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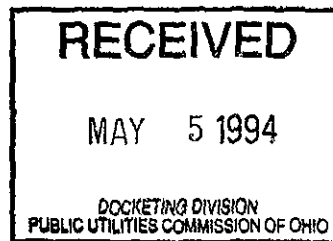


May 4, 1994

Regulatory Law Office  
U 3781

SUBJECT: Ohio Public Utilities Commission Case No.  
93-487-TP-ALT: Application of Ohio Bell Telephone Company  
for Approval of an Alternative Form of Regulation

Mrs. Daisy Crockron  
Chief  
Docketing Department  
Ohio Public Utilities Commission  
180 East Broad Street, 10th Floor  
Columbus, Ohio 43266-0573



Dear Mrs. Crockron:

Enclosed for filing with the Ohio Public Utilities Commission are the original and 20 copies of the Direct Testimony of Harry Gildea on behalf of the Department of Defense and All Other Federal Executive Agencies in the above-referenced proceeding.

Copies have been served in accordance with the enclosed Certificate of Service.

Sincerely,

*Robert A. Ganton*  
Robert A. Ganton  
Trial Attorney  
Regulatory Law Office

**BEFORE**  
**THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of  
The Ohio Bell Telephone Company  
for Approval of an Alternative  
Form of Regulation

Case No. 93-487-TP-ALT

DIRECT TESTIMONY

of

HARRY GILDEA

on behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE AND  
ALL OTHER FEDERAL EXECUTIVE AGENCIES

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May 3, 1993

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DOCKETING DIVISION  
PUBLIC UTILITIES COMMISSION OF OHIO

## Table of Contents

	<u>Page</u>
Introduction .....	1
Interests of the Federal Executive Agencies.....	3
Scope of Testimony.....	3
Alternative Regulation of Ohio Bell.....	4
Ohio Bell's Proposed Plan.....	4
General Evaluation of the Price Cap Plan .....	5
Productivity Adjustment .....	6
Future Adjustments and Monitoring .....	9
Service Classifications, Rates and Tariffs.....	10
Classification of Services.....	10
Classification of Services in Cells .....	14
Cell-Specific Pricing Limitations.....	14
Structure of Local Exchange Service .....	16
Disaggregation of Service and Establishment Charges.....	22
Disaggregation of Centrex Rates.....	22
Long Run Service Incremental Costs .....	23
Barriers to Competition.....	23
Unbundling of the Local Loop.....	23
Number Assignment and Portability.....	25
Compensation for Terminating Local Traffic.....	25
1+ intraLATA Presubscription.....	26
Contracts for Services.....	27
Centrex Resale and Sharing.....	28
Commitments by Ohio Bell.....	29
Infrastructure Commitments.....	29
Rate Design Commitments .....	31
Additional Staff Commitments .....	32

1                                   **DIRECT TESTIMONY OF HARRY GILDEA**

2    **Introduction**

3           Q.    What is your name and business address?

4           A.    My name is Harry Gildea. My business address is 1220 L Street, N.W.,  
5 Suite 410, Washington, D.C. 20005.

6           Q.    What is your professional background?

7           A.    Since 1972, I have been a consultant with Snavelly, King & Associates.  
8 Before that time, I was with the Economic Development Administration, a part of the  
9 U.S. Department of Commerce. From 1962 to 1969, I was responsible for the  
10 operations research consulting practice of Peat Marwick Livingston & Company in the  
11 Washington area. Previously, I was a research engineer with Sylvania Electric  
12 Products, which was a subsidiary of General Telephone and Electronics Corporation.

13          Q.    What is your educational background?

14          A.    I received the degrees of Bachelor of Science in Electrical Engineering  
15 and Master of Science in Electrical Engineering from the Massachusetts Institute of  
16 Technology in 1958.

17          Q.    What is the nature of your work with Snavelly, King & Associates?

18          A.    I assist clients in cases before state and Federal regulatory commissions  
19 involving public utilities. Most of this work has been in the telecommunications field,  
20 but I have also participated in gas, electric and water cases, as well as cases  
21 concerning the United States Postal Service.

22                My telecommunications work has encompassed a wide range of  
23 monopoly and competitive services, including local exchange services, message  
24 telephone services, private line services, Centrex, telex, video, data, cable, personal  
25 communications services, and other services.

26          Q.    Have you testified previously before this Commission?

1           A.     Yes. I testified in Case No. 74-761-TP-AIR, concerning the rates and  
2 charges of the Ohio Bell Telephone Company ("Ohio Bell" or "the Company").

3           Q.     Have you testified before other regulatory commissions?

4           A.     Yes. I have testified as an expert witness before the Federal  
5 Communications Commission and the Federal Energy Regulatory Commission, as  
6 well as the state regulatory commissions of California, Connecticut, the District of  
7 Columbia, Florida, Georgia, Illinois, Maryland, Massachusetts, Michigan, Missouri,  
8 New Jersey, New York, Pennsylvania, Rhode Island, Texas and Virginia. My  
9 testimony has addressed a wide range of issues in the areas of rate of return, rate  
10 base and expenses, and rate structure.

11          Q.     Have you had additional experience in the telecommunications field?

12          A.     Yes. I have been a consultant to the Federal Executive Agencies on rate  
13 design and tariff issues in several major Federal procurement activities, including the  
14 Aggregated System Procurement ("ASP") for local telephone services and the  
15 FTS2000 system for intercity telecommunications services.

16                I have performed damage studies in three antitrust cases involving  
17 telecommunications firms. I have also been a consultant to the International  
18 Telephone & Telegraph Corporation, the Radio Corporation of America, Western  
19 Union International, and TRT Telecommunications Corporation in several proceedings  
20 before the Federal Communications Commission, and a case before the United States  
21 Court of Appeals. In addition, I have served as a consultant to the United States  
22 government, the government of Canada, various telecommunications firms, and users  
23 of telecommunications services in proceedings before regulatory agencies. Also, I  
24 testified as an expert witness in a proceeding before the General Services  
25 Administration Board of Contract Appeals concerning the selection of  
26 telecommunications firms.

27          Q.     For whom are you testifying in this case?

1           A.     I am testifying on behalf of the customer interests of the United States  
2     Department of Defense and All Other Federal Executive Agencies ("FEAs").

3     **Interests of the Federal Executive Agencies**

4           Q.     What are the customer interests of the FEAs in this proceeding?

5           A.     The Federal Government is a major user of virtually all types of services  
6     and facilities provided by the local exchange carriers in Ohio. Because of the location  
7     of many Federal offices in Cleveland, Columbus, and other places in Ohio, as well as  
8     military installations in the state, the Federal Government is one of the largest end  
9     users of Ohio Bell's services.

10          Pursuant to the *Competition in Contracting Act*, P.L. 98-369, and other  
11     legislation, the Federal Government has adopted policies for acquiring  
12     telecommunications services through competitive procurements. The FEAs would like  
13     to receive competitive bids from as many suppliers as possible. Ideally, there would  
14     be a variety of choices available, each using a different mix of components from the  
15     telephone company's network and from the facilities of competing firms.

16          In a competitive environment, there would be no monopoly facilities or services.  
17     A large number of suppliers would offer components of the telecommunications  
18     system using interconnections transparent to the user.

