

1 *Proposed Rate Changes*

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3 **Q. Historically, the Public Staff has resisted access charge reductions when they would**
4 **result in increases in local rates. Why has the Public Staff's accepted the**
5 **rebalancing provisions in the Joint Stipulation?**

6 A. N.C.G.S. 62-133.5 requires the Commission to allow a local exchange company that is
7 under price regulation to rebalance its rates, and the Public Staff agreed to provisions in
8 BellSouth's original price cap plan that would allow gradual increases in rates for basic local
9 service after the three-year cap was lifted. The Public Staff recognized at that time that
10 some degree of gradual rebalancing would be necessary. Since the price plan has been in
11 effect, switched access charges have been substantially reduced in the federal jurisdiction,
12 and in many state jurisdictions. Understandably, AT&T was anxious to see a similar
13 reduction in North Carolina. Under the Sprint and GTE price plans, access charge
14 reductions can be offset with increases in rates for other services in the basic basket. It was
15 reasonable for BellSouth to request similar flexibility under its plan. Rather than resist any
16 such rebalancing, the Public Staff focused on ensuring that the increases were spread over a
17 variety of services. The Public Staff also insisted that these increases be accompanied by
18 service quality improvements, which will be discussed in the fifth section of my testimony.

19
20 **Q. Carriers that provide toll service in the state will benefit from the lower switched**
21 **access rates. Will customers also benefit from the access rate reduction?**

22 A. Yes. As a party in the Joint Stipulation, AT&T has agreed to flow through to consumers
23 every dollar of access rate reductions that it gains from the Joint Stipulation. Furthermore,
24 Staff has petitioned the Commission for an order mandating that all providers of toll service
25 in North Carolina flow through to consumers the reduction in access rates. [Joint Stipulation,
26 p. 2]

1 **Q. How will the flow through affect consumers?**

2 A. It will result in lower toll rates and, in turn, lower toll bills for most consumers. Access
3 applies during times when toll charges don't apply—for instance, while the call is being dialed,
4 and during call attempts that aren't answered. Accordingly, the initial reduction in access
5 from the current composite rate of \$.063 per minute to \$.04 would translate into a
6 corresponding reduction in toll rates of approximately 2.5 cents per toll minute. However,
7 the reductions only apply to access purchased from BellSouth, while the flow through will
8 benefit all parts of the state. Accordingly, I estimate that toll rates will decline by
9 approximately 1.2 cents per minute statewide. That would suggest a savings of
10 approximately \$.50 per month for a customer that uses 40 minutes of intrastate long
11 distance. While the number of calls may fluctuate each month, and some customers place
12 fewer calls than others, intrastate long distance service is an important component of most
13 customers' monthly bills. Consequently, it is fair to say that the flow through provisions will
14 translate into real savings on most consumers' monthly bills—including those living outside of
15 BellSouth's service area.

16 Another benefit to consumers will be a reduction in the disparity between intrastate
17 and interstate toll rates. When consumers see toll rates as low as 5 cents per minute
18 advertised on national television, they can be confused and disappointed when they discover
19 that these rate plans don't apply to calls within North Carolina. Because the per-minute
20 interstate access rates have declined sharply in recent years, many interstate calling plans
21 have lower per minute rates than the lowest analogous intrastate rates. By reducing
22 intrastate access and toll rates, this discrepancy can be reduced, thereby reducing consumer
23 confusion and irritation, and enhancing the competitive process in the intrastate toll market.

24
25 **Q. Are there any other consumer benefits that can be expected as a result of this**
26 **aspect of the Joint Stipulation?**

1 A. Yes. Lower prices for toll service will serve to stimulate toll calling. Economic theory tells
2 us that as the price of a good decreases, the amount of that good demanded by consumers
3 will increase. There is every reason to anticipate that general principle will hold in this case.
4 Both consumers and carriers will benefit when consumers respond to price reductions by
5 increasing the frequency or duration of their toll calls. Because the telecommunications
6 business is a declining cost industry, when traffic is stimulated, prices for toll service can be
7 expected to decline even further under competitive conditions.

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9 **Q. Can you comment further on the proposed increases in basic local rates, as**
10 **permitted by the Joint Stipulation?**

11 A. Yes. Those consumers that rarely place intrastate toll calls will experience an increase in
12 their monthly bill. However, the increase will be relatively modest, since the Joint Stipulation
13 calls for only gradual upward adjustments to rates. For those consumers that place a lot of
14 toll calls, the net effect will likely be a reduction in their monthly bill. Since the total dollar
15 amount of the rate increases is substantially less than the total amount of the rate decreases
16 (BellSouth is absorbing the difference), it is reasonable to conclude that the average
17 consumer will, on balance, benefit from the rate changes. The proposed increase in local
18 rates is not extreme, and for most consumers it will be further ameliorated (or completely
19 offset) by the toll rate reductions.

20 The proposed changes to local rates are moderate, and they will be spread out over
21 a period of two years. More specifically, during the first year of the revised Plan, the rate for
22 basic local service paid by a typical residential consumer will increase by just \$0.48 per
23 month. This represents an increase of 3.8% for consumers who are currently paying a local
24 rate of \$12.51 per month. By the end of the phase-in period, local rates will probably have
25 increased by \$1.50 per month as a result of the access reductions, but this would still be just
26 12% more than the existing \$12.51 rate. To place this in perspective, it should be

1 recognized that the resulting monthly charge will still be slightly below the price which was
2 charged in 1984 for the most expensive local calling service (\$14.77).

3 I would also note that the proposed increases in basic local service do not exceed
4 the percentage increases which are allowed under the existing price cap plan. Admittedly,
5 some consumers may feel that any increase in local rates is objectionable. However, it
6 should be recognized that AT&T and others have argued for years that a realignment of toll
7 and local rates is needed and justified by the underlying economics of the industry. It would
8 not be in the public interest to adopt a policy of delay, if the final result could be a sudden,
9 radical change in rates. A longstanding principle of rate making is that even where
10 substantial rate changes are needed, customers should not be exposed to sudden and
11 extreme increases in rates, particularly if the increases are unrelated to expansions in service
12 offerings, and even more particularly if no reasonable substitute for the service is readily
13 available. For equitable and other reasons, regulatory commissions have often found that
14 "rate shock" should be avoided, or minimized. The Joint Stipulation avoids the risk of rate
15 shock by adopting moderate increases in local rates which are gradually phased in over a
16 period of years.

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18 **Q. Aside from the benefits you have already mentioned, are there any additional**
19 **benefits arising from this provision of the Joint Stipulation?**

20 A. Yes. First, from the perspective of potential competitors, the realignment of rates may make
21 the residential local exchange market more profitable. As BellSouth raises monthly rates for
22 local service over the next two years, competing local providers ("CLPs") may gain a
23 window of opportunity to convince residential customers to try a different carrier, and some
24 customers may be stimulated by the rate increase to seek out other alternatives. Second,
25 from BellSouth's perspective, the Joint Stipulation may offer long term benefits, since it will
26 reduce the incentive and opportunity for "cherry-picking" of high revenue customers. The
27 realignment of local and toll rates will reduce disparities in the revenues and profits generated

1 by different types of consumers. Under the existing rate design, switched access revenues
2 are critically important in determining the extent to which particular customers are profitable
3 to serve. By concentrating their marketing efforts on customers that use a lot of toll service,
4 competitors can take away a relatively large fraction of BellSouth's revenues while serving a
5 relatively small fraction of the total customers. After the realignment of rates, BellSouth will
6 face less exposure to this type of "cherry picking"

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