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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

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1. Q: PLEASE STATE YOUR NAME AND CURRENT POSITION.

A: My name is Raymond Warren Lawton. I am Associate Director for Telecommunications Research at The National Regulatory Research Institute.

2. Q: WHAT ARE YOUR QUALIFICATIONS AND EDUCATIONAL BACKGROUND?

A: I have a B.A. in political science from the State University College of New York at Oswego, and an M.A. and Ph.D. from The Ohio State University (OSU) in Political Science. I have been Associate Director of the Telecommunications and Water Division of the National Regulatory Research Institute (NRRI) since 1986 and I previously was a Senior Research Specialist at the NRRI. Prior to that time I held senior positions at the Ohio Department of Economic and Community Development and the Ohio Office of Budget and Management. I am also an Adjunct Associate Professor in the School of Public Policy and Management at OSU and also hold appointments as a Research Scientist and as an Associate at the Center For Advanced Studies in Telecommunications at OSU. My most recent research has focused on universal service, price caps, and alternative forms of telecommunications regulation. A more complete biographical sketch is attached to this testimony.

3. Q: WHAT RESEARCH HAVE YOU CONDUCTED ON THE OHIO BELL TELEPHONE COMPANY/AMERITECH OF OHIO PROPOSAL FOR ALTERNATIVE REGULATION?

A: I am a member of the NRRI study team (N-ST) that reviewed the proposed price caps plan as a consultant to the Staff of the Public Utilities Commission of Ohio. I worked under Dr. Vivian Witkind Davis, the project leader. I had primary responsibility for chapters two through seven.

4. Q: DO YOU HAVE ANY OVERVIEW COMMENTS YOU WOULD LIKE TO MAKE ABOUT THE RECOMMENDATIONS AND APPROACH OF THE N-ST?

A: Yes, I do. The N-ST recommendations follow three primary thrusts. The first is to eliminate those proposed price cap features that would allow an incumbent to engage in anticompetitive behavior. Such behavior would delay the development of competitive telecommunications markets in Ohio. The second follows from the observation that anticompetitive practices are only possible where an incumbent has captive customers. Accordingly, protection of captive customers also reduces the possibility of anticompetitive behavior. The third thrust recognizes that price caps and any other form of regulation are subject to the Commission's basic legislatively mandated oversight. The

three thrusts were developed in relation to the expression of legislative intent found in R.C. 4927. N-ST's recommendations clearly envision price caps as a transitional mechanism and seek only to ensure that the price caps proposal submitted does not introduce delays in the evolution of competitive telecommunications markets in Ohio.

5. Q: AFTER REVIEWING THE OBJECTIONS RECEIVED TO THE STAFF REPORT AND THE ADDENDUM PREPARED BY THE NRRI STUDY TEAM, DO YOU HAVE ANY MODIFICATIONS YOU WISH TO MAKE?

A: No, I have no modifications and support each of the recommendations made in the N-ST report.

6. Q: DO YOU AGREE WITH THE AMERITECH OHIO OBJECTION TO DOCUMENTING THAT A PRICE CAPS PLAN MUST BE OF MORE BENEFIT TO CONSUMERS THAN TRADITIONAL REGULATION? (AO E.1)

A: No, I do not agree. The *Miriam-Webster Third New International Dictionary* (unabridged) defines reform as "...to put an end to (an evil) by enforcing or introducing a better method or course of action..."(p. 1909) Accordingly, demonstration that the submitted price caps plan is as good or better than

what it replaces is a reasonable request. In addition, it is clearly the intent of R.C. 4927.02 that any alternative form of regulation meet announced criteria. Unquestionably Ohio legislators had in mind that any alternative form of regulation, such as price caps, would be as good or better (in terms of the R.C. criteria) than the form of regulation being replaced. The Commission's own rules place a burden of proof upon the applicant to demonstrate net benefit.

7. Q: DO YOU AGREE WITH AMERITECH OHIO OBJECTION TO N-ST 2.1 THAT A PRICE CAP PLAN THAT INCLUDES ADEQUATE SAFEGUARDS FOR RATEPAYERS AND OTHERS IS A RATIONAL, APPROPRIATE ALTERNATIVE TO RATEBASE, RATE-OF-RETURN REGULATION AT THIS TIME IN OHIO? (AO E.1)

A: Adequate safeguards for Ohio ratepayers must be a fundamental part of any price cap plan.

8. Q: DO YOU AGREE WITH AMERITECH OHIO'S RESPONSE TO N-ST 2.19 WHERE AMERITECH OHIO OBJECTS TO STATING WHETHER ITS STABLE PRICES WOULD BE MORE STABLE THAN THOSE UNDER RATEBASE, RATE-OF-RETURN REGULATION (RBROR). (AO E.1)

A: Since Ameritech Ohio selected this attribute of its plan, that is stabilized prices, to present as a benefit of its price cap reform, it would be reasonable to assume that the prices envisioned would be more stable than under RBROR. Ameritech Ohio should be asked by the Commission to clearly state its policy regarding stabilized prices.

