

1 **Q. In this phase of the docket, the Company is providing estimates of both “onset costs”**
2 **and “nonrecurring costs.” How are these two types of costs distinct?**

3 A. Onset costs are the costs associated with the modifications to the Company’s network and
4 supporting systems needed to conform to the requirements of the 1996 Act that ILECs make
5 their retail services and service elements available to competing local exchange carriers. For the
6 most part they are fixed, volume insensitive costs which are incurred at the start of competition.
7 However, some costs that are classified by the Company as “onset costs” are affected by the
8 level of anticipated demand, or the volume of competitive activity. Nonrecurring costs are
9 almost entirely demand-sensitive costs, which are associated with the actual provision of
10 unbundled elements to competitive carriers. They differ from recurring costs (the subject of
11 Phase II of this proceeding) in that they are one-time costs incurred as a result of an order to
12 initiate or change service. The nonrecurring and onset costs are similar in one way: they both
13 tend to be associated with the process whereby end use customers change from one carrier to
14 another.

15 Bell Atlantic - North proposes that all of these costs be recovered from its competitors-
16 -some on a per-carrier basis, some on a per-transaction basis. However, this is not the only
17 alternative. A portion of the onset costs could reasonably be borne by Bell Atlantic - North,
18 because they are fixed costs which are required by the 1996 Act; they are not specifically and
19 exclusively attributable to the CLECs. I will discuss this point in more detail later in my
20 testimony.

21
22 **Q. You have discussed the differences between onset and nonrecurring costs. Are there**
23 **also similarities in these two categories?**

24 A. Yes. Both of these two categories of costs closely relate to the process by which customers
25 obtain or change their telephone service. The impact of both onset and nonrecurring costs falls
26 heavily on customers that change carriers, as well as those who move to a new location. In
27 economic terms, these are classified as “transaction costs,” like brokerage fees and credit card
28 processing fees. It is well established that high transaction costs reduce the efficiency of
29 markets, and make it more difficult to achieve effective competition. In general, high transaction

1 costs discourage transactions, inhibit the exercise of consumer choice, and create market
2 friction (i.e., slow down or halt competitive pressures by inhibiting customers from “shopping
3 around” or slowing the movement and impact of changing price signals). An important
4 characteristic of purely competitive markets are that transaction costs are very low, relative to
5 the value of the goods and services being purchased. Where transaction costs are high,
6 effective competition is less likely to exist.

7 These general economic characteristics are particularly applicable in this context. If the
8 Commission were to approve high nonrecurring charges, it will tend to discourage new carriers
9 from entering the market, and will tend to discourage customers from changing from one carrier
10 to another. Currently, Bell Atlantic - North directly serves nearly 100 percent of the retail
11 market. If relatively high levels of onset and nonrecurring costs are incurred and imposed on
12 CLECs, it will be relatively costly for end-user customers to switch from Bell Atlantic - North
13 to another carrier.

14 From a public policy perspective, there is a clear trade-off between the level of
15 transaction costs applicable to the CLECs (and imposed on their customers) and the intensity
16 and degree of competitive pressures which can be expected to emerge over time. With
17 relatively low transaction costs, it will be easier for CLECs to enter the market, and it will be
18 relatively costless for customers to change carriers, in order to “try out” a competing carrier’s
19 service, or to respond to a small price difference. With high transaction costs, movement
20 between carriers will be discouraged, and minor differences in prices and quality won’t be
21 sufficient to motivate such changes. In general, a high level of transaction costs will tend to result
22 in a market that is relatively rigid and inefficient. Customers will be discouraged from changing
23 carriers, and the transition away from monopoly conditions may be greatly slowed, or
24 precluded entirely. Accordingly, from a public interest perspective, it is preferable to keep
25 transaction costs as low as possible.

26 From an incumbent carrier’s perspective, of course, these problems may seem like
27 benefits. Thus, if Bell Atlantic - North incurs a high level of onset and nonrecurring costs and
28 passes them along to its competitors, that will have two salutary effects for Bell Atlantic -
29 North: it will discourage competitive entry, and it will impede the CLECs’ ability to gain market

1 share.

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3 **Q. If the actual level of transaction costs is relatively high, would there be any benefit to**
4 **recovering some of these costs through recurring monthly rates, in order to minimize**
5 **the transaction fees paid by customers that are changing carriers?**

6 A. Yes. It is obviously preferable to minimize the actual level of transaction costs actually incurred.
7 Where a relatively high level of costs has already been incurred, or must necessarily be
8 incurred, there would be some benefit to shifting the incidence of these costs away from the
9 transactions themselves. In other words, from a public policy perspective, it may be preferable
10 to recover some of the onset and nonrecurring costs through recurring charges imposed on all
11 customers--not just those who choose to change carriers--in other words, to treat a portion of
12 the actual transaction cost as a general cost of promoting competition, spread to all customers.
13 A precedent can be found in the FCC's decision to impose a \$5 cap on the fee for changing
14 presubscribed interexchange carriers. While the full cost of changing carriers was estimated to
15 substantially exceed this amount, as a matter of policy the FCC decided to cap the fee at a
16 relatively modest level which wouldn't discourage customers from changing carriers in response
17 to minor differences in pricing or service quality. The remaining costs of changing carriers, if
18 any, are recovered through recurring switched access rates.

19
20 **Q. Has the low cost of changing interexchange carriers been a pro-competitive factor in**
21 **long distance markets?**

22 A. Yes. The overall effect of this policy has been to enhance competition and diminish AT&T's
23 market power. The primary beneficiaries of this policy have been price-sensitive customers,
24 who change carriers frequently, and the smaller carriers, who have gradually been increasing
25 their share of the market. As a result, market share data reflect a fairly dramatic erosion of
26 AT&T's market dominance since implementation of equal access. According to the FCC,
27 between 1984 and the second quarter of 1997, AT&T's national share of long-distance
28 revenues decreased from approximately 90 percent to 51 percent. During the same period,
29 MCI's share rose from 5 percent to 17 percent, Sprint's share rose from 3 percent to 9

1 percent, World Com's share increased from virtually nothing to 7 percent, and collectively the
2 hundreds of other competitors increased from 4 percent to 16 percent. [FCC News, October
3 10, 1997.]

4 As competition has intensified, the "churn rate" for long-distance carrier presubscription
5 has also increased. A recent market analysis estimated the residential turnover rate in 1997 at
6 about 25 percent. [*tele.com*, March 1998, p. 19.] In other words, it has been estimated that
7 roughly one in four households changes long distance carriers each year. Customers would not
8 be as willing to change IXCs, nor would carriers be as sensitive to competitive pressures, if the
9 nonrecurring fees associated with changing carriers were high.

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