

1 **Rate Design**

2
3 **Q. Do you have any comments concerning the Company's proposal to eliminate the**
4 **distinction between the dial tone line and usage rates?**

5 A. I agree with this proposal. No useful purpose is served by chopping the local exchange rate into
6 multiple portions, each with a separate name and separate price. My view is that retail subscribers
7 don't demand dial tone; they demand the ability to make and receive telephone calls, both local
8 and long distance, and to enjoy the various ancillary services that carriers can provide. Attempts
9 to separately price access to dialtone, as if it were a separate service, are inconsistent with the way
10 most customers view the services they receive, as well as the historical pricing patterns within the
11 industry. Although US West is not alone in its practice of separately labeling two different portions
12 of its local exchange rate, this artificial distinction has not been widely accepted by regulators, nor
13 has it been well received by consumers in jurisdictions where it has been adopted.

14 Since the industry is becoming more competitive, it is not surprising that anachronistic
15 pricing practices like this would become less attractive to carriers. Instead of trying to align its
16 prices to be consistent with its view of cost causation principles, US West is now trying to align its
17 prices to be consistent with consumer preferences. This is one of the benefits of the trend towards
18 increased competition—carriers are becoming more focused on their customers, and less focused
19 on their regulatory advocacy efforts. Unnecessarily complicated and confusing prices are not
20 attractive to consumers. As competition intensifies, I would anticipate that prices will increasingly
21 respond to consumer preferences, rather than carrier preferences.

22 Given a choice, most consumers would prefer simple, easily understood prices which
23 translate into predictable, understandable monthly bills. We have already seen some evidence of
24 this trend in the wireless segment of the industry, which is moving away from charging customers
25 for every minute and every feature they use. As more carriers have entered the market and
26 competition has intensified, wireless carriers are moving towards simpler, more attractive pricing

1 plans. Instead of just focusing on their internal cost structure, and trying to keep the full cost of their
2 services hidden from view, wireless carriers are increasingly moving towards simple, easily
3 understood pricing plans which bundle usage and features into convenient, attractive packages.

4 I anticipate that as competition intensifies, a similar pattern will evolve in the markets which
5 US West currently dominates. The Company will find it increasingly necessary to consider
6 consumer preferences—not just its own view of its cost structure and “what the traffic will bear.”

7
8 **Q. You mentioned some proposed changes to the zone rates, can you comment on this
9 further?**

10 A. Yes. As with local residential service, the Company is proposing to increase the zone increment
11 charge paid by businesses that operate outside the base rate area. For customers in zone 1, the
12 current monthly rate of \$1.00 would be raised ten-fold to \$10.00 while customers in zone 2 would
13 experience a five-fold increase from the current level of \$3.00 to \$15.00 per month [Teitzel,
14 Supplemental, p. 38]

15 Mr. Teitzel claims this proposal is justified by the FCC’s recent (May 1, 2000) mandate
16 that states deaverage the UNE loop rates charged by incumbent LECs. Under this FCC
17 requirement, US West will be increasing loop rates paid by competitive carriers in areas outside
18 the BRA. Mr. Teitzel and Witness Million argue that it is appropriate to increase retail rates
19 outside the BRA, in order to maintain an appropriate difference between retail and wholesale
20 prices:

21
22 Discrepancies between the retail and wholesale price structures undermine
23 competition and competitive neutrality. Otherwise, competitors could obtain
24 unbundled loops for low-cost urban business consumers at a deaveraged price,
25 and purchase high-cost longer loops at a non-deaveraged retail price less the
26 avoided discount. This presents an arbitrage opportunity for Competitive Local
27 Exchange Carriers (CLECs) that choose the economically more attractive option
28 of providing service to high-cost customers through resale. [Million, Direct, p. 6]

1
2 It is certainly appropriate to be concerned about the balance between retail and wholesale
3 rates. However, the problem is not as severe as the Company implies, because it has once again
4 failed to consider the full range of revenues generated by businesses outside the BRA. As explained
5 earlier, the loop and port are shared costs which carriers can and do recover through a variety of
6 different revenue sources. In evaluating whether CLECs can profitably serve customers outside the
7 BRA, it is necessary to consider all of the revenues a CLEC will generate—including revenues from
8 toll, switched access, and optional features.