9. Q: DOES THE COMMISSION NEED AUTHORITY TO INDEPENDENTLY MONITOR TAX AND ACCOUNTING RULE CHANGES AND OTHER CANDIDATE EXOGENOUS EVENTS? (AO E.1)

A: The Commission has oversight obligations that will exist under price caps or any other form of regulation. Given Ameritech Ohio's objection and the thrust of some of Ameritech Ohio's price caps plan reasoning that less oversight is required, it is important that the Commission state its authority and obligation in this area. Silence in the face of the Ameritech Ohio objection may imply agreement and limit the oversight options the Commission has available to protect ratepayers and telecommunications providers in Ohio from anticompetitive practices. If only Ameritech Ohio can present a list of candidate exogenous events, Ohio consumers will be disadvantaged by information asymmetry. That is, only Ameritech Ohio will be scanning the environment to determine exogenous events. (N-ST 2.5 and 5.2)

1 10. Q: SHOULD AMERITECH OHIO BE ASKED TO STATE THAT ITS PRICE
2 CAPS PLAN WILL RESULT IN PRICING AND QUALITY OF SERVICE
3 OPTIONS THAT ARE AT LEAST AS GOOD AS THOSE UNDER
4 RBROR. (AO E.1)
5
6 A: Ameritech Ohio has a burden of proof of showing that a pricing reform like
7 price caps is at least as good as what is being replaced. The Commission by
8 stating this will give Ameritech Ohio a standard it can use for guidance.
9 Ratepayers and Ohio telecommunications providers deserve the protection
10 afforded by such a policy statement. (N-ST 4.5)
11
12 11. Q: SHOULD THE COMMISSION STATE ITS POLICY REGARDING THE
13 FREQUENCY, STANDARDS, AND LEVEL OF OVERSIGHT AND
14 EXOGENOUS ADJUSTMENT MONITORING ROUTINES TO BE USED
15 IN FACING ITS RESPONSIBILITIES REGARDING EXOGENOUS
16 CHANGES? (AO E.1)
17
18 A: Ameritech Ohio proposed in its application an exogenous adjustment process
19 that gives the Commission too little time to evaluate the merits of a claim for
20 exogenous treatment. Further, the Ameritech Ohio proposed procedure only
21 allows for Ameritech Ohio to submit requests for exogenous change. Just as
22 the Commission independently monitored, audited and evaluated financial

submitted by Ameritech Ohio that show why this regulatory safeguard should be abolished.

13. Q: SHOULD AMERITECH OHIO DEMONSTRATE THAT OHIO RESIDENTIAL CUSTOMERS BENEFIT FROM PRICE CAPS IN A MONOPOLY MARKET?

A: The proposed Ameritech Ohio price caps plan has multiple incentives that can encourage Ameritech Ohio to engage in price discrimination such that monopoly customers are disadvantaged along with Ameritech Ohio competitors. Benefits could include increased infrastructure investments, more services, and lower prices. If infrastructure investments are essentially the same as under RBROR, if only the same services are offered in the basic POTS package, and if prices increase or remain the same while competitive prices fall, then it would be hard to conclude that the residential monopoly customer benefits from price caps. Ameritech Ohio has the burden to demonstrate this point or to propose additional safeguards to overcome this problem. (N-ST 6.1)

14. Q: SHOULD STAFF CONTINUE TO HAVE OVERSIGHT OF USAGE MEASURES USED? (AO E.1)

information submitted by utilities and developed uniform systems of accounts, so too must adequate procedures be designed to deal with big ticket exogenous change items. Recall that only big changes will be proposed, so just when the impact on the ratepayer will be the greatest the Commission could find itself without independent data. The Commission has long recognized the danger inherent in having asymmetrical financial information and developed responsible and efficient routines for independently monitoring and auditing the financial information submitted by utilities. The same danger to the ratepayer and Ohio telecommunications provider will exist if Ameritech Ohio's objection is sustained. (N-ST 5.9 and 5.10)

12. Q: SHOULD THE COMMISSION CONTINUE TO RECEIVE COST DATA FROM AMERITECH OHIO UNDER PRICE CAPS?. (AO E.1)

A: Apparently Ameritech Ohio feels such comparative data would not "...provide a reasonable basis to evaluate an alternative regulation plan." (AO E.1) There is no other way that the Commission can monitor the price caps reform without this information. Nor is it clear how the Commission could fully perform its duties without ready access to this information. Ameritech Ohio, at a minimum, has a burden of proof to show why this important regulatory safeguard should be eliminated. No data or other information have been

A: Without these data the Staff would be unable to perform its duties. In particular, it should be expected that the demand for competitive and noncompetitive Ameritech Ohio telecommunications services will change in ways nearly impossible to predict. Costs are allocated in terms of existing data on current usage patterns. Without such data in the future, the Commission will be over assigning costs to the current biggest users (say, the monopoly residential customer) and understating the cost of providing new services. This will cause economic distortions. Also LRSIC analyses will be fatally flawed because the cost floor will be based upon old usage patterns. This would produce a "regulatory lag" that hurts monopoly residential customers and Ameritech Ohio competitors. (N-ST 6.2)

