

1            **Local Service Rates**

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3            **Q.            What does the Company propose in regard to local exchange services?**

4            A.            The Company's original request contained the following general rate design  
5            changes:

- 6            1.            Eliminate Rate Groups and replace them with Exchange Categories
- 7                       defined by density and a metropolitan/non-metropolitan designation;
- 8            2.            Reprice, and generally increase, local exchange service rates;
- 9            3.            Eliminate ELS adders;
- 10          4.            Eliminate separate touch call charges;
- 11          5.            Eliminate zone charges;
- 12          6.            Merge Usage Sensitive tariffs based upon GTE-Southwest VA's
- 13                     structure;
- 14          7.            Restructure Lifeline rates;
- 15          8.            Set key service rates equal to B-1 rates;
- 16          9.            Separately price rotary service in conjunction with PBX trunk service;
- 17          10.          Other miscellaneous rate structure merger changes.

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19            In its supplemental filing GTE withdrew its proposal to define Exchange  
20            Categories based on density and metropolitan-calling areas, lowered the  
21            proposed increase for local exchange rates, and proposed a rotary service rate  
22            of \$5.50 per line regardless of the rate group.

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24            **Q.            What is the revenue effect of these changes, based on the Company's**  
25            **revised filing?**

26            A.            The repricing of Basic Local Service results in about a \$21 million increase; the  
27            elimination of the ELS adder reduces revenue by around \$150,000; the  
28            changes to usage pricing increase revenue by approximately \$1.1 million; the  
29            elimination of touchtone charges reduces revenue by about \$8.8 million; the  
30            elimination of zone charges drops revenue by around \$960,000; the  
31            introduction of rotary surcharges adds approximately \$1.1 million. The overall  
32            change in revenues that results from these changes is an increase of  
33            \$13,248,773, or 12.66%.

1 **Q. Do you agree with the Company's local service rate design proposal?**

2 A. No, I do not. The overall effect of this proposal is a significant increase in rates,  
3 including some very large ones for particular customers. According to Mr.  
4 Carlson's testimony, "basic rates are residually priced to create an overall  
5 revenue neutral rate design" [Carlson Testimony, p. 17.] As discussed later in  
6 my testimony, the Company has reduced toll and access rates by fairly large  
7 amounts; this translates into large increases in local rates under the Company's  
8 "revenue reduction of \$1 million" proposal. I disagree with these increases, as  
9 well as with other aspects of the proposed rates, for two reasons: (1) The  
10 residual pricing results in excessive increases for local services, violating the  
11 principles of intercustomer equity and rate continuity. (2) The increases are not  
12 justified on the basis of actual costs, even though the Company attempts to  
13 support a cost argument by assigning the full cost of local loops to basic local  
14 exchange service.

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16 **Q. Would you please explain the first of these disagreements?**

17 A. Yes. I fundamentally disagree with the Companies' proposal to substantially  
18 increase rates for residential basic local service. As shown on Schedule 4  
19 attached to my testimony, all of GTE's existing residential R-1 customers will  
20 experience rate increases, and in many cases these increases are quite large.  
21 For instance, when the R-1, touchtone, zone charge, and ELS changes are  
22 considered, the Windsor exchange would face a nearly 100% increase in local  
23 rates. All told, 20 exchanges would experience at least a 50% increase of rates.

24 Imposed on captive ratepayers who have no economically appropriate  
25 substitute, a doubling of rates would not be appropriate, even if it were  
26 supported by appropriate cost or other evidence (it is not). Whatever the rate  
27 GTE demands, customers will have to pay or abandon their telephone service;  
28 unless and until a competitor enters the market, they will have nowhere else to  
29 go (except to leave the network entirely). If these increases are accepted, the  
30 great majority of customers will simply grit their teeth, curse the Commission,  
31 and pay the bill. Basic local service is considered a necessity by most  
32 customers, and thus it is highly price inelastic. Even so, these increases could  
33 have an adverse impact on universal service. A 50% increase of basic local

1 service rates would surely force some customers off the network and  
2 discourage some potential subscribers from joining

3 The Company is advocating a massive realignment of local and other  
4 prices on the basis of anticipated competitive pressures. However, competitive  
5 pressures will not necessarily require the type of drastic rebalancing of rates that  
6 is being proposed by the Company. To the contrary, it is not unusual for  
7 unregulated markets to maintain pricing relationships analogous to those that  
8 currently exist in the telecommunications industry. Gillette used to practically  
9 give away the razor in order to make money on razor blades. Polaroid sells  
10 inexpensive cameras and cleans up on film. As any car dealer knows, much of  
11 the profit margin is in the options.