9 Moreover, the Company has not adequately considered the policy goals of maintaining a
10 reasonable degree of rate continuity, and ensuring a reasonable degree of comparability between
11 retail rates in urban and rural areas. Accordingly, while I don't dispute the general thrust of US
12 West's proposals in this area, I disagree with the magnitude of those proposals.

13
14 **Q. Do you have any comments concerning the Company's toll rate proposals?**

15 A. Nationwide, toll volumes are increasing, toll costs are declining, and competition is intensifying.
16 Given this context, a reduction in toll rates seems reasonable. US West has provided evidence that
17 it faces real (not hypothetical) competition for its toll service in Arizona markets. In light of its
18 substantial decline in market share, it is reasonable to give it considerable flexibility in responding
19 to market conditions. Adding further credibility to the Company's proposals is the fact that it hasn't
20 proposed to slash its retail toll rates below its wholesale switched access rates. Nor has it
21 proposed to slash its toll rates across the board. In fact, it has proposed to increase rates in certain
22 categories, where it apparently believes its current rates are below market levels.

23 I do have one dispute with US West's toll rate calculations, however. The Company has
24 proposed a very substantial reduction in rates charged residential customers, yet it has not taken
25 into account the increased volume of traffic which will undoubtedly result from this proposal. As
26 customers experience reductions in the toll rates they are paying, they will be stimulated to place

1 additional toll calls, and to talk longer. This concept is referred to as price elasticity—the effect of
2 a change in price on the quantity of a service that consumers demand.

3 Typically in regulatory proceedings, price elasticity effects are not considered, for good
4 reason. The demand for many telephone services is relatively inelastic, meaning that the volume
5 demanded isn't very responsive to changes in price. Also, where price increases are involved, the
6 dampening effect of a price increase generally has the effect of offsetting or ameliorating the general
7 trend towards increased volume which results from the impact of inflation, increasing personal
8 income levels, and shifting tastes and preferences. Since future volumes are generally going to
9 exceed test year volumes, regardless of whether rates will be increased or not, regulators generally
10 do not adjust the price out calculations to reflect the reduction in volume which will result from the
11 proposed rate increase.

12 While it isn't necessary or appropriate to adjust all of the various price-out calculations to
13 reflect the effects of price elasticity, it would be appropriate to make an exception with regard to
14 the Company's proposed toll rate reductions. In this instance, the reductions are very substantial,
15 and they will serve to accelerate the trends towards increasing volume (rather than offsetting this
16 trend). The Company does not adequately account for this phenomenon. It has proposed a
17 **** Proprietary Proprietary**** decrease in toll rates and just a **** Proprietary**
18 **Proprietary**** increase in volume. Based upon econometric studies of the impact of toll price
19 changes in the past, it is reasonable to assume that this rate reduction will increase volume by at
20 least **** Proprietary Proprietary****. This is calculated by multiplying a conservative
21 estimate of the price elasticity of demand for toll service (.5) times the proposed price decrease
22 (**** Proprietary Proprietary****). After making this adjustment, I estimate that the
23 proposed reduction in residential toll rates will result in a decrease in revenues of **** Proprietary**
24 **Proprietary**** as calculated by US West.

25
26 **Q. What is your reaction to the Company's switched access proposals?**

1 A. I don't have any objection to the Company's concept of restructuring its rates to be more closely
2 aligned with cost, as well as the corresponding interstate rates. I agree that it would be desirable
3 to lower the overall level of access rates--provided this can be accomplished without forcing local
4 exchange customers to pay substantially higher rates. The general trend in telecommunications costs
5 and rates is downward, and it is not unreasonable for the interexchange carriers and their customers
6 to share in the benefits of this downward trend.

7 I do find the plan put forward by the Company to be objectionable, in that it places so
8 much of the rate increase burden on residential basic exchange rates, while simultaneously placing
9 none of the burden on toll customers. The net effect is to impose a substantial shift of the revenue
10 burden from toll and switched access to the local category. Such a severe shift in the cost burden
11 is unwarranted, unnecessary, and inappropriate. The Company's proposals to reduce the IC and
12 CCL rates have the effect of increasing residential local exchange rates beyond a reasonable level.

