

1 Switched Access Rates

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3 **Q. Would you please summarize the Company's proposals regarding**
4 **switched access?**

5 A. In the direct testimony of Mr. Bailey, GTE proposes to decrease its revenue
6 from switched access by a total of \$16,241,649 (prior to the effects of ELS
7 conversion,) a reduction of approximately 30%. This substantial reduction is
8 achieved via the Company's proposals to:

- 9 1) Merge the GTE South-Southwest VA and GTE South-Contel
10 VA tariffs.
- 11 2) Mirror the Interstate General Telephone Operating Companies
12 (GTOC) tariff FCC No.1 structure, using rate levels equivalent
13 to those contained in the GTE System Telephone Companies
14 (GTSC) tariff FCC No. 1 as a basis for several of the rate
15 elements. These elements include the End Office Switching
16 Information Surcharge, and Transport rate elements. The
17 Company proposes to implement the local transport structure
18 as authorized by the FCC in CC Docket 91-213 with the
19 exception of the Interconnection Rate.
- 20 3) Convert GTE South-Southwest VA's CCL rate per access line
21 to a minute-of-use (MOU) rate.
- 22 4) Eliminate non-premium switched access rates.
- 23 5) Introduce a zone pricing structure for several switched access
24 rate elements.

25
26 In the Company's supplemental filing this reduction has been
27 significantly scaled back to a 8.3%, or \$4.5 million dollar reduction. Other
28 changes to GTE's original proposal are:

- 29
30 1) Implement the local transport restructure with a non-zero
31 Interconnection Rate (IR).
- 32 2) Include IR revenues in the intrastate end user line charge.
- 33 3) Include ZonePlus in all three zones, and adjust the percentage
34 discount between each zone.

1 elements. Second, the Company has proposed a zone pricing structure that will
2 initially affect the Information Surcharge and end-office switching rates. The
3 Company has proposed to divide its service territory into three zones:
4

5 Zone 1- Central offices with traffic density equal to or greater than 40
6 DS1 equivalents. A central office not meeting this criterion can still be
7 classified in Zone 1 if its boundary is contiguous with a Zone 1 central
8 office and its traffic density is 10 DS1 equivalents or higher.
9

10 Zone 2 - Central offices with traffic density of 10 to 39 DS1
11 equivalents, not otherwise classified as Zone 1 by proximity.
12

13 Zone 3 - All other central offices. (Traffic density of less than 10 DS1
14 equivalents.)
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16 Additionally, the Company has proposed a ZonePlus plan that offers a
17 10% reduction on all originating or terminating MOUs at a single location
18 exceeding 2,000 per month. Only traffic within proposed Zone 1 offices
19 qualifies.

20 As Mr. Bailey describes it, “the Company recommends a tariff
21 structure consisting of three zones which will be used to group offices of like
22 competitive potential.” [Bailey Testimony, p. 17.] The Company has proposed
23 to set the Zone 1 rate at the interstate benchmark, with Zones 2 and 3 at 15%
24 and 30% premiums, respectively. According to the Company, these levels are
25 based on GTE South’s initial judgement on market conditions.

26 The total impact of the Company’s end office switching original
27 proposal was a revenue reduction of \$5,176,225. Combining this figure with an
28 approximate increase of \$900,000 in the Information Surcharge category, the
29 Company listed its revenue change for the “End Office” category as a reduction
30 of approximately \$4.2 million, or 27%.

31 In its supplemental filing the Company’s revised its changes for Zone Pricing by
32 extending the 10% ZonePlus reduction for qualifying usage to all zones and
33 dropped the Zone 2 and Zone 3 rates for EOS and Information Surcharge from
34 15% to 10%, and from 30% to 20% respectively.

1 **Q. Please describe the Company's proposals for Carrier Common Line.**

2 A. The third major element of the Company's original proposal includes an overall
3 reduction in the carrier common line (CCL) revenues, as well as a modification
4 of the current rate structure. Currently, GTE South-Southwest VA's CCL rate
5 is \$3.8278 per access line. The Company proposes to revise the CCL to a
6 minute of use (MOU) basis at a rate that achieves revenue neutrality for the
7 category. In addition, the Company proposed a two-year phase-down of CCL
8 rates, beginning one year after the effective date of the decision in this
9 proceeding. The loss of revenue associated with the phase-down would be
10 recovered by an intrastate end-user line charge of approximately \$1.53 per
11 business and residence line.

12 The Company's rationale for the phase-down was its stated belief that
13 the expansion of competition requires GTE to rebalance rates in order to
14 compete effectively. The effect of this proposal is to further shift revenues from
15 the access to local categories and to further compress the differential between
16 residence and business local exchange rates, since the proposed end-user
17 charge would be equivalent to a uniform increase in local exchange rates of
18 \$1.53 per line per month.