15. Q: DO STAFF NEED THE RESOURCES TO MONITOR AND CARRY OUT OVERSIGHT RESPONSIBILITIES IN A PRICE CAPS ENVIRONMENT? (AO E.1)

A: Staff need the ability to monitor, investigate, audit, and collect data in a price caps environment. The skill mix and duties required of staff will be different in a price caps environment. To cite but one example, staff will need to continue to upgrade and maintain their indexing skills. (N-ST 7.7)

Ameritech Ohio will benefit from a clear statement of the Commission's data and oversight expectations. This would allow Ameritech Ohio to develop and strengthen the procedures it uses to comply with Commission information needs. Absent a clear statement, Ameritech Ohio may not maintain data or access to data in ways that permit the Commission to carry out its duties.

Ameritech Ohio has not shown that any of its objections are in conformance with R.C. 4927.02. The net result of sustaining these objections would be to deny the Commission ordinary access to data. It would not be in the public interest or efficient for the Commission to have to convene a hearing every time it needs data in a future price caps regime.

16. Q: SHOULD THE PRODUCTIVITY OFFSET USED FOR AMERITECH OHIO BE IN IN A RANGE FROM 3.3 PERCENT TO 4.55 PERCENT? (AO E.7)

A: Ameritech Ohio has not advanced any information countering the N-ST recommendation 3.8-of a 3.3 percent to 4.55 percent range for a productivity offset. Accordingly, Ameritech Ohio has not satisfied a burden of proof test. The N-ST recommendation reflects the range chosen by state commissions that have adopted price caps plans. If Ameritech Ohio truly had a productivity of 1.9 percent, it may not have been able to survive financially

with a basic rate freeze that has existed since the last Ameritech Ohio rate case.

17. Q: SHOULD AMERITECH OHIO DOCUMENT FOR THE COMMISSION THE MODERNIZATION ANALYSIS IT PERFORMED FOR ITS INFRASTRUCTURE INVESTMENT? (AO E.7)

A: Without this information it will not be possible to accurately determine if the investment is commensurate with the revenues generated under price caps. In particular, such an analysis could show if there is a mismatch between, say, residential revenues and investments that support basic residential services. Ameritech Ohio should be asked to provide this information. Proprietary information, of course, can be protected through normal Commission procedures. (N-ST 3.1)

18. Q: SHOULD THE PRODUCTIVITY ANALYSIS BE ADJUSTED TO REFLECT THE LOW SALES EXPERIENCED DURING THE STUDY PERIOD EXAMINED? (AO E.7)

A: This adjustment is vital because otherwise revenues are understated and Ameritech Ohio investments and other expenses are overstated. This is particularly important because the heart of Ameritech Ohio's infrastructure

investment is based upon the notion of the increasing efficiency possible through investments in infrastructure. If the calculation underlying the proposed adjustment of 1.9 percent is wrong—that is it is too low—and efficiency also subsequently increases, then Ohio consumers and Ameritech Ohio competitors will be disadvantaged by paying more than they should because the permitted price ceiling will be too high. Protestations that the ceiling price is not necessarily the price that Ameritech Ohio will choose should be disregarded unless Ameritech Ohio formally announces such a policy. Prices for captive customers in price caps are always near the ceiling and closer to the ceiling than the more competitive services included under a price cap. Ameritech Ohio should show the Commission a productivity offset adjustment recalculation that includes this adjustment. (N-ST 3.2) This response also is appropriate for objections raised that Ameritech Ohio should include known productivity increases from the Ameritech purchase plan (N-ST 3.3), increased revenues from cellular traffic (N-ST 3.4), and increased savings through labor force reductions. (N-ST 3.6)

19. Q: HAVE EARNINGS-SHARING OR CONSUMER DIVIDENDS BEEN USED IN STATE OR FEDERAL PRICE CAP PLANS? (AO E.8)

A: The FCC adopted a consumer dividend as a safeguard for residential and business consumers that would provide protection from errors in the

adjustment factor and future productivity increases. Three state commissions have earnings sharing with their price cap plans. No court has overturned either the consumer dividend or earnings sharing, so Ameritech Ohio's assertion that no legal basis exists for such established regulatory mechanisms is not established, compelling, or persuasive. (N-ST 3.7)

20. Q: IS AN AUTOMATIC SERVICE QUALITY ADJUSTMENT THAT USES ONLY A NEGATIVE SERVICE QUALITY ADJUSTMENT IN THE BEST INTEREST OF AMERITECH OHIO, OHIO CONSUMERS, AND TELECOMMUNICATIONS PROVIDERS IN OHIO? (AO E.10)