19     **Scope of Testimony**

20          Q.     What is the purpose of your testimony?

21          A.     Ohio Bell filed an Application with the Public Utilities Commission of Ohio  
22     for an alternative form of regulation. In this plan, known as "Advantage Ohio," the  
23     Company proposed to replace rate of return regulation with a price cap procedure.  
24     Ohio Bell made a number of "commitments" and also proposed a number of changes  
25     in the way that individual services would be offered and priced if the Commission  
26     accepts alternative regulation.

1           The Staff reviewed the proposed plan and described its findings and  
2 recommendations in a detailed Report of Investigation ("Staff Report"). In April 1994,  
3 the FEAs filed "Objections to the Staff Report of Investigation." My testimony also  
4 addresses the Staff Report and supports the FEAs' previously filed "Objections."

5           The FEAs require virtually all types of telecommunications services,  
6 ranging from basic exchange services now provided solely by Ohio Bell in most of the  
7 state to advanced services for which there are often competitive alternatives.  
8 Therefore, the FEAs have an interest in a broad range of issues in this proceeding. To  
9 address the issues in the Staff Report, my testimony is divided into four principal parts:

- 10           • the appropriate structure for alternative regulation of Ohio Bell;
- 11           • the classification and pricing of services offered through tariffs and  
12 contracts;
- 13           • steps to help reduce the barriers to competition in Ohio; and
- 14           • Ohio Bell's proposed commitments with alternative regulation.

15 I shall begin by discussing Ohio Bell's proposed alternative regulation plan.

## 16 **Alternative Regulation of Ohio Bell**

### 17 Ohio Bell's Proposed Plan

18           Q. Please describe Ohio Bell's proposed alternative regulation plan.

19           A. Ohio Bell proposes a plan that regulates only the prices of the  
20 Company's services, and not its earnings.<sup>1</sup> The Company's proposed price cap  
21 framework establishes three "baskets" or groups of services: residence, non-  
22 residence and carrier services. Prices for services in the carrier basket would be  
23 capped at the interstate access rates determined under the price cap rules of the  
24 Federal Communications Commission. A proposed Price Cap Index would be applied  
25 to the residence and non-residence baskets. In addition to this ceiling on price  
26 increases for the baskets, there would be limits on the price increases for many

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<sup>1</sup> Staff Report, page 32.

1 individual services. I shall discuss price limits on individual services in a subsequent  
2 section of my testimony.

3 Q. How does Ohio Bell propose to develop its Price Cap Index?

4 A. Ohio Bell's proposed Price Cap Index would be developed annually and  
5 would include four components. The first component is a measure of inflation in the  
6 general economy. Ohio Bell proposes the Gross Domestic Product Price Index  
7 published by the United States Department of Commerce as this general measure.<sup>2</sup>

8 The second component is an offset to the Gross Domestic Product Price  
9 Index that reflects the extent to which the Company's productivity improvement  
10 exceeds that of the nation's economy. Ohio Bell proposes a productivity adjustment of  
11 1.9 percent.<sup>3</sup>

12 The third component of the proposed Price Cap Index is a "Service  
13 Quality Adjustment." This adjustment is based on 13 indices of performance defined in  
14 the Commission's Minimum Telephone Service Standards.<sup>4</sup>

15 The fourth component of the proposed Price Cap Index is an "Exogenous  
16 Impacts Adjustment." This adjustment reflects significant tax and accounting changes  
17 that are outside of the Company's control.<sup>5</sup>

18 General Evaluation of the Price Cap Plan

19 Q. Do you believe that the Commission should approve this plan for Ohio  
20 Bell?

21 A. No. I do believe that some form of alternative regulation is appropriate  
22 for Ohio Bell. and that the Company's plan has many good features. However, I agree  
23 with the Staff that the proposed plan should not be accepted without modification.

24 Q. What features of the Price Cap Index are acceptable?

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2 Staff Report, page 33.

3 Staff Report, page 33.

4 Staff Report, page 33.

5 Staff Report, page 33.



1           A.     I agree with the Staff that the general structure of the formula for the Price  
2     Cap Index is acceptable. I also agree that the Gross Domestic Product Price Index is  
3     the appropriate measure of the general inflation level.<sup>6</sup>

4           The Staff addresses Ohio Bell's proposed service quality adjustment  
5     procedure in detail.<sup>7</sup> I believe that the Price Cap Index should reward greater service  
6     quality and have no objections to the Staff's recommended modifications to Ohio Bell's  
7     proposed service quality adjustment procedure.

8           Ohio Bell proposes an Exogenous Impacts Adjustment to reflect tax and  
9     accounting changes outside of the Company's control. The Staff suggests a number  
10    of specific criteria to be used to determine whether an adjustment is warranted.<sup>8</sup> I  
11    believe that the Staff's proposals will help to avoid disputes in administering the  
12    adjustment.

13   Productivity Adjustment

14          Q.     Do you agree with the productivity adjustment in the Price Cap Index?

15          A.     A productivity offset should be included in the Price Cap Index, but the  
16     1.9 percent adjustment proposed by Ohio Bell is much too small. I agree with the Staff  
17     that the annual intrastate productivity offset should be in the range of 3.3 percent to  
18     4.55 percent.<sup>9</sup>

19          Q.     Why?

20          A.     The productivity offset must motivate the Company to exceed past  
21     performance. Even if the Company has experienced productivity changes as low as  
22     1.6 percent, as it contends, I believe that the Price Cap Index should contain a larger  
23     offset to provide a very strong motivation for future improvement.

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6     Staff Report, page 37.

7     Staff Report, pages 39-41.

8     Staff Report, pages 42-43.

9     Staff Report, page 38.

1 Strong motivation is particularly important because Ohio Bell's plan does  
2 not provide for any regulation of the Company's earnings. In a general rule, the FEAs  
3 have supported continued regulation of earnings. Also, some Commissions have  
4 retained control over earnings along with price caps.

5 Q. Has the FCC retained earnings regulation for the Regional Bell Holding  
6 Companies?

7 A. Yes. The FCC has instituted a price cap procedure for many companies,  
8 requiring that they share earnings in excess of designated amounts with ratepayers.  
9 Carriers subject to these rules may select a productivity offset of either 3.3 percent or  
10 4.3 percent. If the carrier selects a productivity adjustment factor of 3.3 percent, there  
11 is equal sharing between the carrier and its ratepayers if the achieved return exceeds  
12 12.25 percent. If the carrier selects a productivity adjustment factor of 4.3 percent,  
13 there is equal sharing if the overall return exceeds 13.25 percent.

14 Ohio Bell's proposed plan does not contain any earnings sharing  
15 provisions. Under its plan, Ohio Bell will enjoy greater potential for higher profitability  
16 than carriers regulated by the FCC (including Ameritech.) Clearly, the absolute  
17 minimum offset in the Price Cap Index for Ohio Bell is the lower offset of 3.3 percent  
18 employed by the FCC.

19 Q. Is there are additional evidence supporting a productivity offset in the  
20 range of 3.3 percent to 4.55 percent?

21 A. Yes. The Company has maintained its financial health without  
22 substantial rate changes since 1985.<sup>10</sup> The first sentence in the Chairman's letter  
23 contained in the Ameritech Annual Report to Stockholders for 1992 states, "By almost  
24 any measure, 1992 was a banner year for Ameritech."<sup>11</sup> The annual report indicates  
25 that in the 1987 to 1991 period, Ameritech's customer lines per employee increased

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10 Staff Report, page 1.