13
14 **Q. US West's primary rationale for decreasing switched access charges are the threat of**
15 **competition and the need to bring prices more in line with costs. How well supported are**
16 **these arguments?**

17 A. Not well at all. Ms. Wilcox argues that access markets are changing around the nation and that
18 the Company believes Arizona is currently seeing facilities-based competition for access and that
19 such competition will grow in the near future. She concludes:

20
21 Today, US West's switched access service is still used by long distance carriers
22 to reach many of their customers via US West's local switched network.
23 However, with the changes in the telecommunications industry, and the emergence
24 of alternative providers, for local and other services, alternative to US West
25 switched access services are continuously increasing ... Competitive local
26 exchange carriers offer direct competition to US West's switched access service.
27 [Wilcox, Original Direct, p. 4]
28

1 She cites direct connection, private networks, wireless services, internet telephony and
2 email as current and potential sources for access competition. However, the arguments she makes
3 are very general in nature, and are not supported with detailed factual evidence. For instance, she
4 provided no estimates of the market shares held by competitive access providers and competitive
5 local exchange carriers.

6 Looking behind these sweeping generalities, one finds the picture to be rather different than
7 Ms. Wilcox implies. While it is certainly true that access competition is increasing, it is also true that
8 the overall market continues to grow. The primary impact of increased competition has been to
9 reduce the rate of growth which US West and other incumbent LECs have been experiencing in
10 their switched access traffic volumes and revenues. The market for switched access continues to
11 be overwhelmingly dominated by local exchange carriers like US West. While competitive access
12 providers have emerged as niche players in many of the nation's larger metropolitan areas, these
13 carriers have limited facilities and very limited market penetration. The traditional local exchange
14 carriers generally continue to enjoy an extremely large share of the switched access market (e.g.,
15 more than 90%), even in areas where competitors have been in the market for many years.
16 Furthermore, new entrants do not necessarily focus on price cutting. For instance, some of the new
17 entrants have emphasized faster service, greater reliability and better transmission quality, rather
18 than cost savings.

19
20 **Q. Won't access rates decline as competitive pressures increase?**

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

1 is certainly no basis for concluding that a massive shift in revenue responsibility is necessary from
2 access to local exchange.

3 Quite the contrary is true. The evidence suggests that access markets are still largely
4 characterized by monopoly conditions, that competitive pressures will be slow to build, and that
5 new entrants are unlikely to emphasize switched access rate reductions as a primary strategy for
6 gaining market share. When access prices do decline over time, it has typically been the result of
7 increased volume, reduced cost, and lower profits. That type of access price reduction, the product
8 of external economic forces, is quite unlike the price reduction proposed here: a government-
9 enforced shifting of revenue responsibility from access to local markets.

10
11 **Q. Do you accept the proposition that switched access rates need to be redesigned?**

12 A. Yes. Recent FCC actions to encourage unbundling, expanded interconnection rights, and co-
13 location are designed to increase competition in the switched access market, and potentially to
14 improve efficiency and drive down access rates. As far as I can tell, US West is not claiming it
15 currently faces severe competitive pressures. Rather, it has pointed out that "alternatives to US
16 West switched access are continuously increasing" [Wilcox, Original Direct, p. 4] This vague
17 statement is hard to deny; but it is also hard to take very seriously. Since the Commission has not
18 been given any detailed information concerning growth in competition for switched access markets,
19 the mere fact that competition is "continuously increasing" could be taken to mean that additional
20 local exchange carriers are entering the market. To the extent these carriers gain an increasing share
21 of the market for basic local exchange service, they will also gain an increasing share of the market
22 for various ancillary services, including switched access. The mere fact that more competitors are
23 entering the market is not evidence of a competitive crisis, or a sign that substantial repricing action
24 is needed. Even if one accepts the fact that competition is increasing, it does not follow, by any
25 known logic, that an immediate reduction in access prices should be accomplished at the expense
26 of local exchange ratepayers.

1 Competition, when it comes, may well drive down more than prices--it can serve to drive
2 down costs and profits, as well. Furthermore, there is no reason to assume that competitive carriers
3 will develop pricing strategies which are centered around switched access reductions. Nor is there
4 any reason to anticipate that competitive pressures will be more severe in the market for switched
5 access than in the market for other services offered by the Company. If anything, I would anticipate
6 downward pricing pressure to emerge in the market for Caller ID and custom calling features well
7 before such pressures emerge in the market for switched access service. Yet, the Company has
8 proposed to maintain or increase the price of these services at the same time that it is proposing
9 to reduce the CCL and IC rates. While I recognize there is considerable uncertainty concerning
10 the manner in which competition will unfold, the appropriate response to these uncertainties is not
11 to further increase basic local exchange rates in order to accommodate a reduction in switched
12 access rates.