19 In its supplemental filing, the Company proposed stepping down the
20 switched access rates over several years, offset by an escalating intrastate end
21 user line charge. This would mean an immediate shift in revenue responsibility
22 from the switched access category to local customers of nearly \$5 million, and
23 nearly \$10 million more in subsequent years. Hence, the Company has not
24 completely abandoned its proposal to shift roughly \$16 million from the long
25 distance carriers to local customers; primarily, it is proposing to implement this
26 rebalancing over a longer period of time.

27 Additionally, the Company proposes to establish zones for the CCL
28 rate element, like the ones for end-office switching. Initially, the CCLC would
29 be the same for all zones, but zone differentials would be introduced during the
30 phase-down process. Finally, the Company has proposed to eliminate
31 nonpremium rates for switched access.

32

1 **Q. What is your reaction to the Company's switched access proposals?**

2 A. I agree with some of the proposals for restructuring of its rates, and I agree that
3 it would be desirable to lower the overall level of access rates--provided this
4 can be accomplished without forcing local exchange customers to pay
5 substantially higher rates. I don't find the concept of reducing access charges to
6 be objectionable. Quite the contrary, the general trend in telecommunications
7 costs and rates is downward, and it is not unreasonable for the interexchange
8 carriers and their customers to share in the benefits of this downward trend.

9 What I find objectionable is the concept of implementing such a
10 reduction through either the original "revenue neutral" filing, or the \$1 million
11 reduced revenue supplemental filing. Both allow the Company to maintain an
12 excessive level of revenues and profits, and imposing a massive shift in the
13 revenue burden from the toll to local category. Such an extreme shift is
14 unwarranted, unnecessary, and inappropriate. The Company's proposal to
15 phase down its CCL rates, recovering the lost revenues through an end-user
16 line charge, suffers from the same deficiency. It represents, in effect, a further
17 increase in local exchange rates, since the revenue burden would shift from toll
18 carriers to local exchange customers, who would be required to pay this fee
19 even if they place and receive nothing but local calls.

20
21 **Q. GTE's primary rationale for decreasing switched access charges is the
22 threat of competition. How well supported is this argument?**

23 A. Not well at all. Mr. Bailey argues that access markets are changing around the
24 nation and that the Company believes Virginia will be affected in the near future.
25 He concludes:

26
27 Today's uneconomic switched access rates cannot be sustained in a
28 climate of intensifying competition. Alternative carriers are not burdened
29 with an uneconomic pricing structure as is the Company. [GTE, Bailey
30 Direct Testimony, p. 6.]

31
32 However, he furnished no information concerning who these alternative
33 access carriers are, how many of them have entered the Company's markets,
34 or the extent to which they have gained market share. In fact, he failed even to

1 document his allegations that access markets are changing elsewhere in the
2 nation. For instance, he provided no estimates of competitive access carrier
3 market shares.

4 This reticence is understandable, since switched access continues to be
5 a market overwhelmingly dominated by local exchange carriers like GTE.
6 While competitive access providers have emerged as niche players in some of
7 the nation's larger metropolitan areas, they have limited facilities and very
8 limited market penetration. The traditional local exchange carriers generally
9 continue to enjoy an extremely large share of the switched access market (e.g.,
10 more than 95%), even in areas where competitors have entered the market.
11 Furthermore, new entrants do not necessarily focus on price cutting. For
12 instance, Metropolitan Fiber Systems has emphasized faster service, greater
13 reliability and better transmission quality, rather than cost savings.

14
15 **Q. Won't access rates decline as competitive pressures increase?**

16 A. It is reasonable to assume that nationally, access rates will continue to trend
17 downward, as a result of technological improvements, increasing traffic
18 volumes, and improved efficiency. To the extent competition increases, it will
19 tend to hasten or reinforce this downward trend. One of the advantages of
20 effective competition is that it forces all carriers to operate more efficiently, and
21 it creates incentives for cost cutting and technological enhancements. However,
22 I find no evidence that the Company's access rates are "too high," relative to its
23 existing level of efficiency, and there is certainly no basis for concluding that a
24 massive shift in revenue responsibility is necessary from access to local
25 exchange.

26 Quite the contrary is true. The evidence suggests that access markets
27 are characterized by monopoly conditions, that competitive pressures will be
28 slow to build, and that new entrants are unlikely to emphasize switched access
29 rate reductions as a primary strategy for gaining market share. When over time
30 access prices do decline, it will be as a result of increased volume, reduced
31 cost, and lower profits. That type of access price reduction, the product of
32 external economic forces, is quite unlike the price reduction proposed here: a
33 government-enforced shifting of revenue responsibility from access to local
34 markets.

1 **Q. Do you accept the proposition that switched access rates need to be**
2 **redesigne d?**

3 A. Yes. Recent FCC actions to encourage unbundling, expanded interconnection
4 rights, and co-location are designed to increase competition in the switched
5 access market, and potentially to improve efficiency and drive down access
6 rates.