11 Ameritech Annual Report to Stockholders for 1992, page 2.

1 at the rate of 4.5 percent per year.<sup>12</sup> Growth in the number of customer lines per  
2 employee is a measure of Ohio Bell's past productivity improvement.

3 Q. Have other state commissions recently adopted productivity offsets as  
4 large as 4.5 percent with earnings sharing?

5 A. Yes. California adopted a combination plan for the local exchange  
6 carriers under its jurisdiction. The California plan, which employs a 4.5 percent  
7 productivity adjustment factor, has a target rate of return of 11.5 percent on total  
8 investment. Between 13.0 percent and 16.5 percent return, there is equal sharing  
9 between the telephone company's shareholders and its ratepayers. In the event of  
10 higher earnings, the company is required to make refunds to maintain a level not  
11 exceeding 16.5 percent. A company is permitted to file for a rate increase if its return  
12 on total investment is less than 8.25 percent.

13 The 4.5 percent productivity adjustment factor now used in California is  
14 almost exactly at the top of the range recommended by the Ohio Staff. Moreover, the  
15 4.5 percent factor in California is likely to be increased, because an Administrative  
16 Law Judge has recommended that a 6 percent factor be applied for the intrastate  
17 operations of the Pacific Telephone and Telegraph Co.

18 As the California Commission has recognized, it is important to provide  
19 strong motivation for local exchange carriers through a significant productivity offset,  
20 because these companies will continue to exert market power for many years.

21 Q. Will Ohio Bell still enjoy substantial power as telecommunications  
22 markets become more competitive?

23 A. Yes. It is very important to recognize that although Ohio Bell is facing  
24 increasing competition, the firm will still enjoy substantial market power for many  
25 years. In the first place, the development of competition in Ohio will continue to be  
26 uneven geographically. The most rapid development will be in the urbanized areas.

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<sup>12</sup> *Id.*, page 40.

1           Secondly, there are services for which Ohio Bell will continue to have a  
2 *de facto* monopoly for a long period of time. Even if a competing firm constructed an  
3 extensive system, Ohio Bell will have a ubiquitous network with connections to almost  
4 every home and business establishment. A very large business customer, such as the  
5 Federal Government, will still originate calls to locations only accessible through  
6 facilities controlled by Ohio Bell.

7           In short, Ohio Bell will continue to have substantial market power. If price  
8 cap regulation is adopted, it will still be necessary for the Commission to exercise  
9 control over the Company's activities. A significant productivity offset is an important  
10 form of control. There are additional requirements, such as the need for the  
11 Commission to monitor the development of the Price Cap Index very closely.

12 Future Adjustments and Monitoring

13           Q.     What are the proposed procedures for updating the Price Cap Index?

14           A.     Ohio Bell proposes to adjust the Price Cap Index each year. The  
15 Company would submit documentation supporting changes on March 1. The updated  
16 parameters would become effective on April 1.

17           The Staff believes that a one-month period is too short and recommends  
18 that three months be allowed for review.<sup>13</sup> The Staff also presents additional  
19 recommendations concerning the review process.<sup>14</sup>

20           Q.     Do you agree with the Staff's position?

21           A.     Yes. I believe that the Staff's recommendations will provide an  
22 opportunity for a more detailed review of proposed changes in the Price Cap Index. A  
23 thorough review is important, especially in the partially regulated environment  
24 proposed by Ohio Bell, so I strongly recommend that the Staff's recommendations be  
25 adopted by the Commission.

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13     Staff Report, page 50.

14     Staff Report, pages 51-52.

1 Q. What is the duration of the proposed alternative regulation plan?

2 A. Ohio Bell proposes that its plan continue indefinitely.<sup>15</sup> The Staff  
3 believes that the Commission should establish a five-year sunset provision.<sup>16</sup>

4 Q. Do you agree with the Staff that the plan should have a five-year sunset  
5 provision?

6 A. Yes. The Commission should conduct a complete review of alternative  
7 regulation after five years of experience. In addition, the Commission and its Staff  
8 should be able to monitor developments throughout the five-year period.

9 The Company proposes to provide data describing the development of  
10 competition, technology deployment, new service introduction, pricing, and service  
11 quality in the fifth year of the plan.<sup>17</sup> The Staff recommends that the Company file such  
12 information at the end of the fourth year.<sup>18</sup> I strongly concur with the Staff that  
13 substantial information should be filed no later than the end of the fourth year.

14 In fact, I recommend more stringent requirements than those suggested  
15 by the Staff. Summary information should be available on an annual basis, or even  
16 more frequently, so that the Commission can gauge the development of competition.  
17 This information is particularly important if Ohio Bell is required to make components of  
18 the local loop available to other telecommunications firms on an unbundled basis, as I  
19 recommend in a subsequent section of this testimony. Also, the Commission should  
20 monitor Ohio Bell's earnings.

## 21 **Service Classifications, Rates and Tariffs**

### 22 Classification of Services

23 Q. How are Ohio Bell's services grouped in the proposed price cap plan?

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15 Staff Report, page 52.

16 Staff Report, page 53.

17 Staff Report, page 52.

18 Staff Report, page 53.

1           A.     Ohio Bell proposes three service groups or "market baskets" based on  
2 the type of user: residence, non-residence, and carrier services.

3           Q.     Does the Staff Report note a potential problem with this grouping of  
4 services?

5           A.     Yes. The Staff states that one of the "more controversial" elements of  
6 Ohio Bell's proposal is that the plan includes both monopoly services and competitive  
7 services in the same basket.<sup>19</sup> The Staff is concerned that with baskets defined by  
8 type of user, and with considerable flexibility to price services within a basket, the  
9 Company will have the opportunity and incentive to subsidize competitive services  
10 with excessive charges for monopoly services. One solution to this potential problem  
11 is to define the baskets so that competitive and non-competitive services are not  
12 grouped together.

13          Q.     Do you agree with the Staff that there is a potential problem with  
14 grouping competitive and non-competitive services in the same basket?

15          A.     Yes. Moreover, I believe that there is a cross-subsidy problem that is  
16 possibly more severe than the one mentioned by the Staff. From the information in the  
17 Staff report, it appears that there will be a major imbalance in the revenue-to-cost  
18 relationships for local exchange services. Service for residence subscribers will  
19 continue to be priced far below the appropriate level. If all residence services are  
20 contained in one basket and all business services are in a separate basket, it will be  
21 difficult to address this important disparity.

22          Q.     Is there are an alternative way to Classify Ohio Bell's services for the  
23 price cap procedure?

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19     Staff Report, page 34.

1           A.     Yes. For price caps, the services could be classified on the basis of the  
2 "cells," used to denote the competitive level of the service. Ohio Bell's services are  
3 classified into four cells;<sup>20</sup>

- 4           •     "Cell 1" services are basic local exchange services that provide access  
5 and local usage, as well as installation and maintenance services not  
6 available from competitive sources, and services essential for public  
7 safety and privacy.
- 8           •     "Cell 2" services are not fully competitive, but there are "adequate"  
9 alternatives, not necessarily similar in nature and function, available from  
10 at least one other provider.
- 11          •     "Cell 3" services are "discretionary" in nature. Also, new services will  
12 generally be classified in this cell.
- 13          •     "Cell 4" services are services which are highly competitive and for which  
14 functionally equivalent or substitute services are available.

