

**ORIGINAL**

DOCKET NO. 070126-TL Villages of Avalon, Phase II

WITNESS: Direct Testimony Of Gregory L. Shafer, Appearing On Behalf Of Staff

DATE FILED: August 10, 2007

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EDCC COMMISSION CLERK

ORIGINAL

Direct Testimony Of Gregory L. Shafer

1  
2 Q. Please state your name and address.

3 A. Gregory L. Shafer, 2540 Shumard Oak Blvd. Tallahassee, Florida 32399-0850.

4 Q. By whom are you employed and in what capacity?

5 A. I am employed by the Florida Public Service Commission, Division of Competitive  
6 Markets and Enforcement, as a Public Utilities Supervisor, in the Bureau of Performance  
7 Analysis.

8 Q. What are your current responsibilities as a public utilities supervisor?

9 A. I presently supervise four professional staff in the preparation of analysis and reports  
10 relating to telecommunications policy and the status of competition in telecommunications  
11 markets in Florida. In addition, I function as the agency's legislative analyst on  
12 telecommunications issues before the Florida Legislature.

13 Q. Please summarize your educational and professional background.

14 A. I have a Bachelors degree in Economics from the University of South Florida and a  
15 Masters degree in Economics from Florida State University.

16 My professional experience includes two years as a Field Economist with the U.S.  
17 Department of Labor, Bureau of Labor Statistics. I have been employed by the Florida Public  
18 Service Commission since September 1983. I spent five plus years in the Division of  
19 Communications in various capacities, with the final two years as Supervisor of the  
20 Economics Section. While working in the Division of Communications, I testified in the  
21 Interexchange Carrier Rules docket and in the AT&T Waiver Request (forbearance) docket.

22 I spent approximately 10 years as Bureau Chief of the Bureau of Special Assistance in  
23 the Division of Water and Wastewater and have testified in several water and wastewater  
24 cases on the calculation of margin reserve. I also testified on ratesetting policy in the Southern  
25 States (a.k.a. Florida Water Service, Inc.) rate case, Docket No. 950495-WS.

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No. 950495-WS.

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FPSC-COMMISSION CLERK

1 For approximately five and a half years I worked on telecommunications issues as both  
2 a manager and senior analyst in the legislative and intergovernmental affairs divisions for the  
3 Commission. I prepared bill analyses and testified before legislative committees on  
4 telecommunications topics relating to the commission. I also prepared comments for  
5 submission to the Federal Communications Commission. I also provided testimony in the  
6 access charge reduction and rate rebalancing dockets on the state of the telecommunications  
7 market in Florida and the possible impacts of rate rebalancing.

8 For the last two and a half years I have worked in the Division of Competitive Markets  
9 and Enforcement as a Public Utilities Supervisor in the Bureau of Performance Analysis. My  
10 duties have included the oversight of the preparation of the Commission's Annual Report to  
11 the Legislature on the Status of Competition of the Telecommunications Industry in Florida,  
12 as well as comments to the Federal Communications Commission and continuing involvement  
13 in legislative analysis and testimony for telecommunications issues.

14 Q. What is the purpose of your testimony in this proceeding?

15 A. The purpose of my testimony is to provide the Commission with historical background  
16 and analytical perspectives on the petition for waiver of the carrier-of-last-resort (COLR)  
17 obligation by AT&T Florida, Inc.

18 Q. What is your understanding of the general history of the COLR obligation?

19 A. My understanding of the COLR obligation is that prior to 1995, when an explicit  
20 obligation to serve was first codified in Florida Statutes, there existed a so-called "regulatory  
21 compact" or "regulatory bargain" under which all public utilities operated. This "compact"  
22 held that in exchange for exclusivity in service territories and a guaranteed opportunity to earn  
23 a fair and reasonable return on investment, a company accepted economic regulation and the  
24 duty of non-discrimination. It is this duty of non-discrimination that became the obligation to  
25 serve all persons requesting service, or the COLR obligation.

1 Q. To your knowledge, how has the Florida Public Service Commission (FPSC)  
2 historically applied the COLR obligation?