A: Yes. Standard modernization analysis includes all the productivity gains expected from all sources, including from meeting existing service quality standards. To have a second "positive," additional, incentive would over reward Ameritech Ohio for the quality levels it should receive anyway from its prudent investment in efficiency-increasing technology. It is unclear what Ameritech Ohio means when it says that the N-ST recommendation improperly balances improvements with service quality maintenance. Further, increases in the positive incentive recommended by Ameritech Ohio could slow the development of competition and increase the price paid by residential and small business customers. Over provisioning of quality would

give a distorted economic signal to Ameritech Ohio and could ultimately hurt it. (N-ST 4.8)

21. Q: SHOULD UNUSED PRICING AUTHORITY BE BANKED FROM ONE TIME PERIOD TO THE NEXT? (AO E.17)

A: No. The intent of price caps is to encourage the efficiency-increasing actions of utilities and to provide financial rewards for successful actions. Banking has only two uses. The first is as an incentive to the utility to be inefficient. Inefficiency occurs because the utility knows that it has banked unused pricing authority to cover any mistakes it makes. This incentive is not available to unregulated firms. The second is as a means to engage in predatory pricing behavior. Banking allows the utility to under price its competitors and to then jump up its prices to a ceiling when competitors are vanquished. State and federal price cap plans do not allow banking. Ameritech Ohio's banking provision is not in conformance with R.C. 4927.02 because of its anticompetitive impact. (N-ST 2.17 and 2.18)

22. Q: SHOULD THERE BE A NINETY (90) DAY REVIEW PERIOD FOR PROPOSED PCI ADJUSTMENTS? (AO E.20)

A: Ameritech Ohio objects to the Commission independently monitoring PCI data and to allowing Staff or other parties 90 days to review the material and file any objections. Simple prudence requires that Staff have adequate time to review financial data and data that will set the pricing parameters for a company as large as Ameritech Ohio. "Real time" lag can easily be reduced by having Ameritech Ohio file 90 days early. It is incorrect to view the annual filing of PCI adjustments as a minor technicality needing little oversight. Big ticket items are being approved by the Commission and deserve a corresponding level of attention. (N-ST 2.11)

23. Q: IS IT IMPORTANT FOR AMERITECH OHIO TO PROVIDE THE COMMISSION WITH FIVE OR MORE YEARS OF QUALITY OF SERVICE DATA BEFORE A PRICE CAPS PLAN WITH AN AUTOMATIC SERVICE ADJUSTMENT FACTOR IS IMPLEMENTED? (AO E.21)

A: Yes, it is very important. If Ameritech Ohio has historical quality of service data, it should be provided to the Commission. It is hard to understand why these data would not exist. If Ameritech Ohio does not have such data, this is unusual. Several actions should be undertaken. First, a study should be undertaken that reliably establishes baseline quality of service data. The two data points submitted by Ameritech Ohio are insufficient to do this. Staff and

Ameritech Ohio can work together to design and conduct such a study. Joint participation will give confidence in the results. Second, the Commission should express its concern that such data were not available and ask for assurances that it will be available over the life of any price caps plan. It is not possible to have a quality of service adjustment factor without reliable, audit-quality, and consistent data. Without such assurance, the proposed Ameritech Ohio data series could be modified without Commission oversight. An unexamined or unreliable quality of service data base is not in the interest of consumers or in the long run interest of Ameritech Ohio. (N-ST 2.2 and 4.4)

24. Q: DOES AN ACCEPTABLE MECHANISM EXIST TO CHECK THE ARITHMETIC ACCURACY OF GDP-PI DATA SUBMITTED BY AMERITECH OHIO? (AO E.23)

A: The legislatively mandated obligations of the Commission mean that adequate time and procedures be available to check all important information submitted by a utility. These data are important and integral to the operation of the price cap plan and need to be examined. Mr. Romo's testimony does not indicate that the Commission would have adequate time. Since Ameritech Ohio gets these data early, the Commission should also have an equivalent amount of time to review the data. (N-ST at 29)

25. Q: IS IT IMPORTANT TO USE A "REPRESENTATIVE TIME PERIOD" FOR CALCULATIONS FOR CUSTOMER SERVICE GROUPS? (AO E.24)

A: Mr. Romo's testimony does not state how these periods will be determined. The Commission needs to know this so that it can have confidence in the calculations and be able to audit, or reproduce them. All audit quality financial data have stated time periods and are supposed to identify any material assumptions or factors impacted by the selection of nonstandard time periods. Ameritech Ohio should be asked to document all calculations underlying data for customer service groups. (N-ST 2.8)

26. Q: DO YOU RECOMMEND THAT AMERITECH OHIO BE ASKED TO PROVIDE THE COMMISSION WITH INFORMATION ABOUT ANY UNITS THAT WILL BE DIFFERENT FROM THOSE CONTAINED IN COMMISSION TARIFFS? (AO E.25)

A: Yes. Ameritech Ohio should expand upon its response in a way that is sufficient to allow Staff to understand the new proposed units and the correspondence of these units to those in Commission tariffs. Ameritech Ohio, the Commission, and all regulatory experts know that the selection of units or weights will directly affect the costs assigned to different services.