15          Q.     Does the Staff Report indicate that residence exchange service is under  
16 priced?

17          A.     Yes. The Staff refers to an Ohio Bell study of the costs of its network  
18 access lines, or local loops, used to provide exchange service.<sup>21</sup> In this study, the  
19 Company developed costs for three density regions, Area B, Area C and Area D. Area  
20 B had the most dense concentration of access lines and Area D the least dense. The  
21 Staff and the Company agree that the monthly rates for residence service do not cover  
22 the long run incremental costs for access lines in Areas C and D.

23          Q.     Is residence exchange service typically under priced relative to business  
24 service?

---

20     Staff Report, page 54.

21     Staff Report, page 72.

1           A.     Yes. Before 1984, when Ohio Bell and the other Bell System companies  
2 enjoyed a virtual monopoly over all telephone services and equipment, it was possible  
3 to maintain a rate structure that departed substantially from the structure of costs. An  
4 important basis of the telephone rate structure, not only in Ohio but throughout the  
5 country, was a concept known as "value of service." Services perceived to be "more  
6 valuable" bore higher rates than those that were "less valuable." Business services  
7 were often deemed to have "greater value" so that business subscribers were charged  
8 higher rates for local service than residence subscribers. Also, long distance service  
9 was perceived to be "more valuable" than local service and therefore was offered at  
10 rates well above costs.

11                 When the Bell System was broken up in 1984, the telephone companies  
12 lost their virtual monopoly over customer premise equipment. Ohio Bell was required  
13 to transfer its embedded customer premise equipment to AT&T. This transfer  
14 eliminated the Company's monopoly over customer exchange networks, that is,  
15 intercommunications systems on the subscribers' premises. Private Branch Exchange  
16 switches provided by other firms began to compete forcefully with the Centrex services  
17 offered by Ohio Bell.

18                 Also, while Ohio Bell previously enjoyed a monopoly in the provision of  
19 intraLATA toll services, the Commission has authorized competition for this service. In  
20 addition, the aggressive activities of Competitive Access Providers, or "CAPS," have  
21 eliminated Ohio Bell's previous monopoly position in providing tie lines between the  
22 interexchange carrier and the Company's central offices.

23                 The effect of emerging competition has been to drive the prices for  
24 competitive services in the direction of their costs. For example, it is no longer feasible  
25 for Ohio Bell to maintain rates for intraLATA toll services that are significantly higher  
26 than their competitor's charges. In addition, access charges can no longer be



1 maintained significantly above the costs that the CAPs incur to provide alternative  
2 access.

3 Because competition is eroding the profit margins for its some of Ohio  
4 Bell's services, it is becoming much less feasible for Ohio Bell to maintain low rates for  
5 services that have not been as profitable. Primary among these low-profit services is  
6 residence exchange access. The rates for residence exchange services must be  
7 increased if Ohio Bell is to survive as a viable source of universal telephone service.

#### 8 Classification of Services in Cells

9 Q. In response to an earlier question, you discussed the classification of  
10 Ohio Bell's services by "cells" according to the level of competition that has developed.  
11 Does the Staff Report address other important issues concerning the classification of  
12 services in cells?

13 A. Yes. The Staff has several objections to Ohio Bell's proposed  
14 classification of services. The Staff proposes to change the classification for a number  
15 of Ohio Bell's specialized digital services from Cell 4 to Cell 2.<sup>22</sup> The Staff also  
16 proposes to change the classification of all "Digital Specialized Network Services"  
17 originating and terminating in downtown Cleveland and Columbus, as well as digital  
18 private lines in these areas, from the competitive Cell 4 classification to Cell 2.

19 Q. Do you agree with this change by the Staff?

20 A. No. I believe that these services should be classified in Cell 4.  
21 Competition is greatest for services provided to businesses located in very  
22 concentrated areas. Also, competition in these areas is expected to increase in the  
23 future as competitors enter the most dense markets first.

#### 24 Cell-Specific Pricing Limitations

25 Q. What are the pricing limitations on groups of services under the proposed  
26 alternative regulation plan?

---

22 Staff Report, page 56.

1           A.       Under the proposed plan, individual services are required to meet the  
2       "pricing parameters" of their respective cell classifications as well as the revenue cap  
3       for the service group.<sup>23</sup> Ohio Bell proposes that increases for Cell 1 services in the  
4       residence and non-residence groups be no greater than five percent per year above  
5       the Price Cap Index. Ohio Bell proposes an exception, allowing coin telephone  
6       charges to be rounded up to the nearest multiple of five cents.

7           Ohio Bell proposes to establish pricing parameters for Cells 2 through 4  
8       that are consistent with rules established previously by the Commission. For Cell 2,  
9       the limits include a minimum and maximum rate level. The maximum rate would be  
10      twice the minimum rate. If the Commission has previously established both minimum  
11      and maximum rates, both will continue unchanged. However, if these limits have not  
12      been established, the minimum level will be the current price and the maximum level  
13      will be two times the current price.

14          The rules for Cell 3 are similar to those for Cell 2, except that there would  
15      be no maximum level for Cell 3 services. There are no specific pricing parameters for  
16      Cell 4 services. However, Ohio Bell would be required to support its rates for services  
17      in this cell, as well as services in Cells 2 and 3, with Long Run Service Incremental  
18      Cost studies.

19          Q.       Does the Staff agree with Ohio Bell's proposals to limit price changes?

20          A.       The Staff agrees with many of the Company's proposals, including  
21      detariffing of Cell 4 services.<sup>24</sup> However, the Staff believes that for services in Cells 2  
22      and 3, annual increases should be limited to 15 percent and annual decreases to 10  
23      percent.<sup>25</sup>

24          Q.       Do you agree with the Staff's recommendations concerning these pricing  
25      limitations on services?

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23      Staff Report, pages 43-44.

24      Staff Report, page 47.

25      Staff Report, page 46.

1           A.     I agree that the existence of competitive alternatives justifies detariffing  
2 Cell 4 services. Also, for services in Cells 2 and 3, for which there is less effective  
3 competition, I believe the Staff 's proposed limitation on maximum rates increases is  
4 appropriate.

5           I believe that there should not be a limit of 10 percent on price reductions  
6 for these services. The Staff states that a limit provides some protection to competitors  
7 against predatory pricing.<sup>26</sup> However, the 10 percent limit is far more likely to prevent  
8 rationale pricing than predatory pricing. It is possible that the service could still be  
9 priced far above long run incremental costs even after a rate reduction greatly  
10 exceeding 10 percent.

11 Structure of Local Exchange Service

12          Q.     What are the elements of local exchange service?

13          A.     The principal pricing elements of this service are exchange access,  
14 usage, and service and establishment charges. Ohio Bell is proposing to  
15 disaggregate exchange access rates into two rate elements: the central office  
16 termination and the network access line.<sup>27</sup>

17          Q.     Does the Staff recommend that the Commission approve Ohio Bell's  
18 request to disaggregate exchange access rates?

19          A.     Yes. The Staff recommends that the Commission adopt this proposal.<sup>28</sup>

20          Q.     Do you concur with the Staff on this point?

21          A.     Yes. Disaggregation allows the rate structure to comport more closely  
22 with underlying costs. Furthermore, pricing disaggregation provides the necessary  
23 foundation for offering the elements of exchange access separately, which I  
24 recommend in a later section of this testimony.

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26     Staff Report, page 46.

