

1 **6. *Rate Rebalancing and Access Charges***

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3 **Q. Can you now discuss access charges, and how this issue relates to other issues in this**
4 **proceeding?**

5 A. Access charge issues are intimately connected to the issue of Universal Service. Switched
6 access service is an important source of revenues that has historically been used to help pay for
7 the costs of providing Universal Service. some carriers have advocated reducing these rates
8 and replacing the lost revenues with an alternative source of funding, such as higher local
9 exchange rates. This form of “rate rebalancing,” could endanger the Universal Service goal,
10 particularly if it is implemented in an extreme manner.

11
12 **Q. What is your view of proposals to lower switched access rates?**

13 A. I don’t find the concept of reducing access charges to be objectionable, provided this can be
14 accomplished without forcing local exchange customers to pay substantially higher rates. The
15 general trend in telecommunications costs and rates is downward, and it is not unreasonable for
16 the interexchange carriers and their customers to share in the benefits of this downward trend.
17 In many jurisdictions access charges have declined, yet local rates have remained relatively
18 stable. A similar result is achieved by the settlement Agreement, which calls for a substantial
19 reduction in access rates, along with a more modest reduction in local rates. Unlike the
20 illustrative proposal set forth in GTE’s original filing, the access rate reductions in the settlement
21 Agreement do not involve any offsetting increases to local rates.

1 **Q. Some say that switched access charges must be slashed to extremely low levels, due to**
2 **the threat of competition. How well supported is this argument?**

3 A. Not well at all. Switched access continues to be a market overwhelmingly dominated by the
4 incumbent local exchange carriers. While competitive access providers have emerged as niche
5 players in some of the nation's larger metropolitan areas, they have limited facilities and very
6 limited market penetration. The traditional local exchange carriers generally continue to enjoy an
7 extremely large share of the switched access market (i.e. more than 90%), even in areas where
8 competitors have entered the market. Furthermore, new entrants do not necessarily focus on
9 price cutting; some have emphasized faster service, greater reliability and better transmission
10 quality, rather than cost savings.

11
12 **Q. Won't access rates decline as competitive pressures increase?**

13 A. It is reasonable to assume that access rates will continue to trend downward, as a result of
14 technological improvements, increasing traffic volumes, and improved efficiency. To the extent
15 competition increases, it will tend to hasten or reinforce this downward trend. One of the
16 advantages of effective competition is that it forces all carriers to operate more efficiently, and it
17 creates incentives for cost cutting and technological enhancements. The local and access rate
18 reductions included in the settlement Agreement are consistent with this general trend.

19 However, there is no basis for concluding that the settlement doesn't go far enough in
20 reducing access rates, or that an immediate and massive shift in revenue responsibility from
21 access to local exchange is necessary. Quite the contrary is true. The evidence suggests that
22 access markets are characterized by monopoly conditions, and that new entrants are unlikely to
23 emphasize switched access rate reductions as a primary strategy for gaining market share. Over
24 time access prices will likely continue to decline, as a result of increased volume, reduced cost,
25 and lower profits. That type of access price reduction, the product of external economic forces,

1 is quite unlike the price reductions sometimes advocated by incumbent LECs and their larger
2 interexchange customers: a government-enforced shifting of revenue responsibility from access
3 to local markets.

4
5 **Q. Shouldn't GTE's basic local exchange rates be increased, in order to accommodate an**
6 **even greater reduction to access rates?**

7 A. No. The settlement Agreement appropriately reduces access charges without increasing basic
8 local rates. For more than 15 years, interexchange carriers have advanced the argument that the
9 joint costs of local networks (e.g. the loop costs) should be entirely the responsibility of local
10 ratepayers. As market conditions have evolved, some parties have continued to recycle these
11 arguments, by adapting them to fit changing market conditions. Prior to divestiture, the
12 argument was that toll competition was increasing, and thus local rates needed to be increased
13 while toll rates needed to be reduced.

14 In the mid-1980's, the theme was amplified and repeated throughout the country, with
15 an emphasis on the potential effect of the divestiture. Some of the Bell Operating Companies
16 even implied that unless local rates were dramatically increased at the time of divestiture,
17 disaster would befall them. Local rates were not increased as much as requested or predicted,
18 and events subsequently proved the argument to be false. LEC profits remained strong,
19 "bypass" never grew as rapidly as predicted, and in most markets the LECs enjoyed strong
20 growth in their switched access service, despite the fact that rates were not reduced as much as
21 the IXCs had sought. Not only has history proven this argument false, it is inherently
22 inconsistent with both economic theory and common sense.