One calculation method may favor residential customers, while another may favor competitive services. Nonoptimal units or weights will provide perverse incentives that may delay the evolution of competition and harm some current ratepayers. Without inspection of this information, the Commission can not know what cost shifts are occurring. The Ameritech Ohio explanation requires more data. Ameritech Ohio and Commission staff can work jointly on this in order to ensure that an allocation system that meets R.C. 4927 is fashioned. (N-ST 2.10)

27. Q: SHOULD AMERITECH OHIO HAVE THE COMMISSION INVITE COMMENTS ON ANTICOMPETITIVE IMPACTS OF THE USE OF ANY UNITS PROPOSED BY AMERITECH OHIO? (AO E.26)

A: Soliciting comments is the most efficient way the Commission can determine if the units Ameritech Ohio selects have anticompetitive impacts. Solicitation does not mean that the Commission has to agree with the comments of the parties. Rather, it simply allows comments. If the proposed system is "competitor neutral" than there should be no particular problem. If the proposed system is not neutral, this should be readily evident through the comments received. The Commission would be acting well within its authority to take prudent actions designed to avoid endorsing a potentially anticompetitive system of units and weights. (N-ST 2.11)

28. Q: IS IT IMPORTANT TO HAVE AMERITECH OHIO STATE WHETHER ITS PRICES WILL BE MORE STABLE THAN THOSE UNDER RATEBASE, RATE-OF-RETURN REGULATION? (AO E.27)

A: This N-ST recommendation (N-ST 2.19) was occasioned by Ameritech Ohio witness Romo saying that "Ohio Bell's price cap plan will stabilize prices for services". Since prices under RBROR have been very stable, the intent was to find out what was meant by this statement. Further, as Romo advances price stability as a positive benefit that consumers will receive in return for the advantages Ameritech Ohio receives, it is prudent to ask what is meant. Ameritech Ohio's response that "[price caps are] separate and distinct from rate of return regulation" is not responsive and insufficient. If price stability is not equal to or greater than that experienced under RBROR, then Ameritech Ohio should cease making this claim and whatever weight that had been accorded this assertion should be appropriately discounted by the Commission.

29. Q: SHOULD A MULTI-YEAR TREND IN AN EXOGENOUS FACTOR BE REQUIRED BEFORE IT CAN BE CONSIDERED IN AN EXOGENOUS ADJUSTMENT REQUEST? (AO E.28)

A: Many candidate exogenous events truly will fall in the category of normal business risk faced by all telecommunications providers. A multi-year period

may be necessary because the financial impact of an event may subsequently be overcome in future years and the "one year only" time frame will make it difficult to go back and take the adjustment out of the base price. (N-ST 5.1)

30. Q: IS IT IMPORTANT TO HAVE A NINETY (90) DAY REVIEW PERIOD BY STAFF FOR CANDIDATE EXOGENOUS CHANGES? (AO E.29)

A: Yes. Given objections above raised by Ameritech Ohio that reject having the Staff monitor for candidate exogenous events (re N-ST 2.9 and 5.5), the assertion that "...it is very likely that the Staff will be aware in a timely fashion [of exogenous changes]..." can not be supported. Staff will need a reasonable review period because of the complex and subtle analysis inherent in any exogenous adjustment request. Staff will need to monitor and to review in order to carry out their statutory obligations. The Ameritech Ohio objection should be denied and a 90-day review period be selected by the Commission. (N-ST 5.3)

31. Q: IS A SERVICE-SPECIFIC EXOGENOUS ADJUSTMENT IMPRACTICAL AND COSTLY? (AO E.30)

A: No. The N-ST recommendation only asks that the Commission determine whether a service specific or general revenue impact is more advantageous to the residential consumer and Ameritech Ohio competitors. (N-ST 5.7)

32. Q: SHOULD AMERITECH OHIO'S PROPOSED EXOGENOUS ADJUSTMENT FACTOR BE REJECTED OR MODIFIED? (AO E.31)

A: Yes. Ameritech Ohio's objection to N-ST 5.8 and 5.19 simply say that the original adjustment factor is appropriate and does not respond to the issues raised. Without the modifications proposed by N-ST the exogenous adjustment will be able to be easily used to make changes that unduly advantage Ameritech Ohio and hurt Ohio consumers and Ameritech Ohio's competitors. The net result of the N-ST recommended changes will be to ensure that the Commission has adequate oversight authority sufficient to ensure that all exogenous adjustments are needed and "competitively neutral".