27     Staff Report, page 62.

28     Staff Report, page 62.

1 Q. Does Ohio Bell propose additional changes to "disaggregate" exchange  
2 access service?

3 A. Yes. The Company proposes to deaverage the charges for the resulting  
4 network access line rate elements for non-residence subscribers. Thus, the network  
5 access line rate for the most dense area, Area B, would be the least, and the  
6 corresponding rate for Area D would be the greatest, to reflect cost differences. Also,  
7 the Company proposes to offer volume discounts for non-residence subscribers.

8 Q. Does the Staff accept these Ohio Bell proposals?

9 A. Yes. The Staff Report indicates its agreement with the Company's  
10 proposal to geographically deaverage rates, assuming that recommendations  
11 concerning Touch-Tone are also accepted.<sup>29</sup> The Staff also accepts the discount  
12 structure proposed by the Company.<sup>30</sup>

13 Q. Do you also believe that the Commission should adopt these proposals?

14 A. Yes. The network access line consists principally of the local loop  
15 connecting the subscriber to the telephone company's local central office. In densely  
16 developed areas, more subscribers are located close to a telephone company central  
17 office, so that the access facilities are shorter. Also, the local loops will generally be  
18 routed over cables with a greater number of wire pairs, which have a lower cost per  
19 pair than the lower cross-section cables used for sparsely developed areas.

20 Finally, local distribution facilities are now being multiplexed in many  
21 densely developed areas to reduce the costs of wire plant and save space in conduits.  
22 The opportunities for saving costs through multiplexing multiple local channels are  
23 greater for service to high density locations such as office buildings.

24 Discounts for many local loop terminations at a single location are also  
25 cost justified, for many of the same reasons. Also, Ohio Bell faces competition by firms

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29 Staff Report, page 63.

30 Staff Report, page 64.

1 who can bypass its local distribution facilities and provide connections directly to large  
2 customer locations. The Company should have the authority to meet competition  
3 through a discounted rate structure. This rate structure should reflect the lower unit  
4 costs of providing a large number of connections at a single location.

5 Q. What are the Staff's recommended monthly rates for local exchange  
6 services?

7 A. The Staff proposes to eliminate Touch-Tone as a separate service and  
8 institute a "more equitable rate design among subscribers."<sup>31</sup> The Staff proposes that  
9 the network access line rate be \$4.95 monthly for all residence customers.<sup>32</sup> The Staff  
10 states that the monthly network access line rates for non-residence subscribers  
11 should be \$13.25 for Area B, \$15.25 for Area C, and \$17.25 for Area D.<sup>33</sup> In addition,  
12 the Staff recommends a monthly central office termination rate of \$3.00 for residence  
13 subscribers.<sup>34</sup> The corresponding charge would range between \$4.00 and \$7.70  
14 monthly for business subscribers.<sup>35</sup>

15 As I stated previously, residence subscribers are given the option of flat  
16 rate local service. This service is provided through a flat rate usage package.  
17 Assuming a \$135 million startup reduction, the Staff proposes a residence flat rate  
18 usage charge of \$8.55 monthly.<sup>36</sup> Thus, residence flat rate customers in all areas  
19 would pay \$16.50 monthly, including the \$4.95 network access and \$3.00 central  
20 office termination charges.<sup>37</sup> Business subscribers must obtain local service on a  
21 measured basis. The Staff is not proposing changes in the usage charges.

22 Q. Do you agree with the Staff proposed rates?

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31 Staff Report, page 69.

32 Staff Report, page 68.

33 Staff Report, page 68.

34 Staff Report, page 68.

35 Staff Report, page 68.

36 Staff Report, pages 48-49.

37 Staff Report, page 49.

1           A.     No. Although I agree with the proposals to disaggregate and deaverage  
2 the rate structure, I absolutely do not agree with the proposed rates.

3           Q.     Why?

4           A.     The Staff's proposed rates do not comport with the cost relationships for  
5 this service. There is no reason for business network access line rates to be two to  
6 three times the network access line rate for residence subscribers.

7                     Also, if the network access line rate for business subscribers is to be  
8 deaveraged geographically, it would be logical to deaverage the residence network  
9 access line rate as well. I would expect the proportion of residence subscribers to be  
10 greatest in Area D, the least dense of the three rate groups. Therefore, if residence  
11 network access line rates are to be compared with business rates, the appropriate  
12 comparison is with Area D. The Staff's proposed rate of \$17.25 monthly for business  
13 subscribers in Area D is 350 percent of the proposed \$4.95 residence monthly rate.

14                    Furthermore, there is no apparent basis for a central office rate for  
15 business subscribers larger than the rate for residence subscribers. Under the Staff's  
16 proposed rate design, a business subscriber would pay a minimum of \$17.25 monthly,  
17 plus charges for all usage, while a residence flat rate subscriber would pay \$16.50  
18 monthly, with no limit whatsoever on the number or duration of local calls.

19           Q.     Is there any justification for the Staff's rate recommendations for local  
20 exchange service?

21           A.     There is no cost support for residence rates that are lower than non-  
22 residence rates. In fact, cost relationships should support higher residence rates.

23                    I suspect that the Staff's proposals reflect the traditional "value of service"  
24 pricing concepts that I mentioned earlier in this testimony. These approaches, which  
25 resulted on low residence rates set on a "residual" basis, can no longer be sustained.

26           Q.     What rate changes do you recommend for local exchange services?

1           A.     The charges for local exchange services to residence and non-  
2 residence subscribers should be set on the basis of their respective costs. In fact, the  
3 rates for each unbundled service element should be set on the basis of the costs for  
4 the element.

5           The Staff is recommending some important steps to unbundle and  
6 deaverage rates. However, the rates recommended by the Staff do not reflect the  
7 costs of service to residence subscribers.

8           Q.     What do you recommend?

9           A.     I recommend three actions. First, any adjustment in Ohio Bell's revenue  
10 requirement to start alternative regulation should be used to start aligning rates with  
11 costs. For example, a reduction in overall revenues should be used to cut rates for  
12 message toll service, local messages, or other services that may be priced above  
13 costs rather than to reduce rates for residence exchange services that are priced  
14 below costs. If there are wide disparities between revenues and costs, it will not be  
15 practical to close the gaps in one step. Therefore, even if there is a reduction in overall  
16 revenues, it would be wise to increase the rates for services that are far below costs to  
17 start the normalization process.

18          Q.     What is your second recommendation?

19          A.     I recommend that the Commission not accept the Staff's proposed limits  
20 on annual rate increases for local exchange services. My understanding of the Staff's  
21 rate design proposals is that they would limit the annual rate increases for all Cell 1  
22 services, including all elements of residence and non-residence local exchange  
23 service, to five percent per year in addition to any change in the Price Cap Index.  
24 Although I recognize that some degree of rate continuity is important, I believe that the  
25 Staff's limitation should be relaxed. If any rate element is below cost, I believe that the  
26 annual limit should be a 15 percent increase, including any change in the Price Cap

1 Index. This 15 percent limit is consistent with the Staff's recommendations on  
2 maximum price increases for services in Cells 2 and 3.

3 Q. What is your third recommendation with respect to these services?

4 A. I recommend that the Commission institute a formal plan to transition  
5 Ohio's Bell rates to fully reflect costs in a reasonable period of time. For this purpose, I  
6 suggest that the Commission may wish to consider the procedures adopted by the  
7 Massachusetts Department of Public Utilities in Docket D.P.U. 89-300. In that docket,  
8 the Department adopted six goals: economic efficiency, fairness, simplicity, earnings  
9 stability, continuity and universal service.

