechanism is
18 much larger than it would need to be to ensure that residential telephone service is
19 affordable for low income households. An artificially low price also prohibits proper
20 cost recovery, sends the wrong economic signals, and causes consumers to over-
21 consume basic local telephone service (i.e., purchase more phone lines than they
22 would if service was priced at average cost). From an economic perspective, this
23 represents an inefficient allocation of resources. From a practical perspective, if the
24 support is to be funded through rates for services that are priced above their average
25 cost, it would not be sustainable in the long run. Finally, pricing basic residential

1 telephone service at artificially low levels serves as a significant impediment that
2 discourages competitors from entering the local market and prevents consumers from
3 enjoying the benefits of local telephone competition.

4
5 Therefore, rather than holding the price of basic residential local telephone service
6 artificially low for the sake of affordability for the least financially able consumers,
7 support should be targeted towards those individuals, families, or households that truly
8 need such assistance to be able to purchase local telephone service.

9
10 **Q. Would it be relatively easy to target assistance to needy customers?**

11 **A.** Yes. Since the Federal Lifeline Assistance program is already in place, it should be
12 relatively easy to add any additional targeted assistance to the Lifeline program's
13 existing eligibility mechanisms.

14
15 The affordability of any service is relative to each individual household's income. It
16 goes without saying that an increase of \$6.00 is more affordable for households in the
17 top 50th percentile of income levels than for households in the bottom half of income
18 levels. However, the households in the lower income levels may already control their
19 phone bill by using minimal amounts of intrastate toll calling services and therefore,
20 may only see a small increase or even a decrease in their total monthly bill for local
21 service and toll usage. Of course, the concern should be focused on consumers in
22 households for whom affordability might truly be an issue. In Florida, the Legislature
23 has addressed affordability by requiring ILECs that have rebalanced rates pursuant to
24 Section 364.164 to offer their Lifeline Assistance Plan to customers with income at or

1 below 135% of the federal poverty level.⁵⁶ The Commission acknowledged this
2 requirement in the Rebalancing Dockets. Therefore, Section 364.10, Florida Statutes,
3 resolves the affordability issues for those households whose income levels are less
4 than 135% of the current poverty level by targeting Lifeline support toward those
5 households.

6
7 *E. Lifeline ensures that basic local service will remain affordable for low-income*
8 *families.*

9
10 **Q. Is Lifeline an effective method of ensuring that telephone rates remain affordable**
11 **for low-income families?**

12 **A.** Yes, as the FPSC determined in the Rebalancing Dockets, the best way to help low-
13 income families continue to afford basic local service was to continue to use Lifeline
14 subsidies, which are targeted toward low-income families. In paragraph 11 in the
15 summary of decision portion of the Rebalancing Order, the Commission stated:

16
17 Although we find that it is not a benefit that we should weigh in the
18 balance in considering whether or not to grant the Petitions, the
19 amended Lifeline provisions in Section 364.10 will help to protect
20 economically disadvantaged consumers from the effect of local
21 rate increases....

22

⁵⁶ See Section 364.10(3)(a), Florida Statutes [Exhibit No. ____ (DCB-32)], and the Rebalancing Order at pages 6 and 15.

1 The same finding is appropriate in this proceeding for Alltel that Florida's Lifeline
2 rules are sufficient to help protect economically disadvantaged consumers from the
3 effect of local rate increases.

4
5 **Q. Is it possible that competition could eliminate the need for Lifeline assistance?**

6 **A.** The Commission indicated in the Rebalancing Dockets that it anticipates that the
7 development of a more competitive local telephone market would put downward
8 pressure on prices for residential telephone service perhaps to the extent that the need
9 for Lifeline assistance could be eliminated. The Commission stated:

10
11 Although we cannot predict the future with certainty, economic
12 theory suggests, and we are encouraged to believe, that the
13 establishment of a more competitive local market will put
14 downward pressure on local exchange prices that will eventually
15 reduce the need for targeted assistance programs such as Lifeline.⁵⁷

16

17 *F. Increasing rates for basic local service has not had a negative impact on*
18 *universal service in other states.*

19

20 **Q.** **Will increasing rates for basic local service have a negative impact on universal**
21 **service?**

22 **A.** No. This topic has been studied a number of times. Crandall and Waverman (2000)
23 summarized the results of research, all of which concluded that the price of local
24 service has very little impact on the decision to subscribe to telephone service. They

⁵⁷ See Rebalancing Order at 10.