3 A. My understanding is the FPSC has consistently interpreted the COLR obligation to  
4 mean that any person shall be able to obtain service at just, reasonable, and affordable rates.  
5 However, the FPSC has also recognized that requests for service in remote and previously  
6 unserved areas may require certain levels of investment by a company that under economic  
7 regulation may have detrimental impacts to the other ratepayers of the utility. For this reason,  
8 the FPSC has provisions for line extension charges for incumbent telecommunications carriers  
9 (and main extension charges for water and wastewater utilities) that apply to customers  
10 requesting services under certain circumstances. These charges are generally referred to as  
11 contributions in aid of construction (CIAC). In addition, advances for construction can be  
12 paid by developers and reimbursed as individual consumers come on line. In a rate base rate-  
13 of-return (ROR) regulatory environment, these charges permit the utility to uphold its  
14 obligation to serve without unduly burdening the other customers of the utility.

15 Q. Is the telecommunications industry in Florida currently under ROR regulation?

16 A. No. Only Frontier Communications of the South, Inc., a small rural incumbent local  
17 exchange company (ILEC) serving fewer than 5,000 access lines in Florida, remains under  
18 ROR regulation. All the remaining ILECs in Florida have elected price cap regulation which  
19 became available in 1996 after the Florida Legislature passed a law that permitted competition  
20 for local exchange services.

21 Q. What is the distinction between ROR regulation and price cap regulation as it relates to  
22 the COLR obligation?

23 A. The primary distinction between ROR regulation and price cap regulation is that under  
24 ROR regulation, a carrier is entitled to the opportunity to earn a reasonable return on its  
25 investment and a regulatory body sets rates designed to provide that return. If a carrier must

1 | serve in a remote, high-cost, or economically disadvantaged area where profitability on a per  
2 | customer basis is low or negative, that low return or loss is theoretically offset by the  
3 | profitability of serving the general body of ratepayers.

4 |         Under a price cap regulatory framework, the Commission does not consider the overall  
5 | earnings of the company and the company does not have the opportunity to petition the  
6 | Commission for rate revenue recovery with the very limited exception of the so-called  
7 | “changed circumstances” provision. The company is given pricing flexibility over a large  
8 | category of services and other services are allowed certain increases subject to government  
9 | inflation measures as contained in the statute. In short, the company is given significant  
10 | pricing flexibility as a tool to manage their earnings capacity in a more competitive  
11 | environment, rather than depending on regulatory bodies to set compensatory prices.

12 | Q.     Why do you believe the Legislature addressed the obligation to serve in its 1995  
13 | revision to Florida Statutes?

14 | A.     The Legislature’s stated intent was to maintain universal service for  
15 | telecommunications services while opening Florida’s telecommunications markets to  
16 | competition. Section 364.025, Florida Statutes, contains both the COLR obligation and a  
17 | statement as to the scope of universal service. The section further states the objective “. . . that  
18 | during this transition the ubiquitous nature of the local exchange telecommunications  
19 | companies be used to satisfy these (universal service) objectives.” The transition that is  
20 | referred to is the transition to a competitive telecommunications market. In most competitive  
21 | markets, participants are generally free to enter or exit the market at will. I believe that an  
22 | explicit COLR obligation imposed on ILECs was included in the statute in order to avoid a  
23 | situation during the transition to a competitive environment that would leave customers or  
24 | groups of customers without telecommunications service.

25 | Q.     To what service or services does the COLR obligation apply?

1 A. The statute identifies universal service as “. . . access to an evolving level of  
2 telecommunications services that, taking into account advances in technologies, services, and  
3 market demand for essential services, the commission [the PSC] determines should be  
4 provided at just, reasonable, and affordable rates, including to those customers in rural,  
5 economically disadvantaged, or high-cost areas.” The statute expressly states that “until  
6 January 1, 2009, each local exchange telecommunications company shall be required to  
7 furnish basic local exchange service within a reasonable time period to any person requesting  
8 service within the company’s service territory.” To date, the FPSC has not expanded the  
9 scope of that requirement to include additional services.

10 Q. Do you interpret the COLR obligation to apply to broadband or video services?

11 A. No. Broadband service is expressly excluded from the statutory definition of “service”  
12 under Chapter 364, and video services are not included in that definition.

13 Q. Would you agree that in most competitive markets, serving unprofitable customers  
14 does not make good business sense?