10 To implement these goals, the Massachusetts agency required New  
11 England Telephone Company to develop "illustrative tariffs" that were based on the  
12 strict application of cost-of-service principles, meaning that rates of return among  
13 classes of service were equalized and that rates for traffic-sensitive service elements  
14 were at their full marginal cost. The Department recognized that while these rates  
15 represented a desirable objective, they could not feasibly be implemented in a single  
16 filing because they would have required such a large increase in residence rates that  
17 would have violated the principle of rate continuity and might adversely have affected  
18 universal service.<sup>38</sup>

19 Using the illustrative tariffs, the Massachusetts agency set target rates  
20 that were based on, although not always identical to, the illustrative rates. These  
21 target rates were used as a framework to guide the transition from the value-of-service  
22 rate structure to one that reflected cost causation. The agency then directed New  
23 England Telephone to make a series of revenue-neutral transitional filings to bring the  
24 rates to their target levels. With Commission approval, the Company has implemented  
25 four annual transitional steps towards equalized rates of return among customer  
26 classes. Two more steps are planned.

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38 Massachusetts D.P.U. 93-125, January 13, 1994, pages 6-8.



1 Q. What is the initial requirement in Ohio?

2 A. The requirement is to initiate the studies necessary to establish the target  
3 rates that equalize rates of return for principal groups of services and also ensure that  
4 each rate element recovers its marginal cost. Since these cost studies and rate  
5 analyses may require some time, I recommend that the Commission initiate this inquiry  
6 as soon as possible.

7 Disaggregation of Service and Establishment Charges

8 Q. The previous discussion has concerned the recurring monthly charges  
9 for local exchange services. Are there also proposals relating to the non-recurring  
10 charges for these services?

11 A. Yes. Ohio Bell proposes to disaggregate service and establishment  
12 charges to that they match the work requirements of each individual work request. The  
13 Staff concurs with these proposals.

14 Q. Do you concur with this Staff position?

15 A. Yes. I agree with virtually any step that makes it easier to match charges  
16 with costs.

17 Disaggregation of Centrex Rates

18 Q. Are there also proposals to disaggregate Centrex rates?

19 A. Yes. Ohio Bell proposes to disaggregate and deaverage Centrex  
20 Service exchange access and station intercommunication line rates. The station  
21 intercommunication line would be disaggregated into an intercommunication line rate  
22 and a station feature rate. The intercommunication line rate would be geographically  
23 priced, based on access area, and also subject to quantity discounts. The Staff  
24 concurs with these proposals.<sup>39</sup> The Staff also agrees with an Ohio Bell proposal to  
25 disaggregate Centrex service and establishment charges as for exchange access.<sup>40</sup>

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39 Staff Report, page 69.

40 Staff Report, page 70.

1 Q. Do you agree with these positions of the Staff?

2 A. Yes. Disaggregation enables a better match between rates and costs.

3 Also, it smoothes the transition to a more competitive telecommunications  
4 environment.

5 Long Run Service Incremental Costs

6 Q. Has Ohio Bell provided descriptions of the methodology and  
7 assumptions that it will use to conduct cost studies submitted under the terms of the  
8 alternative regulation plan.

9 A. Yes. The Company provided information on its Long Run Service  
10 Incremental Cost (LRSIC) methodology. The Staff has reviewed this information and  
11 accepts LRSIC as a critical factor in evaluating prices for Ohio Bell's services.<sup>41</sup>

12 Q. Do you believe that long run incremental costs are the appropriate  
13 benchmark for pricing services?

14 A. Yes. No service should be priced below its long run incremental costs.

15 **Barriers to Competition**

16 Unbundling of the Local Loop

17 Q. Does the Staff Report address other issues critical to the development of  
18 competitive markets for telecommunications services?

19 A. Yes. The Staff Report notes that Ohio Bell cites the need to respond to  
20 current and pending competition as a primary factor in motivating its proposed  
21 alternative regulation plan.<sup>42</sup> The Staff supports the ongoing transition to the  
22 competitive marketplace for telecommunications services. In this connection, the Staff  
23 makes a number of recommendations that I shall address in this section of my  
24 testimony. The first recommendation concerns unbundling of the local loops provided  
25 by Ohio Bell.

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<sup>41</sup> Staff Report, pages 71–74.

<sup>42</sup> Staff Report, page 74.

1 Q. What are the Staff's recommendations for unbundling local loops?

2 A. The Staff notes that although Ohio Bell is proposing disaggregated  
3 pricing for exchange access, the Company is not proposing to make the components  
4 available to users on an unbundled basis. The Staff believes that customers  
5 (including competitors) should have the opportunity to purchase only those portions of  
6 Ohio Bell's network that they require.<sup>43</sup>

7 Q. Do you agree that the local loop should be unbundled so that Ohio Bell's  
8 customers and competitors are able to obtain the loop's constituent elements  
9 separately?

10 A. Yes, I strongly agree. Maximum unbundling of Ohio Bell's network will  
11 help to foster competition for local services. This competition will benefit all parties in  
12 the long run. Only competition can ensure that the traditional telephone companies  
13 provide the best possible service at the lowest possible cost. While residence  
14 subscribers may be less likely than business subscribers to be able to choose among  
15 competitive alternatives, they will benefit if the telephone companies are able to  
16 compete effectively for the high volume, low cost services to business, institutional and  
17 governmental customers. The economies of scale and scope and the efficiencies of  
18 new technologies generally mean that larger, more technically sophisticated systems  
19 have lower costs for all subscribers.

20 Q. Have other regulatory Commissions addressed the need to unbundle  
21 local loops?

22 A. Yes. The New York Public Service Commission requires the New York  
23 Telephone Company to unbundle the local loop into "link" and "port" components. The  
24 Commission recognized that competitive link providers will need access to unbundled  
25 ports to interconnect their facilities in order to provide services to customers.<sup>44</sup>

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<sup>43</sup> Staff Report, page 75.

<sup>44</sup> Re: *Telecommunications Interconnection Arrangements*, 128 PUR 4th 97, 104 (1991).

1 Number Assignment and Portability

2 Q. Does the Staff Report contain a recommendation concerning portability  
3 of telephone numbers which is important to the development of competition?

4 A. Yes. The Staff points out that while Bellcore has national responsibility  
5 for number assignment, Ohio Bell administers the assignment of NXX codes in the  
6 state.<sup>45</sup> The Staff believes that placement of this responsibility with Ohio Bell may  
7 impede the efforts of new market entrants to obtain numbers. Therefore, the Staff  
8 recommends that the responsibility for numbers within Ohio be transferred to an  
9 independent organization.

10 Q. Do you concur with this recommendation by the Staff?

11 A. Yes. It is my understanding that no competitive access provider has  
12 applied to the Ohio Commission to provide switched local exchange service on a  
13 facilities basis, that is, to provide dial tone in competition with Ohio Bell. However,  
14 firms are applying to provide this service in other states. From my own experience in  
15 participating in several of these proceedings, I know that number assignment is one of  
16 the most contested issues. By taking the step that the Staff recommends, Ohio will be  
17 better positioned to deal with the number assignment problem when competitors seek  
18 to provide local service here.

19 Compensation for Terminating Local Traffic

20 Q. Does the Staff Report contain a recommendation concerning charges for  
21 terminating local message traffic?

22 A. The Staff notes that Ohio Bell does not have a tariff that provides for  
23 termination of local traffic under consistent rates, terms, and conditions.<sup>46</sup> The Staff  
24 recommends that the Company file a uniform tariff for termination of switched local  
25 traffic within 12 months of the start of the alternative regulation plan.