23 By such reasoning, the local exchange networks are preexisting entities for which the
24 LECs and their subscribers are responsible and to which interexchange carriers more or less
25 incidentally connect in the course of completing long distance calls. To IXCs, the cost of the

1 local subscriber's loop, drop wire, and port should be considered exclusively part of the
2 incremental cost of local exchange service and none of these costs should be recovered from
3 switched access and other categories of service. By that reasoning it is wrong for GTE to
4 charge more than the direct cost of providing access.

5 As I explain in Appendix C, this entire line of reasoning is invalid. These are joint costs
6 which are necessary for the provision of toll, access, and custom calling service. To assign the
7 entire amount of these joint costs to local exchange is not economically valid, nor is it consistent
8 with the result which would occur in a competitive market. Considerable uncertainty presently
9 exists concerning the course of future competitive trends, but there is no reason to assume that
10 market forces will drastically reduce switched access rates while increasing local rates. In my
11 opinion, the Commission should not attempt to anticipate the outcome of these uncertainties by
12 drastically "rebalancing" local and access rates.

13 Switched access rate reductions are not objectionable, provided they are accomplished
14 without imposing rate increases on local residence customers. The general trend in
15 telecommunications costs and rates is downward, and it is not unreasonable for interexchange
16 carriers and their customers to share in the benefits of this downward trend. The settlement
17 Agreement provides a good example of the type of switched access rate reductions which are
18 appropriate. These reductions—though quite substantial—are not financed through a "revenue
19 neutral" filing, thereby making local rates less affordable. Instead, GTE has agreed to reduce its
20 revenues and profits, consistent with the current declining cost environment, thereby making
21 feasible reductions to both switched access and basic local rates.

1 **Q. Can GTE afford to lower both switched access and local rates?**

2 A. Yes, there is good reason to assume that the Company can absorb reductions in both
3 categories of rates, without endangering service quality or imposing an undue burden on its
4 stockholders. While the settling parties didn't reach agreement on the most appropriate way to
5 calculate GTE's Indiana intrastate earnings level, there is good reason to assume it is currently
6 earning more than its cost of capital. With the exception of access charges (which have
7 mirrored federally mandated reductions), the Company's rates have not been reduced in more
8 than a decade. Yet, this has been a time in which telephone carriers have experienced
9 increasing economies of scale, technological advances, and other favorable trends which have
10 the effect of reducing their costs. Nationwide, GTE has enjoyed extraordinarily high profits in
11 recent years. According to its 1998 annual report, GTE Corporation's return on equity for
12 1998 was 28.4%. Over the past 5 years, GTE Corporation enjoyed an average return on
13 equity of 32.32%. [www.gte.com] Needless to say, these profit levels exceed its actual cost of
14 equity by a wide margin.

15 As competition increases, telecommunications prices are likely to decline over time, as
16 a result of technological improvements, increasing efficiency, increasing volumes, reduced costs,
17 and lower profit margins resulting from increased competition. That type of gradual price
18 reduction, the product of external economic forces, is quite different from a large,
19 government-enforced, shifting of revenue responsibility from access to local markets prior to
20 effective competition.

21 A radical rebalancing of existing revenues from Basket 2 to Basket 1 would not be in
22 the public interest. A longstanding principle of rate making is that even where revenue shortfalls
23 exist (not the case here), customers should not be exposed to sudden and extreme increases in
24 rates, particularly if the increases are unrelated to improvements in service quality or expansions
25 in service offerings, and even more particularly if no reasonable substitute for the service is

1 readily available. Otherwise, the abrupt nature of these increases may cause subscribers to
2 drop off the system, to the detriment of universal service and society in general. For equitable
3 and other reasons, regulatory commissions have often found that “rate shock” should be
4 avoided, or minimized. Where customers do not have other viable options (e.g., where effective
5 competition does not exist), extreme or abrupt rate increases are not appropriate or desirable.
6 Substantially increasing rates to residence customers would violate the rate continuity principle.