33. Q: DO YOU STILL RECOMMEND THAT THE COMMISSION ADOPT THE LIST OF CANDIDATE EVENTS THAT AMERITECH OHIO SAYS ARE NOT ELIGIBLE FOR EXOGENOUS TREATMENT? (AO E.32)

A: Yes. It is important to ratify this important area of consensus. A clear listing will help future commissioners and Ameritech Ohio managers to better

understand the type of events that can be considered exogenous. This knowledge should eliminate unnecessary hearings over previously excluded events. This is important because the list of events that Ameritech Ohio excludes is consistent with its definition of an exogenous adjustment, so no harm would be done by codifying this agreement. (N-ST 5.15)

34. Q: IS IT APPROPRIATE TO EXCLUDE OHIO SPECIFIC TAXES AS A CANDIDATE EXOGENOUS ADJUSTMENT FACTOR? (AO E.33)

A: The GDP-PI already includes the impact of Ohio taxes. To allow an additional exogenous adjustment would let Ameritech Ohio collect twice for the tax: once in the GDP-PI and once as an exogenous adjustment. This would give Ameritech Ohio an incentive to be inefficient and should be avoided. Ameritech Ohio's assertion that reliance on the GDP-PI would underestimate the impact is unproven and shows a fundamental misunderstanding of the way that the GDP-PI accurately and fully records the impact of price changes in all sectors of the American economy. GDP-PI picks up all changes and, therefore, cannot under or overestimate any particular price from any industry, or state, or region. (N-ST 5.16)

35. Q: IS IT IMPORTANT THAT THE EVENTS AMERITECH OHIO IDENTIFIES AS NOT BEING EXOGENOUS BE INCLUDED IN THE FINAL COMMISSION ORDER? (AO E.34)

A: Yes. One of the reasons Ameritech Ohio is asked to respond to data requests is to provide the Commission with accurate information that the Commission can use in its decision making. To respond to a nonproprietary data request and then ask that the response not be included in the order raises many questions. It puts the Commission in an untenable position and should be rejected. The rationale is that if the Ameritech Ohio information is not reliable, then Ameritech Ohio should withdraw the information and supply the Commission with more accurate information regarding its view of what would constitute an exogenous adjustment. The use of an exogenous adjustment factor is new in Ohio and capable of many interpretations. The Commission vitally needs to know Ameritech Ohio's view so that it can know if an expansive or restrictive definition is being used. To advance a restrictive list and then seek to exclude it from the order reduces confidence in the information. The final Commission order should incorporate this list either directly or by reference. Further, Ameritech Ohio's concern that the list is too restrictive is baseless as Ameritech Ohio could have chosen to exclude candidate events. (N-ST 5.18, 5.4, 5.5, and 5.6)

36. Q: IS IT APPROPRIATE TO HAVE PROFIT-SHARING IF OTHER FEATURES OF AMERITECH OHIO'S PROPOSED PRICE CAP PLAN ARE NOT MODIFIED? (AO E.35)

A: Yes. Profit-sharing is a standard feature of price cap plans. In all instances commissions recognize that a portion of the profits earned by a utility are due to its own efforts and a portion to the very valuable assets given the utility by virtue of its franchise. These include restricting competition, awarding strategic rights-of-ways, and giving antitrust protection. As profit-sharing gives the utility higher profits than would have been possible under RBROR , it cannot be concluded that the utility has not been appropriately rewarded for its increased efficiency under profit sharing. Profit sharing is in the public interest when the other features of the price cap plan take a disproportionate part of the consumer surplus. Profit sharing is consistent with price regulation, as most states use it. Ameritech Ohio has not shown why this recommendation should be withdrawn or modified. (N-ST 7.2)

37. Q: IS IT IMPORTANT TO CLARIFY THE POSITION OF AMERITECH OHIO ABOUT ITS POLICY REGARDING CEILING PRICING? (AO G.5)

A: If Ameritech Ohio will not engage in ceiling pricing, then it should state this policy position. This would be an important piece of information. The

incentives inherent in a price caps plan are such that it is economically (though perhaps not tactically) irrational for a utility not to price at the ceiling for captive customers. To do so would be to voluntarily surrender nearly guaranteed revenues, which would be economically irrational. Available evidence indicates that price cap utilities price at the ceiling for inelastic customers. Neither the testimony of Mr. Mckenzie, nor the pricing limitations of the price cap cited in the objection overcome the evidence supporting the original N-ST recommendation. (N-ST 2.20)

38. Q: SHOULD AMERITECH OHIO FORECAST INDIVIDUAL SERVICE DEMANDS? (AO G.10)

A: It should forecast demand. The N-ST recommendation is trying to overcome, namely reliance on historical data. A negative "consumer lag" exists when historical information is used because it places more cost responsibility on the current largest user--the residential customer-- while minimizing the impact on new services. This issue can be resolved easily if Ameritech Ohio and the Staff meet and agree on a method. (N-ST 2.6)

39. Q: IS IT IMPORTANT FOR A PRICE CAPS ORDER TO CONTAIN A COMMISSION POLICY STATEMENT REGARDING UNACCEPTABLE PRICING BEHAVIORS? (AO G.11)