12 For phone companies, the largest profit margins are in enhanced  
13 services. For example, the incremental cost of Call Waiting is typically  
14 estimated to be just pennies a month, yet customers are charged several dollars  
15 a month. The same is true for services like Caller ID, which costs next to  
16 nothing at the margin, but brings in a hefty level of revenues. The revenue the  
17 LECs earn from such add-on services, as well as from toll and access, has  
18 traditionally allowed them to keep basic rates lower than would otherwise be  
19 possible. This pricing approach is similar to the one used by grocery stores,  
20 which sell milk and eggs at a very small markup, thereby enticing customers into  
21 their store. Most customers also buy other items, which have higher markups.  
22 While the markup on local exchange service may not be as extreme as the  
23 markup applied to custom calling, the service does cover its incremental costs,  
24 and provide a very substantial contribution towards joint and common costs.  
25 Encouraging marginal customers to join (or remain on) the network increases its  
26 value for all, and it allow the Company to generate additional revenues from  
27 other services that are used by these marginal customers (e.g access to 800  
28 numbers).

29 There is no reason to abandon this market proven rate structure at this  
30 time. As competitors enter the market, it may eventually be necessary for the  
31 incumbent carriers to respond with some rebalancing of their rates. For  
32 instance, the price of Call Waiting service might decline, if competitors decide  
33 to heavily discount this particular service. However, there is no reason to

1                   prejudge the potential outcome of that competitive process, or to accept a  
2                   drastic realignment of prices even before that process begins.

3                   Furthermore, to raise basic local exchange rates, in many cases to  
4                   double their current levels, is to violate the long-established principle of rate  
5                   continuity. Even in a proceeding in which a revenue increase is required (which  
6                   the instant docket is not), a rebalancing of rates, where merited, should be  
7                   gradual. In this instance, however, the Company's overearnings make possible  
8                   a substantial decrease in basic local rates at the same time that the Company  
9                   lowers toll and access rates. As shown on Schedule 5, I am recommending a  
10                  reduction of \$24,735,641 or 23.92% in Basic Local Service, and this amount  
11                  can be spread appropriately among the Company's residential and business  
12                  customers.

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14                  **Q.                   Turning to other aspects of the proposal, would you please discuss the**  
15                  **Company's original plan to eliminate rate groups and replace them with**  
16                  **Exchange Categories?**

17                  A                   Yes. GTE South currently has 10 rate groups in its Contel VA and 2 rate  
18                   groups in its Southwest VA tariff. Each exchange falls into a rate group based  
19                   upon the number of access lines that a customer can reach on a local (toll-free)  
20                   basis. Currently, there is a rather large differential between the rates in the  
21                   smaller and larger exchanges. In the smallest group, Rate Group I, GTE South -  
22                   Contel VA customers (such as customers in Wakefield or Surry) currently pay  
23                   \$6.69 per month, whereas customers in the largest exchanges (such as Lorton  
24                   or Manassas) pay \$13.45 per month. GTE South - Southwestern customers in  
25                   Rate Group I (only the Pocahontas Exchange) pay \$13.41, and Rate Group II  
26                   customers (all others) pay \$15.05.

27                   The Company indicated in its direct testimony that it considers this  
28                   pricing pattern to be inconsistent with the pattern of costs-- customers receiving  
29                   the lowest rates are those that the Company considers to be the most costly to  
30                   serve. In its supplemental filing GTE has withdrawn its proposal for density and  
31                   metropolitan-based pricing-- not because it has had a change of heart about  
32                   costing, but because it concedes that the proposal is premature:

1 The density groupings were not well understood by the public, and  
2 while I believe a fundamental change in the way in which local exchange  
3 service is priced is necessary and inevitable, I recognize that the  
4 proposal was, perhaps, ahead of its time. [Supplemental Carlson  
5 testimony, p. 8,9.]  
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7 Therefore, even though it has at least temporarily abandoned its plans  
8 for density groupings, the Company has not modified its fundamental  
9 conclusions about the cost of serving local exchanges. Yet, these conclusions  
10 are fatally flawed. They are based entirely upon differences in the average cost  
11 of local loops, despite the fact that loop costs are not part of the direct,  
12 incremental, or marginal cost of local service. In fact, the Company has  
13 completely ignored differences in the cost of providing local switching in smaller  
14 exchanges, relative to larger exchanges, despite the fact that switching costs  
15 represent the majority of the direct, incremental, and marginal costs of providing  
16 local exchange service.