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45 Staff Report, pages 76-77.

46 Staff Report, page 77.

1 Q. Do you concur with this recommendation?

2 A. Yes. According to the Staff Report, Ohio Bell maintains a number of  
3 arrangements, with differing rates, terms and conditions, for terminating various types  
4 of traffic, such as interstate message toll, intrastate message toll, and messages  
5 originating on the networks of the cellular firms.<sup>47</sup> I agree with the Staff that these  
6 distinctions can not be sustained in a competitive environment. Also, I do not know of  
7 any cost basis for differing rates. If there are no substantial cost differences, uniform  
8 rates should apply.

9 1+ intraLATA Presubscription

10 Q. Does the Staff Report contain an important recommendation concerning  
11 competition for intraLATA message service?

12 A. Yes. The Staff observes that additional barrier inhibiting the  
13 development of competition is the absence of 1+ presubscription for intraLATA  
14 message toll service.<sup>48</sup> Ohio has enjoyed facilities-based intraLATA toll competition  
15 for some time, but use of a carrier other than the local exchange company requires  
16 dialing an access code. To remedy this problem, the Staff recommends that Ohio Bell  
17 implement 1+ intraLATA presubscription within 24 months of the start of the alternative  
18 regulatory plan.

19 Q. Do you agree with this recommendation?

20 A. Yes. The requirement to dial an access code provides an unfair  
21 advantage to the local exchange carrier. It is true that the inconvenience of dialing  
22 extra digits can be mitigated by using the automatic dialing feature of some customer  
23 premises equipment. Therefore, users with more sophisticated equipment may be  
24 somewhat indifferent to the need to dial more digits. However, 1+ presubscription will

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<sup>47</sup> Staff Report, page 77.

<sup>48</sup> Staff Report, pages 77-78.

1 certainly provide a more equal basis for selection among carriers by many residence  
2 and smaller business subscribers.

3 Contracts for Services

4 Q. Does the Staff Report address services provided by the Company  
5 pursuant to Individual Case Basis (ICB) contract arrangements?

6 A. Yes. The Staff notes that Ohio Bell seeks the authority to enter into  
7 contracts on a case-by-case basis or through a pre-approval process.<sup>49</sup> These  
8 contracts would apply to services in all four cells if it can be demonstrated that a  
9 competitive alternative exists. Also, Ohio Bell proposes that all contracts be  
10 implemented upon filing with the Commission. In addition, the Company promises to  
11 submit a Long Run Service Incremental Cost study supporting its contract prices.

12 The Staff agrees with many of Ohio Bell's proposals concerning  
13 contracts. However, I do not interpret the Staff's analysis as providing authority to  
14 contract for services in Cell 1, basic local exchange services. Also, the Staff states that  
15 Ohio Bell should be required to submit proposed contracts and supporting cost  
16 justification for Commission review in a 30-day period, unless the contractual  
17 arrangement has been approved previously.<sup>50</sup>

18 Q. Do you concur with the Staff's positions concerning contracts?

19 A. No. Ohio Bell should be able to contract for services in Cell 1. Also, I  
20 disagree with a 30-day delay in the effectiveness of a contract. Such a requirement  
21 may restrict the ability of Ohio Bell to participate in active competitive bidding to  
22 provide telecommunications services.

23 Q. Why is it important to provide maximum flexibility for contract services?

24 A. Contracts benefit users, telecommunications firms, and all ratepayers.  
25 Many larger users, including the FEAs, are increasing their reliance on contracts with

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49 Staff Report, pages 79-80.

50 Staff Report, page 80.

1 ICB pricing to obtain the telecommunications services they need. If all local exchange  
2 companies, including both new and incumbent firms, are not permitted to individually  
3 tailor telecommunications systems to the needs of their customers and price them  
4 accordingly, the number of alternative sources of supply available to end users will be  
5 sharply limited. This would stifle competition and innovation.

6 Without the ability to offer ICB pricing, local exchange carriers would not  
7 be able to participate as viable competitive bidders for substantial telecommunications  
8 business. Economies of scale and scope and the efficiencies of the new technologies,  
9 usually cause larger, more technologically sophisticated systems to have lower unit  
10 costs. By denying the local exchange carriers the opportunity to provide contract  
11 services with ICB pricing, the carriers are deprived of the ability to participate in  
12 profitable markets.

13 Furthermore, conventional controls over competitively bid services  
14 should be relaxed. If regulation threatens to modify or reverse the prices, terms or  
15 conditions of the bid of a regulated carrier, the firm is unable to guarantee that its offer  
16 can be converted into a binding contract. Furthermore, a carrier should not be  
17 required to disclose the costing support for its bid except in generalized terms. Such  
18 disclosure would place the carrier at a severe disadvantage compared to unregulated  
19 competitors.

#### 20 Centrex Resale and Sharing

21 Q. Does the Staff Report address any important issues concerning resale  
22 and sharing of Centrex services?

23 A. Yes. The Staff notes that Ohio Bell proposes to continue the regulations  
24 regarding resale and sharing of local services.<sup>51</sup> The Staff objects to a provision of  
25 these regulations that allows resale of Centrex service only if it is provided on a

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<sup>51</sup> Staff Report, page 80.

1 measured-rate basis.<sup>52</sup> The Staff states that this provision puts resellers and sharers  
2 at a competitive disadvantage because the Company offers Centrex to end users on  
3 either a measured-rate or a message-rate basis. Therefore, the Staff recommends  
4 that Ohio Bell be required to make Centrex service available to resellers and sharers  
5 on both pricing plans.<sup>53</sup>

6 Q. Do you agree with this Staff recommendation?

7 A. Yes. If the Company provides Centrex service on a message-rate basis  
8 to end users, it should also provide the service on this basis to resale and sharing  
9 customers.

## 10 **Commitments by Ohio Bell**

### 11 Infrastructure Commitments

12 Q. Does Ohio Bell propose to a number of commitments relating to  
13 telecommunications infrastructure if its proposed alternative regulation plan is  
14 adopted?

15 A. Yes. Ohio Bell describes a number of commitments. Specifically, the  
16 Company commits to:

- 17 • invest \$1.6 billion over the next five years to upgrade the  
18 telecommunications infrastructure in the Company's service area;
- 19 • within five years, deploy a fiber optic based, two-way interactive,  
20 distance learning network to serve all high schools and institutions of  
21 higher learning that want video services;
- 22 • underwrite a staff of experts who would assist educators in developing  
23 and implementing distance learning applications;
- 24 • join with government agencies and other businesses to seek grants to  
25 help finance video equipment for distance learning applications;
- 26 • propose a discounted tariff for elementary and secondary schools that  
27 would apply to a variety of existing telecommunications services;

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52 Staff Report, pages 80-81.