A: Unacceptable pricing is most likely in noncompetitive markets and those markets in the earliest stage of transition from a noncompetitive market. Ameritech Ohio in its objection has presented no data or compelling argument that the proposed 10 percent floor on price decreases is not in the public interest. The only reason Ameritech Ohio would need greater flexibility would be if it misjudged competitive pressure and kept its prices too high as a way to maximize profits. A ten percent limit will give Ameritech Ohio the necessary incentive to price efficiently. The advantage of a clear Commission statement is that it will avoid litigation and other time consuming regulatory actions. (N-ST 2.13)

40. Q: ARE PRICE FLOORS IMPORTANT TO THE PRICE CAPS PLAN? (AO G.12)

A: Yes. If Ameritech Ohio has been pricing efficiently along the way, then it will have no need for a pricing floor greater than ten percent. The Ameritech Ohio proposal and the objection lack pricing safeguards. This can easily delay the emergence of sustainable competition in Ohio and would be counter to the standards expressed in R.C. 4927. The selection of a 10 percent standard is not vague, and all Ohio consumers will benefit by having Ameritech Ohio price competitively. Customers are harmed when the incumbent is allowed to engage in predatory pricing. (N-ST 2.14)

41. Q: IS IT IMPORTANT TO HAVE AN EXPLICIT STATEMENT FROM AMERITECH OHIO REGARDING ITS CEILING PRICING POLICY? (AO G.13)

A: No new requirements are called for by this recommendation. Instead Ameritech Ohio is simply being asked to clarify if the statements throughout its testimony that Ameritech Ohio will not necessarily price at the ceiling are actual Ameritech Ohio policy statements. This is an important feature of the price caps plan and the Commission would benefit from accurate information. The Ameritech Ohio objection should be rejected. (N-ST 2.20)

42. Q: ARE LRSIC STUDIES SUFFICIENT? (AO G.14)

A: No. LRSIC studies may not meet R.C. 4927 goals in a price cap environment as they do not guarantee that anticompetitive pricing will not occur. No information is presented via the objection (G.14) that rebuts this concern. (N-ST 6.3)

43. Q: ARE PRICE REDUCTION LIMITATION NECESSARY? (AO G.15)

A: Yes. The proposed price caps plan contains customer service classifications with competitive and noncompetitive markets. Price reduction limitations give

the utility the incentive to price efficiently and avoid predatory pricing. These two aspects benefit Ohio consumers and promote the emergence of competitive markets. Ameritech Ohio's objection does not present new information and does not address the original problems identified by N-ST 63.

44. Q: IS IT IMPORTANT FOR THE COMMISSION TO ESTABLISH A POLICY ON THE FREQUENCY REQUIRED FOR UPDATING INCREMENTAL COST STUDIES? (AO G.16)

A: Yes. The public interest would not be served if incremental studies were never updated, or were constantly being updated, or were updated solely at the discretion of the applicant. This recommendation takes the reasonable position that the Commission and Ameritech Ohio should agree to an updating policy. In doing so a contentious matter can be taken off any future agenda. Ameritech Ohio would benefit by knowing the rules in advance. Further, all parties could have greater confidence in the studies, as they would know that the time periods selected were not subject to manipulation. This recommendation takes no particular position on frequency, but it seems reasonable that the Staff and Ameritech Ohio can meet to agree upon a mutually acceptable time table. As productivity will continue to improve in the future, both demand and cost data supporting existing incremental studies

should also be expected to change. A schedule will help the Commission ensure that the studies submitted are reasonably current. Ameritech Ohio has presented no information supporting its objection. (N-ST 6.7)

45. Q: SHOULD A STAFF STUDY BE UNDERTAKEN REGARDING THE INITIAL BASE PRICE? (AO G.17)

A: Ameritech Ohio objects that a reduction would be inconsistent with alternative regulation and the need to make commitments, but presents no evidence. N-ST recommendation 7.1 should be sustained as all it says is that if a study shows that a base price reduction is called for, then an adjustment should be made. Several jurisdictions have had similar studies and adjustments. It is important to begin at a proper price level so that subsequent changes are not further distorting.

46. Q: IS A FIVE-YEAR FREEZE APPROPRIATE? (AO G.19)

A: A five-year freeze would benefit residential consumers. The productivity gains experienced by Ameritech Ohio over a five-year period should offset any inflationary changes. N-ST recommendation 7.6 does, however, say that if a base price reduction occurs that a shorter freeze period may be appropriate.

47. Q: IS IT IMPORTANT FOR AMERITECH OHIO TO DOCUMENT THE MODERNIZATION ANALYSIS IT HAS UNDERTAKEN FOR ITS INFRASTRUCTURE COMMITMENTS? (AO L15)

A: Yes. Ameritech Ohio has three concerns. First, it objects to the suggestion of a modernization analysis. Second, it feels modernization has not been adequately defined. Third, it says that the reporting form Ameritech Ohio proposes is sufficient. In respect to the first concern, it is highly unlikely that Ameritech Ohio would propose an infrastructure improvement with out having first conducted a modernization analysis. Ameritech Ohio and all other well-managed firms routinely do this in order to see if an investment will yield a sufficient payback within a self-selected time period. Standard business practice and the modernization decision rule call for selecting an investment if and only if sufficient revenues are available. Therefore, objecting to the suggestion of a modernization study is not sustainable. Ameritech Ohio should share its modernization investment study with the Commission, with any appropriate proprietary safeguards.