17 My experience in other jurisdictions indicates that calling volumes are  
18 higher in larger exchanges, for the simple reason that people make more local  
19 phone calls when there are more people they can reach without paying a toll  
20 charge. To the extent the smaller exchanges in Virginia have smaller calling  
21 volumes, and thus lower switching costs, the pattern of cost differentials would  
22 not be consistent with the Company's original pricing proposals. Unfortunately,  
23 the Company has simply ignored these cost differences, and thus we don't have  
24 any specific data on differences in the cost of providing local service in small  
25 relative to large exchanges.

26 The Company also argues that the smaller exchanges are less  
27 susceptible to competitive pressures. Granting the point, it simply means that  
28 the proposed pricing scheme will help insulate the Company from competitive  
29 pressures in the larger exchanges, where competitive entry will be more likely.  
30 While this might be consistent with the Company's corporate interest, there has  
31 been no showing that the proposed pricing change is consistent with the public  
32 interest. Why should the Company be allowed to substantially increase prices in  
33 smaller exchanges, simply because such price increases may be made  
34 sustainable by competition will be slow to emerge in these areas?

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**Q. In its supplemental filing has the Company proposed any changes to its rate groups?**

A. Yes. GTE proposes to consolidate the first three groups into a single group with a calling scope of up to 8,000 weighted access lines. It also proposes to lower the calling scope limit for the highest rate group. It is making these changes because the expanded calling areas left no exchanges in the lowest two rate groups. In addition the Company proposes to lower the calling scope for its highest rate group. Due to this change and the expected growth of access lines the Company expects three exchanges will fall into this highest group. This will mean additional revenue from these three exchanges.

**Q. Do you agree with the Company's current proposal for changes in rate groupings?**

A. No, I do not. The current proposal is driven by a mistaken view of costs, combined with an attempt to make a strategic response to potential changes in competitive conditions. As I have shown in Schedules 1 and 2, the actual pattern of costs is not consistent with the proposed rate design. While some simplification and flattening of the rate groups might be reasonable, the Company's current proposal has not been adequately supported, violates the principle of rate continuity, and should be rejected.

**Q. Would you please explain GTE's proposal concerning Extended Local Service adders?**

A. Certainly. The Company wants to eliminate Extended Local Service (ELS) adders. These rate elements recover revenues that were lost from toll service when local calling scopes were expanded. The ELS adders complicate the Company's rate design and require some customers to pay higher rates than others with the same calling scope. I agree that it is reasonable to phase out, or eliminate, the ELS adders, thereby simplifying the Company's local exchange rates.

1           **Q.           Have you analyzed the Company's proposals concerning Usage**  
2           **Sensitive Service pricing?**

3           A.           Yes, I have. The Company has proposed to offer residential and business  
4           Usage Sensitive Service (USS) under a merged tariff, using GTE South-  
5           Southwest VA as the basis. This will include a basic rate equal to 60% of the  
6           standard (unlimited service) local exchange rate, plus separate usage charges  
7           for first and additional minutes over six mileage bands. The Southwest VA tariff  
8           includes a 40% discount in the evening and a 60% discount for night/weekend  
9           calling. The Company has proposed to keep one element of the GTE South-  
10          Contel VA tariff-- separate, lower usage rates for calling within the home  
11          exchange. In addition, adoption of the rate band compression plan in the  
12          Company's revised proposal would result in a single USS rate for all  
13          customers.

14                   Contel VA's tariff currently includes rates that range from \$0.035 to  
15                   \$0.095 for the first minute and \$0.018 to \$0.047 for each additional minute, for  
16                   the shortest to longest mileage bands. GTE South-Southwest VA's tariff  
17                   (although structured somewhat differently) includes rates that range from \$0.03  
18                   for the first minute and \$0.01 for each additional minute within the home  
19                   exchange to \$0.14 for the first minute and \$0.05 for each additional minute on  
20                   the longest calls.

21                   While the proposed merged tariff includes a set-up rate and a per-  
22                   minute rate, it will effectively include rates that range from \$0.035 to \$0.06 for  
23                   the first minute and \$0.018 to \$0.038 for each additional minute, for the  
24                   shortest to longest mileage bands. Calls made during the single off-peak period  
25                   would be discounted 50%.

26                   At present, a Conte-VA caller placing a four-minute daytime call that  
27                   covers 15 miles pays \$0.159, while a GTE South-Southwest VA caller placing  
28                   a similar call pays \$0.160. Under the proposed tariff, each caller would pay  
29                   \$0.134.