7 However, the full impact of these changes may be years away, and the
8 Company appears to be avoiding claiming otherwise. As far as I can tell, GTE
9 is not saying that it faces a competitive crisis now, but rather that at some point
10 in the future "alternative carriers will present significant market rivalry to GTE
11 South." [Bailey Testimony, p. 6.] Since the Company has been prudently vague
12 about when this rivalry is expected to emerge, or how significant it will be, the
13 statement is hard to deny; but it is hard to take seriously either. Even if one
14 accepts the conclusion, it does not follow, by any known logic, that an
15 immediate reduction in access prices should be accomplished at the expense of
16 local exchange ratepayers.

17 Competition, when it comes, may well drive down more than prices--it
18 can serve to drive down costs and profits, as well. Therefore, and given the
19 massive uncertainty which presently exists concerning federal legislation and
20 other factors, it would not be appropriate to raise local rates at this juncture, in
21 order to accommodate a downward shift in switched access prices which might
22 or might not eventually occur in the absence of regulatory action.

23 In my opinion, the appropriate response to these uncertainties is not to
24 be found in the Company's proposed "rebalancing" of local and access rates. If
25 the Company could document reductions in costs or increases in efficiency, a
26 moderate decline in rates might be justified. That is a far different thing from a
27 drastic reduction in rates which is designed to enhance the Company's strategic
28 positioning at the expense of its captive local ratepayers. However, given the
29 circumstances of this proceeding, I do not believe any reduction in the overall
30 level of access revenues is appropriate.

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1 **Q. Do you have any comments on the Company's zone proposals?**

2 A. Yes, I do. The Company's zone pricing differentials as originally proposed
3 represented a significant move away from statewide averaged rates, which have
4 been historically vital to universal service. The modified zone proposals found in
5 the Company's supplemental filing do not significantly alter the impact on
6 universal service. If allowed, these differentials would create a substantial
7 access cost difference between urban and rural parts of the state. Long distance
8 carriers already face differences in internal costs when serving urban and rural
9 areas, (e.g., advertising costs per thousand people reached tend to be lower in
10 metropolitan areas). They also face differences exist in the access rates charged
11 by carriers serving more and less densely populated parts of the state.
12 However, the proposed zone pricing would exacerbate these differences, while
13 setting a significant precedent. By increasing the costs of doing business in rural
14 areas, relative to more densely populated areas, the Commission will be
15 encouraging long distance competitors to concentrate their efforts on the urban
16 centers, and/or to use discount plans, rate designs and other devices which will
17 result in higher rates in rural areas, relative to the rates paid in the metropolitan
18 areas.

19 Certainly, some movement away from statewide average rates may
20 ultimately be an unavoidable consequence of the trend towards increased
21 competition; otherwise, cost based pricing will not be possible. However, such
22 a fundamental change will need to be accompanied by wide-ranging provisions
23 for maintaining universal service in high cost areas and wire centers, perhaps
24 through mechanisms for targeted customer support. I therefore seriously
25 question the necessity or appropriateness of the Commission taking steps to
26 accelerate such a movement at this time. At best it is premature. At worst, it is a
27 step in the wrong direction. Arguably, the Commission should be using its
28 regulatory authority to slow down, or offset the trend away from statewide
29 average rates--just the opposite of GTE's proposal in this case. If the
30 Commission is ready and willing to encourage a movement towards high rural
31 rates and low urban rates, it should do so with its eyes open, after a full airing of
32 the pros and cons, including the implications for other carriers, such as Bell
33 Atlantic, and the potential public policy consequences, including the potential
34 adverse impact on economic development in the less urbanized parts of the

1 state and the need for targeting underwriting or subsidy of service in high cost
2 areas.

3 It should be understood that even if competitive pressures for
4 deaveraging eventually were to increase, the Commission would not be a
5 helpless bystander. My experience in the state of Alaska (which has far more
6 extreme cost differences between urban and rural areas) demonstrates that
7 regulatory authorities can encourage a climate in which effective competition
8 and statewide average rates coexist.

9
10 **Q. What do you recommend concerning the proposed restructuring of**
11 **access rates?**

12 A. I recommend that the Commission allow the Company to restructure certain
13 aspects of its access rates. More specifically, I think it would be reasonable to
14 implement most of the Company's transport restructuring proposal. This is the
15 timely and appropriate, considering the changes being implemented in the
16 federal jurisdiction. Similarly, I recommend that the Companies be permitted
17 restructure the CCL rate elements. However, it should not be permitted to
18 phase down the overall level of CCL revenues if this were to require an
19 increase in local exchange rates. Finally, I recommend that the zone pricing
20 proposal be rejected as premature and contrary to the public interest.

21 As shown on Schedule 5 attached to my testimony, if the Commission
22 accepts the Attorney General's recommendations concerning the Company's
23 revenue requirement, these restructurings can be accomplished in the context of
24 a substantial overall reduction in switched access revenues, and without
25 increasing any local exchange rates. Otherwise, the restructuring should be
26 implemented in a revenue neutral manner, thereby ensuring that local ratepayers
27 are not required to fund modifications to the access rates.