Responding to the second concern, a modernization investment study is the study that a company routinely undertakes in order to determine if it should replace its existing technology or mode of production with a new or different technology or mode of production using a decision rule that says that

replacement can only occur if and only if the net future revenue stream will be increased. It is not a strategic plan or a business plan, although it may receive inputs on projected revenues and demand from these and other sources. Ameritech Ohio's modernization study should be submitted to the Commission. The third concern is answered by the response to the first two concerns. The proposed form is inadequate in that it does not adequately identify infrastructure goals or the reasoning behind investment patterns. (N-ST 3.1)

48. Q: SHOULD AMERITECH OHIO STATE CLEARLY IN WRITING WHAT IT MEANS BY A RESIDENTIAL RATE FREEZE? (AO L17)

A: Yes. This recommendation was formulated because of the confusion that exists about exactly what is meant by a freeze. The Ameritech Ohio response does not address this very important and legitimate issue, it simply refers to a previous series of statements that originally caused the confusion. Ameritech Ohio should issue a policy statement that supersedes all previous statements and state if its policy means that residential rates will remain the same for the freeze period. Given the importance of a freeze in any quid pro quo, it is important that all parties clearly know what has been agreed to by a freeze. Ameritech Ohio should be asked to provide a written statement to the Commission. (N-ST 7.5)

49. Q: IS THERE A CLEAR NEED FOR A PRICE CAPS PLAN WITH A SET TERM AND FOR AN EVALUATION PLAN? (AO K.4)

A: Yes. The N-ST 7.8 recommendation recommends a five-year price cap plan but qualifies this by saying that the length of the plan should be determined by the plan features agreed to by the Commission. Ameritech Ohio has not provided any information to change this position. Ameritech Ohio's proposal for an indefinite period is out of the mainstream of price cap plans.

Simple prudence and the public stewardship obligations of the Commission make the N-ST 7.8 recommendation of an evaluation of the plan an indispensable action. Commissions routinely evaluate price caps after an agreed upon number of years. Ameritech Ohio, Ohio consumers, and other telecommunications providers need the stability provided by knowing the length of time of the trial period. No one is advantaged by a plan that can be changed at an unknown interval. Ameritech Ohio, for example, might define indefinite as ten years, while others might assume three-to-five years. This type of uncertainty needlessly raises the cost of doing business and the cost of regulation with no appreciable offsetting benefits. The proposal of an indefinite period should be rejected.

By the same token, once an agreed upon time period is known, rational policy making processes necessarily require accurate and timely information about the impact of the price caps plan. Adoption of N-ST 7.8 will allow the Commission to carry out its evaluative activities in a cost effective manner. Having adequate lead time also means that Staff, Ameritech Ohio, and other parties can work together in a consensual manner to design data collection routines. It can also avoid the frustrating and costly problem of either having missing data or the wrong data. It can reduce costs by collecting data routinely, rather than through more expensive post hoc collection efforts.

50. Q: DOES THIS CONCLUDE YOUR TESTIMONY?

A: This concludes my testimony.

Biosketch

Raymond Lawton, Ph.D. is currently Associate Director for Telecommunications Research at The National Regulatory Research Institute, the official research arm of the state regulatory commissions. He also is an Adjunct Associate Professor at the School of Public Policy and Management at The Ohio State University. He is the recipient of a OSU Graduate School Ameritech Fellowship to conduct independent research on the cost structure of telecommunications networks. He recently taught a seminar on telecommunications tariffs in Tashkent, Uzbeckistan for the Confederation of Independent States at the request of the U.S. State Department.

Dr. Lawton has conducted research and has numerous published reports on topics such as pricing, telecommunications competition, local calling areas, modernization, reliability, price caps, and regulatory reform. His other areas of research and publications include management audits, water policy, program evaluation, and qualitative research methods. He is an active member of the Staff Communications Committee and the Staff Management Analysis Committee of the National Association of Regulatory Utility Commissioners. He has conducted numerous tutorials for state commissioners and has regularly made presentations and presented papers at national regulatory forums and conferences.

Dr. Lawton received his Ph.D. from The Ohio State University in political science in 1972. He has held senior positions at the Academy for Contemporary Problems, the Ohio Office of Budget and Management, and at the Ohio Department of Economic and Community Development. He has provided sponsored research and technical assistance to many state, federal, and international agencies.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Prepared Testimony submitted on behalf of the Public Utilities Commission of Ohio was served by regular, U.S. mail, postage prepaid or hand delivered to the parties of record on this 4th day of August, 1994.

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