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31                   The Companies propose to use Conte's existing rate structure in the  
32                   combined tariff. As a result, some of GTE's customers will experience an  
33                   increase in the usage portion of their bill, while others will experience a  
34                   decrease. In general, those placing relatively short duration calls will experience

1 the greatest increase--particularly if their calls are concentrated in the evening  
2 and night/weekend periods. Conversely, those placing daytime calls of relatively  
3 long duration will experience some savings.  
4

5 **Q. What buyup rates are the Companies currently experiencing?**

6 A. Of GTE's current 25,297 residential single-line customers, only 122, or fewer  
7 than one half of one percent, subscribe to measured service. Of Conte's  
8 320,599 residential single line customers, 5,004 have selected measured  
9 service, a buyup rate of 1.6%. According to the exhibits of Mr. Carlson, the  
10 Company has not calculated any customer shifts between flat-rate and  
11 measured rate services in this filing  
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13 **Q. What do you think of the Company's proposal concerning usage  
14 charges?**

15 A. Although Usage Sensitive Service (USS) is an important option that should be  
16 available to low-usage customers, the Company's treatment of this service is  
17 less than optimal. The Company has proposed to change the rate and/or  
18 structure of nearly every service it offers, sometimes dramatically, yet its tariff  
19 for USS is barely altered. I believe that there is a missed opportunity here to  
20 make the USS rate more attractive to customers. Although subscribers who  
21 make just a few calls per month might wish to economize by switching to USS,  
22 they may be put off by the perceived complexity of the rate structure. Most  
23 consumers dislike complicated local usage tariffs; they prefer a simple per-call  
24 or per-minute charge. Per-call rates (e.g., 10 cents per call) are most popular,  
25 because they allow customers to track their expenses solely through the number  
26 of calls they make. Other measures find less favor. According to a customer  
27 survey our firm performed in Indiana, of the four possible elements of local  
28 measured service billing call duration is clearly the most bothersome. [Ben  
29 Johnson Associates, *Survey of Telephone Customers Regarding Local  
30 Measured Service Pricing*, May 1988, p. 14.]

31 I recently analyzed the rate filing of GTE Southwest/Contel of the West  
32 in New Mexico. In that proceeding the Company proposed to eliminate the  
33 time- and distance-sensitive portions of its tariff in favor of a \$.10 per call tariff.

1 In my opinion, this simpler approach advocated by GTE in New Mexico is  
2 preferable to the more complex approach used by GTE in this proceeding  
3

4 **Q. Do you agree with the relationship between the flat rate price and the**  
5 **USS price that has been proposed in this proceeding?**

6 A. Yes, I do. As discussed above, the Company has set the measured rate at  
7 60% of the flat rate. This is consistent with the current pricing relationship, and  
8 in my opinion is reasonable.  
9

10 **Q. What rate design changes has the Company proposed for Lifeline**  
11 **customers?**

12 A. Currently, the Virginia Universal Service plan (Lifeline) offers low income  
13 customers up to \$3.50 off of local rates, plus a waiver of the Federal SLC, for  
14 a total discount of up to \$7.00. The Company has proposed to convert Lifeline  
15 to USS and provide subscribers with a \$4.00 usage allowance.

16 The change could be very expensive for some customers. For  
17 example, in the Windsor exchange lifeline customers now pay \$3.19 for Lifeline  
18 service, \$1.64 for Touch Call, and \$0.11 in zone charges, for a total of \$4.94  
19 per month for unlimited service. The Company proposes to charge \$11.75 in  
20 that exchange for USS service, less a \$3.50 discount for Lifeline callers. With  
21 elimination of zone charges and Touch Call charges, the Lifeline customer's  
22 new total local exchange bill would be \$8.25, representing a \$3.31, or 67%,  
23 increase in monthly rates. On top of this increase, the Lifeline customer would  
24 have to pay usage charges on all calls beyond approximately one four-minute  
25 call per day.

26 In my opinion, this proposal is not appropriate, and has not been  
27 adequately justified. There is no logical reason to force low income customers  
28 onto a usage-sensitive price schedule--especially one with extreme markups  
29 over actual costs. If adopted, this tariff would force low income customers  
30 either to pay extreme markups on their usage or to curtail their usage (despite  
31 the fact that the cost of providing this usage is negligible). In order to get flat  
32 rate service, they would have to forgo the low income discount. None of these  
33 options are fair or reasonable. In my view, the existing low income rate design  
34 should be continued.