1 presented evidence from the literature that the elasticity of demand for local service
2 ranges from -0.006 to -0.17, with most of the more recent estimates well below -0.1.
3 These relatively low elasticity levels mean that consumers are not responsive to
4 changes in price. In their own estimates, Crandall and Waverman found that the local
5 monthly rate is insignificant in the subscription decision. Thus, any increase to the
6 rates for basic local residential telephone service is likely to have little, if any, impact
7 on penetration.⁵⁸

8
9 In the Rebalancing Dockets, the FPSC also considered this issue and concluded that
10 increasing basic local rates has little impact on whether consumers subscribe to local
11 telephone service. The Commission stated:

12
13 Experience from other states that have rebalanced local and toll
14 rates shows that approval of the ILECs' proposals will have little,
15 if any, negative impact on the availability of universal service.
16 While no customer likes to see a rate increase, the record shows
17 that basic local service will continue to remain affordable for the
18 vast majority of residential customers.⁵⁹

19
20 Accordingly, the Commission should make the same finding in this proceeding for
21 Alltel that basic local service will continue to remain affordable for the vast majority
22 of residential customers even after the Commission rebalances local rates.

⁵⁸ Robert Crandall and Leonard Waverman, *Who Pays for Universal Service? When Telephone Subsidies Become Transparent*, Brookings Institute, (2000), pp. 91 – 93, a copy of which is included in Exhibit No. ____ (DCB-33).

⁵⁹ Rebalancing Order at 14.

1 VIII. SUMMARY

2

3 Q. Please summarize your testimony and your conclusions.

4 A. Increasing competition for telecommunications services that have traditionally
5 supported basic local residential telephone services is making it difficult to maintain
6 the high margins required to continue to provide support for local residential telephone
7 services. The Florida legislature recognized this problem and passed the Act, which
8 allows ILECs to rebalance their rates by increasing rates for basic local telephone
9 service and offset the increase by reducing rates for intrastate switched access rates.

10

11 Alltel's proposed rate rebalancing plan satisfies the statutory requirements of Section
12 364.164, Florida Statutes. Specifically, Alltel has proposed to increase rates for basic
13 local telephone service and to offset the increase by reducing rates for intrastate
14 switched access that currently provide support for basic local telecommunications
15 service. The existence of local service support prevents the creation of a more
16 attractive competitive local exchange market. The elimination of implicit support will
17 enhance competitive market entry into Alltel's residential local exchange market.
18 Enhanced market entry will result in the creation of a more competitive residential
19 local exchange market that will ultimately benefit consumers.

20

21 Alltel's rate rebalancing proposal will enhance economic welfare in Alltel's service
22 territory. Cost analysis indicates that Alltel's rates for basic residential local service
23 are currently priced significantly below average cost. Moving these rates toward
24 average cost will give consumers and competitors cost-based pricing signals which
25 will lead to more economically rational utilization of telecommunications services.

1 This, in turn, will help foster competition, which will increase consumer welfare by
2 creating consumer choice, placing downward cost pressure on firms, driving prices
3 downward, and stimulating innovation and investment.

4 Alltel's rate rebalancing plan will result in rates that will continue to be affordable
5 because the proposed rates are in line with those already deemed affordable by the
6 Commission for BellSouth, Verizon, and Sprint in the Rebalancing Dockets.
7 Additionally, Lifeline assistance is available to ensure that local residential rates will
8 remain affordable for low-income families.

9
10 In order for competition to develop in local markets, residential telephone rates must
11 be rebalanced and moved toward average cost. Residential rates that are priced below
12 this level and supported by other services make it much more difficult for competitors
13 to enter local markets. Additionally, telecommunications services, such as intrastate
14 switched access, that have borne the burden of supporting local residential rates are
15 facing increasing competitive pressures and should no longer be required to support
16 local residential telephone services.