15 A. Yes. Certainly no business in a competitive market can survive serving only  
16 unprofitable customers. However, there are many reasons why a business may choose to  
17 provide a product or service below its actual cost, even if it is not required. For example,  
18 average pricing for a service or commodity is a standard business strategy in order to  
19 overcome the administrative difficulty of attempting to charge each individual customer a  
20 different rate based on the unique costs to serve or deliver a commodity to a particular  
21 location.

22 Q. Do you believe that the COLR obligation as embodied in Florida Statutes in 1995 was  
23 primarily an obligation to serve customers that would otherwise have been uneconomic to  
24 serve?

25 A. Generally, yes. However, the determination as to whether an individual customer or

1 | group of customers is economic to serve is not always straightforward. Given the freedom to  
2 | serve or not to serve, a profit maximizing entity will first serve areas that provide the greatest  
3 | return, dollar for dollar, rather than serving all profitable customers or areas indiscriminately.  
4 | Furthermore, business strategies may differ in regard to the timing of a return on investment.  
5 | Some businesses may desire a shorter time period for earning a return versus others.

6 |         For these reasons and others, it is important to understand upon what criteria a business  
7 | determines whether a particular investment makes economic sense. It could be unprofitable, it  
8 | could be only marginally profitable, or it may just be less profitable relative to other  
9 | investment opportunities.

10 | Q.     Have there been any changes to the COLR obligation as contained in Florida Statutes  
11 | since 1995?

12 | A.     Yes, the sunset date for the COLR obligation has been extended on more than one  
13 | occasion and is currently set at January 1, 2009. In addition, the 2006 Legislature added four  
14 | criteria to Section 364.025, Florida Statutes, that provide for an automatic waiver of the COLR  
15 | obligation for ILECs in certain multidwelling business or residential properties, including but  
16 | not limited to apartments, condominiums, subdivisions, office buildings or office parks  
17 | (hereinafter referred to as multidwelling environments).

18 | Q.     How would you characterize those four criteria?

19 | A.     I would generally characterize them as situations where there are either physical or  
20 | contractual obstacles to serve that make it virtually impossible for the ILEC to provide service.  
21 | That is, either a building owner or property manager, or a developer, has denied the ILEC  
22 | access to the property for purposes of installing the necessary infrastructure to provide basic  
23 | local exchange telecommunications service; or the building owner or property manager, or  
24 | developer, has entered into an exclusive agreement; or has entered into an incentive agreement  
25 | with a service provider to restrict access for the local exchange company. I believe it is safe to

1 | say that the Legislature recognized that in these situations it was impossible for the ILEC to  
2 | meet its COLR obligation either to the building or development collectively, or to individual  
3 | residents or businesses within the building or development.

4 | Q. Is it true that the 2006 change to the COLR law also included a provision that  
5 | permitted the designated carrier of last resort to petition the FPSC for a waiver of its COLR  
6 | obligation in a multidwelling environment for good cause shown?

7 | A. Yes.

8 | Q. Why do you believe that provision was included in the statute?

9 | A. I believe the Legislature wanted to afford the telecommunications industry and the  
10 | FPSC the flexibility to address unforeseen or unanticipated situations that may place a carrier  
11 | of last resort in a similar posture of being unable to fulfill its obligation, as do the four specific  
12 | criteria contained in the statute.

13 | Q. How are consumers protected by the COLR obligation?

14 | A. As I previously noted, I believe the consumer is protected by the guarantee of being  
15 | able to obtain basic local service from at least one telecommunications provider, regardless of  
16 | where he or she lives and regardless of the amount of revenue he or she generates above the  
17 | basic local service rate. Currently, Florida law requires the wireline ILEC to be the COLR.

18 | Q. In the case of multidwelling environments such as identified in the COLR statute, how  
19 | are individual consumers guaranteed access to telecommunications service?

20 | A. The multidwelling environment is somewhat different than the case of an individual  
21 | consumer. In many multidwelling environment situations the ability, responsibility, and right  
22 | to acquire service is exercised by the building or development owner or property manager.  
23 | The protection afforded an individual consumer is lost in these circumstances.

24 | Q. What recourse does an individual consumer have in a multidwelling environment?

25 | A. In the case of a physical lockout of an ILEC the only possible recourse would be a



1 wireless alternative or the ability to choose not to reside in that particular location. In the case  
2 of a contractual obstacle, the consumer may be able to acquire service from an alternative  
3 provider if physical access is not prohibited, or he or she may elect wireless. In many  
4 instances, the consumer will be required to pay for the service selected by the developer or  
5 building owner as well as for the preferred service he or she may be seeking.