13
14 **Q. Do you have any comments concerning the Company's proposed changes to its**
15 **miscellaneous general and local exchange services?**

16 A. Throughout his original direct testimony, Mr. Teitzel justifies his proposed increases to basic local
17 rates by claiming that US West is trying to bring its rates more into alignment with its costs. I have
18 already commented extensively on the fact that I disagree with his interpretation of the underlying
19 costs. I would like to make one additional point in this context: the Company has definitely not been
20 consistent in trying to move rates towards cost. To the contrary, many of its rate proposals would
21 move its rates farther away from its costs. For example, the direct cost of providing Caller ID
22 service is minimal--other than the shared costs of the loop and switch. The software and hardware
23 included in most digital switches incorporate the ability to provide Caller ID to all customers at
24 minimal additional cost. At most, the direct cost of providing Caller ID service is perhaps \$.20 per
25 month, while the rate is currently \$5.95 per month. If US West truly were attempting to move its
26 residential rates towards cost, it would be proposing to reduce this rate, or even to eliminate it

1 (bundling it with basic local exchange service). Instead, Mr Teitzel proposes to increase the rate
2 to \$6.95 per month.

3 Similarly, the Company proposes to increase the rates it charges for many of its directory
4 listing services. These include privacy, premium, and internet listings. Concluding that privacy
5 listings should be priced in the same manner as premium listings, Mr. Teitzel supports raising non-
6 published rates to \$3.00 per month and non-listed rates to \$2.00 per month. Under this plan,
7 business and residence customers are charged the same price to have their name excluded from
8 US West directories and directory assistance. Similarly, premium and internet listings see
9 increases, with internet listings rising the greatest amount—from \$3.00 per month to \$6.00 for email
10 listings and \$1.50 per month to \$12.00 for URL listings. Here again, the cost of providing these
11 listings is simply ignored. Whatever the cost of printing a firm’s URL address in the phone book,
12 it obviously can’t be any more than the cost of printing a regular address. There obviously isn’t any
13 cost justification for charging \$12.00 per month for these listings—the only possible justification is
14 that this is “what the traffic will bear.” Similarly, whatever it may cost to add another listing to the
15 directory, it certainly can’t cost much to delete a listing from the phone book. If the cost isn’t
16 negative, it certainly must be extremely low. Yet, the Company proposes to charge customers
17 \$2.00 per month for this convenience. Here again, the proposed rate changes are clearly moving
18 away from cost, rather than towards it.

19
20 **Q. In your opinion, how should the Commission view the rates for such ancillary services?**

21 A. It is important to keep the price of basic local exchange service at an affordable level. This furthers
22 the goal of universal service, and it is consistent with pricing patterns which often occur in
23 competitive markets, where the most basic offerings are priced at relatively low levels, and
24 premium offerings command higher markups. For instance, the automobile industry typically
25 generates higher profit margins on its luxury cars than it does on its economy models, and it often
26 places much higher markups on optional features than it does on the basic automobile itself.

1 Similarly, airlines obviously generate higher profit margins on the full coach tickets sold to business
2 travelers than they from the much cheaper tickets sold to leisure travelers.

3 It is reasonable to continue the historic practice of pricing many residence services lower
4 than the analogous business services, as well as the practice of pricing basic service at relatively
5 low, attractive prices and generating higher profit margins from custom calling, premium listings, and
6 other ancillary services.

7

8 **Q. Do you have any other comments concerning the Company's proposed rate changes for**
9 **miscellaneous general and local exchange services?**

10 A. While don't necessarily agree with all aspects of these proposals, I have not studied them in detail,
11 and I am not specifically disputing any of them. For illustrative purposes, I have generally assumed
12 the Commission will accept these proposals. One important exception concerns switched access
13 service, where I believe the certain of the proposed rate reductions should not be approved, since
14 they place undue upward pressure on basic exchange rates.