17
18 Approving Alltel's petition to rebalance rates will align prices for basic local
19 telephone service and intrastate switched access more closely to average cost which
20 will lead to more economically rational choices by consumers and provide competitors
21 with a better opportunity to compete in local telephone markets.

22
23 **Q. Does this conclude your prepared direct testimony?**

24 **A.** Yes, it does.

25

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Alltel Florida, Inc.'s Petition)
To Reduce Intrastate Switched Network)
Access Rates In A Revenue Neutral)
Manner Pursuant to Section 364.164,)
Florida Statutes)
_____)

David C. Blessing Exhibits

Volume I

- Exhibit DCB-0: Composite Exhibit - Tables
- Exhibit DCB-1: Belinfante, Alexander; *Telephone Subscribership in the United States (Data Through March 2003)*; Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission; Table 2; Released November 2003.
- Exhibit DCB-2: Belinfante, Alexander; *Telephone Subscribership in the United States (Data Through March 2005)*; Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission; Table 2; Released May 2005.
- Exhibit DCB-3: Florida Statute § 364.164.
- Exhibit DCB-4: (Non-Confidential) Hatfield HAI 5.0a – Default and ALLTEL-specific model runs plus input changes.
- Exhibit DCB-4: (Confidential) Hatfield HAI 5.0a – Default and ALLTEL-specific model runs plus input changes.
- Exhibit DCB-5: ALLTEL Florida 2004 embedded cost study.
- Exhibit DCB-6: Florida Statute § 364.025 Universal Service.
- Exhibit DCB-7: In re: *Determination of the cost of basic local telecommunications service, pursuant to Section 364.025, Florida Statutes*, Docket No. 980696-TP, Order No. PSC-99-0068-FOF-TP (excerpts).
- Exhibit DCB-8: Order No. PSC-96-0680-FOF-TL; Before The Florida Public Service Commission, In Re: Request for Approval of 1995 Depreciation Study by ALLTEL Florida, Inc.; Docket No. 950887-TL; Issued: May 23, 1996.
- Exhibit DCB-9: See *Handbook of Telecommunications Economics*, Amsterdam: Elsevier Science, 2001; *Chapter 10, UNIVERSAL RESIDENTIAL TELEPHONE SERVICE*, Michael H. Riordan, *Columbia University*, August 29, 2001.

Exhibit DCB-10: Order No. PSC-03-1469-FOF-TL Florida Public Service Commission; Comprised of Docket No. 030867-TL, In re: 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.. 030868-TL, In re: 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. 030869-TL, In re: 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.; and Docket No. 030961-TI, In re: Flow-through of LEC switched access reductions by IXCs, pursuant to Section 364.163(2), Florida Statutes.; Issued: December 24, 2003.

Volume II

Exhibit DCB-11: Agustin J. Ros and Karl McDermott, "Are Residential Local Exchange Prices Too Low? Drivers to Competition in the Local Exchange Market and the Impact of Inefficient Prices," in Michael Crew, *Expanding Competition in Regulated Industries*, Kluwer Academic Publishers, 2000.

Exhibit DCB-12: Amended Direct Testimony of Dr. Kenneth Gordon On behalf of Verizon Florida Inc., BellSouth Telecommunications, Inc., and Sprint-Florida Inc. Before the Florida Public Service Commission; in Docket No. 030867-TL, In re: 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.. 030868-TL, In re: 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. 030869-TL, In re: 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.; and Docket No. 030961-TI, In re: Flow-through of LEC switched access reductions by IXCs, pursuant to Section 364.163(2), Florida Statutes. See Also Final Order No. PSC-03-1469-FOF-TL, Issued: December 24, 2003.

Exhibit DCB-13: James Eisner and Dale E. Lehman, *Regulatory Behavior and Competitive Entry*, presented at the 14th Annual Western Conference Center for Research in Regulated Industries, June 28, 2001; p. B24.

Exhibit DCB-14: Agustin J. Ros and Aniruddha Banejee, "Telecommunications Privatization and Tariff Rebalancing: Evidence from Latin America," *Telecommunications Policy*, 24 (2000) 233-252.