6 Q. Why are such exclusive arrangements permitted in a competitive telecommunications  
7 market?

8 A. Such arrangements are the result of the tension between property rights and  
9 competitive markets for communications services in general, including voice, video and data.

10 Q. Do you believe that a multidwelling environment that is uneconomic for a  
11 telecommunications provider with a COLR obligation to serve is sufficient grounds for the  
12 FPSC to waive that obligation?

13 A. I can envision a circumstance where I could conclude that this would be sufficient  
14 grounds for this Commission to grant a waiver. However, that circumstance would include  
15 fairly extreme conditions. For example, if the incremental investment required of the  
16 company is small and there is no other provider under contract to provide service to the  
17 building or development, I would be hard pressed to conclude that a waiver served the public  
18 interest. By the same token, if the level of investment was so substantial that failure to garner  
19 a reasonable return over the life of the investment would have a detrimental impact to the  
20 company's ability to provide services generally, then that would be a case where it may serve  
21 the public interest to grant a waiver.

22 The problem is the large gray area in between those two extremes that constitutes most  
23 circumstances that have been brought before the FPSC to date. In that gray area I would  
24 suggest that the failure to recoup and earn a return on the investment over a typical planning  
25 horizon is not a sufficient condition by itself on which to base a waiver of the COLR

1 obligation.

2 Q. How does the fact that the COLR obligation applies to telecommunications service  
3 impact the instant waiver petition by AT&T?

4 A. In this case, and in other previous waiver petitions before the Commission, the  
5 petitioning company has asserted that it is being restricted to the provision of voice service  
6 only and is prohibited, either physically or contractually, from providing data and video  
7 services. The petitioners have made the point that being able to offer only one service  
8 impedes their ability to maximize revenues. In effect, the Commission is being asked to factor  
9 into their decision making calculus, the status of the competitive market place for services  
10 outside its jurisdiction. As relevant as those factors may be in the dynamics of contractual  
11 negotiations, it is not clear that the Legislature intended for the Commission to extend its  
12 reach to that extent.

13 Q. Do you believe that the availability of an alternative provider should be sufficient basis  
14 for granting a waiver of the COLR obligation?

15 A. At this time, I do not believe that the mere presence of alternative service providers is a  
16 sufficient basis for granting a waiver. It is, however, a necessary condition. The dilemma  
17 faced by the Commission in reaching a conclusion that availability of an alternative provider  
18 constitutes good cause for waiving the COLR obligation is that in a multidwelling  
19 environment the decision affects multiple consumers. While the Commission's own analysis  
20 suggests that a significant number of Florida residential consumers have individually selected  
21 alternative providers such as wireless and VoIP providers, it is not yet clear that a majority of  
22 Florida consumers accept these alternatives as a substitute for traditional wireline  
23 telecommunications service. Further, in the absence of a contractual obligation, alternative  
24 providers such as cable VoIP providers or wireless providers do not have the same obligation  
25 to serve required of ILECs, nor are they subject to statutory price constraints or FPSC quality

1 of service standards as are ILECs.

2 Q. Does this conclude your testimony?

3 A. Yes.

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BEFORE THE PUBLIC SERVICE COMMISSION

In re: Petition for relief from carrier-of-last-resort (COLR) obligations pursuant to Section 364.025(6)(d), F.S., for Villages of Avalon, Phase II, in Hernando County, by BellSouth Telecommunications, Inc. d/b/a AT&T Florida.

DOCKET NO. 070126-TL

DATED: AUGUST 10, 2007

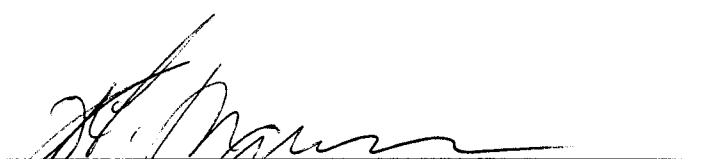
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that one true copy of STAFF'S DIRECT TESTIMONY OF GREGORY L. SHAFER has been furnished to the following by U. S. and Electronic mail this 10th day of August, 2007:

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