53 Staff Report, page 81.



- 1 • deploy optical fiber facilities to all hospitals, libraries, country jails, and  
2 court buildings in its service area within five years;
- 3 • convert all analog central office switching systems to advanced digital  
4 switching systems within five years;
- 5 • transport 97 percent of the Company's interoffice circuits over fiber optic  
6 facilities within five years;
- 7 • expand the availability of Integrated Services Digital Network switching  
8 system technology to all access lines within five years;
- 9 • equip all switches that serve customer lines with Signaling System 7  
10 within five years; and
- 11 • conduct special trials of new and emerging communications applications  
12 at selected locations during the coming year.<sup>54</sup>

13 Q. Does the Staff concur with these proposed commitments?

14 A. The Staff performed an analysis of the proposed commitments.<sup>55</sup> One of  
15 the Staff's observations is that a substantial part of the \$1.6 billion proposed  
16 infrastructure investment is "business as usual" necessary to meet existing minimum  
17 standards. The Staff recommends that only \$382 to \$476 million be identified  
18 specifically as an infrastructure commitment in any plan approved for Ohio Bell.<sup>56</sup>

19 The Staff also makes a number of specific recommendations concerning  
20 steps that it believes should be taken to improve the effectiveness of the proposed  
21 expenditures for development. However, my overall impression is that the Staff  
22 believes that Ohio Bell should, by and large, undertake the proposed programs  
23 because they would be beneficial to residents and businesses in Ohio.

24 Q. Do you believe that the Commission should accept Ohio Bell's proposed  
25 commitments?

26 A. I have no position on the merits of Ohio Bell's proposed investments and  
27 plans. However, I believe that the costs of these activities should not be included in

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54 Staff Report, pages 97-98.

55 Staff Report, pages 103-113.

56 Staff Report, page 104.

1 the rates and charges for services for which Ohio Bell has a monopoly or dominant  
2 position in the market.

3 Q. Why?

4 A. Even if Ohio Bell's infrastructure commitments have merit, which they  
5 may or may not, it is not reasonable to "tax" captive users to pay for them. Also,  
6 charges to ratepayers for these programs may be counterproductive because the  
7 necessary increases in rates to pay for the programs will, to some extent, put a damper  
8 on the development of the telecommunications infrastructure that the plan seeks to  
9 improve. Furthermore, I believe that is appropriate to decouple decisions regarding  
10 the appropriate regulation of telecommunications carriers from decisions regarding  
11 social programs.

12 Rate Design Commitments

13 Q. Does Ohio Bell also propose commitments concerning the rates and  
14 charges for its services if its proposed alternative regulation plan is adopted?

15 A. Yes. Ohio Bell commits to:

- 16 • maintain flat rate service as a local service option for residence  
17 customers,
- 18 • not increase the rates for any services, except possibly certain services to  
19 other carriers, in the first year of the plan, and
- 20 • not increase any residence and business exchange access and local  
21 usage rates, including the rates for residence flat rate service, for three  
22 years.

23 Q. Does the Staff concur with the Company's commitment to continue flat  
24 rate service as an option for residence subscribers?

25 A. Yes. The Staff considers Ohio Bell's commitment to continue flat rate  
26 service to be in the public interest and supports this feature of the plan.<sup>57</sup>

27 Q. Do you agree with the Staff's position on this matter?

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<sup>57</sup> Staff Report, pages 104-105.

1           A.     I agree that the Company should be allowed to continue to offer flat rate  
2 service, at least for some period of time. However, the rates for this service should  
3 cover its costs. As I have stated previously in this testimony, it does not appear that the  
4 rates for the service are even near the corresponding costs. Therefore, while I agree  
5 that residence flat rate service should be continued, the service should not be  
6 continued at existing rates.

7           Q.     Does the Staff concur with the Company's commitments to no rate  
8 increases at all (except possibly carrier services) in the first year and no increases for  
9 residence and business exchange access and local usage rates for three years?

10          A.     In both cases, the Staff states that the propriety of the commitment  
11 depends upon the extent of any pro forma revenue adjustments, as well as on the  
12 price cap framework approved in this proceeding.<sup>58</sup> I believe that the Staff is adopting  
13 this position because of the probable need to change rates in the near term in order to  
14 implement "startup adjustments" that are required to begin price cap regulation.

15          Q.     Do you agree with the Staff 's position on this matter?

16          A.     I agree with the Staff that adjustments in Ohio Bell's rates are almost  
17 certainly required to start price cap regulation. If the rates are not properly initialized at  
18 the start, the price cap plan will not be effective in preventing the Company from  
19 exploiting its market power for many services.

20                 Apart from the matter of initialization, there are major requirements to  
21 address imbalances between business and residence rates, as I have noted  
22 previously in this testimony. I do not believe that exchange service rates should be  
23 frozen for three years because that would impede effective solution of this problem.

24          Additional Staff Commitments

25          Q.     Does the Staff recommend additional commitments by Ohio Bell?

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<sup>58</sup> Staff Report, page 106.

1           A.     Yes. The Staff recommends a number of additional commitments if  
2 alternative regulation is adopted. The first group of commitments concerns "public  
3 input and customer education." The Staff has many recommendations in this area.<sup>59</sup>  
4 For example, the Staff recommends that Ohio Bell commit to an annual customer  
5 survey program to obtain a broader base of input to help the Company formulate future  
6 infrastructure proposals.

7           Q.     Do you concur with these recommendation by the Staff?

8           A.     I believe that input from the public would be helpful. Any business  
9 should be closely tuned to its customers' wishes, particularly if it faces increasing  
10 competition. However, as I have stated, I do not believe that the costs of the  
11 infrastructure improvements outlined by Ohio Bell should be borne by ratepayers.  
12 Therefore, the costs of input related to this activity should not be borne by ratepayers  
13 either.

14          Q.     Does the Staff also add a commitment related to universal service in  
15 Ohio?

16          A.     Yes. The Staff notes that Ohio Bell does not make a specific commitment  
17 to maintain universal service. The Staff believes that the overall value of the plan  
18 would be enhanced by the Company's commitment to "continued universal service  
19 objectives."<sup>60</sup> Also, the Staff makes a number of specific recommendations  
20 concerning programs for assistance to persons having difficulty making payments for  
21 telephone services.

22          Q.     Do you concur with the Staff's position on universal service?

23          A.     Yes. I believe that universal service is important. However, it is not  
24 necessary to maintain artificially low rates for residence exchange service in order to  
25 have universal service.

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59     Staff Report, pages 113-117.

60     Staff Report, page 117.

1           Most people regard telephone service as a critical element of modern  
2 life. The service is becoming increasingly price inelastic as its value to consumers  
3 increases. Furthermore, increases in the rates for residence exchange access will be  
4 ameliorated by reductions in the rates for other services. Moreover, I believe that  
5 residence subscribers ultimately benefit by the rate changes necessary for Ohio Bell to  
6 operate in a competitive environment.

7           It is no longer practical for business services to subsidize middle and  
8 upper income residence subscribers. There is no justification for continuing to provide  
9 service to a large majority of residence subscribers at rates that fail to cover the  
10 incremental costs of the service. To aid low income subscribers, I believe that the  
11 proper approach is to maintain an "economy service" or "lifeline" program specifically  
12 targeted to the needs of households with income levels that make telephone service  
13 under normal market rates a true financial hardship. The costs of this program should  
14 be borne by all local exchange companies. I also believe that toll restricted service  
15 should be offered to "distressed" accounts to minimize the number of customers  
16 denied basic service because of their inability to pay their telephone bills in full.

17       Q.     Does that conclude your pre-filed testimony?

18       A.     Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that the original and 20 copies of the Direct Testimony of Harry Gildea on behalf of the U.S. Department of Defense, and All Other Federal Executive Agencies, were sent to the Ohio Public Utilities Commission by Federal Express and that one copy each was sent by Federal Express or by first class mail to other known parties on May 4, 1994.

  
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