Exhibit DCB-15: Florida Public Service Commission, *Annual Report To The Florida Legislature On The Status Of Competition In The Telecommunications Industry In Florida as of May 31, 2004*, p. 75

Exhibit DCB-16: Unite Communications Systems @ <http://www.uniteone.net/index.html>.

Exhibit DCB-17: Utopia Net website @ <http://www.utopianet.org/>.

Exhibit DCB-18: Grant County (Washington State) Public Utility District Zip fiber network website @ <http://www.gcpud.org/zipp/zippnews.htm>.

Exhibit DCB-19: Chelan County (Washington State) Public Utility District fiber network website @ https://fiber.chelanpud.org/euedu/about_Us/PUD_Fiber/Presentations/

Volume III

Exhibit DCB-20: Wyoming PSC 2005 Annual Telecom Report.

Exhibit DCB-21: Bresnan Communications home page @ <http://bresnan.com>.

Exhibit DCB-22: Contact Communication's home page @ <http://www.contactcom.net/default.htm>

Exhibit DCB-23: FCC *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, Table 1.1 July 2005.

Exhibit DCB-24: US Census Bureau, 2003 Household Income and Expenditures.

Exhibit DCB-25: CPI - All Urban Consumers - All Items - Year to Year Average Change in CPI; U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C. 20212; Consumer Price Index, All Urban Consumers – (CPI-U), U.S. City Average – All Items.

Exhibit DCB-26: *CTIA - the Wireless Association's Annualized Wireless Industry Survey Results, December 1985 – December 2004 Reflecting Domestic U.S. Commercially-Operational Cellular, ESMR and PCS Providers*, p.2 @ http://www.ctia.org/research_statistics/statistics/index.cfm/AID/10030.

Exhibit DCB-27: National Cable Television Association at <http://www.ncta.com>. State date from Nielsen Media Research representing January 2005 TV households and September 2004 cable TV households.

Exhibit DCB-28: National Cable Television Association at <http://www.ncta.com>; Industry Overview, Statistics & Resources, revenue data provided by Kagan Research LLC.

Exhibit DCB-29: "Trends in Telephone Service" - May 2004; FCC Industry Analysis and Technology Division Wireline Competition Bureau, Table 2.5. (June 30, 2003 data).

Volume IV

Exhibit DCB-30: Second Interim Order On Rehearing Before the Illinois Commerce Commission; In re: Illinois Independent Telephone Association Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act; Docket 00-0233; Consolidated with Illinois Commerce Commission On Its Own Motion Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act; Docket 00-0335; dated: March 13, 2002.

- Exhibit DCB-31:** Wyoming Public Service Commission "2000 ANNUAL TELECOMMUNICATIONS REPORT" prepared by the Commissioners and Staff of the Wyoming Public Service Commission; January 10, 2000.
- Exhibit DCB-32:** Florida Statute § 364.10 Lifeline.
- Exhibit DCB-33:** Robert Crandall and Leonard Waverman, *Who Pays for Universal Service?: When Telephone Subsidies Become Transparent*, Brookings Institute, (2000), pp. 91 - 93.
- Exhibit DCB-34:** *Senate Staff Analysis and Economic Impact Statement of CS/SB 654 - the Tele-Competition Innovation and Infrastructure Enhancement Act.*, dated April 8, 2003.
- Exhibit DCB-35:** Verizon Wireless America's Choice Calling Plan for Live Oak, FL found at <http://www.verizonwireless.com/b2c/store/>.
- Exhibit DCB-36:** "eBay to Acquire Skype" eBay press release dated September 12, 2005; available at http://investor.ebay.com/downloads/eBay_PressRelease.pdf.
- Exhibit DCB-37:** Cox Communications website at <http://www.cox.com/GainesvilleOcala/>
- Exhibit DCB-38:** Time Warner Inc, Form 10-Q Quarterly Report, Filed 8/3/2005 For Period Ending 6/30/2005.
- Exhibit DCB-39:** CV of David C. Blessing.
- Exhibit DCS-40:** *Local Telephone Competition: Status as of June 30, 2004*; Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission; Table 13; Released December 2004.