1           **Q.           You mentioned some changes to the business rates, can you comment**  
2           **on this further?**

3           A.           Yes. The Company is proposing to reduce the differential between residential  
4           and business local exchange service. On page 34 of his direct testimony, Mr.  
5           Carlson states that "the Company proposes to narrow the B-1 to R-1 multiple  
6           from a range of 2.1 to 2.4 down to 1.95." [GTE, Carlson Direct Testimony,  
7           p.34.] In supplemental testimony the Company has revised this back up to 2.1.  
8           [GTE, Carlson Supplemental Testimony, p. 12.] Regulatory commissions have  
9           long recognized that the higher costs of business exchange service in  
10          comparison to residential service should be reflected in the rates. The  
11          Company's data indicates that the typical B-1 customer places **\*\*\*proprietary**  
12          **begin\*\*\*                   \*\*\*proprietary end\*\*\*** as many calls as the typical  
13          R-1 customer. The minutes of use by an average B-1 customer exceeds the  
14          minutes used by an average R-1 customer, but the differential is mitigated by  
15          the fact that residential calls typically last longer than business calls.

16                   Unfortunately, the Company's cost data are inadequate to support an  
17          accurate estimate of the impact of these differences in usage patterns on the  
18          incremental cost of providing business and residential local exchange service.  
19          For instance, the Company has failed to consider differences in peak versus  
20          off-peak local usage. In other jurisdictions, I have found that business  
21          customers tend to place a higher percentage of their calls during the peak usage  
22          hours, while residential customers tend to place more calls at night and on  
23          weekends, when most portions of the network are operating well below their  
24          peak capacity. In evaluating relative differences in the cost of serving  
25          residential and business customers, differences in peak usage patterns can be  
26          very important. These differences should not be ignored, as the Company has  
27          done (as reflected in the cost estimates shown on Schedule 2 attached to my  
28          testimony).

29                   The Company's proposal to narrow the existing business/residential  
30          differential, though not well supported, is relatively modest and reasonably  
31          consistent with the limited usage and cost data available in this proceeding. On  
32          the other hand, I disagree with the Company's proposal to collapse its basic  
33          business service and key system into a single rate. Data provided by the  
34          Company show considerable differences in usage among the three business

1 service categories. While single-party business lines carry an average of  
2 **\*\*\*proprietary begin\*\*\*** **\*\*\*proprietary end\*\*\*** outgoing calls per  
3 month, key system and PBX lines carry **\*\*\*proprietary begin\*\*\***  
4 **\*\*\*proprietary end\*\*\*** outgoing calls per month, respectively.

5 The rationale for charging higher rates for customers with key and PBX  
6 systems is based on the fact that usage costs per line increase significantly  
7 where numerous instrument lines feed into a single telephone system with a  
8 limited number of access (outside) lines.

9 I recommend using uniform differentials among the three business  
10 services, at levels which are roughly consistent with, but somewhat below, the  
11 differentials that currently exist in GTE's tariff, as well as the usage differentials  
12 just mentioned. More specifically, I recommend setting the rate for key system  
13 service at 1.4 times the rate for B-1 service, and I recommend setting the rate  
14 for PBX service at 2.0 times the rate for B-1 service. However, the PBX trunk  
15 rate of 1.8 times the B-1 rate, as recommended in the supplemental filing  
16 generally meets the above criteria and would be acceptable.

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18 **Q. What is the Company's proposal concerning Touch Calling?**

19 A. GTE has proposed to eliminate the separate charge for residence and business  
20 Touch Calling service, bundling that service with basic local exchange service.  
21 Touch Calling has historically been a nonbasic, discretionary feature priced  
22 separately at a substantial markup above its direct cost- -thereby minimizing the  
23 price of the cheapest grade of local exchange service and promoting universal  
24 service. However, as more as more rotary-dial phones have reached the end of  
25 their useful life and been replaced by tone-dial phones, and as customers have  
26 become increasingly accustomed to the speed and convenience of push button  
27 dialing, Touch Calling service has become a virtual necessity for most  
28 customers. It is now used by approximately 88% of all residential customers  
29 and 99% of all business customers in GTE's service territory. Over the next  
30 several years the number of customers still using rotary-dial service can be  
31 expected to shrink even further.

32 It is therefore reasonable to incorporate Touch Calling  
33 into basic local exchange service and eliminate the separate  
34 charge. This change will simplify the Company's tariffs, it will

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be more consistent with current cost conditions (Touch Calling can be provided from modern electronic offices essentially at no cost), it will reduce billing costs, it will relieve customers of the need to place a Touch Calling service order, and it will save time and money all around. The operation of remaining rotary-dial phones will not be affected.